AXIS DIRECT

ICICI BANK

BANKS & FINANCIAL SERVICES

09 OCT 2017 | Visit Note

BUY

Target Price: Rs 350

Near-term concerns to prevail

We met the management of ICICI Bank (ICICIBC) to get insights of the business and outlook on asset quality. Overall loan growth will remain soft due to run-down of overseas portfolio (15% in Q1FY18 vs. 24% in Q1FY16) but robust growth in retail/SME will keep domestic loan growth strong. Decline in overseas portfolio should bottom out in Q3 while retail/SME should continue to grow at 15%+ in coming quarters.

Incremental lending at lower yields and transition to MCLR should keep margin under pressure but expect to maintain it at +3%. Slippages in FY18 to be significantly lower vs. FY17 and should largely follow from the drilldown list while those outside the list should be limited to a couple of lumpy accounts. However, credit costs are likely to stay elevated due to ageing of NPAs and RBI directive to upfront provisions on cases referred to NCLT and select stressed sectors. **Maintain BUY.**

CMP	: Rs 283
Potential Upside	: 24%

MARKET DATA

No. of Shares	: 6,416 mn
Free Float	: 100%
Market Cap	: Rs 1,814 bn
52-week High / Low	: Rs 315 / Rs 217
Avg. Daily vol. (6mth)	: 18.2 mn shares
Bloomberg Code	: ICICIBC IB Equity
Promoters Holding	: 0%
FII / DII	: 36% / 30%

Key highlights – Credit costs unlikely to wane in FY18

- Softer **loan growth** will continue due to run-down of overseas portfolio but strong traction in retail (18-20% YoY growth) and SME (15-18% YoY growth) segments will lead to higher-than-industry growth in the domestic portfolio
- **Margin** will be under pressure, as the entire loan book migrates to MCLR, higher rated corporates gain focus and repricing of existing loan at lower rates, but the management expects it to maintain it above 3%
- **Slippages** will be significantly lower in FY18 (Rs 335 bn in FY17) but **credit costs** (~320 bps in FY17) will stay elevated due to ageing of NPAs and RBI directing banks to upfront provisions on select cases

Maintain BUY with SOTP based TP of Rs 350: We derive comfort from expected resolution of lumpy assets in steel sector, expectations of lower slippages, rising share of domestic retail business and one-off listing gains from ICICI Lombard IPO and further stake sale of ICICI Pru Life/Home Finance materializing in coming quarters. ICICIBC is trading at 1.2x FY19 P/ABV (adjusted for cost and value of subsidiaries). Maintain BUY with SOTP based TP of Rs 350.

Financial summary (Standalone)

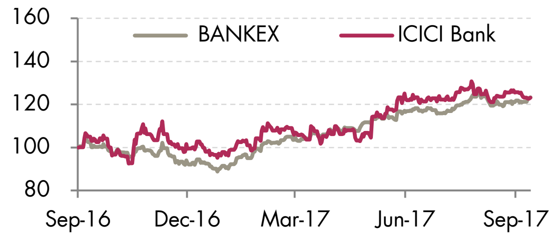
Y/E March	FY16	FY17	FY18E	FY19E
PAT (Rs bn)	97	98	116	133
EPS (Rs)	17	17	18	21
EPS chg (%)	(13.2)	0.6	7.9	14.8
Book value (Rs)	149	166	168	185
Adj. BV (Rs)	135	138	143	162
PE (x)*	10.4	10.4	9.6	8.4
P/ABV (x)*	1.6	1.5	1.4	1.2
RoE (%)	11.8	10.7	11.4	11.8
RoA (%)	1.4	1.3	1.4	1.5
Net NPA (%)	3.0	5.4	4.6	3.9

Source: Company, Axis Capital
Note: ABV includes cost of investments
*P/E and P/ABV excludes value & cost of subsidiaries

Key drivers (%)

