ICICI direct.com
On-line Share Trading

Initiating Coverage

Kotak Mahindra Bank (KOTMAH)

Current price	Target price
Rs 670	Rs 1065
Potential upside	Time Frame
59%	15-18 months

OUTPERFORMER

Wizard of financial services ...

Kotak Mahindra Bank (KMB) has a strong presence in most of the financial services. With its integrated business model, it is well-positioned to capitalise on the growing equity cult in the country. The company is among the best plays in the financial services sector with significant embedded value in its multiple growing businesses. We initiate coverage with an OUTPERFORMER rating.

- **Demand for financial services to intensify**
India's changing demographics in favour of a younger population, rising incomes and changing mindset of people (willingness to take risk) would be the fuel to the ongoing investment and consumption boom. We believe the major beneficiary of this boom will be the financial services sector. KMB is well-positioned to capitalise on the ample opportunities in the Indian financial sector.

- **Leader in securities broking, investment banking**
Kotak Securities, a KMB subsidiary, is one of India's leading stock broking firms with a 9% market share in FY07. Backed by an extensive network of over 800 branches, we expect a 34% CAGR in trading volumes and a 23% CAGR in broking revenues over FY07-10E. But this growth will be achieved at the cost of broking yields which are expected to come down from 0.08% in FY07 to 0.05% in FY10E. Kotak Mahindra Capital Company (KMCC), another subsidiary, is a leader in the capital markets. The mammoth investments and fund-raising plans by corporates across sectors are expected to drive KMCC's investment banking business.

- **Banking, asset management and insurance to add value**
Though currently small in size, banking, asset management and insurance verticals would be the next winners for KMB. Leveraging the group's extensive branch network, we expect these businesses to witness robust growth in coming years.

Valuations

The stock is trading at 3x FY10E BV (excluding the m-cap of subsidiaries). We believe KMB would be able to continue commanding such valuations with ROEs expected to rise to 20% in FY10E from 11.3% in FY07. Using a SOTP valuation, we get a target price of Rs 1,065 per share. This represents an upside of 59% over a 15-18 months time frame.

Exhibit 1: Sum-of-the-parts valuation

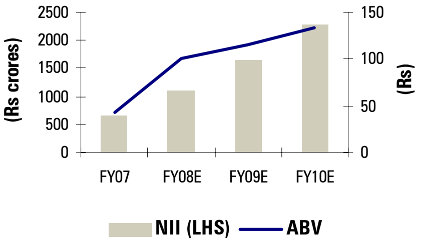
Company	Basis of valuation	Rs/ share
KMB	3x FY10E ABV	400
Kotak Life	16x NBAP at 16% margin	138
Kotak Mahindra Prime	1.2x FY10E net-worth	52
Kotak Mahindra Capital	20x FY10E PAT	82
Kotak Securities	20x FY10E PAT	283
AMC	5% to 8% of FY10E AUM based on asset class	110
	Value per share of KMB	**1,065**

Source: ICICIdirect Research

Analysts' Names

Chirag J Shah
chirag.shah@icicidirect.com
Kajal Jain
kajal.jain@icicidirect.com

Sales & EPS trend



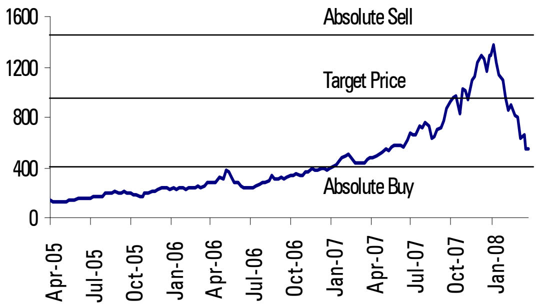
Stock metrics

Bloomberg Code	KMB IN
Reuters Code	KTKM.BO
Promoters' holding	52.63%
Market Cap (Rs cr)	22,780
52 Week H/L	1435 / 402
Sensex	16,086
Average volumes	186253

Comparative return metrics

Stock return	3 M	6M	12M
Kotak Mah. Bank	-54%	-38%	20%
Reliance Capital	-54%	-28%	68%

Price Trend



Company Background

Kotak Mahindra Bank (KMB), formerly known as Kotak Mahindra Finance (KMFL), was promoted in 1985 by Uday S Kotak and Sidnery A Pinto along with Kotak & Company under the name Kotak Capital Management Finance. The promoters were joined by Harish Mahindra and Anand Mahindra of Mahindra & Mahindra in 1986, and the company was renamed Kotak Mahindra Finance. Kotak Mahindra Finance started as a finance company and was later converted in to a bank in 2002. The company has established itself as one of India's leading financial institutions with a range of services encompassing corporate finance, capital market financing, asset reconstruction, commercial vehicle finance, consumer finance, car finance, investment banking, mutual funds, and life insurance.

KMB offers finance solutions that encompass every phase of life for individual as well as a corporates. It also had international partnerships with Goldman Sachs (one of the world's largest investment banks and brokerage firms), Ford Credit (one of the world's largest dedicated automobile financiers) and Old Mutual (a large insurance, banking and asset management conglomerate) through joint ventures and subsidiary companies.

The company came out with a public issue in 1993, after which it has been paying dividends. It also rewarded the shareholders with bonus shares, one in 1995 (ratio 1:1) and the other in 2005 (3:2).

Shareholding pattern

Shareholder	% holding
Promoters	52.63
Institutional investors	32.77
Other investors	1.87
General public	12.74

Promoter & Institutional holding trend (%)

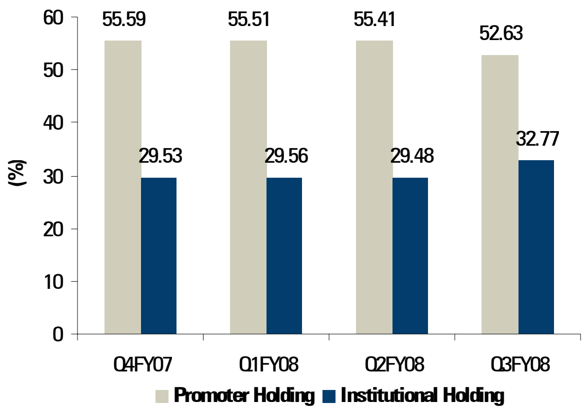
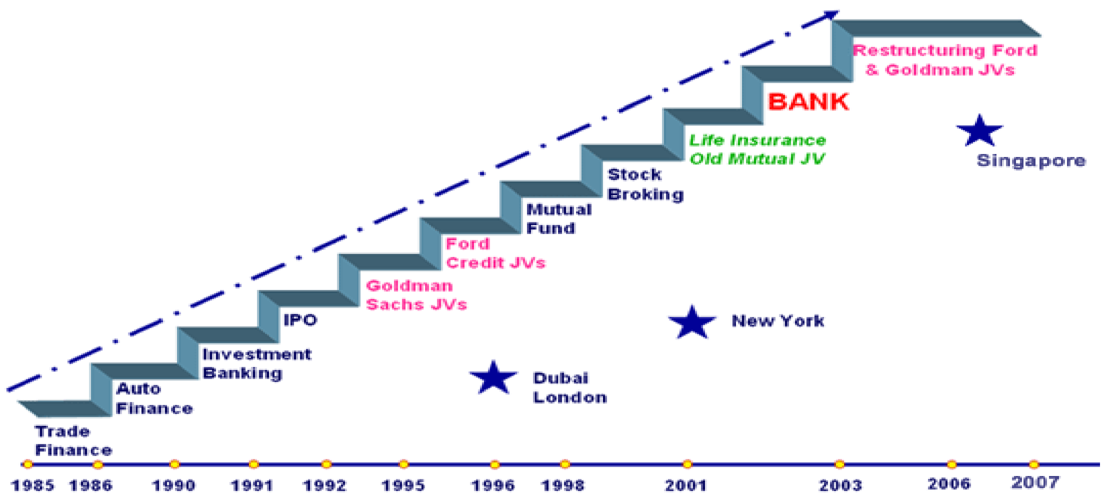


Exhibit 2: Business Model (Inching up the financial services space)



Source: Company, ICICIdirect Research

INVESTMENT RATIONALE

Demand for financial services to intensify

The Indian economy looks set to grow at a robust pace in the coming years. The changing demographics with a youthful population, rising disposable incomes and changing mindset of people (achievement of aspirations) in favour of consumption would be the key drivers for GDP growth. The strong internals of the economy makes us believe that India party will continue and make the country a preferred investment destination as compared to other emerging economies

The above point can be reinforced from the fact that the financial services sector, which is a barometer of the state of the economy, has shown robust growth. This growth is reflected in across all sectors – banking, asset management, brokerage, and insurance.

Exhibit 3: Financial services sector poised for robust growth

Rs bn	2006	2007	CAGR
Advances	5897	19232	27%
As a % of GDP	26%	47%	
Mutual Funds	1006	3264	27%
As a % of GDP	4%	8%	
Life Insurance Premium	501	1574	33%
As a % of GDP	2%	4%	
Stock Market Turnover	8195	29049	27%
As a % of GDP	36%	70%	

Source: RBI, AMFI, IRDA, ICICIdirect Research

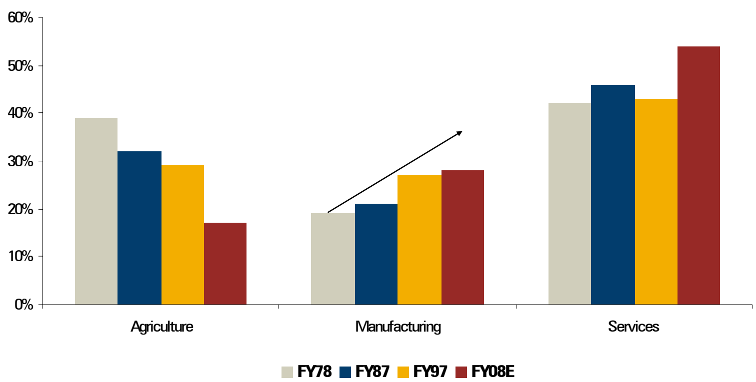
The growth in stock market turnover and mutual fund AUM as a % of GDP lags growth in advances as a % of GDP. This signifies that good times for stock markets and mutual funds are here to stay

We believe that the financial services sector would be a major beneficiary of the investment and consumption boom in India. This would happen as a result of the following robust macro trends in the economy.

Sustained economic growth

Nominal GDP has been growing more than 12%- 13 % in the last three years, making India the second-fastest growing economy in the world after China. This robust growth has been backed by a strong surge in the manufacturing and industrial sectors, apart from the evergreen services sector. Buoyed by a host of factors such as robust corporate earnings, increasing incomes and higher savings rate, we expect the economy to grow by ~ 8% (on real basis) over the next couple of years.

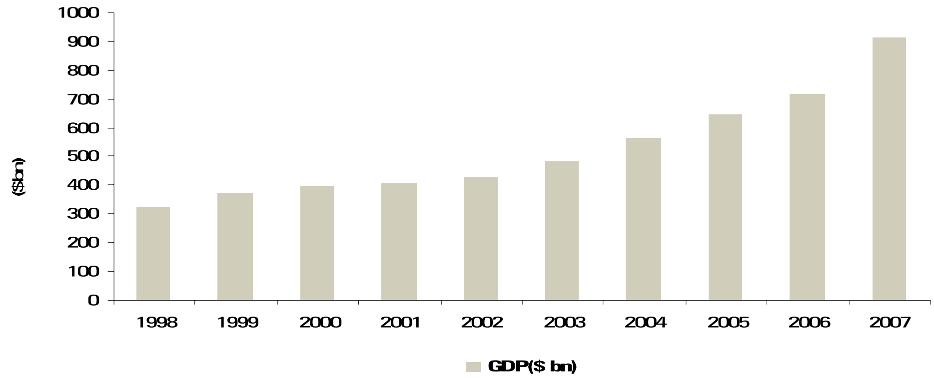
Exhibit 4: Composition of GDP to skew towards manufacturing going forward



Source: RBI

Manufacturing will be the key driver for the GDP growth going forward

Exhibit 5: GDP on a roll

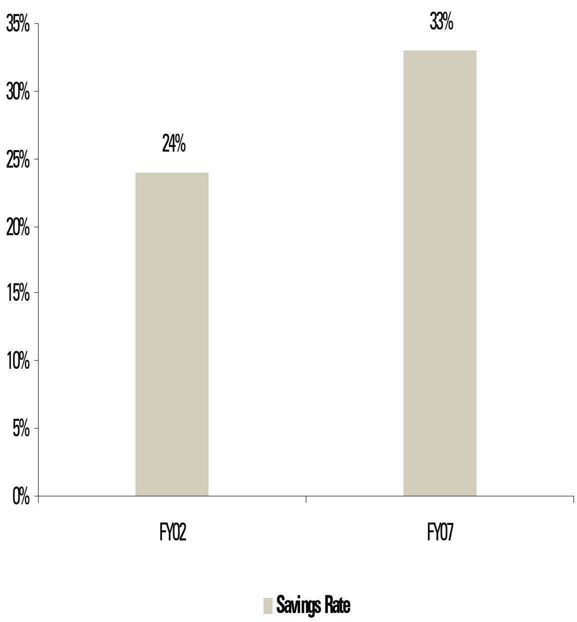


Source: Bloomberg, ICICIdirect Research

High savings rate

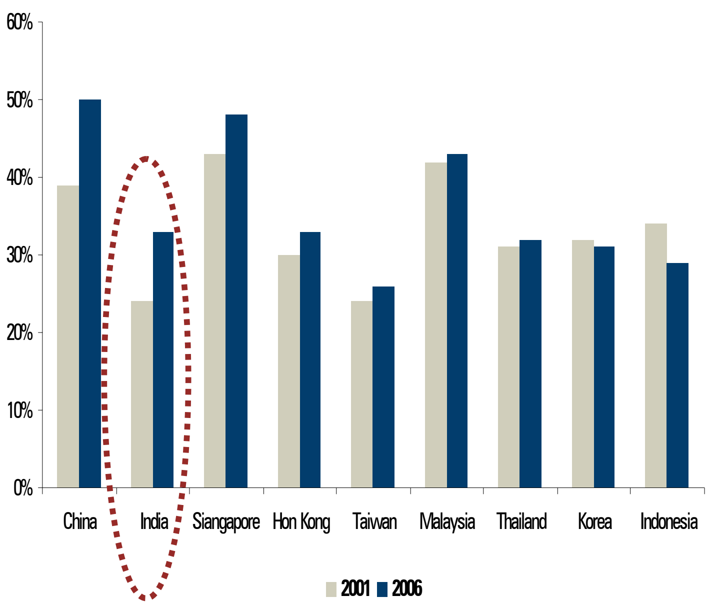
India's savings rate has been rising consistently over the past few years. Riding the robust economic growth of the last few years, savings crossed the 30% mark. The same trend has been witnessed in the corporate savings (despite of the fact that India Inc has been very active in the M&A space). But this figure is still lower other Asian countries.

Exhibit 6: Savings have crossed the 30% mark …



Source: RBI, ICICIdirect Research

Exhibit 7: … however, room still left for the rate to go up



Source: Bloomberg, ICICIdirect Research

The high savings rate provide the opportunity to channelise the funds in equity-linked and other financial products

Currently, most savings generated by households and the public sector are locked in bank deposits which yield a minimal rate of return. This reflects the low-risk appetite of many savers. With the capital market witnessing a boom (though the markets have faced severe correction), several financial products (mainly equity-linked) have been launched with the intention of luring investors for superior returns. A classic example of the above would be the ULIPs (unit-linked insurance plans) which provide insurance cover along with the chance to earn a superior return from the stock markets. The changes in demographic would also create a huge and sustainable demand for financial products and ensure the buoyancy in the financial services sector.

Changes in demographic would also create a huge and sustainable demand for financial products and ensure buoyancy in the financial services sector.

