IDFC INSTITUTIONAL SECURITIES
India Research

Rs1085

# ICICI Bank

**OUTPERFORMER**

RESULT NOTE

**Mkt Cap: Rs1,248bn; US$27.3bn**

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**Result:** **Q3FY11**
**Comment:** **Staying the course**
**Revision:** **Earnings upgraded by 4.1% for FY11E and 1.9% for FY12E**

Key valuation metrics

| Year to March 31 (Rs m) | NII | yoy chg (%) | Net profit | yoy chg (%) | EPS (Rs) | Adj. Book Value per share (Rs) | P/ Adj.Bk (x) | PER (x) | RoE (%) |
|---|---|---|---|---|---|---|---|---|---|
| FY08 | 73,041 | 29.6 | 41,577 | 33.7 | 37.4 | 418 | 2.60 | 29.0 | 11.7 |
| FY09 | 83,666 | 14.5 | 37,581 | (9.6) | 33.8 | 445 | 2.44 | 32.1 | 7.8 |
| FY10 | 81,144 | (3.0) | 40,250 | 7.1 | 36.1 | 463 | 2.34 | 30.0 | 8.0 |
| FY11E | 89,350 | 10.1 | 52,558 | 30.6 | 45.7 | 478 | 2.27 | 23.7 | 9.9 |
| FY12E | 111,926 | 25.3 | 67,552 | 28.5 | 58.7 | 515 | 1.54 | 18.5 | 11.8 |

## Key highlights

ICICI Bank reported strong results with a net profit of Rs14.4bn (up 31% yoy), ahead of our estimate of Rs13.9bn. Core performance exhibited strength as NII and fee income gained traction, provisions expenses declined sharply, and CASA ratio remained robust, leading to a 25bp yoy expansion in RoA to 1.5%. Advances grew 6% qoq as corporate loan momentum remained strong and the decline in retail was arrested.

- **Strong growth in NII…:** NII came in at ~Rs23.1bn, ahead of our estimates, led by traction in loan book and sequentially steady margins.
- **…as margins remain steady:** Reported margins were steady qoq as well as yoy at 2.6% as the benefit of increasing yields was offset by higher cost of funds. The management indicated that the bank is earning a margin of 3% on the domestic book, while the international book is delivering a NIM of ~85bp (up from 50bp in FY10 and 80bp in Q2FY11). With spreads on incremental international business higher at ~125bp, international margins are expected to rise further to ~100bp. (Exhibit 2).
- **Traction in credit offtake; expected to gain pace:** Credit increased by 6.4% qoq, led by strong momentum in corporate loans and a pause in the decline of retail loans (a 1% sequential expansion). On the corporate book, traction was led by working capital and term loans, though project finance loans remained muted. The composition of the retail book remained largely stable and the bank reiterated its intent to grow secured auto loans (26%) and mortgage loans (66%) in the segment. Retail disbursements grew by a robust 34% yoy to Rs71bn (flat qoq), of which Rs40bn emanated from mortgage loans. Going forward, we expect the robust corporate sanctions pipeline to drive loan book momentum (~22% CAGR over FY10-12E). (Exhibits 5 & 6).
- **Provisioning expenses decline qoq; coverage ratio inches up**: The management indicated that delinquencies remained low in the quarter, which aided a 27% qoq decline in provisions expenses to Rs4.6bn, as against Rs6.4bn in Q2FY11. Correspondingly, the bank's coverage ratio increased by 330bp qoq to 71.8%, ahead of the

regulatory requirement of 70%. With coverage ratio requirement met and slippages on a decline, credit costs are expected to taper off significantly from here. Net restructured loans stood at Rs25.6bn (~1.2% of net advances), flat sequentially. While Rs6bn of loans were restructured during the quarter, a similar amount was also repaid over the quarter. (Exhibit 7).

