India Equity Research

Banking

15 June 1999

NEW CEO NEW ACCOUNTS

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The Clean-up Artists

Forecasts for financial institutions have to take into account the coming of a new chief executive officer (CEO). Some new CEOs have presented shocking results in their first year. Robust profits of previous years have suddenly evaporated, replaced by marginal profitability or even losses. We believe unreported non-performing assets (NPAs) are being "discovered" and provided for by the new CEO. The situation is exacerbated since first, the outgoing CEO does not want to report significant decline in profits which will reflect on his stewardship. Secondly, the new CEO wants to absolve himself of responsibility for the past and take credit for any eventual improvement in the company.

Significant Decline in Profits Under New CEO

Institution	IFCI	IndusInd Bank	IDBI
New CEO	PV Narasimham	KR Maheshwari	GP Gupta
Date of taking charge as CEO	16 July 1998	3 October 1998	1 July 1998
FY1998 (Rs mn)			
Reported Net Profit	3,705	911	15,014
Adjusted Net profit*	196	911	14,636
FY1999 (Rs mn)			
Reported Net Profit	235	368	12,590
Adjusted Net profit*	-2,843	368	10,160
Decline over FY1998 (%)			
Reported Net Profit	-93.7%	-59.6%	-16.1%
Adjusted Net profit*	-	-59.6%	-30.6%

**Adjusted for below the line deductions*

- **IFCI and IndusInd Bank outstanding examples.** The Industrial Finance Corporation of India (IFCI), India's oldest development financial institution, reported a loss in FY1999 of Rs2.8bn. IndusInd Bank reported a 60% decline in net profits to Rs368mn in FY1999. A significant increase in reported non-performing assets and bad debt provisions was the main explanation. In both institutions, the FY1998 annual report failed to provide any warning signals to investors. In our opinion, the need for extra provisions was recognised only because new managing directors (MD) had taken charge in both the institutions. In IFCI, the new MD took charge on 16 July 1998 and in IndusInd Bank the new MD was appointed on 3 October 1998.

- **Optimism prevailed in IndusInd Bank's FY1998 annual report.** In IndusInd Bank's FY1998 annual report, the directors were extremely positive about the bank's performance. They stated, "as a prudent measure, the bank concentrated on consolidating its portfolio in terms of asset quality. New proposals were taken up very selectively after thoroughly evaluating the creditworthiness of the borrowers and the industry prospects…it is hoped that [with the economic revival]…the NPA level will be reduced significantly during 1998-99." In FY1999, IndusInd Bank's net NPAs increased 97% from Rs970mn (3.96% of asset) to Rs1.91bn (7.2% of assets).

- **IndusInd Bank accepts that its FY1998 profits were inflated.** Reporting its FY1999 results the management stated, "the current year's profit is reduced on account of provisions relating to previous year amounting to Rs271mn the [FY1999] profit without this adjustment works out to Rs639mn." This casts doubt on the credibility of the bank's accounts and its internal and external auditors. It is now apparent that in FY1998, the management adopted a liberal accounting policy which was not disclosed to shareholders at the appropriate time. Such behaviour is particularly unfortunate since this organisation was rated as a number one bank by various prestigious bank surveys and was given the highest possible safety rating of PR1+ by the credit rating agency CARE.

- **IFCI's performance though worse, was expected.** IFCI has always been perceived to be a poorly managed institution but its accounts had never revealed it until FY1999. The new MD accepted that the FY1999 performance was because of problems in the past when he stated, "the accumulated non-performing assets of the past necessitated large provisioning…"(*Financial Express* 29 May 1999). IFCI's net NPAs increased 50% from Rs26.6bn (14% of portfolio) to Rs40bn (21% of the portfolio). Of course, the departing MD had not raised any significant concern to warn investors.

- **Both companies paid dividends in FY1998 despite impending problems.** In FY1998 IFCI maintained its dividend at Rs3 per share and IndusInd Bank maintained its dividend at Rs2 on an expanded equity. Both institutions announced interim as well as final dividends in FY1998. In FY1999, both slashed their dividend – IFCI to Rs1 and IndusInd Bank to Rs1.25.

- **IFCI and IndusInd shareholders' investment depreciated significantly.** Between the announcement of their FY1998 and the FY1999 results, shareholders of both institutions have lost considerably. IFCI reported its FY1998 results on 22 June 1998 when its share price closed at Rs26.9 (Sensex 3,079), its FY1999 results were announced on 28 May 1999 (share price Rs12.9, Sensex 3,771). This represented a decline of 52% in absolute value and 74% in relative to the Sensex. IndusInd Bank announced its FY1998 results on 14 May 1998 (share price Rs36.9, Sensex 3,898) and its FY1999 results on 28 May 1999 (share price Rs17, Sensex 3,771). IndusInd Bank's share price therefore declined 54% in absolute terms and 52% relative to the Sensex.

- **Monitoring the tenure of CEOs is imperative.** Accounts of banks whose profits vary according to the length of service of their CEO do not reflect a "true and fair" picture. The most glaring example was the case of Indian Bank, a 100% government-owned bank which reported profits in FY1995 and declared results which made it insolvent under a new MD in FY1996. Despite the "independence" of auditors and the board of directors, the managing director of a bank has tremendous leeway in presenting the accounts. We believe that the CEOs tenure must be monitored since the advent of a new CEO may suddenly transform the accounts for the worse. Conversely, the last year of the departing CEO, must also be viewed with caution since departing CEOs tend to report far better results than warranted so as to depart with glory. We believe that this happened in IDBI in FY1998 and was rectified in FY1999 under the new managing director.

- **ICICI, Bank of India and Global Trust Bank (GTB) are some institutions where we have concerns.** In Bank of India, a new managing director was appointed in 5 December 1998 and we expect Bank of India's profits to be affected in FY1999. We also have similar concerns regarding ICICI, although we do not expect any significant deterioration in the accounts to be reported until FY2002 since the existing managing director's term ends 1 May 2001 (assuming no extension is granted). In GTB the existing MD is also a key promoter - investors are unlikely to have the benefit of a "new broom" in the near future.

Tenure of Existing Managing Directors

Institution	Managing Director (MD)	Date of taking charge as MD	Date term Ends@	First Accounts under Current MD	Last Accounts under Current MD*
HDFC Bank	Aditya Puri	30 Aug 1994	30 Aug 1999	FY1995	FY1999
Bank of Baroda	K Kannan	19 Jan 1995	1 Nov 1999	FY1995	FY1999
Bank of India	S Rajagopal	5 Dec 1998	31 Mar 2000	FY1999	FY1999
HDFC	DM Satwalekar	1 Feb 1993	1 Feb 2000	FY1993	FY1999
IndusInd Bank	KR Maheshwari	3 Oct 1998	3 Oct 2000	FY1999	FY2000
SBI	GG Vaidya	1 Feb 1999	30 Oct 2000	FY1999	FY2000
Corporation Bank	RS Hugar	1 Apr 1997	31 May 2000	FY1997	FY2000
IDBI	GP Gupta	1 Jul 1998	1 Jan 2001	FY1999	FY2000
IFCI	PV Narasimham	16 Jul 1998	1 Sep 2001	FY1999	FY2000
ICICI	KV Kamath	1 May 1996	1 May 2001	FY1997	FY2001
Oriental Bank	Dalbir Singh	1 Nov 1996	1 Nov 2001	FY1997	FY2001
Global Trust Bank	Ramesh Gelli	8 Dec 1993	10 July 2002	FY1994	FY2002
ICICI Bank	HN Sinor	1 June 1998	1 June 2003	FY1999	FY2003

**Tenure can be extended*

@ approximate

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