kotak Institutional Equities

# ICICI Bank (ICICIBC)

Banks/Financial Institutions

**ADD**

DECEMBER 23, 2009

UPDATE

Coverage view: Attractive

Price (Rs): 863

Target price (Rs): 880

BSE-30: 17,231

**Awaiting growth, for now.** With key issues of liability management, asset quality, unsecured loans and international banking being addressed to a great extent, the management is awaiting loan growth, resulting in better leverage and RoEs. We also believe that faster growth, funded by core deposits, would be crucial for improving RoEs, resulting in higher valuations for the bank. However, RoE in the near term is likely to be driven by lower provisions and lower costs. Retain ADD.

**Company data and valuation summary**

ICICI Bank

| Stock data | | | |
|---|---|---|---|
| 52-week range (Rs) (high,low) | | | 984-252 |
| Market Cap. (Rs bn) | | | 960.3 |
| **Shareholding pattern (%)** | | | |
| Promoters | | | 0.0 |
| FIIs | | | 65.1 |
| MFs | | | 7.1 |
| **Price performance (%)** | **1M** | **3M** | **12M** |
| Absolute | (6.0) | 2.1 | 102.1 |
| Rel. to BSE-30 | (6.2) | (1.0) | 13.6 |

| Forecasts/Valuations | 2009 | 2010E | 2011E |
|---|---|---|---|
| EPS (Rs) | 33.8 | 37.3 | 45.6 |
| EPS growth (%) | (0.3) | 10.6 | 22.1 |
| P/E (X) | 25.6 | 23.1 | 18.9 |
| NII (Rs bn) | 83.7 | 89.2 | 99.0 |
| Net profits (Rs bn) | 37.6 | 41.5 | 50.7 |
| BVPS | 444.9 | 467.8 | 495.8 |
| P/B (X) | 1.9 | 1.8 | 1.7 |
| ROE (%) | 7.8 | 8.2 | 9.5 |
| Div. Yield (%) | 1.3 | 1.4 | 1.7 |

## Retain positive view, but valuations do not provide big upsides

We are increasing our TP for ICICI Bank to Rs880 from Rs850 earlier, mainly to factor is somewhat higher valuations for its insurance business. We value ICICI Prudential Life at Rs230 bn (EV of Rs87 bn + appraisal value of Rs143 bn on factoring 19X NBV FY2011E). The per share value of ICICI Prudential Life works out to be Rs140 per share (for 74% stake and 10% holding discount) from Rs115 earlier. The additional capital requirement for ICICI Prudential is likely to be negligible on account of somewhat slower growth in the current fiscal and seemingly higher cost control. While we retain our positive view for ICICI Bank, upsides might be limited (after an already 8% up-move over last 3 trading sessions)

## Image makeover – learning from its mistakes

In a recent meeting, the management highlighted its initiatives to change the general perception about the bank. Some of these aspects are very important and quite commendable as well, in our view:

(1) The management is trying to project a very soft image of itself across all customers and different from its earlier 'know all' approach.

(2) The bank is trying to build personal relations with its customers and has been increasing its branch banking focus, compared to its earlier strategy of pushing customers towards ATMs and internet, which never allowed any relationship to be built between the customer and the bank.

(3) Most of the loan products would be done by the bank and the use of DSA has been reduced to bare minimum – should ensure better loan writing and better service.

(4) Media interactions are being handled only at the highest level and dissemination of information taken very seriously – a key issue which also precipitated the crisis last year.

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## Awaiting loan growth; strategy focused on secured credit

The management reiterated its focus on secured retail and domestic corporate loans — mainly mortgages, auto and project financing. Mortgage disbursements for ICICI Bank have increased to about Rs6 bn per month, as compared to Rs1-2 bn per month over the previous 2-3 quarters. ICICI Bank seems to be back in the auto loans business and intends to grow the portfolio at a faster pace from now on. Further, the traditional business of infrastructure finance is likely to be a big focus area and likely to grow at a fast pace, even as most other segments slow down or even decline.

