Sharekhan by BNP PARIBAS

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Axis Bank

Valuation gap to narrow vs. peers on sustained improved performance

Banks	Sharekhan code: AXISBANK
Reco/View: Buy ↔	CMP: **Rs. 932** / Price Target: **Rs. 1,140** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING Updated Oct 08, 2022				26.15
Medium Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

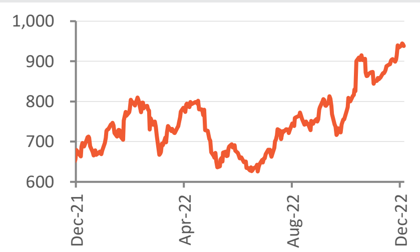
Company details

Market cap:	Rs. 2,86,379 cr
52-week high/low:	Rs. 950 / 618
NSE volume: (No of shares)	93.6 lakh
BSE code:	532215
NSE code:	AXISBANK
Free float: (No of shares)	264.4 cr

Shareholding (%)

Promoters	-
FII	50.9
DII	41.2
Others	7.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.5	18.0	43.2	30.7
Relative to Sensex	9.2	15.5	26.2	24.4

Sharekhan Research, Bloomberg

Summary

- We believe Axis Bank has strengthened its franchise (both on assets as well as liability side) over the past few years to deliver sustained improved performance over the medium term. On the back of this, the current valuation gap (Axis Bank trading at 1.4x its FY2025E Core BV) vs. its core peer (ICICI Bank at 1.9x its FY2025E Core BV) is expected to narrow down over the next 6-12 months.
- Concerns on growth in granular retail liabilities vs. peers are expected to fade away as the bank has started gaining market share on CASA front (10% system growth vs. 14% for Axis in the past one year) aided by leveraging digital ecosystem, focusing on corporate salary account acquisition, and cross-sell liability products to existing clients. Further, Citi Bank's acquisition is expected to improve CASA ratio by 200bps. Branch expansion is likely to further accelerate growth.
- NIM gap vs. core peer (ICICI Bank) is also narrowing (at 36bps in H1FY2023 vs. 64 bps in H1FY2022). Return on RWA is now closer to its peers; improved underwriting practices by taking learnings from past cycles are key positives. It has already converged on loan growth, credit cost, and ROE with the frontline banks. Due to all these factors, we see the bank emerging as stronger in this leg of upcycle and valuation multiple inching higher closer to its peers.
- At the CMP, the bank trades at 2.0x/1.7x/1.4x its FY2023E/FY2024E/FY2025E Core BV, offering attractive risk reward. We maintain Buy with a revised PT of Rs. 1,140. We believe valuations are reasonable, given structural improvement in the franchise.

Axis Bank is now emerging as structurally a stronger franchise, which will continue to deliver consistent performance. On the asset side, it has a clear focus on generating higher growth in Retail, SME, and Mid-Corporate Segments. We believe this endeavor will be supported by a favourable macroeconomic environment, digital capabilities developed across technology, data analytics, and design. On the liability front, the bank has started to gain market share on CASA front, which is a key positive. Retail term deposits momentum is yet to pick up. The bank has left behind all asset-quality challenges – both on the retail and wholesale businesses. Gross slippages have been declining and the outlook is quite optimistic, given the benign credit cycle. In addition, the bank carries a large buffer of non-NPA provisions to cushion itself from any potential shocks. Structural changes in the franchise are likely to narrow the valuation gap with its peers.

