

**BUY**

TP: Rs 1,550 | ▲ 17%

**KOTAK MAHINDRA  
BANK**

| Banking

| 27 July 2020

## Moratorium share dips; asset quality slips on prudent measures

Kotak Bank's (KMB) PAT at Rs 12.4bn declined 8.5% YoY given a 33% drop in fee income and higher Covid-related provisions worth Rs 6.2bn. Despite a 2% YoY dip in loan growth and 30bps QoQ NIM contraction to 4.4%, NII growth held strong at 17% YoY. Loans under moratorium dropped to 9.7% with ~95% of customers rolling over from phase-1. Slippages rose to ~Rs 80bn (vs. Rs 49bn QoQ) as a large account turned NPA and as KMB observed prudence in granting moratorium. Maintain BUY as we roll to a Sep'21 TP of Rs 1,550 (vs. Rs 1,450).

Vikesh Mehta  
research@bobcaps.in

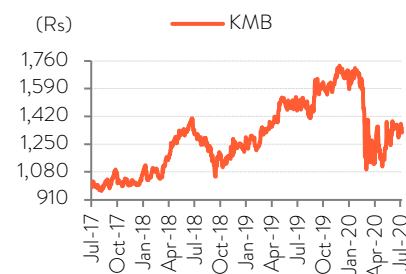
**Moratorium share in line with large private banks:** Overall moratorium share declined from ~26% of loans under phase-1 to 9.7% as on 30 June, which is in line with Axis and HDFC Bank. The share of KMB's wholesale book under moratorium is in low single digits but this is higher for SME loans. Collection from moratorium phase-1 customers improved in June-July but is yet to reach pre-pandemic levels. The bank has Covid-related provisions worth Rs 12.7bn (0.6% of loans).

Ticker/Price	KMB IN/Rs 1,323
Market cap	US\$ 35.0bn
Shares o/s	1,979mn
3M ADV	US\$ 103.1mn
52wk high/low	Rs 1,740/Rs 1,001
Promoter/FPI/DII	30%/40%/30%

Source: NSE

**Higher slippages dent asset quality:** GNPA rose 45bps QoQ to 2.7% as slippages were higher at Rs 79.6bn. KMB prudently focused on the fundamental viability of borrowers and businesses before granting moratorium under phase-2, which led to some accounts turning NPA. This apart, a large account also slipped into NPA. Management highlighted that collection efficiency in June/July has improved for the CV, CE, agri and tractor segments. The bank has cumulative specific, standard and Covid provisions worth 107% of GNPA's.

## STOCK PERFORMANCE



Source: NSE

**Maintain BUY:** We like KMB for its proven and stable leadership, substantial improvement in liability franchise, best-in-class margins and sound underwriting standards. Maintain BUY as we roll forward to a Sep'21 TP of Rs 1,550 (vs. Rs 1,450).

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	112,590	134,997	148,390	168,584	190,791
NII growth (%)	1812.1	1990.2	992.1	1360.9	1317.2
Adj. net profit (Rs mn)	36,116	59,472	64,525	75,869	87,296
EPS (Rs)	25.5	31.1	33.2	38.4	44.1
P/E (x)	51.8	42.5	39.9	34.5	30.0
P/BV (x)	6.0	5.2	4.2	3.8	3.4
ROA (%)	1.7	1.8	1.7	1.8	1.8
ROE (%)	12.2	13.1	11.7	11.5	11.9

Source: Company, BOBCAPS Research

**BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda**

Important disclosures, including any required research certifications, are provided at the end of this report.



