

19 October 2020

Karnataka Bank

Strong quarter, sharp reduction in moratorium book; Buy

Rating: **Buy**

Target Price: Rs60

Share Price: Rs43

Higher margins and lower opex led to sharp, ~21% y/y, PPOP growth for Karnataka Bank. The standstill on NPA recognition led to asset quality and PCR improving. With earnings expected to pick up in FY22 and limited downside from current levels, we maintain a Buy, at a TP of Rs60 valuing it at 0.3x P/ABV on its FY22e book.

Moratorium book sharply contracts. The bank's moratorium book came down to ~11.4% in Sep'20 (from ~51.2% in Jun'20). The reduction was largely on account of repayments, ie, recovery of one EMI in Sep'20. Management expects this book to come down below 1% by Dec'20.

Asset quality may come under stress in H2 FY21. GNPA sequentially improved 6bps as slippages were negligible given the standstill on NPA recognition by the Supreme Court. Consequently Rs920m could not be recognised as NPA during the quarter. The bank expects 2% of overall loans to be restructured, 0.5-0.6% to slip to NPA. Given the weak economic environment and the pandemic-related disruptions to continue for the next couple of months, we expect delinquencies to be higher than management spoke of. Higher slippages may keep credit elevated in the medium term.

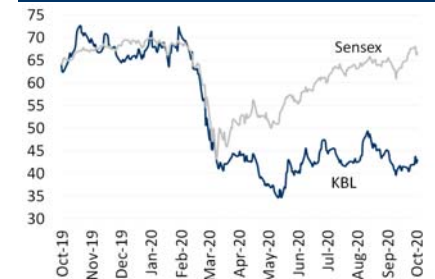
Valuation. Our Oct'21 target of Rs60 is based on the two-stage DDM model. This implies a ~0.3x P/ABV multiple on its FY22e book. **Risks:** High provisioning, large slippages from its agriculture and MSME books.

Key data	KBL IN / KBNK.BO
52-week high / low	Rs75 / 34
Sensex / Nifty	39983 / 11762
3-m average volume	\$1.2m
Market cap	Rs13bn / \$182.3m
Shares outstanding	311m

Shareholding pattern (%)	Sep '20	Jun '20	Mar '20
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	7.3	8.7	12.8
- Domestic institutions	6.6	8.8	10.7
- Public	86.0	82.6	76.6

Estimates revision (%)	FY21e	FY22e
Net interest income	3.5	(0.2)
Pre-provisioning profit	7.7	7.9
PAT	173.0	8.5

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY18	FY19	FY20	FY21e	FY22e
Net interest income (Rs m)	18,577	19,051	20,304	20,962	22,983
Pre-provisioning profit (Rs m)	14,732	14,498	16,568	18,345	21,237
Provisions (Rs m)	11,630	8,420	11,348	12,281	11,757
PAT (Rs m)	3,256	4,772	4,318	4,535	7,091
EPS (Rs)	11.5	16.9	13.9	14.6	22.8
NIM (%)	3.1	2.8	2.8	2.7	2.7
Cost-income (%)	47.6	50.1	51.6	47.3	44.6
RoE (%)	6.2	8.5	7.3	7.3	10.5
RoA (%)	0.5	0.6	0.5	0.5	0.8
Advances growth (%)	27.7	16.0	3.9	-2.0	8.0
GNPA (%)	4.9	4.4	4.8	6.3	4.4
CAR (%)	12.0	13.2	12.7	12.7	12.7
P / E (x)	3.7	2.5	3.1	3.0	1.9
P / BV (x)	0.2	0.2	0.2	0.2	0.2
P / ABV (x)	0.3	0.3	0.3	0.3	0.2

