



## Karnataka Bank Q2 FY16 Quarterly Update

### MARKET DATA

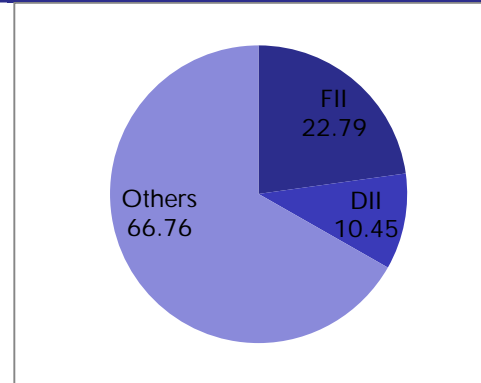
Fig. in ₹ (in Cr.) except Ratios

Networth	3,789
Price/Book Value Ratio (FY16E)	0.7
EPS-Unit Curr. (FY16E)	25.5
Market Price (1/11/2015)	128
P/E Ratio (FY16E)	4.9
52 Week High (7/9/2015)	108.3
52 Week Low (6/7/2015)	158
Market Capitalisation	2,415

### AVERAGE MONTHLY VOLUME ('000)

BSE	179.4
NSE	1,566.7

### SHARE HOLDING PATTERN



RETURN (%)	3M	6M	12M
Stock	-9.1	1.7	3.5
BSE	-5.5	-1.7	-4.7

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### Quarterly Performance:

Particulars ` Cr	Q2 FY16	Q2 FY15	% YoY	Q1 FY16	%QoQ	FY15	FY14	% YoY
Interest Income	1,248	1,176	6%	1,229	2%	4,698	4,189	12%
Interest Expenses	941	878	7%	898	5%	3,530	3,133	13%
Net Interest Income	307	297	3%	331	(7)%	1,169	1,056	11%
Other Income	121	103	18%	119	2%	507	505	0%
Total Income	428	400	7%	450	(5)%	1,676	1,561	7%
Operating Expenses	258	238	9%	211	22%	953	875	9%
Operating profit before provisions	169	163	4%	239	(29)%	723	687	5%
Total Provisions	35	84	(58)%	116	(70)%	214	278	(23)%
PBT	134	79	70%	123	9%	542	408	33%
Taxes	32	(10)	(438)%	14	132%	91	98	(7)%
PAT	102	89	16%	109	(6)%	451	311	45%

In Q2FY16, Karnataka bank reported good set of numbers. On q-o-q basis, Gross NPA declined by 8bps from 3.26% in Q1 FY16 to 3.18% in Q2 FY16 and by 35 bps y-o-y from 3.53% in Q2FY15. NII increased to ₹1,248 crs.in Q2 FY16, while PAT growth was 16% at ₹102 crs.

### Loan book growth muted; however guidance remains good

Loan book growth remained muted at 3% q-o-q (up 9% y-o-y) to ₹32,443 crs. The bank is increasing focus on the retail book. For the period, the retail mix as % of total loan book improved from 49% to 51%. The management has guided for loan of ₹37,500 by FY16. Given sluggish pick up, we remain conservative and expect growth of 13% to ₹35,798 crs in FY16.

### NIMs remain steady

NIMs remained steady at 2.41% compared to 2.36%. Yield on advances declined marginally q-o-q by 13bps to 11.85% due to impact of base rate cut in June 2015 and marginal decline in yield on investment. Increasing share of retail book helped improve the yields. The cost of deposit declined 20 bps to 7.67%. The bank has taken two base rate cuts so far totalling 50bps. However, the deposit cut of upto 125bps will help combat the NIM pressure. Amount stuck under RIFD investment declined 400 crs. on y-o-y basis; Additional 200 crs. to get released in H2FY16.

### Steady NIM; Expected to come down due to competition

NIMs declined by 2bps q-o-q (up 7bps y-o-y) to 3.79% due to fall in the yield on advances more than that of cost of funds. Yield on advances decreased by 21bps q-o-q (9bps y-o-y). Cost of funds declined by 16bps q-o-q (13bps y-o-y) due to reduction in deposit rates. CASA has improved by 106bps q-o-q (down 136bps y-o-y) and supported the fall in the cost of funds on sequential basis. NIMs are expected to be at ~3.5% in next 24 months due to rise in competition and change in base rate calculation methodology which has been recently proposed by RBI.

