

BUY

TP: Rs 1,450 | ▲ 26%

**KOTAK MAHINDRA
BANK**

| Banking

| 22 April 2020

Quality franchise; capital raising adds buffer – reiterate BUY

Kotak Mahindra Bank (KMB) has received **board approval** to raise ~Rs 75bn in capital which will bolster CAR by ~300bps, reduce promoter stake to 29% and build buffers against contingencies. KMB's CAR has always been well above the regulatory threshold, which in part explains the lower ROE than HDFCB. Liability franchise continues to improve (56% CASA ratio for Q4) and a reduced savings rate would curb cost of funds. We reiterate BUY but revise our Mar'21 TP to Rs 1,450 (vs. Rs 1,875) as we cut FY21-FY22 EPS 17-25% on slower growth ahead.

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Diluting 3.4% equity to raise Rs 74.8bn: KMB has received board approval to raise equity capital by issuing up to 65mn shares, which entails dilution of 3.4%. We believe this capital infusion exercise ticks multiple boxes – (1) it reduces promoter stake to 29% from 30% currently. As per the bank's **agreement** and **approval** from RBI, promoter holding has to be pared to 26% by Aug'20; (2) KMB is well capitalised with a 17.7% tier-1 ratio – this capital raise will add ~300bps to the tier-1 ratio and further strengthen the balance sheet in a turbulent period; (3) part of the capital could be used to support subsidiaries.

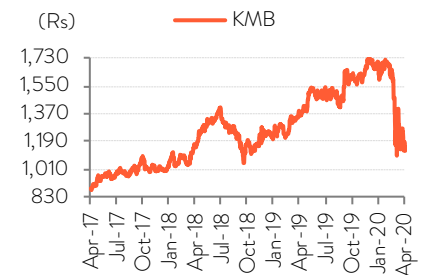
Top-notch liability franchise: The bank continues to do exceedingly well on the liability front. **Proforma numbers for Q4FY20** indicate that the CASA ratio improved by 250bps QoQ to 56.2%, likely aided in part by the Yes Bank saga. KMB also reduced the interest rate on savings deposits by up to 150bps in Apr'20. This will lead to substantial savings for the bank and drive down its cost of funds, thereby providing a cushion to margins.

Maintain BUY: KMB fares well in terms of its capital position and liability franchise. However, we reduce FY21-FY22 EPS by 17-25% to factor in slower loan growth and increased credit costs despite solid underwriting standards, given buildup of economic stress due to Covid-19. Maintain BUY.

Ticker/Price	KMB IN/Rs 1,152
Market cap	US\$ 28.8bn
Shares o/s	1,910mn
3M ADV	US\$ 92.7mn
52wk high/low	Rs 1,740/Rs 1,001
Promoter/FPI/DII	30%/40%/30%

Source: NSE

STOCK PERFORMANCE



Source: NSE

IMPACT OF RS 74.8BN EQUITY INFUSION IN KMB

Particulars	Pre-issue	Post-issue
Tier-1 (%)	17.7	19.9
CAR (%)	18.2	20.5
Shares held by promoter (#)	572	572
Promoter holding (%)	30	29

Source: Company, BOBCAPS Research | Our capital adequacy calculations are based on net worth

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	95,317	112,590	133,737	149,552	170,423
NII growth (%)	1729.6	1812.1	1878.3	1182.5	1395.5
Adj. net profit (Rs mn)	40,619	42,571	63,009	65,310	75,983
EPS (Rs)	21.8	25.5	33.0	33.6	38.5
P/E (x)	52.8	45.2	34.9	34.2	29.9
P/BV (x)	5.9	5.2	4.5	3.7	3.3
ROA (%)	1.7	1.7	1.9	1.7	1.8
ROE (%)	12.5	12.2	13.9	11.8	11.6

Source: Company, BOBCAPS Research

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Valuation methodology

KMB is currently trading at 2.2x FY22E core P/BV. In our view, the bank merits premium valuations given the substantial improvement in liability franchise, best-in-class margins and sturdy asset quality. Moreover, its proven and stable leadership contrasts with the uncertainty surrounding management changes at most private sector peers.