	Q2'17	Q3'17	Q4'17	Q1'18
Loan growth	11	5	7	3
NIM	3.1	3.1	3.6	3.3
GNPA Ratio	6.8	7.9	8.7	8.8

Price performance

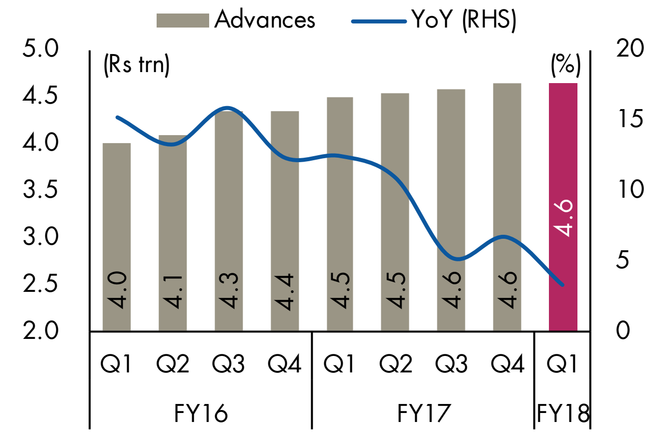


Contraction in overseas book to keep overall loan growth soft

- Bank's loan growth over past few quarters has turned weak due to rationalization in overseas book and lack of funding opportunities on the corporate side
- However, strong growth in retail and SME segments has enabled the bank's domestic book to grow ~2x the industry average
- Management believes overseas portfolio should continue to decline by ~20% YoY in Q2FY18 as well but should bottom out in Q3FY18, as base effect comes into play; however focus to remain limited on increasing overseas exposure
- Rationalization of overseas book complements ICICIBC's objective of increasing the proportion of domestic loans, improving the portfolio mix through lending to retail and higher rated corporate borrowers, and reducing concentration risk
- Strong traction in retail and SME should continue with 18-20% and 15-18% growth expected in these portfolios
- Management is reasonably comfortable with the rate at which the unsecured retail portfolio is growing and, this traction should continue

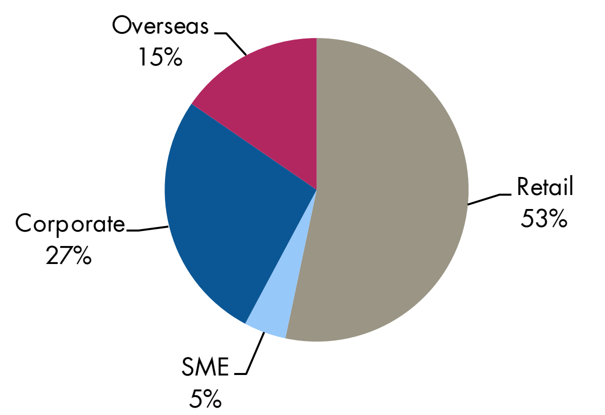
Retail/SME segments should continue to grow at 15%+

Exhibit 1: Overall loan growth to remain soft …



Source: Company, Axis Capital

Exhibit 2: … due to decline in overseas book, whose share has declined from 24% to 15% over the last two years



