

July 19, 2018

Kotak Mahindra Bank

Q1FY19 Result Update

Moderate growth in loan book; however higher disbursement per branch

Advances grew 24% YoY (from 1,423,590 mn) & 4% QoQ (from 1,697,179 mn) to 1,769,270 mn. Meanwhile branch count only increased from 1,388 to 1,391 in the quarter. Corporate book grew 3% QoQ from 994,020 mn to 1,041,520 mn whereas retail book grew 5% QoQ from 703,160 mn to 727,750 mn. Corporate book was driven by 11% QoQ growth in corporate banking division. Retail book was driven by 5% QoQ growth in CV segment. Due to robust 11% QoQ growth, corporate banking division contribution in loan book went up from 30.7% in Q4FY18 to 32.6% in Q1FY19.

Uptick in advance yield was offset by low realizable investment yield

Advances grew by 5% QoQ, whereas interest income grew by 6% QoQ from 39,245 mn to 41,682 mn on the back of 7bps improvement in advance yield from 9.5% to 9.6%. However, income from investments went up by 3% QoQ from 11,130 mn to 11,419 mn, despite 10% QoQ rise in investments due to steep contraction in realized investment yield from 7.4% to 6.7%. Further, 5bps uptick in cost of funds from 5.20% to 5.25% resulted in contraction of NIM by 5bps from 4.35% in Q4FY18 to 4.30% in Q1FY19.

Improvement in operational efficiency allowed for higher provisioning

Bank's cost to income ratio improved by 16bps to 45.8%. This allowed for higher provisioning on advances of 60.8% as oppose to 56.5% in previous quarter. Alongside, provisions due to investment rose 59% QoQ from 1319 mn to 2095 mn. This resulted in significant rise of cumulative credit cost from 0.5% in Q4FY18 to 0.7% in Q1FY19. However, GNPA improved from 2.22% to 2.17% and NNPA came at 0.86% as oppose to 0.98% in previous quarter.

Weak performance of subsidiaries

Major subsidiaries such as KM Prime, KM Investments posted lower PAT QoQ. Prime posted PAT of 1,390 mn (v/s 1,600mn in Q4FY18), KM Investments posted 480 mn (v/s 950 mn).

Valuations

PAT grew 12% YoY & de-grew 9% QoQ to 10249 mn. This lowered ROAA% to 1.53% from 1.75% in Q4FY18 and ROAE% to 10.79% from 12.19% in Q4FY18. We arrive at a SOTP valuation of INR 1423 (4.7x FY20E ABVPS of INR 245 + subsidiary valuation of INR 270) implying an upside potential of 5.6% with a Neutral rating.

(INR Mn)	FY16	FY17	FY18	FY19E	FY20E
Net interest income	69,003.7	81,261.5	95,316.8	120,815.0	150,089.4
Growth%	63%	18%	17%	27%	24%
Pre-provisioning profit	40,410.9	59,848.1	71,581.7	93,229.9	116,755.9
Growth%	35%	48%	20%	30%	25%
Adjusted PAT	20,897.8	34,115.0	40,843.0	49,153.5	62,691.4
Growth%	12%	63%	20%	20%	28%
EPS (INR)	11.4	18.5	21.4	25.8	32.9
BVPS (INR)	130.6	150.0	196.7	222.4	255.3
ABVPS (INR)	123.7	140.7	187.9	213.3	245.4

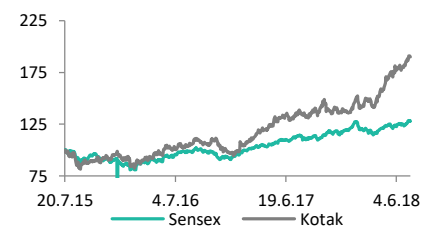
NEUTRAL

Downside Scenario	Current Price	Price Target	Upside Scenario
	1347	1423	
		6% ▲	

Stock Details	
Industry	BFSI
Sensex	36,351
Nifty	10,957
Bloomberg Code	KMB:IN
Eq. Cap. (Rs. Mn)	9,531
Face Value (Rs.)	5
52-w L/H	962/1,424
Market Cap (Mn)	2,564,700

	Valuation Data		
	FY18A	FY19E	FY20E
NIM	4.2%	4.3%	4.3%
Book value	197	222	255
Adj BV	188	213	245
ROAA	1.7%	1.7%	1.7%
ROAE	12.5%	12.3%	13.8%

