

HOLD
 TP: Rs 2,122 | ▲ 12%

KOTAK MAHINDRA BANK

| Banking

| 25 July 2023

Non-core income drives up profitability

- Strong core and non-core revenue supported Q1 income growth of 50% YoY though NIM contracted 15bps sequentially
- Opex elevated (+26% YoY) and credit cost settling at higher levels (46bps) amid rising unsecured portfolio share
- Retain HOLD with an unchanged TP of Rs 2,122, valuing the stock at 3.1x FY25E P/ABV with subsidiary value of Rs 505

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Healthy Q1: KMB posted healthy PAT growth of 67% YoY to Rs 34.5bn in Q1FY24 supported by higher NII (+33%) and other income (+115%), with the latter bolstered by treasury gains of Rs 2.4bn vs. a loss of Rs 8.6bn in Q1FY23 and dividend income. Operating expenses grew 26% YoY and 9% QoQ, leading to a 56bps sequential rise in C/I ratio.

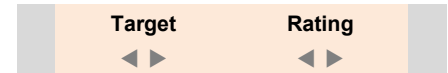
Steady loan growth: The bank clocked credit growth of 17% YoY (+3% QoQ) underpinned by targeted unsecured retail loans in segments such as payment products, microfinance, tractors & commercial vehicles, and home loans. The unsecured book constituted 10.7% of advances vs. a target share of under 10%.

NIM dips sequentially on higher cost of funds: NIM decreased 15bps QoQ to 5.1% owing to upward deposit rate repricing and an increased share of KMB's 'ActivMoney' product (attracts 5.25% interest vs. 3.5% for savings accounts, albeit still lower than the +7% cost for term deposits). Management retained NIM guidance for FY24 at over 5% considering rising yields on the unsecured book.

Stable asset quality; credit cost normalising: Slippages were elevated at 168bps of advances vs. 119bps in Q4, but better upgrades and recoveries steadied GNPA/NNPA at 1.8%/0.4%. Credit cost soared to 46bps vs. 19bps in Q4 and 3bps in Q1FY23, which management believes is a process of normalisation as unsecured loan share moves up. We maintain our credit cost assumptions at 40bps each for FY24/FY25 and expect stable asset quality with GNPA/NNPA/PCR of 1.6%/0.4%/77% by FY25. KMB is well capitalised with CAR of 22% and CET1 at 20.9% in Q1.

Maintain HOLD: The stock is currently trading at a premium valuation of 2.6x FY25E P/ABV which is well above peers and captures KMB's high-margin business, healthy return ratios and stable asset quality, in our view. This apart, leveraging of the unsecured business would be key to watch as will the management's succession plan. We thus maintain our HOLD rating and TP of Rs 2,122 as we continue to value the bank at 3.1x FY25E ABV (Gordon Growth Model) and add in Rs 505/sh for subsidiaries.

Key changes



Ticker/Price	KMB IN/Rs 1,897
Market cap	US\$ 45.9bn
Free float	74%
3M ADV	US\$ 136.7mn
52wk high/low	Rs 2,064/Rs 1,644
Promoter/FPI/DII	26%/39%/21%

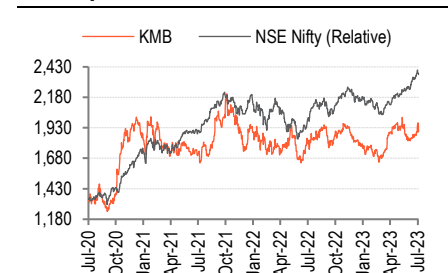
Source: NSE | Price as of 24 Jul 2023

Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Net interest income	21,552	24,496	28,056
NII growth (%)	28.1	13.7	14.5
Adj. net profit (Rs mn)	10,939	11,838	13,716
EPS (Rs)	55.1	59.6	69.0
Consensus EPS (Rs)	55.1	60.1	69.3
P/E (x)	34.5	31.8	27.5
P/BV (x)	4.5	4.0	3.5
ROA (%)	2.8	2.2	2.2
ROE (%)	17.9	13.3	13.5

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Fig 1 – Quarterly snapshot: Income

