

Company Flash

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Kotak Mahindra Bank (KTKM.BO)

Citi India Conference 2008: Day 1 Takeaways

- Conference takeaways** — Kotak Mahindra spoke with investors at the Citi India Investor Conference 2008. Here are some of the highlights of that presentation.
- Business overview** — Only brokerage is showing signs of a slowdown. Management suggests the overall business is still strong. Out of the four businesses that Kotak operates — banks life insurance, corporate and investment banking and Investment services — only brokerage could see some slowdown in line with the market. Other businesses continue to grow.
- MTM charge on derivatives position; one default, but little risk ahead** — Management said there were no open derivatives positions on its books. There are client corporate positions, which are squared with other banks. It estimates the total MTM position in the market today is about \$3bn, of which Kotak would have 4-5%. However about 85% of these are with large corporates and till date has seen only one case of default. Some of these positions are out of the money for the corporate (not KTKM); and KTKM believes the risk of these translating into losses for itself is remote. Kotak has, however, slowed this business, but believe loss of revenue would be minimal.
- Attrition** — It remains an issue, but is in line with industry. Specifically, wealth management attrition is at 8%, bank attrition at the front office at 35%, middle-management at 12% - all in line with industry averages. The talked about loss of the derivatives team has been largely internal, and is business as usual.

Hold/Medium Risk	2M
Price (11 Mar 08)	Rs681.00
Target price	Rs1,110.00
Expected share price return	63.0%
Expected dividend yield	0.1%
Expected total return	63.1%
Market Cap	Rs234,716M
	US\$5,810M

Price Performance (RIC: KTKM.BO, BB: KMB IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	7,297	23.56	318.9	28.9	9.4	39.3	0.1
2007A	5,382	16.89	-28.3	40.3	6.9	19.6	0.1
2008E	8,173	24.35	44.2	28.0	4.1	18.4	0.1
2009E	10,263	29.82	22.5	22.8	3.5	16.7	0.1
2010E	12,114	35.21	18.0	19.3	3.0	16.8	0.2

Source: Powered by dataCentral

Aditya Narain, CFA¹

 +91-22-6631-9879
 aditya.narain@citi.com

See Appendix A-1 for Analyst Certification and important disclosures.

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Kotak Mahindra Bank

Company description

KTKM is a private-sector bank in which Mr. Uday Kotak, the major shareholder, and his associates have a 55% stake. Main businesses of the bank are consumer lending, retail broking, investment banking, asset management, and rapidly growing life insurance. Its focus is to develop a niche wealth-management platform.

Investment strategy

KTKM, in our view, is a high-quality play on the growing financial-services market in India. It is backed by a management team that has a track record of managing market and credit risk well and of being conservative in its approach. We see Kotak as a leveraged play on: 1) Ongoing disintermediation, with a shift from traditional bank-deposit-type savings instruments to more market-oriented ones - Kotak is a direct provider of these services and looks well positioned to capture the distribution potential of these services. 2) KTKM has a strong market position in consumer lending, has robust and specialized distribution and is probably one of only two players with experience in consumer-credit cycles. Kotak is highly leveraged to this segment. Over 80% of its asset book is in consumer lending. We think its portfolio is well managed, mature and profitable. 3) Direct exposure to growth in the capital market - Kotak is a leader in the primary and secondary markets, which is backed by an extensive and independent distribution franchise. However, its high dependence on the capital market raises the risk of business cyclicality. This risk appears more pronounced in the near term, given the recent market upswing. We rate Kotak Hold/Medium Risk, as we believe returns from the stock will be muted after its recent surge.

Valuation

Our target price of Rs1110 (Rs825 previously) is based on our EVA methodology. KTKM's relatively high share of securities fees suggests a valuation benchmark of an investment bank. However, there are no such comparables in the Indian market, and Kotak is much smaller than its global peers. Hence, we use EVA to value Kotak. In our EVA methodology, we have used an 800bp risk-free rate and a market beta of 1. We are not consolidating the insurance subsidiary's financials, and value it independently with a value of Rs115 per share (previously Rs105). Our EVA upgrade is based on higher earnings, higher longer term margins and greater momentum on the fee income front. We are also attributing discrete value to the Asset management business, which we were not doing previously.

We also benchmark our valuation of a sum of parts methodology – our target price based on this is Rs1025 (previously Rs780), which values the banking business at 3X FY09E PBV (previously 2.5X FY09E), 20X FY09E PE multiple to the investment banking and broking business (previously 18X), the insurance subsidiary at Rs115 per share (previously Rs105), and we attribute Rs110 to

the AMC business (6% of AUM for MF, and 9% for Portfolio and alternative assets, at estimated FY09E levels).

Risks

We rate KTKM as Medium Risk, though our quantitative risk-rating system suggests Low Risk. We believe a higher risk rating is justified in part because of the strong stock performance over the recent past and in part because of KTKM's relatively small balance sheet. The key downside risks to our target price include: (1) KTKM is growing aggressively. The pace of change amid KTKM's conservatism and the competitive business environment could create execution risks; (2) KTKM generates more revenues from the capital markets than any other bank in India, and its profitability in the recent past has been significantly boosted by strong equity markets. The cyclical nature of the capital markets, particularly after a strong performance, is a key risk to earnings and valuations. Upside risks to our rating and target price include: (1) KTKM's strong position in the capital markets and relatively high earnings reliance could significantly boost earnings and valuations; and (2) stronger-than-expected performance and benchmark valuations for the unlisted life-insurance venture.

Appendix A-1

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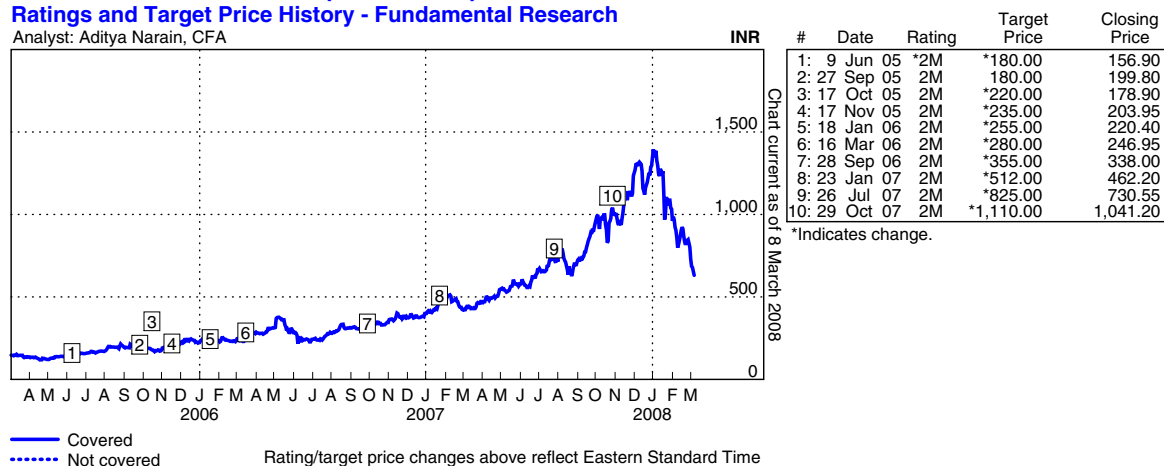
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Kotak Mahindra Bank (KTKM.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Aditya Narain, CFA



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