



ACTION
Buy

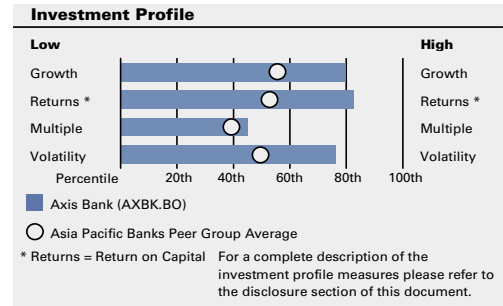
Axis Bank (AXBK.BO)

Return Potential: 17%

Resilient growth at sub-midcycle value; keep Buy, raise TP to Rs770

Source of opportunity

Despite the YTD absolute return of 27%, we believe there is upside to Axis's (AXBK.BO) share price due to: 1) continued growth momentum, resilient profitability and balance sheet profile (ROA, NPA and CAR); 2) an under-appreciated deposit franchise and diversified revenue streams rendering Axis's earnings less pro-cyclical, and 3) valuation that is below mid-cycle levels (2009E P/B of 2.0 X vs 5-year median P/B of 2.2X). Change in risk appetite by the market for equities could impact the stock price, however, there are unlikely to be significant company specific concerns after a strong showing by the bank in its 4Q08 results.



Catalyst

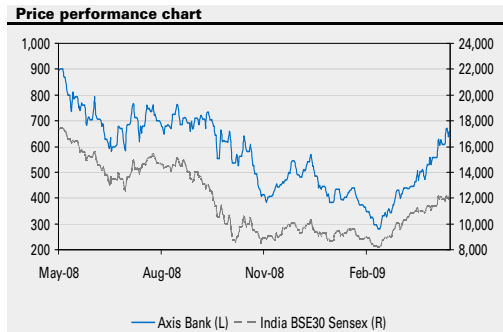
We raise our EPS estimates by 3% to 5% for 2009E through 2011E mainly due to higher non-interest income and lower operating cost. Our 2009 credit cost assumptions for Axis are still above the mid-cycle levels. We note that our Global ECS Research team continues to argue for a pro-cyclical stance, which implies the potential for better than we expected credit cost environment in 2009. A rapid transition in the senior management, namely the CEO, would be an added catalyst; a quick succession would likely reduce any concerns about the bank losing growth momentum due to vacancy of the CEO position.

Key data	Current
Price (Rs)	659.40
12 month price target (Rs)	770.00
Market cap (Rs mn / US\$ mn)	236,754.9 / 4,794.6
Foreign ownership (%)	32.9

	3/09	3/10E	3/11E	3/12E
EPS (Rs) New	49.09	61.28	76.66	95.24
EPS revision (%)	0.0	3.4	5.2	3.4
P/B (X)	2.3	2.0	1.7	1.4
P/E (X)	13.4	10.8	8.6	6.9
Dividend yield (%)	1.5	2.1	2.7	3.3
P/POP (X)	6.7	5.0	4.2	3.4
PPOP growth (%)	59.4	32.3	21.2	21.4
Provision ROA (%)	2.8	2.8	2.8	2.7
Credit cost (%)	0.9	1.2	1.0	0.9
ROA (%)	1.41	1.37	1.37	1.36
ROE (%)	19.1	20.3	21.6	22.8

Valuation

We raise our 12-m TP by 13% to Rs770 due to upward revision in our EPS estimates during 2009E-2011E as well as long term growth expectation. Our Rs770 TP is based on 2.3X 2009E P/B, derived using the GS CAMELOT based 3-stage DDM.



Key risks

Risks: 1) loss of growth momentum due to shift in the strategic focus of the bank and or attrition in senior management; 2) higher than expected increase in credit costs adversely impacting earnings growth prospects.

Share price performance (%)	3 month	6 month	12 month
Absolute	50.1	33.3	(26.2)
Rel. to India BSE30 Sensex	18.8	2.7	5.1

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 5/15/2009 close.

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Axis Bank: Summary financials

