

## Karnataka Bank Limited

March 25, 2022

### Ratings

Facilities	Amount (Rs. crore)	Rating <sup>1</sup>	Rating Action
<b>Basel III Compliant Tier II Bonds#</b>	<b>300.00 (Rs. Three hundred crore only)</b>	<b>CARE A; Stable (Single A; Outlook: Stable)</b>	<b>Assigned</b>

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 & Key Rating Drivers

The rating assigned to the Bond issue of Karnataka Bank Limited (KBL) factors in the long and established operational track record of the Bank with over nine decades in financial services, adequate capital adequacy levels, moderate but consistent profitability and its sticky and granular retail deposit base with stable CASA deposit share. The rating is however constrained on account of its moderate asset quality and increase in stressed assets during 9mFY22 (refers to period from April 01 to December 31) as a result of restructuring done under the RBI Covid-19 resolution framework. The performance of retail assets and the repayment behaviour of the restructured portfolio will be key to KBL's credit profile. The rating also gets capped by the bank's relatively small size and substantial regional concentration with top 5 states contributing to 82.3% of gross advances as on December 31, 2021 (March 31, 2021:78.0%).

### Rating Sensitivities

#### Positive Factors - Factors that could lead to positive rating action/upgrade:

- Improvement in CAR > 15% and CETI Ratio of 13 % on a sustained basis.
- NNPA/Networth < 20% on sustained basis alongwith significant reduction in restructured advances.
- Improvement in profitability on sustained basis

#### Negative Factors- Factors that could lead to negative rating action/downgrade:

- Material Deterioration in asset quality (GNPA above 7.5%) impacting earnings profile of the bank and 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 banking. Over the years it has developed a strong deposit base in the state of Karnataka and adjoining states like Maharashtra, Andhra Pradesh, and Tamil Nadu. Mr. Mahabaleshwara MS is the MD and CEO, who has more than 3 decades of industry experience in banking. He is assisted by a team of General Managers heading various departments. KBL has a network of 859 branches, 915 ATMs spread across 22 states and 2 Union Territories and has employee base of over 8,400 employees.

**Adequate Capital Levels:** Aided by profit accretion and decline in risk weighted assets on account of decline in advances, Bank's Total CAR and Tier I CAR improved to 14.85% and 12.34% respectively as on March 31, 2021 as against 12.88% and 10.66% respectively as on March 31, 2020. Albeit improvement, Capital adequacy of KBL stood low among its peers though it has been above the regulatory requirement.

Total CAR and Tier I CAR stood at 14.15% and 11.74% as on December 31, 2021 (Total CAR: 14.87% including 9MFY22 profits). Bank's current capital cushion would be adequate to meet moderate growth requirement, but in case of higher growth in advances, it may be required to raise additional capital.

**Moderate but Consistent Profitability:** During FY21, Pre-Provision Operating Profit rose 20.7% over FY20 to Rs. 1,999.1 crores (FY20: Rs. 1,656.7 crores) supported by an improvement in Net Interest Margin (NIM) and higher treasury profits aided by fall in G-Sec yields in H1FY22. NIM improved from 2.53% in FY20 to 2.61% in FY21 aided by decline in cost of deposits. Operating expense to total assets remained stable at 2.01% (FY20: 2.04%). KBL had higher credit costs in FY21 partly on account of accelerated provisions made by the bank which had improved the provision coverage ratio (PCR). Consequently, Return on Total Assets (ROTA) remained stable at 0.58% in FY21 as against 0.54% in FY20. During 9MFY22, the bank reported total income and PAT of Rs.5340 crore and Rs.378 crore respectively (9MFY21: Rs. 5901 cr and Rs.451 cr). Lower income and PAT was on

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careedge.in](http://www.careedge.in) and other CARE Ratings Ltd.'s publications.

account of lower treasury income booked at Rs.33 crore in 9MFY22 as against Rs.600 crore in 9MFY21. During this period ROTA stood at 0.58%.

Going forward, the bank expects NIM to improve led by its 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.

**Stable and Granular Resource Profile with Improvement in CASA deposits:** The deposit base of the bank has remained stable and sticky and constitutes 87% of total liabilities. The bank has a strong deposit profile with 88.84% (PY: 89.64%) of deposits being in less than 1 crore category as on Mar 31, 2021. Reliance on external borrowings is limited to Tier-II bonds and borrowings from RBI and other financial institutions. The share of wholesale deposits stood negligible at 0.01% as on March 31, 2021 (PY: 0.08%). The share of retail deposits was 68.5% as on Mar 31, 2021 (PY: 70.3%) and was at 68.7% as on December 31, 2021. The proportion of low-cost CASA deposits increased to 31.49% as on March 31, 2021 as against 28.91% as on March 31, 2020 and the same stood stable at 31.3% as on December 31, 2021.

