Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Company Update

Axis Bank

Strong value proposition strengthening the core franchise

Banks	Sharekhan code: AXISBANK		
Reco/View: **Buy** ↔	CMP: **Rs. 845**	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 27.33
Updated Dec 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

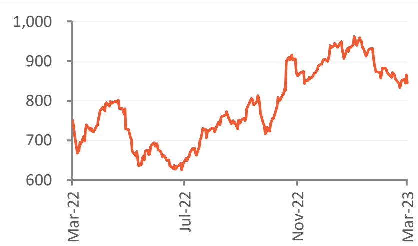
Company details

Market cap:	Rs. 2,60,053 cr
52-week high/low:	Rs. 970 / 618
NSE volume: (No of shares)	90.1 lakh
BSE code:	532215
NSE code:	AXISBANK
Free float: (No of shares)	273.8 cr

Shareholding (%)

Promoters	-
FII	49.5
DII	39.7
Others	10.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.6	-6.6	16.9	12.7
Relative to Sensex	-1.9	-0.9	16.7	7.9

Sharekhan Research, Bloomberg

Summary

- Axis Bank has completed the acquisition of Citibank`s India consumer business and the deal is valued at Rs. 11,603 crore vs earlier disclosed acquisition price of Rs. 12,325 crore driven by some final adjustments.
- Tier-1 ratio would decline by ~180 bps after this transaction and the bank has indicated that it has comfortable CET-1 levels (~13.78%) to grow without any disruption. Bank is not expecting to approach the market anytime soon for equity capital raise.
- Management commentary did not suggest any further steep deterioration in customer retention and employee attrition going ahead but it remains a key monitorable from here on.
- We believe Citi business would be ROE Neutral in FY24 & FY25 for Axis Bank while ROE accretive starting from FY26E and it brings strong value proposition for the existing franchise. The stock currently trades at 1.6x/1.4x/ its FY2024E/FY2025E core BV estimates. We maintain our Buy rating on the stock with an unchanged PT of Rs. 1,140.

Axis Bank announced it has completed the acquisition of Citibank India's consumer business at a marginally lower deal value considering some final adjustments well within the stipulated timelines announced earlier. The deal is consummated at 17.7x -18.7 P/E based on normalised earnings estimates. This acquisition gives access to a large, affluent and profitable consumer franchise. It gets access to a sizable granular deposit base with deep corporate salary relationships (>1,600 Suvidha corporates and 2.4mn retail customers) which makes the value proposition of Axis Bank stronger. The effective merger date is 1 March 2023. The estimated earnings from Citi`s business after the final adjustments were broadly unchanged (run rate of Rs.800 crore to 850 crore p.a) and integration costs related to the acquisition (Rs 1,500 crore on post tax basis to be incurred over the next 18 months) also remained unchanged despite lower relationship acquired. From the previous announcement, total deposits acquired were lower by ~20%, credit card portfolio is marginally lower by 3%, wealth management AUM declined by 15% while mortgage, personal loans & other retail loan book were broadly similar. Employee base has also declined by 11%. Management commentary did not suggest any further steep deterioration in customer retention & employee attrition going ahead but it remains a key monitorable from here on. Tier-1 ratio would decline by ~180 bps after this transaction and the bank has indicated that it has comfortable CET-1 levels to grow without any disruption. Bank is not expecting to approach the market anytime soon for equity capital raise.

- **Taking the impact of the merger into estimates:** In Q4FY2023, the key impact would be goodwill amortisation on account of which the bank is expected to report loss in Q4FY2023. In addition, the bank would take additional charge on the P&L towards one-time policy harmonisation cost and provisions and transaction expenses, which include banker fees, duties, and taxes etc. during Q4FY2023. The complete transition is expected to be completed in the next 18 months. The bank would also incur one-time integration cost amounting to Rs. 1,500 crore post-tax spread linearly over the next six quarters. Earnings estimates of Rs. 800 crore to Rs. 850 crore from Citi business are recurring in nature and do not include any impact of integration cost and synergies on account of the merger. Moreover, it is after considering the tax rate for domestic banks. Currently, RoE for Citi business is estimated at ~21.7% and, hence, this business would be RoE accretive for Axis Bank from FY2026E, but it would be RoE neutral in FY2024E and FY2025E due to a major one-time integration cost. Tier-1 ratio would decline by ~180 bps after this transaction and the bank has indicated that it has comfortable CET-1 levels to grow without any disruption. The bank is not expecting to approach the market anytime soon for equity capital raise.
- **Strong value proposition:** This acquisition gives access to a large, affluent and profitable consumer franchise. It gets access to a sizable granular deposit base with deep corporate salary relationships (>1,600 Suvidha corporates and 2.4mn retail customers) which makes the value proposition of Axis Bank stronger. It also provides upsell opportunity to Citi's customer base and attract NTB customers with a wider bouquet of products which could potentially increase revenue. At the same time, we acknowledge that it would probably take a year to understand the full benefits and challenges. While key monitorable from here on will be customer retention & employee attrition going ahead however the size of this transaction is relatively small compared to net worth.

