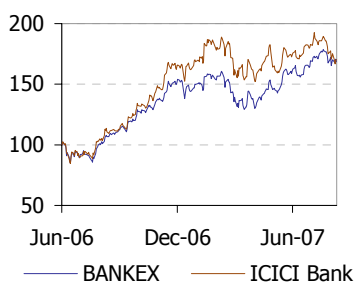


# ICICI Bank

 Relative to sector: **Outperformer**
**Punit Srivastava**

 Email: punit@enam.com  
 Tel: 9122 6754 7609

 Associate: **Neha Sanghai**  
 Email: neha@enam.com

**Relative Performance**


Source: Bloomberg, ENAM Research

**Stock data**

 No. of shares : 1,111mn  
 Market cap : Rs 972bn  
 52 week high/low : Rs 1,010/ Rs 576  
 Avg. daily vol. (6mth) : 2.0 mn shares  
 Bloomberg code : ICICIBC IN  
 Reuters code : ICBK.BO

**Shareholding (%) Jun-07 QoQ chg**

FII's & NRIs	: 45.9	0.9
ADRs	: 24.9	(1.6)
Banks / FIs	: 11.6	(0.4)
MFs/UTI	: 5.0	0.6
Others	: 12.6	0.5

## OPPORTUNITY AMONG SHORT TERM FEARS

ICICI Bank's stock has recently underperformed the banking sector, largely due to the huge equity offering along-with a relatively weak Q1 results. Higher Gross NPAs, pressure on NIMs, low ROE, impending risk of a slowdown in credit growth and the recent fears of the CDO exposure have taken a toll on the stock price, which corrected by ~13% from its recent high.

### Pain getting overdone, better days ahead

We believe that most of the worries are getting overdone. While NIM has likely bottomed out, fee-income growth remains on track and asset growth of 25-30% is achievable. New premiums in Life Insurance are likely to show better growth in coming months with base effect tapering off from Q2 onwards. Non Life Insurance is also building up substantial value for the group. Valuations at 1.1x FY09E Banking BV are even cheaper than most large Public Sector Banks.

### Risk to reward ratio very favourable

We believe that the risk-reward ratio at current levels is extremely favourable. We believe that there is a good value in many of the group's businesses like Insurance, Venture Capital, Securities and overseas banking subsidiaries, which cannot be ignored at current levels. These businesses are likely to build significant scale in the years to come and offer substantial upsides in the medium to longer term.

### SOTP gives a price target of Rs 1,260

We assign a total value of Rs 426 to the value of investments of ICICI Bank, with the biggest contributor being the Life Insurance at Rs 225 per share, followed by overseas banking subsidiaries at Rs 77 and General Insurance at Rs 31 per share. Our SOTP valuations lead to a price target of Rs 1260. Stripping out the value of investments, the stock quotes at 1.1x FY09 Banking BV and 9.1x FY09E Banking earnings. Re-iterate our sector **Outperformer** rating on the stock.

**Financial summary**

Y/E Mar	PAT (Rs bn)	EPS (Rs)	BV (Rs)	P/BV (x)	Banking BV (Rs)	P/Banking BV (x)	P/E (x)	P/Banking EPS (x)	NPAs (%)	RoE (%)	ROE on Banking BV
2006	25.4	28.5	250	3.5	205	2.3	30.7	16.4	0.7	16.2	16.0
2007	31.1	34.6	270	3.2	222	2.1	25.3	13.5	1.0	13.4	15.5
2008E	42.7	38.4	424	2.1	384	1.5	22.8	14.6	1.5	12.0	13.5
2009E	54.6	49.1	457	1.9	417	1.1	17.8	9.1	1.5	11.2	12.8

Source: Company, ENAM estimates; Note: Value of investments at Rs 426 per share for FY09. Banking BV is calculated after deducting the cost of investments from the reported BV

