



## Kotak Mahindra Bank

**Date:** 20-06-2020

### OVERVIEW

**Recommendation:** Buy on dips for a target of Rs. 2020 per share by 2025

**Valuation** target valuation of ₹4,00,000crores

**Current Market Price:** ₹1340

**Time Horizon:** 5-6 years

### ECONOMIC MOAT

**Company History:** founded in 2003

**Company Management**

**MD & CEO:** Uday Kotak

**Chairmen:** Prakash Apte



## **About the company:**

Kotak Mahindra Bank is an Indian private sector bank headquartered in Mumbai, Maharashtra, India. It offers banking products and financial services for corporate and retail customers in the areas of personal finance, investment banking, life insurance, and wealth management. As of April 2019, it is the second largest Indian private sector bank by market capitalization, with 1600 branches & 2519 ATMs.

In 1985 Uday Kotak founded what later became an Indian financial services conglomerate. In February 2003, Kotak Mahindra Finance Ltd. (KMFL), the group's flagship company, received a banking license from the Reserve Bank of India (RBI). With this, KMFL became the first non-banking finance company in India to be converted into a bank: Kotak Mahindra Bank Limited.

In a study by Brand Finance Banking 500 published in February 2014 by Banker magazine (from The Financial Times stable), KMBL was ranked 245th among the world's top 500 banks with brand valuation of around half a billion dollars (\$481 million) and brand rating of AA+

### **Acquisition of ING Vysya Bank**

In 2015, Kotak Bank acquired ING Vysya Bank in a deal valued at ₹150 billion (US\$2.1 billion). With the merger, total employment jumped to almost 40,000, and the count of branches reached 1,261. After the merger, ING Group, which controlled ING Vysya Bank, owned a 7% share in Kotak Mahindra Bank



## Pros:

- Kotak Mahindra bank's 811 model enabled it to acquire 80 million users in just a time period of 18 years and helping it double its customer base
- Bank have maintained profit growth rate of 24% CAGR from the year 2015 and net interest income at a growth rate of 23% CAGR from 2015, which concludes increase in net efficiency.
- Bank has shown a correlation of more than 1 between net profit growth and share price return from last 5 years as CAGR of share price is 26% and that of net profit stands at 24%.
- Total assets observed a growth of 28% CAGR whereas net worth of the bank has growth at a CAGR of 27%.
- Advances and asset under management of the organization have grown at 29% CAGR.

## Cons:

- Kotak's price to book ratio at 4.79X being a private bank seems to much and we feel that other private banks are at 33% discount to this price to book ratio.
- The bank has delivered low return on equity growth for a five -year period ranging from 11% to 14% whereas its other parameters such as net interest, advances and assets have compounded at more than 20%
- Other income has fallen more than 40% in the last quarter of 2020.



## **COMPETITIVE MOAT OF KOTAK MAHINDRA BANK:**

- One of the best competitive advantage, we believe Kotak Mahindra bank have is its humble management and the transparency offered by them. The Uday kotak lead bank has always stand ahead in the way the management has vision for the banking sector as well as the Indian economy.
- The bank has successfully shown the more than equal level of correlation between its share price returns and its net profit growth since 2015. The share price return stands at 26% CAGR and the net profit grew at 24% CAGR during the same period of time.
- Another competitive moat we believe kotak Mahindra bank have is that I periodically come up with innovative strategies and banking business model which stands out for it among the Indian banking sector. Citing an example kotak Mahindra bank introduced its Dial 811 model and gained 80 million users in a time frame of just 18 months and point to especially notice in that is majority of the users are from Urban area
- It is being said that for any business “bottom line is what it matters at the end of the day” and taking that for kotak Mahindra bank the net profit has shown a compounded annual growth of 33% for the last decade.

We believe that kotak Mahindra bank will lead the Indian banking sector in the coming 4-5 years as it has the least Net NPA of 0.70% as on march 2020 and the growth in majority of the parameters is more than 22% annually considering like total assets, net worth, total advances and more.



