ICICI Bank Limited

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Issue Summary

• **Type**	Public Issue 100% Book building	• **Shares on offer**	108 m shares (at the higher end of the price band)
• **Size**	Rs 100.6 bn (inclusive of a greenshoe option of Rs 13.1 bn)	• **Face Value**	Rs 10 per share
• **Offer Price**	Rs 885 to Rs 950 per share. Discount of Rs 50 for retail investors	• **Minimum subscription**	6 shares. Retail investors have been allowed to pay Rs 250 on application, Rs 250 on allotment and the rest on call
• **Listing**	NSE and BSE	• **Lead Managers**	Goldman Sachs, DSP Merrill Lynch, Enam Financial, JM Morgan Stanley
• **Bid/Issue opens**	June 19, 2007	• **Bid/Issue closes**	June 22, 2007

Issue structure

	QIB's	Non-Institutional Investors	Retail Investors	Existing retail Investors
No of shares (m)*	54.0	16.2	32.4	5.4
% of total size	50%	15%	30%	5%
Minimum bid / application size	Rs 1,00,000	Rs 1,00,000	6 equity shares	6 equity shares
Maximum bid / application size	Not exceeding issue size	Not exceeding issue size	Rs 100,000 net of retail discount	Rs 100,000 net of retail discount

* Including greenshoe option

Objects of the issue

- Augment the capital base to support future asset growth, invest in subsidiaries and expand international presence. The bank's capital adequacy ratio (CAR) was 11.7% at the end of FY07.

- Gear up for risk compliances and adherence to Basel-II norms.

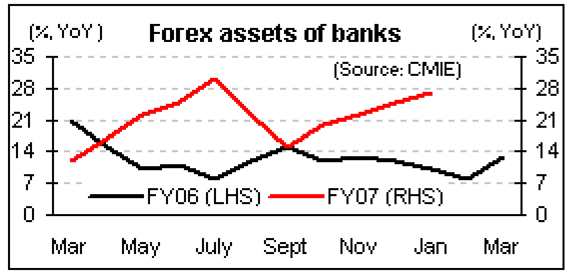
Company background

- **Business**

With 10% share of India's total non-food credit disbursements and 12% of the banking system's deposits in FY07, ICICI Bank is the second largest bank in the country after SBI in terms of asset size. The bank has grown its share from 7.1% of total non-food credit in FY04 to 10.2% in FY07. At the end of March 2007, the bank had assets of over US$ 84 bn (Rs 3 trillion) and a franchise of over 3,200 ATMs and 750 branches spread across the country. Retail assets constituted 65% of advances in FY07. The bank is focusing on loan origination in the retail and agriculture segments and on non-fund based products and services, as well as capitalising on opportunities presented by the domestic and international expansion of Indian companies. Besides the bank itself being the market leader across retail loan portfolios, its subsidiaries ICICI Life Insurance, ICICI General Insurance and ICICI AMC are leaders in their respective businesses. The bank's insurance and asset management businesses are currently owned by its 100% subsidiary ICICI Financial Services (earlier ICICI Holdings).

- **Sector**

Despite the severe liquidity pressure post the repo and CRR (cash reserve ratio) hike, the money supply continued to remain buoyant during FY07, expanding by 21% YoY, outpacing RBI's projections of 15% YoY growth. The growth was mainly driven by a sharp expansion in term deposits and surplus inflow of foreign exchange assets. Bank credit growth was 28% YoY in FY07, while housing loans grew by 32% YoY. In FY07, private sector banks accounted for approximately 19.9% of aggregate deposits and 20.2% of gross bank credit outstanding of the scheduled commercial banks. Their network of 6,567 branches accounted for 9.4% of the total branch network of scheduled commercial banks in the country. The central bank as well as the major players in the sector expect the growth rates to moderate in FY08 and FY09, as the higher interest rates will have a lagged effect on incremental off takes. Lack of adequate provisioning may also impact the asset slippage levels (NPAs) although not bringing the same to alarming rates.



