



Strong Contender!

7th September, 2016

CMP: Rs. 156
Target Price: Rs. 197
Recommendation: BUY

Stock Info

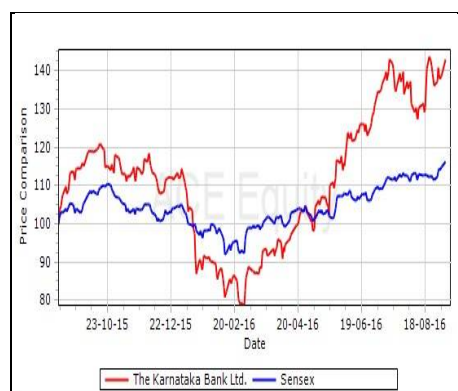
BSE Group	A
BSE Code	532652
NSE Symbol	KTKBANK
Bloomberg	KBL IN
Reuters	KBNK.BO
BSE Sensex	28,978
NSE Nifty	8,943

Market Info

Market Capital(Rs Cr)	2,837
Equity Capital(Rs Cr)	188
Avg. Trading Vol.	95,551
52 Wk High/ Low	160/85
Face Value	10

Shareholding Pattern (%)	(Jun 2016)
Promoters	0.0
Domestic Institutions	9.8
Foreign Institutions	19.6
Public & Others	70.6

Price Chart:



Company Profile

Karnataka Bank Limited is a leading 'A' Class Scheduled Commercial Bank in India. The bank was incorporated on February 18th, 1924 at Mangalore, a coastal town of Dakshina Kannada district in Karnataka State. The bank took shape in the aftermath of patriotic zeal that engulfed the nation during the freedom movement of 20th Century India. Over the years the bank grew with the merger of Sringeri Sharada Bank Ltd., Chitradurga Bank Ltd. and Bank of Karnataka.

Investment Argument

- **Operational efficiency** – The bank has sturdy management over its expenses. Cost – Income ratio for the bank decreased from over 60% in FY 11 to 53.7% in FY 16, helped by healthy income.
- **Rising margins** – Net interest margin for the bank has ascended to 2.5 in FY 16 against 2.15 reported in FY 11. Positive traction helped by better CASA mix to continue further.
- **Healthy return ratios** – The RoE for the bank mounted to 14.0 in FY 15 from 9.6 in FY 11 while RoA climbed to 0.9 in FY 15 from 0.7 in FY 11. Though FY 16 witnessed a drop, the ratios stood strong with RoE at 11.7 and RoA at 0.8.
- **Focus on retail book** – The retail portion for the bank has gained traction against the corporate book. The retail to corporate ratio improved from 44.3 : 55.7 in FY 11 to 52.8 : 47.2 in FY 16.

Concern

- **Asset quality dwindles** – Net non performing loans for the bank surged from 1.6 in FY 11 to 2.4 in FY 16. Continued surge in loan defaults may lead to stressed profitability.

Valuation

At CMP of Rs 156 per share the stock trades at P/E and P/ABV multiple of 8.1 (x) and 1.2 (x). We have valued the stock at P/ABV multiple of 1.5 (x) to its FY 18 estimates and arrived at fair value of Rs 197 per share. We initiate coverage with "BUY" rating on the stock.

Snapshot

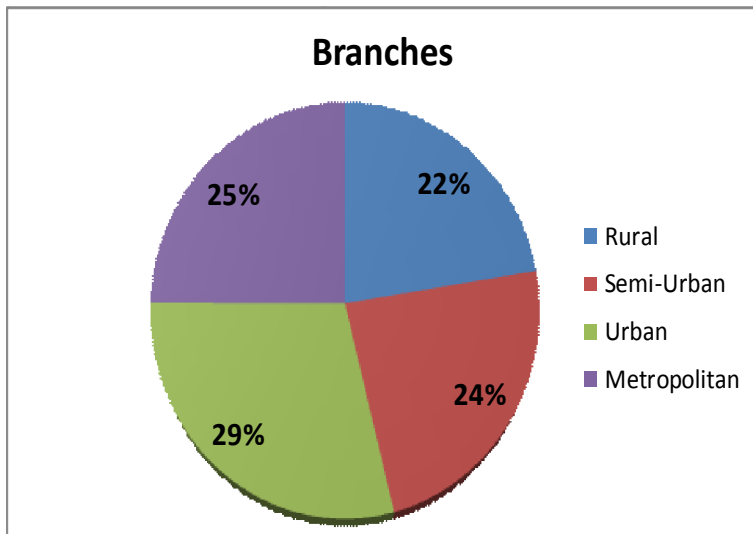
Particulars (Rs Cr)	FY 15	FY 16	FY 17	FY 18
NII	1169	1303	1493	1723
Operating Profit	773	855	1046	1217
Profit After Tax	451	415	474	545
EPS(Rs)	24.0	22.0	16.8	19.3
ROE(%)	14.0	11.7	11.3	11.2
P/E (x)	5.1	6.9	9.3	8.1
P/ABV (x)	0.8	1.0	1.2	1.2

