

Karur Vysya Bank Ltd.

Recommendation	HOLD
CMP	Rs. 79
Target Price	Rs. 94
Sector	Banking

Stock Details	
BSE Code	590003
NSE Code	KARURVYSYA
Bloomberg Code	KVB IN
Market Cap (Rs Cr)	Rs. 6,291
Free Float (%)	97.9%
52- week H/L (Rs)	101/63
Avg. volume (BSE+NSE)	1464900
Face Value (Rs)	2
Div per share (FY 18)	0.60
Shares o/s (Cr)	72.7

Relative Performance	1Mth	3Mth	1Yr
KVB	0.8%	17.1%	-11.4%
Sensex	1.8%	10.1%	13.7%



Shareholding Pattern		Mar'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	16.5	60.6	1.3	6.1%
FY19E	2,363	3%	1,711	211	-39%	2.6	29.8	50.1	1.6	3.3%
FY20E	2,751	16%	2,018	508	141%	6.4	12.4	52.9	1.5	7.7%
FY21E	3,210	17%	2,430	820	61%	10.3	7.7	57.3	1.4	11.4%

Elevated slippages and higher provisions to impact FY20E performance

- Advances stood at Rs. 50,616 Cr vs Rs. 45,973 Cr in Q4FY18, a growth of 10% YoY. Retail loans exhibited a robust growth of 48% YoY contributing 22% to the overall advances (Core Retail growth stood at 24% while the remaining growth was contributed by IBPC portfolio taken on books for 90 days). The bank chose to grow cautiously in Agri (+3% YoY), SME (+6% YoY) and Corporate (-2% YoY) with each contributing 16%, 34% and 28% respectively. We expect loan growth of 15% CAGR over FY19-21E.
- NIMs were higher 22 bps QoQ at 3.88% on the back of increase in yields. Yield improvement is mainly on the back of the risk based pricing approach adopted by the bank. NIMs shall continue to rise and the management has guided for levels of 4.25% going ahead. Drop in reversals on NPA shall alone drive up NIMs by 10-12 bps as slippages moderate. Total income grew by 5% YoY on the back of 31% YoY growth in non-interest income.
- Opex growth stood at 15% YoY. Cost/income ratio at 48.6% continued to remain elevated both on QoQ (+70bps) and YoY basis (+490bps).
- PBP declined by 3% YoY to Rs. 465 Cr, however it grew by 9% QoQ.
- Provisions during the quarter stood at Rs. 352 Cr vs Rs. 394 Cr in Q4FY18 and Rs. 400 Cr in Q3FY19. Credit cost for the quarter eased out sequentially and YoY from 3.5% in Q3FY19 and 3.6% in Q4FY18 to 2.9%. Credit costs are expected to remain elevated in FY20E as the bank targets to increase its PCR from the current level of 44% to 55-60% over next couple of years.
- The bank reported Net Profit of Rs. 60 Cr vs Rs. 51 Cr in Q4FY18 (+19% YoY) and Rs. 21 Cr in Q3FY19 (+183% QoQ).

Valuation and Outlook

Sharpening focus on the retail and SME segments while building revenue as well as profit momentum (loan/PAT CAGR of 15%/97%, respectively, over FY19-21E) and transformation into a granular and higher RoE business combined with cheap valuations at 1.3x FY21 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. 94, based on 1.6x FY21E ABV (33% discount to CUB).**

