

July 27, 2011

Reco	Previous Reco
Hold	Hold
CMP	Target Price
Rs496	Rs535
EPS change FY12E/13E (%)	-10.2/-4
Target Price change (%)	-4
Nifty	5,547
Sensex	18,432

### Price Performance

(%)	1M	3M	6M	12M
Absolute	(5)	(24)	(17)	6
Rel. to Nifty	(6)	(20)	(15)	4

Source: Bloomberg

### Relative Price Chart



Source: Bloomberg

### Stock Details

Sector	Banks
Bloomberg	CBK@IN
Equity Capital (Rs mn)	4100
Face Value(Rs)	10
No of shares o/s (mn)	410
52 Week H/L	433/257
Market Cap (Rs bn/USD mn)	220/4,645
Daily Avg Volume (No of sh)	46918
Daily Avg Turnover (US\$m)	0.3

### Shareholding Pattern (%)

	Jun-11	Mar-11	Dec-10
Promoters	67.7	67.7	73.2
FII/NRI	15.6	15.0	13.6
Institutions	10.3	11.5	7.4
Private Corp	1.6	0.9	0.8
Public	4.8	4.9	5.1

Source: Capitaline

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- CBK results below expectations with NII at Rs17.9bn and net profit at Rs7.3bn. Slippages at Rs13.6bn, though remain high were lower than Rs19bn in previous quarter
- NII lower driven by interest income reversal of Rs2bn. Adjusted for the same NII growth was at 15.4% (in line). NIMs down by 40bps as expected
- One positive in the results – one of very few banks to have system classified NPAs upto as low as Rs2 lakh loan. We do not expect any -ve surprises on NPAs going forward
- Lowering earnings by 10.2%/4% for FY12E/FY13E for higher provisions (one-time). Large infra book and low NIMs remain key -ves. Maintain HOLD with TP of Rs535 (1.1x FY13E ABV)

### NII growth below expectations

CBK's Q1FY12 NII grew by just 3.8%yoy (-9.1%qoq) to Rs17.9bn driven by flat advances and 70bps contraction in NIM's. The bank reversed interest income on written off accounts to the tune of Rs2bn during the quarter, adjusted for which NII would have grown by 15.4% to Rs19.9bn inline with expectation.

### Yield analysis

%	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	YoY (bps)	QoQ (bps)
Yield on advances*	9.0	9.4	9.5	9.6	10.3	123	67
Yield on investments*	7.5	7.6	7.9	7.5	7.7	18	21
Yield on assets*	7.8	8.1	8.1	8.1	8.5	65	38
Cost of funds*	5.2	5.2	5.2	5.6	6.4	115	75
NIM*	2.6	2.9	2.9	2.5	2.1	-50	-37
NIM (Reported)	3.0	3.2	3.2	3.1	2.4	-59	-70

Source: Company, Emkay Research

### ... as NIM's contracted sharply

The bank's NIM's contracted by a sharp 70bps qoq to 2.4% as cost of deposits increased by a higher 125bps qoq as against just 77bps increase in yield on advances. Higher cost of funds could be attributed to deterioration in CASA mix along with higher interest on term deposits, which has shown an increase on 6.3%qoq.

### Valuation table

Y/E March 31	Net income	Net profit	EPS (Rs)	ABV (Rs)	RoA (%)	RoE (%)	PE (x)	P/ABV (x)
FY2010	85,384	30,214	73.7	261.9	1.2	26.8	7.3	1.9
FY2011	105,263	40,259	90.9	355.0	1.3	26.4	5.5	1.4
FY2012E	110,282	39,214	88.5	414.9	1.1	20.0	5.6	1.2
FY2013E	125,149	46,800	105.6	486.8	1.3	20.1	4.7	1.0

Source: Company, Emkay Research

**Key financials – Quarterly**

Rs mn	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	YoY (%)	QoQ (%)
Net Interest Income	17,271	20,033	21,192	19,729	17,931	3.8	-9.1
Other Income	7,340	4,996	5,376	9,330	5,268	-28.2	-43.5
Fee Income	1,638	1,740	1,690	2,490	1,739	6.1	-30.2
Net Income	24,610	25,029	26,568	29,059	23,199	-5.7	-20.2
Total Operating Expenses	9,785	10,872	11,428	12,109	10,495	7.3	-13.3
As % Of Net Income	39.8	43.4	43.0	41.7	45.2		
Employee Expenses	6,612	7,274	7,838	7,825	6,677	1.0	-14.7
As % Of Net Income	26.9	29.1	29.5	26.9	28.8		
Other Expenses	3,173	3,597	3,591	4,284	3,818	20.3	-10.9
As % Of Net Income	12.9	14.4	13.5	14.7	16.5		
Operating Profit	14,826	14,157	15,140	16,950	12,704	-14.3	-25.1
As % Of Net Income	60.2	56.6	57.0	58.3	54.8		
Provisions	2,200	1,579	1,573	5,460	3,446	56.6	-36.9
Prov for NPA	1,388	1,990	1,300	5,410	2,850	105.4	-47.3
PBT	12,626	12,578	13,567	11,490	9,259	-26.7	-19.4
Total Tax	2,500	2,500	2,500	2,500	2,000	-20.0	-20.0
Adjusted PAT	10,126	10,078	11,067	8,990	7,259	-28.3	-19.3
Extra Ordinary Items	0	0	0	0	0		
Reported PAT	10,126	10,078	11,067	8,990	7,259	-28.3	-19.3
Reported EPS	24.6	24.6	27.0	20.3	4.6	-81.5	-77.5

