

Company

28 July 2010 | 9 pages

Corporation Bank (CRBK.BO)

 Equity
 Estimate change

1Q11 Results: In-line; Strong Loan Growth, Improving NIMs

- 1Q11 profits up 28%; in-line with our estimates** — Corp's 1Q11 profits were up 27.8% yoy, driven by a) higher-than-estimated loan growth (+37% YoY), b) expansion in NIMs (+12bps qoq) and c) higher fee income growth (+45% yoy). However, this was offset by a) increase in operating costs (+34% yoy) and b) rising credit costs (+98% yoy). Fundamentally, a decent quarter, though its modest deposit franchise and high asset deterioration pose key challenges ahead.
- P&L: Improving NIMs and fees, but offset by rising costs** — Corp's NIMs expanded to 262bps (+36bps yoy and +12bps qoq) in a difficult quarter. However, we believe its modest deposit franchise (24% average CASA) will likely cap further gains, especially in a rising rate environment. Fee income growth remained strong (+45% yoy) but was largely offset by an increase in costs – both operating (higher employee costs, likely to remain under pressure) and credit costs (increasing slippages). Overall, a good quarter but appears vulnerable to macro pressures.
- Balance sheet: Growth is there, but near-term asset quality concerns** — Corp's loan growth was strong at 37% yoy, led by SME (+49%) and agri (+47%) segments, and management guidance remained at 25% growth for FY11E. However, this was accompanied by rising NPLs (+12% qoq) and mostly from agri and SME segments. We believe Corp's continued high growth in these segments (seeking higher NIMs) can increase its vulnerability to asset risks. Moreover, its deposit mix remains well below industry and we believe it will be challenging to scale it up.
- Healthy return profile, but lacks deposit franchise; Maintain Hold** — Corp's return profile has consistently remained high (18-20% ROEs) and valuations are reasonable; however, likely peaking of NIMs and high credit costs are likely to pressure returns near term. We adjust our earnings 2-4% over FY11-12E as we incorporate FY10 actuals; maintain Hold (2M) with a target price of Rs565.

Hold/Medium Risk	2M
Price (28 Jul 10)	Rs565.10
Target price	Rs565.00
Expected share price return	0.0%
Expected dividend yield	3.0%
Expected total return	3.0%
Market Cap	Rs81,058M US\$1,737M

Price Performance (RIC: CRBK.BO, BB: CRPBK IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2009A	8,928	62.24	21.5	9.1	1.7	19.6	2.2
2010A	11,703	81.59	31.1	6.9	1.4	21.9	2.9
2011E	14,037	97.86	20.0	5.8	1.2	22.1	3.0
2012E	16,541	115.32	17.8	4.9	1.0	21.7	3.2
2013E	20,288	141.44	22.6	4.0	0.8	22.0	3.4

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	9.1	6.9	5.8	4.9	4.0
P/E reported (x)	9.1	6.9	5.8	4.9	4.0
P/BV (x)	1.7	1.4	1.2	1.0	0.8
P/Adjusted BV diluted (x)	1.7	1.4	1.2	1.0	0.8
Dividend yield (%)	2.2	2.9	3.0	3.2	3.4
Per Share Data (Rs)					
EPS adjusted	62.24	81.59	97.86	115.32	141.44
EPS reported	62.24	81.59	97.86	115.32	141.44
BVPS	341.37	402.60	483.47	580.79	703.23
Tangible BVPS	341.37	402.60	483.47	580.79	703.23
Adjusted BVPS diluted	341.37	402.60	483.47	580.79	703.23
DPS	12.50	16.50	17.00	18.00	19.00
Profit & Loss (RsM)					
Net interest income	16,910	22,103	27,898	32,641	38,679
Fees and commissions	2,648	3,023	3,385	3,758	4,171
Other operating Income	8,424	8,842	7,920	8,645	9,846
Total operating income	27,982	33,967	39,203	45,043	52,696
Total operating expenses	-10,466	-12,600	-13,961	-15,498	-17,206
Oper. profit bef. provisions	17,516	21,367	25,242	29,545	35,489
Bad debt provisions	-2,109	-4,125	-3,541	-4,107	-4,459
Non-operating/exceptionals	-1,545	-619	-750	-750	-750
Pre-tax profit	13,862	16,623	20,951	24,689	30,281
Tax	-4,935	-4,921	-6,914	-8,147	-9,993
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	8,928	11,703	14,037	16,541	20,288
Adjusted earnings	8,928	11,703	14,037	16,541	20,288
Growth Rates (%)					
EPS adjusted	21.5	31.1	20.0	17.8	22.6
Oper. profit bef. prov.	32.1	22.0	18.1	17.0	20.1
Balance Sheet (RsM)					
Total assets	869,058	1,116,673	1,274,131	1,474,299	1,707,844
Avg interest earning assets	749,827	969,567	1,172,205	1,353,072	1,572,338
Customer loans	491,793	639,420	760,086	895,548	1,054,412
Gross NPLs	5,592	6,509	9,511	13,748	17,797
Liab. & shar. funds	869,058	1,116,673	1,274,131	1,474,299	1,707,844
Total customer deposits	739,839	927,337	1,061,071	1,233,805	1,434,801
Reserve for loan losses	6,672	7,395	10,935	15,042	19,500
Shareholders' equity	48,965	57,749	69,348	83,307	100,870
Profitability/Solvency Ratios (%)					
ROE adjusted	19.6	21.9	22.1	21.7	22.0
Net interest margin	2.26	2.28	2.38	2.41	2.46
Cost/income ratio	37.4	37.1	35.6	34.4	32.7
Cash cost/average assets	1.4	1.3	1.2	1.1	1.1
NPLs/customer loans	1.1	1.0	1.3	1.5	1.7
Reserve for loan losses/NPLs	119.3	113.6	115.0	109.4	109.6
Bad debt prov./avg. cust. loans	0.5	0.7	0.5	0.5	0.5
Loans/deposit ratio	66.5	69.0	71.6	72.6	73.5
Tier 1 capital ratio	8.9	9.2	9.1	9.3	9.6
Total capital ratio	13.7	15.3	14.7	14.5	14.5

