

**BUY**

TP: Rs 1,635 | ▲ 15%

**KOTAK MAHINDRA  
BANK**

| Banking

| 26 October 2020

**Above-expected quarter**

Kotak Bank's (KMB) Q2FY21 PAT at Rs 21.8bn (+27% YoY) beat estimates given strong 31% YoY operating profit growth and lower provisions. Asset quality trends were reassuring with flat GNPA (ex-SC interim order) and improving collection efficiency across products. Per management, KMB's non-specific provision buffer is adequate. NBFC, securities and asset management subsidiaries saw strong traction. NIM rose 10bps QoQ to 4.5%, partly aided by the QIP in Q1. We raise FY21-FY23 EPS 10-11% and revise our Sep'21 TP to Rs 1,635 (vs. Rs 1,550).

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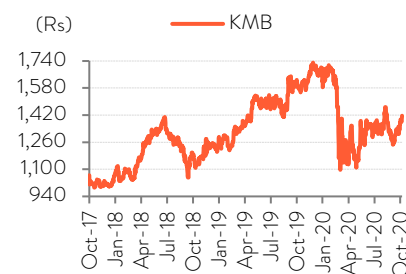
**Flat proforma GNPA a positive:** GNPA ratio declined to 2.55% (2.7% in Q1) given the SC directive of not classifying standard accounts as NPA. Even had the bank tagged NPAs, GNPA ratio would have been flat at 2.7%, which is positive in our view. Collection efficiency is now in the mid-90s and close to February levels. Bounce and resolution rates are near-normal for secured products (CV/CE, tractor, home loans) and improving MoM for unsecured products. Aided by the ECLG scheme, SME/MSME asset quality is stable. KMB has ~6% market share in the scheme and has disbursed ~80% of the sanctioned limit.

**Gearing up for growth:** The overall loan book declined by 4% YoY given a sharp drop in corporate, SME, CV and select unsecured segments. Management highlighted its intent to be more aggressive on the asset side via higher customer acquisition, deepening relationships and cross-selling.

**Maintain BUY:** We like KMB for its proven and stable leadership, strong liability franchise, best-in-class margins and sound underwriting standards. We raise our FY21-FY23 earnings estimates by 10-11% to factor in lower operating expenses and credit costs. Maintain BUY with a revised Sep'21 SOTP-based TP of Rs 1,635 (vs. Rs 1,550).

Ticker/Price	KMB IN/Rs 1,417
Market cap	US\$ 37.9bn
Shares o/s	1,979mn
3M ADV	US\$ 75.1mn
52wk high/low	Rs 1,740/Rs 1,001
Promoter/FPI/DII	30%/40%/30%

Source: NSE

**STOCK PERFORMANCE**

Source: NSE

**KEY FINANCIALS**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	112,590	134,997	151,531	172,320	197,106
NII growth (%)	1812.1	1990.2	1224.8	1371.9	1438.3
Adj. net profit (Rs mn)	36,116	59,472	71,336	83,614	96,372
EPS (Rs)	25.5	31.1	36.7	42.3	48.7
P/E (x)	55.5	45.5	38.6	33.5	29.1
P/BV (x)	6.4	5.6	4.5	4.0	3.5
ROA (%)	1.7	1.8	1.9	2.0	2.0
ROE (%)	12.2	13.1	12.8	12.5	12.8

