

23 January 2023

Karur Vysya Bank

Strong quarter, strong earnings expected to continue; retaining a Buy

Rating: **Buy**

Target Price: Rs.135

Share Price: Rs.108

KVB's Q3 FY23 profitability improved, its RoA coming at 1.32% (up 40bps q/q) on account of a strong operating performance. Key positives were 1) improving asset quality, 2) credit growth in mid-teens, 3) expanded margins and 4) strong liquidity and capitalisation. With credit growth expected to be in the mid-teens and moderating credit costs, earnings are expected to be strong. We retain our Buy rating, with a TP of Rs135, valuing the stock at 1.1x P/ABV on the FY25e book.

Asset quality further improves. GNPA and NNPA improved respectively 131bps and 47bps sequentially on account of lower slippages and strong recoveries. Slippages for the quarter were Rs1.6bn (~1% of loans), much lower than the five-year average (excl. the Covid period). PCR (incl. w/o) sequentially improved 393bps to 90.9%. The standard restructured book was Rs11.6bn (down 6% q/q) constituting 1.9% of loans. Surprisingly, the overall SMA 30+ for the bank was Rs5.9bn (0.9% of loans), the lowest of its peers. With most of the stress already delinquent/restructured and collections reaching pre-Covid levels, net slippages are expected to be negative in the near term. We expect GNPA to hold below 2% through FY24 and FY25.

RoA to remain above 1%. With growth expected to be in mid-teens and a moderating slippage run-rate, medium-term credit costs are expected to be soft. Higher business growth combined with benign credit costs would lead to strong profitability in the medium term. We estimate a 1.2% RoA through FY24 and FY25.

Valuation. Our Jan'24 target of Rs135 is based on the two-stage DDM model. This implies a ~1.1x P/ABV multiple on its FY25e book. **Risks:** Lumpy slippages from the corporate book; stress in the SME book.

| Key financials (YE Mar) | FY21 | FY22 | FY23e | FY24e | FY25e |
|--------------------------------|--------|--------|--------|--------|--------|
| Net interest income (Rs m) | 23,595 | 27,154 | 33,605 | 37,499 | 43,682 |
| Pre-provisioning profit (Rs m) | 12,915 | 16,302 | 23,528 | 25,661 | 30,193 |
| Provisions (Rs m) | 7,571 | 6,993 | 10,060 | 9,795 | 10,868 |
| PAT (Rs m) | 3,594 | 6,733 | 10,074 | 11,868 | 14,455 |
| EPS (Rs) | 4.5 | 8.4 | 12.6 | 14.8 | 18.1 |
| NIM (%) | 3.5 | 3.7 | 4.1 | 3.9 | 4.0 |
| Cost-income (%) | 60.6 | 53.2 | 46.1 | 47.0 | 46.2 |
| RoE (%) | 5.3 | 9.3 | 12.6 | 13.4 | 14.6 |
| RoA (%) | 0.5 | 0.9 | 1.2 | 1.2 | 1.3 |
| Advances growth (%) | 9.3 | 9.9 | 16.0 | 16.0 | 16.0 |
| GNPA (%) | 7.9 | 6.0 | 2.4 | 2.1 | 1.8 |
| CAR (%) | 19.0 | 19.5 | 17.7 | 16.8 | 16.1 |
| P/E (x) | 24.0 | 12.8 | 8.6 | 7.3 | 6.0 |
| P/BV (x) | 1.2 | 1.1 | 1.0 | 0.9 | 0.8 |
| P/ABV (x) | 1.5 | 1.3 | 1.1 | 1.0 | 0.9 |

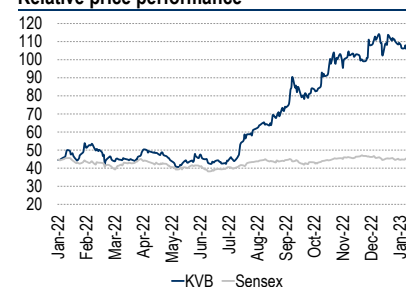
Source: Company, Anand Rathi Research

| Key data | KVB IN / KARU.BO |
|--------------------|--------------------|
| 52-week high / low | Rs116 / 42 |
| Sensex / Nifty | 60942 / 18119 |
| 3-m average volume | \$8.8m |
| Market cap | Rs87bn / \$1065.3m |
| Shares outstanding | 799m |

