

NOVEMBER 15, 2011

BUY

MEDIUM RISK

PRICE Rs.456

TARGET Rs.650

BFSI

EARLIER RECO

ACCUMULATE

Price	Rs.731
Target	Rs.830
Date	Oct 22, 2010

SHARE HOLDING (%)

Govt.	67.7
FII	14.6
FI	10.9
Body Corporates	1.8
Public & Others	5.0

STOCK DATA

Reuters Code	CNBK.BO	
Bloomberg Code	CBK.IN	
BSE Code	532483	
NSE Symbol	CANBK	
Market Capitalization*	Rs.202.0 bn US\$ 4.0 bn	
Shares Outstanding*	443 mn	
52 Weeks (H/L)	Rs.839 / 401	
Avg. Daily Volume (6m)	58,845 Shares	
Price Performance (%)		
1M	3M	6M
2	1	(21)
200 Days EMA: Rs.508		

*On fully diluted equity shares

Part of  Bonanza



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Canara Bank has posted a 15% YoY decline in net profit in Q2FY12, mainly dragged by lower NII & higher NPA provisions. NII declined by 2% YoY while core fee income saw a decent growth of 17% YoY.

Key Highlights of Q2FY12

- During Q2FY12, NII declined marginally by 2% YoY and stood at Rs.19.61 bn. Its NIMs fell by 64 bps YoY due to interest income reversal of Rs.1.2 bn (Interest income on Agri loan reversed on migration to system based NPA recognition norms) and higher cost of retail as well as bulk deposits. The Bank saw a decent growth of 24% YoY in its Advances & 25% YoY growth in Deposits. Its term deposits grew by 34% YoY while CASA grew by 12% YoY. CASA's share in total deposits declined by 305 bps YoY but was stable sequentially, now forming 25.8% of its total deposits.
- The Bank's non interest income saw a robust growth of 66% YoY on higher treasury income (Rs.1490 mn in Q2FY12 as against Rs.15.8 mn in Q2FY11) while recoveries from written off accounts saw a strong growth of 108% YoY.
- Its operating expenses were largely contained with marginal increase of 9% YoY, mainly due to slower growth in employee expenses (5% YoY increase). As a result of a fall in its NII, its Cost to Income ratio stood at 44.9% in Q2FY12 as compared to 43.5% in Q2FY11. Its operating profit grew by 13% YoY and stood at Rs.16.1 bn.
- The Bank's total provisions in Q2FY12 increased by 250% YoY to Rs.5.53 bn, largely on account of higher provisions on investment depreciation (Rs.4.7 bn in Q2FY12 as against Rs.2.1 bn in Q2FY11) and higher provision on fresh bad loans, as a result of which the Bank's net profit saw a de-growth of 15% and stood at Rs.8.52 bn for Q2FY12.
- The Bank has opened 180 branches & 407 ATMs in H1FY12, taking its reach to 3437 branches & 2623 ATMS. It plans to open more than 300 branches and increase ATMs strength to 3000 in FY12.

NIMs fall YoY, but improves QoQ after a steep fall in Q1FY12

- In Q2FY12, its NIMs fell by 64 bps YoY due to interest income reversal of Rs.1.2 bn & higher cost of retail as well as bulk deposits and stood at 2.64%. However, it improved by 22 bps QoQ due to efficient re-pricing of its advances during the quarter. Although the Bank has targeted a NIM of 2.8% for FY12, given its sharply lower H1 figures, we estimate it to remain at Q2FY12 level (2.64%).

