

# Initiating Coverage

## Sector: Banking



<b>Karnataka Bank Ltd</b>	<b>BUY</b>
Horizon	<b>12 - 15 months</b>
Target Price (Rs.)	<b>190</b>
Upside	<b>18%</b>

### Executive Summary

The Karnataka Bank Ltd. provides personal and business banking products and services in India. The company offers current and savings accounts, cash certificates, fixed deposits, cumulative deposits, insurance linked savings bank deposits, and resident foreign currency accounts. It also offers education loans, industrial finance, insurance services and MSME loans. As of March 31, 2010, it had 464 branches, 217 ATM outlets, 8 regional offices and 1 international division.

### Concerns

- MSME and retail sector may lead to higher NPAs.
- Liquidity crunch.
- RBI may raise rates again if the inflation doesn't cool down.
- Increase in competition from NBFCs

### Key Investment considerations

- Business Momentum picking up
- Cheap Valuations
- Rights Issue of 2 shares for every five held.
- Take Over Candidate.
- Strongest Regional Player in South India
- Fee Income will augment in the coming quarters
- Credit disbursements set to increase
- Strong September Quarter Performance
- Strong Presence in retail segment

### Investment Strategy

Period	Cash
<b>Short Term</b>	Buy
<b>Mid Term</b>	Start Accumulating
<b>Long Term</b>	Start Accumulating

Please read our detailed report below for further information, analysis and details of the Greshma CSI Ranking model and the Greshma Risk Return Matrix

## Investment Summary:

- **Business Momentum picking up:** Karnataka Bank's (Ktkbank) business growth has picked up in the first half of FY11. We believe this will continue to grow in the future driven by an increase in the branches and the initiatives taken by the bank. The business turnover crossed Rs. 40,000 crore in 2010.
- **Rights Issue:** The Bank is offering a rights issue in the ratio of 2:5 at price not exceeding Rs.100. This will create an additional upside for the stock and higher returns for the investors.
- **Take Over Candidate:** With the de regulation of the banking sector in the offing, we believe that these small banks will be pt candidates for takeover. This would be a step towards the expected consolidation expected in this sector.
- **Cheap Valuations:** The company is attractively valued at TTM P/E of 10x and 1.08x P/BV which gives us an ample potential for upside and less risk of a downside.
- **Strongest Regional Player in South India:** Ktkbank is the strongest regional player in South India with more than 350 branches spread over Maharashtra, Karnataka and Tamil Nadu.
- **Fee Income will augment in the coming quarters:** KtkBank is planning to increase its branches from the current 464 to 480 branches by end of March 2011. The bank will also be launching new products like Online trading, Travel Card, Gift Card, Smart Card, POS Terminal etc. by the end of current financial year. This will help the bank to diversify its current product portfolio and drive non interest income.
- **Credit disbursements set to increase:** Credit is expected to grow on the basis of higher CASA ratio which the Ktkbank plans increase by offering different type of savings accounts. Also the bank has simplified its retail loan schemes. The bank plans to focus mainly on Retail as well as MSME sectors for going forward.
- **Strong September Quarter Performance:** The bank has performed very strongly in the September quarter the

# BUY

<b>CMP (Rs.)</b>	<b>160.75</b>
<b>Target price (Rs.)</b>	<b>190</b>
<b>Potential upside</b>	<b>18%</b>
<b>Holding Period</b>	<b>12 – 15 months</b>

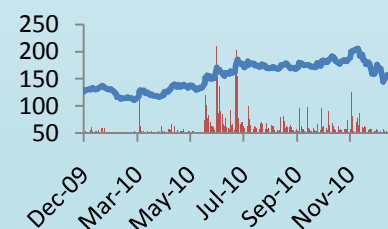
### Stock Matrix

No. of shares(mns)	<b>134.40</b>
FV(Rs.)	<b>10.00</b>
BV	<b>141.98</b>
Market Cap(Rs. Mn)	<b>20920.41</b>
52 week high / low(Rs.)	<b>209.25/109.10</b>
Beta	<b>1.08</b>
Avg. daily vol. (Rs. Mn)	<b>20.07</b>
BSE Code	<b>532652</b>
NSE Code	<b>KTKBANK</b>

### Shareholding (%)

	Jun – 10	Sep – 10	QoQ % Change
Promoters	0	0	0
FII's	27.64	28.78	4.12
DII's	6.96	6.16	-11.49
Individuals	45.02	45.17	0.33
Corporate	19.52	18.22	-6.66
Others	0.86	1.67	94.19

### Price performance



(Source: Prowess)

Contact:

[research@greshma.com](mailto:research@greshma.com)

☎: 91-22- 3005 6400

income has increased by 14% and the PAT has increased by 75% to Rs. 287.20 Mn.