Source: Company, Anand Rathi Research

Yuvraj Choudhary, CFA
Research Analyst

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Net interest income	18,577	19,051	20,304	20,962	22,983
NII growth (%)	24.6	2.6	6.6	3.2	9.6
Non-interest income	9,543	10,020	13,960	13,855	15,340
Income	28,120	29,071	34,264	34,817	38,323
Income growth (%)	22.3	3.4	17.9	1.6	10.1
Operating expenses	13,388	14,573	17,696	16,472	17,086
PPOP	14,732	14,498	16,568	18,345	21,237
PPOP growth (%)	47.9	-1.6	14.3	10.7	15.8
Provisions	11,630	8,420	11,348	12,281	11,757
PBT	3,102	6,078	5,220	6,063	9,480
Tax	-155	1,306	903	1,528	2,389
PAT	3,256	4,772	4,318	4,535	7,091
PAT growth (%)	-28.0	46.6	-9.5	5.0	56.4
FDEPS (Rs / sh)	11.5	16.9	13.9	14.6	22.8
DPS (Rs / sh)	4.0	3.0	0.0	0.0	0.0

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Share capital	2,826	2,826	3,109	3,109	3,109
Reserves & surplus	51,275	55,026	56,596	61,131	68,222
Deposits	628,713	684,521	717,852	753,744	836,656
Borrowings	8,160	33,255	40,651	24,761	25,256
Liabilities	703,737	790,458	833,135	857,420	949,170
Advances	472,518	548,282	569,643	558,250	602,910
Investments	154,444	161,850	175,453	207,035	244,301
Cash & bank bal	35,458	34,117	27,561	30,317	33,348
Fixed & other assets	7,616	7,750	8,264	8,429	8,851
Total assets	703,737	790,458	833,135	857,420	949,170
No. of shares (m)	283	283	311	311	311
Deposits growth (%)	10.8	8.9	4.9	5.0	11.0
Advances growth (%)	27.7	16.0	3.9	-2.0	8.0

Source: Company, Anand Rathi Research

Fig 3 – Ratio analysis

Year-end: Mar (%)	FY18	FY19	FY20	FY21e	FY22e
NIM	3.1	2.8	2.8	2.7	2.7
Other inc. / total inc.	33.9	34.5	40.7	39.8	40.0
Cost-income	47.6	50.1	51.6	47.3	44.6
Provision coverage	41.1	34.2	37.3	45.0	49.3
Dividend payout	34.7	17.8	0.0	0.0	0.0
Credit-deposit	75.2	80.1	79.4	74.1	72.1
Investment-deposit	24.6	23.6	24.4	27.5	29.2
Gross NPA	4.9	4.4	4.8	6.3	4.4
Net NPA	3.0	3.0	3.1	3.6	2.3
BV (Rs)	191.4	204.7	192.1	206.6	229.4
Adj. BV (Rs)	156.7	164.7	152.5	161.7	198.4
CAR	12.0	13.2	12.7	12.7	12.7
- Tier 1	11.3	11.2	10.7	10.7	10.7
RoE	6.2	8.5	7.3	7.3	10.5
RoA	0.5	0.6	0.5	0.5	0.8

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

Conference call takeaways

Moratorium

- The moratorium book has come down to 11.4% in Sep'20, from 51% in Jun'20.
- 11.4% consists of the accounts which were under moratorium in Aug'20 and haven't paid in Sep'20.
- Management expects this book to be under 1% by Dec'20.
- It expects 2% of the loans to be restructured.

Asset quality

- It expects 0.6% of the loans to turn delinquent in Q3 FY20.
- Slippages were non-existent during the quarter given the SC order of not classifying the accounts as NPA till further notification. But for this, accounts amounting to Rs920m would have slipped into NPA.
- Recoveries of Rs230m from technically written-off accounts during the quarter.
- Collection efficiency as of Sep'20: 70-75%.
- Covid'19-related provisions of Rs979m.
- Restructuring during the quarter was Rs430m.
- Aims to increase PCR to above 80% by Mar'21.

Other highlights

- Expects NIM to be above 3% in FY21.
- Disbursed Rs16bn toward MSME (under the credit-guarantee scheme) during the quarter.

Capital

- Would maintain capital at ~1% above regulatory norms.
- Is willing to raise capital at right valuations.

