

**Canara Bank****Rs262**  
**OUTPERFORMER**

## RESULT NOTE

Mkt Cap: Rs107.2bn; US \$2.4bn

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**Result:** Q4FY06

**Comment:** Operating performance in-line with expectations, Maintain estimates

**Last report:** 18 February 2006 (Price Rs264; Recommendation: Outperformer)

## Key valuation metrics

Year to 31 March	2004	2005	2006	2007E	2008E
Net profit (Rs m)	13,944	11,095	13,432	17,177	19,644
yoy growth	36.9	(20.4)	21.1	27.9	14.4
Shares in issue (m)	410	410	410	410	410
EPS (Rs)	34.0	27.1	32.8	41.9	47.9
EPS growth (%)	36.9	(20.4)	21.1	27.9	14.4
PE (x)	7.7	9.7	8.0	6.2	5.5
Book value (Rs/share)	128.1	149.0	175.2	210.1	251.0
Adj. Book value (Rs/share)	117.4	138.9	166.8	209.2	256.0
P/ Adj. Book (x)	2.2	1.9	1.6	1.2	1.0
RONW (%)	29.7	19.5	20.2	21.8	20.8

Canara bank has reported net profit of Rs4.94bn for Q4 FY06 – 382% yoy growth – which is significantly better than our estimates of 243% yoy growth. Although the operating performance of the bank in terms of NII growth and fee income growth is in line with expectations and operating profit and PBT numbers are also in line with estimates, the higher than expected net profit has been the result of tax write-back related to deferred tax assets. In a rising interest rate scenario, the bank has largely been able to protect its margins while its asset quality has improved significantly over the year. We maintain our earning estimates and expect the bank to report 21% CAGR in earnings growth over FY05-08 with average RoE of 21%. The stock trades at attractive valuation of 1.2 x FY07 adjusted book. Maintain Outperformer with 12-month target price of Rs330, which is 1.6 x FY07E adjusted book.

#### □ NII growth driven by loan growth and improving CD ratio

Canara Bank has reported 13.7% yoy growth in net interest income for FY06 (7.1% yoy growth for Q4FY06), which is broadly in line with our expectations. The NII for Q4FY06 at Rs9.83bn was marginally short of our estimate of Rs10.38bn. Loan book of Canara bank has grown by 31% yoy driven by housing, other retail loans, agriculture and SME segments. CD ratio of the bank has improved from 62.3% as on Mar-05 to 68.0% as on Mar-06

	Outstanding as on Mar-06 (Rs bn)	Yoy growth (%)
Retail loans	145.52	29.0
Out of which housing	56.0	33.5
Agriculture	120.3	37.0
SME	124.2	20.7
Total loan book	794.3	31.0

Source: Company

### ❑ Rising deposit costs have led to 10 bps sequential NIM in margins

Deposit costs of Canara bank increased by about 13 bps during the quarter to 4.98%. Deposit growth which was hovering at 13-14% till Q2 and Q3FY06 has gone up to 20.3% yoy during Q4FY06 leading to decline in CASA ratio (from 34.9% as on Dec-05 to 33.3% as on Mar-06). To tide over difficult liquidity situation in Q4, the bank had affected two rounds of 25-50 bps hike in retail deposit rates during Feb and Mar-06. As a result, bank's NIM has come down to 2.96% during Q4FY06 compared to 3.06% during Q3 FY06. For the full year, NIM has averaged at 2.95% (compared to 3.00% during FY05).

For the quarter ended	Mar-2005	Dec-2005	Mar-2006
Yield on advances (%)	8.35	8.41	8.26
Yield on investments	7.64	7.76	7.78
Cost of deposits	4.58	4.85	4.98
NIM	3.40	3.06	2.96

Source: SSKI research

### ❑ Operating expenses increasing with wage revision and technology spend

Although overall employee expenses of the bank has just grown by ~10% for FY06, if VRS expenses for the previous year are excluded then the growth is as high as 27% mainly due to payment of wage arrears during first nine months of FY06. Going forward, we expect employee expenses to grow at 10-13% for next two years. Other operating expenses are likely to go up in FY07 as bank aggressively rolls out CBS platform. Canara bank aims at networking about 1,000 of its 2,532 branches on CBS by the end of FY07.

### ❑ Decline in provisioning leads to sharp jump in PBT

Profit before tax of Canara bank has witnessed 678% yoy growth for Q4FY06, which is largely in line with expectations. During Q4FY05, the bank had provided almost Rs5.50bn towards NPA provisioning as a part of clean-up exercise. However, net profit for the quarter under consideration at Rs4.94bn is significantly higher than our expectation of Rs3.50bn – mainly due to tax write-back of Rs400m related to deferred tax assets. The break-up of provisions for FY06 is as follows.

