
Rating Rationale for Corporation Bank's Rs 2000 Crore CDs Rating

Brickwork Ratings assigns “BWR P1+” for Corporation Bank Certificate of Deposits (CDs) Issue of Rs. 2000 Crore

Instrument: Certificate of Deposits

Ratings: BWR P1+

Brickwork Ratings has assigned BWR P1+ (Pronounced BWR P one Plus) for Corporation Bank's proposed Certificate of Deposits Issue of INR 2000 crore or INR 20.00 billion. Brickwork ratings' 'BWR P1+' stands for an instrument that is considered to offer the BEST credit quality (Short term) in terms of timely serving of debt obligations. Brickwork Ratings has recently rated Corporation Bank's Upper Tier II Bonds Issue with “BWR AAA+” (Outlook: Stable) rating. This new addition to the bank's resources profile would not affect the rating. The rating factored higher operating profits, improving asset quality, comfortable capital adequacy, healthy low cost deposits, stable earning assets, well diversified credit deployment, lean operating cost structure and the Government of India's equity stake.

The bank has posted strong growth in total business, deposits and advances along with continuously improving quality of loans during FY 09. With total business growth of 29.47%, the bank skillfully managed the challenging economic conditions faced during FY 09. As a result, the bank's total business stood at INR 1224.96 billion in FY09 as against INR 946.10 billion in the previous year.

The bank has maintained high standard in asset quality as evidenced by lower non-performing levels during the year. In order to ensure the quality assets, the bank resorted to close monitoring of loan assets and individual case specific strategy. As a result, the bank's asset quality is the best among its peer group. During FY09, the bank's gross NPAs stood at 1.14%, which is 55 bps lower than that of peers' 1.69%. Similarly, its net NPAs at 0.29%, was 43 bps lower than the peers' average of 0.72%.

The bank has generated impressive revenues and profit figures with significant improvement in core income and fee based income. As a result, the bank's profit before tax and net profit surged 43.59% (INR 17.96 billion) and 21.46% (INR 8.92 billion) respectively during FY 09. As a result, the bank's asset utilization ratio stood at 2.59% in the financial year 2009.

Table I: Corporation Bank's Improving Strengths

| Criteria | FY 09 | FY 08 | FY 07 |
|--|--------------|--------------|--------------|
| Deposits (INR Billion) | 739.83 | 554.24 | 423.56 |
| Demand and Saving Deposits | 231.63 | 194.05 | 144.29 |
| Term Deposits | 507.20 | 360.19 | 279.28 |
| | | | |
| Advances (INR Billion) | 485.12 | 391.85 | 299.49 |
| | | | |
| Non-Performing Assets | | | |
| Gross NPAs | 1.14% | 1.47% | 2.05% |
| Net NPAs | 0.29% | 0.32% | 0.47% |
| | | | |
| Profit | | | |
| Gross Profit (INR Billion) | 17.96 | 12.51 | 11.40 |
| Net Profit (INR Billion) | 8.92 | 7.34 | 5.36 |
| | | | |
| ROA | 1.28% | 1.38% | 1.11% |
| ROE | 18.23% | 17.38% | 14.24% |
| | | | |
| Business per Employee (INR Million) | 104.9 | 83.9 | 64.5 |
| Net worth (INR Billion) | 48.97 | 42.29 | 37.65 |
| CRAR | 13.61% | 12.09% | 12.76% |
| Branches | 1054 | 981 | 901 |
| ATMs | 1032 | 957 | 929 |

The strategy of emphasizing on clientele base expansion and thrust on increasing the share of core deposit in the overall deposit mix of the bank, adopted during the previous year, was continued during FY 09. As a result, the bank's total deposits have registered a net addition of INR 185.59 billion to reach INR 739.83 billion during FY09, registering a growth of 33.49% during the year. The current deposits in absolute terms grew from INR 105.06 billion to INR 131.74 billion during FY 09 registering a growth rate of 25.39%. The bank's savings deposits portfolio registered a growth rate of 13.37% to close at INR 100.89 billion in FY 09 as against INR 89.99 billion in FY 08. Consequently, the bank's low cost deposits improved to INR 232.63 billion during FY09 recording a growth rate of 19.88%. Similarly, the term deposits have increased by INR 147.00 billion and stood at INR 507.20 during FY 09 registering a growth of 40.81%.

