



# Kotak Mahindra Bank Ltd.

TWENTY-SECOND ANNUAL REPORT 2006-07



## Directors' Report

To the Members of  
KOTAK MAHINDRA BANK LIMITED

The Directors present their Twenty Second Annual Report together with the audited accounts of your Bank for the year ended 31st March 2007.

### FINANCIAL HIGHLIGHTS

#### A) Kotak Mahindra Bank Limited – Consolidated Financial Highlights:

	31st March 2007 Rs. crore	31st March 2006 Rs. crore
Total income	4352.30	2906.19
Total expenditure, excluding provisions and contingencies	3421.11	2238.72
Operating Profit	931.19	667.47
Provisions and contingencies, excluding provision for tax	152.50	51.24
Profit before tax	778.69	616.23
Provision for taxes	254.21	213.00
Profit after tax	524.48	403.23
Less: Share of minority interest	0.66	63.02
Add: Share in profit of Associates	14.42	2.25
Consolidated profit for the Group	538.24	342.46
Earnings per Equity Share		
Basic (Rs.)	16.60	11.09
Diluted (Rs.)	16.47	11.01

The above figures for the previous year ended 31st March 2006 excludes non recurring income related to profit on sale of investments of Hutch.

#### B) Kotak Mahindra Bank Limited – Standalone Financial Highlights:

	31st March 2007 Rs. crore	31st March 2006 Rs. crore
Total Income	1,637.76	936.95
Operating Profit	325.8	210.6
Total expenditure, excluding provisions and contingencies	1,311.94	726.39
Provisions and contingencies, excluding tax provisions	122.57	36.96
Profit before tax	203.25	173.60
Provision for taxes	61.88	55.37
Profit after tax	141.37	118.23
Add: Surplus brought forward from the previous year	286.36	194.42

	31st March 2007 Rs. crore	31st March 2006 Rs. crore
Add: Transfer from Kotak Mahindra Capital Company Limited on demerger	216.76	—
Amount available for appropriation	644.49	312.65
Appropriations:		
Transfer from Kotak Mahindra Capital Company Limited on demerger appropriated to General Reserve	216.76	—
Statutory Reserve under Section 17 of the Banking Regulation Act, 1949	35.50	29.75
General Reserve	7.25	3.00
Transfer to Capital Reserve	4.05	9.65
Transfer from Investment Fluctuation Reserve	—	(38.30)
Proposed Dividend	22.86	19.46
Corporate Dividend Tax	3.89	2.73
Surplus carried to Balance Sheet	354.18	286.36

### DIVIDEND

Keeping in mind the overall performance and the outlook for your Bank, the Directors recommend a dividend of 7% (previous year 6%), entailing a payout of Rs. 22.86 crores (previous year Rs. 19.46 crores). The corporate dividend tax amounts to Rs. 3.89 crores (previous year Rs. 2.73 crores). The dividend would be paid to all the shareholders, including holders of Global Depository Shares, whose names appear on the Register of Members/Beneficial Holders list on the Book Closure date.

### CAPITAL

#### Tier – I Capital

During the year your Bank has successfully raised approximately US \$ 100 million through issue of Global Depository Shares (GDS) at an issue price of US \$ 6.66 (then approximately Rs. 300/-) per GDS.

During the year, your Bank has allotted 18,61,083 shares arising out of the exercise of employees stock options granted to the employees, employees of your subsidiaries and Executive Directors of your Bank.

#### Tier – II Capital

During the year your Bank has issued Unsecured Redeemable Non-Convertible Subordinated Debt Bonds in the form of Promissory Notes/ Debentures through private placement for an amount aggregating to Rs. 189.90 crore to augment the Tier-II capital to meet the growth in assets of your Bank and to enhance the Capital Adequacy Ratio. These Bonds

have been listed on the Wholesale Debt Market segment of the National Stock Exchange of India Limited. Your Bank has appointed IDBI Trusteeship Services Limited as the Trustees for these Bonds issued, as aforesaid. Outstanding Unsecured Redeemable Non-Convertible Subordinated Debt Bonds as at 31st March 2007 stood at Rs. 429.90 crore.

### Upper Tier – II Capital

During the year your Bank also issued and allotted Unsecured, Non Convertible Redeemable Subordinated Debt (US\$ denominated debentures) that qualify for Upper Tier II capital of the Bank for an aggregate amount of US\$ 45 million to International Finance Corporation, Washington.

