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IPO Note

# ICICI Bank

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Price Band: Rs 885-950

June 19, 2007

## Intermittent dilutions but steady performance

Since April'2004, this is the third time when bank is raising capital to support its business growth. Frequent dilutions deteriorate the earning and return ratios. This raises the concern that weather this aggressive growth is really profitable or not. Here we have tried to look at the sustainable returns which bank can generate with its current pace of growth with meeting its capital adequacy requirement as well.

We find that though intermittent dilutions deteriorate the return ratios but if we look at longer period business growth and resultant need of capital infusion to support such growth to meet the capital adequacy requirement then on sustainable basis we can look forward to RoE of 17.5% for the Bank.

On sum of parts valuations valuation basis we arrive at fair value of Rs. 1118 per share of ICICI Bank with one-year perspective. We recommend subscribing to the issue.

### Issue details

- Issue opens from June 19, 2007 to June 22, 2007
- Domestic issue size Rs. 87500 mn + green shoe Rs. 13125 mn = Rs. 100625 mn
- 5% reserved for retail share holders
- Price band: Rs. 885 - 950

Lower end of price band will result in issuance of 227.4 mn shares while upper end of price band will result in issuance of 211.8 mn shares.

Apart from domestic issue, Bank has also lined up ADR issue of similar size.

### Investment Argument

#### Despite dilutions sustainable returns remain attractive

Since April'2004, this is the third time when bank is raising capital to support its business growth. Frequent dilutions deteriorate the earning and return ratios. This raises the concern that weather this aggressive growth is really profitable or not. Here we have tried to look at the sustainable returns which bank can generate with its current pace of growth with meeting its capital adequacy requirement as well.

Here we have assumed 30% growth in its assets. Given its aggressive growth and lower CASA ratio, we have kept NIM stable at 2.5%. We have also assumed that bank fully utilizes the limit of perpetual debt and tier - II capital. With these assumptions, if bank has to maintain its tier - I capital adequacy at 6%, as stipulated under Basle - II norms, then bank can achieve sustainable RoE of 17.5% with consistent 5% dilution in equity. Thus though intermittent dilutions deteriorate the return ratios but if we look at longer period business growth and resultant need of capital infusion to support such growth to meet the capital adequacy requirement then on sustainable basis we can look forward to RoE of 17.5% for the Bank.



**Sustainable RoE Model**

(Rs)

Year	0	1	2	3	4	5	6	7	8	9	10
Ave Int Earning Assets	100	130	169	220	286	371	483	627	816	1,060	1,379
Ave Total Assets	108	140	182	236	307	399	519	675	877	1,140	1,482
Ave Networth	7.5	7.8	8.2	10.4	13.5	17.7	23.1	29.9	38.7	50.1	65.5
NII	2.5	3.3	4.2	5.5	7.1	9.3	12.1	15.7	20.4	26.5	34.5
Fee	2	2.6	3.4	4.4	5.7	7.4	9.7	12.5	16.3	21.2	27.6
Treasury	0.1	0.1	0.2	0.2	0.3	0.4	0.5	0.6	0.8	1.1	1.4
Operating Expense	2.5	3.3	4.2	5.5	7.1	9.3	12.1	15.7	20.4	26.5	34.5
Operating Profit	2.1	2.7	3.5	4.6	6.0	7.8	10.1	13.2	17.1	22.3	29.0
Prov for NPA	0.4	0.5	0.7	0.9	1.1	1.5	1.9	2.5	3.3	4.2	5.5
Prov for Investments	0.1	0.1	0.2	0.2	0.3	0.4	0.5	0.6	0.8	1.1	1.4
Prov for Stand. Assets	0.4	0.5	0.7	0.9	1.1	1.5	1.9	2.5	3.3	4.2	5.5
PBT	1.2	1.6	2.0	2.6	3.4	4.5	5.8	7.5	9.8	12.7	16.5
Tax	0.36	0.5	0.6	0.8	1.0	1.3	1.7	2.3	2.9	3.8	5.0
PAT	0.84	1.1	1.4	1.8	2.4	3.1	4.1	5.3	6.9	8.9	11.6
ROA (%)	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
ROE (%)	11.2	14.0	17.3	17.7	17.7	17.7	17.6	17.6	17.7	17.8	17.7
NW	8	8	8	10	14	18	23	30	39	50	66
Perpetual debt	1.1	1.2	1.2	1.6	2.0	2.7	3.5	4.5	5.8	7.5	9.8
Tier - I	8.7	9.0	9.4	12.0	15.6	20.3	26.5	34.4	44.5	57.7	75.3
Tier - II	8.7	9.0	9.4	12.0	15.6	20.3	26.5	34.4	44.5	57.7	75.3
Total	17.3	18.0	18.9	24.0	31.1	40.6	53.1	68.7	89.0	115.3	150.7
RWA	91	119	154	201	261	339	441	574	746	969	1,260
Tier - I (%)	9.5	7.6	6.1	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Tier - II (%)	9.5	7.6	6.1	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Total (%)	18.9	15.1	12.2	12.0	11.9	12.0	12.0	12.0	11.9	11.9	12.0

