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India
India Banks

ICICI Bank (ICBK.NS - INR 876.40) 1-Overweight

Operating Results

Weathering the headwinds

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Investment Conclusion

- The bank reported an acceptable set of numbers. Top-line was slighlty below expectations, but cost-cutting measures led to a much better than expected bottom-line. Maintain 1-Overweight on the stock.

Summary

- NII growth of 24%yoy was broadly in line with our expectation. There was some negative impact from year end shoring up of low yielding agri loans but deposit costs moved down resulting in 10bps QoQ NIM improvement.
- Bottom-line was higher than expectation primarily on significantly lower employee expenses.
- No further deterioration in asset quality, with the slippage rate in line with the amount seen in the last few quarters. We believe that the current slippage rate is already in the price.
- Lack of disclosure on FX losses is a clear negative
- Life insurance subsidiary has disappointed with NBAP reporting a growth of only 42%yoy while premiums grew 68% yoy. Also the impact of de-tariffing has dented the growth and earnings of the general insurance business.

FY Mar	2007A	2008E		2009E		2010E	
Currency INR	Actual	Old	New	Old	New	Old	New
Adjusted Net Profit	17642.0	29486.0	29486.0	46356.0	46356.0	59268.0	59268.0
Adjusted EPS	19.6	29.3	29.3	41.7	41.7	53.3	53.3
Adjusted PE Ratio	44.7	29.9	29.9	21.0	21.0	16.4	16.4
BVPS	204.0	347.0	347.0	353.0	353.0	375.0	375.0
P/BV	4.3	2.5	2.5	2.5	2.5	2.3	2.3
ROE	8.9	8.0	8.0	10.6	10.6	12.7	12.7
Dividend Yield	1.1	1.5	1.5	1.6	1.6	1.8	1.8

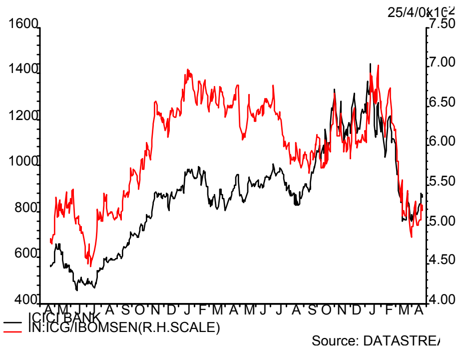
Market Data

Market Cap (mn)	975151.0
Shares Outstanding (mn)	1112.7
Free float (%)	79.0
Trading Volume	N/A
Convertible	0
Share per ADR	2

Financial Summary

Net Interest Margin	2.7
Net NPL/Loans	1.4
PL provisions/Loans	1.0
Tier 1 ratio	8.6

Stock Overview



Source: DATASTREAM

Reuters	ICBK.NS
Bloomberg	ICICIBC IN
ADR	

Performance	1M	3M	12M
Absolute %	-0.4	-30.4	-8.9
Rel. Market %	-5.5	-23.0	-26.6
Rel. Sector %	-	-	-

52 Week Range 1439.90 - 756.50

Stock Rating

New: 1-Overweight
Old: 1-Overweight

Target Price

New: INR 1315.00
Old: INR 1315.00

Sector View: 1-Positive

Figure 1: Q4FY08 Results Summary

INR mn	Q4 FY07	Q3 FY08	Q4 FY08A	Q4 FY08E	YoY growth	QoQ growth
Net interest income	16,087	19,597	20,795	21,623	29%	6%
Non-interest income	21,000	24,266	23,617	22,551	12%	-3%
Operating expenses	(19,206)	(21,276)	(21,505)	(23,432)	12%	1%
Operating profit	20,541	22,587	22,907	20,743	12%	1%
Net profit	8,255	12,302	11,498	8,844	39%	-7%

Source: Company, Lehman Brothers estimates;

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NII growth broadly in line with expectation; some negative impact from lower lending yields

ICICI Bank reported net interest income (NII) of INR 20.8bn, representing growth of 29%yoy compared to our estimate of INR 21.6bn. Lending yields were down 30bps QoQ which has had some negative impact on NII. We highlight that the bank had been indicating lower yields this quarter as they usually pick up substantial low yielding agricultural advances at the year-end to meet the priority sector lending targets. The cost of deposits of the bank was down indicating the benefits of bulk deposit re-pricing. We note that short term CP/CD rates are down c.130bps yoy. Overall the NIMs improved by 10bps sequentially to 2.4%.