### OPERATIONS

Your Bank has completed four years of successful operations as a commercial bank. During the year the Bank crossed the significant milestone of 100 full fledged branches. It ended the year with 105 branches and 135 ATMs. The footprint of the Bank now covers 69 locations.

The Bank offers a very wide range of products and services targeted at retail customers, delivered through a state of the art technology platform. In addition to branch banking, convenience banking facilities offered by the Bank include telephone banking, internet banking, mobile banking, direct pay services, payment gateway for online shopping, a global debit card, a prepaid spending card and facility to transfer of funds to all Visa debit and credit cards in India.

Your Bank also offers depository services that allow customers to hold equity shares, government securities, bonds and other securities in electronic or dematerialised format. Your Bank targets to have around 200 full-fledged branches by mid next year. Your Bank continues to acquire customers at a reasonable pace and maintains its strong presence in distribution of third party products (primarily mutual funds and life insurance).

Overall the trajectory of our businesses continue to remain in line with the plans and has given your Bank the confidence to plan for further growth in the years to come.

The year continued to see a surge in credit demand from the corporate and SME business segments both for working capital and term facilities. Your Bank was able to tap this opportunity by offering a variety of products from plain vanilla debt issuance to Asset Backed Securities, Mortgage Backed Securities, structured products and loan syndication. The year also saw an increase in demand for trade finance both domestic and international and your Bank was able to tap this opportunity through structured product offerings to customers.

Your Bank was also able to provide products and services to segments of financial institutions group through customized credit and transaction banking offerings. Your Bank increased its thrust in offering customized solutions on derivatives, foreign exchange, and transaction banking across the spectrum of customers. Your Bank continued its presence as a "collection banker" in a number of the Initial Public Offers and New Fund Offers.

Commercial Vehicles division maintained its momentum in line with the movement in transportation industry. With continued thrust on investment

in infrastructure, the construction equipment segment witnessed good growth in its business volumes. The division reaffirmed the status of having best in class portfolio through robust risk management practices. During the year the commercial vehicles & construction equipments division has moved one step closer to becoming one stop shop for the needs of transportation and infrastructure industry through launch of unique products to meet their working capital requirement and through fund and non-fund based products to cater to their specific requirements. The thrust on cross sell of other banking products saw a good growth in fee income for the division, which the division proposes to focus on, going forward.

With the government's emphasis on the Agriculture Finance sector, the Agriculture Finance business in the Bank is well set to develop the potential that the sector is offering. The Agriculture Finance business has segmented its client profile and developed products like project financing, working capital funding, commodity funding, contract farming finance besides tractor and retail loans.

The Home Finance business saw the continued growth rate it has witnessed since inception as a result of the growth in the real estate market.

Similarly the Personal loan business grew significantly and your Bank improved its presence across newer geographies.

Your Bank consolidated its position in the Stressed Assets Portfolio by resolving several accounts pertaining to the previous year's purchase and buying accounts at a reasonable price. Last year, as a result of a general economic buoyancy further aided by surge in real estate prices, there was a slowdown in auction of the NPA portfolios by banks/NBFCs. Of the assets that were auctioned by banks/NBFCs, pricing mismatch between the buyers and sellers resulted in the failure of many auctions.

As a strategy, to counter the impact of reduced portfolio sale by the banks/NBFCs, your Bank invested in single asset transactions. For stressed companies with a good turn around prospects, your Bank managed to buy out the entire or majority loan portfolios and restructured their debt. These investments would enable in contributing significant returns in the coming years. Moving forward, a combination of portfolio buy out and single asset transactions would provide good return for this business.

Your Bank has an active proprietary desk trading in all products such as Fixed Income, Money Markets, Derivatives, Foreign Exchange and Bullion. The proprietary desk helped the treasury to build robust client businesses which included Forex and Derivatives, Bullion and Debt Capital Markets (DCM). Apart from the above the Treasury plays an important role in Balance Sheet Management and implementation of Funds Transfer Price between various business units. Your Bank's Treasury has developed the capability to price and value complex currency and interest rate derivative transactions. This capability was developed through significant investment in technology and qualified personnel. This gave it a distinct competitive advantage in the market place. In the area of DCM the Bank offered Securitisation, Loan and Bond syndication, mezzanine financing, promoter funding and acquisition financing products. The Bank is one of the active players in the securitisation market particularly in corporate loan securitisation.

