ICRA

June 14, 2017

Axis Bank Limited

Summary of rated instruments

Instrument*	**Rated Amount (Rs. crore)**	**Amount Outstanding (Rs. crore)**	**Rating Action**
Basel III Complaint Tier II Bonds Programme	5,000	-	[ICRA]AAA(hyb)(stable); assigned
Basel III Complaint Tier II Bonds Programme	7,350	6,580	[ICRA]AAA(hyb)(stable); outstanding
Infrastructure Bonds Programme	14,205	13,705	[ICRA]AAA(stable); outstanding
Lower Tier II Bonds Programme	5,925	5,925	[ICRA]AAA(stable); outstanding
Basel III Complaint Tier I Bonds Programme	3,500	3,500	[ICRA]AA+(hyb)(stable); outstanding
Certificates of Deposit Programme	50,000	-	[ICRA]A1+; outstanding

*Instrument details are provided in Annexure-1

Rating action

ICRA has assigned a rating of [ICRA]AAA(hyb)(stable) (pronounced ICRA triple A hybrid with a stable outlook) to the Rs. 5,000 crore Basel III compliant Tier II bonds programme Axis Bank Limited (ABL)[1].

The letters "hyb" in parenthesis suffixed to a rating symbol stand for "hybrid", indicating that the rated instrument is a hybrid subordinated instrument with equity-like loss-absorption features; such features may translate into higher levels of rating transition and loss-severity vis-à-vis conventional debt instruments.

ICRA has the rating of [ICRA]AAA(hyb) outstanding for Rs. 7,350 crore of Basel III complaint Tier II bonds programme of ABL. ICRA also has the rating of [ICRA]AAA(stable) (pronounced ICRA triple A) outstanding for Rs. 14,205 crore infrastructure bonds programme and Rs. 5,925 crore Lower Tier II bonds programme of ABL. ICRA also has the rating of [ICRA]AA+(hyb)(stable) (pronounced ICRA double A plus hybrid) outstanding for the Rs. 3,500 crore Basel III compliant Tier I bonds programme of ABL. ICRA also has the rating of [ICRA]A1+ (pronounced ICRA A one plus) outstanding for Rs. 50,000 crore certificates of deposit programme of ABL. The outlook on long term ratings is stable.

The rating for the Basel III compliant Tier I bonds is one notch lower than the Basel III complaint Tier II bonds of the bank as these instruments have the following loss absorption features that make them riskier.

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[1] For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications.

- The bank has the discretion at all times to cancel distribution and payments; cancellation of discretionary payments shall not be an event of default.
- The minimum capital conservation ratio applicable to the banks may restrict the bank from servicing these Tier I bonds in case the Common Equity Tier-I (CET-I) falls below the limit prescribed by RBI.

Rationale

The highest credit quality ratings of the bank's debt instruments are supported by ABL's strong position in the Indian financial system with a 4.8% share in banking sector advances, its sound capitalisation levels, extensive corporate relationships and retail franchise. While the bank's slippages increased during FY2017, affecting its net profitability and internal capital generation, its strong operating profitability, and relatively better solvency profile provide comfort. In light of the bank's exposure to stressed sectors, the pace of fresh NPA generation and recoveries from the existing stock of stressed advances would be a key monitorable.

Given the above distinguishing features of the Basel III compliant Tier I bonds, ICRA has assigned a one notch lower rating on these bonds than the rating on the Tier II instruments. The distributable reserves[2] that can be used for servicing the coupon in a situation of inadequate profits or a loss during the year, stood at a comfortable 8.4%[3] of risk weighted assets as on March 31, 2017. The rating on the Tier I bonds continues to be supported by the bank's sound capitalisation (CRAR: 14.95%; CET-I capital of 11.13% and Tier I capital: 11.87% as on March 31, 2017) .The rating on the Additional Tier I (AT-I) bonds also factors in the pressure on profitability which is expected to continue in near term given the asset quality related concerns. However, adequate operating profits and additional buffer in the form of high capital levels provide comfort.

Key rating drivers

Credit strengths

- Sound core profitability supported by high fee income, constituting one-fourth of operating revenues; however, net profitability in FY2017 impacted by increased credit costs
- Healthy resource profile with a large share of CASA deposits resulting in lower than average cost of interest bearing funds in relation to industry average, which also supports profitability
- Established track record and consistently strong growth driven by established franchise and supported by experienced and capable management
- Robust capitalisation levels with capital adequacy ratio at 14.95% and Tier I ratio at 11.87% (including CET-I capital of 11.13%) as on March 31, 2017

Credit weaknesses

- Ability to control credit costs, NPA generation, and recoveries from existing gross NPAs in the view of the high exposure to stressed sectors such as iron and steel, power and infrastructure
- Moderation in fee income growth because of the slowdown in corporate credit

[2]Calculated as per the amendment in Basel III capital regulations for AT-I bonds by the RBI, vide its circular dated February 2, 2017. As per the amended definition, "distributable reserves" include all reserves created through appropriation from profit and loss account.

