



India Essentials

Wednesday, 6 May 2009

ICICI Bank (Downgrade to Underperform)

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Too much too soon

Seshadri Sen

We downgrade ICICI Bank to Underperform from Outperform following the recent rally in the stock price. We cut our target price to Rs436 from Rs465. Limited leverage to economic growth. We believe ICICI's ability to leverage on economic growth is constrained by the need to restructure the deposit base first – and we estimate this will take at least 4–6 quarters. Thus the upside, in case of a sooner-than-expected recovery, could be limited to fees.

Rocks on Stocks

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Cashburn in 2009

Tim Rocks

Margins across Asia remain low for several years as Asia digests a decade of over-investment. Asia's financial position deteriorated during 2008, as leverage ratios rose for the first time in a decade. This represents a major inflection point. An even greater increase will occur in 2009; even if restocking leads to a production rise in Asia over the rest of the year, many Asian companies will continue to burn significant amounts of cash.

Rocks on Stocks

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Watching margins

Tim Rocks

We examine analysts' EBITDA margin forecasts for 2009. Profit margins across Asia fell to their lowest levels in a decade during 2008. The good news is that analysts are assuming that margins remain subdued in 2009. In aggregate, margins are assumed to be about the same in 2009 as 2008. However, there are some sectors where a large amount of good news is already factored into margin forecasts, while in others, margin forecasts are too pessimistic.

Macquarie Commodities Comment

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Promising PMIs

Isaac Feehely

PMIs ticked up again in April, with promising new orders data, but ex-China remain substantially below 50, the threshold between growth and contraction. Latest news Base metals prices were mixed on Tuesday, with copper closing down by 1.6%, while the other metals made small gains on Friday's close. US construction spending rose by 0.3% in March, the first increase in six months. In other US construction news, pending home sales jumped by 3.2% MoM as buyers were encouraged by favourable prices and mortgage rates.

INDIA

ICICI Bank

6 May 2009

ICICIBC IN Underperform

Stock price as of 05 May 09	Rs	569.00
12-month target	Rs	436.00
Upside/downside	%	-23.4
Valuation	Rs	436.00
- Sum of Parts		

GICS sector		banks
Market cap	Rs m	633,317
30-day avg turnover	US\$m	41.7
Market cap	US\$m	12,689
Number shares on issue	m	1,113

Investment fundamentals

Year end 31 Mar		2008A	2009E	2010E	2011E
Net interest inc	bn	73.0	84.1	92.1	103.9
Non interest inc	bn	88.1	76.1	76.6	83.7
Underlying profit	bn	79.6	89.8	93.9	99.9
PBT	bn	50.6	51.7	54.9	68.9
PBT Growth	%	38.6	2.2	6.3	25.4
Adjusted profit	bn	41.6	37.8	39.9	47.5
EPS adj	Rs	37.37	33.94	35.82	42.73
EPS adj growth	%	8.0	-9.2	5.5	19.3
PE rep	x	15.2	16.8	15.9	13.3
PE adj	x	15.2	16.8	15.9	13.3
Total DPS	Rs	11.00	11.00	11.00	13.50
Total div yield	%	1.9	1.9	1.9	2.4
ROA	%	1.1	1.0	1.0	1.2
ROE	%	11.7	7.9	7.9	9.0
Equity to assets	%	11.6	12.9	13.1	12.7
Price/book	x	1.4	1.3	1.2	1.2

ICICIBC IN rel SENSEX performance, & rec history



Source: FactSet, Macquarie Research, May 2009 (all figures in INR unless noted)

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Too much too soon

Event

- We downgrade ICICI Bank to Underperform from Outperform following the recent rally in the stock price. We cut our target price to Rs436 from Rs465.

Impact

- Limited leverage to economic growth.** We believe ICICI's ability to leverage on economic growth is constrained by the need to restructure the deposit base first – and we estimate this will take at least 4–6 quarters. Thus the upside, in case of a sooner-than-expected recovery, could be limited to fees. Our loan growth forecasts remains modest, at 3% and 9% in FY3/10 and FY3/11, respectively, after factoring in shrinkage in the overseas loan book.
- Asset quality – unlikely to surprise on the upside.** We think our loan-loss forecasts are realistic, with limited scope of positive surprise. Retail NPLs should continue to remain at elevated levels for a few more quarters, regardless of the overall economic outlook, as they are a function of the weak underwriting by the bank in 2007. We expect wholesale delinquencies to start accelerating, with the quantum of restructured assets being a lead indicator. We think it is too early to be playing for positive surprises on asset quality.
- Subsidiaries – too early for a turnaround.** We also see limited upside from the subsidiaries. It is true that the equity markets are a major determinant of top-line growth (and hence valuations) of the life insurance subsidiary, but we do not yet see a strong upside to our existing forecasts. Again, it is probably too early to play for such a turnaround, given the lack of visibility.