Provision towards	For FY06 (Rs bn)
NPAs	6.35
Provision for depreciation (including HTM transfer)	3.17
Out of which amortization	0.62
Provision for standard assets	1.48
Other provisions	(0.32)
Total provisions	10.68

Source: company

### ❑ Continued improvement in Asset Quality

Canara Bank's Net NPAs have come down to 1.12% as of Mar-06 from 1.88% as on Mar-05. The bank has affected cash recoveries of Rs9.72bn during FY06 (compared to Rs8.69bn for FY05).

### ❑ Capital adequacy comfortable

Canara Bank's overall Capital Adequacy Ratio stands at 11.22%. Its Tier-I CAR has improved to 7.81% as on Mar-06 compared to 6.83% as on Dec-05 mainly because of treatment of investment fluctuation reserve of Rs12.08bn as part of Tier-I capital. Considering the strong growth momentum in its core business and increased capital requirement due to Basel II norms, there is a possibility that bank may go for capital raising during FY06-07.

### ❑ Management guidance for FY0607

Canara bank management has indicated that it would aim at deposit growth of about 18% and loan growth of 19.6% for FY06-07. Outstanding loans and deposits are expected to go up to Rs950bn and Rs1.38tn by FY06-07.

## □ Maintain earning estimates, reiterate Outperformer

Canara bank has delivered healthy operating performance, which is broadly in line with our expectations. We maintain our earning estimates for FY07 and FY08 and expect EPS of Rs41.9 and Rs47.9 for FY06-07 and FY07-08 respectively. With average RoE over FY06-08 of ~21%, the stock trades at attractive valuations of 1.2 x FY07 and 1.0 x FY08 adjusted book. Maintain Outperformer with 12-month price target of Rs330.

### Earnings model

(Rs m)	Q4FY05	FY05	Q1FY06	Q2FY06	Q3FY06	Q4FY06	FY06	FY07E	FY08E
Total intt income	20,329	75,720	19,795	21,013	22,401	23,906	87,115	102,294	119,945
Interest expense	11,142	44,215	11,467	12,946	12,818	14,069	51,300	62,194	73,289
Net interest income	9,187	31,505	8,328	8,067	9,582	9,838	35,815	40,100	46,656
<i>yoy growth</i>	8.2	15.0	11.6	10.6	26.6	7.1	13.7	12.0	16.3
Other income	4,604	15,438	2,591	3,928	3,115	4,145	13,775	14,891	16,318
<i>yoy growth</i>	27.7	(25.5)	(29.3)	7.2	(11.1)	(10.0)	(10.8)	8.1	9.6
Fee income	3,454	9,574	2,291	3,848	2,715	3,755	11,614	13,102	14,757
<i>yoy growth</i>	39.5	16.7	18.3	42.3	16.8	8.7	21.3	12.8	12.6
Profit on sale of investments	1150	5,002	300	80	399.8	390	1,170	650	250
Net revenue	13,790	46,943	10,919	11,995	12,697	13,982	49,590	54,992	62,974
Operating expenses	6,232	21,090	5,316	6,184	5,702	6,269	23,471	27,115	30,771
Operating profit	7,558	25,853	5,603	5,811	6,995	7,713	26,119	27,877	32,203
<i>yoy growth</i>	11.5	(11.3)	(13.1)	1.1	14.7	2.1	1.0	6.7	15.5
Provisions	6,975	13,058	3,034	2,026	2,449	3,178	10,687	6,405	6,184
Prov for NPA	5499.8	8068.9	1145.2	1650.7	492.6	3063.4	6,352	3,695	4,315
PBT	583	12,795	2,569	3,785	4,546	4,535	15,432	21,471	26,019
Tax	(440)	1,700	700	720	980	(400)	2,000	4,294	6,375
PAT	1,023	11,095	1,869	3,065	3,566	4,935	13,432	17,177	19,644
<i>yoy growth</i>	(73.4)	(20.4)	(44.4)	(22.8)	30.2	382.4	21.1	27.9	14.4
<b>Ratios</b>									
Net interest margin/Average assets	3.4	3.0	3.0	2.8	3.1	3.0	2.9	2.8	2.9
Non fund revenues/Avg assets	1.7	1.4	0.9	1.4	1.0	1.3	1.0	1.0	0.9
Core fee inc/Avg assets	1.3	0.4	0.8	1.3	0.9	1.2	0.5	0.4	0.4
Operating expenses/avg assets	2.3	2.0	1.9	2.2	1.9	2.0	1.9	1.9	1.9
Cost/Net revenue	45.2	44.9	48.7	51.6	44.9	44.8	47.3	49.3	48.9
NPA Prov/avg assets	2.0	0.8	0.4	0.6	0.2	1.0	0.5	0.3	0.3
Tot prov/avg assets	0.6	1.2	0.3	0.2	0.2	0.3	0.9	0.4	0.4
PBT/avg assets	0.2	1.2	0.9	1.3	1.5	1.4	1.3	1.5	1.6
RoA	0.4	1.1	0.7	1.1	1.2	1.6	1.1	1.2	1.2
Tax/PBT	(75.5)	13.3	27.2	19.0	21.6	(8.8)	13.0	20.0	24.5

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