ICICI Bank

April 1, 2019

DALAL & BROACHA
STOCK BROKING PVT. LTD.

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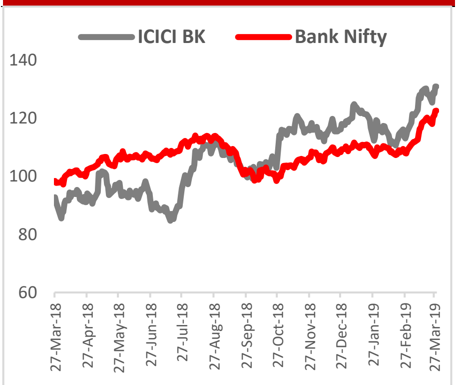
Initiating Coverage @ Dalal & Broacha

BUY	
Current Price (Rs)	399
52 Week Range	400/256
Target price (Rs)	461
Expected Upside (%)	16

Key Share Data	
Market Cap (Rs.bn)	2571
Market Cap (US$ mn)	37186
No of o/s shares (Mn)	6441
Face Value	2
Monthly Avg. vol (BSE+NSE) Nos'000	226
BSE Code	532174
NSE Code	ICICIBANK
Bloomberg	ICICIBC:IN

Price performance



% Shareholding	Dec-18	Sep-18
FII	42.7	45.3
DII	46.4	44.2
Others	10.9	10.5
Total	100	100

Earnings to normalize; Improvement in key financial metrics

ICICI bank's business profile has strengthened significantly over last few quarters, with moderation in NPA addition (Rs 92.4 Bn in 9MFY19 vs 140.3 Bn in 9MFY18)**, de-risking the balance sheet** (BB & Below rated pool declined from 9.4% in Q4FY18 to 5.2% in Q3FY19)**, steady pick-up in retail credit offtake** (clocking ~20% growth) **and a sharp improvement in provision coverage ratio** (up from 48% in Q4FY18 to 68% in Q3FY19)**.** Besides, Bank has adopted a new approach to corporate lending with an enhanced focus on portfolio quality (incremental lending to higher rated corporates) and earnings quality (increasing focus on non-credit, predictable income including transaction banking).

Superior liability franchise; scores one of the highest CASA ratio in industry

ICICI bank's liability franchise is relatively better than most of its peers, with average CASA ratio quoting at 46% of the total deposits in Q3FY19. In CASA share, the current account (CA) contributes Rs 886 Bn (14.6% of total deposits) and savings account (SA) contributes Rs 2108 Bn (34.7% of total deposits). Due to this strong CASA franchise, the bank has managed to keep their cost of deposits low (one of the lowest in financial space), which help the bank in a current tight liquidity environment. Going forward, **in order to maintain stable CASA ratio, the bank will invest further in strengthening its franchise and will leverage technology to improve customer experience and operating efficiency**.

Better capitalization to support credit growth

ICICI bank has maintained healthy capitalization levels, with CET I, Tier I and CRAR at 13.7%, 15.1% and 17.2% (as % of risk weighted assets) as on December 31, 2018. Bank has a strong track record of maintaining sufficient CET1 capital cushion above the minimum regulatory requirements. Furthermore, **Bank can raise additional capital through the sale of stakes in subsidiaries (already raised around Rs 155 billion in the last few years).** With strong cash accrual & ability to raise capital, we believe that the bank has adequate resources to support incremental credit growth over the medium term.

Asset quality continues to improve; credit costs to reduce

In last few quarters, ICICI bank has reported significant improvement in its asset quality and its management is making sure that they do not repeat the same mistake by focusing on lending to higher rated well-established corporates and avoid concentration risk in its portfolio with incremental lending under a revised concentration risk framework. **While the proportion of "A- and above" rated loans to total loans increased from about 52% at March 2016 to over 66% at December 2018, its proportion of "BB & below" rated loans to total loans declined from 19.6% to 5.2% at the same time**. Exposure to top 20 borrowers and top 10 groups as a % of total exposure also improved from 13.3% and 18.5% at March 2016 to 11.5% & 13.7% at December 2018.

With closer to the end of the NPA recognition cycle and higher provision coverage ratio, we believe that the bank's credit cost will start coming down meaningfully over the next few quarters. Thus, **we have assigned a 'Buy' rating on ICICI Bank with a price target of Rs 461, valuing the stock at 1.9x FY21E standalone P/BV and ascribing a value of Rs 102 for subsidiaries.** We project PPOP CAGR of 11% over FY18-21E, driven by rising loan growth, improving margins, and better operational efficiency.

Key Financials

Year	NII	Growth (%)	PPOP	Growth (%)	PAT	Growth (%)	ABVPS	PB (X)
FY17	217	2	265	11	98	1	167	2.4
FY18	230	6	247	-7	68	(31)	159	2.5
FY19E	263	14	237	-4	39	(42)	166	2.4
FY20E	313	19	285	20	138	251	184	2.2
FY21E	375	20	340	19	175	27	206	1.9

ICICI Bank

ICICI Bank is one of India's largest private sector bank with total consolidated assets of Rs 11,242.8 billion ($ 172.5 billion) and profit after tax (PAT) of Rs 67.8 billion ($ 1.0 billion) for the year ended March 31, 2018. Bank offers a wide range of banking products and financial services to corporate and retail customers through a variety of delivery channels and through its group companies. It is also one of the three banks that has been classified as 'Domestic Systemically Important Banks (D-SIBs)' by the Reserve Bank of India (RBI), highlighting its significance to the overall financial system. The Bank maintained a strong capital position with capital adequacy ratios significantly above regulatory requirements.

Investment Rationale

- Retail franchise strengthens; business metrics set to improve
- Asset quality continues to improve; credit costs to reduce
- Superior liability franchise; scores one of the highest CASA ratio in industry
- Better capitalization to support credit growth

ICICI Bank vision 2020: Anchored on "Preserve, Grow, Change" strategy

	Focus Area	Key outcomes
Preserve	Robust funding base	Maintain robust funding franchise
		Maintain average CASA ratio at 45%
		Maintain retail deposit proportion at over 70%
	Digital Leadership	offer best in-class digital offerings for customers & automate internal processes for increased efficiency
Grow	Loan growth	Domestic loan growth of 15%, with retail at > 20% driven by personal loans & credit cards at 40%, business banking at 35% & 15% mortgage
	Core profitability	Drive fee income growth of mid -high teens
	Beyond banking financial services	In insurance, AMC & securities businesses focus on the savings & protection opportunities along with market leadership and value creation
Change	Corporate lending approach	Hard limit on borrower groups based on rating and track record.
		Lower the group exposure limits (Except for highly rated Indian & global conglomerates)
	Portfolio mix	Retail loans proportion to rise to over 60%, overseas loans proportion to be < 10% levels
	Asset quality	Bring NNPLs to below 1.5% levels
	Provision coverage	Raise provision coverage ratio to over 70% levels

Source: D&B Research, Company

Loan growth picked up over the past few quarters

ICICI bank's loan growth has started improving in last few quarters, after experiencing tepid rise for the past few years, with retail being the key driver showing steady 20% growth. Bank has made substantial progress in de-risking its balance sheet and improved its portfolio mix with a higher share of retail loans, which has stable asset quality.