### Asset quality surprised negatively led by corporate account

The headline Gross NPA improved during the quarter by 35bps y-o-y to 3.18%. Slippages was ₹139 crs. while write off and upgradation stands at ₹35 crs. and ₹104 crs. respectively. The continuous focus on recovery cell in both regional and head office seems to be playing off. Sale to ARC was nil. However, sale to the tune of ₹150 to 200 crs. is expected in H2FY16. No accounts were restructured and pipeline remain nil except one account of ₹150 crs. in the rice export sector. Management has guided for 2.5% and 1.5% for Gross NPA and net NPA respectively.

### Outlook & Valuation

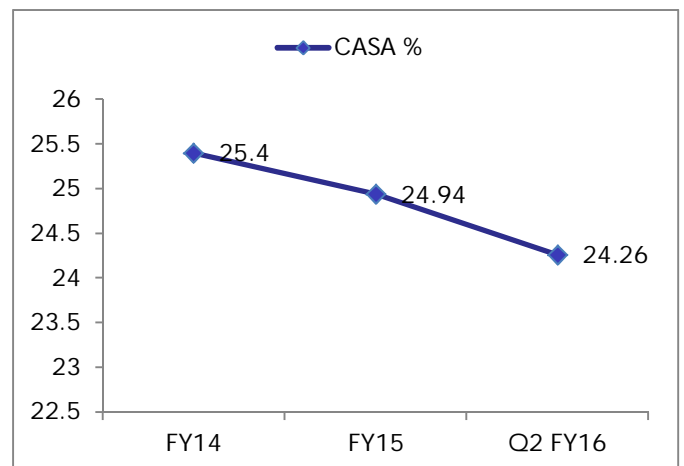
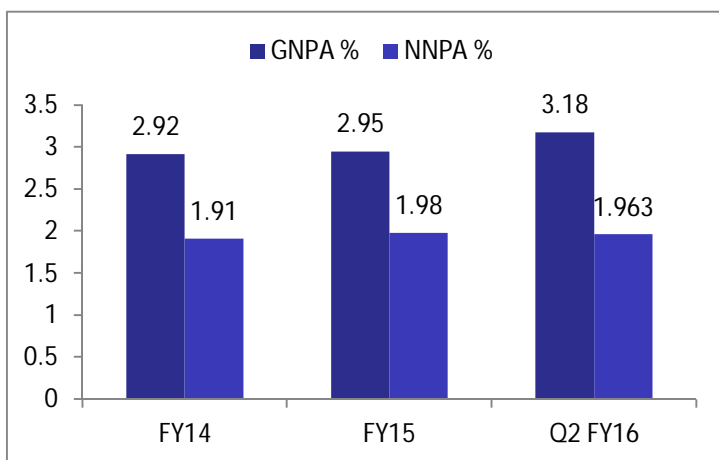
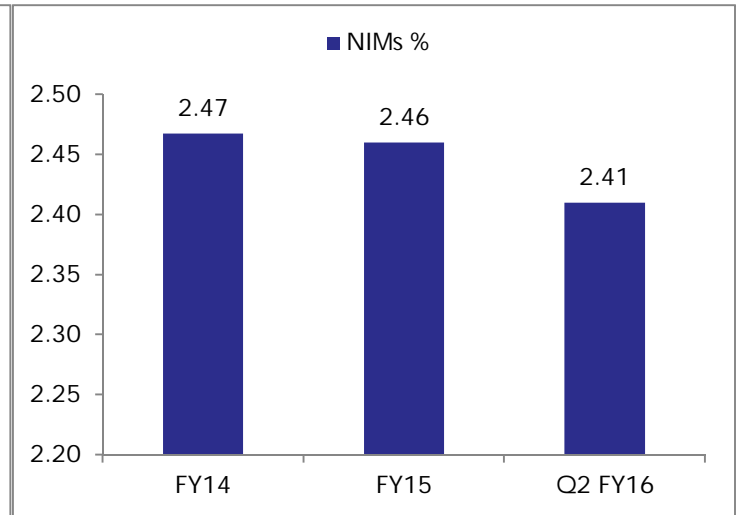
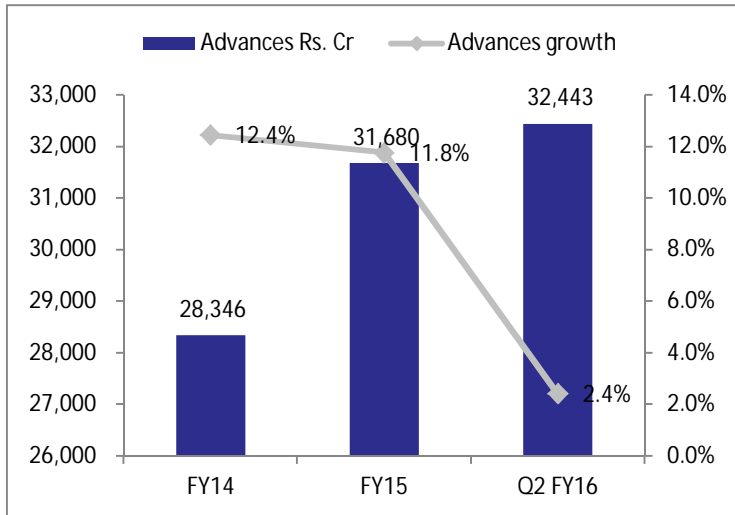
We expect loan book to grow better than industry at 15% CAGR (FY15-17E) along with improvement in NIMs (from 2.46% to 2.57%). Thus, backed by operating performance, we expect RoA and RoE to improve towards 0.88% and 14% by FY17. At CMP of ₹128 Karnataka Bank is trading at P/B multiple of 0.7x its FY16E ABV of ₹178 and 0.6x its FY17E ABV of ₹201. We maintain a BUY rating with a target of ₹146 with an upside potential of 14% by March'16.



