

ICICI Bank

A step in the right direction

Core growth dwindled further to puny +4% y/y – potential drag on re-rating

Dragged by moderate loan growth (+12% y/y), tepid core fee (+3.5% y/y) and shrinking margins (-16bps q/q), core PPOP growth faded to +4% y/y in Q4FY16. Q4FY16 Core PPOP was ~13% lower than our estimates. We fear weak core profitability would be key overhang on the re-rating potential of the stock, apart from high provisions in FY17.

Watch list of weak exposure 12% of loans - closer to our estimates

GNPL rose to 5.8% (+2% in FY16) due to 6.4% annualized Gross NPL formation, which was in line with UBSe. ICICI Bank disclosed its exposure to corporates below investment grade (including non-fund based) in key stressed sectors, which along with restructured loans stands at Rs526bn as of March 2016 (12% as % of loans), which is in line with our estimates as discussed in July 2015 note ([link](#)) and our report released in Feb 2016 ([link](#)). The bank didn't provide any guidance on credit costs as it wanted to keep flexibility in resolving stressed loans (haircuts), however this may lead to stock volatility in the near term.

Created contingent provisions of 80bps – a step in right direction

Loan loss provisions were at 3% annualized in Q4FY16. The bank forgone PAT growth in order to create contingent (excess) provisions of Rs36bn (~80bps of loans), which we believe is a right move. Given the size of weak exposures this may not protect future earnings completely. We expect gains from life insurance IPO to partly offset the impact of higher provisions in FY17.

Valuation: Earnings cut by 18/19% in FY17/18 – Maintain Neutral

The bank is taking right steps to resolve asset quality issues, which is positive long term in our view. We increase our credit cost estimates to 200/ 150 bps for FY17/18E. We are less cautious on the stock than earlier and maintain PT of Rs260. However, due to weak core earnings in FY17, we maintain Neutral rating.

Equities

India
Banks, Ex-S&L

12-month rating **Neutral**

12m price target **Rs260.00**

Price **Rs236.60**

RIC: ICBK.BO BBG: ICICIB IB

Trading data and key metrics

52-wk range	Rs331.25-183.35
Market cap.	Rs1,370bn/US\$20.6bn
Shares o/s	5,790m (ORD)
Free float	100%
Avg. daily volume ('000)	26,099
Avg. daily value (m)	Rs5,736.5
Common s/h equity (03/16E)	Rs872bn
P/BV (03/16E)	1.6x
Tier 1 ratio	13%

EPS (UBS, diluted) (Rs)

	UBS	Cons.
03/16E	16.77	17.41
03/17E	18.18	23.64
03/18E	20.06	28.37

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Highlights (Rsm)	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Revenues	222,121	269,034	312,157	365,471	385,826	408,164	459,897	524,159
Profit before tax	113,897	140,343	161,178	121,957	150,578	166,169	214,490	242,935
Net earnings (local GAAP)	83,255	98,816	114,733	97,263	105,405	116,319	150,143	170,055
Net earnings (UBS)	83,255	98,816	114,733	97,263	105,405	116,319	150,143	170,055
Tier 1 ratio %	12.8	12.8	12.8	13.1	12.1	11.8	11.7	11.4
EPS (UBS, diluted) (Rs)	14.43	17.13	19.82	16.77	18.18	20.06	25.93	29.45
Profitability/valuation	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
ROE (UBS) %	13.1	14.1	14.9	11.6	11.6	11.8	13.9	14.3
P/PPOP (diluted)	8.8	7.3	9.1	5.7	5.6	5.6	4.9	4.3
P/BV x	1.7	1.6	2.2	1.6	1.5	1.3	1.2	1.1
P/BV (UBS) x	1.7	1.6	2.2	1.6	1.5	1.3	1.2	1.1
P/E (UBS, diluted)	13.9	12.2	15.7	14.1	13.0	11.8	9.1	8.0
Net dividend yield %	2.0	2.2	1.6	1.8	2.0	2.2	2.8	3.2

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of Rs236.60 on 29 Apr 2016 22:38 HKT

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PIVOTAL QUESTIONS

Q: Have we seen the peak of NPL cycle?

