

# 3Q: Earnings beat, but Neutral on weak outlook

## Raise PO on strong 3Q, but remain Neutral on weak outlook

We raise our PO on Axis Bk to Rs1050 driven by 3Q earnings surprise (~7% ahead) driven by fees. However, we have tweaked our earnings est. by only 2-3% (FY12/13), lower than 3Q surprise, as we estimate a margin contraction (+25-30bps qoq) in 4Q driven by priority sector lending (low-yielding). We maintain our Neutral, as Axis post recent rally (+20%) trades at +1.7x FY13 adj; which is already at 1SD below avg. PB multiple. Hence, it is unlikely to re-rate much more given a leg down in growth (EPS growth at only +15% in FY13 vs. +25%) and rising NPL concerns, as we build in credit cycle, hence risk-return is balanced.

## 3Q Earnings ~7% ahead on higher fees; loan growth slows

3QFY12 earnings of Axis Bk came in at Rs11bn, up 24% yoy (~7% ahead) on a sharp jump in fees. But asset quality disappointed (discussed separately below). Top-line grew 24% yoy, but was ~2% below est., as growth in volumes moderated to 20% yoy (vs. 27% yoy in 2Q) and margin declined ~6bps yoy to 3.75%. CASA too declined ~70bps yoy / qoq to 41.6%. Clear surprise was fee income (up 26% yoy, 10% above estimates) driven by processing fee and loan syndication.

## Net slippages rise qoq; but asset quality manageable, as yet

Axis bank 3Q net slippages (net of recoveries / up-gradations) grew 24% qoq to +Rs4.1bn vs. Rs3.3bn in 2Q (and Rs2bn in 1Q). Hence, headline gross NPLs up 10% qoq, net up 24% qoq, but asset quality remains manageable with prov. coverage at ~75%. We continue to expect a credit cycle for the sector from Apr-May'12 including Axis Bk and we believe market may be pricing in lower delinquency which may actually disappoint going ahead. Hence, we est. slippages at +1.7% in FY13 (vs. <1.4% in FY12), with a upside risk to our est.

## Estimates (Mar)

(Rs)	2010A	2011A	2012E	2013E	2014E
Net Income (Adjusted - mn)	25,144	33,885	41,991	48,321	57,647
EPS	65.81	83.08	102.28	117.70	140.41
EPS Change (YoY)	29.9%	26.2%	23.1%	15.1%	19.3%
Dividend / Share	12.00	14.00	17.00	19.00	23.00
GDR EPS (US\$)	1.39	1.82	2.03	2.34	2.79
GDR Dividend / Share (US\$)	0.253	0.307	0.338	0.378	0.457

## Valuation (Mar)

	2010A	2011A	2012E	2013E	2014E
P/E	15.3x	12.1x	9.9x	8.6x	7.2x
Dividend Yield	1.19%	1.39%	1.68%	1.88%	2.28%
Pre-exceptional PE	15.33x	12.15x	9.87x	8.57x	7.19x
Price / Book	2.58x	2.18x	1.85x	1.57x	1.33x
RoE / PB	7.42x	8.87x	10.98x	12.61x	15.06x
Price / Pre-Provision Profit	6.87x	6.11x	5.18x	4.29x	3.68x

## Bank of America Merrill Lynch

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## Stock Data

Price (Common / GDR)	Rs1,009 / US\$20.28
Price Objective	Rs1,050 / US\$21.00
Date Established	22-Jan-2012 / 22-Jan-2012
Investment Opinion	C-2-7 / C-2-7
Volatility Risk	HIGH / HIGH
52-Week Range	Rs784.00-Rs1,461
Market Value (mn)	US\$8,232
Market Value (mn)	Rs414,261
Shares Outstanding (mn)	410.5 / 410.5
Average Daily Volume	2,944,653
BofAML Ticker / Exchange	XAXSF / BSE
BofAML Ticker / Exchange	XBKSF / LIN
Bloomberg / Reuters	AXSB IN / AXBK.BO
ROE (2012E)	20.3%
Total Dbt to Cap (Mar-2011A)	NA
Est. 5-Yr EPS / DPS Growth	19.0% / 17.0%
Free Float	50.0%

## Key Changes

(Rs)	Previous	Current
Price Obj.	965.00	1,050.00
2012E EPS	100.07	102.28
2013E EPS	114.92	117.70
2014E EPS	139.21	140.41

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Refer to important disclosures on page 7 to 10. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4. Link to Definitions on page 4. 11128637

