Company Focus

21 January 2008 | 12 pages

ICICI Bank (ICBK.BO)

Target price change ☑
Results ☑

Buy: 3Q Results; Rising P&L, Slumbering Balance Sheet

- **Rise of 35%, 20% ahead of our expectations, with P&L bias** — ICICI's profits were ahead of expectations, if qualitatively a little mixed. Key takeaways: a) P&L pickup, on fairly broad-based gains; b) asset quality drift continues, and growth appears to be slipping away; c) business focus: subsidiaries to the fore, as its (questionable) international focus continues. Overall, the P&L shine was likely dulled a bit by the balance sheet and its direction.
- **P&L shows signs of an up-tick** — While margins are up (remaining low, but getting better positioned for expansion), fee income growth has accelerated to over 33% (in spite of slackening growth), and cost pressures appear to be stabilizing. There is some evidence of ICBK's potential to raise profitability (a long-held expectation) through its franchise.
- **Balance sheet: quality and direction raise questions —** Balance sheet issues are likely to take center stage as: a) domestic loan growth moderates further (retail 12% yoy), b) int'l ops remain a key focus, in spite of questionable economics, and challenging markets, and c) asset deterioration continues at a steady (expected) pace. In sum, there are more questions than answers.
- **Momentum and focus on subsidiaries** — ICBK's financial services subsidiaries' sustained momentum, and ICICI Securities' IPO intentions are likely to remain a market focus.
- **Raise TP to Rs1,510** — This incorporates higher subsidiary valuations, slower asset growth and easier rate environment. Maintain Buy/Low Risk (1L).

Buy/Low Risk	**1L**
Price (18 Jan 08)	Rs1,245.45
Target price	Rs1,510.00
from Rs1,235.00	
Expected share price return	21.2%
Expected dividend yield	0.8%
Expected total return	**22.1%**
Market Cap	Rs1,385,610M
	US$35,338M

Price Performance (RIC: ICBK.BO, BB: ICICIBC IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	25,397	28.13	5.2	44.3	5.0	14.6	0.7
2007A	31,097	34.46	22.5	36.1	4.6	13.4	0.8
2008E	43,396	39.12	13.5	31.8	2.9	12.1	0.8
2009E	58,356	52.60	34.5	23.7	2.6	11.7	0.9
2010E	78,380	70.65	34.3	17.6	2.4	14.3	1.0

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	44.3	36.1	31.8	23.7	17.6
P/E reported (x)	44.3	36.1	31.8	23.7	17.6
P/BV (x)	5.0	4.6	2.9	2.6	2.4
P/Adjusted BV diluted (x)	5.1	4.6	2.9	2.7	2.4
Dividend yield (%)	0.7	0.8	0.8	0.9	1.0
Per Share Data (Rs)					
EPS adjusted	28.13	34.46	39.12	52.60	70.65
EPS reported	28.13	34.46	39.12	52.60	70.65
BVPS	249.55	273.27	432.40	474.94	524.50
Tangible BVPS	249.55	273.27	432.40	474.94	524.50
Adjusted BVPS diluted	245.96	269.34	427.33	469.38	518.36
DPS	8.50	10.00	10.50	11.00	12.00
Profit & Loss (RsM)					
Net interest income	41,870	66,357	96,307	129,650	176,939
Fees and commissions	30,019	43,309	58,467	78,930	98,662
Other operating Income	20,347	26,321	28,040	34,218	38,233
Total operating income	**92,237**	**135,986**	**182,814**	**242,797**	**313,834**
Total operating expenses	-44,795	-66,907	-90,063	-116,826	-147,354
Oper. profit bef. provisions	**47,442**	**69,080**	**92,751**	**125,971**	**166,480**
Bad debt provisions	-8,173	-22,264	-24,646	-32,916	-42,502
Non-operating/exceptionals	-8,303	-10,338	-11,000	-12,000	-12,000
Pre-tax profit	**30,966**	**36,479**	**57,105**	**81,056**	**111,978**
Tax	-5,565	-5,378	-13,706	-22,696	-33,595
Extraord./Min. Int./Pref. Div.	-4	-4	-4	-3	-3
Attributable profit	**25,397**	**31,097**	**43,396**	**58,356**	**78,380**
Adjusted earnings	25,397	31,097	43,396	58,356	78,380
Growth Rates (%)					
EPS adjusted	5.2	22.5	13.5	34.5	34.3
Oper. profit bef. prov.	60.5	45.6	34.3	35.8	32.2
Balance Sheet (RsM)					
Total assets	**2,513,890**	**3,446,580**	**4,525,911**	**5,905,976**	**7,666,205**
Avg interest earning assets	1,953,003	2,799,421	3,789,066	5,019,223	6,595,843
Customer loans	1,496,945	2,017,661	2,862,441	3,785,593	5,003,982
Gross NPLs	22,226	41,260	79,581	109,745	138,970
Liab. & shar. funds	**2,513,890**	**3,446,580**	**4,525,911**	**5,905,976**	**7,666,205**
Total customer deposits	1,650,832	2,305,102	3,218,029	4,469,492	6,071,431
Reserve for loan losses	17,274	34,377	55,998	86,572	125,769
Shareholders' equity	**225,560**	**246,533**	**477,553**	**524,198**	**578,535**
Profitability/Solvency Ratios (%)					
ROE adjusted	14.6	13.4	12.1	11.7	14.3
Net interest margin	2.14	2.37	2.54	2.58	2.68
Cost/income ratio	48.6	49.2	49.3	48.1	47.0
Cash cost/average assets	2.1	2.2	2.3	2.2	2.2
NPLs/customer loans	1.5	2.0	2.8	2.9	2.8
Reserve for loan losses/NPLs	77.7	83.3	70.4	78.9	90.5
Bad debt prov./avg. cust. loans	0.7	1.3	1.0	1.0	1.0
Loans/deposit ratio	90.7	87.5	89.0	84.7	82.4
Tier 1 capital ratio	9.2	7.7	11.8	10.0	9.1
Total capital ratio	13.4	10.1	15.5	13.0	11.9