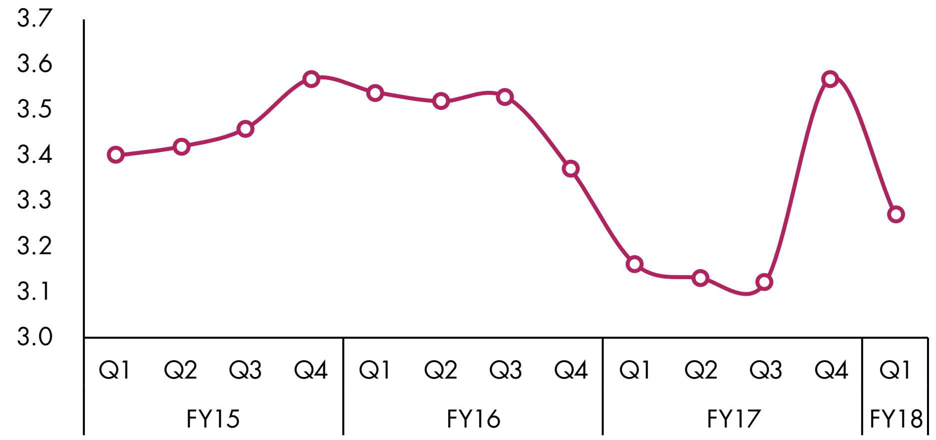
Source: Company, Axis Capital

Near term margin outlook remains challenging

- Management highlighted refinancing rates have come down sharply and incremental lending has been at highly competitive rates (~50-100 bps lower than previous rates)
- At present, ~70% of domestic loan book is on floating rate and 56% of these loans are linked to MCLR; hence, migration of loans to MCLR regime to keep pressure on yields
- Margin will reel under pressure, as more loans migrate to MCLR, higher rated corporates gain focus, incremental lending spreads remains tight and repricing of existing loan happen at lower rates
- Since the impact of fresh slippages will be limited and that the bank has recently reduced deposit rates, the management is confident of maintaining NIM at +3% in FY18

Margin will reel under pressure due to refinancing at lower yields and loans migrating to MCLR regime

Exhibit 3: Expect NIM to remain under pressure in FY18



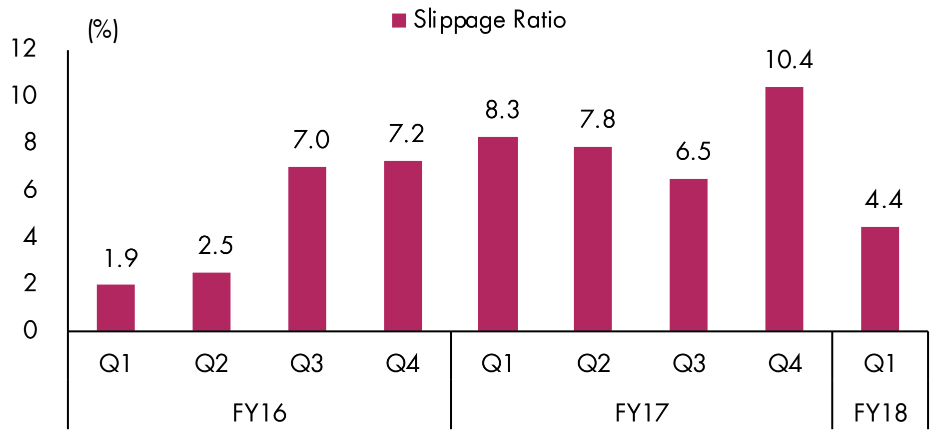
Source: Company, Axis Capital

Slippages could wane but credit costs likely to stay elevated

- Fresh slippages in FY18 could be significantly lower than that in FY17 (Rs 335 bn) and should largely come from its drilldown list
- Barring slippages, management expects repayments and upgrades to drive further reduction in its drill down list (Rs 204 bn in Q1FY18)
- However, management does not expect any significant reduction in provisions owing to ageing of NPAs and RBI asking banks to upfront provisions on exposure to NCLT cases and certain stressed sectors (telecom)
- Collections in its rural financing portfolio has been impacted somewhat

Fresh slippages in FY18 could be significantly lower but provisions will remain high

Exhibit 4: Slippages in FY18 to be significantly lower than FY17



Source: Company, Axis Capital

Exhibit 5: Sum of the parts valuation

SOTP	Valuation basis	ICICI stake	Value per share (Rs)
JVs			
ICICI Prudential Life Insurance	At CMP	55%	39
ICICI Lombard General Insurance	25x FY19E P/E	56%	24
ICICI Prudential AMC	5% of AUM	51%	10
Value per share from JVs			*74*
Domestic subsidiaries			
ICICI Securities Ltd.	15x FY19E earnings	100%	12
ICICI Home Finance	2.5x FY19E BV	100%	7
Value per share from Domestic Subs.			19
Overseas banking subsidiaries			
ICICI Bank UK	1.5x trailing BV	100%	7
ICICI Bank Canada	1.5x trailing BV	100%	8
Value per share from Overseas Subs.			15
ICICI Bk (Standalone business)	1.7x FY19E ABV		242
Value per share of ICICI Bank			350

