

## Company In-Depth

23 April 2007 | 7 pages

# Corporation Bank (CRBK.BO)

## Upgrade to Buy; Catch a Falling Star

 Rating change   
 Target price change   
 Estimate change 

- Upgrade to Buy, post 26% underperformance** — We are raising CRBK to a Buy/Medium Risk (1M), from Sell (3M), post significant 26% underperformance over the past 6 months – raising target price to Rs410 (Rs375 previously). Corp is amongst the best managed and capitalized Government banks, and offers potential returns at industry average benchmark valuations.
- Higher rate environment a risk; but the business remains fine** — Higher interest rates could be a drag on growth, moderate margins, and threaten asset quality. We see a slower growth environment, and while Corp should see a structural slowdown in growth, we expect it to sustain its mix of profitability with quality.
- Growth and margins; should settle in-line with industry** — Corp Bank's loan growth has been moderating after an accelerated performance; and along with margins, should settle at industry averages. Corp should continue to generate a higher proportion of fees than peers; but its large fee share could well moderate growth levels.
- Amongst better managed Government Banks** — Corp Bank is a leader amongst Government peers; in management, fee businesses, use of technology, capital cushion, alliances (strategic alliance with LIC), and disclosures. We believe this, along with volatile stock performance and recent underperformance – offers an attractive investment opportunity. We are also raising earning 22-30%, to factor in a strong 9M FY07 operating performance.

<b>Buy/Medium Risk</b>	<b>1M</b>
<i>from Sell/Medium Risk</i>	
Price (20 Apr 07)	Rs305.50
Target price	Rs410.00
<i>from Rs375.00</i>	
Expected share price return	34.2%
Expected dividend yield	2.6%
<b>Expected total return</b>	<b>36.8%</b>
Market Cap	Rs43,821M
	US\$1,054M

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



See Appendix A-1 for Analyst Certification and important disclosures.

### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	4,022	28.04	-20.2	10.9	1.4	13.8	2.1
2006A	4,445	30.99	10.5	9.9	1.3	13.8	2.3
2007E	5,417	37.77	21.9	8.1	1.2	15.1	2.5
2008E	6,662	46.44	23.0	6.6	1.0	16.3	2.6
2009E	8,115	56.58	21.8	5.4	0.9	17.2	2.6

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
<b>Valuation Ratios</b>					
P/E adjusted (x)	10.9	9.9	8.1	6.6	5.4
P/E reported (x)	10.9	9.9	8.1	6.6	5.4
P/BV (x)	1.4	1.3	1.2	1.0	0.9
P/Adjusted BV diluted (x)	1.4	1.3	1.2	1.0	0.9
Dividend yield (%)	2.1	2.3	2.5	2.6	2.6
<b>Per Share Data (Rs)</b>					
EPS adjusted	28.04	30.99	37.77	46.44	56.58
EPS reported	28.04	30.99	37.77	46.44	56.58
BVPS	212.98	235.29	265.55	304.00	352.57
Tangible BVPS	212.98	235.29	265.55	304.00	352.57
Adjusted BVPS diluted	212.98	235.29	265.55	304.00	352.57
DPS	6.50	7.00	7.50	8.00	8.00
<b>Profit &amp; Loss (RsM)</b>					
Net interest income	11,294	12,268	13,243	16,051	18,902
Fees and commissions	1,551	1,568	1,804	2,038	2,242
Other operating Income	4,095	4,146	4,426	4,508	4,538
<b>Total operating income</b>	<b>16,940</b>	<b>17,983</b>	<b>19,474</b>	<b>22,597</b>	<b>25,683</b>
Total operating expenses	-6,370	-7,468	-7,995	-8,794	-9,673
<b>Oper. profit bef. provisions</b>	<b>10,570</b>	<b>10,515</b>	<b>11,479</b>	<b>13,803</b>	<b>16,009</b>
Bad debt provisions	-1,603	-2,348	-1,893	-2,360	-2,397
Non-operating/exceptionals	-2,921	-1,422	-1,500	-1,500	-1,500
<b>Pre-tax profit</b>	<b>6,046</b>	<b>6,745</b>	<b>8,086</b>	<b>9,943</b>	<b>12,112</b>
Tax	-2,024	-2,300	-2,668	-3,281	-3,997
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
<b>Attributable profit</b>	<b>4,022</b>	<b>4,445</b>	<b>5,417</b>	<b>6,662</b>	<b>8,115</b>
Adjusted earnings	4,022	4,445	5,417	6,662	8,115
<b>Growth Rates (%)</b>					
EPS adjusted	-20.2	10.5	21.9	23.0	21.8
Oper. profit bef. prov.	16.5	-0.5	9.2	20.2	16.0
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>339,238</b>	<b>405,066</b>	<b>508,537</b>	<b>591,800</b>	<b>682,671</b>
Avg interest earning assets	304,119	360,801	444,101	537,275	625,046
Customer loans	190,478	245,301	318,161	382,477	448,207
Gross NPLs	6,473	6,256	8,390	10,153	11,912
<b>Liab. &amp; shar. funds</b>	<b>339,238</b>	<b>405,066</b>	<b>508,537</b>	<b>591,800</b>	<b>682,671</b>
Total customer deposits	272,332	328,765	423,355	497,529	578,083
Reserve for loan losses	5,014	5,676	7,570	9,930	12,327
Shareholders' equity	<b>30,549</b>	<b>33,749</b>	<b>38,090</b>	<b>43,605</b>	<b>50,572</b>
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	13.8	13.8	15.1	16.3	17.2
Net interest margin	3.71	3.40	2.98	2.99	3.02
Cost/income ratio	37.6	41.5	41.1	38.9	37.7
Cash cost/average assets	2.0	2.0	1.8	1.6	1.5
NPLs/customer loans	3.4	2.6	2.6	2.7	2.7
Reserve for loan losses/NPLs	77.5	90.7	90.2	97.8	103.5
Bad debt prov./avg. cust. loans	1.0	1.1	0.7	0.7	0.6
Loans/deposit ratio	69.9	74.6	75.2	76.9	77.5
Tier 1 capital ratio	12.2	11.4	10.0	9.5	9.4
Total capital ratio	13.5	12.6	11.0	10.4	10.3