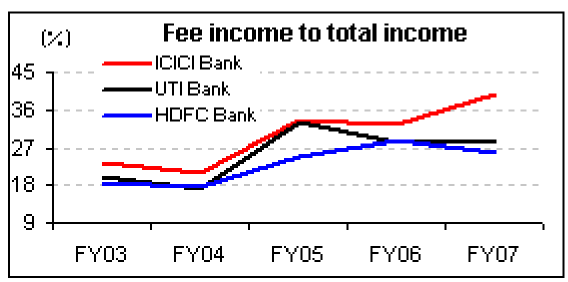
- **Promoters**

ICICI Bank was originally promoted in 1994 by ICICI Limited, an Indian financial institution. ICICI was formed in 1955 as a development financial institution at the initiative of the World Bank, the Government of India and representatives of Indian industry. In the 1990s, ICICI transformed its business from a development financial institution offering only project finance to a diversified financial services group. ICICI Bank's initial capital was contributed by ICICI (75%) and 25% by SCICI Ltd. In October 2001, the Board of Directors of ICICI and ICICI Bank approved the merger of ICICI and two of its wholly owned retail finance subsidiaries, ICICI Personal Financial Services Limited and ICICI Capital Services Limited, with ICICI Bank.

Reasons to apply

- **Leading the market:** With 30% share of the Indian retail lending market, ICICI Bank possesses the largest retail loan portfolio in the country. Retention of the highest market share across product categories has been the mainstay of ICICI Bank's performance in the last couple of fiscals. While the bank has largely outperformed the sectoral average as well as the figures clocked by most of its peers in terms of advance growth in the past 3 to 4 fiscals, the growth in assets was also aided by its initiatives in the rural and international markets. While the rural portfolio grew by 37% YoY, total advances of the bank's international branches, levered by its Indian corporate clientele overseas, reported a growth of 95% YoY in FY07. Going forward, the bank estimates its annual advance growth to continue at a multiple of 3 times the economy's GDP growth - at 25% (i.e. 3 times of FY08E GDP growth of around 8%).

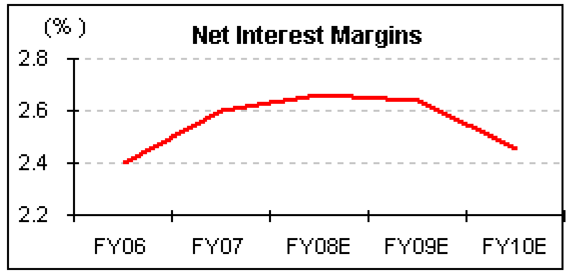
- **Fees substitute treasury gains:** While most banks are currently devoid of treasury gains in a rising interest rate scenario, ICICI Bank has been able to substitute the same with higher fee income generation. Fee income (constituting 40.5% of ICICI Bank's total income) grew by 45% YoY in FY07. Of this fee income, 55% was derived from retail assets while the remaining 45% was from corporate and international assets. Considering that, in the future, the bank is expected to successfully leverage its corporate client base overseas, it may well be able to sustain this strong growth rate in the future as well. ICICI Bank has far surpassed its closest competitors HDFC Bank and UTI Bank in terms of fee income contribution to total income. We believe that the higher fee income contribution will continue to insulate the bank's bottomline against any negative surprises on the treasury side.



- **Capital comfort:** ICICI Bank's CAR (capital adequacy ratio) declined to 11.7% in FY07 from 13.4% at the end of March 2006. Towards shoring up the capital base for complying with the Basel II norms (the RBI having already issued final guidelines for the same) as also to meet up the expected growth in credit, the bank has decided to raise capital to the tune of US$ 5 bn (Rs 200 bn) through a follow on issue in the domestic market as well as an ADR issue in FY08.

