Axis Bank Ltd.

EQUITY REPORT

January 2nd, 2015

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Incorporated in 1993, Axis Bank is the third largest private sector bank in India. Axis Bank offers the entire spectrum of financial services to customer segments covering Large and Mid-Corporates, MSME, Agriculture and Retail Businesses. In order to expand its geographical presence across the country and to tap the growing business and financial opportunities, the bank is focusing on its retail segment by expanding its branch network. During Q2FY15, the Bank added 84 branches and 216 ATMs in Q2FY15, taking its total network to 2,505 branches (covering 1,686 centers) and 13,146 ATMs as on 30th September 2014.

Investment Rationale

Healthy superior returns to withstand the current growth – Axis Bank continued to report strong earnings growth with strong earnings, return ratios and stable asset quality over the last few quarters notwithstanding the adverse domestic macroeconomic environment. The bank's RoEs stayed in the range of 16-18% while RoAs increased consistently to 1.7% now. We expect the bank to sustain the strong earnings performance over FY14-16E on the back of its low credit and operating costs, low funding costs, and a diversified revenue stream.

Strong branch network expansion to augment growth – In order to expand its geographical presence across the country and to tap the growing business and financial opportunities, the bank is focusing on its retail segment by expanding its branch network. This will further strengthen its low-cost deposit base. In the last two years, Axis Bank expanded its reach by adding ~800 branches or 33% of its existing branches. The bank's consistent focus towards branch expansion has enabled the bank improve its retail franchise. Further, the bank is planning to open 150 to 200 more branches in rest of the FY15E.

NIM to remain at moderate level on low cost deposit & better asset-liability mix – Despite a challenging environment, Axis Bank has been able to maintain its NIM of more than 3% since FY08. At the end of 30th September 2014, the NIM of Axis Bank rose to 3.97% up by 10 bps QoQ, mainly due to 2 bps QoQ decline in cost of fund driven largely from a better mix of assets between retail and corporate. With the bank's continued focus to enlarge its distribution network by widening its geographic reach is likely to boost its low-cost CASA deposit base, thereby providing a much needed boost to the bank's NIM. However, reduction in base rate will keep the bank's NIM at moderate level in H2FY15E, but in line the management guidance of +3.5%.

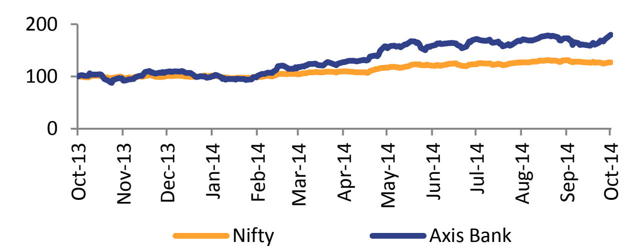
Market Data

Rating	BUY
CMP (₹)	514
Target (₹)	600
Potential Upside	17%
Duration	Long Term
Face Value (₹)	2.0
52 week H/L (₹)	516.9/216.5
Adj. all time High (₹)	516.9
Decline from 52WH (%)	0.6
Rise from 52WL (%)	137.4
Beta	1.1
Mkt. Cap (₹bn)	1,207.5
Book value (₹bn)	382.2

Fiscal Year Ended

Y/E	FY13A	FY14A	FY15E	FY16E
NII (₹bn)	96.7	119.5	146.5	184.7
Net Profit (₹bn)	51.8	62.2	73.8	93.0
Share Capital (₹bn)	4.7	4.7	4.7	4.7
EPS (₹)	22.1	26.5	31.4	39.6
P/E (x)	23.3	19.4	16.4	13.0
P/BV (x)	3.6	3.2	2.7	2.0
ROA (%)	1.7	1.7	1.8	1.9
ROE (%)	18.5	17.4	17.7	17.9

One year Price Chart



Shareholding Pattern	Sep'14	Jun'14	Diff.
Promoters	28.9	29.2	(0.3)
FII	47.5	48.4	(0.9)
DII	10.9	11.2	(0.3)
Others	12.7	11.3	1.4

Axis Bank; the country's third largest private sector lender

Incorporated in 1993, Axis Bank is the third largest private sector bank in India. Axis Bank offers the entire spectrum of financial services to customer segments covering Large and Mid-Corporates, MSME, Agriculture and Retail Businesses.