- **Strong Presence in retail segment:** The bank has a strong presence in the retail segment; this will help the bank in augmenting fee income as there is a possibility of cross selling their products of insurance, mutual funds etc. Also in the retail though the volumes are low but they are margins are high and it will improve the banks bottom-line.

### Company Background:

The Karnataka Bank Ltd. provides personal and business banking products and services in India. The company offers current and savings accounts, cash certificates, fixed deposits, cumulative deposits, insurance linked savings bank deposits, and resident foreign currency accounts. It also provides education loans, home loans, car finance, working capital finance, term loans, and infrastructure finance; business finance products, such as retail trade finance, project finance, export finance, and agriculture finance, as well as finance for small, medium, and large scale industries; debit and credit cards; and insurance services. In addition, the company offers ATM, Internet and mobile banking, money transfer services, and NRI services. As of March 31, 2010, it had approximately 464 branches, 217 ATM outlets, 8 regional offices, 1 international division, 1 data centre, 1 customer care centre, 5 service branches, 2 currency chests, 6 extension counters, and 2 central processing centers. The company was founded in 1924 and is headquartered in Mangalore, India.

### Key Managerial Personnel:

Name	Title
Bhat, P. Jayarama	Chief Executive Officer, Managing Director,
Hande, P. Jairama	Chief Financial Officer and General Manager
Aranha, Meera Laetitia B.	Chief Compliance Officer
Balachandra, Y. V. V.	Compliance Officer and Company Secretary
Bhat, M. V. Shankar	Legal Adviser
Adiga, S. Anandarama	Deputy General Manager
Krishna, Anantha	Part Time Non Executive Chairman,
Shastri, R. V.	Additional Director
Bhat, Ullal R.	Additional Director
Chandrasekaran, T. R.	Additional Director
Hegde, S. R.	Director
Kumar, D. Harshendra	Director
Manjunath, S. V.	Director
Mohan, H. Rama	Director
Murty, M. S.	Additional Director
Vishwanath, T. S.	Additional Director

## Q2 FY 11 Result Update

Karnataka bank during the quarter ended Sept 2010 reposted total income of Rs 6.35 billion up by 16% on Y – o- Y basis whereas up by 3.6% on Q –o- Q basis. This was supported by stellar wholesale and retail banking growth. During the quarter the margins of the bank were impacted mainly due to higher provision to comply with RBI guideline of 70% provisional coverage. The net profit after tax was Rs 287 million up by 75% on Y –o-Y basis but down by 38% on Q –o- Q basis. The net profit margin stood at 4.5%. During the quarter the bank posted Net interest income of Rs 1.39 billion which is up by 150% from Rs 554 million in the corresponding quarter last year whereas up by 16% from the previous quarter. The Net interest margin in the quarter stood at 1.87% from 0.85% in Sept 2009 quarter. This has been boosted by increase in CASA from 22.5% in Sept 2009 to 25.6% in this quarter and 25% growth in advances.

