

## Muted Quarter, Gearing for Growth!

**Est. Vs. Actual for Q2FY25:** NII – **MISS**; PPOP – **MISS**; PAT – **MISS**

**Changes in Estimates post Q2FY25**

**FY25E/FY26E/FY27E (in %):** NII -6.0/-4.8/-1.1; PPOP -19.8/-17.3/-11.4; PAT -6.3/-6.8/-1.3

### Recommendation Rationale

- Firing up the Growth Engine:** KTKBANK's growth in Q2FY25 was muted owing to the bank's conscious decision to forego opportunities in the lower-yielding PSU/bulk advances. The bank has now beefed up its senior management team to ensure healthy growth in focus areas such as **retail (housing/mortgage, vehicle, gold and education loans) and direct-to-corporate advances**. The bank has also strengthened its team by bringing in a new Head – Retail Assets and Retail Collections. With the senior management team and processes in place, the bank will look to accelerate the pace of credit growth in H2. However, given its transitory phase, the management has lowered its credit growth guidance for FY25E to 15% and expects to accelerate to 18% from FY26E onwards. KTKBANK remains well placed on LDR (currently at 75%) with scope to improve it further to 80%.
- NIM improvement levers present:** Despite the slight miss on NIMs vs guided range of 3.4-3.6%, the management remains confident of improving margins in the coming quarters as growth accelerates in the retail and mid-market corporate segment lending support to yields. Additionally, improving LDR and utilization of excess liquidity by deploying it to pursue retail growth should support NIMs. The management has guided for a gradual replacement of the lower-yielding loans over the next 3-4 quarters. Assuming a quarterly run-rate of loan book improvement to the tune of Rs 4-5K Cr, the management expects yields to improve by 70-90bps, positively impacting NIMs. We expect NIMs to remain range-bound between 3.3-3.5% over FY25-27E.

### Sector Outlook: Positive

**Company Outlook:** Post a pause on growth, KTKBANK is gearing to improve its growth momentum supported by processes and management team in place and support from comfort on LDR. We believe KTKBANK trades at attractive valuations for the healthy mid-teen growth delivery, improving asset quality, strengthening fee income profile, and gradually declining cost ratios. The bank remains well positioned to deliver a steady RoA/RoE of 1.2-1.3%/13-15% over FY25-27E.

**Current Valuation:** 0.8x Sep'26E ABV; **Earlier Valuation:** 0.85x FY26E ABV

**Current TP:** Rs 275/share; **Earlier TP:** Rs 275/share

**Recommendation:** We maintain our **BUY** recommendation on the stock on inexpensive valuations

**Alternative BUY Ideas from our Sector Coverage**

**City Union Bank (TP – Rs 185)**

### Financial Performance:

- Operational Performance:** KTKBANK reported muted advances growth of 13% YoY and flat QoQ. Retail advances grew by 4% QoQ. Deposit growth was also subdued at 12% YoY and flat QoQ. CASA deposits and TDs grew by 8/1% and 14/-1% YoY/QoQ respectively. C-D Ratio stood comfortable at 75.3% vs 74.8/75.3% YoY/QoQ. **During the quarter, the bank consciously let go of low-yielding Bulk/PSU advances and high-cost deposits.**
- Financial Performance:** NII de-grew by 8% QoQ and grew by a modest 1% YoY. Non-interest income growth was muted at 8% YoY and de-grew by 3% QoQ. Opex growth was modest at 17/3% YoY/QoQ. C-I Ratio shot up significantly to 58.3% vs 51.3/52.8% owing to weak top-line growth. PPOP de-grew by 12/18% YoY/QoQ. Credit costs remained steady at 17bps vs 22bps QoQ. PAT grew by 2% YoY and de-grew by 16% QoQ.
- Asset quality** improved with GNPA/NNPA down 33/20bps QoQ and stood at 3.2/1.5%. Slippages during the quarter stood at Rs 243 Cr a sharp drop from Rs 416 Cr in Q1FY25. Slippages ratio stood at 1.3% vs 2/2.5% YoY/QoQ.

