

Karnataka Bank Limited

August 30, 2019

Ratings

Instrument	Amount (Rs. crore)	Rating ¹	Rating Action
Basel III Compliant Tier II bonds	720 (reduced from Rs.800 crore)	CARE A; Stable (Single A); Outlook: Stable	Reaffirmed
Lower Tier II Bonds	250	CARE A; Stable (Single A); Outlook: Stable	Reaffirmed
Total facilities	970 (Rs. Nine Hundred Seventy Crore Only)		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating assigned to the Bond issue of Karnataka Bank Limited (KBL) continues to take into account the established track record of the bank, satisfactory capital adequacy position strengthened by consistent profitability and fresh issue of Tier II bonds of Rs.720 crore during FY19, comfortable liquidity profile and stable growth in advances. The rating is, however, constrained by regional concentration and modest size of operations of the bank, modest asset quality which witnessed marginal improvement during FY19 (refers to the period April 1 to March 31) due to lower slippages. The rating also takes note of the increase in operating expenses impacting operating profitability parameters even as bank witnessed growth in net interest income and earned sizeable trading income.

Going forward, ability of Karnataka Bank Ltd to control incremental slippages and improve its asset quality and profitability parameters amidst weak demand outlook and challenging operating environment would be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Strengths

Long standing track record: KBL is an old generation private sector bank. Established in the year 1924, it has a proven track record of 90 years. Over the years it has developed a strong deposit base in the state of Karnataka and its adjoining states like Maharashtra, Andhra Pradesh and Tamil Nadu.

Satisfactory Capital Adequacy: The bank's capital adequacy ratio (CAR) improved and remained well above regulatory requirements with Basel III CAR of 13.17% as on March 31, 2019 (March 31, 2018: 12.04%) and Basel III Tier I CAR and CET I both at 11.17% as on March 31, 2019 (March 31, 2018: 11.29%). Improvement in total CAR was on account of fresh issue of Tier II bonds of Rs.720 crore during FY19 and accretion of profits. The Basel III CAR has deteriorated to 12.70% and Basel III Tier I CAR and CET I stood at 10.70% as on June 30, 2019. The CAR of 12.70% does not factor in the net profit earned by the bank in Q1FY20. The bank had free reserves of Rs. 3,738 crore as on March 31, 2019 (FY18: Rs. 3427 crore) and has not raised any Additional Tier I (AT I) Bonds under Basel III.

Consistent profitability: During FY19, the bank reported a business growth of 11.95% supported by 8.88% growth in deposits and 16.00% growth in advances. In FY19, the total income of the bank grew by 8.31% supported by growth in interest income by 8.89% and growth in non-interest income by 4.99%. Of the non-interest income of Rs.1,001 crore (PY: Rs.954 crore), Rs.163.2 crore (PY: Rs.197.5 crore) was from profit on sale of investments. The bank reported net interest income of Rs.1,905 crore in FY19 as against Rs.1,858 crore in FY18.

Owing to bank's concentrated efforts in mobilizing new advances towards better rated corporate clients has led to decrease in yield on advances leading to decline in NIM from 2.78% in FY18 to 2.56% in FY19.

Bank operating profit declined to Rs.1,450 crore (FY18:Rs.1,473 crore) owing to increase in operational expenses by 8.84% majorly due to increase in employee expenses (increased by 15.39% in FY19). Owing to the same, bank's cost to income also witnessed marginal deterioration during FY19 and stood at 50.13% as on March 31, 2019 as against 47.61% as on March 31, 2018.

KBL reported PAT of Rs. 477 crore in FY19 as compared to a PAT of Rs.326 crore during FY18. Increase in profit was on account of lower provisioning cost during FY19 at Rs.972 crore as against Rs.1147 crore during FY18. ROTA improved to 0.64% as on March 31, 2019 (FY18: 0.49%).

During Q1FY20, the bank's performance remained stable and reported PAT of Rs.175 crore (Q1FY19: Rs.163 crore) on total income of Rs.1,829 crore (Q1FY19: Rs.1,617 crore).

¹Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.

Adequate liquidity position: According to the structural liquidity statement (SLS) submitted by the bank as on June 30, 2019, there were no negative cumulative mismatches in up to 1 year maturity bucket. Further, the bank also maintains excess SLR investment over and above regulatory requirement. Additionally, the term deposits have a roll over rate ~86%. These factors provide cushion to the bank's liquidity profile. KBL's liquidity coverage ratio remained comfortable at 241.07% (quarterly average for Apr'19-Jun'19) against the minimum regulatory requirement of 100%, as on March 31, 2019. Further, the bank has access to systemic liquidity by way of RBI's LAF and MSF schemes.

