

13 July 2020

Karnataka Bank

Strong quarter, bracing for a tough year ahead; Buy

Rating: **Buy**

Target Price: ₹60

Share Price: ₹47

Higher Treasury income and lower opex cost led to a sharp, ~93% y/y, PPOP growth for Karnataka Bank. Asset quality and PCR improved. With half the bank's portfolio under moratorium, asset quality may come under stress once the moratorium is lifted keeping FY21 earnings muted. With the expected pick-up in earnings in FY22 and limited downside from current levels, we maintain a Buy, at a TP of ₹60 valuing it at 0.3x P/ABV on its FY22e book.

Asset quality may come under stress in H2 FY21. Q1 slippage was ₹1.6bn (1.2% of loans). Although the bank extended the moratorium to these customers, it classified those accounts where visibility of recovery was low as NPA. Given the weak economic environment and ~51% of the bank's current book under moratorium (the highest among regional banks), we expect delinquencies to sharply increase once the moratorium is lifted. We have built in a 5% slippage rate for FY21.

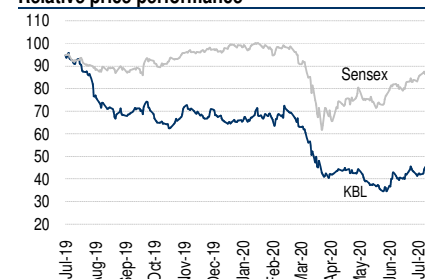
Earnings to remain muted in FY21. With an expected higher delinquency rate in H2 FY21, credit cost in the medium term is expected to be high. This and the weaker operating performance (attributed to slower business growth) would keep earnings weak in FY21. We estimate a 0.2% RoA for FY21 and 0.7% for FY22.

Valuation. Our Jul'21 target (of ₹60) is based on the two-stage DDM model. This implies a ~0.3x P/ABV multiple on its FY22e book. **Risks:** High provisioning, large slippages from its agriculture and MSME books.

Key data	KBL IN / KBNK.BO
52-week high / low	₹95 / 34
Sensex / Nifty	36694 / 10803
3-m average volume	\$2.3m
Market cap	₹15bn / \$195.4m
Shares outstanding	311m

Shareholding pattern (%)	Mar '20	Dec '19	Sep '19
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	12.8	13.5	13.7
- Domestic institutions	10.7	11.0	11.9
- Public	76.6	75.5	74.4

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY18	FY19	FY20	FY21e	FY22e
Net interest income (₹ m)	18,577	19,051	20,304	20,256	23,030
Pre-provisioning profit (₹ m)	14,732	14,498	16,568	17,031	19,682
Provisions (₹ m)	11,630	8,420	11,347	14,811	10,948
PAT (₹ m)	3,256	4,772	4,318	1,661	6,533
EPS (₹)	11.5	16.9	13.9	5.3	21.0
NIM (%)	3.1	2.8	2.7	2.6	2.7
Cost-income (%)	47.6	50.1	51.6	47.5	46.1
RoE (%)	6.2	8.5	7.3	2.7	10.1
RoA (%)	0.5	0.6	0.5	0.2	0.7
Advances growth (%)	27.7	16.0	3.9	4.0	12.0
GNPA (%)	4.9	4.4	4.8	6.3	4.3
CAR (%)	12.0	13.2	12.7	12.1	12.0
P / E (x)	4.1	2.8	3.4	8.8	2.2
P / BV (x)	0.2	0.2	0.2	0.2	0.2
P / ABV (x)	0.3	0.3	0.3	0.3	0.3

Source: Company, Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Net interest income	18,577	19,051	20,304	20,256	23,030
NII growth (%)	24.6	2.6	6.6	-0.2	13.7
Non-interest income	9,543	10,020	13,961	12,178	13,466
Income	28,120	29,071	34,264	32,434	36,496
Income growth (%)	22.3	3.4	17.9	-5.3	12.5
Operating expenses	13,388	14,573	17,696	15,403	16,814
PPOP	14,732	14,498	16,568	17,031	19,682
PPOP growth (%)	47.9	-1.6	14.3	2.8	15.6
Provisions	11,630	8,420	11,347	14,811	10,948
PBT	3,102	6,078	5,220	2,221	8,734
Tax	-155	1,306	903	560	2,201
PAT	3,256	4,772	4,318	1,661	6,533
PAT growth (%)	-28.0	46.6	-9.5	-61.5	293.3
FDEPS (₹ / sh)	11.5	16.9	13.9	5.3	21.0
DPS (₹ / sh)	4.0	3.0	0.0	0.0	0.0

