WAY2WEALTH
Your Personal Investment Guide

Karnataka Bank

Rs 95

29th May 2006

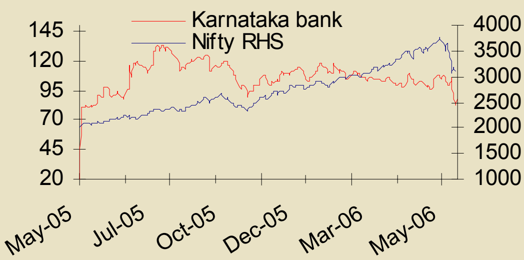
Growth at reasonable value

Buy

SCRIP DETAILS	
Market Cap (Rs crores)	1,152
P/E (x)-FY07 (e)	5.7
P/ BV (x)- FY07 (e)	0.9
P/ Adj BV- FY07 (e)	1.0
Dividend (Rs.)/ Yield (%)	3/ 3.2
Equity Capital (Rs crores)	121.3
Face Value (Rs)	10.0
52 Week High/Low (Rs)	137/ 75
Website: www.karnatakabank.com	
NSE Code	KTKBANK
Sensex	10809
Nifty	3209

SHARE HOLDING PATTERN (As on 31 Mar 2006)	
Promoters	-
Mutual Funds/ Banks/ FIs	7.7
FIIs	18.9
Public & Others	66.6
Others	6.8

COMPARATIVE PRICE MOVEMENT



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Karnataka Bank has come out with a good set of numbers for the quarter. The net profit of Rs 51 crores for Q4FY06 is better than the expectations of Rs 45 crores. All-round performance, backed by control over asset quality, has improved the profitability of the Bank during the quarter. The Bank has been very conservative in its business growth, till now. However, it plans to grow fast in FY07 and also intends to add another 20 branches during the year, to its existing 395 branches, across the country.

NII growth to accelerate further: The interest income grew by 31% during the quarter, to Rs 271 crores, on the back of a 50% growth in interest on advances. While most of the banks have reported a decline in the interest on investments, Karnataka Bank has shown a growth of 12% during Q4FY06. However, the interest expenses went up by 38% in Q4, despite which, the Bank has reported a 21% growth in the NII during the period. Though the deposit rates will go up during the year, leading to higher interest expenses, the lending rates are likely to firm up further, which will accelerate the NII growth, going ahead.

Non-interest income likely to accelerate: Non-interest income during Q4 fell marginally by 3.5%, to Rs 37.2 crores from Rs 38.5 crores in Q4FY05. For FY06, total other income declined sharply by 24.6%, to Rs 167 crores, mainly due to fall in treasury gains. However, the Bank is taking lot of initiatives to improve its core fee income. The Bank is planning to be a part of a new non life insurance JV, with a share holding of 15%; this will also help in accelerating fee income growth.

Lower operating-cost powers operating-profit growth: During Q4FY06, there was a substantial decline in staff costs, down 47%, which helped the operating profits escalate by 38%, to Rs 96.8 crores. However, for the full year, even though the employee cost declined by 7.2%, operating costs went up by 22.4%; as a result, the operating profits declined by 3.6%, to Rs 328 crores from Rs 340 crores in FY05. 95% of the Bank's business has already been covered under core banking solutions, as a result of which the operating cost is likely to be under control, going ahead, and the cost to income ratio will remain below 40%.

Business growth to remain robust: Business growth for the Bank remained strong during the year. Advances grew by 24% YoY, to Rs 7,792 crores, on the back strong demand from corporate as well as retail segments. Deposit mobilisation was not a constraint for the Bank, as it was able to increase the total deposit base by 22%, to Rs 13,243 crores in FY06. For FY07, the Bank has targeted a total business of Rs 25,000 crores, comprising of Rs 15,000 crores of deposits and Rs 10,000 crores of advances, representing a growth of 13.3% and 28.3%, respectively, over FY06. The Credit- Deposit ratio of the Bank remained almost unchanged, at 58.8% during the year, which is likely to improve to 66% during FY07.

Financials

Figures (in Rs crores)	Q4FY06	Q4FY05	Chg (%)	FY06	FY05	Chg (%)
Interest income	270.9	206.7	31.0	1,018.0	839.9	21.2
Interest expense	169.8	123.1	37.9	652.1	523.0	24.7
Net Interest Income	101.1	83.6	20.9	366.0	316.9	15.5
Other Income	37.2	38.5	-3.5	166.8	221.2	-24.6
Profit before provs and taxes	96.8	70.1	38.0	328.3	340.7	-3.6
Provisions and contingencies	20.2	-4.8	-520.8	59.2	100.5	-41.1
PBT	76.6	75.0	2.2	269.1	240.2	12.0
Taxes	25.6	34.7	-26.3	93.1	93.1	0.0
PAT	51.0	40.3	26.7	176.0	147.1	19.6
EPS (Rs)	4.2	3.3	26.7	14.5	12.1	19.6
CAR (%)	11.8	14.2		11.8	14.2	
Net NPAs (%)	1.2	2.3		1.2	2.3	
Deposit	13,243.2	10,837.0	22.2	13,243.2	10,837.0	22.2
Advances	7,791.6	6,287.4	23.9	7,791.6	6,287.4	23.9

Valuation and Conclusion

Karnataka Bank has approached a balanced approach in its business growth and now plans to accelerate growth rates when the inertest rates are firming up. This strategy should help the Bank in improving the future NIM, which is around 2.8% currently. Going ahead, the Bank would be able to generate a sustainable ROE of ~16%, which is quite comparable to its peers. Meanwhile, the Bank is also comfortably placed in terms of capital requirements, with CAR at 11.8%. The Bank is also a prospective candidate for consolidation within the banking industry, going ahead. Further, the Bank offers an attractive dividend yield of 3.2%. At the CMP of Rs 95, the stock is attractively valued at 5.7x its FY07 (e) EPS of Rs 16.7 and 0.9x and 1x its FY07 (e) BV and Adj BV of Rs 105 and Rs 95, respectively. At the current valuation, Karnataka Bank is one of the cheapest banks in the banking sector. Looking at the above factors, we advise investors to **BUY** the stock with a one-year target price of Rs 135, an upside of 42% from the current level.

WAY2WEALTH Research

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