Prabhudas Lilladher

Company Report
Industry : Banks

Kotak Mahindra Bank

It's a cycle - growth will return

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Contents

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Company Report

November 6, 2009

Kotak Mahindra Bank

Rating	Accumulate
Price	Rs718
Target Price	Rs835
Implied Upside	16.4%
Sensex	16,064

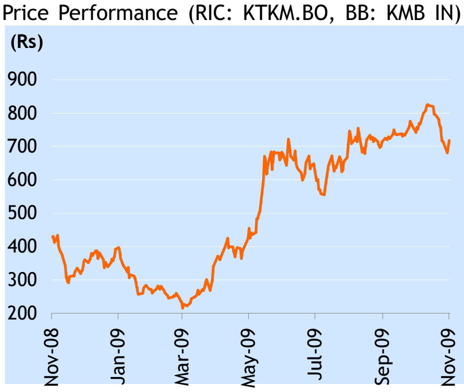
(Prices as on November 5, 2009)

Trading Data	
Market Cap. (Rs bn)	249.1
Shares o/s (m)	345.7
Free Float	51.6%
3M Avg. Daily Vol ('000)	268.3
3M Avg. Daily Value (Rs m)	197.9

Major Shareholders	
Promoters	48.4%
Foreign	29.4%
Domestic Inst.	4.1%
Public & Others	18.1%

Stock Performance	1M	6M	12M
Absolute	(2.0)	74.3	72.3
Relative	2.5	38.9	6.1

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



Source: Bloomberg, PL Research

Kotak Mahindra Bank (KMB) is the most diversified entity amongst all Indian financial conglomerates and also continues to remain the most leveraged play in the Indian capital market space. Our report mainly focuses on the incremental improvement in the core performance of the group which continues be on an uptrend and concludes that consolidated earnings (ex-insurance) are likely to bounce back faster than market expectation. We base our investment rationale on the following arguments:

- **Strong growth expected post FY10 as capital adequacy highest among peers:** With steady economic recovery, we expect KMB to grow at a much faster pace than its peers; this should help in restoring RoEs faster. We do not rule out an inorganic growth option.
- **Most diversified financial conglomerate remains the biggest beneficiary of a capital market turnaround:** KMB's dominant presence in broking and investment banking along with better-than-industry performance in life insurance, mutual fund and private equity should help consolidated earnings bounce back faster.
- **One subsidiary's loss is other's gain:** Fee income generating businesses in the country are undergoing an overhaul which will keep a lid on faster improvement in RoEs. But a financial conglomerate with a commercial bank will always perform better than a standalone broking and distribution entity.
- **Valuations leave limited upside; Accumulate:** On a consolidated basis the stock is trading at 16.2xFY11E EPS, 2.5xFY11E BV and 2.6xFY11E ABV. Most of the re-rating in the stock has already happened due to a turnaround in capital market activities. We continue to favour KMB from a medium-to-long term perspective due to its excellent management bandwidth and its ability to scale-up all its financial verticals once the economy turns around. At the current valuations, the stock has limited upside and hence, we initiate coverage with an **'Accumulate'** rating, with a 12 month forward price target of Rs835.
- **Risks to our investment outlook:** Risk aversion in global equities re-emerges for a sustained period. Domestic retail NPL cycle continues to worsen beyond Q2FY10.

Key Financials (Y/e March)	FY09	FY10E	FY11E	FY12E
Net Interest Income (Rs m)	21,865	23,199	24,635	30,506
Growth (%)	*28.6*	*6.1*	*6.2*	*23.8*
Operating Profit (Rs m)	13,672	21,581	24,289	28,854
PAT (Rs m)*	6,588	10,821	13,003	17,171
EPS (Rs)*	19.1	31.3	37.6	49.7
Growth (%)	*(38.4)*	*64.2*	*20.2*	*32.0*
Net DPS (Rs)	1.2	1.8	2.3	2.9

Source: Company Data; PL Research   ** Consolidated but excludes insurance*

Profitability & Valuation	FY09	FY10E	FY11E	FY12E
*NIM (%)***	5.4	5.2	4.5	4.4
RoAE (%)	*10.7*	*15.6*	*16.4*	*18.8*
RoAA (%)	*1.6*	*2.4*	*2.4*	*2.5*
P / BV (x)*	3.2	2.8	2.5	2.1
P / ABV (x)*	3.4	3.0	2.6	2.2
PE (x)*	32.3	19.4	16.2	12.3
Net dividend yield (%)	*0.2*	*0.2*	*0.3*	*0.4*

Source: Company Data; PL Research   **CMP Adjusted for Rs108/share - Insurance Valuation*

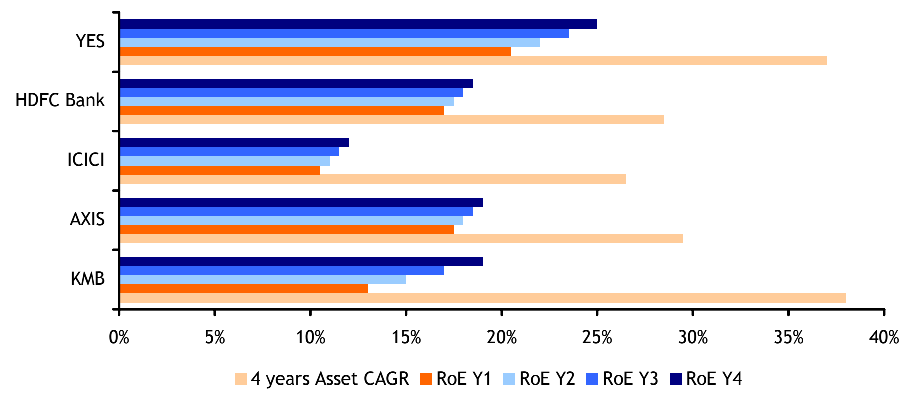
*** Calculated on Average Assets*

Investment rationale

Strong growth expected post FY10 as capital adequacy highest among peers, inorganic growth option remains a possibility

Once economic recovery happens, we expect KMB to grow at a much faster pace than its peers; this should help in restoring RoEs faster. Only YES Bank is likely to grow at a matching pace (post dilution) with a much superior RoE. However, for YES Bank most of its other capital market related revenues flow through the bank P&L, while for KMB, capital market linked revenues mainly flows through its separate subsidiaries that would have much superior RoEs. Consolidated RoEs for KMB will improve by 500-600 bps to ~19% over the next 2-3 years.

KMB will be amongst the fastest growing new age private sector banks without any capital dilution due to its higher Tier I at 15.3% and smaller asset base



Source: Company Data, PL Research

We don't rule out an inorganic growth option. Valuations of possible target banks are down 34% on average from their peak levels and stress levels on asset quality are in the public domain. Hence, acquisition at this juncture may not turn out to be as expensive as some of its larger peers have experienced in the current economic downturn.

Acquisition risks are much lower today but finding the correct match has been difficult - other listed PVT banks are trading 34% below their peaks and asset quality levels are mostly in public domain to make a better informed decision.

Trend in asset quality, valuations, RoE and stock performance for possible target banks

Co_Name	GNPA %	NNPA %	TTM End (P/E)	TTM End (P/BV)	Decline from peak	Gain from recent lows	YTD return	Off from all time highs	RoE
Bank of Rajasth.	2.1%	0.7%	8.5	1.4	-80.3%	144.2%	84.3%	-51.8%	10.1%
City Union Bank	1.8%	1.1%	5.7	1.1	-77.2%	142.7%	87.0%	-44.7%	19.1%
Dev.Credit Bank	9.3%	3.9%	-	1.0	-91.4%	148.0%	56.7%	-78.7%	8.0%
Dhanalaksh.Bank	2.0%	0.9%	9.5	1.3	-65.8%	252.3%	166.5%	20.4%	16.3%
Federal Bank	2.6%	0.3%	7.0	0.9	-67.9%	102.2%	41.8%	-35.0%	13.1%
IndusInd Bank	1.6%	1.1%	15.6	2.0	-80.1%	362.1%	221.8%	-8.2%	12.3%
ING Vysya Bank	1.3%	1.2%	8.7	1.1	-72.2%	178.4%	93.3%	-22.7%	13.9%
Karnataka Bank	3.8%	1.0%	5.5	1.0	-79.9%	137.4%	67.0%	-52.3%	12.7%
Karur Vysya Bank	2.0%	0.2%	6.5	1.3	-65.3%	103.9%	68.5%	-29.2%	17.1%
South Ind.Bank	2.2%	1.1%	5.3	0.9	-79.1%	204.1%	132.5%	-36.3%	15.9%

Source: Capitaline, Bloomberg, PL Research

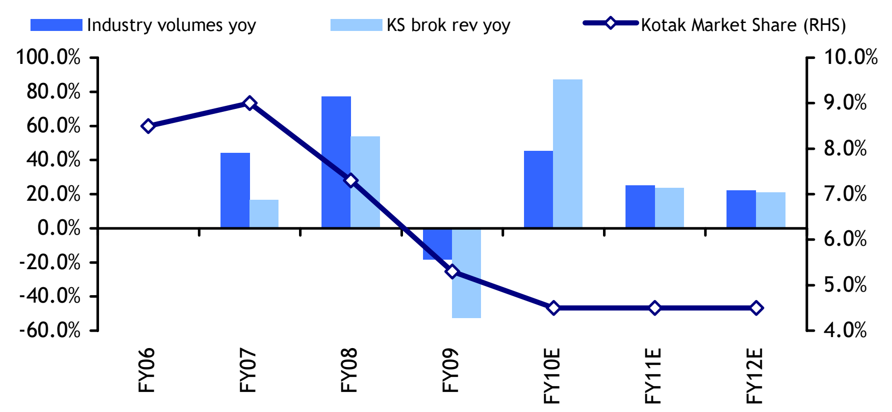
Incremental performance of its key subsidiaries will remain strong; remains the biggest beneficiary of a capital market turnaround

KMB, which is the most diversified financial services conglomerate, will be the biggest beneficiary of a turnaround in the capital markets. The continuous erosion in the market share of its broking business has been a negative; we expect the fall to now stabilise in the 4.5% range.

Its dominant presence in broking and investment banking, along with better-than-industry performance in life insurance, mutual fund and private equity should help the consolidated earnings bounce back faster.

Other large financial conglomerates like HDFC and ICICI Bank have a dominant portion of their revenues and earnings coming from lending businesses which are more stable in nature. Hence, the turnaround in capital market activities does not provide a major upside as it is in the case of KMB. This is because 29% and 50% of its revenues and earnings, respectively are linked to capital market related activities.