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Quarterly Results

Particulars (Rs. Cr)	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Comments
Interest Earned	1384	1402	1422	1491	1443	1457	1443	1474	<i>NIMs have improved sequentially on the back of improved yields and the risk based pricing approach of the bank. We expect the NIMs to inch up further.</i>
Interest Expended	846	847	861	848	859	878	862	854	
Net Interest Income	539	555	562	643	584	579	581	619	
<i>Growth</i>	12%	12%	9%	11%	8%	4%	3%	-4%	
NIMs	3.76%	3.81%	3.76%	4.13%	3.65%	3.57%	3.60%	3.88%	<i>Non-Interest income is exhibiting robust growth on the back of good traction in fee income (~68% of total non-interest income) and also due to recoveries from w/off to the tune of Rs. 10 Cr during the quarter.</i>
Other Income	236	230	225	209	255	176	260	272	
% of total income	30%	29%	29%	25%	30%	23%	31%	31%	
Total Income	775	785	786	852	838	755	841	892	
<i>Growth</i>	20%	10%	14%	5%	8%	-4%	7%	5%	<i>C-I Ratio continues to remain elevated at 47.9%.</i>
Employee exp	151	155	153	179	179	173	198	212	
Other op exp	174	203	212	193	200	221	218	215	
Total op exp	325	358	365	372	379	393	416	427	
<i>Growth</i>	-10%	-9%	-12%	22%	16%	10%	14%	15%	<i>The quarterly provisioning rate was high and shall continue to remain elevated as KVB aims to take the PCR to 55-60% by the end of FY20. Credit cost for the quarter eased out at 2.9% vs 3.46% QoQ and 3.61% YoY.</i>
Cost to income ratio	42.0%	45.6%	46.4%	43.7%	45.2%	52.1%	49.4%	47.9%	
Profit before prov.	449	427	421	480	460	361	425	465	
Provisions	233	321	325	394	423	213	400	352	
<i>Growth</i>	249%	170%	244%	81%	81%	-34%	23%	-11%	<i>Retail loans exhibited a robust growth of 48% YoY (core growth of 24%) 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.</i>
Credit Cost	2.28%	3.07%	3.12%	3.61%	3.75%	1.85%	3.46%	2.92%	
Profit before tax	216	106	96	86	37	148	25	112	
Tax	68	30	25	35	-9	65	3	52	
Profit after tax	148.0	75.6	71.5	50.6	45.9	83.7	21.2	60.0	<i>GNPAs have inched up mainly due to the slippages from the legacy corporate book.</i>
<i>Growth</i>	1%	-40%	-38%	-77%	-69%	11%	-70%	19%	
No. of shares	60.9	60.9	72.7	72.7	72.7	79.9	79.9	79.9	
EPS	2.4	1.2	1.0	0.7	0.6	1.0	0.3	0.8	
Advances	42,401	44,237	44,836	45,973	47,886	48,140	47,766	50,616	<i>Slippages</i>
<i>Growth</i>	8%	12%	17%	11%	13%	9%	7%	10%	
CASA Ratio	29.2%	27.6%	28.1%	29.1%	30.0%	29.5%	29.8%	29.9%	
CAR	11.7%	12.2%	13.9%	14.4%	14.1%	0.1%	0.1%	0.2%	
Slippages	323	427	713	629	785	190	888	480	<i>Slippage Ratio</i>
<i>Slippage Ratio</i>	3.0%	3.9%	6.4%	5.5%	6.6%	1.6%	7.4%	3.8%	
Gross NPA	4.3%	4.8%	5.9%	6.6%	7.4%	7.7%	8.5%	8.8%	
Net NPA	2.9%	3.2%	3.9%	4.2%	4.4%	4.4%	5.0%	5.0%	
PCR (Calculated)	34.0%	34.1%	36.2%	38.2%	41.4%	44.7%	43.4%	45.6%	<i>ROA</i>
ROA	1.0%	0.5%	0.4%	0.3%	0.3%	0.5%	0.3%	0.3%	
ROE	11.7%	5.8%	4.6%	3.2%	2.9%	5.3%	1.3%	3.7%	

Source: Company data, Nirmal Bang Retail Research

Key Conference-call highlights and our takeaways

Asset Quality

- a) The management had provided guidance on Net Slippages for 5 qtrs starting Q4FY19 at Rs. 1100 Cr. With ~Rs. 400 Cr recognized in Q4FY19, the remaining ~Rs. 700 Cr would be recognized in the next 4 quarters (FY20), as per the management. Post FY20, Net Slippages would be at 1.5% on a steady state basis.
- b) The management expects SME slippages to be slightly elevated in Q1FY20 (~2.6%). However, they are expected to moderate to 1.5% from H2FY20 onwards.
- c) The bank will continue to have higher provisions (~Rs. 1200 Cr) in FY20E as the bank intends to increase the PCR from current levels of 44.1% and to 55-60%.
- d) Current quarter saw restructuring of Rs. 68 Cr taking the restructured book to Rs. 72 Cr. Rs. 50 Cr worth loans would be restructured in the next 3-6 months. By the end of H1FY20, the restructured book would be in the neighborhood of Rs. 120 Cr.
- e) The bank's exposure to the NCLT list 1 and 2 put together stands at ~Rs. 400-500 Cr.
- f) KVB aims to get SMA1+SMA2 book below 300 bps of the total book and the SMA2 book alone below 100 bps.
- g) NBFC exposure stands at 3% of the total book. KVB is not exposed to DHFL, Reliance Home and Zee Entertainment however the bank has exposure to Reliance Communications (exposure in three digits). Although, NPAs will not be materially impacted due to this.

