Axis Bank

25 March 2019

Reuters: AXSB.BO; Bloomberg: AXSB IN

Management Meet Update

Creating Para-Banking Supermarket Is The Key

We recently met Amitabh Chaudhry, MD & CEO, Rajiv Anand, ED, Wholesale Banking, Jairam Sridharan, CFO, Deepak Maheshwari, Chief Credit Officer, Cyril M Anand, Chief Risk Officer, Ravi Narayanan, President and Head - Branch Banking, Jagdeep Mallareddy, Head – Retail Lending, Sanjeev Moghe, EVP and Head – Cards and MAB and Balaji N, EVP and BIU Head of Axis Bank (ABL) and gleaned incremental insight into the strategy of the bank. *We share our detailed takeaways below*. We revise our estimates upward for FY20/FY21 but downgrade ABL to Accumulate from Buy rating, revising upward our target price to Rs819 (from Rs762 earlier), valuing the stock at 2.1x FY21E (2.8x FY20E) standalone P/BV and ascribing a value of Rs 33 to the subsidiaries.

Subsidiaries

- The management admitted that, in the past, they have been late in terms of developing a full suite of financial services subsidiaries.
- The subsidiaries need to be scaled up to be made more profitable.
- RBI view on group holding structure
  - It is not clear, at this point, what stand RBI would take regarding bank holding company structure.
  - It is not known, at this point, whether RBI will allow Axis Bank to acquire a meaningful stake in an insurer.
  - Axis Bank will have conversation with RBI and discuss various alternatives with them.

Corporate lending

- Business focus
  - On the corporate lending front, there is a clear intention to pivot to the working capital side away from term lending.
  - Apart from project finance, Axis Bank also intends to be judicious regarding guarantee business and slow this business down.
- Offering the full suite of products to corporate clients is important
  - There are about 5-7 banks that can offer the full suite of products to corporate clients and Axis Bank is one of them.
  - There is a clear “One Axis” strategy on the ground where the intention is to present the full suite of offerings in unison to corporate clients.
  - The CEOs of Axis Capital (investment banking arm) report to Mr Rajiv Anand, ED, Wholesale Banking to ensure better integration.
  - Debt Capital Markets is a key offering to deepen relationships with corporate clients.
- Corporate customer loyalty – Customers served by the bank have often stayed loyal to the bank even after becoming big. The bank sees current mid-sized customers behaving similarly as they grow big.

(The takeaways are continued from page 2 onwards).

ACCUMULATE

Sector: Banking

CMP: Rs749

Target Price: Rs819

Upside: 9%

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Key Data

Current Shares O/S (mn)	2,571.2
Mkt Cap (Rsbn/US$bn)	1930/27.9
52 Wk H / L (Rs)	767/478
Daily Vol. (3M NSE Avg.)	1,13,25,350

Price Performance (%)

	1 M	6 M	1 Yr
Axis Bank	6.7	22.2	50.3
Nifty Index	4.5	2.7	13.7

Source: Bloomberg

Corporate lending (continued….)

- View on infrastructure lending
    - The view on infrastructure lending is that it is difficult for banks to do the nature and quantum of lending they did earlier unless the sponsors put in more money.
    - As a matter of approach, Axis Bank does not intend to finance greenfield, limited equity, no-recourse projects.
- Refinancing
    - This will be an important business for the bank over the next 12-18 months.
    - Currently, corporate clients have as much as 15-30 banks catering to them and they will look to bring this down to 4-6 banks.
- Commercial banking
    - A new vertical has been created to focus specifically on commercial banking.
    - Invoicemart
        - Axis Bank has about a 40% market share on the TREDs platform for trade receivables.
- Government business
    - Axis Bank is the sole trustee for the PFRDA.
    - 89% of India's districts are covered by Axis Bank as the central and state governments prefer banks with reach when they decide to hand out business to them.
    - Axis Bank is deeply involved in the Raipur Smart City project.
    - Axis Bank is also involved with the Kochi Metro project.
    - In government business, the bank understands the need to provide a comprehensive solution rather than just being the lowest bidder.
- SME lending
    - SME lending is no longer about just providing credit.
    - The intention is to cross sell effectively. For example, Burgundy accounts are offered to SME promoters.
    - About 75-80% of existing merchant clients have current accounts.
    - The RaROC of the SME business is about 1.3x of the large Corporate business.
    - It is in the realm of possibility that the SME lending opportunity could be as big and fruitful over the next decade as retail lending has been over the past decade.
- Cash management
    - Axis Bank lays emphasis on this business due to reasons including the fact that there is direct correlation with generating current account balance.
- Impact of Working Capital Demand Loan regulation
    - The burden of cash flow management has been transmitted back to the corporate from the bank.
    - The overall demand for working capital demand loan will really depend on pricing.
    - If the pricing from banks is not attractive, the corporate will resort to commercial paper.

