Stock Update

Karur Vysya Bank Ltd.

September 07, 2022

RETAILRESEARCH

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Karur Vysya Bank Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Banks	Rs.71.95	Buy between Rs.71-73 & add more on dips to Rs.63	Rs.81	Rs.88	2 quarters

HDFC Scrip Code	KARVYSEQNR
BSE Code	590003
NSE Code	KARURVYSYA
Bloomberg	KVB IN
CMP Sep 06, 2022	71.95
Equity Capital (Rs. Cr)	160
Face Value (Rs)	2
Equity Share O/S (Cr)	80
Market Cap (Rs Cr)	5,755.4
Adj Book Value (Rs)	78.7
Avg. 52 Wk Volumes	1791799
52 Week High	73.85
52 Week Low	41.75

Share holding Pattern % (Jun, 2022)	
Promoters	2.3
Institutions	38.2
Non Institutions	59.5
Total	100.00

* Refer at the end for explanation on Risk Ratings

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Our Take:

With century long operating history and deep-rooted presence in the southern states, Karur Vysya Bank (KVB) has been able to build a granular and sticky retail franchise as well as a well-diversified advances portfolio across segments. After many years of distressed credit history and low profitability, the bank has been reporting improved numbers lately, which shows early signs of a turnaround in quality of earnings. The management has given healthy growth guidance for the current financial year.

We are bullish on Indian banking sector as majority of the bad book clean-up has been done and there could be lower slippages and higher resolutions and recoveries in the coming quarters. Majority of the banks have built reasonable capital buffers and are now managing their portfolio proactively. Indian economy is recovering steadily from the pandemic led slowdowns which is also visible from the rising credit growth in the system. KVB with improved loan book quality, steady NIM trajectory, granular deposit franchise, adequate capitalization and improving line of sight on lower credit costs looks promising. The bank is available at 0.7x FY24E ABV, which gives decent room for upside.

We had issued Initiating Coverage on KVB on 12th October, 2020 and recommended Buy on dips to Rs.30.5-31.5 and add further on dips to Rs.27.5-28.5 band, for fair value of Rs.34 over the next two quarters. (Link)

Valuation & Recommendation:

In Q1FY23, KVB has clocked multi-year high RoA of 1.1%, the asset quality also improved. Management has guided for 15% growth in loan book in FY23, while maintaining the NIM at current level. Net slippages are estimated to be in negative territory for short term. The loan portfolio quality stands superior with high share of secured retail loans and higher rated corporates loans (rated BBB and above 65% in June 22 vs 47% in June 21) mix. We have envisaged 11% CAGR in Net Interest Income and 21% CAGR in net profit over FY22-FY24E. With a steady inch-up in PCR to 65%, SMA-1+2 portfolios at sub-1% and rising collection efficiencies, we expect credit costs to average 110bps vs 170bps in FY22. Strong focus on digitization could keep opex in check. Further, we have estimated that the loan book would grow at 16% CAGR over this period. ROAA could sustainably improve to 1% by FY24E. Due to improving loan growth metrics and asset quality parameters, the stock could undergo gradual rerating over a period of time.

We feel that investors can buy Karur Vysya Bank Ltd. between Rs.71-73 (0.71x FY24E ABV) and add more on dips to Rs.63 (0.62x FY24E ABV) band. We expect the Base case fair value of Rs.81 (0.8x FY24E ABV) and the Bull case fair value of Rs.88 (0.87x FY24E ABV) over the next 2 quarters.

