Stock Update

Sharekhan
by BNP PARIBAS

Axis Bank

Mixed quarter, provisioning indicates challenges ahead

Sector: Banks & Finance
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 458**	
Price Target: **Rs. 540**	↓

↑ Upgrade ↔ No change ↓ Downgrade

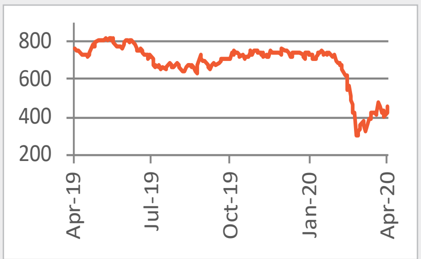
Company details

Market cap:	Rs. 129,122 cr
52-week high/low:	Rs. 826/622
NSE volume: (No of shares)	106.5 lakh
BSE code:	532215
NSE code:	AXISBANK
Sharekhan code:	AXISBANK
Free float: (No of shares)	237.9 cr

Shareholding (%)

Promoters	16.0
FII	45.5
DII	22.8
Others	15.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	27.2	-38.2	-35.6	-40.3
Relative to Sensex	19.5	-16.2	-17.4	-22.6

Sharekhan Research, Bloomberg

Axis Bank posted mixed numbers for Q4FY2020. While operating results were in line, elevated provisions (especially provisions related to the COVID-19 impact) caused the bank to post a loss. The management indicated that the COVID-19 impact on the economy is likely to be a long period and considerable challenges now exist for players across the board. Net interest income (NII) increased by 19% y-o-y to Rs. 6,807 crore (we expected 16.2% y-o-y), while non-interest income increased by 13% y-o-y to Rs. 3,985 crore (driven by higher recoveries). Retail fees constituted 64% of total fee income. Net interest margin improved by 11 bps y-o-y to 3.55% but was down q-o-q by 2 bps. The bank's domestic loan growth slowed a tad to 15.5% y-o-y, but retail business momentum remained strong with Retail loans rose by 24% y-o-y while corporate loans up by 11% y-o-y. Asset quality was mixed with GNPA rising by 11 bps (as the bank chose not to avail the April 17 dispensation). During the quarter, the bank made provisions of Rs. 7,730 crore, including Rs. 3,000 crore related to COVID-19; taking overall additional provisions to Rs. 5,983 crore. These provisions held by the bank towards various contingencies together with the standard asset provisions, translate to a standard asset coverage of 1.3%. There were lower slippages of Rs. 3,920 crore during Q4FY20 (from Rs 6,214 crore in Q3FY20 and Rs 3,012 crore in Q4FY19). Corporate slippages stood at Rs. 1,839 crore (~47% of total slippages). Excluding one account of Rs. 750 crore, ~ 84% of this came from previously disclosed 'BB' and below-rated clients. Axis Bank entered into an agreement with Max Financial Services where it will hold a 30% stake in Max Life Insurance post the transaction (deal expected to be completed in 12-18 months, regulatory approvals awaited). The deal will provide to Axis Bank with a strong insurance player as a strategic partner, and we see it as mutually beneficial relationship for both Axis Bank and Max Life Insurance. Axis may be paying close to Rs. 1,592 crore as total consideration, but the price is yet to be finalised. We believe that while Axis Bank's is being prudent, the COVID-19 impact is likely to impact both growth and credit costs for the banking sector including Axis Bank. We are fine-tuning our estimates and target multiple considering the dynamic environment. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 540.

Key positives

- At March 31, 2020, the bank holds in aggregate additional provisions of Rs 5,983 crore. Notably, this is over and above the NPA provisioning and the 0.4% standard asset provisioning requirement on standard assets.
- Decent business growth with total deposits grew by 19% y-o-y (on a quarterly average basis) and the loan book grew by 15% y-o-y.

Key negatives

- Higher provisions (including for the COVID-19 impact) and the sobering management commentary indicates of challenges ahead.
- Loan loss provisions jumped by 41% QOQ basis, indicating elevated levels of stress.

Our Call

Valuation: Axis Bank is available at 1.3x FY22E book value and we believe valuations are reasonable and reflect the business slowdown and challenges for growth and margins. We have accordingly revised our estimates and target multiples. However, we believe given the comfortable liquidity, the overall franchise value, healthy capitalisation levels and a high provision coverage ratio (PCR) for Axis Bank will be able to ride over medium-term challenges. The deal with MFS is also a long-term positive that can yield considerable benefits. We maintain our Buy rating on the stock with a revised price target of Rs. 540.

