

**ICICI Bank**

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,086	ICICIB IN
S&P CNX: 2,945	REUTERS CODE
	ICBK.BO

21 July 2006

**Buy**
*Previous Recommendation: Buy*
**Rs485**

Equity Shares (m)	889.8
52-Week Range	671/432
1,6,12 Rel.Perf.(%)	-2/-22/-27
M.Cap. (Rs b)	431.3
M.Cap. (US\$ b)	9.2

YEAR	NET INCOME	PAT	EPS	EPS	P/E	P/BV	CAR	ROE	ROA	P/ABV
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	(%)	(X)
3/06A	96,932	25,401	28.5	4.9	17.0	1.9	13.4	14.6	1.3	2.0
3/07E	127,814	31,030	34.9	22.2	13.9	1.8	11.6	13.3	1.1	1.8
3/08E	166,668	39,158	44.0	26.2	11.0	1.6	10.5	15.2	1.0	1.6

ICICI Bank reported strong earnings for 1QFY07, higher than our expectations. Net interest income (NII) increased 52% to Rs14.8b aided by strong advances growth. As expected, margins declined, on back of higher funding costs, however the decline was lower than expected. Balance sheet continued to grow rapidly coupled with strong traction in fee income. Provisions increased YoY due to higher investment related amortization in the quarter, as well as increased provision requirements on certain asset classes by RBI. Despite lower treasury gains and higher provisions, earnings grew 17% in 1QFY07 to Rs6.2b.

- ✍ Strong balance sheet expansion – retail continues to drives growth
- ✍ NIMs decline YoY; shall improve from 2QFY07
- ✍ Fee growth continues to be robust
- ✍ Asset quality steady; net NPL at 0.8%

Core margin expansion is likely to be a key positive for ICICI Bank. While margins have declined in 1Q, the increased lending rates from July shall result in improved margins (15-20bp) from 2QFY07 onwards. This coupled with strong volume growth robust traction in fee revenues will drive earnings growth. Improving performance of its subsidiaries will serve as a key valuation driver (currently the subsidiaries are valued at ~Rs144 per share of ICICI Bank). Adjusting for the value of its subsidiaries, the stock is available at 1.1x FY08E BV. Reiterate **Buy**.

**QUARTERLY PERFORMANCE**

(RS MILLION)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Interest Income	31,160	33,333	37,106	41,478	50,386	53,666	56,847	62,409	143,075	223,308
Interest Expense	21,465	22,598	24,168	27,742	35,634	37,287	39,636	44,779	95,974	157,335
<b>Net Interest Income</b>	<b>9,695</b>	<b>10,735</b>	<b>12,938</b>	<b>13,736</b>	<b>14,753</b>	<b>16,379</b>	<b>17,211</b>	<b>17,630</b>	<b>47,100</b>	<b>65,973</b>
Growth (%)	53.7	56.7	76.5	73.8	52.2	52.6	33.0	28.3	46.5	40.1
Other Income	10,905	11,115	11,792	16,019	12,776	13,894	15,919	19,253	49,831	61,841
<b>Net Income</b>	<b>20,600</b>	<b>21,850</b>	<b>24,730</b>	<b>29,755</b>	<b>27,528</b>	<b>30,273</b>	<b>33,130</b>	<b>36,883</b>	<b>96,932</b>	<b>127,814</b>
Operating Expenses	10,892	11,410	12,784	14,942	15,215	15,974	16,364	17,008	50,025	64,560
<b>Operating Profit</b>	<b>9,708</b>	<b>10,440</b>	<b>11,946</b>	<b>14,813</b>	<b>12,314</b>	<b>14,300</b>	<b>16,766</b>	<b>19,875</b>	<b>46,907</b>	<b>63,254</b>
Growth (%)	74.7	38.9	54.9	68.9	26.8	37.0	40.4	34.2	58.7	34.9
Provisions and Contingencies	2,979	3,038	3,951	5,973	4,828	4,861	5,926	7,340	15,941	22,955
<b>Profit before Tax</b>	<b>6,729</b>	<b>7,402</b>	<b>7,995</b>	<b>8,840</b>	<b>7,486</b>	<b>9,439</b>	<b>10,840</b>	<b>12,535</b>	<b>30,966</b>	<b>40,299</b>
Provision for Taxes	1,429	1,602	1,593	941	1,286	2,360	2,818	2,805	5,565	9,269
<b>Net Profit</b>	<b>5,300</b>	<b>5,800</b>	<b>6,402</b>	<b>7,899</b>	<b>6,200</b>	<b>7,079</b>	<b>8,022</b>	<b>9,730</b>	<b>25,401</b>	<b>31,030</b>
Growth (%)	23.0	31.2	23.7	28.5	17.0	22.1	25.3	23.2	26.7	22.2
Interest Expense/Interest Income (%)	68.9	67.8	65.1	66.9	70.7	69.5	69.7	71.8	67.1	70.5
Other Income/Net Income (%)	52.9	50.9	47.7	53.8	46.4	45.9	48.0	52.2	51.4	48.4
Cost /Income (%)	52.9	52.2	51.7	50.2	55.3	52.8	49.4	46.1	51.6	50.5

