

BUY

TP: Rs 1,450 | ▲ 22%

**KOTAK MAHINDRA
BANK**

| Banking

| 13 May 2020

Liability franchise remains strong

Kotak Bank's (KMB) Q4FY20 PAT at Rs 12.7bn (-10% YoY) missed estimates as the bank made Covid-related general provisions of Rs 6.5bn. About 26% of the loan book is under moratorium, with a higher share of retail loans. Slippages were lower at Rs 4.9bn as the asset classification standstill benefit was offered to loans worth Rs 6.6bn. The liability franchise remains robust, marked by a CASA ratio of 56.2% and healthy account opening traction (~14k accounts per day in May thus far). Maintain BUY with a Mar'21 TP of Rs 1,450.

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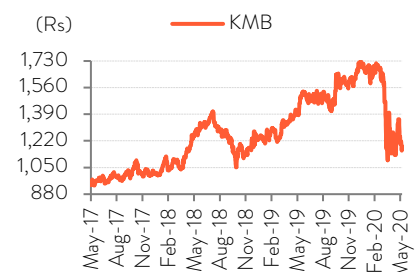
One-fourth of portfolio under moratorium: According to management, ~26% of borrowers by value have availed of the RBI's moratorium up to 30 April. The retail segment has the largest share of such loans followed by SME and corporate accounts. KMB made Covid-19-related general provisions worth Rs 6.5bn on overdue accounts under moratorium.

Ticker/Price	KMB IN/Rs 1,187
Market cap	US\$ 30.1bn
Shares o/s	1,910mn
3M ADV	US\$ 107.8mn
52wk high/low	Rs 1,740/Rs 1,001
Promoter/FPI/DII	30%/40%/30%

Source: NSE

Slippages decline on regulatory forbearance: KMB's headline GNPA/NNPA ratio declined by ~20bps QoQ each to 2.3%/0.7% in Q4. Slippages at Rs 4.9bn (vs. Rs 10.6bn in Q3) would have been Rs 6.6bn higher if we exclude the impact of regulatory forbearance on overdue loans. The SMA-2 book declined sharply to ~Rs 1bn (vs. Rs 2.7bn in Q3). Management believes unsecured lending, credit cards, MFI and CV loans will see pandemic-related stress.

STOCK PERFORMANCE



Source: NSE

Liability franchise continues to improve: KMB's CASA ratio expanded 250bps QoQ, spurred by a sharp 30% YoY growth in savings deposits. This month as well, the bank continues to acquire ~14k customers/day via the digital route.

Maintain BUY: We like KMB for its proven and stable leadership, substantially improved liability franchise, best-in-class margins and prudent underwriting standards. Maintain BUY with an unchanged Mar'21 TP of Rs 1,450.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Net interest income	95,317	112,590	135,118	148,015	168,721
NII growth (%)	1729.6	1812.1	2000.9	954.5	1398.9
Adj. net profit (Rs mn)	40,619	36,116	59,472	65,575	76,565
EPS (Rs)	21.8	25.5	31.1	33.7	38.7
P/E (x)	54.4	46.5	38.1	35.2	30.7
P/BV (x)	6.0	5.3	4.7	3.8	3.4
ROA (%)	1.7	1.7	1.8	1.7	1.8
ROE (%)	12.5	12.2	13.1	11.9	11.7

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q4FY20	Q4FY19	Q3FY20	YoY (%)	QoQ (%)	FY20	FY19	YoY (%)
Income Statement								
Interest income	68,047	64,023	67,356	6.3	1.0	269,418	239,432	12.5
Interest expense	32,450	33,544	33,061	(3.3)	(1.8)	134,300	126,843	5.9
Net interest income	35,597	30,479	34,295	16.8	3.8	135,118	112,590	20.0
Non-interest income	14,894	12,703	13,414	17.2	11.0	53,600	46,040	16.4
Net total income	50,490	43,182	47,710	16.9	5.8	188,718	158,630	19.0
Staff expenses	9,696	8,567	10,915	13.2	(11.2)	38,776	31,594	22.7
Other operating expenses	13,542	11,792	12,914	14.8	4.9	49,733	43,554	14.2
Operating expenses	23,238	20,359	23,829	14.1	(2.5)	88,509	75,148	17.8
Pre-provisioning profit	27,253	22,823	23,881	19.4	14.1	100,208	83,482	20.0
Total provisions	10,475	1,713	4,440	511.6	135.9	22,162	9,624	130.3
Profit before tax	16,778	21,110	19,441	(20.5)	(13.7)	78,047	73,858	5.7
Tax	4,112	7,032	3,482	(41.5)	18.1	18,575	25,205	(26.3)
Profit after tax	12,666	14,078	15,959	(10.0)	(20.6)	59,472	48,653	22.2
Balance Sheet								
Advances	2,197,482	2,056,948	2,167,740	6.8	1.4	2,197,482	2,056,948	6.8
Deposits	2,628,205	2,258,804	2,393,540	16.4	9.8	2,628,205	2,258,804	16.4
CASA ratio (%)	56.2	52.5	53.7	367bps	248bps	56.2	52.5	367bps
Yields and margins (%)								
Net interest margin	4.7	4.5	4.7	24bps	3bps	-	-	-
Yield on advances	9.7	9.9	9.8	(22bps)	(9bps)	-	-	-
Cost of funds	4.6	5.4	5.0	(77bps)	(45bps)	-	-	-
Key ratios (%)								
Cost/Income	46.0	47.1	49.9	(112bps)	(392bps)	46.9	47.4	(47bps)
Tax rate	24.5	33.3	17.9	(880bps)	660bps	23.8	34.1	(1033bps)
Loan to Deposit ratio	83.6	91.1	90.6	(745bps)	(695bps)	83.6	91.1	(745bps)
Capital adequacy ratios (%)								
Tier 1	17.3	16.9	17.7	40bps	(40bps)	17.3	16.9	40bps
Total CAR	17.9	17.5	18.2	40bps	(30bps)	17.9	17.5	40bps
Asset quality (Rs mn)								
Gross NPAs	5,026,890	4,467,940	5,413,200	12.5	(7.1)	5,026,890	4,467,940	12.5
Net NPAs	1,557,890	1,544,370	1,925,080	0.9	(19.1)	1,557,890	1,544,370	0.9
Gross NPA ratio (%)	2.3	2.1	2.5	11bps	(21bps)	2.3	2.1	11bps
Net NPA ratio (%)	0.7	0.8	0.9	(4bps)	(18bps)	0.7	0.8	(4bps)
Coverage Ratio (%)	69.0	65.4	64.4	357bps	457bps	69.0	65.4	357bps