| Shareholding pattern (%) | Sep'22 | Jun'22 | Mar'22 |
|--------------------------|--------|--------|--------|
| Promoters | 2.3 | 2.3 | 2.3 |
| - of which, Pledged | 8.2 | 8.2 | 8.2 |
| Free float | 97.7 | 97.7 | 97.7 |
| - Foreign institutions | 15.4 | 15.4 | 15.4 |
| - Domestic institutions | 22.8 | 22.8 | 21.9 |
| - Public | 59.5 | 59.5 | 60.5 |

| Estimates revision (%) | FY24e | FY25e |
|------------------------|-------|-------|
| NII | 1.1 | 0.9 |
| PPOP | 0.3 | 0.1 |
| PAT | 0.5 | 0.1 |

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 | 23,595 | 27,154 | 33,605 | 37,499 | 43,682 |
| <i>NII growth (%)</i> | 0.5 | 15.1 | 23.8 | 11.6 | 16.5 |
| Non-interest income | 9,188 | 7,691 | 10,011 | 10,961 | 12,473 |
| Income | 32,784 | 34,844 | 43,615 | 48,460 | 56,154 |
| <i>Income growth (%)</i> | -6.4 | 6.3 | 25.2 | 11.1 | 15.9 |
| Operating expenses | 19,868 | 18,542 | 20,087 | 22,799 | 25,961 |
| PPOP | 12,915 | 16,302 | 23,528 | 25,661 | 30,193 |
| <i>PPOP growth (%)</i> | -26.7 | 26.2 | 44.3 | 9.1 | 17.7 |
| Provisions | 7,571 | 6,993 | 10,060 | 9,795 | 10,868 |
| PBT | 5,344 | 9,309 | 13,469 | 15,866 | 19,325 |
| Tax | 1,750 | 2,577 | 3,394 | 3,998 | 4,870 |
| PAT | 3,594 | 6,733 | 10,074 | 11,868 | 14,455 |
| <i>PAT growth (%)</i> | 52.9 | 87.3 | 49.6 | 17.8 | 21.8 |
| FDEPS (Rs / sh) | 4.5 | 8.4 | 12.6 | 14.8 | 18.1 |
| DPS (Rs / sh) | 0.5 | 1.6 | 2.5 | 3.0 | 3.6 |

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rs m)

| Year-end: Mar | FY21 | FY22 | FY23e | FY24e | FY25e |
|----------------------------|----------------|----------------|----------------|------------------|------------------|
| Share capital | 1,599 | 1,600 | 1,601 | 1,601 | 1,601 |
| Reserves & surplus | 67,999 | 74,362 | 82,422 | 91,916 | 103,480 |
| Deposits | 632,784 | 686,762 | 789,776 | 908,242 | 1,044,479 |
| Borrowings | 25,283 | 13,391 | 14,998 | 17,397 | 20,181 |
| Minority interests | 0 | 0 | 0 | 0 | 0 |
| Total liabilities | 746,236 | 800,443 | 918,422 | 1,051,299 | 1,204,033 |
| Advances | 503,635 | 553,346 | 641,882 | 744,583 | 863,716 |
| Investments | 160,189 | 172,161 | 196,263 | 219,815 | 246,192 |
| Cash & bank balance | 35,141 | 35,943 | 39,177 | 42,703 | 46,547 |
| Fixed & other assets | 5,391 | 4,785 | 4,881 | 5,125 | 5,381 |
| Total assets | 746,232 | 800,437 | 918,422 | 1,051,299 | 1,204,033 |
| No. of shares (m) | 799 | 800 | 800 | 800 | 800 |
| <i>Deposits growth (%)</i> | 7.1 | 8.5 | 15.0 | 15.0 | 15.0 |
| <i>Advances growth (%)</i> | 9.3 | 9.9 | 16.0 | 16.0 | 16.0 |

