

**INITIATING COVERAGE**
**Kotak Mahindra Bank Ltd**
**HOLD**
**Share Data**

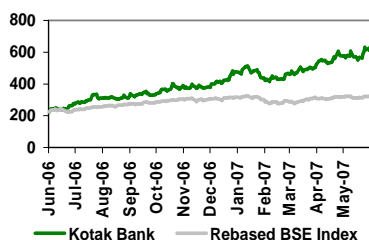
Market Cap	Rs. 207.48 bn
Price	Rs. 634.95
BSE Sensex	14,431.06
Reuters	KTKM.BO
Bloomberg	KMB IN
Avg. Volume (52 Week)	0.19 mn
52-Week High/Low	635/221.6
Shares Outstanding	326.76 mn

**Valuation Ratios**

Year to 31 March	2008E	2009E
EPS (Rs.)	24.6	36.5
+/- (%)	49.5%	48.1%
PER (x)	25.8x	17.4x
P / PPP (x)	43.1x	64.5x
P / BV (x)	4.9x	3.8x

**Shareholding Pattern (%)**

Promoter / RBI	56
FII's	22
Institutions	5
Public & Others	17

**Relative Performance**

**Long Term Growth**

Kotak Mahindra Bank is one of the India's fastest growing financial conglomerates. In January 2007, it reached the milestone of 100 branches. The bank has shown strong operating performance supported by increasing CASA deposit, high NIM, and low net NPAs. The bank is leveraging its investment banking relationship to offer commercial banking and advisory services. However, the termination of Kotak's JV with Goldman Sachs is likely to have an impact on its IB business. For FY08E, we expect the bank EPS to increase to Rs. 24.6 supported by its integrated business model and expected change in the product mix.

**Key Figures**

Year to March	FY05	FY06	FY07	FY08E	FY09E	CAGR (%)
(Figures in Rs mn, except per share data) (FY07-09E)						
Net Interest Income	4,475	6,961	10,470	18,936	31,488	73.4%
Total Income	14,342	25,132	33,752	51,531	77,121	51.2%
Pre-Prov Operating Profit	3,277	7,941	9,312	14,091	21,089	50.5%
Net Profit	1,709	7,297	5,382	8,047	11,914	48.8%
Interest Expense/Interest Income (%)	42.3%	42.7%	48.3%	40.2%	37.0%	
Cost/Income Ratio (%)	77.1%	68.4%	72.4%	72.7%	72.7%	
<b>Per Share Data (Rs.)</b>						
EPS	5.7	23.5	16.5	24.6	36.5	48.8%
PER (x)	112.2x	27.0x	38.5x	25.8x	17.4x	
PPP per share	10.9x	25.5x	28.5x	43.1x	64.5x	
Book value per share	60.7x	81.4x	100.8x	125.4x	161.8x	

- We expect Kotak to report net profit CAGR of 48.8% for FY07-09E driven by a growing economy, emerging core commercial banking business, and a continuing growth in CASA deposit.
- At the current price of Rs. 635 the stock is trading at a forward P/BV of 5.1x FY08E and 3.9x FY09E.
- Our target price of Rs. 690 is based on a P/BV valuation and represents an upside of 8.6% from current levels. We initiate coverage with a Hold with a one year perspective.

### Rationale

*The bank offers diverse product and has cross selling ability*

#### *Diverse products and cross selling ability*

Kotak provides cutting edge products both on the commercial banking as well as on high margin advisory side of the business. Moreover, it is in position to exploit cross selling opportunities in commercial banking leveraging its existing Investment Banking relationships.

*NIM is highest in the industry*

#### *Healthy Net Interest Margin (NIM)*

Kotak's NIM continues to be healthy and it is among the highest in the industry. In FY07, NIM was relatively flat at 5.2% and CASA to deposit ratio increased 3pts to 22%. Given that the bank began operations just four years ago, we believe that the CASA to deposit ratio would continue to improve thereby improving margins on asset-liability mix.

#### *Focus on advances growth*

Kotak has a strong presence in retail lending and its advances have grown by 49% in FY07. With the increase in distribution, we expect advances to grow in future as well. Moreover, corporate and SME banking is expected to witness a significant growth in near to medium term.

*Bank has crossed the milestone of 100 branches in FY07*

#### *Expanding branch network*

Kotak continues to invest in its infrastructure and distribution reach. The bank is basically concentrated in big cities and it had 105 branches as of March 31, 2007. It has huge untapped market in tier II cities and plans to add another 100 branches in the next 15 months. This will boost the distribution side of the business and ensure strong growth in fee based income. Further, increase in CASA balances would improve bank's NIM.

#### *NPAs under control*

Net NPAs of the bank are under control. For the FY07, net NPA (as a percentage of advances) decreased 4bps to 0.17%. Though, we expect the ratio to increase on account of possible defaults in increasing interest rate scenario.

### Key Risks

#### *Dependence on buoyant capital market*

#### *Exposure to capital market*

The earnings of Kotak could be volatile, as it is largely dependent on broking volumes and capital market activity. In FY07, 47.5% of its PAT was attributable to Kotak Securities. It has benefited significantly from a buoyant capital market in recent years. As the brokerage business is largely dependent on the buoyancy of the capital markets, volumes and profits may dip considerably during lean capital markets.

#### *Personnel loan growing*

#### *Change in advances mix*

During FY07, the advances mix has changed from auto and commercial vehicle to higher mix of personal (unsecured) and home loans, which have grown by 96% and 81% respectively. With the hardening of the interest rates, housing portfolio may not register the impressive growth that Kotak has witnessed in FY06. Besides, NPAs may crop up in Personal/Housing loan portfolio due to increase in the interest rates.

#### *Trading at the forward P/BV FY08E of 5.1x and Target Price of 690*

### Outlook

The present economic scenario offers immense opportunities for Kotak to grow in scale and reach coupled with the value creation. We see an upside on the growing significance of the commercial banking and life insurance businesses. The bank, with its integrated business model, would be able to take advantage of this growth in the coming years. Non-interest income, high NIM, huge advances growth, diverse product and cross selling will help Kotak to reach the target EPS of Rs. 24.6 for FY08.

At the current price of Rs. 635, the stock is trading at a forward P/BV of 5.1x FY08E and 3.9x FY09E.

Based on a target P/BV multiple of 5.5x we value the banking and non-banking operations of Kotak bank at Rs. 690/share. We initiate the coverage with Hold.

### Company Background

Kotak Mahindra Bank formerly known as Kotak Mahindra Finance is one of India's growing financial conglomerate, offering complete financial solutions that encompass every sphere of life. From commercial banking, to stock broking, to mutual funds, to life insurance, to investment banking, the group caters to the diverse financial needs of the individuals and the corporate.

The group has a net worth of over Rs. 32 bn, employs around 10,800 people in its various businesses and has a distribution network of branches, franchisees, representative offices and the satellite offices across 300 cities and towns in India and offices in New York, London, Dubai, Mauritius and Singapore. The Group services around 2.6 mn customer accounts.

Its segments include lending, corporate banking, treasury & investments, retail liabilities, broking, asset management, and insurance.

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