



- Karnataka Bank (KBL) reported better Q1FY22 numbers compared to previous quarter with NII growing by 7.4% YoY against -13.3% YoY in Q4FY21. Cost of deposits (CoD) reduced 47 bps QoQ to record low at 4.8%, providing support to NII despite contraction in interest income. NIM improved by 57 bps QoQ to 2.98% during Q1FY22 on the back of decline in interest cost. Though weak other income and high provisioning weighed on bottom line.
- Loan book de-grew by -4.5 YoY for the 3rd straight quarter though it witnessed modest pick of 0.2% on sequential basis. Corporate book witnessed 8.4% QoQ pick up after many quarters of sequential contraction. Advances break-out include retail at 52.2%, large corporate at 14.3% and MSME at 33.5% as of Q1FY22.
- Gross slippages reduced to Rs414 cr (Rs1,176 cr in Q4FY20). Reported slippages came from below Rs50 cr category and 62% accounted by the MSME. GNPA improved 9bps QoQ to 4.8% on account of reduction in slippages. However, increase in restructuring book to 5.2% (3.4% in Q4FY21) faded optimism. We believe elevated restructuring book to keep credit cost/slippages at higher level of over 2% in FY22E.
- Mgmt guided for ~15% credit growth in FY22 which we think if materializes it could further take NIM over 3% given the likely low CoD. Key business risk is high restructuring and thereby slippages from this particular book requires close monitoring. Stock is currently trading at extremely cheap valuation at 0.33x trailing P/ABV factoring in possible higher slippages and weak business growth. KTK has come with QIP proposal of 15 cr shares which could lead to almost 50% equity dilution. If the bank becomes successful to bring well reputed institutional investors to QIP, it will help to improve business sentiments and could trigger re-rating of stock to higher multiples. Bank also planned to augment borrowings. These initiatives would help the bank to improve capital ratios and subsequently funding the business growth. We will keep a close eye on development over QIP investments. We maintain our 'Hold' rating on stock with revised target price at Rs72 valuing bank at 0.4x FY23E ABV.

### NIM improves, weak other income and high provisioning weigh on profitability

NII grew by 7.4% YoY (-13.3% YoY in Q4FY21) led by decline in CoD. Interest income declined by -5.7% YoY, though the impact was offset by 47bps QoQ decline in CoD. NIM rose by 57 bps QoQ to 2.98% in Q1FY22 boosted by declined interest cost. Other income de-grew by -54.5% YoY on account of steep reduction in trading profits. C/I reduced to 48.9% (53.9% in Q4FY21) due to controlled OPEX. Provisioning remained elevated, growing 7.7% QoQ. KTK reported net profit of Rs106 cr as compared to Rs31 cr in Q4FY21 and Rs196 cr in Q1FY21.

### Business growth remains weak

Advances de-grew by -4.5% YoY. On sequential basis, advances grew at modest 0.2% QoQ. During the quarter, retail (-1.2% QoQ) and MSME book (-0.2%) witnessed sequential contraction. While corporate book grew by 8.4% over the previous quarter. As per mgmt, the bank is witnessing good credit enquiries getting converted both in retail and mid corporate segments. Deposits grew by 6.1% YoY while the growth in low cost deposits (CASA) remained strong at 14.1% YoY. CASA share stood at 30.8% as of Q1FY22.

#### Rating Matrix

CMP	Rs63
Rating	Hold
Target Price	Rs72
Upside Potential	14.3%
52 week H/L	Rs73/39
Face value	Rs10
Mar. Cap.	Rs1,965 cr
Category	Small Cap
Sector	Banking

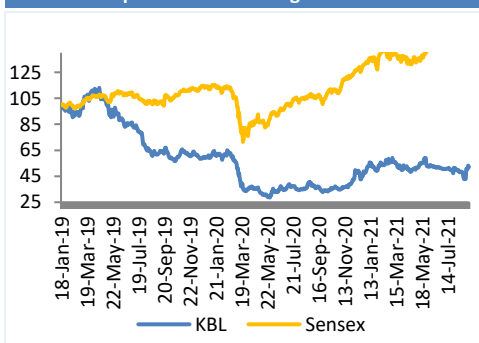
#### Shareholding Pattern

Particulars	Jun'21	Mar'21	Dec'20	Sep'20	Jun'20
Promoters	-	-	-	-	-
FPIs	10.0%	9.4%	8.1%	7.3%	8.7%
MFs	0.2%	0.2%	0.4%	0.6%	2.0%
Insti.	15.8%	15.3%	14.2%	14.0%	17.4%
Non. Inst.	84.2%	84.7%	85.8%	86.0%	82.6%