Source: Company, Anand Rathi Research

Fig 3 – Ratio analysis %

| Year-end: Mar | FY21 | FY22 | FY23e | FY24e | FY25e |
|-------------------------|------|------|-------|-------|-------|
| NIM | 3.5 | 3.7 | 4.1 | 3.9 | 4.0 |
| Other inc. / total inc. | 28.0 | 22.1 | 23.0 | 22.6 | 22.2 |
| Cost-income | 60.6 | 53.2 | 46.1 | 47.0 | 46.2 |
| Provision coverage | 58.5 | 63.3 | 68.0 | 68.0 | 68.0 |
| Dividend payout | 11.1 | 19.0 | 20.0 | 20.0 | 20.0 |
| Credit-deposit | 79.6 | 80.6 | 81.3 | 82.0 | 82.7 |
| Investment-deposit | 25.3 | 25.1 | 24.9 | 24.2 | 23.6 |
| Gross NPA | 7.9 | 6.0 | 2.4 | 2.1 | 1.8 |
| Net NPA | 3.4 | 2.3 | 0.8 | 0.7 | 0.6 |
| BV (Rs) | 87.1 | 95.0 | 105.0 | 116.9 | 131.3 |
| Adj. BV (Rs) | 72.0 | 83.9 | 100.6 | 112.4 | 126.9 |
| CAR | 19.0 | 19.5 | 17.7 | 16.8 | 16.1 |
| - Tier 1 | 17.0 | 17.5 | 16.0 | 15.4 | 14.9 |
| RoE | 5.3 | 9.3 | 12.6 | 13.4 | 14.6 |
| RoA | 0.5 | 0.9 | 1.2 | 1.2 | 1.3 |

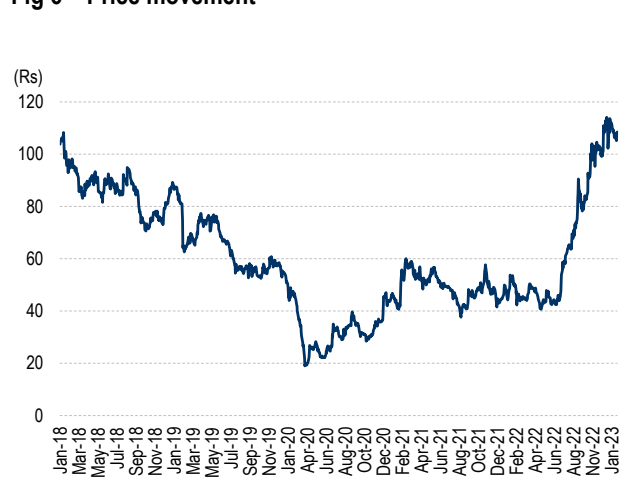
Source: Company, Anand Rathi Research

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 – Movement of GNPA

| GNPA | Q3 FY21 | Q4 FY21 | Q1 FY22 | Q2 FY22 | Q3 FY22 | Q4 FY22 | Q1 FY23 | Q3 FY23 | Q3 FY23 |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Opening balance (Rs m) | 39,984 | 38,425 | 41,429 | 41,675 | 39,716 | 38,875 | 34,310 | 31,072 | 24,565 |
| Slippages (Rs m) | 50 | 9,060 | 5,190 | 1,640 | 2,240 | 3,000 | 1,390 | 1,310 | 1,620 |
| Gross slippage ratio (%) | 0.0 | 7.2 | 4.2 | 1.3 | 1.7 | 2.2 | 1.0 | 0.9 | 1.1 |
| Reductions (Rs m) | 1,610 | 6,060 | 4,940 | 3,600 | 3,080 | 3,070 | 4,630 | 7,810 | 9,450 |
| Closing balance (Rs m) | 38,425 | 41,429 | 41,675 | 39,716 | 38,875 | 34,310 | 31,072 | 24,565 | 16,743 |
| GNPA (%) | 7.4 | 7.9 | 8.0 | 7.4 | 7.0 | 6.0 | 5.2 | 4.0 | 2.7 |
| NNPA (%) | 2.6 | 3.4 | 3.7 | 3.0 | 2.6 | 2.3 | 1.9 | 1.4 | 0.9 |
| Restructured advances (%) | 1.4 | 1.9 | 2.1 | 3.1 | 3.0 | 3.0 | 2.6 | 2.0 | 1.9 |
| Stressed assets (%) | 8.7 | 9.8 | 10.0 | 10.5 | 10.0 | 8.9 | 7.9 | 6.0 | 4.5 |

