

January 27, 2009

ACCUMULATE

Price	Target Price
Rs174	Rs186

Sensex	8,674
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Price Performance

(%)	1M	3M	6M	12M
Absolute	(8)	0	(7)	(37)
Rel. to Sensex	2	13	54	26

Source: Capitaline

Stock Details

Sector	Banks
Reuters	CNBK.BO
Bloomberg	CBK@IN
Equity Capital (Rs mn)	4100
Face Value	10
52 Week H/L	324/135
Market Cap	Rs75bn/US\$1.4bn
Daily Avg Volume (No of shares)	1101893
Daily Avg Turnover (US\$)	4.1mn

Shareholding Pattern (%)

	D'08	S'08	J'08
Promoters	73.2	73.2	73.2
FII/NRI	12.0	13.3	13.5
Institutions	7.9	6.3	5.9
Private Corp	0.9	1.1	1.2
Public	6.1	6.2	6.3

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Concern on asset quality

Canara Bank (CNBK) reported a net profit of Rs7.0bn, inline with our expectations. However operating performance came in better than expectations, driven by strong NII growth of 33.2% yoy, and robust other income. The NII growth was driven by 35bps expansion in NIMs and strong growth in advances. The other income grew significantly to Rs3.4bn from Rs1.0bn in corresponding quarter last year.

The problem of asset quality continues to persist as the gross NPAs have gone up sharply by Rs9.4bn sequentially to Rs25.2bn. Of this, Rs4bn is with respect to RGPPL-Dabhol project which are been classified as sub-standard asset now. Apart from the same the bank has also added Rs5.4bn of other NPAs at gross level which are spread over various accounts. A large part of the same is attributed to technical classification and is likely to be reclassified as standard asset by next quarter.

The current valuations of the stock at 3.4x FY10E EPS and 0.7x FY10E ABV are reasonable in the sector, We upgrade the stock to ACCUMULATE from REDUCE.

NII growth above expectations

CNBK has reported a 33.2%yoy increase in its NII to Rs12.4bn ahead of our expectation driven by 35bps expansion in NIM's and 30.8%yoy growth in advances.

Margin expansion led by increase in spread

The bank NIM's for the quarter expanded by 35bps to 2.4% as the yield on advances increased by 105bps to 11.2% and cost of funds increased by a lower 69bps to 6.9%. However, on sequential basis the NIMs have remained flat (unlike other PSU banks). The management has attributed the same to Rs400 write off in the interest income on the interest due from RGPPL-Dabhol which was booked earlier.

Yield analysis

(%)	Q3FY09	Q3FY08	Q2FY09	% yoy chg	% qoq chg
Yield on Advances	11.2	10.2	10.7	105	57
Yield on Investments	8.2	8.2	8.0	5	23
Yield on assets	9.3	8.3	8.9	104	44
Cost of funds	6.9	6.2	6.4	69	53
NIM	2.4	2.0	2.5	35	-9
NIM(Reported)	2.8	2.4	2.7	33	5

Source: Company, Emkay Research

Note: calculated on basis of average quarterly balances

Faster balance sheet growth hurts CASA float

The bank's balance sheet during the quarter grew at a healthy pace during the quarter. The bank's advances grew by a stronger 30.8% yoy to Rs1.3tn, while deposit grew by 21.3% yoy to Rs1.7tn during the quarter. As a result the CASA float (as % of total deposits including international deposits) declined by 210bps to 29.8% during the quarter.

Deposit mix

Rs bn	Q3FY09	Q3FY08	Q2FY09	% yoy chg	% qoq chg
CASA deposit	521	460	549	13.3	-5.1
Term deposits	1,227	982	1,166	25.0	5.2
Total deposits	1,748	1,442	1,715	21.3	1.9
CASA (%)	29.8	31.9	32.0	-210	-220

Source: Company, Emkay Research

Advances growth picks up

The advances growth remained strong during the quarter at 31% yoy and 8.1% sequential. The growth was mainly driven by SME and corporate advances. The share of infrastructural advances improved during the quarter to 12.5%, up 100bps yoy.

Advances mix

Rs bn	Q3FY09	Q3FY08	Q2FY09	% yoy chg	% qoq chg
Retail	180	172	172	4.6	4.6
Agri	189	163	164	15.8	15.2
SME	214	170	164	25.9	30.9
Others	706	480	693	47.0	1.8
Total	1,289	986	1,193	30.8	8.1

Source: Company, Emkay Research

Other income grows strong

The other income during the quarter grew by 38.6% to Rs75.8bn, driven by higher trading and fee income. The trading income increased to Rs3.4bn from 9.6bn in the corresponding quarter last year. Fee income (including forex) increased by 32.9%yoy to Rs.2bn in Q3FY09.

