

6 February 2013

Karur Vysya Bank

Prudent credit growth, improving NIM; Buy

Key takeaways

Prudent credit growth; NIM improves. Karur Vysya Bank (KVB) continues to register higher credit growth (22.6%) than the system, driven by retail and agri segments. This, however, has been modest compared to its own, over 25%, growth in the last 10 quarters, given the challenging macro-environment. We expect the bank to register a healthy business CAGR of 25% over FY12-15, led by SME and retail loans. Reported NIM improved 14bps qoq on the higher credit-deposit ratio of 77% (up 110bps qoq). We expect NIM of over 3%, aided by high credit-deposit and a greater proportion of CASA (23%) over FY13-15.

Branch expansion continues; treasury augments profits. The bank continues to invest in its branch network, which increased to 515 (up 18.9% yoy), which led to sharp, 790bps yoy, jump in core-cost income, to 50.4%. We expect cost-assets to improve to 1.6%, by FY15 (from 1.8% in FY13) as the bank leverages its huge investments. Non-interest income grew a subdued 18% yoy, led by a 92% yoy jump in treasury profits.

Asset quality slips on one-offs, outlook better. Gross NPA increased 9.4% qoq, with fresh slippages of ₹1.5bn (2.1% of loans), a result of the bank classifying one large account as NPA. While restructured advances grew 27% qoq, to ₹3.3bn, at 3.3% of loans, it is better than some of its peers. Management expects asset quality to improve, given the quality of the portfolio and healthy underwriting standards. Capital adequacy with CRAR of 13.4% (tier 1 of 12.3%) suffices to protect against incremental delinquencies.

Our take. Healthy business growth, better productivity and stable asset quality could provide the impetus for high RoA of 1.4% and RoE of above 20% over FY13-15. We reiterate a Buy. At our Mar'14 target, the stock would trade at PBV of 1.7x FY14e and 1.5x FY15e. Our price target is based on the two-stage DDM (CoE: 13%; beta: 0.6; Rf: 8%). **Risks.** Slower credit growth, sharp rise in defaults.

Quarterly results (YE: Mar)	3QFY12	3QFY13	% yoy	9MFY12	9MFY13	% yoy
Net interest income (₹m)	2,347	3,084	31.4	6,379	8,482	33.0
Non-interest income (₹m)	894	1,055	17.9	2,236	2,948	31.8
Operating expenses (₹m)	1,344	2,019	50.3	3,810	5,339	40.2
Cost-to-income (%)	41.5	48.8	732bps	44.2	46.7	250bps
Pre-provisioning profit (₹m)	1,897	2,120	11.7	4,806	6,090	26.7
Provisions (₹m)	360	652	81.1	642	346	(46.1)
PBT (₹m)	1,537	1,468	(4.5)	4,164	5,743	37.9
Tax (₹m)	288	337	17.2	731	1,826	149.8
PAT (₹m)	1,249	1,130	(9.5)	3,433	3,917	14.1
EPS (₹)	11.7	10.5	(9.5)	36.3	36.5	0.6

Source: Company, Anand Rathi Research

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Rating: **Buy**

Target Price: ₹574

Share Price: ₹506

Key data	KVB IN / KARU.BO
52-week high / low	₹592/ ₹352
Sensex / Nifty	19660 / 5957
3-m average volume	US\$1.7m
Market cap	₹55bn / US1.03m
Shares outstanding	107.2m

Shareholding pattern (%)	Dec '12	Sep '12	Jun '12
Promoters	3.1	3.1	3.2
- of which, Pledged	-	-	-
Free Float	96.9	96.9	96.8
- Foreign Institutions	28.6	28.5	28.5
- Domestic Institutions	10.9	10.9	10.7
- Public	57.4	57.5	57.6

Estimates revision (%)	FY13e	FY14e	FY15e
NII	(1.0)	-	-
PAT	(4.7)	-	-
EPS	(4.7)	-	-
RoE (bps)	(86)-	-	-

Financials (YE: Mar)	FY13e	FY14e
Net interest income (₹m)	12,013	15,764
Net profit (₹m)	5,562	7,483
EPS (₹)	51.9	69.8
Growth (%)	17.7	58.8
PE (x)	9.8	7.3
PABV (x)	1.8	1.5
RoE (%)	19.3	22.4
RoA (%)	1.3	1.47
Dividend yield (%)	3.6	3.7
Net NPA (%)	0.3	0.3