## iQprofile<sup>SM</sup> Axis Bank Ltd.

Key Income Statement Data (Mar)	2010A	2011A	2012E	2013E	2014E
<b>(Rs Millions)</b>					
Net Interest Income	50,045	65,630	80,611	94,817	109,268
Net Fee Income	25,652	33,574	41,632	50,375	60,953
Securities Gains / (Losses)	7,140	3,593	3,054	4,000	4,400
Other Income	6,664	9,154	10,668	12,805	15,386
<b>Total Non-Interest Income</b>	<b>39,456</b>	<b>46,321</b>	<b>55,354</b>	<b>67,180</b>	<b>80,740</b>
Total Operating Income	89,501	111,951	135,965	161,997	190,008
Operating Expenses	(37,097)	(47,794)	(59,071)	(69,456)	(81,730)
<b>Pre-Provision Profit</b>	<b>52,404</b>	<b>64,157</b>	<b>76,894</b>	<b>92,540</b>	<b>108,278</b>
Provisions Expense	(13,561)	(11,213)	(12,237)	(14,293)	(16,111)
<b>Operating Profit</b>	<b>38,843</b>	<b>52,944</b>	<b>64,657</b>	<b>78,248</b>	<b>92,167</b>
Non-Operating Income	(327.10)	(1,588)	(2,448)	(6,127)	(6,127)
<b>Pre-Tax Income</b>	<b>38,516</b>	<b>51,357</b>	<b>62,209</b>	<b>72,121</b>	<b>86,040</b>
Net Income to Comm S/Hold.	25,144	33,885	41,991	48,321	57,647
<b>Adjusted Net Income (Operating)</b>	<b>25,144</b>	<b>33,885</b>	<b>41,991</b>	<b>48,321</b>	<b>57,647</b>

### Key Balance Sheet Data

Total Assets	1,806,479	2,427,134	2,942,960	3,344,642	3,860,487
Average Interest Earning Assets	1,586,138	2,048,485	2,602,977	3,053,133	3,501,046
<b>Weighted Risk Assets</b>	<b>1,401,480</b>	<b>2,050,055</b>	<b>2,497,427</b>	<b>2,899,081</b>	<b>3,469,512</b>
Total Gross Customer Loans	1,043,431	1,424,078	1,737,376	2,015,356	2,418,427
Total Customer Deposits	1,413,002	1,892,378	2,319,277	2,638,111	3,060,279
<b>Tier 1 Capital</b>	<b>150,475</b>	<b>179,487</b>	<b>214,560</b>	<b>218,536</b>	<b>223,092</b>
Tangible Equity	150,475	179,487	214,560	218,536	223,092
<b>Common Shareholders' Equity</b>	<b>160,444</b>	<b>189,988</b>	<b>224,302</b>	<b>264,042</b>	<b>311,302</b>

### Key Metrics

Net Interest Margin	3.16%	3.20%	3.10%	3.11%	3.12%
<b>Tier 1 Ratio</b>	<b>10.7%</b>	<b>8.8%</b>	<b>8.6%</b>	<b>7.5%</b>	<b>6.4%</b>
Effective Tax Rate	34.7%	34.0%	32.5%	33.0%	33.0%
Loan / Assets Ratio	57.8%	58.7%	59.0%	60.3%	62.6%
<b>Loan / Deposit Ratio</b>	<b>73.8%</b>	<b>75.3%</b>	<b>74.9%</b>	<b>76.4%</b>	<b>79.0%</b>
Oper Leverage (Inc Growth - Cost Growth)	6.2%	-3.8%	-2.1%	1.6%	-0.4%
Gearing (Assets / Equity)	11.3x	12.8x	13.1x	12.7x	12.4x
Tangible Common Equity / Assets	8.3%	7.4%	7.3%	6.5%	5.8%
Tangible Common Equity / WRAs	10.7%	8.8%	8.6%	7.5%	6.4%
Revenue Growth	36.0%	25.1%	21.5%	19.1%	17.3%
Operating Expense Growth	29.8%	28.8%	23.6%	17.6%	17.7%
Provisions Expense Growth	61.9%	-17.3%	9.1%	16.8%	12.7%
Operating Revenue / Average Assets	5.5%	5.3%	5.1%	5.2%	5.3%
Operating Expenses / Average Assets	2.3%	2.3%	2.2%	2.2%	2.3%
<b>Pre-Provision ROA</b>	<b>3.2%</b>	<b>3.0%</b>	<b>2.9%</b>	<b>2.9%</b>	<b>3.0%</b>
ROA	1.5%	1.6%	1.6%	1.5%	1.6%
<b>Pre-Provision ROE</b>	<b>39.9%</b>	<b>36.6%</b>	<b>37.1%</b>	<b>37.9%</b>	<b>37.6%</b>
ROE	19.2%	19.3%	20.3%	19.8%	20.0%
RoTE	16.7%	18.9%	19.6%	22.1%	25.8%
RoWRAs	1.8%	1.7%	1.7%	1.7%	1.7%
Dividend Payout Ratio	22.6%	19.8%	18.3%	17.8%	18.0%
<b>Efficiency Ratio (Cost / Income Ratio)</b>	<b>45.0%</b>	<b>44.1%</b>	<b>44.4%</b>	<b>44.0%</b>	<b>44.0%</b>
<b>Total Non-Interest Inc / Operating Inc</b>	<b>44%</b>	<b>41%</b>	<b>41%</b>	<b>41%</b>	<b>42%</b>
Market-Related Revenue / Total Revenues	13.2%	8.2%	7.1%	7.3%	7.1%
Provisioning Burden as % of PPP	25.9%	17.5%	15.9%	15.4%	14.9%
NPLs plus Foreclosed Real Estate / Loans	0.4%	0.3%	0.4%	0.7%	0.7%
<b>Loan Loss Reserves / NPLs</b>	<b>214.6%</b>	<b>289.7%</b>	<b>200.0%</b>	<b>171.9%</b>	<b>213.4%</b>
Loan Loss Reserves / Total Loans	0.9%	0.8%	0.8%	1.2%	1.5%
Provisions Expense / Average Loans	1.4%	0.9%	0.8%	0.8%	0.7%