No. Our analysis of loan approvals to leveraged corporates ([link](#)) indicates that ICICI Bank has relatively high loan approvals (equal to 14% of Mar'15 loan book) to large leveraged corporates. Exposure to Power, Metal and Construction are also high at 4.4%, 3.9% and 1.6% respectively. [more →](#)

Q: Is the retail liability franchise sustainable

Yes. ICICI Bank is gaining market share in alternate channels like digital banking. Our analysis of ATM/POS transactions and Franchise SA deposits as a % of reported SA deposits ([link](#)) indicates that ICICI's savings deposits base is more sustainable. [more →](#)

Q: Can earnings growth be higher than industry average in the medium term?

Yes. We believe that ICICI would gain market share in retail loan driven by improving retail footprint and strong digital presence. On the corporate side, we expect ICICI to gain market share from capital starved SOE banks. [more →](#)

UBS VIEW

We believe that asset quality remains the key concern for ICICI in the near term given its high exposure to leveraged corporates and stressed sectors and low provisions on these loans. However, we are positive on ICICI in the medium term given its strong retail liability franchise and likely gain in market share in loans. We are also positive on asset management and insurance business in the medium term given likely improvement in share of financial savings (as a % of GDP)

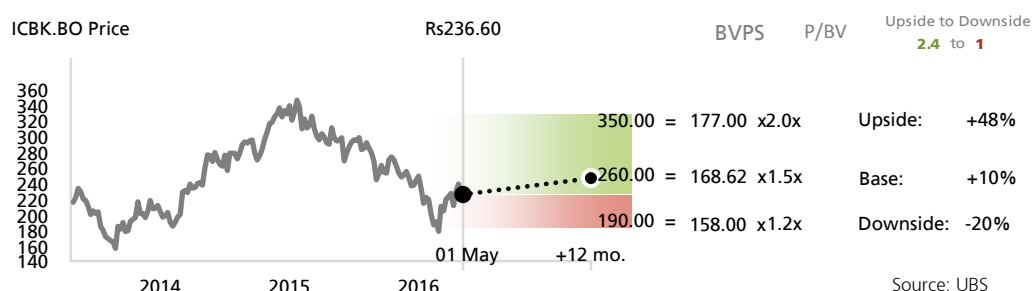
EVIDENCE

Our analysis of loan approvals to around 100 potentially stressed companies ([link](#)) indicates that ICICI has high exposure to large leveraged corporates. Our analysis of mobile app downloads and Franchise SA ([link](#)) indicates that ICICI has a strong presence in digital banking and its SA deposits are more transaction oriented and more sustainable compared to peers. Strong loan growth in retail and wholesale segment indicates the market share improvement.

WHAT'S PRICED IN?

The stock has corrected sharply in last 12-18months and is currently trading below 5-yr average and -1 SD which, we believe, is due to NPL risks. While it is trading at a significant discount to other large private sector banks, we believe that consensus earnings are still not factoring in sharp increase in credit costs.

UPSIDE / DOWNSIDE SPECTRUM



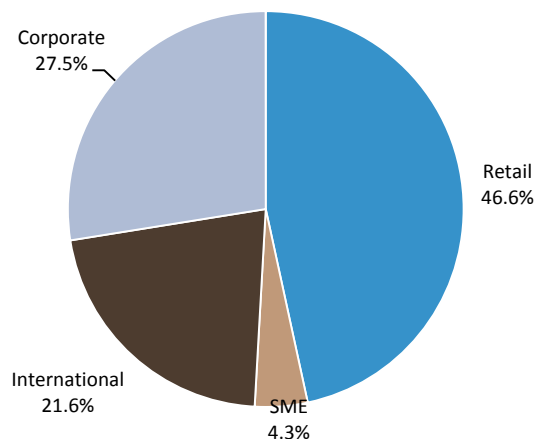
Value drivers

	Loan growth	Credit costs	Net interest margin
Rs 350 upside	19.0%	0.8%	3.8%
Rs 260 target	16.0%	1.0%	3.6%
Rs 190 downside	12.0%	1.2%	3.3%

