Kotak Mahindra Bank

28 July 2020

1QFY21 Result Update

Reuters: KTKM.BO; Bloomberg: KMB IN

Treading cautiously and steadily

Kotak Mahindra Bank (KMB) reported NII growth of 17.8% YoY and 4.6% QoQ despite advances declining by 1.9% YoY and 7.2% QoQ, reflecting strong quality of earnings at lower risk. NIM stood at 4.4%, down 8bps YoY and 32bps QoQ. Deposit flows were strong with a growth of 12.3% YoY, down marginally QoQ, despite the bank reducing its rates considerably during the quarter. The cost of SA stood at 4.22% compared to 5.23% in 4QFY20 and 5.51% in 1QFY20. With the bank having taken cuts in the latter part of the quarter, we expect SA rates to drop further in 2QFY21. On the back of this, coupled with a low-rate environment, the cost of funds dropped to 4.2% compared to ~4.6% in 4QFY20. This helped in sustaining strong margins even as calc. yield on advances dropped ~30bps QoQ. The fee income generation was affected due to the lockdown, but we expect it to pick up 2QFY21 onwards as the economy continues to open and there is better momentum in insurance sales. Overall, non-interest revenue was down 41.3% YoY and 48.1% QoQ as the bank chose not to book MTM gains on the bond portfolio (other income ex-fee was negative Rs20mn). Employee costs were mostly in control, up 1% YoY but down 6.1% QoQ. Note that employees above a certain salary threshold have taken a pay cut. Other opex was down 9.9% YoY and 19.4% QoQ. With the bank being extra cautious in terms of lending, we expect FY21E to see exceptionally low opex, gradually normalizing in FY22E. Operating profit grew by 9.4% YoY but was down 3.7% QoQ. The bank set aside Rs6.2bn as covid-related provisions, post which the covid-related provisions outstanding stand at Rs12.7bn. PAT was down 8.5% YoY and 1.7% QoQ. In terms of asset quality, the bank reported an increase of 45bps in GNPA ratio to 2.7%, which was partially driven by a decline in loan book. Total slippages during the quarter were ~Rs8bn, out of which Rs5bn flowed from the moratorium pool. Management commentary suggested that the bank has been stringent in granting second moratorium to its customers and has rather chosen to recognize stress upfront. The trend (of upfront stress recognition) is expected to continue and therefore we are building in higher NPA ratios for the bank in FY21/22E. The loan book under moratorium stands at 9.65%, out of which 9.15% is from moratorium 1.0. ~80% of the moratorium 2 book is secured in nature. The bank continues to remain cautious on unsecured retail loans. Per se, on the key P&L Items, KMB posted NII growth of 18% YoY at Rs37,239mn, PPOP growth of 9% YoY at Rs26,237mn and PAT decline of 9% YoY at Rs12,445mn. NII was 2% above estimate; PPOP/PAT were 6%/18% below estimates. We have revised our estimates for FY21/FY22 and retained Buy rating on KMB with a revised target price of Rs1,578 (from Rs1,614 earlier), valuing the standalone bank at 3.5xFY22E P/BV and ascribing a value of Rs328 to the subsidiaries.

Loan book growth: Overall loan book declined by 1.9% YoY and 7.2% QoQ. The bank remains cautious on the corporate banking segment (down 1% YoY, 10% QoQ) as well as SME (down 21% YoY, 11%% QoQ). Unsecured retail credit remains under watch with the credit card portfolio down 5% YoY and 8% QoQ. PL, BL and CD portfolio declined by 3% YoY and 7% QoQ. Focus on mortgages remains strong with the portfolio growing by 8% YoY (down 3% QoQ). Agri and tractors, which have been relatively unharmed, grew by 0.4% and 15% YoY, respectively. CV/CE, where the sector has been under stress, registered a drop of 7% YoY and 4% QoQ.

