Corporation Bank - BUY

CMP Rs555, Target Rs648

Sector: Banking	
Sensex:	17,969
CMP (Rs):	555
Target price (Rs):	648
Upside (%):	16.7
52 Week h/l (Rs):	590 / 320
Market cap (Rscr) :	8,172
6m Avg vol ('000Nos):	76
No of o/s shares (mn):	143
FV (Rs):	10
Bloomberg code:	CRPBK IB
Reuters code:	CRPBK.BO
BSE code:	532,179
NSE code:	CORPBANK

Prices as on 20 Jul, 2010

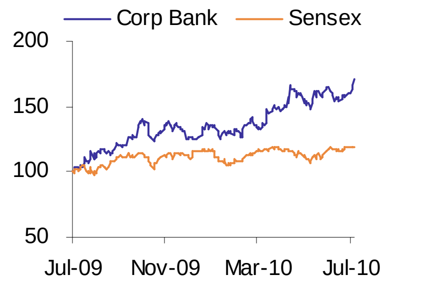
Shareholding pattern

March '10	(%)
Promoters	57.2
Institutions	12.7
Non promoter corp hold	10.0
Public & others	20.1

Performance rel. to sensex

(%)	1m	3m	1yr
Corp Bank	4.9	14.3	55.3
BOB	3.5	15.8	56.1
BOI	21.8	10.8	(3.2)
Allahabad Bk	9.9	9.2	94.9

Share price trend



Corporation Bank is all set to establish a pan-India presence. Excess reliance on term deposits and tepid LDR had dragged margin performance for the last several quarters. Further, while asset quality remained at comfortable levels, CASA ratio was in the low 28-29% range. With above system loan growth, enhanced focus on garnering CASA deposits thereby leading to improvement in margins, planned branch addition especially in North India, and limited accretion in NPLs, we expect Corporation Bank to witness healthy 21% CAGR in its balance sheet and 22% CAGR in net profit over FY10-12E. Recommend BUY with a six-month time frame.

Above system loan growth; focus across all segments of credit

Traditionally, Corporation Bank has outpaced the system loan growth. During FY10, the bank reported a healthy 30% yoy growth in loans (highest amongst its peers). Growth was witnessed across all segments - Large corporate (up 53% yoy), SME (up 24% yoy) and Retail (up 25% yoy). With a view to ensure hassle-free flow of credit, the bank has set up care centres at all zonal offices. The expansion plans, in addition to strong brand identity and increasing credit demand, will enable the bank to witness sturdy 25% CAGR in loan book over FY10-12E.

Branch addition targeted at enhancing CASA franchise

As against 100+ branches added during FY10, the bank management has guided for 200+ branch addition during FY11. With rich presence in South and West India, a large number of new branches are now targeted to be set up in North India and semi-urban and Tier III cities. During the year, some of the existing and new branches were targeted at mobilising retail and CASA deposits. Net interest margins for the bank have remained in a low range of 2.25-2.5% of past several quarters. This was on account of the bank's heavy reliance on term deposits and tepid LDR.

Valuation gap with peers point towards re-rating - BUY

Traditionally, Corporation Bank has traded at par with its larger peer Bank of Baroda. However, in recent past, this valuation gap has widened significantly. We assign 1.15x multiple to FY12PB to arrive at price target of Rs648. Improvement in margins on the back of enhanced CASA ratio and better asset quality management is likely to enable the bank command premium valuation. **BUY**.

Financial summary

Y/e 31 Mar (Rs m)	FY09	FY10A	FY11E	FY12E
Total operating income	27,982	33,968	43,273	53,637
yoy growth (%)	30.6	21.4	27.4	24.0
Operating profit (pre-provisions)	17,516	21,367	27,621	34,181
Net profit	8,928	11,703	13,846	17,434
yoy growth (%)	21.5	31.1	18.3	25.9
EPS (Rs)	62.2	81.6	96.5	121.5
BVPS (Rs)	331.7	388.9	464.6	563.8
P/E (x)	8.9	6.8	5.7	4.6
P/BV (x)	1.7	1.4	1.2	1.0
ROE (%)	19.6	21.9	21.8	22.8
CAR (%)	13.6	15.4	13.4	12.9
Tier I (%)	8.9	9.3	8.6	8.5

