AUDITING FRAUD III

Baffling Banks

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GMT RESEARCH

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[redacted]

Banks that raised four or more of our audit red flags underperformed their peers over the last 1, 3 and 5 years, underscoring the importance of credible accounts to the investor. Even in mature markets, banks that raised the most red flags often paid lower audit fees and saw poor share price performance. This report highlights some of Asia's main offenders including the likes of China CITIC Bank, China Minsheng Bank and IDBI Bank but many more are mentioned within (in both Asia and globally). Investors should be alarmed that despite increased regulations, fines and losses since the Global Financial Crisis, audit costs at global banks such as HSBC and JP Morgan have fallen, suggesting that little has been learned.

Email Rob for his auditing spreadsheet to scan companies in your portfolio for accounting issues.

What Should an Audit Cost?

In our third and final instalment on audit costs, we look at the banking sector around the world. Based on 500 large finance companies, our research shows that normal audit fees are 0.2-0.8bp of assets for banks, 0.3-3.0bp for insurance companies and 0.9-4.7bp for asset managers. But there are notable variances. For example, Canara Bank (CBK IN) in India has assets just 50% larger than IDBI (IDBI IN) but pays 20x the fees. In Japan, Shinsei Bank (8303 JP) pays 10x the fees of Shizuoka Bank (8355 JP) despite similar assets. At a country level, the top of the normal range in China is 0.41bp which is below the bottom of the normal range for US banks at 0.47bp. The Philippines is even cheaper; Philtrust (PTCPM) manages to get multi-billion dollar business audited for under US$13,000.

Auditing Red Flags

Our list of red flags is based on 15 ratios covering seven key areas. They aim to test how important management's subjective judgement is to the accounts. The implication is that greater subjectivity should be reflected in a more thorough audit. SMFG (SMFG JP), State Bank of India (SBI IN), China Citic (998 HK) and Banco Bogota (BOGOTA CB) are the largest of the 7 banks from around the world that raised 8+ flags. Stocks with **4+ red flags, underperformed the rest over 3 years by 37%** using a global list of finance companies, underscoring the importance of credible accounts. Figure 1 lists Asian banks with a high number of red flags AND low auditing costs. These are possibly more liable to future write-downs given questionable audits.

Mining the Data

In Europe, bank assets are still falling. Elsewhere, there is asset growth, but not as fast as equity, so leverage is falling. Still, risk weighted assets bottomed in 2012 and have started to rise again, which is positive. Even so, some of the countries which have been recently growing assets have now either raised loan/deposit ratios close to 1 (India), or have high leverage (Russia and Turkey). To prevent excessive risk, banks in all three countries will require more capital to fund any further growth.

Figure 1: Baffling Banks: Asian Companies with 6 or More Red Flags and Low Auditing Costs

Name (Ticker) - Flags		Name (Ticker) - Flags		Name (Ticker) - Flags	
China Citic Bk (998 HK)	- 8	China Minsheng (600016 CH)	- 7	Industrial Bank (601166 CH)	- 6
IDBI Bank (IDBI IN)	- 6	Bank Of Comm. (3328 HK)	- 6	China Merch Bank (600036 CH)	- 6
Shang Pudong (600000 CH)	- 6	Bank Of Beijing (601169 CH)	- 6	Bank Of Ningbo (002142 CH)	- 6
Bank Of Nanjing (601009 CH)	- 6	Yes Bank Ltd (YES IN)	- 6	Hokuhoku Financial (8377 JP)	- 6
Yamaguchi (8418 JP)	- 6				

Source: GMT Research

About the Author

Robert Medd trained as a Cost and Management Accountant in the UK. He moved to Hong Kong in 1996 to work in Research at Deutsche Bank, where he was rated by Institutional Investor, Asiamoney etc. for his Microstrategy and Quant research. He then moved to Goldman Sachs to help generate ideas for hedge funds. Robert has since been on the buy side at Deephaven and Fortress and a couple of smaller funds. Ever since he arrived in Asia, Robert has met and analysed companies across the whole region from India to Japan and Mongolia to New Zealand.

The Auditing Fraud Series of Reports

This report is the final instalment of a three part series on auditing costs in Asia. In the first instalment, we tacked the issue of auditing costs in industrial companies in Asia whilst in the second we turned our attention to the property sector. Summary paragraphs are below with links to the full report, slide decks and short videos:

AUDITING FRAUD: Tomorrow's Scandals?

By Robert Medd, 14 May 2014

In several recent corporate collapses the published accounts proved to be an illusion. One can but conclude that the level of due diligence at audit time was inadequate. To see where the next scandal might be or at least where investors should be concerned, we have cross checked audit costs, a proxy for time spent on due diligence, against companies with problematic accounts. Several well-known names such as Toshiba, China Coms Construction and Venture Manufacturing are amongst the 22 companies on our shortlist in the table below.

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AUDITING FRAUD II: Property Problems

By Robert Medd, 11 June 2014

It has been a long time since an Asian property company collapsed but investors would be wise to consider the possibility. Our analysis of subjective accounting standards and auditing costs shows that many property companies have weak balance sheets and even these numbers may be unreliable given limited audits, especially in China and India. China Vanke, Carnival, Hopson and Shenzhen Investment stand out as the worst offenders. Several others attract attention due to their extreme exposure to at least one of the ratios reviewed, including Lippo Karawaci, NTT Urban, CapitaMalls and Tokyu Fudosan. Still, property companies in Malaysia and Indonesia look very healthy. Moreover, share prices of quality companies with normal audit fees and less subjective accounting actually rose 47% over the last three years underlining the importance of financial statements in stock selection.

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What Should an Audit Cost?

Fundamental investors need quality audits

Fundamental investors need high quality published accounts. Moreover, a high quality audit should be of benefit to the company. A good auditor will suggest how accounting processes can be improved, advise management on corporate best practice and check that the directors, never mind shareholders, are not being deceived. A cheap audit might signify thriftiness but it also suggests that either management does not want anyone looking too closely at the business or the controlling shareholder sees the business as their personal fiefdom.

Pragmatic managements hire quality auditors

Audit fees are a guide to quality of the audit and the seniority of audit staff

Accountants typically charge by the hour, so, although the final fee may be discounted and altered, the audit cost remains, at its core, a time-driven calculation. The fee therefore provides an indication of either the amount of time spent verifying the accounts or the seniority of staff looking at the audit. For example, all audits in China must be signed off by a qualified accountant, but there are not enough to go around. As a result, there is not much difference in salary for qualified staff between the local and the major firms. However, at local firms, cheaper underlings, who have less experience and are less likely to ask awkward questions, do more of the basic auditing.

Beware fly-by audits; make sure the auditor is based in Asia

In the past, this lack of local staff even resulted in companies being audited by accounting staff that was unable to speak or read the local language. The overseas offices of major audit firms, typically in North America, often flew into Asia for a whistle-stop audit prior to and after an IPO. With the benefit of hindsight, it is not hard to see why so many US-listed Asia plays have blown up.

We have compared fees globally

In this report, by looking into the audit costs for over 500 large listed finance companies, we attempt to set out some benchmarks for audit fees. Although cost cannot be the only measure of auditing quality, it provides a start. Apparently some of the large audit firms are desperate to audit flagship companies in China, so are prepared to lose money now as an investment in the future, thereby providing "quality" despite the low costs. It sounds reasonable but we have heard that the opposite case is also true, i.e. name brand auditors use less than the best staff to keep costs low.

Creating some fee benchmarks

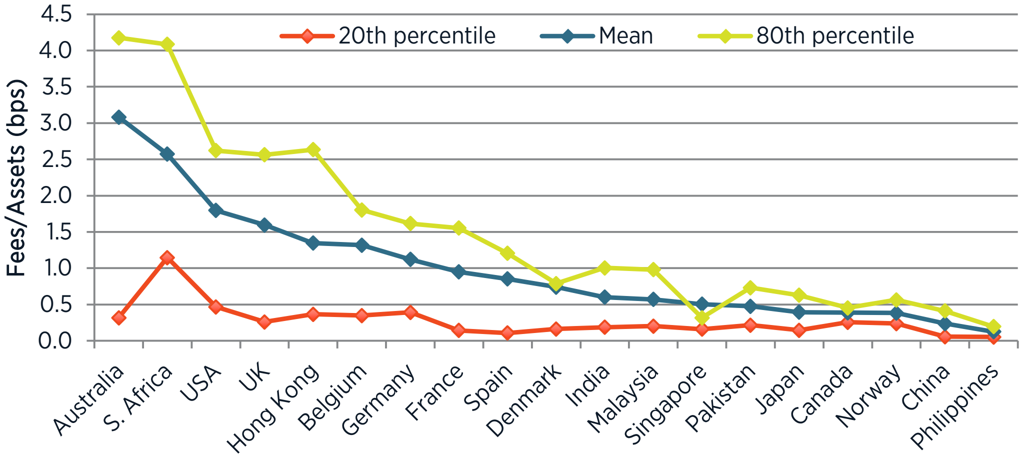
20th percentile is Low
80th percentile is High

We think that assets provide a better basis for comparison when reviewing finance companies, so, to create comparability, fees were divided by asset values. To set some benchmarks, we have taken the range from the 21st percentile to the 79th percentile to represent a fair and reasonable cost. For the banks, this means the highest "normal" fee is 6x the lowest "normal" fee. Outside this range and one starts to wonder just what happened. Why should an audit cost many multiples of that of a similar company in the same industry or how can a proper audit be done for a fraction of the price of competitors? Sadly, audit fees are not disclosed by listed companies in Korea and Taiwan, so while we have checked these companies for problem accounts, there is no comparison with fees.

Costs vary from country to country and across the type of company

Fee levels vary between countries, as shown in Figure 2, and of the countries with a reasonable sample, the highest are in Australia (0.3-4.1 basis point range) and the lowest in China and the Philippines (0.05-0.41 basis point range). Some of this difference will be due to salary levels but, as mentioned earlier, it is more likely to be due to the seniority of staff actually doing the audit. In some countries, the overall range may also be affected because they have more fund managers and insurance companies - both expensive to audit - in the sample, which distorts the range. Nonetheless, the major difference in cost will be due to differences in the amount of effort and time put in. For a complete comparison of fees by country please see Appendix I.

Figure 2: Auditing Fees/Assets Around The World

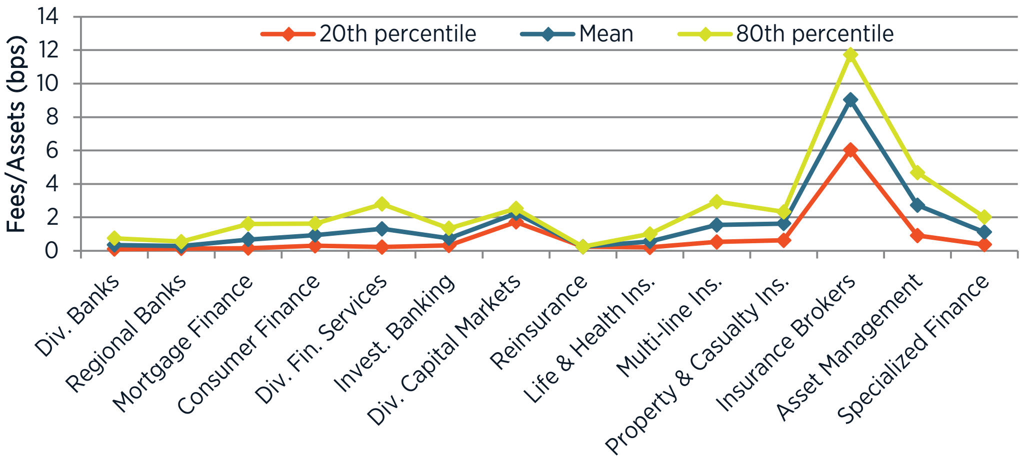


Source: GMT Research and Bloomberg

Australia, US and UK have wide ranges due to different types of companies

On a sub-sector basis, large banks and large insurers benefit from scale and automation. The greater the human input needed, the greater the audit fee, so brokers (whether investment bankers or insurance sales) and asset managers pay higher fees than their banking counterparts, as shown in Figure 3. We assume that asset managers (largely composed of fund management companies) have higher costs due to statutory requirements and having less scale than the banks.

Figure 3: Auditing Fees/Assets Across Different Types of Finance Company



Source: GMT Research

The larger businesses seem to benefit from scale

The difference between the 20th to 80th percentiles allows for the highest normal fee to be up to 10x the lowest in the same sector. However, in almost every industry there are 'extreme' fees, as shown in Figure 4, both exceptionally high and low. For example, in the life insurance sector, the minimum audit fee is 0.02bp whilst the highest is 4bp.

But there are norms and exceptions

Figure 4: Auditing Fees/Assets for Different Finance Companies

Sector	Min. (Bps)	20th percentile (Bps)	Mean (Bps)	80th percentile (Bps)	Max. (Bps)	No of co.'s
Diversified Banks	0.02	0.10	0.4	0.8	3	169
Regional Banks	0.04	0.14	0.3	0.6	4	132
Thrifts & Mortgages	0.06	0.16	0.7	1.6	3	12
Consumer Finance	0.06	0.31	0.9	1.6	9	29
Other Div. Fin. Services	0.04	0.23	1.3	2.8	8	16
Investment Banking	0.18	0.32	0.8	1.3	3	37
Div. Capital Markets	1.61	1.72	2.2	2.5	4	5
Reinsurance	0.24	0.24	0.2	0.2	0	1
Life & Health Insurance	0.02	0.20	0.6	1.0	4	35
Multi-line Insurance	0.06	0.53	1.5	2.9	8	20
Property & Casualty Ins.	0.21	0.62	1.6	2.3	7	23
Insurance Brokers	5.41	6.03	9.0	11.7	15	5
Asset Management	0.52	0.92	2.7	4.7	37	30
Specialized Finance	0.03	0.37	1.1	2.0	12	27

* For companies with at least US$1bn of assets. Source: GMT Research and Bloomberg

Extreme fees may be due to a lack of disclosure

It is possible that differences in audit costs arose because of one of the following: limited disclosure; perhaps tax or corporate advice was bundled together as part of the audit fee; a corporate reorganization; or perhaps the company structure is just more complex than its competitors; or possibly only the parent company's fees were disclosed in the accounts. But the differences in audit cost can be startling. For example, although Canara's assets are 50% larger than IDBI's, Canara's fees are 20x IDBI's. In Japan, Shizuoka Bank has a similar level of assets to Shinsei, but pays less than a tenth of Shinsei's fees, as shown in Figure 5.

Figure 5: Contrasting Audit Costs at Indian and Japanese Banks

Name	Ticker	Mkt Cap (US$bn)	Assets (US$bn)	Audit Cost ($)	Audit Fee (Bps)
IDBI Bank Ltd	IDBI IN	2,847	54.9	394,367	0.07
Canara Bank	CBK IN	3,435	83.7	7,837,717	0.94
Shizuoka Bank	8355 JP	7,161	103.8	898,675	0.08
Shinsei Bank Ltd	8303 JP	5,750	90.4	7,538,886	0.81

Source: GMT Research and Bloomberg

Local banks are simple...

...but audits for less than US$25,000 for companies with multi-billion US$ turnover is unrealistic

Unlike the international commercial or investment banks, local banks deal with relatively simple products and usually do not have balance sheets stuffed with exotic products that are hard to value. Nevertheless, processes still need to be checked, systems validated and valuations cross-referenced, all of which takes time. We find it hard to believe that the audits were more than simple box ticking at Philtrust bank and Muthoot Finance. They cost less than US$24,000 despite both companies having multi-billion dollar loan portfolios, as shown in Figure 6.

Figure 6: Asia's Lowest Audit Fees for Finance Co's with >US$1bn of assets

Name	Ticker	Sector	Mkt Cap (US$bn)	Assets (US$bn)	Audit Cost ($)	Audit Fee (Bps)
Philtrust Bank	PTC PM	Diversified Banks	1,870	2,353	12,940	0.05
Muthoot Finance	MUTH IN	Consumer Finance	1,248	4,273	23,988	0.06
Gruh Finance Ltd	GRHF IN	Thrifts & Mortgages	1,202	1,209	36,437	0.30
China Bank Corp	CHIB PM	Diversified Banks	1,977	7,883	42,192	0.05
Asia United Bank	AUB PM	Regional Banks	530	2,367	42,442	0.17

Source: GMT Research and Bloomberg

Accounting Red Flags

Ideally, accounts should show an honest and faithful representation of a company's affairs. They would avoid legalese and provide clear explanations where necessary. Given that many accounting standards are reasonably simple, clear and well understood, this should be possible. However many finance company assets are illiquid, untraded and have a long life, e.g. life insurance, mortgages, and corporate debt. Valuation is often not only based on a theoretical model but relies on management's judgement. Unfortunately management often have performance-based incentive schemes, which creates conflicts of interest.

