BUY
TP: Rs 1,950 | ⮝ 18%

KOTAK MAHINDRA BANK

Banking | 06 December 2019

In a league of its own – initiate with BUY

Kotak Mahindra Bank (KMB) has forged a powerful banking franchise backed by a formidable liability profile. Its cost of funds is now comparable to larger peers and serves as a strong moat that enables the bank to gain profitable market share while de-risking the balance sheet. A calibrated growth approach alongside strong underwriting standards should keep asset quality stable and contain credit costs at 40-60bps over FY20-FY22E. We initiate coverage with BUY and a Mar'21 TP of Rs 1,950, with subsidiaries driving 25% of our valuation.

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Exemplary liability franchise: KMB's relentless focus on CASA and retail deposits has turned its funding mix more granular and bridged its cost of funds differential with top private banks. We believe the bank's liability profile will continue to improve (57% CASA ratio by FY22E) and the multiplier effect of its granularity will further strengthen return ratios (17% ROE by FY22E).

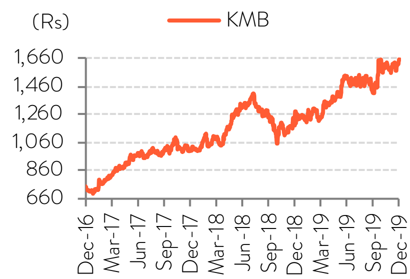
Judicious growth; comfortable asset quality: KMB has stringent underwriting standards and also targets risk-adjusted returns on lending – practices that have traditionally led to prudent growth. We model for a loan CAGR of 20% over FY19-FY22 amid the current cautious lending climate. KMB's NIM is forecast to stay resilient, compensating for its measured growth aspirations. We also see limited downside risks to asset quality given the bank's demonstrated ability to initiate timely damage control measures, and thus model for moderate credit cost of 40-60bps over the next three years.

Initiate with BUY: We expect a 29% PAT CAGR over FY19-FY22 underpinned by KMB's strong liability profile and sound asset quality – both key drivers for a sustained valuation premium. Our Mar'21 SOTP-based target price of Rs 1,950 is set at 4.5x FY22E adj. P/B. Regulatory overhang from promoter's stake sale remains a key valuation risk.

Ticker/Price	KMB IN/Rs 1,649
Market cap	US$ 44.2bn
Shares o/s	1,910mn
3M ADV	US$ 58.4mn
52wk high/low	Rs 1,684/Rs 1,210
Promoter/FPI/DII	30%/40%/30%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	95,317	112,590	137,749	167,851	206,767
NII growth (%)	1729.6	1812.1	2234.6	2185.3	2318.5
Adj. net profit (Rs mn)	40,619	42,738	66,040	83,222	104,947
EPS (Rs)	21.8	25.5	34.6	43.6	55.0
P/E (x)	75.6	64.7	47.7	37.8	30.0
P/BV (x)	8.4	7.4	6.5	5.6	4.7
ROA (%)	1.7	1.7	2.0	2.1	2.3
ROE (%)	12.5	12.2	14.5	15.8	17.1

Source: Company, BOBCAPS Research

Investment rationale

Formidable liability franchise

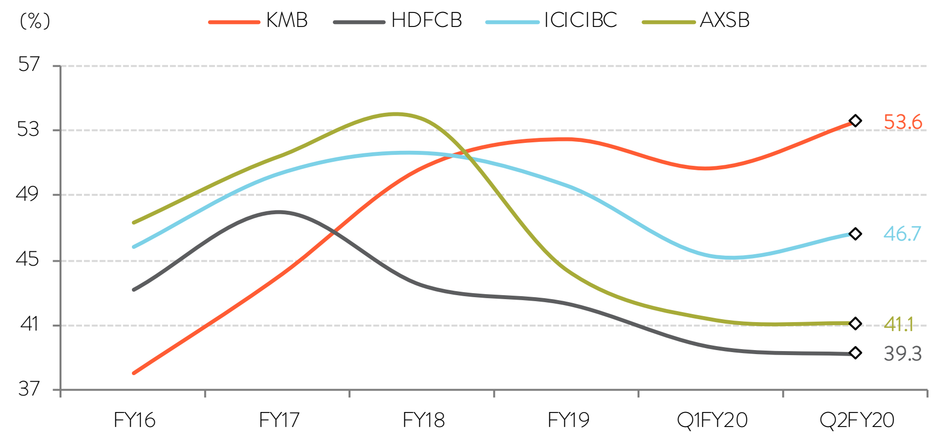
KMB has built an exemplary liability franchise over the last three years, swiftly surpassing larger peers such as HDFC Bank, ICICI Bank and Axis Bank in terms of low-cost deposits. At 53.6%, its CASA ratio is now the highest in the system. The bank's strategy of offering higher rates on savings deposits has worked well, enlarging the share of these funds to 37% of deposits vs. ~29% on average for comparable private players. We believe the strong deposit accretion phase is sustainable as KMB's '811' digital account launch to tap the mass market continues to catalyse growth in retail liabilities.

Best CASA franchise among peers

KMB has clearly been in a league of its own in terms of fortifying its liability franchise – the bank has ramped up CASA share from 37% in FY16 to 52.5% in FY19 and successfully closed the gap with larger peers. In fact, at 53.6% as on Q2FY20, KMB now has the highest CASA ratio in the industry, well ahead of peers. In our view, a series of strategies ranging from the acquisition of ING Vysya Bank to its digital banking initiative '811' have worked in KMB's favour to create a best-in-class liability franchise.

KMB has surpassed HDFCB, ICICIBC and AXSB in terms of CASA deposit base

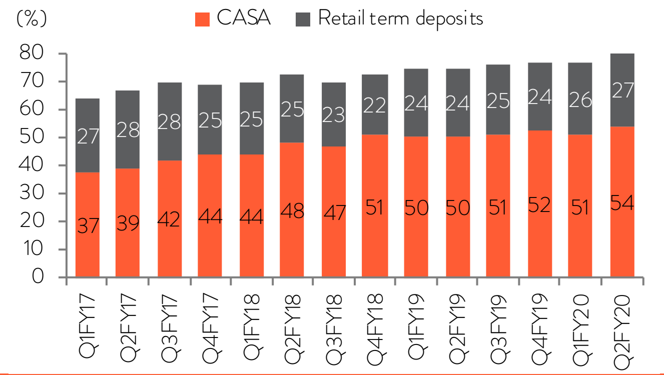
FIG 1 – KMB'S CASA RATIO BEST AMONG PEERS



