30 April 2007 | 11 pages

ICICI Bank (ICBK.BO)

Buy: 4Q07 Results - Modest, Overshadowed by $5b Capital Raising Plans

- **Plans to raise $5b in new capital, stock overhang ?** — ICICI surprises again on capital raising – in timing (quite unexpected), in scale ($5b), and in the face of some-moderation in its growth rate, particularly the consumer segment. Management plans raising over next two months; will take preference over listing of its insurance businesses, though will be independent of it. Scale and timing of offering likely to pressure the stock near term. Maintain Buy/Low Risk (1L).

- **Why now and so much, and could it have waited?** — Management's reasons a) Increased regulatory requirements, b) Transformational growth environment. This would be ICBK's 3rd large capital raising since mid-2004; in our view, it could have waited. However, management's track record in leveraging new capital, and generating returns for investors, is good.

- **What will this do to ICBK's Financials** — Quick estimates suggest FY09 should see a) ROE at the 12-13% level; 300-400bp below current estimates, b) 2-4% earnings dilution and c) Tier 1 Capad at about 12%, 400bp higher. In effect, substantially enhanced capital cushion, greater growth flexibility but suppressed profitability.

- **The quarter, meanwhile, was a little disappointing** — 4Q07 profits rose 4%yoy; 11% below our expectations, as core margins down 10bp qoq, fee income growth eased, and regulatory provisioning rose. Overall growth remained on cue, though consumer growth is now slowing visibly. And asset quality trends were not decisive – more deterioration, but appears granular, suggesting pressures rather than troubles.

Buy/Low Risk	**1L**
Price (27 Apr 07)	Rs933.65
Target price	Rs1,125.00
Expected share price return	20.5%
Expected dividend yield	1.0%
Expected total return	**21.5%**
Market Cap	Rs839,291M
	US$20,571M

Price Performance (RIC: ICBK.BO, BB: ICICIBC IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	20,049	26.74	2.7	34.9	5.5	19.5	0.9
2006A	25,397	28.13	5.2	33.2	3.7	14.6	0.9
2007E	35,130	38.91	38.3	24.0	3.3	14.9	1.0
2008E	41,194	45.63	17.3	20.5	3.0	15.6	1.0
2009E	51,539	57.09	25.1	16.4	2.6	17.1	1.0

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	34.9	33.2	24.0	20.5	16.4
P/E reported (x)	34.9	33.2	24.0	20.5	16.4
P/BV (x)	5.5	3.7	3.3	3.0	2.6
P/Adjusted BV diluted (x)	5.6	3.8	3.4	3.0	2.6
Dividend yield (%)	0.9	0.9	1.0	1.0	1.0
Per Share Data (Rs)					
EPS adjusted	26.74	28.13	38.91	45.63	57.09
EPS reported	26.74	28.13	38.91	45.63	57.09
BVPS	170.35	249.55	278.91	315.09	362.33
Tangible BVPS	170.35	249.55	278.91	315.09	362.33
Adjusted BVPS diluted	167.40	245.96	274.90	310.55	357.11
DPS	8.50	8.50	9.00	9.00	9.50
Profit & Loss (RsM)					
Net interest income	28,390	41,870	66,562	88,290	113,560
Fees and commissions	19,210	30,019	43,528	57,457	74,695
Other operating Income	14,952	20,347	25,679	23,438	26,619
Total operating income	**62,552**	**92,237**	**135,769**	**169,185**	**214,874**
Total operating expenses	-32,991	-44,795	-64,908	-84,404	-108,521
Oper. profit bef. provisions	**29,561**	**47,442**	**70,862**	**84,781**	**106,353**
Bad debt provisions	1,128	-8,173	-15,818	-17,345	-20,720
Non-operating/exceptionals	-5,416	-8,303	-10,000	-11,000	-12,000
Pre-tax profit	**25,272**	**30,966**	**45,044**	**56,436**	**73,633**
Tax	-5,220	-5,565	-9,910	-15,238	-22,091
Extraord./Min. Int./Pref. Div.	-4	-4	-3	-4	-4
Attributable profit	**20,049**	**25,397**	**35,130**	**41,194**	**51,539**
Adjusted earnings	20,049	25,397	35,130	41,194	51,539
Growth Rates (%)					
EPS adjusted	2.7	5.2	38.3	17.3	25.1
Oper. profit bef. prov.	24.4	60.5	49.4	19.6	25.4
Balance Sheet (RsM)					
Total assets	**1,676,593**	**2,513,890**	**3,123,338**	**3,816,703**	**4,594,540**
Avg interest earning assets	1,358,109	1,953,003	2,651,655	3,299,608	4,030,989
Customer loans	965,132	1,496,945	2,001,439	2,467,960	2,977,855
Gross NPLs	27,704	22,226	40,818	60,250	81,084
Liab. & shar. funds	**1,676,593**	**2,513,890**	**3,123,338**	**3,816,703**	**4,594,540**
Total customer deposits	998,188	1,650,832	2,143,685	2,729,966	3,386,009
Reserve for loan losses	22,541	17,274	34,097	50,691	70,281
Shareholders' equity	**128,999**	**225,560**	**251,685**	**283,876**	**325,911**
Profitability/Solvency Ratios (%)					
ROE adjusted	19.5	14.6	14.9	15.6	17.1
Net interest margin	2.09	2.14	2.51	2.68	2.82
Cost/income ratio	52.7	48.6	47.8	49.9	50.5
Cash cost/average assets	2.3	2.1	2.3	2.4	2.6
NPLs/customer loans	2.9	1.5	2.0	2.4	2.7
Reserve for loan losses/NPLs	81.4	77.7	83.5	84.1	86.7
Bad debt prov./avg. cust. loans	-0.1	0.7	0.9	0.8	0.8
Loans/deposit ratio	96.7	90.7	93.4	90.4	87.9
Tier 1 capital ratio	7.6	9.2	8.5	7.9	7.5
Total capital ratio	11.8	13.4	11.2	10.3	9.8

