ICICI Bank – REDUCE

ICICIBC IN	Rs918	Banks	16 April 2010	Company update

Looking for growth

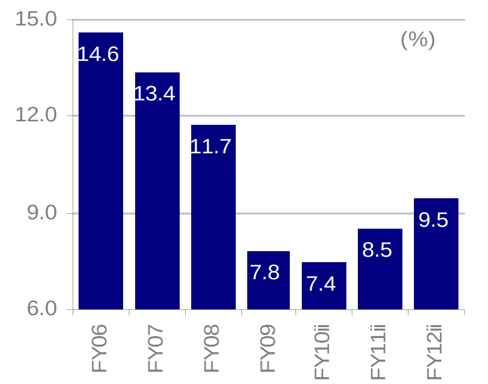
After seven consecutive quarters of contraction in its loan book, ICICI Bank is now looking to grow its domestic loan book by 20% in FY11. The bank has already made credible progress towards increasing CASA and stabilising asset quality. We expect the bank's loans to grow at sub-industry rate in FY11, with no material NIM expansion. Provision charges are likely to remain high to meet RBI's required 70% NPL coverage by 2QFY11. We expect the RoE to remain in single digits until FY12, and view the stock as expensive on PE and PEG basis. We retain REDUCE.

New retail strategy needs time: In contrast to its earlier strategy of discouraging branch-banking and aggressively acquiring new customers through direct-marketing agents (DMAs) and call centres, the bank is now focussing on cross-selling to existing customers. We believe this change in stance will take some time to trickle down to customers. Unlike in the past, the bank is unlikely to be a price leader, as it has more competition from government banks and has fewer products to offer, having reduced its focus on credit-card and unsecured personal loans.

Material NIM expansion unlikely: While the CASA ratio has risen by 12pps to 40% over the past year, NIMs have expanded by only 20bps over the same period. The growing proportion of overseas loans, coupled with the bank's exit from high-yielding retail loans, has effectively capped NIM expansion. We expect these factors to continue to play out over FY11 as the proportion of overseas loans remains high and the bank concentrates on secured retail lending.

NPLs have peaked, but credit charges may not decline: Gross NPLs have declined by 10% and gross retail NPLs by 16%, since peaking in 4QFY09. However, the NPL coverage ratio of 51% (62%, considering technical write-offs, which are yet to be approved by RBI) remain well below the minimum 70% stipulated by RBI. As such, we expect provision charges to remain high.

RoE to remain in single digits till FY12



Source: Company, IIFL Research

Financial Summary

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Pre prov. operating inc. (Rs m)	79,607	89,252	96,231	97,532	111,133
Net profit (Rs m)	41,577	37,581	37,830	45,721	54,105
EPS (Rs)	37.4	33.8	34.0	41.1	48.6
Growth (%)	8.0	-9.7	0.7	20.9	18.3
PER (x)	24.6	27.2	27.0	22.4	18.9
Book value (Rs)	418	445	468	496	531
PB (x)	**2.2**	**2.1**	**2.0**	**1.8**	**1.7**
CAR (%)	14.0	15.5	17.9	18.5	17.7
ROA (%)	1.1	1.0	1.0	1.2	1.2
ROE (%)	**11.7**	**7.8**	**7.4**	**8.5**	**9.5**
Dividend yield (%)	1.2	1.2	1.1	1.2	1.4

Price as at close of business on 15 April 2010

12-mth TP	**(Rs) 836 (-9%)**
Market cap (US$ m)	**23,007**
52Wk High/Low (Rs)	1010/372
Diluted o/s shares (m)	1115
Daily volume (US$ m)	100
Dividend yield FY10ii (%)	1.1
Free float (%)	100.0

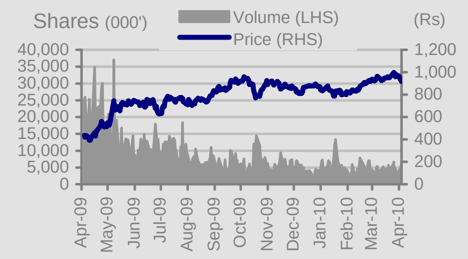
Shareholding pattern (%)

Promoters	0.0
FIIs	37.2
Domestic MFs	25.0
Others	9.5
ADRs	28.3

Price performance (%)

	1M	3M	1Y
ICICI Bank	-0.6	9.0	107.3
Rel. to Sensex	-3.4	8.7	46.4
Axis Bank	0.5	6.5	127.7
HDFC Bank	8.0	15.5	80.7
St Bk of India	1.9	-4.2	58.6

