

Karnataka Bank

Bharat ka Karnataka Bank-New age ambitions



BANK

Long Term Recommendation Karnataka Bank

'Bharat ka Karnataka Bank' - New age ambitions

- Karnataka Bank (KBL), with a predominant presence in South India is in the process of evolving into a new-age private bank. The Bank is on the verge of completion of its transformation journey which included strengthening the top management and the Board, strengthening its technology framework & setting up policies and processes in place. In this transformative journey, the bank has set-up dedicated collection and monitoring team, established mechanisms to preempt extreme scenarios like sharp drop in asset quality, has improved HR function by establishing structure for incentivising and promoting employees and has tied up with multiple insurance/wealth management companies to launch & cross sell new products.
- Currently, KBL has a balance sheet size of ~INR 1.16lac cr as on Q2FY25, operating with 931 branches with major presence South India and 1,505 ATM and Recyclers across India. Bank is intending to be present across India; hence branch opening is expected to be out of home state. Over the years, it has developed a strong deposit base mainly in Karnataka and from the adjoining states like Maharashtra, Andhra Pradesh, and Tamil Nadu.
- Historically, over FY02–09, KBL franchise consistently delivered a RoA of more than 1%. However, since then, it has undershot the 1% mark annually due to fall in non-interest income and concurrent decline in operating efficiencies. This was reflected in its elevated cost-to-income ratio, which rose to an average ~56% during FY10–17 from an average ~38% over FY02–09. In 2017, KBL tied up with the Boston Consulting Group to kick off 'KBL Vikaas'. This transformation project was aimed to boost sales and other income, optimise cost and pricing, develop products, and keep asset quality under control. This modernization project was put on the back burner due to the COVID-19 pandemic but was reignited by the new MD & CEO Mr Srikrishnan H in 2023.
- The transformation project did start bearing fruit, with RoA crossing the 1% mark by the end of FY23. RoA stood at 1.4% at the end FY24. The management is ensuring its performance stays stable and consistent, while retaining return ratios at current levels. Its focus on tech investments and strengthening the board (by adding specialists) continues. There is also a renewed emphasis on growing the retail segment.
- Overall, a strengthened board, tech transformation drive, improving sourcing channels, centralised underwriting, separate collection verticals and fee income initiatives would drive loan growth & increase other income, sticky granular deposits would ensure stable NIMs and loan sourcing/management would keep asset quality in check and thus improve credit cost.
- We expect 17% credit growth over FY24–27 with a RoA/RoE of 1.4%/14% in FY27 and a consistent improvement in asset quality. We expect a re-rating as operating efficiencies kick in. We initiate coverage with a 'BUY' rating and a TP of INR310 (0.8x FY27E P/ABV).

Specialist external talent

KBL strengthened its top management by bringing in external talent. In the last two years, around ~52% of its top management, including the CEO, was onboarded from the industry. Thus, altering its earlier practice of just internally promoting candidates. The bank is looking towards the future by having more industry specialist filling in the necessary gaps and increasing the management's bandwidth. All these intangible efforts are making the bank future ready and competitive.

Favourable C/D ratio and liquidity parameters to spur loan growth

KBL enjoys a favourable credit-to-deposit ratio of 74% versus an avg. ~91% for private banks. Aided by renewed sourcing and underwriting processes, it has enough headroom for credit growth. KBL enjoys enough liquidity, with LCR at 269% as of Q1FY25 end against the regulatory requirement of 100% and the industry average of ~130%. Furthermore, it has completed its target capital raise of INR1,500cr within a record six months, out of which INR700cr was completed in Q4FY24 itself. CRAR stood at a healthy ~18% at the end of Q1FY25.

Stable NIM and improved credit cost will drive return ratios

KBL enjoys a loyal and sticky retail deposit base that is much to the envy of any new age private bank. It has a granular deposit franchise, with 85% of term deposits less than INR2cr at the end of Q1FY25. This favourable deposit franchise ensures availability of low-cost funds to the bank. This, coupled with a secular improvement in the balance sheet and a revamped risk pricing of loans, will ensure structurally higher NIM. Initiatives to increase monitoring, setting up of dedicated collection teams, ~90% secured book, and a healthy PCR will ensure reduced slippage, thus improving asset quality and reducing credit costs.

Valuation and view

We expect credit growth to pick-up from current levels given KBL's strengthened sales force, greater distribution presence, and reduction in TAT. We anticipate loan growth of ~17% CAGR, a stable NIM of ~3.4% will keep rising opex ~2.3% in check, with the C/I ratio hovering ~50% by FY27. Lower credit cost at ~0.7% will ensure a healthy return profile, with a RoA of 1.4%. Given the attractive valuation and expected improvement across various operating and efficiency parameters, we expect the re-rating in the stock going ahead. Hence, we initiate coverage with a 'BUY' rating and a TP of INR310 (0.8x FY27E P/ABV), which offers a potential upside of 50% from its CMP.

Key financials

Year to March	FY22	FY23	FY24	FY25E	FY26E	FY27E
Net revenue (INR cr)	3,445	4,178	4,618	4,840	5,694	6,649
Net profit (INR cr)	509	1,180	1,306	1,398	1,710	2,033
Basic EPS (INR cr)	16	38	35	37	45	53
P/E ratio (x)	12.7	5.5	6.0	5.7	4.6	3.9
Adjusted BV	190	230	259	291	335	387
P/ABV ratio (x)	1.1	0.9	0.8	0.7	0.6	0.5

CMP: INR207

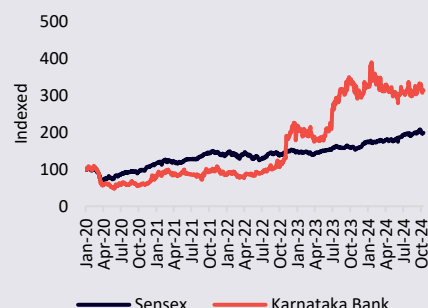
Rating: BUY

Target price: INR310

Upside: 50%

Date: October 30, 2024

Bloomberg:	KBL:IN
52-week range (INR):	192/286
M-cap (INR cr):	7,812
Promoter holding (%)	-



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Business structure

KBL’s advances are expected to clock 17% CAGR over FY24–27E, driven by its renewed focus on MSME and agricultural loans as well as the anticipated addition of products in the retail segment. The bank’s net revenue/operating profit/net profit is estimated to grow at a CAGR of 13%/15%/16% over FY24–27E, considering the improvement in operating efficiencies and moderation in credit cost. RoA/RoE improves to 1.42%/14% in FY27E.

Given the attractive valuations expected stability in return ratios and asset quality, we initiate coverage with a ‘BUY’ rating with a TP of INR310 (0.8x FY27E P/ABV), which offers a potential upside of 50%.

KBL’s NIM toned down in FY24 as the interest rate cycle is bottoming out but will stay structurally high above 3.4% over FY24-27E

Tech capex and lateral hiring will keep C/I ratio elevated initially but it is expected to start softening from FY26. Credit cost is expected to remain soft because of improving underwriting, dedicated collection, strengthened monitoring and moderating restructured book.

We expect return ratios (RoA/RoE) to improve to 1.42%/13.7% in FY27E from 1.35%/13.7% in FY24, largely driven by a higher revenue, stable NIM, and lower credit cost

INR cr	FY24	FY25E	FY26E	FY27E
NII	3,299	3,606	4,176	4,880
OI	1,319	1,233	1,518	1,769
Opex	2,454	2,662	2,942	3,342
PAT	1,306	1,398	1,710	2,033

(%)	FY24	FY25E	FY26E	FY27E
RoA	1.35	1.27	1.37	1.42
RoE	13.7	12.2	13.1	13.7

INR	FY27E ABV	CMP
0.8x (CMP)	387	207

At the CMP, FY27E P/ABV is 0.5x

+

FY24–27E RoE of 12.2–13.7%

+

Exit price of 0.8x FY27E ABV at the TP of INR310, implies an upside of 50%

Upside: 50%

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Focus charts

Exhibit 1: Launching of some products in retail will augment the overall credit growth

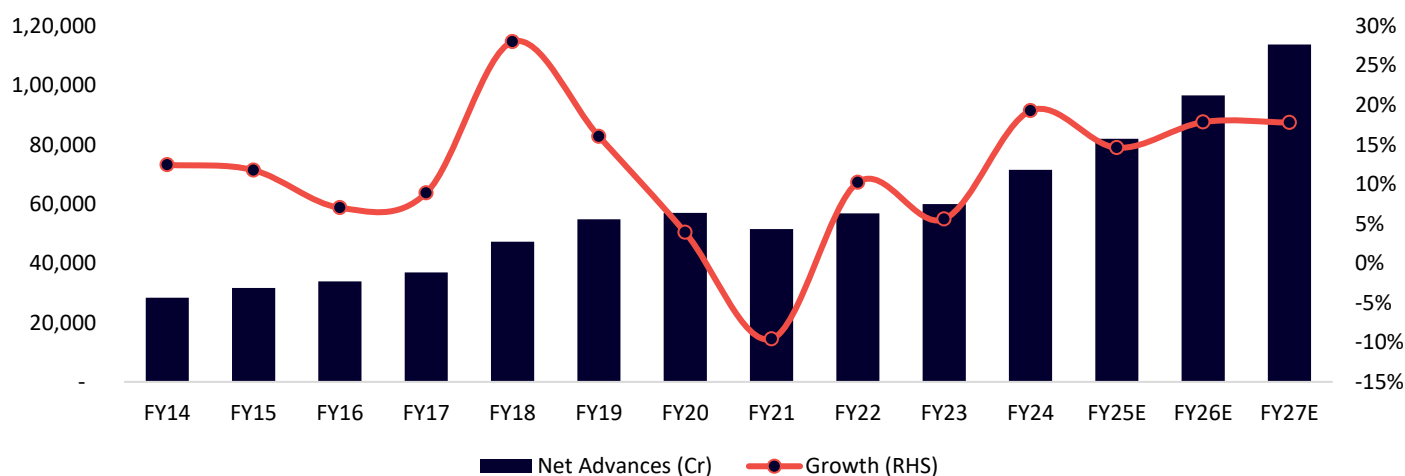


Exhibit 2: Exiting low yielding advances as well letting go of high-cost deposits will boost NIM in medium to long term

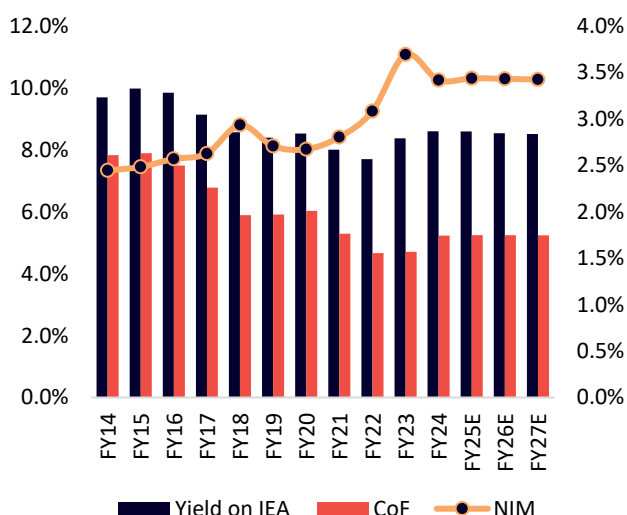


Exhibit 3: Multiple tie-ups with life/general insurance and wealth management will augment fee income, resulting substantial boost in net revenue over FY24-27E

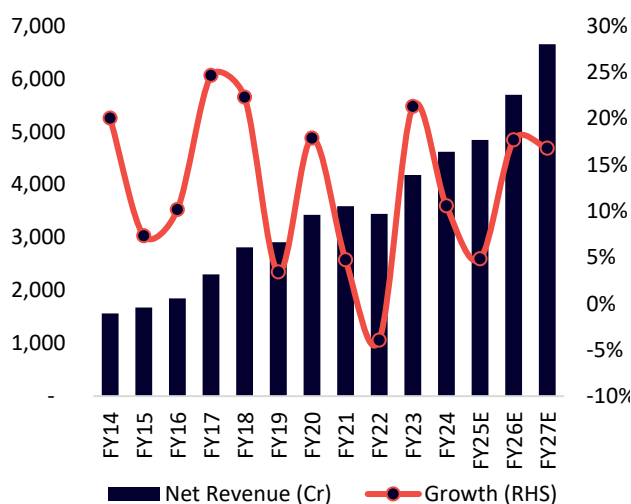


Exhibit 4: As top management onboarding is completed and investment in tech is also expected to soften; hence opex to moderate going forward.

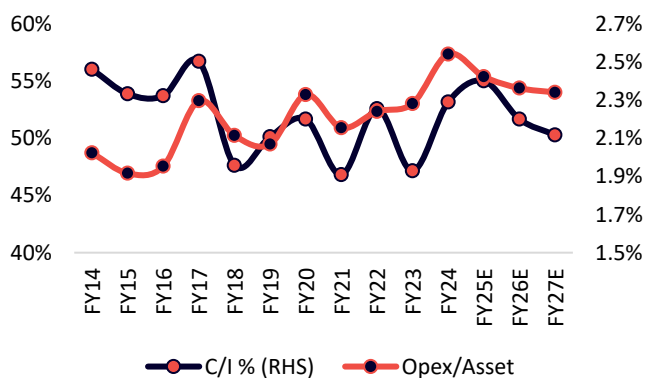
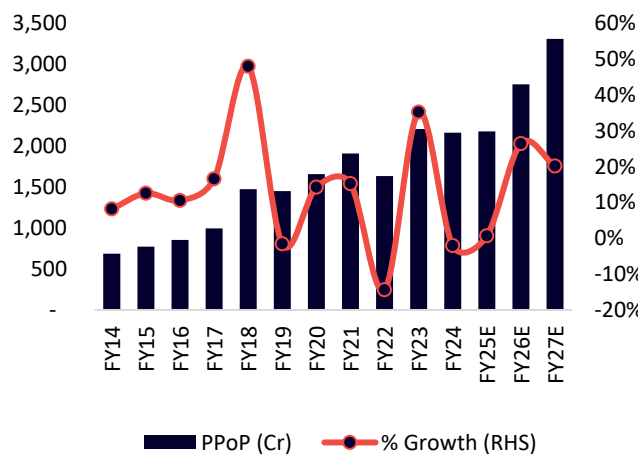


Exhibit 5: Therefore, PPOP growth to accelerate



Source: Company, Nuvama Wealth Research

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Exhibit 6: Improving credit underwriting, moderating restructure book and higher secured mix will keep credit cost under control



Exhibit 8: Better customers selection and improving credit underwriting will lead to sustained improvement in asset quality

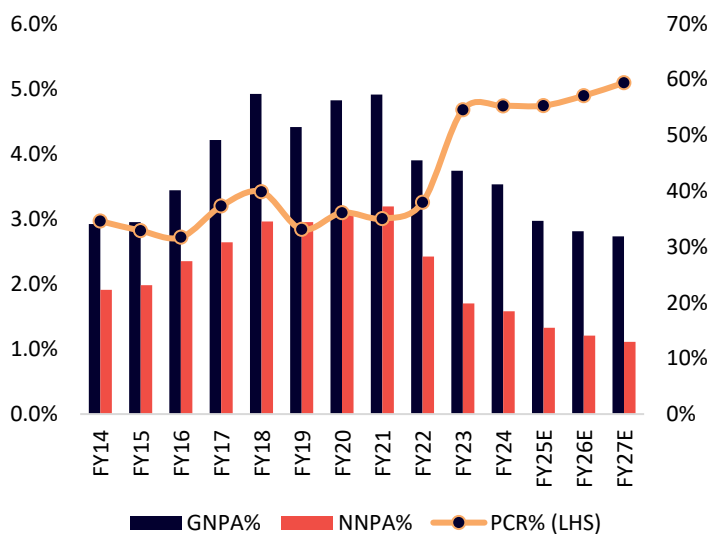


Exhibit 7: All above initiatives will lead to healthy jump in PAT

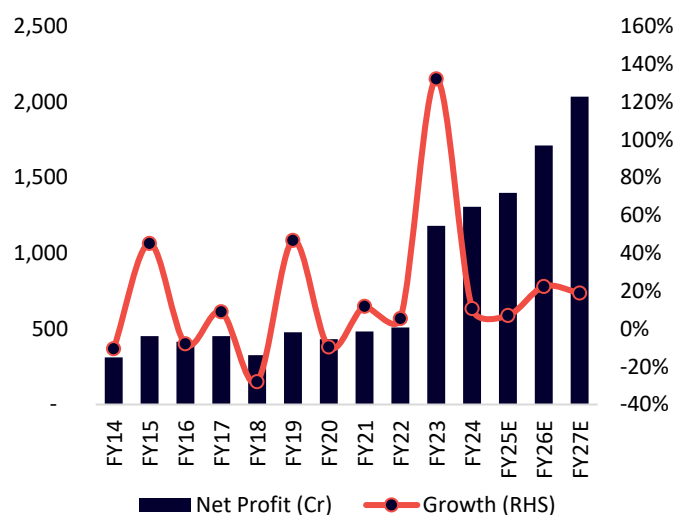
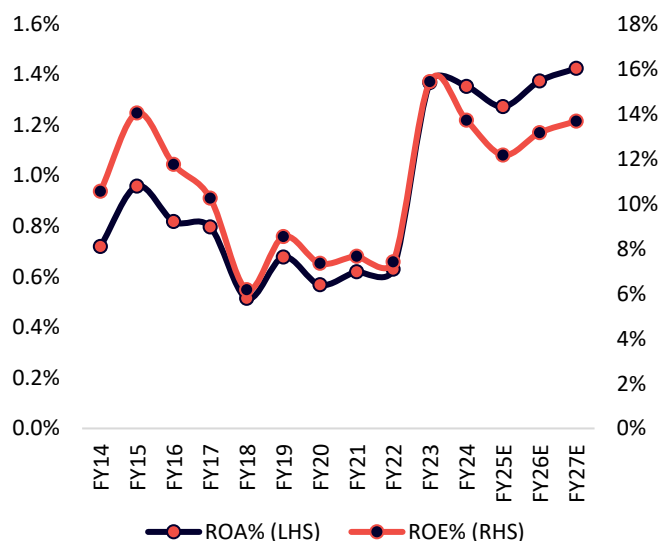


Exhibit 9: Return ratios are expected to improve on account of above initiatives



Source: Company, Nuvama Wealth Research

Investment Rationale

I. Technology, Management & employee upgrade: Embracing the Future

Technology initiatives

In 2017, KBL tied up with the Boston Consulting Group (BCG) to kick off 'KBL *Vikaas*' — a business transformation project. During the course of this transformation, the bank mainly focussed on: (a) growth with improved sales productivity and designing of new products; (b) cost optimisation with process automation and digitisation; (c) working on improvement in asset quality by boosting collections as well as strengthening its underwriting practices; (d) enhancing profitability by optimising pricing and focus on fee income; (e) shareholder value enhancement through investor engagement, communication, and corporate branding.

KBL, along with BCG, formed an internal core team to drive and monitor the progress of these transformation milestones. However, this modernisation drive was put on hold during the COVID-19 pandemic. It was restarted by the new MD & CEO Mr Srikrishnan H and ED Mr Sekhar Rao in 2023. The project has helped resolve certain difficulties with the bank's retail loans business that was holding back growth. As part of this initiative, KBL established a Digital Centre of Excellence (DCoE) and a dedicated internal division focused on driving digital innovations and technological enhancements. KBL *Vikaas* resulted in a large part of the customer onboarding process getting digitised, both on the asset and liability side. The focus is now on acquiring customers digitally.

The bank boosted the number of home loan processing hubs to five from three and aims to take it to eight to enhance its capacity to process home loans. Product design and pricing for home and gold loans, which were out of sync with market trends, were updated. To ensure its product features, pricing, and policies are up to date, it has set up a product management group. This function was earlier managed by the credit sanctions team, which led to inefficiencies in benchmarking its products. An outbound sales team was set up in FY24 to execute tie-ups with builders and auto dealers.

