

January 21, 2008

BUY

Price Target Price
Rs1,173 **Rs1,600**

Sensex **17,605**

Price Performance

(%)	1M	3M	6M	12M
Absolute	7	20	26	28
Rel. to Sensex	8	13	3	(4)

Source: Capitaline

Stock Details

Sector	Banking
Reuters	ICBK.BO
Bloomberg	ICICIBC@IN
Equity Capital (Rs mn)	10,949
Face Value	10
52 Week H/L	1,465/719
Market Cap	Rs1.4tn/USD34.1bn
Daily Avg Volume (No of shares)	4.0mn
Daily Avg Turnover (US\$)	125.2mn

Shareholding Pattern (%)

(31 st Dec.'07)	
Promoters	-
FII	70.4
Institutions	16.9
Private Corp.	5.4
Public	7.4

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ICICI Bank

Result
Update

Earnings inline, asset quality continues to worry

ICICI Banks (ICICI) Q3FY08 results were in line with our estimates. The NII at Rs19.6bn, NIM at 2.25%, fee income growth of 33% present the robust operating performance of the bank. Moreover, a slower balance sheet growth has helped the bank to report 5bps expansion in NIMs to 2.25%. We believe that the strategy of transferring the low profitable business of home loans to a subsidiary will help the bank to maintain the margins at current level.

However, the bank has continued to disappoint on the asset quality as the gross slippages continue to rise. For M9FY08, the gross slippages were at 1.1% of the gross advances compared with 1.1% for FY07.

The stock is currently quoting at 18.1x FY10E FPER and 2.4x FY10E ABV with likely RoE of 13.3% in FY10E. We maintain our BUY recommendation on the stock with price target of Rs1,600.

NII grows 32% led by increase in NIM's...

ICICI Bank's NII grew by 32% yoy to Rs19.6bn inline with our expectation of Rs19.3bn, helped by higher NIM's. A slower balance sheet growth [advances up 24.7% (Rs Rs2155bn) and deposits up just 17% (Rs2298bn)] has helped the bank to report 5bps expansion in NIMs to 2.25%.

Adjusted NII

Rs bn	Q3FY08	Q3FY07	Q2FY08	% yoy chg	% qoq chg
Reported NII	19,597	14,848	17,860	32.0	9.7
Add: HTM Amortisation	2,120	2,240	2,100		
Adjusted NII	21,717	17,088	19,960	27.1	8.8

Source: Company, Emkay Research

Yield analysis (%)

	Q3FY08	Q3FY07	Q2FY08	yoy chg (bps)	qoq chg (bps)
Yield on advances	10.9	10.2	11.0	73	(11)
Yield on investments	7.6	6.5	6.9	106	68
Yield on assets	9.1	8.3	8.8	80	27
Cost of funds	6.8	6.1	6.7	74	12
NIM	2.3	2.2	2.1	5	16
NIM – reported	2.3	2.2	2.2	10	7

Source: Company, Emkay Research

* Calculated on basis of average quarterly balances

... As the CASA increased

The bank has been able to witness slight expansion in its margin as the CASA share increased from 24% in 3QFY07 to 27% in 3QFY08. The increase was mainly driven by slower growth in Deposits, which grew by just 17%yoy to Rs2,298bn.

CASA mix

Rs bn	Q3FY08	Q3FY07	Q2FY08	% yoy chg	% qoq chg
Total deposits	2,298	1,969	2,283	16.7	0.6
Savings account	380	289	348	31.6	9.1
Current account	240	181	230	32.6	4.3
CASA as % Of total	27.0	23.9	25.3		
Term deposits	1,678	1,499	1,705	11.9	-1.6

Source: Company, Emkay Research

International business drives advances growth

ICICI Bank's advances book has grown by 24.7% yoy led by almost 2.5x increase in the international loan portfolio. The 80% of the incremental advances have come from the international business.

Portfolio mix

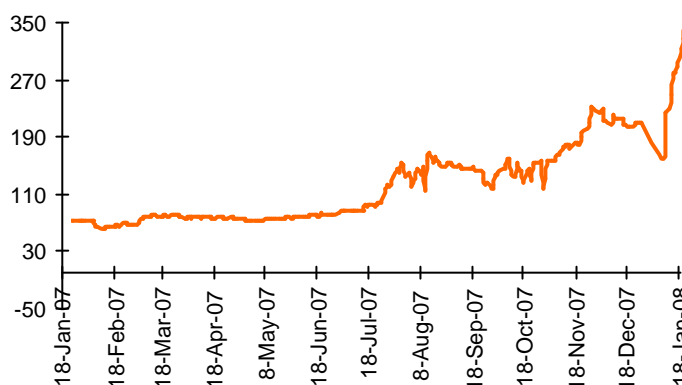
Rs bn	Q3FY08	Q3FY07	Q2FY08	% of total portfolio	% yoy chg	% qoq chg
Retail	1,323	1,179	1,310	61.4	12.2	1.0
International	453	173	370	21.0	162.0	22.3
Others	379	376	391	17.6	1.0	-3.0
Total advances	2,155	1,728	2,071		24.7	4.1

Source: Company, Emkay Research

... but international borrowings are getting costlier

However, we see some risks here as the spreads on the borrowings by Indian corporates in overseas markets has gone up significantly over last few months driven by events in US and as the amount of borrowings by Indian corporates has also gone up dramatically. Hence, the growth in the international advances might not be sustainable.