Source: - Company Data Ace Equity, Arihant Research



Business Profile

Incorporated in 1924, Karnataka Bank is one of the oldest time tested private sector Banks. With over 88 years experience at the forefront of providing professional banking services and quality customer service, the bank now has a national presence with 2,033 service outlets including 733 branches, 3 Extension Counters and 1,297 ATMs in 484 centres across India. The bank has the strongest presence in South India with 574 branches and offers wide variety of corporate and retail banking products and services to over 7.5 million customers. Business turnover for the bank as on June 30, 2016 stood at Rs 86,447 crore.



Business Divisions

- Personal Banking
Under this Karnataka Bank offers wide range of products and services such as saving accounts, deposit scheme, home loans, education loans, debit card, mobile banking, internet banking and many more.
- Corporate Banking
It offers spectrum of services to its corporate clients such as working capital finance, term loans, Infrastructure finance and other services.
- For its insurance services it has a tie up with PNB MetLife Insurance Company and the bank also forayed into General Insurance business by promoting a Joint Venture company called Universal Sampo General Insurance Co. Ltd.
- It also provides RTGS and Money Transfer Facility to its NRI clients through Western Union Money Transfer.

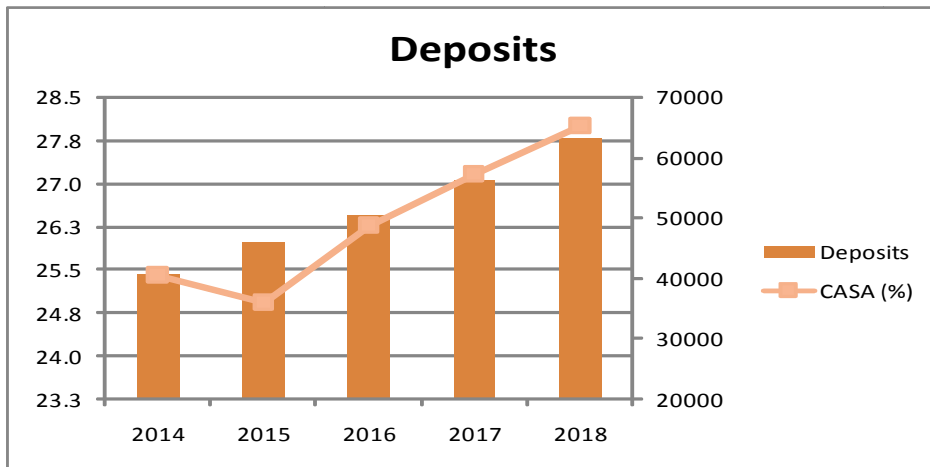
Business Performance

For the year FY 16 the bank registered a growth of 10.6% over the previous year. Total business for the bank stood at Rs 84,390 crores with advances at Rs 33,903 crores reporting, a growth of 7% over the previous year and deposits at Rs 56,273 crores, a growth of 9.7% over the previous year. Total assets of the Bank increased from Rs 51,836 crore to Rs 56,500 crore recording a growth of 9% for the year FY 16.



