

September 30th, 2011

KARNATAKA BANK LTD.

BUY

Karnataka Bank Ltd. (KBL), a premier private sector bank, is a leading 'A' Class Scheduled Commercial Bank in India

- Dominant player in the southern state:** - Out of the total 478 branches as on March 31st 2011, KBL has over 370 branches on the southern state. The bank has leveraged upon its strong presence in southern state. Its advances have grown at a CAGR of 17% over last 4 years from Rs 108bn in FY08 to Rs 173bn in FY11.
- Acquired 15% stake in Universal Somp General Insurance Ltd.:** - In the absence of any strategic relationship with other players, the fee based income has remained the concern for the bank. However, recently the bank has acquired 15% stake in one of the largest firm, Universal Somp General Insurance Ltd. We believe this investment to be earning accretive.
- Increasing branch network:** - KBL has been leveraging on its branch reach over last few years. No. of branches have increased from 398 in FY06 to 478 branches in FY11. Increasing branch network has helped the bank to garner more business growth. The deposit per branch has increased from Rs335mn to Rs 572mn.
- Improvement in CASA profile:** - Increasing branch has not only helped to garner more business, but also has improved deposit franchise of the bank. Share of low cost CASA deposit has grown from below 20% during FY06 to 24% by FY11.
- Improvement in NIM:** - Improvement in deposit franchise is evident from increasing margin. NIM has improved from 1.11% in FY10 to 2.15% in FY11. However, going forward on account of higher cost of funds and likely slowdown in advance growth, the margins may come under pressure.

Based on standalone FY13 P/ABV multiple of 0.80, the fair value for the company works out to be Rs 105/share.

Financial Snapshot (Standalone)

Projections (Rs Mn)	FY2009	FY2010	FY2011	FY2012E	FY2013E
Interest income	19,174	19,760	23,708	33,313	37,682
% growth		3%	20%	41%	13%
Other Income	3,532	3,787	2,918	3,331	3,391
% growth		7%	-23%	14%	2%
Total income	22,706	23,547	26,626	36,645	41,074
% growth		4%	13%	38%	12%
Operating expenditure	3,465	3,860	5,490	6,346	7,146
% growth		11%	42%	16%	13%
Provisions & contingencies	2,135	937	1,507	2,168	2,120
% growth		-56%	61%	44%	-2%
Net income	2667	1671	2046	2772	2838
EPS	22	12	11	15	15
BVPS	129	137	129	140	150
ABVPS	120	123	114	123	131
ROE	19.33%	10.66%	11.16%	11.41%	10.80%
ROA	1.17%	0.62%	0.65%	0.78%	0.71%
P/E				5.74	5.60
Price/ BV				0.61	0.56
Price/ ABV				0.69	0.64

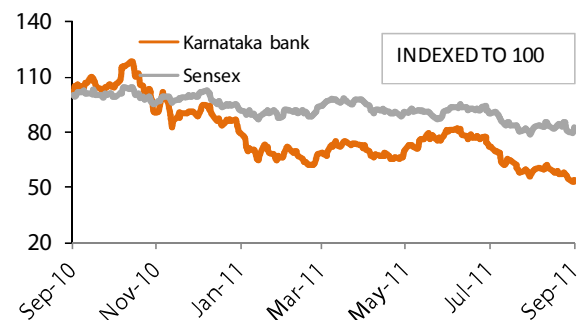
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Recommendations	<= 1 year	1 - 2 yrs	2 - 5 yrs
Strong Buy			
Buy			
Hold			
Reduce			
Sell			

Strong Buy - Expected Returns > 20% p.a.
Buy - Expected Returns from 10 to 20% p.a.
Hold - Expected Returns from 0% to 10% p.a.
Reduce - Expected Returns from 0% to 10% p.a. with possible downside risk
Sell - Returns < 0%



