

# Canara Bank

**BUY**  
Maintained

**Rs430**

## Core performance healthy

Reason for report: Q4FY10 results review & earnings revision

Canara Bank's net profit of Rs5.03bn (much lower than estimated) was largely due to Rs7.3bn provisions in Q4FY10. Operating numbers were strong with core operating profit (ex treasury) up 43% YoY, driven by 22.4% growth in NII, 19.8% rise in other income (ex trading gains) and stable costs. Key highlight was sharp increase in provisions led by slippages and ~Rs3bn write-offs. While reported RoE is likely to be +22% through FY10-12E, we believe that sustainable RoE is likely to be 16-17% (adjusting for trading gains and normalised tax rates). We believe that the stock could trade at 1.3x FY12E ABV, translating into our revised target price of Rs523/share. Continued high slippages remains a key risk.

- ▶ **Healthy advances growth; margins improve.** Credit growth at 22.5% YoY was healthy, with corporate & MSME advances being key drivers. Though deposits rose 25.9% YoY, CASA ratio saw marginal increase QoQ to 29.1%. However, bulk deposits have been consistently pared-down to negligible levels. This has led to a steady QoQ improvement in NIMs over the past two quarters to 2.8% in Q4FY10. We expect margins to sustain at ~2.8% by FY12E.
- ▶ **Other income (ex treasury) healthy; costs sustain.** Growth in other income (ex treasury) was healthy at 19.8% YoY; however, overall other income was subdued YoY due to sedate trading profits of Rs114mn in Q4FY10 (Rs3.5bn in Q4FY09). Operating expenses were flat YoY as staff costs declined 6.1% YoY. Cost-to-income fell to 38% in Q4FY10 (from 40.9% in Q4FY09). We expect cost-to-income to stabilise at ~40% through to FY12E.
- ▶ **Slippages high; provisions increase on NPAs, write-offs.** Gross slippages were high in the quarter at Rs13.45bn (Rs7.68bn net of recoveries), largely emanating from personal loans and trade finance. Provisions increased 106% YoY due to slippages as well as technical write-offs of ~Rs3bn in Q4FY10 (Rs9bn on FY10 and Rs52bn cumulative). Restructured assets stood at Rs75.7bn (4.4% of gross advances) with Rs5.1bn total slippages.
- ▶ **Operating numbers strong; valuations inexpensive.** Operating numbers for Q4FY10 were strong, with core operating profit growth of 43% in the quarter, though asset quality faltered. We marginally raise earnings to reflect higher growth, flat margins at ~2.8% (I-Sec) and higher loan loss provisions through FY10-12E. We expect sustainable RoE of 16-17% and believe that the stock could trade at 1.3x FY12E ABV, translating into target price of Rs523/share. BUY.

## Banking

Target Price Rs523

### Earnings revision

(%)	FY10E	FY11E
Sales	↑ 0.4	↑ 2.1
EBITDA	↓ 1.1	0.0
EPS	↑ 0.6	↑ 3.3

### Target price revision

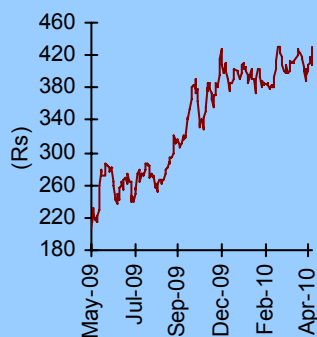
Rs523 from Rs426

### Shareholding pattern

	Sep '09	Dec '09	Mar '10
Promoters	73.2	73.2	73.2
Institutional investors	20.5	21.2	21.3
MFs and UTI	3.0	2.1	2.2
Insurance Cos.	7.1	7.6	7.6
FIs	10.4	11.5	11.5
Others	6.3	5.7	5.5

Source: BSE

### Price chart



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Market Cap	Rs176.2bn/US\$4.0bn
Reuters/Bloomberg	CNBK.BO/CBK IN
Shares Outstanding (mn)	410.0
52-week Range (Rs)	431/208
Free Float (%)	26.8
FII (%)	11.5
Daily Volume (US\$/'000)	6,420
Absolute Return 3m (%)	6.2
Absolute Return 12m (%)	106.8
Sensex Return 3m (%)	7.4
Sensex Return 12m (%)	44.7