Kotak Bank Vs SENSEX



	Shareholding Pattern		
	Jun'18	Mar'18	Jun'17
Promoters	30.0	30.0	30.1
FIIs	39.9	39.6	40.2
MF	6.9	7.1	6.4
Retail	9.5	9.8	10.2
Others	13.7	13.6	13.2
	100.0	100.0	100.0

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Q1FY19 Result Analysis

(INR Mn)	Q1FY19	Q1FY18	Q4FY18	Y-o-Y	Q-o-Q
Interest on Advances/Bills	41,682	34,782	39,245	20%	6%
Interest on Investment	11,419	8,858	11,130	29%	3%
Interest on bal. with RBI & Others	925	2,153	1,837	-57%	-50%
Other Interest	772	766	1,022	1%	-24%
INTEREST EARNED	54,797	46,558	53,234	18%	3%
Net-Interest Income (NII)	25,829	22,456	25,798	15%	0%
Other Income	25,829	22,456	25,798	15%	0%
Total Income	51,658	44,911	51,595	15%	0%
Operating Expenses	17,150	15,571	17,134	10%	0%
Pre-Provisional Profits	20,325	15,954	20,180	27%	1%
Provisions & Contingencies	4,696	2,037	3,069	131%	53%
PBT	15,629	13,916	17,110	12%	-9%
Provision for Taxes	5,380	4,789	5,870	12%	-8%
Adjusted Net Profit	10,249	9,127	11,241	12%	-9%

- Bank's total operating income grew 15% YoY from 44,911 mn in Q1FY18 & remained flat QoQ from 51,595 mn in Q4FY18 to 51,658 mn in this quarter on back of 18% YoY growth in interest income propelled by 24% YoY growth in advances.
- Bank's Net Interest Income grew 20% YoY from 22,456 mn in Q1FY18 & 6% QoQ from 25,798 mn in Q4FY18 to 25,829 mn in this quarter. Yield on advances contracted from 10.0% in Q1FY18 to 9.6% in Q1FY19 but its impact was offset by reduction in cost of funds from 5.33% in Q1FY18 to 5.25% in Q1FY19.
- Bank's quarterly cost to income ratio contracted by 363bps YoY to 45.8%.
- Bank's quarterly pre-provisioning profit grew 27% YoY from 15,954 mn in Q1FY18 & 1% QoQ from 20,180 mn in Q4FY18 to 20,325 mn in this quarter.
- Bank's net profits came at 10,249 mn in this quarter due to increased provisioning. Provisions due to investment loss rose 19 times from 109 mn in Q1FY18 to 2,095 mn in Q1FY19.
- Gross NPA ratio came at 2.17% (v/s 2.58% in Q1FY18) and NNPA came at 0.86% (v/s 1.25% in Q1FY18). Provision coverage ratio was 60.8% (v/s 52.3% in Q1FY18).

(INR Mn)	Q1FY19	Q1FY18	Q4FY18	Y-o-Y	Q-o-Q	Comment
Deposits	1,897,440	1,635,180	1,926,433	16%	-2%	CASA came at 50.3%
Borrowings	334,940	196,960	251,542	70%	33%	-
Investments	710,250	522,510	645,624	36%	10%	Significant improvement was seen to meet SLR requirements
Advances	1,769,270	1,423,590	1,697,179	24%	4%	Moderate QoQ due to 11% growth in corporate banking division followed by 5% growth in each CV/CE and home loan segment followed by de-growth of 7% & 1% in Agri & SME division.
Total Assets	2,714,890	2,263,850	2,649,334	20%	2%	-

