

BUY

TP: Rs 1,875 | ▲ 16%

**KOTAK MAHINDRA
BANK**

| Banking

| 20 January 2020

Growth slips while credit cost spikes

Kotak Mahindra Bank's (KMB) Q3FY20 PAT at Rs 16bn was below estimates due to weak NII growth and high provisions. Key disappointments were loan growth slipping to a multi-quarter low of 10% YoY and 9MFY20 credit cost spiking to 67bps. Management has toned down its growth guidance from the mid-teens to 10-15% YoY but believes credit cost for FY20 can be held ~60bps. The SMA-2 book declined to Rs 2.7bn (0.1% of loans) given some lumpy corporate slippages. We cut FY20-FY22 EPS by 6-7% and revise our TP to Rs 1,875 (vs. Rs 1,950).

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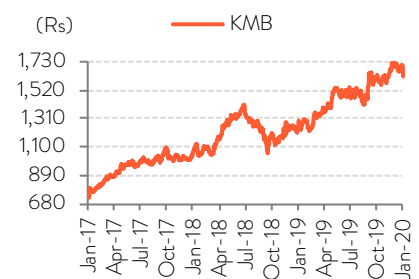
Slight miss on asset quality: KMB's GNPA ratio increased 14bps QoQ to 2.46%, driven by a couple of lumpy corporate accounts and slippages in SME, CV/CE and small business loans. The SMA-2 book declined to Rs 2.7bn (0.1% of loans) vs. Rs 4.3bn (0.2%) in Q2 given the corporate slippages. Stress in the unsecured personal loan/credit card portfolio has increased but remains in line with the industry, while NPAs in the agriculture segment were largely stable during the quarter. 9MFY20 credit cost stood at 67bps but guidance for FY20 was maintained near 60bps levels. Telecom exposure to stressed players is low.

Ticker/Price	KMB IN/Rs 1,618
Market cap	US\$ 43.5bn
Shares o/s	1,910mn
3M ADV	US\$ 57.0mn
52wk high/low	Rs 1,735/Rs 1,210
Promoter/FPI/DII	30%/40%/30%

Source: NSE

Loan growth at multi-quarter low: Loan growth dropped to ~10% YoY in Q3 largely due to sluggish growth in the corporate (3%) and CV/CE (6%) segments. Low working capital utilisation slowed growth in the corporate segment. The retail segment grew 18% YoY as the agri, home loan and small business segments grew in the range of 15-20%. FY20 loan growth guidance stands lowered from the mid-teens to 10-15% YoY. Management highlighted that its '811' digital banking product is driving strong cross-sales across products – growth in balances from these customers is steady with a rise in savings deposits.

STOCK PERFORMANCE



Maintain BUY: We cut FY20-FY22 EPS estimates by 6-7% to build in slower growth and higher credit costs, yielding a revised Mar'21 TP of Rs 1,875.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	95,317	112,590	133,258	160,501	196,487
NII growth (%)	1729.6	1812.1	1835.7	2044.4	2242.1
Adj. net profit (Rs mn)	40,619	41,632	61,842	77,531	97,975
EPS (Rs)	21.8	25.5	32.4	40.6	51.3
P/E (x)	74.2	63.4	49.9	39.8	31.5
P/BV (x)	8.2	7.3	6.4	5.5	4.8
ROA (%)	1.7	1.7	1.9	2.1	2.2
ROE (%)	12.5	12.2	13.6	14.9	16.3

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

Standalone (Rs mn)	Q3FY20	Q2FY20	Q3FY19	YoY (%)	QoQ (%)
Net interest income	34,295	33,496	29,391	16.7	2.4
Non-interest income	13,414	12,244	9,639	39.2	9.6
Net total income	47,710	45,740	39,030	22.2	4.3
Staff cost	10,915	9,150	8,370	30.4	19.3
Other op expenses	12,914	11,504	11,276	14.5	12.3
Total operating expenses	23,829	20,654	19,646	21.3	15.4
Pre-provisioning profit	23,881	25,086	19,384	23.2	(4.8)
Total provisions	4,440	4,079	(323)	(1,474.6)	8.8
Profit before tax	19,441	21,006	19,707	(1.4)	(7.5)
Tax	3,482	3,762	6,798	(48.8)	(7.4)
PAT	15,959	17,245	12,909	23.6	(7.5)
Key balance sheet items					
Advances	2,167,740	2,132,994	1,964,320	10.4	1.6
Deposits	2,393,540	2,330,715	2,138,040	12.0	2.7
Key Ratios (%)					
NIM	4.7	4.6	4.3	36bps	8bps
Cost/Income	49.9	45.2	50.3	(39bps)	479bps
Tax rate	17.9	17.9	34.5	-	-
Loan to Deposit ratio	90.6	91.5	91.9	(131bps)	(95bps)
CASA ratio	53.7	53.6	50.7	298bps	10bps
Capital Adequacy (%)					
Tier-I ratio	17.7	17.6	17.6	10bps	10bps
Tier-II ratio	0.5	0.6	0.5	0bps	(10bps)
Total CAR ratio	18.2	18.2	18.1	10bps	0bps
Asset Quality					
Gross NPA	54,132	50,336	41,287	31.1	7.5
Net NPA	19,251	18,114	13,973	37.8	6.3
Gross NPA ratio (%)	2.5	2.3	2.1	39bps	14bps
Net NPA ratio (%)	0.9	0.9	0.7	18bps	4bps
PCR (%)	64.4	64.0	66.2	(172bps)	42bps

