



3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✓	✓	✗
+ Positive = Neutral - Negative			

What has changed in 3R MATRIX

	Old		New
RS	✓	↔	✓
RQ	✓	↔	✓
RV	✗	↔	✗

ESG Disclosure Score NEW

ESG RISK RATING
Updated Dec 08, 2022

22.79

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

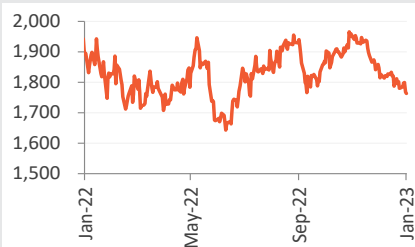
Company details

Market cap:	Rs. 3,50,197 cr
52-week high/low:	Rs. 1,997/1,630
NSE volume: (No of shares)	25.8 lakh
BSE code:	500247
NSE code:	KOTAKBANK
Free float: (No of shares)	145.0 cr

Shareholding (%)

Promoters	26.0
FII	40.9
DII	20.1
Others	13.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.5	-5.4	-3.6	-6.9
Relative to Sensex	-3.8	-7.6	-12.4	-9.6

Sharekhan Research, Bloomberg

Kotak Mahindra Bank

Strong business growth; Margin continues to scale new highs

Banks	Sharekhan code: KOTAKBANK		
Reco/View: Buy	↔	CMP: Rs. 1,763	Price Target: Rs. 2,250 ↔
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- Kotak Mahindra Bank (KMB) reported strong earnings, with standalone PAT up 31% y-o-y/8% q-o-q, led by strong operating profit growth (up 43% y-o-y/8% q-o-q) and lower provisions. However, the bank reversed Rs. 38 crore of contingent provisions.
- Loan growth remained healthy (up 23% y-o-y/6% q-o-q) with a 30bps q-o-q margin expansion to 5.47%. Traction in deposits (up 13% y-o-y/6% q-o-q) picked up, led by strong growth in term deposits (32% y-o-y/13% q-o-q). CASA growth was flat y-o-y/q-o-q. CASA ratio moderated to 53.3% vs. 56.2% in the last quarter.
- Slippages moderated down by 24% q-o-q at Rs. 748 crore, of which Rs. 171 crore got upgraded in Q3FY2023 itself. Coupled with healthy recoveries and upgrades, asset quality improved with GNPA and NNPA ratios declining by 18 bps and 12 bps q-o-q to 1.90% and 0.43%, respectively. Net slippages were negative. SMA 2 book stood at Rs. 191 crore versus Rs. 119 crore q-o-q. Restructured book stood at 0.25% of advances vs. 0.34% q-o-q.
- We remain positive on the bank, while near-term focus would be on transition of Mr. Uday Kotak (MD and CEO) who would retire in December 2023. We maintain our Buy rating with an unchanged SOTP-based PT of Rs. 2,250. The stock currently trades at 2.8x/2.4x/2.1x its FY2023E/FY2024E/FY2025E core BV estimates.

Kotak Mahindra Bank (KMB) reported strong performance, beating consensus and our estimates. Net interest income (NII) grew by 30% y-o-y/11% q-o-q, led by strong advances growth (23% y-o-y/6% q-o-q) along with margin improvement. Net interest margin (NIM) improved by 30 bps q-o-q to 5.47%. Margin improvement can be attributed to the increasing share of higher-yielding unsecured loans and the repricing of floating-rate loans partly offsetting the increase in cost of deposits. Core fee income grew by 23% y-o-y/5% q-o-q. Opex grew by 30% y-o-y/12% q-o-q due to increased retail business volumes, higher technology-related spending, and additional pension cost. Operating profit grew by 43% y-o-y/8% q-o-q, led by healthy NII growth and higher core fee income despite higher opex growth. Credit cost during the quarter stood at 27 bps versus 26 bps q-o-q and remained benign. There was a reversal of contingent provisions worth Rs. 38 crore during the quarter. PAT grew by 31% y-o-y/8% q-o-q, driven by strong PPOp growth and lower provisions. Asset quality saw improvement sequentially, with GNPA and NNPA declining by 18 bps/12bps q-o-q to 1.90%/0.43%. Net slippages were negative for the quarter. SMA-2 book stood at Rs. 191 crore versus in Q3FY2023 Rs. 119 crore in Q2FY2023. The restructured book stood at 0.25% of advances versus 0.34% q-o-q. Advances growth remained strong, up 23% y-o-y and 6% q-o-q. The share of unsecured retail advances stood at 9.3% of advances vs. 8.7% in the last quarter and 6.3% in Q3FY2022, reflecting strong growth in the unsecured retail portfolio. Traction in deposits (up 13% y-o-y/6% q-o-q) picked up, led by strong growth in term deposits (32% y-o-y/13% q-o-q). CASA growth was flat y-o-y/q-o-q. CASA ratio moderated to 53.3% in Q3FY2023 vs. 56.2% in Q2FY2023.