The credit portfolio of the bank registered a robust growth of 23.80% during FY 09. Growth in the credit was achieved through intense marketing of the various loan

products of the bank both under retail and corporate segments. Advances increased from INR 391.85 billion as on 31st March 2008 to INR 485.12 billion as on 31st March 2009, thus registering an absolute increase of INR 93.26 billion. Retail lending continued to be the focused area. The outstanding credit under retail lending improved from INR 88.13 billion during FY 08 to INR 93.38 billion during FY 09, registering a growth of INR 5.25 billion.

The bank has maintained a high standard in asset quality through appropriate risk management measures and recovery measures as evidenced by lower NPA levels. Close surveillance and initiation of prompt remedial action in borrowal accounts has ensured high quality of assets for the bank. It is evidenced by the fact that the standard assets constitute 98.86% of the bank credit as on 31st March 2009. Over the years, the bank's asset quality has been steadily improving through better credit culture and monitoring. As a result, Gross NPAs have come down to 1.14% as on 31st March 2009 from 1.47% for the same period a year ago. The bank's Net NPAs have shown a similar trend, which have declined to 0.29% in FY09 from 0.32% in FY08. The declining trend in the non-performing assets has been witnessed not only in terms of percentage level but also in absolute level. The bank's gross NPAs stood at INR 5.84 billion during FY09 as compared to INR 6.24 billion during FY08.

Interest income recorded a growth of INR 15.51 billion from INR 45.16 billion in the year 2007-08 to INR 60.67 billion during the year 2008-09 as against the interest expenses which grew from INR 30.73 billion during FY 08 to INR 43.76 billion during FY 09. The bank's net interest income recorded a growth of INR 2.47 billion during the same period. The bank's non-interest income grew from INR 6.99 billion in FY 08 to INR 11.07 billion in FY 09. The bank has posted a strong operating profit of INR 17.96 billion for the year ending March 31, 2009 up by 43.60% y-o-y. Further, the bank posted 21.47% growth in net profit to reach INR 8.92 billion in FY 09, as compared to INR 7.34 billion for the same period a year ago. The interest income on advances continued to be a major contributor to the bank's top line performance with a 34.34% growth and strongly supported by non-interest income with 58.22% growth. As on 31st March 2009, the bank has provided risk coverage of 75.27%.

The bank has an internal capital adequacy assessment policy to comprehensively evaluate capital adequacy requirements. The bank had a capital adequacy ratio of

12.09% under Basel I as on 31st March 2008, which is well above the minimum stipulated ratio of 9%. Keeping in view of the growth, the bank has identified capital requirements for the year. Accordingly, the bank has issued Tier I perpetual Bonds and lower Tier II Subordinated Bonds amounting INR 2.37 billion and INR 17.00 billion respectively. As a result the capital adequacy ratio under Basel I has improved significantly to 13.66% by March 2009. The bank's tier I under Basel I stood at 8.93% as on 31st March 2009.

Table II: Corporation Bank Financials

| Financials (INR Billion) | 2008-09 | 2007-08 |
|---------------------------------|----------------|----------------|
| Interest Income | 60.67 | 45.16 |
| Interest Expenses | 43.77 | 30.73 |
| Net Interest Income | 16.90 | 14.43 |
| Non-interest Income | 11.07 | 6.99 |
| Operating Income | 27.97 | 21.42 |
| Employee Expenses | 4.67 | 4.27 |
| Other Operating Expenses | 5.34 | 4.64 |
| Operating Profits | 17.96 | 12.51 |
| Provisions & Contingencies | 4.10 | 1.86 |
| Profit Before Tax | 13.86 | 10.65 |
| Provision for Tax | 4.94 | 3.31 |
| Profit After Tax | 8.92 | 7.34 |

During FY 09, the bank's Net Worth had improved progressively to reach INR 48.97 billion with 15.79% growth over the previous year. Similarly, the bank's Return on Assets stood at 1.28% during FY 09, which is 10 bps lower than that the previous year figure of 1.38%. However, ROE has improved consistently from 17.38% in FY 08 to 18.23% in FY 09.

