BUY (Maintained)

CMP: **INR 211** Target Price: **INR 270** ▲ 28%

ICICI Securities

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18 September 2024

India | Equity Research | Company Update

Karur Vysya Bank

Banking

Takeaways from overseas NDR

We hosted Karur Vysya Bank (KVB) for overseas NDR. The investors seem to have acknowledged the remarkable transformational journey of KVB under the current management with steady growth and superior RoA. The management explained the hard work behind the numbers, suggesting that superior performance / delivery on NIM, growth, asset quality and RoA are structural and outcome of the multiple initiatives undertaken. The bank acknowledged headwinds on systemic deposits growth, NIM and credit costs but explained the steps it is taking to mitigate the same. The bank has one of the lowest LDRs (83%) and one of the highest LCRs (185%), and thus, should sustain ~15% CAGR in loan for FY24–26E. KVB's all-inclusive SMA 1+2 (<0.5%) and NNPA (<0.4%), being amongst the lowest, alongside its limited (<3%) exposure to unsecured retail, nourishes our confidence of benign credit costs.

Our estimates are unchanged. Overall, we expect KVB to sustain its leadership on RoA/RoE within mid and small private banks space. Maintain **BUY** with an unchanged target price of INR 270, valuing the stock at ~1.6x FY26E ABV. Key risk is slower-than-expected deposits growth impacting growth and NIM.

NIM deceleration likely but KVB is trying to cushion the impact

- The bank is cognisant of pressure on NIM, though it has been trying to mitigate the impact to the extent possible.
- It reiterated its guidance of NIM to be ~4.0% in Q2FY25 vs 4.13% in Q1. Given the expectation of policy rate cut, NIM could touch 3.8% by Q4FY25.
- Around 45% of loans are EBLR linked, which would re-price almost immediately in rate cut scenario. The MCLR-linked book (40%) should be more resilient as the pricing is linked internally.
- The bank also been trying to adjust the lending spreads. By increasing the spreads, it intends to cushion the hit on yields when policy rates are cut.
- There was a decline in base rate and MCLR by the bank recently. It clarified that it was not linked to deposits rates but was mainly driven by change in opex ratio. The opex behaviour has been a bit volatile with initial surge and then easing off, due to wage bipartite. MCLR and base rate have been revised to reflect the lower opex growth. The opex trajectory is likely to be reasonably smooth and thus should not impact MCLR in any material way going ahead.

Financial Summary

Y/E March	FY23A	FY24A	FY25E	FY26E
NII (INR bn)	33.5	38.1	41.8	46.8
Op. profit (INR bn)	24.8	28.3	29.5	32.3
Net Profit (INR bn)	11.1	16.0	18.4	19.8
EPS (INR)	13.8	20.0	22.9	24.6
EPS % change YoY	63.8	44.7	14.7	7.4
ABV (INR)	102.6	122.0	142.2	163.4
P/BV (x)	2.0	1.8	1.5	1.3
P/ABV (x)	2.1	1.8	1.5	1.3
Return on Assets (%)	1.3	1.6	1.6	1.5
Return on Equity (%)	13.7	17.2	17.0	15.8

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Market Data

Market Cap (INR)	169bn
Market Cap (USD)	2,016mn
Bloomberg Code	KVB IN
Reuters Code	KARU.BO
52-week Range (INR)	233 /125
Free Float (%)	97.0
ADTV-3M (mn) (USD)	5.2

Price Performance (%)	3m	6m	12m
Absolute	(1.2)	19.7	56.2
Relative to Sensex	(8.5)	5.7	33.5

Earnings Revisions (%)	FY25E	FY26E
PAT	-	-

Previous Reports

08-09-2024: Company Update

19-07-2024: Q1FY25 results review

Strong growth in non-corporate to sustain; corporate drag likely to reduce

- The corporate book is anything above INR 250mn ticket size and thus it includes a lot of mid-corporate as well. Around 40% of loans are below INR 500mn ticket size and ~90% of loans are below INR 1.5bn ticket size. The focus has been to granularise the book and average ticket size is around INR 375mn. The size of the corporate book above INR 1.5bn ticket size is now similar to FY22 at ~INR 18bn. As %age of overall loans, the share has come down to 2.4% vs 3.3% in FY22.
- The ticket size between INR 50-250mn is managed by commercial units and there are 16 units. There is again focus on granularity and the average ticket size is INR 5mn only.
- The bank has ~7% exposure to textile segment. The segment is already past the worst period and the outlook is getting better.
- Overall, underlying growth is much higher but churn in corporate book (up 5% YoY in FY24) had restricted overall loan growth at ~16% YoY in FY24. In Q1FY25, non-corporate growth was ~20% YoY, though flattish corporate book led to broadly unchanged 16% YoY overall growth.
- Corporate book share has now come down to 18% vs 23% in Q1FY23. The bank does not expect much change in the loan mix going ahead and thus the drag from corporate book should ease.