Source: Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Net interest income	7,669	9,171	12,013	15,764	19,756
NII growth (%)	35.8	19.6	31.0	31.2	25.3
Non-interest inc	2,643	3,502	4,302	5,230	6,320
Total income	10,312	12,673	16,314	20,994	26,075
Total Inc growth (%)	27.0	22.9	28.7	28.7	24.2
Op. expenses	4,306	5,416	7,423	8,755	10,691
Operating profit	6,006	7,257	8,891	12,240	15,384
Op profit growth (%)	29.7	20.8	22.5	37.7	25.7
Provisions	393	938	945	1,700	2,222
PBT	5,613	6,320	7,946	10,540	13,162
Tax	1,457	1,302	2,384	3,057	3,817
PAT	4,156	5,017	5,562	7,483	9,345
PAT growth (%)	23.7	20.7	10.9	34.5	24.9
FDEPS (₹/share)	44.0	46.8	51.9	69.8	87.2
DPS (₹/share)	13.6	14.0	15.0	15.5	16.0

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Share capital	945	1,072	1,072	1,072	1,072
Reserves & surplus	20,426	26,010	29,553	35,106	42,458
Deposits	247,219	321,116	395,960	501,638	635,638
Borrowings	13,757	28,151	26,304	27,783	31,038
Minority interests	-	-	-	-	-
Total liabilities	282,346	376,349	452,888	565,599	710,205
Advances	178,145	239,492	296,970	371,212	464,016
Investments	77,318	105,061	120,768	150,492	190,691
Cash & bank bal	17,745	20,355	22,016	28,058	36,323
Fixed & other assets	9,139	11,442	13,134	15,837	19,176
Total assets	282,346	376,349	452,888	565,599	710,205
No. of shares (m)	94	107	107	107	107
Deposits growth (%)	28.3	29.9	23.3	26.7	26.7
Advances growth (%)	32.0	34.4	24.0	25.0	25.0

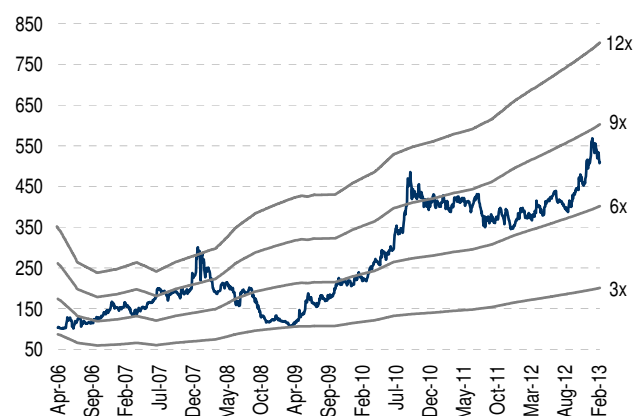
Source: Company, Anand Rathi Research

Fig 3 – Key ratios

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
NIM (%)	3.2	2.9	3.0	3.2	3.2
Other inc / total inc (%)	25.6	27.6	26.4	24.9	24.2
Cost-income (%)	41.8	42.7	45.5	41.7	41.0
Provision coverage (%)	94.0	75.5	75.2	76.7	77.4
Dividend payout (%)	31.0	29.9	28.9	22.2	18.3
Credit-deposit (%)	72.1	74.6	75.0	74.0	73.0
Investment-deposit (%)	31.3	32.7	30.5	30.0	30.0
Gross NPA (%)	1.3	1.3	1.4	1.4	1.5
Net NPA (%)	0.1	0.3	0.3	0.3	0.3
BV (₹)	226.2	252.7	285.8	337.6	406.2
Adj. BV (₹)	225.1	247.6	279.2	329.5	391.9
CAR (%)	14.4	14.3	12.4	11.5	10.9
- Tier 1 (%)	13.1	13.3	11.1	10.4	10.0
RoE (%)	22.1	20.7	19.3	22.4	23.4
RoA (%)	1.7	1.5	1.3	1.5	1.5

