ICICI Bank

Mixed quarter, but well poised to ride over crisis

Sector: Banks & Finance
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 338**	
Price Target: **Rs. 454**	↓

↑ Upgrade ↔ No change ↓ Downgrade

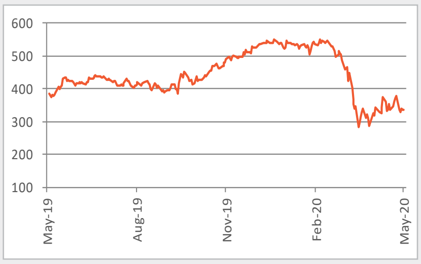
Company details

Market cap:	Rs. 2,18,670 cr
52-week high/low:	Rs. 552/269
NSE volume: (No of shares)	181.1 lakh
BSE code:	532174
NSE code:	ICICIBANK
Sharekhan code:	ICICIBANK
Free float: (No of shares)	647.3 cr

Shareholding (%)

Promoters	0.0
FII	43.7
DII	44.6
Others	11.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.9	-36.8	-31.0	-12.3
Relative to Sensex	0.0	-14.0	-9.5	3.2

Sharekhan Research, Bloomberg

ICICI Bank posted mixed numbers for Q4FY20 in these tough times, wherein operating performance was largely in line, but large provisions (partly due to one large account and COVID-19) resulted in lower-than-expected PAT. Net Interest margin (NIM) improved to 3.87% levels and sequential improvement in asset quality was also positive, though elevated slippages were dampeners. Net interest income (NII) increased by 17% y-o-y to Rs. 8,927 crore and were in-line with expectations. Profit after tax (PAT), at Rs. 1,221 crore, declined by 70% q-o-q, but rose by 26% y-o-y (still below expectations). Provisions jumped to Rs 5967 crores, due to higher COVID-19 related provisions pertaining of Rs. 2725 crore (was in excess of RBI requirements). Smart improvements in net interest margin (NIM) at 3.87% in Q4 FY2020 (improved by 10 bps q-o-q and 15 bps y-o-y). Most importantly, the GNPA/ NNPA ratio (as a percentage of gross advances) decreased by 35 bps/ 6 bps, respectively, to 6.04% / 1.54% vis-à-vis Q3FY20. While elevated slippages were a concern, almost the entire corporate slippages, which emerged from outside the 'BB and below' book were due to two overseas accounts (one in healthcare, another oil trading firm) with no India linkages. These two accounts have been substantially provided for and no further P&L impact is expected due to them as per the management. The bank is adequately capitalized (CET-1 at 13.4%) and the management has not indicated equity raising plan for the near term. We believe that while ICICI Bank is being prudent, COVID-19 is likely to impact both growth and credit costs for the banking sector as a whole and ICICI Bank is no exception. The management indicated that the COVID-19 impact on the economy is likely to be prolonged and considerable challenges now exist for players across the board. We are cutting our estimates and target multiple considering the dynamic environment. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 454.

Key positives

- Domestic loan growth was decent at 13% y-o-y, driven by retail loans (up by 16% y-o-y) and the high yielding retail business (including Non Fund Based outstanding) now comprises of 63% of the total portfolio.
- Fee income growth was in line with advances, even though the latter part of Q4 (where typically third party sales are high) was truncated due to the lockdown indicates business strength.
- A provision coverage ratio (including cumulative technical write-offs) of 86.8% on NPAs and Provision buffer of Rs. 2,725 crore are notable.

Key negatives

- Gross slippages remained high at Rs 5,306 crore which was a dampener.
- Around 30% of borrowers by value have opted for moratorium benefit. While these are early days, the proportion is significant and the performance of the portfolio will be a key monitorable.