Recently, with the launch of its overseas subsidiary, Axis Bank UK Ltd., the Bank's overseas presence has grown to eight foreign offices, i.e. four branches, one each in Singapore, Hong Kong, DIFC (Dubai) and Colombo (Sri Lanka), three representative offices in Shanghai (China), Dubai and Abu Dhabi and an overseas subsidiary in London, UK. The Bank's retail businesses grew steadily during the year and there was credible growth of both retail deposits and loans, supported by an expanding network that is crucial to the retail franchise. The Bank continues to balance growth with profitability and generate value for its stakeholders. This is evidenced by the consistent healthy return on assets and return on equity.

As on 30th September 2014, the bank's capital adequacy ratio (CAR) as per Basel III norms continues to remain strong at 14.84% (excluding profit of H1FY15) with Tier-I capital ratio of 11.51% as of Q2FY15, giving bank the ability to grow their business further without raising fresh equity capital in the near term.

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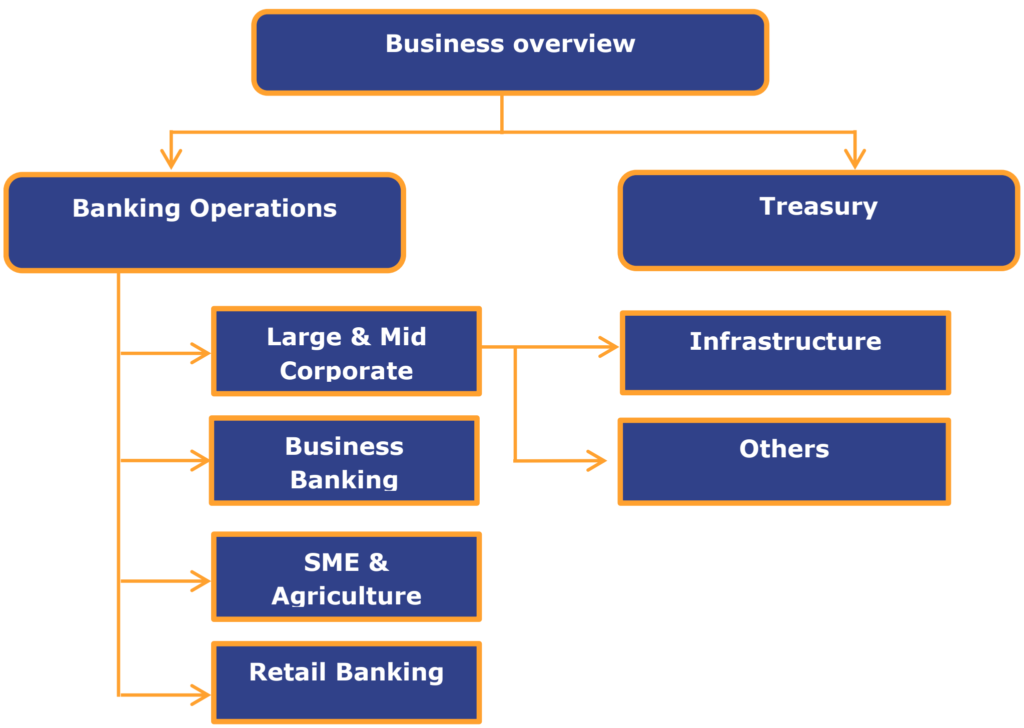
Business Overview



Loan book is expected to grow by 20% in FY15E

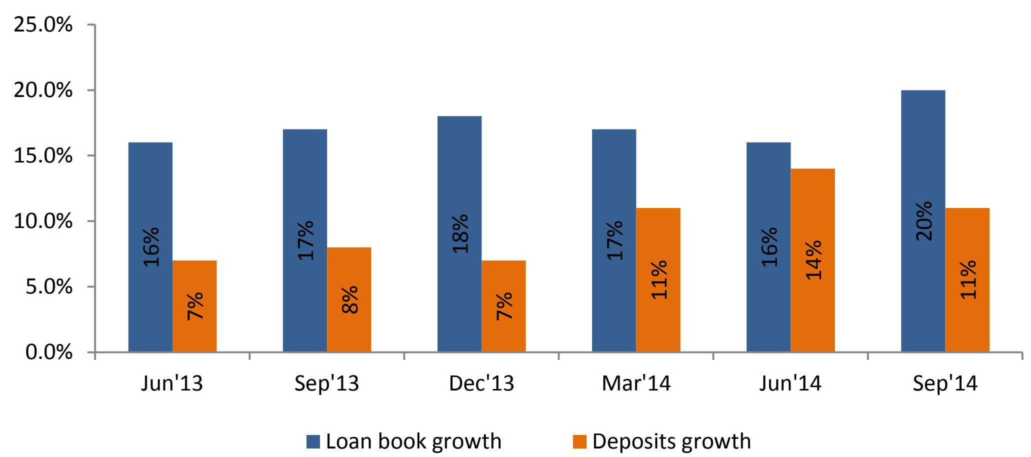
The bank continues to remain focus towards retail loans and is eyeing to increase the retail loans proportion to 40% by the end of FY15E from 32% as on FY14.