Kotak Securities (KS) market share steadily declined, expect to stabilise at ~4.5%

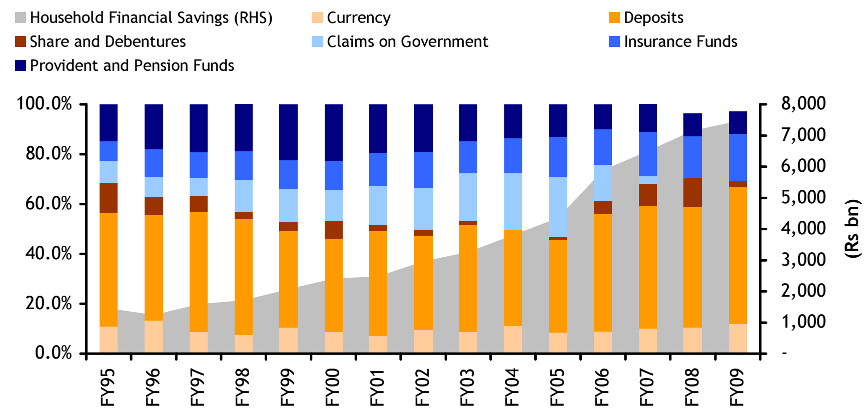


Source: Company Data, PL Research

One subsidiary's loss is other's gain - investing in a fully integrated financial conglomerate hedges the regulatory risk on fee income

If we take a look at the various subsidiaries of KMB and its holding structure (refer to Annexure), we are reasonably sure that the concerns over KMB's distribution model suffering under a regulated fee income environment is not entirely true. We hold an argument based on the household financial savings data we have compiled over the last 15 years. Household savings grew at a CAGR of ~12.4% over FY1994-2009. The detailed break-up of financial savings when analysed clearly depicts that saving's allocation merely moves from one basket to another. In times of uncertainty, bank deposits get the highest allocation, while equities are dumped. If equity markets are doing well, share and debentures continue to rise. Insurance has also become a critical savings option. Based on the savings allocation data over the last 15 years, we can reasonably conclude that the diversified model of KMB, along with its excellent top management quality and brand recognition, stands to gain over a longer time period. The same argument also holds true in case of the regulatory risk on fee income and KMB distribution model. Lower fees and commissions may hurt its distributing arm but will correspondingly increase AUMs at a much cheaper cost for its asset management subsidiaries.

Trend in household financial savings data



Source: RBI, PL Research

We agree that the fee income generating businesses in the country are undergoing an overhaul which will keep a lid on faster improvement in RoEs. We also remain convinced that a financial intermediary with a commercial bank will always perform better than a standalone broking and distribution company as one subsidiary's loss is other's gain.

Summarizing KMB Group's development over FY08-11E - Successfully sailed through stormy water

KMB operates as a financial conglomerate with top presence in major capital market related businesses (broking and investment banking). It also has presence in banking, asset management, alternate assets and non-banking finance. Details of its various subsidiaries and holdings in each of them are mentioned in Annexure. FY08 had been an excellent year for all its subsidiaries. However, from FY09 onwards, the tide turned the other way as revenues and earnings collapsed. We have analysed the changes in various key parameters for the KMB group in FY09 on a YoY basis and also presented in a tabular form the standings of its key subsidiaries as on FY11E vis-à-vis FYO8A. The purpose of this exercise is to gauge the improvement expected in the core fundamentals of the group over the next two years.

Compression in multiples was a major negative for the stock apart from its decline in core fundamentals

KMB consolidated - story so far	FY09	Remarks	Change FY09 (YoY)	Impact on stock	Change by FY11E from FY09
Book value per share (Rs)	188.7	Improved by	12%	↑	29%
GNPAs - with stressed assets (Rs bn)	8.3	Higher than expectations	47%	↓↓	23%
NNPAs - with stressed assets (Rs bn)	4.5	Higher than expectations	25%	↓↓	13%
GNPAs - excluding stressed assets (Rs bn)	5.6	Higher than expectations - CV & PL portfolios under stress	196%	↓↓	29%
NNPAs - excluding stressed assets (RS bn)	2.7	Higher than expectations - CV & PL portfolios under stress	266%	↓↓	26%
RoE - annualised	10.5	Has contracted significantly	-(1100-1200)bps	↓	500-600bps
Earnings - excluding insurance (Rs bn)	6.4	Under pressure, outlook uncertain	-40%	↓↓	104%
Net revenues - excluding insurance (Rs bn)	34.2	Down but lower than expectations	-11%	↓↓	45%
Costs - excluding insurance (Rs bn)	20.5	Did not decline significantly	0%	↓↓	23%
Consolidated advances (Rs bn)	225.0	Due to a cautious strategy - positive under current context	2%	⇔	54%
Contraction in valuation multiples		Average multiples down between 30-60%, due to contraction in earnings, RoE, increased risks etc.	-(30-60)%	↓↓↓	
Stock Price	—	The factors highlighted above substantiate to a great extent the decline in stock price	-84%*	↓↓↓	16.4%**

Source: Company Data, PL Research ** Decline from January 08 highs to March 09 lows* *** based on our Target Price*

The lending businesses performed relatively well, but capital market related businesses suffered

Decline in revenues & earnings in FY09 from FY08 peak (Rs bn)

Bus. Entities	Rev	PAT	Rev	PAT	Remarks
KS	13.3	4.1	-46%	-70%	Revenues declined with market, earnings decline sharper as costs declined with a further lag
KMCC	2.9	1.2	-66%	-89%	Primary capital market activities came to a standstill and since costs are not variable in nature like the broking business, the entity reported losses in Q3FY09 & Q4FY09
KMP	7.4	1.0	33%	56%	Auto loan portfolio continues to do well, but some losses suffered on repossessed vehicles.
KM Bank	0.4	2.9	204%	-14%	Provisioning requirement has dented bottom line, overall banking performance remains healthy

Source: Company Data, PL Research

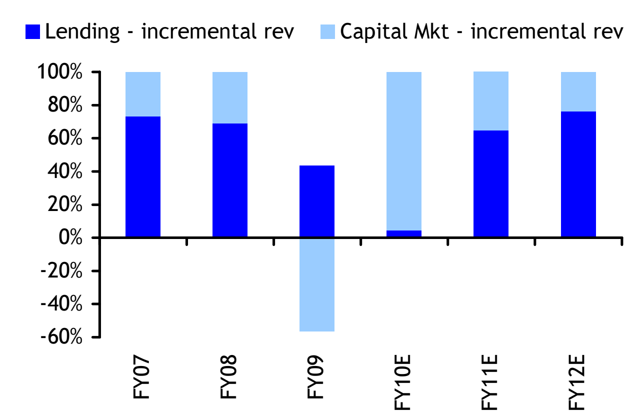
The lending businesses are expected to scale up decently in the next two years and capital market related businesses are also likely to bounce back

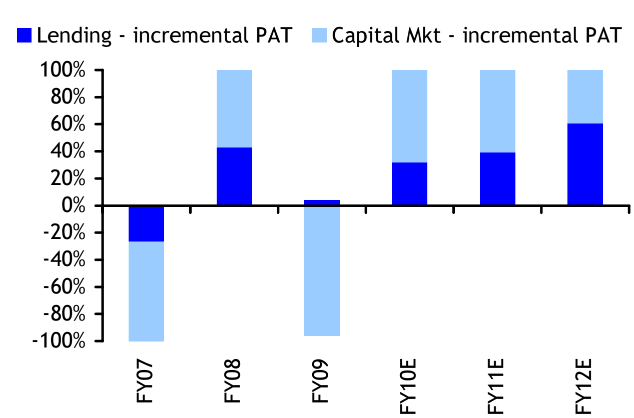
Recovery in revenues & earnings by FY11E vis-a-vis FY08 (Rs bn)

Bus. Entities	Rev	PAT	Rev	PAT	Remarks
KS	13.2	3.8	99%	94%	Expect broking business to catch up with its FY08 peak performance by FY12E.
KMCC	1.7	0.6	61%	51%	Our recovery expectation remains modest, severe competition will hinder its growth going forward.
KMP	11.4	2.1	153%	204%	Lending businesses should continue to perform well post the retail NPL cycle peaking in FY10E
KM Bank	40.6	4.3	135%	145%	Banking business to gain with improvement in liability profile

Source: Company Data, PL Research

Incremental contribution of its lending businesses from FY11E to be meaningful and provide stability to its revenues and earnings, should also reflect in more stable valuation multiples





Source: Company Data, PL Research

KMB - expect growth to return with improving economy; restructuring remains low due to loan mix

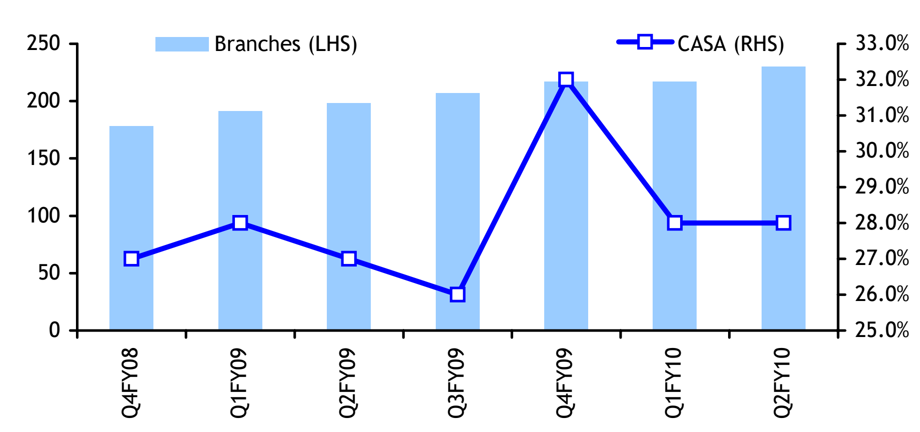
Adopted the most cautious approach among peers, expect growth to return once economy turns around: High Tier I capital adequacy at 15.3% will help the bank to grow without any dilution in the medium term. Excess capital could be utilised for inorganic growth to boost RoEs.

Restructured loans remain low, but delinquencies spiked: Almost 74% of consolidated advances are held in the banking subsidiary. However, delinquencies in Commercial Vehicles (CV), Personal Loans (PL) and credit card portfolios have been much more than anticipated and hence, the bank has decided to reduce its retail exposure. Restructured assets stood at Rs1.0-1.5bn (less than 1% of standalone advances) which is significantly below industry average of 4-5%.

Outlook for sectors primarily responsible for credit losses and higher delinquencies have improved considerably: We observe that most of the negatives have been discounted in the price regarding deterioration in asset quality. The retail small ticket personal loan (STPL) portfolio has run down and remaining balance is ~Rs1bn. Again, significant improvement in housing sales and real estate sector outlook over the past few months should augur well for its real estate exposure (Rs7bn consolidated). The sale of CVs has improved and once economic activity picks up, the pain in the CV portfolio will also alleviate. Hence, we feel that the step adopted by the bank to wait and not to cut losses will pay handsome dividends (in the form of provision write-backs or cash recoveries if fully written off), going forward.

