

RESULT UPDATE

MID CAP

Share Data

Reuters code	KBNK.BO
Bloomberg code	NKBLIN
Market cap. (US\$ mn)	555
6M avg. daily turnover (US\$ mn)	7.1
Issued shares (mn)	134
Target price (Rs)	150

Performance (%) 1M 3M 12M

Absolute	5	5	31
Relative	1	(7)	12

Valuation ratios

Yr to 31 Mar	FY11E	FY12E
EPS (Rs)	12.8	16.7
+/- (%)	2.2	30.8
ABV (x)	135.8	146.2
+/- (%)	6.5	7.7
PER (x)	14.1	10.8
PBV (x)	1.3	1.2
Dividend/Yield (%)	2.4	2.8

Major shareholders (%)

FII's	32
MF's	5
BFST's	3
Public & Others	60

Financial highlights

(Rs mn)	2QFY10	2QFY11	YoY (%)	1HFY10	1HFY11	YoY (%)	FY10	FY11E	YoY (%)	FY12E	YoY (%)
Interest Earned	4,944	5,719	15.7	9,717	11,165	14.9	20,434	24,986	22.3	30,314	21.3
Interest Expended	4,390	4,328	(1.4)	8,697	8,579	(1.4)	17,078	19,377	13.5	23,535	21.5
Net Interest Income	554	1,391	151.0	1,020	2,586	153.6	3,356	5,609	67.1	6,779	20.9
Other Income	535	636	18.8	1,859	1,323	(28.9)	3,113	2,904	(6.7)	3,504	20.7
Total Income	5,479	6,355	16.0	11,576	12,488	7.9	23,547	27,889	18.4	33,818	21.3
Total Net Income	1,090	2,027	86.0	2,879	3,908	35.8	6,469	8,513	31.6	10,283	20.8
Staff Expenses	531	717	35.1	1,041	1,402	34.7	2,068	2,711	31.1	3,234	19.3
Other operating expenses	493	554	12.4	855	996	16.4	1,793	2,235	24.7	2,591	15.9
Operating Profit	66	756	1,041.8	983	1,511	53.7	2,608	3,567	36.7	4,458	25.0
Provision & Contingencies	52	577	1,000.8	227	718	215.9	711	1,431	101.3	1,311	(8.4)
Provision for tax	(150)	(108)	(27.7)	192	41	(78.7)	226	427	88.8	913	113.6
Reported Profit	164	287	75.7	564	752	33.3	1,671	1,709	2.2	2,234	30.8

Karnataka Bank

Maintain Underperformer

Price: Rs 180

BSE Index: 20,169

18 October 2010

2QFY11 Result – Margins expands, but high provisions spoil profit growth

Karnataka Bank (KBL) reported a strong NII growth of 151% YoY and 16.4% QoQ to Rs 1.4 bn ahead of our estimates of Rs 1.2 bn, led by margin expansion (up ~10 bps QoQ), strong loan growth (up 8.4% QoQ) and higher C-D ratio of 62.6% (60.4% in 1QFY11). However, higher provisioning costs (credit costs ~Rs 345 mn and MTM on investment book ~Rs 180 mn) led to sharply lower than expected profit, which grew by 75.7% YoY (down 38.2% QoQ) to Rs 287 mn against our estimates of Rs 398 mn.

- **Loan growth picks up, margins expand:** Loan growth picked up impressively with 25.6% YoY and 8.4% QoQ to Rs 156.8 bn and the bank consciously improving its C-D ratio to 62.6% coupled with healthy CASA deposit growth (11% QoQ and 32% YoY) led to improvement in NIMs to reach 2% (up ~10 bps QoQ).
- **Asset quality remains steady QoQ:** Gross NPAs increased by 3.4% QoQ and the slippages ratio was stable QoQ. Bank continues to improve its NPA coverage up at 70.6% (69.7% in 1QFY11), thereby fulfilling regulatory requirements.
- **Rights issue in the near-term to improve CAR:** Board has proposed for a rights issue in the ratio of 2:5, in order to strengthen its capitalisation base to meet its future growth. Rights issue is likely in 3QFY11E. As on 2QFY11-end, the bank has total CAR of 11.7%.

