

ICICI Bank

Beaten down to bargain levels

In the past six months, ICICI Bank has underperformed its peers due to a mix of equity dilution overhang, rise in NPLs and recent concerns on credit derivatives. We see the price correction as an opportunity, and hence upgrade to Buy. Target price Rs931.90.

Key forecasts

	FY06A	FY07A	FY08F	FY09F	FY10F
Reported PTP (Rsm)	30964.8	36481.9	50701.9	68195.6	87542.3
Reported net profit (Rsm)	25399.5	31101.9	39294.0	49441.8	62811.6
Reported EPS (Rs)	28.5	34.6	35.6	44.6	56.3
Normalised EPS (Rs)	28.5	34.6	35.6	44.6	56.3
Dividend per share (Rs)	8.50	10.0	11.0	12.0	13.0
Normalised PE (x)	28.9	23.9	23.2	18.5	14.7
Price/book value (x)	3.31	3.06	1.96	1.83	1.67
Dividend yield (%)	1.03	1.21	1.33	1.45	1.57
Return on avg equity (%)	14.6	13.4	11.1	10.2	11.9

Accounting Standard: Local GAAP

Source: Company data, ABN AMRO forecasts

year to Mar, fully diluted

Stock down 13% since early July; upgrading to Buy

The share price has fallen 13% since early July (vs 4.8% for the Nifty) evidently due to a combination of factors such as equity dilution overhang, increase in NPLs and recent concerns on credit derivatives. We see the recent share price correction as an opportunity to enter the stock and upgrade our recommendation to Buy.

Concerns on credit derivatives seem overdone

ICICI Bank has an exposure of Rs59bn in credit derivatives (as at March 2007). Of this, about 70% is linked to Indian corporate transactions and the rest is international exposure. According to management, the underlying asset quality remains comfortable and an economic loss is unlikely. However, the bank will have to book a notional mark-to-market loss due to widening credit spreads. In the bank's international subsidiaries, the derivatives exposure is below Rs20bn but no exposure to US subprime segments, according to management.

ICICI Financial Services – valuing the exit price for an investor

According to Press Trust of India, ICICI Bank received the Foreign Investment Promotion Board's approval to dilute up to 24% of its stake in ICICI Financial Services. In June 2007, ahead of the equity dilution, ICICI Bank received bids for 5.9% of ICICI Financial Services for Rs26.5bn, thus valuing the company at Rs446bn. This comprises the value of ICICI Bank's 51% stake in the mutual fund and 74% stake in life-insurance and non-life insurance ventures. According to our calculations (post-tax and holding company discount), the per-share value of ICICI Financial Services is about Rs305. We value the same at Rs222/share in our sum-of-the-parts valuation. However, if management is able to place a further stake in ICICI Fin Serv for similar/higher valuations, then we believe the value per share of the subsidiary for a shareholder of ICICI Bank will be higher than our estimates.

Buy; target price unchanged at Rs931.90

We estimate ICICI Bank's core average ROE at about 11% for the next three years (excluding dividend income, investment in subsidiaries and profits of international subsidiaries). Excluding the value of subsidiaries, the stock trades at 10.2x FY09F earnings and 1.1x adjusted book value FY09F. We find this attractive. We upgrade to Buy but maintain our Rs931.90 target price. (For a detailed investment argument, please see our report, Fighting too many battles, dated 25 July 2007.)

Priced at close of business 17 August 2007.

Mafatlal Chambers – C Wing, Ground Floor, N.M. Joshi Marg, Lower Parel (E), Mumbai 400 013, India. Tel : +91 022 6754 8411 Fax : +91 022 6754 8420

Buy (from Hold)

Absolute performance

n/a

Short term (0-60 days)

Neutral

Market relative to region

Banks

India

Price

Rs825.95

Target price

Rs931.90

Market capitalisation

Rs911.68bn (US\$22.05bn)

Avg (12mth) daily turnover

Rs313.21m (US\$7.35m)

Reuters

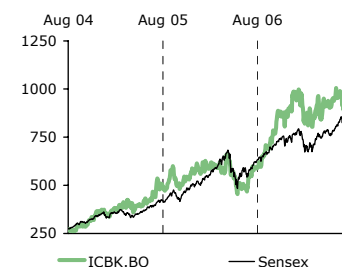
ICBK.BO

Bloomberg

ICICIBC IN

Price performance (1M) (3M) (12M)

