Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Kotak Mahindra Bank

Stands tall with strong fundamentals

Banks & Finance	Sharekhan code: KOTAKBANK	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	Positive	↔	Positive
RQ	Positive	↔	Positive
RV	Neutral	↔	Neutral

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,795**	
Price Target: **Rs. 2,130**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

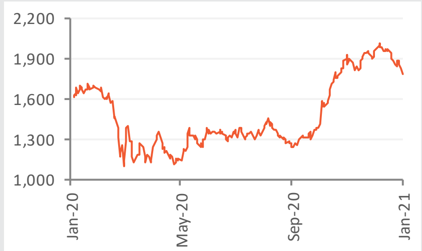
Company details

Market cap:	Rs. 3,55,525 cr
52-week high/low:	Rs. 2,026 / 1,000
NSE volume: (No of shares)	50.4 lakh
BSE code:	500247
NSE code:	KOTAKBANK
Free float: (No of shares)	146.5 cr

Shareholding (%)

Promoters	26.0
FII	48.9
DII	12.9
Others	12.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-8.5	29.3	40.5	16.4
Relative to Sensex	-11.4	7.6	9.7	-4.6

Sharekhan Research, Bloomberg

Summary

- Kotak Mahindra Bank's (KMB) Q3FY2021 numbers were healthy, with strong operational numbers, improved asset quality (on a sequential basis), healthy CASA, and advances traction, which were positives.
- The bank's gross NPA ratio and net NPA ratio (proforma basis) would have been 3.27% and 1.24%, respectively (was 2.7% and 0.7% in Q2FY2021); but proactive front-loading of provisions with restructured assets at 0.28% indicate stable asset-quality outlook.
- The bank's management commentary is more positive on growth, also seen in strong sequential growth in advances, which is encouraging.
- We value the standalone bank at ~4.5x its FY2023E book value and its subsidiaries at ~Rs. 490 per share. We recommend a Buy on KMB with an SOTP-based price target (PT) of Rs. 2,130.

Kotak Mahindra Bank (KMB) reported healthy results for Q3FY2021 with operational numbers coming strong because of healthy CASA growth. Advances growth grew 4.5% q-o-q and lower reported NPAs. The liability side continues to perform well with CASA at 58.9% (was 57% in Q2FY2021) and NIM at 4.5% (proforma NIM at 4.31%). However, the bank appears to have front-loaded the provisions cost; and hence, PAT came lower than expectations. The bank's gross NPA ratio and net NPA ratio (proforma basis) would have been 3.27% and 1.24%, respectively (was 2.7% and 0.7% in Q2FY2021). As a matter of prudence, the bank has made additional provisions (including interest accrued) as of December 31, 2020, of Rs. 814 crore on such advances, including Rs. 722 crore for Q3FY2021. Hence, proactive front-loading of provisions, with restructured assets at 0.28% and SMA2 at 0.31% indicate stable asset-quality outlook. On the operational front, net interest income (NII) came at Rs. 4006.8 crores, up 16.8% y-o-y and up by 2.4% q-o-q basis, and was in line with expectations. Pre-provision operating profits (PPOP) stood at Rs. 3,083 crore, up 29% y-o-y, but down 6.5% on a q-o-q basis, mainly due to lower traction in other income. Notably, the bank's management is known for its prudent and proactive stance on asset quality and provisions. Hence, proactive front-loading of provisions, with restructured assets at 0.28% and SMA2 at 0.31% indicate stable asset-quality outlook. Strength in the liability profile indicates that the margin outlook is likely to be stable (with a positive bias) for the medium term. The bank's management commentary is more positive on growth, also seen in the strong sequential growth in advances, which is encouraging. We believe the bank's outlook has improved; collections efficiency has normalised for secured loans and is near pre-Covid levels for unsecured advances. We have fine-tuned our estimates accordingly. The bank is well capitalised, with low drag from NPAs and strong leadership, which we believe allow the bank the right mix. The bank is revving up for growth. We maintain Buy on the stock with our SOTP-based PT of Rs. 2,130.

Key positives

- Reported GNPA at 2.26% and NNPA at 0.5% (was 2.55% and 0.64% in Q2FY2021) declined on a q-o-q basis; COVID-19 Provision as on December 31, 2020, was Rs. 1,279 crore.
- During Q2FY2020, the bank's CASA ratio improved by 58.9% (up by 180 bps sequentially), taking it to the best-ever CASA ratio yet again.

