

**RESULTS REVIEW**
**Share Data**

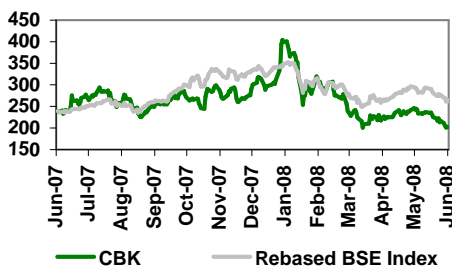
Market Cap	Rs. 83 bn
Price	Rs. 202.5
BSE Sensex	15,566.10
Reuters	CNBK.BO
Bloomberg	CBK IN
Avg. Volume (52 Week)	0.1 mn
52-Week High/Low	Rs. 421.45 / 198.05
Shares Outstanding	410 mn

**Valuation Ratios**

Year to 31 March	2009E	2010E
EPS (Rs.)	48.7	62.1
+/- (%)	27.7%	27.4%
PER (x)	4.2x	3.3x
P / PPP (x)	2.2x	1.6x
P / ABV (x)	0.8x	0.7x

**Shareholding Pattern (%)**

Promoter	73
FII's	14
Institutions	6
Public & Others	7

**Relative Performance**

**Canara Bank**
**Buy**
**Geared to deliver in future: Upgrade to Buy**

We upgrade our rating on Canara Bank from **Hold** to **Buy** on account of the following reasons:

- Net interest income and margins to gain momentum.** The Bank witnessed a decline in NII by 13% yoy, as high interest rates on preferential rate deposits increased the cost of funds, and aggregate advances growth was muted owing to a reduction in low-yield advances. However, we expect that this trend will change as the Bank has stepped forward to reduce the high-cost preferential deposits and low-yield loans. Thus, we expect an increase in yield and fall in cost of funds will lead to an improvement in the net interest margin (NIM).
- Accelerated growth in non-interest income will improve ROA.** Non-interest income increased 53% yoy in FY08 and we believe that this momentum will get a further boost with the planned launch of asset management business and the increased cross-selling of third party products through its wide branch network. Given that both these initiatives are light on assets, we believe that the Bank's return ratios would progressively look better.
- Improved asset quality: an added advantage.** The Bank's net NPA ratio fell 10bps yoy to 0.84%. The fall is a result of sound risk management policies and not higher provisioning as reflected in 20bps fall in the gross NPA ratio to 1.31%. Further, since the Bank does not have exposure to exotic derivatives, it has not evidenced any M-T-M losses unlike its counterparts.

**Key Figures (Standalone)**

Quarterly Data	Q4'07	Q3'08	Q4'08	YoY %	QoQ%	FY07	FY08	YoY %
(Figures in Rs mn, except per share data)								
Net Interest Income	10,593	9,344	9,225	(12.9)%	(1.3)%	40,268	35,378	(12.1)%
Net Operating Income	16,855	14,808	16,368	(2.9)%	10.5%	54,778	57,507	5.0%
Pre-Prov Operating Profit	10,521	7,578	9,392	(10.7)%	23.9%	29,125	29,594	1.6%
<b>Net Profit</b>	5,051	4,588	4,641	(8.1)%	1.1%	14,208	15,650	10.1%
Cost/Operating Income(%)	37.6%	48.8%	42.6%	-	-	46.8%	48.5%	-
NPA ratio	0.94%	0.89%	0.84%	-	-	0.94%	0.84%	-
<b>Per Share Data (Rs.)</b>								
PPP per share	25.7	18.5	22.9	(10.7)%	24.0%	71.0	72.2	1.6%
EPS	12.3	11.2	11.3	(8.1)%	1.2%	34.7	38.2	10.2%
ABVPS	197.8	224.7	202.3	2.3%	(9.9)%	197.8	202.3	2.3%

### Valuation

We have valued Canara Bank using the Gordon growth model. We have arrived at a target P/B of 1.3x by using a sustainable RoE of 15%, which gives a target price of Rs. 301. Hence, we upgrade our rating on the stock from **Hold to Buy**.

