Equity Research Asia Pacific

ICICI Bank

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New frontiers

ICICI Bank continues to find new business opportunities and execute them aggressively in a rapidly growing economy, creating significant long-term value. Profitability remains below that of its peers, but is improving. We initiate coverage with an OUTPERFORM rating and target price of Rs985.

- **Rapidly widening footprint.** ICICI Bank is a market leader in retail banking and has successfully spawned non-bank businesses. It is now embarking on significant rural banking plans and has already established a presence in international banking. It has also established a robust liabilities franchise, with strong growth and market share gains in savings and current deposits. However, the aggressive asset growth ambitions mean that liquidity tightening could be a risk to growth and profitability, although we expect adequate liquidity in the system.
- **What about profitability?** ICICI Bank's earnings profile is improving – margins are likely to rise modestly, but remain well below those of its peer banks. ICICI Bank's funding costs are higher, and its loan yields are lower, due to aggressive growth and a different business mix. Lower margins are partly compensated by lower operating costs – a benefit of scale and technology. Credit costs should also be lower than HDFC Bank's due to the different loan mix, but we forecast provisioning should rise substantially as the retail book seasons and growth slows. Fee performance has been impressive. ROEs and operating profitability is also rising, along with strong EPS growth.
- **Value from all parts.** We have valued ICICI Bank at Rs985/share on a sum of the parts, as we think it would best capture the value of its diverse business lines. We attribute a 2.75x FY3/08 BV multiple to the core banking business, on an estimated underlying 18.5-19% ROE, or Rs712 per share, and Rs272 for its subsidiaries. The stock has outperformed the Sensex over the past three to six months. We believe the rapidly diversifying business and asset franchise, together with strong earnings growth of 25-28% over two years and rising ROEs in a strong economic environment would support higher valuations. We initiate coverage with an OUTPERFORM rating and a target price of Rs985.

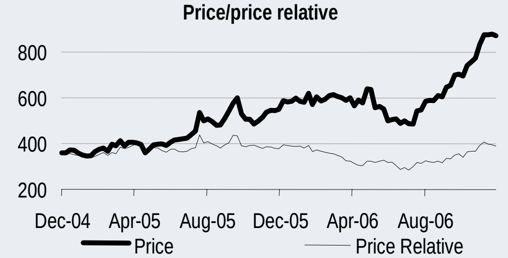
ICICI Bank has become the second-largest commercial bank in India in asset size following the merger with ICICI. On an asset base of Rs1,253 bn (US$28.1 bn), it has 450 branches with 11,500 employees.

For a full list of companies mentioned in this report, please see page 19

Rating	**OUTPERFORM***
Price (07 Dec 06)	**870.85 (Rs)**
Target price (12 months)	**985.00 (Rs)**
Market cap (Rs mn)	**778,011.29 (US$ 17,459.86)**
Enterprise value (Rs mn)	**778,011.29**
52-wk price range	**887.75 - 454.50**
Region/Country	**Asia Pacific/India**
Sector	**Regional Banks**
Date	**8 December 2006**

** Stock ratings are relative to the relevant country index.*

Price/price relative



The price relative chart measures performance against the BOMBAY SE 30 SHARE SENSITIVE index
On 07/12/06 the BOMBAY SE 30 SHARE SENSITIVE index closed at 13972.03
On 07/12/06 the spot exchange rate was Rs44.56/US$1

Performance over	1M	3M	12M
Absolute (%)	**13.1**	**43.5**	**60.5**
Relative (%)	**6.5**	**21.7**	**2.2**

Year	3/06A	3/07E	3/08E	3/09E
Pre-provision profit (Rs mn)	**38,913.3**	**59,653.9**	**81,196.4**	**108,576.9**
Pre-tax profit (Rs mn)	**30,966.1**	**41,057.8**	**56,558.5**	**72,825.6**
Net attributable profit	**25,400.7**	**32,025.1**	**41,287.7**	**50,977.9**
EPS (CS adj., Rs)	**30.56**	**35.30**	**45.51**	**56.19**
CS adj. BVPS (Rs)	**249.55**	**275.28**	**310.28**	**355.03**
ROE (%)	**14.62**	**13.71**	**15.85**	**17.22**
P/E (adj., x)	**28.5**	**24.7**	**19.1**	**15.5**
P/B (x)	**3.49**	**3.16**	**2.81**	**2.45**

Dividend (3/07E, Rs)	**9.00**	Free float (%)	**100.00**
Dividend yield (3/07E, %)	**1.03**	Number of shares (mn)	**893.39**
LTD ratio (3/07E, %)	**86.99**	Total capital ratio (3/07E, %)	**12.42**
Cost/income (3/07E, %)	**54.47**	Tier 1 ratio (3/07E, %)	**8.48**
Net interest margin (3/07E, %)	**2.04**	Reserves/NPL (3/07E, %)	**87.89**
ROA (3/07E, %)	**1.08**	NPL/gross loans (3/07E, %)	**1.60**

Source: Company data, Thomson Financial Datastream, Credit Suisse estimates

Research team

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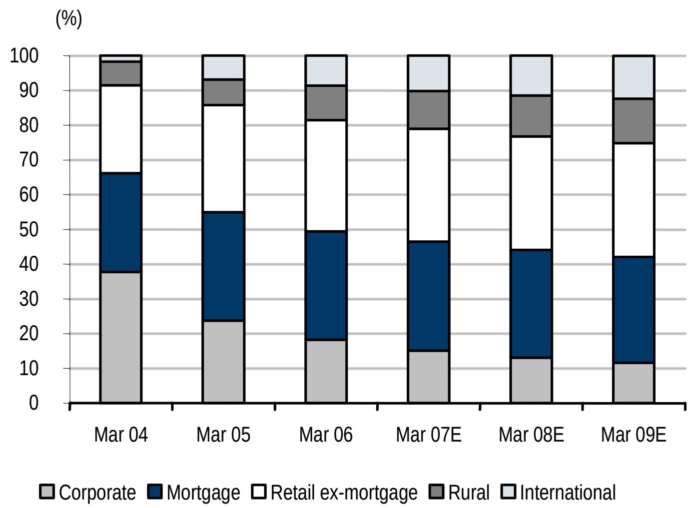
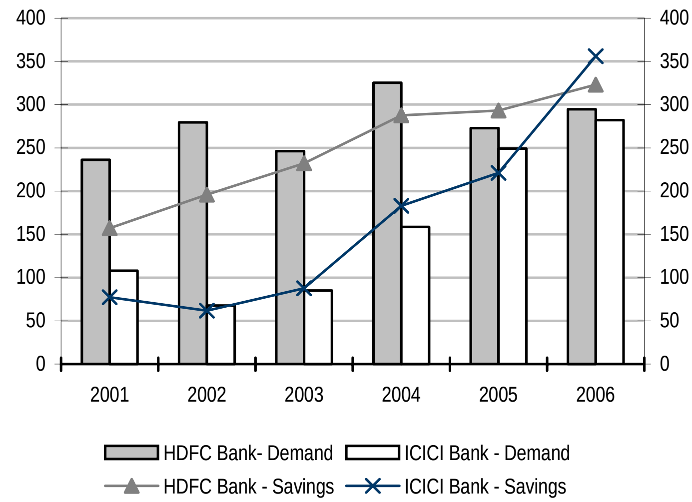
Focus charts

Figure 1: Rapidly diversifying business mix



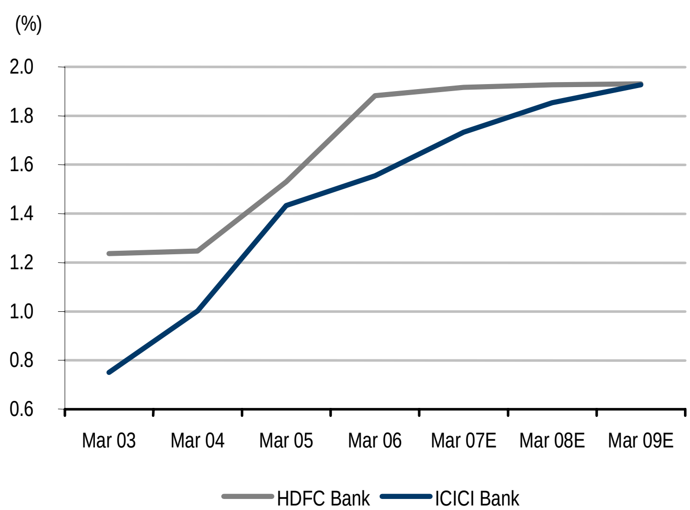
Source: Company data, Credit Suisse estimates