Source: Company, India Infoline Research

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Loan growth targeted at 25% CAGR over FY10-12E

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Loan growth outpaced peers – BOB, BOI, Andhra Bank and Allahabad Bank

Targeted Pan India presence

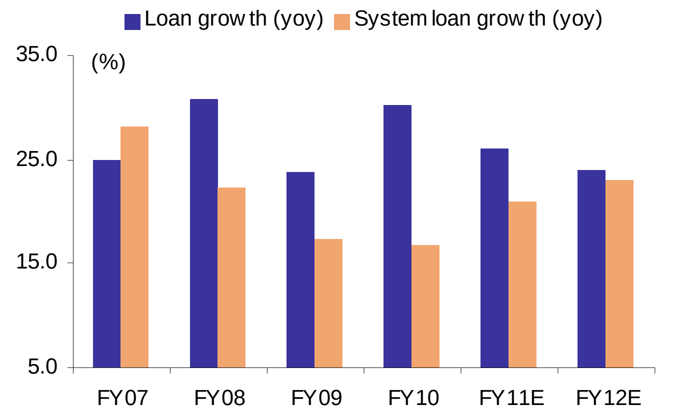
Corporation Bank has outpaced the system loan growth over the past several periods. This is clearly evident from the healthy 28% CAGR in loan book as against 19% CAGR in system loans during FY07-10. Loan growth for the bank at 30% yoy during FY10 was much higher than its larger peers – BoB (22% yoy), BoI (18% yoy), Andhra Bank (27% yoy) and Allahabad Bank (22% yoy). With primary presence in South and West India, the bank now plans to expand pan-India. The expansion plans, in addition to strong brand identity and increasing credit demand, will enable the bank to witness sturdy 25% CAGR in loan book over FY10-12E.

Large, SME and retail segment witnessed healthy growth

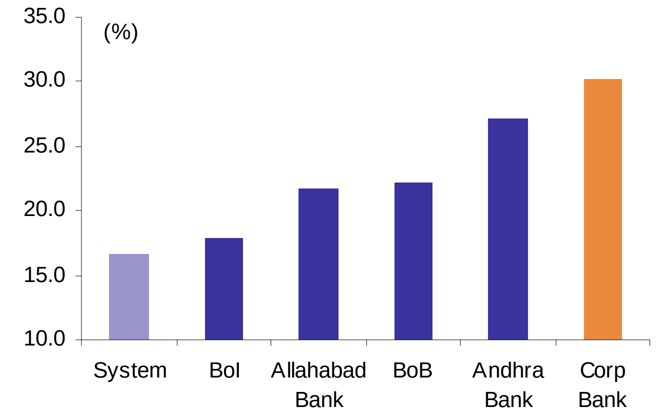
Set-up MSME care centres to ensure hassle free flow of credit

During FY10, the bank witnessed steady growth across all segments of credit. Lending to large corporates grew 53% yoy and constituted ~37% of total book. Amongst large corporate, growth was witnessed across sectors of Infrastructure, Chemicals, Dye and Paints, Iron and Steel. SME and retail loan book too grew at healthy 24-25% yoy respectively. With a view to ensure hassle-free flow of credit to the MSME segment, the bank has set-up MSME care centers at all its zonal offices. Even on the retail front, the bank has been actively increasing its exposure towards secured segments of housing and mortgage loans. (up 17% and 53% yoy respectively).