Steady growth in retail loans

Segment-wise (%)	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Retail	18.9	22.5	20.6	20.0	20.5	21.6
Corporate	4.3	4.5	4.6	5.0	5.4	0.2*
Overseas book	-21.4	-14.3	-13.8	-9.8	-3.8	-5.4
SME	7.5	17.4	14.0	17.2	20.5	12.6
Total	**6.3**	**10.5**	**10.4**	**11.2**	**12.8**	**11.7**

*Growth in corporate portfolio was about 10% YoY excluding net NPAs & restructured loans in Q3FY19

On the corporate front, the bank has increased the proportion of higher-rated loans in the incremental portfolio, reduced the concentration in its portfolio with incremental lending under a revised concentration risk framework and reduced the proportion of exposure to key sectors under stress. Besides, the bank has also strengthened its credit monitoring process by deploying state-of-the-art systems and analytical tools for effective monitoring and analysis of its portfolio. The bank is using analytics to develop early warning mechanisms for proactive monitoring.

Shift towards high rated and well-established corporates

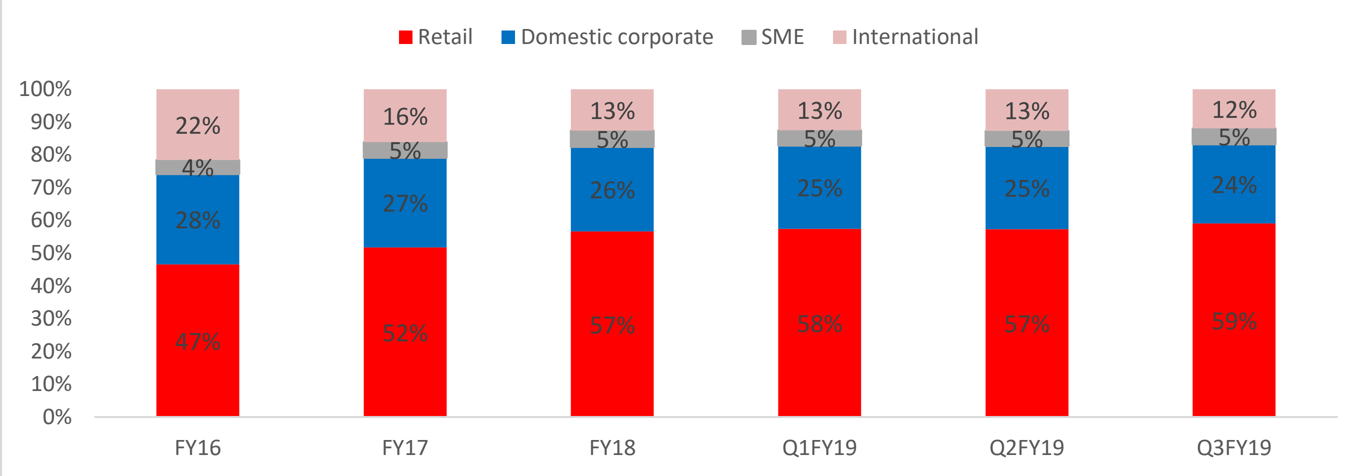
Rating category	FY16	FY17	FY18	Q1FY19	Q2FY19	Q3FY19
AA- and above (a)	30.6%	37.2%	42.4%	43.3%	44.7%	45.3%
A+, A, A- (b)	21.3%	19.0%	20.1%	20.0%	20.8%	21.0%
A- and above (a+b)	**51.9%**	**56.2%**	**62.5%**	**63.3%**	**65.5%**	**66.3%**
BBB+,BBB, BBB	27.8%	28.7%	27.5%	27.9%	27.5%	28.3%
BB and below	19.6%	14.6%	9.4%	8.1%	6.8%	5.2%
Unrated	0.7%	0.5%	0.6%	0.7%	0.2%	0.2%

Source: D&B Research, Company

Retail franchise strengthens; business metrics set to improve

With a robust branch network and constant investments in technology, we expect that the bank's Retail credit to grow at a CAGR of 20% over FY18-20E. Bank's management is continuously taking initiatives to de-risk its portfolio by adding granularity & by moving asset composition in favour of the retail segment (share of retail loans has increased to 59% in Q3FY19 from < 40% a few years ago). Focus on the retail segment will not only help the bank in stabilizing its asset quality but also improve profitability (through better margin and lower credit costs). The proportion of retail loans in the total loan portfolio is expected to increase, while the proportion of overseas loans is expected to decline.

Retail segment would remain the key driver of growth



Source: D&B Research, Company

Under the retail segment, business banking, credit cards and personal loans will grow at a higher pace due to their lower base, while home loans would continue to be the largest part of the portfolio. Credit cards and personal loans segments are having higher yields, which will go on to boost overall margins. These segments will primarily be driven by a focus on cross-selling to its existing customer base. Bank's credit card penetration in its own eligible customers is around 30%.

The recent liquidity crunch in the financial sector has been a credit-positive event for PVT Banks like ICICI Bank as it has given them an opportunity of low-risk growth. In last three quarters, Bank has bought retail loan portfolios, primarily home & vehicle loans, from NBFCs & HFCs of about Rs 68 billion.

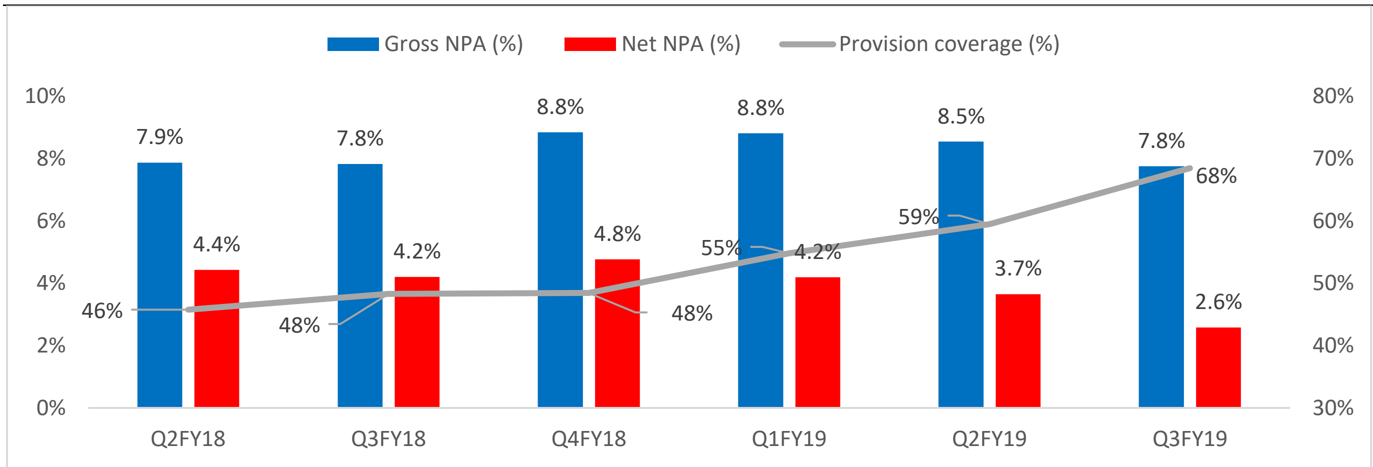
% of Total Retail/ Rs in billion	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Secured loans							
Home loans	54%	53%	53%	52%	52%	52%	51%
	1327	1384	1448	1501	1545	1608	1711
Vehicle loans	17%	17%	16%	16%	16%	16%	16%
	413	427	451	468	477	489	531
Business banking	4%	4%	4%	5%	4%	5%	5%
	94	107	121	135	132	155	171
Rural loans	15%	14%	14%	15%	14%	14%	14%
	368	366	390	433	427	436	463
Others	2%	2%	2%	2%	2%	2%	2%
	42	54	54	60	63	75	64
Unsecured loans							
Personal loans	6%	6%	7%	7%	8%	8%	8%
	151	166	185	209	223	251	278
Credit cards	3%	3%	3%	3%	3%	3%	3%
	81	83	90	94	103	105	114