- **Healthy growth in core fee income:** Core fee income grew by a strong 14% yoy to Rs16.3bn in Q3FY11, led by growth in corporate and international fees. On the corporate side, syndication and lending fees contributed to the traction, while on the international front remittances and lending-related fees exhibited strength. While retail fees continued to decline yoy, it was steady qoq. The bank booked treasury gains of Rs210m in Q3FY11. Overall other income increased by 5% yoy to Rs17.5bn. (Exhibit 4).
- **Elevated CASA ratio:** In line with the bank's strategy of fortifying its liability franchise, CASA deposits grew by 23% yoy while CASA ratio improved by 20bp qoq to 44.2% (39.6% in Q3FY10). Current deposits increased by 16% yoy and savings deposits increased by 27% yoy. Average CASA increased from 39.2% in Q2FY11 to 40.3% in Q3FY11. (Exhibit 3).
- **Operating expenses:** Operating expenses increased by 26% yoy and 9% qoq to Rs17.2bn – affected by aggressive branch rollout in the previous quarter (275 branches added in Q1FY11), expenses for the Bank of Rajasthan merger and bonus provisions made in the quarter. The management indicated that Rs900m of cost pertained to the full impact of the BoR merger in Q2FY11. We expect operating costs to increase in tandem with asset growth, keeping the ratio of opex to average assets stable at current levels (~1.75% in Q3FY11).
- **Subsidiaries maintain leadership:** The buoyant capital markets have driven an uptick in the performance of ICICI's life insurance subsidiary. ICICI Prudential Life's APE increased ahead of the peers in Q3FY11 (up 10% yoy); the insurer reported PAT of Rs1.3bn (including surplus from non-participating policyholders' funds). Notably, the insurer maintained NBAP margin of 17.6% in Q3FY11 despite the new IRDA guidelines coming into effect. General insurance business premium increased to Rs10.1bn in Q3FY11 from Rs8.3bn in Q3FY10.

## Valuations & view

**After two years of calibrated growth, ICICI Bank delivered a sharp expansion in core profitability this quarter. Consistent delivery on its plan to increase CASA ratio, improve credit quality and curtail costs, has paid off with the bank's RoA surging to 1.5%. We believe ICICI is now firmly en route to the next phase of its strategy – delivering high profitability with acceleration in balance sheet growth. Owing to better-than-expected traction in NII as also emerging visibility on credit costs, we are increasing our earnings estimates by 4.1% for FY11 and 1.9% for FY12. We expect the bank to deliver 30% CAGR in earnings, driven by steeply declining credit costs, expanding margins and strong loan growth. We see a 370bp rise in core business RoE to ~14% over FY10-12. This, we believe, would drive a structural re-rating of the stock from 1.8x currently to 2.5x core book. We reiterate our Outperformer stance with a 12-month price target of Rs1,450 (Rs215/ share for non-banking investments and 2.5x FY12E core book). ICICI Bank remains our top pick in the Indian financials space.**

## ICICI Bank - SOTP

| | (Rs bn) | | (Rs/ share) | | Valuation methodology |
|---|---|---|---|---|---|
| | FY11 | FY12 | FY11 | FY12 | |
| Life insurance | 252 | 277 | 151 | 165 | 30% discount to DCF value |
| Non-life insurance | 10 | 10 | 9 | 9 | 10x FY10 earnings |
| Asset Management | 19 | 19 | 17 | 17 | 5% of AuM |
| ICICI Ventures | 9 | 9 | 8 | 8 | 10% of AuM |
| ICICI Securities | 18 | 18 | 16 | 16 | Comparables |
| **Total subsidiaries** | **308** | **333** | **201** | **215** | |
| ICICI Bank core value | 1,297 | 1,414 | 1,124 | 1,235 | 2.5x banking book |
| **Total value (Rs per share)** | | | **1,325** | **1,450** | |

