

## INDIA

# IDBI

8 December 2006

### IDBI IN Underperform

Stock price as of 07 Dec 06	Rs	83.50
12-month target	Rs	65.00
Upside/downside	%	-22.2
Valuation	Rs	65.00
- Gordon Growth Model		

GICS sector		banks
Market cap	Rs m	60,437
30-day avg turnover	Rs m	56.0
Market cap	US\$m	1,355
Number shares on issue	m	723.8

### Investment fundamentals

Year end 31 Mar		2006A	2007E	2008E	2009E
Net interest inc	m	3,799	6,171	10,007	14,655
Non interest inc	m	12,804	11,119	11,220	10,609
Underlying profit	m	8,009	7,774	8,984	11,356
PBT	m	5,884	6,611	8,089	10,661
PBT Growth	%	104.0	12.4	22.4	31.8
Recurring profit	m	5,884	6,611	8,089	10,661
Reported profit	m	5,609	6,082	7,078	9,329
EPS rep	Rs	7.75	8.40	9.78	12.89
EPS rep growth	%	82.0	8.4	16.4	31.8
EPS adj	Rs	7.75	8.40	9.78	12.89
EPS adj growth	%	82.0	8.4	16.4	31.8
PE rep	x	10.8	9.9	8.5	6.5
PE adj	x	10.8	9.9	8.5	6.5
ROA	%	0.7	0.6	0.6	0.7
ROE	%	9.1	9.2	10.0	12.1
Equity to assets	%	7.2	6.6	6.1	5.8
Price/book	x	0.9	0.9	0.8	0.7

### IDBI IN rel SENSEX performance, & rec history



Source: Datastream, Macquarie Research, December 2006 (all figures in INR unless noted)

### Analysts

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## The long and winding road

### Event

- We initiate coverage of Industrial Development Bank of India (IDBI) with an Underperform rating and a target price of Rs65, 21% below current levels. The bank is in a significant phase of restructuring, but the large legacy has left it with a long and winding road ahead of it, and we do not see rapid improvement in financials.

### Impact

- Legacy effect on NIM.** IDBI is weighed down with a heavy burden of legacy, as it struggles with its large book of bad loans, manifested in the SASF bonds, and high cost borrowings. As a result, IDBI does and will continue to suffer from sub-normal NIM for quite some time. While there will be improvement, normalisation will take some time, in our view.
- The UWB acquisition is not enough.** The UWB acquisition is unlikely to help matters significantly. While the added branches will be positive, we do not see it as being enough to sort out the bank's problem with legacy high-cost liabilities. Of course, hitches in integration could worsen matters.
- Dependent on continued government support.** IDBI already enjoys considerable government support, in the form of the SASF (stressed asset stabilisation fund) and forbearance on statutory reserves. We do not see the bank being able to forego these concessions in the short term – most likely, the government is likely to extend these. Apart from the event risk that this represents, we also believe it ties the bank down into its unprofitable development role.
- Equity book remains the only upside.** The only upside that remains is the unbooked gains on the equity book. Even here, the listed book has run out of cushion. The gains on the unlisted book are substantial however, though we believe some of these could take a while to be unlocked, and could as easily be played through other listed banks with better core businesses.

### Earnings revision

- Initiating coverage.

### Price catalyst

- 12-month price target: Rs65.00 based on a Gordon Growth Model methodology.
- Catalyst: Margin compression, Integration with UWB.

### Action and recommendation

- We know that IDBI interests deep value investors, but we believe that the value unlocking could take an unreasonably long time, definitely beyond our forecast horizon. While a truly long-term investment (five-plus years) could be profitable, it's a winding road with disproportionate risks. We initiate coverage with an Underperform rating and a target price of Rs65.

Please refer to the important disclosures on inside back cover of this document, or on our website [www.macquarie.com.au/research/disclosures](http://www.macquarie.com.au/research/disclosures).

**Fig 1 Selected ratios**

%	2005	2006	2007E	2008E	2009E
<b>GROWTH PROJECTIONS</b>					
Growth in Net Interest Income	-179.2	102.2	62.4	62.2	46.4
Growth in Pre Provision Profit	-37.1	121.8	-2.9	15.6	26.4
Growth in Net Profit	-33.9	82.5	8.4	16.4	31.8
<b>OPERATING EFFICIENCY</b>					
Cost to income	97.3	90.4	66.6	63.7	57.3
Cost to assets	0.7	1.1	1.1	1.2	1.1
Overhead ratio	93.3	76.0	22.6	30.2	29.3
<b>ASSET ANALYSIS</b>					
Loans to earning assets	59.7	63.2	62.1	60.8	59.3
Earning assets to Total assets	93.6	94.2	94.2	94.1	94.2
Loans to Total assets	55.8	59.5	58.5	57.2	55.8
<b>LOAN ANALYSIS</b>					
Net loan growth	54.3	12.7	15.6	14.0	13.0
<b>DEPOSIT ANALYSIS</b>					
Deposit growth	290.8	72.2	81.2	59.2	30.1
Demand & savings to ttl deposit	38.3	29.5	25.9	20.3	19.5
Time deposit to total deposit	61.7	70.5	74.1	79.7	80.5
<b>LIQUIDITY</b>					
LDR	337.9	219.8	140.9	100.8	87.5
Gilts to Deposits	9.1	11.1	13.0	16.5	20.0
Earning Assets to deposits	504.0	321.0	207.2	151.7	135.0
<b>PROVISIONING</b>					
Loan loss reserve to assets	0.5	0.6	0.6	0.6	0.5
Reserve cover	30.3	49.5	53.3	64.5	99.7
Provisions to loans	0.2	0.4	0.2	0.1	0.1
<b>ASSET QUALITY</b>					
Gross NPLs	2.7	2.1	1.9	1.5	0.9
Net NPLs	1.9	1.1	1.0	0.6	0.1
<b>CAPITAL ADEQUACY</b>					
Tier 1 CAR	11.9	11.7	8.4	8.2	8.0
Total CAR	15.5	14.8	12.1	11.4	10.6
Equity to assets	7.3	7.2	6.6	6.1	5.8
<b>CAPITAL MANAGEMENT</b>					
Dividend payout	35.2	9.7	11.9	19.4	23.3
Dividend yield	1.8	0.9	1.2	2.3	3.6
EPS	4.3	7.7	8.4	9.8	12.9
BVPS	82.1	88.0	94.3	102.0	111.6
<b>PROFITABILITY</b>					
ROA	0.45	0.70	0.67	0.67	0.76
ROE	10.45	9.12	9.22	9.97	12.1
Pre provision profit ROE	6.1	12.6	11.4	12.2	14.1
Non-int. inc. to ttl. inc.	19.1	19.2	14.8	12.9	10.4
<b>SPREAD ANALYSIS</b>					
Int. rate received on int. E.A.	7.86	6.74	7.07	7.16	7.46
Int. rate paid on int. bearing liab.	4.07	6.84	6.86	6.65	6.69
Spread	3.79	-0.09	0.20	0.51	0.77
Net Interest Margin	0.28	0.48	0.68	0.95	1.19
<b>VALUATION</b>					
PER (x)	19.4	10.7	9.8	8.4	6.4
PB (x)	1.0	0.9	0.9	0.8	0.7
PUP (x)	16.5	7.5	7.7	6.7	5.3

Source: Macquarie Research, December 2006

### The long and winding road

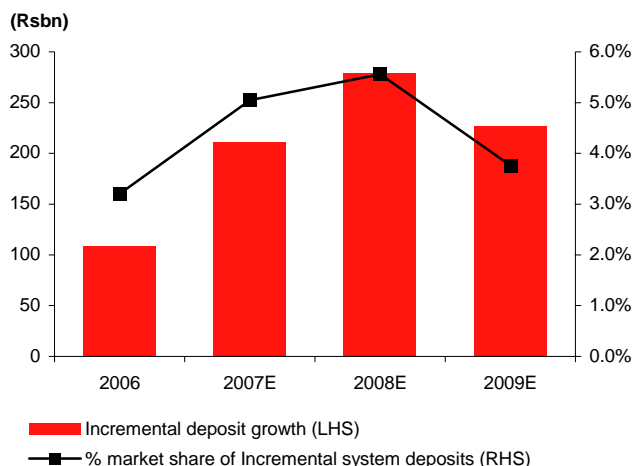
We initiate coverage of Industrial Development Bank of India (IDBI) with an Underperform rating and a target price of Rs65, 21% below current levels. The bank is in a significant phase of restructuring but the large legacy has left it with a long and winding road ahead of it, and we do not see rapid improvement in financials.

#### Legacy effect on NIM

IDBI is weighed down with a heavy burden of legacy, as it struggles with its large book of bad loans, manifested in the SASF bonds, and high cost borrowings. As a result, IDBI does, and will continue to, suffer from sub-normal NIM for quite some time. While there will be improvement, normalisation will take some time.

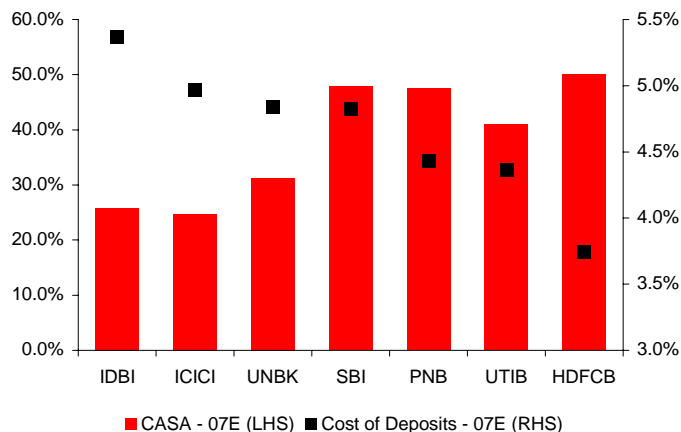
**Borrowing costs bottom out.** IDBI's borrowing costs have bottomed out due to the high cost of incremental deposits as well as the need to replace its erstwhile borrowings, which are coming up for redemption. With its branch franchise still not fully complete, the need for incremental deposits (figure 2) is very high.

