October 26, 2020

Result Report Q2 FY21 | Sector: Financials

Kotak Mahindra Bank Limited

BUY	CMP Rs1,417	Target Rs1,670	Upside 17.8%

Expansion in core PPOP to drive non-linear earnings growth; Upgrade earnings by 10-12% and rating to BUY

We raise FY21/22 earnings and ABV estimates by 10-12% and 2.5-3% respectively on the back of material upgrade in PPOP expectations (higher NII and lower cost growth now) and significant reduction in credit cost assumption. The latter being underpinned by low impeding and susceptible flow (small SC-order slippage pool and SMA-2 + robust customer asset mix with only 6% coming from unsecured products) and management commentary on current Covid buffer (62 bps of adv.) being adequate to address potential stress. We estimate the stand-alone bank to deliver 20-22% earnings CAGR on a 6-7% loan CAGR over FY20-22 because of expansion in core PPOP margin.

We see no deterioration in RoA for the current year despite higher provisions and expect profitability to improve to life-time high in FY22. KMB has underperformed in recent months and its valuation premium to HDFCB has dissipated. Expect valuation to re-rate from current 3x FY22 P/ABV is response to likely continuation of non-linear earnings growth. Upgrade rating to BUY and 12m PT to Rs1,670.

Key highlights of standalone bank performance

- ✓ A nearly 20% PPOP beat supported by 10% NII outperformance. Substantial decline in deposit cost driven by rationalization of SA and TD rates aided robust NII performance (5% qoq and 17% yoy)
- ✓ NIM improves by 12 bps qoq to 4.5%. Core fees recover 36% qoq and treasury income comes in at Rs4bn v/s estimate of Rs3bn.
- ✓ Share of CASA improves marginally to 57%. Cost growth was restrained on the back of reduction in non-staff expenses.
- ✓ Loan book was stable with unsecured loans (PL, CC and BL) growing 3% qoq, agri finance up 7% qoq and the Corporate portfolio declining 3% qoq
- ✓ Reported GNPL and NNPL at 2.6% and 0.6% v/s proforma (including accounts that would have slipped after Aug 31) at 2.7% and 0.7% respectively. Rs920mn of provisions made against such pending slippages (~Rs3bn).
- ✓ Covid provisions at Rs12.8bn (60 bps of net adv.) with no addition in Q2 FY21. However, the bank raised core PCR significantly
- ✓ Overall a 68% earnings beat supported by better-than-expected PPOP and much lower-than-estimated provisions

Exhibit 1: Financial Summary

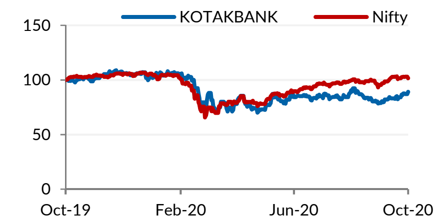
Y/e 31 Mar (Rs mn)	FY19	FY20	FY21E	FY22E
Operating income	158,630	188,718	214,300	245,954
PPOP	83,482	100,208	124,020	140,778
Net profit	48,653	59,472	66,909	89,717
yoy growth (%)	19.1	22.2	12.5	34.1
EPS (Rs)	25.5	31.1	33.8	45.4
Adj.BVPS (Rs)	216.7	248.1	307.4	351.9
P/E (x)	55.6	45.6	41.9	31.2
P/adj.BV (x)	6.5	5.7	4.6	4.0
ROE (%)	12.1	12.9	12.0	13.3
ROA (%)	1.7	1.8	1.8	2.1
CAR (%)	17.5	17.9	26.4	26.0

Source: Company, YES Sec – Research

Stock data (as on October 26, 2020)

Nifty	11,768
52 Week h/l (Rs)	1740 / 1001
Market cap (Rs/USD mn)	2804604 / 37978
Outstanding Shares (mn)	1,979
6m Avg t/o (Rs mn):	6,642
Div yield (%):	-
Bloomberg code:	KMB IN
NSE code:	KOTAKBANK