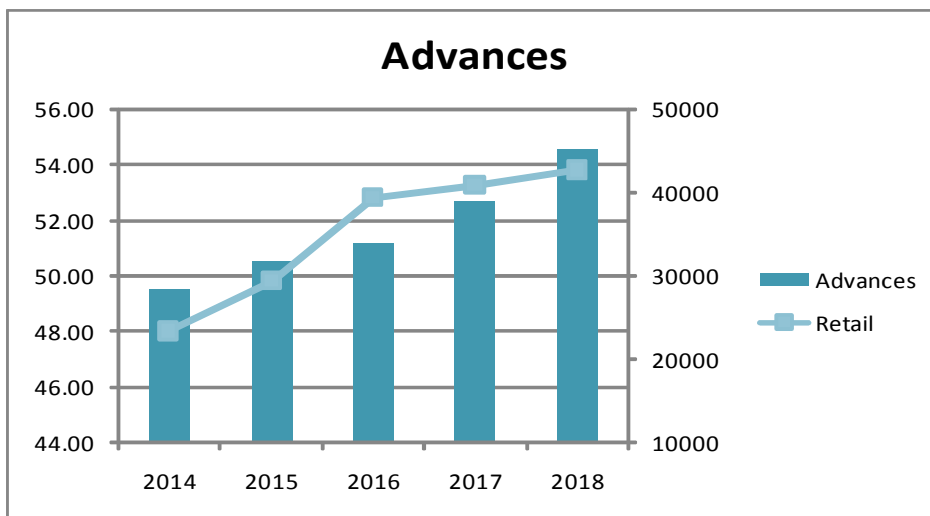
Deposits

Deposits for the bank witnessed a steady growth over the years. For the year FY 14-16, the deposits grew at a CAGR of 11.5% on back of strong CASA deposits which grew at 13.5% for the same period. Proportion of CASA deposits increased from 25.4% in FY 14 to 26.3% in FY 16 led by strong growth in savings deposits which grew at a CAGR of 15% for FY 14-16. Improving CASA base pushed cost of deposits lower to 7.5% for FY 16 against 7.9% registered in FY 14. Further we expect the deposits to grow at a CAGR of 12% for FY 16-18 backed by CASA growth of 15.5% with a savings deposits growth at CAGR of 16% resulting in proportion of CASA at 28% for FY 18.



Loan Portfolio

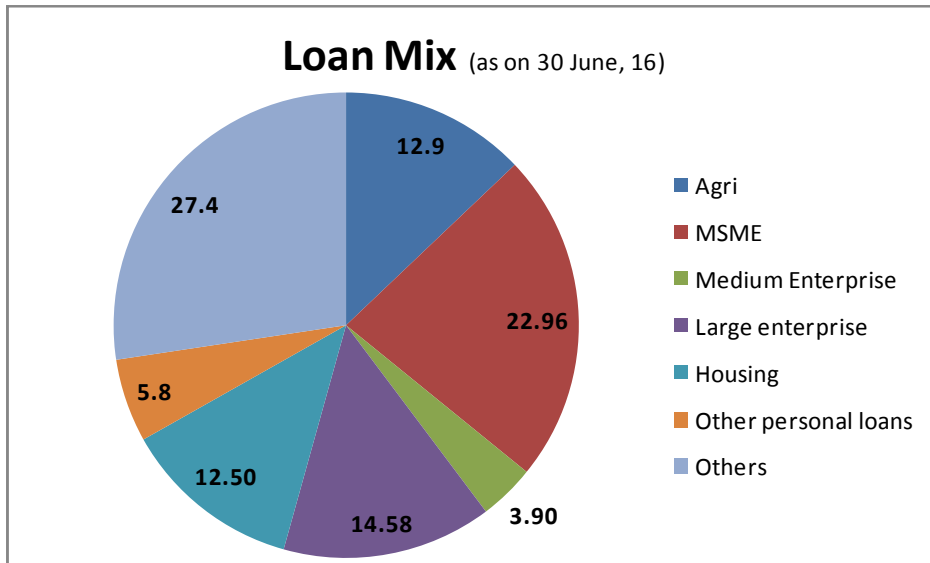
Bank has reported sturdy credit growth though FY 16 stood weak as bank reported single digit growth of 7% for FY 16 and grew at a CAGR of 9.4% for FY 14-16. Retails loans for FY 16 grew at 13% while corporate loan reported minimal growth of 1%. Yield on advances for the bank slid from 12.2% in FY 14 to 11.6% in FY 16. However, proportion of corporate loans dropped in favor of retail. The share of retail loans in the loan mix augmented from 44.3% in FY 12 to 52.8% in FY 16. Priority sector advances increased from 43.6% in FY 12 to 47.6% in FY 16. We expect credit growth to resume going ahead with the loan portfolio to tilt further in favor of retail loans.