Loan growth targeted at 25% CAGR over FY10-12E

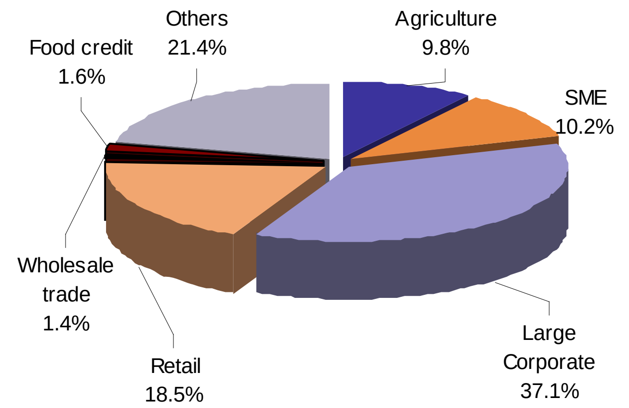


Trend in loan growth (FY10), Corp Bank outpaced system and relative peers

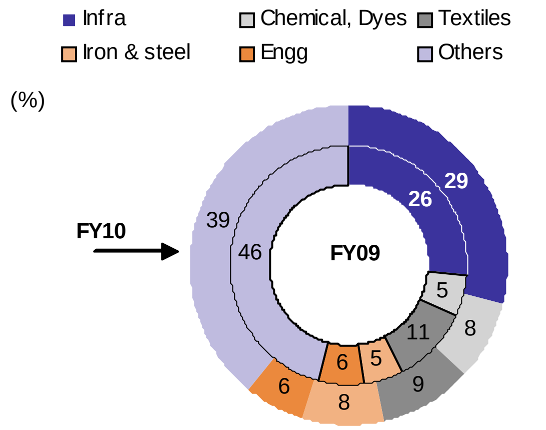


Source: Company, India Infoline Research

Loan book breakdown – FY10



Infra, Chemical & Dyes, Textiles, Iron & Steel were key areas of growth - % of large and SME book



Source: Company, India Infoline Research

Margins subdued due to excess reliance on term deposits

Heavy reliance on term deposits and tepid LDR resulted in lower margins

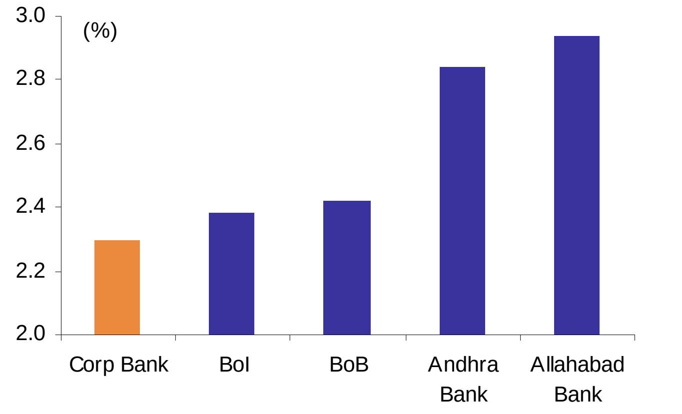
In spite of healthy loan growth, net interest margins for the bank remained squeezed in the low range of 2.25-2.5% for past several quarters. These low levels of margins were largely on account of bank's heavy reliance on term deposits and tepid LDR. Loan-to-deposit ratio for the bank remained in the narrow band of at 66-68% for past several quarters. Also, term deposits for the bank grew at rapid 30%+ yoy as against 25% yoy growth in total deposits and mere 14% yoy growth in CASA deposits.

Impact of rising interest cost and daily savings account balance will be offset by improving credit demand and base rate implementation

Base rate set at 7.75% - lower against its peers

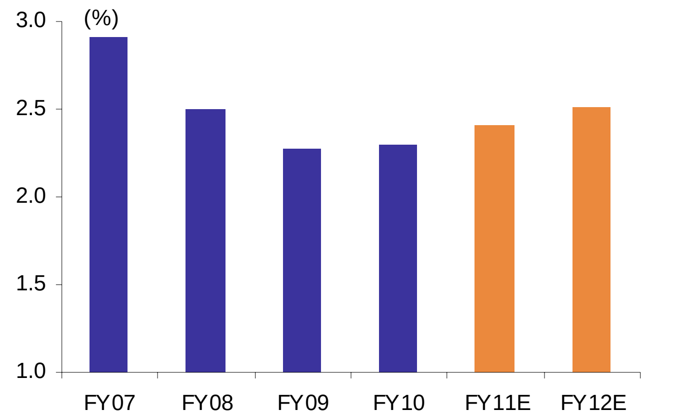
NIM for the bank at 2.3% (end FY10), were much lower as compared to its peers – BoI (2.38%), BoB (2.42%), Andhra Bank (2.84%) and Allahabad Bank (2.94%). While the rising interest scenario in addition to implementation of interest on daily average savings account balance is expected to increase interest cost, improving credit demand and implementation of base rate would more or less offset this impact on margins. The bank has set its base rate at 7.75%, marginally lower than its peers – BoI (8%), BoB (8%), Allahabad Bank (8%). We expect margins to improve by 20bps+ in FY10-12E.

