

Company

6 September 2010 | 8 pages

Kotak Mahindra Bank (KTKM.BO)

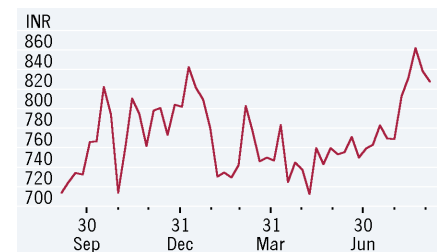
 Equity

Takeaways from India Investor Conference, Sept 6-7

- Takeaways from India Conference** –Kotak Mahindra Bank presented at Citi's India Conference on September 6-7. Below are key takeaways.
- Growth expectations - will it really be that high?** Management suggests that loan demand bottom-up remains fairly broad-based and strong- however, top down, data are beginning to look a little shaky. If this is reconciled with the fact that loan growth ex of 3G funding and auto growth is in single digits, its 30-35% growth expectation might moderate to 20%+. Comfortable with its own growth momentum currently, given its small base, but the overall loan growth outlook for the system has probably moderated over the last month.
- Regulatory pressures on Insurance likely to start playing out** - Management fairly cautious on the growth outlook on the Life Insurance business, with new regulations on products and commissions coming into effect from September. KTKM suggests the downside risks are probably a little more on growth than on margins, but it could well be more significant than the broader market is currently anticipating. KTKM would be relatively better positioned than most peers on account of its lower cost structure - nonetheless it will probably see the life business reversing to losses over the next two years.
- Margins should continue to hold-** KTKM's margins continue to remain amongst the highest in the system, and management remains fairly confident of maintaining them above the 5% levels. It does see some pressure from the increased wholesale asset bias, and a tighter liquidity environment, but do believe it is positioned to pass through funding cost pressures, as long as demand tends to remain generally firm.
- Please see further notes on page 3.

Buy/Medium Risk	1M
Price (06 Sep 10)	Rs833.95
Target price	Rs1,050.00
Expected share price return	25.9%
Expected dividend yield	0.1%
Expected total return	26.0%
Market Cap	Rs305,210M
	US\$6,566M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2009A	6,524	18.85	-36.0	44.2	4.4	10.6	0.1
2010A	13,070	37.57	99.4	22.2	3.7	18.1	0.1
2011E	17,533	49.07	30.6	17.0	2.8	18.5	0.1
2012E	21,011	57.49	17.1	14.5	2.3	17.5	0.1
2013E	26,355	72.11	25.4	11.6	1.9	18.3	0.1

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	44.2	22.2	17.0	14.5	11.6
P/E reported (x)	44.2	22.2	17.0	14.5	11.6
P/BV (x)	4.4	3.7	2.8	2.3	1.9
P/Adjusted BV diluted (x)	4.8	3.9	2.8	2.4	2.0
Dividend yield (%)	0.1	0.1	0.1	0.1	0.1
Per Share Data (Rs)					
EPS adjusted	18.85	37.57	49.07	57.49	72.11
EPS reported	18.85	37.57	49.07	57.49	72.11
BVPS	188.69	227.23	301.68	358.37	429.71
Tangible BVPS	188.69	227.23	301.68	358.37	429.71
Adjusted BVPS diluted	175.07	213.99	293.33	350.62	422.42
DPS	0.75	0.85	0.90	0.95	0.95
Profit & Loss (RsM)					
Net interest income	23,741	28,283	31,558	34,159	41,036
Fees and commissions	15,352	11,145	17,926	21,942	27,289
Other operating Income	2,080	12,187	10,462	15,839	19,232
Total operating income	41,173	51,615	59,947	71,939	87,557
Total operating expenses	-27,713	-27,479	-30,965	-37,006	-43,770
Oper. profit bef. provisions	13,460	24,136	28,981	34,933	43,787
Bad debt provisions	-3,298	-5,107	-2,566	-3,277	-4,071
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	10,162	19,029	26,415	31,656	39,716
Tax	-3,635	-5,755	-8,818	-10,567	-13,283
Extraord./Min. Int./Pref. Div.	-3	-204	-65	-78	-78
Attributable profit	6,524	13,070	17,533	21,011	26,355
Adjusted earnings	6,524	13,070	17,533	21,011	26,355
Growth Rates (%)					
EPS adjusted	-36.0	99.4	30.6	17.1	25.4
Oper. profit bef. prov.	-24.0	79.3	20.1	20.5	25.3
Balance Sheet (RsM)					
Total assets	402,338	551,148	641,942	843,947	1,112,388
Avg interest earning assets	375,233	445,240	552,435	682,279	903,207
Customer loans	229,666	303,437	405,980	537,813	710,135
Gross NPLs	7,906	9,167	9,600	11,543	14,098
Liab. & shar. funds	402,338	551,148	641,942	843,947	1,112,388
Total customer deposits	138,228	218,192	282,564	384,159	522,506
Reserve for loan losses	4,690	6,195	8,442	10,890	13,987
Shareholders' equity	65,225	79,109	109,975	130,640	156,648
Profitability/Solvency Ratios (%)					
ROE adjusted	10.6	18.1	18.5	17.5	18.3
Net interest margin	6.33	6.35	5.71	5.01	4.54
Cost/income ratio	67.3	53.2	51.7	51.4	50.0
Cash cost/average assets	6.9	5.8	5.2	5.0	4.5
NPLs/customer loans	3.4	3.0	2.4	2.1	2.0
Reserve for loan losses/NPLs	59.3	67.6	87.9	94.3	99.2
Bad debt prov./avg. cust. loans	1.5	1.9	0.7	0.7	0.7
Loans/deposit ratio	166.2	139.1	143.7	140.0	135.9
Tier 1 capital ratio	19.7	17.3	20.2	17.0	14.7
Total capital ratio	22.5	19.3	21.8	18.6	16.2