Consistent increase in the branch network (>25% CAGR increase in branches in the past decade) coupled with strong corporate relationships has supported the loan book growth in the past that grew at a CAGR of 23.05% (between FY10-14). Until FY12, the bank's loan book was largely skewed towards the corporate segment. The bank has now focusing more on the retail loans, which has resulted in the proportion of retail loans increasing to 32% as on FY14 from 22% in FY12. The bank further intends to increase the retail loans proportion to 40% by the end of FY15E.

The bank has witnessed a healthy 20% YoY growth in its advances during Q2FY15 to ₹2,422.0 billion mainly attributed by 27% YoY growth in the domestic retail advances. During Q1FY15, the bank has re-organised the agriculture lending business. As a result, the retail portion of agriculture advances has been merged with the existing retail advances, while non-retail agriculture advances have been merged into the SME business. After this change, the outstanding retail advances, including retail agriculture, stood at ₹943.2 billion as on 30th September 2014 against ₹710.4 billion as on 30th September 2013. Meanwhile, the core retail advances (excluding Loans against FCNR deposits) of the bank witnessed a robust growth of 27% YoY and stood at ₹902.8 billion and accounted for 38% of the net advances of the bank. However, the advances to the SME segment (including non-retail agriculture) posted 15% growth at ₹377.0 billion as on 30th September 2014 and accounted for 16% of the net advances.

On the corporate loan front, the bank continues to adopt a cautious approach in fresh lending to large and mid-corporate. During Q2FY15, the corporate loan book of the bank grew only 13% YoY to `1,101.8 billion largely driven by the refinancing of existing loans and working capital finance.

Business growth trend over the quarters



We believe that the bank's strong positioning in the retail space and expected revival in corporate credit demand will help Axis Bank to achieve a loan growth of ~20% in FY15E.

With the economy showing signs of revival, the bank remains optimistic of further growth in the corporate segment from H2FY15E onwards. Further, the bank will continue to focus on secured lending, which comprised 88% of the total retail loans. We believe that the bank's strong positioning in the retail space and expected revival in corporate credit demand will help Axis Bank to achieve a loan growth of ~20% in FY15E.

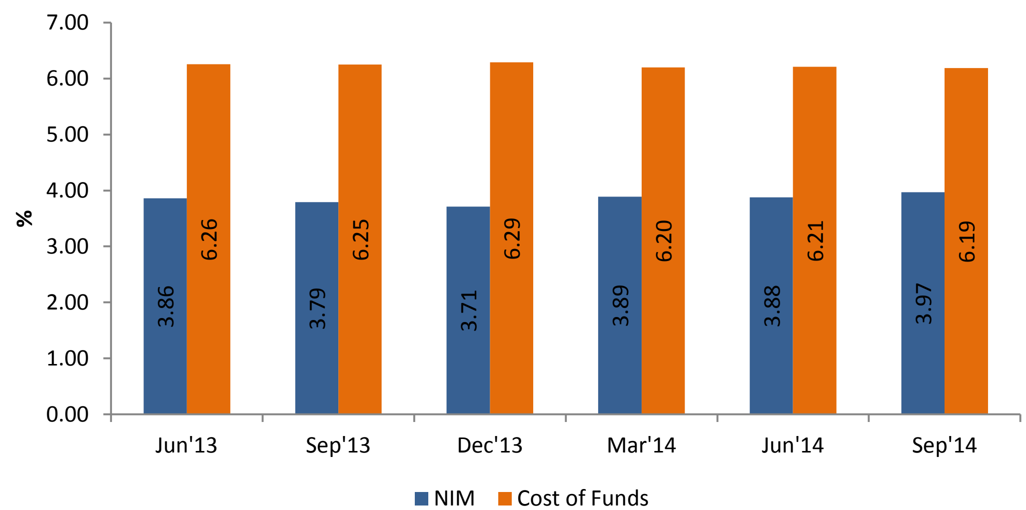
NIM to stay at 3.8-3.9% in FY15E in line with management guidance

Over FY15-16E, we expect NIMs to stay at 3.8-3.9% levels in FY15E in line with management guidance.

