

Company Results Review

18 April 2007 | 8 pages

Pusan Bank (005280.KS)

Buy: 1Q Above Expectations on Writebacks

 Rating change
 Target price change
 Estimate change

- Upside surprise** — Pusan Bank's 1Q07 earnings surprised on the upside. Net profit came in at W76.2bn, 34% higher than our estimate due to lower provisioning expenses and better SG&A cost control.
- Signs of NIM stabilization** — Net interest income was 2.4% above our forecast as net interest margin edged up 7bps qoq on rising asset yields.
- Higher non-interest income, thanks to one-offs** — Higher-than-expected non-interest income was mainly due to a W8.3bn recovery in KAMCO fund.
- Restructuring saving SG&A cost** — SG&A cost was 6% below our expectation as staff restructuring in 2006 saved labor cost. We raise our earnings estimates by 3.6% and 4.1% for 2007 and 2008 to reflect better cost control.
- No sign of asset quality deterioration** — We have not detected any signs of asset quality deterioration in 1Q07; we maintain our full-year credit cost estimate of W65.3bn, or 38bps of total credit, for 2007 due to possible asset-quality deterioration in 2H07E. However, we prefer to err on the side of caution; there was virtually nil credit cost in 1Q07, thanks to write-backs of W9.2bn.
- Retaining Buy/Low Risk** — We expect a good turnaround story from the stock in 2007. Its valuation appears compelling at 8.7x P/E and 1.44x P/B, with a 17.6% ROE based on 2007E. Our new target price is W17,900 (up from W17,000), which offers a 31% total expected return including a forecast 3.9% dividend yield.

Buy/Low Risk	1L
Price (18 Apr 07)	W14,050
Target price	W17,900
	<i>from W17,000</i>
Expected share price return	27.4%
Expected dividend yield	3.9%
Expected total return	31.3%
Market Cap	W2,060,905M
	US\$2,219M

Price Performance (RIC: 005280.KS, BB: 005280.KS)



Figure 1. Pusan Bank — Statistical Abstract

Year to	Net Profit	EPS	EPS Growth	P/E	BVPS	P/B	ROE
31-12	(W Bils.)	(Won)	(%)	(x)	(Won)	(X)	(%)
2005	179	1,220	34.8	11.5	7,816	1.80	16.5
2006	184	1,253	2.8	11.2	8,718	1.61	15.2
2007E	238	1,623	29.5	8.7	9,771	1.44	17.6
2008E	251	1,710	5.3	8.2	10,881	1.29	16.6
2009E	277	1,892	10.6	7.4	12,022	1.17	16.5

Source: Citigroup Investment Research estimates

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¹Citigroup Global Markets Korea Securities Ltd

