Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Kotak Mahindra Bank

Growth gears shifting slowly

Banks & Finance	Sharekhan code: KOTAKBANK	Result Update

Summary

- Kotak Mahindra Bank (KMB) Q2FY21 numbers were strong with operational numbers beating expectations, stable asset quality (on a proforma basis) which were positives.
- Even on a proforma basis, GNPA would have been 2.70% and NNPA would have been at 0.74%; stable from Q1 levels), indicating better outlook
- Management indicated a shift of gears, to have higher focus on advances growth; with improving outlook (collection efficiency (for September at ~95%) is positive.
- We value standalone bank at ~3.9x its FY2023E book value and its subsidiaries at ~Rs. 360 per share. We recommend a Buy on KMB with an SOTP based price target (PT) of Rs 1730.

Kotak Mahindra Bank (KMB) reported strong results for Q2FY21 with operational numbers beating expectations and sequentially stable asset quality (on a proforma basis), which were positives. Net Interest Income (NII) came in at Rs. 3,913.2 crore, down 14.3% y-o-y but up 5.1% q-o-q basis, and was above expectations. Pre-provision operating profits (PPOP) stood at Rs 3,297.5 crore, up by 31.4% y-o-y and 25.7% on q-o-q basis, helped by cost control and higher other income. The bank has not recognised any NPAs since August 31, 2020 (in line with the court orders). In the absence of the said order (or on a proforma basis), GNPA would have been 2.70% and NNPA 0.74%, stable as compared to Q1 levels, indicating better asset quality. KMB has already made full provisions for such advances and the non-specific provisions towards advances (including standard and COVID-19 provisions) is at 177% of the NNPA of the Bank. Notably, the bank management is known for its prudent and proactive stance on asset quality and provisions. Hence, a reduced Provisions, and a proforma stable asset quality indicates improved outlook. The liability focus has been yielding strong results, and CASA ratio stood at 57.1% as compared to 53.6% as on September 30, 2019. Notably, the bank's management indicated a shift of gears and expects incrementally higher focus on growth in advances. We believe the outlook for the bank has improved, with collections efficiency (for September) at ~95% of the overall bank levels. With unsecured and vulnerable segment of loans at ~6% of total advances, along with provision buffers, we believe the asset quality is at well-managed levels. A pick-up in advances growth (given the prudent management), we believe will be positive. We have fine-tuned our FY21E & FY22E estimates and introduce FY2023E earnings estimate with this note. We recommend a Buy on the stock with our SOTP-based price target (PT) of Rs. 1,730.

Key Positives

- Within other income, fee income grew to Rs. 1,058 crore, up by 36.3% q-o-q, backed by smart traction in general banking fees.
- Reported GNPA at 2.55% & NNPA at 0.64% declined on a q-o-q basis; even on proforma basis GNPA / NNPA would have been 2.70% / 0.74%, sequentially stable
- During Q2FY20, the bank's CASA ratio improved by 350 bps to 57.1% taking it to the best ever CASA ratio yet again.

Key Negatives

- A cautious stance resulted in advances book at Rs. 204844, posting a decline of 4% y-o-y and flat q-o-q.

Our Call

We value KMB on a standalone basis at ~3.9x its FY2023E book value and its subsidiaries at ~Rs. 360 per share. The stock has seen corrections by ~19% from its highs and we believe the risk-reward is favourable, indicating an attractive entry point for long-term investment. The bank's strong operating metrics, prudent and agile leadership team, well capitalized balance sheet, as well as the quality of its subsidiaries (formidable players in own segments) provide long-term value to the franchises. With the recent QIP and capital issue, the bank is placed comfortably with a Tier-1 capital of 22.8% (standalone) with the wherewithal for probable inorganic opportunities. We recommend a Buy on the stock with our SOTP based price target (PT) of Rs. 1,730.

Key Risks

A prolonged lockdown and consequent rise in NPAs can pose risks to profitability.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
NII	11,259	13,500	13,966	15,008	16,511
PPoP	8,348	10,021	10,335	11,369	12,792
PAT	4,865	5,947	6,064	7,388	8,133
EPS (Rs)	25.5	30.9	31.8	38.8	42.7
BVPS (Rs)	224.7	256.2	327.2	364.4	405.4
PE (x)	55.6	45.9	44.5	36.5	33.2
PBV (x)	6.3	5.5	4.3	3.9	3.5
RoE (%)	11.3	12.1	9.7	10.6	10.5
RoA (%)	1.6	1.7	1.4	1.5	1.5

Source: Company; Sharekhan estimates

Note: We now convert Kotak Mahindra Bank into a stock update; It was earlier a 'Viewpoint' under our coverage

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

Reco/View

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,416**	
Price Target: **Rs. 1,730**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