Our Call

Valuation - For ICICI Bank, we use the sum-of-the-parts (SOTP) methodology, where we value the standalone bank at ~1.6x its FY2022E BV and rest of the subsidiaries at ~Rs 118 per share. We believe valuations are reasonable, considering the overall franchise value as a whole and strong capitalisation and a high provision coverage ratio (PCR) are comfort factors. However, for the near term, we believe the impact of COVID-19 pandemic may prolong demand recovery and earnings normalization phase. Hence, we have accordingly cut our estimates for FY21E and FY22E due to the Covid 19. At present valuations, it is at a reasonable entry point for long term investors. We maintain our Buy rating on the stock with a revised price target of Rs. 454.

Key Risks

Slowdown in consumer spending and higher slippages due to COVID-19 vulnerabilities and slippages from the corporate book (especially from BB and below-rated portfolio) could impact earnings outlook.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E
Net Interest Income (NII)	27,015	33,267	34,647	38,264
Net profit (Rs cr)	3,364	7,931	13,931	17,248
EPS (Rs)	5.2	12.3	21.5	26.6
P/E (x)	65.0	27.7	15.8	12.7
BVPS (Rs)	162.5	174.3	193.5	216.7
P/BV (x)	2.1	1.9	1.8	1.6
RoE (%)	3.1%	7.1%	11.4%	12.6%
RoA (%)	0.4%	0.8%	1.1%	1.2%

Source: Company; Sharekhan estimates

ICICI Bank – Key Concall Highlights:

- **COVID -19 impact and response:** ~ 97% of the bank's branches were functional and functioned with reduced working hours during the lockdown. March was impacted, but the first two months of 2020 were normal.
- **Technology initiatives:** In March 2020, the bank launched a comprehensive digital banking platform called ICICI STACK, which offers nearly 500 services to ensure uninterrupted banking experience to its retail, business banking, SME and corporate customers.
- **Slippages:** Almost the whole of corporate slippages that emerged from outside the BB and below-rated book is due to two overseas accounts with no India linkages. One account was in the healthcare sector and another was an oil trading account in West Asia. These two accounts have been substantially provided for and no further P&L impact is expected due to them.
- **Overseas book:** Around 63% of this book comprises Indian entities, while another ~16% is to non-Indian but India-linked entities and around 7% is to entities of NRI / PIO-linked entities. About ~14% is to entities with no linkage to India. The bank plans to cut down exposure to the entities with no linkage to India. This "local" portfolio has been reduced 30% y-o-y but more could have been done. As such, the management feels there is not a major concern on this portfolio right now.
- **Commercial Real estate (CRE):** The Commercial real estate (CRE) is about 3% of total loan book. About 12% of this book is to builders rated BB and below or which are already NPA. Hence most of the stressed book already reflected in the Watchlist.
- **NBFC book:** NBFC book is about 5% of loan book. Only about 2% of this book is in BB and below or NPA bucket. Bank's exposure is largely to well-rated entities with long vintage, PSUs, and entities owned by banks and well-established corporate groups.
- **BB and below book:** The downgrades into BB and below book were granular in nature. A few emerged from the CRE sector. Apart from an account each in the telecom, power and construction sector, all other accounts were of ticket size of < Rs. 60 crores.
- **RBI moratorium:** Opt-out option was provided to specific segments in the retail lending business viz, commercial vehicle loans, certain rural loans and two-wheeler loans. These segments contribute about 11% to the total loan book and displayed a higher than average participation in the moratorium.
- **Moratorium value and present status:** The proportion, in value terms, of the overall loan book that was given / opted for moratorium amounted to about 30% as of end-April. The moratorium participation is generally well spread across segments with no segment having a high or low participation. The exposure of accounts that did not slip into NPA as of March end, due to the RBI moratorium amounted to Rs. 1309 crore, implying a benefit of 18 bps to GNPA Ratio. On these loans, the Bank has made provisions equivalent to that on NPA accounts.
- **Provisions:** The total provision pertaining to COVID-19 was Rs. 2,725 crore which was in excess of the RBI requirement. The RBI provision needed (on accounts that would have turned NPA as of March 31, but did not due to moratorium) was Rs 605 crore (if 5% provision cover is considered). No benefit was taken from the relaxation to RBI's June 7, 2019 Circular. Around Rs. 7,940 crore worth of balance sheet provisions are not being considered towards the calculation of PCR.
- **Retail asset quality:** Bank had been tightening the retail lending under-writing standards even further after the advent of COVID-19.
- **Unsecured book:** The bank has grown this portfolio from a low base primarily through cross-sell. Around 70% of personal loan (PL) and credit cards (CC) book is to existing customers. Nearly 85% of unsecured consumer finance customers are salaried. Of the salaried customers, 75% are ultra-safe MNC and government employees. Non-salaried customers only have a marginally higher delinquency level that the salaried customers. Salaried customers working in the segments acutely impacted by COVID-19 such as restaurants, travel and tourism is low. The bank has reduced pre-approved limits in the credit card business. The bank, as such, is not worried about their unsecured book any more than their secured book.
- **Self employed, under the unsecured book:** The self-employed segment in these portfolios is ~ 25% and while this segment could be more impacted in the current environment, the proportion of customers in highly impacted sectors like restaurants and travel and tourism is low.