Stock movement



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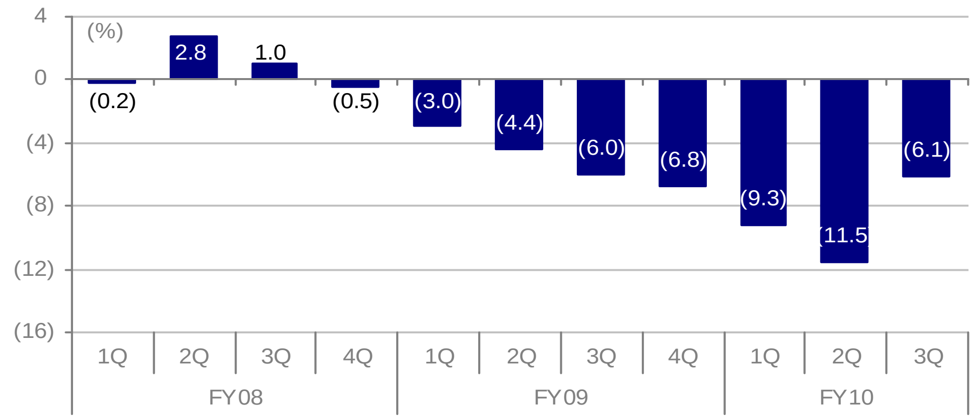
Loan growth on a rebound?: ICICI Bank's retail book shrank by 39% over the last two years, while the overall loan book contracted by 17%. This trend accelerated over 9MFY10, with the retail book shrinking by 25%, and the overall loan book contracting by 18%. 'Other secured loans', including gold loans and loans against FDs, is the only retail category to have grown in the first nine months of FY10 (up 51% over 9MFY10, albeit on a small base). Domestic corporate loans (up 23% YoY in 9MFY10) are the only other segment to have grown over 9MFY10. However, both these segments recorded a QoQ decline in 3QFY10.

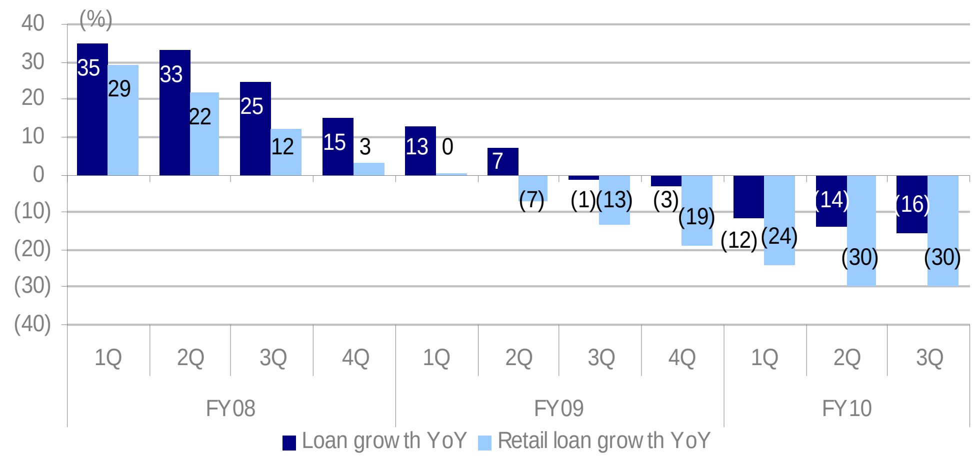
Management maintains that the loan book should expand from hereon, and is aiming for 20% growth in the domestic loan book for FY11 and 15% growth in total loan book, assuming flat-to-declining trend in the international loan book (27% of total in 3QFY10). However, we believe 10-12% loan growth in FY11 is more realistic, given that the bank has been out of the retail market for some time and can no longer afford to be a price leader in any segment. Domestic corporate and SME lending have not been focus areas for the bank in the past, and it should take a while for the bank to find its foothold in these segments.

Figure 1: QoQ retail loan growth – the bank will have to grow its retail book significantly to meet its 20% domestic loan growth target



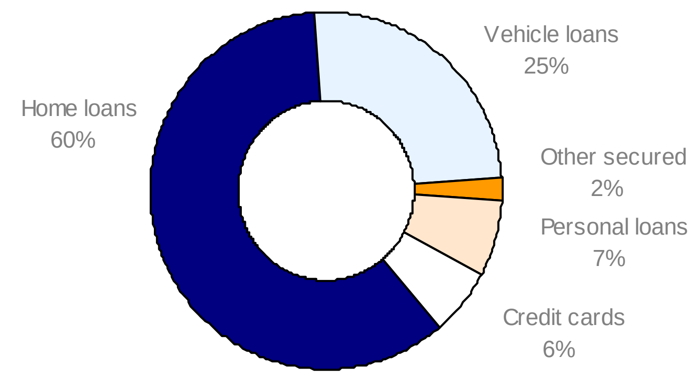
Source: Company, IIFL Research

Figure 2: Total and retail loan growth trends – contraction has been sharper in FY10 as compared to FY09



