Kotak Mahindra Bank (KOTMAH)

ICICI direct Research

CMP: ₹ 1769 | Target: ₹ 1810 (2%) | Target Period: 12 months | HOLD

October 27, 2024

Result Update

Slippages impact PAT; lifting of ban remains crucial

About the stock: Kotak Mahindra Bank is one of the leading private sector banks in India providing a wide array of banking and financial services, boasting around ₹ 5,10,598 crore in customer assets.

- It spans over 2013 branches and 3329 ATMs
- Consistent in delivering superior ROA of 2+% and ROE of 13+%

Q2FY25 performance: Kotak Mahindra Bank reported weak performance in Q2FY25, owing to full impact of embargo impacting margins amid change in asset mix. NII growth came at 11.5% YoY driven by 14.7% YoY (3.1% QoQ) rise in advances to ₹3,99,522 crore, aided by SME (31% YoY) and consumer (18% YoY) loans. NIM declined by 11 bps QoQ to 4.91% due to a shift towards secured assets and increased cost of funds. Higher provisions impacted PAT which came at ₹ 3,344 crore, up 4.8% YoY. Credit cost surged 10 bps QoQ to 0.65%, as GNPA rose 10 bps QoQ to 1.49% and NNPA increased 8 bps QoQ to 0.43%, amid stress in retail micro credit. Deposit accretion came at 15.1% YoY (3.1% QoQ) to ₹4,61,454 crore, driven by 26% YoY term deposit gains & CASA ratio at an industry-leading 43.6%.

Investment Rationale

- Slippages from unsecured book remains a spoiler: Increased slippages, particularly from delinquencies in credit card segment (contributing to 30-40% of slippages) has led to higher credit cost thus impacting earnings. Management anticipates strain to pan out over next 2-3 quarters, expect credit costs, currently at 0.65%, to continue to remain in similar range for FY25E. PCR declined 400 bps QoQ to 71% with management comfortable in maintaining PCR of 70% on average without any contingent buffer. Expect credit to remain higher at 65-75 bps in FY25-26E.
- Decline in unsecured book, amid embargo, remain headwind for margins: Advances growth moderated at 14.7% YoY, backed by SME (31% YoY) and consumer (18% YoY), while commercial segment saw muted growth & corporate book de-grew 1% sequentially. RBI tech embargo continues to loom large as share of retail microcredit dipped further 30 bps QoQ to 11.3% of net advances. Liabilities accretion came at 15.1% YoY (3.1% QoQ) led by term deposits (26% YoY), though CoF seems to be largely stable. Higher liquidity, change in asset mix and liabilities accretion through term deposits remains headwinds for margins trajectory. Acquisition of SCB unsecured book and 50 bps cut in SA rates (for balance under ₹5 lakhs) to provide marginal support to margins amid slower unsecured credit growth. Expect credit growth at 16.2% CAGR in FY24-27E; lifting of ban remains major catalyst aiding growth and margins.

Rating and Target Price

- Focus on building sustainable growth franchise remains intact, though RBI's embargo on issuance of credit cards, delinquencies from unsecured retail bucket and anticipated volatility in margins remain as challenge.
- Rolling on to FY27E, we value standalone bank at 1.75x FY27E BV and assign ₹574 for subsidiaries, thus broadly maintaining target price at ₹1810 per share and Hold rating.

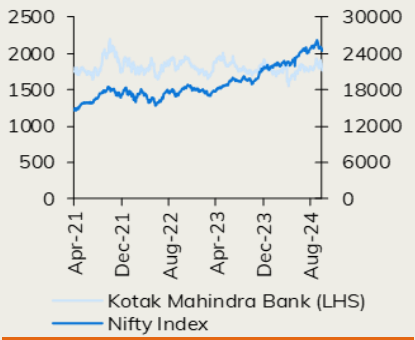
Particulars

Particulars	Amount
Market Capitalisation	₹ 3,51,676 crore
52 week H/L	1,953 / 1,544
Net worth	₹ 1,29,972 crore
Face value	₹ 5

Shareholding pattern

(in %)	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
Promoter	25.9	25.9	25.9	25.9	25.9
FII	41.0	39.7	37.6	33.2	33.4
DII	20.0	21.4	23.4	27.7	27.9
Others	13.1	13.0	13.1	13.3	12.8

Price Chart



Key risks

(i) Efforts undertaken lead to uptick in margins

(ii) Deterioration in quality of unsecured pool

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Key Financial Summary

₹ crore	FY21	FY22	FY23	FY24	3 year CAGR (FY21-FY24)	FY25E	FY26E	FY27E	3 year CAGR (FY24-27E)
NII	15340	16818	21552	25993	19%	28721	32496	37082	13%
PPP	11762	12051	14848	19587	19%	20455	23251	26775	11%
PAT	6965	8573	10939	13782	26%	15726	14440	16848	7%
ABV	308	357	415	481		557	627	707	
P/E	50.3	40.9	32.0	25.4		22.3	24.3	20.8	
P/ABV	5.7	4.9	4.3	3.7		3.2	2.8	2.5	
RoA	1.9	2.1	2.4	2.5		2.4	2.0	2.0	
RoE	12.4	12.6	14.0	15.3		15.1	12.1	12.5	

