

Kotak Mahindra Bank**Rs 494****Steady quarter; expensive valuation****HOLD****KRChoksey**
INTEGRATED FINANCIAL SOLUTIONS

The bank reported consolidated earnings of Rs 432 crore which grew 18.9% y-o-y & 4.1% q-o-q, in line with our expectation. Lending business and life insurance continued to be key profit growth drivers at consolidated level. Asset management, investment banking and securities broking businesses remained under pressure due to lower volumes and poor profitability during the quarter. On standalone basis, NII saw modest growth of 11.3% y-o-y & 6.6% q-o-q led by strong loan growth of 41.1% y-o-y. NIM (calc) contracted 6bps q-o-q to 4.63% due to strong growth in low yield corporate loan book and 88bps contraction in CASA ratio. Standalone PAT grew 33.5% y-o-y and 3.2% q-o-q driven by healthy operating net revenues and lower provisions. Broadly, asset quality has been stable during the quarter with 0.4% Net NPA ratio. **Downgrade to HOLD.**

Steady performance in Banking business: Bank's NII grew by 11.3% y-o-y and 6.6% on q-o-q to Rs 605 crore led by strong loan growth and marginal contraction in NIMs. Non-interest income grew 52.5% y-o-y aided by healthy growth fee income. Healthy operating net revenues coupled with lower provisions supported the bottom line during the quarter. Net profits came in at Rs260 crore growing 33.5% y-o-y & 3.2% q-o-q. We expect the bank to deliver 26.7% CAGR in net earnings over FY11-FY13 driven by strong loan growth, steady asset quality and improving productivity in new branches.

Consolidated PAT growth at 18.9% y-o-y supported by lending & life insurance businesses: Kotak prime (KP) reported PAT of Rs90 crore vs. Rs94 crore in Q1FY12, marginal decline q-o-q. Consumer finance loan book saw healthy growth sequentially 6.8% q-o-q to Rs11,145 crore. KP's Capital adequacy ratio remained at healthy levels of ~ 15.9%. Capital market linked businesses (securities, IB and AMC) showed weak operating and earnings performance due to fall in equity markets, lower yields and subdued investment sentiments. Capital market businesses' earnings were down 43.5% y-o-y and 3.0% q-o-q. Life insurance business continued to show steady performance with Rs53 crore PAT & 37.6% growth in first year premium. Consolidated PAT registered a growth of 18.9% y-o-y and 4.1% q-o-q aided by healthy performance in lending businesses and steady profitability in life insurance.

Asset quality held up well: Broadly, asset quality trends have been stable during the quarter. Both on absolute and % terms, gross NPAs and Net NPAs were declined q-o-q basis, reflecting better quality of loan book. Gross NPAs and Net NPA stood at 1.6% & 0.4% respectively with provision coverage ratio 66%.

Valuation & Recommendation

The Bank delivered steady operating performance at consolidated level during the quarter. Modest NII growth, healthy non interest income and lower provision supported net profit growth. Strong loan growth outlook, aggressive branch expansion strategy, superior pricing approach to risky segments, building quality liability franchise and best-in-class margins will drive earning growth in medium term. We expect standalone earnings to grow 26.7% CAGR over FY11-FY13 driven by strong loan and healthy fee income growth. Slowdown in auto financing and prolong weaker business cycle for capital market businesses are key headwinds for the stock performance in near term. At Rs 491, the stock is trading at 17.4x core FY13 earnings and 2.7x core FY13 book. **The stock has outperformed the market by 15% in last three months, resulting into unfavorable risk- reward, hence we downgrade our investment rating on the stock from BUY to HOLD with a target price Rs 537 based on SOTP valuation.**

Key Financials- Standalone**Rs in crore**

Particulars	FY10	FY11	FY12E	FY13E
Net Interest Income	1858	2097	2625	3302
Pre-provision profit	1297	1325	1805	2301
Net Profit	561	818	1077	1313
EPS	8.1	11.1	14.6	17.8
BVPS	64.4	92.2	104.9	121.2
ABVPS	54.5	84.7	97.3	112.8
Core P/E	38.5	28.0	21.3	17.4
Core P/ABV	5.6	3.6	3.1	2.7