Our Call

Valuation – We maintain our Buy rating with an unchanged PT of Rs. 1,140: The deal brings in strong value proposition for Axis bank which would help to strengthen the existing core franchise while at the same time we acknowledge that it would probably take a year to understand the full benefits and challenges related to merger. Key monitorable from here on will be customer retention & employee attrition in Citi business going ahead however as the size of this transaction is relatively small compared to net worth which gives the additional comfort. At the CMP, the Bank trades at 1.6x/1.4x its FY2024E/FY2025E core BV estimates, offering attractive risk reward. We maintain Buy with an unchanged PT of Rs. 1,140. It is well positioned for closing the valuation gap with peers as it reports consistent steady performance on a sustained basis going ahead and as merger synergies helps to further improve its market share.

Key Risks

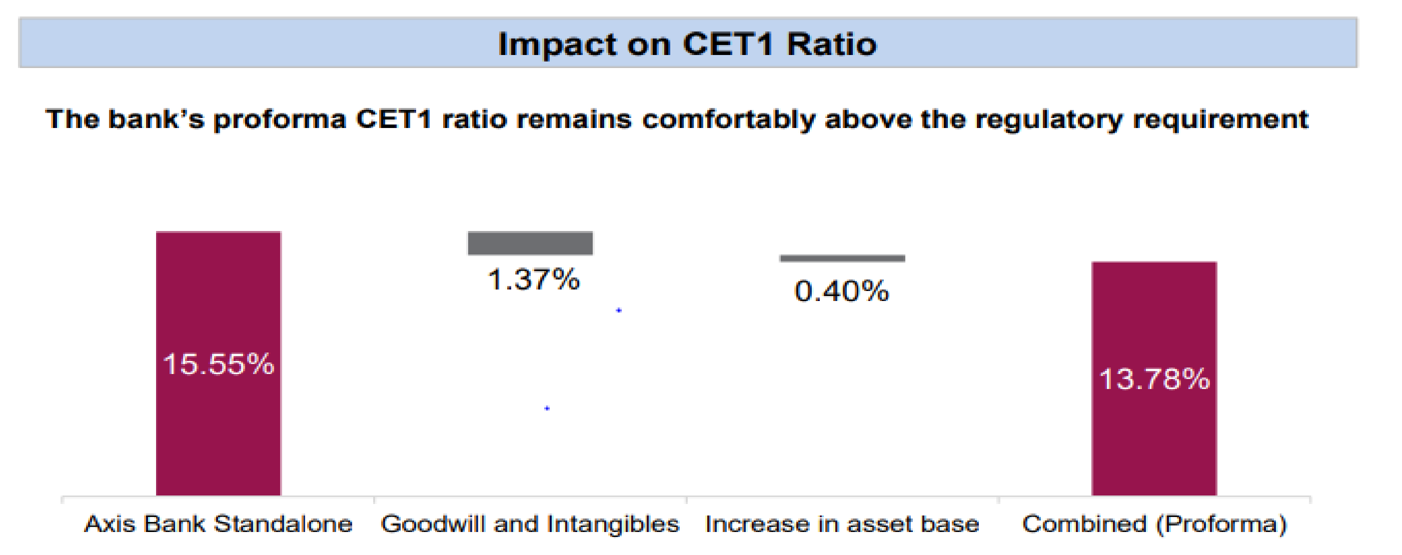
Economic slowdown due to which slower loan growth, higher-than-anticipated credit cost, slower growth in retail deposit franchise, lower-than-expected margins, and transition of Citi's portfolio not on expected lines.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Net Interest Income	33,132	43,386	48,404	53,919
Net profit	13,026	9,920	23,879	25,993
EPS (Rs.)	42.4	32.3	77.7	84.5
P/E (x)	18.7	24.6	10.2	9.4
P/BV (x)	2.1	2.0	1.6	1.4
RoE	12.0	8.3	17.4	16.1
RoA	1.2	0.8	1.7	1.7

