

2Q earnings beat; Maintain Buy on positive risk return

2Q: +25% beat on treasury gains, offset by credit costs

Corp Bk's 2Q earnings came in at Rs4.0bn, a 14% yoy growth and a +25% higher than est. driven by a) treasury gains, partly offset by higher credit costs driven by higher than estimated slippages (+2x qoq). Top-line growth modest (~4% yoy), but ~3% ahead driven by 17% loan growth and margin decline by 45bps yoy (up 32bps qoq). Core fee growth strong (+30% yoy). CASA, while down yoy by +320bps, is up qoq by 80bps, to ~22%.

Slippages rise +2x qoq, but asset quality is manageable

Corp Bank's slippages increased by +2x qoq to Rs5bn driven by corporate / non-priority slippages. However, mgmt. is looking at corporate recovery in the ensuing quarters. Resultantly, headline gross NPLs increased qoq by 27% (at 1.3%) and net increased by 81% qoq (at 0.9%), provision cover at ~65% (vs. ~75% in 1Q). We estimate FY12 slippages at ~Rs16/20bn (vs. Rs8.1bn in FY11) and credit costs normalizing at +60/80bps in FY12/13.

Maintain Buy and PO on positive risk-return

While 2Q earnings beat was +25%, we more or less maintain our FY12/13 (earnings tweak by ~1%), as we normalize strong 2Q treasury gains and build in higher credit costs. We maintain our Buy rating and PO, as risk-return remains positive, with stock trading at 0.9x FY12E adj. book / 0.8x FY13E adj. book, with RoEs of still +20%. Our PO is still at a +30% discount to Gordon theory multiples. We believe the discount may remain owing to weak liability franchise, as also we remain worried on its +55% SME loan growth that makes the loan profile riskier and, low stock liquidity (Govt. & LIC own ~84% of stock).

Estimates (Mar)

(Rs)	2010A	2011A	2012E	2013E	2014E
Net Income (Adjusted - mn)	11,703	14,133	15,776	18,204	21,090
EPS	81.59	95.41	106.50	122.89	142.37
EPS Change (YoY)	31.1%	16.9%	11.6%	15.4%	15.9%
Dividend / Share	16.50	20.00	23.00	28.00	35.00
Pre-exceptional EPS	81.59	95.41	106.50	122.89	142.37
Pre-exceptional EPS Change (YoY)	31.1%	16.9%	11.6%	15.4%	15.9%
Book Value / Share	402.60	481.86	540.91	633.00	736.87

Valuation (Mar)

	2010A	2011A	2012E	2013E	2014E
P/E	5.3x	4.5x	4.0x	3.5x	3.0x
Dividend Yield	3.85%	4.66%	5.36%	6.53%	8.16%
Pre-exceptional PE	5.26x	4.49x	4.03x	3.49x	3.01x
Price / Book	1.10x	0.890x	0.793x	0.677x	0.582x
RoE / PB	19.94x	24.60x	26.27x	30.91x	35.72x
Price / Pre-Provision Profit	2.88x	2.42x	2.17x	1.81x	1.57x

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Refer to important disclosures on page 7 to 9. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4. Link to Definitions on page 4. 11104477

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Stock Data

Price	Rs428.80
Price Objective	Rs540.00
Date Established	21-Aug-2011
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs399.00-Rs814.85
Mrkt Val / Shares Out (mn)	US\$1,304 / 148.1
Market Value (mn)	Rs63,518
Average Daily Volume	66,748
BofAML Ticker / Exchange	XCRRF / BSE
Bloomberg / Reuters	CRPBK IN / CRBK.BO
ROE (2012E)	20.8%
Total Dbt to Cap (Mar-2011A)	NA
Est. 5-Yr EPS / DPS Growth	20.0% / 20.0%
Free Float	16.5%

