Balancing growth and risk

Kotak Mahindra (KMB) reported steady performance amidst Covid-19 pandemic with NII up 18/5% YoY/QoQ even as loan growth was muted (down 7% QoQ) and NIM moderation at 4.4% (down 9bps YoY). Deposit franchise remains strong despite cut in rates. CASA stood at 57%. Slippages were higher at Rs 7.96bn as management took the stance of not pushing doubtful loans under moratorium. Consequently G/NNPAs marginally deteriorated to 2.7/% QoQ. Moratorium 2.0 stands at 9.7% which includes 9.15% from morat 1.0.PAT was down 9/2% YoY/QoQ to Rs 12445mn

KMB has been one of the most consistent performers over the years, which was driven by best in class return ratios & margin profile. Its long term focus continues on maintaining risk adjusted returns. We are positive on the stock over the long - term given management strength and sustainability, strong deposit franchise, robust NIM and comfortable asset quality. However, KMB will not be immune to the current cycle and ROEs of 10- 11% for FY21F/22E leave limited room for any re-rating, in our view, given rich valuations. Hence, **we initiate with a Hold rating with a Target price of Rs 1410, while acknowledging it to be amongst the best placed to ride the cycle**

Key Concall Takeaways

- Moratorium 2.0 stands at 9.7% of AUM. This includes 9.15% from moratorium 1.0. Morat in real estate are around mid single digits while in the wholesale book morat is in low single digits. On loans where the bank had doubts on the repayment capacity, it has not pushed it under moratorium and let those loans slip. As a result of which slippages were elevated at Rs 7.96bn (1.6%) vs Rs 4.9bn (0.9%) QoQ.
- 80% of the moratorium amount is collateralized.
- Demand indicators are flattening in July post witnessing a surge in June. Bank envisages the economy reaching normalised levels over the course of next 4 qtrs (by Q1FY22)
- In near term since the risk-reward in lending is unfavorable, the bank will focus on growing in areas which do not require capital. The bank sees a huge opportunity in fee and distribution related businesses.
- Bank has not booked treasury income during the quarter and is sitting on Rs 30bn MTM in the balance sheet which will be utilised at appropriate time.
- Bank believes credit costs to be higher in FY21 but expect more visibility by Dec' quarter.
- Board has approved the renewal of Mr Uday Kotak and Mr Deepak Gupta for a period of 3yrs starting from 21 Jan '21 and application has been made to RBI.

Key Financials (Standalone)

(Rs. bn)	FY19	FY20	FY21E	FY22E
NII	113	135	157	176
PPOP	84	100	117	133
Net Profit	49	59	58	77
EPS (Rs.)	24.5	29.5	29.0	38.5
ABV	216.0	247.0	304.0	342.0
P/ABV	6.0	5.2	4.3	3.8
ROAA	1.7	1.8	1.6	1.9
NNPA (%)	0.7	0.7	0.7	0.7

Source: Company, Axis Research9

(CMP as of Jul 27, 2020)

CMP (Rs)	1322
Upside /Downside (%)	7%
High/Low (Rs)	1740/453
Market cap (Cr)	261695
Avg. daily vol. (6m) Shrs.	2,929,446
No. of shares (Cr)	197.89

Shareholding (%)

	Jun-20	Mar-20	Dec-19
Promoter	75.9	75.9	75.9
FIIs	5.8	5.3	5.6
MFs / UTI	3.2	3.6	2.8
Banks / FIs	0.2	0.1	0.2
Others	14.9	15.1	15.5

Financial & Valuations

Y/E Mar (Rs. bn)	2020	2021E	2022E
NII	135	157	176
PPOP	100	117	133
Net Profit	59	58	77
EPS (Rs.)	29.5	29.0	38.5
ABV	247.0	304.0	342.0
P/ABV	5.2	4.3	3.8
ROAA	1.80	1.60	1.90
NNPA (%)	0.70	0.70	0.65

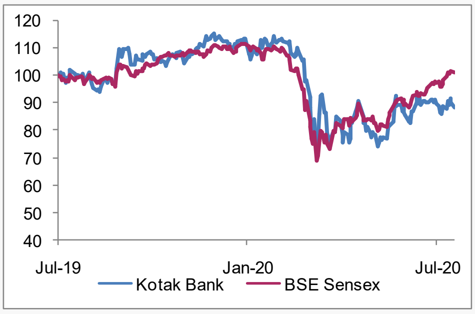
Change in Estimates (%)

