

Axis Bank

Future-proofing efforts meet early-stage gains

Axis Bank (AXSB) showcased its transformation journey and outcomes over the past three years. The heavy Tech investments (2.5x in past 3 years) and re-jigged portfolio granularity on both sides of the balance sheet are gradually yielding positive results at the margin. While AXSB is likely to continue its investment phase, resulting in elevated opex ratios, the bank is incrementally focused on high-yielding profit pools by leveraging its branch network, digital capabilities and partnerships to drive productivity gains. Deposit mobilisation is likely to remain a challenge and our forecasts factor in loan/deposit CAGR of 17%/18% over FY22-FY25E due to an untenably high loan-to-deposit ratio (~90%). While we expect near-term RoAs to come off as deposit pricing catches up, we are now relatively more constructive on potential medium-term RoEs for the franchise. Maintain BUY with a TP of INR1,195 (standalone bank at 2.2x Sep-24 ABVPS), even as we argue for gradual convergence with ICICIBC valuation multiples.

- **MSME + "SURU" + unsecured retail = new profit growth engines:** AXSB is inching up its exposure to MSMEs (including mid-corporate), Bharat Banking (rural and semi-urban markets) and unsecured retail (Personal loans + Credit cards), which are likely to emerge as new growth drivers. Unsecured retail is likely to be led by KTB customers (through partnerships) and NTB customers (AA framework etc.), while SURU (Semi-Urban + Rural) is likely to be driven by branches, and FinTech partnerships. The SURU strategy is likely to help address the bank's PSL shortfall, especially in a couple of specific buckets.
- **Tech investments to sustain; digital journeys WIP:** AXSB's transformation journey in enhancing its digital capabilities and transformation remains WIP, although a bulk of the heavy lifting in terms of building core blocks appears to be largely done. While AXSB has maintained that continued digitisation of several customer journeys and new product launches are likely to keep near-term tech spends elevated, we see significant potential for sustained medium-term productivity gains from the continued investment phase.
- **Deposit re-pricing headwinds inevitable:** AXSB's deposit mobilisation and re-pricing of deposits are likely to emerge as a near-term headwind for its aspirational loan growth rate. The bank is currently pricing its deposits 15-25 bps lower than its peers in an increasingly tightening liquidity environment.
- **Early promise calls for gradual convergence with peer:** AXSB finally seems to be on track to deliver steady performance with lower shocks. While the bank is on track to deliver ~14-15% RoE over the next couple of years, we argue that enhanced productivity and gradual exercising of pricing power in chosen segments could drive sustained medium-term RoEs. We argue for a gradual convergence in valuation multiples with ICICIBC.

Financial Summary

(INR bn)	FY20	FY21	FY22	FY23E	FY24E	FY25E
NII	252.1	292.4	331.3	411.3	478.9	551.7
PPOP	234.4	231.3	247.4	305.7	367.3	423.8
PAT	16.3	65.9	130.3	186.5	205.4	227.5
EPS (INR)	5.8	21.5	42.4	60.8	66.9	74.1
ROAE (%)	2.1	7.1	12.0	15.1	14.5	14.2
ROAA (%)	0.2	0.7	1.2	1.5	1.5	1.4
ABVPS (INR)	261.5	302.9	350.0	413.5	468.6	530.7
P/ABV (x)	3.4	2.9	2.5	2.1	1.9	1.7
P/E (x)	152.8	41.0	20.8	14.5	13.2	11.9

Source: Company, HSIE Research

BUY

CMP (as on 24 Nov 2022)	INR879
Target Price	INR1,195
NIFTY	18,484

KEY CHANGES	OLD	NEW
Rating	BUY	BUY
Price Target	INR 1,095	INR 1,195
EPS %	FY22E	FY23E
	-	-

KEY STOCK DATA

Bloomberg code	AXSB IN
No. of Shares (mn)	3,073
MCap (INR bn) / (\$ mn)	2,700/33,069
6m avg traded value (INR mn)	7,665
52 Week high / low	INR 920/618

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	17.1	32.3	28.2
Relative (%)	11.7	17.1	21.5

SHAREHOLDING PATTERN (%)