Some accounting standards are ripe for manipulation

Valuation relies on management but they have a conflict of interest

An outsider would assume that the collapse in confidence and ensuing financial problems in 2008 indicated that investors had lost faith in financial company accounts. On the back of this, presumably there would be a renewed emphasis on the need for rigorous audits and independent cross-checks on managements' assumptions. A review of audit costs for some of the world's largest banks shows that while audit costs have risen at UBS, Banco Santander and Goldman Sachs, they have fallen at the Chinese banks, Toronto Dominion and HSBC. Even at JP Morgan, despite large fines and losses, audit costs are unchanged, as shown in Figure 7.

2008 should have raised fees but in fact some have fallen

Figure 7: Auditing Fees Pre and Post Crisis at Some Major Banks

Name	Ticker	2007 (Bps)	2008 (Bps)	2012 (Bps)	2013 (Bps)	Change
China Const Bank	939 HK	0.23	0.22	0.10	0.10	(57%)
Ind & Comm Bank	601398 CH	0.20	0.19	0.11	0.08	(57%)
Toronto-Dom Bank	TD CN	0.42	0.31	0.27	0.25	(40%)
HSBC Hldgs Plc	HSBA LN	0.29	0.31	0.26	0.26	(8%)
J P Morgan Chase	JPM US	0.35	0.36	0.36	0.35	(1%)
BNP Paribas	BNP FP	0.21	0.17	0.20	0.22	9%
Unicredit Spa	UCG IM	0.22	0.30	0.27	0.25	15%
Citigroup Inc	C US	0.37	0.45	0.45	0.46	22%
Barclays Plc	BARC LN	0.24	0.19	0.28	0.31	32%
Deutsche Bank	DBK GR	0.25	0.25	0.25	0.34	35%
Goldman Sachs Gp	GS US	0.47	0.68	0.68	0.66	41%
Banco Santander	SAN SM	0.42	0.41	0.57	0.76	81%
UBS Ag	UBSN VX	0.31	0.32	0.68	0.78	148%

Source: GMT Research and Bloomberg

This report highlights the areas where subjectivity is not only material but, we believe, should have raised questions during the audit. We calculate 15 ratios to analyse **trading profits, intangibles, employees, lending rates, asset growth, non-performing loans, leverage and long term investments** and flag the extreme cases.

A high quality audit not only tests the business processes (i.e. do invoices go through the system and get properly accounted for?) but also conducts a "sanity" test (i.e. does a ratio, process, relationship, etc., look right?). In this report, our Red Flags represent the "sanity test" that should have given auditors pause for thought. To this end, we awarded companies red flags wherever the numbers on our ratios either seemed excessive or made a material impact on the accounts.

Red Flags represent a "Sanity Test"

We looked through the accounts of over 1,400 commercial and retail style banks and another 1,100 finance companies globally, 800 of which are based in Asia. This report only draws on the 1,700 companies with a market capitalisation in excess of US$1bn, but our spread sheet contains the data on all the companies (available from robert@gmtresearch.com on request).

Report covers co.s with US$1bn+ assets

The Spreadsheet has full details on 2,500 companies

The ratios are important because those companies with a higher number of red flags underperformed those with less. The 34% of companies which had four or more red flags and a market capitalisation of over US$1bn under-performed those with fewer red flags by 80% over the last 5 years and 37% over the last three years, as shown in Figure 8.

Figure 8: Red Flags and stock performance - Globally

Red Flags	0	1	2	3	4	5	6	7	8	9
Performance over 5 years										
Equal weight	80%	58%	63%	59%	52%	48%	30%	21%	61%	43%
Cap. Weighted	76%	18%	53%	60%	(13%)	(14%)	(72%)	(70%)	18%	43%
No of companies	102	136	138	87	87	63	46	20	6	1
Performance over 3 years										
Equal weight	29%	22%	28%	24%	27%	12%	5%	(9%)	9%	17%
Cap. Weighted	32%	18%	30%	30%	6%	1%	(50%)	(40%)	19%	17%
No of companies	143	168	152	96	105	69	58	23	9	1

NB The number of companies change because not all companies were listed 3 & 5 years ago. Source: Bloomberg and GMT Research

In Asia, the 65 banks with 4+ flags, that had both assets over US$1bn and a market capitalisation of over US$1bn, also underperformed by 50% over 5 years and 21% over the last three years, as shown in Figure 9.

Figure 9: Red Flags and stock performance - Asia

Red Flags	0	1	2	3	4	5	6	7	8	9
Performance over 5 years										
Equal weight	99%	17%	71%	60%	34%	31%	20%	(3%)	(2%)	43%
Cap. Weighted	55%	11%	65%	98%	4%	44%	(5%)	25%	9%	43%
No of companies	10	19	25	23	16	22	13	4	4	1
Performance over 3 years										
Equal weight	8%	8%	20%	21%	44%	13%	17%	(14%)	(4%)	17%
Cap. Weighted	3%	(5%)	25%	33%	(8%)	14%	(2%)	12%	20%	17%
No of companies	23	20	30	26	23	24	17	5	6	1

NB The number of companies change because not all companies were listed 3 & 5 years ago. Source: Bloomberg and GMT Research

Greater problems should = Greater cost

Common sense suggests that the more problematic the accounts, the more time auditors need to go through the books. But nearly half of the high flag companies in Asia had low fees, whereas just 25% of all Asian companies have low fees. We list the 37 high flag, low fee companies in ascending red flag order in Figure 10.

High flags, low fees –

Chinese dominate due to low fees

The Chinese banks top the list, led by the smaller Chinese banks like China Citic, 8 flags, China Minsheng and Industrial Bank, both with 7 flags. Lower down, the large banks, ICBC, Agbank and China Construction have 4 flags. All in all, 14 out of the 34 companies are from China. While most Chinese banks already have low audit fees, they are 0.05 basis points or less at the highest flag scorers.

Figure 10: 4+ Red Flags and Low Audit Fees in Asia

Name	Ticker	Industry	Mkt Cap (US$bn)	Red Flags (No.)	Audit Fee (Bps)
China Citic Bank	998 HK	Diversified Banks	30.8	8	0.05
China Minsheng	600016 CH	Diversified Banks	34.0	7	0.04
Bank Of Comm.	3328 HK	Diversified Banks	48.4	6	0.05
China Merch Bank	600036 CH	Diversified Banks	42.5	6	0.04
Industrial Bank	601166 CH	Diversified Banks	30.3	6	0.02
Shang Pudong	600000 CH	Diversified Banks	28.9	6	0.02
Bank Of Beijing	601169 CH	Regional Banks	11.3	6	0.04
Bank Of Ningbo	002142 CH	Regional Banks	4.2	6	0.06
Bank Of Nanjing	601009 CH	Regional Banks	3.8	6	0.07
Yes Bank Ltd	YES IN	Diversified Banks	3.8	6	0.07
Yamaguchi Finance	8418 JP	Regional Banks	2.8	6	0.09
IDBI Bank Ltd	IDBI IN	Diversified Banks	2.7	6	0.07

Name	Ticker	Industry	Mkt Cap (US$bn)	Red Flags (No.)	Audit Fee (Bps)
HDFC Bank Ltd	HDFCB IN	Diversified Banks	32.8	5	0.03
Ping An Bank	000001 CH	Diversified Banks	18.0	5	0.04
Axis Bank Ltd	AXSB IN	Diversified Banks	14.7	5	0.05
Resona Holdings	8308 JP	Regional Banks	13.3	5	0.14
Huaxia Bank	600015 CH	Diversified Banks	11.7	5	0.03
Bank Of Yokohama	8332 JP	Regional Banks	7.4	5	0.08
Metro Bank & Tst	MBT PM	Diversified Banks	5.4	5	0.05
Joyo Bank Ltd	8333 JP	Regional Banks	4.2	5	0.10
Hiroshima Bank	8379 JP	Regional Banks	3.0	5	0.10
Hokuhoku Financial	8377 JP	Regional Banks	2.9	5	0.12
Gunma Bank Ltd	8334 JP	Regional Banks	2.7	5	0.10
Nishi-Nippon City	8327 JP	Regional Banks	2.0	5	0.14
Keiyo Bank Ltd	8544 JP	Regional Banks	1.5	5	0.14
Ind & Comm Bk	601398 CH	Diversified Banks	200.6	4	0.08
China Const Bank	939 HK	Diversified Banks	185.3	4	0.10
Agricultural Bank	601288 CH	Diversified Banks	133.1	4	0.08
Bank Philippine	BPI PM	Diversified Banks	8.0	4	0.10
Chiba Bank Ltd	8331 JP	Regional Banks	6.2	4	0.08
Chugoku Bank Ltd	8382 JP	Regional Banks	3.1	4	0.12
China Bank Corp	CHIB PM	Diversified Banks	2.0	4	0.05
Higo Bank Ltd	8394 JP	Regional Banks	1.3	4	0.14
Hyakugo Bank	8368 JP	Regional Banks	1.0	4	0.10

Source: GMT Research and Bloomberg

At least China requires companies to disclose their audit fees. There are still some countries in Asia where this is not required. In Figure 11, we list the 22 companies that score 4+ flags and do not reveal their audit costs. The largest include Bank International Indonesia, 8 flags, Bank Central Asia, CIMB group, E Sun Financial and BS Financial, 6 flags, Bank Mandiri and Hana Financial, 5 flags.

At least there is disclosure in China unlike Taiwan, Korea etc.

Figure 11: 4+ Red Flags and No Audit Fee Disclosure in Asia

High flags but no auditing disclosure

Name	Ticker	Sector	Market Cap (US$bn)	Flags (No.)
Bank Intl Indonesia	BNII IJ	Diversified Banks	1.5	8
Bank Central Asia	BBCA IJ	Diversified Banks	22.7	6
E.Sun Financial	2884 TT	Diversified Banks	4.1	6
BS Financial Group	138930 KS	Regional Banks	3.4	6
CIMB Thai Bank	CIMBT TB	Diversified Banks	1.4	6
Bank Permata	BNLI IJ	Diversified Banks	1.3	6
China Everbright	601818 CH	Diversified Banks	19.2	5
Bank Mandiri	BMRI IJ	Diversified Banks	19.0	5
CIMB Group Holding	CIMB MK	Diversified Banks	19.0	5
Hana Financial	086790 KS	Diversified Banks	10.8	5
Woori Finance	053000 KS	Diversified Banks	7.9	5
Bank Negara Indo	BBNI IJ	Diversified Banks	7.5	5
Industrial Bank	024110 KS	Diversified Banks	7.2	5
Taishin Holdings	2887 TT	Diversified Banks	4.5	5
Bank Danamon	BDMN IJ	Diversified Banks	3.4	5
Bank For Foreign	VCB VN	Diversified Banks	3.1	5
DGB Financial	139130 KS	Regional Banks	2.0	5
Bank Of Chongqing	1963 HK	Regional Banks	1.8	5
Pan Indonesia	PNBN IJ	Diversified Banks	1.7	5
Hong Leong Finance	HLFG MK	Diversified Banks	5.2	4
Taiwan Cooperative	5880 TT	Diversified Banks	4.8	4
Vietnam JS Comm.	CTG VN	Diversified Banks	2.5	4
Bank Tabungan	BTPN IJ	Diversified Banks	2.1	4
Thanachart Capital	TCAP TB	Diversified Banks	1.3	4

Name	Ticker	Sector	Market Cap (US$bn)	Flags (No.)
King's Town Bank	2809 TT	Diversified Banks	1.2	4

Source: GMT Research

In Figure 12, we list the companies from around the world that raised 7 or more red flags. Unfortunately, the audit data is missing for many of these companies. It is particularly disappointing that Bloomberg does not collect audit data on the larger banks.

Figure 12: 7+ Red Flags around the World

Name	Ticker	Sector	Mkt Cap (US$bn)	Flags (No.)	Audit Cost ($)	Audit Fee (Bps)
State Bank Ind	SBIN IN	Diversified Banks	33	9	0.78	Normal
China Citic Bk	998 HK	Diversified Banks	31	8	0.05	Low
Banco Bogota	BOGOTA CB	Diversified Banks	11	8	N/A	N/A
Bank Of India	BOI IN	Diversified Banks	3.1	8	0.94	High
Alior Bank Sa	ALR PW	Diversified Banks	1.9	8	N/A	N/A
Syndicate Bank	SNDB IN	Regional Banks	1.6	8	0.97	High
Corporation Bank	CRPBK IN	Diversified Banks	1.0	8	0.95	High
SMFG	8316 JP	Diversified Banks	61	7	0.21	Normal
Unicredit Spa	UCG IM	Diversified Banks	53	7	0.25	Normal
China Minsheng	600016 CH	Diversified Banks	34	7	0.04	Low
Banco Santa	SANB11 BZ	Diversified Banks	26	7	N/A	N/A
Banca Monte Dei	BMPS IM	Diversified Banks	15	7	N/A	N/A
Natl Bank Greece	ETE GA	Diversified Banks	14	7	N/A	N/A
Bzwbk	BZW PW	Diversified Banks	12	7	N/A	N/A
Bankinter	BKT SM	Diversified Banks	7	7	N/A	N/A
Banco Espirito	BES PL	Diversified Banks	7	7	N/A	N/A
SVB Financial Gr	SIVB US	Diversified Banks	6	7	N/A	N/A
BBVA Banco Conti	CONTINC1 PE	Diversified Banks	6	7	N/A	N/A
Corpbanca	CORPBANC CI	Diversified Banks	4	7	N/A	N/A
Intergroup Fin S	IFS PE	Diversified Banks	3.0	7	N/A	N/A
Getin Noble Bank	GNB PW	Diversified Banks	2.8	7	N/A	N/A
Union Bank India	UNBK IN	Diversified Banks	2.4	7	0.93	High
Union Bank Philipp	UBP PM	Diversified Banks	1.8	7	0.19	Normal
Indian Overseas	IOB IN	Diversified Banks	1.6	7	1.19	High
Oriental Bank	OBC IN	Diversified Banks	1.6	7	1.06	High
Bank Intl Indonesia	BNII IJ	Diversified Banks	1.5	7	N/A	N/A
First Bancorp	FBP US	Diversified Banks	1.3	7	N/A	N/A
Sekerbank	SKBNK TI	Diversified Banks	1.0	7	N/A	N/A

Source: GMT Research and Bloomberg

On a positive note, the major banks that raised 1 or less red flags are listed in Figure 13.

Figure 13: 1 or less Red Flags around the World

Name	Ticker	Sector	Mkt Cap (US$bn)	Flags (No.)	Audit Cost ($)	Audit Fee (Bps)
Itausa	ITSA4 BZ	Diversified Banks	25,003	0	N/A	N/A
Standard Bank	SBK SJ	Diversified Banks	22,228	0	1.11	High
Kasikornbank	KBANK TB	Diversified Banks	14,960	0	N/A	N/A
Hong Leong Bank	HLBK MK	Diversified Banks	7,771	0	0.17	Normal
RMB Holdings Ltd	RMH SJ	Div. Fin. Services	7,084	0	0.33	Low
Arab Bank Plc	ARBK JR	Diversified Banks	6,882	0	N/A	N/A
Provident Fin	PFG LN	Consumer Finance	5,399	0	2.21	Normal
China Merchant	600999 CH	Investment Banking	9,254	0	0.22	Low
Citigroup	C US	Diversified Banks	143,809	1	0.46	Normal
Discover Financial	DFS US	Consumer Finance	29,114	1	1.00	Normal
Shinhan Financial	055550 KS	Diversified Banks	21,123	1	N/A	N/A
Natl Bk Of Abu D	NBAD UH	Diversified Banks	18,697	1	N/A	N/A
Banco Venezuela	BVL VC	Diversified Banks	18,548	1	N/A	N/A
Riyad Bank	RIBL AB	Diversified Banks	14,397	1	N/A	N/A
Grupo Btg	BBTG11 BZ	Div. Capital Markets	14,344	1	N/A	N/A
Kb Financial	105560 KS	Diversified Banks	13,040	1	N/A	N/A
Abu Dhabi Comm.	ADCB UH	Diversified Banks	11,502	1	N/A	N/A
Masraf Al Rayan	MARK QD	Diversified Banks	10,403	1	N/A	N/A
CTBC Financial	2891 TT	Diversified Banks	9,580	1	N/A	N/A
Voya Financial	VOYA US	Div. Fin. Services	9,160	1	N/A	N/A
Investec Ltd	INL SJ	Div. Capital Markets	7,995	1	1.75	Low
Investec Plc	INVP LN	Div. Capital Markets	7,991	1	2.02	Normal
Arab Natl Bank	ARNB AB	Diversified Banks	7,441	1	N/A	N/A
Dubai Islamic	DIB UH	Diversified Banks	7,212	1	N/A	N/A
Santander Consum.	SC US	Consumer Finance	6,819	1	N/A	N/A
Ingbsk	ING PW	Diversified Banks	5,635	1	N/A	N/A
First Financial	2892 TT	Diversified Banks	5,433	1	N/A	N/A
Bendigo and Adel.	BEN AU	Regional Banks	5,261	1	0.40	Normal
Aeon Financial	8570 JP	Consumer Finance	5,261	1	N/A	N/A
Citic Securities	600030 CH	Investment Banking	20,379	1	0.51	Low
GF Securities	000776 CH	Investment Banking	9,155	1	0.18	Low
Raymond James	RJF US	Investment Banking	7,124	1	N/A	N/A
Lazard Ltd	LAZ US	Investment Banking	6,849	1	N/A	N/A
Huatai Securities	601688 CH	Investment Banking	6,827	1	N/A	N/A
Founder Securities	601901 CH	Investment Banking	5,222	1	N/A	N/A

Source: GMT Research and Bloomberg

Red Flag 1: Loan Interest Premium

Scored if the loan interest spread is in the top 25% for the country.

