Banking
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ICICI

Rating: Sell **Price: Rs54**

Tier-I capital is overstated and premium to SBI is unjustified

Preference Capital Included In Tier-I Capital

ICICI has included Rs3.5bn of twenty year preference share in its tier-I capital in FY1998 and H1FY1999 in violation of the Reserve Bank of India (RBI) guidelines on capital adequacy. The inclusion of preference share in tier-I capital was not made public in its FY1998 annual report nor at the announcement of its H1FY1999 results. The information has been made public only in the company's prospectus for its domestic bond issue. ICICI has asked the RBI for permission to include the twenty year preference issue in tier-I capital. We believe that only equity and unencumbered reserves should qualify for tier-I capital.

- **Statement in FY1998 annual report is misleading.** Commenting on capital adequacy the directors state, "As on 31 March 1998, ICICI's capital adequacy ratio was 13.0%, with tier-I capital ratio at 9.5%. ICICI calculates its capital adequacy in line with the relevant guidelines issued by the RBI" No attempt was made to disclose to share holders that ICICI had included an amount of Rs3.5bn in tier-I capital.

- **Bond prospectus disclosure reveals the inclusion.** In the ICICI Safety Bonds December 1998 prospectus states (page 43), "Having regard to terms of issue, [of Rs3.5bn 20 year tenor] preference shares have been included in tier-I capital."

- **RBI guidelines are clear and unequivocal.** The RBI guideline on capital adequacy for development financial institutions dated 29 March 1994 very clearly state, that cumulative perpetual preference shares are to be included in tier-II capital. In the Indian context however, companies cannot issue perpetual preference shares and the maximum tenor of preference shares is twenty years. We have therefore included preference shares with a minimum maturity of five years in tier-II capital.

- **ICICI has made representations to RBI** – we are informed that senior management in ICICI have made representations to the RBI for permitting the Rs3.5bn in preference share in tier-I capital. ICICI argues that 20 years is a long tenor and since it has to pay a nominal dividend of .001% per annum it should qualify for tier-I capital.

- **Permanence and ability to absorb losses are hallmarks of tier-I capital.** The two salient features of tier-I capital are permanence and the ability to absorb losses. Unfortunately, for ICICI its Rs3.5bn preference share issue is neither permanent nor can it absorb losses. Therefore in our opinion such issues should never be considered for tier-I capital.

- **ICICI auditors have chosen to be silent.** ICICI's auditors have not drawn shareholders' attention to the RBI violation. On 31 March 1998 the concerned amount was an "advance against issue of preference shares" (page F6 of FY1998 annual report) and did not even qualify as preference capital. Accordingly, in FY1998, the Rs3.5bn should not have been included in tier-I or tier-II capital. Although tier-I and tier-II disclosures are made in the Directors Report rather than the accounts, we find the auditors acquiescence in the publication of misleading information in the Directors Report regrettable.

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- **ICICI's FY1998 tier-I capital adequacy was therefore only 8.7% and not 9.5% and its total capital adequacy was 12.2% and not 13%.** Similarly for H1FY1999, we estimate ICICI's tier-I capital was 8.5% and not the 9.2% reported. However, the total capital adequacy for H1FY1999 would remain unchanged at 12.3% since the preference capital of Rs3.5bn is transferred from tier-I to tier-II capital.

- **Capital adequacy, the most important ratio for a financial intermediary.** Capital adequacy and more importantly tier-I capital is the most important ratio for a financial intermediary. The amount of capital a financial intermediary has determines the absolute amount of business it may do, and its ratios affect its credit ratings and thus the cost of loan capital and subordinated debt and in some cases the willingness of counterparties to deal with the financial intermediary. Therefore any attempt to inflate capital adequacy is a potentially serious and significant concern.

- **Liberal accounting policies are a symptom of deteriorating fundamentals.** In our experience companies adopt liberal accounting policies to cover up flagging fundamentals otherwise there is rarely a valid business reason.

- **Valuation.** We are concerned that if ICICI violates the regulator's guideline on capital adequacy, it may not conform to RBI guideline's on income recognition, NPL identification and NPL provisioning. Based on our concerns regarding the quality of ICICI's capital adequacy, ICICI's rising NPLs and the fact that on a price to adjusted book value for FY1999, ICICI is trading at 2.6x a premium of 141% to SBI we recommend a Sell.

Note: ICICI is a Development Financial Institution which the analyst has followed for some time but for which ASKRJ has not published a full note. ICICI will form part of our core coverage in due course.