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Conference Call Highlights

1. Government yield have moved from 7.4% (31st March 2018) to 7.9% (30th June 2018). Bank had 46% fixed income investments categorized as HTM and 54% as AFS & HFT. Bank recognized full MTM losses of 200cr (v/s 11cr in Q1FY18). Accordingly, bank expects to realize positive carry forward value going ahead.
2. GNPA came at 2.17% and bank made provisioning of 60.8% with highest provisioning in SME segment because of its cautious stance.
3. Bank emphasized on over-valuation of collateral carried out in the banking industry. In fact, bank provided for higher provisioning due to its cautious stance on the same. To manage the same, bank is increasing count of its internal valuers to manage the risk going forward.
4. Going ahead, bank is targeting retail segment. During earnings call of March 2017, management mentioned their aim of doubling their customer base of 8million then, by Sept'18. As of 30th June 2018, customer base stood at 14.5million. Also, bank is adding 5 lac new customer every month on average(including 811).
5. To achieve the aim, bank is giving higher interest rate on CASA. Interest rate on SA stood at 5.6%, 200bps higher than average. In fact, bank estimates hit of ~1600 crores on P&L, of which 1200cr is because of higher interest rate.
6. Going ahead, management expects NIM to improve by i) passing hike to customer; ii) improvement in CASA (currently CASA was 50.3%). However, we expect delay in materialization since MCLR regime prolongs the passing of rate as oppose to base rate regime.
7. Bank is moving aggressively towards digitalization. During Q1FY19, 89% of recurring deposit, 67% of fixed deposit were sourced digitally. Also mobile banking volume grew 172% YoY, active monthly customer on mobile app grew 105% YoY. Mobile banking transaction crossed 1cr in volume and 10,000 cr in value. Also, bank launched WhatsApp banking in the quarter and super home loan service (get home loan in 4 hours).
8. Management is confident of a sustainable 20-25% growth in FY19. Also, CV growth is expected 10-15% if overloading norms are not allowed for old vehicles. Growth is expected to come from CE, wholesale banking & consumer loan business.
9. Corporate credit growth of 25% YoY & 11% QoQ in Q1FY19 came due to i) one case of NCLT ii) secular market share gain. Management commented on having few more NCLT cases in pipeline.
10. Yield on investment was low since investments were moved from high duration to low duration as credit spread between 1 year & 10 year was almost zero. Yield for 2 year & 10 year was also low. Reportedly, 2 year bond was at 7.65% and 10 year bond was yielding 7.75%. As of 30th June 2018, modified duration of combined fixed income assets was ~ 2 year.
11. Management commented that SME segment (or business banking segment) reported single digit growth since it is still in the revival phase.
12. Under KM Prime, financing of 2W is expected to start from next month.
13. Group is focusing on growing its consumer finance business through KMB as oppose to KM Prime because of better technology & 811.
14. Ideally CD ratio is expected to be in range of 80-85%.
15. Bank has guided of adding 100 new branches in FY19.
16. Overall, management is looking to aggressively tap more retail customers due to its sticky nature. Initiatives like 811, techno-driven, high interest rate on SA is effort on achieving the same.

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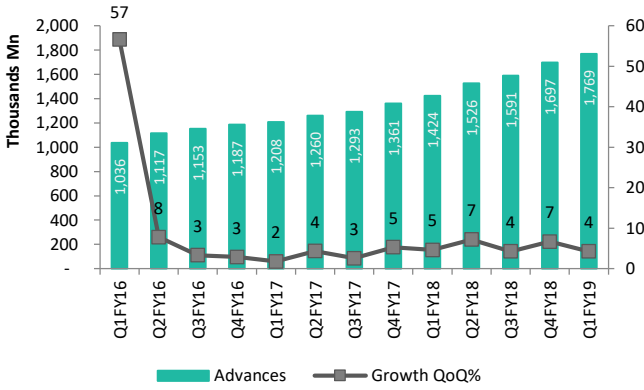
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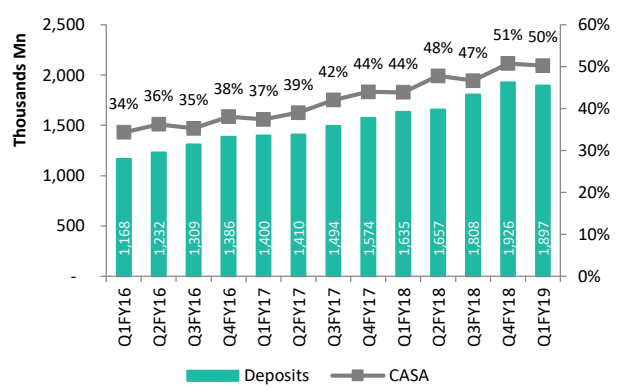
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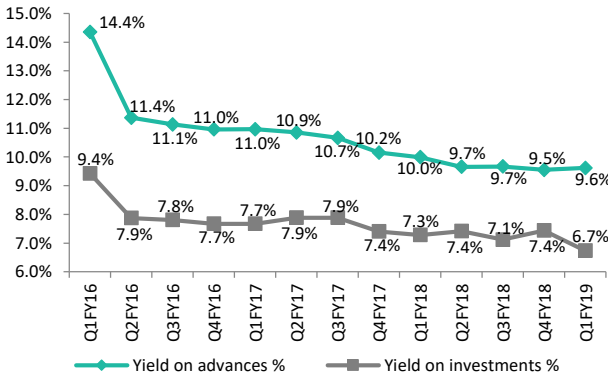
Advances Profile



