Equity Research
January 16, 2010
BSE Sensex: 17554

INDIA

Axis Bank

BUY
Maintained

Firm on its axis

Rs1,078

Reason for report: Q3FY10 results review

Banking

Target price Rs1,228

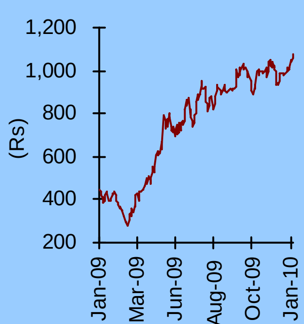
Target price revision
Rs1,228 from Rs1,110

Shareholding pattern

	Jun '09	Sep '09	Dec '09
Promoters	45.6	42.3	41.9
Institutional investors	39.0	42.1	42.4
MFs and UTI	6.8	7.4	7.0
Insurance Cos.	2.8	2.5	2.1
FIIs	29.4	32.2	33.3
Others	15.4	15.6	15.7

Source: BSE

Price chart



Axis Bank's Q3FY10 results surprised positively – net profits rose an impressive 31% YoY propped by 45% YoY NII rise and 35% YoY surge in other income, despite tepid advances growth at 12.5% YoY. Expansion-related costs pushed up overall operating expenses 28% YoY. Cost-to-income at 41.2% was stable QoQ and declined 408bps YoY. Asset quality was healthy with GNPAs and NNPAs at 1.23% and 0.46% respectively. Restructured accounts were at Rs23.1bn or 2.42% of gross advances (2.53% in Q2FY10). We raise FY11E earnings 7.4% to factor in higher-than-expected margin and lower FY11 loan-loss provision. We raise our target price to Rs1,228/share based on 2.7x FY11E BV (implying 16.6x FY11E EPS). Maintain BUY. Sluggish credit growth and NPL rise are the key risks.

- **Margins rise even as credit growth remains tepid.** Subdued 12.5% YoY credit growth in Q3FY10 was a result of just 4% YoY corporate credit growth. Deposits grew 7.7% YoY with large-scale deposit repricing and strong accretion to CASA, which in turn led to 46% CASA ratio in Q3FY10. These coupled with the effect of capital raising led to margin expanding a sharp 48bps to 4% QoQ. We expect margin to come off from ~4%, but it will likely expand 18-20bps YoY in FY10E to 3.18%, leading to 21% NII CAGR through FY11E.
- **Strong core fee performance; costs up.** Other income grew a strong 35% YoY, led by 29% YoY rise in fee & commission income. Trading income rose 49% YoY to Rs1.7bn. Despite a sharp 28% YoY rise in operating expenses, cost-to-income was stable QoQ at 41.2% in Q3FY10. We expect FY11E cost-to-income ratio at 42-44%.
- **Asset quality surprises positively.** GNPAs & NNPAs rose 2bps & 1bp to 1.23% & 0.46% respectively. Accretion of Rs870mn from restructured accounts in Q3FY10 led to total restructured accounts at 2.42% of gross advances (2.53% in Q2FY10). We reduce FY11E loan-loss provisions to 105bps to factor in likely lower slippages.
- **Earnings upgrade, maintain BUY.** Axis Bank is a strong play on pick-up in corporate credit growth, which will materialise as system credit growth picks up hereon. We anticipate this to lead to stronger YoY margin expansion and healthy other income growth through FY11. We FY11E earnings 7.4% to reflect better-than-anticipated margin accretion, higher other income growth and lower loan-loss provisions. We raise our target price to Rs1,228/share based on 2.7x FY11E BV (implying 16.6x FY11E EPS). Reiterate BUY. Continued sluggishness in credit growth and re-emergence of slippages are the key risks.

