Indiabulls

CORPORATION BANK RESEARCH

EQUITY RESEARCH — February 25, 2009

RESULTS REVIEW

Share Data

Market Cap	Rs. 23.40 bn
Price	Rs. 163.4
BSE Sensex	8902.56
Reuters	CRBK.BO
Bloomberg	CRPBK IN
Avg. Volume (52 Week)	0.02
52-Week High/Low	Rs. 358 / 155
Shares Outstanding	143.4 mn

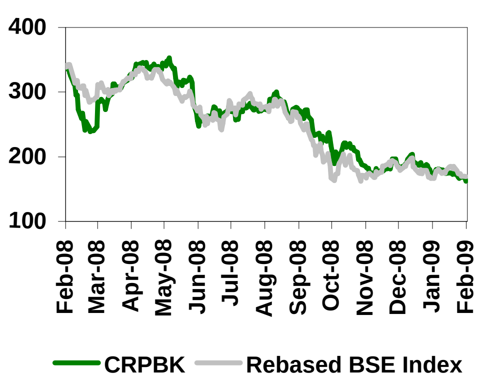
Valuation Ratios

	2009E	2010E
EPS (Rs.)	58.9	46.3
+/- (%)	14.9%	(21.3%)
PER (x)	2.9x	3.6x
P / PPP (x)	1.5x	1.3x
P / ABV (x)	0.5x	0.5x

Shareholding Pattern (%)

Promoter	57
FIIs	8
Institutions	31
Public & Others	4

Relative Performance



Corporation Bank — Hold

Slowing Down

Corporation Bank's operating profit grew by **61.9% yoy**, driven by a 43.2% rise in the NII and a 69% rise in other income. However, comparing on a like-to-like basis, without the MTM gains, the operating profit grew by 31% yoy. Despite healthy numbers, the impact of the business-cycle downturn has been evident in a moderate advances growth (3.2% sequentially), and a 75% yoy rise in delinquencies for 9M FY09. In view of the ongoing economic downturn, we retain our conservative estimates for margins, but downward-revise those for credit quality and business-growth. This tempers our fair-value estimate to Rs.182. While, we do believe that CorpBank's stock price reflects these concerns, we see limited upside in current environment. Therefore, we downgrade our rating to **Hold**.

Advances growth to remain moderate: We expect CorpBank's advances growth to average ~18% and ~16% for FY09 and FY10 respectively. This downward revision in our growth estimates is based on funding and delinquency concerns. Funding concerns stem from a below-average growth in deposits (2.7% qoq) and delinquency concerns emerge from the advances-mix. The Bank's advances-mix is dominated by large industries (30.6%), retail (20%), SMEs (10.4%) and agriculture (9.2%), which are likely to face near-term headwinds. Therefore, the Bank's credit off-take is likely to remain moderate.

NIM to come under strain: The Bank's NIM compressed from 2.81% in Q3'08 to 2.53% presently. This, in our view, was on account of higher cost of borrowing. For FY09–10, we expect margins to range between 2.3% and 2.4%, after accounting for (a) a stable spread between yield on

Key Figures (Standalone)

Quarterly Data	Q3'08	Q2'09	Q3'09	YoY %	QoQ%	9M'08	9M'09	YoY %
(Figures in Rs. mn, except per share data)								
Net Interest Income	3,482	4,067	4,780	37.2%	17.5%	10,695	12,627	18.1%
Net Operating Income	5,007	5,810	7,600	51.8%	30.8%	15,293	18,766	22.7%
Pre-Prov Operating Profit	2,776	3,515	4,494	61.9%	27.9%	8,476	11,219	32.4%
Net Profit	1,909	1,915	2,565	34.3%	33.9%	5,294	6,323	19.4%
Cost to Income Ratio	44.6%	39.5%	40.9%	-	-	44.6%	40.2%	-
NIM	2.81%	2.43%	2.53%	-	-	-	-	-
NPA ratio	0.33%	0.40%	0.33%	-	-	0.33%	0.33%	-
Per Share Data (Rs.)								
PPP per share	19.4	24.5	31.3	61.9%	27.9%	59.1	78.2	32.3%
Diluted EPS	13.3	13.4	17.9	34.3%	33.9%	36.9	44.1	19.4%
BVPS	299.4	321.0	338.9	13.2%	5.6%	299.4	338.9	13.2%

advances and cost of deposits, and (b) a higher cost of borrowing. We have assumed almost stable spreads based on the reduction in retail-lending and deposit rates, (twice in the past two months). Although the reduction is slightly higher on the lending-rate side than on the deposits-rate end, we expect that the relatively higher rates charged on the wholesale-lending side are likely to maintain a reasonable stability in spreads.