Expect branch network to increase to 250 by March 2010 from 230 at present. CASA levels have now stabilised above regulatory SLR levels minimising negative spreads on the investment book to a large extent.

Trend in bank's branch expansion and CASA ratio



Source: Company Data, PL Research

CVs & personal loans comprising 19% of consolidated advances; CV sales have picked up, expect recovery in the CV portfolio

As on September 2009	Standalone (Rs bn)	% of con. book	YoY gr. (%)	Other subs.	% of con. book	Consld. (Rs bn)	% of con. book	YoY gr. (%)
Advances (Rs bn)	197.0	73.6%	15.6	70.7	26.4%	267.7	100.0%	11.4
CV & Con Eqp	33.5	100.0%	(10.6)	-	0.0%	33.5	12.5%	(10.6)
Auto loans	-	-	-	55.3	100.0%	55.3	20.7%	11.7
Personal loans	16.4	95.5%	(44.4)	0.8	4.5%	17.2	6.4%	(45.3)
Home loans	31.1	100.0%	(4.4)	-	0.0%	31.1	11.6%	(4.4)
Corporate banking	59.8	103.9%	102.7	(2.3)	-3.9%	57.5	21.5%	95.0
Stressed assets	-	-	-	3.0	100.0%	3.0	1.1%	(48.3)
Agriculture finance	21.7	100.0%	38.4	-	0.0%	21.7	8.1%	38.4
Others	34.6	71.4%	34.1	13.9	28.6%	48.5	18.1%	25.8
Investments / treasury assets	**91.3**			**9.3**		**100.6**		
Total advances & investments	**288.3**			**79.9**		**368.3**		

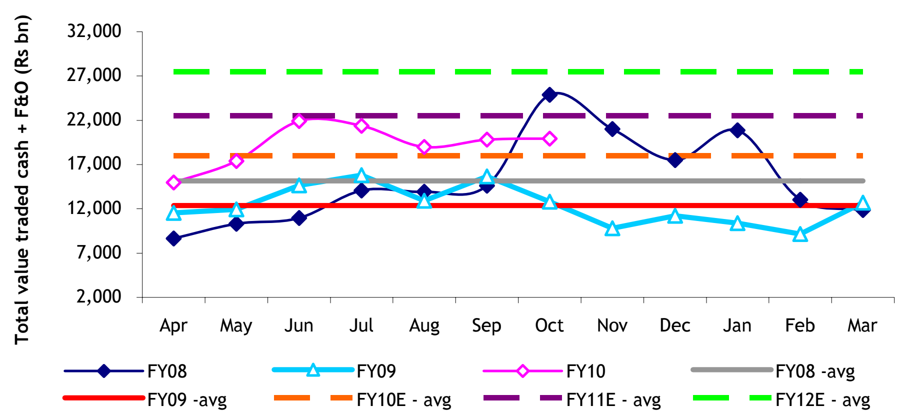
Source: Company Data, PL Research

Subsidiaries - Capital market related subsidiaries to report substantial improvement, while lending and asset management businesses to provide the required stability.

Kotak Securities (KS) - all round improvement expected

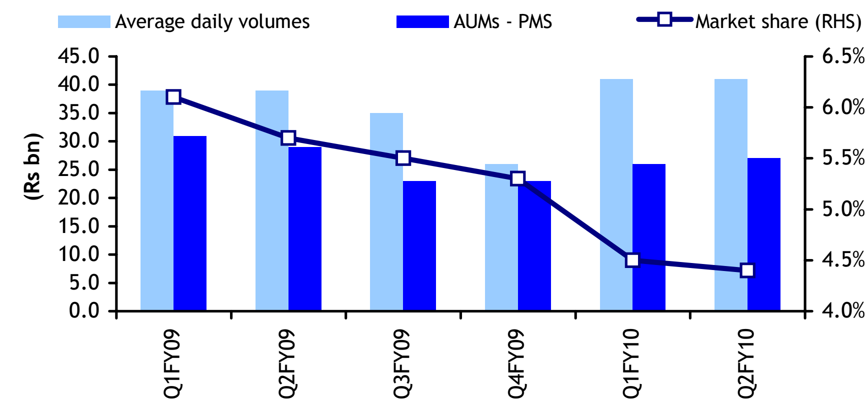
Volumes have declined and share of F&O activities have gone up which has resulted in lower revenues for brokerage companies. KS has been losing market share due to stiff competition, preference for type of business KS wants to do and trading pattern (promoter driven volumes where KS claims it has low presence). We expect market share levels to stabilise at current levels of 4.5% going forward.

Market activity has considerably improved in FY10; current volumes are higher than our assumptions



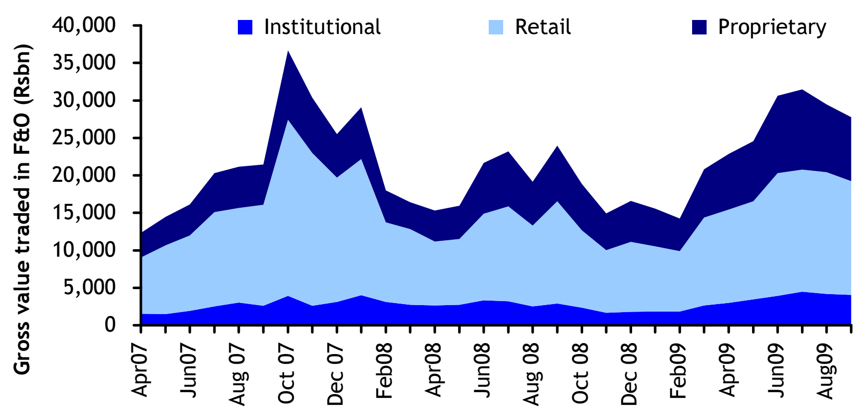
Source: Company Data, PL Research

KS has been losing market share steadily, expect it to stabilise at ~4.5% levels



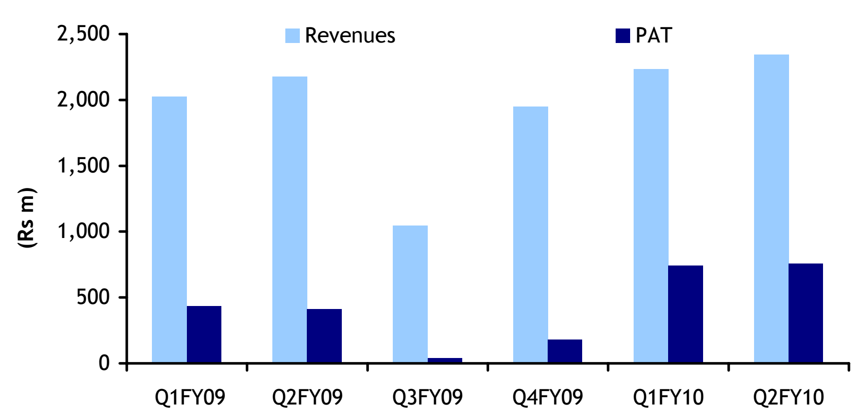
Source: Company Data, PL Research

Proprietary volumes have shown a decline, but it's more of competition that's eroded KS market share than mix of market volumes



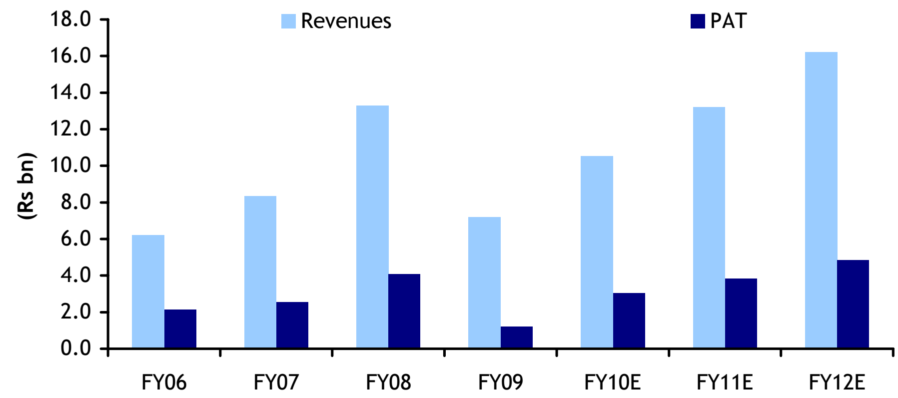
Source: NSE, PL Research

Earnings have bounced back sharply with recovery in equity market activities.



Source: Company Data, PL Research

We expect market share levels to stabilise and earnings to improve, going forward



Source: Company Data, PL Research

Valuation of other listed broking companies

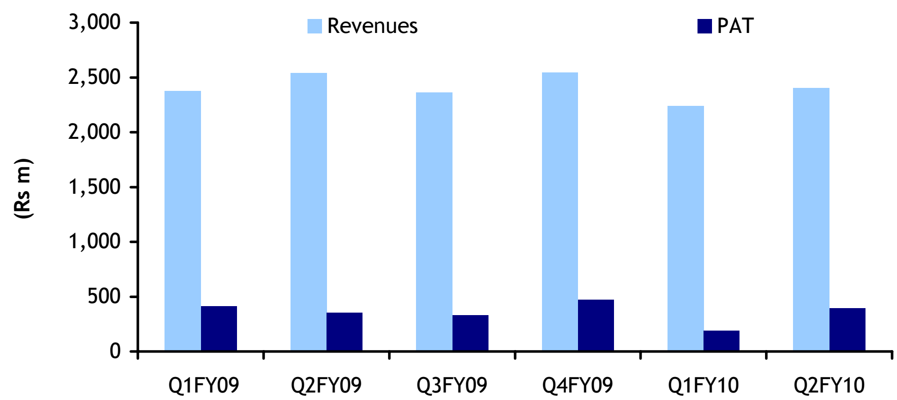
Leading brokerage companies	CMP	P/BV	P/E	Mcap/Sales
Edelwiess	456	1.3	10.4	2.7
India Infoline	130	1.6	13.1	2.6
Motilal Oswal	154	2.0	11.5	2.7
Reliance Capital	794	2.3	22.4	2.8

Source: Company Data, PL Research

Kotak Mahindra Prime (KMP) - auto sales continues to remain strong, expect provisioning to taper off with turnaround in economic activity

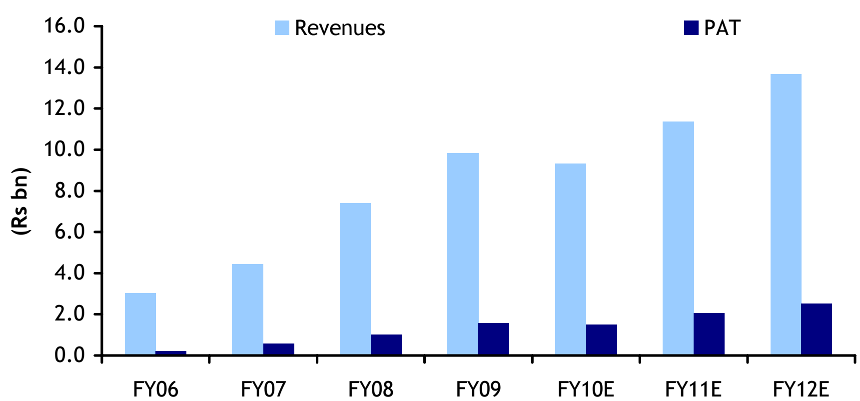
KMP is primarily into car finance business. Asset quality has not become a serious concern yet, but the recent onslaught from PSU banks will definitely put pressure on margins and business volumes in the medium term.