(Rs mn)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	YoY (%)	QoQ (%)
Income Statement							
Interest Income	56,568	63,976	71,433	77,809	82,982	46.7	6.6
Income on investments	14,419	14,860	16,464	18,843	20,074	39.2	6.5
Int. on bal. with RBI & inter-bank funds & Others	2,398	2,092	2,090	1,558	1,944	(19.0)	24.8
Interest income	73,385	80,928	89,986	98,209	105,000	43.1	6.9
Interest expense	26,415	29,934	33,457	37,184	42,663	61.5	14.7
Net interest income	46,970	50,994	56,529	61,026	62,337	32.7	2.1
Growth YoY (%)	19.2	26.8	30.4	35.0	32.7	1,355bps	(226bps)
Non-interest income	12,438	19,542	21,000	21,863	26,833	115.7	22.7
Growth YoY (%)	(21.4)	7.8	54.0	19.7	115.7	13,717bps	9,603bps
Non-interest income (Ex- Trading income)	21,008	19,542	21,000	21,853	24,433	16.3	11.8
Total income	59,408	70,536	77,529	82,888	89,170	50.1	7.6
Growth YoY (%)	7.5	20.9	36.1	30.6	50.1	4,256bps	1,952bps
Staff expenses	11,728	14,147	14,778	14,545	16,470	40.4	13.2
Other operating expenses	19,847	20,714	24,253	21,870	23,204	16.9	6.1
Operating expenses	31,575	34,861	39,031	36,415	39,674	25.6	8.9
Pre-Provisioning Profit (PPoP)	27,833	35,675	38,498	46,474	49,496	77.83	6.5
Growth YoY (%)	(10.8)	14.3	42.5	39.1	77.8	8,866bps	3,869bps
Pre-Provisioning Profit (Ex- Trading income)	36,403	35,675	38,498	46,464	47,096	29.4	1.4
Growth YoY (%)	16.6	14.3	42.5	39.1	29.4	1274bps	(974bps)
Provisions	236	1,370	1,488	1,476	3,643	1,444.3	146.9
Growth YoY (%)	(97.5)	(67.7)	(213.0)	(148.2)	1444.3	154,182bps	15,9253bps
PBT	27,597	34,305	37,010	44,998	45,853	66.2	1.9
Tax	6,885	8,498	9,091	10,042	11,330	64.6	12.8
PAT	20,712	25,807	27,919	34,956	34,523	66.7	(1.2)
Growth YoY (%)	26.1	27.0	31.0	26.3	66.7	4,054bps	4,037bps
Per Share							
FV (Rs)	5	5	5	5	5	0.0	0.0
EPS (Rs)	10	13	14	17	17	66.6	(0.1)
Book Value (Rs)	365	388	403	420	438	20.1	4.2

Source: Company, BOBCAPS Research

Fig 2 – Quarterly snapshot: Balance Sheet & Others

Balance sheet (Rs mn)	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	YoY (%)	QoQ (%)
Deposits	3,164,830	3,252,032	3,446,660	3,630,961	3,862,540	22.0	6.4
Growth YoY (%)	10.4	11.5	12.9	16.5	22.0	1,160bps	555bps
Advances	2,801,710	2,940,232	3,107,340	3,198,612	3,285,820	17.3	2.7
Growth YoY (%)	28.8	25.1	22.9	17.9	17.3	(1,156bps)	(64bps)
Investment	891,830	988,624	1,122,190	1,214,037	1,238,730	38.9	2.0
Equity	746,520	770,759	799,360	835,203	870,110	16.6	4.2
Assets	4,247,680	4,419,951	4,647,840	4,898,625	5,129,910	20.8	4.7
Growth YoY (%)	7.6	8.2	11.2	14.1	20.8	1,320bps	670bps
Yield (%)							
Yield on Funds	7.12	7.76	8.24	8.51	8.66	153bps	14bps
Cost of Funds	3.16	3.54	3.77	3.95	4.30	115bps	35bps
Spread	3.97	4.22	4.47	4.56	4.35	39bps	(21bps)
Net Interest Margin	4.56	4.89	5.18	5.29	5.14	58bps	(15bps)
Ratios (%)							
Other Income / Net Income	20.9	27.7	27.1	26.4	30.1	916bps	372bps
Cost to Income ratio	53.2	49.4	50.3	43.9	44.5	(866bps)	56bps
CASA ratio	58.1	56.2	53.3	52.8	49.0	(910bps)	(383bps)
C/D ratio	88.5	90.4	90.2	88.1	85.1	(346bps)	(302bps)
Investment to Assets	21.0	22.4	24.1	24.8	24.1	315bps	(64bps)
Assets Quality							
GNPA	63,786	62,102	59,946	57,683	59,092	(7.4)	2.44
NNPA	17,493	16,304	13,448	11,933	13,018	(25.6)	9.1
Provision	46,292	45,799	46,498	45,750	46,074	(0.5)	0.7
GNPA (%)	2.24	2.08	1.90	1.78	1.77	(47bps)	(1bps)
NNPA (%)	0.62	0.55	0.43	0.37	0.40	(22bps)	3bps
Provision (%)	72.6	73.7	77.6	79.3	78.0	540bps	(134bps)
Others							
Branches	1,702	1,710	1,752	1,780	1,788	86	8
ATMs	2,761	2,802	2,814	2,963	3,047	286	84