**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q1FY21	Q1FY20	Q4FY20	YoY (%)	QoQ (%)
<b>Income Statement</b>					
<b>Interest income</b>	<b>69,119</b>	<b>66,399</b>	<b>68,047</b>	<b>4.1</b>	<b>1.6</b>
Interest expense	31,880	34,668	32,450	(8.0)	(1.8)
<b>Net interest income</b>	<b>37,239</b>	<b>31,730</b>	<b>35,597</b>	<b>17.4</b>	<b>4.6</b>
Non-interest income	7,735	13,047	14,894	(40.7)	(48.1)
Net total income	44,974	44,778	50,490	0.4	(10.9)
Staff expenses	9,109	9,015	9,696	1.0	(6.1)
Other operating expenses	9,628	11,773	13,542	(18.2)	(28.9)
Operating expenses	18,737	20,789	23,238	(9.9)	(19.4)
Pre-provisioning profit	26,237	23,989	27,253	9.4	(3.7)
<b>Total provisions</b>	<b>9,620</b>	<b>3,168</b>	<b>10,475</b>	<b>203.7</b>	<b>(8.2)</b>
<b>Profit before tax</b>	<b>16,617</b>	<b>20,822</b>	<b>16,778</b>	<b>(20.2)</b>	<b>(1.0)</b>
Tax	4,173	7,220	4,112	(42.2)	1.5
<b>Profit after tax</b>	<b>12,445</b>	<b>13,602</b>	<b>12,666</b>	<b>(8.5)</b>	<b>(1.7)</b>
<b>Balance Sheet</b>					
Advances	2,039,980	2,080,300	2,197,482	(1.9)	(7.2)
Deposits	2,615,240	2,329,310	2,628,205	12.3	(0.5)
CASA ratio (%)	56.7	50.7	56.2	601bps	56bps
<b>Yields and margins (%)</b>					
Net interest margin	4.4	4.5	4.7	(9bps)	(32bps)
Yield on advances	9.4	10.0	9.7	(64bps)	(29bps)
Cost of funds	4.2	5.4	4.6	(117bps)	(40bps)
<b>Key ratios (%)</b>					
Cost/Income	41.7	46.4	46.0	(476bps)	(436bps)
Tax rate	25.1	34.7	24.5	(956bps)	60bps
Loan to Deposit ratio	78.0	89.3	83.6	(1,131bps)	(561bps)
<b>Capital adequacy ratios (%)</b>					
Tier 1	21.1	17.3	17.3	380bps	380bps
Total CAR	21.7	17.8	17.9	390bps	380bps
<b>Asset quality (Rs mn)</b>					
Gross NPAs	56,193	46,135	50,269	21.8	11.8
Net NPAs	17,771	15,244	15,579	16.6	14.1
Gross NPA ratio (%)	2.7	2.2	2.3	51bps	45bps
Net NPA ratio (%)	0.9	0.7	0.7	14bps	16bps
Coverage Ratio (%)	68.4	67.0	69.0	142bps	(63bps)

Source: Company, BOBCAPS Research

## Valuation methodology

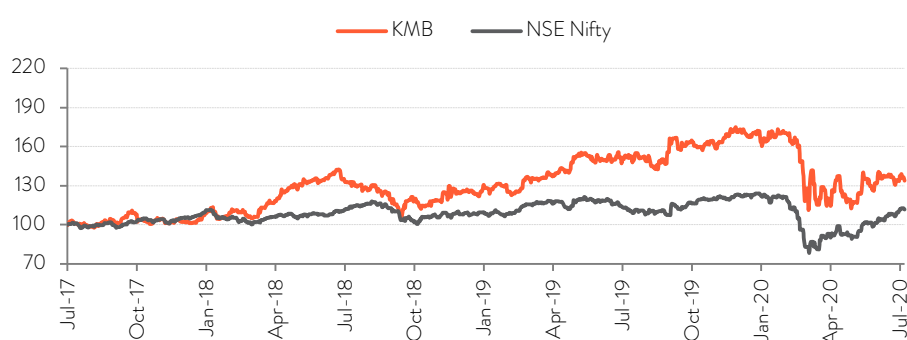
KMB is currently trading at 2.5x FY22E core P/BV. We like the bank for its proven and stable leadership, substantial improvement in liability franchise, best-in-class margins and sound underwriting standards. We continue to value KMB using the SOTP methodology to arrive at a Sep'21 target price of Rs 1,550 (Rs 1,450 earlier). Our increased target price is driven by a higher value for the core business (Rs 1,061/sh vs. Rs 1,002/sh earlier), which is based on an unchanged P/BV multiple of 3x on Sep'22E using the Gordon Growth Model. Subsidiaries drive ~30% of our fair value. Maintain BUY.