### Result Highlights

Interest costs (33% yoy) far exceeded the rise in interest income (18% yoy) and resulted in a 13% fall in the net interest income. A higher rate of interest on the preferential rate deposits increased the cost of funds. As the Bank is aggressively retiring these deposits, we expect the cost of funds to fall in the future. In the meanwhile, as the Bank is getting rid of low-yield loans, we expect it to lend more aggressively in FY09, thereby earning higher interest and income. As a result, the net interest income and net interest margin would pick up.

Non-interest income increased 14% yoy to Rs. 7.1 bn. On yearly basis, the growth was very impressive at 53%. As the Bank is venturing into insurance and asset management businesses, the growth in other income is believed to be sustained.

Operating expenses increased 10% yoy to Rs. 7 bn. The Bank's employee costs declined by 4%, owing to its virtually stagnant workforce. On the other hand, due to the addition of 100 more branches in FY08, other operating expenses increased 31% yoy. These expenses, coupled with a negative net interest income, resulted in 8% fall in net profit to Rs. 4.6 bn.

Deposits grew by 8% yoy to Rs. 1.5 tn. The modest increase was on account of the Bank's decision to reduce preferential rate deposits by 24% over the year which was impacting the bottom line through higher costs. After factoring in the reduction in these deposits, the aggregate growth in deposits turns out to be about 17%. In a similar fashion, the Bank's decision to reduce the low-yielding loans to rebalance the loan portfolio led the advances to grow by 9% yoy to Rs. 1.1 tn. The CASA ratio was virtually constant at 32.29%. Asset quality continued to improve as the net NPA ratio declined by 10 bps to 0.84%.

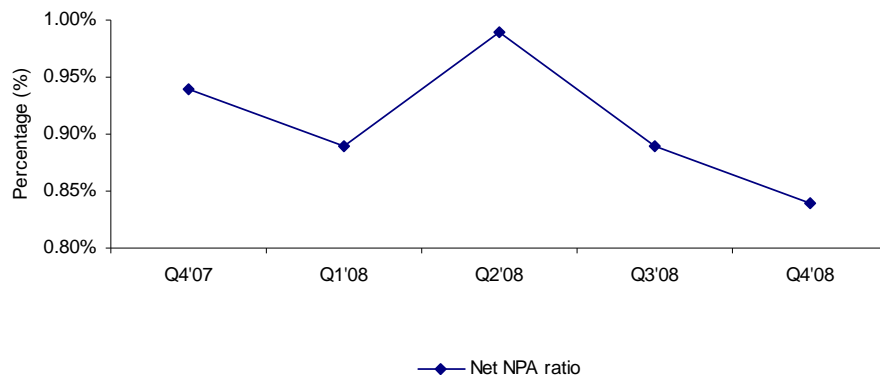
*NIM set to rise*

*Employee expenses contained*

*Balance sheet expected to grow faster in FY09*

### Net NPAs falling

*Improvement in asset quality*



Source: Company data, Indiabulls research

### Outlook

*New ventures to drive growth*

Despite the evidenced decline across certain key parameters like net interest income, we keep a positive outlook about the future prospects of the Bank. We expect net interest income and net interest margin to rise in the future. In addition, we believe that non-interest income will emerge as a key growth driver for the Bank as the new ventures of insurance and asset management will provide enough opportunities for the Bank to cross-sell those products and enhance the other income. A consistent improvement in asset quality with both gross and net NPAs declining, too smoothes the future growth of the Bank.

At the current price of Rs. 202.5, the stock trades at a forward P/ABV of 0.8x FY09E and 0.7x FY10E. We believe that the stock is undervalued and upgrade our rating from **Hold** to **Buy** on the stock with a target price of Rs. 301 for FY09.