Source: Company, BOBCAPS Research

Earnings call highlights

Asset quality

- Despite higher slippages (Rs 12bn in Q1FY24 vs. Rs 8.2bn in Q4FY23), KMB's asset quality remained stable with GNPA and NNPA at 1.8% and 0.4% respectively and PCR at 78% (vs. 79% in Q4).
- Credit cost was elevated at 46bps of advances vs. 19bps in Q4FY23 and 3bps in Q1FY23 as the share of unsecured loans moved up.
- The SMA-2 book was flat QoQ at ~Rs 2bn.

NII and NIM

- NII grew 33% YoY (2% QoQ) while other income surged 115% YoY (23% QoQ) driven by treasury gains and dividend income.

- NIM during the quarter contracted 15bps QoQ to 5.1% due to a higher cost of funds. Management expects margins to sustain above 5% for the fiscal.

Loans

- Advances grew 17% YoY and deposits were up 22%. Management kept growth guidance for both metrics unchanged at 1.5-2x of nominal GDP growth.
- The corporate loan book grew 16% YoY and 7% QoQ with strong traction in the MNC and NBFC segments, and is likely to remain price competitive.
- The SME book was subdued with 9% YoY (1% QoQ) growth on the back of underutilisation of the sanctioned limit.
- KMB has carved out a new mid-corporate segment and has a new team in place to capture the opportunity in this segment.
- Within retail, home loans and LAP grew 18% YoY (3% QoQ) while the credit card book rose 67% YoY (13% QoQ). Personal and consumer durable loans were up 44% YoY (6% QoQ), while agricultural lending remained muted at 8% YoY (-4% QoQ).
- Unsecured retail advances (including retail micro finance) constituted 10.7% of net advances in Q1.

Deposits

- Deposits climbed 22% YoY led by term deposits, mainly from KMB's 'ActivMoney' product which grew 24% QoQ. Management indicated that the product is opportunistic both in terms of volume and price and will help it tide over the muted deposit mobilisation environment (given a better trade-off in terms of active money cost of 5-5.25% vs. term deposit cost of +7% and savings account cost of 3-3.5%).
- CASA growth dipped 1.3% QoQ (+3% YoY), leading to a 383bps sequential decline in CASA ratio.

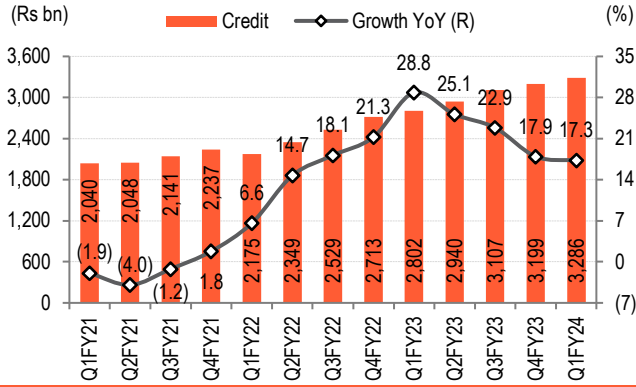
Operating expenses

- Opex during the quarter remained elevated and C/I ratio stood at 44.5%.
- Employee expenses moved up off a low base (absence of pension benefits in the prior quarter), whereas other operating expenses increased on the back of higher promotional and technology expenses that are guided to remain elevated for a few quarters.

