

BUY

TP: Rs 2,100 | ▲ 17%

**KOTAK MAHINDRA
BANK**

| Banking

| 25 January 2021

Manageable stress formation in Q3 – maintain BUY

Kotak Bank's (KMB) Q3FY21 PAT of Rs 18.5bn (+16% YoY) was backed by strong 29% growth in operating profit. Asset quality weakened marginally with a ~60bps QoQ rise in proforma GNPA ratio to 3.3%, largely led by the unsecured retail portfolio. The SMA-2 book increased to 0.3% of loans and Covid-linked restructuring amounted to 30bps of loans. KMB's loan book grew 4.5% QoQ and its CASA ratio rose to ~59%. We raise our TP to Rs 2,100 (vs. Rs 1,635) as we roll over to Mar'23 valuations and now value the core book at 3.7x P/BV.

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Stress formation remains moderate: KMB has not used any analytical approach and declared 90dpd overdue accounts as NPA. Proforma GNPA ratio rose to 3.3% in Q3 (vs. 2.7% in Q2) given slippages worth ~Rs 20bn. Management highlighted that 40-45% of this increase arose from unsecured retail segments such as credit cards, personal and business loans. Asset quality was stable in the corporate portfolio, but CVs (especially the bus segment) are still facing stress.

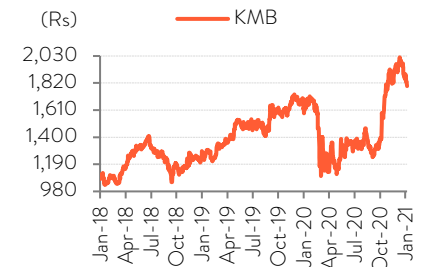
Collection efficiency has improved MoM for the bank, reaching pre-Covid levels for the secured segment and near-normal levels for the unsecured portfolio. KMB's Covid-specific restructured and SMA-2 books stood at 30bps of loans each, manageable in our view.

Growth should pick up gradually: KMB's loan book grew 4.5% QoQ steered by growth in the corporate, home loan/LAP and tractor financing segments. Management highlighted that disbursements across segments are picking up and credit demand has improved QoQ. CASA ratio climbed further to 58.9% while the average cost of savings accounts dropped 6bps QoQ to 3.8%.

Maintain BUY: We like KMB for its proven and stable leadership, strong liability franchise, best-in-class margins and sound underwriting standards. BUY.

Ticker/Price	KMB IN/Rs 1,794
Market cap	US\$ 48.7bn
Shares o/s	1,979mn
3M ADV	US\$ 166.2mn
52wk high/low	Rs 2,027/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	157,666	180,059	206,597
NII growth (%)	1812.1	1990.2	1679.3	1420.3	1473.8
Adj. net profit (Rs mn)	36,116	59,472	71,509	85,048	100,426
EPS (Rs)	25.5	31.1	36.8	43.0	50.8
P/E (x)	70.3	57.7	48.8	41.7	35.3
P/BV (x)	8.1	7.1	5.7	5.0	4.4
ROA (%)	1.7	1.8	1.8	1.9	2.0
ROE (%)	12.2	13.1	12.8	12.7	13.3

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY21	Q3FY20	Q2FY21	YoY (%)	QoQ (%)	9MFY21	9MFY20	YoY (%)
Income Statement								
Interest income	67,905	67,356	68,361	0.8	(0.7)	205,385	201,371	2.0
Interest expense	27,837	33,061	29,228	(15.8)	(4.8)	88,946	101,849	(12.7)
Net interest income	40,068	34,295	39,132	16.8	2.4	116,439	99,522	17.0
Non-interest income	13,344	13,414	14,520	(0.5)	(8.1)	35,600	38,706	(8.0)
Net total income	53,412	47,710	53,652	12.0	(0.4)	152,038	138,227	10.0
Staff expenses	9,593	10,915	9,901	(12.1)	(3.1)	28,602	29,080	(1.6)
Other operating expenses	12,986	12,914	10,777	0.6	20.5	33,391	36,191	(7.7)
Operating expenses	22,579	23,829	20,678	(5.2)	9.2	61,993	65,272	(5.0)
Pre-provisioning profit	30,833	23,881	32,975	29.1	(6.5)	90,045	72,956	23.4
Total provisions	5,990	4,440	3,686	34.9	62.5	19,296	11,687	65.1
Profit before tax	24,843	19,441	29,289	27.8	(15.2)	70,749	61,269	15.5
Tax	6,308	3,482	7,444	81.2	(15.3)	17,924	14,463	23.9
Profit after tax	18,535	15,959	21,845	16.1	(15.1)	52,825	46,806	12.9
Balance Sheet								
Advances	2,141,030	2,167,740	2,048,446	(1.2)	4.5	2,141,030	2,167,740	(1.2)
Deposits	2,653,040	2,393,540	2,615,636	10.8	1.4	2,653,040	2,393,540	10.8
CASA ratio (%)	58.9	53.7	57.1	517bps	173bps	58.9	53.7	517bps
Yields and margins (%)								
Net interest margin	4.5	4.7	4.5	(18bps)	1bps	-	-	-
Yield on advances	8.9	9.8	9.2	(92bps)	(36bps)	-	-	-
Cost of funds	3.6	5.0	3.8	(142bps)	(21bps)	-	-	-
Key ratios (%)								
Cost/Income	42.3	49.9	38.5	(767bps)	373bps	40.8	47.2	(645bps)
Tax rate	25.4	17.9	25.4	748bps	(3bps)	25.3	23.6	173bps
Loan to Deposit ratio	80.7	90.6	78.3	(987bps)	239bps	80.7	90.6	(987bps)
Capital adequacy ratios (%)								
Tier 1	23.0	17.7	22.8	530bps	20bps	23.0	17.7	530bps
Total CAR	23.6	18.2	23.4	540bps	20bps	23.6	18.2	540bps
Asset quality (Rs mn)								
Gross NPAs	49,280	54,132	53,360	(9.0)	(7.6)	49,280	54,132	(9.0)
Net NPAs	10,640	19,251	13,038	(44.7)	(18.4)	10,640	19,251	(44.7)
Gross NPA ratio (%)	2.3	2.5	2.6	(20bps)	(29bps)	2.3	2.5	(20bps)
Net NPA ratio (%)	0.5	0.9	0.6	(39bps)	(14bps)	0.5	0.9	(39bps)
Coverage Ratio (%)	78.4	64.4	75.6	1,397bps	284bps	78.4	64.4	1,397bps