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 Other Highlights

- a) Advances stood at Rs. 50,616 Cr vs Rs. 45,973 Cr in Q4FY18 a growth of 10% YoY. Retail loans exhibited robust growth of 48% YoY contributing 22% to the overall advances (Core Retail growth stood at 24% while the remaining growth was contributed by IBPC portfolio taken on books for 90 days). The bank chose to grow cautiously in Agri (+3% YoY), SME (+6% YoY) and Corporate (-2% YoY) cautiously, with each contributing 16%, 34% and 28% respectively.
- b) The bank concluded most of the digital initiatives in Retail & SME during the quarter, thus ensuring implementation of risk based pricing, which transpired into NIM expansion during the quarter. NIMs expanded sequentially to 3.88% in Q4FY19 vs 3.60% QoQ entirely on the back of increase in yields which came in at 9.81% vs 9.59% QoQ. This is on the back of the risk based pricing approach adopted by KVB. Also, a major chunk of its book is easily repricable. Yield resetting only happens for new loans in Retail while in SME it happens on the entire book as they are Working Capital loans. Thus NIMs shall continue to rise and the management has guided for levels of 4.25% going ahead. Drop in reversals on NPA shall alone drive up NIMs by 10-12 bps as slippages moderate.
- c) KVB enjoys a healthy capital adequacy with CAR of 16% and Tier 1 of 14.3%. It thus does not require any additional capital to be raised in the near future.
- d) Bank expects total advances growth to be at ~15% in line with the system growth rate. Retail will be the focus area to accelerate growth and is expected to grow at ~30%. Corporate growth is estimated at 5% and SME is expected to grow in “mid-teens”.
- e) KVB has guided for FY20 exit quarter RoA of 1.0% which we believe will be a tall ask. We forecast ROA of 0.7% for FY20E and 1.0% for FY21E.

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Valuation & View

- Despite KVBs stellar performance in its core segment of Retail & SME over a decade back, its decision to aggressively grow the corporate book over FY07-12 and the subsequent stress due to defaults in the corporate book 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 guidance given by the management during the quarter is higher than their previous guidance. To that extent, we revise our estimates down and now expect FY20E to remain subdued. 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 15%/97%, respectively, over FY19-21E) and transformation into a granular and higher RoE business combined with cheap valuations at 1.3x FY21 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. 94, based on 1.6x FY21E ABV (33% discount to CUB).**

Dupont ROE

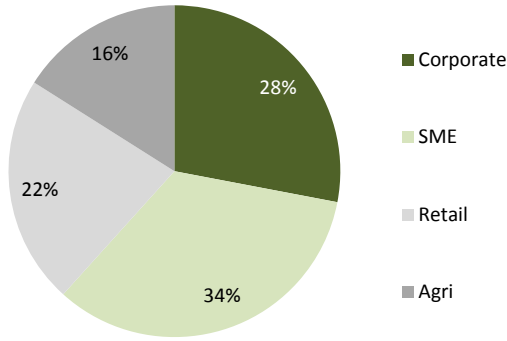
	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
NII	2.7%	2.6%	2.8%	3.2%	3.4%	3.6%	3.5%	3.7%	3.8%
Other Income	1.1%	1.1%	1.1%	1.3%	1.3%	1.4%	1.4%	1.5%	1.5%
Total Income	3.8%	3.8%	3.9%	4.4%	4.7%	5.0%	4.9%	5.2%	5.4%
Opex	1.8%	2.1%	2.1%	2.1%	2.1%	2.2%	2.4%	2.5%	2.5%
PPP	2.0%	1.7%	1.8%	2.3%	2.6%	2.8%	2.5%	2.7%	2.9%
Provisions	0.3%	0.9%	0.9%	0.7%	1.1%	2.0%	2.0%	1.7%	1.4%
PBT	1.7%	0.8%	0.9%	1.6%	1.5%	0.8%	0.5%	1.1%	1.5%
Tax Rate	24%	2%	-7%	38%	31%	31%	35%	35%	35%
ROA	1.3%	0.8%	0.9%	1.0%	1.0%	0.5%	0.3%	0.7%	1.0%
Leverage	12.8	15.3	13.8	12.7	12.6	11.4	10.7	11.1	11.7
ROE	16.7%	12.1%	11.8%	12.9%	12.6%	6.1%	3.3%	7.7%	11.4%

Source: Company, NBRR

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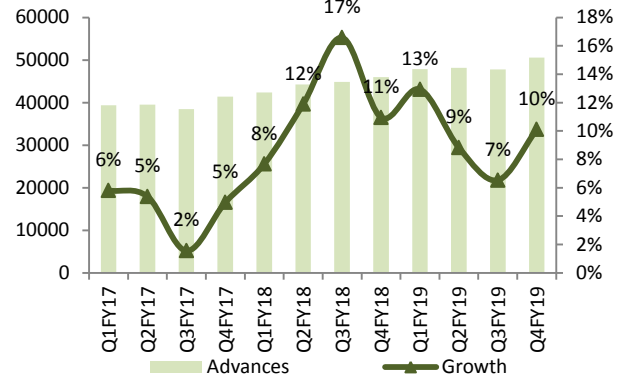
Story in Charts

Loan Book Mix



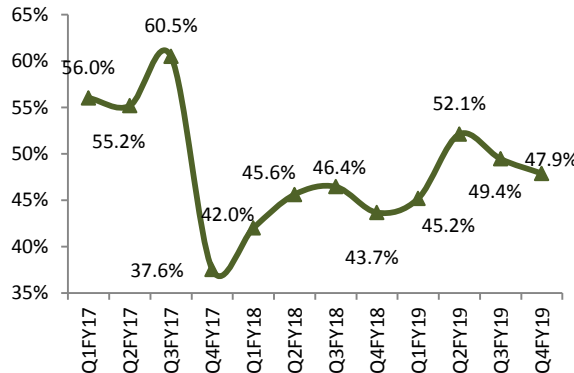
Source: Company, NBRR

Muted Advances growth



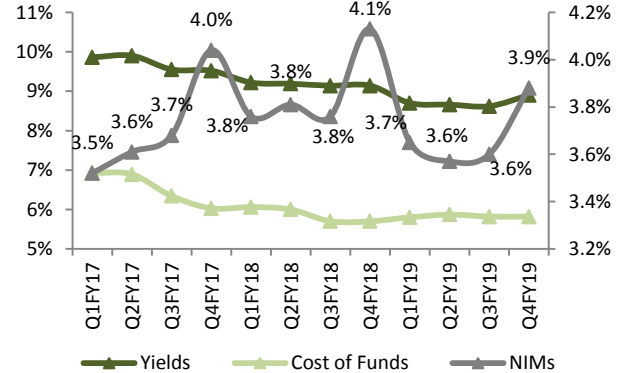
Source: Company, NBRR

C-I Ratio to decline with acceleration in loan growth



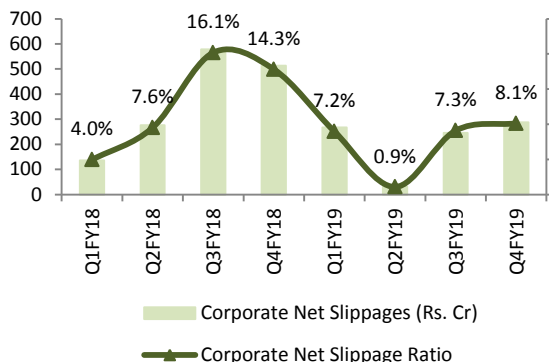
Source: Company, NBRR

Improvement in yields lead to higher NIMs



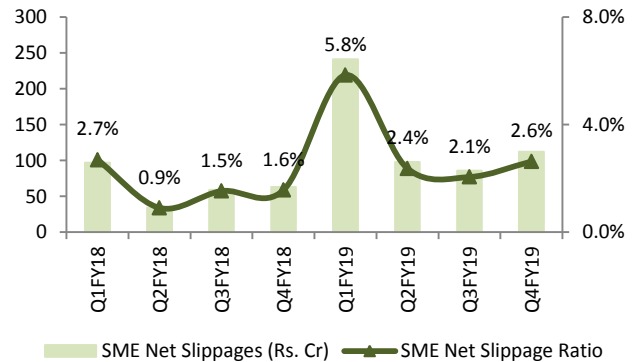
Source: Company, NBRR

Corporate Net Slippages



Source: Company, NBRR

SME Net Slippages



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	6,521	7,526
Interest expended	3,549	3,402	3,453	3,771	4,316
NII	2,074	2,298	2,363	2,751	3,210
Non interest income	782	900	963	1,103	1,296
Total income	2,856	3,198	3,326	3,853	4,507
Growth	15%	12%	4%	16%	17%
Operating expenses	1,285	1,421	1,615	1,836	2,077
<i>Growth</i>	<i>8%</i>	<i>11%</i>	<i>14%</i>	<i>14%</i>	<i>13%</i>
<i>Staff costs</i>	<i>608</i>	<i>639</i>	<i>761</i>	<i>889</i>	<i>1,034</i>
<i>Other Op Exp</i>	<i>677</i>	<i>782</i>	<i>854</i>	<i>947</i>	<i>1,043</i>
Profit before prov	1,571	1,777	1,711	2,018	2,430
Growth	21%	13%	-4%	18%	20%
Provisions	687	1,274	1,389	1,241	1,177
<i>Growth</i>	<i>85%</i>	<i>85%</i>	<i>9%</i>	<i>-11%</i>	<i>-5%</i>
Profit before tax	884	503	322	777	1,253
Taxes	278	158	111	268	433
Net profit	606	346	211	508	820
Growth	7%	-43%	-39%	141%	61%

Key Ratios	FY17	FY18	FY19	FY20E	FY21E
Yield on Advances	11.3%	10.3%	9.8%	10.1%	10.2%
Yield on Tot Assets	9.6%	9.1%	8.7%	9.0%	9.2%
Cost of Borrowings	6.5%	5.9%	5.7%	5.7%	5.7%
Spread	4.82%	4.39%	4.05%	4.37%	4.51%
NIM	3.70%	3.87%	3.68%	3.95%	4.05%