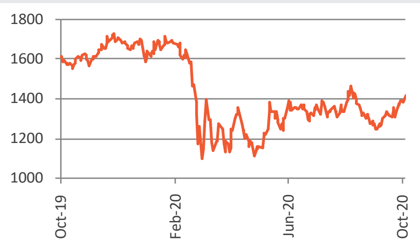
Company details

Market cap:	Rs. 271,098 cr
52-week high/low:	Rs. 1,740/1,000
NSE volume: (No of shares)	50.4 lakh
BSE code:	500247
NSE code:	KOTAKBANK
Free float: (No of shares)	134.1 cr

Shareholding (%)

Promoters	26.1
FII	46.0
DII	15.3
Others	12.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	10.7	2.4	8.6	-11.1
Relative to Sensex	5.0	-1.9	-17.9	-13.4

Sharekhan Research, Bloomberg

Key Concall highlights

- **Business update:** While parts of the world are seeing a second wave, but India is at better place. India is showing resilience, but risk during festive times remains. Financial institutions have shown resilience helped by regulator measures.
- **Liquidity:** Excess liquidity has helped and helped stabilise the financial situation.
- Financial institutions: Management indicated that the bank is a strong financial institution, which has earnings and sustainability of earnings growth, The right mix of credit risk which has to make sense for clients, having a strong balance sheet both in terms of quality and provisions, and a Business model which has sustainability.
- **Well-provided:** The KMB is well-provided for and its assets quality well managed.
- **Shift in Gears:** Made a strategic drive in 2011 to build a strong and sustainable Liability franchise, today has resulted in 57% CASA along with 8% of retail low cost term deposits which together forms ~65% of total deposits. The bank believes it is time for different approach and will start looking at asset side of additional customer franchise.
- **Growth avenues:** Seeing strong traction in financial services businesses, life insurance and asset management business, etc. Believe now Kotak Mahindra Bank is future-ready.
- **Recovery:** Non-urban centers showing strong signs of recovery.
- **Digitalisation:** the bank has enabled digital loan sanctions and collections as well. Digital onboarding of customers through Genie, continues to remain high at 98%. Empowered advisors using "Boost", an app for superior engagement and improving productivity. Average ticket size on both UPI and other channels have increased.
- **Branch:** Branch operations now at 90% and the bank saw growth in all customer TD markets.
- **SME- Working Capital:** Helped by GoI schemes. The bank looks to build on the opportunity.
- **Unsecured retail loans:** KMB have now started to enhance the book, but will continue to move with focus on quality. Launch of two new credit cards will help in customer acquisition. Secured bounce rates are now at pre-COVID levels. Collection teams and sales team are back on the field.
- **Commercial vehicle and Construction Equipment:** Seeing improving trend in month on month basis. KMB expects the agri-book post-harvest to improve further. Collections in September have been better than August. Demand for construction equipment in improving, is closer to normal.
- **Microfinance:** September collections better than earlier months, some segments have also begun disbursements. Given a good rural economy, tractor sales expected to pick up.
- **Wholesale Bank:** The bank had been alert on the corporate loan segment and avoided large ticket size exposures. It maintained profitability and on the customer side focused on minimising impact. On the debt capital market segment is seeing improved traction. Credit substitutes and corporate banking book has seen lower growth. At these times, we believe credit substitutes are safer. Also, the syndication business has been improving. Focus on high profitability and predictability of earnings.
- **SME:** In March, the bank was concerned about the SME book. However, during the year, helped by government steps like ECLGS and moratorium etc, the asset quality has been under control. The delinquency has improved (become lower) on a y-o-y basis.
- **Consumer behaviour post lower deposit rates:** At granular levels, the deposits from retail customers is steady; the bank has reduced rates over last few quarters but this segment has been stable and growing. However, some large-ticket deposits did dwindle.
- **Rates and cross selling:** The bank's liability engine was driving growth till now. From here, KMB is looking to kickstart asset engine. It is open to growth, but the approach is to take the right direction for growth, and is getting signs of an opportunity. Post COVID-19, scenario is now looking improved.