Others

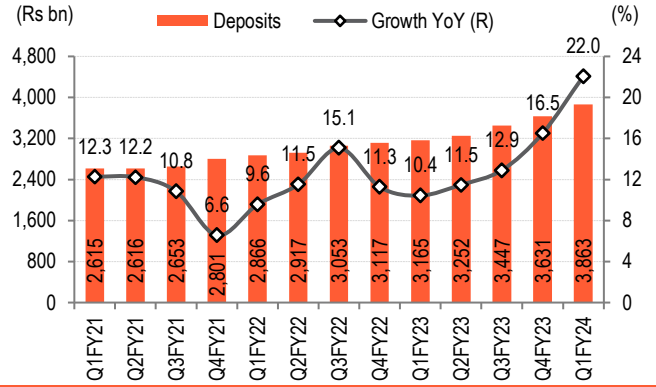
- In terms of succession plan, management indicated that leadership transition is on track and will be disclosed at the appropriate time.
- KMB stated that it is open to inorganic growth options.

Fig 3 – Credit increased 17% YoY in Q1FY24



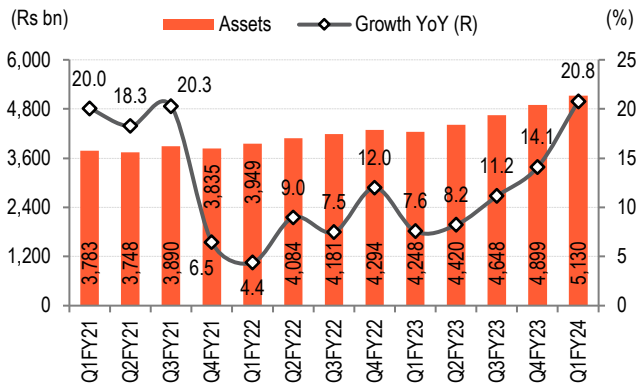
Source: Company, BOBCAPS Research

Fig 4 – Deposits grew 22% YoY driven ‘ActivMoney’