**FIG 2 – SOTP VALUATION**

Sum of Parts	Company Value (Rs bn)	Stake in Company (%)	Value for KMB (Rs bn)	Per Share (Rs)	Contribution to TP (%)	Comments
Core Business	2,098	100	2,098	1,061	68	Valued at 3x Sep'22E P/BV on Gordon Growth Model
Kotak Life	503	100	503	254	16	6x trailing Embedded Value
Kotak Prime	201	100	201	102	7	2.5x Sep'22E P/BV
Kotak AMC	100	100	100	51	3	6% of Q1FY21 AAUM
Kotak Securities	96	100	96	49	3	14x Sep'22E P/E
Kotak Investments	43	100	43	22	1	10x Sep'22E P/E
International subsidiaries	15	100	15	8	0	10x Sep'22E P/E
KMCC	10	100	10	5	0	10x Sep'22E P/E
<b>Sum of Parts</b>			<b>3,067</b>	<b>1,550</b>		

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)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Net interest income</b>	<b>112,590</b>	<b>134,997</b>	<b>148,390</b>	<b>168,584</b>	<b>190,791</b>
NII growth (%)	1812.1	1990.2	992.1	1360.9	1317.2
Non-interest income	46,040	53,721	57,530	65,518	73,188
Total income	158,630	188,718	205,920	234,102	263,979
Operating expenses	(75,148)	(88,509)	(96,580)	(108,367)	(120,100)
Operating profit	83,482	100,208	109,340	125,735	143,880
Operating profit growth (%)	1,662.5	2,003.6	911.2	1,499.5	1,443.1
Provisions	(22,162)	(22,162)	(22,613)	(23,761)	(26,546)
PBT	61,320	78,047	86,727	101,974	117,334
Tax	(25,205)	(18,575)	(22,202)	(26,105)	(30,037)
<b>Reported net profit</b>	<b>36,116</b>	<b>59,472</b>	<b>64,525</b>	<b>75,869</b>	<b>87,296</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>36,116</b>	<b>59,472</b>	<b>64,525</b>	<b>75,869</b>	<b>87,296</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Equity capital	9,544	9,565	9,890	9,890	9,890
Reserves & surplus	414,461	475,616	611,283	682,801	765,093
Net worth	429,005	490,182	626,173	697,692	779,983
Deposits	2,258,804	2,628,205	2,864,744	3,208,513	3,593,534
Borrowings	327,043	384,493	403,718	435,733	470,401
Other liabilities & provisions	106,870	99,637	108,359	121,021	135,153
<b>Total liabilities and equities</b>	<b>3,121,721</b>	<b>3,602,517</b>	<b>4,002,993</b>	<b>4,462,959</b>	<b>4,979,071</b>
Cash & bank balance	246,755	532,923	307,307	215,097	183,355
Investments	711,891	750,515	838,648	966,936	1,117,991
Advances	2,056,948	2,197,482	2,373,280	2,658,074	2,977,043
Fixed & Other assets	106,127	121,597	483,758	622,852	700,682
<b>Total assets</b>	<b>3,121,721</b>	<b>3,602,517</b>	<b>4,002,993</b>	<b>4,462,959</b>	<b>4,979,071</b>
Deposit growth (%)	17.3	16.4	9.0	12.0	12.0
Advances growth (%)	21.2	6.8	8.0	12.0	12.0

### Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
EPS	25.5	31.1	33.2	38.4	44.1
Dividend per share	0.8	1.0	1.3	1.9	2.2
Book value per share	222.1	253.6	314.0	350.2	391.8

Source: Company, BOBCAPS Research

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
P/E	51.8	42.5	39.9	34.5	30.0
P/BV	6.0	5.2	4.2	3.8	3.4
Dividend yield (%)	0.1	0.1	0.1	0.1	0.2

