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January 23, 2013

## Kotak Mahindra Bank

### F3Q13: Good Numbers

Stock Rating  
**Underweight**

Industry View  
**In-Line**

**Kotak reported a PAT of Rs5.8bn at the consolidated level (25% YoY, +15% QoQ), 6% ahead of MSe. The beat was mainly driven by the banking, insurance and AMC businesses, partially offset by lower than expected profits at the auto financing, broking, investment banking and other capital market-related businesses. At the bank, loan growth picked up, cost/income moderated appreciably and asset quality improved – both GNPL ratio and credit costs were lower QoQ.**

**The key trends from this quarter's results include:**

**a) Banking business:** The profits in this segment grew by 31% YoY, 29% QoQ.

**NII grew 26% YoY, 9% QoQ:** Loan growth picked up to 26% YoY, 11% QoQ from 22% YoY, 7% QoQ last quarter. This was mainly driven by a pickup in corporate and business banking loans, agri loans and personal loans. The CV/CE book contracted by 1% QoQ (+7% YoY); management highlighted that it was a conscious decision to slow down lending to this segment, as they continue to see asset-quality stress here. Management is now guiding to FY13 loan growth of around 25% vs. 20%+ previously.

NIM's (on our computations) moderated by ~5 bps QoQ, likely driven by the increased proportion of low-yielding corporate loans and a 1% decline in CA/deposits. SA/deposits also was lower, by 20 bps, to 12.8%, despite 12% sequential growth in SA deposits (owing to strong growth in CD's to fund balance sheet growth).

**Cost/Income ratio improved appreciably, to 49% from 52% in F2Q13 and F3Q12:** Management noted that execution on costs is a result of internal focus on improving productivity and suggested that they expect to sustain this ratio around or <50%.

The bank added 18 branches this quarter (52 branches

#### Key Ratios and Statistics

Reuters: KTKM.NS Bloomberg: KMB IN  
India Financial Services

Shr price, close (Jan 22, 2013)	Rs640.75
52-Week Range	Rs673.60-418.25
Mkt cap, curr (bn)	US\$8.8

Fiscal Year ending	03/12	03/13e	03/14e	03/15e
ModelWare EPS (Rs)	24.8	27.1	31.9	37.7
ModelWare net inc (Rs mn)	18,322	20,052	23,610	27,905
Net int inc (Rs mn)	39,285	40,914	48,438	57,982
P/E	22.2	23.7	20.1	17.0
P/BV	3.2	3.2	2.8	2.4
Return on avg eqty (%)	15.4	14.5	14.8	15.1

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).  
e = Morgan Stanley Research estimates

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YTD), taking the total network to 407 branches. Management is targeting 500 branches by Dec-13.

**Asset-quality trends improved sequentially:** GNPL's including stressed assets were flat QoQ, +21% YoY, and corresponding GNPL ratio improved to 1.46% from 1.61%. Core lending GNPL ratio moved lower QoQ, to 1.2% from 1.33% last quarter. The bank's stock of restructured loans is extremely low at Rs100mn (0.02% of loans).

Computed coverage ratio (excluding technical write-offs) moved higher QoQ, to 56% from 53%. Coverage ratio including technical write-offs was 66.6% vs. 64.7% last quarter.

Total provisions charge this quarter was Rs424mn (35 bps of loans, annualized). Approximately half of this, Rs200mn, was on account of standard provisioning. This compares with underlying provisioning level of 26bps in F2Q13 (headline provisions were 64 bps including provisioning on stressed asset acquisition).

Management mentioned that it continues to see signs of slowing demand and asset-quality pressure in the commercial vehicle and construction equipment segment, while the household segment hasn't seen much stress as of now.

**b) Kotak Prime:** The NBFC business recorded a profit of Rs1.05bn (+1% YoY and -8% QoQ). Loan growth picked up to 30% YoY, 6% QoQ from 21% YoY, 8% QoQ last quarter, partially because of base effect. Management indicated that while the car financing market itself is slowing, Kotak has gained share. Profits this quarter were also affected by MTM on investments – Rs150-200 mn as per management.

**c) Broking/Investment banking:** Profits from the broking business were up 58% YoY, -5% QoQ. The company's market share in overall volumes improved sequentially, to 2.6% for the quarter from 2.5% in F2Q13, but was down YoY from 2.9% in F3Q12.

Profits at the investment banking unit declined YoY and QoQ – Rs20mn in F3Q13, as compared with Rs40mn in F2Q13 and F3Q12.