Source: Company, BOBCAPS Research

Valuation methodology

We cut FY20-FY22 EPS estimates by 6-7% to build in slower growth and higher credit costs, yielding a revised Mar'21 SOTP-based target price of Rs 1,875 (from Rs 1,950 earlier). The core business is valued at 4.3x FY22E P/ABV based on the Gordon Growth Model, while subsidiaries drive ~25% of our fair value.

We like KMB for its fortified liability franchise and best-in-class margins. Moreover, the bank has a proven and stable leadership which contrasts with the management flux at most private sector peers. Maintain BUY.

FIG 2 – REVISED ESTIMATES

Particulars (Rs bn)	New			Old			Change (%)		
	FY20	FY21	FY22	FY20	FY21	FY22	FY20	FY21	FY22
Net interest income	133	161	196	138	168	207	(3.3)	(4.4)	(5.0)
Pre-provisioning profit	100	121	148	104	128	158	(4.3)	(5.3)	(6.0)
Net profit	62	78	98	66	83	105	(6.4)	(6.8)	(6.6)

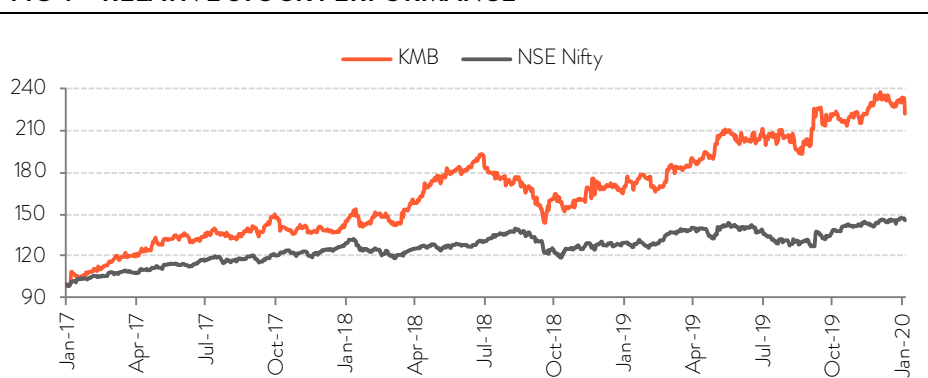
Source: BOBCAPS Research

FIG 3 – 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	2,596	100	2,596	1,360	73	Valued at 4.3x Mar'22E P/ABV on Gordon Growth Model
Kotak Life	438	100	438	230	12	6x trailing Embedded Value
Kotak Prime	224	100	224	117	6	3x Mar'22E P/BV
Kotak AMC	118	100	118	62	3	7% of Q2FY20 AAUM
Kotak Securities	86	100	86	45	2	16x Mar'22E P/E
Kotak Investments	71	100	71	37	2	20x Mar'22E P/E
International subsidiaries	30	100	30	16	1	15x Mar'22E P/E
KMCC	15	100	15	8	0	20x Mar'22E P/E
Sum of Parts			3,579	1,875		

Source: BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Regulatory overhang from promoter's stake sale remains a key valuation risk.
- 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	133,258	160,501	196,487
NII growth (%)	1729.6	1812.1	1835.7	2044.4	2242.1
Non-interest income	40,522	46,040	53,019	62,185	74,150
Total income	135,839	158,630	186,277	222,686	270,638
Operating expenses	(64,257)	(75,148)	(86,510)	(101,606)	(122,611)
Operating profit	71,582	83,482	99,767	121,080	148,027
Operating profit growth (%)	1,960.6	1,662.5	1,950.7	2,136.3	2,225.5
Provisions	(9,624)	(16,646)	(16,646)	(16,872)	(16,340)
PBT	61,958	66,836	83,121	104,208	131,687
Tax	(21,339)	(25,205)	(21,279)	(26,677)	(33,712)
Reported net profit	40,619	41,632	61,842	77,531	97,975
Adjustments	0	0	0	0	0
Adjusted net profit	40,619	41,632	61,842	77,531	97,975