Figure 2: Strong low-cost deposits franchise



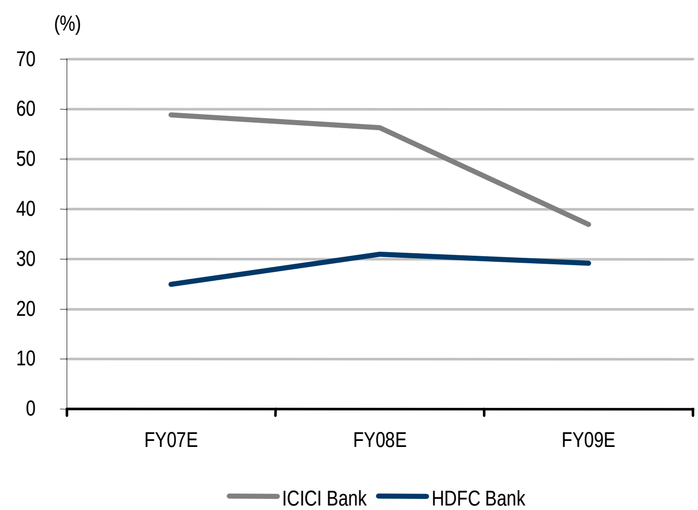
Source: Company data, Credit Suisse estimates

Figure 3: Rapidly growing fee income



Source: Company data, Credit Suisse estimates

Figure 4: Strong growth in core operating profit



Source: Company data, Credit Suisse estimates

Figure 5: Sum-of-the-parts valuation

Business	Basis	Year	Multiple	Value per share	Comments
Core banking business	BV	FY08	2.75	712.3	Based on about a 18.5-19% underlying ROE for core operations
Overseas banking subsidiaries	BV	FY06	2.5	32.8	Discount to core operations, on FY06 BV, relatively lower profitability in investment phase
Investment banking	PAT	FY08	10	22.8	Cyclical business, at a high point in the cycle currently
Asset management (%)	AUM	FY08	5	17.4	M&A transactions in industry in the past at 4-6% of AUM
Private equity (%)	AUM	FY08	10	16.8	Higher return potential, and higher growth in the near future, than mutual funds
Life insurance	NBAP	FY08	15	174.3	Factoring 90% growth in FYP in FY07E and 60% in FY08E, at a 20% NBAP margin
Non-life insurance	PAT	FY08	14	8.2	
Total				985	

Source: Company data, Credit Suisse estimates

Financial summary

Figure 6: Financial summary

Year-end 31 Mar (Rs mn)	FY05	FY06	FY07E	FY08E	FY09E
Income statement					
Interest income	97,819	135,055	219,015	297,101	391,717
Interest expenses	65,709	95,974	162,488	219,391	288,026
Net interest income	32,110	39,080	56,526	77,710	103,692
Fee income	20,980	32,569	51,219	72,871	98,854
Operating income	53,090	71,650	107,745	150,581	202,545
Operating cost	33,742	47,259	63,397	85,700	111,704
Pre-provision operating profits	19,349	24,391	44,348	64,880	90,841
Loan loss provisions	(1,214)	7,947	18,596	24,638	35,751
Operating profits	20,476	16,217	25,752	40,243	55,090
Non operating items	4,796	14,749	15,306	16,316	17,736
Pre-tax profits	25,272	30,966	41,058	56,559	72,826
Taxes	5,220	5,565	9,033	15,271	21,848
PAT	20,052	25,401	32,025	41,288	50,978
Balance sheet					
Total cash	129,300	170,402	246,969	331,633	438,218
Total investments	504,874	715,474	904,140	1,158,641	1,507,465
Total advances	914,051	1,461,631	2,030,162	2,704,364	3,496,264
Fixed assets	40,380	39,807	47,769	59,711	71,653
Other assets	87,989	126,575	164,548	213,912	278,086
Total assets	1,676,594	2,513,890	3,393,587	4,468,260	5,791,686
Net worth	125,499	222,060	244,955	276,099	315,918
Sub/hybrid debt	82,089	101,444	149,472	169,472	196,972
Total	998,188	1,650,832	2,333,763	3,204,500	4,304,961
Total borrowings	335,445	385,219	465,811	559,779	638,950
Other liabilities/provisions	131,873	150,835	196,086	254,911	331,385
Total liabilities	1,676,593	2,513,890	3,393,587	4,468,260	5,791,686
Key ratios	-	-	-	-	-
NIM (net of amortisation, %)	2.40	2.01	2.04	2.11	2.15
Credit costs as % of average loans	(0.16)	0.67	1.07	1.04	1.15
Operating expenses as % of average assets	2.30	2.26	2.15	2.18	2.18
ROAA, (%)	1.4	1.2	1.1	1.1	1.0
ROAE, (%)	19.5	14.6	13.7	15.8	17.2
Tier I (%)	7.59	9.20	7.79	6.75	6.12
EPS, Rs	27.2	28.5	36.0	46.4	57.3
EPS (% change)	2.5	5.4	26.1	28.9	23.5
BVPS, Rs	170.4	249.6	275.3	310.3	355.0
DPS, Rs	8.5	8.5	9.0	10.0	11.0

Source: Company data, Credit Suisse estimates

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Rapidly widening footprint

ICICI Bank has been at the forefront of creating growth opportunities in a rapidly expanding and broadening financial services sector. The bank's retail assets strategy has worked well – it is a market leader across products. ICICI Bank has also successfully spawned non-bank businesses – insurance, fund management and investment banking. It is now embarking on significant rural banking plans, and has already established a presence in international banking. It has also established a robust liabilities franchise, with strong growth and market-share gains in savings and current deposits. However, the aggressive asset growth ambitions mean that liquidity tightening could be a risk to growth and profitability, though we expect adequate liquidity in the system.

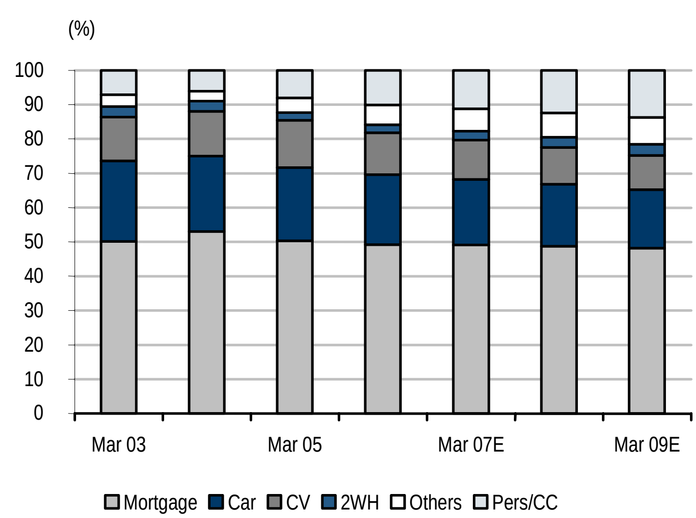
At the forefront of a rapidly expanding financial sector

Management has demonstrated its ability to strategise and enter new business segments, and with strong execution skills to grow aggressively. ICICI Bank is diversifying its business presence very rapidly – it is the second-largest bank in India, and is growing fast and increasing market share across segments. The legacy project portfolio is now a small part of the overall business.

Market leader for retail banking

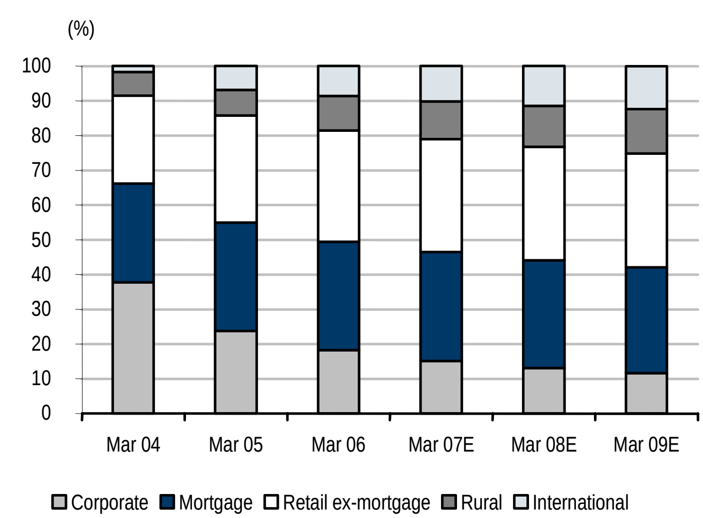
The bank has successfully executed its retail assets strategy – the bank is a leader across all retail lending segments – it has attained significant scale and reduced operating costs, although profitability of this business is still not fully clear. Management has said that retail loans are likely to decline in proportion to the balance sheet. We believe this is likely to result in a higher focus on profitability, something already reflecting in higher auto and CV spreads in the past nine to 12 months.

Figure 7: **Mix of retail loans**



Source: Company data, Credit Suisse estimates

Figure 8: **Loan mix**



Source: Company data, Credit Suisse estimates

Not just banking

Strong insurance and mutual fund businesses and growing venture capital presence

Growth has been spread across other financial services businesses. The life insurance subsidiary is a leader within private life insurance players (with a 30% market share, and about 8-10% overall). The mutual fund is also among the top three mutual fund companies in the country. ICICI Bank's venture capital business is now also growing fast, with almost Rs63 bn under management (as at March 2006), with a strong focus on real estate private equity opportunities. The bank has also successfully seeded a BPO and an IT services company. Management is now focusing on the future growth drivers: international and rural banking.