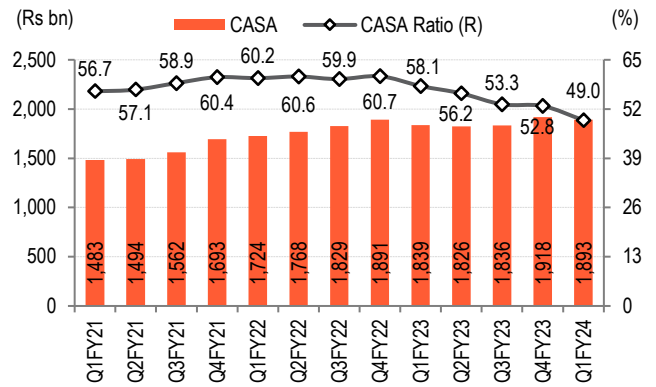
Source: Company, BOBCAPS Research

Fig 5 – Asset growth at 21% YoY



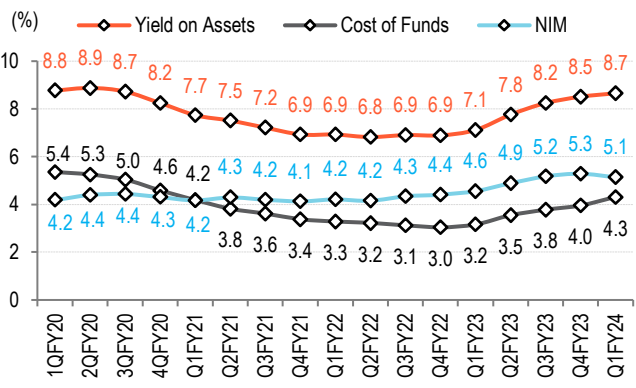
Source: Company, BOBCAPS Research

Fig 6 – Decline in CASA due to subdued SA mobilisation



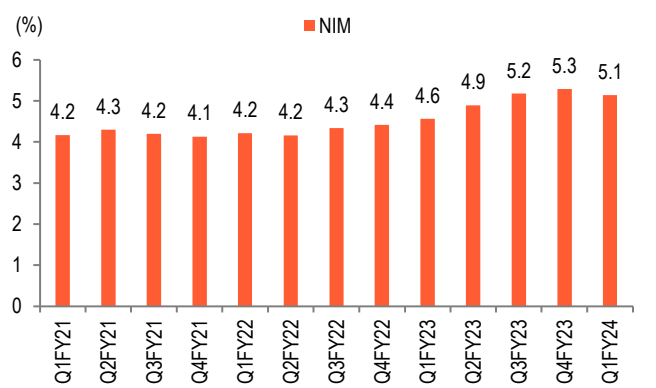
Source: Company, BOBCAPS Research

Fig 7 – NIM (calc.) declined 15bps QoQ



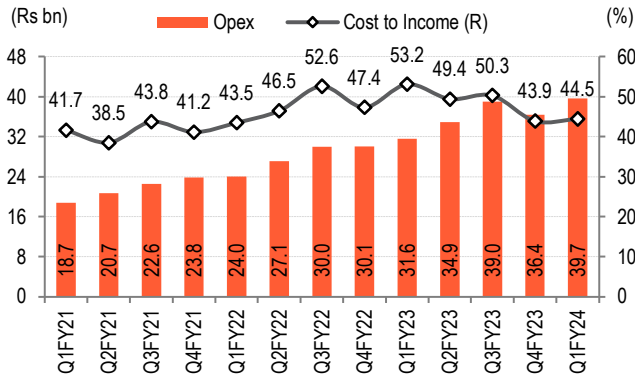
Source: Company, BOBCAPS Research

Fig 8 – NIM (calc.) forecast at 4.7% for FY24E-FY25E



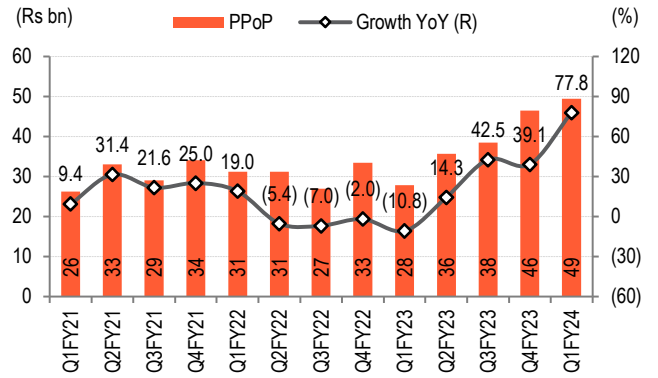
Source: Company, BOBCAPS Research

Fig 9 – Opex remained elevated on higher employee and promotional cost



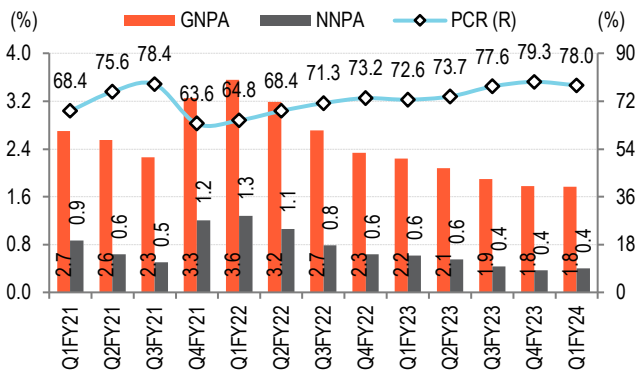
Source: Company, BOBCAPS Research

Fig 10 – Healthy topline coupled with non-core income supported PPOP growth



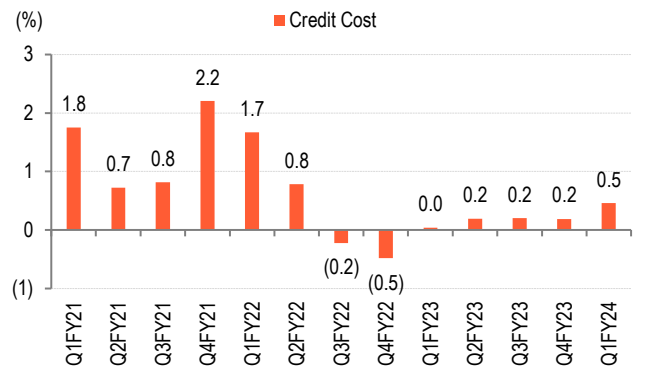
Source: Company, BOBCAPS Research

Fig 11 – Asset quality remained stable



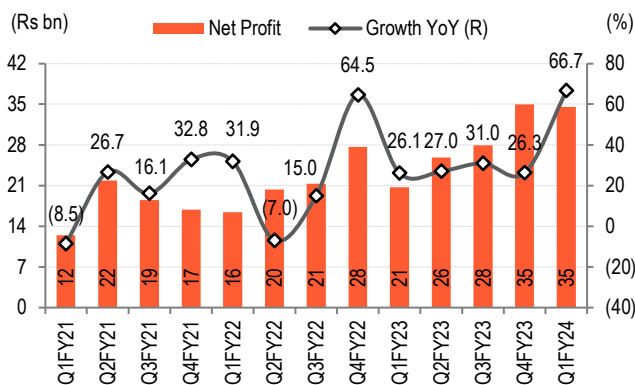
Source: Company, BOBCAPS Research

Fig 12 – Credit cost normalising



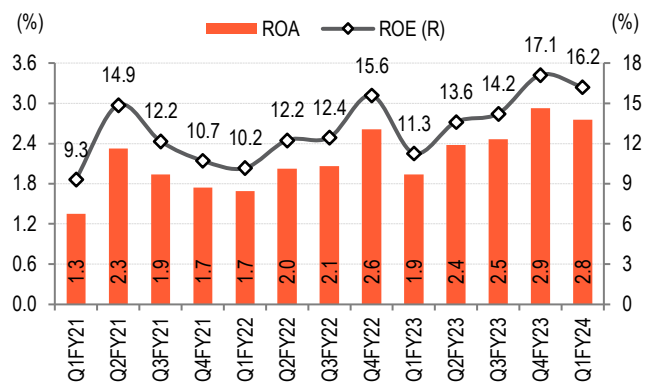
Source: Company, BOBCAPS Research

Fig 13 – PAT growth bolstered by non-core income



Source: Company, BOBCAPS Research

Fig 14 – Return ratios held strong



Source: Company, BOBCAPS Research

Valuation methodology

KMB has delivered a robust Q1FY24 performance supported by healthy business growth across segments. We maintain our credit and deposit growth estimates at 18% and 17% CAGR respectively over FY23-FY25, supporting a strong NII CAGR of 14.1% over the same period. We continue to model for NIM at 4.7% through to FY25 considering higher opex and pencil in a 16% PPOP CAGR over our forecast period, accompanied by improvement in return ratios (to 14%/2.3% ROE/ROA in FY25).