STOCK DATA				
BSE / NSE Code	532652 / KTKBANK			
Bloomberg Code	KBL IN EQUITY			
No. of Shares (Mn)	188			
Sensex / Nifty	16697.25 / 5014.80			
PRICE DATA				
CMP Rs (29th Sept. 2011)	84.5			
Beta	1.22			
Market Cap (Rs mn)	15903			
52 Week High-Low	192.51/ 83			
Average Daily Volume	207,619			
STOCK RETURN (%)				
	30D	3M	6M	1Y
Karnataka bank	-6%	-34%	-23%	-47%
Sensex	3.8%	-11.1%	-13.2%	-18.2%
Nifty	4.2%	-10.8%	-13.0%	-18.0%
SHARE HOLDING PATTERN (%)				
Promoters	0.0			
Institutional	31.6			
Non Institutional	68.4			
Total	100.0			
1 Year Price Performance (Rel. to Sensex)				



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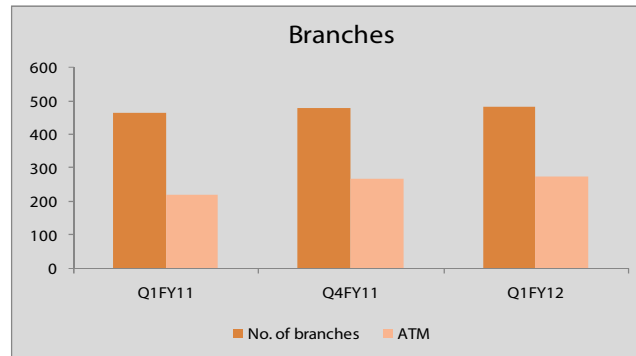
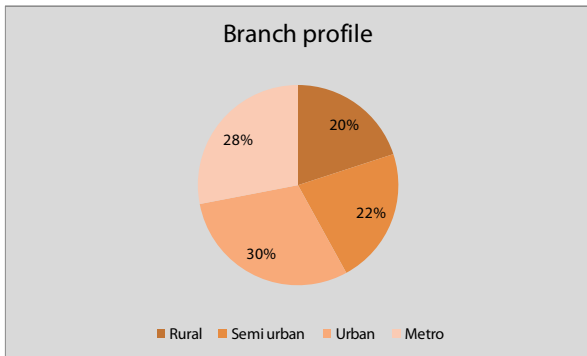
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BUSINESS PROFILE

Karnataka Bank Ltd, a premier private sector bank, is a leading 'A' Class Scheduled Commercial Bank in India. The Bank offers a total value package, a one-stop shop for all the banking needs. They provide working capital finance, term loans and infrastructure finance to help the business grow. The Bank operates in four business segments, namely treasury, corporate and wholesale banking, retail banking and other banking operations. The Bank was promoted by B R Vysarayachar and other leading members of the south kanara region. Under the guidance of K S N Adiga, the second chairman of the Bank who held the post for a period of 21 years, the bank made significant progress thereby providing a strong foundation and as a result grew in stature in terms of number of branches, deposits, advances etc.

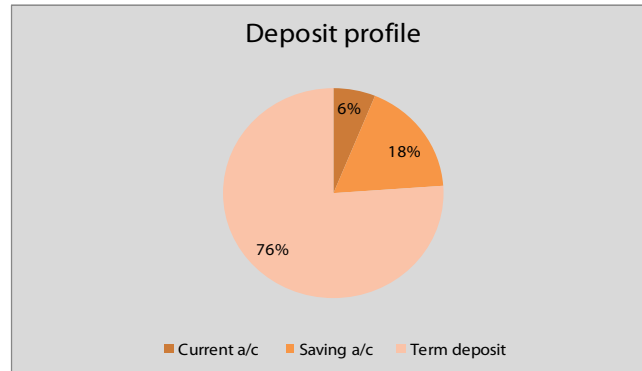
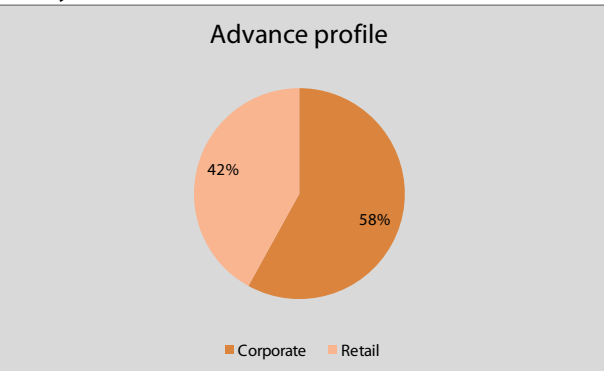
Diversified branch network