Credit quality outlook–grim: Although the Bank's gross and net NPA ratios have fallen both on a yearly as well as a sequential basis, the 75% yoy rise in delinquencies (for 9M FY09 over 9M FY08) is a cause for concern. We expect further deterioration in credit quality as the Bank is considerably focused on large industries (particularly infrastructure and engineering), SMEs, agriculture and retail. Moreover, it has high exposure to sensitive sectors (as percent of net bank credit) – commercial real estate (5.7%) and capital markets and commodities (3.2%). The encouraging fact is that the Bank is consciously trying to reduce its exposure to these sectors.

Valuation

We have valued the Bank using Discounted Equity Cash Flow (DECF) model where we have applied a cost of equity of 15.42% (calculated using CAPM) and an estimated terminal growth rate of 8.08%. This results a fair value estimate of Rs. 182, which implies an upside of 11% over the current market price of Rs.164.3.

We have tempered our fair value estimate downwards based on revised assumptions for credit quality and business-growth, having retained those for margins. Moreover, our fair-value estimate is in line with the book-value per share, adjusted for per share delinquencies (based on our estimates). At the end of the third quarter, the BVPS stood at Rs. 338.87. Removing the potential delinquencies from this yields Rs. 294. Adjusting this for the impact of an anticipated slowdown in growth (terminal growth rate of 8.08% vis-à-vis cost of equity of 15.42%) by applying a long-term

P/B multiple of 0.61x, we arrive at Rs. 176, close to our fair value estimate of Rs. 182. Therefore, on grounds of potential deterioration in asset quality and growth concerns, we downgrade our rating to **Hold**.

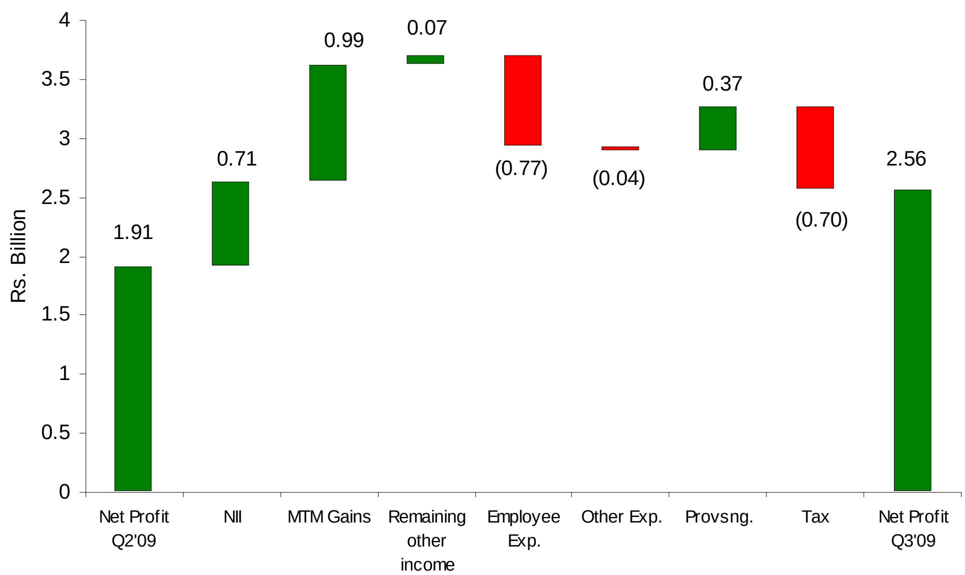
Sensitivity Analysis of the Fair Value Estimate:

		Cost of Equity				
		15.12%	15.27%	**15.42%**	15.57%	15.72%
Terminal growth	7.78%	185	180	176	172	169
	7.93%	188	184	179	175	171
	8.08%	191	187	**182**	178	174
	8.23%	195	190	186	181	177
	8.38%	199	194	189	185	180

Result Highlights and Outlook

Drivers of Profit: The operating profit increased by 61.9% yoy and by 27.9% qoq. The yoy growth was driven by a strong growth in both the NII and in other income, whereas sequentially, the sharp rise in other income was the chief profit-booster. Scrutiny of other income reveals that without the MTM gains (counted as part of other income), the operating profit would have grown by 31% yoy, but would have fallen by 1% qoq.