Source: Company, BOBCAPS Research

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**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q2FY21	Q2FY20	Q1FY21	YoY (%)	QoQ (%)	6MFY21	6MFY20	YoY (%)
<b>Income Statement</b>								
Interest income	68,361	67,616	69,119	1.1	(1.1)	137,479	134,015	2.6
Interest expense	29,228	34,120	31,880	(14.3)	(8.3)	61,109	68,789	(11.2)
<b>Net interest income</b>	<b>39,132</b>	<b>33,496</b>	<b>37,239</b>	<b>16.8</b>	<b>5.1</b>	<b>76,371</b>	<b>65,226</b>	<b>17.1</b>
Non-interest income	14,520	12,244	7,735	18.6	87.7	22,256	25,291	(12.0)
<b>Net total income</b>	<b>53,652</b>	<b>45,740</b>	<b>44,974</b>	<b>17.3</b>	<b>19.3</b>	<b>98,626</b>	<b>90,518</b>	<b>9.0</b>
Staff expenses	9,901	9,150	9,109	8.2	8.7	19,010	18,165	4.6
Other operating expenses	10,777	11,504	9,628	(6.3)	11.9	20,405	23,278	(12.3)
Operating expenses	20,678	20,654	18,737	0.1	10.4	39,414	41,443	(4.9)
<b>Pre-provisioning profit</b>	<b>32,975</b>	<b>25,086</b>	<b>26,237</b>	<b>31.4</b>	<b>25.7</b>	<b>59,212</b>	<b>49,075</b>	<b>20.7</b>
Total provisions	3,686	4,079	9,620	(9.6)	(61.7)	13,306	7,247	83.6
Profit before tax	29,289	21,006	16,617	39.4	76.3	45,906	41,828	9.7
Tax	7,444	3,762	4,173	97.9	78.4	11,617	10,981	5.8
<b>Profit after tax</b>	<b>21,845</b>	<b>17,245</b>	<b>12,445</b>	<b>26.7</b>	<b>75.5</b>	<b>34,289</b>	<b>30,847</b>	<b>11.2</b>
<b>Balance Sheet</b>								
Advances	2,048,446	2,132,994	2,039,980	(4.0)	0.4	2,048,446	2,132,994	(4.0)
Deposits	2,615,636	2,330,715	2,615,240	12.2	0.0	2,615,636	2,330,715	12.2
CASA ratio (%)	57.1	53.6	56.7	354bps	41bps	57.1	53.6	354bps
<b>Yields and margins (%)</b>								
Net interest margin	4.5	4.6	4.4	(11bps)	10bps	-	-	-
Yield on advances	9.2	10.0	9.4	(82bps)	(18bps)	-	-	-
Cost of funds	3.8	5.3	4.2	(143bps)	(36bps)	-	-	-
<b>Key ratios (%)</b>								
Cost/Income	38.5	45.2	41.7	(662bps)	(312bps)	40.0	45.8	(582bps)
Tax rate	25.4	17.9	25.1	751bps	31bps	25.3	26.3	(95bps)
Loan to Deposit ratio	78.3	91.5	78.0	(1,320bps)	31bps	78.3	91.5	(1,320bps)
<b>Capital adequacy ratios (%)</b>								
Tier 1	22.8	17.6	21.1	520bps	170bps	22.8	17.6	520bps
Total CAR	23.4	18.2	21.7	520bps	170bps	23.4	18.2	520bps
<b>Asset quality (Rs mn)</b>								
Gross NPAs	53,360	50,336	56,193	6.0	(5.0)	53,360	50,336	6.0
Net NPAs	13,038	18,114	17,771	(28.0)	(26.6)	13,038	18,114	(28.0)
Gross NPA ratio (%)	2.6	2.3	2.7	23bps	(15bps)	2.6	2.3	23bps
Net NPA ratio (%)	0.6	0.9	0.9	(21bps)	(23bps)	0.6	0.9	(21bps)
Coverage Ratio (%)	75.6	64.0	68.4	1,155bps	719bps	75.6	64.0	1,155bps

Source: Company, BOBCAPS Research

## Valuation methodology

KMB is currently trading at 2.3x FY23E core P/BV. We like the bank for its proven and stable leadership, strong liability franchise, best-in-class margins and sound underwriting standards. Post the Q2FY21 results, we increase our FY21-FY23 EPS estimates by 10-11% to adjust for lower operating expense and credit cost assumptions.