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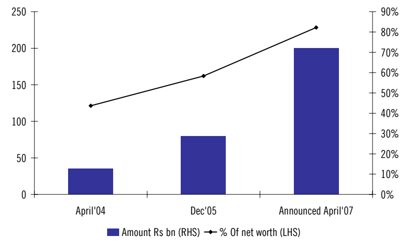
Why the Capital Raising

Management's reasons

ICICI decision to raise $5b in new equity capital from the market is, in management's words, because of a) Continued growth momentum in the economy, reflected in strong demand from the corporate sector, and continued retail lending growth potential; b) Increased regulatory capital for new business – as highlighted by RBI's guidelines on Basle 2 requirements, which come into effect from March 2008, released over the weekend.

Figure 1. Capital Raised and as a % to Net worth



Source: Company Reports and Citigroup Investment Research

Are these entirely new?

a) The growth potential; probably not. ICICI's management has in fact been one of the leading proponents of the India, and India related opportunity and potential. And they have, over the last few years, been among the biggest beneficiaries of the high and broad-based growth the market has witnessed.

b) Increased capital requirement on account of Basle 2. Yes, this is relatively new; was put forth by the RBI in a relatively soft manner in March 2007, and has been finalized on Friday – a day prior to RBI's capital raising announcement. What are the primary implications of these regulations: a) Minimum Tier 1 raised to 6% (from 4.5%) b) Higher risk weightages for retail and some other assets - effectively, ICBK will not get the benefit of the estimated 1% Tier 1 release that it would have got as per the previous regulations.

These regulations do not impact ICBK's current capital adequacy – but do a) Limit the Tier 1 cushion; b) Eliminate Tier 1 capital release expected March 08 onwards. Is this unique to ICBK? No. Though it impacts ICBK a little more given its higher retail asset exposure (where the bulk of capital release was expected).

Could ICBK have waited – any alternatives

In our view, ICBK could have waited (probably a market view too, given that the capital raising announcement does appear to be a surprise). This is because a) It does have reasonable capital - Tier 1 is at 7.4%, and this could have supported 20-25% growth levels for at-least a year; b) ICBK announced the proposed listing of its Insurance and AMC businesses, which it recently transferred into a holding company – would have been a source of capital generation, if small stakes in this company were sold; and c) There does appear some easing in the broader growth environment, particularly in the retail segment. In effect, raising capital at this stage is a call management is making on being well capitalized; rather than a necessity.

Is this the first time ICBK is raising so much, and ahead of expectations. No, ICBK has surprised the market with the scale and timing of its capital raising twice in the relative recent past. It has, however, gone on in both cases to leverage up this capital ahead of expectations, supported by relatively strong returns for investors over the period. It has disappointed on the returns on its equity; ROEs have remained lower than targeted levels, and we would expect the current capital raising to be a further drag on ICBK's ROE

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How will it affect financials

The planned scale of capital raising is large – the Rs200b ($5b) that ICBK is planning will expand its current capital base by over 80%, and will hurt returns over the near to medium. We roughly estimate that in FY09, the first full year of capital deployment, there will be a) 2-4% earnings dilution; b) ROE likely to be in the 12-13% levels – an estimated 400bp lower than our current forecasts which do not factor in new capital and c) This is based on a 10-12% higher asset base assumption, though ICBK will be in a position to leverage much more aggressively, which could raise the ROE and moderate the earnings dilution, as illustrated above.

There will be meaningful gains on the balance-sheet. We estimate ICBK should have Tier 1 capital that is about 400bp higher than our current estimates, at the 12% levels. This should give it significant growth cushion, operational flexibility, and potentially will be a meaningful competitive advantage too. Post this capital raising, ICBK should be well ahead of SBI in terms of its capital base.

Will it be challenging raising such a large amount of capital

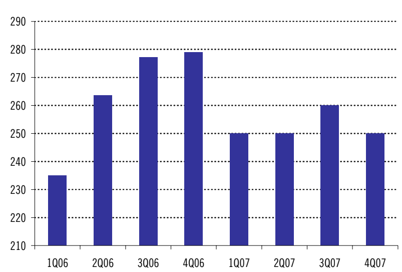
Rs200b or $5b is a very large amount; by far the largest capital raising attempted by an Indian entity. In addition, with its foreign ownership capped at 74%, the offering will need a minimum of Rs52b to be invested by domestic investors only.

We do believe the scale of the offering will be a challenge; this will however not be a first time for ICBK. Both its capital raisings in the recent past have been large, have followed relatively strong stock performance, but have been completed within an aggressive schedule. On each occasion though, the pricing has been done at a discount to peak prices, or price levels at the time of the capital raising announcement. We do expect relatively similar price pressures on the stock, leading into the offering.

Let's not forget the quarter – bit on the disappointing side

While the capital raising has overshadowed the quarterly performance; it does have its takeaways. To start with, it has fallen short of our expectations. Net profit growth at 4% is about 11% below our expectations, and below consensus too. This is also one of the first quarters in many, when ICICI's profit growth has been single digit, and has meaningfully fallen short of expectations. But we believe in ICBK's case, trends in key fundamentals – Margins, Asset quality and growth the biggest direction drivers.

Figure 2. NIM (Bps)



Source: Citigroup Investment Research

Margins: A slight dip, and a modest outlook

4Q07 was expected to a relatively difficult quarter for ICBK on margins – funding costs had risen sharply in the market, it carried a relatively large exposure to interest rate sensitive deposits, and it was expected to pursue growth.

While ICBK's headline margins are up about 6bp qoq – adjusted for a one-off CRR income gain, they are actually about 10bp lower qoq. While this is not extreme, the relative disappointments stems from the fact that most other banks in the system – private and Government, have actually been able to expand their margins over the quarter.

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Figure 3.4Q07 -Financial highlights (Rupees Million, percent)

RS M	4Q07	4Q06	YoY %	3Q07	QoQ%	Citigroup Investment Research Comments
Interest Income	66,616	41,483	60.6	58,247	14.4	Ahead of expectations, bolstered by about Rs650 in bunched CRR returns
Interest Expense	(47,869)	(27,742)	72.5	(41,159)	16.3	Relfects aggressive deposit mobilisation at high rates
Net Interest Income	**18,747**	**13,741**	**36.4**	**17,088**	**9.7**	**Ahead - though asset expansion rather than margin backed**
Fee-Based Income	14,270	11,050	29.1	13,450	6.1	Relative moderation in pace - in part on account of a high base effect, and possibly some moderation in retail asset expansion
Other Non-Interest Income	6,730	4,970	35.4	6,356	5.9	Large gain from NSE stake sale, though likely offset by possible fixed income losses and interest rate mark down on credit bonds
Non Interest Income	21,000	16,020	31.1	19,806	6.0	
Operating Income	39,747	29,761	33.6	36,894	7.7	
Operating Expenses	(19,206)	(14,947)	28.5	(17,133)	12.1	Control showing through, with costs expansion lagging asset expansion
Pre-Provision Profit	**20,541**	**14,814**	**38.7**	**19,761**	**3.9**	
Charges for Bad Debts	(8,763)	(3,545)	147.2	(6,670)	31.4	High on account of stricter regulatory general provisioning requirements, though largely in line with expectations. Upward trend in provisions is likely to continue
Other Operating Items	(2,660)	(2,430)	9.5	(2,240)	18.8	Amortization of the investment portfolio
Operating Profit	9,118	8,839	3.2	10,852	-16.0	
Pre-Tax Profit	9,118	8,839	3.2	10,852	-16.0	
Tax	(866)	(941)	-7.9	(1,751)	-50.5	Relatively low tax - partly on account of low tax on large NSE sale
Net Profit	**8,252**	**7,898**	**4.5**	**9,101**	**-9.3**	
EPS	9	10.67	-13.4	10.2	-9.3	
Customer Loans	1,958,660	1,461,631	34.0	1,727,631	13.4	Relatively strong growth in quarter; usually a low profit and challenging environment to grow in. Primary asset expansion continues on offshore loans, with retail disbursements flat, and mortgages actually falling
Customer Deposits	2,305,100	1,650,832	39.6	1,968,928	17.1	Aggressive expansion continues - at a high cost. Almost all growth in the form of term deposits, which erodes an already poor deposit mix
AIEA	2,697,100	2,038,580	32.3	2,627,710	2.6	
AIBL	2,674,274	1,854,442	44.2	2,404,488	11.2	
Total Assets	3,446,581	2,513,890	37.1	2,958,321	16.5	Growth rates remain high, though moderation starts showing through, as the base gets high
Avg Assets	3,202,451	2,319,100	38.1	2,891,023	10.8	
Gross Non-Performing Loans (NPL) excluding W/off	42,150	20,750	103.1	37,170	13.4	Further deterioration; asset erosion now on for the 4th quarter - almost entirely in the consumer segment. Suggests pressures of high growth showing - though, consistent with 3Q07, and probably not enough to suggest and asset reversal
Loan Loss Reserves (LLR)	(21,960)	(10,000)	119.6	(18,600)	18.1	Coverage levels remain relatively moderate - ICBK does hold about 65bp of loans in general provisions
Shareholders' Funds	243,130	222,060	9.5	244,450	-0.5	
Book Value Per Share	270	250	8.1	273.49	-1.3	
Key Ratios (%)	**4Q07**	**4Q06**	**Bps Δ YoY**	**3Q07**	**Bps Δ QoQ**	**Citigroup Investment Research Comments**
ROAA (annualized)	0.96	1.26	-30	1.23	-27	
ROAE (annualized)	13.58	14.23	-65	14.89	-132	Profitability remains low; with aggressive capital raising plans announced, ROEs are only likely to moderate
Net Interest Margin (bps)	266	279	-13	260	6	Adjusted for CRR inflows, margins at 250bp suggest a fall
Fee Inc/Operating Income	35.9	37.1	-123	36.5	-55	A fall back in fee income share; we expect fee incomes to largely remain at these level, with possible pressures, as the proportion of capital rises
Other Non-Interest Inc/Op Inc	52.8	53.8	-99	53.7	-85	
Op. Cost/ Operating Income	48.3	50.2	-190	46.4	188	Some moderation as growth eases, and some benefits of scale continue to flow through
Loan-to-Deposit Ratio (LDR)	85.0	88.5	-357	87.7	-277	
NPL/Loan Ratio	2.2	1.4	73	2.2	0	NPA's are up; as some pressures of growth and asset quality start showing through
LLR/NPL Ratio	52	48	391	50	206	

Source: Citigroup Investment Research

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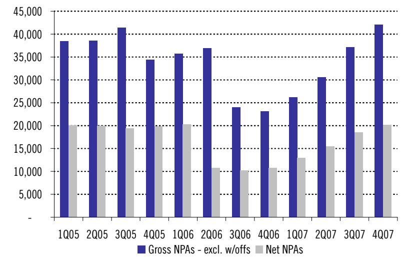
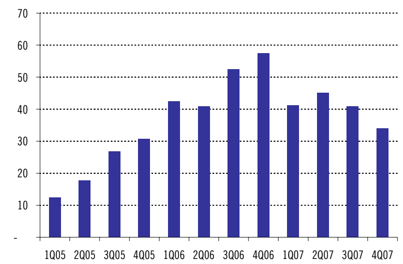
Figure 4. Gross NPA excluding write off and Net NPA (Rs M)



Source: Citigroup Investment Research

Figure 5. Loan Growth (yoy,%) Moderating



Source: Citigroup Investment Research

More important, however, is management's indication that there will continue to be pressure on margins; over the near term, only to be made up towards the latter half of the year. This is disappointing in the context of the near-term outlook; and the expectation that ICBK's aggressive lending rate increases should have covered it for funding cost pressures. While relatively high asset growth in the last quarter is also likely to be a cause for these modest margins, the fact that ICBK is well below industry averages on margins, and yet sees reductions as the broader market expands, is a key disappointment with these results. While not totally unexpected, it does contrast peers in facing the same environmental issues

Asset Quality – The key focus, but not directional

In our view, the health of ICBK's asset book – on the back of sustained high growth, higher interest rates, and signs of wear and tear in the previous two quarters, could potentially have been the make or break of this quarter. It is neither.

There is a bit of a continuation of the trends witnessed through the previous three quarters. That is; some more deterioration on the retail book, increased provisioning, and a slowly rising trend in Gross and Net NPA levels. There is however neither an acceleration in NPLs – nor a slowdown or reversal; in fact incremental deterioration in the current quarter is very similar to 3Q07. NPL levels at the product level also remain relatively consistent; the 8% loss levels on credit cards (12 month trailing balances), remains high and consistent, but largely with the range of expected losses in that product segment in the Indian market. Net NPA's in the mortgage segment have also been formally discosed for the first time0.71% - a little higher than our expectations, but management suggests this is consistent with March 06 levels; meaningfully lower than Government banks, but higher than HDFC.

Management remains relatively comfortable with the asset quality environment – even though they are watching it, particularly given the relatively aggressive interest rate increases over the recent past. Our own sense on ICBK's asset quality is that there will continue to be a consistent but steady increase in NPA's – along with increases in loan loss provisioning. However, this is unlikely to snowball into something meaningfully larger, or one which would meaningfully damage ICBK's P&L, or balance-sheet. Our view is premised largely on the fact that the economy is doing well – and is broad-based. And so asset quality risks lie in execution issues, frauds and other risks of relatively high growth, and a limited few business and retail segments that could be facing operating pressures. We do not believe there is a larger malaise – at the retail, corporate or at the system level, that should meaningfully undermine the balance-sheet.

Nonetheless, ICBK's asset health will and should remain under watch; though the quarter's numbers themselves do not give meaningful direction.

Growth – Momentum moderates and consumer slows, but remains robust

ICBK's pace of growth is now well past its peak; yoy growth numbers are now meaningfully lower than its peak about a year ago, as a combination of a) High base b) Higher interest rates c) An easing in demand in some segments – notably the consumer segment where disbursement growth for the quarter was

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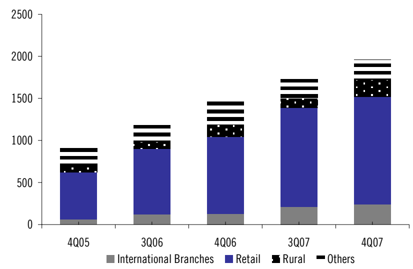
Figure 6. Loan Mix (Rs Bn)



Source: Citigroup Investment Research

down to single digits, and negative for mortgages and d) Funding constraints, moderate its pace of growth.

But do we see ICBK becoming an industry average or slow growth bank anytime soon; no. It expanded relatively aggressively in the quarter with over 13% qoq, and management suggests with its capital raising plans, that it does not intend letting up.

Will the market support such growth; the consumer market, at least for now, probably will not. We do however sense that management will be meaningfully more aggressive in the corporate segment than it has been in the past few years; in part in the offshore markets (most rapidly growing part of ICBK's loan book over the last year), and likely in the domestic market too. Management also remains committed to building and expanding its rural and agriculture business – some operational losses not withstanding during the year. In effect, we believe we are likely to see the portfolio balance shifting away a little from the consumer segment.

ICICI Bank

Company description

ICICI Bank was founded in 1994 by ICICI Ltd., which was then the country's leading development finance institution. It is a leader in retail lending, with more than 30% market share in all consumer-finance segments. ICICI Bank has international banking operations as its key focus area.

Investment thesis

Our Buy/Low Risk (1L) rating is premised on: (1) the bottoming of ICICI Bank's margin cycle, which we expect will start picking up from FY08; (2) a broadening asset mix, which should reduce the risk and profitability strain from concentration; (3) the growing value of its subsidiary businesses; (4) and its broad exposure to the strong momentum in the Indian economy. The bank, in our view, offers one of the best exposures to the consumer finance and financial services opportunity in India, and has been at the forefront of building market leadership in most products. ICICI Bank also offers large exposure to the corporate lending and capex cycle, which should be viewed against the economy's bright prospects.

Valuation

Our target price of Rs1,125 is based on our EVA methodology, which captures the long-term value of the business and is a standard valuation measure for our India banking universe. Our target price is premised on the following: (1) a risk-free rate of 8%; (2) a long-term loan loss of 100bps; and (3) subsidiary value of Rs216 per share. We prefer to use EVA as our primary methodology because we believe it better adjusts for the relatively dynamic cost of capital and better captures the long-term value of the business. On our sum-of-the-parts methodology, our fair value for ICICI Bank is Rs1,051 (up from Rs754 previously). We value ICICI Bank's banking business on a 3x FY08E PBV to

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reflect sustained growth, healthy asset quality and a profitable operating environment. We value the subsidiaries at Rs185 based on FY08E multiples.

Risks

Our risk rating is Low based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. The downside risks that could impede the shares from reaching our target price include: (1) a large NPA book; (2) low margins could also be affected by NPAs, interest-rate volatility and competition; (3) aggressive growth in a range of business areas raises the risk of some failures; (4) international operations without much experience; and (5) additional capital calls.

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Appendix A-1

Analyst Certification

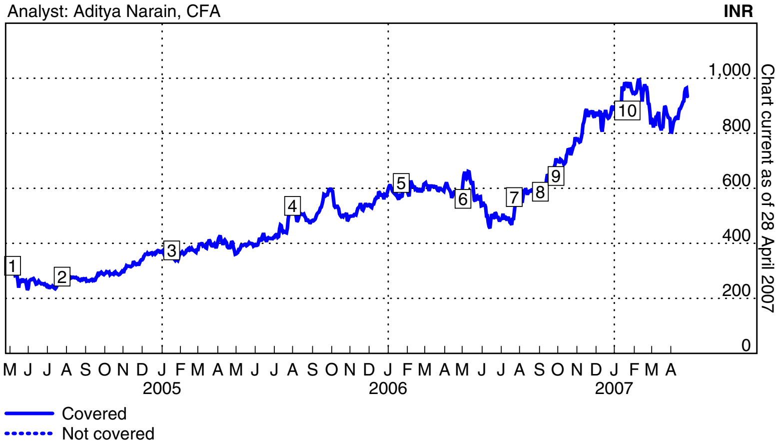
We, Aditya Narain, CFA and Manish Chowdhary, CFA, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

ICICI Bank (ICBK.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Aditya Narain, CFA



#	Date	Rating	Target Price	Closing Price
1:	3 May 04	*2M	*350.00	314.85
2:	26 Jul 04	*1M	350.00	257.30
3:	18 Jan 05	1M	*430.00	350.95
4:	1 Aug 05	*3M	*515.00	533.30
5:	22 Jan 06	*3L	*550.00	569.75
6:	2 May 06	*1L	*700.00	621.95
7:	23 Jul 06	1L	*650.00	514.90
8:	4 Sep 06	1L	650.00	620.75
9:	28 Sep 06	1L	*795.00	708.40
10:	22 Jan 07	1L	*1,125.00	977.20

*Indicates change.

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