

## Company Focus

14 July 2008 | 9 pages

# AXIS Bank (AXBK.BO)

 Target price change   
 Results 

## Buy: 1Q09 Results – Very Profitable, with Reasonable Quality

- Up 88% YoY - 47% ahead of expectations** — It is another strong quarter – this time against relatively muted and cautious expectations. The P&L is the stand out. The balance sheet sees some pressures and needs watching, but remains comfortable. Management remains confident, has some caution on the asset quality environment, but sticks to its high growth, strong profitability and steady business mix view
- P&L – 80% fee growth most of the way** — Axis' pre-provisioning profits are up 118% YoY on a mix of accelerating 80%+ fee income growth (broad-based), some cost control, and 90% NII growth (boost by capital, margins fall). This revenue growth is the backbone of the quarter, enough to offset relatively large and equity heavy MTM. Overall, a strong show and a likely step ahead of peers.
- Balance sheet - Some stress and questions, but fairly comfortable** — Market expectations of Axis' asset risks have been modest. This quarter does not provide the answers. While the pace of deterioration rises (45bps), it's not too significant or concentrated, and net NPAs remain sub 1%. Overall, asset quality is better than expected and remains on the 'keenly watch', rather than worry, list.
- Management remains confident - no stepping back on growth or profitability** — Axis management has stood out for its confidence in its business outlook (over the last 6 months): high growth, strong profitability, with manageable asset risks. It is delivering on numbers (quality & quantity) and holding its views.
- Maintain Buy** — But cut TP to Rs807 (Rs912) on higher risk free rate (9.5%).

<b>Buy/Low Risk</b>	<b>1L</b>
Price (14 Jul 08)	Rs635.80
Target price	Rs807.00
	<i>from Rs912.00</i>
Expected share price return	26.9%
Expected dividend yield	1.0%
<b>Expected total return</b>	<b>27.9%</b>
Market Cap	Rs227,975M
	US\$5,329M

### 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	27.6	5.3	21.0	0.8
2008A	11,464	35.24	52.9	18.0	2.6	18.9	1.1
2009E	13,593	37.41	6.2	17.0	2.3	14.6	1.0
2010E	17,466	48.06	28.5	13.2	2.0	16.4	1.0
2011E	21,955	60.42	25.7	10.5	1.7	17.7	1.1

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)	27.6	18.0	17.0	13.2	10.5
P/E reported (x)	27.6	18.0	17.0	13.2	10.5
P/BV (x)	5.3	2.6	2.3	2.0	1.7
P/Adjusted BV diluted (x)	5.4	2.6	2.3	2.0	1.7
Dividend yield (%)	0.8	1.1	1.0	1.0	1.1
<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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Figure 1. AXBK: 1Q09 Results – Key Highlights (Rupees Million, Percent)

	1Q09	1Q08	YoY %	4Q08	QoQ%	Citi Investment Research Comments
Interest Income	22,664	15,111	50.0	20,154	12.5	
Interest Expense	(14,560)	(10,901)	33.6	(11,870)	22.7	
<b>Net Interest Income</b>	<b>8,105</b>	<b>4,209</b>	<b>92.5</b>	<b>8,284</b>	<b>-2.2</b>	<b>A little ahead of expectations, though boosted YoY by capital raising</b>
Fee-Based Income	5,138	2,715	89.2	4,153	23.7	Significant and broad based momentum - a show stealer, in spite of a weaker market environment
Other Non-Interest Income	1,110	967	14.8	1,412	-21.3	Well ahead of expectations - a mix of FX treasury revenues, and positive trading gains on the fixed income and treasury businesses
Non Interest Income	6,248	3,682	69.7	5,565	12.3	Primary driver of ahead of expectation performance
<b>Operating Income</b>	<b>14,353</b>	<b>7,892</b>	<b>81.9</b>	<b>13,849</b>	<b>3.6</b>	
Operating Expenses	(6,329)	(4,212)	50.3	(6,621)	-4.4	A positive surprise - slowing in growth, and a QoQ reduction in part supported one-offs in the previous quarter
Pre-Provision Profit	8,023	3,679	118.1	7,228	11.0	Significantly strong show - a mix of revenue momentum, and cost control
Charges for Bad Debts	(715)	(496.1)	44.2	(1,642)	-56.4	Provisioning remains relatively modest in spite of increased deterioration, and modest loan loss coverage levels
Other Operating Items	(2,252)	(513)	339.0	0	NM	Relatively hefty mark-downs - a mix of equity, Government bonds and corporate debt; a little ahead of expectations, and reflecting slightly aggressive equity portfolio positions
Operating Profit	5,056	2,670	89.3	5,586	-9.5	Well ahead of expectations
Pre-Tax Profit	5,056	2,670	89.3	5,586	-9.5	
Tax	(1,755)	(921)	90.6	(1,972)	-11.0	
<b>Net Profit</b>	<b>3,301</b>	<b>1,750</b>	<b>88.7</b>	<b>3,614</b>	<b>-8.6</b>	<b>50% ahead of expectations</b>
EPS	9.2	6.2	47.4	10.1	-9.0	
Customer Loans	611,600	412,850	48.1	596,610	2.5	Moderate growth over the quarter - management continues to target and expect 40-45% growth for the year
Customer Deposits	889,730	610,910	45.6	876,260	1.5	Slow quarter, with a marked moderation in mix with the CASA share falling to 40% (45%) over quarter
AIEA	951,220	658,570	44.4	843,185	12.8	
Total Assets	1,136,600	791,090	43.7	1,095,780	3.7	
Avg Assets	1,116,190	761,830	46.5	1,000,795	11.5	
Non-Performing Loans (NPL)	6,383	4,831	32.1	4,946	29.1	About Rs1.9b in deterioration (45bps of starting loans) - a little weaker than expectations, primarily credit card driven, but well within manageable levels
Loan Loss Reserves (LLR)	(3,127)	(2,019)	54.8	(2,463)	26.9	Provisioning focus remains low, though management has not written off during the quarter
Shareholders' Funds	87,420	34,060	156.7	88,072	-0.7	
Book Value Per Share	244	121	101.6	115	112.3	
Key Ratios at a Glance (Percent)						
<b>Key Ratios (%)</b>	<b>1Q09</b>	<b>1Q08</b>	<b>Bps Δ YoY</b>	<b>4Q08</b>	<b>Bps Δ QoQ</b>	
ROAA (annualized)	1.18	0.92	26	1.44	-26	
ROAE (annualized)	15.11	20.55	-544	16.41	-131	
Net Interest Margin (bps)	<b>341</b>	256	85	393	-52	Dips QoQ, but is largely in line with expectations, and management suggests should be able to sustain current levels
Fee Inc/Operating Income	35.8	34.4	139	30.0	581	The most impressive part of the performance, and a standout
Other Non-Interest Inc/Op Inc	43.5	46.7	-313	40.2	335	
Op. Cost/ Operating Income	44.1	53.4	-928	47.8	-371	Bolstered by revenues, though management shows some signs of absolute control
Loan-to-Deposit Ratio (LDR)	68.7	67.6	116	68.1	65	
NPL/Loan Ratio	1.0	1.2	-13	0.83	21	QoQ increase - needs watching but trends are generally ok
LLR/NPL Ratio	49	42	719	50	-82	

