

Kotak Mahindra Bank Ltd.



Kotak Mahindra Bank Ltd. Earnings impacted due to higher provisions; Deposit mobilisation remains strong

| | | | | | |
|-------------------------|----------------------------|---------------------------------|--|-------------------------------------|--------------------------|
| CMP INR 1,551 | Target INR 1,650 | Potential Upside 6.4% | Market Cap (INR Cr) INR 3,06,975 | Recommendation ACCUMULATE | Sector Banking |
|-------------------------|----------------------------|---------------------------------|--|-------------------------------------|--------------------------|

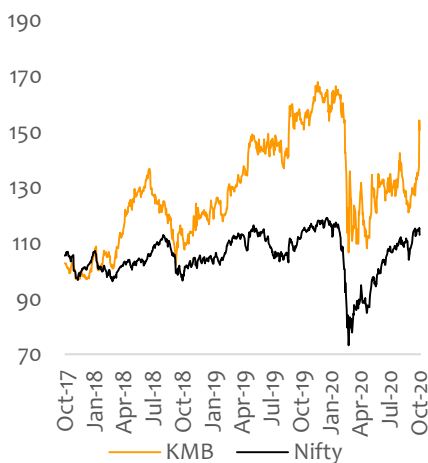
Result Highlights of Q2FY21:

- NII has grown strongly 17% YoY/5% QoQ to INR 3,913 Cr. on stronger NIMs as funding costs improved.
- Advances fell 4% YoY/flat QoQ to INR 2,04,845 Cr.
- Deposits too have not grown sequentially, 12% YoY but funding costs (computed) have been lower by 36 bps QoQ
- CASA was at 54%, lower 257 bps QoQ/ higher 56 bps YoY. CASA and TDs below INR 5 Cr. was 91% of total deposits.
- The other incomes rose robustly, growing 88% QoQ as fee income growth regained strength.
- GNPA were 2.55% & NNPA were 0.64%. Ex the Supreme Court's (SC) standstill, GNPA would have been 2.70% and NNPA 0.74%. The Bank has provided for such advances. The total credit costs are 0.62% of advances.

MARKET DATA

| | |
|---------------------|-----------|
| Shares outs (Cr) | 198 |
| Equity Cap (INR Cr) | 59,923 |
| Mkt Cap (INR Cr) | 3,06,975 |
| 52 Wk H/L (INR) | 1740/1001 |
| Volume Avg (3m K) | 4550 |
| Face Value (INR) | 5 |
| Bloomberg Code | KMB IN |

SHARE PRICE PERFORMANCE



KEY FINANCIALS

| Particulars (INR Crores) | FY18 | FY19 | FY20 | FY21E | FY22E |
|--------------------------|-------|--------|--------|--------|--------|
| NII | 9,532 | 11,259 | 13,500 | 14,853 | 15,339 |
| PPOP | 7,158 | 8,348 | 10,021 | 11,688 | 12,543 |
| PAT | 4,084 | 4,865 | 5,947 | 7,191 | 8,099 |
| EPS | 21.4 | 25.5 | 31.1 | 37.6 | 42.3 |
| NIM | 4.3% | 4.2% | 4.5% | 4.5% | 4.5% |
| Advances Growth | 24.7% | 21.2% | 6.8% | 2.8% | 15.0% |

Source: Company, KRChoksey Research

Advances degrow but earning profile remains strong

The bank's earnings grew 27% YoY despite a 3% YoY fall in loan book. This has been on account of healthy NIMs, strength in other incomes and tamed credit costs. The NIMs rose 12 bps QoQ/ lower by 9 bps YoY (high base) to 4.52% despite the higher share of low yielding book as the bank has reduced its attractive savings rates. The cost of SA is now 3.87%, lower by 35 bps QoQ. The CASA rose to 57.1% from 56.7% last quarter. The other incomes rose 19% YoY on strong fee on third party and insurance products. This aided the C/I ratio, now at 39%, lower by 312 bps QoQ and 662 bps YoY.

Secured book growth to remain stronger

The home loans, LAP and MSME have fared better in terms of collection and credit uptick. The agriculture book grew 7% YoY and tractors alone grew 18% YoY. Home loans and LAP has grown 4% YoY. The corporate and CV book degrow 7% YoY and the small business and unsecured degrow 12% YoY. The collection efficiency has been improving month on month but its far from pre Covid level for unsecured segment. Hence the focus is likely to remain on the secured segment – LAP, home loans and MSME – aided by the credit guarantee schemes.