Exhibit 8: Savings are skewed towards bank deposits

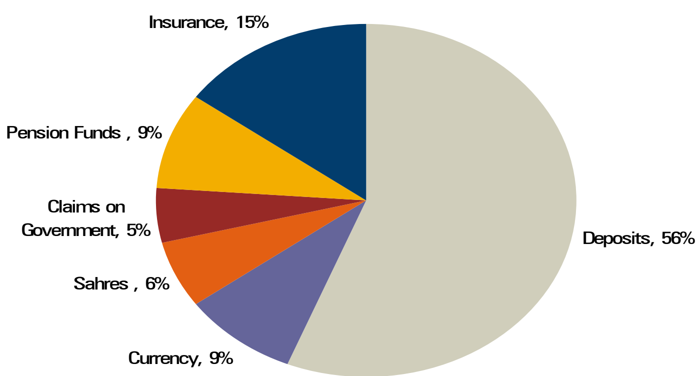
	FY05	FY06	FY07
Total Household Savings	4.3	6	7.6
% of GDP	13.9	16.7	19.4
Composition			
Shares & Debentures	1.4	1.4	1.5
Mutual Funds	0.4	3.6	4.8
Claims on Government	24.5	14.6	6.2
Currency	8.5	8.7	8.6
Provident and Pension Funds	13	10.5	9.2
Insurance Funds	15.7	14.2	15
Deposits	37.2	47.1	55.7
Total	**100**	**100**	**100**

Source: RBI, ICICIdirect Research

Though Equity & MF's as a % of savings have gone up, there is still huge room for it to go up

We expect the trend in deposits as a % of savings to remain the same

Exhibit 9: Breakdown of financial savings (FY07)

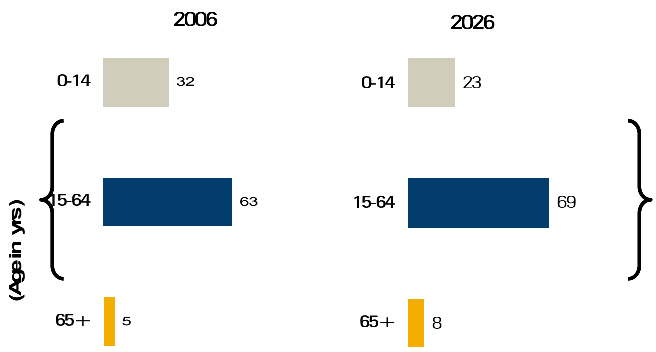


Source: RBI, ICICIdirect Research

Changing demography

Demography is the parameter where India scores over its emerging peers. The huge young population makes India a strong domestic consumption story and less vulnerable to external economic shocks and crises. India's age dependency is declining, which will in turn have a positive impact on household savings (age dependency has declined from 80% in 1970's to around 55% now)

Exhibit 10: Increase in middle-aged population to support consumption growth (% of population)



The increase of population in the young age will create humongous opportunities for:

- ✓ ***Consumer Loans***
- ✓ ***Insurance products***
- ✓ ***Asset management Services***
- ✓ ***Wealth management services***

Source: India Census Data, ICICIdirect Research

There has been a rise in disposable incomes and spending power of the huge Indian middle class (one of the youngest population in the world) which will bring the wave of demand in the financial services sector. NCAER expects the middle class to make up 44% of the population by FY10 compared with 33% now, and this would result in a further increase in household savings rate.

Exhibit 11: Rise in middle class

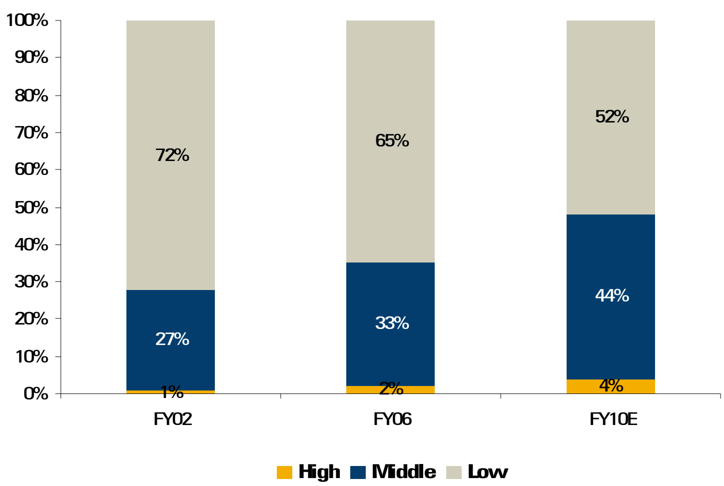
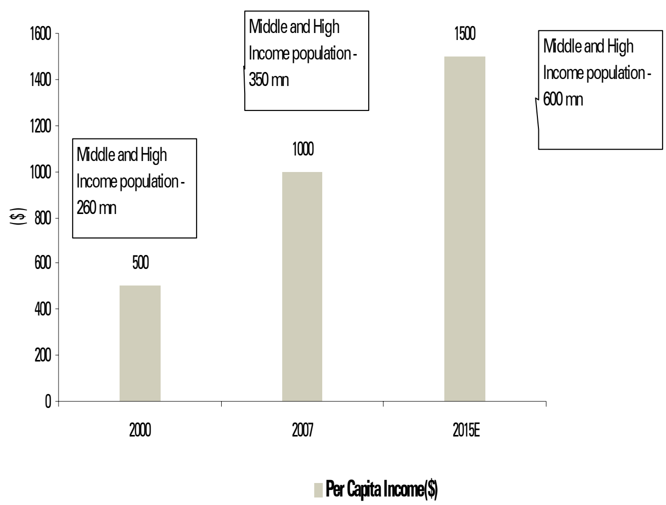


Exhibit 12: Consuming population to grow manifold



Source: NCAER, ICICIdirect research

Kotak Mahindra Bank*: In a sweet spot to cash in on the opportunities.*

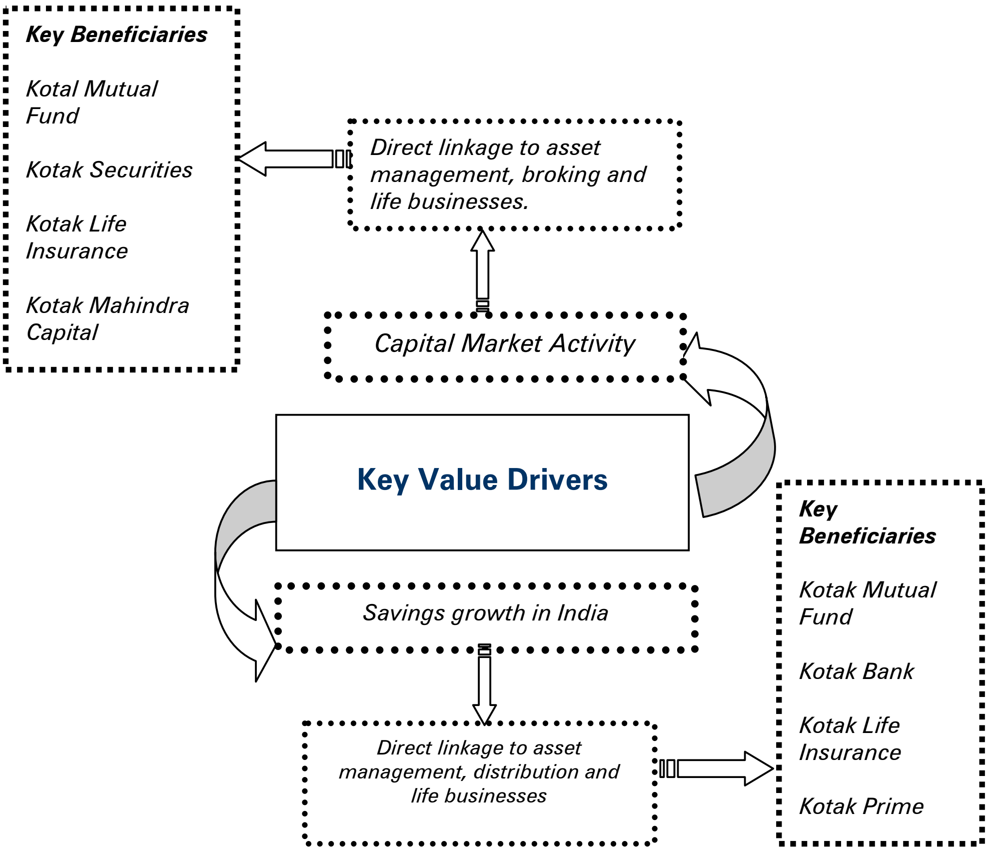
KMB is one of the pioneer financial conglomerates in the country with a presence across all the financial verticals like banking, securities, investment banking, asset management, consumer finance and life insurance. The company has diversified product offerings and has an experienced management.

The group is making strong progress on its defined strategy of becoming an integrated financial services player providing services and products (domestic and global) to both domestic and overseas customers, setting up vast distribution network, leveraging on the brand name *'Kotak'* and a strong net worth.

KMB is making strong progress on its defined strategy of becoming an integrated financial services player

The bank has established itself as a strong player in the securities and investment banking business but is relatively very small in the banking, insurance and asset management business. So we feel that the next leg of growth would be the banking and Insurance business where it is on path to attain and provide scalability to its business model.

Exhibit 13: Next growth wave



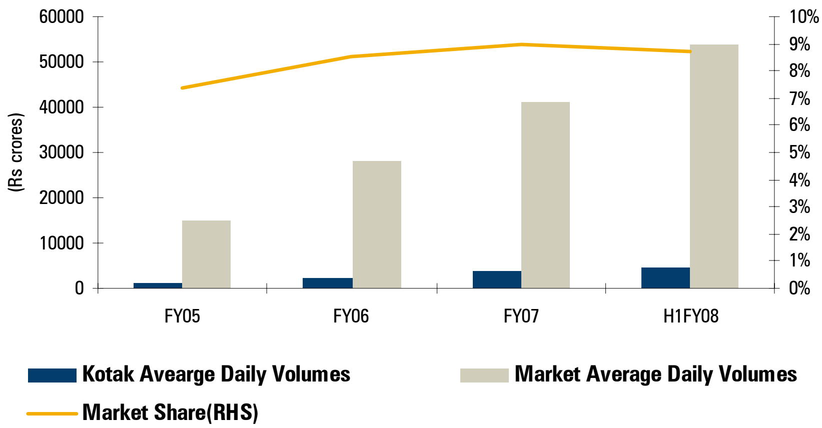
Source: ICICIdirect Research

Kotak Securities: Great growth potential

Kotak Securities (K-Sec), a KMB subsidiary, is one of India's leading stock broking firms with a 9% market share in FY07 (8.5% in FY06). The company clocked an average daily turnover of Rs 3,720 crore in FY07 against Rs 2,440 crore in FY06. The ending of the JV with Goldman Sachs in May 2006 has not made any meaningful impact on its market share. Rather, KMB has enhanced its efforts to gain size and momentum by leveraging on its strong brand name, wide distribution network, strong client base and also the backing of the other businesses of the Kotak group (which enables K-Sec to distribute third party products like mutual funds, car loans, bank loans, which in turn boost its other income).

K-Sec is leveraging on its strong brand name, wide distribution network and strong client base in order to gain size and momentum

Exhibit 14: Sustaining the market share



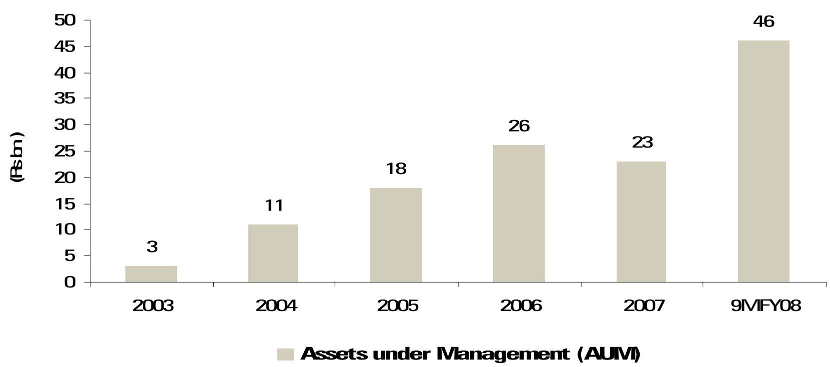
Source: Company, ICICIdirect Research

Being a market leader K-sec will witness a upturn faster than the peers when the volumes on the bourses pick up

K-Sec also offers portfolio management services to its HNI clients as asset management function, which fetched management fees and a certain percentage of profit over a pre-defined hurdle rate. The portfolio AUM as of H1FY08 was at Rs 3,500 crore. K-Sec has entered into the distribution of third party products like mutual funds (all companies), insurance products (Om Kotak Life) through its wide distribution network.

K-Sec also offers portfolio management services to its HNI clients. It has also entered into the distribution of third party products like MF units and insurance products

Exhibit 15: PMS AUM to witness robust growth



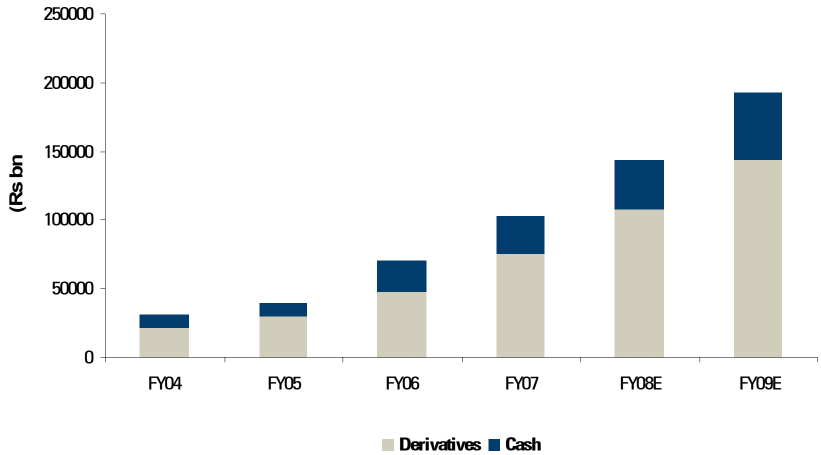
Source: Company, ICICIdirect Research

The Indian capital markets have been vibrant, backed by strong macro fundamentals, good corporate earnings, greater foreign investors' confidence in Indian companies, and increased retail and institutional participation. Trading volumes witnessed a 40% CAGR over FY04-07. The rise of the equity culture, which is partly supported by favourable demographics and partly by buoyant markets, has lead to more household savings being channeled towards equity and mutual funds. This has resulted in robust growth in retail brokerage volumes. Growing corpus of life insurance companies, together with improved visibility of India as an asset class among global investors, is attracting greater foreign flows (FII/FDI/NRI inflows amounted to US$48 billion in FY07). Further, change in regulations permitting pension and provident funds to invest in equities is expected to boost institutional volumes.

The recent crash in the stock prices in the month of January has led to decline in the volume on the bourses by almost 50 %. The major drop in the volumes was witnessed in the derivatives segment. We believe that the impact of this will be felt for the next 6-9 months after which normalcy will get restored.