Source: D&B Research, Company

Asset quality continues to improve; credit costs to reduce

In last few quarters, ICICI bank has reported significant improvement in its asset quality and its management is making sure that they do not repeat the same mistake by focusing on lending to higher rated well-established corporates & avoid concentration risk in its portfolio with incremental lending under a revised concentration risk framework. While the proportion of “A- and above” rated loans to total loans increased from about 52% at March 2016 to over 66% at December 2018, its proportion of “BB & below” rated loans to total loans declined from 19.6% to 5.2% at the same time. Exposure to top 20 borrowers and top 10 groups as a % of total exposure also improved from 13.3% and 18.5% at March 2016 to 11.5% & 13.7% at December 2018.

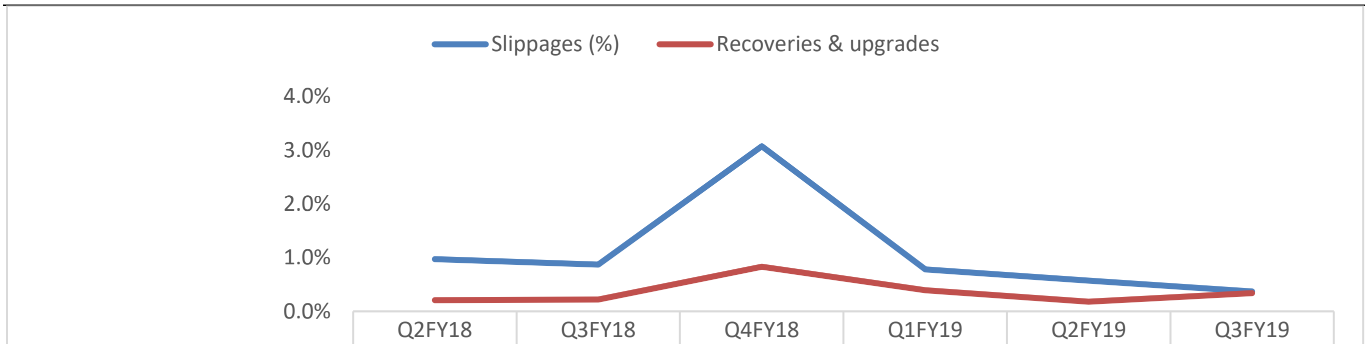
NNPAs dip led by lower slippages & higher provisioning



Source: D&B Research, Company

Bank’s gross NPAs stood at 7.75% as on Dec 31, 2018, which is moderated from 8.8% in Q4 FY18, but still it is higher than the average for private sector banks. Bank’s Net NPAs improved significantly from 4.8% in Q4FY18 to 2.6% in Q3FY19, while PCR increased from 48% to 68% at the same time. With additional buffers in terms of high capital levels, moderation in fresh addition to NPAs and expected resolution of a few large corporate NPAs referred to the IBC, overall pressure on bank's asset quality is likely to reduce over the medium term.

Slippages Plunged Sequentially



	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Slippages (%)	0.97%	0.87%	3.07%	0.78%	0.57%	0.37%
Recoveries & upgrades	0.21%	0.22%	0.83%	0.39%	0.18%	0.34%

Source: D&B Research, Company

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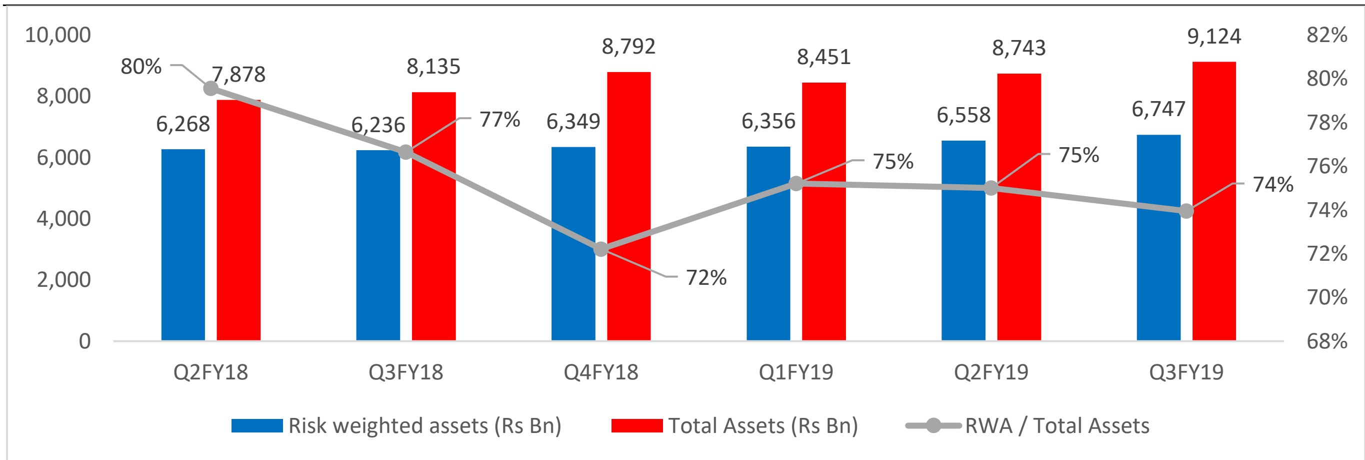
Net stressed pool declined to 6.8% of loans

