

## Kotak Mahindra Bank

### 3Q FY13 results: positive surprise driven by loan growth

Kotak reported consolidate PAT of Rs5.77B (JPMe Rs5.44B), up 25% y/y. The surprise was driven by the parent bank (the subs actually missed, collectively) on the back of strong asset growth. The consolidated loan book grew 10% q/q – the y/y growth of 27% was well above management guidance of 20-23%. The corporate book growth of 15% q/q was the key driver of the growth. The return of growth momentum should be a trigger for the stock, and we maintain our OW rating.

- **Return of loan growth.** Standalone loan growth accelerated to 33% y/y, primarily driven by the corporate book. Kotak capitalized on the strong demand for working capital lending – we see this as a good sign as the bank seems to be penetrating this segment now. Personal loans and autos also grew smartly – the bank seems to be going slow on CVs where they have been flagging portfolio stress for some time. .
- **Margins bottoming out.** Consolidated margins declined from 4.6% to 4.5% q/q and management expects this to stabilize at the current levels. We think this depends on the deposit pricing scenario and the CASA momentum. We see clear loan pricing pressure as low-risk segments are likely to offer better growth opportunities.
- **Asset quality solid.** Credit costs held up well at <50bp. Management sees no obvious signs of stress except in the CV/CE, where the momentum is getting worse. The recoverability of these loans still remains robust given the collateral, but we do expect some upward bias in credit costs, going forward.
- **Cost-income < 50%.** Opex growth remained muted and the standalone cost-income slipped below 50%. We expect the downward trend to continue as a) new branches are lower-cost so some operating leverage is creeping in, b) incremental loan growth is driven by corporates where origination costs tend to be low, and c) the weak economic environment helps contain rent and wage inflation.

#### Kotak Mahindra Bank (Reuters: KTKM.BO, Bloomberg: KMB IN)

Year-end Mar (Rs in mn)	FY10A	FY11A	FY12E	FY13E	FY14E
Operating Profit (Rs mn)	22,979	22,224	26,181	34,791	46,229
Net Profit (Rs mn)	12,310	14,924	18,118	21,945	28,069
Cash EPS (Rs)	17.68	20.25	24.46	29.63	37.90
Fully Diluted EPS (Rs)	16.97	19.02	23.35	28.41	36.41
DPS (Rs)	0.43	0.50	0.60	0.73	0.93
EPS growth (%)	90.6%	14.6%	20.8%	21.1%	27.9%
ROE	16.6%	15.5%	15.1%	15.8%	17.3%
P/E	36.2	31.6	26.2	21.6	16.9
BVPS (Rs)	116.16	150.82	173.39	201.30	237.64
P/BV	5.5	4.2	3.7	3.2	2.7
Div. Yield	0.1%	0.1%	0.1%	0.1%	0.1%

Source: Company data, Bloomberg, J.P. Morgan estimates.

## Overweight

KTKM.BO, KMB IN

Price: Rs640.75

Price Target: Rs650.00

### India

#### Financials

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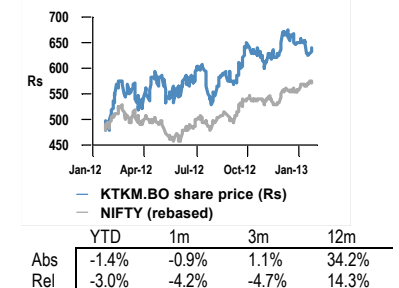
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#### Price Performance



#### Company Data

52-wk range (Rs)	677.00 - 472.65
Market cap (Rs mn)	477,208
Market cap (\$ mn)	8,877
Shares outstanding (mn)	745
Fiscal Year End	Mar
Price (Rs)	640.75
Date Of Price	22 Jan 13
Avg daily value (Rs mn)	1,051.2
Avg daily value (\$ mn)	19.6
Avg daily vol (mn)	1.8
NIFTY	6,049
Exchange Rate	53.76

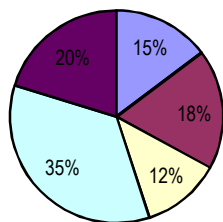
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### Company Description

Kotak Mahindra Bank (Kotak) is focused on retail lending while building a strong wholesale lending franchise – it also operates in investment banking and broking, asset management and insurance. It has a loan book size of ~US\$16B. Kotak is well capitalized and is expanding on an exercise to deepen distribution over the next few years

### Retail loan breakdown



■ Home ■ Car ■ CV ■ Corporate ■ Others

Source: Company

### EPS: J.P. Morgan vs consensus

Rs	J. P. Morgan	Consensus
FY13E	29.6	28.0
FY14E	37.9	34.2

Source: Bloomberg, J.P. Morgan.