Source: Company, Anand Rathi Research

Fig 8 – Break-up of advances (%)

| | Q3 FY21 | Q4 FY21 | Q1 FY22 | Q2 FY22 | Q3 FY22 | Q4 FY22 | Q1 FY23 | Q3 FY23 | Q3 FY23 |
|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Corporate | 24.3 | 23.4 | 23.0 | 22.8 | 22.1 | 22.8 | 23.0 | 22.2 | 22.9 |
| Commercial | 32.2 | 31.6 | 31.3 | 30.5 | 32.3 | 31.4 | 31.3 | 32.0 | 31.9 |
| Retail | 22.3 | 23.2 | 23.3 | 23.7 | 23.2 | 23.0 | 22.8 | 22.9 | 22.5 |
| Housing | 9.4 | 9.5 | 10.2 | 9.9 | 9.7 | 10.1 | 10.0 | 10.0 | 9.8 |
| Auto | 1.9 | 2.0 | 1.9 | 2.0 | 1.9 | 1.9 | 1.9 | 1.8 | 1.7 |
| Education | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.2 | 0.2 |
| Personal | 1.0 | 1.0 | 1.1 | 0.8 | 0.7 | 0.7 | 0.6 | 0.6 | 0.5 |
| Jewel | 3.0 | 3.3 | 3.4 | 3.4 | 3.1 | 3.3 | 3.2 | 3.0 | 2.8 |
| LAP | 3.1 | 3.1 | 3.2 | 3.1 | 3.0 | 3.2 | 3.2 | 3.4 | 3.4 |
| Other retail | 3.5 | 4.1 | 3.2 | 4.2 | 4.5 | 3.6 | 3.7 | 4.0 | 4.0 |
| Farm | 21.3 | 21.8 | 22.4 | 22.9 | 22.3 | 22.7 | 22.8 | 22.9 | 22.7 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: Company, Anand Rathi Research

Quarterly snapshot

Fig 9 – Income statement

| (Rs m) | Q1 FY21 | Q2 FY21 | Q3 FY21 | Q4 FY21 | Q1 FY22 | Q2 FY22 | Q3 FY22 | Q4 FY22 | Q1 FY23 | Q3 FY23 | Q3 FY23 |
|---------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
| Interest income | 13,761 | 13,947 | 13,503 | 13,493 | 13,759 | 13,980 | 14,045 | 14,093 | 14,735 | 15,795 | 16,952 |
| Interest expense | 8,143 | 7,932 | 7,667 | 7,367 | 7,380 | 7,176 | 7,173 | 6,993 | 7,277 | 7,581 | 8,062 |
| Nil | 5,618 | 6,015 | 5,836 | 6,126 | 6,379 | 6,803 | 6,872 | 7,099 | 7,459 | 8,214 | 8,890 |
| y/y growth (%) | (3.8) | 0.9 | 1.1 | 3.7 | 13.5 | 13.1 | 17.8 | 15.9 | 16.9 | 20.7 | 29.4 |
| Non-interest income | 3,171 | 1,828 | 2,633 | 1,691 | 2,033 | 1,647 | 1,956 | 2,055 | 1,991 | 2,416 | 3,175 |
| Total Income | 8,790 | 7,842 | 8,469 | 7,817 | 8,412 | 8,450 | 8,828 | 9,154 | 9,450 | 10,629 | 12,065 |
| y/y growth (%) | 2.9 | (10.3) | 1.1 | (16.6) | (4.3) | 7.7 | 4.2 | 17.1 | 12.3 | 25.8 | 36.7 |
| Operating expenses | 4,051 | 4,243 | 5,782 | 5,793 | 4,293 | 4,696 | 4,813 | 4,741 | 4,695 | 4,906 | 5,175 |
| Of which staff cost | 2,136 | 2,206 | 3,683 | 3,512 | 2,274 | 2,512 | 2,434 | 2,232 | 2,357 | 2,339 | 2,557 |
| PPOP | 4,739 | 3,600 | 2,687 | 2,024 | 4,119 | 3,754 | 4,016 | 4,413 | 4,755 | 5,723 | 6,890 |
| y/y growth (%) | 6.5 | (16.5) | (30.2) | (59.5) | (13.1) | 4.3 | 49.5 | 118.0 | 15.4 | 52.5 | 71.6 |
| Total provisions | 3,376 | 1,959 | 2,130 | 241 | 2,474 | 1,657 | 1,461 | 1,401 | 1,547 | 2,272 | 3,641 |
| PBT | 1,363 | 1,640 | 557 | 1,783 | 1,646 | 2,097 | 2,555 | 3,012 | 3,208 | 3,451 | 3,249 |
| Tax | 308 | 491 | 211 | 740 | 557 | 442 | 700 | 877 | 921 | 949 | 356 |
| PAT | 1,055 | 1,149 | 346 | 1,044 | 1,089 | 1,654 | 1,855 | 2,135 | 2,287 | 2,502 | 2,893 |
| y/y growth (%) | 44.7 | 81.4 | 129.8 | 24.7 | 3.2 | 44.0 | 435.6 | 104.5 | 110.1 | 51.3 | 56.0 |