Source: Company, BOBCAPS Research

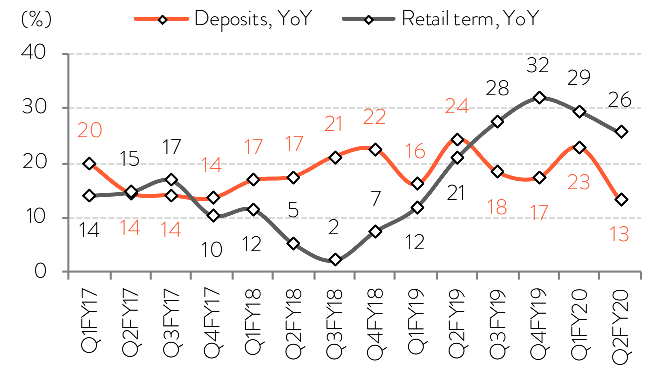
Apart from CASA, KMB has also worked to garner term deposits below Rs 10mn (i.e. retail term deposits or RTD), which are crucial for long-term stability of the liability franchise. It has been gradually replacing wholesale term deposits with RTDs, raising the granularity of its liability profile. The share of CASA + RTD has increased to 80% currently from 64% in Q1FY17.

FIG 2 – SHARE OF CASA+RTD HAS BEEN RISING



Source: Company, BOBCAPS Research

FIG 3 – RTD GROWTH OUTPACING OVERALL DEPOSIT GROWTH OF LATE

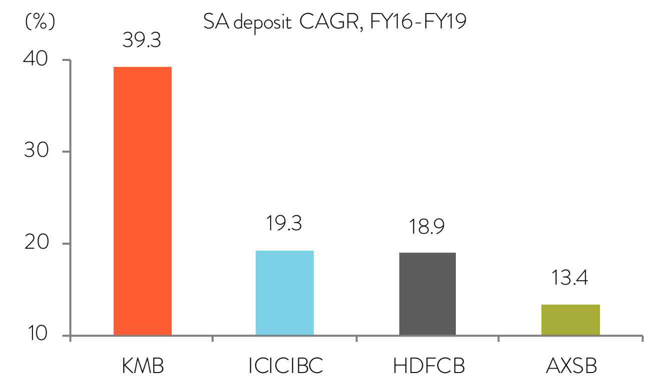


Source: Company, BOBCAPS Research

Differential savings rate a key growth lever

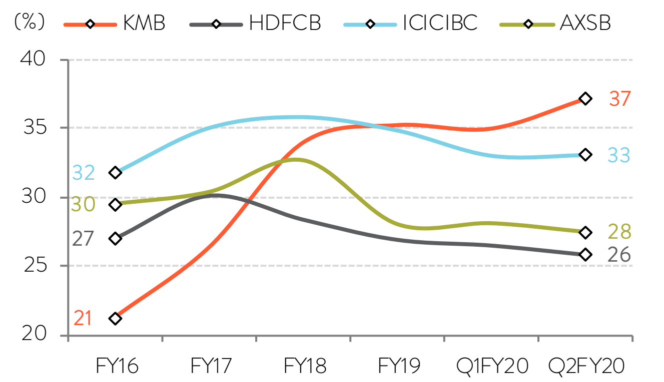
KMB's savings account deposits (SA) have increased at a CAGR of ~40% over FY16-FY19 – more than double the run-rate at the top-3 large private banks (~17% CAGR on average for HDFCB, ICICIBC and AXSB). Moreover, despite having only half the deposit base, incremental SA market share gains for KMB have been similar to those of AXSB. The share of SA in the bank's overall deposits has improved from ~21% in FY16 to ~37% currently.

FIG 4 – KMB'S SA DEPOSIT GROWTH OVER FY16-FY19 HAS OUTSTRIPPED LARGE PRIVATE BANKS…



Source: Company, BOBCAPS Research

FIG 5 – …LEADING TO MATERIAL IMPROVEMENT IN SHARE OF SA IN ITS TOTAL DEPOSITS

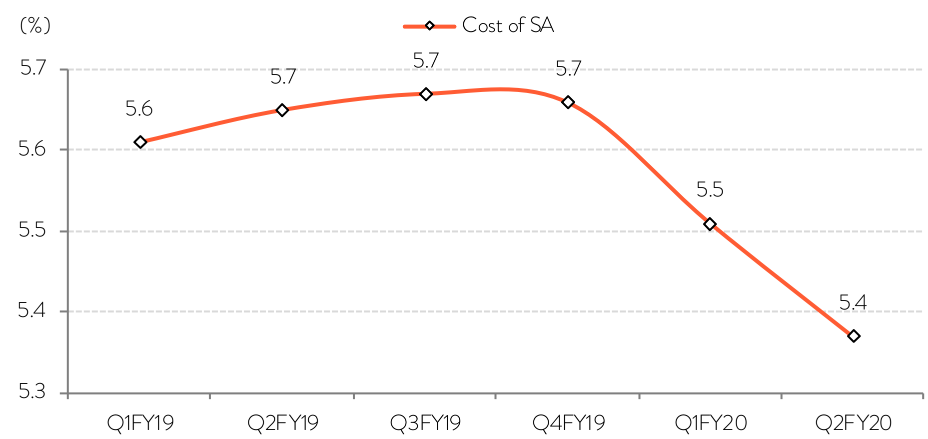


Source: Company, BOBCAPS Research

We note that the bank's remarkable SA accretion is partly led by its strategy of offering higher savings-deposit rates than competition. At ~5.4% as on Q2FY20, the cost of SA for KMB is ~180bps higher than the average of 3.6% for larger peers, and sets the bank back by Rs 14bn-15bn per annum. However, this is a cost KMB is willing to pay given the multiplier effect that CASA has on cost of funds, customer acquisition, product cross-sales and fee income. Moreover, SA deposits offer better advantages than wholesale funds as they improve granularity of the liability profile.

