

26 May 2024

Karnataka Bank

Weak Q4, earnings to improve; maintaining a Buy

The weak Q4 operating performance stemmed from Karnataka Bank's lower NIM and higher opex, as also seen in Q3. However, lower provisions and taxes aided profitability, with RoA at 0.96% (down 25bps). Asset quality remained under pressure. Ahead, with credit growth likely in mid-teens and modest credit costs, earnings would be good, with the RoA likely sustaining above 1%. We maintain a Buy, with a lower 12-mth TP of Rs298, 0.9x P/BV on its FY26e book.

Slippages to be high, to stabilise in few quarters. Headline asset quality remained under pressure in Q4 due to elevated slippages of Rs5.25bn (3% of loans), primarily stemming from the restructured book. The standard restructured book is Rs15.8bn now (2.2% of loans). We expect slippages to normalise in a couple of quarters as the restructured book runs down. We expect GNPA/NNPA to decline to 3.3%/1.5% by Q4 FY25.

1%+ RoA likely to be sustained through FY25/26. As we had highlighted earlier, NIM is under pressure, at 3.3% (down 16bps q/q) on a better C/D ratio and upward repricing of the bank's cost of funds. On a steady-state basis, we expect NIM to stabilise near 3.4-3.5% as cost of funds stabilises and the C/D ratio gradually increases. With an easing slippage run-rate, credit cost is likely to be modest. With the expected pick-up in business growth, stable margins, no major increase in opex and modest provisioning, we expect RoA to be >1% through FY25/26.

Valuation. Our TP of Rs298 is based on the two-stage DDM model. This implies a ~0.9x P/BV multiple on its FY26e book. **Risks:** High provisioning, large slippages from its agriculture and MSME books.

Key financials (YE Mar) (Rs m)	FY22	FY23	FY24	FY25e	FY26e
Net interest income	24,910	31,851	32,987	38,440	43,936
Pre-provisioning profit	16,340	22,082	21,633	25,801	29,833
Provisions	9,394	7,672	6,006	8,495	11,646
PAT	5,086	11,802	13,063	12,945	13,604
EPS (Rs)	16.3	37.8	34.6	34.3	36.1
NIM (%)	3.1	3.7	3.4	3.5	3.5
Cost-income (%)	52.6	47.1	53.2	51.5	50.7
RoE (%)	7.4	15.4	13.7	11.4	10.9
RoA (%)	0.6	1.2	1.2	1.1	1.0
Advances growth (%)	10.2	5.6	19.3	16.0	16.0
GNPA (%)	3.9	3.7	3.5	3.3	3.0
CAR (%)	15.7	17.4	18.0	15.6	15.3
P / E (x)	13.5	5.8	6.4	6.4	6.1
P / BV (x)	1.0	0.8	0.8	0.7	0.6
P / ABV (x)	1.1	0.9	0.8	0.8	0.7

Source: Company, Anand Rathi Research

Rating: Buy

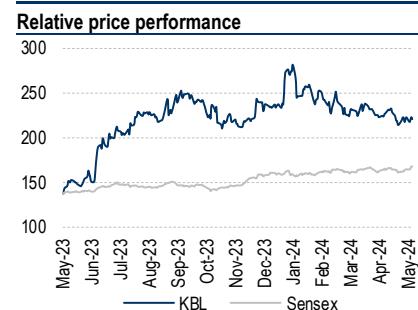
Target Price (12-mth): Rs.298

Share Price: Rs.221

Key data	KBL IN / KBNK.BO
52-week high / low	Rs.287 / 136
Sensex / Nifty	75410 / 22957
3-m average volume	\$4.6m
Market cap	Rs.84bn / \$1,004.9m
Shares outstanding	377m

Shareholding pattern (%)	Mar'24	Dec'23	Oct'23
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	18.9	19.0	20.4
- Domestic institutions	23.1	17.7	17.4
- Public	58.1	63.3	62.2

Estimates revision (%)	FY25e	FY26e
Net interest income	(2.4)	(5.7)
Pre-provisioning profit	(3.0)	(7.7)
PAT	(4.5)	(12.2)



