

**BUY** Karur Vysya Bank

Your success is our success

**Poised to reclaim and sustain ~1.5% RoA**

BFSI - Banks ▶ Management Meet Update ▶ June 13, 2023

**TARGET PRICE (Rs): 165**

**KVB has staged a strong recovery over the past two years, from its corporate asset quality woes. Bank reported net credit growth of 16% YoY in FY23, mainly led by strong traction in the retail/agri/MSME portfolio. Within Retail, mortgages remain the key growth driver; Bank now plans to accelerate gold loan growth too. Separately, KVB targets to gradually scale-up the MFI book, for which it is building the right team/processes. That said, the bank believes that its growth strategy will be guided only by a favorable risk-reward ratio and it will, therefore, not chase growth without profitability.**

**We expect KVB to deliver the best RoA/RoE among peers, at 1.5%/15-16% over FY24-26E, with NIMs/fees and LLP being key drivers. We retain BUY, with revised TP of Rs165 (Rs155 earlier), factoring-in 4-6% earnings upgrade and valuing KVB at 1.2x FY25E ABV. KVB remains our preferred pick in the small-cap banking space, given superior returns/capital ratios and Mgmt credibility.**

**Karur Vysya Bank: Financial Snapshot (Standalone)**

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Net profit	6,733	11,061	14,171	16,703	18,824
Loan growth (%)	8.5	15.5	14.4	15.2	16.0
NII growth (%)	15.1	23.3	9.8	13.1	12.4
NIM (%)	3.7	4.1	4.0	3.9	3.9
PPOP growth (%)	26.2	51.9	6.7	13.4	15.1
Adj. EPS (Rs)	8.4	13.8	17.7	20.8	23.5
Adj. EPS growth (%)	87.2	63.9	28.1	17.9	12.7
Adj. BV (INR)	83.2	102.7	118.7	136.7	156.7
Adj. BVPS growth (%)	17.2	23.5	15.7	15.1	14.6
RoA (%)	0.9	1.3	1.5	1.5	1.5
RoE (%)	9.3	13.7	15.4	15.9	15.6
P/E (x)	13.5	8.3	6.4	5.5	4.9
P/ABV (x)	1.4	1.1	0.9	0.8	0.7

Source: Company, Emkay Research

**Growth strategy to be guided by favorable risk-reward ratio**

KVB is finally on a growth track, after a nearly sub-10% credit growth over FY15-22 due to Bank's corporate de-bulking strategy, followed by MD resignation and Covid-induced disruption. With asset-quality issues now largely behind, Bank has clocked 16% YoY net credit growth; for FY24, it guides for a slightly lower number, as it believes in gradually pacing up growth amid macro dislocations, to avoid any accidents. Within Retail, Bank would retain focus on growing its mortgages/LAP portfolio, while also ramping-up its retail gold portfolio. Bank pulled the plugged on the personal loan front in FY23, but plans to focus on building a healthy MFI portfolio over time. MFI growth will be initially led by the BC model, while Bank is building its team/processes; it will accelerate growth once it gains confidence on the risk-reward front. Bank's NEO (new & emerging opportunities) channel — armed with its own feet-on-street, underwriting and credit assessment teams — is helping expand customer acquisition in home loans/supply-chain financing; the bank has also tied-up with fintechs like Amazon, to source loans.

**Healthy margins, contained cost ratios to help sustain core profitability**

Bank has reasonable CASA ratio at 33%, which it nevertheless plans to gradually improve to 40% in the long run, equipped with a mix of physical + digital strategy and thus help sustain its healthy NIMs (>3.8-4%). After a long haul, the bank has decided to open 35 branches in FY24, and plans to thereafter build a formidable CASA base. Bank believes that a cluster-based approach would help it not only to ramp up its MSME asset book, but its CASA base as well. Cost-income ratio has come down, below its traditional range of 53-60%, which the bank aims to sustain at 45-50%, thus supporting KVB's core RoA at 2.4-2.6% over FY24-26E.