#### Quarterly Snapshot (Q1FY22)

Particulars	(Rs cr)	YoY (%)	QoQ (%)
NII	575	7.4%	25.2%
Other Income	236	-54.5%	-36.8%
Total Income	811	-23.1%	-2.6%
OPEX	396	5.2%	-11.6%
PPOP	414	-38.8%	8.0%
PAT	106	-46.0%	238.3%
Advances	51,791	-4.5%	0.2%
Deposits	76,215	6.1%	0.7%
GNPA	2,549	-0.3%	-1.5%
Slippage	414		

#### Relative Capital Market Strength



#### Key Financials (Rs cr)

Particulars	FY19	FY20	FY21	FY22E	FY23E
NII	1,905	2,030	2,183	2,480	2,794
Gr. (%)	2.6%	6.6%	7.5%	13.6%	12.7%
NIM	2.8%	2.8%	2.9%	3.0%	3.0%
PPOP	1,450	1,657	1,999	2,045	2,273
A.PAT	477	432	483	537	618
Eq./As. (%)	7.3%	7.2%	7.8%	7.5%	7.2%
RoE (%)	8.5%	7.3%	7.7%	7.8%	8.4%
CASA(%)	28.1%	28.9%	31.5%	30.2%	29.9%
GNPA (%)	4.4%	4.4%	4.9%	4.8%	4.2%
P/ABV (x)			0.44	0.36	0.32

### Q1FY22 Key result highlights

*NII revived sequentially on decline in CoD*

*NIM improved to 3.0% from 2.4% in the previous quarter*

*Other income impacted by weak trading profit*

*OPEX remained contained helping to improved C/I ratio despite contraction in total income*