- **Proforma GNPAs:** Mortarium 1 & 2, Court stay on NPA and restructuring are lots of factors affecting clarity. However, the management is of the view that adequate and comfortable provisions on a stock basis and many areas (MSME helped by ECLGS scheme) have done well. Enabled banks to lend, but also helped the original exposure of banks and therefore the quality of existing MSME book.
- **Unsecured urban consumers segment:** They are the worst-impacted. Employees with lower salaries are more vulnerable than employees of higher salaries. Already have reduced risky unsecured loans.
- **Provision:** Presently carrying 110 bps of extra provisions (including the COVID-19 provision is 60 bps) is there should be sufficient. Normal provision is 35-40 bps per quarter.
- **Collections efficiency:** Many segments are still below normal, of which unsecured loans is one. However, it is improving but it is still early days. Commercial vehicle and Construction equipment (CEQ) loan collections in September are closer to pre-COVID levels. CEQ collections is now almost near normal, tractor side and rural is near to normal. Unsecured retail not yet Collection efficiency near the Pre-COVID levels. For the whole bank the collection efficiency is closer at around ~95%.
- **Strong ECLGS conversion at 65%:** ECLGS is ~5% of the system, much higher than the Advances market share. Rolled out initiatives across commercial, wholesale and retail to get through that is why the market share in ECLGS scheme was higher.
- **Commercial Real Estate:** The bank's non-fund exposure to commercial Real estate isn't very high; restructuring exposure is early days and the bank has some months to go for final cut-off. the bank doesn't plan to do pari-passu loans etc, and most are project-specific loans.
- **SMA 2 exposures:** SMA 2 is Rs 133 crores (0.06%), which will not include the loans that have slipped post September but not recognised.

Results (Standalone) **Rs cr**

Particulars	Q2FY21	Q2FY20	y-o-y %	Q1FY20	q-o-q %
Interest Earned	6836.1	6761.6	1.1	6911.9	-1.1
Interest Expense	2922.8	3412.0	-14.3	3188.0	-8.3
Net Interest income	3913.2	3349.6	16.8	3723.9	5.1
Other Income	1452.0	1224.4	18.6	773.5	87.7
Net Operating Income	5365.2	4574.0	17.3	4497.4	19.3
Operating Expenses	2067.8	2065.4	0.1	1873.7	10.4
Operating Profit	3297.5	2508.6	31.4	2623.7	25.7
Prov for Contingencies	368.6	407.9	-9.6	962.0	-61.7
PBT	2928.9	2100.6	39.4	1661.7	76.3
TAX	744.4	376.2	97.9	417.3	78.4
PAT	2184.5	1724.5	26.7	1244.5	75.5

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Credit growth yet to pick up, private banks placed better

Even though at the system level bank's credit offtake is still tepid, with a credit growth of 5.26% in the fortnight ended September 11, indicating a continued scenario of weak credit offtake. However, while deposits rose by 11.98 % (best since March 31, 2017) to Rs 142.48 trillion that indicates healthy deposit growth traction, helped by the accommodative stance of the RBI resulting in surplus liquidity, which provides succour in terms of lower cost of funds for banks and financials. The end of the loan moratorium is a relief, and going forward, collection efficiency is likely to be a function of book quality, client profile as well as economic pick-up. At present, we believe that the banking sector is likely to see increased risk-off behaviour, with tactical market share gains for well-placed players. We believe that private banks, with improved capitalisation and strong asset quality (with high coverage, provisions buffers) are structurally better placed to take-off once the situation normalises.