- **Structural improvement visible in the franchise:** a. The bank's focus on growing its asset franchise in a granular manner should lead to sustainable growth in PPoP. Share of retail loans has increased from 45% in FY2017 to 55% in H1FY2023. Retail, SME, and mid-corporate loans remain key focused segments and these segments are growing at a healthy pace in a granular manner. b. The bank has started gaining market share on CASA front, aided by leveraging digital ecosystem, focusing on corporate salary account acquisition, and cross-sell liability products to existing clients. c. Narrowing of NIMs gap led by better risk-adjusted returns and better product mix. d. Improvement in core operating profitability aided by margin improvement and healthy loan growth. e. Strong improvement in underwritings and reduction in impaired loans along with improvement in RWA to advances. Due to these factors, we see the bank emerging stronger in this leg of upcycle and valuation multiple inching higher, closer to its peers.
- **NIM to improve further:** We expect further improvement in NIM over the medium term, which will be driven by – a. Loan growth skewed towards the higher yield segment (i.e., unsecured); currently unsecured loans stand at 9% of the total book vs. peers at ICICI Bank at ~12% b. Improvement in low-cost granular deposit base. Going forward, we believe benefits from repricing of the book, which is still left, would get offset by increased cost of deposits as frontline banks have already started to raise rates of retail deposits across maturities. Overall, there should be an upward trajectory seen in margins over the medium term and gap with peers should reduce further.

Our Call

Valuation – We maintain our Buy rating with a revised PT of Rs. 1,140: Axis Bank currently trades at 2.0x/1.7x/1.4x its FY2023E/FY2024E/FY2025E Core BV. We believe its valuations are reasonable, given structural improvement in the franchise. The bank is taking a more sustainable path for growth on both assets as well as liability side. New digital products offering, both in assets and liability segments, are growing well, as reflected in strong growth in customer acquisition. It is well positioned for closing the valuation gap with peers as it reports strong performance on a sustained basis and as Citi's acquisition is consummated successfully going forward.

Key Risks

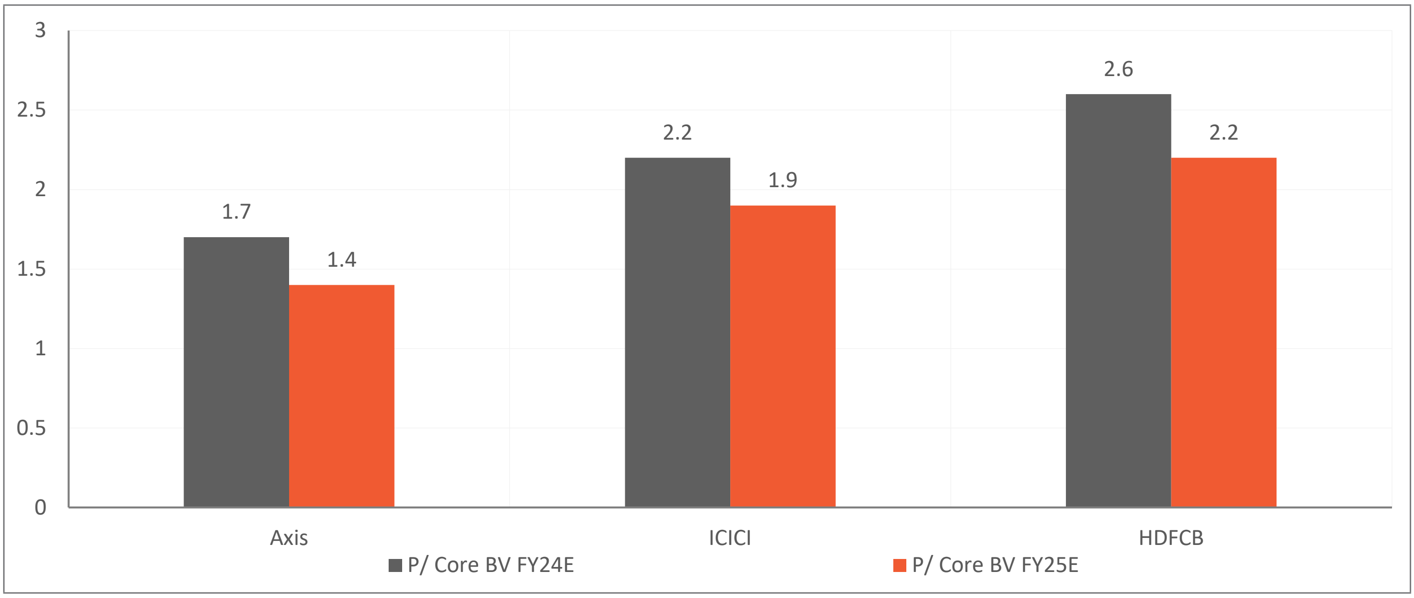
Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost and lower-than-expected margin expansion.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Net Interest Income (NII)	33,132	44,138	52,529	61,467
PAT	13,026	20,590	25,400	29,097
EPS (Rs.)	42.4	67.1	82.7	94.8
P/E (x)	20.8	13.1	10.6	9.3
P/BV (x)	2.3	2.0	1.7	1.4
RoE (%)	12.0	16.4	17.1	16.6
RoA (%)	1.2	1.6	1.8	1.8