### Outlook:

While the credit growth delivery is slightly delayed given the bank's decision to forego growth in lower-yielding segments, we expect KTKBANK to accelerate its growth momentum from FY26E onwards, thereby delivering a healthy Credit/Deposit growth of 17/13% CAGR over FY24-27E. Backed by slower growth and lower NIMs in FY25, we cut our NII/Earnings estimates by 5-6%/6-7% respectively over FY25-26E, while broadly maintaining out FY27E estimates with minor revisions.

### Valuation & Recommendation:

We value the bank at 0.8x Sep'26E ABV vs. its current valuation of 0.6x Sep'26E ABV to arrive at a target price of Rs 275/share, implying an upside of 29% from the CMP. **We maintain our BUY rating on the stock on reasonable valuations.**

### Key Financials (Standalone)

(Rs Cr)	Q2FY25	QoQ (%)	YoY (%)	Axis Est.	Variance
Net Interest Income	834	-7.7	+1.4	924	-9.8
PPOP	460	-17.6	-11.8	590	-21.9
Net Profit	336	-16.1	-15.7	411	-18.2
NNPA (%)	1.5	-20 bps	+10 bps	1.6	-14 bps
RoA (%)	1.3	-24 bps	-13 bps	1.3	-20 bps

Source: Company, Axis Securities Research

(CMP as of 23 Oct, 2024)

CMP (Rs)	214
Upside /Downside (%)	29%
High/Low (Rs)	286/192
Market cap (Cr)	8,080
Avg. daily vol. (6m) Shrs.	21,81,511
No. of shares (Cr)	37.8

### Shareholding (%)

	Mar-24	Jun-24	Sep-24
Promoter	0.0	0.0	0.0
FII's	18.9	14.7	10.3
MF's / UTI	23.0	22.6	21.6
Others	58.1	62.7	68.1

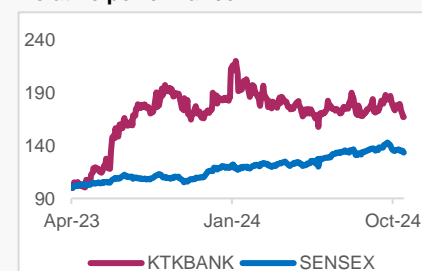
### Financial & Valuations

Y/E Mar (Rs Cr)	FY25E	FY26E	FY27E
NII	3,596	4,252	5,168
PPOP	2,037	2,465	3,126
Net Profit	1,395	1,592	2,008
EPS (Rs)	37.0	42.2	53.2
ABV (Rs)	288.1	322.0	364.1
P/ABV (x)	0.7	0.6	0.5
RoA (%)	1.2	1.2	1.3
NNPA (%)	1.4	1.3	1.2

### Change in Estimates (%)

Y/E Mar	FY25E	FY26E	FY27E
NII	-6.0	-4.8	-1.1
PPOP	-19.8	-17.3	-11.4
PAT	-6.3	-6.8	-1.3

### Relative performance



Source: AceEquity, Axis Securities Research

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## Key Takeaways

- **Slippages under control; Asset Quality to improve:** KTKBANK appears to be progressing well on asset quality improvement, with slippages showcasing a downward trend. The slippages in the restructured book have also been gradually declining. The management remains confident of slippages remaining under control and capping slippage ratio at 0.5% in FY25E. Similarly, the healthy trend in recoveries is likely to continue driving asset quality improvement. Given healthy asset quality, we expect credit costs to remain steady at 0.3-0.5% over FY25-27E.
- **C-I Ratio to improve to sub-50% in the coming quarters:** In Q2FY25, Opex growth was impacted by one-offs resulting in a sharp uptick in C-I Ratio. The management has indicated that the C-I Ratio will decline to go into H2FY25 and should remain at the mid-50% level. KTKBANK will continue to rationalize costs with process centralization alongside improving branch-level productivity. The investments in tech, infra and team strengthening are complete and improving efficiency should drive the C-I Ratio toward 50% over the ensuing quarters.
- **Strengthening fee income profile:** The management has identified multiple levers to strengthen the fee income profile. KTKBANK will look to increase the cross-sell penetration on both retail and direct-to-corporate loans. Additionally, the bank will look to enhance cross third-party distribution from insurance and investment distribution products.

