

### INITIATING COVERAGE

### CANARA BANK

**HOLD**

#### Share Data

Market Cap	Rs. 113.32 bn
Price	Rs. 276.35
BSE Sensex	15092.15
Reuters	CNBK.BO
Bloomberg	CBK IN
Avg. Volume (52 Week)	0.11 mn
52-Week High/Low	Rs. 314.85/ 171.30
Shares Outstanding	410.05 mn

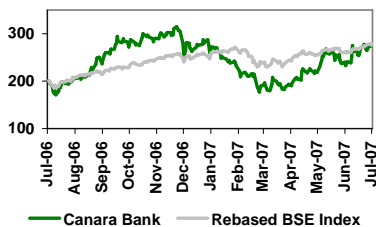
#### Valuation Ratios

Year to 31 March	2008E	2009E
EPS (Rs.)	36.7	37.2
+/- (%)	5.9%	1.4%
PER (x)	7.5x	7.4x
P/PPP (x)	3.6x	3.2x
P/BV (x)	1.2x	1.0x

#### Shareholding Pattern (%)

Promoters	73
FII's	17
Institutions	3
Public & Others	7

#### Relative Performance



#### Consistent performer

Canara Bank is one of the premier state owned banks in the country with 2,575 branches spread across 25 states in India. The bank has recently entered into the insurance and asset management business to strengthen its status in the financial market. Its wide network, diverse financial services and good asset quality enables the bank to encash the growth opportunities in the financial services sector. Implementation of core banking solution in terms of future profitability would be a key to its success. Other factors such as low CASA mix of 31.5% and high interest rate risk would limit its valuation upside.

#### Key Figures

Year to March	FY05	FY06	FY07	FY08E	FY09E	CAGR (%)
(Figures in Rs mn, except per share data) (FY07-09E)						
Net Interest Income	31,505	35,815	40,268	45,868	49,195	10.5%
Total Income	91,158	100,271	128,155	159,659	199,399	24.7%
Pre-Prov Operating Profit	25,853	25,499	29,125	31,864	35,055	9.7%
<b>Net Profit</b>	<b>11,095</b>	<b>13,432</b>	<b>14,208</b>	<b>15,046</b>	<b>15,261</b>	<b>3.6%</b>
Interest Exp / Interest Income (%)	58%	59%	65%	68%	73%	
Cost to Income Ratio (%)	45%	48%	47%	48%	48%	
<b>Per Share Data (Rs.)</b>						
EPS	27.1	32.8	34.7	36.7	37.2	
PER (x)	10.2x	8.4x	8.0x	7.5x	7.4x	
PPP per share	63.1	62.2	71.0	77.7	85.5	
Book value per share	146.1	171.2	197.8	234.5	271.8	

- Driven by a growing economy, we expect advances and deposits to grow at a CAGR of 19% and 26% respectively through FY07-09E.
- We believe net income will grow marginally at a CAGR of 3.6% for FY07-09E due to implementation of the Core Banking Solution which would result in higher operating expenses and low CASA ratio.
- At current price of Rs. 276, the stock trades at forward P/BV of 1.2x FY08E and 1.0x FY09E.
- We believe that the stock is fairly valued and initiate coverage on Canara Bank with a HOLD rating and a 12 month price target of Rs. 281 based on P/BV of 1.2x.

*Net NPA ratio halved to 0.94 through FY05-07*

## Rationale

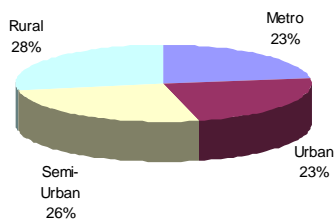
### *Asset quality on track*

Continuous focus on prudent credit management has facilitated progressive improvement in the Canara Bank's assets quality. Net Non-Performing Assets (NPAs) ratio came down 18 bps to 0.94% during FY07. In absolute terms, the bank's gross NPAs level declined over 16.5% to Rs. 14.9 bn during FY07 with gross NPA ratio declining 74 bps to 1.51%. The improvement in asset quality was driven by cash recoveries which increased 5.5% to Rs. 10.3 bn during the same period.

### *Wide network of branches and ATM*

The bank has a strong domestic presence with branches spread across India. During 2006-07, the bank added 29 new branches and upgraded 16 extension counters into branches taking the total branches in India to 2,575. The bank's ATM strength was augmented by 317 to 1,132 during FY07. With 28% of its branches in rural area the bank is poised to take advantage of the growth potential in the sector. Canara Bank has pact with SBI and National Financial Switch where in customers of Canara Bank will have increased access to over 14,000 ATMs across the country. With branch and ATM expansion, we anticipate that bank would have greater penetration resulting in increase of deposits.

### Branch Network



*Impressive CAR at 13.5%*

### *Capital adequacy ratio*

The bank has a sufficient capital adequacy ratio (CAR) of 13.5% against benchmark of 9%. Even a 100 to 150 basis point correction in CAR due to Basell II norms will leave the bank with enough capital to fund its future asset growth.