**Fig 2 Needs large deposits to stand still.**



Source: Macquarie Research, December 2006

**Fig 3 Low CASA – high cost of deposits**

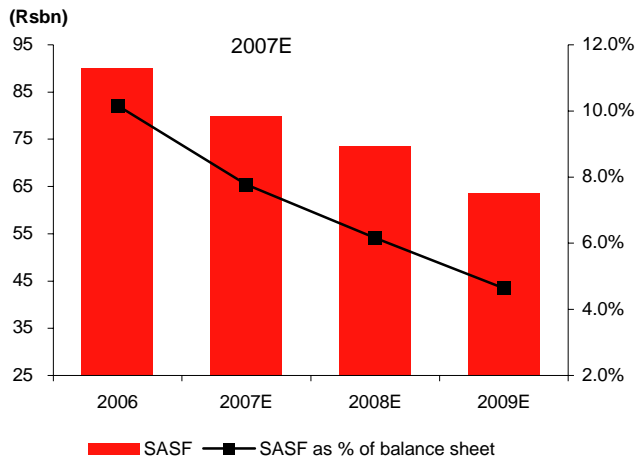


Source: Macquarie Research, December 2006

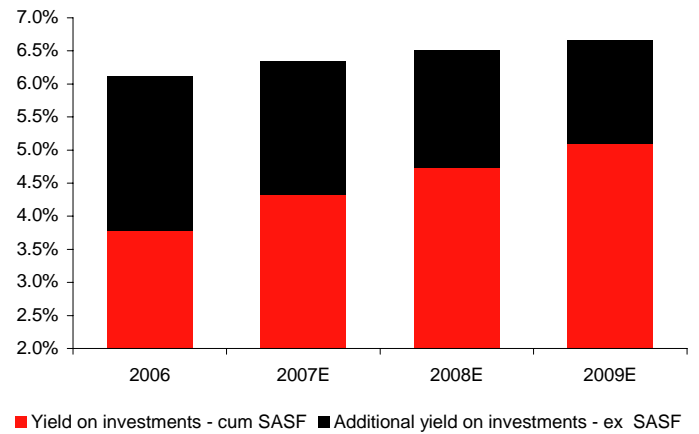
As a result, the bank is unable to convert its growing branch network into a significant lowering of deposit costs. This is because of the treadmill effect of its balance sheet – fresh deposits are contributing more to repaying old borrowings than to fresh assets – our estimates show that 20% of the next three years' deposits will be used to repay old borrowings. The bank is thus being pushed into higher deposit growth than its network can sustain and this keeps funding costs relatively high.

**SASF burden remains heavy.** On the asset side, the burden of past NPAs will continue to be a drag. The SASF (see description in the next paragraph) remains a large part of the balance sheet and is only declining very slowly. While NPA recoveries have been reasonably smart, the quantum of legacy NPLs is so large for IDBI that it will continue to depress earnings for quite some time. As we see in the charts below, the legacy NPLs will remain a serious issue for some time.

**Fig 4 SASF investments – slowly declining**



**Fig 5 SASF a serious drag on yields**



SASF – Stressed asset stabilisation fund

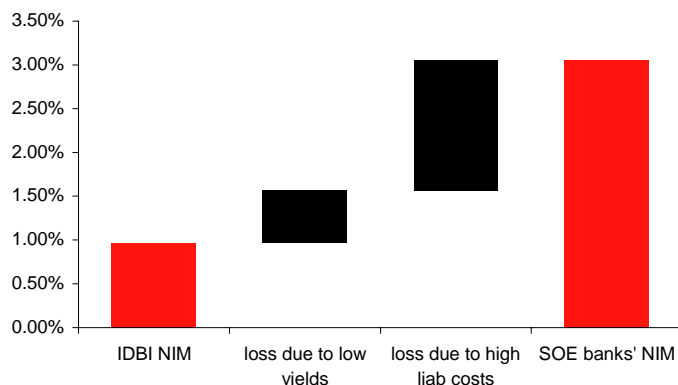
Source: Macquarie Research, December 2006

Source: Macquarie Research, December 2006

The bank transferred Rs90bn to a special purpose vehicle, the SASF, against which the government issued zero-coupon 20-year bonds. The bank can swap recovered bad loans against redemption of these securities on an ongoing basis. The swap rescued the bank from making crippling capital provisions against these NPAs – which would have lowered its FY3/07E Tier I to 7.87%, from 8.42%, and certainly would have prevented it from completing the UWB acquisition. However, that is all the relief it gets, it does not solve the problems of liquidity (these bonds are not tradable) nor depressed asset yields (the bonds are zero-coupon).

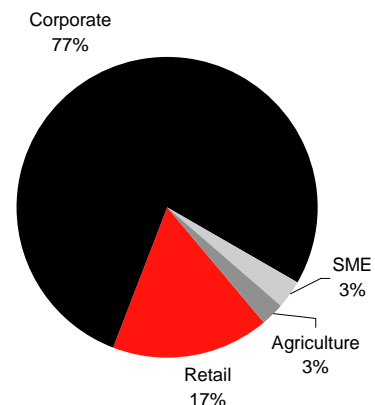
**Sub-normal NIM.** The effect of IDBI's problems is that its NIMs are depressed to subnormal levels. The impact is felt on three counts. Apart from the legacy high cost borrowings and the negative impact of the SASF (discussed above), there is a third reason – the preponderance of low-yield loans as the bank grows its book in the AAA corporate and infrastructure space. Therefore, despite the bank getting the benefits of SLR and CRR forbearance from the government, its margins are still below par.

**Fig 6 Fund costs the real problem**



Source: Company data, Macquarie Research, December 2006

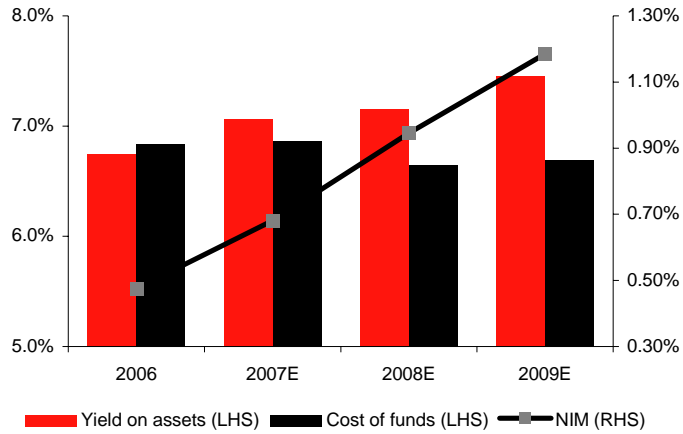
**Fig 7 High concentration in low-yield segments**



Source: Company data, Macquarie Research, December 2006

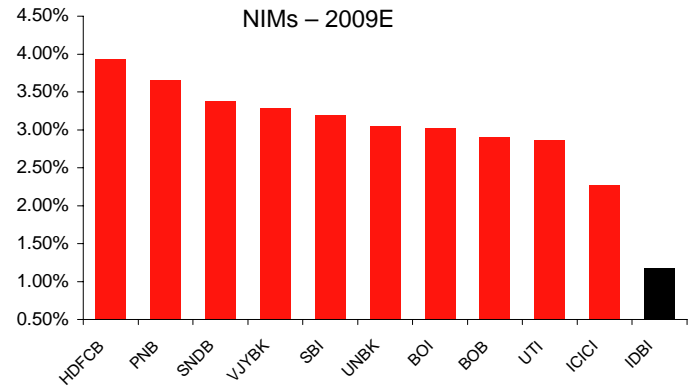
**Improvement, but still below par.** It's not all bad, though. The NIM is set to improve, on the back of the SASF impact slightly diminishing – we expect a 71bp improvement in the NIM over the next three years (see chart). As figure 8 illustrates, the improvement will be led primarily by a bounce back in asset yields.

**Fig 8 NIMs set to improve...**



Source: Company data, Macquarie Research, December 2006

**Fig 9 ..but will still lag other banks**



Source: Company data, Macquarie Research, December 2006

However, the NIM will still remain below par for quite some time. As we discussed in the previous section, the SASF and the liability problems will persist for some time. As figure 9 shows, the bank's improved NIM, even in FY3/09, will still remain significantly lower than other SOE or state banks.

## The UWB acquisition is not enough

The UWB acquisition is unlikely to help matters significantly. While the added branches will be positive, we do not see it as being enough to sort out the bank's problem with legacy high-cost liabilities. Of course, hitches in integration could worsen matters.

**Added branches a positive.** The UWB acquisition has grown IDBI's branch network by 115% to 430. The Reserve Bank of India's (RBI) tight licensing norms that restrained opening new branches had placed a scarcity value on branches. The merger would, therefore, give IDBI access to a ready physical infrastructure, enabling the bank to strengthen its franchise, though only in Western India where UWB has significant presence.

The additional branches will be beneficial to IDBI in many respects, specifically:

- As IDBI manages its transformation from a financial institution to a commercial bank, it finds roughly 54% of the liabilities in the form of long-term borrowings. The significant increase in the branch network would provide easy access to retail deposits (enabling it to replace its high long-term borrowings with such deposits) and also improve its deposit mix.
- IDBI (which has always been dominant in industrial financing), would get exposure to agriculture credit through UWB as nearly half the number of UWB branches are in semi-urban and rural areas, and should complement IDBI's loan book.

**Not enough, however.** While the UWB branches would be a strong boost, we believe that this is not enough for two reasons:

1. Given the requirements of deposits for IDBI to replace old borrowings, we estimate an incremental deposits/branch ratio for FY3/07 at Rs432m – over and above the Rs 282m that UWB currently clocks. This should prove to be a steep challenge - we believe that IDBI will have to continue to resort to wholesale deposits which will keep its funding costs at very high levels.