Higher provisions to restrict earnings growth in FY10, evident in Q1FY10...



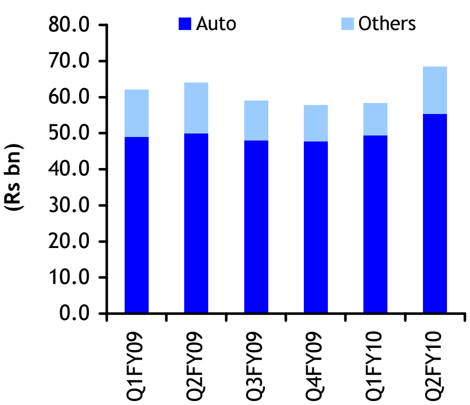
Source: Company Data, PL Research

...revenues likely to dip, higher provisions to keep earnings almost flat



Source: Company Data, PL Research

Trend in advances - loan book remains stable with auto loans at ~80%



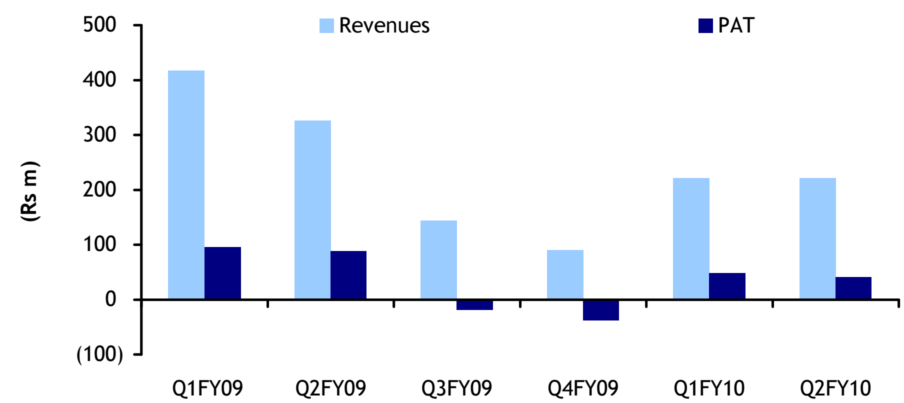
Source: Company Data, PL Research

Kotak Mahindra Capital Company (KMCC) - worst seems to be over, market conditions critical for healthy performance

The primary market activities came to a grinding halt after a hugely successful FY08, aptly reflected in its modest FY09 performance. A favourable domestic electoral result, improvement in global liquidity and investor's risk appetite has helped in resumption of a sharp rally in the Indian equity markets. The long awaited pipeline of IPOs and QIPs are finally raising capital from the primary markets. Hence, earnings visibility has improved significantly for KMCC.

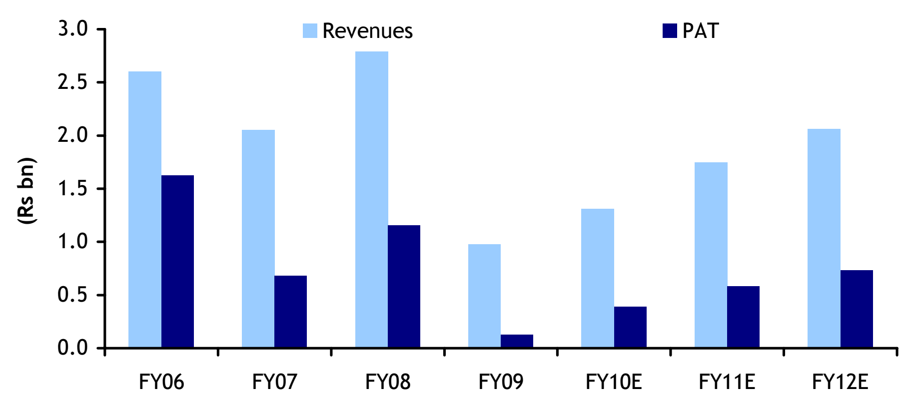
However, there is intense competition which has resulted in very low yields and restricted faster recovery in earnings. Although the investment banking space will improve we expect KMCC to loose market share in this business and hence revenue and earnings unlikely to surpass FY08 peak.

Revenues and earnings have bounced back in Q1FY0 after a dismal FY09



Source: Company Data, PL Research

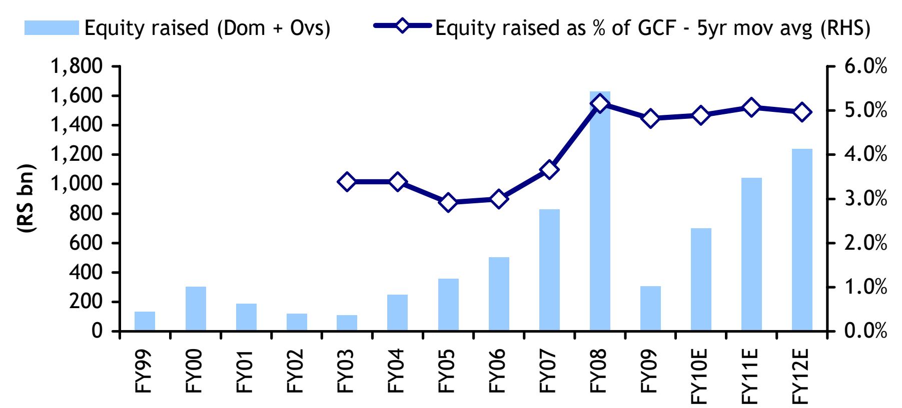
Worst is behind, earnings visibility in the medium term has improved considerably but intense competition to erode market share



Source: Company Data, PL Research

We have tried to use the 5-year moving average ratio between equity raised and Gross Capital Formation (GCF) as the benchmark for possible total domestic and overseas primary market activities which are expected over the next 2-3 years. GCF is estimated at ~30% of nominal GDP. For FY10, we have a better visibility regarding the IPO pipeline. However, our argument is that there will be new sectors which will get listed over the next 2-3 years, like Life Insurance. This sector is likely to replace the real estate sector which was the newly discovered sector between FY07-08. Again, many banks will need to raise capital over the next 2-3 years and infrastructure companies will also tap the markets on and off. Based on these very macro assumptions, we observe that the 5-year moving average can stabilise in the 5% range over the next 2-3 years.

Expected total primary market activities over the next 2-3 years



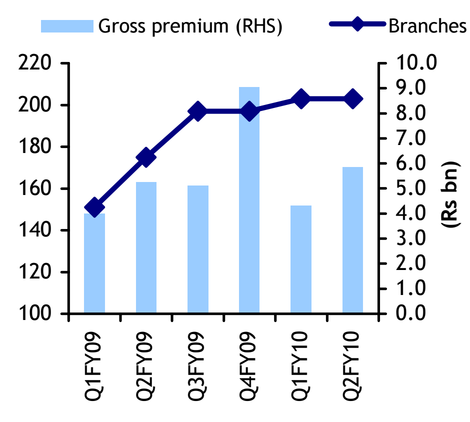
Source: Prime Database, CMIE, PL Research

Kotak Mahindra Life Insurance (KMLI) - expect premium growth to improve, remains a key focus area for the group

The depressed equity markets have had a significant impact on the growth of the life insurance industry as the industry premiums declined by 4% YoY in FY09.

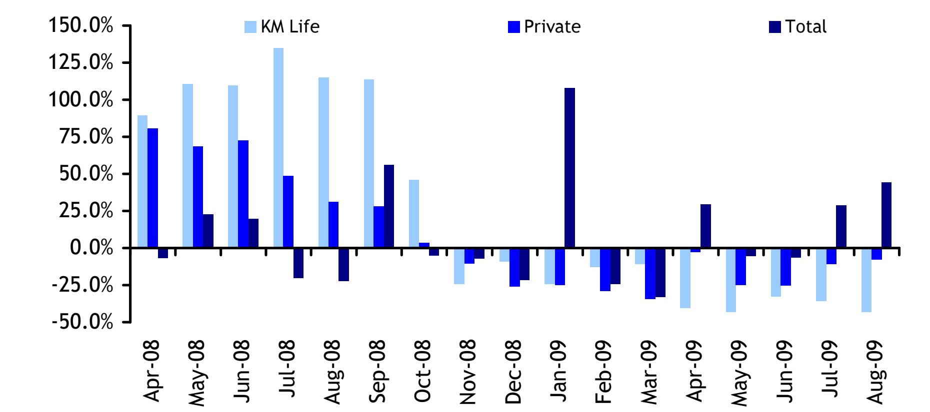
However, KMLI is relatively much smaller in size, but remains one of the most efficient private life insurers. Its capital efficiency is among the best, market share has remained steady and has performed better than the private life insurance sector's performance. Its new premiums grew by 21.4%, while private sector declined by 1.8%. It also turned profitable in FY09, reporting a PAT of Rs143m. We expect the APE (annualised premium equivalent) growth in FY10 to be at 10-15%, slightly higher than private industry growth of 5-10%.