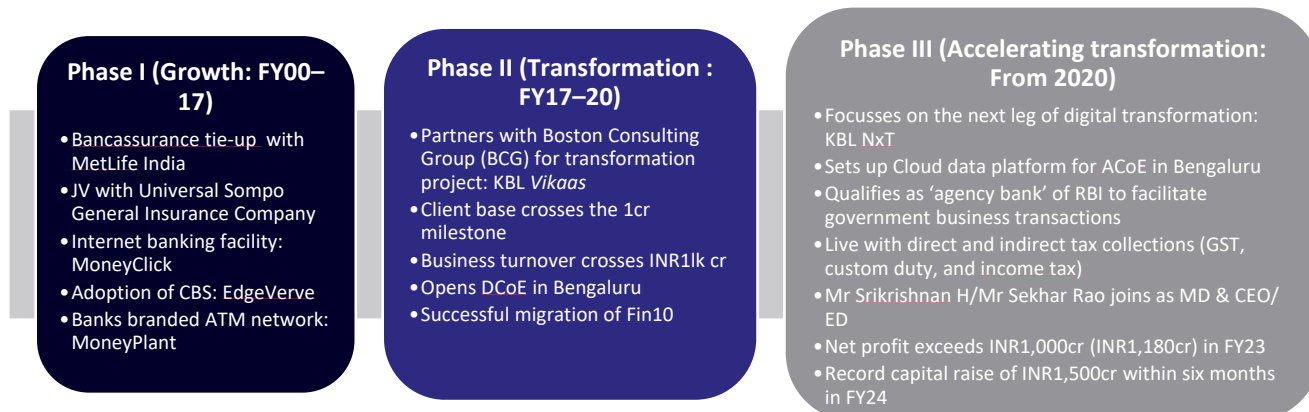
The bank has now set up an Analytical Centre of Excellence (ACoE) in Bengaluru in partnership with Ernst & Young LLP at Bengaluru for developing innovative end-to-end digital solutions for deepening customer engagement and enhancing experiential customer touchpoints and delivery channels. The state-of-the-art centre is spread over a super built-up area of 40,000 sq. ft. It employs more than 300 skilled employees.

ACoE leverages the AWS Cloud data platform to review and analyse customer behaviour trends, enabling KBL to better understand its client requirements and offer a diverse range of products and services from its existing portfolio. This approach enhances the customer's overall financial journey. The bank is enhancing its data analytic capabilities through the implementation of OFSAA modules for asset liability management, liquidity risk management, IFRS9, fund transfer pricing, and profitability management.

With these initiatives, KBL has been able to significantly upgrade its underwriting capabilities and improve TAT. It has launched an innovative range of digital products. This is the largest tech investment by KBL in the last couple of years. It launched 18 products focused on 'RAM — retail, agri, and MSME' and engaged with 13 new partnerships (with fintechs) in FY24 alone. This aspirational transformation journey of the bank (KBL *Vikaas*), which was launched in 2017, has successfully completed six years. It was further remodelled as KBL *Vikaas* 3.0 with visible accomplishments and is surging ahead with various futuristic initiatives based on the three principles: '**run the bank, grow the bank, and change the bank**'.

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Exhibit 10: Transformation journey



Source: KBL investor ppt, Company, Nuvama Wealth Research

KBL incurred INR90cr on IT-related capex in FY24. It has set aside a tech budget of INR132cr for FY25. The business transformation project has started bearing fruit, with RoA finally crossing the 1% mark in FY23 and it sustained another in FY24. The management is ensuring its performance stays stable and consistent, while retaining return ratios at current levels. Its focus on tech investments continues. There is a renewed emphasis on the retail segment.

Fintech partnership helping growth; digitalisation of operations & analytics in decision making to improve.

Fintech:

- KBL has crossed the milestone of 3 lakhs cards with SBI Cards and Payment Services Private Limited and is under discussion with other banks for partnership.
- It has tied up with NBFCs (Clix Capital Services Pvt and Satin Creditcare Network) to provide loans to MSMEs and MFIs.
- Has partnered with two life insurers (HDFC Life & Bajaj Allianz) and with a general insurer (ICICI Lombard General Insurance).
- Tie-up with two online trading platforms; implementation of comprehensive wealth management platform is under discussion.
- Empanelled with 8 AMCs, Tie-up with MF transaction platform; Enabling recharge through mobile banking, UPI, and NETC FASTag portal.

Digitalisation:

- Launched new corporate website with API portal for partners.
- Digitalisation for rollout of government schemes (PM Svanidhi & PM Vishwakarma)
- Implementation of Central Bank Digital Currency
- Scaling up of account aggregator

Analytics:

- In the last one year, KBL has worked towards embedding data and analytics in its business processes to enable data-driven decision making. It has laid the foundation architecture for a central data repository on the Cloud, with data quality management and remediation.
- Several use cases are being implemented and the outcome of the analysed data is being used for marketing and running targeted campaigns to existing customers. Around 43 use cases have been identified and provided with the appropriate intelligence needed for driving product penetration.
- The data is used for better product proposition to its customers, optimise collection efforts through advances analytics, proactively monitor and control delinquency levels (scorecard), and analyse the wallet share of its customers.
- Has worked on enhancement of data link to enable seamless exchange of information across branches.

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Exhibit 11: Future initiatives planned for 2025, focussing on robust growth through digitisation



Source: Company, Nuvama Wealth Research

These strategic initiatives are designed to fortify the bank's financial standing and generate long-term value. By staying at the forefront of technological advancements, KBL aims to drive robust and sustainable growth and ensure its leadership in the industry.

- **Implementation of the liability platform:** A comprehensive bank-wide liability platform will be introduced for seamless customer onboarding throughout their journey.
- **Pre-approved and flow-based loans:** The bank will launch innovative loan products that are pre-approved and flow-based, thus enhancing customer convenience and access to credit.
- **Hyperlocal SEO and MarTech platform:** Developing a localised search engine optimisation (SEO) and marketing technology platform to better reach and serve customers.
- **National back-office transformation:** Revamping operations at its national back-office to enhance efficiency and delivery.
- **Overhaul of core systems:** Major systems including collections, loan origination systems (LOS), and loan management systems (LMS) will be overhauled to streamline processes and improve performance.
- **Supply chain and trade finance platform:** Introducing a new platform to support supply chain and trade finance activities.
- **Transformation of the contact centre:** Modernising the bank's contact centre to enhance customer support and engagement.
- **Transformation of the digital omnichannel** to create a seamless digital experience across all channels.
- **Data governance and warehouse enhancement:** Improving data governance and expanding its data warehousing capabilities for better data management and utilisation.
- **Unified digital retail sales and credit hub:** Establishing a centralised digital hub for retail sales and credit operations.

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Management Upgrade:

Apart from technology initiatives, the new management aims to create an organisational structure that is aligned with growth. This includes lateral hiring in key areas and moving towards a CTC-based compensation structure. The management is now focussed on hiring specialists at mid/senior levels, expanding business sourcing channel, instill sales culture, adopting practices for generating yields/fee pricing and focussing on retail advances.

Since 2017, KBL has improved governance, management quality, and systems. The new management have been inducting directors with banking experience and bringing in domain experts. In the last two years, ~52% of the top management has been hired from the industry. In the last 8–10 months, it has brought in a new CIO, a new Chief Product Officer, a new wholesale and a mid-sized corporate business head, and a new investor relationship and a partnership head.

KBL has redefined key result areas (KRAs) and **introduced 3Ps — Pay for Person, Position, and Performance** - thus fostering a dynamic and a results-oriented culture. To attract talent, it is tweaking its employee policies to instil a competitive spirit and accountability in the bank by i) hiring on a CTC basis for AGM and above designations, ii) including variable pay to incentivise performance, and iii) tracking branch-wise P&L with transfer pricing.

Exhibit 12: About ~52% of the management is hired within last two years (Orange highlights); New onboarding continues.

Joined	Name	Role	Previous organisation
Jun-23	Mr Srikrishnan H	MD & CEO	Former MD & CEO at Jio Payments Bank; ED at Yes Bank; and part of the founding team of HDFC Bank
Feb-23	Mr Sekhar Rao	Executive Director	Former COO at CSB Bank; National Head at RBL Bank; and Co-founder of Savvy India
Aug-95	Mr Balachandra Y V	Chief Operating Officer	Has 28 years of operations experience at KBL
Aug-90	Mr Gokuldas Pai	Chief Business Officer	A 34-year veteran at across various business functions at KBL
Sep-22	Mr Abhishek Sankar Bagchi	Chief Financial Officer	Former CFO of NSDL Payments Bank and Deputy-VP, Finance & Accounts, at Axis Bank
Nov-19	Mr Pankaj Gupta	Chief Digital & Marketing Officer	Formerly at Sify Technologies, HCL Services, Wipro Infotech
Jun-24	Mr Niranjana Kumar	Chief Human Resources Officer	Former Lead HR at HDFC Bank for 17 years
Dec-23	Mr Ramaswamy Subramanian	Chief Product Officer	Former CPO at Dvara KGFS and Head – Products at Suryoday Small Finance Bank
Feb-24	Mr Venkat Krishnan	Chief Information Officer	Former CTO at IndusInd Bank; CIO at Ujjivan Small Finance Bank; and CTO at Yes Bank
Aug-95	Mr Ananthpadmanabha B.	Chief Technology Officer	Has a long-term association with the bank
Dec-95	Mr Kannan K	Chief Information Security Officer	Has a long-term association with the bank
May-97	Mr Vinaya Bhat J	Chief Compliance Officer	Has a long-term association with the bank
Mar-23	Mr Gurumurthy R K	Head – Treasury	Formerly at DBS Bank, Laxmi Vilas Bank, Bank One, and ING Vysya Bank
Apr-24	Mr Padmanaban T. A	Head-Digital Banking Project	Has over 12 years of digital banking and technology experience at various private sector banks
Jul-86	Mr. Venkateswarlu Mallineni	Head - Liabilities Sales & Third-Party Products	Has 24 years of extensive experience in retail banking, specialising in the liability business, third-party products, institutional and government business, etc.
Aug-86	Mr Ravichandran S	Head - Nonretail Sanctions	Has a long-term association with the bank
Jul-90	Mr Ramesh Bhat	Head of Credit Monitoring Department	Has a long-term association with the bank
Aug-95	Mr Chandra Shekar	Head - Legal and Recovery	Has a long-term association with the bank
May-97	Mr Jayanagara Rao S	Head - Branch Banking	Has a long-term association with the bank
Jul-90	Mr Raja B.S	Head of Internal Audit	Has a long-term association with the bank
Jul-24	Mr Sreenivas M	Head – Retail Lending, SME, MSME & Agri Business	Has over 23 years of diverse managerial expertise in secured and unsecured lending. He was formerly with Aditya Birla Housing, Kotak Mahindra Bank, IDBI Bank, and State Bank of Hyderabad
Jul-24	Mr Ramasubramanian B	Head – Collections	Has more than 27 years of experience across banking operations, especially in collections, portfolio and risk management, legal, and retail asset operations

Source: Company, Nuvama Wealth Research. Orange highlights are newly added members

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Exhibit 13: Specialists on board with no shareholding >5% (Orange highlight are newly onboarded)

Sr. no.	Name	Designation	About
1	Mr P Pradeep Kumar	Part Time Chairman, Independent Director	Former MD of State Bank of India
2	Mr Srikrishnan H.	MD & CEO	Former MD & CEO of Jio Payments Bank; ED at Yes Bank; and part of the founding team at HDFC Bank
3	Mr Sekhar Rao	Executive Director	Former COO at CSB Bank; National Head at RBL Bank; and Co-founder of Savvy India
4	Mr B R Ashok	Non-Executive Director	Partner, M S K C & Associates
5	Justice A V Chandrashekar	Independent Director	Former Judge, High Court of Karnataka
6	Ms Uma Shankar	Independent Director	Former ED at the Reserve Bank of India
7	Dr D S Ravindran	Independent Director	Former Principal Secretary in the Government of Karnataka
8	Mr Balakrishna Alse S	Independent Director	Former ED at Oriental Bank of Commerce
9	Mr Kalmanje Gururaj Acharya	Independent Director	Senior Partner at K G Acharya & Co. and former Independent Director at State Bank of Mysore
10	Mr Jeevandas Narayan	Independent Director	Former MD at State Bank of Travancore and Deputy MD at State Bank of India
11	Mr Harish HV	Independent Director	Former Partner at Grant Thornton and founder of ECube Investment Advisors

Source: Company, Nuvama Wealth Research, ED is newly formed position

The new management has initiated several processes and system changes, which will benefit the bank in the future these include:

- Dividing branches into clusters for better monitoring while adding feet on the street and DSAs.
- It has begun colending and has partnered with fintechs.
- Creation of CASA team across regions & creating dedicated team of 650 people for sourcing assets & liabilities
- Making a conscious effort to increase engagement with the state government for business.
- Starting fee income generating products, co-branded credit cards, FASTag etc. It has started focussing on forex and transaction banking to help grow its non-core income.
- Onboarding life and health insurance firms, thus improving its ability to cross sell.
- Shifting to cash flow-based lending from collateral-based and better underwriting with loan pricing through CIBIL and internal ratings.
- Using data analytics to aid operations in finding the right product at the right price for the right customer.
- Diversifying from crop loans to MSME funding in the agri segment. Aided with quick digital underwriting and have started providing special loans to women entrepreneurs and KBL equipment loan digi journey.
- Funding farmers via various organisations to induce a group-based obligation. Helping farmers to use crop insurance to mitigate risks. Towards this, it has established a dedicated team of technical experts to assist farmers. It has also established agri development branches.
- Launching new liability products like corporate savings accounts, flexi current account, etc.

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Employee Upgrade:

KBL boasts of 8,907 employees, with an average age of 38.14 years. Women constitute 2,799 or ~31.42% of the total workforce. To enhance HR efficiency, it utilises the PeopleSoft-Oracle HRMS to centralise employee data and streamline processes, thus enabling data-driven decision-making in recruitment, training, promotions, and manpower planning.

It has operationalised the employee career and development system (ECDS) and the performance management system (PMS) to ensure a structured approach to performance evaluation and career development. In conjunction with the PMS, ECDS identifies potential talent and grooms employees for succession planning. This approach helps in recognising and developing future leaders and ensures sustained organisational growth.

To enhance employee engagement and satisfaction, which directly impacts productivity and retention rates, the bank has implemented several initiatives, including:

- An employee stock option plan (ESOPs) to provide employees with ownership in the company.
- Internal and fast-track promotions for career advancement within the organisation.
- Milestone awards for recognising and rewarding employees for their long-term service and achievements.
- Industry-governed facilities to ensure that employee benefits and working conditions meet industry standards.

The management’s commitment to promoting internal talent is evident in the internal promotion rate, which rose to 8.9% in FY24 from 5.28% in FY23. The retention rate was 96.67% in FY24, indicating a stable workforce.

Exhibit 14: Total employee count

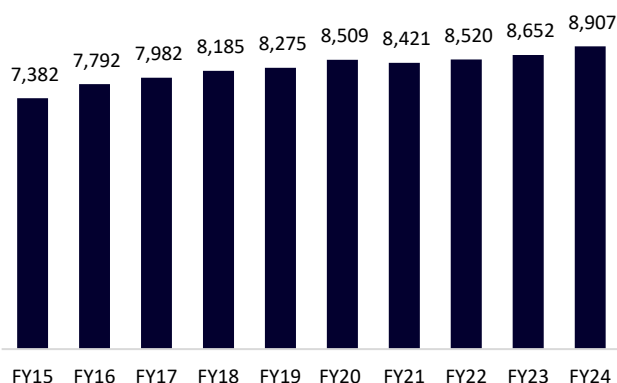
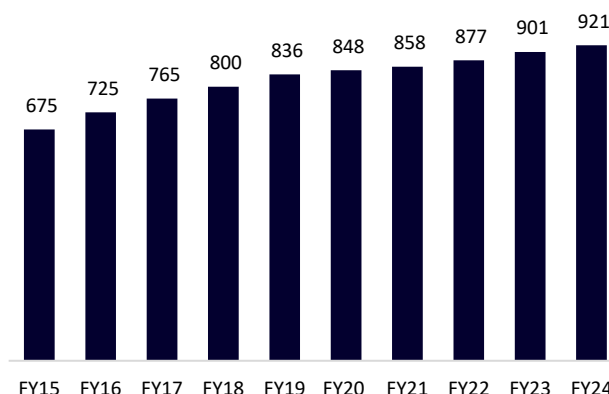


Exhibit 15: Branch strength



Source: Company, Nuvama Wealth Research

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II. Strong liability franchise & favourable liquidity: Bolstering Change

Granular & Sticky liability franchise

Being a 100-year-old bank present in the state, KBL enjoys a loyal and sticky retail deposit base much to the envy of any new age private bank.

'Bharat ka Karnataka Bank'

- Coinciding with its centenary year, the management repositioned the franchisee as a pan Indian bank. It branded itself with the tagline: **"Aap ka Karnataka Bank, Bharat ka Karnataka Bank."**
- Also, as part of this commemorative celebrations of this milestone achievement KBL has opened 19 new branches across the country.
- Incidentally out of 931 branches in India, 590 branches are in Karnataka. As such 2/3rd of the branches are in Karnataka and the interior locations in Karnataka.
- In the next couple of years, the franchisee aims to have a 50:50 mix between Karnataka and the non-Karnataka business.