Planning to take branch network to over 600 by FY13

The branch network of the bank is evenly distributed around the southern region. Rural branches constitute 20% of the total branches while semi urban, urban and metro branches constitutes 22%, 30% & 28% respectively. Network in the rural and semi urban areas is likely to improve CASA share. In terms of branch network, it has marginally improved since Q1FY11. However, the bank has stated that it plans to take total number of branches to more than 600 by FY13.

Advances are concentrated around corporate and retail sector

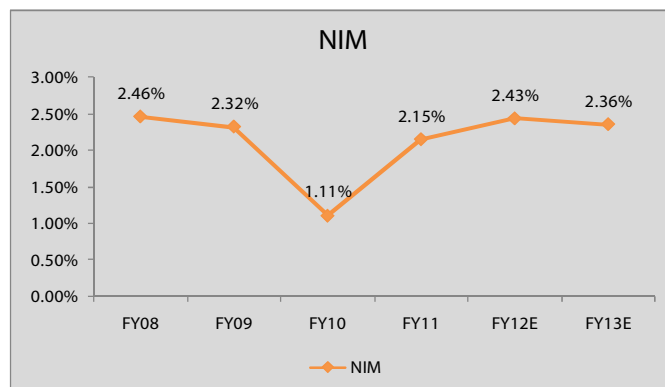


CASA ratio stood at 24% by FY11

In terms of the advances, it is mainly concentrated around corporate lending and retail lending which constitutes 58% and 42% respectively. Corporate lending caters to high profile corporate clients as well as growing SME sector while retail portfolio has exposure towards home loans, vehicle loans etc. The advance portfolio is largely concentrated at a maturity of around 3 years, which implies frequent repricing of loan portfolio. With respect to deposit profile, term deposit constitutes 76% of it while; CASA accounts constitute the rest 24%.

BUSINESS PERFORMANCE

Particulars (Rs bn)	FY08	FY09	FY10	FY11
No of branches	431	447	464	478
Total deposits	170	203	237	273
CASA Share	38	41	55	68
CASA share(%)	22%	20%	23%	25%
CASA per branch	0.09	0.09	0.12	0.14



CASA share has improved during previous years

Share of low cost current account and saving account deposit in total deposit remained one of the concerns for the bank. It stood at below 20% during FY05 as against average public sector bank of close to 30%. However, since then the bank has been expanding its branch network. Number of branches has increased from around 370 in FY05 to 478 till FY11. Increasing the branch network augured well for the bank in terms of increasing CASA share which increased by 300bps from 22% in FY08 to 25% in FY11. Attractive saving product policies and targeting SME players for their working capital needs helped the bank to increase the share of CASA during the same period. Further, CASA share per branch also increased from Rs 0.09bn in FY08 to Rs 0.14bn in FY11.

Improvement in CASA profile is likely to drive margin improvement

Improvement in CASA share drove improvement in NIM, which increased from 1.11% in FY10 to 2.15% in FY11. With the increase in CASA profile, the bank could curtail its cost of deposits which declined by 94bps from 7.54% in FY10 to 6.60% in FY11. However, going forward, pressures are likely to mount on cost of deposits on account of 50bps increase in saving rates and around 100bps increase across other deposit maturities. Nevertheless, we believe that short term advance profile (around 50% of the advances are extended for 1 to 3years period) is likely to allow frequent repricing of the advances. This will enable the bank to maintain NIM.