Rs in billion	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Loan book	4,827.80	5,053.87	5,123.95	5,162.89	5,444.87	5,643.08
Break-up of stressed pool						
Gross NPA	**445**	**460**	**541**	**535**	**545**	**516**
BB and below outstanding	**274**	**253**	**133**	**246**	**218**	**188**
Gross restructured loans	20	18	16	14	14	4
Non-fund o/s to restructured loans	4	4	4	4	1	2
Non-fund o/s to Nonperforming loans	21	22	30	29	30	34
Drilldown list	196	191	47	44	33	0
Other loans under RBI schemes not included in drilldown list	32	18	22	19	19	0
Non-fund o/s to borrowers where S4A has been implemented	0	0	15	15	15	0
Other borrowers with o/s greater than Rs 1.00 bn	0	0	0	55	46	97
Other borrowers with o/s less than Rs 1.00 bn	0	0	0	67	59	51
Security receipts	**35**	**34**	**34**	**34**	**34**	**33**
Total stressed pool	**754**	**748**	**708**	**815**	**797**	**737**
Stressed pool to loans (%)	**15.6%**	**14.8%**	**13.8%**	**15.8%**	**14.6%**	**13.1%**
Non-NPA pool of stressed loans (%)	**5.7%**	**5.0%**	**2.6%**	**4.8%**	**4.0%**	**3.3%**
Net stressed pool	550	526	446	522	473	384
Net stressed pool to loans (%)	**11.4%**	**10.4%**	**8.7%**	**10.1%**	**8.7%**	**6.8%**

Source: D&B Research, Company

Lower RWA/total assets indicates better risk profile of incremental assets

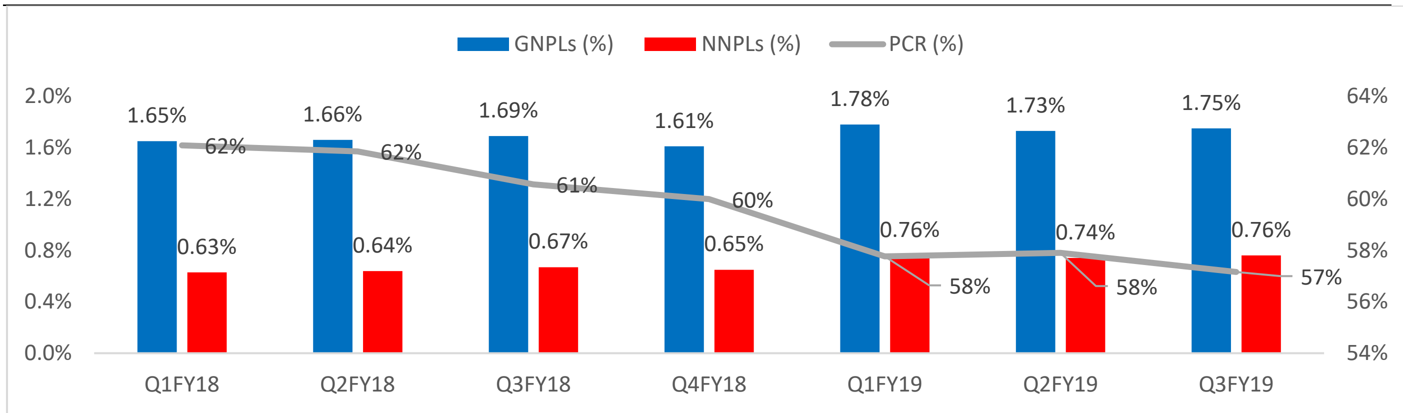


Source: D&B Research, Company

Asset quality remains stable in retail portfolio

Bank's retail portfolio has a stable asset quality, with adequate provisioning and better returns profile. Around 88% of retail portfolio is secure, while remaining 12% is unsecured, which includes Personal loans & Credit cards. In the last retail credit cycle, the risk of poor underwriting stems from a weak liability franchise as rising interest rates or falling margins force lenders to justify high risk-taking. However, with a strong liability franchise, ICICI bank can take the lower risk and same time deliver steady returns.

Stable Asset quality in retail portfolio

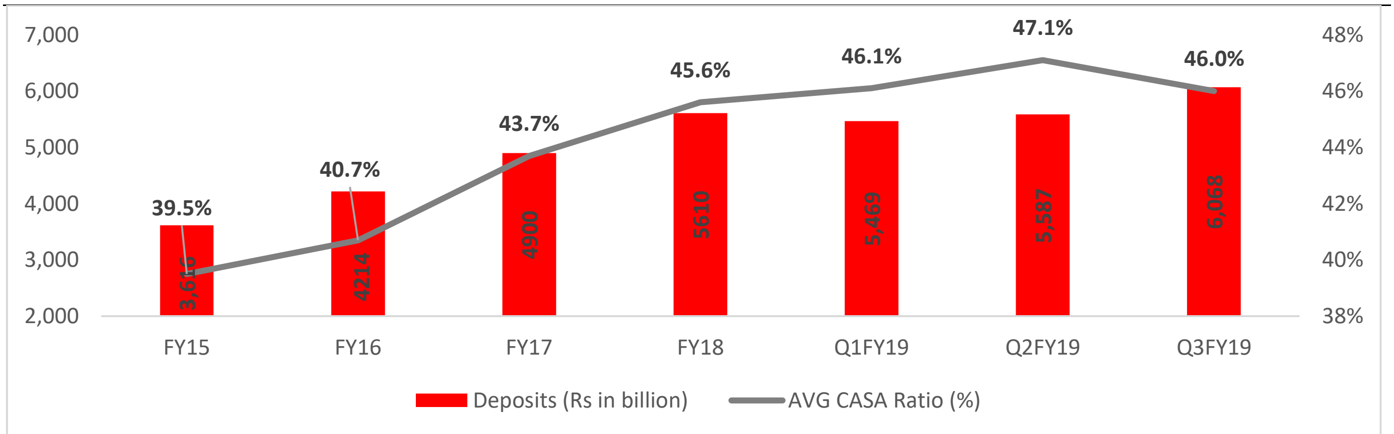


Source: D&B Research, Company

Superior liability franchise; scores one of the highest CASA ratio in industry

ICICI bank's liability franchise is relatively better than most of its peers, with average CASA ratio quoting at 46% of the total deposits in Q3FY19. In CASA share, the current account (CA) contributes Rs 886 Bn (14.6% of total deposits) and savings account (SA) contributes Rs 2108 Bn (34.7% of total deposits). Due to this strong CASA franchise, the bank has managed to keep their cost of deposits low (one of the lowest in financial space), which help the bank in a current tight liquidity environment. Going forward, in order to maintain stable CASA ratio, the bank will invest further in strengthening its franchise and will leverage technology to improve customer experience and operating efficiency. We don't expect that ICICI will increase deposit rates like certain new age banks that are acquiring new customers by hiking rates. Therefore, expansion into newer geographies will further drive SA growth.

