

**MARCH 18, 2010**
**CHANGE IN RECO.**

Coverage view: **Attractive**

Price (Rs): **964**

Target price (Rs): **910**

BSE-30: **17,519**
**Valuations stretched despite factoring in better environment; downgrade to**

**REDUCE.** We find the ICICI Bank's stock expensive at 1.9XPBR FY2011E despite factoring in an uptrend in its core business (expansion in spreads and decline in delinquencies). We believe that ICICI Bank's stated target of 15% RoEs may still be couple of years away. Post the recent up-move of 15% over the last month (7% outperformance), we do not find any upside at current levels; downgrade the stock to REDUCE with a target price of Rs910.

**Company data and valuation summary**

ICICI Bank

**Stock data**

52-week range (Rs) (high,low) 984-314

Market Cap. (Rs bn) 1,072.8

**Shareholding pattern (%)**

Promoters 0.0

FIs 65.2

MFs 7.1

**Price performance (%)**

	1M	3M	12M
Absolute	14.7	19.1	188.0
Rel. to BSE-30	6.9	13.6	47.5

**Forecasts/Valuations**

	2010	2011E	2012E
EPS (Rs)	37.3	47.0	59.0
EPS growth (%)	12.0	26.0	25.4
P/E (X)	25.8	20.5	16.3
NII (Rs bn)	82.4	92.4	108.4
Net profits (Rs bn)	41.6	52.4	65.6
BVPS	467.8	496.7	532.9
P/B (X)	2.1	1.9	1.8
ROE (%)	8.2	9.8	11.5
Div. Yield (%)	1.3	1.6	2.0

**We find valuations expensive in light of subdued RoEs in the medium term**

We believe that the current valuations are running ahead, despite assuming much better business performance over next two years. Improvement in margins and reduction in delinquencies will push ICICI Bank's RoEs to 14.8% in FY2012E from 10.2% in FY2010E, in our view. Any further improvement in RoEs is likely to be a function of a higher-than-expected growth, which we believe will be challenging in light of the highly competitive lending environment.

**International business continues to remain a drag on overall profitability**

International loans account for about 26% of the total loans of the parent book and ICICI Bank earns about 50 bps spread on the international business. We do not believe that this is likely to be a high RoE business and even as the proportion of international business reduces, drag on profitability and returns is likely to continue for ICICI Bank for some time. Thus, even as the domestic loan growth is likely to be about 20%, a subdued international book is likely to result in a lower overall growth for ICICI Bank. Its international banking subsidiaries had delivered an RoE of 13% (UK) and 3% (Canada) in FY2009, and we do not expect significant improvement out there.

**Growth will pick up; but will still remain sub-industry level**

ICICI Bank has done commendable work on costs and is currently working on the lowest cost/assets amongst its peer groups. However in the process, it has vacated/reduced exposures on markets like personal loans, credit cards, 2-wheelers, etc. This coupled with continued rundown of the international business will make above-industry growth very difficult for ICICI Bank. We believe that the lending markets are fairly competitive and to grow faster than the market, the bank might have to compromise on its pricing, which again is not a great strategy in our view. Thus we do not expect a very fast growth for ICICI Bank—16% CAGR growth for FY2010-FY2012E.

Manish Karwa

manish.karwa@kotak.com  
Mumbai: +91-22-6634-1350

M B Mahesh

mb.mahesh@kotak.com  
Mumbai: +91-22-6634-1231

Nischint Chawathe

nischint.chawathe@kotak.com  
Mumbai: +91-22-6634-1545

Kotak Institutional Equities Research  
kotak.research@kotak.com  
Mumbai: +91-22-6634-1100

### We expect margins to continue expanding more than management's guidance

We assume margins of 2.8% (increase of 23 bps) in FY2011E, over FY2010E, despite a 12-15 bps loss on margins due to higher interest payout on savings balances, as the proportion of international business reduces and rising interest rates would benefit margins. ICICI Bank makes about 3% margin on the domestic business and about 50 bps on the international business. The management, however, believes that improving margins would be challenging in FY2011E, as deposit costs are going up, coupled with the higher interest likely to be paid on the savings balances.

