

RESULTS REVIEW
Share Data

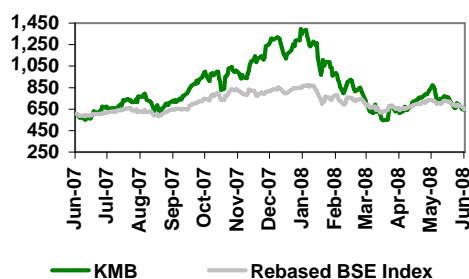
Market Cap	Rs. 220.2 bn
Price	Rs. 638.8
BSE Sensex	15,514.79
Reuters	KTKM.BO
Bloomberg	KMB IN
Avg. Volume (52 Week)	0.3 mn
52-Week High/Low	Rs. 1,435.55 / 536.55
Shares Outstanding	344.7 mn

Valuation Ratios (Standalone)

Year to 31 March	2009E	2010E
EPS (Rs.)	45.9	63.9
+/- (%)	57.4%	39.1%
PER (x)	13.9x	10.0x
P / PPP (x)	0.02x	0.02x
P / ABV (x)	3.0x	2.3x

Shareholding Pattern (%)

Promoter	53
FII's	25
Institutions	5
Public & Others	17

Relative Performance

Kotak Mahindra Bank
Buy
A consistent performer: Maintain Buy

Kotak Mahindra Bank ended the year with encouraging numbers. We maintain our **Buy** rating on the stock on account of the following reasons:

- Core business is getting stronger.** The standalone banking profit jumped c.86% yoy to Rs. 692.1 mn. CASA ratio increased about 500 bps over the year, leading to a 40 bps rise in consolidated NIM to 5.6%, one of the highest in the industry. Net NPA ratio fell 20 bps to 1.78%. Going forward, we expect the Bank to maintain the momentum in CASA ratio with the expected addition of 100 branches in FY09. Asset quality is also expected to improve further as the Bank has indicated its inclination to focus on quality lending, especially in the retail segment.
- International business is showing robust growth.** International subsidiaries are reporting stronger numbers, both in absolute as well as relative terms. Net profit increased c.124% yoy to Rs. 178 mn. The contribution of these subsidiaries to consolidated profit increased from 4.7% in Q4'07 to 7.4% in Q4'08.
- Non-banking businesses are showing encouraging prospects.** We have identified life insurance, investment banking, and alternate assets management as the future growth areas. Life insurance is likely to get a boost due to the Bancassurance channel being developed by the Bank. The Investment Banking division has been involved in a number of key IPOS and QIPs, such as Reliance Power, SBI, Future Capital etc. Alternate assets grew by around 4.7 times in FY08 to Rs. 56 bn. We expect impressive growth in FY09 as the Bank continues to raise funds.

Key Figures (Standalone)

Quarterly Data	Q4'07	Q3'08	Q4'08	YoY %	QoQ%	FY07	FY08	YoY %
(Figures in Rs mn, except per share data)								
Net Interest Income	1,957	3,474	3,908	99.7%	12.5%	6,199	12,258	97.8%
Net Operating Income	2,922	5,520	4,301	47.2%	(22.1)%	9,385	16,893	80.0%
Pre-Prov Operating Profit	959	2,590	1,691	76.2%	(34.7)%	3,258	6,699	105.6%
Net Profit	373	1,017	692	85.7%	(31.9)%	1,414	2,939	107.9%
Cost/Operating Income (%)	67.2%	53.1%	60.7%	-	-	65.3%	60.3%	-
Net Interest Margin*	-	5.7%	-	-	-	5.2%	5.6%	-
NPA ratio	1.98%	1.68%	1.78%	-	-	1.98%	1.78%	-
Per Share Data (Rs.)								
PPP per share	2.9	7.5	4.8	66.3%	(35.2)%	10.0	19.7	97.5%
EPS	1.1	2.9	2.0	75.2%	(32.4)%	4.3	8.7	99.8%
Adj. BVPS*	99.0	163.0	169.0	70.7%	3.7%	99.0	169.0	70.7%

* Consolidated basis

Please see the end of the report for disclaimer and disclosures.

