Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Kotak Mahindra Bank

Steady Q1; deposit growth encouraging

Banks	Sharekhan code: KOTAKBANK
Reco/View: Buy ↔	CMP: Rs. 1,971
	Price Target: Rs. 2,250 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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 19.09

Updated Jul 08, 2023

Medium Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 3,91,699 cr
52-week high/low:	Rs. 2,063 / 1,644
NSE volume: (No of shares)	49.3 lakh
BSE code:	500247
NSE code:	KOTAKBANK
Free float: (No of shares)	147.1 cr

Shareholding (%)

Promoters	25.9
FII	41.6
DII	19.6
Others	12.9

Price chart

Price performance

()	1m	3m	6m	12m
Absolute	6.8	4.1	11.8	9.4
Relative to Sensex	1.8	-7.7	1.8	-10.3

Sharekhan Research, Bloomberg

Summary

- Kotak Mahindra Bank's earnings growth was steady , rising 67% y-o-y which translated to RoA of ~2.8% led by higher other income despiteNIMs compression, higher opex growth and slightly higher credit cost. Sustainable RoAs for the bank is expected in the range of 2.2-2.5%
- Headline asset quality trends remained stable q-o-q with GNPA/NNPA ratio at 1.77%/0.40% although slippages ratio was higher at 1.7% versus 1.2% q-o-q (cal. as % of 12m trailing loans) due to seasonality in the portfolio and normalisation of slippages but it remained lower on y-o-y basis. Kotak`s slippage ratio still continues to be lower than the top large private bank which is a key positive.
- Core credit cost stood at 54 bps vs 24 bps q-o-q (excluding reversal of provisions). The bank does not see any potential stress in the any of the portfolio segment but guided that normalisation of slippages and credit cost is expected to happen. Deposit growth (up 6% q-o-q) picked up sharply and outpaced loan growth. Traction in deposits was led by term deposits and a newly product launched Activ money for saving account holders.
- The bank guided that it is on track with leadership transition and would come out with development sooner. We maintain our Buy rating with an unchanged SOTP-based PT of Rs. 2,250. The stock currently trades at 3.0x/2.6x its FY2024E/FY2025E core BV estimates.

Kotak Mahindra Bank (KMB) reported steady performance in Q1FY24 led by higher other income (dividend & treasury income). Net interest income (NII) grew by 33% y-o-y/2% q-o-q. Net interest margin (NIM) declined by 18 bps q-o-q to 5.57% on the expected lines. NIMs are likely to moderate further as cost of deposits would put further pressure on cost of funds in coming quarters which would be partly offset by increasing share of unsecured portfolio in the overall loan mix. Core fee income grew by 20% y-o-y/ down 5% q-o-q. There was a treasury gain of Rs. 240 crore vs Rs. 1 crore q-o-q and loss of Rs. 857 crore in Q1FY23. Total operating expenses grew by 31% y-o-y/9% q-o-q driven by investment in tech, distribution cost incl. staff cost and some promotional costs. Opex-to-average assets stood at 3.2% vs 3.0% q-o-q. Operating profit grew by 78% y-o-y/7% q-o-q. Core credit cost stood at 54 bps vs 24 bps q-o-q (excl. reversal of provisions). The bank does not see any potential stress in the any of the portfolio segment but guided that normalisation of slippages and credit cost is expected to happen. During the quarter, there was a reversal of contingent provisions worth Rs. 50 crore and Rs. 27 crore from provisions created on account of restructured book. PBT grew by 66% y-o-y/2% q-o-q. Headline asset quality trends remained stable q-o-q with GNPA/NNPA ratio at 1.77%/0.40% although slippages ratio was higher at 1.7% versus 1.2% q-o-q (cal. as a % of trailing 12-month loans) due to seasonality in the portfolio and normalisation of slippages but it remained lower on y-o-y basis. Net slippages stood at Rs. 513 crore vs Rs. 36 crore q-o-q. SMA-2 book stood at Rs. 203 crore versus Rs. 204 crore in the last quarter. The restructured book stood at 0.19% of advances vs 0.22% q-o-q. Advances growth was broad-based, up 17% y-o-y and 3% q-o-q. The share of unsecured retail advances stood at 10.7% of advances vs. 10.0% in the last quarter, reflecting strong growth in the unsecured retail portfolio. Deposit growth (+6% q-o-q) picked up sharply and outpaced loan growth. Traction in deposits was led by term deposits (49% y-o-y/ 15% q-o-q) and a newly product launched Activ Money for savings account holders. CASA growth was muted at 3% y-o-y / down 1%. CASA ratio moderated to 49.0% vs 58% in y-o-y.