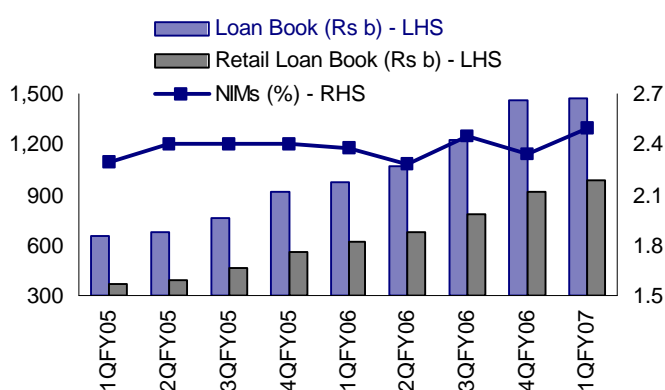
E: MOST Estimates \* Qly Nos adjusted for Auto DMA chgs for FY06

ICICI Bank reported strong earnings for 1QFY07, higher than our expectations. Net interest income (NII) increased 52% to Rs14.8b aided by strong advances growth. As expected, margins declined, on back of higher funding costs, however the decline was lower than expected. Balance sheet continued to grow rapidly coupled with strong traction in fee income. Provisions increased YoY due to higher investment related amortization in the quarter, as well as increased provision requirements on certain asset classes by RBI. Despite lower treasury gains and higher provisions, earnings grew 17% in 1QFY07 to Rs6.2b.

### Strong balance sheet expansion – retail drives growth

ICICI Bank has grown its balance sheet aggressively by 47% YoY to Rs2,663b. Aggressive deposit raising and strong loan growth (mainly fuelled by retail) has led to this strong growth. Loans have increased by 50% YoY to Rs1,471b. Retail loans have continued to drive growth for the bank, having grown by 59% YoY. The proportion of retail has increased to 67% of total loans and 64% of customers' assets. International loan book of the bank has also grown strongly YoY from Rs70b to Rs134b in 1QFY07.

QUARTERLY TREND OF LOAN BOOK AND RETAIL LOANS



Source: Company/Motilal Oswal Securities

In order to support this strong loan growth, the bank has been aggressively growing its deposit base. While CASA deposit growth of 54% YoY continue to be robust, as a

percent of deposits, CASA proportion has declined by nearly 100bp to 21.9%. Balance sheet growth continues to be largely fuelled by term deposits (mainly bulk deposits; ~50-55% of total). Overall deposit base has increased by 61% YoY to Rs1,830b. Deposit costs have increased from 5.2% to 5.8% YoY, although they are largely stable QoQ.

### NIMs decline YoY; shall improve from 2QFY07

The bank has reclassified DMA charges payable for auto loans as operating expenses and shall not deducted through interest income. As a result, reported NIMs for the bank has improved to 2.7% for FY06 and 2.6% for 1QFY06.