Key Risks

- A prolonged lockdown and consequent rise in NPAs can pose risks to profitability.

Valuation

Particulars	FY19	FY20	FY21E	FY22E
Net interest income (Rs cr)	21,708	25,206	24,934	27,330
Net profit (Rs cr)	4,676	1,627	3,509	9,909
EPS (Rs)	18.2	5.8	12.4	35.1
PE (x)	25.0	78.9	36.6	13.0
Book value (Rs/share)	256.9	299	327.3	356.1
P/BV (x)	1.8	1.5	1.4	1.3
RoE (%)	7.2	2.1	3.9	10.2
RoA (%)	0.6	0.2	0.3	0.8

Source: Company; Sharekhan estimates

Key highlights from earnings call

- All industries likely to get affected and the impact will stretch longer than anticipated. If the lockdown continues, both retail and wholesale customers will be stressed.
- The bank took steps to plan and continue business much before the actual lockdown. This helped in being better prepared. Over 96% of its ATMs and 94% of its bank branches are operational.
- Liquidity Coverage ratio (LCR) is at 112% on average for Q4 and currently stands at a healthy 120%.
- Lower slippages were negated by higher accretion in BB & below-rated book. Slippages came at a four-quarter low of Rs. 3920 crore and 84% of slippages came from previously disclosed BB and below-rated book.
- The outstanding BB and below-rated book (including non-fund based & investments) increased by 12% q-o-q to Rs. 10,996 crore from 9,783 crore. Total BB & Below book comprised of 5.4% of corporate loans versus 5.0% in Q3FY20.
- Bank expects further downgrades into the BB and below-rated books owing to the COVID pandemic. It also stated that sectors like infrastructure, power, hotels and power generation together form ~60% mix in the BB and below-rated book.
- Credit cost for the quarter stood at 5.5% as the bank made Rs. 3000 crore excess provision due to COVID-19 which was over and above the required regulatory requirement. The bank expects an increase in provisioning in the current year. Extra provisions were made because the bank anticipates these corporate may have stress in the near term.
- Loans to better-rated corporates helped keep growth in risk-weighted assets (RWA) in check.
- Is doing NPA recognition on a daily basis, and fully provides for Personal Loans within 90 DPD of getting overdue.
- Exposure to NBFCs stands at Rs. 23,507 crore, to MFIs at Rs. 5,791 crore, to RE at Rs. 17,730 crore (50% LRD).
- The retail unsecured book constitutes 20% mix, of which 82% are salaried customers mostly having a salary account with the bank.
- SME book is 85% secured. 78% are working capital-based loans. The bank had been defocusing on this book since a year. Average Ticket Size is less than Rs. 4 crore. Avg rating is A- and above. Almost the entire incremental wholesale book in FY20 has come from 'A' or above rated assets.
- Non-SLR book: Bank has utilized TLTRO route to acquire high rated corporate bonds at attractive yields.
- While ~80% of home loan book is vanilla home loans, the entire PL loans is sourced from salaried customers.
- Q4FY2020 was not impacted due to COVID. However, fee income was impacted due to lockdown.
- Further tightening portfolio risk thresholds, done risk management practices and stress tests.
- Expect fee income to slow down and provisions to rise significantly. The bank has seen some early greenshoots, and the COVID-19 will last for long. However, post the lockdown, the management indicated confidence that the bank will bounce back stronger than its competition.
- Risk overview: Had already separated all underwriting segment, and strengthening the risk filters. It was already cautious over the SME sector. For loan disbursements, cashflows and income generation ability is the key deciding element.
- Around 85% of the SME book is secured and the remaining is to supply chain finance. The book is well diversified, spread across 180 locations.
- Moratorium was opted by 25-28% of AUMs, accounting for 10-12% in terms of no. of accounts. Most of them were using moratorium to conserve cash rather than due to liquidity stress.