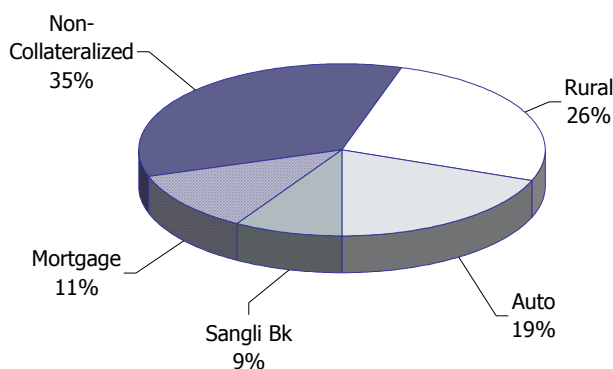
### **CDO exposure: No major worries**

Even if we consider higher amount of MTM hit in ICICI Bank's USD 1.5bn exposure in CDOs/CDs, we believe that it's only a short term risk as the underlying credit risk on these instruments are very low. As almost 70% of the exposure is in the domestic market, the MTM hit in this segment should again be relatively low. Also if the bank intends to hold the instruments till maturity, the actual losses are unlikely to materialize.

### **NPAs have risen, though still not alarming**

Gross NPAs have risen to Rs 60bn in Q1 almost 24% sequential rise from FY07 levels. The addition in NPAs have largely come from the unsecured loans, which comprise ~14% of the retail portfolio. While we don't expect the NPAs to come down in the near future, the levels of NPAs in our opinion are still not alarming.

### **Break-up of Accretion of NPAs in Q1FY08**



Source: Company

Of the Rs 11.5bn of NPAs added during Q1FY08, almost 35% came from the non-collateralized retail loans, which formed 14% of the retail loans and ~9% of the total loan book. Some of the small ticket size loans (~Rs 30,000 per loans) on an average yield 38% and hence the slippages are also quite high. Even the larger ticket size loans (average of Rs 100,000 or more) offer an average yield of around 18%. Total additions in NPAs from the mortgage segment were quite low with gross NPAs in this segment at 1.2%. The bank's rural portfolio also saw some deterioration during the quarter with almost 25% of the new additions in NPAs coming from this segment.

While we do expect NPAs to remain high (both in % and absolute terms) in the coming quarters, the intensity of such additions is expected to be low. While the Gross NPAs at 2.9% of the total loan book in Q1FY08 are on the higher side, net NPAs at 1.3% are so far under control.

### **NIM likely to see some expansion due to capital raising**

While on the one hand, negatives of a huge equity dilution is already reflecting in the stock price, positives like NIM expansion on account of such dilution will likely come from Q2 onwards. We expect NIM to expand in the coming

quarters, largely due to the recent raising of fresh capital of USD 5bn. Excluding equity dilution, NIM is unlikely to expand in Q2 and Q3. However, as the high cost bulk deposits start maturing towards the end of Q3 and Q4, we expect the interest spread to see some expansion. Most of the non-mortgage retail portfolio of ICICI Bank is fixed and hence the re-pricing is likely to take time.

In a rising interest rate environment, non-mortgage retail loans, (accounting for 37% of the loan book) being fixed rate in nature, are not re-priced rapidly, and they put maximum pressure on NIM on the asset side. Around Rs 25bn of non-mortgage retail loans are maturing per month, which were originated at lower rates. This will help the bank to show a better NIM towards the year-end and in FY09.

### **Impact of new ECB norms to be neutralized by higher growth in domestic lending**

ICICI Bank has a leadership status in ECBs with overseas lending in broadly four areas - M & A Funding, Proprietary Funding, Foreign Currency Funding and Rupee Funding, all of them mostly to the Indian Corporates. While the total overseas assets are around USD 22bn, the lending book is in the range of 50-60% of the total assets. The impact of the new ECB norms will largely come on the Rupee Funding segment. However, the bank is also likely to gain from the loan syndication market, which is likely to grow significantly in the absence of funding through ECBs. Of the Rs 1.98 trillion of total loan book in Q1FY08, corporate loans (non rural) were not more than Rs 150-200bn; accounting for ~10% of the total lending book. Hence this segment is also likely to grow at a higher rate in the coming quarters.