## Unsecured loans unlikely to be a focus area in the near term

We believe that the bank is willing to lose its market dominance in the personal loan and credit cards segment. With these being scale businesses and the bank might not be able to run profitable businesses on a smaller scale, the bank might even look at reducing the book further. The focus is only on its own customers and current volumes in both these businesses are negligible.

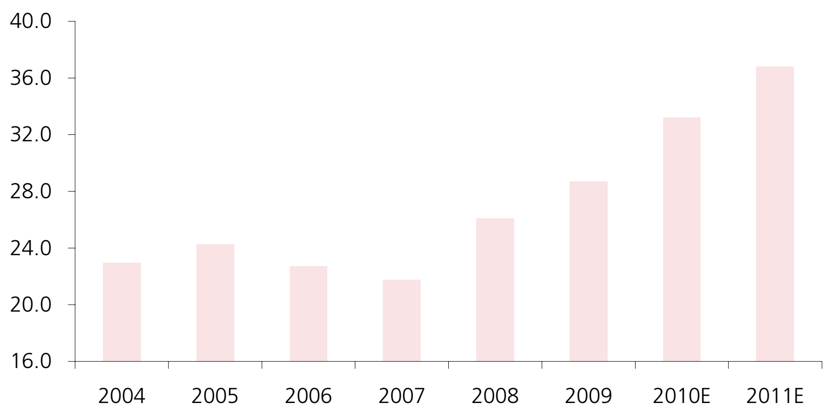
## International book also likely to shrink

The current bond issuance of $750 mn was placed at a fine rate of 2.93 bps over LIBOR. Also, the spreads have reduced somewhat on its other papers. However, the current spreads are still high and the intent is to slowly scale back its international book. While concerns on asset quality and ALM mismatch have reduced, the overseas operations still don't seem to be profitable with margins at just 0.5%. International book accounts for 27% of total parent loan book and a declining trend out here is likely to curtail the overall loan growth for the bank; however, it would be positive for margins.

## Liability focus working well

We believe that one of the key challenges and a crucial business trend for ICICI Bank would be its ability to grow its CASA deposit franchisee. Post the crisis in 3QFY09, the bank has worked well to improve its core deposits. The strategy of focusing on low-cost deposits over the past few quarters appears to be paying off— savings deposits are averaging about Rs 12 bn every month. However, growth in current deposits (similar to experience of other industry participants) has been sluggish. Significant addition in bank branches can help the company improve its CASA deposits in the future. We model CASA deposit growth of 21% yoy in FY2010E (CASA proportion at 33% as of March 2010) and 21% in FY2011E (CASA proportion at 37% as of March 2011).

**CASA % would grow on back of slower balance sheet growth**
Casa deposits as a % of total deposits, March fiscal year-ends, 2004-2011E (%)

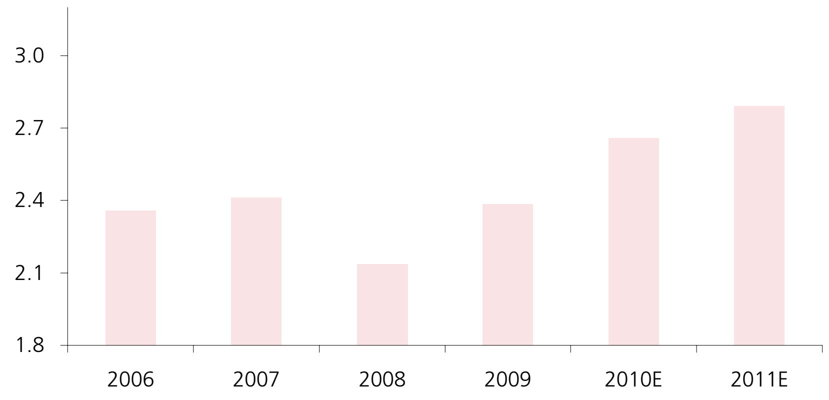



Source: Company, Kotak Institutional Equities

## Margins to improve on back of deposit re-pricing

A clear focus on correcting its liability profile, steep yield curve currently (wholesale deposit rates are very reasonable) and slower loan growth augur well for margins of ICICI Bank. However, its strategy of not growing its high yielding personal loans and credit cards coupled with high competition in mortgages and project finance will restrict margin growth for the bank. We assume margins of 2.7% (increase of 35 bps) in FY2010E and 2.8% (increase of 8 bps) in FY2011E.