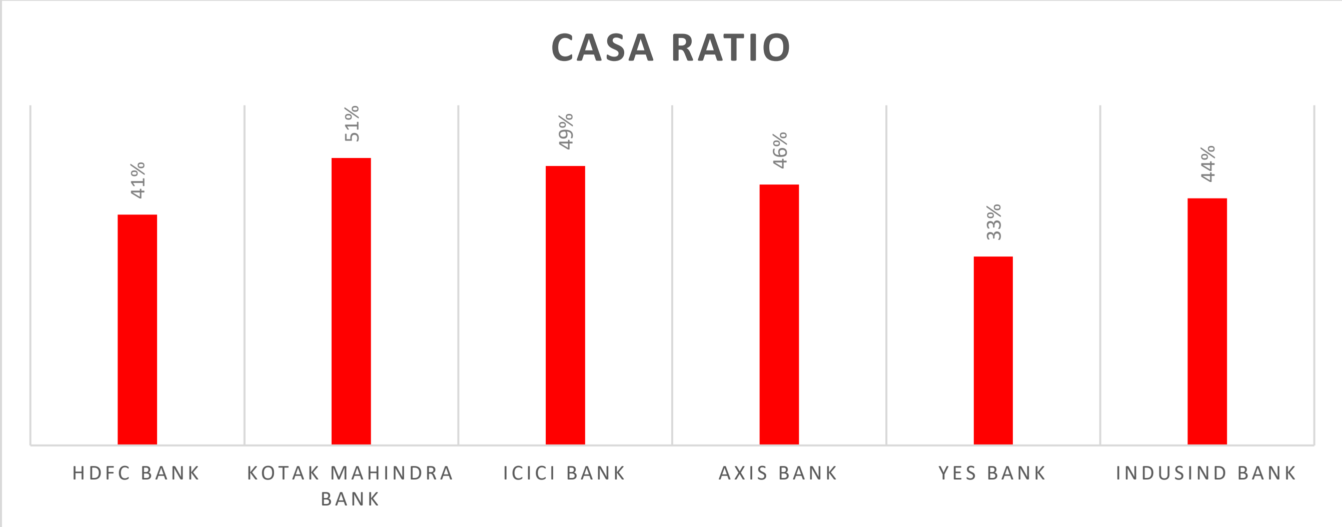
CASA Deposit Trend



Source: D&B Research, Company

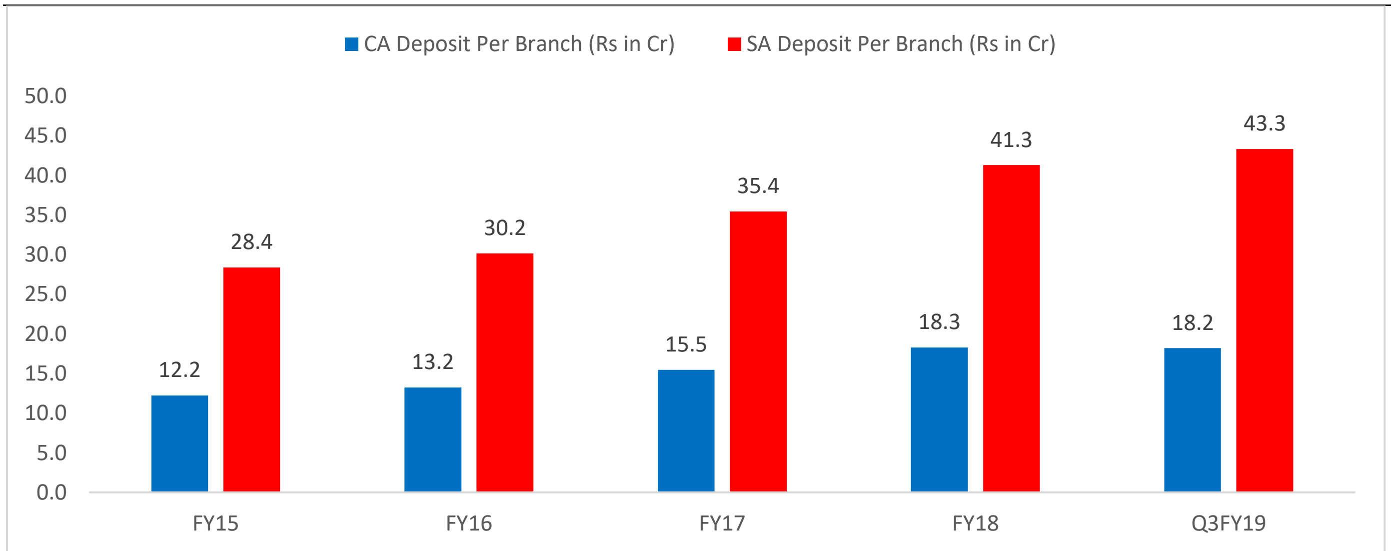
The bank is focused on maintaining its average CASA ratio at over 45% and the proportion of retail to total deposits at over 70%. Bank's average CASA ratio has improved from 39.5% in FY15 to 46% in Q3FY19, due to which cost of deposits declined from 6.18% in FY15 to 4.88% in Q3FY19. Cost of deposits is also declined due to a decrease in the cost of term deposits & savings deposits. In CY2017, Bank reduced its interest rate on SA deposits by 50 bps on deposits below Rs 5 million from 4% to 3.5%.