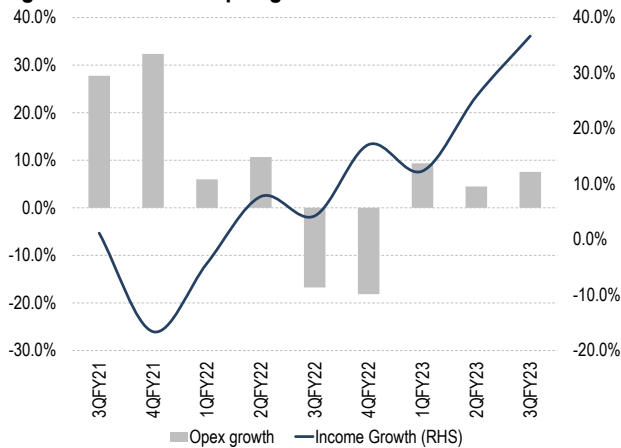
Source: Company, Anand Rathi Research

Fig 10 – Balance sheet

| (Rs m) | Q1 FY21 | Q2 FY21 | Q3 FY21 | Q4 FY21 | Q1 FY22 | Q2 FY22 | Q3 FY22 | Q4 FY22 | Q1 FY23 | Q3 FY23 | Q3 FY23 |
|-------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Equity capital | 1,600 | 1,599 | 1,600 | 1,599 | 1,600 | 1,599 | 1,600 | 1,600 | 1,600 | 1,601 | 1,600 |
| Reserves & Surplus | 65,460 | 66,608 | 66,950 | 67,999 | 69,090 | 70,342 | 72,200 | 74,362 | 76,650 | 77,888 | 80,800 |
| Deposits | 600,650 | 611,224 | 620,890 | 632,784 | 643,980 | 654,101 | 668,710 | 686,762 | 711,680 | 736,141 | 761,750 |
| Borrowings | 10,410 | 13,827 | 13,900 | 25,283 | 9,870 | 11,576 | 12,960 | 13,391 | 26,110 | 22,806 | 14,730 |
| Other Liabilities | 15,680 | 18,490 | 22,640 | 18,567 | 18,060 | 21,118 | 20,650 | 24,323 | 22,430 | 25,214 | 31,250 |
| Equity and Liabilities | 693,800 | 711,747 | 725,980 | 746,232 | 742,600 | 758,736 | 776,120 | 800,437 | 838,470 | 863,650 | 890,130 |
| Deposits y/y growth % | (2.7) | (1.8) | (0.3) | 7.1 | 7.2 | 7.0 | 7.7 | 8.5 | 10.5 | 12.5 | 13.9 |
| Deposits q/q growth % | 1.7 | 1.8 | 1.6 | 1.9 | 1.8 | 1.6 | 2.2 | 2.7 | 3.6 | 3.4 | 3.5 |
| Assets | | | | | | | | | | | |
| Cash and cash balances | 26,300 | 25,731 | 26,520 | 31,241 | 32,590 | 33,645 | 32,780 | 35,943 | 42,520 | 46,906 | 44,020 |
| Advances | 461,310 | 478,218 | 495,120 | 503,635 | 499,620 | 513,813 | 532,270 | 553,346 | 575,590 | 601,614 | 617,090 |
| Investments | 170,330 | 184,346 | 163,550 | 160,189 | 164,080 | 163,870 | 171,470 | 172,161 | 183,860 | 182,947 | 187,260 |
| Other assets | 20,400 | 21,240 | 20,270 | 19,204 | 19,410 | 19,560 | 20,170 | 20,884 | 15,210 | 15,078 | 22,290 |
| Total Assets | 693,800 | 711,747 | 725,980 | 746,232 | 742,600 | 758,736 | 776,120 | 800,437 | 838,470 | 863,650 | 890,130 |
| Advances y/y growth % | (1.8) | 1.5 | 5.1 | 9.3 | 8.3 | 7.4 | 7.5 | 9.9 | 15.2 | 17.1 | 15.9 |
| Advances q/q growth % | 0.1 | 3.7 | 3.5 | 1.7 | (0.8) | 2.8 | 3.6 | 4.0 | 4.0 | 4.5 | 2.6 |

