

October 25, 2018

Kotak Mahindra Bank

Q2FY19 Result Update

Strong growth in deposits driven by both CASA and Term deposits

Deposits grew 8% QoQ to 2.06 trillion. CASA improved by 8% QoQ to 1.03 trillion while term deposits rose 9% QoQ to 1.02 trillion. CASA ratio came at 50.2% v/s 50.3% in previous quarter.

Moderate growth in advances backed by home loans

Advances grew 5% QoQ to 1.85 trillion. Within advances, growth came from home loans (+6% QoQ), Credit cards & small business (+11% QoQ), agricultural loans (+6% QoQ). Overall, retail book grew 7% QoQ while corporate book registered moderate growth of 3% QoQ.

Cash for liquidity

With regards to liquidity management, Bank increased cash and equivalent balance by 91% QoQ. While investments registered drop of 4% QoQ.

NIM under pressure; rising cost; reduced advance to deposit ratio

NIM came at 4.2% v/s 4.3% in previous quarter. Cost of funds rose from 5.25% to 5.41%, while yield on advances rose from 9.6% to 9.9%. Advance to deposit ratio came at 90% v/s 93% in previous quarter.

Operational efficiency in line

Cost to income ratio came at 46.2% v/s 45.8%. Total operating income grew 4% QoQ while operating expense grew 5% QoQ due to 6% QoQ growth in other operating expenses.

Normalizing credit cost

Provisions shrank 25% QoQ resulting in credit cost of 0.51% v/s 0.72% in previous quarter. GNPA came at 2.17%, NNPA came at 0.81%.

Valuations

PAT grew 15% YoY & 11% QoQ to 11417 mn. This improved ROAA% to 1.63% from 1.53% in Q1FY19 and ROAE% to 11.61% from 10.79% in Q1FY19. We value bank at FY20E P/ABV of 4.8x and subsidiary at INR 220 per share, arriving at a target price of 1371, implying an upside potential of 17%.

| (INR Millions) (Standalone) | FY16 | FY17 | FY18 | FY19E | FY20E |
|-----------------------------|------------|------------|------------|------------|------------|
| Net interest income | 69004 | 81261 | 95317 | 108673 | 130842 |
| Growth% | 63% | 18% | 17% | 14% | 20% |
| Pre-provisioning profit | 40411 | 59848 | 71582 | 84980 | 102752 |
| Growth% | 35% | 48% | 20% | 19% | 21% |
| Adjusted PAT | 20898 | 34115 | 40843 | 43570 | 52985 |
| Growth% | 12% | 63% | 20% | 7% | 22% |
| EPS (INR) | 11.4 | 18.5 | 21.4 | 22.8 | 27.8 |
| BVPS (INR) | 130.6 | 150.0 | 196.7 | 222.0 | 249.8 |
| ABVPS (INR) | 123.7 | 140.7 | 187.9 | 212.9 | 239.9 |

Source: Company, NSPL Research

* Read last page for disclaimer & rating rationale

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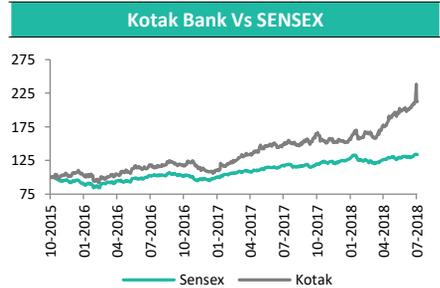
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Strong Buy*



| Market Data | |
|--------------------------|-----------|
| Industry | BFSI |
| Sensex | 34033 |
| Nifty | 10224 |
| Bloomberg Code | KMB:IN |
| Eq. Cap. (INR Million) | 14,535 |
| Face Value (INR) | 5 |
| 52-w L/H | 982/1,417 |
| Market Cap (INR Million) | 2,244,544 |

| Valuation Data | FY18A | FY19E | FY20E |
|----------------|-------|-------|-------|
| NIM | 4.2% | 3.9% | 3.9% |
| Book value | 196.7 | 222.0 | 249.8 |
| Adj BV | 187.9 | 212.9 | 239.9 |
| ROAA | 1.7% | 1.5% | 1.5% |
| ROAE | 12.5% | 10.9% | 11.8% |