Profit model (Rs mn)	3/09	3/10E	3/11E	3/12E	Balance sheet (Rs mn)	3/09	3/10E	3/11E	3/12E
Net interest income	36,865.7	51,197.7	61,675.3	76,154.7	Gross loans	821,276.2	1,034,808.0	1,293,510.1	1,616,887.6
Non-interest income	27,190.3	32,140.4	40,228.5	48,574.7	NPLs	8,942.0	20,887.3	30,143.2	37,269.1
Operating revenue	64,056.0	83,338.1	101,903.7	124,729.5	Loan loss reserves	10,274.8	19,746.9	28,358.1	36,300.7
Non-interest expense	(28,581.7)	(36,403.0)	(45,013.0)	(55,667.4)	Total interest earning assets	1,420,791.8	1,757,209.6	2,221,572.8	2,777,060.9
Provision operating profit	35,474.3	46,935.1	56,890.8	69,062.0	Other non-interest earning assets	56,428.7	64,126.8	80,969.0	101,116.2
Total provision charge	(7,619.4)	(12,154.7)	(13,310.9)	(14,724.8)	Total assets	1,477,220.5	1,821,336.4	2,302,541.7	2,878,177.1
Associates	0.0	0.0	0.0	0.0	Customer deposits	1,173,740.0	1,427,026.2	1,784,821.9	2,233,476.4
Pretax profit	27,854.9	34,780.4	43,579.9	54,337.2	Total interest-bearing liabilities	1,300,372.2	1,599,406.5	2,021,977.0	2,527,471.3
Tax	(9,699.1)	(12,173.1)	(15,253.0)	(19,018.0)	Total equity	102,121.1	120,329.9	142,219.7	168,128.6
Minorities	0.0	0.0	0.0	0.0	CAMEL ratios (%)	3/09	3/10E	3/11E	3/12E
Net profit	18,155.8	22,607.3	28,326.9	35,319.2	C: Tier 1 capital ratio	9.3	8.9	8.3	7.9
Dividends	3,590.0	5,080.6	6,580.6	8,043.0	C: Equity/loans	12.5	11.8	11.2	10.6
Dividends payout (%)	19.7	22.4	23.1	22.8	C: Equity/assets	6.9	6.6	6.2	5.8
Earnings growth drivers (%)	3/09	3/10E	3/11E	3/12E	A: NPL ratio	1.1	2.0	2.3	2.3
Net interest margin	2.87	3.16	3.04	3.01	A: Loan loss reserves/NPLs	114.9	94.5	94.1	97.4
Provision charge/total loans	0.93	1.19	1.05	0.93	E: Net interest margin	2.87	3.16	3.04	3.01
YoY Growth (%)					E: Non int inc/oper revenues	42.45	38.57	39.48	38.94
Customer deposits	33.9	21.6	25.1	25.1	E: Cost-income ratio	44.6	43.7	44.2	44.6
Loans	36.7	25.0	24.6	24.9	E: ROAA	1.41	1.37	1.37	1.36
Net interest income	42.6	38.9	20.5	23.5	L: Loan/deposit ratio	69.5	71.5	71.2	71.1
Fee income	60.5	20.0	25.0	25.0	Key CAMELOT assumptions	3/09	3/10E	3/11E	3/12E
Non-interest income	51.4	18.2	25.2	20.7	GS CAMELOT implied P/B (X)	3.1	--	--	--
Operating revenue	46.2	30.1	22.3	22.4	GS CAMELOT implied P/E (X)	15.7	--	--	--
Operating expenses	(32.6)	(27.4)	(23.7)	(23.7)	Risk-free rate (%)	8.1	8.1	8.1	8.1
Preprovision operating profit	59.4	32.3	21.2	21.4	Equity risk premium (%)	6.0	6.0	6.0	6.0
Provision charges	120.3	59.1	7.1	4.2	CAMELOT beta (X)	0.8	--	--	--
Pretax profit	69.2	24.9	25.3	24.7	Risk-adjusted cost of equity (%)	12.9	--	--	--
Net profit	69.5	24.5	25.3	24.7	3-yr adjusted DPS CAGR (%)	30.0	--	--	--
EPS	56.8	24.8	25.1	24.2	Sustainable ROE estimate (%)	20.0	--	--	--
DPS	66.7	40.0	28.6	22.2	LT dividend payout estimate (%)	77.0	--	--	--
Market dimensions	3/09	3/10E	3/11E	3/12E	Ex-growth bond-equivalent P/B (X)	1.6	--	--	--
No of branches	0.0	0.0	0.0	0.0	Loan portfolio (%)	3/09	3/10E	3/11E	3/12E
No of staff (000)	0.0	0.0	0.0	0.0	Commercial & corporate	80.5	80.5	80.5	80.5
Revenues/staff (US\$)	NM	NM	NM	NM	Mortgages/home loans	NM	NM	NM	NM
Net profit/staff (US\$)	NM	NM	NM	NM	Consumer	19.5	19.5	19.5	19.5
DuPont analysis (%)	3/09	3/10E	3/11E	3/12E	Valuation (current price)	3/09	3/10E	3/11E	3/12E
ROE	19.1	20.3	21.6	22.8	P/E basic (X)	13.4	10.8	8.6	6.9
x leverage	7.4	6.7	6.4	6.0	P/B (X)	2.32	1.99	1.70	1.43
=ROA	1.41	1.37	1.37	1.36	P/PPOP (X)	6.7	5.0	4.2	3.4
% of assets	3/09	3/10E	3/11E	3/12E	Dividend yield (%)	1.5	2.1	2.7	3.3
Net interest income	2.87	3.10	2.99	2.94	EPS, basic (Rs)	50.66	62.63	77.77	96.61
Fee income	1.65	1.54	1.54	1.53	EPS, fully-diluted (Rs)	49.09	61.28	76.66	95.24
Non-interest income	2.11	1.95	1.95	1.88	EPS, basic growth (%)	57.6	23.6	24.2	24.2
Operating revenue	4.98	5.05	4.94	4.82	EPS, fully diluted growth (%)	56.8	24.8	25.1	24.2
Operating expenses	2.22	2.21	2.18	2.15	BVPS (Rs)	284.46	331.58	389.02	459.88
Preprovision operating profit	2.76	2.85	2.76	2.67	DPS (Rs)	10.00	14.00	18.00	22.00
Loan loss provisions	0.59	0.73	0.63	0.52					
Pretax profits	2.17	2.11	2.11	2.10					
Taxes	0.75	0.74	0.74	0.73					