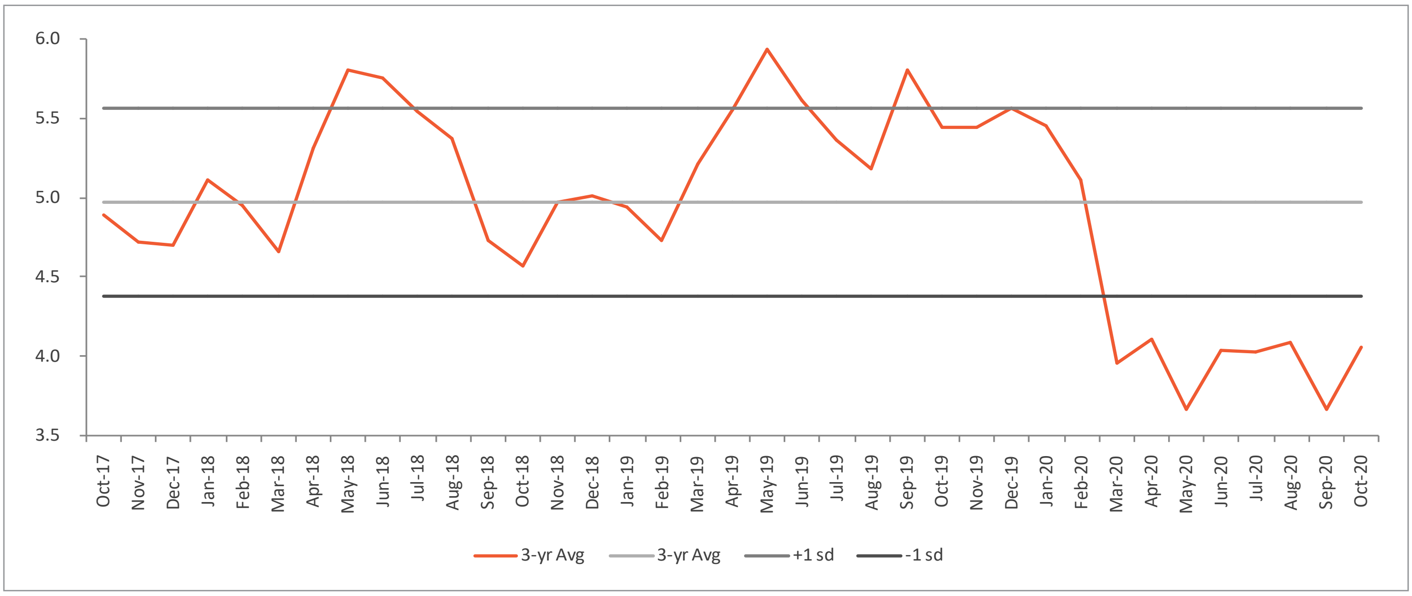
■ Company outlook - Promising outlook

We believe that with KMB's strong retail positioning, with mass-affluent customer base, the bank is likely to see lesser asset quality issues from the retail segment, which is more dominated by home loans and the loan against property (LAP) segments, while personal loans, consumer durables, etc, comprise 4% and credit cards only 2% and are less of a concern due to smaller size. Kotak Mahindra Bank has a diversified and integrated financial services offering: KMB has a wide spectrum of financial products and services that would help it balance against market cycles, hedge against downturns in specific segments and access multiple growth avenues. The broad product spectrum helps meet customers' diverse financial and investment requirements, enhancing overall customer experience.

■ Valuation

We value KMB on a standalone basis at ~3.9x its FY2023E book value and its subsidiaries at ~Rs. 360 per share. The stock has seen corrections by ~19% from its highs and we believe the risk-reward is favourable, indicating an attractive entry point for long-term investment. The bank's strong operating metrics, prudent and agile leadership team, well capitalized balance sheet, as well as the quality of its subsidiaries (formidable players in own segments) provide long-term value to the franchises. With the recent QIP and capital issue, the bank is placed more comfortably with a Tier-1 capital of 22.8% (standalone) and adequate liquidity makes it well-placed to ride over medium-term challenges, but also offer the bank a wherewithal for probable inorganic opportunities. We recommend a Buy on the stock with our SOTP based price target (PT) of Rs. 1,730.

One-year forward P/BV (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs)	P/BV (x)		P/E (x)		RoA (%)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Kotak Mahindra Bank	1416	4.3	3.9	44.5	36.5	1.4	1.5	9.7	10.6
ICICI Bank	405	2.1	1.9	22.5	16.2	1.0	1.3	9.6	11.9
HDFC Bank	1213	3.4	3.0	23.4	19.1	1.7	1.8	15.5	16.4
Axis Bank	493	1.5	1.4	20.8	12.4	0.7	1.1	7.6	11.7

Source: Company, Sharekhan Research

About company

Established in 1985, Kotak Mahindra Group (Group) is one of India's leading financial services conglomerate. Kotak Mahindra Bank has a national footprint of 1,600 branches and 2516 ATMs. The Group offers a wide range of financial services that includes commercial banking, to stock broking, mutual funds, insurance and investment banking, the Group caters to the diverse financial needs of both individuals and the corporate sector. It has a well diversified pan India (~30% each in North, West and South regions and 8% in Eastern India) and has one of the highest CASA ratio in the Industry.

Investment theme

We believe KMB continues to be an attractive business franchise, with a well-rounded products and services offering, shaping up well for the long term. Consistent performance across interest rate and asset cycles is a key differentiator and indicates the management's quality and strength of the franchise. Its Subsidiaries are shaping up well and while at present, they are relatively small, we believe each one has strong business strengths and are well on way to be significant value contributor to the consolidated business in the long term. We find Kotak Mahindra Bank to be an attractive franchisee with a strong balance sheet, with pan India reach and healthy capitalization which will help it tide over the medium term challenges.

Key Risks

A prolonged lockdown and consequent rise in NPAs can pose risks to profitability.

Additional Data

Key management personnel

Mr. U. Kotak	Executive Vice Chairman and Managing Director
Mr. D. Gupta	Joint Managing Director
Ms. S. Ekambaram	Country Head - Consumer Banking
Mr. K.V.S. Manian	Country Head - Wholesale & Investment Banking
Mr. D Kannan	Country Head - Commercial Banking

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Capital Group Cos Inc/The	12.8
2	CANADA PENSION PLAN INVESTMENT B	6.4
3	Canada Pension Plan Investment Boa	6.0
4	Invesco Ltd	3.5
5	INVESCO OPPENHEIMER DEVELO	3.4
6	SBI Funds Management Pvt Ltd	2.8
7	Life Insurance Corp of India	2.5
8	NEW WORLD FUND INC	2.0
9	Sumitomo Mitsui Financial Group In	1.7
10	JPMorgan Chase & Co	1.5

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan
by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;