Fiscal year end 31-12	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	11.5	11.2	8.7	8.2	7.4
P/E reported (x)	11.5	11.2	8.7	8.2	7.4
P/BV (x)	1.8	1.6	1.4	1.3	1.2
P/Adjusted BV diluted (x)	1.8	1.6	1.4	1.3	1.2
Dividend yield (%)	2.9	3.0	3.9	4.3	5.3
Per Share Data (W)					
EPS adjusted	1,220	1,253	1,623	1,710	1,892
EPS reported	1,220	1,253	1,623	1,710	1,892
BVPS	7,816	8,718	9,771	10,881	12,022
Tangible BVPS	7,816	8,718	9,771	10,881	12,022
Adjusted BVPS diluted	7,816	8,718	9,771	10,881	12,022
DPS	405	420	550	600	750
Profit & Loss (WM)					
Net interest income	515,036	617,355	674,545	719,526	788,560
Fees and commissions	62,955	73,614	84,922	96,204	104,595
Other operating Income	70,322	-20,828	-5,887	-5,512	-5,996
Total operating income	648,314	670,141	753,580	810,219	887,159
Total operating expenses	-320,885	-329,046	-360,722	-385,563	-415,427
Oper. profit bef. provisions	327,429	341,095	392,858	424,656	471,732
Bad debt provisions	-93,400	-60,237	-65,293	-79,630	-89,898
Non-operating/exceptionals	15,545	-23,430	858	863	875
Pre-tax profit	249,575	257,428	328,422	345,888	382,709
Tax	-70,641	-73,572	-90,316	-95,119	-105,245
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	178,934	183,856	238,106	250,769	277,465
Adjusted earnings	178,934	183,856	238,106	250,769	277,465
Growth Rates (%)					
EPS adjusted	34.8	2.8	29.5	5.3	10.6
Oper. profit bef. prov.	6.9	4.2	15.2	8.1	11.1
Balance Sheet (WM)					
Total assets	19,049,884	21,710,789	24,042,815	26,215,106	28,556,329
Avg interest earning assets	17,557,223	19,926,893	22,441,240	24,743,682	27,031,329
Customer loans	12,374,630	15,153,166	16,857,860	18,642,034	20,571,994
Gross NPLs	116,900	127,800	162,354	206,907	256,732
Liab. & shar. funds	19,049,884	21,710,789	24,042,815	26,215,106	28,556,329
Total customer deposits	13,065,585	13,293,044	13,578,275	14,404,778	15,279,977
Reserve for loan losses	188,508	220,717	252,851	295,394	345,305
Shareholders' equity	1,146,529	1,278,836	1,433,249	1,596,007	1,763,457
Profitability/Solvency Ratios (%)					
ROE adjusted	16.5	15.2	17.6	16.6	16.5
Net interest margin	2.93	3.10	3.01	2.91	2.92
Cost/income ratio	49.5	49.1	47.9	47.6	46.8
Cash cost/average assets	1.8	1.6	1.6	1.5	1.5
NPLs/customer loans	0.9	0.8	1.0	1.1	1.2
Reserve for loan losses/NPLs	161.3	172.7	155.7	142.8	134.5
Bad debt prov./avg. cust. loans	0.8	0.4	0.4	0.4	0.4
Loans/deposit ratio	94.7	114.0	124.2	129.4	134.6
Tier 1 capital ratio	9.1	8.1	8.1	8.0	7.9
Total capital ratio	12.3	11.1	10.6	10.5	10.3

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Figure 2. Pusan Bank — 1Q07P Earnings Review

(Wbn, %)	1Q07P	1Q07E	% diff	4Q06	% qoq	1Q06	% yoy	% of annual
Interest income	325.9	324.8	0.4%	317.6	2.6%	274.1	18.9%	24.0%
Interest expenses	162.1	164.9	-1.7%	157.0	3.2%	118.7	36.6%	23.6%
Net interest income	163.8	159.9	2.4%	160.6	2.0%	155.4	5.4%	24.3%
Non-interest income	26.6	19.1	39.2%	7.4	259.5%	10.0	166.0%	33.7%
Total Operating income	190.4	179.0	6.4%	168.0	13.3%	165.4	15.1%	25.3%
SG&A expenses	78.5	83.5	-6.0%	102.4	-23.3%	73.1	7.4%	21.1%
Pre-provisioning profits	111.9	95.5	17.2%	65.6	70.6%	92.3	21.2%	29.3%
Provisions	4.8	16.3	-70.6%	6.1	-21.3%	19.6	-75.5%	7.4%
Operating income	106.2	79.2	34.2%	59.5	78.5%	72.7	46.1%	33.6%
Non operating income	-0.6	0.2	nm	-26.7	nm	-6.2	nm	-69.9%
Pre-tax profits	105.6	79.4	33.0%	32.8	222.0%	66.5	58.8%	33.3%
Taxes	29.4	22.7	29.6%	9.2	219.6%	18.7	57.2%	33.7%
Net profits	76.2	56.7	34.4%	23.6	222.9%	47.8	59.4%	33.2%