## Key Risks to Our Estimates and TP

- The key risk to our estimates remains a slowdown in overall credit momentum which could potentially derail earnings momentum for the bank.
- Asset Quality challenges could pose challenges for credit costs and impact our earnings estimates.

## Change in Estimates

(Rs Cr)

	Revised Estimates			Old Estimates			% Change		
	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E
NII	3,596	4,252	5,168	3,824	4,467	5,225	-6.0	-4.8	-1.1
PBP	2,037	2,465	3,126	2,540	2,980	3,526	-19.8	-17.3	-11.4
PAT	1,395	1,592	2,008	1,490	1,709	2,035	-6.3	-6.8	-1.3

Source: Company, Axis Securities Research

**Results Review (Standalone)**
**(Rs Cr)**

	Q2FY25	Q2FY24	% YoY	Q1FY25	% QoQ	H1FY25	H1FY24	% YoY
Net Interest Income	834	822	1.4	903	-7.7	1736.9	1637.1	6.1
Non-Interest Income	270	250	8.1	279	-3.3	548.9	573.4	-4.3
Operating expenses	643	550	17.0	624	3.1	1266.9	1087.2	16.5
Staff Cost	350	307	13.9	320	9.4	669.8	599.7	11.7
Pre provision profits	460	522	-11.8	559	-17.6	1019.0	1123.3	-9.3
Provisions and contingencies	31	120	-73.9	40	-22.2	71.6	271.4	-73.6
PBT	429	402	6.6	518	-17.2	947.4	851.9	11.2
Provision for Tax	93	72	29.1	118	-21.2	211.0	150.9	39.8
PAT	336	330	1.8	400	-16.1	736.4	701.0	5.1
<b>Business Update</b>								
Gross Advances	75316	66936	12.5	75455	-0.2	75316.0	66936.0	12.5
Deposits	99968	89532	11.7	100164	-0.2	99968.0	89532.0	11.7
CASA Deposits	30810	28650	7.5	30590	0.7	30810.1	28650.2	7.5
CASA Ratio	30.8	32.0	-118bps	30.5	28bps	30.8	32.0	-118bps
C-D Ratio	75.3	74.8	58bps	75.3	1bps	75.3	74.8	58bps
Yields on Advances	9.6	10.0	-45bps	9.5	3bps	9.9	9.4	52bps
Cost of Deposits	5.5	5.2	34bps	5.5	3bps	5.3	4.6	67bps
NIMs (%)	3.2	3.6	-35bps	3.5	-31bps	3.5	3.6	-14bps
Cost-Income ratio (%)	58.3	51.3	699bps	52.8	552bps	53.2	47.1	601bps
<b>Asset Quality</b>								
Gross NPA (%)	3.2	3.5	-26bps	3.5	-33bps	3.2	3.5	-26bps
Net NPA (%)	1.5	1.4	10bps	1.7	-20bps	1.5	1.4	10bps
PCR (%)	77.7	83.0	-527bps	76.1	166bps	77.7	83.0	-527bps
Slippages	243	314	-22.6	416	-41.7	659	607	-22.6
Slippage Ratio %	1.3	2.0	-66bps	2.3	-98bps	1.8	2.0	-66bps
<b>Capital Adequacy</b>								
CRAR	17.6	16.2	138bps	17.6	-2bps	17.6	16.2	138bps
Tier I	15.9	13.1	282bps	15.9	3bps	15.9	13.1	282bps
Tier II	1.7	3.1	-144bps	1.7	-5bps	1.7	3.1	-144bps

