ICICI Bank

Price Objective Change **BUY**

Equity | India | Banks-Retail
23 July 2007

Merrill Lynch

Worst is behind us

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Raising PO to Rs1,225

We are raising our PO on ICICI Bank to Rs1,225 as we believe the stock, trading at 1.7x FY08 adj. book (after deducting value of subsidiaries) could re-rate to 1.8-2.0x book, one year forward as we see improved visibility of earnings in coming quarters, rising value of subs and manageable asset quality despite sharp up-tick in NPLs. Hence, adding value of subs (Rs383) in FY09, we arrive at our new PO of Rs1,225. We believe risk-return is still positive versus peer banks with RoE forecast to rebound to +13% in two years. A sharp rise in NPL's is the key risk to our PO.

1QFY08 results ahead of estimates; but weak quality

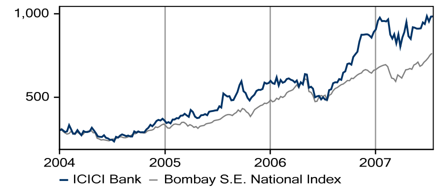
1QFY08 earnings growth at 25% yoy, while 3.5% ahead of estimates, was disappointing in terms of weaker top line and sharper than expected rise in NPL's. Top line grew by only 16% owing to 30bps qoq margin compression and gross NPL's rose 25% qoq owing to rise in non-collateralized NPL's a and NPL's relating to its rural/mortgage loans. A 35% jump in fees and lower than expected opex was the key positives of the results.

Net profit to grow +35% in FY09; post 25% growth in FY08

1QFY08 is likely the worst quarter with margins at the trough and sharp deterioration in asset quality. We expect significant margin expansion, in part owing to the US$5bn equity infusion, and net profit growth of +25% in FY08 rising to +35% as the bank leverages on growth opportunities and sustains fee revenue growth at +35%. This captures about 2.5x jump in credit costs and NPL's by FY09. Net NPL's to be manageable at 0.9-1.2% through FY08-09.

Stock Data

Price (Common / ADR)	Rs985.15 / US$52.42
Price Objective	RS1,125 to Rs1,225 / US$54.00 to US$56.00
Date Established	23-Jul-2007 / 23-Jul-2007
Investment Opinion	C-1-7 / C-1-7
Volatility Risk	HIGH / HIGH
52-Week Range	Rs478.10-Rs1,010
Market Value (mn)	US$26,871
Shares Outstanding (mn)	1,099.9 / 549.9
Average Daily Volume	562,422
ML Symbol / Exchange	ICIJF / BSE
ML Symbol / Exchange	IBN / NYS
Bloomberg / Reuters	ICICIBC IN / ICBK.BO
ROE (2007E)	13.4%
Total Dbt to Cap (Mar-2006A)	NA
Est. 5-Yr EPS / DPS Growth	24.0% / 12.0%
Free Float	74.0%



Estimates (Mar)

(Rs)	2005A	2006A	2007E	2008E	2009E
Net Income (Adjusted - mn)	20,052	25,401	31,102	38,973	53,248
EPS	27.22	31.23	34.96	39.18	48.41
EPS Change (YoY)	2.1%	14.8%	11.9%	12.1%	23.6%
Dividend / Share	8.50	8.50	10.50	13.00	16.00
ADR EPS (US$)	1.21	1.41	1.61	1.94	2.40
ADR Dividend / Share (US$)	0.379	0.384	0.483	0.645	0.794

Valuation (Mar)

	2005A	2006A	2007E	2008E	2009E
P/E	36.2x	31.5x	28.2x	25.1x	20.3x
Dividend Yield	0.863%	0.863%	1.07%	1.32%	1.62%
Pre-exceptional PE	36.20x	31.54x	28.18x	25.14x	20.35x
Price / Book	8.63x	4.88x	4.46x	2.32x	2.16x
RoE / PB	2.26x	3.00x	3.00x	4.73x	5.08x
Price / Pre-Provision Profit	24.55x	18.69x	14.91x	13.46x	9.77x

Refer to important disclosures on page 16 to 18. Analyst Certification on page 14. Price Objective Basis/Risk on page 14.
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iQprofile℠ ICICI Bank

Key Income Statement Data (Mar)	2005A	2006A	2007E	2008E	2009E
(Rs Millions)					
Net Interest Income	32,390	47,100	66,358	87,874	120,708
Net Fee Income	19,210	30,019	43,309	60,632	81,853
Securities Gains / (Losses)	5,440	7,034	1,967	(1,367)	(8,249)
Other Income	9,512	12,778	14,016	18,045	22,709
Total Non-Interest Income	34,161	49,831	59,292	77,310	96,313
Total Operating Income	66,552	96,932	125,650	165,183	217,022
Operating Expenses	(36,991)	(50,025)	(66,906)	(84,701)	(106,075)
Pre-Provision Profit	29,560	46,907	58,744	80,482	110,946
Provisions Expense	(500.00)	(7,947)	(21,593)	(33,015)	(42,747)
Operating Profit	32,848	46,953	37,821	47,979	69,839
Non-Operating Income	(3,788)	(7,993)	(670.70)	(511.67)	(1,640)
Pre-Tax Income	25,272	30,966	36,480	46,955	66,560
Net Income to Comm S/Hold.	20,052	25,401	31,102	38,973	53,248
Adjusted Net Income (Operating)	20,052	25,401	31,102	38,973	53,248

Key Balance Sheet Data					
Total Assets	1,676,594	2,513,890	3,446,580	4,202,069	5,155,357
Average Interest Earning Assets	1,253,604	1,801,747	2,605,384	3,384,706	4,176,955
Weighted Risk Assets	1,350,168	1,937,815	2,892,120	2,686,583	3,435,312
Total Gross Customer Loans	914,052	1,461,631	1,958,655	2,605,011	3,360,465
Total Customer Deposits	998,188	1,650,832	2,305,102	2,861,149	3,637,653
Tier 1 Capital	102,463	191,820	215,033	230,630	254,552
Tangible Equity	120,340	222,060	243,033	467,463	501,001
Common Shareholders' Equity	125,500	222,060	243,033	467,463	501,001