Credit Costs factored in earnings, but GNPA optically lower

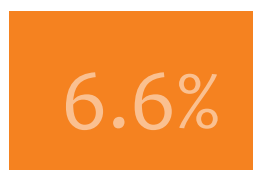
The bank has 0.62% of its advances towards nonspecific provisions. It believes this is sufficient as a large part of the book is secured showing normalcy. We too believe that provisions for the stress book are front ended and there is unlikely to be material adverse surprise in credit costs. While GNPA were lower at 2.55%, excluding the dispensation they were in the same line as last quarter at 2.7%.

MARKET INFO

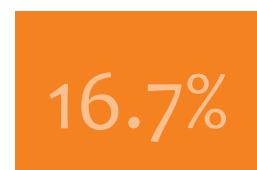
| | |
|--------|--------|
| SENSEX | 39,922 |
| NIFTY | 11,730 |

SHARE HOLDING PATTERN (%)

| Particulars | Sep-20 | Jun-20 | Mar-20 |
|-------------|--------|--------|--------|
| Promoters | 26.05 | 26.07 | 29.92 |
| FIIs | 42.23 | 42.15 | 39.17 |
| DIIs | 14.96 | 15.27 | 12.46 |
| Others | 16.76 | 16.51 | 18.45 |
| Total | 100 | 100 | 100 |



NII CAGR between FY20 and FY22E



PAT CAGR between FY20 and FY22E

Kotak Mahindra Bank Ltd.

CASA franchise tested, but outgrows advances

The bank has lowered its attractive SA rates. The cost of SA is 3.87%, lower by 35 bps QoQ. Despite this, CASA has risen to 57.1%, higher by 40 bps QoQ/640 bps YoY. SA rose 26% YoY. The bank continues to focus on granular deposit even as high-ticket deposit may be price sensitive. Overall deposits grew 12% YoY. We expect the deposit growth to slow with lower aggression. However the CD is favourable.

Securities, investments and Capital Markets outperform, NBFCs lag

Among its subsidiaries, PAT for Securities grew 34% YoY, life insurance grew 19% YoY and Kotak investments grew 10% YoY. The Prime NBFC has degrown 23% YoY. This has been on account of strong opportunities with higher retail demat opening for securities, healthy capital raising plans and IPOs by corporates and opportunities in life insurance business.

Concall Highlights:

- Focus of the bank is on earning growth and customer acquisition.
- INR 93 Cr of additional provisions exists. Nonspecific provision is 177% of NNPA.
- The provisions at 0.62% of the book are currently sufficient.
- Focus is on secured products with home and SME doing well. Comfort on Unsecured is still some time away. Government liquidity scheme is helpful, and it plans to build a granular book. The market share in government sponsored scheme is 6%.
- It has 5.1% market share in digital driven by mobile.
- It has launched 2 Credit Cards for mass affluent along with a Secured CC last quarter.
- Collection efficiency in retail unsecured has improved and it is at pre Covid level in secured.
- In Commercial vehicles disbursements have improved. Collection efficiency for large operators is 75-85%. Smaller player face challenges. Agriculture and allied and non-urban shows promise.
- Passenger vehicle is likely to take longer time though collections have improved MoM.
- Collection efficiency in agriculture has improved and credit uptick is likely.
- There is MoM improvement in MFI as well.
- Tractor have grown 8-10% in H1 and is likely to do well in the next two quarters.
- It has avoided large concentrated low spread business book on corporate banking. It has maintained focus on customer profitability.
- INR 12,000 Cr has migrated from SME to Commercial banking and INR 2,400 Cr is lower WC utilisation.
- The bank plans to improve customer acquisition drive through all means – organic, inorganic, digital and physical and plans to monetise its liability customers for advances.
- The lower SA cost has led to attrition and shift to FD for the higher ticket size. But the granular growth remains.
- Securities has done well with strong client acquisition. The margin norms impact is transient.

Valuation and view

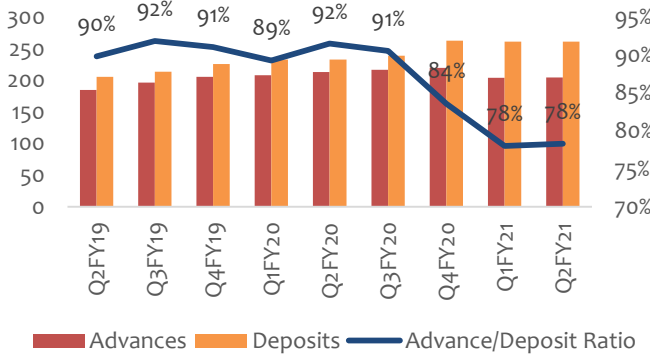
The bank has been highly cautious on its advance growth with advances degrowing over the last two quarters. This has been on expected lines on account of the bank's strategy and its customer segment. The change in strategy to now monetize their customers on the liability side is a much-awaited step and a positive. Its deposit have also shown strength despite the fall in erstwhile attractive saving rates. This augurs well for the inherent strength of its franchise. While we await more details of the momentum of the strategy on its asset side and its faring at this juncture, the inroads is a positive. The deposit and advance strategy combined is likely to improve the NII and earning profile.