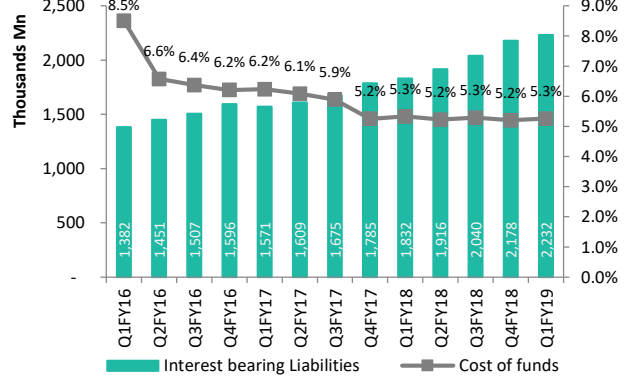
Deposits Profile



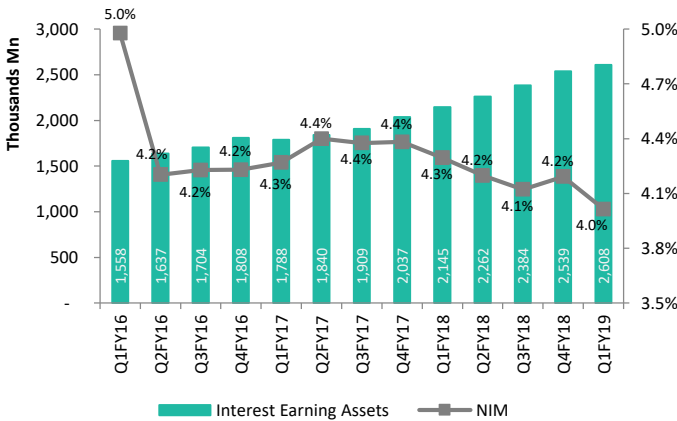
Yield Profile



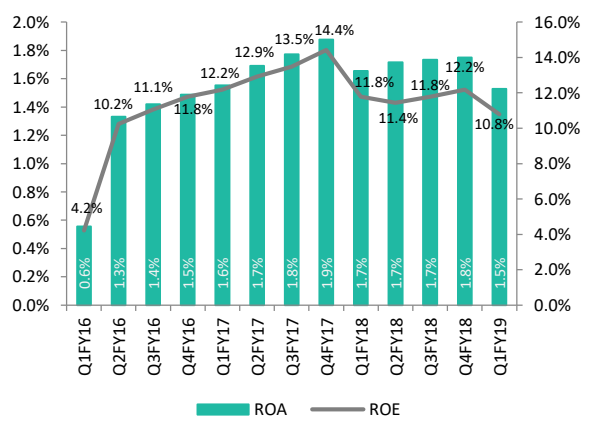
Interest Bearing Liabilities



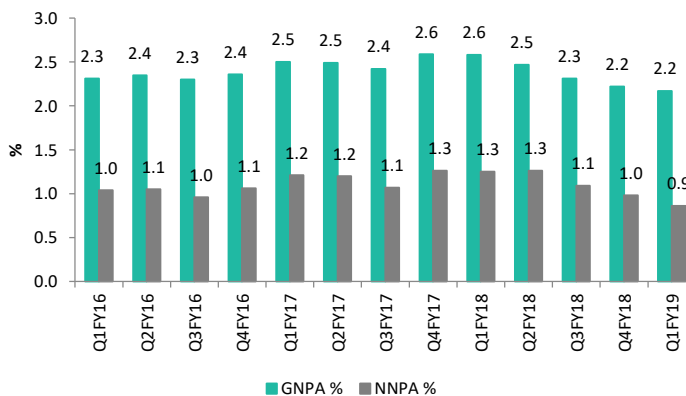
Interest Earning Assets



Return Ratios



Asset Quality



Source: Company, NSPL Research



Profit & Loss (INR Mn)	FY16	FY17	FY18	FY19E	FY20E
Interest earned	163,841.8	176,989.3	197,484.9	245,601.9	303,843.8
Interest expended	94,838.1	95,727.8	102,168.1	124,787.0	153,754.4
Net interest income	69,003.7	81,261.5	95,316.8	120,815.0	150,089.4
Non-interest income	26,122.3	34,771.6	40,522.1	50,249.0	62,194.0
Total income	95,126.1	116,033.1	135,838.9	171,064.0	212,283.4
Operating expenses	54,715.2	56,185.0	64,257.2	77,834.1	95,527.5
Pre-provisioning profit	40,410.9	59,848.1	71,581.7	93,229.9	116,755.9
Provisions	9,173.7	8,367.4	9,399.5	18,395.2	21,310.2
Profit before tax (PBT)	31,237.2	51,480.7	62,182.2	74,834.7	95,445.7
Tax expense	10,339.4	17,365.7	21,339.2	25,681.2	32,754.3
Adjusted PAT	20,897.8	34,115.0	40,843.0	49,153.5	62,691.4