Market Cap	Rs435.1bn/US$9.5bn
Reuters/ Bloomberg	UTBK.BO/AXSB IN
Shares Outstanding (mn)	403.6
52-week Range (Rs)	1093/278
Free Float (%)	58.1
FII (%)	33.3
Daily Volume (US$/'000)	55,290
Absolute Return 3m (%)	7.1
Absolute Return 12m (%)	143.0
Sensex Return 3m (%)	1.3
Sensex Return 12m (%)	88.3

Year to Mar	2008	2009	2010E	2011E
NII (Rs mn)	25,854	36,862	48,905	61,416
Net Profit (Rs mn)	10,710	18,154	24,135	29,911
EPS (Rs)	29.9	50.6	59.8	74.1
% Chg YoY	27.9	68.9	18.3	23.9
P/E (x)	36.0	21.3	18.0	14.5
P/BV (x)	4.4	3.8	2.7	2.4
Net NPA (%)	0.4	0.4	0.5	0.6
Dividend Yield (%)	0.6	0.9	1.2	1.4
RoA (%)	1.2	1.4	1.5	1.6
RoE (%)	17.6	19.1	18.4	17.4

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Table 1: Q3FY10 results review

(Rs mn, year ending March 31)

	Q3FY10	Q3FY09	% YoY	Q2FY10	% QoQ	YTDFY10	YTDFY09	% YoY
Interest income	28,837	29,848	(3.4)	28,604	0.8	86,496	77,963	10.9
Interest expenses	15,345	20,551	(25.3)	17,107	(10.3)	51,052	51,427	(0.7)
Net interest income	**13,491**	**9,297**	**45.1**	**11,497**	**17.3**	**35,444**	**26,536**	**33.6**
Non-interest income	9,881	7,322	35.0	10,656	(7.3)	30,122	20,514	46.8
Total income	23,372	16,619	40.6	22,153	5.5	65,567	47,050	39.4
Staff cost	3,085	2,661	16.0	3,042	1.4	9,221	7,402	24.6
Other op expenses	6,540	4,862	34.5	6,053	8.0	17,779	13,785	29.0
Total op expenses	9,626	7,522	28.0	9,095	5.8	26,999	21,186	27.4
Pre-provisioning profit	**13,746**	**9,096**	**51.1**	**13,058**	**5.3**	**38,567**	**25,864**	**49.1**
Other Prov & Contingencies, net	3,731	1,320	182.7	4,989	(25.2)	11,873	6,845	73.5
PBT	10,015	7,777	28.8	8,069	24.1	26,694	19,019	40.4
Tax	3,455	2,768	24.8	2,752	25.5	9,198	6,680	37.7
PAT	**6,560**	**5,009**	**31.0**	**5,316**	**23.4**	**17,497**	**12,339**	**41.8**

Source: Company data, I-Sec Research

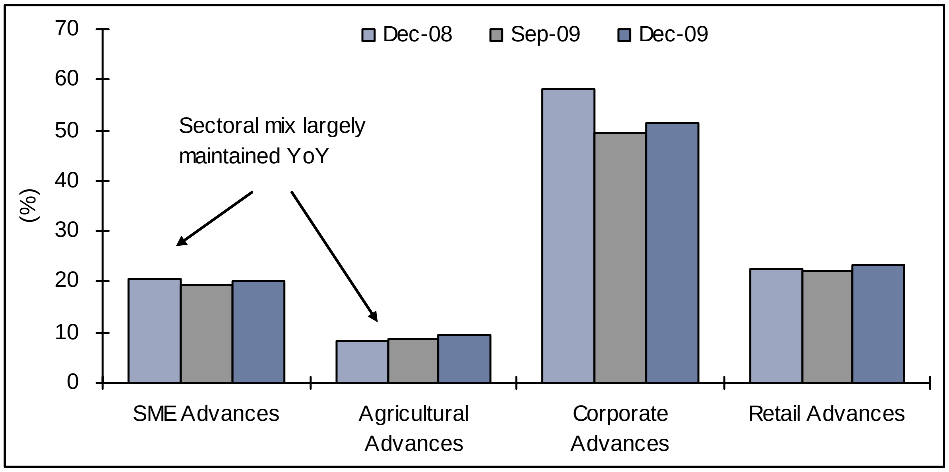
Margin rises even as credit growth remains tepid

Credit growth remained subdued at 12.5% YoY, partly due to high Q3FY09 base when it rose 55% YoY and partly due to the continued slowdown in systemic credit. The loan profile was largely stable (Chart 1). Corporate credit grew a tepid 4% YoY in Q3FY10. Axis Bank continued to focus on secured retail credit, with the share of mortgages and passenger car loans rising to 71% and 14% from 67% and 13% respectively in Q2FY10.