Stock performance



	1M	3M	1Y
Absolute return	13.1%	5.0%	-10.8%

Shareholding pattern

Promoter	26.1%
FII+DII	57.4%
Others	16.5%

Δ in earnings estimates

	FY20e	FY21e	FY22e
EPS (New)	31.1	33.8	45.4
EPS (Old)	31.1	30.1	41.2
% change	0.0%	12.3%	10.2%

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MANAGEMENT COMMENTARY

Strategic focus now on asset franchise

- ✓ Up until now, the strategic drive was to build a strong and sustainable liability franchise – reflected in 57% CASA and another 8% of low-cost deposits
- ✓ Management now shifting focus to building an asset side customer franchise - will open-up number of channels for customers acquisition as against only deposits
- ✓ Inorganic growth/acquisition (denied speculations with IndusInd) could be one of the ways for augmenting the customer franchise

Liability franchise

- ✓ Cost of SA deposits in Q2 FY21 at 3.87% v/s 5.37% a year ago – SA rates have been cut substantially in recent quarters
- ✓ Average SA growth at 32% - there is further room to cut deposit rates but timing will be strategic
- ✓ SA customer behavior largely unchanged to rate cuts at the granular end
- ✓ Deposit customers acquisition at 90% of pre-Covid level in Sept.

Non-interest income

- ✓ Strong recovery in core fee income - Distribution income 50% yoy and 19% qoq - General Banking 15% lower yoy
- ✓ Higher non-fee income included recovery on stressed assets + some profit on sale of premises + some equity gains booked

Asset quality and provisions

- ✓ Taken provisions on all accounts that would have slipped if not for SC order
- ✓ Covid provisioning buffer at Rs12.8bn, 62 bps of advances
- ✓ Stock of provisions for potential stress adequate and conservative considering the mix of assets and loan book
- ✓ Worst impacted segment is unsecured urban consumers – employees of smaller companies disproportionately impacted

Consumer Banking

- ✓ Home loan encouraging traction across metros and urban cities – bounce rate back to pre-Covid level
- ✓ Demand coming back for LAP – bank will retain focus to grow
- ✓ In MSME ECGL scheme has been a growth driver - utilization of limits improved by customers – bank has started new customers acquisition
- ✓ Unsecured retail loans – bank started origination based on emerging credit and collection trends – will pursue calibrated growth
- ✓ Overall collection trends improving month-on-month
- ✓ Bounce rate declining – for secured products at pre-Covid level – unsecured collections improving
- ✓ Bank has made investment in technology and capacity enhancement which is improving collections and resolutions – further economic unlock aiding collections
- ✓ CV/CE disbursement on the increase – fleet utilization at 75-85% for most large operators which is further expected to improve – collection rising too

- ✓ Passenger transportation severely impacted – will take longer time to recover
- ✓ Demand for construction equipment getting better with each passing month – utilization of equipment close to pre-Covid level – collections improving
- ✓ Agri finance collection efficiency back to normal level and credit demand is getting better - good kharif harvest to drive demand

Wholesale banking (Corporate + Large SME)

- ✓ Continue to avoid large concentrated exposure
- ✓ Impact of low rates in DCM – thus growing through credit substitutes

Exhibit 2: Result Table - Standalone

(Rs mn)	Q2 FY21	Q1 FY21	% qoq	Q2 FY20	% yoy
Total Interest Income	68,361	69,119	(1.1)	67,616	1.1
Interest expended	(29,228)	(31,880)	(8.3)	(34,120)	(14.3)
Net Interest Income	39,132	37,239	5.1	33,496	16.8
Other income	14,520	7,735	87.7	12,244	18.6
Total Income	53,652	44,974	19.3	45,740	17.3
Operating expenses	(20,678)	(18,737)	10.4	(20,654)	0.1
PPOP	32,975	26,237	25.7	25,086	31.4
Provisions	(3,686)	(9,620)	(61.7)	(4,079)	(9.6)
PBT	29,289	16,617	76.3	21,006	39.4
Tax	(7,444)	(4,173)	78.4	(3,762)	97.9
PAT	21,845	12,445	75.5	17,245	26.7

