Axis Bank

5 November 2018

Reuters: AXSB.BO; Bloomberg: AXSB IN

2QFY19 Result Update

Elevated Rating Downgrades A Thing Of The Past

Axis Bank (ABL) reported 2QFY19 results with the key pointers being: (1) Lower NPA accretion regime since 4QFY18 seems durable since (a) Gross slippages Rs 27.77bn compared well with past run rate (b) Sub-investment grade corporate book, which is the key source of emerging corporate NPA, looks relatively contained at 170 bps of customer assets and (c) Management indicated an end to the rating downgrade cycle. (2) NIM expansion in 1HFY19 would be driven mainly by the corporate book and also, to an extent, by retail book excluding home loans. Full year FY19 NIM to be similar to FY18 level (3) Operating expenses tracked lower than core total income growth as ABL displayed continued superior digital strategy outcomes (See *comprehensive* conference call takeaways on page 2). Per se, on the results front, ABL posted 15% YoY NII growth to Rs52,321mn, PPOP growth of 8% YoY to Rs40,940mn and PAT growth of 83% YoY to Rs7,896mn. We have revised our estimates for FY19/FY20/FY21 and retained Accumulate rating on ABL, revising our target price to Rs667 (from Rs604 earlier) and valuing the stock at 1.9x 1HFY21E P/BV.

Asset quality entered a lower stress regime as sub-investment grade book saw an outsized increase for the last time: Gross slippage of Rs27.77bn compared well with an 8-quarter average of Rs 69bn upto 4QFY18. We think decline in slippage quantum since 4QFY18 is a durable shift to a lower stress regime since (a) The sub-investment grade corporate book remains the key source for emerging corporate NPA, given the proportion of corporate slippages emerging from this book has averaged 88% over the past 10 quarters (b) The sub-investment grade corporate book itself has shrunk 15% QoQ on a net basis to Rs 88.6bn, a manageable 1.7% of customer assets. (c) Management stated that the cycle of elevated downgrades into the sub-investment grade pool has been completed. Whole bank PCR improved to 73%, provision on NCLT List 1 and 2 stood at ~Rs 42bn for ~Rs 46bn exposure (~90% PCR) and provision on all NCLT cases stood at ~Rs 95bn for ~Rs 110bn exposure (~85% cover).

NIM expansion in 1HFY19 would be driven mainly by the corporate book and also, to an extent, by retail book excluding home loans. Full year FY19 NIM to be similar to FY18 level: Headline NIM contracted 10 bps QoQ to 3.36% but, adjusted for the 17 bps positive one-off impact in 1QFY19 due to the recovery on a key IBC List 1 account, the core NIM was up 7 bps QoQ. The key driver for NIM expansion was and will continue to be the corporate book since, firstly, almost all of it is MCLR-linked. Secondly, on the corporate book, pricing power is returning, including due to the NBFC sector upheaval. Thirdly, the improved asset quality on the corporate book would also help. Furthermore, the retail book excluding mortgages is also seeing a return of pricing power. Management reiterated that FY19 NIM would be maintained at a level similar to that in FY18.

Operating expenses tracked lower than core total income growth as ABL displayed continued superior digital strategy outcomes: Operating expenses grew 14% YoY, within which staff cost grew 8.5% YoY. This was aided by superlative digital strategy outcomes including (a) highest mobile transaction value in the industry (b) 82%, 90% and 97% of retail (total), personal loan and credit card customers, respectively, being sourced internally. Share of branch transactions for individual customers was just 6% in 2QFY19 compared with 9% in 2QFY18.

Valuation and outlook: We have revised our NII estimates by 0%/0%/2.1%, PPOP estimates by 0%/0%/2.3% and PAT estimates by 0%/-6.7%/0.3%, for FY19/FY20/FY21, respectively. We have retained Accumulate rating on ABL, revising our target price to Rs667 (from Rs604 earlier) and valuing the stock at 1.9x 1HFY21E P/BV.