Flagged if top quartile

As the Korean credit card companies showed in the early 2000's, building a loan portfolio is easy. The real talent is lending to people who intend to pay you back at a rate that compensates for those that do not. Given that, within a country, all banks are handing out a fungible commodity, it is hard to see why an individual bank can earn a premium lending spread without taking on undue risk. In the short term this usually makes for excellent funding profits, only to turn into capital losses when the economy reverses. Alternatively, if the lending premium is taken to extremes, the lender runs the risk of political intervention, as happened recently in Japan, which resulted in fines, losses and a collapse of the industry. Raising funds cheaply is a far better and more sustainable route to profits than lending expensively.

Excessive lending premia suggest too much risk is being taken

Interest income was benchmarked to the local six month deposit rate. Six months is long enough to reduce volatility, short enough to be widely quoted and liquid enough to be representative of the interbank market. We then calculated an average premium for the country and a rate for the 75th percentile. Unsurprisingly some of the largest premia are in countries that have, or usually have, high interest rates i.e. Mexico, Brazil and Sri Lanka, or where the banking industry is controlled, i.e. China. However, it is a surprise to see such a large average spread in Denmark, as shown in Figure 14. Of course a high average loan premium makes it far easier for a bank to rebuild its balance sheet following a rise in NPLs.

Premia based on 6 month deposit rate

Figure 14: Highest Loan Interest Premia Around the World

Market	Region	Country	Reference rate 6 Months	Average Loan Interest premium	75th Percentile	No of companies
Emerging	Latam	Mexico	3.0%	20.4%	22.5%	10
Emerging	Asia	Sri Lanka	8.0%	11.3%	13.4%	15
Emerging	Latam	Brazil	10.8%	7.3%	10.5%	22
Emerging	Asia	Vietnam	3.9%	7.3%	8.4%	8
Emerging	Asia	Thailand	2.3%	7.1%	7.7%	19
Emerging	Latam	Peru	4.2%	6.8%	7.3%	6
Developed	Europe	Denmark	0.6%	6.0%	6.9%	16
Emerging	Latam	Chile	1.3%	5.6%	7.0%	9
Emerging	Asia	China	2.8%	5.5%	7.9%	26
Emerging	Asia	Philippines	0.7%	5.0%	6.4%	16

Source: GMT Research and Bloomberg

Perhaps unsurprisingly, 4 out of our top 10 spreads are in consumer finance, including Credit Acceptance, J Trust and Acom, and four are in emerging markets, including Panamericano, Capitec and the TCS Group. Naturally the company with the largest spread, Compartamos, is in both emerging markets and consumer finance, as shown in Figure 15.

Emerging markets + consumer credit = fat loan spreads

Figure 15: Companies with the Highest Loan Interest Premia Around the World

Name	Ticker	Industry	Mkt cap (US$bn)	Loan Interest premium	Audit Fee (Bps)	Audit Fee Range
Compartamos Sab.	GENTERA* MM	Consumer Finance	3.2	57%	N/A	N/A
TCS Group Hldg.	TCS LI	Regional Banks	1.2	39%	N/A	N/A
Capitec Bank Hldg	CPI SJ	Diversified Banks	2.4	29%	0.7	Normal
Union Bank	UBN NL	Diversified Banks	1.0	25%	N/A	N/A
Credit Acceptance	CACC US	Consumer Finance	2.8	24%	N/A	N/A
J Trust Co Ltd	8508 JP	Consumer Finance	1.7	23%	2.3	Normal
Seven Bank Ltd	8410 JP	Regional Banks	4.8	20%	0.6	High
Challenger Ltd	CGF AU	Div. Financial Services	3.8	19%	1.7	Normal

Name	Ticker	Industry	Mkt cap (US$bn)	Loan Interest premium	Audit Fee (Bps)	Audit Fee Range
Panamericano	BPNM4 BZ	Diversified Banks	1.6	18%	N/A	N/A
Acom Co Ltd	8572 JP	Consumer Finance	6.3	17%	1.1	Normal

Source: GMT Research and Bloomberg

Consumer finance also leads to large spreads in Asia

In Asia, the top ten are also dominated by consumer names as shown in the table below.

Figure 16: Companies with the Highest Loan Interest Premium in Asia

Name	Ticker	Industry	Mkt cap (US$bn)	Loan Interest premium	Audit Fee (Bps)	Audit Fee Range
J Trust Co Ltd	8508 JP	Consumer Finance	1.7	23.7%	2.30	Normal
Seven Bank Ltd	8410 JP	Regional Banks	4.8	20.4%	0.63	High
Challenger Ltd	CGF AU	Div. Financial Services	3.8	18.7%	1.67	Normal
Acom Co Ltd	8572 JP	Consumer Finance	6.3	17.2%	1.10	Normal
Bank Tabungan	BTPN IJ	Diversified Banks	2.1	16.1%	N/A	N/A
Aiful Corp	8515 JP	Consumer Finance	2.8	13.5%	1.51	Normal
Bajaj Finance Lt	BAF IN	Consumer Finance	1.7	12.6%	0.19	Low
Shriram Transprt	SHTF IN	Consumer Finance	3.2	12.6%	0.32	Low
Credit Saison Co	8253 JP	Consumer Finance	3.6	12.3%	0.96	Normal
Muthoot Finance	MUTH IN	Consumer Finance	1.2	11.4%	0.06	Low

Source: GMT Research and Bloomberg

But Indian Consumer finance may not be all it seems

A high quality audit is needed to ensure that not only is the company following legal lending practices but adequate provisions are being made. The audit costs for the three Indian companies, Bajaj Finance, Shriram Transport and Muthoot Finance, seem to be far too low for businesses with such high spreads.

For a complete comparison of interest rates by country please see Appendix II.

Red Flags 2 & 3: Non-Performing Loans

Two flags if uNPLs look to be out of control

Flag 2: Scored if un-provisioned NPLs exceed 10% of equity.

Flag 3: Scored if the two year average NPL growth rate is greater than 5%.

Ideally unsecured NPLs would be fully provisioned...

It is remarkable, really, that finance companies are not required to fully provision for the unrecoverable portion of NPLs. It is of even greater concern when the lack of provision is of a size that is material to a company's equity base.

...but not if you are allowed to extend and pretend

Of course, if the government is playing "extend and pretend", then banks are allowed to carry on doing business while they are technically bankrupt i.e. un-provisioned NPLs (uNPLs) exceed equity. This is in the hope that, eventually, uNPLs can be slowly written-off out of the banks operating profits.

Lots of uNPLs and high leverage = Delayed recovery

The problem is that if banks have lots of uNPLs and lots of leverage, recovery can take a very long time. Banca Monte Dei is levered 32x and its uNPLs are 18% of its total assets and over 3x equity. It therefore needs to make a pre-provision Return on Assets of 2.4% on the performing assets to fund the current provisioning level of 2.1%. In this scenario, although the bank survives, it takes close to 9 years to clean up the book, the bank makes no profit, is totally reliant on cheap funding and cannot create new loans. Given the recent corporate debt crisis in Europe, it is perhaps not surprising that all of the banks with the highest uNPLs are located there, as shown in Figure 17.

Figure 17: Un-Provisioned NPL's- Globally

Name	Ticker	Industry	Mkt Cap (US$bn)	Unprovisioned NPLs as % of Equity	Total Assets / Total Common Equity	Last Years Provisions as a % of Net Loans
Banca Monte Dei	BMPS IM	Diversified Banks	15.2	331%	32	2.1%
Eurobank Ergasia	EUROB GA	Diversified Banks	8.1	260%	24	4.0%
Piraeus Bank	TPEIR GA	Diversified Banks	14.9	230%	12	3.7%
Natl Bank Greece	ETE GA	Diversified Banks	13.6	221%	19	2.0%
Banca Carige	CRG IM	Diversified Banks	2.4	219%	27	4.0%
Alpha Bank A.E.	ALPHA GA	Diversified Banks	13.0	184%	10	3.6%
Banco Popolare S	BP IM	Diversified Banks	6.7	169%	15	1.9%
Banca Pop Emilia	BPE IM	Diversified Banks	4.4	153%	15	1.7%
Bank Ireland	BKIR ID	Diversified Banks	11.3	147%	17	1.9%
Credito Valtelli	CVAL IM	Regional Banks	1.6	138%	14	1.3%

Source: GMT Research and Bloomberg

Far better provisioning in Asia

Banks in Asia have either failed to recognise their NPLs, or post 1997, Internet bubble, SARs, GFC, Japanese bubble - choose your crisis - are far more conservative. Even the highest uNPLs, at Ashikaga and Indian Overseas are below 40%. Moreover, apart from Resona, Nishi- Nippon and Hokuhoku, their auditors have at least spent some time checking their accounts, as shown in Figure 18.

Figure 18: Un-Provisioned NPL's Asia

Name	Ticker	Industry	Mkt Cap (US$bn)	Unprovisioned NPLs as % of Equity	Audit Fee (Bps)	Audit Fee Range
Ashikaga Holding	7167 JP	Diversified Banks	1.4	39%	0.17	Normal
Indian Overseas	IOB IN	Diversified Banks	1.6	37%	1.19	High
UCO Bank	UCO IN	Diversified Banks	1.7	34%	1.17	High
Hokuhoku Financial	8377 JP	Regional Banks	2.9	32%	0.12	Low
Resona Holdings	8308 JP	Regional Banks	13.3	32%	0.14	Low
Corporation Bank	CRPBK IN	Diversified Banks	1.1	31%	0.95	High
Nishi-Nippon City	8327 JP	Regional Banks	2.0	31%	0.14	Low
Juroku Bank Ltd	8356 JP	Regional Banks	1.4	30%	0.15	Normal
Union Bank India	UNBK IN	Diversified Banks	2.3	29%	0.93	High
State Bank India	SBIN IN	Diversified Banks	32.3	29%	0.78	Normal

Source: GMT Research and Bloomberg

Excessive NPLs growth is a problem…

…slightly eased by lower leverage

Excessive NPL growth suggests that either the company's lending processes are inadequate or worse. Red flag 3 captures the point that a good auditor should be in an excellent position to help management by analysing operational processes and checking for incompetence or fraud. The low levels of leverage at Alinma (Saudi Arabia), Muthoot Finance (India) and Qatar Islamic, as shown in Figure 19, means they can probably ride a few years of NPL growth. However, the low levels of provisioning at Alinma, Qatar Islamic, Banif (Portugal) and Sacombank (Vietnam) will need to rise.

Figure 19: Average of the Last Two Year's NPL Growth - Globally

Name	Ticker	Industry	Mkt Cap (US$bn)	NPL growth Average Last 2 Years	Total Assets / Total Common Equity	Last Year's Provisions as a % of Net Loans
Alinma Bank	ALINMA AB	Diversified Banks	7.4	626%	4x	0.6%
Qatar Islamic Ba	QIBK QD	Diversified Banks	5.8	603%	7x	0.2%
Santander Rio-B	BRIO AR	Diversified Banks	2.2	325%	8x	1.8%
Ahli United Bank	AUB BI	Diversified Banks	4.7	313%	10x	0.9%
Muthoot Finance	MUTH IN	Consumer Finance	1.2	278%	6x	2.3%
Commercial Bank	CBQK QD	Diversified Banks	5.4	185%	7x	0.9%
Banif - Banco In	BANIF PL	Diversified Banks	1.6	168%	17x	N/A
Banco Sabadell	SAB SM	Diversified Banks	14.2	168%	16x	0.9%
Daycoval-Pref	DAYC4 BZ	Regional Banks	1.1	165%	6x	5.6%
Sacombank	STB VN	Diversified Banks	1.2	154%	9x	0.4%

Source: GMT Research and Bloomberg

Again, be careful with Indian finance co.s

In Asia, 5 of our top 10 come from India: Bajaj Finance, Muthoot, Power Finance, L&T Finance and Yes Bank. Such high NPL growth rates, over 800% for Bajaj and 278% for Muthoot, plus extremely low audit costs should raise investor concerns.

Figure 20: Average of the Last Two Year's NPL Growth - Asia

Name	Ticker	Industry	Mkt Cap (US$bn)	NPL growth Average last 2 years	Audit Fee (Bps)	Audit Fee Range
Bajaj Finance	BAF IN	Consumer Finance	1.7	807%	0.19	Low
Muthoot Finance	MUTH IN	Consumer Finance	1.2	278%	0.06	Low
Power Finance	POWF IN	Specialized Finance	6.6	236%	0.03	Low
Sacombank	STB VN	Diversified Banks	1.2	154%	N/A	N/A
Boc Hong Kong	2388 HK	Diversified Banks	31.0	151%	0.13	Normal
Hana Financial	086790 KS	Diversified Banks	10.8	116%	0.20	N/A
Allahabad Bank	ALBK IN	Diversified Banks	1.2	103%	N/A	High
L&T Finance	LTFH IN	Div. Financial Services	2.0	88%	1.11	Low
Yes Bank Ltd	YES IN	Diversified Banks	3.8	85%	0.23	Low
J Trust Co Ltd	8508 JP	Consumer Finance	1.7	84%	0.07	Normal

Source: GMT Research and Bloomberg

Red Flag 4 & 5: NPL Provisions

Flag 4: Scored if last year's provisions exceed 2% of net loans.

Flag 5: Scored if the average provision rate over 2 years is lower than the actual loss rate.

Flagged if provisions are either high as a % of loans or are less than actual losses

Provisioned NPLs are obviously a step up from Un-provisioned NPLs, but the difference between Provisioned and Un-provisioned NPLs is merely an accounting distinction. In reality, the company is making bad loans and losing money. If the provision is less than the lending premium, as in the case of TCS Holdings (Russia), Compartamos (Mexico), Panamericano (Brazil) and some of the others in Figure 21, then losses can be met from operating income. But unless the business is loan sharking, which can become politically unacceptable, as shown recently in Japan, the high loss/high premium is a dangerous business model. Any collapse of the lending premium would very quickly lead to disaster.

High premium/ high NPL businesses are risky...

...Premiums can collapse but the NPLs continue

Figure 21: Most Recent Provisions as a % of Net Loans – Globally excluding India

Name	Ticker	Industry	Mkt Cap (US$bn)	Provision as a % of Net Loans	Lending premium	Total Assets / Total Common Equity
TCS Group Holding	TCS LI	Regional Banks	1.2	12%	39%	5
Compartamos Sab	GENTERA* MM	Consumer Finance	3.2	8%	57%	3
Panamericano	BPNM4 BZ	Diversified Banks	1.6	7%	18%	9
Brd-Groupe Socie	BRD RO	Diversified Banks	2.0	6%	0%	9
Daycoval	DAYC4 BZ	Regional Banks	1.1	6%	9%	6
Union Bank Nigeria	UBN NL	Diversified Banks	1.0	5%	25%	5
Bradesco Sa	BBDC4 BZ	Diversified Banks	65.2	5%	8%	13
Eurobank Ergasia	EUROB GA	Diversified Banks	8.1	4%	5%	24
OTP Bank Plc	OTP HB	Diversified Banks	5.6	4%	11%	7
Banca Carige	CRG IM	Diversified Banks	2.4	4%	4%	27

Source: GMT Research and Bloomberg

India dominates the Asia list below. However although IDBI, M&M Finance and Bajaj Finance have low audit fees, all the rest are being subject to some level of accounting scrutiny.

Asia- it's all about India

Figure 22: Most Recent Provisions as a % of Net Loans - Asia

Name	Ticker	Industry	Mkt Cap (US$bn)	Provision as a % of Net Loans	Audit Fee (Bps)	Audit Fee Range
M&M Fin Services	MMFS IN	Consumer Finance	2.6	7%	0.33	Low
Bajaj Finance Ltd	BAF IN	Consumer Finance	1.7	7%	0.19	Low
Corporation Bank	CRPBK IN	Diversified Banks	1.1	6%	0.95	High
Allahabad Bank	ALBK IN	Diversified Banks	1.2	5%	1.11	High
Punjab Natl Bank	PNB IN	Diversified Banks	5.7	4%	0.84	High
Bank Of India	BOI IN	Diversified Banks	3.0	4%	0.94	High
IDBI Bank Ltd	IDBI IN	Diversified Banks	2.7	4%	0.07	Low
Central Bk India	CBOI IN	Diversified Banks	1.7	4%	0.60	Normal
Indian Overseas	IOB IN	Diversified Banks	1.6	4%	1.19	High
Indian Bank	INBK IN	Diversified Banks	1.3	4%	1.41	High

Source: GMT Research and Bloomberg

Perhaps the most obvious test of management's provisioning skill is to see how actual losses match up to provisions. Without knowing the duration of the NPLs it is difficult to be entirely accurate. However, we have assumed that the company will seek to resolve the problem within 2 years of a loan becoming non-performing.