Source: Company, Emkay Research

**Deposit profile deteriorates sharply**

The bank's CASA mix deteriorated sharply to 25.4% from 28.3% in preceding quarter, as the current deposit declined by 38% sequentially, while term deposits increased by a sharp 6.3% qoq.

**Deposit mix**

Rs bn	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	YoY (%)	QoQ (%)
Current Deposits	158	177	179	245	152	-3.8	-38.0
Savings Deposits	536	543	586	586	609	13.7	3.9
CASA	694	720	765	831	761	9.7	-8.4
Term deposits	1,695	1,772	1,870	2,109	2,240	32.2	6.3
Total Deposits	2,389	2,492	2,635	2,940	3,002	25.7	2.1
CASA (%)	29.0	28.9	29.0	28.3	25.4	-368	-292

Source: Company, Emkay Research

### Lower recovery and trading loss hit other income

The bank's other income reported a decline of 43.5% qoq to Rs5.3bn led by lower recovery and higher trading loss during the quarter. However, the fee income including forex gains and other components grew by 22% yoy and 5.1% qoq.

#### Fee income

Rs mn	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	YoY (%)	QoQ (%)
Fee/Commission income	1,638	1,740	1,690	2,490	1,739	6.1	-30.2
Trading gains/(losses)	2,240	16	290	-180	-770	-134.4	327.6
Forex gains/(losses)	744	710	1,200	1,160	960	29.1	-17.2
Dividend income	354	400	360	1,720	625	76.6	-63.7
Recovery	880	650	720	3,270	663	-24.7	-79.7
Other	1,485	1,480	1,116	870	2,052	38.2	135.9
<b>Total</b>	<b>7,340</b>	<b>4,996</b>	<b>5,376</b>	<b>9,330</b>	<b>5,268</b>	<b>-28.2</b>	<b>-43.5</b>

Source: Company, Emkay Research

### Core operating profit growth better if adjusted for interest reversal

Though the reported operating profit declined by 14% yoy (25% qoq), adjusted for the interest income reversal and pension cost, the growth in core operating profit could have been higher at 21% yoy.

#### Core operating profit growth at 21%

Rs mn	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	YoY (%)	QoQ (%)
Reported operating profit	14,826	14,157	15,140	16,950	12,704	-14.3	-25.1
Less: Treasury gains	2,240	16	290	-180	-770		
Core operating profit	12,586	14,142	14,850	17,130	13,474		
Add: Pension/gratuity	1,275	2,251	3,056	3,696	1,267		
Add: interest income reversal					2,000		
Adjusted operating profit	13,861	16,392	17,906	20,827	16,740	20.8	-19.6

Source: Company, Emkay Research

### Lower provisioning despite higher slippages

Despite high slippages during the quarter, the bank has provided just Rs2.8bn for NPAs. In fact, provisions during the quarter were just in accordance with the new provisions norms of RBI. We expect the provisions to remain high in coming quarters as the bank tries to inch up its PCR which fell to 69.5% during the quarter.

### Slippages remain high; but may have peaked out

As CBK moved all the accounts above Rs2lakhs (one of few banks) to system based NPA recognition, the slippage rate remains higher at 2.6% for the quarter as against 1.8% for FY11. The higher slippages during the quarter were primarily driven by SME segment.

Since the bank has already classified loans upto Rs2lakh under system based recognition, we believe that the scope for negative surprises in CBK's NPAs now remains limited and the slippages may continue to get lower in coming quarters.

#### Asset quality

Rs mn	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	YoY (%)	QoQ (%)
Gross NPAs	25,491	26,361	27,533	30,892	36,063	41.5	16.7
Net NPAs	17,294	18,597	19,910	23,473	28,711	66.0	22.3
Gross NPAs (%)	1.5	1.5	1.4	1.5	1.7		
Net NPAs (%)	1.0	1.1	1.1	1.1	1.3		
Net NPAs/Net worth (%)	10.9	11.1	11.4	11.7	240.9		
Provision cover (%)	32.2	29.5	27.7	24.0	20.4		
Provision cover incl tech write off (%)	78.0	77.1	75.9	73.0	69.5		

Source: Company, Emkay Research

**Valuations and view**

We have downgraded earnings by 10.6%/3.2% for FY12E/FY13E for higher provisions (one-time) and marginally lower NIMs. We believe that the scope for negative surprises in CBK's slippages now remains limited. A large infra book and low NIMs remain key negatives for the stock. Maintain HOLD with TP of Rs535 (1.1x FY13E ABV).

