

July 26, 2007

REDUCE

Price Target Price
Rs273 **Rs228**

Sensex **15,699**

Price Performance

(%)	1M	3M	6M	12M
Absolute	4	23	9	47
Rel. to Sensex	(4)	11	(2)	(3)

Source: Capitaline

Stock Details

Sector	Banks
Reuters	CNBK.BO
Bloomberg	CBK @IN
Equity Capital (Rs mn)	4100
Face Value	10
52 Week H/L	320/174
Market Cap	Rs112bn/US\$2.8bn
Daily Avg Volume (No of shares)	691,506
Daily Avg Turnover (US\$)	4.4mn

Shareholding Pattern (%)

(31st Mar.'07)	
Promoters	73.2
FII	17.5
Institutions	3.1
Private Corp.	0.4
Public	5.9

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Canara BankResult
Update**Margins continue to slide**

Canara Bank (CNBK) reported disappointing numbers for Q1FY08 as the NII declined by 5.7% yoy to Rs8.9bn (vis-à-vis our expectations of 13.8% growth). However, higher other income, modest Opex and lower investment depreciation helped the bank to post a strong (but still lower than our estimates) 26% yoy growth in net profit to Rs2.4bn. The NIMs have slid by a steep ~60bps on yoy basis and 62bps qoq. Although the GNPA have declined significantly, lower provisioning cover meant a steep increase in NPA provisioning requirements which we believe is likely to continue in future.

We believe that the pressure on margins will continue for CNBK as the CASA mix continues to be at one of the lowest in the industry at 33%. The bank remains prone to interest sensitivity and instability of earnings. At the current market price of Rs273, the stock is quoting at 6.2x its FY09E EPS and 1.3x FY09E ABV with likely RoE of 20.0% in FY09E. We maintain our REDUCE recommendation with price target of Rs228.

NII declines by 5.7% - rising deposit cost hurts

CNBK has reported a 5.7% yoy decline in its NII to Rs8.9bn (compared with our expectations of 13% growth). The decline in NII was attributable to 143bps increase in the cost of funds.

Yield analysis

(%)	Q1FY08	Q1FY07	Q4FY07	% yoy chg	% qoq chg
Yield on Advances	9.76	8.27	9.13	149	63
Yield on Investments	7.62	7.91	7.93	-29	-32
Yield on assets	8.22	7.41	8.06	81	16
Cost of funds	6.04	4.61	5.40	143	65
NIM	2.17	2.79	2.66	-62	-48
NIM-Reported	2.54	3.21	3.15	-67	-61

Source: Company, Emkay Research

Note: calculated on basis of average quarterly balances

The advances for the quarter have grown by 18% yoy to Rs948bn primarily driven by robust growth in agricultural and SME advances. The deposits grew by 12% yoy to Rs142bn, whereas, the CASA remained stable at 32% of deposits.

Advances book

Rs bn	Q1FY08	Q1FY07	Q4FY07	% yoy chg	% qoq chg
Retail	172	155	175	10.7	-1.7
Of which housing	67	59	67	13.0	0.3
Agri	156	116	155	35.0	0.6
SME	151	111	142	35.5	6.0
Others	469	421	513	11.4	-8.5
Total	948	803	985	18.0	-3.8

Source: Company, Emkay Research

Other income and modest Opex provide help

The other income provided some help as it grew by 47.2% yoy to Rs3.8bn, which helped the bank to report 5.6% yoy growth in net revenues to Rs12.7bn.

With a modest 7.5% yoy growth in Opex to Rs6.1bn, the operating profit grew by 3.7% yoy to Rs6.1bn.

Lower provisioning aids further

With provision cover having fallen consistently, the NPA provisioning is likely to remain high as during the current quarter. However, due to the lower investment depreciation, the total provision came down significantly, thereby helping the bank to report a 26.0% yoy growth in net profit to Rs2.4bn.

Asset quality remains robust but provision to remain high

CNBK's asset quality has continued to remain robust with GNPA's having declined to 1.55% (2.15% last year) and NNPA's to 0.89% (0.91% last year) as on June 2007.

We expect the provisioning to rise further from hereon, as the provision cover has fallen to 43% from 58% last year.

Capital adequacy remains robust

With Tier I capital adequacy ratio of 7.2%, the bank is very comfortably capitalised for future growth and would not require any equity dilution soon.

Valuations and view

We believe that the pressure on margins will continue for CNBK as the CASA mix continues to be at one of the lowest in the industry at 33%. The bank remains prone to interest sensitivity and instability of earnings. At the current market price of Rs273, the stock is quoting at 6.2x its FY09E EPS and 1.3x FY09E ABV with likely RoE of 20.0% in FY09E. We maintain our REDUCE recommendation with price target of Rs228.

Quarterly results

Rs mn	Q1FY08	Q1FY07	Q4FY07	% yoy chg	% qoq chg
Net interest income	8,941	9,478	10,593	-5.7	-15.6
Other Income	3,801	2,582	6,262	47.2	-39.3
Net income	12,742	12,060	16,855	5.6	-24.4
Operating expenses	6,621	6,158	6,334	7.5	4.5
Pre-provision profits	6,121	5,902	10,521	3.7	-41.8
Provisions	3,015	3,743	4,970	-19.4	-39.3
<i>NPA</i>	1,550	1,091	1,018	42.0	52.3
Profit before tax	3,106	2,159	5,551	43.8	-44.1
Taxes	700	250	500	180.0	40.0
Net Profit	2,406	1,909	5,051	26.0	-52.4

Valuation table

Y/E March 31	Net income Rs mn	Net profit Rs mn	EPS (Rs)	ABV (Rs)	RoA (%)	RoE (%)	PE (x)	P/ABV (x)
FY2006	49,590	13,432	32.8	149.7	1.1	20.6	8.3	1.8
FY2007E	54,778	14,208	34.7	175.2	1.0	18.8	7.9	1.6
FY2008E	59,227	14,883	36.3	188.5	0.8	17.9	7.5	1.4
FY2009E	67,775	17,956	43.8	211.1	0.8	20.3	6.2	1.3

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