**Valuation of banking business**

Assuming perpetual growth rate of 10% and cost of equity of 13%, we arrive at price to book value multiple of 2.5 for the bank.

We have considered sustainable growth in book value i.e 5% dilution, instead of actual dilution to arrive at fair value of the bank.

**Valuation of banking business**

(Rs m)

Bank's networth - FY 08 (with 5% dilution)	260,854
Core ABV/ share of bank - FY 08	276
Sustainable RoE (%)	17.5
Perpetual growth rate (%)	10.0
CoE (%)	13.0
P/BV multiple	2.5
Value of banking business/ share (Rs)	691

This translates to Rs. 691 as fair value of the bank.



## Valuation of ICICI Financial Services

Confirmed offer of Rs. 26500 mn for 5.9% stake in ICICI Financial Services (holding company for ICICI Bank's stake in its life insurance, general insurance and asset management subsidiaries) translates to value of Rs. 449 bn for the ICICI Financial Services. This translates to value of Rs 384 per share for ICICI Bank.

## Valuation of ICICI Financial Services

5.9% Stake	26,500
Value of ICICI Financial Services	449,153
<i>ICICI Bank's Holding (%)</i>	<i>95.0</i>
Value of ICICI Bank's holding	426,695
Value per share of ICICI Bank (Rs)	384

## Sum of parts valuation and outlook

### Sum of parts valuation

Company	Value/share
ICICI Bank - parent	691
Subsidiaries	
ICICI Financial services	384
ICICI Securities	14
ICICI Ventures	11
ICICI Bank - UK	19
Total Subsidiaries	428
<b>Total</b>	<b>1,118</b>

Thus sum of parts valuations results in fair value of Rs. 1118 per share of ICICI Bank with one-year perspective. We recommend subscribing to the issue.



**Income Statement**

(Rs m)

Y/e March	FY06	FY07	FY08E	FY09E
Interest Earned from Advances	102,066	160,963	226,138	304,776
Interest Earned from Investments	36,928	59,885	79,114	102,282
Others	4,068	9,094	7,576	8,239
<b>Total Interest Income</b>	<b>143,061</b>	<b>229,943</b>	<b>312,828</b>	<b>415,296</b>
Interest expense	95,974	163,585	223,216	294,721
NII	47,087	66,358	89,612	120,575
<i>Growth (%)</i>	<i>65.9</i>	<i>40.9</i>	<i>35.0</i>	<i>34.6</i>
Treasury Income	6,963	4,874	2,437	2,559
NTNII	34,846	54,418	76,815	103,148
Non Interest Income	41,809	59,292	79,252	105,707
<b>Total Income</b>	<b>184,870</b>	<b>289,235</b>	<b>392,080</b>	<b>521,003</b>
<i>Growth (%)</i>	<i>44.1</i>	<i>56.5</i>	<i>35.6</i>	<i>32.9</i>
Operating Expense	50,012	66,906	90,065	120,638
Operating Profit	38,884	58,744	78,799	105,643
<i>Growth (%)</i>	<i>31.5</i>	<i>51.1</i>	<i>34.1</i>	<i>34.1</i>
Core Operating Profit	31,921	53,870	76,362	103,084
<i>Growth (%)</i>	<i>32.5</i>	<i>68.8</i>	<i>41.8</i>	<i>35.0</i>
NPA Provisions	7,947	13,681	18,019	26,124
Investment Provisions	7,767	10,387	1,065	1,964
<b>Total Provisions</b>	<b>7,918</b>	<b>22,264</b>	<b>27,442</b>	<b>38,800</b>
PBT	30,966	36,480	51,357	66,843
Tax Provisions	5,565	5,378	12,839	18,716
<i>Effective Tax Rate (%)</i>	<i>18.0</i>	<i>14.7</i>	<i>25.0</i>	<i>28.0</i>
PAT	25,401	31,102	38,518	48,127
<i>Growth (%)</i>	<i>26.7</i>	<i>22.4</i>	<i>23.8</i>	<i>24.9</i>