The bank's aggregate investment as on 31st March 2009 stood at INR 249.37 billion with maturity mix of securities, consistent with the risk perceptions and investment policy guidelines. Treasury operations have been yielding significant returns. During FY09, the bank has generated INR 4.42 billion income from treasury operations, with a growth rate of 227.40%. Despite difficult market conditions, yield on investments have improved to 7.68% as on 31st March 2009 from 7.37% in the previous year.

Table II: Corporation Bank Vs Peer Group

| Key Ratios | CORP | Peers |
|-------------------------|-------------|--------------|
| Operating Ratios | | |
| Cost of Deposits | 7.02% | 6.15% |
| Cost of Funds | 6.30% | 5.99% |
| Return on Funds | 8.73% | 9.29% |
| Net Interest Margin | 2.43% | 2.81% |
| Earnings | | |
| NIM | 2.43% | 2.81% |
| Non-Interest Income | 11.07 | 12.10 |
| Return on Assets (ROA) | 1.28% | 1.14% |
| Return on Equity (ROE) | 18.23% | 17.65% |
| Cost to Income | 35.79% | 40.55% |
| Asset Quality | | |
| Gross NPA | 1.14% | 1.69% |
| Net NPA | 0.29% | 0.72% |
| Real Estate Loans | 15.03% | 11.47% |
| Term Loans | 45.43% | 57.54% |
| Capital Adequacy | | |
| Tier 1 | 8.89% | 9.22% |
| Total Capital | 13.61% | 13.32% |
| Leverage | 17.00 | 17.40 |
| Liquidity | | |
| CASA | 31.44% | 30.40% |
| Credit Deposit Ratio | 65.57% | 71.41% |

BWR has made a study of the performance of Corporation Bank vis-à-vis its peers in certain key parameters as given in the table above. BWR rating methodology has defined peer banks as those with closely similar size/operation as the Corporation bank.

It is observed that the bank's cost of deposits and cost of funds was 87 bps and 31 bps higher than its peers as on 31st March 2009. As a result of higher cost of deposits, the bank's net interest margin has dipped significantly as compared to its peers.

The bank's return on assets at 1.28% was 14 bps higher than its peer banks. Similarly, ROE was significantly higher (58 bps) than its peers. The bank stands out as the best performer as regards quality of advances made. The gross and net NPAs are substantially

lower at 1.14% and 0.29% respectively as against its peers' which stood at 1.69% and 0.72% respectively. Further, the bank's term loan component at 45.43% against the peers' figure of 57.54%, works to the bank's advantage. The bank has been very stable with its loan portfolio; however the exposure to sensitive sectors like real estate is a cause for concern. During FY09, the bank's real estate loans stood at 15.03%, which is 3.56% higher than its peers' average of 11.47%.

As on 31st March 2009, the Corporation Bank's CASA deposit ratio stood at 31.44%, which is slightly higher than its peers' average of 30.40%. Although this ratio has slipped subsequent on 31st March 2008, it is observed that consistent efforts are being made to increase the low cost deposits and improve the ratios.

Corporation Bank has the highest capital adequacy ratio amongst its peers. As on 31st March 2009, the CRAR under Basel II was 13.61%, which is 29 bps higher than its peers' average of 13.32%.

A special feature of BWR, it is an application of leverage ratio for analyzing the bank's performance. Brickwork calculates Leverage that assesses bank's capital adequacy with reference to both on and off balance sheet exposures. The bank has shown the best leverage of 17 as compared to its peers' average of 17.40

Shortcomings:

In the analysis of the Corporation Bank's performance for FY 2009, a few shortcomings as under have been noticed.