Key Metrics					
Net Interest Margin	2.58%	2.61%	2.55%	2.60%	2.89%
Tier 1 Ratio	6.1%	7.6%	6.2%	5.5%	4.9%
Effective Tax Rate	20.7%	18.0%	14.7%	17.0%	20.0%
Loan / Assets Ratio	53.1%	57.4%	55.8%	60.4%	63.0%
Loan / Deposit Ratio	89.1%	87.4%	83.4%	88.7%	89.3%
Oper Leverage (Inc Growth - Cost Growth)	-1.9%	10.4%	-4.1%	4.9%	6.1%
Gearing (Assets / Equity)	13.4x	11.3x	14.2x	9.0x	10.3x
Tangible Common Equity / Assets	7.2%	8.8%	7.1%	11.1%	9.7%
Tangible Common Equity / WRAs	8.9%	11.5%	8.4%	17.4%	14.6%
Revenue Growth	26.9%	45.6%	29.6%	31.5%	31.4%
Operating Expense Growth	28.8%	35.2%	33.7%	26.6%	25.2%
Provisions Expense Growth	-89.4%	1,489.4%	171.7%	52.9%	29.5%
Operating Revenue / Average Assets	4.5%	4.6%	4.2%	4.3%	4.6%
Operating Expenses / Average Assets	2.5%	2.4%	2.2%	2.2%	2.3%
Pre-Provision ROA	2.0%	2.2%	2.0%	2.1%	2.4%
ROA	1.4%	1.2%	1.0%	1.0%	1.1%
Pre-Provision ROE	28.8%	27.0%	25.3%	22.7%	22.9%
ROE	19.5%	14.6%	13.4%	11.0%	11.0%
RoTE	16.7%	11.4%	12.8%	8.3%	10.6%
RoWRAs	1.5%	1.3%	1.1%	1.5%	1.6%
Dividend Payout Ratio	31.2%	27.2%	30.0%	33.2%	33.0%
Efficiency Ratio (Cost / Income Ratio)	60.5%	55.6%	54.1%	50.9%	47.1%
Total Non-Interest Inc / Operating Inc	51%	51%	47%	47%	44%
Market-Related Revenue / Total Revenues	12.9%	12.1%	6.7%	4.6%	1.5%
Provisioning Burden as % of PPP	1.7%	16.9%	36.8%	41.0%	38.5%
NPLs plus Foreclosed Real Estate / Loans	3.9%	2.1%	2.5%	3.2%	3.6%
Loan Loss Reserves / NPLs	71.4%	63.6%	72.4%	83.9%	95.8%
Loan Loss Reserves / Total Loans	2.8%	1.3%	1.8%	2.7%	3.4%
Provisions Expense / Average Loans	0.1%	0.7%	1.3%	1.5%	1.5%

Other Metrics					
Income / Employee	6.66	9.23	11.42	14.36	18.09
(Operating Expenses) / Employee	3.70	4.76	6.08	7.37	8.84
Pre-Provision Profit / Employee	2.96	4.47	5.34	7.00	9.25
Net Profit / Employee	2.01	2.42	2.83	3.39	4.44

Company Description

ICICI, originally set up to provide direct finance for development of industrial projects, is India's leading financial institution. It has built a strong retail franchise to complement its corporate banking activities and capitalize on the fast growing retail market. It has a multi-channel distribution network, wide product range and a strong brand. Managing growth is the key issue.

Stock Data

Shares / ADR	2.00
Price to Book Value	4.5x

Raising PO to Rs1225

We are raising our PO on ICICI Bank to Rs1225 post its recent US$5bn equity raising and its 1QY08 results which, in our view, probably reflect the worst quarter in terms of top line growth and asset quality. The stock, trading at 1.8x FY08 adj. book (after deducting value of subsidiaries of Rs297share for FY08) could continue to trade at 1.8x to even 2.0x book, one year forward (FY09) as we greater visibility of earnings and much better quality of earnings in terms of top line. Moreover, we expect net profit growth of 25% in FY08 and +36% in FY09 (earnings growth to be flat in FY08 rising to +36% in FY09) after factoring in --- rise in credit costs which captures a --- jump in NPL's arising from the shift in loans towards non-collaterized retail loans and operational issues relating to its mortgage and rural loans. Hence, at 1.8-2.0x FY09 book and factoring in the rising value of its subs estimated at Rs380/share for FY09, we get our new PO of Rs1225.

Sharp rise in NPL's or interest rates impacting growth are key risks to our PO.

1QFY08 Results Review

ICICI Bank's 1QFY08 results at Rs7.75bn, up 25% yoy, were about 3-4% ahead of our estimates. However, the quality of the earnings was relatively weak owing to weaker top line and sharper than expected rise in NPL's qoq. While we had expected some margin compression, the overall impact on a yoy basis was more pronounced owing to the added impact of no interest on cash balances. The more encouraging aspect was the lower than expected rise in operating costs and the strong growth in non-interest income supported by a 35% growth in core fees. Asset quality was disappointing. While the shift in the loan mix is expected o result in a uptick in retail NPL's, the 25% qoq rise in gross NPL's was disconcerting. Net NPL's too rose by almost 30% qoq to 1.3% of loans v/s 1.0% in Mar'07. We, however, believe this is the worst quarter and do see consistent improvement in the earnings quality in coming quarters and FY09.