### Fig 10 UWB branches extremely unproductive

	Deposits per branch (Rs m)
IDBI (at 31 March 2006)	1520.52
UWB (at 31 March 2006)	281.75

Source: Macquarie Research, December 2006

2. UWB is concentrated in western India – IDBI will have to continue to roll out branches in the northern and eastern regions, which together constitute 37% of overall commercial bank deposits in India.

**Integration glitches could be a negative surprise.** Our estimates do not factor in any significant problems with regard to the integration of UWB with IDBI – this leaves scope for a negative surprise. The risks are many:

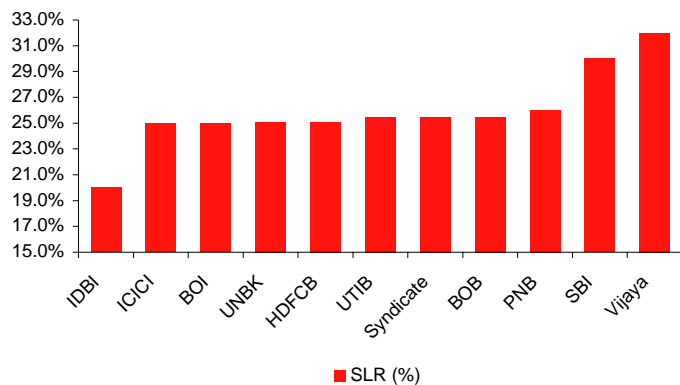
- *Technology:* The core banking platforms for both UWB and IDBI are different. UWB is on a CMC/TCS core banking platform, while IDBI is on Infosys' Finnacle. The transition of UWB to Finnacle could take longer than anticipated.
- *Employees:* UWB will add around 3,000 employees to IDBI's headcount, taking the total number of employees of IDBI to more than 7,500 employees. The IDBI management does not anticipate the problems that it had when integrating its own subsidiary IDBI Bank, given that UWB's employee profile is more similar to IDBI's than it was at IDBI Bank.

### Dependent on continued government support

IDBI already enjoys considerable government support, in the form of the SASF and forbearance on CRR and SLR. We do not see that the bank being able to forego these concessions in the short term – most likely, the government is likely to extend these. Apart from the event risk that this represents, we also believe it ties the bank down into its unprofitable development role.

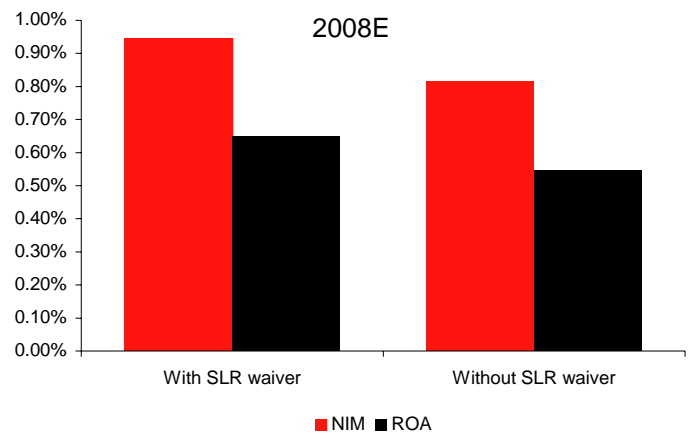
**Forbearance on SLR/CRR needed longer.** IDBI currently enjoys forbearance on SLR through a special dispensation from the government. At the moment, the bank maintains an SLR of 11%. These obviously protect its profitability from slipping even further down.

Fig 11 Significant SLR advantage...



Source: Macquarie Research, December 2006

Fig 12 ...which supports profitability



Source: Macquarie Research, December 2006

Going forward, we do not see IDBI being able to meet the regulatory norms for SLR and CRR. Our forecasts show that IDBI can only achieve a 20% SLR by FY3/09, against the regulatory minimum of 25%. With its current forbearance set to expire by FY3/08, the bank will need to go back to the government for an extension of the deadline. We do not see too many problems in that permission coming through, but it still represents an event risk.

**SASF support will also need to continue.** We also see the bank needing continued support from the SASF. Here, there need not be a revision of existing terms – the SASF bonds have a maturity of 20 years, of which only two years have been used. We expect the SASF to remain operational for another three to four years at least: Management intends to sell down any outstanding bad loans thereafter and wind down the SASF in another five years.

**Not a free lunch.** This continued support from the government is not a free lunch – it carries two risks with it:

- *Event risk* - Much of these dispensations change with the attitudes of individuals in key positions of government. It is unlikely, but not impossible, that any government administration would refuse IDBI an extension of these waivers, but...
- *Could extract a price* - .the government is bound to extract a price from IDBI on this score, in the form of its lending profile. There is already pressure that banks should lend for “productive purposes” – i.e., to infrastructure and industrial projects. Given the subsidies that the government gives IDBI, it will continue to insist that IDBI de-emphasises the more profitable retail credit and concentrate on project finance, which will hurt ROA in the long term.

## Equity book remains the only upside

The only upside that remains is the unbooked gains on the equity book. Even here, the listed book has run out of cushion. The gains on the unlisted book are substantial however, though we believe some of these could take a while to be unlocked, and could be as easily played through other listed banks with better core businesses.

**Cushion of the listed book gone.** The cushion of the listed book (Rs80bn) is now gone, according to management guidance. The bank has booked equity profit of Rs9bn (115% of PBT) over the last six quarters, primarily from its historic book of listed equities acquired as part of its project financing of the nineties. This upside is now significantly exhausted, leaving little scope for future profit.

**Unlisted book still has significant upside.** However, the bank still has a significantly large unlisted equity portfolio which it can unlock. The book value of this is Rs12bn – we do not have details of each investment. Some of the larger investments are IDBI Capital Markets, SIDBI and the National Stock Exchange (NSE). Of these, we believe NSE has significant value.

**Fig 13 Valuation of NSE**

	Rs m
FY3/06 profits	1,950
Mark-up for consolidation (+25%)	2,438
Expected growth for FY3/07 (+30%)	3,169
Expected growth for FY3/08 (+25%)	3,961
PER	30
Valuation	118,828
Discount for holding co/unlisted stock (30%)	83,180

Source: Macquarie Research, December 2006

Our rough back-of-the-envelope valuation (see table) of NSE gives us a value of Rs83bn, based on its FY3/06 financials and the multiples enjoyed by other exchanges in Singapore and Hong Kong. NSE's 7.5% stake (after adjustment for a 30% holding company and unlisted share discount), will add a significant ~Rs8.7/share to IDBI.

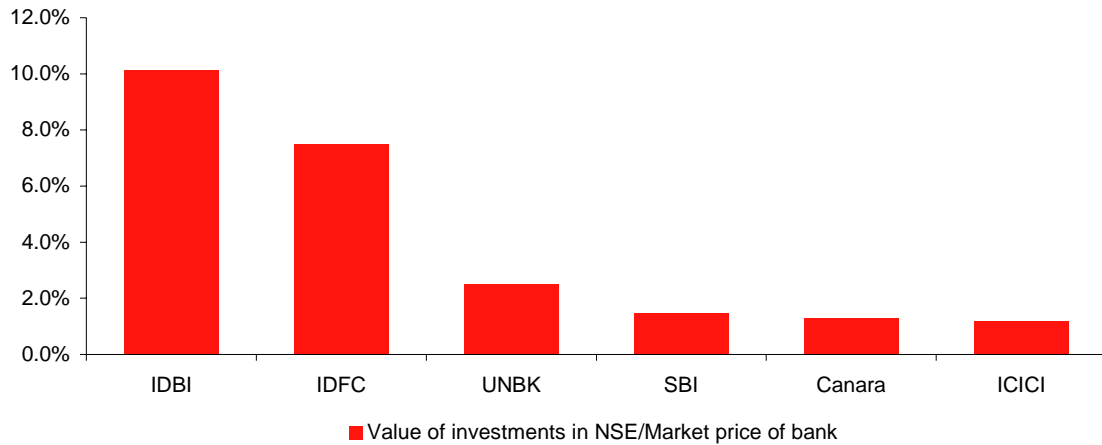
**Uncertainty of value unlocking.** The value unlocking of IDBI's NSE holding has many uncertainties:

- The government is grappling with norms on foreign investments in stock exchanges, with various FDI and FII caps being contemplated. BSE is very keen to push forward with an IPO, but the government has yet to clarify foreign ownership norms. This will constrain valuations and our 30% discount may not be enough.
- There is no timetable for a deal to unlock this value. We are also not sure that the government will be keen to see SOE banks dilute holdings in what is perceived as a very strategic institution.

**Can be played through other banks.** As figure 14 shows, the NSE valuation can be played through other stocks where the core business is in better shape – albeit not with the same level of upside.



**Fig 14 NSE can be played through other banks too...**



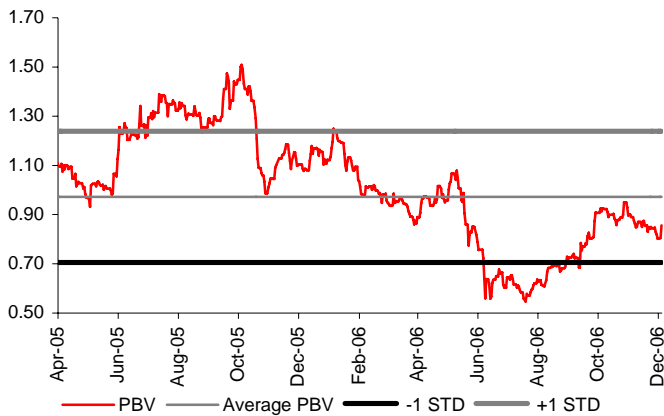
Source: Macquarie Research, December 2006

**Valuation**

We have set a 12-month target price of Rs65, 21% lower than current levels.