Deposits growth challenge at system level; KVB appears well placed

- The bank acknowledges that slower deposits growth has been a challenge at system level. However, it has been proactive in anticipating the same and has made a slew of changes.
- The bank had hired a battery of feet-on-street employees for sourcing and cross-selling products including deposits. The team now has employees from almost all leading banks and the bank has been able to assimilate the learnings as well. KVB has benchmarked and refurbished its deposits products and now has 24 variants of deposits to cater to the varying needs of its customers. It is also focusing on new segments such as institutional, government, and TASC etc to boost up deposits. The bank also offers differentiated rate on savings accounts.
- The bank has also aligned the incentive structure for deepening of the accounts after acquiring them. For better coordination, it has merged retail liability and asset functions as well.
- The bank intends to open 100 new branches in FY25. Of these, 80 would be 'lite branch' which would be thinly manned and would work as spoke branches. The distribution of new branches would be biased towards South and West.
- TD renewal rate is around 85%.
- Overall, the bank expects deposits growth of ~14% YoY for FY25, suggesting that it should sustain market share gains.

Edge on asset quality likely to sustain

- The bank has one of the lowest net NPA and SMA book in the entire industry.
- The bank has been a key beneficiary of strong digital LOS (loan origination system) which has improved the quality of incoming customers. There is minimal discretion and customer selection and monitoring process has become strong.
- The approval rate post the new origination system implementation has reduced to 40-45% vs ~90% earlier and thus it works on better customer selection ab initio.
- The post digital LOS stress rate is just 15% of the pre-digital origination. Initially, there was some resistance by the branches when LOS was implemented but now everyone is on the same page as the results have been good.
- Restructured loans have reduced to ~85bps of loans. The bank has provided ~48% on restructured loans.
- The bank has been proactively providing INR 250mn for the last 5 quarters on prudential basis to strengthen its balance sheet, keeping in mind the ECL implementation.
- The bank does not see any material issues in asset quality as share of unsecured is small (<3%) and underlying portfolio quality has been holding-up well.

BNPL and unsecured loans – share contained at <3% with risk mitigants

- The bank has been calibrated on unsecured retail lending growth and has differentiated approach. It offers BNPL in tie-up with Amazon and uses business correspondents for MFI lending.
- The total share of unsecured retail including MFI is <3%.
- The bank has BNPL tie-up with Amazon and Axio (NBFC). Axis has strong relationship with Amazon. There is co-lending and FLDG arrangement with Axio. 80% of the balance is in bank's book and the rest is with Axio.
- The bank earns net yields of 12% on BNPL. It has 5% FLDG as well. The cohort losses have been 3-3.5% and thus the bank does not have any material credit costs as of now.
- Among millions of Amazon customers, a small proportion qualifies for BNPL. The bank has around 4-5mn Amazon BNPL customers. There are huge cross-sell opportunities using analytics though the bank is making cautious inroads.
- MFI AUM is around INR 3 bn. The bank uses three partners including NOCPL for origination.

Digital and technology

- The bank had hired Boston Consulting Group for tech implementation earlier.
- The bank has strong digital capabilities. It captures most of the data through automatic processes. The bank does not require and take wet signatures. There is huge improvement in turnaround time in the business.
- The bank has closed multiple processing centres as its back office work has been digitised to a large extent.

