

First Read

Kotak Mahindra Bank

Growth better than Q3; expect momentum to sustain

Q4 earnings inline– maintain Buy for high sustainable growth

Q4 earnings at Rs9.8bn (+40% YoY) were in line with UBS estimates, driven by better than expected PPOP and higher loan loss provisions. We believe Kotak Mahindra Bank (Kotak) offers one of the highest sustainable earnings growth rates over next five years (of the Indian banks under our coverage, given its 1) low NPL risk; 2) quality retail franchise; and 3) ability to consummate inorganic growth opportunities. We expect a 29% EPS CAGR over FY17-20, without factoring in any inorganic growth.

High PPOP growth offset by Corporate NPLs: subs healthy growth

Loan growth accelerated to 5.3% QoQ and 14.7% YoY driven by CE/CV and corporate loans whereas business banking and agriculture loans growth was weak. Growth in business banking segment accelerated during the quarter to 7.6% QoQ. CASA deposits ratio improved further by 200bp QoQ to 44%. Income in stressed assets loans and trading gains supported 47% YoY growth in non-interest income during Q4. Lending subsidiary (Prime) continue to report weaker growth due to intense competition whereas other NBFC (KM Investments- focused on real estate and capital markets) recorded a strong loan growth of 44% YoY. Broking and life insurance subs reported healthy profit growth of 44% YoY and 21% YoY in FY17 respectively.

Outlook – Management confident of sustaining growth momentum

Management is confident of sustaining the growth momentum gained in Q4 on loans and expect stable asset quality. New consumer loan products are planned to boost growth in Kotak Prime (its lending sub). The bank is gaining traction on digital channels as reflected in their improving share in mobile app downloads and mobile payments.

Valuation: Maintain Buy with a price target of Rs1050

We believe Kotak's premium valuation is justified given its high-quality management, strong earnings growth trajectory and low NPL risks on the balance sheet and hence maintain Buy. We derive our price target from a sum-of-the-parts valuation, assigning Rs820/share to the banking business (3.7x FY19E P/BV based on the residual-income model) and value of subsidiaries at Rs230 per share.

Equities

India

Banks, Ex-S&L

12-month rating

Buy

12m price target

Rs1,050.00

Price

Rs914.55

RIC: KTKM.BO BBG: KMB IB

Trading data and key metrics

52-wk range Rs914.55-694.90

Market cap. Rs1,670bn/US\$26.0bn

Shares o/s 1,826m (ORD)

Free float 63%

Avg. daily volume ('000) 2,832

Avg. daily value (m) Rs2,355.1

Common s/h equity (03/17E) Rs272bn

P/BV (03/17E) 6.2x

Tier 1 ratio 16%

EPS (UBS, diluted) (Rs)

	UBS	Cons.
03/17E	18.67	25.54
03/18E	23.79	31.16
03/19E	29.74	38.36

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Highlights (Rsm)	03/14	03/15	03/16	03/17E	03/18E	03/19E	03/20E	03/21E
Revenues	51,198	62,522	95,126	115,408	136,614	166,554	208,482	257,259
Profit before tax	22,725	28,330	31,237	51,497	67,841	84,799	113,829	147,162
Net earnings (local GAAP)	15,025	18,660	20,898	34,245	45,115	56,391	75,696	97,863
Net earnings (UBS)	15,025	18,660	20,898	34,245	45,115	56,391	75,696	97,863
Tier 1 ratio %	17.0	15.8	16.1	16.0	18.4	17.1	16.2	16.3
EPS (UBS, diluted) (Rs)	9.76	12.12	11.45	18.67	23.79	29.74	39.91	51.60
Profitability/valuation	03/14	03/15	03/16	03/17E	03/18E	03/19E	03/20E	03/21E
ROE (UBS) %	13.8	14.1	11.0	13.4	14.1	14.2	16.5	19.3
P/POP (diluted)	21.2	27.7	30.5	28.4	23.2	18.6	14.0	10.8
P/BV x	4.4	5.9	5.1	6.2	4.7	4.1	3.5	2.9
P/BV (UBS) x	4.4	5.9	5.1	6.2	4.7	4.1	3.5	2.9
P/E (UBS, diluted)	36.3	44.4	59.0	49.0	38.4	30.8	22.9	17.7
Net dividend yield %	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs914.55 on 27 Apr 2017 22:36 HKT

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Figure 1: Quarterly summary

Particulars (Rs mn)	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	QoQ
Interest Income	42,654	43,869	44,125	44,676	44,320	(0.8)
Interest Expenses	24,082	24,678	24,171	24,173	22,706	(6.1)
Net Interest Income	18,572	19,191	19,954	20,503	21,614	5.4
Y/y growth	65.4	20.1	18.9	16.1	16.4	
Other Income	6,819	7,332	8,311	9,102	10,027	10.2
- Fee income	6,100	5,640	6,300	7,250	7,570	4.4
Y/y growth	56.8	34.9	37.9	26.5	24.1	
Total Revenue	25,392	26,523	28,265	29,605	31,640	6.9
Operating Expenses	13,450	13,373	13,864	14,328	14,620	2.0
Y/y growth	44.5	(16.1)	10.9	11.7	8.7	
PPOP	11,942	13,150	14,401	15,277	17,020	11.4
Y/y growth	38.7	120.3	37.8	26.8	42.5	
Provision Expenses	2,004	1,795	1,978	1,921	2,674	39.2
PBT	9,937	11,355	12,423	13,356	14,346	7.4
Tax	2,980	3,936	4,290	4,558	4,582	
PAT	6,958	7,420	8,133	8,798	9,765	11.0