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	9,528	9,544	9,544	9,544	9,544
Reserves & surplus	365,310	414,461	473,467	546,997	639,354
Net worth	374,838	429,005	488,011	561,541	653,898
Deposits	1,926,433	2,258,804	2,575,036	3,012,792	3,645,479
Borrowings	260,811	327,043	311,603	327,183	351,911
Other liabilities & provisions	87,252	106,870	124,224	144,484	168,149
Total liabilities and equities	2,649,334	3,121,721	3,498,874	4,046,000	4,819,436
Cash & bank balance	196,201	246,755	269,472	301,194	340,756
Investments	645,623	711,891	758,296	835,411	942,578
Advances	1,697,179	2,056,948	2,365,490	2,791,279	3,405,360
Fixed & Other assets	110,330	106,127	105,614	118,116	130,742
Total assets	2,649,334	3,121,721	3,498,874	4,046,000	4,819,436
Deposit growth (%)	22.4	17.3	14.0	17.0	21.0
Advances growth (%)	24.7	21.2	15.0	18.0	22.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	21.8	25.5	32.4	40.6	51.3
Dividend per share	0.6	0.8	1.3	1.8	2.6
Book value per share	196.7	222.1	253.1	291.6	340.0

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	74.2	63.4	49.9	39.8	31.5
P/BV	8.2	7.3	6.4	5.5	4.8
Dividend yield (%)	0.0	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	4.3	4.4
Non-interest income	1.7	1.6	1.6	1.6	1.7
Operating expenses	2.7	2.6	2.6	2.7	2.8
Pre-provisioning profit	3.0	2.9	3.0	3.2	3.3
Provisions	0.4	0.3	0.5	0.4	0.4
PBT	2.6	2.3	2.5	2.8	3.0
Tax	0.9	0.9	0.6	0.7	0.8
ROA	1.7	1.7	1.9	2.1	2.2
Leverage (x)	7.4	7.2	7.3	7.3	7.4
ROE	12.5	12.2	13.6	14.9	16.3

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	17.3	18.1	18.4	20.4	22.4
Pre-provisioning profit	19.6	16.6	19.5	21.4	22.3
EPS	17.4	17.0	27.0	25.4	26.4
Profitability & Return ratios (%)					
Net interest margin	4.2	4.1	4.2	4.4	4.6
Fees / Avg. assets	1.2	1.2	1.2	1.2	1.2
Cost-Income	47.3	47.4	46.4	45.6	45.3
ROE	12.5	12.2	13.6	14.9	16.3
ROA	1.7	1.7	1.9	2.1	2.2
Asset quality (%)					
GNPA	2.2	2.1	2.6	2.6	2.3
NNPA	1.0	0.8	0.9	0.9	0.8
Provision coverage	56.5	65.4	64.1	65.1	64.5
Ratios (%)					
Credit-Deposit	88.1	91.1	91.9	92.6	93.4
Investment-Deposit	33.5	31.5	29.4	27.7	25.9
CAR	18.2	17.5	17.4	16.9	16.2
Tier-1	17.6	16.9	16.8	16.3	15.7

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

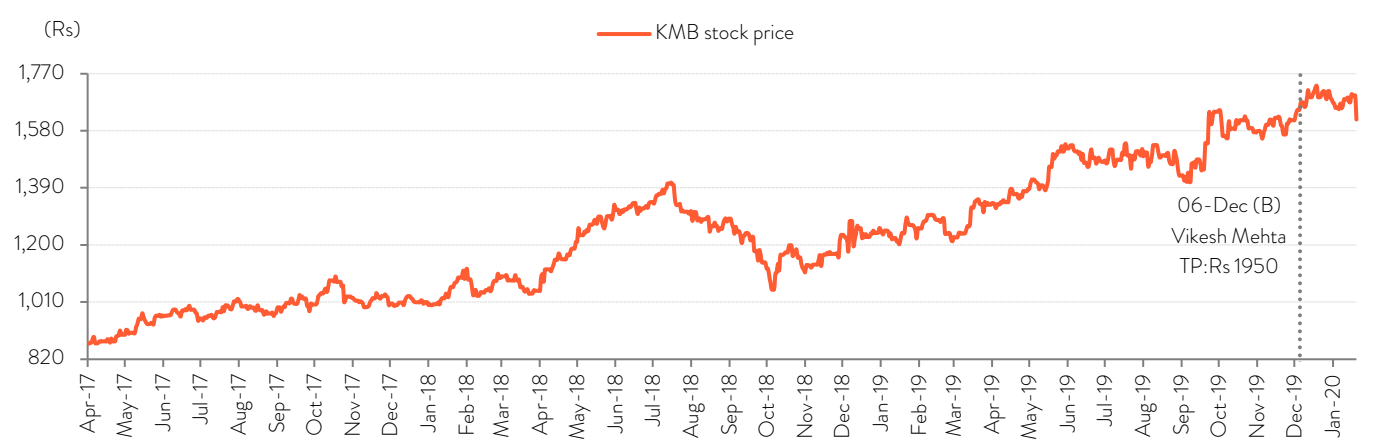
ADD – Expected return from >+5% to +15%

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)

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



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

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