Fee income

- Wholesale banking fees have been tapering off and this needs to be rectified.
- Credit-related corporate fee income stream has been de-growing but this de-growth is now behind the bank.
- Despite slowing down guarantee business, overall wholesale fee income traction should improve.
- The bank feels its relationship managers have not demanded its fair share of the corporate wallet and would be acting to fill this gap.

Retail lending

- NBFC crisis impact
    - The NBFC crisis is an opportunity on the retail lending side.
    - Loan against property is an area where the bank is clearly benefiting.
- About 50% of retail lending business is sourced from branches.
- The lion's share of higher risk products are sourced internally.
- Used car finance is an area where there is an ongoing shift from unorganised to organised sector.
- GST and increased electronic payments is increasing the opportunity size for banks.
- Profitability of the overall retail business
    - The overall yield from all retail businesses as a proportion of retail assets has declined.
    - This is not due to any issue on the lending side but rather due to liability fees being impacted due to regulation.
    - However, there has been positive delta from the cards business.
- Cross sell to existing liability customers
    - The penetration into existing liability customers is in the mid single digits.
    - The proportion of liability customers which are eligible for retail loans is about 35%.
- Cards business
    - A typical cards customer uses his card about 6 to 8 times a month.
    - A frequently transacting customer helps deepen the relationship with the bank. CASA balances for such a customer generally improve.
    - Form factor in the payments industry
        - In the US, payments are mostly done via plastic mode.
        - In China, wallets and QR codes dominate the payments scene.
        - The Indian scenario is still evolving and it remains to be seen how things pan out.
        - The bank is not betting on one form factor over the other and stands prepared to benefit from any scenario.
    - Mobile app is key since it improves the engagement index of a card customer.
    - About 19% of the current 22.5mn customer base is currently penetrated for credit card business.
    - Regarding UPI, the intention is to make it a profitable business on a standalone basis.
    - Revolve rates
        - The bank is comfortable with revolve rates that it is currently seeing but does not intend to drive revolve rates up from here.
        - The industry operates on a revolve rate of ~33% on a number basis (i.e. not amount basis).
    - EMI offering
        - EMI on card generates direct interest revenue to begin with.
        - It also pushes customers to purchase consumer durables on EMI.
        - The Head of Cards business, Mr Sanjeev Moghe, comes from Bajaj Finance and is well versed with EMI offerings business.
        - Proportion of consumer durables in cards outstanding would be in the early teens.
        - A couple of banks would be higher than this proportion than Axis Bank.
        - The potential for merchant EMI business is large.
    - Threats to the payments business
        - There is always a theoretical regulatory threat.
        - The entry of Reliance in the payments business needs to be watched.
        - Paytm's evolution in the mobile banking business also needs to be watched.
    - The proportion of penal fees in cards revenue is not meaningful.

- Most of the key cards players are operating in a similar RoTA ballpark.
- Card deals with merchants
    - Axis Bank is neither under or over-rewarding its customers.
    - The bank decides on deals with merchants based on analysis.
    - A lot of Axis Bank's customer base is new to bureau and this enables the bank to clinch better deals with merchants.