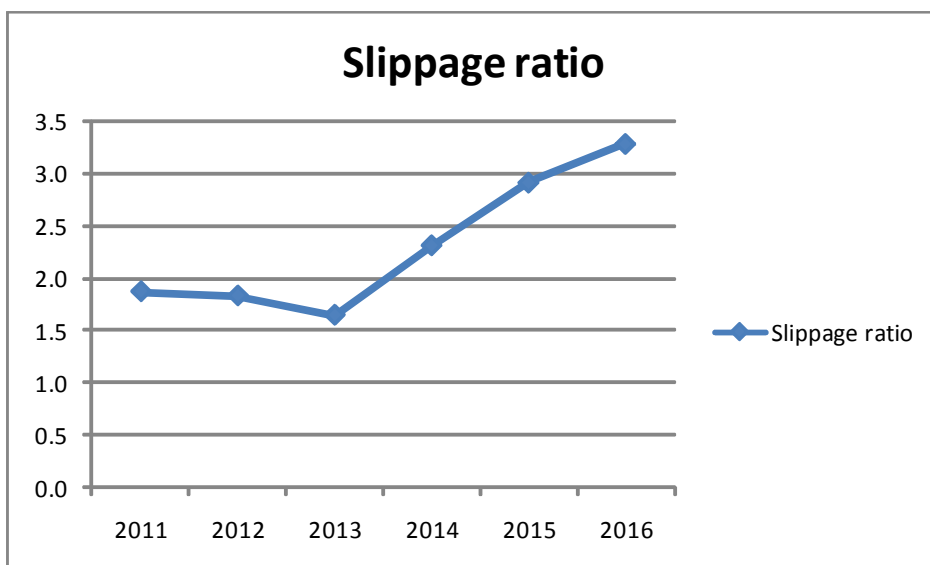
Sector Blend

Loan balance for the bank grew in favor of MSME and Housing. As on FY 16 loans to agriculture stood at 13.3% while that for large enterprises stood at 14.3% dropping from 14.6% and 16.0% respectively over FY 14-16. Loans to MSME stood at 23.5% as on FY 16 and that for housing stood at 12.6% rising from 16.9% and 10.7% respectively over FY 14-16.



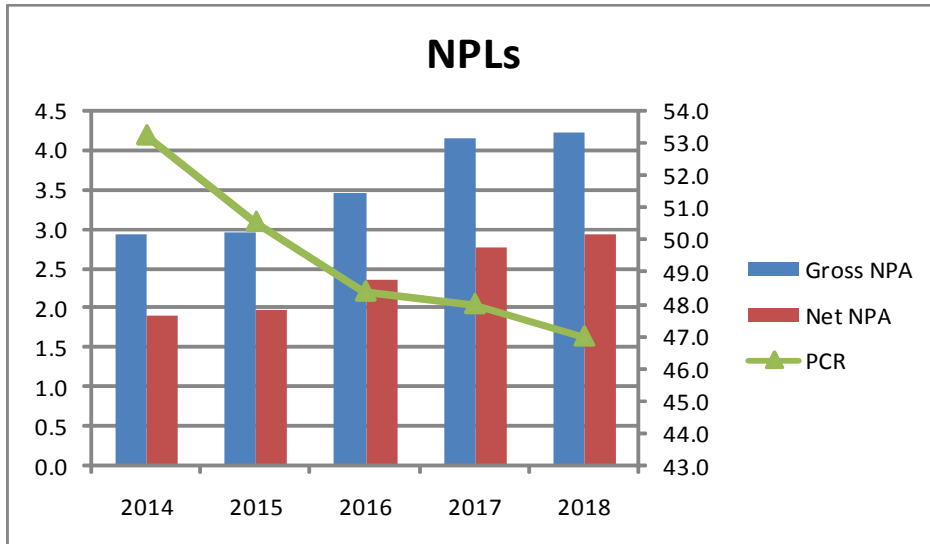
Asset Quality

Slippages for the bank mounted to 3.3% in FY 16 from 1.9% in FY 11 majorly on account of defaults in the corporate loans. For Q1 FY 17 the slippage ratio stood at 0.9%. However, stable numbers are expected going forward with greater focus on recovery.