Key positives

- Margin expansion of 30 bps was ahead of expectations
- Strong operating profit growth
- Robust business growth with better asset-quality trends

Key negatives

- There was a sharp uptick in total operating expenses.
- Degrowth in savings deposits balances (down 5% y-o-y/2% q-o-q).

Management Commentary

- The bank maintained its stance of sustaining healthy business growth (both in the secured and unsecured book) with desired risk-adjusted returns, taking the share of unsecured retail advances to mid-teens by the end of FY2024E from the current 9.3% of advances.
- Management is focusing on strengthening and continuous building up of its granular retail liability franchise. The bank is confident that government-led agency business along with a focus on acquiring salary accounts will gradually lead to granular growth and pick-up in SA balances.
- Accelerated investments are expected to continue for strengthening the existing franchise and for future growth. The bank expects operating leverage to start reflecting from H2FY2024.

Our Call

Valuation – We maintain our Buy rating on the stock with an unchanged PT of Rs. 2,250: We believe the bank is well positioned to benefit from the strong credit demand cycle and rising interest rate cycle with its calibrated growth stance, strong underwriting, better assessment capabilities, and stable asset-quality trends adding moat to its business franchise. Margins have inched up further, and the outlook remains buoyant, given the improving asset mix, a higher mix of floating loans, and further repricing of floating loans partly offsetting the increase in deposit rates. We believe margins have not yet peaked out. Further, we expect its subsidiaries to contribute to consolidated earnings, as they gain scale and market share gradually going forward. The stock is currently trading at 2.8x/2.4x/2.1x its FY2023E/FY2024E/FY2025E Core BV. Near-term focus would be on the succession plans of Mr. Uday Kotak (MD and CEO), who would retire by December 2023, and a smooth transition. We maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 2,250.

Key Risks

Economic slowdown can lead to slower loan growth, higher-than-anticipated credit cost, and slower growth in retail liabilities.

Valuation (Standalone)

Particulars	FY22	FY23E	FY24E	FY25E
Net Interest Income	16,818	21,594	26,147	30,993
Net profit	8,573	10,415	11,956	14,876
EPS (Rs.)	43.0	52.5	60.2	75.0
P/E (x)	27.0	22.1	19.3	15.5
P/BV (x)	3.2	2.8	2.4	2.1
RoE	12.7	13.5	13.5	14.6
RoA	2.1	2.3	2.3	2.5

Source: Company; Sharekhan estimates

Key result highlights

Robust NII growth: NII grew by 30% y-o-y/11% q-o-q, led by healthy advances growth and margin improvement. NIM improved by 30 bps q-o-q to 5.47%. Margin improvement can be attributed to an increasing share of higher-yielding unsecured retail advances and repricing of floating rate loans, partly offsetting rising cost of deposits. 55% of the book consists of EBLR linked, 14% linked to MCLR/base rate/another benchmark, and rest 31% fixed rate book. Out of the 31% of fixed-rate book, 9% has a tenure less than one year. We believe margins have not yet peaked out for the bank, but the quantum of margin expansion is expected to be lower on account of repricing of floating rate loans compared to the previous quarters due to relatively higher cost of deposits. However, a higher mix of unsecured retail loans will boost NIM in the next 4-5 quarters.