Source: Company, BOBCAPS Research

Valuation methodology

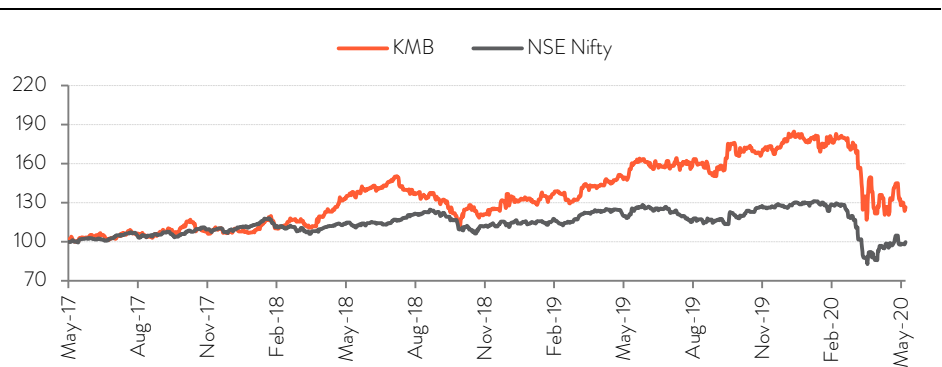
KMB is currently trading at 2.2x FY22E core P/BV. We like the bank for its proven and stable leadership, substantial improvement in liability franchise, best-in-class margins and prudent underwriting standards. We value KMB using the SOTP methodology and maintain our Mar'21 target price at Rs 1,450. 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 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	1,983	100	1,983	1,002	69	Valued at 3x Mar'22E P/BV on Gordon Growth Model
Kotak Life	424	100	424	214	15	6x trailing Embedded Value
Kotak Prime	187	100	187	94	7	2.5x Mar'22E P/BV
Kotak AMC	112	100	112	56	4	6% of Q4FY20 AAUM
Kotak Securities	79	100	79	40	3	14x Mar'22E P/E
Kotak Investments	53	100	53	27	2	15x Mar'22E P/E
International subsidiaries	20	100	20	10	1	10x Mar'22E P/E
KMCC	12	100	12	6	0	15x Mar'22E P/E
Sum of Parts			2,869	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	FY20P	FY21E	FY22E
Net interest income	95,317	112,590	135,118	148,015	168,721
NII growth (%)	1729.6	1812.1	2000.9	954.5	1398.9
Non-interest income	40,522	46,040	53,600	58,064	65,327
Total income	135,839	158,630	188,718	206,079	234,048
Operating expenses	(64,257)	(75,148)	(88,509)	(95,328)	(107,377)
Operating profit	71,582	83,482	100,208	110,751	126,671
Operating profit growth (%)	1,960.6	1,662.5	2,003.6	1,052.1	1,437.4
Provisions	(9,624)	(22,162)	(22,162)	(22,613)	(23,761)
PBT	61,958	61,320	78,047	88,139	102,910
Tax	(21,339)	(25,205)	(18,575)	(22,564)	(26,345)
Reported net profit	40,619	36,116	59,472	65,575	76,565
Adjustments	0	0	0	0	0
Adjusted net profit	40,619	36,116	59,472	65,575	76,565

