BUY

Result Update

Stock Information

Bloomberg Code:	KMB IN
CMP (Rs):	641
TP (Rs):	664
Mcap (Rs bn/US$ bn):	477/8.9
3M ADV (₹ mn/US$ mn):	415/7.7

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	(1)	1	30	(1)
Rel. to Sensex	(5)	(5)	10	(4)

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs bn)

	FY12	FY13E	FY14E
NII	25.1	31.1	37.9
PAT	10.9	12.7	17.4
Con. BVPS (Rs)	175	202	239

Source: Bloomberg, Ambit Capital research

Analysts

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Kotak Mahindra Bank

Beats estimates; surprises on loan growth

Results overview: Kotak Mahindra Bank's (KMB) 3QFY13 consolidated net profit at Rs5.8bn was up 25% YoY (15% QoQ) and was 5% above our estimates and in line with consensus estimates). The strong profit growth was primarily driven by: (1) strong NII growth of 26% YoY in the banking business, (2) net profit growth of 43% YoY in capital market subsidiaries, and (3) AMC's net profit growth of 70% YoY, which was slightly offset by flattish profits of the NBFC and insurance businesses.

Barring NIMs, operationally, all key parameters improved with 27% YoY loan growth (vs 21% a quarter ago), QoQ improvement in credit quality with annualised provisioning cost of 31bps (vs 35bps in 2QFY13), and 300bps QoQ improvement in cost-to-income ratio. However, NIMs declined by 7bps QoQ at both the standalone and consolidated level at 4.5% and 4.6% respectively, as the ~10bps decline in cost of funds was more than offset by 14bps decline in yield on interest earning assets. The strong traction on the liability side continued, with 26% YoY increase in CASA deposits (with savings deposits increasing 49% YoY). Capital market business remained subdued despite a pick up in activity levels over the past three months.

The management guided towards >25% loan growth, stable NIMs of 4.5%, no significant deterioration in credit quality, continued improvement in cost/income ratio, continued traction in liability franchise, and improvement in the profitability of capital market, asset management and insurance subsidiaries. The management noted that the recent policy initiatives are sentimentally positive but fundamentally the situation has not improved meaningfully for the management to change its cautious stance on growth. However, the management stated that as long as risk-adjusted returns are favourable, the bank would not hesitate to expand its loan book.

Where do we go from here? At valuation of ~15.4x FY14 P/E and 2.6x FY14 P/B, we do not envisage a significant rerating of the stock in the near term. We continue to prefer KMB in the banking sector. Its negligible exposure to large ticket sized infra projects and negligible restructured assets on its books would keep the company relatively immune from the asset quality risk that we are envisaging for the rest of the banking space. On the other hand, improving CASA ratio, declining wholesale rates and its strong presence in capital-market-related businesses mean that it is well placed to benefit from a lower interest rate environment and improved capital markets. Moreover, a well-capitalised balance sheet (tier 1 ratio of 15%) means that the company could take the inorganic route to expand its balance sheet by acquiring assets/companies and maintain earnings growth. On a longer-term basis, we believe that KMB is the best structural play on the Indian financial services industry, given its strong and wide presence across BFSI and a capable and experienced management team that has held the reins for more than a decade. We maintain our BUY stance on the stock with a target price of Rs664/share

Key takeaways from the results and post results conference call:

- **Loan growth picks up:** Consolidated loan book growth increased 27% YoY vs a run rate of 21% in the previous quarter, despite a slowdown in the CV/CE loan portfolio, because the growth was driven by agri loans, business banking (SME loans) and corporate banking. The management highlighted the opportunistically available risk-adjusted margins in such segments and revised its loan growth guidance to ~25% in contrast to >20% guidance given in the previous quarter's earnings call.

- **NIMs decline:** NIMs declined by 7bps QoQ at both the standalone and consolidated level at 4.5% and 4.6% respectively, as the ~10bps decline in cost of funds was more than offset by 14bps decline in yield on interest earning assets. The management maintained its guidance of NIMs of >4.5%. We are building in NIMs of ~4.6% and 4.5% for the standalone bank in FY13 and FY14 respectively, because an increasing proportion of low-cost CASA deposits in the liability mix and slightly lower cost for wholesale liabilities would offset the decline in lending yields going forward.

