



Sample Financial Management Assignment | www.expertsmind.com

FINANCIAL MANAGEMENT

Sample ASSIGNMENT

**KOTAK MAHINDRA BANK
LTD.**

ASSIGNMENT 1- VALUE CREATION FRAMEWORK

Kotak Mahindra Bank Limited is a private sector bank and was incorporated in 1985 as Kotak Mahindra Capital Management Finance limited and was renamed as Kotak Mahindra Finance limited in 1986. It was finally renamed as Kotak Mahindra Bank limited in 2003. Kotak Mahindra Finance Ltd. is the first company in the Indian banking history to convert to a bank. The promoters Kotak Mahindra group holds around 58 percent of the total share capital of the bank, Institutional investors hold about 24%, while the Indian public holds around 14 percent. The Chairman of the bank is Mr. K. M. Gherda and the Executive VC and Managing Director is Mr. Uday Kotak.

The registered office of the bank is in Mumbai. As of September 30th 2009, the bank has 230 full-fledged bank branches across 135 locations, and 410 ATMs. Kotak Mahindra was recently honored with the "Best Private Banking Services" award by Euromoney 2009, and is ranked as one of the top five companies for "Corporate Governance Best Practices" in the Asia Pacific region, according to the IR Global Rankings 2009.¹

SERVICES

The bank offers services in retail and corporate banking. In retail banking it offers deposits such as saving and current accounts and term deposits. Retail banking also offers loans such as personal and home loans. To the retail customers these above services are further facilitated with Net Banking, Phone Banking, Home Banking, ATM Network, Mobile Banking etc. The corporate banking division offers current accounts, asset reconstruction, trade finance, treasury products, investment products etc. The investment products of the bank include term deposits and mutual funds. The bank also offers services to the NRI community.

The Management team is as follows:

Name	Designation
Shankar Acharya	Part Time Chairman
Anand Mahindra	Non Executive Director
Cyril Shroff	Director
Shishir Bajaj	Director
C Jayaram	Executive Director
Sudipto Mundle	Additional Director
Name	Designation
Uday Kotak	Exec. Vice Chairman & Mang Dir

Asim Ghosh	Director
Pradeep N Kotak	Director
Shivaji Dam	Director
Dipak Gupta	Executive Director

PROMOTERS

Kotak Mahindra Group holds around 58% of the share capital. The promoters held around 52.39% of the shares, and the non promoters hold around 32.09% (March 2009).ⁱⁱ Among these, Mr. Uday Kotak holds 44.30% of the shares, other executive directors hold around 0.80% and Kotak Trustee Company Pvt. Ltd. holds 3.89% of the shares. However with Anand Mahindra end as its promoter, the promoters share is now 48.40%, and non-promoters have 51.60% (Sept '09).ⁱⁱⁱ The top promoters are:

1. Uday Suresh Kotak - 44.30%
2. Kotak Trustee Company Pvt. Ltd. - 3.89%
3. Anuradha Mahindra - 2.49%
4. Avion Aerosols Pvt Ltd - 1.10%

The bank has its branches in 135 locations, and plans to increase it to around 150 by the end of fiscal year 2010.

PEER GROUP

Kotak Mahindra Bank is a private sector bank, but its peer group can include even the public sector banks. However, the financials of the company are such that it would be best to compare it to the banks in the private sector. From the BT 500 list, I got the top 10 private sector banks. Using data from CMIE, I compared the bank with its other peers, and included State Bank of India in order to get an idea of the best industry figures. This was the result:

Rs. Crores	PAT	MC	BVPS	EPS	MP	P/E	P/BV
Axis Bank Ltd.	1815.36	40910.20	253.07	44.98	1013.55	22.54	4.00
Federal Bank Ltd.	500.49	4232.58	253.06	29.28	247.60	8.46	0.98
H D F C Bank Ltd.	2244.94	78007.06	321.85	49.31	1713.55	34.75	5.32
I C I C I Bank Ltd.	3758.13	97303.23	447.96	33.75	873.80	25.89	1.95
I N G Vysya Bank Ltd.	188.78	3379.23	142.59	15.81	282.95	17.90	1.98
IndusInd Bank Ltd.	148.34	5822.59	40.61	3.62	142.05	39.25	3.50
Karur Vysya Bank Ltd.	235.84	2096.61	250.25	43.71	388.60	8.89	1.55
Kotak Mahindra Bank Ltd.	276.10	29224.66	112.62	7.96	842.75	105.85	7.48
Yes Bank Ltd.	303.84	7841.88	54.47	10.19	263.00	25.81	4.83
State Bank of India	9121.23	145197.11	912.73	143.67	2287.00	15.92	2.51

Source: CMIE Prowess

Based on the market cap of Kotak Mahindra Bank, I have chosen its peers as Axis Bank Ltd., HDFC Bank Ltd. and ICICI Bank Ltd.