Despite the bank's solid underwriting standards, we are pruning loan growth and raising credit cost assumptions for the next two years given the buildup of economic stress due to Covid-19. Our FY21-FY22 EPS estimates thus stand reduced by 17-25%.

We value KMB using the SOTP methodology to arrive at a revised Mar'21 target price of Rs 1,450 (vs. Rs 1,875 earlier). The core business is valued at 3x FY22E P/BV based on the Gordon Growth Model, while subsidiaries drive ~30% of our fair value. Maintain BUY.

FIG 1 – REVISED ESTIMATES

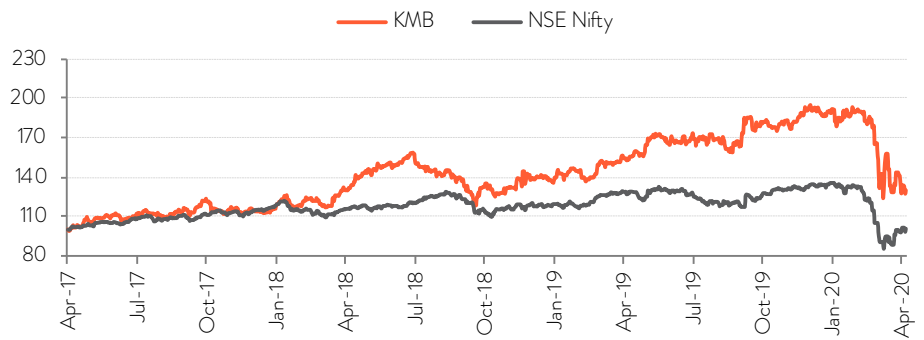
Particulars	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Net interest income (Rs mn)	133,737	149,552	170,423	133,737	160,501	196,487	-	(6.8)	(13.3)
Pre-provisioning profit	100,396	110,368	123,347	100,396	121,080	148,027	-	(8.8)	(16.7)
Net Profit (Rs mn)	63,009	65,310	75,983	63,009	77,531	97,975	-	(15.8)	(22.4)
EPS (Rs)	33	34	38	33	41	51	-	(17.2)	(25.0)

Source: BOBCAPS Research

FIG 2 – SOTP VALUATION

Sum of Parts	Company Value (Rs bn)	Stake in Company (%)	Value for KMB (Rs bn)	Per Share (Rs)	Comments
Core Business	1,976	100	1,976	1,001	Valued at 3.3x Mar'22E P/BV on Gordon Growth Model
Kotak Life	424	100	424	215	6x trailing Embedded Value
Kotak Prime	187	100	187	95	2.5x Mar'22E P/BV
Kotak AMC	112	100	112	57	6% of Q2FY20 AAUM
Kotak Securities	79	100	79	40	14x Mar'22E P/E
Kotak Investments	53	100	53	27	15x Mar'22E P/E
International subsidiaries	20	100	20	10	10x Mar'22E P/E
KMCC	12	100	12	6	15x Mar'22E P/E
Sum of Parts			2,862	1,450	