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

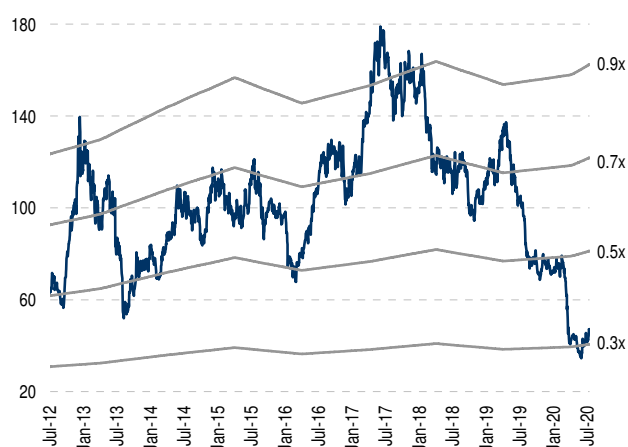
Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Share capital	2,826	2,826	3,109	3,109	3,109
Reserves & surplus	51,275	55,026	56,596	58,257	64,790
Deposits	6,28,713	6,84,521	7,17,852	7,53,744	8,51,731
Borrowings	8,160	33,255	40,651	39,838	40,635
	0	0	0	0	0
Liabilities	7,03,737	7,90,458	8,33,135	8,68,790	9,71,812
Advances	4,72,518	5,48,282	5,69,643	5,92,428	6,63,520
Investments	1,54,444	1,61,850	1,75,453	1,84,226	2,06,333
Cash & bank bal	35,458	34,117	27,561	30,317	33,348
Fixed & other assets	7,616	7,750	8,264	8,429	8,851
Total assets	7,03,737	7,90,458	8,33,135	8,68,790	9,71,812
No. of shares (m)	283	283	311	311	311
Deposits growth (%)	10.8	8.9	4.9	5.0	13.0
Advances growth (%)	27.7	16.0	3.9	4.0	12.0

Source: Company, Anand Rathi Research

Fig 3 – Ratio analysis

Year-end: Mar (%)	FY18	FY19	FY20	FY21e	FY22e
NIM	3.1	2.8	2.7	2.6	2.7
Other inc. / total inc.	33.9	34.5	40.7	37.5	36.9
Cost-income	47.6	50.1	51.6	47.5	46.1
Provision coverage	41.1	34.2	37.3	41.7	42.7
Dividend payout	34.7	17.8	0.0	0.0	0.0
Credit-deposit	75.2	80.1	79.4	78.6	77.9
Investment-deposit	24.6	23.6	24.4	24.4	24.2
Gross NPA	4.9	4.4	4.8	6.3	4.3
Net NPA	3.0	3.0	3.1	3.7	2.5
BV (₹)	191.4	204.7	192.0	197.4	218.4
Adj. BV (₹)	156.7	164.7	152.5	147.5	180.6
CAR	12.0	13.2	12.7	12.1	12.0
- Tier 1	11.3	11.2	10.7	10.1	10.0
RoE	6.2	8.5	7.3	2.7	10.1
RoA	0.5	0.6	0.5	0.2	0.7

Source: Company, Anand Rathi Research

Fig 4 – Price-to-Book band


Source: Bloomberg

Fig 5 – One-year-forward price-to-book value


Source: Company, Anand Rathi Research

Fig 6 – Price movement


Source: Bloomberg

Key Highlights

Conference call takeaways

Moratorium

- Of the ~51% portfolio under moratorium, 6.3% opted for the moratorium in June.
- The portfolio under moratorium includes all accounts which have also opted for a moratorium for one instalment.