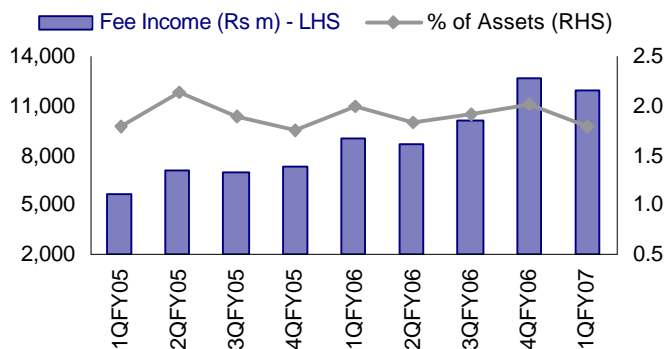
While NII increased by 52% to Rs14.8b, margins declined to 2.5% in 1QFY07 from 2.7% in FY06 and 2.6% in 1QFY06. However, excluding the sell down gains, margins actually improved from 2.2% to 2.5% YoY (FY06 margins at 2.4%).

With a 100bp lending rate hike on home loans being effective from July 2006 onwards, margins are likely to improve by 15-20bp from 2QFY07 onwards. For FY07, we are expecting stable margins at 2.7% on a reported basis. However, excluding sell down gains, core margins are likely to improve in FY07. This also indicates that in the following 3 quarters of FY07, margins for the bank are likely to be better, which shall result in strong NII growth resulting in robust earnings growth.

### Fee growth continues to outperform

A key highlight is the continued traction in its core fee revenues. Fees (non-treasury) to total assets now stand at 1.8% in 1QFY07. In 1QFY07, core fees increased by 50% to Rs9.9b, while treasury and other non-interest income (lease income) declined YoY. Of the current fees, 60% arises from retail; ~13% comes from international operations and the balance from corporates. We expect growth in fee income to continue to remain robust going forward on the back of growing fees from distribution products and international operations.

## FEE INCOME – STRONG GROWTH OVER THE LAST FEW QUARTERS



Source: Company/Motilal Oswal Securities

Treasury income declined by 52% YoY to Rs880m, as fixed income business faced rough environment. However, gains from equity book (the bank has sold half of its stake in NCDEX to Goldman Sachs) of Rs1.45b in the quarter resulting in a net treasury gain of Rs880m. Currently 80% of G-sec investments, which form nearly 75% of bank's total investment book are in HTM. Total portfolio duration is less than two years and AFS book the duration is less than one year.

### Asset quality steady; net NPLs at 0.8%

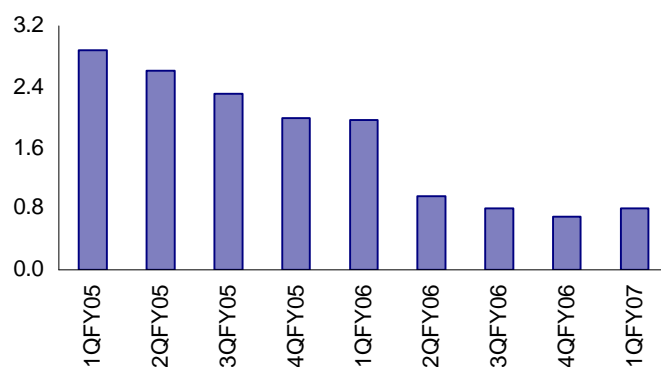
While asset quality has improved on a YoY basis, there is a marginal deterioration in asset quality on a QoQ basis. Absolute gross NPAs have increased by 10% QoQ to Rs32.7b. Absolute Net NPAs have increased 20% to Rs12.9b. The management has indicated that increase in gross and net NPAs on absolute basis sequentially is in line with the asset growth which the bank has been witnessing over the last 4 quarters. Further incrementally the portfolio mix of retail loans has been changing towards high-yielding retail loans (credit cards, personal loans, etc), wherein the risks are also high.

### Provisioning increase sharply on higher investment and NPA provisions

The bank has provided 0.55% for standard assets (for certain loan categories), resulting in higher NPL provisioning

in 1QFY07 to the tune of Rs470m. Further amortization expenses for the bank have also increased to Rs2.67b, against Rs1.5b during 1QFY06. Overall the provisions have increased by 62% YoY during 1QFY07.