Flag 5 compares provisions to actual losses

A flag was raised if either (i) actual losses exceed provisions and reserves were below 100% of NPLs or (ii) reserves were greater than NPLs but the actual loss was over 3x the level of the last two years provisions. Apart from Swedbank (Sweden) and Valiant Holdings (Switzerland), the rest of the global top ten have reserves in excess of NPLs, as shown in Figure 23, and some have seen a dramatic drop in NPLs. However at Al Ahli Bank (Kuwait), NPLs have been rising and falling only marginally at Iberiabank (US), JP Morgan (US) and CAF (France). To be provisioning at levels so far below actual losses looks rather suspect.

Flags raised if losses > provisions and Reserves < NPLs

Figure 23: Actual Losses vs Annual Provisions - Globally

Name	Ticker	Industry	Mkt Cap (US$bn)	Actual Losses/ Annual Provisions	Reserves as % of NPLs	NPLs growth 2 yr ave.
Al Ahli Bank	ABQK QD	Diversified Banks	2.3	46.5	125%	37%
Iberiabank Corp	IBKC US	Regional Banks	2.1	22.1	196%	(3%)
Swedbank Ab-A	SWEDA SS	Diversified Banks	30.1	21.0	53%	(45%)
Assoc Banc-Corp	ASBC US	Regional Banks	2.9	15.9	132%	(29%)
Jpmorgan Chase	JPM US	Diversified Banks	217.8	14.4	168%	(5%)
Zions Bancorp	ZION US	Regional Banks	5.6	5.5	165%	(35%)
Regions Financia	RF US	Regional Banks	14.9	5.0	103%	(34%)
Valiant Hldg Ag	VATN SW	Regional Banks	1.7	4.9	N/A	N/A
Saudi Investment	SIBC AB	Diversified Banks	4.2	4.3	178%	(44%)
Cr De Ca Idf	CAF FP	Regional Banks	2.8	4.1	125%	(4%)

Source: GMT Research and Bloomberg

In Asia, it is Japan's turn to provide most of the names. Only Hong Leong from Malaysia, as shown in Figure 24, prevents a clean sweep. After years of recession, management does not appear very good at provisioning for losses in Japan, but the auditors at Daiwa Secs, Hachijuni, Keiyo Bank, Bank of Kyoto and Yamaguchi Finance don't appear keen to investigate why.

Japan, poor forecasting and blind auditors

Figure 24: Actual Losses vs Annual Provisions - Asia

Name	Ticker	Industry	Mkt Cap (US$bn)	Actual Losses/ Annual Provisions	Audit Fee (Bps)	Audit Fee Range
Century Tk Leas.	8439 JP	Specialized Finance	3.6	63.3	0.49	Normal
Daiwa Secs Grp	8601 JP	Invest. Banking & Broker	15.1	27.0	0.20	Low
Hachijuni Bank	8359 JP	Regional Banks	3.2	23.2	0.12	Low
Keiyo Bank Ltd	8544 JP	Regional Banks	1.5	15.3	0.14	Low
Hong Leong Capital	HLG MK	Invest. Banking & Broker	1.1	12.1	1.64	Normal
Senshu Ikeda Hd	8714 JP	Regional Banks	1.2	11.3	0.19	Normal
Bank Of Kyoto	8369 JP	Regional Banks	3.4	9.6	0.08	Low
Yamaguchi Financ.	8418 JP	Regional Banks	2.8	7.6	0.09	Low
Okasan Sec	8609 JP	Invest. Banking & Broker	1.8	5.0	1.37	Normal
IBJ Leasing Co	8425 JP	Specialized Finance	1.1	4.8	0.89	Normal

Source: GMT Research and Bloomberg

Red Flag 6 & 7: Employees

Flags for high pay and high assets managed

Flag 6: Scored if average employee pay is in the top 20th percentile.

Flag 7: Scored if the loans/employee is in the top 20th percentile

Pay for performance has an intrinsic conflict of interest

High pay usually means compensation packages have a substantial amount of performance-related pay. Although we are great believers in merit based compensation, if management's pay is defined by performance and management can decide what the performance is, there is a clear conflict of interest. We are not flagging high pay because it is bad, but because auditors need to check that on the inherent conflict.

Leverage usually means illiquid assets that are hard to value

The listed US asset management companies pay far in excess of other global companies, with average pay over US$1m. Although they are flagged in the spreadsheet, they were excluded from the screen for Figure 25 in order to provide a slightly broader result. It comes as no surprise to see the Investment banks top the best paid list. Some like Greenhills (US) are not using leverage to generate their profits but for the others like Goldman (US), Icap (UK), DVB (Germany), Walliser Kant (Switzerland), UBS (Switzerland) and Morgan Stanley (US), leverage is clearly relevant. Typically where there is leverage, there are illiquid assets that rely on management's judgement and require greater auditor scrutiny.

Figure 25: Employee Pay – Globally, excluding Asset Managers

Name	Ticker	Industry	Mkt cap US$bn	Average Employee pay (US$)	Total Assets/ Total Common Equity
Greenhill & Co	GHL US	Invest Banking & Broker	1.3	487,981	1.3x
Goldman Sachs Gp	GS US	Invest Banking & Broker	78.4	383,374	12.8x
Icap Plc	IAP LN	Invest Banking & Broker	4.1	378,895	26.4x
Paris Orleans	PAOR FP	Div. Capital Markets	1.7	324,371	7.1x
Home Loan Service	HLSS US	Thrifts & Mortgages	1.6	323,611	5.9x
DVB Bank	DVB GR	Diversified Banks	1.5	310,693	16.7x
Raymond James	RJF US	Invest Banking & Broker	7.1	300,889	6.3x
Walliser Kant-Br	WKB SW	Regional Banks	1.2	294,890	13.0x
UBS Ag	UBSN VX	Diversified Banks	73.4	293,821	21.0x
Morgan Stanley	MS US	Invest Banking & Broker	63.7	291,734	13.3x

Source: GMT Research and Bloomberg

Salaries are lower in Asia

Although the spread of market capitalisation is similar, salaries are a lot lower in Asia. Only Challenger of Australia comes close to US levels, as shown in Figure 26. In addition, most of the companies are rather more traditional banks with presumably less incentive for employees to value assets in a way that benefits them. Their leverage also looks reasonably modest, apart from China Merchant Bank.

Figure 26: Employee Pay, Highest in Each Country – Asia, excluding Japan

Name	Ticker	Industry	Mkt cap (US$bn)	Average Employee pay (US$)	Total Assets / Total Common Equity	Audit Fee (Bps)	Audit Fee Range
Challenger Ltd	CGF AU	Div. Fin.Services	3.8	282,529	9.1	1.67	Normal
China Ever Ltd	165 HK	Div. Capital Markets	2.3	152,959	1.3	2.28	Normal
DBS Group Hldgs	DBS SP	Diversified Banks	33.1	81,986	12.1	0.17	Normal
China Merch Bk	600036 CH	Diversified Banks	42.5	64,488	15.1	0.04	Low
Mega Financial H	2886 TT	Diversified Banks	10.2	61,586	12.9	N/A	N/A
Metro Bank & Tr	MBT PM	Diversified Banks	5.4	35,606	10.7	0.05	Low
CIMB Thai Bank P	CIMBT TB	Diversified Banks	1.4	34,804	12.8	N/A	N/A
Bank Central Asia	BBCA IJ	Diversified Banks	22.7	31,135	7.8	N/A	N/A

Source: GMT Research and Bloomberg

Salaries do vary in Japan

Japanese companies were separated out in Figure 27 to illustrate the spread in both pay, levels of leverage and audit fees. For all the talked about conformity in Japan, salary levels at Nomura are close to double those at Okasan. Even the more local broker Matsui appears to be paying its employees rather better. Notwithstanding their leverage, both Daiwa and Nomura managed to get audited very cheaply.

Figure 27: Employee Pay in Japan

Name	Ticker	Industry	Mkt cap (US$bn)	Average Employee pay (US$)	Total Assets / Total Common Equity	Audit Fee (Bps)	Audit Fee Range
Nomura Holdings	8604 JP	Invest. Banking & Brkr	27.7	205,717	17.3	0.32	Low
Matsui Securities	8628 JP	Invest. Banking & Brkr	2.9	192,662	5.5	0.83	Normal
Tokai Tokyo Fin.	8616 JP	Invest. Banking & Brkr	2.2	132,821	4.4	0.84	Normal
Daiwa Secs Grp	8601 JP	Invest. Banking & Brkr	15.1	129,430	17.9	0.20	Low
Aozora Bank Ltd	8304 JP	Invest. Banking & Brkr	5.4	119,329	13.3	0.52	Normal
Okasan Sec	8609 JP	Invest. Banking & Brkr	1.8	113,503	4.8	1.37	Normal
Mizuho Financial	8411 JP	Diversified Banks	49.6	110,013	28.6	0.20	Normal
Shinsei Bank Ltd	8303 JP	Regional Banks	5.8	108,415	14.1	0.81	High
Monex Group Inc	8698 JP	Invest. Banking & Brkr	1.1	104,677	11.5	0.84	Normal
Credit Saison Co	8253 JP	Consumer Finance	3.6	98,686	5.5	0.96	Normal

Source: GMT Research and Bloomberg

Do the employees have too much to monitor?

The next concern is whether employees realistically monitor the assets they are supposed to be managing. Computers and systems are constantly improving but, as the Americans found out in 2008, employees will not always put all the required data into them. Even when they do, the system may not be good enough. To get a sense of what was reasonable, we calculated the average loans per employee in any country and then flagged companies in the top quartile.

Fannie and Freddie- 10x the assets of others!

Fannie and Freddie in the US stand out for having 10x the assets per employee of the nearest comparable company, as shown in Figure 28. Shinkin (Japan), Thurgauer (Switzerland) and Svenska (Sweden) not only have high loans per employee but they are also highly levered so any problems will be greatly magnified.

Figure 28: Loans managed per Employee- Globally

Name	Ticker	Industry	Mkt cap (US$bn)	Loans managed per Employee (US$m)	Average Employee pay (US$)	Total Assets / Total Common Equity
Fannie Mae	FNMA US	Thrifts & Mortgages	23.3	415	164,595	(26)
Freddie Mac	FMCC US	Thrifts & Mortgages	12.9	337	164,853	(27)
Bbva Banco Conti	CONTINC1 PE	Diversified Banks	5.5	45	N/A	12
Dvb Bank Se	DVB GR	Diversified Banks	1.5	45	310,693	17
Shinkin Central	8421 JP	Diversified Banks	8.8	35	N/A	25
Zuger Kantona-Br	ZG SW	Regional Banks	1.5	31	185,933	12
Thurgauer Kantbk	TKBP SW	Regional Banks	1.8	27	171,166	21
First Gulf Bank	FGB UH	Diversified Banks	17.3	25	152,317	6
Valiant Hldg Ag	VATN SW	Regional Banks	1.7	24	148,697	13
Svenska Han-A	SHBA SS	Diversified Banks	31.1	23	152,221	22

Source: GMT Research and Bloomberg

HDFC illustrates the India vs. Australia cost difference.

The highest assets managed per employee in Asia are far more modest, but then so are salaries, as shown in Figure 29. Housing and Development Finance is perhaps a fine example of why one should outsource to India: US$16m of assets are managed by an employee paid half of their counterpart at Westpac or Commonwealth Bank in Australia. However, in contrast to many Indian companies, HDFC is paying Australian levels of audit fees on a per asset basis. The Chinese banks pay similar salaries for varying level of assets, but only BOC HK pays proper audit fees.

Figure 29: Loans managed per Employee- Asia excluding Japan

Name	Ticker	Industry	Mkt cap (US$bn)	Loans managed per employee (US$m)	Average Employee pay (US$)	Audit Fee (Bps)	Audit Fee Range
Housing Dev Fin	HDFC IN	Thrifts & Mortgages	25.0	16.4	53,965	0.27	Normal
Westpac Banking	WBC AU	Diversified Banks	100.9	15.1	119,959	0.27	Normal
Comm. Bank Aust.	CBA AU	Diversified Banks	125.2	12.8	120,793	0.29	Normal
Bank Of Beijing	601169 CH	Regional Banks	11.3	10.3	58,322	0.04	Low
Boc Hong Kong	2388 HK	Diversified Banks	31.0	8.2	59,782	0.13	Normal
Hang Seng Bank	11 HK	Diversified Banks	31.0	7.7	57,973	0.10	Normal
Shanghai Pudong	600000 CH	Diversified Banks	28.9	7.4	54,993	0.02	Low
Taiwan Cooperative	5880 TT	Diversified Banks	4.8	7.2	56,139	N/A	N/A
China Citic Bk-H	998 HK	Diversified Banks	30.8	6.7	61,828	0.05	Low
Dah Sing Banking	2356 HK	Diversified Banks	2.4	5.6	70,152	0.43	Normal

Source: GMT Research and Bloomberg

Assets managed in Japan is lower than the US

In Japan, the companies with the highest loans per employee manage between US$14m to US$20m, which falls somewhere between the West and Asia. The exception is Shinkin Central, as shown in Figure 30, which manages far more per employee, at US$35m. Despite this, all the banks, with the exception of Aozora, pay very low audit fees.

Figure 30: Loans Managed per Employee- Japan

Name	Ticker	Industry	Mkt Cap (US$bn)	Loans managed per employee (US$m)	Audit Fee (Bps)	Audit Fee Range
Shinkin Central	8421 JP	Diversified Banks	8.8	34.8	0.03	Low
Bank Of Yokohama	8332 JP	Regional Banks	7.4	19.7	0.08	Low
Chiba Bank Ltd	8331 JP	Regional Banks	6.2	17.7	0.08	Low
Aozora Bank Ltd	8304 JP	Diversified Banks	5.4	17.0	0.52	Normal
Shizuoka Bank	8355 JP	Regional Banks	7.2	16.3	0.08	Low
Resona Holdings	8308 JP	Regional Banks	13.3	15.8	0.14	Low
Ashikaga Holding	7167 JP	Diversified Banks	1.4	14.7	0.17	Low
North Pacific Ba	8524 JP	Regional Banks	1.7	14.6	0.18	Low
Hiroshima Bank	8379 JP	Regional Banks	3.0	14.5	0.10	Low
Yamaguchi Finance	8418 JP	Regional Banks	2.8	14.0	0.09	Low

Source: GMT Research and Bloomberg

Insurance assets/employee is 2x that of banks

We ran a similar screen for insurance companies in Figure 31. All but Platinum Underwriting in the US, manage more assets per employee than the normal banks reviewed above. At the top three, Fidelity & Guaranty (US), Ambac (US) and Third Point (US), employees look after double the assets per employee run by the banks.

Figure 31: Insurance Assets managed per Employee- Globally

Name	Ticker	Industry	Mkt Cap (US$bn)	Assets managed per Employee (US$m)
Fidelity & Guaranty	FGL US	Life & Health Insurance	1.4	128
AMBAC Financial	AMBC US	Property & Casualty Ins.	1.2	128
Third Point Rein	TPRE US	Reinsurance	1.6	108
Greenlight Cap.	GLRE US	Reinsurance	1.2	103
Amer Equity Invt	AEL US	Life & Health Insurance	1.8	95
St James's Place	STJ LN	Life & Health Insurance	6.6	88
MBIA Inc	MBI US	Property & Casualty Ins.	2.5	75
Friends Life Gp.	FLG LN	Life & Health Insurance	7.6	56
Assured Guaranty	AGO US	Property & Casualty Ins.	4.8	50
Platinum Under.	PTP US	Reinsurance	1.7	32

Source: GMT Research and Bloomberg

There are not enough listed insurance companies with enough data in Asia to draw any dramatic conclusions. But it is clear from Figure 32 that even the largest, Sony Financial (Japan), has far lower assets/employee than would be considered normal in the US.

