November 29, 2024

The Karur Vysya Bank Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Certificates of deposit	3,000.00	3,000.00	[ICRA]A1+; Reaffirmed
Total	**3,000.00**	**3,000.00**	

**Instrument details are provided in Annexure I*

Rationale

The rating continues to factor in the comfortable buffer maintained by The Karur Vysya Bank Limited (KVB) for its Tier I capital ratio (589 basis points (bps) over the regulatory ask of 9.5%) as on September 30, 2024. This was largely supported by the advances mix, with a high share of gold loans attracting lower risk weights, and the improved and healthy rate of internal accruals in recent years. KVB reported a healthy return on average total assets (RoA) of 1.64% in FY2024 (1.30% in FY2023; <1.0% between FY2020 and FY2022) with the annualised RoA improving further to 1.71% in H1 FY2025. The enhanced earnings profile was supported by the improvement in the bank's asset quality profile in recent years, characterised by a lower fresh non-performing advances (NPA) generation rate as well as healthy recoveries. The resultant decline in credit costs and increased coverage on gross NPAs (GNPAs) led to an improvement in the GNPA and net NPA (NNPA) ratios to 1.10% and 0.28%, respectively, as on September 30, 2024, from 1.40% and 0.40%, respectively, as on March 31, 2024 (compared to levels as high as 8.7% and 3.9%, respectively, in FY2020).

KVB's current account and savings account (CASA) ratio stood at 29.5% as on September 30, 2024, remaining lower than the private sector banks' (PVBs) average. The deposit base remains granular with limited dependence on wholesale deposits. The bank also witnessed a steep decline in its daily average liquidity coverage ratio (LCR) to 128% in Q2 FY2025 from 185% in Q1 FY2025. This was driven by the recalibration in the LCR computation, resulting in higher outflows, following the suggestions made by the regulator.

Nonetheless, the asset quality remains a near-term monitorable as various macro-economic shocks, geopolitical concerns and emerging stress in the retail sector may translate into asset quality deterioration. Moreover, since the regional concentration of KVB's operations remains high, its assets and liabilities are exposed to local socio-economic and political risks.

Key rating drivers and their description

Credit strengths

Comfortable capitalisation – KVB's capitalisation profile remains comfortable with the reported CET I and CRAR at 15.39% and 16.28%, respectively, as on September 30, 2024 (15.46% and 16.67%, respectively, as on March 31, 2024). Further, the improvement in the bank's profitability in the last two years, with a return on equity (RoE) of 17.81% in H1 FY2025 and 15.98% in FY2024, enhances its capitalisation profile. The relatively low risk-weighted density of the asset base is driven by the significant share of gold loans, which attract a lower risk weight. ICRA expects KVB to maintain comfortable cushions over and above the regulatory Tier I requirements and the negative triggers.

Healthy earnings profile – KVB's net interest margin (NIM) moderated to 3.82% (annualised) of average total assets in H1 FY2025 from 3.89% in FY2024 because of the increase in the cost of funds amid challenges in deposit raising. Given the expectation that the cost of deposits will remain elevated, the NIM is likely to moderate further in H2 FY2025. Nevertheless, the improvement in the operating expenses ratio along with the increase in non-interest income helped the bank report higher operating profitability (annualised) of 2.73% in H1 FY2025 (2.58% in FY2024, 2.87% in FY2023). Credit costs were slightly higher in H1 FY2025 compared to FY2024, but remained below earlier levels, helping KVB report a healthy RoA of 1.71% (annualised) in H1 FY2025 (1.64% in FY2024). RoA is expected to remain above ICRA's negative trigger of 1% in the near-to-medium term provided there are no sudden asset quality shocks.

Improved asset quality and solvency[1] profile – The improvement in KVB's headline asset quality in recent years has been sustained with the GNPA and NNPA at 1.10% and 0.28%, respectively, as on September 30, 2024 (1.40% and 0.40%, respectively, as on March 31, 2024) in contrast to the high levels of 8.68% and 3.92%, respectively on March 31, 2020. This was driven by the moderation in the annualised fresh NPA generation rate to 0.98% in H1 FY2025 (0.89% in FY2024) from the relatively higher levels of 4% in FY2020. Besides this, overall recoveries and upgrades remained healthy during FY2024-H1 FY2025. Further, the bank has increased the provision cover on its past stressed assets and reduced the NNPAs to 0.28% as on September 30, 2024 from 3.92% March 31, 2020. The solvency profile improved to 2.3% as on September 30, 2024 from 3.2% as on March 31, 2024 and the high level of 35.80% as on March 31, 2020. With the internal capital generation rate and capitalisation levels expected to remain healthy, ICRA expects the solvency to remain at a comfortable level in the near term.