Source: Company, IIFL Research

Figure 3: Retail loan book break-up in 3QFY10 – unsecured lending to go down further

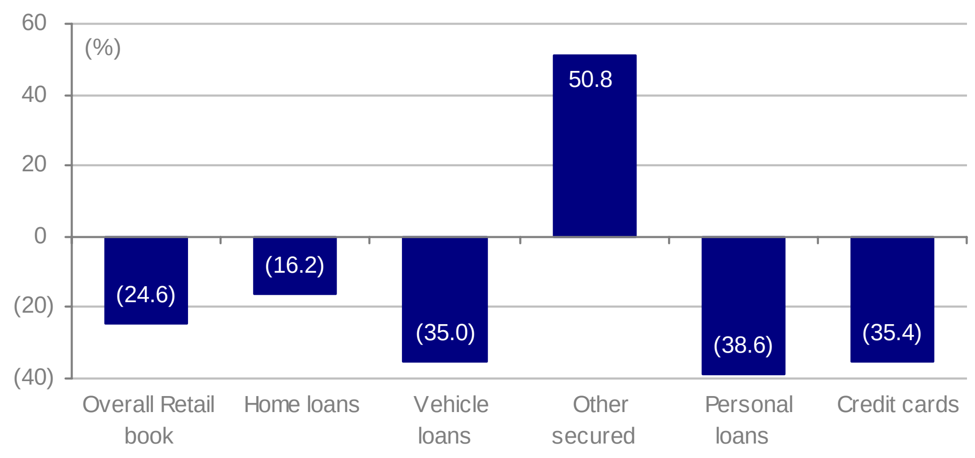


Source: Company, IIFL Research

Shifting retail focus: ICICI Bank is increasingly focussed on reconnecting with its existing customers and tapping its customer base for cross-selling products. This is in contrast to its earlier strategy of aggressively acquiring new customers across all products segments. Earlier, DMAs were working on customer acquisition; now, after the sharp cut in their number (DMA expenses in 3QFY10 were down by over 90% from 3QFY08), they are largely following up with customers for residual paperwork. The bank is looking at only secured lending to grow its retail base, which is positive from credit quality perspective, but negative from asset yield and NIM perspective.

The bank expects home loans, auto loans, and CV loans to drive consumer loan growth. However, it is no longer a price leader in any of these segments. The bank was forced to lower its mortgage rates following a rate cut by HDFC in December 2009. Similarly, its auto loan rates are benchmarked to those of HDFC Bank.

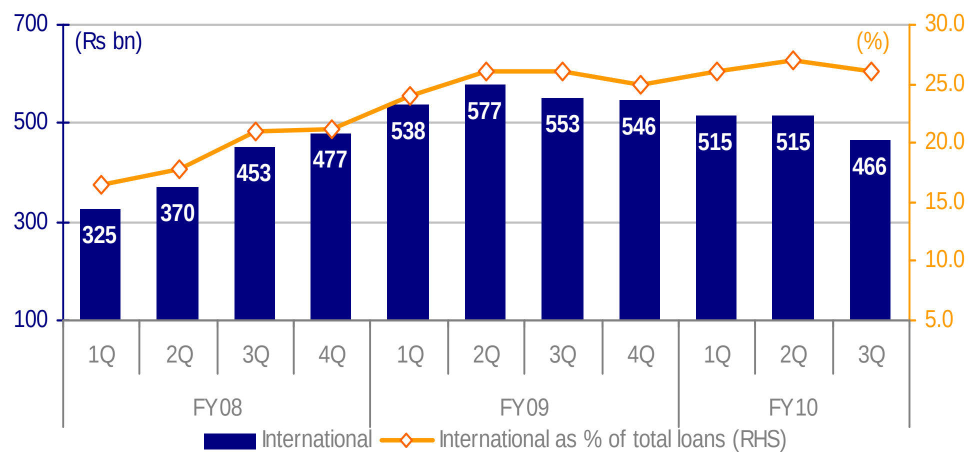
Figure 4: Growth of retail segments over 9MFY10 – all segments apart from 'other secured' have seen a decline; focus going forward remains on secured loans