Being a market leader in securities business K-Sec is well prepared to cash in on the on going equity market boom

Exhibit 16: Volumes set to increase going forward



Source: SEBI, ICICIdirect Research

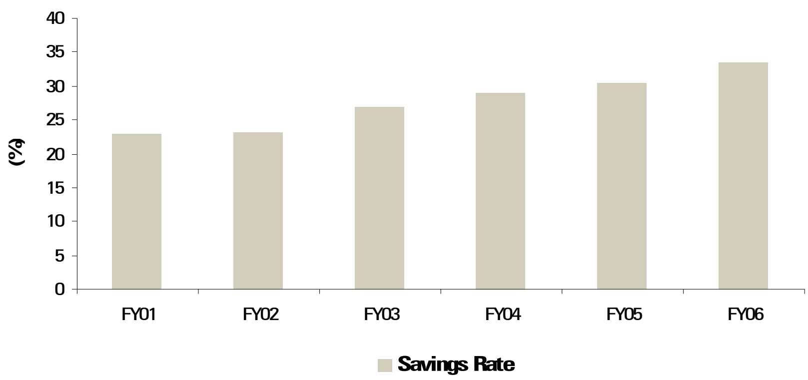
K-Sec's strong brand name, extensive mass reach, wide distribution network and proven research capabilities makes it a serious player in the Indian broking space. We believe that K-Sec is uniquely placed to capture the growth in the retail and institutional business.

Increase in turnover to help attain business traction

We expect that with the expansion of GDP, introduction of new innovative financial products, shift of household savings from deposits to equities and equity-related financial would boost the turnover of the market. This would have a positive impact on the market cap-GDP ratio, which is still low in India (even after the volumes on the bourses have grown significantly) when compared to other countries.

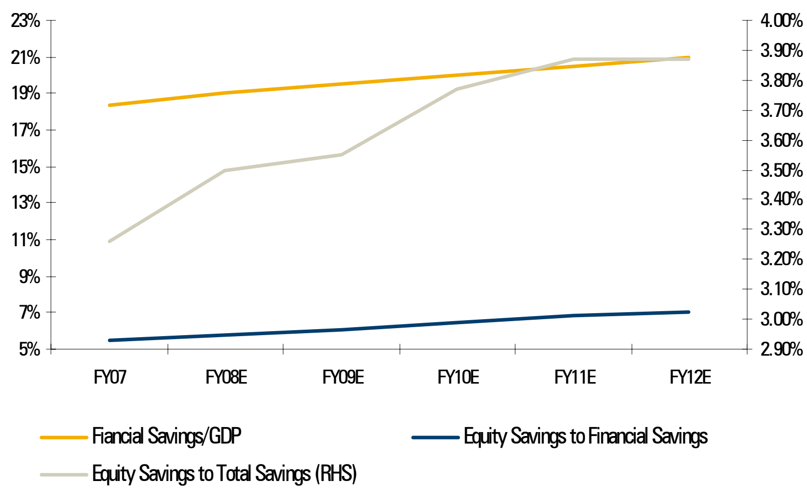
As this period of correction, which the Indian markets are going through gets over, we believe domestic investors (mutual funds and retail investors) will aggressively flock to the markets and compete with the institutional money, which in turn will make the markets more mature and healthier. We believe that equity savings-financial savings ratio will inch up to 7% in FY12E which is currently at 5.4% in FY07. Similarly the proportion of equity savings to total savings would go up from 3.3% in FY07 to 3.8% in FY10E. This would increase the average volumes to Rs 136,000 crore in FY10E.

Exhibit 17: Savings rate moving up steadily



Source: RBI, ICICIdirect Research

Exhibit 18: Share of financial savings to go up



Source: ICICIdirect Research

Increase in the proportion of equity savings to financial savings will bring in more business for stock broking houses.

Insurance companies, with the introduction of unit linked products, have seen large inflows in their equity funds. Even banks and corporate treasuries are active in the equity markets to boost their incomes. Total equity investment portfolios of insurance companies have grown at rapid pace due to money collected through ULIPs. Also, the regulatory approvals given to pension funds and trusts (which are sitting on huge investment surpluses) will boost up the volumes on the bourses significantly.

K-Sec, which is the market leader in the brokerage space, is in a sweet spot to cash in the huge opportunities because of the following:

1. Wide distribution network

As on March 31, 2007, two-third's of K-Sec's broking volumes came from its retail customers, which it serviced through its 813 offices (owned and franchise) which is spread across 277 cities. The company plans to increase its reach by 250-300 offices over the next 24-30 months. Even in the online broking space, K-Sec continued do well. The company had over 115,000 registered online customers as on March 31, 2007, and clocked volumes of ~ Rs 1,000 crore.

Focus on ramping up the distribution network will help K-Sec increase its clientele and ramp up the business volume

We believe that with its aggressive plans of ramping up the distribution facility, continuous focus on launching innovative products (like introducing the flat brokerage scheme for clients having small ticket transactions) and a establish brand name will help the company to widen its customer base. This is expected to increase the average daily turnover to Rs 7800 crore by FY10.

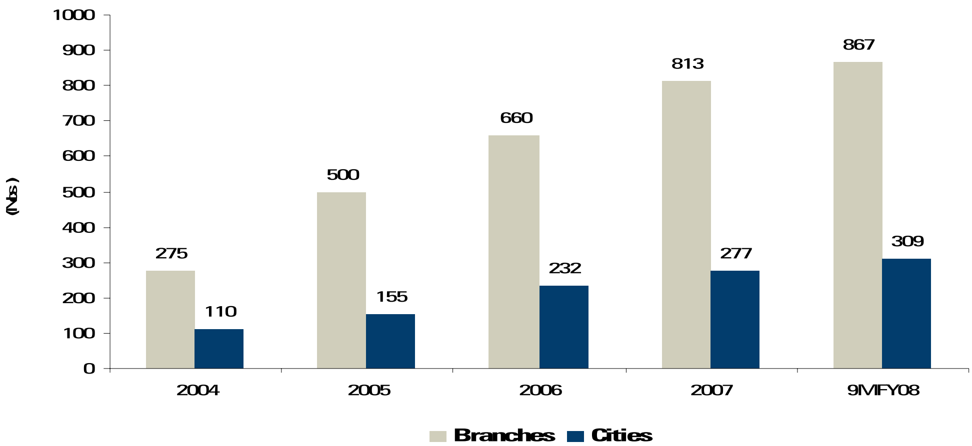
Exhibit 19: Distribution network of major brokerages (FY07)

Company	Customer base	Outlets	Cities	Market share
Kotak Securities	**338,000**	**813**	**277**	**9.00%**
Indiabulls	600,000	683	210	**4.90%**
Motilal Oswal	300,000	1288	385	**4.12%**
Religare	237,000	1,217	392	**3.90%**
India Infoline	500,000	596	345	**3.50%**
IL& FS	110,000	294	132	**1.60%**

S

ource: Company, ICICIdirect Research

Exhibit 20: K-Sec ramping-up its distribution network



Source: Company, ICICIdirect Research

2. Investment banking business under the same umbrella creates synergy

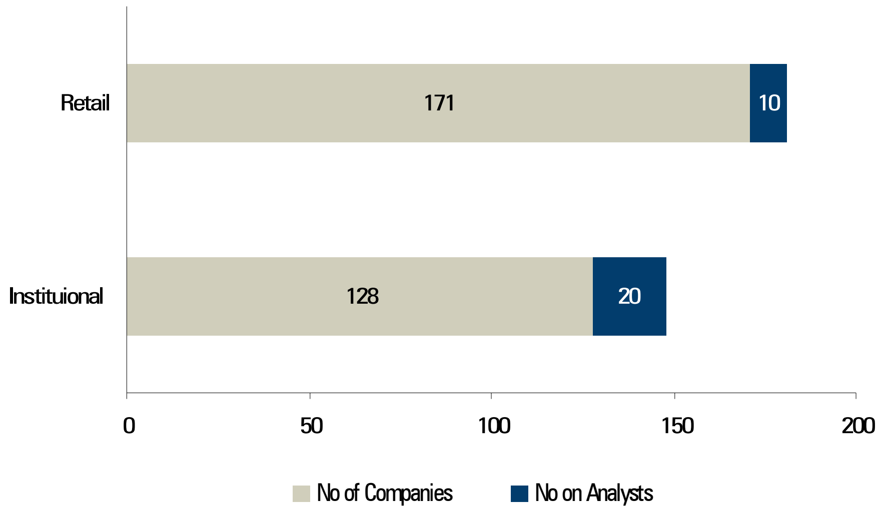
The Kotak group also has a investment banking vertical, Kotak Mahindra Capital Company (KMCC). K-Sec is one of the top distributors of IPO products and has participated in the distribution of 90 public issues during FY07, mobilizing over Rs 24,600 crore in the retail segment itself. The buoyant growth in the distribution business is synergistic, considering KMCC's strong foothold in the IPO and the M&A market. We believe that these synergies will help K-Sec garnering good fee income going forward. (Though pricing issues in IPO's which has led to the recent withdrawals of IPO's has created a lull in the primary market. But going forward we believe that this aberrations will be tackled and the buoyancy of the primary market will stage a comeback)

Leadership in investment banking vertical will enhance the distribution fees of K-Sec

3. Wide research coverage

We believe research capabilities would be the key differentiator in the broking industry. K-Sec has two different research set-ups: one for retail customers and the other for institutional clients. Its research coverage is wide and expanding with 128 companies covered by the institutional desk, and 171 companies covered by the retail desk.

Exhibit 21: Research Coverage (9MFY08)



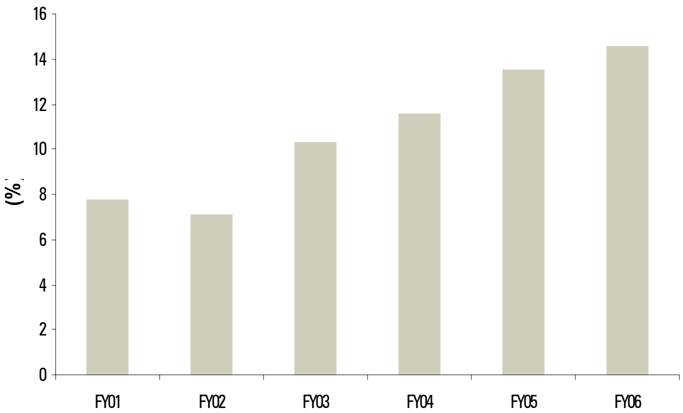
Source: Company, ICICIdirect Research

A strong research team and wide coverage of companies gives K-sec a extra edge

4. But increase in volumes at cost of contracting yields

Going forward, competition would intensify in the Indian broking space, which would result in a fall in broking yields for all the players. High degree of fragmentation in the industry is expected to trigger a fall in broking yields

Exhibit 22: Share of top five brokers at 15%



Source: SEBI, ICICIdirect Research

Exhibit 23: Trend in market share (%) of brokers

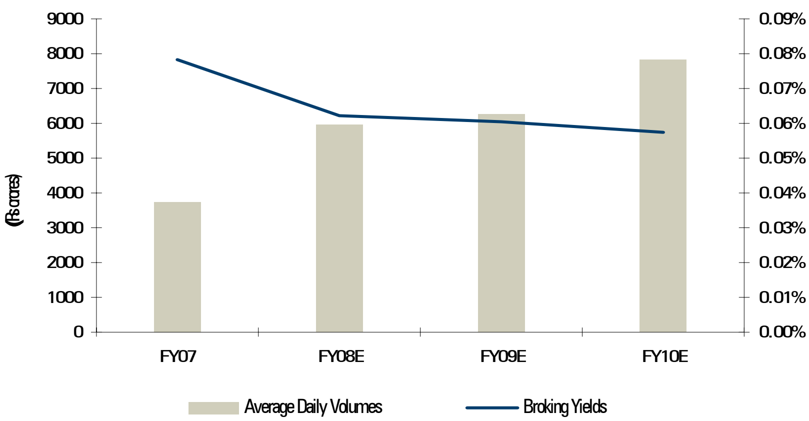
Brokers	Top 5	Top 10	Top 25	Top 50	Top 100
October 2007	15	26	46	62	76
2006-07	15	24	43	57	71
2005-06	15	23	38	53	68
2004-05	15	20	35	49	65
2003-04	14	17	30	44	61
2002-03	12	16	29	42	59
2001-02	10	12	24	36	53

Source: NSE, ICICIdirect Research

K-Sec will see good growth in volumes but this will come at the cost of yields which would come down from 0.08% in FY07 to 0.055% in FY10E

Owing to highly competitive nature of the brokerage business, brokerage commissions have gone down significantly over the years, making the survival of independent brokers difficult. Many smaller brokers have joined hands with larger players. Most of the leading players have increased their market share over the last few years. Leveraging its extensive network and established brand name, we believe K-Sec would be able to increase its turnover. We expect a 34% CAGR in volumes over FY07-10E and a 23% CAGR in broking revenues. But this growth in volumes and revenues will be achieved at the cost of broking yields, which are expected to reduce from 0.08% in FY07 to 0.055% in FY10E.

Exhibit 24: Loss in yields to be offset through increased volumes



Source: ICICIdirect Research

Valuations

We believe K-Sec is uniquely positioned to capture the growth in both retail and institutional broking businesses. We expect a 19% CAGR in earnings from broking over FY07-10E. K-Sec is a market leader in the domestic brokerage space and we believe it should command premium valuations compared to its peers like Edelweiss securities, Motilal Oswal and India Infoline, whose stocks are trading at 10x-15x FY09E earnings. We value K-Sec at 20x its FY10E earnings to arrive at Rs 283 per share of KMB, i.e. Rs 9,246 crore.

We are assigning a P/E of 20x on FY10E earnings keeping in view the levels of volatility that is prevailing in the stock markets. Also the volumes on the exchanges have come down drastically which will dampen the earnings for the next few quarters coupled with the increase in the short capital gains tax to 15%. This will have a adverse bearing on the volumes of the markets as well as on the business of K-Sec. But we feel that within next 6-9 months normalcy will be back in the markets.

Exhibit 25: K-Sec: Key Financials and valuation

	FY06	FY07	FY08E	FY09E	FY10E
Sales	**620.5**	**828.7**	**1282.0**	**1302.0**	**1549.1**
% growth		33.5%	64.4%	40.6%	31.0%
Broking income	**487.1**	**591.4**	**899.9**	**897.6**	**1065.9**
% growth		21.4%	66.4%	-0.2%	18.8%
broking yield	0.08%	0.06%	0.06%	0.06%	0.05%
PMS Aum	**2600**	**2300**	**4830**	**5313**	**6641**
Fee Income	84.4	110.5	217.4	223.1	265.7
% Yield	3.2%	4.8%	4.5%	4.2%	4.0%
% growth		31.0%	96.7%	2.7%	19.0%
Interest Income	**49.02**	**126.77**	**164.80**	**181.28**	**217.54**
% growth		159%	212.2%	10.0%	20.0%
Operating profit	**320.5**	**365.1**	**512.8**	**494.8**	**542.2**
%growth		13.9%	40.4%	-3.5%	9.6%
Margin	51.6%	44.1%	42.0%	38.0%	35.0%
Other Income					
profit on sale of Investments	36	67	33	17	18
dividend income	6	10	10	12	18
Net Profit	**215.5**	**255.7**	**384.6**	**390.6**	**426.0**
%growth		18.6%	50.4%	1.6%	9.1%
Margin	35%	31%	30%	30%	28%
Net Profit inclusive of Other Income	**257.4**	**332.5**	**427.9**	**419.3**	**462.3**
Value at 20x earnings			**8557.9**	**8385.2**	**9246.3**
Value per Share			**262**	**257**	**283**

Source: ICICIdirect Research

Kotak Mahindra Capital (KMCC): Maintaining leadership

The Kotak Mahindra Group carries on its investment banking business through Kotak Mahindra Capital Company (KMCC), a subsidiary of Kotak Mahindra Bank (KMB). Kotak bought the 25% stake held by Goldman Sachs in KMCC in May 2006 by paying a consideration of Rs 210 crore, making it a 100% subsidiary. KMCC has a strong presence in managing equity issuances and advising on M&A transactions, and has benefited largely from the boom in investment banking activity in India. The company de-merged its principal and trading investments division (including primary dealership) in March 2007 (to free up surplus capital) and now primarily operates as a full-service investment bank, offering advisory and transactional services. The primary dealership business was merged with the treasury function of the bank and it led to addition of Rs 200 crore to KMB's net worth.