### P&L sensitivity metrics

	EBITDA impact (%)	EPS impact (%)
NIMs		
Impact of each 25bp	5.0%	6.0%
Cost to Income		
Impact of each 100bp	3.0%	3.6%
Provisions/Assets		
Impact of each 25bp	0.0%	6.0%

Source: J.P. Morgan estimates

### Price target and valuation analysis

Our Mar-14 PT for Kotak of Rs650 is based on a 2-stage Gordon growth model implying 2.7x FY14E book. Our valuations factor in a Cost of Equity of 14.6%, normalized ROE of ~22%, and terminal growth of 5%.

Risk free rate	8.0%
Equity Risk Premium	6.0%
Cost of Equity	14.6%
Terminal growth	5.0%
Stage 2 growth	26.0%
Mar-14 PT	650
Insurance Valuation	26

### Normalised ROE

NII/Assets	4.5%
Revenues/assets	7.3%
Costs/Assets	3.7%
Provisions/assets	0.4%
ROA	2.2%
ROE	22.0%

Source: J.P. Morgan estimates

Kotak's lending business continues to surprise on growth and asset quality and we expect the positive trend to continue. Key risks to our OW recommendation and price target are a slowdown in retail credit due to weak sentiment and asset quality shocks from specific events.

Table 1: 3Q13 results: consolidated

Rs MM, YE Mar.	3Q FY12	2Q FY13	3Q FY13	YoY	QoQ
Net interest income	9,997	11,607	12,316	23.2%	6.1%
Non interest income	9,005	14,260	13,457	49.4%	-5.6%
Non interest expenses	11,804	18,000	16,836	42.6%	-6.5%
Pre Prov profits	7,198	7,867	8,937	24.2%	13.6%
Provisions	452	614	589	30.3%	-4.0%
PBT	6,746	7,253	8,348	23.7%	15.1%
Tax	2,083	2,192	2,489	19.5%	13.6%
PAT	4,662	5,061	5,858	25.7%	15.8%
Affiliates/Minorities	36	40	88	NM	NM
Attributable PAT	4,626	5,022	5,771	24.7%	14.9%
Cost/Income	62.1%	69.6%	65.3%	3.20%	-4.26%
Prov/PBT	6.3%	7.8%	6.6%	0.31%	-1.21%
Tax rate	30.9%	30.2%	29.8%	-1.07%	-0.40%
NIM	4.7%	4.7%	4.6%		
<b>Operating data</b>					
Gross NPAs	6,780	8,300	8,241	21.5%	-0.7%
Net NPAs	2,465	3,833	3,648	48.0%	-4.8%
Coverage	63.6%	53.8%	55.7%	-7.91%	1.91%
NIMs	4.7%	4.7%	4.6%	-0.10%	-0.10%
CASA	27.7%	27.1%	25.9%	-1.73%	-1.17%
<b>Loan book growth</b>					
CV loans	75,400	81,830	80,710	7.0%	-1.4%
Car loans	97,710	117,480	122,170	25.0%	4.0%
Personal loans	16,890	21,410	24,200	43.3%	13.0%
Home loans	79,350	92,860	98,690	24.4%	6.3%
Corp/SME	166,970	202,490	233,150	39.6%	15.1%
Others	92,150	96,480	111,290	20.8%	15.4%
<b>Total Loan book</b>	<b>528,470</b>	<b>612,550</b>	<b>670,210</b>	<b>26.8%</b>	<b>9.4%</b>

Source: Company reports and J.P. Morgan calculations.