Source: Company, ICICI Direct Research

ICICI Securities – Retail Equity Research

Concall highlights and outlook

- Kotak Mahindra Bank aims to become India's 3rd largest private bank by 2030, through mix of organic and in-organic means as opportunity arrives.
- Q2FY25 was the first quarter under the full impact of RBI embargo wherein the bank was barred from on-boarding customers digitally and issuance of new credit cards. This has led to lower growth and consequently pressure on NIM.
- Growth was restricted on the MFI side of the business due to visibility of stress with the management being cautious within this sector and anticipate this strain to continue for the next one or two quarters.
- The tech embargo had an effect on the unsecured retail business, particularly on the credit card business as lower disbursement in the microcredit business. Total share of retail unsecured asset businesses dipped 30 bps to 11.3%. Credit stress was witnessed in the credit card business due to overleveraging of certain kind of customers, contributing to 30-35% of slippages.
- Commercial vehicle industry saw a 10% degrowth in Q2, largely due to the goods segment, although the passenger segment continued to grow. Bank's market share rose marginally, but growth was relatively muted. This segment of CV saw disruptions in the last two quarters largely due to heat, rains and climatic risks. Tractor finance remained flat.
- The change in asset mix shifting towards secure assets resulted in reduction in yield on advances and consequently reduction in NIM for the quarter by about 11 bps to 4.91%. Nearly 60% of loans are linked to external benchmark.
- With the ongoing festival season, above-normal monsoon & anticipation of increased government spends as well as in rural infra, management, expects better H2 performance for sectors like CV and tractor finance.
- There was significant progress on the technology front, with beta launch of a new customer-facing mobile app to enhance customer experience.
- The bank's Capital Markets, Asset Management, and Insurance segments each grew over 50% year-on-year, showcasing strong performance across multiple business lines.
- Operating costs were stable at 2.2% with Q-o-Q growth with reduction in acquisition cost for 811 products but higher IT spent to meet the remedial measures relating to embargo.
- The bank is focussed on the affluent customer segments in terms of new acquisitions and in line with this tuck-in acquisition strategy, recently announced a deal to acquire Standard Chartered Bank's ₹4,100 personal loan book, providing opportunities for upselling and cross-selling to ~95,000 customers which would improve yield on advances by ~2bps.
- Bank has created new slab with 50 bps reduction in interest rates for balance under ₹5 lakhs, effective from 17 October 2024. Expected benefit on NIM of recently announced cut in savings accounts deposits (50bps) would be 4 bps.
- The management refrained from giving any timeline about RBI embargo status but stated that they are focused on systematically resolving any issues to address RBI's concerns.
- ₹1363 crore of post-tax treasury gains for the quarter has been directly accounted in reserves, without passing through P&L (as per revised RBI guidelines).
- Q1FY25 consists of dividend income of ₹380 crore.
- Bank has undertaken change in accounting policy for credit cards in March 2024 wherein 100% provision is made at 180 DPD, but write-off has been brought down from earlier 2 years to 270 days.

Exhibit 1: Variance Analysis

	Q2FY25	Q2FY24	YoY (%)	Q1FY25	QoQ (%)	Comments
NII	7,019.6	6,296.6	11.5	6,842.4	2.6	Credit off-take offset by decline in NIM
NIM (%)	4.91	5.22	-31 bps	5.02	-11 bps	Impacted by increased cost of funds & change in advance mix towards secured loans
Other Income	2,684.2	2,314.5	16.0	2,929.0	-8.4	Fee income growth at 14% YoY
Net Total Income	9,703.8	8,611.2	12.7	9,771.4	-0.7	
Staff cost	1,951.4	1,634.6	19.4	1,870.5	4.3	
Other Operating Expenses	2,653.2	2,366.5	12.1	2,646.8	0.2	Reduction in acquisition cost for digital accounts offset by higher IT spends
PPP	5,099.3	4,610.1	10.6	5,254.1	-2.9	
Provision	660.4	366.6	80.2	578.5	14.2	Stress build up seen in unsecured retail portfolio
PBT	4,438.9	4,243.6	4.6	4,675.6	-5.1	Higher provisions impacted earnings
Tax Outgo	1,095.1	1,052.6	4.0	1,156.0	-5.3	
Exceptional item	0.0	2,730.0	NA	0.0	NA	
PAT	3,343.7	3,191.0	4.8	3,519.6	-5.0	
Key Metrics						
GNPA	6,033.2	6,087.0	-0.9	5,477.2	10.2	Delinqencies in unsecured retail (credit card) segment
NNPA	1,723.8	1,275.0	35.2	1,376.3	25.2	
Advances	3,99,522	3,48,284	14.7	3,89,957	2.5	Growth in SME & secured consumer book aided advances growth
Deposits	4,61,454	4,00,963	15.1	4,47,418	3.1	Term deposit accretion at 26% YoY