	Jun-22	Sep-22
Promoters	9.7	9.7
FIs & Local MFs	31.8	32.3
FPIs	50.9	50.4
Public & Others	7.6	7.6
Pledged Shares	-	-

Source : BSE

Pledged shares as % of total shares

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Key takeaways from the Analyst Meet

Tech investments to build for the future

- FY21-22 has been a period of continuous investments in tech and future growth, keeping cost ratios elevated; targeting to achieve ~2% cost to assets by FY25
- Multiple transformational projects at various stages of driving differentiation and productivity outcomes around a) retail asset productivity (Project Unnati); b) full-stack lifecycle management in cards business (Project Zenith); c) working capital loan originations (Project Sankalp); and d) merchant acquisition (Project Kanban)
- Build-out stage in projects such as SIDDHI and Triumph to grow and introduce new products to enrich offerings across segments
- Bank is driving digital transformation in wholesale via Project Neo to build a leading digital corporate bank reflecting in 5x YoY growth in transaction value.

Early signs of productivity gains

- Axis 2.0, an independent end-to-end digital business built using proprietary capabilities forms 20% of incremental disbursements. Looking to acquire new customers at scale and convert itself into a digital lending powerhouse by leveraging existing and new customers, making it user friendly and providing hyper personalized customer experience

P&L outcomes

- Robust balance sheet and growth driven by internal accruals; accretion to CET1 over FY19-22 has been better than peers
- Embarked on journey to structurally improve NIMs including ability to offset any potential increases in funding costs
- Retail fees reflective of quality of incremental business being written; wholesale fees muted due to a large share of negligible-fee yielding government deposits
- Better rating mix of clients with focus on improving transaction banking fees led by higher incremental sanctions to better-rated corporates

Deposit strategy

- Differentiated approach for garnering incremental deposits with focus on market share movement in the Top 50 meaningful districts
- Looking to increase the share of deposits with low run-off rates as per LCR norms i.e. deposits from Retail + Small Business Customers (52% in H1FY23) and reduce share of callable deposits
- Other deposit growth strategies include a) leveraging Bharat Banking network to build a robust rural ecosystem; b) leveraging One-Axis for wallet share gain across verticals; c) strengthening corporate salary franchise; and d) sweating the franchise for productivity maximisation

Bharat Banking (Semi-Urban + Rural - SURU strategy)

- Offers opportunity for market share gains with rising formalisation of credit
- 4x growth in network in partnership with CSCs in past 18 months
- Driving deeper penetration via all retail asset products, sourcing liabilities through available asset acquisition channels and introducing MSME business
- Creating new product propositions (20+ in pipeline); PSL-accretive portfolio with high growth potential

Retail Banking

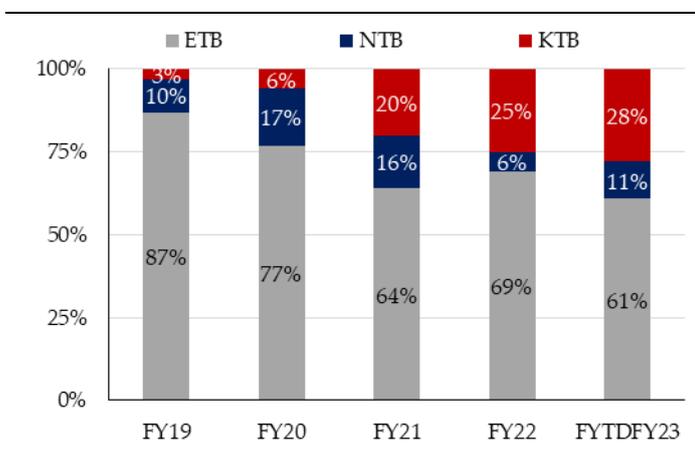
- Focused on delivering strong growth in retail loans, driven by business mix optimisation; early work around Account Aggregator framework to accelerate retail lending growth further

High-yielding segments to fix pricing power handicap

- New growth engines emerging:** Axis Bank is incrementally focusing on three key segments - MSME (including mid-corporate), Bharat Banking (Rural & Semi-urban markets) and Unsecured retail (Persona loans + Credit cards) to drive higher business growth and profitability. Unsecured retail would be incrementally driven by KTB customers (through partnerships) and NTB customers (utilising the AA framework and other such architecture), while SURU (Semi-Urban + Rural) growth would be driven by branches, CSCs, FinTechs, and corporate partnerships. The SURU strategy would aid in addressing PSL shortfall, particularly in “marginal and small farmers” (47% of target) and weaker sections (54% of target).