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Figure 1. Corporation Bank – 1Q11 Financial Highlights (Rupees Million, Percent)

	1Q11	1Q10	YoY %	4Q10	QoQ%	CIRA Comments
Interest Income	20,278	17,422	16.4	19,222	5.5	Loan yields have started to increase a qoq - management says largely driven by mix shift towards more SME
Interest Expense	(13,302)	(12,747)	4.4	(12,824)	3.7	Cost of funds down sharply 119 bps yoy to 4.98%
Net Interest Income	6,976	4,675	49.2	6,398	9.0	Loan growth and NIM expansion of 36 bps yoy key reasons
Fee-Based Income	2,526	1,739	45.3	2,608	-3.1	Steady momentum - 45% yoy; meaningfully above expectations and only one of few PSU banks showing a healthy growth in core fee income in 1Q11
Other Non-Interest Income	135	1,854	-92.7	119	13.7	Sharp decline - though largely expected
Non Interest Income	2,661	3,593	-25.9	2,727	-2.4	
Operating Income	9,637	8,269	16.5	9,124	5.6	
Operating Expenses	(3,431)	(2,556)	34.2	(2,889)	18.7	Upward trend continues; 2nd pension options still not factored in - will likely keep costs under pressure
Pre-Provision Profit	6,206	5,712	8.6	6,235	-0.5	
Pre-Provision Profit (ex-trading gains)	6,071	3,858	57.4	6,116	-0.7	Fundamentally a significant jump up over last year; looking to stabilise at current levels
Charges for Bad Debts	(1,187)	(600)	97.9	(1,027)	15.6	Relatively sharp increase in credit costs - some slippage from agri and SMEs
Other Operating Items	(79)	(950)	-91.7	0	NM	
Operating Profit	4,940	4,162	18.7	5,089	-2.9	
Pre-Tax Profit	4,940	4,162	18.7	5,089	-2.9	
Tax	(1,600)	(1,550)	3.2	(1,355)	18.1	
Net Profit	3,340	2,612	27.8	3,734	-10.6	Overall, healthy numbers (in-line with estimates) though fundamentally remains exposed to a tighter interest rate environment
EPS	23.3	18	27.8	22	6.9	
DPS	-	0	NM	17	NM	
Customer Loans	648,050	473,776	36.8	632,026	2.5	Strong growth in SME (49%) and Agri (47%) yoy
Customer Deposits	910,350	721,272	26.2	927,337	-1.8	Average CASA share still low at 24% - will be the key in a tighter liquidity environment
AIEA	1,065,187	824,301	29.2	1,022,644	4.2	
AIBL	1,019,673	709,535	43.7	939,249	8.6	
Total Assets	1,132,279	873,513	29.6	1,116,673	1.4	
Avg Assets	1,068,084	884,548	20.7	1,067,794	0.0	
Non-Performing Loans (NPL)	7,268	6,115	18.8	6,509	11.7	Continues to rise relatively sharply; management seems comfortable and expects to contain delinquencies. Suggests have already shifted recognition of NPLs to system based (from manual) and further impact should be negligible
Loan Loss Reserves (LLR)	(4,510)	(4,609)	-2.1	(4,537)	-0.6	Coverage levels continue to head down - leaves little cushion on earnings
Shareholders' Funds	61,090	51,582	18.4	57,749	5.8	
Book Value Per Share	426	360	18.4	403	5.8	
Key Ratios (%)	1Q11	1Q10	Bps Δ YoY	4Q10	Bps Δ QoQ	
ROAA (annualized)	1.25	1.26	-1	1.28	-3	
ROAE (annualized)	21.9	20.3	161	21.6	23	
Net Interest Margin (bps)	262	226	36	250	12	Positive surprise - in contrast to peers and despite savings a/c impact of ~ 10bps
Fee Inc/Operating Income	26.2	21.0	518	28.6	-237	Fee Income growth continues to remain strong; management confident of maintaining them ahead of asset growth
Other Non-Interest Inc/Op Inc	27.6	43.5	-1584	29.9	-227	
Op. Cost/ Operating Income	35.6	30.9	469	40.3	-467	Costs likely to come under more pressure due to a) higher employee benefit costs and b) branch expansion targets (150-200 in FY11)
Loan-to-Deposit Ratio (LDR)	71.2	65.7	550	68.2	303	
NPL/Loan Ratio	1.12	1.29	-17	1.0	9	Restructured assets now 4.3% of loans - flat qoq
LLR/NPL Ratio	62	75	-1331	70	-764	
Reported LLR (Incl Technical w/o)	77	75	135	81	-406	Some reduction in coverage levels - still above the required levels
Amount of Technical w/o's included	4,578	1	-	67	3,753	22.0