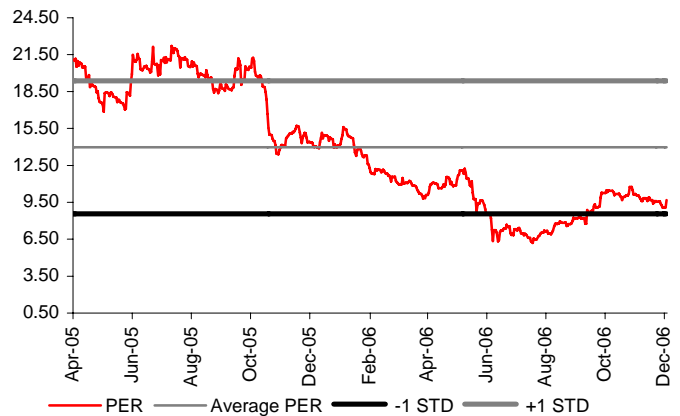
Our base price is derived using a Gordon Growth Model (GGM) methodology. The valuation is the present value of the GGM price, using FY3/08E BV and FY3/09E ROE. This gives a valuation of Rs65, implying a P/BV of 0.7x and a PER of 7.7x on FY3/07E.

**Fig 15 IDBI - P/BV**



Source: Bloomberg, Macquarie Research, December 2006

**Fig 16 IDBI - PER**



Source: Bloomberg, Macquarie Research, December 2006

**Key assumptions.** Cost of equity = 14.4, terminal growth rate = 5%, ROE assumptions = 12.1%.

**Fig 17 Gordon growth model (scenarios with different ROE/BV combinations and sensitivity to g)**

	I.a	I.b	I.c	I.d	II.a	II.b	II.c	II.d
ROE	11.1%	12.1%	13.1%	14.1%	11.1%	12.1%	13.1%	14.1%
CoE	14.4%	14.4%	14.4%	14.4%	14.4%	14.4%	14.4%	14.4%
g	5.0%	5.0%	5.0%	5.0%	7.0%	7.0%	7.0%	7.0%
Payout ratio =(ROE-g) / ROE	54.8%	58.6%	61.7%	64.5%	36.8%	42.0%	46.4%	50.3%
ROE - g	6.1%	7.1%	8.1%	9.1%	4.1%	5.1%	6.1%	7.1%
COE - g	9.4%	9.4%	9.4%	9.4%	7.4%	7.4%	7.4%	7.4%
Implied PB (x)	0.6	0.8	0.9	1.0	0.6	0.7	0.8	1.0
Implied PE (x)	5.8	6.2	6.6	6.9	5.0	5.7	6.3	6.8
Book value per share (Rs)	101.97	101.97	101.97	101.97	101.97	101.97	101.97	101.97
Implied target price (Rs)	65.87	76.72	87.56	98.41	56.11	69.89	83.67	97.45
Present value of target price		65.00						
Current share price (Rs)	82.55	82.55	82.55	82.55	82.55	82.55	82.55	82.55
Up/Downside (%)	-20.2	-21.3	6.1	19.2	-32.0	-15.3	1.4	18.1

Source: Macquarie Research, December 2006

At our valuation, the stock would trade at 0.7 FY3/07E P/BV – lower than its average valuation in recent history and far cheaper than other banks. However, this is more than justified by its low ROE.

**Scenario analysis.** It is clear that IDBI is suffering from a significant part of its book being locked up in SASF. We evaluated a scenario where the bank liquidated the SASF bonds, by selling the underlying bad assets and absorbing the loss upfront.

Clearly, the ROA would normalise to roughly 1.1% and the ROE to approximately 20%. However, the bank's capital adequacy would sink and a recapitalisation would be necessary – we assume that would take place at current market prices.

An important assumption to support this would be the quantum of losses that would be needed on the NPL liquidation. Our assessment is that the recoverable amount would be Rs35bn, based on the management's assessment of annual recoveries through to FY09, and assuming (generously) that 50% of the remainder is recoverable in one shot. The NPV of this is Rs35bn, necessitating a writeoff of Rs45bn from the current net worth, with the capital replenished by an equity issuance. We also simulated a scenario where the NPV was Rs45bn, higher than our estimates.

**Fig 18 Core financials are better than they look...**

	Scenario 1	Scenario 2
	Selling NPLs: our valuations	Selling NPLs at premium to our valuation
Loss on SASF/selling bonds	45,000	35,000
Price of equity raising	75	75
Quantum of issuance	20,000	10,000
FY07 T1 ratio	5.78%	5.78%
Target price	79	92

Source: Macquarie Research, December 2006

The target price in such a scenario does move up significantly, with a 7–20% upside depending on the assumptions on the recoverability of the NPLs. We see this scenario as having too many ifs and buts: both the saleability of such a large block of NPLs as well as the ability of the bank, after such a huge writeoff (72% of FY06 net worth), to raise further capital in the market.

Fig 19 State and private banks price tracker and valuations

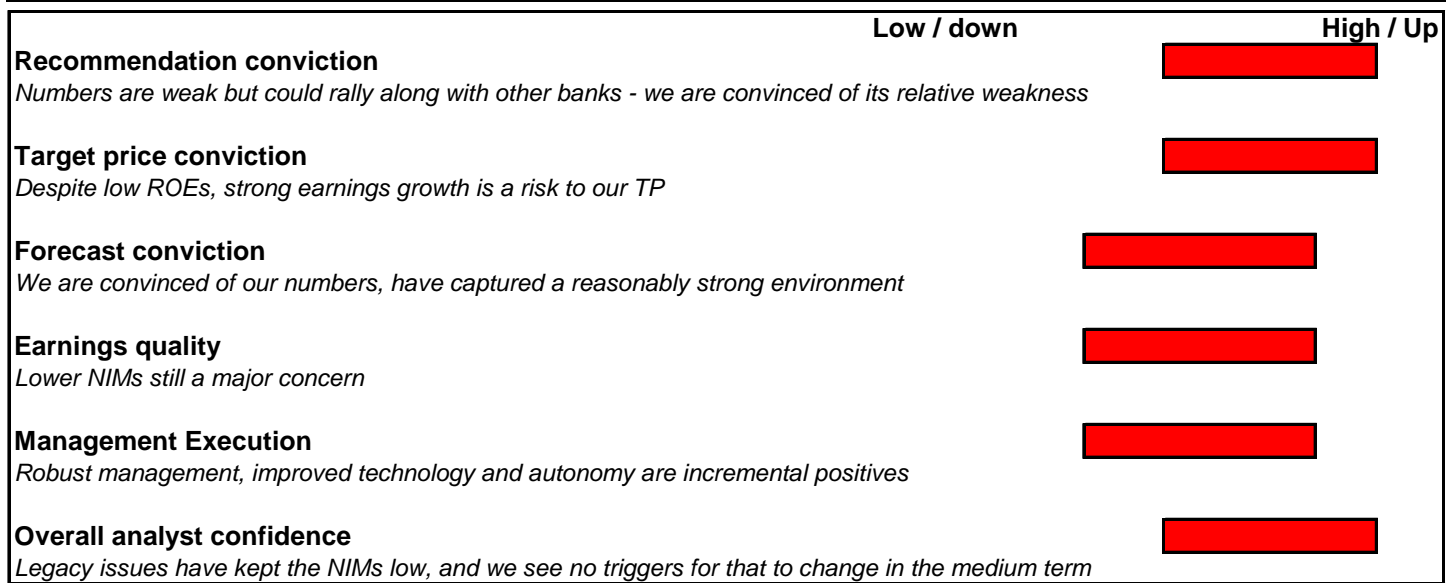
Ticker	Price (Rs)*	Mkt cap US\$m	Mkt cap Rs m	ROE (%)		PER (x)		P/BV (x)		Share price performance (%)			
				2007E	2008E	2007E	2008E	2007E	2008E	1M	3M	6M	
<b>Private banks</b>													
CBOP	CBOP IN	30	975	43,756	11.4	13.4	36.9	22.5	3.7	3.2	11.9	15.9	18.2
HDFC Corporation	HDFC IN	1590	8,849	396,961	30.7	30.8	26.3	21.9	7.4	6.1	4.1	21.1	36.6
HDFC Bank	HDFCB IN	1089	7,639	342,702	19.2	19.0	30.8	24.9	5.5	4.0	9.1	26.2	50.7
ICICI Bank	ICICIBC IN	871	17,343	778,011	14.3	17.8	23.2	16.8	3.2	2.8	13.4	42.8	60.7
Kotak	KMB IN	383	2,781	124,755	15.2	14.8	29.2	23.9	4.0	3.6	4.8	21.2	37.2
UTI Bank	PNB IN	483	3,022	135,573	19.8	20.0	21.8	17.8	4.0	3.0	10.3	39.3	62.1
Yes Bank	YES IN	130	779	34,965	12.2	17.7	38.8	23.8	6.1	5.5	13.4	45.8	51.9
<b>Weighted average</b>					<b>19.07</b>	<b>20.66</b>	<b>26.19</b>	<b>20.18</b>	<b>4.68</b>	<b>3.87</b>	<b>9.79</b>	<b>32.79</b>	<b>51.07</b>
<b>Stated owned banks (SOE)</b>													
Allahabad Bank	ALBK IN	93	930	41,699	20.3	20.0	5.8	5.2	1.1	1.0	4.9	26.5	22.2
Andhra Bank	ANDB IN	90	972	43,626	17.9	18.2	8.2	7.1	1.2	1.1	-5.5	4.8	31.2
Bank of Baroda	BOB IN	264	2,143	96,130	12.0	14.1	9.8	7.5	1.1	1.0	0.0	4.2	16.4
Bank of India	BOI IN	205	2,225	99,820	18.3	19.7	10.4	8.3	1.8	1.5	16.0	44.7	77.6
Canara Bank	CBK IN	308	2,810	126,075	17.5	18.2	10.1	7.9	1.6	1.3	6.0	23.0	42.4
Corporation Bank	CRPBK IN	372	1,190	53,367	14.5	14.7	10.3	8.8	1.4	1.3	-6.0	14.8	36.9
IDBI	IDBI IN	83	1,332	59,769	10.8	10.8	9.8	8.4	0.9	0.8	2.8	22.8	28.2
IOB	IOB IN	122	1,486	66,656	25.3	22.5	7.4	6.6	1.7	1.4	8.7	24.4	56.1
OBC	OBC IN	250	1,396	62,635	14.1	13.6	7.8	6.8	1.2	1.1	2.1	26.1	38.4
PNB	PNB IN	555	3,897	174,835	16.7	21.5	10.6	7.0	1.6	1.4	7.3	17.9	41.5
SBI	SBIN IN	1338	15,699	704,241	16.6	18.4	10.8	7.8	1.6	1.4	20.6	41.1	59.2
Syndicate Bank	SNDB IN	80	933	41,836	27.3	25.0	5.2	4.6	1.3	1.1	2.1	3.9	27.6
UBI	UNBK IN	129	1,450	65,059	24.8	26.2	5.9	4.6	1.3	1.1	-2.4	9.7	23.4
Vijaya Bank	VJYBK IN	52	498	22,348	20.1	21.8	6.2	4.9	1.2	1.0	-5.5	7.8	28.6
<b>Weighted average</b>					<b>15.43</b>	<b>16.70</b>	<b>8.71</b>	<b>6.57</b>	<b>1.34</b>	<b>1.14</b>	<b>9.95</b>	<b>25.61</b>	<b>42.54</b>

