February 10, 2023(Revised)

Kotak Mahindra Bank Limited: [ICRA]AAA (Stable) assigned to infrastructure bonds; rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Infrastructure bonds	2,038.00	2,038.00	[ICRA]AAA (Stable); reaffirmed
Infrastructure bonds	-	2,000.00	[ICRA]AAA (Stable); assigned
Total	**2,038.00**	**4,038.00**	

**Instrument details are provided in Annexure I*

Rationale

The rating continues to be supported by Kotak Mahindra Bank Limited's (KMBL) strong capitalisation levels with the Tier I and CRAR at 20.7% and 21.7%, respectively (including 9M FY2023 profits), as on December 31, 2022, which in turn is supported by the bank's healthy internal capital accretion. While the growth in net advances remained muted, following the onset of Covid-19, it picked up strongly thereafter, backed by an improvement in the operating environment. KMBL has maintained the granularity of its deposit base as well as the high share of low-cost current and savings account (CASA) deposits. This was accompanied by a steady reduction in the interest rate, which resulted in the gradual lowering of the cost of funds and a stable improvement in the lending spreads. Going forward, sustaining the growth momentum will entail a higher growth in deposits at competitive rates and will remain the key for maintaining the current profitability levels.

Notwithstanding the Covid-19-induced pressures on the asset quality that led to a relative increase in fresh non-performing advances (NPA) generation, KMBL continued to maintain healthy asset quality metrics. Going forward, the material weakening of macro-economic parameters and rising interest rates could pose challenges to the asset quality. However, the credit costs are expected to remain much lower in relation to the operating profitability, given the strong asset quality, and the bank is expected to generate strong internal accruals. Accordingly, ICRA expects KMBL to maintain strong capital cushions and solvency along with healthy capital accretion, thereby driving the Stable outlook on the rating.

Key rating drivers and their description

Credit strengths

Strong capitalisation supported by healthy internal capital generation – KMBL's standalone capital adequacy ratio remains strong with the Tier I at 20.7% and CRAR at 21.7% as on December 31, 2022. While a capital raise of Rs. 7,442.5 crore further strengthened the capital cushions in FY2021, KMBL has continued to maintain healthy capital accretion, with the average return on equity (RoE) at 10-15% over FY2018-9M FY2023. In ICRA's view, KMBL's capital position, coupled with healthy internal accruals, provides it with a strong buffer that will support stronger book growth, although any possible inorganic growth-driven capital consumption will remain a monitorable.

Further, at the Group level, the bank has subsidiaries that are in the lending, insurance, asset management and broking businesses. KMBL's capitalisation remains strong on a consolidated basis as well with a common equity tier-I (CET-I) ratio of 22.3% (including 9M FY2023 profits) as on December 31, 2022. The subsidiaries are self-sufficient, in terms of capital requirement, and any capital support to them is expected to remain manageable in relation to the bank's overall profits and capital.

Strong CASA deposit base leading to lower cost of funds – KMBL's deposit base grew by 12.9% as on December 31, 2022 (15.1% as on December 31, 2021) on a YoY basis to Rs. 3.45 lakh crore (Rs. 3.05 crore as on December 31, 2021), supported by a stronger growth in term deposits (32% YoY growth). Moreover, strong traction in term deposits along with slower build-up of CASA has led to a relative moderation in the overall share of CASA deposits in total deposits to 53.3% as on December 31, 2022 from 59.9% as on December 31, 2021. Nevertheless, the share of CASA continues to remain one of the highest in the industry. As strong asset growth sustains and liquidity conditions tighten, KMBL's deposit rate differential could rise in relation to peer banks. Given the high share of CASA, the overall granularity of the deposit base remains satisfactory with CASA and term deposits (<Rs. 5 crore) accounting for 83% of the overall deposits as on December 31, 2022 compared to 88% as of December 31, 2021.

