

KOTAK MAHINDRA BANK

BANKS & FINANCIAL SERVICES

HOLD

Target Price: Rs 965

Buyback of Old Mutual's stake in K-Life

Event: Kotak Mahindra Bank (KMB) released a statement today announcing plans to buy back Old Mutual's (foreign partner) 26% stake in joint venture Kotak Life Insurance (K-Life) for Rs 12.9 bn. The buyout is subject to regulatory approvals, and will result in Kotak Mahindra Group holding 100% equity in K-Life.

Our view: This values the company at ~Rs 50 bn, ~55% lower than ~Rs 110 bn considered in our SOTP-based model. Although disclosures to form a thorough opinion on valuations are limited, we believe this is a stark discount to intrinsic value and a positive for KMB. This is likely given that Old Mutual is restructuring its overseas businesses and was eyeing exits in Indian & Chinese JVs

CMP : Rs 915
Potential Upside : 6%

MARKET DATA

No. of Shares : 1,841 mn
Free Float : 68%
Market Cap : Rs 1,684 bn
52-week High / Low : Rs 920 / Rs 690
Avg. Daily vol. (6mth) : 2.4 mn shares
Bloomberg Code : KMB IB Equity
Promoters Holding : 32%
FII / DII : 39% / 8%

Raise SOTP-based TP by Rs 15 to Rs 965 to factor in increased stake in K-Life

- ◆ We do not foresee any challenges in the deal going through, as both parties have agreed on cordial terms and no regulatory hurdles are likely. We factor in 100% stake in the Life Insurance subsidiary and continue to attribute a valuation of ~Rs 110 bn to the life insurance business
- ◆ The proposed QIP in an already well-capitalized KMB will put further pressure on the management for finding targets for inorganic growth. Nonetheless, KMB has in the past demonstrated its ability to optimize capital allocation and create shareholder wealth
- ◆ KMB enjoys strong growth visibility and pristine asset quality, has witnessed significant traction in CASA, and can further realize synergies leading to lower cost ratios. We value KMB at SOTP-based TP of Rs 965. At CMP, KMB trades at 4.7x/3.9x FY18E/19E ABV, implying 6% upside from our TP. Maintain **HOLD**

Financial summary (Standalone)

Y/E March	FY16	FY17	FY18E	FY19E
Adj. PAT (Rs mn)	20,898	34,115	40,594	48,928
EPS (Rs)	11	18	22	27
EPS chg (%)	(5.3)	62.9	19.0	20.5
Book value (Rs)	130	150	171	196
Adj. BV (Rs)	122	139	159	184
PE (x)*	66.5	39.8	32.6	26.2
P/ABV (x)*	6.4	5.5	4.7	3.9
RoE (%)	11.0	13.2	13.7	14.4
RoA (%)	1.4	1.7	1.7	1.8
Net NPA (%)	1.1	1.3	1.1	1.0

Source: Company, Axis Capital Note: ABV includes cost of investments

*P/E and P/ABV excludes value & cost of subsidiaries

Key drivers

(Rs mn)	Q2FY17	Q3FY17	Q4FY17
Loan growth (YoY)	12.9	12.1	14.7
CASA	39.0	42.0	44.0
Cost-income	49.1	48.4	46.2