Acquired 15% stake in Universal Somp General Insurance

KBL recently acquired 15% stake in one of the leading insurance company, Universal Somp General Insurance Ltd. Before this, the bank was not involved with any insurance business. We believe that, such investment will result in accretion in EPS in the near future as such alliance is likely to boost fee based income of the bank. However, given an introductory stage of the bank in insurance business and likely competition in the industry, is likely to prolong the benefits out of this business.

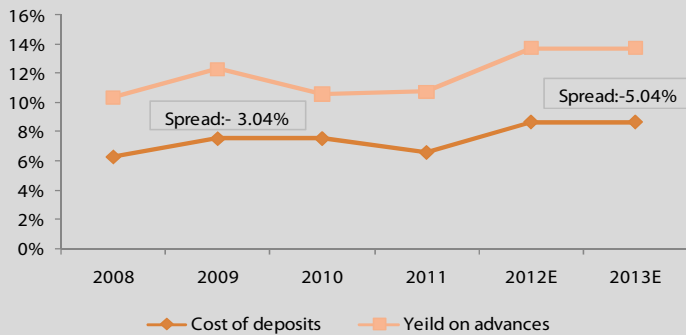
Bank is likely to benefit from improving CASA profile

Improvement in CASA profile is likely to drive margin improvement

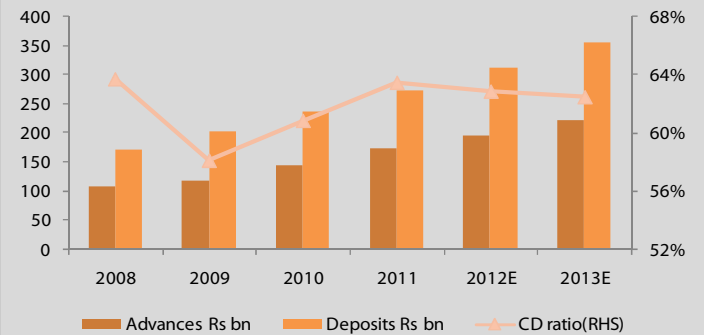
Foray into insurance sector is likely to boost fee based income

BUSINESS PERFORMANCE CONTD.

Spread analysis



Advance - Deposit



Spread is likely to widen

Spread between yield on funds and cost of funds is expected to widen from 3.04% in FY10 to 5.04% in FY12 as full transmission of monetary policy measures is yet to be seen. Increase in base rate is likely to result in yield on funds rising faster than relative cost of funds.

Advances of the bank have grown at a CAGR of 17% over last 4 years from Rs 108bn in FY08 to Rs173bn in FY11. Credit to deposit ratio also remained stable at around 62% over the same period. In the wake of rising yield on advances and stubbornly higher inflationary scenario, we believe that advance growth may take a hit during FY12 and FY13. We have thus pegged the advance growth to be 13% and 14% over the same period. On one hand, the increase in yield on funds is likely to protect NIM; slower than expected advance growth may negate this benefit.

Spreads are likely to widen on account of rising yield on advances

Peer comparison:

Peer Group Comparison

Companies Rs bn	Total income	NIM	NP margin	P/ E (x)	P/B (x)
Karnataka Bank	27	2%	8%	7.66	0.65
Lakshmi Vilas Bank	12	3%	8%	9.76	1.17
DCB	6	3%	3%	41.78	1.59

* FY11 figures

Improvement in CASA share and NIM makes the bank attractive than peers

We are comparing Karnataka Bank with other 2 banks, Lakshmi Vilas Bank and Development Credit Bank. In terms of NIM although the peer firms outperformed Karnataka bank, NIM of Karnataka Bank has improved by 104 bps from 1.11% in FY10 to 2.15% in FY11, whereas NIM of LVB has fallen for the same period. In terms of profitability, DCB reported positive bottom line after 8 consecutive negative bottom-line. Hence we believe that considering the stable business model and likely improvement in NIM, Karnataka bank may perform better than its peers.