Year to March	2009	2010E	2011E	2012E
NII (Rs bn)	47.2	56.8	69.4	83.8
Net Income (Rs bn)	20.7	30.2	32.8	38.1
EPS (Rs)	50.5	73.7	80.1	92.9
% Chg YoY	32.4	45.8	8.7	15.9
P/E (x)	8.5	5.8	5.4	4.6
P/BV (x)	1.8	1.4	1.2	1.0
Net NPA (%)	1.1	1.1	1.0	0.8
Dividend Yield (%)	1.9	2.3	3.0	3.5
RoA (%)	1.0	1.3	1.1	1.1
RoE (%)	22.6	26.8	23.6	22.5

**Table 1: Q4FY10 results review***(Rs mn, year ending March 31)*

	Q4FY10	Q4FY09	% YoY	Q3FY10	% QoQ	YTD FY10	YTD FY09	% YoY
Interest income	47,966	46,539	3.1	46,878	2.3	187,520	171,191	9.5
Interest expenses	31,990	33,486	(4.5)	32,100	(0.3)	130,714	124,012	5.4
<b>NII</b>	<b>15,976</b>	<b>13,053</b>	<b>22.4</b>	<b>14,778</b>	<b>8.1</b>	<b>56,805</b>	<b>47,178</b>	<b>20.4</b>
Non-interest income	7,101	8,465	(16.1)	7,813	(9.1)	28,579	23,112	23.7
Total income	23,077	21,518	7.2	22,591	2.2	85,384	70,290	21.5
Staff cost	4,981	5,303	(6.1)	4,754	4.8	21,937	18,772	16.9
Other op expenses	3,792	3,489	8.7	3,137	20.9	12,838	11,881	8.1
Total op expenses	8,772	8,792	(0.2)	7,891	11.2	34,775	30,653	13.5
<b>Pre-provisioning profit</b>	<b>14,305</b>	<b>12,726</b>	<b>12.4</b>	<b>14,700</b>	<b>(2.7)</b>	<b>50,609</b>	<b>39,638</b>	<b>27.7</b>
Other provisions and contingencies, (Net)	7,274	3,538	105.6	1,674	334.5	12,394	13,914	(10.9)
PBT	7,031	9,188	(23.5)	13,026	(46.0)	38,215	25,724	48.6
Provisions for taxes	2,000	2,000	-	2,500	(20.0)	8,000	5,000	60.0
<b>PAT</b>	<b>5,031</b>	<b>7,188</b>	<b>(30.0)</b>	<b>10,526</b>	<b>(52.2)</b>	<b>30,215</b>	<b>20,724</b>	<b>45.8</b>
NIMs (%)	2.8	2.8		2.7		2.8	2.8	
CASA (%)	29.1	30.7		28.7		29.1	30.7	
CAR (%)	13.4	14.1		14.4		13.4	14.1	
Tier 1 (%)	8.5	8.0		9.2		8.5	8.0	
GNPAs (Rs mn)	25,903	21,680		26,189		25,903	21,680	
NNPAs (Rs mn)	17,997	15,073		19,762		17,997	15,073	
GNPAs (%)	1.5	1.6		1.8		1.5	1.6	
NNPAs (%)	1.1	1.1		1.3		1.1	1.1	
Provision coverage (%)	30.5	30.5		24.5		30.5	30.5	

Source: Company data, I-Sec Research

**Healthy advances growth; margins improve**

Credit growth at 22.5% YoY was healthy, with corporate & MSME advances being key drivers. Infrastructure advances increased 89% YoY and MSME credit picked up 30% YoY. Though deposits rose 25.9% YoY, CASA ratio increased marginally QoQ to 29.1%. However, bulk deposits have been consistently pared down to negligible levels contributing to 75bps YoY reduction in cost of deposits to 6.12% for FY10 (6.87% in FY09). This has led to a steady QoQ improvement in NIMs over the past two quarters to 2.8% in Q4FY10. We expect margins to sustain at ~2.8% by FY12E.