**Margins to rise in FY2010E and stabilize thereafter**
Net interest margins, March fiscal year-ends, 2004-2011E (%)

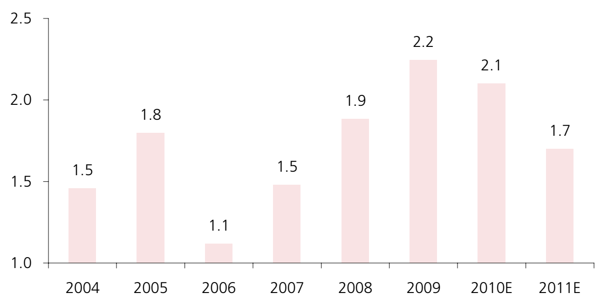



Source: Company, Kotak Institutional Equities

## Asset quality under control; should see better trends

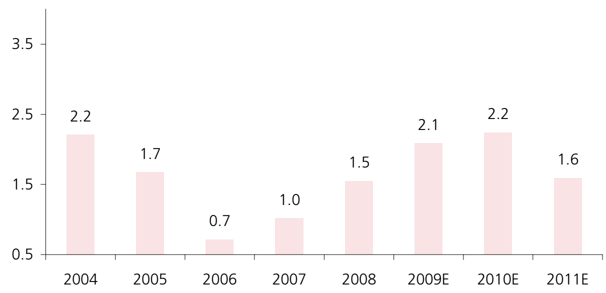
We believe that the incremental addition to NPLs (especially the unsecured NPLs) has slowed down in recent months and other segments are also witnessing positive trends with incremental restructuring being low. Overall asset quality trends are behaving well. While we are still modeling delinquencies at around 2% for FY2010E and 1.7% in FY2011E, the trend could be better and could result in upsides. The net delinquencies (net of recoveries) are expected to fall from 1.8% in FY2008 to 0.7% in FY2011E. Hence, credit provision requirement for ICICI Bank is likely to fall from 1.7% of average loans in FY2009 to 1.2% in FY2011E and 1.0% in FY2012E – the biggest driver to profitability.

**We are now modeling a declining trend in slippages**
Incremental slippage as proportion of opening advances, March fiscal year-ends, 2004-2011E (%)




Source: Company, Kotak Institutional Equities estimates

**As slippages decline, declining net NPLs**
Net NPLs as proportion of loans, March fiscal year-ends, 2004-2011E (%)




Source: Company, Kotak Institutional Equities estimates

## Costs under control, but unlikely to decline further

Another commendable performance by ICICI Bank has been its ability to rationalize costs across the group level despite significant growth in branches over last two years. While the management claims there are still some costs which need to be reduced, we believe that absolute level of costs (esp. employee expenses) would start rising; however, cost to asset ratio is likely to sustain at current levels.

## ICICI Prudential Life – low capital requirement; could achieve high RoEs

The management highlighted that the excessive cost initiatives entailed by the group have resulted in controlling the cost overruns which the insurance venture was likely facing. With slower growth and low capital drain, the incremental capital requirement for the insurance company is likely to be negligible and it is likely to turn profitable by FY2012, and overtime it could well achieve an RoEs of 30%+. While the growth has been slow in the first half, it has been picking up on back of better capital markets and even the low base of 2HFY09 is likely to provide some comfort to ICICI Prudential Life.