[3] Including profits for FY2017

Description of key rating drivers

The bank's loan book stood at Rs. 373,069 crore as on March 31, 2017 as compared with Rs. 338,774 crore as on March 31, 2016, reporting a moderate growth of ~10% (as compared with a growth of 21% in FY2016) on account of the bank's cautious approach to incremental lending to corporate segment and subdued credit demand in the domestic market. With the subdued corporate credit offtake and the bank's focus on the retail segment, its retail credit growth stood at 21% YoY in FY2017 as compared with below 1% YoY growth in the corporate segment. As on March 31, 2017, the corporate segment constituted 42% of the bank's overall advances (46% as at March 31, 2016), retail advances constituted 45% (41% as at March 31, 2016) and SME advances accounted for 13% (13% as at March 31, 2016). The bank's share of total banking sector credit improved to 4.8% of advances as on March 31, 2017 as against 4.6% level as on March 31, 2016 given its higher than systemic credit growth of the banking sector.

The headline asset quality of the bank continued to deteriorate; during H2FY2016, the management disclosed a corporate book watch list of ~Rs. 22,000 crore (~7% of loan book) of which ~60% was expected to slip into the NPA category in FY2017 and FY2018. During FY2017, the bank reported higher than expected slippages of Rs. 21,781 crore (Rs. 7,345 crore in FY2016), of which ~75% were from the watch list. Consequently, there was an increase in gross NPAs to 5.04% and net NPAs to 2.11% as at March 31, 2017 as compared with 1.67% and 0.70% as at March 31, 2016. The bank reported a divergence of Rs. 9,478 crore in the gross NPA amount as on March 31, 2016 as compared with the RBI assessed amount. However, as on March 31, 2017, majority of the amount have been recognised as NPA with only Rs. 2,407 crore being standard because the irregularities were resolved. With fresh NPA generation, provisioning cover (including prudential and technical write-offs) declined to ~65% as at March 31, 2017 from 72% as at March 31, 2016. Despite a decline, the provision cover remains better than the banking sector average. With the increase in NPAs, the bank's solvency level weakened, with net NPAs / net worth of 15.5% as on March 31, 2017 as compared with 4.7% as on March 31, 2016; however, ICRA expects the bank's strong operating profitability to provide coverage against future credit costs enabling it to maintain an above average solvency profile and capitalisation indicators. Nonetheless, given its high exposure (fund based plus non-fund based) to stressed sectors such as iron and steel, power and infrastructure, which together stood at ~12% as on March 31, 2017 (banking sector average of 16%), the bank's ability to control further slippages and recover from already slipped accounts shall remain a key monitorable.

Supported by increase in deposits post demonetisation, the CASA ratio increased to 51% as on March 31, 2017 (47% as on March 31, 2016). The bank's CASA ratio remains among the highest in its peer group and a significant credit positive in light of the higher granularity of depositor base and the lower cost of borrowings. The deposit base has been supported by the bank's established franchise and wide branch network. As at March 31, 2017, the bank had 3,304 branches and 14,163 ATMs as against 2,904 branches and 12,743 ATMs as on March 31, 2016. For FY2017, the cost of interest bearing funds stood at 5.4% as compared with 5.8% for private banks and 5.7% for the banking sector overall.

Axis Bank's Net Interest Margins (NIMs) declined to 3.21%[4] in FY2017 from 3.41% in FY2016 on account of subdued credit growth, increase in NPAs resulting in a decline in earning assets and overall decline in the market yields. However, the NIMs received support from a healthy deposit profile of the bank (CASA of 51.41% as on March 31, 2017) which reduced the cost of borrowings. The NIMs nevertheless remained better than the banking system average of 2.46% for FY2017. Historically, fee income has been a strong source of income for the bank which coupled with healthy NIMs resulted in overall strong core operating profitability before provisions and treasury gains. In FY2017, with the