Table 1: 1QFY08 Results summary

(Rs mn)	1QFY07	Q1FY08A	YoY Chg
Income statement			
Interest earned	50,386	75,661	50%
- on Advances / Bills	*34,372*	*54,492*	59%
- Income on investments	*13,425*	*19,140*	43%
- on bal with RBI and other banks	*2,459*	*1,521*	-38%
- Others	*131*	*508*	289%
Interest Expended	35,634	58,519	64%
Net Interest Income	14,753	17,143	16%
Other income	12,776	17,153	34%
- Treasury Income	*880*	*1,950*	122%
- Other Income	*11,896*	*15,821*	33%
Operating income	27,528	34,295	25%
Total Operating expenses	15,215	19,053	25%
Operating profit	12,314	15,242	24%
Provisions and contingencies	4,828	5,523	14%
- NPL provisions	2,158	5,523	156%
- Investment provisions	2,670	-	-100%
PBT	7,486	9,720	30%
Provision for Tax	1,286	1,969	53%
PAT	6,200	7,751	25%

Source: Company, Merrill Lynch Research

Key result highlights

We discus below the key highlights of the 1QFY08 results;

- Top line (net interest income) growth at 16% was much lower than expected owing in part to a sharper than expected margin contraction of almost 40bps qoq and 20bps yoy. This was principally owing to a) increase in the CRR requirements to 6.5% (cash balances on which the bank from this fiscal has stopped earning any interest) and b) delayed impact of the higher funding costs from deposits garnered during the latter part of the 4QFY07.
- Importantly, the interest revenues came in higher than envisaged owing to higher yields on its investment book and a 35% loan growth driven principally by overseas loans and non-collateralized retail loans.
- There does appear to be a marked slowdown in housing loans which saw disbursement growth of <15% at Rs45bn. Housing loans, however, still constitute almost 51% of total retail loans (Rs1274bn) which account for 64% of total loans.
- Growth in non-interest income remains very buoyant supported by a +35% growth in fees and some monies from profits realized from some venture stake sale. It also helps reinforce our view that the bank's international operations appear to be contributing to higher fees.
- Operating costs growth, while high at 37% yoy, was actually slightly lower than expected as the bank has managed to contain the DMA expenses. The rise, as expected, was principally owing to higher employee expenses as the bank has recruited more people and relating to costs of fresh branch openings.
- The rise in NPL's was somewhat disconcerting. While we expected and are penciling in an uptick in the retail NPL cycle, the 25% qoq increase in gross NPL's to Rs60bn (from Rs48bn in Mar'07) was higher than envisaged. It was led principally by a rise in the non-collateralized retail NPL's and about Rs3bn from rural NPL's (which was part of the operational issues that the bank, has since, addressed). Net NPL's also rose by 30% to Rs26bn.

Key Takeaways of the results

We discuss the key takeaways from these results and then detail out our future outlook factoring in the US$5bn equity raised by the bank last month.

Margins at the trough

We believe net interest margins for the bank at 2.3% appear to be at the trough even if we were not to factor in the fresh US$5bn equity raising that the bank has done which would positively impact the banks' margins. We believe the funding costs should begin to stabilize at around 7.9% while we could still some uptick in the loan yields. Absence of any capital raising would have, however, still resulted in full year margins (FY08) being much lower than last year – though sequentially margins are likely to show an uptick from next quarter qoq. However, owing to the fresh capital raising, we expect the bank to end the year with margins at +2.6%. As discussed later, we believe the capital raising alone could expand margins by almost another 30bps in FY09.

Asset quality issues have re-surfaced; to build in higher NPL's

The most disconcerting feature of the results was the sharp uptick in NPL's. While we had expected an uptick, a 25% qoq rise was much ahead of estimates. The Rs12bn increase in NPL's qoq was principally contributed by the non-collaterized retail loans (about 1/3rd of fresh NPLs) , rural loans where the bank had some operational management issues and regular retail loans including mortgage. The bank did highlight that in some of the mortgage loans, the delays in collecting fresh cheques etc have resulted in NPL's which should be more temporary. We do believe mortgage at the sector level is still amongst the preferred asset class to lend to.

Given the nascent stage of its non-collateralized retail portfolio, we reckon NPL's are likely to show an uptick over the next 2 quarters to the extent of around 10-15% qoq. Hence, NPL's are likely to come in higher than envisaged. We are accordingly factoring in almost a 70% rise in NPL's in FY08 and almost 2.5x jump by FY09 as detailed later. We still contend that we do think the asset quality issues are likely to remain manageable and net NPL's are unlikely to be much higher than 1% of loans.

Volume growth could be higher, especially with fresh capital

We believe overall volume growth could come in higher at +30% in FY08 supported by rising overseas loans and part of the non-collateralized loans. Mortgage and some of the regular retail loans are likely to see moderation to between 20-25%.

Fee – cost gap should see improvement

The positive feature of the results has been the consistent buoyancy seen in fees which is in part driven by NRI remittances (8% of fees) and retail at 55% of fees. However, the bigger driver is likely to be fees the bank is managing from corporates as part of its international foray / loan syndication / overseas financing. Further, the rise in operating costs also appears to be in sync / lower tan envisaged given the sharp rise in its employee base and its ongoing distribution expansion.

Looking Ahead – FY08 and Beyond

Factoring in the US$5n equity infusion, we now expect EPS growth to be flattish during FY08 (<2%) rising to +36% in FY09 and 32% in Fy10. Net profit growth would, however, be at +30% CAGR through FY07-10 including in FY08 (25%) owing to:

- Volume growth of +33% in FY08 and 28-29% in FY09 as the bank leverages its additional capital and also is well positioned to capitalize on the growth opportunities in both the retail and corporate segment.

- Margin expansion of almost 50bps over 2 years (30bps during FY09) arising from the US$5bn equity infusion over two years. In FY08, we estimate full year margins to be still marginally lower at 2.6%; but clearly expanding sequentially qoq from the 2Q onwards as the bank benefits from easing funding costs and the equity infusion. Margins are, in our view, at the trough at current levels.

- Fee revenue growth of +35% as the bank leverages on both its expanding overseas business and gains from rapid customer acquisition.

- Cost income ratio to fall to 47% by FY09 from +50% last year after building in its distribution expansion. The bank should benefit from economies of scale as it expands its top line and also acquires more customers.