Fig 7 – Portfolio under moratorium – as on 30/6/20

Category	% of borrowers who have availed of a moratorium	
	Number	Value
Agri	19.34	39.98
Micro (industry / service)	64.40	61.37
Small (industry / service)	65.23	61.60
Medium (industry / service)	66.32	59.33
Retail	45.92	52.91
Corporate	56.55	34.74
Total	34.67	46.62

Source: Company, Anand Rathi Research

Other highlights

- Management is aiming for ₹1bn in operating-cost reduction in FY21.
- It states that ~45% is a sustainable level for the C/I ratio for the bank.

Capital

- Would maintain capital at ~1% above regulatory norms.
- Is willing to raise capital at right valuations.

Fig 8 – Asset quality

Break-up of GNPA (₹ m)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21
Opening balance	23,463	24,564	24,375	25,943	27,775	27,999
Slippages	4,020	5,260	5,310	6,375	3,041	1,668
<i>Gross slippages (%)</i>	2.9	4.0	4.0	4.6	2.1	1.2
Reductions	2,919	5,449	3,742	4,544	2,816	4,091
Closing balance	24,564	24,375	25,943	27,775	27,999	25,576
<i>GNPA (%)</i>	4.4	4.6	4.8	5.0	4.8	4.6
<i>Restructured advances (%)</i>	1.0	0.6	0.1	0.2	0.2	0.2

Source: Company, Anand Rathi Research

Quarterly snapshot

Fig 9 – Income statement

(₹ m)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21
Interest income	15,313	15,844	16,296	16,216	16,392	16,157
Interest expense	10,504	10,898	11,309	11,138	11,099	10,806
NII	4,809	4,946	4,987	5,078	5,293	5,351
y/y growth %	-11.2	5.6	6.6	4.1	10.1	8.2
Non-interest income	2,906	2,448	3,088	4,021	4,404	5,189
Total Income	7,715	7,394	8,075	9,099	9,697	10,540
y/y growth %	-7.7	9.2	20.7	15.3	25.7	42.6
Operating expenses	4,472	3,894	3,941	4,081	5,781	3,770
Of which, staff cost	2,035	1,769	1,632	1,865	3,704	2,017
PPOP	3,242	3,500	4,134	5,018	3,915	6,770
y/y growth %	-31.8	-5.1	16.0	25.3	20.8	93.4
Total provisions	2,177	2,011	2,624	3,147	3,565	5,091
PBT	1,065	1,489	1,510	1,871	350	1,680
Tax	448	(266)	451	640	77	(284)
PAT	617	1,754	1,059	1,231	273	1,964
y/y growth %	461.2	7.5	-5.3	-12.3	-55.8	11.9

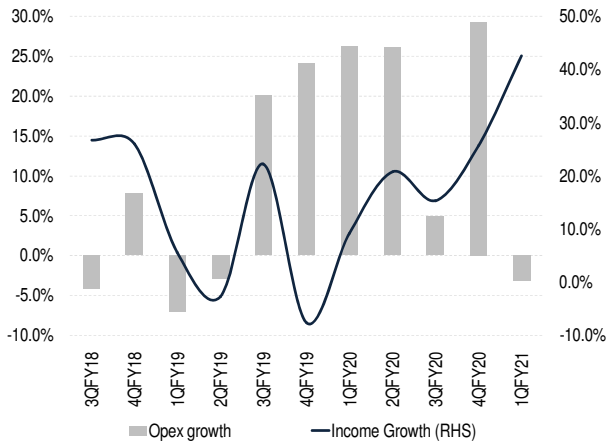
Source: Company, Anand Rathi Research

Fig 10 – Balance sheet

(₹ m)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21
Equity capital	2,826	2,826	2,826	2,826	3,109	3,109
Reserves & Surplus	55,026	56,780	56,648	57,879	56,596	60,450
Deposits	6,84,521	6,85,207	7,01,897	7,13,560	7,17,852	7,18,540
Borrowings	33,255	-	24,481	-	40,651	-
Other Liabilities	14,829	-	15,811	-	14,928	-
Equity and Liabilities	7,90,458		8,01,662		8,33,135	
Deposits y/y growth (%)	8.9	9.2	9.9	9.5	4.9	4.9
Deposits q/q growth (%)	5.1	0.1	2.4	1.7	0.6	0.1
Assets						
Cash and cash balances	36,098	-	38,529	-	29,195	-
Advances	5,48,282	5,28,188	5,34,684	5,49,110	5,69,643	5,42,095
Investments	1,61,850	1,71,410	1,79,346	1,79,990	1,75,453	1,82,770
Other assets	44,228	-	49,103	-	58,844	-
Total Assets	7,90,458		8,01,662		8,33,135	
Advances y/y growth (%)	16.0	10.7	7.0	5.7	3.9	2.6
Advances q/q growth (%)	5.5	-3.7	1.2	2.7	3.7	-4.8