ICICI Bank CDS spreads



Source: Bloomberg, Emkay Research

Retail loans slow down as expected

The growth in the retail advances have further slowed down as they grew by just 12.2% yoy for Q3FY08, much slower than 21.7% for H1FY08. However, the slow down was much in line with our expectations as the disbursement in this segment have been on decline over last three quarters.

Retail loan mix

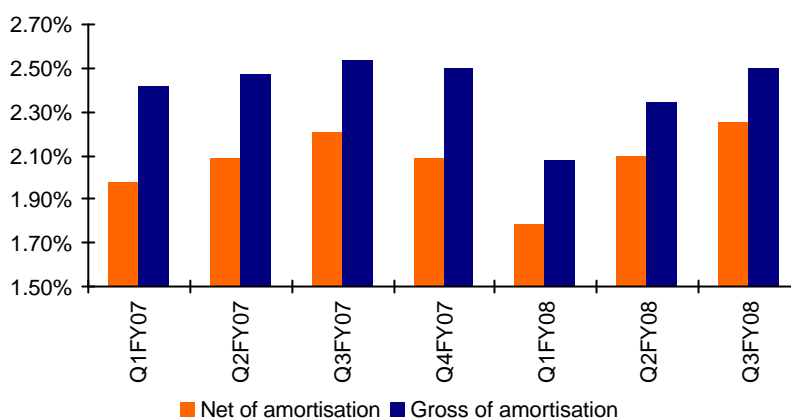
	Rs bn	% yoy change	Proportion	Change in bps	
				yoy	Qoq
2-wheelers	35	29.6	2.6	36	44
Cars	170	-13.7	12.8	-386	-217
CV	180	28.6	13.6	173	59
Personal loans	138	27.8	10.4	127	22
Credit cards	78	69.6	5.9	199	69
Mortgages	668	11.9	50.5	-14	34
Others	54	-15.6	4.1	-135	-11
Total	1,323	12.2	100.0		

Source: Company, Emkay Research

Is margin expansion here to stay?

The slower balance sheet growth has helped the bank to report improving margins over last three quarters, as they have expanded by another 15bps on sequential basis to reach at the FY07 levels.

Improving margins



Source: Company, Emkay Research

However, we believe that the issue needs to be seen in the following perspectives:

1. Home loans and car loans business is getting costlier

The slow down in the retail loans has come mainly from mortgages and car loans, which are lower yielding. While these products offer yields of 11% and 15% respectively, the associated funding costs (like CRR and SLR) have risen sharply. Even the difference between home loan yields and SLR bonds has now widened to about 3.5-4.0% making it unprofitable business for banks like ICICI Bank which have traditionally had higher proportion of term deposits.

Arbitrage in spreads between banks and NBFCs

%	Bank	NBFC
Yield on mortgages	10.50	10.50
Actual funding cost	6.70	8.00
Associated funding cost	1.66	0.00
Actual spreads	2.14	2.50

Source: Emkay research, Assuming CASA of 22%

2. The higher funding cost finds solution in terms of home finance subsidiary

Hence, the bank is now putting the housing finance business, in the a separate subsidiary viz., ICICI Home Finance

The bank has capitalised the housing finance subsidiary to the extent of Rs5bn and further capital will be infused as and when required. We believe that accelerated growth in the balance sheet will be seen, once the optimal capitalization of the home finance subsidiary is done.

This along with the redemption of the high cost term deposits in March 2008, will help the bank to sustain the margins.

Other income continues to grow ...

The other income has grown by 22.5% yoy primarily driven by 32.7% growth in the Fee income. We expect the fee income growth to pick up further in coming quarters as the bank undertakes more international business.

The treasury profits have seen a decline of 9% yoy during the current quarter due to higher MTM losses of Rs1.5bn on the CDS portfolio.

Fee income

Rs mn	Q3FY08	Q3FY07	Q2FY08	% yoy chg	% qoq chg
Fee income	17,850	13,450	14,860	32.7	20.1
Treasury	2,820	3,100	1,750	-9.0	61.1
Other	3,600	3,260	4,109	10.4	-12.4
Total	24,270	19,810	20,719	22.5	17.1

Source: Company, Emkay Research

... Slower growth in operating expenses help

Aided by much slower growth in the direct marketing agency (DMA) expenses, the operating expenses grew by much slower 24.2% yoy.