\* Prices are in local currency as of 06 December 2006

CBOP - Centurion Bank of Punjab, IOB - Indian Overseas Bank, IDBI - Industrial Development Bank of India, OBC, Oriental Bank of Commerce, PNB - Punjab National Bank, SBI - State Bank of India, UBI - Union Bank of India

Source: Bloomberg, Company data, Macquarie Research, November 2006

**Fig 20 IDBI– Analyst matrix**



Source: Macquarie Research, November 2006

## Risks to recommendation

**High growth.** We are forecasting the bank to grow assets at 18% CAGR over FY3/06–09E, significantly below private sector banks. We could be surprised here, which may lead to a short-term improvement in ROE. However, as we discussed earlier in the report, we are unconvinced that the bank has the bandwidth to grow quickly and would worry about loan and deposit quality if growth picks up.

**Accelerated NPA recoveries:** Given the favourable economic environment, we have assumed strong traction in NPA recoveries. While our NPA recovery forecast is largely based on management guidance (given that we have not been able to do a detailed analysis, due to lack of data), any significant uptick in recoveries could drive the stock price against our target price.

**Moves with the sector.** We are very positive on the banking sector as a whole, given the favourable economic environment. Under those circumstances, we could see IDBI stock appreciate, albeit at a slower rate than other bank stocks – our forecast of a downside to the target price would then be at risk.

## Fig 21 SWOT analysis

STRENGTHS	WEAKNESS
<p><b>Increased branch network:</b> The 230 UWB branches have increased its branch network distribution by more than 100%. Low cost retail deposits will be more accessible now.</p> <p><b>Forbearance on CRR/SLR:</b> Gives it a competitive advantage over other banks as it provides additional funds for credit.</p> <p><b>Strong relationship:</b> Its 40-year history of being a non-bank financial institution has enabled it to cement strong relationships with large corporates.</p>	<p><b>High cost liabilities</b> – IDBI's legacy high cost liabilities have put pressure on its NIM in the past. While this is being slowly replaced with relatively low cost retail deposits, NIM will be at sub normal levels.</p> <p><b>Relatively high NPLs</b> - IDBI is weighed down with a heavy burden of legacy, as it struggles with its large book of bad loans, manifested in the SASF bonds. While SASF bonds are slowly getting redeemed, they will pose a negative threat to margins in the medium term.</p> <p><b>Different technology background:</b> Delays in integration of different IT platforms of IDBI with UWB could hamper operational efficiency and put a strain on existing resources.</p> <p><b>Ownership:</b> Being state-owned, its competitiveness is eroded, mainly through being unable to attract talent as a result of non-competitive compensation structure.</p>
OPPORTUNITIES	THREATS
<p><b>Merger with other banks:</b> With the RBI encouraging consolidation in the sector, the possibility of merger with other public sector seems a distinct possibility – this would enhance competitiveness. If such an event arises in future, the experience of UWB merger would certainly help IDBI.</p> <p><b>Foray into life insurance:</b> Its joint venture with Fortis and Federal Bank could provide additional robust streams of income given huge latent demand in the life insurance sector</p> <p><b>Low loan and retail penetration:</b> Retail credit in India provides significant potential for growth given its under-penetration. The country's loan-to GDP ratio is at 8% and its mortgage/GDP ratio is at 4%.</p>	<p><b>Integration with UWB:</b> Any significant glitches/delays in the integration process between IDBI and UWB could materially hamper the operations of the merged entity.</p> <p><b>Commoditisation of asset spreads:</b> IDBI's revenue streams are more skewed towards asset spreads rather than fees. That is a threat of being commoditised by other SOE banks with must lower cost structures.</p> <p><b>Competition:</b> Private sector banks will continue to pose the largest threat to IDBI's market share. The possible entry of foreign banks post FY3/09 could further add to its competitive pressures.</p> <p><b>Economic slowdown:</b> An economic slowdown could start to hit its asset quality and put downward pressure on margins.</p> <p><b>Rising rates.</b> IDBI is currently transitioning its book from large borrowings to high deposits. Tightness in liquidity would make this liability swap more difficult.</p>

Source: Macquarie Research, November 2006

## Industry issues

We identify the foremost industry issues below, and assess where IDBI stands.

**Net interest margin:** Although generic interest rates have been rising for some time, rising loan yields have significantly outstripped both government bonds and deposit rates. While PLRs have gone up marginally (50–100bp), the spreads around PLRs have shot up in 2006. For example, vehicle loan yields have risen by 300–400bp. Housing loans have gone up less, by 150bp, however the effect on bank earnings is significant as more than 80% of housing loans are floating rate so the entire book gets repriced within a quarter.

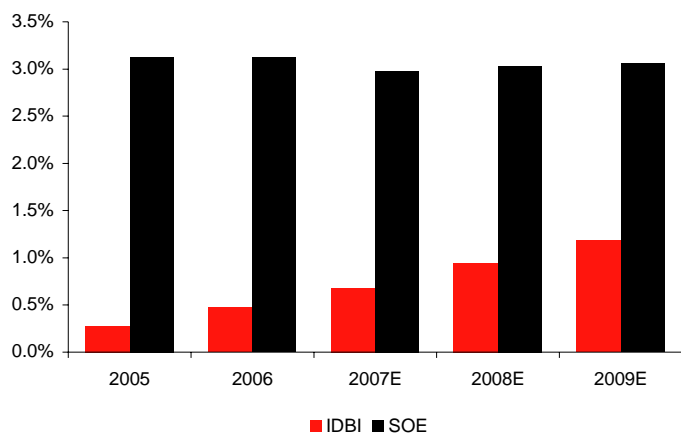
Obviously, deposit rates have also risen. But the tightness seen in February–March has eased considerably. Short-term interbank rates, a good proxy for deposit rates, have declined by 100bp from their peak in mid-March to around 6.5%.

Logically, NIM should now spike – lending rates are not only rising faster than deposit rates, but loans also reprice faster than deposits. In fact around 35–40% of banks’ liabilities, CASA deposits and equity, do not reprice at all.

However, the rise in NIM will be dampened by falling investment yields (banks are still sitting on large legacy portfolios with yields well above the marginal); investment yields last year were 8–9% while incremental yields are still below 7%.

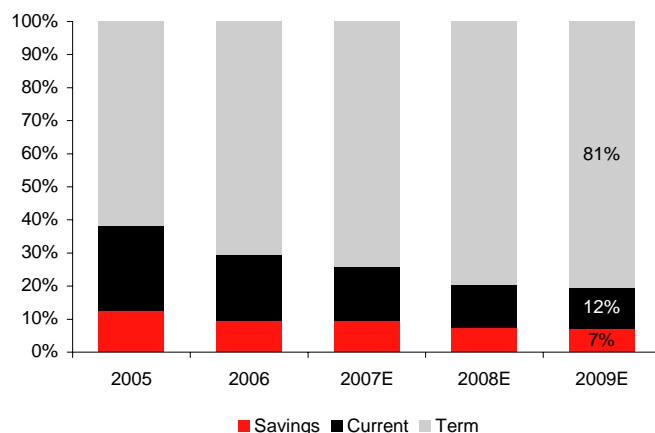
IDBI will suffer from poor NIM going forward. We have discussed this extensively in the previous sections – IDBI is weighed down by its legacy bad loans and high-cost borrowings, which will take some time to unwind. We see IDBI’s NIM remaining well below industry averages through to FY3/09.

**Fig 22 IDBI’s NIM to lag average SOE NIMs**



Source: Company data, Macquarie Research, December 2006

**Fig 23 High cost deposits to form a larger**

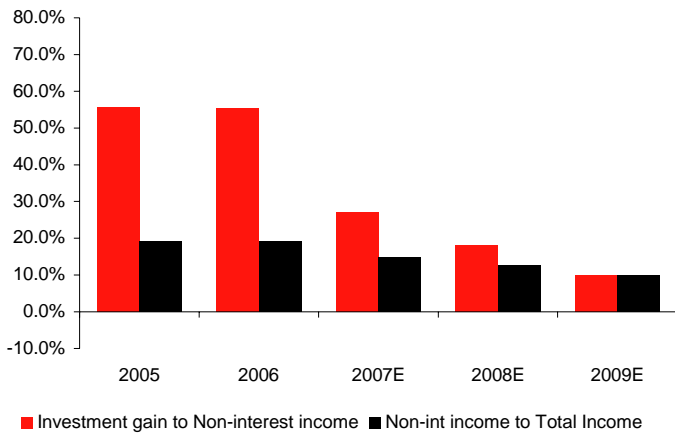


Source: Company data, Macquarie Research, December 2006

**Non-interest income.** With a structurally rising interest rate environment, bond trading profits will continue to shrink. In fact, there is concern over investment depreciation provisions, where banks are seeking to smooth out the losses by transferring their debt investments to the HTM category. The absence of trading profits puts the spotlight on the possible weakness in the industry’s non-lending businesses, ie, fees.