Source: Company reports, Citi Investment Research

Figure 2. AXBK: 1Q09 Results – Key Business Parameters (Rupees Million, Percent)

Deposit Profile	1Q09	1Q08	YoY %	4Q08	QoQ%	Citi Investment Research Comments
Savings	190,260	123,120	54.5	199,820	-4.8	Moderation over quarter, though a little positive if average balances taken into account
Current	164,230	107,500	52.8	200,450	-18.1	
Low Cost Deposits (CASA)	354,490	230,620	53.7	400,270	-11.4	
Term	535,240	380,290	40.7	475,990	12.4	Primary driver of growth - hence also the increase in costs
Total	889,730	610,910	45.6	876,260	1.5	
% CASA	40	38	209.2	46	-583.7	
Loan Mix	1Q09	1Q08	YoY %	4Q08	QoQ%	
Corporate	408,850	275,290	48.5	405,620	0.8	The primary focus of growth ahead - slow for the quarter though
Agricultural	56,370	40,950	37.7	55,070	2.4	
Retail	146,380	96,610	51.5	135,920	7.7	
Advances	611,600	412,850	48.1	596,610	2.5	
Asset Quality	1Q09	1Q08	YoY %	4Q08	QoQ%	
Gross NPA	6,383	4,831	32.1%	4,946	29.1%	Deterioration has picked up
NET NPA	3,257	2,812	15.8%	2,483	31.2%	
Provisions	3,127	2,019	54.8%	2,463	26.9%	No write-offs in the quarter
Loan loss coverage	49%	42%		50%		Coverage remains modest
Provisions in P&L	715	496	44.2%	1,642	-56.4%	...as does the P&L charge

Source: Company reports, Citi Investment Research

## 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 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 have revised our target price down from Rs912 to Rs807 as we raise the risk free rate from 8.5% to the current 9.5%. We have in addition marginally lowered our long term loan growth rate to account for the higher interest rate environment.

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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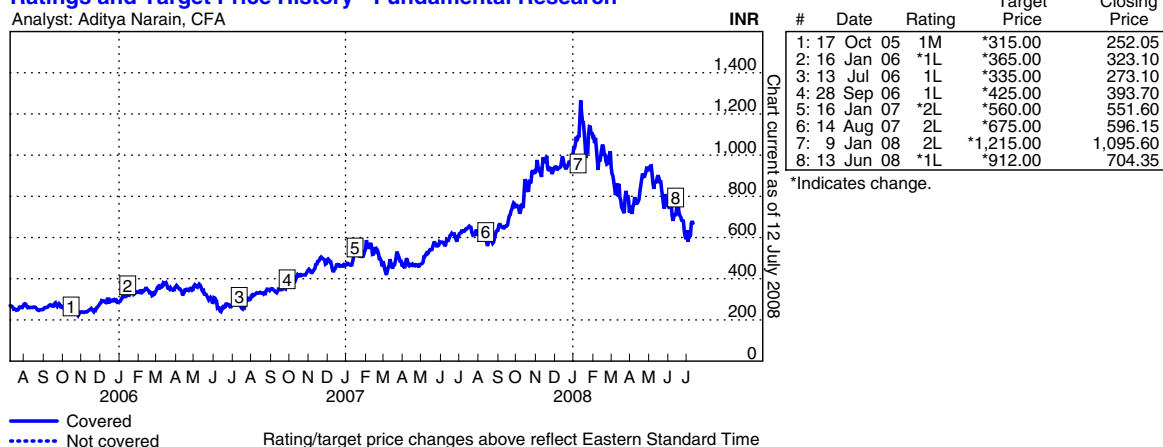
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Analyst: Aditya Narain, CFA



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