Key Rating Weaknesses

Moderate asset quality parameters: Bank's asset quality parameters though improved, remained inferior than its peer rated banks. Further, its provision coverage ratio also remained lower than its peers. During FY19, slippage ratio improved to 3.06% as against 5.74% in FY18. As on March 31, 2019, Gross NPA (GNPA) and Net NPA (NNPA) ratios decreased to 4.41% from 4.92% in FY18 owing to recoveries, upgradations and also aided by lower slippages. Net NPA remained stable at 2.95% (FY18: 2.96%). During FY19, bank made recoveries/upgradations amounting to Rs.1,367 crore (PY: Rs.1,325 crore). However, with bank providing for lower provisioning has resulted in deterioration in provision coverage ratio to 34.18% in FY19 as against 41.06% in FY18. Standard restructured assets outstanding as on March 31, 2019 stood at Rs.299 crore (March 31, 2018: Rs.283 crore). The major sectors contributing to restructured assets as on March 31, 2019 were infrastructure and large industry segment contributing 63% of the total restructured assets. During Q1FY20, GNPA and NNPA stood at 4.55% and 3.33% respectively.

Regional concentration and modest size of operations: The operations of the bank are spread mainly in the state of Karnataka and its adjoining states. Karnataka constituted around 43.45% of total credit exposure as on March 31, 2019. Six states Karnataka, Maharashtra (17.62%), Tamil Nadu (7.23%), Delhi (7.45%), Andhra Pradesh (4.26%) and Telangana (4.40%) constituted around 84.40% (PY:82.93%) of the total advances. With total assets of Rs.78,634 crore as on March 31, 2019; KBL is one of the small sized banks in India.

Analytical approach: Standalone.

Applicable Criteria

[CARE's Criteria on assigning Outlook to Credit Ratings](#)

[CARE's Policy on Default Recognition](#)

[Financial ratios – Financial sector](#)

[CARE's Rating Methodology for 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 March 31, 2019; the branch network was spread across 836 branches (March 31, 2018: 800) and 1210 ATMs and 1 extension counters.

The bank has a strong presence in South India with 655 branches as on March 31, 2018 (of which 520 branches are located in Karnataka). All branches are under Core Banking Solution since 2007. The Total Capital Adequacy of the bank under Basel III as on March 31, 2019 stood at 13.17% (Mar'18: 12.04%) and 12.70% as on June 30, 2019, with Tier I and CET I both at 11.17% (Mar'18: 11.29%) and 10.70% as on June 30, 2019. The bank's Gross NPA ratio and Net NPA ratio stood at 4.41% and 2.95% as on March 31, 2019 (GNPA 4.92% and NNPA 2.96% as on Mar'18) and 4.55% and 3.33% respectively as on June 30, 2019.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	6378	6908
PAT	326	477
Interest coverage (times)	1.41	1.36
Total Assets	69957	78634
Net NPA (%)	2.96	2.95
ROTA (%)	0.49	0.64

A: Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Bonds-Lower Tier II	November 17, 2012	11.0% p.a.	November 17, 2022	250.00	CARE A; Stable
Bonds-Tier II Bonds	September 19, 2018	12.0% p.a.	February 18, 2029	720.00	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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Bonds-Lower Tier II	LT	-	-	-	1)Withdrawn (17-Oct-18) 2)CARE A; Stable (26-Sep-18)	1)CARE A; Stable (09-Oct-17)	1)CARE A (07-Oct-16)
2.	Bonds-Lower Tier II	LT	-	-	-	1)Withdrawn (29-May-18)	1)CARE A; Stable (09-Oct-17)	1)CARE A (07-Oct-16)
3.	Bonds-Lower Tier II	LT	250.00	CARE A; Stable	-	1)CARE A; Stable (26-Sep-18)	1)CARE A; Stable (09-Oct-17)	1)CARE A (07-Oct-16)
4.	Bonds-Tier II Bonds	LT	720.00	CARE A; Stable	-	1)CARE A; Stable (26-Sep-18)	-	-

Note on complexity levels of the rated instrument: CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.

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