The bank also plans to expand customer acquisition drive through the non digital channel. We await finer details on this too. But we like this strategy too as most of the branches are in metros and urban. The bank has barely scratched any opportunities beyond the metros and urban centers, and further branch expansion and customer acquisition is a positive. Cumulatively we like the strategy to focus on the earnings, that have shown healthy growth of 12% YoY in H1FY21 despite the higher credit costs. We expect 21% YoY growth in PAT despite 3% YoY growth in advances for FY21 on account of reduction in costs. We expect CAGR 17% growth in earning over FY20-21E and improving ROA to 1.9% in FY21 and 2% in FY22 from 1.8% in FY20.

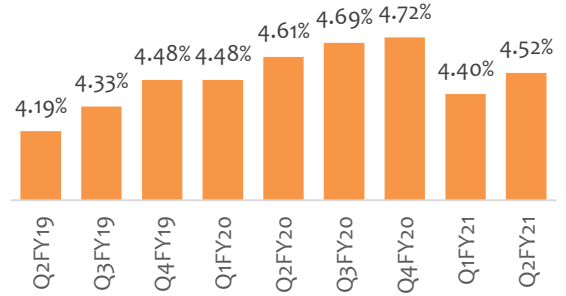
It is currently trading at 4.3x FY22 P/ABV (standalone). We believe the premium valuation is likely to persist on account of controlled credit costs, no material risk on asset quality, opportunities driven by the change in strategy, strong earning momentum. The risk related to the pandemic are factored in the earnings. We raise our target to INR 1,650 per share, using SOTP valuation applying a P/B multiple 4.7x to the FY22 adj. BVPS of INR 315 (standalone business) for the bank and INR 182 per share for subsidiaries, an upside of 6.4% over the CMP. Accordingly, we reiterate our "ACCUMULATE" recommendation on the shares of KMB.

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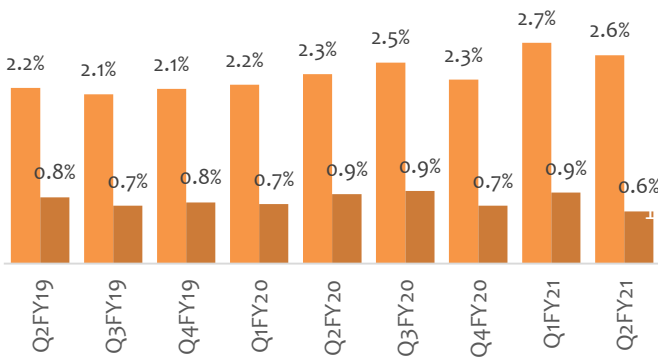
Advances and deposit (INR ‘000 Cr): Advance growth tepid, CD Ratio moderates further



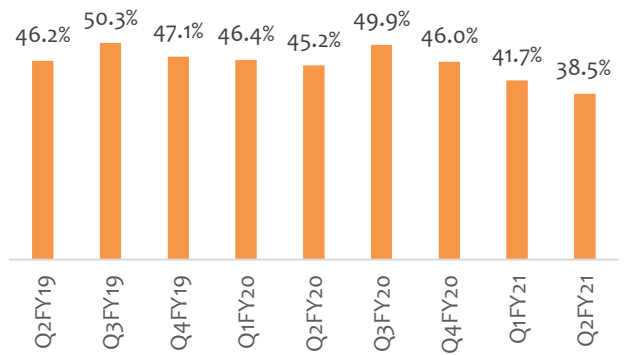
NIM: Improvement sequentially, but secured book rising



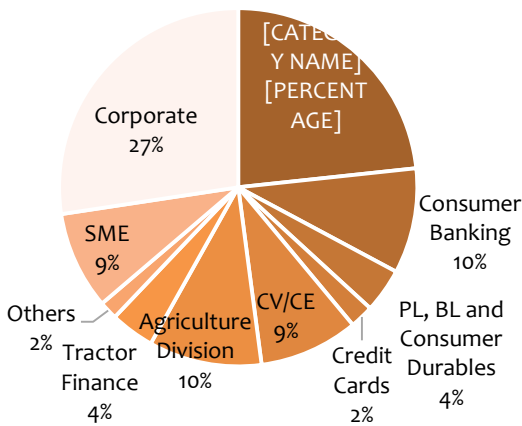
Asset quality: Optically better, but stress levels same as last quarter