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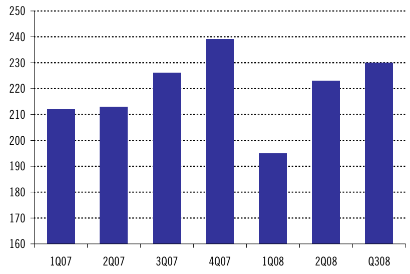
Powered by: dataCentral

Figure 1. ICICI Bank – 3Q08 Financial Highlights (Rs million, %)

Rs Million	**3Q08**	**3Q07**	**YoY %**	**2Q08**	**QoQ%**	**Citi Investment Research Comments**
Interest Income	79,118	56,009	41.3	75,165	5.3	
Interest Expense	(59,521)	(41,159)	44.6	(57,305)	3.9	
Net Interest Income	**19,597**	**14,850**	**32.0**	**17,860**	**9.7**	**Strong showing - ahead of expectations, and backed by a slight margin expansion**
Fee-Based Income	17,850	13,450	32.7	14,858	20.1	Meaningful pick up over the quarter, in spite of a moderation in asset growth
Other Non-Interest Income	6,416	6,356	0.9	5,861	9.5	Remains a driver of business, even as it incorporates an additional MTM charge of Rs1.5b (2q/Rs1.2b) on CDO/CDS exposure
Non Interest Income	24,266	19,806	22.5	20,719	17.1	
Operating Income	**43,863**	**34,656**	**26.6**	**38,579**	**13.7**	
Operating Expenses	(21,276)	(17,133)	24.2	(19,708)	8.0	Stabilising - helped by moderating asset growth
Pre-Provision Profit	**22,587**	**17,524**	**28.9**	**18,871**	**19.7**	
Charges for Bad Debts	(7,603)	(6,672)	14.0	(6,445)	18.0	In line with expectations, though could have been raised given ongoing deterioration
Pre-Tax Profit	**14,983**	**10,852**	**38.1**	**12,427**	**20.6**	
Tax	(2,681)	(1,751)	53.1	(2,401)	11.7	
Net Profit	**12,302**	**9,101**	**35.2**	**10,026**	**22.7**	**20% ahead of our expectations - driven by NII**
EPS	11.1	10.2	8.6	9.0	22.7	
Customer Loans	2,155,170	1,727,631	24.7	2,071,210	4.1	Moderating and increasingly dependent on the international book
Customer Deposits	2,297,790	1,968,928	16.7	2,283,070	0.6	Growth moderates - and its quality improves with a rising CASA level
AIEA	3,151,190	2,627,710	19.9	3,085,937	2.1	
AIBL	3,130,285	2,404,488	30.2	3,014,807	3.8	
Total Assets	3,766,995	2,958,321	27.3	3,649,442	3.2	Growing with the market/market share gain days are over
Avg Assets	3,708,219	2,891,023	28.3	3,609,382	2.7	
Gross Non-Performing Loans (NPL) excluding W/off	65,460	37,170	76.1	59,315	10.4	Steady deterioration - 10% QoQ, inline with the previous quarter, and retail asset biased - a drift, rather than anything decisive
Loan Loss Reserves (LLR)	(33,182)	(18,600)	78.4	(29,606)	12.1	
Shareholders' Funds	465,140	244,450	90.3	447,520	3.9	
Book Value Per Share	418	273	52.9	402	3.9	Has used some capital for its subsidiaries
Key Ratios (%)	**3Q08**	**3Q07**	**Bps ∆ YoY**	**2Q08**	**Bps ∆ QoQ**	
ROAA (annualized)	1.31	1.23	8	1.10	21	
ROAE (annualized)	10.58	14.89	-431	8.96	162	Pressured by large capital, and subsidiary investments
Net Interest Margin (bps)	230	226	4	223	7	Uptick - modest, but a positive, and possibly a benefit of easing balance-sheet growth
Fee Inc/Operating Income	40.7	38.8	189	38.5	218	Impressive, and the key positive takeaway from the results
Other Non-Interest Inc/Op Inc	55.3	57.1	-183	53.7	162	
Op. Cost/ Operating Income	48.5	49.4	-93	51.1	-258	
Loan-to-Deposit Ratio (LDR)	93.8	87.7	605	90.7	307	
NPL/Loan Ratio	3.0	2.2	89	2.9	17	
LLR/NPL Ratio	51	50	65	50	78	