Cost of SA for KMB is ~180bps higher than larger peers

FIG 6 – HIGHER SA COST YIELDS MULTIPLE BENEFITS



Source: Company, BOBCAPS Research

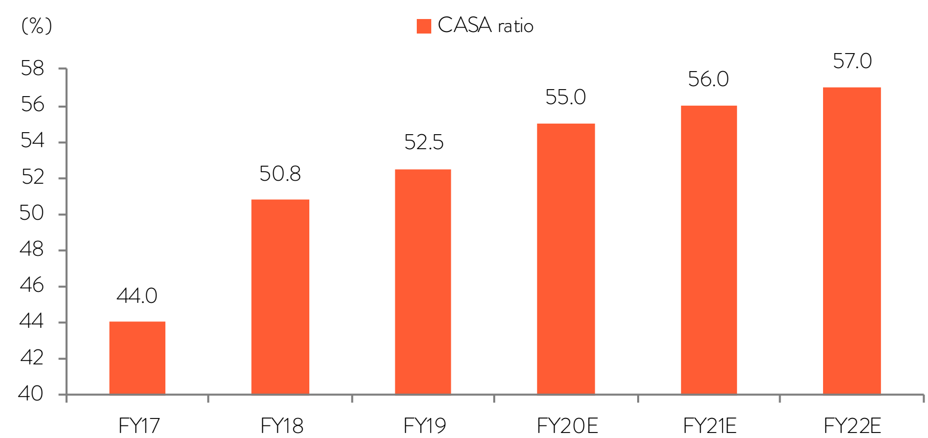
811 could be the next big trigger

Traditionally, KMB focused on affluent and high net worth individuals (HNI) for deposit accretion. Further, branches played a key role in customer acquisition. In Mar'17, the bank adopted a new 'phygital' strategy with the launch of a digital bank account christened '811', to tap the mass market at large. Since then, KMB has more than doubled its client base, with 70-75% of incremental customers being acquired via this digital route. A unique feature of '811' is that it is a zero-balance account that levies no charges on digital transactions.

With 811, KMB is catching customers early; balances to improve as accounts mature

The average balance held by '811' customers is currently low but a majority of these clients are aged between 25 and 35 years. This means the bank is catching customers early and balances are expected to improve as they mature, alongside added benefits from potential monetisation via product cross-selling. In our view, the higher interest rates offered on SA deposits coupled with sustained customer acquisition efforts via 811 should propel KMB's CASA ratio 300bps higher over the next three years to ~57% by FY22.

FIG 7 – CASA PROGRESSION TREND EXPECTED TO SUSTAIN



Source: Company, BOBCAPS Research

Calibrated growth backed by best-in-class margins

In order to maximise risk-adjusted returns, KMB calibrates growth in its loan book closely with the macro climate, which in turn makes for volatile loan growth trends. We are fairly comfortable with this strategy as growth ultimately matches that of peers over a cycle. In addition, with industry-leading margins (4.6% in Q2FY20), KMB can afford to take fewer risks while its ability to deliver strong return ratios remains intact. We expect NIM to remain resilient and pencil in ~45bps improvement to 4.6% (calc.) over FY19-FY22, which should compensate for KMB's measured growth aspirations.

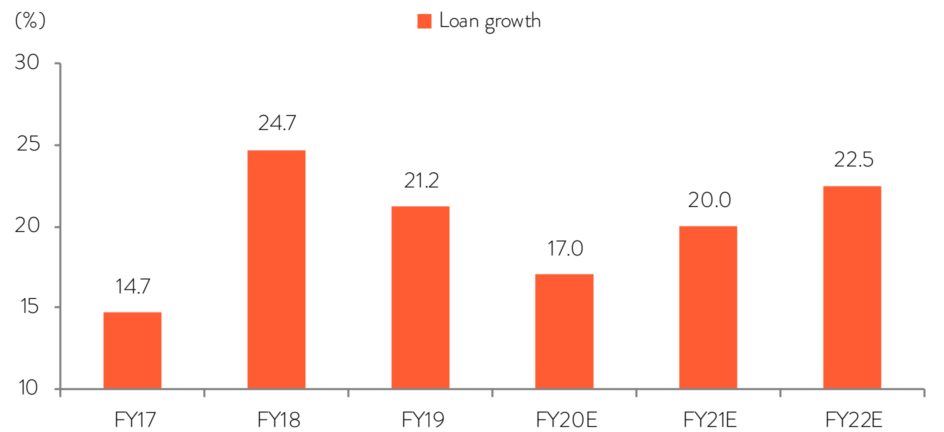
Prudent focus on risk-adjusted returns

KMB is often branded as conservative by virtue of its focus on risk-adjusted returns

KMB is often branded as a conservative player by virtue of its relentless focus on risk-adjusted returns. The bank deliberately slows down growth during weak macro conditions and accelerates the same sharply when the economy recovers. Traditionally, KMB has not shied away from growth but the search for better pricing against the risks it undertakes has led to a volatile loan growth trend as compared to peers.

The bank recently toned down its FY20 loan growth guidance from ~20% to the mid-teens, citing emerging stress in various pockets of the economy that may elevate credit risk. We believe guided growth levels look achievable and model for a loan CAGR of 20% over FY19-FY22.

FIG 8 – LOAN GROWTH LIKELY TO REMAIN STEADY

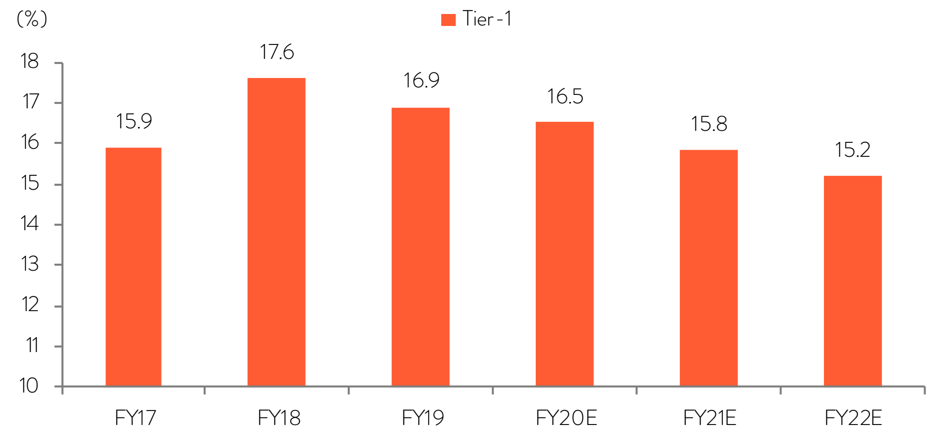


Source: Company, BOBCAPS Research

High capital buffer to buttress growth

KMB has ample capital in place to fuel its growth needs but nonetheless observes prudence while expanding its loan book. The bank currently has a tier-1 ratio of 17.6% (as of Q2FY20) which is the highest amongst peers. Our growth forecasts suggest tier-1 capital will remain robust even in FY22, implying no capital raising requirements for a few years thereafter as well.

FIG 9 – STRONG CAPITAL ADEQUACY



Source: Company, BOBCAPS Research

Lower cost of funds aiding NIMs

KMB's cost of funds differential with top-3 banks has reduced

At 4.6% as on Q2FY20, KMB's NIM is the best in the banking industry. Apart from efficient loan pricing, benefits from a lower cost of funds have bolstered margins. The bank has improved the share of deposits in its funding profile from 58% in FY11 to 74% currently. This coupled with granularity in deposits, as discussed earlier, has reduced its cost of funds differential with the top-3 banks, viz. HDFCB, ICICIBC and AXSB.