Earnings and target price revision

- We are reducing our FY3/10 and FY3/11 EPS estimates marginally by 1% and 4%, respectively. The key drivers include lower loan growth and fees partially offset by higher margin and lower opex. We are reducing our subsidiary contribution to Rs61/share from Rs78/share. Our target price is reduced by 6% to Rs436.

Price catalyst

- 12-month price target: Rs436.00 based on a Sum of Parts methodology.
- Catalyst: Continued asset quality pressures in 1H FY3/10E.

Action and recommendation

- Our fundamental view on the bank is broadly unchanged. We believe the bank is restructuring its deposits and its approach, and the franchise remains strong and capable of delivering results in a two- to three-year timeframe. There, however, remain significant challenges over the next three to four quarters.
- In that context, we do not believe a PER of 14x (ex-subs) is a sufficient discount to either the broad market or the other private banks. With ROEs expected at 8–9% through to FY3/11, the recent rally (up 31% in five trading sessions), looks overdone. We downgrade ICICI Bank to Underperform from Outperform.

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Rocks on Stocks

5 May 2009



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Cashburn in 2009

Asia's deteriorating financial position

Margins across Asia remain low for several years as Asia digests a decade of over-investment. Asia's financial position deteriorated during 2008, as leverage ratios rose for the first time in a decade. This represents a major inflection point. An even greater increase will occur in 2009; even if restocking leads to a production rise in Asia over the rest of the year, many Asian companies will continue to burn significant amounts of cash.

How much worse will 2009 be?

Analysts are assuming only a mild fall in cash generation this year by being overly aggressive on the potential for cost cuts and working capital improvements. We can identify US\$125bn in questionable additions to cashflow from such assumptions. The risks are greatest in cement, steel and construction.

Implications of a cash shortfall

Cashflows across Asia will not be enough to meet current dividend and capex plans. The shortfall will be at least US\$50bn, but could approach US\$200bn. Either significant new financing will be required, which will be a real challenge in Korea in particular, or dividends and capex will be cut. The sectors most at risk are materials and construction (again), along with energy, transport and telcos.

Stock picking in a challenging environment

While the near-term focus will be on a pick-up in production linked to a restocking cycle, it is also important not to extrapolate this better news. The production rise may not lead to higher earnings and, if end-demand recedes again, there will be renewed pressure on the financial positions of Asian companies.

The risks are greatest in the materials and construction sectors primarily, followed by energy and capital goods (such as shipbuilding). Absent from this list are tech companies, where analysts have been much more conservative in their forecasts, and where cash positions and cash generation is much better. Valuations also support a preference for tech over the materials and construction sectors, where optimism on fiscal policy has seen valuations rise already.

Analyst

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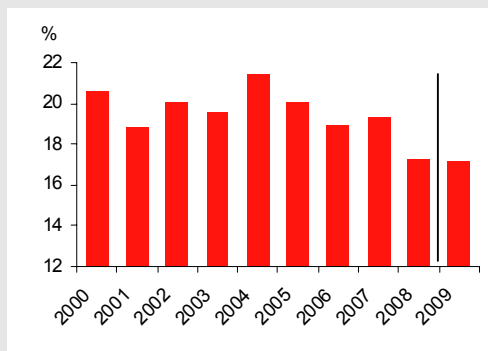
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Rocks on Stocks

5 May 2009

EBITDA margin forecasts for Asia ex-Japan



Source: Macquarie Research, May 2009

Watching margins

Event

- We examine analysts' EBITDA margin forecasts for 2009.

Impact

- Profit margins across Asia fell to their lowest levels in a decade during 2008. The good news is that analysts are assuming that margins remain subdued in 2009. In aggregate, margins are assumed to be about the same in 2009 as 2008.
- However, there are some sectors where a large amount of good news is already factored into margin forecasts, while in others, margin forecasts are too pessimistic.
- Stocks where margins are already forecast to be above 2007 levels, suggesting that further upside is limited, include:
 - ⇒ Chinese consumer stocks such as Belle, Li Ning and Dongfeng. This may be a reasonable assumption given that the Chinese economy remains strong, but it does suggest that further earnings upside is limited.
 - ⇒ Chinese construction companies also have high expectations built in. While it makes sense to assume volumes will be strong, particularly amongst the Chinese names, margins are also assumed to be very high.
 - ⇒ Margins are also assumed to be high in Hong Kong property.
- Stocks where margins are forecast to remain below previous historical lows, so there may be potential for upside earnings surprises, are:
 - ⇒ Tech hardware companies such as Lenovo, Compal, Samsung, LG Display. Since restocking will be a major issue in tech, and the chance of a recovery in prices is high, the upside to earnings is potentially large.
 - ⇒ Container and bulk shipping companies also have very high expectations built in, and the inventory rebound would be positive for container companies in particular.