Source: BOBCAPS Research

FIG 3 – RELATIVE STOCK PERFORMANCE

Source: NSE

Key risks

- A worsening economic environment can impact our loan growth and credit cost assumptions and lead to deterioration in KMB's asset quality.
- KMB derives significant value from its insurance, lending and capital markets subsidiaries; should they perform poorly, this will have an adverse impact on the bank's fair value and subsequently on our target price.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	95,317	112,590	133,737	149,552	170,423
NII growth (%)	1729.6	1812.1	1878.3	1182.5	1395.5
Non-interest income	40,522	46,040	52,002	56,338	63,394
Total income	135,839	158,630	185,739	205,890	233,817
Operating expenses	(64,257)	(75,148)	(85,343)	(95,522)	(110,470)
Operating profit	71,582	83,482	100,396	110,368	123,347
Operating profit growth (%)	1,960.6	1,662.5	2,026.1	993.3	1,176.0
Provisions	(9,624)	(15,707)	(15,707)	(22,585)	(21,219)
PBT	61,958	67,775	84,689	87,782	102,127
Tax	(21,339)	(25,205)	(21,680)	(22,472)	(26,145)
Reported net profit	40,619	42,571	63,009	65,310	75,983
Adjustments	0	0	0	0	0
Adjusted net profit	40,619	42,571	63,009	65,310	75,983

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	9,528	9,544	9,544	9,869	9,869
Reserves & surplus	365,310	414,461	474,580	610,945	682,572
Net worth	374,838	429,005	489,124	625,814	697,441
Deposits	1,926,433	2,258,804	2,629,247	2,865,880	3,209,785
Borrowings	260,811	327,043	311,603	327,183	351,911
Other liabilities & provisions	87,252	106,870	117,785	128,032	142,999
Total liabilities and equities	2,649,334	3,121,721	3,547,759	3,946,909	4,402,135
Cash & bank balance	196,201	246,755	214,234	211,657	225,669
Investments	645,623	711,891	781,453	874,315	1,009,492
Advances	1,697,179	2,056,948	2,194,764	2,370,345	2,654,786
Fixed & Other assets	110,330	106,127	357,308	490,593	512,188
Total assets	2,649,334	3,121,721	3,547,759	3,946,909	4,402,135
Deposit growth (%)	22.4	17.3	16.4	9.0	12.0
Advances growth (%)	24.7	21.2	6.7	8.0	12.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	21.8	25.5	33.0	33.6	38.5
Dividend per share	0.6	0.8	1.3	1.5	1.9
Book value per share	196.7	222.1	253.6	314.5	350.8

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	52.8	45.2	34.9	34.2	29.9
P/BV	5.9	5.2	4.5	3.7	3.3
Dividend yield (%)	0.1	0.1	0.1	0.1	0.2

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	4.0	3.9	4.0	4.0	4.1
Non-interest income	1.7	1.6	1.6	1.5	1.5
Operating expenses	2.7	2.6	2.6	2.5	2.6
Pre-provisioning profit	3.0	2.9	3.0	2.9	3.0
Provisions	0.4	0.3	0.5	0.6	0.5
PBT	2.6	2.3	2.5	2.3	2.4
Tax	0.9	0.9	0.7	0.6	0.6
ROA	1.7	1.7	1.9	1.7	1.8
Leverage (x)	7.4	7.2	7.3	6.8	6.4
ROE	12.5	12.2	13.9	11.8	11.6

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	17.3	18.1	18.8	11.8	14.0
Pre-provisioning profit	19.6	16.6	20.3	9.9	11.8
EPS	17.4	17.0	29.4	1.9	14.4
Profitability & Return ratios (%)					
Net interest margin	4.2	4.1	4.3	4.5	4.6
Fees / Avg. assets	1.2	1.2	1.1	1.1	1.1
Cost-Income	47.3	47.4	45.9	46.4	47.2
ROE	12.5	12.2	13.9	11.8	11.6
ROA	1.7	1.7	1.9	1.7	1.8
Asset quality (%)					
GNPA	2.2	2.1	2.6	3.1	3.0
NNPA	1.0	0.8	1.0	1.0	0.9
Provision coverage	56.5	65.4	63.7	69.0	69.7
Ratios (%)					
Credit-Deposit	88.1	91.1	83.5	82.7	82.7
Investment-Deposit	33.5	31.5	29.7	30.5	31.5
CAR	18.2	17.5	17.2	18.9	18.7
Tier-1	17.6	16.9	16.6	18.4	18.2

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: KOTAK MAHINDRA BANK (KMB IN)



B – Buy, A – Add, R – Reduce, S – Sell

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