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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Resilient growth at sub-midcycle valuation

Exhibit 1: We expect growth for Axis to remain robust driven by strong revenue growth, albeit being moderate compared to its history and ROE to be resilient driven by cost control
Valuation summary of Axis

(In %)	Attributable profits		EPS	EPS	BVPS	DPS	Dividend	P/E (X)	P/B (X)	ROE	ROA	Tier 1 ratio	TE/TA
	In Rs mn	Yoy	(Rs)	growth	(Rs)	(Rs)	yield						
2000	861	69%	6.5	67%	22.9	1.5	0.2%	102.0	28.85	31.8%	0.99%	5.8%	2.8%
2001	1,341	56%	9.3	44%	32.1	2.0	0.3%	70.8	20.57	29.3%	1.07%	6.4%	4.3%
2002	1,922	43%	10.0	7%	39.9	2.2	0.3%	66.1	16.53	25.1%	1.13%	6.4%	4.7%
2003	2,783	45%	11.9	20%	49.1	2.5	0.4%	55.3	13.44	27.1%	1.27%	6.4%	4.7%
2004	3,346	20%	14.1	18%	88.0	2.8	0.4%	46.9	7.50	18.9%	1.08%	8.9%	6.4%
2005	4,851	45%	17.1	22%	103.1	3.5	0.5%	38.6	6.40	18.4%	1.11%	7.3%	5.8%
2006	6,590	36%	22.8	33%	120.5	4.5	0.7%	28.9	5.47	21.0%	1.07%	6.4%	4.6%
2007	10,710	63%	31.3	37%	245.1	6.0	0.9%	21.1	2.69	17.6%	1.17%	10.2%	8.0%
2008P	18,156	70%	49.1	57%	284.5	10.0	1.5%	13.4	2.32	19.1%	1.41%	9.3%	6.9%
2009E	22,607	25%	61.3	25%	331.6	14.0	2.1%	10.8	1.99	20.3%	1.37%	8.9%	6.6%
2010E	28,327	25%	76.7	25%	389.0	18.0	2.7%	8.6	1.70	21.6%	1.37%	8.3%	6.2%
2011E	35,319	25%	95.2	24%	459.9	22.0	3.3%	6.9	1.43	22.8%	1.36%	7.9%	5.8%
2008P-2011E CAGR	25%		25%		17%	30%		2008P-2011E Average		20.9%	1.38%		
2004-2008P CAGR	52%		36%		38%	36%		2004-2008P Average		19.0%	1.17%		

Source: Datastream, Company data, Goldman Sachs Research estimates.

Despite a strong performance (up 27% YTD), we believe there are many reasons to stay constructive on Axis:

- Sustained growth momentum and resilient profitability and balance sheet profile: we believe Axis would likely sustain robust earnings growth despite a slowdown in demand for new loans driven by continued market share gains, improving NIM due to strengthening funding profile and cost controls ensuring that revenues grow in line with cost even after taking into account the ongoing expansion plans for distribution.