Exhibit 16: In next couple of years branch mix between Karnataka and non-Karnataka is expected to be 50:50 (As on Q1FY25)

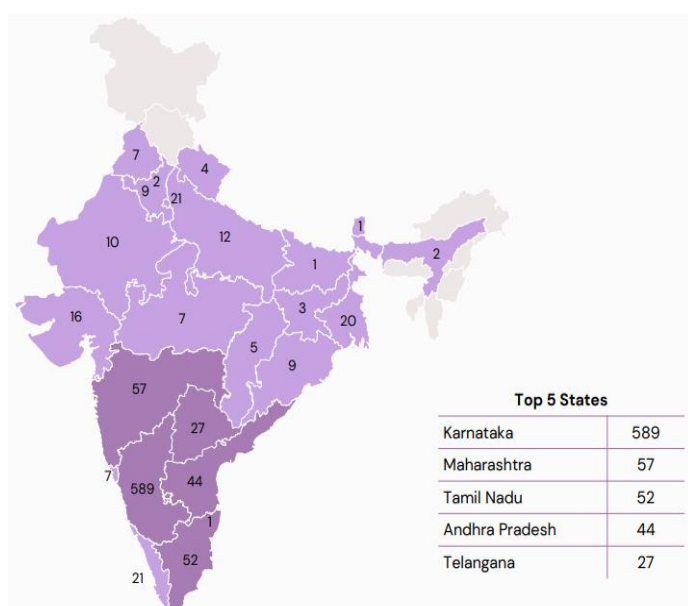
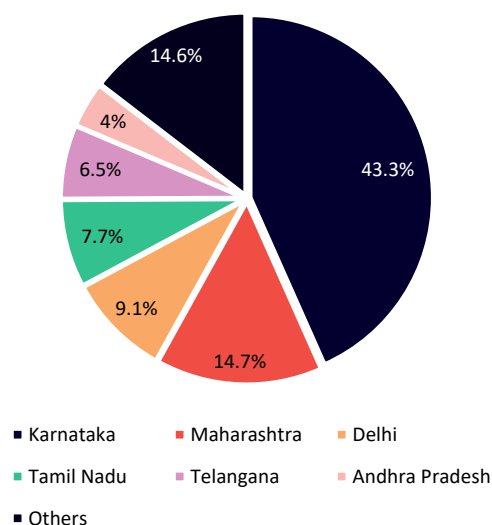


Exhibit 17: Increasing branch mix to non-Karnataka will augment the overall deposits (Deposits share in FY24)



Source: Company, Nuvama Wealth Research

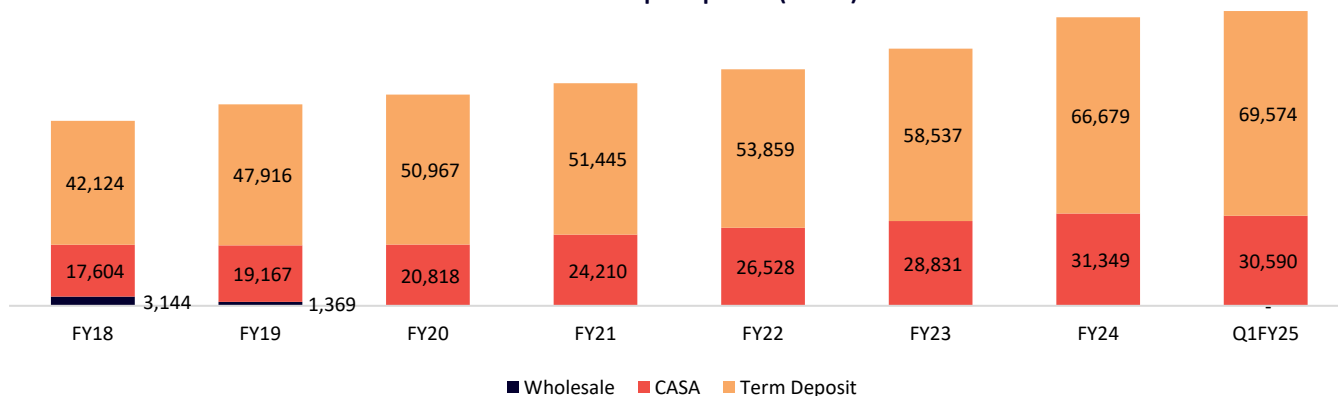
To enhance its deposit franchise, the bank is: i) leveraging its brand identity in Karnataka; ii) tapping government business within the state as well as at the pan-India level (It is going live with CBDT and aims to reverse migrate large MSME customers that used other bank accounts for tax payments to KBL); iii) launching a bundled salary product; iv) enhancing internet banking for current accounts; v) creating a large outbound sales team in metros for CASA (via KBL Services); and vi) offering a competitive flexi FD account.

The bank has introduced a slew of products to garner additional deposits like: i) flexi fixed deposit facilities for government agencies; ii) a special fixed deposit scheme of 445 days; iii) 180-day deposits (special tenure based); iv) the corporate salary account programme; v) the senior citizen savings account (to be launched); and vi) KBL current account purple privilege that provides banking services to medium and large businesses. We believe all these initiatives will augment the retail deposits base.

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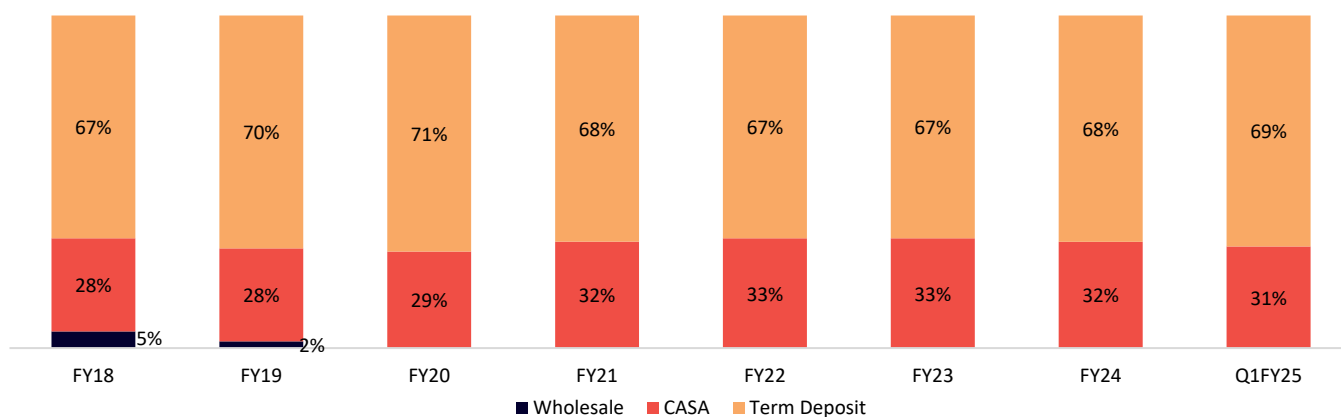
Exhibit 18: Deposit profile (INR cr)



Source: Company, Nuvama Wealth Research

There is ample headroom to grow deposits across geographies over the next two-to-three years. A strong deposit franchise helps in lower liquidity requirement and availability of additional funds for loan growth.

Exhibit 19: KBL's deposit profile



Source: Company, Nuvama Wealth Research

KBL enjoys a healthy granular deposit franchise with 84.6% of term deposits less than INR2cr as on Q1FY25 (85.5% in Q2FY25). The concentration of the top 20 depositors is one of the lowest among its peers which bolsters the fact that its deposit franchise is indeed granular.

Exhibit 20: Breakup of retail term deposits in June

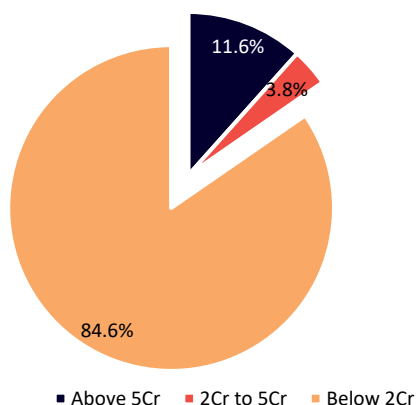
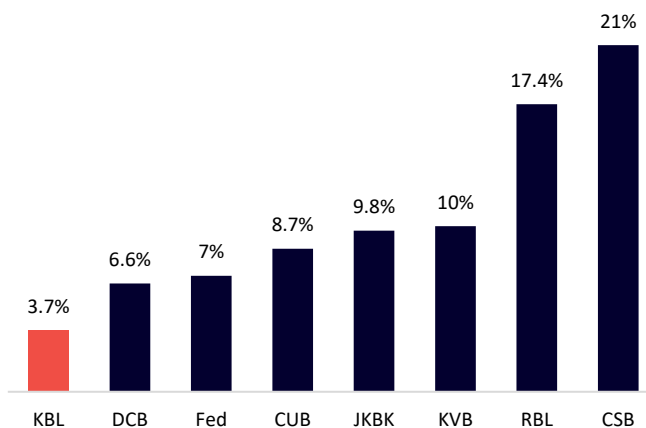


Exhibit 21: Top 20 depositors for its peers in FY24



Source: Company, Nuvama Wealth Research

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CASA ratio improved by 400bp from pre-COVID levels and is comparable to its peers. The bank has established a CASA deposit team across all 14 regions to gain further traction. In FY24, CASA ratio stood ~32% (up 55bp QoQ, but down 97bp YoY). In Q1FY25, the CASA ratio eased to 30.5% from 32% QoQ, which is in-line with industry trend. The management advocated the need for improving the ratio in coming quarters. In this regard, the bank has created a liabilities sales structure to focus on salary accounts, current accounts, and the government business.

Exhibit 22: Moderation in CASA is in-line with Industry trend (%)

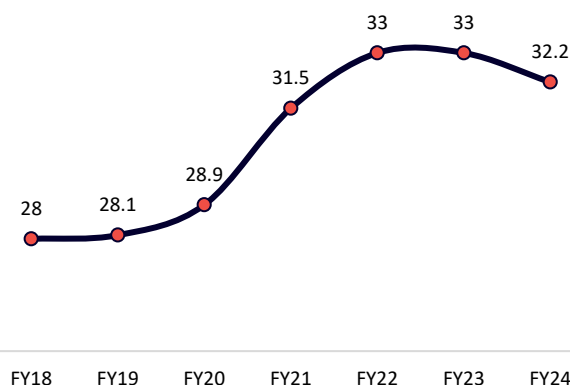
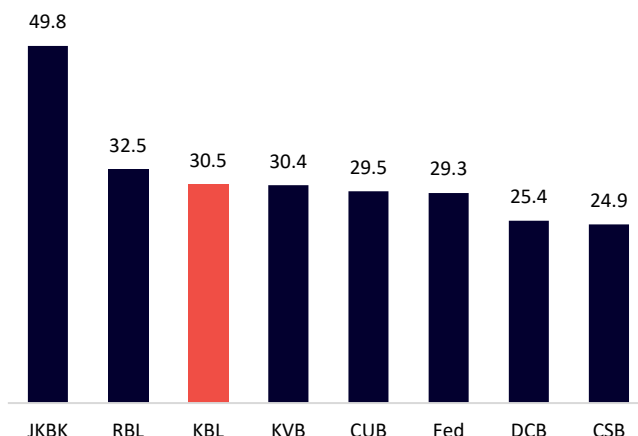


Exhibit 23: CASA for its peers in Q1FY25 (%)



Source: Nuvama Wealth Research

A strong liability franchise is clearly visible with KBL enjoying a lower cost for funds (CoF) advantage as compared to its peers. The bank benefitted from lower interest rates in FY22 and FY23. The increase in CoF in FY24 is commensurate with industry norms and an increase in yields. CoF (calc.) stood above 5% in Q1FY25 on tight liquidity and deposit mobilisation conditions.

Exhibit 24: KBL Cost of Funds

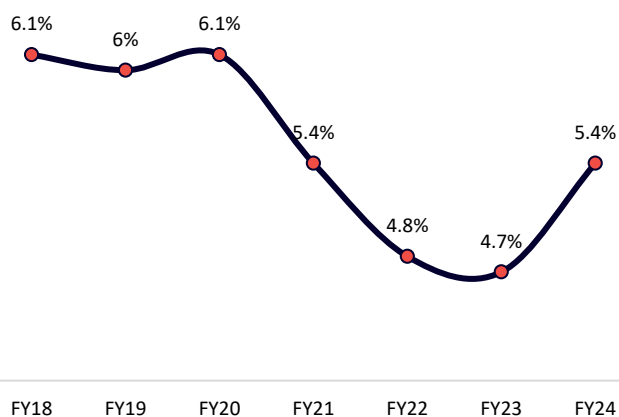
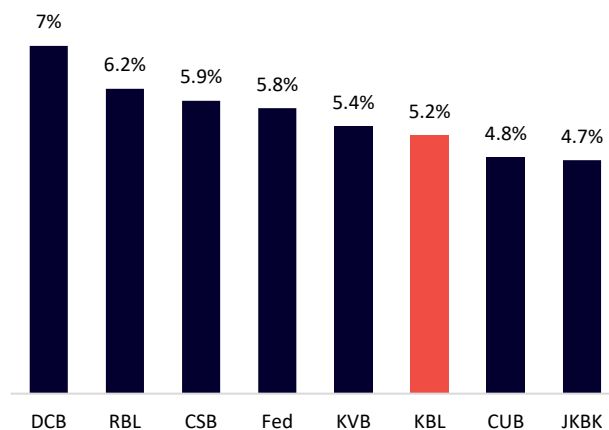


Exhibit 25: CoF for its peers in Q1FY25



Source: Nuvama Wealth Research

KBL has been empanelled by the CBDT to collect direct and indirect taxes. It has been integrated with state-level treasuries (like *Khajane II* in Karnataka and *MAHAKOSH* in Maharashtra) for revenue collection. The bank has already gone live for customs duty payments and GST collection. It is integrated with the national *JanSamarth* portal. These are key markets for KBL's savings and current accounts. It is targeting these customers both digitally as well as through branches. And it believes that with the improving collections part, due to the government business and the fact that it is an agency bank will help secure additional state and central government accounts. Moreover, focus on opening current account, the CASA push to the government business and the flow that KBL get from the GST taxes and customs duty collection would definitely have a positive impact on cost for funds going ahead.

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Favourable liquidity and capital position

A higher Liquidity Coverage Ratio (LCR) ensures sufficient head room for growth which can be directed to better yielding assets and supports margin as well. In fact, the bank has one of the highest LCR, at 269%, among its peers as of Q1FY25. (As on end Q2FY25, the LCR stands at 143.93% well above the regulatory guidelines of 100%. The bank has proactively implemented RBI's revised draft guidelines on LCR well before its applicable timeline of 1st April 2025. KBL has made certain changes in arriving at the values of Level 1 High Quality Liquid Assets (HQLA) and runoff factors considered for arriving at Outflow/Inflow.)

Exhibit 26: LCR for KBL

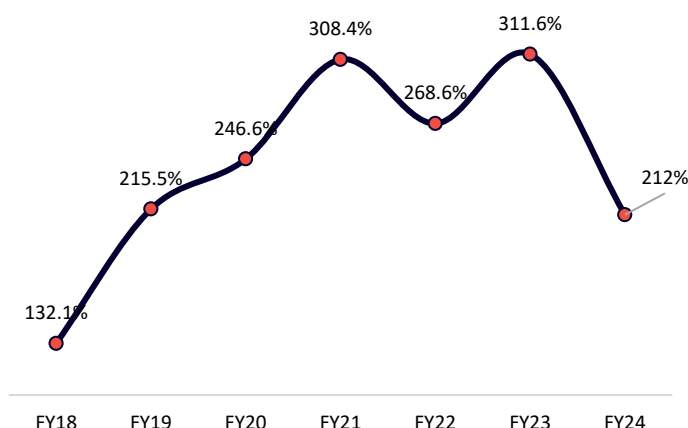
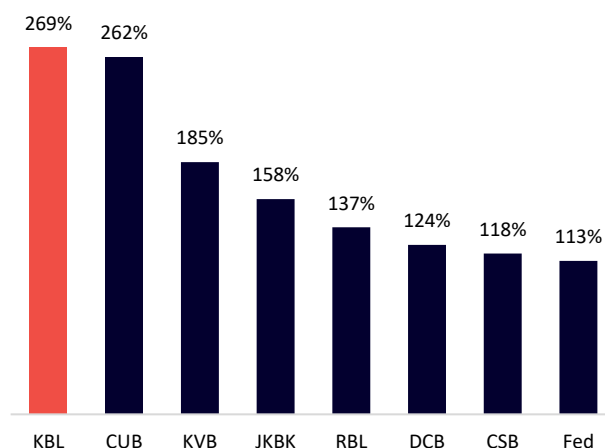


Exhibit 27: LCR for its peers in Q1FY25



Source: Company, Nuvama Wealth Research

On September 22, 2023, KBL decided to raise INR1,500cr in equity capital. Within a record six months, it raised INR900cr through a preferential issue of equity shares backed by marquee institutional investors. A further INR600cr was raised via a qualified institutional placement. Institutional holding thus reached ~42% in FY24 from ~26% in FY23. This helped bolster its CAR and reposition KBL for accelerated growth. The bank redeemed INR400cr/INR320cr of Tier II Bonds through exercise of call option in Nov-23 and redeemed INR 320 cr. of Tier-2 Bonds through exercise of call option in Feb. CRAR stood above 17.6% in Q1FY25 (17.6% in Q2FY25).

Exhibit 28: Capital raising lead to healthy CRAR

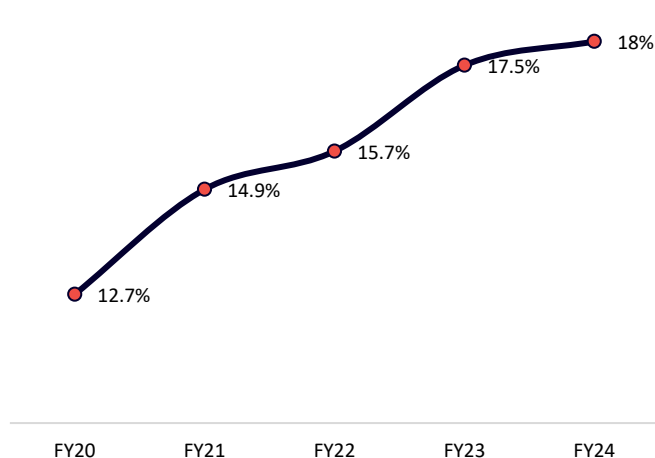
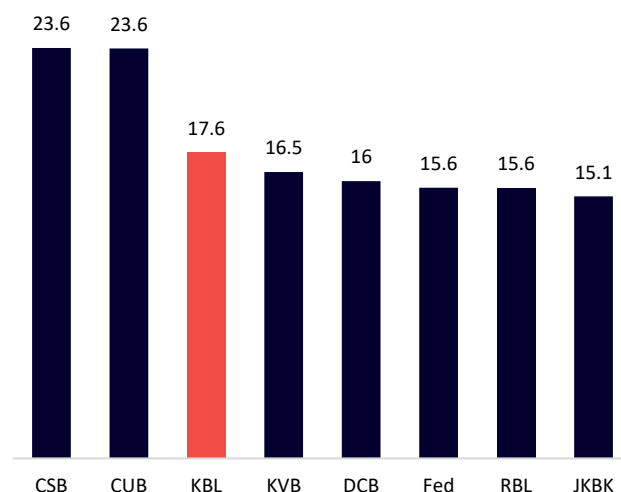


Exhibit 29: CRAR for its peers in Q1FY25



Source: Company, Nuvama Wealth Research

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III. Loan growth: Metamorphosis

Past 'Imperfect'

Though a 100-year-old bank, KBL's progress in the last 24 years has been a roller coaster one. With the dawn of the new millennium, the bank clocked 22% CAGR in advances over FY01–06, with an average RoA/RoE of 1.2%/19%. From FY06–14, growth in advances fell to 18% CAGR, with an RoA/RoE of 1%/14%. Return ratios lagged due to a higher C/I ratio during the same period.

From FY14, KBL faced asset quality pressures with the infra segment going through a bad business cycle. During FY14–17, loan book growth slowed to 9% CAGR, with a RoA/RoE of 0.8%/12%. In 2017, it tied up with the Boston Consulting Group to kick off KBL *Vikaas*. However, it still pursued loan growth in the MSME and agri segment which was affected by the roll out of GST, demonetisation, and an erratic monsoon. Although advances clocked 16% CAGR over FY17–20, asset quality pressures exacerbated the fall in return ratios (RoA/RoE: 0.6%/8%).

The COVID-19 pandemic in FY20 was the final nail in the coffin. This time around, KBL reduced its loan book by 0.2% over FY20–22. As KBL *Vikaas* took a back burner during the pandemic, RoA/RoE fell further to 0.6%/7.5%.