COMPANY DESCRIPTION

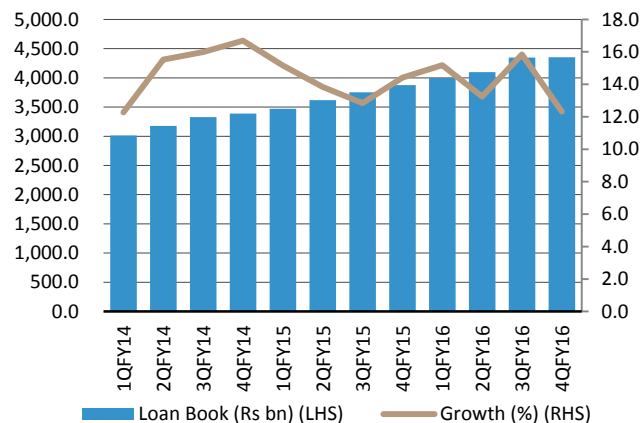
ICICI Bank is one of the largest banks in India, with an asset base of Rs6.4trn as at June 2015. It has an extensive network of 4,054 branches and over 12,964 ATMs. As at end-Sept 2015, its loan book was Rs4.1trn and deposits were Rs3.8trn. The bank's tier-1 capital ratio was 12.1% and its current account/savings account ratio was 45.1%. The bank has invested in overseas subsidiaries, including ICICI Bank UK, ICICI Bank Canada, and domestic subsidiaries such as ICICI Home Finance, ICICI AMC, ICICI Prudential Life and ICICI Lombard General Insurance

Figure 1: Loan Breakup (Q4FY16)



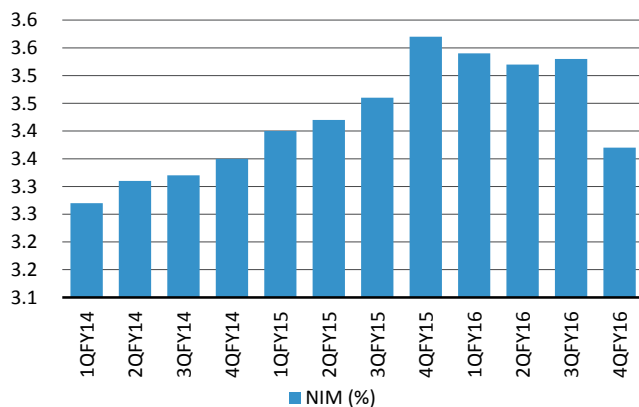
Source: Company Data, UBS

Figure 2: Loan book growth



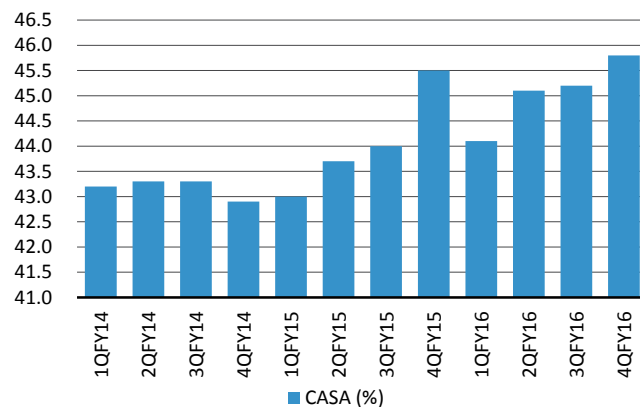
Source: Company Data, UBS

Figure 3: Trend in NIM (%)