One of the highest CASA ratio in the industry



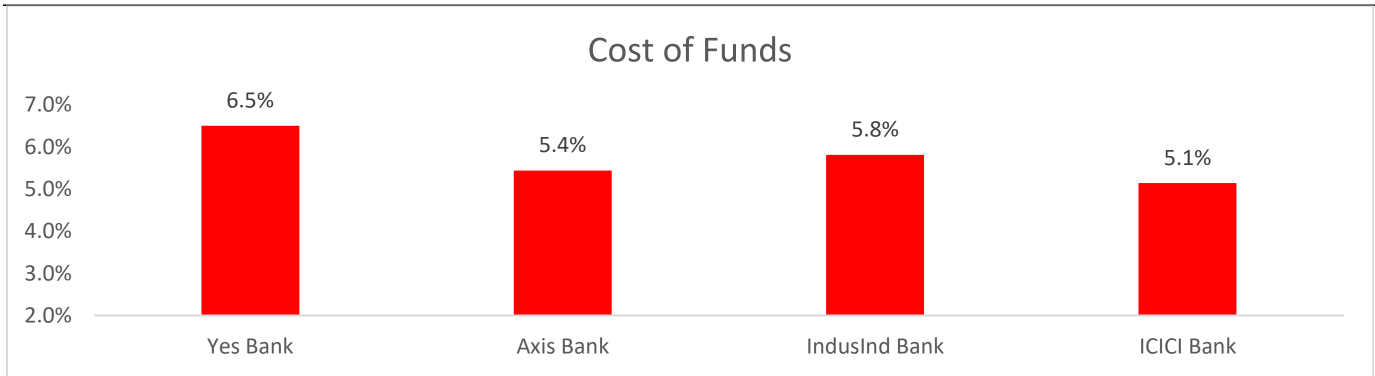
Source: D&B Research, Company

Improving branch efficiency; traction in CA and SA deposits Per Branch



Source: D&B Research, Company

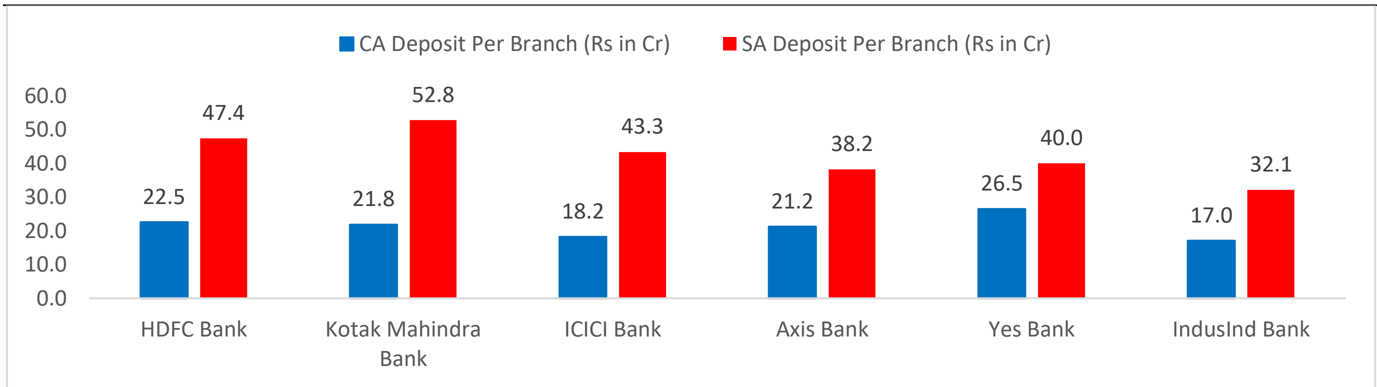
Cost of funds compared to peers



Source: D&B Research, Company

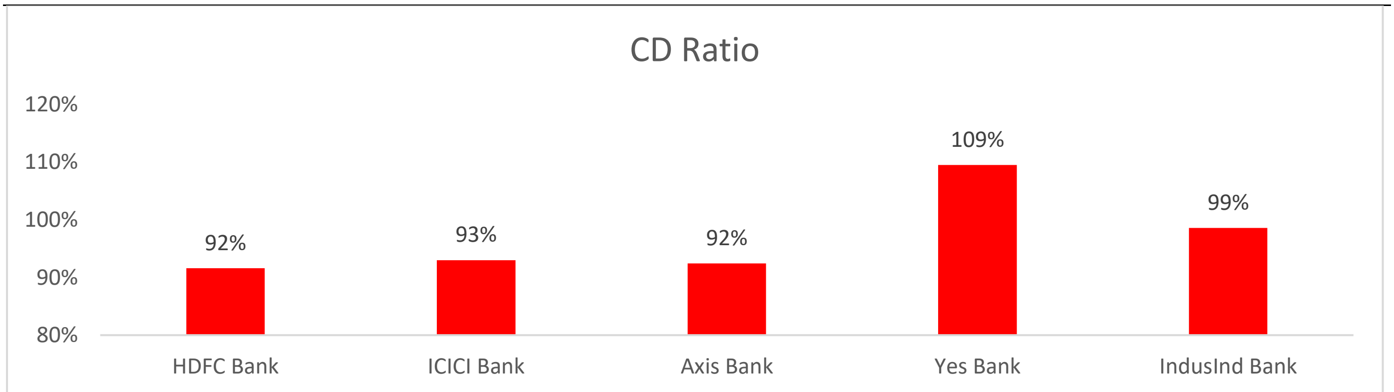
With a strong retail franchise across geographies, the bank is expected to maintain higher-than-industry-average CASA levels and thus will be able to maintain competitive funding cost over the medium term. Bank's robust deposit franchise & ability to mobilize deposits provide cushion to its liquidity profile along with its healthy rollover rate of deposits & excess SLR investments also provide comfort.

CA & SA deposits Per Branch compare to peers



Source: D&B Research, Company

Credit-to-Deposit ratio (CD ratio) compared to peers



Source: D&B Research, Company

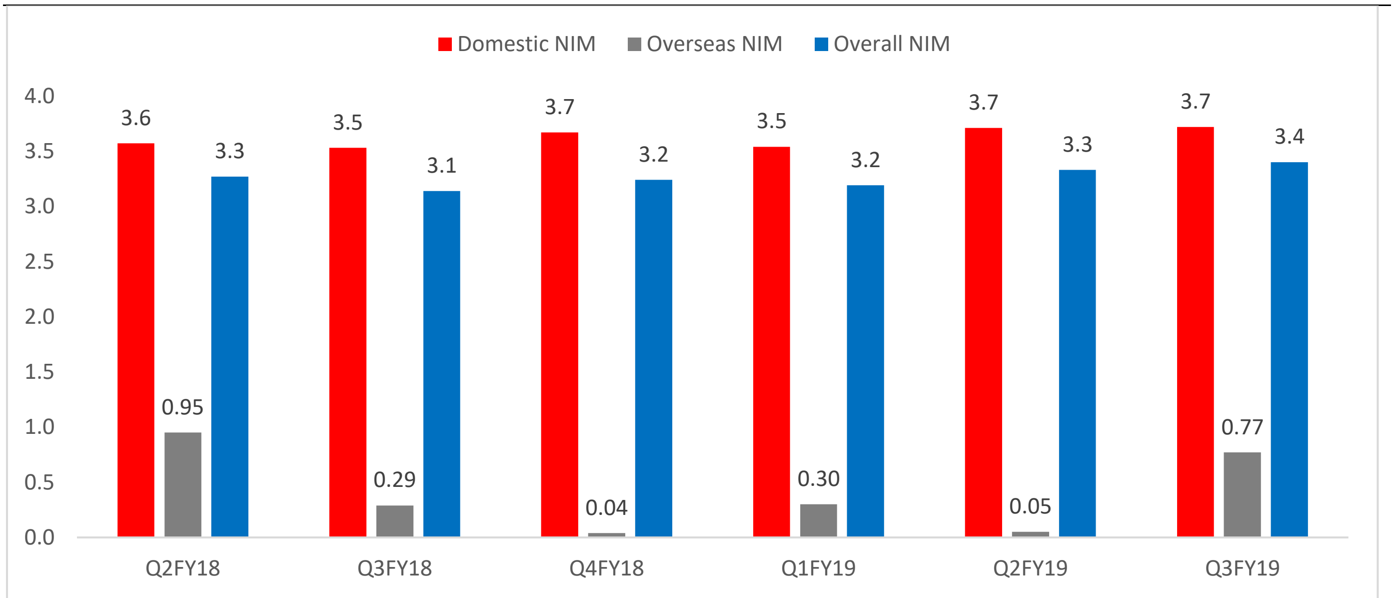
With relatively better CD ratio of 93% (as compared to 109% for Yes Bank, 99% for IndusInd Bank), healthy CASA momentum 18% CAGR over the last three years, increased granularity deposits (top 20 depositors constituted 6.2% in FY18 Vs 7.04% in FY17), bank is well positioned to tap the strong growth opportunities available in the banking space due to the vacationing of space by impaired PSBs.

In the past, most of the poor underwriting was done due to weak liability franchise coupled with falling NIMs, forced lenders to justify high risk-taking. A strong liability franchise has allowed ICICI to take lower risk and deliver steady returns.