Valuation

We have valued Kotak Mahindra Bank by using the sum-of-the-parts valuation methodology. The core business is valued at a target P/B multiple of 4x, which gives us a target price of Rs. 465. The subsidiaries are valued at P/E multiples, new business achieved profit (NBAP) multiple, and percentage of AUM, depending on the particular business. These subsidiaries, taken together, lead to a value of Rs. 575. On the basis of our valuation, we maintain our **Buy** rating on the stock with a target price of Rs. 1,040 for FY09.

Result Highlights

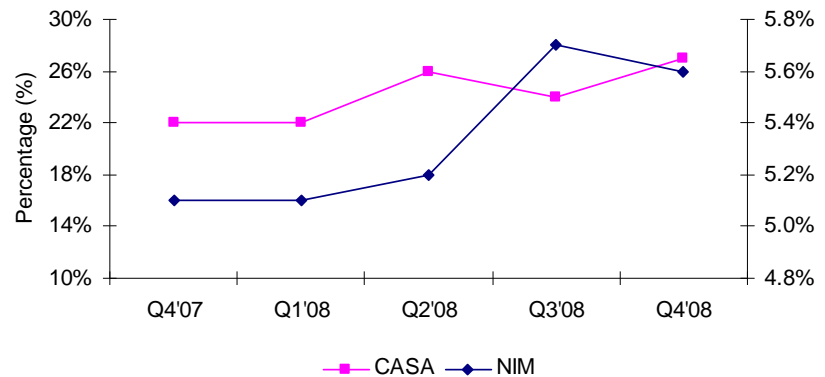
Standalone business – Strong numbers

Standalone net profit soared 85.7% yoy to Rs. 692.1 mn. While net interest income almost doubled to Rs. 3.9 bn, non-interest income succumbed to the downturn in the markets and Mark-to-market loss of around Rs. 6.1 bn, and the consequent provisions of around 860 mn being made. The last quarter witnessed a c.59% yoy fall in other income to Rs. 393.5 mn. CASA ratio increased almost 500 bps yoy to 27%. This increase, coupled with equity infusion in the year led to an improvement in the net interest margin (consolidated) by almost 40 bps to 5.6%. Asset quality too showed signs of improvement as the net NPA ratio fell 20 bps to 1.78%. While presently the net NPA ratio is one of the highest in the industry, we expect it to fall further in the future as the Bank is now focusing more on sound risk management policies in order to attain growing and “risk-adjusted spreads”. This is getting reflected in the Bank keeping away from low-ticket loans (loans having ticket size as low as Rs. 50-60,000) and lower-end credit cards.

The strong standalone business was affected by mark-to-market losses

Mobilisation of low-cost deposits lead to an increased NIM

Growing CASA leading to rising margins



Source: Company data, Indiabulls research

Investment banking – consistent performance

Investment Banking – Presence in prominent IPOs

Kotak Mahindra Capital Company (KMCC) had a decent quarter as profit after tax increased c.23% yoy to Rs. 254 mn. However, the numbers do not accurately reflect the performance as the trading and principal division was de-merged from the Bank in March 2007. KMCC scored as the lead manager for prominent IPOs such as Reliance Power, Future Capital, SBI etc. We expect the successful execution of the abovementioned and other similar IPOs will help the Bank in attracting more opportunities in the investment banking space.

Securities business – Unabated growth

Stock Broking – Continuous growth momentum

Kotak's stock broking business accounted for 7.3% of total average daily market volumes in FY08. Net profit witnessed a c.35% yoy increase to Rs. 1 bn. The AUM (under PMS) increased c.48% yoy to around Rs. 34 bn.

Insurance business – comprehensive growth

Life Insurance – Surging premiums

Life Insurance gross premium continued to grow at a healthy pace of c.73% yoy to Rs. 8.1 bn. The first year regular premium increased 103.1% to Rs. 5.2 bn for the year as a whole. Kotak added 44 branches in the quarter to reach a total of 150 branches. The last quarter witnessed a profit of Rs. 17 mn vis-à-vis a Rs. 101 mn loss in Q4'07. This was on account of the fact that more than 50% of the yearly premium was collected in the last quarter, whereas the costs were evenly spread throughout the year. The Bank is focusing now on the Bancassurance Sales Channel for selling

insurance as it considers it the most efficient way of reaching to a wide circle of customers. With the number of branches on the rise, we expect a bright future for the insurance business.

