Detailed Report
SECTOR: BANKING

MOTILAL OSWAL

ICICI Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,809	ICICIBC IN
	REUTERS CODE
S&P CNX: 3,210	ICBK.BO

26 May 2006

Buy

Previous Recommendation: Neutral

Rs563

Building up

Strong growth in domestic business, leading to leadership in most segments

Aggressively ramping up international and rural operations – the next growth engine

Stable margins, high fee income and low NPAs to improve profitability

Significant value creation in subsidiaries

SOTP-based target price of Rs709 implies 26% upside; upgrade to Buy

Manish Karwa (Mkarwa@MotilalOswal.com;Tel:+91 22 39825409) /
Rajat Rajgarhia (Rajat@MotilalOswal.com;Tel:+91 22 39825441) Veekesh Gandhi (VeekeshGandhi@MotilalOswal.com)

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Y/E MARCH	2005	2006	2007E	2008E
NII (Rs b)	28.4	41.9	57.1	72.8
OP (Rs b)	30.8	46.9	63.4	83.2
PAT (Rs b)	20.1	25.4	31.3	39.7
EPS (Rs)	27.2	28.5	35.2	44.6
EPS Growth (%)	2.5	4.8	23.2	26.8
BV/Share (Rs)	170.3	249.5	279.6	313.6
P/E (x)	0.7	19.7	16.0	12.6
P/BV (x)	3.3	2.3	2.0	1.8
ABV (Rs)	156.8	241.4	273.0	309.0
P/ ABV x)	3.6	2.3	2.1	1.8
RoE (%)	19.5	14.6	13.3	15.0
RoA (%)	1.4	1.2	1.1	1.1

KEY FINANCIALS	
Shares Outstanding (m)	890.0
Market Cap. (Rs b)	500.8
Market Cap. (US$ b)	10.9
Past 3 yrs Operating Income Growth (%)	68.5
Past 3 yrs NP Growth (%)	98.0
Dividend Payout (%)	36.0
Dividend Yield (%)	1.5
P/E to Growth (x)	1.1

STOCK DATA	
52-W High/Low Range (Rs)	671/385
Major Shareholders (as of March 2006)	(%)
Domestic Institutions	15.1
FII/FDIs	73.5
Public	11.4
Average Daily Turnover	
Volume ('000 shares)	1,495.0
Value (Rs million)	832.5
1/6/12 Month Rel. Performance (%)	9/-18/-21
1/6/12 Month Abs. Performance (%)	-1/4/41

ICICI Bank has been aggressively growing its domestic business and holds the lion's share in most of the segments it operates in. This is significant, as the strong economic growth will open multiple growth opportunities for large banks. While ICICI Bank continues to be the dominant player in retail lending, the management is now considering significant diversifications in non-retail lending. We expect strong loan growth of 25% CAGR over the next couple of years.

International & Rural – next growth engines: We expect robust balance sheet growth of 26% over FY06-08 period, supported by a strong growth in rural and international assets. In just three years, ICICI Bank has built a presence in 12 locations overseas and an international loan book of Rs370b and a rural loan book of Rs140b. These new segments will also help the bank to generate stable deposits and higher fee income.

Fee income, stable margins and low NPAs to drive earnings: Fee income (CAGR of 91% in FY02-06) will contribute to over 50% of total income for the bank, in line with the top banks globally. Stable interest margins and low NPAs will further drive the earnings growth. We believe that ICICI Bank's earnings model is a lot more stable now to drive a 25% CAGR despite lower trading gains and higher tax rates.

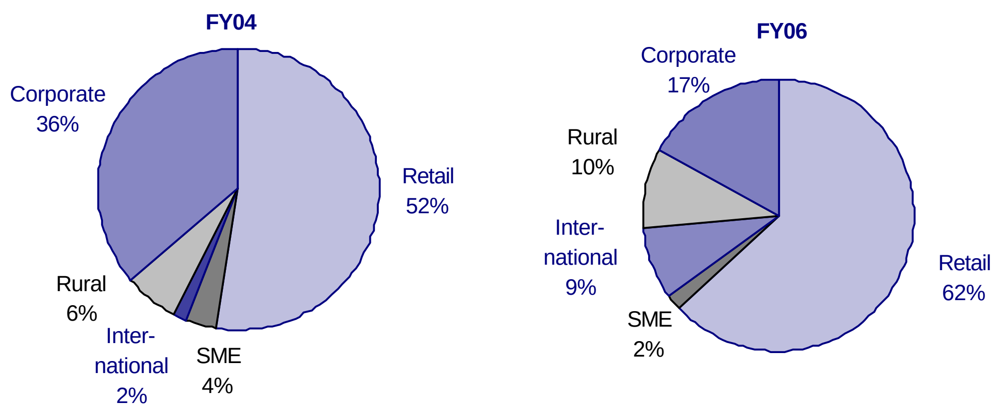
Subsidiaries – creating significant value: Over the years, ICICI Bank has nurtured subsidiaries (life insurance, asset management, capital markets etc), several of which have become leaders in their respective fields. Most subsidiaries have attained respectable scale and are still exhibiting strong growth rates. We believe that these subsidiaries are creating significant value for ICICI Bank. We value the key subsidiaries of ICICI Bank at Rs144 per share.

Valuations attractive; Buy: We expect ICICI Bank's earnings to grow at a CAGR of 25% over FY06-08 (our estimates are conservative and have further scope for upgrades). Adjusting for the value of its subsidiaries, the stock quotes at 9.4x FY08E earnings and 1.3x FY08E book value. We believe that, adjusted for the value of its subsidiaries, the stock should quote at 1.8x FY08E book value. Given the bank's high growth visibility and with concerns on profitability and asset quality allayed, we upgrade our recommendation from Neutral to **Buy**. Our SOTP-based target price of Rs709 implies a 26% upside.

Strong growth in domestic business – leadership in most segments

Over the last couple of years, ICICI Bank has grown its loan book at a CAGR of 53% to Rs1,462b, while the balance sheet size has expanded at 41% CAGR to Rs2,514b. Retail advances, which grew 64% during FY06, remain the primary growth drivers and constituted 63% of the bank's total loans as at end-FY06. While growth in corporate loans is also picking up, rural credit presents the next big growth opportunity in our opinion. The bank's aggressive deposit raising has supported the robust loan growth.

BREAK-UP OF LOAN BOOK



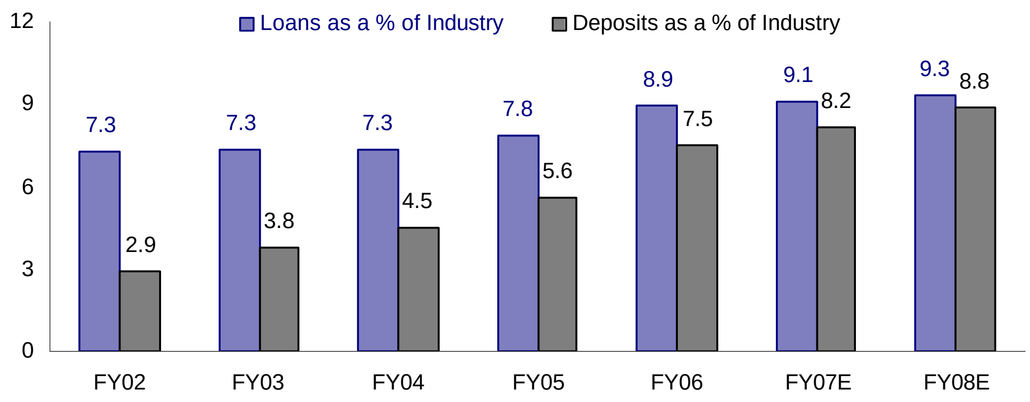
Source: Company/Motilal Oswal Securities

Gaining market share

Post its merger in FY02, ICICI Bank has been consistently gaining market share on back of its aggressive growth both in deposits and advances. ICICI Bank's advances book has expanded at a CAGR of 33% (FY02-06), with the system average loan growth being at 24% over FY02-06. At the same time its market share in advances have increased from 7.3% in FY03 to 8.9% in FY06. We expect the bank to grow its advances at a CAGR of 25% over FY06-08 and will further increase its market share to 9.3% by FY08.

The growth in deposits have been even more stronger, with deposits growing at a CAGR of 51% over FY02-06 period. Its market share has increased from 3.8% in FY03 to 7.5% in FY06. We expect deposits to maintain strong growth of a 30% CAGR over FY06-08 period. We expect the banks market share in deposits to improve from 7.5% in FY06 to 8.8% in FY08.

ICICI BANKS MARKET SHARE IN LOANS AND DEPOSITS AS A % OF INDUSTRY



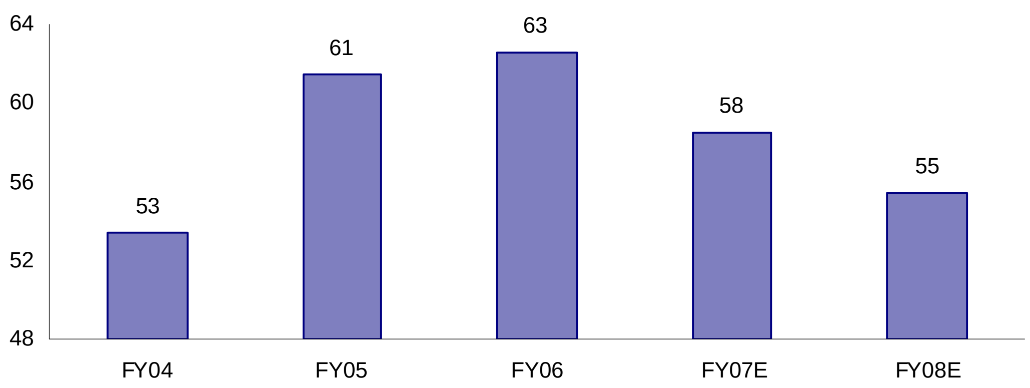
Source: Company/Motilal Oswal Securities

With this market share, ICICI Bank has emerged as the 2nd largest bank in India. This is significant, considering the fact that the bank had a much smaller distribution network compared with other banks. With the economy expected to maintain a healthy growth of 7-8% over the next few years, multiple growth opportunities for banks will open up. Within this, size will be an important consideration, as ICICI Bank will be best positioned to participate in every growth opportunity. We also expect the top 2-3 players to set the pricing terms, which will also mean a significant involvement of ICICI Bank.

Retail loans driving growth

Over the last three years, ICICI Bank has become the market leader in retail lending. It's balance sheet, which was wholesale loan dominated at the time of the merger of ICICI into it, is now retail asset dominated. Retail loans constituted 63% of the bank's total loans as at end-FY06. We expect the proportion of retail loans to decline hereon, as corporate and rural loans are likely to grow faster.

ICICI BANK: PROPORTION OF RETAIL LOANS TO TOTAL LOANS (%)



Source: Company/Motilal Oswal Securities

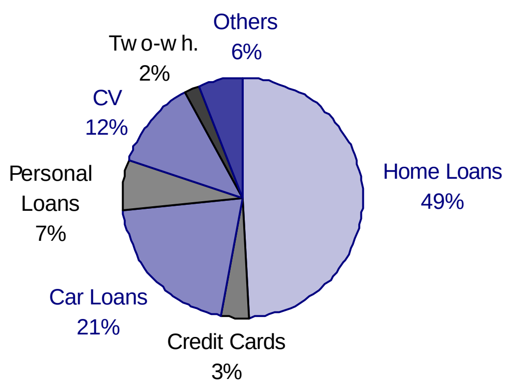
Within the retail loans, ICICI Bank has dominated almost every category and has emerged as a top player in most of the categories. In FY06, the bank had a huge 33% market share in the total industry volumes in all forms of retail lending. We expect ICICI Bank to continue to be a top player in most of the categories, even though we expect retail portfolio to decline as a proportion of total loans.

ICICI BANK: SHARE OF RETAIL LENDING (RS B)

PRODUCT	INDUSTRY VOLUMES (FY06)	ICICI BANK'S VOLUMES	ICICI BANK'S MARKET SHARE (%)
Mortgages	825	257	31
Auto Loans	430	173	40
Commercial Loans	290	92	32
Personal Loans	230	65	28
Two-wheeler Loans	92	33	36
Total	**1,867**	**621**	**33**
Credit Cards (million numbers)	18	5	29

Source: Company/Motilal Oswal Securities

BREAK-UP OF RETAIL LOAN BOOK (%)



Source: Company/Motilal Oswal Securities

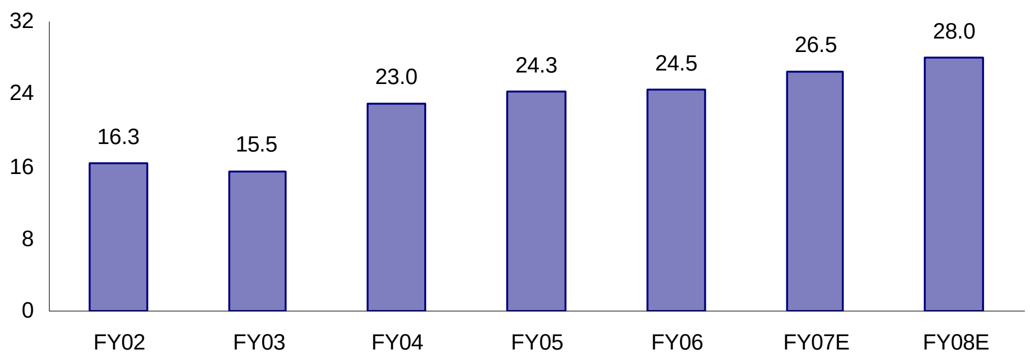
Growth in corporate loans picking up

India's corporate sector is in the expansion mode and growth in corporate loans is picking up. We estimate that India's corporate sector would need funds of US$150b over the next 3-5 years. The much needed investment flow to infrastructure provides another avenue for credit deployment. With the recent lending rate hikes, the profitability of corporate loans has improved for Indian banks. ICICI Bank's aggressive international expansion would help it to meet the credit needs of Indian companies in international markets, as they expand overseas.

Aggressive deposit raising supporting loan growth

The share of total deposits has grown from 30% of the balance sheet in FY02 to 66% in FY06. However, CASA deposits (low cost deposits) accounted for just 24% of total deposits in FY06. This is primarily because ICICI Bank continues to raise wholesale deposits to repay erstwhile ICICI's borrowings and to fund its strong balance sheet growth. Nevertheless, CASA deposits have grown at a CAGR of 67% during FY02-06.

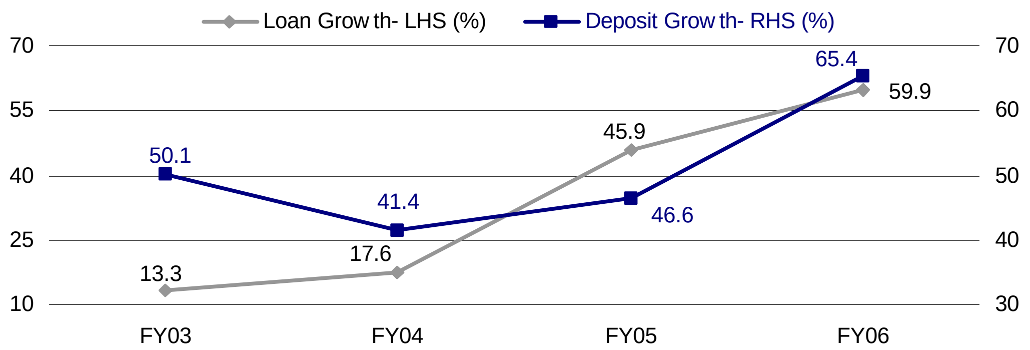
CASA AS A % OF TOTAL DEPOSITS



Source: Company/Motilal Oswal Securities

While ICICI Bank has been able to speedily build up a retail asset base, growing its retail liabilities is the next big challenge for the bank. The bank has aggressive plans to increase its branch network in semi-urban and rural areas to grow its retail liabilities. It intends to open more than 100 branches in FY07, subject to RBI licensing.

AGGRESSIVE DEPOSIT RAISING SUPPORTING LOAN GROWTH

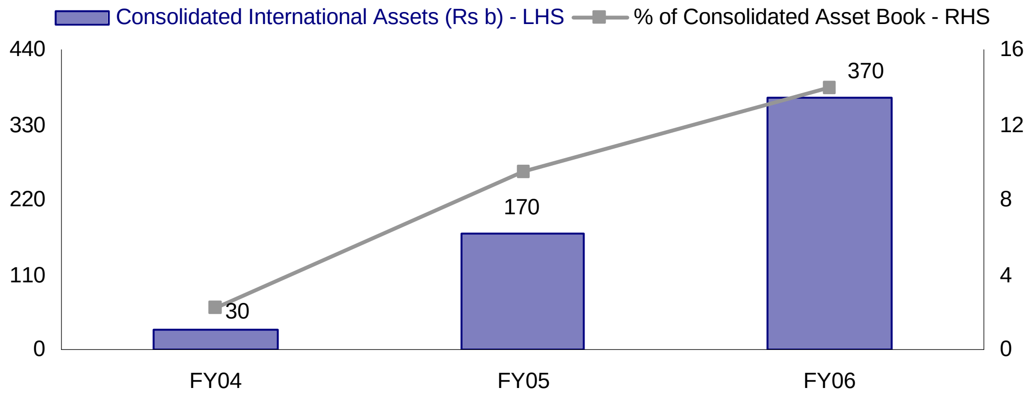


Source: Company/Motilal Oswal Securities

International & Rural operations - the next growth engine

The international operations of ICICI Bank are a classical case of doing business in developed countries with the costs of developing countries. The bank's low cost advantage comes from its back office support from India. We believe that international operations would be the next growth engine for ICICI Bank. In just three years, the bank has built a presence in 12 locations overseas. It aims at increasing the contribution of international assets from 14% of total assets to 25% of total assets over the next two years. Also, strong remittances (about US$20b in FY05) to India and increasing cross border acquisitions by Indian companies offer big opportunities for fee income growth.

GROWING INTERNATIONAL ASSETS



Source: Company/Motilal Oswal Securities

Expect aggressive growth over the next 2-3 years

Over the last three years, ICICI Bank's international operations have built a loan book of Rs125b on a stand alone basis. Including its banking subsidiaries in Canada and UK, which has built up substantial scale, total international asset size is Rs370b (US$8.1b), which accounts for 14% of the total consolidated asset book. We expect aggressive growth in international operations over the next 2-3 years. The bank intends to increase the contribution of international assets to 25% of total assets by FY08.

INTERNATIONAL OPERATIONS – A SNAPSHOT

	%
Net Interest Margins	1.0
Fee Income	1.4
Treasury	0.2
Sub-total	2.6
Less: Opex	0.8
Sub-total	1.9
Less: Provisions	0.3
Sub-total	1.6
Less: Tax	0.5
PAT	1.1
Leverage	16.0
RoE	17.9

Source: Company/MOSt

Profitability to increase; sustainable RoE of 17-18%

Currently, almost all of ICICI Bank's international business is wholesale. Going forward, it plans to aggressively tap retail customers at locations having Indian-centric population. Besides enabling higher growth, this would help lower cost of funds and expand margins. The bank's profitability would also be buoyed by its low operating costs (as compared to local banks abroad), as all its transaction-related activities are carried out in India.

ICICI Bank has been focusing on fee-rich activities. Fees from international operations contribute 12% of its total fee income. The bank has already built a 20% market share in inward remittances in India. As strong fee accretion offsets the relatively lower margins, the overall profitability for its international operations is similar to that of its domestic operations. We estimate the bank's net interest margin from international operations at 1%, while fee income generated is nearly 1.4% of assets.

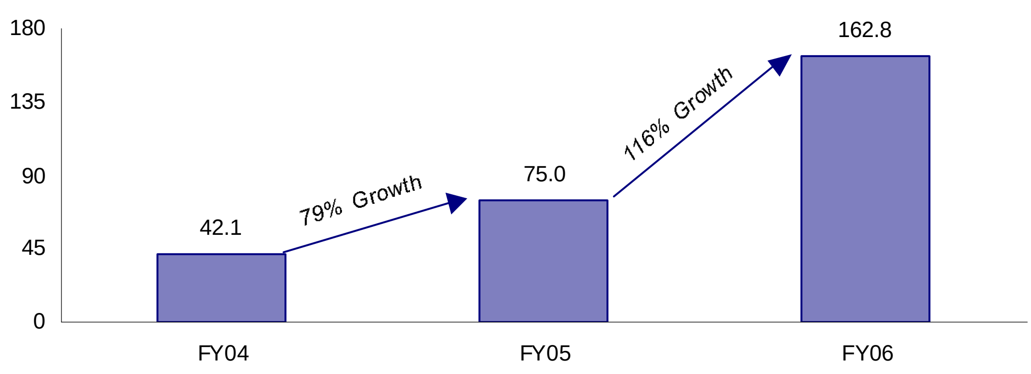
We estimate RoE of 17-18% from international operations, which is similar to the sustainable RoE we expect from its domestic operations. As the potential leverage in the international market could be high, RoE could expand further in international operations.

Rural credit presents the next big growth opportunity

Credit penetration is abysmally low in the rural segment (~15% of GDP, against a national average of ~40%) and presents a big opportunity. While yields in this business are high, higher operating costs and low ticket-size are the key drawbacks due to which banks have been slow to expand in this arena.

Considering the growth potential, however, ICICI Bank is aggressively focusing on the rural segment mainly through micro-finance institutions, franchisees, co-operatives, internet kiosks and selective branches. Its product portfolio is not restricted to just farmer loans. The bank also offers innovative products like warehouse receipt financing and jewel loans.

STRONG GROWTH IN RURAL CREDIT (RS B)



Source: Company/Motilal Oswal Securities

In FY06, ICICI Bank's rural and agri-business portfolio grew 120% to Rs163b. Rural initiatives are also augmenting the bank's fees, as it also uses its rural points-of-presence (PoPs) to distribute investment and insurance products. We believe that corporate loans and rural credit would constitute a higher share of ICICI Bank's total loan book, going forward. This would help balance its loan portfolio, which is currently tilted heavily towards retail lending.

Margins likely to sustain

ICICI Bank posted NIMs of 2.4% for 4QFY06 and FY06. We expect NIMs to sustain at this level for FY07. The reported margins in 4QFY06 were adversely impacted on account of new norms on securitization, adjusted for which margins improved by 20bp. Though the bank had to resort to high cost borrowings in March 2006, and funding costs are likely to be higher in 1QFY07, we are not worried. This is because ICICI Bank has already raised its lending rates to counter rising cost of funds. Also, the bank maintains a very low duration investment book, which would enable faster re-pricing of investments in a rising interest rate scenario and favorably impact overall margins. Once interest rates stabilize, it could look at securitization.

TREND IN YIELD AND COSTS (%)

	FY05				FY06			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Yield on Advances	10.0	9.3	9.4	9.4	8.7	8.7	8.7	8.7
Cost of Deposits	4.5	4.3	4.3	4.7	5.0	4.9	4.8	5.2
Cost of Funds	6.0	5.7	5.6	5.8	5.9	5.8	5.7	5.9
NIMs	**2.3**	**2.4**	**2.4**	**2.4**	**2.4**	**2.3**	**2.5**	**2.4**

Source: Company/Motilal Oswal Securities

Funding costs will remain high

ICICI Bank has grown its balance sheet at an aggressive rate, which was not well supported by its relatively smaller branch network. To sustain its strong balance sheet growth, ICICI Bank had resorted to bulk borrowing. Moreover, as the bank also repriced its old liabilities raised at very high rates, it resorted to bulk deposits. The trend of raising bulk deposits continued in FY06, with a significant raising done in March 2006. As a result, we believe that funding costs would be higher in 1QFY07 – we estimate a 30bp increase. The bank's cost of funds was 5.9% in 4QFY06, which we estimate would rise to 6.2% in 1QFY07. Moreover, the proportion of low cost funds is lower for ICICI Bank compared with other banks. However, as the bank now plans to expand its network very significantly, we expect bulk deposits growth to slow down, which will provide more stability to the deposit base. However, we expect ICICI Bank to have a higher cost of funds compared to other banks, even going forward.

However, loan rates have already been raised

ICICI Bank has increased its loan rates significantly over the last few months. It has increased its lending rate for corporates by 175bp over the last five months, a big part of which is likely to be effective from 1QFY07. Further, over the last three months, ICICI Bank has hiked its mortgage (30% of portfolio) rates by 100bp (50bp would be effective from 1QFY07 and another 50bp from 2QFY07). Even yields on incremental auto (15% of portfolio) loans have gone up by >150bp over the last six months. We expect overall loan yields to improve from 8.7% in 4QFY06 to >9% in 1QFY07. Moreover, as the bank is now improving its focus on non-retail segments, where loan yields are rising faster, we expect overall loan yields to improve, going forward.

SERIES OF RATE HIKES BY ICICI BANK

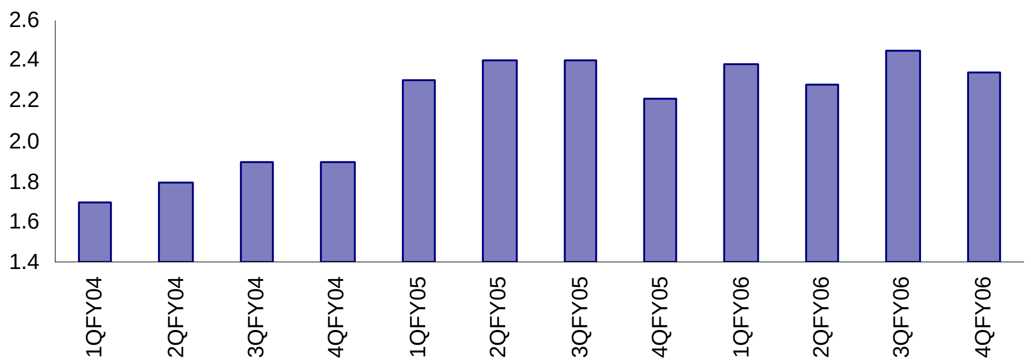
6-May	Home loan rates hiked by 50bp
14-Mar	PLR hiked by 100bp to 12.75%
7-Mar	Auto loan rates hiked by 50bp, discounts withdrawn
13-Feb	Home loan rates hiked by 50bp
3-Feb	PLR hiked by 25bp to 11.75%
13-Jan	PLR hiked by 25bp to 11.50%
30-Nov	Auto loan rates hiked by 50bp discounts withdrawn

Source: Company/Motilal Oswal Securities

Low duration to enable faster re-pricing of investment book

ICICI Bank maintains a very low duration investment book of about one year, mainly consisting of T-Bills and floaters. The average yield on this portfolio was just 6.5% in FY06. As interest rates have been moving up, the bank will benefit from faster re-pricing of this portfolio. Moreover, the bank carries very little risk on marked-to-market basis. We expect re-pricing of the bond portfolio to also lead to stable margins in FY07.

TREND IN MARGINS OVER THE LAST 12 QUARTERS (%)



Source: Company/Motilal Oswal Securities

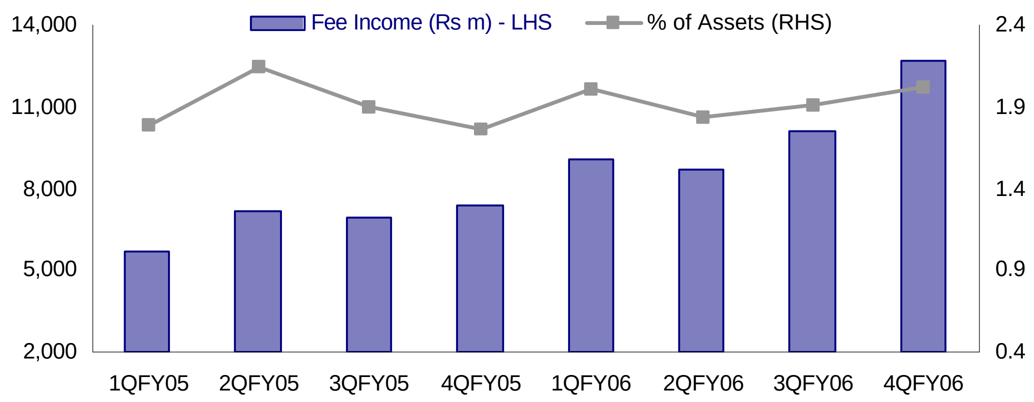
Securitization to emerge as an option once interest rates stabilize

ICICI Bank used to earn about 15% of its NIMs through securitization during the last 7 quarters (till 3QFY06). However, post the change in securitization norms and sharp interest rate volatility in 4QFY06, ICICI Bank did not resort to securitization in 4QFY06. We however, believe that as the interest rates stabilize, the securitization market will again emerge as a source to raise liquidity. Profits would not be booked as a one-time income (which ICICI Bank was doing earlier) at the time of securitization, but would accrue over the life of the asset. Thus, a sharply reduced securitization income would put pressure on the bank's margins in the initial year. However, margins would improve as the securitized book increases. For FY07, excluding securitization, we expect margins to improve by 20bp, while including securitization, margins are likely to remain stable. Higher securitization income in FY08 would be positive for overall margins.

Fee-based revenues to take center-stage

ICICI Bank is increasingly moving towards a fee-based model, in line with international banks. The bank's fee income, which constitutes 2% of total assets, is growing fast. Core fees (excluding treasury gains) have grown at a CAGR of 91% during FY02-06. We expect a CAGR of 38% over FY06-08, on the back of its increasing retail assets and liabilities, growing international operations and other fee-based products.

ICICI BANK: GROWING FEE INCOME



Source: Company/Motilal Oswal Securities

COMPOSITION OF TOTAL INCOME (%)

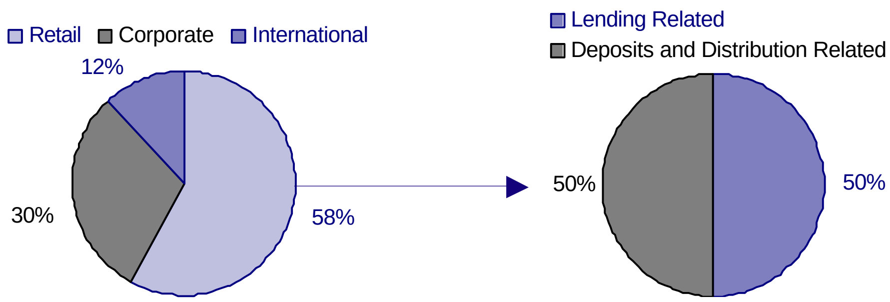
CONTRIBUTION	FY04	FY05	FY06	FY07E	FY08E
Net Interest Income	39	45	46	48	48
Fee Income	36	47	44	48	50
Treasury Income	24	9	10	4	3
Total Income	**100**	**100**	**100**	**100**	**100**

Source: Company/Motilal Oswal Securities

Present across the value chain, across all product profiles

ICICI Bank is present across the value chain and has products to suit all customer demands. It is the leader in the credit cards market, with a 30% market share, and ranks amongst the top three banks in terms of ATMs. It is also big in other fee-generating activities like acquired business (POS), wealth management, third party distribution and other fee-generating products.

BREAK-UP OF FEE INCOME



Source: Company/Motilal Oswal Securities

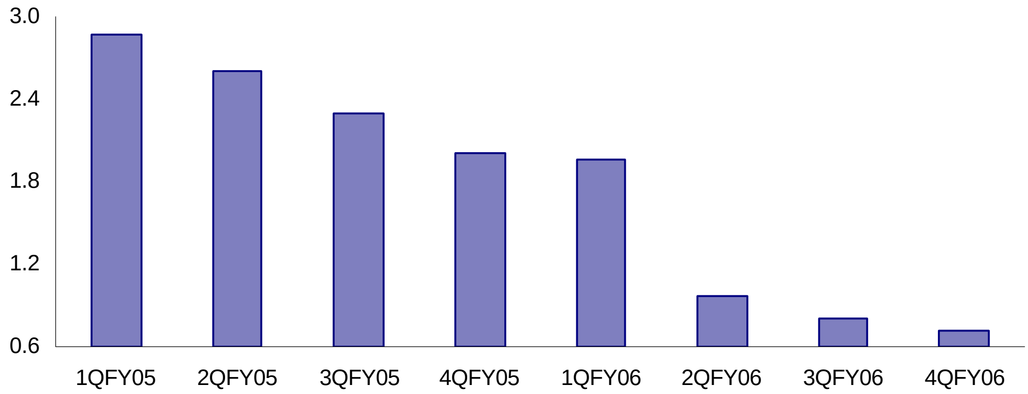
The bank generates 58% of its fee income from retail, 30% from corporate and 12% from international operations. Of the retail fees, 50% come from the lending business – fees from housing loans, vehicle loans, and credit cards. We believe that the bank is ideally placed to tap opportunities in new segments such as wealth management and banc assurance, which could emerge as major contributors to fee income. ICICI Bank offers an ideal mix of size, scale, distribution and knowledge of these products.

ICICI Bank has already built a strong revenue base from its international operations with a 20% market share of inward remittances in India. While interest margins from international operations are lower at about 1%, fee income opportunities are significant.

NPAs – problems have largely been addressed

Historically, the biggest concern for ICICI Bank had been its asset quality. However, the bank has been able to bring down its NPAs significantly during the last couple of years. While a number of legacy NPAs have been restructured and there have been upgradations, incremental NPAs have been low. We believe that the concern relating to ICICI Bank's NPAs has been addressed to a large extent.

IMPROVING ASSET QUALITY (%)



Source: Company/Motilal Oswal Securities

NPAs on retail loans continue to be low…

ICICI Bank's NPAs on retail loans are significantly better than the rest of the industry. As against an industry average of 2.5% gross NPAs on retail, ICICI Bank has been able to control its gross NPAs at just 1.5% in FY06. This is despite the bank having grown its retail assets aggressively over the last three years. In fact the largest product in the retail basket, mortgages have just 0.9% slippages, against an industry average of 1.9%. Incrementally, on a higher base, the percentage of slippages has been consistently falling for ICICI Bank. With nearly 63% of its loans in the retail segment and very low incremental NPAs, we do not see any concern relating to asset quality in the near term.

… and the bank is already providing 0.4% on standard assets

In line with RBI guidelines, ICICI Bank built in a 40bp provision on its standard assets during FY06. It will have to make a 100bp provisioning for mortagages over Rs2m, following a recent RBI guideline, which will result in higher provisioning in 1QFY07. However, as incremental slippages continue to be low and the bank already has sufficient provision coverage, the growth in provisioning requirements would only be in line with its asset growth.

Subsidiaries – creating significant value

Over the years, ICICI Bank has nurtured subsidiaries, several of which have become leaders in their respective fields. Most subsidiaries have attained respectable scale and are still exhibiting strong growth rates. We believe that these subsidiaries are creating significant value for ICICI Bank. We value the key subsidiaries of ICICI Bank at Rs144 per share. We believe that it would be realistic to assume a 20% increase in value on an annualized basis, going forward. Further, there exists possibility to unlock value from some of the key subsidiaries, at an appropriate time.

PERFORMANCE OF KEY SUBSIDIARIES (RS M)

	FY05	FY06	GR. (%)
PAT			
ICICI Lombard (General Insurance)	484	503	3.9
ICICI Prudential (Life Insurance) - NBAP	3,120	5,280	69.2
ICICI Securities	640	1,570	145.3
Prudential ICICI AMC	172	311	80.8
ICICI Ventures	324	503	55.2

Source: Company/Motilal Oswal Securities

ICICI Prudential Life Insurance Company

ICICI Prudential Life Insurance Company is one of the fastest growing life insurance companies in India, with an 11% market share. It is the largest life insurance company amongst the private sector players. During FY06, the company's new business achieved profit (NBAP) increased by 69% to Rs5.3b.

ICICI Bank holds 74% of the life insurance venture. The management has reiterated that whenever norms for FDI are revised, it would have to sell an additional 23% to the foreign partner. However, the sale would be made at a value prevailing at that point of time and not at any pre-determined price.

We have valued ICICI Prudential Life Insurance Company on a DCF basis. We estimate that its new business (non-single premium) will grow at 50% in FY07 and 30% in FY08. Beyond that, we have assumed a slower growth rate because of high base. We have assumed a 20% margin on regular premium payment policies and 5% margin on single premium policies. We have built up a gradual decline in margins and a terminal growth of 5%. We value the life insurance venture at Rs140b (20x FY07E NBAP). For its 74% holding, the value per share for ICICI Bank is Rs116.

ICICI Lombard

ICICI Lombard is the largest private sector player in the non-life insurance business, with a 31% market share. It achieved a profit after tax of Rs500m (US$11m) in FY06 compared to Rs480m (US$11m) in FY05 despite claims from floods in major cities and investments in the retail franchise. About 58% of its gross written premiums comprised non-corporate business. In our view, ICICI bank's general insurance venture is worth Rs11.3b, which translates into Rs9 per share of ICICI Bank, for its 74% stake.

Prudential ICICI Asset Management Company

Prudential ICICI Asset Management Company was among the top two private sector mutual funds in India as on 31 March 2006, with assets under management of over Rs235b (US$5.3b) and about 10% market share. Its venture capital fund management company manages nine funds, with a corpus of over US$1b. This business is also gaining scale and significance. We estimate value of its asset management company at Rs9.5b, translating into Rs11 per share of ICICI Bank, for its 51% stake in the venture.

ICICI Securities

ICICI Securities is India's leading full service investment bank, with a dominant position in all segments of its operations – Corporate Finance, Fixed Income and Equities. The company has handled 31 equity transactions, raising more than Rs137b in FY06. In FY06, it registered a 146% increase in profit after tax to Rs1.6 and posted an RoE of 34%. We estimate value of its brokerage and investment banking business (ICICI Securities) at Rs27b, which translates into Rs30 per share of ICICI Bank.

VALUE OF SUBSIDIARIES

	(RS M)	HOLDING (%)		
ICICI Pru Life	139,794	74	116	for 74% stake in ICICI Pru
I-Sec	27,130	100	30	valued at 12xFY08 earnings
I-Ventures	11,789	100	13	valued at 15xFY08 earnings
I-Lombard	11,318	74	9	valued at 15xFY08 earnings
I-AMC	18,647	51	11	valued at 6% of AUMs (FY08E)
Total	**208,678**		**180**	
Discount (20%)			36	
Value per Share of ICICI Bank (Rs)			144	

Source: Company/Motilal Oswal Securities

Other investments

ICICI Bank has also been making investments in other ventures, a number of which have attained respectable size and are likely to provide meaningful value to ICICI Bank. It has a 4% stake in IDFC, 12% stake in National Stock Exchange (premier stock exchange in India), 15% stake in NCDEX (premier commodity exchange), 60% stake in its BPO arm, ICICI One-Source and a 54% stake in its software venture, 3-I Infotech. While we are not considering the value of these ventures in our valuation exercise, we believe that the unrealized gains on these ventures could emerge as a decent source for treasury gains, as and when ICICI Bank divests these holdings.

Upgrading stock recommendation to Buy

On the back of strong balance sheet expansion, we expect ICICI Bank to witness strong growth in earnings. We expect NII to grow at a CAGR of 32% during FY06-08 and NIMs to remain stable at about 2.4%. Fee income should grow at 38% CAGR over FY06-08. Despite expecting lower treasury income and steady provisioning going forward, we expect earnings to grow at 25% CAGR during FY06-08. Adjusting for the value of subsidiaries, the stock trades at 9.4x FY08E earnings and 1.3x FY08E book value. We believe that this is extremely attractive considering that ICICI Bank is likely to maintain strong growth and RoE is likely to improve going forward.

ICICI Bank's subsidiaries are adding significant value. Further, as these ventures are growing faster than the bank, value created by them would be higher as we move forward. We believe that it would be realistic to assume 20-25% higher value, going forward. Also, ICICI Bank will unlock value in its life insurance subsidiary, if the government allows higher FDI or if it lists the insurance venture. We currently value ICICI Bank's five key subsidiaries at Rs144 per share.

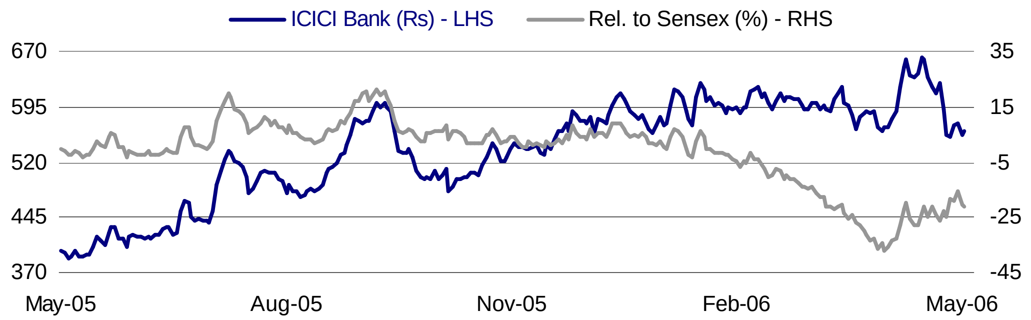
We believe that ICICI Bank's core business should trade at 1.8x FY08E book value, which translates into Rs565 per share. Adding to this the value of its subsidiaries (Rs144 per share), we arrive at a target price of Rs709 – implying a 26% upside. We upgrade our stock recommendation to **Buy**.

SOTP VALUATION

Core business	
FY08E BV (Rs)	314
P/B Multiple	1.8
	565
Add : Value of Subsidaries	144
Target Price (Rs)	709
Upside (%)	26

Source: Motilal Oswal Securities

STOCK PERFORMANCE (1 YEAR)



Concerns

Strong loan growth will require consistent funding through bulk deposits: As ICICI Bank continues to grow its loan book at an aggressive rate, it will need to fund this growth in the near term through bulk deposits. If the liquidity conditions in the system gets further tightened, this could put pressure on the cost of funds.

Continous check on asset quality: Given the pace of loan growth in the last few years, there will always be concerns on probable NPAs in event of a slowdown. Though the possibility is low and the recent norms by RBI for making higher general provisions provides cushion, we believe that any signs of building higher NPAs will be viewed very negatively.

Capital requirement: Strong growth and the present low RoE could result in the bank requiring capital again by FY08. Currently, its capital adequacy ratio is 13.4%, with Tier-I capital of 9.2%. The bank could, however, raise capital through hybrid instruments and resort to securitization (which has slowed down over the last six months). The management does not intend to raise any equity capital till FY08. Also, whenever FDI is increased in the insurance sector, ICICI Bank would sell its stake in ICICI Prudential Life Insurance Company, which would release capital for its core business.

Low RoE: ICICI Bank has done frequent dilutions in the last few years, which has resulted in low RoEs. As the bank has recently raised capital, its RoE is suppressed at 13-15%, which has resulted in lower discounting for the stock. However, as the bank leverages its capital, we expect RoE to increase and expect sustainable RoE to be at 17-18%. We believe that a key trigger for the stock's rerating has to be a sustained improvement in its RoE.

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2004	2005	2006	2007E	2008E
Interest Income	90,024	94,099	137,845	194,460	262,045
Interest Expended	70,153	65,709	95,975	137,335	189,294
Net Interest Income	**19,871**	**28,390**	**41,870**	**57,124**	**72,752**
Change (%)	*39.5*	*42.9*	*47.5*	*36.4*	*27.4*
Other Income	30,668	35,397	49,821	62,741	80,275
Profit on Sale of Investment	12,246	5,461	9,270	5,000	4,000
Other Non-interest Income	18,422	29,935	40,551	57,741	76,275
Net Income	**50,540**	**63,787**	**91,692**	**119,865**	**153,027**
Change (%)	*10.1*	*26.2*	*43.7*	*30.7*	*27.7*
Operating Expenses	25,731	33,013	44,795	56,440	69,851
Employee Expense	5,461	7,374	10,823	15,401	18,360
Operating Income	**24,808**	**30,774**	**46,897**	**63,425**	**83,176**
Change (%)	*-3.5*	*24.0*	*52.4*	*35.2*	*31.1*
Provisions & Contingencies	5,810	5,532	15,943	19,100	24,030
Provision for NPAs	4,823	116	7,943	9,100	11,030
PBT	**18,998**	**25,242**	**30,954**	**44,325**	**59,146**
Tax	2,627	5,190	5,563	13,038	19,479
PAT	**16,371**	**20,052**	**25,391**	**31,287**	**39,666**
Change (%)	*35.7*	*22.5*	*26.6*	*23.2*	*26.8*
Proposed Dividend	6,138	7,231	7,565	8,455	9,345

E: MOSt Estimates

BALANCE SHEET					(RS MILLION)
Y/E MARCH	2004	2005	2006	2007E	2008E
Capital	6,164	7,368	8,900	8,900	8,900
Preference Capital	3,500	3,500	3,500	3,500	3,500
Reserves & Surplus	73,942	118,132	213,160	239,913	270,234
Net Worth	**83,606**	**129,000**	**225,560**	**252,313**	**282,634**
Deposits	**681,086**	**998,188**	**1,650,830**	**2,146,079**	**2,789,903**
Change (%)	*41.4*	*46.6*	*65.4*	*30.0*	*30.0*
CASA	156,311	242,287	404,453	568,711	781,173
CASA Dep (% of Total)	*23.0*	*24.3*	*24.5*	*26.5*	*28.0*
Borrowings	398,461	417,534	486,670	559,671	643,621
Other Liabilities & Prov.	98,343	139,633	150,832	191,555	243,275
Total Liabilities	**1,261,496**	**1,684,353**	**2,513,890**	**3,149,617**	**3,959,431**
Current Assets	84,706	129,300	170,400	222,378	340,191
Investments	427,429	504,874	715,470	887,183	1,101,881
Change (%)	*20.5*	*18.1*	*41.7*	*24.0*	*24.2*
Advances	**626,476**	**914,052**	**1,461,630**	**1,842,141**	**2,319,945**
Change (%)	*17.6*	*45.9*	*59.9*	*26.0*	*25.9*
Retail	334,230	561,330	914,738	1,076,738	1,286,652
Retail (% of Total)	*53.4*	*61.4*	*62.6*	*58.5*	*55.5*
Net Fixed Assets	**40,564**	**40,380**	**39,891**	**39,791**	**39,291**
Other Assets	82,320	95,748	126,499	158,124	158,124
Total Assets	**1,261,496**	**1,684,353**	**2,513,890**	**3,149,617**	**3,959,431**

ASSUMPTIONS					(%)
Deposit Growth	41.4	46.6	65.4	30.0	30.0
Advances Growth	17.6	45.9	59.9	26.0	25.9
Investments Growth	20.5	18.1	41.7	24.0	24.2
Dividend	75.0	85.0	85.0	95.0	105.0
CRR	4.5	5.0	5.0	5.0	5.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2004	2005	2006	2007E	2008E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	8.6	7.0	7.2	7.6	8.2
Avg. Cost-Int. Bear. Liab.	7.0	5.3	5.4	5.7	6.2
Interest Spread	1.6	1.8	1.8	1.9	2.0
Net Interest Margin	1.9	2.1	2.2	2.2	2.3
Profitability Ratios (%)					
RoE	21.9	19.5	14.6	13.3	15.0
RoA	1.4	1.4	1.2	1.1	1.1
Int. Expended/Int.Earned	77.9	69.8	69.6	70.6	72.2
Other Inc./Net Income	60.7	55.5	54.3	52.3	52.5
Efficiency Ratios (%)					
Op. Exps./Net Income	50.9	51.8	48.9	47.1	45.6
Empl. Cost/Op. Exps.	21.2	22.3	24.2	27.3	26.3
Busi. per Empl. (Rs m)	85.3	89.4	100.5	118.3	126.4
NP per Empl. (Rs lac)	12.0	11.1	10.2	10.4	11.0

E: MOSt Estimates

VALUATION

Y/E MARCH	2004	2005	2006	2007E	2008E
Asset-Liability Profile (%)					
Adv./Deposit Ratio	92.0	91.6	88.5	85.8	83.2
Invest./Deposit Ratio	62.8	50.6	43.3	41.3	39.5
G-Sec/Invest. Ratio	70.0	68.3	71.4	77.7	84.5
Gross NPAs to Adv.	4.7	3.0	1.9	1.9	1.8
Net NPAs to Adv.	2.2	1.7	0.7	0.9	0.8
CAR	10.4	11.8	13.4	11.6	10.4
Tier 1	*6.1*	*7.6*	*9.2*	*8.1*	*7.3*

Book Value (Rs)	130.0	170.3	249.5	279.6	313.6
Price-BV (x)	4.3	3.3	2.3	2.0	1.8
Adjusted BV (Rs)	115.0	156.8	241.4	273.0	309.0
Price-ABV (x)	4.9	3.6	2.3	2.1	1.8
EPS (Rs)	26.6	27.2	28.5	35.2	44.6
EPS Growth (%)	34.9	2.5	4.8	23.2	26.8
Price-Earnings (x)	21.2	20.7	19.7	16.0	12.6
OPS (Rs)	40.2	41.8	52.7	71.3	93.5
OPS Growth (%)	-4.1	3.8	26.2	35.2	31.1
Price-OP (x)	14.0	13.5	10.7	7.9	6.0

E: MOSt Estimates

N O T E S

For more copies or other information, contact
Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari
Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No

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