Established retail franchise resulting in granular asset and liability base – KVB has an operational track record of more than 108 years and has established a retail franchise in southern India. Its branch network stood at 841 as on September 30, 2024, with more than 80% in the southern states of Tamil Nadu, Andhra Pradesh, Telangana, Kerala and Karnataka. Over the years, the bank has built a granular asset profile with the share of the top 20 exposures at 4.24% of total exposures as on March 31, 2024 (5.09% of as on March 31, 2023) and 42% of the Tier I capital as on March 31, 2024, down from 51% as on March 31, 2023. Further, the deposit base remains granular with limited dependence on wholesale deposits, which is reflected in the high share (~80% of total term deposits) of term deposits of less than Rs. 5 crore, while the top 20 depositors accounted for ~11% of the total deposits as on June 30, 2024. KVB's credit-to-deposit ratio stood at 83% as on September 30, 2024.

KVB's CASA ratio stood at 29.5% as on September 30, 2024, remaining lower than the PVBs' average. However, due to limited dependence on external borrowings, the bank's cost of average interest-bearing funds stood at 5.52% in Q1 FY2025 (5.42% in H1 FY2025, 5.28% in FY2024), lower than the PVBs' average of 5.59% (5.53% in FY2024).

Credit challenges

Asset quality remains monitorable – The bank's overall stressed book, comprising special mention account[2] (SMA-1), SMA-2 and the standard restructured book, declined to Rs. 964 crore (1.2% of standard advances) as on September 30, 2024 from Rs. 1,284 crore (1.9%) as on September 30, 2023. While the stressed book has moderated and remains comparatively lower than the much higher levels in the past, its performance will remain a monitorable in the near term from an asset quality perspective. Moreover, macro-economic factors, geopolitical concerns and the stress in the retail sector could impact the borrowers' cash flows and debt servicing capacity. Against this backdrop, KVB's ability to contain slippages and maintain high recovery rates will remain key for maintaining a healthy asset quality in the near to medium term.

Moderate scale and geographically concentrated operations – KVB had a modest market share of 0.45% in net advances and 0.44% in deposits as on March 31, 2024. Its operations remain geographically concentrated with ~85% of its total branches (841) located in South India and ~54% in Tamil Nadu as on September 30, 2024 (54% as on September 30, 2023). These states also contributed ~79% to the bank's total advances exposure as on March 31, 2024. Moreover, as the liability profile is largely granular in nature, its geographical distribution would also be similar. Such concentration exposes the bank's assets to local socio-economic and political risks. ICRA expects KVB's operations to remain regionally concentrated with the same unlikely to improve in the near to medium term.

[1] Solvency ratio = (Net NPA+ Net non-performing Investments + Net Security Receipts)/Core Equity Tier-I (CET-I) Capital

[2] SMA is defined as a special mention account (SMA), which is an account exhibiting signs of incipient stress, resulting in the borrower defaulting in the timely servicing of their debt obligations though the account has not yet been classified as an NPA as per the extant RBI guidelines; SMA-1 accounts are overdue by 31-60 days while SMA-2 accounts are overdue by 61-90 days. The SMA-level data is for the entire bank, including exposures below Rs. 5crore

Environmental and social risks

While banks like KVB do not face material physical climate risks, they are exposed to environmental risks indirectly through their portfolio of assets. If the entities or businesses, to which banks and financial institutions have an exposure, face business disruptions because of physical climate adversities or if such businesses face climate transition risks because of technological, regulatory or customer behaviour changes, the same could translate into credit risks for banks. However, such risk is not material for KVB as it benefits from adequate portfolio diversification. Further, the lending is typically short to medium term, allowing it to adapt and take incremental exposure to businesses that face relatively fewer downside environmental risks.

With regard to social risks, data security and customer privacy are among the key sources of vulnerability for banks as material lapses could be detrimental to their reputation and invite regulatory censure. KVB has not faced material lapses over the years. Customer preferences are increasingly shifting towards digital banking, which provides an opportunity to reduce the operating costs. KVB has been making the requisite investments to enhance its digital interface with its customers. While it contributes to promoting financial inclusion by lending to the underserved segments, its lending practices remain prudent as reflected in the healthy asset quality numbers in this segment compared with its peers.

Liquidity position: Strong

KVB's liquidity profile remains strong supported by excess statutory liquidity ratio (SLR) holdings of 3.48% of net demand and time liabilities (NDTL) on September 30, 2024. These holding also aid the positive cumulative gaps across all the near-term maturity buckets as per the structural liquidity statement as on September 30, 2024. The bank's LCR declined to 128% in Q2 FY2025 from 185% in Q1 FY2025. This was driven by the recalibration in LCR computation, resulting in higher outflows, following the suggestions made by the regulator.

