

Huge restructuring pipeline to impact profitability

May 10, 2012

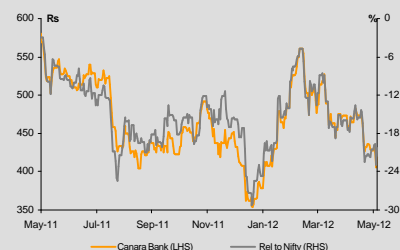
Reco	Previous Reco
Reduce	Hold
CMP	Target Price
Rs419	Rs410
EPS change FY13E/14E (%)	20/NA
Target Price change (%)	-18
Nifty	4,966
Sensex	16,420

Price Performance

(%)	1M	3M	6M	12M
Absolute	(9)	(20)	(12)	(28)
Rel. to Nifty	(4)	(14)	(8)	(20)

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Banks
Bloomberg	CBK@IN
Equity Capital (Rs mn)	4430
Face Value(Rs)	10
No of shares o/s (mn)	443
52 Week H/L	592/349
Market Cap (Rs bn/USD mn)	186/3,473
Daily Avg Volume (No of sh)	688409
Daily Avg Turnover (US\$mn)	6.2

Shareholding Pattern (%)

	Mar-12	Dec-11	Sep-11
Promoters	67.7	67.7	67.7
FII/NRI	14.6	13.6	14.6
Institutions	11.0	11.3	10.9
Private Corp	1.9	2.5	1.8
Public	4.9	4.9	5.0

Source: Capitaline

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- CBK'S Q4FY12 NII at Rs20.4bn - inline with est. However, muted non-int inc and higher employee and provision cost dragged net profit. PAT at Rs8.3bn was lower than est
- Q4FY12 Slipp. at Rs11.2bn (1.4% ann.) and restructuring at Rs27bn (1.2%). Despite higher NPA prov, PCR remains low at 16%. Rec/Upd at 60% of op NPL remains the only +ve
- NIM at 2.2%(calc) dragged by a) lower CASA mix (24%) b) lower share of high yielding assets (25% of loans) and c) excess reliance on bulk deposits (42% of deposits)
- Downgrade to REDUCE on concerns over a) NNPL / networth at 15%, b) slipp in restructured book at 30% and c) huge restructuring pipeline in Q1FY13 calling for higher prov

Results inline; higher rest pipeline to keep pressure on profitability

Canara Bank Q4FY12 NII grew by 3.4%yoy, inline with expectation. The growth in NII was led by 6%qoq growth in advances even as NIM's remained stable at 2.5%. However led by lower other income and higher employee expense operating profit came in lower than expected at Rs14.9bn. Further led by higher NPA provisioning, net profit declined by 7.8% yoy to Rs8.3bn.

While the broad asset quality remained stable with GNPA remaining flat sequentially, slippage was substantially higher at Rs11.2bn which was partially offset by higher write offs at Rs5.3bn. Of the total slippages, Rs7.94 was attributed to large industries which was spread across sectors. Restructuring was also higher at Rs27.5bn, which included Rs14.8bn of Air India restructuring. The bank hasn't taken any SEB restructuring till date, and has guided for Rs55bn of SEB restructuring in Q1FY13. As a result of which the provisioning requirements will remain higher.

Yield analysis

%	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12	YoY (bps)	QoQ (bps)
Yield on advances*	9.6	10.3	10.8	10.9	11.0	137	8
Yield on investments*	7.5	7.7	7.5	7.5	7.8	32	29
Yield on assets*	8.1	8.5	8.7	8.7	9.0	91	29
Cost of funds*	5.6	6.4	6.5	6.6	6.8	117	21
NIM*	2.5	2.1	2.2	2.1	2.2	-26	8
Yield on advances#	9.7	10.5	10.7	10.9	10.9	120	8
Cost of funds#	5.4	6.5	6.6	6.6	6.7	135	13
NIM#	3.1	2.4	2.6	2.5	2.5	-62	-2

Source: Company, Emkay Research

Valuation table

Y/E March 31	Net income	Net profit	EPS (Rs)	ABV (Rs)	RoA (%)	RoE (%)	PE (x)	P/ABV (x)
FY2011	105,263	40,259	90.9	354.0	1.3	26.4	4.6	1.2
FY2012	106,169	32,827	74.1	389.7	0.9	17.0	5.7	1.1
FY2013E	116,131	35,581	80.3	454.8	0.9	16.1	5.2	0.9
FY2014E	133,400	43,550	98.3	546.0	0.9	17.2	4.3	0.8