**Table 2: Infrastructure, SME key drivers; corporate credit declines***(Rs mn)*

	FY09	FY10	% YoY
Retail advances	197,980	239,020	20.7
Priority Sector	487,630	593,100	21.6
<i>Agriculture</i>	<i>201,440</i>	<i>250,520</i>	<i>24.4</i>
SSI/SME	238,230	310,740	30.4
Corporate Advances	458,350	550,490	20.1
<b>Total</b>	<b>1,382,190</b>	<b>1,693,350</b>	<b>22.5</b>
Industrial Advances	521,420	875,040	67.8
Infrastructure Advances	173,130	327,410	89.1

Source: Company data, I-Sec Research

**Table 3: Composition of retail advances**

(Rs mn)	FY10	% Composition
Retail advances	239,020	
Housing	101,160	42
Trade Finance	53,830	23
Personal loans	54,550	23
Education loans	29,480	12

Source: Company data, I-Sec Research

**Table 4: Advances and deposits growth healthy**

(Rs mn)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
Deposits	1,748,390	1,868,930	1,936,570	2,042,840	2,088,990	2,346,510
Deposits growth (%)	21.7	21.3	23.9	19.1	19.5	25.6
Advances	1,289,200	1,382,190	1,406,680	1,464,560	1,474,110	1,693,350
Advances growth (%)	30.4	28.9	28.1	22.7	14.3	22.5

Source: Company data, I-Sec Research

**Table 5: Margins expand QoQ due to deposits re-pricing**

(%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
NIM	2.75	2.78	2.70	2.66	2.71	2.80
Cost of Deposits	6.81	6.87	6.48	6.47	6.25	6.12
Yield on advances	10.69	10.79	10.05	10.02	10.01	9.81

Source: Company data, I-Sec Research

**Other income (ex treasury) healthy; costs sustain**

Growth in other income (ex-treasury) was healthy at 19.8% YoY; however, overall other income was subdued YoY due to sedate trading profits of Rs114mn in Q4FY10 (Rs3.5bn in Q4FY09). Operating expenses were flat YoY and staff costs declined 6.1% YoY as the bank continued to induct new employees at the entry level (lower pay scale) to replace older retirees (higher pay scales). Other operating expenses rose 8.7% YoY with opening of 41 branches in Q4FY10, supplemented by expenses on upgrading branches to CBS. Cost-to-income fell to 38% in Q4FY10 (from 40.9% in Q4FY09). We expect cost-to-income to stabilise at 40% through to FY12E.

**Table 6: Forex, recoveries strong; trading gains a drag on overall numbers**

(Rs mn)	Q4FY09	Q4FY10	% YoY
Commission, Exchange and Brokerage	1,630	2,130	31
Profit on exchange transactions	140	440	214
Profit on sale of investments	3,490	1,140	(67)
Dividends	110	320	191
Recoveries in w/o a/cs	990	1,490	51
Miscellaneous Income	2,100	1,580	(25)
<b>Total</b>	<b>8,460</b>	<b>7,100</b>	<b>(16)</b>

Source: Company data, I-Sec Research

**Slippages high; provisions increase on NPAs, write-offs**

Gross slippages were high during the quarter at Rs13.45bn. However, of these, the bank recovered Rs5.77bn and therefore reported net slippages of Rs7.68bn. Retail slippages were high at Rs3.71bn, with legacy personal loans and trade finance being major contributors. The bank recorded technical write-offs of ~Rs3bn in Q4FY10 (Rs9bn on FY10 and Rs52bn cumulative). However, management indicated that high write-offs are typically for tax benefits and that strong recoveries continue from these accounts. As a result of these fully-provided technical write-offs as well as the high level of slippages in the quarter, provisions increased 106% YoY.

Outstanding restructured assets stood at Rs75.7bn in March '10, with ~Rs63bn (3.7% of gross advances) under RBI special dispensation mechanism. Of these, Rs5.1bn slipped into NPAs, which comprise slippages from agriculture (Rs2.1bn), personal loans (Rs1.1bn) and others. Agriculture-related restructured assets of Rs5.65bn stand largely resolved. Management indicated that ~75% of its GNPA's are sub-standard with higher prospects of recovery. Nevertheless, we marginally increase our loan loss provisions to 70bps and 65bps for FY11E and FY12E.