### Other Metrics

Income / Employee	4.14	4.23	4.47	4.63	4.73
(Operating Expenses) / Employee	1.71	1.81	1.94	1.99	2.03
Pre-Provision Profit / Employee	2.42	2.43	2.53	2.65	2.69
Net Profit / Employee	1.16	1.28	1.38	1.38	1.43

### Company Description

Axis Bank, erstwhile UTI Bank, promoted in 1994, is a new generation private sector bank, with a balance sheet size of Rs1.8tn. It has built a reasonable retail infrastructure, with 1027 branches and a wide product range. The bank is poised to leverage on its multi-channel, technology-driven retail network. Well placed in a rising interest rate scenario.

### Investment Thesis

We have a Neutral rating on Axis Bank as we believe its rapid loan growth of +63% over the past 2 years is likely to moderate (less than 25%), as the 3G funding effect fades away. The company has 20% SME exposure but credit costs have increased recently due to slippages from SME, agri and unsecured retail loans.

### Stock Data

Shares / GDR	1.00
Price to Book Value	1.8x

### Key Changes (GDR)

(US\$)	Previous	Current
Price Obj.	17.50	21.00
2012E EPS	1.99	2.03
2013E EPS	2.28	2.34
2014E EPS	2.77	2.79

## 3QFY12 Result Summary

Table 1: 3QFY12 Results Summary

(Rs mn)	3QFY12	3QFY11	yoy	Remarks
Interest earned	57,770	38,383	50.5%	
- on Advances	39,636	26,006	52.4%	Supported by loan growth of 20% yoy, Yield increasing ~200bps
- on investments	17,752	11,668	52.1%	Investment book growth of +50% yoy.
- on bal with RBI	155	482	-67.9%	
- Others	227	228	-0.2%	
Interest Expended	36,367	21,052	72.7%	Cost of Funds up 150bps yoy and 15bps qoq. CASA declined ~70bps both yoy and qoq to 41.6%
<b>Net Int. Income</b>	<b>21,403</b>	<b>17,331</b>	<b>23.5%</b>	Topline growth ~2% below estimate. Margins declined ~5bps yoy and qoq to 3.75%
Other income	14,298	11,477	24.6%	
- Fee income	12,226	9,680	26.3%	Driven by corporate (34% yoy), Retail (26% yoy), Treasury profit high on currency volatility
- Treasury income	1,177	1,350	-12.8%	
Operating income	35,701	28,808	23.9%	
<b>Total Opex</b>	<b>15,109</b>	<b>12,224</b>	<b>23.6%</b>	Cost-income ratio at +42%. Addition of +370 branches and +3000 ATMs over last 12 months.
Employee exp	5,420	3,962	36.8%	
Other Opex	9,689	8,262	17.3%	
<b>Operating profit</b>	<b>20,592</b>	<b>16,585</b>	<b>24.2%</b>	
Provisions	4,223	3,139	34.6%	Includes Rs430mn for Investment provisions, Rs570mn for Standard Assets and Restructured (Rs20mn) Gross NPLs up 10% qoq (at 1.1%) and Net up 24% qoq at (39bps) Coverage at +75% (incl prudential w/o). New slippages at
- NPL Provisions	3,340	2,330	43.3%	Rs5.4bn vs Rs5bn in 2Q. Fresh Restructuring Rs3bn. O/S book at Rs27bn (1.6% of Loans)
PBT	16,369	13,446	21.7%	
Provision for Tax	5,346	4,532	18.0%	
<b>PAT</b>	<b>11,023</b>	<b>8,914</b>	<b>23.7%</b>	Earnings 7% ahead of estimates owing to higher fees income