Strong start in international business

The US will be a large potential market, once regulations are in place

International expansion has been a focus area for the past two to three years, and has grown rapidly. Lending through international branches forms 9% of loans, while together with the international subsidiaries, the business contributes about 15% of loans. Fees from international operations contribute about 12% of fees (standalone). ICICI Bank is already present in ten countries, key among which are Singapore, Hong Kong, the UK, Canada, Bahrain and Russia, with retail banking services in the UK and Canada. The US is a large market where the bank intends to enter once regulatory clearances are in place. The key drivers for this business have been the NRI segment, remittances and Indian companies expanding their business horizons outside India. The bank has a 20% market share in inward remittances to India, and plans to extend this product offering to other countries as well. We believe the bank also has a major presence in the syndication of loans of Indian companies overseas.

Rural opportunities – the next big thing?

Large opportunity, but execution challenging

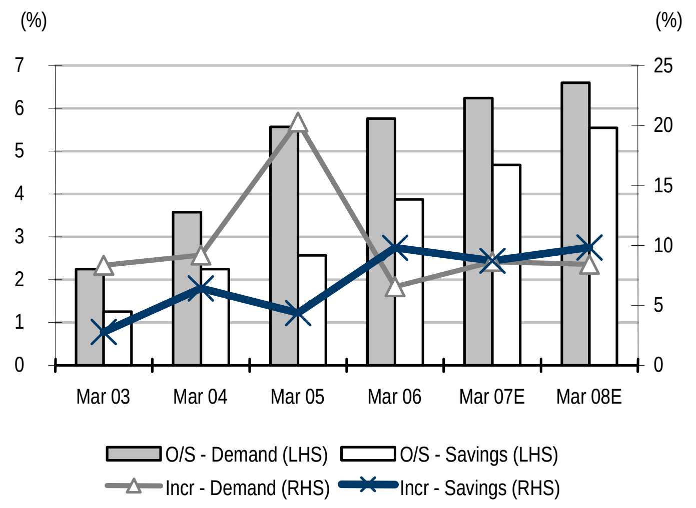
The bank is now targeting rural India as the next big growth driver – it believes that 50% of GDP comes from the rural areas, and is a vast opportunity. The rural lending book is already about Rs140 bn (at March 2006, excluding retail in rural areas). Management has indicated that rural business could grow to about 20% over the next three to four years. The bank aims to adopt a partnership model with micro-credit agencies and companies, and use rural dealers and Internet kiosks for asset businesses. It is developing low-cost technology operating platforms which should enable the bank to scale up operations. The bank is targeting all customer segments – corporate, retail farmers and small businesses and micro credit. It is also experimenting with risk sharing arrangements for certain products.

A robust liabilities franchise, but liquidity still a risk

Rapid growth and rising market share

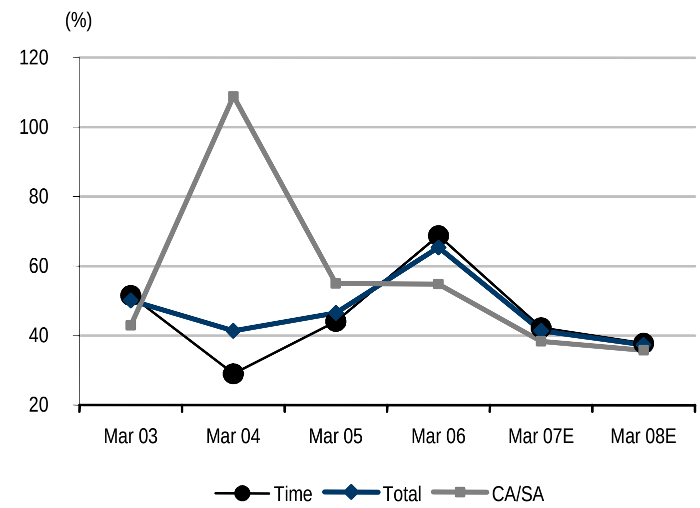
ICICI bank has developed a robust liabilities franchise very rapidly (over the past three to four years). Savings deposits have had a CAGR of 55% over the past four years, and continue to grow at over 45% even off the high base. Demand deposits have also had a CAGR of 57% over the same period. ICICI Bank's market share of savings and current deposits has risen steadily over the same period.

Figure 9: ICICI Bank – market share of demand and savings deposits



Source: Company data, Credit Suisse estimates

Figure 10: Deposit growth

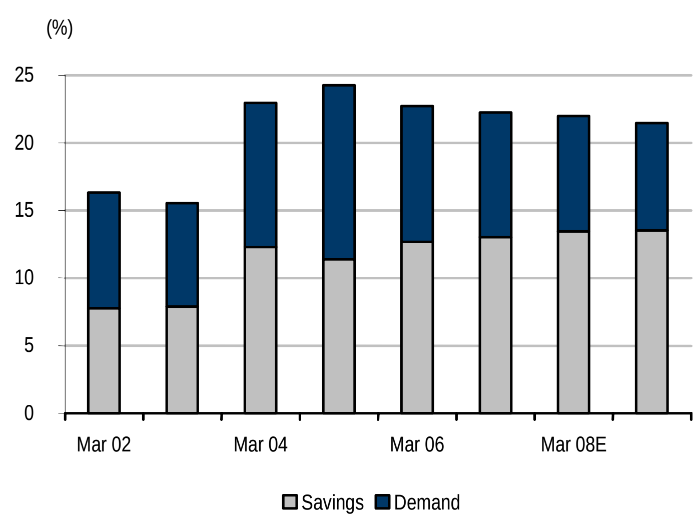


Source: Company data, Credit Suisse estimates

CASA per branch is comparable to HDFC Bank's

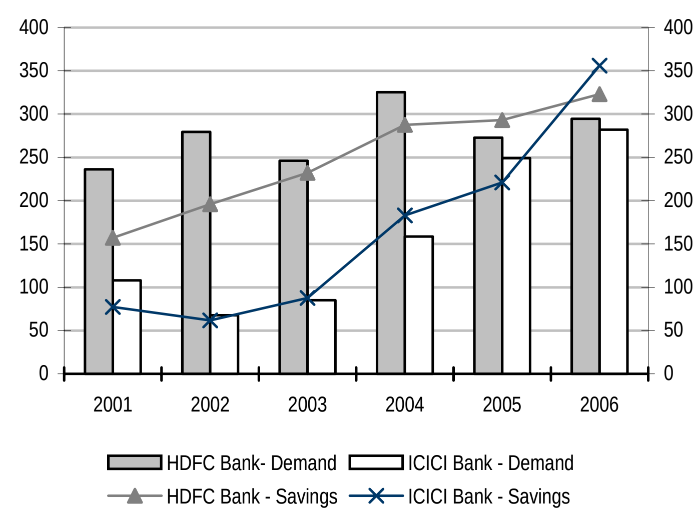
ICICI Bank's deposit profile is actually similar to HDFC Bank's, the best in class in the industry, compared on low-cost deposits per branch – indicating a very strong performance on the liabilities platform. However, this strong performance does not reflect in a strong deposit mix on the balance sheet.

Figure 11: Demand and savings balances a percentage of deposits



Source: Company data, Credit Suisse estimates

Figure 12: Demand and savings deposits per branch (Rs mn)



Source: Company data, Credit Suisse estimates

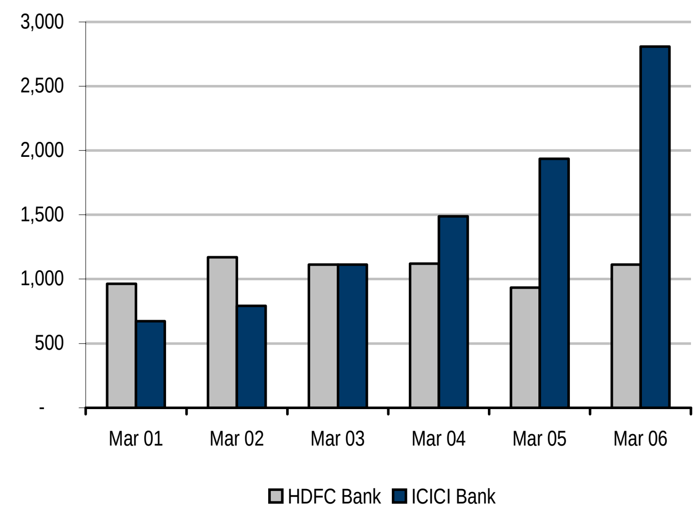
The need to grow time deposits aggressively

The share of demand and savings deposits in its overall deposit base has not increased, and remains at a below-industry average of 23%. This is largely on account of the bank's strong growth ambitions on its asset side over the past three to four years, which has required ICICI Bank to grow its time deposits book very aggressively – time deposits rose 70% in FY3/06, and have risen at a CAGR of 48% over the past four years. A part of the high growth has also been to replace the maturing borrowing of the erstwhile parent balance sheet, but that portion has come down significantly. In FY3/06, the securitisation market also slowed, further increasing the need for ICICI Bank to raise time deposits to match asset growth.