Table 2: 3Q FY13 results: subsidiaries

Rs MM, YE Mar.	3Q FY12	2Q FY13	3Q FY13	YoY	QoQ
<b>Kotak Mahindra Bank</b>					
PAT	2,760	2,800	3,620	31.2%	29.3%
<b>Kotak Mahindra Prime (KMP)</b>					
Profit before royalty & taxes	1,520	1,700	1,580	3.9%	-7.1%
PAT	1,040	1,140	1,050	1.0%	-7.9%
<b>KMCC</b>					
PAT	40	40	20	-50.0%	-50.0%
<b>Kotak Securities</b>					
Total income	1,340	1,550	1,460	9.0%	-5.8%
PAT	240	400	380	58.3%	-5.0%
<b>Kotak Asset Management</b>					
Total income	30	-50	110	266.7%	-320.0%
PAT	30	-50	110	266.7%	-320.0%
<b>Kotak Insurance</b>					
Gross premium income	6,390	6,200	5,950	-6.9%	-4.0%
Profit	470	470	530	12.8%	12.8%
<b>International subsidiaries</b>					
PAT	-40	80	50	-225.0%	NM

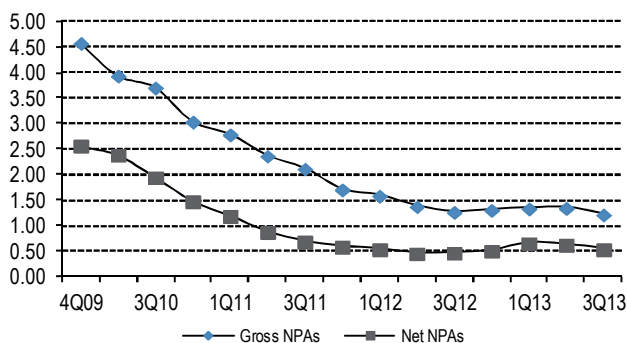
Source: Company reports and J.P. Morgan calculations.

Table 3: 3Q FY13 results: standalone

Rs MM, YE Mar.	3Q FY12	2Q FY13	3Q FY13	YoY	QoQ
NII	6,514	7,581	8,228	26.3%	8.5%
Other income	2,820	2,508	3,049	8.1%	21.6%
Total Revenues	9,333	10,089	11,277	20.8%	11.8%
Employee expense	2,260	2,428	2,636	16.6%	8.6%
Other expense	2,638	2,840	2,915	10.5%	2.7%
Operating expense	4,898	5,267	5,551	13.3%	5.4%
PPOP	4,435	4,822	5,726	29.1%	18.7%
Provisions	307	706	424	38.0%	-40.0%
PBT	4,128	4,116	5,302	28.4%	28.8%
Tax	1,368	1,312	1,686	23.2%	28.5%
PAT	2,760	2,804	3,616	31.0%	29.0%
Standalone Loan book	397,720	454,430	502,450	26.3%	10.6%
Standalone margins	4.63%	4.63%	4.56%	-0.07%	-0.07%
Credit cost	0.32%	0.64%	0.35%	0.04%	-0.29%
NIM	4.70%	4.70%	4.60%	-2.1%	-2.1%

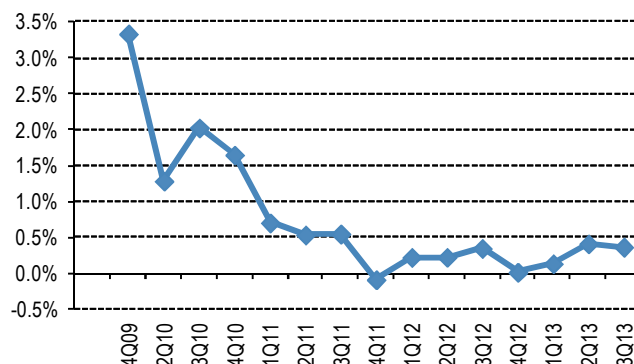
Source: Company reports and J.P. Morgan calculations.

Figure 1: NPLs remain under control



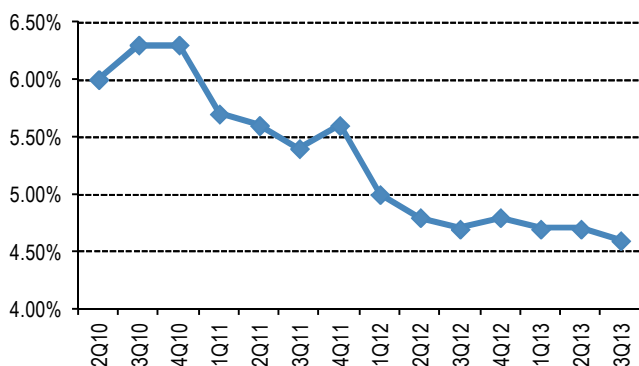
Source: Company reports and J.P. Morgan estimates.