| Shareholding Pattern | | | |
|----------------------|------------|------------|------------|
| | Sept'18 | Jun'18 | Sept'17 |
| Promoters | 30.0 | 30.0 | 30.1 |
| FII's | 39.4 | 39.9 | 39.9 |
| MF | 6.9 | 6.9 | 6.6 |
| Retail | 9.8 | 9.5 | 10.1 |
| Others | 13.9 | 13.7 | 13.4 |
| | 100 | 100 | 100 |



Q2FY19 Result Analysis

| (INR Millions) (Standalone) | Q2FY19 | Q2FY18 | Q1FY19 | Y-o-Y | Q-o-Q |
|------------------------------------|---------------|---------------|---------------|------------|------------|
| Interest on Advances/Bills | 44,592 | 35,595 | 41,682 | 25% | 7% |
| Interest on Investment | 11,968 | 9,734 | 11,419 | 23% | 5% |
| Interest on bal. with RBI & Others | 800.2 | 1,491 | 925 | -46% | -13% |
| Other Interest | 749.1 | 781.8 | 772 | -4% | -3% |
| INTEREST EARNED | 58,109 | 47,601 | 54,797 | 22% | 6% |
| Net-Interest Income (NII) | 26,891 | 23,127 | 25,829 | 16% | 4% |
| Other Income | 26,891 | 23,127 | 25,829 | 16% | 4% |
| Total Income | 53,782 | 46,253 | 51,658 | 16% | 4% |
| Operating Expenses | 17,994 | 15,417 | 17,150 | 17% | 5% |
| Pre-Provisional Profits | 20,950 | 17,248 | 20,325 | 21% | 3% |
| Provisions & Contingencies | 3,538 | 2,165 | 4,696 | 63% | -25% |
| PBT | 17,412 | 15,083 | 15,629 | 15% | 11% |
| Provision for Taxes | 5,995 | 5,140 | 5,380 | 17% | 11% |
| Adjusted Net Profit | 11,417 | 9,943 | 10,249 | 15% | 11% |

Source: Company, NSPL Research

- Bank's total operating income grew 16% YoY from 46253 mn in Q2FY18 & 4% QoQ from 51658 mn in Q1FY19 to 53782 mn in this quarter on back of 22% YoY growth in interest income propelled by 21% YoY growth in advances.
- Bank's Net Interest Income grew 16% YoY from 23127 mn in Q2FY18 & 4% QoQ from 25829 mn in Q1FY19 to 26891 mn in this quarter. Yield on advances expanded from 9.7% in Q2FY18 to 9.9% in Q2FY19 but its impact was offset by increase in cost of funds from 5.22% in Q2FY18 to 5.41% in Q2FY19.
- Bank's quarterly cost to income ratio contracted by 100bps YoY to 46.2%.
- Bank's quarterly pre-provisioning profit grew 21% YoY from 17248 mn in Q2FY18 & 3% QoQ from 20325 mn in Q1FY19 to 20950 mn in this quarter.
- Bank's net profits came at 11471 mn (+15% YoY, +11% QoQ) in this quarter.
- Gross NPA ratio came at 2.15% (v/s 2.47% in Q2FY18) and NNPA came at 0.81% (v/s 0.86% in Q2FY18). Provision coverage ratio was 62.8% (v/s 49.7% in Q2FY18).

| (INR Millions) | Q2FY19 | Q2FY18 | Q1FY19 | Y-o-Y | Q-o-Q | Comment |
|----------------|-----------|-----------|-----------|-------|-------|--|
| Deposits | 2,058,298 | 1,656,709 | 1,897,440 | 24% | 8% | CASA came at 50.2% (v/s 50.3% QoQ, 47.8% YoY) |
| Borrowings | 325,835 | 259,229 | 334,940 | 26% | -3% | |
| Investments | 679,150 | 527,965 | 710,250 | 29% | -4% | |
| Advances | 1,849,403 | 1,525,741 | 1,769,270 | 21% | 5% | Growth driven by Small business (+11% QoQ), home loans (+6% QoQ), agri loans (+6% QoQ) |
| Total Assets | 2,888,361 | 2,369,695 | 2,714,890 | 22% | 6% | |

