Kotak Mahindra Bank Limited

January 29, 2018

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Infrastructure Bonds Programme	1,500.00	1,500.00	[ICRA]AAA (Stable); reaffirmed
Lower Tier II Bonds Programme	185.80	185.80	[ICRA]AAA (Stable); reaffirmed
Lower Tier II Bonds Programme	439.20	-	[ICRA]AAA (Stable); withdrawn
Upper Tier II Bonds Programme	150.00	-	[ICRA]AA+ (Stable); withdrawn
Total	**2,275.00**	**1,685.80**	

Rating action

ICRA has reaffirmed the rating of [ICRA]AAA (pronounced as ICRA triple A) for the Rs. 1,500 crore infrastructure bonds programme and the Rs. 185.80 crore of lower tier II bonds programme of Kotak Mahindra Bank Limited (KMBL)[1]. ICRA has also withdrawn the rating of [ICRA]AAA for the Rs. 439.20 crore lower tier II bonds programme and the rating of [ICRA]AA+ (pronounced as ICRA double A plus) for the Rs. 150 crore upper tier II bonds programme of KMBL. The ratings for the instruments are withdrawn since there is no amount outstanding against them (either redeemed or unutilised). The outlook on the long-term ratings is Stable.

Rationale

The highest credit quality ratings for KMBL are supported by the bank's long track record, its experienced senior management team and its strong financial and operational performance over the years. The ratings continue to reflect KMBL's strong capitalization levels (CRAR: 18.7% and Tier I capital: 18.0% as on December 31, 2017), healthy resource profile (CASA of 46.7% as on December 31, 2017) and retail franchise (1,375 branches and 2,171 ATMs as on December 31, 2017). The ratings continue to factor in the gradual improvement in the bank's liability profile supported by improving granularity in the deposits and reducing share of the bulk deposits. Further, the stringent underwriting standards along with strong risk management systems have helped the bank to maintain a healthy asset quality (gross NPA% and net NPA% of 2.31% and 1.09% as on December 31, 2017) through cycles. On the back of healthy growth in advances (23% YoY as on December 31, 2017), stable net interest margins (NIMs of 4.00% for 9MFY2018) and contained credit costs on account of comfortable asset quality, the bank has been able to maintain healthy profitability with return on assets of 1.70% for 9MFY2018. ICRA believes its ability to grow at a healthy pace supported by strong capitalisation and maintaining comfortable asset quality and healthy profitability will remain a key rating sensitivity.

[1] For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications

Outlook: Stable

In ICRA's opinion, KMBL will continue to report steady growth with good asset quality, healthy profitability indicators and strong capitalisation. The outlook may be revised to Negative in case there is a significant deterioration in the bank's asset quality or solvency indicators.

Key rating drivers

Credit strengths

Healthy growth – KMBL's credit portfolio registered a growth of ~15% in FY2017 in line with the private sector bank average and stood at Rs. 136,082 crore as on March 31, 2017 as compared to Rs. 118,665 crore as on March 31, 2016. The credit portfolio further grew by 23% (YoY) to Rs. 159,071 crore as on December 31, 2017. As on December 31, 2017, corporate advances constituted 59% of the bank's overall advances while the retail advances constituted 41%. Though the share of corporate advances has increased marginally post-merger, KMBL's corporate exposures being largely in the form of working capital and corporate group level advances and the absence of any significant exposure to stressed sectors provide comfort. ICRA expects a credit growth for KMBL to remain healthy in the medium term supported by healthy capitalisation and comfortable asset quality.

Strong capitalisation as compared to peer banks – KMBL's overall capitalisation levels remain strong with capital adequacy ratio at 18.7% and Tier I ratio at 18.0% as on December 31, 2017 as against a regulatory requirement of 10.875% and 8.875% respectively[2] as on March 31, 2018. The capitalisation was further strengthened by ~Rs. 5,800 crore qualified institutional placement (QIP) done by KMBL in May 2017 for dilution of its promoter stake to 30.06% as on December 31, 2017 to meet regulatory requirements. The solvency (Net NPA/ Net worth) for KMBL remains comfortable at 4.75% as on December 31, 2017 significantly lower than the private sector bank average, thus increasing the bank's ability to absorb asset quality shocks, if any. In ICRA's view, KMBL's current capital position provides it adequate room to scale up its lending operations while maintaining adequate buffer over regulatory capital requirement in the medium term.