BUY

Sector: Banking

CMP: Rs1,322

Target Price: Rs1,578

Upside: 19%

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Key Data

Current Shares O/S (mn)	1,978.8
Mkt Cap (Rsbn/US$bn)	2617.2/35
52 Wk H / L (Rs)	1,740/1,000
Daily Vol. (3M NSE Avg.)	7,192,454

Price Performance (%)

	1 M	6 M	1 Yr
Kotak Mahindra Bank	(1.3)	(18.3)	(12.5)
Nifty Index	7.2	(8.1)	(1.4)

Source: Bloomberg

Y/E Mar (Rsmn)	Q1FY21	Q1FY20	Q4FY20	*YoY (%)*	*QoQ (%)*
Interest Income	69,119	66,277	68,047	4.3	1.6
Interest Expense	31,880	34,668	32,450	-8.0	-1.8
Net Interest Income	**37,239**	**31,609**	**35,597**	**17.8**	**4.6**
Reported NIM (%)	4.40	4.48	4.72	*-8 bps*	*-32 bps*
Non Interest Income	7,735	13,169	14,894	-41.3	-48.1
Total Income	44,974	44,778	50,490	0.4	-10.9
Staff Cost	9,109	9,015	9,696	1.0	-6.1
Other Op Exp	9,628	11,773	13,542	-18.2	-28.9
Total Operating Expenses	18,737	20,789	23,238	-9.9	-19.4
Cost to Income (%)	41.7	46.4	46.0	*-476 bps*	*-436 bps*
Pre-Provisioning Operating Profit	26,237	23,989	27,253	9.4	-3.7
Provisions	9,620	3,168	10,475	203.7	-8.2
PBT	16,617	20,822	16,778	-20.2	-1.0
Tax	4,173	7,220	4,112	-42.2	1.5
-effective tax rate	25.11	34.67	24.51	*-956 bps*	*60 bps*
PAT	12,445	13,602	12,666	-8.5	-1.7
Deposits	26,15,240	23,29,310	26,28,210	12.3	-0.5
Advances	20,39,980	20,80,300	21,97,480	-1.9	-7.2

Source: Company, Nirmal Bang Institutional Equities Research

Liability inflows strong: Overall deposits grew by 12.3% YoY (down 0.5% QoQ). CASA deposits grew by 26% YoY but were flat QoQ. CASA ratio stood at 56.7%, up from 56.2% in 4QFY20, despite the bank lowering its rates considerably during the quarter. CASA and TDs below Rs50mn formed 90% of total deposits compared to 82% last year.

Comprehensive Conference Call Takeaways

Asset quality

- In granting moratorium 2 to customers, the bank has exercised extreme caution and stringent criteria. The focus has been on assessing the viability of the borrower, on satisfaction of which further moratorium has been granted. The ones deemed unviable have been allowed to flow through to the NPA pool.
- Collection teams have been strengthened by moving extra staff from sales as well by using risk analytics. The bank has also enabled digital solutions to aid collections.
- In terms of the HFC sector, the incremental exposure has been towards the top rated companies in India.
- Total slippages contain one very large account (quantum in early triple digits). As per the bank, several banks, which have exposure to this borrower, have most likely still classified it as standard.
- The overdue, when the moratorium began, was Rs130bn. Out of this, Rs5bn has slipped into NPA in 1QFY21.
- The reduction in the moratorium percentage has been due to repayment by some customers. Collections in June have been better than April and May but the bank continues to watch the trend and the effort is to improve it further.
- Moratorium in the real estate exposure (part of the wholesale book) is in middle single digits. Moratorium in the overall wholesale book is in low single digits. In recent times, the real estate exposure has been moved towards much higher rated developers.
- Credit cost for the current year could be significantly high (compared to FY20). A better picture is likely to emerge only after December 2020. As per the bank, one-time restructuring could delay stress recognition for a long time. However, the management is very clear in terms of recognizing the pain upfront.

