



COMPANY UPDATE
Pusan Bank (005280.KS)

Neutral

1Q2007 results: Off to a solid start, further margin stability is key

What's changed

Pusan Bank reported record quarterly net profit for 1Q2007 of W76bn on two exceptional recovery items. Adjusting for the one-offs, net profit was W64bn (+144%qoq, +34%yoy), 12% better than our forecast of W57bn, owing to lower underlying credit cost annualizing at an impressive 36bps. Quarterly net interest margins also marked a consecutive rise (+7bps) as some pricing discipline was restored on the lending side, albeit margins still being lower than 1Q06 by 33bps. The bank has already achieved 32% of its annual net profit target of W237bn.

Implications

Loan demand from the export-driven SMEs (e.g. shipbuilding, auto parts, and machineries) appears to be steady (+4%qoq), however slightly short in achieving the bank's annual target of 18% SME loan growth. More critically, quarterly decline in deposits (-3%qoq, +7%yoy) may begin to weigh on further margin stability as loan-to-deposits reached an all-time high of 110%. Management indicates it will focus its efforts on (a) timely debenture issuance and (b) more low cost deposit campaigns to defend its year-end margin target of 3.00% versus 3.04% in 1Q.

Valuation

Our GS Camelot based 12-month price target is W16,100 (1.67X 07E PBR). We maintain our Neutral rating on Pusan Bank.

Key risks

Slow down in exports and/or property prices would have negative implications for top line growth and asset quality.

Impact on related securities

We expect to see a similarly solid set of 1Q results from Daegu Bank (005270.KS, Buy) on April 19th, with matching one off gains as Pusan Bank, but with some non-recurring margin pressures.

INVESTMENT LIST MEMBERSHIP

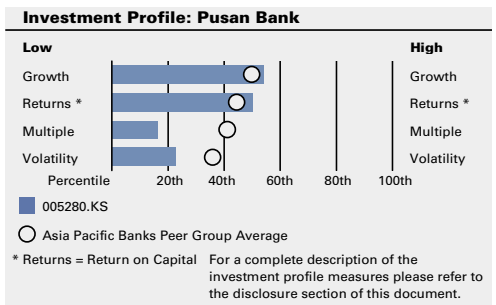
Neutral

Coverage view: Attractive

South Korea:
 Banks

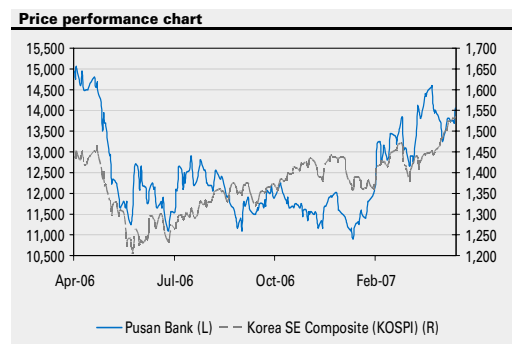
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Key data	Current
Price (W)	14,050
12 month price target (W)	16,100
Market cap (W bn / US\$ mn)	2,060.9 / 2,217.8
Foreign ownership (%)	57.4

	12/05	12/06E	12/07E	12/08E
EPS (W)	1,220	1,261	1,474	1,740
EPS growth (%)	34.8	3.3	17.0	18.0
P/B (X)	1.8	1.6	1.5	1.3
P/E (X)	11.5	11.1	9.5	8.1
Dividend yield (%)	2.9	3.0	3.5	4.1
P/PPOP (X)	6.3	6.2	5.6	4.7
PPOP growth (%)	7.1	0.5	12.5	17.8
Preprovision ROA (%)	1.8	1.6	1.6	1.8
Credit cost (%)	0.8	0.3	0.5	0.5
ROA (%)	0.99	0.91	0.96	1.04
ROE (%)	16.5	15.2	16.1	17.0



Share price performance (%)	3 month	6 month	12 month
Absolute	21.1	18.6	(5.4)
Rel. to Korea SE Composite	9.2	4.6	(12.0)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 4/18/2007 close.