**d) Asset management:** Profits from the three asset management businesses (i.e., domestic mutual funds, investment advisors and international subsidiaries) were up 267% YoY, +83% QoQ at Rs220mn.

**Domestic mutual funds:** Domestic MF AUM (average for the quarter) rose 7%YoY and 5% QoQ. This segment recorded a profit of Rs110mn (+267% YoY) vs. a loss of Rs50mn in F2Q13. The loss in F2Q13 was due to higher upfront distribution fee on debt income funds.

**International subs:** This segment recorded a profit of Rs50mn vs. a profit of Rs80mn in F2Q13 and a loss of Rs40mn in F3Q12.

Exhibit 1

## Kotak (Consol) F3Q13: Actuals vs Estimates

Rs mn	F3Q12	F2Q13	F3Q13e	F3Q13A	Actual vs Estimate	%YoY	%QoQ
Kotak Mahindra Bank (Standalone)	2761	2804	3137	3620	15%	31%	29%
Kotak Mahindra Primus	1040	1140	1200	1050	-13%	1%	-8%
Kotak Mahindra Old Mutual Life Insurance	470	470	400	530	33%	13%	13%
Kotak Securities	240	400	400	380	-5%	58%	-5%
Investment advisors	70	90	90	60	-33%	-14%	-33%
Kotak Mahindra Capital Company	40	40	100	20	-80%	-50%	-50%
Kotak Mahindra AMC & Trustee Co	30	-50	40	110	175%	267%	NA
Kotak Mahindra Investments	30	160	80	80	0%	167%	-50%
International subsidiaries	-40	80	60	50	-17%	NA	-38%
<b>Total consolidated profit after tax</b>	<b>4641</b>	<b>5134</b>	<b>5507</b>	<b>5900</b>	<b>7%</b>	<b>27%</b>	<b>15%</b>
Minority interest & other adjustments	10	110	40	130	225%	1200%	18%
<b>PAT (after minority interest / adjustments)</b>	<b>4631</b>	<b>5024</b>	<b>5467</b>	<b>5770</b>	<b>6%</b>	<b>25%</b>	<b>15%</b>

Source: Company Data, Morgan Stanley Research

## Kotak Bank

Exhibit 2

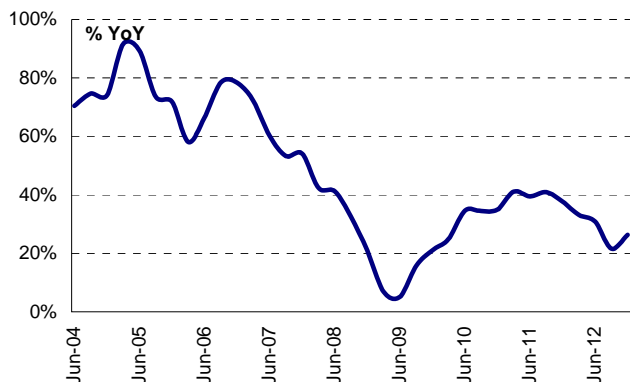
### Kotak Bank (Standalone): F3Q13 Results Summary

Rs Mn	F3Q12	F2Q13	F3Q13	YoY	QoQ
Interest earned	16410	19237	20946	28%	9%
Interest expended	9895	11656	12717	29%	9%
<b>Net Interest Income</b>	<b>6515</b>	<b>7581</b>	<b>8229</b>	<b>26%</b>	<b>9%</b>
Other income	2820	2508	3049	8%	22%
<b>Total income</b>	<b>9334</b>	<b>10089</b>	<b>11277</b>	<b>21%</b>	<b>12%</b>
<b>Operating expenses</b>	<b>4898</b>	<b>5267</b>	<b>5551</b>	<b>13%</b>	<b>5%</b>
--Employee Expenses	2260	2428	2636	17%	9%
--Other operating expenses	2638	2840	2915	11%	3%
<b>Pre Provision Profit</b>	<b>4436</b>	<b>4822</b>	<b>5726</b>	<b>29%</b>	<b>19%</b>
Provisions & contingencies	307	706	424	38%	-40%
<b>Profit before tax</b>	<b>4129</b>	<b>4116</b>	<b>5303</b>	<b>28%</b>	<b>29%</b>
Provision for taxes	1368	1312	1686	23%	28%
<b>Profit after tax</b>	<b>2761</b>	<b>2804</b>	<b>3617</b>	<b>31%</b>	<b>29%</b>