Premium collection has largely tracked branch expansion



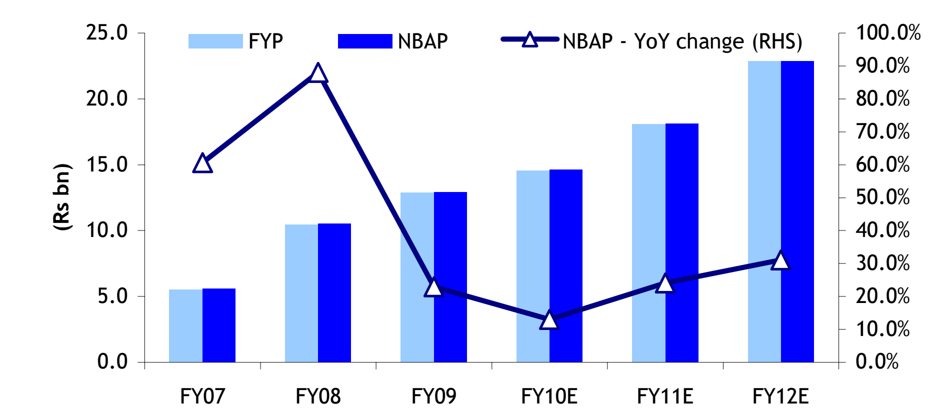
Source: Company Data, PL Research

KMLI performed better than industry for most of FY09; H2FY09 base remains low, should help YoY growth to improve



Source: Company Data, PL Research, IRDA

We expect premium growth to moderate, going forward

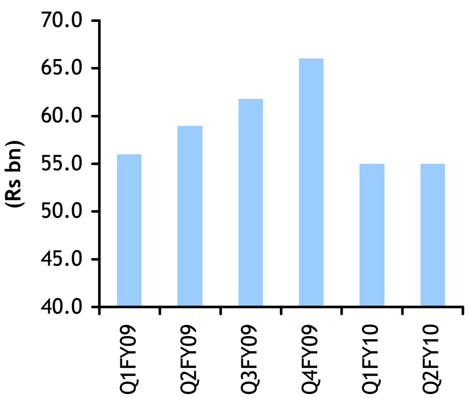


Source: Company Data, PL Research

Kotak Mahindra Investment Advisors (KMIA) - management fees to remain a stable earnings source

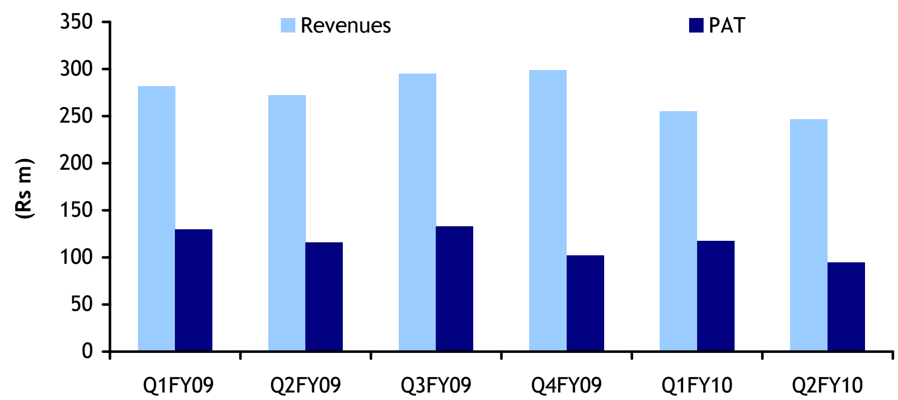
The private and real estate funds are managed by KMIA; the steady stream of management fees are likely to continue. Currently total commitments stands at $1.3bn through four private equity funds and three realty funds which has investments in about forty Indian companies; It is also expected to launch an Infrastructure Fund.

Total commitment levels remain healthy



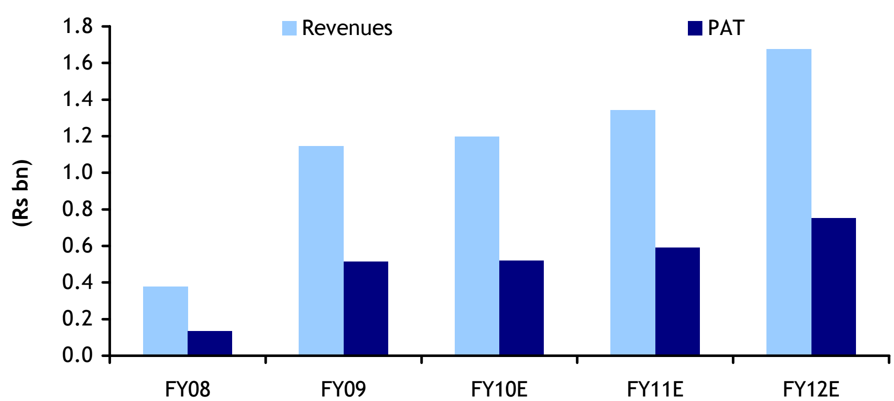
Source: Company Data, PL Research

Quarterly performance remains steady, mainly due to management fees



Source: Company Data, PL Research

No substantial decline expected in revenues and earnings

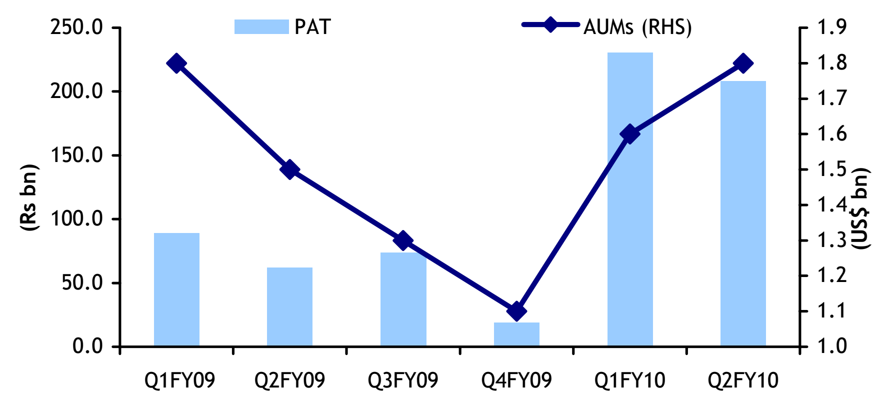


Source: Company Data, PL Research

Kotak Mahindra International subsidiaries - performance impacted due to volatile capital markets

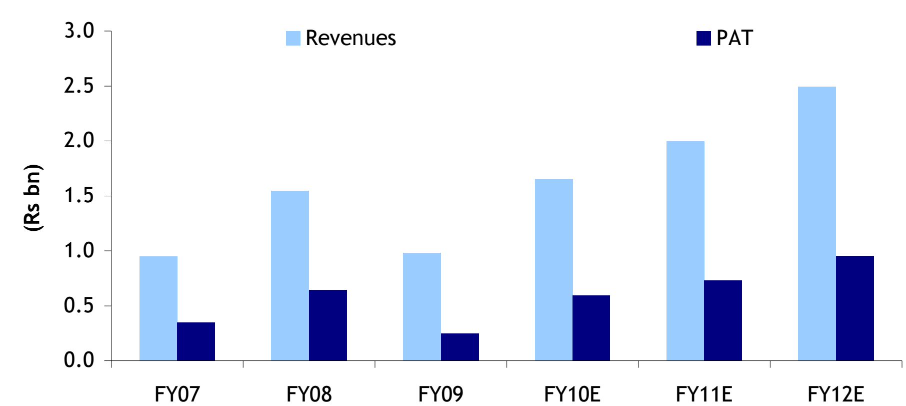
Performance of the overseas subsidiaries continued to remain under pressure in FY09 as the lack of overseas fund raising (GDRs, FCCBs, ECBs) etc. took a toll on the earnings. Decline in NAVs for offshore funds have also resulted in lower management fees from these funds. We expect earnings of the overseas subsidiaries to rebound strongly, with both primary and secondary market activities having picked up significantly from its lows. Equity assets managed or advised is at US$1.6bn. Our expectations are substantiated by the strong rebound in Q1FY10 and Q2FY10 earnings.

AUMs have improved along with NAVs, resulting in robust earnings growth



Source: Company Data, PL Research

Positive bias for emerging equity markets to be a major driver for strong performance of its international subsidiaries

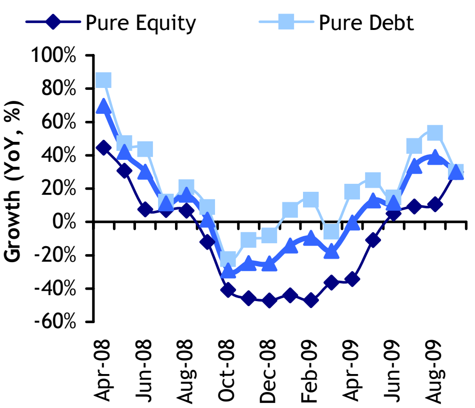


Source: Company Data, PL Research

Kotak Asset Management (KAMC) - growing faster than industry

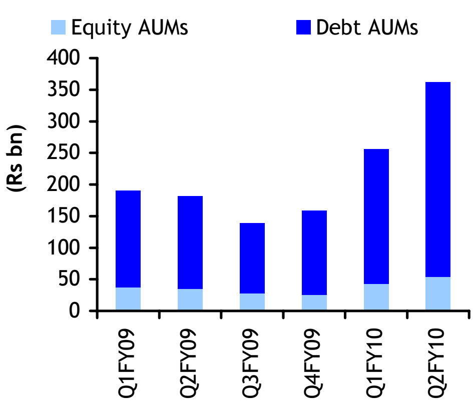
The asset management businesses in India have been seriously impacted by the global and domestic slowdown in equities. The FMP debacle had also impacted the debt funds managed by AMC's in India. During FY09, industry AUMs declined 17% YoY, while KMC has demonstrated a much better performance, with AUMs remaining stable at Rs159bn as on March 2009.