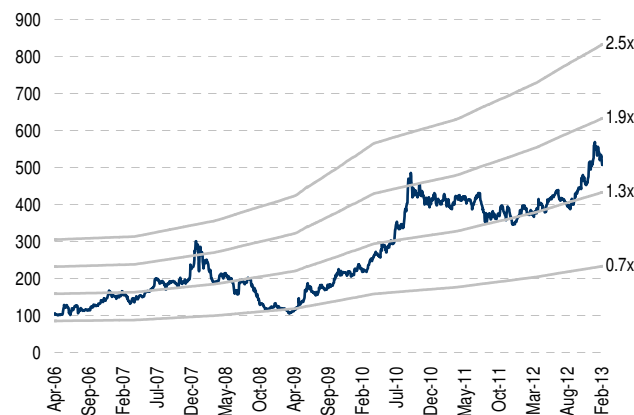
Source: Company, Anand Rathi Research

Fig 4 – PE band



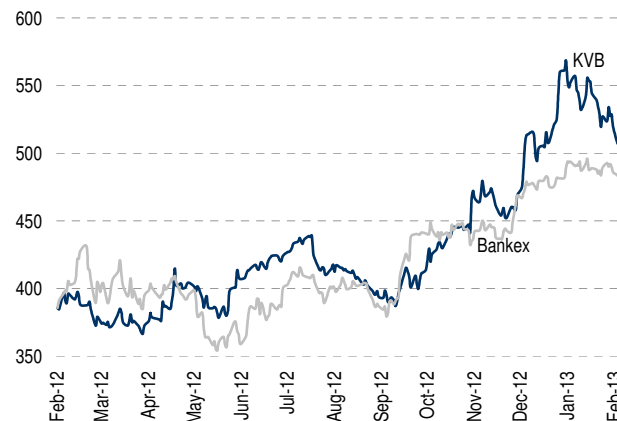
Source: Bloomberg, Anand Rathi Research

Fig 5 – Price-to-book band



Source: Bloomberg, Anand Rathi Research

Fig 6 – KVB vs. Bankex



Source: Bloomberg

Result highlights

Fig 7 – 3QFY13 results

(₹m)	3QFY13	3QFY12	% Chg	9MFY13	9MFY12	% Chg
Net interest income	3,084	2,347	31.4	8,482	6,561	29.3
Non-interest income	1,055	894	17.9	2,948	2,384	23.7
-Fees	926	702	31.9	2,585	2,258	14.5
-Treasury gains	129	67	92.4	363	126	189.2
Pre-provisioning profits	2,120	1,897	11.7	6,090	5,127	18.8
PAT	1,130	1,249	(9.5)	3,917	3,549	10.4

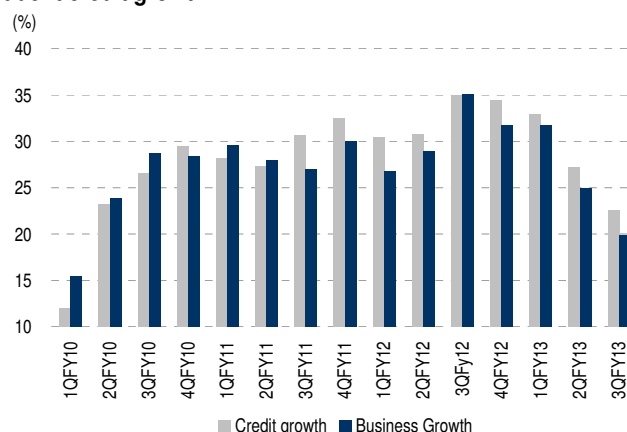
	3QFY13	3QFY12	YoY	2QFY13	QoQ
Credit	273,170	222,830	22.6	253,939	7.6
Deposits	354,940	301,070	17.9	334,443	6.1
Credit-to-deposits	77.0	74.0	295bps	75.9	103bps
CASA %	20.5	20.4	9bps	21.7	(116)ps
Gross NPA	3,532	3,221	9.6	3,227	9.4
Net NPA	1,018	643	58.2	802	27.0
Gross NPA %	1.3	1.5	(16)bps	1.3	3bps
Net NPA %	0.4	0.3	9bps	0.3	6bps
Capital adequacy %	71.2	80.0	(885)bps	75.2	(398)bps
-Tier-1 %	13.4	13.3	11bps	14.0	(64)bps

Source: Company, Anand Rathi Research

Prudent credit growth

At 22.6% yoy, credit growth (although lower than the past six-quarter growth of over 30%) continues to be significantly faster than the system. Deposits, though, grew slower, at 17% yoy, thereby increasing the credit-deposit by 300bps yoy, to 77%. We expect advances and deposits over FY12-15 to register CAGRs of 25% and 26% respectively, driven primarily by the rapid increase in number of branches over the past 24 months.