Accelerated investments to continue to strengthen the franchise: Opex grew by 30% y-o-y/12% q-o-q mainly due to increased retail business volumes, higher technology-related spending, and additional pension cost. The bank guided that opex growth would be higher than revenue growth in the next four quarters due to increased investments in tech and higher business volumes to sustain accelerated growth in the future. The bank expects operating leverage to start reflecting from H2FY2024.

Credit cost remained benign: Credit cost (excluding reversals) was reported at 27 bps versus 26 bps q-o-q, which remained benign during the quarter. There was reversal of contingent provisions worth Rs. 38 crore during the quarter. Total contingent provisions now stand at Rs. 400 crore as of December 2022. The bank has guided that the credit cycle continues to remain benign despite the rising rate cycle. The bank is not seeing any potential risk from any of the portfolios.

Asset quality continues to improve: Asset quality witnessed improvement sequentially, with GNPA and NNPA declining by 18 bps/12bps q-o-q to 1.90%/0.43%. PCR was at ~78% vs. 78%. Net slippages were negative for the quarter. Gross slippages moderated to Rs. 748 crore vs. Rs 983 crore in the last quarter. Recoveries and upgrades stood at Rs. 874 crore versus Rs. 945 crore q-o-q. Write-off stood at Rs. 90 crore vs. Rs. 206 crore q-o-q. SMA-2 book stood at Rs. 191 crore versus Rs. 119 crore q-o-q. Standard restructured book (including COVID + MSME) stood at 0.25% of advances vs. 0.34% q-o-q. The bank continues to carry contingent provisions of Rs. 400 crore (0.13% of advances).

Growth pedals would continue while managing risk: Advances growth was strong, up by 23% y-o-y/6% q-o-q. Home and LAP portfolio, which constitutes ~26% of the book, rose by 29% y-o-y/4% q-o-q. Personal loans and credit cards grew by 70% y-o-y/10% q-o-q and 85% y-o-y/16% q-o-q, respectively. Microfinance (on low base) and SME segments rose by 121% y-o-y/ 20% q-o-q and 25% y-o-y/4%q-o-q, respectively. CV/ CE grew by 27% y-o-y/5% q-o-q, as it continues to witness higher demand. The wholesale corporate book grew by 2% y-o-y/7% q-o-q. CV, tractor, microfinance, SME, and unsecured segments saw higher traction. Collections are also stable. In the MFI segment also, collection efficiency is improving, which is giving the confidence to grow books higher, although the base is very lower. The bank has expanded into three new geographies in MFI loans. In business and commercial banking, better utilisation and capex-led demand is witnessed and there is no apparent deviation in collection. The bank is confident of sustaining its asset growth (both in secured and unsecured), with desired risk-adjusted returns. Pricing pressure has been seen in the large corporate book during the quarter. Thus, the bank did more credit substitutes (32% y-o-y/ 5% q-o-q) on shorter-end tenure and is focusing on mid-corporate book, as risk-adjusted returns are attractive. Moreover, credit substitutes help in optimising PSL cost and returns. NBFCs, structured lending in the infra sector, and CRE projects in affordable housing are seeing strong demand. Credit quality in the ECLGS book continues to be better. Robust loan growth is expected to sustain in the unsecured retail segment (currently form 9.3% of advances). It is expected to grow to mid-teens by the end of FY2024E.

Clear focus on strengthening and continuously building retail liability franchise: Traction in deposits (up 13% y-o-y/6% q-o-q) picked up, led by strong growth in term deposits (32% y-o-y/13% q-o-q). CASA growth was flat y-o-y/q-o-q. CASA ratio moderated to 53.3% vs. 56.2% in the last quarter. Some of the HNI and affluent customers' lumpy balances have moved from savings accounts to liquid and debt funds offering higher rates. The bank is confident on mobilising higher saving deposits (from government business and acquiring salary account). CA growth was granular and strong. Term deposit pricing continues to remain competitive and is seeing higher traction.

