

18 November 2019

Kotak Mahindra Bank – BUY

CMP :Rs.1,626.0
Target Price :Rs.1,947.0
Upside : 20%+
Stop Loss :Rs.1,420.0 (closing basis)

Investment Thesis

Recently stock price of Kotak Mahindra Bank Ltd. (Kotak Bank) corrected by ~4% from Rs.1,684.00 despite reporting good set of numbers in the recent quarters.

Kotak Bank has presence across all financial verticals, namely banking, securities, investment banking, asset management, consumer finance and life insurance. It has a diversified product offering and has an experienced management. Kotak Bank, post receiving a licence in 2002, has been witnessing continued improvement in business growth and asset quality. Post merger of ING Vysya Bank, Kotak Bank's loan book was at Rs.1,186.65bn with alteration in composition of loan portfolio, retail advances proportion declining to ~41% from 50%. With the integration process complete, the bank is stepping up on growth with credit offtake inching up to 21.2% in FY19. In the past seven years, credit and deposit of Kotak Bank have grown at higher than industry averages to Rs.2,133bn and Rs.2,331bn, respectively, by Q2FY20. Going ahead, growth momentum is expected to continue, led by retail and CV segments.

Kotak Bank has best NIM in the industry at 4.2-4.5% led by high yielding retail loans and corporate loans. Its NII has grown from Rs.18,580mn in FY10 to Rs.112,590mn in FY19 led by strong credit and savings deposit growth. Post merger, NIM has declined to ~4.2% in Q1FY16, owing to a decline in proportion of high yield retail credit and higher interest outgo on saving account of ING Vysya Bank. Kotak Bank's margin trajectory continued to improve during Q2FY17-Q1FY18, led by higher accretion of low cost deposit. However, with higher exposure to better rated corporate and reversal in agri-loans, NIM declined at 4.2% in Q2FY19. With focus on retail lending, better rated corporate lending and unfolding of integration benefits, we expect NIM to remain ~4.2-4.5% in FY20-21E.

Financials

- During the past 5 years, Interest Income of Kotak Bank has grown at CAGR of 22.3% while PAT grown at CAGR of 26.5% in the same period.

Standal. (Rs. Mn)	FY17	FY18	FY19	FY20E	FY21E
Interest Income	176,989	197,485	239,432	275,347	316,649
NII	81,261	95,317	112,590	129,478	148,900
% growth	17.8	17.3	18.1	15.0	15.0
PAT	34,115	40,843	48,653	55,951	64,344
ABV (INR)	147.1	193.7	218.9	238.3	259.6
P/ABV (x)	11.0	8.4	7.4	6.8	6.3
RoE (%)	12.4%	10.9%	11.5%	12.1%	12.8%

- Kotak Bank has reported 24.6% YoY growth in NII to Rs.33,496mn in Q2FY20 led by healthy 15.3% YoY growth in credit offtake and surge of 40bps YoY in NIM at 4.61%.

Stock Data

Market Cap (Rs. Mn)	31,00,127
Market Cap (\$ Mn)	43,725.3
Shares O/S (in Mn)	1,908.7
Avg. Volume (3 month)	2,873,000
52-Week Range (Rs.)	1,684 / 1,098

Shareholding Pattern

Promoters	29.97%
FII's	40.15%
Institutions	12.26%
Others (incl. body corporate)	17.62%

Performance (%)	1M	6M	1Yr
Absolute	0.4%	16.3%	39.6%
BSE Bankex	8.9%	10.0%	19.0%

Key Ratios

Div Yield	0.1%
TTM PE	53.6x
ROE	12.0%
TTM EPS (Rs.)	30.3/-

- Advances growth of Kotak Bank moderated to 15.3% YoY as ongoing slowdown in the economy impacted credit growth especially in small business and CV. Deposit growth was at 13.2% YoY to Rs.2,331bn with CASA ratio improved by 290bps QoQ to 53.6%.
- Kotak Bank's NIM improved by 41bps YoY to 4.61 in Q2FY20 led by change in asset mix coupled with steady growth in CASA.
- Asset quality remained stable with 13bps QoQ increase in GNPA ratio to 2.32% at Rs.50.34bn and NNPA increased by 12bps QoQ to 0.85% at Rs.18.11bn.

Key Business Highlights

- Kotak Bank is a private sector bank engaged in business of retail banking, corporate/wholesale banking, vehicle financing, etc.
- Kotak Bank is the 4th largest private bank in India by market capitalization with a network of 1,503 branches across ~700 locations and 2,394 ATMs in the country.
- Kotak Bank offers a wide range of banking products and financial services for corporate and retail customers through a variety of delivery channels and specialized subsidiaries in the areas of personal finance, investment banking, general insurance, life insurance, and wealth management.