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

| | ICICI Share (%) | FY2011 | Valuation methodoly adopted |
|---|---|---|---|
| **Value of ICICI standalone** | **100** | **602** | Based on Residual growth model |
| **Subsidiaries** | | | |
| **ICICI Financial Services** | **94** | **171** | |
| ICICI Prudential Life | 74* | 140 | 19X NBAP, margin assumed is 14% |
| General Insurance | 74* | 11 | 1X FY2011 PBR |
| Mutual Fund | 51* | 20 | 3% of AUMs as of March 2011, assuming 20% CAGR growth |
| **Other subsidiaries/associates** | | | |
| ICICI Securities Ltd | 100 | 13 | 1X FY2011 PBR |
| ICICI Securities Primary Dealer | 100 | 2 | 1X FY2011 PBR |
| ICICI Homes Ltd | 100 | 19 | 1.5X FY2011 PBR |
| ICICI Bank UK | 100 | 25 | 1XFY2011 PBR |
| ICICI Bank Canada | 100 | 36 | 1XFY2011 PBR |
| Venture capital/MF | 100 | 11 | 10% of AUM of US$2 bn |
| **Value of subsidiaries** | | **278** | ` |
| Value of company | | **881** | |

Source: Company, Kotak Instititional Equities estimates.

Source: Company, Kotak Institutional Equities

Forecasts and valuation for ICICI Bank
March fiscal year-ends, 2008-2011E

| | PAT (Rs bn) | EPS (Rs) | P/E (X) | BVPS (Rs) | P/B (X) | RoE (%) | EPS excl. dividend (Rs) | P/E (standalone) (X) | BVPS (standalone) (Rs) | P/B (standalone) (X) |
|---|---|---|---|---|---|---|---|---|---|---|
| 2008 | 41.6 | 39.9 | 21.6 | 418 | 2.1 | 11.7 | 28.9 | 20.3 | 341 | 1.7 |
| 2009 | 37.6 | 33.8 | 25.6 | 445 | 1.9 | 7.8 | 30.7 | 19.0 | 331 | 1.8 |
| 2010E | 41.5 | 37.3 | 23.1 | 468 | 1.8 | 8.2 | 33.9 | 17.3 | 347 | 1.7 |
| 2011E | 50.7 | 45.6 | 18.9 | 496 | 1.7 | 9.5 | 41.8 | 14.0 | 369 | 1.6 |

Source: Company, Bloomberg, Kotak Institutional Equities estimates

ICICI Bank growth rates and key ratios
March fiscal year-ends, 2007-2011E (%)

| | 2007 | 2008 | 2009 | 2010E | 2011E |
|---|---|---|---|---|---|
| **Growth rates (%)** | | | | | |
| Net loan growth | 34.0 | 15.2 | (3.2) | (4.1) | 15.6 |
| Customer assets growth | 38.6 | 17.6 | (2.9) | (3.5) | 14.1 |
| Corporate loans | 33.0 | 30.4 | 12.4 | 3.6 | 20.5 |
| Total retail loans | 34.8 | 3.2 | (18.9) | (14.9) | 7.4 |