Source: Company, YES Sec – Research

Exhibit 3: Business Data - Standalone

(Rs mn)	Q2 FY21	Q1 FY21	% qoq	Q2 FY20	% yoy
Advances	2,048,450	2,039,980	0.4	2,132,990	(4.0)
CV & CE	183,630	184,420	(0.4)	196,880	(6.7)
Agri.	209,260	195,480	7.0	270,680	(22.7)
Mortgage loans	477,320	471,680	1.2	443,710	7.6
Small Busi, PLs & CC	402,680	391,740	2.8	348,520	15.5
Business + Corp. Bkg	742,370	761,670	(2.5)	823,740	(9.9)
Deposits	2,615,636	2,615,240	0.0	2,330,715	12.2
CA	404,540	385,940	4.8	382,000	5.9
SA	1,089,900	1,097,540	(0.7)	867,120	25.7
Others	1,121,196	1,131,760	(0.9)	1,081,595	3.7
Investments	1,167,237	1,026,930	13.7	743,306	57.0
Borrowings	417,891	479,200	(12.8)	266,645	56.7

Source: Company, YES Sec – Research

Exhibit 4: Key Ratios - Standalone

(%)	Q2 FY21	Q1 FY21	chg qoq	Q2 FY20	chg yoy
NIM	4.5	4.4	0.1	4.6	(0.1)
Cost of Funds	3.8	4.2	(0.4)	5.3	(1.4)
CASA	57.1	56.7	0.4	53.6	3.5
C/D (x)	78.3	78.0	0.3	91.5	(13.2)
Non-int. income	27.1	17.2	9.9	26.8	0.3
Non-int. income / Int. exp.	49.7	24.3	25.4	35.9	13.8
Cost to Income	38.5	41.7	(3.1)	45.2	(6.6)
Prov. /Income	4.4	12.5	(8.1)	5.1	(0.7)
RoE	14.9	9.3	5.5	15.3	(0.4)
RoA	2.4	1.4	1.0	2.2	0.2
CAR	22.1	21.2	0.8	19.1	3.0
Gross NPA	2.6	2.7	(0.2)	2.3	0.2
Net NPA	0.6	0.9	(0.2)	0.9	(0.2)

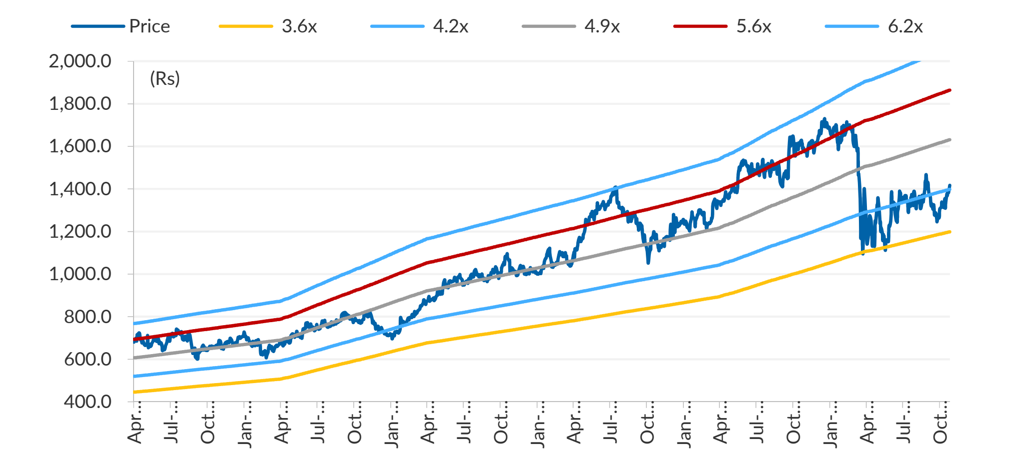
Source: Company, YES Sec – Research

Exhibit 5: Consolidated PAT - Subsidiaries

(Rs mn)	Q2 FY21	Q1 FY21	% qoq	Q2 FY20	% yoy
Kotak Mahindra Bank	21,840	12,440	75.6	17,240	26.7
Kotak Mahindra Prime	1,330	680	95.6	1,720	(22.7)
Kotak Life Insurance	1,710	1,610	6.2	1,440	18.8
Kotak Securities	1,990	1,690	17.8	1,490	33.6
Kotak Mahindra Capital	140	60	133.3	10	1,300.0
Kotak Mahindra AMC	840	710	18.3	850	(1.2)
Kotak Investments	740	430	72.1	670	10.4