**Q2FY16 CONFERENCE CALL HIGHLIGHTS: -**

- Advances have grown 9.2%; No QIP for this year; may be next year
- CAR is comfortable at 11.95%
- `1704 crs. RIFD investment compared to last year of `2090 crs. Yield has gone up 4.75% to 5.02%. `200crs. would be additional recovered by FY16
- In FY16, recoveries and up gradations expected to be same as FY15
- 50 branches for this year are at strategic places
- Technology geared up for the competition; received award on Technology Adoption
- Base rate twice in last 4 months 1st June 0.25, 5th Oct 0.25, deposit lowered 9% to 7.75%
- No additional impact on NIM due to sharper lowering on deposits

**Graphs for important parameters**





## QUARTERLY PERFORMANCE:

Particulars	Sep-15	Sep-14	% YoY	Jun-15	%QoQ	FY15	FY14	% YoY
Interest Income	1,248.4	1,175.7	6.18%	1,229.1	1.57%	4,698.4	4,188.8	12.17%
Interest Expenses	941.5	878.4	7.18%	897.7	4.87%	3,529.6	3,132.8	12.67%
Net Interest Income	306.9	297.3	3.23%	331.3	-7.37%	1,168.9	1,056.0	10.69%
Other Income	121.0	102.8	17.71%	119.1	1.59%	507.0	505.3	0.33%
Fee Income	217.0	93.0	133.33%	109.0	99.08%	394.0	404.0	-2.48%
Total Income	427.9	400.1	6.95%	450.4	-5.00%	1,675.8	1,561.3	7.34%
Operating Expenses	258.4	237.5	8.82%	211.4	22.24%	952.6	874.6	8.91%
Employee	124.9	130.6	-4.40%	100.3	24.54%	524.7	525.4	-0.14%
Others	133.6	106.9	24.96%	111.2	20.17%	427.9	349.2	22.54%
Operating Profits before provisions	169.5	162.6	4.22%	239.0	-29.10%	723.3	686.7	5.33%
PBT	134.4	79.0	9.11%	123.2	22.01%	542.4	408.3	32.83%
Taxes	32.1	-9.5	NA	13.8	35.21%	90.9	97.6	-6.85%
PAT	102.3	88.5	-6.48%	109.3	19.47%	451.5	310.7	45.30%
EPS	5.4	4.7	-6.48%	5.8	19.50%	24.0	16.5	45.25%
<b>Asset Quality</b>								
GNPA ` Cr	1,043.7	1,060.9	0.94%	1,034.0	-1.62%	944.2	835.9	12.96%
NNPA ` Cr	635.3	702.2	-0.54%	638.7	-9.53%	623.6	538.0	15.90%
GNPA %	3.2	3.5	-32	3.3	-8	3.0	2.9	5
NNPA %	2.0	2.4	-44	2.1	-9	2.0	1.9	8
PCR % Calculated	39.1	33.8	532	38.2	91	34.0	35.6	-168
PCR % Reported	NA	NA	NA	NA	NA	50.5	53.2	-267
Slippages	149.0	230.0	-35.22%	265.0	-43.77%	929.8	654.0	42.18%
Slippage Ratio	0.5	0.8	-31	0.8	-39	2.9	2.3	63
Credit Cost %	0.43	1.13	-69	1.48	-105	0.68	0.98	-31
Stressed Assets % of Advances	9.98%	10.34%	-36	10.32%	-34	9.37%	9.52%	-15
<b>Ratios %</b>								
Fees to Advances	2.7	1.3	142	1.4	128	1.2	1.4	-18
Cost to Income ratio	60.4	59.4	104	46.9	1346	56.8	56.0	82
Tax Rate	23.9	-12.0	NA	11.2	NA	16.8	23.9	NA
Loan/Deposit	66.4	67.2	-86	67.0	-66	68.9	69.8	-99
CASA %	24.3	24.3	-4	25.0	-74	24.9	25.4	-46
CAR (Basel III) %	11.7	12.1	-38	12.1	-37	12.4	13.2	-79
Tier I %	10.1	10.0	1	10.3	-23	10.5	10.7	21
Tier II %	1.7	2.0	-39	1.8	-14	1.9	2.5	-58
Opex to Loan book	3.2	3.2	-1	2.7	49	3.0	3.1	-8
<b>Margins %</b>								
Yield on Advances	11.9	12.0	-19	12.0	-13	12.0	12.2	-20
Cost of Deposits	7.7	7.9	-21	7.7	0	7.9	7.9	-3
Quarterly NIMs	2.4	2.4	4	2.6	-14	2.4	2.4	-4
Capital	188.5	188.5	0%	188.5	0%	188.5	188.4	0%
Net Worth	3,600.7	3,262.5	10.37%	3,498.4	2.92%	3,389.1	3,052.2	11.04%
FV	10.0	10.0	0%	10.0	0%	10.0	10.0	0%
Deposits	48,872.0	44,196.4	10.58%	46,767.0	4.50%	46,008.6	40,582.8	13.37%
Investments	16,394.6	16,933.0	-3.18%	16,985.0	-3.48%	15,988.1	15,226.8	5.00%
Loans	32,442.9	29,717.6	9.17%	31,352.0	3.48%	31,680.0	28,345.5	11.76%
BV-Calculated	191.1	173.1	10.39%	185.6	2.92%	179.8	162.0	11.00%
Adjusted Networth	2,965.4	2,560.3	15.82%	2,859.7	3.70%	2,765.5	2,514.2	10.00%
Adj. BV	157.3	135.8	15.85%	151.7	3.70%	146.7	133.5	9.96%



