

13 January 2021

Karnataka Bank

Steady quarter, less stress than expected; Buy

Rating: **Buy**

Target Price: Rs85

Share Price: Rs68

Lower treasury income and higher opex (one-time superannuation expense) led to a ~13% sequential decline in operating profit for Karnataka Bank. With the standstill on NPA recognition, asset quality and PCR improved. With the expected pick-up in earnings in FY22 and limited downside from current levels, we maintain a Buy, at a TP of Rs85 valuing it at 0.3x P/ABV on its FY23e book.

Asset quality may come under stress in Q4 FY21. GNPA sequentially improved 81bps as slippages were negligible given the standstill on NPA recognition by the Supreme Court. Consequently, Rs3.37bn could not be recognised as NPA during the quarter. The bank expects 1.74% of loans to go for restructuring, of which eventually ~50% could slip in to NPA. Even with the weak economic environment and the pandemic-related disruptions, asset quality surprising held up well even considering the proforma financials. However, we expect delinquencies to be slightly higher than management guided to.

Earnings to be muted in the short term. With an expected higher delinquency rate next quarter, credit cost in the next two quarters is expected to be high, then normalise. This and the weaker operating performance (attributed to slower business growth) would keep FY21 earnings weak. We estimate a 0.6% RoA for FY21 and 0.8% for FY22.

Valuation. Our Jan'22 target (of Rs85) is based on the two-stage DDM model. This implies a ~0.3x P/ABV multiple on its FY23e book. **Risks:** High provisioning, large slippages from its agriculture and MSME books.

Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Net interest income (Rs m)	19,051	20,304	23,827	26,066	28,874
Pre-provisioning profit (Rs m)	14,498	16,568	20,389	23,441	27,145
Provisions (Rs m)	8,420	11,348	13,398	13,264	12,601
PAT (Rs m)	4,772	4,318	5,229	7,612	10,879
EPS (Rs)	16.9	13.9	16.8	24.5	35.0
NIM (%)	2.8	2.8	3.1	3.1	3.1
Cost-income (%)	50.1	51.6	45.9	43.4	41.2
RoE (%)	8.5	7.3	8.4	11.1	13.9
RoA (%)	0.6	0.5	0.6	0.8	1.1
Advances growth (%)	16.0	3.9	-2.0	8.0	10.0
GNPA (%)	4.4	4.8	4.9	4.0	3.2
CAR (%)	13.2	12.7	12.8	12.9	13.2
P / E (x)	4.0	4.9	4.0	2.8	1.9
P / BV (x)	0.3	0.4	0.3	0.3	0.3
P / ABV (x)	0.4	0.4	0.4	0.3	0.3

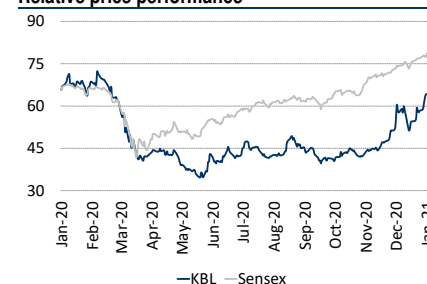
Source: Company, Anand Rathi Research

Key data	KBL IN / KBNK.BO
52-week high / low	Rs75 / 34
Sensex / Nifty	49517 / 14563
3-m average volume	\$2.6m
Market cap	Rs21bn / \$287.5m
Shares outstanding	311m

Shareholding pattern (%)	Dec '20	Sep '20	Jun '20
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	8.1	7.3	8.7
- Domestic institutions	6.1	6.6	8.8
- Public	85.8	86.0	82.6

Estimates revision (%)	FY21e	FY22e
Net interest income	13.7	13.4
Pre-provisioning profit	11.1	10.4
PAT	15.3	7.4