September 30th, 2011

VALUATION

We estimate that the company's NII will increase at a CAGR of 19.27% over FY11-13 to Rs 8.71bn and PAT to grow at CAGR of 17.78% over the same period to Rs 2.83bn.

Based on standalone FY13 P/ABV multiple of 0.80, the fair value for the company works out to be Rs 105/share.

We recommend a "BUY" rating on the stock.

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Financial Analysis and Projections (Standalone)

Particulars (Rs Mn)	FY2009	FY2010	FY2011	FY2012E	FY2013E
Interest income	19,174	19,760	23,708	33,313	37,682
other income	3,532	3,787	2,918	3,331	3,391
Total income	22,706	23,547	26,626	36,645	41,074
interest expended	14,438	17,078	17,584	25,359	28,969
NII	4,736	2,682	6,125	7,954	8,713
Operating income	8,267	6,469	9,042	11,286	12,105
Operating expenditure	3,465	3,860	5,490	6,346	7,146
PPP	4,802	2,608	3,553	4,940	4,959
Provisions & contingencies	2,135	937	1,507	2,168	2,120
Net income	2,667	1,671	2,046	2,772	2,838
ROE	19%	11%	11%	11%	11%
ROA	1.17%	0.62%	0.65%	0.78%	0.71%
EPS	21.94	12.47	10.87	14.73	15.08
BVPS.	128.88	136.79	129.07	139.67	150.41
ABVPS	120.13	122.71	114.03	122.70	131.10
Valuation Ratios (x)				FY2012E	FY2013E
P/E				5.74	5.60
Price/ BV				0.61	0.56
Price/ ABV				0.69	0.64

Key working ratios

Particulars	FY2011	FY2012E	FY2013E
Interest income as % of AWF*	8.08%	9.92%	9.96%
Other income as % of AWF*	0.99%	0.99%	0.90%
Cost to income ratio	60.71%	56.23%	59.03%
Advance growth	20.17%	12.83%	13.81%
Deposit growth	15.19%	13.91%	14.52%
Cost of deposits	6.60%	8.67%	8.67%
Yield on funds	10.75%	13.70%	13.70%
Spread	4.15%	5.03%	5.03%
NIM	2.15%	2.43%	2.36%
Yield on investments	5.97%	6.37%	6.26%
% of NPA to net advances	1.63%	1.63%	1.63%
Provisions as a % of GNPA	46.52%	44.54%	44.54%

*AWF is average total assets

Balance Sheet

Particulars (Rs Mn)	FY2009	FY2010	FY2011	FY2012E	FY2013E
Source of funds					
Capital	1,216	1,340	1,882	1,882	1,882
Reserves & Surplus	14,454	16,988	22,409	24,404	26,425
Total Shareholders Funds	15,670	18,327	24,291	26,286	28,307
Deposits	203,333	237,306	273,364	311,390	356,608
Borrowings	40	6,916	10,863	8,455	8,455
Other Liabilities and Provisions	9,535	7,665	8,411	8,408	8,505
TOTAL LIABILITIES	228,578	270,216	316,930	354,538	401,875
Application of funds					
Cash and balances with RBI	13,650	17,431	19,398	18,683	21,396
Balances with Banks and Money at Call	958	625	463	1,340	1,189
Investments	89,615	99,920	115,063	131,104	149,862
Advances	118,100	144,357	173,481	195,745	222,778
Fixed Assets	1,385	1,481	1,455	1,495	1,581
Other Assets	19,478	24,458	26,931	26,194	27,655
TOTAL ASSETS	228,578	270,216	316,930	354,538	401,875



