

2 November 2022

Karnataka Bank

Strong quarter, business growth to pick up; upgrading to a Buy

Rating: **Buy**

Target Price: Rs.140

Share Price: Rs.113

A steep rise in margins and negative provisions led to Karnataka Bank's Q2 strong profitability, with its RoA at 1.7%. With most pandemic-related stress already recognised/re-structured, the focus now shifts toward growth. Key positives were 1) strong traction in retail loans, 2) moderation of slippages and 3) strong margin improvement. With credit growth picking up and moderating credit costs, earnings are expected to normalise in the medium term. We upgrade our rating to a Buy, with a higher TP of Rs140, valuing the stock at 0.6x P/ABV on its FY25e book

Asset quality improves. GNPA decreased 67bps sequentially to 3.4%, caused by lower slippages and strong recoveries. Slippages were Rs3bn (2% of loans), less than previous quarters and better than we expected. The re-structured book was Rs33.3bn, down 8.9% q/q.

Medium-term RoA to move toward 1%. Q2 NIM rose 45bps q/q to 3.78% on the sharp rise in yields (incl. one-off recovery). We expect NIM to stabilise near 3.5%. We are working with a 190bp credit cost for this year, to account for a tail risk from accelerated slippages in the restructured book. We expect credit costs to moderate in a couple of quarters, leading to normalisation in RoA. We estimate 0.9% RoA for FY25

Valuation. Our Nov'23 target (of Rs140) is based on the two-stage DDM model. This implies a ~0.6x P/ABV multiple on its FY24e book. **Risks:** High provisioning, large slippages from its agriculture and MSME books.

Key financials (YE Mar) (Rs m)	FY21	FY22	FY23e	FY24e	FY25e
Net interest income	21,832	24,910	31,624	34,706	38,256
Pre-provisioning profit	19,083	16,340	20,687	23,118	26,482
Provisions	12,964	9,394	12,299	10,875	12,180
PAT (Rs m)	4,826	5,086	6,274	9,157	10,698
EPS (Rs)	15.5	16.4	20.2	29.4	34.4
NIM (%)	2.9	3.2	3.6	3.5	3.5
Cost-income (%)	46.8	52.6	48.4	48.3	47.6
RoE (%)	7.7	7.4	8.5	11.2	11.7
RoA (%)	0.6	0.6	0.6	0.8	0.9
Advances growth (%)	-9.6	10.2	14.0	12.0	12.0
GNPA (%)	4.9	3.9	3.2	3.0	3.0
CAR (%)	14.9	15.7	15.1	15.1	15.2
P / E (x)	7.3	6.9	5.6	3.8	3.3
P / BV (x)	0.5	0.5	0.5	0.4	0.4
P / ABV (x)	0.6	0.6	0.5	0.5	0.4

Source: Company, Anand Rathi Research

Key data	KBL IN / KBNK.BO
52-week high / low	Rs.113 / 55
Sensex / Nifty	60906 / 18083
3-m average volume	\$2.5m
Market cap	Rs.35bn / \$423.6m
Shares outstanding	311m

Shareholding pattern (%)	Sep'22	Jun'22	Mar'22
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	18.2	15.5	11.9
- Domestic institutions	5.3	5.3	5.3
- Public	76.5	79.2	82.7

Estimates revision (%)	FY23e	FY24e
Net interest income	8.4	4.2
Pre-provisioning profit	(0.0)	(6.7)
PAT	(2.5)	8.8

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Net interest income	21,832	24,910	31,624	34,706	38,256
<i>NII growth (%)</i>	7.5	14.1	27.0	9.7	10.2
Non-interest income	14,042	9,539	8,447	10,021	12,286
Income	35,874	34,449	40,071	44,727	50,542
<i>Income growth (%)</i>	4.7	-4.0	16.3	11.6	13.0
Operating expenses	16,791	18,109	19,384	21,610	24,059
PPOP	19,083	16,340	20,687	23,118	26,482
<i>PPOP growth (%)</i>	15.2	-14.4	26.6	11.8	14.6
Provisions	12,964	9,394	12,299	10,875	12,180
PBT	6,119	6,946	8,388	12,243	14,302
Tax	1,294	1,859	2,114	3,085	3,604
PAT	4,826	5,086	6,274	9,157	10,698
<i>PAT growth (%)</i>	11.8	5.4	23.4	46.0	16.8
FDEPS (Rs / sh)	15.5	16.4	20.2	29.4	34.4
DPS (Rs / sh)	1.8	0.0	2.0	2.0	2.0

