Kotak Mahindra Bank

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Result Update

Strong footing despite growth concerns

- KMB reported a healthy operating performance with NII and core PPoP growing at 17% YoY each. Nil treasury gains impacted overall PPoP. Loan growth declined YoY by 2% (7% QoQ) and has been a key dampener for NIM (down 30 bps QoQ), apart from surplus liquidity.
- Moratorium at 9.7% declined from 26% in April-end, where the bank has extended moratorium 2.0 only to fundamentally viable customers, 80% of which are secured. Total COVID-19 related provisions stood at 0.6% of advances for the bank.
- Despite weak loan growth, continued moderation in CoF supports NII growth. Given the comfort on CoF, growth should not be a challenge for the bank eventually. KMB's conservative stance on lending and strong risk practices should result in relatively lower asset quality risks in our view.
- However, valuations look rich. **We maintain ACCUMULATE rating with an unrevised TP of Rs1,450 based on 3.3x FY22E ABV for the standalone bank and the value of its subsidiaries, implying a FY22E P/ABV of 4.6x.**

Sharp decline in CoF a significant advantage

CoF have declined by 40 bps in Q1FY21 and by 85 bps over the last two quarters and is now amongst the lowest in industry. KMB reduced its SA deposit rates by 50-200 bps for ticket size upto Rs10mn in early 1QFY21. It nonetheless continued to see good accretion in SA balances, with CASA growth at 26% YoY and CASA ratio at 56.7%. Lower CoF provides significant competitive advantage in lowering its asset side risks and tapping emerging growth opportunities.

Asset risks likely to be lower relative to peers

The bank's decision of extending moratorium 2.0 to only viable borrowers resulted in uptick in GNPAs during the quarter (up 45 bps 2.7%) from previously overdue accounts. Lower utilization of limits by borrowers in the SME/hotel segment and lower than average moratorium levels in the RE book indicate that the bank is better placed on asset side risks. We factor in slippages and credit costs of 3% and 160 bps (190 bps excluding the drawdown of previous year's COVID provisions) respectively for FY21E.

Q1FY21 Result (Rs Mn)

Particulars	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Net interest income	37,239	31,730	17.4	35,597	4.6
Other income	7,735	13,047	(40.7)	14,894	(48.1)
Total Net Income	44,974	44,778	0.4	50,490	(10.9)
Operating expenses	18,737	20,789	(9.9)	23,238	(19.4)
Pre-provision profits	26,237	23,989	9.4	27,253	(3.7)
Provisions	9,620	3,168	203.7	10,475	(8.2)
Tax expense	4,173	7,220	(42.2)	4,112	1.5
Reported Net Profit	12,445	13,602	(8.5)	12,666	(1.7)
			(bps)		(bps)
Advances Growth (%)	(1.9)	17.6	(1,952)	6.8	(877)
NIM (%)	4.4	4.5	(9)	4.7	(32)
RoA (%)	1.3	1.7	(39)	1.5	(16)
RoE (%)	9.4	12.6	(318)	11.1	(171)
Gross NPA (%)	2.7	2.2	51	2.3	45

CMP	Rs 1,323
Target / Upside	Rs 1,450 / 10%
BSE Sensex	37,920
NSE Nifty	11,132

Scrip Details

Equity / FV	Rs 9,565mn / Rs 5
Market Cap	Rs 2,530bn
	US$ 34bn
52-week High/Low	Rs 1,740/Rs 1,001
Avg. Volume (no)	6,004,520
NSE Symbol	KOTAKBANK
Bloomberg Code	KMB IN

Shareholding Pattern Jun'20(%)

Promoters	26.1
MF/Banks/FIs	14.9
FIIs	42.2
Public / Others	16.9

Valuation (x)

	FY20A	FY21E	FY22E
P/E	39.0	45.8	35.6
P/ABV	5.7	4.6	4.1
ROAA	1.9	1.5	1.9
ROAE	14.1	10.3	11.2

Estimates (Rs mn)

	FY20A	FY21E	FY22E
NII	140,408	155,601	167,302
PPOP	105,620	113,859	123,166
PAT	64,883	57,163	73,549
Adj BV	231.8	284.9	321.9

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Other Important Highlights:

- Slippages include one large account above 100 cr, in early 3 digits.
- ~95% of loans under moratorium 2.0 are from moratorium 1.0.
- Incrementally growth could come from the mortgage business, especially from secured home loans and MSME guarantee scheme where the bank disbursed Rs35 bn in July.
- The bank's unrealized MTM gains stood at ~Rs 30bn during the quarter. MTM gains have grown by ~Rs 10bn over Mar-20
- Core fee income declined by 33% YoY – however, the distribution business has done well YoY. Banking related fees (processing fees, LC/BG fees, transaction banking fees etc.) were down by ~40% yoy
- Insurance and broking subsidiaries delivered a good set of numbers while loan growth trends for lending subsidiaries remained weak. AMC business saw market share gains in both equity and overall AUM, though profitability was impacted by weaker capital markets.

Risks to our View: Higher than expected impact of COVID-19 on asset quality and growth, fee and recoveries, higher-than-expected slippages from corporate/SME portfolio.

Exhibit 1: Actual v/s estimates

(₹ mn)	Actual	Estimated	% Variance	Comments
NII	37,239	34,800	7.0	Sharp decline in CoF aided NII
Operating Profit	26,237	26,699	(1.7)	
PAT	12,445	12,516	(0.6)	

Source: Company, DART

Exhibit 2: Change in estimates

	Previous		Revised		Change %	
Particulars	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Net Operating Revenue	2,08,529	2,23,454	2,07,351	2,24,649	(0.6)	0.5
Pre Provision Profits	1,12,551	1,19,261	1,13,859	1,23,166	1.2	3.3
PAT	55,985	70,879	57,163	73,549	2.1	3.8

Source: Company, DART

Exhibit 3: SOTP Valuation

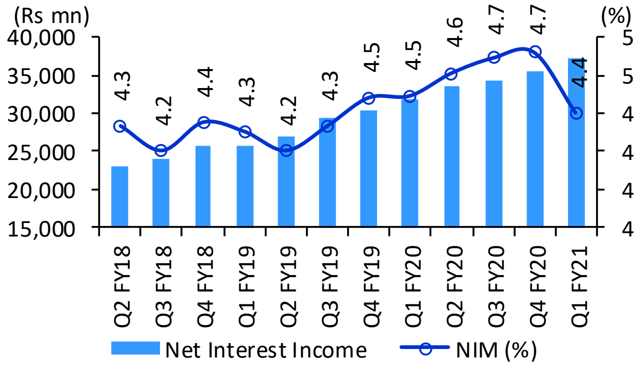
Entity	Stake	Per Share Value	Methodology
Standalone Bank (A)	**100%**	**1,075**	**3.3x FY22E ABV**
Kotak Mahindra Prime	100%	71	2x Net Worth
Kotak Mahindra Life Insurance	100%	212	3.5x EV
Kotak Securities	100%	66	18x P/E
Kotak Mahindra Capital	100%	10	21x P/E
Asset Management Business	100%	75	8x AUM
Kotak Mahindra Investments	100%	11	1x Net Worth
Value of Subsidiaries (B)		**446**	
Holdco. Discount	**15%**		
Value of the bank (A+B)		**1,450**	
Contribution of subs to total (%)		26	