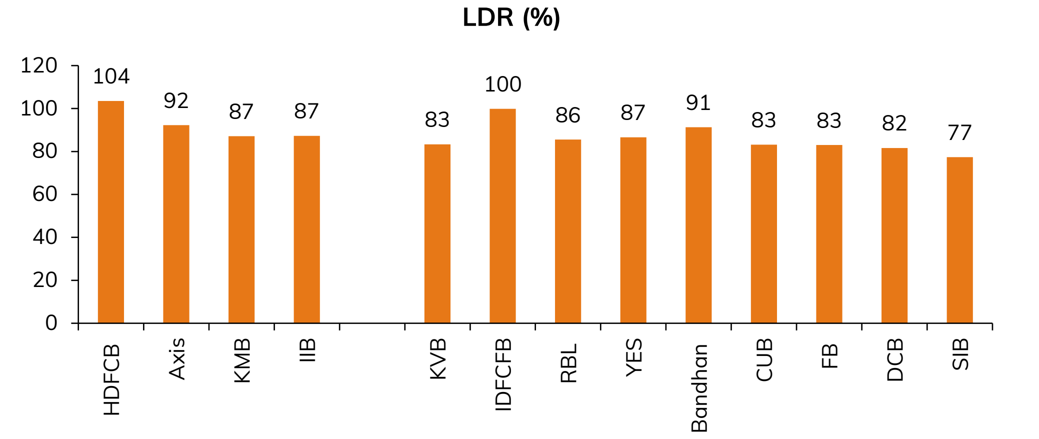
Staff, culture and productivity

- There has been phenomenon change in the availability of the talent at the bank.
- The bank has hired around 1,300 staff laterally on its payroll. Almost everyone has been inducted on CTC model (vs IBA model).
- As of now, around 33% of the staff is on CTC model while the rest is on IBA model. The proportion of the CTC staff is likely to go up further over the next couple of years.
- The bank has employees from almost every large private bank and thus the culture has been diverse, yet productive.
- As there is difference in the productivity of the employee (between CTC and IBA), it is difficult to quantify the financial gains.
- The chief HR manager has also been hired laterally. Having the chief HR from a large private bank has been a game-changer.
- Median age of the bank staff is ~35 years.
- The ESOP issuances in the recent year has been bit restrictive. This, in our view, could be one area, where the bank may have to step-up.

RoA likely to be resilient

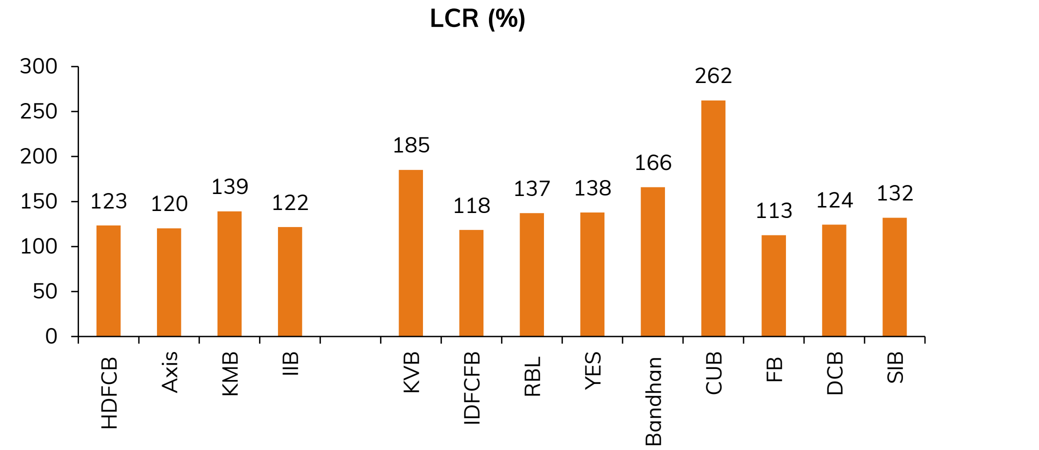
- The bank is aware of the impending pressure on NIM. However, it guides for resilient RoA for FY25, benefitting from better fee income and improvement in credit costs.
- The bank intends to sweat its strong capital by leveraging off balance sheet business and thus extracting better fee income. It is also hopeful of healthy rise in cross-sell / third-party products driven by improved headcounts, offerings and productivity.
- The bank had created prudential provisions of INR 1 bn (10bps of assets) in FY24. It has been continuing the same in Q1FY25, but this offers clear cushion for coming quarters.

Exhibit 1: Elevated LDR appears to be key headwind for loan growth ahead; KVB appears well positioned with LDR at 83%, amongst lowest within peers.