The bank aims to double the share of MSME + Mid-corporate in the overall loan mix over the next decade. Further, the personal loans sourced digitally typically yield ~100bps higher compared to traditional channels and generates ~15bps higher fee yields.

Exhibit 1: Axis Bank’s Credit Cards sourcing mix



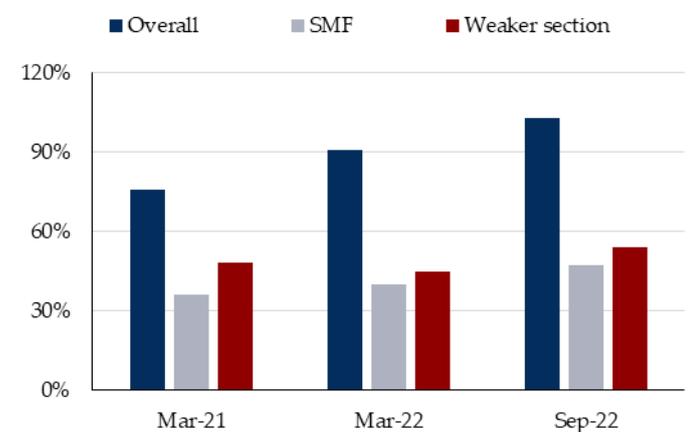
Source: Company, HSIE Research

Exhibit 2: Axis Bank’s distribution strength in Semi-Urban + Rural markets

Distribution in RUSU markets	Sep-22
Branches	2,065
% of total branches	43.4%
Districts served	659
BCBO outlets	134
CSC VLE network	54K+

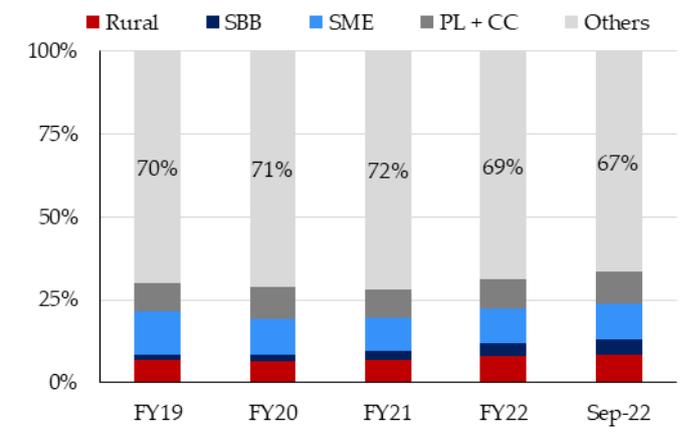
Source: Company, HSIE Research

Exhibit 3: AXSB falling short on PSL requirements in SMF and weaker section



Source: Company, HSIE Research

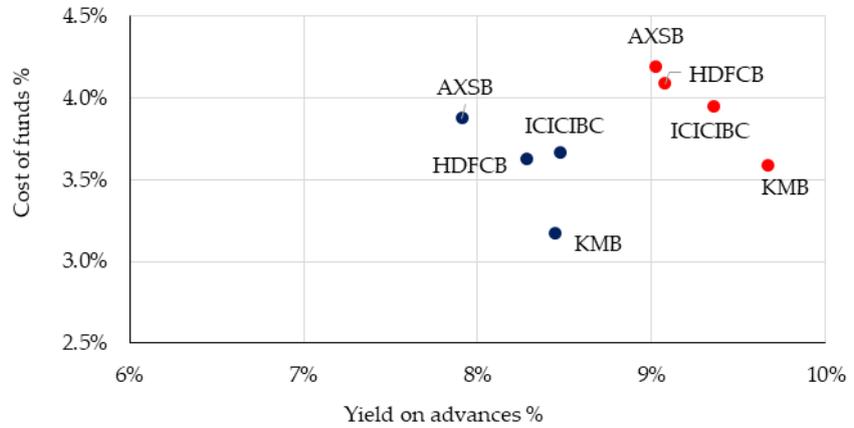
Exhibit 4: Loan mix - ~33% contribution from Rural, SBB, SME and unsecured retail