Trend in NIM (end FY10) – Corp Bank vis-à-vis peers



Source: Companies, India Infoline Research

Margins to improve in coming period



Source: Company, India Infoline Research

Increasing CASA proportion – A key thrust area

During FY10, CASA ratio for the bank declined by sharp 290bps to 28.6%. This decline in CASA proportion was against the industry trend, which reported significant improvement in CASA deposits.

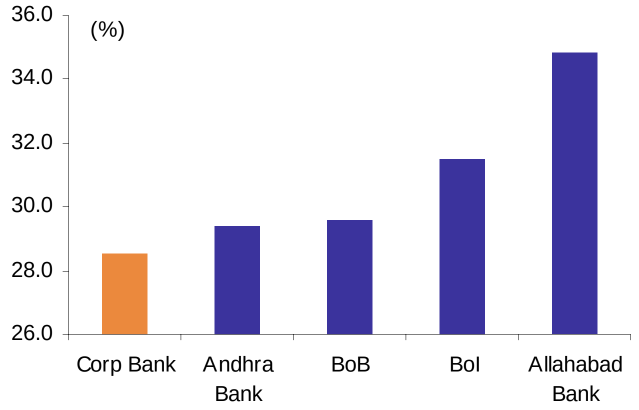
Existing and new branches focused at mobilising retail and CASA deposits

With a view to enhance the CASA franchise, the bank added ~100 branches during FY10. A large number of existing branches and new branches are now focused at increasing retail deposits and mobilising CASA franchise. The bank also opened ~0.5mn+ no-frills accounts and added over 0.8mn clienteles during the year.

Planned branch addition to enable improve CASA franchise

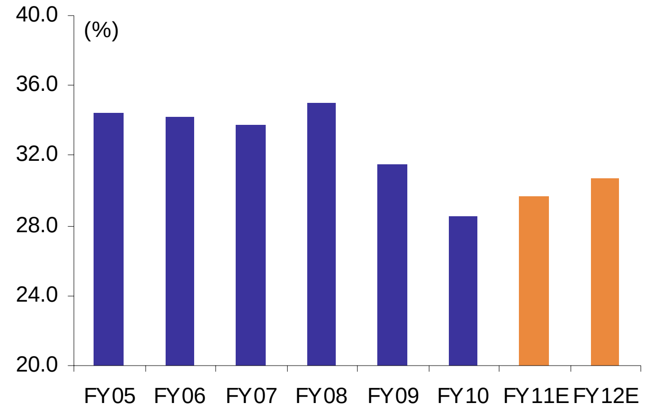
Impetus given towards increasing CASA proportion in addition to planned branch addition will enable the bank to improve its CASA proportion. We have factored in ~200bps improvement in CASA ratio during FY10-12E.

Trend in CASA ratio (end FY10) – Corp Bank vis-à-vis peers



Source: Companies, India Infoline Research

CASA proportion to improve on back of planned branch addition



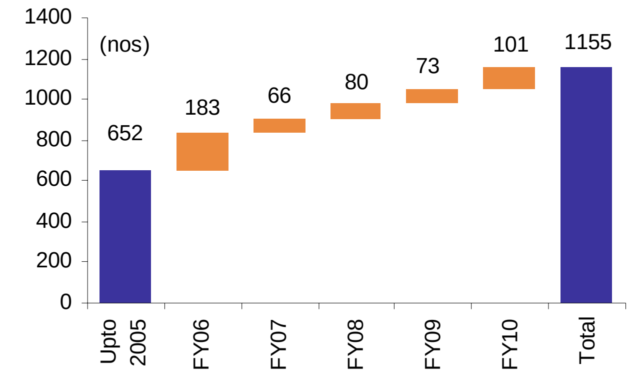
Source: Company, India Infoline Research