Target Price – 12M	Mar-24
<b>Change in TP (%)</b>	<b>6.5</b>
Current Reco.	BUY
Previous Reco.	BUY
Upside/(Downside) (%)	44.9
CMP (13-Jun-23) (Rs)	113.9

Stock Data	Ticker
52-week High (Rs)	116
52-week Low (Rs)	43
Shares outstanding (mn)	799.2
Market-cap (Rs bn)	91
Market-cap (USD mn)	1,104
Net-debt, FY24E (Rs mn)	3,716
ADTV-3M (mn shares)	3
ADTV-3M (Rs mn)	331.0
ADTV-3M (USD mn)	4.0
Free float (%)	97.0
Nifty-50	18,716
INR/USD	82.4
<b>Shareholding, Mar-23</b>	
Promoters (%)	2.2
FPIs/MFs (%)	17.9/30.8

**Price Performance**

(%)	1M	3M	12M
Absolute	18.3	14.3	144.8
Rel. to Nifty	15.7	4.8	106.4

**1-Year share price trend (Rs)****Anand Dama**

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**Lower slippages, healthy PCR to limit incremental LLP**

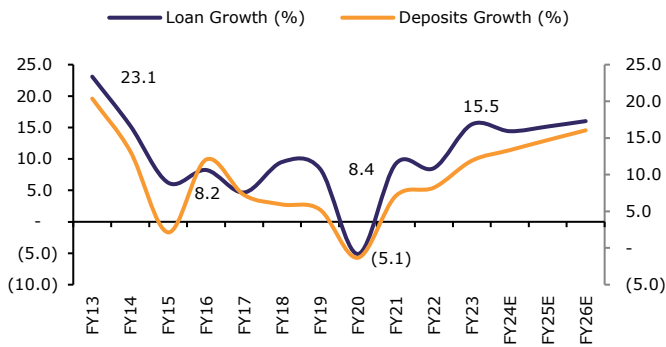
Bank has guided for contained slippages at 1% for FY24 which, coupled with better recovery/w-offs, should lead to steady reduction in GNPA to below 2%. The SMA2 book stands at only 0.2%, while the RSA book too has declined, to 1.5% of loans, with limited risk of relapse. The bank carries healthy PCR at 68% (technical PCR at 92%), while it has guided for LLP at 75bps in FY24 vs 150bps in FY23. We have conservatively built-up a slightly higher PCR (70%) and hence LLP of 1%, factoring-in the incremental macro dislocation and Bank's strategy to build some contingent buffer.

**Attractive valuations, despite the run-up, make KVB a compelling BUY**

With asset-quality stress and concerns around Management stability/credibility now largely behind, KVB is on course to reclaim the best RoA/RoE among peers, at ~1.5%/15-16% over FY24-26E, on a sustainable basis, led by better quality growth, NIMs/fees and contained LLP. This, coupled with the healthy capital ratio (CET 1: ~16.8%) and attractive valuation (0.8x FY25E ABV), makes KVB one of the preferred picks among small-cap banks. We retain BUY, with revised TP of Rs165/share (vs Rs155 earlier), valuing the bank at 1.2x FY25E ABV.