Figure 2: Credit costs stay below 50bp



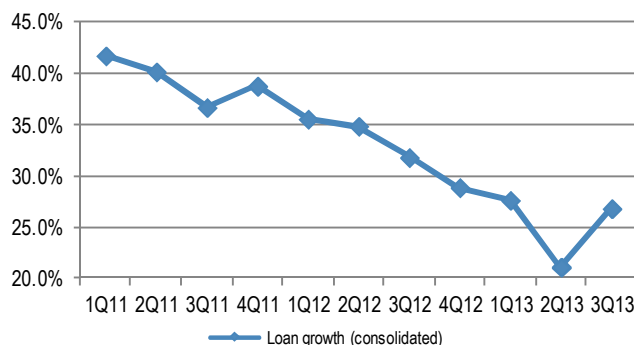
Source: Company reports and J.P. Morgan estimates.

Figure 3: Margins trending down – nearing the bottom, we think



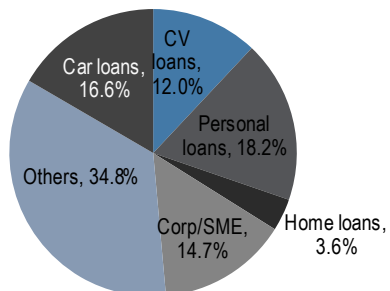
Source: Company reports and J.P. Morgan estimates.

Figure 4: Loan growth accelerates, breaking recent trend



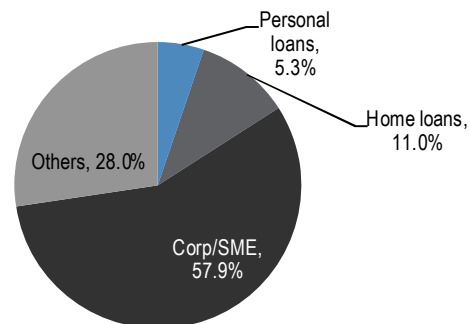
Source: Company reports and J.P. Morgan estimates.

Figure 5: Loan book still retail-oriented



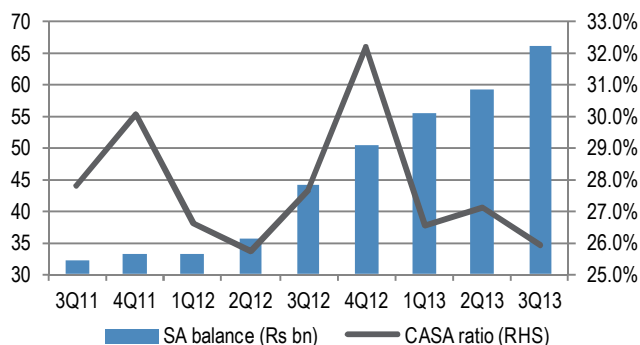
Source: Company reports and J.P. Morgan estimates.

Figure 6: Corporate book drives incremental 3Q loan book



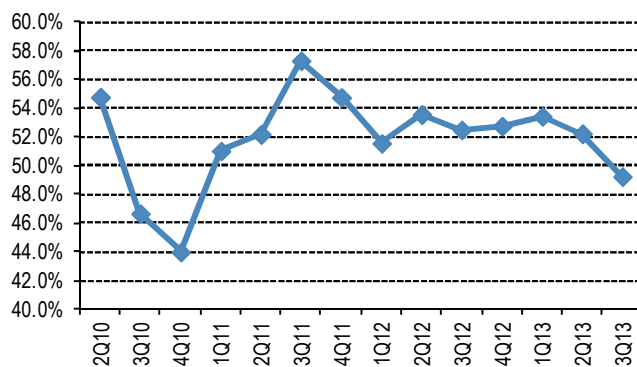
Source: Company reports and J.P. Morgan estimates.

Figure 7: High SA growth but strong base depressed CASA ratio



Source: Company reports and J.P. Morgan estimates.

Figure 8: Falling cost-income offsetting NIM pressures



Source: Company reports and J.P. Morgan estimates.