Fig 7 – Asset quality

Break-up of GNPA (Rs m)	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21
Opening balance	24,564	24,375	25,943	27,775	27,999	25,576
Slippages	5,260	5,310	6,375	3,041	1,668	22
<i>Gross slippages (%)</i>	4.0	4.0	4.6	2.1	1.2	0.0
Reductions	5,449	3,742	4,544	2,816	4,091	3,711
Closing balance	24,375	25,943	27,775	27,999	25,576	21,888
<i>GNPA (%)</i>	4.6	4.8	5.0	4.8	4.6	4.0
<i>Restructured advances (%)</i>	0.6	0.1	0.2	0.2	0.2	0.2

Source: Company, Anand Rathi Research

Quarterly snapshot

Fig 8 – Income statement

(Rs m)	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21
Interest income	15,844	16,296	16,216	16,392	16,157	16,037
Interest expense	10,898	11,309	11,138	11,099	10,806	10,288
NII	4,946	4,987	5,078	5,293	5,351	5,749
<i>Y/Y growth %</i>	5.6	6.6	4.1	10.1	8.2	15.3
Non-interest income	2,448	3,088	4,021	4,404	5,189	3,298
Total Income	7,394	8,075	9,099	9,697	10,540	9,047
<i>Y/Y growth %</i>	9.2	20.7	15.3	25.7	42.6	12.0
Operating expenses	3,894	3,941	4,081	5,781	3,770	4,043
Of which, staff cost	1,769	1,632	1,865	3,704	2,017	2,046
PPOP	3,500	4,134	5,018	3,915	6,770	5,004
<i>Y/Y growth %</i>	-5.1	16.0	25.3	20.8	93.4	21.0
Total provisions	2,011	2,624	3,147	3,565	5,091	3,221
PBT	1,489	1,510	1,871	350	1,680	1,783
Tax	(266)	451	640	77	(284)	589
PAT	1,754	1,059	1,231	273	1,964	1,194
<i>Y/Y growth %</i>	7.5	-5.3	-12.3	-55.8	11.9	12.8

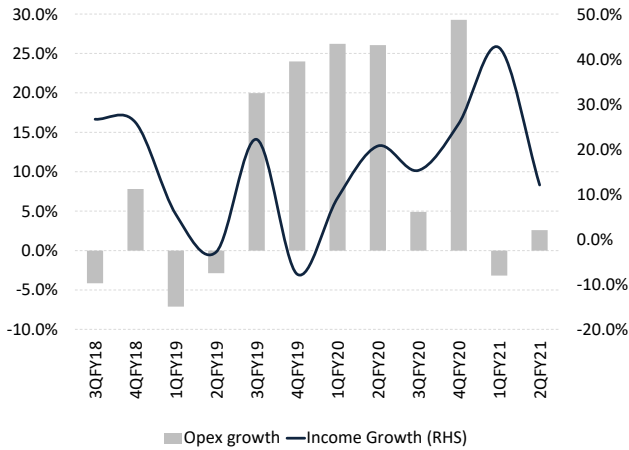
Source: Company, Anand Rathi Research

Fig 9 – Balance sheet

(Rs m)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q2FY21
Equity capital	2,826	2,826	2,826	3,109	3,109	3,109
Reserves & Surplus	56,780	56,648	57,879	56,596	60,450	61,648
Deposits	685,207	701,897	713,560	717,852	718,540	729,290
Borrowings	-	24,481	-	40,651	-	22,247
Other Liabilities	-	15,811	-	14,928	-	17,604
Equity and Liabilities		801,662		833,135		833,896
<i>Deposits y/y growth (%)</i>	9.2	9.9	9.5	4.9	4.9	3.9
<i>Deposits q/q growth (%)</i>	0.1	2.4	1.7	0.6	0.1	1.5
Assets						
Cash and cash balances	-	38,529	-	29,195	-	31,371
Advances	528,188	534,684	549,110	569,643	542,095	540,989
Investments	171,410	179,346	179,990	175,453	182,770	199,558
Other assets	-	49,103	-	58,844	-	61,978
Total Assets		801,662		833,135		833,896
<i>Advances y/y growth (%)</i>	10.7	7.0	5.7	3.9	2.6	1.2
<i>Advances q/q growth (%)</i>	-3.7	1.2	2.7	3.7	-4.8	-0.2