#### Margins to rise in FY2011 and stabilize thereafter

Net interest margins, March fiscal year-ends, 2006-2012E (%)



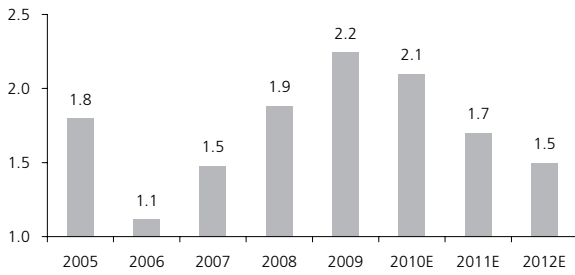
Source: Company, Kotak Institutional Equities

### Asset quality—worst behind; expect lower slippages and lower provisions

We expect improving trends on asset quality, Given the better-than-expected demand conditions, economic growth may likely be better and lead to lower slippages (than previously anticipated). We believe that incremental addition to NPLs (especially the unsecured NPLs) has already slowed down in recent months. We now expect delinquencies to fall below 2% in FY2011E. The net delinquencies (net of recoveries) are expected to fall from 1.8% in FY2008 to 0.7% in FY2011E. Our credit provision requirement is also declining from 2.1% of average loans in FY2010E to 1.4% in FY2011E and 1.1% in FY2012E.

**We already model a declining trend in slippages**

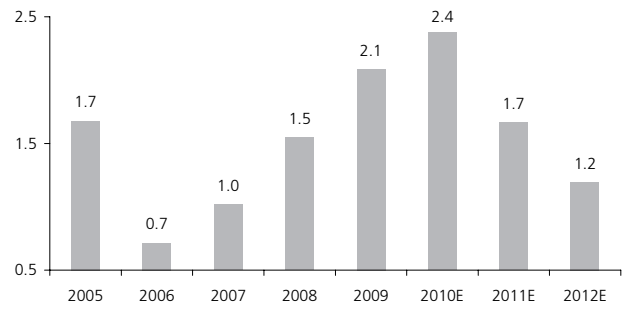
Incremental slippage as proportion of opening advances, March fiscal year-ends, 2005-2012E (%)



Source: Company, Kotak Institutional Equities estimates

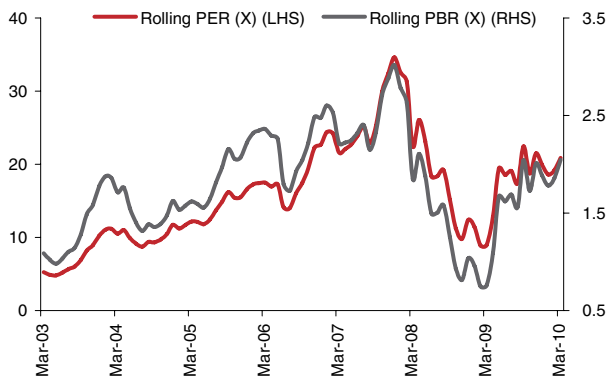
**As slippages decline, we expect net NPLs to decline**

Net NPLs as proportion of loans, March fiscal year-ends, 2005-2012E (%)



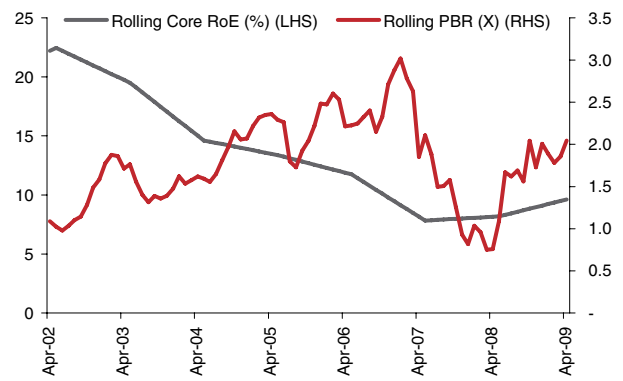
Source: Company, Kotak Institutional Equities estimates