Source: Company, HSIE Research

- New profit engines to improve pricing power on the asset side:** The above three segments are likely to improve the yields on the asset side for Axis Bank. The bank currently undershoots on asset yields compared to its peers, while having a higher cost of funds, leading to lower NIM compared to peers.

Exhibit 5: Double whammy for Axis Bank compared to peers



Source: Company, HSIE Research | Blue dot: Q4FY22; Red dot: Q2FY23 | Note: HDFC Securities is a subsidiary of HDFC Bank

Sustained investments search for productivity gains

- Tech investments to sustain; digital journey remains WIP:** Having tripled its Tech investments over the past 3 years, Axis Bank’s journey in enhancing its digital capabilities and transformation remains WIP, although the heavy lifting in terms of building core platforms and re-wiring customer journeys is largely behind. The management maintained that digitisation on a lot of customer journeys and new products launches are likely to keep Tech spends elevated in the near-term.

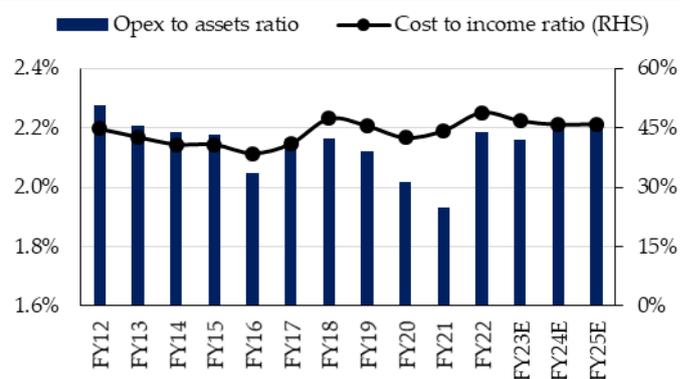
However, the bank is gradually making strides on driving productivity gains through increased use of digitisation such as building end-to-end digital journeys for retail customers, digital platforms for MSME clients as well as its own employees to monitor and drive productivity/cross-sell etc.

Exhibit 6: Share of digital personal loans during H1FY23

Sourcing	Processing	Share by value
Physical	Physical	45%
Physical	Digital	35%
Digital	Digital	20%

Source: Company, HSIE Research

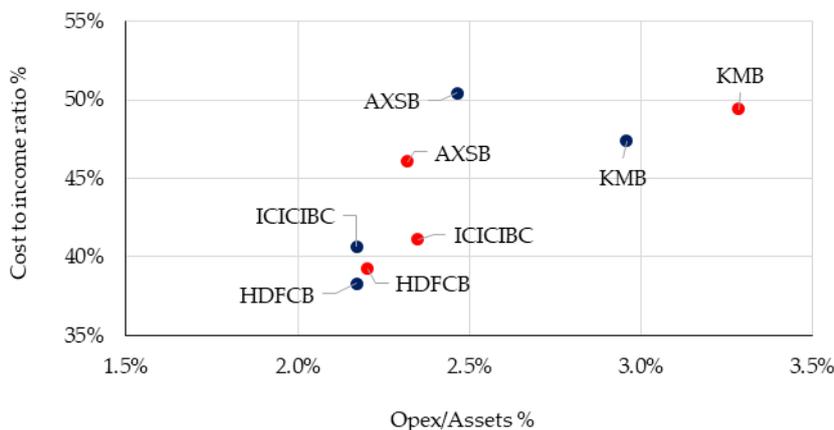
Exhibit 7: Opex-to-assets ratio to remain elevated



Source: Company, HSIE Research

- Guidance on opex-to-assets-ratio:** Technology and digital spends grew 19% YOY in Q2FY23 and constituted ~8% of total operating expenses. In line with its “Open Philosophy”, AXSB has launched Account Aggregator based loans and credit cards in Q2FY23 and built full stack for end-to-end digital lending and cards for both existing and new customers.