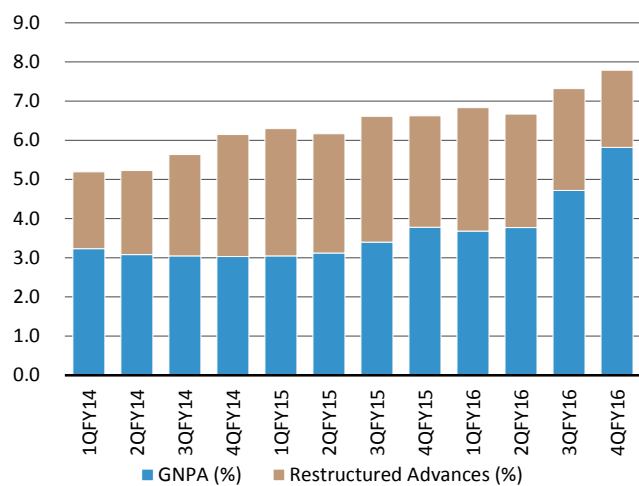
Source: Company Data, UBS

Figure 4: Trend in CASA (%)



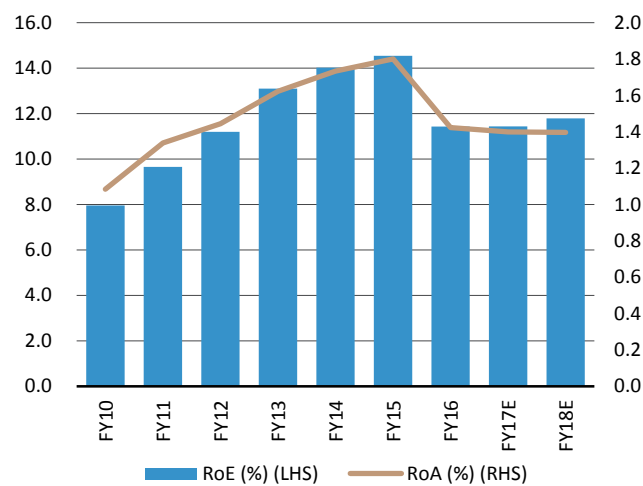
Source: Company Data, UBS

Figure 5: Asset Quality stress continues



Source: Company Data, UBS

Figure 6: Return ratios to remain weak



Source: Company Data, UBS

ICICI Bank (ICBK.BO)