Profitability expected to remain strong despite elevated cost pressure – The decline in the cost of interest-bearing funds supported the steady expansion in the lending spreads, resulting in an improvement in the net interest margin (NIM) to 4.6% of average total assets (ATA) in 9M FY2023 (4.0-4.1% in FY2020-FY2022). However, a further improvement from this level is expected to remain limited as the lending spreads could come under pressure amidst the tighter liquidity conditions. Non-interest income improved to 1.9% of ATA in 9M FY2023 (1.4% in FY2022, 1.5% in FY2021), supported by the growth in retail fees.

Further, the operating profitability remains healthy with a core operating profit (before credit provisions) of 3.3% of ATA in 9M FY2023 (2.8% in FY2022, 3.2% in FY2021), which, along with KMBL's satisfactory asset quality levels as well as the partial reversal of Covid-19 provisions (in FY2022), helped keep the credit cost at a lower level. As a result, the overall reported credit costs remained low at 0.1% of ATA in 9M FY2023 (0.27% in FY2022, 0.49% in FY2021). Accordingly, the bank's return on assets (RoA) remained strong at 2.2% in 9M FY2023 (2.1% in FY2022, 1.9% in FY2021), despite sizeable mark-to-market (MTM) losses/trading losses on the investment book as the yields surged. Going forward, the ability to sustain these profitability levels will remain dependent on KMBL's ability to grow the liability franchise.

Asset quality metrics remain satisfactory – The fresh NPA generation remained at comparatively higher levels, following the onset of the pandemic, at 2.0-2.5% of standard advances in FY2021-FY2022. As the operating environment improved, the annualised fresh NPA generation witnessed a relative moderation to 1.6% in 9M FY2023 and the rate of NPA generation is expected to remain between 1.2-1.7%, as seen during FY2017-FY2020. The headline asset quality metrics remained satisfactory with gross NPAs (GNPAs; %) and net NPAs (NNPAs; %) at 1.9% and 0.4%, respectively, as on December 31, 2022. The overall improvement in the asset quality metrics was also supported by the meaningfully high recoveries and upgrades, which helped offset the impact of the relatively higher slippages. The overall overdue book (special mention accounts (SMA)-2) for larger exposures (>Rs. 5 crore) remains small and manageable at 0.06% of standard advances, while the standard restructured book remains limited at 0.25% of standard advances as on December 31, 2022.

Further, the share of the unsecured retail book, primarily comprising personal loans, microloans and credit cards, inched up to 9.3% as on December 31, 2022 from 6.3% as on December 31, 2021. Going forward, weakening macro-economic parameters such as rising inflation, higher interest rates and a depreciating currency, could lead to hardships for borrowers and pose challenges to the asset quality of banks, particularly in the unsecured segments. However, ICRA expects the strong operating profitability and capital cushions to remain a source of comfort with the solvency level likely to remain strong.

Credit challenges

Incremental deposit mobilisation at competitive rates will be a monitorable – The deposit base has grown by ~10-13% on a YoY basis on an average over the last several quarters (with overall deposits at Rs. 3.45 lakh crore as on December 31, 2022), although book growth has seen a comparatively sharper rebound and increased to YoY growth of ~23% as on December 31, 2022 (excluding credit substitutes). Sustaining the robust traction in advances will necessitate a stronger deposit build-up over the near to medium term. While KMBL has managed to improve its deposit base despite successive rate cuts (largely undertaken in FY2021), leading to the narrowing of the differential in the cost of funds with peer banks, its ability to do so in a tighter liquidity environment will remain critical for maintaining the cost advantage.

Environmental and social risks

While banks like KMBL do not face material physical climate risks, they are exposed to environmental risks indirectly through their portfolio of assets. If the entities or businesses to whom banks and financial institutions have an exposure, face business disruptions because of physical climate adversities or if such businesses face climate transition risks because of technological, regulatory or customer behaviour changes, it could translate into credit risks for banks. However, such a risk is not material for KMBL as it benefits from adequate portfolio diversification. Further, the lending is typically short-to-medium term, allowing it to adapt and take incremental exposure to businesses that face relatively lesser downside environmental risks.