Source: Citi Investment Research and Analysis, Company

Figure 2. Earnings Revision Summary

	Net Profit			EPS			DPS	
	Old	New	% change	Old	New	% change	Old	New
2011E	13,757	14,037	2.0%	95.9	97.9	2.0%	14.0	17.0
2012E	15,887	16,541	4.1%	110.8	115.3	4.1%	15.0	18.0
2013E	NA	20,288	NA	NA	141.4	NA	NA	19.0

Source: Citi Investment Research and Analysis estimates

Corporation Bank

Company description

Corporation Bank is a small government bank based in the southern city of Mangalore, where most of its branches are located. The bank has 1054 branches and extension counters, 1032 ATMs and around 11,900 employees. The government has a 57.17% stake in the bank. Around 60% of the bank's business is in metropolitan locations. Corporation Bank has a strategic alliance with LIC, India's largest life-insurance company. LIC has a 26% stake in the bank. The obvious synergies of this alliance are in insurance distribution and treasury. The bank has high credit standards. Gross NPAs have been about 1.2% as at March 2009, below the average for government banks. Loan loss reserve ratios have been high, at 65-85% over the past 10 years.

Investment strategy

We rate Corporation Bank shares Hold/Medium Risk. Corporation Bank's key strengths are: a) Low NPLs with adequate coverage levels (although higher restructurings are a risk); b) Relatively higher profitability with ROEs in excess of 20%; c) Strong management and technology - resulting in higher fee income growth. However, it also faces challenges: a) Corp Bank's asset restructurings are amongst the highest in the industry (5% of loans). While headline asset quality data appears fine, we expect higher lapses to NPLs for Corp Bank given its mid-market asset franchise; b) Its funding franchise is modest relative to peers, interest rate sensitive and could face challenges in scaling up its low cost deposit ratio; and finally c) Valuations are now above mid-cycle levels - leaving limited room for upside.

Valuation

Our target price of Rs565 is based on our EVA model, which captures the long-term value of the business, and is a standard valuation measure for our India banking coverage. Our EVA-based target price is premised on a risk-free rate of 8.0% (in-line with peers), lower than industry average margins of 180bps as we expect margins to remain under pressure on account of higher than industry loan growth; and higher than industry long-term capital ratio of 6% average. We are also benchmarking our target price for Corp Bank on a 1.1x 1-year-forward P/BV, which is at a discount to larger public sector banks due to its

modest scale, regional funding franchise and relatively concentrated asset exposures. This translates into a fair value of Rs566.

Risks

We rate Corporation Bank shares Medium Risk based on our quantitative risk-rating system, which tracks the 260-day share price volatility of the stock. Key downside risks to our target price include: a) reversal in the low interest rate and easy liquidity environment; b) deterioration in the asset quality/economic outlook; and c) a reduction in corporation bank's net interest margins and profitability. Upsides risks include: a) Better than expected asset quality performance; b) Continued low interest rate environment, which is NIM supportive; and c) Improvement in the bank's deposit franchise.

Appendix A-1

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Corporation Bank (CRBK.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Manish Chowdhary, CFA

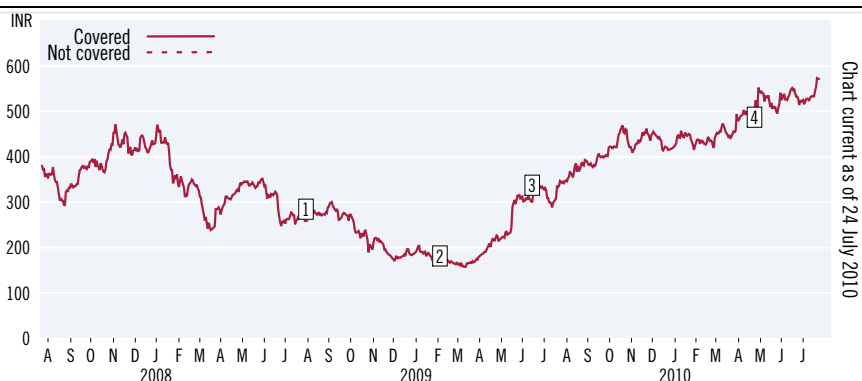


Chart current as of 24 July 2010

	Date	Rating	Target Price	Closing Price
1	30-Jul-08	*2M	*295.00	262.35
2	4-Feb-09	*3H	*175.00	178.35

	Date	Rating	Target Price	Closing Price
3	14-Jun-09	*1H	*425.00	301.30
4	23-Apr-10	*2M	*565.00	498.75

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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