#### Key Rating Weaknesses

**Modest Asset Quality with Increase in Stressed Assets:** Gross NPA (GNPA) and Net NPA (NNPA) ratios stood at 4.11% and 2.45% respectively as on December 31, 2021 as against 4.91% and 3.18% as on March 31, 2021. PCR (including Technically Written Off accounts) improved from 70.05% as on March 31, 2021 to 73.74% as on December 31, 2021 on the back of increased provisioning. Bank's total restructured advances stood at Rs.4690 crore as on December 31, 2021. Bank's standard restructured assets stood at Rs. 4,370 crore (7.71% of gross advances) as on December 31, 2021 as against Rs. 1490 crore (2.82% of gross advances) as on March 31, 2021. Net Stressed assets as a % of net worth moderated to 93.55% as of December 31, 2021 from 58.81% as on March 31, 2021.

**Regional Concentration and Relatively Small Size of Operations:** The bank has limited presence with relatively small network of 859 branches as on December 31, 2021. The bank's operations are geographically focused in Karnataka which accounted for 540 branches and constituted around 45.4% of the gross advances as on December 31, 2021 (March 31, 2021: 45.8%). With total assets of Rs. 84,690 crore as on March 31, 2021, KBL is one of the smaller banks in India.

#### Liquidity: Adequate

The Bank's liquidity position is adequate. There were no negative cumulative mismatches in up to 1 year maturity bucket according to the bank's structural liquidity statement (SLS) as on December 31, 2021. Further, the bank has maintained excess SLR investment of Rs. 4788 crore as on February 25, 2022 equivalent to 5.92% of SLR requirement. Additionally, liquidity remains supported by its stable and sticky deposit base. KBL's liquidity coverage ratio remained comfortable at 287.97% as on December 31, 2021 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

[Criteria on assigning 'Outlook' and 'Credit Watch' to Credit Ratings](#)  
[CARE's Policy on Default Recognition](#)  
[Financial Ratios-Financial Sector](#)  
[CARE's Rating Methodology for Banks](#)  
[Criteria for Rating Basel III - Hybrid Capital Instruments issued by 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 December 31, 2021, the branch network was spread across 859 branches and 915 ATMs across India. The Bank has strong presence in South India with 678 branches as on December 31, 2021 (of which 540 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)	31-03-2020 (A)	31-03-2021 (A)	9MFY22 (Prov)
Total operating income	7736	7727	5340
PAT	432	483	378
Total Assets	82403	84690	90067
Net NPA (%)	3.08	3.18	2.45
ROTA (%)	0.54	0.58	0.58

A: Audited; Prov: Provisional

**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 (Rs. crore)	Rating assigned along with Rating Outlook
Bonds-Tier II Bonds	-	-	-	Proposed	300.00	CARE A; Stable

**Annexure-2: Rating History of last three years**

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	Bonds-Lower Tier II	LT	-	-	-	-	-	1)Withdrawn (17-Oct-18) 2)CARE A; Stable (26-Sep-18)
2	Bonds-Lower Tier II	LT	-	-	-	-	-	1)Withdrawn (29-May-18)
3	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)	1)CARE A; Stable (26-Sep-18)
4	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)	1)CARE A; Stable (26-Sep-18)
5	Bonds-Tier II Bonds	LT	300.00	CARE A; Stable				

\*Long Term / Short Term

**Annexure-3: Detailed explanation of covenants of the rated instrument / facilities:** Not Applicable

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

Sr. No	Name of instrument	Complexity level
1	Bonds-Tier II Bonds	Complex

**Annexure 5: Bank Lender Details for this Company:** Not Applicable

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

## Contact us

### Media Contact

Name – Mr. Mradul Mishra  
Contact no. - +91-22-6754 3596  
Email ID - [mradul.mishra@careedge.in](mailto:mradul.mishra@careedge.in)

### Analyst Contact

Name: Ms. Janet Felsia Thomas  
Contact no.: 9833161236  
Email ID: [janet.thomas@careedge.in](mailto:janet.thomas@careedge.in)

Name - Mr. Sudhakar Prakasam  
Phone -044 -2850 1013  
Email ID - [p.sudhakar@careedge.in](mailto:p.sudhakar@careedge.in)

### Relationship Contact

Name: Mr. Nitin Kumar Dalmia  
Contact no.: 080-46625555  
Email ID: [nitin.dalmia@careedge.in](mailto:nitin.dalmia@careedge.in)

### About CARE Ratings Limited:

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