

## Company Flash

8 September 2008 | 8 pages

# AXIS Bank (AXBK.BO)

## Buy: London Corporate Day Takeaways

- 35-40% loan growth expectation for the year** — Management expects growth in the 35-40% range for FY09; a step-down from its 50% growth levels, but aggressive on an absolute and relative basis. They see possible growth constraints emanating from a) Margins (floor at 3%, currently at 3.4%); b) Capital (comfortable for about 18 months); & c) Perceived inability to pass on any further rate hikes. Management suggests base case growth expectations at 30% – well ahead of peers, and market expectations (and appetite).
- Asset quality – higher risks but not threatened** — Axis suggests mkt. concerns on asset quality - theirs and generally, overdone. Maintain sub 50bps net NPA expectations (now 47bps). Suggests their SME book is focused & protected (77bps Net NPA now), agri could see some pressure but lesser than PSU Banks, & retail loans pain is largely past (small book, remedial action taken). Mkt. perceptions on asset risks relatively high – mgmt addressing head-on.
- Distribution – driving deposits and fees** — Axis continues to build distribution – 200 new branch licenses (713 existing branches); geographically targeted, should support a 50%+ growth in savings accounts, achieve a 45% CASA target, and support a 50% fee income growth (help from corporate fees). Axis' distribution strategy a key driver of its success; expect more of the same.
- Some caution; lots of confidence** — Axis is a little cautious relative to the recent past; on growth, asset risk and margins. That notwithstanding, management remains distinctly confident and upbeat on its own growth, return and risk outlook – and markedly more so than peers and pundits.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (08 Sep 08)	Rs710.85
Target price	Rs807.00
Expected share price return	13.5%
Expected dividend yield	0.9%
<b>Expected total return</b>	<b>14.4%</b>
Market Cap	Rs255,069M US\$5,711M

### Price Performance (RIC: AXBK.BO, BB: AXSB IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2007A	6,588	23.05	34.0	30.8	5.9	21.0	0.7
2008A	11,464	35.24	52.9	20.2	2.9	18.9	1.0
2009E	13,593	37.41	6.2	19.0	2.6	14.6	0.9
2010E	17,466	48.06	28.5	14.8	2.2	16.4	0.9
2011E	21,955	60.42	25.7	11.8	1.9	17.7	1.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
<b>Valuation Ratios</b>					
P/E adjusted (x)	30.8	20.2	19.0	14.8	11.8
P/E reported (x)	30.8	20.2	19.0	14.8	11.8
P/BV (x)	5.9	2.9	2.6	2.2	1.9
P/Adjusted BV diluted (x)	6.0	2.9	2.6	2.3	1.9
Dividend yield (%)	0.7	1.0	0.9	0.9	1.0
<b>Per Share Data (Rs)</b>					
EPS adjusted	23.05	35.24	37.41	48.06	60.42
EPS reported	23.05	35.24	37.41	48.06	60.42
BVPS	120.49	245.13	276.93	319.26	373.63
Tangible BVPS	120.49	245.13	276.93	319.26	373.63
Adjusted BVPS diluted	118.10	241.29	272.59	314.25	367.78
DPS	5.28	7.03	6.20	6.50	7.00
<b>Profit &amp; Loss (RsM)</b>					
Net interest income	15,671	25,854	35,416	46,013	59,239
Fees and commissions	7,790	13,207	18,490	24,037	30,046
Other operating Income	2,311	4,748	4,734	5,715	7,039
<b>Total operating income</b>	<b>25,772</b>	<b>43,808</b>	<b>58,640</b>	<b>75,764</b>	<b>96,325</b>
Total operating expenses	-12,146	-21,549	-30,626	-38,601	-49,228
<b>Oper. profit bef. provisions</b>	<b>13,626</b>	<b>22,259</b>	<b>28,014</b>	<b>37,163</b>	<b>47,096</b>
Bad debt provisions	-2,009	-4,975	-7,526	-10,895	-13,631
Non-operating/exceptionals	-1,657	-65	-200	-200	-200
<b>Pre-tax profit</b>	<b>9,960</b>	<b>17,219</b>	<b>20,288</b>	<b>26,068</b>	<b>33,265</b>
Tax	-3,372	-5,755	-6,695	-8,603	-11,310
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
<b>Attributable profit</b>	<b>6,588</b>	<b>11,464</b>	<b>13,593</b>	<b>17,466</b>	<b>21,955</b>
Adjusted earnings	6,588	11,464	13,593	17,466	21,955
<b>Growth Rates (%)</b>					
EPS adjusted	34.0	52.9	6.2	28.5	25.7
Oper. profit bef. prov.	37.1	63.4	25.9	32.7	26.7
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>732,572</b>	<b>1,095,778</b>	<b>1,364,069</b>	<b>1,752,856</b>	<b>2,279,008</b>
Avg interest earning assets	577,305	853,683	1,163,182	1,495,250	1,938,816
Customer loans	370,288	597,991	796,324	1,087,372	1,482,427
Gross NPLs	4,187	4,946	9,231	11,841	15,715
<b>Liab. &amp; shar. funds</b>	<b>732,572</b>	<b>1,095,778</b>	<b>1,364,069</b>	<b>1,752,856</b>	<b>2,279,008</b>
Total customer deposits	587,856	876,262	1,134,381	1,480,836	1,957,261
Reserve for loan losses	1,523	1,379	5,013	7,832	11,015
Shareholders' equity	<b>33,932</b>	<b>87,685</b>	<b>99,060</b>	<b>114,201</b>	<b>133,652</b>
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	21.0	18.9	14.6	16.4	17.7
Net interest margin	2.71	3.03	3.04	3.08	3.06
Cost/income ratio	47.1	49.2	52.2	50.9	51.1
Cash cost/average assets	2.0	2.4	2.5	2.5	2.4
NPLs/customer loans	1.1	0.8	1.2	1.1	1.1
Reserve for loan losses/NPLs	36.4	27.9	54.3	66.1	70.1
Bad debt prov./avg. cust. loans	0.7	1.0	1.1	1.2	1.1
Loans/deposit ratio	63.0	68.2	70.2	73.4	75.7
Tier 1 capital ratio	5.9	10.5	8.9	7.8	6.9
Total capital ratio	8.6	12.2	10.7	9.6	8.6