Financial Summary

Particulars (Rs Cr)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY21	FY22	FY23E	FY24E
NII	746	638	16.9%	710	5.0%	2,360	2,715	2,976	3,325
PPOP	475	429	10.9%	441	7.7%	1,429	1,630	1,874	2,196
PAT	229	109	110.1%	214	7.1%	359	674	814	985
EPS (Rs.)	2.9	1.4	110.3%	2.7	7.1%	4.5	8.4	10.2	12.3
ROAE (%)						5.3	9.3	10.3	11.5
ROAA (%)						0.5	0.9	1.0	1.0
ABVPS (Rs.)						65.6	78.7	91.0	101.5
P/ABV (x)						1.1	0.9	0.8	0.7
P/E (x)						16.0	8.6	7.1	5.8

(Source: Company, HDFC sec)

Recent Developments

Q1FY23 Result Update

- KVB has reported strong overall recovery in Q1FY23 earnings. Net Interest Income grew by 16.9% YoY and 5% QoQ, on the back of gradual pick-up in loan growth and improvement in NIMs to 3.8%.

- Non-interest income has marginally declined by Rs.4 Cr over corresponding previous quarter. This is mainly due to higher depreciation on investments amounting to Rs.37 Cr and lower investment trading income of Rs.40 Cr, which has off set the improved fee-based and other income. The management does not expect any significant depreciation on AFS/SLR portfolio considering the low duration.

- Total operating expenses fell 1% QoQ. The bank targets to add 15 new branches in FY23, while several cost control measures have also put in place. The Cost to income ratio is at 49.68%, management aims to keep the ratio at around 50% levels.

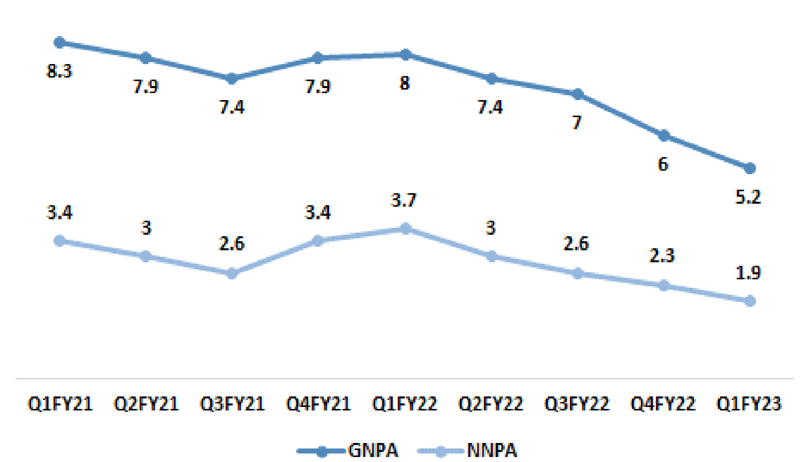
- The core operating profit rose by 10.9% YoY. With lower credit cost, the net profit grew by 7.1% QoQ and 110% YoY. KVB clocked RoA of 1.1%, which is a multi-quarter high.

Consistent improvement in asset quality

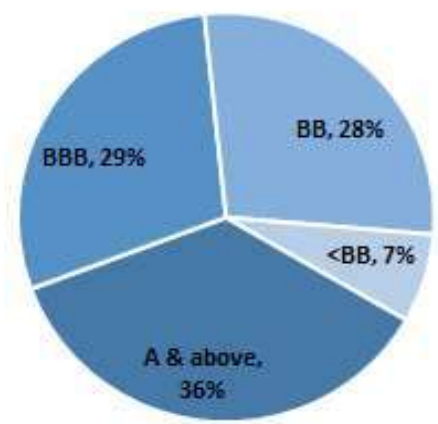
GNPA and NNPA improved sequentially to 5.2% and 1.9% compare to 6% and 2.3%, supported by reasonably strong upgrades and recoveries. The Provision Coverage Ratio is now at 64.6% (improved by 140 bps). Product wise GNPA is: Commercial (6.7%), Corporate (2.8%), Retail (2.8%) and Agriculture (0.9%). Excluding the moratorium period, the slippages were at the multi-year low level of ~1%. Furthermore, the SMA pool is now at mere 1% of the loan book, which is one of the best amongst the peers. The restructured book declined by 7% QoQ and now stands at 2.6% of the loan book. The aggregate stress pool (NNPA + restructured + Standard Restructured), improved 50bps QoQ to ~3.3%.