Source: Company, Emkay Research

Key financials – Quarterly

Rs mn	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12	YoY (%)	QoQ (%)	FY12	FY11	YoY (%)
Net Interest Income	19,729	17,931	19,617	19,186	20,402	3.4	6.3	77,135	77,927	-1.0
Other Income	9,330	5,268	8,283	7,790	7,693	-17.5	-1.3	29,034	27,326	6.3
Fee Income	2,490	1,739	2,040	2,050	2,150	-13.7	4.9	7,979	7,558	5.6
Net Income	29,059	23,199	27,900	26,976	28,094	-3.3	4.1	106,169	105,253	0.9
Total Operating Expenses	12,109	10,495	11,846	11,209	13,187	8.9	17.7	46,737	44,193	5.8
<i>As % Of Net Income</i>	<i>41.7</i>	<i>45.2</i>	<i>42.5</i>	<i>41.6</i>	<i>46.9</i>			<i>44.0</i>	<i>42.0</i>	
Employee Expenses	7,825	6,677	7,670	7,125	8,259	5.6	15.9	29,731	29,548	0.6
<i>As % Of Net Income</i>	<i>26.9</i>	<i>28.8</i>	<i>27.5</i>	<i>26.4</i>	<i>29.4</i>			<i>28.0</i>	<i>28.1</i>	
Other Expenses	4,284	3,818	4,177	4,084	4,928	15.0	20.7	17,007	14,645	16.1
<i>As % Of Net Income</i>	<i>14.7</i>	<i>16.5</i>	<i>15.0</i>	<i>15.1</i>	<i>17.5</i>			<i>16.0</i>	<i>13.9</i>	
Operating Profit	16,950	12,704	16,053	15,767	14,907	-12.1	-5.5	59,431	61,060	-2.7
<i>As % Of Net Income</i>	<i>58.3</i>	<i>54.8</i>	<i>57.5</i>	<i>58.4</i>	<i>53.1</i>			<i>56.0</i>	<i>58.0</i>	
Provisions	5,460	3,446	5,531	3,512	4,616	-15.5	31.4	17,105	10,727	59.5
Prov for NPA	5,335	2,850	4,768	1,422	3,900	-26.9	174.3	12,939	10,012	29.2
PBT	11,490	9,259	10,522	10,755	10,291	-10.4	-4.3	40,827	50,333	-18.9
Total Tax	2,500	2,000	2,000	2,000	2,000	-20.0	0.0	8,000	10,000	-20.0
Adjusted PAT	8,990	7,259	8,522	9,976	8,291	-7.8	-16.9	34,048	40,333	-15.6
Extra Ordinary Items	0	0	0	-1,500	0			-1,500	0	
Reported PAT	8,990	7,259	8,522	8,755	8,291	-7.8	-5.3	32,827	40,333	-18.6
Reported EPS	20.3	17.7	20.8	21.4	20.2	-0.4	-5.3	80	97	-17.2

Source: Company, Emkay Research

Loan growth remains dismal; share of high yielding assets on decline

Loan growth at 9.4% yoy seems far too lower when compared to its peers at 16%+ yoy. On a full-year basis, loan growth has primarily been in nature of agri (+21% yoy) and others (+14% yoy). As highlighted in our Q3FY12 results update, the share of high yielding retail + SME continues to remain low at 26% (down from 30% in Q4FY11). On a sequential basis, loan growth remained healthy at 6% qoq.

Advance Break Up – Corporate & Others form 60% of total book

Rs bn	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12	YoY (%)	QoQ (%)	% of total
SME	377	370	398	390	349	-7.4	-10.6	15.0
Agriculture	263	305	328	312	319	21.4	2.5	13.7
Retail	253	240	251	250	248	-1.9	-0.7	10.7
Mortgages	152	152	158	158	158	3.9	0.0	6.8
Others	1,232	1,235	1,203	1,241	1,409	14.3	13.5	60.6
Total	2,125	2,150	2,179	2,193	2,325	9.4	6.0	100.0

Source: Company, Emkay Research

... and has thereby attributed for lower margin

A 6% qoq loan growth, 29bps sequential rise in calc yield on assets to 9% and 160bps qoq increase in LDR to 71% has more than offset the 21bps increase in cost of funds. Resultant, calc. NIM at 2.2% was up 8 bps qoq. However, we remain wary of the fact that NIM at 2.2% remain dismal when compared to its peers – BoB (Q4FY12 global NIM at 2.6%) and BoI (Q4FY12 global NIM at 2.7%). We believe with a) lower share of high yielding assets and b) recent 25bps reduction in lending rates, margins will remain under pressure. We expect NIM to ease to 2.1 % over FY13-14E.