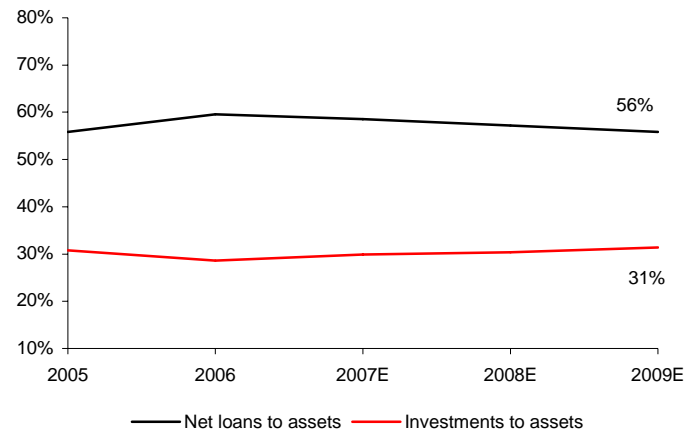
Fee income has signified the weakness of state-owned banks vs private sector banks. Private sector banks have managed to corner a large part of the emerging market – ie, retail fees. These come from the distribution of third party products, as well as new services on the back of strong technology platforms. As a result, private banks have been demonstrating blockbuster growth in fees, upwards of 35–40%, whereas state-owned banks struggle to grow fees beyond the 5–7% range. While the new IT investments have seen state-owned banks clawing back, IDBI still has not seen strong traction in its fee business. We believe this is some time away, as the bank is still some way off in building a strong stream of retail fees. Corporate fees should pick up, however.

**Fig 24 Investment gains expected to decline**



Source: Macquarie Research, December 2006

**Fig 25 Loans to assets – expected to be stable**



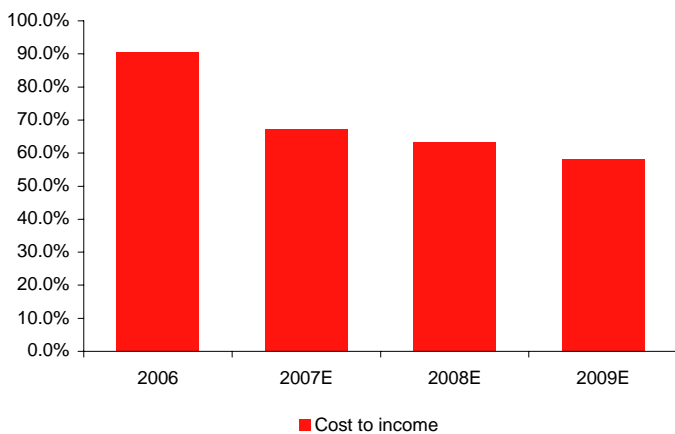
Source: Company data, Macquarie Research, December 2006

Costs. Costs will also see a dichotomy between private sector and state-owned banks. While private sector banks will continue to invest in personnel (ie, wages), branches and IT, and marketing and branding, state-owned banks will concentrate on using technology to milk their distribution structure better. State-owned banks will also benefit from a shrinking workforce as 2–4% of their workers are expected to retire every year for the next five years. Investments in technology will enable the banks to continue to grow their balance sheets without replacing this retiring workforce.

Other costs will surely rise as competition intensifies – such as marketing and technology. But wages account for 65–70% of most state-owned banks’ costs – once these are under control, opex/assets should continue to fall.

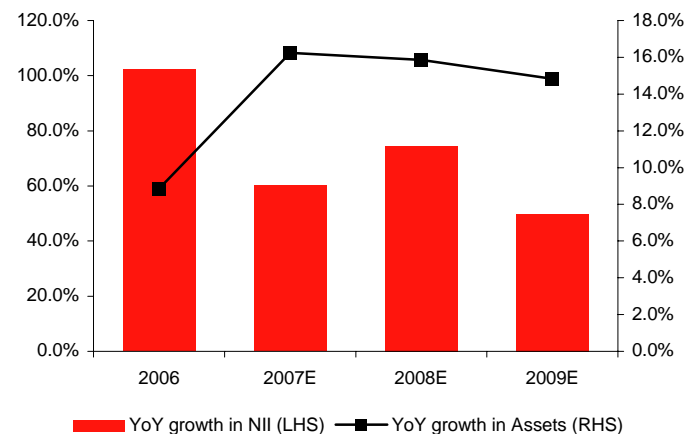
Our estimates include additional operating expenses for the integration process of UWB with IDBI. However high opex (estimated to growth at a CAGR of 38% over FY03/06-09E) would be more than offset by higher yields on its loan book coupled with decreasing cost of funds keeping its cost-to income under check (estimated NII growth at a CAGR of 61% over FY03/06-09E).

**Fig 26 Cost to income - set to improve**



Source: Company data, Macquarie Research, December 2006

**Fig 27 Asset growth to remain robust**

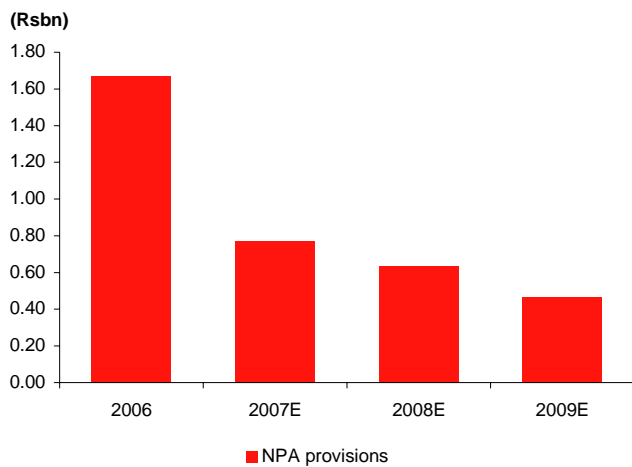


Source: Macquarie Research, December 2006

**Asset quality.** We see asset quality improving both cyclically and structurally for Indian banks. On the cyclical side, the current buoyancy in the economy continues to drive better financial health from borrowers. Rising land prices further boost the recovery of legacy bad loans. On the structural side, the improved legal and regulatory environment has made it easier to recover loans and is spurring a rapidly growing secondary market for distressed debt. We believe that “loss given default” has shrunk from 75–80% to around 55–60% on an NPV basis – this is based on discussions with market experts on distressed debt.

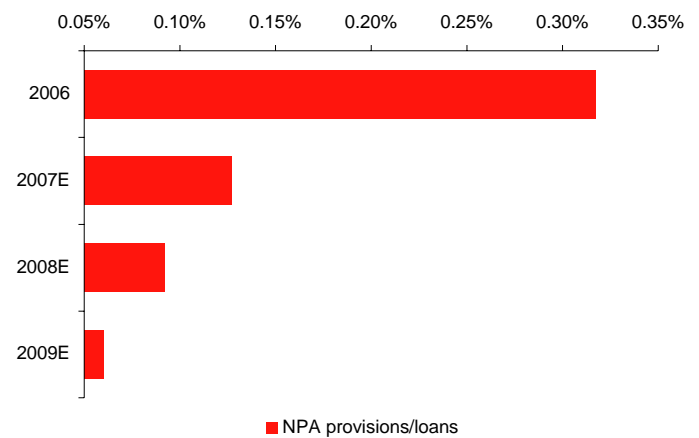
We expect IDBI’s NPA provisions and NPA/loan ratio to improve, given the relatively strong traction in recoveries as we see in some other banks. Currently, the published figures do not reflect the NPAs masked by the SASF transfer. Overall, the asset quality should continue to improve.

**Fig 28 NPA provisions set to reduce, leading to...**



Source: Company data, Macquarie Research, December 2006

**Fig 29 Lower NPA/loans ratio**



Source: Macquarie Research, December 2006

**Capital adequacy.** We see a structural shift in capital management in India over the next two to three years. In January 2006, the RBI expanded the options for banks to raise non-equity capital through perpetual bonds (15% of Tier 1) and upper Tier-2 bonds (50% of tier-1 capital over and above traditional tier-2 bonds). This allowed banks to increase leverage of equity to risk capital from 1.6 to 2.25. The effect on balance sheet management is expected to be dramatic as banks can leverage equity far better and push up their ROE.

IDBI is unlikely to benefit from these norms in a significant manner in the next three years, given its capital adequacy being comfortable at 14.6% at 30 September 2006 (14.8% at 31 March 2006). The Tier 1 CAR will come under some strain after the UWB acquisition, but we see the bank remaining comfortable.



### Company profile

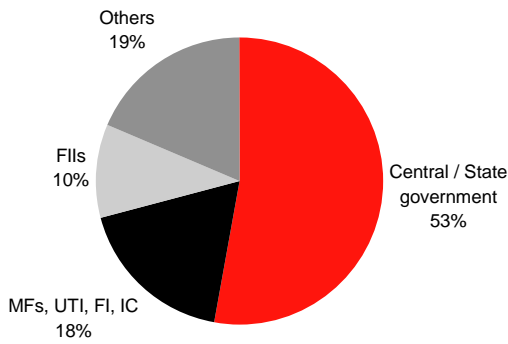
IDBI was set up as a non-banking institution to provide project finance. In 2004, IDBI was converted into a banking company and was subsequently merged with its banking subsidiary. It now functions as a full service commercial bank. A brief history of IDBI is enumerated below.