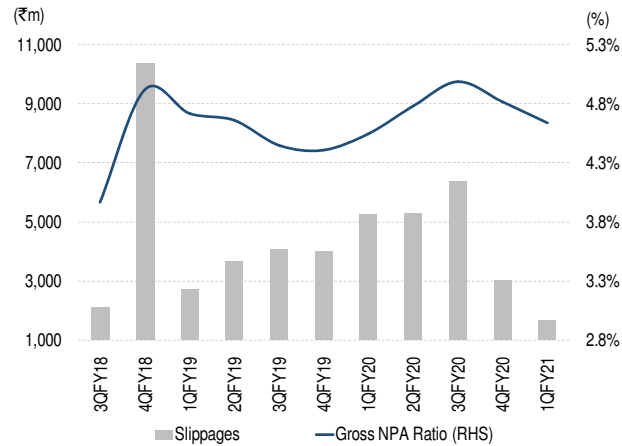
Source: Company, Anand Rathi Research

Fig 11 – Income vs. Opex growth



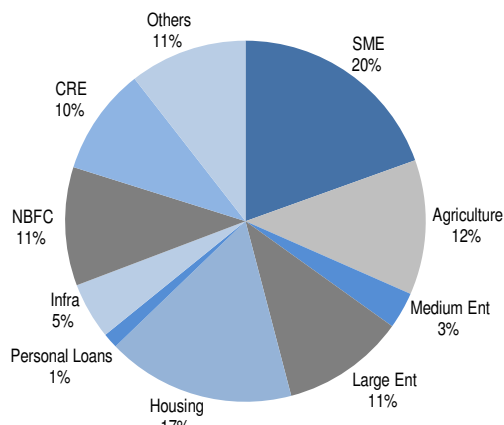
Source: Company, Anand Rathi Research

Fig 12 – Gross NPA and slippages



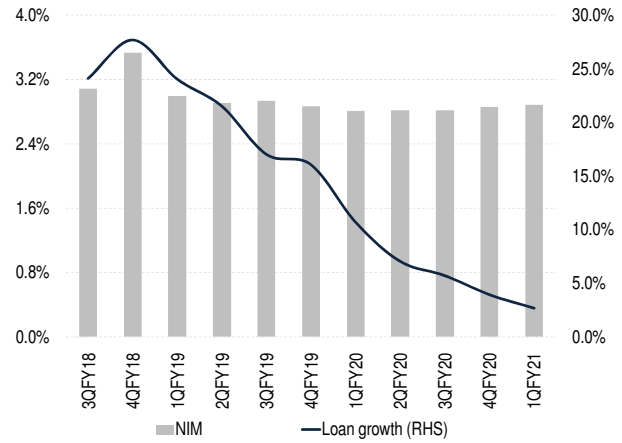
Source: Company, Anand Rathi Research

Fig 13 – Loan break-up



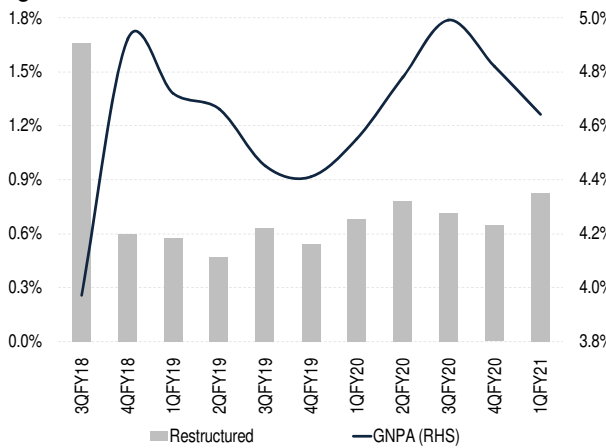
Source: Company, Anand Rathi Research

Fig 14 – Credit growth vs. NIM (%)