## **TAKE ON KOTAK MAHINDRA BANK**

- We believe Kotak Mahindra Bank will emerge to the next heights in the years to come and will take full benefits from the growth of India INC and the digital banking space. Currently the bank is a bit overvalued in terms of book value to us but the other parameters are too great to compensate and convince an investor to buy at current price levels. As soon as the Indian economy recovers from the corona effect, banking sector will be the first to show the boom and banks like HDFC Bank and Kotak Mahindra Bank will enjoy that demand utilizing their in-depth reach among rural as well as urban areas.
- Currently the bank is growing its net profit at 26% CAGR from the year 2015, its dial 811 model to acquire customers was a huge success and it nearly doubled its customer base in a period of 18 months. The bank possesses a 52.5% CASA ratio and has well diverse insurance business whose embedded value stands at 7300 crore rupees. The asset under management for the organization grew at a CAGR of 24% from 2015
- Taking the valuation into consideration for Kotak Mahindra Bank, the bank is currently valued at 31.24X (TTM) and its return on assets is highest among private banks that stands at 1.72% and net profit margin too which stands at 25.71% on income. We believe if the bank continues to grow its total assets at the same pace, its book value will grow along that and the price to book ratio currently which makes it overvalued will be on track.
- The bank as an organization on a consolidated basis has other income which stands at Rs.16825 crores which again is more than 50% of total interest earned by Kotak Mahindra Bank, hereby we can conclude that along with the lending business the organization is growing in other business fields as well and has the potential to grow in future too.
- Mr. Uday Kotak who owns a good amount stake in the bank and is the managing director as well as the founder of the bank comes from a very humble and non-billionaire background and that proves it all for the quality check of the management



## FUTURE OUTLOOK OF KOTAK MAHINDRA BANK

Years	2019	2020	2021A	2022A	2023A	2024A	2025A	2026A
Revenue In Crores	45,979.11	50,299.69	52,311.68	58,589.08	65,619.77	73,494.14	82,313.44	92,191.05
Net Profit In Crores	7,119.69	8,607.08	8,686.27	9,771.84	10,992.00	12,363.34	13,904.47	15,636.29
Net NPA(%)	0.70%	1.50%	1.30%	1.20%	1.10%	0.90%	0.90%	0.80%

Taking into consideration the growth of the company in the future and the demand for the banking products of Kotak Mahindra, we would like to say that just ignoring Kotak Mahindra Bank on the basis of much higher trailing price to earnings ratio and on a high price to book value will not be a wise decision to make and investing is all about the wise decision one makes.

- Currently the bank stands at a price to earnings multiple of 31X and sales multiple of 7.41X but to much things not to bullish we would calculate our future price target on a 10% discount to the P/E of FY-20 in the year 2025 that will make its future assumed P/E at 26X(FY-2025) and sales multiple at 30%
- So, going by the above data we value Kotak Mahindra Bank at 26X the earnings of 2025, which makes the total valuation at Rs. 406,536 crores
- And by the sales multiple, we value Kotak Mahindra Bank at 5X the revenue of 2025, which makes the valuation stand at Rs 4,60,955 crores
- At it's a bank and Nobody can predict the unseen non-performing assets of the bank so we take a margin of safety of 8% on the average of valuation from P/E as well as sales multiple we get a of Rs. 4,00,000 crores
- **Thus, our forecasted market capital of Kotak Mahindra Bank stands at Rs 400,000 crores**
- **The per share target for Kotak Mahindra Bank till 2025 comes up to Rs 200 per share**



## Economy and Industry Analysis

- The banking sector is believed to be the “heart of the economy” and we believe it will further drive the growth of the Indian Economy but there will be dent on the pace of the financial as well as banking sector. Thereafter as soon as the corona effect on the economy is taken over, banking sector will be the first to recover and lead the growth of the company
- Taking the stimulus given by the government, banks have increased the advance rate and have been increasingly granting loans to medium and small-scale enterprises under the guarantee scheme.
- As it is been said that “Chaos is a ladder”, and from the covid-19 effect opportunities will also emerge in internet based businesses and especially data related businesses will boom and this situation will also help banking sector to strengthen its reach in the digital banking sector and banks can increase customers via dial and open schemes which kotak bank also offers
- The economy will face a muted or maybe a negative growth for the current fiscal year and maybe few of the quarters of the FY22. The country has been in lockdown for the last 40 days and more, with no commercial trade within country, inter states of India just the necessities and businesses in the FMCG as well as pharma space are operating ahead of other sectors of the economy due to their nature of product falling under the necessities
- The economy will have to pass through the tough times of corona with a cautious hand with spending, stimulus to boost business but in our views some things are just unavoidable and can't be just overcome with unilateral transfers. The country will have to face the corona pandemic to overcome it