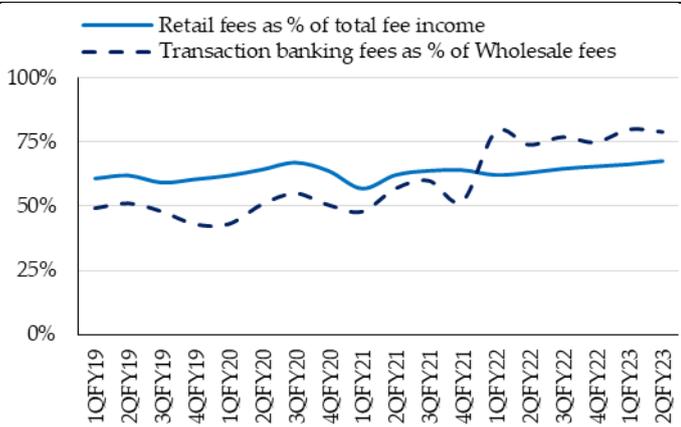
Exhibit 8: Axis Bank’s cost efficiency vs. peers



Source: Company, HSIE Research | Blue dot: Q4FY22; Red dot: Q2FY23 | Note: HDFC Securities is a subsidiary of HDFC Bank

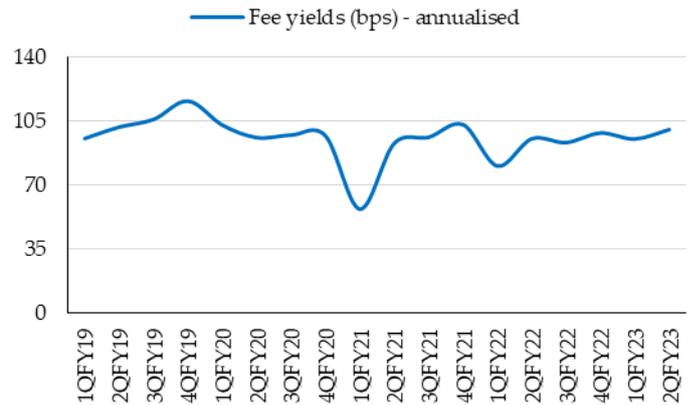
- Focus on improving fee yields through retail payments and transaction banking:**
 AXSB's fee yields marginally improved to 0.74% of business in FY22 as retail fee contribution to the overall pool improved to ~64% (68% in Q2FY23) driven mainly by credit cards. Distribution income (~18% of retail fees) productivity stays strong with a growth of 29% YoY primarily led by life insurance business although the income from mutual fund distribution has been relatively soft in recent times.

Exhibit 9: Improving granularity of fee income



Source: Company, HSIE Research

Exhibit 10: Blended fee yield (as % of total business) – gradually inching up



Source: Company, HSIE Research

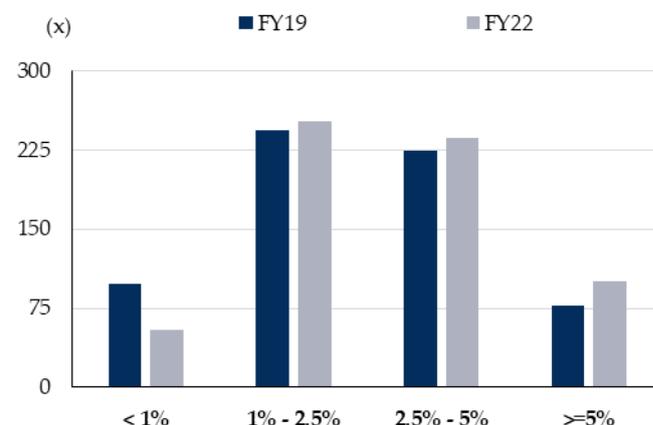
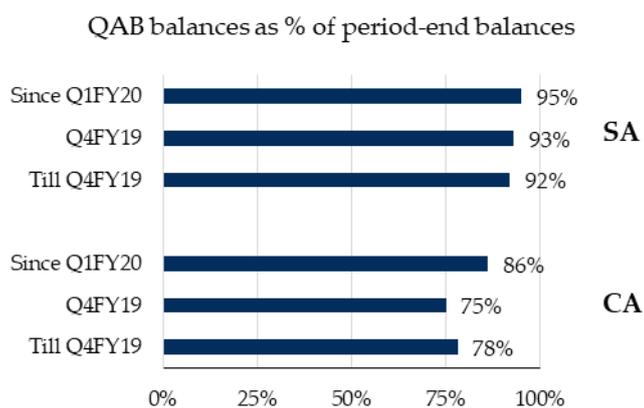
Rising granularity of deposits amid re-pricing pressures