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Net interest income	19,051	20,304	23,827	26,066	28,874
NII growth (%)	2.6	6.6	17.4	9.4	10.8
Non-interest income	10,020	13,960	13,855	15,340	17,317
Income	29,071	34,264	37,681	41,406	46,191
Income growth (%)	3.4	17.9	10.0	9.9	11.6
Operating expenses	14,573	17,696	17,293	17,965	19,046
PPOP	14,498	16,568	20,389	23,441	27,145
PPOP growth (%)	-1.6	14.3	23.1	15.0	15.8
Provisions	8,420	11,348	13,398	13,264	12,601
PBT	6,078	5,220	6,991	10,177	14,544
Tax	1,306	903	1,762	2,565	3,665
PAT	4,772	4,318	5,229	7,612	10,879
PAT growth (%)	46.6	-9.5	21.1	45.6	42.9
FDEPS (Rs / sh)	16.9	13.9	16.8	24.5	35.0
DPS (Rs / sh)	3.0	0.0	0.0	0.0	0.0

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Share capital	2,826	3,109	3,109	3,109	3,109
Reserves & surplus	55,026	56,596	61,825	69,437	80,316
Deposits	684,521	717,852	753,744	836,656	928,688
Borrowings	33,255	40,651	24,761	25,256	25,761
Liabilities	790,458	833,135	857,420	949,170	1,061,126
Advances	548,282	569,643	558,250	602,910	663,201
Investments	161,850	175,453	207,035	244,301	283,390
Cash & bank bal	34,117	27,561	30,317	33,348	38,350
Fixed & other assets	7,750	8,264	8,429	8,851	9,293
Total assets	790,458	833,135	857,420	949,170	1,061,126
No. of shares (m)	283	311	311	311	311
Deposits growth (%)	8.9	4.9	5.0	11.0	11.0
Advances growth (%)	16.0	3.9	-2.0	8.0	10.0

Source: Company, Anand Rathi Research

Fig 3 – Ratio analysis

Year-end: Mar (%)	FY19	FY20	FY21e	FY22e	FY23e
NIM	2.8	2.8	3.1	3.1	3.1
Other inc. / total inc.	34.5	40.7	36.8	37.0	37.5
Cost-income	50.1	51.6	45.9	43.4	41.2
Provision coverage	34.2	37.3	62.5	60.9	64.1
Dividend payout	17.8	0.0	0.0	0.0	0.0
Credit-deposit	80.1	79.4	74.1	72.1	71.4
Investment-deposit	23.6	24.4	27.5	29.2	30.5
Gross NPA	4.4	4.8	4.9	4.0	3.2
Net NPA	3.0	3.1	1.9	1.6	1.2
BV (Rs)	204.7	192.1	208.9	233.4	268.4
Adj. BV (Rs)	164.7	152.5	185.3	211.6	250.6
CAR	13.2	12.7	12.8	12.9	13.2
- Tier 1	11.2	10.7	10.8	10.9	11.2
RoE	8.5	7.3	8.4	11.1	13.9
RoA	0.6	0.5	0.6	0.8	1.1

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

- The moratorium book came down to 1.74% in Dec'20, from 11.4% in Sep'20 and 51% in Jun'20.
- The bank is planning an OTR (one-time restructuring) of this 1.74% portfolio. Management expects 50% of these accounts to eventually turn non-performing.

Asset quality

- Proforma asset quality. GNPA: 3.95% (3.16% reported) and NNPA: 2.42% (1.74% reported)
- Slippages were non-existent during the quarter given the SC order of not classifying the accounts as NPA till further notification. Accounts amounting to Rs4.27bn (Rs3.37bn in Q3 FY20 and Rs901m in Q2 FY20) would have slipped into NPA (were there no SC order).
- During the quarter recovered Rs268m from technically written-off accounts.
- SMA-2: RS3.42bn.

Other highlights

- Expects NIM to hold above 3% in FY21.
- Disbursed Rs19.16bn toward GECL (under the credit-guarantee scheme) as of Dec'20.