Source: Company Reports and Citigroup Investment Research

Figure 3. Pusan Bank — Key Balance Sheet Items

(Wtn, %)	1Q07	1Q06	YoY	4Q06	QoQ
Total Assets	23.4	19.1	22.5%	22.8	2.6%
Total Loans	15.3	12.3	24.9%	14.9	2.8%
Total Deposits	18.0	15.3	17.1%	17.8	1.1%
NIM	3.04%	3.37%	-33bps	2.97%	7bps
NPL ratio	0.79%	1.16%	-0.37%p	0.83%	-0.04%p
NPL coverage ratio	173.6%	139.9%	33.7%p	175.8%	-2.18%p
Delinquency ratio	0.67%	1.11%	-0.44%p	0.75%	-0.08%p
Consumer loans (+1M)	0.91%	1.22%	-0.31%p	0.88%	0.03%p
SME (+14 days)	0.56%	1.11%	-0.55%p	0.66%	-0.10%p
Credit cards (+1M)	2.55%	2.87%	-0.32%p	2.43%	0.12%p

Source: Company Reports and Citigroup Investment Research

Figure 4. Pusan Bank – TP Calculation

Risk-free rate (%) - (Rf)	5.0%
Equity risk premium (%) (Rp)	5.6%
Beta (B)	1.15
Cost of equity	11.4%
g	4%
adj. ROE (Avg of 2006 and 2007)	17.1%
Cost of equity	11.4%
Fair P/BV	1.74
Fair value from (ROE-g)/(COE-g)	17,918
Discount to fair value	0
Target Price	17,900
Current share price	14,050
Expected total return	31.3%
Implied 2007E P/E	11.03
Implied 20078E P/B	1.83

Source: Citigroup Investment Research

Figure 5. Pusan Bank — Earnings Revision

Year to	Net Profit (Wbn)		EPS (Won)		% change	DPS (Won)	
	Old	New	Old	New		Old	New
31-12							
2007E	230	238	1,567	1,623	3.6	550	550
2008E	241	251	1,642	1,710	4.1	600	600
2009E	268	277	1,830	1,892	3.4	750	600

Source: Citigroup Investment Research estimates

Figure 6. Pusan Bank — Key Assumption Changes

(%)	2007E		2008E		2009E	
	Old	New	Old	New	Old	New
Loan growth (%)	11.2%	11.2%	10.6%	10.6%	10.4%	10.4%
Corporate	13.3%	13.3%	11.4%	11.4%	11.5%	11.5%
Consumer	5.2%	5.2%	7.3%	7.3%	7.3%	7.3%
Others	15.0%	15.0%	15.0%	15.0%	10.0%	10.0%
Credit card asset growth (%)	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Deposit growth (%)	9.7%	9.7%	8.2%	8.2%	8.4%	8.4%
Loan / Deposit (%)	113.0%	113.0%	117.9%	117.9%	122.7%	122.7%
Net interest margin (%)	2.99%	2.99%	2.89%	2.89%	2.90%	2.90%
Fees and commission growth (%)	13.4%	13.4%	12.8%	12.8%	8.8%	8.8%
Non-interest income / total income	10.5%	10.5%	11.2%	11.2%	11.1%	11.1%
Total OP revenue growth	12.4%	12.5%	7.5%	7.5%	9.4%	9.5%
Cost / income (%)	49.4%	47.9%	49.2%	47.6%	48.2%	46.8%
Credit cost / total credit (%)	0.38%	0.38%	0.42%	0.42%	0.43%	0.43%

Source: Citigroup Investment Research estimates

Pusan Bank

Company description

Pusan Bank was established in 1967 as a regional bank servicing Pusan, the second-largest city in Korea, and Gyeongnam province. The bank has the largest market share of deposits (30.7%) and loans (19.4%) in Pusan. Its branch network spans 209 locations and serves 3.2m customers. Because it has successfully maintained its strong franchise and No.1 market share in Pusan, the bank has survived testing times.