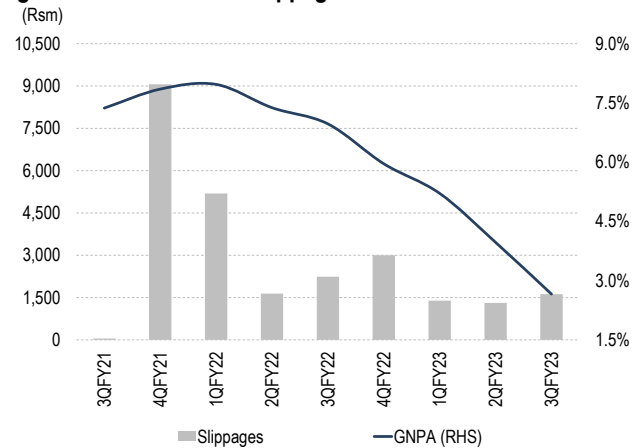
Source: Company, Anand Rathi Research

Fig 11 – Income vs. Opex growth



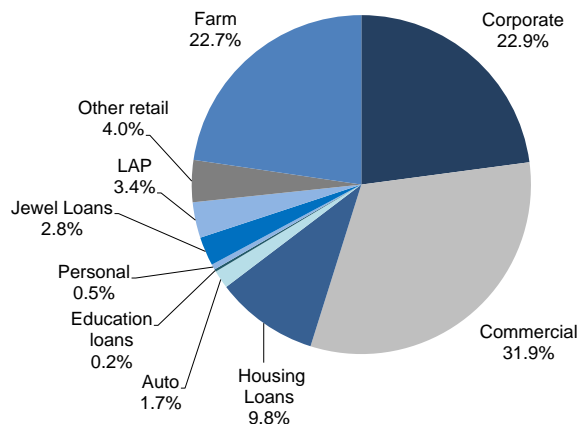
Source: Company, Anand Rathi Research

Fig 12 – Gross NPA and slippages



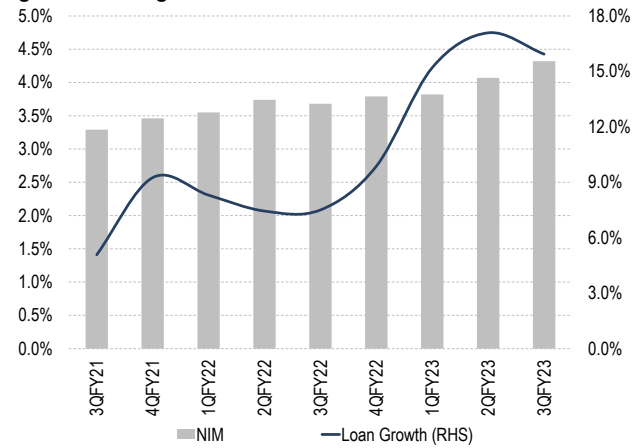
Source: Company, Anand Rathi Research

Fig 13 – Loan break-up



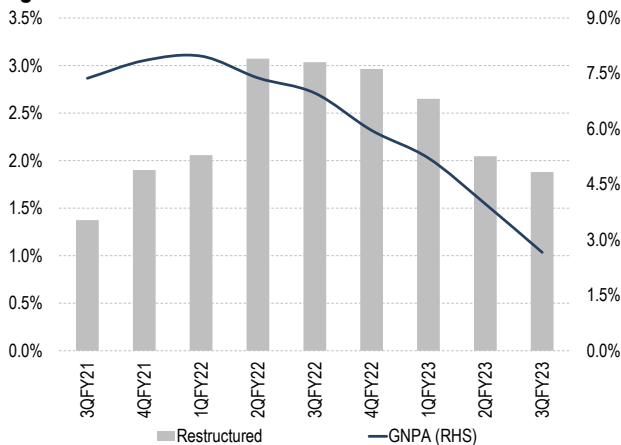
Source: Company, Anand Rathi Research

Fig 14 – Credit growth vs. NIM



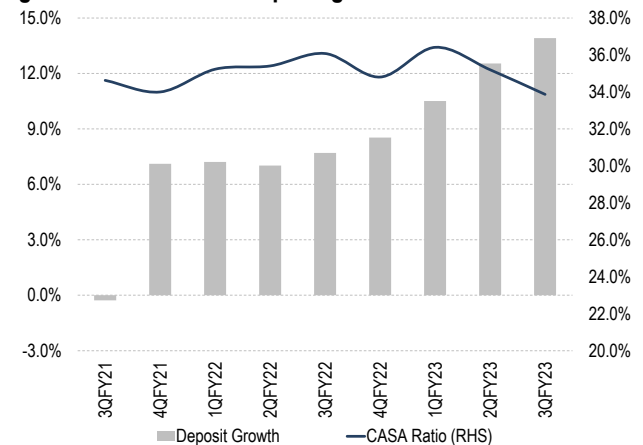
Source: Company, Anand Rathi Research

Fig 15 – Restructured assets vs. GNPA



Source: Company, Anand Rathi Research

Fig 16 – CASA ratio vs. Deposit growth



Source: Company, Anand Rathi Research

Valuation

Our Jan'24 target of Rs135 is based on the two-stage DDM model. This implies a ~1.1x P/ABV multiple on its FY25e book.

We are positive about the bank's loan-growth potential, largely driven by its retail and commercial books.

Fig 17 – Change in estimates

| (Rs m) | FY23e | | | FY24e | | |
|-------------------------|--------|--------|-------|--------|--------|-------|