Strengthening retail franchise with good CASA deposit base; reducing reliance on wholesale funding – During FY2017, the share of CASA in the bank's deposit profile improved, driven by a growth in both current account (CA) and savings account (SA) deposits, following demonetization and stood at ~44% as on March 31, 2017 and further improved to 46.7% as on December 31, 2017. The improvement in CASA is supported by the strengthened retail franchisee of the bank post-merger with erstwhile ING Vysya Bank Limited (eIVBL) and further by the bank's initiatives like '811 scheme' and offering higher saving account interest rate to strengthen the retail customer base. ICRA takes note of the gradually declining reliance on wholesale funding with CASA and term deposits with ticket size lower than Rs. 5 crore increasing to 75% of overall deposits as on December 31, 2017 from 63% as on March 31, 2014, indicating improving granularity in the overall resource profile. Though the bank provides higher savings interest rate, with the increase in CASA, the bank's cost of funds declined in FY2017 bringing it in line with private sector bank's average.

Comfortable asset quality – KMBL's asset quality remains stable with GNPA% and NNPA% at 2.31% and 1.09% respectively as on December 31, 2017. Post-merger with eIVBL, the asset quality had witnessed deterioration with GNPA% and NNPA% increasing to 2.36% and 1.06% as on March 31, 2016 as compared to 1.85% and 0.92% as on March 31, 2015 on account of recognition of stress in accounts taken over from eIVBL. ICRA notes that the current asset quality levels are comfortable in comparison with its peers and takes comfort from the bank's corporate exposures being largely in the form of working capital and corporate group level advances and the absence of any significant exposure to

[2] Including Capital conservation buffer of 1.25%

stressed sectors. The provision coverage ratio (excluding technical write-offs) is comfortable at ~53.5% as on December 31, 2017. Further, the stock of stressed assets is limited with a small standard restructured book of Rs. 67 crore (~0.04% of net advances) and SMA2 outstanding of Rs. 308 crore (0.19% of net advances) as on December 31, 2017. The ability of the bank to maintain its asset quality while growing at a healthy pace will remain a key rating sensitivity.

Healthy profitability supported by stable NIMs and controlled credit costs – With the declining interest rate scenario, the yield on average earning assets declined during FY2017 but was better than the average yields of private banks because of relatively lower NPA levels leading to a higher income earning assets. The decline in yields was moderated out by a concurrent decline in cost of funds and increased credit-deposit (CD) ratio which resulted in the bank reporting stable net interest margins (NIMs) of 3.99% during FY2017 and 4.00% during 9MFY2018. The core profitability was supported by an increase in non-interest income (1.71% during FY2017 and 1.67% for 9MFY2018), which along with contained credit costs (0.34% for FY2017 and 0.32% for 9MFY2018) lead to an increase in return on assets to 1.68% for FY2017 and 1.70% for 9MFY2018. However, with increase in equity in May 2017, the RoE was marginally lower at 12.35% for 9MFY2018 as compared to 13.23% during FY2017. Going forward, the ability of the bank to grow at a healthy pace while maintain a healthy profitability and comfortable asset quality will remain a key rating sensitivity.

Credit challenges

Ability to maintain SA deposits while reducing interest rates remains to be seen – The SA for the bank is being supported by the higher savings account interest rate offered by KMBL similar to some other private sector banks. Ability of the bank to maintain its SA deposits in future while reducing the interest rate on these deposits remains to be seen.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

ICRA Rating Methodology for Banks

About the company:

KMBL is the flagship company of the Kotak Group. KMBL began operations in 1986 as a bill discounting and leasing NBFC - Kotak Mahindra Finance Limited - which was converted into a bank in 2003. Effective April 1, 2015, ING Vysya Bank merged with KMBL.

KMBL had a network of over 1,375 branches as on December 31, 2017. The bank’s advances stood at Rs. 159,071 crore with corporate advances accounting for 59% of the total. KMBL reported a PAT of Rs. 3,411 crore for FY2017 as against PAT of Rs. 2,090 crore for FY2016. For 9MFY2018, KMBL reported a PAT of Rs. 2,960 crore while its net worth stood at Rs. 36,297 crore as on December 31, 2017.