*Provisioning remained elevated*

*PAT also supported by tax credit*

*Advances contracted during quarter*

*GNPA improved due to decline in slippages*

### Five Quarters at a Glance

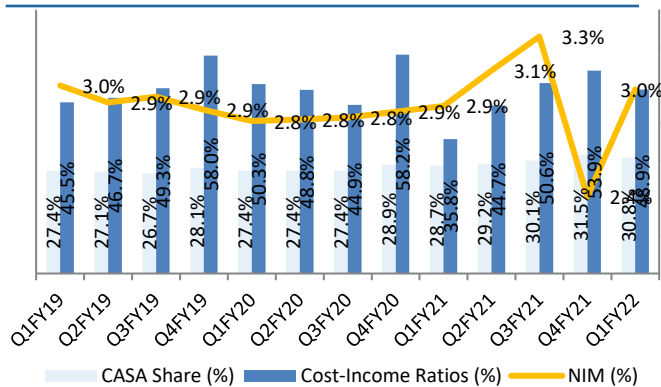
Particulars (Rs cr)	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	YoY	QoQ
Interest Earned	1,616	1,604	1,596	1,417	1,524	-5.7%	7.5%
Interest Expended	1,081	1,029	981	958	949	-12.2%	-1.0%
NII	535	575	614	459	575	7.4%	25.2%
Other Income	519	330	273	373	236	-54.5%	-36.8%
Total Income	1,054	905	887	832	811	-23.1%	-2.6%
Operating Expenditures	377	404	449	449	396	5.2%	-11.6%
PPOP	677	500	438	384	414	-38.8%	8.0%
P&C	509	322	214	342	368	-27.7%	7.7%
PBT	168	178	224	42	46	-72.5%	10.2%
Tax	-28	59	88	11	-60	111.0%	-670.9%
Net Profit	196	119	135	31	106	-46.0%	238.3%
Outstanding Shares	311	311	311	311	311		
Dil. EPS	6	4	4	1	3	-46.0%	238.3%
<b>Balance Sheet items/ratios</b>							
Deposits	71,854	72,929	73,826	75,654	76,215	6.1%	0.7%
CASA	20,594	21,275	22,199	23,823	23,490	14.1%	-1.4%
Term Deposits	51,260	51,654	51,627	51,831	52,725	2.9%	1.7%
Advances	54,209	54,099	53,188	51,694	51,791	-4.5%	0.2%
CD Ratio (%)	75.4%	74.2%	72.0%	68.3%	68.0%		
CASA Share (%)	28.7%	29.2%	30.1%	31.5%	30.8%		
CAR(%)	13.1%	13.1%	13.8%	14.9%	13.4%		
Tier 1 (%)	11.1%	11.1%	11.4%	12.3%	11.1%		
<b>Operating ratios</b>							
Cost of deposits (%) (cum)	5.7%	5.5%	5.4%	5.3%	4.8%		
Yield on advances (%), (cur)	9.3%	9.4%	9.4%	9.1%	8.9%		
NIM (%)	2.9%	3.1%	3.3%	2.4%	3.0%		
Cost-Income Ratios (%)	35.8%	44.7%	50.6%	53.9%	48.9%		
Tax Rate (%)	-16.9%	33.0%	39.5%	25.1%	-129.9%		
<b>Assets Quality</b>							
Gross NPA	2,558	2,189	1,707	2,588	2,549		
Net NPA	1,631	1,195	924	1,642	1,553		
Gross NPA (%)	4.6%	4.0%	3.2%	4.9%	4.8%		
Net NPA (%)	3.0%	2.2%	1.7%	3.2%	3.0%		
Coverage Ratio(%)	36.2%	45.4%	45.9%	36.6%	39.1%		
<b>Slippages</b>							
O/s Restructured loans	601	558	690	1,735	2,685		
RA % of loan book	1.1%	1.0%	1.3%	3.4%	5.2%		
Gross slippages	167	2	1	1,176	414	148.3%	-64.8%
Reduction (Recoveries+ Up)	409	371	484	294	454	10.9%	54.2%
Slippages (Net Addition to)	-242	-369	-482	882	-39	-83.8%	-104.5%
Slippages (%)	0.3%	0.0%	0.0%	2.2%	0.8%		
<b>Advances Break-Out</b>							
Retail Advances (<Rs50 mn)	47.9%	49.5%	51.4%	53.0%	52.2%		
Large Corporates	21.4%	18.0%	15.5%	13.2%	14.3%		
Mid Corporates & SMEs	30.7%	32.5%	33.1%	33.8%	33.5%		
<b>Network</b>							
ATMs	1,024	1,016	1,014	1,001	981		
Branches	858	859	857	858	858		

Source: Choice Broking Research

Particulars (Rs cr)	Q1FY22 Actual	Q1FY22 Estimates	Var. (%)	Comments
NII	575	587	-2.0%	In line with our estimate
Other Income	236	370	-36.3%	Impacted by decline in trading profit
Total Income	811	957	-15.3%	Weighed down by lower other income
OPEX	396	412	-3.8%	In line with our estimate
P&C	368	391	-5.9%	
<b>PAT</b>	<b>106</b>	<b>114</b>	<b>-6.8%</b>	
Deposits	76,215	77,850	-2.1%	In line with our estimate
Advances	51,791	53,853	-3.8%	Decline was sharper than estimated due to weak growth in retail, MSME
GNPA	2,549	2,694	-5.4%	

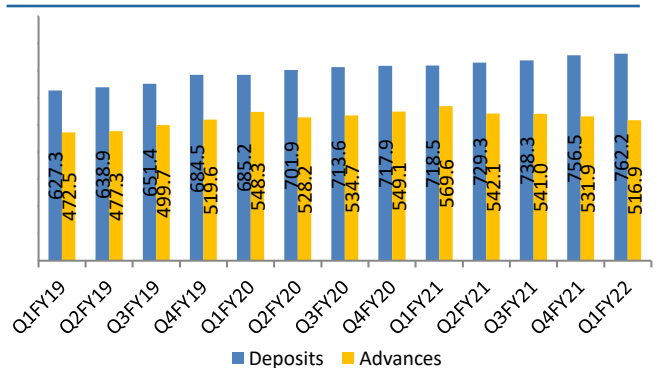
Estimates (Rs cr)	Old		Revised		Change	
	FY22E	FY23E	FY22E	FY23E	Var. (%)	
NII	2,492	2,794	2,480	2,794	-0.5%	0.0%
OPEX	1,852	2,138	1,836	2,138	-0.8%	0.0%
Other Income	1,536	1,617	1,401	1,617	-8.8%	0.0%
P&C	1,439	1,437	1,416	1,437	-1.6%	0.0%
PAT	545	618	537	618	-1.4%	0.0%
GNPA	5.1%	4.4%	4.8%	4.2%	-5.9%	-3.3%
Advances	58,070	66,498	58,070	66,498	0.0%	0.0%
Deposits	84,098	93,560	84,098	93,560	0.0%	0.0%
Adj. BVPS (Rs)	171.8	191.8	176.3	195.2	2.6%	1.8%

