

23 October 2024

Karnataka Bank

Challenging quarter, RoA to hold near 1%; maintaining a Buy

De-growth in NII (lower margins) and less non-interest income (lower fees) led to 19% q/q decline in core operating profits for Karnataka Bank. Modest provisions supported profitability. Asset quality improved sharply. Ahead, with credit growth in mid-teens and modest credit costs, earnings are expected to be good, with the RoA likely holding near 1%. We maintain our Buy recommendation, with a 12-mth TP of Rs298, 0.8x P/ABV on its FY27e book.

Asset quality improves. GNPA/NNPA fell 33bps/20bps q/q on lower slippages and higher recoveries. Slippages were Rs2.4bn (~135% of loans), less than those of the last quarter and our expectations. The standard restructured book was Rs12.7bn, constituting 1.7% of loans. With a lower stress pipeline, net slippages are expected to remain under 1%. We expect GNPA/NNPA to fall to 3.1%/1.2% by Q4 FY25.

RoA to persist near 1% in the medium term. NIM for the quarter declined 31bps q/q to 3.23% on account of higher cost of funds and base impact (a one-off tax refund during the last quarter). On a steady-state basis, we expect NIM to stabilise near 3.3%-3.4% as the cost of funds steadies and C/D gradually increases. With a moderate slippage run-rate, credit cost is expected to be modest. With strong credit growth, stable margins, no major increase in opex and no heavy provisioning, we expect the RoA to hold near 1% in the medium term.

Valuation. Our TP of Rs298 is based on the two-stage DDM model. This implies a ~0.8x P/ABV multiple on its FY27e book. **Risks:** High provisioning, large slippages from its agriculture and MSME books.

Key financials (YE Mar) (Rs m)	FY23	FY24	FY25e	FY26e	FY27e
Net interest income	31,851	32,987	36,203	41,508	48,043
Pre-provisioning profit	22,082	21,633	21,910	24,943	30,002
Provisions	7,672	6,006	3,089	7,167	10,392
PAT	11,802	13,063	14,078	13,297	14,669
EPS (Rs)	37.8	34.6	37.3	35.2	38.9
NIM (%)	3.7	3.4	3.3	3.3	3.4
Cost-income (%)	47.1	53.2	54.7	54.2	51.9
RoE (%)	15.4	13.7	12.3	10.5	10.6
RoA (%)	1.2	1.2	1.1	1.0	1.0
Advances growth (%)	5.6	19.3	16.0	16.0	16.0
GNPA (%)	3.7	3.5	3.1	2.7	2.5
CAR (%)	17.4	18.0	16.8	16.4	16.0
P / E (x)	5.7	6.2	5.7	6.1	5.5
P / BV (x)	0.8	0.7	0.7	0.6	0.6
P / ABV (x)	0.9	0.8	0.7	0.6	0.6

Source: Company, Anand Rathi Research

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Rating: **Buy**

Target Price (12-mth): Rs.298

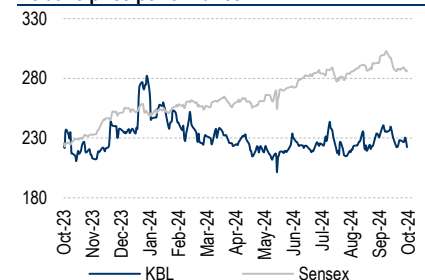
Share Price: Rs.214

Key data	KBL IN / KBNK.BO
52-week high / low	Rs.287 / 192
Sensex / Nifty	80,082 / 24,436
3-m average volume	\$6.6m
Market cap	Rs.81bn / \$963.8m
Shares outstanding	378m

Shareholding pattern (%)	Sep'24	Jun'24	Mar'24
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	10.3	14.7	18.9
- Domestic institutions	22.1	22.9	23.1
- Public	67.7	62.4	58.1

Estimates revision (%)	FY25e	FY26e
NII	(5.8)	(5.5)
PPoP	(15.1)	(16.4)
PAT	8.8	(2.3)

