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India  
India Banks

## Canara Bank (CNBK.NS - INR 232.45) 1-Overweight

Operating Results

Lukewarm Q4; Maintain 1-OW on valuations

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### Investment Conclusion

Canara Bank reported results above ours as well as street expectations. We highlight that expectations were rather tempered given the weak operating performance in the last three quarters. However, with the stock trading at 1.0x FY09E BV and 5.5x FY09E earnings, we believe valuations are cheap and factor in the weaker operating profile vis-à-vis peers. We maintain 1-OW rating on the stock.

FY Mar Currency INR	2007A	2008E		2009E		2010E	
	Actual	Old	New	Old	New	Old	New
Adjusted Net Profit	14208.0	15908.0	15908.0	17471.0	17471.0	20454.0	20454.0
Adjusted EPS	33.1	34.3	34.3	42.6	42.6	49.9	49.9
Adjusted PE Ratio	7.0	6.8	6.8	5.5	5.5	4.7	4.7
BVPS	175.0	257.0	202.0	287.0	232.0	321.7	267.0
P/BV	1.0	0.9	0.9	0.8	0.8	0.7	0.7
ROE	15.5	12.8	12.8	14.3	14.3	14.9	14.9
Dividend Yield	N/A	N/A	N/A	N/A	N/A	N/A	N/A

### Summary

- NII came in at INR 9.2bn (13%yoy decline) higher than our expectation of INR 8.4bn.
- Non-interest income came in at INR 7.1bn, much higher than our expected INR 4.9bn. While we do not have the breakup, we believe that a significant contribution might have come from trading gains.
- We believe current valuations of 1.0x FY09E adjusted BV and 5.5x FY09E earnings are inexpensive both from a historical perspective as well as compared to peers. We maintain 1-OW rating.
- We will get back with more details and review our estimates once we speak to the management and receive more information on the results

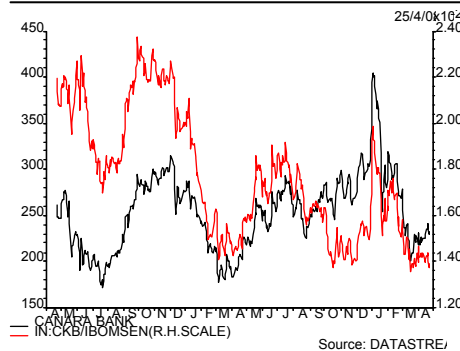
### Market Data

Market Cap (mn)	95304.5
Shares Outstanding (mn)	410.0
Free float (%)	29.0
Trading Volume	92767.0
Convertible	0
Share per ADR	N/A

### Financial Summary

Net Interest Margin	2.6
Net NPL/Loans	0.9
PL provisions/Loans	0.8
Tier 1 ratio	7.7

### Stock Overview



Reuters CNBK.NS  
Bloomberg CBK IN  
ADR

Performance	1M	3M	12M
Absolute %	1.5	-19.7	3.0
Rel. Market %	-3.7	-11.2	-17.1
Rel. Sector %	-	-	-

52 Week Range 404.40 - 200.90

### Stock Rating

New: 1-Overweight  
Old: 1-Overweight

### Target Price

New: INR 340.00  
Old: INR 340.00

Sector View: 1-Positive

**\*Note: We will get back with more details and review our estimates once we speak to the management and receive more information on the results**

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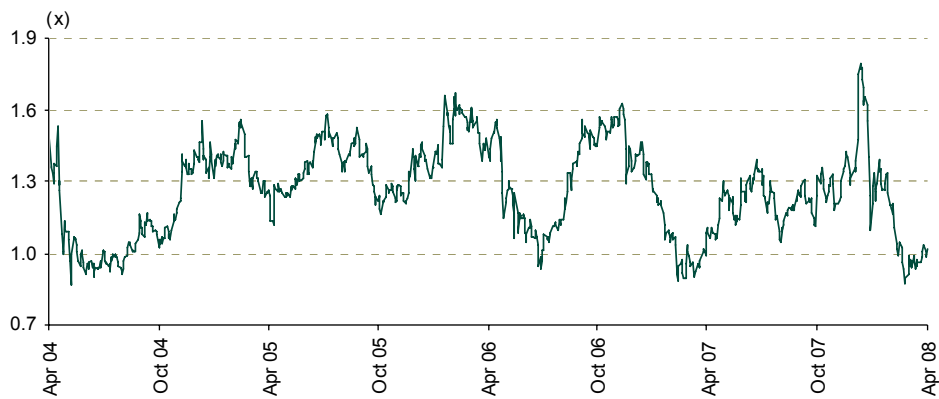
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**Figure 1: Q4FY08 Results Summary**