Source: Company, KRChoksey Research

Target Price (Rs): 537

Potential Upside : 8.7%

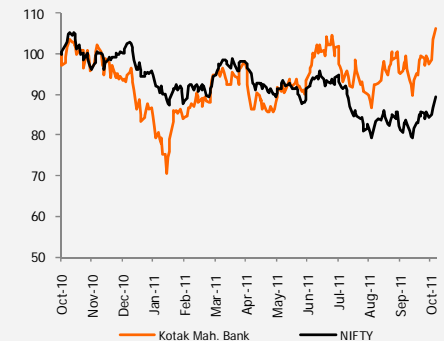
Previous TP (Rs): 530

Market Data

Equity sh. O/S (cr)	73.9
MCAP (Rs crs)	37,568
52 Wk H/L (Rs)	520/333
Avg Vol (3m avg)	9,26,835
Fee float (%)	55%
Face Value (Rs)	5
Bloomberg Code	KMB IN

Market Info:

SENSEX	17782
NIFTY	5355

Price Performance**Share Holding pattern (%)**

Particulars	Sep-11	Jun-11	Chg
Promoters	45.5	45.5	0.0
FIIIs	26.6	26.0	0.6
Institutions	5.2	5.4	-0.3
Others	22.8	23.1	-0.3
Total	100	100	

Source: BSE

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NII up 11.3% y-o-y & 6.6% q-o-q led by strong loan growth

Net interest income grew by 11.3% y-o-y and 6.6% q-o-q basis to Rs 605 crore. The calculated NIMs declined by 6bps q-o-q to 4.8% due to 88bps contraction in CASA ratio, strong growth in low yield corporate loan and rise in cost of term deposits. Yield on avg interest bearing asset up by 22bps while cost of funds increased by 29bps resulted into 6bps contraction in NIMs. We believe NIMs continue to be under pressure in the next couple of quarters due to rising cost of funds and higher growth in corporate loan book than retail loan book. We are building in 12bps NIM contraction in FY12 factoring change in incremental loan book mix and increase in cost of deposits.

Exhibit :1 Loan and NII growth Trend

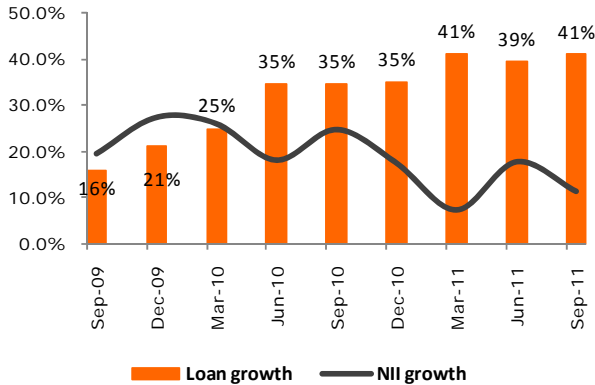
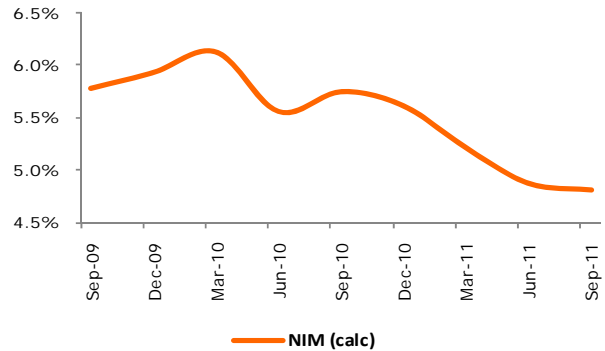