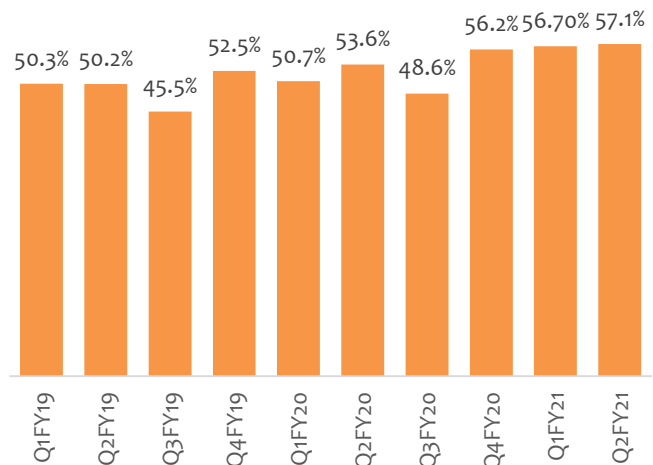
C/I: Lower as other incomes grow strong



AUM: Growth in agri and home loans



Share of CASA ratio trending higher



Source: Company, KRChoksey Research

Kotak Mahindra Bank Ltd.

KEY FINANCIALS

Exhibit 1: Profit & Loss Statement (Standalone)

| INR Crores | FY 18 | FY 19 | FY 20 | FY 21E | FY 22E |
|----------------------------|--------|--------|--------|--------|--------|
| Interest Income | 19,749 | 23,943 | 26,930 | 27,993 | 30,284 |
| Interest Expense | 10,217 | 12,684 | 13,430 | 13,141 | 14,945 |
| Net Interest Income | 9,532 | 11,259 | 13,500 | 14,853 | 15,339 |
| Non interest income | 4,052 | 4,604 | 5,372 | 6,124 | 6,859 |
| Operating income | 13,584 | 15,863 | 18,872 | 20,977 | 22,199 |
| - Employee expense | 2,950 | 3,184 | 3,878 | 3,789 | 3,856 |
| - Other operating expense | 3,475 | 4,331 | 4,973 | 5,500 | 5,800 |
| Operating Expense | 6,426 | 7,515 | 8,851 | 9,289 | 9,656 |
| PPOP | 7,158 | 8,348 | 10,021 | 11,688 | 12,543 |
| Provisions | 940 | 962 | 2,216 | 2,100 | 1,744 |
| PBT | 6,218 | 7,386 | 7,805 | 9,588 | 10,799 |
| Tax Expense | 2,134 | 2,520 | 1,857 | 2,397 | 2,700 |
| PAT | 4,084 | 4,865 | 5,947 | 7,191 | 8,099 |
| Diluted EPS (INR) | 21.43 | 25.49 | 31.09 | 37.59 | 42.34 |

Source: Company, KRChoksey Research

Kotak Mahindra Bank Ltd.

Exhibit 2: Balance Sheet (Standalone)

| INR Crores | FY18 | FY19 | FY20 | FY21E | FY22E |
|---------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Source of Funds | | | | | |
| Capital | 953 | 1,454 | 1,457 | 1,457 | 1,490 |
| Reserves & Surplus/ Others | 36,531 | 41,446 | 47,562 | 54,592 | 62,535 |
| Networth | 37,484 | 42,900.4 | 49,018 | 56,049 | 64,025 |
| Borrowings | 25,154 | 32,248 | 37,993 | 34,194 | 30,775 |
| Deposits | 1,92,643 | 2,25,880 | 2,62,821 | 2,89,103 | 3,32,468 |
| Other liabilities & provisions | 9,652 | 11,143 | 10,420 | 11,841 | 10,981 |
| Total Equity & Liabilities | 2,64,933 | 3,12,172 | 3,60,252 | 3,91,186 | 4,38,248 |
| Uses of Funds | | | | | |
| Cash & bank balances | 8,909 | 10,878 | 9,505 | 5,000 | 10,000 |
| Balance with other banks | 10,712 | 13,798 | 43,787 | 27,361 | 14,111 |
| Net investments | 64,562 | 71,189 | 75,052 | 1,20,177 | 1,39,856 |
| Loans & advances | 1,69,718 | 2,05,695 | 2,19,748 | 2,25,880 | 2,59,762 |
| Fixed assets | 1,527 | 1,652 | 1,623 | 1,704 | 2,519 |
| Other assets | 9,506 | 8,961 | 10,537 | 11,063 | 12,000 |
| Total Assets | 2,64,933 | 3,12,172 | 3,60,252 | 3,91,186 | 4,38,248 |

Source: Company, KRChoksey Research

Kotak Mahindra Bank Ltd.