We believe that majority of the stress has been recognised, the loan book quality has been improved and the collection efficiencies are also reaching at the pre-Covid level, which could result in negative net slippages at least for the near term. All these parameters along with adequate PCR should help the bank lower down the credit cost, which could lead to improved profitability. We expect credit costs to average 110bps compared to 170bps in FY22.

NPA Trend(%)



Improving Risk Profile



Driving growth across verticals - 15% loan book growth guidance

During the quarter, there was strong credit growth across the verticals. The loan book grew by 14% YoY and 4% QoQ. The retail loans have grown by 11% YoY (contributes 23% in loan book mix), management has stated that they have made certain significant changes in the structure and this could help them in building a sound retail book in the coming quarters. The Agri loan book, which consists mainly of jewellery loans, grew by 15%/4% YoY/QoQ and is expected to continue this trend. ~68% of corporate loans are less than Rs.100 Cr and the Average ticket size is Rs. 37.72 Cr. The high industrial exposure is in Infrastructure, food processing and Textile sectors. KVB is incrementally focused on driving granular growth (LAP, commercial banking, and other retail) and has confidently guided for a 15% loan growth during FY23.

Loan Book trend (Rs Cr):

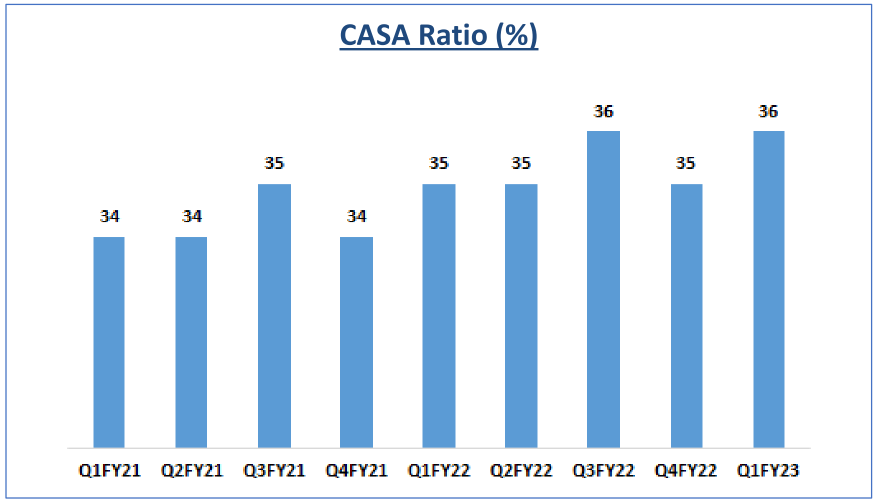
	Q1FY23	Q1FY22	Q4FY22	YoY	QoQ	Mix
Agriculture	**13611**	**11800**	**13044**	**15%**	**4%**	**23%**
Retail	**13598**	**12279**	**13265**	**11%**	**3%**	**23%**
Housing loan	5967	5370	5823	11%	2%	44%
Gold loans	1906	1806	1891	6%	1%	14%
Mortgage (LAP) loans	1899	1668	1832	14%	4%	14%
Vehicle loans	1103	1019	1085	8%	2%	8%
Other	2723	2416	2634	13%	3%	20%
Commercial	**18677**	**16092**	**18094**	**16%**	**3%**	**31%**
Corporate	**13726**	**12144**	**13147**	**13%**	**4%**	**23%**
Gross Advances	**59612**	**52315**	**57550**	**14%**	**4%**	