Key positives

- Deposits growth (+6% q-o-q) picked up sharply and outpaced loan growth. Traction in deposits was led by term deposits (49% y-o-y/ 15% q-o-q) and a newly-launched Activ Money for savings account holders.

Key negatives

- Opex growth remained higher. Opex to average assets ratio stood at 3.2% vs 3.0% q-o-q.
- Credit cost and slippages ratios were higher sequentially although the bank do not see any potential stress in the any of the portfolio segment but guided that normalisation of slippages and credit cost is happening.

Management Commentary

- The bank maintained its stance growing at 1.5-2x, the nominal GDP rate and guided that macro-outlook is positive for India.
- The bank do not see any potential stress arising in the any of the portfolio segment including unsecured portfolio but guided that normalisation of slippages and credit cost is happening.
- Deposit growth picked up sharply led by strong traction in term deposits and a newly product launched Activ Money for saving account holders that helped SA balances to pick up sequentially.

Our Call

Valuation – We maintain a Buy rating on the stock with an unchanged PT of Rs. 2,250: KMB would continue to command premium valuations, given a high growth potential and strong assessment capabilities in terms of underwriting. In the journey to add scale to its business, some of the matrices like cost-to-income ratios may witness near-term challenge. NIMs are also likely to moderate further as cost of deposits would put further pressure on cost of funds in coming quarters which would be partly offset by increasing share of unsecured portfolio in the overall loan mix. As most banks are geared to capture growth opportunities with improving credit behaviour, we believe the superior liability franchise would be key to sustain growth and healthy margins. We expect its subsidiaries to contribute to consolidated earnings, as they gain scale and market share gradually going forward. Stock is currently trading at 3.0x/2.6x its FY2024E/FY2025E Core BV. The near-term focus would be on the transition of its MD & CEO..

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Net Interest Income	16,818	21,552	25,316	28,677
Net profit	8,573	10,939	12,488	14,131
EPS (Rs.)	43.0	54.9	62.9	71.1
P/E (x)	33.6	26.3	23.0	20.3
P/BV (x)	4.0	3.4	3.0	2.6
RoE	12.7	14.1	14.0	13.8
RoA	2.1	2.4	2.4	2.4