Capital

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

Fig 7 – Asset quality

Break-up of GNPA (Rsm)	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
Opening balance	24,375	25,943	27,775	27,999	25,576	21,888
Slippages	5,310	6,375	3,041	1,668	22	14
Gross slippages (%)	4.0	4.6	2.1	1.2	0.0	0.0
Reductions	3,742	4,544	2,816	4,091	3,711	4,836
Closing balance	25,943	27,775	27,999	25,576	21,888	17,066
GNPA (%)	4.8	5.0	4.8	4.6	4.0	3.2
Restructured advances (%)	0.1	0.2	0.2	0.2	0.2	0.2

Source: Company, Anand Rath Research

Quarterly snapshot

Fig 8 – Income statement

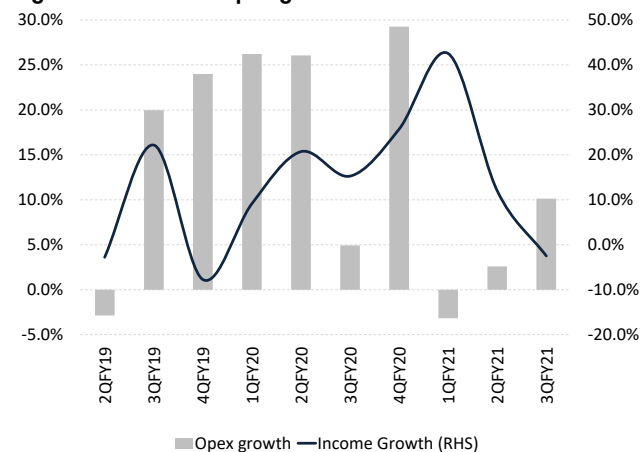
(Rs m)	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
Interest income	16,296	16,216	16,392	16,157	16,037	15,955
Interest expense	11,309	11,138	11,099	10,806	10,288	9,815
NII	4,987	5,078	5,293	5,351	5,749	6,141
Y/Y growth %	6.6	4.1	10.1	8.2	15.3	20.9
Non-interest income	3,088	4,021	4,404	5,189	3,298	2,731
Total Income	8,075	9,099	9,697	10,540	9,047	8,872
Y/Y growth %	20.7	15.3	25.7	42.6	12.0	-2.5
Operating expenses	3,941	4,081	5,781	3,770	4,043	4,494
Of which, staff cost	1,632	1,865	3,704	2,017	2,046	2,675
PPOP	4,134	5,018	3,915	6,770	5,004	4,378
Y/Y growth %	16.0	25.3	20.8	93.4	21.0	-12.8
Total provisions	2,624	3,147	3,565	5,091	3,221	2,142
PBT	1,510	1,871	350	1,680	1,783	2,236
Tax	451	640	77	(284)	589	884
PAT	1,059	1,231	273	1,964	1,194	1,352
Y/Y growth %	-5.3	-12.3	-55.8	11.9	12.8	9.8