Source: Company, NSPL Research



Conference Call Highlights

1. SMA 2 book came at 165cr (0.09% of advances – among lowest in industry)
2. Management highlighted comfortable growth of credit to be around 20%, taking into consideration robust risk management policies.
3. Pricing power to improve by sept end
4. Net interest margin came under pressure due to a) lead lag effect and b) increase in leverage.
5. Bank witnessing slow down in car loan, consumer durable loan segments. Management expects it to remain weak.
6. Bank is better placed than peer due to a) adequately liquidity, b) pricing power and , c)ability to pick & choose portfolios
7. Long term funding consists of interest rate risk and liquidity risk.
8. Bank has consciously tried to reduce growth in auto loan segment, because of reduction in margins.
9. Bank to open to buy out portfolio, including housing portfolios.
10. CASA and term deposits below 5cr constitute 79% of total deposits
11. Term deposits below 1cr were 49743cr
12. Bank had 1425 branches by end of this quarter
13. During the quarter, rise in operating expenses were primarily function of marketing cost (re-launch of 811 starring Ranvir Singh)
14. Total provisions for investment came at 130cr v/s 200cr in previous quarter
15. SME industry still continues to be under stress
16. Within real estate financing industry, majority of stress came from financing of land and significant stress came from residential project financing. This has led to abandoning of projects by developers because projects are no longer viable.

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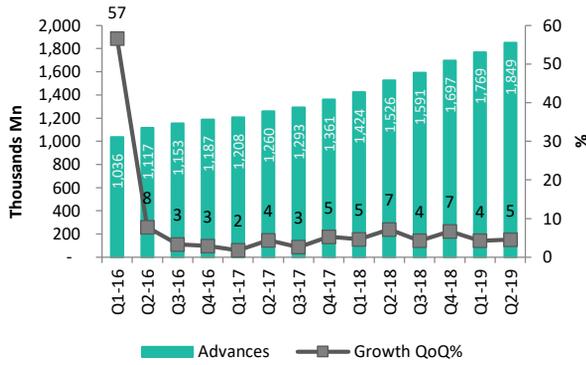
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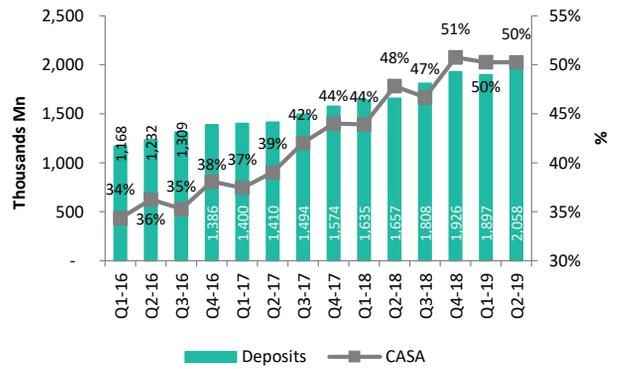
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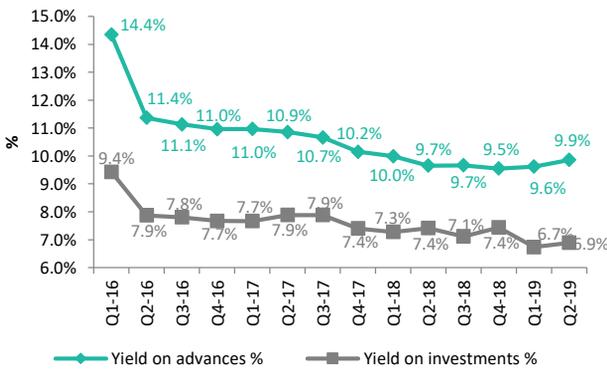
Advances Profile