Focus on improving operating efficiency

The bank is focused on improving operating efficiency, through steady growth in loan book, better cost management by offering technology-enabled services, approaching to new markets and stabilizing margins by increasing proportion of retail loans & reducing the proportion of overseas loans in the total loan portfolio. During 9M FY19, the bank's core operating profits grew by 13% YoY, though higher credit provisions & lower treasury income resulted in bank reporting 58% YoY declined in net profits. While NII for the bank grew at 14% YoY, its non-interest income primarily comprises fee income (transaction-based income & forex income) remained largely stable. Furthermore, the bank's overall margin faced pressure owing to interest reversals on slippages & declining overseas margins.

Stable domestic margin



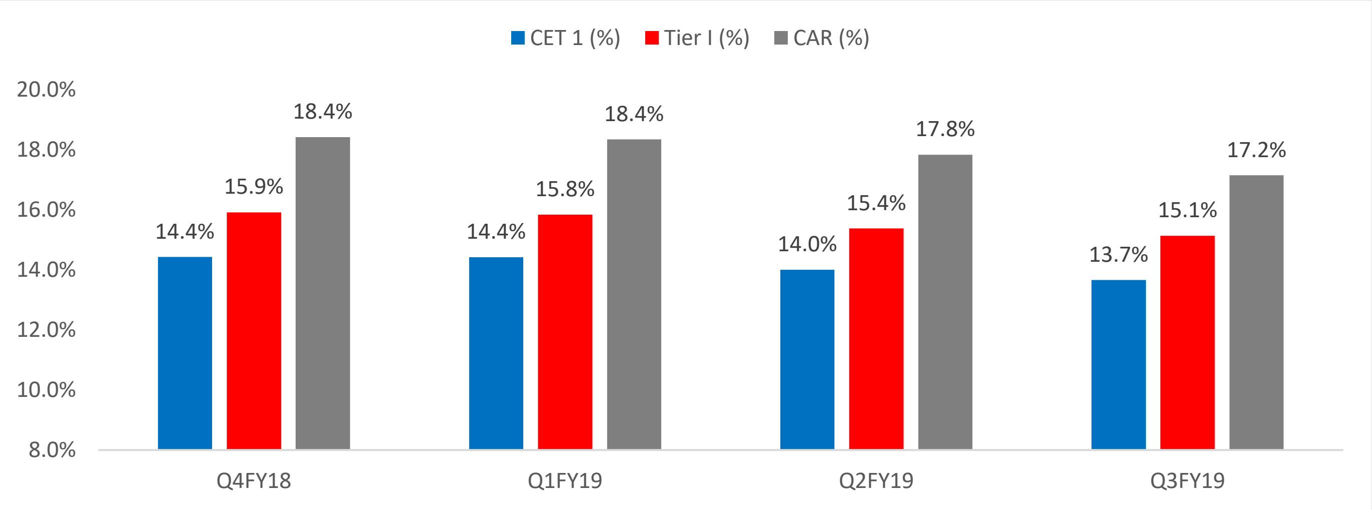
Source: D&B Research, Company

Going forward in short-term margins will remain volatile post shifting to external benchmarking for floating rate products. However, with lower slippages expected in FY20 thus resulting in the lower reversal of interest income, we expect that the bank's NIMs to improve from current levels. Bank's credit costs are expected to moderate in FY20 with lower incremental slippages.

Better capitalization to support credit growth

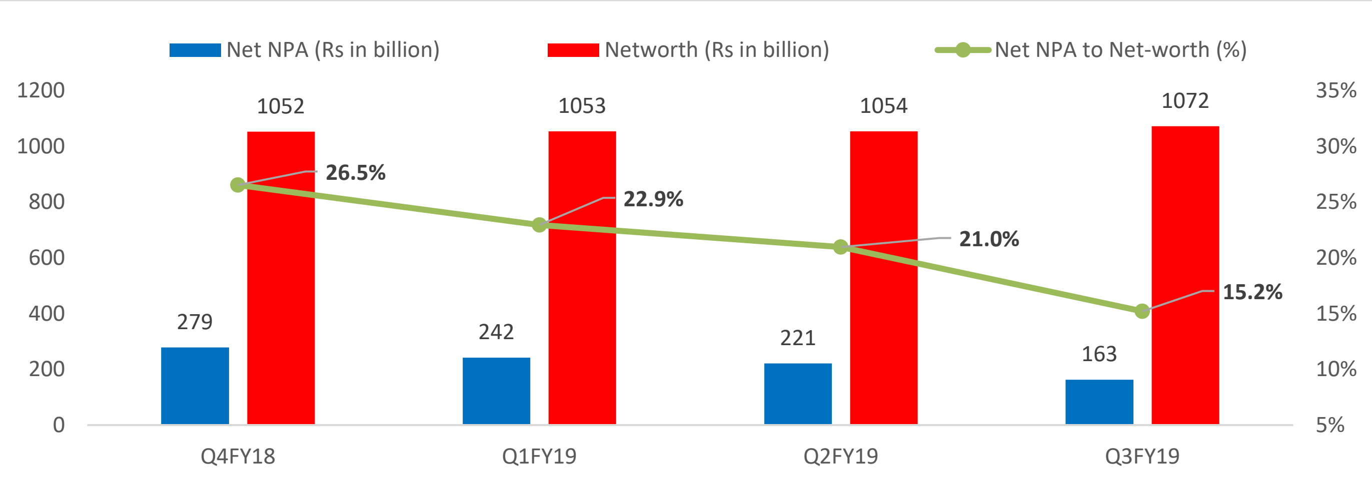
ICICI bank has maintained healthy capitalization levels, with CET I, Tier I and CRAR at 13.7%, 15.1% and 17.2% (as % of risk weighted assets) as on December 31, 2018. Bank has a strong track record of maintaining capital adequacy ratio higher than minimum regulatory requirements. Furthermore, Bank can raise additional capital through the sale of stakes in subsidiaries (already raised around Rs 155 billion in the last few years). With strong cash accrual & ability to raise capital, we believe that the bank has adequate resources to support incremental credit growth over the medium term.