- Improving deposit granularity; rising share of premium deposits:** AXSB's granularity on the deposits side continues to improve with average CASA balances up 13% YOY in Q2FY23. Premium segment share in the retail savings portfolio has also increased by ~220 bps YOY to 49%. AXSB remains focused on the quality of NTB acquisitions and deepening of ETB relationships through its branch channels.

The bank's digital acquisition channel, ASAP for savings accounts, is focused on higher throughput with offerings limited to minimum-balance and paid (annual charges) accounts instead of zero-balance accounts, resulting in higher average balances at INR22K per account, compared to peers such as Kotak 811 etc.

Exhibit 11: QAB share %

Exhibit 12: No. of districts with > 5% market share in deposits



Source: Company, HSIE Research

Source: Company, HSIE Research

- Overall sub-par deposit accretion invites structural risk:** Despite management confidence on delivering sustained performance metrics, recent print on the wedge between credit growth and deposit growth (>700bps in Q2FY23) raises concern, especially given its untenable loan-to-deposit ratio (Q2FY23: 90%). We believe the bank's ability to make sustained progress on its guided roadmap is contingent on a sharp build-up in deposit momentum. Our forecasts build in deposit CAGR at 18% (loan CAGR at 17%) over FY22-25E to address the current untenable loan-to-deposit ratio. Any slippage on this parameter is likely to pose a structural risk.

Valuation and recommendation

- **Return ratios on a strong footing in Q2:** Strong core operating profit growth coupled with benign credit costs resulted in a significant improvement in the bank's Q2FY23 return ratios. RoE recovery in FY22 was mainly led by ~50% yoy decline in provisions primarily from the wholesale portfolio benefitting from a healthy asset quality environment. This coupled with strong organic upgrades offer us near-term comfort and we build in 70bps of credit cost for FY23E.
- **Near-term return ratios to correct; constructive on medium-term RoEs:** Although AXSB is likely to see some near-term reversals from its Q2FY23 RoA and RoE print, we believe that the bank is on track to deliver steady performance with fewer shocks. While the bank is on track to deliver ~14-15% RoE over the next couple of years, we argue that enhanced productivity and gradual exercising of pricing power in chosen segments could drive sustained medium-term RoEs. We argue for a gradual convergence in valuation multiples with ICICIBC.
- As each business of the group is approaching critical mass, the 'One Axis' strategy is further entrenched, reflecting in greater cross-sell and higher profitability. The subsidiaries contribute INR90 (8% of aggregate valuation), after factoring in a 20% holding company discount.

Exhibit 13: SOTP-based valuation of Axis Bank

SoTP valuation	Value (INR mn)	% Stake	per share (INR)	% of TP	Valuation Methodology
Axis Bank (standalone, Sep-24 E ABVPS)	3,391,599	100.0%	1,105	92%	RI-based
Axis Finance	39,915	100.0%	13	1%	1.5x Mar-24 BVPS
Axis AMC	277,356	75.0%	68	6%	7% of Mar'24 avg AUM
Axis Capital	45,000	100.0%	15	1%	15x FY24 EPS
Axis Securities	52,200	100.0%	17	1%	15x FY24 EPS
Max Life Insurance	426,217	13.0%	18	2%	HSIE TP
Total value of subsidiaries			112	9%	
Less: Holding company discount			22	2%	
Total SoTP valuation			1,195	100%	