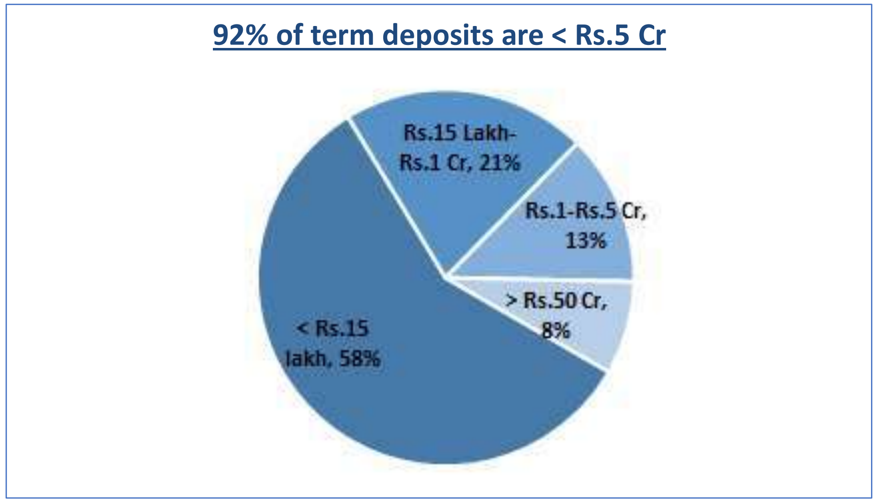
Adequate Capitalization

As of Q1FY23, the Capital Adequacy Ratio stood at 19.21% including Tier-1 capital at 17.25%. The capitalization level remains at a superior level compared to other similar mid-size peer banks. This addition buffer provides cushion against any asset quality shocks that could arise in future as well as it could facilitate loan growth without having to raise additional capital at least in the near future.

Strengthening liability franchise

Over the past few quarters, the CASA ratio has improved meaningfully. It is now stood at 36% and the bank aims to bring it up to 40% level. The bank has a granular retail deposit base; about 92% of the term deposits are from the retail segment that is less than or equal to Rs.5 Cr. During the quarter, bank has recorded 14% YoY growth in CASA (SA up by 11% YoY and CA up by 24%) and 11% YoY growth in total deposits. Management has stated that the operating team is activated for aggressive mobilization of retail term deposits.





NIM could sustain at 3.75% level

During the quarter under review, the NIM improved by 27 bps YoY and 3 bps QoQ at 3.82%. Yield on advances remained flat while marginally lower cost of funds (-2bps QoQ), coupled with higher recoveries have supported NIMs. The management has guided for steady NIMs in FY23 on the back of loan mix skewed towards granular and high-yielding commercial banking and retail segments.

With a view to build up deposits to meet the asset growth and to be competitive in the market, KVB has raised interest rates and term deposits on certain buckets. ~30% of the portfolio is linked to EBLR, of which ~33% is working capital and rest is term loans; management expects that the hike in cost of deposit could be offset by this floating rate book.

KVB Neo - a 'Bank within a Bank'

With a view to evolve from a branch based business to a Modern alternative distribution mechanisms, the bank has launched KVB Neo - a 'Bank within a Bank' in FY20. This enables KVB to access distribution channels such as aggregation through third parties, outbound sales force, Fintech partnerships, co-origination etc.

Staffed with industry specialists and equipped with the most contemporary technology, KVB Neo is a strategic initiative to enable business growth. NEO was conceptualized to skim the market and operate niche segments via increasing the geographical presence and penetration in the retail banking space. NEO operates through a standalone open market acquisition channel instead of operating through Bank's distribution network. Moreover, the main focus is expanding the distribution network by creating significant footprint in Tier-2 & Tier-3 cities and exploring Alliances & Partnerships under co-lending & co-origination with NBFCs in consumer banking space. This helps the bank in getting higher growth at a reduced cost.

The bank has formed partnerships with fin-techs and NBFCs for sourcing customers such as Amazon (Co-lending), Rupeek (Jewel Loan under PL), Cholamandalam Finance (Vehicle and Equipment finance) and IIFL etc. NEO is under discussion with various partners for digital as well as non-digital based solutions for expanding the sourcing channels. We feel that this channel would bring sustainable growth in the retail-high RoA segment. Further, the co-lending partnerships could fetch higher growth for MSME book.