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	3.9	4.0	3.9	4.0	4.0
Non-interest income	1.6	1.6	1.5	1.5	1.6
Operating expenses	2.6	2.6	2.5	2.6	2.5
Pre-provisioning profit	2.9	3.0	2.9	3.0	3.0
Provisions	0.3	0.7	0.6	0.6	0.6
PBT	2.1	2.3	2.3	2.4	2.5
Tax	0.9	0.6	0.6	0.6	0.6
ROA	1.7	1.8	1.7	1.8	1.8
Leverage (x)	7.2	7.4	6.9	6.4	6.4
ROE	12.2	13.1	11.7	11.5	11.9

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Net interest income	18.1	19.9	9.9	13.6	13.2
Pre-provisioning profit	16.6	20.0	9.1	15.0	14.4
EPS	17.0	22.0	6.6	15.6	15.1
<b>Profitability &amp; Return ratios (%)</b>					
Net interest margin	4.1	4.2	4.2	4.6	4.7
Fees / Avg. assets	1.2	1.1	1.1	1.1	1.1
Cost-Income	47.4	46.9	46.9	46.3	45.5
ROE	12.2	13.1	11.7	11.5	11.9
ROA	1.7	1.8	1.7	1.8	1.8
<b>Asset quality (%)</b>					
GNPA	2.1	2.3	3.0	2.8	2.7
NNPA	0.8	0.7	0.9	0.8	0.7
Provision coverage	65.4	69.0	69.7	71.6	74.3
<b>Ratios (%)</b>					
Credit-Deposit	91.1	83.6	82.8	82.8	82.8
Investment-Deposit	31.5	28.6	29.3	30.1	31.1
CAR	17.5	17.9	19.9	19.6	19.4
Tier-1	16.9	17.3	19.3	19.1	18.9

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

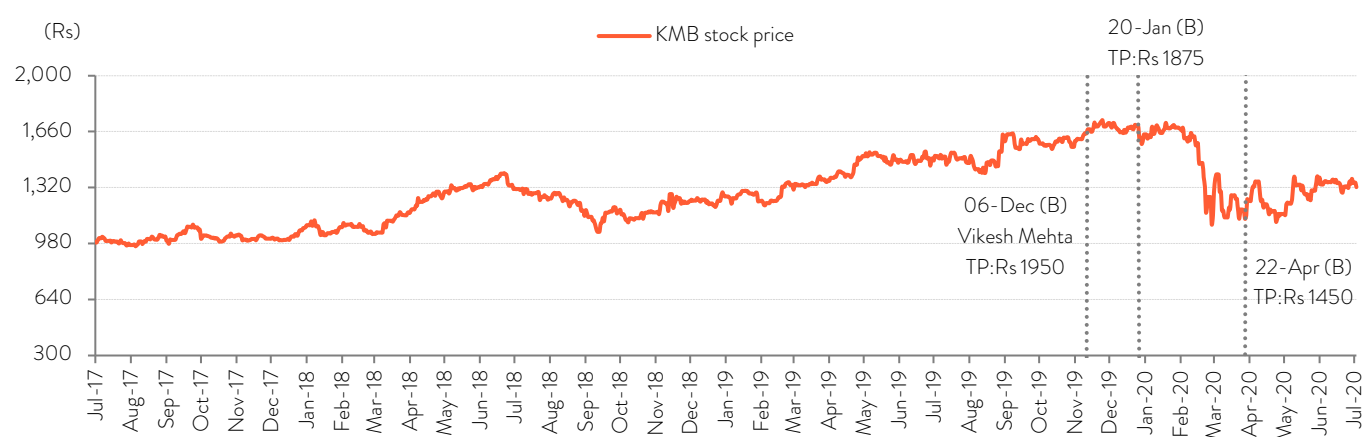
**ADD** – Expected return from >+5% to +15%

**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)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): KOTAK MAHINDRA BANK (KMB IN)



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

### Rating distribution

As of 30 June 2020, out of 95 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 49 have BUY ratings, 23 have ADD ratings, 12 are rated REDUCE, 10 are rated SELL and 1 is UNDER REVIEW. None of these companies have been investment banking clients in the last 12 months.

### Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

### General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2020. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations

expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

### **Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014**

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.