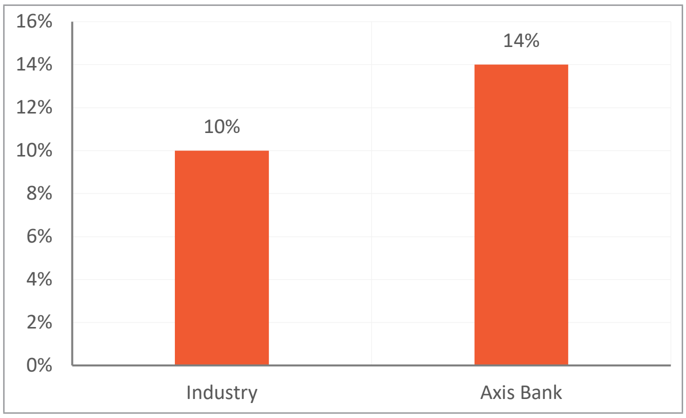
Source: Company; Sharekhan estimates

Structural changes in the franchise are likely to narrow the valuation gap with its peers.



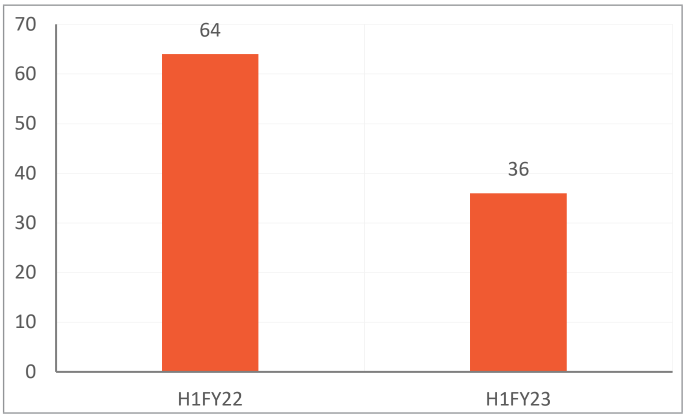
Source: Company, Sharekhan Research

CASA growth in last one year for Axis Bank Vs Industry