Source: Company data

Figure 2: NPL analysis

Particulars	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	QoQ
GNPL (Rs bn)	30.2	30.6	31.8	31.8	35.8	12.6
GNPL (%)	2.1	2.5	2.5	2.4	2.6	+20bp
NNPL (Rs bn)	13.5	14.7	15.2	13.8	17.2	24.6
NNPL (%)	0.9	1.2	1.2	1.1	1.3	+20bp
Provision coverage	55.1	52.0	52.3	56.6	52.0	-460bp

Source: Company data

Figure 3: Key parameters

Particulars	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	QoQ
Loans (Rs bn)	1,187	1,208	1,260	1,293	1,361	5.3
y/y growth	79.4	16.6	12.9	12.1	14.7	
Deposits (Rs bn)	1,386	1,400	1,410	1,494	1,574	5.4
y/y growth	85.2	19.9	14.5	14.1	13.5	
CASA ratio	38.1	37.4	39.0	42.0	44.0	+200bp
NIM (%)	4.4	4.4	4.5	4.5	4.6	+10bp
LLP as % of loans	0.6	0.6	0.5	0.4	0.8	+33bp
Cost to income ratio	53.0	50.4	49.1	48.4	46.2	+220bp

Source: Company data

Figure 4: Key Subsidiary performance

Particulars	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	QoQ
Kotak Prime	131	120	130	133	133	-
Kotak Securities	51.0	60.0	96.0	85.0	121.0	42.4
Kotak Mahindra Investments	50	40	53	48	56	16.7
Kotak Mahindra Old Mutual Life Insurance	77.0	71.0	63.0	68.0	101.0	48.5

Source: Company data

Forecast returns

Forecast price appreciation	+14.8%
Forecast dividend yield	0.1%
Forecast stock return	+14.9%
Market return assumption	11.7%
Forecast excess return	+3.2%

Valuation Method and Risk Statement

We base our price target on a sum-of-the-parts (SoTP) valuation wherein we value the lending business on the residual-income model.

We believe key risks include an economic slowdown, deviation from execution track record, delay in realising synergies from the merger with ING Vysya and risk from new entrants.

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Neutral	FSR is between -6% and 6% of the MRA.	38%	28%
Sell	FSR is > 6% below the MRA.	16%	18%
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Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2017.

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UBS Securities India Private Ltd: Vishal Goyal, CFA; Ishank Kumar, CFA.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Kotak Mahindra Bank⁷	KTKM.BO	Buy	N/A	Rs914.55	27 Apr 2017

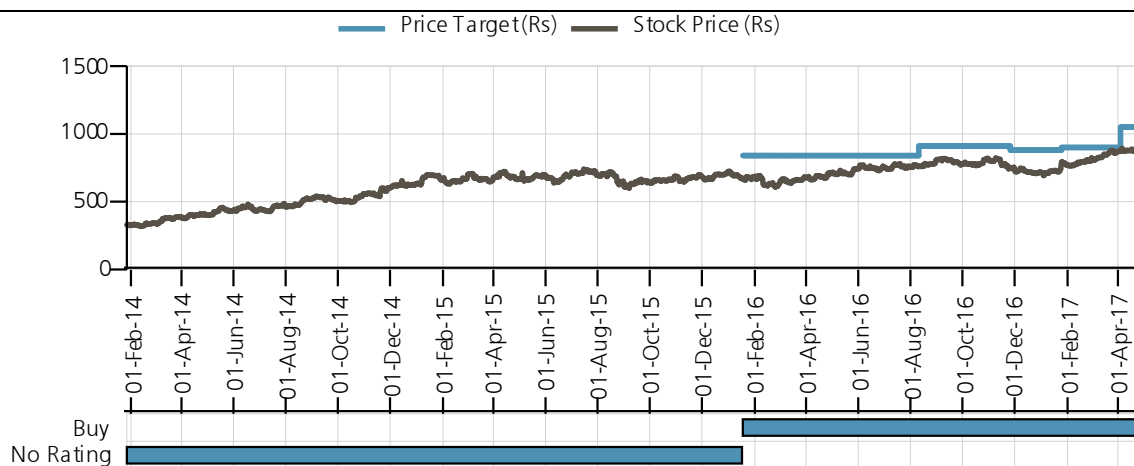
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Kotak Mahindra Bank (Rs)



Date	Stock Price (Rs)	Price Target (Rs)	Rating
2014-01-27	329.05	-	No Rating
2016-01-18	667.15	840.0	Buy
2016-08-11	764.05	910.0	Buy
2016-11-26	749.75	880.0	Buy
2017-01-25	794.65	900.0	Buy
2017-04-04	875.0	1050.0	Buy

Source: UBS; as of 27 Apr 2017

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