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Equity capital	9,528	9,544	9,565	9,890	9,890
Reserves & surplus	365,310	414,461	473,936	610,928	683,103
Net worth	374,838	429,005	488,501	625,818	697,993
Deposits	1,926,433	2,258,804	2,628,205	2,864,744	3,208,513
Borrowings	260,811	327,043	384,721	403,957	436,362
Other liabilities & provisions	87,252	106,870	99,409	108,186	120,771
Total liabilities and equities	2,649,334	3,121,721	3,600,836	4,002,705	4,463,639
Cash & bank balance	196,201	246,755	532,923	290,523	311,929
Investments	645,623	711,891	750,515	838,771	967,199
Advances	1,697,179	2,056,948	2,197,482	2,373,280	2,658,074
Fixed & Other assets	110,330	106,127	119,916	500,130	526,437
Total assets	2,649,334	3,121,721	3,600,836	4,002,705	4,463,639
Deposit growth (%)	22.4	17.3	16.4	9.0	12.0
Advances growth (%)	24.7	21.2	6.8	8.0	12.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
EPS	21.8	25.5	31.1	33.7	38.7
Dividend per share	0.6	0.8	0.0	1.3	1.9
Book value per share	196.7	222.1	252.7	313.9	350.3

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
P/E	54.4	46.5	38.1	35.2	30.7
P/BV	6.0	5.3	4.7	3.8	3.4
Dividend yield (%)	0.1	0.1	0.0	0.1	0.2

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Net interest income	4.0	3.9	4.0	3.9	4.0
Non-interest income	1.7	1.6	1.6	1.5	1.5
Operating expenses	2.7	2.6	2.6	2.5	2.5
Pre-provisioning profit	3.0	2.9	3.0	2.9	3.0
Provisions	0.4	0.3	0.7	0.6	0.6
PBT	2.6	2.1	2.3	2.3	2.4
Tax	0.9	0.9	0.6	0.6	0.6
ROA	1.7	1.7	1.8	1.7	1.8
Leverage (x)	7.4	7.2	7.4	6.9	6.4
ROE	12.5	12.2	13.1	11.9	11.7

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
YoY growth (%)					
Net interest income	17.3	18.1	20.0	9.5	14.0
Pre-provisioning profit	19.6	16.6	20.0	10.5	14.4
EPS	17.4	17.0	22.0	8.3	14.8
Profitability & Return ratios (%)					
Net interest margin	4.2	4.1	4.2	4.2	4.5
Fees / Avg. assets	1.2	1.2	1.2	1.1	1.1
Cost-Income	47.3	47.4	46.9	46.3	45.9
ROE	12.5	12.2	13.1	11.9	11.7
ROA	1.7	1.7	1.8	1.7	1.8
Asset quality (%)					
GNPA	2.2	2.1	2.3	3.0	2.8
NNPA	1.0	0.8	0.7	0.9	0.8
Provision coverage	56.5	65.4	69.0	69.7	71.6
Ratios (%)					
Credit-Deposit	88.1	91.1	83.6	82.8	82.8
Investment-Deposit	33.5	31.5	28.6	29.3	30.1
CAR	18.2	17.5	18.0	20.0	19.6
Tier-1	17.6	16.9	17.4	19.4	19.1

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

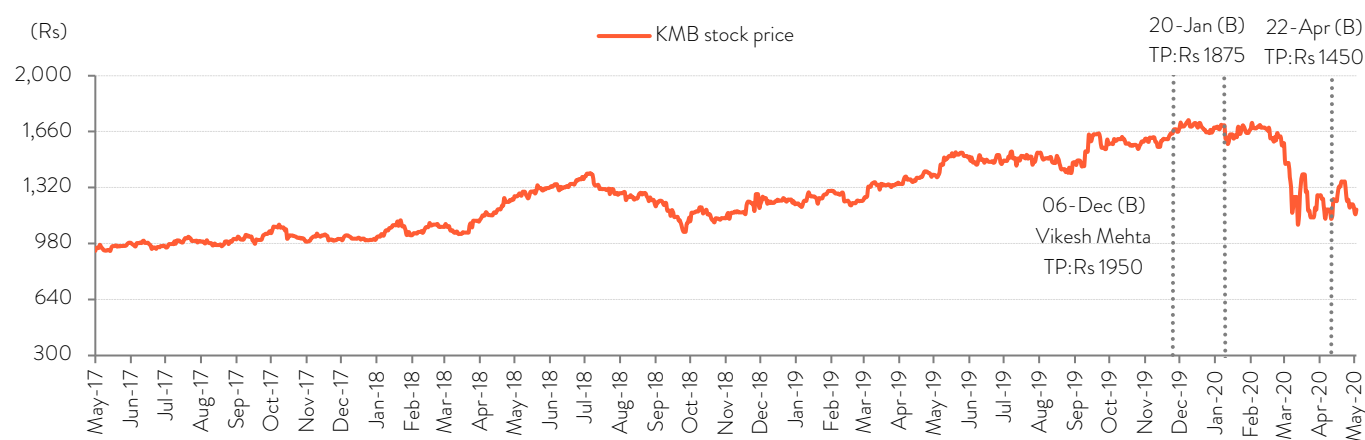
ADD – Expected return from >+5% to +15%

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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