[4] All ratios are as per ICRA calculations

decline in NIMs and muted fee income growth of on account of slower growth in corporate credit, the operating profitability levels declined to 2.5% of ATA (3.1% in FY2016). However, the bank's operating profitability levels are comparable with peers and private sector banks apart from being better than the banking system average of 1.6% of ATA during FY2017. The fee income stood at 1.5% of ATA during FY2017 as compared with 1.7% of ATA during FY2016. Within fee income, while corporate fee income growth declined in FY2017, retail fees grew marginally. With higher slippages during FY2017, the bank's credit provisions were higher at 2.15% of ATA in FY2017 (0.75% in FY2016). Despite the elevated credit costs, supported by treasury gains, the bank reported a PAT to ATA of 0.65% in FY2017 (1.67% in FY2016). Going ahead, the pressure on profitability is expected to continue in near term given the pressure on asset quality; however, strong core operating profitability and buffers in terms of high capital levels and the ability to monetize its investments provide comfort.

The bank's capitalisation continues to remain healthy supported by strong internal accruals, as reflected in the CRAR of 14.95% and a Tier I ratio of 11.87% (including CET-I of 11.13%) as on March 31, 2017 under Basel III as compared with CRAR of 15.29% and Tier I ratio of 12.51% (including CET-I of 12.48%) as on March 31, 2016. During FY2017, the bank issued AT I bonds, resulting in a 0.68 bps improvement in Tier I and CRAR.

Analytical approach:
To arrive at the ratings, ICRA has taken into account the standalone financials of the bank and key operational developments in the recent past.

Links to applicable criteria
ICRA Rating Methodology for Banks
ICRA Rating Methodology for Basel III Compliant Non-Equity Capital Instruments

About the company
Incorporated in December 1993, Axis Bank Limited (ABL) is a new private sector bank. Over the years, the bank's strong business growth enabled by a robust branch network, healthy net interest margins, competitive cost of funds, healthy capitalisation and established track record have catapulted it into the position of India's third largest private sector bank. As on March 31, 2017, the bank had a network of 3,304 domestic branches, 14,163 ATMs and an international presence through branches in DIFC (Dubai), Singapore, Hong Kong, Colombo, Shanghai and representative offices in Abu Dhabi, Dhaka and Dubai.

For FY2017, ABL reported a net profit of Rs. 3,679 crore on total assets of Rs. 6.01 lakh crore and had a regulatory capital adequacy of 14.95% (Tier-I of 11.87% and CET-I of 11.13%) as on March 31, 2017. The bank reported gross NPAs of 5.04% and net NPAs of 2.11% as on March 31, 2017.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating history for last three years:
Table:

Sr. No.	Instrument	Current Rating (FY2018)			Chronology of rating history for the past 3 years										
		Type	Rated amount (Rs. crore)	June 2017	FY2018	FY2017				FY2016		FY2015			
					Apr 2017	Nov 2016	Oct 2016	Jun 2016	May 2016	Oct 2015	Sep 2015	Jan 2015	Dec 2014	Oct 2014	Apr 2014
1	Basel III Compliant Tier II Bonds Programme	Long Term	5,000	[ICRA] AAA (hyb) (stable)	-	-	-	-	-	-	-	-	-	-	-
2	Basel III Compliant Tier II Bonds Programme	Long Term	7,350	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	[ICRA] AAA (hyb) (stable)	-	-	-
3	Infrastructure Bonds Programme	Long Term	14,205	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	-
4	Lower Tier II Bonds Programme	Long Term	5,925	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)	[ICRA] AAA (stable)
5	Basel III Compliant Tier I Bonds Programme	Long Term	3,500	[ICRA] AA+ (hyb) (stable)	[ICRA] AA+ (hyb) (stable)	-	-	-	-	-	-	-	-	-	-
6	Certificate of Deposits Programme	Short Term	50,000	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+
7	Upper Tier II Bonds Programme	Long Term	-	-	withdrawn	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)
8	Perpetual Bonds Programme	Long Term	-	-		withdrawn	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)	[ICRA] AA+ (stable)