Income Statement

Year to 31st March (Rs mn)	1996*	1997	1998	1999E	2000E
Net interest income	8,346	10,381	14,196	16,772	18,549
Other income	2,065	2,596	4,394	4,785	5,870
Total income	**10,411**	**12,977**	**18,590**	**21,557**	**24,419**
Total overheads	**-2,708**	**-3,464**	**-4,614**	**-5,455**	**-6,156**
Bad debt provisions	-867	-948	-2,163	-3,349	-5,346
Provisions for std. Assets	0	0	0	-1,144	-211
Profit before tax	**6,836**	**8,565**	**11,813**	**11,609**	**12,706**
Tax	-1,065	-1,043	-950	-1,259	-1,507
Others	378	173	-55	0	0
Net profit	**6,149**	**7,695**	**10,808**	**10,350**	**11,199**
Equity dividend	-1,547	-1,959	-2,610	-2,638	-2,827
Tax on equity dividend	0	-196	-270	-264	-283
Preference dividend	-55	-113	-93	-62	-58
DPS (Rs)	3.70	4.50	5.50	5.50	5.50
EPS (Rs)	**15.0**	**15.9**	**18.1**	**20.0**	**21.7**
EPS growth	8.0%	5.5%	13.9%	10.7%	8.3%
Net interest margin	3.61%	3.56%	3.85%	3.51%	3.12%
Cost-to-Income	8.3%	9.4%	8.5%	9.6%	9.8%
Average tax rate	14.8%	11.9%	8.1%	11.0%	12.0%
Gross NPL	na	10.0%	10.4%	9.4%	9.1%
Net NPL	na	7.8%	7.7%	6.5%	6.3%
Provisions/gross NPL	na	27.9%	33.1%	33.1%	33.1%

FY1998 EPS excludes extra-ordinary income of Rs9.36bn

* We have merged the erstwhile SCICI's accounts for comparison

Return on Assets

Year to 31st March (%)	1996	1997	1998	1999E	2000E
Net interest income	3.3	3.2	3.5	3.2	2.9
Other income	0.8	0.8	1.1	0.9	0.9
Overheads	-1.1	-1.1	-1.1	-1.0	-1.0
Bad debts	-0.3	-0.3	-0.5	-0.6	-0.8
Standard asset provisions	0.0	0.0	0.0	-0.2	-0.03
Taxes	-0.4	-0.3	-0.2	-0.2	-0.2
Others	0.1	0.1	0.0	0.0	0.0
ROA	**2.4**	**2.4**	**2.6**	**2.0**	**1.7**
ROE	**22.2**	**21.8**	**25.5**	**21.9**	**20.2**

Ratios

Year to 31st March (x)	1996	1997	1998	1999E	2000E
Price earnings	6.30	3.60	5.10	2.70	2.50
2-year lynch	na	na	1.93	4.50	3.80
Price to book value	1.23	0.65	1.01	0.51	0.47
Price to adjusted book value	3.55	1.84	4.89	2.58	2.05
Dividend yield (%)	3.9	8.9	10.8	10.2	10.2

Historic valuation at year end prices

Balance Sheet

As at 31st March (Rs mn)	1996*	1997	1998	1999E	2000E
Cash	14,864	20,287	27,586	26,934	32,475
Investments	48,137	60,449	77,872	96,869	114,306
Advances	**183,234**	**229,194**	**287,218**	**387,744**	**457,538**
Leased assets	12,528	19,171	26,755	32,106	40,133
Net fixed assets	2,780	3,281	4,364	5,455	6,819
Current assets	21,794	27,621	32,351	38,174	39,319
Miscellaneous assets	1,305	2,666	3,056	3,056	3,056
Assets	**284,642**	**362,669**	**459,202**	**590,339**	**693,645**
Rupee debt	154,522	202,702	272,535	376,921	444,767
Foreign debt	80,278	91,237	101,951	112,146	132,332
Total debt	**234,800**	**293,939**	**374,486**	**489,067**	**577,099**
Current liabilities	18,169	24,222	31,662	37,361	44,086
Liabilities	**252,969**	**318,161**	**406,148**	**526,428**	**621,186**
Preferential equity	900	750	6,352	9,808	9,808
Equity	3,706	4,755	4,782	4,796	5,141
Reserves	27,067	39,003	41,921	49,307	57,511
Total equity	**30,773**	**43,758**	**46,703**	**54,103**	**62,652**
Total liab & equity	**284,642**	**362,669**	**459,203**	**590,339**	**693,645**