*Venturing into insurance and asset management business*

### *New Initiatives*

In order to capitalize its wide network and strong brand, Canara Bank is entering into emerging financial avenues such as insurance and asset management businesses. For insurance joint venture, it has signed a MoU with HSBC and Oriental bank of Commerce. It is partnering with Netherland based

Robeco Groep N.V (part of Rabo Bank group) for entering into the asset management business. With diversified financial set up, Canara Bank would be able to take advantage of the robust growth in the financial services sector and also be in a strong position to compete with its peers.

### Key Risks

#### *Low CASA ratio*

*Low cost deposits ratio decreased 180bps to 31.5% during FY06-07*

Despite Canara Bank's strong domestic presence, its CASA ratio has remained considerably low at 31.5% vis-a-vis other PSU banks like SBI and PNB. Banks with such a large branch network usually have a 45%-50% CASA ratio. The low CASA led the bank to resort to high cost wholesale deposits to meet its advances growth resulting in contraction of the NIM to 4.1% in FY07 vs. 4.5% in FY06. Going forward, NIM is expected to remain under pressure as the bank's cost of funds is expected to have an upward bias.

#### *Lagging on technology front*

*Slow implementation of CBS to hurt margins*

Canara bank has been slower than peers on the technology front. Out of total of 2,575 branches, it has approximately 13% branches with the Core Banking Solution. As significant branches are yet to be brought on CBS, current operating cost ratio is low and the same is likely to increase during FY08. Slow pace of technology up gradation has also resulted in lower growth in fee income. Any further delay in maturing core technology implementation would impact Canara Bank's financials and would be a risk to our ratings.

#### *High interest rate risk*

With 57% of investments under the Available for Sale (AFS) category, Canara Bank's investment portfolio is exposed to interest rate risk. Though the bank has increased Held to Maturity investments from 36.8% to 41%, it is on a lower side relative to its peers. In case of sharp rise in interest rates, the bank will have to provide for MTM losses on the AFS which would negatively impact margins.

## Outlook

Deepening financial services and government focus on rural areas offer Canara Bank the opportunity to grow fast. With fast changing banking scenario experienced during last couple of years, the bank has undertaken a brand building exercise to position itself as a strong customer oriented bank catering to all segments. The roll out of the core banking solution over the medium term should enable it to improve its cost competitiveness.

Pursuing the global expansion drive, Canara Bank has identified 21 prominent centres worldwide for starting its branches / offices. During FY07, the bank commissioned its second branch at Hong Kong which is expected to contribute considerably to its international business.

At current price of Rs. 276, the stock trades at forward P/BV of 1.2x FY08E and 1.0x FY09E. We believe that the stock is fairly valued and initiate coverage on Canara Bank with a HOLD rating and a 12 month price target of Rs. 281 based on P/BV of 1.2x.

## Company Background

Canara Bank, founded over 100 years ago with the name of Canara Bank Hindu Permanent Fund in Mangalore, India, is one of the oldest and major commercial banks of India. Its name was changed to Canara Bank Limited in 1910. As of March 31<sup>st</sup>, 2007, the bank has a network of 2,575 branches, spread over 25 States/4 Union Territories of India. The bank also has international presence in several centers, including London, Hong Kong, Moscow, Shanghai, Doha, and Dubai. The bank operates in two segments: banking operations and treasury operations. Banking operations consist of corporate banking, retail banking, personal and commercial banking, cash management services, forex operations, deposits and allied services. Treasury operations consist of dealing in statutory liquidity ratio (SLR) and non-SLR securities.

*Leading state owned bank*

## Disclaimer

This report is not for public distribution and is only for private circulation and use. The Report should not be reproduced or redistributed to any other person or person(s) in any form. No action is solicited on the basis of the contents of this report.

This material is for the general information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be considered as an offer to sell or the solicitation of an offer to buy any stock or derivative in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of Indiabulls Securities Limited. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. You are advised to independently evaluate the investments and strategies discussed herein and also seek the advice of your financial adviser.

Past performance is not a guide for future performance. The value of, and income from investments may vary because of changes in the macro and micro economic conditions. Past performance is not necessarily a guide to future performance.

This report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such. Any opinions expressed here in reflect judgments at this date and are subject to change without notice. Indiabulls Securities Limited (ISL) and any/all of its group companies or directors or employees reserves its right to suspend the publication of this Report and are not under any obligation to tell you when opinions or information in this report change. In addition, ISL has no obligation to continue to publish reports on all the stocks currently under its coverage or to notify you in the event it terminates its coverage. Neither Indiabulls Securities Limited nor any of its affiliates, associates, directors or employees shall in any way be responsible for any loss or damage that may arise to any person from any error in the information contained in this report.

The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject stock and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. No part of this material may be duplicated in any form and/or redistributed without Indiabulls Securities Limited prior written consent.

The information given herein should be treated as only factor, while making investment decision. The report does not provide individually tailor-made investment advice. Indiabulls Securities Limited recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. Indiabulls Securities Limited shall not be responsible for any transaction conducted based on the information given in this report, which is in violation of rules and regulations of National Stock Exchange or Bombay Stock Exchange.