Fig 8 – Prudent credit growth



Source: Company

Loan mix diversifying

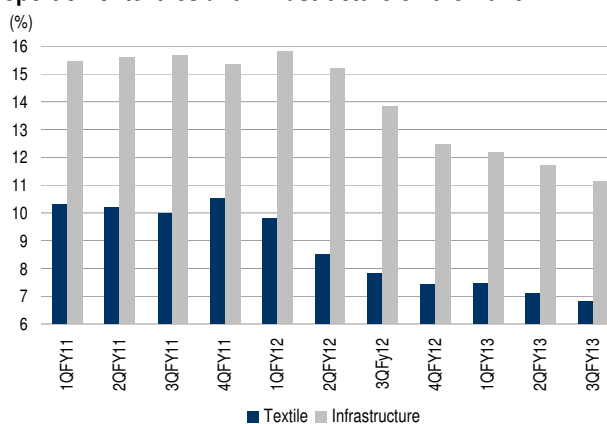
The proportion of corporate advances has decreased from 43% in 3QFY12 to 36% in 3QFY13, on account of the sharper focus on SME and gold loans. Further, the share of textiles (6.8%) and infrastructure (11.2%) in the loan book has been steadily coming down as the bank lends further to other sectors. Ahead, we expect the proportion of higher-yielding SME and gold loans to constitute the larger proportion in the loan mix.

Fig 9 – Loan mix - Agri and retail drive growth during the quarter



Source: Company

Fig 10 – Proportion of textiles and infrastructure on the wane



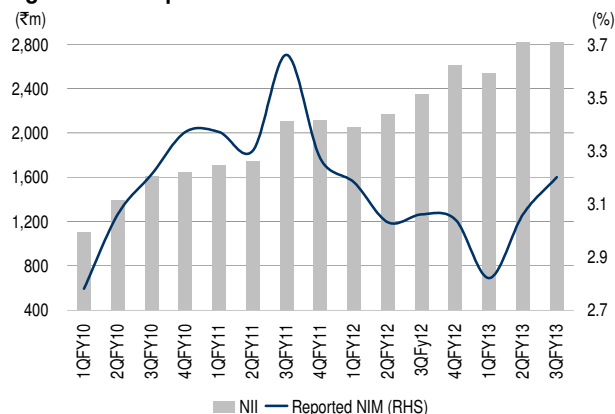
Source: Company, Anand Rathi Research

NIM improves on better asset pricing

Reported NIM improved 14bps qoq on the higher credit-deposit ratio, with the share of CASA in the deposit mix continuing to be stable, at 20.5%. Current account deposits recorded greater traction (up 21% yoy), as the bank increased the number of its branches (up 18% yoy) and its ATM network (up 63% yoy)

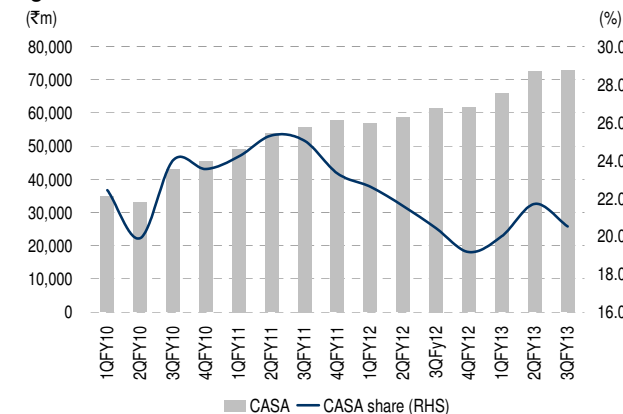
We expect the share of CASA to improve to ~23% over FY14-15. An improving proportion of CASA is likely to help NIM hold at 3% in FY13 and 3.1% in FY14.

