



Corporation Bank

STOCK INFO.	BLOOMBERG
BSE SENSEX: 12,698	CRPBK IN
	REUTERS CODE
S&P CNX: 3,678	CRBK.BO

26 October 2006

Sell

Rs397

Previous Recommendation: Sell

Equity Shares (m)	143.4
52-Week Range	445/205
1,6,12 Rel.Perf.(%)	-3/10/-45
M.Cap. (Rs b)	56.9
M.Cap. (US\$ b)	1.3

YEAR	NET INCOME	PAT	EPS	EPS	P/E	P/BV	CAR	ROE	ROA	P/ABV
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	(%)	(X)
3/06A	17,983	4,445	31.0	10.5	12.8	1.7	13.9	13.8	1.2	1.7
3/07E	19,342	5,311	37.0	19.5	10.7	1.5	12.1	14.8	1.2	1.5
3/08E	22,235	6,393	44.6	20.4	8.9	1.3	10.9	15.7	1.2	1.3

Net interest income (NII) grew merely 3% YoY to Rs3.17b, on the back of lower margins due to higher funding costs and the fall in investment yields. Business growth was robust with loans increasing 38% to Rs280b, while deposits grew 28% to Rs380b. On the back of trading losses, other income declined 18% YoY, during 2QFY07. Asset quality remained satisfactory.

- ✍ NII grew 3% YoY; spreads declined by 36bp YoY
- ✍ Loans grew by 38%; deposits by 28% YoY
- ✍ Treasury income declined YoY; other income grew by 11%
- ✍ Asset quality improved, with net NPAs falling to 0.5%

We believe margin improvement would be a challenging task for Corporation Bank, as it does not have any excess SLR to fund its loan growth. Further, with deposits coming in at a higher price alongside the slow absolute CASA deposits growth (15%), we believe incremental margins will remain at similar levels. Investment yields at 7.6% would continue to decline. The stock trades at 1.3x FY08E BV and 8.9x FY08E BV. With RoEs likely to be at 15%, current valuations capture the upside. We maintain our **Sell** recommendation.

QUARTERLY PERFORMANCE

	(RS MILLION)									
	FY06				FY07E				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Interest Income	5,968	6,473	6,770	7,054	7,301	8,325	8,327	8,777	26,265	32,730
Interest Expense	3,159	3,407	3,485	3,945	4,053	5,158	4,880	5,072	13,997	19,163
Net Interest Income	2,809	3,065	3,285	3,109	3,248	3,167	3,448	3,704	12,268	13,567
% Change (Y-o-Y)	0.7	6.5	19.1	8.5	15.6	3.3	5.0	19.1	8.6	10.6
Other Income	1,696	1,380	1,065	1,574	1,875	1,131	1,250	1,520	5,715	5,775
Net Income	4,505	4,445	4,349	4,683	5,123	4,297	4,698	5,224	17,983	19,342
% Change (Y-o-Y)	18.8	8.6	-11.6	13.3	13.7	-3.3	8.0	11.5	6.2	7.6
Operating Expenses	1,735	1,806	1,935	1,992	1,883	1,941	2,148	2,134	7,468	8,105
Operating Profit	2,770	2,639	2,415	2,692	3,240	2,357	2,550	3,090	10,515	11,237
% Change (Y-o-Y)	21.6	9.6	-26.5	24.9	17.0	-10.7	5.6	14.8	3.8	6.9
Other Provisions	813	960	908	1,089	1,063	387	575	1,226	3,770	3,250
PBT	1,957	1,679	1,507	1,602	2,177	1,970	1,975	1,864	6,745	7,987
Tax Provisions	722	623	356	600	735	700	632	596	2,300	2,676
Net Profit	1,235	1,056	1,151	1,003	1,442	1,270	1,343	1,268	4,445	5,311
% Change (Y-o-Y)	17.1	285.5	-28.8	-6.8	16.8	20.3	16.7	26.4	10.5	19.5
Cost to Income Ratio (%)	38.5	40.6	44.5	42.5	36.8	45.2	45.7	40.9	41.5	41.9
Interest Expense/Interest Income (%)	52.9	52.6	51.5	55.9	55.5	62.0	58.6	57.8	53.3	58.5
Other Income/Net Income (%)	37.6	31.0	24.5	33.6	36.6	26.3	26.6	29.1	31.8	29.9

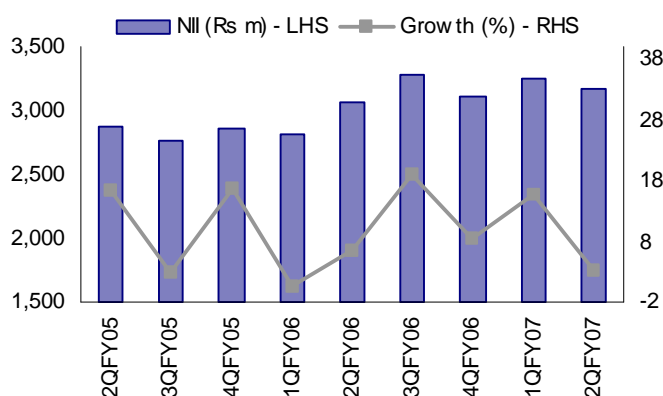
E: MOST Estimates

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NII grew 3% YoY; spreads decline 36bp YoY

Corporation Bank posted lower-than-expected growth in net interest income to Rs3.2b in 2QFY07 on the back of lower margins as funding costs increased coupled with the fall in investment yields.