Q3FY10 deposits grew 7.7% YoY owing to 5.5% decline in term deposits (largely due to deposits repricing & low term deposits rates) and 29% YoY growth in CASA deposit. As a result, CASA ratio bounced back sharply to 46% in Q3FY10 (42.8% in Q2FY10 and 38% in Q3FY09).

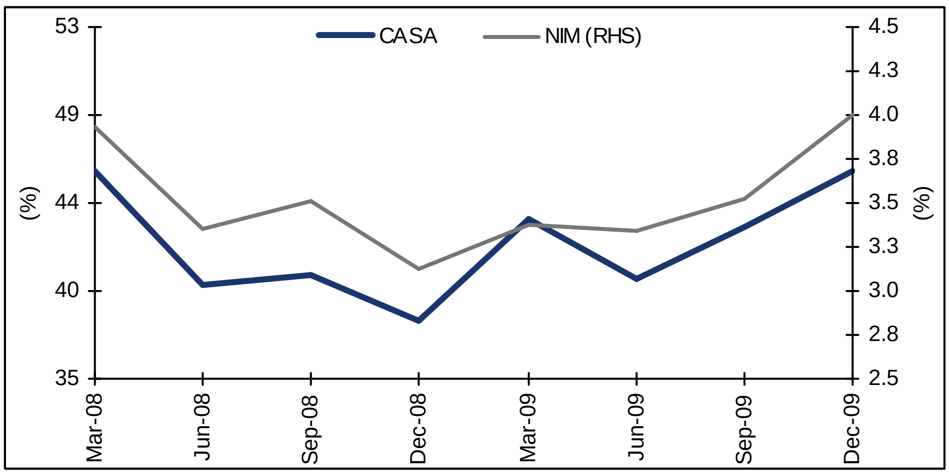
While yield on advances remained steady at 9.92% in Q3FY10, cost of deposits sharply declined due to the dual effect of deposit repricing and strong accretion to average daily CASA balances. The cost of funds declined 58bps QoQ and 208bps YoY to 4.83% in Q3FY10. Sharp reduction in cost of funds, the effect of Rs38bn capital raising and steady yields together led to sharp 48bps QoQ and 88bps YoY margin expansion to 4% in Q3FY10. Given that most of the high cost deposits have already run down coupled with our expectations of rising deposit costs at the margin, we expect NIMs to decline from the current 4% even as yield on advances remains stable. As a result, we expect margins to come-off from the current 4%. However, NIMs will remain buoyant YoY. We expect FY10E & FY11E margin to expand 22bps & 18bps YoY. We estimate NII CAGR to be 21% through FY11E, higher than our previous estimate of 19%.