  Assuming that the bank raises the fresh capital in the domestic market at Rs 900 per share and in the overseas market at Rs 934 per share (considering the prevailing ADS price of US$ 46 and each representing 2 equity shares), its adjusted book value (after considering the equity dilution out of this issue as also the issue of ADS) would also rise sharply to Rs 403 per share in FY08 and potentially Rs 435 per share in FY09. We expect that post capital raising, the bank's 'return on equity' (13.4% in FY07) would be temporarily depressed in FY08 but will rebound to the same levels by FY09. The enhanced book value will poise the bank attractively against its peers in terms of forward valuations, despite the fact that the issue will entail a dilution of 24% of the current share capital base.

- **Better margins:** The bank is still carrying debt of erstwhile ICICI to the tune of Rs 108 bn (15% of total borrowings in FY07) in its books and servicing interest at the rate of 10.5% on it. Offloading the ICICI burden at the earliest is one of the solutions to bringing down the bank's cost of funds and the capital raising will enable it to accelerate this process. The replacement of the high cost borrowings with equity funds and low cost deposits is expected to improve its net interest margins in FY08 and FY09. Thereafter, however, we expect the interest rates to soften and pressurise the bank's incremental asset yields.



- **Subsidiaries add value:** The board of directors of ICICI Bank has recently approved the incorporation of a new wholly owned subsidiary – ICICI Holdings (renamed as ICICI Financial Services), and the transfer of its investments in ICICI Prudential Life Insurance, ICICI Lombard General Insurance and Prudential ICICI Asset Management to this new holding company. ICICI Bank currently holds 74% stake each in ICICI Life and ICICI General Insurance and 51% of ICICI AMC. ICICI Life (market share of about 29% in the private sector and 9% overall) and ICICI General (market share of about 36% in the private sector and 13% overall) are the largest private sector life insurance and general insurance companies in India while ICICI AMC (market share of about 12%) manages the largest mutual fund in India. While ICICI Bank will retain the majority ownership in ICICI Financial Services, the subsidiary may consider a public listing of its equity shares to meet a part of the further capital requirements of ICICI Life and ICICI General. Also, it must be noted that as per the IRDA (Insurance Regulatory Development Authority of India) guidelines, the insurance companies are supposed to seek listing within 10 years of incorporation and going by that guideline, ICICI Life will be listed by 2010 and the General Insurance business will have to be listed by 2011.

  We have added the value of these three entities based on our (post FY08 dilution) earnings estimate per share for ICICI Bank shareholders to our FY10 target price. The valuation of these three subsidiaries have been estimated based on the historical net book adjusted profit (NBAP)* of ICICI Life Insurance and net profit reported by the general insurance and AMC businesses.

  **NBAP is a metric for the economic value of the new business written during a defined period. It is measured as the present value of all the future profits for the shareholders, on account of the new business based on standard assumptions of mortality, expenses and other parameters. (Source: ICICI Bank)*

Reasons not to apply

- **'Dis'economies of scale:** While ICICI Bank's branch and employee efficiency compares favourably against its peers in the private and public sector banking space, the rapid expansion in franchise and employee base has led to the bank compromising in terms of efficiency. Going forward, as the bank's growth rate gets moderated, we expect efficiency ratios to improve. The heavy employee intake in the last four fiscals (average 30% growth per year) has escalated the cost to income ratio to 53% in FY07. However, excluding the DMA (direct marketing agents) and lease depreciation costs, the bank has reported a cost to income ratio of 40% in this fiscal. We see no improvement on this parameter until FY10, as the bank needs to incur the costs of building up scale.

- **Slippages likely:** The aggressive growth in retail assets seems to have shown a red signal to the bank in FY07, as there has been a visible growth in incremental delinquencies in absolute terms. The accretion of Sangli Bank's NPAs (which ICICI Bank acquired in FY07) has also added to the bank's gross NPA levels (2.5% in FY07 from 1.6% in FY06). The same has, however, got partially camouflaged in percentage terms due to the higher growth in advances.