Source: Company, HSIE Research

Financials

Income Statement

(INR mn)	FY20	FY21	FY22	FY23E	FY24E	FY25E
Interest Income	6,26,352	6,33,462	6,73,767	8,67,306	10,01,823	11,63,472
Interest Expenses	3,74,290	3,41,071	3,42,444	4,56,040	5,22,960	6,11,769
Net Interest Income	2,52,062	2,92,391	3,31,323	4,11,265	4,78,863	5,51,702
Non-Interest income	1,55,366	1,22,636	1,52,205	1,62,709	1,98,687	2,32,491
Total income	4,07,428	4,15,027	4,83,528	5,73,974	6,77,550	7,84,193
Operating Expenses	1,73,046	1,83,751	2,36,104	2,68,235	3,10,265	3,60,368
Operating Profit	2,34,381	2,31,276	2,47,425	3,05,739	3,67,285	4,23,826
Provisions	1,85,339	1,43,217	73,595	56,392	92,672	1,19,663
PBT	49,042	88,059	1,73,829	2,49,347	2,74,613	3,04,163
Tax	32,770	22,174	43,570	62,836	69,203	76,649
PAT	16,272	65,885	1,30,259	1,86,512	2,05,411	2,27,514

Source: Company, HSIE Research

Balance Sheet

(INR mn)	FY20	FY21	FY22	FY23E	FY24E	FY25E
Share capital	5,643	6,128	6,140	6,140	6,140	6,140
Reserves	8,43,835	10,09,903	11,44,115	13,16,565	14,97,111	16,99,759
Networth	8,49,478	10,16,030	11,51,741	13,24,190	15,04,736	17,07,385
Deposits	64,01,049	69,79,857	82,17,207	95,61,575	1,13,56,480	1,35,85,007
Borrowings	14,79,541	14,28,732	18,51,339	16,20,547	15,56,519	15,07,402
Current Liab	4,21,579	4,43,362	5,31,492	5,92,342	6,87,674	7,88,603
Total Liabilities & Equity	91,51,648	98,67,980	1,17,51,778	1,30,98,655	1,51,05,410	1,75,88,397
Cash balance	9,72,683	6,17,298	11,09,871	7,19,363	9,41,287	12,43,590
Advances	57,14,242	61,43,994	70,76,959	83,50,721	97,03,049	1,12,73,368
Investments	15,67,343	22,61,196	27,55,970	29,12,880	31,85,481	36,09,205
Fixed assets	43,129	42,450	45,722	48,008	50,409	52,929
Other assets	8,54,252	8,03,038	7,63,253	10,67,682	12,25,185	14,09,305
Total Assets	91,51,648	98,67,980	1,17,51,778	1,30,98,655	1,51,05,410	1,75,88,397

Source: Company, HSIE Research

Key Ratios

	FY20	FY21	FY22	FY23E	FY24E	FY25E
VALUATION RATIOS						
EPS (INR)	6	22	42	61	67	74
Earnings Growth (%)	-65%	305%	98%	43%	10%	11%
BVPS	301	332	375	431	490	556
Adj. BVPS	261	303	350	413	469	531
ROAA (%)	0.19%	0.69%	1.21%	1.50%	1.46%	1.39%
ROAE (%)	2.15%	7.06%	12.02%	15.07%	14.52%	14.17%
P/E (x)	153	41	21	15	13	12
P/ABV (x)	3.4	2.9	2.5	2.1	1.9	1.7
P/PPOP (x)	11.5	11.7	10.9	8.8	7.4	6.4

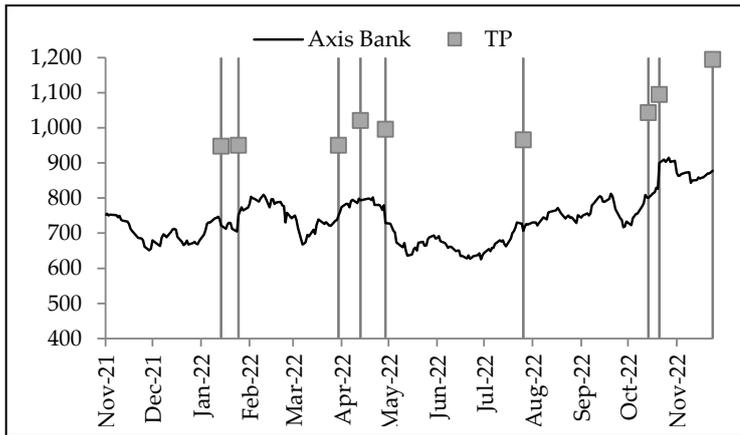
PROFITABILITY (%)