## Kotak Mahindra Bank: Summary of Financials

Income Statement						Growth Rates					
Rs in millions, year end Mar	FY10	FY11	FY12E	FY13E	FY14E		FY10	FY11	FY12E	FY13E	FY14E
NIM (as % of avg. assets)	6.3%	5.4%	4.8%	4.7%	4.6%	Loans	30.9%	37.4%	28.7%	31.2%	31.2%
Earning assets/assets	95.4%	96.4%	96.5%	96.2%	96.3%	Deposits	25.3%	9.7%	14.1%	20.7%	25.5%
Margins (% of earning assets)	6.0%	5.2%	4.6%	4.5%	4.5%	Assets	33.2%	32.8%	26.6%	32.5%	31.6%
						Equity	19.7%	37.4%	15.6%	16.1%	18.1%
Net Interest Income	25,897	29,972	34,413	43,538	56,921	RWA	37.6%	34.1%	25.8%	32.6%	31.8%
Total Non-Interest Income	16,765	16,815	18,982	20,922	24,003	Net Interest Income	18.5%	15.7%	14.8%	26.5%	30.7%
Fee Income	-	-	-	-	-	Non-Interest Income	37.4%	0.3%	12.9%	10.2%	14.7%
						of which Fee Grth	-	-	-	-	-
Other Operating Income	-	-	-	-	-	Revenues	52.7%	22.5%	31.7%	62.0%	38.5%
Total operating revenues	42,663	46,787	53,395	64,460	80,925	Costs	-2.7%	24.8%	10.8%	9.0%	16.9%
						Pre-Provision Profits	66.3%	-3.3%	17.8%	32.9%	32.9%
Operating costs	-19,683	-24,563	-27,214	-29,669	-34,696	Loan Loss Provisions	71.8%	-71.4%	-37.6%	256.0%	74.9%
						Pre-Tax	-	-	-	-	-
Pre-Prov. Profits	22,979	22,224	26,181	34,791	46,229	Attributable Income	91.9%	21.2%	21.4%	21.1%	27.9%
Provisions	-5,641	-1,613	-1,008	-3,587	-6,274	EPS	90.6%	14.6%	20.8%	21.1%	27.9%
Other Inc/Exp. (treasury Income)	493	912	822	900	1,100	DPS	13.3%	17.6%	20.0%	21.1%	27.9%
Exceptionals	0	0	0	0	0						
						<b>Balance Sheet Gearing</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>	<b>FY14E</b>
Pre-tax	17,831	21,522	25,995	32,104	41,055	Loan/deposit	128.8%	144.5%	141.2%	114.3%	108.3%
Tax	5,521	6,598	7,876	10,159	12,987	Investment/assets	5.0%	5.5%	5.6%	4.9%	4.3%
Minorities	-	-	-	-	-	Loan/Assets	62.2%	64.4%	65.4%	64.8%	64.6%
Other Distbn.	-	-	-	-	-	Customer deposits/liab.	58.6%	54.2%	55.4%	66.1%	68.3%
Attributable Income	12,310	14,924	18,118	21,945	28,069	LT debt/liabilities	27.3%	32.1%	33.5%	25.8%	24.4%
						<b>Asset Quality/Capital</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>	<b>FY14E</b>
<b>Per Share Data Rs</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>	<b>FY14E</b>	Loan loss reserves/loans	0.0%	0.0%	0.0%	0.0%	0.0%
EPS	17.68	20.25	24.46	29.63	37.90	NPLs/loans	3.0%	1.7%	1.2%	1.1%	1.4%
DPS	0.43	0.50	0.60	0.73	0.93	Specific loan loss reserves/NPLs	0.0%	0.0%	0.0%	0.0%	0.0%
Payout	2.4%	2.5%	2.5%	3.4%	3.5%	Growth in NPLs	10.4%	-23.9%	-4.3%	17.0%	62.9%
Book value	116.16	150.82	173.39	201.30	237.64	Tier 1 Ratio	15.4%	18.0%	15.7%	14.0%	12.0%
Fully Diluted Shares	696.28	736.87	740.69	740.69	740.69	Total CAR	18.4%	19.9%	17.5%	15.4%	13.0%
						<b>Key Balance sheet Rs in millions</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>	<b>FY14E</b>
						Net Loans	307,637	422,706	544,004	713,663	936,379
						LLR	0	0	0	0	0
						Gross Loans	307,637	422,706	544,004	713,663	936,379
						NPLs	9,167	6,977	6,677	7,810	12,727
						Investments	24,926	35,805	46,368	54,178	61,880
						Other earning assets	14,835	15,426	25,997	34,787	45,939
						Avg. IEA	412,825	554,816	717,577	929,824	1,228,557
						Goodwill	-	-	-	-	-
						Assets	494,387	656,622	831,239	1,101,047	1,449,401
						Deposits	238,865	292,610	385,365	624,193	864,694
						Long-term bond funding	135,099	210,652	278,148	283,981	352,977
						Other Borrowings	-	-	-	-	-
						Avg. IBL	322,068	438,613	583,388	785,844	1,062,922
						Avg. Assets	432,804	575,504	743,930	966,143	1,275,224
						Common Equity	80,879	111,134	128,431	149,101	176,016
						RWA	432,677	580,266	729,834	967,771	1,275,239
						Avg. RWA	373,506	506,471	655,050	848,803	1,121,505
						<b>Du-Pont Analysis</b>	<b>FY10</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>	<b>FY14E</b>
						NIM (as % of avg. assets)	6.3%	5.4%	4.8%	4.7%	4.6%
						Earning assets/assets	95.4%	96.4%	96.5%	96.2%	96.3%
						Margins (as % of Avg. Assets)	6.0%	5.2%	4.6%	4.5%	4.5%
						Non-Int. Rev./ Revenues	39.3%	35.9%	35.5%	32.5%	29.7%
						Non IR/Avg. Assets	3.9%	2.9%	2.6%	2.2%	1.9%
						Revenue/Assets	9.9%	8.1%	7.2%	6.7%	6.3%
						Cost/Income	46.1%	52.5%	51.0%	46.0%	42.9%
						Cost/Assets	4.5%	4.3%	3.7%	3.1%	2.7%
						Pre-Provision ROA	5.3%	3.9%	3.5%	3.6%	3.6%
						LLP/Loans	-2.1%	-0.4%	-0.2%	-0.6%	-0.8%
						Loan/Assets	62.7%	63.5%	65.0%	65.1%	64.7%
						Other Prov. Income/ Assets	0.1%	0.2%	0.1%	0.1%	0.1%
						Operating ROA	5.3%	3.9%	3.5%	3.6%	3.6%
						Pre-Tax ROA	4.1%	3.7%	3.5%	3.3%	3.2%
						Tax rate	-	-	-	-	-
						Minorities & Outside Distbn.	0.0%	0.0%	0.0%	0.0%	0.0%
						ROA	2.8%	2.6%	2.4%	2.3%	2.2%
						RORWA	3.3%	2.9%	2.8%	2.6%	2.5%
						Equity/Assets	17.2%	16.7%	16.1%	14.4%	12.7%
						ROE	16.6%	15.5%	15.1%	15.8%	17.3%

