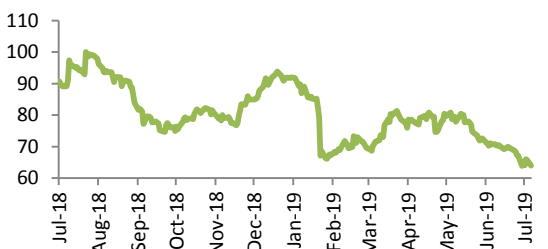


Karur Vysya Bank Ltd.

Recommendation	HOLD
CMP	Rs. 64
Target Price	Rs. 88
Sector	Banking

Stock Details			
BSE Code	590003		
NSE Code	KARURVYSYA		
Bloomberg Code	KVB IN		
Market Cap (Rs Cr)	Rs. 5,251		
Free Float (%)	97.9%		
52- week H/L (Rs)	101/63		
Avg. volume (BSE+NSE)	993250		
Face Value (Rs)	2		
Div per share (FY 19)	0.60		
Shares o/s (Cr)	79.9		
Relative Performance (%)	1Mth	3Mth	1Yr
KVB	-10%	-17%	-28%
Sensex	-5%	-3%	1%



Shareholding Pattern		Jun'19
Promoters Holding	2.1%	
Institutional (Incl. FII)	41.8%	
Public & others	56.1%	

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Year	NII (Rs cr)	Growth (%)	PBP (Rs cr)	PAT (Rs cr)	Growth (%)	EPS (Rs)	PE (x)	Adj BVPS (Rs)	P/ABV (x)	RoE (%)
FY18	2,298	11%	1,777	346	-43%	4.8	13.8	60.6	1.1	6.1%
FY19E	2,363	3%	1,711	211	-39%	2.6	24.9	50.1	1.3	3.3%
FY20E	2,492	5%	1,842	365	73%	4.6	14.4	52.4	1.3	5.6%
FY21E	2,842	14%	2,164	670	84%	8.4	7.8	54.6	1.2	9.6%

Disappointment on all fronts; Recovery hopes move to FY21E

- Advances stood at Rs. 49,182 Cr vs. Rs. 47,886 Cr in Q1FY19, a tepid growth of 3% YoY (a 10 quarter low). Retail loans continued to maintain growth momentum at 32% YoY contributing 22% to the overall advances vs 17% YoY. The bank chose to grow cautiously in Agri (-1% YoY), SME (flat YoY) and Corporate (-9% YoY) with each contributing 17%, 34% and 28% respectively. We expect loan growth of 11% CAGR over FY19-21E.
- NIMs were down 39 bps QoQ and stood at 3.49% (lowest in the last 13 qtrs.) Q4FY19 NIM consisted of non-recurring benefit impacting NIMs by 8bps. NIMs were also impacted due to increase in CoF by 6bps and an increase in investment book having an impact of 6bps. Incremental reversals on Agri portfolio and carrying impact of IBPC (which the bank is reducing) further compressed NIMs by 4bps and 5bps respectively. Total income grew by 2% YoY, non-interest income grew at a sluggish rate of 6% YoY.
- Opex growth stood at 8% YoY. Cost/income ratio at 47.9% remained flat QoQ but continued to be elevated on YoY basis (+270bps).
- PBP declined by 3% YoY to Rs. 445 Cr.
- Provisions during the quarter stood at Rs. 330 Cr vs. Rs. 423 Cr in Q1FY19 and Rs. 352 Cr in Q4FY19. Credit cost for the quarter eased out sequentially and YoY from 2.9% in Q4FY19 and 3.7% in Q1FY19 to 2.6%. Credit costs are expected to remain elevated in FY20E as the bank targets to increase its PCR from the current level of 49% to 55% in coming quarters.
- The bank reported Net Profit of Rs. 73 Cr vs. Rs. 46 Cr in Q1FY19 (+59% YoY) and Rs. 60 Cr in Q4FY19 (+21% QoQ).

Valuation and Outlook

Sharpening focus on the Retail and SME segments while building revenue as well as profit momentum (loan/PAT CAGR of 11%/78%, respectively, over FY19-21E) and transformation into a granular and higher RoE business combined with cheap valuations at 1.2x FY21E ABV provides decent scope for re-rating in the long term. However, continued elevated stress in the Corporate and SME books combined with higher credit costs in order to shore up the PCR, should translate to sub optimal ROA in FY20E. **We maintain our 'HOLD' rating on the stock with a price target of Rs. 88, based on 1.6x FY21E ABV (33% discount to CUB).**

Karur Vysya Bank Ltd.