Loans and business growth

- Current focus is to protect the balance sheet rather than focusing on the short-term P&L.
- NII growth of 18% YoY on the back of tepid loan book growth signifies higher quality of earnings (higher earnings for lower risk). The bank has also deferred recognizing significant MTM gains on the investment book (significant in quantum). As a result, there has been a net loss in terms of non-interest revenue other than fee income.
- Mortgage continues to be a focus area. Non-metros have shown better traction during the quarter.
- In the MSME segment, the bank has seen customers exercising prudence. This is indicated by lower working capital utiliaztion levels across customers and cities. Many of those eligible for the government emergency credit scheme have not taken it out of leverage concerns. The bank continued to see traction in terms of acquiring good quality customers in the MSM space in June. Besides the credit business, focus has also been on generating fee income in the MSME segment.
- The bank launched 811 credit card in 1QFY21, which allows the bank to tap data from untouched segments.
- Stance on unsecured loans continues to be cautious, especially in case of new loans. The bank would continue to keep tight underwriting criteria in this segment in the near future.
- In the CV/CE space, there has been a steep fall in sales, which affected the disbursals. Structural changes in the last few quarters in this space have affected segment growth. However, the movement has improved to 75-80% of pre-covid levels now. Capacity/fleet utilization levels have improved to ~70-80%, which has led to improved cash flows with the operators. PVs continue to suffer. Given the covid situation, the bank would remain cautious on new disbursals while at the same time focus on managing the existing portfolio.

- In the agri business, customers have been less affected as activity levels and cash flows have been good. Non-operation of organized services led to some bit of impact on the ultimate agri supply chain, which resulted in lower limit utilization levels. On the other hand, a good harvest and timely procurement have helped on the cash flows and collections front.
- Direct exposure in the MFI business is in the non-metro markets. Though the localized operations affected collections, June has been better.
- In the tractor business, growth has been good in May and June. Deep distribution and digital processes have helped the bank to continue with normal operations in this segment. Collections in this segment have been close to pre-covid levels. The outlook for the tractor business is good.
- In the corporate and SME book, the bank continues to exercise caution, especially on the companies with high leverage. Since the coverage and presence in the corporate segment is quite good, the ability to scale up disbursals is huge as and when the bank is reasonably comfortable on the economy and overall corporate India performance. Meanwhile, the focus remains on improving spreads and profitability on this book through increasing share of non-risk revenues.
- On the SME portfolio, the portfolio behaviour has been stable. The bank had rationalized this portfolio last year. Currently, the portfolio is showing under utilization of limits which indicates lower economic activity as well as good quality of the book.
- The bank is seeing good opportunity in special situation funds.
- In the consumer space, the focus is much more on secured retail (home loans, LAP).
- The bank has been focusing on growing the mortgage business where the market is huge.

Margin, liabilities and liquidity

- The bank continues to see strong flow of deposits. CASA growth has come on the back of new customer acquisition as well deepening of the existing customer base. SA has grown across all retail customer segments and therefore the growth is granular in nature.
- As per the bank, there is more room to bring down the cost of funds. Cost of SA should fall further in 2QFY21 as some of the rate cuts have happened in the latter part of 1Q. This should enable the bank to getter better risks at lower prices.

Fee and other income

- The bank sees huge opportunity in terms of making revenue through fee and franchise income. In line with this view, the bank has been scaling up its wealth management business (broking, insurance, AMC).

Operating expenses

- There is possibility of number of branches being less in the post-covid world.

Macros

- Current expectation is that the economy should stabilize by September/October on a national basis. The bank expects the economy to get back to 90% of normal level by 4QFY21 and to FY20 run-rate by 2QFY22.
- As per the bank, the banking and financial sector is likely to go through significant challenges in terms of capital.

Others

- Regarding the RBI discussion paper on CEO timelines, the management commented that the board has already approved the reappointment of Uday Kotak and Deepak Gupta. Further, the management highlighted that the bench of the bank is very strong and deep and committed to the long-term interests of the bank. Ultimately, the culture of the bank will be driven by the management as well as the board, which would comprise the promoter family as well.