- **Business Banking:** The average ticket size of this book is Rs 1-1.5 crore. The delinquency on this book has been fairly low till March 31. The bank expects this portfolio to behave well but admitted the COVID-19 situation is an unprecedented event and thus there are vulnerabilities that may emerge.
- **Home loans and mortgage loans:** Home loans (~ 70% of mortgage portfolio) are granular in nature with average ticket size of about Rs. 30 lakh. It is geographically well-diversified and has been built on fundamental premises of cashflow assessment of underlying borrower. The average LTV ratio of the home loan portfolio is about 65%. The share of under-construction properties in the home loan book is broadly in line or lowers than the market average. Around 70% of the mortgages book is home loans while the rest are loans against property (LAP).
- **LAP book:** The LAP portfolio (~30% of the mortgage portfolio) has conservative LTV ratios (averaging ~55%) and lending is based on cash flows of business/individuals with limited reliance on the value of collateral. The valuation of the property is carried out internally.
- **Liquidity:** Daily average liquidity coverage ratio (LCR) has been maintained at 125%. Period-end LCR is higher than this.
- **Cost of deposits:** The bank's retail term deposit rates are the lowest among private sector banks. Only a large PSU bank has even lower term deposit rates.
- **Margin Guidance:** Typically, maintenance of high liquidity will impact margins (Daily average LCR has been maintained at 125%). Also, MCLR has been decreased by 25 bps and the lack of loan demand will also affect business. The shift from MCLR to external benchmark is margin-dilutive for the bank at this point in time. Because of the Covid crisis, achieving ROE target of 15% is likely to be elongated.
- **Fee and other income:** Dividend income from insurance subsidiaries would be NIL in FY21 as per IRDAI recommendation.
- **Operating expenses:** Employee expenses have jumped due to pension provisioning increased due to yield decline. No incremental hiring is taking place. Absolute variable cost is primarily related to sourcing and is not huge. Semi-variable cost, however, can be lowered with operational tweaks.
- **Agri and Microbanking:** Gold loans are about 2% of the loan book. KCC (Kisan Credit Card) forms about 3% of the loan book. Exposure to direct microfinance is very small.
- **Loan growth guidance:** There has been almost no disbursement for the last six weeks. The LAP book has grown slower than the home loans portion. The bank has brought down the home loan pricing and aims to gain on balance transfer.