Quarterly Results

Particulars (Rs. Cr)	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Comments
Interest Earned	1384	1402	1422	1491	1443	1457	1443	1474	1493	NIMs were down 39 bps QoQ and stood at 3.49% (lowest in the last 13 qtrs.) NIMs were impacted due to certain non-recurring benefits that accrued in the previous quarter. We expect NIMs to inch up going ahead.
Interest Expended	846	847	861	848	859	878	862	854	909	
Net Interest Income	539	555	562	643	584	579	581	619	584	NIMs
Growth	12%	12%	9%	11%	8%	4%	3%	-4%	0%	
NIMs	3.76%	3.81%	3.76%	4.13%	3.65%	3.57%	3.60%	3.88%	3.49%	
Other Income	236	230	225	209	255	176	260	272	270	Non-Interest income grew by 6% YoY, with fee incomes contributing to ~62% of the total non-interest income.
% of total income	30%	29%	29%	25%	30%	23%	31%	31%	32%	
Total Income	775	785	786	852	838	755	841	892	854	C-I Ratio continues to remain elevated at 47.9% on a YoY basis (+270 bps). However, Cost-to-Assets ratio has shown slight improvement at 2.3% (Flat YoY and -30bps QoQ)
Growth	20%	10%	14%	5%	8%	-4%	7%	5%	2%	
Employee exp	151	155	153	179	179	173	198	212	204	C-I Ratio continues to remain elevated at 47.9% on a YoY basis (+270 bps). However, Cost-to-Assets ratio has shown slight improvement at 2.3% (Flat YoY and -30bps QoQ)
Other op exp	174	203	212	193	200	221	218	215	205	
Total op exp	325	358	365	372	379	393	416	427	409	The quarterly provisioning rate continued to remain high in-line with management guidance of Rs. 1200 Cr provisions for FY20. It shall continue to remain elevated as KVB aims to take the PCR to 55% by the end of FY20. Credit cost for the quarter eased out to 2.7% vs 2.9% QoQ and 3.7% YoY.
Growth	-10%	-9%	-12%	22%	16%	10%	14%	15%	8%	
Cost to income ratio	42.0%	45.6%	46.4%	43.7%	45.2%	52.1%	49.4%	47.9%	47.9%	
Profit before prov.	449	427	421	480	460	361	425	465	445	The quarterly provisioning rate continued to remain high in-line with management guidance of Rs. 1200 Cr provisions for FY20. It shall continue to remain elevated as KVB aims to take the PCR to 55% by the end of FY20. Credit cost for the quarter eased out to 2.7% vs 2.9% QoQ and 3.7% YoY.
Provisions	233	321	325	394	423	213	400	352	330	
Growth	249%	170%	244%	81%	81%	-34%	23%	-11%	-22%	
Credit Cost	2.28%	3.07%	3.12%	3.61%	3.75%	1.85%	3.46%	2.92%	2.72%	
Profit before tax	216	106	96	86	37	148	25	112	115	Retail loans exhibited a robust growth of 32% YoY (core growth of 27%) contributing 22% to the overall advances. The bank chose to grow the Agri, SME and Corporate book cautiously, with each contributing 16%, 34% and 28% resp.
Tax	68	30	25	35	-9	65	3	52	42	
Profit after tax	148.0	75.6	71.5	50.6	45.9	83.7	21.2	60.0	72.9	GNPAs have inched up mainly due to elevated slippages from the SME book.
Growth	1%	-40%	-38%	-77%	-69%	11%	-70%	19%	59%	
No. of shares	60.9	60.9	72.7	72.7	72.7	79.9	79.9	79.9	79.9	Retail loans exhibited a robust growth of 32% YoY (core growth of 27%) contributing 22% to the overall advances. The bank chose to grow the Agri, SME and Corporate book cautiously, with each contributing 16%, 34% and 28% resp.
EPS	2.4	1.2	1.0	0.7	0.6	1.0	0.3	0.8	0.9	
Advances	42,401	44,237	44,836	45,973	47,886	48,140	47,766	50,616	49,182	GNPAs have inched up mainly due to elevated slippages from the SME book.
Growth	8%	12%	17%	11%	13%	9%	7%	10%	3%	
CASA Ratio	29.2%	27.6%	28.1%	29.1%	30.0%	29.5%	29.8%	29.9%	29.7%	
CAR	11.7%	12.2%	13.9%	14.4%	14.1%	0.1%	0.1%	0.2%	16.0%	
Slippages	323	427	713	629	785	190	888	480	474	
Slippage Ratio	3.0%	3.9%	6.4%	5.5%	6.6%	1.6%	7.4%	3.8%	3.9%	
Gross NPA	4.3%	4.8%	5.9%	6.6%	7.4%	7.7%	8.5%	8.8%	9.2%	
Net NPA	2.9%	3.2%	3.9%	4.2%	4.4%	4.4%	5.0%	5.0%	4.9%	
PCR (Calculated)	34.0%	34.1%	36.2%	38.2%	41.4%	44.7%	43.4%	45.6%	48.5%	
ROA	1.0%	0.5%	0.4%	0.3%	0.3%	0.5%	0.3%	0.3%	0.4%	
ROE	11.7%	5.8%	4.6%	3.2%	2.9%	5.3%	1.3%	3.7%	4.5%	