**Valuations have moved up sharply of late**



Source: Company, Kotak Institutional Equities

**Valuations are running high for a likely improvement in RoEs**



Source: Company, Kotak Institutional Equities

## ICICI Bank- Sum-of-the-parts based valuation (FY2011E)

	ICICI Share (%)	FY2011	Valuation methodology adopted
<b>Value of ICICI standalone</b>	<b>100</b>	<b>618</b>	Based on Residual growth model
<b>Subsidiaries</b>			
<b>ICICI Financial Services</b>	<b>94</b>	<b>172</b>	
ICICI Prudential Life	74*	140	19X NBAP, margin assumed is 14%
General Insurance	74*	12	1X FY2011 PBR
Mutual Fund	51*	20	3% of AUMs as of March 2011, assuming 20% CAGR growth
<b>Other subsidiaries/associates</b>			
ICICI Securities Ltd	100	21	15X FY2011 PER
ICICI Securities Primary Dealer	100	2	1X FY2011 PBR
ICICI Homes Ltd	100	19	1.5X FY2011 PBR
ICICI Bank UK	100	25	1X FY2011 PBR
ICICI Bank Canada	100	36	1X FY2011 PBR
Venture capital/MF	100	11	10% of AUM of US\$2 bn
<b>Value of subsidiaries</b>		<b>287</b>	
<b>Value of company</b>		<b>905</b>	

Source: Company, Kotak Institutional Equities

Forecasts and valuation for ICICI Bank  
March fiscal year-ends, 2008-2012E

	PAT	EPS	P/E	BVPS	P/B	RoE	EPS excl. dividend	P/E (standalone)	BVPS (standalone)	P/B (standalone)
	(Rs bn)	(Rs)	(X)	(Rs)	(X)	(%)	(Rs)	(X)	(Rs)	(X)
2008	41.6	39.9	24.1	418	2.3	11.7	28.9	23.5	341	2.0
2009	37.6	33.8	28.5	445	2.2	7.8	30.7	22.0	331	2.0
2010E	41.5	37.3	25.8	468	2.1	8.2	33.9	20.0	347	1.9
2011E	52.4	47.0	20.5	497	1.9	9.8	43.2	15.7	370	1.8
2012E	65.6	59.0	16.3	533	1.8	11.5	54.8	12.4	403	1.7

Source: Company, Bloomberg, Kotak Institutional Equities estimates

ICICI Bank growth rates and key ratios  
March fiscal year-ends, 2007-2012E (%)

	2007	2008	2009	2010E	2011E	2012E
<b>Growth rates (%)</b>						
Net loan growth	34.0	15.2	(3.2)	(12.2)	15.5	16.0
Customer assets growth	38.6	17.6	(2.9)	(10.8)	13.8	14.5
Corporate loans	33.0	30.4	12.4	(3.6)	17.5	16.4
Total retail loans	34.8	3.2	(18.9)	(24.2)	12.0	15.4
Deposits growth	39.6	6.0	(10.7)	(3.5)	15.4	16.2
Borrowings growth	43.8	19.1	5.9	(17.9)	4.1	6.3
Net interest income	46.8	10.1	14.5	(1.6)	12.1	17.4
Loan loss provisions	172.6	25.1	38.8	12.1	(31.2)	(9.0)
Non-interest income	26.5	29.3	(13.7)	(2.4)	9.3	12.6
Net fee income	44.3	29.4	0.4	0.6	15.0	15.0
Net capital gains	48.7	62.5	(29.0)	(22.3)	(20.0)	-
Total income	35.8	19.8	(0.9)	(2.0)	10.8	15.1
Operating expenses	28.3	21.9	(13.6)	(16.1)	21.4	14.5
Employee expenses	49.4	28.6	(5.2)	(11.2)	39.4	18.0
DMA	9.5	1.2	(65.7)	(76.0)	20.4	32.6
<b>Asset management measures (%)</b>						
Yield on average earning assets	8.4	9.0	8.9	8.0	8.1	8.2
Interest on advances	9.4	10.7	10.0	8.7	8.8	8.9
Interest on investments	7.8	7.8	7.6	6.9	8.0	8.0
Average cost of funds	6.3	7.3	7.0	6.0	5.8	5.8
Interest on deposits	5.9	7.2	6.8	5.7	5.3	5.3
Other interest	7.4	7.7	7.5	6.6	7.1	7.1
<b>Difference</b>	<b>2.1</b>	<b>1.7</b>	<b>1.8</b>	<b>2.1</b>	<b>2.3</b>	<b>2.5</b>
Net interest income/earning assets	2.4	2.1	2.4	2.5	2.8	2.9
New provisions/average net loans	1.3	1.3	1.7	2.1	1.4	1.1
Loans-to-deposit ratio	64.1	67.5	69.7	66.4	68.3	69.7
Share of deposits						
Current	9.3	10.1	9.9	13.1	13.8	13.0
Fixed	78.2	73.9	71.3	62.2	60.0	61.8
Savings	12.5	16.0	18.8	24.7	26.2	25.2
Tax rate	14.7	17.8	26.6	25.0	28.0	28.0
Dividend payout ratio	29.0	29.5	32.6	33.0	33.0	33.0
<b>ROA decomposition - % of average assets</b>						
Net interest income	2.2	2.0	2.1	2.2	2.5	2.6
Loan loss provisions	0.7	0.7	1.0	1.1	0.8	0.6
Net other income	2.3	2.4	2.0	2.0	2.2	2.2
Operating expenses	2.3	2.2	1.8	1.6	1.9	2.0
Invt. Depreciation	0.0	—	—	—	—	—
(1- tax rate)	85.3	82.2	73.4	75.0	72.0	72.0
<b>ROA</b>	<b>1.0</b>	<b>1.1</b>	<b>1.0</b>	<b>1.1</b>	<b>1.4</b>	<b>1.6</b>
Average assets/average equity	12.8	10.5	8.1	7.2	7.0	7.3
<b>ROE</b>	<b>13.4</b>	<b>11.7</b>	<b>7.8</b>	<b>8.2</b>	<b>9.8</b>	<b>11.5</b>