Our earnings estimates capture almost a 2.5x jump in credit costs through FY09 (and tripling of credit costs by Fy10) as we pencil in a rising NPL cycle and higher credit costs arising from that. Specific provisions are forecast to rise from 73bps of loans to +100bps by FY09; while total provisions are likely to rise to 130bps by FY09 v/s 110bps during FY07. Additionally, we also continue to build in higher investment provisions as the bank expands its G-sec book in sync with its deposit base.

Loan growth driven by overseas, u/s retail

As shown in the table, we expect overseas loans to still grow by almost 50% in the coming year. This is coming off a low base and does not include loans through the bank's subsidiaries which amounted to about Rs120bn (50% of what is reflected). Moreover, the growth is driven by the increasing shift of Indian corporate's seeking greater share in export markets. The share of o/s loans is likely to rise to 14% of total loans.

Retail, however, would remain the mainstay of growth still accounting for +60% of total loans. However, within retail, the share of unsecured retail is likely to rise to 20% by FY09 v/s 15% in FY07.

Corporate loan growth, while picking up is likely to still account for just under 15% of its total loan book.

Table 2: Loan mix, growth and forecast

(Rs bn)	FY05	FY06	FY07	FY08	FY09	FY10
Corporate (incl SME / Capex etc)	276	336	335	423	516	619
Rural loans	75	147	201	272	353	442
Overseas loans	62	125	240	420	630	851
Retail	567	922	1,277	1,614	1,998	2,436
- Mortgage	285	450	640	768	906	1,069
- Non-Mortgage Retail Loans	282	472	637	846	1,091	1,366
- Regular loans	235	372	447	559	682	818
- Unsecured loans - CC	20	35	55	77	104	131
- Unsecured loans - Personal	25	60	120	180	261	352
- Unsecured loans - Sub-prime	2	5	15	30	45	65
Total Credit	980	1,529	2,054	2,728	3,497	4,347
Loan Growth	*41.3%*	*56.1%*	*34.3%*	*32.8%*	*28.2%*	*24.3%*
Unsecured retail loans	47	100	190	287	410	549
Growth Rates (yoy)						
Corporate (incl SME / Capex etc)	-6%	22%	0%	26%	22%	20%
Rural loans	50%	96%	37%	35%	30%	25%
Overseas loans	313%	102%	92%	75%	50%	35%
Retail	69%	63%	38%	26%	24%	22%
- Mortgage	71%	58%	42%	20%	18%	18%
- Non-Mortgage Retail Loans	67%	68%	35%	33%	29%	25%
- Regular loans	60%	58%	20%	25%	22%	20%
- Unsecured loans - CC	67%	75%	57%	40%	35%	26%
- Unsecured loans - Personal	150%	140%	100%	50%	45%	35%
- Unsecured loans - Sub-prime	1900%	150%	200%	100%	50%	45%
Total Credit	41.3%	56.1%	34.3%	32.8%	28.2%	24.3%
Non-collaterized retail loans	113%	113%	90%	51%	43%	34%
Loan Mix (% of total credit)	FY05	FY06	FY07	FY08	FY09	FY09
Corporate (incl SME / Capex etc)	28%	22%	16%	15%	15%	14%
Rural Loans	8%	10%	10%	10%	10%	10%
Overseas loans	6%	8%	12%	15%	18%	20%
Retail	58%	60%	62%	59%	57%	56%
- Mortgage (as % of retial)	50%	49%	50%	48%	45%	44%

Table 2: Loan mix, growth and forecast

- Non-Mortgage Retail Loans	50%	51%	50%	52%	55%	56%
- Regular loans	41%	40%	35%	35%	34%	34%
- Unsecured loans - CC	4%	4%	4%	5%	5%	5%
- Unsecured loans - Personal	4%	7%	9%	11%	13%	14%
- Unsecured loans - Sub-prime	0%	1%	1%	2%	2%	3%
Total Credit	100%	100%	100%	100%	100%	100%
Non-collaterized retail loans	8.3%	10.8%	14.9%	17.8%	20.5%	22.5%

Source: Merrill Lynch Research

Margin expansion driven principally due to equity infusion

As mentioned earlier, we believe net interest margins for the bank at 2.3% appear to be at the trough even if we were not to factor in the fresh US$5bn equity raising that the bank has done which would positively impact the banks' margins. We believe the funding costs should begin to stabilize at around 7.9% while we could still some uptick in the loan yields. Absence of any capital raising would have, however, still resulted in full year margins (FY08) being much lower than last year – though sequentially margins are likely to show an uptick from next quarter qoq. However, owing to the fresh capital raising, we expect the bank to end the year with margins at +2.6%.

We believe the capital raising alone could expand margins by almost another 30bps in FY09 to almost 2.9% by FY09 as the bank leverages its additional equity to fund loan growth.

Asset quality to be manageable despite sharp rise in NPL's

We are building in a much sharper NPL upswing over the next 2 years owing to the change in the loan mix towards higher yielding but riskier loans and the deterioration seen during the 1QFY08. We show below the NPL mix by loan category in the retail segment.

As detailed, we are factoring in a sharp rise in the unsecured retail loans, especially the personal loans and sub-prime which are yet to have full seasoning. The credit card segment, in contrast, has had gross NPL's of 15% (this is much higher v/s other banks owing to absence of write offs; unlike most banks that aggressively write off NPL's). Overall, we are factoring in a 2.5x fold jump in retail NPL's to about Rs81bn by FY09 v/s Rs31bn in FY07. We are factoring in doubling of NPL's in the unsecured retail segment next year and tripling by FY09.

For instance, the NPL's in the non-collateralized segment during the 1QFY08 were estimated at +10% of total loans during a period when loans itself have not grown that sharply qoq relative to the NPL increase, We are factoring in a peak of 12% on an outstanding basis and +18% on a 1 year lag basis.

We, however, expect the mortgage and other retail segments to do much better as we strongly contend that the sharp rise in income levels in India and the changing demographics are still very strong supports in helping contain delinquencies in the broader retail market. We remain hopeful that the actual NPL experience is likely to be better than our estimates.