New branches to be set up in North India and semi-urban and Tier III cities

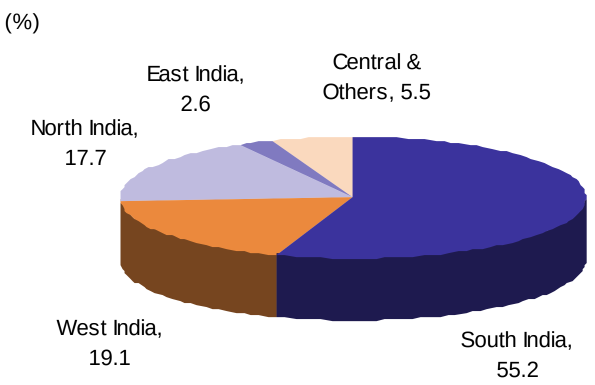
Pan-India presence – Next on radar

After a prolonged period of balance sheet consolidation, Corporation Bank has now actively started expanding its foot print. While the bank added 174 branches during FY04-07, it added over 170 branches during FY08-10. Around 74% of these branches are located in South and West India. Going forward, the bank plans to add ~200 branches during FY11. A large amount of these branches are targeted to be set up in North India and also in semi-urban and Tier III cities.

Over 170+ branches added in past 2 years



Strong presence in South and West India



Source: Company, India Infoline Research

Improving efficiency, different avenues for fee generation

Unlike its peers, the bank reported 30bps improvement in cost-to-income ratio during FY10. While the branch addition along with higher employee cost and other expenses is expected to increase the operating expenses, diversified avenues for fee income is expected to off-set this impact. We have factored in 26% CAGR in total income over FY10-12E and 24% CAGR in operating expenses over FY10-12E.

Best in class asset quality, coverage ratio remain comfortable

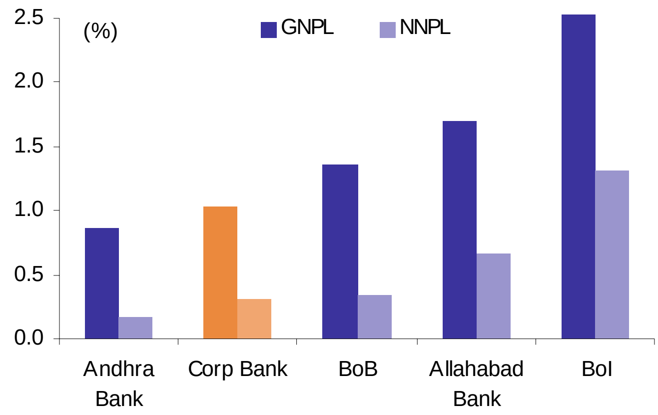
Three-pronged strategy has helped better management

The **three-pronged strategy** towards NPA management – Preventive actions, Recovery and Upgradation, and resolution and settlement**,** has enabled the bank to content its asset quality at comfortable levels. As against a sturdy 30% yoy growth in loans during FY10, gross NPL for the bank were up mere 16% yoy at Rs6509mn or 1.03%. NNPL too remained comfortable at 0.31% of total loans. Further, while incremental slippages constituted 0.9% of average loans, provisioning charges too were raised by 1x yoy.

Asset quality comfortable with GNPL and NNPL at 1.03% and 0.31% respectively

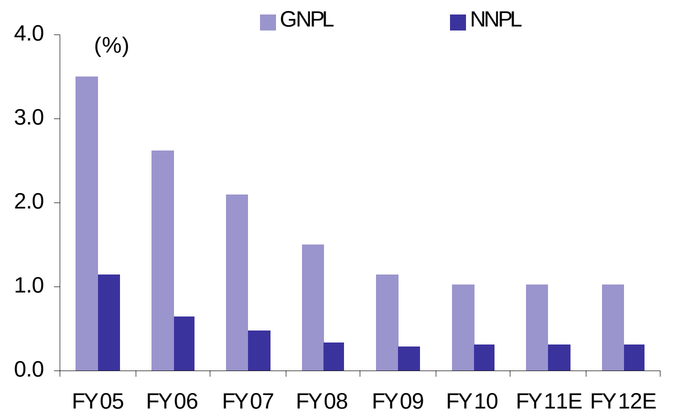
GNPL and NNPL for the bank at 1.03% and 0.31% of total loans are significantly lower than its peers – BoB (1.4% and 0.34%), Allahabad Bank (1.7% and 0.66%) and BOI (2.9% and 1.31%). Coverage ratio for the bank too has improved to 80%. We have factored in 25% CAGR in GNPL (largely in line with loan growth) over FY10-12E.

Asset quality - Best amongst its peers (end FY10)



Source: Companies, India Infoline Research

Trend in GNPL and NNPL



Source: Company, India Infoline Research

~60-70% of GNPL belong to priority sector

Over the past few years, GNPL from priority sector have constituted ~60-70% of total GNPL. Farm debt waiver scheme and implementation thereafter have resulted in significant rise in GNPL from agriculture sector.