Chart 1: No reshuffle expected in credit profile



Source: Company data, I-Sec Research

Chart 2: Strong CASA growth aids margins



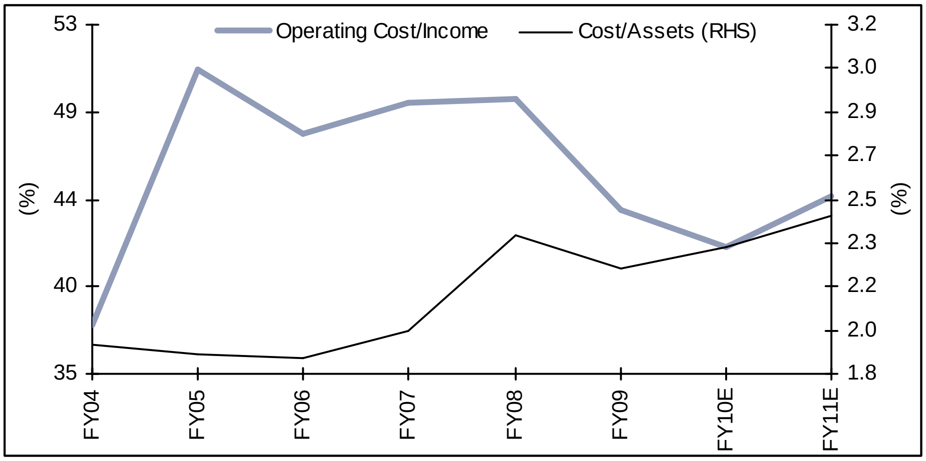
Source: Company data, I-Sec Research

Strong core fee performance; costs up

Other income growth was strong at 35% YoY, driven by 29% YoY rise in fee and commission income. The prime contributors to the robust performance were fee income from Large and Mid-Corporate (up 69% YoY), Retail banking fees (up 38% YoY), treasury-related fees (up 33% YoY), SME and Agri lending businesses (up 18% YoY) and Business Banking (up 13% YoY). Trading income was up 49% YoY to Rs1.7bn. Other income (ex-treasury) rose 32% YoY. We expect the impressive fee income performance to continue and increase our other income CAGR estimate to 21% through FY11E (from 19% earlier) to factor in the possibility of higher fee income, especially as credit offtake picks up.

The quarter saw buoyant operating costs, led by a 35% YoY network expansion-led growth in other operating income and a 16% YoY rise in staff costs. Overall increase in operating expenses stood at 28% YoY. Cost-to-income stood at 41.2% in Q3FY10 (stable QoQ and down 408bps YoY). We expect cost-to-income ratio at 42-44% through FY11E.

Chart 3: Cost ratios to remain favourable



Source: Company data, I-Sec Research

Asset quality springs positive surprise

We were positively surprised by asset quality movement in Q3FY10 – GNPAs & NNPAs rose only 2bps and 1bp to 1.23% and 0.46% respectively. Provision coverage ratio (including some technical write-offs allowed by the RBI) stood at 69% compared with the calculated 63.4%. However, including the entire technically written-off accounts, provisioning coverage ratio was 87.8%, much higher than the RBI stipulated 70%. The management indicated a positive experience in asset quality of the retail loan book, with diminution in delinquencies in personal loans and credit cards segment and lower number of SME loans getting restructured incrementally. As per our calculations, annualised delinquencies (as a percentage of previous period advances) have diminished markedly to 1.85% in Q3FY10 vis-à-vis 2.69% in Q2FY10.

Accretion of restructured accounts seems to have peaked out with Axis Bank restructuring Rs870mn worth accounts in Q3FY10, which resulted in total restructured accounts at 2.42% of gross advances (2.53% in Q2FY10). Outstanding restructured advances stood at Rs23.1bn in Q3FY10 versus Rs23.63bn in Q2FY10. Of the restructured assets, SME and large/mid-corporate loans were roughly equal in proportion with the rest emanating from Agricultural sector. Textiles and education loans accounted for ~60% of total restructured assets. Of the total restructured advances, ~71% were on account of principal deferment and the remaining faced both interest rescheduling and principal deferment. Axis also witnessed slippages of Rs570mn from the restructured accounts portfolio. However, we lower FY11E loan-loss provisions to 105bps from 115bps earlier to reflect a better asset quality scenario.

