

October 30, 2015

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Rating	Accumulate
Price	Rs688
Target Price	Rs715
Implied Upside	3.9%
Sensex	26,657
Nifty	8,066

(Prices as on October 30, 2015)

Trading data

Market Cap. (Rs bn)	1,062.2
Shares o/s (m)	1,544.7
3M Avg. Daily value (Rs m)	890.8

Major shareholders

Promoters	33.77%
Foreign	34.67%
Domestic Inst.	4.22%
Public & Other	27.34%

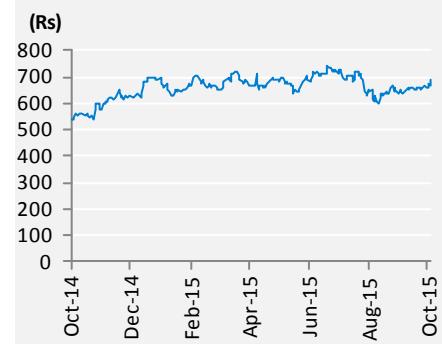
Stock Performance

(%)	1M	6M	12M
Absolute	6.1	3.2	25.7
Relative	4.2	4.5	28.2

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2016	20.9	21.4	-2.6
2017	25.3	31.5	-19.6

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



Source: Bloomberg

KMB's Q2FY16 consolidated PAT of Rs9.42bn was above estimates (PLe: Rs7.8bn) as Bank earnings starts returning on track. Merger has started slowing stabilizing into the Bank as Q2FY16 witnessed lower integration & credit costs. Loan growth at 11% YoY remained slow, but management remains confident to return to 20% growth trajectory in Q3FY16. Overall consolidated PAT was led by securities & AMC biz, while Kotak Prime & insurance biz continue to remain sluggish. Stress from the combined book remained static at 2.5% of loans, while Q2FY16 saw marginal stress adding up from e-IVBL book. We believe, synergies from the merger will start reflecting in return ratios only from mid FY17, as KMB is still in process of integrating credit underwriting & technology systems and selectively unveiling products in its network. We retain 'Accumulate' with PT of Rs715.

- **Slow core performance, but getting back on track:** S'lone PAT of Rs5.7bn was on lower integration cost, investment depreciation write-back & steady credit costs. Bank's core performance has started getting back on track but remained slow with sluggish advances growth of 11% YoY (merged book) mainly driven by retail & Agri, however, management re-affirmed to bring back growth of 20% in Q3FY16. Fee income growth also remained modest on one off items but is still being led by TPD fees. Management guided fees growth of 15-20% going ahead as they are already witnessing higher transactions value esp. on retail side.
- **CASA growth traction continues:** KMB has witnessed granular CASA growth on higher rate offering of 6% to IVBL customers which has improved CASA growth of the erstwhile Bank from ~10-12% in FY15 to ~23% currently and has enabled to improve overall CASA ratio to ~34% for the merged entity. Management is targeting to improve the CASA ratio further to 40% going ahead.
- **Asset quality largely stable; capital market subs doing well:** Asset quality was largely stable with GNPs/NNPs at 2.4% & 1.1% v/s 2.3% & 1.0% in Q1FY16 respectively. Credit costs was steady at 90bps (incl. bad derivative transaction) and continues to guide 80bps of credit cost for FY16. Overall stressed assets (transferred into recovery department so called 'Bad Bank' in Q1FY16) remained static at 6% of IVBL's fund + non-fund exposure or 2.5% of merged book. On the subsidiaries side, capital market businesses continue to do well propelling profitability in the consolidated business.

Key financials (Y/e March)	2014	2015	2016E	2017E
Net interest income (Rs m)	48,382	52,991	66,280	80,666
Growth (%)	16.1	9.5	25.1	21.7
Operating profit (Rs m)	37,669	43,178	54,388	66,127
PAT (Rs m)	22,858	27,367	32,257	39,156
EPS (Rs)	14.8	17.7	20.9	25.3
Growth (%)	11.3	19.4	17.9	21.4
Net DPS (Rs)	0.4	0.5	0.6	0.8