*Source: IDFC Securities Research*

## Quarterly results

| P&L (Rs m) | Q3FY10 | Q4FY10 | Q1FY11 | Q2FY11 | Q3FY11 | FY10 | FY11E | FY12E |
|---|---|---|---|---|---|---|---|---|
| **Net interest income** | **20,581** | **20,349** | **19,911** | **22,044** | **23,117** | **81,144** | **89,350** | **111,926** |
| *yoy growth (%)* | *3.4* | *(4.9)* | *0.3* | *8.3* | *12.3* | *(3.0)* | *10.1* | *25.3* |
| Non interest income | 16,730 | 18,908 | 16,805 | 15,780 | 17,490 | 74,777 | 68,746 | 83,588 |
| *yoy growth (%)* | *(33.5)* | *13.0* | *(19.6)* | *(13.5)* | *4.5* | *(1.7)* | *(8.1)* | *21.6* |
| Fee income | 14,220 | 15,210 | 14,130 | 15,900 | 16,250 | 62,967 | 68,346 | 79,588 |
| *yoy growth (%)* | *5.6* | *13.3* | *7.1* | *14.6* | *14.3* | *(12.1)* | *8.5* | *16.4* |
| Trading | (260) | 1,960 | 1,040 | (1,440) | 210 | 6,809 | (3,350) | 250 |
| **Net revenue** | **37,311** | **39,258** | **36,716** | **37,824** | **40,607** | **155,920** | **158,096** | **195,514** |
| Op expenses | 13,624 | 15,269 | 14,835 | 15,704 | 17,179 | 58,598 | 65,277 | 78,251 |
| *yoy growth (%)* | *(21.4)* | *(7.9)* | *(4.0)* | *10.2* | *26.1* | *(16.8)* | *11.4* | *19.9* |
| **Operating profit** | **23,687** | **23,989** | **21,881** | **22,120** | **23,428** | **97,322** | **92,820** | **117,262** |
| *yoy growth (%)* | *(14.5)* | *11.3* | *(13.5)* | *(9.2)* | *(1.1)* | *9.0* | *(4.6)* | *26.3* |
| Provisions | 10,022 | 9,898 | 7,978 | 6,410 | 4,650 | 43,869 | 22,743 | 24,726 |
| *yoy growth (%)* | *(0.5)* | *(8.7)* | *(39.7)* | *(40.2)* | *(53.6)* | *15.2* | *(48.2)* | *8.7* |
| **PBT** | **13,665** | **14,091** | **13,903** | **15,710** | **18,778** | **53,453** | **70,077** | **92,537** |
| Tax | 2,660 | 4,036 | 3,643 | 3,350 | 4,410 | 16,008 | 17,519 | 24,985 |
| **PAT** | **11,005** | **10,056** | **10,260** | **12,360** | **14,368** | **40,250** | **52,558** | **67,552** |
| *yoy growth (%)* | *(13.5)* | *35.2* | *16.8* | *18.8* | *30.6* | *7.1* | *30.6* | *28.5* |
| **Key Ratios (%)** | | | | | | | | |
| NIMs (reported) | 2.6 | 2.6 | 2.5 | 2.6 | 2.6 | | | |
| NIMs (calculated) | 2.3 | 2.3 | 2.2 | 2.3 | 2.4 | 2.2 | 2.3 | 2.4 |
| Fee income /avg assets | 1.6 | 1.7 | 1.6 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 |
| Non-fund rev/Avg assets | 1.9 | 2.1 | 1.8 | 1.7 | 1.8 | 2.0 | 1.7 | 1.8 |
| Op expense/avg assets | 1.5 | 1.7 | 1.6 | 1.7 | 1.8 | 1.6 | 1.7 | 1.7 |
| Cost/Net rev. | 36.5 | 38.9 | 40.4 | 41.5 | 42.3 | | | |
| Prov/avg assets | 1.1 | 1.1 | 0.9 | 0.7 | 0.5 | 1.2 | 0.6 | 0.5 |
| Tax/PBT | 19.5 | 28.6 | 26.2 | 21.3 | 23.5 | 29.9 | 25.0 | 27.0 |
| RoA | 1.2 | 1.1 | 1.1 | 1.3 | 1.5 | 1.1 | 1.3 | 1.4 |
| CRAR | 19.4 | 19.4 | 20.2 | 20.2 | 19.8 | | | |
| Tier-I | 14.2 | 14.0 | 14.0 | 13.8 | 13.7 | | | |
| CD ratio | 90.7 | 89.7 | 91.8 | 87.0 | 94.9 | | | |
| **Balance Sheet (Rs bn)** | | | | | | | | |
| Credit | 1,793 | 1,812 | 1,844 | 1,942 | 2,067 | | | |
| yoy change (%) | (15.6) | (17.0) | (6.9) | 1.8 | 15.3 | | | |
| Deposits | 1,977 | 2,020 | 2,009 | 2,231 | 2,177 | | | |
| yoy change (%) | (5.5) | (7.5) | (4.4) | 12.8 | 10.2 | | | |