Price (Rs)	974.6	935.8	590.6
Absolute %	-15.3	-11.7	39.8
Rel market %	-8.4	-10.7	13.5
Rel sector %	-8.7	-9.0	30.5



Stock borrowing: n/a

Volatility (30-day): 27.86%

Volatility (6-month trend): ↓

52-week range: 1009.90-580.00

Sensex: 14141.52

BBG AP Banks: 170.69

Source: ABN AMRO, Bloomberg

Researched by

ABN AMRO Institutional
Equities Team

www.abnamrobroking.co.in

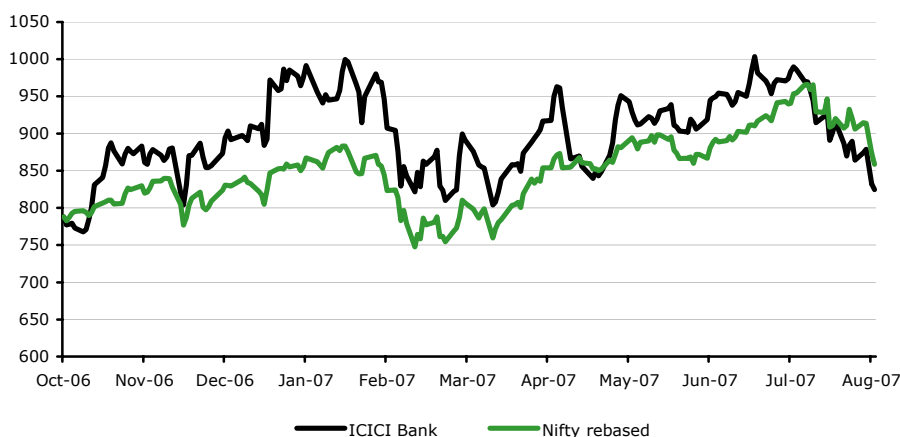
Beaten down to bargain levels

Over the past six months, ICICI Bank has underperformed its peers due to a combination of equity dilution overhang, increase in NPLs and recent concerns on credit derivatives. Upgrade to Buy with a Rs931.90 target price.

Stock down 13% since early July; upgrade to Buy

The share price has fallen 13% since early July (vs 4.8% for the Nifty) evidently due to a combination of factors such as equity dilution overhang, increase in NPLs and recent concerns on credit derivatives. We see the recent share price correction as an opportunity to enter the stock and upgrade our recommendation to Buy.

Chart 1 : ICICI Bank vs NSE Nifty (rebased)



Source: NSE

Concerns on exposure to credit derivatives seem overdone

Only the overseas branches and subsidiaries of ICICI Bank are allowed to invest in credit derivatives. As per the bank's annual report (March 2007, page F38), the branches have a non-funded exposure of Rs59bn to credit derivatives. According to management, of this about 70% is linked to Indian corporate transactions for ECBs/FCCBs and the rest is exposure to international corporates/institutions.

According to management, most of the exposure is to rated companies. Note that due to widening spreads, the bank may book a notional mark-to-market loss in 2QFY08. However, we believe any economic loss is unlikely as the exposure is secured by the underlying corporate/institution. Hence, concerns on exposure to credit derivatives appear overdone.

In the international subsidiaries, management estimates exposure to credit derivatives at less than Rs20bn and no exposure to US subprime segments. The underlying exposure would be a combination of retail, corporates based out of UK/Canada and some Indian corporates. Overall, funded exposure of overseas branches and banking subsidiaries was Rs31.5bn at the end of FY07.

Table 1 : ICICI Bank - credit derivatives exposure

(Rsbn)	FY06	FY07
ICICI Bank standalone		
Outstanding credit derivatives		
- Notional principal amount	23.5	59.1
- of which credit protection bought through overseas branches	n/a	0.4
Funded investments	12.9	14.7
Investments in credit derivatives by overseas branches and banking subsidiaries (source: Form 20F)		
Funded instruments	n/a	31.5
Notional principal of unfunded instruments	n/a	60.4

Credit derivatives include credit default swaps, credit-linked notes and collateralised debt obligations

Source: Standalone data – annual report, offer document dated 11 May 2007. Other data: Form 20F for FY07, ABN AMRO

ICICI Financial Services – valuing the exit price for an investor

According to Press Trust India, ICICI Bank has got the approval from the Foreign Investment Promotion Board to dilute up to 24% of its stake in ICICI Financial Services.