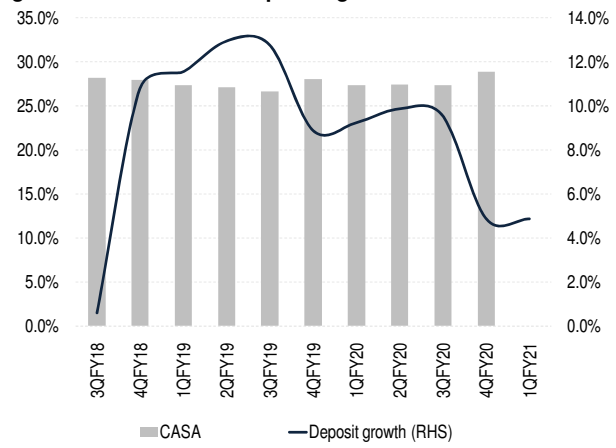
Source: Company, Anand Rathi Research

Fig 15 – Restructured assets vs. GNPA



Source: Company, Anand Rathi Research

Fig 16 – CASA ratio vs. Deposits growth



Source: Company, Anand Rathi Research

Valuation

Our July'21 target (of ₹60) is based on the two-stage DDM model. This implies a ~0.3x P/ABV multiple on its FY22e book.

Risks

- As the bank turns more vigorous in its retail foray, it is likely to face keener competition.
- More-than-expected slippages could pose challenges to our estimates.

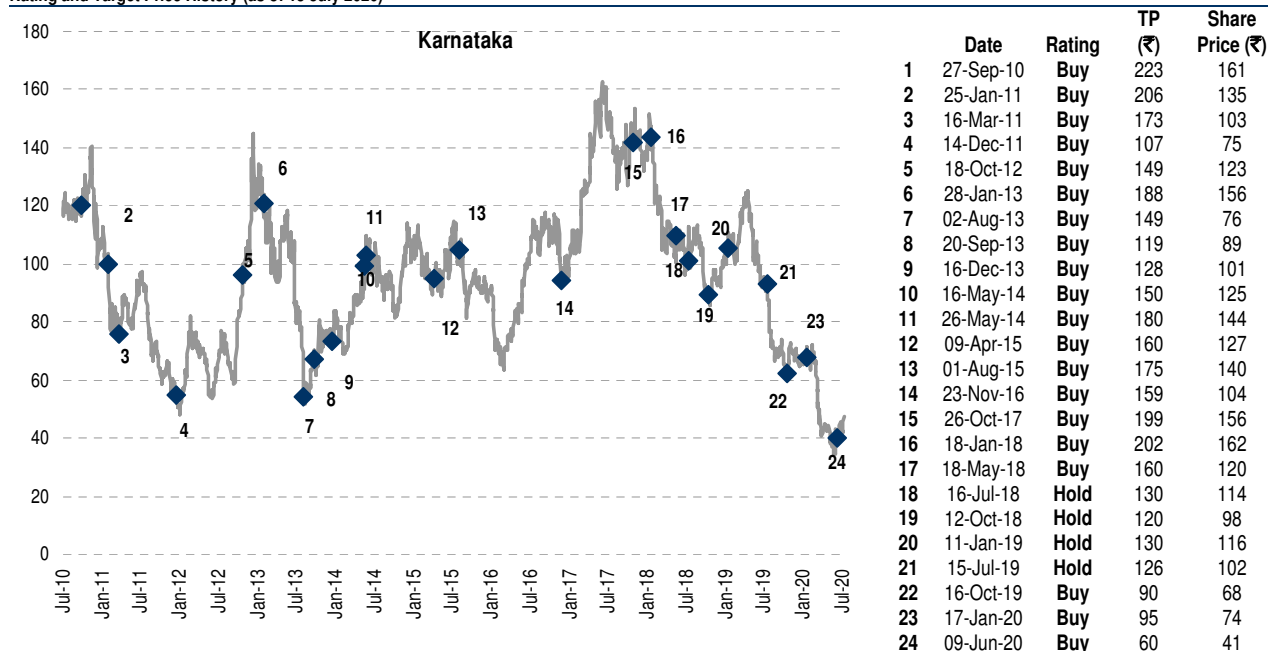
Appendix

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