Source: Company, Kotak Institutional Equities estimates

ICICI Bank, income statement and balance sheet  
March fiscal year-ends, 2007-2012E (Rs mn)

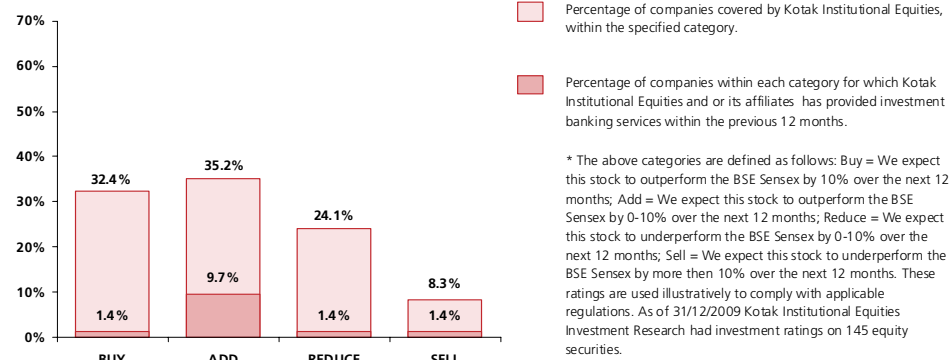
	2007	2008	2009	2010E	2011E	2012E
Total interest income	229,943	307,883	310,925	261,657	270,074	308,380
Interest on advances	160,963	226,010	223,238	178,344	181,265	212,948
Interest on investments	59,885	74,660	74,031	65,573	79,727	85,607
Total interest expense	163,585	234,842	227,259	179,291	177,708	199,982
Deposits from customers	116,477	171,102	157,852	121,876	121,236	140,423
Net interest income	66,358	73,041	83,666	82,366	92,366	108,398
Loan loss provisions	21,593	27,010	37,500	42,023	28,913	26,303
<b>Net interest income (after prov.)</b>	<b>44,765</b>	<b>46,031</b>	<b>46,166</b>	<b>40,342</b>	<b>63,453</b>	<b>82,095</b>
Other income	68,126	88,108	76,037	74,181	81,058	91,247
Net fee income	43,309	56,053	56,259	56,610	65,101	74,866
Net capital gains	11,152	18,121	12,864	10,000	8,000	8,000
Miscellaneous income	2,741	656	3,306	3,637	3,637	3,637
Operating expenses	66,906	81,542	70,451	59,131	71,796	82,171
Employee expense	16,167	20,789	19,717	17,517	24,418	28,826
DMA	15,239	15,427	5,289	1,270	1,529	2,028
Pretax income	36,480	50,561	51,170	55,393	72,715	91,170
Tax provisions	5,378	8,984	13,588	13,848	20,360	25,528
<b>Net Profit</b>	<b>31,102</b>	<b>41,577</b>	<b>37,581</b>	<b>41,545</b>	<b>52,355</b>	<b>65,643</b>
% growth	22.4	33.7	(9.6)	10.5	26.0	25.4
<b>PBT+provision-treasury gains</b>	<b>46,439</b>	<b>61,485</b>	<b>76,388</b>	<b>87,417</b>	<b>93,628</b>	<b>109,473</b>
% growth	51.6	32.4	24.2	14.4	7.1	16.9
<b>Balance sheet (Rs mn)</b>						
Cash and bank balance	371,213	380,411	299,666	291,685	313,783	341,188
Cash	20,670	28,478	28,557	27,553	31,807	36,961
Balance with RBI	166,399	265,297	146,806	143,845	161,688	183,939
Balance with banks	20,362	12,049	44,016	44,016	44,016	44,016
Outside India	162,783	74,587	80,286	76,272	76,272	76,272
Net value of investments	912,578	1,114,543	1,030,583	1,076,504	1,125,246	1,235,303
Investments in India	867,540	1,051,164	934,784	978,228	1,024,255	1,133,239
Govt. and other securities	673,682	753,777	633,775	655,812	696,839	802,824
Shares	19,373	29,201	17,031	17,031	17,031	17,031
Subsidiaries	26,072	46,383	61,195	66,195	71,195	74,195
Debentures and bonds	24,628	18,872	26,001	32,501	32,501	32,501