Source: Axis Capital

Financial summary (Standalone)

Profit & loss (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Interest earned	527	542	572	622
Interest expended	(315)	(324)	(344)	(369)
Net interest income	**212**	**217**	**228**	**253**
Non interest income	153	195	169	187
Net income	**365**	**412**	**397**	**441**
Operating expenses	**(127)**	**(148)**	**(157)**	**(170)**
Staff expenses	(50)	(57)	(60)	(64)
Other operating expenses	(77)	(90)	(97)	(106)
Operating profit	**239**	**265**	**239**	**271**
Provisions & contingencies	(117)	(152)	(98)	(98)
Pre-tax profit	**122**	**113**	**142**	**172**
Tax expense	(25)	(15)	(26)	(40)
Profit after tax	**97**	**98**	**116**	**133**
Extraordinary item	-	-	-	-
Minority interest/Associates	-	-	-	-
Adj. PAT	97	98	116	133

Balance sheet (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Total assets	**7,207**	**7,718**	**8,241**	**8,926**
Cash & Balances with RBI	599	757	713	697
Investments	1,604	1,615	1,684	1,745
Advances	4,353	4,642	5,101	5,705
Fixed assets	76	78	84	87
Other assets	576	625	658	691
Total liabilities	**7,207**	**7,718**	**8,241**	**8,926**
Equity capital	12	12	13	13
Preference capital	-	-	-	-
Reserves & surplus	857	957	1,054	1,165
Networth	869	969	1,067	1,177
Borrowings	1,748	1,476	1,421	1,404
Deposits	4,214	4,900	5,370	5,936
Other liabilities & prov.	347	343	352	378

Source: Company, Axis Capital

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
Per share data				
FDEPS (Rs.)	17	17	18	21
BV (Rs.)	149	166	168	185
Adj. BV (Rs.)	135	138	143	162
DPS (Rs.)	5	-	3	3
Dividend payout (%)	30	-	14	14
Yields & Margins (%)				
Yield on advances	9.5	8.8	8.7	8.6
Cost of deposit	5.5	5.0	5.0	4.9
Net interest margin	3.5	3.3	3.2	3.3
Asset quality (%)				
Gross NPAs	5.8	8.8	8.0	7.5
Net NPAs	3.0	5.4	4.6	3.9
Credit cost	1.7	3.2	1.8	1.3
Provisioning coverage	50.6	40.2	45.0	50.0
Capital (%)				
Tier-I	13.1	14.4	14.0	13.3
CAR	16.6	17.4	16.8	15.8
Efficiency (%)				
ROA	1.4	1.3	1.4	1.5
ROE	11.8	10.7	11.4	11.8
Cost to income	35	36	40	39
CASA	46	50	49	48
Effective tax rate	20	13	19	23
Growth (%)				
Net interest income	11	2	5	11
Fee income	8	(4)	26	10
Operating expenses	10	16	7	8
Profit after tax	(13)	1	18	15
Advances	12	7	10	12
Deposits	17	16	10	11
Total assets	12	7	7	8

Source: Company, Axis Capital

Note: ABV includes cost of investments

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Research Team

Sr. No	Name	Designation	E-mail
1	Hiren Trivedi	Research Associate	hiren.trivedi@axissecurities.in
2	Kiran Gawle	Associate	kiran.gawle@axissecurities.in

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DEFINITION OF RATINGS	
Ratings	Expected absolute returns over 12-18 months
BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

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