Profitability & Valuation	2014	2015	2016E	2017E
NIM (%)	4.50	4.43	4.66	4.62
RoAE (%)	13.7	13.9	14.4	15.2
RoAA (%)	2.13	2.29	2.27	2.24
P / BV (x)	5.7	5.1	4.5	3.9
P / ABV (x)	5.8	5.2	4.5	3.9
PE (x)	46.3	38.8	32.9	27.1
Net dividend yield (%)	0.1	0.1	0.1	0.1

Source: Company Data; PL Research

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Exhibit 1: Q2FY16 – Operating performance getting back on track

Standalone Bank*	2Q15	1Q16	2Q16	YoY gr.	QoQ gr.
NII	10,389	15,982	16,787	61.6%	5.0%
Other income	4,665	5,924	6,157	32.0%	3.9%
Total Revenues	15,054	21,906	22,945	52.4%	4.7%
Employee expense	3,545	9,288	6,230	75.7%	-32.9%
Other expense	4,172	6,649	6,267	50.2%	-5.7%
Operating expense	7,717	15,937	12,497	61.9%	-21.6%
PPOP	7,336	5,970	10,448	42.4%	75.0%
Provisions	537	3,053	1,764	228.8%	-42.2%
PBT	6,800	2,917	8,684	27.7%	197.7%
Tax	2,355	1,019	2,989	26.9%	193.3%
PAT	4,445	1,898	5,695	28.1%	200.1%
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Consolidated PAT					
Standalone Bank	4,445	1,898	5,695	28%	200%
Kotak Prime	1,250	1,190	1,270	2%	7%
KMCC	-70	30	70	-143%	133%
Kotak Securities	660	670	780	18%	16%
International subsidiaries	130	250	320	146%	28%
Kotak AMC	-10	200	230	-2400%	15%
Kotak Investment Advisors	40	0	0	-100%	NA
Kotak Mahindra Investments	250	300	360	44%	20%
Lending business	5,695	3,088	6,965	22%	126%
Flow business, Subsidiaries	1,000	1,450	1,760	76%	21%
Consolidated PAT (ex insurance)	6,695	4,538	8,725	30%	92%
Insurance	520	660	480	-8%	-27%
Consolidated PAT	7,215	5,198	9,205	28%	77%

Source: Company Data, PL Research

*Please note: Yearly financials for Standalone Bank are not comparable on ING-Kotak merger

Key Q2FY16 Concall highlights:

Updates on business from merger:

- Have integrated the retail banking business from the IVBL into KMB in Q2FY16.
- **Liabilities** – Seeing traction in CASA for erstwhile IVBL which saw growth of 23% YoY which used to be 10-12% in past few quarters.
- **Assets/Products** – Started selling Auto products (Kotak Prime) in e-IVBL branches (312 branches) which was not there in the erstwhile Bank. SME book (largely trader book) continues to see traction, with robust asset quality of 25bps on loans. Some of the products have been unified in merged co like gold loans, personal loans, LAP.
- **Cross selling** – Insurance products were introduced in Q4FY15 and have seen good traction.

Balance sheet – Growth/Outlook:

- **Loan book** – Loan growth on merged basis YoY stands at ~11% and management confident to reach to 20% YoY growth by Q3FY15 end. Have rationalized certain exposures and also exited some exposures and hence have seen flattish growth in wholesale loan book. **Outlook:** Continue to guide 20% YoY loan growth in FY16. Traction to pick-up from Wholesale in coming quarters, while retail/SME traction will continue.
- **CASA** – CASA ratio currently at 33% and CASA would come back to 35% in next 2-four quarters and would like to move towards 40% going ahead.
- **Mortgages/LAP** – Still seeing good growth but certain segment of market have got aggressive but KMB continues to have stable metrics on LTVs, yields and asset quality. Historically, 60% of e-IVBL book has been SME/LAP.
- **Agri** – KMB was lacking on agriculture financing business, but on merger have acquired decent agri portfolio offering crop loans, tractor financing & broader Agri Financing. Have seen decent growth in Agri Financing, while tractor loan remains soft. Crop loans are basically Kisan Credit Card (KCC) with business being flattish as integration of risk system, credit underwriting etc has taken time.

Margins:

- Margins are likely to remain between 4.1-4.3 percent going ahead.

Fees, Opex & capacity building:

- **Fees** – remains tepid (on merged entity) on one-off income in e-IVBL in Q2FY15, while hit from bad derivative transaction. However, transactions value has picked up and confident fee income to return back to trend levels.