Source: Company reports and J.P. Morgan estimates.

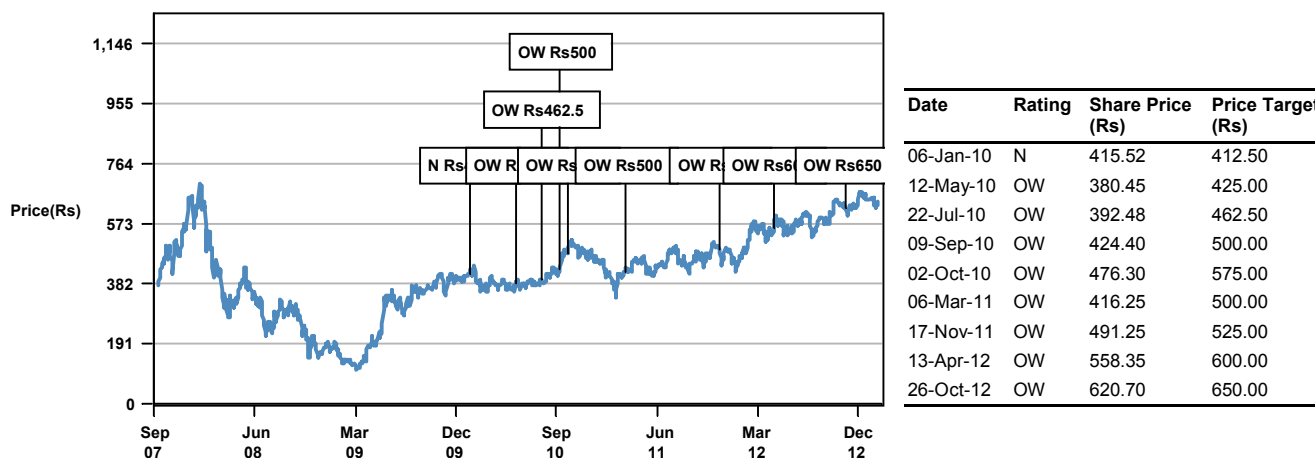
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Kotak Mahindra Bank (KTKM.BO, KMB IN) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jan 06, 2010.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

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