Table 2: Segment-wise break-up of restructured loans

SME	41%
Large and Mid-Corporate Credit	40%
Agri	19%

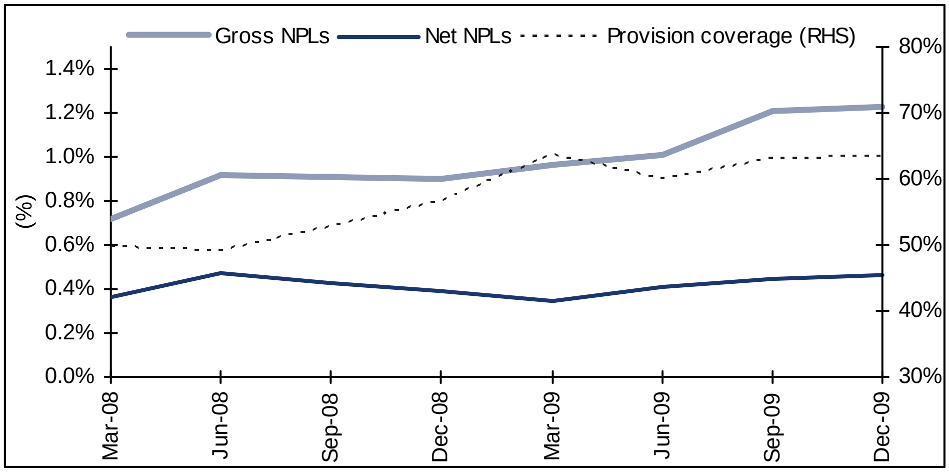
Source: Company data, I-Sec Research

Table 3: Sector-wise break-up of restructured loans

Textiles	40%
Education	21%
Agriculture	19%
IT & ITES	11%
Others	9%

Source: Company data, I-Sec Research

Chart 4: GNPAs rise marginally; stress seems lower-than-expected

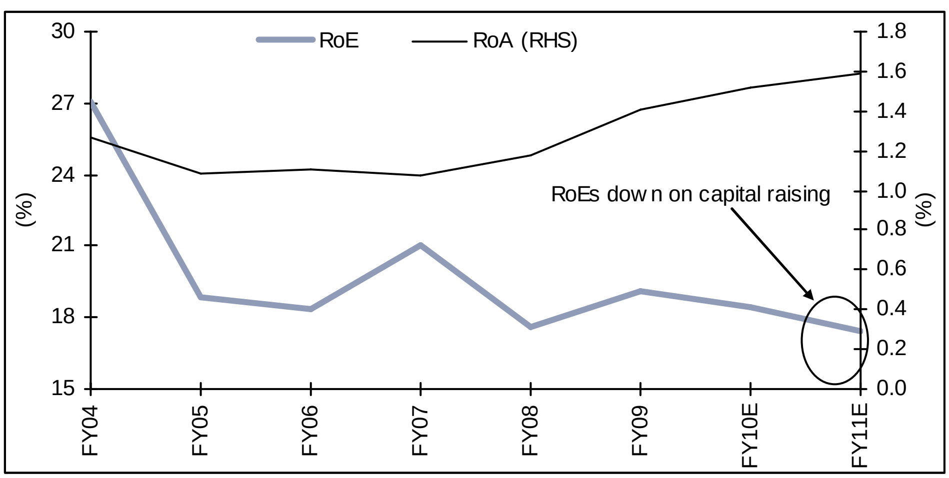


Source: Company data, I-Sec Research

Earnings upgrade; maintain BUY

Axis Bank's impressive results and its improving asset quality have been the key positives this quarter. In our view, margin should expand significantly on a YoY basis in FY10 due to the effect of capital raised, strong CASA accretion and deposit repricing. Other income is likely to remain strong as Axis leverages its well-diversified other income stream to generate strong fee income. High provisions and gradual diminution in outstanding restructured advances gives us comfort on the asset quality. Hence, we upgrade FY11E earnings 7.4% to reflect better-than-anticipated margin accretion, higher other income growth and lower loan-loss provisions. We raise our target price to Rs1,228/share based on 2.7x FY11E BV (implying 16.6x FY11E EPS). Reiterate Buy. Continued sluggishness in credit growth and re-emergence of slippages are the key risks.