Fee income growth was below our expectation

The bank reported fee income of INR 19.3bn as compared to our expectation of INR21.9bn, recording a growth rate of 35%yoy. Retail fee growth was weak at 19% yoy which we believe would have continued to be impacted by the retail loan growth slowdown. International fees reported a growth of only 4% yoy. While we were estimating that the remittances market would see a strong comeback in Q4, clearly this does not seem to have been the case.

Higher than expected treasury gains boost non-interest income

Net trading gains came in at INR 1.6bn vis-à-vis our estimate of INR 0.5bn. Note that the bank has booked $100mn of MTM losses related to its CDS portfolio in this line item. This implies that trading gains this quarter have been very strong at about INR 5.6bn.

Higher bottom-line primarily on account of lower employee expenses

ICICI reported earnings of INR 115bn well above street expectations as well as our expectation of INR 88.5bn. The primary driver of this seems to be the lower employee costs which came in at INR 4.7bn much below our expectation of INR 6.5bn. The bank has made no bones of its move to cutting its employee expenses with widely publicized news that it would not dole out any employee bonuses or offer salary increments this year. This, we believe, may have been reflected in this quarter’s numbers.

No turnaround in loan growth as yet; HFC gathers momentum

The overall loan growth of the bank stood at 23% yoy (adjusting for the sell down of about INR 150bn). While the international loan growth slowed down vis-à-vis the trend so far, growth continues to be healthy at 96% yoy. The housing finance company has gathered momentum booking INR 25bn of mortgage disbursements. We believe that this model would benefit from lower effective funding costs and would enable the bank to compete on pricing in mortgages which should aid growth going forward, in our view. We are building in a 15% growth in mortgage disbursements in FY09E.

No further deterioration seen in asset quality

The asset quality trend hasn’t shown any signs of further stress. Gross slippages were INR 11.3bn (Q1-11.9bn, Q2-10bn, and Q3-8.2bn). We think that the stock price already factors in the current rate of bad debt accretion and hence this quarter’s slippages data point is a positive vis-à-vis market expectations.

There had been many concerns of late such as that following the recent Crisil’s downgrade of two of ICICI’s securitized personal and car loan pools. We had highlighted that these were pool specific issues and we would not view the downgrade as a signal of further deterioration in the bank’s portfolio.

We believe that a bulk of the asset quality issues faced by the bank in recent quarters is on account of the personal loan portfolio. The bank has significantly moderated its growth in this portfolio from 119% yoy in FY07 to 20% this year. We believe that the lagged impact of scaling down of this business should start having a positive impact on asset quality over the next few quarters. We are building in net slippages of 2.1% in FY09E and 2% in FY10E and consequently a provisioning rate of 1.8% and 2% in FY09E and FY10E respectively.

FX losses – joker in the pack; lack of disclosures is a negative

There has been no disclosure on the amount of client losses on FX derivatives or the amount of provisions which the bank has made to cover possible credit losses. We believe this a negative as there continues to be uncertainty on the amount of losses that the bank may have to eventually bear on the FX derivatives.

Our own calculation on provisions indicates that there has been very little provisioning for FX losses this quarter.

Figure 2: Estimated FX provisions

INR mn	Q4FY08
Gross slippages QoQ (A)	11,340
Increase in net NPA QoQ (B)	2,296
Estimated specific provisions (A) - (B)	9,045
Total provisions taken through P&L	9,475
General provisions	250
Estimated specific provisions (A) - (B)	9,045
Implied FX provisions	**180**

Source: Company, Lehman Brothers estimates

Healthy savings deposits growth; plus strong prospects given the on track branch expansion

While overall casa growth was only 28% yoy, importantly growth in savings deposits was a healthy 36% yoy. The bank now boasts of a 10% incremental market share in savings deposits. We believe the underlying enablers for a further strong growth in casa deposits are now even more favorable than before. The bank has been on track in its branch network expansion adding 353 branches this quarter. Further the bank aims to add another 150 branches by May'08. We believe the bank would be able to gain incremental market share in savings deposits and the current branch addition provides visibility to this end. We are building in a 40% yoy growth pa in savings deposits in the next two years.