Y/E Mar	FY21E	FY22E
NII	-	-
PPOP	-	-
PAT	-	-

Axis vs Consensus

EPS Estimates	2021E	2022E
Axis	29.0	38.5
Consensus	33.7	40.4
Mean Consensus TP (12M)		**1400**

Relative performance



Source: Capitaline, Axis Securities

Siji Philip
Sr. Research Analyst

Call: (022) 4267 1738
email: siji.philip@axissecurities.in

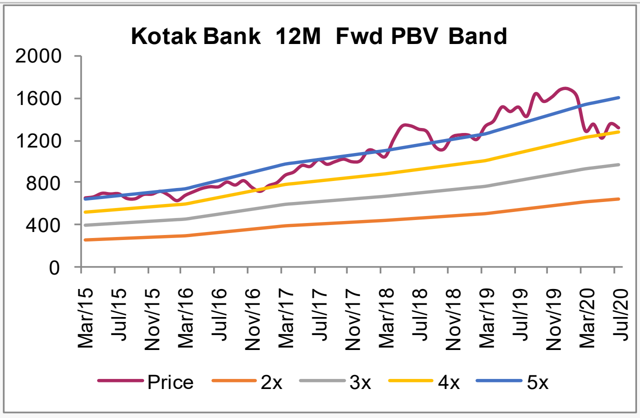
Key Concall Takeaways

- **Macro/Sectoral Remarks by Mr. Uday Kotak**
  - ✓ Markets are taking in longer term view with liquidity and lower cost of funds.
  - ✓ Industry is pressing a lot on one-time restructuring but this will disturb the repaying culture. Even if one time restructuring were to be announced, it will come with heightened provisioning.
  - ✓ If Covid-19 stabilizes by Q3Y20, economy could return to 2019-20 run-rate by Q2FY22 and economic activity at +90% levels by March'20.
  - ✓ Post Covid, share of physical/digital could be at 50:50 in long term post COVID from 80:20 pre-Covid.
- **Segmentwise**
  - ✓ -In MSME segment, bank has seen traction in acquiring quality customers from June and focused on fee income from this segment
  - ✓ -In the CV segment, bank is going cautious in disbursements. PV segment is facing some stress due to movement restrictions
  - ✓ -Construction equipment business is better placed with demand pick-up month on month. Collection efficiency is better compared to the CV segment
- Increase in borrowing was primarily on market repo borrowings at 3-3.2%
- On the Government guranteed MSME schemes, as of June end bank only disbursed Rs 5.5bn but by 23rd July it crossed Rs 40bn
- Deposit growth was driven by new acquisitions as well as existing customers. CASA and Term Deposits below Rs 50mn were 90% of total deposits compared to 82% last year while sweep deposits were 7.2% of the total deposits. Cost of saving account is 4.22% vs 5.5% earlier.
- Bank is also focused on growing the mortage book and believed there is hughe opportunity in the same.
- Provisions came at Rs 9.62bn (~1.9%) vs 2/0.7% QoQ/YoY. Additional Covid 19 related provision stood at Rs 6.16bn in Q1FY21. Total COVID related provisions as at June 30, 2020 stands at Rs 12.66bn (0.6% of advances).
- Launched 811 credit card during the quarter

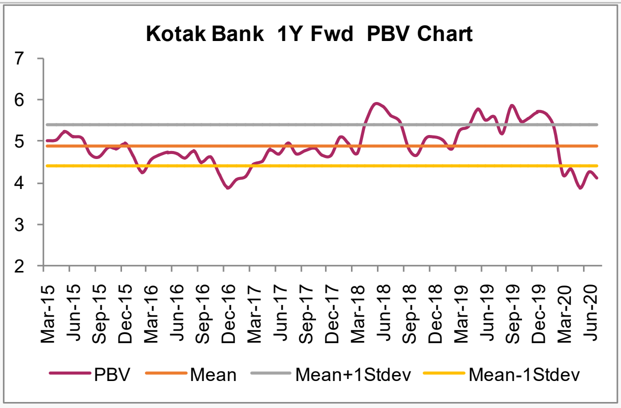
Key Risks

- Greater-than-anticipated asset quality impact on account of Covid-19
- 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 overall performance

Kotak Bank 12M Fwd PBV Band



Kotak Bank Std Deviation Band



Source: Company, Axis Securities

Valuation & Outlook

We believe KMB Kotak Bank remains best placed across metrics, in our view, with a best-in-class liability franchise, prudent underwriting, strong capital position, adequate margin levers, and strong currency to explore inorganic opportunities

We are positive on the stock on account of its:

- **Robust liability franchise:** KMB's continued focus on CASA and retail deposits has turned its funding mix more granular and lowered its its cost of funds and aligned with top private banks. We believe the bank's liability profile will continue to improve (~59% CASA ratio by FY22E) and the multiplier effect of its granularity will further strengthen return ratios (11.9% ROE by FY22E).