Source: Company, Axis Securities Research

## Financials (Standalone)

### Profit & Loss

(Rs Cr)

Y/E March	FY24	FY25E	FY26E	FY27E
Net Interest Income	3,299	3,596	4,252	5,168
Other Income	1,319	1,174	1,321	1,497
<b>Total Income</b>	<b>4,618</b>	<b>4,769</b>	<b>5,573</b>	<b>6,665</b>
Total Operating Exp	2,454	2,732	3,107	3,539
<b>PPOP</b>	<b>2,163</b>	<b>2,037</b>	<b>2,465</b>	<b>3,126</b>
Provisions & Contingencies	601	241	416	542
<b>PBT</b>	<b>1,563</b>	<b>1,796</b>	<b>2,049</b>	<b>2,584</b>
Provision for Tax	256	400	457	576
<b>PAT</b>	<b>1,306</b>	<b>1,395</b>	<b>1,592</b>	<b>2,008</b>

Source: Company, Axis Securities Research

### Balance Sheet

(Rs Cr)

Y/E March	FY24	FY25E	FY26E	FY27E
<b>SOURCES OF FUNDS</b>				
Equity Share Capital	377	377	377	377
Reserves & Surplus	10,471	11,657	13,011	14,718
<b>Net Worth</b>	<b>10,848</b>	<b>12,035</b>	<b>13,388</b>	<b>15,095</b>
Deposits	98,058	1,10,713	1,25,526	1,42,385
Borrowings	1,02,457	1,17,274	1,36,109	1,59,031
Other Liabilities	<b>2,779</b>	<b>2,900</b>	<b>3,353</b>	<b>3,905</b>
<b>Total Liabilities</b>	<b>1,16,085</b>	<b>1,32,209</b>	<b>1,52,850</b>	<b>1,78,031</b>
<b>APPLICATION OF FUNDS</b>				
Cash & Bank Balance	7,993	8,692	9,227	9,755
Investments	24,302	26,553	30,105	35,573
Advances	71,509	82,448	97,041	1,13,869
Fixed & Other Assets	12,281	14,516	16,476	18,835
<b>Total Assets</b>	<b>1,16,085</b>	<b>1,32,209</b>	<b>1,52,850</b>	<b>1,78,031</b>

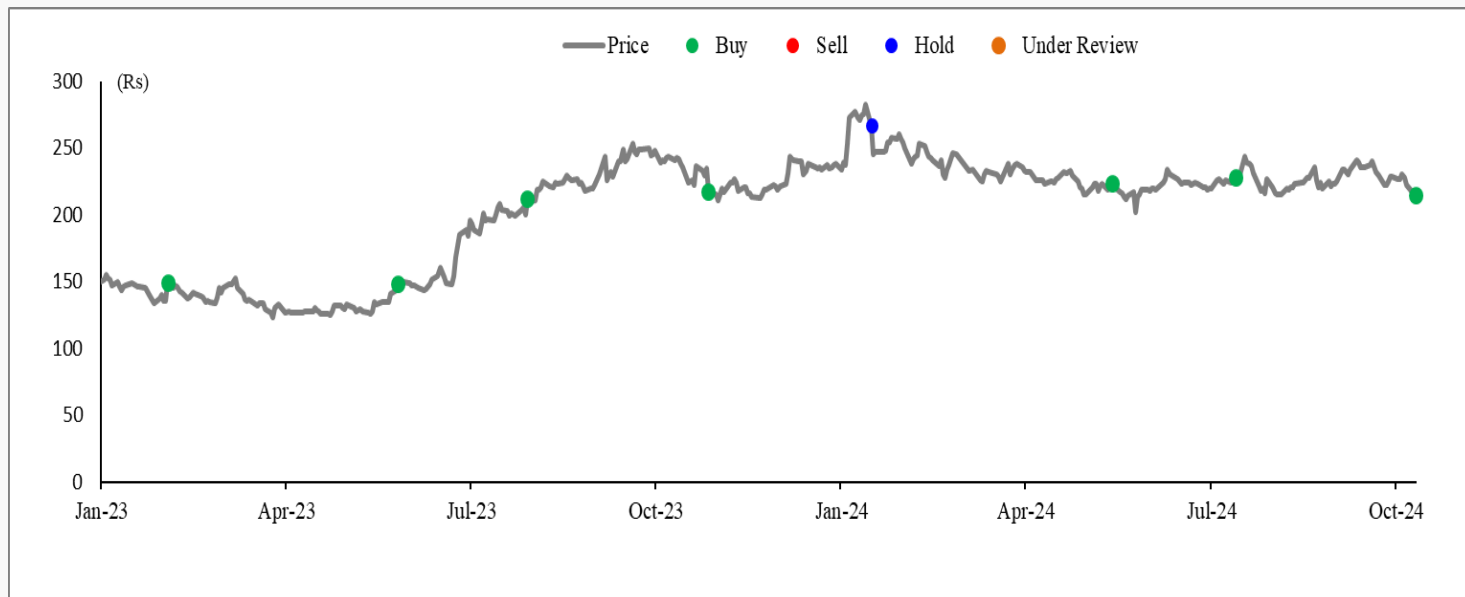
Source: Company, Axis Securities Research