INR mn	Q407	Q308	Q408	Q408E	YoY growth	QoQ growth
Net interest income	10,593	9,344	9,225	8,420	-13%	-1%
Non-interest income	6,262	5,464	7,143	4,861	14%	31%
Operating income	16,855	14,808	16,368	13,281	-3%	11%
Core operating income	16,855	13,474	16,368	13,281	-3%	21%
Operating expenses	(6,334)	(7,230)	(6,976)	(7,121)	10%	-4%
Operating profit	10,521	7,578	9,392	6,160	-11%	24%
Provision charges	(4,970)	(1,990)	(3,751)	(392)	-25%	88%
Profit before tax	5,551	5,588	5,641	5,769	2%	1%
Tax provided	(500)	(1,000)	(1,000)	(2,011)	100%	0%
Tax rate	9%	18%	18%	35%		
Net profit	5,051	4,588	4,641	3,758	-8%	1%
Advances	985,057	985,810		1,083,563		

Source: Company, Lehman Brothers estimates

**Figure 2: Canara Bank 1 year forward P/BV**



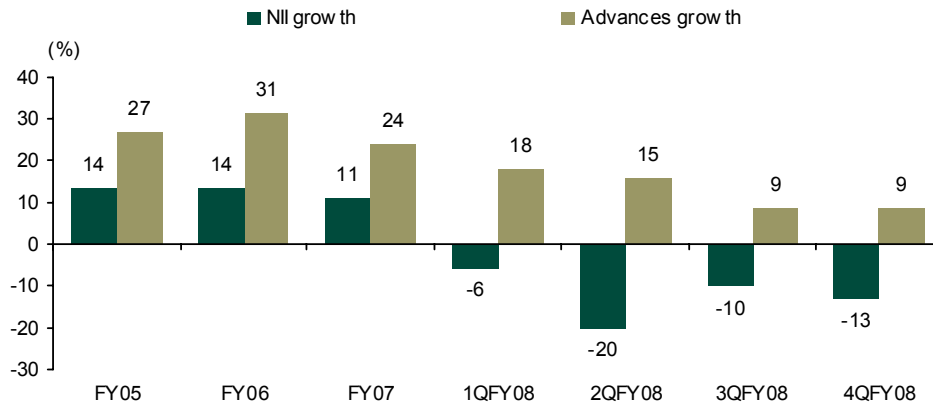
Source: Company, Lehman Brothers research

**Figure 3: Canara Bank 1 year forward P/E**



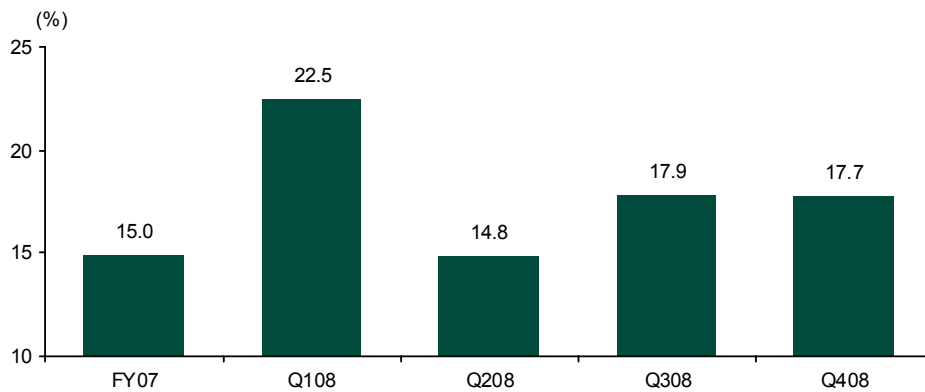
Source: Company, Lehman Brothers research