Too few Asian Insurers

Figure 32: Insurance Assets managed per Employee- Asia

Name	Ticker	Industry	Mkt cap (US$bn)	Assets managed per employee (US$m)	Average Employee pay (US$)	Audit Fee (Bps)	Audit Fee Range
Sony Financial H	8729 JP	Life & Health Insurance	7.5	10.9	N/A	0.32	Normal
T&D Holding Inc	8795 JP	Life & Health Insurance	9.4	6.5	N/A	0.28	Normal
Cathay Financial	2882 TT	Life & Health Insurance	18.7	4.6	N/A	N/A	N/A
China Life Ins-H	2628 HK	Life & Health Insurance	66.1	3.2	3,551	0.26	Low
Qbe Insurance	QBE AU	Property &Casualty Ins.	13.4	2.8	6,176	6.20	High

Source: GMT Research and Bloomberg

Red Flags 8 & 9: Leverage

Flag 8: Scored if Total Assets/Total Common Equity exceeds 15x

Flagged if leverage >15x or Risk Assets > 8x

Flag 9: Scored if Risk Weighted Assets/Total Common Equity exceeds 8x

Leverage was not an audit concern in our previous reports…

In our other audit reports, we did not consider leverage to be an auditing issue. Banks are usually reasonably forthcoming about how much someone has borrowed and it is increasingly difficult for non-finance companies to keep debt off balance sheet. Verifying that cash exists is usually far more of a problem than verifying debt. Leverage is key to most finance company business models, so the size and management of a company's assets should be a point of focus for the auditor. The greater the leverage the more the auditor needs to understand both what is going on and the valuation of the assets.

… It is different for finance companies

Europeans are highly levered and slow to reduce assets

It is amazing to see that even 6 years after the financial crisis, not only is First National (Canada) levered 67x but it is still growing its asset base. The major Europeans, such as Credit Agricole, Banca Monte Dei, Deutsche and Societe Generale, are shrinking their assets, but only very slowly, as shown in Figure 33.

Figure 33: Total Assets/Total Common Equity- Global

Name	Ticker	Industry	Mkt Cap (US$bn)	Total Assets/ Common Equity	Asset Growth 2 year ave.
First National F	FN CN	Thrifts & Mortgages	1.3	67.0	33%
Credit Agricole	ACA FP	Diversified Banks	37.9	38.2	(7%)
Banco Com Port.	BCP PL	Diversified Banks	4.6	34.0	(8%)
Banca Monte Dei	BMPS IM	Diversified Banks	15.2	32.3	(3%)
Slm Corp	SLM US	Consumer Finance	3.5	31.5	(10%)
Natixis	KN FP	Diversified Banks	20.7	30.2	(18%)
Liberbank Sa	LBK SM	Diversified Banks	2.8	29.9	0%
Deutsche Bank.	DBK GR	Diversified Banks	50.7	29.4	(4%)
Soc Generale Sa	GLE FP	Diversified Banks	44.4	27.8	(5%)
Taishin Holdings	2887 TT	Diversified Banks	4.5	27.6	3%

Source: GMT Research and Bloomberg

European banks are still highly levered

Unfortunately, the companies in Figure 33 are fairly representative of the countries in Europe, as shown in Figure 34. It is remarkable that banks in Europe should still be so highly levered and still so reluctant to reduce their asset base. Progress has been made in Belgium, down from 45x, and Germany, down from 47x, but they are still the most levered countries at 30x and 26x respectively.

Figure 34: Leverage in Europe

Name	Total Assets/ Common Equity 2013	2012	2011	2010	2009	Change in Assets 3 year ave.
Belgium	30.3	41.3	90.2	44.2	45.4	(19%)
Germany	26.4	33.4	36.7	42.9	47.6	(6%)
France	25.5	27.3	29.4	29.7	29.4	(0%)
Portugal	24.9	21.9	28.1	25.7	20.3	(3%)
Holland	22.8	21.4	25.4	26.8	29.5	(5%)
Switzerland	20.7	25.8	27.3	28.5	29.4	(6%)
Denmark	20.5	22.6	24.9	27.2	27.5	0%
UK	17.4	18.7	19.3	19.4	21.5	(2%)
Italy	16.5	15.1	16.1	13.4	13.3	(2%)
Spain	15.2	19.1	16.2	16.1	16.7	1%
Ireland	13.6	13.7	12.9	31.4	23.4	(9%)

NB All years are financial rather than calendar years. Source: Bloomberg and company accounts

Japanese companies are taking a different path.

The Japanese banks with the most leverage are actually growing their assets, if slowly. As shown in Figure 35, Senshu and Resona are already levered over 36x yet both decided to marginally increase their assets. If Premier Abe can persuade corporate Japan to start investing again, it will be very hard for any of these banks to supply corporate credit without selling down their bond holdings or cutting other assets. Still, this high leverage did not seem to bother the auditors at Resona, Hokuhoku, Shinkin and 77 Bank.

Figure 35: Total Assets / Total Common Equity - Japan

Name	Ticker	Industry	Mkt Cap US$bn	Total Assets/ Common Equity	Asset Growth 2 year ave.	Audit cost (bps)	Audit Fee range
Senshu Ikeda Hldg	8714 JP	Regional Banks	1.2	36.6	1%	0.19	Normal
Resona Holdings	8308 JP	Regional Banks	13.3	36.6	2%	0.14	Low
Mizuho Financial	8411 JP	Diversified Banks	49.6	28.6	5%	0.20	Normal
Ashikaga Holding	7167 JP	Diversified Banks	1.4	26.6	2%	0.17	Normal
Hokuhoku Financial	8377 JP	Regional Banks	2.9	24.7	0%	0.12	Low
Shinkin Central	8421 JP	Diversified Banks	8.8	24.6	6%	0.03	Low
North Pacific Bank	8524 JP	Regional Banks	1.7	24.4	(0%)	0.18	Normal
Nanto Bank Ltd	8367 JP	Regional Banks	1.1	24.3	3%	0.15	Normal
SMFG	8316 JP	Diversified Banks	60.7	22.2	5%	0.21	Normal
77 Bank Ltd	8341 JP	Regional Banks	2.0	22.1	5%	0.09	Low

Source: GMT Research and Bloomberg

Multiples are lower in Asia

Across the rest of Asia, the highest leverage multiples are lower but Thanachart, Corporation Bank, UCO bank, Huaxia and Syndicate have grown assets at a double-digit pace over the last two years, as shown in Figure 36. Auditors have taken some note and the three Indian banks have high audit costs that illustrate that there are auditors prepared to put in some due diligence.

Figure 36: Total Assets / Total Common Equity - Asia

Name	Ticker	Industry	Mkt Cap US$bn	Total Assets/ Common Equity	Asset Growth 2 year ave.	Audit cost (bps)	Audit Fee range
Taishin Holdings	2887 TT	Diversified Banks	4.5	27.6	3%	N/A	N/A
Taiwan Bus Bank	2834 TT	Diversified Banks	1.6	23.2	0%	N/A	N/A
Thanachart Capital	TCAP TB	Diversified Banks	1.3	22.2	13%	N/A	N/A
Corporation Bank	CRPBK IN	Diversified Banks	1.1	21.9	17%	0.95	High
Uco Bank	UCO IN	Diversified Banks	1.7	21.3	11%	1.17	High
Taiwan Cooperative	5880 TT	Diversified Banks	4.8	20.6	(1%)	N/A	N/A
Huaxia Bank	600015 CH	Diversified Banks	11.7	19.6	16%	0.03	Low
Syndicate Bank	SNDB IN	Diversified Banks	1.6	19.5	14%	0.97	High
Natl Aust Bank	NAB AU	Diversified Banks	74.1	19.2	4%	0.29	Normal
Woori Finance	053000 KS	Diversified Banks	7.9	19.1	(5%)	N/A	N/A

Source: GMT Research and Bloomberg

ASEAN lending growth has possibly been too fast

Analysed at the country level, Japan's financial institutions remain far more levered than the rest of Asia, but has had the slowest asset growth over the last three years. China, Malaysia, Thailand, the Philippines and Indonesia have all grown rapidly which makes one wonder about asset quality even if leverage still looks reasonable, as shown in Figure 37.

Figure 37: Leverage in Asia

Market	Total Assets/ Common Equity 2013	2012	2011	2010	2009	Change in Assets 3 year ave.
Japan	22.3	24.5	26.1	26.6	37.2	5%
Australia	16.5	17.0	17.6	17.6	18.0	6%
Taiwan	16.1	15.7	16.3	17.0	16.8	7%
China	15.5	16.0	16.5	17.0	18.8	14%
Korea	14.8	14.3	13.6	13.8	15.7	8%
India	14.8	14.8	14.4	13.4	10.3	16%
Malaysia	12.7	12.8	13.6	12.7	13.1	15%
Singapore	12.6	11.7	12.2	11.3	10.8	12%
Hong Kong	11.0	11.6	11.9	12.1	12.5	9%
Thailand	10.3	10.4	10.6	10.3	10.6	14%
Philippinnes	10.1	8.5	9.2	10.0	10.0	16%
Indonesia	8.2	8.5	9.0	9.6	10.4	17%

NB All years are financial rather than calendar years. Source: GMT Research and Bloomberg

Risk weighted leverage over time gives an indication of the appetite for risk

Banks are often keen to downplay absolute leverage because central banks have decided that some assets have no risk. But why would a bank want to leverage up on zero risk assets for no return? Still, comparing risk weighted leverage to normal leverage over time gives some insight into bankers' appetite for risk. Moreover, a bank could be lowly geared but only own very risky assets or vice versa. As a result, Flag 9 is raised when banks' risk weighted assets are 8x their equity.

The Europeans continue to embrace risk at a high level

The companies in Figure 37 have higher risk weighted leverage than many banks have total leverage. One can but hope that their auditors are doing appropriate due diligence given the risks these companies are taking on. As noted earlier, the European banks like Banco Com Port, Banca Monte Dei, Banca Carige and Graubunder either have remarkable appetites for risk while their countries are stagnating, or they are unwilling to get rid of assets for some other reason.

Figure 37: Risk Weighted Assets/Total Common Equity - Global

Name	Ticker	Industry	Mkt Cap (US$bn)	Risk Weighted Assets / Total Equity (%)	Total Assets / Total Equity (%)
Banco Com Port	BCP PL	Diversified Banks	4.6	18.2	34.0
Senshu Ikeda Hdg	8714 JP	Regional Banks	1.2	17.6	36.5
Banca Monte Dei	BMPS IM	Diversified Banks	15.2	13.7	32.3
Banca Carige	CRG IM	Diversified Banks	2.4	13.6	26.5
Resona Holdings	8308 JP	Regional Banks	13.3	13.0	36.5
Graubundner	GRKP SW	Diversified Banks	3.5	12.9	22.2
Central Bk India	CBOI IN	Diversified Banks	1.7	12.8	18.1
Ashikaga Holding	7167 JP	Diversified Banks	1.4	12.8	26.5
Banco Bilbao Viz	BBVACL CI	Diversified Banks	1.5	12.7	15.2
Nomos Bank	NMOS RM	Diversified Banks	3.1	12.6	12.9

Source: Bloomberg and company accounts

Asian banks run similar risk weighted leverage

Some banks in Asia are also happy to have high rates of risk weighted leverage. The range of 12 to 13x risk weighted assets/equity is very similar to the levels seen in our global screen. But, as Figure 38 shows, apart from Resona and the three Chinese banks, auditors appear to be paying attention as exemplified by normal audit costs.

Figure 38: Risk Weighted Assets/ Total Common Equity - Asia

Name	Ticker	Industry	Mkt Cap (US$bn)	Risk Weighted Assets / Total Equity (%)	Audit fee (Bps)	Audit Fee Range
Senshu Ikeda Hdg	8714 JP	Regional Banks	1.2	17.6	0.19	Normal
Resona Holdings	8308 JP	Regional Banks	13.3	13.0	0.14	Low
Central Bk India	CBOI IN	Diversified Banks	1.7	12.8	0.60	Normal
Ashikaga Holding	7167 JP	Diversified Banks	1.4	12.8	0.17	Normal
Huaxia Bank Co	600015 CH	Diversified Banks	11.7	12.5	0.03	Low
Taiwan Bus Bank	2834 TT	Diversified Banks	1.6	12.5	N/A	N/A
Union Bank India	UNBK IN	Diversified Banks	2.3	12.3	0.93	High
Allahabad Bank	ALBK IN	Diversified Banks	1.2	12.0	1.11	High
Shang Pudong-A	600000 CH	Diversified Banks	28.9	11.8	0.02	Low
China Minsheng-A	600016 CH	Diversified Banks	34.0	11.8	0.04	Low

Source: Bloomberg and company accounts

Red Flag 10 & 11: Asset Growth

Flag 10: Scored if Loan growth over the last two years exceeds 12%

Flag 11: Scored if Risk Weighted Asset growth exceeds 10%

Flagged if
1 Loan growth >12%
2 RWA growth >10%

A finance company is not like a factory. It is hard to build capacity in a meaningful way ahead of demand. To avoid credit problems, employee growth needs to match asset growth. Unfortunately it is hard to keep up with asset growth that organically compounds in excess of 10%. Buying organisations with assets does not necessarily help, as the new people and systems take time to be integrated.

Fast asset growth creates staffing problems

It is, therefore, amazing to see such high loan growth rates in Figure 39. Many of these countries have low loan to deposit ratios and so they can self-fund further loan growth. As long as leverage remains under control, they are, at an aggregate level, in safe territory. However, Turkey, Russia, Sri Lanka, Botswana and Georgia are already reliant on external funding to sustain current debt levels. Investors hoping to see continued growth in these countries need to take into account the extra currency risk required to finance it. India and China can both self-fund, though India will soon be constrained. Still, banks in both countries would probably be wise not to take on much more leverage. Greece remains over-loaned and over-levered.

Some countries are ok, but Turkey, Russia and India should be watched carefully

Figure 39: The Fastest Loan Growth Rates around the World + China

Name	Loan to deposit rates	Total Assets/ Equity	Loan Growth Rates				
			2013	2012	2011	2010	2009
Ghana	0.5	5.4	36%	51%	27%	10%	22%
Argentina	1.0	6.9	28%	32%	42%	47%	2%
Turkey	1.2	10.0	28%	17%	32%	31%	5%
Nigeria	0.2	7.3	27%	17%	14%	38%	75%
Philippines	0.6	10.1	24%	17%	19%	14%	7%
Colombia	1.0	9.7	24%	17%	23%	36%	3%
Qatar	0.9	7.4	23%	26%	33%	15%	10%
Russia	1.2	9.6	23%	23%	42%	17%	(0%)
Sri Lanka	1.1	9.1	22%	24%	38%	25%	(5%)
Indonesia	0.9	8.2	21%	22%	27%	25%	15%
Peru	0.7	12.4	21%	13%	18%	31%	(0%)
Zimbabwe	0.8	6.9	20%	19%	73%	98%	-
Botswana	1.1	8.2	19%	30%	88%	54%	16%
Greece	1.3	14.6	19%	1%	(6%)	2%	4%
India	0.9	14.8	18%	20%	30%	17%	23%
Singapore	0.9	12.6	17%	8%	24%	20%	1%
Kenya	0.5	6.3	15%	12%	39%	28%	51%
Georgia	1.2	5.5	15%	17%	6%	-	-
China	0.7	15.5	13%	14%	15%	20%	34%

NB All years are financial rather than calendar years. Source: Bloomberg and company accounts

The growth rates for some companies shown in Figure 40 are astounding. Even ignoring 2 year average loan growth of 267% at Ocwen's (US) and 145%at PSG's (S. Africa), most of the rest have averaged over 50% growth p.a. for the last two years. Leverage at TCS (Russia) and Encore (US) is still below 5x so maybe they can cope if the quality of the loan growth proves to be poor. However, at over 11x, Grupo BTG (Brazil) and Banco Provincal (Venezuela) do not have the same safety cushion.

How can management possibly control loan growth at over 40%?

Figure 40: Loan Growth – Global

Name	Ticker	Industry	Mkt Cap (US$bn)	Loan Growth 2 year ave.	Total Assets / Total Equity (%)
Ocwen Finl Corp	OCN US	Thrifts & Mortgages	5.1	267%	4.4
Psg Group Ltd	PSG SJ	Div. Financial Services	2.0	145%	4.3
Tcs Group Holding	TCS LI	Regional Banks	1.2	87%	4.8
Grupo Btg-Unit	BBTG11 BZ	Div. Capital Markets	14.3	79%	11.1
Viewpoint Financ	VPFG US	Regional Banks	1.1	61%	6.5
Banco Provincial	BPV VC	Diversified Banks	10.8	55%	11.0
Encore Capital G	ECPG US	Consumer Finance	1.2	54%	4.7
Philipp Natl Bnk	PNB PM	Diversified Banks	2.3	50%	7.6
Bankunited Inc	BKU US	Regional Banks	3.5	49%	7.8
Prosperity Bncsh	PB US	Regional Banks	4.3	44%	6.7

Source: Bloomberg and company accounts

J Trust and Seven manage to grow in a flat market

Unlike their larger competitors, J Trust and Seven Bank continue to grow their loan books in Japan despite the moribund economy, as shown in Figure 41. It's concern that despite such high growth rates, low audit fees are present at M&M Financial (India), Malaysia Building and China Bank. How will these banks ensure loan quality is maintained?