Results Rs cr

Particulars	Q4FY20	Q4FY19	y-o-y %	Q3FY20	q-o-q %
Interest earned	19,189	17,293	11.0	19,064	0.7
Interest expense	10,262	9,673	6.1	10,519	-2.4
Net interest income	**8,927**	**7,620**	**17.1**	**8,545**	**4.5**
Non-interest income	4,255	3,621	17.5	4,574	-7.0
Net total income	13,182	11,241	17.3	13,119	0.5
Operating expenses	5,792	5,008	15.7	5,571	4.0
Pre-provisioning profit	**7,390**	**6,233**	**18.6**	**7,549**	**-2.1**
Provisions	5,967	5,451	9.5	2,083	186.5
Profit before tax	1,423	782	81.9	5,465	-74.0
Tax	201	-187	NA	1,319	-84.7
Profit after tax	**1,221**	**969**	**26.0**	**4,146**	**-70.5**
Gross NPA (%)	5.5	6.7	-117 bps	6.0	-42 bps
Net NPA (%)	1.4	2.1	-65 bps	1.5	-8 bps

Source: Company; Sharekhan Research

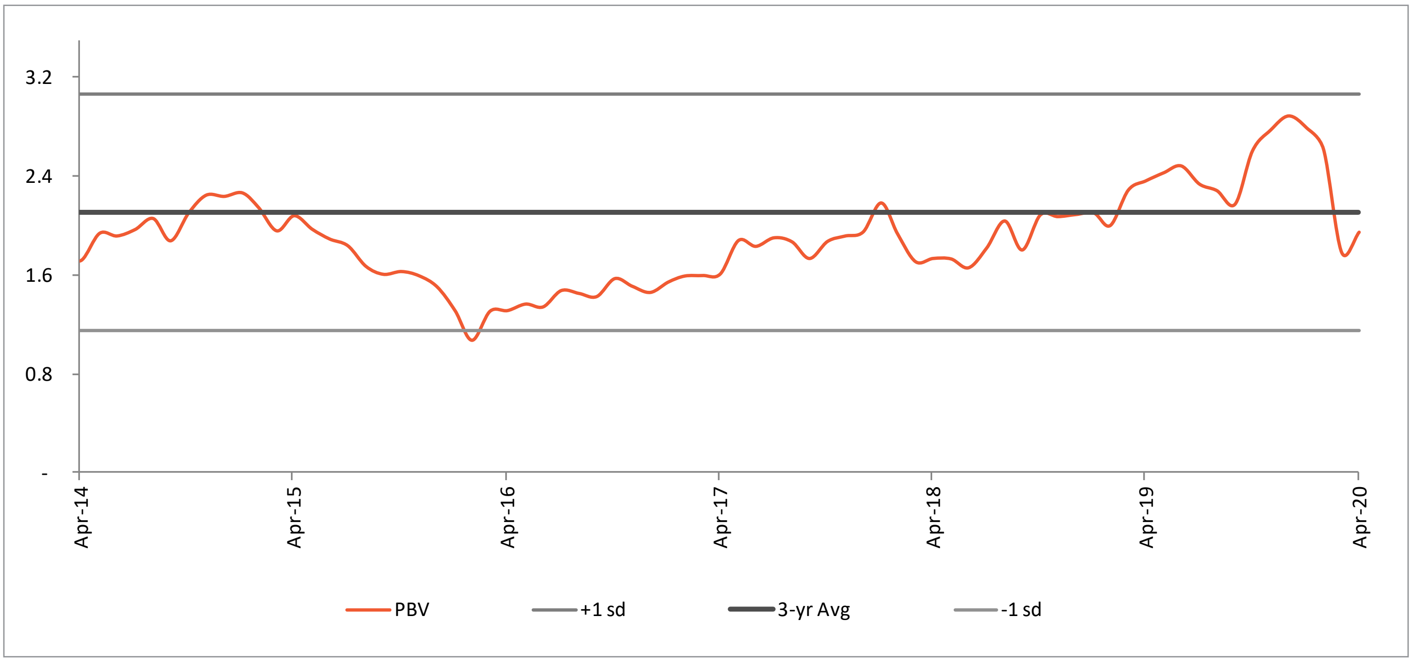
Outlook

ICICI Bank remains a strong business franchise with strong capitalization and displays a stable trend in asset quality. The stress has been on de-bulking and better risk management has reflected positively on asset quality trends so far. However, the COVID-19 pandemic, we believe will elongate the recovery and improvement in profitability further. The lockdown is disrupting financial markets and consumer behavior and India is also likely to be impacted. While it is still developing, intuitively, we believe, increasing lockdowns/voluntary social distancing would lead to reduced consumer mobility, deferral of spending and increased economic stress across the board. In response, lenders such as ICICI Bank are tightening credit filters etc, but medium-term challenges persist. We find ICICI Bank to be an attractive franchisee with a strong balance sheet, pan-India reach, which will help it tide over medium term challenges. Moreover, its well-performing subsidiaries too add value. We find the bank attractive in the medium to long term.