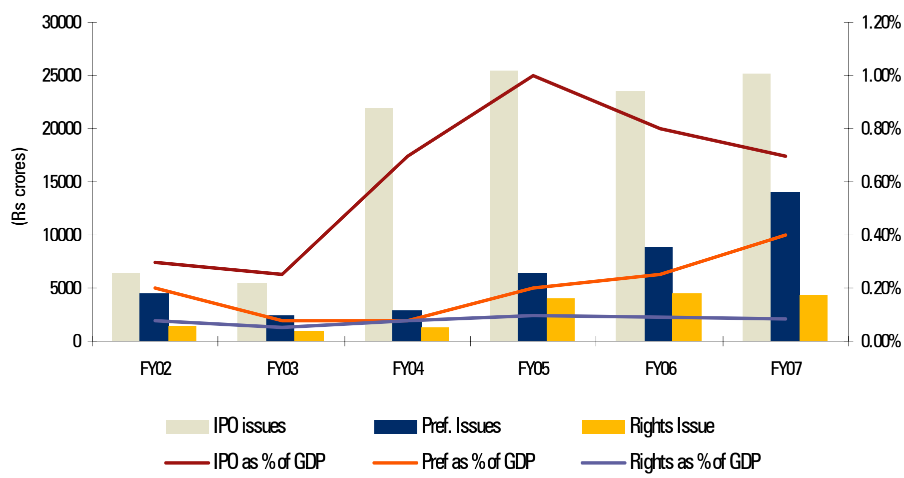
Robust outlook for investment banking

With the investment and capex cycle on an upswing, Indian corporates are aggressively expanding their scale of operations. To fund their ambitions, corporates have aggressively raised money (in form of equity issuances, preferential and QIP placements and debt placements) from both domestic as well as international capital markets. During FY07, the investment banking sector saw 85 domestic IPO's worth Rs 25,000 crore, 25 QIPs (amounting to Rs 5,000 crore), 107 overseas offerings of Rs 71,300 crore, and closed 90 M&A deals worth Rs 15,100 crore. In the current calendar year (till August), India ranked second in equity issuances and fourth in M&A advisory in Asia Pacific (including Japan) with market shares of 17.3% and 10.3% in the segments respectively.

Leadership in investment banking vertical will enhance the distribution fees of K-Sec

The year 2008 will bring a lot of action in M&A and private equity market. We believe that the next growth area in the investment banking will be private equity space which is in a very nascent stage in India.

Exhibit 26: Growing primary market

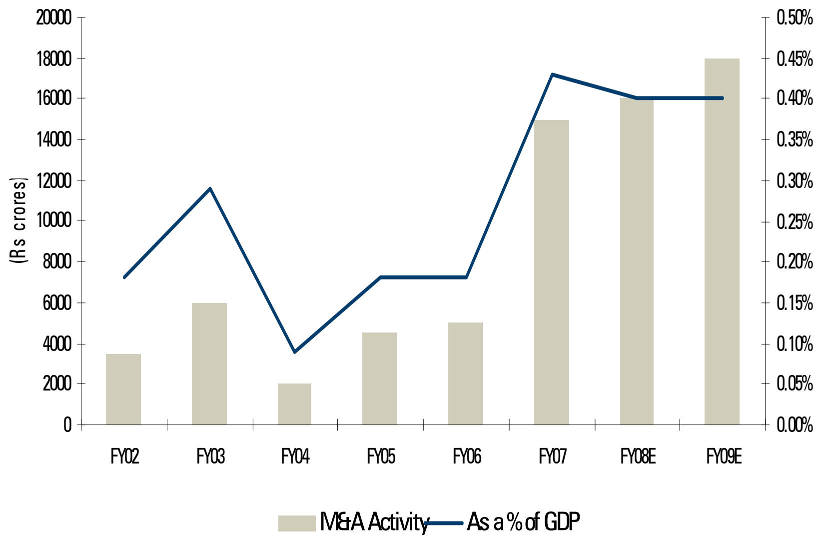


Source: Prime Database, ICICIdirect Research

In the past 18-24 months, there has been a significant increase in financial advisory activities in India and M&A volumes have grown by over 80% over FY05-07. In FY07, the industry closed 90 M&A transactions worth Rs 15,100 crore and the ratio of completed M&A volumes to market capitalization has gone up to 0.4% from 0.2% over the past 3 years. We believe that this is just the beginning and with many companies expanding, a lot action will happen in this space, which will in turn throw opportunities for investment banking companies in India.

In FY07 the Investment banking industry closed 90 deals worth Rs 15,100 and ratio of completed M&A deals to market cap went up from 0.2% to 0.4% in the past two years

Exhibit 27: M&A activity gaining pace

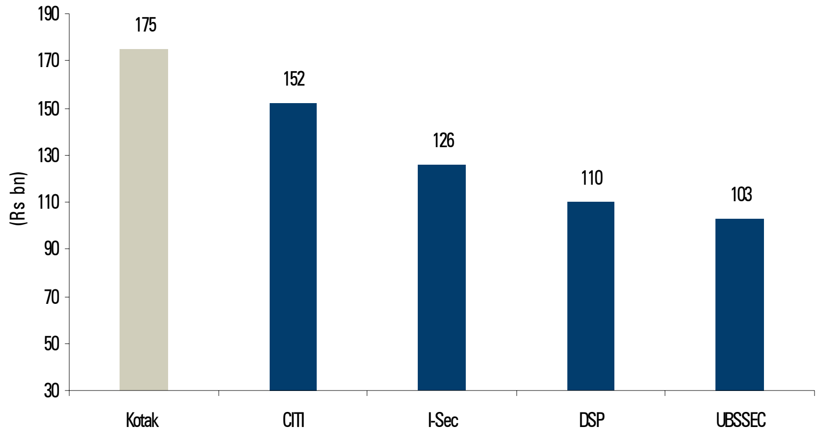


Source: Prime Database, ICICIdirect Research

KMCC has been a favourite among the Indian corporates for the job of a book running lead manager. The following reasons make KMCC a preferred lead manager in equity issuances.

- Kotak group also houses banking and securities business. This brings with it the benefit of strong distribution and marketing network and a wide retail and institutional relationship base. With 50% of the Issues reserved for the non institutional investors, a dominant retail player has become a necessity in case of a book running manger. KMCC, with its deep retail and HNI network scores above its international peers and has therefore made a strong foothold in the equity issuances and the primary market in India.
- KMCC also has the necessary credentials to manage a equity offering. This is evident from the fact that it has very well managed big ticket issues like DLF and Power Grid Corporation and recently Future Capital Holdings and Reliance Power.

Exhibit 28: Emerged as the No 1 player in IPOs and QIPs in H1FY08.



Source: Company

Exhibit 29: Recent IPO pipeline (KMCC as a book runner):

Year	Company	Issue Size (Rs crores)
2008	Techpro Systems	225
2008	IRB Infra developers*	1100-1150
2008	Vascon Engineering	400-500

*Source: *Recently concluded, Company*

KMCC in the current fiscal has maintained its leadership in being the lead manager. Till date it has closed 7 deals worth Rs. 13793 cores.

KMCC has also been the leader in the QIP space for the past two years. It managed three issues worth Rs 100 crore in FY07. We expect the trend to continue going forward in FY08 and FY09. Revenue sharing in IPOs is generally 50% each between K-Sec and KMCC.

Exhibit 30: Establishing a strong foothold in the primary market.

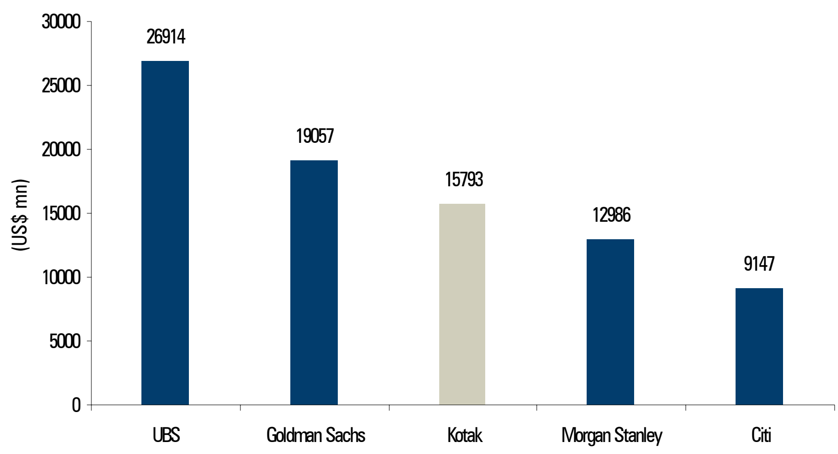
	FY07		FY08(till date)	
Investment Banker	**Amount (Rs crore)**	**No of Issues**	**Amount (Rs crore)**	**No of Issues**
JM Financial Consultants	15069	13	11144	3
DSP ML	14262	10	20693	4
Citigroup	11103	4	12206	6
ENAM	10176	17	14167	8
KMCC	***4912***	***9***	***13973***	***7***
SBI Capital	4194	8	9255	2
I-Sec	8112	12	23175	8

Source: Bloomberg, ICICIdirect Research

M&A, private equity to be next growth drivers

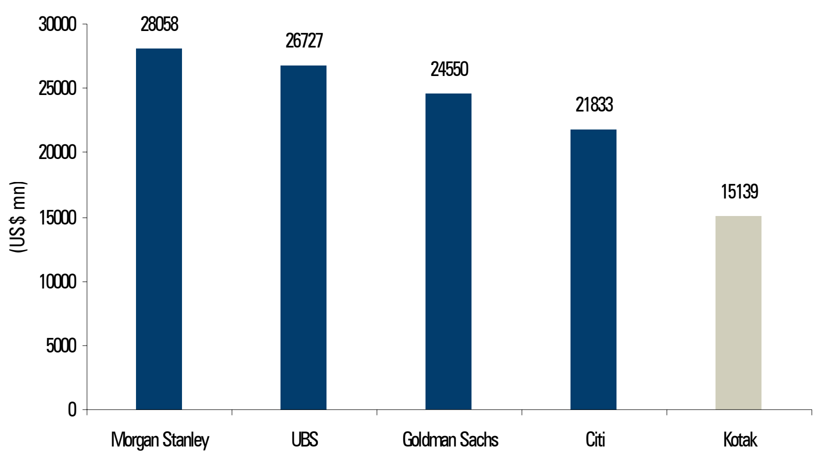
Though this space is dominated by international names like JP Moran, UBS and Lehman Brothers, KMCC has been able to garner good business from this avenue over the last three years. It has emerged as the No 3 player (the only Indian player) in India announced deals and the No 5 player in Asia (ex-Japan) announced deals in H1CY07.

Exhibit 31: India announced deals



Source: Company, ICICIdirect Research

Exhibit 32: Asia (ex Japan) announced deals



Source: Company, ICICIdirect Research

KMCC has been able to garner good business from the M&A space both in the domestic as well as international markets

Valuations

KMCC has a healthy pipeline of mandates in various sectors for both equity offerings and M&A. Already during H1FY08; it has emerged as the top book running lead manager and has executed mandates worth Rs 25600 crores in the IPO market and Rs. 7000 crores in the QIP segment.

We believe that the Indian economy is going to grow at ~ 8% for the next few years. This will propel companies to scale-up in size and go global which would present a huge opportunity for KMCC as a favoured book running manager. We expect KMCC's IPO and M&A advisory revenues to grow at a 34% CAGR over FY07-10E (advisory revenues for FY10E is expected to touch Rs 293 crores) and trading and investment income reach Rs 126 crore by FY10E at a 15% CAGR.

On the operating margins front, we expect the margins to remain stable with a downward bias which will be range from 40%-42% over FY07-FY10E. On the profitability front we expect KMCC's profitability to grow at a 26% CAGR on the back of a healthy order pipeline.

KMCC is purely an investment bank. Its revenues and profits would be highly lumpy and unpredictable *(it can get slow in a market where bouts of volatility and uncertainty persists*). With the economy set to report robust growth, corporate earnings to sustain and the need to scale up business models will keep the pipeline for KMCC robust. This would certainly lead to strong traction in earnings given the strong foothold of KMCC in the primary and the M&A market. We believe KMCC would command premium valuations compared to its domestic peers. We have valued it at 20x its FY10E earnings of Rs127 crore, which gives us an enterprise value of Rs 3,356 crore, translating into Rs 182 per share of KMB.

With economy set to report robust growth, corporate earnings to sustain and need to scale up the business models will keep the healthy deal pipeline for KMCC

Exhibit 33: KMCC: Key Financials (Rs crore)

	FY07	FY08E	FY09E	FY10E
Income	**204.6**	**292.1**	**349.4**	**419.5**
Investment Banking	**121.1**	**187.7**	**234.6**	**293.3**
%growth	*15%*	55%	25%	25%
Trading & principal Investments	**83.5**	**104.4**	**114.8**	**126.3**
%growth	*-46%*	25%	10%	10%
PBT	**85.9**	**123.9**	**141.3**	**166.5**
Margin	*42%*	*42%*	*40%*	*40%*
%growth	*-53%*	*44%*	*14%*	*18%*
Investment Banking	64.7	95.7	112.6	134.9
%growth	*15%*	*48%*	*18%*	*20%*
Margin	***53%***	***51%***	***48%***	***46%***
Trading & principal Investments	21.2	28.2	28.7	31.6
%growth	*-83%*	*33%*	*2%*	*10%*
Margin	***25%***	***27%***	***25%***	***25%***
Tax	***18.0***	***27.5***	***33.0***	***32.2***
Effective tax rate	***21%***	***22%***	***23%***	***19%***
PAT	**67.9**	**96.4**	**108.3**	**134.3**
Margin	***33%***	***33%***	***31%***	***32%***

Source: ICICIdirect Research

Kotak Mahindra Asset Management Company (KMAMC)

Kotak runs its asset management business through Kotak Mahindra AMC (mutual fund), Kotak Investment Advisors (alternative assets), Kotak Mahindra (UK) and other international subsidiaries (offshore India dedicated funds) and Kotak Securities (PMS). As of H1FY08 the asset management company had over US$ 11.7 billion of assets managed and advised through mutual fund insurance, portfolio and offshore funds (including alternate assets). The asset management business has also bagged various laurels for itself some of them listed below.

Exhibit 34: Awards bagged by KMAMC

Award from	Award for
Lipper	Best bond house (2006)- Kotak Mutual
Lipper	Kotak bond regular plan was ranked the best debt fund over 3 years (2006)
ICRA	Kotak bond regular plan was ranked ICRA-MFR1 & was recipient of Silver award
NDTV	Best Mutual fund house (2006)

Source: Company, ICICIdirect Research

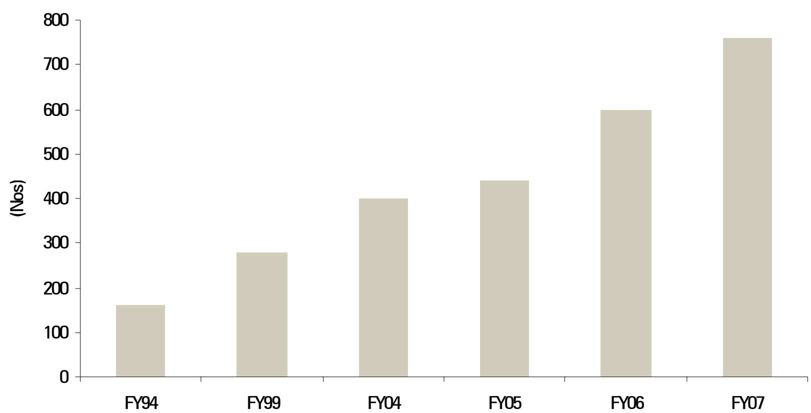
Asset management will be the next growth driver for the Kotak group

In terms of size, the asset management business is small in size as compared to other businesses of the Kotak group and also relatively small in the asset management industry. But we believe asset management business is the next growth driver for Kotak group as it is trying to grow this segment by leveraging on the brand name, cross selling opportunities via the established distribution network of securities segment, banking vertical and insurance business. Also apart from these we believe the two important growth drivers would be to increase visibility further in the metro and non-metro regions and focus on geographic expansion on one hand and new product offerings & value added services initiatives on the other.

