

Kotak Mahindra Bank (KTKM.BO)

Model Update

- **Raise Earnings and Maintain Neutral** — The business is in good shape: we raise earnings marginally over FY13-15E, our TP is Rs677 based on SOTP, and we maintain our Neutral recommendation – reflecting a strong business with an enhanced outlook – but rich valuations.

- Company Update
- Estimate Change

Neutral	2
Price (28 Jan 13)	Rs671.00
Target price	Rs677.00
Expected share price return	0.9%
Expected dividend yield	0.2%
Expected total return	1.1%
Market Cap	Rs499,737M
	US\$9,289M

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



Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2011A	15,667	21.84	16.1	30.7	4.5	16.6	0.1
2012A	18,322	24.77	13.4	27.1	3.9	15.4	0.2
2013E	21,552	28.99	17.0	23.1	3.3	15.4	0.2
2014E	27,184	36.48	25.8	18.4	2.8	16.6	0.2
2015E	33,496	44.95	23.2	14.9	2.4	17.3	0.2

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2011	2012	2013E	2014E	2015E
Valuation Ratios					
P/E adjusted (x)	30.7	27.1	23.1	18.4	14.9
P/E reported (x)	30.7	27.1	23.1	18.4	14.9
P/BV (x)	4.5	3.9	3.3	2.8	2.4
P/Adjusted BV diluted (x)	4.6	3.9	3.4	2.9	2.5
Dividend yield (%)	0.1	0.2	0.2	0.2	0.2
Per Share Data (Rs)					
EPS adjusted	21.84	24.77	28.99	36.48	44.95
EPS reported	21.84	24.77	28.99	36.48	44.95
BVPS	148.78	174.18	201.74	237.67	282.08
Tangible BVPS	148.78	174.18	201.74	237.67	282.08
Adjusted BVPS diluted	145.30	170.27	196.43	230.57	272.42
DPS	1.00	1.20	1.20	1.20	1.20
Profit & Loss (Rsm)					
Net interest income	35,069	39,285	47,612	56,880	71,106
Fees and commissions	8,370	13,419	17,126	20,694	24,252
Other operating Income	12,422	8,885	9,136	9,986	12,421
Total operating income	55,861	61,588	73,874	87,560	107,779
Total operating expenses	-31,911	-34,036	-40,406	-45,610	-55,670
Oper. profit bef. provisions	23,950	27,552	33,468	41,950	52,109
Bad debt provisions	-1,476	-987	-1,908	-2,027	-2,912
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	22,474	26,565	31,560	39,923	49,197
Tax	-6,782	-8,060	-9,614	-12,583	-15,519
Extraord./Min. Int./Pref. Div.	-25	-183	-394	-156	-182
Attributable profit	15,667	18,322	21,552	27,184	33,496
Adjusted earnings	15,667	18,322	21,552	27,184	33,496
Growth Rates (%)					
EPS adjusted	16.1	13.4	17.0	25.8	23.2
Oper. profit bef. prov.	-0.8	15.0	21.5	25.3	24.2
Balance Sheet (Rsm)					
Total assets	736,811	923,494	1,167,065	1,464,998	1,833,910
Avg interest earning assets	610,746	793,608	1,004,126	1,281,999	1,627,082
Customer loans	418,610	537,515	690,531	885,442	1,134,025
Gross NPLs	7,120	6,997	9,096	11,629	15,278
Liab. & shar. funds	736,811	923,494	1,167,065	1,464,998	1,833,910
Total customer deposits	273,130	364,607	529,370	736,720	970,604
Reserve for loan losses	6,190	6,079	7,726	9,314	11,536
Shareholders' equity	109,629	129,010	150,133	176,870	209,920
Profitability/Solvency Ratios (%)					
ROE adjusted	16.6	15.4	15.4	16.6	17.3
Net interest margin	5.74	4.95	4.74	4.44	4.37
Cost/income ratio	57.1	55.3	54.7	52.1	51.7
Cash cost/average assets	5.0	4.1	3.9	3.5	3.4
NPLs/customer loans	1.7	1.3	1.3	1.3	1.3
Reserve for loan losses/NPLs	86.9	86.9	84.9	80.1	75.5
Bad debt prov./avg. cust. loans	0.4	0.2	0.3	0.3	0.3
Loans/deposit ratio	153.3	147.4	130.4	120.2	116.8
Tier 1 capital ratio	20.3	17.8	16.5	15.0	14.1
Total capital ratio	22.9	20.6	19.0	17.3	16.2