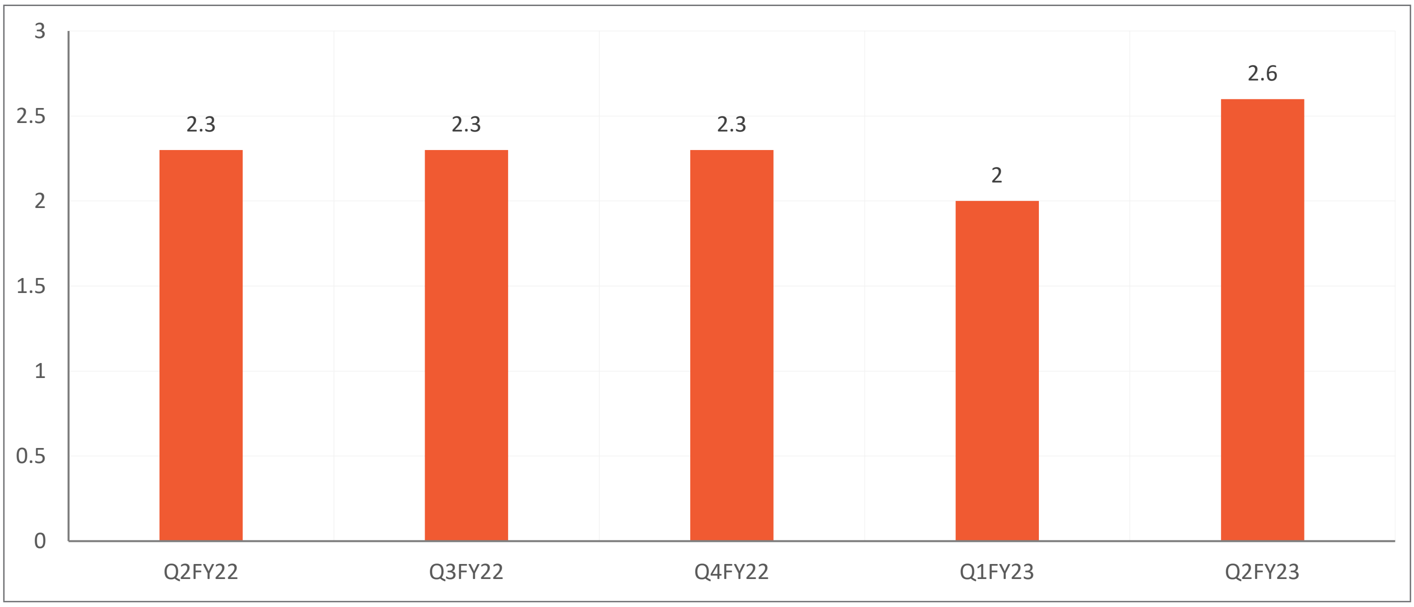
Source: Company, Sharekhan Research

NIMs gap vs. core peer (ICICI Bank) is also narrowing.



Source: Company, Sharekhan Research

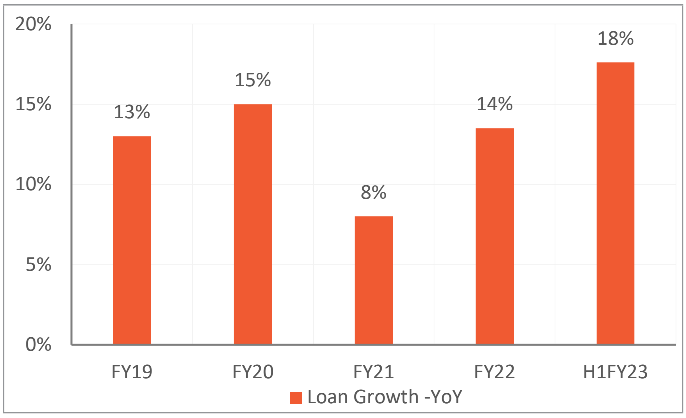
Operating Profitability has started to improve