Source: Company, DART

Quarterly Financials

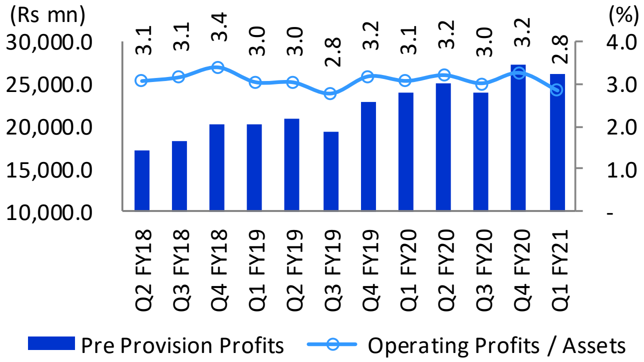
Profit and Loss (Rs mn)	Q1FY21	Q1FY20	% yoy / bps	Q4FY20	% qoq / bps
Interest Income	**69,119**	**66,399**	**4.1**	**68,047**	**1.6**
Interest Expenses	**31,880**	**34,668**	**(8.0)**	**32,450**	**(1.8)**
Net Interest Income	**37,239**	**31,730**	**17.4**	**35,597**	**4.6**
NII to Net Operative Income	82.8	70.9	1,194	70.5	1,230
NIM (%)	4.40	4.49	(9)	4.7	(32)
Commission, exchange and brokerage	7,760	11,500	(32.5)	12,700	(38.9)
Profit on Sale / Rev of Investments	(20)	1,550	(101.3)	2,190	(100.9)
Other Income - Total	**7,735**	**13,047**	**(40.7)**	**14,894**	**(48.1)**
Other Inc to Net Oper. Income (%)	17.2	29.1	(1,194)	29.5	(1,230)
Net Operating Revenue	**44,974**	**44,778**	**0.4**	**50,490**	**(10.9)**
Employee Expenses	9,109	9,015	1.0	9,696	(6.1)
Empl. Cost/Oper. Exps. (%)	20.3	20.1	12	19.2	105
Other Opex	9,628	11,773	(18.2)	13,542	(28.9)
Other Opex/ Assets (%)	0.3	0.4	(11)	0.4	(14)
Total Opex	**18,737**	**20,789**	**(9.9)**	**23,238**	**(19.4)**
Cost to Income Ratio (%)	41.7	46.4	(476)	46.0	(436)
Pre-Provision Profits	**26,237**	**23,989**	**9.4**	**27,253**	**(3.7)**
Provisions & Contingencies - Total	**9,620**	**3,168**	**203.7**	**10,475**	**(8.2)**
NPA Provisions as % PPP	36.7	13.2	2,346	38.4	(177)
Profit Before Tax	**16,617**	**20,822**	**(20.2)**	**16,778**	**(1.0)**
Current period tax	4,088	7,220	(43.4)	4,112	(0.6)
Tax	**4,173**	**7,220**	**(42.2)**	**4,112**	**1.5**
Effective Tax Rate (%)	25.1	34.7	(956)	24.5	60.1
Reported Profits	**12,445**	**13,602**	**(8.5)**	**12,666**	**(1.7)**
RoA (%)	1.4	1.8	(40)	1.9	(51.0)
Basic EPS (Rs)	6.4	7.1	(9.8)	6.4	0.9