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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 45% 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

We rate KTKM Neutral with a target price of Rs677. KTKM, in our view, is a play on the overall financial-services market in India and 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 believe KTKM has transformed itself into a 'bank-asset manager-broker' from a more cyclical 'broker-bank'. While we believe this increases the business stability, franchise and earnings sustainability, though it is still meaningfully linked to capital market performance. While capital market businesses (broking, asset management, life insurance), remain an integral part of overall customer strategy, they are currently under pressure from a cyclical, regulatory and competitive perspective. We believe, there is value and synergy for the group to be had from these businesses but going forward these will provide the upside kickers than form the bulk of the value of the stock.

KTKM's lending businesses have now reached critical scale, have enough capital for growth, improving deposit mix, a strong return profile and improving asset quality performance. Kotak's relatively lower exposure to the perceived vulnerable segments of infrastructure and power along with its strong asset quality performance has led to a strong outperformance for the company over recent months. However, given its relatively higher valuations now, we believe any upside from here would have to be based on a more positive macro or growth environment, which is likely to remain under pressure near-term.

Valuation

Our target price of Rs677 is based on our valuation of KTKM's different businesses via the sum-of-the-parts methodology. This values the banking business at Rs476 per share at 3.0x PBV 1-year forward, the vehicle loan financing business at Rs96 per share at 2.5x 1-year forward P/BV, the investment banking and broking business at 1.2x 1-year forward P/BV or Rs41, the insurance subsidiary at Rs17 (12x 1-year forward NBAP), and we attribute Rs47 to the AMC business (6% of AUM for domestic MF, and 8% for Portfolio and alternative assets). Our target multiples are in line with the best of breed private-sector banks and other financial services business.

Risks

We believe key downside risks to our target price and the business would be: a) Sharp downturn in the capital markets; b) Significant pressure on asset quality; and c) Sharp increases in interest rates, which can pressure its relatively wholesale funding mix. Key upside risks would include: a) Continued strong asset quality performance; b) Improvement in its relatively moderate deposit franchise; and c) Macro, capital market turnaround.

Appendix A-1

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Ratings and Target Price History Fundamental Research

Analyst: Aditya Narain, CFA
Covered since March 26 2012



	Date	Rating	Target Price	Closing Price
1	24-Aug-10	*1M	*525.00	428.63
2	20-Jan-11	1M	*495.00	419.30
3	26-Sep-11	*2M	*500.00	457.60
4	5-Oct-11	2M	*490.00	429.45

	Date	Rating	Target Price	Closing Price
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*2	490.00	447.10
7	26-Mar-12	2	*550.00	530.95
8	19-Jul-12	2	*583.00	579.25

	Date	Rating	Target Price	Closing Price
9	10-Oct-12	2	*646.00	628.85
10	22-Jan-13	2	*677.00	640.55

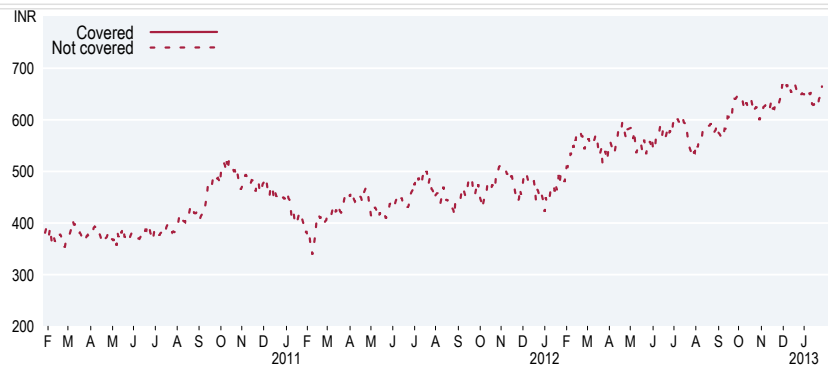
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Kotak Mahindra Bank (KTKM.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Aditya Narain, CFA
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