Exhibit : 2 Net interest margin continued to be under pressure

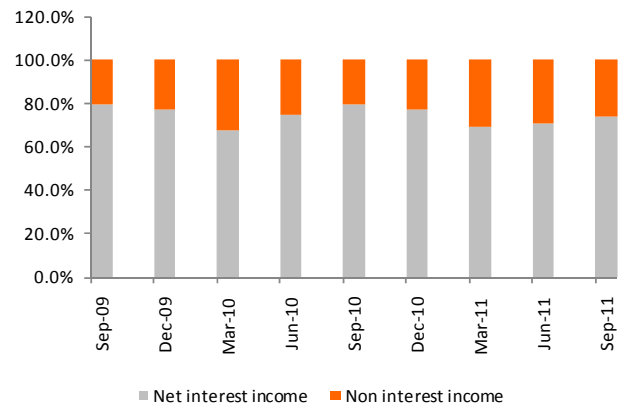
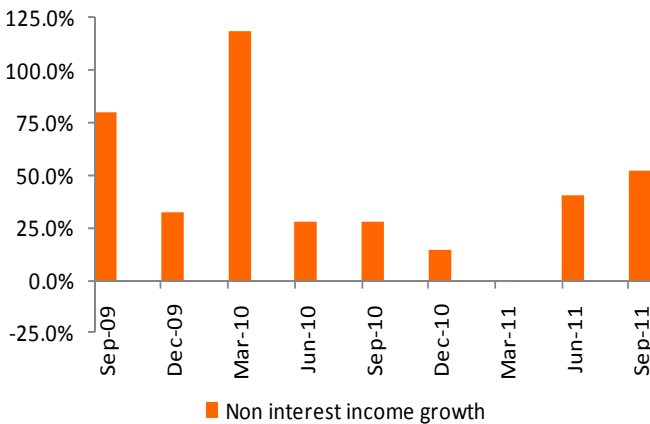


Source: Company, KRChoksey Research

Noninterest income up 52.5% y-o-y but down 7.1% q-o-q

Non- interest income grew by 52.5% y-o-y to Rs 229 crore driven by core fee income; however it declined by 7.1% q-o-q. Subdued recoveries and up-gradations coupled with poor treasury performance dragged the non-interest income during the quarter. We are factoring in 27% CAGR in fee income over FY11-FY13e driven by retail and corporate businesses.

Exhibit :3 Non Interest Income Growth



Deposit growth grew by 28.6% y-o-y

The standalone deposit was up 17.2% q-o-q and 28.6% y-o-y to Rs 36,390 crore driven by strong traction in term deposits and stepped up mobilization through CDs while Current account deposits and saving deposits growth were 17.1% q-o-q & 7.8% q-o-q respectively. CASA ratio declined 88bps to 25.7%, lower than the normalized level of ~30%. Consolidated deposits grew by 30.5% y-o-y to Rs 34,473 crore.

Exhibit :4 CASA ratio and Growth in term deposits trend

Rs in crore	Q2FY12	Q1FY12	Q2FY11	Q-o-Q	Y-o-Y	Mix
Deposits	36390	31047	28287	17.2%	28.6%	100.0%
CA	5792	4947	5875	17.1%	-1.4%	15.9%
SA	3564	3307	3143	7.8%	13.4%	9.8%
CASA	9356	8254	9018	13.4%	3.7%	25.7%
TDs	19827	16819	14536	17.9%	36.4%	54.5%
CDs	7207	5974	4733	20.6%	52.3%	19.8%
CASA ratio	25.7%	26.6%	31.9%	-88 bps	-617 bps	-

Source: Company, KRChoksey Research

Strong growth momentum in loan book

Advances increased by 41.1% y-o-y and 15.5% q-o-q to Rs 37,349 crore driven by robust credit demand from corporate as well as retail segment. Corporate loans grew by 50.8% y-o-y and 32.9% q-o-q. Strong traction was seen in CV & construction space (up 62.1% y-o-y) followed by personal loans and mortgage loans, up by 30.8% and 26.8% y-o-y respectively during the quarter. Consolidated advances grew by 34.8% y-o-y to Rs 50,581 crore.