In our view, lower funding cost erects a strong moat around the bank's business model as it reduces the need to take risks on assets and still allows for healthy return ratios. Going forward, margins are likely to remain resilient, which we believe will offset KMB's measured growth aspirations. We pencil in ~45bps improvement in NIM to 4.6% over FY19-FY22.

FIG 10 – KMB HAS CLOSED THE GAP WITH PLAYERS IN TERMS OF COST OF FUNDS

Cost of funds (%)	Q2FY16	Q4FY16	Q2FY17	Q4FY17	Q2FY18	Q4FY18	Q2FY19	Q4FY19	Q1FY20	Q2FY20
Kotak Bank	6.6	6.2	6.1	5.2	5.2	5.2	5.4	5.4	5.4	5.3
HDFC Bank	5.9	5.8	5.5	5.1	5.1	5.0	5.2	5.3	5.4	5.4
ICICI Bank	5.9	5.5	5.5	4.8	4.9	4.6	4.8	4.9	5.0	5.0
Axis Bank	5.9	5.6	5.6	5.0	5.0	4.9	5.2	5.3	5.5	5.5
IndusInd Bank	6.8	7.0	6.5	6.0	5.9	5.9	6.4	6.5	6.7	6.8
State Bank of India	5.7	5.7	5.4	5.0	5.1	4.8	4.9	4.9	4.9	4.9

Source: Company, BOBCAPS Research

Credit costs contained amid sound asset quality

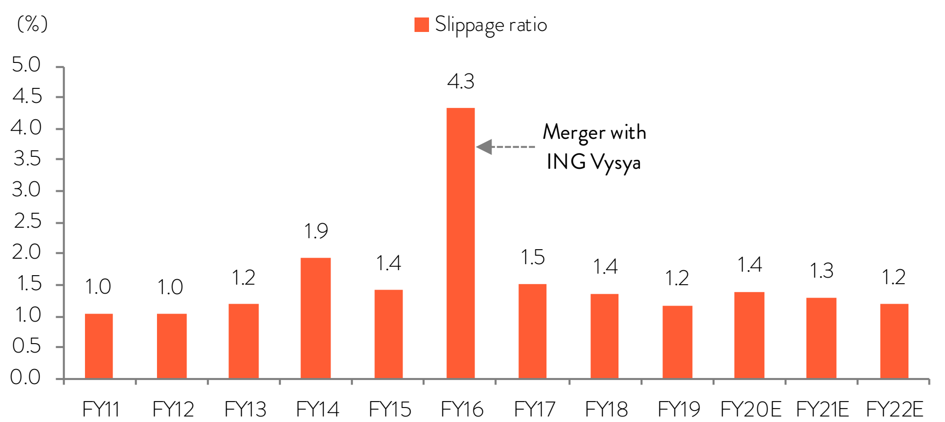
KMB has one of the strongest balance sheet positions among Indian banks, characterised by manageable gross NPA levels (2.3% as of Q2FY20) and a low share of stressed loans outside the NPA pool. Its ability to pre-empt stress buildup and initiate damage control measures early on has not only kept a tight leash on slippages but also reined in credit cost (at sub-50bps over the past nine years). We model for healthy credit cost of 40-60bps over FY19-FY22.

Well managed asset quality

With 2.3% gross NPA and low stressed loans outside the NPA pool (SMA-2 loans at 0.2%) as on Q2FY20, KMB remains one of the best managed banks in the industry. A coverage ratio of 64% on GNPA also lends comfort. KMB's strong asset quality is a testament to its robust risk management practices.

Despite the various disruptive events witnessed by the sector over the past few years (demonetisation, GST and RERA implementation), the bank has managed to keep slippages in check, at <1.5% of advances over FY17-FY19. Slippages did rise marginally in FY16 but a large part of the pain emanated from merger with the erstwhile ING Vysya Bank.

FIG 11 – SLIPPAGE RATIO HAS REMAINED FAIRLY LOW

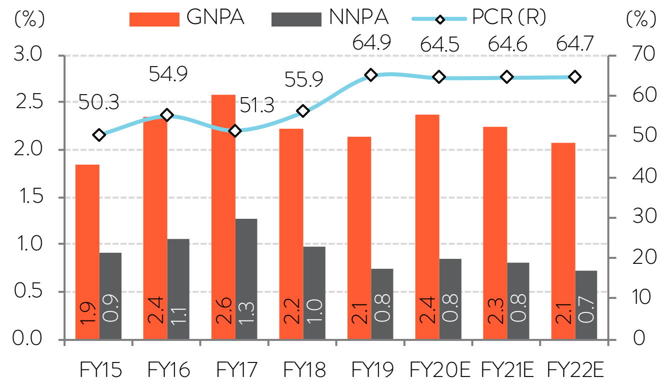


Source: Company, BOBCAPS Research

Proactive portfolio rebalancing holds the key

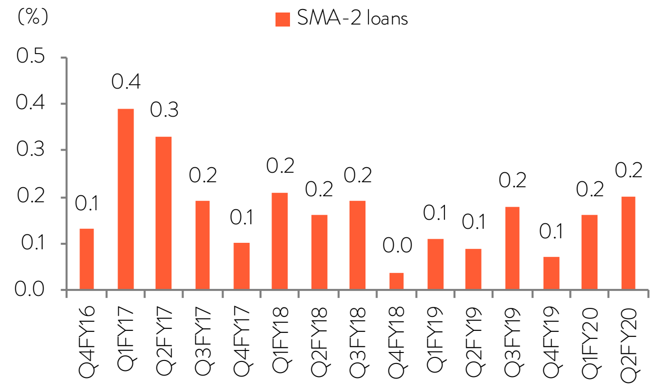
One of the key reasons for its sound asset quality is that KMB proactively rebalances portfolios, especially corporate accounts, to reflect the economic climate and reduce exposure to situations with heightened risk.

FIG 12 – HEADLINE NPA TO STAY MANAGEABLE WITH ADEQUATE PCR



Source: Company, BOBCAPS Research

FIG 13 – SHARE OF SMA-2 LOANS AMONG THE LOWEST IN THE INDUSTRY



Source: Company, BOBCAPS Research

Correcting course for a few pockets of stress

Ahead of the curve in anticipating stress and initiating damage control

KMB's management has often been ahead of the curve in anticipating stress looming in troubled sectors and quick to initiate damage control measures. For instance, the bank turned cautious on the SME sector ~2-2.5 years ago when quite a few of its peers were growing rapidly in the segment. Disruptions from demonetisation and GST later manifested as widespread stress in the sector.