Price performance

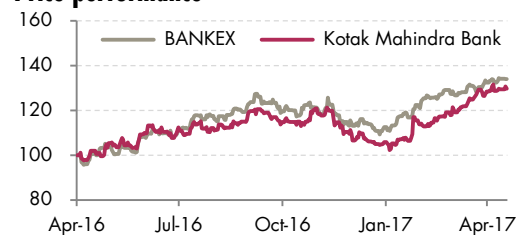


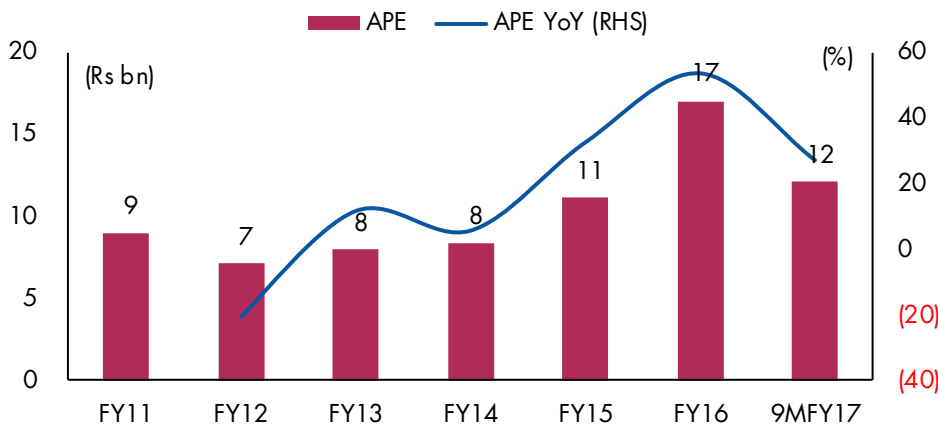
Exhibit 1: SOTP

Particulars	Valuation basis	Value per share (Rs)
Kotak Life Insurance	14x FY19E NBAP (14%) + EV	60
Kotak AMC	5% of AUM	25
Kotak Securities	14x FY19E earnings	29
<i>Kotak Prime</i>	3.3x FY19E ABV	84
Kotak Private Equity	5% of AUM	3
Kotak Mahindra Investments	3x FY19E ABV	19
Bank (Standalone business)*	4x FY19E ABV	746
Value per share of Kotak Bank		965

Source: Company, Axis Capital * does not factor in capital consumption from investment into K-Life

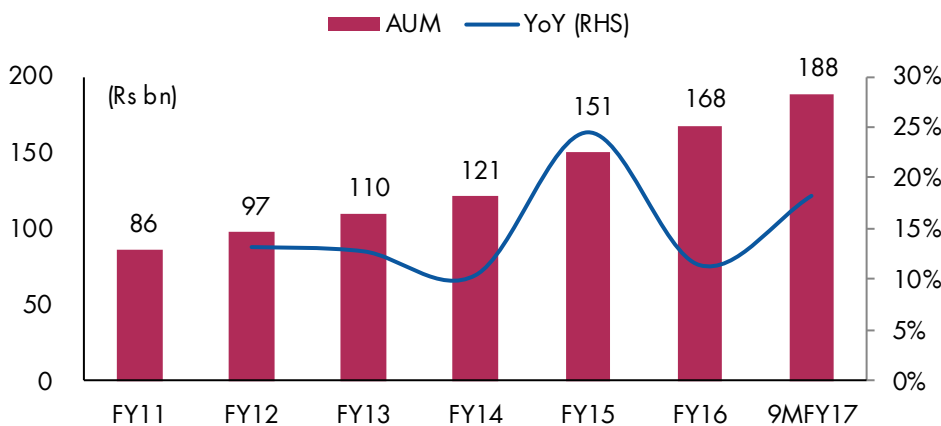
Kotak Life Insurance in charts

Exhibit 2: After consolidation during FY11-14, premium growth has begun to show signs of recovery