India Growth Fund, a SEBI registered Venture Capital Fund with a committed corpus of Rs. 707 crore, which is managed by the Private Equity Division of your Bank, continues to be in an active investment mode and as at 31st March 2007, had made investment in 10 companies. The portfolio of India Growth Fund comprises companies in a diverse mix of growth sectors like home retail, logistics, home textiles, airline, light engineering, life sciences and software technology.

As at the end of the year, your Bank's Capital Adequacy was 13.46% and the Tier 1 Capital Adequacy was 8.81% and the net NPAs were at 0.18% of net advances excluding stressed assets portfolio. The net NPAs of the Bank including stressed assets portfolio were at 1.98%.

## SUBSIDIARIES

Your Bank along with its subsidiaries offers complete financial solutions to its customers. The key business segments where the subsidiaries operate include investment banking, stock broking, car finance, asset management and life insurance.

Kotak Mahindra Capital Company Limited and Kotak Securities Limited posted a good financial performance on the back of strong capital markets and the robust overall economic growth. The life insurance subsidiary, Kotak Mahindra Old Mutual Life Insurance Limited continued its growth momentum in premium income. The international subsidiaries have gained impetus and have now become gainful contributors to the profits of the Group. Kotak Mahindra Asset Management Company Limited, Kotak Mahindra Prime Limited and the other subsidiaries also posted growth in profits and had a good year.

The various activities of the subsidiaries are outlined in the Management Discussion and Analysis section appended to this Report.

During the year, the name of Kotak Mahindra Private Equity Trustee Limited was changed to Kotak Mahindra Trusteeship Services Limited.

During the year, the shareholders of the Bank, at the Court convened meeting held on 5<sup>th</sup> December 2006, approved a Scheme of Arrangement between the Bank, Kotak Mahindra Capital Company Limited (KMCC) and their respective shareholders and creditors, for demerger of undertaking, comprising of Trading & Principal, including Primary Dealership division (PD division) of KMCC, to the Bank. In this regard, the Hon'ble High Court of Judicature at Bombay accorded its approval to the petition filed, pursuant to Sections 391 to 394 of the Companies Act, 1956, vide Order dated 15<sup>th</sup> February 2007. The Scheme of Arrangement became effective from 20<sup>th</sup> March 2007.

The aforesaid demerger was carried out with a view to consolidate and synergise the financial services business of the Kotak Group. The PD division of KMCC has been effectively consolidated with the treasury function of the Bank for a more integrated and synergistic functioning of the division. The Bank, with its substantially higher net worth, will further strengthen in future, the growth and profitability of the PD division.

Another petition was filed before the Hon'ble High Court of Judicature at Bombay pursuant to Sections 391 to 394 of the Companies Act, 1956, in respect of a Scheme of Arrangement between Kotak Mahindra Securities

Limited (KMML), KMCC and their respective shareholders and creditors, for demerger of undertaking comprising of the Trading and Clearing operations and strategic investments of KMML to KMCC. The Hon'ble Bombay High Court granted its approval to the Scheme, vide Order dated 15<sup>th</sup> February 2007 and the necessary approval from the National Stock Exchange of India Limited / Securities and Exchange Board of India is pending.

This demerger was carried out with a view to consolidate all capital market related activities into KMCC, which has a substantially higher net worth than KMML.

As per the Banking License granted to the Bank by the Reserve Bank of India in February 2003, it was stipulated that all indirect (second level) subsidiaries should either be merged or made direct (first level) subsidiaries of the Bank. The Bank had the following indirect subsidiaries:

1. Kotak Mahindra Securities Limited
2. Kotak Mahindra (International) Limited
3. Kotak Mahindra (UK) Limited
4. Kotak Mahindra Inc.
5. Global Investment Opportunities Fund Limited

With a view to comply with the foregoing license condition, the Bank made further investments to subscribe to additional shares in the aforesaid companies in order to make them direct subsidiaries. The Bank now holds 51% of each of these companies.

In terms of the approval granted by the Central Government vide their letter dated 11<sup>th</sup> January 2007 under Section 212(8) of the Companies Act, 1956, abridged Annual Report which consists of the financial statements of your Bank on standalone basis as well as consolidated financial statements of the group for the year ended 31st March 2007 have been sent to all the members of the Bank. It does not contain Annual Reports of the Bank's subsidiary companies. **The Bank will make available full Annual Report (including the Annual Reports of all subsidiaries) upon request by any member of the Bank. These Annual Reports will be available on Bank's website and will also be available for inspection by any member at the Registered Office of the Bank.**

## EMPLOYEE STOCK OPTION SCHEME

The stock options granted to the employees currently operate under two schemes, namely Kotak Mahindra Equity Option Plan 2002 – 2003 ("Plan 2002-03") and Kotak Mahindra Equity Option Scheme 2005 ("Scheme 2005"). The disclosures below are in respect of the year ended 31st March 2007.