Profitability Ratios	FY17	FY18	FY19	FY20E	FY21E
Cost / Income Ratio	45.0%	44.4%	48.6%	47.6%	46.1%
ROE	12.0%	6.1%	3.3%	7.7%	11.4%
ROA	1.00%	0.54%	0.31%	0.69%	0.98%

Per Share Data	FY17	FY18	FY19	FY20E	FY21E
EPS	9.9	4.8	2.6	6.4	10.3
BVPS	82.6	86.2	80.4	85.5	94.0
Adjusted BVPS	65.7	60.6	50.1	52.9	57.3

Bal. Sheet (Rs. Crs)	FY17	FY18	FY19	FY20E	FY21E
Equity capital	122	145	160	160	160
Reserves & surplus	4,914	6,119	6,263	6,675	7,351
Net worth	5,036	6,264	6,423	6,835	7,511
Deposits	53,700	56,890	59,868	67,916	78,364
<i>(of which CASA)</i>	<i>14,889</i>	<i>16,577</i>	<i>17,915</i>	<i>20,705</i>	<i>24,246</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	71,190	81,914
Total liab and equity	61,808	66,929	69,340	78,025	89,425
Cash and bank bal	1,555	1,337	762	912	1,062
Bal. with RBI	2,790	2,960	2,935	3,261	3,685
Investments	14,857	15,803	14,882	16,339	18,265
Net Advances	40,908	44,800	48,581	55,180	63,916
<i>Growth</i>	<i>5%</i>	<i>10%</i>	<i>8%</i>	<i>14%</i>	<i>16%</i>
Other assets	1,697	2,029	2,181	2,333	2,497
Total assets	61,808	66,929	69,340	78,025	89,425

Asset Quality	FY17	FY18	FY19	FY20E	FY21E
GNPA	1,484	3,016	4,450	5,250	6,122
GNPA ratio	3.6%	6.6%	8.8%	9.1%	9.2%
NNPA	1,033	1,863	2,420	2,607	2,927
NNPA ratio	2.5%	4.2%	5.0%	4.7%	4.6%
PCR (Calculated)	30%	38%	46%	50%	52%
Credit Cost	1.7%	2.9%	2.9%	2.3%	1.9%

Balance Sheet Ratios	FY17	FY18	FY19	FY20E	FY21E
CD Ratio	76.2%	78.7%	81.1%	81.2%	81.6%
CASA	27.7%	29.1%	29.9%	30.5%	30.9%
CAR	12.5%	14.4%	16.0%	15.1%	14.4%
Tier - 1	11.9%	13.9%	14.3%	13.4%	12.7%

Valuation Ratios	FY17	FY18	FY19	FY20E	FY21E
P/E	7.9	16.5	29.8	12.4	7.7
P/BV	1.0	0.9	1.0	0.9	0.8
P/ABV	1.2	1.3	1.6	1.5	1.4

Source: Company data, NBRR

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