Source: Company, Sharekhan Research

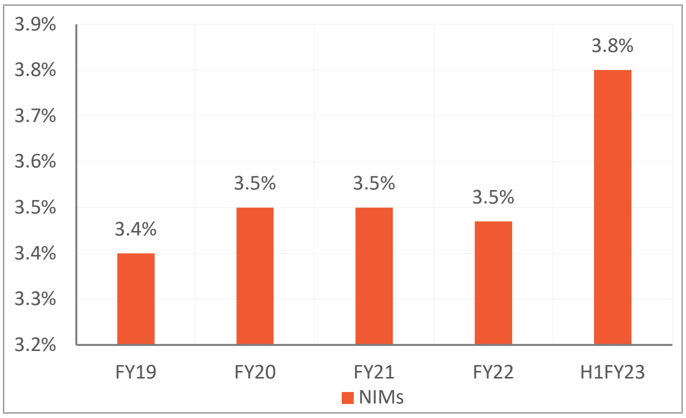
Financials in charts

Trend in Loan growth



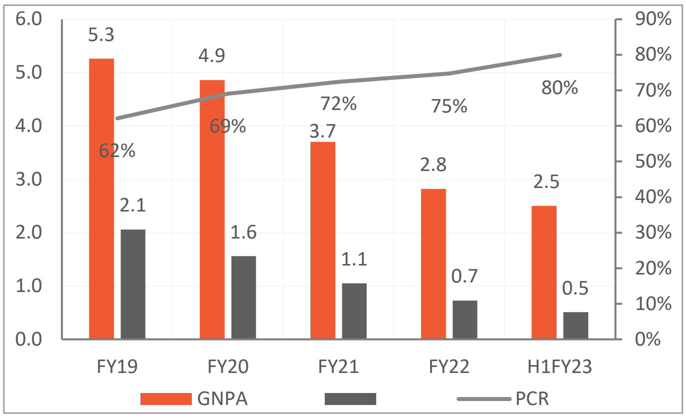
Source: Company, Sharekhan Research

Trend in NIMs



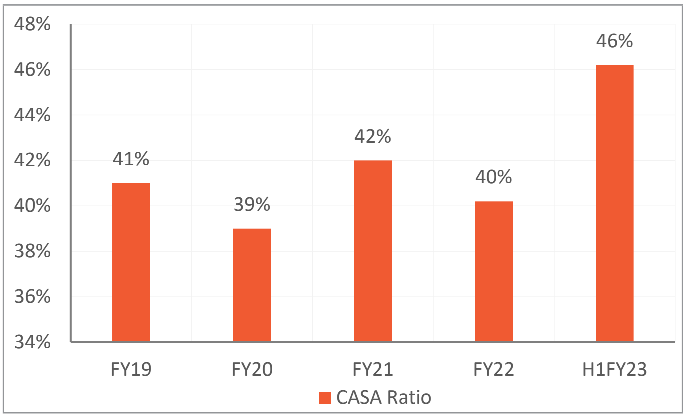
Source: Company, Sharekhan Research

Trend in Asset Quality



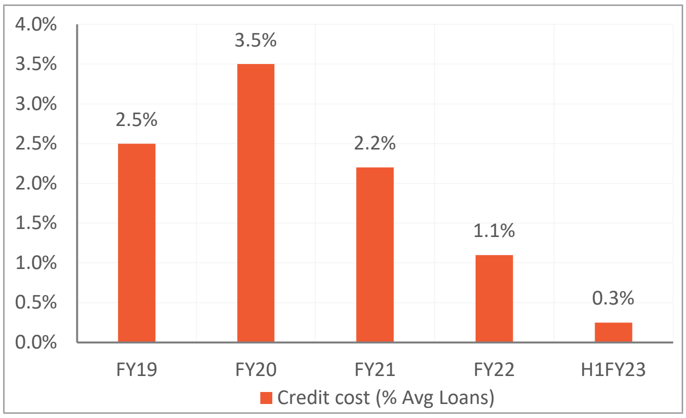
Source: Company, Sharekhan Research

Trend in CASA



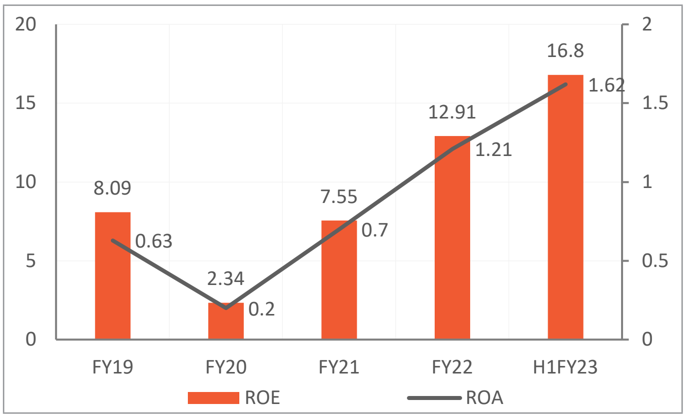
Source: Company, Sharekhan Research

Trend in Credit Cost



Source: Company, Sharekhan Research

Trend in Return Ratio



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Strong credit offtake; Top private banks placed better