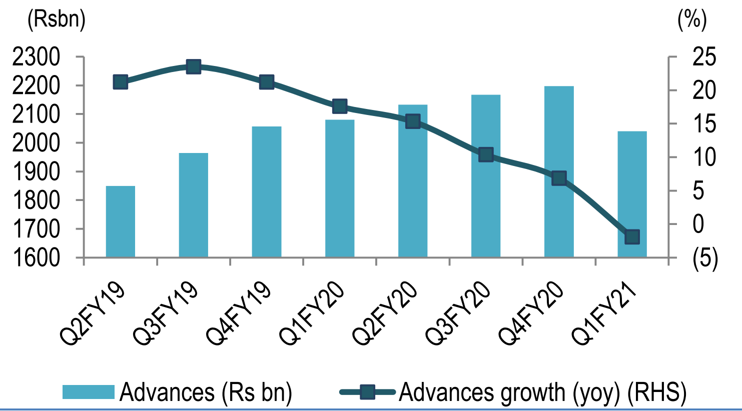
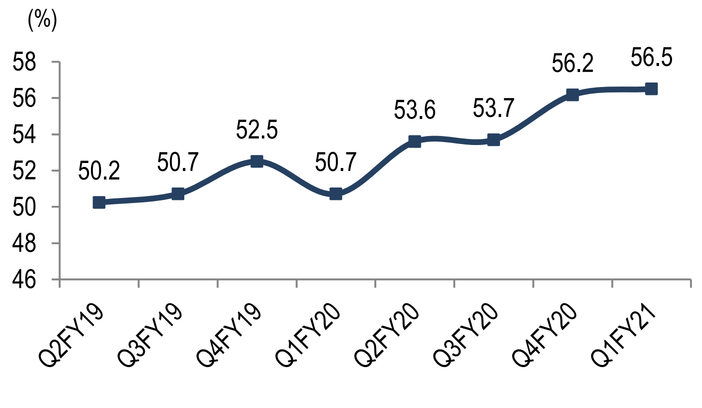
Exhibit 1: Advances, advances growth	Exhibit 2: CASA ratio (%)
	
Source: Company, Nirmal Bang Institutional Equities Research	*Source: Company, Nirmal Bang Institutional Equities Research*

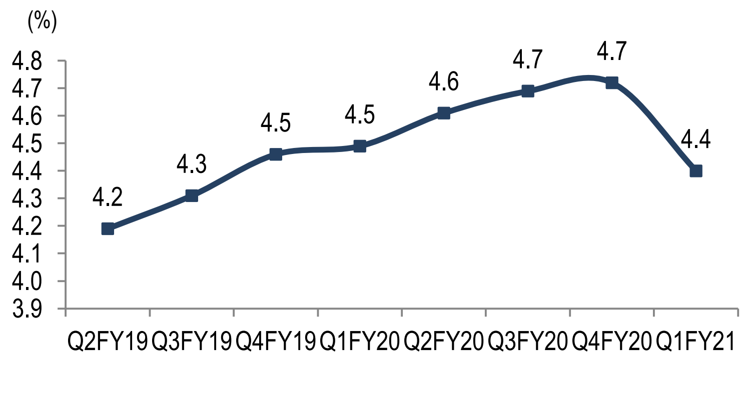
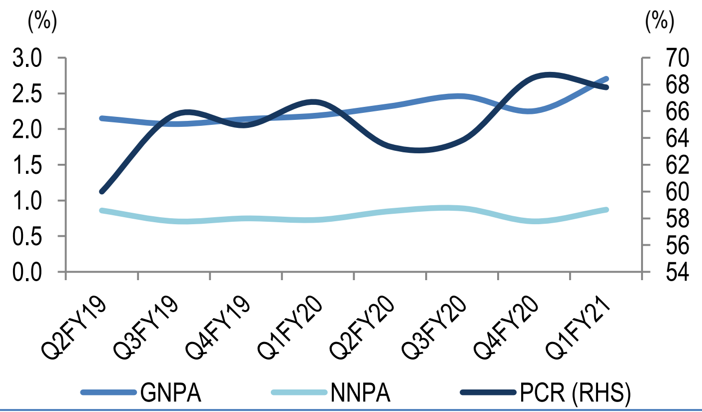
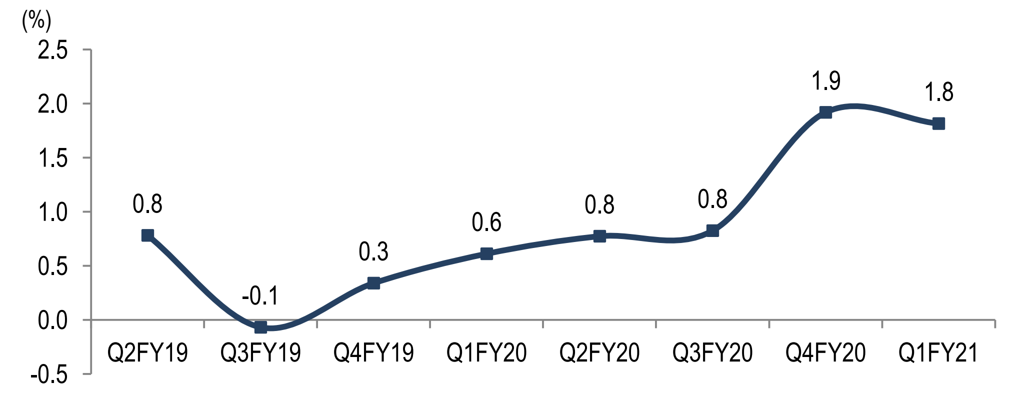
Exhibit 3:NIM (Standalone, Reported, %)	Exhibit 4:Asset Quality (%)
	