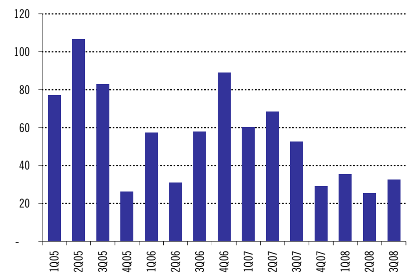
Source: Company reports, Citi Investment Research

Figure 2. NIM (bps)



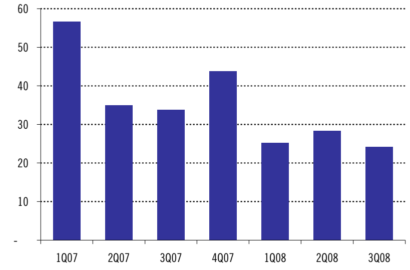
Source: Company reports

Figure 3. ICBK – Growth in Fee Incomes, %



Source: Company reports

Figure 4. ICBK – YoY Growth in Operating Expenses, (%)



Source: Company reports

P&L leads, balance sheet lags

It was a mixed quarter. While ICBK surprised quantitatively (20% ahead of our expectations) and qualitatively on the P&L, the balance sheet does not reveal very definite trends, and raises more questions that it provides answers. The quarter also reinforces ICICI's strong positioning in the broader financial services space in India. Management's plans to highlight and list some subsidiaries suggest that these businesses are probably going to be in greater focus over the near to medium term. They should also provide a source of profit, capital and market valuation benchmarks for the company. We look at these issues in greater detail later in this note.

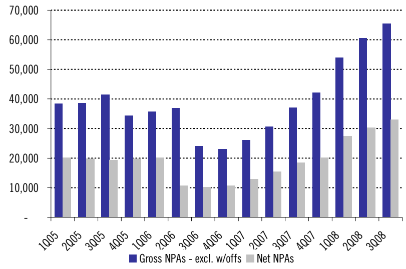
P&L: Directionally positive

The P&L is a positive, and clearly highlights the earnings expansion potential of the existing balance sheet and its existing business franchise. The underlying profits were 20% ahead of our expectations, and unlike in the past, they were driven by key operating parameters, rather than through one-off gains, or suppressed provisioning. In order of importance, the key positives were in the form of:

- **Margins** — ICBK's margin expanded to about 230bps (vs. 223 the previous quarter), in a quarter where we expect the broader sector to continue to face pressure. While margins remain well under industry averages, we believe the margin support was likely generated by slowing balance sheet growth (which enabled ICBK to improve its deposit mix), and possibly some easing in the interest rate environment during the quarter. Importantly, the quarter did suggest that ICBK could start to return to industry level margins – a long held expectation, although there are recent indications of this. Additionally, we believe the easier interest rate environment (which would support a meaningfully whole-sale borrower like ICBK), the new reality of easier asset growth, and a meaningful expansion in ICBK's branch base over the near term, should also contribute to an uptrend.