Source: Company, IIFL Research

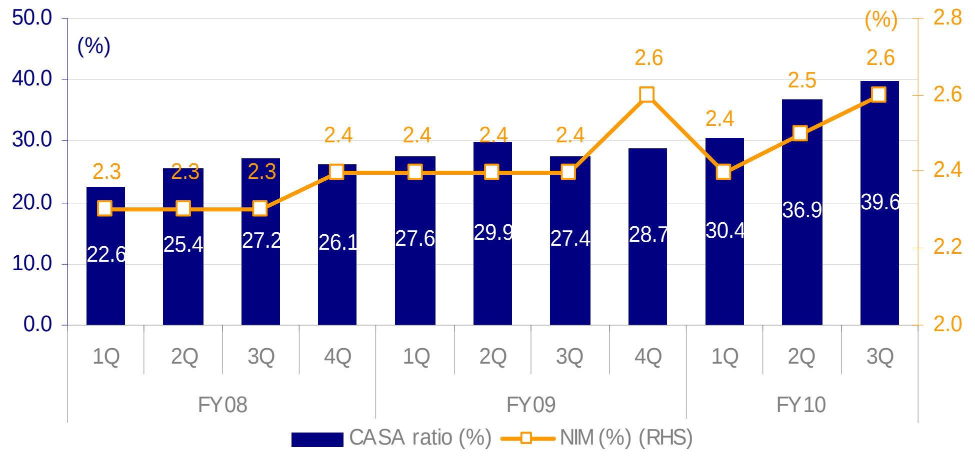
Material NIM expansion is unlikely: While a favourable change in funding mix is positive for NIMs, offsetting factors will not let it expand materially; for instance, liquidation of higher-yielding retail loans and growing share of low-margin overseas loans. Overseas loans, now accounting for 27% of the standalone loan book, earn NIMs of 50bps or less. NIM on the domestic loan book is healthy at about 2.9%. Blended NIM of 2.6% is unlikely to expand materially. We have assumed 10bps expansion in FY10 and a further 10bps expansion in FY11.

Figure 5: International loans as % of total – constraining NIM expansion



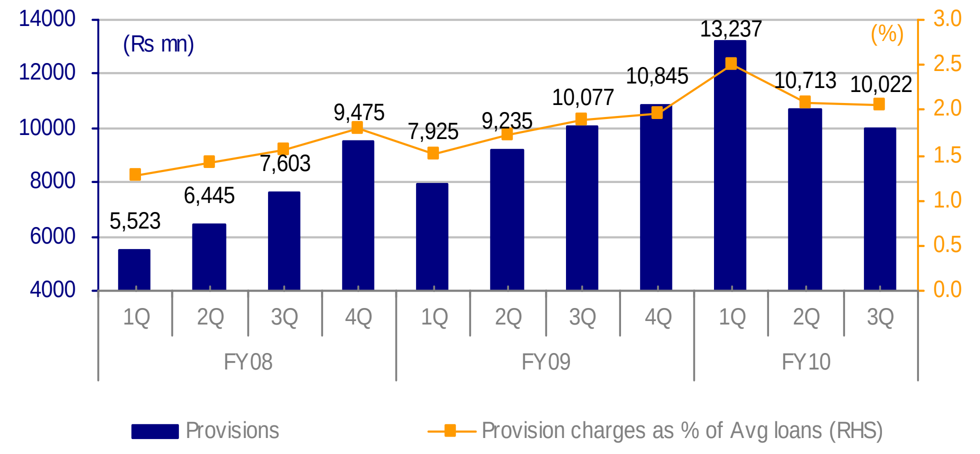
Source: Company, IIFL Research

Figure 6: CASA and NIM trend – CASA was up 12pps YoY for 3QFY10, but NIM expanded by just 20bps



Source: Company, IIFL Research

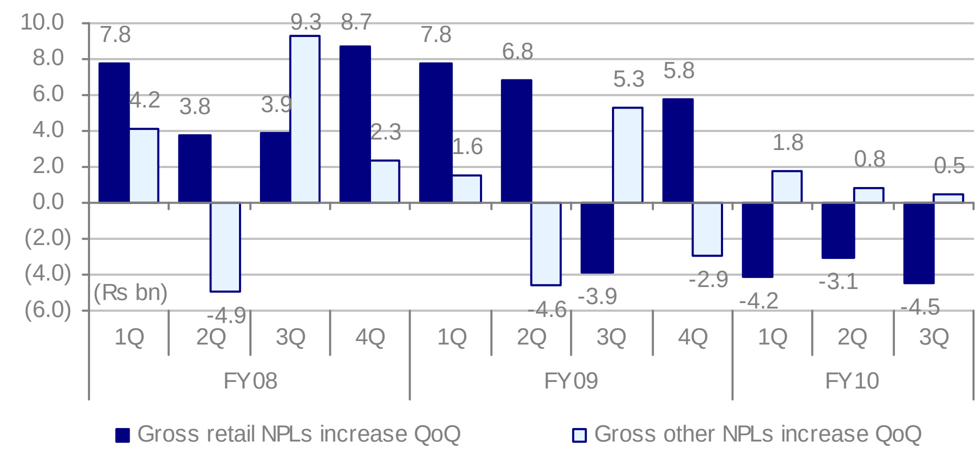
Figure7: Outstanding provisions and provision charges as % of average loans – likely to remain high at least in 1HFY11