**Fig 30 IDBI milestones**

Year	Milestones
1964	On 1 July, IDBI was established by an Act of Parliament, as a wholly owned subsidiary of the Reserve Bank of India (RBI).
1976	100% ownership was transferred from RBI to Government of India (GOI)
1995	The domestic initial public offering (IPO) reduces GOI's stake, initially to 72% and post capital restructuring to 58.1%. The current GOI shareholding is 53%.
2004	On 1 October, IDBI converted into a banking company (Industrial Development Bank of India Ltd)
2005	On 2 April, IDBI merged its hitherto banking subsidiary (IDBI Bank Ltd) with itself. However the 'appointed date' of merger was 1 October 2004.

Source: Company data, Macquarie Research, December 2006

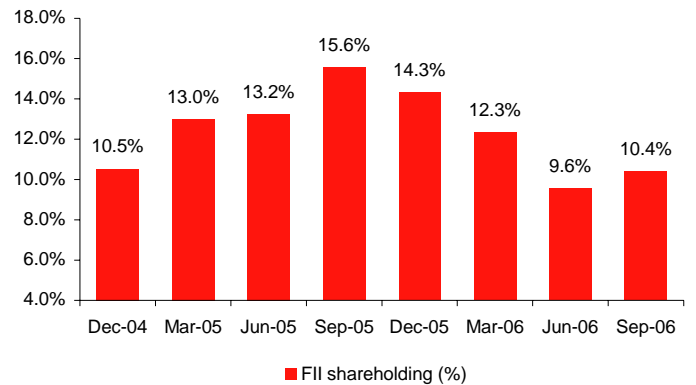
**Fig 31 IDBI – shareholding pattern at 30 September 2006**



MFs- Mutual Funds, FI - Financial institutions, IC - Insurance companies, FIIs – Foreign institutional investors

Source: Company data, Macquarie Research, December 2006

**Fig 32 FII shareholding (%)**



No limit on FII shareholding

Source: Company data, Macquarie Research, December 2006

**Fig 33 IDBI share price performance vs Nifty**

1. IDBI buys Tata Home Finance Limited (a subsidiary of Taty Finance Ltd) for Rs500m.

2. Finance Ministry appoints Mr M Damodaran, Chairman of UTI as the next chairman of IDBI

3. Indian banks' rating outlook raised to stable from negative by S&P because of improvement in asset quality & profitability

4. FQFY3/04 - Net income more than doubled to Rs 376.4m on back of robust loan growth to individuals and companies.

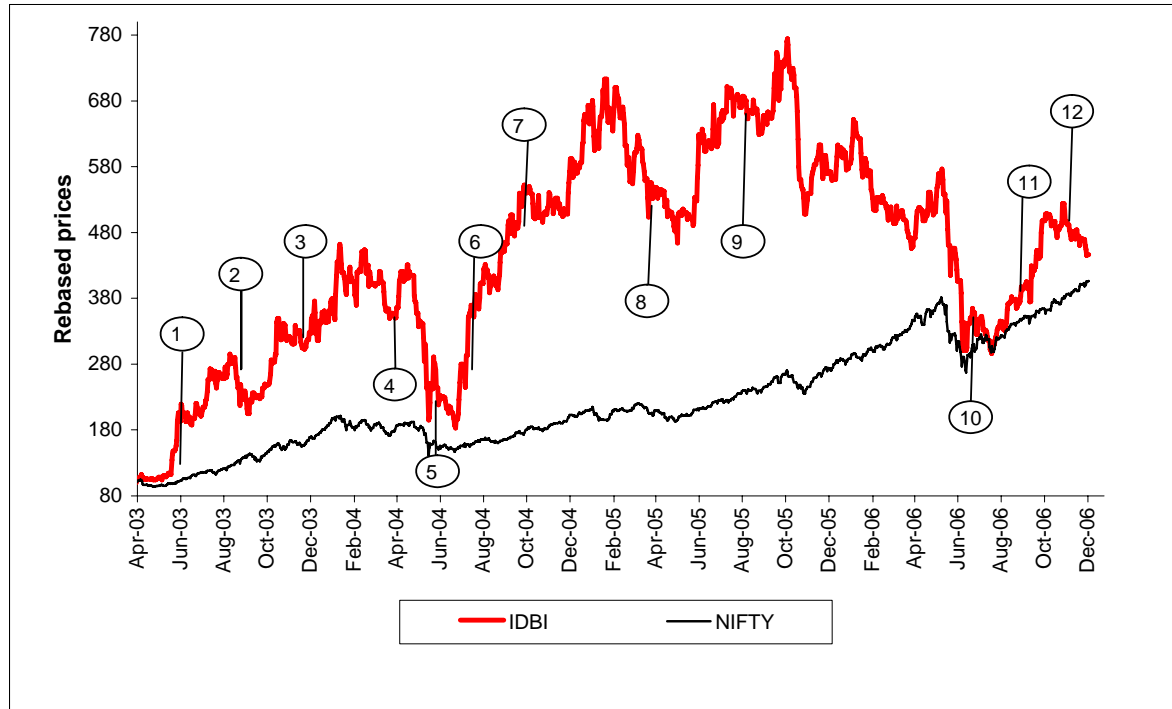
5. Indian stocks slump to their biggest one day decline in 12 years over worries that the Congress party (with support of Communist parties) will come into power

6. Shares of IDBI rose by 10% on reports of a planned bailout by the Government. The Govt plans to issue Rs90bn of bonds to an asset management trust that will take over bad loans of IDBI

7. IDBI became a commercial bank accepting deposits and making loans to individuals, after 4 decades of lending exclusively to corporates

8. India's Finance ministry named Mr VP Shetty to head IDBI. Mr Shetty was earlier the Chairman & Managing Director of Canara Bank

9. IDBI awards Rs 560m contract to IBM for consolidating its IT infrastructure & setting up of data & disaster recovery centre in the Southern Indian city of Chennai.



12. IDBI, Fortis & Federal Bank agree to set up a Life Insurance Co. IDBI to hold 48%, while Fortis & Federal Bank to hold 26% each in the proposed venture.

11. Govt of India sanctions a scheme of amalgamation of United Western Bank (UWB) with IDBI. IDBI to pay total consideration of Rs1.5bn to UWB shareholders

10. RBI asks IDBI to pay fine of Rs0.5m for violating rules relating to giving loans against shares and for financing purchase of shares in primary market

Source: Bloomberg, Macquarie Research, November 2006

## Quant perspective

### Welcome to the Alpha Model

This section introduces another part of the Macquarie Research product: the Macquarie Alpha Model. The Alpha Model is our quantitative model that ranks stocks based on seven criteria that we have found effective in differentiating outperforming stocks from underperforming stocks (see details below).

Developed over five years ago, the Alpha Model has been successful in distinguishing outperforming versus underperforming stocks across the region as well as in India. We believe the Alpha Model is among the first of its kind for India.

### Details behind the Alpha Model

The Macquarie Alpha Model – or the Alpha Model – is our quantitative model that ranks stocks based on seven criteria that we have found effective in differentiating outperforming stocks from underperforming stocks.

The seven criteria, or 'factors', that we look at are:

- Earnings revisions (from I/B/E/S)
- Value (using a combination of forward earnings yield and dividend yield)
- Consensus recommendations from I/B/E/S
- The change in consensus recommendations
- Earnings certainty, which is the dispersion of analysts' EPS forecasts
- Long-term price momentum (12 months)
- Short-term price reversion (1 month)

As in the case of IDBI, the quant view on a stock may not necessarily be in line with the view based on fundamental analysis. However, we believe that this presents a different perspective on the stock, which we believe investors will find useful.

## IDBI – Look elsewhere for Bank Exposure

The Macquarie Alpha Model holds a positive view on the Indian banks with a positive aggregated market cap weighted alpha score. However, several of the larger banks, (eg, State Bank, ICICI and HDFC) are ranking poorly in the quant model, suggesting that the majority of opportunities in the banking sector are more towards the smaller end. Indian Overseas Bank (IOB) is the top-ranked bank, rating No.2 on the Alpha model – based on cheap valuations (P/E of 7.0 and a dividend yield of 3.0%), and strong earnings revisions.

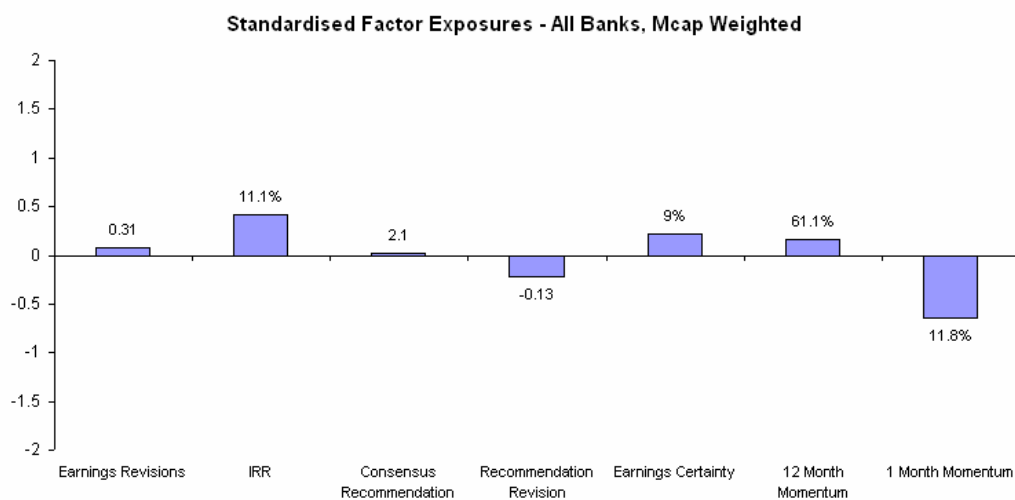
**Fig 34 Macquarie Alpha Model Rankings**