Trend in CASA, NIM and C/I ratios

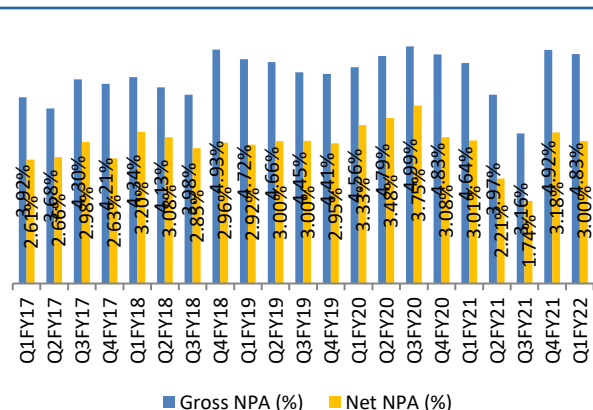


Trend in business (Rs bn)

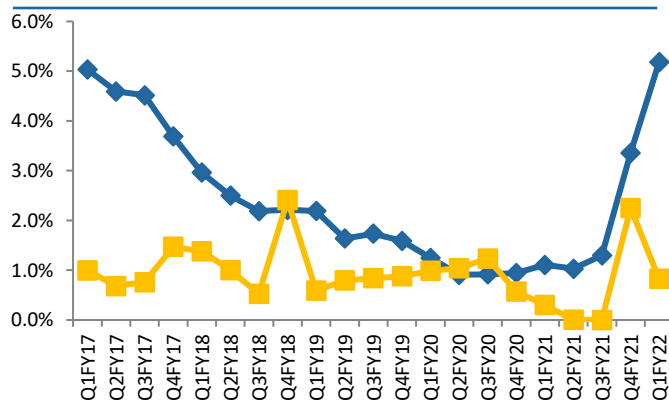
Source: Choice Broking Research



Assets quality trend



RA % of loan book and Slippages (%)

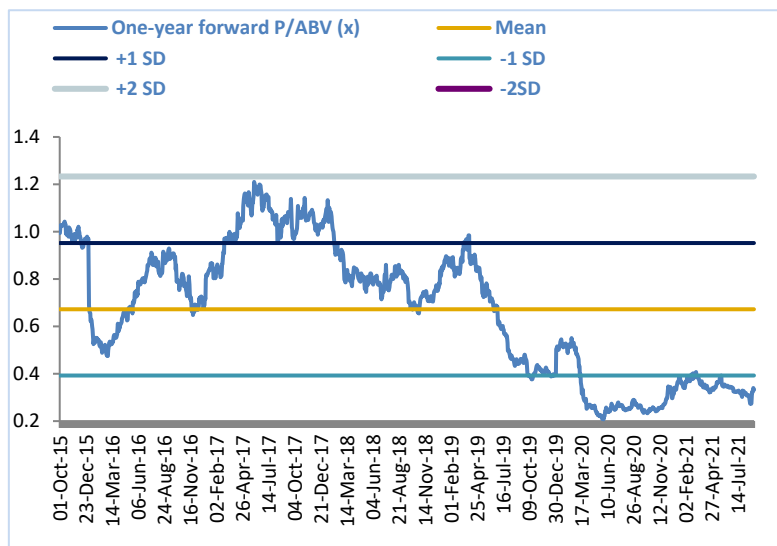


## Valuation and View

Mgmt guided for ~15% credit growth in FY22 which we think if it materialises could further take NIM over 3% given the likely low CoD. Key business risk is high restructuring and thereby slippages from this particular book requires close monitoring. Stock is currently trading at extremely cheap valuation at 0.4x trailing P/ABV factoring in possible higher slippages and weak business growth. KTK has come with QIP proposal of 15 cr shares which could lead to almost 50% equity dilution. If the bank remains able to bring well reputed institutional investors to QIP, it will help to improve business sentiments and could trigger re-rating to stock at higher multiples.