Source: Company; Sharekhan estimates

Exhibit 1 : Bank guides that it is well capitalised even after acquisition, to fund near term growth

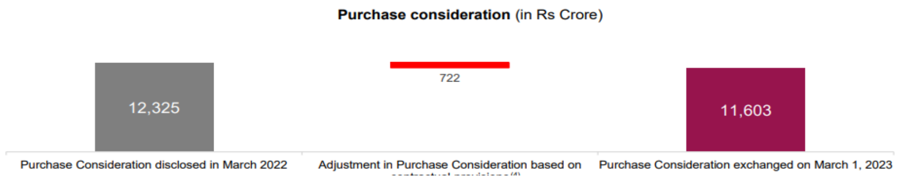


Source: Company

Exhibit 2: Transaction value metrics

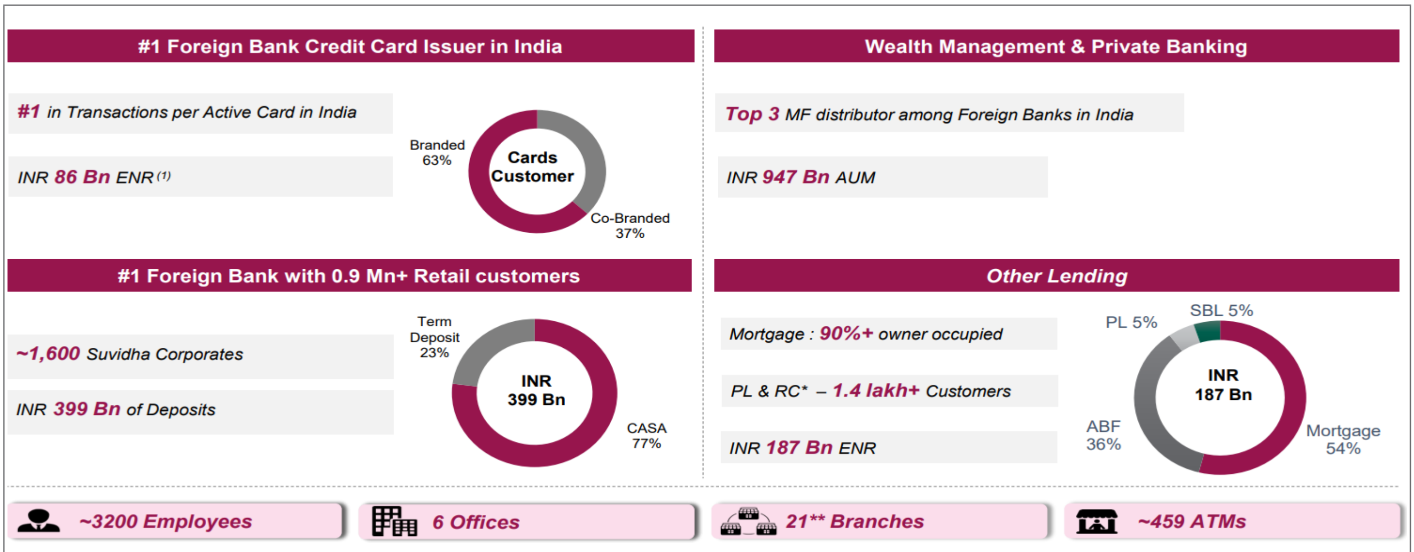
Purchase Consideration *(subject to customary and contractual adjustments)*	**11,603**	**Acquisition PAT** *(current estimate not materially different from Mar'22 disclosure)*	**800-842 (1)**
Add: Estimated Equity Requirement (@13% of RWA)	**3,292**	**Implied P / E**	**17.7x – 18.7x (2)**
Implied Equity Value	**14,895**	**Estimated integration cost (3)** *(post tax impact over 2 financial years)*	**1,500**

~6% decline in Purchase Consideration (subject to true/up down and other customary and contractual adjustments)



Source: Company

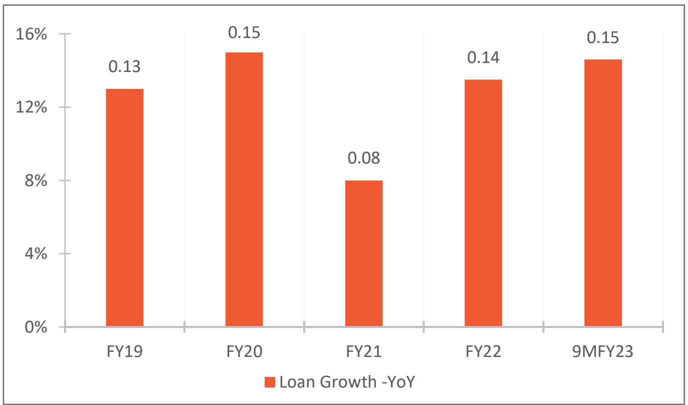
Exhibit 3: Overview of acquired portfolio