Source: Company Data, Morgan Stanley Research

Exhibit 3

### Loan growth was strong +26% YoY (+10.6%QoQ)



Source: Company data, Morgan Stanley Research

Exhibit 4

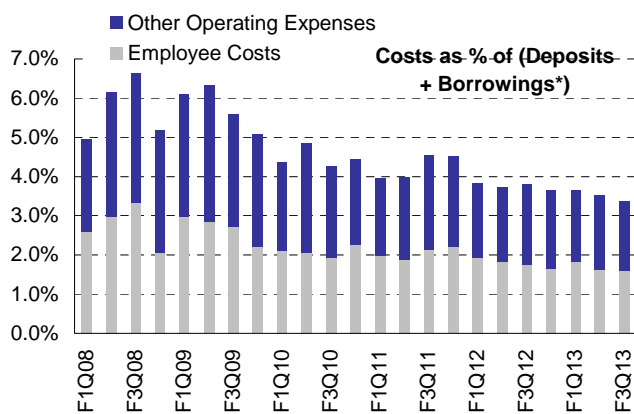
### While CV/CE loans contracted QoQ, business banking, corporate banking, agri segment and unsecured loans drove strong sequential loan growth

	F3Q12	F2Q13	F3Q13	YoY	QoQ
<b>Rs mn</b>					
Commercial Vehicles & Construction Equipment	75400	81830	80710	7%	-1%
Personal Loans	16890	21210	23990	42%	13%
Home Loans	79350	92860	98690	24%	6%
Corporate + Business Banking	169660	184360	213470	26%	16%
Others	56420	74170	85590	52%	15%
<b>Total Advances</b>	<b>397720</b>	<b>454430</b>	<b>502450</b>	<b>26%</b>	<b>11%</b>
<b>% Mix</b>					
Commercial Vehicles & Construction Equipment	19%	18%	16%		
Personal Loans	4%	5%	5%		
Home Loans	20%	20%	20%		
Corporate + Business Banking	43%	41%	42%		
Others	14%	16%	17%		
<b>Total Advances</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>		

Source: Company Data, Morgan Stanley Research

Exhibit 5

### Cost control was good; Opex ratio was lower QoQ

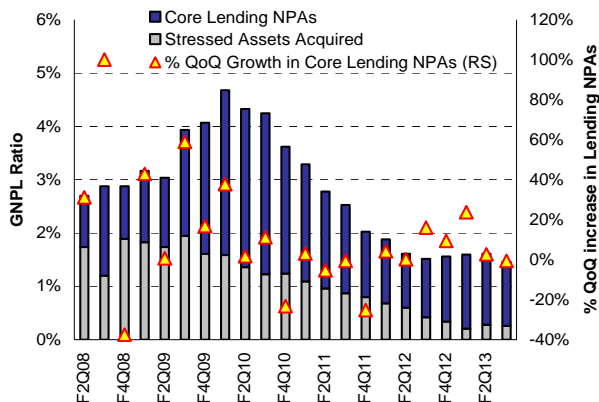


Source: Company data, Morgan Stanley Research; \*This is annualized data. We use deposits + borrowings since we don't have quarterly data on assets.

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Exhibit 6

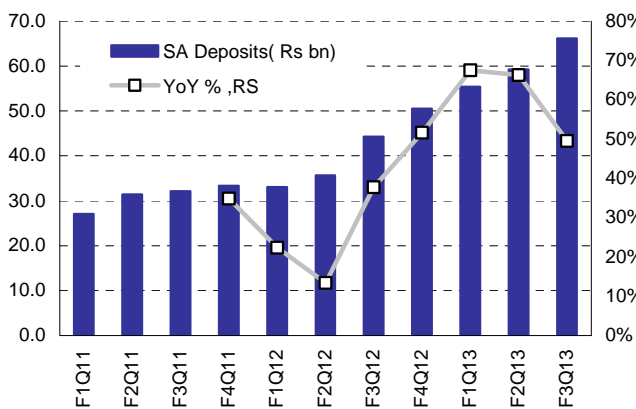
### Core lending NPAs were broadly stable QoQ