NPL breakdown – Priority sector constitutes ~60%+ of GNPL

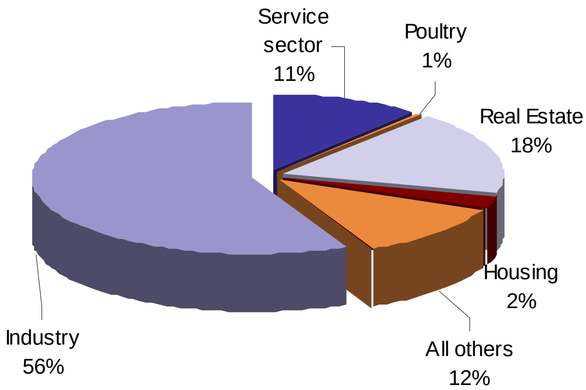
(Rs mn)	FY08	FY09	FY10
Priority sector	**3,728**	**3,728**	**3,977**
Agriculture	794	794	1,215
SME	831	831	787
Others	2,103	2,103	1,974
Non-Priority sector	**1,864**	**1,864**	**2,533**
Large industry	383	383	377
Wholesale Trade	77	77	74
Others	1,404	1,404	2,082
Total	**5,592**	**5,592**	**6,509**
Priority sector (%) of total	66.7	66.7	61.1

Source: Company, India Infoline Research

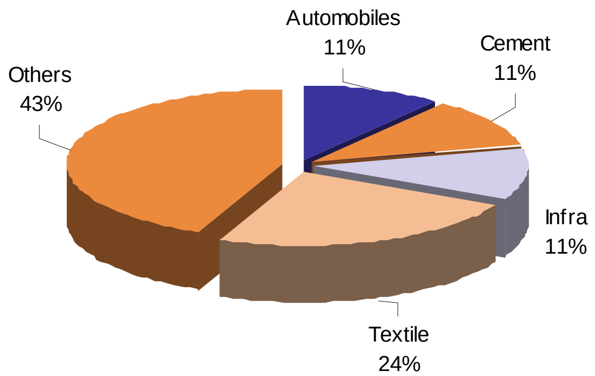
Restructured loan portfolio constitutes 4.3% of total loan portfolio

Restructured loan portfolio constituted ~Rs28bn or 4.3% of total loans. Of this, ~65% of loans restructured belonged to large and service sector. Amongst large corporate, restructuring was witnessed across sectors of Automobiles, Infrastructure, Cement and Textile. Service sector and real estate loans constituted a mere 11% and 18% respectively of total loans restructured. Since Q2 FY10, the quantum of loans restructured has slowed down. We expect minimal slippages in restructured loans.

Restructured loan portfolio



Automobiles, Cement, Infra and Textile were the key segment of restructuring



Source: Company, India Infoline Research

Capital adequacy remains healthy; high GoI and LIC holding provides sufficient cushion towards funding

Strong GOI and LIC holding provide sufficient cushion towards fund raising

Corporation Bank has been able to maintain its capital adequacy ratio (CAR) at comfortable levels of ~13-17% for past few quarters. The bank raised over Rs20.5bn of capital during the year (Rs15.5bn through Upper Tier II bonds and Rs5bn through Tier I Bonds), which has supported a strong growth in its loan book during the year. However, the high CAR ratio depicts good asset quality (highly rated corporate) which requires lower risk-weightings as per Basel II norms, thereby resulting in healthy CAR. Tier I CAR has remained at ~9-10% levels, as against the statutory requirement of 6%.

GoI currently hold ~57% stake in the bank and with LIC strategic stake of ~26%, the bank has adequate cushion to raise capital.