In June 2007, ahead of the equity dilution, ICICI Bank received bids for 5.9% of ICICI Financial Services for Rs26.5bn, thus valuing the company at Rs446bn. This comprises the value of ICICI Bank's 51% stake in the mutual fund and 74% stake in life-insurance and non-life insurance ventures.

Based on the diluted equity, we believe the value of the holding company (Rs446bn) translates into Rs380 per share of ICICI Bank (pre-capital gains tax). Furthermore, assuming that a part of the business will not be sold for strategic/regulatory reasons, we estimate the saleable value at Rs175 per share (post capital-gains tax) and unsaleable at Rs130 per share (post holding-company discount). (For the detailed calculations, please refer to Table 15 in our report, *Fighting too many battles*, dated 25 July 2007.) We value these businesses at Rs221.6 in our sum-of-the-parts valuation for ICICI Bank.

However, if management is able to place a further stake in ICICI Fin Serv for similar/higher valuations, then, we believe, the value per share of the subsidiary for a shareholder of ICICI Bank will be higher than our estimates.

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ICICI BANK: KEY FINANCIAL DATA

Income statement

Rsm	FY06A	FY07A	FY08F	FY09F	FY10F
Net interest income	47086.4	66357.9	86555.6	109934	140504
Non-interest income	49760.0	69620.0	81234.0	101862	124522
Total income	96846.4	135978	167790	211795	265026
Operating costs	-46696	-63347	-80494	-99812	-124422
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
Other costs	-3471.6	-3565.0	-3921.5	-4313.7	-4745.0
Pre-prov operating profit	46678.5	69065.9	83374.6	107670	135859
Provisions charges	-15714	-32584	-32673	-39474	-48317
Post-prov op prof	30964.8	36481.9	50701.9	68195.6	87542.3
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
Reported PTP	30964.8	36481.9	50701.9	68195.6	87542.3
Taxation	-5565.3	-5380.0	-11408	-18754	-24731
Minority interests	n/a	n/a	n/a	n/a	n/a
Preference dividends	n/a	n/a	n/a	n/a	n/a
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	25399.5	31101.9	39294.0	49441.8	62811.6

Source: Company data, ABN AMRO forecasts

year to Mar

Balance sheet

Rsm	FY06A	FY07A	FY08F	FY09F	FY10F
Net loans to customers	1461631	1958655	2574987	3343473	4341783
Other int earn assets	737017	941996	1139381	1374302	1657694
Goodwill	n/a	n/a	n/a	n/a	n/a
Oth non-int earn assets	144839	174716	188657	203956	220749
Total assets	2513889	3446580	4207188	5289428	6680837
Total customer deposits	1664678	2325510	2969901	3870914	5064893
Oth int-bearing liab	486663	706611	573138	694894	818825
Non int-bearing liab	136988	167826	195319	218605	243720
Total liabilities	2288329	3199947	3738358	4784413	6127438
Share capital	8898.3	8993.0	11038.0	11093.2	11148.6
Reserves	213162	234140	454292	490422	538741
Total equity (excl min)	225560	246633	468830	505015	553399
Minority interests	n/a	n/a	n/a	n/a	n/a
Total liab & sh equity	2513889	3446580	4207188	5289428	6680837
Risk weighted assets	2085940	2899930	3699577	4756357	6151447
Est non-perf loans	10526.8	19920.4	29880.6	37350.8	46688.4
Specific provisions	0.00	0.00	0.00	0.00	0.00
General provisions	0.00	0.00	0.00	0.00	0.00

Source: Company data, ABN AMRO forecasts

year ended Mar

Capital

Rsm	FY06A	FY07A	FY08F	FY09F	FY10F
Risk weighted assets	2085940	2899930	3699577	4756357	6151447
Reported net profit	25399.5	31101.9	39294.0	49441.8	62811.6
Opening risk assets	1350170	2085940	2899930	3699577	4756357
Closing risk assets	2085940	2899930	3699577	4756357	6151447
Change in risk assets	735770	813990	799647	1056780	1395090
Capital required	51503.9	56979.3	55975.3	73974.6	97656.3
Free capital flow	-26104	-25877	-16681	-24533	-34845
Ordinary dividend paid	-7563.6	-8993.0	-12142	-13312	-14493
Share buy back/spec div	n/a	n/a	n/a	n/a	n/a
Equity / preference issue	n/a	n/a	n/a	n/a	n/a
Cash flow from financing	-7563.6	-8993.0	-12142	-13312	-14493
Net capital flow	-33668	-34870	-28823	-37845	-49338
Tier 1 capital	208868	220561	440258	473943	519827
Tier 1 capital ratio (%)	10.0	7.61	11.9	9.96	8.45

Lines in bold can be derived from the immediately preceding lines.