Source: Company data, Morgan Stanley Research

Exhibit 7

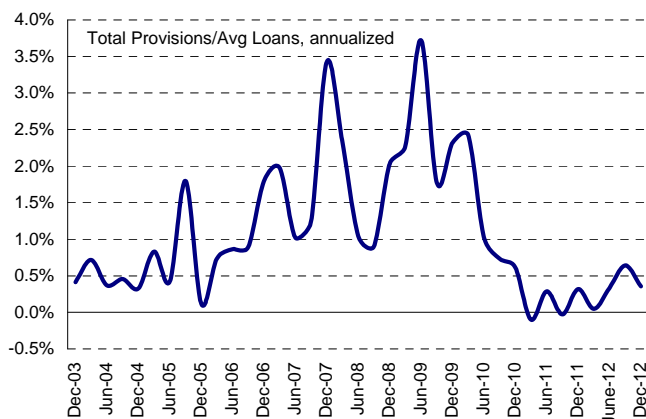
### SA deposit accretion continues to be robust (49% YoY, 12% QoQ)



Source: Company Data, Morgan Stanley Research

Exhibit 8

### Total provisions were lower QoQ at 35bps of average loans (annualized) from 64bps last quarter



Source: Company data, Morgan Stanley Research

## Kotak Prime

Exhibit 9

### Kotak Prime: F3Q13 Results Summary

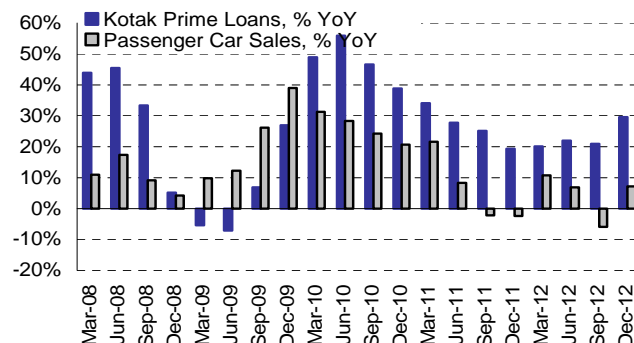
	F3Q12	F2Q13	F3Q13	% QoQ	% YoY
PBT	1520	1700	1580	-7%	4%
Taxes	480	560	530	-5%	10%
PAT	1040	1140	1050	-8%	1%

Loan Book	123790	151730	160420	6%	30%
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Source: Company Data, Morgan Stanley Research

Exhibit 10

### Kotak Prime: Loan growth was 30% YoY, 6% QoQ (Pick up in YoY growth is owing to base effect – passenger car sales/financing were particularly weak in F2Q12 and F3Q12)

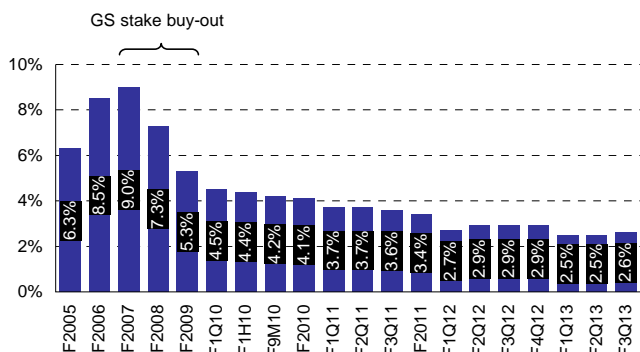


Source: Company data, Morgan Stanley Research

## Investment Banking / Broking

Exhibit 11

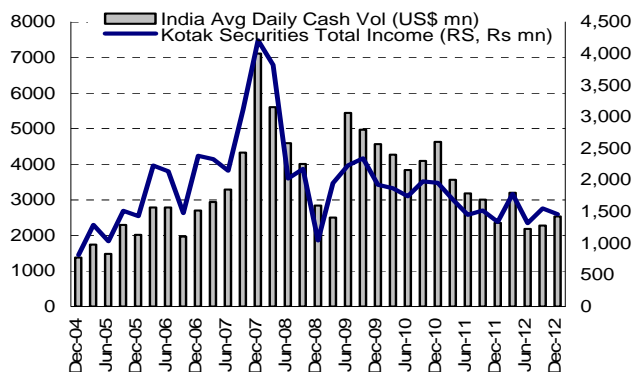
**Market share in system trading volumes improved to 2.6% for the quarter**



Source: Company data, Morgan Stanley Research

Exhibit 12

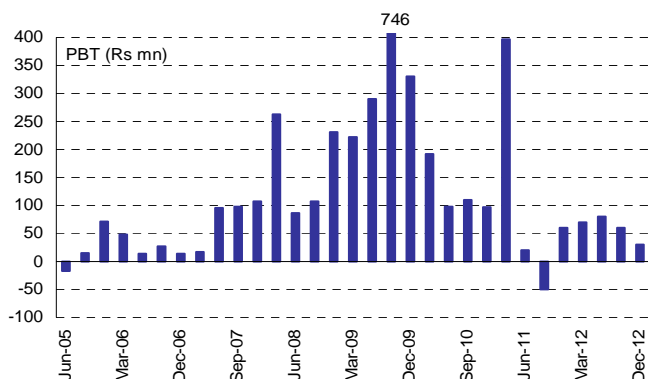
**Revenues and profitability were lower QoQ**