Yields as reported

%	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12	YoY (bps)	QoQ (bps)
Yield on advances*	9.6	10.3	10.8	10.9	11.0	137	8
Yield on investments*	7.5	7.7	7.5	7.5	7.8	32	29
Yield on assets*	8.1	8.5	8.7	8.7	9.0	91	29
Cost of funds*	5.6	6.4	6.5	6.6	6.8	117	21
NIM*	2.5	2.1	2.2	2.1	2.2	-26	8
NIM (Reported)	3.1	2.4	2.6	2.5	2.5	-62	-2

Source: Company, Emkay Research

CASA declines further; excess reliance on TD will add to margin pressure

FY12 deposit growth at 11% yoy (4% qoq) was predominantly in nature of term deposits (+17% yoy / 5% qoq). Bulk deposit including CD's constituted 42% of the total deposit. CASA ratio at 24% has been on a steep decline for past few quarters (30% in FY10, 28% in FY11). The mgmt attributed the reason for declining CASA ratio towards lower CA deposits from corporates. In our view, an increasing reliance on term deposits (76% of deposits) will call for higher cost and in-turn add to margin pressures. SA deposits were up 11% yoy (2% qoq).

Deposit mix – CASA ratio falling consistently

Rs bn	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12	YoY (%)	QoQ (%)
Current Deposits	245	152	167	155	148	-39.5	-4.4
Savings Deposits	586	609	640	634	648	10.5	2.3
CASA	831	761	808	789	796	-4.2	0.9
Term deposits	2,109	2,240	2,318	2,366	2,474	17.4	4.6
Total Deposits	2,940	3,002	3,126	3,155	3,271	11.3	3.7
CASA (%)	28.3	25.4	25.8	25.0	24.3	-393	-66

Source: Company, Emkay Research

Non-int income disappoints; C/income rises to 47% (42% in Q3)

Non-interest income at Rs7.7bn was down 18% yoy and was dragged by lower a) fee income at Rs2.1bn (Rs2.5bn in Q4FY11), b) recoveries in w/off accounts of Rs980mn (Rs3.3bn in Q4FY11) and c) dividend income at Rs140mn (Rs870mn in Q4FY11). Respite came in form of higher trading gains at Rs950mn and forex gains of Rs1.3bn.

C/income too surprised negatively at 47% of total income vs 42% in Q3FY12. Employee expenses were up 16% qoq. The mgmt attributed the reason for such a steep increase toward additional provisioning towards pension cost.

Non-interest income

Rs mn	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12	YoY (%)	QoQ (%)	FY12	FY11	YoY (%)
Fee/Commission income	2,490	1,739	2,040	2,050	2,150	-13.7	4.9	7,979	7,558	5.6
Trading gains/(losses)	-180	-770	1,490	1,570	950	-627.8	-39.5	3,240	2,365	37.0
Forex gains/(losses)	1,160	960	1,070	1,010	1,310	12.9	29.7	4,350	3,814	14.1
Dividend income	1,720	625	200	150	140	-91.9	-6.7	1,115	2,834	-60.7
Recovery	3,270	663	1,350	680	980	-70.0	44.1	3,673	5,520	-33.5
Other	870	2,052	2,133	2,330	2,163	148.6	-7.2	8,677	5,235	65.8
Total	9,330	5,268	8,283	7,790	7,693	-17.5	-1.3	29,034	27,326	6.3

Source: Company, Emkay Research

Asset quality stable, but with a pinch

While the bank has been able to show slight improvement in asset quality with GNPA ratio falling to 1.7% from 1.8% in Q3FY12, large part of the improvement was led by higher write offs during the quarter at Rs5.3bn. The slippages for the quarter was substantially higher at Rs11.2bn, mainly attributed to 9 corporate accounts spread across sectors. However stable recoveries/ upgradation at Rs6.1bn and higher write offs helped in keeping the Gross NPA flat sequentially.

Asset quality

Rs mn	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12	YoY (%)	QoQ (%)
Gross NPAs	30,892	36,063	37,933	39,986	40,318	30.5	0.8
Net NPAs	23,473	28,711	31,170	32,654	33,863	44.3	3.7
Gross NPAs (%)	1.5	1.7	1.7	1.8	1.7		
Net NPAs (%)	1.1	1.3	1.4	1.5	1.5		
Net NPAs/Net worth (%)	11.7	13.8	14.5	14.5	14.9		
Provision cover (%)	24.0	20.4	17.8	18.3	16.0		
Provision cover incl tech write off (%)	73.0	69.5	68.6	69.1	67.6		

Source: Company, Emkay Research

High restructuring pipeline to keep pressure on profitability

CBK'S outstanding restructured book which currently is at Rs80bn, 3.4% of the total advances, will double in Q1FY13 as the management guided for SEB restructuring of Rs55bn coupled with Rs10bn of additional restructuring in the next quarter. While there will not be any NPV hit on the SEB restructuring, standard asset restructuring of 2% will keep the provisioning at significantly higher levels, keeping the profitability under tremendous pressure.