Subsidiaries performance: Subsidiaries – Kotak Prime/Kotak Capital/Kotak Securities/Kotak Investments reported net earnings decline of 11%/73%/11%/23%. Kotak Life reported PAT of Rs. 330 crore vs. Rs. 247 crore in Q3FY2022. Kotak AMC reported PAT of Rs. 150 crore vs. Rs. 149 crore in Q3FY2022. The bank is focusing on scaling up the alternate asset class business meaningfully.

Results (Standalone)

	Rs cr				
Particulars	Q3FY23	Q3FY22	Q2FY23	Y-o-Y %	Q-o-Q %
Interest Inc.	8,999	6,897	8,093	30%	11%
Interest Expenses	3,346	2,563	2,993	31%	12%
Net Interest Income	5,653	4,334	5,099	30%	11%
NIM (%)	5.47	4.62	5.17	18%	6%
Core Fee Income	1,847	1,496	1,760	23%	5%
Other Income	253	-132	194	-291%	30%
Net Income	7,753	5,698	7,054	36%	10%
Employee Expenses	1,478	1,200	1,415	23%	4%
Other Opex	2,425	1,797	2,071	35%	17%
Total Opex	3,903	2,997	3,486	30%	12%
Cost-to-Income Ratio	50.3%	52.6%	49.4%		
Pre-Provision Profits	3,850	2,701	3,568	43%	8%
Provisions & Contingencies – Total	149	-132	137	-213%	9%
Profit Before Tax	3,701	2,833	3,431	31%	8%
Tax	909	701	850	30%	7%
Effective Tax Rate	25%	25%	25%		
Reported Profits	2,792	2,131	2,581	31%	8%
Basic EPS (Rs.)	14.06	10.75	13.00	31%	8%
Diluted EPS (Rs.)	14.06	10.74	12.99	31%	8%
RoA (%)	2.48	2.04	2.36		
Advances	3,10,734	2,52,935	2,94,023	23%	6%
Deposits	3,44,666	3,05,286	3,25,203	13%	6%
Gross NPA	5,995	6,983	6,210	-14%	-3%
Gross NPA Ratio (%)	1.90	2.71	2.08		
Net NPA	1,345	2,004	1,630	-33%	-18%
Net NPAs Ratio (%)	0.43	0.79	0.55		
PCR – Calculated	77.6%	71.3%	73.7%		

Source: Company, Sharekhan Research

SOTP valuation

Subsidiary/Associate	Per share value (Rs.)
Kotak Mahindra Prime	127
Kotak Mahindra Securities	110
Kotak Mahindra Life Insurance	231
Kotak Mahindra Capital	22
Kotak Mahindra AMC	54
Others	59
Valuation of subs. (with a 20% holding company discount)	603
Core Bank	1,647
Total SOTP-based valuation (Rs.)	2,250

Source: Company, Sharekhan estimates

Outlook and Valuation

■ Sector view - Deposit mobilisation to be in focus; Banks with strong deposit franchise placed better

System-level credit offtake grew by ~17.4% y-o-y in the fortnight ending December 16, 2022, indicating loan growth has been sustaining, given distinct signs of an improving economy and revival of investments and loan demand. On the other hand, deposits rose by ~9.4% but are trailing advances growth. We should see sustained acceleration in loan growth. Margins are likely to improve, but momentum is expected to moderate, and margins are expected to peak out by H1FY2024. Asset quality is not a big issue on the corporate lending end, as only de-leveraging is observed. From the retail side, there could be some pressure, but nothing is significant. Asset quality is likely to remain stable in the medium term. Banks are in a sweet spot in terms of fundamentals. In the past few years, lenders have been cautious about lending to the 'BB and below' category, thus the general risk, which they are carrying on the corporate loan portfolio, is low. On the retail loans front, due to COVID-19, banks have already seen one downcycle. Most of the exposure has been taken into credit costs. In terms of the MSME book, we need to be watchful. At present, we believe the banking sector is likely to see higher risk-off behaviour, with tactical market share gains for well-placed players. We believe large banks with a strong capital base, robust deposit franchise, and asset quality (with high coverage and provision buffers) are well placed to capture growth opportunities.