ACCUMULATE

Sector: Banking

CMP: Rs611

Target Price: Rs667

Upside: 9%

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Key Data

Current Shares O/S (mn)	2,569.4
Mkt Cap (Rsbn/US$bn)	1,567.2/21.6
52 Wk H / L (Rs)	678/478
Daily Vol. (3M NSE Avg.)	13,472,580

Price Performance (%)

	1 M	6 M	1 Yr
Axis Bank	2.8	16.5	14.6
Nifty Index	(4.1)	(1.5)	1.2

Source: Bloomberg

Y/E March (Rsmn)	2QFY19	2QFY18	1QFY19	*YoY (%)*	*QoQ (%)*
Interest Income	1,32,810	1,12,351	1,27,770	*18.2*	*3.9*
Interest Expenses	80,489	66,955	76,102	*20.2*	*5.8*
Net Interest Income	**52,321**	**45,396**	**51,668**	***15.3***	***1.3***
NIM (%)	**3.4**	**3.5**	**3.5**	***(9bps)***	***(10bps)***
Non-Interest Income	26,784	25,855	29,250	*3.6*	*(8.4)*
Operating Income	**79,105**	**71,251**	**80,918**	***11.0***	***(2.2)***
Staff costs	11,747	10,828	12,278	*8.5*	*(4.3)*
Other operating expenses	26,418	22,650	24,920	*16.6*	*6.0*
Total operating expenses	38,165	33,478	37,198	*14.0*	*2.6*
Cost- to-income (%)	*48.2*	*47.0*	*46.0*	*126bps*	*228bps*
Pre-provision profit	**40,940**	**37,773**	**43,720**	***8.4***	***(6.4)***
Provisions	29,274	31,404	33,377	*(6.8)*	*(12.3)*
PBT	**11,666**	**6,369**	**10,343**	***83.2***	***12.8***
Tax	3,770	2,045	3,333	*84.4*	*13.1*
-Effective tax rate	32.3	32.1	32.2	*0.6*	*0.3*
PAT	**7,896**	**4,324**	**7,011**	***82.6***	***12.6***
EPS (Rs)	3.1	1.8	2.7	*70.4*	*12.6*
BV (Rs)	253.2	234.3	250.0	*8.1*	*1.3*
Deposits	47,96,796	41,64,306	44,70,793	*15.2*	*7.3*
Advances	45,61,213	41,01,708	44,10,745	*11.2*	*3.4*

Source: Company, Nirmal Bang Institutional Equities Research

Comprehensive Conference Call Takeaways

Asset Quality

- The management stated that the elevated ratings downgrade cycle has been completed for the bank.
- The management stated that ~99.6% of the total NBFC and HFC book is rated A or better.
- The management stated that as of this quarter end, total exposure to IL&FS group stood at Rs8,250mn, of which, Rs2,300mn is fund-based and Rs5,870mn is non-fund based. The bank made a 20% provision on the funded exposure. Rs5,390mn of the total exposure is part of the BB and below rated book.
- The management stated that the restructuring pool has not moved over the last 2 quarters as the restructuring is still in play. They believe that the accounts under the book are unlikely to slip in the next few quarters.
- The management stated that about Rs7,000mn worth of accounts from the restructured pool form part of the BB rated book.
- The management stated that there's no certainty with regards to the devolvement of non-fund based exposure. Currently, Non-funded exposure under NPA bucket amounts to Rs28,000mn.
- The management stated that during this quarter, only a few hundred crores were added to the sub investment grade book by way of rating downgrades.
- The management stated that most of the upgrades into the BBB rated book came from steel sector.
- The management stated that the LGD expectation ranges between 60-65%. Hence, PCR has to be made accordingly.
- SMA2 book stood under 40bps of the total loan book as of this quarter end.
- The management stated that the net slippages from the non-corporate book are stable and benign at Rs6,180mn. Gross slippages seem to be higher due to transition to daily recognition mechanism but upgrades are higher too.
- Real estate exposure stood at ~Rs110bn as of this quarter end. About 60% of the total exposure is LRD, on which the management is fairly comfortable. Remaining share is mostly commercial real estate, with the residential real estate exposure being less than Rs10bn. About 50% of the total book is rated A or better. ~44% is rated BBB+ or BBB. Rest of the exposure is mostly BB rated.
- Exposure of the bank to NCLT List 1 and List 2 stood at ~Rs46bn as of this quarter end. The management stated that they have made a ~90% provision on this exposure, amounting to Rs42bn till the end of this quarter.
- Exposure of the bank to all the cases under NCLT (including List 1 and 2) stood at ~Rs110bn as of this quarter end. The management stated that they have made a cumulative provision of ~Rs95bn on this exposure.
- Outstanding SR book stood at ~Rs30bn as of this quarter end.
- Almost the entire pool of written-off accounts has come from the corporate book.
- The management stated that the power sector cases are on status quo due to the court decision. They will have to wait and see whether the cases will be tried under NCLT or not.
- The management stated that there were no sales made to ARCs during this quarter.