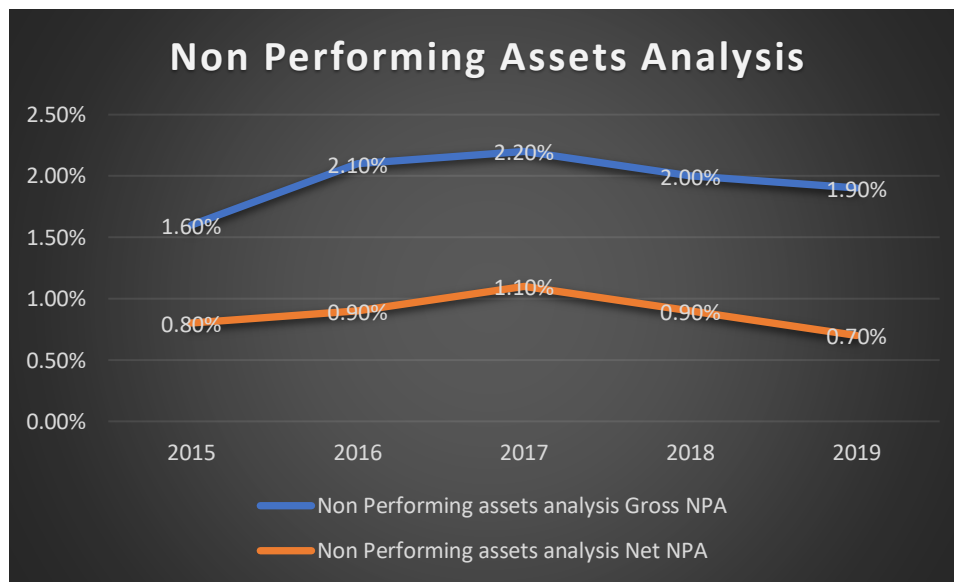


## FINANCIAL HIGHLIGHT

### Profit and loss Account with Forecast

Kotak Mahindra Bank									
Rs. crores's		2019A	2020A	2021E	2022E	2023E	2024E	2025E	2026E
<b>Income Statement Rs. crores's</b>									
Revenue		45,979.11	50,299.69	52,311.68	58,589.08	65,619.77	73,494.14	82,313.44	92,191.05
Total expenditure		34,358.03	36,319.79	38,187.52	42,770.03	47,902.43	53,650.72	60,088.81	67,299.47
Gross Profit		11,621.08	13,979.90	14,124.15	15,819.05	17,717.34	19,843.42	22,224.63	24,891.58
Provisions and others		1,045.37	2,558.10	2,813.91	3,095.30	3,404.83	3,745.31	4,119.85	4,531.83
Profit before Tax		10,575.71	11,421.80	11,310.24	12,723.75	14,312.51	16,098.10	18,104.78	20,359.75
Taxes		3,456.02	2,814.72	2,623.98	2,951.91	3,320.50	3,734.76	4,200.31	4,723.46
Net Income		7,119.69	8,607.08	8,686.27	9,771.84	10,992.00	12,363.34	13,904.47	15,636.29
<b>Assumptions</b>									
Revenue growth			9.4%	4.0%	12.0%	12.0%	12.0%	12.0%	12.0%
COGS % of revenue		74.7%	72.2%	73.0%	73.0%	73.0%	73.0%	73.0%	73.0%
other expenses		1,045.4	2,558.1	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Tax rate		32.7%	24.6%	23.2%	23.2%	23.2%	23.2%	23.2%	23.2%
net NPA (%)		0.7%	1.5%	1.3%	1.2%	1.1%	0.9%	0.9%	0.8%