Source: Company data, Morgan Stanley Research

Exhibit 13

**Investment banking profits were lower QoQ**

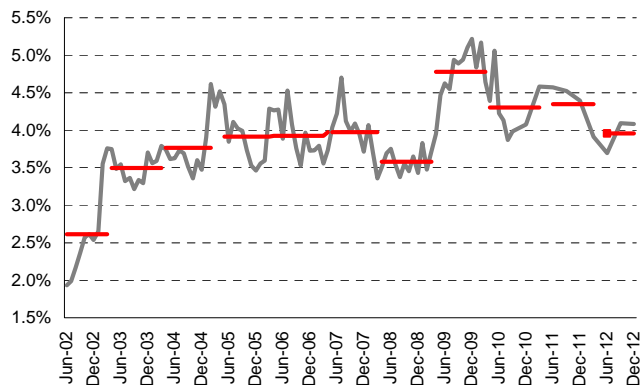


Source: Company data, Morgan Stanley Research

## Asset Management

Exhibit 14

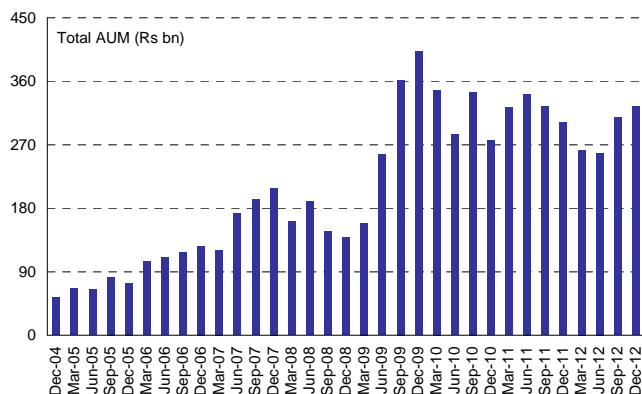
**Market share in domestic mutual funds was stable QoQ**



Source: Company data, Morgan Stanley Research

Exhibit 15

**Domestic AUMs (average for the quarter) were up 5% QoQ**



Source: Bloomberg, Morgan Stanley Research

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Exhibit 16

## Kotak: Assets Under Management

Rs. Bn	Dec-11	Sep-12	Dec-12
Domestic Funds	263	302	311
-- Equity	29	34	28
-- Debt	234	268	282
Offshore Funds	73	101	96
PMS	10	11	11
Alternative Assets	58	50	45
<b>Total</b>	<b>404</b>	<b>464</b>	<b>463</b>
Insurance	83	95	102
<b>Total including Insurance</b>	<b>487</b>	<b>559</b>	<b>565</b>

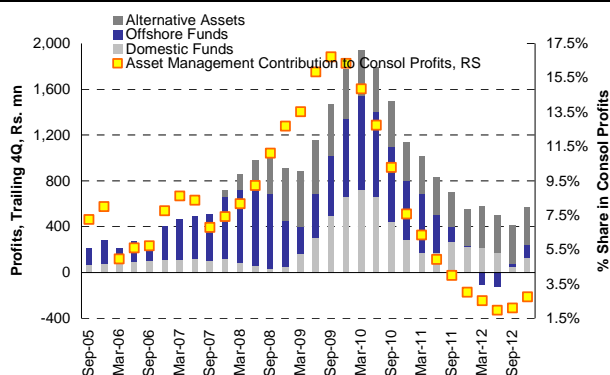
### As % of Total AUMs

Domestic Funds	54%	54%	55%
-- Equity	6%	6%	5%
-- Debt	48%	48%	50%
Offshore Funds	15%	18%	17%
PMS	2%	2%	2%
Alternative Assets	12%	9%	8%
<b>Total</b>	<b>83%</b>	<b>83%</b>	<b>82%</b>
Insurance	17%	17%	18%
<b>Total including Insurance</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: Company Data, Morgan Stanley Research