  The bank's net NPAs (as percentage of total advances) increased to 1% in FY07, from 0.7% in FY06. This was seemingly a result of incremental delinquencies (slippages in asset quality) in the retail portfolio. The gross and net NPAs in retail portfolio were 2.4% and 1.2% respectively in FY07. The net NPAs in the home loan portfolio stood at 0.7%. Also, the bank clarified that 54% of the NPAs were from non-collateralised assets such as personal loans and credit cards. Importantly, despite the consistent rise in net NPAs over the past fiscal, the provisioning cover has continued to decline, which calls for additional risk mitigation.

Financials Analysis

(Rs m)	FY06	FY07	FY08E	FY09E	FY10E
Interest Income	137,845	229,942	310,811	397,175	460,483
Interest Expense	95,975	163,584	222,638	289,928	338,948
Net Interest Income	41,870	66,359	88,173	107,247	121,535
Net interest margin (%)	2.4%	2.6%	2.7%	2.6%	2.4%
Other Income	49,831	59,290	79,137	110,792	144,029
Other Expense	44,795	66,906	97,040	130,823	159,338
Provisions & Contingencies	15,941	22,264	19,884	16,064	11,094
Profit before tax	30,966	36,479	50,386	71,151	95,132
Tax	5,565	5,377	9,070	17,788	23,783
Profit after Tax	25,400	31,102	41,317	53,363	71,349
Effective tax rate (%)	18.0%	14.7%	18.0%	25.0%	25.0%
Net profit margin (%)	18.4%	13.5%	13.3%	13.4%	15.5%
No. of shares (m)	889.8	899.3	1,118.8	1,118.8	1,118.8
Fully diluted EPS (Rs)	22.7	27.8	36.9	47.7	63.8

Comparative Valuations & Comments

FY07UA	RONW (%)	NIM (%)	Cost/Income (%)	Net NPA (%)	Business/branch (Rs m)	Profit/employee (Rs m)	P/ABV* (x)	Dividend yield (%)
ICICI Bank	13.4%	2.6%	40.0%	1.0%	6,313	0.9	1.8	1.1%
HDFC Bank	19.5%	4.3%	46.3%	0.5%	1,685	0.5	2.6	0.6%
SBI	14.4%	3.3%	54.2%	1.6%	825	0.2	1.5	1.1%

* Price to adjusted book value (P/ABV) for HDFC Bank and SBI has been calculated by considering prices as on 15th June 2007 on the basis of FY10E standalone adjusted book value.

P/ABV for ICICI Bank has been calculated by considering the post issue capital (FY10E standalone adjusted book value) and at the higher end of the price band (less Rs 50 discount).

Post merger with ICICI, ICICI Bank emerged as the largest private banking entity in the country with forte in retail banking. Being one of the first 'universal banks' in the country, the bank appreciably capitalised on the growing consumer credit market. In tandem with its asset growth, the bank has also pared its NPA levels (majority of which was inherited from the erstwhile ICICI). Not to mention, the investment in subsidiaries across diverse business interests and international foray that have aided the bank's fee income levels. Going forward, given the relatively low consumer credit penetration in the country (8% of GDP), the growth prospects of the bank appear enthusing. At the same time, improvements are due on the net interest margin and asset quality fronts.

ICICI Bank’s ability to profitably sustain market share across retail credit portfolios will determine its growth going forward. Notwithstanding the fact that our concerns with respect to the bank’s increasing delinquencies and pressure on margins were vindicated in FY07, we see improving prospects for the bank in the medium to long term. Having said that, the listing of the subsidiaries will be very lucrative for ICICI Bank’s shareholders.

We have arrived at a FY10E target price of Rs 1,318 for the bank based on sum of the parts valuation. The FY10 target price for ICICI Bank's core banking business is Rs 1,220. The FY10 target price for ICICI Prudential Life Insurance, ICICI Lombard General Insurance and Prudential ICICI Asset Management are Rs 85, Rs 7 and Rs 6 respectively. At the upper end of the price band (Rs 900 factoring in the Rs 50 discount to retail investors), the stock is expected to generate compounded annual returns of 14.4% (46% point to point) until FY10. Based on this premise and given the upsides offered by the listing of ICICI Financial Services, we would recommend investors to **'APPLY'** to the issue.