Outlook

- This analysis confirms our view to move away from Chinese cyclical stocks, where expectations are already high, and focus on laggards in technology and transport, where expectations are low and the potential upside to earnings is high.

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Wednesday 6 May 2009

LME cash price

	US ¢/lb	% Change day on day
Aluminium	68.4	0.2
Copper	205.5	-1.6
Lead	63.2	0.3
Nickel	541.6	0.8
Tin	580.1	0.8
Zinc	68.2	0.8

Other prices

		% Change day on day
Gold (\$/oz)	910.00	2.9
Silver (\$/oz)	13.11	7.9
Platinum (\$/oz)	1135.00	5.5
Palladium (\$/oz)	223.00	5.2
Oil WTI	53.93	3.3
Cobalt (99.8%)	16.50	0.0
\$US/€ exchange rate	1.34	0.7
US\$/A\$ exchange rate	0.74	1.7

LME/COMEX stocks

	Tonnes	Change
LME Aluminium	3,797,125	4,825
Nymex Aluminium	9,830	0
Nymex Al. Pieces	23,100	-71
LME Copper	394,925	-3,775
Comex Copper	43,596	0
Lead	72,250	-75
Nickel	113,550	-654
Tin	12,560	0
Zinc	328,425	-525

Source: LME, Comex, Nymex, SHFE, Metal Bulletin, Reuters, LBMA, Macquarie Research

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Commodities Comment

Promising PMIs

Feature article

- PMIs ticked up again in April, with promising new orders data, but ex-China remain substantially below 50, the threshold between growth and contraction.

Latest news

- Base metals prices were mixed on Tuesday, with copper closing down by 1.6%, while the other metals made small gains on Friday's close.
- US construction spending rose by 0.3% in March, the first increase in six months. In other US construction news, pending home sales jumped by 3.2% MoM as buyers were encouraged by favourable prices and mortgage rates.
- Xstrata's copper cathode production fell by 8.9% YoY in 1Q09, while its mined production fell by only 1.3% YoY. The cathode decline was driven by flooding in Queensland, slowing the delivery of anode, and by a slump in sulphuric acid demand, which left Xstrata's Canadian smelters overstocked with acid and unable to process all available third-party material.
- Xstrata produced 17.4mt of thermal coal in 1Q09, up by 10.1% (1.6mt) YoY. Production was particularly strong in Colombia due to the recent acquisition of Glencore's Prodeco assets. Average realised thermal coal prices for the quarter ranged from \$72.8/t out of South Africa to \$103.5/t out of Australia.
- Xstrata's average hard coking coal price in 1Q09 was \$169.9/t, compared with the average full-year 2008 price of \$232.5/t as customers sought to defer expensive contracted cargoes to after 1Q09. Average semi-soft coking coal prices, at \$194.9/t, actually exceeded realised hard coking coal prices. Semi-soft production was down by 0.4mt (24%), which the company attributed to a longwall change at its United mine.
- Xstrata's ferrochrome production fell by 76% in 1Q09. Its South African operations idled 80% of their production capacity in response to weak demand. Xstrata says "destocking continues in the stainless steel sector."
- Bumi Resources, Indonesia's largest coal exporter, reported that 1Q09 production fell by 10% YoY to 11.3mt, citing seasonally challenging operating conditions and efforts to control supply in a soft market. The company's cash cost at its Kaltim Prima and Arutmin mines fell to \$27.5/t from \$30.7/t in 1Q08.

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Recommendation proportions – For quarter ending 31 March 2009

	AU/NZ	Asia	RSA	USA	CA	EUR
Outperform	40.44%	49.55%	44.83%	38.49%	67.19%	43.84%
Neutral	38.60%	15.57%	39.66%	46.43%	28.12%	39.04%
Underperform	20.96%	34.88%	15.52%	15.08%	4.69%	17.12%

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Futures - Tim Smith (852) 3922 2113
Structured Products - Andrew Terlich (852) 3922 2013