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Share capital	3,109	3,112	3,113	3,113	3,113
Reserves & surplus	63,315	67,835	74,109	83,266	93,965
Deposits	756,549	803,868	888,275	981,543	1,084,606
Borrowings	27,349	35,838	50,905	53,450	58,795
Liabilities	865,854	933,105	1,037,201	1,142,961	1,261,724
Advances	515,158	567,831	647,328	725,007	812,008
Investments	216,352	220,410	246,859	262,905	281,308
Cash & bank balance	48,661	39,572	40,364	41,171	41,994
Fixed & other assets	8,384	8,182	8,591	9,020	9,471
Total assets	856,154	920,406	1,037,201	1,142,961	1,261,724
No. of shares (m)	311	311	311	311	311
<i>Deposits growth (%)</i>	5.4	6.3	10.5	10.5	10.5
<i>Advances growth (%)</i>	-9.6	10.2	14.0	12.0	12.0

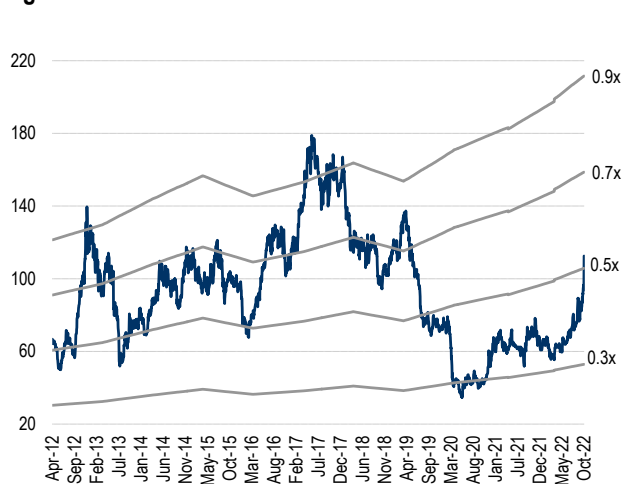
Source: Company, Anand Rathi Research

Fig 3 – Ratio analysis

Year-end: Mar (%)	FY21	FY22	FY23e	FY24e	FY25e
NIM	2.9	3.2	3.6	3.5	3.5
Other inc. / total inc.	39.1	27.7	21.1	22.4	24.3
Cost-income	46.8	52.6	48.4	48.3	47.6
Provision coverage	36.4	38.8	50.4	37.0	40.2
Dividend payout	11.6	0.0	0.0	0.0	0.0
Credit-deposit	68.1	70.6	72.9	73.9	74.9
Investment-deposit	28.6	27.4	27.8	26.8	25.9
Gross NPA	4.9	3.9	3.2	3.0	3.0
Net NPA	3.2	2.4	1.6	1.9	1.8
BV (Rs)	213.7	228.0	248.1	277.5	311.8
Adj. BV (Rs)	176.6	197.0	224.6	245.9	278.9
CAR	14.9	15.7	15.1	15.1	15.2
- Tier 1	12.3	12.7	12.4	12.7	13.0
RoE	7.7	7.4	8.5	11.2	11.7
RoA	0.6	0.6	0.6	0.8	0.9