*Calculated ratios are on average quarterly balance*

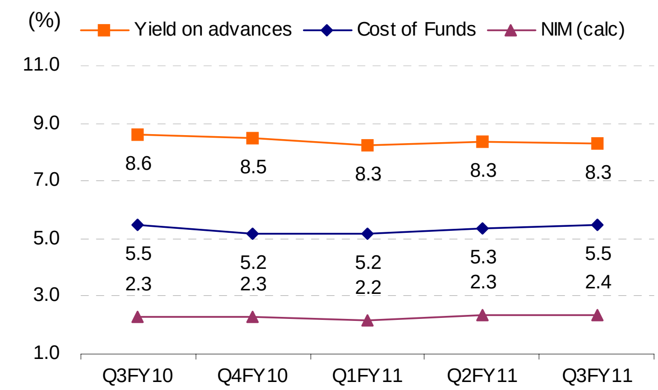
Exhibit 1: Overseas subsidiaries' asset and liability profile

| UK subsidiary | As of Dec'10 | US$ m | Comments |
|---|---|---|---|
| **Assets** | | | |
| Loans & advances to customers | 57% | 3,955 | Increased from 50% in Sep'09. Also includes securities re-classified as loans. ~80% of total loan book is exposure to Indian corporates, the balance being to U.K. companies |
| **Bonds/notes of FIs** | **16%** | **1,127** | Exposure to senior debt of banks being run-down opportunistically (down from 25% in Dec'09) |
| **Asset backed securities** | **2%** | **119** | Down from 6% in Dec'08 as the bank re-classified US$137mn as loans, and also continues to reduce exposure |
| Other investments | 5% | 357 | |
| Cash & liquid securities | 17% | 1,155 | Sharp rise of 40% qoq; excess liquidity owing to volatile environment |
| India-linked investments | 4% | 287 | Includes US$122m of India-linked credit derivatives |
| **Total assets** | **100%** | **7,000** | |
| **Liabilities** | | | |
| Term Deposits | 51% | 3,556 | Proportion of retail term deposits up to 75% of deposits from 69% in Jun'10. Regulation permits the bank to lend retail term deposits (unlike demand deposit). Increased credit deployment to rub-off positively on margins |
| Long-term Debt | 10% | 840 | |
| Syndicated Loans | 8% | 560 | |
| Demand Deposits | 16% | 1,008 | |
| Net worth | 9% | 651 | PAT of US$ 12.1m in Q3 |
| Other liabilities | 6% | 385 | |
| **Total Liabilities** | **100%** | **7,000** | Capital adequacy ratio at 21.2% |

| Canada subsidiary | As of Dec'10 | CAD$m | Comments |
|---|---|---|---|
| **Assets** | | | |
| Loans & advances to customers | 66% | 3,107 | Indian corporates comprise ~80% of total exposure |
| Federally insured mortgages | 7% | 315 | |
| Asset backed securities | 2% | 80 | |
| Other investments | 8% | 367 | |
| Cash & liquid securities | 15% | 714 | |
| India-linked investments | 3% | 118 | Includes CAD 80m of India-linked credit derivatives |
| **Total assets** | **100%** | **4,700** | |
| **Liabilities** | | | |
| Term Deposits | 60% | 2,829 | Retail term deposits comprise the bulk |
| Borrowings | 2% | 75 | |
| Demand Deposits | 15% | 710 | |
| Net worth | 21% | 978 | |
| Other liabilities | 2% | 108 | |
| **Total Liabilities** | **100%** | **4,700** | **Capital adequacy ratio at 26.1%** |