Table 3: Retail NPL Mix and Forecast

Gross Retail NPL's	FY06	FY07	FY08	FY09	FY10
Mortgage loans	4.0	6.4	9.6	13.0	15.6
Retail regular loans	3.8	8.4	12.5	18.2	21.8
Retail - Unsecured loans - CC	5.3	8.3	13.2	18.5	23.3
Retail - Unsecured loans - Personal	2.5	5.6	12.7	20.9	28.9
Retail - Unsecured loans - Sub-prime	0.5	2.3	6.2	10.5	13.7
Sub-total Retail - Non-Mortgage	12.0	24.5	44.6	68.1	87.7
Total Retail Loans	16.0	30.9	54.2	81.1	103.2
U/s loans	8.3	16.1	32.1	49.9	65.9
NPL by segment (as % of loans)					
Mortgage loans	0.9%	1.0%	1.3%	1.4%	1.5%
Retail regular loans	1.0%	1.9%	2.2%	2.7%	2.7%
Retail - Unsecured loans - CC	15.0%	15.0%	17.1%	17.8%	17.8%
Retail - Unsecured loans - Personal	4.2%	4.7%	7.1%	8.0%	8.2%
Retail - Unsecured loans - Sub-prime	10.0%	15.0%	20.6%	23.4%	21.0%
Sub-total Retail - Non-Mortgage	2.5%	3.8%	5.3%	6.2%	6.4%
Total Retail Loans	1.7%	2.4%	3.4%	4.1%	4.3%
U/s loans	8.3%	8.5%	11.2%	12.2%	12.0%
NPL by lagged basis - 1 yr					
Mortgage loans	1.7%	1.5%	1.7%	2.6%	2.0%
Retail regular loans	-2.1%	3.4%	5.6%	5.1%	3.0%
Retail - Unsecured loans - CC	46.9%	20.0%	24.8%	24.0%	17.8%
Retail - Unsecured loans - Personal	10.0%	9.0%	11.8%	13.7%	9.8%
Retail - Unsecured loans - Sub-prime	15.8%	58.3%	39.4%	28.9%	21.0%
Sub-total Retail - Non-Mortgage	3.3%	6.6%	12.2%	11.3%	8.0%
Total Retail Loans	2.5%	4.2%	6.6%	8.0%	5.9%
U/s loans	22.3%	14.9%	17.7%	18.4%	12.9%

Source: Merrill Lynch Research Estimates

Aggregate NPL's to rise to 3.2%; Net NPL's to remain <1%

Corporate NPL's to be relatively better, going forward, after factoring in the recent NPl's arising in the rural segment owing to some operational issues that the bank has since addressed, as the economic outlook continues to be fairly robust. In aggregate, we forecast gross NPL's to rise to 3.3% of loans by FY09 v/s 2.4% in FY07; almost 2.5x in absolute levels to Rs115bn by FY09 v/s Rs48bn in FY07. We, however, still expect net NPL's to be between 0.9-1.2% through FY09 as we are building in higher credit costs. The NPL's should, in our view, see a sharp drop in FY10, especially net NPL's to potentially below 0.5%.

Table 4: Total NPL Forecast

(Rs bn)	FY06	FY07	FY08	FY09	FY10
Retail NPLs	16.0	30.9	54.2	81.1	103.2
Corporate NPLs	13.6	17.6	27.0	34.7	42.6
Total NPL'S	29.6	48.5	81.2	115.8	145.9
Retail NPLs as % of retail loans	1.7%	2.4%	3.4%	4.1%	4.2%
Corporate NPLs as % o corp. loans	2.2%	2.3%	2.4%	2.3%	2.2%
Total gross NPL's as % of loans	2.0%	2.4%	3.0%	3.3%	3.3%
Specific Provisions	12.9	27.2	50.7	84.9	127.6
General Provisiosn	6.0	8.0	17.4	26.0	33.5
Total Provisions	18.8	35.1	68.2	110.9	161.1
Net NPL's (net of specific)	10.8	19.9	30.5	30.9	18.2
Net NPL's as % of loans	1.1%	1.1%	1.2%	0.9%	0.4%
Net NPl s(net of all provisions; % of loans)	0.7%	0.7%	0.5%	0.1%	-0.4%

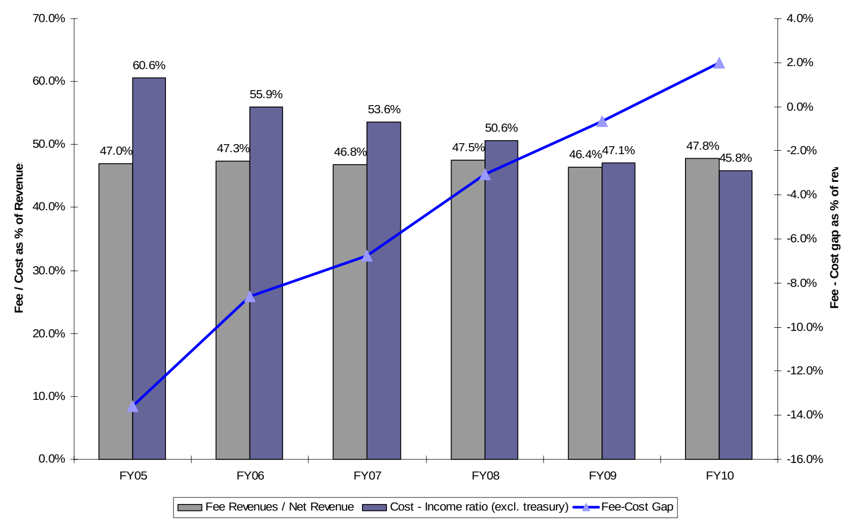
Source: Merrill Lynch Research Estimates

Fee - Cost gap to narrow; turn positive by FY10

IBank's fee revenues should continue to show a +40% growth in coming years owing to both ongoing customer acquisition which should improve with the acquisition of the Sangli branch network and the recent 100 branch expansion. It's C-I ratio (excluding treasury gains) should also improve to <50% by FY09 v/s 53% in FY07 supported by again the expanding branch expansion (that should help boost revenues) and better containment of DMA expenses.