**Ratio Analysis**
**(%)**

Y/E March	FY24	FY25E	FY26E	FY27E
<b>VALUATION RATIOS</b>				
EPS	34.6	37.0	42.2	53.2
Earnings Growth (%)	-0.1	0.1	0.1	0.3
BVPS	287.6	319.0	354.9	400.1
Adj. BVPS	257.6	288.1	322.0	364.1
ROAA (%)	1.2	1.2	1.2	1.3
ROAE (%)	13.7	13.1	13.5	15.2
P/E (x)	6.2	5.8	5.1	4.0
P/ABV (x)	0.8	0.7	0.7	0.6
<b>PROFITABILITY</b>				
NIM (%)	3.5	3.3	3.4	3.5
Cost-Income Ratio (%)	53.2	57.3	55.8	53.1
<b>BALANCE SHEET STRUCTURE RATIOS</b>				
Loan Growth (%)	19.3	15.3	17.7	17.3
Deposit Growth (%)	12.2	12.9	13.4	13.4
C/D Ratio (%)	72.9	74.5	77.3	80.0
Equity/Assets (%)	15.2	14.6	13.8	13.3
Equity/Loans (%)	9.3	9.1	8.8	8.5
CAR (%)	18.0	18.3	17.3	16.5
Tier 1 CAR (%)	16.2	16.7	15.8	15.1
<b>ASSET QUALITY</b>				
Gross NPLs (%)	3.6	3.4	3.2	3.0
Net NPLs (%)	1.6	1.4	1.3	1.2
Coverage Ratio (%)	56.2	58.9	59.9	59.9
Credit costs (%)	0.9	0.3	0.5	0.5
<b>ROAA TREE</b>				
Net Interest Income	3.1	2.9	3.0	3.0
Non-Interest Income	1.2	0.9	0.9	0.9
Operating Cost	2.3	2.2	2.2	2.1
Provisions	0.6	0.2	0.3	0.3
Tax	0.2	0.2	0.2	0.3
ROAA	1.2	1.2	1.2	1.3
Leverage (x)	11.3	10.9	11.2	11.6
ROAE	13.7	13.1	13.5	15.2

Source: Company, Axis Securities Research

## Karnataka Bank Price Chart and Recommendation History



Date	Reco	TP	Research
06-Feb-23	BUY	170	Result Update
31-May-23	BUY	175	Result Update
04-Aug-23	BUY	250	Result Update
03-Nov-23	BUY	250	Result Update
24-Jan-24	HOLD	275	Result Update
27-May-24	BUY	255	Result Update
25-Jul-24	BUY	275	Result Update
24-Oct-24	BUY	275	Result Update

Source: Axis Securities Research

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BUY	More than 10%
HOLD	Between 10% and -10%
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