Source: Company, BOBCAPS Research

Valuation methodology

KMB is currently trading at 3.2x FY22E core P/BV. We like the bank for its proven and stable leadership, strong liability franchise, best-in-class margins and sound underwriting standards. We marginally raise our FY22-FY23 EPS estimates by 2-4% to adjust for better NII growth and lower operating expense.

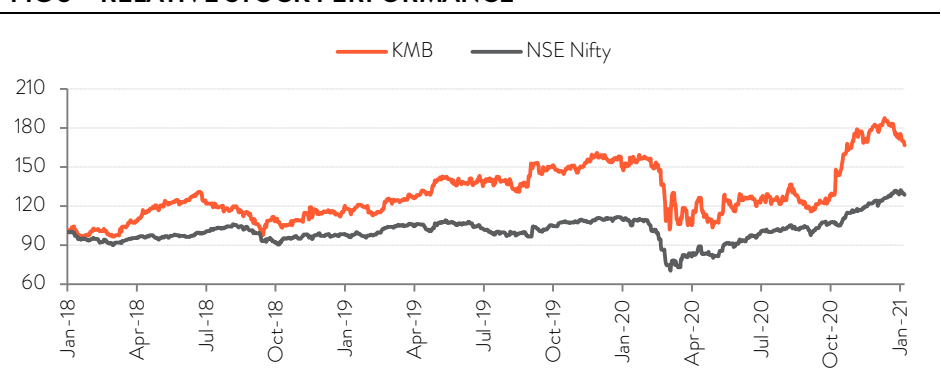
We continue to value KMB using the SOTP methodology and roll forward to a revised Mar'22 target price of Rs 2,100 (Rs 1,635 earlier). Our increased target is driven by a higher value for the core business (Rs 1,456/sh vs. Rs 1,120/sh earlier), which is based on a revised P/BV multiple of 3.7x (3x earlier) on Mar'23E, using the Gordon Growth Model. Subsidiaries continue to 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)	157,666	180,059	206,597	151,531	172,320	197,106	4.0	4.5	4.8
Pre-provisioning profit	122,277	141,295	164,208	118,050	135,501	155,692	3.6	4.3	5.5
Net Profit (Rs mn)	71,509	85,048	100,426	71,336	83,614	96,372	0.2	1.7	4.2
EPS (Rs)	37	43	51	37	42	49	0.2	1.7	4.2

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
Net interest income	112,590	134,997	157,666	180,059	206,597
NII growth (%)	1812.1	1990.2	1679.3	1420.3	1473.8
Non-interest income	46,040	53,721	50,322	56,208	63,890
Total income	158,630	188,718	207,988	236,267	270,487
Operating expenses	(75,148)	(88,509)	(85,710)	(94,973)	(106,279)
Operating profit	83,482	100,208	122,277	141,295	164,208
Operating profit growth (%)	1,662.5	2,003.6	2,202.3	1,555.3	1,621.7
Provisions	(22,162)	(22,162)	(26,163)	(26,983)	(29,227)
PBT	61,320	78,047	96,114	114,311	134,981
Tax	(25,205)	(18,575)	(24,605)	(29,264)	(34,555)
Reported net profit	36,116	59,472	71,509	85,048	100,426
Adjustments	0	0	0	0	0
Adjusted net profit	36,116	59,472	71,509	85,048	100,426

