Axis Bank

Better positioned than peers

Meeting Update

September 2, 2008

Rating	Outperformer
Price	Rs723
Target Price	Rs921
Implied Upside	27.4%
Sensex	14,499

(Prices as on September 1, 2008)

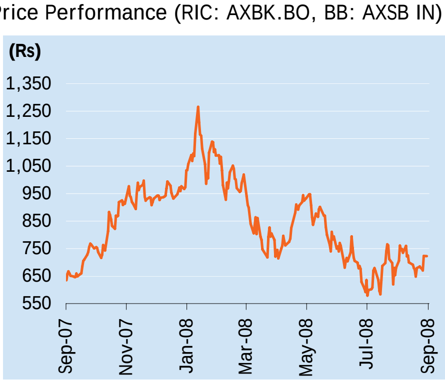
Trading Data	
Market Cap. (Rs bn)	259.2
Shares o/s (m)	358.6
Free Float	57.6%
3M Avg. Daily Vol ('000)	797.9
3M Avg. Daily Value (Rs m)	550.1

Major Shareholders	
Promoters	42.4%
Foreign	36.4%
Domestic Inst.	9.3%
Public & Others	11.9%

Stock Performance

(%)	1M	6M	12M
Absolute	7.7	(28.0)	15.6
Relative	8.3	(11.0)	20.4

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



Source: Bloomberg

- **Likely to continue its growth trajectory:** Axis Bank has been one of the best performing new-age private sector banks over the last couple of years. However, the bank's Q1FY09 financial performance, which was higher than street expectations, was marred by deterioration in asset quality levels mainly in the credit card portfolio. But deterioration in asset quality is a system-wide risk (emanating from higher interest rates and slowdown in the economy) and not specific to Axis Bank. The bank's earnings trajectory is likely to remain the highest among its peers. It also has provision coverage of ~79% (including accumulated write-offs). Thus it makes Axis bank better placed than its peers in absorbing asset quality risks.
- **Brief outlook on the sector:** The banking and financial services space has remained under pressure over the past few months mainly due to escalating inflation (latest WPI at 12.4%), primarily driven by high commodity prices. As a result, RBI has tightened its monetary policy actions giving rise to higher lending and deposit rates. Moderation in credit growth, higher MTM provisions on investment portfolio and risks to higher deterioration in asset quality levels have given rise to earnings risk for the banks in FY09. We would be ardently watching the core earnings performance of banks in Q2FY09, as the impact of higher lending and deposit rates on banks margins will come to the fore.
- **Outlook and valuation:** We continue to prefer private banks and Axis Bank ranks among our top picks. We feel that there are upside risks to our earnings forecast from higher fee income growth, which can be sustainable, going forward. At the CMP of Rs723, the stock is quoting at 14.7x FY10E EPS, 2.2x FY10E BV and 2.2x FY10E ABV. We maintain our Outperformer rating with a price target of Rs921.

Key financials (Rs m)	FY07	FY08	FY09E	FY10E
Net interest income	14,683	25,854	34,239	42,104
Growth (%)	*36.2*	*76.1*	*32.4*	*23.0*
Operating profit	12,639	22,260	30,492	35,970
PAT	6,590	10,710	13,230	17,607
EPS (Rs)	23.4	29.9	37.0	49.2
Growth (%)	*34.4*	*28.0*	*23.5*	*33.1*
Net DPS (Rs)	4.5	6.0	7.0	8.0

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08	FY09E	FY10E
*NIM (%)**	*2.5*	*2.9*	*2.8*	*2.6*
RoAE (%)	*21.0*	*17.6*	*14.3*	*16.8*
RoAA (%)	*1.1*	*1.2*	*1.0*	*1.1*
P / BV (x)	6.0	2.9	2.5	2.2
P / ABV (x)	6.3	3.0	2.5	2.2
PE (x)	30.9	24.1	19.5	14.7
Net divided yield (%)	*0.6*	*0.8*	*1.0*	*1.1*

Source: Company Data; PL Research: ** calculated on average interest earning assets.*

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In our PL Banking week, Axis Bank was represented by Mr. S. Sengupta, President Finance & Accounts. The key takeaways from our discussions are presented below:

Fee income growth likely to remain robust: The bank expects to maintain the strong growth trajectory it has displayed in its core fee income over the past few years. Loan processing charges, annual service charges, ATM usage fees and cross selling of banking products have together built up a very strong and sustainable fee income base for the bank. The bank is now able to undertake non-fund based overseas business exposures (like LCs & BGs) for its Indian corporate clients doing business overseas on its own balance sheet due to its international presence in Singapore, Hongkong and Dubai. Hence, corporate fees have reported strong growth up 93% YoY for Q1FY09. Axis Bank is also a dominant player in the domestic debt-syndication market. Debt markets have not slowed down to the extent that equity markets have displayed over the last few months. Its capital market segment fees grew by 149% YoY during Q1FY09.