Valuation

- Kotak Bank's asset quality has been one of the most stable with NNPA ratio of less than 1% and negligible restructured assets, which depicts the strong operational business model of the bank. With the integration of ING Vysya Bank, GNPA surged to 2.3% in Q1FY16 owing to incremental addition of stressed assets. Kotak Bank has identified total stress to the tune of 6% in erstwhile ING Vysya Bank's book, which constitutes 2.5% of the merged entity. With majority of asset quality problems from ING being recognized, we expect NPA growth of Kotak Bank to moderate going ahead. With balance sheet growth coupled with steady slippages, GNPA and NNPA ratios are expected to stabilize at 2% and 0.9%, respectively, in FY20-21E. Going ahead, we expect credit cost to remain steady at ~50 bps in FY20-21E.
- Branches build-up gradually enabled Kotak Bank to maintain healthy margins of >4.5% since FY08 despite a challenging environment. In the past two or three years, due to higher focus on savings deposits and demonetization, low cost deposits have witnessed a robust built up with CASA ratio of 50.7% in Q1FY20. The combined branch network post merger is at 1,503 as of June 2019. Going ahead, it is poised to pedal credit growth focusing on retail, better rated corporate. We expect credit and deposit growth to be remain over 20% CAGR in FY19-21E.
- With presence across all financial verticals, credit offtake inching up to 21%, best NIM in the industry led by high yielding retail loans, one of the most stable asset quality, credit cost to remain steady at ~50 bps, strong CASA deposits growth and branches are expected to deliver a strong performance, we value Kotak Bank at 7.5x FY21E ABV of Rs.259.60 to arrive at target price of Rs.1,947.00, an upside of ~20%.

Risk & Concern

- Slower than expected economic growth may lead to deterioration in asset quality and earnings growth of Kotak Bank.
- Post RBI's license for new banks and NBFCs venturing into lending sectors into tier-II and tier-III cities may poses a risk to the Kotak Bank's growth momentum going ahead.
- Any change in key personnel may alter Kotak Bank's growth strategy and impact earnings growth.

Graphs & Charts

Figure 1: Interest Income Trend

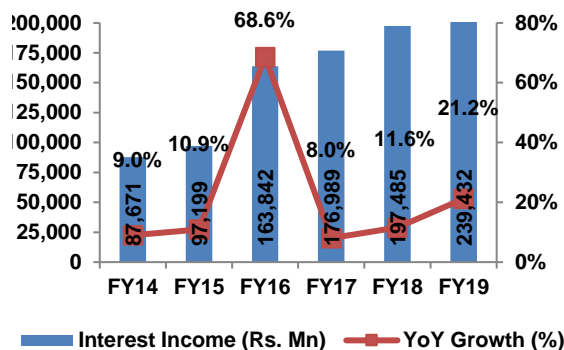


Figure 2: Net Interest Income Trend

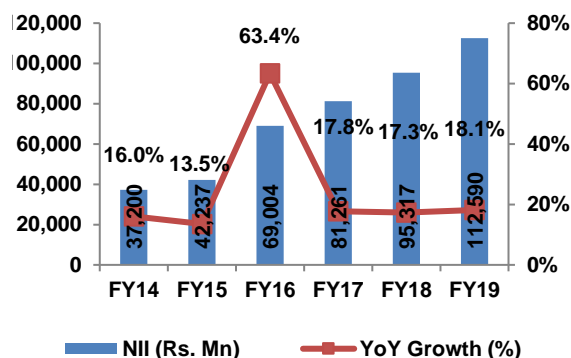


Figure 3: PAT Trend

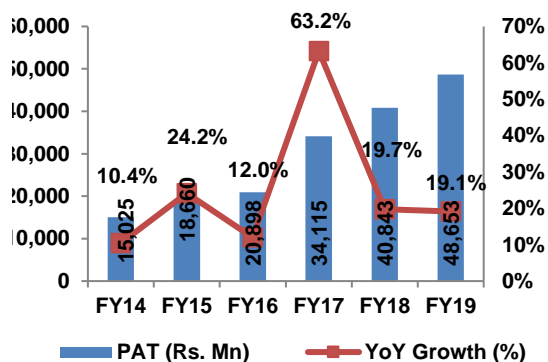
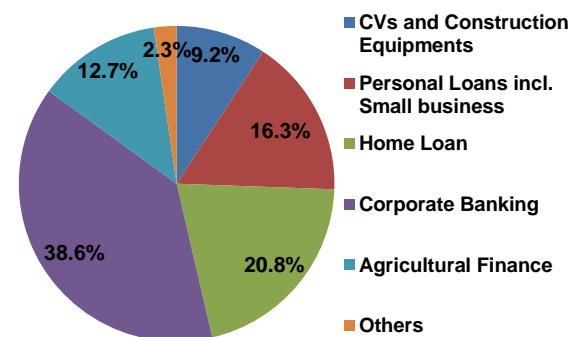


Figure 4: Loan Book Break-up (Q2FY20)



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Disclosure:

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