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1
Instrument Details

Instrument	Date of issuance / sanction	Coupon rate	Maturity date	Rated Amount (Rs. crore)	Current rating and outlook
Basel III Compliant Tier I Bonds Programme	14-Dec-2016	8.75%	Perpetual (Call: 14-Dec-2021)	3,500	[ICRA]AA+(hyb)(stable)
Basel III Compliant Tier II Bonds Programme	-	-	-	5,770^	[ICRA]AAA(hyb)(stable)
Basel III Compliant Tier II Bonds Programme	12-Feb-2015	8.45%	12-Feb-2025	850	[ICRA]AAA(hyb)(stable)
Basel III Compliant Tier II Bonds Programme	30-Sep-2015	8.50%	30-Sep-2025	1,500	[ICRA]AAA(hyb)(stable)
Basel III Compliant Tier II Bonds Programme	27-May-2016	8.50%	27-May-2026	2,430	[ICRA]AAA(hyb)(stable)
Basel III Compliant Tier II Bonds Programme	23-Nov-2016	7.84%	23-Nov-2026	1,800	[ICRA]AAA(hyb)(stable)
Infrastructure Bonds Programme	-	-	-	500^	[ICRA]AAA(stable)
Infrastructure Bonds Programme	05-Dec-2014	8.85%	05-Dec-2024	5,705	[ICRA]AAA(stable)
Infrastructure Bonds Programme	30-Oct-2015	8.25%	30-Oct-2025	3,000	[ICRA]AAA(stable)
Infrastructure Bonds Programme	20-Oct-2016	7.60%	20-Oct-2023	5,000	[ICRA]AAA(stable)
Lower Tier II Bonds Programme	01-Dec-2011	9.73%	01-Dec-2021	1,500	[ICRA]AAA(stable)
Lower Tier II Bonds Programme	20-Mar-2012	9.30%	20-Mar-2022	1,925	[ICRA]AAA(stable)
Lower Tier II Bonds Programme	31-Dec-2012	9.15%	31-Dec-2022	2,500	[ICRA]AAA(stable)
Certificate of Deposits	-	-	7-365 days	50,000	[ICRA]A1+

^yet to be placed; other instruments are outstanding as on May 31, 2017
Source: ABL

Contact Details

Analyst Contacts

Karthik Srinivasan
+91 22 61143 444
karthiks@icraindia.com

Anil Gupta
+91 124 4545 314
anilg@icraindia.com

Neha Parikh
+91 22 6114 3426
neha.parikh@icraindia.com

Akshay Kumar Jain
+91 22 6114 3430
akshay.kumar@icraindia.com

Relationship Contact
L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

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ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.
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For more information, visit **www.icra.in**

Registered Office
ICRA Limited
1105, Kailash Building, 11th Floor, 26, Kasturba Gandhi Marg, New Delhi 110001
Tel: +91-11-23357940-50, Fax: +91-11-23357014

Corporate Office
Mr. Vivek Mathur
Mobile: +**91 9871221122**
Email: vivek@icraindia.com

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon 122002
Ph: +91-124-4545310 (D), 4545300 / 4545800 (B) Fax; +91- 124-4050424

Mumbai **Mr. L. Shivakumar** Mobile: +**91 9821086490** Email: shivakumar@icraindia.com 3rd Floor, Electric Mansion Appasaheb Marathe Marg, Prabhadevi Mumbai—400025, Board : +91-22-61796300; Fax: +91-22-24331390	**Kolkata** **Mr. Jayanta Roy** Mobile: **+91 9903394664** Email: jayanta@icraindia.com A-10 & 11, 3rd Floor, FMC Fortuna 234/3A, A.J.C. Bose Road Kolkata—700020 Tel +91-33-22876617/8839 22800008/22831411, Fax +91-33-22870728
Chennai **Mr. Jayanta Chatterjee** Mobile: +**91 9845022459** Email: jayantac@icraindia.com 5th Floor, Karumuttu Centre 634 Anna Salai, Nandanam Chennai—600035 Tel: +91-44-45964300; Fax: +91-44 24343663	**Bangalore** **Mr. Jayanta Chatterjee** Mobile: +**91 9845022459** Email: jayantac@icraindia.com 'The Millenia' Tower B, Unit No. 1004,10th Floor, Level 2 12-14, 1 & 2, Murphy Road, Bangalore 560 008 Tel: +91-80-43326400; Fax: +91-80-43326409
Ahmedabad **Mr. L. Shivakumar** Mobile: +**91 9821086490** Email: shivakumar@icraindia.com 907 & 908 Sakar -II, Ellisbridge, Ahmedabad- 380006 Tel: +91-79-26585049, 26585494, 26584924; Fax: +91-79-25569231	**Pune** **Mr. L. Shivakumar** Mobile: +**91 9821086490** Email: shivakumar@icraindia.com 5A, 5th Floor, Symphony, S.No. 210, CTS 3202, Range Hills Road, Shivajinagar,Pune-411 020 Tel: + 91-20-25561194-25560196; Fax: +91-20-25561231
Hyderabad **Mr. Jayanta Chatterjee** Mobile: +**91 9845022459** Email: jayantac@icraindia.com 4th Floor, Shobhan, 6-3-927/A&B. Somajiguda, Raj Bhavan Road, Hyderabad—500083 Tel:- +91-40-40676500	