



Karnataka Bank Ltd. (KBL)
(Medium Risk Medium Return)

CMP Rs.135 (FV 10)
Date: 18 September 2009



Karnataka Bank Ltd.
Your Family Bank. Across India.

Key Data	
NSE Code	KTKBANK
Face Value	Rs.10
52 Week High	160
52 Week Low	56
Average Volume	2 Lakhs

Shareholding as on 30.06.09

■ FII	■ Domestic FI
■ Body Corporate	■ Public & Others

Company background

Karnataka Bank Limited was incorporated on February 18th, 1924 at Mangalore (Karnataka) to promote “Swadeshi” banking among farmers and artisans in the area. The Bank grew with the merger of Sringeri Sharada Bank Ltd (1942), Chitradurga Bank Ltd (1964) and Bank of Karnataka (1966).

It has network of 455 branches, 175 ATMs and customer base of 4 Million (38 Lakh depositors and 2 Lakh borrowers).

Investment Rationale

- Indian economy is in long term growth trajectory, with a saving rate of nearly 30%, but vast part of country remains under-banked.
- There are about 65000 total bank branches of commercial banks in India, i.e. 1 bank branch per 18000 persons, the ratio is very high compared to about 2500 persons per bank branch in US and about 3500 persons per branch in China. (Source: Wikipedia)
- Besides, traditional borrowing lending, there is good scope for newer financial products like Mutual Funds, Insurance, Depository services, Capital Market services, Forex services etc.
- In the recent global economic crises, Indian banks were in better position than their global peers, due to diversified folios and strict vigilance by RBI.
- PSU Bank and Old private banks were in a better position due to their conservative approach.

- Old private banks, though have much smaller network than PSU Banks, but they enjoy better margins as they cater to a niche markets and target selected Geographies, Trades, Communities etc.
- KBL has operations concentrated in the state of Karnataka, with 3 South Indian states Karnataka (36.06%), Andhra Pradesh (6.67%) and Tamil Nadu (9.93%), accounting for combined over 52% of the bank's Loans and Advances folio in FY2009.
- Bank is also providing Forex remittance services.
- It is also providing Depository services, and sales of 3rd party products eg. Insurance, Mutual Funds etc.
- Bank has shown slow and steady growth due to its risk adverse approach. Its margins are high due its stronghold in the niche market.
- The bank has ratio of about 9000 customers per branch (CPB) i.e. about half the national average of 18000 CPB.
- The bank is expanding its network in North and Eastern India, where there are good opportunities.
- It is gradually improving its CASA. In FY08 its CASA was 22%, increased to 25% in FY09. In FY2010 CASA is expected to grow to 27% in FY2010. This should improve the margins.
- On Y-o-Y basis in Q1 FY10 its deposits grew by 21%, whereas advances grew only 7.5%. Credit growth was muted in last 5 quarters from Q2 FY2009 to Q2 FY2010 due to economic slow down. Bank's Net Interest Income growth was flat in Q1 FY10 but Interest costs grew 35.96% during the period.
- As the costly Debt raised during Q2 FY 2009 to Q4 FY2009 is replaced by cheaper funds raised from Q2 FY2010 onwards, margins should improve.
- With improved sentiments, good credit off take is expected from Q3 FY2010. With a high CAR of 14.3%, it is in strong position to lend as demand picks up.
- It is a good dividend payer. It has paid continuous dividend in past 2 decades, with year on year increased dividend in past 5 years.
- There is no identifiable promoter of the bank, this makes it an attractive M&A candidate.

Financial Highlights

(Rs. Crore)	Q1 FY09	Q1 FY 10	% Y-o-Y	Q4 FY09	% Q-o-Q	FY09	FY 10E	% Change
Interest on Advances	335	332	-0.90	352	-5.68	1391	1530	10.00
Inc. from Investment	116	145	25.00	140	3.57	545	615	12.84
Inc. on RBI Bal.	6	1	-83.33	1	0.00	5	5	0.00
Other Interest	1	0		5		7	1	-85.71
Total Interest	458	478	4.37	498	-4.02	1948	2151	10.43
Other Income	50	132	164.00	143	-7.69	322	425	31.99
Total Income	508	610	20.08	641	-4.84	2270	2576	13.48
Operating Expenses	75	87	16.00	85	2.35	346	355	2.60
Interest Costs	317	431	35.96	417	3.36	1444	1730	19.81
Operating Profit	116	92	-20.69	139	-33.81	480	491	2.31
Provisions	103	18	-82.52	9	100.00	81	70	-13.58
Tax	-8	34		47	-27.66	133	140	5.26
Net Profit	21	40	90.48	83	-51.81	266	281	5.68
Equity (FV 10)	121	121		121		121	121	
EPS Rs.	1.74	3.31	90.48	6.86	-51.81	21.98	23.23	5.68
CAR (%)	11.98	14.38		13.48		13.48	14	
Gross NPA	417	447		443		443	450	
G-NPA %	3.76	3.74		3.66		3.66	3	
Net NPA	150	110		116		116	95	