Key negatives

- SMA2 outstanding stands at Rs. 654 crore, which was 0.31% of net advances, although at manageable levels, but the same has risen from Rs. 133 crore or 0.06% of net advances in Q2FY2021.

Our Call

We value KMB on a standalone basis at ~4.5x its FY2023E book value and its subsidiaries at ~Rs. 490 per share. The bank's strong operating metrics, prudent and agile leadership team, well-capitalised balance sheet, as well as quality of its subsidiaries (formidable players in their own segments) provide long-term value to the franchises. The stock is available at 4.8x/4.3x its FY2022E/FY2023E BVPS. With the recent QIP and capital issue, the bank is placed comfortably with tier-1 capital of 23.6% (standalone) and has the wherewithal for capitalising on opportunities. We recommend Buy on the stock with an SOTP-based PT of Rs. 2,130.

Key risk

Any delay in economic pickup may elongate the recovery trajectory, resulting in consequent rise in risk of NPAs affecting profitability.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
NII	11,259	13,500	15,868	17,417	17,061
PPoP	8,348	10,021	11,542	12,621	13,078
PAT	4,865	5,947	6,967	8,319	8,321
EPS (Rs.)	25.5	30.9	36.6	43.7	43.7
BVPS (Rs.)	224.7	256.2	331.7	373.6	415.6
PE (x)	70.4	58.1	49.1	41.1	41.1
PBV (x)	8.0	7.0	5.4	4.8	4.3
RoE (%)	11.3	12.1	11.0	11.7	10.5
RoA (%)	1.6	1.7	1.7	1.7	1.6

Source: Company; Sharekhan estimates

Key Conference call takeaways

- **Business Update:** Loan growth is coming back and q-o-q is 4.5%. KMB sees continuation of improving growth momentum beyond Q3FY2021.
- **Business growth with strong quality:** Seeing traction on corporate (good quality) and consumer unsecured credit are growing faster (with satisfactory client quality).
- **Stress cycle:** The company sees a much different picture between corporate and retail secured. Unsecured retail is 6% of loan, which has given 40% of the delta in reported and proforma basis.
- Total restructured: Total restructured loans stand at 0.28%, and most stress has been flowed to 90+dpd bucket. KMB has made appropriate provision on the book accordingly, assuming as if the SC order deferment was not there.
- **Improving book quality:** Secured book is now much better. The CV segment has also found some strength. The intercity, school buses etc. have caused the proforma GNPA to come higher.
- **Interest reversal:** The entire interest reversal has been provided through P&L. That is why some rise in SMA2 and are closely watching. Taken entire interest reversal in the provision item.
- **Branches will continue to be important:** Financial services and banking are about culture. Some parts of the old culture have been retained, especially when financial companies become too focused on cross sell. KMB views that branches will be required, but will be lesser than pre-Covid. Execution is the mantra for roadmap going forward.
- **Auto Loans:** The CV traction is improving, but passenger vehicles (PV) traction was slow.
- **Loan buyout outlook:** Management believes there would not be much acquisition of stressed assets for at least for next ~6 months due to the NCLT Process
- **Mobile Banking:** Bank has ~5% market share in mobile banking in terms of transaction value and transaction volume is up 73% YoY, value up by 40% YoY
- **Collections:** Bank indicates that Construction equipment demand and collections efficiency have normalised, as indicated by the bank. MFI collection efficiency and business metrics have improved on sequential basis.
- **Corporate and SME book:** The bank has been a positive surprise. Have been able to grow corporate book. SME side is seeing improved traction with improving utilisation, which was subdued post ECLGS. Overall, the bank is seeing healthy traction.
- **Real Estate:** KMB remains cautious on the LRD segment. Commercial Real Estate (CRE) is now seeing good traction on the residential side as well. Developers saw healthy new sales during Q3FY2021.
- **Investment banking:** Debt capital market (DCM) traction is good, with IPOs etc. pipeline coming in now much better than Q2FY2021.
- **Restructuring:** Now looking at how to bridge the gap by providing support. Want the MSME to survive in a low risk environment. Next year, there can be a stress test of the present book quality. If the bank had not given ECLGS support loans, customers would have collapsed.
- **Restructuring from unsecured:** Management does not expect significant restructuring in Q4. Bank views the unsecured consumer retail segment, as a vulnerable segment.
- **MSME Outlook:** Seen utilisation come back in MSME and expects better performance in future. ECLGS was a very helpful move and helped the sector. KMB's book of SME has received Rs. 47,000 crore ECLGS scheme.