**Table 7: Sectoral break-up of restructured advances as on March '10**

<i>(Rs mn)</i>	
Overall slippages	13,450
Reported slippages (net of recovery)	7,680
Medium industries	100
Large corporates	450
Retail slippages	3,710
Housing	850
Auto	100
CanBudget	120
Personal loans	1,110
Education loans	330
Trade finance	1,060
Miscellaneous	140

Source: Company data, I-Sec Research

**Table 8: Movement in NPLs – Significantly high slippages in FY10**

<i>(Rs mn)</i>	FY09	FY10
<b>Opening balance</b>	<b>14,156</b>	<b>21,680</b>
Add : Slippages	16,000	32,660
Less : Recoveries	5,000	10,820
Upgradations	1,600	8,660
Write-offs	6,500	8,800
<b>Closing Balance</b>	<b>21,680</b>	<b>25,903</b>

Source: Company data, I-Sec Research

**Table 9: Provisions for Q4 increase sharply on slippages, write-offs**

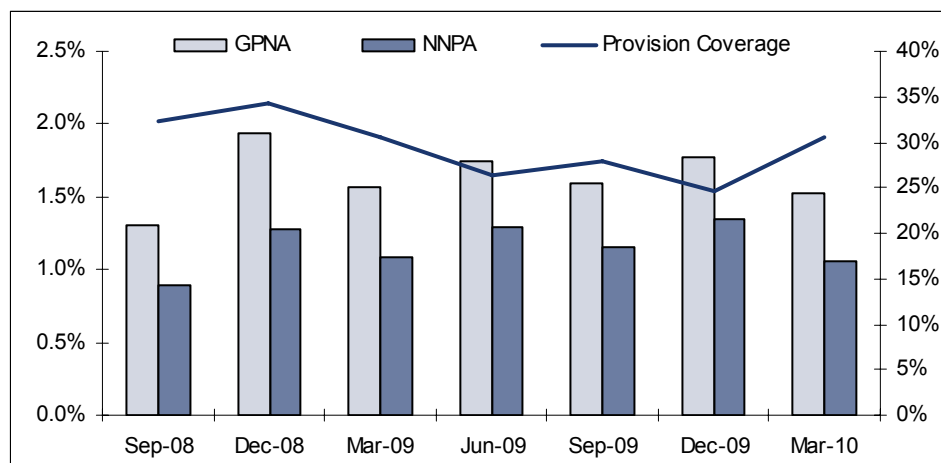
<i>(Rs mn)</i>	Q4FY09	Q4FY10	% YoY	FY09	FY10	% YoY
NPA	2,500	5,780	131	9,000	14,044	56
Standard Assets	840.0	1,430.0	70	840	1,640	95
Depreciation on Investment	200.0	60.0	(70)	4,076	(3,290)	-
<b>Total</b>	<b>3,540</b>	<b>7,270</b>	<b>105.6</b>	<b>13,916</b>	<b>12,394</b>	<b>(11)</b>

Source: Company data, I-Sec Research

**Table 10: Investment book as on March '10**

	% of total	Modified duration (yrs)
AFS	21.1	1.93
HTM	78.9	5.65
Total (Rs bn)	691.1	4.97

Source: Company data, I-Sec Research

**Chart 1: Asset quality improves sequentially; provisions rise**

Source: Company data, I-Sec Research

**Operating numbers strong; valuations inexpensive – BUY**

Operating numbers for Q4FY10 were strong, with core operating profit growth at 43% in the quarter, though asset quality faltered. We increase our credit growth assumptions for Canara Bank and currently estimate loan CAGR of 22% through FY10-12E. We believe that the bank is adequately capitalised for the medium term, given its CAR at 13.43% (tier I of 8.54%). The bank has headroom to raise Rs7bn for Innovative Perpetual Debt Instruments and Rs29.85bn in tier II. We marginally raise earnings to reflect higher growth, flat margins at (I-Sec) ~2.8% through FY10-12E and loan loss assumptions at 70bps and 65bps for FY11E and FY12E respectively. We have assumed tax rates at 25% and 29% for FY11 and FY12 respectively (FY10 tax rate at 21%). While reported RoE are likely to be +22% through to FY12, we believe that sustainable RoE is likely to be 16-17% (adjusting for trading gains and normalised tax rates). We believe that the stock could trade at 1.3x FY12E ABV translating into revised target price of Rs523/share. Continued high slippages remains a key risk.