Exhibit 30: Loan growth CAGR

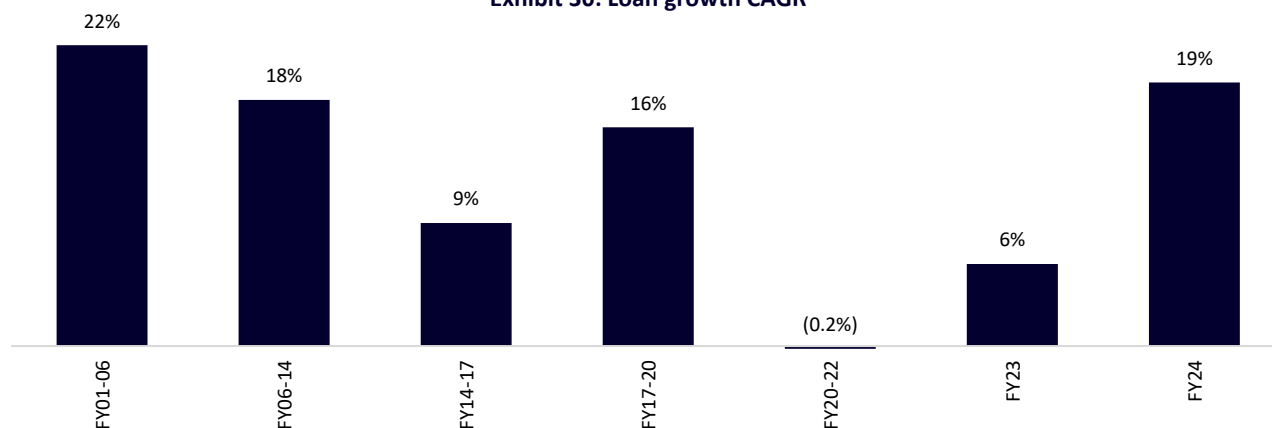
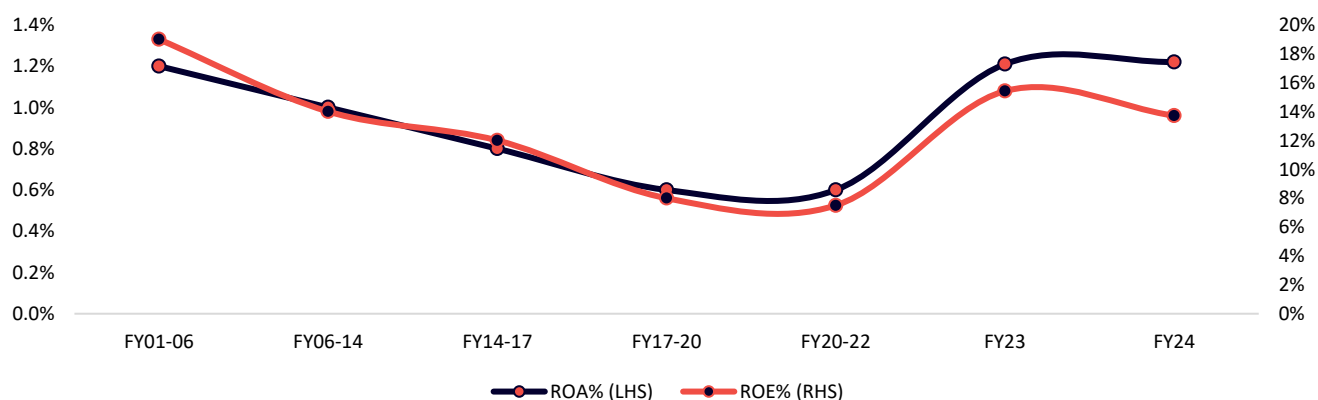


Exhibit 31: Return profile



Source: Company, Nuvama Wealth Research

In FY23, the new management restarted the KBL *Vikaas* initiative. It consciously reduced the number of loans that were highly ineffective in terms of both pricing and quality to improve asset quality and deliberately trimmed down the balance sheet size.

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KBL had made large advances (~INR2,500cr) at yields below the G-Sec rate. These advances were run down in Q4FY23 to protect NIM. This had an adverse impact on loan growth in FY23, but it helped shore up liquidity as the management opted to park these in G-Secs rather than redeploy them in low yielding advances. Overall, RoA/RoE improved to 1.4%/15% in FY23.

Exhibit 32: Net advances (INR cr)

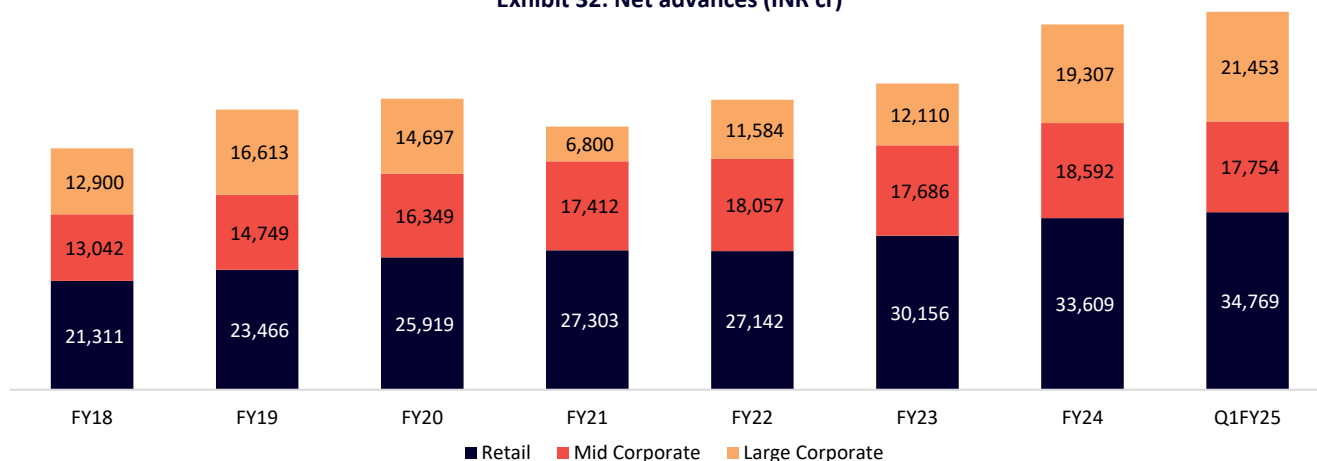
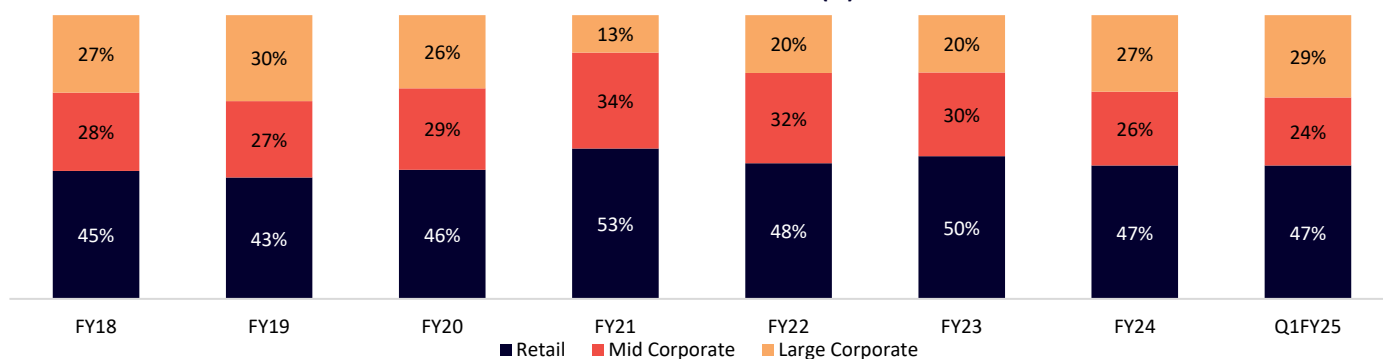


Exhibit 33: Net advances (%)



Source: Company, Nuvama Wealth Research

Present 'Perfect'

In FY24, as KBL was improving its digital infrastructure and revamping its retail operations, it relied on corporate loans for growth in the medium term. The bank is targeting large ticket loans to mostly AA and AAA rated corporates.

Advances grew at a healthy 19% YoY and 5% QoQ to INR71,509cr in Q4FY24. Of this, corporate advances rose 27% YoY and 6% QoQ in Q4FY24. Greater traction in large corporate advances in FY24 has been more opportunistic lending given the fact that the CD ratio had some headroom to grow. It will get replaced with mid-sized corporate lending where KBL has a far greater opportunity to cross sell. In the medium term, it made sense for the bank to park excess liquidity (LCR: 212% and C/D ratio: 73% as on end Q4FY24) with higher rated corporates as it slowly gains momentum in the retail, MSME, and agri segments. Moreover, these corporate loans will also help in cross selling salary accounts, cash management services, etc.

The management has guided that RAM will be the key growth driver, with the focus on retail, home, and gold loans. It is targeting credit growth 2-3% higher than systemic level this year and from next year they are targeting mid-to-high teens; however, we have projected 17% CAGR over FY24-27E with a target mix of retail: 50%, mid-corporate/SME: 30%, and large corporate: 20%.

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Future 'Retail'

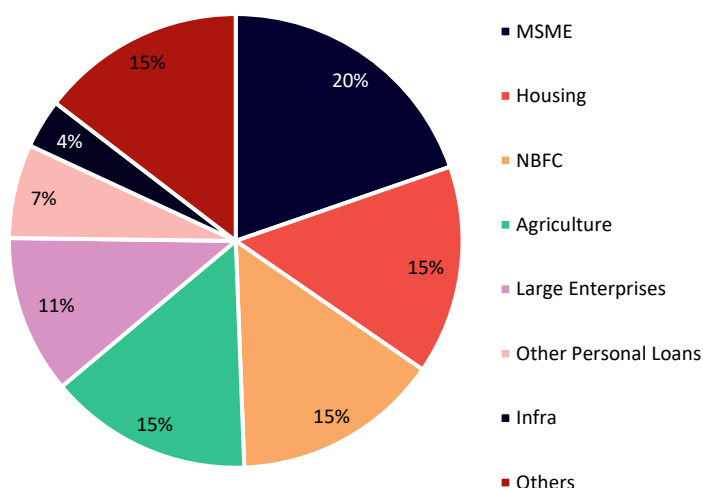
The management has taken the following initiatives to boost retail loans:

- Technical difficulties in its retail loan business that were holding back growth have been resolved. Product design and pricing for home and gold loans, which were out of sync with market trends, have been updated.
- An outbound sales team has been set up to execute tie-ups with builders and auto dealers. Since these measures will take time to fructify, the bank will engage in co-lending to boost growth.
- The bank has inducted ~365/~270 sales officers/feet on the ground personnel for covering key markets and target segments.
- It has empowered 14 regional offices to handle small ticket loans. These offices have been further decentralised into 51 clusters with separate cluster heads.
- It has partnered with six business correspondents to strengthen its home, car, gold, retail, and agri loan portfolio.
- Leveraging customer data to cross-sell to existing customer base
- KBL has a large customer base with a product penetration of 1.2-1.3. This customer base is sufficient to generate the initial momentum needed for its national retail rollout. It progressively aims to raise penetration to more than two. Gold loans account for less than 5% of the total book, with an average yield of 10–12%. The management aims to raise its contribution to 7–8%.

Going forward, growth will accrue from the RAM segment. The franchisee has:

- Created a separate vertical for each segment and set up credit processing and sanction centres at the regional and head office level to improve TAT.
- Deployed 102 AFOs as part of hunting teams at branches and clusters to source quality agri proposals.
- For focussed monitoring, divided all its branches into 38 clusters, with no cluster having more than 25 branches.
- Set aside 200 personnel from branches and hired 450 employees for sourcing from the market. It has hired a specialist sales force for agri loans.
- Partnered with various fintechs for co-lending; and hired a chief product officer for expanding its product portfolio (like two-wheeler and three-wheeler loans) and introducing new features and services.

Exhibit 34: KBL's sectoral exposure as of June

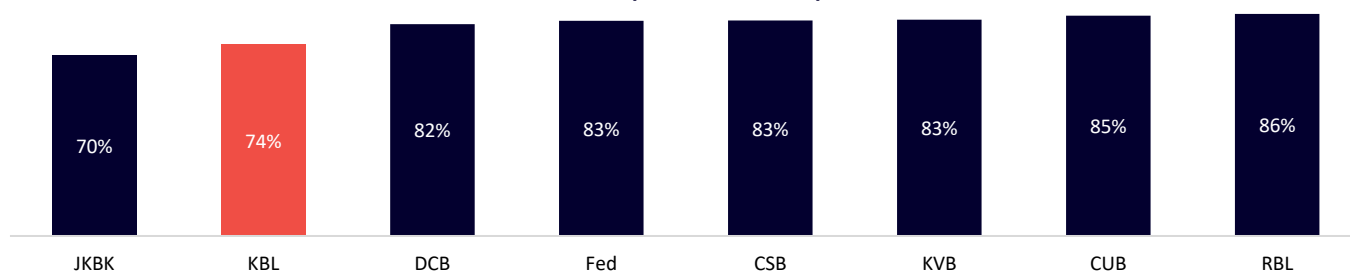


Source: Company, Nuvama Wealth Research

...Aided by a favourable credit-to-deposit ratio

The CD ratio for most banks has peaked after linking their loan growth to deposit accretion. KBL is in a sweet spot as it can still drive loan growth, thanks to its surplus liquidity and low C/D ratio vis-à-vis its peers.

Exhibit 35: Credit-to-deposit ratio for its peers in Q1FY25



Source: Company, Nuvama Wealth Research

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Fee income to gain traction with higher loan growth

In addition to improving loan growth, which will invariably aid fee income, various third-party products will help drive non-loan income for the bank. Tie up with insurance companies, co-branded credit cards, FASTag, and sourcing forex and cash management for its corporate clients are steps in the right direction.

Exhibit 36: multiple tie-ups with Life/General insurance and wealth management to augment Fee income

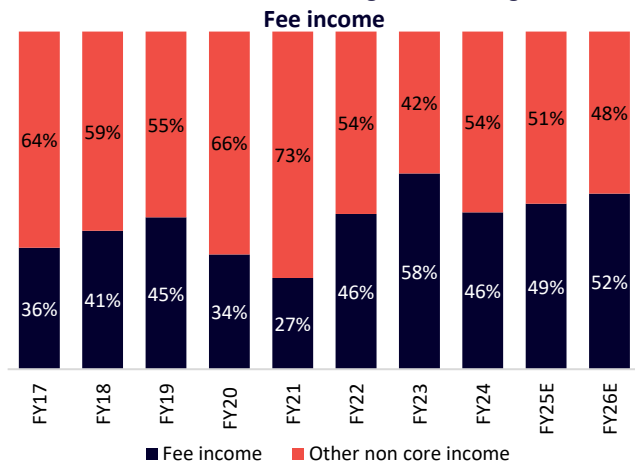
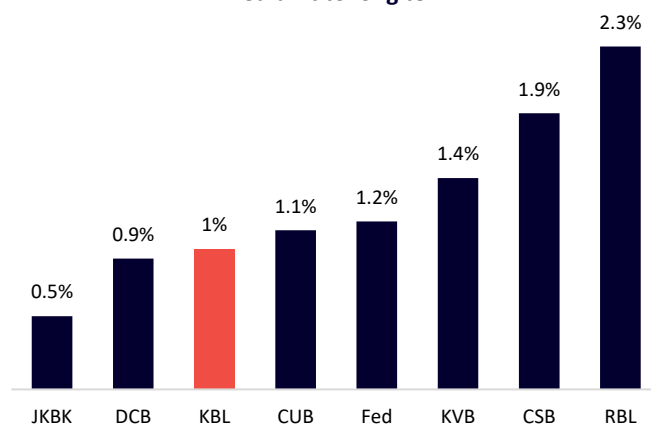


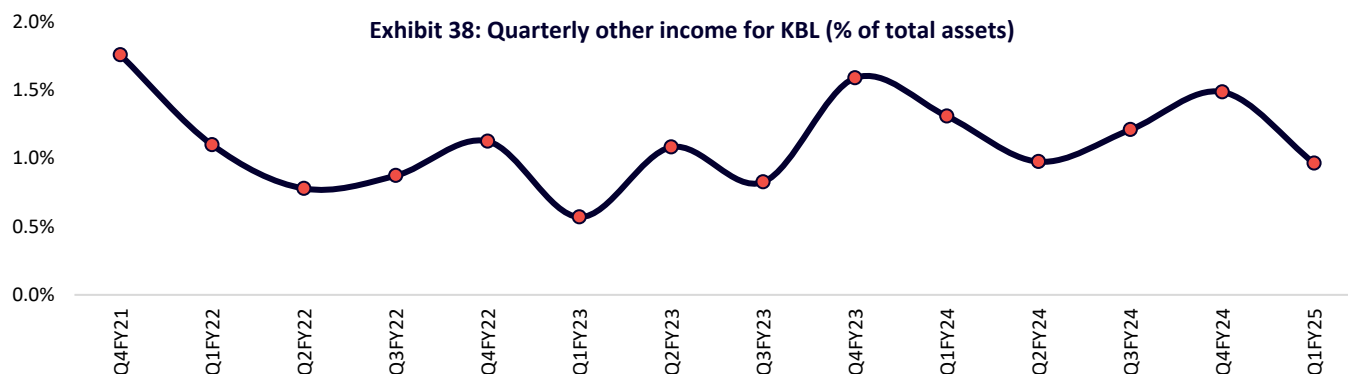
Exhibit 37: Other income-to-asset ratio for its peers in Q1FY25; however it is expected to rise in medium to long term



Source: Company, Nuvama Wealth Research

Compared to peers, KBL's non-core income has a definite scope for growth. We expect the bank to start with the low hanging fruit and steadily increase its fee income, which will help protect operating margin. Third-party products, government agency business, and cross selling of loans via covenants will boost revenue in FY25 and FY26.

Exhibit 38: Quarterly other income for KBL (% of total assets)



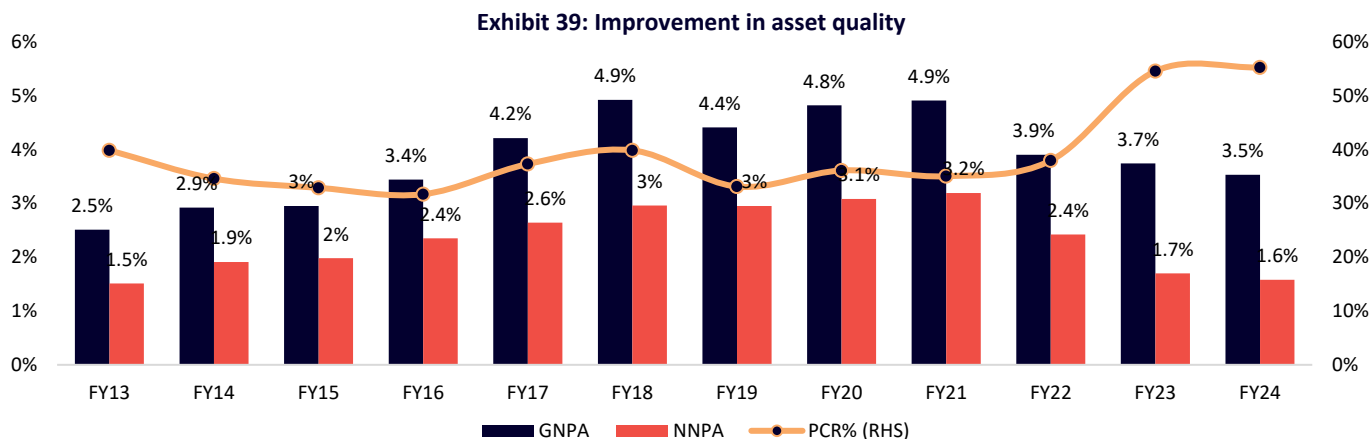
Exploring avenues for generating non-core income

- KBL has crossed the milestone of 3 lakhs cards with SBI Cards and Payment Services Private Limited and is under discussion with other banks for partnership.
- Have partnered with two life insurers (HDFC Life & Bajaj Allianz) and with a general insurer (ICICI Lombard General Insurance).
- Tie-up with two online trading platforms; implementation of comprehensive wealth management platform is under discussion.
- Empanelled with 8 AMCs, Tie-up with MF transaction platform; Enabling recharge through mobile banking, UPI, and NETC FASTag portal.
- Digitalisation for rollout of government schemes (PM SVANidhi & PM Vishwakarma)
- Implementation of Central Bank Digital Currency.

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IV. Improvement in Asset quality: The Catalyst

If we look back at the last 10–15 years, certain specific facets regarding KBL's asset quality emerge. As the bank pursued growth by lending via a consortium, downturn in the corporate cycle in FY14 led to a build-up in bad assets till a point where GNPA peaked at 4.9% in FY18, with a gross slippage ratio of 5.9%.