Key Changes

(Rs)	Previous	Current
2012E EPS	105.04	106.50
2013E EPS	123.19	122.89
2014E EPS	142.69	142.37

iQprofileSM Corporation Bank

Key Income Statement Data (Mar)	2010A	2011A	2012E	2013E	2014E
(Rs Millions)					
Net Interest Income	19,033	29,397	32,977	39,246	44,904
Net Fee Income	6,458	7,594	8,505	9,610	11,052
Securities Gains / (Losses)	6,157	2,095	2,500	2,750	2,750
Other Income	2,318	3,555	3,797	4,330	4,966
Total Non-Interest Income	14,934	13,244	14,802	16,691	18,768
Total Operating Income	33,967	42,641	47,779	55,937	63,671
Operating Expenses	(12,600)	(16,417)	(18,518)	(20,748)	(23,258)
Pre-Provision Profit	21,367	26,224	29,260	35,189	40,413
Provisions Expense	(3,453)	(5,478)	(6,025)	(9,339)	(10,273)
Operating Profit	17,915	20,746	23,235	25,850	30,140
Non-Operating Income	(1,292)	(1,410)	(2,200)	(1,250)	(1,250)
Pre-Tax Income	16,623	19,336	21,035	24,600	28,890
Net Income to Comm S/Hold.	11,703	14,133	15,776	18,204	21,090
Adjusted Net Income (Operating)	11,703	14,133	15,776	18,204	21,090

Key Balance Sheet Data

Total Assets	1,116,673	1,435,086	1,708,640	1,932,015	2,215,536
Average Interest Earning Assets	665,232	856,187	1,058,682	1,220,041	1,401,632
Weighted Risk Assets	698,550	900,336	985,188	1,244,648	1,583,707
Total Gross Customer Loans	636,563	872,429	1,025,361	1,186,361	1,394,298
Total Customer Deposits	927,337	1,167,475	1,417,258	1,607,966	1,854,871
Tier 1 Capital	64,616	78,239	87,125	100,767	116,153
Tangible Equity	64,616	78,239	87,125	100,767	116,153
Common Shareholders' Equity	57,749	71,378	80,125	93,767	109,153

Key Metrics

Net Interest Margin	2.86%	3.43%	3.11%	3.22%	3.20%
Tier 1 Ratio	9.3%	8.7%	8.8%	8.1%	7.3%
Effective Tax Rate	29.6%	26.9%	25.0%	26.0%	27.0%
Loan / Assets Ratio	57.0%	60.8%	60.0%	61.4%	62.9%
Loan / Deposit Ratio	68.6%	74.7%	72.3%	73.8%	75.2%
Oper Leverage (Inc Growth - Cost Growth)	1.0%	-4.8%	-0.8%	5.0%	1.7%
Gearing (Assets / Equity)	19.3x	20.1x	21.3x	20.6x	20.3x
Tangible Common Equity / Assets	5.8%	5.5%	5.1%	5.2%	5.2%
Tangible Common Equity / WRAs	9.3%	8.7%	8.8%	8.1%	7.3%
Revenue Growth	21.4%	25.5%	12.0%	17.1%	13.8%
Operating Expense Growth	20.4%	30.3%	12.8%	12.0%	12.1%
Provisions Expense Growth	92.9%	58.7%	10.0%	55.0%	10.0%
Operating Revenue / Average Assets	3.4%	3.3%	3.0%	3.1%	3.1%
Operating Expenses / Average Assets	1.3%	1.3%	1.2%	1.1%	1.1%
Pre-Provision ROA	2.2%	2.1%	1.9%	1.9%	1.9%
ROA	1.2%	1.1%	1.0%	1.0%	1.0%
Pre-Provision ROE	40.0%	40.6%	38.6%	40.5%	39.8%
ROE	21.9%	21.9%	20.8%	20.9%	20.8%
RoTE	18.1%	18.1%	18.1%	18.1%	18.2%
RoWRAs	1.7%	1.6%	1.6%	1.5%	1.3%
Dividend Payout Ratio	20.2%	21.0%	21.6%	22.8%	24.6%
Efficiency Ratio (Cost / Income Ratio)	45.3%	40.5%	40.9%	39.0%	38.2%
Total Non-Interest Inc / Operating Inc	44%	31%	31%	30%	29%
Market-Related Revenue / Total Revenues	20.9%	7.4%	7.7%	7.3%	6.7%
Provisioning Burden as % of PPP	16.2%	20.9%	20.6%	26.5%	25.4%
NPLs plus Foreclosed Real Estate / Loans	1.0%	0.9%	1.6%	2.4%	2.9%
Loan Loss Reserves / NPLs	69.7%	49.7%	57.0%	62.6%	67.3%
Loan Loss Reserves / Total Loans	0.7%	0.5%	0.9%	1.5%	2.0%
Provisions Expense / Average Loans	0.6%	0.7%	0.6%	0.8%	0.8%