Source: Company, IIFL Research

NPL accretion peaked, but provision charges unlikely to decline: The bank made Rs13bn of NPL provisions in 1QFY10 and Rs10bn each in 2QFY10 and 3QFY10. At present, provision charges amount to 2% of average outstanding loans, and the bank's target is to gradually bring this figure down to 1.2%. Retail NPL accretion has peaked, in our view, and the bank expects incremental slippages to be lower in the quarters ahead. However, provision charges are likely to remain high, to reach 70% NPL coverage by September 2010, as required by RBI. To achieve this, the bank would have to make additional provisions of Rs17bn, assuming no change in NPLs from 3QFY10 level. The bank made Rs25bn of technical write-offs in 9MFY10 (allowed by RBI for the purpose of calculating NPL coverage), which may take up the present coverage to 62% and lower future provisioning requirement. However, the RBI is yet to confirm if these write-offs can be considered technical.

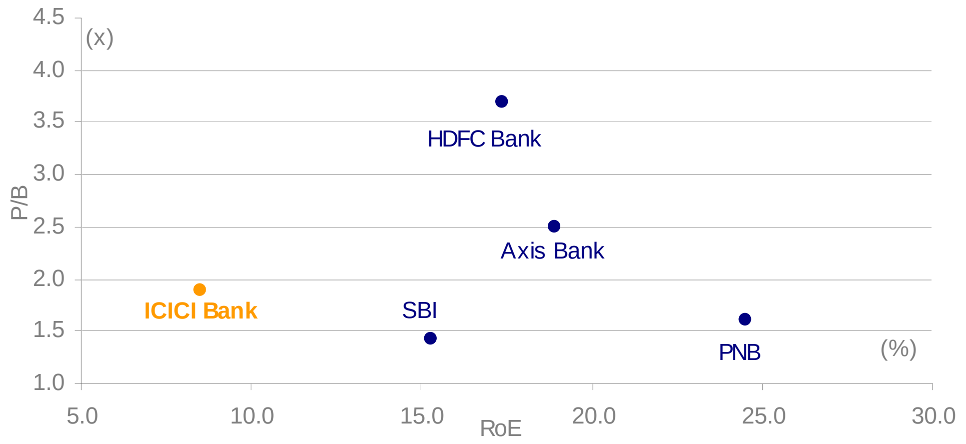
Figure 8: QoQ increase in gross retail and other outstanding NPL – retail NPLs have been declining for the past three quarters



Source: Company, IIFL Research

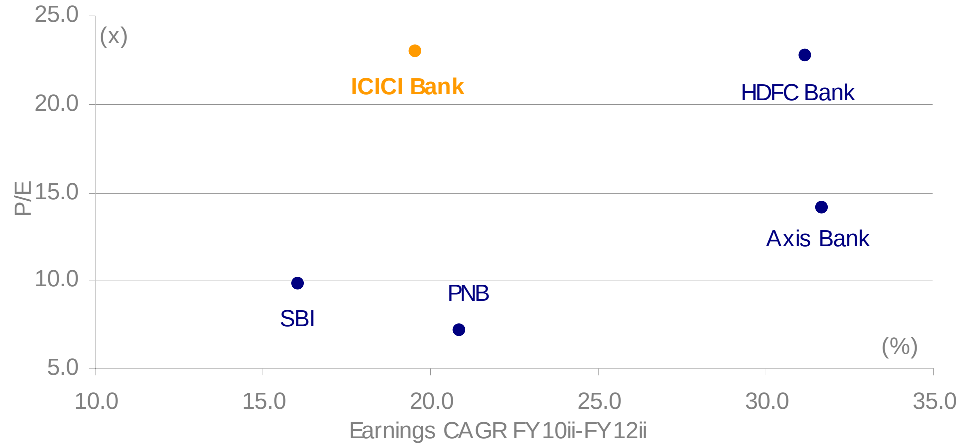
Consistent under-performance, valuations still expensive: ICICI Bank's stock has consistently underperformed its peer group and the market, be it over the past six months, two years, three years or five years. In the past three years, ICICI Bank delivered 16% price appreciation, compared to over 100% by most of its peer group, including Axis (158%), PNB (146%), SBI (140%) and HDFC Bank (109%). ICICI Bank's current valuations of 1.9x FY11ii P/B appear reasonable versus those of other private banks—but that is without considering underlying profitability and growth prospects, both of which are likely to remain inferior for ICICI Bank. On PER and PEG, ICICI Bank is expensive.