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY23	FY24	FY25e	FY26e	FY27e
Net interest income	31,851	32,987	36,203	41,508	48,043
<i>NII growth (%)</i>	27.9	3.6	9.7	14.7	15.7
Non-interest income	9,926	13,189	12,134	12,983	14,282
Income	41,777	46,177	48,337	54,492	62,325
<i>Income growth (%)</i>	21.3	10.5	4.7	12.7	14.4
Operating expenses	19,695	24,543	26,427	29,548	32,323
PPoP	22,082	21,633	21,910	24,943	30,002
<i>PPoP growth (%)</i>	35.1	-2.0	1.3	13.8	20.3
Provisions	7,672	6,006	3,089	7,167	10,392
PBT	14,410	15,627	18,821	17,777	19,610
Tax	2,608	2,565	4,743	4,480	4,942
PAT	11,802	13,063	14,078	13,297	14,669
<i>PAT growth (%)</i>	132.1	10.7	7.8	-5.5	10.3
FDEPS (Rs / sh)	37.8	34.6	37.3	35.2	38.9
DPS (Rs / sh)	5.0	5.5	5.6	5.3	5.8

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY23	FY24	FY25e	FY26e	FY27e
Share capital	3,124	3,773	3,773	3,773	3,773
Reserves & surplus	79,010	1,04,712	1,16,679	1,27,981	1,40,449
Deposits	8,73,680	9,80,578	10,98,248	12,30,037	13,77,642
Borrowings	15,627	43,995	44,875	49,363	54,299
Other liabilities	19,142	27,787	33,941	40,017	51,001
Liabilities	9,90,583	11,60,846	12,97,515	14,51,171	16,27,164
Advances	5,99,516	7,15,086	8,29,500	9,62,220	11,16,176
Investments	2,33,264	2,43,021	2,52,741	2,60,324	2,68,133
Cash & bank balance	61,595	79,927	86,322	93,227	1,00,685
Fixed & other assets	96,209	1,22,811	1,28,952	1,35,400	1,42,170
Total assets	9,90,583	11,60,846	12,97,515	14,51,171	16,27,164
No. of shares (m)	312	377	377	377	377
<i>Deposits growth (%)</i>	8.7	12.2	12.0	12.0	12.0
<i>Advances growth (%)</i>	5.6	19.3	16.0	16.0	16.0

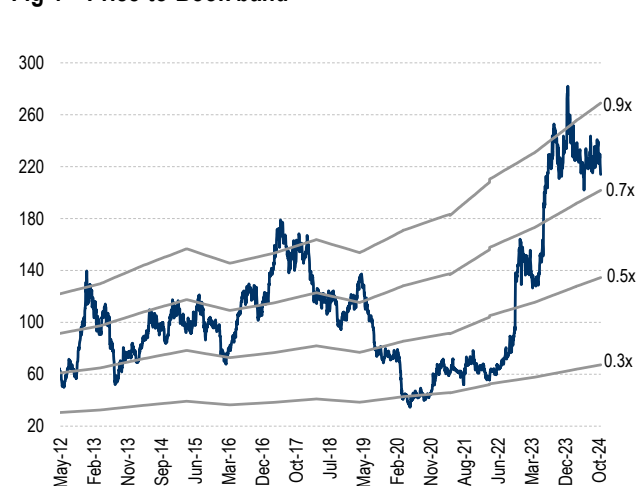
Source: Company, Anand Rathi Research

Fig 3 – Ratio analysis

Year-end: Mar (%)	FY23	FY24	FY25e	FY26e	FY27e
<i>NIM</i>	3.7	3.4	3.3	3.3	3.4
<i>Other inc. / total inc.</i>	23.8	28.6	25.1	23.8	22.9
<i>Cost-income</i>	47.1	53.2	54.7	54.2	51.9
<i>Provision coverage</i>	55.5	56.2	60.0	60.0	60.0
<i>Dividend payout</i>	13.2	15.9	15.0	15.0	15.0
<i>Credit-deposit</i>	68.6	72.9	75.5	78.2	81.0
<i>Investment-deposit</i>	26.7	24.8	23.0	21.2	19.5
<i>Gross NPA</i>	3.7	3.5	3.1	2.7	2.5
<i>Net NPA</i>	1.7	1.6	1.2	1.1	1.0
<i>BV (Rs)</i>	263.0	287.6	319.3	349.2	382.3
<i>Adj. BV (Rs)</i>	240.1	266.6	300.1	330.1	361.6
<i>CAR</i>	17.4	18.0	16.8	16.4	16.0
<i>- Tier 1</i>	14.2	16.2	15.3	15.0	14.8
<i>RoE</i>	15.4	13.7	12.3	10.5	10.6
<i>RoA</i>	1.2	1.2	1.1	1.0	1.0