Financial Summary

Exhibit 2: Profit and loss statement ₹ crore

(Year-end March)	FY22	FY23	FY24	FY25E	FY26E	FY27E
Interest Earned	27038.8	34250.9	45798.9	53728.1	61008.2	69827.9
Interest Expended	10220.9	12698.9	19805.7	25007.3	28512.3	32746.3
Net Interest Income	16817.9	21551.9	25993.2	28720.8	32495.8	37081.6
Growth (%)	9.6	28.1	20.6	10.5	13.1	14.1
Non Interest Income	6354.4	7083.1	10273.1	11532.1	13309.2	15416.7
Net Income	23172.3	28635.0	36266.3	40252.9	45805.0	52498.3
Operating expense	11121.4	13787.0	16678.8	19797.5	22553.9	25723.2
Gross profit	12050.9	14848.0	19587.5	20455.4	23251.1	26775.1
Provisions	689.6	457.0	1573.7	3011.6	3868.9	4159.8
Taxes	2788.6	3451.7	4232.1	4448.2	4942.5	5766.9
Exceptional item	0.0	0.0	0.0	2730.0	0.0	0.0
Net Profit	8572.7	10939.3	13781.6	15725.6	14439.8	16848.4
growth (%)	23.1	27.6	26.0	14.1	-8.2	16.7
EPS	43.3	55.2	69.5	79.3	72.9	85.0

Source: Company, ICICI Direct Research

Exhibit 3: Key ratios

(Year-end March)	FY22	FY23	FY24	FY25E	FY26E	FY27E
Valuation						
No. of Equity Shares	198.2	198.2	198.2	198.2	198.2	198.2
EPS (₹)	43.3	55.2	69.5	79.3	72.9	85.0
BV (₹)	365.6	421.1	487.6	565.4	636.8	720.1
ABV (₹)	356.8	415.1	481.2	556.5	627.0	706.6
P/E	40.9	32.0	25.4	22.3	24.3	20.8
P/BV	5.0	4.3	3.7	3.2	2.8	2.5
P/ABV	4.9	4.3	3.7	3.2	2.8	2.5
Yields & Margins (%)						
Yield on avg earning assets	7.3	7.9	8.9	8.9	8.7	8.7
Avg. cost on funds	3.2	3.5	4.6	4.8	4.8	4.8
Net Interest Margins	4.5	5.0	5.1	4.7	4.6	4.6
Avg. Cost of Deposits	3.1	3.5	4.5	4.9	4.9	4.9
Yield on average advances	7.8	9.1	10.2	10.1	10.0	10.0
Quality and Efficiency (%)						
Cost / Total net income	48.0	48.1	46.0	49.2	49.2	49.0
Credit/Deposit ratio	87.0	88.1	83.8	83.8	85.2	86.5
GNPA	2.4	1.8	1.4	1.6	1.8	1.9
NNPA	0.6	0.4	0.3	0.4	0.4	0.5
RoE	12.6	14.0	15.3	15.1	12.1	12.5
RoA	2.1	2.4	2.5	2.4	2.0	2.0

Source: Company, ICICI Direct Research

Exhibit 4: Balance sheet ₹ crore

(Year-end March)	FY22	FY23	FY24	FY25E	FY26E	FY27E
Sources of Funds						
Capital (incl PCNPS)	1492	1493	994	994	994	994
ESOPS	31	60	79	79	79	79
Reserves and Surplus	70964	81967	95646	111057	125208	141719
Networth	72488	83520	96719	112130	126281	142792
Deposits	311684	363096	448954	518314	595184	683773
Borrowings	25967	23416	28368	30774	33725	37286
Other Liabilities & Provision:	19289	19830	26316	29153	32320	35858
Total	429428	489862	600357	690371	787510	899709
Applications of Funds						
Fixed Assets	1644	1920	2155	2693	3232	3774
Investments	100580	121404	155404	169525	185719	204195
Advances	271254	319861	376075	434141	506845	591743
Other Assets	33027	14135	13934	16209	17587	18735
Cash with RBI & call money	55951	32542	52788	67803	74126	81263
Total	429428	489862	600357	690371	787510	899709

Source: Company, ICICI Direct Research

Exhibit 5: Growth ratios

(Year-end March)	FY22	FY23	FY24	FY25E	FY26E	FY27E
Total assets	12.0	14.1	22.6	15.0	14.1	14.2
Advances	21.3	17.9	17.6	15.4	16.7	16.8
Deposits	11.3	16.5	23.6	15.4	14.8	14.9
Total Income	13.9	23.6	26.7	11.0	13.8	14.6
Net interest income	9.6	28.1	20.6	10.5	13.1	14.1
Operating expenses	29.6	24.0	21.0	18.7	13.9	14.1
Operating profit	2.5	23.2	31.9	4.4	13.7	15.2
Net profit	23.1	27.6	26.0	14.1	-8.2	16.7
Book value	13.7	15.2	15.8	15.9	12.6	13.1
EPS	23.1	27.6	26.0	14.1	-8.2	16.7

Source: Company, ICICI Direct Research

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Reduce: -15% to -5%;

Sell: <-15%

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