

## Company Focus

1 November 2007 | 9 pages

# Central Bank Of India (CBI.BO)

 Rating change   
 Target price change   
 Estimate change 

## Sell: Disappointing 1H08 Results; Cutting Target Price, Estimates

- 1H08 profits up 3%; operationally a weak performance** — Operationally, it was a disappointing half year. Key pressure points were on margins, non-interest incomes and asset recoveries. Asset quality improvement was the key positive though off a relatively high base. We are reducing earnings 20-7% over FY08-10E, risk rating to Medium, TP to Rs121. Maintain Sell.
- Margins: sharp reduction, limited upsides** — CBI's margins declined 46bps yoy to 273bps in 1H08; largely due to higher cost deposit accretion in 4Q07 (an industry phenomenon) that has hit CBI relatively more than peers. We expect margins to have bottomed, though competitive pressure is likely to limit upside, given its relatively higher proportion of lower yielding corporate loans.
- Other P&L drivers also sluggish** — Non-interest incomes, including fees and asset recoveries have been slower than peers. CBI though has a large base of written off assets to recover from; stronger management focus and new initiatives suggest improvements – though gradual, over the medium term.
- Balance sheet: Growing and improving quality** — CBI's loan portfolio has grown 25% yoy – above industry levels; has still more headroom to accelerate growth in 2H08 (LDR of 60% now). Asset quality has also improved with reductions in NPLs; increasing coverage ratios provide some comfort.
- Lowering risk rating to Medium** — to account for CBI's large size, diversified asset base and high share of low cost deposits providing stability to operations.

<b>Sell/Medium Risk</b>	<b>3M</b>
<i>from Sell/High Risk</i>	
Price (31 Oct 07)	Rs128.80
Target price	Rs121.00
<i>from Rs130.00</i>	
Expected share price return	-6.1%
Expected dividend yield	2.7%
<b>Expected total return</b>	<b>-3.3%</b>
Market Cap	Rs52,053M
	US\$1,328M

### Price Performance (RIC: CBI.BO, BB: CBOI IN)

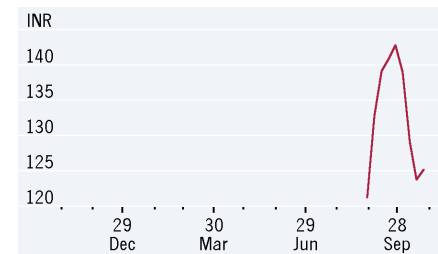


Figure 1. Central Bank – Statistical Abstract

Year to	Net Profit	FD EPS	EPS Growth	P/E	P/BV	RoAE	ROAA	Div Yld
March 31	(Rs Mils.)	(Rs)	(%)	(X)	(X)	(%)	(%)	(%)
FY06	2,574	2.3	-28.0	55.6	4.9	7.7	0.4	0.3
FY07	4,978	15.4	570.7	8.3	1.6	15.5	0.6	2.4
FY08E	4,922	12.2	-20.7	10.5	1.5	14.1	0.5	2.7
FY09E	7,392	18.3	50.2	7.0	1.3	17.2	0.6	2.7
FY10E	8,385	20.7	13.4	6.1	1.1	17.1	0.6	3.1