Exhibit 2: Axis: a 16-year view through several cycles

(In %)	ROE	ROA	EPS (Rs)	DPS (Rs)	BVPS (Rs)	Div payout	In Rs mn							Cost-Inc	Credit cost	Gross NPL ratio	
							NPAT	NII	Non int	Op Rev	Op Exp	PPOP	Prov				Pretax
1996	11.2%	1.05%	1.3	-	12.5	0%	152	356	241	597	264	333	89	241	44%	1.86%	0.0%
1997	10.9%	0.68%	1.4	-	13.9	0%	166	334	609	943	398	546	252	283	42%	1.65%	0.0%
1998	17.0%	0.88%	2.4	1.0	15.6	42%	311	726	466	1,193	510	683	220	463	43%	1.13%	0.0%
1999	22.9%	0.96%	3.9	1.2	18.2	31%	509	904	912	1,816	654	1,162	375	787	36%	0.95%	5.5%
2000	31.8%	0.99%	6.5	1.5	22.9	23%	861	983	1,630	2,613	1,288	1,325	281	1,045	49%	0.51%	4.6%
2001	29.3%	1.07%	9.3	2.0	32.1	21%	1,341	1,985	4,159	6,144	2,071	4,073	1,939	2,134	34%	3.74%	5.2%
2002	25.1%	1.13%	10.0	2.2	39.9	22%	1,922	3,224	4,105	7,329	3,229	4,100	1,087	3,013	44%	1.56%	3.2%
2003	27.1%	1.27%	11.9	2.5	49.1	21%	2,783	5,653	5,401	11,054	4,192	6,862	2,566	4,296	38%	2.90%	2.9%
2004	18.9%	1.08%	14.1	2.8	88.0	20%	3,346	6,829	4,158	10,987	5,814	5,173	135	5,038	53%	0.02%	2.0%
2005	18.4%	1.11%	17.1	3.5	103.1	20%	4,851	9,907	7,296	17,203	8,141	9,063	1,748	7,314	47%	0.67%	1.7%
2006	21.0%	1.07%	22.8	4.5	120.5	20%	6,590	14,683	10,101	24,784	12,146	12,638	2,674	9,965	49%	0.25%	1.1%
2007	17.6%	1.17%	31.3	6.0	245.1	19%	10,710	25,854	17,955	43,808	21,549	22,259	5,794	16,465	49%	0.71%	0.8%
2008P	19.1%	1.41%	49.1	10.0	284.5	20%	18,156	36,866	27,190	64,056	28,582	35,474	7,619	27,855	45%	1.07%	1.1%
2009E	20.3%	1.37%	61.3	14.0	331.6	23%	22,607	51,198	32,140	83,338	36,403	46,935	12,155	34,780	44%	1.30%	2.0%
2010E	21.6%	1.37%	76.7	18.0	389.0	23%	28,327	61,675	40,228	101,904	45,013	56,891	13,311	43,580	44%	1.11%	2.3%
2011E	22.8%	1.36%	95.2	22.0	459.9	23%	35,319	76,155	48,575	124,729	55,667	69,062	14,725	54,337	45%	0.92%	2.3%

Source: Company data, Goldman Sachs Research estimates.

- An under-appreciated deposit franchise and diversified revenue streams rendering its earnings less pro-cyclical—strong deposit franchise (CASA deposit ratio of 43% as of March 2009 and likely to rise further due to slower asset growth), diversified loan book (across corporate, SME, agriculture and retail) and diversified revenue streams (non-interest income/operating revenue of 42%) are likely to lend stability and sustainability of earnings growth and ROE.

- Our credit cost assumption for Axis is still at or above mid-cycle levels. We believe a pro-cyclical stance by our Global ECS Research team implies the potential for better than we expected credit cost environment in 2009.
- Disciplined use of capital: Axis growth strategy has focused on protecting returns. It is the only bank within our coverage universe that has delivered an improvement in ROA driven by core earnings through 2008. This is mainly attributable to its deposit led balance sheet growth and cross-selling banking services across customer groups improving fee income growth across businesses.
- A rapid transition in the CEO position could alleviate any concerns about potential discontinuity in the short-term resulting in the loss of growth momentum. The board of Axis appointed Ms. Shikha Sharma, ex-CEO of ICICI Prudential Life, as the new CEO and MD. The uncertainty about succession is cleared, but leaves a vacuum in the short term due to the abrupt departure of the incumbent, Mr. P.J. Nayak. The shareholder meeting to decide on the ratification of Ms. Sharma is scheduled for June 1, 2009, following which it will also need to be ratified by the RBI (Reserve Bank of India). Given the vacancy in the CEO position, we believe there could be greater urgency for Ms. Sharma to assume the new role prior to the expected appointment in August, when Mr. Nayak's term would have ended.
- We believe there are opportunities to enhance value, and hence change in the CEO position could bring in more positive drivers of value as opposed to any concern of disruption in its market position which the market could be concerned about. We believe the finalization of the CEO position would remove a key concern on the stock.
- At about 2X 2009E P/B, Axis is trading below the mid-cycle P/B of 2.2X. Given a pro-cyclical stance, we would argue for valuation above the mid-cycle level. As discussed before, the pro-cyclical stance could imply potential for better than expected earnings growth supporting a valuation above the mid-cycle level.