### Key Highlights

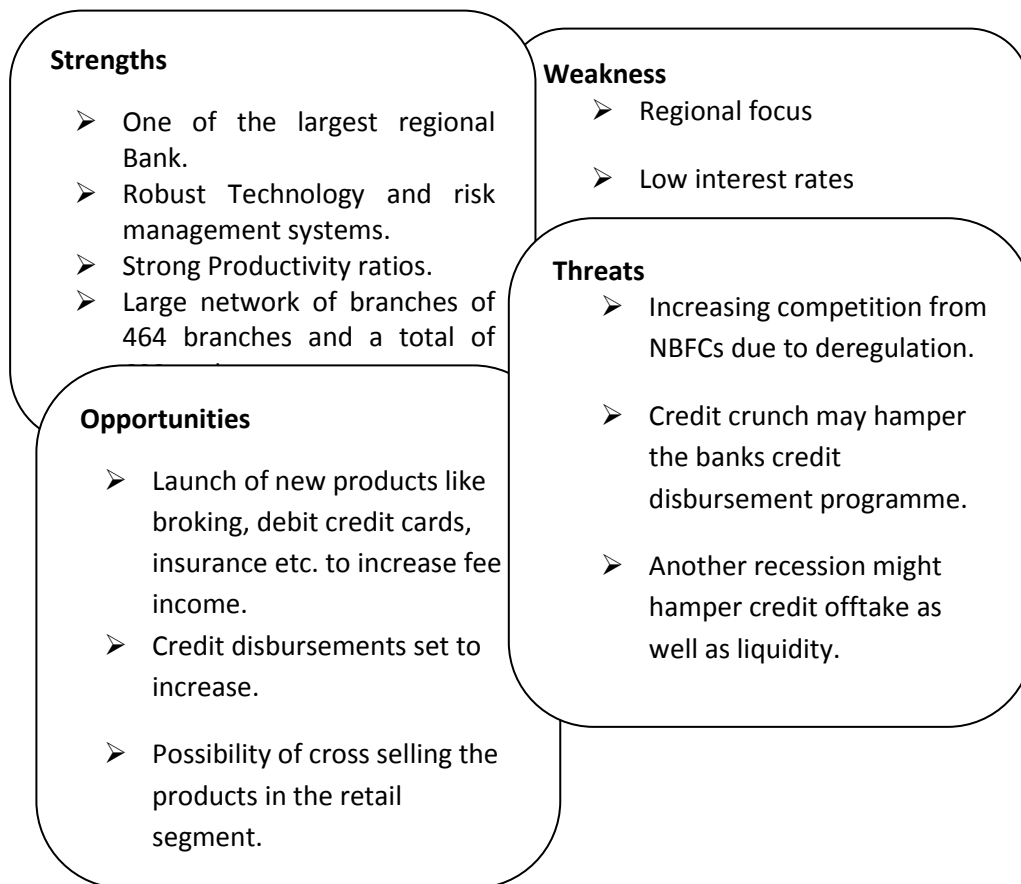
- Cost of deposits has fallen from 8.11% to 6.95% on Y –o- Y basis.
- Yield on advances currently stands at 10.7%.
- Main focus on retail banking and targets to take it to 60% of the total business
- Gross NPA stands at 3.66% Vs 3.86% whereas the Net NPA stands at 1.11% down by 23 bps from 1.34% in the corresponding quarter last year.
- The Capital Adequacy ratio in the quarter stood at 12.1%.
- The advances have grown by 20% and currently stand at Rs 156.8 billion.

## Valuation

Karnataka bank is currently quoting at price by Book value of 1.04x its FY 12E book value of Rs 152. We value banks at discount than its peer due to high Gross NPA and the NIM also stands at 1.87%, we value the bank at P/B of 1.25x at its FY 12E Book value of Rs 152 We arrive at target price of 191 for the stock.

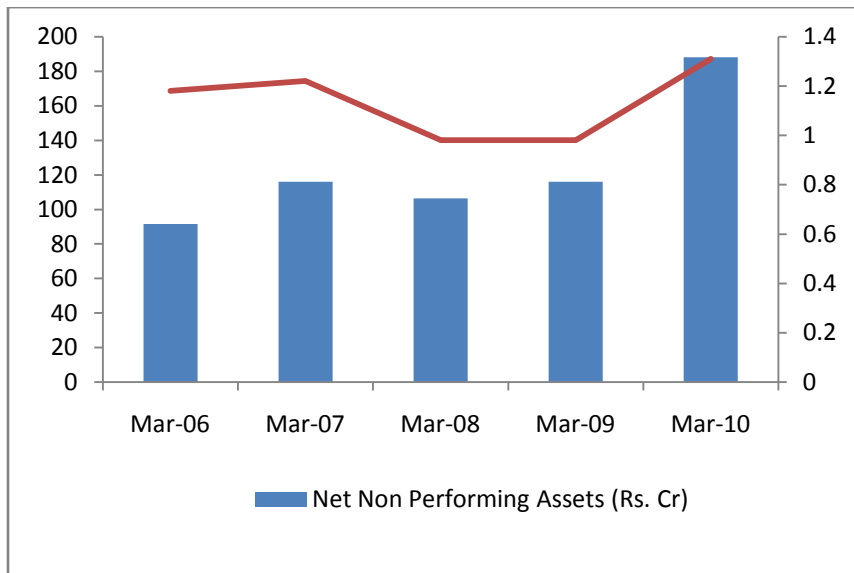
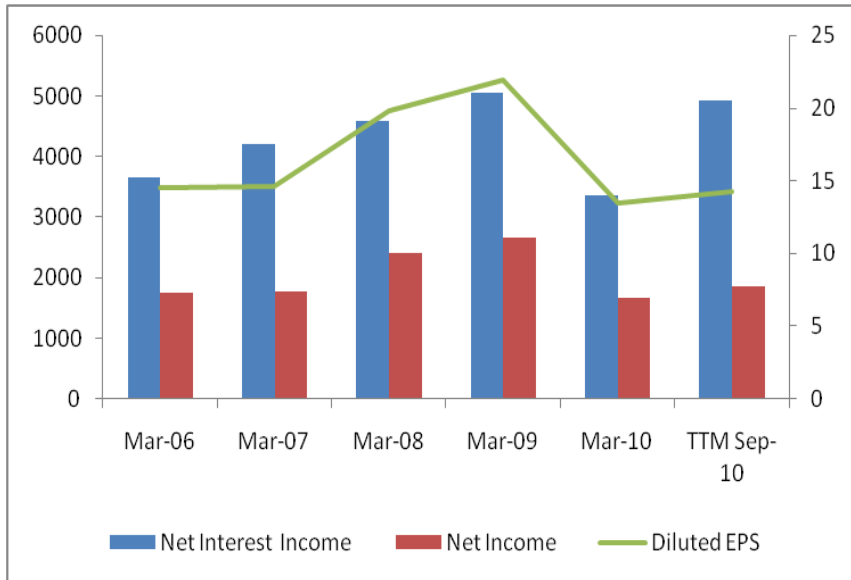
We recommend Accumulate for Karnataka Bank with upside potential of 18% from current levels. We also expect stock to rerate once new banking license will be given which we expect decisions to be taken in Q4Fy11 as the stock can be a good takeover candidate.