Source: Company data, Nirmal Bang Retail Research

Key Conference-call highlights and our takeaways

Asset Quality

- a) Asset Quality worsened with GNPA's at 9.17% vs 8.79% in Q4FY19 and 7.44% in Q1FY19. Gross Slippages came at Rs. 474 Cr (slippage ratio of 3.9%) vs Rs. 480 Cr in Q4FY19 (Slippage ratio of 3.8%) and Rs. 785 Cr in Q1FY19 (slippage ratio of 6.6%).
- b) The net slippages are down to Rs. 61 Cr (lowest in the last 8 quarters, due to higher recoveries) significantly below the management's earlier guidance of ~Rs. 220 Cr per quarter. SME slippages remained elevated in-line with management guidance, whereas corporate portfolio showed higher recoveries during the quarter. We forecast net slippages of Rs. 966 Cr for FY20E.
- c) SME Net slippages: The larger pool of customers which were classified as stressed are now classified as NPA and there will now be a slowing of NPA accretion.
- d) The bank maintained its guidance of elevated provisions at Rs. 1200 Cr for FY20E as the bank intends to increase the PCR from current levels of 49% to 55%.
- e) Commercial Real estate: Exposure to large developers is a very small component of the portfolio and stands at ~Rs. 2700 Cr. There is just one developer account having loan value of over Rs. 100 Cr. The CRE portfolio remains static.
- f) Textile Book: Has exposure in 2 geographies – Southern India and Gujarat. The bank has deep understanding of the textile business and does not foresee any major stress in this portfolio.
- g) NBFC exposure stands at 4% of the total book. KVB is not exposed to DHFL, Reliance Home and Zee Entertainment however the bank has exposure to McLeod Group which is classified as an NPA.

Karur Vysya Bank Ltd.

Operational Highlights

- a) Advances stood at Rs. 49,182 Cr vs Rs. 47,886 Cr in Q1FY19, a tepid growth of 3% YoY. Retail loans continued to maintain its growth momentum at 32% YoY (ex-IBPC growth was 27%) contributing 21% to the overall advances vs. 17% YoY. The bank chose to grow cautiously in Agri (-1% YoY), SME (Flat YoY) and Corporate (-9% YoY) with each contributing 17%, 34% and 28% respectively.
- b) Retail loans would continue the positive upward trajectory. On the SME side, substantial growth is expected from small ticket loans. **As per the management, overall growth would be in “low teens” vs. previous guidance of “mid-teens”. We expect the loan growth to be at ~11 CAGR over FY19-21E.**
- c) SME Book: The bank has re-aligned business in 3 parts – (A) Small business group – Less than Rs. 2 Cr ticket size (60% of the book) managed through entirely digital process (B) Business banking process which is relationship based with a ticket size of Rs. 2-15 Cr and (C) Emerging Corporates with ticket size of >Rs. 15 Cr where Institution and corporate RMs handle this segment. Focus is to grow small ticket volumes.
- d) Deposit growth was considerable and the bank raised time deposits (retail) with a view to stay liquid in times of tight liquidity. Deposits grew 7% YoY and stood at Rs. 61,711 Cr vs Rs. 57,554 Cr in Q1FY19. This quarter, Avg. CA growth was 9% YoY and Avg. SA growth was 10% YoY with CASA ratio of 30% (flat YoY).
- e) NIMs were down 39 bps QoQ and stood at 3.49% (lowest in the last 13 qtrs.) as deposits increased by Rs. 4,000 Cr. Q4FY19 NIM consisted on non-recurring benefit impacting NIMs by 8bps. NIMs were also impacted due to increase in CoF by 6bps, increase in investment book impact of 6bps. Incremental reversals on Agri portfolio and carrying impact of IBPC (which the bank is reducing) further compressed NIMs by 4bps and 5bps respectively.