Other Metrics

Income / Employee	2.58	3.08	3.43	4.01	4.54
(Operating Expenses) / Employee	0.959	1.18	1.33	1.49	1.66
Pre-Provision Profit / Employee	1.63	1.89	2.10	2.52	2.88
Net Profit / Employee	0.890	1.02	1.13	1.30	1.51

Company Description

Corporation Bank, established in 1906, is a mid-sized state-owned bank with a balance sheet size of Rs970bn. It has a network of +1000 branches with larger presence in southern India. LIC, the largest life insurer in India, has taken a strategic stake of 26% in the bank.

Investment Thesis

While Corporation Bank is a small government bank based in the southern city of Mangalore, it 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. Additionally, its better than industry asset quality and high coverage levels should provide support to earnings and valuations in a rising interest rate scenario.

Stock Data

Price to Book Value 0.8x

2QFY12 Results Summary

Table 1: 2QFY12 Results Summary

Particulars	2QFY11	2QFY12	yoy	Remarks
Interest earned	21,581	30,907	43.2%	
- on Advances / Bills	14,795	22,104	49.4%	led by 17% yoy loan growth
- Income on investments	6,072	7,895	30.0%	
- on bal with RBI	31	86	180.0%	
- Others	684	822	20.2%	
Interest Expended	14,429	23,471	62.7%	
Net Interest Income	7,152	7,436	4.0%	3% ahead of estimates. Margins decline 45bps yoy but up 30bps qoq
Other income	2,261	3,987	76.3%	
- Treasury Income	45	1,233	2670.6%	
- Other Income	2,217	2,754	24.3%	Core fee income up 30% yoy
Operating income	9,414	11,423	21.3%	
Total Operating Expenses	3,679	4,422	20.2%	
Employee expenses	1,866	2,347	25.8%	
Other Operating expenses	1,813	2,075	14.4%	
Operating profit	5,735	7,001	22.1%	
Provisions	976	2,048	109.7%	
- NPL provisions	884	1,727	95.4%	Gross NPLs (at 1.3%) up 27% qoq and Net (at 0.9%) up 81%. Cover at -65%. 2Q Slippages at Rs5bn vs Rs1.5bn in 1Q.
- Investment provisions	89	192	115.2%	
- Other provisions	3	129	3770.2%	
PBT	4,759	4,954	4.1%	
Provision for Tax	1,241	943	-24.0%	
PAT	3,517	4,011	14.0%	Earnings +25% ahead on treasury gains

Source: BofA Merrill Lynch Global Research Estimates

Price objective basis & risk Corporation Bank (XCRRF)

We set our PO at Rs540 for Corporation Bk. Our PO is based on historical traded forward PB multiple, implying a multiple of 0.9x FY13 book. We maintain Buy and PO, as risk-return remains positive, with stock trading at 0.9x FY12 adj. book, with RoEs of still +20%. Our PO is still at a +30% discount to Gordon theory multiples. We believe the discount may remain owing to weak liability franchise, as also we remain worried on its +55% SME loan growth that makes the loan profile riskier, high exposure to high risk sectors (Power, Textiles, Steel ,etc) at almost 17% of loans and, low stock liquidity (Govt. & LIC own 84% of stock). Risks are margin compression owing to mismatch between lending and deposit cuts. Low CASA deposit franchise may lead to a spike in funding costs and hurt margins in rising rate environment.

Link to Definitions Financials

Click [here](#) for definitions of commonly used terms.