| Deposits growth | 39.6 | 6.0 | (10.7) | 3.4 | 15.4 |
| Borrowings growth | 43.8 | 19.1 | 5.9 | (14.3) | 5.8 |
| Net interest income | 46.8 | 10.1 | 14.5 | 6.6 | 11.0 |
| Loan loss provisions | 172.6 | 25.1 | 38.8 | 8.3 | (22.2) |
| Non-interest income | 26.5 | 29.3 | (13.7) | 2.1 | 5.3 |
| Net fee income | 44.3 | 29.4 | 0.4 | 3.1 | 13.4 |
| Net capital gains | 48.7 | 62.5 | (29.0) | (6.7) | (33.3) |
| Total income | 35.8 | 19.8 | (0.9) | 4.5 | 8.4 |
| Operating expenses | 28.3 | 21.9 | (13.6) | (2.8) | 14.9 |
| Employee expenses | 49.4 | 28.6 | (5.2) | 9.8 | 18.7 |
| DMA | 9.5 | 1.2 | (65.7) | (71.4) | 14.1 |
| **Asset management measures (%)** | | | | | |
| Yield on average earning assets | 8.4 | 9.0 | 8.9 | 7.9 | 7.9 |
| Interest on advances | 9.4 | 10.7 | 10.0 | 8.9 | 8.9 |
| Interest on investments | 7.8 | 7.8 | 7.6 | 7.0 | 7.0 |
| Average cost of funds | 6.3 | 7.3 | 7.0 | 5.6 | 5.5 |
| Interest on deposits | 5.9 | 7.2 | 6.8 | 5.6 | 5.4 |
| Other interest | 7.4 | 7.7 | 7.5 | 5.8 | 5.9 |
| **Difference** | **2.1** | **1.7** | **1.8** | **2.2** | **2.4** |
| Net interest income/earning assets | 2.4 | 2.1 | 2.4 | 2.7 | 2.8 |
| New provisions/average net loans | 1.3 | 1.3 | 1.7 | 1.9 | 1.4 |
| Loans-to-deposit ratio | 64.1 | 67.5 | 69.7 | 68.1 | 69.8 |
| Share of deposits | | | | | |
| Current | 9.3 | 10.1 | 9.9 | 11.1 | 11.7 |
| Fixed | 78.2 | 73.9 | 71.3 | 65.7 | 63.7 |
| Savings | 12.5 | 16.0 | 18.8 | 23.2 | 24.7 |
| Tax rate | 14.7 | 17.8 | 26.6 | 28.0 | 28.0 |
| Dividend payout ratio | 29.0 | 29.5 | 32.6 | 33.0 | 33.0 |
| **ROA decomposition - % of average assets** | | | | | |
| Net interest income | 2.2 | 2.0 | 2.1 | 2.4 | 2.5 |
| Loan loss provisions | 0.7 | 0.7 | 1.0 | 1.1 | 0.8 |
| Net other income | 2.3 | 2.4 | 2.0 | 2.1 | 2.1 |
| Operating expenses | 2.3 | 2.2 | 1.8 | 1.8 | 2.0 |
| Invt. Depreciation | 0.0 | — | — | — | — |
| (1- tax rate) | 85.3 | 82.2 | 73.4 | 72.0 | 72.0 |
| **ROA** | **1.0** | **1.1** | **1.0** | **1.1** | **1.3** |
| Average assets/average equity | 12.8 | 10.5 | 8.1 | 7.4 | 7.4 |
| **ROE** | **13.4** | **11.7** | **7.8** | **8.2** | **9.5** |