Despite a challenging environment, Axis Bank has been able to maintain its NIM of more than 3% since FY08 on the back of strong deposit franchise of the bank. At the end of 30th September 2014, the NIM of Axis Bank rose to 3.97% up by 10 bps QoQ, mainly due to 2 bps QoQ decline in cost of fund driven largely from a better mix of assets between retail and corporate. Besides, the bank's strong focus on rising the low-cost CASA deposits and reducing dependence on wholesale funds has been able to narrow the gap vis-à-vis its peers (ICICI Bank, HDFC Bank) in terms of liability franchise. This should help to sustain the net interest margin at healthy levels going ahead.

With the bank's continued focus to enlarge its distribution network by widening its geographic reach is likely to boost its low-cost CASA deposit base, thereby providing a much needed boost to the bank's NIM. However, reduction in base rate will keep the bank's NIM at moderate level in H2FY15E, but in line the management guidance of +3.5%. Over FY15-16E, we expect NIMs to stay at 3.8-3.9% levels in FY15E in line with management guidance.

NIM & cost of funds trend



Increasing retail deposit base to drive CASA growth

The bank's consistent branch and ATMs expansion approach would help the deposits base to grow by ~15% in FY15-16E.

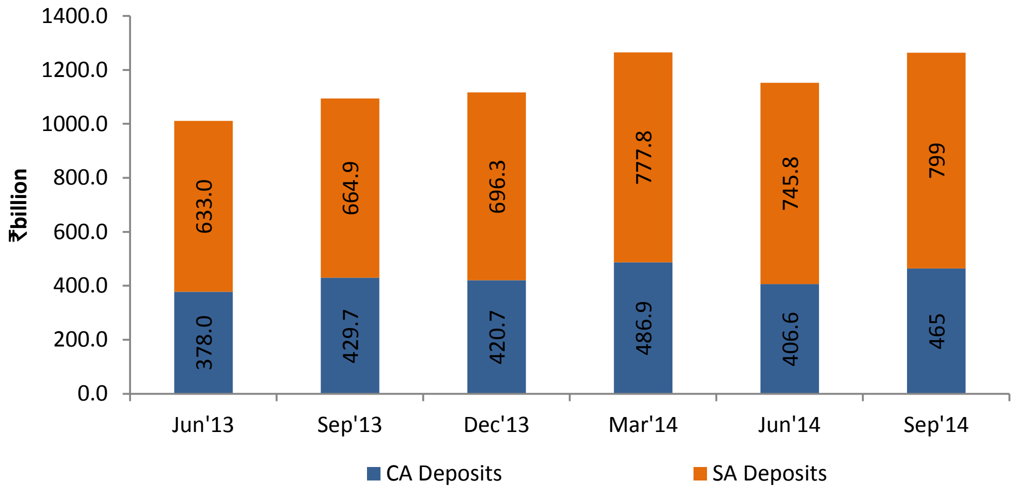
Axis Bank is having a strong deposit base under its kitty. The bank has witnessed 11% YoY growth in its deposits at ₹2,837.3 billion during Q2FY15, which is one of the best in class, which was mainly led by expansion of branches and ATMs. On the CASA front, the bank has also witnessed an impressive performance in Q2FY15, with the CASA deposits grew robustly by 15.5% YoY and 9.7% QoQ on the back of strong growth in both current as well as saving deposits. As a result, the bank's CASA ratio improved to 45% in Q2FY15 as compared to 42.0% in Q1FY15 and 43.0% in Q2FY14.

During Q2FY15, the savings deposits of the bank grew robustly by 20.1% YoY and 7.1% QoQ driven by strong customers acquisition, as it acquired ~500,000 new customers during the quarter. However, the bank's current account deposits grew by 8.2% YoY and 14.4% QoQ, driven by healthy growth in corporate business.

The bank has been consistently improving its liability profile and gaining market share in low cost deposits which has enabled it to contain the cost of funds. During H1FY15, the savings deposits of the bank grew 19% YoY, while current account deposits grew by 10% YoY. As a result, the CASA deposits (constituting 40% of total deposits) during H1FY15 grew 16% YoY. Retail term deposits (constituting 62% of the bank's term deposits) on the other hand grew 43% YoY.

We expect the bank's deposits base to grow by ~15% in FY15-16E on account of consistent branch and ATMs expansion. In addition to this, with healthy low cost deposit base, we expect the bank's NIM to improve further ahead.