	03/13	03/14	03/15	03/16E	% ch	03/17E	% ch	03/18E	03/19E	03/20E
Profit & Loss (Rsm)										
Net income interest	138,664	164,756	190,396	212,240	11.5	221,073	4.2	256,823	291,781	335,464
Total non interest income	83,457	104,279	121,761	153,231	25.8	164,753	7.5	151,341	168,117	188,695
Total income	222,121	269,034	312,157	365,471	17.1	385,826	5.6	408,164	459,897	524,159
Total cash expenses	(85,227)	(97,329)	(108,369)	(119,871)	-10.6	(134,664)	-12.3	(153,328)	(174,035)	(198,670)
Pre-depreciation operating profit	136,894	171,705	203,789	245,600	20.5	251,162	2.3	254,836	285,862	325,489
Depreciation & amort (excl. goodwill)	(6,163)	(5,760)	(6,590)	(6,965)	-5.7	(7,437)	-6.8	(7,910)	(8,382)	(8,855)
Operating profit pre provisions	130,730	165,946	197,199	238,635	21.0	243,725	2.1	246,926	277,480	316,634
Total provisions	(16,834)	(25,603)	(36,021)	(116,678)	-223.9	(93,146)	20.2	(80,757)	(62,990)	(73,699)
Operating profit post provisions	113,897	140,343	161,178	121,957	-24.3	150,578	23.5	166,169	214,490	242,935
Income from associates & JVs (pre-tax)	0	0	0	0	-	0	-	0	0	0
Other pre-tax items	0	0	0	0	-	0	-	0	0	0
Profit before tax (UBS)	113,897	140,343	161,178	121,957	-24.3	150,578	23.5	166,169	214,490	242,935
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	113,897	140,343	161,178	121,957	-24.3	150,578	23.5	166,169	214,490	242,935
Tax	(30,642)	(41,527)	(46,446)	(24,694)	46.8	(45,173)	-82.9	(49,851)	(64,347)	(72,881)
Profit after tax	83,255	98,816	114,733	97,263	-15.2	105,405	8.4	116,319	150,143	170,055
Other post-tax items	0	0	0	0	-	0	-	0	0	0
Preference dividends	0	0	0	0	-	0	-	0	0	0
Minorities	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	83,255	98,816	114,733	97,263	-15.2	105,405	8.4	116,319	150,143	170,055
Net earnings (before pref divs)	83,255	98,816	114,733	97,263	-15.2	105,405	8.4	116,319	150,143	170,055
Net earnings (UBS)	83,255	98,816	114,733	97,263	-15.2	105,405	8.4	116,319	150,143	170,055
Per share (Rs)										
EPS (local GAAP, basic)	14.43	17.13	19.82	16.77	-15.3	18.18	8.4	20.06	25.93	29.45
EPS (UBS, diluted)	14.43	17.13	19.82	16.77	-15.3	18.18	8.4	20.06	25.93	29.45
PPOP (diluted)	22.66	28.77	34.06	41.16	20.8	42.03	2.1	42.59	47.92	54.83
Net DPS	4.00	4.61	5.00	4.33	-13.3	4.70	8.4	5.18	6.69	7.58
BVPS	115.64	126.93	138.91	150.42	8.3	163.10	8.4	177.10	195.16	215.63
BVPS (UBS)	115.64	126.93	138.91	150.42	8.3	163.10	8.4	177.10	195.16	215.63
Balance sheet (Rsm)										
Banking assets (year end)	5,367,947	5,946,416	6,461,293	7,119,919	10.2	7,854,616	10.3	8,797,318	9,923,441	11,251,287
Banking assets (average)	5,129,318	5,657,181	6,203,854	6,790,606	9.5	7,487,267	10.3	8,325,967	9,360,379	10,587,364
Total assets (year end)	5,367,947	5,946,416	6,461,293	7,119,919	10.2	7,854,616	10.3	8,797,318	9,923,441	11,251,287
Risk weighted assets (RWA) (year end)	4,419,440	4,986,030	5,448,960	6,071,130	11.4	6,811,054	12.2	7,578,827	8,537,138	9,677,083
Risk weighted assets (RWA) (average)	4,202,720	4,702,735	5,217,495	5,760,045	10.4	6,441,092	11.8	7,194,941	8,057,983	9,107,111
Customer loans	2,902,494	3,387,027	3,875,221	4,352,639	12.3	4,962,009	14.0	5,805,550	6,792,494	7,947,218
Customer loans (average)	2,719,885	3,144,760	3,631,124	4,113,930	13.3	4,657,324	13.2	5,383,780	6,299,022	7,369,856
Interest earning assets (average)	4,953,199	5,484,058	6,036,675	6,613,807	9.6	7,296,305	10.3	8,135,179	9,169,739	10,396,848
Customer deposits	2,926,136	3,319,137	3,615,627	4,214,257	16.6	4,804,253	14.0	5,669,019	6,689,442	7,893,542
Common s/h equity (year end)	667,060	732,133	804,294	872,155	8.4	945,697	8.4	1,026,853	1,131,610	1,250,258
Common s/h equity (average)	635,544	699,596	768,213	838,224	9.1	908,926	8.4	986,275	1,079,231	1,190,934
Total SHF (equity, pref & MI) (year end)	667,060	732,133	804,294	872,155	8.4	945,697	8.4	1,026,853	1,131,610	1,250,258
Total SHF (equity, pref & MI) (average)	635,544	699,596	768,213	838,224	9.1	908,926	8.4	986,275	1,079,231	1,190,934
Net tangible assets	667,060	732,133	804,294	872,155	8.4	945,697	8.4	1,026,853	1,131,610	1,250,258
Balance sheet structure (%)										
Loans / banking assets (year end)	54.1	57.0	60.0	61.1	1.9	63.2	3.3	66.0	68.4	70.6
Deposits / banking assets (year end)	54.5	55.8	56.0	59.2	5.8	61.2	3.3	64.4	67.4	70.2
Loans / deposits	99.2	102.0	107.2	103.3	-3.6	103.3	0.0	102.4	101.5	100.7
Total SHF / banking assets (year end)	12.4	12.3	12.4	12.2	-1.6	12.0	-1.7	11.7	11.4	11.1