Source: Company, Kotak Institutional Equities estimates

**ICICI Bank, income statement and balance sheet**
March fiscal year-ends, 2007-2011E (Rs mn)

| | 2007 | 2008 | 2009 | 2010E | 2011E |
|---|---|---|---|---|---|
| Total interest income | 229,943 | 307,883 | 310,925 | 264,424 | 279,047 |
| Interest on advances | 160,963 | 226,010 | 223,238 | 191,182 | 202,249 |
| Interest on investments | 59,885 | 74,660 | 74,031 | 67,221 | 70,505 |
| Total interest expense | 163,585 | 234,842 | 227,259 | 175,197 | 180,021 |
| Deposits from customers | 116,477 | 171,102 | 157,852 | 124,271 | 130,616 |
| Net interest income | 66,358 | 73,041 | 83,666 | 89,226 | 99,026 |
| Loan loss provisions | 21,593 | 27,010 | 37,500 | 40,620 | 31,589 |
| **Net interest income (after prov.)** | **44,765** | **46,031** | **46,166** | **48,607** | **67,437** |
| Other income | 68,126 | 88,108 | 76,037 | 77,597 | 81,744 |
| Net fee income | 43,309 | 56,053 | 56,259 | 58,026 | 65,787 |
| Net capital gains | 11,152 | 18,121 | 12,864 | 12,000 | 8,000 |
| Miscellaneous income | 2,741 | 656 | 3,306 | 3,637 | 3,637 |
| Operating expenses | 66,906 | 81,542 | 70,451 | 68,499 | 78,729 |
| Employee expense | 16,167 | 20,789 | 19,717 | 21,657 | 25,704 |
| DMA | 15,239 | 15,427 | 5,289 | 1,515 | 1,729 |
| Pretax income | 36,480 | 50,561 | 51,170 | 57,706 | 70,452 |
| Tax provisions | 5,378 | 8,984 | 13,588 | 16,158 | 19,726 |
| **Net Profit** | **31,102** | **41,577** | **37,581** | **41,548** | **50,725** |
| % growth | 22.4 | 33.7 | (9.6) | 10.6 | 22.1 |
| **PBT+provision-treasury gains** | **46,439** | **61,485** | **76,388** | **86,325** | **94,041** |
| % growth | 51.6 | 32.4 | 24.2 | 13.0 | 8.9 |
| **Balance sheet (Rs mn)** | | | | | |
| Cash and bank balance | 371,213 | 380,411 | 299,666 | 302,455 | 326,790 |
| Cash | 20,670 | 28,478 | 28,557 | 29,521 | 34,079 |
| Balance with RBI | 166,399 | 265,297 | 146,806 | 152,646 | 172,423 |
| Balance with banks | 20,362 | 12,049 | 44,016 | 44,016 | 44,016 |
| Outside India | 162,783 | 74,587 | 80,286 | 76,272 | 76,272 |
| Net value of investments | 912,578 | 1,114,543 | 1,030,583 | 1,086,974 | 1,138,189 |
| Investments in India | 867,540 | 1,051,164 | 934,784 | 988,698 | 1,037,198 |
| Govt. and other securities | 673,682 | 753,777 | 633,775 | 666,283 | 709,783 |
| Shares | 19,373 | 29,201 | 17,031 | 17,031 | 17,031 |
| Subsidiaries | 26,072 | 46,383 | 61,195 | 66,195 | 71,195 |
| Debentures and bonds | 24,628 | 18,872 | 26,001 | 32,501 | 32,501 |
| Net loans and advances | 1,958,656 | 2,256,161 | 2,183,108 | 2,092,648 | 2,420,093 |
| Corporate loans | 866,656 | 1,129,531 | 1,269,788 | 1,315,330 | 1,585,243 |
| Total retail loans | 1,092,000 | 1,126,630 | 913,320 | 777,318 | 834,850 |
| Fixed assets | 39,234 | 41,089 | 38,016 | 39,486 | 38,999 |
| Net leased assets | 10,032 | 7,971 | 4,623 | 5,759 | 4,895 |
| Net owned assets | 29,202 | 33,118 | 33,393 | 33,728 | 34,104 |
| Other assets | 164,899 | 205,746 | 241,636 | 241,636 | 265,800 |
| **Total assets** | **3,446,581** | **3,997,951** | **3,793,010** | **3,763,200** | **4,189,871** |
| | | | | | |
| Deposits | 2,305,102 | 2,444,311 | 2,183,478 | 2,257,153 | 2,605,688 |
| Borrowings and bills payable | 752,449 | 896,494 | 949,806 | 814,027 | 861,020 |
| Preference capital | 3,500 | 3,500 | 3,500 | 3,500 | 3,500 |
| Other liabilities | 145,897 | 192,444 | 164,395 | 167,683 | 167,683 |
| **Total liabilities** | **3,203,448** | **3,533,249** | **3,297,679** | **3,242,362** | **3,637,891** |
| Paid-up capital | 8,990 | 11,127 | 11,133 | 11,133 | 11,133 |
| Reserves & surplus | 234,140 | 453,575 | 484,197 | 509,705 | 540,847 |
| **Total shareholders' equity** | **243,130** | **464,702** | **495,330** | **520,838** | **551,980** |

Source: Company, Kotak Institutional Equities estimates

"I, Manish Karwa, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report."

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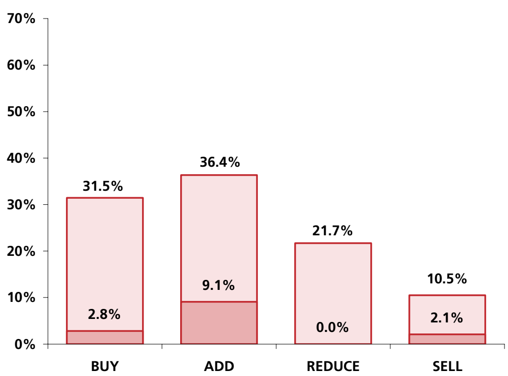


Percentage of companies covered by Kotak Institutional Equities, within the specified category.

Percentage of companies within each category for which Kotak Institutional Equities and or its affiliates has provided investment banking services within the previous 12 months.

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Source: Kotak Institutional Equities

As of September 30, 2009

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

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

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