Mixed performance by the various subsidiaries

- **International banking subsidiaries**
  The UK subsidiary, reported a 10% yoy earnings decline to INR 15.5bn. The impact of the MTM hits on the CDS portfolio as well as that on the investments in local corporate paper clearly seems to have been the reason for this decline in earnings. On the positive side though, the traction in garnering retail deposits has been impressive achieving a growth of 90%yoy. We highlight that the UK subsidiary has been forced to hold corporate investments as against loans which have contributed to a part of the MTM hits. This is due to regulatory constraints which necessitate a track record in retail deposits stickiness before the business is allowed to lend in the local market. The growth in retail deposit base in this context is a positive.

- **Life insurance performance has been a disappointment**
  ICICI had previously announced its life insurance premium collections which had indicated a significant slowdown in the month of March to only 20% yoy. The full year FY08E premium growth was 68% yoy. The further disappointment post the result has been the growth reported in NBAP of the insurance business which was much lower at only 42% yoy. As expected, policy lapses do not seem to be an issue currently with a persistency rate of 78% in FY08 as compared to 70% in FY07. However, clearly there are risks to the insurance subsidiary valuations from slowing growth. We are building in NBAP margins of 14% in our valuations. However, downside risk remains if the hypothesis that the state of equity markets significantly govern new business sales of insurers. We highlight that in such a scenario our worst case valuation of the insurance subsidiary would be INR 150/shr as compared to our base case valuation of INR 245/shr.

- **Securities business reports strong earnings** of INR 15bn in FY08, above our expectation of INR 13bn. Further, the primary dealership business reported earnings of INR 1.4bn.

- The price de-regulation in the industry clearly seems to have impacted the general insurance business which reported 8% yoy decline in premiums in Q4FY08. Also the earnings of this business have taken a hit with a reported loss of INR 120mn in Q408 as against a profit of INR 190mn in Q407. The management attributed this to the third party motor pool funding.

Weathering the headwinds; Maintain 1-OW on attractive valuations

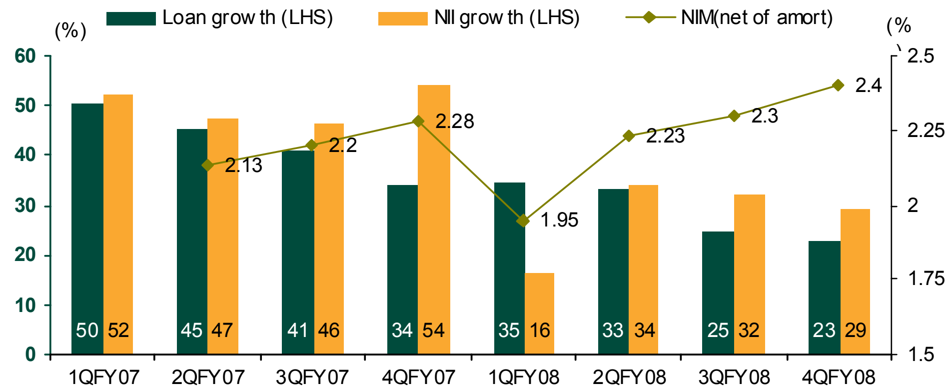
The stock is currently trading at 1.5xFY09E BV and 12.6x earnings. At current valuations, we believe that the price has already discounted the worst. We continue to maintain our 1-Overweight rating and our top pick stance on the stock.

Figure 3: Q4FY08 Results Summary

INR mn	Q4 FY07	Q3 FY08	Q4 FY08A	Q4 FY08E	YoY growth	QoQ growth
Net interest income	16,087	19,597	20,795	21,623	29%	6%
NIM	2.28%	2.23%	2.40%			
Non-interest income	21,000	24,266	23,617	22,551	12%	-3%
Fee/Commission income	14,270	17,850	19,280	21,895		
Operating income	39,747	43,863	44,411	44,174	12%	1%
Operating expenses	(19,206)	(21,276)	(21,505)	(23,432)	12%	1%
Operating profit	20,541	22,587	22,907	20,743	12%	1%
Bad and doubtful debts charge	(4,190)	(6,963)	0	(9,328)	-100%	-100%
Profit before tax	9,121	14,983	13,432	10,924	47%	-10%
Tax provided	(866)	(2,681)	(1,933)	(2,080)	123%	-28%
Net profit	8,255	12,302	11,498	8,844	39%	-7%
Net advances	1,958,660	2,071,210	2,256,160	2,327,411	15%	9%