Source: Company, Anand Rathi Research

Fig 4 – Price-to-Book band



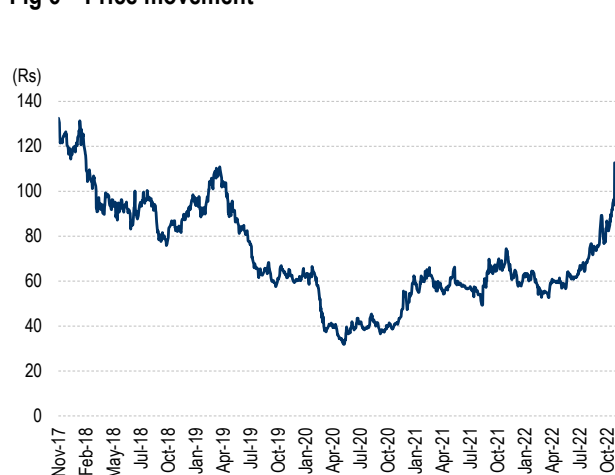
Source: Bloomberg

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



Source: Company, Anand Rathi Research

Fig 6 – Price movement



Source: Bloomberg

Key Highlights

Fig 7 – Asset quality

Break-up of GNPA (Rs m)	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23
Opening balance	25,884	25,491	25,011	23,305	22,508	24,014
Slippages	4,142	4,454	2,977	3,956	5,694	3,027
<i>Gross slippages (%)</i>	3.2	3.3	2.1	2.8	3.9	2.0
Reductions	4,536	4,933	4,683	4,753	4,188	6,524
Closing balance	25,491	25,011	23,305	22,508	24,014	20,517
<i>GNPA (%)</i>	4.8	4.5	4.1	3.9	4.0	3.4
<i>NNPA (%)</i>	3.0	2.8	2.5	2.4	2.2	1.7
<i>Restructured advances (%)</i>	2.9	7.3	7.9	6.7	6.3	5.6

Source: Company, Anand Rathi Research

Quarterly snapshot

Fig 8 – Income statement

(Rs m)	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23
Interest income	15,235	15,543	15,651	15,788	16,291	17,711
Interest expense	9,487	9,172	9,425	9,223	9,415	9,683
NII	5,748	6,371	6,227	6,565	6,876	8,027
Y/Y growth %	7.4	10.8	1.4	43.0	19.6	26.0
Non-interest income	2,257	2,749	1,965	2,569	1,328	2,600
Income	8,004	9,120	8,191	9,134	8,204	10,628
Y/Y growth %	-24.1	7.1	-8.7	17.5	2.5	16.5
Operating expenses	3,965	4,184	4,628	5,333	4,076	4,850
Of which, staff cost	2,244	2,201	2,569	3,136	1,786	2,622
PPOP	4,040	4,936	3,563	3,801	4,128	5,778
Y/Y growth %	-40.3	10.4	-20.5	15.6	2.2	17.1
Total provisions	3,578	3,472	1,385	959	3,629	(138)
PBT	461	1,464	2,178	2,842	499	5,917
Tax	(599)	208	713	1,539	(643)	1,800
PAT	1,061	1,256	1,466	1,304	1,142	4,116
Y/Y growth %	-46.0	5.2	8.3	315.5	7.6	227.7