Risks & Concerns

- A higher-than-expected deterioration in the asset quality could result in the erosion of the Tier I capital. Fresh formation of bad loans could keep provisioning high and return ratios compressed for a longer time. Further, any delay in the recovery, higher than expected haircuts or sharp rise in the slippage could impact the profitability and business growth prospects.
- The bank has high regional concentration. Majority of the business comes from southern region and especially Tamil Nadu. Almost 54% of branches are located in Tamil Nadu. Any slowdown in these regions due to macro issues or agri failure reasons could hurt KVB badly.
- Low business growth and higher slippages are legacy issues for the bank. However, situation seems to be improving going ahead.
- Return ratios for KVB remained low due to higher credit cost, high operating cost and lower yield on advances. Management has taken several steps like focusing on high yield products, building up digital infrastructure, giving incremental loans to higher-rated corporate and secured retail loan etc. which could improve the return ratios going ahead.
- A sudden decline in the market price of gold may adversely affect the bank's financial condition, cash flows and earnings as it may be unable to realize the full value of pledged gold received as security against jewellery loans, which exposes the bank to a potential loss.
- The rise in interest rates may impact the loan growth while a rise in G-sec yields could lead to MTM losses for the banking sector.

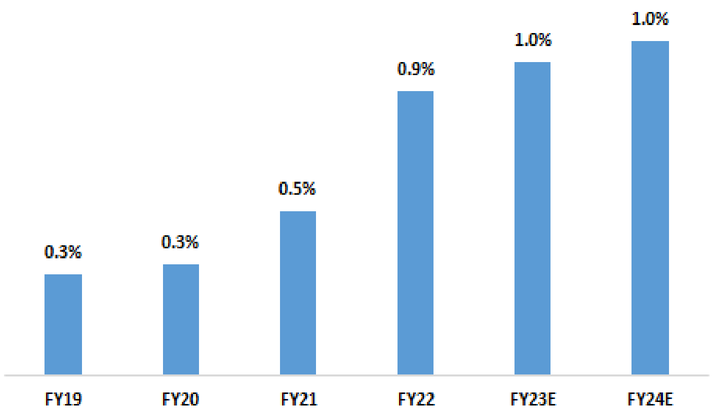
Company Background:

Incorporated in 1916 and headquartered in Karur, Tamil Nadu, Karur Vysya Bank (KVB) is one of the prominent old private sector banks in India. The bank is engaged with customers via a strong distribution network spread across 19 states and 3 Union Territories. Strong foothold in the southern region of India lends it a distinct edge over peers. It provides both commercial and consumer banking services and the businesses are classified as Commercial Banking Group (CBG), Corporate and Institutional Group (CIG), Personal Banking Group (PBG) and Agricultural Banking Group (ABG). As of June 2022, KVB had a network of 789 branches, of which about 54% are located in semi-urban and rural areas.

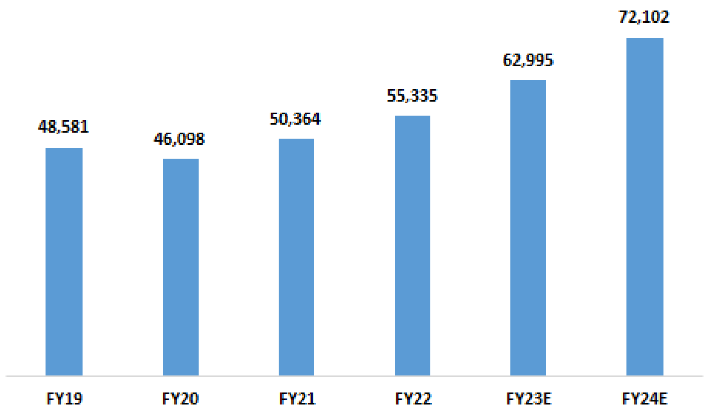
Peer Comparison:

	CMP	P/ABV			P/E			FY22						
		FY22	FY23E	FY24E	FY22	FY23E	FY24E	ROAE (%)	ROAA (%)	NIM %	GNPA %	NNPA %	CASA %	Loan Book (Rs. Bn)
FB	121	1.5	1.4	1.1	13.5	9.6	7.9	10.8	0.9	3.20	2.85	0.96	37.1	1,449
CUB	176	2.4	2.1	1.8	17.1	14.1	11.3	12.2	1.3	3.98	4.70	2.95	32.6	370
DCB	98	0.9	0.8	0.7	10.7	7.0	6.2	7.4	0.7	3.56	4.32	1.97	26.8	291
KVB	72	0.9	0.8	0.7	8.6	7.1	5.8	9.3	0.9	3.79	5.96	2.35	34.8	553

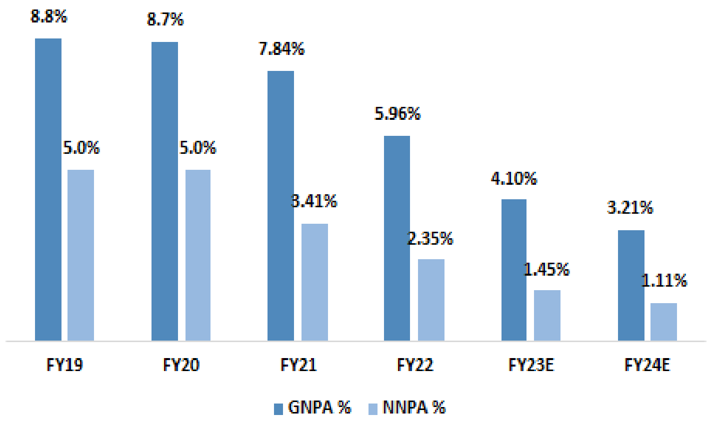
RoAA (%)



Loan book (in Rs. Cr) could grow by 14% CAGR over FY22-24E



NPA Trend



Financials

Income Statement

(Rs Cr)	FY20	FY21	FY22	FY23E	FY24E
Interest earned	5990	5470	5588	6416	7324
Interest expended	3642	3111	2872	3440	3999
Net interest income	**2348**	**2360**	**2715**	**2977**	**3325**
Other income	1155	1057	769	915	1126
Treasury income	340	355	-50	124	156
Total income	3503	3416	3484	3892	4451
Operating expenditure	1742	1987	1854	2017	2255
Pre-provisioning profit	**1761**	**1429**	**1630**	**1874**	**2196**
Non-tax provisions	1489	895	699	787	880
-NPA provisions	1356	634	635	670	753
Profit before tax	**272**	**534**	**931**	**1088**	**1316**
Tax expenditure	37	175	258	274	332
Profit after tax	**235**	**359**	**674**	**814**	**985**

Balance Sheet

(Rs Cr)	FY20	FY21	FY22	FY23E	FY24E
Share capital	160	160	160	160	160
Reserves and surplus	6440	6800	7436	8028	8756
Net worth	6600	6960	7596	8188	8916
Deposits	59075	63278	68676	78184	89683
CASA	18507	21654	23904	27143	30986
Borrowings	1184	2528	1339	1345	1375
Other liabilities and provisions	1419	1857	2432	2139	2376
Total equity and liabilities	**68278**	**74623**	**80043**	**89855**	**102350**
Cash and cash equivalents	4393	6320	4926	6239	7064
Investments	15762	16019	17216	18340	20644
Government securities	13212	14939	15375	15612	17756
Advances	46098	50364	55335	62995	72102
Fixed assets	587	539	479	488	498
Other assets	1438	1381	2088	1793	2043
Total assets	**68278**	**74623**	**80043**	**89855**	**102350**