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- **Asset quality should continue to improve:** A high degree of confidence on asset quality. Management believes its portfolio will continue to see improvements over the near to medium term, the credit card portfolio is well past its peak pressure point, and overall there continues to be significant comfort on the portfolio. Management might look at lending to some unsecured segments over the near term, but has limited aspirations on the credit card side at this point in time.
- **Capital markets - Retail not back yet:** There remains very limited interest from retail equity investors into the market, with no real sense of a turn in this business, at this point in time. Management also sees some additional pressure on the MF's business, as funds now MTM short term funds as per new regulations, which will likely pressure short-term performance in a rising rate market. Management also reiterates the view that cost pressures and attrition levels in the equity business remains high, and is not a sustainable proposition at current cost structure levels.

Kotak Mahindra Bank

Company description

KTKM is a private-sector bank in which Mr. Uday Kotak, the major shareholder, and his associates have a 52% 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 Buy/Medium Risk (1M) with a target price of Rs1050. 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'. We believe this increases the business stability, franchise and earnings sustainability, which were linked to capital market performance. 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. We believe this along with a more open frame of mind for possible acquisitions should drive stock value.

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.

Valuation

Our target price of Rs1050 is based on our valuation of KTKM's different businesses via the sum-of-the-parts methodology. This values the banking business at Rs642 per share at 3.25x PBV 1-year fwd, the vehicle loan financing business at Rs103 per share at 2.5x 1Yr Fwd P/BV, the investment banking and broking business at 15x 1-year Fwd PE or Rs173, the insurance subsidiary at Rs51 at 12x 1Yr Fwd NBAP, and we attribute Rs81 to the AMC business (5% of AUM for MF, and 7% for Portfolio and alternative assets). Our target multiples are in-line with the best of breed private sector banks and other financial services business, however they are not near peak multiples in the historical India scenario, this as we believe, the business' leverage to capital markets have reduced and the near term challenges will cap growth at well below historical peak growth levels.

Risks

We rate KTKM as Medium Risk, even while our quantitative risk rating system, which tracks the 260-day share price volatility of the stock, suggests Low Risk. We believe the Medium Risk rating is justified on account of its relatively smaller balance sheet, capital market leverage and relatively moderate deposit franchise. Downside risks to the stock and 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. These risks could prevent the stock from achieving our target price.

Appendix A-1

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Fundamental Research

Analyst: Manish Chowdhary, CFA

Covered since August 24 2010

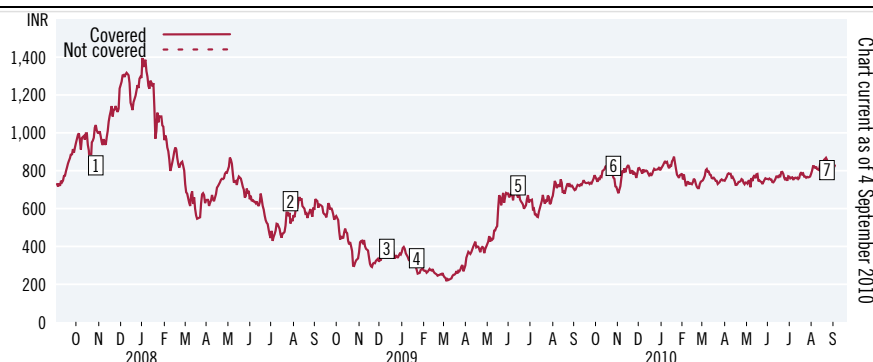


Chart current as of 4 September 2010

	Date	Rating	Target Price	Closing Price
1	29-Oct-07	2M	*1,110.00	1,041.20
2	29-Jul-08	2M	*635.00	521.00
3	11-Dec-08	2M	*400.00	380.05

* Indicates change

	Date	Rating	Target Price	Closing Price
4	22-Jan-09	*3H	*282.00	276.65
5	14-Jun-09	3H	*639.00	671.50
6	27-Oct-09	3H	*700.00	763.25

	Date	Rating	Target Price	Closing Price
7	24-Aug-10	*1M	*1,050.00	857.25

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2010

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