- **Opex** – Opex costs were flat sequentially on lower merger cost incurred of Rs120mn (v/s Rs630mn in Q1FY16) and lower advertisement costs.
- **Branches** – Plan to take branches to 1300 by end March.

Asset Quality:

- Have seen marginal stress from the e-IVBL book in Q2FY16, but total stressed asset book remains at 6% of e-IVBL's fund based + non-fund or 2.5% of combined book.
- **Credit cost** – Credit cost in Q2FY16 was ~80-90bps to advances (merged). **Outlook:** Have been guiding 35bp of credit cost on KMB book, while 50bps on VYSB's asset quality and still maintain the total credit cost guidance of 80bps for FY16.

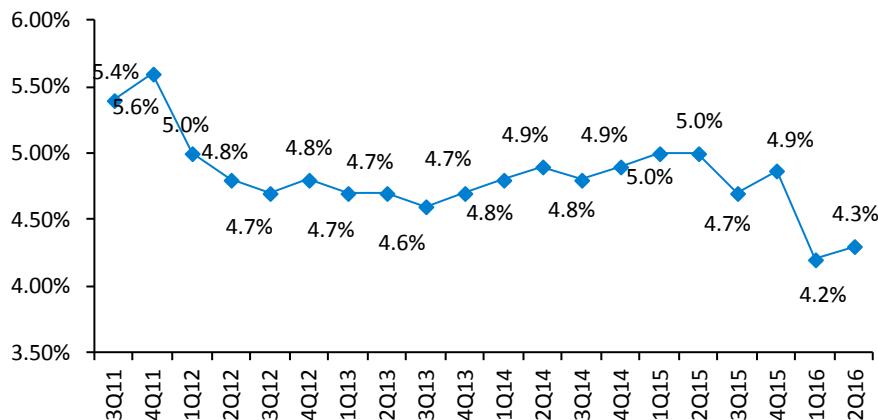
Subsidiaries:

- **Insurance** – KMB has contributed 60% growth to incremental insurance business, while also offer insurance at 95% of the e-IVBL branches.
- **Kotak Prime** – Shifting strategy to make Kotak Prime as an asset finance company catering to financing auto vehicles (so have seen some other businesses draw down).

Digital initiatives:

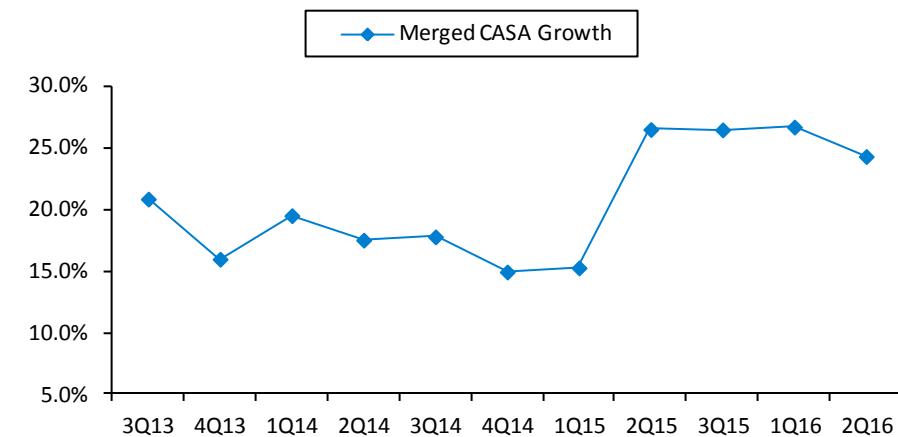
- Launched 'Bharat Banking' app which does not require internet connection and can do 23 different transactions incl. small value fund transfer
- 8% market share in mobile banking transactions. Have seen 81% growth from YTD till July in mobile transactions..