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

ICICI Bank (ICBK.BO)

	03/13	03/14	03/15	03/16E	03/17E	03/18E	03/19E	03/20E
Capital adequacy (Rsm)								
Tier 1 capital	565,616	637,380	696,610	794,820	824,064	898,089	995,358	1,106,310
Total capital	828,355	882,510	927,440	1,009,950	1,137,720	1,227,428	1,341,163	1,469,406
Risk weighted assets (RWA) (year end)	4,419,440	4,986,030	5,448,960	6,071,130	6,811,054	7,578,827	8,537,138	9,677,083
Core tier 1 ratio %	12.1	12.2	12.2	12.6	11.6	11.4	11.3	11.1
Tier 1 ratio %	12.8	12.8	12.8	13.1	12.1	11.8	11.7	11.4
Total capital ratio %	18.7	17.7	17.0	16.6	16.7	16.2	15.7	15.2
Tangible equity	667,060	732,133	804,294	872,155	945,697	1,026,853	1,131,610	1,250,258
Equity / assets %	12.4	12.3	12.4	12.2	12.0	11.7	11.4	11.1
Tangible equity to tangible assets %	12.4	12.3	12.4	12.2	12.0	11.7	11.4	11.1
Asset quality (Rsm)								
Non performing assets	96,470	105,540	152,420	167,662	184,428	202,871	223,158	245,474
Total risk reserves	74,160	72,560	89,865	38,031	79,947	116,288	144,633	177,798
NPLs / loans %	3.2	3.1	3.8	3.8	3.7	3.4	3.2	3.0
NPL coverage %	76.9	68.8	59.0	22.7	43.3	57.3	64.8	72.4
Provision charge / average loans %	0.6	0.8	1.0	2.0	2.0	1.5	1.0	1.0
Net NPAs / shareholders funds %	3.3	4.5	7.8	14.9	11.0	8.4	6.9	5.4
Profitability (%)								
Net interest margin (avg assets)	2.70	2.91	3.07	3.13	2.95	3.08	3.12	3.17
Provisions / operating profit	12.9	15.4	18.3	48.9	38.2	32.7	22.7	23.3
ROE (UBS earnings)	13.1	14.1	14.9	11.6	11.6	11.8	13.9	14.3
RoAdjE (UBS earnings & equity)	13.1	14.1	14.9	11.6	11.6	11.8	13.9	14.3
RoRWA (UBS)	1.98	2.10	2.20	1.69	1.64	1.62	1.86	1.87
RoA (UBS earnings)	1.62	1.75	1.85	1.43	1.41	1.40	1.60	1.61
Productivity (%)								
Cost income ratio	41.1	38.3	36.8	34.7	36.8	39.5	39.7	39.6
Cost / average assets	1.78	1.82	1.85	1.87	1.90	1.94	1.95	1.96
Compensation expense ratio	22.9	20.3	19.4	17.3	18.7	20.5	20.7	20.8
Growth (%)								
Revenue	24.6	21.1	16.0	17.1	5.6	5.8	12.7	14.0
Operating profit pre provisions	31.1	26.9	18.8	21.0	2.1	1.3	12.4	14.1
Net earnings (UBS)	28.8	18.7	16.1	-15.2	8.4	10.4	29.1	13.3
Net DPS	17.2	15.1	8.6	-13.3	8.4	10.4	29.1	13.3
Total assets (year end)	9.8	10.8	8.7	10.2	10.3	12.0	12.8	13.4
Customer loans	14.4	16.7	14.4	12.3	14.0	17.0	17.0	17.0
Customer deposits	14.5	13.4	8.9	16.6	14.0	18.0	18.0	18.0
Value (x)								
Market cap/revenues	5.1	4.5	5.8	3.7	3.6	3.4	3.0	2.6
Market cap/deposits	0.4	0.4	0.5	0.3	0.3	0.2	0.2	0.2
P/PPOP (diluted)	8.8	7.3	9.1	5.7	5.6	5.6	4.9	4.3
P/E (local GAAP, basic)	13.9	12.2	15.7	14.1	13.0	11.8	9.1	8.0
P/E (UBS, diluted)	13.9	12.2	15.7	14.1	13.0	11.8	9.1	8.0
Net dividend yield %	2.0	2.2	1.6	1.8	2.0	2.2	2.8	3.2
P/BV x	1.7	1.6	2.2	1.6	1.5	1.3	1.2	1.1
P/BV (UBS) x	1.7	1.6	2.2	1.6	1.5	1.3	1.2	1.1