On the asset quality front, we now factor in a slight rise in stress from the unsecured book and expect GNPA/NNPA at 1.6%/0.4% with a credit cost estimate of 40bps each in FY24 and FY25 (vs. 15bps earlier). KMB is well capitalised with CAR at 22% (CET1 at 20.9%) as of Q1FY24, which offers ample opportunity for the bank to further leverage its balance sheet for expansion and inorganic growth.

The stock is currently trading at a premium valuation of 2.6x FY25E P/ABV which is well above peers and captures KMB's high-margin business, healthy return ratios and stable asset quality, in our view. This apart, leveraging of the unsecured business would be key to watch as will the upcoming succession plan. We thus maintain our HOLD rating and TP of Rs 2,122 as we continue to value the bank at 3.1x FY25E ABV (Gordon Growth Model) and add in Rs 505/sh for subsidiaries.

Fig 15 – Key operational assumptions

Parameter (%)	FY22	FY23P	FY24E	FY25E
Advances	21.3	17.9	18.1	18.0
Net Interest Income	9.6	28.1	13.7	14.5
PPoP	2.5	23.2	15.6	16.0
PAT	28.7	50.6	8.2	15.9
NIM	4.3	4.9	4.8	4.7
GNPA	2.3	1.8	1.6	1.6
CAR	22.7	21.8	21.2	21.0

Source: Company, BOBCAPS Research

Fig 16 – SOTP valuation summary

Business	Valuation	Holdings (%)	Value (Rs/sh)
Kotak Bank	3.1x FY25E ABV	100	1,617
Kotak Life	1.3x Embedded value	100	95
Kotak Prime	2.5x FY25E ABV	100	129
Kotak AMC	5% of AUM	100	117
Kotak Securities	20x FY25 EPS	100	125
Others	-	100	39

Source: Company, BOBCAPS Research

Fig 17 – Valuation assumption (Gordon growth model)

Parameter (%)	Assumptions
Return on Equity (RoE)	17.4
Cost of Equity (Ke)	12.3
Growth (Period 1)	15.7
Growth (Long Term)	7.0
Initial High Growth Period (yrs)	10.0
Dividend Payout (Period 1)	10.0
Dividend Payout (Long Term)	60.0
Factor 1	1.2
Factor 2	16.5
Justified P/BV Multiple (x)	3.1

Source: BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- above-expected credit growth along with stable asset quality.