Based on the firms' values, the average values were:

PAT/NW= 51.86; MC/PAT= 32.15; MC/NW=3.51; PAT= 1052.42; MC= 29868.67; BVPS= 208.50; EPS= 26.51; MP= 640.87

These values will be used as a reference (average of the top 9 private banks) in assigning +, - or 0 in the valuation framework.

LISTINGS

The company is listed on Bombay Stock Exchange Ltd., National Stock Exchange of India Ltd. and Luxembourg Stock Exchange.^{iv} It is in the BSE Group A, which is a list of 200 companies, selected on the basis of market capitalization. **(BSE Code 500247, NSE Code KOTAKBANK)**

The company is a part of the BSE-100, BSE-200 and S&P CNX 500 Indices. The **S&P CNX 500** is India's first broad-based stock market index of the Indian stock market. The S&P CNX 500 represents about 96% of total market capitalization and about 93% of the total turnover on the NSE.^v

NON-FINANCIAL INDICATORS

The performance measure of a bank is measured not just by its financial indicators, but also by the convenience it provides to its customers. No one would like to have an account at a bank which is not located at other cities, or has a limited presence around the country. This brings the need for Net Banking and also ATMs across the country. As per reports, as on may 31, the total number of ATMs in India was 44857. The number of ATMs per million people is as low as 33 units, which is expected to increase to 56 by 2010.^{vi} Kotak Mahindra Bank has 410 of these ATMs.

SBI	1250	12250
ICICI	950	4831
Axis	831	3752
HDFC	1315	3295

Source:

http://dqindia.ciol.com/content/dqtop20_09/IndustryAnalyses/2009/109081301.asp

Also important are the waiting time for a customer in the bank, and how efficient the processes are. The third indicator can be the number of transactions in a day per the total number of bank customers. If this is high, the bank is doing well.

Thus, the indicators are Reachability, measured by the no. of ATMs and the no. of branches; Efficiency, measured by the Cycle time, and the Waiting time; and the Average no. of transactions per day by the total no. of customers.

BT 500 RANKINGS

Kotak Mahindra Bank is ranked 31st in the BT 500 Rankings. It was ranked 32nd last year, so it has managed to improve its position, on account of the rise in its market capitalization. The rankings of its peers is higher than Kotak Mahindra Bank- ICICI is at 7, HDFC is at 10 and Axis Bank is at 21. HDFC has managed to jump from 16 to 10.^{vii}

VALUATION(Source: CMIE Prowess)

For Measuring Risk:

	Mar05	Mar06	Mar07	Mar08	Mar09			
Axis Bank Ltd.	13.82	16.81	19.37	12.21	17.77	2.93	16.00	0.18
H D F C Bank Ltd.	14.58	16.43	17.74	13.83	15.32	1.54	15.58	0.10
I C I C I Bank Ltd.	15.54	11.26	12.61	8.88	7.53	3.15	11.17	0.28
Kotak Mahindra Bank Ltd.	11.22	13.67	8.51	8.18	7.07	2.68	9.73	0.28

For Measuring Growth:

Rise in EBITDA over the last 5 years:

Axis Bank Ltd.	1837.44	2721.73	4101.68	6224.57	10123.42	High
H D F C Bank Ltd.	2627.02	3607.06	5279.29	7887.04	12863.29	Medium
I C I C I Bank Ltd.	9688.45	14120.1	21550.03	30016.31	29246.85	Slow
Kotak Mahindra Bank Ltd.	336.67	587.14	981.15	1758.2	2042.21	High

For Measuring Profitability:

	Price	BVPS	EPS	P/E	P/BV
Axis Bank Ltd.	1013.55	253.0719	44.97554	22.53558	4.004989
H D F C Bank Ltd.	1713.55	321.8507	49.3137	34.74795	5.324053
ICICI Bank Ltd.	873.8	447.9581	33.74866	25.8914	1.950629
Kotak Mahindra Bank Ltd.	842.75	112.6236	7.96188	105.8481	7.482893

Capital Market Conditions^{viii}:

Axis Bank Limited	LAAA (Stable)		A1+
Kotak Mahindra Bank Limited	LAA+		
ICICI Bank Limited	LAAA (Stable)	MAAA	A1+

HDFC Bank has been given strong credit ratings by CARE, but it is not rated by ICRA.