Outlook

KBL has shown strong core business performance in terms of improving loan growth and NIMs in 1HFY11; however, higher provisioning costs and high restructured loans (~10% of loans) will continue to pose challenge for the bank's turnaround efforts. We have revised our NIMs estimates upwards to ~1.9-2% for FY11-12E (earlier 1.7-1.8%), however, higher operating and provisioning costs will off-sets the NIM benefit. We have revised our earnings estimates downward by 9% each in FY11-12E. We continue to maintain our Underperformer rating on the stock despite stock's inexpensive valuations given the bank's weak deposit franchisee and low return profile.

Income Statement

Yr end 31 Mar (Rs mn)	FY09	FY10	FY11E	FY12E
Interest income	19,801	20,434	24,986	30,314
Interest expense	(14,438)	(17,078)	(19,377)	(23,535)
Net interest income	5,363	3,356	5,609	6,779
<i>Growth (%)</i>	<i>16.9</i>	<i>(37.4)</i>	<i>67.1</i>	<i>20.9</i>
Non-interest income	3,218	3,113	2,904	3,504
Operating income	8,581	6,469	8,513	10,283
Operating expenses	(3,465)	(3,861)	(4,946)	(5,825)
- Staff expenses	(1,904)	(2,068)	(2,711)	(3,234)
Pre-provisions profit	5,116	2,608	3,567	4,458
Core operating profit	3,523	1,461	3,108	3,953
<i>Growth (%)</i>	<i>12.8</i>	<i>(58.5)</i>	<i>112.7</i>	<i>27.2</i>
Provisions & Contingencies	(805)	(711)	(1,431)	(1,311)
Pre-tax profit	4,311	1,898	2,136	3,147
(before non-recurring items)				
Pre-tax profit (after non-recurring items)	4,311	1,898	2,136	3,147
Tax (current + deferred)	(1,330)	(226)	(427)	(913)
Net profit	2,981	1,671	1,709	2,234
Adjusted net profit	2,981	1,671	1,709	2,234
<i>Growth (%)</i>	<i>23.3</i>	<i>(43.9)</i>	<i>2.2</i>	<i>30.8</i>
Net income	2,981	1,671	1,709	2,234

Balance Sheet

Yr end 31 Mar (Rs mn)	FY09	FY10	FY11E	FY12E
Cash and balance with RBI/Banks	14,607	18,056	23,504	27,995
Investments	89,615	99,921	107,342	117,802
Advances	118,100	144,357	175,926	214,639
Interest earning assets	222,323	262,333	306,771	360,436
Fixed assets (Net block)	1,385	1,481	1,557	1,619
Other assets	4,870	6,538	7,863	11,228
Total assets	228,578	270,352	316,191	373,282
Deposits	203,333	237,307	279,362	333,561
Other interest bearing liab.	3,540	6,916	7,266	7,844
Total Interest bearing liab.	212,908	252,024	296,821	352,462
Other liabilities and prov.	6,035	7,801	10,193	11,057
Share capital	1,216	1,340	1,340	1,340
Reserves & surplus	14,454	16,987	18,030	19,480
Shareholders' funds	15,670	18,327	19,370	20,820
Total equity & liabilities	228,578	270,352	316,191	373,282