Source: Company Reports and Citi Investment Research estimates

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
<b>Valuation Ratios</b>					
P/E adjusted (x)	56.2	18.7	9.5	7.0	6.2
P/E reported (x)	56.2	18.7	9.5	7.0	6.2
P/BV (x)	4.2	1.4	1.3	1.1	1.0
P/Adjusted BV diluted (x)	4.9	1.7	1.5	1.3	1.1
Dividend yield (%)	0.3	2.4	2.7	3.1	3.1
<b>Per Share Data (Rs)</b>					
EPS adjusted	2.29	6.87	13.52	18.29	20.75
EPS reported	2.29	6.87	13.52	18.29	20.75
BVPS	30.62	92.24	99.35	112.97	129.04
Tangible BVPS	30.62	92.24	99.35	112.97	129.04
Adjusted BVPS diluted	26.10	77.25	87.33	100.95	117.02
DPS	0.44	3.07	3.50	4.00	4.00
<b>Profit &amp; Loss (RsM)</b>					
Net interest income	23,801	24,744	26,784	31,455	35,725
Fees and commissions	3,028	3,505	3,925	4,318	4,750
Other operating Income	2,484	2,113	1,335	1,808	1,739
<b>Total operating income</b>	<b>29,313</b>	<b>30,362</b>	<b>32,044</b>	<b>37,581</b>	<b>42,213</b>
Total operating expenses	-17,162	-16,844	-18,293	-19,868	-21,855
<b>Oper. profit bef. provisions</b>	<b>12,151</b>	<b>13,519</b>	<b>13,752</b>	<b>17,713</b>	<b>20,358</b>
Bad debt provisions	-1,200	-3,266	-4,720	-5,152	-6,129
Non-operating/exceptionals	-7,192	-3,300	-1,000	-1,000	-1,250
<b>Pre-tax profit</b>	<b>3,759</b>	<b>6,953</b>	<b>8,031</b>	<b>11,560</b>	<b>12,979</b>
Tax	-1,185	-1,973	-2,409	-3,468	-3,894
Extraord./Min. Int./Pref. Div.	0	-2	-700	-700	-700
<b>Attributable profit</b>	<b>2,574</b>	<b>4,978</b>	<b>4,922</b>	<b>7,392</b>	<b>8,385</b>
Adjusted earnings	2,574	4,978	4,922	7,392	8,385
<b>Growth Rates (%)</b>					
EPS adjusted	-28.0	200.2	96.6	35.3	13.4
Oper. profit bef. prov.	-25.4	11.3	1.7	28.8	14.9
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>746,810</b>	<b>930,081</b>	<b>1,099,975</b>	<b>1,274,861</b>	<b>1,473,757</b>
Avg interest earning assets	697,088	813,485	985,282	1,155,452	1,340,422
Customer loans	391,955	536,966	658,621	770,644	901,711
Gross NPLs	26,840	25,720	26,159	31,165	36,822
<b>Liab. &amp; shar. funds</b>	<b>746,810</b>	<b>930,081</b>	<b>1,099,975</b>	<b>1,274,861</b>	<b>1,473,757</b>
Total customer deposits	664,826	827,763	984,643	1,151,043	1,335,210
Reserve for loan losses	17,120	19,012	21,537	25,255	29,606
Shareholders' equity	<b>34,420</b>	<b>37,898</b>	<b>48,153</b>	<b>53,656</b>	<b>60,151</b>
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	7.7	15.5	14.1	17.2	17.1
Net interest margin	3.41	3.04	2.72	2.72	2.67
Cost/income ratio	58.5	55.5	57.1	52.9	51.8
Cash cost/average assets	2.4	2.0	1.8	1.7	1.6
NPLs/customer loans	6.8	4.8	4.0	4.0	4.1
Reserve for loan losses/NPLs	63.8	73.9	82.3	81.0	80.4
Bad debt prov./avg. cust. loans	0.4	0.7	0.8	0.7	0.7
Loans/deposit ratio	59.0	64.9	66.9	67.0	67.5
Tier 1 capital ratio	7.2	6.3	7.3	7.0	6.7
Total capital ratio	11.0	10.4	10.7	9.9	9.7

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Figure 2. Central Bank – Earnings Revision Summary (Rupees Million, Percent)

	Net Profit			EPS			DPS	
	Old	New	% change	Old	New	% change	Old	New
FY08E	6,192	4,922	-20.5	15.3	12.2	-20.5	3.5	3.5
FY09E	7,763	7,392	-4.8	19.2	18.3	-4.8	4.0	4.0
FY10E	8,984	8,385	-6.7	22.2	20.7	-6.7	4.0	4.0

Source: Citi Investment Research estimates

Figure 3. Central Bank – 1H08 Results: Key Highlights (Rupees Million, Percent)