Business and Loan Growth

- Acquisition of Freecharge bore fruits for the bank, as the bank got a complementary client base. Freecharge is no longer merely a payments platform but a platform for various kinds of financial products. Axis Bank has started to offer lending products on this platform. The management stated that they are realising envisioned synergies on this front.
- The management stated that they are RaROC-driven in capital allocation. They are aiming to grow the corporate book at a faster rate. Investment in transaction banking will also be made. The management believes that unsecured lending, small business finance and education loans will grow at a faster rate going forward.
- The management stated that they haven't ruled out portfolio buyouts, and if it will make sense to them, then they will have a look at it.
- The management stated that the Agri book has been behaving well since the first quarter of last financial year. Growth in this segment has become a bit of a challenge and the elections are also coming up.
- The management stated that the growth in home loan segment seems lower as the base is high. Also, they had decided to go slower than market seeing the pricing pressure in this segment. Currently, they are observing how NBFCs will conduct their lending to this segment due to the liquidity issues.
- The management is aiming to become equally-weighted on WC and term loans in the corporate space. Incrementally, WC loans will rise at a faster rate than term loans.
- In this quarter, domestic book has improved and off-shore book has come off and will continue in this path.

Margin, Liabilities and Liquidity

- The management stated that about 54% of the total loan book is linked to MCLR.
- The management guided for NIM to be broadly in line with FY18 level.
- There are 3 factors that will drive improvement in the yield on the corporate book: (1) The fact that almost the entire corporate loan book is linked to MCLR (2) The return of pricing power due to bond market liquidity issues (3) Reduction in slippages, interest reversals etc.
- On the retail loan book excluding mortgages, the management believes that they are seeing a re-emergence of pricing power.
- The management stated that currently they are not witnessing pricing power on their home loan book. Although, since, the HFCs are under pressure, pricing power may emerge.
- The management guided for sustainable global NIM level to be in the range of 350-375bps for the whole bank on a steady state basis.
- The management is expecting good traction on their retail term deposits to continue going forward.

Capital

- The management stated that historically they have consumed 55bps of capital on average.
- Warrants which will expire in June next year, if they get exercised, will give additional 40bps of CET1.

Operating expenses

- The management maintain their guidance of opening 400 branches a year until a total of 4500 branches is reached. Only then they will re-evaluate this pace of branch expansion as they believe physical presence is important when they go deeper into the country. Hence, the digital channel is not a complete replacement of physical presence.

Fee Income

- The management stated that their core franchise is such where for customers, the bank's credit card is the first credit card. So, the spends will take time to build up.
- The management stated that the share of mutual fund fees in the total retail fees is less than 10%, i.e., about Rs1,380mn of ~Rs15,000mn.

Subsidiaries

- The management stated that they are making investment in subsidiaries rather than optimizing their expenses to boost their PAT.
- The management stated that Axis Finance has no NPA so far and has registered an ROE of 17.42%.
- Axis Finance broadly provides services related to promoter funding, real estate funding, structured finance and individual lending.