Key Ratios

Yr end 31 Mar	FY09	FY10	FY11E	FY12E
Valuation ratios (Rs)				
Adjusted EPS	24.5	12.5	12.8	16.7
BVPS	133.4	142.2	151.4	163.4
Adjusted Book NAV/share	123.1	127.5	135.8	146.2
PER (x)	7.3	14.4	14.1	10.8
Price/Book (x)	1.3	1.3	1.2	1.1
Price/Adjusted book (x)	1.5	1.4	1.3	1.2
Dividend Yield (%)	3.3	2.2	2.4	2.8
Du-Pont ratios (%)				
NII/Avg. Assets	2.5	1.3	1.9	2.0
Non-interest income/Avg Assets	1.5	1.2	1.0	1.0
- Fee income / Avg Assets	0.6	0.6	0.6	0.7
- Trading gains / Avg Assets	0.8	0.5	0.2	0.1
Cost / Avg Assets	1.6	1.5	1.7	1.7
Non-tax Provisions / Avg Assets	0.4	0.3	0.5	0.4
Tax Provisions / Avg Assets	0.6	0.1	0.1	0.3
RoA (%)	1.4	0.7	0.6	0.6
Leverage	14.3	14.7	15.6	17.2
RoE (%)	19.5	9.5	8.7	10.6
Balance Sheet ratios (%)				
Loan growth	8.9	22.2	21.9	22.0
Deposit growth	19.5	16.7	17.7	19.4
Loans/Deposits	58.1	60.8	63.0	64.3
Investments/Deposits	44.1	42.1	38.4	35.3
CASA ratio	19.9	23.3	25.7	26.6
Profitability ratios (%)				
NIMs	2.6	1.4	2.0	2.0
Interest spread	2.1	0.9	1.5	1.6
Yield on advances	12.6	10.7	11.0	11.4
Cost of deposits	7.5	7.5	7.3	7.4
Efficiency/other P/L ratios (%)				
Non-interest income/Net income	37.5	48.1	34.1	34.1
Trading income/Net income	18.6	17.7	5.4	4.9
Cost/Income	40.4	59.7	58.1	56.6
Asset quality ratios (%)				
Gross NPLs	3.6	3.7	3.5	3.4
Net NPLs	0.9	1.3	1.0	0.9
Net NPLs/Net worth	6.6	9.9	8.8	8.5
Loan provisions/Avg loans	0.4	0.7	0.8	0.7
Provisions cover	75.9	65.7	72.0	75.0
Capitalisation ratios (%)				
Tier I cap.adequacy	10.7	10.0	8.7	8.0
Total cap.adequacy	13.5	12.4	12.2	12.5

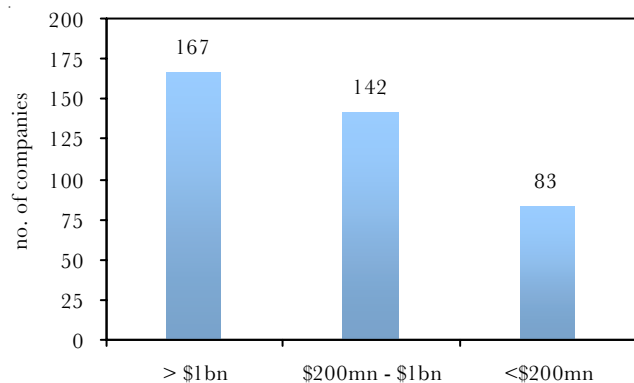
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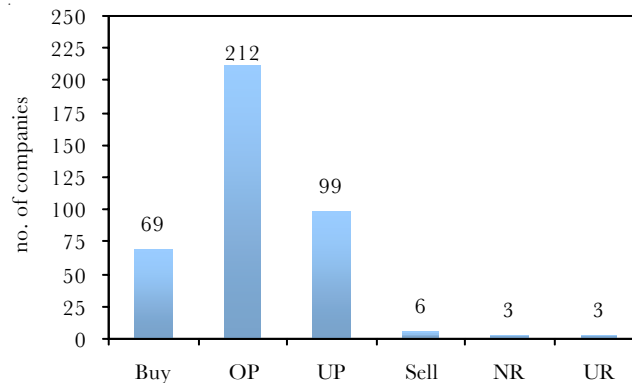
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B&K Universe Profile

By Market Cap (US\$ mn)



By Recommendation



B&K Securities is the trading name of Batlivala & Karani Securities India Pvt. Ltd.

B&K Investment Ratings:

1. **BUY:** Potential upside of > +25% (absolute returns)
2. **OUTPERFORMER:** 0 to +25%
3. **UNDERPERFORMER:** 0 to -25%
4. **SELL:** Potential downside of < -25% (absolute returns)

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