Valuation

For ICICI Bank, we use the sum-of-the-parts (SOTP) methodology, where we value the standalone bank at ~1.6x its FY2022E BV and rest of the subsidiaries at ~Rs 118 per share. We believe valuations are reasonable, considering the overall franchise value as a whole and strong capitalisation and a high provision coverage ratio (PCR) are comfort factors. However, for the near term, we believe the impact of COVID-19 pandemic may prolong demand recovery and earnings normalization phase. Hence, we have accordingly cut our estimates for FY21E and FY22E due to the Covid 19. At present valuations, it is at a reasonable entry point for long term investors. We maintain our Buy rating on the stock with a revised price target of Rs. 454.

One-year forward P/BV Chart



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV (x)		P/E (x)		RoA (%)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
ICICI Bank	344	1.8	1.6	16.0	12.9	1.1	1.2	11.4	12.6
HDFC Bank	929	2.6	2.3	18.5	14.7	1.7	1.9	15.1	16.6
Axis Bank	382	1.2	1.1	12.3	8.3	0.9	1.2	9.6	13.0

Source: Company, Sharekhan research, Bloomberg estimates

About company

ICICI 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 the 2nd largest private sector bank in terms of loan book size, having a pan India presence. It subsidiaries, in Life Insurance, General Insurance and stock broking are all strong entities in their respective fields, and are developing well as a strong franchise, and provide support to overall value. In its banking business, it has continued to improve the portfolio mix towards retail and higher-rated corporate loans and has made significant progress in de-risking the balance sheet. Hence, today the proportion of retail loans in the portfolio mix has increased to 63+%, while an increasingly high proportion of corporate loans disbursed are to customers rated A- and above, which helps de-risking of the overall loan book.

Investment theme

The bank has built an attractive franchise consisting of Banking, Insurance, and Securities business over the years. Since fiscal 2016, the bank has unlocked more than Rs. 14,000 crore of capital in its subsidiaries, which not only demonstrates the value created, it has also resulted in value unlocking along with leaner balance sheet obligations for the parent. We believe the corporate NPA cycle has peaked for the bank but going forward, some risks due to the pandemic, the recovery is likely to be elongated. It has continued to improve its portfolio mix towards retail (granular) and higher-rated corporate loans, and hence, in last four years, which has helped it significantly de-risk its balance sheet from legacy stress and also enhanced the franchise value. We find ICICI Bank to be an attractive franchisee with a strong balance sheet, pan India reach which will help it tide over the medium term challenges. Moreover, its well-performing subsidiaries too add value.

Key Risks

- A slowdown in consumer spending and higher slippages due to COVID-19 vulnerabilities along with slippage from the corporate book (especially from BB and below-rated portfolio) could impact earnings outlook.

Additional Data

Key management personnel

Sandeep Bakhshi	CEO/Managing Director
Rakesh Jha	Chief Financial Officer
Vishakha V Mulye	Executive Director
Anup Bagchi	Executive Director

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	7.9
2	HDFC Trustee Co Ltd/India	4.0
3	SBI Funds Management Pvt Ltd	3.9
4	Dodge & Cox	3.8
5	HDFC Asset Management Co Ltd	3.5
6	Capital Group Cos Inc/The	2.8
7	ICICI Prudential Asset Management	2.6
8	BlackRock Inc	2.2
9	Aditya Birla Sun Life Trustee Co P	2.0
10	Franklin Resources Inc	2.0

Source: Bloomberg

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