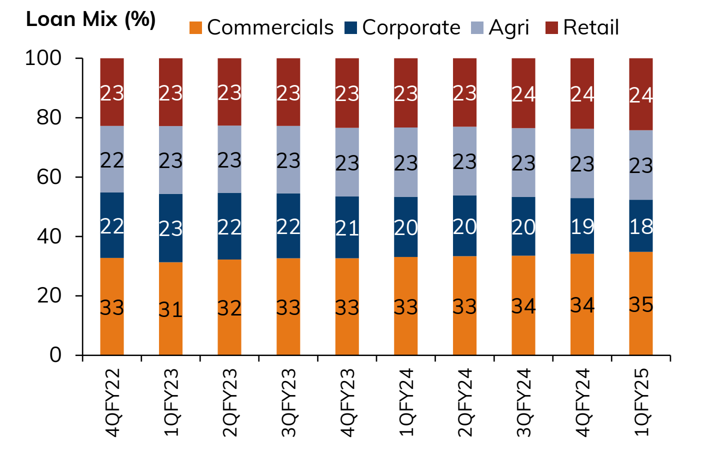
Source: I-Sec research, Company data

Exhibit 2: KVB is well-placed on LCR front as well, amongst highest across peers



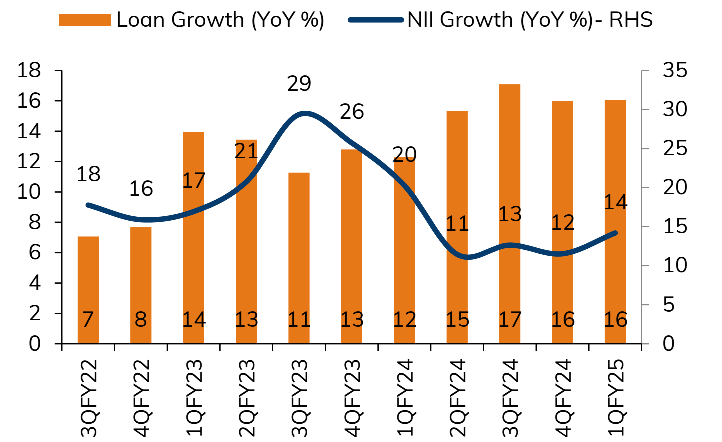
Source: I-Sec research, Company data

Exhibit 3: Loan book broadly stable with small rise in commercial at the cost of corporate book



Source: I-Sec research, Company data

Exhibit 4: Loan growth has been steady at 16-17% YoY



Source: I-Sec research, Company data

Exhibit 5: Deposits trend over the quarters

Particulars (INR mn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24	Q1FY25
Deposits	6,68,710	6,84,860	7,11,680	7,33,975	7,61,750	7,66,376	8,07,150	8,30,685	8,56,650	8,91,127	9,23,490
YoY % change	*7.7*	*8.2*	*10.5*	*12.2*	*13.9*	*11.9*	*13.4*	*13.2*	*12.5*	*16.3*	*14.4*
QoQ % change	2.2	2.4	3.9	3.1	3.8	0.6	5.3	2.9	3.1	4.0	3.6
CASA Deposits	2,41,270	2,39,040	2,59,160	2,59,140	2,58,000	2,54,490	2,65,490	2,67,940	2,70,120	2,70,850	2,80,420
YoY % change	12.2	10.4	15.0	11.9	6.9	6.5	2.4	3.4	4.7	6.4	5.6
QoQ % change	4.2	-0.9	8.4	0.0	-0.4	-1.4	4.3	0.9	0.8	0.3	3.5
CASA Ratio (%)	*36.1*	*34.9*	*36.4*	*35.3*	*33.9*	*33.2*	*32.9*	*32.3*	*31.5*	*30.4*	*30.4*
Term Deposits	4,27,440	4,45,820	4,52,520	4,74,835	5,03,750	5,11,886	5,41,660	5,62,745	5,86,530	6,20,277	6,43,070
YoY % change	*5.3*	*7.1*	*8.1*	*12.4*	*17.9*	*14.8*	*19.7*	*18.5*	*16.4*	*21.2*	*18.7*
QoQ % change	1.2	4.3	1.5	4.9	6.1	1.6	5.8	3.9	4.2	5.8	3.7

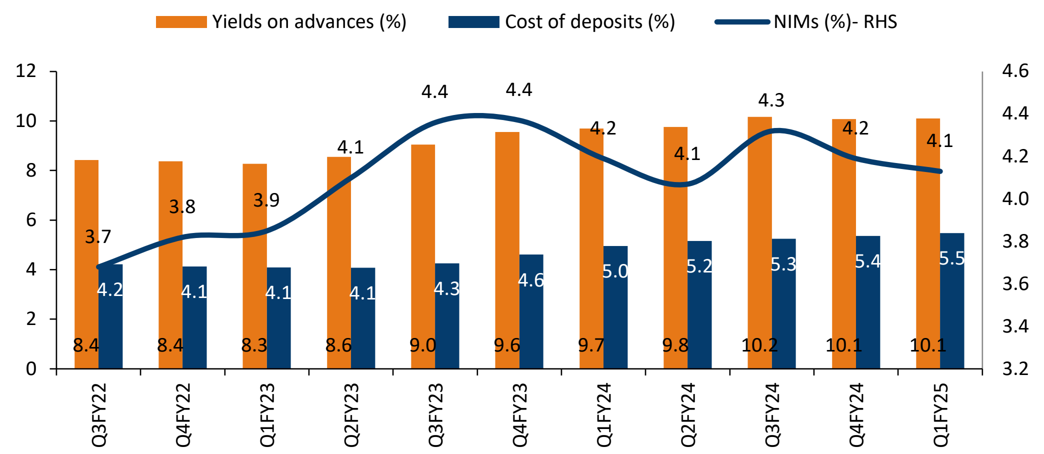
Source: Company data, I-Sec research

Exhibit 6: KVB has one of the lowest cost of deposits, edge is likely to sustain in our view