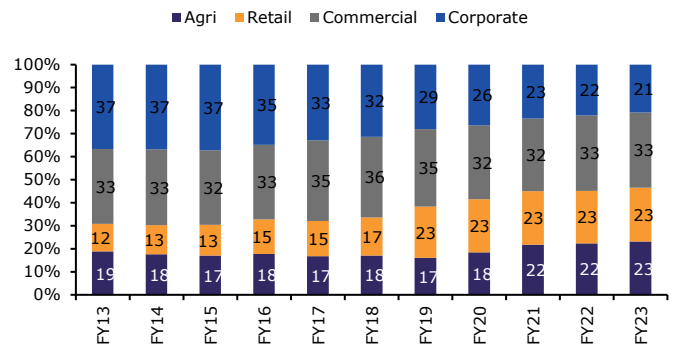
# Story in charts

**Exhibit 1: Credit trajectory set to improve, led by the RAM segment**



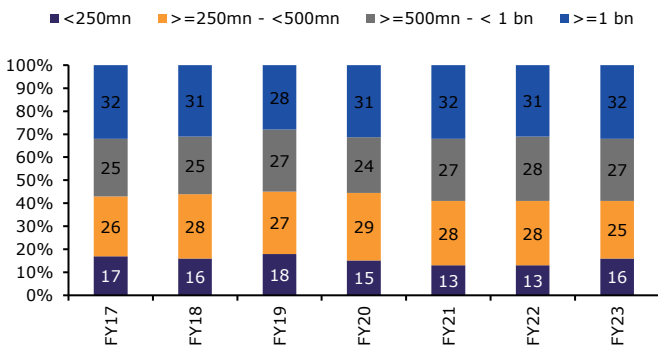
Source: Company, Emkay Research

**Exhibit 2: Low yielding corporate book continues to decline**



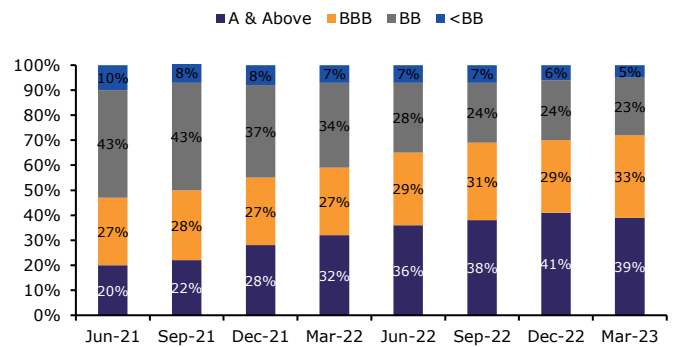
Source: Company, Emkay Research

**Exhibit 3: 68% of the corporate loan ticket size is <Rs1bn**



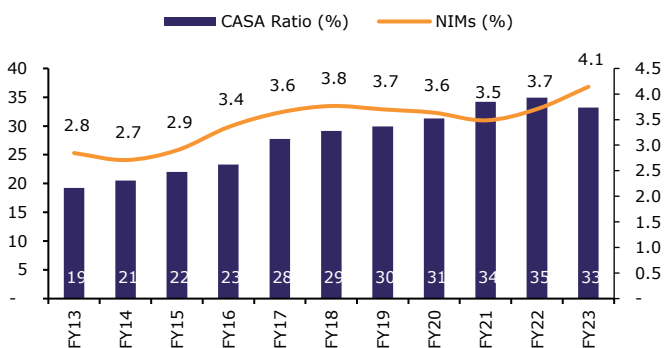
Source: Company, Emkay Research

**Exhibit 4: Share of the BBB & above corporate book has been continuously increasing**



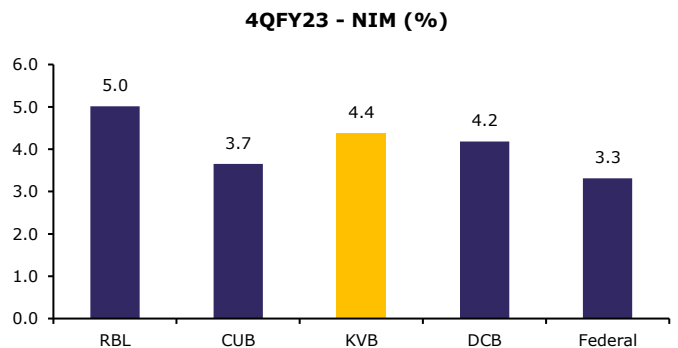
Source: Company, Emkay Research

**Exhibit 5: Better CASA ratio supporting the NIM improvement**



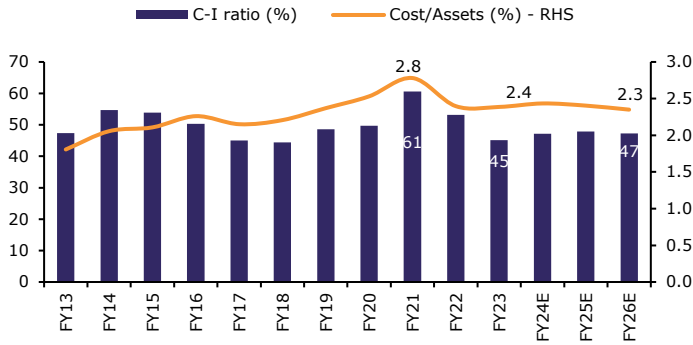
Source: Company, Emkay Research

**Exhibit 6: KVB has reasonably-healthy NIMs among peers**



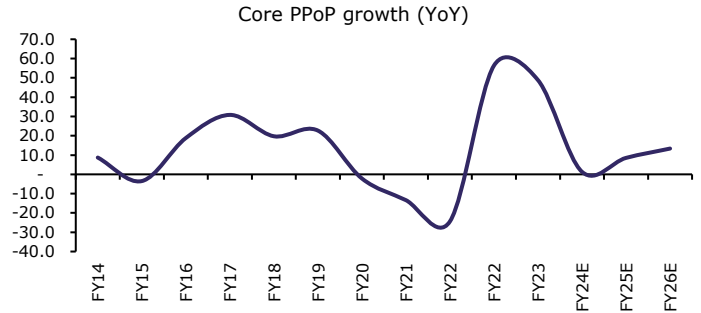
Source: Company, Emkay Research