(Source: Company, HDFC sec)

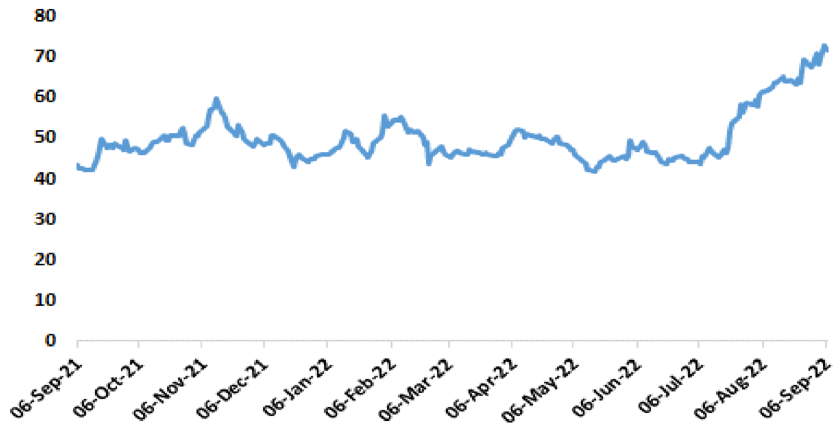
Key Ratio

	FY20	FY21	FY22	FY23E	FY24E
Valuation metrics					
EPS (Rs.)	2.9	4.5	8.4	10.2	12.3
BVPS(Rs.)	83	87.1	95.0	102.3	111.4
ABVPS(Rs.)	60	65.6	78.7	91.0	101.5
RoAA	0.3%	0.5%	0.9%	1.0%	1.0%
RoAE	3.6%	5.3%	9.3%	10.3%	11.5%
P/E (x)	24.0	16.0	8.6	7.1	5.8
P/ABV (x)	1.2	1.1	0.9	0.8	0.7
P/PPOP (x)	3.3	4.0	3.5	3.1	2.6
Profitability ratios					
Yield on advances	9.9%	9.23%	8.56%	8.80%	8.90%
Cost of funds	6.0%	4.94%	4.23%	4.60%	4.69%
Cost of deposits	5.9%	4.93%	4.33%	4.56%	4.67%
Core spread	3.9%	4.31%	4.23%	4.24%	4.23%
Net interest margin	3.7%	3.55%	3.79%	3.80%	3.77%
Operating efficiency ratios					
Cost-average assets	2.5%	2.8%	2.4%	2.4%	2.3%
Cost-income	49.7%	58.2%	53.2%	51.8%	50.7%

Key Ratios

	FY20	FY21	FY22	FY23E	FY24E
Balance sheet structure ratios					
Loan growth	-5.1%	9.3%	9.9%	13.8%	14.5%
Deposit growth	-1.3%	7.1%	8.5%	13.8%	14.7%
C/D ratio	78.0%	79.6%	80.6%	80.6%	80.4%
CASA	31.3%	34.2%	34.8%	34.7%	34.6%
CRAR	17.2%	19.0%	19.5%	17.3%	16.2%
Tier 1	15.3%	16.9%	17.5%	15.7%	14.8%
Asset quality metrics					
Gross NPA	4213	4143	3431	2655	2366
Net NPA	1809	1719	1299	911	797
PCR	57.1%	58.5%	62.1%	65.7%	66.3%
GNPA %	8.7%	7.84%	5.96%	4.10%	3.21%
NNPA %	5.0%	3.41%	2.35%	1.45%	1.11%
Slippages %	3.4%	1.99%	2.10%	1.20%	1.50%
Credit costs %	2.9%	1.31%	1.20%	1.13%	1.11%

One Year Price Chart



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

I, Nisha Shankhala, Research Analyst, MBA, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. SEBI conducted the inspection and based on their observations have issued advise/warning. The said observations have been complied with. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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Any holding in stock –No

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