	1H08	1H07	YoY %	Citigroup Investment Research Comments
Interest Income	37,311	28,791	29.6	
Interest Expense	(25,928)	(17,191)	50.8	Large increase in cost of deposits - has been an industry phenomenon with most PSU banks this quarter
Net Interest Income	11,383	11,601	-1.9	Disappointing quarter - absolute decline in NII despite a strong loan and yield expansion
Fee-Based Income	3,304	4,783	-30.9	
Other Non-Interest Income	810	1,650	-50.9	Slow down in asset recoveries especially disappointing; apart from a reduction in bond gains (a contrast to most peers)
Non Interest Income	2494.4	3132.7	-20.4	
<b>Operating Income</b>	<b>13,878</b>	<b>14,733</b>	<b>-5.8</b>	
Operating Expenses	-8763.4	-8180.8	7.1	Costs relatively in check though has not adopted best practices for employee benefit provisioning
Pre-Provision Profit	5,114	6,552	-21.9	
Charges for Bad Debts	-2441.1	-2977.6	-18.0	
Operating Profit	2,673	3,575	-25.2	
Pre-Tax Profit	2,673	3,575	-25.2	
Tax	-453.7	-1427	-68.2	
<b>Net Profit</b>	<b>2,220</b>	<b>2,148</b>	<b>3.3</b>	<b>Overall a weak quarter with sharp decline in margins and fee incomes</b>
EPS	5.49	5.32	3.3	
Customer Loans	539,710	432,460	24.8	Strong growth - amongst the highest relative to peers - likely to continue higher than industry growth
Customer Deposits	908,450	762,186	19.2	Deposit accretion in line with industry levels - though low cost deposit ratio has declined to 39.4% (from 42.8% earlier)
AIEA	833,957	726,364	14.8	
AIBL	844,859	716,455	17.9	
Total Assets	981,126	830,783	18.1	
Avg Assets	932,070	789,244	18.1	
Non-Performing Loans (NPL)	25,962	28,056	-7.5	One of the better shows among PSU banks (though comes off a relatively high base)
Loan Loss Reserves (LLR)	(18,613)	(19,319)	-3.7	
Shareholders' Funds	35,419	23,372	51.5	
Book Value Per Share	88	72	21.5	
<b>Key Ratios (%)</b>	<b>1H08</b>	<b>1H07</b>	<b>Bps Δ YoY</b>	<b>Citigroup Investment Research Comments</b>
ROAA (annualized)	0.45	0.52	-6	Continues to be amongst the lowest in terms of core profitability
ROAE (annualized)	12.53	18.38	-585	
Net Interest Margin (bps)	273	319	-46	Key disappointment - sharp reduction in margins; large corporate portfolio suggests limited pricing power to increase yields further
Fee Inc/Operating Income	23.8	32.5	-865	
Other Non-Interest Inc/Op Inc	18.0	21.3	-329	
Op. Cost/ Operating Income	63.1	55.5	762	Relatively higher than peers - pressures to remain over the near term with continued branch and technology costs
Loan-to-Deposit Ratio (LDR)	59.4	56.7	267	Has still more room to grow relatively faster - likely to see growth accelerating in 2H08
NPL/Loan Ratio	4.8	6.5	-168	
LLR/NPL Ratio	72	69	283	Improving coverage ratios - some comfort on a higher NPL base

Source: Company Reports and Citi Investment Research estimates

## Central Bank Of India

### Company description

Central is the eighth-largest Indian bank, and the seventh-largest among government banks. This broadly positions it as a large-sized bank, with a deposit market share of about 3%. Central has a wide distribution franchise with over 3,250 branches. This positions it as the third largest domestic bank in terms of branch network.