## NET NPAS QOQ (%)



Source: Company/Motilal Oswal Securities

### Subsidiaries post strong earnings

ICICI Pru Life has continued to witness strong overall growth and has achieved a NBAP of Rs1.86b during 1QFY07 compared to Rs0.7b in 1QFY06 and Rs5.3b in FY06. During the quarter, Prudential ICICI AMC became the largest AMC in India with AUMs of over Rs300b. I-Sec has achieved a profit of Rs240m as its fixed income business did not fare well due to the volatile environment.

### CAR declines; Hybrid capital and BASEL II shall benefit

ICICI bank's CAR declined to 12.5% (13.4% in March 2006), with Tier 1 declining to 8.6% in 1QFY07. The recent hybrid capital norms issued by RBI allowing banks to raise hybrid capital in foreign markets will allow ICICI Bank to raise capital at reasonable costs in the international markets as it has relatively strong external credit rating. Also, as per the current RBI norms, retail loans (other than housing and auto) have a risk-weight of 125%. However, post BASEL II, the risk-weight will decline to 75%, releasing capital for the bank. The bank has communicated that this shall increase its Tier I by approximately 100bp.

**Valuation and view**

Core margin expansion is likely to be a key positive for ICICI Bank. While margins have declined in 1Q, the increased lending rates from July shall result in improved margins (15-20bps) from 2QFY07 onwards. This coupled with strong volume growth robust traction in fee revenues

will drive earnings growth. Improving performance of its subsidiaries will serve as a key valuation driver (currently the subsidiaries are valued at ~Rs144 per share of ICICI Bank). Adjusting for the value of its subsidiaries, the stock is available at 1.1x FY08E BV. Reiterate **Buy**.

## ICICI Bank: an investment profile

ICICI Bank was incorporated in 1994 under the leadership of the erstwhile ICICI Ltd. Bank of Madura was merged with it during 2001. In 2002, the entity underwent a reverse merger with its promoter ICICI Ltd. and emerged the largest private sector bank in India. This was followed by a fundamental shift in the business profile from project and corporate businesses to retail loans. The bank has a balance sheet size of Rs2,663b and a wide geographical reach with 625 branches; extension counters and over 2,275 ATMs across the country.

### Key investment arguments

- ✍ Robust loan growth with margin stability would result in significant net interest income growth; fee income is expected to remain buoyant.
- ✍ Enjoys leadership in most of the retail loan segments
- ✍ Subsidiaries hold significant values.

### Key investment risks

- ✍ Net NPAs have declined below 1%; however higher delinquency may arise on account of robust retail loan book expansion.
- ✍ Frequent capital dilution in order to support growth.

### Recent developments

- ✍ Has successfully raised Rs80b capital from domestic and international sources, along with a greenshoe option of 15%.
- ✍ Recently raised Rs15b via non-convertible debentures (NCDs) at a coupon rate of 8.60% and Rs20b via tier-II subordinated debt.

### Valuation and view

- ✍ Robust loan growth, high fee income and reduction in net NPAs will be the key triggers to watch out for.
- ✍ We expect earnings to grow 22% in FY07 and 26% in FY08. Adjusting the value of subs (~Rs144), the stock trades at 7.7x FY08E EPS and 1.1x FY08E book value.

### Sector view

- ✍ YTD loan growth of 30%+, highest in last 12 years
- ✍ Volatility in interest rates will impact bond gains.
- ✍ Benefits of significant improvement in asset quality, not yet factored in earnings, valuations.
- ✍ We maintain an overweight stance on the sector.