Valuations and view

While the banks margin continue to remain lower at 2.2%(calc.), we believe with consistent decline in CASA levels and increasing reliance on bulk deposit, the NIM's will further come under pressure in FY13/14. Moreover with substantially reduced provisions on incremental NPAs at 55-60% over FY11-12E, the reported PCR stands lowest amongst peers at 16%. On top of that, with huge restructuring pipeline, provisioning requirement are likely to remain high, hence further impact the profitability in FY13/14. We expect the RoAs to remain sub 1% over FY13-14E driven by subdued margins at 2.1% and high credit cost at 70bps. We see very limited upside in the stock despite cheap valuations at 0.9x/0.8x FY13E/ FY14 ABV. Downgrade to REDUCE with price target of Rs410.

Financials

Income Statement (Rs. Mn)

(Year Ending Mar 31)	FY11	FY12	FY13E	FY14E
Net interest income	78,233	77,135	84,514	98,046
Other income	27,030	29,034	31,617	35,354
Net income	105,263	106,169	116,131	133,400
Operating expenses	44,193	46,737	47,344	52,431
Pre provision profit	61,070	59,431	68,787	80,968
PPP excl treasury	58,707	56,191	65,547	77,728
Provisions	10,811	18,604	24,310	26,530
Profit before tax	50,259	40,827	44,477	54,438
Tax	10,000	8,000	8,895	10,888
Tax rate	19.9%	19.6%	20.0%	20.0%
Profit after tax	40,259	32,827	35,581	43,550

Balance Sheet (Rs. Mn)

(Year Ending Mar 31)	FY11	FY12	FY13E	FY14E
Liabilities				
Equity	4,430	4,430	4,430	4,430
Reserves	195,968	222,470	251,313	288,126
Net worth	200,398	226,900	255,743	292,556
Deposits	2,939,726	3,270,537	3,834,929	4,468,267
Borrowings	220,663	244,165	237,800	242,300
Total liabilities	3,360,787	3,741,602	4,328,473	5,003,123
Assets				
Cash and bank	307,081	281,794	323,713	377,169
Investments	816,304	999,879	1,168,246	1,353,255
Customer assets	2,145,366	2,345,594	2,724,995	3,159,132
Others	92,035	114,336	111,519	113,567
Total assets	3,360,787	3,741,602	4,328,473	5,003,123

Key Ratios (%)

(Year Ending Mar 31)	FY11	FY12	FY13E	FY14E
NIM	2.6	2.2	2.1	2.1
Non-Il/avg assets	0.9	0.8	0.8	0.8
Fee income/avg assets	0.2	0.2	0.2	0.2
Opex/avg assets	1.3	1.2	1.1	1.0
Provisions/avg assets	0.5	0.6	0.7	0.7
PBT/avg assets	1.7	1.1	1.1	1.2
Tax/avg assets	0.3	0.2	0.2	0.2
RoA	1.3	0.9	0.9	0.9
RoAE	26.4	17.0	16.1	17.2
GNPA (%)	1.6	1.8	1.9	1.7
NNPA (%)	1.1	1.5	1.3	1.0

Valuations Table

(Year Ending Mar 31)	FY11	FY12	FY13E	FY14E
Net profit (Rs mn)	40,259	32,827	35,581	43,550
Shares in issue (mn)	443	443	443	443
EPS (Rs)	90.9	74.1	80.3	98.3
PER (x)	4.6	5.7	5.2	4.3
FDEPS(Rs)	90.9	74.1	80.3	98.3
FDPER (x)	4.6	5.7	5.2	4.3
Book value (Rs)	379.5	439.6	504.7	587.8
P/BV (x)	1.1	1.0	0.8	0.7
Adj book value (Rs)	354.0	389.7	454.8	546.0
P/ABV (x)	1.2	1.1	0.9	0.8
P/PPP (x)	3.0	3.1	2.7	2.3
Dividend yield (%)	2.6	2.6	3.1	3.1

Recommendation History: Canara Bank – CBK IN

Date	Reports	Reco	CMP	Target
27/01/2012	Canara Bank Q3FY12 Result Update	Hold	464	500
31/10/2011	Canara Bank Q2FY12 Result Update	Hold	469	500
27/07/2011	Canara Bank Q1FY12 Result Update	Hold	496	535
05/05/2011	Canara Bank Q4FY11 Result Update	Reduce	559	560

Recent Research Reports

Date	Reports	Reco	CMP	Target
09/05/2012	Punjab National Bank Q4FY12 Result Update	Hold	768	850
09/05/2012	Union Bank of India Q4FY12 Result Update	Reduce	203	190
07/05/2012	South Indian Bank Q4FY12 Result Update	Hold	23	26
07/05/2012	HDFC Q4FY12 Result Update	Hold	664	700

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