| Eurasia subsidiary | As of Dec'10 | US$m | Comments |
|---|---|---|---|
| Loans & advances to customers | 33% | 120 | Running-off |
| **Corporate bonds** | **2%** | **6** | |
| Retail loans | 16% | 58 | Largely mortgages |
| Cash & liquid securities | 46% | 169 | |
| **Others** | **4%** | **14** | Capital adequacy at 31.8% |
| **Total assets** | **100%** | **367** | |

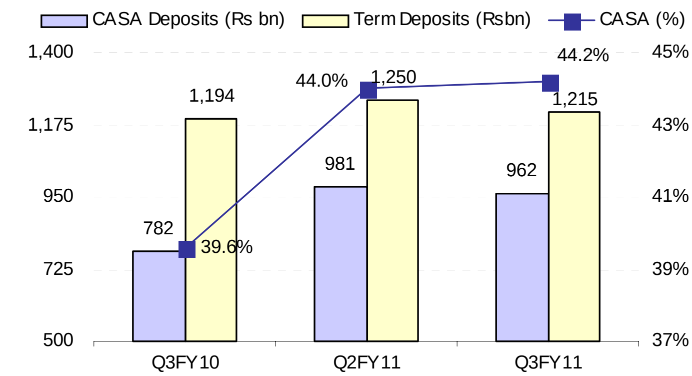
## Exhibit 2: Margins remain steady




- Domestic NIMs at 3.0% and international margins increased at ~85bps (up from 50bp in FY10 and 80bp in Q2).

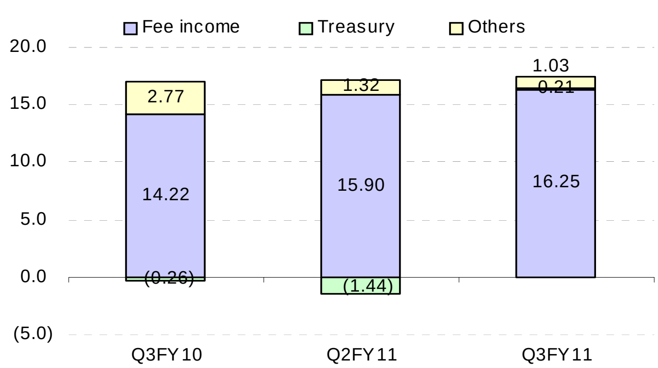
** Calculated on average quarterly balances*

## Exhibit 3: Momentum in CASA sustained



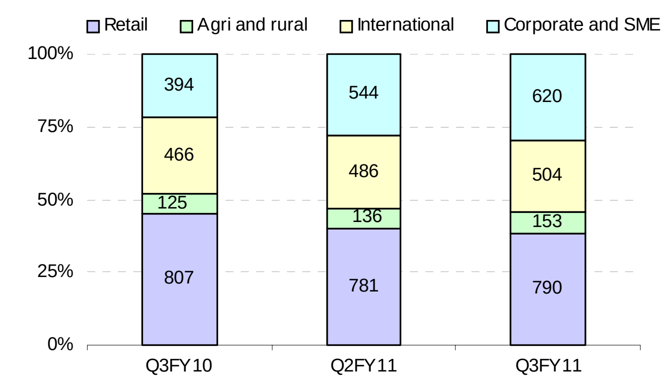

- De-leveraging & increased branches drive CASA up 20bp qoq
- Savings deposits up 2% qoq, while current deposits decline 9% qoq on tight liquidity