Significant proportion of wholesale term deposits

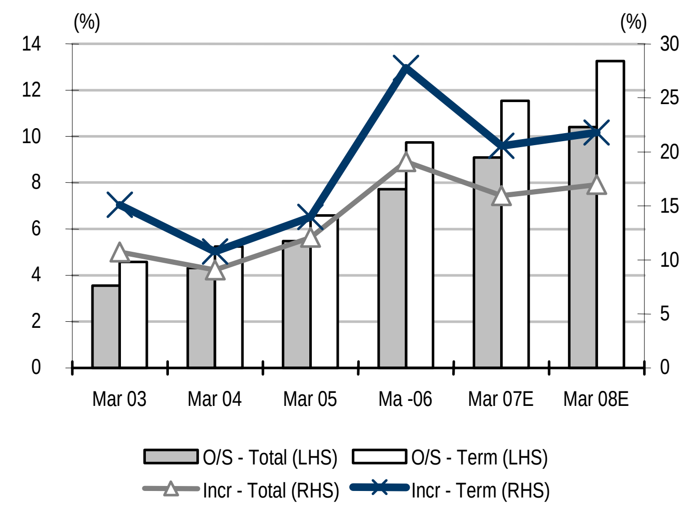
Consequently, ICICI Bank's market share in time deposits has been particularly high, especially in FY3/06, and its deposit base per branch is much higher than that of HDFC Bank. A significant portion of the time deposits is being funded through wholesale sources, which is a rate-sensitive segment and can be volatile.

Figure 13: **Deposits per branch (Rs mn)**



Source: Company data, Credit Suisse estimates

Figure 14: **ICICI Bank – market share of time and total deposits**



Source: Company data, Credit Suisse estimates

We see adequate liquidity, but it is a significant risk

Relatively poor liability mix means that tight liquidity is a significant risk

We expect ICICI Bank's incremental market share in time deposits to remain high (about 20% in FY3/07-08), to enable the bank to fund the estimated asset growth. A significant portion of this would continue to be funded by wholesale term deposits – a risk if liquidity in the banking system reduces significantly.

We believe that liquidity in the banking system is adequate to support growth over the next 12-18 months, barring temporary mismatches, and upside surprises are possible. However, if liquidity does tighten, ICICI Bank would have to pay slightly above the market for wholesale term deposits to maintain growth rates, impacting our earning estimates. A substantial tightening would also mean that the bank may not be able to fund estimated loan growth.

What about ROE?

ICICI Bank's earnings profile is improving – margins are likely to rise modestly, but remain well below those of its peer banks. ICICI Bank's aggressive growth and different mix of business relative to its peers has meant that its funding costs are higher and its loan yields are lower. Lower margins are partly compensated by lower operating costs – a benefit of scale and technology. Credit costs should also be lower (than HDFC Bank) due to the different loan mix, but we forecast provisioning should rise substantially as the retail book seasons and growth slows. Fee performance has been impressive. And though they will remain below HDFC Bank's robust levels, ROEs and operating profitability is also rising, along with strong EPS growth.

Rising, but low, margins – trade-off for growth and scale

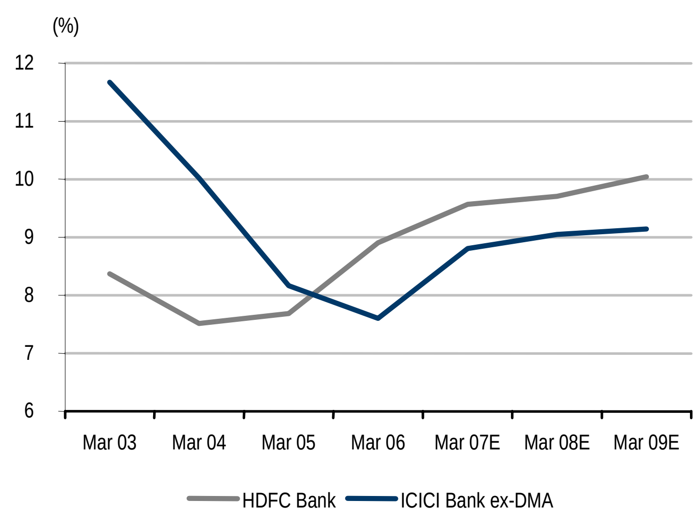
Low asset yields – mix is different

ICICI Bank's loan yields historically were high – its balance sheet was carrying a substantial portion of the legacy project lending portfolio, while the share of retail was relatively low. HDFC Bank, by comparison, had a low-risk and lower yielding corporate portfolio, and lower yielding retail segments like auto and commercial vehicle (CV) loans.

Low yields because of mortgages and international businesses

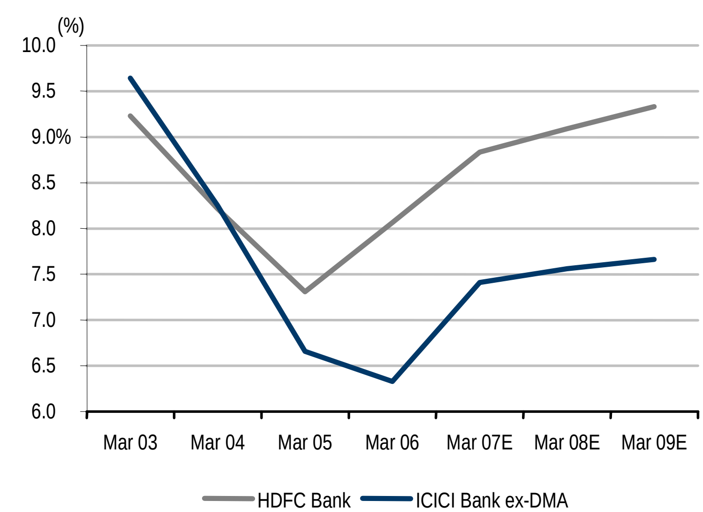
Multiple factors have contributed to the decline in ICICI Bank's yields (adjusted for DMA charges on retail loans) over the past three to four years, both in absolute terms and relative to peers (HDFC Bank): 1) retail lending has increased substantially, and is dominated by lower yielding segments such mortgages, auto and CVs, 2) HDFC Bank's retail lending has also risen, it has a much larger share of higher yielding personal, credit card and business banking segments and 3) international branches contributes about 9% of loans – interest yields are lower, and so the nature of lending is also lower spread.

Figure 15: Loan yield



Source: Company data, Credit Suisse estimates

Figure 16: Yield on interest earning assets



Source: Company data, Credit Suisse estimates

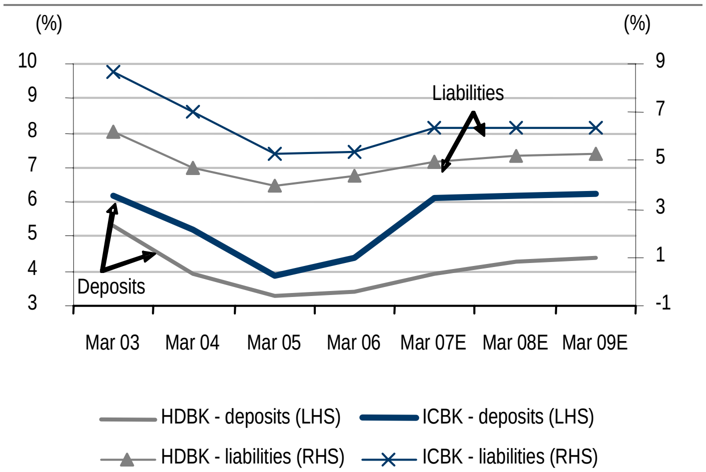
Cost of funding is a significant disadvantage

ICICI Bank's relatively poor deposit profile – a low level of savings and current account deposits – is reflected in its funding cost advantage relative to its peers such as HDFC

Bank. The funding cost disadvantage tends to narrow in periods of easy liquidity and low interest rates, but tends to widen substantially as liquidity tightens and rates rise – the value of the low cost deposit franchise rises significantly. With interest rates (government bond yields and the reverse repo rate) having risen over the past two to three years, we forecast ICICI Bank's funding cost disadvantage is likely to widen.

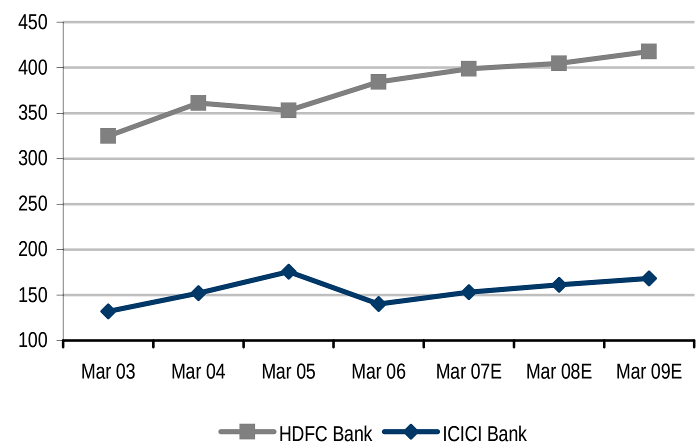
However, the disadvantage on funding cost on the entire interest bearing liability base is not likely to widen as much because: 1) liabilities of the legacy project finance balance sheet are being replaced, even after rates having risen, by lower cost deposits (though the proportion to the balance sheet has declined substantially) and 2) international liabilities are at a lower cost (though the corresponding margin is also lower).