Figure 9: P/Bx vs RoE (FY11ii)



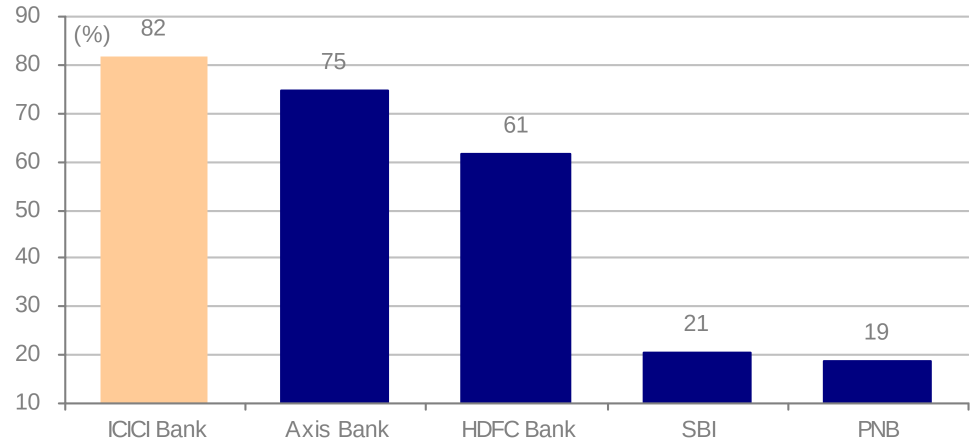
Source: Bloomberg, Companies, IIFL Research

Figure 10: Forward P/E vs earnings CAGR FY10-FY12ii



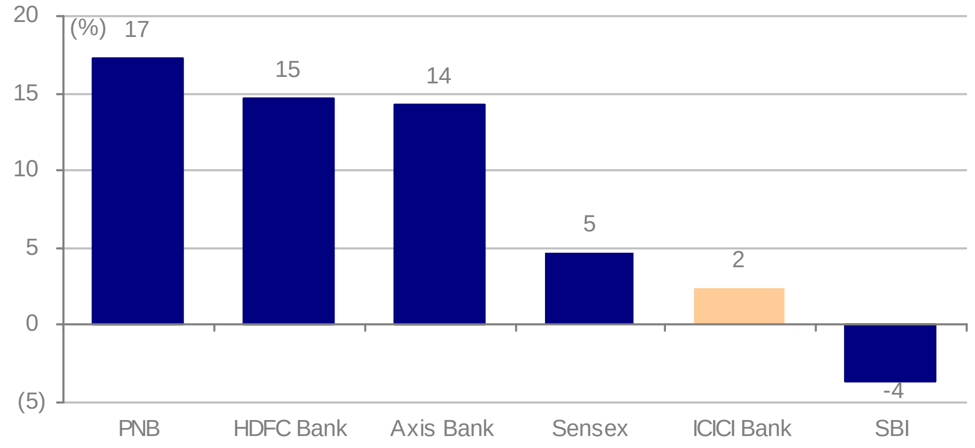
Source: Bloomberg, Companies, IIFL Research