CASA deposits trend



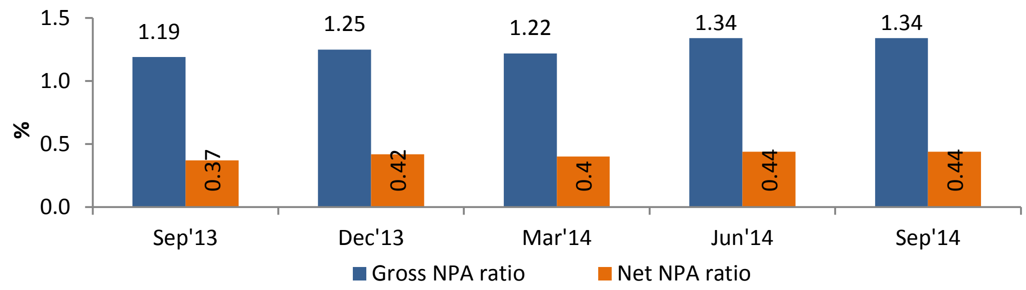
Better risk management to keep asset quality at a comfortable level

The management has given guidance for stressed assets portfolio at ₹65 billion for FY15 as compared to the stressed loans of ~₹26 billion in H1FY15.

The bank consistently maintain its asset quality, with the gross non-performing asset (GNPA) and net non-performing asset (NNPA) ratio remained in 1-1.3% and 0.2-0.45% level, respectively from the past five years. Further, during Q2FY15, the asset quality of the bank remained stable on QoQ basis, with gross non-performing asset (GNPA) and net non-performing asset (NNPA) ratio at 1.34% and 0.44%, respectively. This was partly supported by the provision coverage ratio (PCR) of the bank, which remained healthy at 78% during Q2FY15. During Q2FY15, the bank witnessed high fresh slippages of ₹9.1 billion as compared to ₹6.2 billion in Q1FY15 and ₹6.2 billion in Q2FY14. However, it was well within the management guidance. Recovery and up-gradation rose to ₹1.6 billion as compared to ₹1.0 billion in Q1FY15. The bank has also written-off ₹6.0 billion of NPAs as compared to ₹2.1 billion in Q1FY15.

Meanwhile, the management has given guidance for stressed assets portfolio at ₹65 billion for FY15 as compared to the stressed loans of ~₹26 billion in H1FY15. We expect that the bank's focused towards maintaining its asset quality coupled with its strong retail deposit base to help the lender to augment its secured loans in the coming quarters and thereby provide adequate cushion against probable asset quality risks.

Stable asset quality



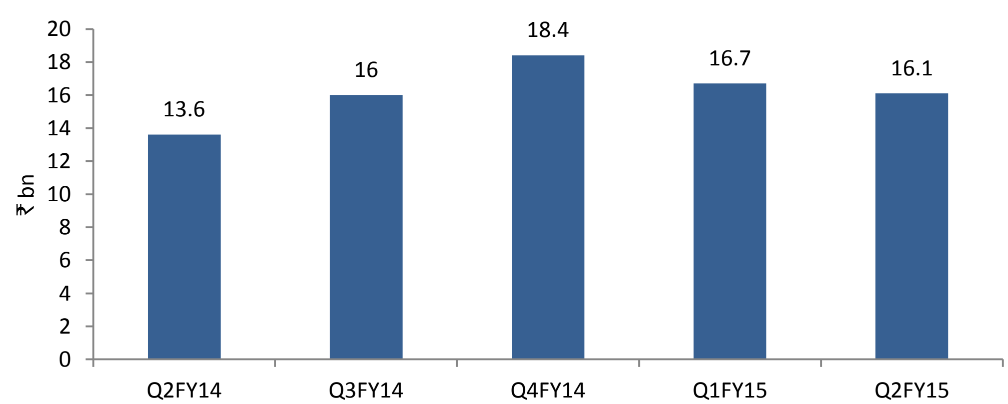
Q2FY15 performance remain impressive

In line with strong NII growth coupled with higher other income has triggered 18% YoY rise in net profit to ₹16.11 billion in Q2FY15 as compared to ₹13.62 billion in Q2FY14.