**Exhibit 7: Cost-income ratio shall settle at 47% due to some pressure on margins**



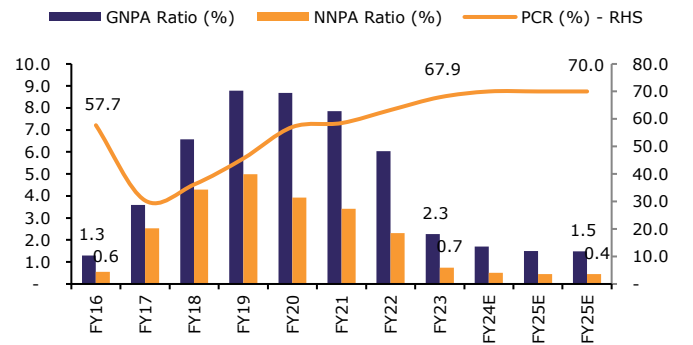
Source: Company, Emkay Research

**Exhibit 8: We expect core PPOP CAGR at 9% over FY23-26E**



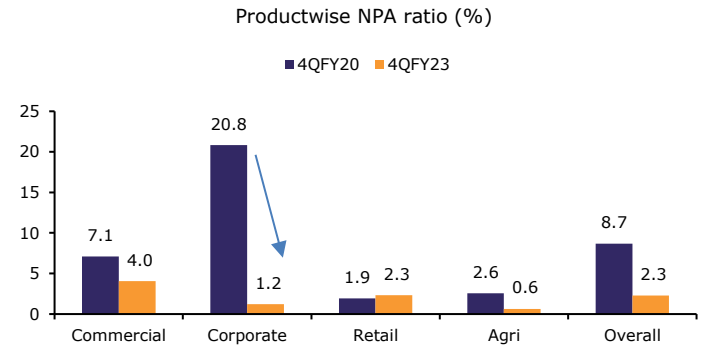
Source: Company, Emkay Research

**Exhibit 9: GNPA ratio to improve, backed by better recoveries and normalization of slippages**



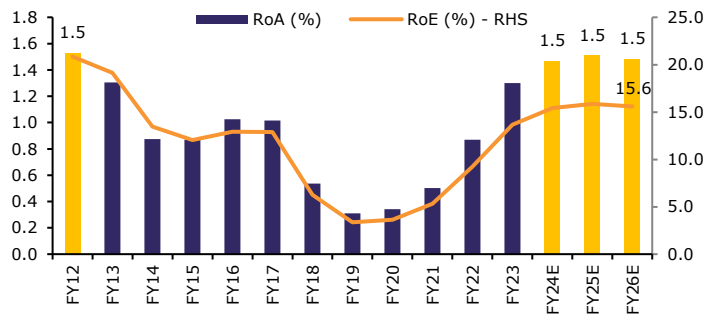
Source: Company, Emkay Research

**Exhibit 10: Corporate and commercial stress is now largely behind, leading to improvement in segmental NPAs**



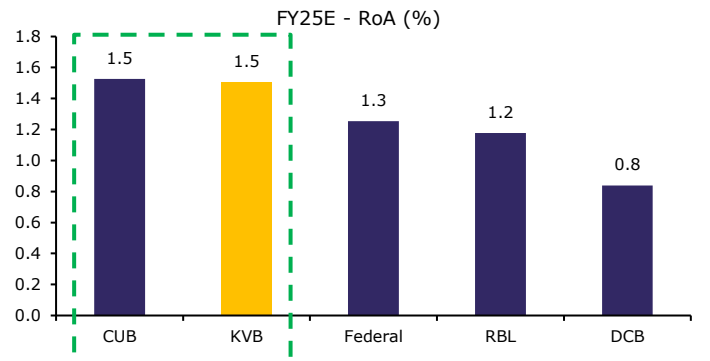
Source: Company, Emkay Research

**Exhibit 11: Bank set to reclaim 1.5% RoA last reported in FY12**



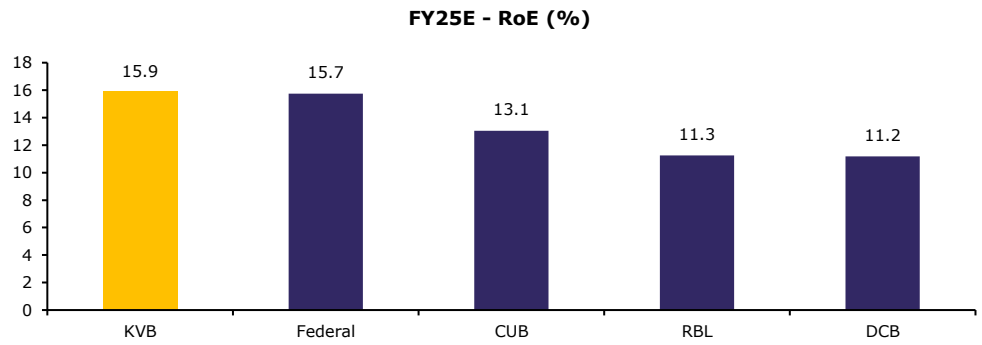
Source: Company, Emkay Research

**Exhibit 12: ...similar to CUBK**



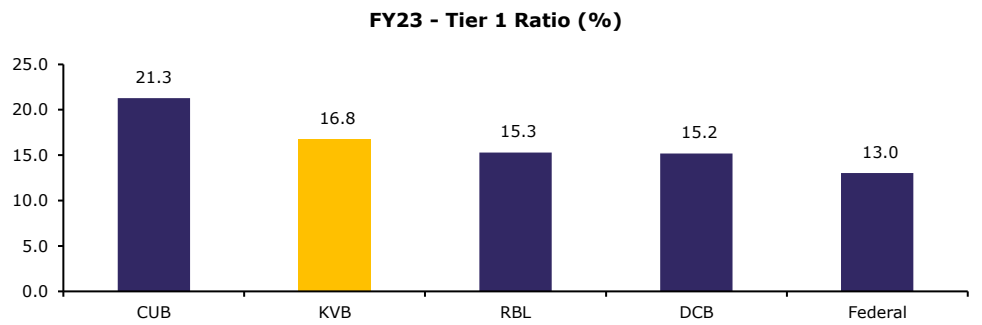
Source: Emkay Research

**Exhibit 13: Best in class RoE among peers**



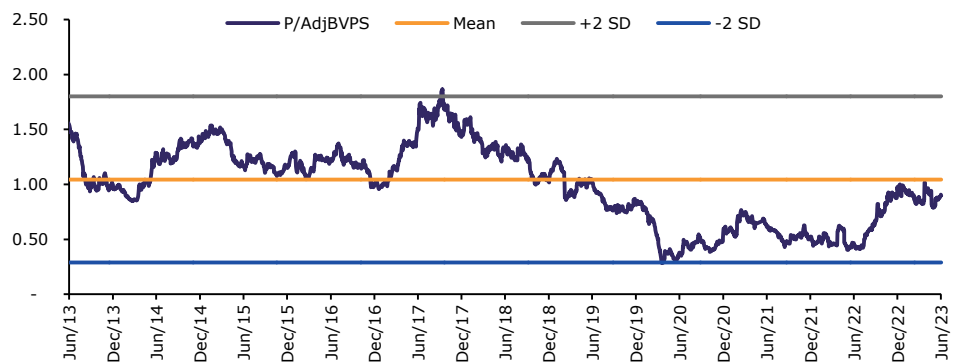
Source: Emkay Research

