

May 11, 2007

REDUCE

Price	Target Price
Rs219	Rs228
Sensex	13,771

Price Performance

(%)	1M	3M	6M	12M
Absolute	14	(10)	(24)	(21)
Rel. to Sensex	9	(4)	(28)	(28)

Source: Capitaline

Stock Details

Sector	Banks
Reuters	CNBK.BO
Bloomberg	CBK @IN
Equity Capital (Rs mn)	4100
Face Value	10
52 Week H/L	320/165
Market Cap	Rs89.7bn/US\$2.2bn
Daily Avg Volume (No of shares)	675006
Daily Avg Turnover (US\$)	3.3mn

Shareholding Pattern (%)

(31st Mar.'07)	
Promoters	73.2
FII	17.2
Institutions	2.6
Private Corp.	0.8
Public	6.3

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Canara BankQuarterly
Update**Uncertainty on margins continues**

Canara Bank's (CanBank) Q4FY07 net profit at Rs5.05bn was ahead of our estimates driven by higher non-interest income (mainly treasury, Forex and wealth management fees) and no provisioning for AS-15. The NIMs have shown 12bps expansion yoy mainly driven by opportunities available in the short term-money markets, albeit the longer-term improvement in NIM remains uncertain. With the investment portfolio remaining tilted towards AFS category, the provisioning remained high as expected (nearly 25% of the pre-provision profits).

The asset quality remains robust driven by higher recoveries as the provision cover now stands at 62.1% compared with 49% last year.

We believe that the pressure on margins will continue for CanBank as the CASA mix continues to be at one of the lowest in the industry at 33%. Also with AFS category comprising of 57% of SLR investment, the bank remains prone to interest sensitivity and instability of earnings. At the current market price of Rs219 the stock is quoting at 5.0x its FY09E EPS and 0.9x FY09E ABV with likely RoE of 18.5% in FY09E. We maintain our REDUCE recommendation with price target of Rs228.

Moderate growth in NII – margins expand 12bps yoy...

CanBank's NII (adjusted for Rs725mn of interest on IT refund) has reported a moderate growth of 16.2% yoy to Rs10.6bn. The growth in NII was achieved on back of 24% yoy growth in advances and 12bps yoy expansion in NIM to 3.15%.

Moderate growth in NII

Rs mn	Q4FY07	Q4FY06	Q3FY07	% yoy chg	% qoq chg
NII	10,593	9,838	10,386	7.7	2.0
Less: Interest on IT refunds	-	725	767	-	-
Adjusted NII	10,593	9,113	9,619	16.2	10.1

Source: Company, Emkay Research

... but may not be sustained

Though CanBank's NIM for Q4FY07 have expanded by 12bps yoy (adjusted for interest on IT refunds) to 3.15% (flat sequentially), the same was partly achieved on back of opportunities available in the short term money markets. With majority of the investment portfolio in the liquid AFS category, CanBank was better placed to take advantage of the spike in the call money rates during Q4FY07. Adjusted for the inter-bank interest, the NIM would have actually dipped.

Deposit mix

Rs bn	Q4FY07	Q4FY06	Q3FY07	% yoy chg	% qoq chg
Total deposits	141.0	116.8	131.7	20.7	7.0
CASA	45.1	38.9	42.1	16.0	7.0
CASA ratio (%)	32.0	33.3	32.0		

Source: Company, Emkay Research

However, with such gains being of short-term nature, we believe that the margin pressure is likely to continue for CanBank in coming quarters, as the CASA franchise remains low.

Robust other income – fee income surprises positively

CanBank's other income for the quarter has grown by 58% yoy to Rs6.3bn, which was driven mainly by the treasury income (Rs916mn; 3x Q4FY06), Forex income (Rs606mn; 2x Q4FY06). Surprisingly, the fee income has also grown by 20% yoy to Rs1,314mn.

Fee income

Rs mn	Q4FY07	Q4FY06	Q3FY07	% yoy chg	% qoq chg
Trading	916	337	303.2	172	202
CEB	1,314	1,096	1,064.1	20	23
Forex	606	343	471.6	77	29
Others	3,427	2,184	1,000.0	57	243
Total	6,262	3,960	2,838.9	58	121

Higher provisioning dents profits

While CanBank's operating profit has grown by a strong 36.4% yoy to Rs10.5bn driven by higher other income and lower employee expenses for no AS-15 provisions, the strong performance was dented because of higher provisioning. The provisioning was higher by 56% yoy to Rs5bn driven mainly by investment depreciation (higher AFS portfolio) and higher standard asset provisioning.

Provisions

Rs mn	Q4FY07	Q4FY06	Q3FY07	% yoy chg	% qoq chg
NPA	1,018	3,063	500.0	-67	104
<i>As % of advances</i>	<i>0.4</i>	<i>1.5</i>	<i>0.2</i>		
Standard assets	880	150	270.0	487	226
One-time provisions	600				
Investment depreciation	2,400	1,339	1,690.0	79	42
Others	72	-1,560	770.0	-105	-91
Total	4,970	2,994	3,230.2		

Asset quality remains robust but slippage rise

CanBank's asset quality has continued to remain robust with GNPA's having declined to 1.5% (2.3% last year) and NNPA's to 0.9% (1.1% last year) as on March 2007.

Although there has been a rise in NNPA's in absolute terms driven by lower provisioning during current year (0.4% of advances compared with 1.5% last year), the reduction in GNPA has helped to increase the provision cover to 62.1% as on March 2007 compared with less than 50% 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 CanBank as the CASA mix continues to be at one of the lowest in the industry at 33%. Also with AFS category comprising of 57% of SLR investment, the bank remains prone to interest sensitivity and instability of earnings. At the current market price of Rs219 the stock is quoting at 5.0x its FY09E EPS and 0.9x FY09E ABV with likely RoE of 18.5% in FY09E. We maintain our REDUCE recommendation with price target of Rs228.

Quarterly results

Rs mn	FY07	FY06	% yoy chg	Q4FY07	Q4FY06	% yoy chg	% qoq chg
Net interest income	40,269	35,815	12.4	10,593	9,838	7.7	2.0
Other Income	14,510	13,156	10.3	6,262	3,960	58.2	109.2
CEB	4,749	4,308	10.2	1,314	1,096	19.9	23.5
Net income	54,778	48,971	11.9	16,855	13,797	22.2	26.0
Operating expenses	25,653	23,472	9.3	6,334	6,269	1.0	-0.5
Pre-provision profits	29,126	25,499	14.2	10,521	7,528	39.8	50.1
Provisions	12,417	10,067	23.3	4,970	2,992	66.1	89.0
NPA	4,579	7,542	-39.3	1,018	3,063	-66.8	103.5
Profit before tax	16,709	15,432	8.3	5,551	4,535	22.4	26.7
Taxes	2,500	2,000	25.0	500	-400		
Net Profit	14,209	13,432	5.8	5,051	4,935	2.3	39.1

Valuation table

Y/E March 31	Net income	Net profit	EPS (Rs)	ABV (Rs)	RoA (%)	RoE (%)	P/ABV (x)	PE (x)
FY2006	49,590	13,432	32.8	149.7	1.1	20.6	1.5	6.7
FY2007E	54,778	14,209	32.3	195.5	0.9	17.6	1.1	6.8
FY2008E	58,948	14,546	35.5	222.4	0.9	17.0	1.0	6.2
FY2009E	67,871	18,169	44.3	257.6	0.9	18.5	0.9	5.0

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