

Company In-Depth

23 April 2007 | 7 pages

Canara Bank (CNBK.BO)

Upgrade to Buy; Large Bank, Attractive Valuation

 Rating change

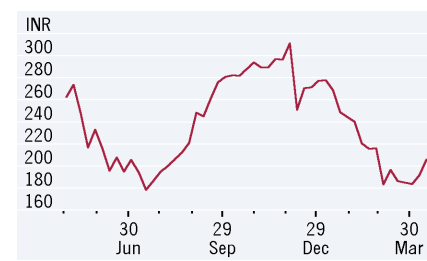
 Target price change

 Estimate change

- Upgrading to Buy post stock price correction** — We are upgrading Canara Bank (Canbank) to a Buy (1M) from a Hold (2M) as current valuations at 0.9x FY08E PBV offer strong returns to our target price of Rs295. Stock price has corrected 23% in last 3 months, underperformed Sensex by 20% and offers 48% upside potential.
- Higher rate environment a risk; but the business remains fine** — Higher interest rates could be a drag on growth, moderate margins, and threaten asset quality. We see a slower environment, but growth should remain above 20%, margins above 300bp, and we do not see significant enough risk on asset quality to risk capital or earnings.
- High growth, healthy margin bank** — Canbank has historically been an above-industry growth bank; but we would expect growth rates to moderate to industry levels. We also expect to see margin stability (sustained at around 300bp). While we could see some earnings instability on account of bond portfolio mark down and pension charges, we expect ROE of more than 16% this year.
- Stable asset quality, management confident on capital** — Canbank's asset quality has continued to improve and is now almost best in class, and management suggests little apparent strain. Management also suggests capital comfort, though we believe capital raising (Canbank is one of the few Government banks with the leeway to raise new capital) is a possibility given expected capital erosion on account of Basle 2 norms in March 2008.

Buy/Medium Risk	1M
<i>from Hold/Medium Risk</i>	
Price (20 Apr 07)	Rs204.35
Target price	Rs295.00
Expected share price return	44.4%
Expected dividend yield	3.2%
Expected total return	47.6%
Market Cap	Rs83,784M
	US\$2,014M

Price Performance (RIC: CNBK.BO, BB: CBK IN)



See Appendix A-1 for Analyst Certification and important disclosures.

Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	11,095	27.06	-17.1	7.6	1.4	19.5	2.7
2006A	13,432	32.76	21.1	6.2	1.2	20.3	3.2
2007E	12,403	30.25	-7.7	6.8	1.0	16.3	3.2
2008E	14,703	35.86	18.5	5.7	0.9	17.0	3.2
2009E	16,920	41.27	15.1	5.0	0.8	17.1	3.2

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	7.6	6.2	6.8	5.7	5.0
P/E reported (x)	7.6	6.2	6.8	5.7	5.0
P/BV (x)	1.4	1.2	1.0	0.9	0.8
P/Adjusted BV diluted (x)	1.4	1.2	1.1	0.9	0.8
Dividend yield (%)	2.7	3.2	3.2	3.2	3.2
Per Share Data (Rs)					
EPS adjusted	27.06	32.76	30.25	35.86	41.27
EPS reported	27.06	32.76	30.25	35.86	41.27
BVPS	149.00	173.96	196.68	225.01	258.75
Tangible BVPS	149.00	173.96	196.68	225.01	258.75
Adjusted BVPS diluted	146.15	171.19	193.92	222.25	255.99
DPS	5.50	6.60	6.60	6.60	6.60
Profit & Loss (RsM)					
Net interest income	31,505	35,815	40,956	48,393	55,730
Fees and commissions	4,109	4,308	4,825	4,922	5,020
Other operating Income	11,329	9,467	8,407	9,193	9,884
Total operating income	46,943	49,590	54,188	62,508	70,635
Total operating expenses	-21,090	-23,471	-26,281	-28,741	-31,432
Oper. profit bef. provisions	25,853	26,119	27,906	33,767	39,202
Bad debt provisions	-8,069	-6,352	-4,377	-9,135	-11,439
Non-operating/exceptionals	-4,989	-4,335	-7,210	-3,627	-3,592
Pre-tax profit	12,795	15,432	16,319	21,004	24,171
Tax	-1,700	-2,000	-3,917	-6,301	-7,251
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	11,095	13,432	12,403	14,703	16,920
Adjusted earnings	11,095	13,432	12,403	14,703	16,920
Growth Rates (%)					
EPS adjusted	-17.1	21.1	-7.7	18.5	15.1
Oper. profit bef. prov.	-8.0	1.0	6.8	21.0	16.1
Balance Sheet (RsM)					
Total assets	1,103,052	1,328,219	1,636,749	1,932,919	2,222,993
Avg interest earning assets	1,030,555	1,190,831	1,451,276	1,749,263	2,040,376
Customer loans	617,115	805,161	1,029,254	1,236,565	1,436,706
Gross NPLs	23,706	17,926	16,781	20,533	26,091
Liab. & shar. funds	1,103,052	1,328,219	1,636,749	1,932,919	2,222,993
Total customer deposits	967,959	1,168,032	1,456,165	1,728,420	1,993,960
Reserve for loan losses	12,901	10,904	9,006	12,268	16,521
Shareholders' equity	61,090	71,322	80,639	92,256	106,089
Profitability/Solvency Ratios (%)					
ROE adjusted	19.5	20.3	16.3	17.0	17.1
Net interest margin	3.06	3.01	2.82	2.77	2.73
Cost/income ratio	44.9	47.3	48.5	46.0	44.5
Cash cost/average assets	2.0	1.9	1.8	1.6	1.5
NPLs/customer loans	3.8	2.2	1.6	1.7	1.8
Reserve for loan losses/NPLs	54.4	60.8	53.7	59.7	63.3
Bad debt prov./avg. cust. loans	1.4	0.9	0.5	0.8	0.9
Loans/deposit ratio	63.8	68.9	70.7	71.5	72.1
Tier 1 capital ratio	7.3	7.6	5.8	5.6	5.7
Total capital ratio	12.9	11.4	10.0	9.5	9.0