Raise TP to Rs770; a pro-cyclical view implies upside risk

We raise our 12-m TP to Rs770 due to upward revision of EPS estimates by 3%-5% during 2009E-2011E. We also raise our long-term growth expectations as market concerns about significant deterioration in asset quality appears to have abated. We believe a pro-cyclical view implies upside risk potential. Our target multiple for Axis is ahead of mid-cycle level of 2.2x.

Exhibit 3: We raise our near-term as well as long-term growth expectation due to unchanged outlook for its fundamentals as well as due to pro-cyclical view of our Global ECS Research team

GS Camelot based 3-stage DDM for coverage stocks

		GS CAMELOT valuation model											CAMELOT Implied multiples (X)		Ex-growth bond eq multiple (x)	Implied 2009E Tangible P/B for target price
		12-mo target price Rs	GS CAMELOT implied value		Capital asset pricing model	3-stage dividend discount model						P/B	P/E	Ex-growth P/B		
Reuters Ticker	Rating		15-May-09 Rs	CAMELOT implied P/B x 2009E BVPS (Rs)	(a) Total disc rate	stage 1	stage 2	stage 3	(b)							(c) = (b)/(a)
					3-year div CAGR	15-year growth rate	Div payout	Sust ROE	L/T growth							
ICICIB	ICBK.BO	Buy	574	590	610	15.0%	18.1%	11.6%	22.5%	17.0%	4.6%	1.22	7.2	1.13	1.26	
Axis	AXBK.BO	Buy	659	770	1,040	13.5%	30.0%	12.6%	37.0%	20.0%	4.6%	3.14	15.7	1.48	2.32	
HDFC	HDFC.BO	Buy	1,936	1,820	2,300	12.8%	18.6%	12.6%	51.5%	23.0%	4.8%	4.06	17.6	1.79	3.45	
HDFCB	HDBK.BO	Neutral	1,185	880	1,138	13.5%	21.0%	12.2%	39.0%	20.0%	4.8%	2.70	13.5	1.48	2.31	
SBI	SBI.BO	Neutral	1,312	1,150	1,150	16.2%	10.2%	11.2%	25.5%	15.0%	4.6%	0.78	5.2	0.93	0.91	
IOB	IOBK.BO	Neutral	66	70	50	16.8%	-7.0%	11.2%	20.0%	14.0%	4.6%	0.42	3.0	0.83	0.58	
IBFSL	IBUL.BO	Neutral	146	100	80	16.8%	-6.0%	12.0%	25.0%	14.0%	4.6%	0.52	3.7	0.83	0.69	
IDFC	IDFC.BO	Sell	95	50	50	15.6%	1.0%	12.0%	25.0%	18.0%	4.6%	0.95	5.3	1.15	0.95	
KMB	KTKM.BO	Sell	507	250	240	15.0%	1.0%	12.2%	24.0%	16.0%	4.8%	0.92	5.7	1.07	1.22	
PNB	PNBK.BO	Sell	575	340	340	16.2%	2.2%	11.2%	25.5%	15.0%	4.6%	0.68	4.5	0.93	0.74	
BOB	BOB.BO	Sell	342	230	230	16.2%	0.0%	11.2%	14.0%	14.0%	4.6%	0.46	3.3	0.86	0.60	

For important disclosures, please go to <http://www.gs.com/research/hedge.html>. For methodology and risks associated with our price targets, please see our previously published research.

Source: Company data, Datastream, Goldman Sachs Research estimates.

Our 12-month target price of Rs770 is based on the mid-point of GS CAMELOT derived P/B multiples and ex-growth value. The key assumptions are as follows:

- Dividend CAGR of 30% for 2009E-2011E
- Sustainable growth rate of 12.6% during the transition phase of 15 years
- Sustainable growth rate of 4.6% for the terminal phase
- COE of 13.5%.

Exhibit 4: Given the growth prospect, ROE, we believe valuation for Axis remains undemanding