## Financials

## Income Statement (Rs. Mn)

(Year Ending Mar 31)	FY10	FY11	FY12E	FY13E
Net interest income	56,805	78,233	84,570	96,383
Other income	28,579	27,030	25,712	28,766
Net income	85,384	105,263	110,282	125,149
Operating expenses	34,776	44,193	45,113	51,186
Pre provision profit	50,608	61,070	65,169	73,963
PPP excl treasury	41,884	58,707	62,806	71,600
Provisions	12,394	10,811	15,573	14,771
Profit before tax	38,214	50,259	49,596	59,192
Tax	8,000	10,000	10,383	12,391
Tax rate	20.9%	20.9%	20.9%	20.9%
Profit after tax	30,214	40,259	39,214	46,800

## Balance Sheet (Rs. Mn)

(Year Ending Mar 31)	FY10	FY11	FY12E	FY13E
<b>Liabilities</b>				
Equity	4,100	4,430	4,430	4,430
Reserves	142,618	195,968	228,962	269,024
Net worth	146,718	200,398	233,392	273,454
Deposits	2,346,514	2,939,726	3,498,797	4,197,279
Borrowings	157,285	220,663	225,163	229,663
Total liabilities	2,650,517	3,360,787	3,957,352	4,700,396
<b>Assets</b>				
Cash and bank	196,532	307,081	367,398	483,350
Investments	676,074	816,304	926,855	1,118,299
Customer assets	1,714,042	2,145,366	2,570,301	3,003,734
Others	63,869	92,035	92,798	95,013
Total assets	2,650,517	3,360,787	3,957,352	4,700,396

## Key Ratios (%)

(Year Ending Mar 31)	FY10	FY11	FY12E	FY13E
NIM	2.3	2.6	2.3	2.2
Non-Il/avg assets	1.2	0.9	0.7	0.7
Fee income/avg assets	0.3	0.2	0.2	0.2
Opex/avg assets	1.3	1.3	1.1	1.1
Provisions/avg assets	0.9	0.5	0.5	0.4
PBT/avg assets	1.4	1.5	1.3	1.3
Tax/avg assets	0.3	0.3	0.3	0.3
RoA	1.2	1.3	1.1	1.3
RoAE	26.8	26.4	20.0	20.1
GNPA (%)	1.7	1.6	1.6	1.7
NNPA (%)	1.1	1.1	1.1	1.2

## Valuations Table

(Year Ending Mar 31)	FY10	FY11	FY12E	FY13E
Net profit (Rs mn)	30,214	40,259	39,214	46,800
Shares in issue (mn)	410	443	443	443
EPS (Rs)	73.7	90.9	88.5	105.6
PER (x)	6.7	5.5	5.6	4.7
FDEPS(Rs)	68.2	90.9	88.5	105.6
FDPER (x)	7.3	5.5	5.6	4.7
Book value (Rs)	277.2	379.5	454.0	544.4
P/BV (x)	1.8	1.3	1.1	0.9
Adj book value (Rs)	261.9	355.0	414.9	486.8
P/ABV (x)	1.9	1.4	1.2	1.0
P/PPP (x)	4.0	3.6	3.4	3.0
Dividend yield (%)	2.0	2.2	2.4	2.6

**Recommendation History: Canara Bank – CBK IN**

Date	Reports	Reco	CMP	Target
05/05/2011	<a href="#">Canara Bank Q4FY11 Result Update</a>	Reduce	559	560
31/01/2011	<a href="#">Canara Bank Q3FY11 Result Update</a>	Hold	602	640
20/10/2010	<a href="#">Canara Bank Q2FY11 Result Update</a>	Reduce	657	636
27/10/2009	<a href="#">Canara Bank Q2FY10 Result Update</a>	Reduce	363	280

**Recent Research Reports**

Date	Reports	Reco	CMP	Target
25/07/2011	<a href="#">Bank of India Q1FY12 Result Update</a>	Hold	404	420
22/07/2011	<a href="#">Union Bank of India Q1FY12 Result Update</a>	Hold	309	330
22/07/2011	<a href="#">Allahabad Bank Q1FY12 Result Update</a>	Accumulate	218	240
22/07/2011	<a href="#">Axis Bank Q1FY12 Result Update</a>	Hold	1,297	1,380

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