Axis Bank has reported a healthy performance in Q2FY15, with the net interest income (NII) of the bank on standalone basis increased by 20% YoY during the quarter under consideration to ₹35.25 billion mainly driven by healthy credit growth of 20% YoY & strong margins of 3.93%. Further, the stable cost of funds scored due to the reduction in term deposit rates also assisted the NII growth. The operating revenue of the lender also witnessed a healthy 17% YoY growth in Q2FY15 to ₹51.7 billion. In line with strong NII growth coupled with higher other income has triggered 18% YoY rise in net profit to ₹16.11 billion in Q2FY15 as compared to ₹13.62 billion in Q2FY14. However, on a sequential basis net profit was a tad lower by 3% from ₹16.67 billion in the June ended quarter, as higher provisions which were up by 87.5% QoQ to ₹7.25 billion in the September quarter has restricted the growth.

- Non-interest income of the Bank grew 10% YoY and 15% QoQ to ₹19.5 billion, mainly due to moderate growth of 11% YoY in fee income in Q2FY15. Growth in core fee income was primarily led by strong growth in retail fee income (up by 24% YoY) which constitutes 38% of total fee income. The YoY growth in trading income was mainly due to lower base on the treasury side in Q2FY14. The RBI came out with a number of regulations last year which led to spike in yields and as a result, banks had booked heavy treasury losses / minimal gain. Misc. Income declined by 74% YoY mainly due to one off repatriation of profit from overseas branch in Q2FY14.
- Going ahead, a revival in the economy and a pick-up in corporate activity are expected to provide a fillip to the fee income growth. The bank expects fee income to grow by ~9-11% in FY15E.

Net profit trend



Balance Sheet (Standalone)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Paid up capital	4,680	4,698	4,719	4,719
Total reserve & surplus	326,399	377,506	445,502	586,900
Deposit	2,526,136	2,809,446	3,239,291	3,725,184
Borrowings	439,511	502,909	628,637	785,796
Other liabilities	108,881	137,889	168,204	193,437
Total Equity & Liabilities	**3,405,607**	**3,832,449**	**4,486,352**	**5,296,037**
Cash & Balance with RBI	147,921	170,413	190,862	213,766
Money call & short notice	56,429	111,974	126,530	144,245
Advances	1,137,375	1,135,484	1,288,775	1,475,647
Investments	1,969,660	2,300,668	2,751,598	3,312,925
Fixed assets	23,556	24,102	25,307	27,585
Other assets	70,666	89,808	103,279	121,869
Total Assets	**3,405,607**	**3,832,449**	**4,486,352**	**5,296,037**

Profit & Loss Account (Standalone)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Interest income	271,826	306,412	370,758	456,032
Interest expense	175,163	186,895	224,274	271,372
Net Interest Income	**96,663**	**119,516**	**146,484**	**184,660**
Non-interest income	65,511	74,052	85,160	102,192
Operating income	**162,174**	**193,569**	**231,644**	**286,853**
Operating expense	69,142	79,008	101,130	123,378
Profit before provisions	**93,031**	**114,561**	**130,514**	**163,474**
Provisions	17,501	21,075	25,079	30,596
Tax	23,736	31,310	31,631	39,863
Net Profit	**51,794**	**62,177**	**73,805**	**93,015**

Key Ratios (Standalone)

Y/E	FY13A	FY14A	FY15E	FY16E
Avg. cost of deposits (%)	2.9	3.0	3.3	3.5
ROA	1.7	1.7	1.8	1.9
ROE	18.5	17.4	17.7	17.9
Interest Expense/ Interest Income	64.4	61.0	60.5	59.5
Investment/Deposit	45.0	40.4	39.8	39.6
Cost-Income Ratio (%)	42.6	40.8	43.7	43.0
C-D Ratio (%)	78.0	81.9	84.9	88.9
BVPS	141.5	162.7	191.6	251.8
P/ BV	3.6	3.2	2.7	2.0
EPS	22.1	26.5	31.4	39.6
P/E	23.3	19.4	16.4	13.0

Valuation and view

Axis Bank has strong asset-liability profile, which will help the bank to expand its market share especially in the retail segment. With strong capital base, Axis Bank continued to focus on enhancing its financial performance through superior cost efficiency, stable NIM and asset quality trends. With strong emphasis on retail & SME segment, we expect loan book of the Axis Bank to grow at a CAGR of 16% in the next two years. Thus, we believe that Axis Bank would continue to attract better valuations than its peers in terms of lower earnings volatility, better return rations, higher provision coverage ratios, improving asset quality and better capitalization.

At a current CMP of ₹514, the stock trades at a p/v of 2.7x FY15E and 2.0x FY16E, book value. We recommend 'BUY' with a target price of ₹600, arrived at FY16E book value which implies potential upside of ~17% to the CMP from a long term perspective.

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