- The bank has not availed any benefit and has made the entire 10% provision wherever loans were overdue. Cumulative value is Rs. 3,474 crore. The bank has a PCR of 69%; additional provisions, including COVID-19 provision of Rs. 5,980 crore.
- The bank is focusing on quality of Wholesale and CBD business segment borrowers and for a shorter tenure.
- The bank has been in process of shutting down its Shanghai, Colombo branches, etc.
- It will continue with all insurance partners including existing private and public ones.
- A very large number of incremental wholesale is coming from A or above. 70% of incremental book on corporate is AA or better, not only in Q4 but since last year.
- The SME book, 85% is SME3 or above (equivalent of A or above). Going up the rating scale and similarly retail book is also better-rated. So overall rating profile of loans is improving.
- Have been conservative in its base case and has taken significant stress assumptions.

Results Rs cr

Particulars	Q4FY20	Q4FY19	YoY %	Q3FY20	QoQ %
Interest income	16,234.1	14,798.0	9.7	15,708.3	3.3
Interest expense	9,426.4	9,092.4	3.7	9,255.3	1.8
Net interest income	**6,807.7**	**5,705.6**	**19.3**	**6,453.0**	**5.5**
Non-interest income	3,985.5	3,526.3	13.0	3,786.6	5.3
Net total income	10,793.2	9,231.9	16.9	10,239.6	5.4
Operating expenses	4,942.1	4,217.5	17.2	4,496.9	9.9
Pre-provisioning profit	**5,851.1**	**5,014.4**	**16.7**	**5,742.7**	**1.9**
Provisions	7,730.0	2,711.4	185.1	3,470.9	122.7
Profit before tax	-1,878.9	2,303.0	NA	2,271.8	NA
Tax	-491.1	797.9	NA	514.8	NA
Profit after tax	**-1,387.8**	**1,505.1**	**NA**	**1,757.0**	**NA**