- **Comfortable asset quality:** KMB has stringent underwriting standards and also targets risk-adjusted returns on lending. These practices have traditionally led to prudent growth. We model for a loan growth decline of 4% for FY21E 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.

- **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 (4.4% in Q1FY21), KMB can afford to take fewer risks while its ability to deliver strong return ratios remains intact. We expect NIM to remain resilient and be in the range of 4.5-4.7x over FY21/FY22E, which should compensate for KMB's measured growth aspirations.

- **Prudent 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.

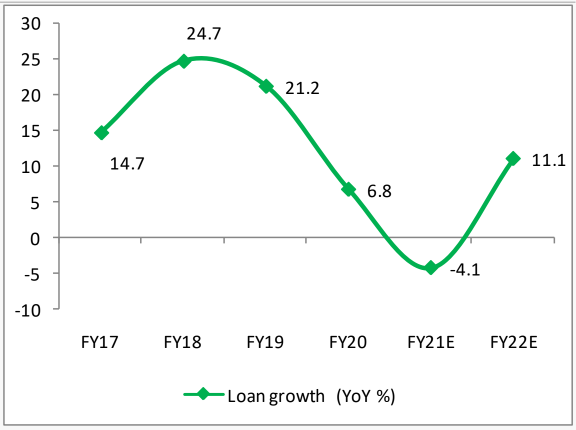
  We estimate RoA/ RoE at 1.9%/11.9%, for FY22E. We value KMB using the SOTP methodology to arrive at a target price of Rs 1,410. The core business is valued at 2.9x FY22E P/ABV. We are positive on the stock over the long - term given management strength and sustainability, strong deposit franchise, robust NIM and and comfortable asset quality. However, KMB will not be immune to the current cycle and ROEs of 10- 11% for FY21F/22E leave limited room for any re-rating, in our view, given rich valuations. Hence, we initiate with a Hold rating with a Target price of Rs 1410, while acknowledging it to be amongst the best placed to ride the cycle.

KMB SOTP Valuation

	Valuation basis	Value per share
Kotak Mahindra Bank	2.9x FY22E ABV	992
Kotak Mahindra Prime	2x FY22E ABV	79
Kotak Mahindra Investments	15x FY22E P/E	32
Kotak Securities	15x FY22E P/E	69
Kotak Mahindra AMC	6% FY22E AUM	84
Kotak Life	Appraisal value	122
KMCC - Investment Banking Business	13x FY22E P/E	7
Kotak Alternative Assets	11% FY22E AUM	17
International business	8x FY22E P/E	8
Total Value		**1410**