### **Holding company issue to be sorted out soon**

While the FIPB approval for the ICICI holding company transaction is still pending, there is a strong likelihood of this transaction getting approved in the near future. The holding company is any way planning an IPO in a year or so.

### **Life Insurance Business – Valuing it at USD 8.3bn**

ICICI Prudential grew its first year gross written premium by only 21% during Q1FY08 to Rs 10.5bn with NBAP margins of ~19%. The growth was low due to the base effect. In Q1FY07, there was a huge growth of almost 180% in APE as the new guidelines of 3 years lock-in came into effect from Q2FY07 onwards. The month of July-07 is understood to have gone quite well and we believe that the new premium growth will be much higher by the year-end. We are valuing the Life Insurance business at USD 8.3bn (20x FY09E NBAP, assuming a CAGR of 42% in NBAP for the next two years) – which gives Rs 225 per share for ICICI Bank's stake of 74% (valued at USD 6.2bn for ICICI Bank).

### Value of Life Insurance Business

ICICI Prudential	(Rs bn)
Estimated value of new policies likely to be sold (on APE basis) in FY09	89
Estimated NBAP margin on APE by FY09	19 %
Estimated NBAP by FY09	16.9
Multiple	20.0
Value of Life Insurance Business	338
Value assigned to ICICI Bank	250
Value per share for Life Insurance Business	225

Source: ENAM Research, Company

### Valuing Non Life Insurance Business at USD 1.1bn

Net profit of Non Life Insurance subsidiary, ICICI Lombard, has grown 36% YoY. More importantly, in FY07, the total net surplus of the company has grown by 59% YoY to Rs 1.38bn, which is a better indication of normalized profits in a scenario of high growth, leading to a normalized ROE of 27%. The gross written premium in Q1FY08 has grown at a lower rate of 9%, largely on account of the company's decision to go slow in the post de-tariff scenario when the pricing war was quite intense. The objective of the company has been to maintain its combined ratio at 97-97.5% for the time being (and later on to bring it down to 95%) and hence its overall profitability, rather than to enter the pricing war and gain market share. We project the total net surplus to grow to Rs 2.3bn by FY09, on which we give 20x to arrive at a total valuation of Rs 46.6bn (\$1.1bn) – Rs 31 per share for ICICI Group, considering the 74% stake of ICICI Bank (Valued at \$852m for ICICI Bank).

### General Insurance Business

ICICI Lombard	(Rs mn)	Note
Gross Written Premium- FY07	30,035	-
Net Written Premiums- FY07	14,508	-
PAT - FY07	684	-
Combined Ratio - FY07	97.5%	-
Total Net Surplus - FY07	1,379	-
Normalised profit -FY09	2,331	Assuming 50% growth in next two years
Value of the Non Life Business	46,610	Giving 20x to FY09E normalized profit
ICICI Bank's share	74%	-
Value of Non Life to ICICI Bank	34,492	-
Value per share for ICICI Bank	31	-

Source: ENAM Research, Company

We have also valued **the Asset Management Business** at ~USD 500m – giving a valuation of 7% of FY09E AUM, which gives a value per share of Rs 19 for ICICI Bank (which holds 51% stake in the AMC business).