■ Company outlook - Sustainable business franchise

We believe structural drivers are in place for KMB, helping it to gain market share, aided by strong credit assessment capabilities and a stable asset-quality matrix. Notably, the franchise continues to be one of the best-managed business franchises and needs to be seen from a long-term perspective. We believe the bank is well positioned to benefit from the strong credit demand cycle and rising rate cycle with its calibrated growth stance, strong underwriting, better assessment capabilities, and stable asset-quality trends, adding a moat to its business franchise. KMB's prudent risk management, higher coverage on bad loans along with comfortable capitalisation levels are additional positives. Key monitorable from here on would be succession plans of Mr. Uday Kotak who would retire by December 2023.

■ Valuation - We maintain our Buy rating on the stock with an unchanged PT of Rs. 2,250

We believe the bank is well positioned to benefit from the strong credit demand cycle and rising interest rate cycle with its calibrated growth stance, strong underwriting, better assessment capabilities, and stable asset-quality trends adding moat to its business franchise. Margins have inched up further, and the outlook remains buoyant, given the improving asset mix, a higher mix of floating loans, and further repricing of floating loans partly offsetting the increase in deposit rates. We believe margins have not yet peaked out. Further, we expect its subsidiaries to contribute to consolidated earnings, as they gain scale and market share gradually going forward. The stock is currently trading at 2.8x/2.4x/2.1x its FY2023E/FY2024E/FY2025E Core BV. Near-term focus would be on the succession plans of Mr. Uday Kotak (MD and CEO), who would retire by December 2023, and a smooth transition. We maintain our Buy rating on the stock with an unchanged PT of Rs. 2,250.

Peer Comparison

Companies	CMP (Rs/ Share)	MCAP (Rs. cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Kotak Mahindra Bank	1,763	3,50,197	22.1	19.3	2.8	2.4	13.5	13.5	2.3	2.3
ICICI Bank	870	6,07,345	15.9	14.0	2.5	2.1	16.9	16.2	2.1	2.1
Axis Bank	931	2,86,229	13.1	10.6	2.0	1.7	16.4	17.1	1.6	1.8

Source: Company; Sharekhan Research

About company

Established in 1985, Kotak Mahindra Group (Group) is one of India's leading financial services conglomerates. KMB has a national footprint of 1,752 branches and 2,814 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 the diverse financial needs of both individuals and the corporate sector. The bank has a well-diversified pan-India presence (~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 is an attractive business franchise, with strong 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 a strong business model and is well on track to be a significant value contributor to the consolidated business in the long term. We find KMB to be an attractive franchise with a strong balance sheet, prudent risk management, and healthy capitalisation.

Key Risks

Economic slowdown can lead to slower loan growth, higher-than-anticipated credit cost, and slow growth in retail liability.

Additional Data

Key management personnel

Mr. Uday Kotak	Managing Director and CEO
Mr. Dipak Gupta	Joint MD
Ms. S. Ekambaram	Head – Consumer Banking
Mr. K.V.S. Manian	Head – Wholesale and Investment Banking
Mr. D. Kannan	Head – Commercial Banking

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	KOTAK UDAY SURESH	25.73
2	CAPITAL GROUP COS INC.	11.59
3	LIFE INSURANCE CORP OF INDIA	6.25
4	CANADA PENSION PLAN INVESTMENT B	4.35
5	EUROPACIFIC GROWTH FUND	4.01
6	SBI FUNDS MANAGEMENT LTD.	3.43
7	INVESCO LTD.	3.25
8	NEW WORLD FUND INC	2.10
9	SUMITOMO MITSUI FINANCIAL GROUP INC.	1.65
10	AXIS ASSET MANAGEMENT CO. LTD.	1.59

Source: Bloomberg

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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 deteriorating 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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