Exhibit 2: Margins improve sequentially on lower interest reversals & benefit from cost of funds



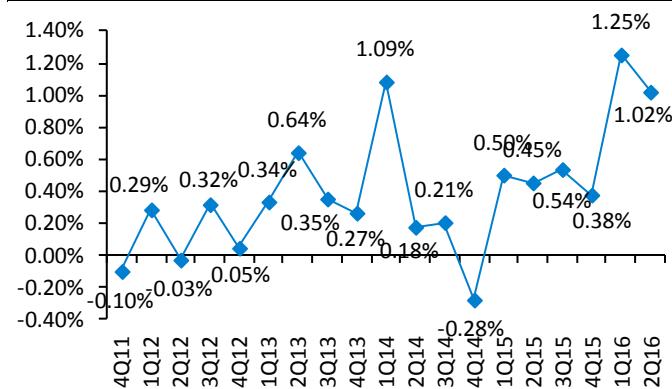
Source: Company Data, PL Research

Exhibit 3: CASA growth on merged basis continues to remain robust mainly led by SA



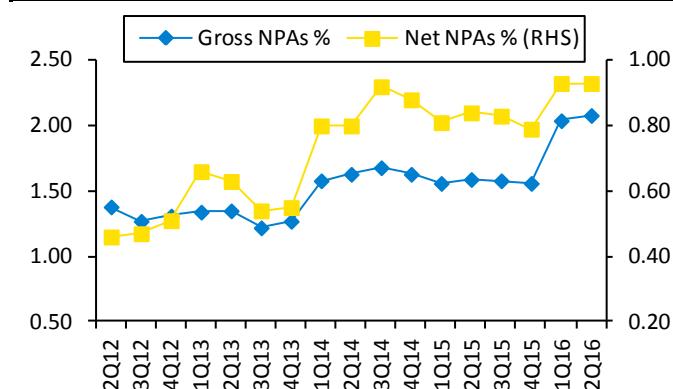
Source: Company Data, PL Research

Exhibit 4: Credit cost steady on lower slippages



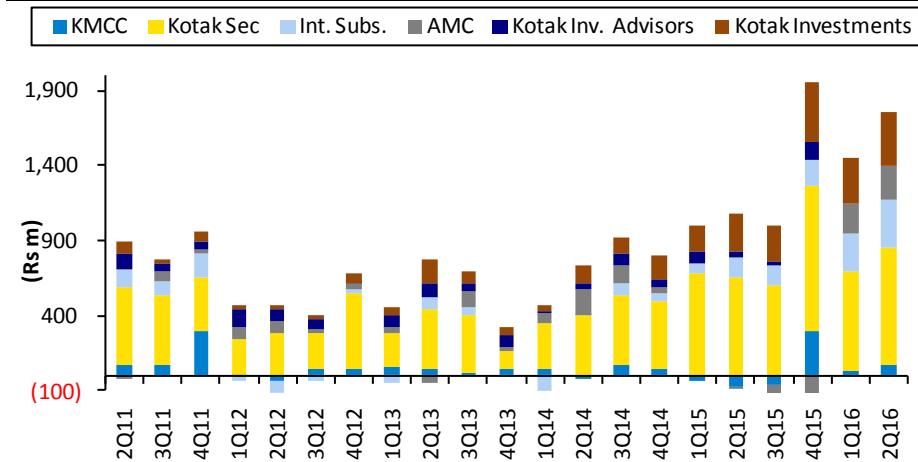
Source: Company Data, PL Research

Exhibit 5: Asset quality remains stable as most pain taken in Q1FY16



Source: Company Data, PL Research

Exhibit 6: Subsidiary businesses continue to hold up steady



Source: Company Data, PL Research

Exhibit 7: Q2FY16 - Subsidiary performance break-up - Insurance profitability remains sluggish

	2Q15	1Q16	2Q16	YoY gr.	QoQ gr.
Kotak Mahindra Bank					
PAT	4,445	1,898	5,695	28.1%	200.1%
Kotak Mahindra Prime (KMP)					
Profit before royalty & taxes	1,900	1,830	1,950	2.6%	6.6%
PAT	1,250	1,190	1,270	1.6%	6.7%
KMCC					
PAT	-70	30	70	NA	NA
Kotak Securities					
Total income	2,240	2,500	2,700	20.5%	8.0%
PAT	660	670	780	18.2%	16.4%
Kotak Asset Management					
PAT (AMC and Trustee Co.)	-10	200	230	NA	15.0%
Kotak Insurance					
Gross premium income	6,680	3,880	8,420	26.0%	117.0%
Profit	520	660	480	-7.7%	-27.3%
International subsidiaries					
PAT	130	250	320	146.2%	28.0%

Source: Company Data, PL Research

Exhibit 8: Consolidated ROEs - Merger synergies to reflect in return ratios in FY17, while subsidiary value addition to be gradual

