Karnataka Bank Limited (Revised)

August 24, 2022

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Basel III Compliant Tier II Bonds #	720.00	CARE A; Stable (Single A; Outlook: Stable)	Reaffirmed
Basel III Compliant Tier II Bonds #	300.00	CARE A; Stable (Single A; Outlook: Stable)	Reaffirmed
Lower Tier II Bonds	250.00	CARE A; Stable (Single A; Outlook: Stable)	Reaffirmed
Total	**1,270.00 (₹ One Thousand Two Hundred Seventy Crore Only)**		

Details of instruments/facilities in Annexure-1

#Tier II Bonds under Basel III are characterized 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 the 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's opinion, the parameters considered to assess whether a bank will reach the PONV are similar to the parameters considered to assess rating of Tier II instruments even under Basel II. CARE has rated the Tier II bonds under Basel III after factoring in the additional feature of PONV.

Detailed rationale and key rating drivers

The rating assigned to the Bond issues of Karnataka Bank Limited (KBL) continues to factor in the long and established operational track record of the Bank with over nine decades in financial services, adequate capitalisation levels, moderate but consistent profitability and its sticky and granular retail deposit base with stable CASA deposit share. Though capitlisation levels are well above regulatory requirements, capital cushion available with the bank is lower than that of its peers. While the bank may not require any growth capital in the current fiscal year, any increase in slippages due to significant amount of restructured book may require the bank to raise additional capital. The rating is however constrained by the bank's relatively small size, substantial regional concentration with top 5 states contributing to 82.6% of gross advances as on June 30, 2022 (March 31, 2021:78.0%), moderate asset quality and increase in stressed assets during FY22 (refers to period from April 01 to March 31) as a result of restructuring done under the RBI Covid-19 resolution framework. Gross stressed assets increased from 8.49% as on March 31, 2021 to 11.67% as on March 31, 2022.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Improvement in CET I Ratio on sustained basis
- Net Stressed Assets/ Net worth < 50% on sustained basis.

Negative factors – Factors that could lead to negative rating action/downgrade:

- Material Deterioration in asset quality (GNPA>7.5%) impacting earnings profile of the bank.
- Inability to maintain sufficient cushion over the regulatory capital.

Detailed description of the key rating drivers

Key rating strengths

Long operational track record: KBL is an old generation private sector bank. Established in the year 1924, it has a proven track record of over nine decades in financial services. Over the years it has developed a strong deposit base in the state of Karnataka and in its adjoining states like Maharashtra, Andhra Pradesh, and Tamil Nadu. Mr. Mahabaleshwara MS is the MD and CEO, who has more than three decades of industry experience in banking. He is assisted by a team of General Managers heading various departments. KBL has a network of 879 branches, 879 ATMs spread across 22 states and 2 Union Territories and has employee base of 8520 employees as on March 31, 2022. It is currently serving over 12 million customers.

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

Adequate capitalisation levels: Aided by steady profit accretion and bank raising tier-II bonds of Rs.300 crore during March 2022 Bank's Total CAR and Tier I CAR improved to 15.66% and 12.65% respectively as on March 31, 2022 as against 14.85% and 12.34% respectively as on March 31, 2021. Capital adequacy of KBL stood low among its peers though it has been above the regulatory requirement. Bank is also in process of obtaining Board approval to raise capital via QIP but given the low equity valuation of Bank, its ability to raise funds would be monitored. However, Bank's current capital cushion would be adequate to meet growth requirement, but in case of higher slippages, it may be required to raise additional capital to maintain sufficient cushion above the regulatory requirement.

Moderate but consistent profitability: Aided by decline in cost of deposits from 5.22% in FY21 to 4.59% in FY22, bank's NIM witnessed improvement from 2.61% in FY21 to 2.83% in FY22 leading to healthy increase of net interest income by 14.1%. However, bank's non-interest income witnessed decrease by 32.1% on account of decrease in treasury profits which stood at Rs.48.6 crore in FY22 as against Rs.624.8 crore in FY21. KBL witnessed lower credit cost of 1.07% during FY22 as against 1.55% in FY21 on account of improvement in GNPA levels leading to Bank's ROTA remaining stable at 0.58% during FY22. (FY21:0.58%). Going forward, the bank expects NIM to improve with focus on increasing exposure to the higher yielding mid corporate/retail/ Agri loans. Further, an increase in NIM will also depend on the ability of the bank to raise deposits at competitive rates and releasing excess liquidity from its investment portfolio. However, KBL's ability to limit credit costs at low levels holds the key to improvement in ROTA given the relatively high share of standard restructured assets.

Stable and granular resource profile with improvement in CASA deposits: The deposit base of the bank has remained stable and sticky and constitutes 88% of total liabilities. The bank has a strong deposit profile with 92% (PY: 93.1%) of deposits being in less than Rs.2 crore category as on March 31, 2022. Reliance on external borrowings is limited to Tier-II bonds and borrowings from RBI and other financial institutions. The share of retail deposits was 67.2% as on March 31, 2022 (PY: 68.5%). The proportion of low-cost CASA deposits increased to 32.8% as on June 30, 2022 as against 31.5% as on March 31, 2021. Going ahead, bank plans to improve the CASA deposit share which would be crucial for bank to raise deposits at competitive rates.