September 30th, 2011

Board Of Directors

Director Name	Current Position	Description
Shri Ananthkrishna	Part Time Non-Executive Chairman of the Board	Shri. Ananthkrishna serves as Part Time Non-Executive Chairman of the Board of Karnataka Bank Ltd. He holds M.Sc from University of Mysore. He has more than 38 years experience in Banking industry. He was the Chairman of the Board, Chief Executive Officer of the Bank. He is a Director on the Board of Indian: Institute of Banking and Finance (IIBF).
P. Jayarama Bhat	Chief Executive Officer, Managing Director, Whole Time Director	Shri. P. Jayarama Bhat serves as Chief Executive Officer, Managing Director, Whole Time Director of Karnataka Bank Ltd. He is a post graduate in Science from University of Mysore. He is a Certified Associate of Indian Institute of Bankers (CAIIB). He has banking experience of over 36 years. He joined the Bank as an Officer in the year 1973 and over the period of time promoted to various positions. In the year 2005, he was promoted as Chief General Manager of the Bank and has been entrusted with the responsibilities of overall supervision of operational areas like Credit Administration, Planning and Development, Investments, Information Technology, Treasury transactions, Money Market Operations, HR&R etc. He has rich experience in all the facets of Banking operations. Besides, Shri. P. Jayarama Bhat was the Director on the Board of Bharat Overseas Bank Ltd as a representative of the Bank for a period of 6 years until it was taken over by Indian Overseas Bank.
T. Chandrasekaran	Additional Director	Shri. T. R. Chandrasekaran has been appointed as Additional Director of The Karnataka Bank Limited with effect from October 15, 2010. He is a Chartered Accountant, Partner, M/s M C Ranganathan & Co., Chartered Accountant.
U. Bhat	Independent Director	Shri. U. R. Bhat serves as Independent Director of Karnataka Bank Ltd. He is one of India's investment advisors and is presently Managing Director of Dalton Capital Advisors (India) Pvt.Ltd., an investment advisory company of the Dalton group, London - a global investment management firm - of which he is a partner. Prior to this, he was the Chief Investment Officer of Jardine Fleming in India - that later became JP Morgan, India - for 7 years advising the India dedicated funds of the Flemings group. He holds an M.Sc. from Indian Institute of Technology, Kanpur and has attended advanced courses on Finance at the Harvard Business School, Boston. He is a Fellow of the Chartered Institute of Bankers, London. He has been writing a monthly editorial column for the last several years in the Economic Times, the world's second financial daily. He has been involved in formulating policies for benchmark indices for the Stock Exchange, Mumbai as a member of its Index Committee.
S. Hegde	Independent Director	Shri. S. R. Hegde serves as Independent Director of Karnataka Bank Ltd. He holds B.A. LL.M degrees from Karnataka University. He joined the Reserve Bank of India in the year 1974 as a Legal Officer. He was holding the position of Legal Adviser-in-Charge, Legal Division DNBS before his retirement in the year 2002. At present he is practicing as an Advocate in Bangalore besides being a Panel Advocate and Retainer for several Banks and National level institutions. He is also an independent trustee for Mutual Funds.
D. Harshendra Kumar	Independent Director	Shri. D. Harshendra Kumar serves as Independent Director of Karnataka Bank Ltd. He holds B.A., is on the Board of the Bank since 25.10.2008. He is the Secretary, Rural Development , Self Employment Training Institute , having branches all over India, Trustee Sri Dharmasthala Munjunatheshwara Trust, Dharmasthala and Secretary, SDM Educational Institutions, member, Council for Advancement of People's and Rural Technology(CAPART). He was earlier on the Board of the Bank between 1992 and 2000.