Figure 11: Equity dilution from FY03 to FY10



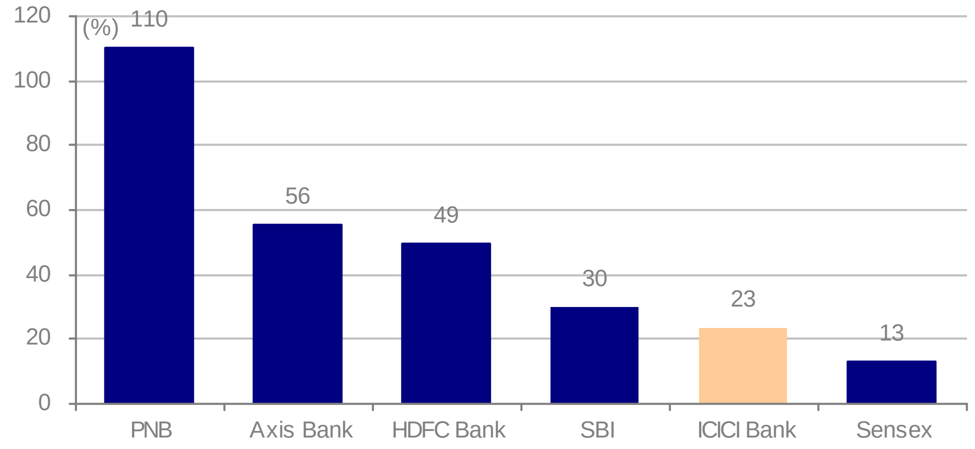
Source: Bloomberg, IIFL Research

Figure 12: Price performance over the past six months



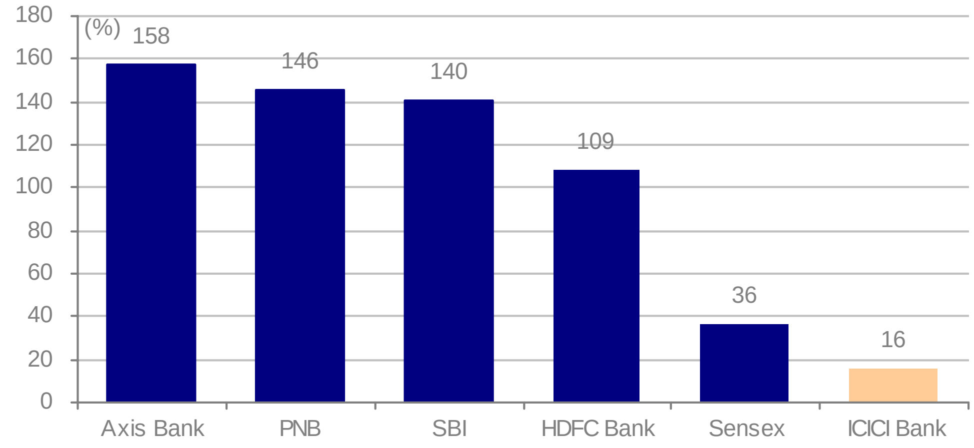
Source: Bloomberg, IIFL Research

Figure 13: Price performance over the past two years



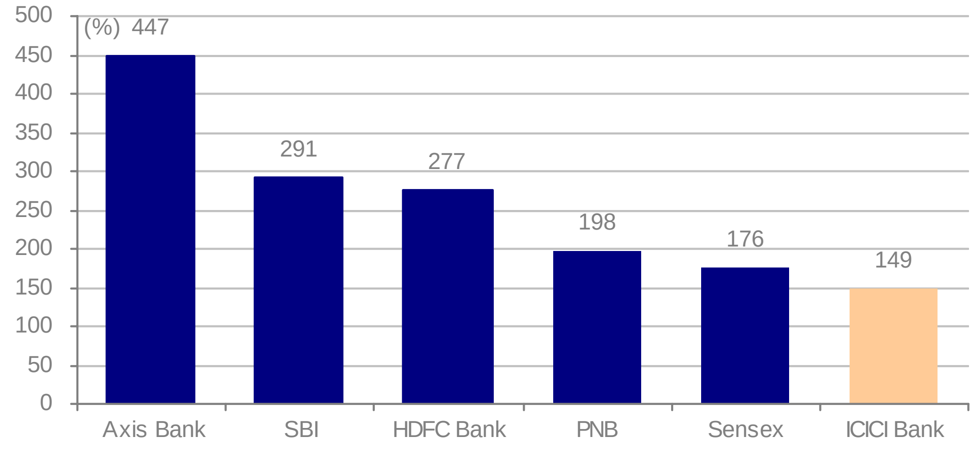
Source: Bloomberg, IIFL Research

Figure 14: Price performance over the past three years



Source: Bloomberg, IIFL Research

Figure 15: Price performance over the past five years



Source: Bloomberg, IIFL Research

Figure 16: Axis Bank's 1-yr-fwd P/B premium over ICICI Bank was in the 20-40% range over the past 15 months, and is likely to continue in the near future

Source: Bloomberg, Companies, IIFL Research

Figure 17: Sum-of-parts valuation – FY11ii

Business	Basis	Rs bn	Multiple (x)	Stake (%)	Value of stake (Rs bn)	% in total	Value/Share (Rs)
Core Banking Business	BV	402	1.6	100	644	69.2	578
ICICI Prudential Life Ins	NBAP	183	12	74	136	14.6	122
ICICI Lombard	PAT	2	20	74	24	2.6	22
ICICI AMC	AuM	675	4	51	14	1.5	12
ICICI Securities	PAT	2	15	100	23	2.5	21
ICICI PD	PAT	2	15	100	29	3.2	26
ICICI Venture Fund	AuM	101	10	100	10	1.1	9
ICICI UK	BV	26	0.8	100	21	2.2	18
ICICI Canada	BV	32	0.8	100	26	2.8	23
ICICI Eurasia	BV	5	0.8	100	4	0.4	3
Total					**930**	**100.0**	**836**