Source: BofA Merrill Lynch Global Research Estimates

## Price objective basis & risk

### Axis Bank (XAXSF / XBKSF)

We set our PO on Axis Bank to Rs1050 (US\$21). Our PO is based on historical traded forward PB multiple, implying a multiple of 1.7x FY13. We are still assigning a 20% premium to theoretical multiples owing to Axis Bks RoEs of +19-20%, good franchise, high low-cost deposit base. We now estimate Axis Bks earnings to grow at more modest at +15-20% growth rate through FY12/13E (vs. +25-30% earlier). We believe Axis trading at +1.7-1.8x FY13 adj. book will not re-rate given a leg down in growth, rising asset quality concerns and Tier 1 est. at 8.0% in FY12 limiting stronger future growth. Risks to our PO are a sharp rise in NPLs leading to higher credit costs or the MTM hits arising from the corporate investment book or inability to grow in sync with expectations owing to moderation in the growth cycle.

## Link to Definitions

### Financials

Click [here](#) for definitions of commonly used terms.

## Analyst Certification

I, Rajeev Varma, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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22 January 2012

**India - Financials Coverage Cluster**

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Corporation Bank	XCRRF	CRPBK IN	Veekesh Gandhi
	Federal Bank	XFDRF	FB IN	Veekesh Gandhi
	HDFC	HGDF	HDFC IN	Rajeev Varma
	HDFC Bank	XHDF	HDFCB IN	Rajeev Varma
	HDFC Bank	HDB	HDB US	Rajeev Varma
	ICICI Bank	ICIJF	ICICIBC IN	Rajeev Varma
	ICICI Bank - A	IBN	IBN US	Rajeev Varma
	IndiaBulls Financial Services	IBLFF	IBULL IN	Veekesh Gandhi
	Indian Bank	INDIF	INBK IN	Rajeev Varma
	LIC Housing Finance, Ltd.	LHFLF	LICHF IN	Veekesh Gandhi
	Manappuram	XMGPF	MGFL IN	Veekesh Gandhi
	Max India	MXXIF	MAX IN	Rajeev Varma
	Power finance corporation Ltd	PWFEE	POWF IN	Veekesh Gandhi
	Punjab	PUJBF	PNB IN	Rajeev Varma
	Reliance Capital	RLCCF	RCAPT IN	Veekesh Gandhi
	Rural Electrification Corporation Ltd	XULEF	RECL IB	Veekesh Gandhi
	SBI	SBINF	SBIN IN	Rajeev Varma
	SBI -G	SBKFF	SBID LI	Rajeev Varma
	Shriram Transport Finance	SHTFF	SHTF IN	Veekesh Gandhi
	Yes Bank Ltd	YESBF	YES IN	Veekesh Gandhi
<b>NEUTRAL</b>				
	Axis Bank	XAXSF	AXSB IN	Rajeev Varma
	Axis Bank - GDR	XBKSF	AXB LI	Rajeev Varma
	Bank of Baroda	BKBAF	BOB IN	Rajeev Varma
<b>UNDERPERFORM</b>				
	Bank of India	XDIIF	BOI IN	Rajeev Varma
	Canara Bank	CNRKF	CBK IN	Rajeev Varma
	IDBI	XDBIF	IDBI IN	Veekesh Gandhi
	Infrastruct Dev	IFDFF	IDFC IN	Rajeev Varma
	Kotak Mahindra Bank	XXRVF	KMB IN	Rajeev Varma
	ORBC	ORBCF	OBC IN	Rajeev Varma
	Union Bank India	UBOIF	UNBK IN	Rajeev Varma

22 January 2012

**iQmethod<sup>SM</sup> Measures Definitions**

<b>Business Performance</b>	<b>Numerator</b>	<b>Denominator</b>
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

