

Company Focus

30 October 2007 | 9 pages

Corporation Bank (CRBK.BO)

Buy: 2Q08 Results: Quality over Growth

- 2Q08 profits in-line, though operationally a modest performance** — CRBK's profits increased 27%yoy in 2Q08. Operationally, however, performance was more modest with core profitability (pre-provision profits ex-trading gains) increasing 6%yoy (down 6%qoq). While P&L performance was slightly above average, balance quality remains healthy; provides a reasonable platform to expand profitably though growth will likely remain slightly below industry levels.
- Margins under pressure, though respectable** — CRBK's margins were under pressure, though a 16bps yoy decline (flat qoq margins) suggests relatively less decline than peers. Management suggests a trade-off towards improving loan mix (higher yields) against higher loan growth; reduction in cost of funds (down 20bps qoq-contrasting peers) – likely to drive some margin expansion.
- Bond gains higher, though costs hurt** — Core fee income increased 10% yoy in 2Q08, slightly below estimates. However, strong gains on bond portfolio and continued asset recoveries have increased non-interest incomes a strong 62%. Employee costs though increased 39% on higher provisioning for pension and other benefits, adding pressure on core operating profits.
- Asset quality continues to be safe** — CRBK's asset quality continues to show little stress (delinquencies have declined to 0.6%) and provisioning cover continues to rise (82% currently). Asset growth is moderate at 17% yoy; we see little stress on asset quality. Management has so far sought quality over growth. Maintain Buy (1M).

Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	4,445	30.99	10.5	13.8	1.8	13.8	1.6
2007A	5,361	37.38	20.6	11.4	1.6	15.0	2.1
2008E	6,531	45.53	21.8	9.4	1.4	16.2	2.1
2009E	7,953	55.44	21.8	7.7	1.2	17.2	2.3
2010E	9,621	67.07	21.0	6.4	1.1	18.0	2.3

Source: Powered by dataCentral

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

Buy/Medium Risk	1M
Price (30 Oct 07)	Rs426.90
Target price	Rs455.00
Expected share price return	6.6%
Expected dividend yield	2.1%
Expected total return	8.7%
Market Cap	Rs61,235M US\$1,556M

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



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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	13.8	11.4	9.4	7.7	6.4
P/E reported (x)	13.8	11.4	9.4	7.7	6.4
P/BV (x)	1.8	1.6	1.4	1.2	1.1
P/Adjusted BV diluted (x)	1.8	1.6	1.4	1.2	1.1
Dividend yield (%)	1.6	2.1	2.1	2.3	2.3
Per Share Data (Rs)					
EPS adjusted	30.99	37.38	45.53	55.44	67.07
EPS reported	30.99	37.38	45.53	55.44	67.07
BVPS	235.29	262.51	299.05	344.49	401.56
Tangible BVPS	235.29	262.51	299.05	344.49	401.56
Adjusted BVPS diluted	235.29	262.51	299.05	344.49	401.56
DPS	7.00	9.00	9.00	10.00	10.00
Profit & Loss (RsM)					
Net interest income	12,268	13,778	16,113	18,640	21,560
Fees and commissions	1,568	1,873	2,153	2,433	2,701
Other operating Income	4,146	4,526	4,356	4,448	4,579
Total operating income	17,983	20,177	22,622	25,522	28,840
Total operating expenses	-7,468	-8,036	-8,928	-9,821	-10,803
Oper. profit bef. provisions	10,515	12,141	13,694	15,700	18,037
Bad debt provisions	-2,348	-3,235	-2,946	-2,830	-2,677
Non-operating/exceptionals	-1,422	-740	-1,000	-1,000	-1,000
Pre-tax profit	6,745	8,165	9,748	11,870	14,360
Tax	-2,300	-2,804	-3,217	-3,917	-4,739
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	4,445	5,361	6,531	7,953	9,621
Adjusted earnings	4,445	5,361	6,531	7,953	9,621
Growth Rates (%)					
EPS adjusted	10.5	20.6	21.8	21.8	21.0
Oper. profit bef. prov.	-0.5	15.5	12.8	14.7	14.9
Balance Sheet (RsM)					
Total assets	405,066	527,206	604,745	695,510	801,295
Avg interest earning assets	360,786	455,045	556,839	642,534	742,475
Customer loans	245,270	306,050	371,012	435,300	509,882
Gross NPLs	6,256	6,246	9,038	10,997	12,867
Liab. & shar. funds	405,066	527,206	604,745	695,510	801,295
Total customer deposits	328,765	423,569	490,709	569,980	662,129
Reserve for loan losses	5,646	6,553	9,499	12,330	15,007
Shareholders' equity	33,749	37,655	42,895	49,413	57,600
Profitability/Solvency Ratios (%)					
ROE adjusted	13.8	15.0	16.2	17.2	18.0
Net interest margin	3.40	3.03	2.89	2.90	2.90
Cost/income ratio	41.5	39.8	39.5	38.5	37.5
Cash cost/average assets	2.0	1.7	1.6	1.5	1.4
NPLs/customer loans	2.6	2.0	2.4	2.5	2.5
Reserve for loan losses/NPLs	90.3	104.9	105.1	112.1	116.6
Bad debt prov./avg. cust. loans	1.1	1.2	0.9	0.7	0.6
Loans/deposit ratio	74.6	72.3	75.6	76.4	77.0
Tier 1 capital ratio	12.0	10.8	10.2	10.0	10.0
Total capital ratio	13.2	11.9	11.2	11.0	10.8