The growth in net profit was relatively muted at 34.3% yoy and at 33.9% qoq. Over Q3'08, growth was restrained by a large increase in tax and provisions. Sequentially, however, the increase in tax despite a fall in provisions, led to the slower net profit growth.



Source: Bank Data
Note: Provisioning fell by Rs. 0.37 bn from Q2'09 to Q3'09.

Advances growth to remain moderate: The Bank's advances grew by 3.2% qoq and have risen by 15% for 9M FY09. We decrease our advances growth estimate from 24% to ~18% for FY09 and from 21% to ~16% for FY10, based on funding and delinquency concerns. Funding seems to have arisen as a concern since, despite the high-interest rate conditions of last quarter, the Bank's deposits increased only by 2.7% sequentially.

Another constraint to advances growth is that the Bank has deployed its incremental funds into investments, which rose by 21% qoq. Given the Bank's significant presence in Large Industries, SME and Retail segments, which we believe are slowing down, we do not anticipate a large credit off-take. Therefore, we expect the Bank to continue to deploy its funds in investments and consequently, moderate our advances growth estimates.

NIM to come under stress*:* The Bank's NIM increased by 10 bps sequentially to 2.53%, however it is much lower than 2.81% recorded in Q3'08. Sequentially, a wider spread between yield on advances and cost of deposits accounts for the rise in NIM. The year-over-year compression is possibly on account of higher cost (and higher amount) of borrowing. We retain our estimates of compression in margin and expect it to average ~2.4% for FY09 and ~2.3% for FY10. These are estimated after baking-in (a) a stable spread between yield on advances and cost of deposits and (ii) a higher cost of borrowing, as is evident in the latest issue of upper tier II bonds (raised Rs. 7 bn as upper tier II bonds at a coupon rate higher than 9%).

Cost-income ratio to trend up, marginally*:* The Bank's cost-income ratio fell to 40.9% for Q3'09 vis-à-vis 44.6% in Q3'08, in line with its declining operating expenses. Sequentially, however, the ratio has risen marginally from 39.5% because the operating expenses for Q3'09 include a provision on AS15, of Rs. 830 mn on actuarial valuation.

MTM profits account for a significant portion of net operating income, and thus are instrumental in the calculation of cost-income ratio (operating expenses/ net operating income). Our model builds-in a scenario with lesser (or nil) MTM profits (after the next 1-2 quarters), which reduces the net operating income. Therefore, we believe that cost-income ratio is likely to trend up, marginally.

Credit Quality outlook–grim: The Bank's gross NPAs decreased by 6.4% yoy to Rs.5.6 bn. Likewise, the gross NPA ratio decreased from

1.71% in Q3'08 to 1.24%. The decrease was on account of cash recovery / upgradation of Rs. 1.9 bn made during the quarter.

We expect the Bank's credit quality to come under increasing stress in the current business-cycle downturn. Our key concern arises from the sharp yoy rise of 75% in delinquencies (additions to gross NPAs) for 9M FY09, versus 9M FY08. This is on account of Corpbank's significant presence in agriculture, SME and infrastructure, where delinquencies are likely to be high. Moreover, the Bank has high exposure (as a percentage of net advances) in sensitive sectors such as commercial real estate (5.7%), capital markets and commodities (3.2%), which seems to be a key concern of the markets.

The encouraging factor is the high coverage ratio of ~73% that the Bank has maintained at the close of Q3'09. For the next 4-6 quarters, we build-in a higher provisioning (after accounting for higher NPAs) into our model which affects the profitability unfavourably.

Capital adequacy and return ratios: At the end of the third quarter, the Bank's total capital adequacy ratio stood at a comfortable 12.76% versus the regulatory minimum of 9%. Of this, Tier 1 capital adequacy is 9.68%. Although the Bank can continue to grow its assets at a robust pace, we believe that a growth higher than ~20% for FY10 onwards shall require capital infusion within the next 12–18 months, which we have not factored in our model.

The Bank's return on average equity (ROAE) for the quarter stood at 17.34% (annualised) and the return on average assets (ROAA) stood at 1.27% (annualised).