VALUATION FRAMEWORK

Axis Bank Ltd.	0	0	+	+	2+
HDFC Bank Ltd.	+	+	+	0	3+
ICICI Bank Ltd.	-	-	+	-	1+,3-
Kotak Mahindra Bank Ltd.	+	-	0	+	2+,1-

Quite clearly, as per the valuation model, HDFC is creating the most value for the shareholders. However, Kotak Mahindra bank Ltd. isn't doing too bad either, but there is a risk associated with it.

TRENDS FOR THE FUTURE

As far as Risk is concerned, the criterion to measure risk has been the standard deviation from the mean for the return on equity values for the last 5 fiscal years. In 2005 and 2006, the ROE was more or less around the values for its peer group, but over the last 3 years, the ROE has really fallen down quite regularly. This has made the standard deviation higher, as the mean has come down. In order to regain the

trust of investors, the firm needs to increase its return substantially, so that the risk comes down. Another indicator of this risk is the Beta values.

Beta Values	
Axis Bank Ltd.	1.20
HDFC Bank Ltd.	0.94
ICICI Bank Ltd.	1.34
Kotak Mahindra Bank Ltd.	1.50

The growth of the firm looks to be strong since they have a capital base that is large enough to take them through the next 2-3 years without the need to raise any capital. Since the firm is already growing at a substantial rate, and continued to grow even during the recessionary scenario, the growth looks very strong.

The firm needs to look after its ability to deal with short term funds, and hence its credit rating is low. Its peers already enjoy a good credit rating and this might be a hurdle for the firm in getting funds and clients.

Finally, if we consider the profitability aspect, then among the 10 mentioned earlier in the peer companies, Kotak Mahindra Bank has a P/E ratio that is more than double of any other competitor. Also its PAT has more than tripled over the last 3 years.

	Mar-05		Mar-06		Mar-07		Mar-08		Mar-09	
	PAT	NW	PAT	NW	PAT	NW	PAT	NW	PAT	NW
Axis Bank Ltd.	335	2422	485	2886	659	3402	1071	8771	1815	1021
HDFC Bank Ltd.	665	4563	871	5300	1	6433	1590	7	2245	2
ICICI Bank Ltd.	2005	0	0	22556	0	3	4158	0	3758	3
Kotak Mahindra Bank Ltd.	85	757	118	865	141	1662	294	3594	276	3906

It is a sign that the firm is doing well, though the industry is competitive. However, the peers are also doing well in this regard, and hence the profitability is expected to come down slightly if Kotak Mahindra Bank does not expand its network, since its network is much smaller than the other players in the market.

All in all, if Kotak Mahindra Bank can reach out to customers better, then it has all the potential to create more value for its shareholders.

ⁱwww.zawya.com/Story.cfm/sidZAWYA20091118075956/Kotak%20Mahindra%20Bank%20launches%20Representative%20Office%20in%20Dubai/

ii Kotak Mahindra Bank 24th Annual Report for 2008-09

iii http://www.domain-b.com/finance/banks/Kotak_Mahindra_Bank/20090603_anand_mahindra.html

iv

<http://www.moneycontrol.com/india/stockpricequote/banksprivatesector/kotakmahindrabank/KMB>

v http://en.wikipedia.org/wiki/S&P_CNX_500

vii BT 500 Rankings

viii <http://www.icra.in/LiveRating.aspx>

ASSIGNMENT 2: VALUATION OF SHARES

1. Constant growth DDM model

$P_0 = D_1 / (K_e - g)$ where P_0 = expected market value of the firm; K_e = expected rate of return; g = growth rate; D_1 = dividend at end of year 1

In order to understand the growth rate for Kotak Mahindra Bank and its peers, I looked at the last few years growth rate, calculated as $g = \text{Retention Ratio} * \text{Return on retained earnings}$. ROE is taken for the year for which data has been collected.

