Morgan Stanley

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ASIA/PACIFIC

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Stock Rating
Equal-weight

Industry View
Cautious

ICICI Bank

We Are Still Not Buyers

What's Changed

Price Target	**Rs375.00 to Rs330.00**
Modelware EPS F2010e	**Down 16%**

While ICICI appears to be trading at attractive multiple (0.8x book), we will stay away. We expect ROE around 5% for F2010 and F2011, as revenues come off and credit costs rise. Given cost of equity of 12-14% in India, fair value (under Gordon growth) comes to 0.4-0.6x book. Plus, we see significant potential pressure on asset quality from the international asset book, adding to problems already existing in the consumer book. Until economic growth rebounds, ICICI's fundamentals are uncertain.

International assets make up 25% of balance sheet, a significant source of concern The bank increased this book from a small base to US$22bn in about three years, implying a significantly unseasoned book. Moreover, many Indian corporates that went abroad to acquire or borrow are facing problems. We now build in impairment of about 10% on these loans with severity of 50%, suggesting a cumulative loss of about 5%.

Current impairment ratio is about 8%. We expect this to go into double digits in F2010. We make relatively conservative assumptions on severity across asset classes. However, we still expect further provisioning of Rs120bn over the cycle. We build in a further Rs80bn of provisioning for F2010 and F2011 combined, but it could be much higher.

Our new target price on the stock is Rs330. Our bear case value is Rs175 and our bull case is Rs600. But, to achieve the bear or bull case, either asset quality has to deteriorate sharply (bear) or the economy and markets have to improve significantly (bull). Neither of these is likely to happen quickly. Until then, the stock is likely to trade in a range of Rs225-440. Should it move meaningfully above or below this range, we would consider it a trading opportunity.

Key Ratios and Statistics

Reuters: ICBK.BO Bloomberg: ICICIBC IN
India Financial Services

Price target	Rs330.00
Upside to price target (%)	(14)
Shr price, close (Mar 27, 2009)	Rs385.20
52-Week Range	Rs960.90-252.75
Sh out, dil, curr (mn)	1,113
Mkt cap, curr (mn)	Rs428,604
EV, curr (mn)	Rs428,604
Avg daily trading volume (mn)	Rs1,530

Fiscal Year ending	03/07	03/08	03/09e	03/10e
ModelWare EPS (Rs)	34.58	37.37	33.25	23.11
Prior ModelWare EPS (Rs)	-	-	31.79	27.36
EBITDA (Rs mn)	40,047	54,524	49,146	35,848
ModelWare net inc (Rs mn)	31,104	41,578	36,993	25,715
P/E	24.7	20.6	11.6	16.7
P/BV	3.9	1.8	0.9	0.8

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
e = Morgan Stanley Research estimates

ICICI Bank Financial Summary

Profit and Loss Statement				
Rs Mln (Year end-March)	**F2007**	**F2008**	**F2009E**	**F2010E**
Interest Income	219956	307883	330019	267651
Interest Expense	163585	234842	248224	186971
Net Interest Income	**56371**	**73041**	**81795**	**80679**
---Fee Income	43309	56053	58856	51227
---Forex Income	6440	1102	1157	1272
---Capital Gains	11152	18802	5000	5000
---Miscellaneous Inc.	3895	631	1000	1000
Total Non Interest Income	69280	88108	73513	63500
Total Operating Income	**125651**	**161149**	**155307**	**144179**
---Employee Exp	16168	20789	18710	16839
---Other Expenses	50738	60753	53145	55111
Total Operating Expenses	66906	81542	71855	71950
Operating Profit	**58745**	**79607**	**83452**	**72229**
---Other Provisions	671	2036	0	0
---Loan Loss Provisions	21593	27010	38467	40958
Total provisions	22264	29046	38467	40958
Profit Before Tax	**36482**	**50561**	**44986**	**31271**
Provision for Tax	5378	8984	7993	5556
Net Profit	**31104**	**41578**	**36993**	**25715**

Balance Sheet Data				
Rs Mln (Year end-March)	**F2007**	**F2008**	**F2009E**	**F2010E**
Share holders equity	243133	464702	489659	507008
Deposits	2305102	2444311	2077664	1869898
Borrowings	512560	656484	622266	519465
Other Liabilities & Prov.	385786	432454	386591	322625
Total Liabilities	**3446581**	**3997951**	**3576179**	**3218995**
Cash & Balances with RBI	187069	293775	134996	95575
Balances with Banks	184144	86636	116380	43420
Investments	912578	1114543	983996	937495
Advances	1958660	2256161	2077521	1869769
Fixed Assets	39234	41089	47252	56703
Other Assets	164899	205746	216034	216034
Total Assets	**3446581**	**3997951**	**3576179**	**3218995**
Earning Assets	3242448	3751116	3312894	2946259
Average Interest Earning Assets	2794977	3496782	3532005	3129576
Average Loans	1710146	2107410	2166841	1973645
Avg Common Equity / Avg Assets	8%	10%	13%	15%
No Of Shares (mn)	899	1113	1113	1113
Asset Quality				
LLP/Avg Advances (bps)	128	130	178	208
Gross NPL	41261	75795	117258	149409
Net NPL	19920	34906	51901	63095
Reserve Coverage	21340	40890	65356	86314
Gross NPL Ratio	2.1%	3.3%	5.5%	7.6%
Net NPL Ratio	1.0%	1.5%	2.5%	3.4%
Coverage Ratio	51.7%	53.9%	55.7%	57.8%

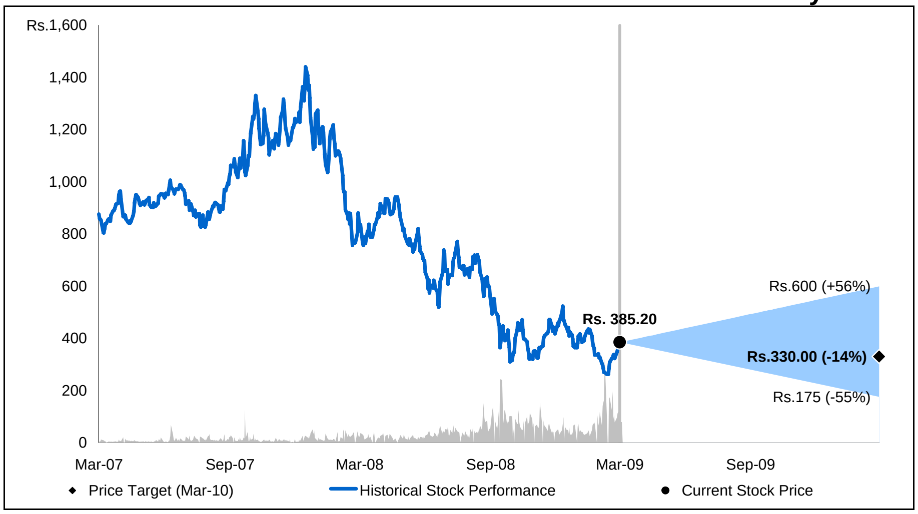
Per Share Data and Valuations				
Year end-March	**F2007**	**F2008**	**F2009E**	**F2010E**
Per Share Data (Rs)				
EPS	34.6	37.4	33.2	23.1
Book Value	270.3	417.6	440.1	455.7
DPS	10.0	11.0	9.6	6.7
Valuations				
PE	11.1	10.3	11.6	16.7
Price to Book	1.4	0.9	0.9	0.8
Dividend Yield	2.6%	2.9%	2.5%	1.7%
ADR Data (ADR=2 shares)				
EPADR (US$)	1.4	1.5	1.4	0.9
P/E	12.5	11.6	13.0	18.7
Yields	2.3%	2.6%	2.2%	1.6%

Ratio Analysis				
Year end-March	**F2007**	**F2008**	**F2009E**	**F2010E**
Spread Analysis				
Average yield on assets	8.2%	8.9%	9.3%	8.6%
Cost of earning assets	6.1%	6.8%	7.0%	6.0%
Net Interest Margin (NIM)	2.1%	2.1%	2.3%	2.6%
Growth Ratios				
Net Interest Income	44%	30%	12%	-1%
Non Interest Income	39%	27%	-17%	-14%
Operating expenses	34%	22%	-12%	0%
Operating Profit	51%	36%	5%	-13%
Net Profit	22%	34%	-11%	-30%
EPS	6%	8%	-11%	-30%
Deposits	40%	6%	-15%	-10%
Advances	34%	15%	-8%	-10%
Total Assets	37%	16%	-11%	-10%
Profitability Ratios				
Return On Equity	13.2%	11.1%	7.8%	5.2%
Return on Assets	1.0%	1.1%	1.0%	0.8%
Efficiency Ratios				
Cost Income Ratio	53.2%	50.6%	46.3%	49.9%
Expenses/Avg Assets	2.2%	2.0%	1.9%	2.1%
Capital Adequacy				
Tier 1 Ratio	7.4%	11.3%	12.3%	13.4%
Tier 2 Ratio	4.3%	3.6%	3.6%	3.6%
Capital Adequacy Ratio	11.7%	14.9%	15.9%	17.0%

Source: Company Data, Morgan Stanley Research
E=Morgan Stanley Research Estimates

Reward Snapshot: ICICI Bank (ICBK.BO, Equal-weight, Price Target Rs330)

Risk-Reward View: Fundamentals Uncertain in Current Economy



Price Target Rs330		Derived from base case scenario.
Bull Case Rs600	26x Base Case 10e EPS	**Margins, loan growth better than base case**. Loan book estimated to be flat for F2010. Margins improve more than expected as low cost deposits proportion improves on back of new branches and low wholesale rates. Credit costs remain high but lower than our base case. International book does not deteriorate as estimated in base case.
Base Case Rs330	14x Base Case 10e EPS	**Marginal improvement in NIMs drives income progression.** Loan book compresses by 10% in F2010. Margins improve slightly due to better funding mix. Credit costs remain high at around 2%. We value non-banking businesses at Rs115 per share.
Bear Case Rs175	8x Base Case 10e EPS	**Pressure on margins and loan growth, Credit costs rise higher than expected.** Loan book compress sharply. Margins remain flat as wholesale rates stay high and branch roll-out is not on expected lines. We assume NPL higher than in our base case. International book asset quality sees higher impairment. We value non-banking businesses lower than in our base case at Rs70 per share.

Investment Thesis

- Largest private-sector bank in India – implies significant scale.
- Interest in other financial services business: life insurance, general insurance, and asset management are among the market leaders.
- Has sizable international presence relative to Indian banks
- Retail NPLs have increased sharply in last few quarters; NPL expected to increase in non-retail and international book
- Valuations: trades at 17x F2010e earnings.

Key Value Drivers

- Loan growth: To slow considerably from current levels.
- NIMs expected to see some improvement with opening up of new branches and wholesale funding cost declining.
- Credit costs likely to rise given the high proportion of unseasoned book, particularly in riskier segments like non retail domestic and international.

Potential Catalysts

- Better than expected performance of international loan book

Key Risks

- Continued deterioration in credit markets causes larger-than-expected losses on international investment book.

Investment Case

This is a reproduction of the note we published earlier today. One change from the earlier note, in Exhibit 13, we added NPLs and Restructured Loans to compare impairment ratio across banks. However, there was an error in the restructured loan data. The exhibit now shows only the NPL ratio. There is no change in our view as a result.

Summary & Conclusions

The key debate on Indian banks in last few months has been about ICICI Bank – what's a good price to buy the stock and whether the current valuation (0.8x book) already captures all possible bad news (especially given the strong capital base with tier 1 at 12.1%). The stock has corrected 73% from a peak of Rs1,440 to Rs385 and has underperformed the Indian market by 21% during this time. We agree that the stock looks attractively valued and is already pricing in some problems in the bank balance sheet. However, we are still not comfortable enough to become a buyer.

We remain concerned about ICICI Bank's international exposure, – which is primarily funded wholesale. If current credit market weakness persists, the international book could face meaningful problems. Given the size of this book – US$22bn (combining exposures through all the entities), which is 25% of total assets and around 210% of shareholders equity – this could create significant problems for the bank.

Hence, from a fundamental perspective, we will refrain from taking a positive long-term view until the credit market thaws and India starts getting international capital flows.

In this note we discuss the following:

1. **We look at earnings during F2004-F2008 (the bull market years) for ICICI Bank and try to calculate the core ROE achieved during this period.** ICICI Bank's earnings (ex capital gains and dividends, which were linked to strong markets and hence not core earnings) show that the bank's average ROE was 10% over this time and around 5% in F2008. Its EPS CAGR was about 5%. This was despite sub-normal credit costs almost through the period. If we apply the Gordon Growth Model to these parameters, fair value comes to around 0.5x - 0.6x book.

   This was the company's profitability during a massive bull market. Unless economic growth revives, it could be much lower over the next two years as revenues taper down and credit costs increase. We forecast about a 5% ROE for F2010 and F2011 with downside risk if credit costs are higher than expected. With the cost of equity staying high, we believe that the fair value of the stock is much less than 1x book – especially, given the overhang on the international book.

2. **We also discuss international balance sheet in some detail.** In our view, this is potentially a big risk to book value. The bank has said that it did not have any bad loans on this book until December 2008. We believe that this status could change quite materially over the next 12 months.

   The balance sheet may become a source of problems in F2010 and F2011. The total asset base in international business increased from US$6.5bn in F2006 to about US$22bn in December 2008 – a CAGR of around 55%. This was the period when Indian corporates were acquiring assets abroad and also borrowing overseas. Both these have turned for the worse – acquisitions have soured, and corporates are finding it tough to service foreign loans.

   The other pressure on international book is from funding. On our calculations, the bank is carrying US$14-15 bn of wholesale funding on its books. If Indian credit rating were to be downgraded to junk (S&P has put India's rating on watch to downgrade to junk), so, most probably, would ICICI Bank's (the bank's rating is linked to sovereign). This could make it difficult to roll over current funding – a potential negative, especially as the asset side is likely to show meaningful stress.

   In our view, the best case scenario for international business is that revenues decline sharply. However, a more likely case is that revenues come off and credit costs rise materially.

3. **The bank had an impaired loan ratio of about 8% (on our calculations) as of December 2008. This could rise sharply if weakness in the economy persists.** We take reported non-performing loans (NPLs), restructured loans and loans sold to ARCIL as impaired loans (see the asset quality section for details). The total coverage on these impaired loans is only about 36%. Such a high-impaired loan book is clearly a big risk, especially if we consider that

most of these loans turned bad when the economy was still robust.

As we move ahead and the economy keeps getting weaker, impaired loans will rise, which could hurt earnings and potentially book value further. We do a stress analysis and, in our bear case, assume that adjusted book value can be half of the current book.

4. **We maintain our Equal-weight on the stock.** For the stock price to break meaningfully either up or down from current levels, international book has to crack (bear case) or markets have to take a sharp upswing, which would help ICICI avoid a sharp pickup in bad loans (bull case). However, neither of these scenarios will unfold quickly.

   Our fair value for the stock is Rs330. However, we believe that this is a volatile stock in the current environment. In our view, until either the bear or the bull case comes by, the stock will likely trade in a range of Rs225-440 (i.e., about 0.5-1x book).

We discuss each of these points in detail in this report.

We are reducing F2010 earnings estimates by 16%, which implies earnings will decline by 30% YoY. We are building in 200 bps of credit costs for F2010 (it was about 185 bps in F3Q09), which may prove low if the economy remains weak and the international book deteriorates. This gives an ROE of about 5% for ICICI Bank in F2010. *See the section on earnings outlook for detailed discussion on earnings.*

Core ROE Has Averaged 10% Last Five Years; EPS Up 5%

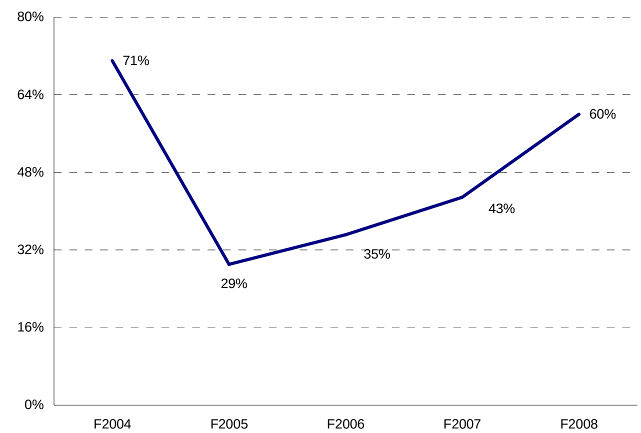
We try to calculate the core earnings and profitability for ICICI Bank. We use the Gordon Growth formula to see what should be the P/B for ICICI given its profitability over the last five years. We do the following:

1. **Look at ROE extracting trading gains and dividend from subsidiaries** For this analysis, we look at historical ROE – but on a core basis. The bank made huge revenues from equity markets (primarily by selling its legacy equity assets) and dividends (a large chunk from its venture capital business). This is unsustainable and is coming off sharply. We also adjust the equity base for investments made in subsidiaries.

   On this basis, the bank's core ROE has averaged about 10% since F2004 – much lower in F2008 and F2009, as equity levels have been high after the 2007 capital raising. This is quite weak, especially given that these were bull markets and revenue progression was strong. As we move into F2010, revenue progression will weaken, which might reduce ROE. We currently estimated ROE for ICICI Bank at 7.5% in F2009 and 5% in F2010.

Exhibit 1

ICICI Bank: Capital Gains + Dividends as % of PBT*



*We take revenues from these sources and divide by PBT, as costs for these two will be small, in our view. Source: Company data, Morgan Stanley Research Estimates

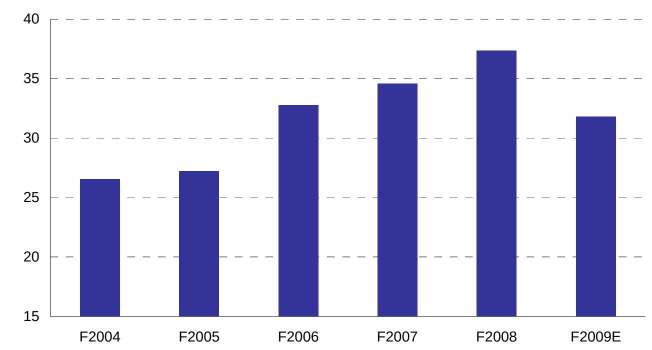
Exhibit 2

ICICI Bank: Core ROE Averaged 10% in F2004-F2008

Rs mn	F2004	F2005	F2006	F2007	F2008
Reported PAT	**16371**	**20052**	**25401**	**31104**	**41578**
Non-core Revenues	13508	7341	10884	15637	30322
Capital Gains	12246	5460	7498	11152	18802
Dividends	1262	1881	3387	4485	11520
Adjusted PAT	**4889**	**13812**	**16149**	**17812**	**15804**
Equity	80106	125500	222060	243133	464702
--Inv in Subsidiaries	14237	20667	28607	40722	85102
Core Equity	65870	104833	193453	202411	379600
Core ROE (%)	**7.7**	**16.2**	**10.8**	**9.0**	**5.4**

Source: Company data, Morgan Stanley Research

Exhibit 3
ICICI Bank: EPS CAGR 5% from F2004-F2009E



E = Morgan Stanley Research Estimates Source: Company data, Morgan Stanley Research

2. **We look at reported EPS growth.** Even reported EPS recorded just a 5% CAGR from F2004-F2009E.

For Gordon growth, we use an ROE of 10% and long-term growth of 5%. This, coupled with a cost of equity of 15%, implies that fair value for ICICI Bank is 0.6x.

Exhibit 4
ICICI Bank: Fair Value Is 0.5x on Gordon

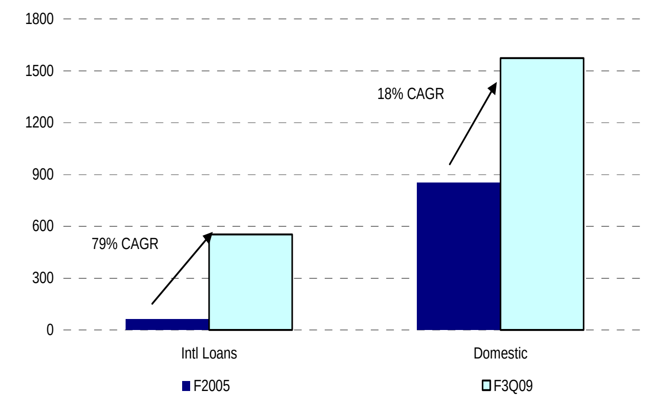
ROE (%)	9.8
Growth, g ()	4.6
COE ()	14
P/B =(ROE - g)/(COE-g)	0.6

Source: Company data, Morgan Stanley Research

International Loan Book Is A Big Concern

We believe that the international book will become a big issue for ICICI Bank, as we move ahead. At the parent level, the international loan book was Rs550bn in December 2008 – a CAGR of 79% since March 2005 or an increase of almost 9x in less than four years. We believe that such rapid growth implies some inherent risks in this loan book.

Exhibit 5
ICICI Bank: At the parent level, bulk of loan growth was driven by international loans over last 3-4 years



Source: Company data, Morgan Stanley Research

The total exposure of ICICI Bank to international business is even greater. ICICI operates in international markets through four different entities: at the parent level (through branch networks in places like Singapore and Hong Kong) and through the three subsidiaries in the UK, Canada and Russia.

On our calculations, the total size of the bank's international loan book was about Rs838 bn (US$17 bn). Plus, ICICI has investments of about US$5 bn, implying total international assets of US$22 bn. Given that the bulk of this is wholesale funded, it may create problems in the future.

Exhibit 6
ICICI Bank: International Assets

Rs bn	ICICI Bank (parent)	ICICI – UK	ICICI - Canada	ICICI – Eurasia	Total Intl
Loans	550	133	143	12	838
Investments	65	159	13	6	243
Total (Rs bn)	**615**	**292**	**156**	**18**	**1081**
Total (US$ bn)	**12.6**	**6.0**	**3.2**	**0.4**	**22.2**
As % of Group Assets					**25%**

ICICI Bank Eurasia is Dec-07 data. Source: Company data, Morgan Stanley Research, Morgan Stanley Research Estimates.

Moreover, there is not much clarity on the composition of this book.

- Until a few months ago, market participants believed that the entire loan book was to Indian corporates abroad. However, the bank subsequently revealed that about 10% of the loan book (at parent level) was to non-Indian companies. At the subsidiary level (UK, Canada and Russia), non-Indian loans are even higher.

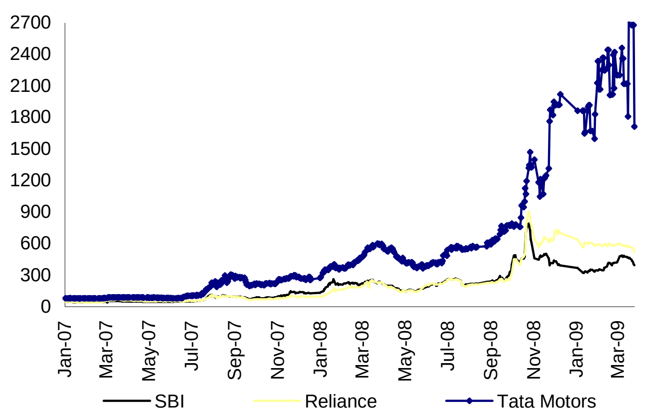
- The bank said that some of the loans through the subsidiaries were for promoter funding (against shares). It has not disclosed the amount, but this clearly could become an issue, especially since such loans are funded wholesale.

  Moreover, recent disclosures show that ICICI Bank was one of the biggest lenders to promoters against shares. Since the number of shares pledged by promoters was significant, it will be difficult to sell in the current market (implying that the collateral may not cover the loans).

- Indian corporates had been aggressively buying assets abroad. ICICI Bank will likely have funded the international expansion of some of these corporates. Such loans could come under severe pressure.

- From F2005-F2008, Indian corporates were aggressive in borrowing money in international markets. Now, however, the credit markets are almost closed for these companies, and they are finding it tough to roll the loans over at a reasonable price. Moreover, the Indian rupee has depreciated sharply since early 2008,which will create a rise in NPLs.

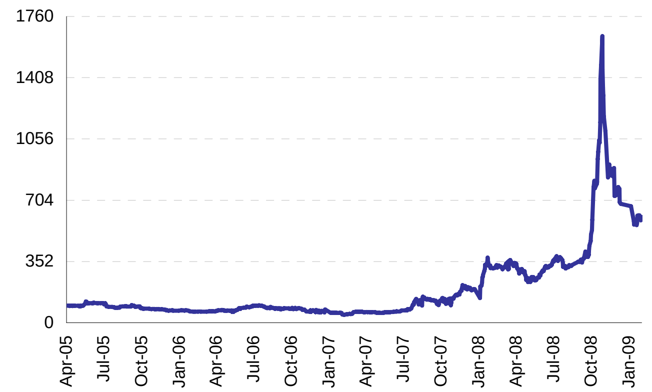
Exhibit 7
India: CDS Trend of Indian Companies



Source: Bloomberg, Morgan Stanley Research

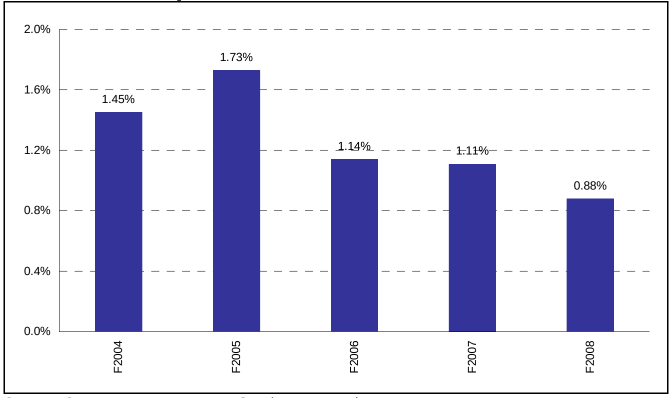
A key problem with international balance sheet is the susceptibility of loans to turn bad in the current economic cycle. The other issue is funding. The bulk of the ICICI's international balance sheet is wholesale funded. Given the current credit market conditions, we believe that it will be difficult for ICICI Bank to roll over these loans when they come due. This will be especially true if India's foreign currency credit rating is downgraded (which in turn implies a potential downgrade of ICICI Bank to same rating).

Exhibit 8
ICICI Bank: CDS Spreads Remain High



Source: Company data, Morgan Stanley Research

Exhibit 9
Net Interest Spreads on International Loan Book



Source: Company Data, Morgan Stanley Research

Even if the asset quality is OK, the bank will likely encounter significant issues with revenue progression. Its net interest margins (NIMs) are likely to compress meaningfully. Plus, given loan origination at zero, fee income will also probably come off sharply.

Hence, the majority of ICICI Bank's loan book is wholesale funded, and quite a few of these loans and investments may face problems, in our view. This clearly places significant potential stress on the international book. Given that this is a large book – 25% of total assets and 2.2x book value – a large weakness here could affect the bank's overall book value.

Exhibit 10
ICICI Bank: International Investment Book

Intl' Investment (by Sub)	US$bn	Comment
ICICI Bank (parent)	1.1	Mostly CDS/CLN
ICICI - UK	3.3	
ICICI - Canada	0.3	
ICICI - Eurasia	0.1	
Total	**4.8**	
Intl' Investment (by Instrument)	**US$bn**	
Senior Bonds	2.5	Mostly banks
RMBS	0.6	
CDS/CLN	1.4	Indian companies
Others	0.3	
Total	**4.8**	

Source: Company data, Morgan Stanley Research

An example of the risk carried by the international book is the exposure in Russia. The Russian subsidiary has a balance sheet of about US$500 mn. On top of that, the rest of ICICI's businesses have another US$500 mn of exposure to Russian syndicated loans. Hence, the total Russian exposure is US$1 bn, or about 10% of ICICI Bank's total equity.

Total Impaired Loans Are Already at 8%

(Please note that not all data is available, we are still trying to do the analysis so some calculations are based on our assumptions)

The gross NPLs at ICICI Bank were Rs90bn in December 2008. However to assess total impaired loans, we add the following:

1. *Treat restructured loans as impaired* These are loans that were facing problems in repayment and whose terms have been modified. In our view, a large chunk of these loans will become NPLs again.

2. *Add NPL sell down to ARCIL.* ICICI Bank sells bad loans to India's asset reconstruction company (ARCIL). This sale takes NPLs off its books, but ICICI is still carrying almost full downside on these loans, in our view. The carrying value of loans sold to ARCIL is around Rs30 bn.

These three add up to Rs170 bn of impaired loans, which is about 8% of total loans.

The bank is currently carrying a provision of Rs62 bn for these impaired loans, on our calculations. This is 36% of total impaired loans. To take coverage up to 75% would require a further provision of Rs66 bn. This would shave 12% off equity invested in the banking business (after taking out the Rs111 bn invested in subsidiaries).

Even if we just add restructured loans and NPLs, ICICI Bank has many more impaired loans than do other Indian banks. Plus, not many other Indian banks have sold loans as aggressively to ARCIL.

Exhibit 11
ICICI Bank: Total Impaired Loan Book

Rs bn	
Gross NPLs	90
Restructured Loans	50
Loans Sold to ARCIL	30
Total Impaired Loans	170
Gross Loans	2187
Impaired Loans Ratio (%)	**7.8**

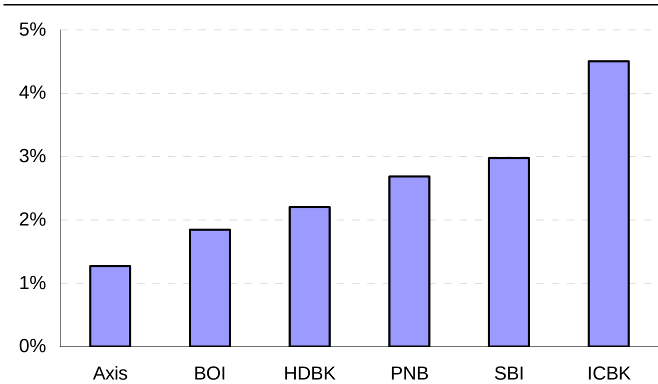
* For gross loans, we added back provision coverage. Source: Company data, Morgan Stanley Research Estimates

Exhibit 12
ICICI Bank: 12% Hit to Book if We Take Provision on Impaired Loans to 75%

Rs bn	
Impaired Loans	170
Total Provisions Currently Carried	62
NPLs	46
Restructured Loans	16
Provision Coverage (%)	36.4
Increment to Take Provision to 75%	66
Post Tax Hit to Book Value	46
Per Share	41
As % of Book Invested in the bank	**12.2**

Source: Company data, Morgan Stanley Research Estimates

Exhibit 13
Indian Banks: NPL Ratios (Dec-08)



Source: Company data, Morgan Stanley Research

The problem will intensify as we move ahead. The cycle has just started to go wrong in corporate loans. Up to now, ICICI Bank's NPLs were mainly in the consumer loan book. In the future, it will see NPLs in the corporate segment too. To assess potential impaired loans over the next 12 months, we break the loan book into three parts: retail; international and others (agriculture, domestic corporate loans, etc.). Until now, ICICI Bank has said that it has seen zero NPLs on international loans; retail is running at 5.7% (of which the mortgage book is running at 1-1.5% NPL ratio, in our view). This suggests that the rest of the NPLs are on other loans.

Back calculating implies that NPLs on other loans are running at about 7%. This is pretty high considering that they are on domestic corporate loans and agriculture. Plus, we are not considering the ARCIL sale and restructured loans in this analysis (most of this will be domestic corporate loans). If we add them, underlying problem loans are higher.

Exhibit 14

ICICI Bank: NPLs Across Loan Categories*

	Mix	NPLs	Source
Retail	53.8%	5.7%	Bank
International (%)	26.0	0.0	Bank
Others (%)	20.2%	7.1%	Balancing Figure
Total (%)	**100.0**	**4.5%**	**Bank**

* These are approximate calculations to get an idea of underlying asset quality across loans.
Source: Company data, Morgan Stanley Research Estimates

Potential Impairments

To assess future potential impairments, we do the following.

1. **Mortgages** We assume that mortgage NPLs increase to 3% of the current loan book. ICICI expanded its mortgage book aggressively from F2004-F2008. With the economy slowing and unemployment rising, mortgage NPLs will rise.

2. **International loans** These will be the big incremental driver of impaired loans for ICICI Bank, in our view. In the last cycle, ICICI Ltd's impaired loan ratio had gone well into double digits before the merger between ICICI Ltd and ICICI Bank in 2002.

   We believe that the international loan book could be equally risky for ICICI Bank. We are building in a 10% impairment (with 50% of this being written off). We would not be surprised if this should be weaker, given the wholesale funding. For Russian loans, we are building in an impairment of 20% and an LGD of 75%.

3. **Non-mortgage retail (secured + unsecured)** We build in an impairment ratio of 20% – it is already running at 10%.

4. **Others** The current impairment ratio on this book is currently about 25% (assuming all restructured + ARCIL loans are in this segment). We assume that the total impairments on this increase to around 30%.

Exhibit 15

ICICI: Potential Incremental Provision Needed

	Loans	NPLs	
Rs bn		Current	Expected
Retail	1185	66	131
International	841	0	78
Others	428	104	128
Total	2453	170	337
Total Provisions Needed			179
Current Provision			62
Incremental Provision Needed			117
Post Tax Impact on Book			82
As % of Book Invested in the Bank			24
Current BV / Share in the bank			339
Adjusted BV / Share			257

Source: Company data, Morgan Stanley Research Estimates

Exhibit 16

ICICI: Loss Given Default Assumptions

Retail	
Mortgages (%)	25
Other secured (%)	50
Unsecured (%)	100
International	
Parent (%)	50
UK (%)	50
Canada (%)	50
Russia (%)	75
Others (%)	25

Source: Company data, Morgan Stanley Research

Earnings Outlook

We are now estimating EPS of Rs23 for F2010. Our key assumptions are as follows:

1. Total loans decline by another 10% in F2010. The bank is not increasing consumer loans and international loan book will also contract. We are also building in a similar contraction in deposits.

2. We believe that NIMs will not improve significantly. While funding will likely decrease, so should asset yields as the bank reduces exposure to higher yield (and riskier) assets. Moreover, NIMs on the international business will likely decline further from current low levels.

3. We are building in a further 15% contraction in fee income in F2010. We already saw a contraction in F3Q09. We expect a lack of loan originations and weak capital market activity to affect fee income in F2010. We would not be surprised if fee income contraction is greater.

4. We are building in about 200 bps of credit costs for F2010, which will be driven by the continued increase in NPLs.

Hence, even though we are building in flat operating costs (despite almost 580 new branch openings), earnings will be down 30% YoY in F2010, by our calculation.

Exhibit 17
ICICI Bank: Earnings Outlook

YoY % Change	F2009E	F2010E
Net Interest Income (%)	**12**	**-1**
Non Interest Income (ex Cap gains) (%)	5	-13
Treasury Income (%)	-73	0
Non Interest Income (%)	-17	-14
Total income (%)	**-4**	**-7**
Operating Expenses (%)	-12	0
Pre provision profit (%)	**5**	**-13**
Loan Loss Provisions (%)	42	6
Profit Before Tax (%)	**-11**	**-30**
Provision for Tax (%)	-11	-30
Reported Profit (%)	**-11**	**-30**
EPS (%)	**-11**	**-30**
ROE (%)	7.8	5.2
ROA (%)	1.0	0.8
Operating Cost/Op Income (%)	46	50
Core Cost Income Ratio (%)	48	52
Annual LLP / Advances (bps)	178	208
Low-cost Deposits %	33	33
Deposits (%)	-15	-10
Advances (%)	-8	-10
Total Assets (%)	-11	-10

Source: Company data, Morgan Stanley Research, E=Morgan Stanley Research Estimates

Target Price Discussion

We value ICICI Bank using a sum-of-parts method. For ICICI Bank (parent), we base our fair value on a residual income (RI) approach, which values a bank at book value plus the present value of excess profits (over the cost of equity). The key assumptions in our base case RI model, which values the parent at Rs215, are cost of equity at 13.8% (risk free rate = 6%, beta = 1.3 and equity risk premium = 6%).

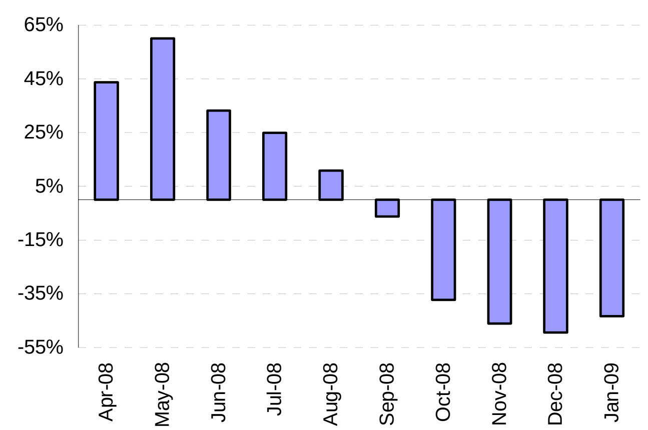
Exhibit 18
ICICI Bank (Parent): Base Case Residual Income Model

Est. Current Fair Value (Rs)	191
10-year bond yield, %	6
Beta	1.3
Market Risk, %	6
Cost of Equity, %	13.8
12 Month Parent Fair Value (Rs)	215

Source: Morgan Stanley Research Estimates

Among the subsidiaries, the key value driver is life insurance. But this business is slowing sharply, lowering valuations.

Exhibit 19
ICICI: Life Insurance New Business Premium (Retail APE) Slowed Sharply (YoY)



Source: Company data, Morgan Stanley Research

Exhibit 20
ICICI Bank: Sum-of-Parts Valuation

Base Case		
Banking Business	**215**	RI Model
Subsidiaries		
Life Insurance	75	Appraised Value Method
General Insurance	10	12x F2009 Earnings
AMC	10	4% of F2009 AUM
ICICI Securities	8	10x F2009 Earnings
ICICI Venture	12	11% of F2009 AUM
ICICI Bank UK	0	
Sum of subs / associates	**115**	
Target Price	**330**	

Source: Company data, Morgan Stanley Research Estimate

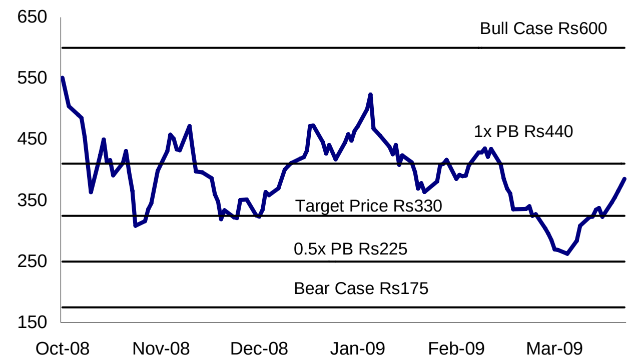
While our fair value for the stock is Rs330, we believe this is a volatile stock and is likely to continue to trade in a wide range. Our bear case is Rs175 and our bull case is Rs600. However, for either of these to be achieved, certain events have to happen that will unfold only over a period of time. For the bear case, asset quality, especially in international business, would have to deteriorate at a rapid pace. For the bull case, economic growth has to rebound.

However, until there is certainty of either of these two events, we expect the stock to trade in a range of around 0.5x-1x book. We would be buyers/sellers if the stock price deviates materially from this range, unless either the bearish or bullish scenario looks very probable.

Key upside risks to our price target include better-than-expected NIMs and asset quality at the banking business and higher-than-expected market share or NBAP margins for the life insurance business. Downside risks include weaker earnings at the banking business and weaker premium growth at the life insurance business.

Exhibit 21

ICICI Bank: Volatile Stock Movement



Source: Company data, Morgan Stanley Research

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Equal-weight/Hold	**1003**	**44%**	**246**	**43%**	**25%**
Not-Rated/Hold	**33**	**1.5%**	**9**	**1.6%**	**27.3%**
Underweight/Sell	**507**	**22%**	**100**	**18%**	**20%**
Total	**2,257**		**571**		

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Industry Coverage:India Financial Services

Company (Ticker)	Rating (as of)	Price (03/27/2009)
Anil Agarwal		
AXIS Bank (AXBK.BO)	U (03/31/2008)	Rs431.2
Corporation Bank (CRBK.BO)	E (03/03/2008)	Rs175.05
HDFC (HDFC.BO)	E (03/27/2009)	Rs1,589.15
HDFC Bank (HDBK.BO)	E (10/18/2006)	Rs996.6
ICICI Bank (ICBK.BO)	E (03/10/2008)	Rs385.2
IDBI (IDBI.BO)	U (10/21/2005)	Rs48.8
IDFC (IDFC.BO)	O (09/16/2005)	Rs58.05
State Bank of India (SBI.BO)	U (05/05/2008)	Rs1,125.35
Ashish Jain		
Bank of Baroda (BOB.BO)	E (03/03/2008)	Rs247.9
Bank of India (BOI.BO)	O (11/30/2006)	Rs233.75
Canara Bank (CNBK.BO)	E (03/03/2008)	Rs167.05
Kotak Mahindra Bank (KTKM.BO)	U (08/21/2006)	Rs301.7
Oriental Bank of Commerce (ORBC.BO)	O (02/25/2009)	Rs119.25
Punjab National Bank (PNBK.BO)	E (03/03/2008)	Rs441.15
Reliance Capital (RLCP.BO)	E (08/20/2008)	Rs371.6
Union Bank of India (UNBK.BO)	E (01/19/2009)	Rs152.45

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