Source: Company, Nirmal Bang Institutional Equities Research	*Source: Company, Nirmal Bang Institutional Equities Research*

Exhibit 5: Credit Cost (Calculated, Annualized, %)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: SOTP valuation

Entity	Valuation methodology	Holding	Value per share (INR)
			FY22E
Kotak Mahindra Bank - standalone	3.5x FY22E BV	100.0%	1,250
Kotak Life Insurance	1.8x FY22E GWP	100.0%	164
Kotak AMC	28x FY22E EPS	100.0%	62
Kotak Prime	1.2x FY22E BV	100.0%	52
Kotak Securities	18x FY22E EPS	100.0%	55
Kotak Investments	2x FY22E BV	100.0%	26
Kotak General Insurance	5x FY22E NWP	100.0%	12
Kotak Capital	18x FY22E EPS	100.0%	7
Others	1x BV	100.0%	9
Holding co. discount (%)			15%
Value of subs (INR per share)			**328**
Value of total (INR per share)			**1,578**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Financial summary

Y/E March (Rsmn)	FY18	FY19	FY20	FY21E	FY22E
Net interest income	95,318	1,12,590	1,34,997	1,47,988	1,68,575
Pre-provisioning Operating profit	71,583	83,482	1,00,208	1,18,965	1,26,641
PAT	40,845	48,653	59,472	60,814	80,230
Gross NPAs (%)	2.2	2.1	2.3	3.6	3.5
Net NPAs (%)	1.0	0.8	0.7	1.1	0.9
RoA (%)	1.7	1.7	1.8	1.6	1.9
RoE (%)	12.5	12.1	13.0	11.0	12.1

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Actual performance versus our estimates

(Rsmn)	Q1FY21	Q1FY20	Q4FY20	*YoY (%)*	*QoQ (%)*	Q1FY21E	*Devi. (%)*
Net interest income	37,239	31,609	35,597	*17.8*	*4.6*	36,182	*2.9*
Pre-provisioning operating profit	26,237	23,989	27,253	*9.4*	*(3.7)*	27,904	*(6.0)*
PAT	12,445	13,602	12,666	*(8.5)*	*(1.7)*	15,191	*(18.1)*

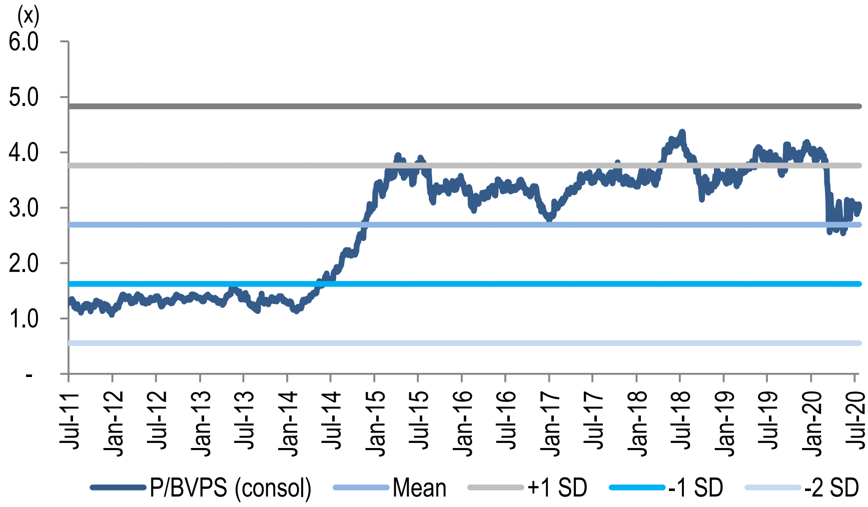
Source: Company, Nirmal Bang Institutional Equities Research N.B.