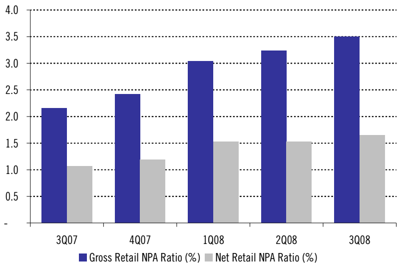
- **Fee income** — The bank's fee income bounced to 32%+ yoy growth (20% qoq), after a decline to 25% in the previous quarter. While the previous quarter did have some one-offs, we believe the current quarter is impressive because: 1) growth has exceeded balance-sheet expansion and ICBK has tended to depend meaningfully on asset-linked fees; 2) the international markets have been soft, and 3) it is fairly broad-based across segments. We do see this as a fairly impressive aspect of the quarter, and we believe it augurs well for the quality of earnings.

Figure 5.ICBK – Gross and Net NPLs (%)



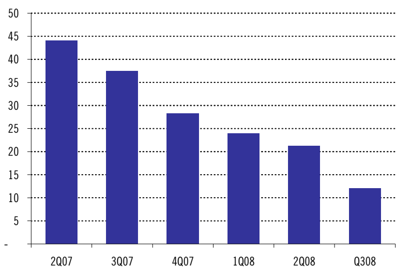
Source: Company reports and Citi Investment Research

Figure 6. ICBK – Retail Gross and Net NPLs (%)



Source: Company reports and Citi Investment Research

Figure 7. ICBK – YoY domestic Loan growth, %



Source: Company reports and Citi Investment Research

- **Operating expenses growth moderates —** ICBK's operating expense growth has also moderated a little to about 24%, which is lower than in many of the past quarters. While this was helped by relatively modest balance-sheet expansion, we do note some stability in its cost expansion, also reflected in a marginally lower cost-to-income ratio. While this may not necessarily continue in the immediate term – there is aggressive branch expansion under way and some of these costs will show up – we sense costs are stabilizing. If ICBK is able to continue to show upsides on margins and fees it would provide a potential driver of operating leverage.

Balance sheet: More questions than answers

ICBK's balance-sheet performance is a little soft, and while not meaningfully directional, it does raise three key points:

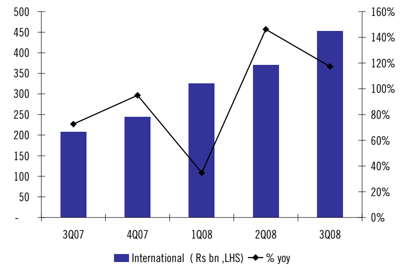
1) Asset quality: Weak, but along expected lines — ICBK recorded an estimated 10% qoq deterioration in its loan book. This was consistent with the previous quarter, with deterioration predominantly in the unsecured retail space. This just sustains the trend and suggests that asset quality remains a watch and pressure point. This is not alarming, however, or meaningfully damaging to earnings or the book. Its toll on the P&L, in the form of provisions, was in line with historical levels, with no change in provisioning levels/coverage. While we expect asset quality to remain an overhang, for this quarter and in the near future it does appear to constitute a source of incremental pain or pleasure.

2) Loan growth: Moderating, and how much lower will it go — In the domestic market, ICBK probably lost market share in the last quarter, a role fairly dramatically reversed over the last year or so. This was in large measure because of its significant retail bias at 61% of its loans, and growing at about 12% yoy, a pace that appears lower than the broader industry. In addition, negative growth in its rural/agricultural portfolio continued on a yoy basis. This was in part because of a seasonal impact, and as ICBK has sought to streamline lending practices, given some operational losses last year. Effectively, the 25% loan growth that it managed in the quarter was driven by its international loan book, which carries a host of other issues, which we discuss later in the note.

The key question is how much will growth moderate, and will it remain the growth bank/stock it has long been viewed as. Our sense is that ICBK's relatively skewed exposure to the retail and international segments, does raise its growth risks. In the near term, ICBK could well be a lower-than-industry growth bank. We believe it could try and avert this growth moderation by aggressively lending to the corporate sector, but this would necessitate another strategic shift in a short time, which could carry some execution risk. We would expect increased lending to this segment to balance the loan book, but it would have to be a dramatic shift to this segment if ICBK is to get back to above-industry growth.