* We have merged the erstwhile SCICI's accounts for comparison

Capital Adequacy

Year to 31st March (Rs mn)	1996*	1997	1998	1999E	2000E
Tier I capital	na	36,821	43,819	50,419	58,968
Tier II capital	na	9,740	16,144	34,512	38,997
Total capital	na	46,561	59,963	84,930	97,965
Risk-weighted assets	na	351,270	461,253	563,405	661,171
Tier I capital	na	10.5%	9.5%	8.9%	8.9%
Tier II capital	na	2.8%	3.5%	6.1%	5.9%
Capital adequacy	**na**	**13.3%**	**13.0%**	**15.1%**	**14.8%**

Tier-I Capital includes certain preference share as assumed by ICICI

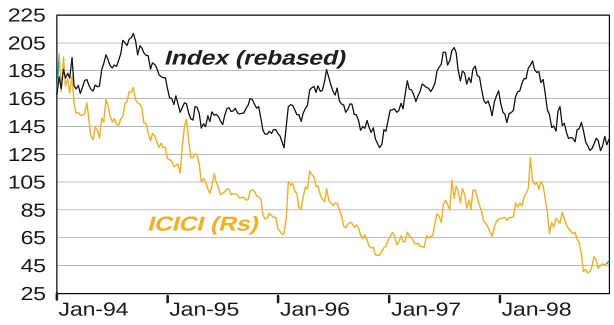
* For FY1996 because of the merged accounts we have not estimated capital adequacy

Adjusted Book Value

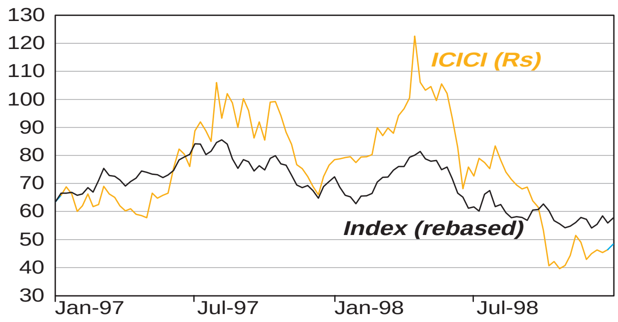
Year to 31st March (Rs mn)	1996	1997	1998	1999E	2000E
Book value (Rs)	77.1	86.4	91.3	106.4	115.9
Equity	29,468	41,092	43,647	51,047	59,596
Net NPLs	-21,605	-22,425	-28,335	-33,435	-38,451
Depreciation on investment*	2,004	-4,050	-5,300	-6,501	-6,500
Unprovided tax liabilities	0	-450	-1,014	-1,077	-1,077
Provisions for std. assets	0	0	0	1,144	1,355
Adjusted equity	9,867	14,167	8,998	10,033	13,568
Adjusted book value (Rs)	**26.6**	**30.7**	**18.8**	**20.9**	**26.4**

* Excluding ICICI Bank

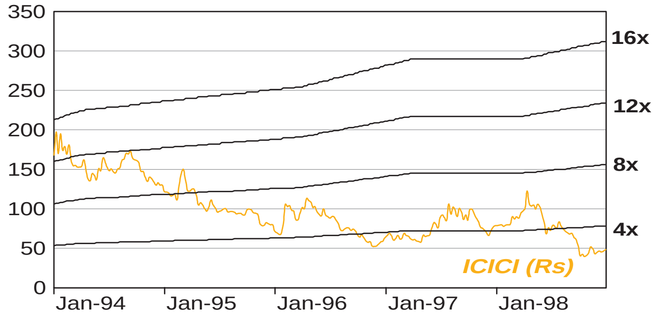
Five-year Price Movement



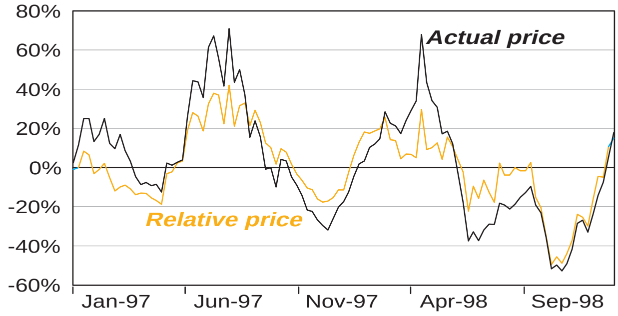
Two-year Price Movement



One-year Rolling Forward PE Bands



Dealing Guide (variation from trend)



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