

Kotak Mahindra Bank

23 October 2019

Reuters: KTKM.BO; Bloomberg: KMB IN

Retail slowdown continues to temper margin strength

Kotak Mahindra Bank (KMB) reported 2QFY20 results with the key takeaways being: (1) Continued caution on business banking and auto loans intensified to the extent that overall consolidated loan book growth was dragged down to 12% YoY (2) Consolidated NIM was up 47 bps YoY and 12bps QoQ, at 4.56% on the back of pricing power and strong traction for granular liabilities (3) Slippage for the quarter was Rs 10bn but asset quality remained broadly under control. (4) While, optically, consolidated operating expenses jumped 31% YoY, the underlying long-term trend remains encouraging. (See *comprehensive* conference call takeaways on page 2 for *significant incremental colour*.) Per se, on the key P&L Items, KMB posted Nil growth of 23% YoY at Rs43,645mn, PPOP growth of 18% YoY at Rs34,178mn and PAT growth of 38% YoY at Rs24,073mn. We have revised our estimates for FY20/FY21/FY22 and have retained a Buy rating on KMB with a revised target price of Rs1,905 (from Rs1,830 earlier) and valuing the stock at 4.2x H1FY22E P/BV.

Continued caution on business banking and auto loans intensified to the extent that overall consolidated loan book growth was dragged down to 12% YoY: Business banking had been clubbed with corporate banking and this combined segment grew 8% YoY, with its share in overall consolidated loan book declining to 37%. We know that KMB has been cautious on business banking and its full year growth on the erstwhile business banking (7.5% of FY19 loan book) for full year FY19 was nil. Deceleration in auto loans, a business conducted by long-standing NBFC subsidiary Kotak Prime, turned more acute with auto loans de-growth -8% YoY, now forming 8% of loan book. Stronger segments included agri, home loans & LAP and small business, personal loans & credit cards, which grew 21%, 23% and 20%, respectively to 11%, 18% and 14%, respectively, of loan book.

Consolidated NIM was up 47 bps YoY and 12bps QoQ, at 4.56% on the back of pricing power and strong traction for granular liabilities: Changes in the yield environment as well as the systemic liquidity crisis have aided a return of pricing power for stronger incumbents such as KMB. Furthermore, traction for granular liabilities continued to be encouraging with CASA ratio standing at 53.6% compared with 50.2% a year ago. Share of CASA and term deposits below Rs 50mn rose to 86% of total deposits compared with 82% in the previous quarter. Premium SA card rate of 6% for Rs 0.1-1mn seems to be serving KMB well so far. Card rate below Rs 0.1mn had been revised lower to 4.0% with CoF benefit as well as a nudge to customers to migrate to higher SA balance.

Slippage for the quarter was Rs 10bn but asset quality remained broadly under control: A key segment from which stress emerged was the erstwhile ING crop loan portfolio. Overall GNPA ratio was 2.17%, up 15 bps QoQ. However, management guided for credit cost of ~60 bps, which is a reasonably controlled number.

Valuation and outlook: We have revised our NII estimates by -0.8%/-2.1%/-3.1%, PPOP estimates by -0.8%/-2.2%/-3.1% and PAT estimates by -2.2%/-3.1%/-3.0% for FY20/FY21/FY22, respectively. We have retained Buy rating on KMB and revised our target price to Rs1,905 (from Rs1,830 earlier), valuing the stock at 4.2x H1FY22E P/BV.

BUY

Sector: Banking

CMP: Rs1,629

Target Price: Rs1,905

Upside: 17%

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Key Data

Current Shares O/S (mn)	1,910.0
Mkt Cap (Rsbn/US\$bn)	3,107.2/43.8
52 Wk H / L (Rs)	1,684/1,098
Daily Vol. (3M NSE Avg.)	3,011,459

Price Performance (%)