#### COMPARATIVE VALUATIONS

		ICICI BANK	HDFC BANK	HDFC
P/E (x)	FY07E	13.9	19.5	17.7
	FY08E	11.0	14.9	14.7
P/ABV (x)	FY07E	1.8	3.6	5.0
	FY08E	1.6	3.0	4.1
RoE (%)	FY07E	13.3	19.8	30.6
	FY08E	15.2	21.7	30.2
RoA (%)	FY07E	1.1	1.4	2.6
	FY08E	1.0	1.4	2.5

#### SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	0.0	0.0	0.0
Domestic Institutions	15.1	15.7	17.3
FII/FDIs	73.5	70.3	71.5
Others	11.4	14.0	11.2

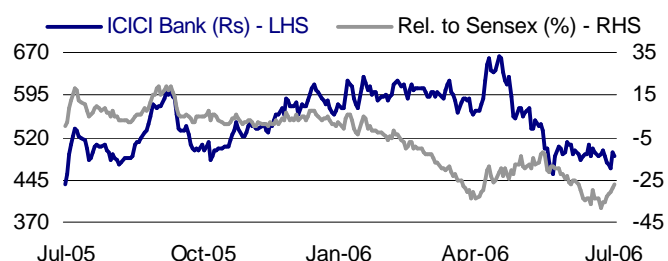
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	34.9	34.4	1.4
FY08	44.0	44.1	-0.3

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
485	710	46.4	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)			
Y/E March	2005	2006	2007E	2008E	
Interest Income	97,849	143,075	223,308	316,262	
Interest Expended	65,709	95,974	157,335	229,388	
<b>Net Interest Income</b>	<b>32,140</b>	<b>47,100</b>	<b>65,973</b>	<b>86,874</b>	
Change (%)	44.3	46.5	40.1	31.7	
<b>Other Income</b>	<b>34,161</b>	<b>49,831</b>	<b>61,841</b>	<b>79,795</b>	
Profit on sale of investment	5,461	6,963	4,000	4,000	
Other non-interest income	28,700	42,869	57,841	75,795	
<b>Net Income</b>	<b>66,301</b>	<b>96,932</b>	<b>127,814</b>	<b>166,668</b>	
Change (%)	25.2	46.2	31.9	30.4	
Operating Expenses	36,741	50,025	64,560	80,888	
Employee expense	7,374	10,823	15,331	19,240	
<b>Operating Income</b>	<b>29,560</b>	<b>46,907</b>	<b>63,254</b>	<b>85,780</b>	
Change (%)	19.2	58.7	34.9	35.6	
Provisions & contingencies	4,288	15,941	22,955	32,864	
Provision for NPAs	-1214	7,947	11,693	18,364	
<b>PBT</b>	<b>25,272</b>	<b>30,966</b>	<b>40,299</b>	<b>52,916</b>	
Tax	5,220	5,565	9,269	13,758	
<b>PAT</b>	<b>20,052</b>	<b>25,401</b>	<b>31,030</b>	<b>39,158</b>	
Change (%)	22.5	26.7	22.2	26.2	
Proposed Dividend	7,231	7,593	8,453	8,898	

BALANCE SHEET		(Rs Million)			
Y/E March	2005	2006	2007E	2008E	
Capital	7,368	8,898	8,898	8,898	
Preference Capital	3,500	3,500	3,500	3,500	
Reserves & Surplus	118,132	213,162	234,682	263,829	
<b>Net Worth</b>	<b>129,000</b>	<b>225,560</b>	<b>247,080</b>	<b>276,227</b>	
<b>Deposits</b>	<b>998,188</b>	<b>1,650,830</b>	<b>2,311,162</b>	<b>3,004,511</b>	
Change (%)	46.6	65.4	40.0	30.0	
CASA	242,287	375,105	554,679	766,150	
CASA Dep (% of total)	24.3	22.7	24.0	25.5	
Borrowings	335,445	385,221	577,831	722,289	
Other Liabilities & Prov.	213,963	252,281	308,222	371,609	
<b>Total Liabilities</b>	<b>1,676,594</b>	<b>2,513,890</b>	<b>3,444,295</b>	<b>4,374,635</b>	
Current Assets	129,300	170,402	170,946	205,634	
Investments	504,874	715,474	1,015,973	1,300,445	
Change (%)	18.1	41.7	42.0	28.0	
<b>Advances</b>	<b>914,052</b>	<b>1,461,631</b>	<b>2,040,463</b>	<b>2,616,703</b>	
Change (%)	45.9	59.9	39.6	28.2	
Retail	561,330	914,738	1,236,790	1,531,745	
Retail (% of total)	61.4	62.6	60.6	58.5	
Net Fixed Assets	40,380	39,807	39,707	39,207	
Other Assets	87,989	126,575	177,205	212,646	
<b>Total Assets</b>	<b>1,676,594</b>	<b>2,513,890</b>	<b>3,444,295</b>	<b>4,374,635</b>	