Is lower growth necessarily negative? We do not think so; if anything, we believe a period of consolidation, and portfolio balancing on the asset and the deposit side, would be good, and is probably necessary (P&L and balance-sheet perspective), but it could impact the growth stock positioning that ICBK has held.

Figure 8. ICBK – International Business Loan Growth (Rs bn , %)



Source: Company Reports and Citi Investment Research

3) International loan book: The leading growth question — ICBK's offshore loan book, primarily to Indian corporates, continues as its growth driver. In the current quarter, this growth was over 100% yoy (though more moderate than the previous quarter), accounting for the bulk of ICBK's 25% loan growth. Equally importantly, its international loans now account for about 23% of its loan book (21% in 2Q08). Management also suggests that it will seek to grow this portfolio at about the same absolute level in the current calendar year, if market conditions are ok.

For us, the value/economics and the necessity of such a large international loan book has become even more questionable. And from a balance and return perspective, at 23% of loans it is well in excess of the 10-15% that we believe would probably be appropriate. Critically, in our view, this lending part of its business probably carries a diminishing return to scale (given that it would remain predominantly driven by wholesale funding) – in sharp contrast to the domestic business, where the franchise should feed off itself, and generate an increasing return on scale.

We believe this continued focus on the international books also sticks out sorely in the context of the current global credit markets, where borrowing spreads are such that incremental growth, if at all possible, will probably be fairly low profit and potentially higher on the risk spectrum. Management's large portfolio and its suggestion that it will continue to pursue this strategy – keeping markets in mind – is likely to increasingly influence valuations, and in our view, this influence will be more negative than positive.

Financial services subsidiaries: To the fore

Analysts (us included), the market, and clearly the bank's management are increasingly shifting focus to ICBK's financial services subsidiaries. These units have for some time been an integral part of the markets 'sums of parts' valuations. The focus has also increased as India's financial services space (ex-banks), and its participants have increasingly sought equity listings.

ICBK's businesses have also done fairly well in the current year (highlighted in figure 9) – while the Life and General insurance businesses continue to be leaders, its other initiatives over the current year include: a) ICICI Securities: It has restructured the firm, and now is setting in place an aggressive distribution and retail broking effort (its on-line platform is already a market leader), and b) a venture capital business with US$2.4bn of AUM and with a strong and long track record, it is seeking to aggressively expand its assets under management for alternative asset classes, and c) AMC is a top three player in the market, and is also seeking to push up its growth and expansion efforts.

ICBK has now announced that it will be listing ICICI Securities, and this could include an additional stake sale. It is also fairly likely to seek listing and/or sell down its stakes in some of it other businesses over the near to medium term. Such moves would create calibrated valuation benchmarks for these businesses, although as we mentioned earlier, the market is already factoring in what we believe are reasonable benchmarks for most of these businesses. While these measures would probably shift the spotlight from the basic lending business, they should also be a source of capital returns for ICBK (needed, given its low return levels), and capital, which should provide it with even more flexibility in how it manages, grows, and restructures it businesses.

Figure 9. ICICI Bank Subsidiary Profit (Rs Million, %)

ICICI Bank Subsidiary	9M08	9M07	Yoy Growth (%)
ICICI Bank Consolidated	27620	22030	25%
ICICI Prudential Life Insurance			
Profit Impact	-6740	-2590	160%
APE	38800	23234	67%
NBAP	7480	5400	39%
ICICI Lombard General Insurance			
Premium	27220	23265	17%
PAT	1150	490	135%
ICICI Securities			
Revenues	5270	NA	NA
PAT	1080	NA	NA
Pru - ICICI AMC			
AUM	692300	333500	108%
PAT	750	330	127%
ICICI - Venture			
AUM	96000	NA	NA
PAT	520	NA	NA

Source: Company reports and Citi Investment Research

ICICI Bank

Company description

ICICI Bank was founded in 1994 by ICICI Ltd., which was then the country's leading development finance institution. It is a leader in retail lending, with more than 30% market share in all consumer-finance segments. ICICI Bank has international banking operations as its key focus area.

Investment strategy

Our Buy / Low Risk (1L) rating is premised on: (1) ICBK's broad exposure to the strong momentum in the Indian economy, and its strong market position in the Indian market; (2) a broad asset mix, which should reduce the risk and profitability strain from concentration; (3) the growing value of its subsidiary businesses; (4). the bank, in our view, offers one of the best exposures to the consumer finance and financial services opportunity in India, and has been at the forefront of building market leadership in most products, and (5) its strong and deep management team. ICICI Bank also offers large exposure to the corporate lending and capex cycle, which should be viewed against the economy's bright prospects.