	1 M	6 M	1 Yr
Kotak Mahindra Bank	5.7	19.9	39.8
Nifty Index	2.8	(1.4)	12.5

Source: Bloomberg

Y/E March (Rsmn)	2QFY20	2QFY19	1QFY20	YoY (%)	QoQ (%)
Interest Income	84,188	73,111	83,142	15.2	1.3
Interest Expenses	40,543	37,728	41,551	7.5	(2.4)
Net Interest Income	43,645	35,384	41,591	23.3	4.9
NIM (%)	4.56	4.09	4.44	47 bps	12 bps
Non Interest Income	41,242	35,180	38,154	17.2	8.1
Total Income	84,887	70,563	79,745	20.3	6.4
Staff Cost	13,962	11,393	13,680	22.5	2.1
Other Op Exp	36,747	30,074	33,431	22.2	9.9
Total Operating Expenses	50,709	41,467	47,111	22.3	7.6
<i>Cost to Income (%)</i>	59.7	58.8	59.1	97 bps	66 bps
Pre-provisioning operating profit	34,178	29,096	32,634	17.5	4.7
Provisions	4,731	3,597	3,502	31.5	35.1
PBT	29,447	25,499	29,132	15.5	1.1
Tax	5,456	8,358	9,863	(34.7)	(44.7)
<i>-effective tax rate</i>	18.5	32.8	33.9	-1425 bps	-1533 bps
PAT (Before Minorities & Associates)	23,991	17,141	19,269	40.0	24.5
Share of Minority Interest	0	0	0	NA	NA
Share in Profit of Associates	82	333	54	(75.4)	52.4
PAT	24,073	17,474	19,322	37.8	24.6
EPS (Rs)	12.6	9.2	10.1	37.8	24.6
BV (Rs)	324.9	282.4	312.8	15.0	3.9
Advances	2,487,402	2,221,723	2,449,900	12.0	1.5
Deposits (Standalone)	2,330,715	2,058,298	2,329,310	13.2	0.1

Source: Company, Nirmal Bang Institutional Equities Research

Comprehensive Conference Call Takeaways

Asset Quality

- As per the bank, the slowdown has had a higher impact in semi-urban and rural India. Given this, the bank has seen rising stress levels in agri crop loans, emanating primarily from the book acquired from ING Vysya. The bank has also seen stress levels increase in the CV book due to low freight rates and low utilisation levels which have elongated payment cycles.
- On the wholesale book, the bank has not had any major hit other than just one account which is slightly over Rs. 1 bn.
- The bank stated its credit costs guidance for the year stands at 60 bps, which is slightly higher than what it had earlier guided for.
- Gross slippages during H1FY20 were Rs. 18 bn, of which Rs. 10 bn came in Q2FY20.
- The bank does not expect any major NPA or slippage concerns in the near term.
- For the bank, secured retail asset quality remains stable, though, it is seeing some uptick in stress on the unsecured retail portfolio (CC, PL).
- In the agri portfolio, apart from the agri crop loan slippages, behaviour on agri term loans and tractor loans was better than previous year.
- In the CRE segment, the bank stated it is mostly dealing with category A builders. Project cashflows are tightly monitored. In most of these cases, the bank ends up getting paid much before the due date since the repayment is linked to the project cashflows.
- Slippages in the LAP segment have been contained.
- RWA at the bank level is Rs. 2.43 trn and at the Group level it is about Rs 3 trn.
- The bank stated its corporate exposures are granular.

Business and Loan Growth

- Given the current slowdown in the economy, the bank continues to focus on 1) building a low cost stable and sustainable liability franchise and 2) risk adjusted returns.
- Guidance in terms of loan book growth is for mid-teens, which will be supported by better NIMs.
- The bank stated that there has been a drop in corporate banking growth rate.
- In corporate assets, the bank's target ROE is ~16%.

Margin, Liabilities and Liquidity

- With respect to external rate benchmarking, the bank stated that it would lead to better transmission of rates and should help in driving demand higher. Accordingly, the bank has stated it expect NIMs to be above 4.3%.
- 70% of the total loan book is floating.
- The bank is adding about 400,000 customers per month on the liability side.
- At 5.37% SA rates, the bank is still ~180 bps higher than competition. On current SA book, this translates into cost of Rs. 14-15 bn per year.

Operating Expenses

- The bank's view on change in corporate tax cut is that it has lowered the cost of capital and hurdle rate at which the bank used to lend earlier.