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Pusan Bank: Summary financials

Profit model (W bn)	12/05	12/06E	12/07E	12/08E	Balance sheet (W bn)	12/05	12/06E	12/07E	12/08E
Net interest income	592.7	617.0	679.1	761.4	Gross loans	12,374.6	15,153.2	16,626.6	18,425.9
Non-interest income	56.4	42.0	47.4	59.4	NPLs	116.9	127.8	137.1	151.7
Operating revenue	649.1	659.0	726.5	820.8	Loan loss reserves	188.5	219.6	250.6	276.7
Non-interest expense	(320.9)	(329.0)	(355.3)	(383.7)	Total interest earning assets	17,025.0	19,795.8	21,435.7	23,414.4
Provision oper profits	328.2	330.0	371.2	437.1	Other non-interest earning assets	2,024.9	1,915.0	2,008.6	2,107.3
Total provision charge	(94.2)	(48.2)	(78.6)	(90.4)	Total assets	19,049.9	21,710.8	23,444.2	25,521.6
Associates	0.3	0.1	0.0	0.0	Customer deposits	13,662.5	14,557.7	15,757.7	17,056.7
Pretax profit	249.6	258.5	300.8	354.9	Total interest-bearing liabilities	17,233.3	19,588.3	20,992.6	22,504.0
Tax	(70.6)	(73.6)	(84.5)	(99.8)	Total equity	1,146.5	1,278.8	1,412.5	1,586.7
Minorities	--	--	--	--	CAMEL ratios (%)	12/05	12/06E	12/07E	12/08E
Net profit	178.9	184.9	216.3	255.2	C: Tier 1 capital ratio	9.1	8.1	8.4	8.7
Dividends	59.4	61.9	71.4	84.2	C: Equity/loans	9.4	8.6	8.6	8.7
Dividends payout (%)	33.2	33.5	33.0	33.0	C: Equity/assets	6.0	5.9	6.0	6.2
Earnings growth drivers (%)	12/05	12/06E	12/07E	12/08E	A: NPL ratio	0.9	0.8	0.8	0.8
Net interest margin	3.4	3.2	3.2	3.3	A: Loan loss reserves/NPLs	161.3	171.8	182.8	182.4
Provision charge/total loans	0.8	0.3	0.5	0.5	E: Net interest margin	3.4	3.2	3.2	3.3
YoY Growth (%)					E: Non int inc/oper revenues	8.69	6.37	6.52	7.24
Customer deposits	6.7	6.6	8.2	8.2	A: Cost-income ratio	49.4	49.9	48.9	46.7
Loans	10.0	22.5	9.7	10.8	E: ROAA	0.99	0.91	0.96	1.04
Net interest income	19.1	4.1	10.1	12.1	L: Loan/deposit ratio	89.2	102.6	103.9	106.4
Fee income	(48.6)	18.1	24.7	14.9	Key CAMELOT assumptions	12/05	12/06E	12/07E	12/08E
Non-interest income	(45.4)	(25.6)	12.9	25.5	GS CAMELOT implied P/B (X)	--	--	1.7	--
Operating revenue	8.0	1.5	10.3	13.0	GS CAMELOT implied P/E (X)	--	--	10.5	--
Operating expenses	(9.0)	(2.5)	(8.0)	(8.0)	Risk-free rate (%)	5.5	5.5	5.5	5.5
Preprovision operating profit	7.1	0.5	12.5	17.8	Equity risk premium (%)	6.5	6.5	6.5	6.5
Provision charges	(25.5)	(48.8)	62.9	15.0	CAMELOT beta (X)	--	--	1.0	--
Pretax profit	31.5	3.6	16.4	18.0	Risk-adjusted cost of equity (%)	--	--	12.3	--
Net profit	34.8	3.3	17.0	18.0	3-yr adjusted DPS CAGR (%)	--	--	9.0	--
EPS	34.8	3.3	17.0	18.0	Sustainable ROE estimate (%)	--	--	16.0	--
DPS	35.0	4.3	15.2	18.0	LT dividend payout estimate (%)	--	--	35.0	--
Market dimensions	12/05	12/06E	12/07E	12/08E	Ex-growth bond-equivalent P/B (X)	--	--	1.3	--
No of branches	202.0	205.0	205.0	205.0	Loan portfolio (%)	12/05	12/06E	12/07E	12/08E
No of staff (000)	1,987.0	2,024.0	2,024.0	2,024.0	Commercial & corporate	57.9	61.1	62.4	63.1
Revenues/staff (W)	326,685.3	325,572.7	358,948.1	405,555.0	Mortgages/home loans	8.8	8.3	8.1	8.0
Net profit/staff (W)	90,052.3	91,352.1	106,844.3	126,066.3	Consumer	30.9	26.3	26.0	25.4
DuPont analysis (%)	12/05	12/06E	12/07E	12/08E	Valuation (current price)	12/05	12/06E	12/07E	12/08E
ROE	16.5	15.2	16.1	17.0	P/E basic (X)	11.5	11.1	9.5	8.1
x leverage	6.3	6.3	6.3	6.5	P/B (X)	1.8	1.6	1.5	1.3
= ROA	0.99	0.91	0.96	1.04	P/PPOP (X)	6.3	6.2	5.6	4.7
% of assets	12/05	12/06E	12/07E	12/08E	Dividend yield (%)	2.9	3.0	3.5	4.1
Net interest income	3.3	3.0	3.0	3.1	EPS, basic (W)	1,220	1,261	1,474	1,740
Fee income	0.3	0.3	0.4	0.4	EPS, fully-diluted (W)	1,220	1,261	1,474	1,740
Non-interest income	0.3	0.2	0.2	0.2	EPS, basic growth (%)	34.8	3.3	17.0	18.0
Operating revenue	3.6	3.2	3.2	3.4	EPS, fully diluted Growth (%)	34.8	3.3	17.0	18.0
Operating expenses	1.8	1.6	1.6	1.6	BVPS (W)	7,816	8,718	9,630	10,817
Preprovision operating profit	1.8	1.6	1.6	1.8	DPS (W)	405	422	487	574
Loan loss provisions	0.5	0.2	0.3	0.4					
Pretax profits	1.4	1.3	1.3	1.4					
Taxes	0.4	0.4	0.4	0.4					