Exhibit 17

## Asset management contribution to profits picked up

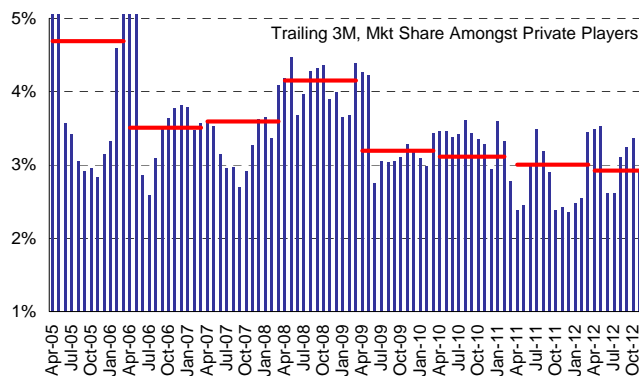


Source: Company data, Morgan Stanley Research

## Insurance

Exhibit 18

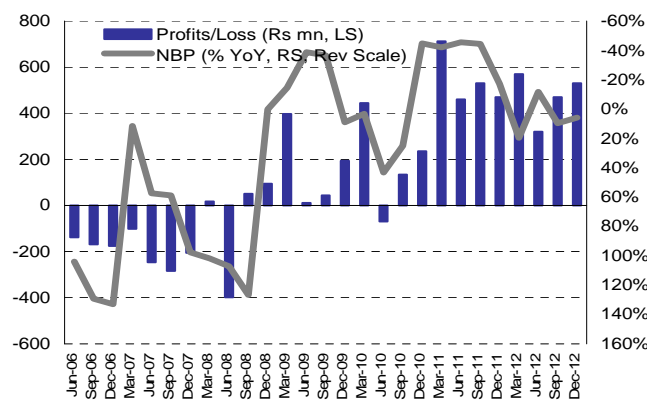
## Kotak Life: Market Share among Private Players



Source: Company data, Morgan Stanley Research

Exhibit 19

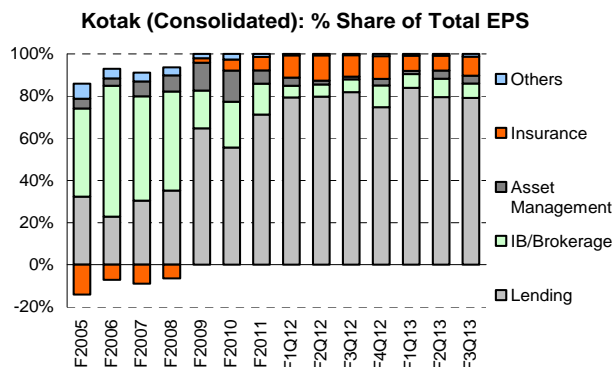
## Life Insurance: Profits/Loss versus NBP Growth



Source: Company data, Morgan Stanley Research \*Data on NBP growth for QE Dec 2012 is not available

Exhibit 20

## Kotak (Consolidated): % Share of Total EPS



Source: Company data, Morgan Stanley Research

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Exhibit 21

## Kotak (Consolidated): F3Q13 Results

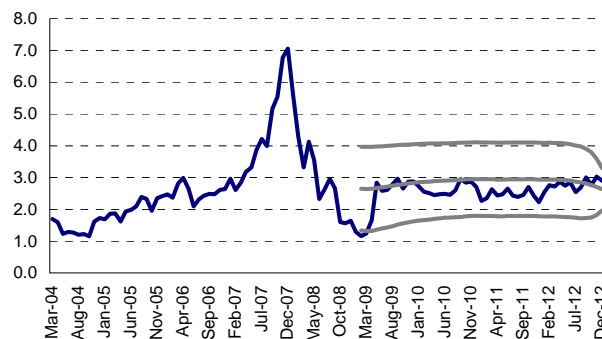
Rs in Mln	F3Q12	F2Q13	F3Q13	YoY	QoQ
Interest earned	22228	26098	28115	26%	8%
Interest expended	12231	14491	15799	29%	9%
<b>Net Interest Income</b>	<b>9997</b>	<b>11607</b>	<b>12315</b>	<b>23%</b>	<b>6%</b>
<b>Non Interest Income</b>	<b>9005</b>	<b>14260</b>	<b>13457</b>	<b>49%</b>	<b>-6%</b>
<b>Total income</b>	<b>19002</b>	<b>25867</b>	<b>25772</b>	<b>36%</b>	<b>0%</b>
<b>Operating expenses</b>	<b>11804</b>	<b>18000</b>	<b>16836</b>	<b>43%</b>	<b>-6%</b>
Employee expenses	4116	4204	4394	7%	5%
Other operating expenses	7688	13796	12442	62%	-10%
---Transfer to Policy holder reserves	3180	9008	7670	141%	-15%
---Others	4508	4789	4771	6%	0%
<b>Operating Profit</b>	<b>7198</b>	<b>7867</b>	<b>8936</b>	<b>24%</b>	<b>14%</b>
Provisions & contingencies	452	614	589	30%	-4%
<b>Profit Before Tax</b>	<b>6746</b>	<b>7253</b>	<b>8347</b>	<b>24%</b>	<b>15%</b>
Provision for taxes	2083	2192	2489	19%	14%
<b>Profit after tax before Minority Interest</b>	<b>4662</b>	<b>5061</b>	<b>5858</b>	<b>26%</b>	<b>16%</b>
---Share of Minority Interest	123	122	138	13%	13%
---Share in Profit of associates	87	82	52	-40%	-36%
<b>Consolidated Profit after tax attributable to the Group</b>	<b>4626</b>	<b>5022</b>	<b>5772</b>	<b>25%</b>	<b>15%</b>
<b>Company Wise PAT</b>					
Kotak Mahindra Bank (Standalone)	2760	2800	3620	31%	29%
Kotak Mahindra Prime	1040	1140	1050	1%	-8%
Kotak-Old Mutual Life Insurance	470	470	530	13%	13%
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Kotak Mahindra Investments	30	160	80	167%	-50%
International subsidiaries	-40	80	50	NA	-38%