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India - Financials Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Corporation Bank	XCRRF	CRPBK IN	Veekesh Gandhi
	Federal Bank	XFDRF	FB IN	Veekesh Gandhi
	HDFC	HGDFE	HDFC IN	Rajeev Varma
	HDFC Bank	XHDFE	HDFCB IN	Rajeev Varma
	HDFC Bank	HDB	HDB US	Rajeev Varma
	ICICI Bank	ICIJF	ICICIB IN	Rajeev Varma
	ICICI Bank - A	IBN	IBN US	Rajeev Varma
	IndiaBulls Financial Services	IBLFF	IBULL IN	Veekesh Gandhi
	Indian Bank	INDIF	INBK IN	Rajeev Varma
	LIC Housing Finance, Ltd.	LHFLF	LICHF IN	Veekesh Gandhi
	Manappuram	XMGPF	MGFL IN	Veekesh Gandhi
	Max India	XXMIF	MAX IN	Rajeev Varma
	Power finance corporation Ltd	PWFEE	POWF IN	Veekesh Gandhi
	Punjab	PUJBF	PNB IN	Rajeev Varma
	Reliance Capital	RLCCF	RCAPT IN	Veekesh Gandhi
	Rural Electrification Corporation Ltd	XULEF	RECL IB	Veekesh Gandhi
	SBI	SBINF	SBIN IN	Rajeev Varma
	SBI -G	SBKFF	SBID LI	Rajeev Varma
	Shriram Transport Finance	SHTFF	SHTF IN	Veekesh Gandhi
	Yes Bank Ltd	YESBF	YES IN	Veekesh Gandhi
NEUTRAL				
	Axis Bank	XAXSF	AXSB IN	Rajeev Varma
	Axis Bank - GDR	XBKSF	AXB LI	Rajeev Varma
	Bank of Baroda	BKBAF	BOB IN	Rajeev Varma
UNDERPERFORM				
	Bank of India	XDIIF	BOI IN	Rajeev Varma
	Canara Bank	CNRKF	CBK IN	Rajeev Varma
	IDBI	XDBIF	IDBI IN	Veekesh Gandhi
	Infrastruct Dev	IFDFE	IDFC IN	Rajeev Varma
	Kotak Mahindra Bank	XXRVF	KMB IN	Rajeev Varma
	ORBC	ORBCF	OBC IN	Rajeev Varma
	Union Bank India	UBOIF	UNBK IN	Rajeev Varma

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

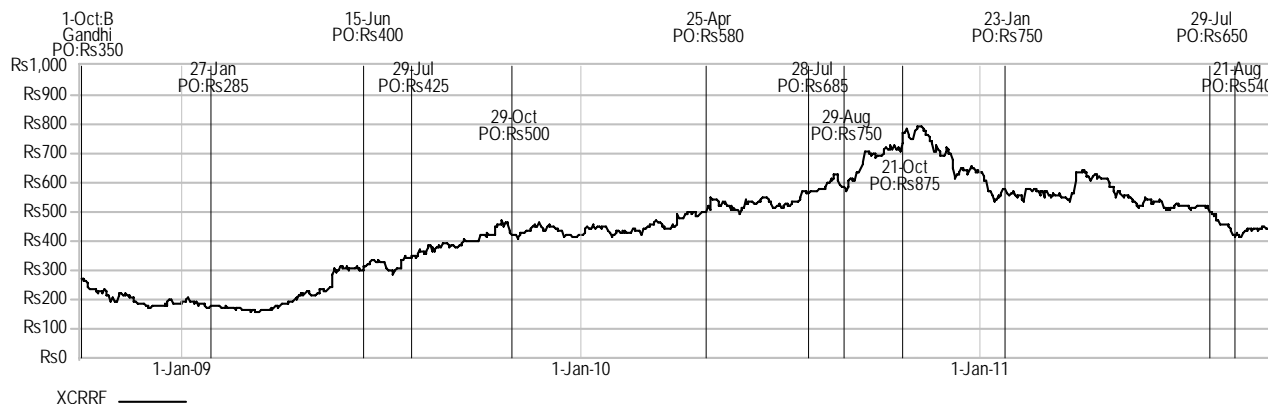
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XCRRF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of [September 30, 2011] or such later date as indicated.

Investment Rating Distribution: Banks Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	123	48.05%	Buy	63	63.00%
Neutral	76	29.69%	Neutral	41	65.08%
Sell	57	22.27%	Sell	27	49.09%

Investment Rating Distribution: Global Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2073	54.13%	Buy	923	49.12%
Neutral	961	25.09%	Neutral	460	52.57%
Sell	796	20.78%	Sell	287	38.32%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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