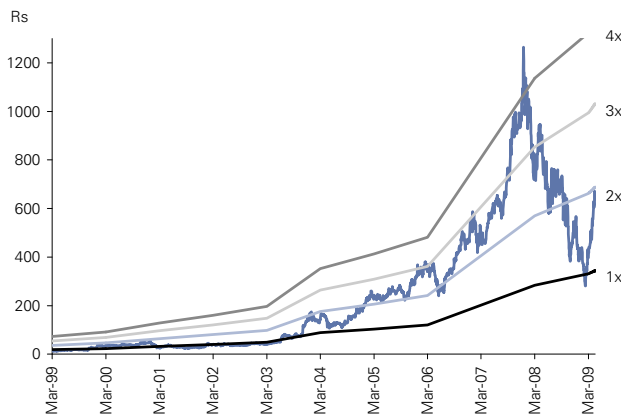
Valuation summary of coverage group

	Price (Rs)	P/E (x)		P/PPOP (x)		P/B (x)		EPS CAGR (%)	ROA (%)		ROE (%)	
	15-May-09	2009E	2010E	2009E	2010E	2009E	2010E	2008E-2010E	2009E	2010E	2009E	2010E
ICICIB	574	15.7	12.9	6.5	5.6	1.22	1.15	15.4	1.0	1.1	8.1	9.2
Axis	659	10.8	8.6	5.0	4.2	1.99	1.70	25.0	1.4	1.4	20.3	21.6
HDFC	1,936	20.4	17.5	14.2	12.2	3.67	3.31	16.0	2.4	2.3	19.0	20.0
HDFCB	1,185	21.2	17.7	9.1	7.5	3.11	2.71	16.2	1.3	1.3	15.8	16.8
SBI	1,312	9.2	8.9	4.1	3.2	1.04	0.94	(7.6)	0.6	0.6	11.9	11.1
IOB	66	4.2	4.9	1.8	1.6	0.55	0.51	(25.3)	0.7	0.5	13.7	10.9
IBFSL	146	9.5	7.8	4.3	3.4	1.00	0.94	4.9	2.3	2.5	10.9	12.5
IDFC	95	16.6	15.5	11.8	11.0	1.81	1.66	(2.1)	2.4	2.4	11.3	11.2
KMB	507	26.0	23.0	13.2	11.4	2.48	2.26	0.5	1.3	1.2	9.9	10.3
PNB	575	11.4	8.4	3.7	3.0	1.26	1.13	(14.7)	0.6	0.7	10.4	12.9
BOB	342	9.6	10.9	3.7	3.2	0.90	0.85	(28.3)	0.5	0.4	9.7	8.0

Source: Company data, Datastream, Goldman Sachs Research estimates.

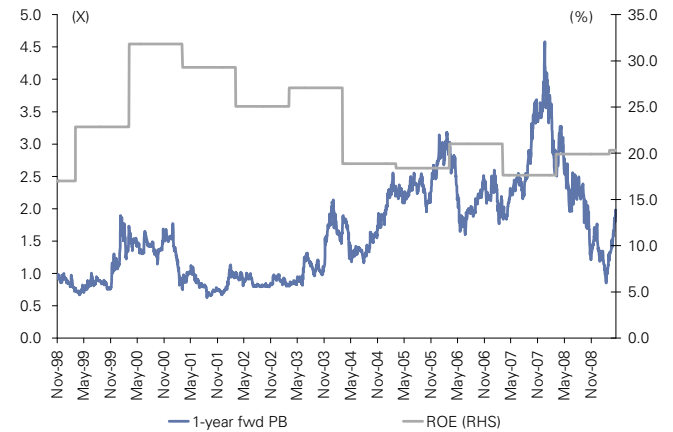
Historical valuation range for Axis suggests that it could trade between 2X and 3X on 12-m forward P/B multiples. Prior to 2004 (before acquisition of financial stake by HSBC), Axis suffered from many limitations including lack of scale, potential constraints on access to capital due to its small size, perceived weakness in its franchise. Since 2004, we believe Axis has not only turned around the corner on all these fronts but has also strengthened its franchise considerably.

Exhibit 5: We believe trading range between 2004 and 2008 is relevant given the strong fundamentals of Axis
1-year forward PB band chart



Source: Datastream, Company data, Goldman Sachs Research estimates.

Exhibit 6: Axis has kept its ROE undiluted through a well disciplined use of capital, warranting a higher P/B
1-year forward PB vs ROE



Source: Datastream, Company data, Goldman Sachs Research estimates.

Growth expectations for Axis have swung widely between 2007 and 2008 due to concerns on significant deterioration in asset quality. Investors could remain concerned about NPL rising further as the loan portfolio seasons; however, they are unlikely to factor a very pessimistic outlook due to the following factors:

1. Robust financial performance in 2008 by the bank demonstrated that asset quality deterioration was more benign than what the market had anticipated. We believe this supports our stance that the underwriting standard of Axis is much superior than the market had factored in.
2. Moderation in loan growth—we expect loan growth for Axis to moderate from CAGR of 54% during 2005-2008 to 25% during 2009E-2011E.
3. Signs of activity level showing a pick-up globally and domestically would likely lead investors to take a more benign view on the asset quality outlook for banks including Axis. Such a view could raise investors' expectations of earnings growth for the bank.