Figure 41: Loan Growth - Asia

Name	Ticker	Industry	Mkt Cap (US$bn)	Loan Growth 2 year ave.	Audit fee (Bps)	Audit Fee Range
Philipp Natl Bnk	PNB PM	Diversified Banks	2.3	50%	N/A	N/A
M&M Fin Services	MMFS IN	Consumer Finance	2.6	42%	0.33	Low
J Trust Co Ltd	8508 JP	Consumer Finance	1.7	38%	2.30	Normal
Security Bank	SECB PM	Diversified Banks	1.7	37%	0.10	Normal
Malaysia Buildng	MBS MK	Thrifts & Mortgages	1.8	35%	0.16	Low
BIMB Hldgs	BIMB MK	Diversified Banks	1.9	29%	0.30	Normal
China Development	2883 TT	Diversified Banks	4.9	29%	N/A	N/A
China Bank Corp	CHIB PM	Diversified Banks	2.0	29%	0.05	Low
Hana Financial G	086790 KS	Diversified Banks	10.8	29%	N/A	N/A
Seven Bank Ltd	8410 JP	Regional Banks	4.8	28%	0.63	High

Source: Bloomberg and company accounts

Risk Weighted Asset growth must be watched... The Russians are risking up

If absolute loan growth is a concern, then Risk Weighted Asset growth matters even more because, by definition, these companies are taking on extra risk. The three Russian companies, TCS, Bank Moskv and Nomos bank are taking on an unusual amount of risk by growing so quickly when risk assets are already over 80% of total assets, as shown in Figure 42. Any economic slowdown could prove very painful.

Figure 42: Risk Weighted Asset Growth - Global

Name	Ticker	Industry	Mkt Cap (US$bn)	Risk Weighted Asset Growth	Risk assets as % of Total Assets
Bzwbk	BZW PW	Diversified Banks	11.5	121%	79%
TCS Group	TCS LI	Regional Banks	1.2	69%	83%
Hana Financial	086790 KS	Diversified Banks	10.8	64%	63%
Syndicate Bank	SNDB IN	Diversified Banks	1.6	64%	52%
Bank Moskvy	MMBM RM	Diversified Banks	8.2	64%	94%
Bankunited	BKU US	Regional Banks	3.5	59%	57%
Corpbanca	CORPBANC CI	Diversified Banks	4.1	50%	85%
Panamericano	BPNM4 BZ	Diversified Banks	1.6	49%	84%
Nomos Bank	NMOS RM	Diversified Banks	3.1	48%	97%
Alior Bank Sa	ALR PW	Diversified Banks	1.9	46%	76%

Source: Bloomberg and company accounts

The audit costs for the Chinese banks, including Bank of Beijing, Industrial Bank and Chongqing Rural, fail to take into account their moves into riskier assets, particularly at a time when there are so many questions about the banking sector in China, as shown in Figure 43.

In China, the auditors are ignoring the move to risk up

Figure 43: Risk Weighted Asset Growth - Asia

Name	Ticker	Industry	Mkt Cap (US$bn)	Risk Weighted Asset Growth 2 year ave.	Audit fee (Bps)	Audit Fee Range
Hana Financial	086790 KS	Diversified Banks	10.8	64%	N/A	N/A
Syndicate Bank	SNDB IN	Diversified Banks	1.6	64%	0.97	High
Bank Of Beijing	601169 CH	Regional Banks	11.3	35%	0.04	Low
Harbin Bank	6138 HK	Regional Banks	4.3	33%	0.29	Normal
Industrial Bank	601166 CH	Diversified Banks	30.3	31%	0.02	Low
Indus. India Bank	IIB IN	Diversified Banks	4.9	31%	0.15	Normal
Bank Of Chonging	1963 HK	Regional Banks	1.8	30%	N/A	N/A
Huishang Bank	3698 HK	Regional Banks	5.0	29%	0.21	Normal
Bank Permata	BNLI IJ	Diversified Banks	1.3	29%	N/A	N/A
Chongqing Rural	3618 HK	Regional Banks	4.2	28%	0.08	Low

Source: Bloomberg and company accounts

Up until 2012, most banks were still in risk-off mode, as shown in the table below. Negative numbers show that risk assets either grew slower than total assets or shrank faster. Hopefully 2013 will be the start of a more positive phase, and even if overall asset growth is sluggish, the move away from Government bonds to corporate credit would be welcomed by the industry if less so by overspending governments.

2013 saw a move into Risk assets apart from Philippines, India and Korea

Figure 44: Risk Weighted Asset less Total Asset Growth by Country (Negative = Risk Avoidance)

Name	2014	2013	2012	2011	2010	2009
UK	-	1%	(1%)	(2%)	(5%)	17%
US	-	6%	(8%)	7%	(7%)	(1%)
France	-	6%	(9%)	(1%)	2%	8%
Canada	-	15%	(1%)	(4%)	(9%)	(5%)
Germany	-	16%	(6%)	(6%)	(3%)	16%
Philippines	-	(15%)	3%	4%	(5%)	(1%)
Korea	-	(8%)	4%	(1%)	(1%)	1%
India	(2%)	(2%)	(3%)	2%	(3%)	(9%)
Thailand	-	2%	(2%)	(1%)	(2%)	(3%)
Singapore	-	2%	(5%)	3%	(9%)	(7%)
Japan	(2%)	2%	(5%)	(9%)	(5%)	(10%)
Australia	-	3%	0%	(8%)	(5%)	2%
Taiwan	-	3%	(1%)	3%	1%	(8%)
Malaysia	-	6%	(8%)	(5%)	4%	(9%)
Indonesia	-	6%	(2%)	8%	12%	(6%)
Hong Kong	-	9%	(3%)	(5%)	5%	(6%)
China	-	17%	(0%)	2%	3%	3%

NB All years are financial rather than calendar years. Source: Bloomberg and company accounts

Red Flag 12: Risk Weighted Assets

Scored if Risk Weighted Assets exceed 70% of Total Assets

Flag if RWA>70% of Total assets

As we have discussed, growth or the change in the amount of risk weighted assets should matter to auditors. In addition to this, most central banks require capital to be set aside to cover risky assets. Management is therefore incentivised to downplay the absolute level of risky assets, because understating these assets frees up capital. Auditors should therefore be checking that the correct procedures are being followed and risk is being appropriately calculated.

Management has an incentive to understate risky assets

Looking at the list of Middle Eastern Banks, in Figure 45, one can but assume either they use very different accounting standards or their central banks do not require the same level of reserves that are the norm elsewhere. On the other hand, their asset growth, apart from Alinma, Nomos and MCB Group, has been reasonably restrained.

Banks in the Middle East do not seem to have the same risk asset capital requirements

Figure 45: Highest Risk Weighted Assets- Globally

Name	Ticker	Industry	Mkt Cap (US$bn)	Risk Weighted Assets as % of Total Assets	Risk weighted Asset growth Last 2 years
Riyad Bank	RIBL AB	Diversified Banks	14.4	100%	6%
Banque Saudi	BSFR AB	Diversified Banks	10.3	98%	9%
Comerica Inc	CMA US	Diversified Banks	9.3	99%	1%
Alinma Bank	ALINMA AB	Diversified Banks	7.4	96%	29%
Mashreqbank	MASQ UH	Diversified Banks	5.3	99%	7 %
Doha Bank	DHBK QD	Diversified Banks	4.2	96%	13%
Bankmuscat	BKMB OM	Diversified Banks	3.9	99%	12%
Comm Bk Of Dubai	CBD UH	Diversified Banks	3.7	98%	11%
Nomos-Bank	NMOS RM	Diversified Banks	3.1	97%	48%
Mcb Group Ltd	MCBG MP	Diversified Banks	1.7	98%	14%

Source: Bloomberg and company accounts

Given how rapid asset growth has been in Indonesia, it is something of a concern to see high risk assets making up over 75% of total assets at Bank Danamon, Pan Indonesia, Bank International Indonesia, Bank Niaga and Bank Permata, Figure 46. Particularly when we are unable to judge the quality of their audits!

Risk weightings are highest in Indonesia

Figure 46: Highest Risk Weighted assets - Asia

Name	Ticker	Industry	Mkt Cap (US$bn)	Risk Weighted Assets as % of Total Assets	Audit fee (Bps)	Audit Fee Range
Bank Danamon	BDMN IJ	Diversified Banks	3.4	84%	N/A	N/A
Kiatnakin Bank	KKP TB	Diversified Banks	1.2	83%	N/A	N/A
Kotak Mahindra	KMB IN	Diversified Banks	11.5	82%	0.4	Normal
Pan Indonesia	PNBN IJ	Diversified Banks	1.7	81%	N/A	N/A
Bank Intl Indonesia	BNII IJ	Diversified Banks	1.5	80%	N/A	N/A
Bank CIMB Niaga	BNGA IJ	Diversified Banks	2.1	80%	N/A	N/A
Ing Vysya Bank	VYSB IN	Diversified Banks	2.0	77%	0.1	Normal
Indusind Bank	IIB IN	Diversified Banks	4.9	77%	0.1	Normal
King's Town Bank	2809 TT	Diversified Banks	1.2	77%	N/A	N/A
Bank Permata Tbk	BNLI IJ	Diversified Banks	1.3	77%	N/A	N/A

Source: Bloomberg and company accounts

Tracking risk weighted assets to total assets over time, as shown in Figure 47, allows investors to get a sense of banks' risk appetite at both an absolute and relative level. It also goes some way to explaining just how/why the German and French banks remain so levered so long after the crisis. The real problem is that by maintaining a large balance sheet of low risk assets, they risk turning themselves into Japanese style, large balance sheet/low return, zombie banks. The US stands out as being the one large developed economy still willing to take on risk.

Figure 47: Risk Weighted Assets as a percentage of Total Assets

Name	2014	2013	2012	2011	2010	2009
Thailand	-	71%	69%	70%	71%	72%
Indonesia	-	69%	66%	68%	63%	57%
US	66%	67%	64%	69%	64%	68%
China		65%	56%	57%	56%	54%
Philippines	-	64%	72%	68%	65%	66%
Korea	-	62%	67%	64%	65%	66%
India	63%	60%	61%	67%	66%	73%
Malaysia	-	56%	53%	57%	60%	59%
Singapore	-	54%	53%	56%	54%	59%
Taiwan	-	50%	50%	49%	52%	52%
Italy	-	49%	48%	54%	54%	56%
Hong Kong	-	46%	44%	46%	49%	47%
Australia	-	45%	44%	44%	48%	50%
Spain	-	45%	46%	50%	54%	54%
Portugal	-	42%	67%	71%	72%	71%
Japan	39%	40%	39%	41%	45%	47%
Canada	-	39%	34%	35%	36%	39%
UK	-	37%	37%	37%	38%	40%
France	-	28%	26%	29%	29%	30%
Germany	-	26%	22%	23%	25%	25%

NB All years are Financial rather than calender years. Source: Bloomberg and company accounts

Red Flag 13: Trading Profits

Scored if Trading Profits are greater than 10% of Revenues.

Flagged if trading is> 20% of revenues

Trading profits at finance companies often have one or more of the following characteristics: a long tail, i.e. profits are booked today but the true profitability of the transaction does not become clear until many years late; or are of high value and frequency, so a small error in judgement or execution can have large consequences; or are extremely complex and outside senior management's understanding. All of this increases risk for the large finance companies and should attract auditor scrutiny. Unfortunately, trading profits are defined differently at each company so this will always be the hardest red flag to judge. Asset Managers either make all their revenues from trading or from fees, depending how the profit is booked. While we have flagged asset managers, they are excluded from the screens below.

Trading is often risky and complex

Asset managers are flagged but excluded from these tables

Nearly all the investment banks get flagged for all the same reasons Lehman went bust and various rogue traders have lost large sums over the recent years. It's a surprise to see three thrift companies, Flagstar (US), Pennymac (US) and Nationstar (US), depending on trading profits for quite so much of their revenues, as shown in Figure 48.

How/why are mortgage companies making so much money from trading?

Figure 48: Trading Profits as % of Revenues - Global

Short Name	Ticker	Industry	Mkt cap (US$bn)	Trading profits as % of Revenues	Total Assets / Total Common Equity
KCG Holdings	KCG US	Invest. Banking & Broker	1.5	62%	4.6x
MMI Holdings Ltd	MMI SJ	Life & Health Insurance	3.9	60%	N/A
Flagstar Bancorp	FBC US	Thrifts & Mortgages	1.0	40%	8.1x
Pennymac Finance	PFSI US	Thrifts & Mortgages	1.2	40%	9.5x
Goldman Sachs	GS US	Invest. Banking & Broker	78.4	40%	12.8x
MBIA Inc	MBI US	Property & Casualty Ins.	2.5	39%	N/A
Amer Equity Invt.	AEL US	Life & Health Insurance	1.8	39%	N/A
Fidelity & Guaranty	FGL US	Life & Health Insurance	1.4	38%	N/A
SVB Financial	SIVB US	Regional Banks	5.9	37%	13.4x
Nationstar Mortgage	NSM US	Thrifts & Mortgages	3.3	31%	14.2x

Source: Bloomberg and Company accounts

Following earlier comments about the complexity of trading within investment banks, it is worth noting that not only are Daiwa and Nomura rather more levered than their American counterparts, but their audit costs are very low as well, as shown in Figure 49.

Daiwa and Nomura, lots of trading and lots of leverage

Figure 49: Trading Profits as % of Revenues - Asia

Short Name	Ticker	Industry	Mkt cap (US$bn)	Trading profits as % of Revenues	Total Assets / Total Common Equity	Audit Fee (Bps)	Audit Fee Range
China Ever Ltd	165 HK	Div. Capital Markets	2.3	49%	1.3	2.28	Normal
Amp Ltd	AMP AU	Life & Health Insurance	15.0	37%	N/A	1.33	Normal
Tokai Tokyo Fin.	8616 JP	Invest. Banking & Broker	2.2	36%	4.4	0.84	Normal
Aozora Bank Ltd	8304 JP	Diversified Banks	5.4	32%	13.3	0.52	Normal
Daiwa Secs	8601 JP	Invest. Banking & Broker	15.1	30%	17.9	0.20	Low
China Develop.	2883 TT	Diversified Banks	4.9	29%	4.0	N/A	N/A
GF Securities	000776 CH	Invest. Banking & Broker	9.2	29%	3.4	0.18	Low
Nomura Holdings	8604 JP	Invest. Banking & Broker	27.7	27%	17.3	0.32	Low
Okasan Sec	8609 JP	Invest. Banking & Broker	1.8	27%	4.8	1.37	Normal
Guoyuan Secs.	000728 CH	Invest. Banking & Broker.	2.9	26%	2.0	0.25	Low

Source: Bloomberg and company accounts

Red Flag 14: Intangibles

Scored if intangibles are greater than 20% of equity.

Flag if> 20% of equity

During the Financial Crisis most listed financial companies traded discounts to book value as the markets questioned both book value and its relevance to a company's survival in a cash squeeze. Goodwill can be justified during a takeover by reference to brand values and staff. However, in most cases the new business is soon subsumed within the acquirer, and both brand and staff may well disappear. As for 'intangibles' such as software and intellectual property, are these really an asset, or just a cost of doing business? If they are so valuable, presumably they will be reflected in the company's profit margins and the market is then able to make its own judgement. Any valuation by management or a consultant leaves too much room for discretion and should require a detailed justification.

Brand values and staff rarely last long after takeovers in the finance sector

As shown in Figure 50, insurance brokers account for 5 out of the 10 highest intangibles/equity and none of these are from Asia, although Jardine Lloyd Thompson is part of Jardine Matheson (JM SP). At all of these companies', intangible values exceed equity by a considerable margin. Given Ambac's problems in 2008/9, it seems remarkably generous to maintain intangibles at 300% of equity for assets that are essentially un-saleable.

Intangibles mostly in the insurance sector

Figure 50: Top Intangibles/Equity from around the World

Name	Ticker	Industry	Mkt Cap (US$bn)	Intangibles/ Equity	Audit Fee (Bps)	Audit Fee Range
Ambac Financial	AMBC US	Property & Casualty Insurance	1.2	301%	N/A	N/A
CI Financial	CIX CN	Asset Management & Custody	9.2	183%	N/A	N/A
Affil. Managers	AMG US	Asset Management & Custody	11.2	178%	9.7	Normal
LPL Financial	LPLA US	Invest. Banking & Brokerage	5.1	166%	N/A	N/A
Arthur Gallagher	AJG US	Insurance Brokers	7.3	155%	N/A	N/A
Jardine Lloyd T.	JLT LN	Insurance Brokers	3.9	146%	11.0	Normal
Power Corp CDA	POW CN	Life & Health Insurance	12.6	145%	0.2	Low
Willis Grp Hldgs	WSH US	Insurance Brokers	7.8	144%	5.4	Low
Aon Plc	AON US	Insurance Brokers	26.9	142%	6.2	Low
Brown & Brown	BRO US	Insurance Brokers	4.4	131%	N/A	N/A

Source: Bloomberg and company accounts

In Asia, it is again the non-bank finance companies that dominate the list, as shown in Figure 51. Although intangibles as a % of equity are not as prominent as the global list, peaking at 110%, the Japanese consumer companies, Aplus and Orient, seem to be using capitalised software costs to underpin book value. In a sector that is experiencing regulatory reform, valuing software so highly seems aggressive.