The basic and diluted EPS increased from Rs.13.31 in Q3'08 to Rs. 17.88 on a non-annualised basis.

Income Statement

(Rs mn, Yr. ending March 31)	FY07	FY08	FY09E	FY10E
Interest Income	33,605	45,166	60,502	71,245
Interest Expense	20,524	30,732	43,386	52,364
Net Interest Income	**13,081**	**14,433**	**17,116**	**18,881**
YoY Growth (%)	*6.6%*	*10.3%*	*18.6%*	*10.3%*
Other Income	6,355	6,998	9,296	11,144
Operating Income	**19,436**	**21,431**	**26,412**	**30,026**
YoY Growth (%)	*14.3%*	*10.3%*	*23.2%*	*13.7%*
Operating Expense	8,036	8,920	10,487	11,961
Pre-Provisioning Profit	**11,400**	**12,511**	**15,925**	**18,065**
Provisions and Contingencies	3,235	1,857	3,192	7,842
Profit Before Tax	**8,166**	**10,654**	**12,733**	**10,223**
Tax	2,805	3,304	4,288	3,578
Net Profit	**5,361**	**7,350**	**8,445**	**6,645**
YoY Growth (%)	*20.6%*	*37.1%*	*14.9%*	*-21.3%*

Balance Sheet

(Rs mn, as on March 31)	FY07	FY08	FY09E	FY10E
Cash and balances with RBI	67,189	89,159	97,897	130,725
Investments	144,175	165,124	259,957	302,239
YoY Growth (%)	*35.4%*	*14.5%*	*57.4%*	*16.3%*
Advances	299,497	391,856	457,209	528,762
YoY Growth (%)	*25.0%*	*30.8%*	*16.7%*	*15.6%*
Fixed Assets (Net)	2,810	2,718	2,897	3,395
Other Assets	13,536	17,121	8,262	9,749
Total Assets	**527,206**	**665,977**	**826,222**	**974,870**
Deposits	423,569	554,244	649,892	774,972
YoY Growth (%)	*28.8%*	*30.9%*	*17.3%*	*19.2%*
Borrowings	30,210	21,376	68,084	78,095
YoY Growth (%)	*82.0%*	*-29.2%*	*218.5%*	*14.7%*
Other Liabilities & Provisions	35,773	48,071	59,638	68,241
Total Liabilities	**489,552**	**623,692**	**777,614**	**921,308**
Share Capital	1,434	1,434	1,434	1,434
Reserves & Surplus	36,220	40,851	47,174	52,127
Total Equity & Liabilities	**527,206**	**665,977**	**826,222**	**974,870**

Key Ratios

	FY07	FY08	FY09E	FY10E
Per share data (Rs.)				
Shares outstanding (mn)	143	143	143	143
Basic EPS	37.4	51.2	58.9	46.3
Diluted EPS	37.4	51.2	58.9	46.3
Book value per share	262.5	294.8	338.9	373.4
Adj. book value per share	262.5	294.8	338.9	373.4
Valuation ratios (x)				
P/PPP	3.6x	3.2x	1.5x	1.3x
P/E	7.7x	5.5x	2.9x	3.6x
P/B	1.1x	1.0x	0.5x	0.5x
P/ABV	1.1x	1.0x	0.5x	0.5x
Performance ratio (%)				
Return on avg. assets	1.2%	1.2%	1.1%	0.7%
Return on avg. net worth	15.0%	18.4%	18.6%	13.0%
Balance Sheet ratios (%)				
Advances to deposits	70.7%	70.7%	70.4%	68.2%
Borrowings to advances	10.1%	5.5%	14.9%	14.8%
Investments to assets	27.3%	24.8%	31.5%	31.0%
Investments to deposits	34.0%	29.8%	40.0%	39.0%
Net Worth to assets	7.1%	6.3%	5.9%	5.5%
Productivity ratio (Rs. mn)				
Opt. expense per employee	0.7	0.7	0.9	0.9
Net profit per employee	0.5	0.6	0.7	0.6
Asset per employee	44.4	55.4	73.0	86.5
Operating ratios (%)				
Operating cost to operating income	41.3%	41.6%	39.7%	39.8%
Operating cost to avg. assets	1.7%	1.5%	1.4%	1.3%

Source: Bank data, Indiabulls research

Note: Some ratios are as per Indiabulls definitions and may not match figures declared by the Bank

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