- **SA interest rates:** Saw gush of money in SA due to dropping of rates in other avenues, so KMB also dropped the rates to 4%. Management is now focused on <1 crore size, granular SA flow.
- **Interest rate outlook:** Management expects gradual firming of interest rate in 2021, so repo would be at ~4%. Management expects 10-year GSEC will be around 6%.
- **CASA rates:** KMB still offers 75 bps higher deposit rates compared to peer banks. Management believes, the bank has a very competitive cost of funds position.
- **Kotak Prime:** Provision number rose during 9MFY2021 in Kotak Prime because all interest reversals, proforma slippages etc. were taken.
- **ECLGS 2 disbursement:** Was a very small number and most disbursement was via ECLGS 1.
- **Outlook on margins and competitive intensity:** Continuing competitiveness in cost of funds and pricing power comfort, along with stable underwriting, will provide stable margins. As the bank frees up lower yield assets to lend at higher yields, it will also provide support to margins.
- **Corporate, consumer, and commercial:** Equity capital markets have provided capital to the corporate sector due to sharp availability of funds.
- **Provisions for COVID-19:** The bank has not dipped into COVID-19 provisions so far. The 62% provision is not counting the COVID-19 provisions.
- **RBI's FSR view on NPA:** The bank's view is that the Reserve Bank of India (RBI) has been cautious and conservative on the expectation and believes that the banking system would do better than that.
- **Rating profile on the overall book:** Around 86% of the total book is rated investment grade.
- **Slippages from the unsecured book:** Out of Rs. 1,500 crore, almost 40% has come from the unsecured book.

Results (Standalone) Rs cr

Particulars	Q3FY21	Q3FY20	YoY%	Q2FY21	QoQ%
Interest Earned	6790.5	6735.6	0.8	6836.1	-0.7
Interest Expense	2783.7	3306.1	-15.8	2922.8	-4.8
Net Interest income	**4006.8**	**3429.5**	**16.8**	**3913.3**	**2.4**
Other Income	1334.4	1341.4	-0.5	1452	-8.1
Net Operating Income	**5341.2**	**4771**	**12.0**	**5365.3**	**-0.4**
Operating Expenses	2257.9	2382.9	-5.2	2067.8	9.2
Operating Profit	**3083.3**	**2388.1**	**29.1**	**3297.5**	**-6.5**
Prov. for Contingencies	599.03	444	34.9	368.6	62.5
PBT	**2484.3**	**1944.1**	**27.8**	**2928.9**	**-15.2**
TAX	630.77	348.17	81.2	744.4	-15.3
PAT	**1853.5**	**1595.9**	**16.1**	**2184.5**	**-15.2**

Source: Company; Sharekhan Research

Outlook and Valuation

Sector View – Credit growth yet to pick up, private banks placed better

The system level bank's credit offtake, which is still subdued, is now improving, with credit growth of 6+% in the latest fortnight. On the other hand, deposits rose by ~12%, which indicate relatively healthy economic scenario. Moreover, the accommodative stance of the RBI, resulting in surplus liquidity, provides succour in terms of easy availability of funds and lower cost of funds for banks and financials. The end of the loan moratorium is a relief. 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 the banking sector is likely to see increased risk-off behaviour, with tactical market share gains for well-placed players. We believe private banks, with improved capitalisation and strong asset quality (with high coverage and provisions buffers) are structurally better placed to take-off once the situation normalises.