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Figure 1. Corporation Bank – 2Q08 Results: Key Highlights (Rupees Million, Percent)

	2Q08	2Q07	YoY %	1Q08	QoQ%	Citi Investment Research Comments
Interest Income	10,638	8,176	30.1	11,004	-3.3	Strong income growth - increasing yields as management not seeking growth at low yields
Interest Expense	(7,092)	(5,158)	37.5	(7,479)	-5.2	
Net Interest Income	3,546	3,018	17.5	3,525	0.6	Maintains profitability - moderate but profitable growth - seems to be doing the trick
Fee-Based Income	992	903	9.9	948	4.6	Key disappointment for the quarter - fee income growth stagnates though maintains reasonable growth for 1H08
Other Non-Interest Income	840	228	268.7	436	92.6	Boosted by trading gains and strong asset recoveries in the quarter
Non Interest Income	1,832	1,131	62.0	1,384	32.3	
Operating Income	5,377	4,148	29.6	4,909	9.5	
Operating Expenses	(2,432)	(1,941)	25.3	(2,154)	12.9	Cost increases are a bit of a surprise - high relative to peers - has taken additional employee benefit provisions in the quarter
Pre-Provision Profit	2,945	2,208	33.4	2,756	6.9	
Pre-Provision Profit (ex-trading gains)	2,399	2,262	6.1	2,560	-6.3	Core operations show a much more modest trend - hit by a stagnant fee performance
Charges for Bad Debts	(631)	(452)	39.6	(385)	63.9	Higher provisioning in the quarter - warrants some caution but won't be anxious as overall asset quality remains comfortable
Other Operating Items	90	215	-58.3	185	-51.6	
Operating Profit	2,404	1,970	22.0	2,556	-5.9	
Pre-Tax Profit	2,404	1,970	22.0	2,556	-5.9	
Tax	(790)	(700)	12.9	(785)	0.6	
Net Profit	1,614	1,270	27.1	1,771	-8.9	Overall profitability remains healthy and in-line, though boosted by asset recoveries and bond portfolio gains
EPS	11.25	8.85	27.1	12.34	-8.9	
Customer Loans	326,657	280,046	16.6	303,510	7.6	Moderate growth - lower than industry levels; focus on higher yielding loans than growth
Customer Deposits	457,425	380,174	20.3	432,310	5.8	Relatively high growth quarter - compared to own history - though overall in line with industry trends
AIEA	497,509	427,413	16.4	488,106	1.9	
AIBL	457,266	381,055	20.0	425,079	7.6	
Total Assets	545,687	462,860	17.9	520,785	4.8	
Avg Assets	533,236	437,788	21.8	523,995	1.8	
Non-Performing Loans (NPL)	6,172	6,163	0.1	6,369	-3.1	Stable asset quality performance - provides comfort
Loan Loss Reserves (LLR)	(5,042)	(4,820)	4.6	(4,962)	1.6	
Shareholders' Funds	41,044	36,461	12.6	39,430	4.1	
Book Value Per Share	286	254	12.6	275	4.1	
Key Ratios (%)	2Q08	2Q07	Bps Δ YoY	1Q08	Bps Δ QoQ	Citi Investment Research Comments
ROAA (annualized)	1.21	1.16	5	1.35	-14	
ROAE (annualized)	15.73	13.93	179	17.96	-223	
Net Interest Margin (bps)	285	301	-16	285	0	Average performance - NIMs stable qoq; though modest declines yoy
Net Interest Margin - Gross of amortisation expenses (bps)	301	320	-19	301	0	
Fee Inc/Operating Income	18.4	21.8	-332	19.3	-87	Fee income levels have stagnated and will be the key to drive fundamental profitability
Other Non-Interest Inc/Op Inc	34.1	27.3	681	28.2	587	
Op. Cost/ Operating Income	45.2	46.8	-156	43.9	136	Cost ratios are largely stable and better than peers
Loan-to-Deposit Ratio (LDR)	71.4	73.7	-225	70.2	121	
NPL/Loan Ratio	1.9	2.2	-31	2.1	-21	
LLR/NPL Ratio	81.7	78	348	77.9	377	High coverage ratios - on higher provisioning in the quarter - suggests management focused on balance sheet quality