Mutual Fund industry sailing through "Blue Sky"

Assets under management (AUM) for India's mutual fund industry have grown at a 31% CAGR over the last five years, backed by strong capital markets and the entry of private players – which has led to the launch of new variants and new products, such as systematic investment plans (SIPs), thereby providing more options to investors.

Exhibit 35: MF's schemes registering healthy growth



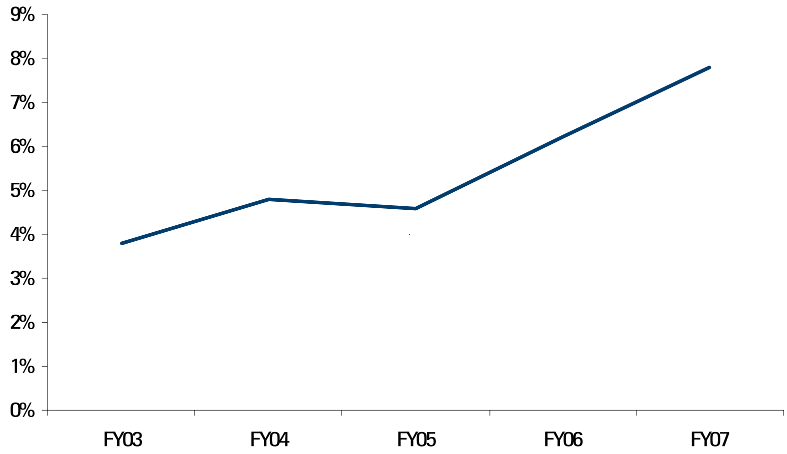
Launch of new products & schemes and the entry of new players will keep the asset under management (AUM) of the MF industry swelling.

Source: AMFI, ICICIdirect Research

In the last three years more new schemes have been added than in the previous 10 years. The complexity and volatility of the equity markets has gone up and that has led to a systematic shift towards money management by mutual funds (MF).

We believe that the macro economic factors such as change in demography, ability of the investor to take risk, innovation of new financial products, consolidation in the industry, improving regulatory framework and increased proportion of savings getting diverted from bank deposits to equity linked products will provide significant opportunities for the Mutual fund industry to grow. This can be supported by the fact that the proportion of equity AUMs has improved significantly from 18% in FY04 to 40% in FY07.

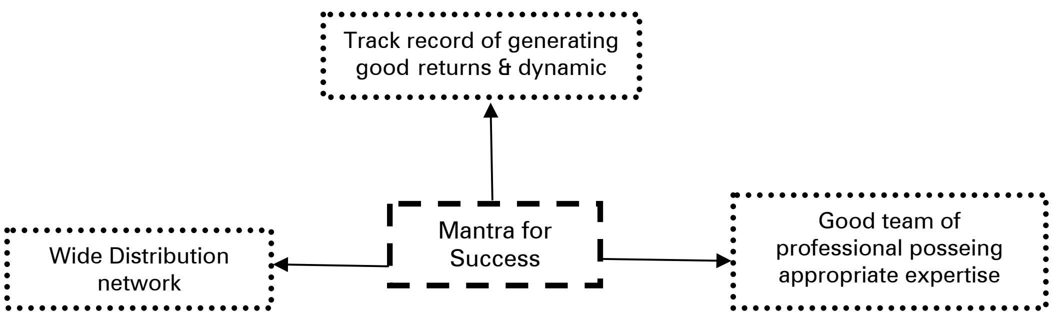
Exhibit 36: MF AUM as a % GDP ratio



Source: AMFI, ICICIdirect Research

We believe that the growth going forward would be stupendous even though the MF industry has grown at a robust pace of 34% over the last five years. Still the penetration of mutual funds is low, with the total AUM forming less than 1% of the total financial assets of the country. This instills confidence that the mutual fund industry is set to register stupendous growth over the next few years.

Exhibit 37: Gateway to success



Source: ICICIdirect Research

KMAMC well-placed to ride this growth

We believe that to grow and scale up in the mutual fund industry, three factors play a key role in deciding the fate of the individual asset management company (AMC) – a wide distribution network, track record of generating good returns and dynamic product basket and a good team of professional possessing appropriate expertise.

Exhibit 38: Success of the Mutual Schemes of KMAMC

5 Star Rating

Scheme Type	Scheme Name	Risk Grade	Return Grade	AUM (Rs crores)
Equity Diversified	Kotak Opportunities	Below Average	High	693
Debt: Floating long term	Koatk Floater LT	Average	High	30.5
Debt:Medium term	Kotak flexi debt	Low	Above average	3624

Ratings as on Feb 28, 2008
Source: Value Research, ICICIdirect Research

Existing distribution network provides immense leverage

The Kotak group has a wide distribution network in form of 68 mutual fund and satellite branches, 133 banking branches, franchises & branches of the K-Sec and the advisors of the life insurance business. K-Sec has over 800 branches spread across 277 cities which can be a big source of selling points of mutual fund products of KMAMC and also has strong retail and HNI relationship base. The aggressive ramping-up of Kotak Mahindra Bank's branches (currently 133, expected to go up to 200 by this fiscal) will further provide a boost to the AUMs.

Speedy expansions of the branches of KMB and K-sec to provide huge cross selling of MF units of KMAMC

Decent track record and dynamic product portfolio

Kotak has fantastic track record especially in the debt funds category which has enabled it to bag various awards from Lipper, ICRA and NDTV (KMAMC has a relatively higher exposure to debt funds, which accounts for nearly 82% of the total mutual fund corpus). The performance of diversified equity scheme was satisfactory, though it has picked up growth in the past three months; growth in equity AUMs over the past three financial years has been more or less in line with the industry growth. With the boom in the equity markets to continue we will see the proportion of the equity AUM to total AUM going up in the next few years.

Other than the regular mutual fund product, KMAMC also manages assets of the insurance company, offers portfolio management services and also runs offshore funds (including alternate assets).

Offshore funds: The next growth wave

Kotak has set up branches in UK, Dubai, Australia and Singapore to raise India-dedicated offshore funds. These are open/close ended traded mutual funds (long only) offered to global investors. These funds are managed/advised by Kotak Mahindra (UK) Ltd and other international subsidiaries. The investment management activity is carried out by a 'research and investment' team established in the Dubai branch. The equity assets managed/advised under these schemes stood at US$2.2 billion as of September 2007.

KMAMC has set up shops in Dubai, Singapore and Australia to raise India dedicated long only funds

The current client base for these funds continues to be HNIs and institutions given the lower brand recognition of Kotak in foreign countries. However, the management aims to tap overseas retail investors by further deepening its distribution network abroad. We expect this segment to grow exponentially. We expect the AUM of

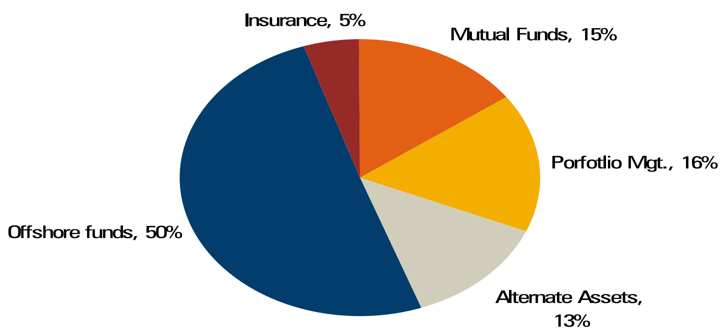
KMAMC offshore funds to grow at a 38% CAGR over FY07-FY10E (AUMs to reach Rs 2,080 crore by FY10E).

Alternative Assets

KMAMC has significantly ramped up its alternative assets segment. Currently it has a corpus of US$ 1 billion which the management expects to double over next 12-18 months. These funds typically carry a 2:20 structure and are a lucrative area in terms of profitability. We expect the AUM under this category to reach Rs 7,200 crore by FY10E implying a 36% CAGR over FY07-10E.

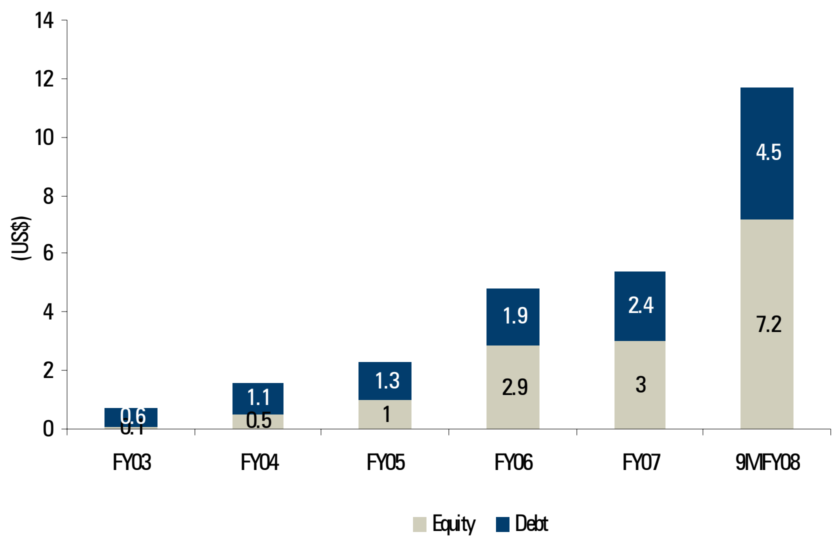
The management expects to significantly ramp up the AUM's under the alternate asset scheme to US$2 bn in a period of 12-18 months

Exhibit 38: Break up of AUM (9MFY08)



Source: Company, ICICIdirect Research

Exhibit 39: Manages over $ 11.7 billion in assets under management



AUM has significantly grown from US$ 1.6 bn in FY04 to US$ 11.7 bn in 9MFY08

Source: Company, ICICIdirect Research

Exhibit 40: Alternate assets: Yielding high growth and value

Funds	Commitments (US$ million)	Investment Focus	Committed
India growth fund	170	High growth sectors of home retail , logistics, home textiles , airline, light engineering and IT	2/3rd in 11 companies
Kotak realty fund			
India real estate fund	100	Real estate sector and allied services	3/4th in 7 companies
Alternate opportunities fund	400	Real estate sector, infrastructure and allied services	
Kotak venture fund	50	Biotechnology and life sciences	1/5th in 2 companies
Total commitments	720		

Source: Company, ICICIdirect Research

Kotak MF has tied up with US-based asset manager T Rowe Price for resident Indians to invest in emerging market (through Luxembourg-domiciled T Rowe Price Funds SICAV-Global Emerging Markets Equity Fund). Till date, it has raised Rs 550 crore (US$130 million) in this offshore fund and further can expand it to US$200 million, the maximum permissible amount for any mutual fund to invest outside India. Besides earning asset management fees, it also benefits in terms of fee income from captive distribution of these products.

Valuations

After the recent deal between Eton Park and Reliance AMC, where the former picked up a 5% in the latter for Rs 500 crore, thus valuing Reliance MF at Rs 10,000 crore (13% of AUM). We believe that this deal has set the valuation benchmark in the industry and re instills the fact that these premium valuations are here to stay for the AMCs and also implies the humungous growth opportunities available for the mutual fund industry potential going forward.

Exhibit 41: Recent deals in asset management space

Acquirer	*Target*	*Valuation As a % of AUM*
Recent Deals		
IDFC	Stanchart MF	5.7%
Eton Park	Reliance MF	13%
Robeco group NV	Canbank MF	10%
UBS	Standard Chartered MF	5%
Earlier Deals		
Societe Generale	SBI MF	7%
BNP Paribas	Sundaram AMC	7%

Source: AMFI, ICICIdirect Research

The deal has set valuation benchmark in the mutual fund industry

Kotak Mutual Fund's AUMs have doubled in the last 18 months to Rs197b as at September 2007. However, the equity component remains low at ~Rs34b (17% of total AUMs). Kotak Mutual Fund's reach is limited at 71 branches (9MY08) and an investor base of 570,600. It continues to be one of the smallest domestic mutual funds in terms of equity AUM. We believe that skewnishness in the proportion of Debt and Equity AUM in the total AUM will steadily start fading. We expect the proportion of equity AUM to remain constant at 11.5%-12% in FY10E from current 12%. We therefore value the domestic mutual fund business by:

Exhibit 42: Assigning value to the MF business

Segment – Domestic Mutual Fund	% of AUM
Equity AUM	8%
Debt AUM	5%
Weighted Average AUM	5.32%

Source: ICICIdirect research

We have valued Equity AUM at 8% of the AUM as the weight of Equity AUM as % of total AUM is quite low

We expect the AUM, especially equity AUM, to grow significantly as the Kotak Group has the entire necessary infrastructure to scale the domestic asset management business. We expect the total domestic AUM to reach Rs 52,722 crore by FY10E (debt-equity – 89%:11%)

Exhibit 43: Domestic mutual fund: Key Financials **(Rs crore)**

	FY06	FY07	FY08E	FY09E	FY10E
Total industry AUM	**230700**	**324794**	**600869**	**961391**	**1442086**
growth %		*40.8%*	*85%*	*60%*	*50%*
Market Share	***4.0%***	***3.1%***	***3.8%***	***3.7%***	***3.7%***
Total MF AUM	**9232**	**10095**	***23034***	***35280***	***52722***
growth %		*9%*	128%	53%	49%
Equity MF AUM	2812	2167	2818	3945	5720
growth %		*-23%*	30%	40%	45%
Debt MF AUM	6419	7928	20216	31335	47002
growth %		*24%*	155%	**55%**	**50%**
Equity MF AUM as a % AUM	***30.5%***	***21.5%***	***12%***	***11%***	***11%***
Debt MF AUM as a % AUM	***69.5%***	***78.5%***	***88%***	***89%***	***89%***
Value of Equity MF at 8% of AUM			225	316	458
Value of Debt MF at 5% of AUM			1011	1567	2350
Total Value			1236	1883	2808
Value per share in KMB(Rs)			**38**	**58**	**86**

Source: ICICIdirect Research

The growth in Equity mutual funds will grow at a rate less than that of debt AUM

The weight of Debt mutual funds will continue to remain high.

We value KMAMC's domestic business at 5.3% its FY10E estimated AUMs of Rs 52,722 crore, which gives us a enterprise value of Rs 2808 crore, translating into Rs 86 per share of KMB.

On the other hand , we expect the offshore funds to grow up to Rs 2,080 crore by FY10E, and funds under the alternate assets segment to grow up to Rs 7200 crore.

Exhibit 44: Value of offshore asset management (Rs crore)

	FY07	FY08E	FY09E	FY10E
Offshore Funds	800	1280	1600	2080
Value @ 8%of AUM			160	208
Value per share in KMB (Rs)				5
Alternate assets	2880	4608	5760	7200
Value @ 8%of AUM			576	720
Value per share in KMB(Rs)				18

Source: ICICIdirect Research

The offshore funds and the alternate assets have been valued at 8% of the total expected AUM of FY10E.

We therefore get a combined value for offshore and alternate assets at Rs 28 per share in KMB. On an aggregate, we value KMAMC's total asset management business at Rs 110 per share for KMB.