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net interest income	1,80,931	1,86,177	2,18,616	2,59,686	3,23,802
Pre-provision profit	1,75,845	1,55,945	1,94,626	2,33,309	2,98,706
PAT	36,793	2,757	69,702	1,04,532	1,47,367
EPS (Rs)	15.4	1.1	27.2	40.7	52.2
BV (Rs)	232.8	247.2	270.4	306.3	399.4
P/E (x)	39.8	568.5	22.5	15.0	11.7
P/BV (x)	2.6	2.5	2.3	2.0	1.5
Gross NPAs (%)	*5.5*	*7.5*	*5.5*	*4.3*	*3.4*
Net NPAs (%)	*2.3*	*3.8*	*2.9*	*2.1*	*1.6*
RoA (%)	*0.7*	*-*	*0.9*	*1.2*	*1.4*
RoE (%)	*6.8*	*0.5*	*10.5*	*14.1*	*15.4*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Actual performance versus our estimates

(Rsmn)	2QFY19	2QFY18	1QFY19	*YoY (%)*	*QoQ (%)*	2QFY19E	*Devi. (%)*
Net interest income	52,321	45,396	51,668	*15.3*	*1.3*	53,518	*(2.2)*
Pre-provision profit	40,940	37,773	43,720	*8.4*	*(6.4)*	47,226	*(13.3)*
PAT	7,896	4,324	7,011	*82.6*	*12.6*	14,601	*(45.9)*

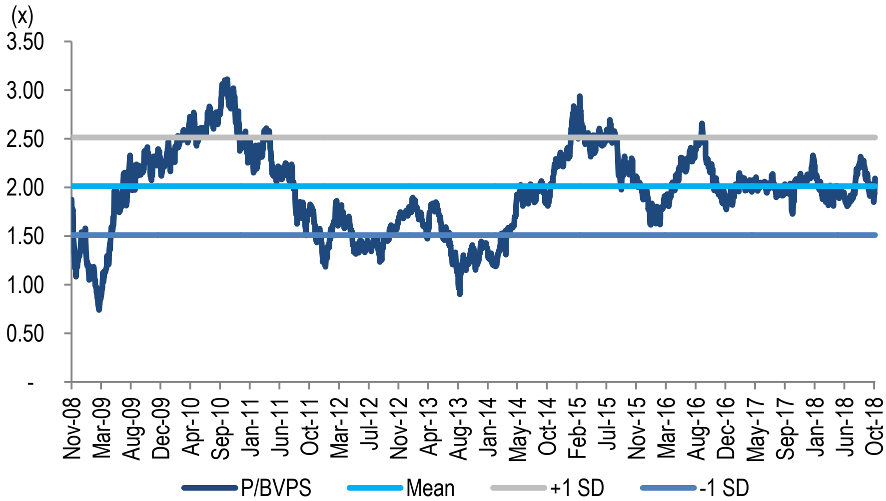
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

	Revised estimate			Earlier estimate			*% Revision*		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	*FY19E*	*FY20E*	*FY21E*
Net interest income (Rsmn)	2,18,616	2,59,686	3,23,802	2,18,616	2,59,686	3,17,153	-	-	2.1
NIM (%)	*3.2*	*3.3*	*3.4*	*3.2*	*3.3*	*3.3*	-	-	*7bps*
Operating profit (Rsmn)	1,94,626	2,33,309	2,98,706	1,94,626	2,33,309	2,92,057	-	-	2.3
Profit after tax (Rsmn)	69,702	1,04,532	1,47,367	69,702	1,11,996	1,46,935	-	(6.7)	0.3