- a) The share of CASA deposits has slipped from 35.01% as of March 2008 to about 31.44% by year ending March 2009.
- b) Consequently the cost of deposits has increased from 5.3% in FY07 to 6.45% in FY08 to 7.02% in FY09.
- c) The net interest margin declined from 3.08% in FY07 to 2.71% in FY08 to 2.43% in FY09.
- d) The real estate exposure at 15.03% of the total advances as at FY09 is high compared with its peers, though it has come down from 22.24% in FY 07.
- e) The bank has restructured nearly 4313 accounts, which is 2.15% of its loan outstanding during FY09. Brickwork expects that the bank's asset quality would deteriorate slightly in the coming year

Mitigants:

The bank has been conscious of the aforesaid deficiencies and is taking requisite steps to bring about improvements. The bank is making concerted efforts to reduce its dependence on high cost bulk deposits. It has introduced several new schemes for mobilizing new savings deposits and is actively pursuing them through appropriate marketing strategies to improve the low cost CASA deposits. It is also encashing upon its technology initiative, especially the cash management services where the bank is still a dominant player. The total adoption of CBS in all its branches and the faster mode of remittances of funds through the recently introduced RTGS / ETF facilities would be expected to augment its current account deposits. The bank has got a good network of branches in metro, urban, semi-urban and rural areas in the 5 states of Southern India. The bank is taking adequate steps to tap the potential and expanding banking services in such areas not only through the help of the branches but also with the additional delivery channels like the ATMs and the bank correspondents. It has strengthened its sales and marketing infrastructure to ensure steady clientele acquisition and also for cross selling and up-selling of various products introduced by the bank. Overall the bank is taking necessary steps for overcoming the deficiencies.

In respect of its lending to the real estate sector, the exposure which was 22.24% in FY07 has come down to 17.41% in FY08 and further reduced to 15.03% in FY09 due to concerted efforts and it is expected that the declining trend will continue. Of this, the exposure to commercial real estate is just about 6.80% in FY09. The remaining portion of advances is for financing residential houses.

Similarly as regards the capital market exposure, the major increase was to meet the bank's commitments towards venture capital and partly for margin trading. As we understand these are adequately secured. As part of its strict compliance with the risk management processes in the bank, these exposures are expected to be handled carefully depending upon the market circumstances. The exposures in the above sectors, being a small portion of the total advances is unlikely to have any major impact.

Bank Profile:

Incorporated in 1906, Corporation Bank is one of the oldest mid-sized public sector banks in India. The bank has always been in the forefront to improve its productivity and efficiency. Over the years the bank has been transforming itself from core banking activities to provide universal banking solutions.

The bank has positioned itself very well in the southern part of the country. As a result, the bank was able to show a relatively good deposit growth compared to its peers in India. The bank continues to expand its technology driven, customer-centric products and services to serve its growing customer base effectively. The bank's product and services consist of cash management services, money market related products, treasury asset managements, forex services, payments and receipts, remittance, merchant banking, LIC premiums, SME Banking facility etc. The bank has implemented Core Banking Solution (CBS) in all its branches, thus covering 100% of overall business. The bank's distribution channel consists of 1054 branches, and 1032 ATMs.

Bank's Shareholding Pattern (As on 31st March 2009)

| Shareholders | Stake |
|------------------------|--------|
| Government of India | 57.17% |
| Financial Institutions | 34.37% |
| Foreign | 3.91% |
| Retail | 4.55% |

Industry Snapshot:

Over the years, the Indian banking sector has benefited from a stable macro economic environment with unparalleled systemic support from the Indian government. The financial year 2009 witnessed a steady deterioration in the global financial condition, which tightened the liquidity position and affected the credit off-take. Nevertheless, the Indian banking sector has skillfully tided over the crisis with ample support and measures to stimulate the economy from the government and RBI.

As scheduled, the banks have successfully implemented the Basel II norms during financial year 2009 in spite of financial crisis in the domestic market. The public sector

banks especially have shown a positive growth on account of proactive measures taken by the government during the year.

While economic activity seems to be picking up, the Indian banking industry is gearing for a notable operational growth. Nonetheless, continuous monitoring and timely corrective action would be necessary as the crisis have not been fully blown over and weakness felt earlier could have repercussion on growth, margins etc. for some more time to come. While leveraging the banking technology, the banks also resorted to cross-selling and up-selling of various products and services to increase their revenues.

Rating Note:

Brickwork Ratings has assigned BWR P1+ (Pronounced BWR P one plus) for Corporation Bank's proposed Certificate of Deposits issue, which signifies **Best** credit quality. The rating has been assigned based on factors like the majority stake held by Government of India, lean operating structure, well diversified loan portfolio and income stream, and comfortable capital adequacy ratios.

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