The net stable funding ratio (NSFR) stood at 144% in Q2 FY2025 (141% in Q4 FY2024), which was well above the regulatory ask of 100%. Access to call money markets and the Reserve Bank of India's (RBI) repo and marginal standing facility (MSF) in case of liquidity related exigencies further strengthen KVB's liquidity profile.

Rating sensitivities

Positive factors – Not applicable as the rating is at the highest level of the short-term scale

Negative factors – ICRA could downgrade the rating on a substantial deterioration in the liability franchise or material weakening in the asset quality, leading to pressure on the profitability with a return on assets of less than 1% for a prolonged period or a decline in the capital cushion below 2% over the regulatory requirements on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Rating Methodology for Banks and Financial Institutions
Parent/Group support	Not Applicable
Consolidation/Standalone	Standalone

About the company

Incorporated in 1916 by the local trader community, The Karur Vysya Bank (KVB) is one of the oldest private sector banks in the country. Based in South India, it was formed to provide financial support to traders and agriculturists in and around Karur, Tamil Nadu. As on September 30, 2024, it had a network of 841 branches with South India constituting more than 80% of the total branches. The bank's net advances stood at Rs. 79,619 crore as on September 30, 2024, spread across the corporate, commercial, retail and agriculture segments.

KVB reported a net profit of Rs. 1,605 crore in FY2024 on an asset base of Rs. 1,05,585 crore compared to Rs. 1,106 crore and Rs. 90,179 crore, respectively, in FY2023. KVB had a market share of 0.45% in total advances and 0.44% in deposits as on March 31, 2024.

Key financial indicators (standalone)

The Karur Vysya Bank	FY2023	FY2024	H1 FY2025
Total operating income^	4,478	5,166	2,944
Profit after tax	1,106	1,605	932
Total assets (Rs. lakh crore) @	0.90	1.06	1.13
Return on average total assets	1.30%	1.64%	1.71%*
CET I	16.79%	15.46%	15.39%
CRAR	18.56%	16.67%	16.28%
Gross NPAs	2.27%	1.40%	1.10%
Net NPAs	0.74%	0.40%	0.28%

Source: Bank, ICRA Research; All ratios as per ICRA's calculations

Amount in Rs. crore unless mentioned otherwise

^Includes net interest income and non-interest income less profit on sale of fixed assets and trading gains, operating income for H1 FY2025 includes trading gain/(loss) if any; @ Total asset base is calculated excluding the revaluation reserves as on the reported date.

**Annualised*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current Rating (FY2025)					Chronology of Rating History for the Past 3 Years					
	Type	Rated Amount (Rs. crore)	Date & Rating in FY2025	FY2025		FY2024		FY2023		FY2022	
			Nov 29, 2024	Date	Rating	Date	Rating	Date	Rating	Date	Rating
Certificates of deposit	Short term	3,000.00	[ICRA]A1+	Jul 17, 2024	[ICRA]A1+	Nov 27, 2023	[ICRA]A1+	Nov 30, 2022	[ICRA]A1+	Jan 3, 2022	[ICRA]A1+
Basel III Tier II bonds	Long term	-	-	Jul 17, 2024	[ICRA]AA- (Stable); withdrawn	Nov 27, 2023	[ICRA]AA- (Stable)	Nov 30, 2022	[ICRA]A+ (Stable)	Jan 3, 2022	[ICRA]A (Positive)

Source: Bank and ICRA Research

Complexity level of the rated instrument

Instrument	Complexity Indicator
Certificates of deposit	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE036D16HR7	Certificates of deposit	Aug 26, 2024	7.42%	Nov 25, 2024	500.00	[ICRA]A1+
INE036D16HS5	Certificates of deposit	Sep 12, 2024	7.50%	Dec 13, 2024	500.00	[ICRA]A1+
INE036D16HS5	Certificates of deposit	Sep 19, 2024	7.50%	Dec 13, 2024	500.00	[ICRA]A1+
INE036D16HT3	Certificates of deposit	Sep 20, 2024	7.50%	Dec 19, 2024	500.00	[ICRA]A1+
INE036D16HU1	Certificates of deposit	Sep 24, 2024	7.50%	Dec 24, 2024	500.00	[ICRA]A1+
INE036D16HV9	Certificates of deposit	Oct 25, 2024	7.41%	Jan 24, 2025	500.00	[ICRA]A1+

Source: Bank, ICRA Research; CDs outstanding as on Nov 21, 2024.

Annexure II: List of entities considered for consolidated analysis

Not applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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