Non finance companies top the list

Figure 51: Top Intangibles/Equity in Asia

Name	Ticker	Industry	Mkt Cap (US$bn)	Intangibles/ Equity	Audit Fee (Bps)	Audit Fee Range
IOOF Holdings Lt	IFL AU	Asset Management & Custody	1.8	110%	21.0	Normal
BT Investment	BTT AU	Asset Management & Custody	1.7	102%	9.4	Normal
Aplus Financial	8589 JP	Consumer Finance	2.1	100%	1.3	Normal
Orient Corp	8585 JP	Consumer Finance	1.9	100%	0.3	Low
HKEX	388 HK	Specialized Finance	21.5	92%	1.0	Normal
ASX Ltd	ASX AU	Specialized Finance	6.5	72%	1.2	Normal
SBI Holdings Inc.	8473 JP	Asset Management & Custody	2.8	60%	2.1	Normal
Monex Group	8698 JP	Invest. Banking & Brokerage	1.1	51%	0.8	Normal
Crisil Ltd	CRISIL IN	Specialized Finance	2.0	51%	15.6	High
AMP Ltd	AMP AU	Life & Health Insurance	15.0	51%	1.3	Normal

Source: Bloomberg and company accounts

CorpBanca in Chile has the highest intangibles amongst the high scoring banks at 59%, as shown in Figure 52. Thankfully in Asia, Intangibles are not a large part of most banks' balance sheets and of the high scorers, only CIMB Group and Ashikaga Holdings with 32% and 49% respectively, make our list.

Intangibles are not material at most banks in Asia

Figure 52: Top Bank Red Flag Scorers with Intangibles/Equity > 30%

Name	Ticker	Mkt Cap (US$bn)	Intangibles/ Equity	Red Flags	Audit Fee (Bps)	Audit Fee Range
Banco Bogota	BOGOTA CB	11.3	40%	8	N/A	N/A
Corpbanca	CORPBANC CI	4.1	59%	8	N/A	N/A
Banco Santander	SAN SM	125.5	37%	6	0.8	Normal
Capital One	COF US	47.7	38%	6	0.4	Normal
CIMB Group	CIMB MK	19.0	32%	6	N/A	N/A
Burgan Bank	BURG KK	3.1	36%	6	N/A	N/A
Home Bancshares	HOMB US	2.2	39%	6	N/A	N/A
Columbia Banking	COLB US	1.4	35%	6	N/A	N/A
Ashikaga Holding	7167 JP	1.4	49%	6	0.2	Normal

Source: Bloomberg and company accounts

Red Flag 15: Long Term Investments

Scored if Long Term Investments exceed 10x of equity.

Flagged if >10x equity

To control risks, limit liability and - perhaps more importantly - reduce on balance sheet leverage and tax, many finance companies have used Joint Ventures, Special Purpose Vehicles, etc. Many of these now have to be consolidated, but there is still plenty of room for constructive accounting. Given the size, diversity and global nature of today's finance companies, it is often hard to understand and monitor the core business, never mind an investment in an "uncontrolled" overseas associate.

Finance companies often have lots of subsidiaries and associates

As with all the audit red flags, it is materiality that matters. If prudence suggests it is best for a finance company to be levered less than 15x, then tying up 10x equity in long term illiquid investments reduces the company's ability to invest in its core business. Moreover, unless disclosure is good, investors have little idea what is happening to a large part of the company's assets.

Investments >10x equity use up too much of the companies leverage and reduce disclosure

Japanese banks are 7 out of the top 10 companies with high multiples of long term investments to equity, as shown in Figure 53. Despite all of the talk of reform, Japanese banks are still clinging to their relationship investments. When one considers that they are now levered between 14.8x, at Hiroshima Bank, to 19.1x, at Nanto Bank, merely to hold their low return investment, it is no surprise that these banks are no longer really banking investments, so much as such geared plays on the stock market.

Japanese banks, still full of relationship investments

The audit cost for most of these Japanese banks is very low, despite their leverage. Given the cost of doing business in Japan, it is hard to see how thorough any risk assessment could have been.

Very low audit costs at these Japanese banks

Figure 53: Long Term Investments in Related Companies as Multiple of Equity

Short Name	Ticker	Industry	Mkt cap (US$bn)	Long Term Investments as multiple of equity	Audit Fee (Bps)	Audit Fee Range
First National	FN CN	Thrifts & Mortgages	1.3	61.6	N/A	N/A
Resona Holdings	8308 JP	Diversified Banks	13.3	27.0	0.1	Low
Wuestenrot & Wue	WUW GR	Div. Financial Services	2.4	21.5	N/A	N/A
Nanto Bank Ltd	8367 JP	Regional Banks	1.1	19.1	0.2	Normal
Hokuhoku Financial	8377 JP	Regional Banks	2.9	18.7	0.1	Low
Taishin Holdings	2887 TT	Diversified Banks	4.5	16.7	N/A	N/A
Musashino Bank	8336 JP	Regional Banks	1.2	16.0	0.2	Normal
Nishi-Nippon	8327 JP	Regional Banks	2.0	15.3	0.1	Low
Shinkin Central	8421 JP	Diversified Banks	8.8	14.8	0.0	Low
Hiroshima Bank	8379 JP	Regional Banks	3.0	14.8	0.1	Low

Source: Bloomberg and company accounts

Conclusion

Extreme fees should raise concern

Firstly, assuming that management at most companies are honest and most auditors do an acceptable job, the normal range of audit fees within an industry should represent a fair cost of auditing. Sadly, auditing costs are not a simple panacea, but they offer investors a glimpse as to how management treats the construction and disclosure of a company's public accounts. Therefore fees outside the range should worry investors.

So should multiple flags and 'normal' fees

Secondly, although auditors cannot be expected to find and prevent all fraud, it is not unreasonable to expect a comprehensive audit, particularly when the accounts have obvious problems. The poor performance of companies with multiple red flags shows that investors recognise warning signs, so it is surprising that many of these companies' auditors did not raise their levels of due diligence. So, while investors should be concerned when they see companies with lots of problems and low auditing costs, even companies with multiple red flags whose costs are in the normal range should attract investor scrutiny. For a detailed breakdown of all the 4+ flag stocks in Asia please refer to Appendix III. For the full spread sheet visit our website or email [redacted]

Investing on the back of extreme audits is a leap of faith

Anyone investing in companies that pay less than normal fees is taking a leap of faith. Either the internal systems are superb and/or that management needs to be transparent and honest. Conversely, investing in companies that pay a lot more than normal ignores the possibility that the auditor has seen something but been persuaded to overlook it.

Banks are de-levering

But India, Russia and Turkey have yet to start and need to slow down

At a macro level, while banks are increasing both assets and more importantly, since 2012, risk weighted assets, they also continue to de-lever. Unfortunately, in most countries and particularly in Europe, this will go a long way to offsetting increasing Government leverage and undermine any expansionist recovery. Banks are getting healthier but absolute leverage is still high in Europe. In the few countries where banks are levering up, they are now moving into risky territory. Either leverage is high (over 14x tin India) and loan to deposit ratios are close to 100% and rising, or loan deposit ratios are already over 100% (like Turkey and Russia) and both absolute and risk weighted leverage is going over 10x.

Happily a few countries now have capacity if the demand is there.

On a positive note, the US, Scandinavian, Hong Kong, Singaporean, Indonesian, Czech and Hungarian banks have risk weighted leverage below 6x, so could take on some more commercial risk even if they wished to keep overall leverage contained.

APPENDIX I: AUDIT FEES BY COUNTRY (BASIS POINTS OF TURNOVER)

Market	Region	Country	Min.	20th percentile	Mean	80th percentile	Max.	No. of companies
Americas	AM	Canada	0.19	0.25	0.4	0.45	1	Americas
Americas	AM	USA	0.15	0.47	1.8	2.62	15	Americas
Developed	Asia	Australia	0.25	0.32	3.1	4.17	382	Developed
Developed	Asia	Hong Kong	0.10	0.37	1.3	2.63	67	Developed
Developed	Asia	Japan	0.03	0.14	0.4	0.63	151	Developed
Developed	Asia	New Zealand	2.09	2.92	3.6	4.36	26	Developed
Developed	Asia	Singapore	0.13	0.16	0.5	0.32	10	Developed
Emerging	Asia	**Banglalesh**	0.03	**0.04**	**0.1**	**0.14**	0	Emerging
Emerging	Asia	**China**	0.02	**0.06**	**0.2**	**0.41**	27	Emerging
Emerging	Asia	India	0.03	0.19	0.6	1.00	16	Emerging
Emerging	Asia	Indonesia	0.20	0.20	0.2	0.20	0	Emerging
Emerging	Asia	Malaysia	0.14	0.20	0.6	0.98	4	Emerging
Emerging	Asia	Pakistan	0.06	0.22	0.5	0.73	2	Emerging
Emerging	Asia	**Philippines**	0.04	**0.05**	**0.1**	**0.19**	1	Emerging
Emerging	Asia	Sri Lanka	0.48	0.50	0.7	0.91	3	Emerging
Developed	Europe	Austria	0.67	0.78	0.9	1.09	1	Developed
Developed	Europe	Belgium	0.04	0.35	1.3	1.80	4	Developed
Developed	Europe	Denmark	0.04	0.16	0.7	0.79	3	Developed
Developed	Europe	Finland	0.39	0.55	0.8	1.01	9	Developed
Developed	Europe	France	0.03	0.14	0.9	1.55	13	Developed
Developed	Europe	Germany	0.21	0.39	1.1	1.61	28	Developed
Developed	Europe	Holland	0.22	0.29	0.4	0.47	1	Developed
Developed	Europe	Ireland	0.59	0.85	1.3	1.65	14	Developed
Developed	Europe	Norway	0.15	0.24	0.4	0.56	25	Developed
Developed	Europe	Portugal	0.44	0.44	0.4	0.44	0	Developed
Developed	Europe	Spain	0.03	0.11	0.9	1.21	3	Developed
Developed	Europe	Sweden	0.06	0.08	0.1	0.12	27	Developed
Developed	Europe	UK	0.02	0.26	1.6	2.56	90	Developed
Emerging	Europe	Montenegro	0.28	0.73	1.4	2.07	3	Emerging
Emerging	MEA	Botswana	4.72	4.72	4.7	4.72	5	Emerging
Emerging	MEA	Kenya	0.74	0.74	0.7	0.74	4	Emerging
Emerging	MEA	South Africa	0.33	1.15	2.6	4.08	71	Emerging

Source: Bloomberg and company accounts

APPENDIX II: MEAN LENDING RATE BY COUNTRY (BASIS POINTS OF TURNOVER)

Market	Region	Country	Reference rate 6 months	Mean lending rate	75th percentile	No. of companies
Americas	AM	Canada	0.33%	3.4%	4.3%	20
Americas	AM	USA	0.26%	4.5%	5.0%	484
Developed	AM	Guam	0.26%	0.0%	0.0%	1
Developed	Asia	Australia	2.88%	2.4%	3.9%	18
Developed	Asia	HK	0.50%	1.6%	3.1%	18
Developed	Asia	Japan	0.02%	1.7%	2.0%	109
Developed	Asia	New Zealand	3.67%	13.1%	13.1%	1
Developed	Asia	Singapore	0.50%	1.7%	2.5%	9
Developed	Europe	Austria	0.14%	5.0%	5.9%	4
Developed	Europe	Belgium	0.14%	3.7%	5.6%	3
Developed	Europe	Denmark	0.55%	6.0%	6.9%	16
Developed	Europe	Faroe Isles	0.55%	5.9%	5.9%	1
Developed	Europe	Finland	0.14%	2.8%	3.5%	3
Developed	Europe	France	0.14%	4.2%	4.7%	19
Developed	Europe	Germany	0.14%	3.3%	4.2%	13
Developed	Europe	Greece	0.14%	5.0%	5.9%	7
Developed	Europe	Holland	0.14%	3.1%	4.6%	2
Developed	Europe	Ireland	0.14%	1.9%	3.8%	4
Developed	Europe	Italy	0.14%	3.3%	3.4%	16
Developed	Europe	Norway	1.67%	3.0%	3.3%	12
Developed	Europe	Portugal	0.14%	4.9%	6.7%	5
Developed	Europe	Spain	0.14%	3.9%	4.7%	8
Developed	Europe	Sweden	0.75%	2.2%	2.7%	5
Developed	Europe	Switzerland	0.33%	1.6%	1.8%	18
Developed	Europe	UK	0.73%	3.0%	4.3%	14
Developed	Tax	Bermuda	0.26%	4.7%	4.7%	1
Developed	Tax	Cayman	0.14%	7.8%	8.5%	3
Developed	Tax	Malta	3.00%	4.1%	6.7%	10
Developed	Tax	Monaco	0.14%	4.9%	4.9%	1
Emerging	Asia	China	2.80%	5.5%	7.9%	26
Emerging	Asia	India	8.75%	3.1%	5.0%	70
Emerging	Asia	Indonesia	7.12%	5.0%	7.2%	39
Emerging	Asia	Korea	4.65%	2.3%	2.3%	13
Emerging	Asia	Malaysia	3.58%	0.8%	1.3%	14
Emerging	Asia	Philippines	0.69%	5.0%	6.4%	16
Emerging	Asia	Sri Lanka	7.99%	11.3%	13.4%	15
Emerging	Asia	Taiwan	0.98%	2.3%	3.0%	23
Emerging	Asia	Thailand	2.29%	7.1%	7.7%	19
Emerging	Asia	Vietnam	3.85%	7.3%	8.4%	8
Emerging	Europe	Bulgaria	0.53%	1.2%	0.0%	6
Emerging	Europe	Croatia	1.10%	6.4%	6.6%	3
Emerging	Europe	Czech Republic	0.11%	6.4%	6.4%	1
Emerging	Europe	Georgia	4.90%	11.1%	11.1%	1
Emerging	Europe	Hungary	1.91%	11.4%	11.5%	2
Emerging	Europe	Lithuania	0.50%	6.4%	6.4%	1
Emerging	Europe	Montenegro	0.14%	6.7%	7.6%	4
Emerging	Europe	Poland	2.60%	3.0%	4.0%	14
Emerging	Europe	Romania	2.53%	5.3%	8.0%	3
Emerging	Europe	Serbia	7.50%	7.3%	8.8%	2
Emerging	Europe	Slovakia	0.17%	4.9%	5.2%	2
Emerging	Latam	Argentina	14.31%	4.1%	5.5%	6
Emerging	Latam	Brazil	10.79%	7.3%	10.5%	22
Emerging	Latam	Chile	1.25%	5.6%	7.0%	9
Emerging	Latam	Colombia	4.31%	3.4%	5.5%	9
Emerging	Latam	Ecuador	3.89%	9.7%	10.3%	2

Market	Region	Country	Reference rate 6 months	Mean lending rate	75th percentile	No. of companies
Emerging	Latam	Jamaica	7.66%	10.8%	13.2%	2
Emerging	Latam	Mauritius	5.90%	0.9%	1.3%	5
Emerging	Latam	Mexico	3.04%	20.4%	22.5%	10
Emerging	Latam	Panama	2.16%	1.0%	1.0%	1
Emerging	Latam	Peru	4.18%	6.8%	7.3%	6
Emerging	Latam	Puerto Rico	0.26%	6.2%	6.2%	1
Emerging	Latam	Trinidad/Tobago	1.50%	14.1%	14.4%	4
Emerging	Latam	Venezuela	14.50%	-2.7%	0.0%	6
Emerging	MEA	Bahrain	0.90%	6.8%	8.0%	9
Emerging	MEA	Botswana	5.18%	12.9%	12.0%	5
Emerging	MEA	Cote D' Ivoire	3.50%	3.4%	5.0%	4
Emerging	MEA	Egypt	9.00%	5.6%	10.5%	12
Emerging	MEA	Israel	0.64%	3.2%	4.0%	12
Emerging	MEA	Jordan	3.46%	5.6%	7.2%	15
Emerging	MEA	Kenya	10.25%	2.8%	4.6%	12
Emerging	MEA	Kazakhstan	2.75%	6.2%	7.9%	4
Emerging	MEA	Kuwait	1.63%	3.9%	5.2%	11
Emerging	MEA	Lebanon	10.00%	4.6%	8.2%	6
Emerging	MEA	Malawi	14.63%	5.1%	6.6%	3
Emerging	MEA	Namibia	4.02%	5.4%	5.5%	2
Emerging	MEA	Nigeria	9.42%	8.8%	12.7%	15
Emerging	MEA	Oman	0.16%	3.2%	5.3%	13
Emerging	MEA	Palestine	3.46%	0.0%	0.0%	4
Emerging	MEA	Qatar	0.93%	3.9%	4.5%	8
Emerging	MEA	Russia	9.21%	2.9%	4.3%	11
Emerging	MEA	South Africa	0.93%	13.2%	22.3%	11
Emerging	MEA	Tanzania	10.11%	5.3%	5.7%	2
Emerging	MEA	Turkey	9.38%	-0.8%	0.0%	17
Emerging	MEA	UAE	0.33%	6.0%	6.5%	20
Emerging	MEA	Uganda	11.43%	8.2%	10.2%	3