Exhibit :5 Advance growth trend

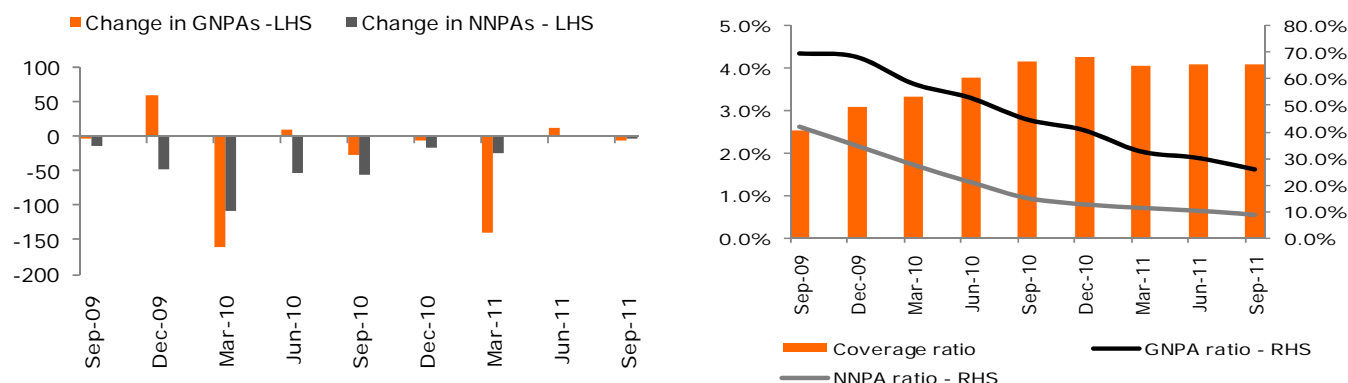
Rs in crore	Q2FY12	Q1FY12	Q2FY11	Q-o-Q	Y-o-Y	Mix
Advances	37349	32339	26462	15.5%	41.1%	100.0%
CVs & Cons. Equip.	7351	6771	4536	8.6%	62.1%	19.7%
Personal loans	1500	1359	1147	10.4%	30.8%	4.0%
Mortgages	7528	7077	5938	6.4%	26.8%	20.2%
Corp. Loans	14900	11214	9883	32.9%	50.8%	39.9%
Agri. Finance	4248	4356	3328	-2.5%	27.6%	11.4%
Others	1822	1562	1629	16.6%	11.9%	4.9%
CD ratio	103%	104%	94%	-153 bps	909 bps	-

Source: Company, KRChoksey Research

Asset quality held up well

The gross NPA declined marginally in absolute terms by 1.1% q-o-q to Rs 609 crore, down 18.9% y-o-y. As a percentage to gross advances it stood at 1.6%, down 27bps q-o-q while net NPA was at 0.6% reflecting comfortable asset quality as the bank has not seen any significance deterioration in asset quality so far. Absence of concentrated loans or exposure to sensitive sectors such as power and telecom also provides comfort on the asset quality front. The coverage ratio excl. write offs was quite healthy at ~66% during the quarter. We are building in 30bps and 55bps credit in FY12 and FY13 respectively.

Exhibit :6 Gross NPA and Net NPA Trend

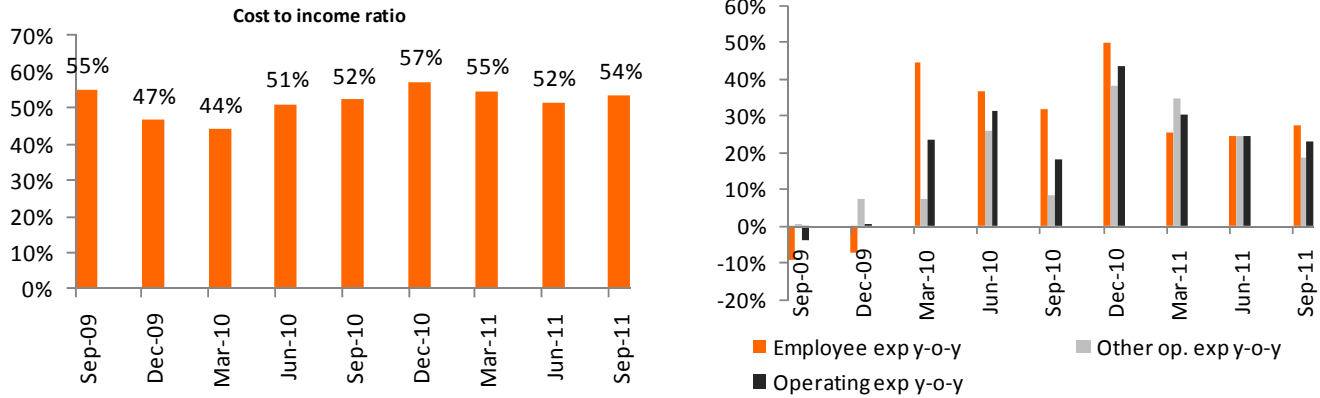


Source: Company, KRChoksey Research

Cost to income ratio inched up 200bps q-o-q to 53.5%

Cost to income increased 200bps q-o-q to 51.5% due to higher other operating expenses. Operating expenses increased by 22.9% y-o-y and 6.7% q-o-q to Rs 438 crore on account of benign advertisement expenses. Employee cost increased marginally by 3% q-o-q at Rs 215 crore.