Other Income

Rs mn	Q3FY09	Q3FY08	Q2FY09	% yoy chg	% qoq chg
Trading	3,440	960	35	258.3	9645.0
CEB + Forex	2,220	1,670	1,552	32.9	43.1
Other	1,915	2,834	1,801	-32.5	6.3
Total	7,575	5,464	3,388	38.6	123.6

Source: Company, Emkay Research

Operating expenses also rose...

Bank's operating expenses increased by 9.0%yoy to Rs7.9bn primarily driven by 13.3%yoy increase in employee expenses.

..... provisioning remains high

The provisioning increased by 77.0% yoy to Rs3.5bn during the quarter, led by NPA provisioning of Rs3.6bn. The bank has not booked treasury gains during the quarter and intends to write back in the Q4FY09. The treasury gains currently on the book could be upto Rs2.0-2.5bn.

Provision break up

Rs mn	Q3FY09	Q3FY08	Q2FY09	% yoy chg	% qoq chg
NPA	3,570	2,540	1,530	40.6	133.3
<i>As % of advances</i>	0.30	0.10	0.13		
Inv. depreciation	-74	-503	-60	-85.2	23.8
Other provisions	27	-47	-29	-157.0	-193.1
Total	3,523	1,990	1,441	77.0	144.5

Source: Company, Emkay Research

Sharp increase in NPAs

The gross NPAs have gone up sharply by Rs9.4bn sequentially to Rs25.2bn. Of this, Rs4bn is with respect to RGPPL-Dabhol project which are been classified as sub-standard asset now. The bank has made provisions of Rs400mn (10%of exposure) as it is a sub-standard asset which is secured.

Apart from the same the bank has also added Rs5.4bn of other NPAs at gross level which are spread over various accounts. A large part of the same is attributed to technical classification due to 90day norm and is likely to be reclassified as standard asset by next quarter. Excluding the RGPPL project, the provision cover would have been slightly better at 38%.

Asset quality

Rs mn	Q3FY09	Q3FY08	Q2FY09	% yoy chg	% qoq chg
Gross NPA	2,515	1,525	1,574	65.0%	59.8%
<i>% of gross advances</i>	1.93	1.54	1.31		
Net NPA	1,654	873	1,065	89.5%	55.3%
<i>% of net advances</i>	1.28	0.89	0.89		
Provision cover (%)	33.7	42.2	32.3		

Source: Company, Emkay Research

Capital adequacy comfortable

The bank is comfortably placed with respect to capital adequacy. At the end of Q3FY09, Canara Bank's CAR was 13.4%, while tier I capital adequacy was at 7.5%.

Valuations and view

The current valuations of the stock at 3.4x FY10E EPS and 0.7x FY10E ABV are attractive in the sector, We retain our ACCUMULATE rating on the stock.

Quarterly results

Rs mn	M9FY09	M9FY08	% yoy chg	Q3FY09	Q3FY08	Q2FY09	% yoy chg	% qoq chg
Net interest income	34,125	26,152	30.5	12,443	9,344	11,490	33.2	8.3
Other Income	14,647	14,986	-2.3	7,575	5,464	3,388	38.6	123.6
Fee income	6,059	5,227	15.9	2,220	1,670	1,552	32.9	43.1
Net income	48,772	41,138	18.6	20,018	14,808	14,877	35.2	34.6
Operating expenses	21,861	20,937	4.4	7,877	7,230	7,142	9.0	10.3
Pre-provision profits	26,912	20,201	33.2	12,141	7,578	7,735	60.2	57.0
Provisions	10,373	6,793	52.7	3,523	1,990	1,441	77.0	144.5
NPA	6,500	5,620	15.7	3,570	2,540	1,530	40.6	133.3
Profit before tax	16,539	13,408	23.4	8,618	5,588	6,294	54.2	36.9
Taxes	3,000	2,400	25.0	1,600	1,000	1,000	60.0	60.0
Net Profit	13,539	11,008	23.0	7,018	4,588	5,294	53.0	32.6

Valuation table

Y/E March 31	Net income	Net profit	EPS	ABV	RoA	RoE	PE	P/ABV
	Rs mn	Rs mn	(Rs)	(Rs)	(%)	(%)	(x)	(x)
FY2007	54,778	14,208	34.7	175.2	1.0	18.8	4.9	1.0
FY2008	57,507	15,650	38.2	180.4	0.9	19.1	4.5	0.9
FY2009E	67,965	18,744	45.7	215.7	0.9	21.4	3.7	0.8
FY2010E	75,788	20,430	49.8	255.4	0.9	21.0	3.4	0.7

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