**Exhibit 14: KVB has a healthy Tier 1 ratio and, hence, sufficient capital to paddle towards growth**



Source: Emkay Research

**Exhibit 15: The stock currently trades at reasonable valuations of 0.9x one-year forward ABV**



Source: Bloomberg, Emkay Research

## Karur Vysya Bank: Standalone Financials and Valuations

Profit & Loss					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Interest Income	55,877	65,166	78,541	87,676	97,748
Interest Expense	28,723	31,677	41,767	46,066	50,959
<b>Net interest income</b>	<b>27,154</b>	<b>33,488</b>	<b>36,775</b>	<b>41,610</b>	<b>46,789</b>
NII growth (%)	15.1	23.3	9.8	13.1	12.4
Other income	7,691	11,589	13,172	14,983	17,557
<b>Total Income</b>	<b>34,844</b>	<b>45,078</b>	<b>49,947</b>	<b>56,592</b>	<b>64,346</b>
Operating expenses	18,542	20,320	23,539	26,640	29,859
<b>PPOP</b>	<b>16,302</b>	<b>24,758</b>	<b>26,408</b>	<b>29,952</b>	<b>34,487</b>
PPOP growth (%)	26.2	51.9	6.7	13.4	15.1
<b>Core PPOP</b>	<b>16,804</b>	<b>25,009</b>	<b>25,408</b>	<b>28,452</b>	<b>32,237</b>