Yield on loans	9.1%	8.0%	7.5%	8.3%	8.4%	8.5%
Cost of Funds	5.0%	4.2%	3.7%	4.3%	4.3%	4.4%
Cost of Deposits	4.9%	4.0%	3.7%	3.8%	3.9%	4.1%
Spread	4.1%	4.0%	3.8%	4.5%	4.5%	4.4%
NIM	3.5%	3.7%	3.6%	3.8%	3.9%	3.9%

	FY20	FY21	FY22	FY23E	FY24E	FY25E
OPERATING EFFICIENCY						
Cost to average assets	2.0%	1.9%	2.2%	2.2%	2.2%	2.2%
Cost-income	42.5%	44.3%	48.8%	46.7%	45.8%	46.0%
BALANCE SHEET STRUCTURE RATIOS						
Loan Growth (%)	15.5%	7.5%	15.2%	18.0%	16.2%	16.2%
Deposits Growth (%)	16.7%	9.0%	17.7%	16.4%	18.8%	19.6%
C/D ratio	89.3%	88.0%	86.1%	87.3%	85.4%	83.0%
Equity/Assets (%)	9.3%	10.3%	9.8%	10.1%	10.0%	9.7%
Equity/Loans (%)	14.9%	16.5%	16.3%	15.9%	15.5%	15.1%
CASA %	41.2%	45.5%	45.0%	46.1%	44.6%	43.5%
CRAR (%)	17.5%	19.1%	18.5%	17.7%	17.2%	16.6%
Tier I (%)	14.5%	16.5%	16.3%	15.9%	15.6%	15.2%
Asset quality						
Gross NPA	302,347	253,148	218,223	154,722	196,488	262,295
Net NPA	93,604	69,935	55,122	32,793	44,217	56,095
PCR	69.0%	72.4%	74.7%	78.8%	77.5%	78.6%
GNPA %	5.1%	4.0%	3.0%	1.8%	2.0%	2.3%
NNPA %	1.6%	1.1%	0.8%	0.4%	0.5%	0.5%
Slippages	3.7%	2.9%	3.0%	2.1%	2.0%	2.0%
Credit costs	2.4%	2.1%	0.8%	0.7%	0.9%	1.0%
ROAA Tree						
Net Interest Income	2.9%	3.1%	3.1%	3.31%	3.40%	3.37%
Non-Interest Income	1.8%	1.3%	1.4%	1.31%	1.41%	1.42%
Operating Cost	2.0%	1.9%	2.2%	2.16%	2.20%	2.20%
Provisions	2.2%	1.5%	0.7%	0.45%	0.66%	0.73%
Tax	0.4%	0.2%	0.4%	0.51%	0.49%	0.47%
ROAA	0.2%	0.7%	1.2%	1.50%	1.46%	1.39%
Leverage (x)	11.3	10.2	10.0	10.0	10.0	10.2
ROAE	2.1%	7.1%	12.0%	15.1%	14.5%	14.2%

Source: Company, HSIE Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
14-Jan-22	740	BUY	948
25-Jan-22	705	BUY	950
31-Mar-22	750	BUY	950
14-Apr-22	793	BUY	1,021
29-Apr-22	780	BUY	996
26-Jul-22	727	BUY	966
14-Oct-22	805	BUY	1,043
21-Oct-22	826	BUY	1,095
25-Nov-22	879	BUY	1,195

Rating Criteria

- BUY: >+15% return potential
- ADD: +5% to +15% return potential
- REDUCE: -10% to +5% return potential
- SELL: >10% Downside return potential

Disclosure:

We, **Krishnan ASV, PGDM, Deepak Shinde, PGDM & Neelam Bhatia, PGDM** authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. SEBI conducted the inspection and based on their observations have issued advise/warning. The said observations have been complied with. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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