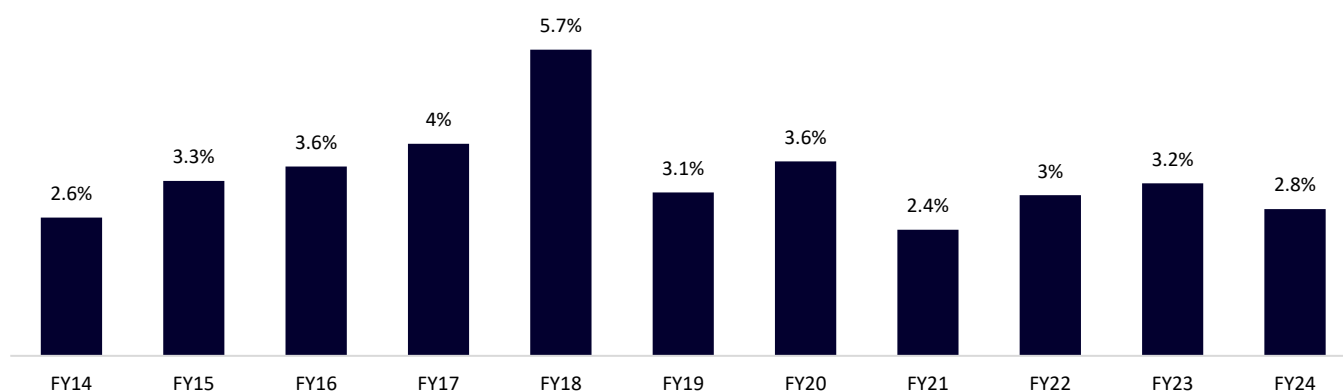


Source: Company, Nuvama Wealth Research

Unlike other banks which faced a similar problem, KBL continued to pursue growth in the MSME and agri segments from FY17. The situation was worsened by demonetisation, roll out of GST, liquidity crisis, and the COVID-19 pandemic. This led to GNPA peaking at 4.9% in FY21. Increase in slippages was not only due to bank-specific factors but also on account of the environment factors.

The overall deterioration in asset quality can also be attributed to lack of a robust long-term strategy to attract and retain good quality customers due to the absence of an organised underwriting process. This, in most cases, resulted in poor customer selection. There was also no risk-based pricing for these onboarded customers, leading to greater delinquencies which got exacerbated due to absence of proper collection mechanism, with no separate monitoring teams.

Exhibit 40: Slippage ratio peaked in FY18, and trended towards the lower end of the range since then.



Source: Company, Nuvama Wealth Research

The overall slippage remained elevated post COVID-19 compared to its peers; however, it was contributed by restructured book. As restructured book moderated substantially over the last 3-4 quarters and remaining restructured book is standard witnessing resilience. In last few quarters, Bank has also strengthened credit underwriting mechanism, set-up a dedicated collection team and enhanced monitoring to arrest the asset quality deterioration. Hence, we expect slippage and subsequently overall GNPA to moderate from here on.

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Exhibit 41: Earlier Slippage was elevated due to slippage from restructured book

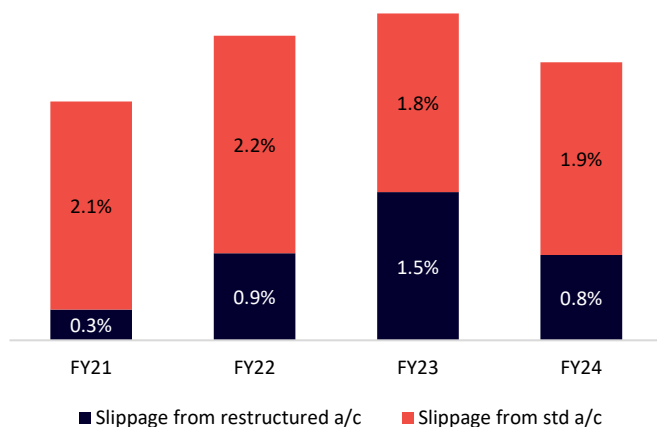
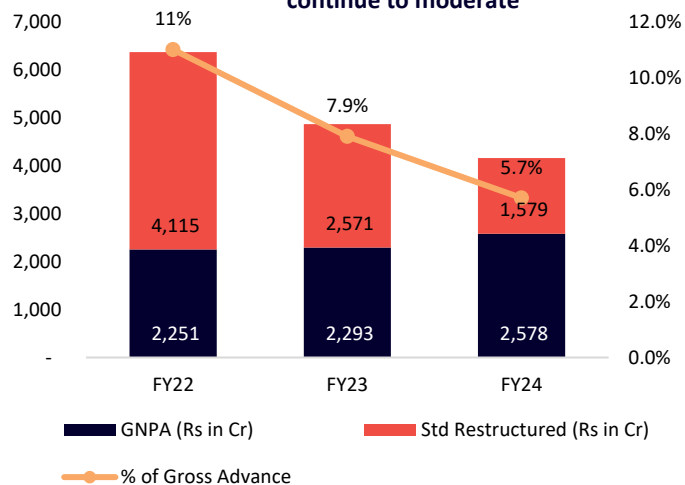


Exhibit 42: However, overall stressed assets continue to moderate



Source: Company, Nuvama Wealth Research

The new management has taken steps in the right direction by trying to bring in structural changes in terms of underwriting and collections.

The new management has made the following changes to improve asset quality

- Improving underwriting processes and criteria:** The bank has tightened its loan underwriting process by establishing SORP collateral for newly sanctioned MSME loans and using crop insurance to mitigate risks inherent risk in the agri sector. It has improved its risk management framework with better credit risk assessment, which defines sector-wise, borrower-wise, and geography-wise credit limits. It has enhanced its audit mechanism at both the head and regional offices. It has divided its branches into clusters for better monitoring. The monitoring team (~250 people) uses data analytics to support operations by finding the right product at the right price for the right customer.
- Digitisation of retail loans with cash flow-based underwriting:** The percentage of sanctions under home, car, and MSME loans through the digital mode has exceeded 91% of eligible loans as of March.
- Centralised underwriting with a separate sanctioning and monitoring head:** A specialised credit monitoring department at the head office level supervises post-sanction monitoring and ensures a systematic follow-up of stressed accounts. Regional collection hubs (RCHs) have been set up at all regional offices. These include regional retail collection teams (RRCTs) and regional corporate collection teams (RCCTs). These teams initiate time-bound and days past due (DPD) wise actions to ensure timely collection of dues under the overall supervision of the credit monitoring department.
- Automated process for overdue and early warning signals:** The bank has implemented behavioural and EWS modules to identify loan accounts that are turning bad and classifying accounts under the low, medium, and high-risk category. Based on the category of borrower, collection activity like sending SMS, emails, calling, and customer visits are prioritised. Its web-based collection tool KBL-Kollect+ has been fine tuned for undertaking prioritised collections. It has set up an auto sweep system for automatic collection of EMIs, instalments, and interest from the borrower's account.
- Separate monitoring team for restructured accounts:** For close monitoring of restructured advances, the bank has formed an exclusive cell — restructured advances monitoring cell — within the credit monitoring department. A consortium and multiple banking arrangement cell has been formed for special monitoring of loan accounts under the consortium and multiple banking arrangement.

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The new management's emphasis on collections by way of a one-time settlement, ARC sale, and SARFAESI has aided recovery and reduced slippages. As of Q1FY25, ~90% of standard restructured customers are repaying, with less than 10% under stress. The standard restructured book has fallen by 45% YoY and 12% QoQ to INR1,395cr in Q1FY25. (As on Q2FY25, it has further fallen further to INR1,268cr).

Exhibit 43: Overall stress is moderating consistently

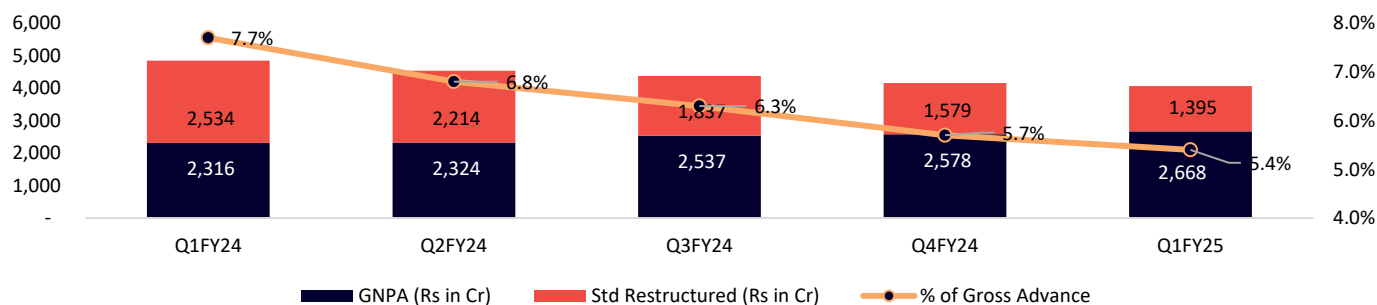


Exhibit 44: Improvement in Asset quality Continues

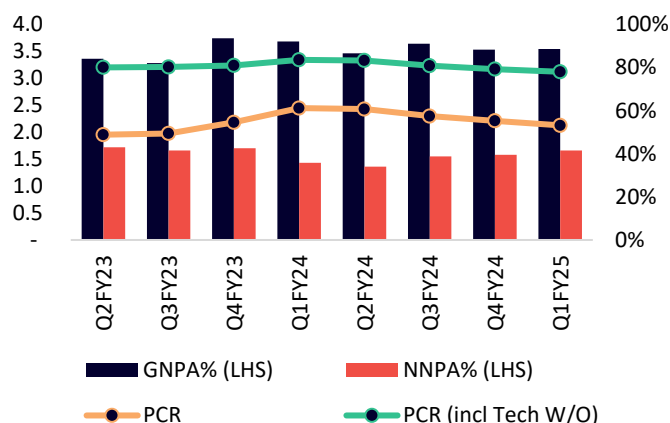
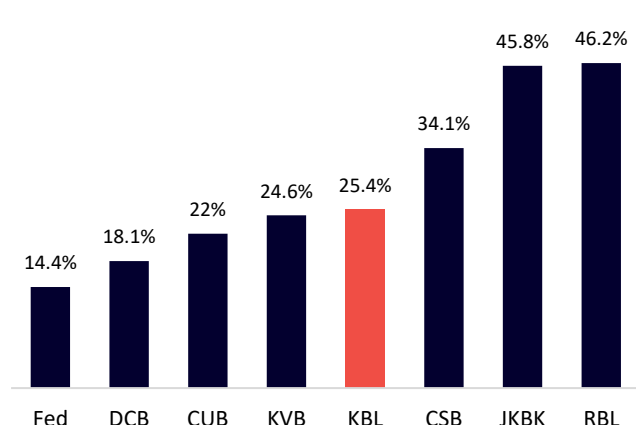


Exhibit 45: Exposure of top 20 customers as a percentage of GNPA in FY24 for its peers



Source: Company, Nuvama Wealth Research

In Q1FY24, slippages moderated to INR292cr (an annualised run-rate of ~2% — the lowest in the last 32 quarters, barring the COVID-19 period), with healthy recoveries and upgrades. However, it increased in Q2 and Q3FY24 as a bunch of assets emerged out of restructuring. The management reiterated that slippage was mainly from the MSME segment. In Q1FY25, it improved again to 2.3% from 3.09% in Q4FY24. As on Q2FY25 it has further improved to INR 243cr beating its earlier record in Q2FY24. However, this time the management has guided that it is set to improve from hereon as there is no scope of negative development on asset quality side.

Exhibit 46: Slippage is expected to moderate as restructured book moderates substantially

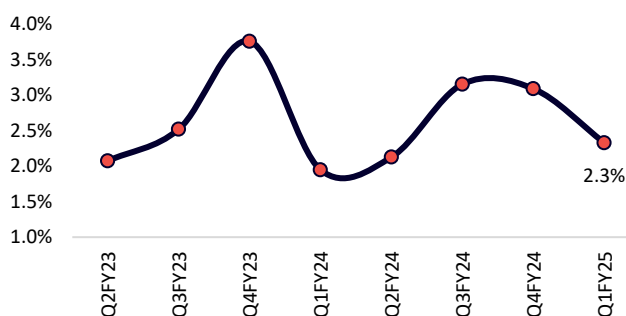
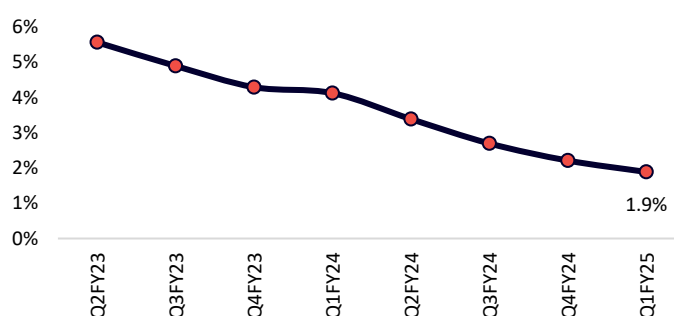


Exhibit 47: Restructured loans as a percentage of total advances softens consistently



Source: Company, Nuvama Wealth Research

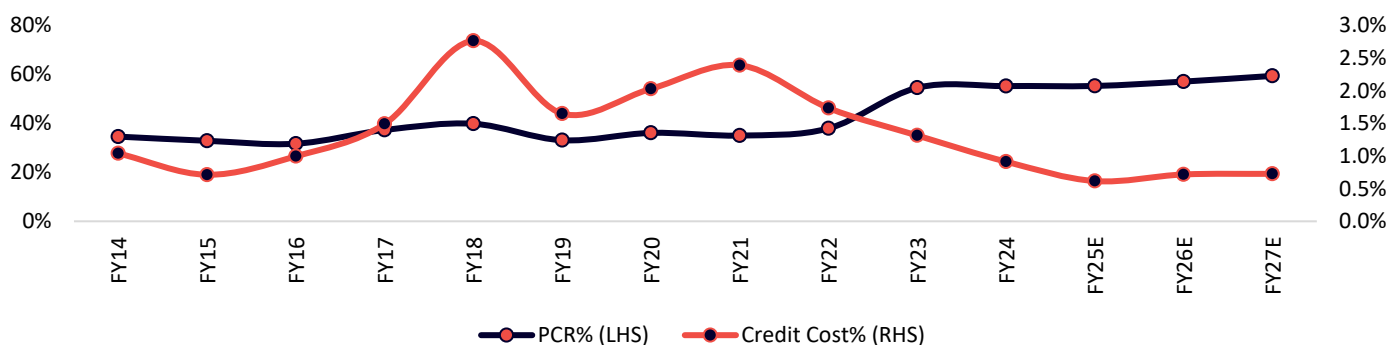
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Higher rated borrowers will improve asset quality and lower credit costs

Taking it forward from BCG, KBL has collaborated with an external consultant to keep working on customer survey, product penetration, revamping credit policy, improving underwriting and recovery process. The impact of these structural changes has already started reducing credit cost for the bank. An improved borrower profile, a secured book, a favourable asset quality cycle, and focus on collections will lower credit costs, in turn aiding overall profitability.

Exhibit 48: Credit cost to improve whilst increasing coverage ratio



Source: Company, Nuvama Wealth Research

Concentration of top 20 borrowers has been range bound between 11–13%, thus reducing concentration risk in the portfolio. With 90% of the book secured, it ensures lower net slippages in the near future.

Exhibit 49: Top 20 borrowers for KBL

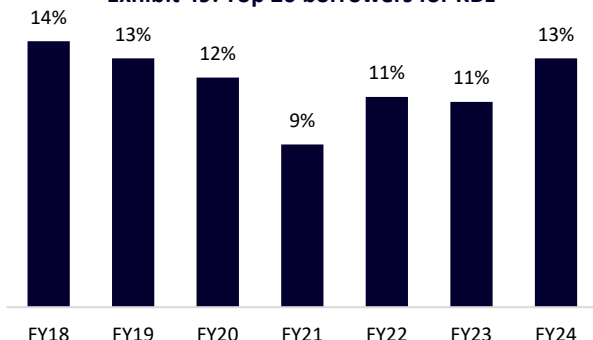
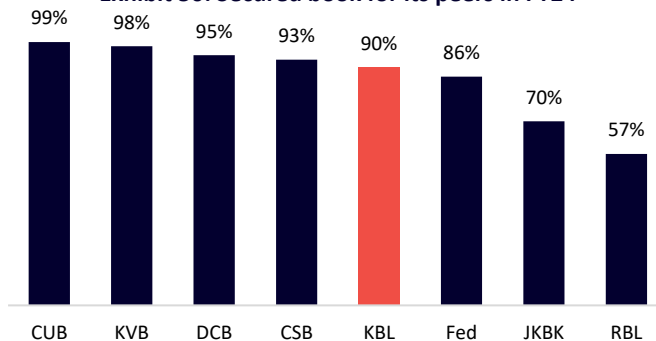


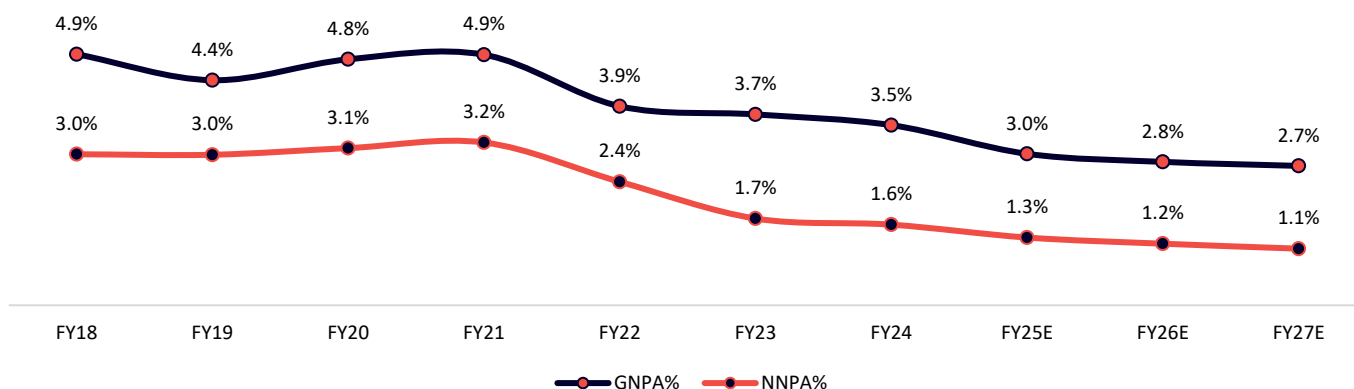
Exhibit 50: Secured book for its peers in FY24



Source: Company, Nuvama Wealth Research

Consequently, we are expecting GNPA and NNPA to moderate hereon.....

Exhibit 51: Improvement in Asset Quality to continue



Source: Nuvama Wealth Research

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V. Improving profitability metrics: Evolution

KBL has a strong presence in its home state of Karnataka. For nearly a century, it has been a stable and well-performing bank. It has delivered a RoA of more than 1% over FY02–09 but undershot the 1% mark annually since then due to a fall in non-interest income and a concurrent decline in operating efficiencies. This was reflected in its cost-to-income ratio, which rose to an average 56% during FY10–17 from an average 38% over FY02–09.

Post-FY17, KBL bought in BCG as consultant to revamp its processes and systems. Loan growth slowed between FY19 and FY22 due to the COVID-19 pandemic and asset quality issues, clocking 2% CAGR over FY20–23. Growth started picking by the end of FY23. The management aims to double the loan book in 42 months, translating into a loan CAGR of ~20% (however, given the slower growth in the first half due exiting of low yielding book, we have projected 17% CAGR over FY24-27E) and a RoA of 1.2-1.4% in the medium term.

Sustainable Margins

Loan growth in FY24 was mainly to higher rated corporates. As its corporate book consists of assets rated AAA, yield stands at 7.5–8%. Yield in the mid-corporate segment is ~11%. Going forward, as the government ramps up infrastructure, growth will be driven by retail, MSME, and agri segments which are expected to generate a higher yield.