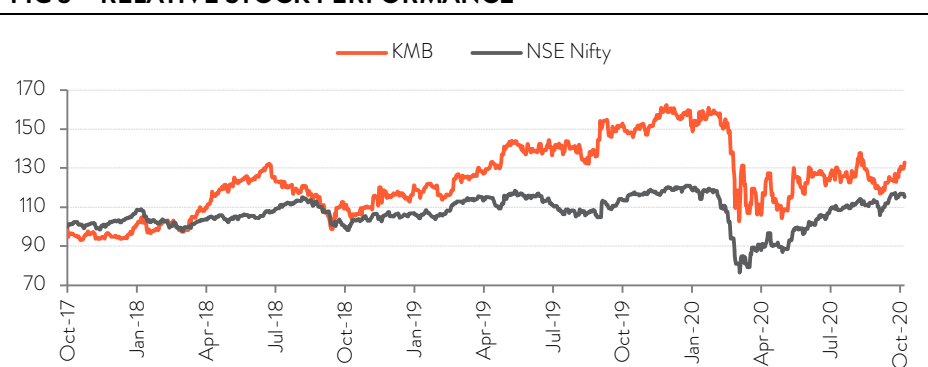
We continue to value KMB using the SOTP methodology and arrive at a revised Sep'21 target price of Rs 1,635 (Rs 1,550 earlier). Our increased target price is driven by a higher value for the core business (Rs 1,120/sh vs. Rs 1,061/sh earlier), which is based on an unchanged P/BV multiple of 3x on Sep'22E using the Gordon Growth Model. Subsidiaries drive ~30% of our fair value. Maintain BUY.

**FIG 2 – REVISED ESTIMATES**

Particulars	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Net interest income (Rs mn)	151,531	172,320	197,106	148,390	168,584	190,791	2.1	2.2	3.3
Pre-provisioning profit	118,050	135,501	155,692	109,340	125,735	143,880	8.0	7.8	8.2
Net Profit (Rs mn)	71,336	83,614	96,372	64,525	75,869	87,296	10.6	10.2	10.4
EPS (Rs)	37	42	49	33	38	44	10.6	10.2	10.4

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.
- The bank 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>151,531</b>	<b>172,320</b>	<b>197,106</b>
NII growth (%)	1812.1	1990.2	1224.8	1371.9	1438.3
Non-interest income	46,040	53,721	52,617	58,791	66,860
Total income	158,630	188,718	204,148	231,111	263,966
Operating expenses	(75,148)	(88,509)	(86,098)	(95,610)	(108,274)
Operating profit	83,482	100,208	118,050	135,501	155,692
Operating profit growth (%)	1,662.5	2,003.6	1,780.4	1,478.3	1,490.1
Provisions	(22,162)	(22,162)	(22,168)	(23,116)	(26,160)
PBT	61,320	78,047	95,882	112,385	129,532
Tax	(25,205)	(18,575)	(24,546)	(28,770)	(33,160)
<b>Reported net profit</b>	<b>36,116</b>	<b>59,472</b>	<b>71,336</b>	<b>83,614</b>	<b>96,372</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>36,116</b>	<b>59,472</b>	<b>71,336</b>	<b>83,614</b>	<b>96,372</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	617,781	697,561	789,513
Net worth	429,005	490,182	632,671	712,451	804,403
Deposits	2,258,804	2,628,205	2,864,744	3,208,513	3,657,705
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>4,009,492</b>	<b>4,477,718</b>	<b>5,067,661</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	2,307,356	2,584,239	2,946,032
Fixed & Other assets	106,127	121,597	556,181	711,446	820,284
<b>Total assets</b>	<b>3,121,721</b>	<b>3,602,517</b>	<b>4,009,492</b>	<b>4,477,718</b>	<b>5,067,661</b>
Deposit growth (%)	17.3	16.4	9.0	12.0	14.0
Advances growth (%)	21.2	6.8	5.0	12.0	14.0

### Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
EPS	25.5	31.1	36.7	42.3	48.7
Dividend per share	0.8	1.0	1.4	1.7	1.9
Book value per share	222.1	253.6	317.3	357.7	404.1

Source: Company, BOBCAPS Research

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
P/E	55.5	45.5	38.6	33.5	29.1
P/BV	6.4	5.6	4.5	4.0	3.5
Dividend yield (%)	0.1	0.1	0.1	0.1	0.1