Karur Vysya Bank Ltd.

Valuation & View

- Despite KVBs stellar performance in its core segment of Retail & SME historically, its decision to aggressively grow the corporate book over FY07-12 and the subsequent stress due to defaults landed the bank in trouble. Since FY14, KVB has shifted its focus back towards Retail & SME.
- The new CEO & MD, Mr. Seshadri's extensive experience & expertise in Retail & SME shall aid KVB in improving efficiency and accelerate the pace of retailization of its loan book.
- The credit cost is expected to remain elevated in FY20E at 2.4%. Although our long term thesis remains intact for KVB, any meaningful improvement in the bank's return ratios can only be expected from FY21E onwards.
- Sharpening focus on the Retail and SME segments while building revenue as well as profit momentum (loan/PAT CAGR of 11%/78%, respectively, over FY19-21E) and transformation into a granular and higher RoE business combined with cheap valuations at 1.2x FY21E ABV provides decent scope for re-rating in the long term. However, continued elevated stress in the Corporate and SME books combined with higher credit costs in order to shore up the PCR, should translate to sub optimal ROA in FY20E. **We maintain our 'HOLD' rating on the stock with a price target of Rs. 88, based on 1.6x FY21E ABV (33% discount to CUB).**

Dupont ROE

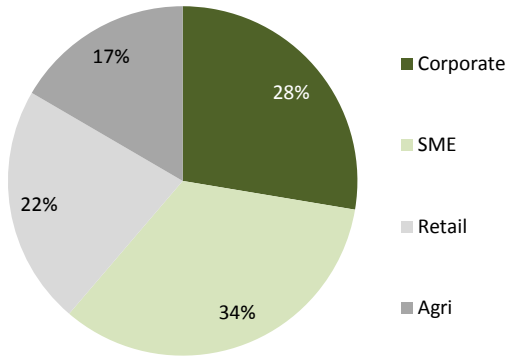
	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
NII	2.75%	2.61%	2.80%	3.18%	3.43%	3.57%	3.47%	3.37%	3.43%
Other Income	1.07%	1.15%	1.11%	1.26%	1.30%	1.40%	1.41%	1.46%	1.47%
Total Income	3.82%	3.76%	3.91%	4.44%	4.73%	4.97%	4.88%	4.83%	4.90%
Opex	1.81%	2.06%	2.11%	2.11%	2.13%	2.21%	2.37%	2.34%	2.29%
PPP	2.01%	1.70%	1.80%	2.32%	2.60%	2.76%	2.51%	2.49%	2.61%
Provisions	0.29%	0.90%	0.92%	0.70%	1.14%	1.98%	2.04%	1.74%	1.37%
PBT	1.72%	0.80%	0.88%	1.62%	1.46%	0.78%	0.47%	0.75%	1.23%
Tax Rate	24%	2%	-7%	38%	31%	31%	35%	35%	35%
ROA	1.30%	0.79%	0.85%	1.01%	1.00%	0.54%	0.31%	0.49%	0.81%
Leverage	12.8	15.3	13.8	12.7	12.6	11.4	10.7	11.3	11.9
ROE	16.7%	12.1%	11.8%	12.9%	12.6%	6.1%	3.3%	5.6%	9.6%

Source: Company, NBRR

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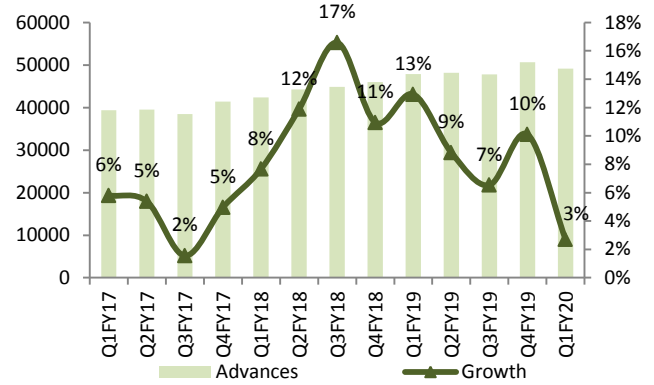
Story in Charts