## Exhibit 4: Non-interest income break up (Rs bn)



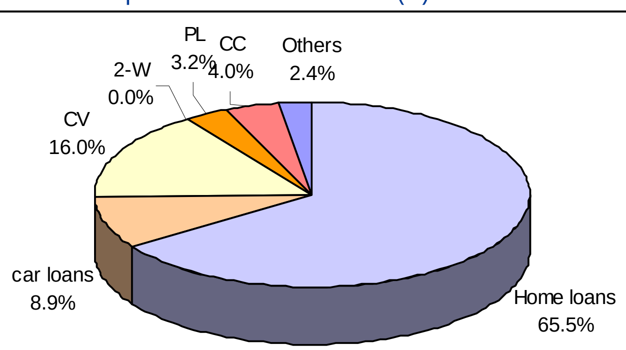

- Revival in fee led by corporate and international fees. Retail fees stable qoq
- Rs210m of treasury gain

## Exhibit 5: Composition of loan book (Rs bn)




- Growth led by corporate sector led by working capital and term loans
- Pause in decline of retail loans – 1% qoq rise

## Exhibit 6: Composition of retail loan book (%)



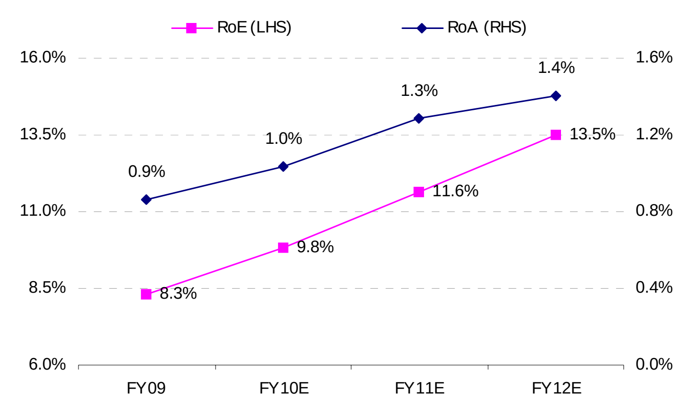

- Composition of retail book remains largely stable as mortgage loans comprise a significant proportion (66% of total)
- High risk loans continue to run off- now at 3% of total

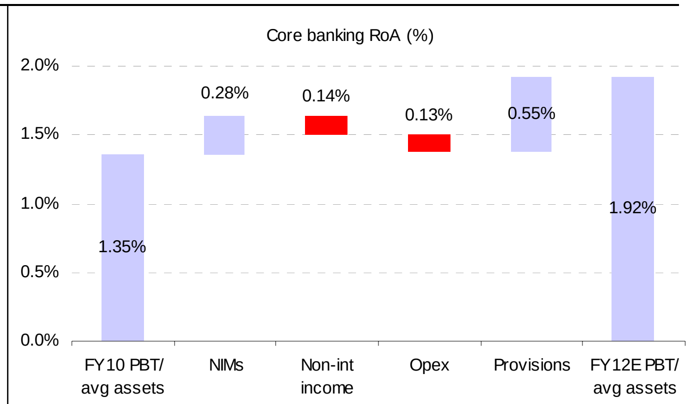
## Exhibit 7: Coverage ratio shored up

| | Q3FY10 | Q2FY11 | Q3FY11 | yoy growth | qoq growth |
|---|---|---|---|---|---|
| Gross NPLs (Rs bn) | 89.26 | 101.41 | 101.87 | 14% | 0% |
| Gross NPLs (%) | 4.84% | 5.06% | 4.75% | (9) | (31) |
| Net NPLs (Rs bn) | 43.57 | 31.92 | 28.73 | -34% | -10% |
| Net NPLs (%) | 2.43% | 2.12% | 1.39% | (104) | (73) |
| Provision coverage (%) | 51.2 | 68.5 | 71.8 | 2,061 | 327 |

- Provision coverage stands at ~72%
- Net addition to gross NPAs negligible

Exhibit 8: See strong traction in core banking RoE and RoA ahead




*Source: IDFC Securities Research*

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Explanation of Ratings:

1. Outperformer: More than 5% to Index
2. Neutral: Within 0-5% to Index (upside or downside)
3. Underperformer: Less than 5% to Index

Disclosure of interest:

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