Stable operating expenses

Rs mn	Q3FY08	Q3FY07	Q2FY08	% yoy chg	% qoq chg
Staff expenses	5,705	4,262	5,199	33.9	9.7
DMA expenses	4,163	3,831	3,854	8.7	8.0
Other operating expenses	11,408	9,039	10,655	26.2	7.1
Total expenses	21,276	17,133	19,708	24.2	8.0

Source: Company, Emkay Research

Driven by slower growth in treasury income and lower amortization expenses, the core operating profit grew by 36.4% yoy.

Core operating profit grows by 36.4%

Rs mn	Q3FY08	Q3FY07	Q2FY08	% yoy chg	% qoq chg
Reported operating profit	22,587	17,526	18,871	28.9	19.7
Less:					
Treasury gains	2,820	3,100	1,750	-9.0	61.1
Lease income	3,600	3,260	4,109	10.4	-12.4
Add: Amortisation expenses	2,120	2,240	2,100	-5.4	1.0
Core operating profit	18,287	13,406	15,112	36.4	21.0

Source: Company, Emkay Research

Asset quality continues to worry

The problem on NPA front continues, with the bank having added nearly Rs6bn of fresh NPA. For M9FY08, the bank has added Rs24bn as fresh NPA which is 1.1% of the gross advances for M9FY08 compared with 1.1% for the full of FY07.

Provisions continue to be high

Rs mn	Q3FY08	Q3FY07	Q2FY08
NPA	6,960	4,379	5,660
As % of advances	0.32%	0.25%	0.27%
Standard assets	640	1,440	780
Others	3	850	5
Total	7,603	6,670	6,445

Source: Company, Emkay Research

Performance of key subsidiaries

- ICICI Pru Life reported a loss of Rs6.7bn in M9FY08. Its New Business Profit (NBP) in M9FY08 was Rs7.5bn
- ICICI Lombard General Insurance profit after tax increased by 134% to Rs1.1bn in M9FY08 from Rs490mn M9FY07
- ICICI Pru AMC's profit after tax increased by 127% to Rs750mn from Rs330mn
- ICICI Securities has reported revenues of Rs2.57bn for Q3FY08 (Rs2.7bn for H1FY08) and a net profit of Rs710mn for Q3FY08 (Rs360mn for H1FY08).

Capital adequacy remains comfortable post FPO

The tier I Capital adequacy of the bank was at comfortable 12.1% as the bank has raised Rs200bn through a combination of FPO and ADS. We believe that the bank would not need further money at least over next 21-27 months to fund its growth.

Valuations and view

The stock is currently quoting at 18.1x FY10E FPER and 2.4x FY10E ABV. Although, we believe that there are a lot of concerns of the standalone operations of the bank, the stock is available at attractive valuations. Stripping of the value of the subsidiaries, the bank is available at 1.6x FY10E ABV which we find attractive. We continue with our BUY recommendation on the stock with price target of Rs1,600.

Quarterly results

	M9FY08	M9FY07	% yoy chg	Q3FY08	Q3FY07	Q2FY08	% yoy chg	% qoq chg
Nil	52,249	40,273	29.7	19,597	14,848	17,860	32.0	9.7
Other Income	64,489	48,287	33.6	24,266	19,810	20,719	22.5	17.1
<i>Fee income</i>	46,990	35,845	31.1	17,850	13,450	14,860	32.7	20.1
<i>Others</i>	174,990	124,420	40.6	64,159	63,600	58,590	0.9	9.5
Net income	116,738	88,560	31.8	43,863	34,658	38,579	26.6	13.7
Operating expenses	60,037	47,700	25.9	21,276	17,133	19,708	24.2	8.0
Operating Profit	56,701	40,861	38.8	22,587	17,526	18,871	28.9	19.7
Provisions & Contingencies	19,260	12,553	53.4	7,603	6,670	6,445	14.0	18.0
<i>NPA</i>	17,320	9,862	75.6	6,960	4,379	5,660	58.9	23.0
Profit before tax	37,441	28,308	32.3	14,983	10,856	12,426	38.0	20.6
Total Tax	7,050	4,512	56.3	2,681	1,751	2,401	53.1	11.7
Net Profit	30,391	23,796	27.7	12,302	9,105	10,026	35.1	22.7

Valuation table

Y/E March 31	Net income Rs mn	Net profit Rs mn	EPS (Rs)	ABV (Rs)	RoA (%)	RoE (%)	PE (x)	P/ABV (x)
FY2007	125,997	31,064	34.5	248.2	1.0	13.4	34.0	4.7
FY2008E	170,530	44,859	39.3	395.8	1.1	12.5	29.8	3.0
FY2009E	219,162	61,301	53.7	432.7	1.2	12.2	21.8	2.7
FY2010E	268,051	73,975	64.9	479.9	1.2	13.3	18.1	2.4

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