WAY2WEALTH
Your Personal Investment Guide

Quarterly Result Analysis

Karnataka Bank

Rs 112

8th November 2006

Hold

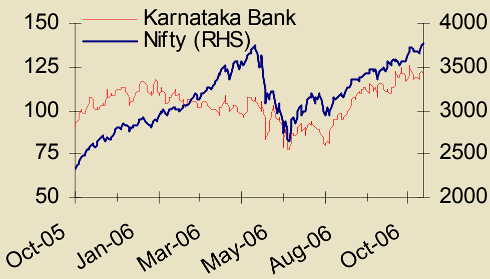
SCRIP DETAILS	
Market Cap (Rs crores)	1358.0
P/E (x)-FY07(E)	6.5
P/BV (x) –FY07(E)	1.1
P/ Adj BV (x) –FY07(E)	1.2
Dividend (Rs)/ Yield (%)	3/ 2.6
Equity Capital (Rs crores)	121.3
Face Value (Rs)	10.0
52 Week High/Low (Rs)	127/ 75

Website: www.karnatakabank.com

NSE Code	KTKBANK
Sensex	13,073
Nifty	3,777

(As on 30th June 2006)	
Promoters	-
Mutual Funds/ Banks/ FIs	6.9
FIIs	27.5
Others	5.2
Public	60.4

COMPARATIVE PRICE MOVEMENT



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Karnataka Bank reported good results for the quarter. Business growth remained decent, with advances and deposits growing by 20% and 11%, respectively. Net interest income moved up smartly, by 8.7%. However, on account of a rise in cost of funds, the Bank continued to witness pressure on the NIM, down 9 bps QoQ. Operating profits were up 13.4% YoY; however, a write-back in excess provisions, taken in the previous quarter, helped the net profit going up 42.6%, to Rs 59.6 crores from Rs 41.8 crores.

Subdued NII growth due to rise in interest cost: The interest income went up by 23%, to Rs 295 crores, on the back of a 32.5% rise in interest on advances, to Rs 118.6 crores, and a 10% growth in interest on investments, to Rs 101 crores. The strong growth in interest on advances was backed by a 20% loan growth and 50 bps YoY-improvement in yield on advances, to 9.11%. However, the interest expenses during the quarter went up by 25%, to Rs 205 crores from Rs 164 crores, resulting in NII growth of 18.7%, to Rs 90.6 crores from Rs 76.4 crores.

NIM continues to be under pressure: The Bank's yield on advances improved by 50 bps YoY, to 9.11% from 8.61%. However, on the flip side, the cost of deposits went up by 41 bps YoY and 16 bps QoQ, to 6.11%, and the yield on investments came down by 37 bps, to 7.57% from 7.94%. This downward repricing of yield on investments, together with rise in cost of deposits, resulted in a 9 bps decline in net interest margins, from 2.56% to 2.47%. Around 65% of Karnataka Bank's loans are advanced at the SUB PLR rates and, the hike in PLR rates, which the Bank had initiated during the quarter, is likely to result in further improvement in its yield on advances as the loans get repriced at better rates. Further, the Bank is now concentrating more on mobilising the low cost deposit, which would enable it in controlling the cost of deposits and backed by this strategy, the Bank is planning to improve its NIM to 2.75%, by FY07 end.

Modest business growth: The Bank witnessed decent business growth for the quarter. Advances grew 20% YoY, to Rs 8,100 crores from Rs 6,737 crores, while deposits were up by 11%, to Rs 12,671 crores from Rs 11,402 crores. The low cost current and savings deposits however had a higher growth and now accounted for 23% of the total deposits compared to 20% a year ago. Bulk deposits accounted for ~15% of the total deposits. The loan book is also well diversified across segments, with retail accounting for 35% and SMEs accounting for 23% of the total loans. Agriculture loans and exports credit from 11% each of the loan book. The credit deposits ratio has improved, to 63.9% from 59.1%, in the same period last year and 58.8% in FY06.

Lower provisions added to the rise in net profits: Staff costs were up 11% while other operating costs were up 23% and despite this, the operating profits were up by 13.4%, to Rs 74 crores. During Q1FY07 the Bank had taken additional provisions on account of investment depreciation and since the same was not required any more, the Bank wrote back Rs 16.3 crores during the quarter under consideration and hence, the PBT was up 45.5%, to Rs 90.4 crores, while PAT was up 42.6%, to Rs 59.6 crores.

Financials

In Rs crores	Q2FY07	Q2FY06	Chg (%)	H1FY07	H1FY06	Chg (%)	FY06
Interest income	295.31	240.08	23.0	581.01	480.7	20.9	1018.0
Interest expense	204.67	163.72	25.0	395.1	313.59	26.0	652.1
Net Interest Income	**90.6**	**76.4**	**18.7**	**185.9**	**167.1**	**11.2**	**366.0**
Other Income	48.7	45.2	7.8	93.6	92.9	0.7	166.8
Operating Profit	**74.1**	**65.3**	**13.4**	**162.2**	**153.3**	**5.8**	**328.3**
Provisions and contingencies	-16.3	3.2	-610.0	16.8	26.2	-35.8	59.2
PBT	90.4	62.1	45.5	145.4	127.1	14.4	269.1
Taxes	30.8	20.3	51.7	49.1	43.6	12.6	93.1
PAT	**59.6**	**41.8**	**42.6**	**96.3**	**83.5**	**15.4**	**176.0**
EPS (Rs.)	4.9	3.4	42.6	7.9	6.9	15.4	14.5
Advances	8100.0	6737.0	20.2	8100.0	6737.0	20.2	7791.6
Deposit	12671.0	11402.0	11.1	12671.0	11402.0	11.1	13243.2
CAR (%)	11.3	13.5		11.3	13.5		11.8
NIM (%)	2.47	2.62					
Yield on advances (%)	9.11	8.61					
Yield on investments (%)	7.57	7.94					
Cost of deposits (%)	6.11	5.70					

Valuation and Conclusion

Karnataka Bank reported good results for the quarter, on the back of decent business growth. The Bank's yield on advances reported improvement during Q2 and is expected to see further improvement in the quarters to come, as the PLR hikes initiated during the quarters would have full impact from Q3 onwards. Karnataka Bank is well advanced, in terms of technology, and 337 out of its 401 branches, accounting for 96% of the business, have been brought under core banking. In order to strengthen its presence further, the Bank is planning to add another 14 branches, mainly in the eastern region, by FY07. The Bank also intends to increase the number of ATMs to 125, from the current 84, which would help in accelerating business growth. The Bank is also well capitalised, with a CAR of 12.25%, to meet the current business growth. However, the investment book of the Bank is still largely exposed to mark-to-market hit, with 45% of the total investment in the AFS category, with average duration of 3.75 years and hence, the Bank may have to take hit if the bench mark yield moves up. At the CMP of Rs 112, the stock is trading at 6.5x its FY07 (E) EPS of Rs 17.3 and 1.1x and 1.2x its FY07 (E) BV and Adj BV of Rs 106 and Rs 98, respectively. On account of NIM pressure, the stock would remain range bound in the short to medium term; however, long-term term investors can continue to hold the stock.

WAY2WEALTH Research

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