Asset Management in losses

Total assets under management (AUM) increased c.33% yoy to Rs. 161.3 bn. There has been a loss of around Rs. 44 mn in Q4'08 vis-à-vis a profit of Rs. 1 mn in Q4'07, on account of the sharp fall in equity markets.

Kotak Mahindra Prime – Impressive upswing

Kotak Prime's profit after tax increased c.24% yoy to Rs. 303 mn. Auto advances increased c.31% yoy to Rs. 47 bn.

Alternate assets management – encouraging trends

We see that the alternate assets management is emerging as a key growth area for the bank, given the encouraging prospects it has displayed over the past year. By the end of FY08, the group raised funds to the tune of Rs 56 bn from around Rs. 12 bn in the beginning of the year. The Bank is likely to earn around 1.5-2% of the average funds for the year as the fixed fee, along with another 20% as performance incentives. With the group raising more funds in FY09, we expect this business to record higher revenues this year.

Alternate assets business to emerge as a key growth driver

Prospect

New business of Asset Reconstruction

Kotak has moved into the asset reconstruction business. We expect this move to be an important, strategic step as it is still an unexplored area for financial institutions. The Bank would be buying the stressed assets portfolio (with the collateral largely consisting of some form of the real estates and guarantee of the promoter) at around 15-16% of the principal value. Benefits will also accrue in the form of interest, as expected at around 15-16% p.a. As there seem to be significant gains from these activities, we consider it as a low-risk, high-gain business and hold a positive view about the venture.

Diversity and strong fundamentals to drive growth

Outlook

Kotak is one of the most diversified financial institutions in India. The company has been successfully running an array of verticals, with comprehensive growth being observed across all major domains. We expect banking, alternative assets management and the international subsidiaries to be the key growth drivers. The Bank has been successful in maintaining certain parameters at an above-industry level, such as net interest margin, and has been recording continuous growth as seen in its CASA ratio. While derivative exposure has severely affected the net interest income in the last quarter, we believe it will not have any substantial long-term impact. We expect the diversified business model to help the Bank operate smoothly even in the face of growing competition, and more so when the Indian banking sector opens up in FY10.

Valuation

Our target price of Rs. 1,040 for FY09E for Kotak Mahindra Bank is based on sum-of-the-parts valuation methodology. We have arrived at a target P/B multiple of 4x for the standalone business through the two-stage Gordon growth model (assuming a sustainable RoE of 12%), thus valuing the standalone banking business at Rs. 465.

Trading at a forward P/B of 3x for FY09

Kotak Mahindra Capital Company has been valued at a target multiple of 17x. This gives the investment banking business a valuation of Rs. 85. The brokerage business has been valued at Rs. 249, based on a target P/E multiple of 15x. The AMC has been valued at 6% of its FY09E AUM, based on a recent stake purchase of Standard Chartered AMC by IDFC. This leads to the valuation of Kotak AMC at Rs. 39. The Life insurance business has been valued at Rs. 104 by using NBAP multiple of 16x. Other subsidiaries, taken together, are valued at Rs. 97.

Target Price Calculation		
Company	Value	Basis
Standalone Bank	465	Based on a target P/B multiple of 4.0x
Investment Banking	85	Based on a target P/E multiple of 17x
Life Insurance	104	Based on a target NBAP multiple of 16x
Broking	249	Based on a target P/E multiple of 15x
Asset Management	39	6% of FY09E AUM
Other Subsidiary	97	
Total	1,040	