## SWOT Analysis



## Financials:

	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E
<b>Total Revenue</b>	<b>3,897.50</b>	<b>4,638.90</b>	<b>6,443.30</b>	<b>7,461.30</b>	<b>5,757.00</b>	<b>7196.25</b>	<b>8995.313</b>
<i>Growth</i>	10.20%	19.00%	38.90%	15.80%	-22.80%	25.00%	25.00%
<b>EBT Excl. Unusual Items</b>	<b>1,852.70</b>	<b>2,263.40</b>	<b>3,387.40</b>	<b>3,996.20</b>	<b>1,896.50</b>	<b>3382.23</b>	<b>4047.81</b>
<i>Margin %</i>	47.50%	48.80%	52.60%	53.60%	32.90%	47.00%	45.00%
<b>Earnings from Cont. Ops.</b>	<b>1,760.30</b>	<b>1,770.30</b>	<b>2,417.40</b>	<b>2,667.10</b>	<b>1,671.20</b>	<b>2518.68</b>	<b>3238.31</b>
<i>Margin %</i>	45.20%	38.20%	37.50%	35.70%	29.00%	35.00%	36.00%
<b>Net Income</b>	<b>1,760.30</b>	<b>1,770.30</b>	<b>2,417.40</b>	<b>2,667.10</b>	<b>1,671.20</b>	<b>2158.87</b>	<b>2968.45</b>
<i>Margin %</i>	45.20%	38.20%	37.50%	35.70%	29.00%	30.00%	33.00%
<b>Diluted EPS Excl. Extra</b>	<b>14.518</b>	<b>14.599</b>	<b>19.849</b>	<b>21.961</b>	<b>13.452</b>	<b>11.47</b>	<b>15.77</b>
<i>Growth</i>	-57.40%	0.60%	36.00%	10.60%	-38.70%	-14.71%	37.50%
<b>Book Value Per Share</b>	<b>91.62</b>	<b>102.07</b>	<b>113.69</b>	<b>128.89</b>	<b>139.78</b>	<b>147</b>	<b>155</b>



Net NPAs are increasing which is a major cause of concern. It has increased due to a one off provision and we expect it cool down in the future

**Greshma`s CSI Ranking Model:**

Valuations: A

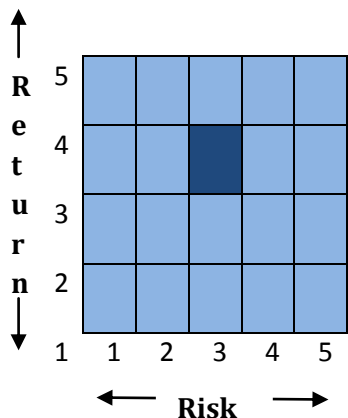
CSI: 4/5

(CSI is arrived on the basis of the underlying strength of the company on the basis of fundamentals and growth prospects)