Source: Company data, ABN AMRO forecasts

year to Mar

ICICI BANK: PERFORMANCE AND VALUATION

Standard ratios	ICICI Bank					HDFC Bank			Axis Bank		
Performance	FY06A	FY07A	FY08F	FY09F	FY10F	FY08F	FY09F	FY10F	FY08F	FY09F	FY10F
Non-int inc/gr op inc (%)	51.4	51.2	48.4	48.1	47.0	32.2	32.8	33.3	38.6	38.0	38.9
Cost/income (%)	51.8	49.2	50.3	49.2	48.7	48.8	48.6	48.6	48.9	49.9	50.0
Costs/average assets (%)	2.39	2.25	2.21	2.19	2.16	3.31	3.30	3.35	2.25	2.23	2.25
Net income growth (%)	26.7	22.5	26.3	25.8	27.0	39.1	25.4	24.8	46.8	20.1	28.7
Net cust loan growth (%)	59.9	34.0	31.5	29.8	29.9	29.3	29.2	29.5	46.5	35.2	31.0
Cust deposit growth (%)	64.6	39.7	27.7	30.3	30.8	23.0	27.2	25.0	29.4	31.2	30.2
Net interest margin (%)	2.39	2.35	2.37	2.42	2.43	4.76	4.71	4.73	2.91	2.85	2.81
Return on avg assets (%)	1.21	1.04	1.03	1.04	1.05	1.56	1.58	1.61	1.15	1.07	1.09
Return on avg equity (%)	14.6	13.4	11.1	10.2	11.9	17.3	15.7	17.1	15.9	12.5	14.4
RORWA (%)	1.53	1.33	1.30	1.27	1.25	1.95	1.89	1.83	1.40	1.27	1.27
				year to Mar			year to Mar			year to Mar	
Valuation	FY06A	FY07A	FY08F	FY09F	FY10F	FY08F	FY09F	FY10F	FY08F	FY09F	FY10F
Normalised EPS growth (%)	4.88	21.2	2.93	25.2	26.4	23.3	24.1	23.6	14.5	19.5	28.1
Reported PE (x)	28.9	23.9	23.2	18.5	14.7	24.8	20.0	16.2	20.9	17.5	13.6
Normalised PE (x)	28.9	23.9	23.2	18.5	14.7	24.8	20.0	16.2	20.9	17.5	13.6
Price/book value (x)	3.31	3.06	1.96	1.83	1.67	3.31	2.94	2.58	2.30	2.08	1.85
Price/adjusted BVPS (x)	3.47	3.33	2.09	1.97	1.83	3.39	3.01	2.65	2.39	2.18	1.94
Dividend yield (%)	1.03	1.21	1.33	1.45	1.57	0.82	0.91	1.10	0.81	0.98	0.98
				year to Mar			year to Mar			year to Mar	
Per share data	FY06A	FY07A	FY08F	FY09F	FY10F	Solvency	FY06A	FY07A	FY08F	FY09F	FY10F
Tot adj dil sh, ave (m)	889.8	899.3	1103.8	1109.3	1114.9	Tier 1 capital ratio (%)	10.0	7.61	11.9	9.96	8.45
Pre-prov prof/share (INR)	52.5	76.8	75.5	97.1	121.9	Total CAR (%)	14.9	14.3	17.7	14.9	12.7
Reported EPS (INR)	28.5	34.6	35.6	44.6	56.3	Equity/assets (%)	8.97	7.16	11.1	9.55	8.28
Normalised EPS (INR)	28.5	34.6	35.6	44.6	56.3	Net cust loans/dep (%)	87.8	84.2	86.7	86.4	85.7
Book value per sh (INR)	249.6	270.4	421.6	452.1	493.2	Rep NPL/gr cus adv (%)	1.52	2.11	2.00	1.93	1.86
Dividend per share (INR)	8.50	10.0	11.0	12.0	13.0	Tot prov/rep NPLs (%)	51.4	50.5	50.4	51.2	51.3
Dividend cover (x)	3.36	3.46	3.24	3.71	4.33	Bad debts/advances (%)	0.54	1.10	0.88	0.88	0.88
				year to Mar						year to Mar	