Source: Company; Sharekhan estimates

Key result highlights

- **NIMs outlook negative:** Net interest income (NII) grew by 33% y-o-y/2% q-o-q. Net interest margin (NIM) declined by 18 bps q-o-q to 5.57% on the expected lines. NIMs are likely to moderate further as cost of deposits would put further pressure on cost of funds in coming quarters which would be partly offset by increasing share of unsecured portfolio in the overall loan mix. The bank is confident on sustaining margins above 5% in FY2024.
- **Accelerated investments keeps costs elevated:** Total operating expenses grew by 31% y-o-y/9% q-o-q driven by investment in tech, higher staff cost and some promotional cost. Opex-to-average assets stood at 3.2% versus 3.0% q-o-q. Accelerated investments in building digital capabilities are expected to continue for strengthening the existing franchise and for future growth. Opex growth would be higher than revenue growth for the next few quarters.
- **Credit cost outlook stable however normalisation to happen:** Core credit cost stood at 54 bps vs 24 bps q-o-q (excl. reversal of provisions). The bank do not see any potential stress in the any of the portfolio segment but guided that normalisation of slippages and credit cost is expected to happen. During the quarter, there was a reversal of contingent provisions worth Rs. 50 crore and Rs. 27 crore from provisions created on account of the restructured book. Total contingent provisions now stands at Rs. 337 crore. The bank do not see any potential stress arising in the any of the portfolio segment including unsecured portfolio but guided that normalisation of slippages and credit costs is happening.
- **Asset quality stable:** Headline asset quality trends remained stable q-o-q with GNPA/NNPA ratio at 1.77%/0.40% although slippages ratio was higher at 1.7% versus 1.2% q-o-q (cal. as % of 12m trailing loans) due to seasonality in the portfolio and normalisation of slippages but it remained lower on y-o-y basis. Net slippages were at Rs. 513 crore vs Rs. 36 crore q-o-q. SMA-2 book stood at Rs. 203 crore vs. Rs. 204 crore in the last quarter. The restructured book stood at 0.19% of advances vs 0.22% q-o-q. Gross slippages were at Rs. 1205 crore vs Rs. 823 crore in the last quarter. Recoveries and upgrades stood at Rs. 692 crore vs Rs. 787crore q-o-q. Write-offs were higher at Rs. 372 crore vs. Rs. 262 crore q-o-q.
- **Loan growth picked up in corporate banking:** Advances grew by 17% y-o-y /3% q-o-q. Home and LAP portfolio, which constitutes ~26% of the book, rose by 18% y-o-y / 3% q-o-q. Personal loans and credit cards grew by 44% y-o-y/6% q-o-q and 67% y-o-y/ 13% q-o-q, respectively. Microfinance (on a low base) grew by 91% y-o-y. CV/CE grew by 23% y-o-y/3% q-o-q. The wholesale corporate book grew by 16% y-o-y/20% q-o-q. CV, tractor, microfinance, and unsecured segments saw higher traction and wholesale corporate growth also picked up sharply. Corporate book witnessed strong demand from MNC (in manufacturing & services) & NBFCs. Pricing pressure is still there in corporate segment. The bank has set up a new mid-corporate segment and it is also building supply chain platform. In the SME space, demand is strong, but limit utilization were lower thus book growth was lower at 9% y-o-y. In the CV segment, although volumes have declined however there is strong demand and collection efficiency continues to flare better. Banks focus is on increasing distribution. Tractor volumes have also declined but bank grew in used as well as new segment. Microfinance is seeing strong asset quality. Rural economy demand is also strong. Robust loan growth is expected to sustain in the unsecured retail segment (currently form 10.7% of advances). It is expected to grow to mid-teens by the end of FY2024. The bank maintained its stance growing at 1.5-2x, nominal GDP rate and guided that macro-outlook is positive for India.
- **Deposit mobilisation improved:** Deposit growth (+6% q-o-q) picked up sharply and outpaced loan growth. Traction in deposits was led by term deposits (49% y-o-y/ 15% q-o-q) and a newly product launched Activ Money for saving account holders that helped SA balances to pick up sequentially. CASA growth was muted at 3% y-o-y / down 1%. CASA ratio moderated to 49.0% vs 58% in y-o-y.
- **Subsidiaries' performance:** Kotak Prime/ Kotak Capital /Kotak Investments reported increase in earnings by 42%/10%/63% in Q1FY2024 while Kotak Securities/ Kotak AMC reported flat earnings growth on y-o-y basis. Kotak Life reported PAT of Rs. 193 crore vs. Rs. 248 crore y-o-y.

Results (Standalone) Rs cr

Particulars	1QFY24	1QFY23	4QFY23	Y-o-Y	Q-o-Q
Interest Inc.	10,500	7,338	9,821	43%	7%
Interest Expenses	4,266	2,641	3,718	62%	15%
Net Interest Income	**6,234**	**4,697**	**6,103**	**33%**	**2%**
NIM (%)	5.57	4.92	5.75	13%	-3%
Core Fee Income	1,827	1,528	1,928	20%	-5%
Other Income	856	-412	258	-308%	232%
Net Income	**8,917**	**5,813**	**8,289**	**53%**	**8%**
Employee Expenses	1,647	1,173	1,454	40%	13%
Other Opex	2,320	1,857	2,187	25%	6%
Total Opex	**3,967**	**3,030**	**3,641**	**31%**	**9%**
Cost to Income Ratio	44.5%	52.1%	43.9%		
Pre Provision Profits	**4,950**	**2,783**	**4,647**	**78%**	**7%**
Provisions & Contingencies - Total	364	24	148	1444%	147%
Profit Before Tax	**4,585**	**2,760**	**4,500**	**66%**	**2%**
Tax	1,133	689	1,004	65%	13%
Effective Tax Rate	25%	25%	22%		
Reported Profits	**3,452**	**2,071**	**3,496**	**67%**	**-1%**
Basic EPS (Rs)	17.38	13.74	17.39	26%	0%
Diluted EPS (Rs)	17.38	13.74	17.39	26%	0%
RoA (%)	2.8	2.0	3.0		
Advances	3,28,582	2,80,171	3,19,861	17%	3%
Deposits	3,86,254	3,16,483	3,63,096	22%	6%
Gross NPA	**5,909**	**6,379**	**5,768**	**-7%**	**2%**
Gross NPA Ratio (%)	1.77	2.24	1.78		
Net NPA	**1,302**	**1,749**	**1,193**	**-26%**	**9%**
Net NPAs Ratio (%)	0.40	0.62	0.37		
PCR - Calculated	78.0%	72.6%	79.3%		