Income Statement					Key Ratios				
(Rs mn, Yr. ending March 31)	FY07	FY08	FY09E	FY10E		FY07	FY08	FY09E	FY10E
Income Statement					Key Ratios				
(Rs mn, Yr. ending March 31)	FY07	FY08	FY09E	FY10E		FY07	FY08	FY09E	FY10E
Interest Income	13,191	25,354	30,878	39,418	Per share data in Rs. (Consolidated)				
Interest Expense	6,992	13,096	13,874	18,158	Shares outstanding (mn)	326.2	344.7	344.7	344.7
Net Interest Income	6,199	12,258	17,004	21,261	Basic EPS	16.6	29.6	46.6	64.8
YoY Growth (%)	63.1%	97.8%	38.7%	25.0%	Diluted EPS	16.5	29.2	45.9	63.9
Other Income	3,187	4,635	6,859	9,946	Book value per share	99.1	169.0	214.3	277.2
Operating Income	9,385	16,893	23,863	31,207	Adj. book value per share	99.1	169.0	214.3	277.2
YoY Growth (%)	56.9%	80.0%	41.3%	30.8%	Valuation ratios (x) (Consolidated)				
Operating Expense	6,127	10,194	13,841	18,100	P/PPP	0.07x	0.04x	0.02x	0.02x
Pre-Provisioning Profit	3,258	6,699	10,023	13,107	P/E	38.8x	21.9x	13.9x	10.0x
Provisions and Contingencies	1,226	2,721	3,033	3,580	P/B	6.4x	3.8x	3.0x	2.3x
Profit Before Tax	2,032	3,978	6,990	9,527	P/ABV	6.4x	3.8x	3.0x	2.3x
Tax	619	1,038	2,097	2,858	Performance ratio (%) (Consolidated)				
Net Profit	1,414	2,939	4,893	6,669	Return on avg. assets	2.3%	2.9%	3.2%	3.2%
YoY Growth (%)	19.6%	107.9%	66.5%	36.3%	Return on avg. net worth	16.6%	22.0%	23.6%	25.6%
Consolidated Net Profit	5,382	9,955	15,608	21,710	Balance Sheet ratios (%) (Consolidated)				
YoY Growth (%)	-26.2%	85.0%	56.8%	39.1%	Advances to deposits	161.2%	160.6%	149.1%	138.4%
Balance Sheet					Borrowings to advances	64.1%	58.1%	53.6%	49.5%
(Rs mn, as on March 31)	FY07	FY08	FY09E	FY10E	Investments to assets	31.9%	31.4%	31.4%	31.4%
Cash and balances with RBI	12,960	n.a.	41,064	56,281	Investments to deposits	94.5%	91.8%	91.8%	88.5%
Investments	68,620	91,420	126,462	174,517	Net Worth to assets	11.3%	14.5%	13.2%	12.2%
YoY Growth (%)	140.3%	33.2%	38.3%	38.0%	Productivity ratio (Rs. mn)				
Advances	109,241	155,522	202,179	262,832	Opt. expense per employee	0.6	0.5	0.5	0.5
YoY Growth (%)	72.1%	42.4%	30.0%	30.0%	Net profit per employee	0.1	0.1	0.2	0.2
Fixed Assets (Net)	1,411	n.a.	2,410	3,071	Asset per employee	18.4	12.3	14.8	15.2
Other Assets	6,923	n.a.	11,497	15,865	Operating ratios (%)				
Total Assets	199,154	246,942	383,611	512,566	Operating cost to operating income	65.3%	60.3%	58.0%	58.0%
Consolidated Assets	286,308	400,831	561,164	785,629	Operating cost to avg. assets	4.1%	4.6%	4.4%	4.0%
Deposits	110,001	164,236	229,930	317,304	Capital Adequacy Ratio* (Standalone)	8.80%	14.50%	10.48%	9.14%
YoY Growth (%)	67.5%	49.3%	40.0%	38.0%					
Borrowings	50,998	51,193	56,610	63,080					
YoY Growth (%)	216.9%	0.4%	10.6%	11.4%					
Other Liabilities & Provisions	21,821	n.a.	56,887	85,330					
Total Liabilities	182,819	215,429	343,427	465,714					
Share Capital	3,262	3,447	3,447	3,447					
Reserves & Surplus	13,073	28,066	36,737	43,406					
Total Equity & Liabilities	199,154	246,942	383,611	512,566					
Consolidated Net Worth	32,330	58,239	73,847	95,558					
FY08 Balance Sheet as per the Bank data					Source: Bank data, Indiabulls research				
					Note: Some ratios are as per Indiabulls definitions and may not match figures declared by the Bank				
					* Tier I Capital				

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