### Overseas Banking Subsidiaries offer good value going ahead

Of the three wholly owned banking subsidiaries in UK, Canada and Russia, ICICI Bank UK offers maximum value to ICICI Bank currently. The UK subsidiary has already built up an asset base of USD 6bn by Q1FY08. While the NIM of the banking subsidiary is not high, a low cost to income ratio of 29% and high component of non-interest income at 64% helped the bank achieve a 1.1% RoA and a 22% ROE in FY07. We are expecting the net profit of ICICI Bank UK to cross USD 110m in FY09 against USD 40m in FY07. Valuing the company at 15x FY09E PAT – at USD 1.6bn. ICICI Bank Canada is also doing well with total asset base crossing USD 2bn by Q1FY08. This subsidiary is also likely to break-even this fiscal and will help to contribute significantly to the value of ICICI group.

### Risk Reward matrix very favourable

We feel that we are quite conservative in valuing the Life Insurance business in the holding company and there could be a good upside to our valuations if the holding company deal goes through. We are arriving at a **value per share of Rs 426** for ICICI Bank's total investments. Our Banking Book Value for ICICI Bank (after deducting the cost of investments) is estimated at Rs 417 for FY09. Hence, after adjusting for the value of investments, the stock trades at **1.1x FY09E Banking BV and 9.3x FY09E earnings**. Even if we write off the net NPAs from the BV (assuming 1.5% net NPAs by FY09), still the stock quotes at 1.2x FY09E Adj Banking BV and remains among the cheapest stock among the large banks' universe. We re-iterate our sector Outperformer rating on the stock.

Also, if we consider the ICICI Holding deal valuations (~USD 11bn) as a benchmark for the holding company valuations, the stock quotes at 0.8x FY09E Banking Book Value and 7.7x FY09E Banking PE.

#### Sum of Part Valuations - ICICI group

FY09	(Rs /share )	Note
ICICI Bank	833	2x FY09E Banking BV
Mutual Fund Business	19	7% of AUM by FY09
Life Insurance	225	20x FY09 NBAP of Rs 16.9bn
General Insurance	31	20x FY09 projected normalized net profit
I-Sec (Group)	27	12x FY09 PAT of Rs 2.5bn
Overseas Banking subsidiaries	77	15x FY09E PAT for ICICI UK & Canada
Other investments	48	Include value of investments in ICICI Venture/NSE/ICICI first Source etc
<b>ICICI Group-Fair Value</b>	<b>1,260</b>	

Source: ENAM Research, Company

## COMPANY FINANCIALS

### P&L Statement

(Rs mn)	FY05	FY06	FY07	FY08E	FY09E
Interest Income	94,099	143,061	229,942	353,968	463,846
Interest Expenses	65,709	95,974	163,585	264,981	344,458
<b>Net Interest Income</b>	<b>28,390</b>	<b>47,087</b>	<b>66,357</b>	<b>88,987</b>	<b>119,387</b>
<b>Non-Interest Income</b>	<b>34,161</b>	<b>41,810</b>	<b>59,290</b>	<b>77,041</b>	<b>100,906</b>
- Fee-based income	20,980	32,590	50,120	70,168	94,727
- Profit on sale of securities	7,110	9,280	10,140	8,500	7,500
- Lease & other income	6,060	7,960	9,020	10,373	11,929
- Bond Amortization	(2,760)	(8,021)	(9,990)	(12,000)	(13,250)
<b>Net Income</b>	<b>62,551</b>	<b>88,896</b>	<b>125,647</b>	<b>166,028</b>	<b>220,293</b>
Operating Expenses	25,167	35,470	49,787	67,212	90,736
<b>Operating Profit</b>	<b>29,560</b>	<b>38,886</b>	<b>58,742</b>	<b>80,737</b>	<b>108,521</b>
Provisions	4,318	7,920	22,260	23,798	33,687
<b>PBT</b>	<b>25,242</b>	<b>30,966</b>	<b>36,482</b>	<b>56,940</b>	<b>74,834</b>
Tax	5,190	5,565	5,380	14,235	20,205
<b>PAT</b>	<b>20,052</b>	<b>25,400</b>	<b>31,102</b>	<b>42,705</b>	<b>54,629</b>