Source: Company Reports and Citi Investment Research

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 918 branches and extension counters, 932 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 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 has indicated acceleration in the past. The bank has high credit standards. Gross NPAs have been about 2% as at June 2007, much 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 Buy/Medium Risk (1M) with a target price of Rs455. Though the stock performance has been strong over the last few months, we still see upsides, albeit more modest. 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 at which it has historically operated.

Valuation

Our target price of Rs455 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 Rs455 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. We are also benchmarking our target price on a 1.3x FY09E P/BV multiple, which is in-line with our industry average target multiple. This translates into a fair value of Rs448. 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 government banking 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 26% 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 affect bond and stock values.

Appendix A-1

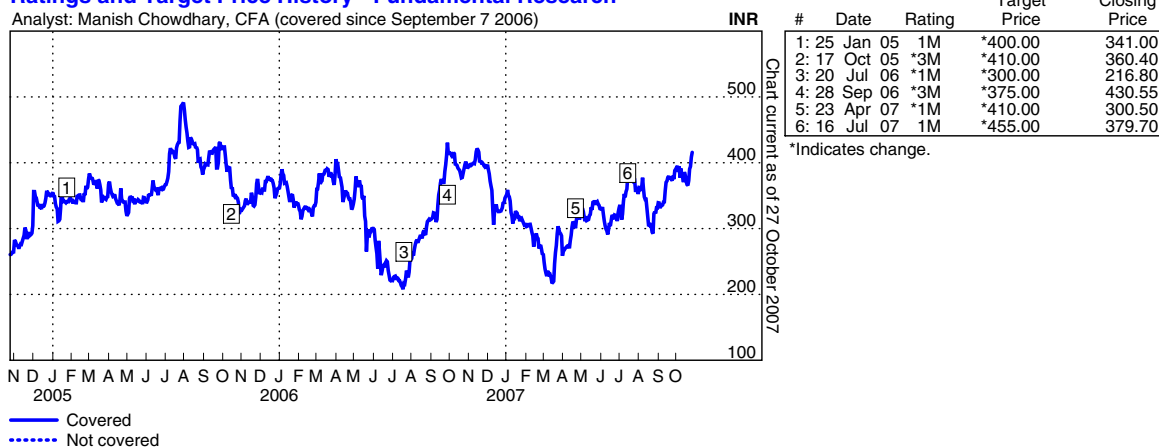
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Analyst: Manish Chowdhary, CFA (covered since September 7 2006)



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