Karnataka Bank Limited

August 21, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Basel III Compliant Tier-II Bonds @	-	-	Withdrawn
Basel III Compliant Tier-II Bonds #	300.00	CARE A+; Stable	Revised from CARE A; Stable

Details of instruments/facilities in Annexure-1.
@Bond has been redeemed by the bank.

#Tier-II Bonds under Basel III are characterised by a 'Point of Non-Viability' (PONV) trigger due to which the investor may suffer a loss of principal. PONV will be determined by the Reserve Bank of India (RBI) and is a point at which the bank may no longer remain a going concern on its own unless appropriate measures are taken to revive its operations, and thus, enable it to continue as a going concern. In addition, the difficulties faced by a bank should be such that these are likely to result in financial losses and raising Common Equity Tier-I capital of the bank should be considered as the most appropriate way to prevent the bank from turning non-viable. In CARE Ratings Limited's (CARE Ratings') opinion, the parameters considered to assess whether a bank will reach the PONV are similar to the parameters considered to assess the rating of Tier-II instruments even under Basel II. CARE Ratings has rated the Tier-II bonds under Basel III after factoring in the additional feature of PONV.

Rationale and key rating drivers

Revision in the rating assigned to the Bond issues of Karnataka Bank Limited (KBL) factors in the consistent improvement in capital adequacy levels in the last four financial years (FYs) supported by steady profitability over the years and completion of equity raise of ₹1,500 crore in FY24. The rating revision also factors in the bank's improving asset quality position with overall decline in stressed asset position with rundown of restructured portfolio. Outstanding standard restructured advances declined from ₹2,571 crore as on March 31, 2023 (4.20% of gross advances) to ₹1,579 crore as on March 31, 2024 (2.16% of gross advances) and further to ₹1,395 crore as on June 30, 2024 (1.85% of gross advances). Owing to reduction in standard restructured advances, bank's gross stressed assets stood lower at 5.39% as on June 30, 2024 (March 31, 2023: 8.43%). Bank's net stressed assets/net worth also reduced to 28.51% as on March 31, 2024 (50.13% as on March 31, 2023) and further reduced to 23.84% as on June 30, 2024.

The rating continues to factor in the long and established operational track record of the bank with over 10 decades, consistent profitability and its sticky and granular retail deposit base with stable current account saving account (CASA) deposit share. However, the rating is constrained by the bank's relatively moderate size and substantial regional concentration with top five states contributing to 85.93% of gross advances as on March 31, 2024. The rating also takes note of moderate asset quality despite improvement witnessed in FY24 and Q1FY25 with reduction in stressed asset position.

CARE Ratings Limited (CARE Ratings) has withdrawn the rating assigned to Tier-II Bonds (Basel III) (ISIN No. INE614B08039 and INE614B08047) of KBL with immediate effect, as the bank has exercised its call option and there is no amount outstanding under the said issue.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors- Factors that could, individually or collectively, lead to positive rating action/upgrade

- Improving size of operations and asset quality while maintaining the profitability levels on a sustained basis.

Negative factors- Factors that could, individually or collectively, lead to negative rating action/downgrade

- Deteriorating asset quality levels with increase in gross non-performing assets (GNPA) to above 7% on a sustained basis.
- Declining capitalisation levels with Tier-I CAR below 11.5%.

Analytical approach:
Standalone

Outlook: Stable

CARE Ratings believes that the entity shall sustain its business and financial risk profiles with credit cost under control over the medium term.

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Detailed description of key rating drivers:

Key strengths

Long operational track record

Established in 1924, KBL has a proven track record of 100 years in financial services. Over the years, it has developed a strong deposit base in Karnataka and in its adjoining states including Maharashtra, Andhra Pradesh, and Tamil Nadu. Srikrishnan H (Managing Director and CEO; on from June 09, 2023) has nearly four decades of industry experience in banking. He is assisted by a team of General Managers heading various departments. 925 branches and 1504 ATMs and recyclers across India and an employee base of 8,907 employees as on March 31, 2024.