Exhibit 52: Quarterly yield on IEA for KBL

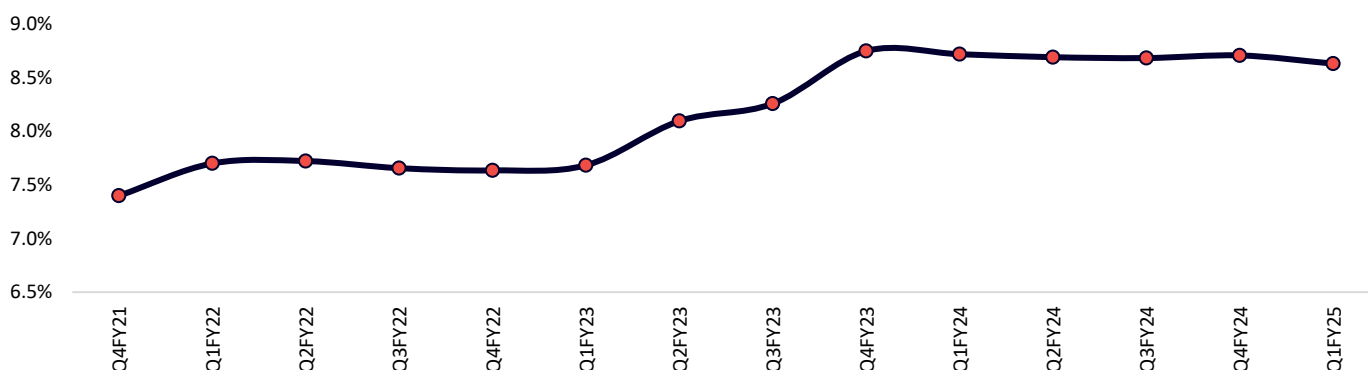


Exhibit 53: Yield on IEA for its peers in Q1FY25; however, we expect Yield to improve largely because of increasing focus on RAM



Source: Company, Nuvama Wealth Research

Though KBL's CoF have increased in line with that of the industry, it has been able to keep it lower than its peers given its sticky and granular franchise base. From last few quarters management consciously let go off some of high-cost deposits; hence we expect CoF to remain soft hereon.

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Exhibit 54: Quarterly CoF for KBL

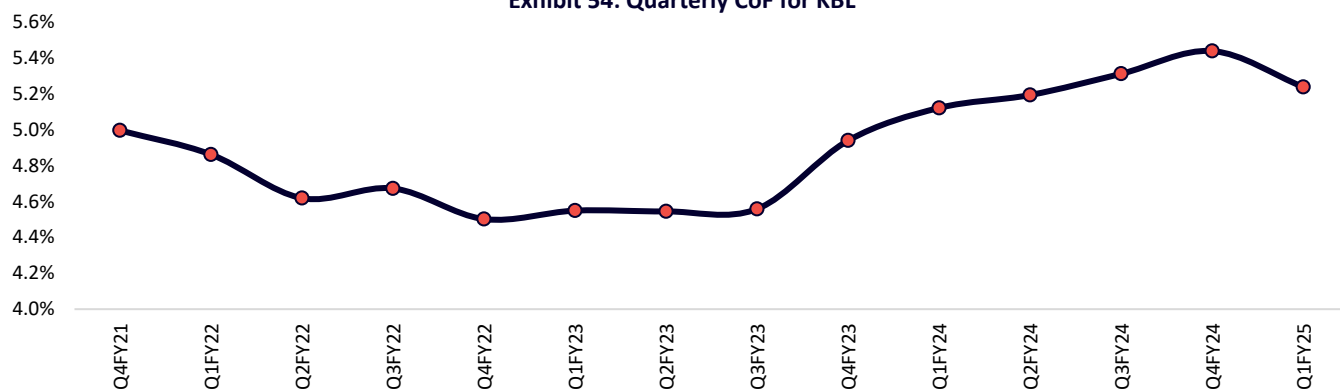
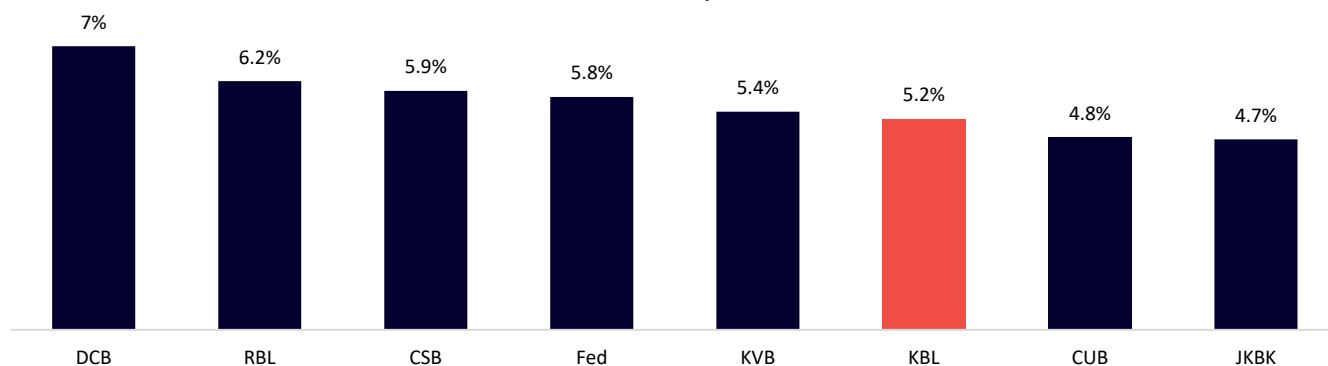


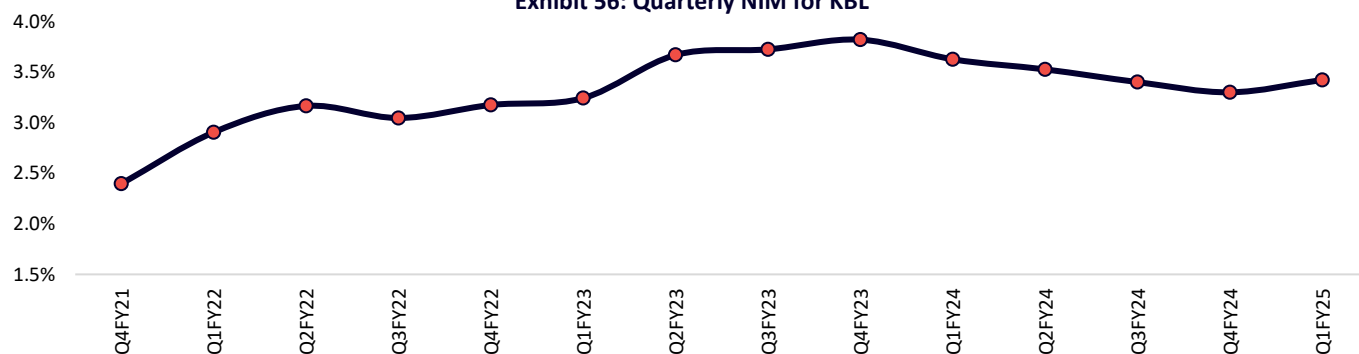
Exhibit 55: CoF for its peers in Q1FY25



Source: Company, Nuvama Wealth Research

Thus, 79% floating loan book along with lower CoF and lower liquidity drag has led to limited NIM compression. We expect NIM to stay slightly elevated as the share of high-yielding loans is likely to increase from here on.

Exhibit 56: Quarterly NIM for KBL

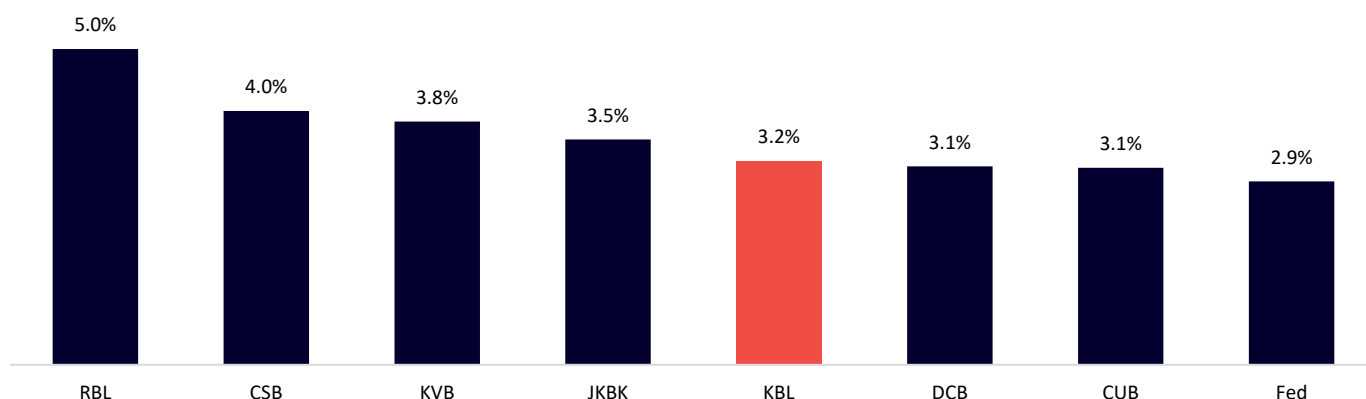


Source: Company, Nuvama Wealth Research

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Exhibit 57: NIM for its peers in Q1FY25; however existing the low yielding loans as well allowing high cost deposits to let go will lead to NIM Expansion in medium-to-long term



Source: Company, Nuvama Wealth Research

Supported by non-core income.

The new management aims to boost fee income and increase non-interest income substantially. KBL has: i) tied-up with several companies to sell third-party products, and ii) been empanelled as a government agency. Cross selling of loans via covenants will aid non-interest income and will subsequently boost net revenue.

Exhibit 58: Quarterly other income for KBL; the benefit of recent tie-ups will augment Fee income which will be visible in upcoming quarters

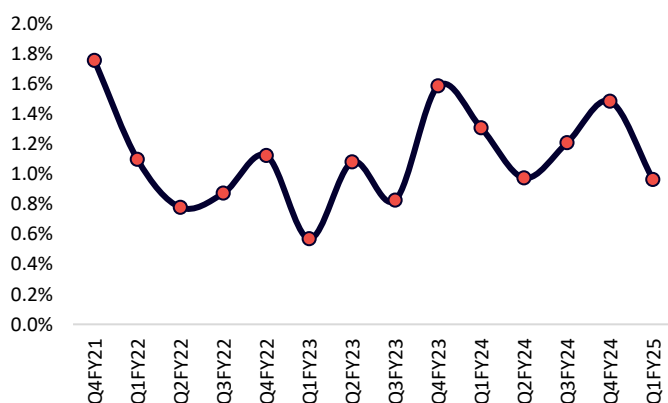
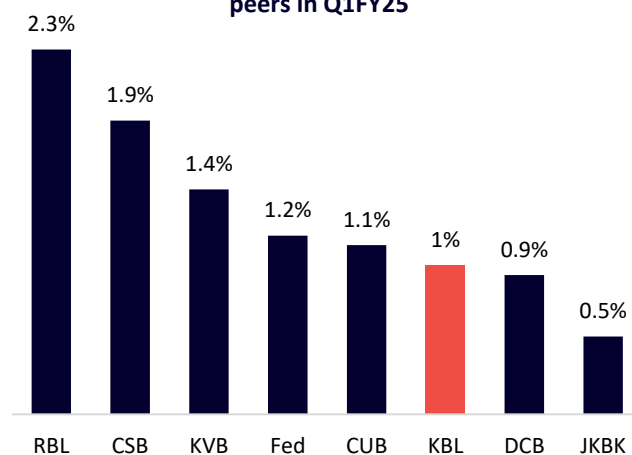


Exhibit 59: Other income-to-asset ratio for its peers in Q1FY25



Source: Company, Nuvama Wealth Research

Other income will offset opex to some extent and help drive PPOP

Branch and employee additions, impetus on new channels, and development of product features will keep opex elevated for some time. The cost-to-income ratio has seen a slight increase in FY24 due to wage revision settlements. On December 7, 2023, the IBA reached a settlement with banks regarding wage hikes. The actual hike was fixed at 17%. So, KBL had to provide for 2% on a retrospective effect. The extra 2% that we have accounted for amounts to almost an extra onetime provision of about INR25 Crore. In Q1FY25, Overall cost-income ratio eased to 53%. However, it jumped to 58% for Q2 due to lower revenue in the quarter. On absolute basis opex remained stable. Management has guided that cost-to-income ratio will come down below 52-55% for the second half of FY25. Over the next two years due to substantial rationalisation of cost structures it is projected to decrease to 50% in FY27E.

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Exhibit 60: Quarterly cost parameters for KBL

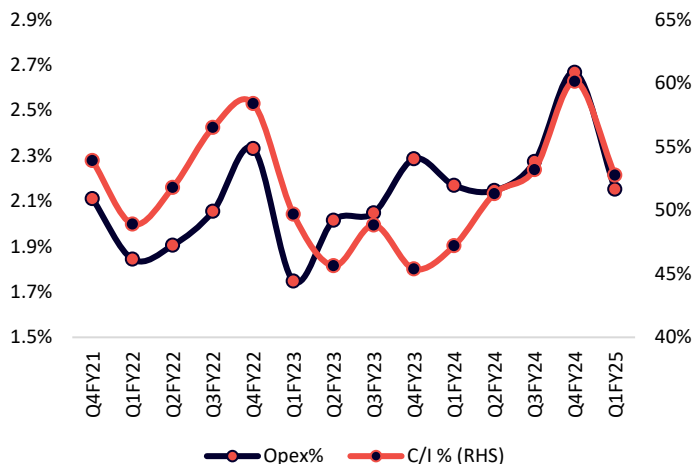
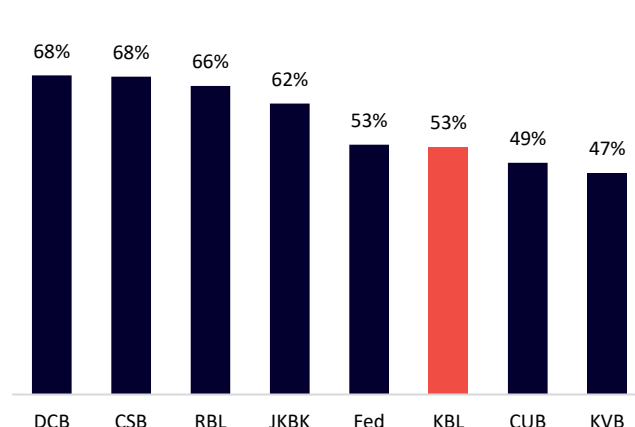


Exhibit 61: C/I ratio for its peers in Q1FY25



Source: Company, Nuvama Wealth Research

KBL created a subsidiary KBL Services to manage all non-critical roles like business sourcing; data entry; contact centre management; back-end processing activities; management of alternate banking channels; IT projects and support; digital capabilities; and providing sub-staff, housekeeping, maintenance staff, and attenders to the parent bank.

Hiring for back-office roles and office support staff will now occur via KBL Services at half the cost. Feet on the street staff, officers, etc. will be hired via KBL Services and will have a lower fixed, but a higher variable compensation structure. This kind of compensation was earlier not possible at the bank level. An across-the-board shift to a CTC-based compensation will take four-to-five years. Opex ratios will stay high in the medium term and keep operating profit in the 2.4–2.6% range.

Exhibit 62: Quarterly PPOP for KBL

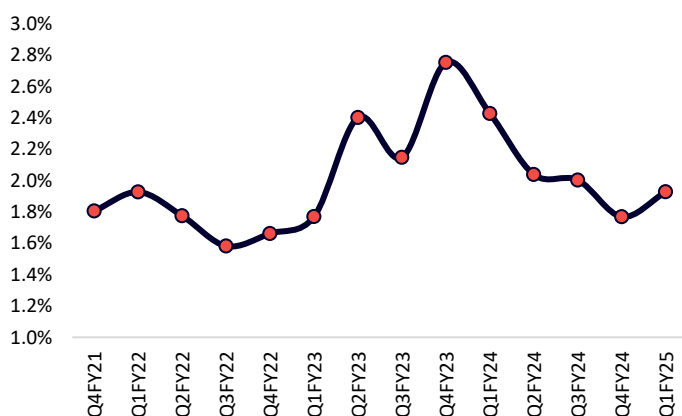
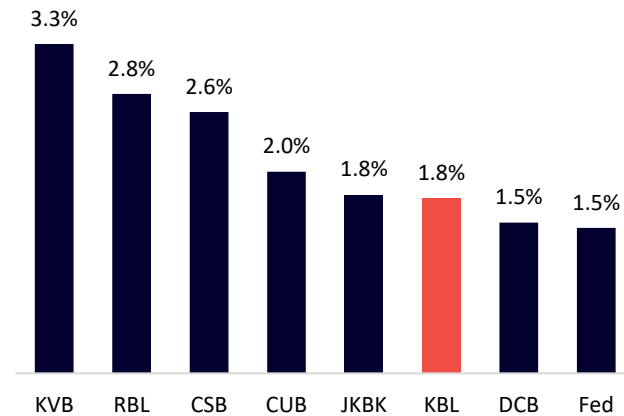


Exhibit 63: PPOP for its peers in Q1FY25



Source: Company, Nuvama Wealth Research

Benign asset quality cycle will keep credit cost subdued

Credit costs have been elevated for the last few years. However, a healthy PCR, higher share of secured loans, and improving credit quality are likely to restrict credit cost at lower levels. However, Management has guided that if profitability exceeds the bank's target, then additional funds will be utilised for accelerated provisioning. Also, various steps like introducing risk-based pricing, emphasis on underwriting & sourcing quality, emphasis on collections & resolutions and enhanced risk management will keep asset quality in check. Steady state credit cost should be ~0.7% for FY24-FY27E vs about 1.6% average during FY14-23.

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Exhibit 64: Quarterly credit cost for KBL

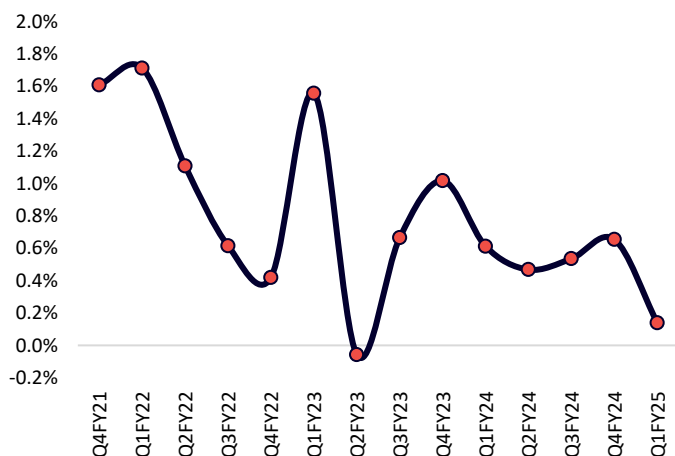
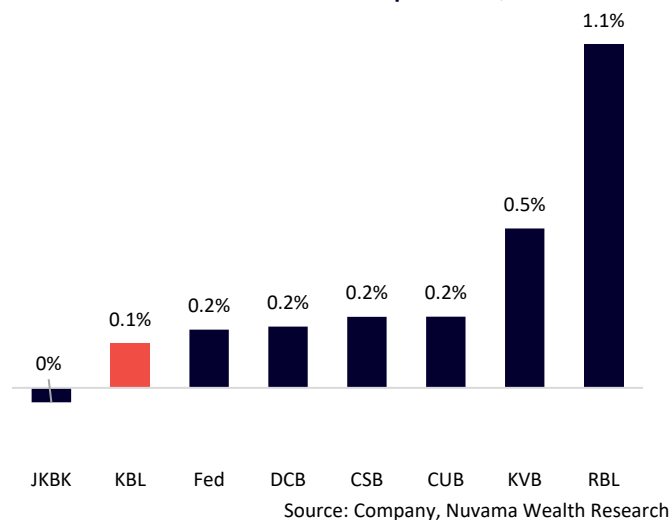


Exhibit 65: Credit cost for its peers in Q1FY25



Return ratios to stay consistent

We believe all above initiatives will translate a healthy and sustainable return ratios over the next few years. In Exhibit 65 below, we observe that RoA/RoE jumped to 1.7%/22% in Q2FY23. This improvement in return ratios was due to lower credit cost. After that, KBL has been able to maintain RoA/RoE at 1.3%/16% over the last five quarters. We expect it to sustain a RoA/RoE of 1.4%/14-15% in the long term.