Cost of deposits (%)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24	Q1FY25
FB	4.3	4.3	4.2	4.4	4.6	5.1	5.3	5.5	5.7	5.9	5.8
RBL	4.8	4.8	4.8	5.1	5.5	5.7	6.1	6.2	6.3	6.4	6.5
Bandhan	5.2	5.1	5.3	5.5	5.8	5.8	6.4	6.5	6.6	6.9	7.0
KVB	4.2	4.1	4.1	4.1	4.3	4.6	5.0	5.2	5.3	5.4	5.5
CUB	4.6	4.5	4.4	4.5	4.6	5.1	5.4	5.5	5.7	5.8	5.7
DCB	6.0	6.0	5.9	5.9	6.0	6.3	6.6	6.8	7.0	7.1	7.1
Yes	4.9	4.8	4.8	5.0	5.3	5.6	5.9	6.0	6.1	6.1	6.1
SIB	4.7	4.5	4.4	4.2	4.3	4.6	4.9	5.0	5.2	5.3	5.4

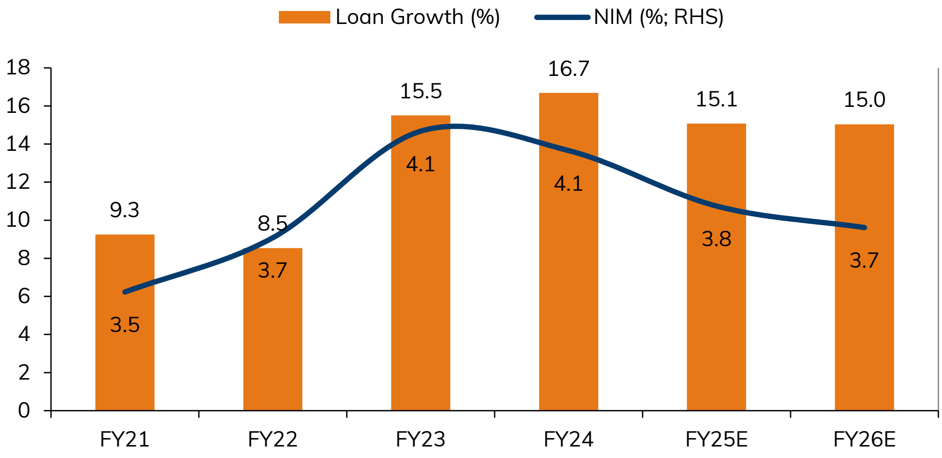
Source: I-Sec research, Company data

Exhibit 7: NIM has been moderating though still healthy at >4.0%



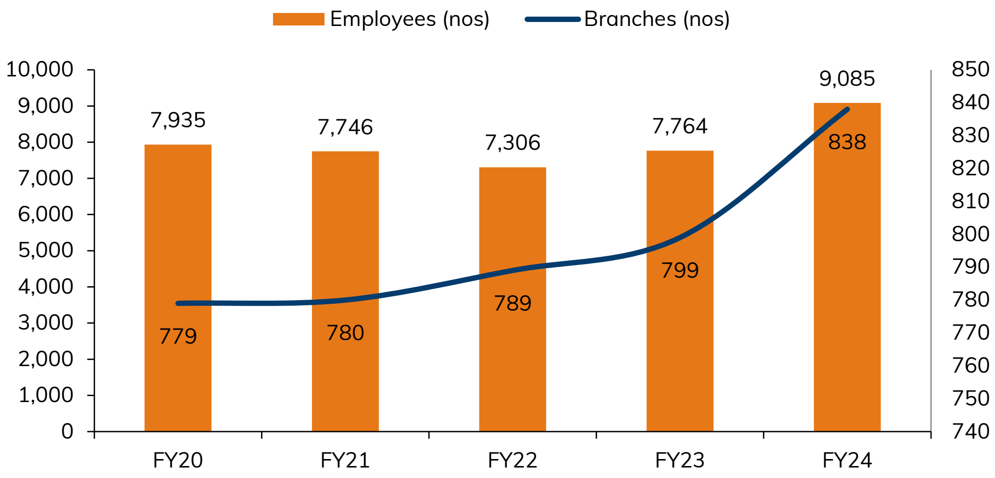
Source: I-Sec research, Company data

Exhibit 8: We estimate loan growth at ~15% CAGR for FY24-26E; our NIM estimates are conservative with cumulative dip of ~30bps in the same period