Higher returns ratio command valuation premium

Bank to witness 21% CAGR in balance sheet and higher 22% CAGR in net profit over FY10-12E

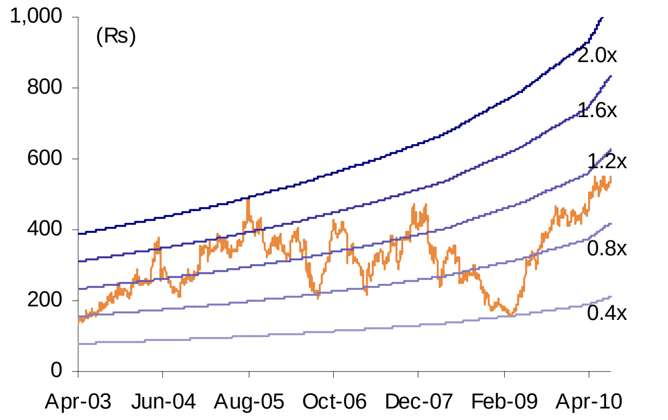
Returns ratio for the bank has remained healthy with RoE of ~20-21% and RoA of ~1.1-1.2% levels for past few years. Going forward with a) planned branch addition (especially in North India) b) improvement in margins on back of increased focus on garnering CASA deposits C) above system loan growth and d) limited accretion in NPLs, we expect Corporation Bank to witness 21% CAGR in its balance sheet and 22% CAGR in net profit over FY10-12E.

Valuations point towards re-rating. BUY

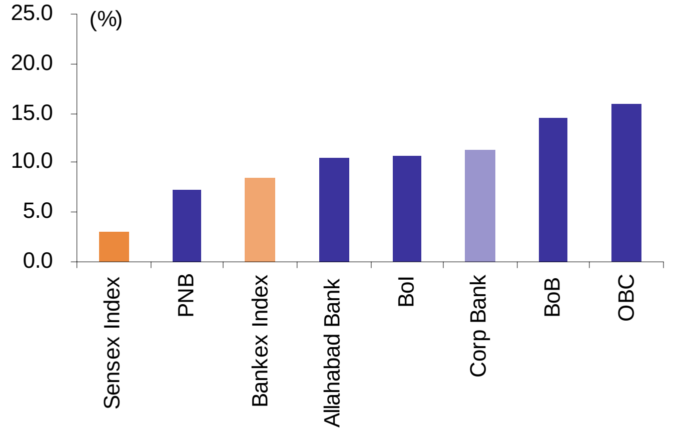
After a decent run-up in valuations for large PSU banks, we expect the valuation gap between these banks and mid-cap banks to narrow down. Traditionally, Corporation Bank has traded at par with its larger peer Bank of Baroda. However, in recent past, this valuation gap has widened significantly. While Bank of Baroda currently trades at 1.4x 1-year forward book, Corporation Bank trades at 1x 1-year forward book, implying a huge discount.

With prospectus for healthy 21% CAGR in balance sheet and 22% CAGR in net profit over FY10-12E, decent returns ratio (RoE ~22% levels, RoA at 1.2% levels), we expect re-rating from current levels. We assign 1.15x multiple to FY12PB to arrive at price target of Rs648. Improvement in margins, enhanced CASA ratio and asset quality management is likely to command premium valuation in coming period. **BUY**.