**Table 11: Earnings revision**

(Rs bn)

	FY11E			FY12E		
	New	Old	% chg	New	Old	% chg
NII	69.4	69.1	0.4	83.8	82.1	2.1
PPP	59.4	60.0	(1.1)	71.0	71.0	(0.0)
Net profit	32.8	32.7	0.6	38.1	36.9	3.3

Source: Company data, I-Sec Research

## Financial Summary

Table 12: Profit and Loss statement

(Rs bn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Interest earned	171.2	187.5	247.1	306.3
Interest expended	124.0	130.7	177.7	222.4
<b>Net interest income</b>	<b>47.2</b>	<b>56.8</b>	<b>69.4</b>	<b>83.8</b>
Other income	23.1	28.6	29.7	33.3
Trading gains	6.7	8.7	6.0	5.8
Fee income	6.4	7.2	8.7	10.1
Operating expenses	30.7	34.8	39.8	46.1
Employee costs	18.8	21.9	25.0	29.0
<b>Pre-provisioning profit</b>	<b>39.6</b>	<b>50.6</b>	<b>59.4</b>	<b>71.0</b>
Loan and investment loss provisions	13.9	12.4	15.6	17.4
Profit before tax	25.7	38.2	43.8	53.6
Income taxes	5.0	8.0	10.9	15.6
<b>Net profit</b>	<b>20.7</b>	<b>30.2</b>	<b>32.8</b>	<b>38.1</b>

Source: Company data, I-Sec Research

Table 13: Balance sheet

(Rs bn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
Share Capital	4.1	4.1	4.1	4.1
Reserves and surplus	96.3	121.3	148.9	180.9
Deposits	1,868.9	2,346.5	2,862.7	3,463.9
Borrowings	70.6	26.2	26.7	27.2
Other liabilities and provisions	134.9	149.1	188.7	206.9
<b>Total liabilities &amp; stockholders' equity</b>	<b>2,174.8</b>	<b>2,647.2</b>	<b>3,231.1</b>	<b>3,882.9</b>
Cash and balances with RBI	166.6	208.6	223.6	238.6
Investments	577.8	692.6	868.3	1,063.6
Advances	1,382.2	1,693.4	2,082.8	2,520.2
Fixed Assets, net	7.6	20.1	20.6	21.1
Other Assets	40.6	32.5	35.7	39.3
<b>Total assets</b>	<b>2,174.8</b>	<b>2,647.2</b>	<b>3,231.1</b>	<b>3,882.9</b>

Source: Company data, I-Sec Research

Table 14: Key ratios

(Year ending March 31)

	FY09	FY10E	FY11E	FY12E
<b>Per-share data (Rs)</b>				
Period-end shares outstanding (mn)	410.0	410.0	410.0	410.0
Basic EPS	50.5	73.7	80.1	92.9
Diluted EPS	50.5	73.7	80.1	92.9
Book value per share	244.9	305.8	373.1	451.1
Adjusted book value per share	208.1	261.9	322.3	401.9
<b>Growth ratios (%)</b>				
Total assets	22.0	21.7	22.1	20.2
Advances	28.9	22.5	23.0	21.0
Deposits	21.3	25.6	22.0	21.0
Book value	21.0	24.9	22.0	20.9
EPS	32.4	45.8	8.7	15.9
<b>Valuation ratios (x)</b>				
P/PPP (pre-provisioning profit)	4.4	3.5	3.0	2.5
P/E	8.5	5.8	5.4	4.6
P/BV	1.8	1.4	1.2	1.0
P/ABV	2.1	1.6	1.3	1.1
Dividend yield (%)	1.9	2.3	3.0	3.5

**Operating ratios (%)**

Operating cost to income	43.6	40.7	40.1	39.4
Operating expenses/ Avg. assets	1.5	1.4	1.4	1.3

**Profitability ratios (%)**

Spread	1.8	1.9	1.8	1.8
Net interest margin	2.8	2.8	2.8	2.8
Return on avg. assets	1.0	1.3	1.1	1.1
Return on avg net worth	22.6	26.8	23.6	22.5

**Asset quality and capital (%)**

Gross NPA	1.6	1.5	1.6	1.6
Net NPA	1.1	1.1	1.0	0.8
Total CAR	13.4	13.4	11.6	10.6

Source: Company data, I-Sec Research

Table 15: Quarterly trend

(Rs bn, year ending March 31)

	Jun-09	Sep-09	Dec-09	Mar-10
Net interest income	12.91	13.14	14.78	15.98
% growth (YoY)	26.7	14.3	18.8	22.4
Other income	4.74	8.93	7.81	7.10
Pre-provision profit	10.41	14.19	14.70	14.30
Net profit	5.55	9.11	10.53	5.03
% growth (YoY)	352.7	72.0	50.0	(30.0)

Source: Company data, I-Sec Research

*I-Sec investment ratings (all ratings relative to Sensex over next 12 months)*

**BUY:** +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

## ANALYST CERTIFICATION

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