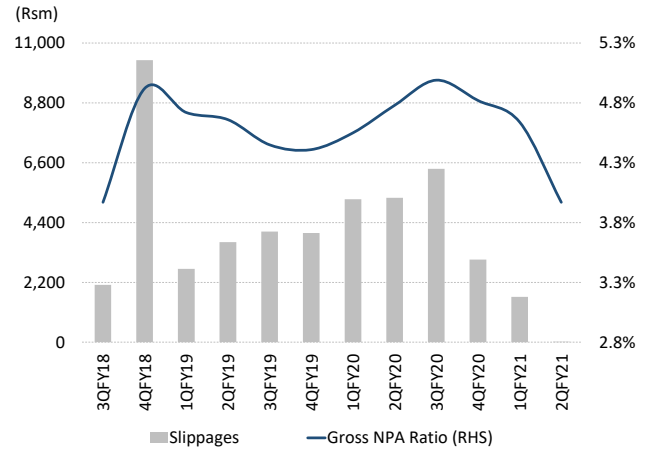
Source: Company, Anand Rathi Research

Fig 10 – Income vs. Opex growth



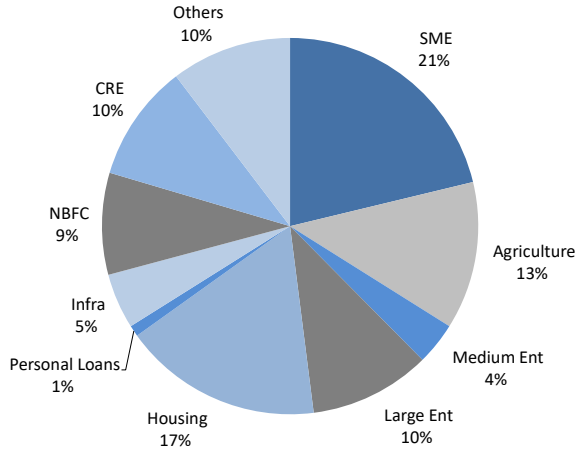
Source: Company, Anand Rathi Research

Fig 11 – Gross NPA and slippages



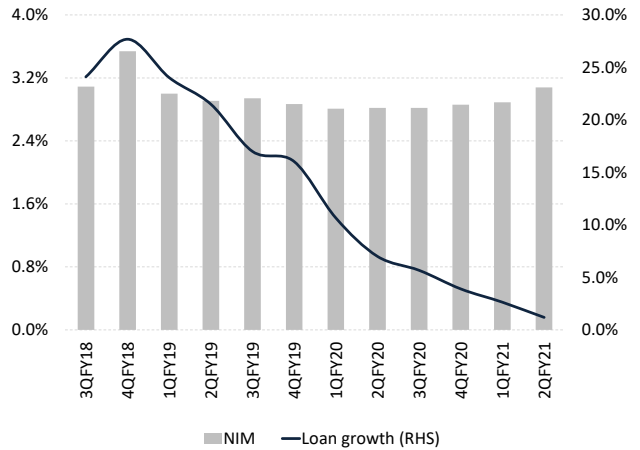
Source: Company, Anand Rathi Research

Fig 12 – Loan break-up



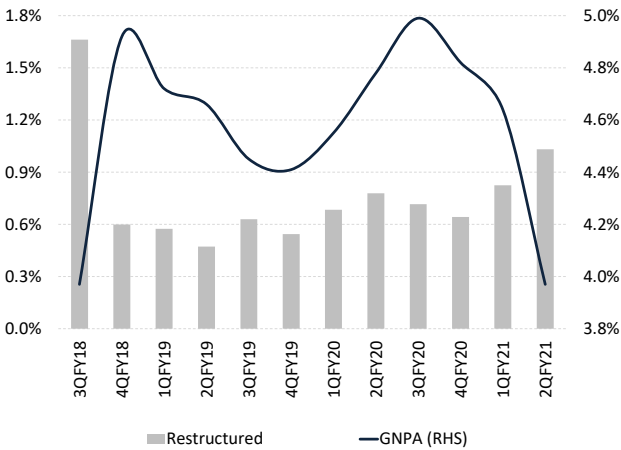
Source: Company, Anand Rathi Research

Fig 13 – Credit growth vs. NIM (%)