We are fairly optimistic about IBank's fee-cost gap ratio improving in the coming quarters and years with fee growth likely to improve through the international business, especially fee revenues arising from the Indian corporate doing international transactions.

Chart 1: Fee-cost gap to narrow



Source: Merrill Lynch Research Estimates

Valuations

ICICI Bank's valuations would, in our view, continue to be based on a sum of parts approach given that the bank is also effectively a holding company for many of its key businesses – life insurance, general insurance, asset management, securities business and its venture capital business.

Sum of parts value @ Rs380/share

We have valued each of its key businesses based on the approach used by us in the past for valuing each of these businesses for all our banks' coverage. We show below the key methodology adopted for each of the businesses.

Life insurance valued at US$10bn

We use the NBAP (new business achieved profit) measure to value the life insurance in the absence of any disclosures for embedded value. This is the methodology by us for valuing all life insurers in India (see our in-depth report dated February 2, 2007 and the latest update dated June 12, 2007).

As argued in our insurance update, we contend that Indian life insurers could command multiples of +20x FY09 owing to their strong growth trajectory and the relatively higher multiples some of their Chinese peers are trading at (25-35x) on the NBAP measure. Moreover, ICICI Prudential, IBank's life insurance joint venture with Prudential of UK (ICICI Bank holds 74% stake) is the largest private life insurer with an estimated market share of about 30% in FY07 amongst the private players.

As we have argued in the past, in our view, distribution and scale is the key driver in helping insurers gain market share in India given the wide geography of the country and the emerging growth from the non-metro areas. ICICI Prudential has over 250,000 agents making it the largest distribution force amongst private insurers and second largest player in the sector after LIC.

Table 5: Life insurance valuations

Year to March (Rs mn)	2005	2006	2007	2008	2009	2010
FYP	14,543	22,935	44,623	72,289	101,205	136,627
Renewal Premiums	7,795	16,585	31,616	60,991	106,624	166,263
Single Premiums	1,300	3,090	7,923	10,696	13,905	15,295
Total Premiums	23,638	42,610	84,162	143,977	221,734	318,186
New Business	15,843	26,025	52,546	82,985	115,110	151,922
APE - New Business	14,673	23,244	45,415	73,359	102,595	138,156
APE - total Business	22,468	39,829	77,031	134,350	209,220	304,420
Growth Rate (yoy)						
FYP	131%	58%	95%	62%	40%	35%
Renewal Premiums	227%	113%	91%	93%	75%	56%
Single Premiums	7%	138%	156%	35%	30%	10%
Total Premiums	139%	80%	98%	71%	54%	43%
New Business	111%	64%	102%	58%	39%	32%
APE - New Business	129%	58%	95%	62%	40%	35%
APE - total Business	155%	77%	93%	74%	56%	46%
NBAP Calculation						
NBAP Margin (FYP)	21.2%	22.7%	19.8%	19.5%	19.2%	18.9%
NBAP Margin (Single Premium)	4.0%	2.5%	2.5%	2.6%	2.6%	2.6%
NBAP Margin (Total)	21.4%	22.7%	19.9%	19.6%	19.3%	19.0%
Total NBAP	3,135	5,283	9,051	14,403	19,831	26,275
% Increase	*53%*	*69%*	*71%*	*59%*	*38%*	*32%*
Multiple (16-20x) of NBAP	25.0	24.0	23.0	22.0	21.0	20.0
Multiple (16-20x) = 18x NBAP	78,378	126,802	208,179	316,875	416,442	525,496
In US$ mn	1,912	3,093	5,078	7,729	10,157	12,817
Equiv. in per Ibank Shr (Rs)- 74% stake	65	106	166	213	280	354

Source: Merrill Lynch Research Estimates

Although, the first year premia growth on APE basis (annualized premia equivalent wherein single premia is taken at 10% of its reported value) at <20% has been markedly below our year end estimates of 60%, we do think that is more of an aberration led by the absence of the 'scarcity effect' prevalent last year and the fact that I-Pru had pushed through very high sales in Mar'07. We continue to expect new business premium on APE basis to rise by 60% during FY08, moderating to <40% in FY09.

Assigning a multiple of 21x FY09 NBAP, we get a value of US$10bn for the life insurance business. With ICICI Bank holding a 74% stake we get a per share value of Rs280/ share.

General insurance valued at US$1.34bn

We had valued the general insurance business at 0.75x net premia implying a PE multiple of 18x assuming normalized earnings are equivalent to 4.5% of net premia. Keeping normalized earnings at 5% of net premia and factoring in a PE of 20x, it implies a multiple of closer to 1.0x net premia which we have used now. This gives us a value of US$1.34bn or Rs50/share factoring IBank's 74% stake in the venture.

The valuations are largely in sync with the very strong growth trajectory expected. Many of the general insurers in Asia and Australia tend to trade at 14-15x on a PE basis.

Table 6: General insurance valuations

(Rs mn)	FY06	FY07	FY08	FY09	FY10
Gross Premium	15,920	30,030	57,057	99,850	149,775
Net Premium	7,340	14,510	29,670	54,917	86,869
Net / GWP	46%	48%	52%	55%	58%
% Growth in net premium	84%	98%	104%	85%	58%
Value = 1.0x NP	8,808	21,765	35,604	54,917	69,495
Value (US$ mn)	215	531	868	1,339	1,695
Value/shr	12.0	24.5	32.4	49.9	63.2
Implied PER (@ 5% PAT margin)	17.6	32.0	24.0	20.0	16.0

Source: Merrill Lynch Research Estimates

Asset Management

The asset management business too has shown a much faster growth than envisaged by us. In the 1QFY08, ICICI Pru's AMC's total assets under management (AUM) have crossed Rs436bn a rise of 27% since Mar'07. We continue to assign a multiple of 2% for its debt funds and 7% for equity funds in sync with benchmark valuations in the market.