Source: Company, Axis Securities

Cautious but calibrated approach on loan growth

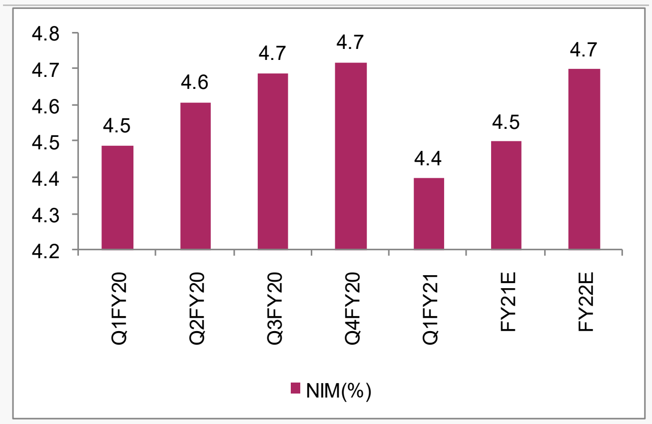


Loan mix

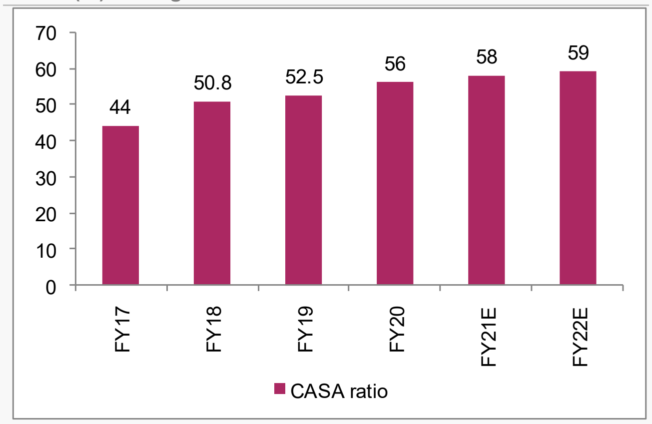
Segments (Rs bn)	Loan Book	Loan mix (%)	Growth YoY (%)
Home Loans/LAP	472	23.1	8.3
Consumer Bank WC	182	8.9	-4.9
PL, BL & Cons. Durables	91	4.5	-2.9
Credit Cards	43	2.1	-4.5
CV/CE	184	9.0	-7.4
Agriculture	195	9.6	0.4
Tractor Finance	75	3.7	15.0
Corporate Banking	581	28.5	-0.6
SME	180	8.8	-21.3
Others	35	1.7	-13.9
Total Advances	**2,040**		

Source: Company, Axis Securities

NIM to be resilient

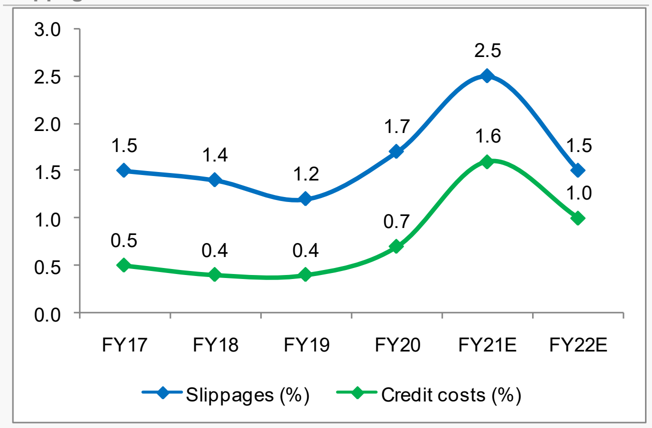


CASA (%) amongst the best

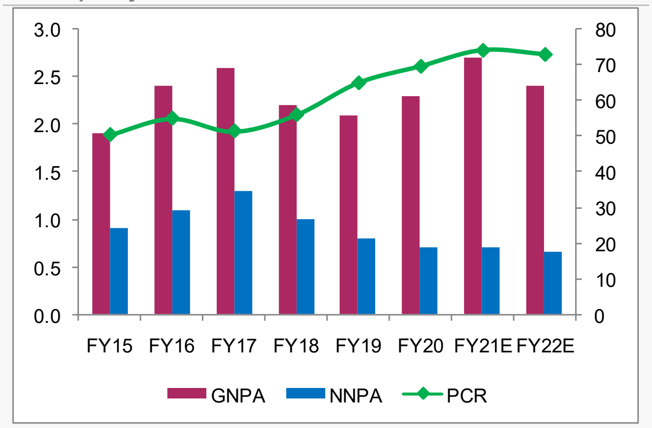


Source: Company, Axis Securities

Slippages to be in control



Asset quality to be maintained



Source: Company, Axis Securities

Result Update (Standalone) (Rs mn)

Y/E March	Q1FY21	Q1FY20	% YoY	Q4FY20	% QoQ
Net Interest Income	37,239	31,609	17.8	35,596	4.6
Non Interest Income	7,735	13,169	-41.3	14,894	-48.1
Operating expenses	18,737	20,789	-9.9	23,238	-19.4
Staff Cost	9,109	9,015	1.0	9,696	-6.1
Pre provision profits	26,237	23,989	9.4	27,253	-3.7
Provisions and contingencies	9,620	3,168	203.7	10,475	-8.2
PBT	16,617	20,822	-20.2	16,778	-1.0
Provision for Tax	4,173	7,220	-42.2	4,112	1.5
PAT	12,445	13,602	-8.5	12,666	-1.7
Deposits (Rs bn)	2615	2329	12.3	2628	-0.5
Advances (Rs bn)	2040	2080	-1.9	2197	-7.2
CD ratio (%)	78	89		84	
CASA (%)	57	51		56	
Tier 1	20.6	17.3		17.3	
CAR	21.2	17.8		17.9	
NIM (%)	4.4	4.5		4.7	
Cost-Income ratio (%)	41.7	46.0		46.0	
Gross NPAs (%)	2.7	2.19		2.25	
Net NPAs (%)	0.9	0.7		0.7	
Coverage ratio (%)	68.4	67.0		69.0	