Exhibit 66: Quarterly RoA for KBL

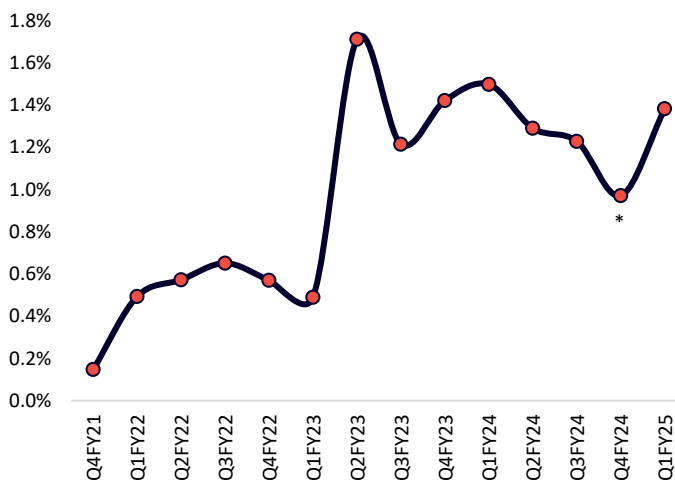
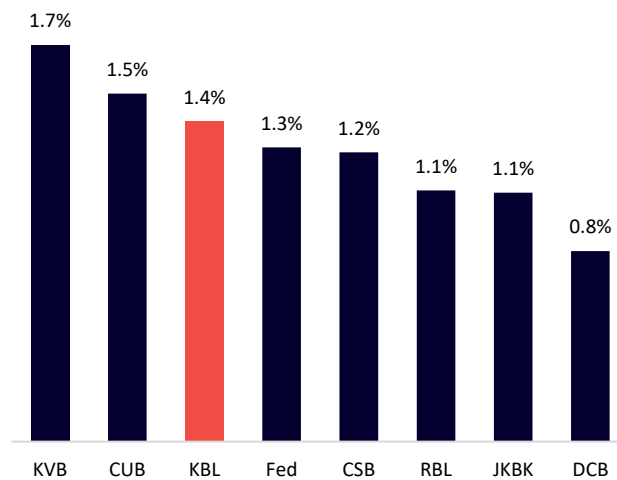


Exhibit 67: RoA for its peers in Q1FY25



*KBL expensed a one-time staff cost of INR152.2cr in Q4FY24 which resulted in a lower RoA. Excluding provisioning cost, RoA would have been ~1.4% in Q4FY24

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Exhibit68: Quarterly RoE for KBL

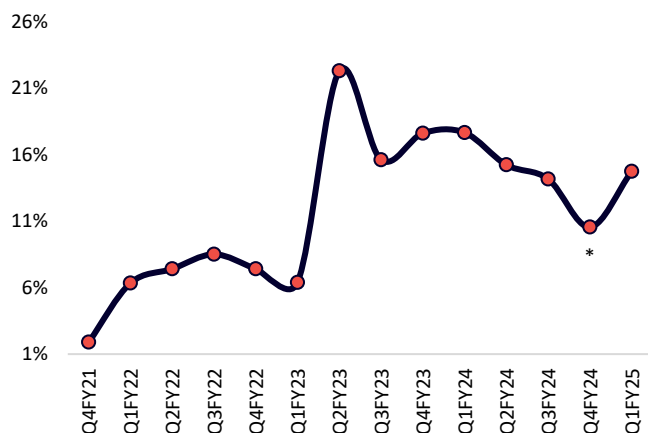
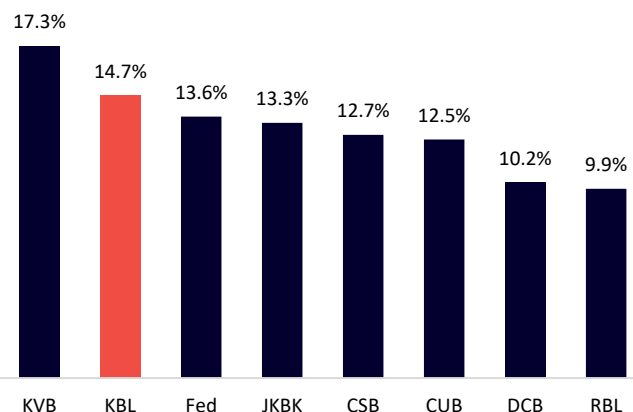


Exhibit69: RoE for its peers in Q1FY25



*Impacted due to the capital raise in Q4FY24. A one-time cost resulted in lower PAT in Q4FY24. KBL has been posting an average RoE of 17% on a sequential basis for the last six quarters

Source: Company, Nuvama Wealth Research

Sustainable improvement in profitability (In a nutshell)

In addition to improving loan growth which will invariably help to book fee income, various third-party products will help drive non-loan income for the bank. NIM will stay structurally higher due to a lower CoF, which is the consequence of a sticky granular deposit profile. We expect C/I ratio to stay elevated as KBL undertakes various technology and HR initiatives. As operational efficiencies kick in, we expect a sustainable growth in PPOP. Emphasis on collection and prudent sanctioning is a step in the right direction to improve asset quality. This will result in lower credit cost which, in turn, will ensure higher return ratios.

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Valuation and view

We believe KBL is well placed to pursue growth with a favourable C/D ratio, adequate LCR, and healthy CRAR at ~18% due to capital infusion in FY24. A sticky granular deposit franchise ensures low-cost funds and a secular improvement in the balance sheet.

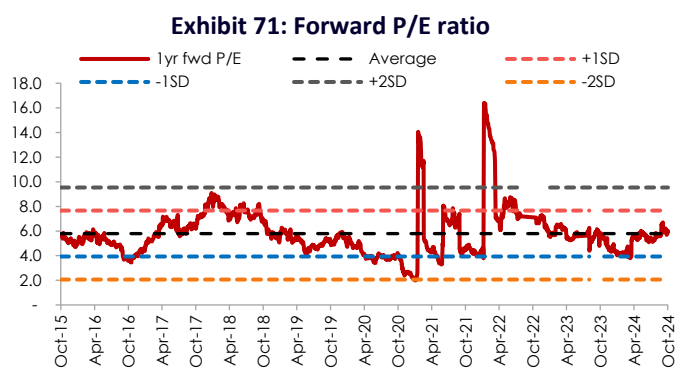
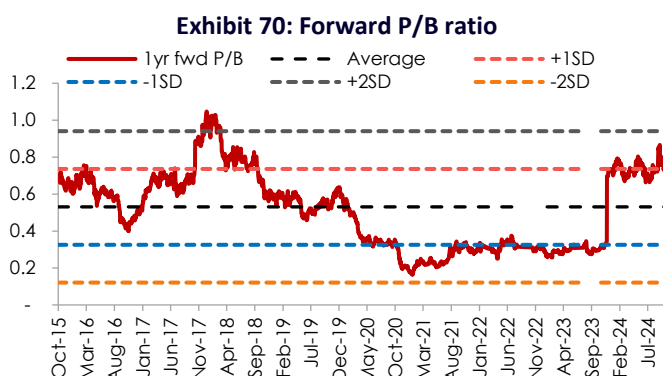
This will help stabilise the structurally higher NIM for the bank. Enhanced product offerings, co-lending agreements, insurance partnerships, and various other initiatives will help boost fee income. The addition of senior level employees and digital transformation will keep operating cost elevated, with the C/I ratio hovering between 50–55%.

The bank's commitment to keep NPAs low through dedicated collection teams, greater monitoring, and higher secured book will keep credit cost in check. The newly onboarded top management, with a rich experience in large private banks, can help create a sales-centric organisation, driven by partnerships and new product offerings, to achieve an analytics-led digital first bank. The changes implemented by the new management are already bearing results. In FY24, the bank reported a record PAT of ~INR1,306cr against a FY23 PAT of INR1,180cr — the highest full-year PAT recorded by the bank in 100 years.

We expect credit growth to pick-up given the company's strengthening sales force, strong distribution presence, and reduction in TAT. The management's focus on improving asset quality and technology will translate in a low opex-to-asset ratio. Given the attractive valuation and expected improvement across various operating and efficiency parameters, the re-rating in the stock will continue. We expect RoA/RoE to stay robust at 1.4%/14% in FY27. At the CMP, the stock is trading at 0.5x FY27E P/ABV. Valuing KBL at 0.8x FY27E P/ABV, we initiate coverage with a 'BUY' rating and TP of INR310, an upside of 50% from its CMP.

Company	CMP	CAGR FY24–26E (%)				RoAE (%)		RoA (%)		P/ABV ratio (x)		P/E ratio (x)	
As October, 29 2024	(INR)	Advances	Revenue	PPOP	PAT	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Federal Bank	201	17%	18%	20%	14%	1.2	1.2	14.4	14.6	1.5	1.3	12.0	10.1
RBL Bank	173	19%	19%	25%	32%	0.8	1.1	10.4	11.9	0.7	0.6	8.6	6.4
Karnataka Bank	207	16%	11%	13%	14%	1.3	1.4	12.2	13.1	0.7	0.6	5.7	4.6
Karur Vysya Bank	222	15%	12%	14%	18%	1.6	1.4	16.6	15.4	1.6	1.4	9.7	9.0
City Union Bank	177	12%	13%	14%	15%	1.6	1.7	12.7	13.1	1.4	1.2	11.6	9.8
DCB Bank	117	19%	17%	24%	20%	0.9	1.0	13.3	14.6	0.7	0.6	6.2	4.7
CSB Bank	309	20%	17%	17%	10%	1.5	1.5	14.4	14.6	1.2	1.1	9.1	7.8

Source: Company, Nuvama Wealth Research



Source: Company, Nuvama Wealth Research

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Key management personnel

Exhibit72: Key managerial personnel

Name	Role	Details
Mr Srikrishnan H	MD & CEO	<p>Assumed charge as the Managing Director & CEO of Karnataka Bank w.e.f. June 09, 2023. Aged 61, he has nearly four decades of experience spread across Commercial, Retail & Transactional Banking, Technology and Payments.</p> <p>At HDFC Bank Limited, he was part of the founding management team, for over 9 years, and as the Country Head - Transactional Banking and Operations, he was involved in setting up the Bank's Corporate and Retail Banking, Treasury and Capital Markets Infrastructure business, launched Commercial Vehicles and Construction Equipment's (CV/CE) lending, Channel Financing, Capital Markets Margin lending and mid-Corporate lending business.</p> <p>At Yes Bank Limited, as Executive Director and member of the Board, was instrumental in setting up the Commercial Banking infrastructure covering Operations, Technology, Retail, Transaction Banking, Payments, Trade Finance, Loan Servicing and Treasury Operation.</p> <p>At Jio Payments Bank Limited, as MD & CEO, he was responsible for application and coordination for approval of license with the RBI, incorporation of the company, formation of the Board, strategic direction, and commencement of operations in 2018.</p> <p>He has worked extensively to build systems and technology to support supply chain finance and provide digital banking platforms to various Banks in and outside India.</p>
Mr Sekhar Rao	Executive Director	<p>Sekhar Rao is on the Board as the Executive Director w.e.f. 1 February 2023. Aged 54 Years, a postgraduate in Business Administration and a BE (Chemical), who has 29+ years of overall work experience across various sectors such as Banking, Information Technology, Payment and Settlement Products, Business Management, Strategy & Operations, of which 19 years in the BFSI sector. He also has an experience of 10+ years in CXO roles reporting to MD & CEO and Board Committees. His areas of experience include setting up and managing centralized operation units and technology teams, consulting for projects in business strategy and banking operation, managing the digital/alternate channels of Banks, setting up of new business verticals, distribution channels, branch network expansion, managing large network of Branches & Business Units and setting up and scaling a Fintech start-up. Prior to joining the Bank, he has been associated with a fintech - Savvy India as the co-founder and a director from April 2020. He was also associated with CSB bank Ltd as the Head – Operations & IT for about six years. Earlier, he has worked with RBL Bank Ltd, ING Vysya Bank Ltd, ICICI Bank Ltd., Asian Paints (I) Ltd., Kansai Nerolac Paints Ltd in various capacities.</p>
Mr Balachandra Y V	Chief Operating Officer	He has been with the bank for 28 years
Mr Gokuldas Pai	Chief Business Officer	He has 34 years of experience across various business functions at KBL
Mr Abhishek Sankar Bagchi	Chief Financial Officer	Mr Bagchi was CFO at NSDL Payments Bank and Deputy VP – Finance & Accounts at Axis Bank before joining KBL
Mr Pankaj Gupta	Chief Digital & Marketing Officer	Prior to joining KBL, Mr Gupta was part of Sify Technologies, HCL Services, and Wipro Infotech
Mr Gurumurthy R K	Head – Treasury	He was a part of DBS Bank, Laxmi Vilas Bank, Bank One, and ING Vysya Bank before joining KBL
Mr Ramaswamy Subramanian	Chief Product Officer	He was former CPO at Dvara KGFS and Head – Products at Suryoday Small Finance Bank before joining KBL
Mr Venkat Krishnan	Chief Information Officer	Prior to joining KBL, he was CTO at IndusInd Bank; CIO at Ujjivan Small Finance Bank; and CTO at Yes Bank

Source: Company

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Key risks

Geographical concentration with comparatively small size of operations:

The bank has limited presence with a small network of 931 branches. With total assets of INR 1,16,085 crore as on Mar 31, 2024, KBL is one of the relatively smaller banks in India. The branches remain concentrated with South India and Karnataka accounting for ~80% and ~64%, respectively.

Asset quality stress in its legacy portfolio:

In the last 2-3 years, restructured book contributed a major share in overall slippage and also SMA-1 & 2 remained high the past (As on FY24 – 2.3%). The overall restructured book is consistently declining; however, as on Q2FY25 it stood at INR 1,268cr. We expect the slippage from above to remain soft. The management’s ability to minimise slippages from this potential vulnerable book, which is high compared to its peers, will ensure higher profitability and solvency at comfortable levels.

General slowdown in economy:

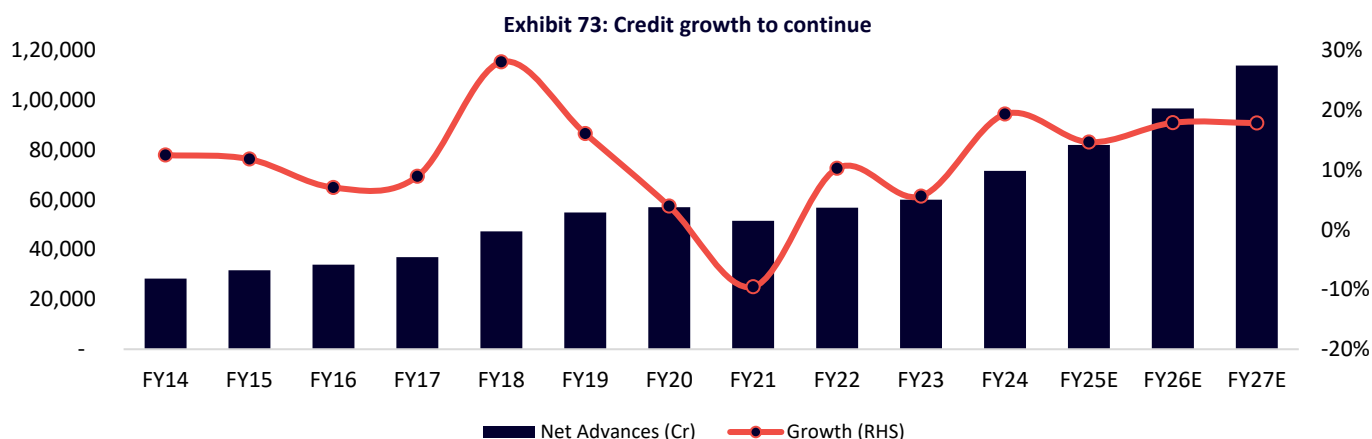
Any slowdown in the economic environment may lead to moderation in credit growth as new product launch will be delayed. Also, it will moderate fee income garnered through multiple tie-ups which will subdue earnings growth. Also impact on asset quality will also be a key monitorable in such scenarios as it affects credit costs and provisioning.

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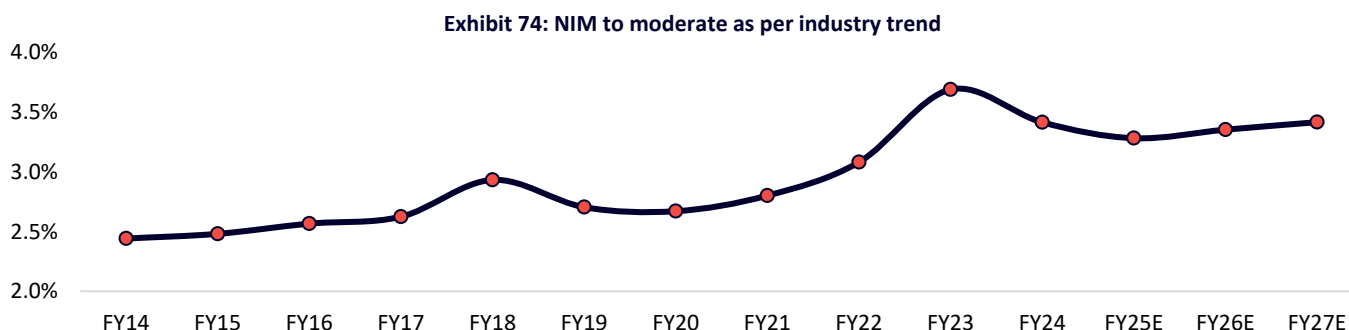
Financial Analysis

KBL posted 14% CAGR in advances over FY14–18, with growth across segments. During FY19–21, advances fell by 3% on account of demonetisation, roll out of GST, and the COVID-19 pandemic. Growth picked up post pandemic with 8% CAGR from FY21-23. The loan growth of 19% in FY24 was driven by corporate loans which will be taken over by the RAM segment as new sourcing channels and products start picking up in FY25 and FY26. We expect 17% CAGR in loan growth over FY24–27 after accounting for various growth factors available to the bank.



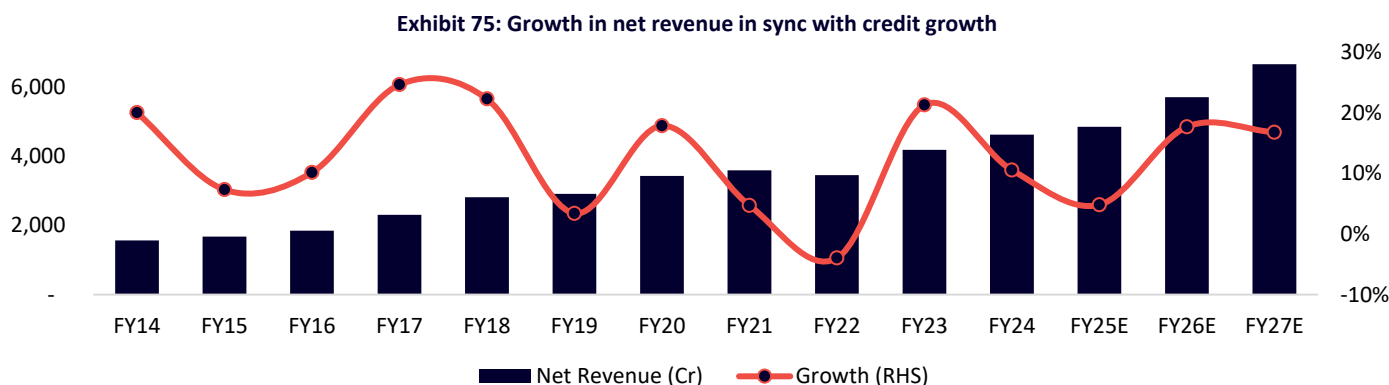
Source: Company, Nuvama Wealth Research

With growth in credit we expect KBL to record 14% CAGR in NII over FY24–27E. NIM is likely to marginally inch-up as interest rate cycle is bottoming out but would remain structurally high compared to peers.