Given the sharp rise in debt funds (+15% YTD), we estimate that the growth for the full year is more likely to be closer to +60% for debt. In aggregate, we are factoring in a 55% rise in total AUM for the full year.

The value of the asset management is now pegged at US$811mn (or Rs30/share factoring in IBank's 51% share). This is principally owing to the higher growth forecast in its debt funds during FY08. This implies a valuation of 8.0% of AUM on a historic basis (FY07). This implies a value of 4.1% for AUM on a blended basis; for FY09.

Table 7: Asset management valuations

Asset Management	FY06	FY07	FY08	FY09	FY10
Assets under management	235,595	379,062	584,703	820,186	1,050,928
- Equity	141,357	170,578	230,280	306,273	382,841
- Debt	94,238	208,484	354,423	513,913	668,087
Multiple					
- Equity = 6.5%	7.5%	8.0%	8.0%	7.5%	7.0%
- Debt = 2%	2.5%	2.5%	2.2%	2.0%	1.5%
Multiple	5.5%	5.0%	4.5%	4.1%	3.5%
Value	12,958	18,858	26,220	33,249	36,820
- Equity	10,602	13,646	18,422	22,970	26,799
- Debt	2,356	5,212	7,797	10,278	10,021
Value (US$ mn)	301	439	640	811	898
Value/ Shr	17.6	21.2	23.8	30.2	33.5

Source: Merrill Lynch Research Estimates

Value of ICICI Financial Holdings estimated at Rs330/share

Based on the above, we estimate the value the 3 businesses above – life insurance, general insurance and asset management at around US$8.9bn or Rs333/share. ICICI Bank has transferred these 3 businesses to ICII Financial services, a 1005 subsidiary of ICICI Bank. The value assigned by us for the ICICI Financial Services is almost a 20% discount to the imputed valuation that was assigned to these businesses based on the proposed market transaction which is still pending regulatory approval.

ICICI Securities & I-Venture valued at Rs51/share

Additionally, we have also assigned a value to ICICI Securities and ICII Venture, 100% owned entities of the bank. We value these at Rs51/share based on market related PER for securities businesses and a DCF analysis for the venture.

Total Sum of Parts pegged at Rs383/share; US$10.3bn

In aggregate, the total value of its subsidiaries is estimated at US$10.3bn or Rs383/share in FY09 (RS297/share in FY08). We strongly reiterate our view that the value of these subsidiaries has to be captured while valuing the bank by deducting their value from the market price and valuing the bank on a stand alone basis.

Table 8: Sum of Parts Valuation

	Market Value of Biz. (US$ mn)				ICICI's Shr - Mkt Value (US$ mn)			IBk's Share /on Per Share basis		
Subsidiary	FY07	FY08	FY09	FY10	FY08	FY09	FY10	FY08	FY09	FY10
ICICI Prudential Life Insurance	4,841	7,729	10,157	12,817	5,719	7,516	9,485	213	280	354
ICICI Lombard General Insurance	531	868	1,339	1,695	643	991	1,254	24	37	47
ICICI Prudential Asset Mgmt	439	640	811	898	326	414	458	12	15	17
ICICI Venture	237	266	299	325	299	336	365	11	13	14
ICICI Securities	907	985	1,006	1,157	985	1,006	1,157	37	38	43
Total	6,955	10,487	13,613	16,892	7,971	10,263	12,720	297	383	474
Holding Co (Mle)	5,811	9,237	12,308	15,410	6,688	8,921	11,197	249	333	417

Source: Merrill Lynch Research Estimates

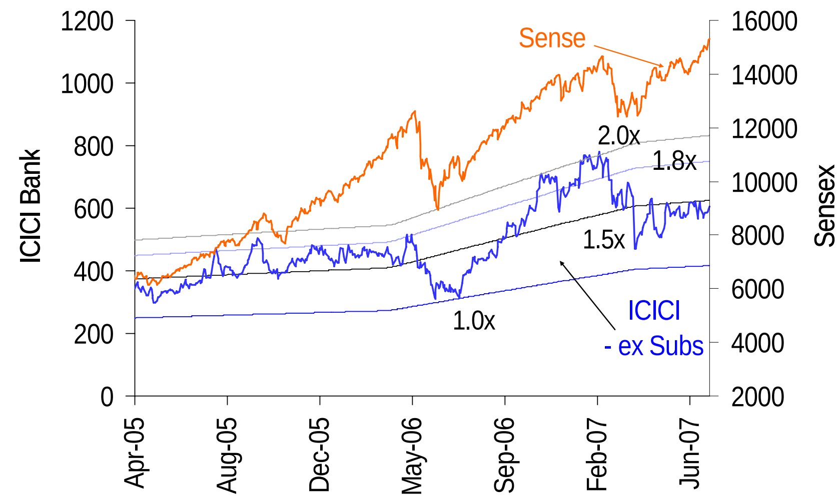
IBank trading at 1.7x FY08 book; can trade upto 1.8-2.0x

After deducting the value of its subsidiaries (Rs297 / share in FY08), IBank is trading at 1.7x FY08 book with a ROE of 11% owing to the US$5bn equity infusion. While the bank's ROE is substantially lower relative to its peers, we contend its risk return trade off is still fairly attractive.

For instance many private banks including trade at +3.0x FY09 book (like UTI Bank) with ROE's of +20% implying a ROE/ (P/BV) measure of +6%. In contrast, even after factoring in the capital dilution, ICICI Bank on a similar measure is effectively offering an implied ROE/ (P/BV) of +8%.

We believe the stock could trade at 1.8-2.0x adj. book, one year forward (FY09) given the improved visibility of earnings we are likely to see in coming quarters, estimated earnings growth of +35% in FY09 and rising value of its subsidiaries. Hence, adding the value of its subsidiaries at Rs383/share, we get our new PO of Rs1225. Sharp rise in NPL's or interest rates impacting growth adversely are key risks to our PO.