Income Statement					Key Ratios				
(Rs mn, Yr. ending March 31)	FY07	FY08E	FY09E	FY10E		FY07	FY08E	FY09E	FY10E
Interest Income	113,646	142,007	139,814	158,373	<b>Per share data (Rs.)</b>				
Interest Expense	73,377	106,629	101,132	113,736	Shares outstanding (mn)	410.0	410.0	410.0	410.0
<b>Net Interest Income</b>	<b>40,268</b>	<b>35,378</b>	<b>38,683</b>	<b>44,638</b>	Basic EPS	34.7	38.2	48.7	62.1
YoY Growth (%)	12.4%	-12.1%	9.3%	15.4%	Diluted EPS	34.7	38.2	48.7	62.1
Other Income	14,509	22,129	32,087	48,130	Book value per share	252.5	282.7	321.0	370.0
<b>Net Operating Income</b>	<b>54,778</b>	<b>57,507</b>	<b>70,770</b>	<b>92,768</b>	Adj. book value per share	197.8	202.3	240.6	289.6
YoY Growth (%)	11.9%	5.0%	23.1%	31.1%	<b>Valuation ratios (x)</b>				
Operating Expense	25,653	27,913	33,262	41,745	P/PPP	2.8x	2.8x	2.2x	1.6x
<b>Pre-Provisioning Profit</b>	<b>29,125</b>	<b>29,594</b>	<b>37,508</b>	<b>51,022</b>	P/E	5.8x	5.3x	4.1x	3.2x
Provisions and Contingencies	12,417	10,544	12,532	19,199	P/B	0.8x	0.7x	0.6x	0.5x
<b>Profit Before Tax</b>	<b>16,708</b>	<b>19,050</b>	<b>24,976</b>	<b>31,823</b>	P/ABV	1.0x	1.0x	0.8x	0.7x
Tax	2,500	3,400	4,995	6,365	<b>Performance ratio (%)</b>				
<b>Net Profit</b>	<b>14,208</b>	<b>15,650</b>	<b>19,980</b>	<b>25,458</b>	Return on avg. assets	1.0%	0.9%	1.0%	1.2%
YoY Growth (%)	5.8%	10.1%	27.7%	27.4%	Return on avg. net worth	16.3%	14.3%	16.1%	18.0%
<b>Balance Sheet</b>					<b>Balance Sheet ratios (%)</b>				
(Rs mn, as on March 31)	FY07	FY08E	FY09E	FY10E	Advances to deposits	69.2%	69.6%	69.6%	71.5%
Cash and balances with RBI	163,739	196,366	239,707	300,672	Borrowings to advances	13.4%	15.3%	14.3%	15.9%
Investments	452,255	493,778	531,009	565,481	Investments to assets	27.3%	27.1%	26.0%	24.3%
YoY Growth (%)	22.3%	9.2%	7.5%	6.5%	Investments to deposits	31.8%	32.0%	30.5%	29.0%
Advances	985,057	1,072,380	1,211,789	1,393,558	Net Worth to assets	6.2%	6.4%	6.4%	6.5%
YoY Growth (%)	24.0%	8.9%	13.0%	15.0%	<b>Productivity ratio (Rs. mn)</b>				
Fixed Assets (Net)	28,614	28,720	28,864	28,913	Opt. expense per employee	0.6	0.6	0.7	0.9
Other Assets	29,945	29,721	34,820	35,099	Net profit per employee	0.3	0.3	0.4	0.6
<b>Total Assets</b>	<b>1,659,610</b>	<b>1,820,965</b>	<b>2,046,189</b>	<b>2,323,723</b>	Asset per employee	35.8	39.7	44.6	50.7
Deposits	1,423,815	1,540,720	1,741,014	1,949,935	<b>Operating ratios (%)</b>				
YoY Growth (%)	21.9%	8.2%	13.0%	12.0%	Operating cost to avg. assets	1.7%	1.6%	1.7%	1.9%
Non-deposit liabilities	132,256	164,335	173,581	222,081					
YoY Growth (%)	48.8%	24.3%	5.6%	27.9%					
<b>Total Liabilities</b>	<b>1,556,071</b>	<b>1,705,055</b>	<b>1,914,595</b>	<b>2,172,016</b>					
Share Capital	4,100	4,100	4,100	4,100					
Reserves & Surplus	99,440	111,810	127,495	147,607					
<b>Total Equity &amp; Liabilities</b>	<b>1,659,610</b>	<b>1,820,965</b>	<b>2,046,189</b>	<b>2,323,723</b>					

Source: Bank data, Indiabulls research

Note: Some ratios are as per Indiabulls definitions and may not match figures declared by the Bank

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