Source: Company, Axis Securities

Financials (Standalone)

Profit & Loss

(Rs bn)

Y/E March	FY19	FY20	FY21E	FY22E
Net Interest Income	113	135	157	176
Other Income	46	54	44	50
Total Income	159	189	201	226
Total Operating Exp	75	89	84	93
PPOP	84	100	117	133
Provisions & Contingencies	10	22	37	27
PBT	74	78	80	106
Provision for Tax	25	19	22	29
PAT	49	59	58	77

Source: Company, Axis Securities

Balance Sheet

(Rs bn)

Y/E March	FY19	FY20	FY21E	FY22E
SOURCES OF FUNDS				
Equity capital	10	10	10	10
Preference capital	5	5	5	5
Reserves	414	476	608	686
Shareholder's Funds	424	486	618	696
Total Deposits	2,259	2,628	2,786	3,092
Borrowings	322	380	388	412
Other Liabilities & Provisions	111	104	130	163
Total Liabilities	3,121	3,603	3,927	4,368
APPLICATION OF FUNDS				
Cash & Bank Balance	247	533	719	814
Investments	712	751	901	991
Advances	2,057	2,197	2,106	2,340
Fixed Assets & Other Assets	107	121	201	223
Total Assets	3,123	3,602	3,927	4,368

Source: Company, Axis Securities

Ratio Analysis (%)

Y/E March	FY19	FY20	FY21E	FY22E
VALUATION RATIOS				
EPS	24.5	29.5	29.0	38.5
Earnings Growth (%)	16.7	20.4	-1.7	32.8
DPS	1.0	-	-	-
BVPS	222	253	309.0	348.0
Adj. BVPS	216	247	304.0	342.0
ROA (%)	1.7	1.8	1.6	1.9
ROE (%)	12.2	13.1	10.6	11.9
P/E (x)	54.0	44.8	45.6	34.3
P/ABV (x)	6.0	5.2	4.3	3.8
Dividend Yield (%)	0.1	-	-	-
PROFITABILITY				
NIM (%)	4.2	4.3	4.5	4.7
Cost-Income Ratio	47.2	47.1	41.8	41.2
BALANCE SHEET STRUCTURE RATIOS				
Loan Growth (%)	21.2	6.8	-4.1	11.1
Deposit Growth (%)	17.3	16.3	6.0	11.0
C/D Ratio (%)	91.1	83.6	75.6	75.7
CASA	52.0	56.0	58.0	59.0
CAR	16.9	17.9	19.8	19.5
CAR Tier I	17.5	17.3	19.6	19.3
ASSET QUALITY				
Gross NPLs (%)	2.1	2.3	2.7	2.4
Net NPLs (%)	0.73	0.7	0.7	0.7
Coverage Ratio (%)	65.4	69.6	74.1	72.9
Credit costs	0.4	0.7	1.6	1.0
Slippages	1.2	1.7	2.5	1.5

Source: Company, Axis Securities

Disclosures:

The following Disclosures are being made in compliance with the SEBI Research Analyst Regulations 2014 (herein after referred to as the Regulations).