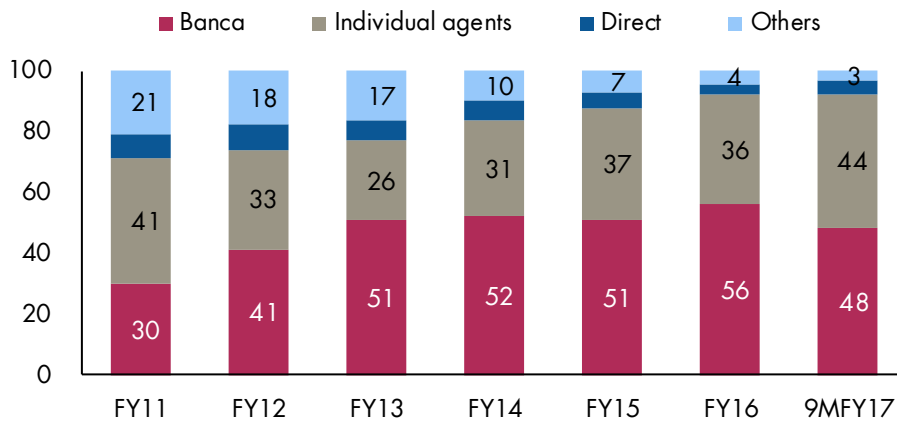
Source: Company, Axis Capital

Exhibit 3: AUM is close to ~Rs 200 bn, leaving ample room for growth



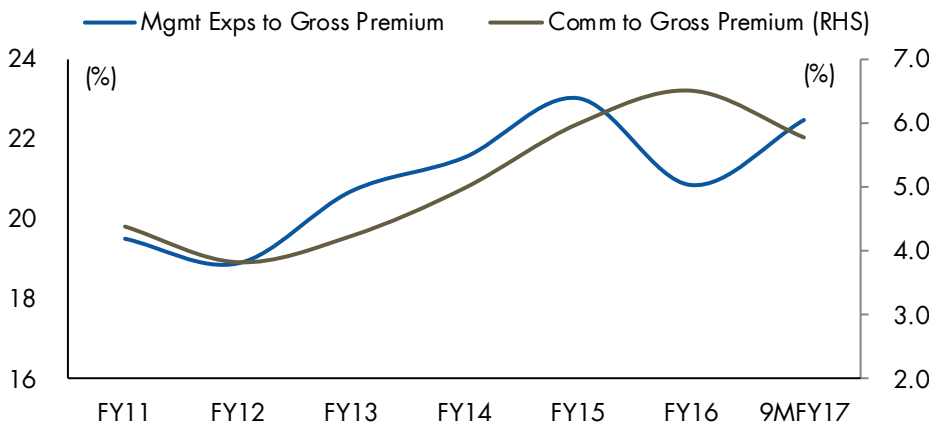
Source: Company, Axis Capital

Exhibit 4: Bancassurance continues to dominate the distribution mix



Source: Company, Axis Capital

Exhibit 5: Operating costs have been sticky, higher compared to peers



Source: Company, Axis Capital

Financial summary (Standalone)
Profit & loss (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Interest earned	164	177	200	231
Interest expended	(95)	(96)	(108)	(125)
Net interest income	69	81	93	106
Non interest income	26	35	43	52
Net income	95	116	136	159
Operating expenses	(55)	(56)	(63)	(72)
Staff expenses	(28)	(27)	(30)	(33)
Other operating expenses	(27)	(29)	(34)	(39)
Operating profit	40	60	73	87
Provisions & contingencies	(9)	(8)	(12)	(13)
Pre-tax profit	31	51	61	74
Tax expense	(10)	(17)	(20)	(25)
Profit after tax	21	34	41	49
Extraordinary item	-	-	-	-
Minority interest/Associates	-	-	-	-
Adj. PAT	21	34	41	49

Balance sheet (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Total assets	1,923	2,146	2,503	2,877
Cash & Balances with RBI	109	226	231	242
Investments	513	451	547	627
Advances	1,187	1,361	1,606	1,879
Fixed assets	16	15	14	14
Other assets	99	93	106	115
Total liabilities	1,923	2,146	2,503	2,877
Equity capital	9	9	9	9
Preference capital	-	-	-	-
Reserves & surplus	230	267	306	353
Networth	240	276	315	362
Borrowings	210	211	230	247
Deposits	1,386	1,574	1,867	2,170
Other liabilities & prov.	87	85	91	97

Source: Company, Axis Capital

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
Per share data				
FDEPS (Rs.)	11	18	22	27
BV (Rs.)	130	150	171	196
Adj. BV (Rs.)	122	139	159	184
DPS (Rs.)	-	1	1	1
Dividend payout (%)	4	3	3	3
Yields & Margins (%)				
Yield on advances	13.5	10.5	10.6	10.4
Cost of deposit	7.4	5.9	5.7	5.7
Net interest margin	4.9	4.3	4.2	4.2
Asset quality (%)				
Gross NPAs	2.4	2.6	2.4	2.3
Net NPAs	1.1	1.3	1.1	1.0
Credit cost	0.8	0.6	0.6	0.6
Provisioning coverage	55.5	54.0	56.0	58.0
Capital (%)				
Tier-I	15.3	15.9	14.9	13.8
CAR	15.3	16.8	15.6	14.3
Efficiency (%)				
ROA	1.4	1.7	1.7	1.8
ROE	11.0	13.2	13.7	14.4
Cost to income	58	48	47	45
CASA	38	44	43	43
Effective tax rate	33	34	34	34
Growth (%)				
Net interest income	63	18	14	15
Fee income	53	29	14	19
Operating expenses	68	3	13	14
Profit after tax	12	63	19	21
Advances	79	15	18	17
Deposits	85	14	19	16
Total assets	81	12	17	15

Source: Company, Axis Capital

Note: ABV includes cost of investments

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Ratings	Expected absolute returns over 12-18 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

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