Provisions & contingencies	6,993	10,389	7,470	7,630	9,332
<b>PBT</b>	<b>9,309</b>	<b>14,369</b>	<b>18,938</b>	<b>22,322</b>	<b>25,155</b>
Extraordinary items	0	0	0	0	0
Tax expense	2,577	3,308	4,767	5,618	6,332
Minority interest	0	0	0	0	0
Income from JV/Associates	0	0	0	0	0
<b>Reported PAT</b>	<b>6,733</b>	<b>11,061</b>	<b>14,171</b>	<b>16,703</b>	<b>18,824</b>
PAT growth (%)	87.3	64.3	28.1	17.9	12.7
<b>Adjusted PAT</b>	<b>6,733</b>	<b>11,061</b>	<b>14,171</b>	<b>16,703</b>	<b>18,824</b>
<b>Diluted EPS (Rs)</b>	<b>8.4</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Diluted EPS growth (%)	86.9	(100.0)	0.0	0.0	0.0
<b>DPS (Rs)</b>	<b>1.6</b>	<b>2.0</b>	<b>2.5</b>	<b>2.8</b>	<b>3.0</b>
<b>Dividend payout (%)</b>	<b>19.0</b>	<b>14.5</b>	<b>14.1</b>	<b>13.4</b>	<b>12.8</b>
Effective tax rate (%)	27.7	23.0	25.2	25.2	25.2
Net interest margins (%)	3.7	4.1	4.0	3.9	3.9
Cost-income ratio (%)	53.2	45.1	47.1	47.1	46.4
Shares outstanding (mn)	800	802	802	802	802