Particulars	Sep-15	Jun-15	Mar-15	Dec-14	Sep-14	FY15	FY14
Interest Income	1,248	1,229	1,196	1,202	1,176	4,698	4,189
Interest Expenses	941	898	905	900	878	3,530	3,133
Net Interest Income	307	331	291	302	297	1,169	1,056
Other Income	121	119	112	163	102.8	507	505
Fee Income	217	109	68	128	93	394	404
Total Income	428	450	403	465	400	1,676	1,561
Operating Expenses	258	211	214	282	238	953	875
Employee	125	100	83	188	131	525	525
Others	134	111	131	94	107	428	349
Operating Profits before provisions	169	239	189	183	163	723	687
Total Provisions	35	116	-4	79	84	214	278
PBT	134	123	194	104	79	542	408
Taxes	32	14	59	(3)	(10)	91	98
PAT (RoA)	102	109	134	107	89	451	311
Average Assets/Average Equity	15.3	15.2	15.4	14.8	15.1	15.4	15.0
RoE	12.11	12.70	14.02	13.18	13.31	14.02	10.53

## REVISED ESTIMATES: -

We lower our loan book assumption due to sluggish H1 and weak economy recovery.

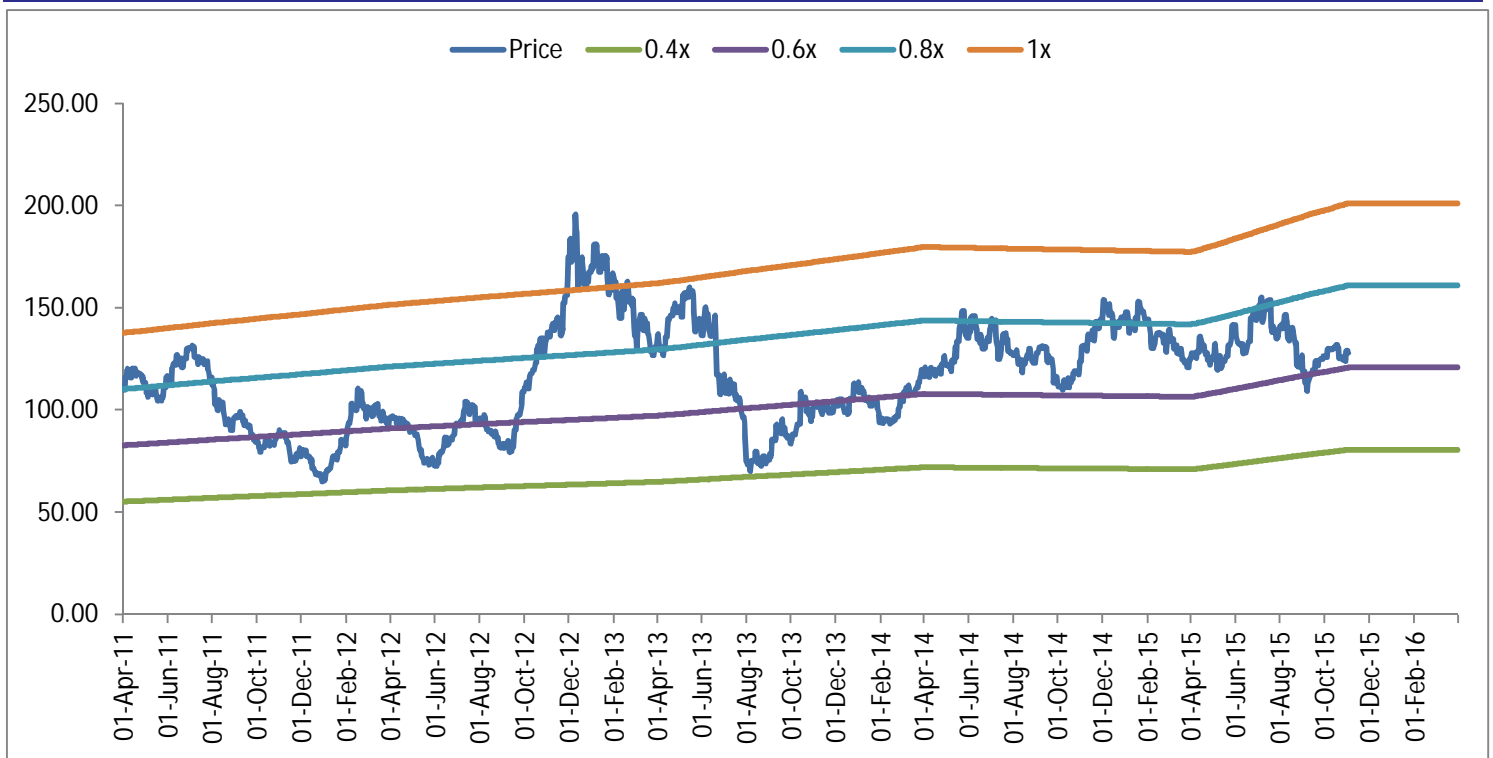
	FY16			FY17		
	Revised	Old	Change	Revised	Old	Change
ROE	13.4	14.0	-0.6bps	14.1	14.7	-0.6bps
BV	177.3	177.7	-0.23%	201.1	202.6	-0.74%
PAT	481	502	-4.18%	563	594	-5.22%
Loan Book	35,798	36,749	-2.59%	41,526	42,629	-2.59%