Key rating weaknesses

Modest asset quality with increase in stressed assets: Gross NPA (GNPA) and Net NPA (NNPA) ratios have improved to 3.90% and 2.42% respectively as against 4.91% and 3.19% as on March 31, 2021. Bank's overall PCR (including Technically Written Off (TWO) accounts) improved from 69.99% as on March 31, 2021 to 73.47% as on March 31, 2022. However, excluding TWO, provision coverage ratio stood relatively low at 38.82% as on March 31, 2022. The bank's slippage ratio continued to remain elevated at 2.94% during FY22 (PY: 2.32%). The Bank had made additional restructuring during FY22, leading to increase in standard restructured assets to Rs. 4115 crore (7.12% of gross advances) as on March 31, 2022 as against Rs. 1490 crore (2.83% of gross advances) as on March 31, 2021. Standard restructured accounts stood at Rs.3652 crore (6.1% of gross advances) as on June 30, 2022 against which bank holds provisions of Rs.487 crore which corresponds to 13.34% on restructured book. With recovery from large corporate account in July 2022, restructured book is expected to come down further, going forward. Gross Stressed assets as a % of gross advances increased to 11.67% as on March 31, 2022 as against 8.49% as on March 31, 2021. Similarly, Net stressed assets to Net worth also increased from 58.88% as on March 31, 2021 to 87.08% as on March 31, 2022.

Regional concentration and small size of operations: The bank has limited presence with a small network of 879 branches as on June 30, 2022. With total assets of Rs. 91,212 crore as on March 31, 2022, KBL is one of the smaller banks in India. The bank's operations are geographically focused in Karnataka which accounted for 558 branches and constituted around 44.5% of the total credit exposure as on June 30, 2022 (PY: 41.2%). The top 5 states contribute to 82.6% of total credit exposure as on June 30, 2022 (March 31, 2021: 78.0%).

Liquidity: Adequate

The Bank's liquidity position is adequate. There were no negative cumulative mismatches in up to one year maturity bucket according to the bank's structural liquidity statement (SLS) as on March 31, 2022. Further, the Bank has maintained excess SLR of Rs. 3343 crore (4.0% of excess SLR as on June 30, 2022). Additionally, liquidity remains supported by its stable and sticky deposit base. KBL's liquidity coverage ratio remained comfortable at 302.07% as on June 30, 2022 against the minimum regulatory requirement of 100%. Additionally, the bank has access to systemic liquidity by way of RBI's LAF and MSF schemes.

Analytical approach: Standalone.

Applicable criteria

Policy on default recognition
Financial Ratios - Financial Sector
Rating Outlook and Credit Watch

[Rating Basel III - Hybrid Capital Instruments issued by Banks](#)
[Rating Methodology - Banks](#)

About the company

Karnataka Bank Ltd. (KBL) is a Mangaluru-based, small-sized, old private sector bank which was set up in 1924. As on June 30, 2022, the branch network was spread across 879 branches and 879 ATMs across India. The Bank has strong presence in South India with 696 branches as on June 30, 2022 (of which 558 branches are located in Karnataka). All the branches are under Core Banking Solution since 2007. The day-to-day affairs of the bank are looked after by Mr. Mahabaleshwara M S (Managing Director and CEO). He is assisted by a team of General Managers heading important functions of credit, recovery, treasury, risk management, planning and development, information technology, vigilance, etc.

Brief Financials (Rs. crore)	31-03-2021 (A)	31-03-2022 (A)	Q1FY23 (Prov)
Total operating income	7,637	7,176	1,762
PAT	483	509	114
Total Assets	84,690	91,212	94,541
Net NPA (%)	3.19	2.42	2.16
ROTA (%)	0.58	0.58	0.49

A: Audited; Prov: Provisional; Total Assets and Tangible Net worth excludes revaluation reserve and deferred tax asset.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Covenants of rated instrument / facility: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated for this company: Annexure 4

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-Lower Tier II	INE614B08021	November 17, 2012	11.00%	November 17, 2022	250.00	CARE A; Stable
Bonds-Tier II Bonds	INE614B08039, INE614B08047	November 16,2018, February 18, 2019	12.00%	November 16, 2028, February 18, 2029	400.00 320.00	CARE A; Stable
Bonds-Tier II Bonds	INE614B08054	March 30, 2022	10.70%	March 30, 2032	300.00	CARE A; Stable

Annexure-2: Rating history for the 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 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Bonds-Lower Tier II	LT	250.00	CARE A; Stable	-	1)CARE A; Stable (25-Aug-21)	1)CARE A; Stable (27-Aug-20)	1)CARE A; Stable (30-Aug-19)
2	Bonds-Tier II Bonds	LT	720.00	CARE A; Stable	-	1)CARE A; Stable (25-Aug-21)	1)CARE A; Stable (27-Aug-20)	1)CARE A; Stable (30-Aug-19)
3	Bonds-Tier II Bonds	LT	300.00	CARE A; Stable	-	1)CARE A; Stable (25-Mar-22)	-	-

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities

Name of the Instrument	Detailed Explanation
A. Non-financial covenants	
I. Lower Tier II Bonds	**Optional call date:** After 18.11.2017 **Subsequent call Dates:** On every anniversary of coupon payment date after first call option due date
II. Basel III Compliant Tier II bonds	**Optional call date:** After 16.11.2023, Rs.400 cr After 18.02.2024, Rs.320 cr **Subsequent call Dates:** On every anniversary of coupon payment date after first call option due date.

Annexure-4: Complexity level of various instruments rated for this company

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

Annexure-5: Bank lender details for this company: Not Applicable

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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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