Source: Company, Emkay Research

Asset quality and other metrics					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
<b>Asset quality</b>					
Gross NPLs	34,311	14,581	12,388	12,572	14,401
Net NPLs	12,608	4,681	3,716	3,772	4,320
GNPA ratio (%)	6.0	2.3	1.7	1.5	1.5
NNPA ratio (%)	2.3	0.7	0.5	0.5	0.4
Provision coverage (%)	63.3	67.9	70.0	70.0	70.0
Gross slippages	8,427	6,540	7,310	9,247	12,190
Gross slippage ratio (%)	1.6	1.2	1.0	1.1	1.3
LLP ratio (%)	1.3	1.5	1.0	1.0	1.0
NNPA to networth (%)	16.2	5.3	3.7	3.2	3.2
<b>Capital adequacy</b>					
Total CAR (%)	19.5	18.6	18.5	18.4	18.2
Tier-1 (%)	17.5	16.8	17.0	17.1	17.1
CET-1 (%)	17.5	16.9	17.0	17.1	17.1
RWA-to-Total Assets (%)	52.0	54.4	54.0	54.0	54.0
<b>Miscellaneous</b>					
Total income growth (%)	(0.5)	20.7	19.5	11.9	12.3
Opex growth (%)	(6.7)	9.6	15.8	13.2	12.1
Core PPOP growth (%)	56.4	48.8	1.6	12.0	13.3
PPOP margin (%)	25.6	32.3	28.8	29.2	29.9
PAT/PPOP (%)	41.3	44.7	53.7	55.8	54.6
LLP-to-Core PPOP (%)	43.1	33.8	23.5	25.1	28.9
Yield on advances (%)	8.9	9.2	9.7	9.4	9.1
Cost of funds (%)	4.2	4.3	5.0	4.8	4.7

Source: Company, Emkay Research

Balance Sheet					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	1,600	1,604	1,604	1,604	1,604
Reserves & surplus	74,362	84,236	96,403	110,860	127,278
<b>Net worth</b>	<b>75,962</b>	<b>85,841</b>	<b>98,007</b>	<b>112,464</b>	<b>128,882</b>
Deposits	684,860	766,376	868,608	997,023	1,150,374
Borrowings	13,391	14,320	16,683	19,636	23,327
<b>Interest bearing liab.</b>	<b>698,250</b>	<b>780,696</b>	<b>885,290</b>	<b>1,016,658</b>	<b>1,173,701</b>
<b>Other liabilities &amp; prov.</b>	<b>26,500</b>	<b>35,258</b>	<b>48,826</b>	<b>54,658</b>	<b>59,365</b>
<b>Total liabilities &amp; equity</b>	<b>800,712</b>	<b>901,794</b>	<b>1,032,123</b>	<b>1,183,781</b>	<b>1,361,947</b>
Net advances	546,612	631,341	722,343	831,866	965,093
Investments	172,161	188,083	212,095	242,511	273,854
Cash, other balances	49,262	46,951	53,117	55,916	58,685
<b>Interest earning assets</b>	<b>768,034</b>	<b>866,376</b>	<b>987,556</b>	<b>1,130,293</b>	<b>1,297,631</b>
Fixed assets	4,785	4,350	6,992	7,804	8,712
Other assets	27,894	31,068	37,576	45,684	55,604
<b>Total assets</b>	<b>800,713</b>	<b>901,794</b>	<b>1,032,123</b>	<b>1,183,781</b>	<b>1,361,947</b>
BVPS (Rs)	95.0	107.0	122.2	140.2	160.7
Adj. BVPS (INR)	83.2	102.7	118.7	136.7	156.7
Gross advances	568,315	641,241	731,014	840,667	975,173
Credit to deposit (%)	79.8	82.4	83.2	83.4	83.9
CASA ratio (%)	34.9	33.2	32.2	33.3	35.2
Cost of deposits (%)	4.2	4.2	5.0	4.8	4.6
Loans-to-Assets (%)	68.3	70.0	70.0	70.3	70.9
Net advances growth (%)	8.5	15.5	14.4	15.2	16.0
Deposit growth (%)	8.2	11.9	13.3	14.8	15.4
Book value growth (%)	9.0	12.7	14.2	14.8	14.6