		Axis Bank Ltd.	Kotak Mahindra Bank Ltd.
Year 2005	Retention Ratio	0.7377	0.7926
	ROE	0.1763	0.1237
	Growth Rate	13.01%	9.80%
Year 2006	Retention Ratio	0.7680	0.8123
	ROE	0.1773	0.1455
	Growth Rate	13.62%	11.82%
Year 2007	Retention Ratio	0.7742	0.8108
	ROE	0.2030	0.1115
	Growth Rate	15.72%	9.04%
Year 2008	Retention Ratio	0.7650	0.8971
	ROE	0.1711	0.1114
	Growth Rate	13.09%	9.99%
Year 2009	Retention Ratio	0.7684	0.8992
	ROE	0.1778	0.0673
	Growth Rate	13.66%	6.05%

Source: CMIE Prowess Database

Over the last year, Services sector has grown at over 10%.^{viii} Based on these, growth rates can be taken as 8% for Axis bank since it has grown consistently at 13% rate over the last 5 years, even in the financial slowdown. This indicates that they are in good health and hence can be expected to

The values are close for Axis and Kotak Mahindra Bank, **so this model is quite efficient** in calculating value. As per the Annual Report 2009, Kotak has diversified its business over the last 2 years, by concentrating on the NRI segment. That has really accelerated its growth. Axis bank is a consistent performer, as indicated by its future predictions and past performance.

3. Liquidation value is the likely price of an asset when it is allowed insufficient time to sell on the open market, thereby reducing its exposure to potential buyers. Liquidation value is typically lower than fair market value. The Liquidation value is the estimated amount of money that an asset or company could quickly be sold for, such as if it were to go out of business. In absence of any information about the life of the assets, Net Worth is considered as the liquidation value.

Another way to calculate the liquidation value is:^{viii}

$$\text{Liquidation Value} = \text{Book Value of assets} * (1 + \text{Inflation Rate})^{\text{average life of assets}}$$

However this model assumes that the assets have no earning capacity, which is a major drawback. Also it may not be possible to calculate the average life of assets.

Hence, **Liquidation value** Kotak Mahindra = **Net worth- Intangible Assets= 3905.53- 22.40= 3883.13 crores**

Liquidation value Axis Bank = **10214.81- 92.44= 10122.37 crores**

For Kotak, the value is almost 1/10th of the actual market cap of the firm, so currently the market value of the firm is well above its liquidity value, indicating that it is in a strong position. Axis Bank has a market cap of about Rs. 40,000, so here also the liquidation model does not give a correct result, indicating that the bank is performing well, and there is no chance of any liquidation.

4. Price-Earnings Ratio Model

PAT(crores)	71.13	102.57	90.31	125.91	389.92
--------------------	-------	--------	-------	--------	--------

Source: CMIE Prowess database

As on day end on 15th Jan:

Sr.	Company	P/E	Sr.	Company	P/E
1	Kotak Mahindra	73.29	9	Bank Of Rajasthan	14.17
2	HDFC Bank	28.07	10	Federal Bank	8.07
3	ICICI Bank	23.82	11	City Union Bank	7.86
4	ING Vysya Bank	21.09	12	Karur Vysya	7.21
5	Yes Bank	20.2	13	Karnataka Bank	7.08
6	IndusInd Bank	19.13	14	South Ind Bk	6.68
7	Axis Bank	18.67	15	JK Bank	6.41
8	Dhanalakshmi Bank	16.99	Average		18.583

Source: www.moneycontrol.com

$$\text{Value} = (\text{P/E})_{\text{Industry Average}} * \text{PAT}_{\text{Firm}}$$

$$= 18.583 * 389.92 \text{ crores} = \mathbf{7245.88 \text{ crores}}$$

The P/E on 31st March 2009 was 35.42, while it has gone up to 73.29 on 15th Jan. Clearly, the fluctuations in P/E ratio can be significant. For example, the price earnings ratio decreased from 33.69 on February 25, 2008 to 10.26 on February 25, 2009.^{viii} Hence, Price-Earnings model should only be used as a reference. Also PAT is only available at the end of a financial year and even at

another time, the same PAT value is used. Hence, it is not a fair indicator of the value of the firm. Also PAT can be manipulated, and thus P/E ratio is not always reliable. Currently, KMB is doing well, and its ratio is more than 4 times that the average. Hence its market cap is close to 30,000 crores, but this value is much lesser. So, it is not a correct indicator.