TREND IN NII GROWTH



Source: Company/ Motilal Oswal Securities

Interest spread for 2QFY07 declined by 36bp to 3.2%, as cost of funds increased sharply for the bank (up 61bp YoY to 4.6% in 2QFY07). With deposits coming in at a higher price and slow absolute CASA deposit growth (15%), incremental margins will remain at similar levels. Moreover, investment yields, at 7.6%, would continue to decline.

CHANGES IN YIELDS (%)

	SEP-05	MAR-06	SEP-06
Yield on advances	8.30	8.26	8.69
Yield on investments	7.87	7.94	7.61
Cost of deposits	4.54	4.55	5.02
Yield on Funds	7.54	7.63	7.79
Cost of Funds	3.98	4.07	4.59
Interest Spreads	3.56	3.56	3.20

Source: Company/ Motilal Oswal Securities

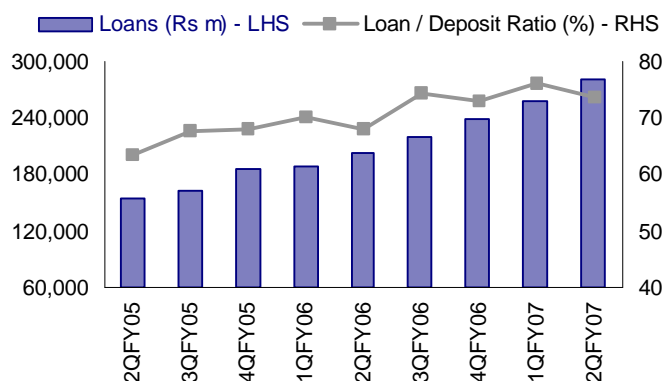
Loans grow 38%; deposits up 28% YoY

Business growth was robust, with loans increasing by 38% to Rs280b, while deposits grew by 28% to Rs380b. The credit:deposit ratio of the bank increased to 74% in 2QFY07 compared with 68% in 2QFY06.

While overall loan growth was 38%, retail loans grew merely 21% in 2QFY07 with home loans growing by 32% during the same period. Excluding home loan growth, other retail loan book grew by a mere 10% in 2QFY07. Priority sector loans grew strongly (42% YoY), with loans to agriculture and SSI growing by 38% and 26%, respectively. We do not expect any capital constraint for loan book expansion, since Corporation Bank has sufficient capital (CAR of 13.3%).

In the case of deposits CASA ratio declined to 30%, compared with 33% in 1QFY07 and 2QFY06. Incremental CASA mobilization to incremental deposits mobilization in 2QFY07 was only 7%, the remainder being mobilized from term deposits. Management attributed this to a large corporate deposit taken during the last week of September, which has now gone out of the balance sheet and expects CASA ratio to improve from 3Q.

EXPANDING LOAN AND DEPOSIT RATIO



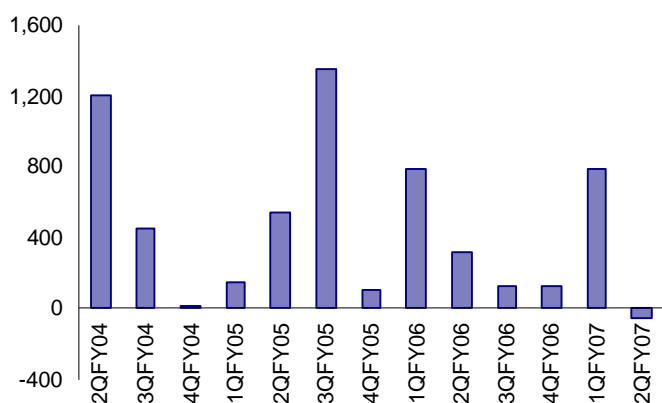
Source: Company/ Motilal Oswal Securities

Treasury income declines YoY; other income grows 11%

Treasury income registered a decline by 117% in 2QFY07. Other income grew by 11% during the same quarter. Fee income grew strongly by 30% YoY to Rs450m, as LG/BG commissions continued to grow strongly. Other income, ex-

treasury and fee income growth was marginal at 2.5% YoY, although recovery of bad debt grew by 52% YoY to Rs282m.