KMB remained immune to these industry-wide challenges by taking corrective steps such as reorganising the business with a risk-averse wholesale team. Management now believes risks in the segment are largely under control and would like to grow the book hereon provided the macro environment turns conducive.

Likewise, the bank now intends to correct course in sectors where it faces stress beyond its appetite. Corporate loan growth has slowed as management believes the risks have risen. A cautious stance on the real estate sector has led KMB to skew its portfolio to the low-risk lease rental discounting product. Agri crop loan is another area where management intends to initiate damage control measures.

FIG 14 – KMB'S RECENT MANAGEMENT COMMENTARY PERTAINING TO THE LOAN PORTFOLIO

Segment	Loan book (Rs bn)	Loan mix (%)	YoY growth (%)	Comments	Key takeaway
Corporate & Business Banking	824	39	7.5	**Corporate Banking:** KMB has grown its corporate book in a sound manner without much delinquency. Of late though, growth in the portfolio has declined amid rising risks in the system.	Growth has come off and risks have risen
				Real Estate: KMB has remained cautious on the sector and gradually raised its exposure to the low-risk lease rental discounting product. Its exposure in the CRE space is to quality developers, bets are not concentrated, and repayments are linked to project cash flows.	De-risking the book
				Business Banking: Growth remained elusive for a while; apart from various initiatives to stabilise the business, it was recently merged with the Wholesale Banking division. Management now believes risks in the segment are largely under control and would like to grow the book hereon provided the environment is conducive.	Portfolio may have stabilised and risks seem to be under control
Commercial Vehicles / Equipment (CV/CE)	197	9	15	Delinquency levels have gone up in the CV space but reduced in the CE segment. Receivables cycle in the CV space has increased due to non-availability of loads, very low capacity utilisation, stagnant freight rates and disruption due to the monsoons in select pockets.	Stress emerging from select pockets
Agri Loans	271	13	21	The legacy agri crop loan portfolio (which is not very large) inherited post-merger with ING Vysya is facing challenges. However, stress in other agri segments such as term loans and tractor loans is lower than the previous year.	Risks have increased
Home Loans & LAP	444	21	23	This portfolio is split evenly between home loans and LAP. The bank is reasonably comfortable with growth trends while slippages are largely manageable.	Comfortable growth; stable asset quality
Small Business, Personal Loans & Credit Cards	349	16	20	Unsecured retail lending, especially credit cards and to a small extent personal loans, is beginning to show signs of stress. Delinquencies in secured retail remain largely stable.	Risks manageable

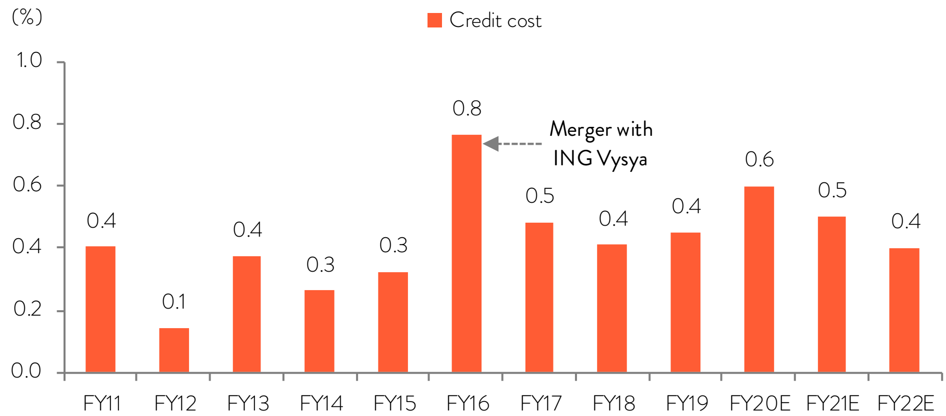
Source: Company, BOBCAPS Research

Credit costs to stay manageable

Corrective measures initiated by the bank should keep credit costs in check

Management has repeatedly demonstrated the ability to curb risks before they spiral out of control. KMB's credit cost over FY11-FY19 has remained at sub-50bps, barring FY16 when it spiked due to the merger with ING Vysya Bank. Going forward, we expect the de-risking measures initiated by the bank to alleviate asset risk and keep credit cost in check at 40-60bps over FY20-FY22.

FIG 15 – CREDIT COST SHOULD REMAIN CONTAINED



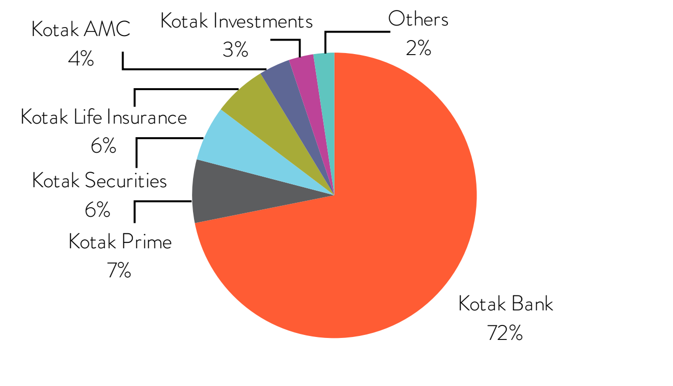
Source: Company, BOBCAPS Research

Upside potential from subsidiaries

Well-structured universal banking model

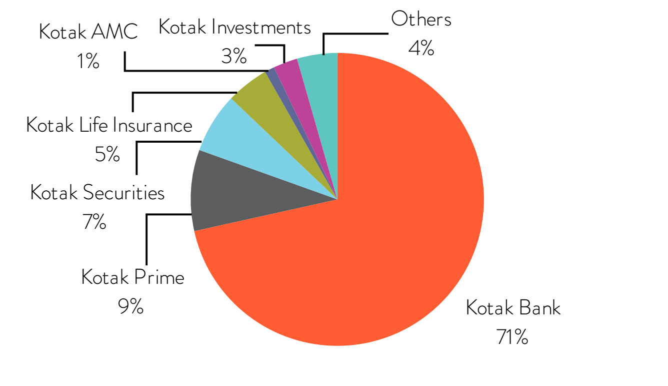
KMB was the first NBFC to receive a commercial banking licence from the RBI in 2003. The Kotak Group as a whole has diversified into various financial services, including broking, insurance, asset management and investment banking, through its subsidiaries. These entities leverage on customers acquired by the bank to sell products, while KMB acts as the lead customer acquisition engine for the group. We see high upside potential in group companies, especially those linked to the capital market business – taken together, they form >25% of our fair value for the bank.