Total domestic AUMs - returning to positive territory



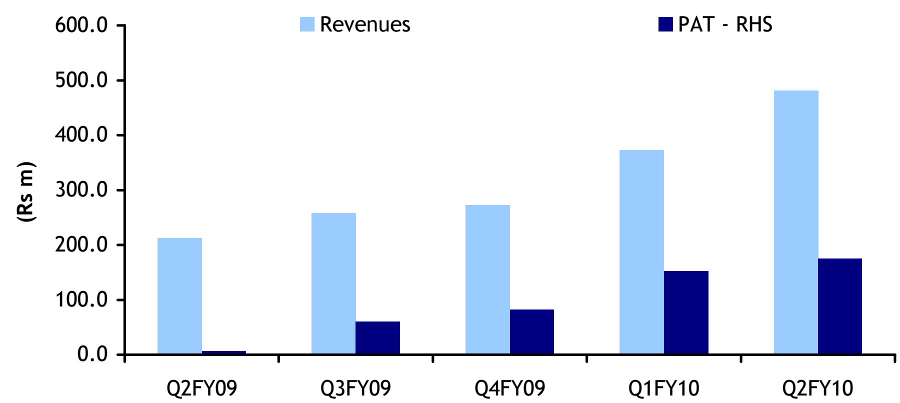
Source: Company Data, PL Research, AMFI

Share of debt funds have increased recently as liquidity remains abundant



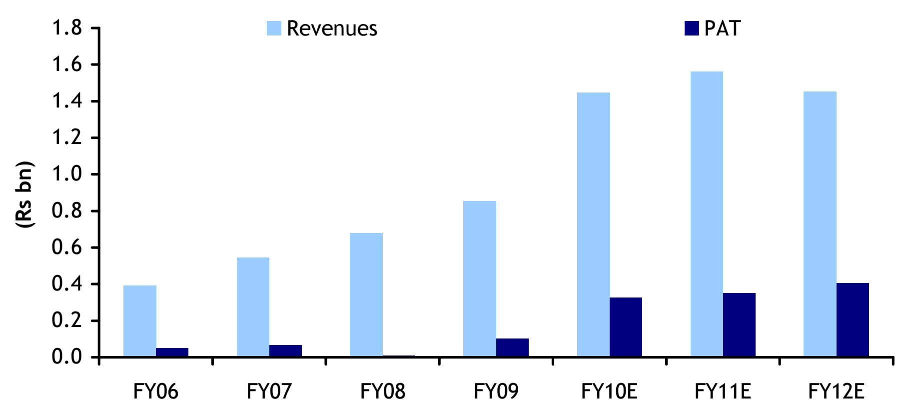
Source: Company Data, PL Research

Absence of NFO expenses & higher AUMs have resulted in better earnings



Source: Company Data, PL Research

Expect stable earnings contribution, going forward from the AMC subsidiary

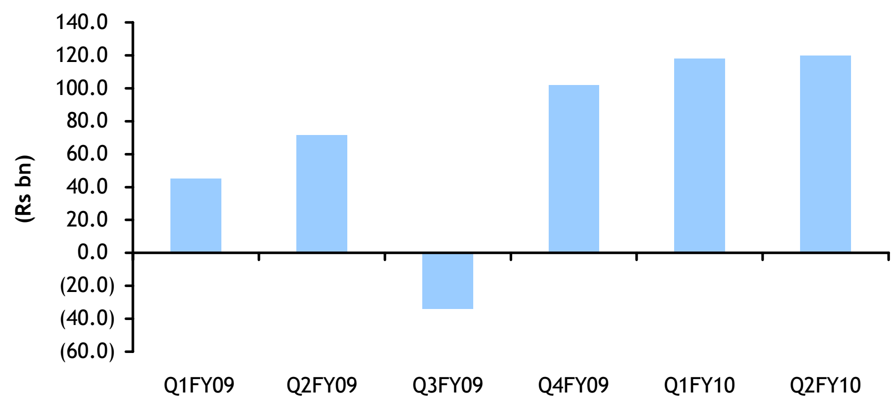


Source: Company Data, PL Research

Kotak Mahindra Investments (KMI) - affected by a very high base of FY08; business opportunities have improved

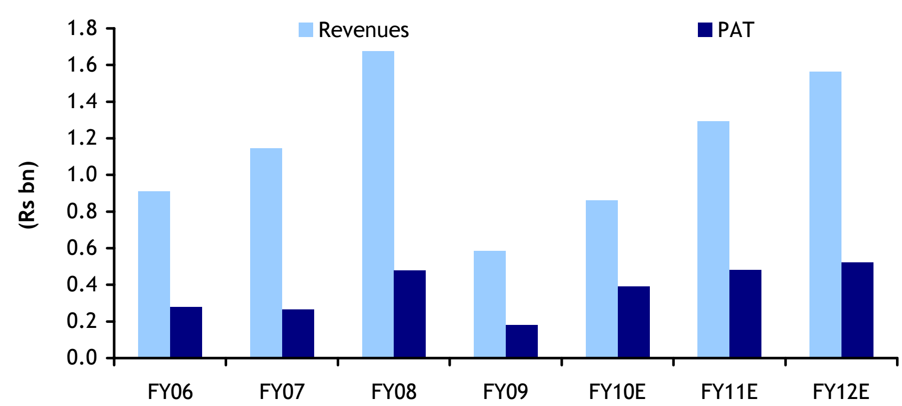
KMI, primarily engaged in holding long-term strategic investments providing margin funding and loans against shares, has been affected as FY08 base is very high and FY09 market conditions were not conducive for its line of businesses. However, business environment has turned around dramatically as depicted by the earnings trend for the last three quarters.

Business opportunities have improved, earnings have bounced back in last 3 quarters



Source: Company Data, PL Research

Unlikely to surpass its FY08 highs, performance to improve over FY09 base



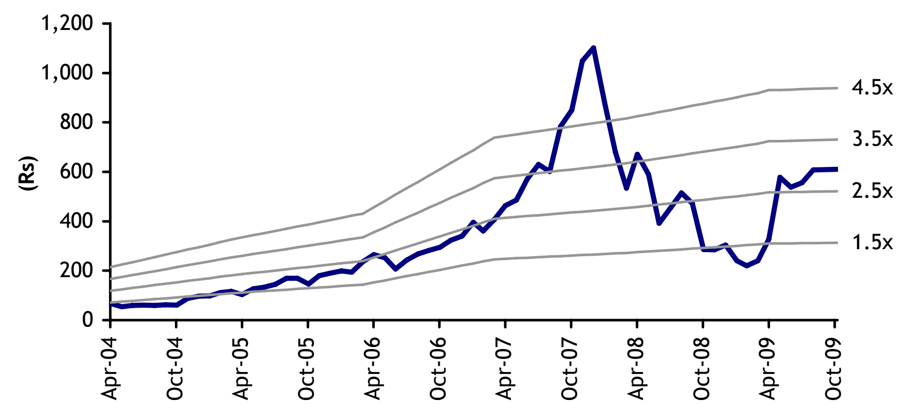
Source: Company Data, PL Research

Valuations

We have adopted the sum of the parts (SOTP) valuation methodology to value KMB and its subsidiaries. Also, we have provided a 15% holding company discount only to its Life Insurance venture, where we believe that with regulatory changes the stake will gradually decrease. However, most of its other 100% subsidiaries is only a separate entity for regulatory compliance and comfort and hence, don't deserve any holding company discount.

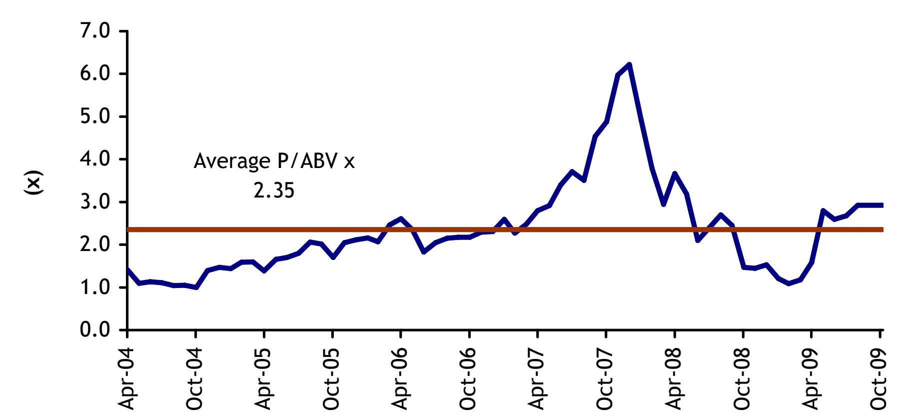
On a consolidated basis the stock is trading at 16.2xFY11E EPS, 2.5xFY11E BV and 2.6xFY11E ABV. Most of the re-rating in the stock has already happened due to a turnaround in capital market activities. We continue to favour KMB from a medium-to-long term perspective due to its excellent management bandwidth and its ability to scale-up all its financial verticals once the economy turns around. At the current valuations, the stock has limited upside and hence, we initiate coverage with an 'Accumulate' rating, with a 12 month forward price target of Rs835.

1yr. forward P/BV Band



Source: Bloomberg, PL Research

Historical trend in 1yr. forward P/BV



Source: Bloomberg, PL Research

Sum of the parts valuation

Subsidiaries		Basis (Rs bn)		CAGR of the basic valuation parameter				Mutliple	Value (Rs bn)		KMB (Rs/Share)		% of SOTP	
		FY11E	FY12E	FY08-11E	FY08-12E	FY09-11E	FY09-12E		FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Kotak Securities - KS	Earnings	3.84	4.86	-2.1%	4.4%	77.8%	58.7%	18.0	69.1	87.4	200	253	27%	27%
KMCC - KMCC	Earnings	0.58	0.73	-20.3%	-10.7%	113.3%	78.8%	15.0	8.7	11.0	25	32	3%	3%
Kotak AMC - KAMC	AUMs	254.6	445.6	8.9%	22.6%	17.3%	34.0%	6.0%	15.3	26.7	44	77	6%	8%
Pvt Equity - KMIA	AUMs	71.5	78.7	8.3%	8.7%	4.9%	6.6%	8.0%	5.7	6.3	17	18	2%	2%
Kotak Prime - KMP	ABV	9.9	12.1	15.2%	16.9%	14.7%	17.1%	2.0	19.8	24.2	57	70	8%	8%
Investments - KMI	ABV	2.6	3.1	13.7%	15.0%	16.9%	17.7%	1.0	2.6	3.1	7	9	1%	1%
International - KMIntl+Inc	Earnings	0.36	0.44	6.4%	10.5%	43.1%	36.4%	15.0	5.4	6.7	16	19	2%	2%
Kotak UK - Kotak UK	Earnings	0.33	0.45	-1.4%	6.4%	114.9%	83.4%	15.0	5.0	6.7	14	19	2%	2%
Kotak OM Life - KM Life*	NBAP	3.3	4.2	17.8%	20.5%	16.8%	20.8%	16.0	38.6	50.0	95	123	13%	13%
Value of subsidiaries per share *											476	621		
KM Bank	ABV **	40.6	45.6					2.3	93.5	105.0	270	304	36%	33%
SOTP - target price											746	924	100%	100%
12 month forward price target based on average of FY11E & FY12E price targets above											835			

Source: PL Research

** post 15% holding company discount for its life insurance venture*

*** ABV - reduced by Rs15.5per share for investments in subsidiaries*

Q2FY10 - Core performance improves

- Consolidated PAT for Q2FY10 was up 86% YoY and 16.5% QoQ to Rs 2,998m, driven by improvement in earnings for the banking business and its capital market subsidiaries.
- Margins remained stable at 6% as liabilities continue to get re-priced faster than its asset book. Going forward, margins are expected to decline, while RoE is expected to improve.
- PAT Standalone was up 163% YoY and 39.4% QoQ to Rs1,259m from Rs479m, driven by an improvement in core income and lower provisions (as asset quality levels have stabilized).
- Asset quality levels of the bank have stabilized, which provides some respite to provisioning requirements. However, RBI's new guidelines for 70% coverage will keep the provisioning elevated.