**OUTLOOK & VALUATION: -**

We expect loan book to grow better than industry at 15% CAGR (FY15-17E) along with improvement in NIMs (from 2.46% to 2.57%). Thus backed by operating performance, we expect RoA and RoE to improve towards 0.88% and 14% by FY17. At CMP of ₹128 Karnataka Bank is trading at P/B multiple of 0.7x its FY16E ABV of ₹178 and 0.6x its FY17E ABV of ₹201. We maintain a BUY rating with a target of ₹146 with an upside potential of 14% by March'16.

**P/BV (Forward)**



Source: Dimensional Securities

**PROFIT & LOSS STATEMENT:**

Particulars	FY14	FY15	FY16E	FY17E
Interest Income	4,189	4,698	5,210	5,927
Interest Expense	3,133	3,530	3,873	4,334
Net Interest Income	1,056	1,169	1,337	1,593
Non- Interest Income	506	507	521	602
Total Income	1,562	1,676	1,859	2,195
Employee Cost	525	525	581	673
Other Operating Expenses	349	394	404	468
Total Operating Expenses	875	919	985	1,141
Operating Profit	687	757	874	1,054
Provisions	278	214	233	249
Pre-tax Income	409	543	641	804
Taxes	98	91	160	241
Net Income	311	452	481	563

Key Ratios	FY14	FY15	FY16E	FY17E
Spread	2.2%	2.3%	2.3%	2.3%
NIM	2.5%	2.5%	2.5%	2.6%
Op Profit Margin	44.01%	45.17%	47.00%	48.00%
RoE	10.6%	14.0%	13.4%	14.1%
RoA	0.7%	0.91%	0.86%	0.88%
NNPA	1.90%	1.97%	1.32%	0.96%



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