FIG 16 – PROFIT CONTRIBUTION TO THE GROUP



Source: Company, BOBCAPS Research

FIG 17 – NET WORTH CONTRIBUTION TO THE GROUP



Source: Company, BOBCAPS Research

Kotak Mahindra Prime (KMPL)

Vehicle finance subsidiary has low 0.6% NNPA

KMPL is a 100% owned subsidiary of KMB that is primarily engaged in vehicle financing. It finances passenger cars and multi-utility vehicles (MUV) to retail customers and funds the working capital and infrastructure setup requirements of car dealers in the form of inventory funding and term loans. The company is also engaged in loans against securities, corporate loans, developer financing and two-wheeler financing.

KMPL is among the largest car financiers in India with high growth potential and healthy return ratios. It has strategic arrangements with various car manufacturers as their preferred financier. As of FY19, KMPL had a 70:30 split between vehicle and others loans, with 0.6% net NPA.

FIG 18 – KOTAK MAHINDRA PRIME: KEY FINANCIALS

Particulars (Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Net interest income	2,710	2,660	2,740	2,920	2,990	3,050
Non-interest income	57	890	560	850	630	640
Total income	3,280	3,550	3,300	3,770	3,620	3,690
Profit before tax	2,140	2,380	2,130	2,400	2,350	2,340
Profit after tax	1,390	1,570	1,390	1,640	1,530	1,720
CAR (%)	17.7	18.2	18.9	19.4	20.1	21.0
ROA (%)	1.8	2.0	1.8	2.2	2.0	2.3
Net NPA (%)	0.4	0.4	0.4	0.4	0.5	0.6
Customer assets	279,080	285,440	279,070	282,680	277,490	272,990
-Car	203,750	207,400	201,910	202,710	195,540	190,410
-Others	75,330	78,040	77,160	79,970	81,950	82,580

Source: Company, BOBCAPS Research

Kotak Securities (KS)

Stockbroking arm contributes 6% of group profit

KS is the bank's stockbroking arm that contributes 6% of the group's total profit and leverages the bank's client base to extend broking services. It had an overall/cash segment market share of 1.7%/9.4% as on Q2FY20. KS services ~1.5mn secondary market customers through over 1,400 branches and franchises.

FIG 19 – KOTAK SECURITIES: KEY FINANCIALS

Particulars (Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Total income	4,150	4,070	3,630	3,960	4,110	4,070
Profit before tax	1,960	1,690	1,490	1,650	1,680	1,810
Profit after tax	1,300	1,120	990	1,110	1,100	1,490
Branches & franchises	1,353	1,419	1,411	1,328	1,329	1,426
Market share (YTD %)	1.7	2.5	2.9	2.6	1.7	1.7

Source: Company, BOBCAPS Research

Kotak Mahindra Life Insurance Company (KLI)

KLI is one of the oldest life insurance players in India

KLI is a 100% life insurance subsidiary of KMB and one of the oldest players in India, established in 2001 as a 74:26 joint venture between KMB and Old Mutual Plc. Old Mutual's stake was completely bought over by Kotak Group in Oct'17. Over the years, KLI has developed a multi-channel distribution network to cater to its customers and markets across India through agency, alternate group and online channels.

FIG 20 – KOTAK MAHINDRA LIFE INSURANCE: KEY FINANCIALS

Particulars (Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Gross premium	11,880	17,180	8,900	34,270	16,400	21,900
-Individual Regular	6,720	11,360	3,860	24,800	8,400	13,660
-Single	780	680	1,050	2,640	910	1,650
-Group	4,380	5,140	3,990	6,830	7,090	6,590
Profit After Tax	1,170	1,270	1,250	1,380	1,340	1,440
AUM	258,252	240,174	253,260	280,000	319,200	303,580
Solvency Ratio (%)	3.1	3.1	3.1	3.0	3.0	3.1

Source: Company, BOBCAPS Research

Kotak Mahindra Asset Management Company (KMAMC)

KMAMC is the sixth largest AMC with AAUM of Rs 1.7tn

Kotak Mahindra Asset Management Company (KMAMC) is the sixth largest player in the industry with Average Assets Under Management (AAUM) at Rs 1.7tn and an overall market share of 6.6% as on Q2FY20. It has an equity AAUM of Rs 0.7tn with a market share of 4.6%.

FIG 21 – KOTAK MAHINDRA AMC & TRUSTEE CO (KMATC): KEY FINANCIALS

Particulars (Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Average Assets Under Management						
-Overall	1,285,560	1,355,080	1,395,620	1,502,710	1,613,390	1,686,580
-Equity	500,360	544,830	559,450	625,600	646,690	689,730
Market share						
-Overall	5.5	5.5	5.9	6.1	6.3	6.6
-Equity	3.8	4.0	4.1	5.5	4.4	4.6
Profit before tax	770	790	1,150	1,160	1,110	1,040
Profit after tax	510	520	760	750	730	850

Source: Company, BOBCAPS Research

Kotak Mahindra Investments (KMIL)

Real estate lending arm has customer assets of Rs 78bn with NNPA of 0.85%

KMIL is a lending subsidiary that offers comprehensive financial assistance and solutions such as structured finance, sponsor financing, construction finance for residential and commercial real estate, lease rental discounting (LRD) and financing against ready inventory (LAP) to real estate developers across various asset classes – these include residential, commercial, retail and IT. As on Q2FY20, this subsidiary had customer assets worth Rs 78bn with NNPA of 0.85%.

FIG 22 – KOTAK MAHINDRA INVESTMENTS: KEY FINANCIALS

Particulars (Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Customer assets	77,050	79,550	79,150	92,420	90,300	78,280
Net interest income	720	610	680	920	870	890
Non-interest income	160	240	120	430	270	230
Total income	880	850	780	1,350	1,140	1,120
Profit before tax	740	700	610	1,110	940	870
Profit after tax	480	450	400	730	630	670
CAR (%)	19.3	20.7	20.2	18.4	19.4	22.4
ROA (%)	2.2	2.0	1.8	3.1	2.5	2.8
Net NPA (%)	0.1	0.0	0.5	0.3	0.6	0.9

Source: Company, BOBCAPS Research

Valuation methodology

We value KMB using the sum-of-the-parts (SOTP) methodology to arrive at a Mar'21 target price of Rs 1,950. The core business is valued at 4.5x FY22E P/ABV based on the Gordon Growth Model, while subsidiaries drive ~25% of our fair value.

KMB is currently trading at 3.5x FY22E core P/ABV as compared to 2.0x for ICICIBC and 2.9x for HDFCB. In our view, KMB merits premium valuations given the substantial improvement in its liability franchise, best-in-class margins and sturdy asset quality. Moreover, the bank has a proven and stable leadership as compared to the uncertainty surrounding management changes at most private sector peers. We estimate a 29% PAT CAGR and ROE expansion to 17% for KMB over FY19-FY22. Initiate with BUY.