Our view: We were apprehensive about the fee income growth for the bank in the beginning of FY09. Hence, we estimated fee income for the bank to slowdown from above 60% YoY growth, as was reported in the last two fiscal years. Our current estimates are at 38% YoY fee income growth. There are some upside risks to our forecast.

Growth opportunities exist, margins likely to be maintained: The bank expects its advances to grow by ~40% driven by large & mid corporate, SME and agricultural businesses. The bank expects to maintain margins in the range of 3.3-3.4% for FY09.

Management has taken cognizance of current economic scenario and their growth aspirations: The bank is unlikely to sacrifice margins, asset quality and capital adequacy to maintain growth.

Our view: We feel that the market is currently cautious about the bank's strong balance sheet expansion (CAGR of 49% for FY06-08), especially at a time when economy is slowing down and risks to asset quality deterioration have heightened. We expect Axis Bank to moderate its growth expectations if interest rates were to further rise from the current levels. Our assumptions factor in a 32% YoY growth in advances for FY09E. Since its loan growth and deposit growth are fairly balanced we don't see any major risk to its growth plans from RBI's perspective.

Asset quality under watch, no meaningful stress visible: The bank has not witnessed any major asset quality issues in its loan portfolio other than the credit card business (portfolio size Rs6.5bn). NPA, in the personal loans segment, is below 1% levels & the bank does not cater to the small ticket personal loan segment which has been the worst hit segment for banks having such exposures. The net NPA levels are still under control at 0.47% of total advances, with 82% of its corporate portfolio being rated 'A' and above.

Corrective actions taken to resolve credit card delinquencies: Aggressive sales and inadequate collection mechanism resulted in high (~12-16%) delinquencies, coupled with the bank's decision to provide credit card to non-Axis bank customers. However, the bank has now tightened its collection mechanisms; legal notices are being sent to all the defaulters. The management has decided to first resolve the persisting problem and then grow the portfolio.

Branch expansion mainly in district headquarters and Tier II cities: The bank has applied to RBI for around 150-200 branches & 400-450 ATM licenses. Since, a major part (60-70%) of the bank's expansion plans would be in the Tier II cities and other under-penetrated areas, it provides an edge to get a nod for most of the approvals from the regulator.

Axis Bank's foray in the North East has yielded results: The bank has succeeded in garnering good savings deposits growth from the 17 branches opened across North East India. The break-even period for these branches is ~12-15 months compared to an average of 18-24 months.

Daily average CASA balances remained stable, period end figures have declined: The CASA balances in absolute terms as on June 2008 have declined to 40% from 46% in Q4FY08. However, based on daily averages, these balances have remained stable. As per past trends, the CASA normally dips in Q1 on a sequential basis. But this time the fall looks sharper owing to large ticket IPOs during Q4FY08 which have resulted in higher float balances. The bank expects to improve its CASA from the current 40% levels to ~43-45%, going forward.

Our view: Growing CASA under the current high interest rate scenario (retail TD rates for 1 year maturity ~10%) would be a challenging proposition, as there would be a natural tendency of depositors to park funds in term deposits rather than keep balances in savings account. However, we feel that with the bank's strategic initiatives to open branches in key locations, product offerings like gift cards, traveller's cards etc. and superior ATM network, CASA is likely to improve to ~43% by March 2008.

MTMs have declined significantly however the court cases are at a preliminary stage: The MTM losses on forex derivatives have come down meaningfully and there could be possibilities of some write-back on the same, based on new RBI guidelines. The court rulings on these cases are currently at a very preliminary stage and are likely to be a long-drawn affair.

External rating of corporate portfolio could improve capital adequacy: The banks Tier I CAR is at 9.93%, as on June 2008. Currently the bank has 25% of its corporate advances rated by an external agency; it plans to get another 45% of the portfolio rated which could provide a 50-75bps relief in terms of capital adequacy requirements. The bank also has sufficient head room for raising further Tier II (Rs60-66bn) & hybrid Tier I (Rs10bn) capital.

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PL's Recommendation Nomenclature

BUY	:	> 15% Outperformance to BSE Sensex	**Outperformer** (OP)	:	5 to 15% Outperformance to Sensex
Market Performer (MP)	:	-5 to 5% of Sensex Movement	**Underperformer** (UP)	:	-5 to -15% of Underperformace to Sensex
Sell	:	<-15% Relative to Sensex			
Not Rated (NR)	:	No specific call on the stock	**Under Review** (UR)	:	Rating likely to change shortly