Hiring

- Among important recruitments, only the Head of Retail Banking and Head of Digital remain to be hired.
- Ganesh Sankaran has recently joined the bank to lead corporate client coverage and he will report to Rajiv Anand, ED, Wholesale Banking.

Opex

- The bank is undergoing an organisational change in terms of cost savings. Significant opportunities exist in this regard and results should start to be visible in the next 2-3 quarters.
- Branch addition strategy
    - The bank plans to add branches at a certain steady pace and believes would have reached critical mass once branch count reaches 5000-5500.
    - The bank feels some small banks may be going slow on branch addition since they may be facing constraints on affordability.
    - The pace of Axis Bank's intended branch expansion is not a function of being slack on the digital front but rather the bank has made significant investments in executing a robust digital strategy.
    - Incremental branches for Axis Bank would come at a lower cost.
    - Historically, branches have broken even in less than 3 years.
    - Where technology fits in
        - The main goal of technology is to augment revenue while also reduce cost.
        - There are essentially 3 broad components to branch-related costs: Rentals, People and Technology and Support Architecture.
        - Due to technology, while the support architecture cost has actually gone up a tad, the rental cost and people cost has been able to come down.
        - Earlier, the bank usually started a branch with 8 people but, it is able to do the same with 2 people now.
- Retail lending
    - The cost of acquisition in retail lending has come down due to changes in channel mix.
    - For retail lending, the broad sourcing mix has been about half from branches, about a third from other proprietary channels and the rest from third party sources.
    - There has been a moderation in the sourcing from third party sources.

RaROC based business focus

- RaROC based business focus was implemented more than a year back.
- Apart from de-focusing project finance and guarantees business, Axis Bank is also reviewing its International business.

Capital

- There will be about 40 bps worth of capital accretion due to Warrants.
- The bank does not see a capital raise in the next 12 months but, after that, capital will be required.

Asset quality

- SME asset quality
  - SME slippages for the bank actually peaked in FY17.
  - The bank has judiciously avoided stressed SME sectors.
- Wholesale asset quality
  - The bank previously had some concentration risk in term of exposure to the infrastructure sector, particularly the power sector and has acted to reduce it.
  - The bank intends to keep exposure to a single industry below a limit of 6%.
- Processes
  - The bank now has a robust early warning system which takes inputs from internal reports on transaction data of borrowers as well as external market reports.
  - Proper separation of business sourcing and credit appraisal function
    - Under-writing has been separated from client coverage. This was not the case till a while ago.
    - The Chief Risk Officer (Mr. Deepak Maheshwari) reports directly to the MD. Only the MD has the power to over-rule a loan rejection by the CRO.
    - Until last year, the credit appraisal department had business targets. This is no longer the case.
  - A stronger rating model has been developed including for project loans, where the earlier model had some lacuna.
  - A separate function has been created for under-writing mid-market clients.
- While there may be quarterly fluctuation for the sub-investment grade pool, over the long-term, this would be trending down.
- Telecom sector exposure
  - The consolidation in the telecom sector is largely behind us.
  - The bank does not see the risk of large guarantees being invoked.
  - The sector should do better prospectively.
- Real estate sector exposure
  - The total exposure is about Rs 160bn
  - Of this, about Rs 100bn is to commercial projects.
  - Of the remaining Rs 50bn plus to residential real estate, about 30% is to residential construction, with borrowers largely being developers with sound track record.
  - The major part of real estate exposure is lease rental discounting.
  - The developers lent to by the bank have a sound track record and no inventory issues with lending generally taking place at an advanced stage of the project.
  - Over the last 9 months, the focus has been on LRD and commercial projects.
- NBFC exposure
  - The total exposure is about Rs 200bn.
  - About 40% of the exposure is to AAA-rated NBFCs.
  - The exposure to NBFCs with any sort of issues is very minimal.
  - As such, it is only certain NBFCs lending to the real estate and infrastructure space that are under any meaningful stress.
- Mid-market client business
  - About half of this book would be to clients rated BBB.
  - However, this is not an issue if the under-writing is good.
  - Under-writing is done based on a thorough cash-flow analysis.
- On RBI's 12th February Circular
  - The Circular, as is, is manageable from the bank's point of view.