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## **AXIS Bank**

### **Company description**

Axis Bank is India's third-largest private-sector bank after the significantly larger ICICI Bank, and HDFC Bank. It is more than twice the size of the next largest private-sector bank. The top three private-sector banks collectively account for almost 9.6% market share, while private-sector banks as a group are about 18.6% of the system. Axis Bank is a small player in the broader banking sector; its market share is less than 2% in terms of loans and deposits. Axis Bank was started by the erstwhile Unit Trust of India (UTI) in 1994, along with LIC and GIC, two government-owned insurance companies. UTI's stake is now held by UTI-I, a government-owned entity, with a 28% holding. LIC and GIC together own 16.3%, and collectively, these government-owned shareholders own approximately 44% of the bank.

### **Investment strategy**

We rate Axis Buy/Low Risk. It is one of the few clean (in terms of asset book), rapidly growing, profitable, and competitive private-sector banks in India. We therefore see it making sustained market-share gains. The Indian banking sector offers significant structural growth on the assets and the liabilities side, and in terms of liability-driven financial services. Although the operating environment has become challenging in recent months, Axis' relatively strong management and risk focus have helped it grow in scale and quality. It looks well positioned to face the changing market environment. Axis also stands to gain disproportionately from opportunities in the sector, in our view. The bank has strong technology and products, an expanding distribution franchise, adequate scale, a strong service culture, and management enterprise - features that should help it stay ahead of large government banks to win market share.

### **Valuation**

Our target price of Rs807 is based on EVA, assuming a risk-free rate of 9.5%, a long-term loan loss assumption of 100bps per annum, and a long-term cost-to-income ratio of 44% given Axis' rapid pace of expansion. We prefer using an EVA-based valuation benchmark to P/BV because EVA concentrates on the economic value creation of the bank. We use P/BV as a secondary valuation methodology. Believing that Axis should trade above government banks and in line with the highest multiples for large private-sector banks given its ROE, we ascribe 3x one-year forward P/B to Axis, equating to Rs863. Axis' ROE of 16-17% should rise as it leverages its capital. The bank's market positioning, P&L and balance sheet should support such valuations, in our view.

## **Risks**

We rate Axis Bank as Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key downside risks to achieving our target price include: a) greater than expected asset quality pressures, as Axis has grown rapidly; b) a sharp slowdown in rapidly growing fee income; c) the bank's large share of wholesale funding could be exposed to tighter funding; d) depends on treasury returns; e) perceived dependence on CEO, who is slated to retire in 2009; and f) a government-related entity is a dominant shareholder in Axis. Any disorderly sale would have an impact on the stock.

# Appendix A-1

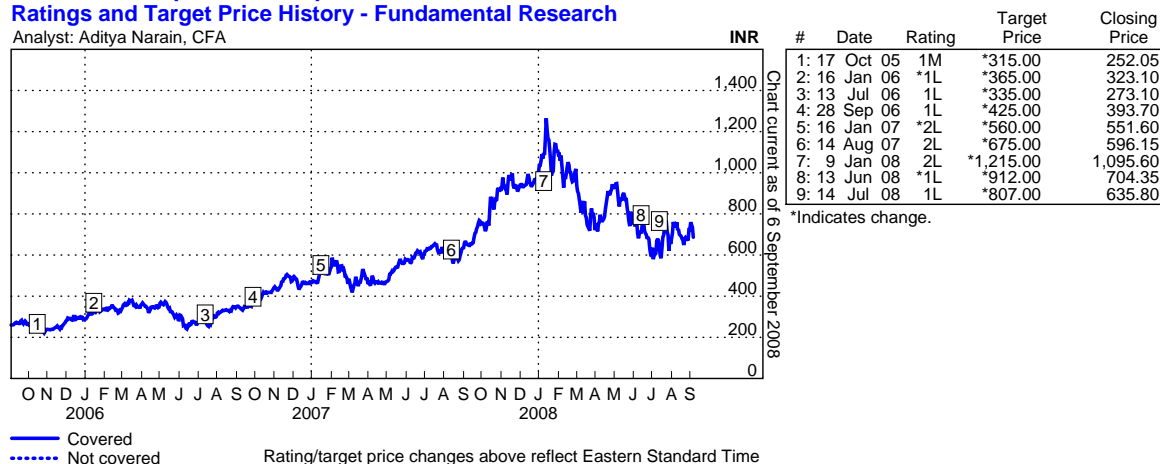
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Analyst: Aditya Narain, CFA



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