Exhibit : 7 Cost to income ratio & Operating exp growth trend



Source: Company, KRChoksey Research

Other Key Highlights

- No branch addition during the quarter. However the bank plans to reach 500branches by CY13.
- Capital adequacy ratio stood at very healthy levels of 17.8% with 15.9%.
- We have tweaked our earnings estimate upward by 3.7% & 0.8% for FY12 and FY13 respectively factoring lower credit costs. Our earnings' estimate is 7% higher than the Bloomberg consensus.

Q2FY12 : Result Analysis

(Rs in crore)	Q2FY12	Q1FY12	Q2FY11	Q-o-Q	Y-o-Y (%)
Income Statement - Standalone					
Interest income	1,465	1,330	1015	10.1%	44.3%
Interest expense	859	762	471	12.8%	82.5%
Net interest income	605	568	544	6.6%	11.3%
Non interest income	212	229	139	-7.1%	52.5%
Operating income	818	797	683	2.7%	19.7%
Operating expenses	438	410	356	6.7%	22.9%
Pre-provision profits	380	386	327	-1.6%	16.3%
Provisions	-2	22	46	-110.7%	-105.2%
Profit before tax	382	364	281	5.1%	36.0%
Tax expense	122	112	87	9.3%	41.4%
Net profit	260	252	195	3.2%	33.5%
Key Balance Items & others - Standalone					
Advances	37,349	32,339	26,462	15.5%	41.1%
Investments	16,944	17,925	13,935	-5.5%	21.6%
Deposits	36,390	31,047	28,287	17.2%	28.6%
Borrowings	12,771	13,863	8,004	-7.9%	59.6%
Gross NPAs	609	616	751	-1.1%	-18.9%
Net NPAs	210	214	253	-1.6%	-17.0%
GNPA %	1.6%	1.9%	2.8%	-27 bps	-117 bps
NNPA %	0.6%	0.7%	1.0%	-10 bps	-39 bps
Provision coverage %	65.5%	65.3%	66.3%	19 bps	-80 bps
CAR	17.8%	18.2%	19.4%	-35 bps	-163 bps
Business Segment wise PAT					
Kotak Mahindra Bank	260	252	195	3.2%	33.5%
Kotak Mahindra Prime	90	94	61	-4.3%	46.7%
Kotak Mahindra Capital Company	-4	1	7	-500.0%	-154.7%
Kotak Securities	29	23	52	26.1%	-44.0%
Kotak Mahindra Life Insurance	53	46	13	15.2%	294.3%
Kotak Mahindra AMC/ Trustee	7	9	-2	-22.2%	-388.1%
International Subsidiaries	-7	-3	12	133.3%	-157.1%
Kotak Investment Advisors Ltd	8	11	11	-27.3%	-24.0%
Kotak Mahindra Investments	3	3	8	0.0%	-62.5%
Total	439	436	357	0.7%	23.1%
MI, Equity Affiliates, Others	(6)	-20	7	-	-
Consolidated PAT	433	416	364	4.1%	18.9%