Source: Company

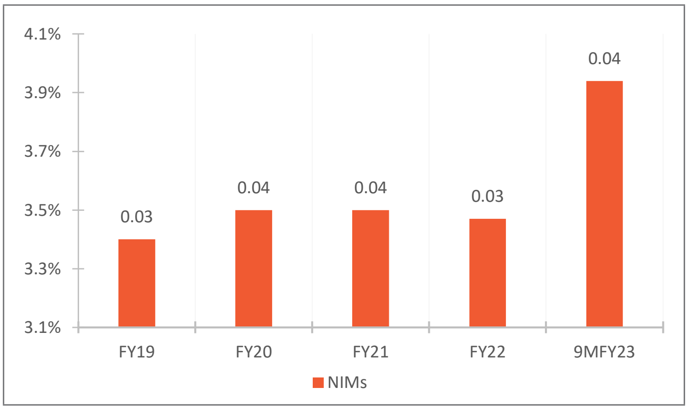
Financials in charts

Trend in Loan growth



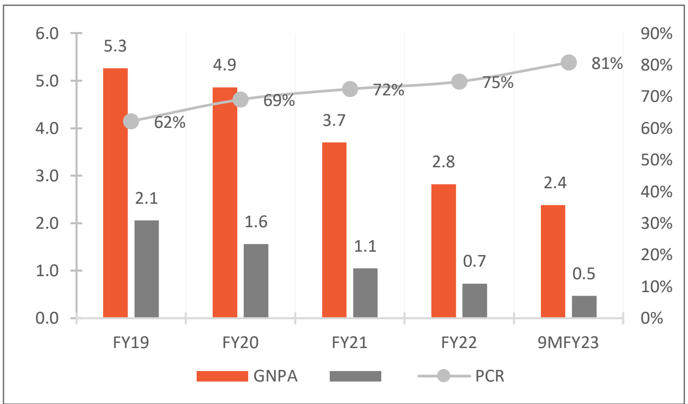
Source: Company, Sharekhan Research

Trend in NIMs



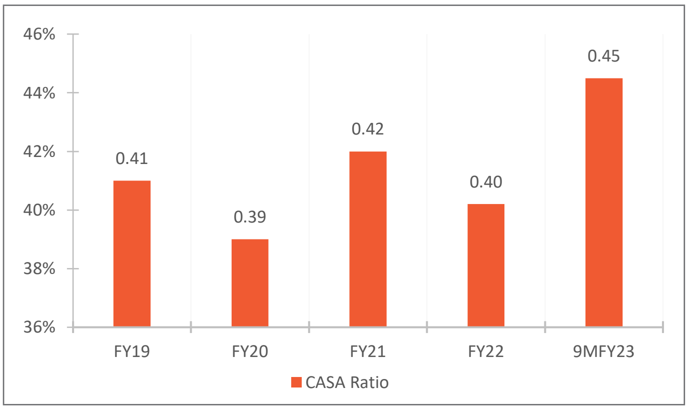
Source: Company, Sharekhan Research

Trend in Asset Quality



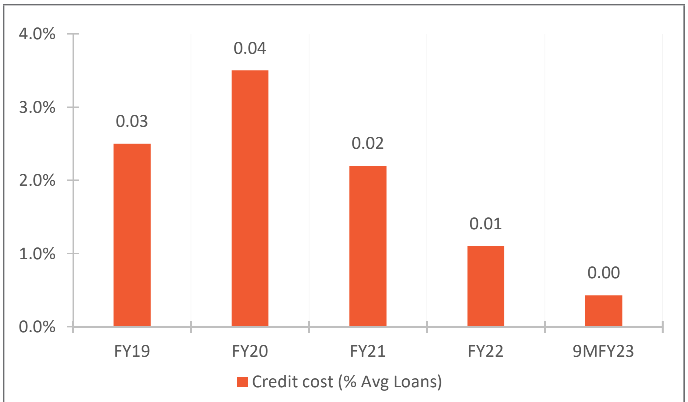
Source: Company, Sharekhan Research

Trend in CASA



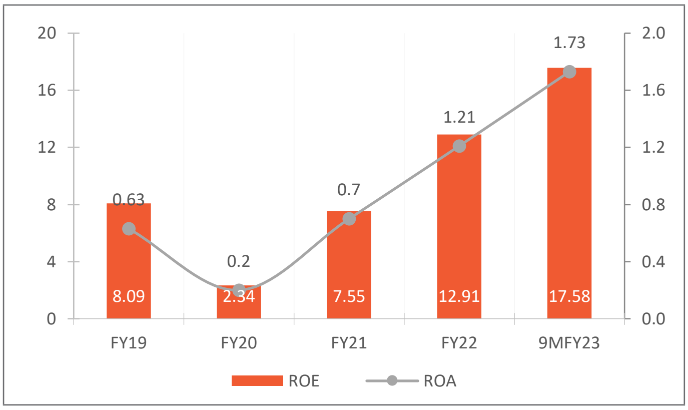
Source: Company, Sharekhan Research

Trend in Credit Cost



Source: Company, Sharekhan Research

Trend in Return Ratio



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Deposits mobilisation to be in focus; Banks with superior liability franchise placed better

System-level credit offtake grew by ~16.1% y-o-y in the fortnight ending February 10, 2023, indicating loan growth has been sustaining, given distinct signs of an improving economy, revival of investments, and strong demand. On the other hand, deposits rose by ~10.2% but still trail advances growth. We should see some moderation in loan growth due to a higher base in FY2024, but loan growth is expected to remain healthy. Margins are likely to improve, but momentum is expected to moderate and margins are expected to peak by the end of FY2024. Asset quality is not a big issue on the corporate lending end due to muted growth in the past few years. From the retail side, there could be some pressure due to adverse macro situation, but nothing is significant. Asset quality is likely to remain stable in the near to medium term. In the past few years, lenders have been cautious about 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 banks with a strong capital base, strong deposit franchise, and asset quality (with high coverage and provision buffers) are well placed to capture growth opportunities.

■ Company Outlook – Attractive 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 mobilisation of low-cost granular liability and higher spending on tech. The key is the higher mobilisation of granular retail liability in the near to medium term to support sustainable growth. The bank's continuous efforts of growing asset franchise in a granular manner (retail loans account for 56% of the total book), focus on mobilisation of low-cost granular deposits, benign credit costs environment, and sustaining improved return ratios matrix bode well for good earnings compounding going ahead, which make it an attractive franchise. We also acknowledge it would probably take a year to understand the full benefits or challenges related to Citi merger.