Figure 4: NII growth, loan growth



Source: Company, Lehman Brothers research

Figure 5: Tax rate



Source: Company, Lehman Brothers research

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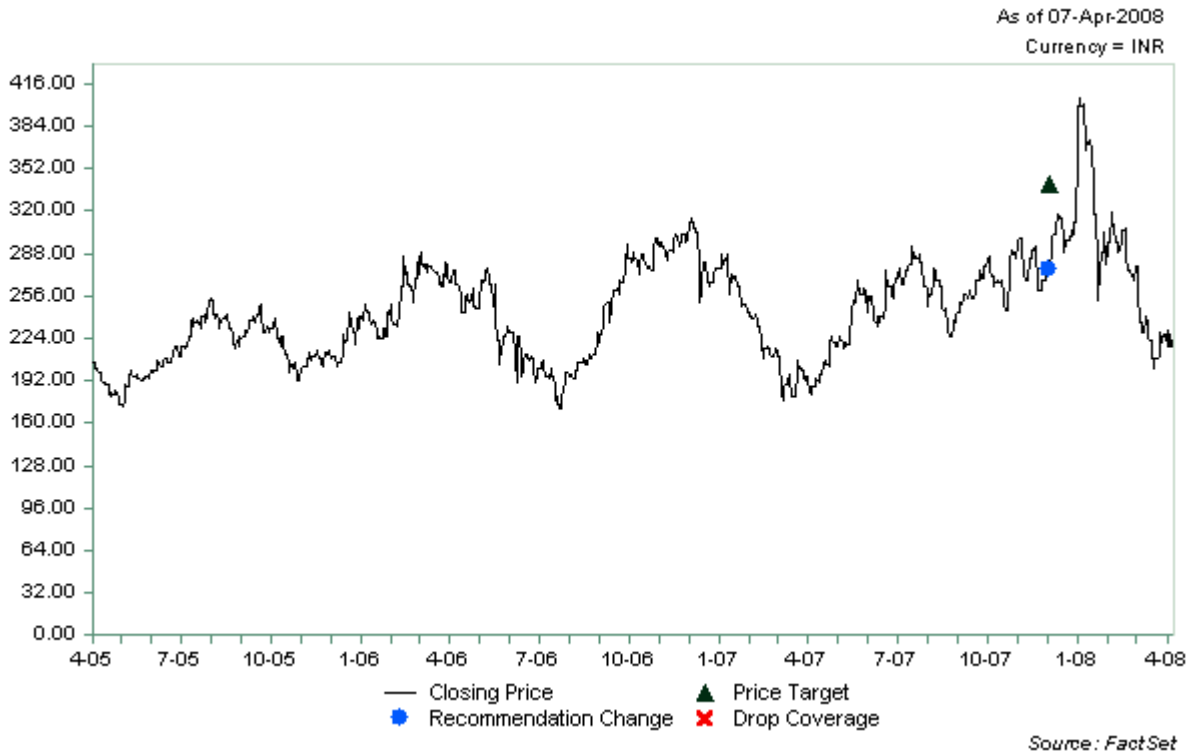
**Canara Bank (CNBK.NS)**

**INR 232.45 (24-Apr-2008)**

**1-Overweight / 1-Positive**

**Rating and Price Target Chart:**

**CANARA BANK**



Currency=INR

Date	Closing Price	Rating	Price Target
03-Dec-07	275.95		340.00

Date	Closing Price	Rating	Price Target
03-Dec-07	275.95	1-Overweight	

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**Valuation Methodology:** We value Canara Bank using a 'three-stage dividend discount model', with explicit forecasts up to FY10E, intermediate growth from FY10E-FY28E and 5% terminal growth in earnings beyond that. We are building in a sustainable ROE of 13.5% and a 16% CAGR in the intermediate phase over FY10E-FY19E and 9% CAGR over FY19E-FY28E.

**Risks Which May Impede the Achievement of the Price Target:** 1) A lower than expected pick up in credit growth. The key disappointment this year has been the weakness in NII growth driven by a sharp slowdown in credit growth. The incremental C/D ratio in 1HFY08 stood at a negative 57% which impacted margins. We are building in incremental C/D ratio of over 100% in 2HFY08 and hence expect some improvement in full year NII growth. We believe that the credit growth for the sector as a whole would pick up with the latest RBI fortnightly data. However, sustained weakness in the bank's credit growth would impact margins as the deposits raised would not be productively deployed. 2) Interest rate movement. Canara Bank has 47% of its investment held in the AFS category. Hence there is a risk to earnings from potentially large depreciation hits in a rising interest rate environment as these AFS investments are marked-to-market at the end of each year. 3) Potential AS15 transitional liabilities. The bank is yet to provide for the unfunded portion of the transitional liabilities arising from adoption of the revised AS15 norms. While the depth of the unfunded portion has not been disclosed, the management has indicated that this could be taken as a one time hit against equity. Based on the declared unfunded corpus of other public sector banks this could amount to anywhere between 5-10% of the book value.

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Company Name	Ticker	Price (24-Apr-2008)	Stock / Sector Rating
Canara Bank	CNBK.NS	INR 232.45	1-Overweight / 1-Positive

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**2-Neutral** - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

**3-Negative** - sector coverage universe fundamentals/valuations are deteriorating.

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