Fig 11 – NIM improves



Source: Company

Fig 12 – CASA stable

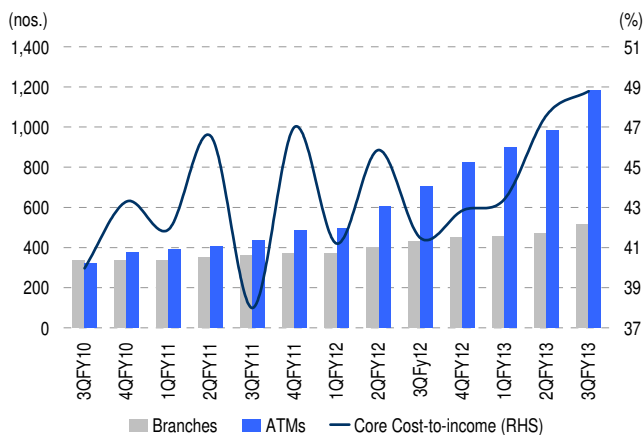


Source: Company

Investment in branch network continues

The bank continues to invest in its branch network which comprised 515 branches (up 18.5% yoy). Also, it wrote off ₹0.25bn in the quarter, which reflected in other operating expenses. As a result, core cost-income has increased nearly 800bps yoy, to 50%. However, with the higher-than-system credit growth, the effective use of technology and reward-management, we expect efficiencies to kick in. We expect cost-assets to improve to 1.6% by FY15 (from 1.8% in FY13) as the bank leverages its huge investments.

Fig 13 – Cost-income rises as KVB continues to invest



Source: Company

Non-interest income subdued

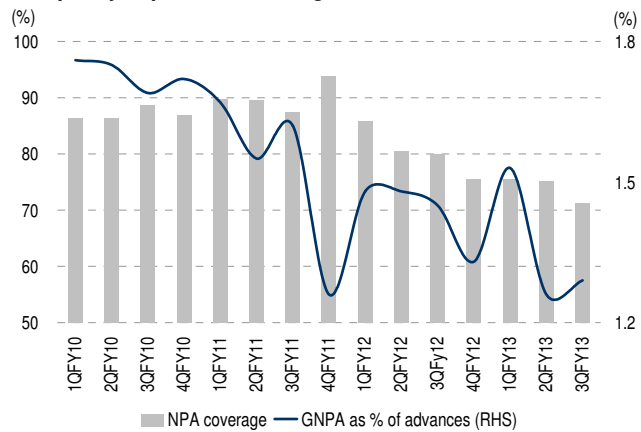
Non-interest income grew a muted 17% yoy, with core fee income growing 12% yoy. However, treasury profits increased 92% yoy to ₹129m. We expect fee income to grow in line with balance sheet growth. We expect fee-assets to be stable, at 0.9% of average earning assets.

Asset quality slips, outlook better

Gross NPAs increased 9% qoq, with fresh slippages of ₹1.4bn (2.1% of loans), a result of classifying one large exposure of ₹0.5bn as NPA. NPA coverage, excl. technical writeoffs, declined to 71%, compared to 80% a year ago. While restructured advances grew 27% qoq, to ₹3.3bn, at 3.3% of loans, it is better than some of its peers. Slippages from this portfolio are likely to be limited according to the management.

Management expects asset quality to improve, given the quality of the portfolio and the bank's healthy underwriting standards. Given the uncertain macro environment, we have, however, factored in a higher provisioning cost of 40bps over FY14-15 vs 11bps in FY12. We expect a 70% NPA coverage to be sustained over FY13-15, led by likely stable asset quality and a 28.2% CAGR in pre-provisioning profits over the same period.

Fig 14 – Asset quality slips, NPA coverage falls



Source: Company

High capital adequacy

At end-3QFY13, capital adequacy was 13.4%, with tier-1 of more than 12.1%, excluding the current year’s profit. We believe the bank is sufficiently capitalized for robust loan growth of 25% over FY12-15.

Valuations

Healthy business growth, improving productivity and stable asset quality could provide the impetus for high RoA of 1.4% and RoE of above 20% over FY13-15. We reiterate a Buy. At our Mar'14 target, the bank would trade at PBV of 2x FY13e and 1.7x FY14e. Our price target is based on the two-stage DDM (CoE: 13%; beta: 0.6; Rf: 8%).

Fig 15 – Past one-year-forward P/BV



Source: Bloomberg, Anand Rathi Research

Risks

- Slower credit growth may impinge on profitability and, subsequently, our earnings estimates.
- Greater dependence on bulk deposits and slower accretion in low-cost deposits could lead to the NIM being lower than estimated.

Financials

We expect the bank's business to register a 25.2% CAGR over FY12-15, with advances and deposit CAGRs of 24.7% and 25.6% respectively. We expect a 23% CAGR in net profit over the same period.