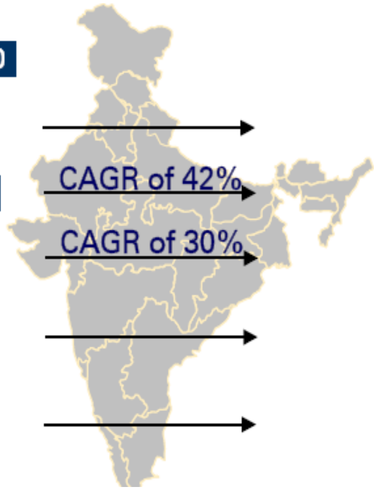
Kotak Mahindra Old Mutual Life Insurance (KMOM)

Kotak Mahindra Old Mutual Life Insurance is a 74:26 JV between Kotak Mahindra Bank and Old Mutual Life. Kotak Life has managed to capture market share of 3% - 4% in last couple of years. It witnessed a declining trend with market share falling from 3.2% in FY07 to 2.8% in YTD November FY07. Consequently, it lagged behind other private life insurers and recorded 74% CAGR growth in APE (annualised premium equivalent) over FY04-07 compared to 80% growth for private players. We can see the movement in industry over the last seven years with number of players growing 16 fold and NBP growing 42% CAGR

The life insurance was started as a JV with Old mutual where KMB has a economic interest of 74%

Life Insurance Industry

Exhibit 45: Evolution of the life insurance industry



	FY 2000		FY 2007
Number of players	1		16
NB premium (Rs bn)	64.00	CAGR of 42%	754.00
Total premium (Rs bn)	270.00	CAGR of 30%	1,696.00
Penetration (as a % of GDP)	1.2%		4.1%
Insurance premium per capita (Rs)	~280		~1,510

Source: IRDA,ICICIdirect Research

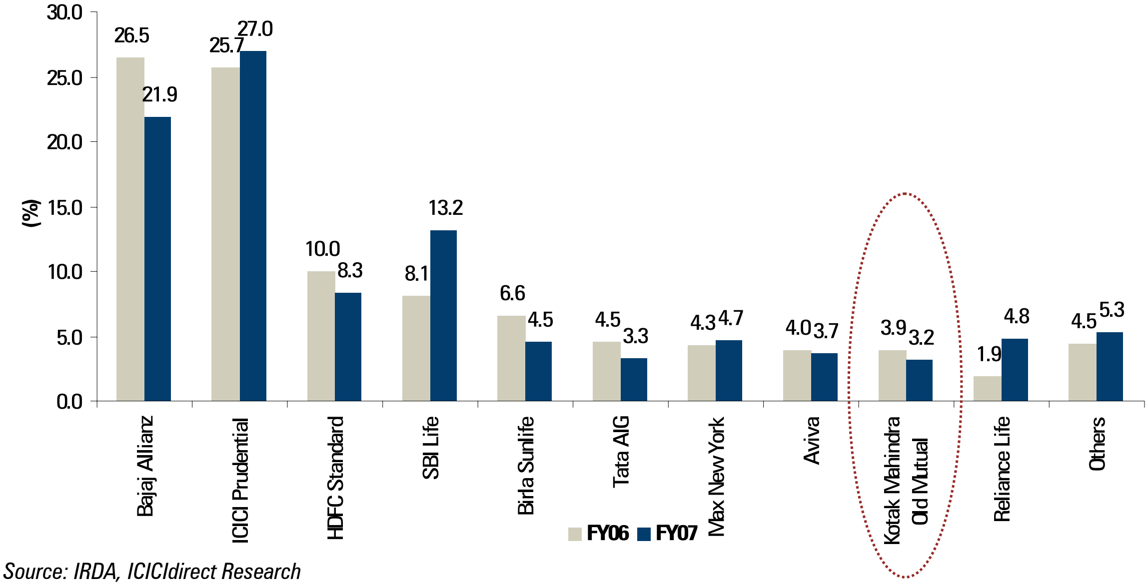
The life insurance industry has witnessed stupendous growth in its annualised premium equivalent (APE) of 35% CAGR over FY03-07. Private players were in the forefront of this sector rally, recording a growth of 80% CAGR in APE over FY03-07, against LIC's volume growth of 26%. Private insurers improved their market share significantly from 11% in FY03 to 34% in FY06. LIC is struggling against this onslaught, as its traditional products are relatively less attractive.

The market share among private players has also undergone a change. ICICI Prudential and Bajaj Allianz have been fastest of the block and have emerged clear winners with a market share of 29-30% and 18-19%, respectively, among private insurers. HDFC Standard Life is also bombarding the market with its well-planned strategies in place, post setting up of a strong base. However, Birla Sun Life's performance was a disappointment in the past eighteen months and it has, in fact, lost market share to other aggressive players. Reliance Life (after taking over AMP Sanmar) and SBI Life have been aggressive lately and have significantly outperformed other leading players, growing exponentially in the last year.

The share of the private players has undergone a change.

ICICIpru and Bajaj Allianz have been the fastest growers

Exhibit 46: Market share of private players



Source: IRDA, ICICIdirect Research

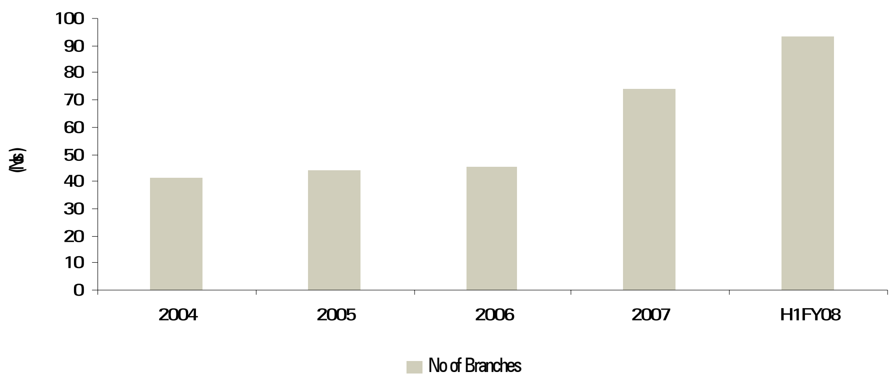
Focus on wide distribution network

KMOM has been focusing on increasing its distribution network by hiring more channel advisors and other distribution channels. It has also increased spending on brand advertisement to improve its brand visibility in a growing but highly competitive industry. KMOM has doubled the count of its branches to 93 in the last 18 months (It plans to increase to100 branches by FY08E and 150 by FY09E) and also significantly ramped up its sales force (2271 sales managers and 26,654 life advisors). We believe that this exercise would enable it improve its brand visibility and help it attract volumes on the business front.

KMOM has doubled the count of its branches to improve its brand visibility in a growing but a highly competitive industry

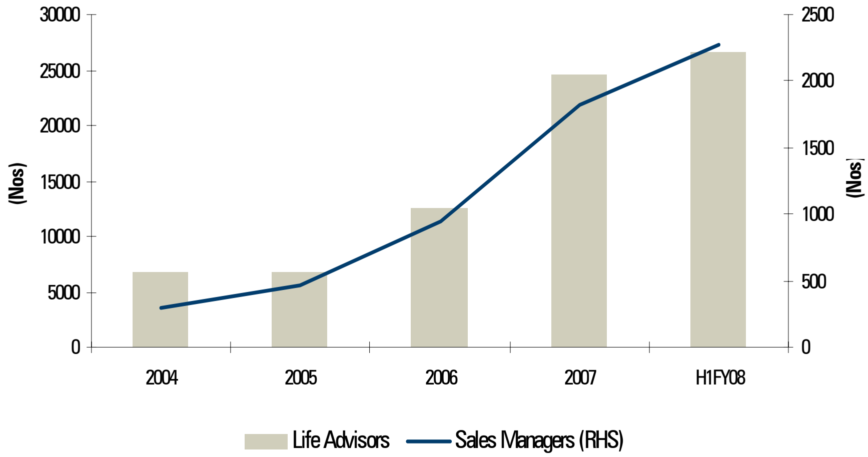
The insurance industry has also seen bancassurance playing a larger role as compared to past. In FY04 it contributed 10.6% in private sector new business premium but in FY06 this proportion became 16.9%. However, due to many banks now starting their own venture, there is a threat and agency force remains as one of the major & safe networks for insurance distribution.

Exhibit 47: Increasing focus on scaling-up distribution network …



Source: Company, ICICIdirect Research

Exhibit 48: … along with ramp-up in sales force



Source: Company, ICICIdirect Research

Cross selling opportunities to bring in volumes

KMOM is leveraging on the client base of the existing group business. Apart from focusing on bancasurance (tie up with KMB) it has also started selling its products via K-sec. KMB and K-sec collectively has a strong client base of 0.8 mn accounts, both retail and HNI's, coupled with 1000 distribution centers. These we believe will KMOM in garnering volumes in business. Currently, Kotak Life's 55% of premium are mobilsed through agency force, 20% through corporate brokers, and 25% through bancassurance. The company wants to grow the share of agency and bancassurance at relatively higher pace than corporate brokers.

ULIPS to dominate products portfolio

The proportion of unit-linked plans in Kotak Life's product mix has gone up (in line with industry trend) to 90% of the premium received during FY07. Due to current boom in the equity market ULIPs as a financial product have been well received by the market and will continue to do well over a couple of years. With markets collapsing, ULIP's might turn out to be better way of investing in the volatile markets and hence we believe that the demand for the same will be buoyant.

The share of ULIP's in the product portfolio remains high

Valuations

KMOM witnessed a 56% jump in GWP (gross written premium) to Rs 972 crore in FY07 from Rs 622 crore in FY06. Private sector life GWP grew 72% to Rs 15,293 crore from Rs 8,853 crore. ULIP forms major part of GWP since last couple of years. Even for Kotak Life also in FY07 ULIP accounted for 90% of new business premium in line with industry as it gives exposure to the booming capital markets along with life cover. We expect overall industry (including LIC) to grow nearly 25% annually for next 3 years. Kotak Life's GWP is expected to grow at 43% CAGR to Rs 2,861 crore and APE at 42% CAGR to Rs 2,533 crore over FY07-10E.

We expect the Life insurance industry to grow at 25% over FY07-FY10E

We expect, being a small sized player in insurance sector Kotak Life's NBAP margins to remain lower between 16%-18%. We derive NBAP of Rs.405 crore at 16% margin. At 16x NBAP, we value Kotak life insurance business at Rs.6486 crore giving Rs. 138 per share of Kotak Bank taking into account its 74% stake.

We expect Kotak Life's GWP and APE to grow at a CAGR of 43% and 42% respectively over FY07-FY10E

Health, pension and micro finance are the key growth areas for the life insurance sector in India. We have already seen health rider policies attached with main policies coming in the market.

Exhibit 49: KMOM Life: Key financials **(Rs crore)**

	FY07	FY08E	FY09E	FY10E
No of Life Insurance Policies	**165200**	**338000**	**608400**	**1003860**
Growth	71%	105%	80%	65%
Average Premium	58808	43114	34731	29469
GWP	**972**	**1409**	**2044**	**2861**
Growth	56.23%	45%	45%	40%
Annual premium				
Single	101.9	122	196	303
	214%	20%	60%	55%
Nonsingle	869.6	1244	1819.6	2503.4
	48%	43%	40%	37%
APE	879.8	1255.756	1839.1648	2533.7254
	48%	47%	43%	38%
NBAP (16%)	**140.8**	**200.9**	**294.3**	**405.4**
NBAP (18%)	**158.4**	**226.0**	**331.0**	**456.1**
Valuation multiple				
16	2252.3	3214.7	4708.3	6486.3
18	2533.9	3616.6	5296.8	7297.1
Kotak's Share @ 74%	1666.7	2378.9	3484.1	4799.9
Value per share of Kotak	**48.1**	**68.7**	**100.6**	**138.6**

Source: ICICIdirect research

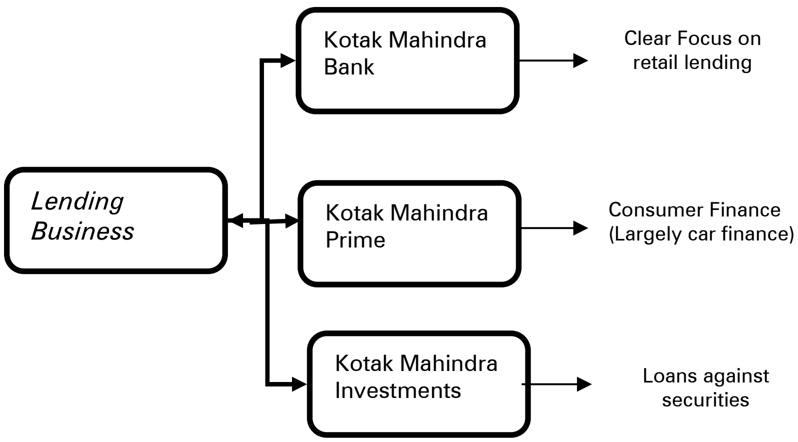
We value KMOM at Rs.139 per share of KMB or Rs 4800 crore (Kotak's share @74%).

Lending business: The genesis of the emergence of Kotak Group

Kotak began operations as a trade finance company in 1986 and was predominantly engaged in consumer lending. However over the years, as the group began expanding its financial services offerings, the share of profits from the lending business has declined. While broking and IB would continue to account for a large share of the group's profits, we expect the profit contribution of the lending business to improve substantially. Kotak carries out its lending business through three entities – Kotak Mahindra Bank, Kotak Mahindra Prime and Kotak Mahindra Investments – each focusing on a niche segment.

The birth of KMB can be traced back to 1986 where it started as NBFC engaged in consumer lending.

Exhibit 50: Segments of lending business



Source: Company, ICICIdirect Research

Kotak Mahindra Bank (KMB)

Kotak started off its financial services, four years ago through Kotak Mahindra Finance (now KMB). It was one of the two institutions awarded a license to operate as a bank in 2002 (the other being Yes Bank). Till then, Kotak operated as a non-banking finance company (NBFC) with interests in consumer loans, broking, investment banking and asset management. It converted to a bank in 2003 to increase its source of revenues and lower its funding costs. Venturing into banking also helped the group to broad-base its revenue streams and de-risk business model from gyrations in capital markets to provide more stability to the earnings. The revenues from banking business grew at a 60% CAGR over FY03-07 and now form 43% of consolidated revenues (excluding insurance). At PAT level, it accounts for 24% of the consolidated PAT. KMB is a relatively smaller size private bank but the banking business has it owns niches in terms of its area of operations and the cadre of customers it caters to (retail and affluent HNIs) and stressed assets portfolio (potential booster for profits going forward).

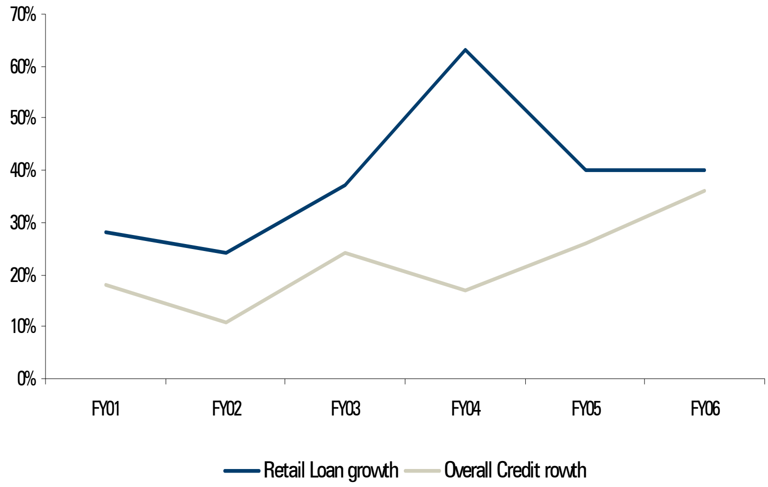
KMB was one of the two private entities to get a banking license back in 2002

Niches will be triggers for scalability and growth of lending business

India's growth unlike other emerging economies is purely a economy which is powering ahead because of the emergence of the middle class and the lower middle class (increase in per capita income, high propensity to consume and save and finally invest). This has directly played its impact on the retail credit which in past two years has grown at a CAGR of 40%. Retail loans, as a percentage of gross advances, increased from 22% in FY04 to 25.5% in FY06. This segment was perfectly penetrated by banks like ICICI Bank and HDFC Bank particularly through auto loans, mortgages, personal loans, and credit cards.