Exhibit 4: NIM impacted by lower CD ratio and surplus liquidity



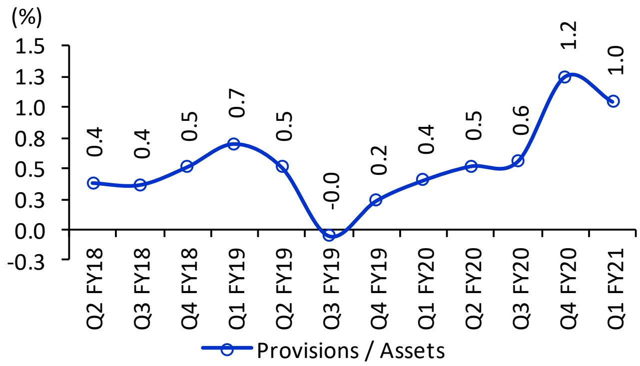
Source: Company, DART

Exhibit 5: PPoP impacted by weak fee



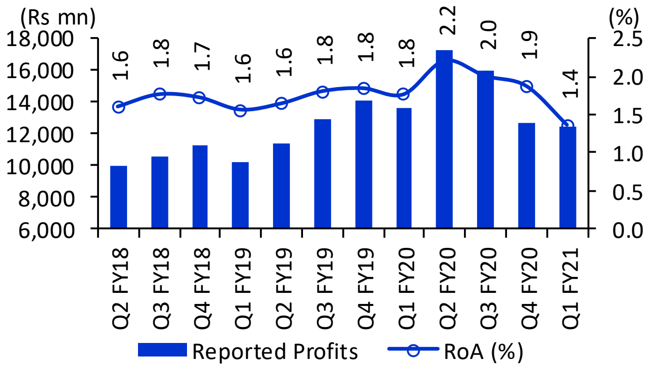
Source: Company, DART

Exhibit 6: Provisions were elevated



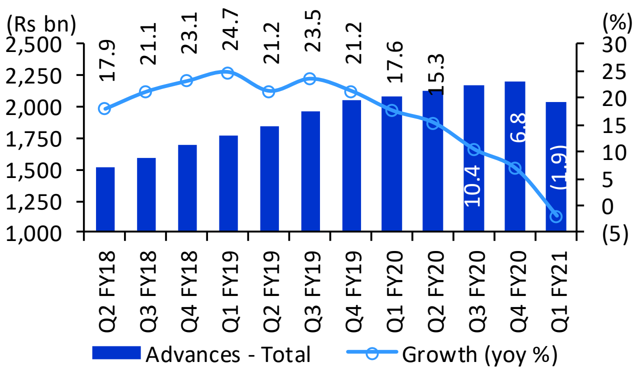
Source: Company, DART

Exhibit 7: High COVID provisions and decline in fee impact profitability



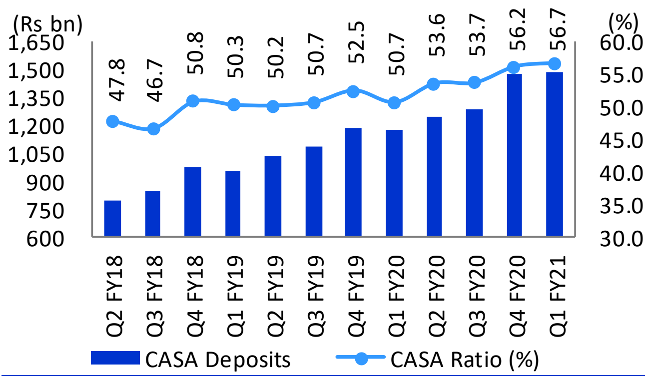
Source: Company, DART

Exhibit 8: Decline in loan growth a key concern



Source: Company, DART

Exhibit 9: CASA trends continue to remain healthy



Source: Company, DART

Balance Sheet Analysis	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	QoQ % / bps	YoY % / bps
Net Worth	442,900	459,119	476,060	490,153	5,77,090	17.7	30.3
Tier 1 (%)	17.3	17.6	17.1	17.3	20.6	330	330
Total CAR (%)	17.8	18.2	18.2	17.9	21.2	333	343
Advances - Total	2,080,300	2,132,994	2,167,740	2,197,482	20,39,980	(7.2)	(1.9)
Investments	772,590	743,306	766,010	750,515	10,26,930	36.8	32.9
Total Assets	3,151,090	3,168,897	3,234,810	3,602,517	37,82,790	5.0	20.0
RoA (%)	1.76	2.20	2.00	1.87	1.36	(51)	(40)
Deposits	2,329,310	2,330,715	2,393,540	2,628,205	26,15,240	(0.5)	12.3
CASA Deposits	1,181,230	1,249,120	1,285,170	1,476,220	14,83,480	0.5	25.6
CASA Ratio (%)	50.7	53.6	53.7	56.2	56.7	53	600
Term Deposits	1,148,080	1,081,595	1,108,370	1,151,985	11,31,760	(1.8)	(1.4)

Source: Company, DART

Asset Quality (Rs mn)	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	QoQ % / bps	YoY % / bps
Gross Advances	21,06,630	21,69,634	22,00,488	22,34,173	20,81,233	(6.8)	(1.2)
Gross NPA	46,135	50,336	54,132	50,269	56,193	11.8	21.8
Gross NPA Ratio (%)	2.19	2.32	2.46	2.25	2.70	45	51
PCR - Calculated (%)	67.0	64.0	64.4	69.0	68.4	(63)	142
Net Advances	20,88,192	21,31,059	21,63,011	21,94,211	20,42,644	(6.9)	(2.2)
Net NPA	15,244	18,114	19,251	15,579	17,771	14.1	16.6
Net NPAs Ratio (%)	0.73	0.85	0.89	0.71	0.87	16	14