ROA Decomposition	2011	2012	2013	2014	2015E	2016E	2017E
Net Interest Income	5.40%	4.77%	4.60%	4.64%	4.58%	4.60%	4.52%
Fees	3.03%	2.59%	2.16%	2.15%	2.41%	2.37%	2.22%
Investment profits	0.16%	0.15%	0.18%	0.20%	0.25%	0.13%	0.10%
Net revenues/Assets	8.60%	7.51%	6.93%	6.99%	7.24%	7.10%	6.85%
Operating Expense	-4.43%	-3.85%	-3.44%	-3.38%	-3.64%	-3.46%	-3.26%
Provisions	-0.29%	-0.14%	-0.23%	-0.31%	-0.12%	-0.19%	-0.18%
Taxes	-1.19%	-1.13%	-1.05%	-1.11%	-1.14%	-1.13%	-1.12%
Total Costs	-5.91%	-5.12%	-4.73%	-4.80%	-4.90%	-4.78%	-4.56%
ROA	2.69%	2.39%	2.20%	2.19%	2.34%	2.32%	2.28%
Equity/Assets	17.31%	16.56%	15.20%	16.06%	16.89%	15.89%	14.81%
ROE	15.5%	14.4%	14.5%	13.7%	13.8%	14.6%	15.4%

Source: Company Data, PL Research

Exhibit 9: We maintain 'Accumulate' with TP of Rs715 based on Mar-17 adjusted book for Bank & Kotak prime, while on SOTP basis for subsidiaries

	Value (Rs m)	Per Share (Rs)	Valuation Basis
Kotak Securities	63,782	41	20x Mar-17 Earnings
Asset Management	29,801	19	6% of AUMs
KMCC	7,112	5	20x Mar-17 Earnings
International subsidiaries	12,069	8	2.5x Mar-17 book
Others	20,453	13	20x Mar-17 Earnings
Insurance	31,346	20	P/NBAP
Total	164,563	107	
Ex insurance	133,216	86	
 Total Subsidiary valuation	164,563	107	
Lending bix valuation	937,753	607	4.1x Mar-17 book
Mar-17 PT		714	

Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2014	2015	2016E	2017E
Int. Earned from Adv.	93,434	100,884	124,027	150,069
Int. Earned from Invt.	20,500	22,158	25,875	30,920
Others	423	354	376	403
Total Interest Income	114,357	123,396	150,278	181,392
Interest expense	65,974	70,406	83,997	100,726
NII	48,382	52,991	66,280	80,666
<i>Growth (%)</i>	16.1	9.5	25.1	21.7
Treasury Income	1,880	3,479	1,800	1,800
NTNII	22,597	29,706	36,062	41,977
Non Interest Income	24,477	33,185	37,862	43,777
Total Income	138,833	156,581	188,139	225,169
<i>Growth (%)</i>	10.9	12.8	20.2	19.7
Operating Expense	35,190	42,998	49,753	58,316
Operating Profit	37,669	43,178	54,388	66,127
<i>Growth (%)</i>	19.3	14.6	26.0	21.6
NPA Provisions	1,632	2,757	5,776	7,063
Investment Provisions	1,844	(1,072)	25	75
Total Provisions	3,282	1,904	5,801	7,138
PBT	34,387	41,273	48,588	58,989
Tax Provisions	11,529	13,906	16,330	19,833
<i>Effective Tax Rate (%)</i>	33.5	33.7	33.6	33.6
PAT	22,858	27,367	32,257	39,156
<i>Growth (%)</i>	14.8	19.7	17.9	21.4

Balance Sheet (Rs m)

Y/e March	2014	2015	2016E	2017E
Par Value	5	5	5	5
No. of equity shares	1,541	1,545	1,545	1,545
Equity	7,703	7,724	7,724	7,724
Networth	186,091	208,000	238,653	275,811
Adj. Networth	179,791	201,068	230,741	266,404
Deposits	590,723	748,603	909,896	1,145,321
<i>Growth (%)</i>	15.8	26.7	21.5	25.9
Low Cost deposits	188,279	272,174	333,092	422,138
<i>% of total deposits</i>	31.9	36.4	36.6	36.9
Total Liabilities	1,108,107	1,285,677	1,556,167	1,933,758
Net Advances	741,079	869,636	1,069,181	1,326,970
<i>Growth (%)</i>	10.1	17.3	22.9	24.1
Investments	250,254	298,829	349,529	440,555
Total Assets	1,108,107	1,285,677	1,556,167	1,933,758

Source: Company Data, PL Research.