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

The deal brings in strong value proposition for Axis bank which would help to strengthen the existing core franchise while at the same time we acknowledge that it would probably take a year to understand the full benefits and challenges related to merger. Key monitorable from here on will be customer retention & employee attrition in Citi business going ahead however as the size of this transaction is relatively small compared to net worth which gives the additional comfort. At the CMP, the Bank trades at 1.6x/1.4x its FY2024E/FY2025E core BV estimates, offering attractive risk reward. We maintain Buy with an unchanged PT of Rs. 1,140. It is well positioned for closing the valuation gap with peers as it reports consistent steady performance on a sustained basis going ahead and as merger synergies helps to further improve its market share.

Peer Comparison

Particulars	CMP	MCAP	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
	Rs/Share	(Rs. cr)	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Axis Bank	845	2,60,053	10.2	9.4	1.6	1.4	17.4	16.1	1.7	1.7
ICICI Bank	854	5,96,148	13.7	12.0	2.1	1.8	16.2	15.7	2.1	2.1

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. The bank had a network of 4,849 domestic branches as of December 2022. Capital adequacy ratio (CAR) stands at 17.6%.

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 mobilisation 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. The balance sheet mix is also improving, which we believe is positive for its profitability and sustainable growth going forward. We believe the bank will have benign credit cost over the medium term along high PCR and contingent buffers, which are likely to bode well for earnings compounding going ahead.

Key Risks

Economic slowdown due to which slower loan growth, higher-than-anticipated credit cost, slower growth in retail deposit franchise, lower-than-expected margins, and transition of Citi's portfolio not on expected lines.

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	7.96
2	SBI FUNDS MANAGEMENT LTD.	4.64
3	ICICI PRUDENTIAL ASSET MANAGEMENT CO. LTD.	3.45
4	DODGE & COX	3.23
5	BLACKROCK INC.	2.98
6	VANGUARD GROUP INC.	2.51
7	REPUBLIC OF SINGAPORE	2.29
8	FIL LTD.	2.23
9	BANK OF NEW YORK MELLON CORP	2.07
10	NPS TRUST AC	2.02

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

Sharekhan

by BNP PARIBAS

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