Key downside risks are:

- reversal in credit cycle, which can lead to higher deterioration than anticipated in asset quality and thus weaker profitability owing to higher provisions, and
- inability to manage cost of funds, which may drag down NIM as well as overall profitability.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Axis Bank	AXSB IN	36.4	972	1,111	BUY
Federal Bank	FB IN	3.4	134	165	BUY
HDFC Bank	HDFCB IN	154.0	1,678	2,061	BUY
ICICI Bank	ICICIB IN	84.3	992	1,015	HOLD
Indusind Bank	IIB IN	13.6	1,436	1,755	BUY
Kotak Mahindra Bank	KMB IN	45.9	1,897	2,122	HOLD
State Bank of India	SBIN IN	67.1	618	729	BUY

Source: BOBCAPS Research, NSE | Price as of 24 Jul 2023

Glossary

Glossary of Abbreviations			
AUCA	Advance Under Collection Account	LCR	Liquidity Coverage Ratio
ARC	Asset Reconstruction Company	MCLR	Marginal Cost of Funds-based Lending Rate
BRDS	Bills Rediscounting Scheme	MTM	Mark to Market
CASA	Current Account and Savings Account	NII	Net Interest Income
CAR	Capital Adequacy Ratio	NIM	Net Interest Margin
CET1	Common Equity Tier 1	NNPA	Net Non-Performing Assets
CD	Credit-Deposit Ratio	PCR	Provision Coverage Ratio
C/I	Cost-Income Ratio	PPOP	Pre-Provision Operating Profit
CRB	Commercial and Rural Banking	PSU	Public Sector Unit
EBLR	External Benchmark-based Lending Rate	RWA	Risk-weighted Assets
ECL	Expected Credit Loss	SLR	Statutory Liquidity Ratio
GNPA	Gross Non-Performing Assets	SMA	Special Mention Account
IBPC	Interbank Participation Certificate	SME	Small and Medium-sized Enterprises
LAP	Loans against Property		

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Net interest income	15,340	16,818	21,552	24,496	28,056
NilI growth (%)	13.6	9.6	28.1	13.7	14.5
Non-interest income	5,007	6,354	7,484	8,928	10,446
Total income	20,346	23,172	29,036	33,423	38,502
Operating expenses	8,584	11,121	14,188	16,257	18,584
PPOP	11,762	12,051	14,848	17,167	19,918
PPOP growth (%)	17.4	2.5	23.2	15.6	16.0
Provisions	2,852	772	457	1,256	1,482
PBT	8,910	11,279	14,391	15,911	18,435
Tax	3,265	4,016	3,452	4,073	4,719
Reported net profit	5,644	7,263	10,939	11,838	13,716
Adjustments	0	0	0	0	0
Adjusted net profit	5,644	7,263	10,939	11,838	13,716

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Equity capital	1,491	1,492	1,493	1,493	1,493
Reserves & surplus	62,238	70,995	82,027	93,865	107,581
Net worth	63,729	72,488	83,520	95,358	109,074
Deposits	280,100	311,684	363,096	424,822	494,918
Borrowings	23,651	25,967	23,416	27,397	31,835
Other liab. & provisions	15,990	19,289	19,830	19,115	26,432
Total liab. & equities	383,470	429,428	489,862	566,693	662,259
Cash & bank balance	39,627	42,924	32,542	37,853	40,009
Investments	105,099	100,580	121,404	138,391	161,531
Advances	223,670	271,254	319,861	377,756	445,752
Fixed & Other assets	15,074	14,671	16,055	12,693	14,967
Total assets	383,470	429,428	489,862	566,693	662,259
Deposit growth (%)	6.6	11.3	16.5	17.0	16.5
Advances growth (%)	1.8	21.3	17.9	18.1	18.0

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23P	FY24E	FY25E
EPS	57.5	73.8	55.1	59.6	69.0
Dividend per share	0.9	1.1	1.5	1.8	3.5
Book value per share	644.0	731.1	417.9	477.5	546.5