Source: Company, Anand Rath Research

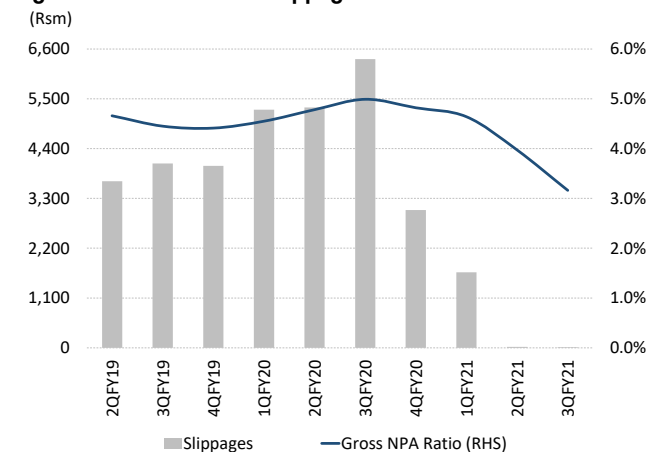
Fig 9 – Balance sheet

(Rs m)	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
Equity capital	2,826	2,826	3,109	3,109	3,109	3,109
Reserves & Surplus	56,648	57,879	56,596	60,450	61,648	62,999
Deposits	701,897	713,560	717,852	718,540	729,290	738,260
Borrowings	24,481	-	40,651	-	22,247	-
Other Liabilities	15,811	-	14,928	-	17,604	-
Equity and Liabilities	801,662		833,135		833,896	
Deposits y/y growth (%)	9.9	9.5	4.9	4.9	3.9	3.5
Deposits q/q growth (%)	2.4	1.7	0.6	0.1	1.5	1.2
Assets						
Cash and cash balances	38,529	-	29,195	-	31,371	-
Advances	534,684	549,110	569,643	542,095	540,989	531,870
Investments	179,346	179,990	175,453	182,770	199,558	206,600
Other assets	49,103	-	58,844	-	61,978	-
Total Assets	801,662		833,135		833,896	
Advances y/y growth (%)	7.0	5.7	3.9	2.6	1.2	-3.1
Advances q/q growth (%)	1.2	2.7	3.7	-4.8	-0.2	-1.7