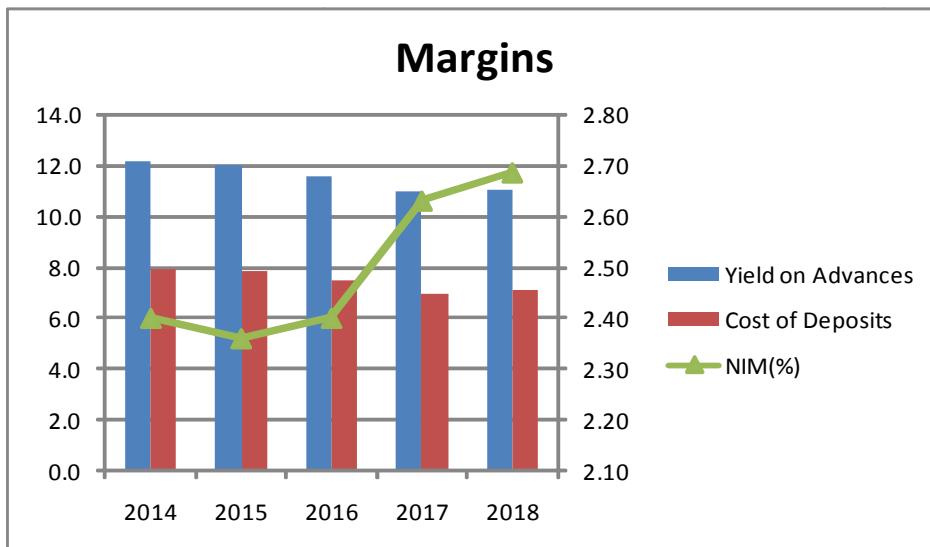


Gross non performing loans for the bank increased from Rs 835 crores in FY 14 to Rs 1,180 crores in FY 16 while net non performing loans increased from Rs 538 crores in FY 14 to Rs 805 crores in FY 16. In percentage terms gross NPLs climbed from 2.9% to 3.4% while net NPLs climbed from 1.9% to 2.4%. Provision coverage ratio for the same period decreased from 53.2% in FY 14 to 48.4% in FY 16. However, better risk management policies and stable or reducing numbers in slippages may lead to improved asset quality.



Margins Trajectory

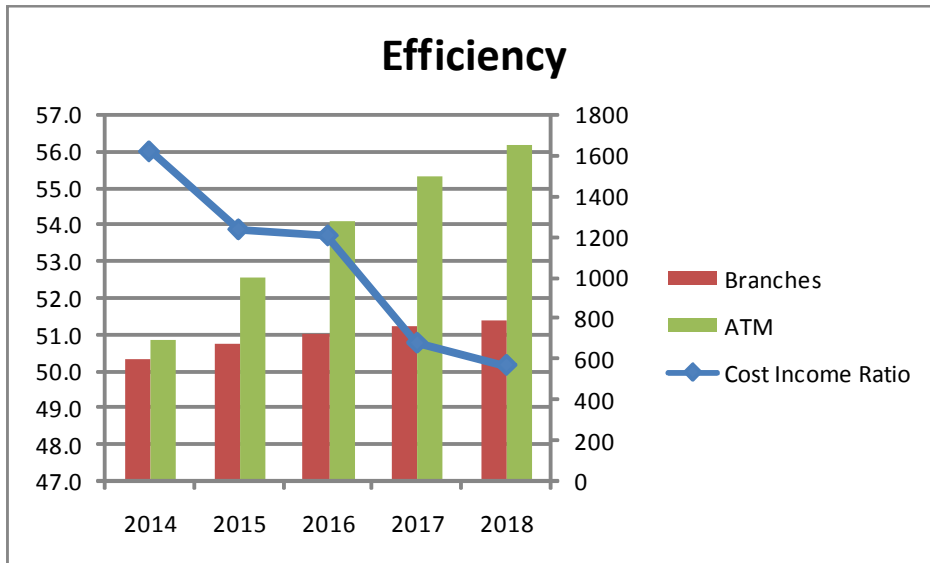
Yield on advances headed south to 11.6% in FY 16 against 12.2% registered in FY 14. However, rising CASA base provided cushion to the bank escorting cost of deposits lower to 7.5% in FY 16 against 7.9% registered in FY 14. Net interest margins for FY 16 stood steady against FY 14 at 2.4 but improved over FY 15 and for the Q1 FY 17 the NIM stood at 2.55%. Shift to MCLR going ahead is expected to further lower yield on advances however improving CASA metrics and repricing of deposits will provide cushion in safeguarding the interest spreads and higher NIMs.