1. Axis Securities Ltd. (ASL) is a SEBI Registered Research Analyst having registration no. INH000000297. ASL, the Research Entity (RE) as defined in the Regulations, is engaged in the business of providing Stock broking services, Depository participant services & distribution of various financial products. ASL is a subsidiary company of Axis Bank Ltd. Axis Bank Ltd. is a listed public company and one of India's largest private sector bank and has its various subsidiaries engaged in businesses of Asset management, NBFC, Merchant Banking, Trusteeship, Venture Capital, Stock Broking, the details in respect of which are available on www.axisbank.com.
2. ASL is registered with the Securities & Exchange Board of India (SEBI) for its stock broking & Depository participant business activities and with the Association of Mutual Funds of India (AMFI) for distribution of financial products and also registered with IRDA as a corporate agent for insurance business activity.
3. ASL has no material adverse disciplinary history as on the date of publication of this report.
4. I/We, Siji Philip, MBA - (Finance), author/s and the name/s subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my/our views about the subject issuer(s) or securities. I/We (Research Analyst) also certify that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. I/we or my/our relative or ASL does not have any financial interest in the subject company. Also I/we or my/our relative or ASL or its Associates may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Since associates of ASL are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report. I/we or my/our relative or ASL or its associate does not have any material conflict of interest. I/we have not served as director / officer, etc. in the subject company in the last 12-month period. Any holding in stock – No
5. 5. ASL has not received any compensation from the subject company in the past twelve months. ASL has not been engaged in market making activity for the subject company.
6. In the last 12-month period ending on the last day of the month immediately preceding the date of publication of this research report, ASL or any of its associates may have:

Received compensation for investment banking, merchant banking or stock broking services or for any other services from the subject company of this research report and / or;

Managed or co-managed public offering of the securities from the subject company of this research report and / or;

Received compensation for products or services other than investment banking, merchant banking or stock broking services from the subject company of this research report;

ASL or any of its associates have not received compensation or other benefits from the subject company of this research report or any other third-party in connection with this report.

Term& Conditions:

This report has been prepared by ASL and is meant for sole use by the recipient and not for circulation. The report and information contained herein is strictly confidential and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ASL. The report is based on the facts, figures and information that are considered true, correct, reliable and accurate. The intent of this report is not recommendatory in nature. The information is obtained from publicly available media or other sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. The report is prepared solely for informational purpose and does not constitute an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments for the clients. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ASL will not treat recipients as customers by virtue of their receiving this report.

DEFINITION OF RATINGS	
Ratings	**Expected absolute returns over 12-18 months**
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning valuation and recommendation
UNDER REVIEW	We will revisit our recommendation, valuation and estimates on the stock following recent events
NO STANCE	We do not have any forward looking estimates, valuation or recommendation for the stock

Disclaimer:

Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to the recipient's specific circumstances. The securities and strategies discussed and opinions expressed, if any, in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient.

This report may not be taken in substitution for the exercise of independent judgment by any recipient. Each recipient of this report should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this report (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. Certain transactions, including those involving futures, options and other derivatives as well as non-investment grade securities involve substantial risk and are not suitable for all investors. ASL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc. Past performance is not necessarily a guide to future performance. Investors are advice necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ASL and its affiliated companies, their directors and employees may; (a) from time to time, have long or short position(s) in, and buy or sell the securities of the company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities or earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or investment banker, lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions. Each of these entities functions as a separate, distinct and independent of each other. The recipient should take this into account before interpreting this document.

ASL and / or its affiliates do and seek to do business including investment banking with companies covered in its research reports. As a result, the recipients of this report should be aware that ASL may have a potential conflict of interest that may affect the objectivity of this report. Compensation of Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. ASL may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. The Research reports are also available & published on AxisDirect website.

Neither this report nor any copy of it may be taken or transmitted into the United State (to U.S. Persons), Canada, or Japan or distributed, directly or indirectly, in the United States or Canada or distributed or redistributed in Japan or to any resident thereof. If this report is inadvertently sent or has reached any individual in such country, especially, USA, the same may be ignored and brought to the attention of the sender. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ASL to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors.

The Disclosures of Interest Statement incorporated in this document is provided solely to enhance the transparency and should not be treated as endorsement of the views expressed in the report. The Company reserves the right to make modifications and alternations to this document as may be required from time to time without any prior notice. The views expressed are those of the analyst(s) and the Company may or may not subscribe to all the views expressed therein.

Axis Securities Limited, Corporate office: Unit No. 2, Phoenix Market City, 15, LBS Road, Near Kamani Junction, Kurla (west), Mumbai-400070, Tel No. – 022-40508080/ 022-61480808, Regd. off.- Axis House, 8th Floor, Wadia International Centre, PandurangBudhkar Marg, Worli, Mumbai – 400 025. Compliance Officer: AnandShaha, Email: compliance.officer@axisdirect.in, Tel No: 022-42671582.SEBI-Portfolio Manager Reg. No. INP000000654