Asset quality declines on complete migration to system based recognition of NPAs

- The Bank witnessed high fresh slippages of Rs.12.36 bn (+2% annualized) with Rs.6.2 bn being contributed on account of migration of "Rs.0.2 mn & below" ticket size loans to system based NPA recognition. However, robust recoveries of Rs.8.1 bn helped contain Gross NPAs in Q2FY12. Fresh slippages were mainly contributed from MSME and non-priority segments.
- In absolute terms, Gross NPLs increased by 44% YoY & 5% QoQ to Rs.37.9 bn and Net NPLs increased by 68% YoY & 9% QoQ to Rs.31.2 bn. In percentage terms, Gross NPA's stood at 1.73% i.e. an increase of 24 bps YoY & 6 bps QoQ, while Net NPLs stood at 1.43% i.e. an increase of 37 bps YoY & 9 bps QoQ in Q2FY12. The Bank has now completely migrated to 100% system based NPA recognition, hence negative surprises from this count may not be expected going forward.
- The Bank's restructured loan portfolio stood at 3.9% of advances. Its provision coverage ratio stood at 67% (incl. technical write-offs) and CAR stood at a healthy 12.8%, with a Tier-I ratio of 9.15%.

OUTLOOK & VALUATION

Canara Bank, in the last 5 years, has grown its business at a CAGR of 17% & APAT at a CAGR of 21% with high ROE of +20% and sound asset quality. However, in light of challenging credit offtake conditions & increasing cost of funds, there has been a sharp slide in its NIMs during H1FY12 along with higher slippages (especially impacted by migration to 100% system based NPA recognition) & high investments provision (due to increased bond yields). Considering these factors and outlook for H2FY12, we have reduced our business & NII growth estimates for FY12 & FY13. We now expect its Advance & Deposit to grow by 17.4% & 16.9% in FY12E and 17.1% & 16.2% in FY13E, while its Net Profit to shrink by 17% in FY12E but grow by 26% in FY13E. The Bank currently trades at an attractive valuation of 0.9x FY13E ABV & 4.9x FY13E Earnings. We believe the stock can trade at 1.3x P/ABV given its wide branch network, strong deposit franchise, decent asset quality & sustainable +18% ROE. We change our rating to "BUY" with a reduced price target of Rs.650.

KEY FINANCIALS

Y/E	EPS (Rs.)	EPS (% chg)	RoE (%)	NIM (%)	Net NPL(%)	CASA (%)	CAR (%)	P/ABV (x)	PER (x)	Div. Yield(%)
Mar.										
FY10	71.4	47.4	25.7	2.8	1.1	29.0	13.4	1.7	6.4	2.0
FY11	89.2	24.9	25.9	3.1	1.1	28.3	15.4	1.3	5.1	2.0
FY12E	73.8	(17.3)	17.0	2.6	0.9	27.6	14.7	1.1	6.2	2.2
FY13E	93.2	26.4	18.3	2.7	0.9	27.4	14.0	0.9	4.9	2.4

QUARTERLY RESULTS STATEMENT

(In mn)

Y/E March	Q2FY12	Q2FY11	YoY Chg	Q1FY12	QoQ Chg
Interest earned	76,145	55,774	36.5%	71,808	6.0%
- on Advances / Bills	58,256	41,096	41.8%	54,828	6.3%
- Income on investments	17,300	14,165	22.1%	16,334	5.9%
- on bal with RBI and other banks	588	513	14.7%	644	-8.8%
- others	1	1	-10.0%	1	-10.0%
Interest Expended	56,528	35,741	58.2%	53,877	4.9%
Net Interest Income	19,617	20,033	-2.1%	17,931	9.4%
Other income	8,283	4,996	65.8%	5,268	57.2%
- Treasury Income	1,490	16	9330.4%	(770)	-293.6%
Operating income	27,900	25,029	11.5%	23,199	20.3%
- Employee expenses	7,670	7,274	5.4%	6,677	14.9%
- Other Operating expenses	4,177	3,597	16.1%	3,818	9.4%
Total Operating Expenses	11,846	10,872	9.0%	10,495	12.9%
Operating profit	16,053	14,157	13.4%	12,704	26.4%
Provisions and contingencies	5,531	1,579	250.3%	3,446	60.5%
- NPL Provisions	4,768	2,067	130.7%	2,850	67.3%
- Investment Provisions	664	(426)	55.9%	96	594.8%
PBT	10,522	12,578	-16.3%	9,259	13.6%
Provision for Tax	2,000	2,500	-20.0%	2,000	0.0%
PAT	8,522	10,078	-15.4%	7,259	17.4%
EPS	19	25	-21.7%	16	17.4%
PPP (Ex-Treasury)	14,563	14,142	3.0%	13,474	8.1%