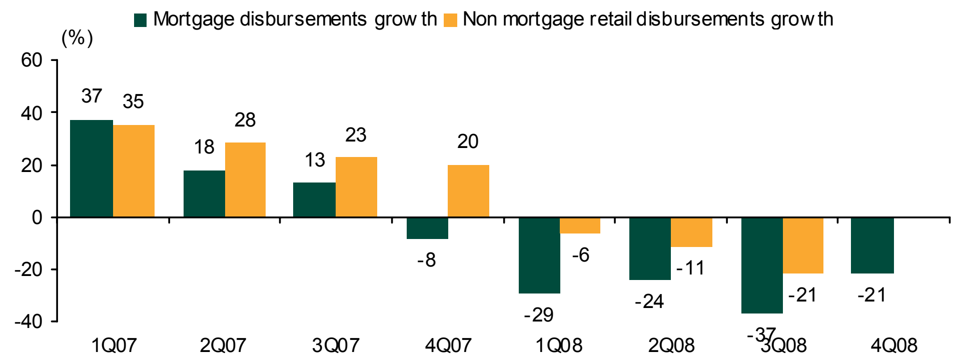
Source: Company, Lehman Brothers estimates

Figure 4: Loan growth, NII growth, NIM



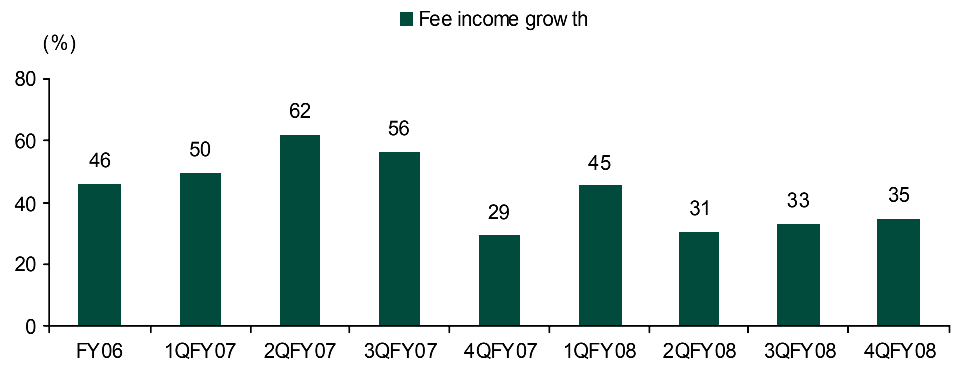
Source: Company, Lehman Brothers research

Figure 5: Slowdown in retail segment



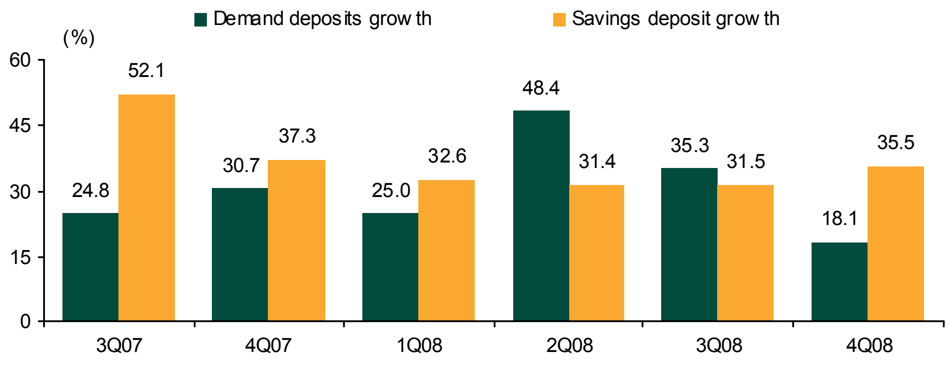
Source: Company, Lehman Brothers research