Bank also planned to augment borrowings. These initiatives would help the bank to improve capital ratios and subsequently funding the business growth. We will keep a close eye on QIP investors. We maintain our 'Hold' rating on stock with revised target price at Rs72 valuing bank at 0.4x FY23E ABV.

P/ABV Valuation	FY19	FY20	FY21	FY22E	FY23E
Adjusted BVPS (Rs)	147.3	135.6	143.9	176.3	195.2
<b>Valuation Parameters</b>					
P/ABV (x)	0.4				



Source: Choice Broking Research

## Financial statements (Standalone, Rs cr)

### Profit And Loss Statement

Particulars	FY19	FY20	FY21	FY22E	FY23E
Interest Income	5,906	6,475	6,232	6,820	7,857
Growth (%)	8.9%	9.6%	-3.7%	9.4%	15.2%
Interest Expended	4,001	4,444	4,049	4,340	5,063
Growth (%)	12.2%	11.1%	-8.9%	7.2%	16.7%
<b>Net Interest Income</b>	<b>1,905</b>	<b>2,030</b>	<b>2,183</b>	<b>2,480</b>	<b>2,794</b>
Net Interest Margin	2.8%	2.8%	2.9%	3.0%	3.0%
Other Income	1,002	1,328	1,495	1,401	1,617
% of Interest Income	17.0%	20.5%	24.0%	20.5%	20.6%
Total Income	2,907	3,358	3,678	3,881	4,411
Growth (%)	3.4%	15.5%	9.5%	5.5%	13.6%
Operating expenses	1,457	1,701	1,679	1,836	2,138
PPOP	1,450	1,657	1,999	2,045	2,273
P&C	842	1,135	1,387	1,416	1,437
P&C % of Advances	1.5%	2.0%	2.7%	2.4%	2.2%
Operating Profit before Tax	608	522	612	629	836
Growth (%)	96.0%	-14.1%	17.2%	2.8%	32.9%
Pre-tax Margin %	20.9%	15.5%	16.6%	16.2%	18.9%
Tax	131	90	129	92	218
% of PBT	21.5%	17.3%	21.1%	14.7%	26.1%
Reported PAT	477	432	483	537	618
Net Profit Margin %	16.4%	12.9%	13.1%	13.8%	14.0%
Extraordinary Income	0	0	0	0	0
<b>Adjusted PAT</b>	<b>477</b>	<b>432</b>	<b>483</b>	<b>537</b>	<b>618</b>
Growth (%)	46.6%	-9.5%	11.8%	11.2%	15.0%

Balance Sheet	FY19	FY20	FY21	FY22E	FY23E
<b>ASSETS</b>					
Cash with RBI & Banks	3,610	2,919	5,316	11,747	12,930
Investments	16,185	17,545	21,635	19,904	20,807
Advances	54,828	56,964	51,694	58,070	66,498
Fixed assets	775	826	838	805	841
Other assets	3,648	5,058	6,099	4,783	4,582
<b>TOTAL ASSETS</b>	<b>79,046</b>	<b>83,313</b>	<b>85,581</b>	<b>95,309</b>	<b>1,05,659</b>

CAPITAL AND LIABILITIES	FY19	FY20	FY21	FY22E	FY23E
Capital	283	311	311	311	311
Reserves and Surplus	5,503	5,660	6,331	6,794	7,300
Deposits	68,452	71,785	75,654	84,098	93,560
Borrowings	3,326	4,065	1,765	2,500	2,759
Other liabilities and provisions	1,483	1,493	1,519	1,606	1,730
<b>TOTAL CAPITAL AND LIABILITIES</b>	<b>79,046</b>	<b>83,313</b>	<b>85,581</b>	<b>95,309</b>	<b>1,05,659</b>