Business	Q2FY12	Q2FY11	YoY Chg	Q1FY12	QoQ Chg
Advances	2,179,373	1,760,711	23.8%	2,150,150	1.4%
Deposits	3,125,772	2,491,865	25.4%	3,001,500	4.1%
- CASA Deposits	807,750	720,010	12.2%	761,050	6.1%
- Term deposits	2,318,022	1,771,855	30.8%	2,240,450	3.5%
Gross NPL	37,933	26,361	43.9%	36,063	5.2%
Net NPL	31,170	18,597	67.6%	28,711	8.6%

Ratio (%)	Q2FY12	Q2FY11	YoY chg (bps)	Q1FY12	QoQ chg (bps)
Gross NPAs	1.7	1.5	24	1.7	6
Net NPAs	1.4	1.1	37	1.3	9
ROA Annualized	1.0	1.5	(51)	0.9	13
C/I Ratio	44.9	43.5	139	43.8	107
CAR	12.8	13.9	(110)	13.4	(59)
-Tier I	9.2	8.8	33	9.6	(44)
Yield on Advances	10.7	9.6	111	10.5	22
Cost of Deposits	7.1	5.7	144	7.1	8
Net Interest Margin	2.6	3.3	(64)	2.4	22
CASA Ratio	25.8	28.9	(305)	25.4	49
Credit / Deposit ratio	69.7	70.7	(94)	71.6	(191)

Source: Company, Sushil Finance Research Estimate

PROFIT & LOSS STATEMENT (Cons)

(Rs.bn)

Y/E March	FY10	FY11	FY12E	FY13E
Interest income	187.6	231.2	290.8	339.4
Interest expense	130.8	152.4	210.2	242.0
Net interest income	56.8	78.8	80.6	97.4
<i>NII Growth %</i>	<i>20.5</i>	<i>38.9</i>	<i>2.3</i>	<i>20.8</i>
Other income	29.3	26.7	28.2	30.6
- Treasury profits	8.8	2.4	1.7	2.1
Total income	86.1	105.5	108.8	128.1
Operating expenses	37.3	45.6	47.3	52.4
Pre-provision Profit	48.8	59.9	61.5	75.7
Total Provisions	12.4	10.8	17.5	18.7
- NPL Provision	15.2	11.9	18.0	19.3
PBT	36.4	49.1	44.0	56.9
Tax	8.3	10.3	10.6	14.8
APAT	30.0	40.3	33.4	42.1
<i>PAT Growth %</i>	<i>46.9</i>	<i>34.5</i>	<i>(17.1)</i>	<i>26.0</i>
PPP (Ex Treasury)	40.0	57.5	59.8	73.6
<i>PPP Growth %</i>	<i>23.5</i>	<i>43.7</i>	<i>4.0</i>	<i>23.0</i>

BALANCE SHEET STATEMENT (Cons)

(Rs.bn)

As on 31 st March	FY10	FY11	FY12E	FY13E
Cash balances	197	308	309	318
Advances	1,695	2,126	2,497	2,924
Investments	711	866	1,031	1,203
- Govt. Securities	641	714	857	1,011
Fixed assets	29	29	32	34
Current assets	33	64	71	78
Total assets	2,665	3,393	3,939	4,557
Equity Cap	4	4	4	4
Reserves and Surplus	147	201	229	266
Shareholders' funds	152	206	234	271
Deposits	2,345	2,938	3,434	3,990
- Demand deposits	681	831	947	1,094
- Term deposits	1,664	2,107	2,487	2,897
Borrowings	85	143	154	167
Current liabilities	84	107	117	129
Total liabilities	2,665	3,393	3,939	4,557