Source: IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Net interest income	73,041	83,666	83,238	90,359	103,307
Fee Income	57,155	56,343	53,530	59,960	68,960
Portfolio gains	18,121	12,864	12,603	13,864	15,943
Others	12,831	6,830	5,820	3,890	4,045
Non-interest income	88,108	76,037	71,953	77,714	88,948
Total operating income	161,149	159,703	155,191	168,074	192,255
Total operating expenses	81,542	70,451	58,960	70,541	81,122
Pre provision operating profit	**79,607**	**89,252**	**96,231**	**97,532**	**111,133**
Provisions for loan losses	27,010	37,500	42,780	33,185	35,199
Other provisions	2,036	582	2,329	2,562	2,818
Profit before tax	**50,561**	**51,170**	**51,122**	**61,785**	**73,115**
Taxes	8,984	13,588	13,292	16,064	19,010
Net profit	**41,577**	**37,581**	**37,830**	**45,721**	**54,105**

Balance sheet summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Net loans & advances	2,256,161	2,183,108	2,073,953	2,322,827	2,671,252
Placements to other banks	86,636	124,302	91,984	103,022	108,173
Cash & equivalents	293,775	175,363	170,685	187,509	207,110
Other interest-earning assets	1,114,543	1,030,583	1,082,112	1,190,323	1,368,872
Total interest-earning assets	**3,751,116**	**3,513,357**	**3,418,734**	**3,803,682**	**4,355,406**
Fixed assets	41,089	38,016	43,719	50,276	57,818
Other assets	205,746	241,636	277,882	305,670	336,237
Total assets	**3,997,951**	**3,793,010**	**3,740,335**	**4,159,628**	**4,749,461**
Customer deposits	2,444,311	2,183,478	2,227,148	2,494,406	2,868,566
Other interest-bearing liabilities	863,986	928,055	833,801	946,131	1,094,010
Total interest-bearing liabilities	3,308,297	3,111,533	3,060,949	3,440,536	3,962,577
Non-interest-bearing liabilities	221,452	182,647	155,250	163,012	192,354
Total liabilities	**3,529,749**	**3,294,179**	**3,216,199**	**3,603,548**	**4,154,931**
Total Shareholder's equity	**468,201**	**498,830**	**524,136**	**556,080**	**594,530**
Total liabilities & equity	**3,997,950**	**3,793,010**	**3,740,335**	**4,159,628**	**4,749,461**

Source: Company data, IIFL Research

Ratio Analysis - I

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Balance Sheet Structure Ratios (%)					
Loans / Deposits	92.3	100.0	93.1	93.1	93.1
Loan Growth	15.2	-3.2	-5.0	12.0	15.0
Growth in Deposits	6.0	-10.7	2.0	12.0	15.0
Growth in Total Assets (%)	16.0	-5.1	-1.4	11.2	14.2
Profitability Ratios					
Net Interest Margin	2.1	2.3	2.4	2.5	2.5
Return on Average Assets	1.1	1.0	1.0	1.2	1.2
Return on Average Equity	11.7	7.8	7.4	8.5	9.5
Non-Interest Income as % of Total Income	54.7	47.6	46.4	46.2	46.3
Net Profit Growth	33.7	-9.6	0.7	20.9	18.3
FDEPS Growth	8.0	-9.7	0.7	20.9	18.3
Efficiency Ratios (%)					
Cost to Income Ratio	50.6	44.1	38.0	42.0	42.2
Salaries as % of Non-Interest costs	25.5	28.0	31.8	31.9	31.9

Ratio Analysis - II

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Credit Quality Ratios (%)					
Gross NPLs as % of loans	3.3	4.3	4.7	4.5	4.1
NPL coverage ratio	52.0	52.8	65.8	70.5	71.7
Total provision charges as % avg loans	1.3	1.7	2.0	1.5	1.4
Net NPLs as % of net loans	1.5	1.7	1.6	1.4	1.2
Capital Adequacy Ratios (%)					
Total CAR	14.0	15.5	17.9	18.5	17.7
Tier I capital ratio	11.8	11.8	14.1	14.4	13.8

Source: Company data, IIFL Research

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.
Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.