Chart 2: P/Book after adjusting for subsidiary value



Source: Merrill Lynch Research

Actual ROE may have been +300bps higher; risk return still very +ve

Moreover, we believe its ROE is also depressed owing to the investments in its insurance venture and its various banking subsidiaries. Additionally, it was the principally the only bank to have been adversely impacted by the change in securitization norms last year.

Our estimates show that the bank has seen a 70-80ps ROE erosion owing to its Rs20n equity infusion in its life insurance business. In addition, we estimate there is an estimated erosion of almost +130-140bps in ROE arising from the change in regulatory norms. In addition, if we were to include the profits from its various subsidiaries we could see a net addition of almost +100bps resulting in an effective increase of almost 300bps to its ROE.

If we were to re-assess the risk return trade off without adjusting for the value of its subsidiaries we would effectively get an implied P/B multiple of 2.1x FY09 book and ROE of +14%, implying a risk return measure of around 6.5% - in sync with peer banks – without assigning any value to the market valuations of its life insurance or general insurance venture. Hence, in effect, you would be buying a bank with a similar trade off plus capturing upside from its insurance ventures which are not built into the estimates

Price objective basis & risk

We believe the stock, trading at 1.7x FY08 adj. book (after deducting value of subsidiaries) could trade at 1.8-2.0x adj. book, one year forward (FY09) given the improved visibility of earnings we are likely to see in coming quarters, estimated earnings growth of +35% in FY09 and rising value of its subsidiaries. Hence, adding the value of its subsidiaries at Rs383/share, we get our new PO of Rs1225. Sharp rise in NPL's or interest rates impacting growth adversely are key risks to our PO.

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Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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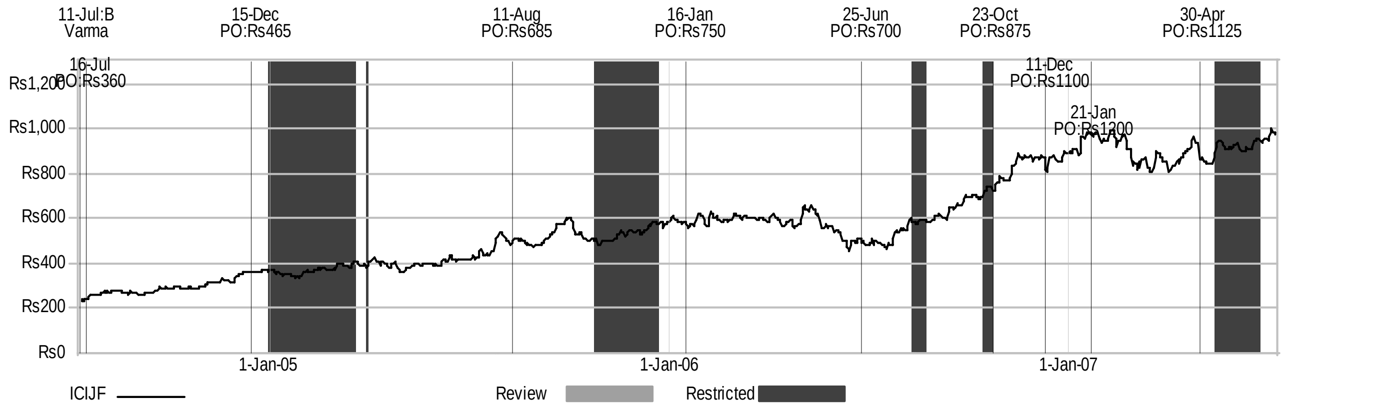
ICIJF Price Chart



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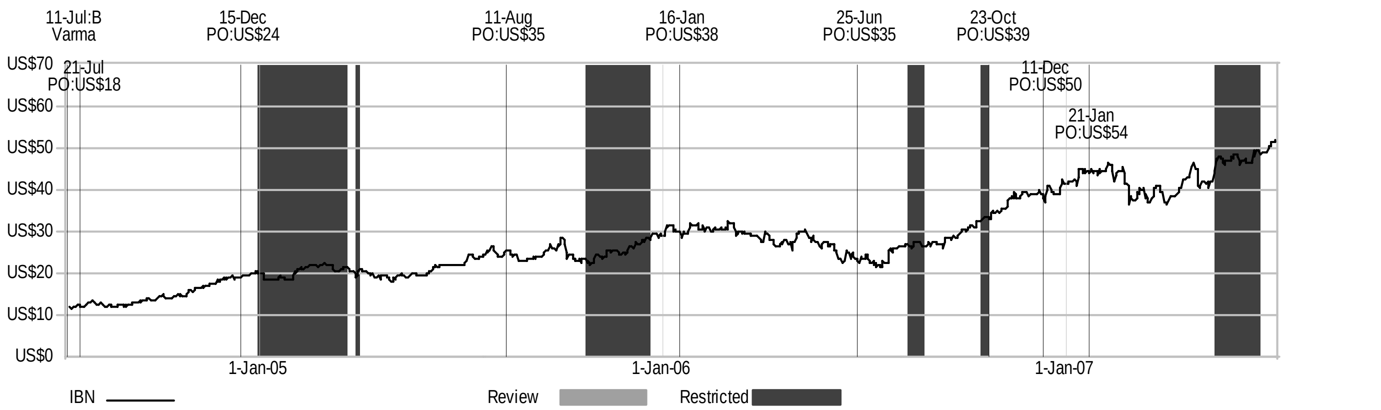
IBN Price Chart



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Neutral	111	43.02%	Neutral	54	55.10%
Sell	27	10.47%	Sell	15	62.50%

Investment Rating Distribution: Global Group (as of 01 Jul 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
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Neutral	1633	45.97%	Neutral	438	29.67%
Sell	244	6.87%	Sell	47	21.66%

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