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Forecast returns

Forecast price appreciation	+9.9%
Forecast dividend yield	2.0%
Forecast stock return	+11.9%
Market return assumption	12.7%
Forecast excess return	-0.8%

Valuation Method and Risk Statement

We believe a sustained economic slowdown could impact the banking and finance sector on several fronts: lead to a slowdown in credit, increase NPL risk, impact fee income, and exert pressure on NIM. We value the stock using a sum-of-the-parts methodology, comprised of Rs193 per share for the banking business (1.2x FY17 P/BV) and Rs67 per share for the subsidiary businesses.

Required Disclosures

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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2016.

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
ICICI Bank ^{7, 16}	ICBK.BO	Neutral	N/A	Rs236.60	29 Apr 2016

Source: UBS. All prices as of local market close.

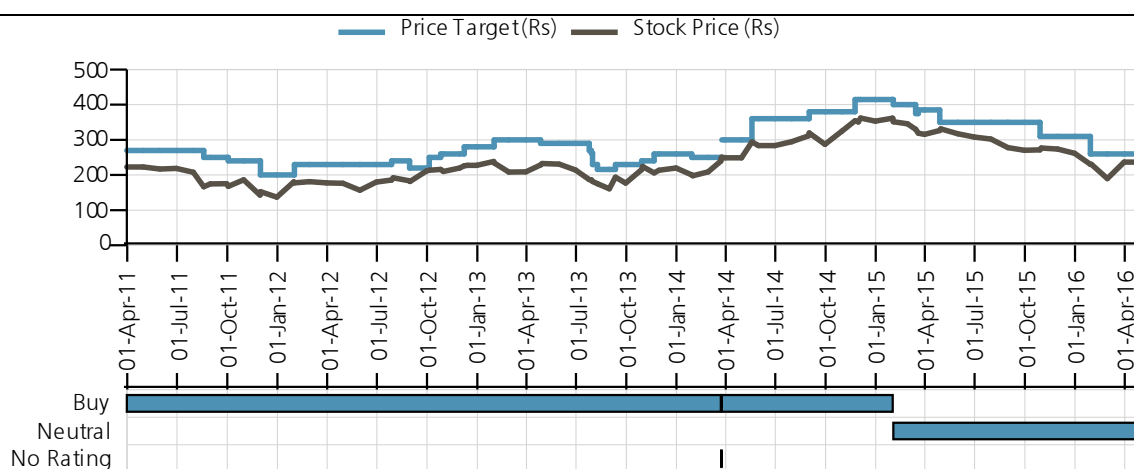
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ICICI Bank (Rs)



Source: UBS; as of 29 Apr 2016

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