Figure 17: Cost of deposits and interest-bearing liabilities



Source: Company data, Credit Suisse estimates

Figure 18: Net interest margin (ex-DMA and ex-amortisation)



Source: Company data, Credit Suisse estimates

Margins to rise, but remain well below those of HDFC Bank

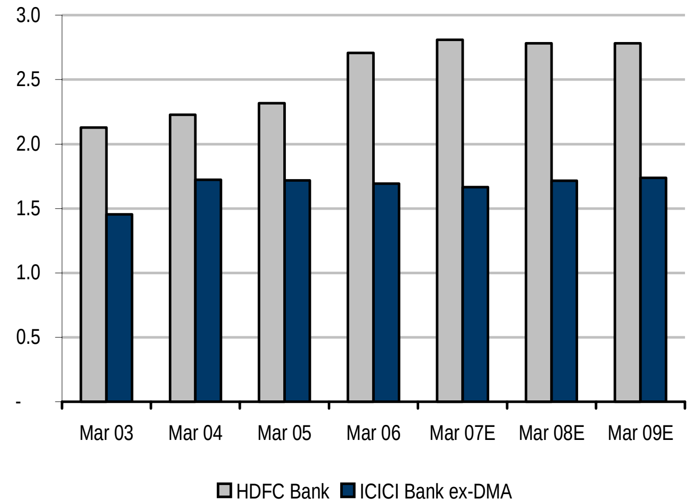
We forecast ICICI Bank's margins to rise modestly over the next two to three years, on: 1) a modest rise in the proportion of personal and credit card loans 2) the rising proportion of rural lending and 3) interest spreads on securitised loans, which would accrue to the bank over the life of the asset. However, margins are likely to remain substantially below those of its peer banks. We believe this reflects ICICI Bank's significant growth objectives, which weigh on funding costs, and are a clear trade-off with margins. However, it also reflects: 1) ICICI Bank's dominant presence in lower risk and larger scale segments like mortgages, auto and CV financing and 2) its lower spread in international banking.

Benefits on operating and credit costs

Scale benefits telling on operating costs

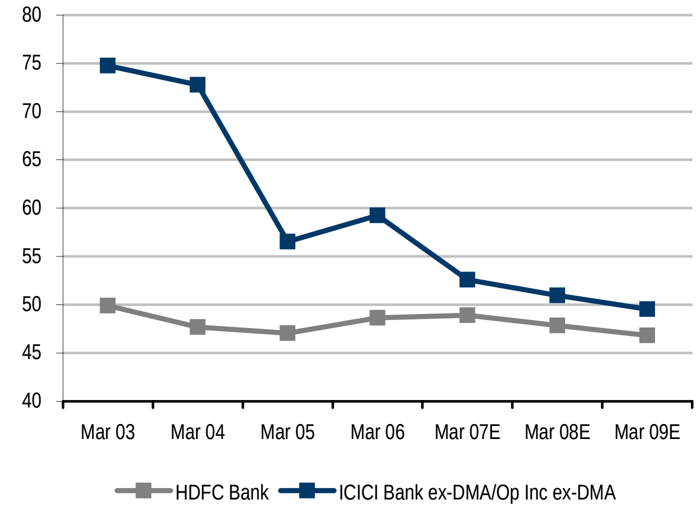
ICICI Bank's substantially lower margins are partially compensated for by operating expenses (ex-DMA charges), which are substantially lower than those of its peer banks (e.g. HDFC Bank) as well as the sector average. The bank is benefiting from: 1) the scale it has been able to achieve on the asset side, especially on retail lending and 2) its adoption of technology, especially relative to government banks. This reflects in the sharp decline in operating costs (as a percentage of operating income), which are now only marginally higher than its peer banks, despite the investments it is making for its rural initiative.

Figure 19: **Operating costs as a percentage of average assets**



Source: Company data, Credit Suisse estimates

Figure 20: **Operating costs as a percentage of operating income**



Source: Company data, Credit Suisse estimates

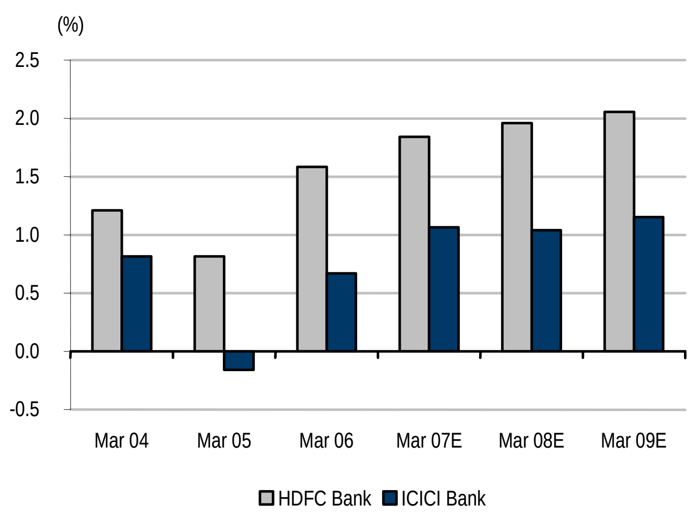
Different loan mix, lower credit costs can be sustained

Provisions to rise as retail book seasons, but will remain lower than those of HDFC Bank

HDFC Bank's higher loan loss provisions are because of: 1) its different asset mix – more tilted towards higher loss segments and 2) ICICI Bank's use of existing balance sheet provisions until FY3/06 (these have now run off), and lower provision cover. We believe that in the future, ICICI Bank will need to raise its provision level substantially as its retail book seasons after four to five years of very rapid growth. Provisions already rose in 1H FY3/07.

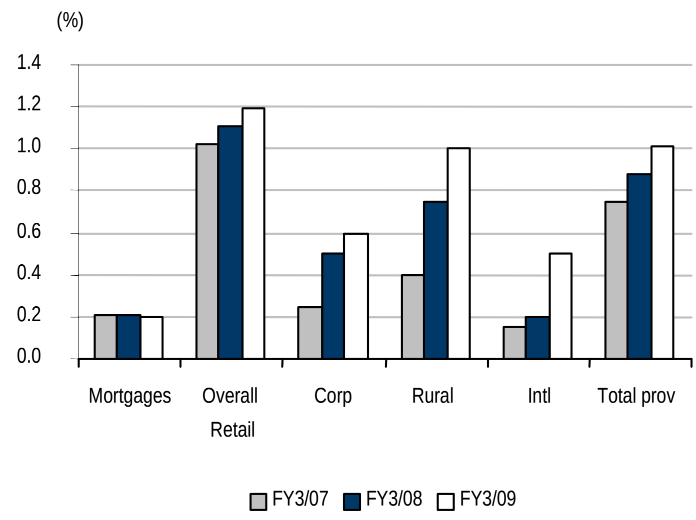
However, we believe ICICI Bank's credit costs would remain lower than those of HDFC Bank – reflecting the higher proportion of low risk mortgage and international lending. We highlight below our expectations for credit costs for different lending segments.

Figure 21: **Loan loss provisions as a percentage of average loans**



Source: Company data, Credit Suisse estimates

Figure 22: **Credit cost assumptions by segment**



Source: Company data, Credit Suisse estimates

Low specific provision cover is a risk

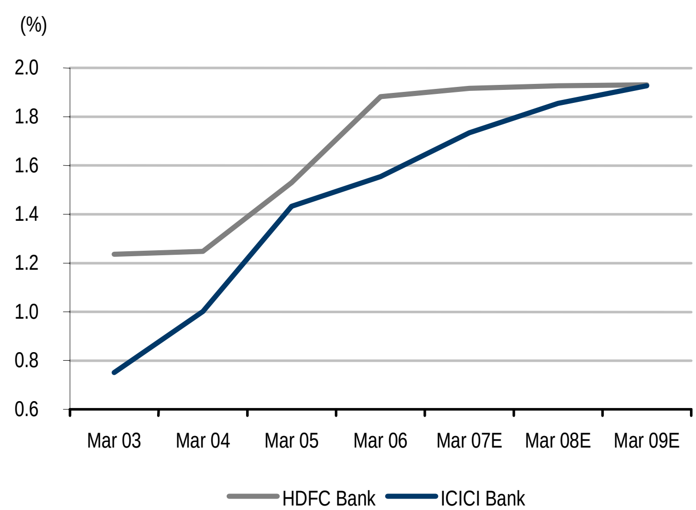
Our estimates are based on our expectation that the asset environment remains benign. ICICI Bank's NPLs have risen in the past two quarters – while we do not believe this is a cause for concern yet, it does warrant a closer watch for a turn in the cycle. The bank remains exposed to a sudden deterioration in the asset quality, or growth, environment. The bank has three areas of possible stress: 1) a relatively unseasoned retail portfolio, with a rising personal and credit card book, and a nascent rural lending initiative 2) the NPL book, which currently has a low specific provision cover of 50% and 3) net restructured loans (project loans) of about Rs53 bn and Rs21 bn of securities from Asset Reconstruction Company of India (ARCIL) (not listed). HDFC Bank, and all the other banks, are also exposed to a sudden change in the environment, but HDFC Bank's coverage is substantially higher (over 100% including general provisions).