1-yr rolling fwd P/BV

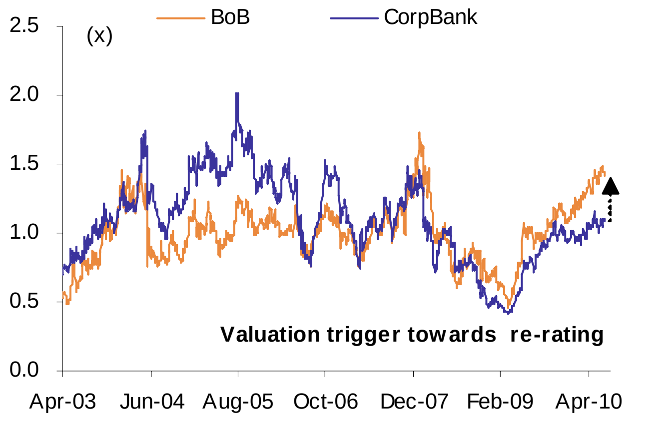


3months price performance

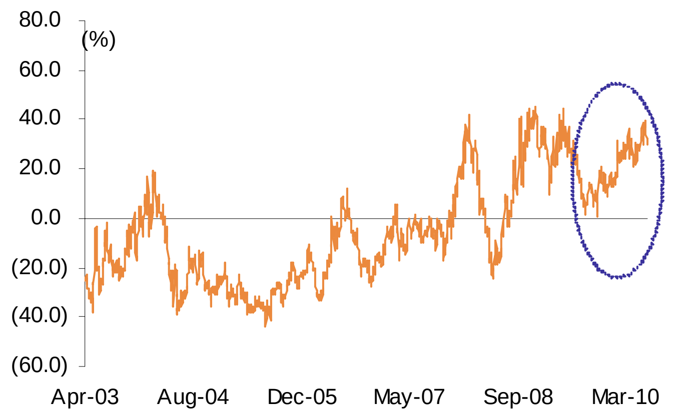


Source: Bloomberg, India Infoline Research

Valuation gap with Bank of Baroda has widened in recent past



... the discount too has widened



Source: Bloomberg, India Infoline Research

Financials

Income statement

Y/e 31 Mar (Rs m)	FY09	FY10	FY11E	FY12E
Interest income	60,674	72,946	91,519	113,371
Interest expense	(43,764)	(50,843)	(62,637)	(77,006)
Net interest income	**16,910**	**22,104**	**28,883**	**36,365**
Non-interest income	11,072	11,864	14,390	17,272
Total op income	**27,982**	**33,968**	**43,273**	**53,637**
Total op expenses	(10,466)	(12,600)	(15,652)	(19,456)
Op profit (pre-prov)	**17,516**	**21,367**	**27,621**	**34,181**
Total provisions	(3,409)	(4,744)	(6,955)	(8,161)
Profit before tax	**14,108**	**16,623**	**20,666**	**26,021**
Taxes	(5,180)	(4,921)	(6,820)	(8,587)
Net profit	**8,928**	**11,703**	**13,846**	**17,434**

Balance sheet

Y/e 31 Mar (Rs m)	FY09	FY10	FY11E	FY12E
Total cash & equ.	105,397	107,919	115,654	135,353
Investments	249,378	345,226	397,064	460,572
Advances	485,122	632,026	796,352	987,477
Total int-ear assets	**839,896**	**1,085,171**	**1,309,070**	**1,583,402**
Fixed assets	2,989	2,893	3,182	3,659
Other assets	26,173	28,609	32,901	39,481
Total assets	**869,058**	**1,116,673**	**1,345,153**	**1,626,542**
Net worth	**48,965**	**57,749**	**69,078**	**83,826**
Deposits	739,839	927,337	1,140,624	1,391,561
Borrowings	48,099	90,775	90,558	99,526
Total int-bear liabs	**787,938**	**1,018,112**	**1,231,182**	**1,491,087**
Non-int-bearing liabs	32,155	40,812	44,894	51,628
Total liabilities	**820,093**	**1,058,924**	**1,276,075**	**1,542,715**
Equity + Total liab	**869,058**	**1,116,673**	**1,345,153**	**1,626,542**

Key ratios

Y/e 31 Mar	FY09	FY10	FY11E	FY12E
Growth matrix (%)				
Net interest inc	17.2	30.7	30.7	25.9
Total op income	30.6	21.4	27.4	24.0
Op profit (pre-prov)	40.0	22.0	29.3	23.8
Net profit	21.5	31.1	18.3	25.9
Advances	23.8	30.3	26.0	24.0
Deposits	33.5	25.3	23.0	22.0
Total assets	30.5	28.5	20.5	20.9
Profitability Ratios (%)				
NIM	2.3	2.3	2.4	2.5
Non-int inc/Total inc	39.6	34.9	33.3	32.2
Return on Avg Equity	19.6	21.9	21.8	22.8
Return on Avg Assets	1.2	1.2	1.1	1.2
Per share ratios (Rs)				
EPS	62.2	81.6	96.5	121.5
BVPS	332	389	465	564
DPS	12.5	16.5	15.0	16.0
Other key ratios (%)				
Credit/Deposits	65.6	68.2	69.8	71.0
Cost/Income	37.4	37.1	36.2	36.3
CASA	31.4	28.6	29.7	30.7
CAR	13.6	15.4	13.4	12.9
Tier-I capital	8.9	9.3	8.6	8.5
Gross NPLs/Loans	1.2	1.0	1.0	1.0
Total prov / Avg loans	0.4	0.7	0.9	0.8
Net NPLs/Net loans	0.3	0.3	0.3	0.3
Tax rate	36.7	29.6	33.0	33.0
Dividend yield	2.3	3.0	2.8	3.0

INDIA PRIVATE CLIENTS

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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