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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1Q2007 results: Off to a solid start, further margin stability is key

Bottom line:

- 1Q2007 net profit of W76bn included two positive one-off recovery items. Ex-one offs, net profit of W64bn (+144%qoq, +34%yoy) was 12% higher than our forecast of W57bn.
- Pusan Bank has already achieved 32% of its annual net profit target, but challenges remain as loan growth in 1Q (+2%qoq) was relatively modest compared to its annual growth target (+12%yoy) while cushion for margin control remains thin against its year-end target of 3.00% versus 3.04% today.

Positive surprise:

- Quarterly margins expanded by 7bps in 1Q as Pusan Bank increased lending spreads on corporates loans by 20-30bps. Management also attributes the improvement to its renewed enforcement of margin control as the top priority to its branch managers.
- NPL ratios improved yet again from 0.83% in the previous quarter to 0.79% in 1Q. By borrower type, SMEs improved from 0.91% to 0.77%, while households and credit cards deteriorated from 0.76% to 0.84% and from 1.29% to 1.89%, respectively. Underlying credit cost marked 36bps, in line with the quarterly trend from the previous quarters.
- 1Q net profit of W76bn included two positive one offs; (a) W8bn recovery from the liquidation of the KAMCO liquidation fund, of which all Korea banks were asked to make participation at the time of establishment in 1997, and (b) W9bn reversal of provisions due to the change in expected loss calculation method, whereby the sample years were revised to include 2004-2006 from 2003-2005 previously.

Negative surprise:

- Deposits declined by 3%qoq, leaving loan-to-deposit ratios at an all-time high of 110%. Management explains future growth will likely be funded by more debenture issuance given the difficult competitive environment for deposit funding. At the same time, low cost deposits increased by 2%qoq in 1Q, leaving some hope for funding cost stability.
- 1Q quarterly loan growth (+2% for overall, +4% for SMEs, and +1% for household) was in line with quarterly sector growth, but slightly short of pace to meet Pusan Bank's annual target (+14% for overall, +18% for SMEs, and +1% for household).

Outlook:

- Management perceives margin control to be the key challenge, with a particular focus on protecting funding costs. More debenture funding and aggressive demand deposit campaigns are set for the rest of the year, according to the bank.
- Pusan Bank's internal survey indicates the average balance of a demand deposit account is roughly W600,000, small enough to leave customers undistracted to the recently popular CMA accounts provided by securities firms.

Exhibit 1: Pusan Bank 1Q07 results summary

Actual vs. GS estimate (W bn)