FINANCIAL RATIO STATEMENT (Cons)

Y/E March	FY10	FY11	FY12E	FY13E
Profitability Ratios				
EPS (Rs)	71.4	89.2	73.8	93.2
Earnings growth (%)	47.4	24.9	(17.3)	26.4
CEPS (Rs)	77.6	95.3	80.4	100.7
PPP / Share (Rs)	119.0	135.2	138.8	170.8
ROAA (%)	1.2	1.3	0.9	1.0
ROAE (%)	25.7	25.9	17.0	18.3
DPS (Rs)	9.0	9.2	10.0	11.0
Dividend Payout (%)	13.7	12.1	13.3	11.6
Efficiency Ratios (%)				
Salary / Non Int. Cost	61.3	67.6	63.2	62.7
C-I ratio (Excl Treasury)	48.2	44.2	44.2	41.6
Other Inc (Ex tr.) / Net Total Inc (Ex Tr.)	26.6	23.6	24.7	22.7
Cost Asset Ratio	1.5	1.5	1.3	1.2
CASA	29.0	28.3	27.6	27.4
Tax Rates	22.7	21.0	24.0	26.0
Asset Quality Ratios (%)				
Gross NPLs	1.5	1.4	1.6	1.5
Net NPLs	1.1	1.1	0.9	0.9
Coverage	77.7	73.0	76.1	74.3
Provision / Loans	0.9	0.6	0.7	0.7

Y/E March	FY10	FY11	FY12E	FY13E
Asset-Liab. Profile (%)				
Capital Adequacy Ratio	13.4	15.4	14.7	14.0
- Tier I CAR	8.5	10.9	10.5	10.2
Adv. / Deposit Ratio	72.3	72.4	72.7	73.3
Loan Growth	22.5	25.5	17.4	17.1
Deposit Growth	25.6	25.3	16.9	16.2
Balance Sheet Growth	20.9	27.3	16.1	15.7
Equity / Assets	5.7	6.1	5.9	5.9
Equity / Loans	8.9	9.7	9.4	9.3
Spreads Analysis (%)				
Yield on Advances	9.1	8.9	9.4	9.3
Yield on Investments	7.1	7.4	7.3	7.4
Cost of funds	5.9	5.5	6.3	6.2
Net Interest Margin	2.8	3.1	2.6	2.7
Valuation				
BV / Share	366.4	460.5	523.9	608.0
Adjusted BV / Share	270.5	360.2	424.1	501.9
Dividend Yield (%)	2.0	2.0	2.2	2.4
P/E (x)	6.4	5.1	6.2	4.9
P/PPP (x)	3.8	3.4	3.3	2.7
P/ABV (x)	1.7	1.3	1.1	0.9

Source : Company, Sushil Finance Research Estimates

Rating Scale

This is a guide to the rating system used by our Institutional Research Team. Our rating system comprises of six rating categories, with a corresponding risk rating.

Risk Rating

Risk Description	Predictability of Earnings / Dividends; Price Volatility
Low Risk	High predictability / Low volatility
Medium Risk	Moderate predictability / volatility
High Risk	Low predictability / High volatility

Total Expected Return Matrix

Rating	Low Risk	Medium Risk	High Risk
Buy	Over 15 %	Over 20%	Over 25%
Accumulate	10 % to 15 %	15% to 20%	20% to 25%
Hold	0% to 10 %	0% to 15%	0% to 20%
Sell	Negative Returns	Negative Returns	Negative Returns
Neutral	Not Applicable	Not Applicable	Not Applicable
Not Rated	Not Applicable	Not Applicable	Not Applicable

Please Note

- Recommendations with "Neutral" Rating imply reversal of our earlier opinion (i.e. Book Profits / Losses).
- ** Indicates that the stock is illiquid With a view to combat the higher acquisition cost for illiquid stocks, we have enhanced our return criteria for such stocks by five percentage points.
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