With regard to social risks, data security and customer privacy are among the key sources of vulnerability for banks as any material lapses could be detrimental to its reputation and invite regulatory censure. KMBL has not faced such lapses over the years, which highlights its sensitivity to such risks. It is seen to be operating responsibly in terms of its selling practices with no instances of fines imposed by the regulatory authorities because of the misconduct. Customer preferences are increasingly shifting towards digital banking, which provides an opportunity to reduce the operating costs. KMBL has been at the forefront of making the requisite investments to enhance its digital interface with its customers. While it contributes to promoting financial inclusion by lending to the under-served segments, its lending practices remain prudent, as reflected in the healthy asset quality numbers in this segment compared with its peers.

Liquidity position: Strong

KMBL's (consolidated Group level) daily average liquidity coverage ratio (LCR) stood at 121% in Q3 FY2023, which is well above the regulatory requirement of 100%. However, it moderated from 146% in Q3 FY2022 as advances growth picked up strongly. Similarly, the net stable funding ratio (NFSR) stood at 120%, which was higher than the regulatory ask of 100%. Besides this, the bank has excess statutory liquidity ratio (SLR) holdings above the regulatory level, which can be utilised to avail liquidity support from the Reserve Bank of India (RBI; through repo), apart from the RBI's marginal standing facility in case of urgent liquidity requirement.

Rating sensitivities

Positive factors – Not applicable

Negative factors – ICRA could assign a Negative outlook or downgrade the rating if there is a deterioration in the asset quality or capital position, leading to the weakening of the solvency profile with net NPA/core equity exceeding 15% on a sustained basis. Further, a sustained RoA of less than 1.0% and/or a decline in the capital cushions over the regulatory levels to less than 4% at the CET I level on a sustained basis will remain negative triggers. A material weakening in the bank's liability franchise, thereby impacting its resource profile, will also be a negative trigger.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	ICRA's Rating Methodology for Banks and Financial Institutions ICRA's Rating Methodology on Consolidation
Parent/Group support	Not applicable
Consolidation/Standalone	For arriving at the rating, ICRA has considered the standalone financials of KMBL. However, in line with ICRA's limited consolidation approach, the capital requirement of the key subsidiaries of the Group, going forward, has been factored in. In ICRA's view, KMBL's subsidiaries will largely remain self-sufficient in meeting their capital requirements in the near to medium term and the bank will continue to comfortably meet the regulatory capital requirements at the consolidated level.

About the company

KMBL is the flagship company of the Kotak Group. It commenced operations in 1986 as a bill discounting and leasing non-banking financial company (NBFC), Kotak Mahindra Finance Limited, which was converted into a bank in 2003. Effective April 1, 2015, ING Vysya Bank merged with KMBL. As on December 31, 2022, KMBL had a network of over 1,750 branches (excluding GIFT and DIFC) and its net advances stood at Rs. 3,10,734 crore. It reported a profit after tax (PAT) of Rs. 7,444 crore in 9M FY2023 against a PAT of Rs. 5,805 crore in 9M FY2022.

The Kotak Group is one of India's leading full services financial conglomerates with a significant presence in the securities and investment banking space. The Group is currently growing its banking, asset management and insurance businesses. It derives synergies from its various platforms, given their presence across the financial spectrum. Other than KMBL, the key subsidiaries of the Kotak Group include Kotak Mahindra Prime Limited (car financing; rated [ICRA]AAA (Stable)/A1+), Kotak Securities Limited (retail and institutional broking and portfolio management services), Kotak Mahindra Investments Limited (commercial real estate lending and securities-based lending; rated [ICRA]AAA (Stable)/A1+), Kotak Mahindra Capital Company Limited (investment banking), Kotak Mahindra Life Insurance Company Limited (life insurance), Kotak Mahindra General Insurance Company Limited (general insurance) and Kotak Mahindra Asset Management Company Limited (asset management business). On a consolidated basis, the Kotak Group reported a PAT of Rs. 10,359 crore in 9M FY2023 compared to Rs. 8,198 crore in 9M FY2022.