Source: Company, ENAM Research

### Balance Sheet

(Rs mn)	FY05	FY06	FY07	FY08E	FY09E
Equity Capital	7,370	8,898	8,990	11,117	11,117
Net worth	125,500	222,060	243,130	471,029	507,630
Preference Share	3,500	3,500	3,500	3,500	3,500
Deposits	998,190	1,650,832	2,305,100	2,996,630	3,895,619
Other borrowings	417,530	486,670	706,610	826,170	983,120
Other Liabilities	131,870	150,830	188,240	353,431	495,030
<b>Total Liabilities</b>	<b>1,676,590</b>	<b>2,513,892</b>	<b>3,446,580</b>	<b>4,650,760</b>	<b>5,884,900</b>
Cash bal with banks and RBI	129,300	170,400	371,210	489,613	625,775
SLR Investments	344,820	510,740	673,680	889,258	1,156,035
Advances	914,050	1,461,631	1,958,660	2,644,191	3,437,448
Other Investments	160,050	204,730	238,900	342,422	339,955
Fixed Assets	38,620	39,500	39,234	40,734	42,234
Other Assets	89,750	126,890	164,896	259,084	297,993
<b>Total Assets</b>	<b>1,676,590</b>	<b>2,513,892</b>	<b>3,446,580</b>	<b>4,650,760</b>	<b>5,884,900</b>
<b>Growth (%)</b>					
Growth in NII	51	66	41	34	34
Growth in Net profit	22	27	22	37	28
Growth in deposits	47	65	40	30	30
Growth in advances	47	60	34	35	30
Growth in SLR	15	48	32	32	30

Source: Company, ENAM Research

**Key Ratios**

(%)	FY05	FY06	FY07	FY08E	FY09E
<b>Valuations</b>					
EPS (Rs )	27	29	35	38	49
ROA	1.4	1.2	1.0	1.1	1.0
ROE	16.0	14.6	13.4	12.0	11.2
BV (Rs )	170	250	270	424	457
Adj. BV (Rs )	150	240	254	395	416
Banking BV (Rs )	136	216	222	384	417
<b>Yields &amp; Margins</b>					
Average Yield on Advances	8.6	8.7	10.4	11.3	11.3
Average cost of funds	5.3	5.4	6.4	7.8	7.9
NIM	2.3	2.6	2.6	2.5	2.5
<b>Asset Quality</b>					
Gross NPAs	5.1	1.9	2.3	3.1	3.2
Net NPAs	2.0	0.7	1.0	1.5	1.5
<b>Capital</b>					
Tier-I CAR	7.6	9.2	7.4	13.3	11.8
Tier-II CAR	4.2	4.2	4.3	4.1	3.8
CAR	11.8	13.4	11.7	17.4	15.6
<b>Others</b>					
Operating Cost as % of Net Income	53	56	53	51	51
Operating cost as a % of average assets	2.3	2.4	2.2	2.1	2.1
Fee-based income as % of net income	33.5	36.7	40	42.3	43.1
% of current deposits	12.8	10.0	9.3	10.0	10.5
% of savings deposits	11.4	12.7	12.5	13.0	13.5
% of Low Cost Deposits	24.2	22.7	21.8	23.0	24.0
Dividend Per Share (Rs)	8.5	8.5	10	11	12.5

Source: Company, ENAM Research

## ENAM Securities Pvt Ltd.

109-112, Dalamal Tower, Free Press Journal Marg, Nariman Point, Mumbai - 400 021, India.

**Tel:- Board +91-22 6754 7500; Dealing +91-22 2280 0167**

**Fax:- Research +91-22 6754 7579; Dealing +91-22 6754 7575**

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#### Disclosure of interest statement (As of August 6, 2007)

1. Analyst ownership of the stock	No
2. Firm ownership of the stock	No
3. Directors ownership of the stock	Yes
4. Investment Banking mandate	No
5. Broking relationship	Yes

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