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward P/BV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 5: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Interest income	4,45,422	4,57,803	5,43,048	6,49,877	7,80,788
Interest expenses	2,64,490	2,71,626	3,24,432	3,90,191	4,56,986
Net interest income	**1,80,931**	**1,86,177**	**2,18,616**	**2,59,686**	**3,23,802**
Fee income	85,211	96,583	1,20,763	1,42,501	1,71,557
Other income	31,702	13,088	13,549	19,927	24,289
Net revenues	2,97,844	2,95,848	3,52,928	4,22,114	5,19,648
Operating expenses	1,21,999	1,39,903	1,58,302	1,88,804	2,20,942
-Employee expenses	38,919	43,130	50,478	58,744	66,204
-Other expenses	83,080	96,774	1,07,824	1,30,060	1,54,738
Operating profit	**1,75,845**	**1,55,945**	**1,94,626**	**2,33,309**	**2,98,706**
Provisions	1,21,170	1,54,729	89,017	74,927	75,423
-Loan loss provision	1,15,055	1,64,637	88,017	73,927	74,423
-Investment depreciation	2,387	(2,110)	-	-	-
-Other provisions	3,727	(7,798)	1,000	1,000	1,000
PBT	54,675	1,216	1,05,609	1,58,382	2,23,283
Tax	17,883	(1,541)	35,907	53,850	75,916
PAT	**36,793**	**2,757**	**69,702**	**1,04,532**	**1,47,367**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Equity capital	4,790	5,133	5,133	5,133	5,646
Reserves & surplus	5,52,835	6,29,319	6,88,755	7,80,919	11,21,951
Shareholders' funds	**5,57,625**	**6,34,452**	**6,93,888**	**7,86,052**	**11,27,597**
Deposits	**41,43,788**	**45,36,227**	**54,06,735**	**64,33,934**	**77,67,238**
Borrowings	10,50,309	14,80,161	18,53,461	21,02,970	24,25,982
Other liabilities	2,62,955	2,62,456	3,02,610	3,27,999	3,37,144
Total liabilities	**60,14,676**	**69,13,296**	**82,56,694**	**96,50,954**	**1,16,57,962**
Cash/cash equivalent	5,02,561	4,34,549	6,22,545	7,34,603	8,80,054
Advances	37,30,693	43,96,503	51,87,874	61,21,691	73,33,786
Investments	12,87,934	15,38,761	18,48,444	21,37,046	27,20,746
Fixed assets	37,469	39,717	43,688	48,057	52,863
Other assets	4,56,019	5,03,766	5,54,143	6,09,557	6,70,513
Total assets	**60,14,676**	**69,13,296**	**82,56,694**	**96,50,954**	**1,16,57,962**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