Chart 5: Capital raising depresses return ratios; expect RoEs to retrace to ~20%



Source: Company data, I-Sec Research

Financial Summary

Table 4: Profit & Loss statement

(Rs bn, year ending March 31)

	FY08	FY09	FY10E	FY11E
Interest earned	70.1	108.4	125.3	155.6
Interest expended	44.2	71.5	76.4	94.2
Net interest income	**25.9**	**36.9**	**48.9**	**61.4**
Other income	18.0	29.0	39.1	42.5
Fee income	13.2	21.7	26.3	32.6
Operating expenses	21.5	28.6	36.6	45.8
Employee costs	6.7	10.0	12.8	15.6
Pre-provisioning profit	**22.3**	**37.2**	**51.4**	**58.1**
Loan and investment loss provisions	5.8	9.4	15.1	13.0
Profit before tax	16.5	27.9	36.3	45.0
Income taxes	5.8	9.7	12.2	15.1
Net profit	**10.7**	**18.2**	**24.1**	**29.9**

Source: Company data, I-Sec Research

Table 5: Balance sheet

(Rs bn, year ending March 31)

	FY08	FY09	FY10E	FY11E
Share Capital	3.6	3.6	4.0	4.0
Reserves and surplus	84.1	98.5	155.6	179.5
Deposits	876.3	1,173.7	1,314.6	1,603.8
Borrowings	56.2	101.9	120.7	151.0
Other liabilities and provisions	75.6	99.5	101.8	127.3
Total liabilities & stockholders' equity	**1,095.8**	**1,477.2**	**1,696.7**	**2,065.7**
Cash and balances with RBI and call money	125.0	150.2	153.9	166.2
Investments	337.1	463.3	554.9	692.7
Advances	596.6	815.6	937.9	1,153.6
Fixed Assets, net	9.2	10.7	11.1	12.4
Other Assets	27.8	37.5	38.9	40.8
Total assets	**1,095.8**	**1,477.2**	**1,696.7**	**2,065.7**

Source: Company data, I-Sec Research

Table 6: Key ratios

(Year ending March 31)

	FY08	FY09	FY10E	FY11E
Per share data (Rs)				
Period end shares outstanding (mn)	357.7	359.0	403.6	403.6
Basic EPS	29.9	50.6	59.8	74.1
Diluted EPS	29.9	50.6	59.8	74.1
Book value per share	245.1	284.5	395.5	454.7
Adjusted book value per share	238.2	275.4	383.8	437.6
Growth ratios (%)				
Total assets	49.6	34.8	14.9	21.8
Advances	61.8	36.7	15.0	23.0
Deposits	49.1	33.9	12.0	22.0
Book value	103.5	16.1	39.0	15.0
EPS	27.9	68.9	18.3	23.9
Valuation ratios (x)				
P/PPP (pre-provisioning profit)	17.3	10.4	8.5	7.5
P/E	36.0	21.3	18.0	14.5
P/BV	4.4	3.8	2.7	2.4
P/ABV	4.5	3.9	2.8	2.5
Dividend yield (%)	0.6	0.9	1.2	1.4
Operating ratios (%)				
Operating cost to income	49.2	43.4	41.6	44.1
Operating expenses/ Avg. assets	2.4	2.2	2.3	2.4
Profitability ratios (%)				
Spread	2.5	2.4	2.7	2.8
Net interest margin	2.9	3.0	3.2	3.4
Return on avg. assets	1.2	1.4	1.5	1.6
Return on avg net worth	17.6	19.1	18.4	17.4
Asset quality and capital (%)				
Gross NPA	0.8	1.0	1.4	1.9
Net NPA	0.4	0.4	0.5	0.6
Total CAR	14.0	13.7	16.2	16.4

Source: Company data, I-Sec Research

Table 7: Quarterly trend

(Rs mn, year ending March 31)

	Mar-09	Jun-09	Sep-09	Dec-09
Net interest income	10,326	10,456	11,497	13,491
% growth (YoY)	24.6	29.0	25.9	45.1
Other income	8,455	9,586	10,656	9,881
Pre-provision profit	11,385	11,764	13,058	13,746
Net profit	5,815	5,620	5,316	6,560
% growth (YoY)	60.9	70.2	32.0	31.0

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)
BUY: +10% outperformance; **HOLD**: -10% to +10% relative performance; **SELL**: +10% underperformance

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