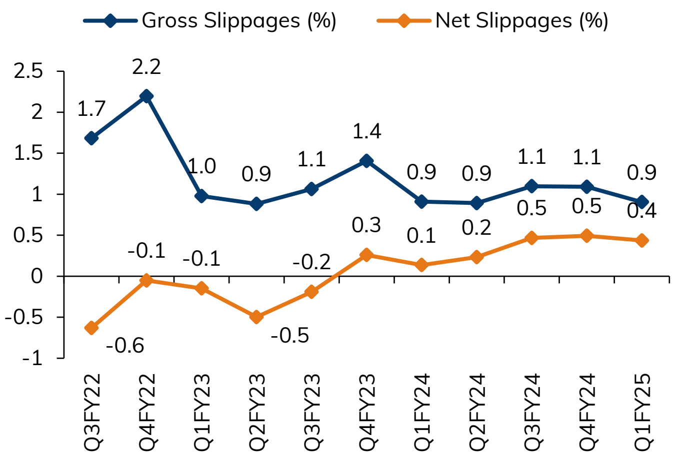
Source: I-Sec research, Company data

Exhibit 9: After being stagnant, staff count had risen significantly in FY24; KVB also intends to open ~100 branches (80 'lite' branch) in FY25



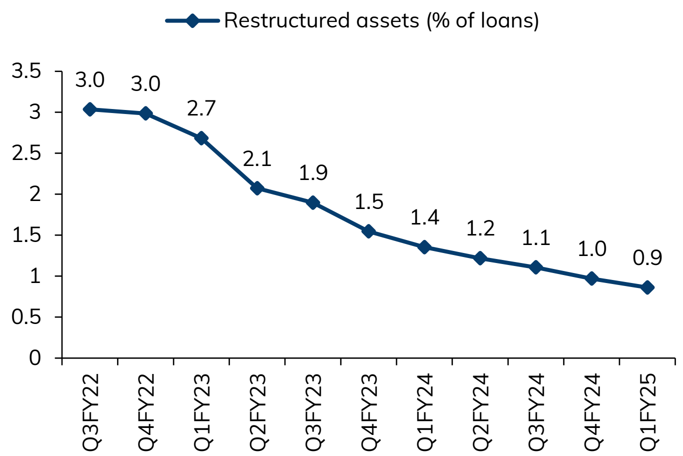
Source: I-Sec research, Company data

Exhibit 10: Gross and net slippages have been range-bound at ~1.0% and 0.5%, respectively