Key financial indicators (standalone)

Kotak Mahindra Bank Limited	FY2021	FY2022	9M FY2022	9M FY2023
Net interest income	15,340	16,818	12,297	15,449
Profit before tax	9,303	11,361	7,715	9,891
Profit after tax	6,965	8,573	5,805	7,444
Net advances (Rs. lakh crore)	2.24	2.71	2.53	3.11
Total assets (Rs. lakh crore)	3.83	4.29	4.18	4.65
CET I	21.2%	21.5%	20.2%*	18.6%*
Tier I	21.4%	21.7%	20.4%*	18.7%*
CRAR	22.3%	22.7%	21.3%*	19.7%*
Net interest margin / ATA	4.13%	4.14%	4.09%	4.61%
PAT / ATA	1.87%	2.11%	1.93%	2.22%
Return on net worth	10.93%	11.83%	11.61%	13.02%
Gross NPAs	3.25%	2.34%	2.71%	1.90%
Net NPAs	1.21%	0.64%	0.79%	0.43%
Provision coverage excl. technical write-offs	64%	73%	71%	78%
Net NPA / Core equity capital	4.6%	2.6%	3.1%#	1.8%#

Source: Kotak Mahindra Bank Limited, ICRA Research; All ratios as per ICRA's calculations including those in the table above
*Amount in Rs. crore unless mentioned otherwise; * Excludes 9M profits; # Core equity capital as per ICRA estimates*

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for past three years

Instrument		Current rating (FY2023)						Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Feb 10, 2023 (Rs. crore)	Date & rating in FY2023			Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Feb 10, 2023	Sep 23, 2022	May 20, 2022	May 24, 2021	Apr 30, 2020	Feb 26, 2019
1	**Infrastructure bonds**	Long Term	2,038	1,650^	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**
2	**Infrastructure bonds**	Long Term	2,000	-^	**[ICRA]AAA (Stable); assigned**					

^ Balance yet to be placed

Complexity level of the rated instruments

Instrument	Complexity Indicator
Infrastructure bonds	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA’s website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE237A08940	**Infrastructure bonds**	Mar 28, 2019	8.25%	Apr 28, 2026	150	[ICRA]AAA (Stable)
INE237A08957	**Infrastructure bonds**	Dec 01, 2022	7.63%	Dec 01, 2029	1,500	[ICRA]AAA (Stable)
Unplaced	**Infrastructure bonds**	Yet to be placed			2,388	[ICRA]AAA (Stable)

Source: Kotak Mahindra Bank Limited

Annexure II: List of entities considered for limited consolidated analysis

Company Name	Ownership	Consolidation Approach
Kotak Mahindra Prime Limited	100.00%	Limited Consolidation
Kotak Mahindra Investments Limited	100.00%	Limited Consolidation
Kotak Securities Limited	100.00%	Limited Consolidation
Kotak Mahindra Capital Company Limited	100.00%	Limited Consolidation
Kotak Mahindra Life Insurance Company Limited	100.00%	Limited Consolidation
Kotak Mahindra Asset Management Company Limited	100.00%	Limited Consolidation
Kotak Mahindra Trustee Company Limited	100.00%	Limited Consolidation
Kotak Mahindra General Insurance Company Limited	100.00%	Limited Consolidation
Kotak Mahindra (International) Limited	100.00%	Limited Consolidation
Kotak Mahindra (UK) Limited	100.00%	Limited Consolidation
Kotak Mahindra INC	100.00%	Limited Consolidation
Kotak Investment Advisors Limited	100.00%	Limited Consolidation
Kotak Mahindra Trusteeship Services Limited	100.00%	Limited Consolidation
Kotak Infrastructure Debt Fund Limited	100.00%	Limited Consolidation
Kotak Mahindra Pension Fund Limited	100.00%	Limited Consolidation
Kotak Mahindra Financial Services Limited	100.00%	Limited Consolidation
Kotak Mahindra Asset Management (Singapore) PTE Limited	100.00%	Limited Consolidation
IVY Product Intermediaries Limited	100.00%	Limited Consolidation
BSS Microfinance Limited	100.00%	Limited Consolidation
Infina Finance Private Limited	49.99%	Limited Consolidation
Phoenix ARC Private Limited	49.90%	Limited Consolidation

Source: Kotak Mahindra Bank Limited

Corrigendum

Rationale dated February 10, 2023, has been revised with changes as below:

- Addition of "ICRA's Rating Methodology on Consolidation" in the analytical approach section

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