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KARNATAKA BANK

GROWTH AND TURNAROUND ACROSS KEY METRICS

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Q1 FY25 Results Recap	Market Cap: ₹8,600 cr	CMP: ₹238.4

Gross Advances

At ₹75,455 crore, advances grew 19.8%/3.4% YoY/QoQ aided by retail book which makes for **47% of the total**. Retail book grew 10.4%/5.6% YoY/QoQ. Large corporate book, which makes for 29% of the total, grew 65.4%/7.1% YoY/QoQ. Mid-corporates, which account for 24% of the total book, grew 2.6%/-4.6% Yoy/QoQ. **Management is focused towards gaining higher share in RAM (i.e Retail, Agriculture and MSMEs).** Recent announcement in Budget 2024 will also help increase MSME business. Management has an aspirational goal to reach to **loan book of ₹1,00,000 crore by FY26**.

Deposit

At ₹100,164 crore, despoits grew 15.2%/2.1% YoY/QoQ aided by Retail Term Deposit. Retail Term Deposit at ₹69,469 crore grew 17.8%/4.2% YoY/QoQ. **CASA Ratio slipped to 30.54% vs 32.19%/31.97% YoY/QoQ**, but management reiterated that this is an industry-wide phenomenon. It has created a **liability sales structure** to focus on CASA - Salary A/c, Current A/c and Govt Business in particular by direct collection of taxes.

Income Matrix

Net Interest Income at ₹903 crore grew 10.9%/8.3% YoY/QoQ. Net Interest Margin came in at 3.54% vs 3.68%/3.30% YoY/QoQ (vs guidance of 3.5% to 3.7%). Despite the low yield on advances (which were re-priced due to competition), the Net Interest Margin (NIM) expanded sequentially due to several factors: **the capital raised**, **interest earned on a tax refund** of ₹80 crore, and the **retirement of ₹720 crore** in Tier II capital that was carrying an interest rate of 12%.

Management guided that following the change in the interest rate trajectory, the re-pricing of deposits would occur earlier than that of advances, which is expected to help achieve better NIMs. **Cost of funds stands at 5.57%** versus 5.20%/5.55% YoY/QoQ as the market is tight on liquidity. Credit cost at 0.11% vs 0.28%/0.2% YoY/QoQ has been achieved due to **lower slippages and growth in advances**. The **guidance for credit cost is around 1%**.

The cost-to-income ratio came in at 52.8% compared to 47.2% YoY and 60.1% QoQ, primarily due to a one-off expense in Q4 FY24. Excluding this expense, the ratio would have been around 53.5%. **The guidance for the cost-to-income ratio is to remain below 50%** within four quarters, driven by the rationalization of the cost structure and improved operational efficiency through centralization.

Asset Quality

Gross NPA 3.54% vs 3.68%/3.53% YoY/QoQ and Net NPA at 1.66% vs 1.43%/1.58% YoY/QoQ. **Net NPA was higher as recovery shifted to Q2.**

The opening Gross Non-Performing Assets (GNPA) stood at ₹2,578 crore. During the quarter, there was an addition of ₹416 crore, while reductions amounted to ₹326 crore, primarily due to upgrades, recoveries, and technical write-offs, resulting in a net addition of ₹90 crore.

Gross slippage was recorded at 0.59%, compared to 0.50% YoY and 0.79% QoQ. **Slippages were approximately ₹500 crore per quarter, thus ₹416 crore in Q1 FY25 was a positive surprise**. Notably, ₹81 crore of the slippage came from the restructured book, indicating a 40% reduction in this segment. The standard restructured advances, excluding related accounts, were ₹1,160 crore, compared to ₹1,338 crore QoQ and ₹2,060 crore YoY, reflecting a healthy trend. The ratio of Gross GNPA plus restructured advances as a percentage of Gross Advances is 5.39%, down from 7.7% YoY and 5.7% QoQ. These metrics collectively highlight that **asset quality is improving with each passing quarter**.

Return Matrix

The **Return on Equity (ROE) is currently 14.45%**, compared to 17.70% YoY and 10.64% QoQ. The decrease is attributed to the ₹1,500 crore raised for growth initiatives and one-off expenses amounting to ₹164 crore incurred in Q4 FY24. The guidance indicates that **ROE is expected to reach 15% in the coming quarters**. The Return on Assets (ROA) stands at 1.38%, compared to 1.47% QoQ and 0.96% YoY, aligning with the guidance range of 1.2% to 1.4%.

Other Highlights

- Hiring across verticals to drive growth
- Consistent profitability can be seen over the years, strong NIM and healthy asset quality generally indicates a stable situation
- Growing digital services may result in cost reduction and customer engagement, better delivery services
- Healthy asset quality ratio can indicate an effective risk management
- A strong capital adequacy ratio ensures that the bank has sufficient capital to cover its risk. **Capital Adequacy Ratio 17.64% vs 17% YoY**
- Steady growth in expanding branches across all tiers can be seen a good sign to investors
- PCR (Provisioning Coverage Ratio) 77.97% vs 83.47%/79% YoY/QoQ. **Guidance is 80% in next two quarters**

PL View

Karnataka Bank is **expanding its advances and deposit base at approximately 20%**, surpassing the industry average growth rate of 15%. The bank has shown improvements across all key metrics, including income, returns, and assets, and this positive trend is expected to continue. Currently trading at an adjusted book value (ABV) of 0.6x for FY26, we believe the **stock warrants a re-rating**. Based on our analysis, we set a **target price of ₹329**, which reflects a valuation of 0.85x book value.

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