Deposits Profile



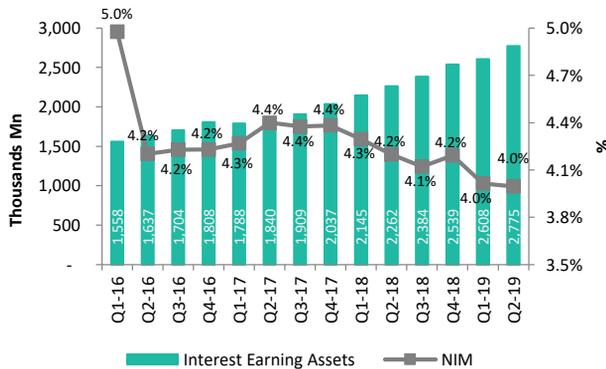
Yield Profile



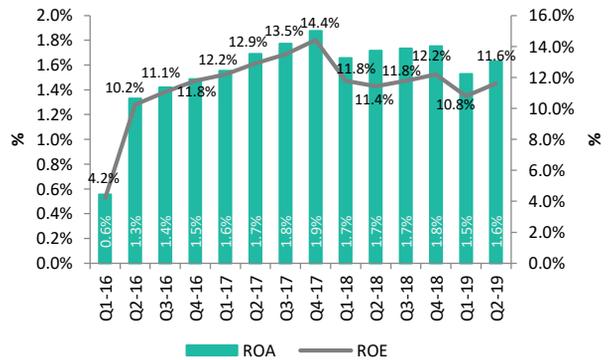
Interest Bearing Liabilities



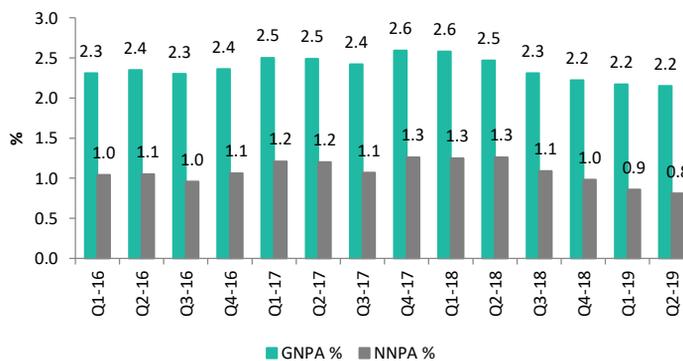
Interest Earning Assets



Return Ratios



Asset Quality



Source: Company, NSPL Research

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| P&L (INR Millions) (Standalone) | FY16 | FY17 | FY18 | FY19E | FY20E |
|---------------------------------|---------------|----------------|----------------|----------------|----------------|
| Interest earned | 163,842 | 176,989 | 197,485 | 240,018 | 295,230 |
| Interest expended | 94,838 | 95,728 | 102,168 | 131,345 | 164,388 |
| Net interest income | 69,004 | 81,261 | 95,317 | 108,673 | 130,842 |
| Non-interest income | 26,122 | 34,772 | 40,522 | 49,577 | 60,148 |
| Total income | 95,126 | 116,033 | 135,839 | 158,250 | 190,989 |
| Operating expenses | 54,715 | 56,185 | 64,257 | 73,270 | 88,237 |
| Pre-provisioning profit | 40,411 | 59,848 | 71,582 | 84,980 | 102,752 |
| Provisions | 9,174 | 8,367 | 9,400 | 18,646 | 22,085 |
| Profit before tax (PBT) | 31,237 | 51,481 | 62,182 | 66,334 | 80,667 |
| Tax expense | 10,339 | 17,366 | 21,339 | 22,764 | 27,683 |
| Adjusted PAT | 20,898 | 34,115 | 40,843 | 43,570 | 52,985 |