System-level credit offtake grew by ~17% y-o-y in the fortnight ending November 4, 2022, indicating loan growth has been sustaining, given distinct signs of improving economy and revival of investments and loan demand. On the other hand, deposits rose by ~8% but are trailing advances growth. We should see loan growth acceleration sustaining. Margins are likely to improve and peak out by Q4FY23. Asset quality is not a big issue on the corporate lending end, as only de-leveraging is being observed. From the retail side, there could be some pressure, but nothing is significant. Asset quality is likely to remain stable in the medium term. Banks are in a sweet spot in terms of fundamentals. In the past two years, lenders have been cautious on lending to the 'BB and below' category, thus the general risk, which they are carrying on the corporate portfolio, is low. On the retail loans front, due to COVID-19, banks have already seen one downcycle. Most of the exposure has been taken into credit costs. In terms of the MSME book, we need to be watchful. At present, we believe the banking sector is likely to see higher risk-off behaviour, with tactical market share gains for well-placed players. We believe large banks with a strong capital base and asset quality (with high coverage and provision buffers) are well placed to capture growth opportunities.

■ Company Outlook – Structural improvement visible in the franchise

We believe the bank is looking for a sustainable growth path in terms of advances growth, led by retail, SME, and mid-corporate segments in a granular manner along with a focus on mobilization of low-cost granular liability and higher spending on tech. The key is the higher mobilisation of granular liability in the medium term to support sustainable growth. The bank's continuous efforts of growing asset franchise in a granular manner (retail loans account for 55% of the total book), focus on mobilisation of low-cost granular deposits, improvement in impaired loans (allow benign credit costs), margin improvement, and improved return ratios matrix would bode well for good earnings compounding going ahead, which makes it an attractive franchise.

■ Valuation – We maintain our Buy rating with a revised PT of Rs. 1,140

Axis Bank currently trades at 2.0x/1.7x/1.4x its FY2023E/FY2024E/FY2025E Core BV. We believe its valuations are reasonable, given structural improvement in the franchise. The bank is taking a more sustainable path for growth on both assets as well as liability side. New digital products offering, both in assets and liability segments, are growing well, as reflected in strong growth in customer acquisition. It is well positioned for closing the valuation gap with peers as it reports strong performance on a sustained basis and Citi's acquisition is consummated successfully going forward.

Peer Comparison

Particulars	CMP	MCAP	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
	Rs/Share	(Rs. cr)	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Axis Bank	932	2,86,379	13.1	10.6	2.0	1.7	16.4	17.1	1.6	1.8
ICICI Bank	908	6,33,531	17.7	14.9	2.6	2.2	16.0	16.2	2.0	2.0

Source: Company, Sharekhan research

About company

Axis Bank 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 is looking for a sustainable growth path in terms of advances growth, led by retail, SME, and mid-corporate segments in a granular manner along with a focus on mobilization of low-cost granular liability and higher spending on tech. New digital product initiatives, both in assets and liability segments, are growing well, as reflected in the strong acquisition growth. Corporate loan book quality has also improved, which we believe is positive for its profitability and growth going forward. We believe the bank will have benign credit cost over the medium term; margin improvement along high PCR is likely to bode well for earnings compounding going ahead.

Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost could affect earnings.

Additional Data

Key management personnel

Mr. Amitabh Chaudhary	MD and CEO
Mr. Rajiv Anand	Executive Director
Mr. Puneet Sharma	CFO and President

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	LIFE INSURANCE CORP OF INDIA	7.97
2	SBI FUNDS MANAGEMENT LTD	4.32
3	ICICI PRUDENTIAL ASSET MANAGEMENT CO LTD	3.59
4	DODGE & COX	3.23
5	BLACKROCK INC	2.96
6	VANGUARD GROUP INC/THE	2.87
7	REPUBLIC OF SINGAPORE	2.39
8	NIPPON LIFE ASSET MANAGEMENT LTD	1.98
9	UTI RETIREMENT SOLUTIONS LTD	1.92
10	MIRAE ASSET GLOBAL INVESTMENTS LTD	1.90

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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