Options granted during the year	Plan 2002 - 03 Nil Scheme 2005 54,86,600 options – Series 1 to 6.	
Options Vested	Plan 2002-03 20,31,825 options. Scheme 2005 Nil	
Options exercised	Plan 2002-03 18,61,083 options. Scheme 2005 Nil	
Total number of shares arising as a result of exercise of options	Plan 2002-03 18,61,083 equity shares of Rs. 10/- each. Scheme 2005 Nil	
Options lapsed	Plan 2002-03 1,02,833 options. Scheme 2005 1,62,000 options.	
Variation of terms of options	No variations made in the terms of the options granted.	
Money realized by exercise of options	Plan 2002-03 Rs. 8,02,34,140/- Scheme 2005 Nil	
Total number of options in force	Plan 2002-03 Outstanding options not yet vested - 17,40,034 options. Scheme 2005 Outstanding options not yet vested - 53,24,600 options.	
Details of options granted to	Plan 2002-03 Nil Scheme 2005	
(i) Senior management personnel	Name of Senior Management Personnel	No. of options granted
	Mr. C. Jayaram	85,000
	Mr. Dipak Gupta	75,000
(ii) Any other employee who receives a grant in any one year of options amounting to 5% or more of options granted during that year	Plan 2002-03 Nil Scheme 2005 3,00,000 options granted to Mr. Vikram Sud, Group Chief Operating Officer under Series 4 constituting 5.47 % of the options granted during the year.	

(iii) Identified employees who were granted option, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant	Plan 2002-03 Nil Scheme 2005 Nil	
Diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of options calculated in accordance with AS20 Earnings Per Share	The diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of options calculated in accordance with AS20 is 16.47 (Consolidated) 4.33 (standalone).	
Where the company has calculated the employee compensation cost using the intrinsic value of stock options, the difference between the employee compensation cost so computed and the employee compensation cost that shall have been recognized if it had used the fair value of the options, shall be disclosed. The impact of this difference on profits and on EPS of the company shall also be disclosed.	* Had the Bank (Consolidated) followed the fair value method for accounting the stock option compensation expense would have been higher by Rs. 4,55,21,197, with consequent lower consolidated profits. On account of the same the diluted EPS of the Bank (Consolidated) would have been lower by Rs. 0.09 per share.	
Weighted – average exercise prices and weighted – average fair values of options shall be disclosed separately for options whose exercise price either equals or exceeds or is less than the market price of the stock.	* The weighted average price of the stock options exercised is Rs. 99.88 and the weighted average fair value is Rs. 220.44.	

\* Note: Above figures are derived by considering the Kotak Group as a whole (Consolidated).

<p>A description of the method and significant assumptions used during the year to estimate the fair values of options, including the following weighted – average information:</p>	<p><b>A. Stock price</b></p> <p>It is the closing market price on the National Stock Exchange of India Limited (NSE) on the date of the respective grant.</p> <p><b>B. Volatility</b></p> <p>Volatility is a measure of the amount by which a price has fluctuated or is expected to fluctuate during a period. The measure of volatility used in the Black-Scholes option-pricing model is the annualized standard deviation of the continuously compounded rates of return on the stock over a period of time.</p> <p>Accordingly, daily volatility of the Bank's stock price on the NSE for the period corresponding to the respective expected live of the different vests, prior to the grant date has been considered.</p> <p><b>C. Risk free interest rate</b></p> <p>The risk-free interest rate being considered for the calculation is the interest rate applicable for maturity equal to the expected life of the options based on the zero-coupon yield curve for Government Securities as on the date of the respective grant.</p> <p><b>D. Time to Maturity / Expected Life of options</b></p> <p>The minimum life of a stock option is the vesting period and the maximum life is vesting period plus the exercise period. The Expected life of the options has been calculated as the average of the two extremes – the minimum life and the maximum life. Since each vest has been considered as a separate grant, the expected life has been calculated for each vest separately.</p> <p><b>E. Dividend yield</b></p> <p>The dividend yield for each year has been derived by dividing the dividend per share by the average market price per share.</p>
---	--

## CORPORATE GOVERNANCE

Pursuant to Clause 49 of the Listing Agreement with the Stock Exchanges, a separate section entitled 'Corporate Governance' has been included in this Annual Report.