N-NPA %	1.39	0.95		0.98		0.98	0.65	
NII	141	47		81		504	421	
CMP (Rs.)	135	135		135		135	135	
PE (X)	77.79	40.84	0.00	19.68	0.00	6.14	5.81	

Peerset Comparison

Rs. Crore	South Indian	BoRajasthan	KARNATAKA	Indusind
Total Interest Income FY 09	1687	1383	1948	2309
Other Income	164	123	322	456
Total Income	1851	1506	2270	2765
Operating Expenses	327	315	346	547
Interest Expenses	1164	998	1444	1850
PBT	360	193	480	368
Provisions	57	21	81	141
Tax	87	55	133	79
Net Profit FY09	216	117	266	148
Equity (FV 10)	113	161	121	355
EPS FY 09 (Rs.)	19.12	7.27	21.98	4.17
CMP (Rs.)	120	78	135	107
PE (X)	6.28	10.73	6.14	25.67
NII	523	385	504	459
CASA (%)	24	27	25	20
GNPA (%)	2.18	2.04	3.66	1.61
Net NPA (%)	1.13	0.73	0.98	1.14
Div. Rs./Share	3	2	6	1.2
No. of Branches	540	470	450	190
Market Cap	1356	1256	1634	3799
M Cap/Sales	0.73	0.83	0.72	1.37
Div. Yield (%)	2.50	2.56	4.44	1.12
Book Value Rs./Share (FY 09)	115	64	129	47
Price/Book Value	1.04	1.22	1.05	2.28

Risks

- Slow down in economy can hurt the financial sector.
- If the credit off take does not grow, the bank could be adversely impacted.
- It is a small regional player, faces threat from pan-India players with very wide network.
- Its expansion into other Geographies, may dilute their targeted approach and also this can bring in competition from existing players in these areas.

Valuation & Recommendation

Karnataka Bank is likely to show an EPS of Rs.23 in FY2010. At CMP Rs.135, it trades at forward PE of 5.8 and dividend yield of 4.5% (on FY09 basis). Investors may BUY in Rs.130-135 range for a target of Rs. 161 i.e. 7 PE on FY 10 estimates.

Financial Projections

P&L A/C (Rs. Crore)	FY 08	FY 09	FY 10E	FY 11E
Interest on Advances	1123	1391	1530	1760
Incm. on Investments	431	545	615	675
Intt. On RBI bal.	3	5	5	10
Other Interest	4	7	1	5
Total Interest Income	1561	1948	2151	2450
Other Income	237	322	425	450
Total Income	1798	2270	2576	2900
Interest Expenses	1102	1444	1730	1972
Operating Expenses	305	346	355	375
PBT	391	480	491	552
Tax	97	133	140	154
Provisions	52	81	70	85
Net Profit	242	266	281	313

Balance Sheet	FY 08	FY 09	FY 10E	FY 11E
Equity	121	121	121	121
Reserves	1259	1445	1632	1843
Deposits	17016	20333	23950	27500
Borrowings	142	4	100	150
Other Liabilities	817	979	1050	1125
Total Liabilities	19355	22882	26853	30739
Cash & Equivalent	1482	1365	1585	1725
Bal with Banks	139	96	112	135
Investments	6327	8961	9986	11114
Advances	10842	11810	14420	16950
Fixed Assets	120	138	150	165
Other Assets	445	512	600	650
Total Assets	19355	22882	26853	30739

Key Ratio	FY 08	FY 09	FY 10E	FY 11E
EPS Rs.	20.00	21.98	23.23	25.90
Div. Rs./Share	5.00	6.00	6.50	7.00
Div. Payout (%)	25.00	27.29	27.98	27.02
Market Cap (@ CMP 135)	1634	1634	1634	1634
M Cap/Sales	0.91	0.72	0.63	0.56

Key Ratio	FY 08	FY 09	FY 10E	FY 11E
Gross NPA (%)	3.5	3.66	3	3
Net NPA (%)	0.98	0.98	0.65	0.7
CAR (%)	12.18	13.48	14	13.5
Credit/Deposit (%)	63.72	58.08	60.21	61.64
CASA (%)	22	25	27	27

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