ASSUMPTIONS	(%)			
Deposit Growth	46.6	65.4	40.0	30.0
Advances Growth	45.9	59.9	39.6	28.2
Investments Growth	18.1	41.7	42.0	28.0
Dividend	85.0	85.0	95.0	100.0
CRR	5.0	5.0	5.0	5.0

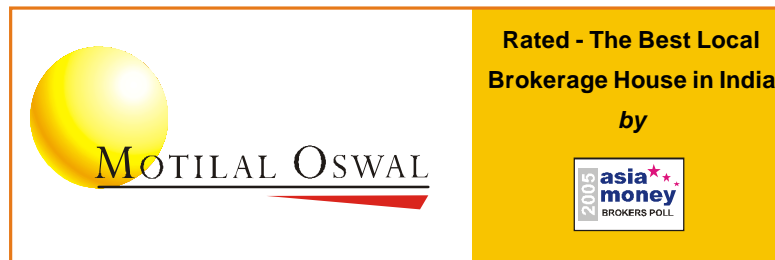
E: M O S t Estimates

RATIOS		2005	2006	2007E	2008E
Y/E March					
<b>Spreads Analysis (%)</b>					
Avg. Yield - Earning Assets		7.3	7.4	8.1	8.7
Avg. Cost-Int. Bear. Liab.		5.4	5.7	6.4	6.9
Interest Spread		1.9	1.7	1.7	1.8
Net Interest Margin		2.4	2.4	2.4	2.4
<b>Profitability Ratios (%)</b>					
RoE		19.5	14.6	13.3	15.2
RoA		14	13	11	10
Int. Expended/Int. Earned		67.2	67.1	70.5	72.5
Other Inc./Net Income		515	514	48.4	47.9
<b>Efficiency Ratios (%)</b>					
Op. Exps./Net Income		55.4	51.6	50.5	48.5
Empl. Cost/Op. Exps.		20.1	21.6	23.7	23.8
Busi. per Empl. (Rs m)		89.4	98.9	124.4	134.8
NP per Empl. (Rs lac)		11.1	10.0	10.3	10.6
<b>Asset-Liability Profile (%)</b>					
Adv./Deposit Ratio		91.6	88.5	88.3	87.1
Invest./Deposit Ratio		50.6	43.3	44.0	43.3
G-Sec/Invest. Ratio		68.3	71.4	67.9	71.6
Gross NPAs to Adv.		3.0	15	13	13
Net NPAs to Adv.		1.7	0.7	0.6	0.5
CAR		11.8	13.4	11.6	10.5
Tier 1		7.6	9.2	7.9	7.0

VALUATION		2005	2006	2007E	2008E
Book Value (Rs)		170.3	249.6	273.7	306.5
Price-BV (x)		2.8	1.9	1.8	1.6
Adjusted BV (Rs)		156.8	241.7	265.3	296.6
Price-ABV (x)		3.1	2.0	1.8	1.6
EPS (Rs)		27.2	28.5	34.9	44.0
EPS Growth (%)		2.5	4.9	22.2	26.2
Price-Earnings (x)		17.8	17.0	13.9	11.0
OPS (Rs)		40.1	52.7	71.1	96.4
OPS Growth (%)		-0.3	31.4	34.9	35.6
Price-OP (x)		12.1	9.2	6.8	5.0

E: M O S t Estimates

**N O T E S**



For more copies or other information, contact

**Institutional:** Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

**Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021**

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

**Disclosure of Interest Statement**

**ICICI Bank**

- |                                                         |    |
|---------------------------------------------------------|----|
| 1. Analyst ownership of the stock                       | No |
| 2. Group/Directors ownership of the stock               | No |
| 3. Broking relationship with company covered            | No |
| 4. Investment Banking relationship with company covered | No |

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.