Investment thesis

We rate Pusan Bank as Buy/Low Risk (1L), with a target price of W17,900. Pusan Bank should sustain at least 10% yoy loan growth for the next three years on steady market share addition in the Gyeongnam area and a strengthened position in Pusan city. The Pusan / Gyeongnam region is the second-largest regional economy in Korea with clustered export-oriented industrial complexes. We expect Pusan Bank to post 29.5% EPS growth in 2007 as the bank focuses on profitability, compared with aggressive loan growth in 2006. The pace of net interest margin contraction, we estimate, will decelerate to 9bps yoy in 2007E from 27bps in 2006 due to less aggressive volume growth.

Valuation

We have used a Gordon Growth model (ROE-g)/(COE-g) to value Pusan Bank in the context of price-to-book paid vis-à-vis ROE (reflecting earnings generation over time) from a long-term growth perspective. P/BV has historically shown a relatively strong correlation with share price return. We used a risk-free rate of 5.0%, corresponding to the current 3-year government bond yield, an equity risk premium of 5.6% to reflect superior corporate governance but smaller scale and a beta of 1.15x to arrive at a cost of equity of 11.4%. We have also applied a 4% perpetual growth rate. We derive a fair P/BV from (ROE-g)/(COE-g). For the ROE, we used an average of two-year forward ROE (2007E~2008E). We set our target price at W17,900. We have also used our proprietary EVA model to gauge

long-term value of the bank. The fair value derived from our EVA model is W18,020.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, rates Pusan Bank as Low Risk. Risks that could prevent the stock from reaching our target price include: (1) It is hard to estimate the impact of the Won's appreciation on the loan portfolio. However, a rapid Won appreciation could leave asset quality eroded. According to various surveys, a W920/US\$1 level would render most SMEs unprofitable; (2) We believe market competition in Pusan and Gyeongnam is less fierce than in the Seoul metropolitan area. Worse-than-expected competition would result in margin compression and marketing cost increases; (3) Worse-than-expected economic activity in the key markets would hurt the bank's loan growth opportunities and asset quality; and (4) The government's anti-speculation measures in the property market could dent mortgage demand.

Appendix A-1

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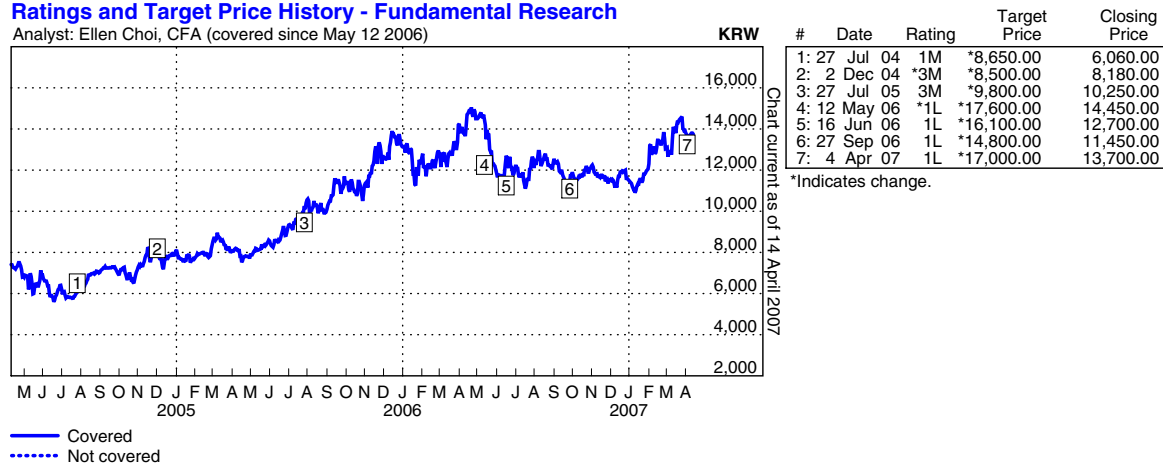
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Analyst: Ellen Choi, CFA (covered since May 12 2006)



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