Similar fee, despite much larger balance sheet

Broad-based fee franchise – a key highlight of the financial performance

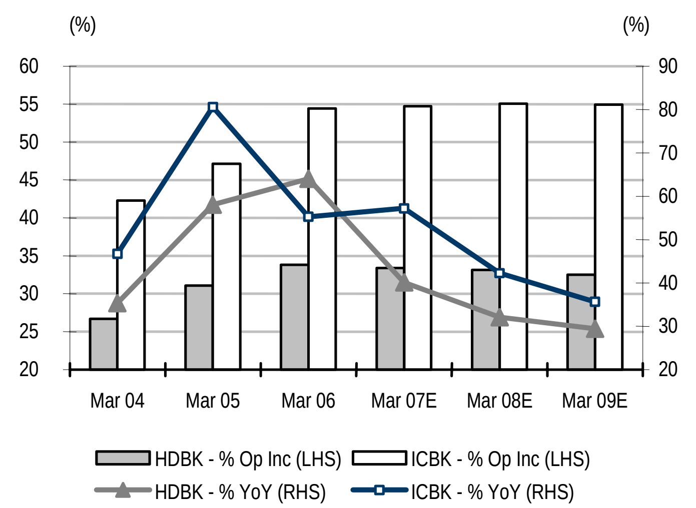
ICICI Bank's fee performance has been extremely robust, with growth averaging 60% annually for the past three years, and continuing at robust rates even in FY3/07. The fee business has seen growth from all segments, driven by the international and retail segments, with wholesale continuing to grow at a steady pace. Retail, wholesale and international segments account for 58%, 30% and 12% of fees now, respectively.

Figure 23: **Fee income as a percentage of average assets**



Source: Company data, Credit Suisse estimates

Figure 24: **Fee income as a percentage of operating income and percentage growth YoY**



Source: Company data, Credit Suisse estimates

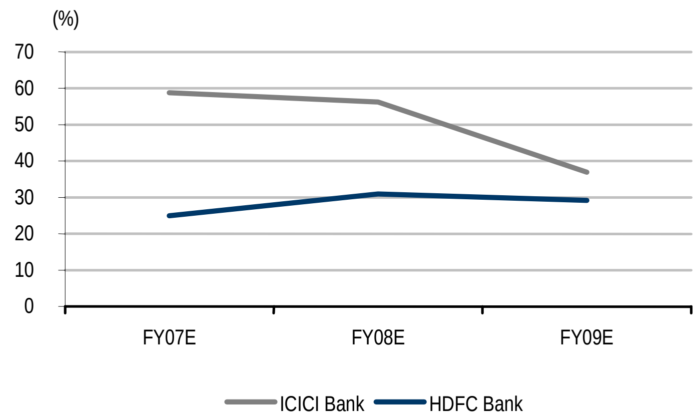
Despite a much larger balance sheet (relative to HDFC Bank), fee income is only modestly lower and accounts for a much larger portion of operating income (largely due to the lower net interest income). We expect fees (as a percentage of average assets) to continue to rise, driven by continuing market share improvement in liabilities, rapidly growing insurance and mutual fund distribution, and the newer international and rural thrusts.

We see strong growth in core operating profits

Improving profitability, but still lags peers

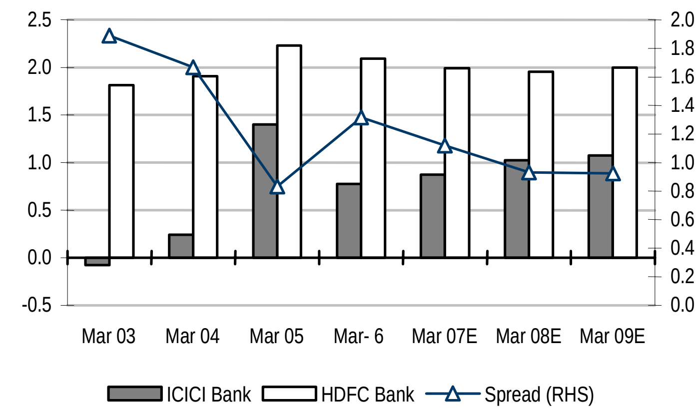
We expect ICICI Bank's core operating profitability (excluding trading and other non-operating items) to improve over the next two to three years, driven by the improvement in margins and fee income, stable costs and rising provisions. Driven by asset growth, growth in operating profits should also be strong, and well above peer banks and the sector's average. However, we believe that ICICI Bank's operating profitability will continue to lag that of its peers, such as HDFC Bank.

Figure 25: Growth in core operating profit



Source: Company data, Credit Suisse estimates

Figure 26: Core operating profit as a percentage of average assets

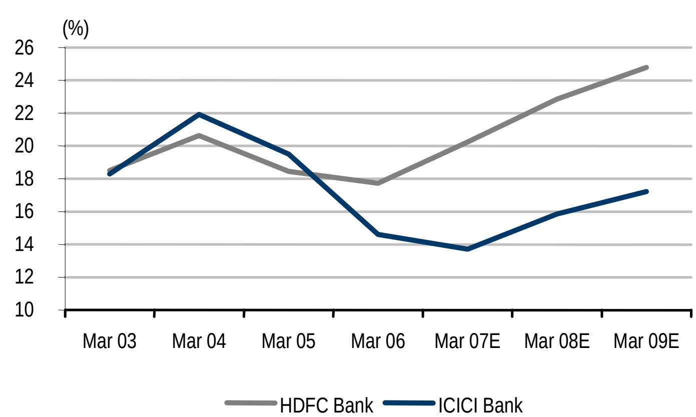


Source: Company data, Credit Suisse estimates

Strong earnings growth and improving ROE, but still lags

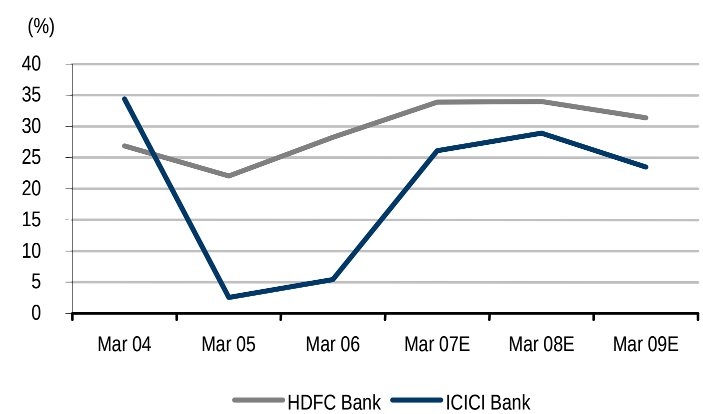
We forecast strong EPS growth too, although we believe it will be lower than operating profit growth, as we expect ICICI Bank's tax rate to rise and contributions from non-operating and trading income to decline. We also forecast ICICI Bank's ROE to improve over the next two years to about 16% in FY3/08E and 17% in FY3/09E, but remain substantially below those of its peer banks. We believe this reflects management's focus on very strong growth, and investing in newer growth areas continuously.

Figure 27: Return on equity



Source: Company data, Credit Suisse estimates

Figure 28: EPS growth



Source: Company data, Credit Suisse estimates

Value, from many parts

We have valued ICICI Bank at Rs985 on a sum-of-the-parts valuation, as we believe this is the best way to capture the value of its diverse business lines. We attribute a 2.75x FY3/08 book value multiple to the core banking business, on an estimated underlying 18.5-19% ROE, or Rs712 per share, and Rs272 for its subsidiaries. The stock has substantially outperformed the Sensex over the past three to six months. However, we think the rapidly diversifying business and asset franchise, together with strong earnings growth of 25-28% over two years and rising ROEs in a strong economic environment would support higher valuations. We initiate coverage with an OUTPERFORM rating and a target price of Rs985.

Figure 29: Sum-of-the-parts valuation

Business	Basis	Year	Multiple	Value per share	Comments
Core banking business	BV	FY08	2.75	712.3	Based on about a 18.5-19% underlying ROE for core operations
Overseas banking subsidiaries	BV	FY06	2.5	32.8	Discount to core operations, on FY06 BV, relatively lower profitability in investment phase
Investment banking	PAT	FY08	10	22.8	Cyclical business, at a high point in the cycle currently
Asset management	AUM	FY08	5%	17.4	M&A transactions in industry in the past at 4-6% of AUM
Private equity	AUM	FY08	10%	16.8	Higher return potential, and higher growth in the near future, than mutual funds
Life insurance	NBAP	FY08	15	174.3	Factoring 90% growth in FYP in FY07E and 60% in FY08E, at a 20% NBAP margin
Non-life insurance	PAT	FY08	14	8.2	
Total				985	

Source: Company data, Credit Suisse estimates

Figure 30: Estimation of ROE of core banking business

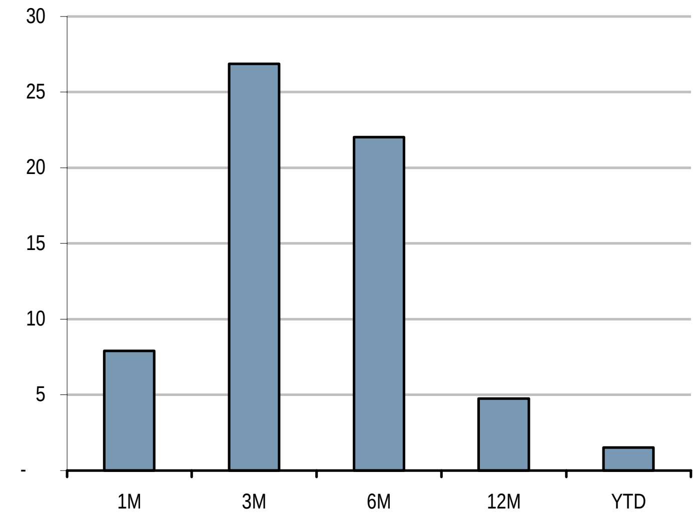
(Rs mn)	FY06	FY07E	FY08E
PAT	25,400.7	32,025.1	41,287.7
Less dividends from subsidiaries	1,635.6	1,962.7	2,355.3
Add: DMA/Fees post-tax	2,117.2	2,328.9	2,561.8
PAT adjusted	25,882.3	32,391.3	41,494.3
ROE, adjusted (%)		16.1	18.7

Source: Company data, Credit Suisse estimates

Strong outperformance over three to six months

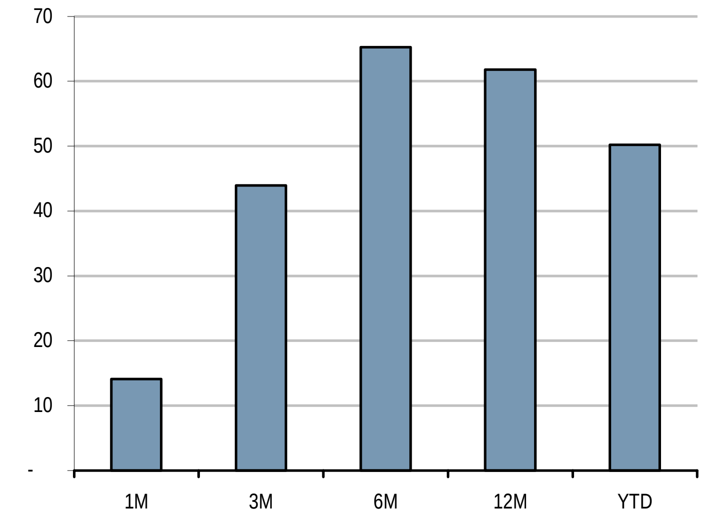
ICICI bank has outperformed the Sensex, and peers over the past three to six months (SBI has outperformed ICICI Bank, though). We believe ICICI Bank’s stock performance has been driven by: 1) 100-105 bp decline in interest rates (government securities yields), after a sharp rise in mid-2006, 2) continuing strong growth and good economic environment and 3) strong, above-consensus results and operating performance.

Figure 31: Relative returns



Source: Company data, Credit Suisse estimates

Figure 32: Absolute returns

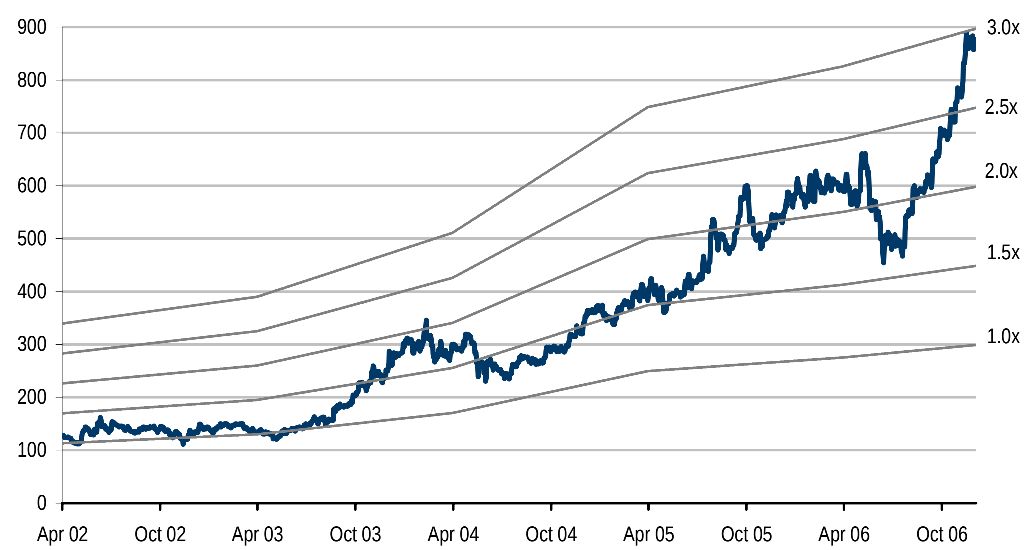


Source: Company data, Credit Suisse estimates

We initiate coverage with an OUTPERFORM rating

The stock has also rerated substantially, and now trades at the highest end of its recent trading history. We think the stock can continue to outperform the Sensex, and trade at the highest end of its trading band. Management has demonstrated its ability to regularly enter new business lines and create value for shareholders, and has successfully restructured the legacy project finance driven balance sheet. Strong EPS growth of 25-28% over two years and improving ROEs, in a strong economic and asset quality environment should also drive strong performance. We initiate coverage on ICICI bank with an OUTPERFORM rating and a target price of Rs985, which suggests potential upside of 13%.

Figure 33: P/B chart



Source: Company data, Credit Suisse estimates

Risks

Downside risks

- Deterioration in asset quality environment – ICICI Bank has a large, relatively unseasoned book, with low provision cover.
- Sharp liquidity crunch – ICICI Bank's funding mix has a significant component of wholesale term deposits, which can be volatile and rate sensitive.
- Execution – the bank is expanding aggressively into rural and international banking, and execution risks can be high.
- Slowdown in growth – our estimates are premised on a strong growth and economic environment.

Upside risks

- Lower risk weights for retail/mortgages on Basel II could allow ROEs to expand, and current capital to run longer than currently estimated.
- The development of vibrant securitisation market – ICICI Bank is a leader in securitisation in India, and this could be a significant funding source.
- Lower SLR requirement – this should reduce pressure on the funding franchise.

Financial statements

Figure 34: **Income statement**

Year-end Mar 31 (Rs mn)	FY05	FY06	FY07E	FY08E	FY09E
Total interest income	97,819	135,055	219,015	297,101	391,717
Total interest expended	65,709	95,974	162,488	219,391	288,026
Net interest income	32,110	39,080	56,526	77,710	103,692
Core fee income	20,980	32,569	51,219	72,871	98,854
Operating income	53,090	71,650	107,745	150,581	202,545
Salaries/wages	7,374	10,823	16,451	23,854	32,203
Depreciation	2,934	3,472	4,166	4,999	5,999
Other operating expenses	23,434	32,964	42,780	56,848	73,502
Total operating expenses	33,742	47,259	63,397	85,700	111,704
Pre-provision operating profits	19,349	24,391	44,348	64,880	90,841
Loan loss provisions	(1,214)	7,947	18,596	24,638	35,751
Total provisions	(1,128)	8,174	18,596	24,638	35,751
Operating profits	20,476	16,217	25,752	40,243	55,090
Profit on sale of investments	5,461	7,498	7,000	6,300	5,985
Total non operating income/(loss)	4,796	14,749	15,306	16,316	17,736
Profit before tax	25,272	30,966	41,058	56,559	72,826
Taxes	5,220	5,565	9,033	15,271	21,848
Profit after tax	20,052	25,401	32,025	41,288	50,978
Dividend	6,330	7,593	8,009	8,898	9,788
Dividend tax	901	1,065	1,121	1,246	1,370
Dividend (Rs per share)	9	9	9	10	11

Source: Company data, Credit Suisse estimates

Figure 35: **Balance sheet**

Year-end Mar 31 (Rs mn)	FY05	FY06	FY07E	FY08E	FY09E
Assets					
Total cash	129,300	170,402	246,969	331,633	438,218
Total investments	504,874	715,474	904,140	1,158,641	1,507,465
Total advances	914,051	1,461,631	2,030,162	2,704,364	3,496,264
Fixed assets	40,380	39,807	47,769	59,711	71,653
Other assets	87,989	126,575	164,548	213,912	278,086
Total assets	1,676,594	2,513,890	3,393,587	4,468,260	5,791,686
Liabilities					
Equity capital	7,367	8,898	8,898	8,898	8,898
Reserves and surplus	118,132	213,162	236,057	267,201	307,020
Net worth	125,499	222,060	244,955	276,099	315,918
Sub/hybrid debt	82,089	101,444	149,472	169,472	196,972
Deposits					
Demand	128,369	165,735	215,455	273,628	342,035
Savings	113,918	209,370	303,586	431,092	581,975
Time	755,900	1,275,727	1,814,722	2,499,779	3,380,951
Total	998,188	1,650,832	2,333,763	3,204,500	4,304,961
Total borrowings	335,445	385,219	465,811	559,779	638,950
Other liabilities/provisions	131,873	150,835	196,086	254,911	331,385
Total liabilities	1,676,593	2,513,890	3,393,587	4,468,260	5,791,686

Source: Company data, Credit Suisse estimates

Figure 36: Key operating ratios

Year-end Mar 31 (%)	FY05	FY06	FY07E	FY08E	FY09E
Loan yield	9.3	8.6	9.6	9.8	9.9
Yield on interest-earning assets	7.3	6.9	7.9	8.1	8.1
Cost of deposits	3.9	4.4	6.1	6.2	6.2
Cost of interest-bearing liabilities	5.3	5.4	6.4	6.4	6.3
NIM (net of amortisation)	2.40	2.01	2.04	2.11	2.15
Loan-to-deposit ratio	91.6	88.5	87.0	84.4	81.2
Assets/equity	14.2	12.1	12.6	15.1	17.3
Gross NPL % of Gross loans	3.0	1.5	1.6	1.8	2.1
Net NPL % of net Loans	1.6	0.7	0.7	0.8	0.9
Loan loss coverage	45	51	54	55	57
Coverage (incl. general provisions)	53	77	88	85	83
Tier I %	7.59	9.20	7.79	6.75	6.12

Source: Company data, Credit Suisse estimates

Figure 37: Change YoY

Year-end Mar 31 (%)	FY05	FY06	FY07E	FY08E	FY09E
Loans	47.2	59.9	38.9	33.2	29.3
Deposits	46.6	65.4	41.4	37.3	34.3
Assets	33.9	49.9	35.0	31.7	29.6
Net interest income	46.7	21.7	44.6	37.5	33.4
Fee income	80.6	55.2	57.3	42.3	35.7
Operating expenses	29.6	40.1	34.1	35.2	30.3
PPOP	158.7	26.1	81.8	46.3	40.0
Operating profit	637.0	(20.8)	58.8	56.3	36.9
PAT	22.5	26.7	26.1	28.9	23.5

Source: Company data, Credit Suisse estimates

Figure 38: ROAA composition

	FY05	FY06	FY07E	FY08E	FY09E
Interest income	6.7	6.4	7.4	7.6	7.6
Interest expenses	4.5	4.6	5.5	5.6	5.6
Net interest income	2.2	1.9	1.9	2.0	2.0
Fee income	1.4	1.6	1.7	1.9	1.9
Operating income	3.6	3.4	3.6	3.8	3.9
Operating cost	2.3	2.3	2.1	2.2	2.2
Pre-provision operating profits	1.3	1.2	1.5	1.7	1.8
Loan loss provisions	(0.1)	0.4	0.6	0.6	0.7
Other provisions and exceptionals	0.0	0.0	-	-	-
Total provisions	(0.1)	0.4	0.6	0.6	0.7
Operating profits	1.4	0.8	0.9	1.0	1.1
Non-operating items	0.3	0.7	0.5	0.4	0.3
Pre-tax profits	1.7	1.5	1.4	1.4	1.4
Taxes	0.4	0.3	0.3	0.4	0.4
PAT (ROAA)	1.4	1.2	1.1	1.1	1.0

Source: Company data, Credit Suisse estimates

Companies Mentioned *(Price as of 07 Dec 06)*

Asset Recontstruction Company India Ltd (ARCIL, NOT LISTED)
HDFC Bank (HDBK.BO, Rs1101.65, NEUTRAL, TP Rs990.00)
ICICI Bank (ICBK.BO, Rs878.20, OUTPERFORM, TP Rs985.00)

Disclosure Appendix

Important Global Disclosures

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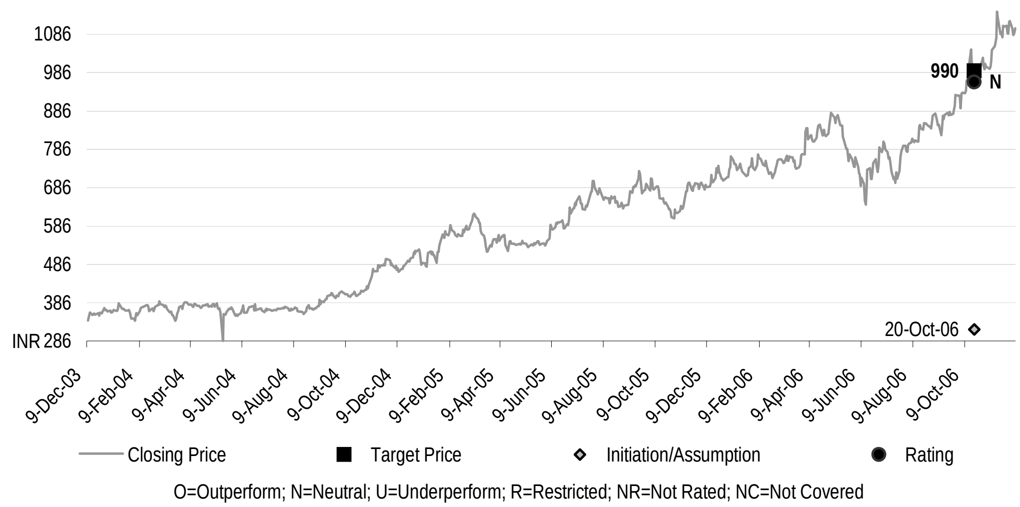
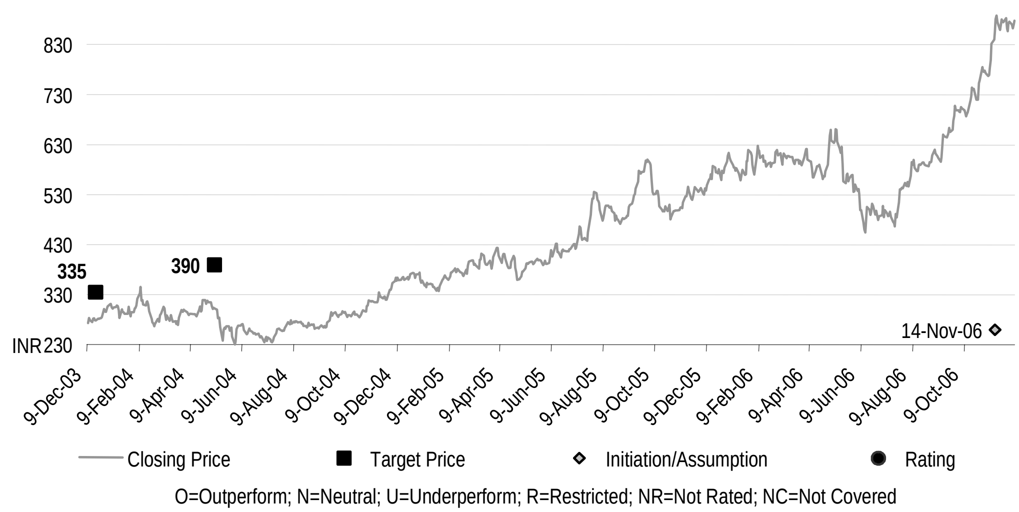
See the Companies Mentioned section for full company names.

3-Year Price, Target Price and Rating Change History Chart for HDBK.BO



HDBK.BO Date	Closing Price Price (INR)	Target Price Price (INR)	Rating	Initiation/ Assumption
20-Oct-06	960.85	990	NEUTRAL	X

3-Year Price, Target Price and Rating Change History Chart for ICBK.BO



ICBK.BO Date	Closing Price Price (INR)	Target Price Price (INR)	Rating	Initiation/ Assumption
19-Dec-03	278.85	335		
07-May-04	302.9	390		
14-Nov-06				X

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Price Target: (12 months) for (HDBK.BO)

Method: Our target price of Rs990 for HDFC Bank is benchmarked off P/BV, P/E and Dividend Discount Model (DDM) analysis. We have valued HDFC Bank on a 1-year forward P/B of 4.5x and P/E of 23.8x. Our DDM analysis assumes a cost of equity of 14% and a terminal growth rate of 5%. We set out target price at Rs990, tilting towards the P/B methodology, but in the fair value range of Rs990-1070 based on the three methodologies.

Risks: Key upside risks to our target price of Rs990 for HDFC Bank are favourable Basel II guidelines, sustainable higher RoEs on use of hybrid capital, M&A activity in the longer-term. Downside risks are a reversal in asset environment, significant increase in competition, high stock valuations and branch licensing continuing beyond the short-term.

Price Target: (12 months) for (ICBK.BO)

Method: We have valued ICICI Bank at Rs985 on a sum of the parts, as we think it would best capture the value of its diverse business lines. We attribute a 2.75x FY3/08 BV multiple to the core banking business, on an estimated underlying 18.5-19% RoE, or Rs712 per share, and Rs272 for its subsidiaries.

Risks: Downside risks 1) Deterioration in asset quality environment – ICICI Bank has a large, relatively unseasoned book, with low provision cover 2) Sharp liquidity crunch – ICICI Bank's funding mix has a significant component of wholesale term deposits, which can be volatile and rate sensitive 3) Execution – The bank is foraying aggressively into rural and international banking, and execution risks can be high 4) Slowdown in growth – our estimates are premised on a strong growth and economic environment. Upside risks are 1) Lower risk weights for retail/mortgages on Basel II – Will allow RoEs to expand, and current capital to run longer than currently estimated 2) Development of vibrant securitisation market – ICICI Bank is a leader in securitisation in India, and this can be a significant funding source 3) Lower SLR requirement – will reduce pressure on funding franchise

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