Net loans and advances	1,958,656	2,256,161	2,183,108	1,916,727	2,213,639	2,568,769
Corporate loans	866,656	1,129,531	1,269,788	1,224,695	1,438,573	1,674,083
Total retail loans	1,092,000	1,126,630	913,320	692,032	775,066	894,686
Fixed assets	39,234	41,089	38,016	39,486	38,999	38,304
Net leased assets	10,032	7,971	4,623	5,759	4,895	4,161
Net owned assets	29,202	33,118	33,393	33,728	34,104	34,144
Other assets	164,899	205,746	241,636	217,473	239,220	239,220
<b>Total assets</b>	<b>3,446,581</b>	<b>3,997,951</b>	<b>3,793,010</b>	<b>3,541,875</b>	<b>3,930,887</b>	<b>4,422,784</b>
Deposits	2,305,102	2,444,311	2,183,478	2,106,676	2,431,976	2,826,018
Borrowings and bills payable	752,449	896,494	949,806	779,347	810,916	861,896
Preference capital	3,500	3,500	3,500	3,500	3,500	3,500
Other liabilities	145,897	192,444	164,395	131,516	131,516	138,092
<b>Total liabilities</b>	<b>3,203,448</b>	<b>3,533,249</b>	<b>3,297,679</b>	<b>3,021,039</b>	<b>3,377,909</b>	<b>3,829,505</b>
Paid-up capital	8,990	11,127	11,133	11,133	11,133	11,133
Reserves & surplus	234,140	453,575	484,197	509,703	541,846	582,146
<b>Total shareholders' equity</b>	<b>243,130</b>	<b>464,702</b>	<b>495,330</b>	<b>520,836</b>	<b>552,979</b>	<b>593,279</b>

Source: Company, Kotak Institutional Equities estimates

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Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of December 31, 2009

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**BUY.** We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.

**ADD.** We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

**REDUCE.** We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

**SELL.** We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

Our target price are also on 12-month horizon basis.

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### Corporate Office

Kotak Securities Ltd.  
Bakhtawar, 1st Floor  
229, Nariman Point  
Mumbai 400 021, India  
Tel: +91-22-6634-1100

### Overseas Offices

Kotak Mahindra (UK) Ltd  
6th Floor, Portsoken House  
155-157 The Minories  
London EC 3N 1 LS  
Tel: +44-20-7977-6900 / 6940

Kotak Mahindra Inc  
50 Main Street, Suite No.310  
Westchester Financial Centre  
White Plains, New York 10606  
Tel:+1-914-997-6120

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