Exhibit 3: Ratio Analysis

| Key Ratio | FY18 | FY19 | FY20 | FY21E | FY22E |
|------------------------------------|-------|-------|-------|-------|-------|
| Growth Rates | | | | | |
| Advances (%) | 24.7% | 21.2% | 6.8% | 2.8% | 15.0% |
| Deposits (%) | 22.4% | 17.3% | 16.4% | 10.0% | 15.0% |
| Total assets (%) | 23.5% | 17.8% | 15.4% | 8.6% | 12.0% |
| NII (%) | 17.3% | 18.1% | 19.9% | 10.0% | 3.3% |
| Pre-provisioning profit (%) | 19.6% | 16.6% | 20.0% | 16.6% | 7.3% |
| PAT (%) | 19.7% | 19.1% | 22.2% | 20.9% | 12.6% |
| B/S Ratios | | | | | |
| Credit/Deposit (%) | 88.1% | 91.1% | 83.6% | 78.1% | 78.1% |
| CASA (%) | 50.8% | 52.5% | 56.2% | 55.4% | 54.7% |
| Advances/Total assets (%) | 64.1% | 65.9% | 61.0% | 57.7% | 59.3% |
| Leverage - Total Assets to Equity | 7.1 | 7.3 | 7.3 | 7.0 | 6.8 |
| Operating efficiency | | | | | |
| Cost/income (%) | 47.3% | 47.4% | 46.9% | 44.3% | 43.5% |
| Opex/total assets (%) | 2.5% | 2.5% | 2.8% | 2.6% | 2.3% |
| Opex/total interest earning assets | 2.9% | 2.8% | 3.0% | 2.8% | 2.5% |
| Profitability | | | | | |
| NIM (%) | 4.3% | 4.2% | 4.5% | 4.5% | 4.5% |
| RoA (%) | 1.7% | 1.7% | 1.8% | 1.9% | 2.0% |
| RoE (%) | 12.5% | 12.1% | 12.9% | 13.7% | 13.5% |
| Asset quality | | | | | |
| Gross NPA (%) | 2.2% | 2.1% | 2.2% | 2.3% | 2.3% |
| Net NPA (%) | 1.0% | 0.8% | 0.7% | 0.7% | 0.6% |
| PCR (%) | 56.5% | 64.4% | 69.0% | 65.0% | 65.0% |
| Credit cost (%) | 0.4% | 0.3% | 0.3% | 0.3% | 0.3% |
| Per share data / Valuation | | | | | |
| EPS (INR) | 21.4 | 25.5 | 31.1 | 37.6 | 42.3 |
| BVPS (INR) | 196.7 | 224.7 | 256.2 | 283.1 | 323.3 |
| ABVPS (INR) | 187.9 | 216.7 | 248.1 | 275.5 | 315.5 |
| P/E (x) | 72.9 | 61.3 | 50.2 | 43.0 | 38.2 |
| P/BV (x) | 7.9 | 7.0 | 6.1 | 5.5 | 4.8 |
| P/ABV (x) | 8.3 | 7.2 | 6.3 | 5.7 | 5.0 |

Source: Company, KRChoksey Research

Kotak Mahindra Bank Ltd.

| Kotak Mahindra Bank | | | | Rating Legend (Expected over a 12-month period) | |
|---------------------|-----------|----------|----------------|---|----------------|
| Date | CMP (INR) | TP (INR) | Recommendation | Our Rating | Upside |
| 28-Oct-20 | 1,551 | 1,650 | ACCUMULATE | Buy | More than 15% |
| 24-Sep-20 | 1,279 | 1,458 | ACCUMULATE | Accumulate | 5% – 15% |
| 14-May-20 | 1,173 | 1,279 | ACCUMULATE | Hold | 0 – 5% |
| 21-Jan-20 | 1,627 | 1,757 | ACCUMULATE | Reduce | -5% – 0 |
| 25-Oct-19 | 1,613 | 1,757 | ACCUMULATE | Sell | Less than – 5% |

ANALYST CERTIFICATION:

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