Key risks include

- significant deterioration in the asset quality, particularly, if macro economic conditions deteriorate—there are lesser reasons to believe so for now;
- loss of growth momentum if the bank were to see significant change in its senior management positions;
- any significant shift in the strategic focus of the bank under the new CEO—given Axis's successful business strategy thus far, we do not see a need for any such strategic shift, and;
- significant increase in credit costs leading to lower earnings growth expectation—investors seem to be concerned that Axis has less provision coverage against its stressed assets—with a significant deterioration in asset quality, we believe such higher provision charges could have an adverse impact on 2009E earnings but unlikely to impair the underlying profitability of the bank.

It will take a lot for loan book stress to impact Axis's earnings

Exhibit 7: A key concern has been about rapid deterioration in the asset quality of Axis; given a moderation in loan growth expectations, robust asset quality and well provisioned NPL, such concerns should diminish, in our view
NPL ratio, LLR/loan, NPL coverage ratio and % new loans to 2009E gross loans

Name	NPL Ratio (bps)		LLR / Loans (bps)		LLR / NPL (%)		Coverage Ratio (bps)		New Loans in 2008 & 2009	Gross Loans 2009	% New loans to 2009
	2008	2004	2008	2004	2008	2004	2008	2004			
Axis	109	198	125	85	115	43	115%	43%	435,733	1,034,808	42.1
HDFC	0	114	NA	105	NA	92	NA	92%	374,333	1,104,313	33.9
HDFCB	198	169	216	204	109	120	109%	120%	609,363	1,249,716	48.8
ICICIB	434	299	294	136	68	45	68%	45%	107,194	2,402,787	4.5
IBFSL	174	0	217	NA	125	NA	125%	NA	31,098	112,203	27.7
SBI	236	NA	134	NA	57	0	57%	NA	2,809,870	8,928,925	31.5
IDFC	17	68	17	68	100	100	100%	100%	17,959	269,267	6.7
KMB	199	0	0	0	0	NA	NA	NA	84,410	304,257	27.7
PNB	212	589	184	536	87	91	87%	91%	612,105	1,829,246	33.5
BOB	127	736	108	427	85	58	85%	58%	582,537	1,658,492	35.1
IOB	251	530	162	413	65	78	65%	78%	264,824	874,762	30.3
Weighted average	178	270	146	219	81	70	90%	78%	5,929,426	19,768,777	30.0

Note: NA refers to data not available

Source: Company data, Goldman Sachs Research estimates.

Exhibit 8: Given Axis's strong ROA, sensitivity of increase in credit cost on its earnings growth is much lower than the coverage universe

Estimated impact of a 10 bp incremental rise in credit costs to bank earnings

(In Rs mn, unless specified)	Fall in pretax profits (bp)	2009E Provs.	YE2008 loans	2009E Credit Cost (bp)	Credit Cost + 10 bp rise	Adjusted 2009 Provisions	Pre Tax Profit 2009E	Pretax profit after adjusting for rise in credit costs
Axis	-236	12,060	821,276	147	157	12,881	34,780	33,959
HDFC	-235	301	905,175	3	13	1,207	38,490	37,585
HDFCB	-266	18,260	1,002,349	182	192	19,262	37,618	36,615
ICICIB	-394	36,587	2,234,008	164	174	38,821	56,668	54,434
IBFSL	-170	3,246	90,675	358	368	3,337	5,338	5,247
SBI	-555	63,651	7,832,391	81	91	71,483	141,221	133,388
IDFC	-261	462	258,854	18	28	721	9,921	9,662
KMB	-273	3,922	258,450	152	162	4,181	9,483	9,224
PNB	-675	24,389	1,604,602	152	162	25,993	23,783	22,178
BOB	-765	12,860	1,447,294	89	99	14,308	18,924	17,477
IOB	-615	6,972	767,335	91	101	7,739	12,471	11,704
India financials	-443	182,710	17,222,406	106	116	199,933	388,696	371,474

Source: Company data, Goldman Sachs Research estimates.

Exhibit 9: It will likely require a significant increase in credit cost/NPL for Axis' earnings growth to be under pressure

Estimated rise in credit costs needed to negate 2009E pretax earnings growth

(In Rs mn, unless specified)	Rise in credit costs (bp)	2008 Pre Tax Profit	2009E Pre Tax Profit	PTP YoY Growth (a)	2009E Provs. (b)	YE2008 loans	2009E Credit Cost (bp)	Total Provs. (a+b)	Tipping point credit cost (bp)
Axis	84	27,855	34,780	6,925	12,060	821,276	147	18,986	231
HDFC	61	32,927	38,490	5,563	301	905,175	3	5,864	65
HDFCB	46	32,983	37,618	4,635	18,260	1,002,349	182	22,895	228
ICICIB	22	51,671	56,668	4,997	36,587	2,234,008	164	41,585	186
IBFSL	-64	5,916	5,338	-578	3,246	90,675	358	2,668	294
SBI	-48	178,971	141,221	-37,750	63,651	7,832,391	81	25,901	33
IDFC	-47	11,125	9,921	-1,204	462	258,854	18	-742	-29
KMB	-43	10,583	9,483	-1,100	3,922	258,450	152	2,822	109
BOB	-100	33,429	18,924	-14,505	12,860	1,447,294	89	-1,645	-11
IOB	-92	19,547	12,471	-7,076	6,972	767,335	91	-104	-1

Source: Company data, Goldman Sachs Research estimates.