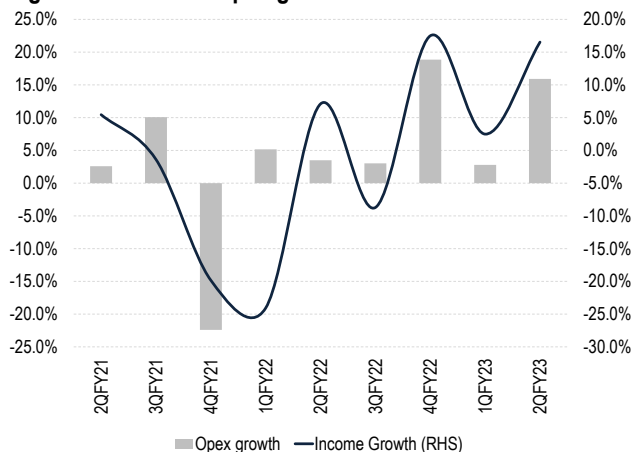
Source: Company, Anand Rathi Research

Fig 9 – Balance sheet

(Rs m)	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23
Equity capital	3,109	3,109	3,109	3,112	3,112	3,113
Reserves & Surplus	64,376	65,072	66,540	67,836	68,980	72,422
Deposits	762,150	769,220	784,290	803,868	805,770	816,337
Borrowings	-	32,463	-	23,138	-	59,437
Other Liabilities	-	23,266	-	22,451	-	28,330
Equity and Liabilities		893,129		920,406		979,639
Deposits y/y growth (%)	6.1	5.5	6.2	6.3	5.7	6.1
Deposits q/q growth (%)	0.7	0.9	2.0	2.5	0.2	1.3
Assets						
Cash and cash balances	-	40,586	-	44,368	-	50,171
Advances	517,910	543,416	554,890	567,831	583,590	598,725
Investments	233,010	228,513	219,910	220,410	231,950	237,582
Other assets	-	80,614	-	87,797	-	93,161
Total Assets		893,129		920,406		979,639
Advances y/y growth (%)	-4.5	0.4	4.3	9.8	12.7	10.2
Advances q/q growth (%)	0.2	4.9	2.1	2.3	2.8	2.6