Loan Book Analysis* (Rs mn)	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	QoQ % / bps	YoY % / bps
CV/CE	1,99,100	1,96,880	1,89,930	1,92,530	*184,420*	*(4.2)*	*(7.4)*
Agriculture Division	2,59,860	2,70,680	2,77,360	2,87,570	*270,510*	*(5.9)*	*4.1*
Auto loans	1,95,740	1,90,550	1,80,080	1,74,850	*161,430*	*(7.7)*	*(17.5)*
Home Loans and LAP	4,22,430	4,43,710	4,60,310	4,68,810	*471,680*	*0.6*	*11.7*
Small Business, PL& Credit Cards	3,37,190	3,48,520	3,56,360	3,42,940	*316,710*	*(7.6)*	*(6.1)*
Others	1,14,660	1,05,930	99,930	90,220	*101,900*	*12.9*	*(11.1)*
Corporate, SME, and Others	9,20,920	9,31,130	9,37,750	9,41,870	*848,004*	*(10.0)*	*(7.9)*
Total Advances	**24,49,900**	**24,87,400**	**25,01,720**	**24,98,790**	***2,354,654***	*(5.8)*	*(3.9)*

*Source: Company, DART; *Consolidated*

Conference Call Highlights

- The bank is deeply committed to fundamental philosophy of maintaining balance sheet strength vs P&L growth. Management remains focused on balancing growth and asset quality and had taken a cautious stance on unsecured retail loans pre-COVID as well
- Average LCR of 150% on a daily average basis
- Core fee income comprising fees saw a 1/3rd dip over last year – however, the distribution business has done well over the last year. Banking related fees (processing fees, LC/BG fees, transaction banking fees etc.) were down by ~40% yoy
- The bank's unrealized MTM gains stood at ~Rs 30bn during the quarter. MTM gains have grown by ~Rs 10bn over Mar-20
- Employee costs were lower due to pay cuts in effect. Other opex trended down as focus on cost controls and efficiencies increased.

Moratorium and Asset Quality:

- Used a surgical criterion for moratorium 2.0 by assessing the fundamental viability and repayment ability of the borrower. Where the customer is deemed unviable, the bank has recognised the account earlier which resulted in a spike in NPAs
- Moratorium 2.0 given largely to those where an underlying security is available. 80% of the book is secured by some underlying security. 95% of moratorium 2.0 customers are from the moratorium 1.0 bucket
- Repayment levels in June were significantly better than April and May levels
- Slippages of 796crs, comprise of one large account (~100crs), a large part of residual slippages are from overdue loans that availed moratorium 1.0
- The bank made additional COVID related provisions of Rs 615crs. Overall COVID related provisions now stand at Rs 12.66bn (0.62% of advances). Total provisions stand at 107% of total GNPAs

Liabilities profile:

- The bank has ramped up services from branches as well as from those working from home.
- Strong growth in deposits continues, driven by acquisitions and growth of customer base. SA growth was spread across all retail customers and remains granular. Launch of Video KYC process also helped gain new customers.
- While branch-based transactions volumes rose in July, the bank has significantly ramped up its digital agenda and has enabled a host of new services via online/digital channels.
- ~8% of new FDs came through digital channels
- The bank is relentlessly focused on maintaining a competitive position on cost of funds despite higher rates being offered vs peer banks through lower dependence on TD/sweeps.

Advances Profile

- **Mortgages –**
    - The bank will focus incrementally on the mortgage business, especially on secured home loans and will remain selective on LAP

- Traction from non-metros was better vis-à-vis metros. There is a lot of interest from customers who want to switch to Kotak

- **MSME –**
  - The bank is exercising prudence with respect to disbursals. Portfolio behaviour remains stable post cleaning up of the book.
  - Working capital utilization remains lower signifying lower levels of economic activity
  - Incremental disbursals are being made to segments where liquidity is required. However, not a lot of customers have opted for additional disbursements.
  - Focus on fee income from MSMEs.
  - Collections were impacted during the quarter, however, improved in June and July.
  - Key leadership and other personnel have been moved to collections to enhance efficiency.
  - The bank started digital acquisitions in April and May, and remains positive on the medium-term horizon
  - Share of loans under the ECGL scheme at 5% of the book is disproportionate to the market share (at ~2%). Not many customers have been availing loans under the scheme.
- **Unsecured loans –**
  - The bank had turned cautious on unsecured retail loans pre-COVID itself. Management believes unsecured loans will gain traction again at a later stage
  - The bank launched 811 credit card which are primarily focused on students and small businesses. The bank is using risk analytics to enhance customer experience in this portfolio.
- **CV/CE –**
  - Steep fall in new CV sales have impacted disbursals. Viability of operators have been impacted as well. Currently witnessing 75-80% of vehicle movement levels.
  - Collection efficiency in June and July were better, although operators continue to face pain.
  - CE is faring slightly better. Mining and construction seem to be getting back on track but not near pre covid levels
- **Agri and rural –**
  - While utilization levels in the portfolio were low, good harvest has helped maintain collection efficiency
  - MFI exposure is primarily to agriculture and allied activities. Localized lockdowns have impacted collections to some extent.
- **Tractors –**
  - Disbursals have been higher in July vs June, with digital processes helping the bank continue the business normally.
  - Management expects the market to improve and will keep focusing on growing the business
- **Corporate –**
  - The bank remains cautious on the segment.