KMB is relatively small bank but the business model has it own niches in terms of area of operations and the class of customers it caters to

Exhibit 51: Retail credit growing faster than overall credit

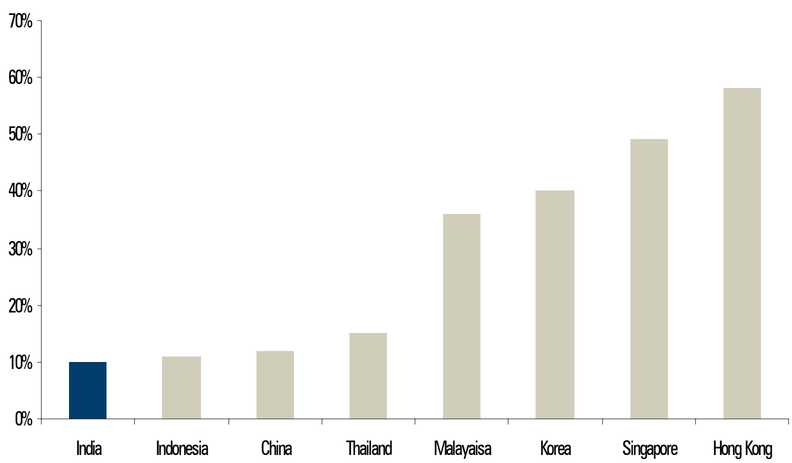


Source: RBI

Growth in retail credit yet to see its best

We believe that the consumer loans industry has lot of steam left, given the strong growth in GDP, rising income levels, high propensity to consume and lower penetration of consumer financing. As of now retail loans constitute just 10% of our GDP. Consumer banking has got a fresh lease of life with maturing/advent of new generation private sector banks. It is now a proven fact that the Indian consumer is more credit hungry with rising income levels and favourable demographics.

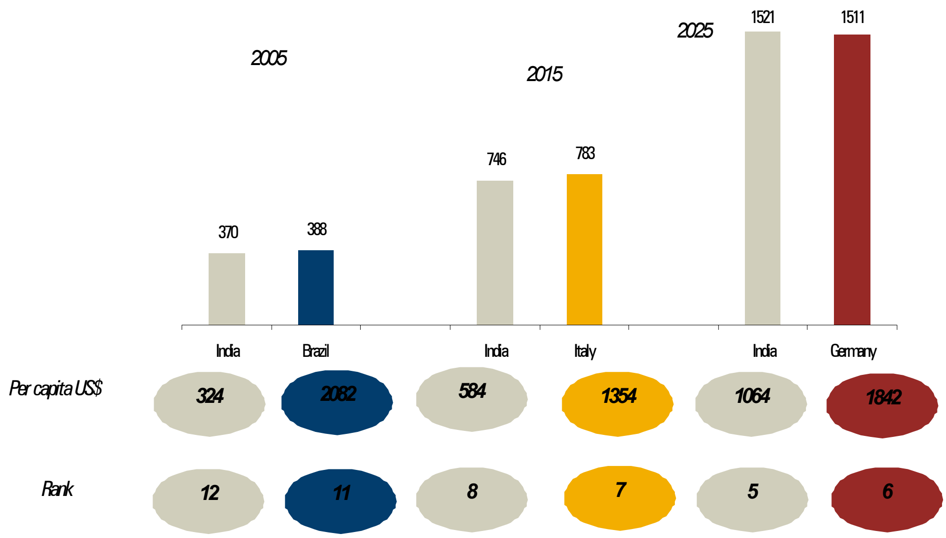
Exhibit 52: Consumer credit as a % of GDP - Best is yet to come



The consumer loans industry has lot of steam left, given the strong growth in GDP, rising income levels, high propensity to consume and lower penetration of consumer financing

Source: United Nations, ICICIdirect research

Exhibit 53: Private consumption to grow



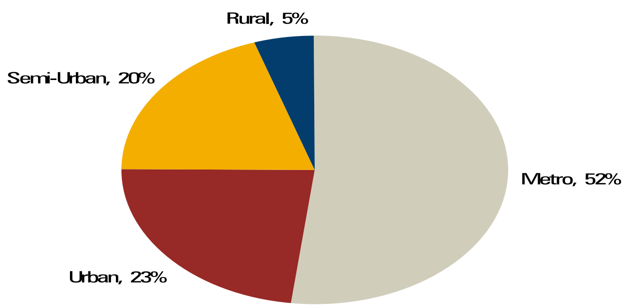
Source: Mckinsey MGI consumer data, ICICIdirect Research

KMB would be a direct beneficiary because of its focus on the niche area of HNIs and mass affluent (rising middle class).

KMB offers a wide range of products and services targeted at retail customers, delivered through a state of art technology platform. KMB focuses on convenience banking and value added services for its customers and provides a host of services (apart from normal lending) like depository services that allows the customers to buy securities. It also provides tailored investment services to individual and HNI clients in various stages and economic cycles. Also the bank is planning to cater to middle and lower end of the Indian population. In other words, they are also taking the fact that the "gold always lies at the bottom of the pyramid". KMB is mainly a metro/sub-metro centric bank focusing on HNIs and mass affluent customers to scale up its business.

KMB has a clear focus on convenience banking and value added services for its clients.

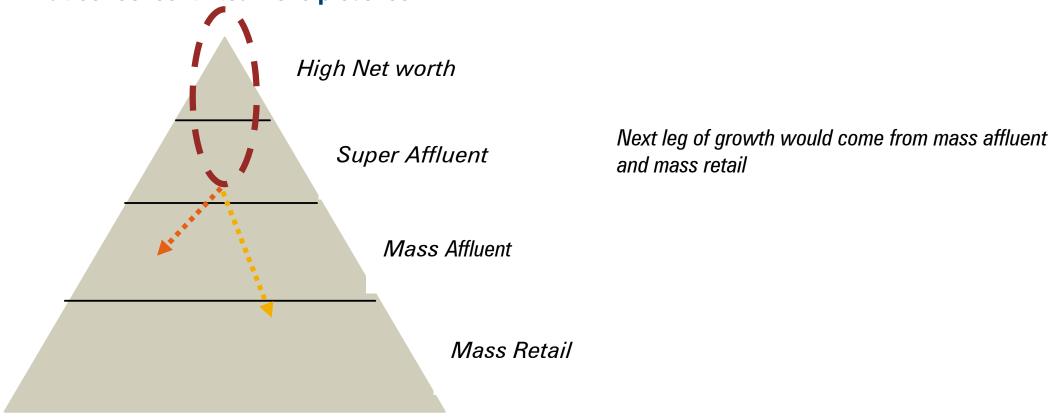
Exhibit 54: Concentrated niche presence



KMB is mainly a metro / sub metro centric bank focusing on HNI's and mass affluent clients.

Source: Company, ICICIdirect Research

Exhibit 55: Concentrated niche presence



Source: Company, ICICIdirect Research

The bank is planning to reach by expanding the network of its branches across the country. KMB started with a single branch in 2003 and very rapidly ramped up its branches to 133 by H1FY08. We believe that KMB is in a sweet spot to tap the retail opportunity by taking the count of its branches to 200 by FY09E. This will help the bank to grow its retail advances (retail loans form the maximum proportion of its loan book). Singular focus and a low base would enable to register healthy growth on the advances and deposits side.

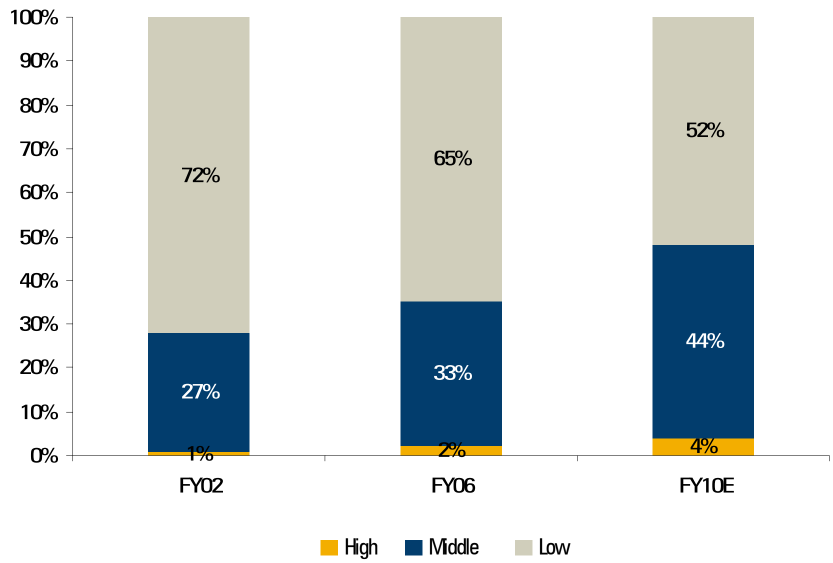
Wealth management services: The first mover advantage

KMB also has a wealth management unit, which focuses on HNIs. The group's scale and reach, coupled with a strong brand has enabled the bank to scale up its wealth management unit. Kotak is currently the wealth manager/advisor to over 3,700 families and around 30% of the top-300 wealthy families in India. It is present in 14 cities, with about 110 relationship managers.

With strong economic prospects forecasted, we believe that wealth management should grow at a much stronger pace. Under the wealth management segment it provides services like distribution of mutual funds, life insurance, private equity, PMS services, real estate fund and IPOs. This in turn generates tremendous business opportunities for the other business verticals of Kotak group and enhances fee and distribution income for KMB

According to NCAER, about 250,000 households in India have investible assets of over Rs 1 crore each, aggregating to ~Rs 450,000 crore. NCAER further projects that by 2009, India would have 400,000 households with investible assets of over Rs1 crore each. We believe wealth management offers a huge and highly profitable opportunity and very few Indian banks are currently focusing on this segment. We expect Kotak to remain a dominant player in this business, given its established relationships and synergies arising out of its IB and asset management businesses.

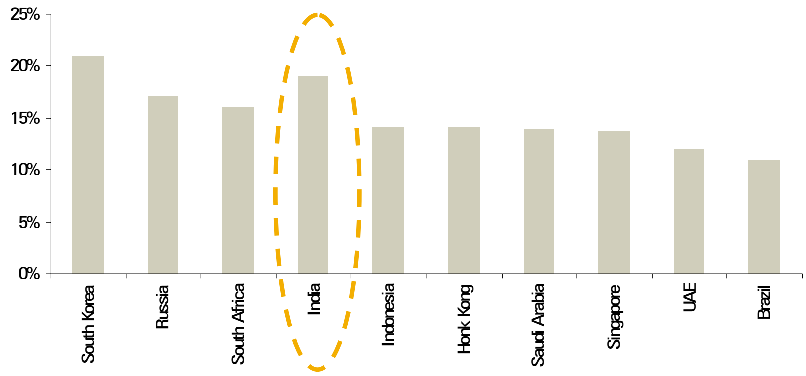
Exhibit 56: Rising middle class to create demand for wealth management services



Source: NCAER, ICICIdirect Research

We believe KMB's wealth management division would grow in leaps and bounds as it has the first mover advantage. Another factor generating demand for wealth management services is the fast rapid pace at which the HNIs are growing in India. The pace of rise in the number of HNIs is the second highest in India followed by South Korea.

Exhibit 57: Pace of HNI growth one of the fastest in India



Source: World wealth report, ICICIdirect Research

Stressed assets portfolio: A hidden gem

KMB, apart from the normal banking, also runs a stressed assets book by purchasing bad loans from different banks, resolving faulty accounts, and recovering maximum possible amount. The bank has stressed assets principal outstanding of Rs 39,000 crore as on 9MFY08, for which it had paid Rs 600 crore, thereby leaving better scope for recovering the buying price. The bank initially started off this business by buying distressed loans, primarily from corporates. However, recently it has tapped retail distressed loans too, particularly from three parties: Citibank, ICICI Bank, and Tata Motors.

-The bank has also tapped organizations like Citibank, ICICI Bank and Tata Motors to buy their distressed assets

However, the management expects the current portfolio of these assets to yield a handsome profit over the next 2-3 years and intends to further consolidate its presence in this business. The business involves big execution risk. Nevertheless, considering the enhanced legal system support for recovery of NPAs, improving economic conditions across industries in India, and sharp rise in prices of real estate, which is usually the collateral could yield windfall gains in the next 12-24 months.

- The management expects to earn a profit of Rs 500 crores over next 3 years

Retail advances to continue dominating loan book

KMB is a relatively smaller playing in the banking space with a market share of less than 1%.But the focus of the bank always has been the retail segment because of which it has been able to garner better yields on advances. The yield on advances has averaged at 11.6%-11.7% levels and we believe KMB to at least earn 11% yields on advances by FY10E. Because of a low base and a singular focus strategy (focusing on retail clients and a metro-centric focus), we believe that KMB will witness a robust surge in advances. We believe that the advances will grow at a 50% CAGR to reach Rs 36,683 crore. Out of this, we believe that retail loans would continue to dominate, though within the retail book segment churning might happen with tilt towards higher yielding asset book. This is quite evident from the fact that over the year's share of commercial vehicle lending has gone down and simultaneously shares of home loans and personal loans have gone up in the retail loan book.

Due to low base effect, we expect KMB's loan book to grow at a CAGR of 50% over FY07-10E

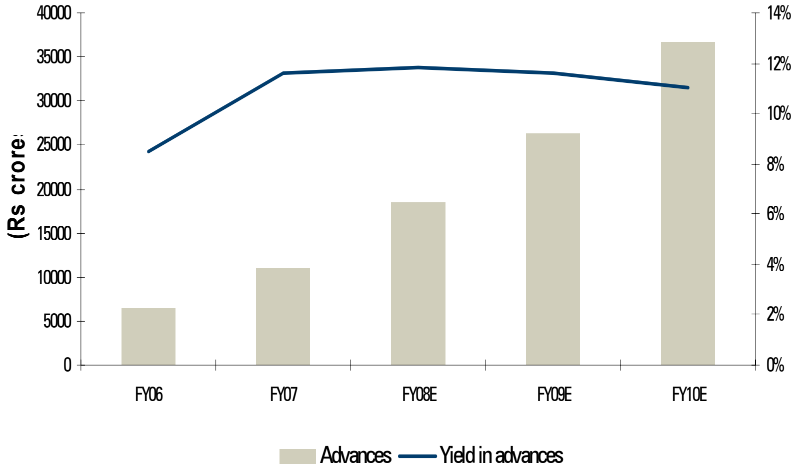
Exhibit 58: Changing Asset mix

	Mar-03	Sep-04	Sep-05	Sep-06	Sep-07
Commercial Vehicles	57%	53%	38%	26%	24%
Personal Loans	15%	15%	16%	17%	19%
Home Loans	0%	8%	13%	16%	16%
Corporate Banking	17%	15%	20%	23%	19%
Others	11%	9%	12%	19%	22%
Total Advances	100%	100%	100%	100%	100%

Source: Company, ICICIdirect Research

The advance book will be dominated by the retail category which in sync with the strategy of the bank

Exhibit 59: Growth in advances and yield on advances to remain healthy



The total advances book is expected to touch Rs 36000 crores by FY10E

Source: ICICIdirect Research

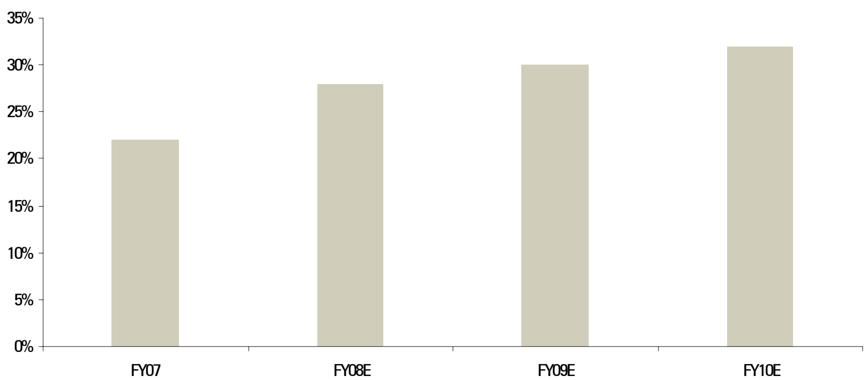
In the corporate segment, KMB is following an integrated approach, given the expertise and scale built by the group in various financial services domains over the years. It would offer a unique basket of products for each customer segment. Kotak intends to tap group synergies for cross-selling, with the bank providing the relationship channel for the group. The bank also provides a wide range of debt and fixed income products. Also KMB aspires to be a serious player in the debt markets by building up quality debt portfolio and sell it to debt investors.