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	3.9	4.0	4.0	4.1	4.1
Non-interest income	1.6	1.6	1.4	1.4	1.4
Operating expenses	2.6	2.6	2.3	2.3	2.3
Pre-provisioning profit	2.9	3.0	3.1	3.2	3.3
Provisions	0.3	0.7	0.6	0.5	0.5
PBT	2.1	2.3	2.5	2.6	2.7
Tax	0.9	0.6	0.6	0.7	0.7
ROA	1.7	1.8	1.9	2.0	2.0
Leverage (x)	7.2	7.4	6.8	6.4	6.3
ROE	12.2	13.1	12.8	12.5	12.8

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Net interest income	18.1	19.9	12.2	13.7	14.4
Pre-provisioning profit	16.6	20.0	17.8	14.8	14.9
EPS	17.0	22.0	17.8	15.3	15.3
<b>Profitability &amp; Return ratios (%)</b>					
Net interest margin	4.1	4.2	4.4	4.8	4.9
Fees / Avg. assets	1.2	1.1	0.9	0.9	1.0
Cost-Income	47.4	46.9	42.2	41.4	41.0
ROE	12.2	13.1	12.8	12.5	12.8
ROA	1.7	1.8	1.9	2.0	2.0
<b>Asset quality (%)</b>					
GNPA	2.1	2.3	3.0	2.8	2.7
NNPA	0.8	0.7	1.0	0.8	0.7
Provision coverage	65.4	69.0	69.3	71.4	74.3
<b>Ratios (%)</b>					
Credit-Deposit	91.1	83.6	80.5	80.5	80.5
Investment-Deposit	31.5	28.6	29.3	30.1	30.6
CAR	17.5	17.9	20.0	20.0	19.7
Tier-1	16.9	17.3	19.5	19.4	19.2

Source: Company, BOBCAPS Research

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

**BUY** – Expected return >+15%

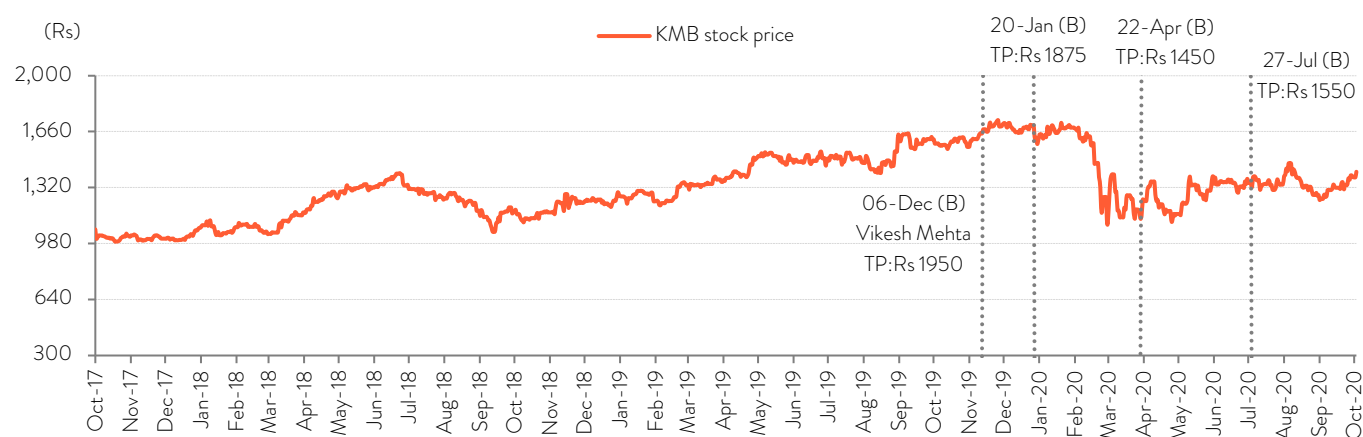
**ADD** – Expected return from >+5% to +15%

**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

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