Q2FY10 Result Overview (Standalone) (Rs m)

Y/e March	Q2FY10	Q2FY09	YoY (%)	Q1FY10	H1FY10	H1FY09	YoY (%)
Interest earned	7,751	7,461	3.9	7,673	15,425	14,586	5.7
Interest expended	3,387	3,806	(11.0)	3,583	6,970	7,406	(5.9)
Net Interest Income	**4,365**	**3,655**	**19.4**	**4,090**	**8,454**	**7,180**	**17.8**
Other Income	1,090	606	79.8	1,269	2,360	1,438	64.1
Net total income	**54,551**	**42,618**	**28.0**	**53,591**	**108,142**	**86,177**	**25.5**
Operating expenses	3,013	3,137	(4.0)	2,516	5,529	6,257	(11.6)
Operating Profit	**2,442**	**1,125**	**117.1**	**2,843**	**5,285**	**2,361**	**123.9**
Provisions & contingencies	773	378	104.3	1,574	2,347	795	195.2
PBT	**1,670**	**747**	**123.6**	**1,269**	**2,938**	**1,566**	**87.7**
PAT	**1,259**	**479**	**163.0**	**903**	**2,162**	**1,024**	**111.2**

Q2FY10 Result Overview (Consolidated) (Rs m)

Y/e March	Q2FY10	Q2FY09	YoY (%)	Q1FY10	H1FY10	H1FY09	YoY (%)
Interest earned	11,060	10,929	1.2	10,627	21,687	21,348	1.6
Interest expended	4,264	5,107	(16.5)	4,377	8,641	9,766	(11.5)
Net Interest Income	**6,796**	**5,822**	**16.7**	**6,251**	**13,046**	**11,582**	**12.6**
Other Income	12,069	7,566	59.5	12,825	24,895	12,020	107.1
Net total income	**18,865**	**13,388**	**40.9**	**19,076**	**37,941**	**23,602**	**60.8**
Operating expenses	13,828	10,224	35.3	13,372	27,200	17,699	53.7
Operating Profit	**5,037**	**3,164**	**59.2**	**5,704**	**10,741**	**5,903**	**82.0**
Provisions & contingencies	806	660	22.2	1,908	2,714	1,072	153.2
PBT	**4,231**	**2,505**	**68.9**	**3,796**	**8,027**	**4,831**	**66.2**
PAT - before minority	**2,959**	**1,612**	**83.6**	**2,726**	**5,685**	**3,005**	**89.2**
PAT - after minority	**2,998**	**1,610**	**86.2**	**2,573**	**5,571**	**3,108**	**79.2**
Asset quality							
GNPA - with stressed assets	10,716	6,843	56.6	10,845	10,716	6,843	56.6
NNPA - with stressed assets	6,403	4,160	53.9	6,679	6,403	4,160	53.9
GNPA (%) - with stressed assets	*3.94*	*2.82*		*4.58*	*3.94*	*2.82*	
NNPA (%) - with stressed assets	*2.39*	*1.73*		*2.87*	*2.39*	*1.73*	
GNPA (%) - w/o stressed assets	*2.93*	*1.15*		*3.41*	*2.93*	*1.15*	
NNPA (%) - w/o stressed assets	*1.72*	*0.53*		*2.07*	*1.72*	*0.53*	

Financials

Income Statement Adjusted (Consolidated but excludes insurance) (Rs m)

Y/e March	FY07	FY08	FY09	FY10E	FY11E	FY12E
Interest Earned from Advances	14,962	26,017	35,110	33,194	38,189	50,567
Interest Earned from Investments	5,142	9,879	7,976	8,639	9,748	11,359
Others	420	440	492	302	406	517
Total Interest Income	**20,524**	**36,335**	**43,578**	**42,135**	**48,342**	**62,443**
Interest expense	11,169	19,336	21,713	18,936	23,707	31,937
NII	**9,354**	**16,999**	**21,865**	**23,199**	**24,635**	**30,506**
Growth (%)	*-*	*81.7*	*28.6*	*6.1*	*6.2*	*23.8*
Treasury Income	1,340	1,974	28	1,977	2,566	3,095
Fee income	10,594	16,937	10,582	15,801	19,325	23,187
Non Interest Income	**13,423**	**21,614**	**12,330**	**19,328**	**24,901**	**29,005**
Net Total Income	22,777	38,614	34,195	42,528	49,536	59,511
Growth (%)	*-*	*69.5*	*-11.4*	*24.4*	*16.5*	*20.1*
Operating Expense	12,891	20,571	20,523	20,947	25,247	30,657
Operating Profit	**9,887**	**18,042**	**13,672**	**21,581**	**24,289**	**28,854**
Growth (%)	*-*	*82.5*	*-24.2*	*57.8*	*12.5*	*18.8*
NPA Provisions	1,309	2,473	3,491	5,346	4,583	3,057
Total Provisions	1,420	3,048	3,511	5,346	4,756	3,057
PBT	**8,466**	**14,994**	**10,161**	**16,234**	**19,533**	**25,797**
Tax Provisions	2,516	4,471	3,603	5,413	6,529	8,626
Effective Tax Rate (%)	*29.7*	*29.8*	*35.5*	*33.3*	*33.4*	*33.4*
PAT Before MI	**6,572**	**10,523**	**6,558**	**10,821**	**13,003**	**17,171**
PAT After MI	**6,712**	**10,663**	**6,588**	**10,821**	**13,003**	**17,171**

Source: Company Data, PL Research

Balance Sheet (Consolidated) (Rs m)

Y/e March	FY07	FY08	FY09	FY10E	FY11E	FY12E
Liabilities						
Capital	3,262	3,447	3,457	3,457	3,457	3,457
Reserves and Surplus	29,069	54,792	61,769	70,426	80,828	94,565
Minority Interest	309	512	629	717	823	962
ESOP Outstanding	284	582	919	1,011	1,112	1,223
Deposits	96,610	136,919	138,228	159,145	206,889	279,300
Borrowings	99,859	127,728	110,600	139,889	172,515	208,985
Policy Holders' Funds	16,798	28,416	37,380	49,429	64,891	87,689
Other Liabilities and Provisions	40,118	53,575	49,357	61,195	74,510	92,541
Total	**286,308**	**405,972**	**402,338**	**485,268**	**605,025**	**768,722**
Assets						
Cash and Balances with RBI	7,919	17,642	10,070	11,205	21,564	28,298
Balances with Banks and Money at Call	13,506	16,051	4,305	3,361	4,232	5,521
Investments	91,285	125,697	133,130	158,093	182,476	227,649
Advances	155,734	219,847	224,976	273,710	345,467	450,345
Fixed Assets	2,353	3,330	3,383	4,134	4,904	5,903
Other Assets	15,476	23,370	26,439	34,732	46,348	50,972
Goodwill on Consolidation	34	34	34	34	34	34
Total	**286,308**	**405,972**	**402,338**	**485,268**	**605,025**	**768,722**

Source: Company Data, PL Research

Key Ratios

Y/e March	FY07	FY08	FY09	FY10E	FY11E	FY12E
Asset quality - with stressed assets						
GNPAs (Rs bn)	3.8	5.7	8.3	12.3	12.1	11.3
GNPAs (%)	*2.4*	*112.0*	*2.8*	*4.5*	*3.5*	*2.5*
NNPAs (Rs bn)	3.0	3.6	4.5	6.7	5.1	4.8
NNPAs (%)	*1.9*	*66.0*	*1.7*	*2.8*	*1.5*	*1.1*
Coverage (%)	*21.3*	*36.1*	*45.4*	*45.8*	*57.6*	*57.8*
NPL prov / loans (%)	*1.0*	*1.3*	*1.6*	*2.1*	*1.5*	*0.8*
Return ratios (%)						
NIM - reported	*5.20*	*5.60*	*6.00*	-	-	-
NIM - calculated	*4.08*	*4.91*	*5.41*	*5.23*	*4.52*	*4.44*
RoAE	*24.5*	*23.5*	*10.7*	*15.6*	*16.4*	*18.8*
RoAA	*2.9*	*3.1*	*1.6*	*2.4*	*2.4*	*2.5*

Source: Company Data, PL Research

Income Statement (Consolidated) Reported (Rs m)

Y/e March	FY06	FY07	FY08	FY09
Interest earned	12,157	19,820	36,484	43,666
Interest expended	5,196	9,771	18,165	19,924
Net interest income	**6,961**	**10,050**	**18,319**	**23,742**
Other Income	16,384	23,119	39,010	28,826
Net total income	**23,345**	**33,169**	**57,329**	**52,568**
Operating expenses	16,671	23,857	39,620	39,108
Pre-provsioning profit	**6,675**	**9,312**	**17,709**	**13,460**
Provisions & Contingencies	512	1,525	3,630	3,298
PBT	**6,162**	**7,787**	**14,079**	**10,162**
Tax	2,130	2,542	4,492	3,635
PAT before minority	**4,032**	**5,245**	**9,587**	**6,527**
Minority	(608)	138	325	(3)
PAT after minority	**3,425**	**5,382**	**9,912**	**6,524**

Source: Company Data, PL Research

Income Statement (Standalone) (Rs m)

Y/e March	FY07	FY08	FY09	FY10E	FY11E	FY12E
Interest Earned from Advances	10,038	18,021	24,937	23,686	26,423	36,433
Interest Earned from Investments	2,808	7,083	5,584	6,664	7,516	8,770
Others	345	250	130	100	171	226
Total Interest Income	**13,191**	**25,354**	**30,651**	**30,450**	**34,110**	**45,429**
Interest expense	6,992	13,096	15,466	13,038	15,935	22,284
NII	**6,199**	**12,258**	**15,185**	**17,412**	**18,175**	**23,144**
Growth (%)	*63.1*	*97.8*	*23.9*	*14.7*	*4.4*	*27.3*
Treasury Income	158	147	(11)	1,000	1,000	750
NTNII	3,029	4,487	3,590	3,512	5,441	5,940
Non Interest Income	**3,187**	**4,635**	**3,579**	**4,512**	**6,441**	**6,690**
Growth (%)	*69.1*	*83.1*	*14.1*	*2.1*	*16.0*	*28.5*
Operating Expense	6,127	10,194	11,964	11,624	13,932	17,611
Operating Profit	**3,258**	**6,699**	**6,800**	**10,300**	**10,684**	**12,223**
Growth (%)	*17.7*	*105.6*	*1.5*	*51.5*	*3.7*	*14.4*
NPA Provisions	602	1,437	2,533	3,351	3,248	1,855
Total Provisions	1,225	2,726	2,539	4,297	4,233	2,661
PBT	**2,033**	**3,973**	**4,261**	**6,003**	**6,451**	**9,563**
Tax Provisions	619	1,038	1,499	2,038	2,191	3,236
Effective Tax Rate (%)	*30.4*	*26.1*	*35.2*	*33.9*	*34.0*	*33.8*
PAT	**1,414**	**2,935**	**2,761**	**3,965**	**4,260**	**6,327**

Source: Company Data, PL Research

Balance Sheet (Standalone) (Rs m)