TRADING GAINS (RS M)



Source: Company/ Motilal Oswal Securities

Asset quality improves with net NPAs down to 0.5%

The bank made cash recovery of Rs1.4b (versus Rs930m in the comparable period) and grew its loan book, as a result of which the gross NPAs declined to 2.2% in 2QFY07 from 3.3% in 2QFY06 (Rs6.2b in 2QFY07 compared with Rs6.9b at the end of 2QFY06). Net NPAs also declined

from 1.0% to 0.5% at the end of 2QFY07. Provision cover increased by 720bp YoY to 78% in 2QFY07.

MOVEMENT OF GROSS NPAS (RS M)

	SEP-05	MAR-06	SEP-06
Opening	6,472	6,473	6,256
Additions	1,489	2,141	1,067
	7,961	8,613	7,322
Reductions - Write off	347	708	32
-Upgradation	161	324	417
-Recovery	567	1,326	710
Total reduction	1,075	2,358	1,159
Closing	6,886	6,256	6,163

Source: Company/ Motilal Oswal Securities

Valuation and view

We believe margin improvement would be a challenging task for Corporation Bank, as it does not have any excess SLR to fund its loan growth. Further, with deposits coming in at a higher price alongside the slow absolute CASA deposits growth (15%), we believe incremental margins will remain at similar levels. Investment yields at 7.6% would continue to decline. The stock trades at 1.3x FY08E BV and 8.9x FY08E BV. With RoEs likely to be at 15%, current valuations capture the upside. We maintain our **Sell** recommendation.

Corporation Bank: an investment profile

Corporation Bank, established in 1906, is a south India-based mid-size public sector bank with a balance sheet size of Rs463b. The government owns 57% of the equity along with LIC as a strategic partner with a stake of 26%. The bank has a network of 861 branches and 905 ATMs out of which 130 units are set up in LIC premises. The bank has always been reputed as amongst the conservative, yet profitable, with high asset quality.

Key investment arguments

- ✂ CAR of 13% allows the bank to keep a very strong focus on loan growth. Incremental loan deposit ratio could remain healthy for next couple of years.
- ✂ With significant sale down and transfer of securities to HTM portfolio, the bank has significantly cushioned its investment portfolio against further rise in interest rates.
- ✂ Set to benefit from the conversion of LIC outlets to bank branches, increasing its branch network and expanding geographical reach.

Key investments risks

- ✂ Lower NII growth along with lower margins will pressurize earnings
- ✂ Should the bank be unable to use its capital, its RoE would continue to remain below the sector average.

COMPARATIVE VALUATIONS

		CORPN.BANK	IOB	ANDHRA BK
P/E (x)	FY07E	10.7	6.7	7.8
	FY08E	8.9	5.9	6.6
P/ABV (x)	FY07E	1.5	1.7	1.4
	FY08E	1.3	1.4	1.2
RoE (%)	FY07E	14.8	26.4	18.7
	FY08E	15.7	24.3	19.3
RoA (%)	FY07E	1.2	1.5	1.3
	FY08E	1.2	1.4	1.3

SHAREHOLDING PATTERN (%)

	SEP-06	JUN-06	SEP-05
Promoter	57.2	57.2	57.2
Domestic Inst	29.4	29.5	30.7
Foreign	11.1	10.2	9.4
Others	2.4	3.2	2.7

Recent developments

- ✂ India Infrastructure Finance Company and Corporation Bank have signed a MoU to jointly undertake financing of infrastructure projects along with OBC and Indian Bank.
- ✂ Corporation Bank, Oriental Bank of Commerce, and Indian Bank which recently formed a strategic alliance (OIC), will set up a credit card venture. The three banks will also set up a common subsidiary overseas.

Valuation and view

- ✂ Though we expect the pressure on margins to continue and NII to grow in the range of 11% in FY07, earnings will grow by 20%. The bank continues to operate at a lower RoE of 13%-15% due to its high capitalization.
- ✂ The stock trades at a P/E of 8.9x FY08E EPS and 1.3x FY08E BV. We maintain **Sell** recommendation.

Sector view

- ✂ Loan growth of 30% in FY06. Likely to remain strong in FY07
- ✂ Volatility in interest rates would impact treasury.
- ✂ Benefits of significant improvement in asset quality not yet factored in earnings, valuations.
- ✂ We maintain an Overweight stance on the sector.