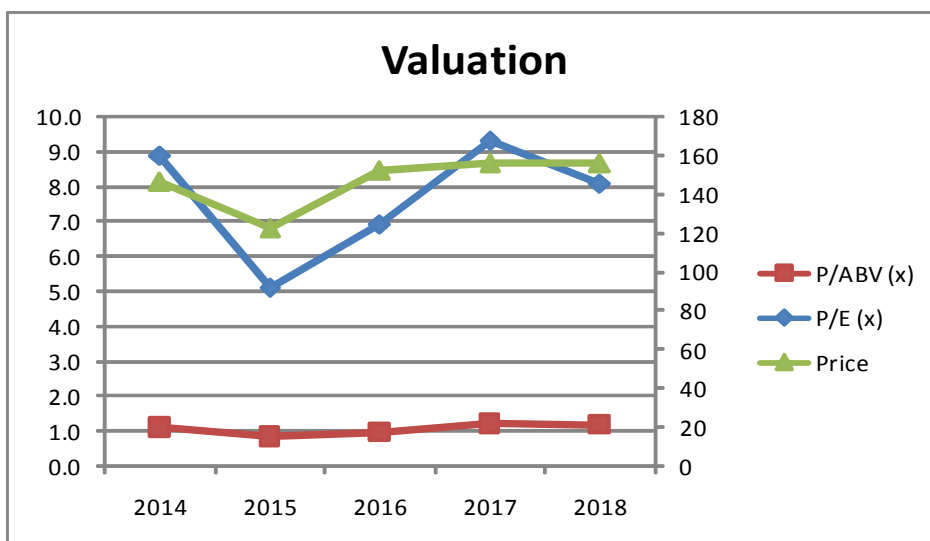
Operational Efficiency

The bank added 125 branches and 575 ATMs over FY 14-16 taking the total number of branches to 725 and ATMs to 1,275. Employee strength for the bank increased from 7,185 in FY 14 to 7,792 in FY 16. Despite rising expansion the bank has continued to keep its costs in control. Cost to income ratio for the bank plunged from 56% in FY 14 to 53.7% in FY 16. Efficiency is further expected to stay intact helped by healthy income.



Valuation & Outlook

Banks total business turnover is projected to increase in a progressive manner to touch Rs 1,80,000 crore by March 2020, with deposits of Rs 1,00,000 crore & advances of Rs 80,000 crore. Service outlets are projected to touch 3,500 [1,000 Branches + 2,500 ATMs] by March 2020. E-lobbies / Mini e-lobbies to touch 250. Digital Banking initiative to be taken forward by increasing the digital touch points. We have valued the stock at P/ABV multiple of 1.5 (x) to its FY 18 estimates and arrived at fair value of Rs 197 per share. We have **“BUY”** rating on the stock.





Peer Group Comparison										
Particulars	NIM	EPS	BVPS	Net Worth	Market Cap.	CMP	P/BV	P/E	RoA	RoE
Karnataka bank	2.5	22.0	195.8	3691	2837	150	0.8	6.8	0.8	11.7
Lakshmi Vilas Bank	2.8	10.1	88.7	1764	2503	140	1.6	14.0	0.7	12.3
South Indian Bank	2.7	2.5	28.5	3846	3005	22	0.8	9.0	0.6	8.7

Quarterly Results					
Particulars	Q1 FY 17	Q1 FY 16	YoY %	Q4 FY 16	QoQ %
Interest Earned	1261	1229	2.6	1278	-1.3
Interest Expended	896	898		918	
NII	365	331	10.1	360	1.4
Other Income	174	119		170	
Operating Expenses	277	211		275	
Employee Cost	128	100		105	
Operating Profit	262	239	9.6	254	3.0
Provisions	136	116		113	
Tax	4	14		35	
Profit After Tax	122	109	11.2	107	13.8

Other Highlights					
Particulars	Q1 FY 17	Q1 FY 16	YoY %	Q4 FY 16	QoQ %
EPS	6.4	5.8		5.7	
BVPS	196	162		180	
RoA	0.9	0.8	0.0	0.8	0.1
RoE	13.0	12.7	0.3	11.7	1.2
NIM	2.6	2.6	0.0	2.4	0.2
C-I ratio	51.4	46.9	4.5	52.0	-0.6
CAR Basel III	11.6	12.1		12.0	
Tier I	10.3	10.3		10.6	
RWA	35797	32786	9.2	34787	2.9
Gross NPA	1389	1034		1180	
Net NPA	911	639		795	
Gross NPA %	3.9	3.3	0.7	3.4	0.5
Net NPA %	2.6	2.1	0.6	2.4	0.3
PCR	48.9	52.7		48.4	
Deposits	51501	46767	10.1	50488	2.0
CASA%	26.2	25.0		26.3	
CASA	13504	11693	15.5	13258	1.9
Advances	34946	31352	11.5	33902	3.1
Retail	52.1	50.7		52.8	
Corporate	47.9	49.3		47.2	
C-D ratio	67.9	67.0		67.1	
Cost of deposits	7.0	7.7	-0.7	7.5	-0.6
Yield on advances	11.0	12.0	-1.0	11.6	-0.6