Exhibit 9: Change in our estimates

	Revised Estimate		Earlier Estimate		*% Revision*	
	FY21E	FY22E	FY21E	FY22E	*FY21E*	*FY22E*
Net Interest Income (Rsmn)	1,47,988	1,68,575	1,49,055	1,66,604	(0.7)	1.2
Operating Profit (Rsmn)	1,18,965	1,26,641	1,20,394	1,40,697	(1.2)	(10.0)
Profit after tax (Rsmn)	60,814	80,230	63,548	91,507	(4.3)	(12.3)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: One-year forward P/BV



Source: Company, Nirmal Bang Institutional Equities Research

Financial statements

Exhibit 11: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20	FY21E	FY22E
Interest income	1,97,486	2,39,432	2,69,296	2,80,244	3,15,462
Interest expenses	1,02,168	1,26,842	1,34,300	1,32,256	1,46,887
Net interest income	**95,318**	**1,12,590**	**1,34,997**	**1,47,988**	**1,68,575**
Non-interest income	40,521	46,040	53,721	51,156	60,485
Total income	**1,35,840**	**1,58,630**	**1,88,718**	**1,99,144**	**2,29,060**
Operating expenses	64,256	75,148	88,509	80,179	1,02,419
Pre-Provisioning Operating profit	**71,583**	**83,482**	**1,00,208**	**1,18,965**	**1,26,641**
Provisions	9,399	9,624	22,162	37,708	19,425
PBT	62,184	73,858	78,047	81,257	1,07,216
Taxes	21,339	25,205	18,575	20,442	26,986
PAT	**40,845**	**48,653**	**59,472**	**60,814**	**80,230**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Key ratios

Y/E March	FY18	FY19	FY20	FY21E	FY22E
Growth (%)					
NII growth	17.3	18.1	19.9	9.6	13.9
Pre-provision profit growth	19.6	16.6	20.0	18.7	6.5
PAT growth	19.7	19.1	22.2	2.3	31.9
Business (%)					
Deposit growth	22.4	17.3	16.4	8.0	12.0
Advance growth	24.7	21.2	6.8	2.7	14.6
CD	87.4	89.7	87.1	81.5	80.5
CASA	50.8	52.5	56.2	57.5	57.5
Operating efficiency (%)					
Cost-to-income	47.3	47.4	46.9	40.3	44.7
Cost-to-assets	2.7	2.6	2.6	2.1	2.4
Spread (%)					
Yield on advances	9.6	9.8	9.9	9.5	9.7
Yield on investments	7.2	7.2	7.2	6.6	6.6
Cost of deposits	5.1	5.3	4.9	4.3	4.2
Yield on assets	8.6	8.6	8.3	7.6	7.7
Cost of funds	5.2	5.3	4.8	4.3	4.3
NIMs	4.2	4.1	4.2	4.1	4.2
Capital adequacy (%)					
Tier I	17.6	16.9	17.3	20.7	20.1
Tier II	0.7	0.5	0.6	0.6	0.6
Total CAR	18.2	17.5	17.9	21.3	20.7
Asset quality (%)					
Gross NPAs	2.2	2.1	2.3	3.6	3.5
Net NPAs	1.0	0.8	0.7	1.1	0.9
PCR	56.5	65.4	69.0	69.5	76.4
Net slippage	0.2	0.4	0.3	1.5	0.4
Credit-cost	0.5	0.4	0.8	1.2	0.6
Return (%)					
RoE	12.5	12.1	13.0	11.0	12.1
RoA	1.7	1.7	1.8	1.6	1.9
Per share					
EPS	21.4	25.5	31.1	30.7	40.6
BV	196.7	224.7	253.6	316.2	356.8
ABV	187.9	216.7	245.5	303.3	345.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Balance sheet