S. Manjunath	Independent Director	Shri. S. V. Manjunath serves as Independent of Karnataka Bank Ltd. He holds B.Sc., is on the Board of the Bank since 25.10.2008. He is an agriculturist. Earlier he had worked as Director of Co-operative Union and as president PCARD Bank and has experience of functioning of these Institutions. He was earlier on the Board of the Bank between 1992 and 2000.
Sitarama Murty M.	Independent Director	Shri. Sitarama Murty M. serves as Independent of Karnataka Bank Ltd. He holds B.Sc.(Hons), M.Sc.(Electronics) and CAIIB joined the Board of the Bank on 30.11.2007. He has over 37 years banking experience in five banks of the State Bank Group including 9 years at the Management level and as Managing Director of State Bank of Mysore, during the period October 2000 to December 2003. He was on the Board of Haryana Vidyut Prasaran Nigam, Chandigarh from 1998 to 2000, when the power sector reforms were put through. He has experience in international banking, foreign exchange and money markets, funds management etc. and served with distinction in these fields, at SBI, Paris, during the economic crisis years 1990 to 1993.
H. Ramamohan	Independent Director	Dr. H. Ramamohan serves as Independent Director of Karnataka Bank Ltd. Dr. H. Ramamohan holds MBBS, FCGP, FIAMS, DMag is on the Board of the Bank since 25.10.2008. He is in private practice as family Physician in Kundapura, Udipi District. He is a member of Govt. of Karnataka Sustainable Forest maintenance and bio-diversity preservation committee for Mangalore circle, a programme of Japan Bank of International Cooperation (JBIC). He is also the Chairman, IMA Academy of Medical Specialities, Kundapur Chapter, President, Amateur Artists' Association, Trustee, Seva Sangam Trust, Managing 20 Kindergarten schools, Treasurer, Seva Sangam Vidya Kendra, Thekkatte- A primary and High school, Treasurer, Coondapur Education Society-managing English medium school and PU college, Advisory Committee member, KMC Hospital, Manipal, Member of the Supreme governing body of the Academy of General Education, Manipal, Member, Quality Assessment and advisory committee, Bhandarkar's College, Kundapura, Vice President, Flora and Fauna Club (a nature club).
R. Shastri	Independent Director	Shri. R. V. Shastri serves as Independent Director of Karnataka Bank Ltd. He is former Chairman and Managing Director of Canara Bank and Indian Overseas Bank, joined the Board of the Bank on 28.01.2006. He has over 36 years Banking experience. He was holding a number of representative positions, prominent among them being Deputy Chairman- Indian Banks' Association, President - IBA Local Chapter, Bangalore, Advisor - Bankers Training College (RBI), etc. He was the Chairman of the Canara Bank's subsidiaries/sponsored entities of the Bank , viz, CanBank Venture Capital Fund Limited, Canbank Factors Ltd, Canbank Computer Services Ltd, Gilt Securities Trading Corporation Ltd, Indo Hong Kong International Finance Ltd, Hong Kong. At present Shri. R.V. Shastri is a Director on the Board of National Housing Bank, Nagarjuna Construction Company Ltd and Lotus India Trustee Company Pvt Ltd.
T. Vishwanath	Independent Director	Shri. T. S. Vishwanath serves as Independent Non-Executive Director of Karnataka Bank Ltd. He is a Bachelor of Commerce (Honours) from the Delhi University and a Fellow Member of The Institute of Chartered Accountants of India. He is a distinguished Alumni Awardee - Shiram College of Commerce - Delhi University - 1996. He is also on the Boards of M/s LIC Mutual Fund Asset Management Company Ltd. and M/s Mangalam Cement Ltd. His association with professional/public appointments include - Chair, India Side, Indo-UK Accountancy Taskforce - Current; Member on the Board of International Accounting Standards Committee from 1998 till October 2000; President, South Asian Federation of Accountants - 1999; Chairman, Vision for SAFA Committee - since 2004; President, The Institute of Chartered Accountants of India - 1996-97; Chairman, Northern India Regional Council of The Institute of Chartered Accountants of India - 1980-81.