Source: Company, Emkay Research

Valuations and key Ratios					
Y/E Mar	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	13.5	8.3	6.4	5.5	4.9
P/B (x)	1.4	1.1	1.0	0.8	0.7
P/ABV (x)	1.4	1.1	0.9	0.8	0.7
P/PPOP (x)	5.5	3.6	3.4	3.0	2.6
Dividend yield (%)	1.4	1.8	2.2	2.5	2.6
<b>Dupont-RoE split (%)</b>					
NII/avg assets	3.5	3.9	3.8	3.8	3.7
Other income	1.0	1.4	1.4	1.4	1.4
Fee income	0.8	0.9	0.9	0.9	0.9
Opex	2.4	2.4	2.4	2.4	2.3
<b>PPOP</b>	<b>2.1</b>	<b>2.9</b>	<b>2.7</b>	<b>2.7</b>	<b>2.7</b>
Core PPOP	2.2	2.9	2.6	2.6	2.5
Provisions	0.9	1.2	0.8	0.7	0.7
Tax expense	0.3	0.4	0.5	0.5	0.5
<b>RoA (%)</b>	<b>0.9</b>	<b>1.3</b>	<b>1.5</b>	<b>1.5</b>	<b>1.5</b>
Leverage ratio (x)	10.6	10.5	10.5	10.5	10.5
<b>RoE (%)</b>	<b>9.3</b>	<b>13.7</b>	<b>15.4</b>	<b>15.9</b>	<b>15.6</b>

Quarterly data					
Rs mn, Y/E Mar	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23
NII	7,099	7,459	8,214	8,890	8,926
NIM(%)	3.8	3.9	4.1	4.4	4.4
PPOP	4,413	4,755	5,723	6,890	7,391
PAT	2,135	2,288	2,502	2,893	3,378
EPS (Rs)	2.67	2.86	3.13	3.62	4.21

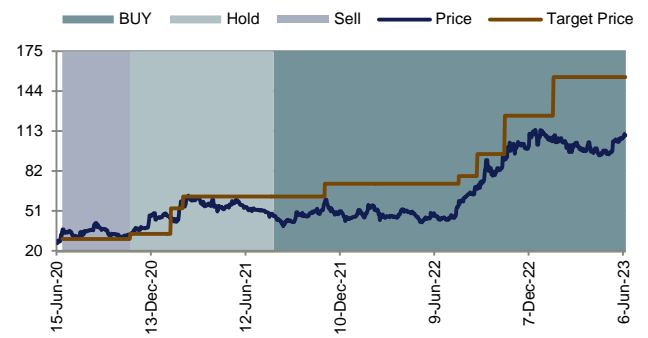
Source: Company, Emkay Research

**RECOMMENDATION HISTORY - DETAILS**

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
16-May-23	98	155	Buy	Anand Dama
09-Mar-23	104	155	Buy	Anand Dama
23-Jan-23	109	155	Buy	Anand Dama
22-Oct-22	91	125	Buy	Anand Dama
03-Oct-22	79	95	Buy	Anand Dama
30-Aug-22	69	95	Buy	Anand Dama
26-Jul-22	59	78	Buy	Anand Dama
22-May-22	45	72	Buy	Anand Dama
01-Feb-22	51	72	Buy	Anand Dama
11-Nov-21	58	72	Buy	Anand Dama
05-Aug-21	47	62	Buy	Anand Dama
01-Jun-21	56	62	Hold	Anand Dama
12-Feb-21	55	62	Hold	Anand Dama
20-Jan-21	46	53	Hold	Anand Dama
03-Nov-20	32	33	Hold	Anand Dama
01-Aug-20	35	29	Sell	Anand Dama
26-Jun-20	37	29	Sell	Anand Dama

Source: Company, Emkay Research

**RECOMMENDATION HISTORY - TREND**



Source: Bloomberg, Company, Emkay Research

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