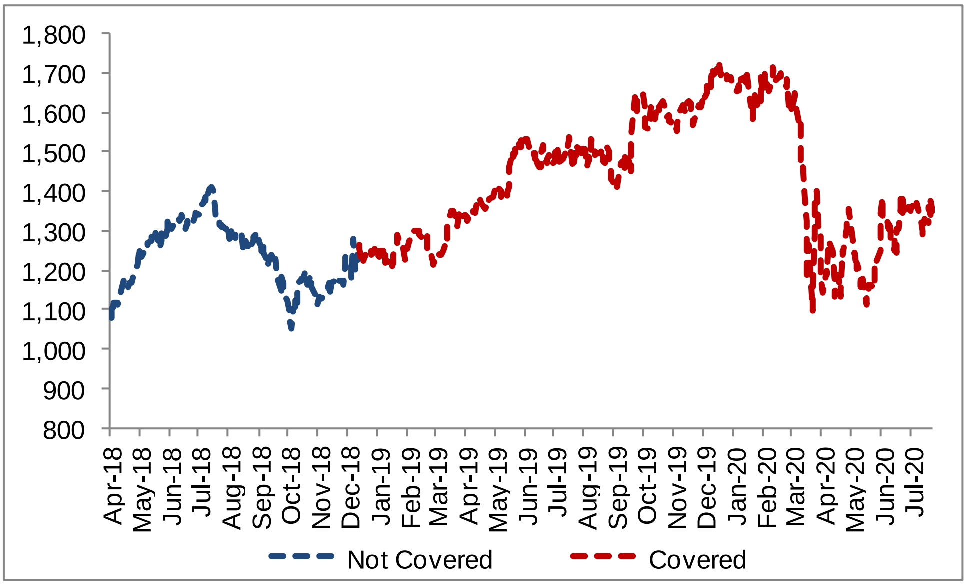
Y/E March (Rsmn)	FY18	FY19	FY20	FY21E	FY22E
Share capital	9,528	14,544	9,565	9,890	9,890
Reserves & surplus	3,65,287	4,14,440	4,75,588	6,15,570	6,95,799
Shareholders' funds	**3,74,816**	**4,28,984**	**4,85,153**	**6,25,460**	**7,05,690**
Deposits	**19,26,430**	**22,58,804**	**26,28,205**	**28,38,462**	**31,79,077**
-Current deposits	3,22,457	3,89,010	4,30,130	4,39,962	4,92,757
-Saving deposits	6,55,290	7,96,847	10,46,090	11,92,154	13,35,212
-Term deposits	9,48,683	10,72,947	11,51,985	12,06,346	13,51,108
Borrowings	2,51,541	3,22,483	3,79,933	4,25,525	4,46,801
Other liabilities	96,521	1,11,430	1,09,197	1,36,529	1,66,663
Total liabilities	**26,49,332**	**31,21,720**	**36,02,517**	**40,25,976**	**44,98,231**
Cash/equivalent	1,96,201	2,46,755	5,32,923	6,36,477	6,45,406
Advances	16,97,179	20,56,948	21,97,482	22,56,601	25,86,558
Investments	6,45,623	7,11,891	7,50,515	9,93,462	10,96,782
Fixed & others assets	1,10,330	1,06,126	1,21,597	1,39,436	1,69,485
Total assets	**26,49,332**	**31,21,720**	**36,02,517**	**40,25,976**	**44,98,231**

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
4 December 2019	Accumulate	1,649	1,781
8 January 2020	Accumulate	1,655	1,781
21 January 2020	Accumulate	1,617	1,757
27 March 2020	Buy	1,390	1,658
9 April 2020	Buy	1,188	1,658
14 May 2020	Buy	1,186	1,463
9 July 2020	Buy	1,463	1,614
28 July 2020	Buy	1,322	1,578

Rating track graph



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BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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