Improvement in capital adequacy levels aided by equity infusion and consistent profitability

Aided by steady profit accretion and completion of ₹1,500 crore equity raise by way of preferential allotment and qualified institutional placement (QIP) over three tranches in FY24, the bank's total capital adequacy ratio (CAR) and Tier-I CAR improved to 18.00% and 16.17%, respectively, as on March 31, 2024, as against 17.45% and 14.18% as on March 31, 2023. CAR% and Tier-I CAR% of the bank stood at 17.64% and 15.94%, respectively, as on June 30, 2024 excluding profits for the quarter and remains adequately above the regulatory requirements.
CARE Ratings expects the current capitalisation would be adequate to support the growth over the medium term.

Consistent profitability

Bank's net interest margin witnessed decline from 3.36% in FY23 to 3.09% in FY24 considering increase in cost of deposits. Bank's non-interest income/ average assets witnessed improvement to 1.24% in FY24 (FY23: 1.05%) supported by increase in commission, brokerage income, and profits from treasury operations. However, Bank's operational expenses/ average total assets witnessed moderation from 2.08% in FY23 to 2.30% in FY24. Consequently, PPOP witnessed decline of 2.0% to ₹2,163 crore in FY24 (FY22: ₹2,208 crore).
KBL witnessed lower credit cost of 0.56% in FY24 as against 0.81% in FY23 considering improvement in GNPA levels leading to stable profitability with Bank's return on total asset (ROTA) at 1.23% in FY24 as against 1.25% in FY23.
Bank reported PAT of ₹400 crore on a total income of ₹2,557 crore in Q1FY25 with ROTA at 1.39% in Q1FY25. CARE Ratings expects the bank to maintain ROTA above 1% in the near term. KBL's ability to limit credit costs at low levels is key to maintenance of ROTA.

Stable and granular resource profile with improvement in CASA deposits

The bank's deposit base has remained stable and sticky and constitutes 85.2% of total liabilities. The bank has a strong deposit profile with 88.68% of deposits being in less than ₹2 crore category as on March 31, 2024. The reliance on external borrowings is limited to Tier-II bonds, borrowings from RBI, and other financial institutions. The proportion of low-cost CASA deposits remained stable at 31.97% as on March 31, 2024 (March 31, 2023: 32.97%). However, they witnessed moderation to 30.54% as on June 30, 2024. Going ahead, the Bank's ability to improve the CASA deposit share would be crucial for it to raise deposits at competitive rates.

Key weaknesses

Moderate asset quality, however, significant decline in stressed asset position in FY24 and Q1FY25

As on March 31, 2024, GNPA and net NPA (NNPA) ratios have improved to 3.53% and 1.58%, respectively, as against 3.74% and 1.70%, respectively, as on March 31, 2023, aided by write-offs and lower slippages in FY24. As on June 30, 2024, the GNPA% stood stable at 3.54%. The bank's slippage ratio witnessed improvement to 2.80% in FY24 (PY: 3.31%). PCR (including Technically Written Off [TWO] accounts) stood stable at 79.22% as on March 31, 2024 (80.86% as on March 31, 2023). PCR (excluding TWO) also stood stable at 56.21% as on March 31, 2024 (55.46% as on March 31, 2023).
Outstanding standard restructured advances also declined from ₹2,571 crore as on March 31, 2023 (4.20% of gross advances) to ₹1,579 crore as on March 31, 2024 (2.16% of gross advances) and further to ₹1,395 crore as on June 30, 2024 (1.85% of gross advances).
Owing to the reduction in standard restructured advances, Bank's gross stressed assets stood lower at 5.39% as on June 30, 2024 (March 31, 2023: 8.43%). Bank's net stressed assets/net worth decreased to 28.51% as on March 31, 2024 (50.13% as on March 31, 2023), which further reduced to 23.84% as on June 30, 2024.

Consistent increase in scale of operations, however, continues to be regionally concentrated
With total assets of ₹115,118 crore as on March 31, 2024; KBL is one of the medium-sized banks in India and the scale of operations has been on a consistent increase. The Bank's overall business crossed ₹1.5 lakh in FY24 and stood at ₹1.76 lakh crore as on June 30, 2024.
The Bank's operations are mainly spread in Karnataka, constituting around 45.77% of the total credit exposure as on June 30, 2024 (PY:45.8%). The top five states contribute to 85.93% of total credit exposure as on March 31, 2024 (PY: 83.16%).