#### Non Performing Assets Analysis

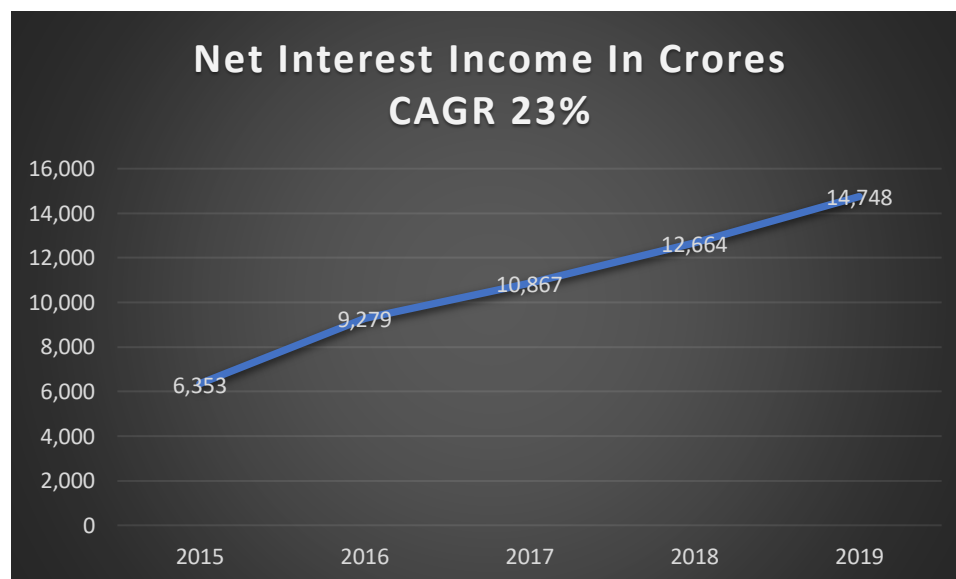




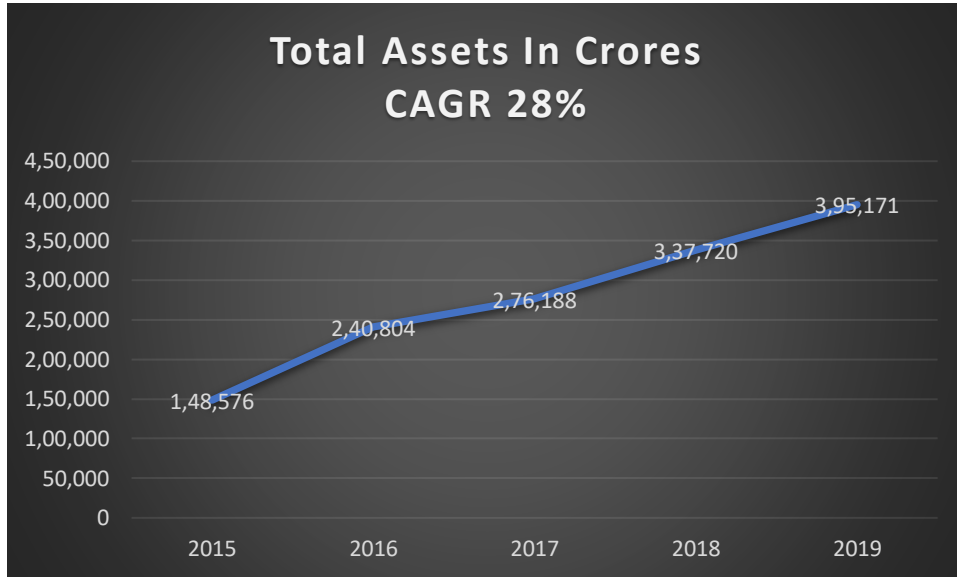
## Common Size Statement

Analysis	2019A	2020A	2021A	2022E	2023E	2024E	2025E	2026E
<b>Common size statement</b>								
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
employee benefit expenses	74.7%	72.2%	73.0%	73.0%	73.0%	73.0%	73.0%	73.0%
Gross Profit	25.3%	27.8%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%
other expenses	2.3%	5.1%	5.4%	5.3%	5.2%	5.1%	5.0%	4.9%
Profit before Tax	23.0%	22.7%	21.6%	21.7%	21.8%	21.9%	22.0%	22.1%
Taxes	7.5%	5.6%	5.0%	5.0%	5.1%	5.1%	5.1%	5.1%
Net Income	15.5%	17.1%	16.6%	16.7%	16.8%	16.8%	16.9%	17.0%