Financial Ratios	FY19	FY20	FY21	FY22E	FY23E
<b>Return / Profitability Ratios (%)</b>					
NIM	2.80%	2.77%	2.89%	3.03%	3.03%
Yield on advances	9.2%	9.2%	9.2%	10.0%	10.1%
Yield on investments (ex. trading profit)	7.0%	6.9%	5.8%	6.3%	6.8%
EPS (Diluted) (Rs)	16.9	13.9	15.5	17.3	19.9
RoA	0.6%	0.5%	0.5%	0.7%	1.0%
RoE	8.5%	7.3%	7.7%	7.8%	8.4%
Cost of Deposits	5.8%	6.0%	5.2%	5.5%	5.7%
<b>Operating ratios (%)</b>					
Credit to Deposit	80.1%	79.4%	68.3%	69.1%	71.1%
Cost to income	50.1%	50.7%	45.6%	47.3%	48.5%
CASA	28.1%	28.9%	0.0%	30.2%	29.9%
Investment / Deposit	23.6%	24.4%	28.6%	23.7%	22.2%
Non interest income / Total income	34.5%	39.5%	40.6%	36.1%	36.7%
<b>Capitalization Ratios (%)</b>					
Equity / Assets	7.3%	7.2%	7.8%	7.5%	7.2%
Loans / Assets	69.4%	68.4%	60.4%	60.9%	62.9%
Investments / Assets	20.5%	21.1%	25.3%	20.9%	19.7%
Dividend payout	20.8%	0.0%	11.6%	11.6%	15.0%
<b>Capital adequacy (%)</b>					
Tier-1 CAR	11.2%	10.7%	12.3%	12.2%	11.4%
Tier-2 CAR	2.0%	2.0%	2.6%	2.1%	2.0%
CAR (Basel III)	13.2%	12.7%	14.9%	14.3%	13.5%
<b>Asset Quality ratios (%)</b>					
Gross NPA	4.4%	4.4%	4.9%	4.8%	4.2%
Net NPA	2.9%	2.9%	3.2%	2.8%	2.3%
Coverage Ratio	33.0%	36.3%	36.6%	42.6%	46.4%
Slippage Ratio	3.1%	3.8%	2.6%	3.0%	2.8%
<b>Per Share Data (Rs)</b>					
EPS (Diluted)	16.9	13.9	15.5	17.3	19.9
DPS	3.5	0.0	1.8	2.0	3.0
BVPS	204.4	192.0	213.7	228.5	244.8
Adjusted BVPS	147.3	135.6	143.9	176.3	195.2
<b>Valuation ratios (x)</b>					
P/E (x)	3.7	4.5	4.1	3.7	3.2
P/BV (x)	0.3	0.3	0.3	0.3	0.3
P/ABV (x)	0.4	0.5	0.4	0.4	0.3
<b>Growth ratios (%)</b>					
Advances	16.0%	3.9%	-9.3%	12.3%	14.5%
Deposits	8.9%	4.9%	5.4%	11.2%	11.3%
Net interest income	2.6%	6.6%	7.5%	13.6%	12.7%
Interest income	8.9%	9.6%	-3.7%	9.4%	15.2%
PAT	46.6%	-9.5%	11.8%	11.2%	15.0%
<b>Business ratios</b>					
Profit per branch (Rs cr)	.57	.51	.56	.61	.69
Business per branch (Rs cr)	147.5	151.8	148.4	162.5	177.8

Source: Choice Broking Research

### Choice's Rating Rationale

The price target for a large cap stock represents the value the analyst expects the stock to reach over next 12 months. For a stock to be classified as Outperform (Buy), the expected return must exceed the local risk free return by at least 5% over the next 12 months. For a stock to be classified as Underperform (Reduce, Sell), the stock return must be below the local risk free return by at least 5% over the next 12 months. Stocks between these bands are classified as Neutral (Hold).

BUY	Absolute Return >15%
Hold	Absolute Return Between 0-15%
Reduce	Absolute Return 0 To Negative 10%
Sell	Absolute Return > Negative 10%

Coverage History			
Date	Recommendation	CMP	Target Price
03-Sep-21	Hold	63	72
01-Jun-21	Hold	64	73
04-Feb-21	Buy	64	87
24-Oct-20	Buy	45	60
20-Jul-20	Buy	45	60

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