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 FY24	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25	Q2 FY25
Opening balance	22,929	23,159	23,242	25,367	25,784	26,685
Slippages	2,929	3,137	5,160	5,276	4,165	2,427
Gross slippages (%)	2.0	2.0	3.2	3.0	2.3	1.3
Reductions	2,699	3,054	3,020	4,859	3,265	4,962
Closing balance	23,159	23,242	25,367	25,784	26,685	24,149
GNPA (%)	3.7	3.5	3.6	3.5	3.5	3.2
NNPA (%)	1.4	1.4	1.6	1.6	1.7	1.5
Restructured advances (%)	4.1	3.4	2.6	2.2	1.9	1.7

Source: Company, Anand Rathi Research

Quarterly snapshot

Fig 8 – Income statement

(Rs m)	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25	Q2 FY25
Interest income	19,587	20,266	21,126	22,006	22,780	22,341
Interest expense	11,441	12,042	12,850	13,665	13,746	14,006
NI	8,147	8,224	8,276	8,340	9,034	8,336
Y/Y growth %	18.5	2.5	-0.9	-3.0	10.9	1.4
Non-interest income	3,238	2,496	3,261	4,194	2,790	2,699
Income	11,385	10,720	11,537	12,534	11,824	11,035
Y/Y growth %	38.8	0.9	11.0	-0.1	3.9	2.9
Operating expenses	5,374	5,499	6,135	7,537	6,238	6,431
Of which, staff cost	2,926	3,072	3,363	4,368	3,198	3,499
PPoP	6,012	5,222	5,402	4,998	5,586	4,604
Y/Y growth %	45.6	-9.6	1.6	-27.1	-7.1	-11.8
Total provisions	1,516	1,199	1,444	1,847	403	313
PBT	4,496	4,023	3,958	3,151	5,183	4,290
Tax	789	720	647	408	1,180	930
PAT	3,707	3,303	3,311	2,742	4,003	3,361
Y/Y growth %	224.7	-19.8	10.1	-22.5	8.0	1.8

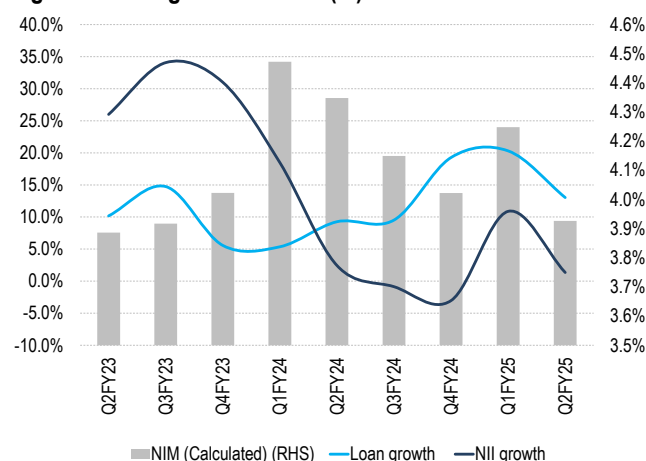
Source: Company, Anand Rathi Research

Fig 9 – Balance sheet

(Rs m)	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25	Q2 FY25
Equity capital	3,124	3,129	3,129	3,773	3,773	3,777
Reserves & Surplus	82,717	84,486	87,797	1,04,712	1,05,027	1,11,669
Deposits	8,69,600	8,95,317	9,21,954	9,80,578	10,01,640	9,99,680
Borrowings	-	53,242	-	43,995	-	24,323
Other Liabilities	-	22,388	-	27,787	-	21,664
Equity and Liabilities	-	10,58,563	-	11,60,846	11,57,700	11,61,113
Deposits y/y growth (%)	7.9	9.7	9.0	12.2	15.2	11.7
Deposits q/q growth (%)	-0.5	3.0	3.0	6.4	2.1	-0.2
Assets						
Cash and cash balances	-	64,419	-	76,561	-	73,921
Advances	6,14,890	6,54,223	6,97,410	7,15,086	7,39,770	7,39,523
Investments	-	2,39,582	-	2,43,021	-	2,14,603
Other assets	-	95,902	-	1,22,811	-	1,28,613
Total Assets	-	10,58,563	-	11,60,846	11,57,700	11,61,113
Advances y/y growth (%)	5.4	9.3	9.5	19.3	20.3	13.0
Advances q/q growth (%)	2.6	6.4	6.6	2.5	3.5	0.0

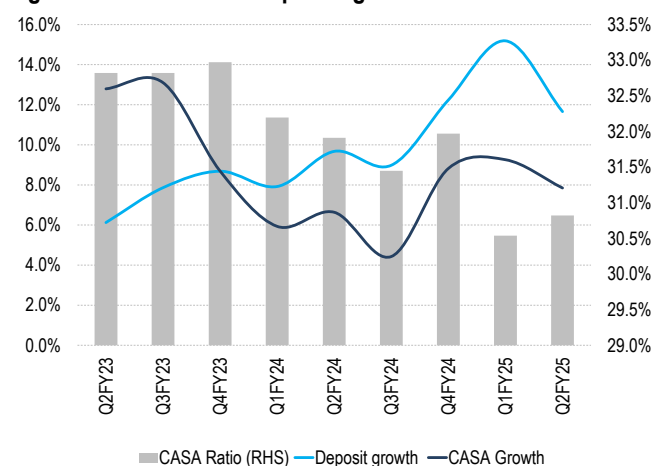
Source: Company, Anand Rathi Research

Fig 10 – Credit growth vs. NIM (%)



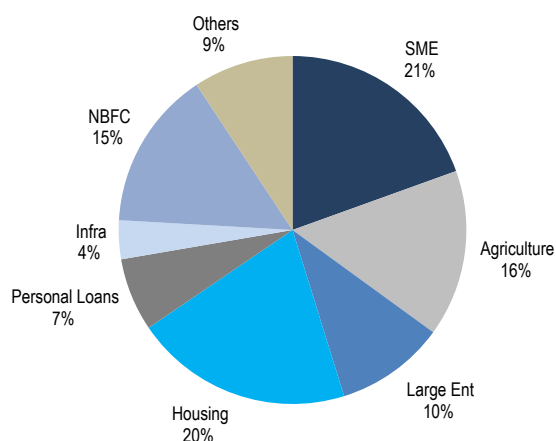
Source: Company, Anand Rathi Research

Fig 11 – CASA ratio vs. Deposits growth



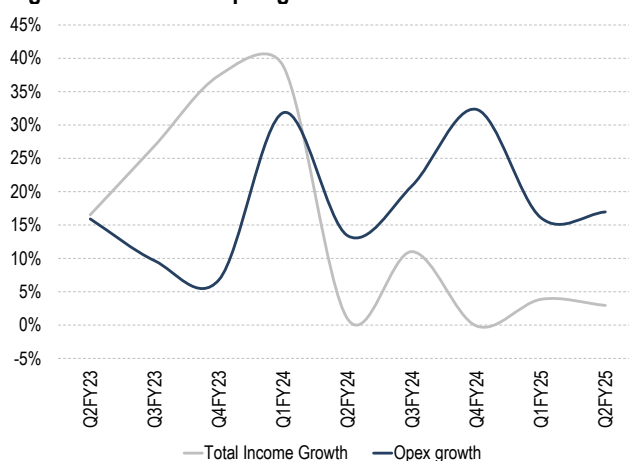
Source: Company, Anand Rathi Research

Fig 12 – Loan break-up



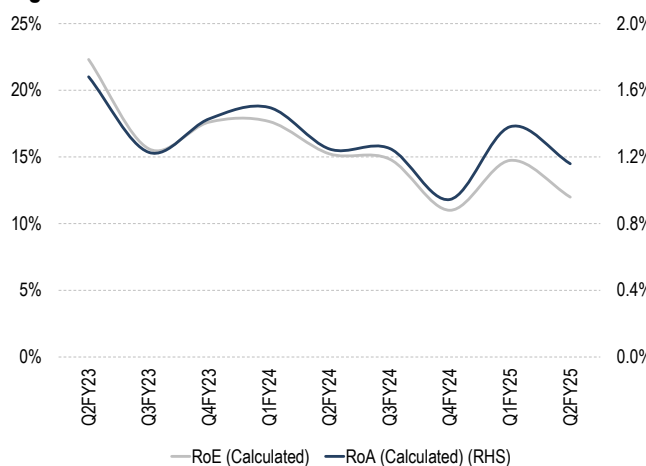
Source: Company, Anand Rathi Research

Fig 13 – Income vs. Opex growth



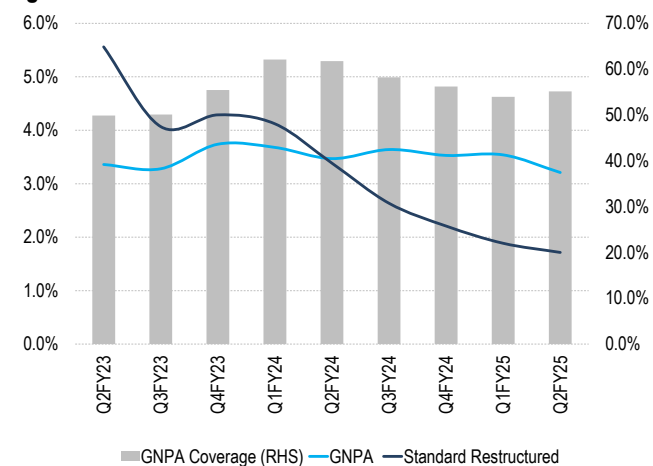
Source: Company, Anand Rathi Research

Fig 14 – RoE vs. RoA



Source: Company, Anand Rathi Research

Fig 15 – Restructured assets vs. GNPA



Source: Company, Anand Rathi Research

Valuation

Our target price of Rs298 is based on the two-stage DDM model. This implies a ~0.8x P/ABV multiple on its FY27e book.

Fig 17 – Change in estimates

(Rs m)	FY25e			FY26e		
	New	Old	Chg %	New	Old	Chg %
Net interest income	36,203	38,440	(5.8)	41,508	43,936	(5.5)
Pre-provisioning profit)	21,910	25,801	(15.1)	24,943	29,833	(16.4)
PAT	14,078	12,945	8.8	13,297	13,604	(2.3)

Source: Anand Rathi Research

Risks

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

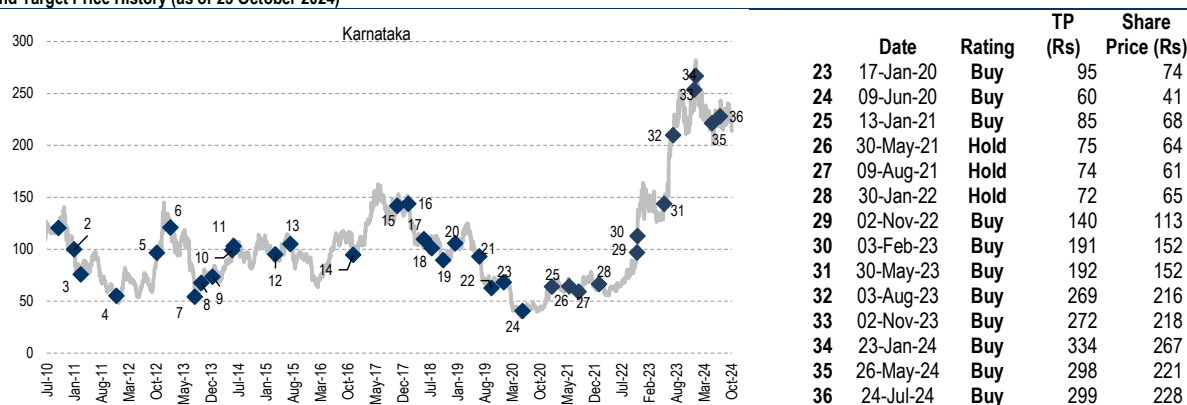
Appendix

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