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	617,946	699,093	794,914
Net worth	429,005	490,182	632,836	713,984	809,804
Deposits	2,258,804	2,628,205	2,864,744	3,208,513	3,657,705
Borrowings	327,043	384,493	510,476	565,985	627,863
Other liabilities & provisions	106,870	99,637	124,526	139,129	155,433
Total liabilities and equities	3,121,721	3,602,517	4,132,582	4,627,610	5,250,804
Cash & bank balance	246,755	532,923	570,702	339,993	246,691
Investments	711,891	750,515	1,109,987	1,284,044	1,511,556
Advances	2,056,948	2,197,482	2,241,432	2,465,575	2,761,444
Fixed & Other assets	106,127	121,597	210,462	537,998	731,114
Total assets	3,121,721	3,602,517	4,132,582	4,627,610	5,250,804
Deposit growth (%)	17.3	16.4	9.0	12.0	14.0
Advances growth (%)	21.2	6.8	2.0	10.0	12.0

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
EPS	25.5	31.1	36.8	43.0	50.8
Dividend per share	0.8	1.0	1.4	1.7	2.0
Book value per share	222.1	253.6	317.4	358.4	406.9

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
P/E	70.3	57.7	48.8	41.7	35.3
P/BV	8.1	7.1	5.7	5.0	4.4
Dividend yield (%)	0.0	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	4.1	4.1	4.2
Non-interest income	1.6	1.6	1.3	1.3	1.3
Operating expenses	2.6	2.6	2.2	2.2	2.2
Pre-provisioning profit	2.9	3.0	3.2	3.2	3.3
Provisions	0.3	0.7	0.7	0.6	0.6
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	1.8	1.9	2.0
Leverage (x)	7.2	7.4	6.9	6.6	6.5
ROE	12.2	13.1	12.8	12.7	13.3

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Net interest income	18.1	19.9	16.8	14.2	14.7
Pre-provisioning profit	16.6	20.0	22.0	15.6	16.2
EPS	17.0	22.0	18.1	17.0	18.1
Profitability & Return ratios (%)					
Net interest margin	4.1	4.2	4.3	4.5	4.8
Fees / Avg. assets	1.2	1.1	0.9	0.9	0.9
Cost-Income	47.4	46.9	41.2	40.2	39.3
ROE	12.2	13.1	12.8	12.7	13.3
ROA	1.7	1.8	1.8	1.9	2.0
Asset quality (%)					
GNPA	2.1	2.3	3.1	2.9	2.8
NNPA	0.8	0.7	1.0	0.8	0.6
Provision coverage	65.4	69.0	67.3	72.7	78.4
Ratios (%)					
Credit-Deposit	91.1	83.6	78.2	76.8	75.5
Investment-Deposit	31.5	28.6	38.7	40.0	41.3
CAR	17.5	17.9	19.5	19.3	19.1
Tier-1	16.9	17.3	18.9	18.8	18.6

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

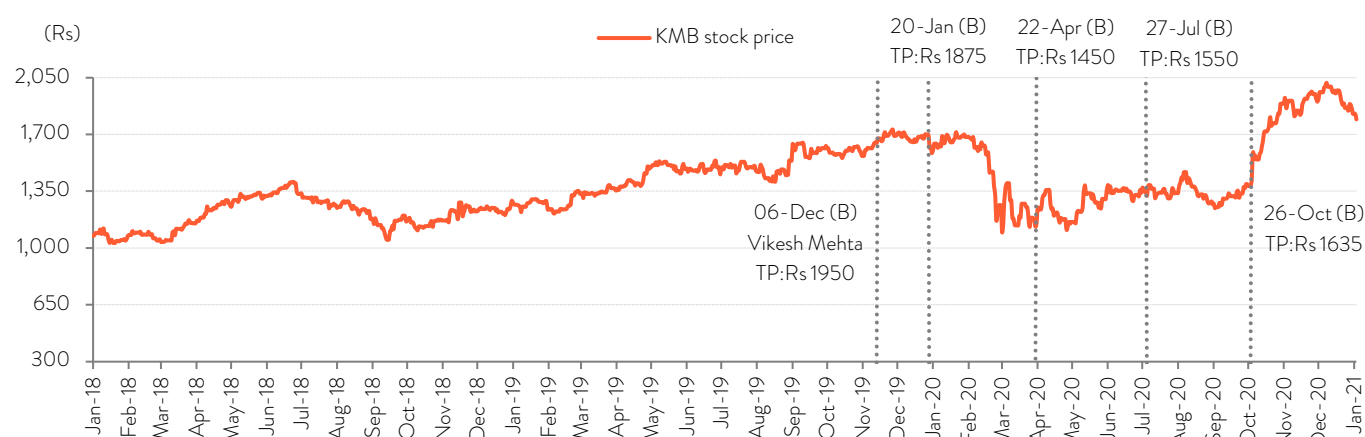
ADD – Expected return from >+5% to +15%

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)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): KOTAK MAHINDRA BANK (KMB IN)



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

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