Source: Company, KRChoksey Research

Subsidiaries Performance

(Rs in crore)	Q2FY12	Q1FY12	Q2FY11	Q-o-Q	Y-o-Y (%)
Key Subsidiaries' Performance					
Kotak Prime - Consumer Finance					
Total Income	365	384	274	-4.9%	33.5%
PBT	129	142	91	-8.7%	42.4%
PAT	87	94	59	-7.3%	48.3%
Total advances	11145	10439	8291	6.76%	34.4%
Car advances	9821	8938	7788	9.9%	26.1%
Net NPAs	22	26	61	-15.4%	-64.1%
Net NPA ratio	0.2%	0.2%	0.3%	0 bps	-10 bps
CAR (%)	15.9%	16.0%	13.4%	-10 bps	250 bps
Kotak Securities					
Total Income	152	145	198	4.8%	-23.2%
PBT	44	36	77	22.2%	-43.2%
PAT	29	23	52	26.1%	-43.9%
Avg daily turnover	4261	3582	4300	19.0%	-0.9%
Market share (%)	2.9%	3.7%	2.7%	-80 bps	20 bps
Kotak Life					
FYP	172	125	298	37.6%	-42.3%
Renewal	426	346	425	23.1%	0.2%
Single	78	40	13	95.0%	500.0%
Gross Premium Income	676	511	735	32.3%	-8.0%
Individual	90	65	244	38.5%	-63.1%
Group	82	60	54	36.7%	51.9%
Profit/Loss	53	46	13	15.2%	307.7%
AUM	8163	8284	7557	-1.5%	8.0%
Solvency Ratio	3.0%	2.9%	2.7%	19 bps	35 bps
Branches	202	202	214	0	-12
Kotak Mah Investments Advisors - Alternate assets management/advisor					
Total Income	24	25	22.1	-4%	9%
PBT	13	15	14.9	-13%	-13%
PAT	8	11	10.6	-27%	-25%
Kotak Mah Capital Company - Investment Banking					
Total Income	13.0	23.0	33.5	-43%	-61%
PBT	-5.0	2.0	11.0	-350%	-145%
PAT	-4.0	1.0	7.3	-500%	-155%
Kotak AMC & Trustee - Mutual fund					
Total Income	33.0	37.0	16.6	-11%	99%
PBT	10.0	13.0	-6.3	-23%	-259%
PAT	7.0	9.0	-4.0	-22%	-275%
Average AUM	32,400	34,200	28,400	-2.8%	-31.3%
Consolidated Net Profit	433	416	364	4.1%	18.9%

Source: Company, KRChoksey Research

SoTP Valuation

Based on FY13	Stake (%)	Value (Rs cr)	Per Share	Methodology
Standalone	100%	26,310	357	2.7x FY13E BVPS
Kotak Mahindra Prime	100%	5,220	71	2.2x FY13E BVPS
Kotak Mahindra Life Insurance	74%	2,126	29	14x NBAP Multiple & 14% Margins
Kotak Securities	100%	2,794	38	12x FY13e earnings
Kotak Capital company	100%	573	8	10x FY13e earnings
AMC Businesses	100%	2,897	39	4% of FY13e AUM
Others		1,980	27	12x FY13e earnings
Subsidiaries/Associate value			180	
Intrinsic Value			537	

Source: KRChoksey Research

Earnings Revision

(Rs in crore)	FY12e		Change (%)	FY13		Change (%)
	Old	New		Old	New	
Net Interest Income	2,640	2,625	-0.59%	3,294	3,302	0.23%
Pre Provision Profit	1,718	1,805	5.09%	2,216	2,301	3.82%
Net Profit	1,045	1,077	3.05%	1,303	1,313	0.77%

Source: KRChoksey Research

KRChoksey Estimates Vs Market Consensus

	FY12			FY13		
	KRC	Bloomberg	Vari (%)	KRC	Bloomberg	Vari (%)
EPS (Rs)	14.6	13.7	6.7%	17.8	16.5	8.2%
DPS (Rs)	1	1	11.4%	1	1	36.1%
BVPS (Rs)	105	119	-12.0%	121	137	-11.6%
PAT (Rs in crs)	1077	1006	7.0%	1313	1227	7.0%
RoA (%)	1.9%	1.8%	-8 bps	1.9%	1.8%	-10 bps
RoE (%)	14.0%	14.0%	-9 bps	15.1%	15.0%	-7 bps

Financials
Income Statement

Rs in crore	FY10	FY11	FY12 E	FY13E
Interest income	4156	5523	6711	8075
Interest expense	2058	2898	3409	4005
Net Interest Income	2097	2625	3302	4070
- Core fee Income	501	641	808	1009
Non interest income	781	996	1208	1464
Operating income	2878	3620	4509	5535
Operating expenses	1553	1815	2209	2666
-Employee cost	784	929	1159	1466
-Other op. expenses	769	886	1050	1200
Pre-provision profits	1325	1805	2301	2869
Provisions	137	242	395	493
PBT	1188	1563	1906	2376
Provision for taxes	370	486	593	739
Net profit	818	1077	1313	1637
Dividend (Inc. tax)	41	76	108	153