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Canara Bank

Figure 1. Earnings revision Table

	Net Profit			EPS			DPS	
	Old	New	% change	Old	New	% change	Old	New
2007E	12,335	12,403	0.55%	30.09	30.25	0.55%	6.6	6.6
2008E	14,558	14,703	1.00%	35.51	35.86	1.00%	6.6	6.6
2009E	16,491	16,920	2.60%	40.22	41.27	2.60%	6.6	6.6

Source: Citigroup Investment Research estimates

Company description

Canara Bank (Canbank) was incorporated in 1910 and nationalized in the first round in 1969. The bank is headquartered in Bangalore, Karnataka. The government holds 73% of the bank's equity. Canara Bank is among the top-five banks in the country, with nearly 5% share in deposits and advances of the banking system. The bank has a large nationwide network of 2,400 branches.

Investment thesis

We rate Canbank Buy/Medium Risk (1M), with a target price of Rs295. It is one of India's larger government banks that has recorded strong and consistent growth over the past five years, with ROE in the 16-17% range. It has also maintained rapid loan growth, which has traditionally been above industry average. In addition, it is one of India's largest banks and, we believe, after SBI, is among the best positioned to participate in relatively large capex-related funding. Canbank's bond portfolio, in the current interest-rate environment, carries limited cushion. The bank also has a mixed record of asset quality; while its NPA levels have improved markedly and are among the best in the sector, its coverage levels remain modest. While the bank's asset quality concerns and higher interest-rate risk should see it trade at a discount to quality government banks, a more favorable loan growth outlook and interest environment could narrow the current large valuation gap.

Valuation

Our target price of Rs295 is based on CIR's EVA model, which in our view captures the long-term value of the business and is a standard valuation measure for our India banking universe. We factor in a risk-free rate of 8.0% in line with other banks in the sector and maintain an industry average margin. We are also benchmarking our target price on a 1.3x FY08E P/BV, which is in line with our valuations for peer banks. Our target multiple continues to be at discounts to the target multiples for the higher quality government banks such as SBI, PNB and Corporation Bank.

Risks

We rate Canara Bank Medium Risk due to its significantly improved asset quality and a relatively large size, as opposed to High Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Canbank remains a high-growth bank, though we believe that the risks are more muted with improvements in asset quality. Downside risks to our target

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price include: (1) deterioration in asset quality; (2) interest-rate volatility and depreciation in the bond portfolio; (3) trading losses in the bond portfolio or equity exposure that the bank might take in the current market environment; and (4) a marked slowdown in credit growth. Key upside risks to our target price include further improvement in asset quality and interest rates moving down.

Appendix A-1

Analyst Certification

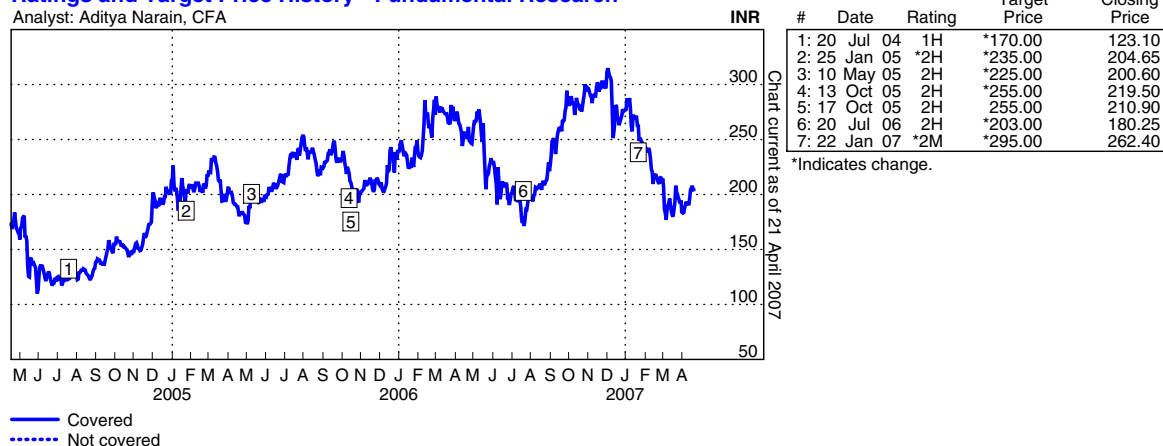
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Canara Bank (CNBK.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Aditya Narain, CFA



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