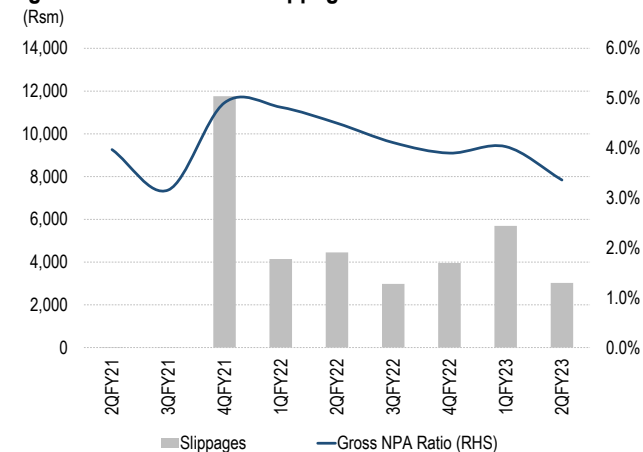
Source: Company, Anand Rathi Research

Fig 10 – Income vs. Opex growth



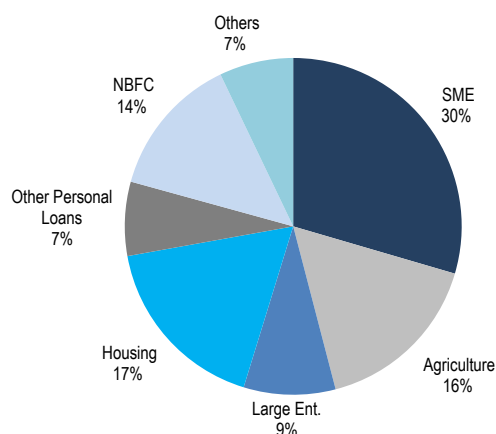
Source: Company, Anand Rathi Research

Fig 11 – Gross NPA and slippages



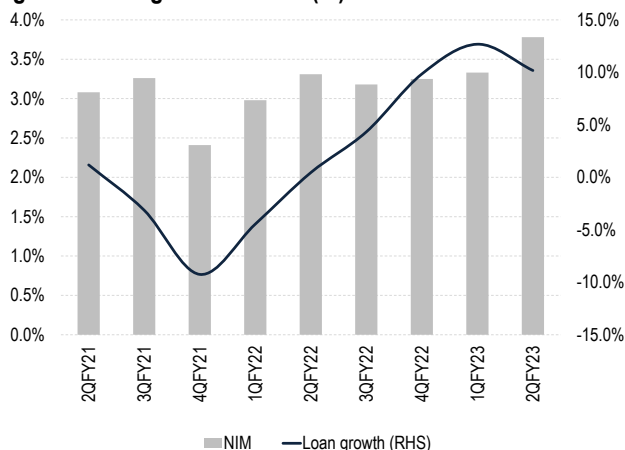
Source: Company, Anand Rathi Research

Fig 12 – Loan break-up



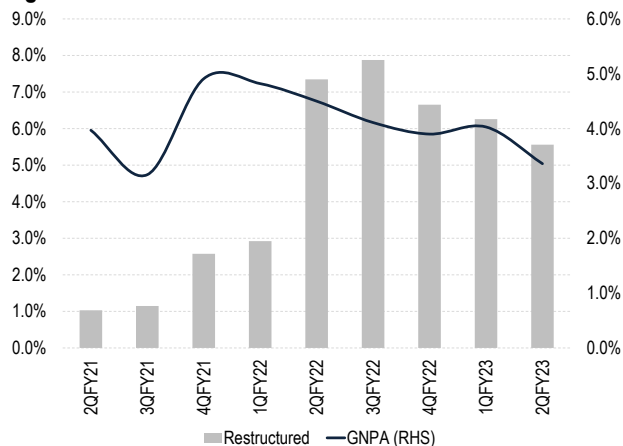
Source: Company, Anand Rathi Research

Fig 13 – Credit growth vs. NIM (%)



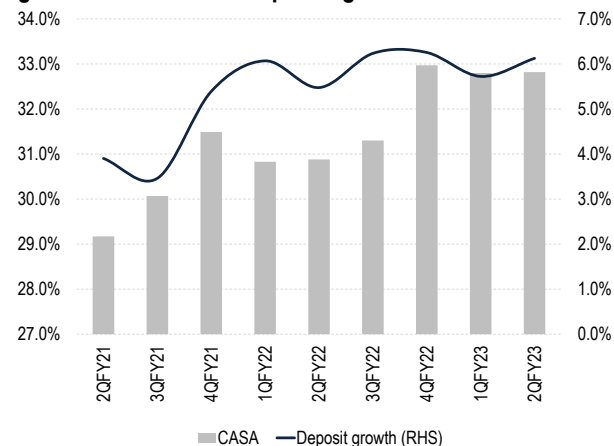
Source: Company, Anand Rathi Research

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 Nov'23 target (of Rs140) is based on the two-stage DDM model. This implies a ~0.6x P/ABV multiple on its FY24e book.

Fig 16 – Change in estimates

(Rs m)	FY23e			FY24e		
	New	Old	Chg (%)	New	Old	Chg (%)
Net interest income	31,624	29,172	8.4	34,706	33,316	4.2
Pre-provisioning profit	20,687	20,687	(0.0)	23,118	24,790	(6.7)
PAT	6,274	6,435	(2.5)	9,157	8,420	8.8

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.

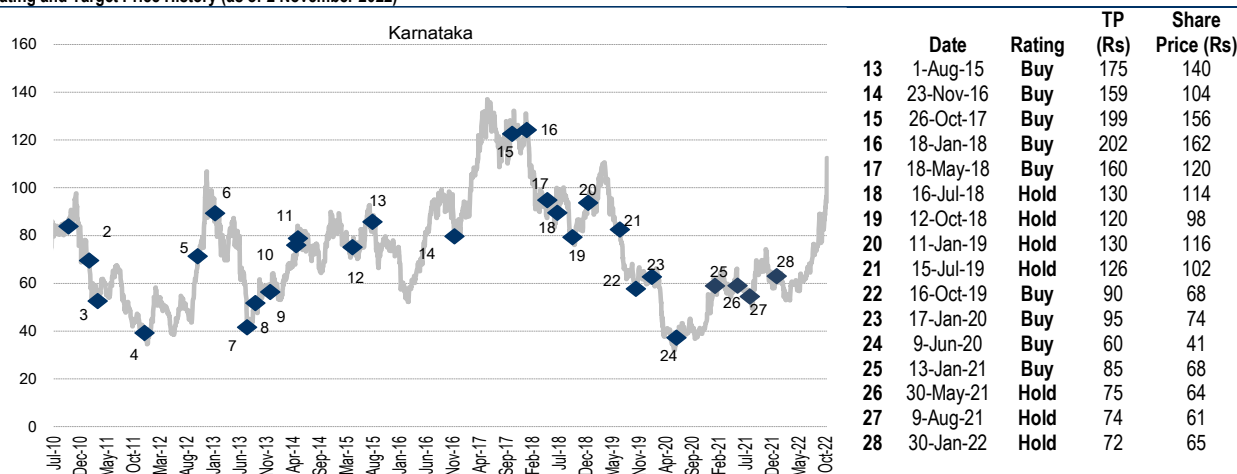
Appendix

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