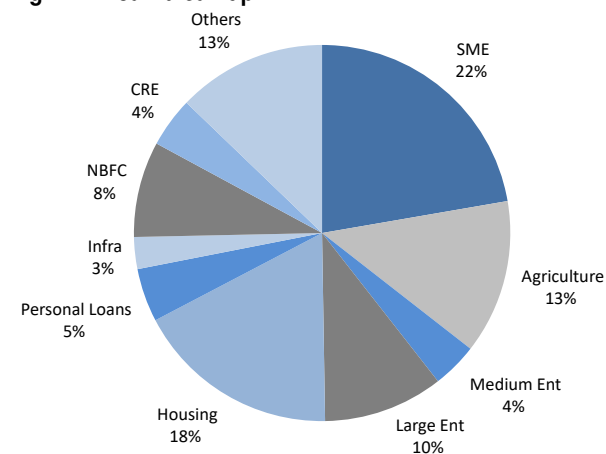
Source: Company, Anand Rath Research

Fig 10 – Income vs. Opex growth

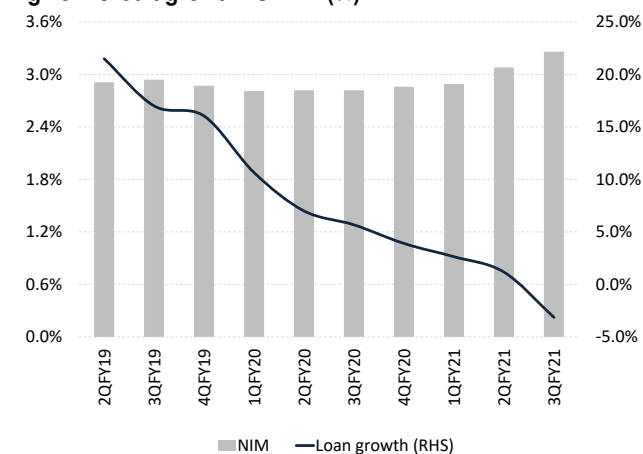
Source: Company, Anand Rathi Research

Fig 11 – Gross NPA and slippages

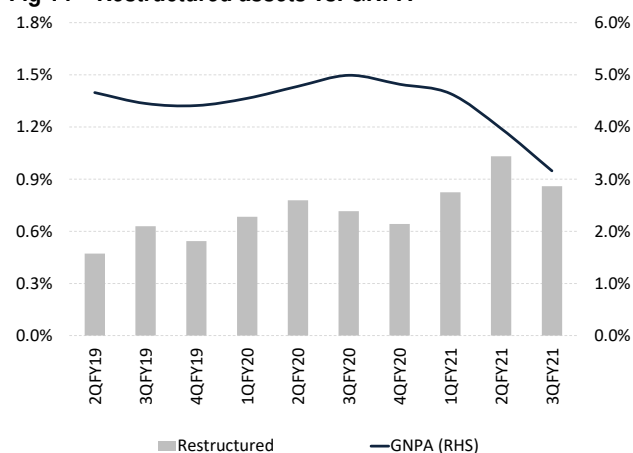
Source: Company, Anand Rathi Research

Fig 12 – Loan break-up

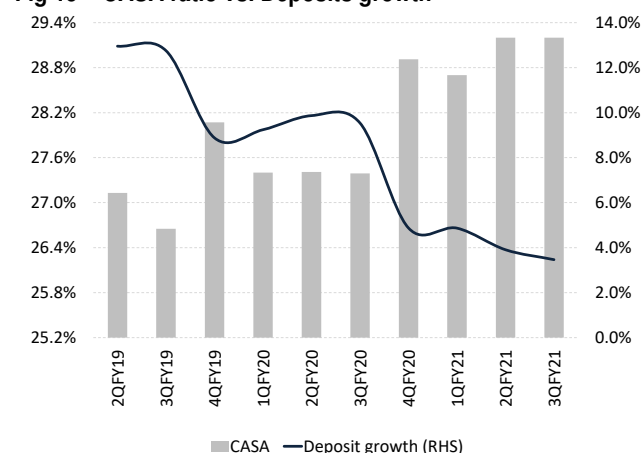
Source: Company, Anand Rathi Research

Fig 13 – Credit growth vs. NIM (%)

Source: Company, Anand Rathi Research

Fig 14 – Restructured assets vs. GNPA

Source: Company, Anand Rathi Research

Fig 15 – CASA ratio vs. Deposits growth

Source: Company, Anand Rathi Research

Valuation

Our Jan'22 target (of Rs85) is based on the two-stage DDM model. This implies a ~0.3x P/ABV multiple on its FY23e book.

Fig 16 – Change in estimates

	FY21e			FY22e		
	New	Old	Chg (%)	New	Old	Chg (%)
Net interest income (Rsm)	23,827	20,962	13.7	26,066	22,983	13.4
Pre-provisioning profit (Rsm)	20,389	18,345	11.1	23,441	21,237	10.4
PAT (Rsm)	5,229	4,535	15.3	7,612	7,091	7.4

Source: Anand Rathi Research

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.

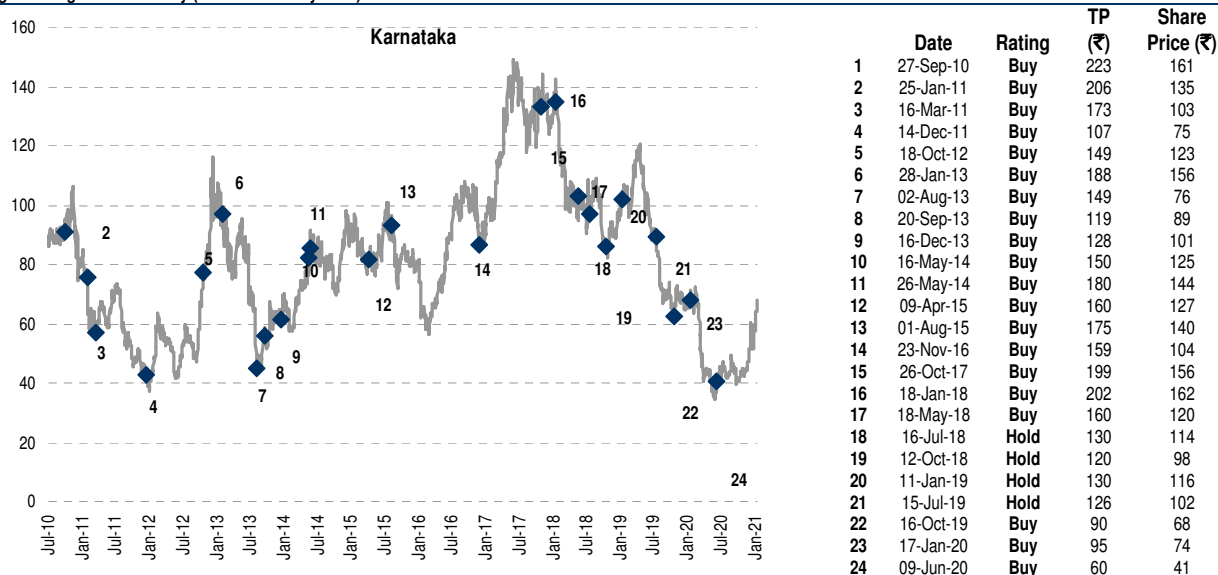
Appendix

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