Increase in branches to augment the CASA and resources.

KMB started its operations in 2003 with a single branch but has significantly ramped up its branches to 133 as on H1FY08 and plans to reach the 200 mark by this fiscal. This would significantly help KMB augmenting its low cost deposits or CASA and deposits base. Branch expansion has aided CASA which stood at 22% as on March 2007 and 26% as of September 2006. Even being a banker for many of the IPO mandates also gives the float of IPO money to the bank. Given its focus on HNI and retail clients we expect the CASA ratio to reach 32% by FY10E.

We expect the NIM's to remain in the range of 4.8%-4.9% till FY10E.Also benefit of branch expansion will increase the CASA which will keep the NIM's buoyant

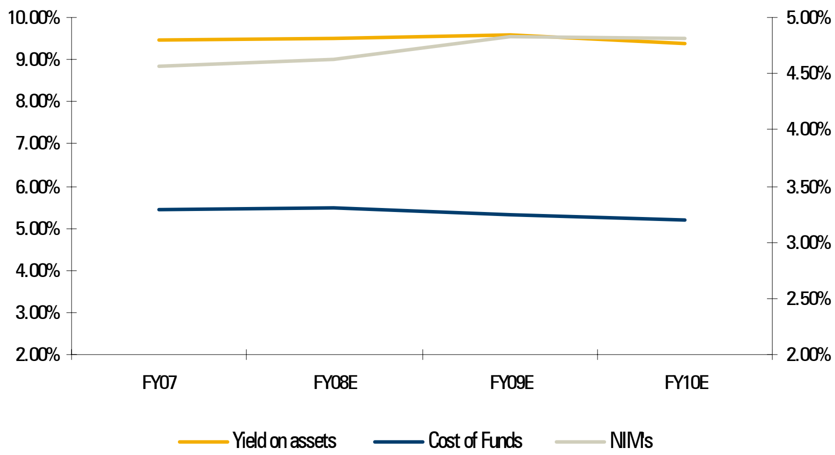
Exhibit 60: Branch expansion to bring in CASA benefit



Source: ICICIdirect Research

Another benefit of branch expansion would be better NIMs as a result of increase in CASA. We expect the deposits to grow at a 53% CAGR to reach Rs 31,395 crore mark. This, aided by high pricing power in retail lending, will sustain NIMs at superior levels of 4.8% - 4.9% till FY10E.

Exhibit 61: NIMs to remain robust going forward



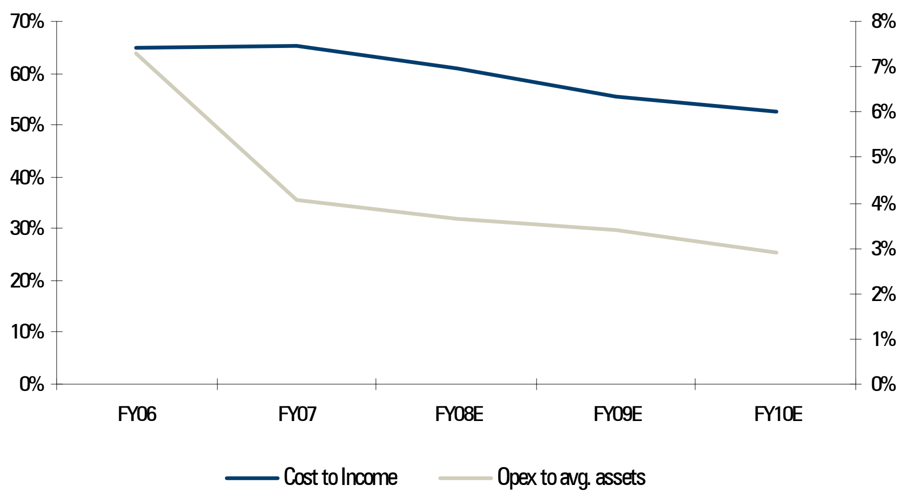
Source: ICICIdirect Research

Expansion plans to keep cost-income ratio relatively high.

KMB has aggressively ramped up its branches to 149 in a span of three years and is targeting to take this tally to 200 by CY08. This has a direct impact on the cost- income ratio, which has been high for KMB given the fact that most of the branches take 18-20 months to break even. As we move ahead the cost- income ratio would come down but relatively will remain high. Even the expansion plans would result into adding more employees which will keep the operating expenses on the higher side. We believe the cost to income ratio to come down from 65% in FY07 to 53% by FY10E.

Ambitious target of 200 branches would keep the cost-to –income ratio high. We expect the ratio to be at 53% in FY10E.

Exhibit 62: Cost – Income ratio to remain high



Source: ICICIdirect Research

Robust fee income to continue going forward:

KMB provides a host of non traditional financial products in the form of wealth management services to HNI clients, various debt and fixed income products to corporate clients, forex, derivatives and NRI remittances. Also KMB enables cross selling of various products designed by the other verticals of the Kotak group (Share trading & depository services, IPO's, margin funding for securities and IPO's etc.) This would result in high traction in the fee income of the bank which we believe to grow at CAGR of 33% over FY07-FY10E. Also recovery on NPA's and the stressed assets front would provide further boost to the non interest income and profitability.

-Provides host of non traditional financial services in the form of debt and fixed income products to corporates.

- KMB also garners healthy fee income from the cross selling of products designed by the other verticals of the business group

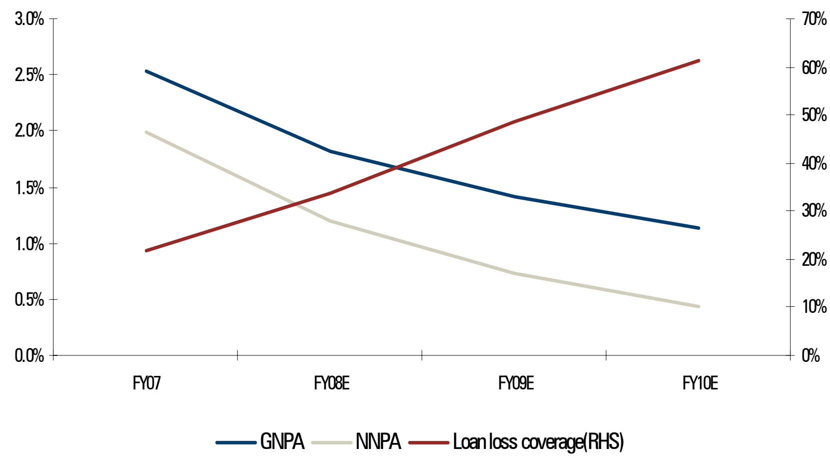
Asset quality to remain healthy

There are always chances of high NPA's for KMB as 75%- 80% of its book is exposed to the retail credit. Also the stressed assets book creates a cause of concern for asset quality. But as a result of effective risk management and credit appraisal processes at the bank and also the management asserts that its credit sanction, control and monitoring systems are very strong. The GNPA and NNPA for FY07 have been at 0.5% and 0.2 %(excluding stressed assets) respectively. Going forward we believe that the asset quality would be sustained and we expect the GNPA and NNPA to be at 1.13% and 0.44% respectively by FY10E.

- We expect the GNPA and NNPA to be at 1.13% and 0.44% respectively

- NNPA's can also rise going forward due to the exposure to the Stressed assets portfolio which has gone up to Rs. 5 bn in the current fiscal

Exhibit 63: Asset quality to sustain



Source: ICICIdirect research

Risks and Concerns

Businesses Significantly Correlated to Capital Markets.

KMB's business verticals like the securities business, asset management and investment banking business are directly leveraged to performance of the capital markets in India, with the performance of all businesses in which it is present being dependent on capital markets. Hence, in the event of any severe downturn in capital market, KMB's profitability may get adversely impacted.

Fragmentation in the financial services space might impact pricing power.

Most segments of the financial services sector are highly fragmented. This signifies the fact that the entry barriers to the industry are low and therefore puts pressure on the pricing power and profitability.
Of late the consolidation has started taking place in the sector but if any unwarranted consolidation in the sector may lead to pricing wars in the industry. The asset management and brokerage segments have a high degree of market fragmentation, as a result of which pricing power tends to be in the hands of intermediaries and end-consumers, rather than market players.

Exposures to exotic derivatives might result in credit losses

KMB has designed various exotic derivative products for the corporate clients. This has been done for corporate to hedge their forex exposure. Any adverse movements in the spreads might result in providing mark-to-market losses and also credit losses for the bank if the corporate client refuses to honour the obligation.

Insurance business still small in size

Scalability of insurance business is essential for deriving the expected valuations. In case of slower insurance premium collection due to competition, valuation of the insurance business may take a hit.

VALUATIONS

We like Kotak Mahindra Bank for its diversified business mix. The bank is in a sweet spot as it is in a position to cash in on the ongoing boom in the financial services space We also believe that the pedigree of the management at helm will guide KMB to be the leader in the securities and investment banking business and also scale up the lending, asset management and insurance business.

We have valued Kotak Mahindra Bank at 3x FY10E BV and we believe that the bank will be able to continue commanding such valuations with ROE's expected to rise to 20% in FY10E from 11.3% in FY07.. We derive bank's value at Rs. 400 per share in total valuation of Rs. 1065 per share based on SOTP methodology.

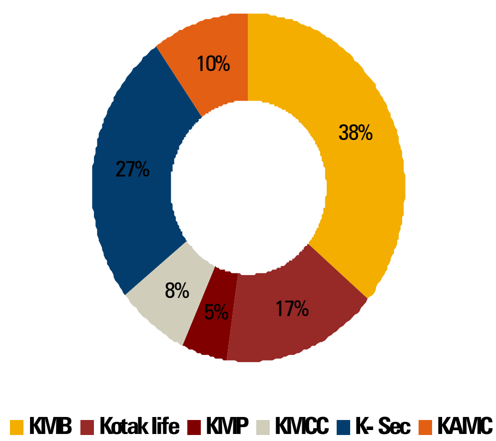
Exhibit 64: Arriving at the value…

SOTP valuation	Basis of valuation	Rs. Per share
KMB	3x FY10E ABV	400
Kotak life	16x NBAP at 16% margin	178
KMP	1.1x FY10E networth	52
KMCC	20x FY10E PAT	82
K- Sec	20x FY10E PAT	283
KAMC	5% to 8% of FY10E AUM based on asset class and 8% of FY10E AUM of Offshore funds and alternate assets	110
		1065

Source: ICICIdirect research

We arrive at an SOTP value of Rs. 1065 per share of Kotak Mahindra bank, giving an upside of 59% from CMP of Rs. 670. With all the businesses in financial services space expected to do well in India, we believe 'kotak' one of the oldest and recognized brands in India will definitely benefit from the same.

Exhibit 64: Share of business segment in valuation



Going forward we believe that the Bank, asset management and insurance business will enhance the value of the shareholders

Source: ICICIdirect Research

Standalone
Profit and Loss Account

(Rs.Crores)

	FY2007	FY2008E	FY2009E	FY2010E
Interest Earned	1354	2285	3283	4454
Interest Expended	699	1173	1628	2168
Net Interest Income	**655**	**1112**	**1655**	**2286**
% growth	1	1	0	0
Non Interest Income	284	386	518	662
Fees and advisory	187	253	334	443
Trading Income and sale of Invt.	-19	-25	-23	-19
Other income	12	16	21	24
Net Income	**939**	**1498**	**2174**	**2948**
Employee cost	293	424	525	631
Other operating Exp.	320	490	685	918
Operating Income	**326**	**584**	**964**	**1398**
Provisions	123	118	140	160
PBT	**203**	**466**	**824**	**12375**
Taxes	62	147	264	396
Net Profit	**141**	**319**	**560**	**842**
% growth	20%	126%	75%	50%

Balance Sheet

(Rs. Crores)

	FY2007	FY2008E	FY2009E	FY2010E
Liabilities				
Capital	326	343	343	343
Reserves and Surplus	1307	3160	3620	4314
Networth	**1634**	**3503**	**3964**	**4657**
Deposits	11000	18540	26068	36722
Borrowings	5100	6555	8341	10427
Subordinated Debt	626	532	718	790
Other Liabilities & Provisions	1528	1247	1327	1355
Total	**19887**	**30377**	**40418**	**53952**
Assets				
Fixed Assets	141	169	196	207
Investments	6862	8780	10870	13127
Advances	10924	18365	26263	36683
Other Assets	664	798	328	709
Cash with RBI & call money	1296	2264	2762	3224
Total	**19887**	**30377**	**40418**	**53952**

Ratio Analysis

Ratios	FY2007	FY2008E	FY2009E	FY2010E
Valuation				
No. of Equity Shares	32.6	34.3	34.3	34.3
EPS (Rs.)	4.3	9.8	17.2	25.8
BV (Rs.)	50.1	107.4	121.5	142.8
BV-ADJ (Rs.)	43.4	100.7	115.7	133.1
P/E	156	68	39	27
P/BV	13.4	6.2	5.5	4.7
P/adj.BV	15.4	6.7	5.8	5.0
Yields & Margins				
Yield on average interest earning assets	9.4%	9.5%	9.6%	9.4%
Avg. cost on funds	5.5%	5.5%	5.3%	5.2
Net Interest Margins	4.6%	4.6%	4.8%	4.80%
Avg. Cost of Deposits	4.8	5.9	5.7	5.50%
Yield on average advances	11.6%	11.8%	11.6%	11%
Profitabilty				
Interest income/ total avg. assets	9.0%	9.1%	9.3%	8.32%
Non-interest income/ Net income	30.2%	25.8%	23.8%	22.50%
Net-interest income/ Net income	40.0%	41.6%	43.5%	44.68%
Cost / Total net income	65.3%	61.0%	55.7%	53%
Quality and Efficiency				
Credit/Deposit ratio	99.3%	99.1%	100.7%	100%
GNPA%	2.5%	1.8%	1.4%	1.13%
NNPA%	2.0%	1.2%	0.7%	0.44%
RONW (%)	11.4%	12.4%	15.0%	20%
ROA (%)	0.9%	1.3%	1.6%	1.57%

RATING RATIONALE

ICICIdirect endeavors to provide objective opinions and recommendations. ICICIdirect assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Outperformer, Performer, Hold, and Underperformer. The performance horizon is 2 years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Outperformer: 20% or more;
Performer: Between 10% and 20%;
Hold: ±10% return;
Underperformer: -10% or more.

Harendra Kumar **Head - Research & Advisory** **harendra.kumar@icicidirect.com**

ICICIdirect Research Desk,
ICICI Securities Limited,
Mafatlal House, Ground Floor,
163, H T Parekh Marg,
Churchgate, Mumbai – 400 020

research@icicidirect.com

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