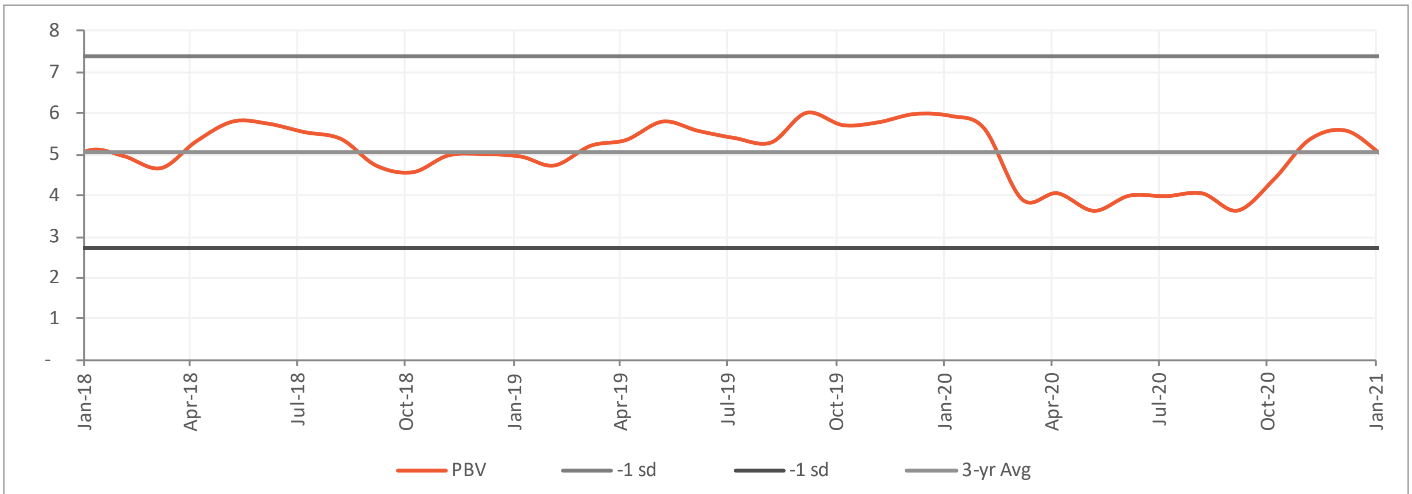
Company Outlook – Strong fundamentals, KMB stands tall

We believe with KMB's strong retail positioning along with mass-affluent customer base, the bank is likely to see lesser asset-quality issues from the retail segment, and has already seen frontloading of provisions and recognitions (albeit on proforma basis), which indicates the bank is entering FY2022E with a relatively clean/normalised book quality. KMB has a diversified and integrated financial services offering that helps 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, thus enhancing overall customer experience. We believe its strength in the liability side, along with strong book quality and robust capital position provide it with strong fundamentals.

Valuation – Maintain Buy on the stock with SOTP based PT of Rs. 2,130

We value KMB on a standalone basis at ~4.5x its FY2023E book value and its subsidiaries at ~Rs. 490 per share. The bank's strong operating metrics, prudent and agile leadership team, well-capitalised balance sheet, as well as the quality of its subsidiaries (formidable players in their own segments) provide long-term value to franchises. The stock is available at 4.8x/4.3x its FY2022E/FY2023E BVPS. With the recent QIP and capital issue, the bank is placed comfortably with Tier-1 capital of 23.6% (standalone) and has the wherewithal for capitalising on opportunities. We maintain Buy on the stock with an SOTP-based PT of Rs. 2,130.

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	1795	5.4	4.8	49.1	41.1	1.7	1.7	11.0	11.7
ICICI Bank	538	2.6	2.4	26.5	19.9	1.2	1.4	10.7	12.3
HDFC Bank	1462	4.0	3.5	26.4	21.7	1.9	2.0	16.5	17.2
Axis Bank	659	2.0	1.8	26.4	16.1	0.8	1.1	8.0	11.4

Source: Company, Sharekhan Research

About company

Established in 1985, Kotak Mahindra Group (Group) is one of India's leading financial services conglomerate. KMB has a national footprint of 1,600 branches and 2,573 ATMs. The Group offers a wide range of financial services that include commercial banking, stock broking, mutual funds, insurance, and investment banking. The Group caters to diverse financial needs of both individuals and the corporate sector. The bank 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 ratios 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. The bank's 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 a significant value contributor to the consolidated business in the long term. We find KMB to be an attractive franchisee with a strong balance sheet, with pan India reach and healthy capitalisation, which will help it tide over medium-term challenges.

Key Risks

Any delay in economic pickup may elongate the recovery trajectory, resulting in consequent rise in risk of NPAs affecting 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Capital Group Cos Inc/The	13.36
2	CANADA PENSION PLAN INVESTMENT B	6.38
3	Canada Pension Plan Investment Boa	5.99
4	Invesco Ltd	3.62
5	Life Insurance Corp of India	3.18
6	SBI Funds Management Pvt Ltd	2.81
7	NEW WORLD FUND INC	1.95
8	Sumitomo Mitsui Financial Group In	1.66
9	JPMorgan Chase & Co	1.59
10	Axis Asset Management Co Ltd/India	1.46

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

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