Figure 6: Fee income growth



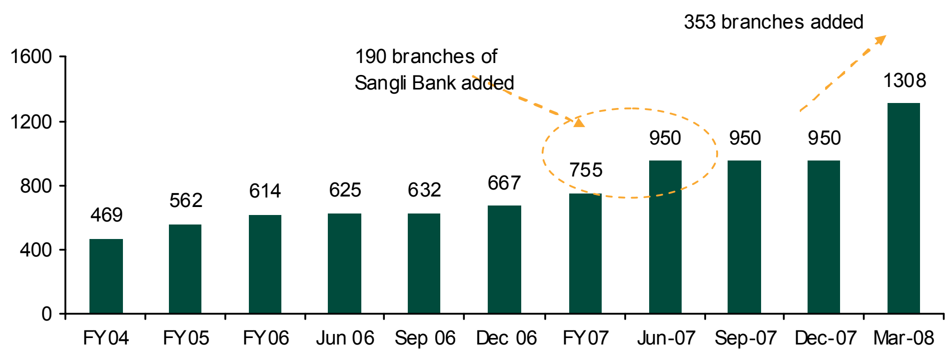
Source: Company, Lehman Brothers research

Figure 7: Casa deposits growth



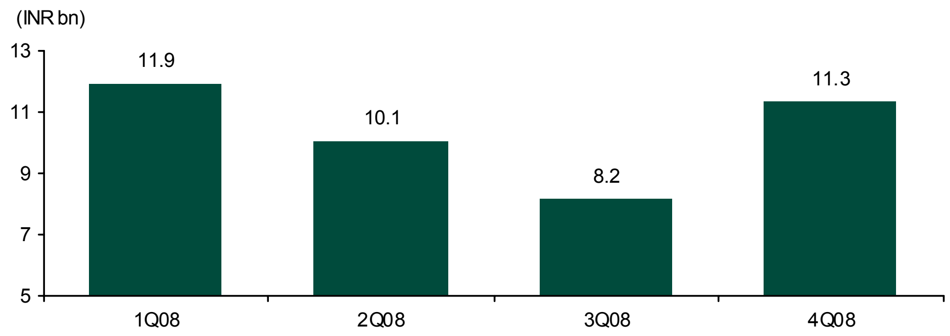
Source: Company, Lehman Brothers research

Figure 8: Branch network expansion



Source: Company, Lehman Brothers research

Figure 9: Asset quality trend – incremental gross slippages



Source: Company, Lehman Brothers research

Analyst Certification:

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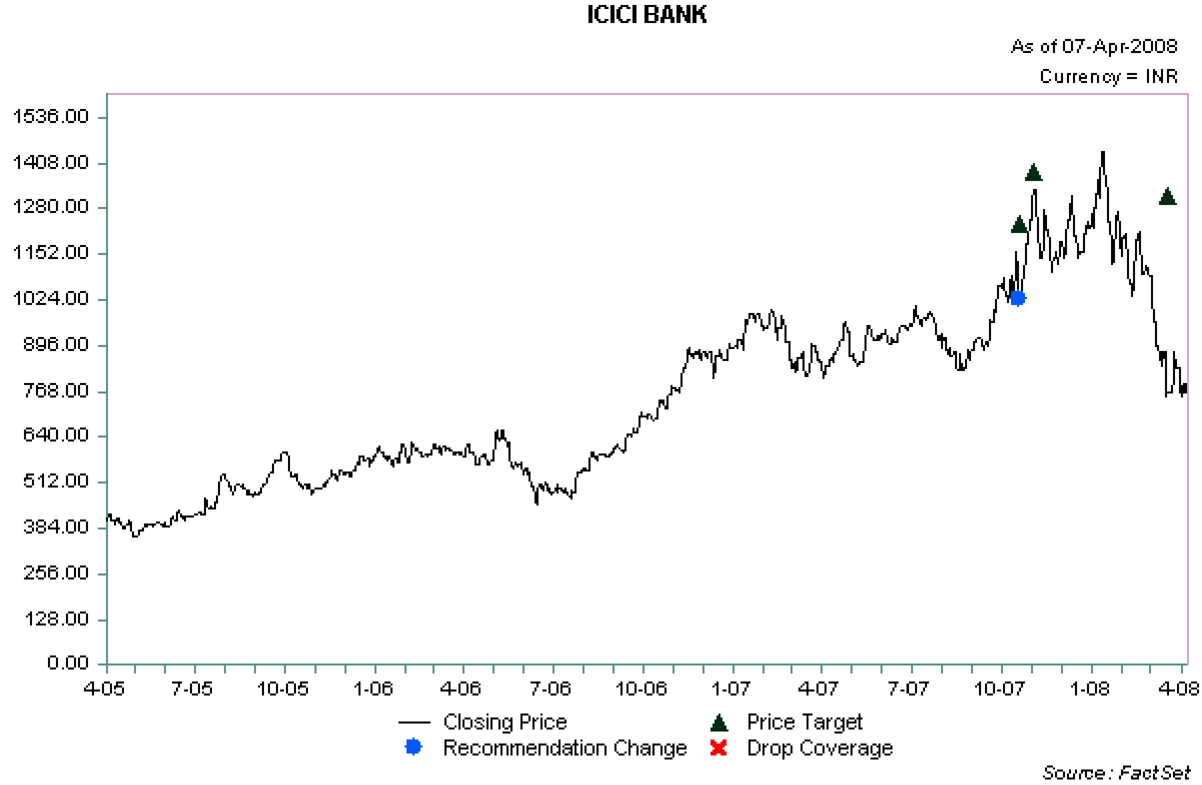
Company Description:

ICICI Bank is India's largest financial institution by market capitalisation. It was originally set up to provide financing for industrial projects. Over the years it has built up a strong retail franchise and is today the market leader in the retail lending segment. The company is currently focusing on its international business, which at present is engaged in funding Indian corporates for their overseas forays as well as domestic capex. Its life and non-life insurance subsidiaries are market leaders within their respective private sector segments. Other subsidiaries include an asset management company, a securities brokerage and a venture capital business.

Important Disclosures:

ICICI Bank (ICBK.NS) **INR 876.40 (24-Apr-2008)** **1-Overweight / 1-Positive**

Rating and Price Target Chart:



Currency=INR

Date	Closing Price	Rating	Price Target
18-Mar-08	767.95		1315.00
02-Nov-07	1330.60		1385.00

Date	Closing Price	Rating	Price Target
20-Oct-07	1024.05		1236.00
20-Oct-07	1024.05	1 -Overweight	

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Valuation Methodology: We use a sum-of-the-parts valuation of the subsidiaries and the parent.

We value the parent using a three-stage DDM - explicit forecasts up to FY10E, intermediate growth phase between FY10E-FY28E and terminal phase beyond that. We build in an intermediate phase asset growth of 21% CAGR over FY10E-FY19E and 13% CAGR over FY19E-FY28E, sustainable RoE of 16% and a discount rate of 13%. We build in a terminal growth of 5% in earnings.

Among the subsidiaries, we value the life insurance business on embedded value and appraisal value. Our appraisal value is based on 22x FY09E NBAP. We value the non-life insurance business at 18x FY09E post-tax combined surplus. The brokerage business is valued at 20x FY09E PAT. We value the asset management business at 6% of FY09E AUM and the venture capital business at 20x FY07 AUM.

Risks Which May Impede the Achievement of the Price Target: We believe that there are two key downside risks to our hypothesis: (1) deterioration in asset quality could be much greater than our expectation; and (2) if turmoil in the international credit markets continues, then ICICI's international lending business would be impacted.

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Company Name	Ticker	Price (24-Apr-2008)	Stock / Sector Rating
ICICI Bank	ICBK.NS	INR 876.40	1-Overweight / 1-Positive

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In addition to the stock rating, we provide sector views which rate the outlook for the sector coverage universe as 1-Positive, 2-Neutral or 3-Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

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2-Equal weight - The stock is expected to perform in line with the unweighted expected total return of the relevant country index over a 12- month investment horizon.
3-Underweight - The stock is expected to underperform the unweighted expected total return of the relevant country index over a 12-month investment horizon.
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1-Positive - sector coverage universe fundamentals/valuations are improving.
2-Neutral - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.
3-Negative - sector coverage universe fundamentals/valuations are deteriorating.

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