FIG 23 – PEER COMPARISON

	KMB			HDFCB			AXSB			ICICIBC		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Core P/ABV (x)	4.8	4.1	3.4	3.9	3.4	2.9	2.5	2.2	1.8	2.8	2.3	2.0
ROA (%)	2.0	2.1	2.3	2.0	2.1	2.1	1.0	1.5	1.6	1.1	1.7	1.8
ROE (%)	14.5	15.8	17.1	17.3	19.5	20.3	11.2	16.0	18.0	10.7	16.8	18.2

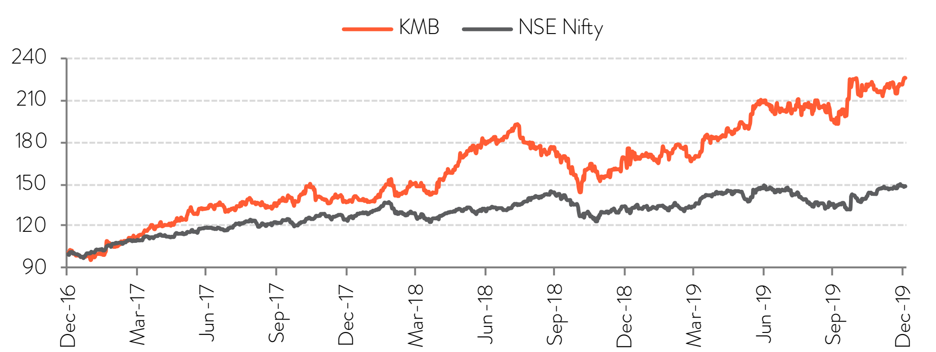
Source: Bloomberg, BOBCAPS Research

FIG 24 – 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	2,740	100	2,740	1,435	74	Valued at 4.5x 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			**3,722**	**1,950**		

Source: BOBCAPS Research

FIG 25 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Lack of clarity on promoter stake to remain an overhang

EQUITY SUPPLY OVERHANG FOR KMB

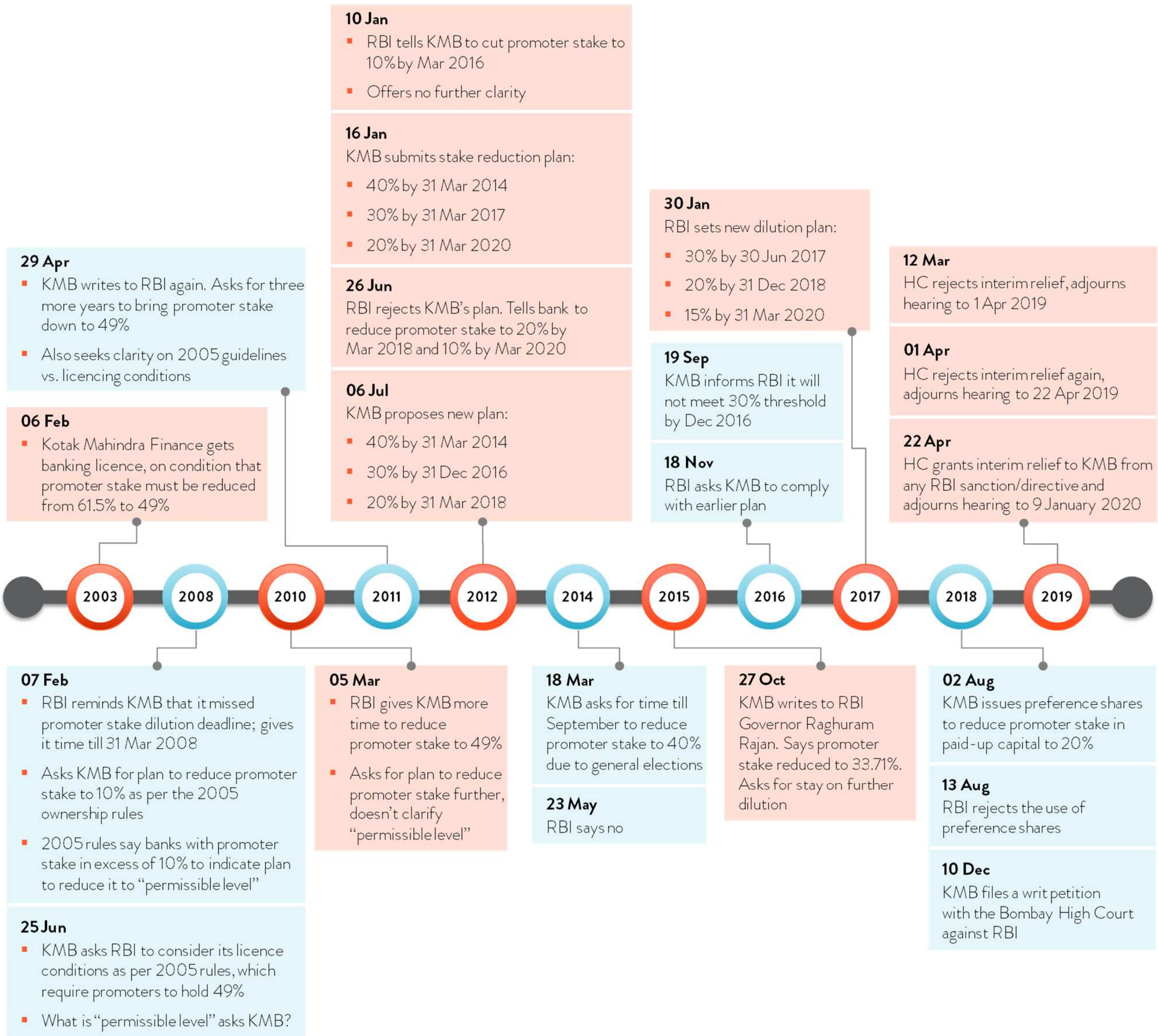
Particulars	(Rs bn)
Current market cap	3,141
Value of promoter's holding at 29.97% stake	941
Value of promoter's holding at regulatory requirement of 20% stake	628
Supply overhang	313
Supply overhang as a % of current market cap	10.0

Source: Company, BOBCAPS Research

As per regulatory guidelines, KMB had to reduce its promoter holding to 20% by end-Dec'18 and further to 15% by Mar'20. The bank in early Aug'18 issued perpetual non-cumulative preference shares (PNCPS) amounting to Rs 5bn and thus reduced promoter holding in paid-up capital to 19.7%. But the RBI did not approve of this plan, following which KMB filed a writ petition with the Bombay High Court against the regulator in Dec'18 maintaining that it was compliant with regulations.