Source: Company; Sharekhan Research

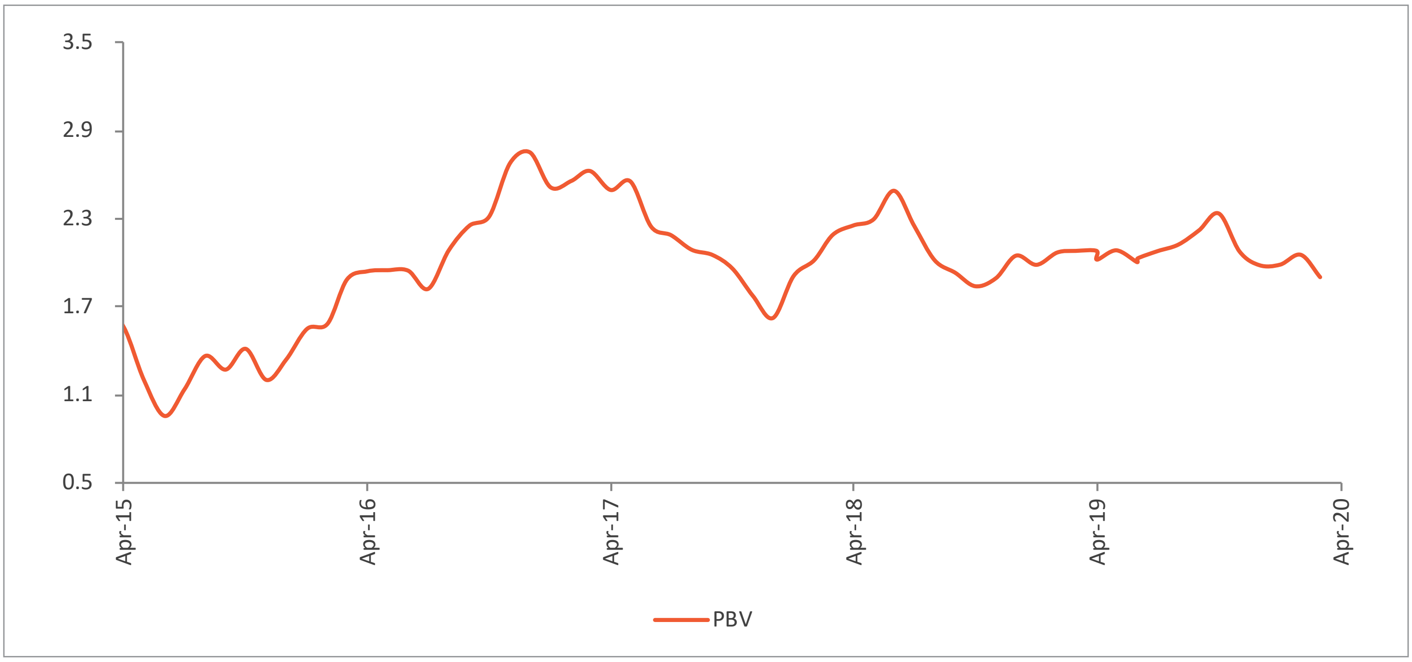
Outlook

The COVID-19 outbreak has caused unprecedented global disruption in financial markets, raising health and livelihood concerns. While it is still in its early days, initial signs indicate that COVID-19 outbreak may result in higher delinquencies and lower credit offtake for BFSI players, including Axis Bank. To deal with the situation, Axis Bank has tightened underwriting standards and oversight. In retail too along with tighter underwriting criteria across product lines, the collections capacity has also been strengthened. Axis Bank's agreement with Max Financial to acquire a 30% strategic stake in the latter will provide a long-term mutually beneficial relationship for both players. We believe that while Axis Bank is being prudent with provision buffer, the COVID-19 impact is likely to impact both growth and credit costs for the banking sector, including Axis Bank.

Valuation

Axis Bank is available at 1.3x FY22E book value and we believe valuations are reasonable. The recent correction reflects the business slowdown and challenges before the bank in terms of growth and margins and we have accordingly revised our estimates and target multiples. However, we believe given the comfortable liquidity, the overall franchise value, healthy capitalisation levels and a high provision coverage ratio (PCR) for Axis Bank will be able to ride over medium-term challenges. The deal with MFS is also a long-term positive that can yield considerable benefits. Currently, we believe risk reward is favorable for long term investors. We maintain our Buy rating on the stock with a revised price target of Rs. 540.

One year forward P/BV (x) Chart



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
	Rs/Share	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
AXIS BANK	458	1.4	1.3	36.8	13.0	0.3	0.8	3.9	10.2
HDFC BANK	932	2.6	2.2	15.5	12.8	2.1	2.1	18.1	18.8
ICICI BANK	360	1.8	1.6	12.6	10.3	1.6	1.7	14.9	16.0

Source: Company, Sharekhan research

About company

Axis Bank is promoted by SUUTI (an entity established in 2003) and today is the third-largest private sector bank in India. The bank offers the entire spectrum of financial services to customer segments covering large and mid-corporates, MSME, Agriculture and retail businesses. The bank has 11 subsidiaries which contribute and benefit from the bank's strong market position across categories.

Investment theme

Axis Bank has a well- diversified loan book having strengths in both retail and corporate segments. The bank's liability profile has improved significantly, which would be helpful in sustaining margins at healthy levels. Of late, the loan book quality is improving, which we believe is positive for its profitability and growth going forward. Due to the COvid-19 pandemic, the growth and credit costs are likely to be impacted for the sector including Axis Bank. However, we believe given the comfortable liquidity, the overall franchise value, healthy capitalization levels and a high provision coverage ratio (PCR) Axis bank will be able to ride over the medium term challenges. The deal with MFS is also a long term positive that can yield considerable benefits. At preset we believe risk reward is favorable for long term investors.

Key Risks

- A prolonged lockdown and consequent rise in NPAs can pose risks to profitability.

Additional Data

Key management personnel

Mr Amitabh Chaudhry	MD & CEO
Mr Rajesh Dahiya	Excecutive Director (Corporate Centre)
Mr Rajiv Anand	Excecutive Director
Mr Jairam Sridharan	Group Excecutive & CFO
Mr Deepak Maheshwari	Group Excecutive & CCO
Mr Ganesh Sankaran	Group Excecutive & Wholesale Banking
Mr Pralay Mondal	Group Excecutive & Head of Retail Banking

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	9.0
2	Unit Trust of India	4.6
3	SBI Funds Management Pvt Ltd	3.6
4	BlackRock Inc	2.7
5	Capital Group Cos Inc/The	2.5
6	Dodge & Cox	2.4
7	ICICI Prudential Asset Management	2.4
8	BANK OF NEW YORK MELLON CORP/THE	2.4
9	Vanguard Group Inc/The	2.3
10	BC ASIA INVESTMENTS	2.0

Source: Bloomberg

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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