**Balance Sheet**

(Rs m)

Y/e March	FY06	FY07	FY08E	FY09E
Par Value	10	10	10	10
No. of equity shares	890	899	1,111	1,111
Equity	8,898	8,993	11,112	11,112
Networth net of RR	222,056	237,463	465,865	497,148
Adj. Networth net of RR	211,529	217,288	437,858	458,039
Deposits	1,650,832	2,305,102	3,126,645	4,226,799
<i>Growth (%)</i>	<i>65.4</i>	<i>39.6</i>	<i>35.6</i>	<i>35.2</i>
Low Cost deposits	375,105	506,479	698,298	948,531
<i>% of total deposits</i>	<i>22.7</i>	<i>22.0</i>	<i>22.3</i>	<i>22.4</i>
<b>Total Liabilities</b>	<b>2,513,890</b>	<b>3,332,352</b>	<b>4,508,487</b>	<b>5,694,607</b>
Gross Advances	1,473,330	1,987,185	2,578,745	3,304,470
Net Advances	1,461,631	1,958,656	2,546,161	3,259,087
<i>Growth (%)</i>	<i>59.9</i>	<i>34.0</i>	<i>30.0</i>	<i>28.0</i>
Investments	715,474	946,467	1,182,542	1,436,414
<b>Total Assets</b>	<b>2,513,890</b>	<b>3,332,575</b>	<b>4,508,487</b>	<b>5,694,607</b>



## Key Ratios

Y/e March	FY06	FY07	FY08E	FY09E
<b>Profitability</b>				
Cost of Deposit	4.4%	5.5%	6.2%	6.4%
Yield on advances	8.6%	9.4%	10.0%	10.5%
Yield on Investments	6.1%	7.2%	7.4%	7.8%
NIM	2.4%	2.4%	2.5%	2.6%
RoA	1.2%	1.1%	1.0%	0.9%
RoE	14.6%	13.5%	11.0%	10.0%
Ro Adj E	15.8%	14.5%	11.8%	0.0%
Treasury gains as % of Total income	3.8%	1.7%	0.6%	0.5%
Treasury gains as % of OP	17.9%	8.3%	3.1%	2.4%
<b>Efficiency</b>				
Cost-Income ratio	56.3%	53.2%	53.3%	53.3%
Burden	16.4%	11.4%	12.0%	12.4%
C-D ratio	88.5%	85.0%	81.4%	77.1%
SLR as % of NDTL	30.3%	30.3%	29.5%	28.0%
SLR as % of investments	71.4%	76.6%	79.7%	82.0%
Business per Employee	122.6	146.1	173.5	204.4
Net Profit per Employee	1.0	1.1	1.2	1.3
Business per Branch	5,069	6,270	7,564	9,129
Net Profit per Branch	41.4	45.7	51.4	58.7
<b>Asset Quality</b>				
Gross NPAs	22,226	48,703	60,591	84,493
Net NPAs	10,527	20,174	28,008	39,109
Gross NPAs to Gross Advances	1.5%	2.5%	2.3%	2.5%
Net NPAs to Net Advances	0.7%	1.0%	1.1%	1.2%
NPA Coverage %	51.4%	58.6%	76.8%	76.7%
<b>Valuation</b>				
CMP	920	920	920	920
Equity	8,898	8,993	11,112	11,112
Market Cap	818,648	827,393	1,022,286	1,022,286
Market Cap to AUM	32.6%	24.8%	22.7%	18.0%
EPS	32.2	34.8	38.3	43.3
Book Value	249.5	264.0	419.3	447.4
Adjusted Book Value	237.7	241.6	394.0	412.2
P/E	28.5	26.5	24.0	21.2
P/BV	3.7	3.5	2.2	2.1
P/ABV	3.9	3.8	2.3	2.2
DPS	8.5	10.8	10.8	13.4
Payout ratio (incl. Div Tax)	34.1%	35.2%	35.0%	35.0%
Dividend Yield	0.9%	1.2%	1.2%	1.5%

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