Code	Name	Market Cap (\$USbn)	Alpha	Rank
IOB	INDIAN OVERSEAS BANK	1.46	19.7%	1
SNDB	SYNDICATE BANK	0.93	12.2%	2
BOI	BANK OF INDIA	2.10	12.2%	3
ALBK	ALLAHABAD BANK	0.90	11.5%	4
UNBK	UNION BANK OF INDIA	1.43	10.4%	5
FB	FEDERAL BANK	0.40	7.8%	6
ANDB	ANDHRA BANK	0.95	5.9%	7
BOB	BANK OF BARODA	2.14	5.2%	8
PNB	PUNJAB NATIONAL BANK	3.69	5.2%	9
VJYBK	VIJAYA BANK	0.49	5.1%	10
UTIB	UTI BANK LTD	2.99	3.4%	11
OBC	ORIENTAL BANK OF COMMERCE	1.34	3.2%	12
CBK	CANARA BANK	2.66	3.1%	13
IDBI	IND. DEV. BANK OF INDIA	1.22	1.5%	14
CRPBK	CORPORATION BANK	1.23	0.7%	15
SBIN	STATE BANK OF INDIA	14.19	0.5%	16
ICICIBC	ICICI BANK LTD	16.77	-2.1%	17
HDFCB	HDFC BANK	7.47	-4.5%	18
CENTD	CENTURION BANK OF PUNJAB LTD	0.92	-7.9%	19

Source: Macquarie Research, November 2006

In general, the banking sector is an attractive sector. Valuations are clearly the key driver to the overall sector, with an IRR of 11.1%. However sentiment behind the sector is only mildly positive (with analyst's recommendations actually falling). The three poorly rated large caps (State Bank, ICICI and HDFC) are scoring negatively on revisions, even though underlying EPS growth is quite strong (ICICI EPS growth is 16.5%, while HDFC is 23.5%)

**Fig 35 What's Driving the Banks ?**



Source: Macquarie Research, November 2006

**IDBI (Neutral)**

IDBI ranked 59<sup>th</sup> out of 160 stocks in the Macquarie Alpha model for the Indian universe. The key positive for the stock is valuation, with a forward P/E of 7.4 and a yield of 2.6%. While this is quite attractive for the Indian universe, and even quite attractive for the Indian banking sector, this is the only criteria that the stock scores positively on. Several of the other key quant factors are strongly negative (eg, price momentum, revisions scores, earnings quality) – and these weigh heavily against the stock. These factors also suggest that there are better alternatives available in the Indian banking sector. For investors looking for value in the banking sector, several other securities are scoring much stronger eg, Union Bank of India, Syndicate Bank and Indian Overseas Banking. These stocks not only offer better value, but also have this in conjunction with better sentiment and momentum.

**Fig 36 IDBI - Balance sheet**

(Rs m)	2004(18m)	2005(6m)	2006	2007	2008	2009
<b>LIABILITIES</b>						
Equity capital	6,528	7,218	7,238	7,238	7,238	7,238
Share Premium	16,245	17,493	17,561	17,561	17,561	17,561
Reserves	35,576	34,573	38,921	43,446	49,008	55,944
Net worth	58,349	59,284	63,721	68,245	73,807	80,743
Sub bonds/pref cap	0	38,778	38,043	39,190	39,190	39,190
Savings deposits	0	18,919	24,990	44,993	56,241	70,301
Current deposits	1	38,867	51,747	76,908	96,135	120,169
Term deposits	38,644	93,241	183,273	349,307	597,798	785,471
Total deposits	38,645	151,026	260,009	471,207	750,174	975,941
Borrowings	483,847	500,055	475,302	400,606	275,606	220,606
Other liabilities	57,814	64,458	48,573	57,277	70,728	82,503
Total	638,655	813,602	885,648	1,036,526	1,209,506	1,398,984
<b>ASSETS</b>						
Loans	328,680	454,136	527,391	606,499	691,409	781,292
Corp investments	0	53,050	43,996	54,037	61,602	69,611
Gilts	90,000	148,983	161,799	204,101	250,019	310,075
Other investments						
- Equity	0	27,065	24,101	24,204	24,204	24,204
- Subs	0	3,141	3,470	3,471	3,471	3,471
- Others	152,431	18,309	20,139	24,486	27,914	31,263
Cash/equiv	19,391	56,532	53,628	59,317	79,177	97,654
Fixed assets	9,067	8,894	8,109	8,364	7,440	6,444
Other assets	39,087	43,494	43,015	52,047	64,270	74,969
Total	638,655	813,602	885,648	1,036,526	1,209,506	1,398,984

Source: Macquarie Research, December 2006

**Fig 37 IDBI - Income statement**

(Rs m)	2004(18m)	2005(6m)	2006	2007	2008	2009
Interest Income	68,430	26,557	53,807	63,970	75,672	91,626
Interest expenses	70,803	24,679	50,008	57,799	65,665	76,971
Net Interest Income	-2,373	1,879	3,799	6,171	10,007	14,655
Fees & Misc Income	2,400	2,787	5,707	8,119	9,220	9,609
Net revenues	27	4,665	9,506	14,289	19,227	24,264
Operating Expense	5,748	4,540	8,595	9,515	12,244	13,908
- Employee exp	1,817	1,493	3,185	3,166	5,201	6,179
- Other opex	3,931	3,046	5,410	6,349	7,043	7,729
Operating profit	-5,722	126	911	4,774	6,984	10,356
Investment profits	11,457	3,484	7,097	3,000	2,000	1,000
Preprovision profit	5,735	3,610	8,009	7,774	8,984	11,356
Provisions	1,120	725	2,125	1,164	895	694
- Loan loss provisions	0	-342	1,673	770	638	470
- Investment depreciation	0	-16	387	394	257	225
- Other provisions	1,120	1,083	65	0	0	0
PBT	4,615	2,885	5,884	6,611	8,089	10,661
Taxes	-35	-188	275	529	1,011	1,333
PAT	4,650	3,073	5,609	6,082	7,078	9,329
Extraordinaries	0	0	0	0	0	0
Reported PAT	4,650	3,073	5,609	6,082	7,078	9,329
Dividends	979	541	1,086	724	1,375	2,171

Source: Macquarie Research, December 2006









**Banks sector performance (%)**

	Absolute performance			Relative to local index			Relative to MSCI Asia Pacific		
	1m	3m	6m	1m	3m	6m	1m	3m	6m
S&P Financials	2.8	7.5	10.5	-0.8	-0.3	-1.2	-2.1	-3.5	-4.5
FTSE Bank	-4.9	0.1	4.3	-4.7	-3.0	-2.6	-9.5	-10.2	-9.9
Australia	-4.0	3.1	7.5	-4.0	-3.2	-0.6	-8.7	-7.4	-7.1
HK (ex HSBC, SCB)	4.9	11.9	15.5	4.8	2.0	-2.6	-0.2	0.5	-0.1
HSBC	-3.9	2.8	7.4	-3.9	-6.3	-9.4	-8.5	-7.6	-7.1
Std Chartered HK	2.9	15.7	19.6	2.9	5.4	0.8	-2.1	3.9	3.4
China	24.4	52.2	56.1	4.5	14.2	21.7	18.4	36.6	34.9
India	12.4	33.1	48.1	6.4	13.9	5.8	7.0	19.5	28.0
Indonesia	4.9	26.0	45.4	-3.1	4.5	7.7	-0.2	13.2	25.6
Malaysia	18.5	18.7	23.5	8.1	4.3	5.0	12.8	6.6	6.7
Philippines	2.1	10.3	10.5	0.5	-5.9	-9.9	-2.8	-0.9	-4.5
Singapore	6.5	16.2	21.9	0.2	1.2	0.4	1.4	4.4	5.4
South Korea	2.0	2.0	3.4	-0.8	-2.4	-5.1	-3.0	-8.4	-10.6
Taiwan	9.2	16.3	8.3	2.1	2.2	-4.2	3.9	4.4	-6.4
Thailand	1.6	12.7	12.3	0.2	6.4	7.9	-3.3	1.2	-2.9

Note: Data as of 5 December 2006

Source: Bloomberg, Macquarie Research, December 2006

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## Recommendation definitions

**Macquarie Australia/New Zealand**

Outperform – return >5% in excess of benchmark return (>2.5% in excess for listed property trusts)  
 Neutral – return within 5% of benchmark return (within 2.5% for listed property trusts)  
 Underperform – return >5% below benchmark return (>2.5% below for listed property trusts)

**Macquarie Asia**

Outperform – expected return >+10%  
 Neutral – expected return from -10% to +10%  
 Underperform – expected return <-10%

**Macquarie First South Securities (South Africa)**

Outperform – expected return >+5%  
 Neutral – expected return from -5% to +5%  
 Underperform – expected return <-5%

**Recommendations** – 12 months

**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

**Recommendation proportions**

	AU/NZ	Asia	RSA
Outperform	42.81%	57.12%	42.20%
Neutral	44.60%	26.36%	46.80%
Underperform	12.59%	16.52%	11.00%

For quarter ending 30 September 2006

**Volatility index definition\***

This is calculated from the volatility of historic price movements.

**Very high–highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low–medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.

\* Applicable to Australian/NZ stocks only

**Financial definitions**

All "Adjusted" data items have had the following adjustments made:  
 Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense  
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / efpowa\*

**ROA** = adjusted ebit / average total assets

**ROA Banks/Insurance** = adjusted net profit / average total assets

**ROE** = adjusted net profit / average shareholders funds

**Gross cashflow** = adjusted net profit + depreciation

\*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

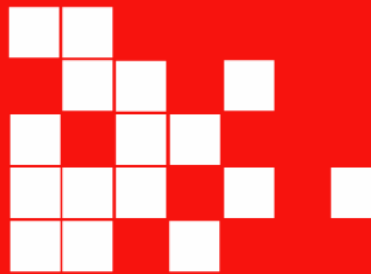
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