| Balance Sheet (INR Millions) (Standalone) | FY16 | FY17 | FY18 | FY19E | FY20E |
|---|------------------|------------------|------------------|------------------|------------------|
| Capital | 9,172 | 9,204 | 9,528 | 9,531 | 9,531 |
| Reserves & Surplus | 230,419 | 266,956 | 365,288 | 408,858 | 461,843 |
| Shareholder's Fund | 239,591 | 276,161 | 374,817 | 418,389 | 471,374 |
| Deposits | 1,386,430 | 1,574,259 | 1,926,433 | 2,208,471 | 2,694,335 |
| Borrowings | 209,753 | 210,955 | 251,542 | 389,730 | 475,471 |
| Other Liabilities | 86,790 | 84,507 | 96,521 | 133,061 | 183,801 |
| Cash & Balances with RBI | 108,797 | 225,720 | 196,201 | 151,444 | 184,762 |
| Investments | 512,602 | 450,742 | 645,624 | 823,858 | 1,005,107 |
| Advances | 1,186,653 | 1,360,821 | 1,697,179 | 2,053,587 | 2,505,376 |
| Fixed Assets | 15,516 | 15,376 | 15,272 | 15,437 | 15,712 |
| Other Assets | 99,030 | 93,240 | 95,059 | 105,347 | 114,045 |
| Total Assets | 1,922,598 | 2,145,900 | 2,649,334 | 3,149,673 | 3,825,002 |

| RATIOS | FY16 | FY17 | FY18 | FY19E | FY20E |
|--|-------|-------|-------|-------|-------|
| Growth rates | | | | | |
| Advances (%) | 79.4% | 14.7% | 24.7% | 21.0% | 22.0% |
| Deposits (%) | 85.2% | 13.5% | 22.4% | 14.6% | 22.0% |
| Total assets (%) | 81.4% | 11.6% | 23.5% | 18.9% | 21.4% |
| NII (%) | 63.4% | 17.8% | 17.3% | 14.0% | 20.4% |
| Pre-provisioning profit (%) | 34.8% | 48.1% | 19.6% | 18.7% | 20.9% |
| PAT (%) | 12.0% | 63.2% | 19.7% | 6.7% | 21.6% |
| 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) | 7.8 | 7.9 | 7.4 | 7.3 | 7.8 |
| Operating efficiency | | | | | |
| Cost/income (%) | 57.5% | 48.4% | 47.3% | 46.3% | 46.2% |
| Opex/total assets (%) | 2.8% | 2.6% | 2.4% | 2.3% | 2.3% |
| Opex/total interest earning assets (%) | 3.0% | 2.8% | 2.5% | 2.4% | 2.4% |
| Profitability | | | | | |
| NIM (%) | 4.9% | 4.2% | 4.2% | 3.9% | 3.9% |
| RoAA (%) | 1.4% | 1.7% | 1.7% | 1.5% | 1.5% |
| RoAE (%) | 11.0% | 13.2% | 12.5% | 10.9% | 11.8% |
| Asset quality | | | | | |
| Gross NPA (%) | 2.4% | 2.6% | 2.2% | 2.0% | 1.8% |
| Net NPA (%) | 1.1% | 1.3% | 1.0% | 0.8% | 0.8% |
| 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 / Valuation | | | | | |
| EPS (Rs.) | 11.4 | 18.5 | 21.4 | 22.8 | 27.8 |
| BV (Rs.) | 130.6 | 150.0 | 196.7 | 222.0 | 249.8 |
| ABV (Rs.) | 123.7 | 140.7 | 187.9 | 212.9 | 239.9 |
| P/BV (x) | 5.2 | 5.8 | 6.8 | 5.3 | 4.7 |
| P/ABV (x) | 5.5 | 6.2 | 7.2 | 5.5 | 4.9 |

Source: Company, NSPL Research

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| Kotak Mahindra Bank | | | | Rating Legend | |
|---------------------|-----------|--------------------|----------------|---------------|---------------|
| Date | CMP (INR) | Target Price (INR) | Recommendation | Strong Buy | More than 15% |
| October 25, 2018 | 1177 | 1371 | Strong Buy | Buy | 5% - 15% |
| July 19, 2018 | 1347 | 1423 | Buy | Hold | 0 - 5% |
| | | | | Reduce | -5% - 0 |
| | | | | Sell | Less than -5% |

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|--|---|
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| Details of Disciplinary History of NSPL | No disciplinary action is / was running / initiated against NSPL |
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| Other disclosures | NO |

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