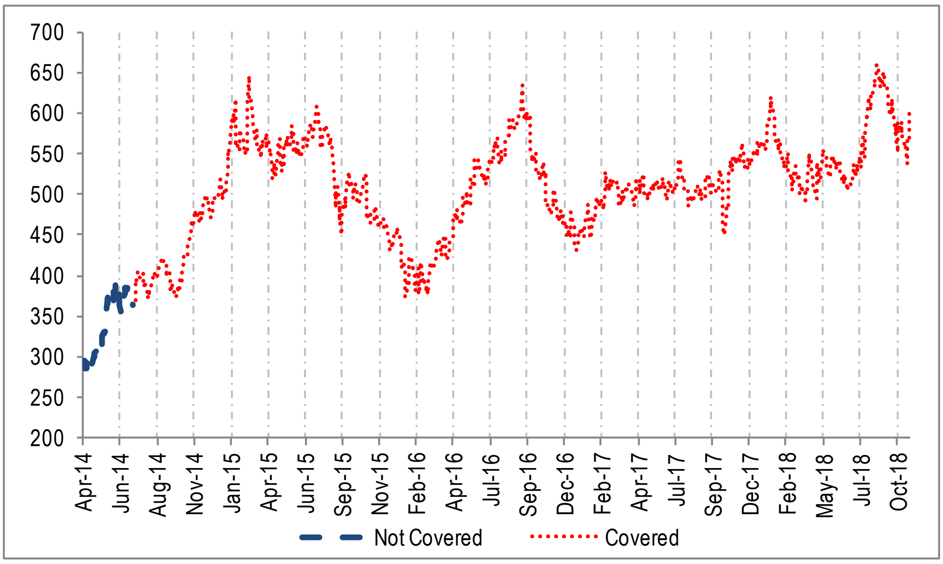
Y/E March	FY17	FY18	FY19E	FY20E	FY21E
Growth (%)					
NII growth	7.5	2.9	17.4	18.8	24.7
Pre-provision profit growth	9.2	(11.3)	24.8	19.9	28.0
PAT growth	(53.1)	(92.5)	2428.4	50.0	41.0
Business (%)					
Deposit growth	15.8	9.5	19.2	19.0	20.7
Advances growth	10.1	17.8	18.0	18.0	19.8
Business growth	13.0	13.4	18.6	18.5	20.3
CD	90.0	96.9	96.0	95.1	94.4
CASA	51.4	53.8	54.0	55.3	56.0
Operating efficiency (%)					
Cost-to-income	41.0	47.3	44.9	44.7	42.5
Cost-to-assets	2.2	2.2	2.1	2.1	2.1
Productivity (Rsmn)					
Business per branch	2,383.3	2,412.3	2,551.1	2,727.7	3,056.6
Business per employee	139.1	149.8	159.4	170.5	191.0
Profit per branch	11.1	0.7	16.8	22.7	29.8
Profit per employee	0.6	-	1.0	1.4	1.9
Spread (%)					
Yield on advances	9.3	8.4	8.4	8.5	8.6
Yield on investments	7.7	7.1	7.3	7.3	7.3
Cost of deposits	5.1	4.4	4.4	4.5	4.4
Yield on assets	8.9	8.0	8.1	8.1	8.2
Cost of funds	5.2	4.6	4.7	4.8	4.7
NIMs	3.6	3.3	3.2	3.3	3.4
Capital adequacy (%)					
Tier I	11.9	13.0	12.9	12.0	14.4
Tier II	3.1	3.5	2.9	2.5	2.4
Total CAR	15.0	16.6	15.8	14.5	16.8
Asset Quality (%)					
Gross NPA	5.5	7.5	5.5	4.3	3.4
Net NPA	2.3	3.8	2.9	2.1	1.6
Provision coverage	65.0	65.0	66.3	70.3	73.6
Slippage	6.1	8.2	2.0	2.0	1.5
Credit-cost	3.1	4.1	1.6	1.2	1.0
Return (%)					
RoE	6.8	0.5	10.5	14.1	15.4
RoA	0.7	0.0	0.9	1.2	1.4
RoRWA	0.8	0.1	1.3	1.7	2.0
Per share					
EPS	15.4	1.1	27.2	40.7	52.2
BV	232.8	247.2	270.4	306.3	399.4
ABV	196.8	182.5	212.0	255.2	358.7
Valuation (x)					
P/E	39.8	568.5	22.5	15.0	11.7
P/BV	2.6	2.5	2.3	2.0	1.5
P/ABV	3.1	3.3	2.9	2.4	1.7

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
23 July 2014	Buy	404	472
20 October 2014	Buy	403	490
8 January 2015	Accumulate	502	490
19 January 2015	Accumulate	515	550
30 April 2015	Accumulate	559	590
27 July 2015	Accumulate	581	590
28 October 2015	Accumulate	518	575
21 January 2016	Accumulate	392	435
27 April 2016	Accumulate	478	470
25 July 2016	Accumulate	537	525
26 October 2016	Accumulate	530	510
20 January 2017	Accumulate	481	490
14 February 2017	Accumulate	491	530
27 April 2017	Accumulate	516	515
26 July 2017	Accumulate	545	515
18 October 2017	Accumulate	513	525
23 January 2018	Accumulate	611	671
27 April 2018	Accumulate	495	473
31 July 2018	Accumulate	570	556
9 October 2018	Accumulate	557	604
5 November 2018	Accumulate	611	667

Rating track graph



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ACCUMULATE -5% to15%

SELL < -5%

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