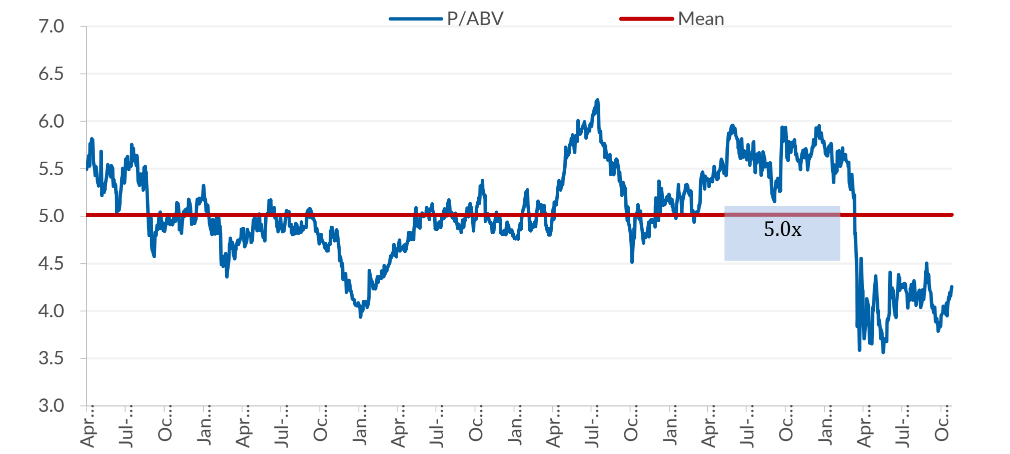
Source: Company, YES Sec – Research

Exhibit 6: 1-year rolling P/ABV band *



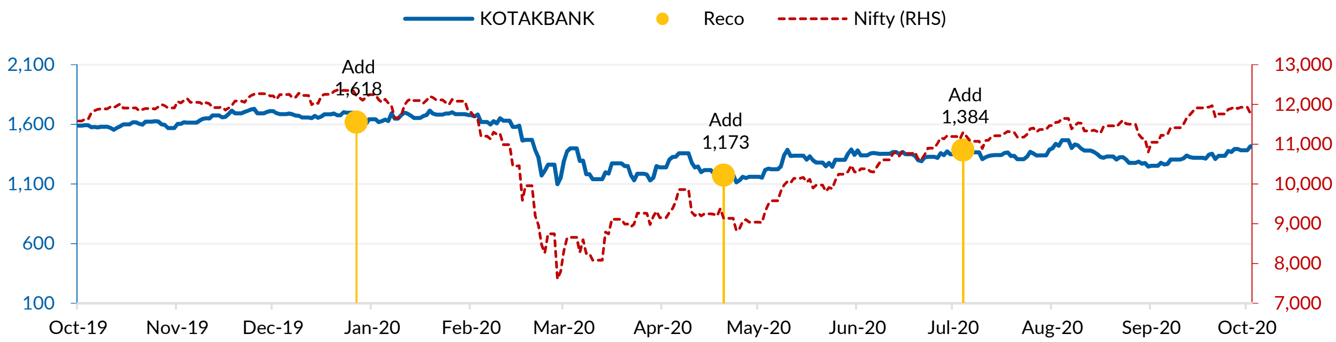
Source: Company, YES Sec – Research, * Price not adjusted for Sub. values

Exhibit 7: 1-yr rolling P/ABV vis-a-vis the mean *



Source: Company, YES Sec – Research, * Price not adjusted for Sub. values

Recommendation Tracker



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