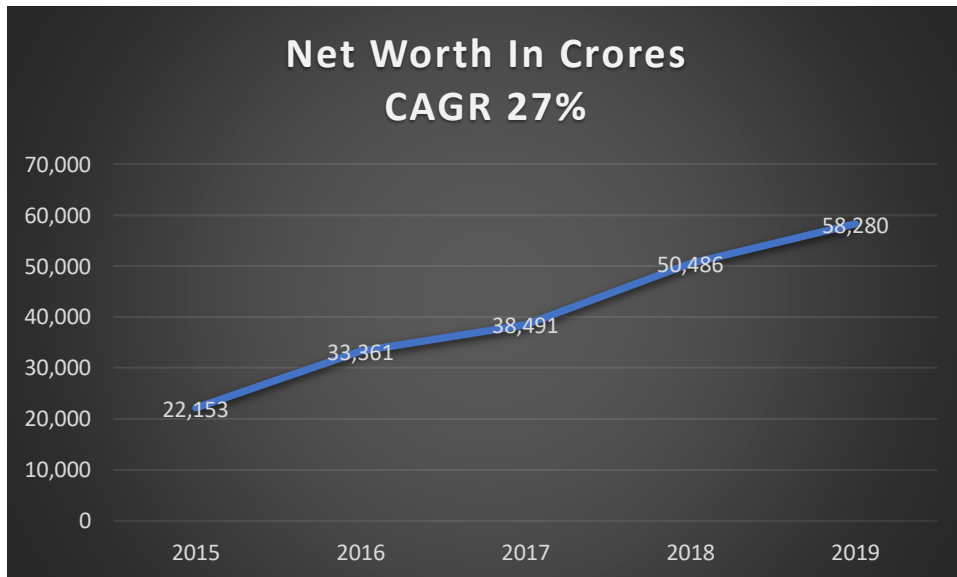
### Total Interest Income in Crores



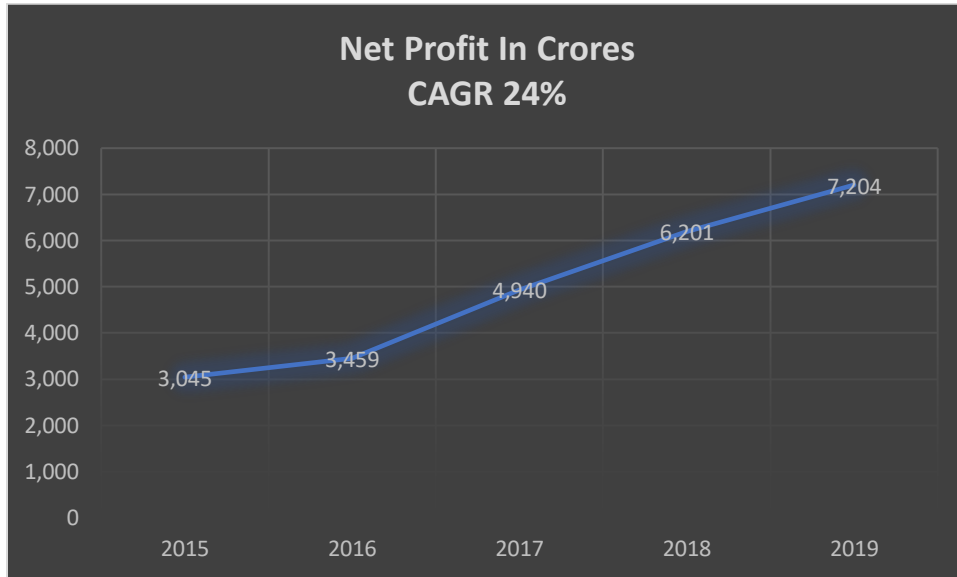
## Total Assets in Crores



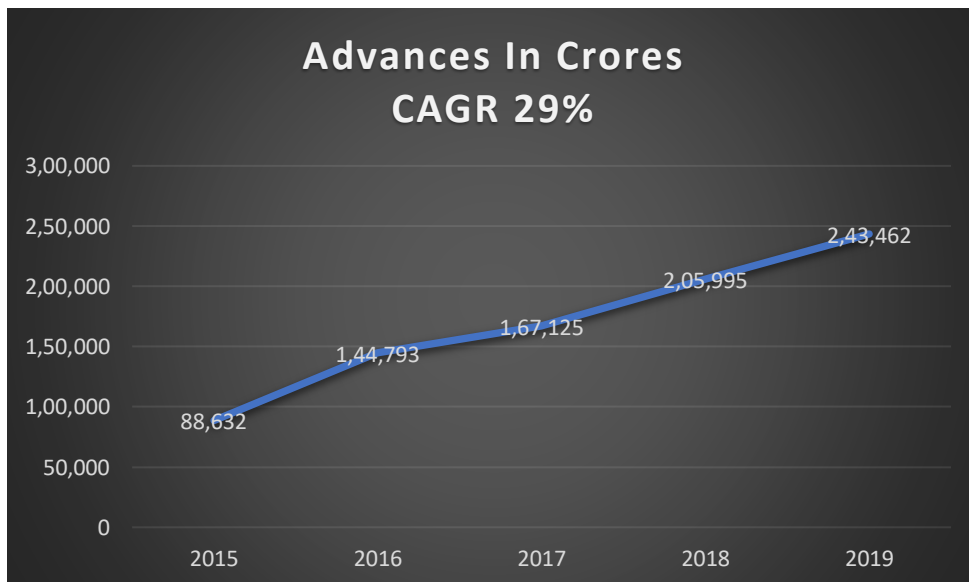
## Net Worth in Crores



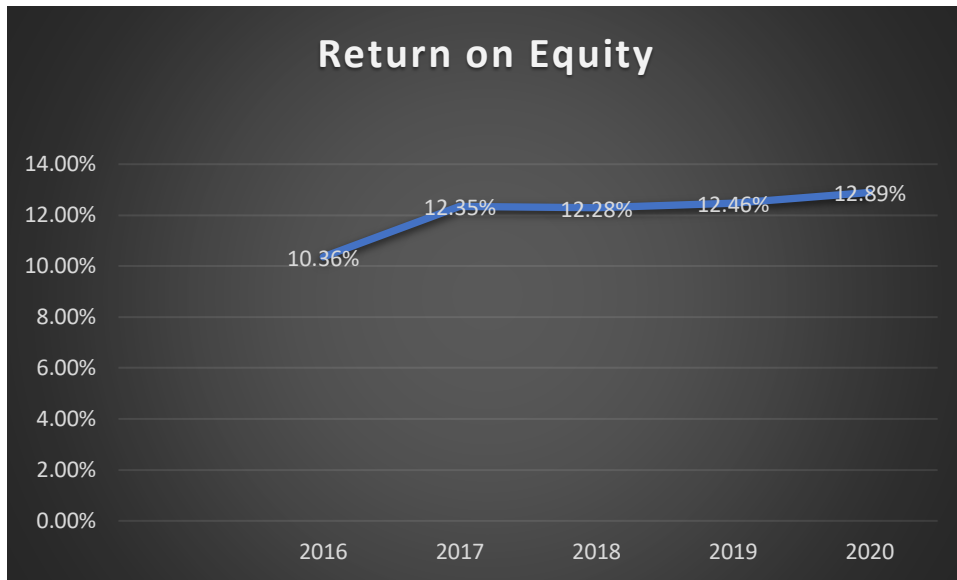
## Net Profits in Crores



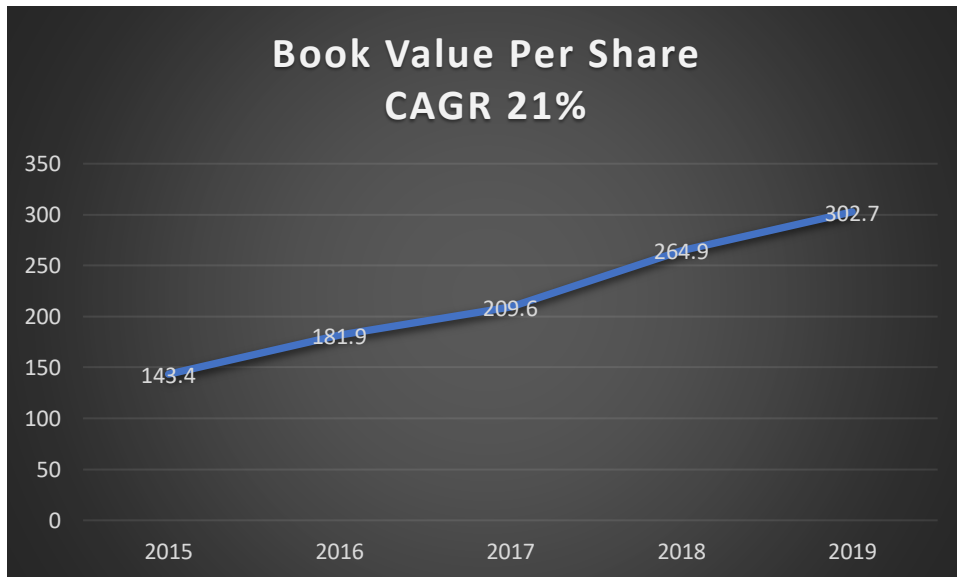
## Advances in Crores



## Return on Equity



## Book value per share



### Dividend Policy:

Kotak Mahindra bank isn't a dividend aristocrat type of stock and there is nothing bad about that as the bank instead of throwing away the most important thing that is cash as dividend its using it for future purposes and lending activities due to this one can observe that there is a correlation of more than 1 between net profit growth and stock price returns from the year 2015



## Comparative Analysis Among the lending Banks

NAME OF THE BANK	GROSS NPA(%)	NET NPA(%)	NET PROFIT MARGIN	CAPITAL ADEQUACY RATIOS(%)	RETURN ON ASSETS