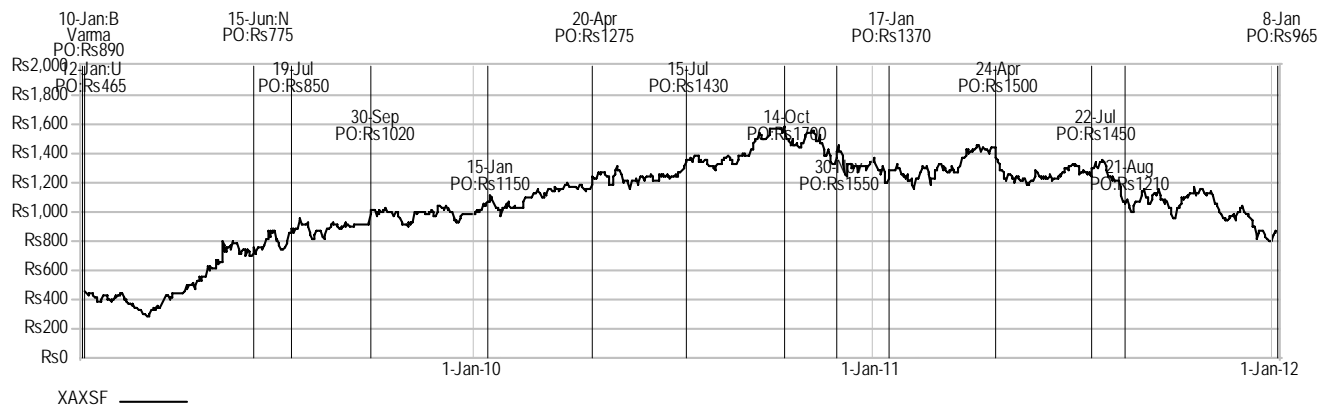
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*iQdatabase<sup>®</sup>* is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by BoFA Merrill Lynch.

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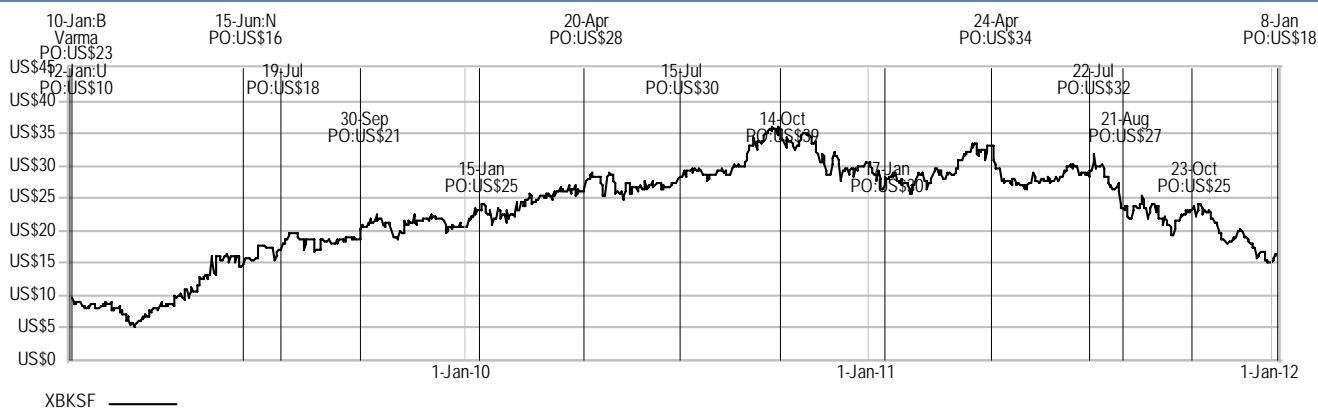
### XAXSF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of [December 31, 2011] or such later date as indicated.

### XBKSF Price Chart



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### Investment Rating Distribution: Banks Group (as of 01 Jan 2012)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	120	48.00%	Buy	85	89.47%
Neutral	76	30.40%	Neutral	53	82.81%
Sell	54	21.60%	Sell	37	71.15%

### Investment Rating Distribution: Global Group (as of 01 Jan 2012)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2029	52.00%	Buy	1337	72.11%
Neutral	1009	25.86%	Neutral	657	71.34%
Sell	864	22.14%	Sell	487	60.20%

\* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

**FUNDAMENTAL EQUITY OPINION KEY:** Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. *VOLATILITY RISK RATINGS*, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. *INVESTMENT RATINGS* reflect the analyst's assessment of a stock's: (i) absolute total return potential and (ii) attractiveness for investment relative to other stocks within its *Coverage Cluster* (defined below). There are three investment ratings: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

\* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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