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Figure 1. Earnings Revision Summary

	Net Profit (RsM)			EPS (Rs)			DPS (Rs)	
	Old	New	% change	Old	New	% change	Old	New
2007E	4,160	5,417	30.2%	29.0	37.8	30.2%	7.5	7.5
2008E	5,357	6,662	24.4%	37.3	46.4	24.4%	8.0	8.0
2009E	6,653	8,115	22.0%	46.4	56.6	22.0%	8.0	8.0

Source: Citigroup Investment Research 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 809 branches and extension counters, 660 ATMs and around 10,700 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 27% stake in the bank. The obvious synergies of this alliance are in insurance distribution and treasury. The bank has 102 service outlets in LIC premises. Although the pace of integration of the bank's branches and ATMs with LIC's branches has been slow over the past 6-12 months, management indicated acceleration in FY05. The bank has high credit standards. Gross NPAs have been between 5.0% and 5.6% since FY99, much below the average for government banks. Loan loss reserve ratios have been high, at 65-85% over the past 10 years.

### Investment thesis

We rate Corporation Bank Buy/Medium Risk (1M) with a target price of Rs410. The stock has corrected 25% from its peak and we believe offers reasonable upside in the current market environment. Corporation has historically traded at a premium to peers, on account of higher profitability in the past. Margins though under pressure in the current environment, should remain relatively protected. Additionally, its better than industry asset quality and high coverage levels should provide support to earnings and valuations in a rising interest rate scenario. Corp Bank however, has a relatively modest scale; and regional concentration that moderates its funding franchise. We believe this will be a competitive challenge, as banks compete more aggressively for liabilities; and should structurally support valuations only in line with peers, rather than the premium it has historically operated at.

### Valuation

Our target price of Rs410 (revised up from Rs375) 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 of Rs410 is premised on a risk free rate of 8%, industry average margins of 230bps and higher than industry long term capital ratio of 6.5% vs 6% average. The upward revision to our target price is premised on revised estimates, and a high asset yield.

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We are also benchmarking our target price on a 1.3x one-year forward P/BV multiple (previously 1.25x), which is in line with our industry average target multiple. This translates into a fair value of Rs395 (previously Rs345). We use EVA to derive our target price as this is our preferred valuation measure for our India banks sector, and reflects our more optimistic outlook on the sector.

### **Risks**

We rate Corporation Bank Medium Risk based on our quantitative risk-rating system which tracks the 260-day share price volatility of the stock. The key downside risks that could impede the stock from reaching our target price include: (1) a less developed funding franchise — a liquidity squeeze in the market could make funding distinctly more expensive; (2) LIC's 27% stake could create a situation where there is increased management interference and control from LIC; (3) Corporation Bank is also overcapitalized — any aggressive measures to address this issue, through an acquisition or aggressive loan growth, could raise its own set of risks; and (4) its large government bond portfolio — this is interest-rate sensitive, and further increases in interest rates would impact bond and stock values.

## Appendix A-1

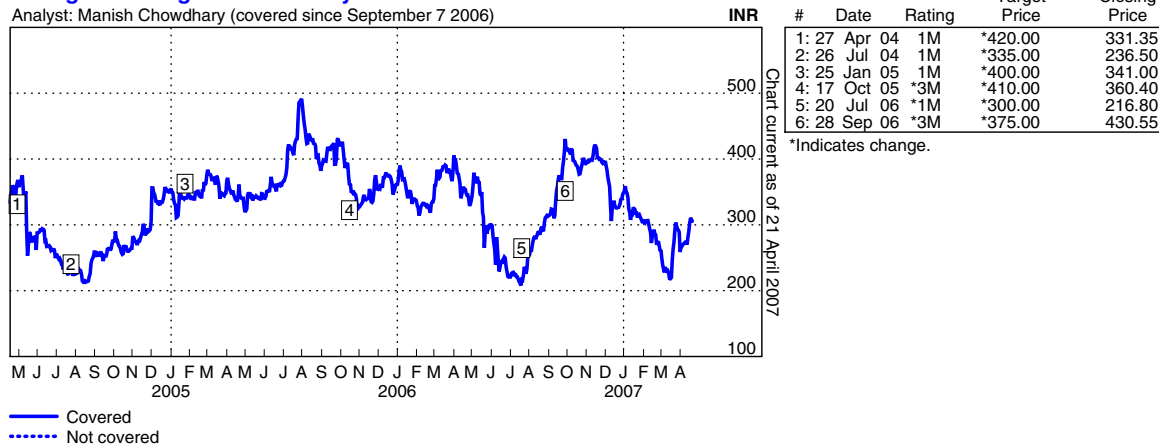
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Analyst: Manish Chowdhary (covered since September 7 2006)



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