    - The Inter Creditor Agreement which necessitates the approval of only 66% of lenders takes care of gridlocks that may arise due to the Circular.
- Retail loan asset quality
    - Axis Bank is one of the few banks to follow the daily recognition norm for asset quality.
    - So far, the bank has not experienced any significant negative impact from job losses and salary cuts in certain sectors.
    - The bank continues to monitor various industries for early signs of stress.
    - Usage of credit bureaus
        - The hit rate has been about 92%.
        - The bank's lending to sub-prime borrowers (CIBIL score below 600) is practically nil.

Liabilities

- There is scope of improving the rate at which CASA market share is being currently garnered.
- The management strongly believes that, given the franchise Axis Bank has at its disposal, the headroom for accelerating deposits growth is significant.
- Branch expansion key to liability strategy
    - More than half the branches added in recent years have been in urban centres with a view to raising liabilities.
    - At the same time, the focus has been to grow in geographies where the bank is not represented or under-represented.
    - Even the large Burgundy, TASC and government liability accounts are sources via branches. Even the servicing of these accounts impinges on the branches.
    - Branch expansion focus
        - The incremental branch expansion will be focused on metro, urban and semi-urban centres.
        - The focus would also be to expand in the developed states of India.
        - Semi urban and rural expansion will also be executed if such expansion would achieve profitable business in under-penetrated businesses.
- Term Deposit penetration in our customer base is low at sub 6%.
- SME, transaction banking, wealth management and corporate customers would all be tapped for liability accretion.
- Customers who come for 'rates shopping' are generally transactional and are not the bank's prime focus.
- Digital push for liabilities
    - The bank is focused on promoting Assisted Digital transactions with a view to generating liabilities wherein the bank is able to explain the benefits of the product to the customer.
    - The idea is to create a digital-enabled eco-system that facilitates cross sell.
    - For example, the bank shows the full suite of products to the broking customer as well.
    - A digital-enabled environment also enables the embellishing of the repository of data on customers on which analytics can be executed.
- The bank has moved from KYC to 'OYC'
    - From knowing your Customer, Catchment and Customer, the bank has moved to oversight of Customer, Catchment and Customer.
    - It is not merely about opening a liability account for a new customer but handling his full journey at Axis Bank in terms of cross sell.
    - The bank is fully aware that this journey is fraught with danger as the client can, potentially, get poached by other banks, NBFCs and even fintech companies.
    - The bank wants to ensure better value accruing to the bank with each interaction with the customer.

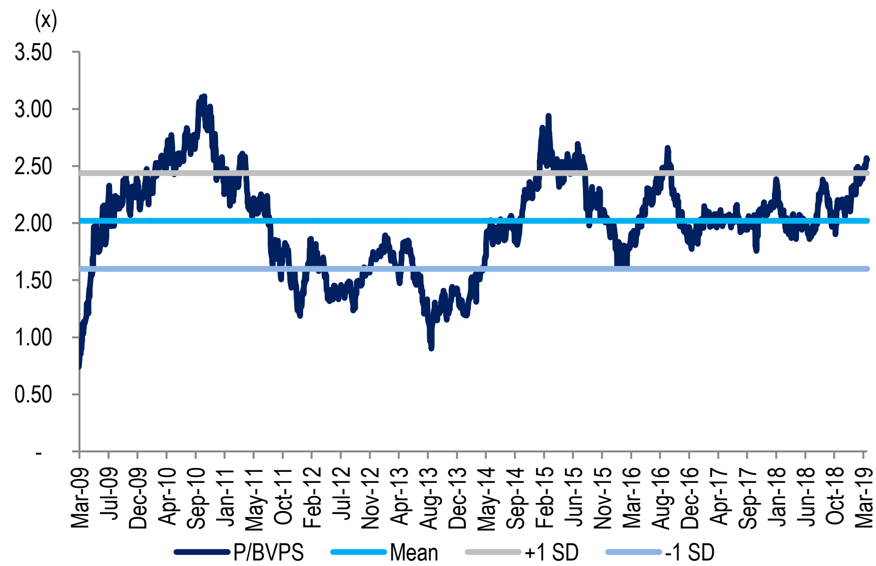
   - The bank has mapped each customer to an employee at the bank.
- Front line sales
   - The mandate to front line sales is to enable a comprehensive relationship with clients so that they save, pay, invest, borrow and shop with the bank.
   - The bank is broadly comfortable with front line sales headcount that it currently has and this is expected to grow broadly in line with business growth.