Profit & Loss Account				
Particulars (Rs Cr)	FY 15	FY 16	FY 17	FY 18
Interest Earned	4698	4992	5557	6361
Interest Expended	3530	3689	4064	4638
NII	1169	1303	1493	1723
Other Income	507	543	630	718
Fee Income	224	238	283	318
Operating Expenses	903	991	1078	1224
Employee Cost	525	443	513	580
Operating Profit	773	855	1046	1217
Provisions and Contingencies	214	327	487	509
Profit Before Tax	559	528	558	708
Taxes	108	113	84	163
Profit After Tax	451	415	474	545

Balance Sheet				
Particulars (Rs Cr)	FY 15	FY 16	FY 17	FY 18
Share Capital	188	188	283	283
Total Reserves	3198	3502	4405	4792
Deposits	46009	50488	56273	63175
Borrowings	1038	1051	960	885
Other Liabilities & Provisions	1401	1270	1441	1687
Total Liabilities	51837	56500	63362	70821
Cash and balance with RBI	2488	2646	3551	3930
Bal. with banks & money at call	126	399	614	739
Investments	14032	16257	17252	18193
Advances	31680	33902	38931	45107
Other Assets	3511	3296	3014	2852
Total Assets	51837	56500	63362	70821

Ratios				
Particulars (%)	FY 15	FY 16	FY 17	FY 18
Advances Growth	11.8	7.0	14.8	15.9
Deposit Growth	13.4	9.7	11.5	12.3
NII Growth	10.7	11.5	14.6	15.4
Net Profit Growth	45.1	-8.0	14.2	14.9
EPS(Rs)	24.0	22.0	16.8	19.3
BVPS(Rs)	180	196	166	179
Adj. BVPS (Rs.)	147	154	128	133
DPS(Rs)	5.0	5.0	3.7	4.0
ROA(%)	0.9	0.8	0.8	0.8
ROE(%)	14.0	11.7	11.3	11.2
C-D ratio	68.9	67.2	69.2	71.4
Cost Income Ratio	53.9	53.7	50.8	50.2
CASA (%)	24.9	26.3	27.2	28.0

Ratios				
Particulars (%)	FY 15	FY 16	FY 17	FY 18
Total CAR (Basel III)	12.4	12.0	13.4	13.7
Net NPA	2.0	2.3	2.8	2.9
Gross NPA	3.0	3.4	4.1	4.2
PCR	50.5	48.4	48.0	47.0
Yield on Advances	12.0	11.6	11.0	11.1
Yield on Investments	7.5	7.5	7.5	7.6
Cost of Deposits	7.9	7.5	7.0	7.1
Interest Spread	4.1	4.0	4.0	4.0
NIM(%)	2.5	2.6	2.6	2.7
Valuation				
P/E (x)	5.1	6.9	9.3	8.1
P/BV (x)	0.7	0.8	0.9	0.9
P/ABV (x)	0.8	1.0	1.2	1.2

Note: Numbers adjusted for rights issue

**Arihant Research Desk**

E. research@arihantcapital.com
T. 022-42254800

Head Office

#1011, Solitaire Corporate park,
Building No. 10, 1st Floor,
Andheri Ghatkopar Link Road,
Chakala, Andheri (E).
Mumbai - 400093
Tel: (91-22) 42254800
Fax: (91-22) 42254880

Registered Office

E-5 Ratlam Kothi
Indore - 452003, (M.P.)
Tel: (91-731) 3016100
Fax: (91-731) 3016199

Stock Rating Scale

	Absolute Return
Buy	> 20%
Accumulate	12% to 20%
Hold	5% to 12%
Neutral	-5% to 5%
Reduce	< -5%

Research Analyst Registration No.

INH000002764

Contact

SMS: 'Arihant' to 56677

Websitewww.arihantcapital.com**Email Id**research@arihantcapital.com**Disclaimer:**

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