Exhibit 10: Only a material deterioration in asset quality would impair Axis' earnings significantly. In our view, this is an unlikely outcome

Estimated rise in credit costs needed to negate 2009E pretax earnings

(In Rs mn, unless specified)	Rise in credit costs (bp)	2009E Provs. (a)	YE2008 loans	2009E credit cost (bp)	Pre tax profit 2009E (b)	Total provs. (a+b)	Tipping point credit cost (bp)
Axis	423	12,060	821,276	147	34,780	46,840	570
HDFC	425	301	905,175	3	38,490	38,792	429
HDFCB	375	18,260	1,002,349	182	37,618	55,878	557
ICICIB	254	36,587	2,234,008	164	56,668	93,256	417
IBFSL	589	3,246	90,675	358	5,338	8,584	947
SBI	180	63,651	7,832,391	81	141,221	204,872	262
IDFC	383	462	258,854	18	9,921	10,382	401
KMB	367	3,922	258,450	152	9,483	13,405	519
PNB	148	24,389	1,604,602	152	23,783	48,171	300
BOB	131	12,860	1,447,294	89	18,924	31,784	220
IOB	163	6,972	767,335	91	12,471	19,443	253
India financials	226	182,710	17,222,406	106	388,696	571,406	332

Source: Company data, Goldman Sachs Research estimates.

Well grounded growth strategy unlikely to warrant a change

We believe Axis's growth strategy is well founded and would unlikely require a significant shift in its strategic focus. We could highlight more opportunities that could enhance bank value as opposed to challenges from the change in the CEO position:

- Axis's growth strategy is embedded on sustaining or improving its cost competitiveness of the deposit franchise—Axis's CASA deposit showed CAGR of 54% during 2002-2008; CASA ratio increased from 23% in 2002 to 43% in 2008. This has been mainly achieved through carefully planned and executed branch network expansion.
- Rapid expansion of network could lead to significant pressure on cost growth. Through relentless focus on cost control, it has kept the cost/income ratio under control, in our view. Despite a four-fold increase in the branch network between 2002 and 2008, cost/income ratio has been maintained at 44%.

- Axis has built a well diversified loan portfolio with no significant concentration of loans and revenues to any one particular segment. Over the last few years, primarily targeted large corporate customers for their stronger balance sheet prospects; this should help the bank navigate through a tougher operating environment without significant deterioration in asset quality, in our view.
- Axis has been well disciplined in its use of capital. Through various capital raising cycles, it has been able to sustain high ROE relative to the peer group.

We believe the bank would likely retain the broad contours of its current strategy given the success and opportunity that the market still offers. However, we could envisage a few changes within these broad contours:

- Given Axis is a large sized bank, its current focus would likely lead to higher loan concentration risk. Such loan concentration risk could become a concern under adverse economic conditions. To reduce such concentration risk, we believe Axis would need to increase its retail asset exposure over time. Only retail assets could reduce the risk associated with lumpy corporate credit exposure.
- Loan concentration risk could be addressed through carefully executed growth in SME and international banking segments. Axis has already built a significant exposure in SME segment and hence might not warrant further increase.
- Axis could raise revenues from consumer banking segment through further opportunities in cross-sell, focus on improving productivity (which are already high compared to the peer group) and developing/expanding new revenue market opportunities such as wealth management. This could help the bank improve its profitability further, in our view.
- Axis may also need to strengthen its capital base given its exposure in corporate banking segment. This will help the bank to absorb potential shocks from any adverse loan concentration risks.
- We believe there exists opportunities for Axis to expand/enhance its presence in the non-banking segment such as life insurance, asset management, etc. Given a rapidly growing customer base, this would likely enhance growth and value for the bank through the non-banking businesses.

Reg AC

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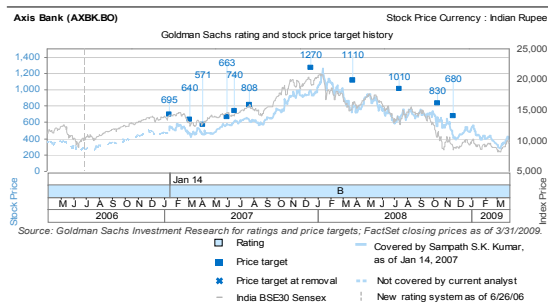
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