5. Price-Book Value Ratio Model

Sr.	Company	P/BV	Sr.	Company	P/BV
1	Axis Bank Ltd.	3.69	9	Indusind Bank Ltd.	2.8
2	Bank Of Rajasthan Ltd.	1.82	10	J&K Bank Ltd.	1
3	City Union Bank Ltd.	1.36	11	Karnataka Bank Ltd.	1
4	Dhanalakshmi Bank Ltd.	2.26	12	Karur Vysya Bank Ltd.	1.45
5	Federal Bank Ltd.	0.99	13	Kotak Mahindra Bank Ltd.	6.93
6	H D F C Bank Ltd.	3.86	14	South Indian Bank Ltd.	1.11
7	I C I C I Bank Ltd.	1.82	15	Yes Bank Ltd.	4.37
8	I N G Vysya Bank Ltd.	1.61	Average P/BV		2.405

Source: CMIE Prowess

Value = (P/BV) Industry Average * Net Worth Firm

= 2.405 * 3905.53 crores = 9392.8 crores

Here also the P/BV ratio of the bank is significantly larger than the industry average. This probably indicates that the firm is valued very highly in the market, and more so when compared to the other banks in the private sector. This probably is because of the Kotak group's role in the bank, that the firm has such high ratios. Net worth is also not an accurate figure currently since we are into the last quarter of the year and the current book value would have increased. So again the firm is probably undervalued by this method as it is much less than its enterprise value and its market cap, which are around 30,000 crores. We can see the limitations of this method when valuing a firm doing well in a struggling industry.

KOTAK MAHINDRA BANK

ASSIGNMENT 3: DEBT AND ITS VALUATION

1. An analysis of the balance sheet and the Annual Report of *Kotak Mahindra Bank* and its peer *Axis Bank* indicated that these two banks have taken no long term debts over its last 10 years, and all the debts have been short term ones. These have been in the form of financial borrowings from Reserve Bank of India and other banks, foreign currency borrowings and sub-ordinated debt. There has been no issue of bonds, debentures or notes. For Axis bank all these have been unsecured, while Kotak Mahindra has secured financial institutional borrowings of Rs. 30,940,709.^{viii}

The distribution of these debts is given below.^{viii}

KOTAK MAHINDRA BANK

Values in Crores	Mar 05	Mar 06	Mar 07	Mar 08	Mar 09
Borrowings	985.5	1849.2	5725.2	5901.4	6734.0
	1	4	7	9	1

Secured borrowings	0	0	149.92	649.85	3094.07
Secured financial institutional borrowings	0	0	149.92	649.85	3094.07
Unsecured borrowings	985.51	1846.66	3982.12	3740.64	3529.94
Unsecured short-term bank borrowings	772.7	1104.95	2191.53	1477.72	650.21
Unsecured borrowings from financial institutions	20	389.41	947.73	1234.66	1911.3
Foreign currency borrowings	109.11	112.3	217.35	246.02	138.49
Sub-ordinated debt	83.7	240	625.51	782.24	829.94
Bank's borrowings from RBI	0	2.58	1593.23	1511	110
Current portion of secured and unsecured long term debt	0	0	0	0	0

AXIS BANK

Values in Crores	Mar 05	Mar 06	Mar 07	Mar 08	Mar 09
Borrowings	2570.01	4469.53	8697.02	9053.37	15519.86
Secured borrowings	0	0	0	0	0
Unsecured borrowings	2570.01	4469.53	8697.02	9053.37	14440.31
Unsecured short-term bank borrowings	170.3	867.98	600	0	300
Unsecured borrowings from financial institutions	1129.91	1223.8	1203.9	546.69	1632.15
Foreign currency borrowings	481.2	589.15	3391.71	5077.35	7173.77
Sub-ordinated debt	788.6	1788.6	3501.41	3429.33	5334.39
Bank's borrowings from RBI	0	0	0	0	1079.55
Current portion of secured and unsecured long term debt	0	0	0	0	0

Like it is generally for banks, all the funding has come through equity. Hence, there have been **no long term debt instruments**, so the 4 parts of the **assignment are not applicable**.