About Kotak Group:

The Kotak Group is one of India’s leading full services financial conglomerate, with significant presence in securities and investment banking space while it is currently growing its banking, asset management and insurance businesses. The group 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), Kotak Securities Limited (retail and institutional broking and portfolio management services), Kotak Mahindra Investments Ltd. (commercial real estate lending and securities based lending), Kotak Mahindra Capital Company (investment banking), Kotak Mahindra Life Insurance Company Ltd (life insurance) , Kotak Mahindra General Insurance Company Ltd (general insurance), Kotak Mahindra Asset Management Company (asset management business) and Kotak Private Equity Group (private equity business).

At the consolidated group level, KMBL's advances constitute 81% of the overall advances of Rs. 195,652 crore of the group as on December 31, 2017. On a consolidated group basis, the Kotak Group reported a PAT of Rs. 4,940 crore in FY2017 as compared to Rs 3,459 crore in FY2016. For 9MFY2018, the Group reported a PAT of Rs. 4,412 crore. The Group's consolidated net worth stood at Rs. 48,621 crore as on December 31, 2017.

Key financial indicators (audited) (standalone)

	FY2016	FY2017	9MFY2017	9MFY2018
Net interest income	6,900	8,126	5,965	6,952
Profit before tax	3,124	5,148	3,713	4,507
Profit after tax	2,090	3,411	2,435	2,960
Net advances	118,665	136,082	129,261	159,071
Total assets	192,260	214,590	201,786	248,646
% Tier 1	15.3%	15.9%	16.5%	18.0%
% CRAR	16.3%	16.8%	17.6%	18.7%
% Net interest margin / Average total assets	4.63%	3.99%	4.04%	4.00%
% Net profit / Average total assets	1.40%	1.68%	1.65%	1.70%
% Return on net worth	10.97%	13.23%	12.85%	12.35%
% Gross NPAs	2.36%	2.59%	2.42%	2.31%
% Net NPAs	1.06%	1.26%	1.07%	1.09%
% Provision coverage excl. technical write offs	55.54%	51.99%	56.60%	53.49%
% Net NPA/ Net worth	5.27%	6.22%	5.22%	4.75%

Amount is Rs. crore

Source: KMBL; ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2018)				Chronology of Rating History for the past 3 years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Jan 2018	FY2017 Sep 2016	FY2016 -	FY2015 Jan 2015	Nov 2014	Aug 2014	Apr 2014
1	Infrastructure Bonds	Long Term	1,500.00	962.00	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)	-
2	Lower Tier II Bonds	Long Term	185.80	185.80	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AA+ (stable)
3	Upper Tier II Bonds	Long Term	-	-	withdrawn	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA (stable)

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Unutilised	Infrastructure Bonds	-	-	-	538.00	[ICRA]AAA(stable)
INE237A08908	Infrastructure Bonds	12-08-2014	9.36%	12-08-2021	262.00	[ICRA]AAA(stable)
INE237A08924	Infrastructure Bonds	14-01-2015	8.72%	14-01-2022	500.00	[ICRA]AAA(stable)
INE237A08932	Infrastructure Bonds	30-03-2015	8.45%	30-03-2022	200.00	[ICRA]AAA(stable)
INE237A08866	Lower Tier II Bonds	09-07-2007	10.25%	09-05-2018	10.80	[ICRA]AAA(stable)
INE237A09153	Lower Tier II Bonds	09-07-2007	10.25%	09-05-2018	25.00	[ICRA]AAA(stable)
INE237A08890	Lower Tier II Bonds	07-04-2011	9.31%	07-04-2021	150.00	[ICRA]AAA(stable)

Source: KMBL

ANALYST CONTACTS

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Anil Gupta
+91 124 4545 314
anilg@icraindia.com

Akshay Kumar Jain
+91 22 6114 3430
akshay.jain@icraindia.com

Neha Parikh
+91 22 6114 3426
neha.parikh@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
naznin.prodhani@icraindia.com

Helpline for business queries:

+91-124-2866928 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87
Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore + (91 80) 2559 7401/4049
Ahmedabad+ (91 79) 2658 4924/5049/2008
Hyderabad + (91 40) 2373 5061/7251
Pune + (91 20) 6606 9999