Stable Loan Book Mix



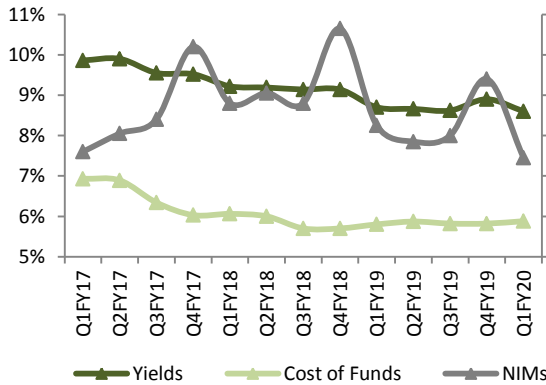
Source: Company, NBRR

Muted Advances growth



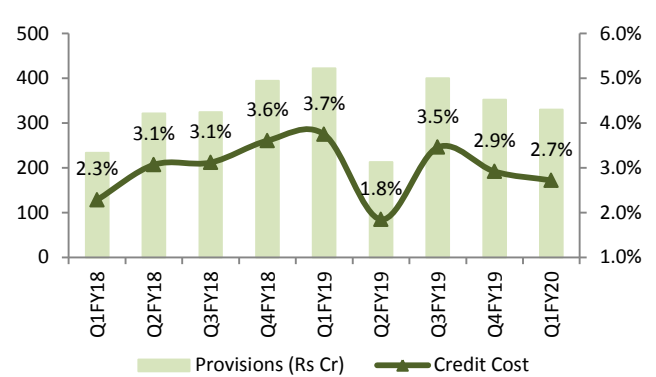
Source: Company, NBRR

NIMS were affected by non-recurring benefit



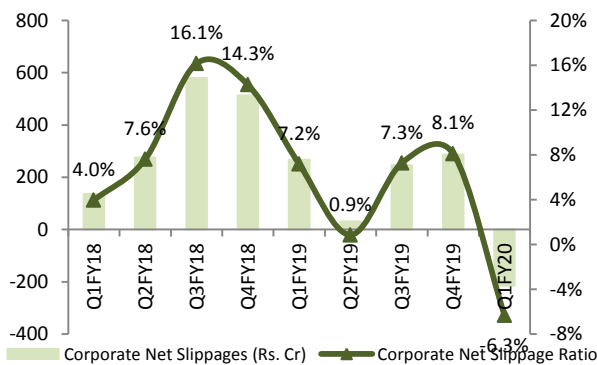
Source: Company, NBRR

Easing Credit Costs



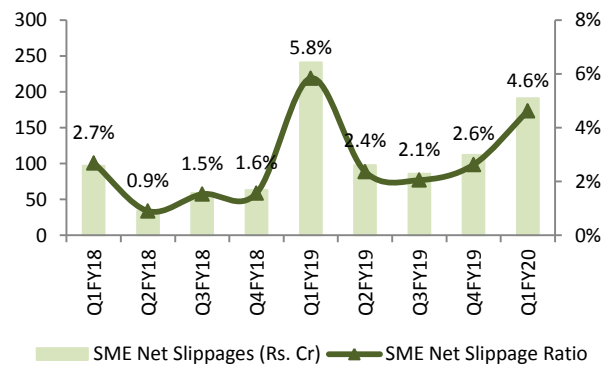
Source: Company, NBRR

Corporate Net Slippages lower due to recoveries



Source: Company, NBRR

SME Net Slippages continue to remain elevated



Source: Company, NBRR

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Financials

P&L (Rs. Crs)	FY17	FY18	FY19	FY20E	FY21E
Interest earned	5,622	5,700	5,816	6,289	7,132
Interest expended	3,549	3,402	3,453	3,796	4,290
NII	2,074	2,298	2,363	2,492	2,842
Non interest income	782	900	963	1,082	1,222
Total income	2,856	3,198	3,326	3,574	4,064
Growth	15%	12%	4%	7%	14%
Operating expenses	1,285	1,421	1,615	1,732	1,900
<i>Growth</i>	<i>8%</i>	<i>11%</i>	<i>14%</i>	<i>7%</i>	<i>10%</i>
<i>Staff costs</i>	<i>608</i>	<i>639</i>	<i>761</i>	<i>850</i>	<i>930</i>
<i>Other Op Exp</i>	<i>677</i>	<i>782</i>	<i>854</i>	<i>882</i>	<i>970</i>
Profit before prov	1,571	1,777	1,711	1,842	2,164
Growth	21%	13%	-4%	8%	17%
Provisions	687	1,274	1,389	1,285	1,140
<i>Growth</i>	<i>85%</i>	<i>85%</i>	<i>9%</i>	<i>-7%</i>	<i>-11%</i>
Profit before tax	884	504	322	557	1,024
Taxes	278	158	111	193	354
Net profit	606	346	211	365	670
Growth	7%	-43%	-39%	73%	84%

Key Ratios	FY17	FY18	FY19	FY20E	FY21E
Yield on Advances	11.3%	10.3%	9.8%	9.7%	9.8%
Yield on Tot Assets	9.6%	9.1%	8.7%	8.7%	8.8%
Cost of Borrowings	6.5%	5.9%	5.7%	5.7%	5.7%
Spread	4.82%	4.39%	4.05%	3.94%	4.09%
NIM	3.70%	3.87%	3.68%	3.57%	3.63%

Profitability Ratios	FY17	FY18	FY19	FY20E	FY21E
Cost / Income Ratio	45.0%	44.4%	48.6%	48.5%	46.7%
ROE	12.0%	6.1%	3.3%	5.6%	9.6%