Liquidity: Strong

According to the bank's structural liquidity statement (SLS) as on March 31, 2024, there are no negative cumulative mismatches in up to one year maturity bucket. KBL's liquidity coverage ratio remained comfortable at 269% as on June 30, 2024, against the minimum regulatory requirement of 100%. Bank has maintained an excess SLR investment of ₹5,148 crore as on June 30, 2024. The excess SLR (as a % of NTDL) stood at 5.13%. These factors provide cushion to the Bank's liquidity profile. Additionally, the Bank has access to systemic liquidity by way of RBI's LAF and MSF schemes.

Environment, social, and governance (ESG) risks

KBL is committed to the well-being of our society and the environment, ensuring that the practices contribute to a greener, more sustainable future. Bank has adopted policies that imbibe the best practices regarding environmental, social, and governance (ESG) principles. Bank has a well-articulated Board-approved ESG policy. ESG Committee of Executives oversees implementation of Bank's Business Responsibility Policy.

Applicable criteria

Criteria on Assigning 'Outlook' or 'Rating Watch' to Credit Ratings
Criteria for Rating Basel III - Hybrid Capital Instruments issued by Banks
Policy on Default Recognition
Financial ratios – Financial sector
CARE Ratings' criteria for rating of banks
CARE Ratings' Policy on Withdrawal of Ratings

About the company and industry

Industry classification

Macro-economic Indicator	Sector	Industry	Basic Industry
Financial services	Financial services	Banks	Private sector banks

KBL is a Mangalore-based, medium-sized private sector bank set up in 1924. As on June 30, 2024, the branch network was spread across 927 branches and 1504 ATMs and recyclers across India. The Bank has strong presence in south India with 707 branches as on June 30, 2024 (of which 589 branches are in Karnataka). As on June 30, 2024, the Bank had advances of ₹75,455 crore and deposits of ₹100,164 crore.

Brief Financials (₹ crore)	March 31, 2023 (A)	March 31, 2024 (A)	June 30, 2024 (A)
Total operating income	8,213	9,617	2,557
PAT	1,180	1,306	400
Total assets	98,110	1,15,118	1,14,823
Net NPA (%)	1.70	1.58	1.66
ROTA (%)	1.25	1.23	1.39

A: Audited; UA: Unaudited; Note: these are latest available financial results

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years: Annexure-2

Covenants of rated instrument/facility: Annexure-3

Complexity level of instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Bonds-Tier-II Bonds	INE614B08039*	November 16, 2018,	12.00%	November 16, 2028	-	Withdrawn
Bonds-Tier-II Bonds	INE614B08047*	February 18, 2019	12.00%	February 18, 2029	-	Withdrawn
Bonds-Tier-II Bonds	INE614B08054	March 30, 2022	10.70%	March 30, 2032	300	CARE A+; Stable

*Bond has been redeemed by the bank.

Annexure-2: Rating history for last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2024-2025	Date(s) and Rating(s) assigned in 2023-2024	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022
1	Bonds-Lower Tier-II	LT	-	-	-	1)Withdrawn (23-Aug-23)	1)CARE A; Stable (24-Aug-22)	1)CARE A; Stable (25-Aug-21)
2	Bonds-Tier-II Bonds	LT	-	-	-	1)CARE A; Stable (23-Aug-23)	1)CARE A; Stable (24-Aug-22)	1)CARE A; Stable (25-Aug-21)
3	Bonds-Tier-II Bonds	LT	300.00	CARE A+; Stable	-	1)CARE A; Stable (23-Aug-23)	1)CARE A; Stable (24-Aug-22)	1)CARE A; Stable (25-Mar-22)

LT: Long term

Annexure-3: Detailed explanation of covenants of rated instruments/facilities: Not applicable

Annexure-4: Complexity level of instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Bonds-Tier-II Bonds	Complex

Annexure-5: Lender details: Not applicable

Note on complexity levels of rated instruments: CARE Ratings has classified instruments rated by it based on complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for clarifications.

Contact us

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About us:

Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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