Y/e March	FY07	FY08	FY09	FY10E	FY11E	FY12E
Equity	3,262	3,447	3,457	3,457	3,457	3,457
Networth	16,335	35,355	38,136	41,495	44,946	50,262
Deposits	110,001	164,237	156,449	187,230	243,398	328,588
Growth (%)	*67.5*	*49.3*	*(4.7)*	*19.7*	*30.0*	*35.0*
Low Cost deposits	29,964	46,699	49,928	56,169	75,454	108,434
% of total deposits	*27.2*	*28.4*	*31.9*	*30.0*	*31.0*	*33.0*
Total Liabilities	**199,166**	**283,153**	**287,119**	**336,144**	**423,229**	**552,060**
Net Advances	109,241	155,522	166,253	202,665	264,969	357,597
Growth (%)	*72.1*	*42.4*	*6.9*	*21.9*	*30.7*	*35.0*
Investments	68,620	91,420	91,102	95,487	102,227	121,578
Total Assets	**199,166**	**283,153**	**287,119**	**336,144**	**423,229**	**552,060**

Source: Company Data, PL Research

Key Ratios (Standalone) (Rs m)

Y/e March	FY07	FY08	FY09	FY10E	FY11E	FY12E
Profitability						
Cost of Deposit	5.9%	7.0%	6.8%	5.4%	5.2%	5.5%
Yield on advances	11.6%	13.6%	15.5%	12.8%	11.3%	11.7%
Yield on Investments	5.8%	8.9%	6.1%	7.1%	7.6%	7.8%
NIM	4.1%	5.1%	5.3%	5.6%	4.8%	4.7%
RoAA	0.9%	1.2%	1.0%	1.3%	1.1%	1.3%
RoAE	11.4%	11.4%	7.5%	10.0%	9.9%	13.3%
Efficiency						
Cost-Income ratio	65.3%	60.3%	63.8%	53.0%	56.6%	59.0%
C-D ratio	99.3%	94.7%	106.3%	108.2%	108.9%	108.8%
Business per Employee	40.6	35.5	38.4	52.2	52.2	69.5
Net Profit per Employee	0.3	0.3	0.3	0.5	0.4	0.6
Business per Branch	2,088	477	1,487	1,547	1,771	2,098
Net Profit per Branch	13.5	4.4	12.7	15.7	14.8	19.3
Asset Quality						
Gross NPAs	2,776	4,392	7,307	9,330	9,507	10,958
Net NPAs	2,168	2,762	3,968	4,665	2,852	3,287
Gross NPAs to Gross Advances	2.5%	2.8%	4.3%	4.5%	3.5%	3.0%
Net NPAs to Net Advances	2.0%	1.8%	2.4%	2.3%	1.1%	0.9%
NPA Coverage %	21.9%	37.1%	45.7%	50.0%	70.0%	70.0%

Source: Company Data, PL Research

Annexure

PAT trend for KMB and key subsidiaries

Sl. No.	Subsidiary (Rs bn)	Stake held	Business	FY08	FY09	FY10E	FY11E	FY12E
	Kotak Mahindra Bank	**-**	**Banking**	**2.94**	**2.76**	**3.97**	**4.26**	**6.33**
	Subsidiaries							
1	Kotak Securities	100%	Stock broking	4.09	1.06	3.04	3.84	4.86
	yoy change			*60%*	*-74%*	*185%*	*26%*	*26%*
2	KMCC	100%	IPOs/M&A/PE	1.15	0.13	0.39	0.58	0.73
	yoy change			*70%*	*-89%*	*206%*	*49%*	*26%*
3	KM AMC	100%	Mutual funds	0.01	0.10	0.33	0.35	0.41
	yoy change			*-85%*	*905%*	*216%*	*8%*	*16%*
4	Kotak Investment Advisors	100%	Pvt Equity & Realty Fund	0.13	0.48	0.52	0.59	0.75
	yoy change			*-*	*257%*	*9%*	*13%*	*27%*
5	KM Prime	100%	Vehicle finance	1.01	1.57	1.49	2.05	2.52
	yoy change			*75%*	*56%*	*-5%*	*38%*	*23%*
6	KM Investments	100%	Investments & lending	0.43	0.14	0.35	0.44	0.47
	yoy change			*57%*	*-68%*	*157%*	*24%*	*7%*
7	KM International	100%	Advisory services & Investment management	0.19	0.10	0.13	0.17	0.21
	yoy change			*49%*	*-49%*	*32%*	*28%*	*27%*
8	KM UK	100%	Asset management, broking & investments	0.35	0.07	0.27	0.33	0.45
	yoy change			*147%*	*-79%*	*278%*	*22%*	*34%*
9	KM OM Life Insurance*	74%	Life Insurance	(0.72)	0.14	-	-	-
	yoy change			*23%*	*-120%*	*-*	*-*	*-*
10	KM Trustee Co.	100%	Trustee Companies	0.07	0.06	0.10	0.11	0.10
	yoy change			*48%*	*-16%*	*67%*	*9%*	*-8%*
11	KM Inc	100%	Broker / Dealer	10	7	19	23	30
	yoy change			*31%*	*-30%*	*165%*	*21%*	*27%*
	Consolidated before MI			**9.76**	**6.69**	**10.78**	**12.96**	**17.12**
	yoy change			***81%***	***-31%***	***61%***	***20%***	***32%***
	Consolidated after MI			**9.92**	**6.59**	**10.82**	**13.00**	**17.17**
	yoy change			***84%***	***-38%***	***64%***	***20%***	***32%***

Source: Company Data, PL Research

Trend in Networth for KMB and key susbsidiaries

Sl. No.	Subsidiary (Rs bn)	FY08	FY09	FY10E	FY11E	FY12E
	Kotak Mahindra Bank	**35.35**	**38.14**	**41.49**	**44.95**	**50.26**
	Subsidiaries					
1	Kotak Securities	11.42	12.52	15.56	19.40	24.25
	yoy change	*52%*	*10%*	*24%*	*25%*	*25%*
2	KMCC	4.01	4.14	4.53	5.11	5.84
	yoy change	*49%*	*3%*	*9%*	*13%*	*14%*
3	KM AMC	0.28	0.38	0.79	1.14	1.55
	yoy change	*4%*	*36%*	*107%*	*44%*	*36%*
4	Kotak Investment Advisors	0.36	0.84	1.36	1.36	1.95
	yoy change	*-8%*	*135%*	*62%*	*0%*	*44%*
5	KM Prime	7.08	8.65	10.14	12.19	14.71
	yoy change	*27%*	*22%*	*17%*	*20%*	*21%*
6	KM Investments	1.80	1.95	2.31	2.74	3.21
	yoy change	*31%*	*8%*	*18%*	*19%*	*17%*
7	KM International	0.64	0.91	1.04	1.20	1.41
	yoy change	32%	42%	14%	16%	18%
8	KM UK	0.60	0.84	1.12	1.45	1.90
	yoy change	*115%*	*40%*	*32%*	*30%*	*31%*
9	KM OM Life Insurance	1.97	2.42	2.38	2.38	2.38
	yoy change	*66%*	*23%*	*-2%*	*0%*	*0%*
10	KM Trustee Co.	0.16	0.21	0.31	0.42	0.51
	yoy change	*27%*	*37%*	*45%*	*34%*	*23%*
11	KM Inc	0.20	0.34	0.53	0.76	1.06
	yoy change	*87%*	*66%*	*57%*	*44%*	*39%*
	Consolidated before MI	**63.90**	**71.35**	**81.56**	**93.11**	**109.06**
	yoy change	***76%***	***12%***	***14%***	***14%***	***17%***
	Consolidated after MI	**58.24**	**65.23**	**73.40**	**83.80**	**98.15**
	yoy change	***80%***	***12%***	***13%***	***14%***	***17%***

Source: Company Data, PL Research

Trend in contribution of PAT and Networth by KMB and all subsidiaries

Sl. No.	Subsidiary	PAT					Net Worth				
		FY08	FY09	FY10E	FY11E	FY12E	FY08	FY09	FY10E	FY11E	FY12E
	Kotak Mahindra Bank	30.1%	41.3%	36.8%	32.9%	37.0%	55.3%	53.4%	50.9%	48.3%	46.1%
	Subsidiaries										
1	Kotak Securities	41.9%	15.9%	28.2%	29.6%	28.4%	17.9%	17.5%	19.1%	20.8%	22.2%
2	KMCC	11.8%	1.9%	3.6%	4.5%	4.3%	6.3%	5.8%	5.6%	5.5%	5.4%
3	KM AMC	0.1%	1.5%	3.0%	2.7%	2.4%	0.4%	0.5%	1.0%	1.2%	1.4%
4	Kotak Investment Advisors	1.4%	7.2%	4.8%	4.6%	4.4%	0.6%	1.2%	1.7%	1.5%	1.8%
5	KM Prime	10.3%	23.5%	13.8%	15.8%	14.7%	11.1%	12.1%	12.4%	13.1%	13.5%
6	KM Investments	4.4%	2.1%	3.3%	3.4%	2.7%	2.8%	2.7%	2.8%	2.9%	2.9%
7	KM International	2.0%	1.5%	1.2%	1.3%	1.2%	1.0%	1.3%	1.3%	1.3%	1.3%
8	KM UK	3.6%	1.1%	2.5%	2.6%	2.6%	0.9%	1.2%	1.4%	1.6%	1.7%
9	KM OM Life Insurance	-7.4%	2.1%	0.0%	0.0%	0.0%	3.1%	3.4%	2.9%	2.6%	2.2%
10	KM Trustee Co.	0.7%	0.9%	0.9%	0.8%	0.6%	0.2%	0.3%	0.4%	0.4%	0.5%
11	KM Inc	1.1%	1.1%	1.8%	1.8%	1.7%	0.3%	0.5%	0.7%	0.8%	1.0%
	Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: Company Data, PL Research

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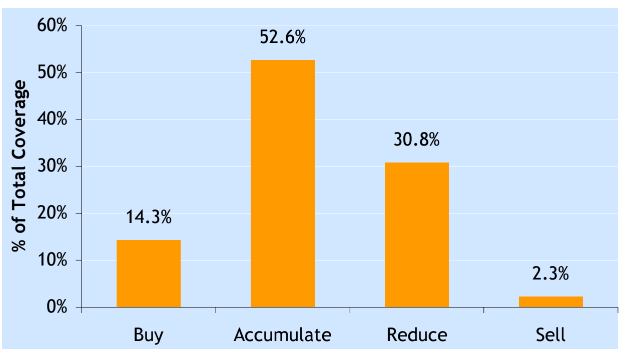

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BUY	:	Over 15% Outperformance to Sensex over 12-months	**Accumulate**	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months	**Sell**	:	Over 15% underperformance to Sensex over 12-months
Trading Buy	:	Over 10% absolute upside in 1-month	**Trading Sell**	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock	**Under Review** (UR)	:	Rating likely to change shortly

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