| | New | Old | Chg % | New | Old | Chg % |
| Net interest income | 37,499 | 37,099 | 1.1 | 43,682 | 43,282 | 0.9 |
| Pre-provisioning profit | 25,661 | 25,589 | 0.3 | 30,193 | 30,171 | 0.1 |
| PAT | 11,868 | 11,814 | 0.5 | 14,455 | 14,438 | 0.1 |

Source: Anand Rathi Research

Risks

- Higher slippages in future (especially from the corporate portfolio) could lead to volatility in asset quality.
- Stress in the SME book.

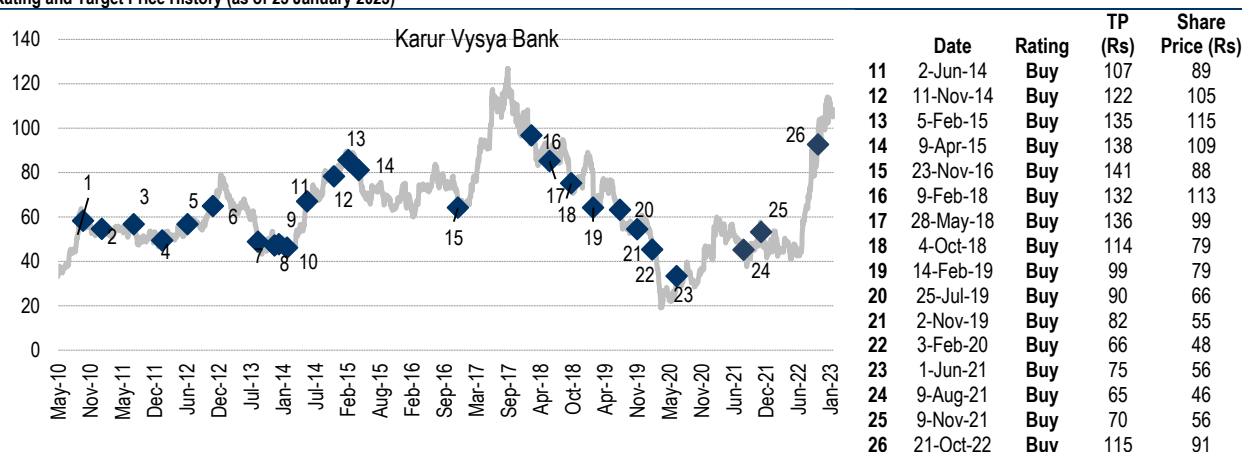
Appendix

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Rating and Target Price History (as of 23 January 2023)



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Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US\$1bn) and Mid/Small Caps (<US\$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)

| | Buy | Hold | Sell |
|---------------------------|------|-------|------|
| Large Caps (>US\$1bn) | >15% | 5-15% | <5% |
| Mid/Small Caps (<US\$1bn) | >25% | 5-25% | <5% |

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