### Investment strategy

We rate Central Bank of India shares Sell / Medium Risk (3M). Key strengths are: a) large balance sheet and strong pan-India distribution; b) relatively superior deposit franchise; and c) relative insulation from interest rate increases. The bank lags its peers meaningfully in: a) Profitability - its ROA of 0.6% is meaningfully lower than the industry average of 1%. We believe profitability is structurally challenged on competitive margins, low fee incomes, and higher provisioning levels relative to peers; b) Asset quality - it has higher-than-industry NPL ratios and delinquencies; and c) technology - implementation has lagged peers and is a competitive disadvantage. Though management is addressing these concerns, we see improvement as only gradual.

### Valuation

We value Central Bank at Rs121 per share based on our EVA model, which we believe better captures the long-term value of the business and is a standard valuation measure for our Indian banking coverage. The key assumptions for our EVA model are: a) industry average interest long term spreads at 2.2%; b) longer-term loan loss provisioning levels of 100bps - in line with peers; and c) lower equity-to-assets ratio of 4.2x as compared to industry average of 6.5x, as Central Bank is relatively more leveraged than peers. Our EVA valuation is premised on an 8% risk-free rate, consistent with our assumptions for other Indian banks. Alternatively, we benchmark Central Bank valuations at a price-to-book (P/BV) of 1.2x FY09E, which is at a slight discount to our target multiples for peer government banks and a larger 15-20% discount to best-of-breed government banks. This methodology implies a value of Rs121 per share of Central Bank. We believe this discount is warranted given Central's 1) lower-than-peers' profitability levels; 2) lower-than-industry asset quality and relatively higher delinquency levels; and 3) slower-than-peers technology roll-out which inhibits faster growth in fee incomes in the near term.

### Risks

We rate Central Bank shares as Medium Risk (in-line with peers) though our quantitative risk-rating system, which tracks 260-day historical share price volatility, suggests High Risk on limited trading history for the stock. We believe Central Bank's large balance sheet size, diversified asset base and high share of low cost deposits, provide relative stability to operations. Key upside risks which could cause the shares to continue to trade above our target price include: (a) Greater-than-expected improvements in asset quality and

delinquency; (b) Higher-than-estimated growth in fees; (c) Improvement in low-cost deposits; (d) Consistently higher sustainable profitability.

# Appendix A-1

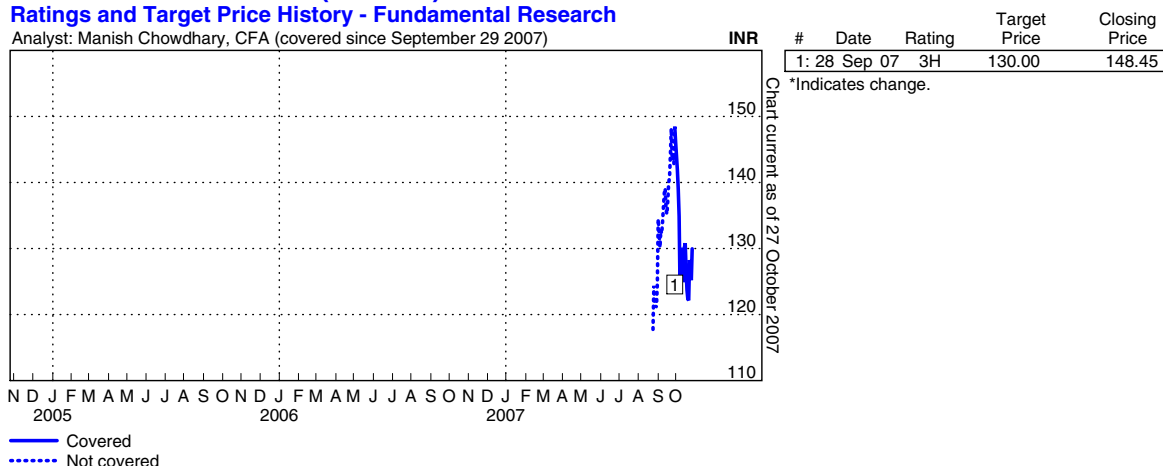
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Analyst: Manish Chowdhary, CFA (covered since September 29 2007)



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## Central Bank Of India (CBI.BO)

1 November 2007

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1 November 2007

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