Fig 16 – Income Statement

Year-end: March (₹m)	FY11	FY12	FY13e	FY14e	FY15e
Interest Income	22,177	32,704	39,848	50,503	64,105
Interest Expended	14,508	23,533	27,835	34,739	44,350
Net Interest Income	7,669	9,171	12,013	15,764	19,756
Growth (%)	35.8	19.6	31.0	31.2	25.3
Non-interest Income	2,643	3,502	4,302	5,230	6,320
Total Income	10,312	12,673	16,314	20,994	26,075
Non-interest income / Total Inc (%)	25.6	27.6	26.4	24.9	24.2
Operating Expenses	4,306	5,416	7,423	8,756	10,693
Employee Expenses	2,295	2,644	3,563	4,290	5,239
Other Expenses	2,011	2,772	3,860	4,466	5,454
Pre-provisioning profit	6,006	7,257	8,891	12,239	15,382
Growth (%)	29.7	20.8	22.5	37.7	25.7
Provisions	393	938	945	1,700	2,222
Profit Before Tax	5,613	6,320	7,946	10,539	13,160
Taxes	1,457	1,302	2,384	3,057	3,817
Tax Rate (%)	26.0	20.6	30.0	29.0	29.0
Profit After Tax	4,156	5,017	5,562	7,482	9,343
Growth (%)	23.7	20.7	10.9	34.5	24.9
Number of Shares	94	107	107	107	107
Earnings Per Share (₹)	44.0	46.8	51.9	69.8	87.2

Source : Company, Anand Rathi Research

Fig 17 – Balance Sheet

Year-end: March (₹m)	FY11	FY12	FY13e	FY14e	FY15e
Share Capital	945	1,072	1,072	1,072	1,072
Reserves and Surplus	20,426	26,010	29,553	35,106	42,458
Net Worth	21,370	27,082	30,624	36,177	43,530
Deposits	247,219	321,116	395,960	501,638	635,638
Other Liabilities & Provisions	13,757	28,151	26,304	27,783	31,038
Total Loans	260,975	349,267	422,264	529,422	666,676
Total Liabilities	282,346	376,349	452,888	565,599	710,205
Advances	178,145	239,492	296,970	371,212	464,016
Investments	77,318	105,061	120,768	150,492	190,691
Cash & Bank Balances	17,745	20,355	22,016	28,058	36,323
Fixed & Other Assets	9,139	11,442	13,134	15,837	19,176
Total Assets	282,346	376,349	452,888	565,599	710,205

Source : Company, Anand Rathi Research

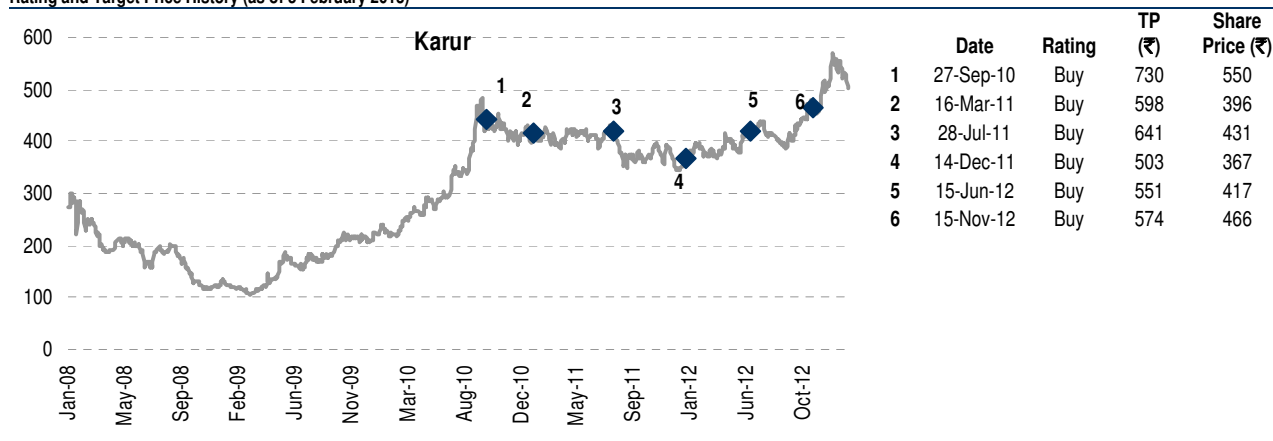
Appendix

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