- **Credit quality improves QoQ:** KMB's gross NPAs were flat QoQ and provisioning cost was 35bps annualised vs 31bps annualised a quarter ago. The management stated that consumer loans (mortgages, auto, personal loans, and credit cards) continue to hold well in terms of asset quality and there are no signs of stress in this segment. However, the management continues to see some stress in its construction equipment and construction-related commercial vehicle loan portfolio. The company has negligible restructured assets of Rs97mn on its books (just 0.02% of loan book) and continues to maintain superior asset quality vs its peers.

- **Liability franchise continues to strengthen:** The company continues to build its liability franchise on the back of savings rate deregulation, with CASA deposits increasing 26% YoY (and 8% QoQ) and with savings deposits increasing 49% YoY (and 12% QoQ). Whilst low cost deposits (CASA + TD Sweep deposits) have increased 26% YoY, their proportion has marginally declined to 19.6% of total borrowed funds of KMB from 20.3% a year ago. The CASA ratio declined by 120bps QoQ to 25.9%, as certificate of deposits issued by the bank increased (57% QoQ). The management maintained its guidance of 500 branches by FY14 with a downward trending cost-to-income ratio, given that the branches have matured to step up the income generation.

- **Capital-market-related businesses remain muted:** Despite some recovery in stock market volumes and capital-raising activities, the capital-market-related income of the company remained muted with a QoQ dip in the profitability in stock broking and investment banking businesses. However, the management stated that they are seeing green shoots of recovery in the capital market businesses in January, with a pick up in broking volumes, investment banking as well as fixed income business. Given the high operating leverage in the capital market business, the profitability contribution from these businesses could increase quite significantly if the capital markets recover going forward.

- **Asset management returns to profitability:** The asset management business returned to profitability during the quarter, because average AUM increased by ~7% QoQ and there were no one-time expense on marketing and distribution during the quarter.

Key Financials

	3QFY13A	3QFY12	2QFY13	YoY Growth (%)	QoQ Growth (%)	3QFY13E
INCOME STATEMENT						
NII	8,229	6,514	7,581	26%	9%	8,000
Other Income	3,049	2,820	2,508	8%	22%	2,869
Total Income	11,277	9,334	10,089	21%	12%	10,869
Operating Expenses	5,551	4,898	5,267	13%	5%	5,641
Operating Profit	5,726	4,436	4,822	29%	19%	5,228
Provisions and Contingencies	424	307	706	38%	-40%	541
PBT	5,303	4,129	4,116	28%	29%	4,687
Tax	1,686	1,368	1,312	23%	28%	1,494
PAT	3,617	2,761	2,804	31%	29%	3,193
Diluted EPS after Extraordinary items	4.84	3.72	3.75	30%	29%	4.27
CONSOLIDATED SNAPSHOT						
Kotak Mahindra Bank	3,617	2,760	2,804	31%	29%	
Kotak Mahindra Prime	1,050	1,040	1,140	1%	-8%	
Kotak Securities	380	240	400	58%	-5%	
Kotak Mahindra Capital Company	20	40	40	-50%	-50%	
Kotak Mahindra Old Mutual Life Insurance	471	470	470	0%	0%	
Kotak Investment Advisors	60	70	90	-14%	-33%	
Kotak Mahindra Investments	161	30	160	437%	1%	
Total PAT	5,950	4,640	5,134	28%	16%	
Minority Interest Equity Affiliates Others	(110)	(10)	(110)			
Consolidated PAT	5,840	4,630	5,024	26%	16%	
BALANCE SHEET						
Net Worth	89,920	76,700	85,970	17%	5%	89,163
Deposits	515,240	383,850	454,640	34%	13%	479,568
Borrowings	185,660	152,420	159,910	22%	16%	184,094
Other Liabilities and Provisions	33,460	28,760	28,430	16%	18%	28,430
Total	824,280	641,730	728,950			781,255
Cash, Bank and Call	29,600	34,300	29,550	-14%	0%	31,811
Investments	265,870	184,380	221,730	44%	20%	235,300
Advances	502,450	397,720	454,430	26%	11%	489,196
Fixed Assets & other Assets	26,360	25,320	23,230	4%	13%	24,949
Total	824,280	641,730	728,940	28%	13%	781,255
Bank Advances						
Commercial Vehicles & Construction Equipments	80,710	75,400	81,830	7%	-1%	83,163
Agriculture Finance	73,100	48,940	64,190	49%	14%	69,101
Mortgage Loans	98,690	79,350	92,860	24%	6%	99,964
Personal Loans	23,990	16,890	21,210	42%	13%	21,610
Corporate Banking	163,250	154,920	138,680	5%	18%	161,435
Others	62,710	22,200	55,660	182%	13%	53,923
Total Advances	502,450	397,720	454,430	26%	11%	489,196
Ratio Analysis						
Yield on Interest Earning Assets	11.60%	11.67%	11.74%			11.54%
Yield on Advances (%)	13.36%	13.55%	13.53%			13.4%
Yield on Investments (%)	8.07%	7.5%	7.90%			7.7%
Cost of Funds (%)	7.73%	7.7%	7.82%			7.64%
Spreads	3.87%	3.97%	3.92%			3.90%
NIMs	4.56%	4.63%	4.63%			4.57%
CASA Ratio	25.9%	28%	27.1%			27%
Cost to income	49%	52%	52%			52%
Opex to average loan book	1.16%	1.3%	1.20%			1.2%
Gross NPAs (%)	1.5%	1.5%	1.6%			1.50%
Net NPAs (%)	0.6%	0.6%	0.8%			0.70%
PCR (%)	56%	63%	54%			53%
Credit costs	0.09%	0.08%	0.08%			0.15%