Capital Cushion above the minimum regulatory requirements



Source: D&B Research, Company

Solvency ratio (net NPA to its net worth) to improve further

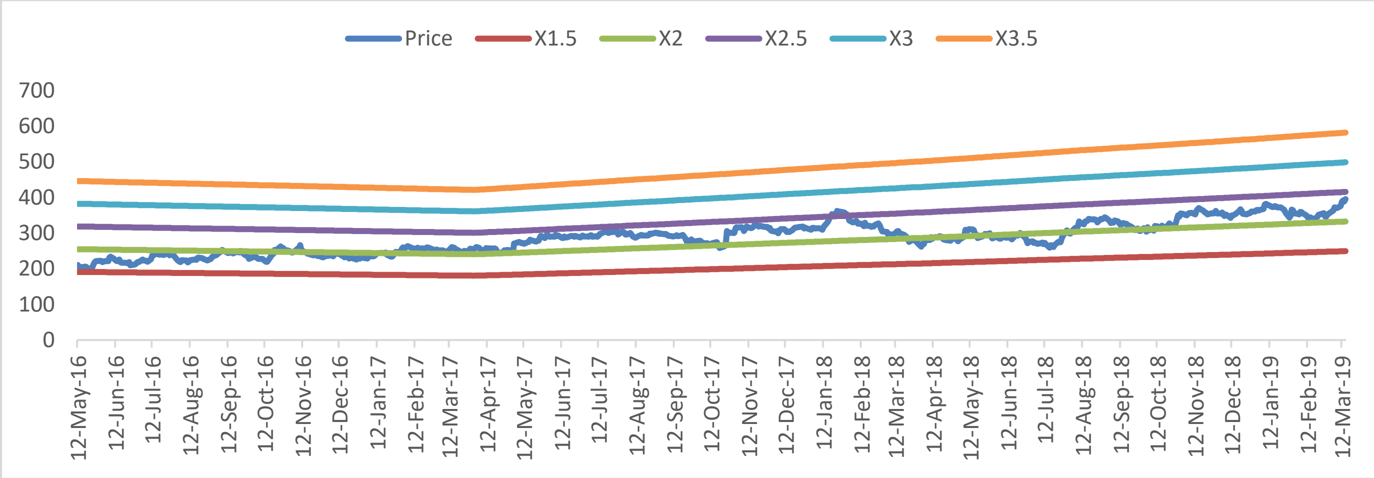


Source: D&B Research, Company

Valuation and outlook

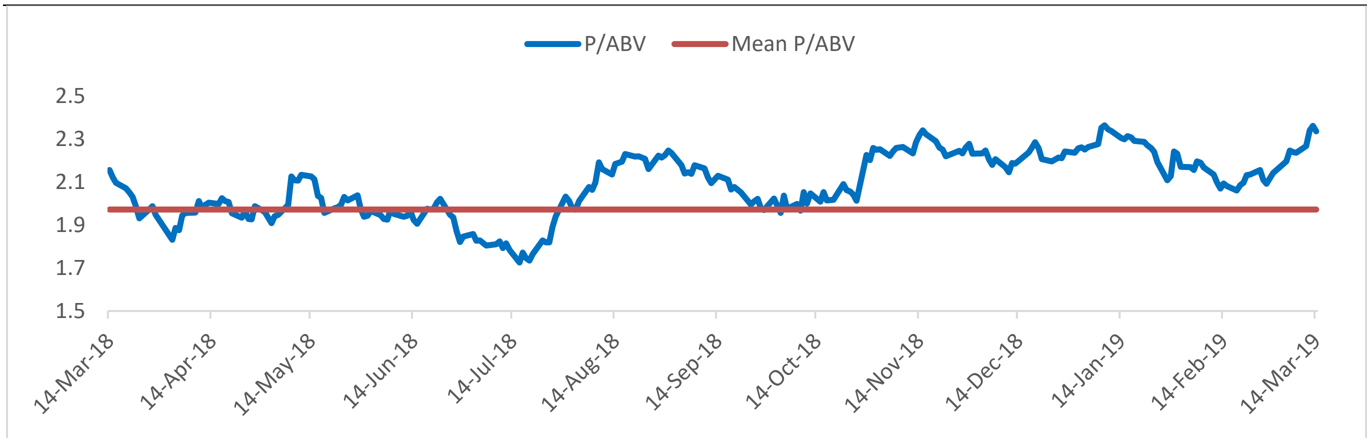
With lower incremental slippages, improving loan growth, superior liability franchise and revival in core operating profit, we believe ICICI bank is well positioned to tap the strong growth opportunities available in the banking space. We also believe that the Bank is closer to the end of the NPA recognition cycle, and therefore credit cost will start coming down meaningfully over the next few quarters. Thus, we have assigned a 'Buy' rating on ICICI Bank with a price target of Rs 461, valuing the stock at 1.9x FY21E standalone P/BV and ascribing a value of Rs 102 for subsidiaries.

P/BV 1 yr forward chart



Source: D&B Research, Company

P/BV 1 yr forward vs. Mean P/BV chart



Source: D&B Research, Company

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Initiating Coverage @ Dalal & Broacha

ICICI Bank

P&L (Rs Bn)	FY17	FY18	FY19E	FY20E	FY21E
Interest Earned	**542**	**550**	**627**	**730**	**867**
Interest Expended	324	319	363	417	492
NII	**217**	**230**	**263**	**313**	**375**
Other Income	195	174	150	170	192
Net Income	**412**	**404**	**414**	**483**	**567**
Operating Expenses	148	157	176	197	224
Emp. Exp	57	59	68	76	87
Other Opex	90	98	107	120	137
PPoP	**265**	**247**	**237**	**285**	**340**
Provisions & Contingencies	152	173	189	96	96
PBT	**113**	**74**	**47**	**189**	**243**
Tax	15	7	8	51	68
PAT	**98**	**68**	**39**	**138**	**175**

Balance sheet (Rs Bn)	FY17	FY18	FY19E	FY20E	FY21E
Liabilities					
Capital +	12	13	13	13	13
Reserves & Surplus +	988	1039	1071	1184	1328
Deposits +	4900	5610	6440	7534	8861
Borrowings +	1476	1829	1646	1777	1918
Other Liabilities	342	302	386	482	578
TOTAL	**7718**	**8792**	**9555**	**10990**	**12697**
ASSETS					
Cash & Bank+	757	842	845	849	914
Investments +	1615	2030	2108	2569	3068
Advances +	4642	5124	5798	6660	7695
Fixed Assets +	78	79	81	89	97
Other Assets +	625	717	723	824	923
TOTAL	**7718**	**8792**	**9555**	**10990**	**12697**

Ratios (%)	FY17	FY18	FY19E	FY20E	FY21E
Growth					
NII	2.4	5.9	14.4	19.0	19.6
PPOP	11.0	-6.6	-4.4	20.4	19.4
Net profit	0.8	-30.9	-42.1	251.4	27.1
Deposits	16.3	14.5	14.8	17.0	17.6
Advances	6.7	10.4	13.2	14.9	15.5
Returns					
ROA	1.3	0.8	0.4	1.3	1.5
ROE	10.3	6.6	3.7	12.1	13.8
Asset quality					
GNPA	8.8	9.9	7.7	5.2	4.4
NNPA	5.4	5.4	2.8	1.9	1.6

Ratios (%)	FY17	FY18	FY19E	FY20E	FY21E
Yield and Cost Ratios					
Cost of Deposit	5.0	4.5	4.5	4.6	4.7
Cost of funds	5.3	4.6	4.7	4.8	4.9
Yield on advances	8.8	8.4	8.7	8.9	9.0
NIM	3.2	3.1	3.1	3.3	3.4
C/I ratio	35.8	38.8	42.8	41.1	40.0
Valuation					
BV (Rs)	172	164	168	186	208
ABV (Rs)	167	159	166	184	206
EPS (Rs)	17	11	6	22	27
P/ABV (x)	2.3	2.4	2.4	2.1	1.9
P/EPS (x)	24	38	65	19	15

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