	1Q06	4Q06	1Q07	QoQ	YoY	GS est. 1Q07E	Actual vs. GS	GS comments
Operating Income	165	169	190	18%	15%	174	9%	
Net Interest Income	155	162	164	1%	5%	163	0%	Net interest income (in-line)
Non-Interest Income	10	7	26	262%	155%	11	138%	
Net Commission Income	15	18	19	7%	31%	19	1%	Fee income (in-line)
Net Other Income	(5)	(11)	6	NM	NM	(8)	NM	Others (positive on one-off)
Non-Interest Expense	73	101	79	-22%	7%	79	-1%	Expense (in-line)
Pre-Provision Operating Profit	92	68	111	63%	20%	95	17%	
Provisions	20	6	5	-21%	-76%	18	-74%	Provisions (positive)
Operating Profit	73	62	106	71%	46%	77	38%	
Non-Operating Profit	(6)	(27)	(1)	NM	NM	2	NM	
Pre-Tax Profit	66	35	106	202%	59%	79	34%	
Tax	19	9	29	227%	58%	22	32%	
Net Profit	48	26	76	193%	59%	57	34%	32% of annual bank budget
	1Q06	4Q06	1Q07	QoQ	YoY			
NIM (QTD): Reported	3.37%	2.97%	3.04%	0.07%p	-0.33%p			Margins quarter-on-quarter (positive)
NIM (YTD): Reported	3.37%	3.08%	3.04%	-0.04%p	-0.33%p			Margins year-on-year (negative)
	1Q06	4Q06	1Q07	QoQ	YoY			
Total Assets	19,132	21,709	22,150	2%	16%			Overall loan growth = +2%qoq
Cash & Due From Banks	1,093	1,029	1,089	6%	0%			Large corp = -12%qoq
Investment Securities	4,849	4,918	4,857	-1%	0%			SME = +4%qoq
Loans & Credits Receivable	12,550	15,153	15,529	2%	24%			Mortgage = +1%qoq
Fixed Assets	345	364	352	-3%	2%			Other consumer = +1%qoq
Other Assets	497	466	533	14%	7%			Credit card = -5%qoq
Total Liabilities	17,994	20,433	20,856	2%	16%			
Customer's Deposits	13,148	14,558	14,116	-3%	7%			Deposits = -3%qoq
Borrowings	3,264	4,163	4,187	1%	28%			Loan-to-deposit = 110%
Corporate Bonds	410	868	1,556	79%	279%			
Other Liabilities	1,172	844	996	18%	-15%			
Total Stockholders Equity	1,138	1,278	1,294	1%	14%			
	1Q06	4Q06	1Q07					
Equity / Loans	9.1%	8.4%	8.3%					
Equity / Assets	5.9%	5.9%	5.8%					
LLR / Gross Loans (%)	1.6%	1.5%	1.4%					1Q07 NPL ratios: SME (+), household/credit card (-)
NPL Ratio (substandard and below)	1.16%	0.83%	0.79%					SMEs: 0.91% (4Q06) to 0.77% (1Q07)
NPL Coverage	139.5%	175.8%	173.7%					Households: 0.76% (4Q06) to 0.84% (1Q07)
ROAA	1.00%	0.48%	1.39%					Credit cards: 1.29% (4Q06) to 1.89% (1Q07)
ROAE	16.7%	8.2%	23.7%					
Cost-to-Income	44.2%	59.7%	41.4%					Cost-to-income = 41%
Fee Income / Oper.Inc.	8.9%	10.6%	10.2%					
Non Interest Income / Oper.Inc.	6.1%	4.2%	13.6%					
Loan / Deposits	95.4%	104.1%	110.0%					
Tier 1 Ratio	9.3%	8.1%	8.4%					
Tier 2 Ratio	2.6%	3.0%	3.6%					
	1Q06	4Q06	1Q07					
As % of Assets								
Operating Income	3.47%	3.14%	3.46%					
Net Interest Income	3.26%	3.01%	2.99%					
Non-Interest Income	0.21%	0.13%	0.47%					
Non-Interest Expense	1.53%	1.88%	1.43%					
Pre-Provision Operating Profit	1.93%	1.27%	2.02%					
Loan Provisions	0.41%	0.11%	0.09%					Underlying credit cost ex-one off = 36bps
Operating Profit	1.52%	1.15%	1.94%					
Non Operating Profit	-0.13%	-0.50%	-0.01%					
Pretax Profit	1.39%	0.65%	1.93%					
Tax	0.39%	0.17%	0.54%					
Net Profit	1.00%	0.48%	1.39%					

Source: Company data, Goldman Sachs Research estimates

Reg AC

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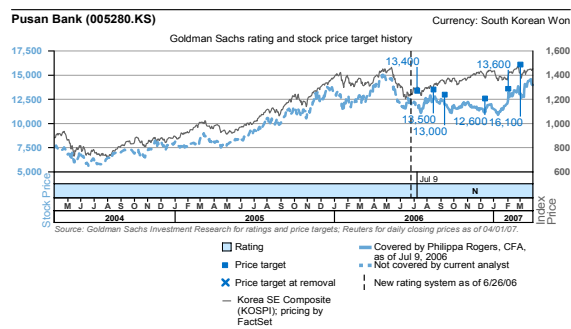
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Return potential represents the price differential between the current share price and the price target expected during the time horizon associated with the price target. Price targets are required for all covered stocks. The return potential, price target and associated time horizon are stated in each report adding or reiterating an Investment List membership.

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Ratings, coverage views and related definitions prior to June 26, 2006

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Definitions

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Coverage views: Attractive (A). The investment outlook over the following 12 months is favorable relative to the coverage group's historical fundamentals and/or valuation. **Neutral (N)**. The investment outlook over the following 12 months is neutral relative to the coverage group's historical fundamentals and/or valuation. **Cautious (C)**. The investment outlook over the following 12 months is unfavorable relative to the coverage group's historical fundamentals and/or valuation.

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