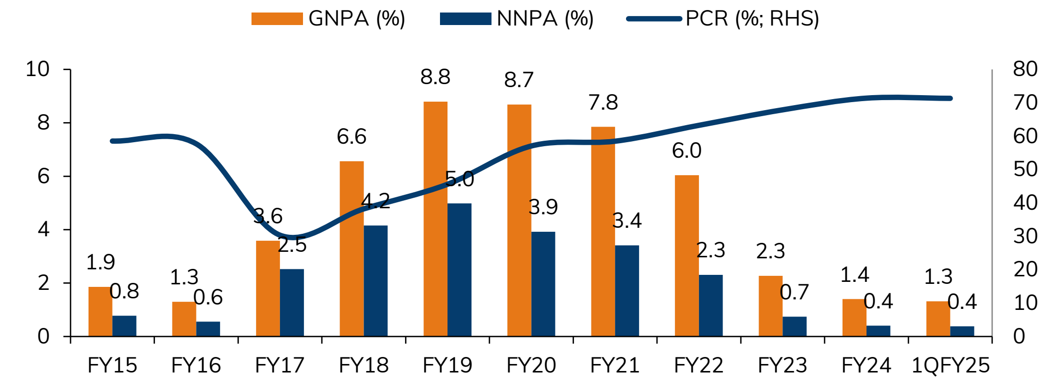
Source: I-Sec research, Company data

Exhibit 11: Restructured loans have now reduced to <1%



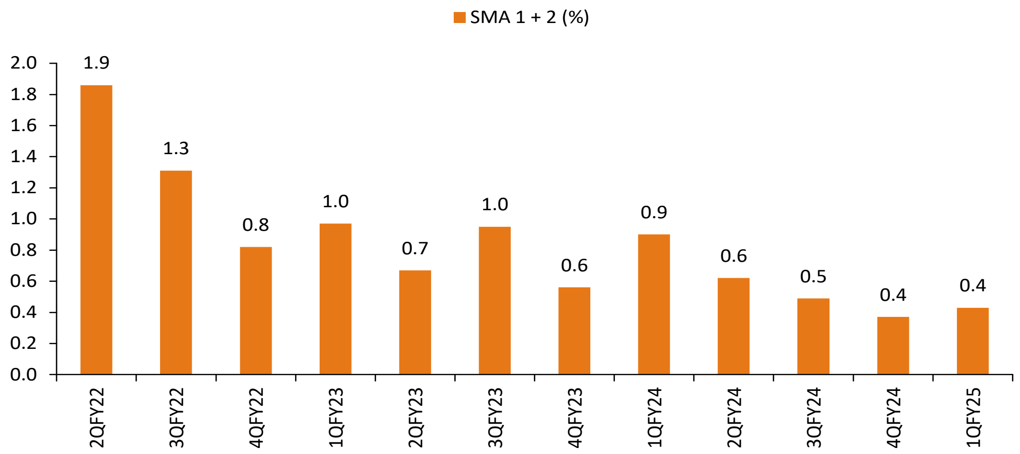
Source: I-Sec research, Company data

Exhibit 12: Remarkable improvement in asset quality with net NPA now at <0.4%



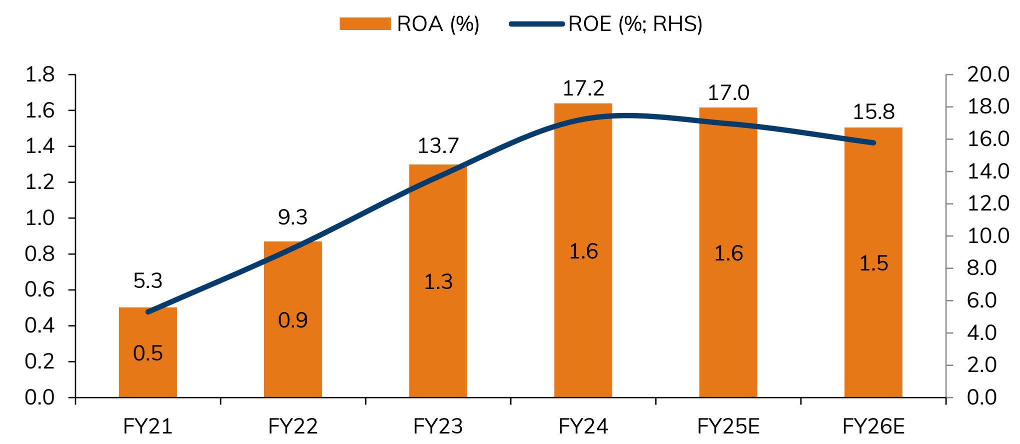
Source: I-Sec research, Company data

Exhibit 13: KVB has one of the lowest all-inclusive SMA 1+2 pool



Source: I-Sec research, Company data

Exhibit 14: Despite moderation, we estimate RoA to remain strong at >1.5%



Source: I-Sec research, Company data

Exhibit 15: Despite healthy re-rating, stock is trading at ~0.5SD above its long-term average; we see healthy upside for re-rating

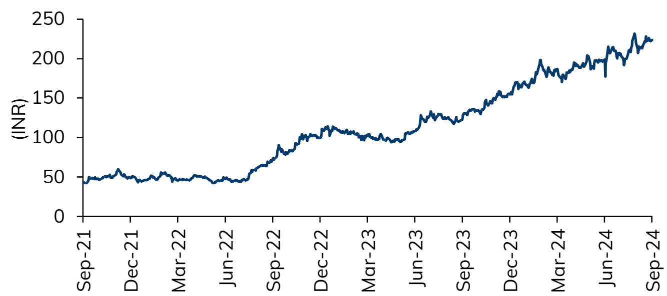
Source: I-Sec research, Company data

Exhibit 16: Shareholding pattern

%	Dec'23	Mar'24	Jun'24
Promoters	2.3	2.2	2.3
Institutional investors	38.2	51.6	38.4
MFs and other	21.1	29.0	21.2
Banks/ FIs	0.0	0.0	0.3
Insurance Cos.	1.5	5.2	1.5
FIIs	15.5	17.4	15.4
Others	59.5	46.2	59.5