Source: Company, Sharekhan Research

SOTP valuation

Subsidiary/Associate	Per share value (Rs.)
Kotak Mahindra Prime	122
Kotak Mahindra Life Insurance	165
Kotak Mahindra Securities	80
Kotak Mahindra AMC	100
Kotak Mahindra Investments	40
Others	20
Total	527
Core Bank	1,723
Total SOTP-based valuation (Rs.)	**2,250**

Source: Company; Sharekhan estimates

Outlook and Valuation

■ Sector View – Deposit mobilisation to be in focus; banks with a superior liability franchise placed better

System-level credit offtake grew by ~15.4% y-o-y in the fortnight ending June 16, 2023, indicating loan growth has been sustaining, given distinct signs of an improving economy, revival of investments, and strong demand. On the other hand, deposits rose by ~12.1%. The gap between advances and deposits growth is narrowing and is expected to further narrow as real deposit rates increase gradually. We should see some moderation in loan growth due to a higher base in FY2024, but loan growth is expected to remain healthy. Margins have likely peaked out in Q4FY2023. Overall asset-quality outlook continues to remain stable to positive for the sector. We believe banks with a robust capital base, strong deposit franchise and asset quality (with high coverage and provision buffers) are well-placed to capture growth opportunities.

■ Company Outlook – Strong business franchise

We believe structural drivers are in place for KMB, helping it to gain market share, aided by strong credit assessment capabilities, strong liability franchise and a stable asset-quality. 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 KMB would continue to command premium valuation, given high growth potential and strong assessment capabilities in terms of underwriting. KMB's prudent risk management, higher coverage on bad loans along with comfortable capitalisation levels are additional positives. Key monitorables from hereon would be the succession plans of 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

KMB would continue to command premium valuations, given a high growth potential and strong assessment capabilities in terms of underwriting. In the journey to add scale to its business, some of the matrices like cost-to-income ratios may witness near-term challenge. NIMs are also likely to moderate further as cost of deposits would put further pressure on cost of funds in coming quarters which would be partly offset by increasing share of unsecured portfolio in the overall loan mix. As most banks are geared to capture growth opportunities with improving credit behaviour, we believe the superior liability franchise would be key to sustain growth and healthy margins. We expect its subsidiaries to contribute to consolidated earnings, as they gain scale and market share gradually going forward. Stock is currently trading at 3.0x/2.6x its FY2024E/FY2025E Core BV. The near-term focus would be on the transition of its MD & CEO.

Peer Comparison

Companies	CMP (Rs/ Share)	MCAP (Rs. cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Kotak Mahindra Bank	1,971	3,91,699	23.0	20.3	3.0	2.6	14.0	13.8	2.4	2.4
ICICI Bank	997	6,97,414	16.8	15.3	2.6	2.2	16.6	15.5	2.1	2.1
Axis Bank	971	2,99,195	11.9	10.8	1.9	1.6	17.4	16.2	1.7	1.7

Source: Company; Sharekhan Research

About the company

Established in 1985, Kotak Mahindra Group (Group) is one of India's leading financial services conglomerates. KMB has a national footprint of 1,788 branches and 3,047 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 ratio in the industry.

Investment theme

We believe KMB is an attractive business franchise, with strong products and services offerings, 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, lower margin than expected, 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

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	KOTAK UDAY SURESH	25.7
2	CAPITAL GROUP COS INC.	9.2
3	LIFE INSURANCE CORP OF INDIA	6.2
4	CANADA PENSION FUND	4.3
5	SBI FUNDS MANAGEMENT LTD.	3.8
6	INVESCO LTD	3.1
7	BLACKROCK Inc	2.1
8	SUMITOMO MITSUI Financial group	1.7
9	JP MORGAN CHASE & Co.	1.6
10	CALADIUM INVESTMENT PTE. LTD.	1.3

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

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