## DIRECTORS

Mr. Cyril Shroff and Mr. Anand Mahindra retire at the Twenty Second Annual General Meeting and are eligible for re-appointment.

The shareholders of the Bank at the Annual General Meeting held on 20<sup>th</sup> July 2006 approved the appointment and payment of remuneration to Dr. Shankar Acharya as part – time Chairman of the Bank for a period of three years. The Ministry of Company Affairs and the Reserve Bank of India, vide their letters dated 11<sup>th</sup> September 2006 and 16<sup>th</sup> June 2006 respectively granted their approvals for the said appointment and remuneration payable to Dr. Shankar Acharya.

## AUDITORS

Messrs S. B. Billimoria & Co., Chartered Accountants, auditors of your Bank, retire on the conclusion of Twenty Second Annual General Meeting.

Pursuant to the guidelines issued by the Reserve Bank of India, an audit firm is allowed to continue as the Statutory Central Auditor of a bank for a period of four years and thereafter the said firm is to be rested for a period of at least two years. Accordingly, it is proposed to appoint Messrs S. R. Batliboi & Co., Chartered Accountants as the statutory auditors of the Bank for the current financial year in place of Messrs S. B. Billimoria & Co. who have completed four years as the statutory auditors. The approval of the shareholders in this regard is being sought at the ensuing Annual General Meeting of the Bank.

## STATUTORY INFORMATION

The Companies (Disclosure of Particulars in the Report of Board of Directors) Rules, 1998, are not applicable to your Bank.

## EMPLOYEES

There was a significant increase in your Bank's staffing particularly in the Retail Banking business. The employee strength of your Bank along with its subsidiaries as of 31st March 2007 was over 10,800 as compared to 6,700 employees last year.

The Bank standalone had around 5,400 employees as of 31st March 2007 (previous year around 3,600). 86 employees employed throughout the year and 36 employees employed for part of the year were in receipt of remuneration of Rs. 24 lacs or more per annum.

Your Bank has in place policies relating to employee service conditions, welfare and training which are reviewed on an ongoing basis by your Bank's Management Committee.

Your Bank continues to focus on training its employees on a continuing basis by deputation to reputed training institutions by holding workshops on various areas including Regulatory Compliance, Risk Management, Customer Care and Communication, Trade Finance, Foreign Exchange Rules and Treasury.

In accordance with the provisions of Section 217(2A) of the Companies Act, 1956 and the rules framed thereunder, the names and other particulars of employees are set out in the annexure to the Directors' Report. In terms of the provisions of Section 219 (1)(b)(iv) of the Companies Act, 1956, the Directors' Report is being sent to all the shareholders of the Bank excluding

the aforesaid annexure. The annexure is available for inspection at the Registered Office of the Bank. Any shareholder interested in obtaining a copy of the said annexure may write to the Company Secretary at the Registered Office of the Bank.

#### **DIRECTORS' RESPONSIBILITY STATEMENT**

The Directors, based on the representations received from the operational management, confirm in pursuance of Section 217 (2AA) of the Companies Act, 1956, that:

- i) your Bank has, in the preparation of the annual accounts for the year ended 31st March 2007, followed the applicable accounting standards along with proper explanations relating to material departures, if any;
- ii) they have selected such accounting policies and applied them consistently and made judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the Bank as at 31st March, 2007 and of the profit of your Bank for the financial year ended 31st March 2007;
- iii) they have taken proper and sufficient care to the best of their knowledge and ability, for the maintenance of adequate accounting

records in accordance with the provisions of the Act for safeguarding the assets of the Bank and for preventing and detecting fraud and other irregularities; and

- iv) the annual accounts have been prepared on a going concern basis.

#### **ACKNOWLEDGEMENTS**

Your Directors would like to place on record their gratitude for the valuable guidance and support received from the Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority and other Government and Regulatory agencies. Your Directors acknowledge the support of the shareholders and also wish to place on record their appreciation of employees for their commendable efforts, teamwork and professionalism.

**For and on behalf of the Board of Directors**

**Dr. Shankar Acharya**  
Chairman

Mumbai, 17th May 2007.