Source: Company, Nuvama Wealth Research

Growth in net revenue is slightly better due to structurally higher NIM (aided by lower CoD) and expected boost in other income due to various initiatives. We have projected net revenue to grow by 13% CAGR over FY24-27E.



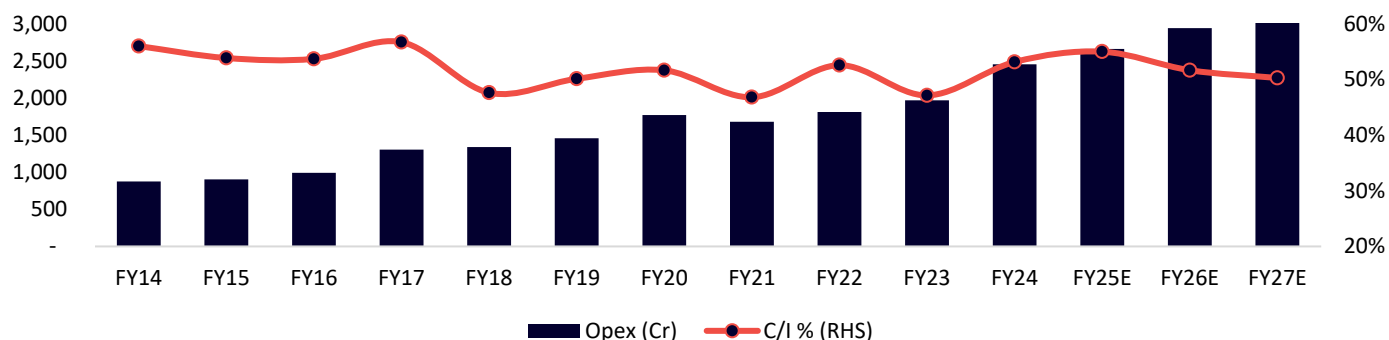
Source: Company, Nuvama Wealth Research

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Greater technology and employee expense has kept C/I ratio elevated ~53% in FY24. We expect the C/I ratio to fall to 50% in FY27 from 55% in FY25 due to higher revenue growth and operational efficiencies.

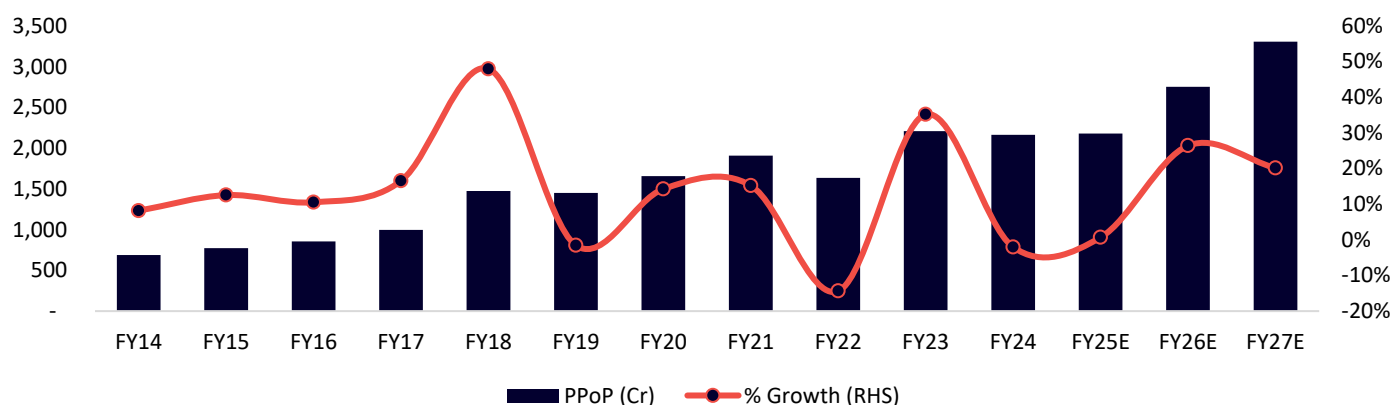
Exhibit 76: Expect C/I ratio to improve on operational efficiencies



Source: Company, Nuvama Wealth Research

We have projected 15% CAGR PPOP growth over FY24-27E which will be improved due to technology upgradation, economy of scale & moderation in costs.

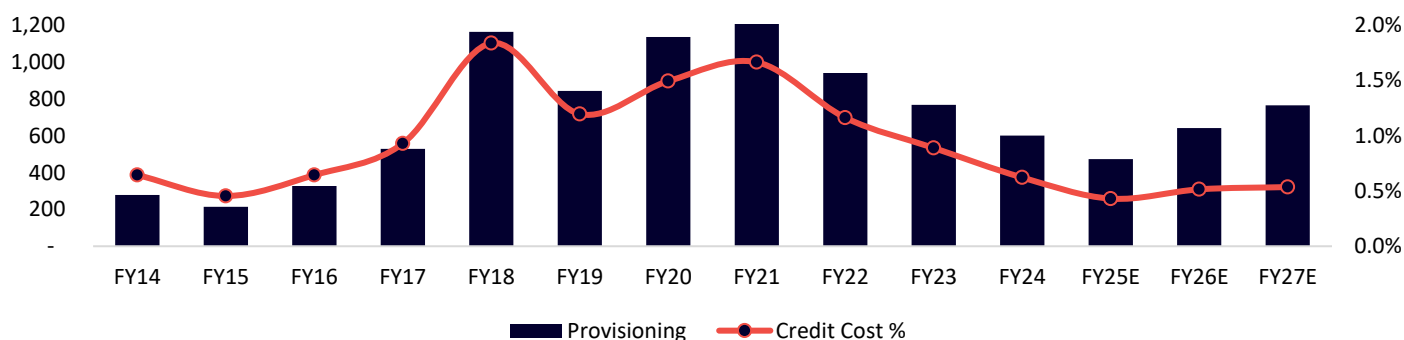
Exhibit 77: Growth in PPOP to accelerate on moderating cost



Source: Company, Nuvama Wealth Research

The management's commitment to keep NPAs low through dedicated collection teams, greater monitoring, higher secured book, and lower slippages will help keep credit cost in check.

Exhibit 78: Expected lower Credit cost (%)



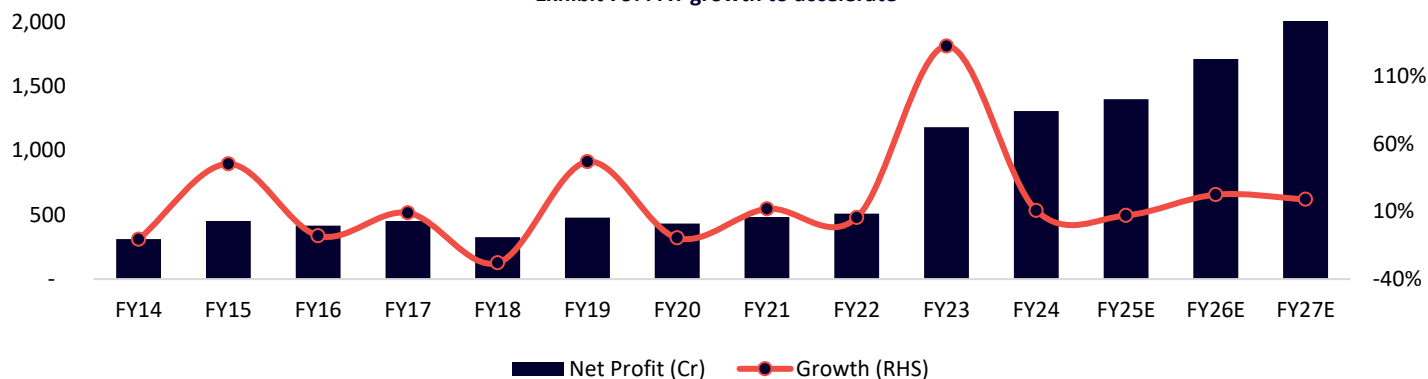
Source: Company, Nuvama Wealth Research

We expect net profit to grow 16% over FY24-27E on account of overall operating efficiencies improves, as described above.

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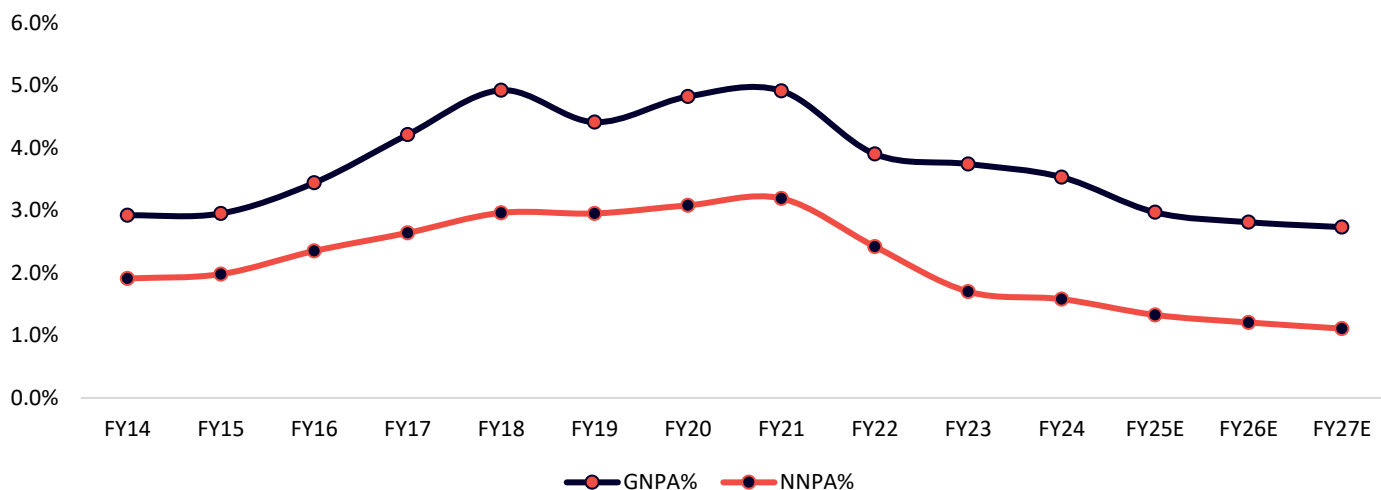
Exhibit 79: PAT growth to accelerate



Source: Company, Nuvama Wealth Research

We expect a substantial improvement in asset quality over the next few years due to proper follow-up of accounts, acceleration in the recovery process, and strengthening of the collection team.

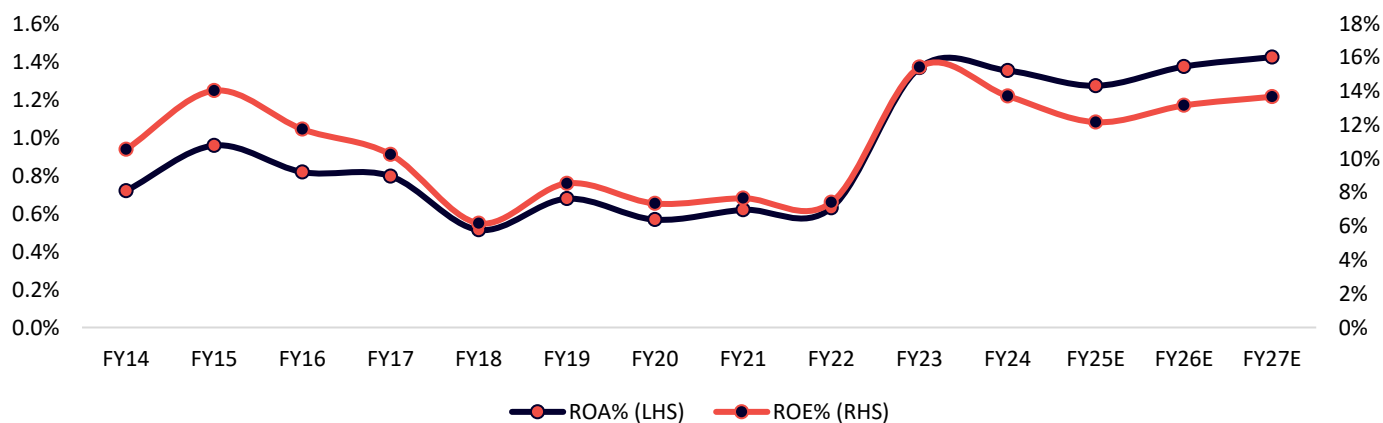
Exhibit 80: Improvement in asset quality to continue



Source: Company, Nuvama Wealth Research

Return ratios were under pressure over FY18–22 but staged a comeback given the improvement in margin and lower credit cost. We expect a RoA/RoE of 1.4%/14% over FY25–27E.

Exhibit 81: Expect return ratios to improve



Source: Company, Nuvama Wealth Research

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Financials

Income Statement (INR cr)

Year to March	FY22	FY23	FY24	FY25E	FY26E	FY27E
Interest income	6,222	7,220	8,299	9,415	10,666	12,262
Interest charges	3,731	4,035	5,000	5,808	6,491	7,382
Net interest income	2,491	3,185	3,299	3,606	4,176	4,880
Other income	954	993	1,319	1,233	1,518	1,769
Net revenue	3,445	4,178	4,618	4,840	5,694	6,649
Operating expense	1,811	1,969	2,454	2,662	2,942	3,342
- Employee expense	1,015	1,069	1,373	1,492	1,653	1,882
- Other opex	796	900	1,081	1,170	1,289	1,460
Pre-provision operating profit	1,634	2,208	2,163	2,178	2,752	3,306
Provisions	939	767	601	473	641	764
PBT	695	1,441	1,563	1,705	2,112	2,542
Taxes	186	261	256	307	401	508
PAT	509	1,180	1,306	1,398	1,710	2,033
Extraordinaries	-	-	-	-	-	-
Reported PAT	509	1,180	1,306	1,398	1,710	2,033
Basic number of shares (cr)	31	31	38	38	38	38
Basic EPS (INR)	16	38	35	37	45	53
Diluted number of shares (cr)	31	31	38	38	38	38
Diluted EPS (INR)	16	38	35	37	45	53

Growth ratios (%)

Year to March	FY22	FY23	FY24	FY25E	FY26E	FY27E
Growth in NII	14%	28%	4%	9%	16%	17%
Growth in non-interest income	-32%	4%	33%	-6%	23%	16%
Growth in net revenue	-4%	21%	11%	5%	18%	17%
Growth in opex	8%	9%	25%	8%	11%	14%
Growth in PPOP	8%	9%	25%	8%	11%	14%
Growth in provisions	-28%	-18%	-22%	-21%	36%	19%
Growth in PAT	5%	132%	11%	7%	22%	19%

Operating ratios (%)

Year to March	FY22	FY23	FY24	FY25E	FY26E	FY27E
Yield on average advances	8.7%	9.6%	9.9%	9.9%	9.8%	9.7%
Yield on investments	6.0%	6.3%	6.3%	6.2%	6.2%	6.2%
Yield on interest earning assets	7.7%	8.4%	8.6%	8.6%	8.6%	8.6%
Cost of deposits	4.6%	4.6%	5.2%	5.3%	5.3%	5.2%
Cost of funds	4.7%	4.7%	5.2%	5.4%	5.3%	5.3%
Spread	3.0%	3.7%	3.4%	3.2%	3.3%	3.3%
Net interest margin	3.1%	3.7%	3.4%	3.3%	3.4%	3.4%
Cost-to-income ratio	52.6%	47.1%	53.2%	55.0%	51.7%	50.3%
Tax rate	26.8%	18.1%	16.4%	18.0%	19.0%	20.0%

Long Term Recommendation Karnataka Bank

‘Bharat ka Karnataka Bank’ - New age ambitions

Balance Sheet (INR cr)

As on March 31	FY22	FY23	FY24	FY25E	FY26E	FY27E
CAPITAL AND LIABILITIES						
Share capital	311	312	377	382	382	382
Reserves and surplus	6,784	7,901	10,471	11,772	13,483	15,516
Warrants	-	-	-	-	-	-
Deposits	80,387	87,368	98,058	1,08,844	1,24,634	1,42,581
Borrowings	2,314	1,563	4,400	4,898	6,232	6,900
Other liabilities and provisions	2,245	1,914	2,779	2,650	1,516	1,108
Total liabilities	92,041	99,058	1,16,085	1,28,546	1,46,246	1,66,487
ASSETS						
Cash and balances with RBI and others	4,437	6,159	7,993	8,490	9,098	9,695
Investments	22,041	23,326	24,302	25,578	27,420	29,229
Advances	56,783	59,952	71,509	81,951	96,575	1,13,752
Fixed assets	818	875	915	933	980	1,029
Other assets	7,961	8,746	11,367	11,594	12,174	12,782
Total assets	92,041	99,058	1,16,085	1,28,546	1,46,246	1,66,487

Balance Sheet ratios (%)

Year to March	FY22	FY23	FY24	FY25E	FY26E	FY27E
Loan growth	10%	6%	19%	15%	18%	18%
Growth in IEA	6%	7%	16%	12%	15%	15%
Growth in deposits	6%	9%	12%	11%	15%	14%
Growth in IBL	7%	8%	15%	11%	15%	14%
Gross NPA ratio	3.9%	3.7%	3.5%	3.0%	2.8%	2.7%
Net NPA ratio	2.4%	1.7%	1.6%	1.3%	1.2%	1.1%
Provision coverage	38%	55%	55%	55%	57%	59%
CAR	16%	17%	18%	18%	17%	16%

RoAE decomposition (%)

Year to March	FY22	FY23	FY24	FY25E	FY26E	FY27E
Net interest income/assets	3.1%	3.7%	3.4%	3.3%	3.4%	3.4%
Other income/assets	1.2%	1.1%	1.4%	1.1%	1.2%	1.2%
Net revenue/assets	4.3%	4.8%	4.8%	4.4%	4.6%	4.7%
Operating expense/assets	2.2%	2.3%	2.5%	2.4%	2.4%	2.3%
Provisions/assets	1.2%	0.9%	0.6%	0.4%	0.5%	0.5%
Taxes/assets	0.2%	0.3%	0.3%	0.3%	0.3%	0.4%
Total cost/assets	3.6%	3.5%	3.4%	3.1%	3.2%	3.2%
Return on assets	0.6%	1.4%	1.4%	1.27%	1.37%	1.42%
Assets/equity	12	11	10	10	10	10
Return on average equity	7.4%	15.4%	13.7%	12.2%	13.1%	13.7%

Valuation metrics

Year to March	FY22	FY23	FY24	FY25E	FY26E	FY27E
Basic EPS	16	38	35	37	45	53
EPS growth	5	131	-8	6	22	19
Book value per share	228	263	288	318	363	417
Adjusted book value per share	190	230	259	291	335	387
Basic P/E ratio	12.7	5.5	6.0	5.7	4.6	3.9
P/BV ratio	0.9	0.8	0.7	0.7	0.6	0.5
P/ABV ratio	1.1	0.9	0.8	0.7	0.6	0.5

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