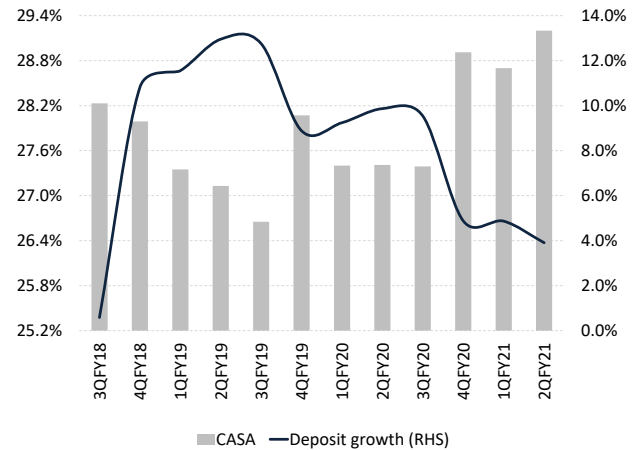
Source: Company, Anand Rathi Research

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 Oct'21 target of Rs60 is based on the two-stage DDM model. This implies a ~0.3x P/ABV multiple on its FY22e book.

Fig 18 – Change in estimates

	FY21e			FY21e		
	New	Old	Chg (%)	New	Old	Chg (%)
Net interest income (Rsm)	20,962	20,256	3.5	22,983	23,030	(0.2)
Pre-provisioning profit (Rsm)	18,345	17,031	7.7	21,237	19,682	7.9
PAT (Rsm)	4,535	1,661	173.0	7,091	6,533	8.5

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.

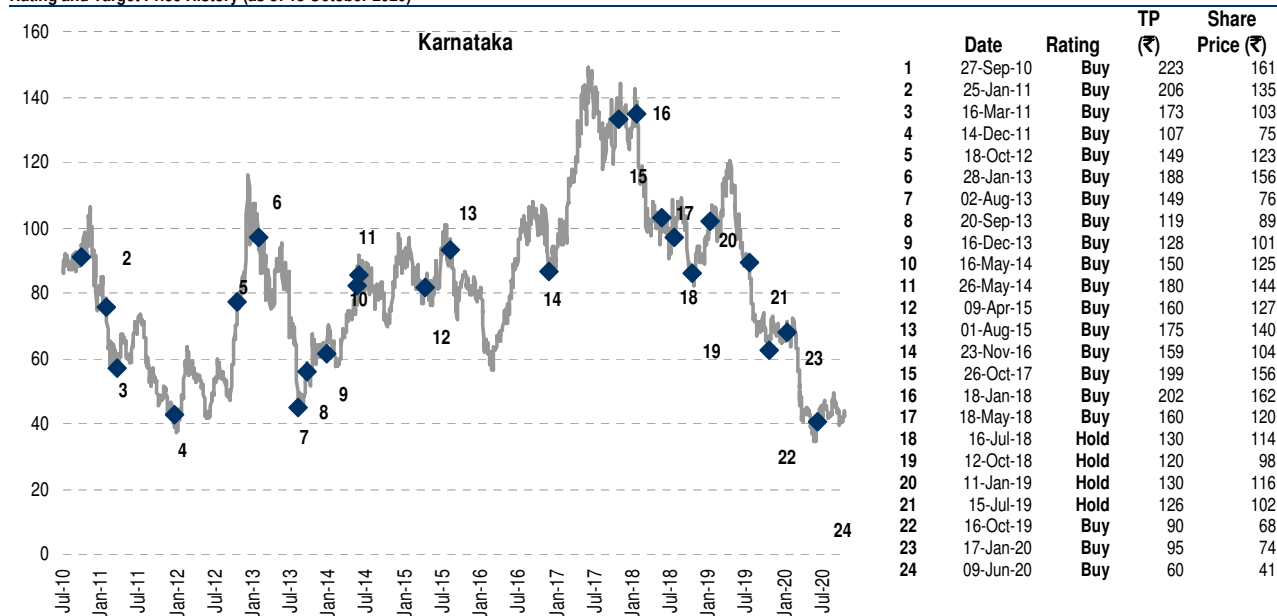
Appendix

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