Source: Bloomberg, I-Sec research

Exhibit 17: Price chart



Source: Bloomberg, I-Sec research

Financial Summary

Exhibit 18: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Interest income	65,165	82,039	95,860	1,07,733
Interest expense	31,677	43,947	54,092	60,949
Net interest income	**33,488**	**38,092**	**41,768**	**46,784**
Non-interest income	11,589	16,587	15,937	17,894
Operating income	**45,077**	**54,679**	**57,705**	**64,677**
Operating expense	20,320	26,388	28,198	32,374
Staff expense	10,060	14,610	14,610	16,802
Operating profit	**24,758**	**28,291**	**29,507**	**32,303**
Core operating profit	**24,704**	**26,171**	**28,857**	**31,503**
Provisions & Contingencies	10,389	7,290	4,916	5,890
Pre-tax profit	**14,369**	**21,002**	**24,591**	**26,413**
Tax (current + deferred)	3,308	4,954	6,190	6,648
Net Profit	**11,061**	**16,048**	**18,402**	**19,765**
Adjusted net profit	**11,061**	**16,048**	**18,402**	**19,765**

Source Company data, I-Sec research

Exhibit 19: Balance sheet

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Cash and balance with RBI/Banks	46,951	56,586	73,883	85,199
Investments	1,88,083	2,23,435	2,45,502	2,75,462
Advances	6,31,341	7,36,675	8,47,738	9,75,176
Fixed assets	4,350	4,329	5,528	6,314
Other assets	31,068	34,828	48,327	63,644
Total assets	**9,01,794**	**10,55,852**	**12,20,979**	**14,05,795**
Deposits	7,66,376	8,91,127	10,30,999	11,92,843
Borrowings	14,320	24,784	24,472	24,287
Other liabilities and provisions	35,258	39,541	48,914	54,678
Share capital	1,604	1,609	1,609	1,609
Reserve & surplus	84,236	98,792	1,14,985	1,32,378
Total equity & liabilities	**9,01,794**	**10,55,852**	**12,20,979**	**14,05,795**
% Growth	12.6	17.1	15.6	15.1

Source Company data, I-Sec research

Exhibit 20: Key ratios

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
No. of shares and per share data				
Adjusted EPS	13.8	20.0	22.9	24.6
Book Value per share	107	125	145	167
Adjusted BVPS	103	122	142	163
Valuation ratio				
PER (x)	15.3	10.6	9.2	8.6
Price/ Book (x)	2.0	1.7	1.5	1.3
Price/ Adjusted book (x)	2.1	1.8	1.5	1.3
Dividend Yield (%)	0.9	1.1	1.3	1.4
Profitability ratios (%)				
Yield on advances	9.0	10.0	10.0	9.8
Yields on Assets	7.7	8.4	8.4	8.2
Cost of deposits	4.2	5.0	5.3	5.2
Cost of funds	3.7	4.5	4.8	4.6
NIMs	4.1	4.1	3.8	3.7
Cost/Income	45.1	48.3	48.9	50.1
Dupont Analysis (as % of Avg Assets)				
Interest Income	7.7	8.4	8.4	8.2
Interest expended	3.7	4.5	4.8	4.6
Net Interest Income	3.9	3.9	3.7	3.6
Non-interest income	1.4	1.7	1.4	1.4
Trading gains	0.0	0.2	0.1	0.1
Fee income	1.4	1.5	1.3	1.3
Total Income	5.3	5.6	5.1	4.9
Total Cost	2.4	2.7	2.5	2.5
Staff costs	1.2	1.5	1.3	1.3
Non-staff costs	1.2	1.2	1.2	1.2
Operating Profit	2.9	2.9	2.6	2.5
Core Operating Profit	2.9	2.7	2.5	2.4
Non-tax Provisions	1.2	0.7	0.4	0.4
PBT	1.7	2.1	2.2	2.0
Tax Provisions	0.4	0.5	0.5	0.5
Return on Assets (%)	1.30	1.55	1.56	1.44
Leverage (x)	10.5	10.5	10.5	10.5
Return on Equity (%)	13.7	17.2	17.0	15.8
Asset quality ratios (%)				
Gross NPA	2.3	1.4	1.3	1.4
Net NPA	0.7	0.4	0.3	0.4
PCR	67.9	71.4	73.0	75.5
Gross Slippages	0.9	1.1	1.2	1.3
LLP / Avg loans	1.2	0.6	0.5	0.6
Total provisions / Avg loans	1.8	1.1	0.6	0.6
Net NPA / Networth	5.5	3.0	2.5	2.6
Capitalisation ratios (%)				
Core Equity Tier 1	16.8	15.5	15.2	14.7
Tier 1 cap. adequacy	16.8	15.5	15.2	14.7
Total cap. adequacy	18.6	16.7	16.3	15.5

Source Company data, I-Sec research

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