Source: Bloomberg and company accounts

APPENDIX III: BANKS IN ASIA WITH A MARKET CAPITALISATION>US$5BN WITH 4+ ACCOUNTING RED FLAGS, IN DESCENDING ORDER OF RED FLAGS

Name	Ticker	Trading profits as % of Revenue	Intangibles as % of Equity	Impact of Deposits on Net Debt	Employee cost US$K	Interest loan premium	Ave. Loan growth 2 years	Risk Weighted Asset growth (2yr ave)	Last year Provisions as % of Net loans	Actual loss vs annual provision	Unprov. NPLs as % of equity	NPL Growth 2 year ave	Leverage (total assets/ Equity)	Risk weighted leverage	Risk weighted assets as % of Assets	Long term Investments as Multiple of equity	Flags	Audit Fee range
State Bk India	SBIN IN	2%	0%	1,040	22		16%	16%	2.8%		29%	28%	16.3	10.1	62%	5.1	9	Normal
China Citic Bk	998 HK	1%	1%	6,744	62		16%	24%	0.6%			48%	16.1	11.5	71%	4.6	8	Low
Bank Of India	BOI IN	3%		1,029			24%	22%	3.5%		27%	42%	18.8	11.4	61%	4.7	8	High
Syndicate Bk	SNDB IN	1%					14%	64%	2.1%	1.1	22%	24%	19.5	9.4	52%	7.0	8	High
Corporation Bk	CRPBK IN	2%		1,230		6%	17%	(19%)	6.0%		31%	61%	21.9	8.1	41%	5.3	8	High
SMFG	8316 JP	15%	11%			2%	5%	11%	(0.2%)	1.1	8%	(14%)	22.2	8.5	38%	10.4	7	Normal
China Minsheng	600016 CH	1%	3%			8%	14%	21%	0.8%			26%	16.3	11.8	72%	4.0	7	Low
Union Bk India	UNBK IN	3%	0%	1,066			14%	17%	1.1%		29%	34%	19.1	12.3	65%	4.4	7	High
Union Bk Phil.	UBP PM	24%	25%		31	8%	19%	11%	1.0%			21%	8.8	4.5	52%	3.6	7	Normal
Indian Overs.	IOB IN	2%					13%	22%	3.9%		37%	53%	17.0	11.5	63%	5.1	7	High
Oriental Bank	OBC IN	1%		1,105			12%	12%	3.3%		23%	26%	16.4	11.0	67%	5.8	7	High
Bank Itl Indon.	BNII IJ	4%	1%	1,288	30		16%		0.9%	2.4	8%	26%	11.5	9.2	80%	3.6	7	N/A
Bank Of Com.	3328 HK	0%	0%	5,317			13%	24%	0.6%			20%	14.2	10.2	72%	4.4	6	Low
China Merch.	600036 CH	0%	5%		64		16%	25%	0.5%			36%	15.1	10.3	68%	4.7	6	Low
Industrial Bank	601166 CH	0%	0%			9%	18%	31%	1.2%			71%	18.4	11.6	63%	3.2	6	Low
Shang Pudong	600000 CH	0%	0%	7,376			15%	24%	0.6%			50%	18.0	11.8	66%	4.6	6	Low
Bk CentralAsia	BBCA IJ	1%		1,453	31		25%	15%	0.6%			20%	7.8	5.7	74%	3.3	6	N/A
Bk Of Beijing	601169 CH	0%	1%	10,349			20%	35%	0.6%			33%	17.1	11.4	66%	4.0	6	Low
Suruga Bank	8358 JP	1%	12%	12,730		3%	5%	5%	0.1%		12%	(11%)	16.4	9.4	55%	11.5	6	Normal
Indusind Bank	IIB IN	4%				6%	26%	31%	2.9%		2%	34%	9.6	7.4	77%	1.9	6	Normal
Harbin Bank	6138 HK	2%				10%	24%	33%	0.5%			33%	16.3	8.3	51%	3.1	6	Normal
Bk Of Ningbo	002142 CH	0%	0%		62	10%	18%		0.8%			35%	18.3	10.6	58%	3.0	6	Low
E.Sun Financial	2884 TT	12%	7%				12%	18%	0.2%			25%	16.7	11.2	67%	8.0	6	N/A
Bk Of Nanjing	601009 CH	0%	0%			9%	20%	26%	0.6%			28%	16.3	9.9	61%	2.4	6	Low
Yes Bank Ltd	YES IN	3%				5%	9%	14%	0.5%		0%	85%	15.3	10.8	70%	6.0	6	Low
BS Financial	138930 KS	2%	4%				14%	15%	0.7%			58%	13.4	9.7	72%	10.8	6	N/A
Yamaguchi Financial	8418 JP	14%	5%	14,038			1%	(3%)		7.6	10%	(5%)	18.6	7.8	42%	13.3	6	Low
IDBI Bank Ltd	IDBI IN	3%		2,007			6%	20%	4.3%		21%	48%	13.9	8.1	58%	2.8	6	Low
Dah Sing Fin.	440 HK	0%	6%		65	3%	12%	14%	0.3%	1.1	1%	5%	10.9	6.9	64%	5.1	6	Normal
CIMB Thai Bk	CIMBT TB	8%	2%	1,971	35		21%	17%	1.7%			(3%)	12.8	9.1	71%	7.3	6	N/A
Ashikaga	7167 JP	6%	49%	14,680			2%	5%	0.1%	3.3	39%	(0%)	26.6	12.8	48%	5.8	6	Normal
Indian Bank	INBK IN	2%					16%	13%	4.2%		26%	61%	13.4	8.4	60%	4.3	6	High
Bank Permata	BNLI IJ	1%	2%	1,551	26		27%	29%	0.4%			(8%)	11.7	9.0	77%	3.0	6	N/A
Musashino Bk	8336 JP	3%	1%	12,817			4%	5%	0.1%	1.8	28%	(1%)	20.7	10.7	52%	16.0	6	Normal
Mizuho Fin.	8411 JP	15%	9%		110		5%	10%	(0.2%)		7%	(7%)	28.6	9.8	34%	14.0	5	Normal
HDFC Bank	HDFCB IN	3%					26%		3.0%		2%	31%	11.4	8.1	71%	2.2	5	Low
ICICI Bank Ltd	ICICIBC IN	3%					15%	11%	1.0%	1.0	6%	8%	9.8	7.1	73%	3.5	5	Normal

Name	Ticker	Trading profits as % of Revenue	Intangibles as % of Equity	Impact of Deposits on Net Debt	Employee cost US$K	Interest loan premium	Ave. Loan growth 2 years	Risk Weighted Asset growth (2yr ave)	Last year Provisions as % of Net loans	Actual loss vs annual provision	Unprov. NPLs as % of equity	NPL Growth 2 year ave	Leverage (total assets/ Equity)	Risk weighted leverage	Risk weighted assets as % of Assets	Long term Investments as Multiple of equity	Flags	Audit Fee range
China Everbright	601818 CH	0%	1%				14%	21%	0.4%			33%	15.8	10.9	69%	3.9	5	N/A
Bank Mandiri	BMRI IJ	2%	1%	1,362	27		23%	18%	1.1%			13%	8.4	5.6	67%	3.3	5	N/A
Ping An Bank	000001 CH	1%	12%				17%	22%	0.8%			59%	16.9	10.4	62%	3.2	5	Low
Axis Bank Ltd	AXSB IN	3%					17%	11%	2.6%		3%	35%	10.1	7.5	74%	2.2	5	Low
Resona	8308 JP	3%	3%	15,761			2%	(4%)	(0.2%)		32%	(7%)	36.6	13.0	36%	27.0	5	Low
Huaxia Bank	600015 CH	0%	0%				16%	23%	0.5%			15%	19.6	12.5	64%	5.6	5	Low
Kotak Mahind.	KMB IN	5%	0%			5%	16%	28%	0.8%		4%	45%	6.4	5.3	82%	0.7	5	Normal
Woori Finance	053000 KS	1%	2%				(5%)	(2%)	1.2%	1.1	18%	52%	19.1	11.3	59%	9.5	5	N/A
Bank Negara	BBNI IJ	3%		49,842	N/A		24%	25%	1.1%			(3%)	8.1	6.1	75%	3.4	5	N/A
Bk Yokohama	8332 JP	5%	1%	19,650			3%	0%	0.1%	1.1	16%	(1%)	16.0	7.7	48%	11.7	5	Low
Shinsei Bank	8303 JP	23%	9%		108	3%	2%	(1%)	(0.0%)		13%	(23%)	14.1	9.1	65%	8.8	5	High
Metro Bank Tst	MBT PM	26%	4%	1,314	36		17%	14%	1.9%			(12%)	10.7	6.4	59%	4.6	5	Low
Aozora Bank	8304 JP	32%	1%	16,981	119		(0%)	8%	0.0%		4%	(14%)	13.3	9.6	73%	9.2	5	Normal
Taishin Hldg	2887 TT	13%	21%				3%		(0.0%)			6%	27.6	0.0	0%	16.7	5	N/A
Joyo Bank Ltd	8333 JP	3%	2%	13,549			4%	5%	0.1%	1.5	16%	(11%)	16.6	6.8	41%	12.4	5	Low
Fukuoka Fin.	8354 JP	6%	19%	13,422			5%	(2%)	0.2%		13%	(4%)	20.6	9.3	45%	14.7	5	Normal
Bk Danamon	BDMN IJ	1%	4%				15%	11%	3.1%			15%	5.9	5.0	84%	2.4	5	N/A
Hiroshima Bk	8379 JP	1%	2%	14,477			4%	(6%)	(0.1%)		16%	(5%)	20.1	8.8	44%	14.8	5	Low
Hokuhoku Fin.	8377 JP	4%	7%	13,266			0%	1%	(0.0%)		32%	(8%)	24.7	10.9	44%	18.7	5	Low
Gunma Bank	8334 JP	2%	2%	12,786			6%	4%	0.1%	1.3	13%	(3%)	15.5	6.9	44%	11.5	5	Low
Dah Sing Bank	2356 HK	3%	5%	5,612	70		12%		0.3%	1.1	1%	5%	9.8	0.0	0%	5.1	5	Normal
Nishi-Nippon	8327 JP	0%	2%	12,710			4%	4%	0.0%		31%	(4%)	19.9	11.3	57%	15.3	5	Low
BIMB Hldgs	BIMB MK	3%				4%	29%	22%	(0.1%)			(13%)	17.7	9.1	51%	7.6	5	Normal
Bk Of Chongq.	1963 HK	0%	0%				19%	30%	0.6%			20%	15.3	8.4	55%	3.2	5	N/A
UCO Bank	UCO IN	1%					11%	10%	3.0%		34%	34%	21.3	10.4	49%	6.6	5	High
North Pacific	8524 JP	1%	4%	14,647			(0%)	1%	0.1%	1.3	24%	(5%)	24.4	11.0	45%	4.8	5	Normal
Central Bk India	CBOI IN	2%	0%				10%	23%	4.4%			26%	18.1	12.8	66%	6.7	5	Normal
Security Bank	SECB PM	12%	5%				37%	27%	0.1%			37%	8.5	6.4	75%	2.5	5	Normal
Shiga Bank Ltd	8366 JP	4%	1%				3%	1%	0.0%	1.6	17%	7%	16.6	7.2	43%	12.8	5	Normal
Keiyo Bank Ltd	8544 JP	3%	0%	13,329			5%	4%	0.0%	15.3	16%	(2%)	16.9	7.7	46%	11.9	5	Low
Juroku Bank	8356 JP	6%	3%				0%	(1%)	0.1%	1.3	30%	(3%)	20.0	9.6	48%	12.7	5	Normal
Senshu Ikeda	8714 JP	8%	5%				1%	2%	0.0%	11.3	23%	17%	36.6	17.6	48%	8.0	5	Normal
Allahabad Bk	ALBK IN	2%					11%	16%	5.4%			103%	18.3	12.0	65%	5.9	5	High
Nanto Bank	8367 JP	3%	3%				3%	4%	0.1%	1.0	27%	(4%)	24.3	9.7	40%	19.1	5	Normal
Hyakujushi	8386 JP	0%	2%				4%	4%	(0.2%)	2.1	23%	(2%)	18.7	9.4	50%	13.5	5	Normal
Ind & Comm.	601398 CH	1%	1%				13%	19%	0.4%			11%	14.8	9.4	63%	6.5	4	Low
China Const.	939 HK	1%	0%				15%	21%	0.5%			8%	14.4	9.3	64%	6.0	4	Low
Agricultural Bk	601288 CH	0%	0%				13%	19%	0.8%			0%	17.3	10.8	62%	7.2	4	Low
Bank Of China	3988 HK	1%	1%				10%	19%	0.3%			8%	15.0	10.2	68%	5.7	4	Normal
Housing Dev.	HDFC IN	1%	0%	16,424	54		17%		0.1%			17%	7.9	0.0	0%	6.2	4	Normal
CIMB Group	CIMB MK	6%	32%			2%	11%	15%	0.3%	3.3	4%	(13%)	12.3	5.8	47%	4.9	4	N/A

Name	Ticker	Trading profits as % of Revenue	Intangibles as % of Equity	Impact of Deposits on Net Debt	Employee cost US$K	Interest loan premium	Ave. Loan growth 2 years	Risk Weighted Asset growth (2yr ave)	Last year Provisions as % of Net loans	Actual loss vs annual provision	Unprov. NPLs as % of equity	NPL Growth 2 year ave	Leverage (total assets/ Equity)	Risk weighted leverage	Risk weighted assets as % of Assets	Long term Investments as Multiple of equity	Flags	Audit Fee range
Hana Financial	086790 KS	3%	7%				29%	64%	0.6%		6%	116%	14.8	9.3	63%	4.7	4	N/A
Bank of Phils.	BPI PM	11%	3%	1,169			18%	13%	0.4%			(29%)	11.4	6.7	59%	5.2	4	Normal
Industrial Bank	024110 KS	3%	2%				4%	7%	0.8%	1.1	1%	34%	16.3	10.4	64%	3.1	4	N/A
Chiba Bank Ltd	8331 JP	3%	1%	17,694			3%	5%	0.1%		15%	3%	15.9	7.0	44%	11.2	4	Low
Bk Of Baroda	BOB IN	4%		1,192			18%		3.2%				17.9	0.0	0%	3.7	4	Normal
Hong Leong	HLFG MK	6%	28%				8%	8%	0.0%			52,572%	17.9	10.0	56%	6.2	4	N/A
Seven Bank	8410 JP	0%	23%			20%	28%	7%	(0.2%)			17%	5.2	1.9	37%	0.4	4	High
Taiwan Coop.	5880 TT	5%	3%	7,183	56		(1%)	2%	0.2%			0%	20.6	11.5	56%	1.2	4	N/A
Bk Tabungan	BTPN IJ	0%	2%			16%	24%	26%	1.3%			73%	7.0	3.9	56%	1.1	4	N/A
Ing Vysya Bk	VYSB IN	3%					12%	27%	0.7%		2%	49%	8.5	9.2	77%	2.5	4	Normal
DGB Financial	139130 KS	3%	3%				9%		0.6%	1.1	1%	12%	13.9	9.8	70%	9.7	4	N/A
China Bank	CHIB PM	18%	3%				29%	14%	0.1%			(9%)	7.7	5.5	72%	4.1	4	Low
Pan Indonesia	PNBN IJ	2%	0%	1,143			22%	22%	0.5%		3%	1%	8.8	7.1	81%	2.5	4	N/A
J Trust Co Ltd	8508 JP	1%	5%			24%	38%		2.9%		6%	84%	1.9	0.0	0%	0.1	4	Normal
Rizal Com Bk	RCB PM	10%	1%	1,430			8%	8%	0.9%	3.3		1%	10.6	7.7	73%	4.9	4	Normal
Kagoshima Bk	8390 JP	4%	3%		90		5%	7%	0.3%		13%	10%	13.9	7.2	52%	10.0	4	Normal
Thanachart	TCAP TB	17%	43%				13%		1.5%			(3%)	22.2	0.0	0%	5.7	4	N/A
Jam & Kashmir	JKBK IN	3%					24%	22%				12%	14.7	9.1	62%	5.3	4	High
Higo Bank Ltd	8394 JP	9%	2%				4%	6%	0.1%	1.1	14%	(6%)	16.4	7.0	43%	12.0	4	Low
King's Town	2809 TT	12%				4%	7%	20%	0.5%			(41%)	8.8	6.8	77%	5.5	4	N/A
Hyakugo Bank	8368 JP	7%	1%				5%	6%	0.1%	1.2	18%	(5%)	17.5	7.5	43%	12.4	4	Low
Daiwa Secs.	8601 JP	30%	7%		129		0%		0.0%	27.0			17.9	5.2	25%	0.2	4	Low

Source: GMT Research