Exhibit 1: Change in our estimates

	Revised estimate			Earlier estimate			*% Revision*		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	*FY19E*	*FY20E*	*FY21E*
Net interest income (Rsmn)	218,616	259,686	318,260	218,616	259,686	319,723	*0.0*	*0.0*	*(0.5)*
NIM (%)	*3.25*	*3.25*	*3.33*	*3.25*	*3.25*	*3.34*	*0 bps*	*0 bps*	*-1 bps*
Operating profit (Rsmn)	184,593	233,762	297,873	184,593	233,422	292,609	*0.0*	*0.1*	*1.8*
Profit after tax (Rsmn)	50,429	101,099	142,377	50,429	100,875	138,903	*0.0*	*0.2*	*2.5*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: One-year forward P/BV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 3: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Interest income	445,422	457,803	543,048	649,877	777,424
Interest expenses	264,490	271,626	324,432	390,191	459,164
Net interest income	**180,931**	**186,177**	**218,616**	**259,686**	**318,260**
Fee income	85,211	96,583	117,504	142,953	176,267
Other income	31,702	13,088	6,774	19,927	24,289
Net revenues	297,844	295,848	342,895	422,566	518,815
Operating expenses	121,999	139,903	158,302	188,804	220,942
-Employee expenses	38,919	43,130	50,478	58,744	66,204
-Other expenses	83,080	96,774	107,824	130,060	154,738
Pre-provisioning operating profit	**175,845**	**155,945**	**184,593**	**233,762**	**297,873**
Provisions	121,170	154,729	108,185	80,582	82,150
-Loan loss provision	115,055	164,637	107,185	79,582	81,150
-Investment depreciation	2,387	(2,110)	0	0	0
-Other provisions	3,727	(7,798)	1,000	1,000	1,000
PBT	54,675	1,216	76,408	153,180	215,723
Tax	17,883	(1,541)	25,979	52,081	73,346
PAT	**36,793**	**2,757**	**50,429**	**101,099**	**142,377**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Equity capital	4,790	5,133	5,133	5,133	5,544
Reserves & surplus	552,835	629,319	669,482	758,212	1,065,863
Shareholders' funds	**557,625**	**634,452**	**674,615**	**763,345**	**1,071,407**
Deposits	**4,143,788**	**4,536,227**	**5,406,735**	**6,433,934**	**7,767,238**
Borrowings	1,050,309	1,480,161	1,853,461	2,102,970	2,454,723
Other liabilities	262,955	262,455	321,883	350,706	364,593
Total liabilities	**6,014,676**	**6,913,295**	**8,256,694**	**9,650,954**	**11,657,962**
Cash/cash equivalent	502,561	434,549	622,545	734,603	880,054
Advances	3,730,693	4,396,503	5,187,874	6,121,691	7,333,786
Investments	1,287,934	1,538,761	1,848,444	2,137,046	2,720,746
Fixed assets	37,469	39,717	43,688	48,057	52,863
Other assets	456,019	503,766	554,143	609,557	670,513
Total assets	**6,014,676**	**6,913,296**	**8,256,694**	**9,650,954**	**11,657,962**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Key ratios