The case was last heard on 22 Apr 2019 and adjourned to 9 Jan 2020, giving interim relief to the bank from any RBI sanction/directive. In our view, a push to dilute through a stake sale or aggressive M&A can be an overhang on the stock.

FIG 26 – DRAWDOWN OF PROMOTER HOLDING: RBI VS. KMB



Source: Company, BOBCAPS Research

Deepening economic slump

A worsening economic environment can impact our loan growth and credit cost assumptions and lead to deterioration in KMB's asset quality.

Underperformance at subsidiaries

KMB derives significant value from its insurance, lending and capital markets subsidiaries; should they perform poorly, it 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**	**137,749**	**167,851**	**206,767**
NII growth (%)	1729.6	1812.1	2234.6	2185.3	2318.5
Non-interest income	40,522	46,040	54,495	65,168	79,362
Total income	135,839	158,630	192,244	233,019	286,129
Operating expenses	(64,257)	(75,148)	(87,941)	(105,149)	(128,621)
Operating profit	71,582	83,482	104,303	127,869	157,508
Operating profit growth (%)	1,960.6	1,662.5	2,494.1	2,259.4	2,317.9
Provisions	(9,624)	(15,539)	(15,539)	(16,012)	(16,451)
PBT	61,958	67,942	88,763	111,858	141,057
Tax	(21,339)	(25,205)	(22,723)	(28,636)	(36,111)
Reported net profit	**40,619**	**42,738**	**66,040**	**83,222**	**104,947**
Adjustments	0	0	0	0	0
Adjusted net profit	**40,619**	**42,738**	**66,040**	**83,222**	**104,947**

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	0	0	0	0	0
Net worth	374,838	429,005	492,016	570,943	669,871
Deposits	1,926,433	2,258,804	2,620,212	3,144,255	3,835,991
Borrowings	260,811	327,043	346,758	375,494	413,091
Other liabilities & provisions	87,252	106,870	124,224	144,484	168,149
Total liabilities and equities	**2,649,334**	**3,121,721**	**3,583,210**	**4,235,176**	**5,087,102**
Cash & bank balance	196,201	246,755	269,472	301,194	340,756
Investments	645,623	711,891	798,821	920,744	1,079,991
Advances	1,697,179	2,056,948	2,406,629	2,887,955	3,537,745
Fixed & Other assets	110,330	106,127	108,287	125,282	128,610
Total assets	**2,649,334**	**3,121,721**	**3,583,210**	**4,235,176**	**5,087,102**
Deposit growth (%)	22.4	17.3	16.0	20.0	22.0
Advances growth (%)	24.7	21.2	17.0	20.0	22.5

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	21.8	25.5	34.6	43.6	55.0
Dividend per share	0.6	0.8	1.4	2.0	2.7
Book value per share	196.7	222.1	255.1	296.5	348.3

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	75.6	64.7	47.7	37.8	30.0
P/BV	8.4	7.4	6.5	5.6	4.7
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	4.1	4.3	4.4
Non-interest income	1.7	1.6	1.6	1.7	1.7
Operating expenses	2.7	2.6	2.6	2.7	2.8
Pre-provisioning profit	3.0	2.9	3.1	3.3	3.4
Provisions	0.4	0.3	0.5	0.4	0.4
PBT	2.6	2.4	2.6	2.9	3.0
Tax	0.9	0.9	0.7	0.7	0.8
ROA	1.7	1.7	2.0	2.1	2.3
Leverage (x)	7.4	7.2	7.4	7.4	7.6
ROE	12.5	12.2	14.5	15.8	17.1

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	17.3	18.1	22.3	21.9	23.2
Pre-provisioning profit	19.6	16.6	24.9	22.6	23.2
EPS	17.4	17.0	35.6	26.0	26.1
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	1.3
Cost-Income	47.3	47.4	45.7	45.1	45.0
ROE	12.5	12.2	14.5	15.8	17.1
ROA	1.7	1.7	2.0	2.1	2.3
Asset quality (%)					
GNPA	2.2	2.1	2.4	2.3	2.1
NNPA	1.0	0.8	0.8	0.8	0.7
Provision coverage	56.5	65.4	65.1	65.1	65.2
Ratios (%)					
Credit-Deposit	88.1	91.1	91.8	91.8	92.2
Investment-Deposit	33.5	31.5	30.5	29.3	28.2
CAR	18.2	17.5	17.1	16.3	15.6
Tier-1	17.6	16.9	16.5	15.8	15.2

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

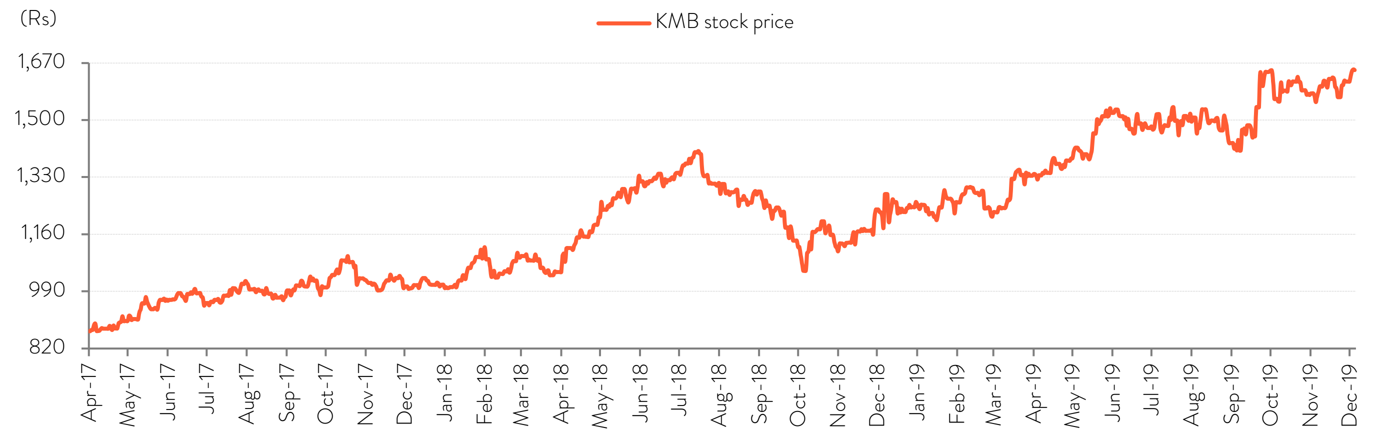
ADD – Expected return from >+5% to +15%

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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