

## Kotak Mahindra Bank (KOTMAH) ₹ 1220

### HC rejects stay, promoter stake sale on cards

The Bombay High Court (HC) denied an interim stay to Kotak Mahindra Bank (KMB) with respect to its December 31 deadline to dilute its promoter holding. The ongoing debate is on using non-convertible perpetual non-cumulative preference shares (PNCPS) as a means for dilution. According to RBI commentary now, PNCPS has no voting rights. The next hearing by the HC is scheduled on January 17, 2019 while the December 31, 2018 deadline to reduce the promoter's stake below 20% still stands.

KMB had issued 100 crore non-convertible PNCPS of face value ₹ 5 each aggregating to ₹ 500 crore. It will be added to the paid-up capital but not equity capital. As per KMB, post the issue, the promoter stake, which was earlier at 30.03%, has declined to ~19.7%, adhering to the RBI requirement on reducing shareholding under 20%.

However, RBI had rejected the same in August 2018. KMB has been in dialogue with the RBI to which they did not receive any response from the regulator. Hence, KMB filed a petition in HC against rejection order of RBI.

RBI had previously mandated that Kotak Mahindra Bank reduce promoter stake to 20% of paid up capital by December 2018 and 15% by March 2020.

Though the transaction does not impact earnings, ambiguity on stake reduction will continue to remain an overhang on the stock price till the same is reduced and bought down to near 20%. A 10% stake sale will result in ~₹ 23,000 crore transaction. Unless it is sold to one or two strategic buyers, it will result in a good amount of stock supply in the market. Also, ₹ 23,000 crore will be coming in the hands of promoter Uday Kotak.

However, if the stake sale route is followed, ambiguity with respect to reduction in promoter stake will be settled, subject to RBI approval. In that case, the transaction looks a positive for minority shareholders as no dilution will happen if we see it from a long term perspective. Another possibility could be that KMB will accept regulatory restriction in terms of branch expansion and wait for the verdict of the court. Going ahead, factoring in the bank's strong earnings trajectory and value of the non-banking business, we retain our positive stance on the bank.

#### Rich valuation to continue on sustained growth and consistent RoA

A consistent performance in terms of RoA at 1.7% and RoE of 12-14% provides confidence. Given the focus on business growth, maintaining risk adjusted returns bodes well in the current scenario. The recent restriction on usage of Aadhaar could limit the pace of customer acquisition in the near term. With non-banking businesses (prime, life insurance and securities business) strong on growth and profitability, value enrichment remains a positive with contribution inching up at 35%. Valuing the stock on SOTP, we maintain our target price at ₹ 1400. Hence, we retain our **BUY** rating on the stock. The stake sale is expected in the next few days to a month.

Rating matrix		
Rating	:	Buy
Target	:	₹ 1400
Target Period	:	12 months
Potential Upside	:	15%

What's changed?	
Target	Unchanged
EPS FY19E	Unchanged
EPS FY20E	Unchanged
Rating	Unchanged

Key financials (standalone)				
₹ crore	FY17E	FY18	FY19E	FY20E
NII	8126	9532	11498	13787
PPP	5985	7158	8784	10705
PAT	3412	4084	4830	6182

Valuation summary (standalone)				
	FY17	FY18	FY19E	FY20E
P/E	65.7	56.8	48.1	37.5
Target P/E	75.5	65.3	55.2	43.2
P/ABV	8.5	6.4	5.8	5.3
Target P/ABV	10.0	7.4	6.8	6.2
Consol P/E	45.3	37.3	30.1	24.6
Consol Target P/E	52.1	42.9	34.6	28.3
Consol P/BV	5.8	4.6	4.1	3.5
Consol Target P/E	6.7	5.3	4.7	4.1
RoA	1.7	1.7	1.7	1.8
RoE	13.2	12.5	12.3	14.3

Stock data	
Market Capitalisation	₹ 232009 crore
GNPA (Q2FY19)	₹ 4033 crore
NNPA (Q2FY19)	₹ 1500 crore
NIM (Q2FY19)	4.2%
52 week H/L	1424/992
Net worth	₹ 38538 crore
Face value	₹ 5
DII holding (%)	8.8
FII holding (%)	39.4

Price performance				
Return %	1M	3M	6M	12M
Kotak Mahindra bank	11.2	1.3	-5.8	22.6
HDFC Bank	7.0	3.3	2.9	14.0
Axis Bank	1.2	-2.5	16.6	14.6

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