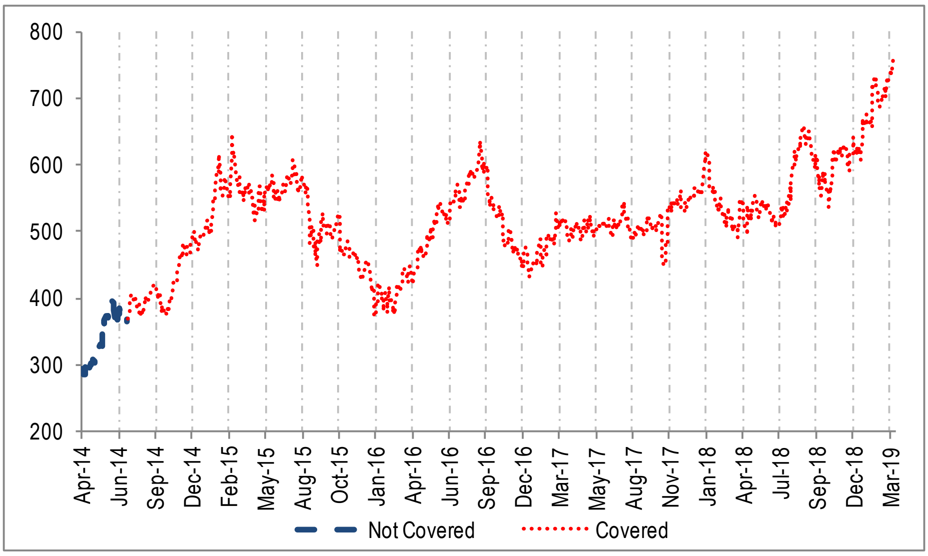
Y/E March	FY17	FY18	FY19E	FY20E	FY21E
Growth (%)					
NII growth	7.5	2.9	17.4	18.8	22.6
Pre-provision profit growth	9.2	(11.3)	18.4	26.6	27.4
PAT growth	(53.1)	(92.5)	1,729.3	100.5	40.8
Business (%)					
Deposit growth	15.8	9.5	19.2	19.0	20.7
Advances growth	10.1	17.8	18.0	18.0	19.8
Business growth	13.0	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	46.2	44.7	42.6
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	12.1	22.0	28.8
Profit per employee	0.6	0.0	0.8	1.4	1.8
Spread (%)					
Yield on advances	9.3	8.4	8.4	8.5	8.5
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	8.1
Cost of funds	5.2	4.6	4.7	4.7	4.7
NIMs	3.6	3.3	3.2	3.3	3.3
Capital adequacy (%)					
Tier I	11.9	13.0	12.5	11.7	13.7
Tier II	3.1	3.5	2.9	2.5	2.4
Total CAR	15.0	16.6	15.5	14.2	16.1
Asset Quality (%)					
Gross NPA	5.5	7.5	5.4	4.3	3.4
Net NPA	2.3	3.8	2.5	1.7	1.1
Provision coverage	65.0	65.0	70.6	75.9	80.9
Slippage	6.1	8.2	2.0	2.0	1.5
Credit-cost	3.1	4.1	2.0	1.3	1.1
Return (%)					
RoE	6.8	0.5	7.7	14.1	15.5
RoA	0.7	0.0	0.7	1.1	1.3
RoRWA	0.8	0.1	0.9	1.6	1.9
Per share					
EPS	15.4	1.1	19.6	39.4	51.4
BV	232.8	247.2	262.9	297.4	386.5
ABV	196.8	182.5	211.9	256.0	356.5
Valuation (x)					
P/E	48.8	697.5	38.1	19.0	14.6
P/BV	3.2	3.0	2.9	2.5	1.9
P/ABV	3.8	4.1	3.5	2.9	2.1

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
13 December 2018	Buy	609	761
30 January 2019	Buy	661	762
25 March 2019	Accumulate	749	819

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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