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net interest income	126,642	147,482	175,513	200,352	233,236
Pre-provisioning Operating profit	101,830	116,211	139,609	156,699	181,499
PAT	61,471	71,197	93,998	105,864	123,438
EPS (Rs)	32.3	37.3	49.2	55.5	64.7
BV (Rs)	264.9	305.3	352.8	406.4	500.8
P/E (x)	50.5	43.7	33.1	29.4	25.2
P/BV (x)	6.1	5.3	4.6	4.0	3.3
Gross NPAs (%)	1.9	1.8	2.2	2.3	2.3
Net NPAs (%)	0.8	0.6	0.8	0.8	0.8
RoA (%)	2.0	1.9	2.3	2.3	2.2
RoE (%)	13.7	13.1	15.0	14.6	14.3

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Actual performance versus our estimates

(Rsmn)	Q2FY20	Q2FY19	Q1FY20	YoY (%)	QoQ (%)	Q2FY20E	Devi. (%)
Net interest income	43,645	35,384	41,591	23.3	4.9	43,478	0.4
Pre-provisioning operating profit	34,178	29,096	32,634	17.5	4.7	34,993	(2.3)
PAT	24,073	17,474	19,322	37.8	24.6	24,388	(1.3)

Source: Company, Nirmal Bang Institutional Equities Research N.B. We were expecting a DTA Reduction of Rs 902mn and an adjusted PAT of Rs 23,486mn.

Exhibit 3: Change in our estimates

	Revised Estimate			Earlier Estimate			% Revision		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Net Interest Income (Rs mn)	175,513	200,352	233,236	176,993	204,724	240,707	(0.8)	(2.1)	(3.1)
NIMs	4.6	4.7	4.6	4.6	4.6	4.5	2 bps	9 bps	15 bps
Operating Profit (Rs mn)	139,609	156,699	181,499	140,779	160,180	187,305	(0.8)	(2.2)	(3.1)
Profit after tax (Rs mn)	93,998	105,864	123,438	96,100	109,246	127,193	(2.2)	(3.1)	(3.0)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward P/BV



Source: Company, Nirmal Bang Institutional Equities Research

Financial statements

Exhibit 5: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Interest income	251,311	299,348	351,033	404,362	476,382
Interest expenses	124,668	151,866	175,520	204,011	243,146
Net interest income	126,642	147,482	175,513	200,352	233,236
Fee income	46,724	53,945	62,813	73,243	87,220
Other income	90,099	106,498	112,760	118,613	134,628
Net revenues	263,465	307,925	351,086	392,208	455,083
Operating expenses	161,635	191,714	211,476	235,509	273,585
-Employee expenses	43,809	48,509	54,443	58,504	62,803
-Other expenses	117,826	143,205	157,033	177,004	210,781
Pre-Provisioning Operating profit	101,830	116,211	139,609	156,699	181,499
Provisions	10,247	10,454	14,279	15,547	16,915
-Loan-loss provision	8,155	10,448	14,348	15,547	16,915
-Provision for investment	2,089	-221	0	0	0
-Other provisions	3	227	-69	0	0
PBT	91,582	105,757	125,331	141,152	164,583
Taxes	30,111	34,560	31,333	35,288	41,146
PAT	61,471	71,197	93,998	105,864	123,438

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Equity capital	9,528	14,544	14,544	14,544	14,689
Reserves & surplus	495,354	568,274	658,771	761,134	941,162
Shareholders' funds	504,882	582,818	673,315	775,678	955,851
Deposits	1,912,358	2,248,243	2,649,955	3,229,516	3,989,385
-Current deposits	317,102	382,793	458,442	568,395	714,100
-Saving deposits	655,292	796,847	1,006,983	1,259,511	1,595,754
-Term deposits	939,964	1,068,603	1,184,530	1,401,610	1,679,531
Borrowings	586,040	664,389	737,428	838,221	970,372
Other liabilities	373,925	456,262	278,008	204,936	77,063
Total liabilities	3,377,205	3,951,712	4,338,706	5,048,351	5,992,672
Cash/equivalent	244,006	312,645	321,978	363,416	436,099
Advances	2,059,973	2,434,620	2,799,813	3,303,779	3,964,535
Investments	909,766	1,034,870	1,015,305	1,141,297	1,306,486
Fixed assets	17,498	18,837	20,721	22,793	25,072
Other assets	145,961	150,741	180,889	217,067	260,480
Total assets	3,377,205	3,951,712	4,338,706	5,048,351	5,992,672