Source: Company data, Morgan Stanley Research;

## Valuation

Exhibit 22

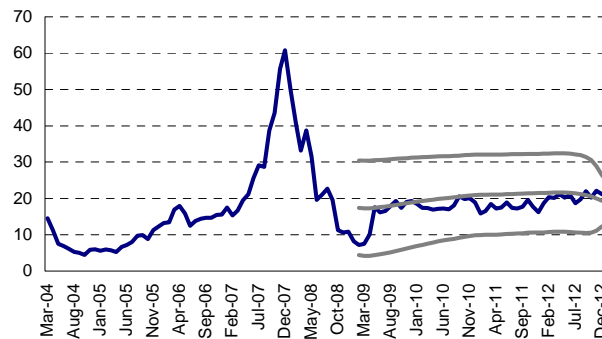
### Valuation: Price to Book



Source: Thomson Reuters, Company Data, Morgan Stanley Research

Exhibit 23

### Valuation: Price to Earnings



Source: Thomson Reuters, Company Data, Morgan Stanley Research



**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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### Global Stock Ratings Distribution

(as of December 31, 2012)



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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
<b>Overweight/Buy</b>	<b>1103</b>	<b>37%</b>	<b>436</b>	<b>41%</b>	<b>40%</b>
<b>Equal-weight/Hold</b>	<b>1301</b>	<b>44%</b>	<b>497</b>	<b>46%</b>	<b>38%</b>
<b>Not-Rated/Hold</b>	<b>108</b>	<b>4%</b>	<b>27</b>	<b>3%</b>	<b>25%</b>
<b>Underweight/Sell</b>	<b>478</b>	<b>16%</b>	<b>111</b>	<b>10%</b>	<b>23%</b>
<b>Total</b>	<b>2,990</b>		<b>1071</b>		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

### Analyst Stock Ratings

**Overweight (O or Over)** - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

**Equal-weight (E or Equal)** - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

**Not-Rated (NR)** - Currently the analyst does not have adequate conviction about the stock's total return relative to the relevant country MSCI Index on a risk-adjusted basis, over the next 12-18 months.

**Underweight (U or Under)** - The stock's total return is expected to be below the total return of the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