Spread Analysis

	FY10	FY11	FY12E	FY13E
Avg Yield on Advances	13.5%	12.7%	12.9%	12.4%
Avg Yield on Invest.	6.7%	6.5%	6.6%	6.6%
Avg Yield on IBA	10.4%	9.8%	10.2%	10.1%
Avg Cost of Deposits	5.0%	5.6%	6.2%	5.8%
Avg Cost of Funds	5.3%	5.8%	6.4%	6.0%
Spread	8.2%	6.9%	6.5%	6.4%
NIM	5.9%	5.0%	4.8%	5.0%

Asset Quality Profile

	FY10	FY11	FY12 E	FY13E
Gross NPA	767	603	709	928
Net NPA	360	211	213	278
Gross NPA %	3.6%	2.0%	1.8%	1.9%
Net NPA %	1.7%	0.7%	0.6%	0.6%
Credit Costs	2.5%	0.4%	0.3%	0.6%

Per Share Data

(Rs)	FY10	FY11	FY12E	FY13E
EPS	8.1	11.1	14.6	17.8
DPS	0.4	0.6	1.0	1.5
BVPS	64.4	92.2	104.9	121.2
ABV	54.5	84.7	97.3	112.8
Core P/E	34.1	24.9	18.9	15.4
Core P/ABV	4.9	3.2	2.8	2.4
Dividend yield	0.09%	0.12%	0.22%	0.32%

Source: KRChoksey Research

Balance Sheet

Rs in crore	FY10	FY11	FY12E	FY13E
Equity capital	348	368	368	368
Reserve and Surplus	4137	6428	7360	8566
Net worth	4485	6796	7729	8934
Deposits	23886	29261	38039	48690
Borrowings	6141	11724	12134	14334
CL and provisions	2869	3032	3639	4549
Total	37436	50851	61578	76544
Cash and Bal. with RBI	2086	2108	2763	3537
Balances with RBI	215	363	397	409
Investments	12513	17121	18069	21180
Advances	20775	29329	38128	48804
Fixed assets	428	426	417	449
Other assets	1421	1503	1804	2165
Total	37436	50851	61578	76544

Dupont Analysis

(As % Average assets)	FY10	FY11	FY12E	FY13E
NII	5.6%	4.8%	4.7%	4.8%
Fee Income	0.9%	1.1%	1.1%	1.2%
Treasury Income	0.2%	0.2%	0.1%	0.1%
Employee Cost	1.8%	1.8%	1.7%	1.7%
Operating Costs	3.6%	3.5%	3.2%	3.2%
Provisions	1.5%	0.3%	0.4%	0.6%
Tax	0.8%	0.8%	0.9%	0.9%
ROAA	1.7%	1.9%	1.9%	1.9%
RoAE	12.5%	13.3%	14.0%	15.1%

Business Profile

	FY10	FY11	FY12E	FY13E
Advances	20,775	29,329	38,128	48,804
CD ratio	87%	100%	100%	100%
Deposits	23,886	29,261	38,039	48,690
CASA Deposits	7,463	8,791	11,610	16,426
CASA Ratio	31.2%	30.0%	30.5%	33.7%

Growth ratios

	FY10	FY11	FY12E	FY13E
Net interest income	22.4%	12.9%	25.2%	25.8%
Fee income	36.5%	63.9%	28.0%	26.0%
Pre-provision Profits	90.7%	2.1%	36.3%	27.4%
Net Profits	103.2%	45.8%	31.6%	21.9%
Advances	25.0%	41.2%	30.0%	28.0%
Deposits	52.7%	22.5%	30.0%	28.0%
Total Assets	30.4%	35.8%	21.1%	24.3%

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Kotak Mahindra Bank			
Date	CMP	Target	Recommendation
28-Oct-11	494	537	HOLD
04-Oct-11	448	530	BUY
22-July-11	490	530	HOLD
09-May-11	431	520	BUY
21-Jan-11	419	520	BUY
25-Oct-10	494	540	HOLD

Rating Legend	
Our Rating	Upside
Buy	More than 15%
Hold	5% - 15%
Reduce	0 – 5%
Sell	Less than 0%

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Phone: 91-22-6633 5000; Fax: 91-22-6633 8060.

Corporate Office:

ABHISHEK, 5th Floor, Link Road, Dalia Industrial Estate, Andheri (W), Mumbai – 400 053.

Phone: 91-22-6696 5555; Fax: 91-22-6691 9576.