ROA	1.00%	0.54%	0.31%	0.49%	0.81%

Per Share Data	FY17	FY18	FY19	FY20E	FY21E
EPS	9.9	4.8	2.6	4.6	8.4
BVPS	82.6	86.2	80.4	83.7	90.6
Adjusted BVPS	65.7	60.6	50.1	52.4	54.6

Bal. Sheet (Rs. Crs)	FY17	FY18	FY19	FY20E	FY21E
Equity capital	122	145	160	160	160
Reserves & surplus	4,914	6,119	6,263	6,532	7,082
Net worth	5,036	6,264	6,423	6,691	7,242
Deposits	53,700	56,890	59,868	68,572	76,571
<i>(of which CASA)</i>	<i>14,889</i>	<i>16,577</i>	<i>17,915</i>	<i>20,900</i>	<i>23,705</i>
Borrowings	1,696	2,382	1,565	1,765	2,015
Other liab and prov	1,376	1,393	1,484	1,509	1,534
Total liabilities	56,772	60,665	62,917	71,846	80,120
Total liab and equity	61,808	66,929	69,340	78,537	87,362
Cash and bank bal	1,555	1,337	762	1,912	2,062
Bal. with RBI	2,790	2,960	2,935	3,293	3,600
Investments	14,857	15,803	14,882	17,422	18,880
Net Advances	40,908	44,800	48,581	53,511	60,252
<i>Growth</i>	<i>5%</i>	<i>10%</i>	<i>8%</i>	<i>10%</i>	<i>13%</i>
Other assets	1,697	2,029	2,181	2,399	2,567
Total assets	61,808	66,929	69,340	78,537	87,362

Asset Quality	FY17	FY18	FY19	FY20E	FY21E
GNPA	1,484	3,016	4,450	5,419	6,469
GNPA ratio	3.6%	6.6%	8.8%	9.7%	10.3%
NNPA	1,033	1,863	2,420	2,505	2,874
NNPA ratio	2.5%	4.2%	5.0%	4.7%	4.8%
PCR (Calculated)	30%	38%	46%	54%	56%
Credit Cost	1.7%	2.9%	2.9%	2.4%	1.9%

Balance Sheet Ratios	FY17	FY18	FY19	FY20E	FY21E
CD Ratio	76.2%	78.7%	81.1%	78.0%	78.7%
CASA	27.7%	29.1%	29.9%	30.5%	31.0%
CAR	12.5%	14.4%	16.0%	15.5%	14.9%
Tier - 1	11.9%	13.9%	14.3%	13.8%	13.2%

Valuation Ratios	FY17	FY18	FY19	FY20E	FY21E
P/E	6.6	13.8	24.9	14.4	7.8
P/BV	0.8	0.8	0.8	0.8	0.7
P/ABV	1.0	1.1	1.3	1.3	1.2

Source: Company data, NBRR

Karur Vysya Bank Ltd.

Disclosure:

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Karur Vysya Bank Ltd.

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