*Please note – We have not integrated merger financials into our estimates and will shortly do so.

Quarterly Financials (Rs m)

Y/e March	Q3FY15	Q4FY15	Q1FY16	Q2FY16
Interest Income	25,001	25,809	39,914	40,057
Interest Expense	14,407	14,578	23,932	23,269
Net Interest Income	10,594	11,232	15,982	16,787
Non Interest Income	4,941	6,681	5,924	6,157
CEB	—	—	—	—
Treasury	—	—	—	—
Net Total Income	15,535	17,913	21,906	22,945
Operating Expenses	8,160	9,306	15,937	12,497
Employee Expenses	3,679	3,789	9,288	6,230
Other Expenses	4,481	5,517	6,649	6,267
Operating Profit	7,376	8,607	5,970	10,448
Core Operating Profit	7,376	8,607	5,970	10,448
Provisions	299	669	3,053	1,764
Loan loss provisions	—	—	—	—
Investment Depreciation	—	—	—	—
Profit before tax	7,077	7,938	2,917	8,684
Tax	2,431	2,667	1,019	2,989
PAT before EO	4,645	5,271	1,898	5,695
Extraordinary item	—	—	—	—
PAT	4,645	5,271	1,898	5,695

Key Ratios

Y/e March	2014	2015	2016E	2017E
CMP (Rs)	688	688	688	688
Equity Shrs. Os. (m)	1,541	1,545	1,545	1,545
Market Cap (Rs m)	1,059,409	1,062,217	1,062,217	1,062,217
<i>M/Cap to AUM (%)</i>	95.6	82.6	68.3	54.9
EPS (Rs)	14.8	17.7	20.9	25.3
Book Value (Rs)	121	135	154	179
Adj. BV (100%) (Rs)	118	132	151	175
P/E (x)	46.3	38.8	32.9	27.1
P/BV (x)	5.7	5.1	4.5	3.9
P/ABV (x)	5.8	5.2	4.5	3.9
DPS (Rs)	0.4	0.5	0.6	0.8
<i>Dividend Yield (%)</i>	0.1	0.1	0.1	0.1

Profitability (%)

Y/e March	2014	2015	2016E	2017E
NIM	4.5	4.4	4.7	4.6
RoAA	2.1	2.3	2.3	2.2
RoAE	13.7	13.9	14.4	15.2

Efficiency

Y/e March	2014	2015	2016E	2017E
Cost-Income Ratio (%)	48.3	49.9	47.8	46.9
C-D Ratio (%)	125.5	116.2	117.5	115.9
Business per Emp. (Rs m)	83	88	94	102
Profit per Emp. (Rs lacs)	14.3	14.9	15.3	16.1
Business per Branch (Rs m)	2,728	2,882	3,065	3,330
Profit per Branch (Rs m)	47	49	50	53

Asset Quality

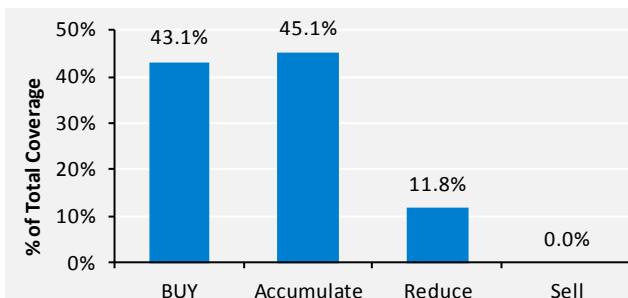
Y/e March	2014	2015	2016E	2017E
Gross NPAs (Rs m)	11,666	13,848	15,780	18,744
Net NPAs (Rs m)	6,300	6,932	7,912	9,407
<i>Gr. NPAs to Gross Adv. (%)</i>	1.6	1.6	1.5	1.4
<i>Net NPAs to Net Adv. (%)</i>	0.9	0.8	0.7	0.7
<i>NPA Coverage (%)</i>	46.0	49.9	49.9	49.8

Source: Company Data, PL Research.

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