Valuation

We raise our target price to Rs1,510 (from Rs1,235), based on our EVA model, which captures the long-term value of the business and is a standard valuation measure for our India banking universe.

Our target price revision is on account of: a) higher value for subsidiaries – now valued at Rs386 (previous Rs313), b) lower risk-free rate – we now factor in 7.75% (8%), given the recent fall in interest rates, and the outlook, and c) lower asset growth expectations over the longer term. Our target price is premised on the following: (1) a risk-free rate of 7.75%; (2) a long-term loan loss of 100bps; and (3) subsidiary value of Rs386 per share (Rs313 earlier).

We also use a sum-of-parts methodology, benchmarking valuations to individual businesses. By this measure, our fair value for ICICI Bank is Rs1,383 (up from Rs1,200 previously). We value ICICI Bank's banking business on a 2.25x FY09E PBV (2XFY09E PBV earlier), reflecting the leverage potential of the business as also peer company valuations, but also factoring in its ROE, which is currently below its cost of capital. In addition, we factor in Rs386 as the value of its subsidiaries (Previously Rs313) – specifically, these are; Life insurance business at Rs246 per share (18X FY09E NBAP), general insurance at Rs40per share (20X FY09E PE), AMC at Rs27 per share (8% of AUM), ICICI Securities at Rs55 per share (20X FY09E), venture fund at Rs21per share (15% of FY09E AUM).

We prefer to use EVA as our primary methodology because we believe it better adjusts for the relatively dynamic cost of capital and better captures the long-term value of the business.

Risks

Our risk rating is Low based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. The downside risks that could impede the shares from reaching our target price include: (1) continued deterioration in asset quality; (2) low margins, with a limited cushion if there is further downside pressure; (3) aggressive growth in a range of business areas raises the risk of some failures; (4) aggressive international operations where returns appear low, and risk levels relatively high, and (5) inability to leverage capital, which keeps ROEs low.

Appendix A-1

Analyst Certification

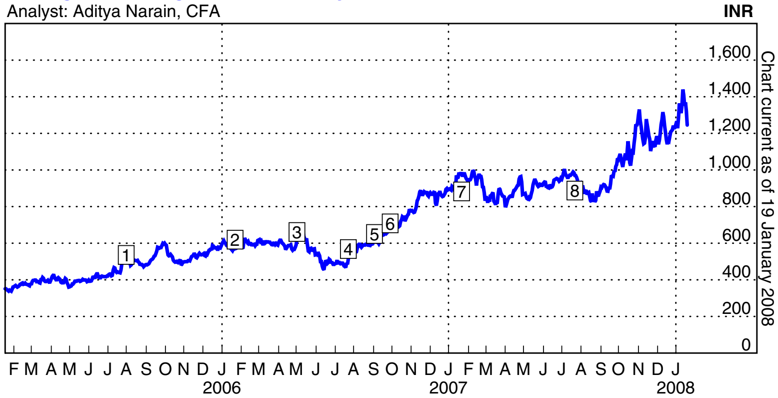
Each research analyst(s), strategist(s) or research associate(s) responsible for the preparation and content of all or any identified portion of this research report hereby certifies that, with respect to each issuer or security or any identified portion of the report with respect to an issuer or security that the research analyst, strategist or research associate covers in this research report, all of the views expressed by that research analyst, strategist or research associate in this research report accurately reflect their personal views about those issuer(s) or securities. Each research analyst(s), strategist(s) or research associate(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst, strategist or research associate in this research report.

IMPORTANT DISCLOSURES

ICICI Bank (ICBK.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Aditya Narain, CFA



#	Date	Rating	Target Price	Closing Price
1:	1 Aug 05	*3M	*515.00	533.30
2:	22 Jan 06	*3L	*550.00	569.75
3:	2 May 06	*1L	*700.00	621.95
4:	23 Jul 06	1L	*650.00	514.90
5:	4 Sep 06	1L	650.00	620.75
6:	28 Sep 06	1L	*795.00	708.40
7:	22 Jan 07	1L	*1,125.00	977.20
8:	22 Jul 07	1L	*1,235.00	970.05

*Indicates change.

Covered
Not covered

Rating/target price changes above reflect Eastern Standard Time

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