Source: Company, Ambit Capital research

Balance sheet

	FY10	FY11	FY12	FY13E	FY14E
Net Worth	45,399	67,960	79,460	93,014	110,402
Deposits	238,864	292,610	385,370	506,725	626,701
Borrowings	61,405	117,239	165,950	140,720	163,751
Other Liabilities and Provisions	28,694	30,700	25,880	28,430	28,430
Total	374,362	508,510	656,660	768,888	929,284
Cash, Bank and Call	23,003	24,710	26,350	31,256	38,445
Investments	125,127	171,210	215,670	232,446	269,460
Advances	207,751	293,290	390,790	480,672	591,226
Fixed Assets & other Assets	18,483	19,280	23,850	24,514	30,153
Total	374,360	508,510	656,660	768,888	929,284

Source: Company, Ambit Capital research

Income statement

	FY10	FY11	FY12	FY13E	FY14E
NII	18,581	22,451	25,125	31,116	37,966
Other Income	6,282	6,330	9,773	10,734	13,310
Total Income	24,864	28,781	34,898	41,850	51,277
Operating Expenses	11,894	15,533	18,348	21,755	24,595
Operating Profit	12,970	13,248	16,550	20,096	26,681
Provisions and Contingencies	4,859	1,371	551	1,497	1,155
PBT	8,111	11,877	15,999	18,598	25,526
Tax	2,500	3,695	5,149	5,926	8,137
PAT	5,611	8,182	10,850	12,672	17,389
Standalone Diluted EPS	8.0	11.3	14.6	17.0	23.3
Consolidated Diluted EPS	18.6	21.6	24.8	28.6	37.5

Source: Company, Ambit Capital research

Ratio analysis

	FY10	FY11	FY12	FY13E	FY14E
Yield on Interest Earning Assets	11.0%	10.6%	11.4%	11.6%	11.1%
Yield on Advances (%)	13.5%	13.3%	14.2%	14.0%	13.3%
Yield on Investments (%)	6.7%	6.5%	6.8%	7.7%	7.6%
Cost of Funds (%)	**5.3%**	**5.7%**	**7.5%**	**7.7%**	**7.0%**
Spreads	5.7%	4.9%	3.93%	3.94%	4.12%
NIMs	6.30%	5.53%	4.65%	4.62%	4.68%
Cost to income	48%	54%	53%	52%	48%
Opex to average loan book	6.4%	6.2%	5.4%	5.0%	4.6%
Gross NPAs (Amt)	7,673	6,035	6,142	7,249	8,686
Net NPAs (Amt)	3602	2,112	2,374	3,244	3,963
Provisions	4,071	3,923	3,768	4,004	4,723
Gross NPAs (%)	3.6%	2.0%	1.56%	1.51%	1.47%
Net NPAs (%)	1.7%	0.7%	0.60%	0.67%	0.67%
PCR (%)	53.1%	65.0%	61.35%	55.24%	54.37%
Credit costs	2.60%	0.55%	0.16%	0.34%	0.22%

Source: Company, Ambit Capital research