Priced as follows: ICBK.BO - Rs825.95; HDBK.BO - Rs1069.25; AXBK.BO - Rs574.65
Source: Company data, ABN AMRO forecasts

ICICI BANK: VALUATION METHODOLOGY

Table 2 : ICICI Bank (sum of the parts), Rs/share

ICICI Financial Services	221.6
ICICI International subsidiaries	30.3
ICICI Securities	18.8
Venture Capital	37.3
Value of other business	308.0
Fair value of parent business	623.9
Target price	931.9

Source: ABN AMRO estimates

ICICI Bank

Company description

Buy

Price relative to country

ICICI Bank is the largest bank in terms of market capitalisation in India and the second-largest commercial bank after SBI. Created from the merger of a retail bank (ICICI Bank) and a development financial institution (ICICI), the bank has grown rapidly since the amalgamation in 2001, and is a market leader in consumer financing. Throughout, ICICI has always angled for volume rather than margins. This is reflected in its lower operating profitability and valuation, relative to HDFC Bank. ICICI can nevertheless boast of strong enterprise risk-management infrastructure and a strong brand franchise. It is also present through associates and subsidiaries in asset management, insurance, investment banking and securities broking.

Strategic analysis

Average SWOT company score:

4

Shareholding pattern

Strengths

4

Second-largest bank in India and enjoys leading positions in almost all consumer lending segments. ICICI Bank also has access to capital at attractive rates.

Weaknesses

4

Reliance on volatile funding sources and an adverse asset-liability mismatch could have an adverse impact on profitability. Large exposure to retail sector could make response to changes in regulatory norms slow.

Opportunities

4

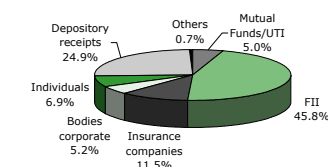
Deepening retail penetration, robust technology backbone and strong brand franchise offer ICICI Bank the opportunity to consistently gain market share in both fund- and non-fund-based revenue streams.

Threats

3

Competition from foreign banks is likely to grow. Public sector banks too could become more competitive after the expected strengthening of their technology infrastructure. ICICI's penchant for volume growth could have consequences in the event of a downturn in the asset quality cycle.

Scoring range is 1-5 (high score is good)



Source: NSE, June 2007

Market data

Headquarters

Landmark, Race Course Circle, Vadodara, Gujarat, India

Website

www.icicibank.com

Shares in issue*

1103.8m

Freefloat

100%

Majority shareholders

LIC of India (8%)

* includes recently concluded dilution

India

Country view

Neutral

Country rel to Asia Pacific

The ABN AMRO Indian PMI suggests the economy is still powering ahead despite the global headwinds, thanks to its domestically-oriented economic structure. Moreover inflationary pressure has eased with the recent rate hikes by the RBI. At the sector level, we still like autos (commercial vehicles), software and construction-related stocks as infrastructure spending should be a growth driver in FY08.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.

Competitive position

Average competitive score:

4-

Broker recommendations

Supplier power

4-

Banks typically lack pricing power on the liability side in the long term, as households can shift their preference among various financial instruments.

Barriers to entry

4-

Distribution access, brand identity and high capital requirements for infrastructure investment, as well as increasing the balance sheet size, act as entry barriers.

Customer power

4+

Asset prices tend to be market-driven. Disintermediation in wholesale lending and competition in retail lending leave banks with a lack of pricing power in the asset markets.

Substitute products

4-

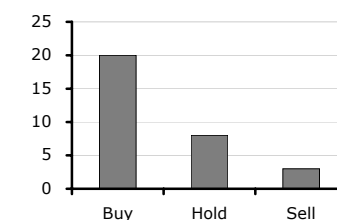
Alternative financial savings pose a threat to the liability franchise. Similarly, disintermediation poses a threat to the asset franchise.

Rivalry

3-

Internal rivalry tends to be intense due to the fragmented nature of the financial markets. Product innovation is duplicated easily, so the life cycle tends to be short.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg