SSKI

INDIA RESEARCH

23 July 2007

BSE Sensex: 15566

ICICI Bank

Rs985

OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs1029bn; US$25.1bn

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Result: Q1FY08

Comment: Margins bottoming out

Last report: 3 May 2007 (Price Rs872; Recommendation: Outperformer)

Key valuation metrics

Year to 31 March	2006	2007	2008E	2009E
Net profit (Rs m)	25,401	31,106	45,257	61,256
yoy growth (%)	*26.7*	*22.5*	*45.5*	*35.4*
Shares in issue (m)	890	899	1,107	1,107
EPS (Rs)	32.8	34.6	40.9	55.3
EPS growth (%)	20.4	5.6	18.1	35.4
PE (x)	30.1	28.5	24.1	17.8
Book value (Rs/share)	249.6	270.4	432.5	479.4
P/ Book (x)	3.9	3.6	2.3	2.1
RoAE (%)	16.5	13.6	12.5	12.1

Fully diluted basis

ICICI Bank reported net profit of Rs 7.75 (25% yoy growth), which is marginally below our estimate of Rs. 7.87bn. Slowdown in retail disbursement coupled with uptick in NPLs are the highlights of the result. Increase in cost of funds coupled with absence of interest payment on CRR balances has taken a toll on margins which have declined by 24 bps YoY in line with expectations. Asset growth continues to remain robust with a 34% growth YoY led by 143% growth in international business which now accounts for 16.4% of total advances. Life Insurance business has witnessed marginal decline in NBAP due to lower margins and slower growth: Partly explained by inflated base in Q1FY07 and benign margin scenario. The bank has successfully completed the capital raising exercise of USD 4.9 billion which should augment capital to ride the continued growth momentum in the economy. We believe that the current quarter has seen margins bottoming which should revive for the balance part of the year as the bank successfully capitalize on the issue proceeds. We expect ICICI Bank to deliver 40% CAGR in net profits over FY07-09; however RoE will remain depressed due to USD 4.9 bn capital raising. Adjusting for the subsidiary valuation of Rs. 253 per share for FY09, stock is currently trading at 1.53x FY09E. Adjusted book value (diluted basis) .We reiterate OUTPERFORMER with a price target of RS 1229 after factoring in the dilution.

KEY ISSUES

❑ Loan growth robust however going more international

ICICI bank has achieved 35% yoy growth in loan book in Q1FY08. The bank has seen a second consecutive quarter of loan growth moderation from the 45 % average recorded earlier.

- Retail portfolio growth has slowed to 29% yoy and constitutes almost 64% of total loan book as compared to 67% a year ago. Retail portfolio which has been the main stay for the bank in the last few years has actually grown slower than the overall portfolio of the bank. Sequentially the retail portfolio has remained stagnant. The growth in retail disbursements have slowed down since Q3FY07, however in the current quarter the bank has actually witnessed a decline in retail disbursement. In the current quarter the total retail disbursements declined by 15% (against 36% yoy growth in Q1FY07). A de-growth in home disbursement (around 28.6% yoy) is key contributor for this slowdown. Rapid increases in lending rates have had the desired effect of slowing down the momentum of retail growth. Within retail the unsecured portion (personal loans and credit cards) continues to grow at healthy pace capturing a higher share of the overall retail portfolio.

Composition of ICICI bank's retail book

% of total retail loan book	Q1FY07	Q407	Q1FY08E
Home loans	50	50	51
Car loans	19	16	15
Commercial Vehicle	12	13	13
2-Wheelers	2	2	2
Personal loans	7	9	9
Credit cards	4	4	5
Others	6	6	5
Total	**100**	**100**	**100**

Source: Company

- International businesses has become significant growth driver (143% yoy growth) in Q1FY08 international loans. International business now accounts for 16.4% of the total advances as against 9% a year earlier. Going forward, as momentum in the bank's rural and international initiatives continue, retail assets would form lesser proportion of total balance sheet – in line with the bank's stated objective.

Composition of ICICI bank's loan book

	O/S as on Jun-07	YoY growth (%)	% of total book
Retail advances	1,274.2	29.1	64.3
Agri and rural advances	141.4	16.0	7.1
International advances	325.2	142.7	16.4
Corporate and SME advances	242.1	5.7	12.2
Total	**1,982.8**	**34.0**	**100**

Source: company

❑ Slowdown in deposit growth, marginal uptick in CASA : A key positive

The bank has slowed down the rapid pace of deposit accumulation in the current quarter. Deposits have grown by 26% as against the average of 50-55% seen in the last few quarters. Sequentially the bank has actually witnessed a decline in the term deposits which should augur well for the margins going forward. CASA however has seen a marginal improvement and continues to remain low at 22%.

Deposit Mix

(%)	Jun-06	Mar-07	Jun-07
Saving deposit	13.2	12.5	13.9
Current deposit	8.7	9.5	8.7
Term deposit	78.0	78.0	77.4
CASA	22.0	22.0	22.6

❑ Pressure on NIMs : Bottomed out

- Net Interest Margins (NIM) of ICICI Bank have declined by almost 24 bps YoY
- This reflect the pressure of the high cost of funds due which has muted the impact of positive from increasing shift towards high yielding unsecured retail assets. Also the impact of absence of interest payment on Higher cash reserve requirement (CRR) has taken a toll on margins .Also an increasing share of international business which operates on lower NIMs contributed to the decline.

- Going forward, we believe that ICICI Bank has demonstrated its ability to pass on the increase in cost of funds, which we believe will help maintaining the NIMs at stable levels as the assets reprice. Float from the issue proceeds would also aid in margin improvement. Improving CASA ratio with the addition of new branches and integration of Sangli branches will further support the containment in increasing in cost of funds. Hence we believe that the margins will expand from the second quarter.

Yield and margins analysis

For the quarter ended	Jun-06	Mar-07	Jun-07
Yield on advances	9.37	10.21	11.06
Yield on investments	7.02	7.58	7.63
Blended Yields	9.03	9.88	10.17
Cost of Funds	6.43	6.88	7.77
NIM(including lease)	2.52	2.57	2.28
NIM (reported)	2.50	2.66	2.30

Source: SSKI research & Company, all ratios calculated on quarterly average balances

❑ NII growth slightly muted

Pressure on margins has taken a toll on NII (including net lease) which has grown at moderate level of 22%, much lower than the previous quarters.

❑ Robust fee income growth

ICICI bank has reported a 35% yoy growth (Adjusting for the reclassification of income from treasury products and services) in fee income, which is slightly lower than previous quarter averages. However, its fees to net revenues ratio of 40% still remains one of the best in the industry. Retail banking contributes a lion share, however, its share has declined to 55% of total fees from the 60% levels seen earlier due to decline in disbursal growth. Corporate and international businesses contribute ~42% to total fees. According to the management, increasing international business has the high potential of being high fee income generators.

❑ Treasury gains boosted by stakes sale

Treasury income increased from 180 mn (without adjusting amortization) in Q1FY07 to 1.95 bn in Q1FY08 led by better equity market conditions and stake sales in investments

❑ Curtailment in expense growth lends support to operating profit growth

Operating expenses grew by 26% in line with expectation .Direct Marketing Agency (DMA) expenses – the commissions paid for sourcing retail loans – has actually de-grown by 2% yoy. Decline in DMA expenses is on the back of reduced commission rates to DMAs due to higher cross selling and due to de-growth in retail disbursement. ICICI Bank's ability to reduce DMA commission rates also indicates the benefits of leadership position that the bank enjoys in retail assets market.DMA expense to average asset improved to 0.44 % from 0.6% YoY. However staff expenses have increased by 46% as the annual increments are paid out in the month of April .In all, expense to average asset has declined by 15bps YoY to 2.34 %.

❑ Provisioning: A key monitor able

- The specific provisions have also gone up significantly, which is partly explained by changing mix of its retail portfolio in favor of higher yielding and unsecured loans.
- Higher yielding loans such as personal loans and credit cards now form almost 14% of total retail advances as compared to 11% a year ago.
- Slower disbursement growth coupled with aging of portfolio has contributed marginal increase in delinquencies
- Standard asset provisions are lower due to a marginal 1% growth in advances QoQ

Break-up of provisions

For the quarter ended (Rs bn)	Jun-06	Mar-07	Jun-07
Standard assets related provisions	0.47	4.57	0.55
Other provisions (including specific loan loss provisions)	1.69	4.19	4.97
Total provisions	2.16	8.76	5.52
Provisions as % of average assets	0.33	1.09	0.63
NPL provisions/avg loans	0.46	0.91	1.01

Source: Company,

❑ Asset quality reflects changing asset mix

Asset quality continued to deteriorate, however in the current quarter the bank has significant addition to its Gross and Net NPA. Gross and net NPA increased by 25% and 36% QoQ respectively. Increasing share of unsecured consumer loan is driving this deterioration .The bank maintains that it has not witnessed any material change in asset quality in a particular class of retail loans except the some increase in home loan delinquency more driven by administrative bottlenecks than actual slippages . Also the increased provisioning is in line with its estimated credit losses from the respective asset classes with the sub prime portfolio, other personal loan portfolio and credit cards witnessing Gross NPL levels of 15%, 6.5% and 10% respectively.

Retail Delinquency

	Dec-06	Mar-07	Jun-07
Retail Gross NPL (Rs bn)	25	31	39
Retail Net NPL (Rs bn)	13	15	19
Retail Gross NPL as % of total	58	64	64
Retail Net NPL as % of total	68	75	71
Unsecured retail gross NPL (Rs bn)	13.5	16.7	20.9
Unsecured retail net NPL (Rs bn)	5.5	7.1	8.9
Unsecured retail gross NPL as % retail NPL	53	54	54
Unsecured retail net NPL as % of retail NPL	44	47	46
Unsecured retal gross NPL (%)	8	9	11
Unsecured retail net NPL (%)	3	4	5

❑ Subsidiaries continue to maintain leadership in their respective areas

Key subsidiaries of ICICI bank – in life insurance, general insurance and AMC businesses – have retained leadership position in their respective areas. Key highlights of subsidiary operations are as follows:

Subsidiary performance

Subsidiary	Performance indicator
ICICI Pru-life	NBAP of Rs 1.65bn for Q1FY08 (a 11% yoy decline, Largest private sector life insurer
ICICI Lombard	Net profit of Rs450 m for Q1FY08 (200% yoy growth), Largest private sector non-life insurer
Prudential ICICI AMC	AUM of Rs436bn, one of the largest private sectors MF in the country

Source: Company

In the current quarter the Life insurance business has seen a decline in NBAP which can be partly explained

- Lower margins of 19.7% vis-a vis ~25 % margins for Q1FY07. However the margins are comparable to the margins of 21% reported in FY07
- APE business growth for the Q1FY08 has been only ~15% in line with our expectation due to inflated base in Q1 FY07. In Q1FY07, APE business growth was 144% due to the aggressive sales of Unit Linked Insurance Plan (ULIP) products before July 2006, when new IRDA guidelines on ULIP came into effect.

❑ Valuing subsidiary business

ICICI Bank has followed the strategy of "universal banking" in the financial services space. Its insurance and asset management businesses too have gained scale over the past few years. The bank runs the largest private sector insurance companies (both life and non life), which have significant value. The bank plans to unlock this value by listing these companies over the medium term. We estimate the total value of these subsidiaries at Rs 253per share of ICICI Bank. We are currently revisiting our valuation of the general insurance business which has the potential of providing further upside to our target price.

❑ ICICI Bank – Continue to maintain Outperformer

Despite the recently completed dilution we believe its is an inexpensive stock backed by a strong earnings story rising on the momentum of India's growth potential and run by a competent management team committed to delivering long-term value . We expect ICICI Bank to deliver 40% CAGR in net profits over FY07-09; however RoE will remain depressed due to USD 4.9 bn capital raising. Adjusting for the subsidiary valuation of Rs. 253 per share for FY09, stock is currently trading at 1.53x FY09E. Adjusted book value (diluted basis) .We reiterate OUTPERFORMER with a price target of RS 1229 after factoring in the dilution.

Quarterly results

Rs m	Q1FY07	Q2FY07	Q3FY07	Q4FY07	FY07E	Q1FY08	FY08E	FY09E
Net interest income	16,293	16,710	19,928	20,577	73,508	19,983	99,535	129,551
yoy growth (%)	*41*	*42*	*44*	*36*	*41*	*23*	*35*	*30*
Non interest income	8,060	11,820	14,310	16,070	60,256	13,880	76,530	98,802
yoy growth (%)	*(4)*	*25*	*41*	*16*	*44*	*72*	*27*	*29*
Fees (%)	10,550	11,380	13,450	14,270	48,950	14,280	68,530	90,802
yoy growth (%)	*60*	*62*	*53*	*36*	*50*	*35*	*40*	*33*
Trading	(2,490)	440	860	1,800	11,306	(400)	8,000	8,000
Net revenue	**24,353**	**28,530**	**34,238**	**36,647**	**133,764**	**33,863**	**176,065**	**228,353**
Operating expenses	14,705	14,842	16,712	18,766	65,025	18,623	86,191	111,849
yoy growth (%)	*43*	*38*	*39*	*32*	*38*	*27*	*33*	*30*
Operating profit	**9,648**	**13,688**	**17,526**	**17,881**	**68,739**	**15,239**	**89,874**	**116,504**
yoy growth (%)	*(1)*	*31*	*47*	*21*	*-*	*58*	*31*	*30*
Provisions	2,158	4,270	6,640	8,760	32,251	5,523	32,586	38,965
PBT	**7,490**	**9,418**	**10,886**	**9,121**	**36,488**	**9,717**	**57,288**	**77,539**
Tax	1,286	1,475	1,751	870	5,382	1,969	12,030	16,283
PAT	**6,204**	**7,942**	**9,135**	**8,251**	**31,106**	**7,748**	**45,257**	**61,256**
yoy growth (%)	*17*	*37*	*43*	*4*	*22*	*25*	*45*	*35*
Key Ratios (%)								
Net interest margin	2.5	2.4	2.8	2.6	2.5	2.3	2.5	2.5
Core fee revenues/avg assets	1.6	1.7	1.9	1.8	1.6	1.6	1.7	1.8
Non fund revenues/avg assets	1.2	1.7	2.0	2.0	2.0	1.6	1.9	1.9
Employee expenses / avg assets	0.6	0.6	0.6	0.6	0.5	0.6	0.6	0.7
DMA exp / avg assets	0.6	0.5	0.5	0.5	0.5	0.4	0.5	0.4
Other operating exp / avg assets	1.1	1.1	1.2	1.3	1.1	1.1	1.1	1.1
Provisions/avg assets	0.3	0.6	0.9	1.1	1.1	0.6	0.8	0.8
PBT/avg assets	1.2	1.4	1.5	1.1	1.2	1.1	1.5	1.5
RoA	1.0	1.2	1.3	1.0	1.0	0.9	1.1	1.2
Tax/PBT	17.2	15.7	16.1	9.5	14.8	20.3	21.0	21.0

Source: SSKI Research

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Disclaimer

Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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