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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY22	FY23	FY24	FY25e	FY26e
Net interest income	24,910	31,851	32,987	38,440	43,936
<i>NII growth (%)</i>	14.1	27.9	3.6	16.5	14.3
Non-interest income	9,539	9,926	13,189	14,772	16,545
Income	34,449	41,777	46,176	53,212	60,481
<i>Income growth (%)</i>	-4.0	21.3	10.5	15.2	13.7
Operating expenses	18,109	19,695	24,543	27,411	30,648
PPoP	16,340	22,082	21,633	25,801	29,833
<i>PPoP growth (%)</i>	-14.4	35.1	-2.0	19.3	15.6
Provisions	9,394	7,672	6,006	8,495	11,646
PBT	6,946	14,410	15,627	17,306	18,187
Tax	1,859	2,608	2,565	4,361	4,583
PAT	5,086	11,802	13,063	12,945	13,604
<i>PAT growth (%)</i>	5.4	132.1	10.7	-0.9	5.1
FDEPS (Rs)	16.3	37.8	34.6	34.3	36.1
DPS (Rs)	4.0	5.0	5.0	5.1	5.4

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY22	FY23	FY24	FY25e	FY26e
Share capital	3,112	3,124	3,773	3,773	3,773
Reserves & surplus	67,836	79,010	1,04,712	1,15,715	1,27,278
Deposits	8,03,868	8,73,680	9,80,578	10,98,248	12,30,037
Borrowings	23,138	15,627	43,995	44,875	45,773
Other liabilities	17,886	19,142	27,787	34,904	44,310
Liabilities	9,15,840	9,90,583	11,60,846	12,97,515	14,51,171
Advances	5,67,831	5,99,516	7,15,086	8,29,500	9,62,220
Investments	2,20,410	2,33,264	2,43,021	2,52,741	2,60,324
Cash & bank balance	44,368	61,595	79,927	86,322	93,227
Fixed & other assets	83,231	96,209	1,22,811	1,28,952	1,35,400
Total assets	9,15,840	9,90,583	11,60,846	12,97,515	14,51,171
No. of shares (m)	311	312	377	377	377
Deposits growth (%)	6.3	8.7	12.2	12.0	12.0
Advances growth (%)	10.2	5.6	19.3	16.0	16.0

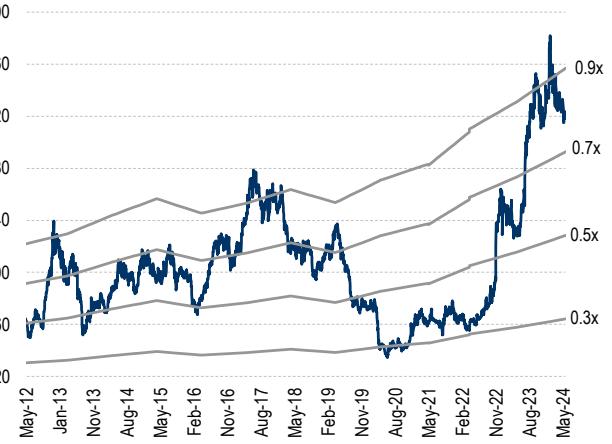
Source: Company, Anand Rathi Research

Fig 3 – Ratio analysis

Year-end: Mar (%)	FY22	FY23	FY24	FY25e	FY26e
NIM	3.1	3.7	3.4	3.5	3.5
Other inc. / total inc.	27.7	23.8	28.6	27.8	27.4
Cost-income	52.6	47.1	53.2	51.5	50.7
Provision coverage	33.0	51.3	56.2	55.0	55.0
Dividend payout	24.5	13.2	14.4	15.0	15.0
Credit-deposit	70.6	68.6	72.9	75.5	78.2
Investment-deposit	27.4	26.7	24.8	23.0	21.2
Gross NPA	3.9	3.7	3.5	3.3	3.0
Net NPA	2.4	1.7	1.6	1.5	1.4
BV (Rs)	228.0	263.0	287.6	316.7	347.4
Adj. BV (Rs)	197.0	240.1	266.6	293.9	323.1
CAR	15.7	17.4	18.0	15.6	15.3
- Tier 1	12.6	14.2	16.2	13.2	13.2
RoE	7.4	15.4	13.7	11.4	10.9
RoA	0.6	1.2	1.2	1.1	1.0

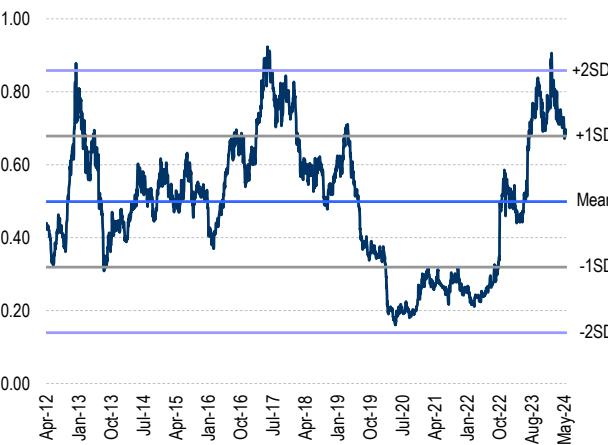
Source: Company, Anand Rathi Research

Fig 4 – Price-to-Book band



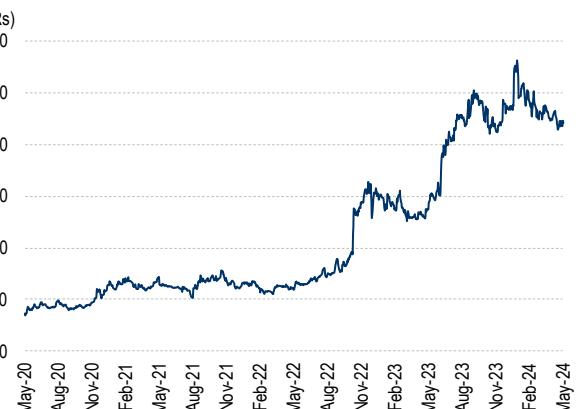
Source: Bloomberg

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



Source: Company, Anand Rathi Research

Fig 6 – Price movement



Source: Bloomberg

Earnings call takeaways

Guidance for FY25

- NIM – 3.5-3.7%
- C/I -- >50%
- Credit cost – 0.85-1%
- RoA -- 1.2-1.4%
- Loan growth – 20-21%
- GNPA – 3%
- NNPA – 1.2%

Business

- Business is expected to be 50:50 from Karnataka/non-Karnataka states in a few years.
- Greater focus ahead would be on the higher-yielding RAM.
- The bank could expand the C/D ratio to reach 80%.
- Gold & housing loans are driving growth in the retail segment.

Capital

- The bank redeemed high cost (12% interest) tier-2 bonds at Rs7.2bn.
- Rs4bn in Nov'23 and Rs3.2bn in Feb'24.

NIM

- The pressure on NIM is due to the cost of funds.
- The CoF has now stabilised.

Opex

- In FY24, Rs2.71bn was provided for wage revision.
- One-time Q4 costs – Rs1.53bn for wage revision, Rs0.11bn for 100-year celebrations.

Asset quality

- Rs2.77bn was recovered in FY24.
- 0.84% credit cost seen in FY24 vs. 1.5% in FY23.
- 75% of the NPA book is collateralised. Management expects good recovery from the NPA pool.
- Q4 slippages were Rs5.25bn.

Key Highlights

Fig 7 – Asset quality

Break-up of GNPA (Rs m)	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24
Opening balance	20,517	20,857	22,929	23,159	23,242	25,367
Slippages	3,771	5,874	2,920	3,074	5,160	5,250
Gross slippages (%)	2.5	3.7	1.9	2.0	3.2	3.0
Reductions	3,431	3,803	2,670	1,560	3,020	4,833
Closing balance	20,857	22,929	23,159	23,242	25,367	25,784
GNPA (%)	3.3	3.7	3.7	3.5	3.6	3.5
NNPA (%)	1.7	1.7	1.4	1.4	1.6	1.6
Restructured advances (%)	4.1	4.3	0.0	0.0	0.0	2.2

Source: Company, Anand Rathi Research

Quarterly snapshot

Fig 8 – Income statement

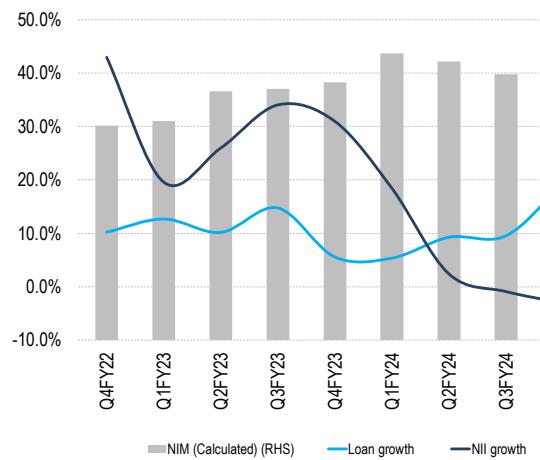
(Rs m)	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24
Interest income	18,508	19,693	19,587	20,266	21,126	22,006
Interest expense	10,160	11,093	11,441	12,042	12,850	13,665
NII	8,348	8,601	8,147	8,224	8,276	8,340
Y/Y growth %	34.1	31.0	18.5	2.5	-0.9	-3.0
Non-interest income	2,045	3,952	3,238	2,496	3,261	4,194
Income	10,393	12,553	11,385	10,720	11,537	12,534
Y/Y growth %	26.9	37.4	38.8	0.9	11.0	-0.1
Operating expenses	5,074	5,695	5,374	5,499	6,135	7,537
Of which, staff cost	2,846	3,438	2,926	3,072	3,363	4,368
PPoP	5,319	6,858	6,012	5,222	5,402	4,998
Y/Y growth %	49.3	80.4	45.6	-9.6	1.6	-27.1
Total provisions	1,649	2,533	1,516	1,199	1,444	1,847
PBT	3,670	4,325	4,496	4,023	3,958	3,151
Tax	663	788	789	720	647	408
PAT	3,007	3,538	3,707	3,303	3,311	2,742
Y/Y growth %	105.1	171.4	224.7	-19.8	10.1	-22.5

Source: Company, Anand Rathi Research

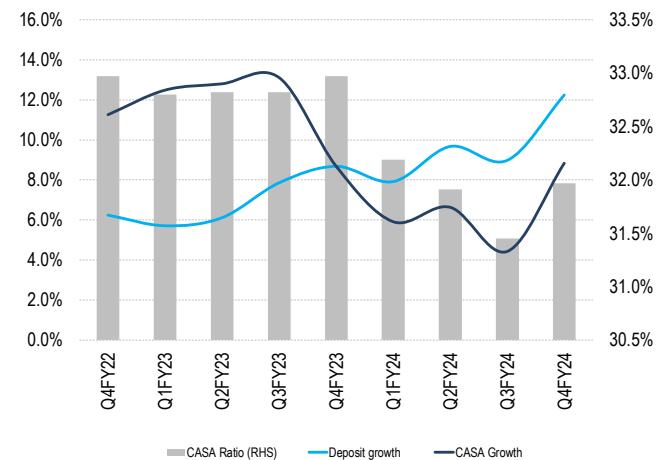
Fig 9 – Balance sheet

(Rs m)	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24
Equity capital	3,120	3,124	3,124	3,129	3,129	3,773
Reserves & Surplus	75,450	79,010	82,717	84,486	87,797	1,04,712
Deposits	845,965	873,680	869,600	895,317	921,954	980,578
Borrowings	-	15,627	-	53,242	-	43,995
Other Liabilities	-	19,143	-	22,388	-	27,787
Equity and Liabilities	-	990,583	-	1,058,563	-	1,160,846
Deposits y/y growth (%)	7.9	8.7	7.9	9.7	9.0	12.2
Deposits q/q growth (%)	3.6	3.3	-0.5	3.0	3.0	6.4
Assets						
Cash and cash balances	-	52,042	-	64,419	-	76,561
Advances	636,733	599,516	614,890	654,223	697,410	715,086
Investments	231,360	233,264	-	239,582	-	243,021
Other assets	-	96,209	-	95,902	-	1,22,811
Total Assets	-	990,583	-	1,058,563	-	1,160,846
Advances y/y growth (%)	14.7	5.6	5.4	9.3	9.5	19.3
Advances q/q growth (%)	6.3	-5.8	2.6	6.4	6.6	2.5

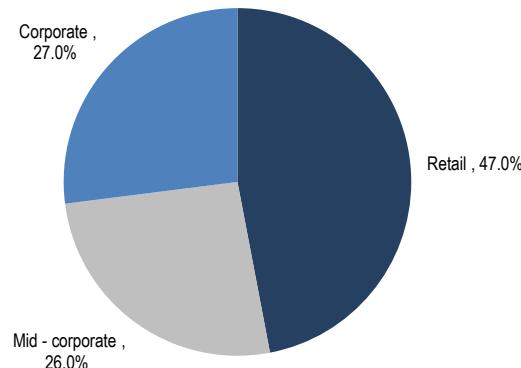
Source: Company, Anand Rathi Research

Fig 10 – Credit growth vs. NIM (%)

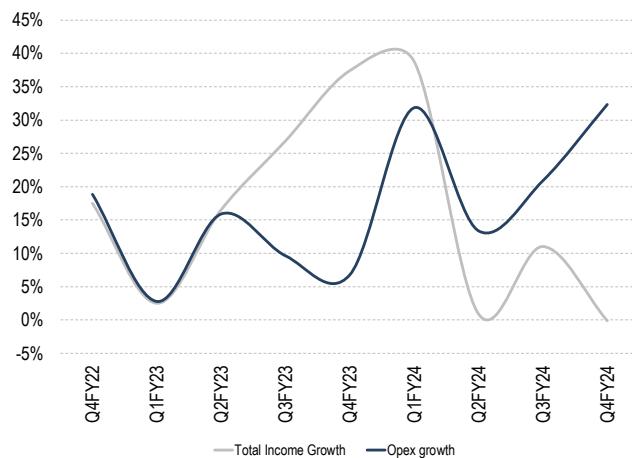
Source: Company, Anand Rathi Research

Fig 11 – CASA ratio vs. Deposits growth

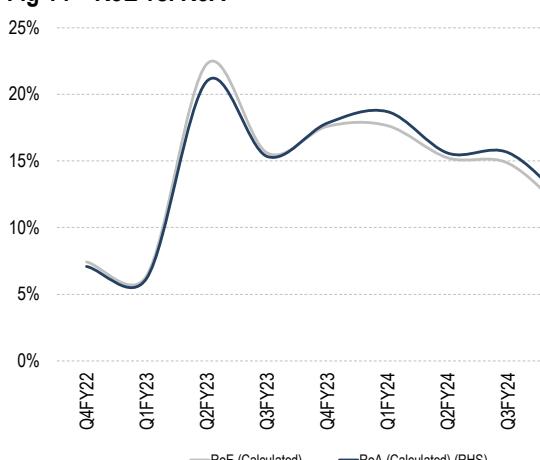
Source: Company, Anand Rathi Research

Fig 12 – Loan break-up

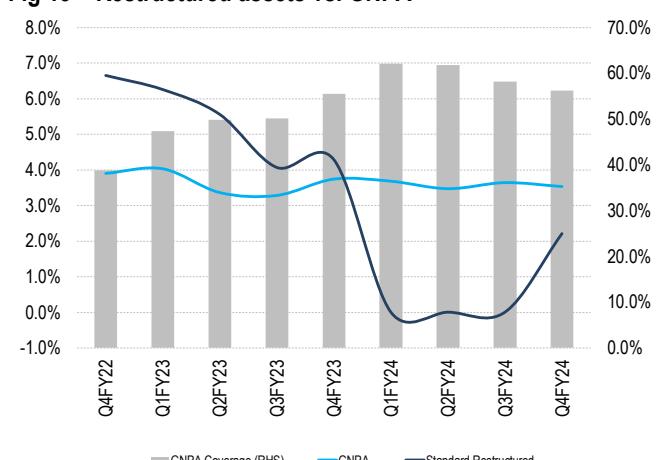
Source: Company, Anand Rathi Research

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 TP of Rs298 is based on the two-stage DDM model. This implies a ~0.9x P/BV multiple on its FY26e book.

Fig 16 – Change in estimates

(Rs m)	FY25e			FY26e		
	New	Old	Chg (%)	New	Old	Chg (%)
Net interest income	38,440	39,372	(2.4)	43,936	46,589	(5.7)
Pre-provisioning profit	25,801	26,606	(3.0)	29,833	32,321	(7.7)
PAT	12,945	13,561	(4.5)	13,604	15,485	(12.2)

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.

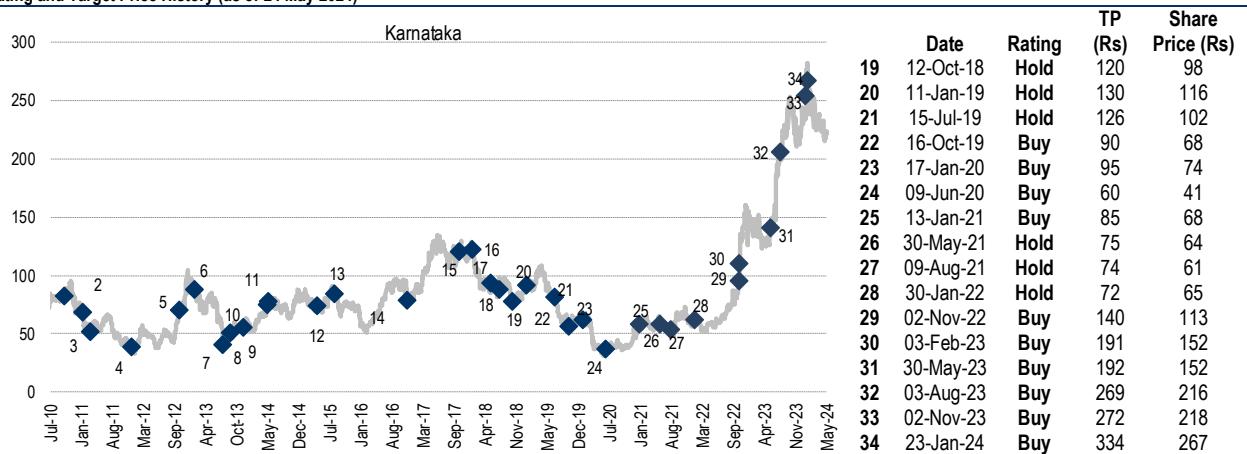
Appendix

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