### Analyst Industry Views

**Attractive (A)**: The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

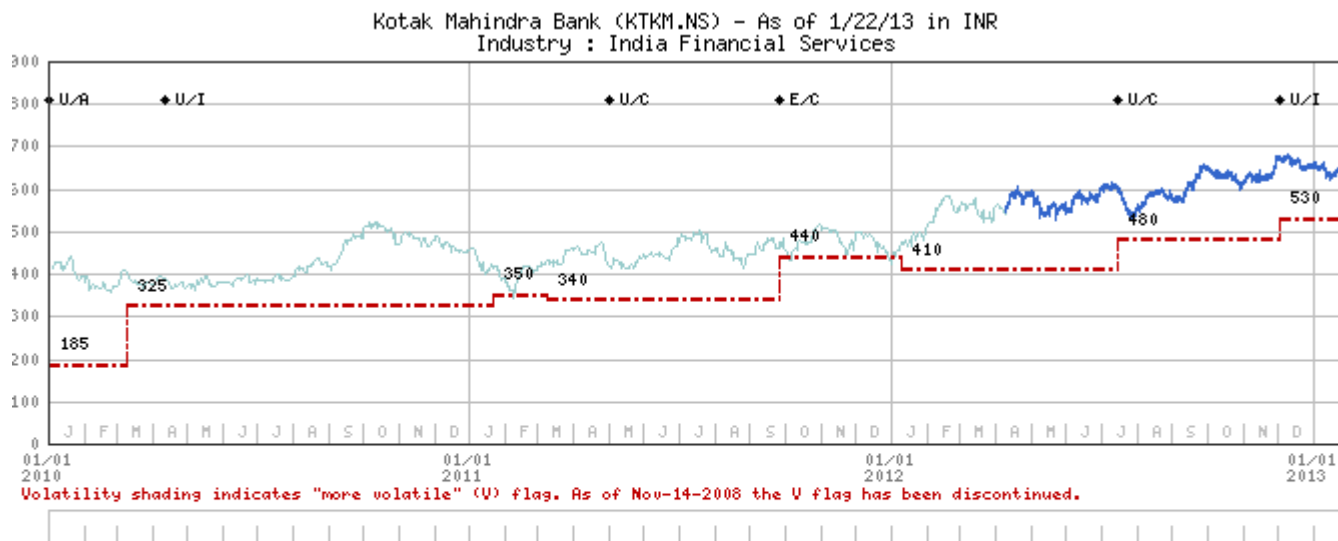
**In-Line (I)**: The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

**Cautious (C)**: The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

### Stock Price, Price Target and Rating History (See Rating Definitions)

January 23, 2013  
Kotak Mahindra Bank



Stock Rating History: 1/1/10 : U/A; 4/12/10 : U/I; 5/2/11 : U/C; 9/27/11 : E/C; 7/16/12 : U/C; 12/3/12 : U/I  
Price Target History: 7/7/08 : 185; 3/10/10 : 325; 1/21/11 : 350; 3/9/11 : 340; 9/27/11 : 440; 1/10/12 : 410; 7/16/12 : 480; 12/3/12 : 530

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)  
Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —  
Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View  
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (U) No Rating Available (NA)  
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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**Industry Coverage: India Financial Services**

Company (Ticker)	Rating (as of)	Price* (01/22/2013)
<b>Anil Agarwal</b>		
AXIS Bank (AXBK.NS)	U (09/05/2012)	Rs1,393.4
Bank of Baroda (BOB.NS)	E (07/16/2012)	Rs871.25
Bank of India (BOI.NS)	U (05/02/2011)	Rs372.55
Canara Bank (CNBK.NS)	U (05/02/2011)	Rs503.9
Corporation Bank (CRBK.NS)	U (12/03/2012)	Rs461.8
HDFC (HDFC.NS)	O (05/08/2012)	Rs813.35
HDFC Bank (HDBK.NS)	O (01/18/2010)	Rs653.75
ICICI Bank (ICBK.NS)	E (09/27/2011)	Rs1,170.15
IDBI (IDBI.NS)	U (10/21/2005)	Rs109.9
IDFC (IDFC.NS)	E (10/28/2012)	Rs176.4
ING Vysya Bank Ltd. (VYSA.NS)	E (12/22/2010)	Rs570.7
IndusInd Bank (INBK.NS)	O (12/03/2012)	Rs417.7
Kotak Mahindra Bank (KTKM.NS)	U (07/16/2012)	Rs640.75
LIC Housing Finance Ltd. (LICH.NS)	O (12/03/2012)	Rs281.05
Oriental Bank of Commerce (ORBC.NS)	U (12/03/2012)	Rs332.3
Punjab National Bank (PNBK.NS)	U (05/02/2011)	Rs882
Shriram Transport Finance Co. Ltd. (SRTR.NS)	O (07/25/2012)	Rs756.4
State Bank of India (SBI.NS)	U (05/02/2011)	Rs2,464.45
Union Bank of India (UNBK.NS)	U (12/03/2012)	Rs261.55
Yes Bank (YESB.NS)	O (10/20/2009)	Rs508.9
<b>Subramanian Iyer</b>		
Multi Commodity Exchange of India Ltd (MCEI.NS)	E (04/10/2012)	Rs1,400.35

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\* Historical prices are not split adjusted.