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23P	FY24E	FY25E
P/E	33.0	25.7	34.5	31.8	27.5
P/BV	2.9	2.6	4.5	4.0	3.5
Dividend yield (%)	0.0	0.1	0.1	0.1	0.2

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23P	FY24E	FY25E
Net interest income	4.6	4.5	5.2	4.6	4.6
Non-interest income	1.5	1.7	1.8	1.7	1.7
Operating expenses	2.4	2.8	3.2	3.1	3.0
Pre-provisioning profit	3.7	3.4	3.8	3.2	3.2
Provisions	0.9	0.2	0.1	0.2	0.2
PBT	2.9	3.2	3.7	3.0	3.0
Tax	1.0	1.1	0.8	0.8	0.8
ROA	1.9	2.1	2.8	2.2	2.2
Leverage (x)	0.1	0.1	0.1	0.1	0.1
ROE	12.3	13.7	17.9	13.3	13.5

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23P	FY24E	FY25E
YoY growth (%)					
Net interest income	13.6	9.6	28.1	13.7	14.5
Pre-provisioning profit	17.4	2.5	23.2	15.6	16.0
EPS	(11.7)	28.3	(25.3)	8.2	15.9
Profitability & Return ratios (%)					
Net interest margin	4.3	4.3	4.9	4.8	4.7
Fees / Avg. assets	0.3	0.4	0.4	0.4	0.4
Cost-Income	42.2	48.0	48.9	48.6	48.3
ROE	12.3	13.7	17.9	13.3	13.5
ROA	1.9	2.1	2.8	2.2	2.2
Asset quality (%)					
GNPA	3.3	2.3	1.8	1.6	1.6
NNPA	1.2	0.6	0.4	0.4	0.4
Slippage ratio	2.5	1.9	1.5	1.6	1.6
Credit cost	1.3	0.3	0.2	0.4	0.4
Provision coverage	62.8	72.7	79.0	75.7	76.7
Ratios (%)					
Credit-Deposit	79.9	87.0	88.1	88.9	90.1
Investment-Deposit	37.5	32.3	33.4	32.6	32.6
CAR	22.3	22.7	21.8	21.2	21.0
Tier-1	21.4	21.7	20.6	20.2	20.0

Source: Company, BOBCAPS Research

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BUY – Expected return >+15%

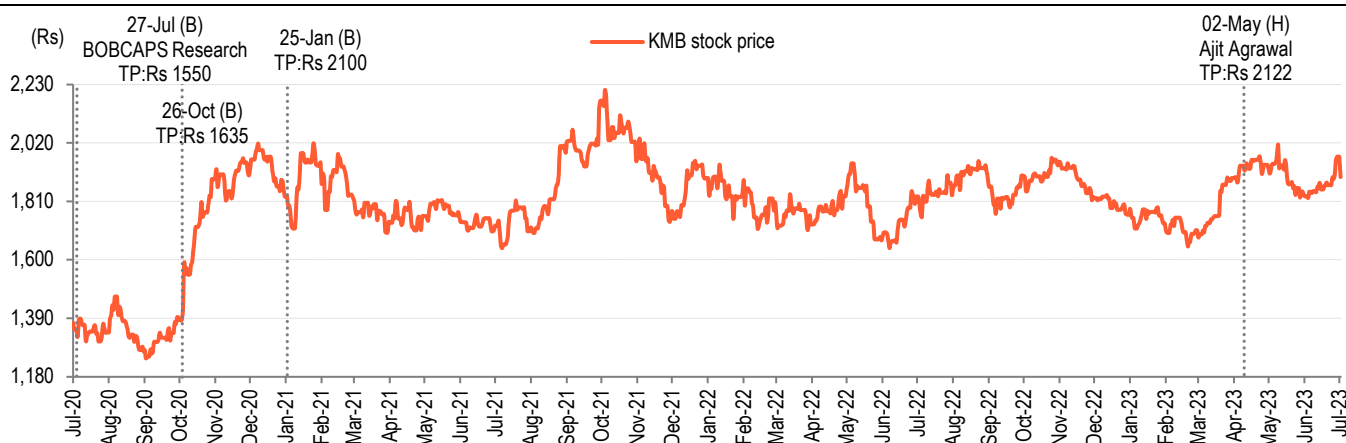
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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Ratings and Target Price (3-year history): KOTAK MAHINDRA BANK (KMB IN)



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