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	37.0	35.0	5.6
FY08	44.6	40.8	9.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
397	-	-	Sell

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)

Y/E March	2005	2006	2007E	2008E	2009E
Interest Income	22,498	26,265	32,730	39,792	47,191
Interest Expended	11,204	13,997	19,163	23,648	28,815
Net Interest Income	11,294	12,268	13,567	16,144	18,376
Change (%)	16.8	8.6	10.6	19.0	13.8
Other Income	5,646	5,715	5,775	6,091	6,393
Net Income	16,940	17,983	19,342	22,235	24,769
Change (%)	13.9	6.2	7.6	15.0	11.4
Operating Expenses	6,813	7,468	8,105	9,072	10,081
Operating Income	10,127	10,515	11,237	13,164	14,689
Change (%)	13.5	3.8	6.9	17.1	11.6
Other Provisions	4,081	3,770	3,250	3,550	3,550
PBT	6,046	6,745	7,987	9,614	11,139
Tax	2,024	2,300	2,676	3,221	3,731
PAT	4,022	4,445	5,311	6,393	7,407
Change (%)	-20.7	10.5	19.5	20.4	15.9
Proposed Dividend	1,059	932	1,004	1,076	1,148

BALANCE SHEET (Rs Million)

Y/E March	2005	2006	2007E	2008E	2009E
Capital	1,434	1,434	1,434	1,434	1,434
Reserves & Surplus	29,115	32,315	36,622	41,939	48,198
Net Worth	30,549	33,749	38,056	43,373	49,633
Deposits	272,332	328,765	410,957	480,819	560,154
Change (%)	17.4	20.7	25.0	17.0	16.5
Borrowings	12,979	19,601	23,913	28,696	34,435
Other Liabilities & Prov	23,379	22,949	29,146	37,015	47,009
Total Liabilities	339,238	405,062	502,070	589,902	691,230
Current Assets	35,806	40,887	48,905	61,793	80,672
Investments	102,611	106,518	122,495	143,320	166,251
Change (%)	-4.0	3.8	15.0	17.0	16.0
Advances	185,464	239,624	311,512	364,469	422,784
Change (%)	33.5	29.2	30.0	17.0	16.0
Net Fixed Assets	2,562	2,559	2,909	3,259	3,609
Other Assets	12,795	15,477	16,250	17,063	17,916
Total Assets	339,239	405,064	502,071	589,903	691,231

ASSUMPTIONS (%)

Deposit Growth	17.4	20.7	25.0	17.0	16.5
Advances Growth	33.5	29.2	30.0	17.0	16.0
Investments Growth	-4.0	3.8	15.0	17.0	16.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	70.0	65.0	70.0	75.0	0.0
CRR	5.0	5.0	5.0	5.0	5.0

E: M OSt Estimates

RATIOS

Y/E March	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning As	7.6	7.4	7.5	7.6	7.7
Avg. Cost-Int. Bear. Lia	4.3	4.4	4.9	5.0	5.2
Interest Spread	3.3	3.0	2.7	2.6	2.5
Net Interest Margin	3.8	3.5	3.1	3.1	3.0

Profitability Ratios (%)

RoE	13.8	13.8	14.8	15.7	15.9
RoA	13	12	12	12	12
Int. Expended/Int. Earne	49.8	53.3	58.5	59.4	61.1
Other Inc./Net Income	33.3	31.8	29.9	27.4	25.8

Efficiency Ratios (%)

Op. Exps./Net Income	40.2	41.5	41.9	40.8	40.7
Empl. Cost/Op. Exps.	41.5	48.7	48.0	46.7	46.7
Busi. per Empl. (Rs m)	38.5	45.3	55.5	65.7	74.8
NP per Empl. (Rs lac)	3.7	3.9	4.6	5.4	6.1

Asset-Liability Profile (%)

Adv./Deposit Ratio	68.1	72.9	75.8	75.8	75.5
Invest./Deposit Ratio	37.7	32.4	29.8	29.8	29.7
G-Sec/Invest. Ratio	81.1	84.7	81.0	77.5	74.8
Gross NPAs to Adv.	3.5	2.6	1.9	1.5	1.2
Net NPAs to Adv.	1.1	0.6	0.4	0.3	0.3
CAR	16.2	13.9	12.1	10.9	0.0
Tier 1	13.6	12.4	11.0	9.8	0.0

VALUATION

Book Value (Rs)	213.0	235.3	265.3	302.4	346.0
Price-BV (x)	19	17	15	13	11
Adjusted BV (Rs)	203.6	228.3	259.0	296.9	340.6
Price-ABV (x)	19	17	15	13	12
EPS (Rs)	28.0	31.0	37.0	44.6	51.6
EPS Growth (%)	-20.7	10.5	19.5	20.4	15.9
Price-Earnings (x)	14.2	12.8	10.7	8.9	7.7
OPS (Rs)	70.6	73.3	78.3	91.8	102.4
OPS Growth (%)	13.5	3.8	6.9	17.1	11.6
Price-OP (x)	5.6	5.4	5.1	4.3	3.9

E: M OSt Estimates

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Disclosure of Interest Statement	Corporation Bank
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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