Balance Sheet (INR Mn)	FY16	FY17	FY18	FY19E	FY20E
Capital	9,171.9	9,204.5	9,528.2	9,530.7	9,530.7
Reserves & Surplus	230,418.7	266,956.2	365,288.3	414,441.8	477,133.2
Shareholder's Fund	239,590.6	276,160.7	374,816.6	423,972.5	486,663.9
Deposits	1,386,430.2	1,574,258.6	1,926,432.7	2,263,226.5	2,806,400.8
Borrowings	209,753.4	210,954.8	251,541.5	399,392.9	495,247.2
Other Liabilities	86,789.6	84,506.8	96,521.5	141,150.7	195,762.3
Cash & Balances with RBI	108,797.2	225,720.1	196,201.1	155,199.3	192,447.1
Investments	512,602.2	450,741.9	645,623.5	844,284.1	1,046,912.3
Advances	1,186,653.0	1,360,821.3	1,697,179.2	2,104,502.3	2,609,582.8
Fixed Assets	15,515.9	15,376.3	15,271.6	15,436.6	15,711.7
Other Assets	99,029.7	93,240.0	95,058.6	108,341.9	119,442.0
Total Assets	1,922,597.9	2,145,899.6	2,649,334.0	3,227,764.2	3,984,095.9

RATIOS	FY16	FY17	FY18	FY19E	FY20E
Growth rates					
Advances (%)	79.4%	14.7%	24.7%	24.0%	24.0%
Deposits (%)	85.2%	13.5%	22.4%	17.5%	24.0%
Total assets (%)	81.4%	11.6%	23.5%	21.8%	23.4%
NII (%)	63.4%	17.8%	17.3%	26.8%	24.2%
Pre-provisioning profit (%)	34.8%	48.1%	19.6%	30.2%	25.2%
PAT (%)	12.0%	63.2%	19.7%	20.3%	27.5%
Balance sheet ratios					
Credit/Deposit (%)	85.6%	86.4%	88.1%	93.0%	93.0%
CASA (%)	38.1%	44.0%	50.8%	50.8%	50.8%
Advances/Total assets (%)	61.7%	63.4%	64.1%	65.2%	65.5%
Leverage (x)	7.8x	7.9x	7.4x	7.4x	7.9x
Operating efficiency					
Cost/income (%)	57.5%	48.4%	47.3%	45.5%	45.0%
Opex/total assets (%)	2.8%	2.6%	2.4%	2.4%	2.4%
Opex/total interest earning assets (%)	3.0%	2.8%	2.5%	2.5%	2.5%
Profitability					
NIM (%)	4.9%	4.2%	4.2%	4.3%	4.3%
RoAA (%)	1.4%	1.7%	1.7%	1.7%	1.7%
RoAE (%)	11.0%	13.2%	12.5%	12.3%	13.8%
Asset quality					
Gross NPA (%)	2.4%	2.6%	2.2%	1.9%	1.7%
Net NPA (%)	1.1%	1.3%	1.0%	0.8%	0.7%
PCR (%)	55.5%	52.0%	56.5%	58.0%	58.0%
Slippage (%)	2.4%	0.6%	0.2%	0.2%	0.2%
Per share data					
EPS (Rs.)	11.4	18.5	21.4	25.8	32.9
BV (Rs.)	130.6	150.0	196.7	222.4	255.3
ABV (Rs.)	123.7	140.7	187.9	213.3	245.4

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Details of Disciplinary History of NSPL	No disciplinary action is / was running / initiated against NSPL
Research analyst or NSPL or its relatives'/associates' financial interest in the subject company and nature of such financial interest	No (except to the extent of shares held by Research analyst or NSPL or its relatives'/associates')
Whether Research analyst or NSPL or its relatives'/associates' is holding the securities of the subject company	NO
Research analyst or NSPL or its relatives'/associates' actual/beneficial ownership of 1% or more in securities of the subject company, at the end of the month immediately preceding the date of publication of the document	NO
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Has research analyst or NSPL engaged in market making activity for the subject company	NO
Other disclosures	NO

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