Kotak Mahindra Bank	2.46%	0.70%	25.71%	18%	1.93%
Icici Bank	6%	1%	13.23%	16%	0.69%
HDFC bank	1.26%	0.36%	22.33%	19%	1.72%
Axis Bank	5%	2%	2.94%	18%	0.20%
State Bank of India	6%	2%	6.30%	13%	0.47%

## VALUATIONS

### Current Situation:

- Share Price: ₹1340.10
- Market Cap: ₹2,65,179.57 Crores
- Total Shares Outstanding:197.880 Crores
- Dividend Yield: 0.06% (for year ended 31<sup>st</sup> march 2020)
- Eps ₹30.05
- Book Value: **₹282.79**
- PE Ratio (TTM):31.1x
- 1 Year Returns: -10.10%



- **Important Valuations indicators:**

- Dividend Per Share: ₹0.80 (31<sup>st</sup> march 2019)
- Cash EPS: ₹44.99
- Earnings Yield (times): 0.03
- Price to sales: 7.41 times
- Enterprise value to net sales: 16.88 times
- Book value including rev. reserves per share: ₹348.33

**Other Valuation Parameters: (consolidated)**

- Interest Income to Total assets (%): **7.55%**
- Cost to income (%): **51.27%**
- Operating profit margin: **-24.55%**
- Net Profit Margin: **25.71 %**
- Return on Equity: **12.89%**
- Return on Assets: **1.93%**



## **Valuation Matrix:**

### **How are we valuing Kotak Mahindra bank at current valuation?**

- Kotak Mahindra bank currently valued at **3.18 times** its forward **revenue of the FY 2025**
- Kotak Mahindra bank is currently trading at a forward **P/E ratio of 19X (FY2025)**

## **TARGETS**

**Recommendation** Buy on dips for a target of Rs. 2020 per share by 2025

**Valuation:** target valuation of Rs. 4,00,000 in 5 years

**Current Market Price** ₹1340

**Time Horizon** 5-6 years

**Disclaimer:** This report is just an analysis of a listed company and I hereby confirm everything mentioned above to be true to my knowledge. Please contact your financial advisor before acting on the recommendation. The author or the website or anyone associated with it is not responsible for any loss incurred.



## **Credits:**

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