- Companies have been categorised as high, medium, and low risk based on opex and leverage levels.
- The bank will be able to quickly scale up exposures once greater clarity on economy emerges
- Also looking at wallet/non-risk/transaction-based share of such businesses.
- Focus on high end of NBFC segment, while HFC exposure is to higher rated entities

- **RE portfolio –**
  - Moratorium levels in low single digits in the RE business.
  - Been cautious on the sector even pre-COVID and have shifted exposures to higher rated entities

Other highlights

- Management believes that BFSI will go through a capital squeeze and will not engage in undertaking unnecessary risk on capital
- Incremental focus on improving distribution fee-based income (MF, securities, insurance)
- The bank's portfolio is well guarded against risks that will arise if an industry wide restructuring is implemented. A rise in provisions should be expected if such an exercise takes place.
- Significant activity witnessed in the special situations fund (17.5% share).

Subsidiary Performance:

Kotak Prime:

- Disbursals were affected due to almost nil car sales in 2020.
- Disbursals resumed in June but with extreme caution
- Fee income has declined while collections continue to be challenged
- The company has made Rs 38crs COVID related provisions (Rs 50crs in last quarter)

Kotak Life/General:

- Higher digital transactions helped to grow vs industry while renewals were affected due to the lockdowns and extension of grace period
- Persistency continues to be high
- Group life business also affected during the period.
- Share of Individual protection in APE has grown to 9.3%
- Kotak Securities
- Contactless account opening via app was introduced during the quarter
- 97% of accounts opened in Q1 were via digital channels

Kotak AMC:

- 85% transactions via digital mode vs 70% in last quarter. Improved connect with customers via digital means
- Drop in QAAUM due to market conditions
- Focus remains on SIPs with ~5.93% market share
- Offshore AUM increased to Rs 2.3bn due to flows and MTM changes

Profit and Loss Account (Rs Mn)

Particulars	FY19A	FY20A	FY21E	FY22E
Interest Income	239,432	269,296	291,382	310,583
Interest expenses	126,842	128,888	135,781	143,281
Net interest income	**112,590**	**140,408**	**155,601**	**167,302**
Other incomes	46,040	53,721	51,750	57,347
Total expenses	75,148	88,509	93,491	101,483
- Employee cost	31,594	38,776	42,266	45,647
- Other	43,554	49,733	51,225	55,835
Pre provisioning profit	**83,482**	**105,620**	**113,859**	**123,166**
Provisions	9,624	22,162	37,469	24,877
Profit before taxes	73,858	83,458	76,390	98,289
Tax provision	25,205	18,575	19,227	24,739
Profit after tax	48,653	64,883	57,163	73,549
Adjusted profit	**48,653**	**64,883**	**57,163**	**73,549**

Balance Sheet (Rs Mn)

Particulars	FY19A	FY20A	FY21E	FY22E
Sources of Funds				
Equity Capital	9,544	9,565	9,890	9,890
Reserves & Surplus	414,461	475,617	606,554	680,104
Minority Interest	0	0	0	0
Net worth	424,005	485,182	616,445	689,994
Borrowings	322,483	379,933	381,436	370,059
- Deposits	2,258,804	2,628,205	2,797,200	2,994,110
- Other interest bearing liabilities	0	0	0	0
Current liabilities & provisions	111,430	104,197	6,195	(34,463)
Total Liabilities	**3,116,721**	**3,597,517**	**3,801,275**	**4,019,700**
Application of Funds				
Cash and balances with RBI	246,756	532,923	561,230	415,804
Investments	711,891	750,515	876,512	954,632
Advances	2,056,948	2,197,482	2,241,432	2,510,403
Fixed assets	16,516	16,231	16,468	16,632
Other current assets, loans and advances	89,611	105,365	110,633	127,228
Total Assets	**3,121,722**	**3,602,517**	**3,806,275**	**4,024,700**

