

Press Release for Canara Bank's IPDI Issue Rating

Brickwork Ratings assigns "BWR AAA+" for Canara Bank's Perpetual Bonds of INR 4.00 billion

Issue Rating: BWR AAA+

Outlook: Stable

Brickwork Ratings has assigned BWR AAA+ (Pronounced BWR Triple A Plus) for Canara Bank's proposed Innovative Perpetual Debt Instrument (IPDI) issue of INR 400 crore or INR 4.00 billion. Brickwork ratings 'BWR AAA+' stands for an instrument that is considered to offer the BEST credit quality in terms of timely serving of debt obligations. The rating factored higher operating profits, comfortable capital adequacy & low cost deposits, well diversified credit deployment, optimum operating cost structure and the Government of India's equity stake.

Incorporated in 1906, Canara Bank is one of the oldest public sector banks in India. The bank is from Dakshina Kannada district of Karnataka that has produced several outstanding banks for the country. The bank has always been in the forefront to improve its productivity and efficiency. Over the years the bank has been transforming itself from core banking activities to value added solutions. The bank has positioned itself very well in the domestic market. As a result, the bank was able to mobilize relatively huge deposits and ranked the third in the deposit base amongst PSU banks in India as of 31st March 2008.

The continuing financial crises in the domestic market and prevailing economic slowdown in the international markets did not have adverse impact on Canara Bank's operating performance. Canara Bank is one of the largest public sector banks with reported total assets of INR 2030.26 billion as on 31st December 2008. The bank has steadily grown its asset base over the years, aided by robust growth in deposits and advances. The bank's total deposits stood at INR 1748.4 billion, a growth of 21% as on 31st December 2008, compared to INR 1441.42 billion a year ago. Similarly, the bank's advances grew by 31% to reach INR 1289.20 billion as compared to INR 985.81 billion in Q3 FY 08.

The bank's cost of deposits reached 6.8% during FY 08 as against 5.66% for peers, therefore the bank's cost of deposits greatly impacted the overall cost of funds in spite of healthy increase in the yield on funds (9.05%). During Q3 FY09, the bank was able to contain the cost of deposits to 6.81%, which has grown by 21 bps from 6.60% (as on 31st Sep' 08), the bank has shown higher returns at 10.69% and higher spreads at 2.34% as on 31st December 2008. Further, the NIM increased by 33 bps to reach a level of 2.75% in the Q3 FY 09. Brickwork expects that the bank will continue to focus on retail deposits growth by leveraging its CBS platform to more branches to gather CASA and term deposits products to generate more low cost deposits.

The bank has well designed internal capital adequacy assessment policy to comprehensively evaluate capital adequacy requirements. As a result, the bank has identified capital requirements in Q3 FY 09 and it started building up Tier II capital by issuing INR 3.25 billion bonds (in Q4 FY 09) to augment capital funds. As on 31st December 2008, the bank's capital adequacy ratio and Tier I capital increased marginally to 13.41% and 7.51% respectively. However, the bank's tier I capital is still lower than its peers and Brickwork expects that bank needs to supplement its Tier I capital in the near term. Brickwork calculates *Leverage* that assesses Canara Bank's capital adequacy with reference to both on

and off balance sheet exposures. The bank has shown a lower leverage of 21.38 compared to its peers' of 21.78.

The bank has been very consistent in generating profit over the years. During FY 08, the bank posted impressive top line and bottom line figures. Canara Bank is one of the most profitable public sector banks in India, with total income of INR 53.83 billion during Q3 FY 08, reflecting the excellent fee based income and focus on healthy earning assets which contributed to improvement in the profitability. Similarly, the operating profit of the bank increased from INR 7.58 billion to INR 12.14 billion, registering an increase of 60.2%. The bank's net profit also increased from INR 4.59 billion to INR 7.02 billion during Q 3 FY 09, with an impressive growth of 52.9%. The bank's profitability is largely driven by lean operating structure, healthy earning assets and growth in non-interest income.

Over the years, the bank's asset quality has been improving through the bank's strict credit culture and monitoring. As a result, the bank's gross NPA level declined during FY 08 stood at Rs.1416 crore. With a gross NPA ratio of 1.31%, the bank continues to be the lowest among the peers. The bank's net NPAs have shown a similar trend, which has declined to 0.84% in FY08 from 0.94% in FY07. However, the bank's asset quality has deteriorated significantly with NPAs and delinquencies reported up considerably in Q3 FY 09. As a result, the bank's gross and net NPAs have increased to 1.94% and 1.28% respectively, which is a cause for concern.

The ratings by-and-large factored the rating factored Government of India's ownership stake, higher operating income, optimum operating cost structure, comfortable low cost deposits and adequate risk adjusted capital. Brickwork expects that current liquidity situation and worsening appetite for credit in domestic market and continuing financial crises in the international markets are likely to affect the bank's net interest margin and in turn put a pressure on the bank's asset quality in the near term. However, the bank was doing reasonably well in first and second quarter in the current financial year. And in the third quarter, the bank's asset quality has deteriorated with NPAs and delinquencies reported up considerably. But the bank is still within its borrowing and lending capacity. We expect that healthy capital adequacy, robust growth in advances and deposits, comfortable CASA deposits, efficient risk management system, and lower operating expenses would enable the bank to sustain its current growth momentum. The detailed Rationale is enclosed as Annexure A

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