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

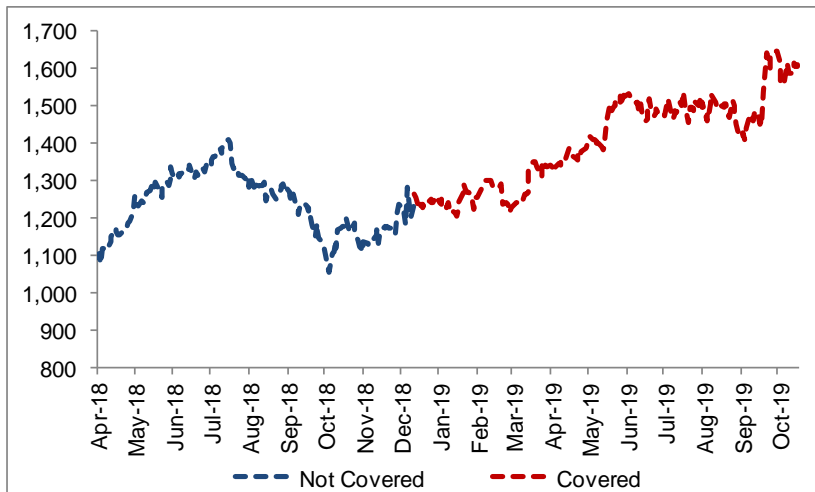
Y/E March	FY18	FY19	FY20E	FY21E	FY22E
Growth (%)					
NII growth	16.5	16.5	19.0	14.2	16.4
Pre-provision profit growth	23.0	14.1	20.1	12.2	15.8
PAT growth	24.2	15.8	32.0	12.6	16.6
Business (%)					
Deposit growth	22.9	17.6	17.9	21.9	23.5
Advance growth	23.3	18.2	15.0	18.0	20.0
Business growth	23.1	17.9	16.4	19.9	21.7
CD	107.7	108.3	105.7	102.3	99.4
CASA	50.8	52.5	55.3	56.6	57.9
Operating efficiency (%)					
Cost-to-income	61.3	62.3	60.2	60.0	60.1
Cost-to-assets	5.3	5.2	5.1	5.0	5.0
Productivity (Rsmn)					
Business per branch	2,861.9	3,121.9	3,493.4	4,057.9	4,791.5
Business per employee	79.4	78.0	90.6	105.2	124.0
Profit per branch	44.3	47.5	60.3	65.8	74.4
Profit per employee	1.2	1.2	1.6	1.7	1.9
Spread (%)					
Yield on advances	9.9	9.9	10.1	10.2	10.2
Yield on investments	6.6	6.6	7.1	7.3	7.3
Cost of deposits	5.1	5.3	5.2	5.0	5.0
Yield on assets	9.0	8.9	9.2	9.4	9.5
Cost of funds	5.5	5.6	5.6	5.5	5.4
NIMs	4.5	4.4	4.6	4.7	4.6
Capital adequacy (%)					
Tier I	17.8	17.5	17.2	16.8	17.2
Tier II	0.6	0.4	0.3	0.3	0.3
Total CAR	18.4	17.9	17.5	17.1	17.6
Asset quality (%)					
Gross NPAs	1.9	1.8	2.2	2.3	2.3
Net NPAs	0.8	0.6	0.8	0.8	0.8
Specific provision coverage	56.5	65.4	65.0	65.0	65.0
Slippage	1.0	0.9	1.2	1.1	1.1
Credit-cost	0.4	0.4	0.5	0.5	0.4
Return (%)					
RoE	13.7	13.1	15.0	14.6	14.3
RoA	2.0	1.9	2.3	2.3	2.2
RoRWA	2.5	2.5	2.8	2.8	2.7
Per share					
EPS	32.3	37.3	49.2	55.5	64.7
BV	264.9	305.3	352.8	406.4	500.8
ABV	256.2	297.2	341.4	392.5	483.9
Valuation (x)					
P/E	50.5	43.7	33.1	29.4	25.2
P/BV	6.1	5.3	4.6	4.0	3.3
P/ABV	6.4	5.5	4.8	4.2	3.4

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
13 December 2018	Buy	1,237	1,558
22 January 2019	Buy	1,267	1,559
8 April 2019	Buy	1,336	1,561
2 May 2019	Buy	1,387	1,638
8 July 2019	Buy	1,517	1,751
23 July 2019	Buy	1,454	1,676
7 October 2019	Buy	1,563	1,830
23 October 2019	Buy	1,629	1,905

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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