E – Estimates

Important Ratios

Particulars	FY19A	FY20A	FY21E	FY22E
(A) Margins (%)				
Yield on advances	9.8	9.9	9.8	9.7
Yields on interest earning assets	8.6	8.3	8.1	8.2
Yield on investments	7.2	7.2	7.2	7.2
Costs of funds	5.3	4.6	4.4	4.4
Cost of deposits	5.3	4.9	4.2	4.1
NIMs	4.1	4.3	4.3	4.4
(B) Asset quality and capital ratios (%)				
GNPA	2.2	2.3	3.8	3.5
NNPA	0.8	0.7	1.2	1.1
PCR	65.4	69.0	69.0	69.0
Slippages	1.2	1.7	3.0	2.0
NNPA to NW	3.6	3.2	4.3	3.9
CASA	52.5	56.2	55.0	55.0
CAR	16.6	16.9	20.1	19.1
Tier 1	16.0	16.4	19.6	18.6
Credit - Deposit	91.1	83.6	80.1	83.8
(C) Dupont as a percentage of average assets				
Interest income	8.3	8.0	7.9	7.9
Interest expenses	4.4	3.8	3.7	3.7
Net interest income	3.9	4.2	4.2	4.3
Non interest Income	1.6	1.6	1.4	1.5
Total expenses	2.6	2.6	2.5	2.6
- cost to income	47.4	45.6	45.1	45.2
Provisions	0.3	0.7	1.0	0.6
Tax	0.9	0.6	0.5	0.6
RoA	1.7	1.9	1.5	1.9
Leverage	7.3	7.3	6.1	5.8
RoE	12.1	14.1	10.3	11.2
RoRwa	1.6	2.0	1.7	1.9
(D) Measures of Investments				
EPS - adjusted	25.5	33.9	28.9	37.2
BV	208.9	239.9	298.4	335.6
ABV	200.8	231.8	284.9	321.9
(E) Growth Ratios (%)				
Net interest income	18.1	24.7	10.8	7.5
PPoP	16.6	26.5	7.8	8.2
Adj PAT	19.1	33.4	(11.9)	28.7
Advances	21.2	6.8	2.0	12.0
Total borrowings	28.2	17.8	0.4	(3.0)
Total assets	17.8	15.4	5.7	5.7
(F) Valuation Ratios				
Market Cap (Rs. mn)	2,530,187	2,530,187	2,530,187	2,530,187
CMP (Rs.)	1323	1323	1323	1323
P/E (x)	51.9	39.0	45.8	35.6
P/BV (x)	6.3	5.5	4.4	3.9
P/ABV (x)	6.6	5.7	4.6	4.1

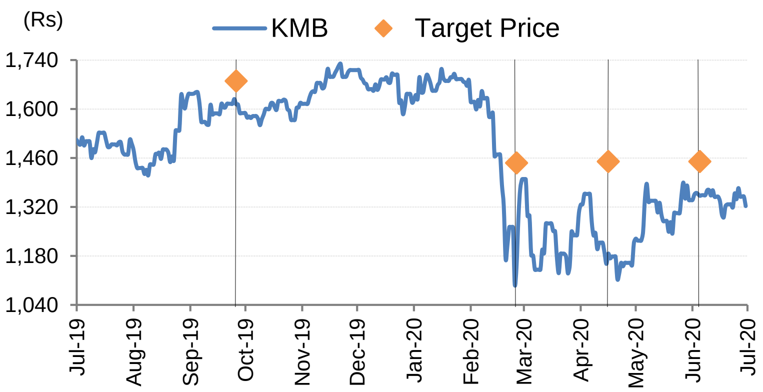
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	**> 20%**
Accumulate	**10 to 20%**
Reduce	**0 to 10%**
Sell	**< 0%**

Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
Oct-19	Accumulate	1,680	1,614
Mar-20	Buy	1,446	1,153
May-20	Buy	1,450	1,187
Jul-20	Accumulate	1,450	1,352

*Price as on recommendation date

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