<b>Valuation</b>	> 20%	A	<b>HOLD</b>		<b>BUY</b>	<b>STRONG BUY</b>	
	+5% TO +20%	B				<b>BUY KTKBANK</b>	
	-5% TO +5%	C	<b>REDUCE</b>			<b>HOLD</b>	
	-5% TO -20%	D	<b>SELL</b>				
	< -25%	E				<b>SELL</b>	
			1	2	3	4	5
			VERY POOR	POOR	MODERATE	GOOD	VERY GOOD
<b>Core Strength Index</b>							

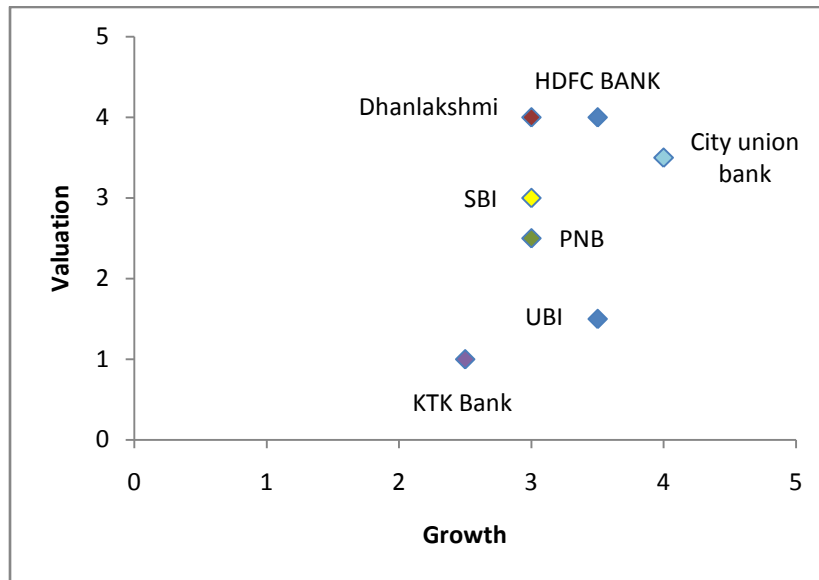
**Greshma`s Risk Return Matrix:**

The company is currently positioned as 4/4 on the risk return model which indicates that there is a high possibility of return with risk being high as well.



1 -Low Risk Low Return  
5- High Risk High Return

### Peer Valuation and Growth



On the left axis there is Valuation where 1 signifies Low valuation and 5 is High Valuation. On the X axis there is the growth of the company, 1 being low growth and 5 being high growth. One should buy companies which are high growth and high valuations and avoid those with low growth and high valuations.



**Technical View**



- From the recent high of 209 levels in Nov'10 the stock observed a sharp selloff and had also breached an important support level of 170 on the downside.
- The stock is also trading below its long term moving averages of 100 & 200 sma.
- There is a series of positive divergence observed on the charts and there will be a short term bounce expected around 174-180 levels only if the prices manages to close above 162 in near term. Till then prices are likely to be in a range of 140 & 162 in short term.
- The 140 level on the downside is likely to act as a good support and if breached would be negative for the stock.

	<b>Supports</b>	<b>Resistance</b>
<b>1</b>	140-143	160-162
<b>2</b>	130-132	180-182

**Expected Stock Performance:**

<b>Period</b>	<b>Performance</b>
Short Term (1-3 months)	Out Perform
Mid Term (6-12 months)	Market Performer
Long Term (more than 12 months)	Out Perform

**Investment Strategy:**

<b>Period</b>	<b>Cash</b>
Short Term	Buy
Mid Term	Start Accumulating
Long Term	Start Accumulating

**DISCLAIMER**

This Report is published by Greshma Shares & Stocks Ltd for private circulation. This report is meant for informational purposes and should not be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. While utmost care has been taken in preparing this report, we claim no responsibility for its accuracy. Recipients should not regard the report as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without any notice and this Report is not under any obligation to update or keep current the information contained herein. Past performance is not necessarily indicative of future results. This Report accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this report. Greshma and its associated companies, directors, officers and employees may from time to time have a long or short position in the securities mentioned and may sell or buy such securities, or act upon information contained herein prior to the publication thereof. Greshma may also provide other financial services to the companies mentioned in the report.