

October 31, 2011

<b>Reco</b>	<b>Previous Reco</b>
Hold	Hold
<b>CMP</b>	<b>Target Price</b>
Rs469	Rs500
EPS change FY12E/13E (%)	-20/-7.6
Target Price change (%)	-4
Nifty	5,327
Sensex	17,705

### Price Performance

(%)	1M	3M	6M	12M
Absolute	6	2	(22)	(35)
Rel. to Nifty	(2)	5	(16)	(26)

Source: Bloomberg

### Relative Price Chart



Source: Bloomberg

### Stock Details

Sector	Banks
Bloomberg	CBK@IN
Equity Capital (Rs mn)	4430
Face Value(Rs)	10
No of shares o/s (mn)	443
52 Week H/L	844/401
Market Cap (Rs bn/USD mn)	208/4,262
Daily Avg Volume (No of sh)	768657
Daily Avg Turnover (US\$m)	6.9

### Shareholding Pattern (%)

	Sep-11	Jun-11	Mar-11
Promoters	67.7	67.7	67.7
FII/NRI	14.6	15.6	15.0
Institutions	10.9	10.3	11.5
Private Corp	1.8	1.6	0.9
Public	5.0	4.8	4.9

Source: Capitaline

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## Results inline at P&L front; Slippages remain higher

- **CBK results ahead of expectation at P&L front with NII at Rs19.6bn and Net profit at Rs8.5bn, however continues to disappoint on asset quality side**
- **NII grew by 9.4%qoq (-2.1%qoq) to Rs19.6bn ahead of consensus led by 22bps expansion in NIM's, albeit advances grew by just 1.4%qoq**
- **Slippages remain higher at 2.4%. Building in 2% slippage rate for FY12, reco/upgrades rate at 80% of opening NPAs can surprise positively on credit costs**
- **Lowering earnings by 20%/ 7.6% for FY12/13 for higher prov. However better recoveries can give positive surprise to our numbers. Maintain HOLD with TP of Rs500**

### Results above expectation; Higher other income boost earnings

CBK's Q2FY12 NII grew by 9.4%qoq (-2.1%yoy) to Rs19.6bn ahead of our expectation led by 22bps expansion in NIM's, albeit advances grew by just 1.4%qoq. The higher NIM's was led by 50bps expansion in yield on advances, while increase in cost of funds was limited to just 11bps. The bank reversed interest income on written off accounts to the tune of Rs1.2bn during the quarter (Rs2.2bn in previous quarter), adjusted for which NII would have grown by lower 3.9% to Rs20.8bn. Moreover with higher trading gains and recoveries, the net profit growth was higher at 17.4%qoq to Rs8.5bn.

The advance grew by a moderate 1.4%qoq, while deposits growth was higher at 4.1%qoq, resulting in CD ratio coming down by almost 200 bps to 70%. Though growth across SME, Retail and Agri was healthy in the range of 5-8%qoq, corporate advance declined by 2.6%qoq.

### Yield analysis

%	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (bps)	QoQ (bps)
Yield on advances*	9.4	9.5	9.6	10.3	10.8	137	50
Yield on investments*	7.6	7.9	7.5	7.7	7.5	-15	-22
Yield on assets*	8.1	8.1	8.1	8.5	8.7	61	24
Cost of funds*	5.2	5.2	5.6	6.4	6.5	128	11
NIM*	2.9	2.9	2.5	2.1	2.2	-67	13
NIM (Reported)	3.2	3.2	3.1	2.4	2.6	-52	22

Source: Company, Emkay Research

### 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	6.8	1.8
FY2011	105,263	40,259	90.9	355.0	1.3	26.4	5.1	1.3
FY2012E	108,705	31,380	70.8	398.6	0.9	16.3	6.6	1.2
FY2013E	130,698	43,210	97.5	472.9	1.3	19.4	4.8	1.0

Source: Company, Emkay Research

**Key financials – Quarterly**

Rs mn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)	YTD'12	YTD'11	YoY (%)
Net Interest Income	20,033	21,192	19,729	17,931	19,617	-2.1	9.4	37,548	37,304	0.7
Other Income	4,996	5,376	9,330	5,268	8,283	65.8	57.2	13,551	12,336	9.9
Fee Income	1,740	1,690	2,490	1,739	2,040	17.2	17.3	3,779	3,378	11.9
Net Income	25,029	26,568	29,059	23,199	27,900	11.5	20.3	51,099	49,639	2.9
Total Operating Expenses	10,872	11,428	12,109	10,495	11,846	9.0	12.9	22,341	20,656	8.2
As % Of Net Income	43.4	43.0	41.7	45.2	42.5			43.7	41.6	
Employee Expenses	7,274	7,838	7,825	6,677	7,670	5.4	14.9	14,346	13,886	3.3
As % Of Net Income	29.1	29.5	26.9	28.8	27.5			28.1	28.0	
Other Expenses	3,597	3,591	4,284	3,818	4,177	16.1	9.4	7,995	6,770	18.1
As % Of Net Income	14.4	13.5	14.7	16.5	15.0			15.6	13.6	
Operating Profit	14,157	15,140	16,950	12,704	16,053	13.4	26.4	28,757	28,983	-0.8
As % Of Net Income	56.6	57.0	58.3	54.8	57.5			56.3	58.4	
Provisions	1,579	1,573	5,460	3,446	5,531	250.3	60.5	8,977	3,779	137.5
Prov for NPA	1,990	1,300	5,410	2,850	4,768	139.6	67.3	7,618	3,377	125.6
PBT	12,578	13,567	11,490	9,259	10,522	-16.3	13.7	19,781	25,204	-21.5
Total Tax	2,500	2,500	2,500	2,000	2,000	-20.0	0.0	4,000	5,000	-20.0
Adjusted PAT	10,078	11,067	8,990	7,259	8,522	-15.4	17.4	15,781	20,204	-21.9
Extra Ordinary Items	0	0	0	0	0			0	0	
Reported PAT	10,078	11,067	8,990	7,259	8,522	-15.4	17.4	15,781	20,204	-21.9
Reported EPS	24.6	27.0	20.3	4.6	4.6	-81.5	0.0	9	49	-81.5

Source: Company, Emkay Research

**NIMs actually decline further adjusted for one time interest**

While the increase in the cost of funds has moderated during the quarter to just 5bps qoq, the margins have failed to pick up significantly driven by inability to pass on the costs without compromising the asset quality, In fact, adjusted for one time income of unapplied interest income on NPAs recovered during the quarter (Rs2.2bn), the NIMs would have contracted by 21bps qoq.

**Yields as reported**

%	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (bps)	QoQ (bps)
Yield on Advances	9.61	9.67	9.74	10.50	10.72	111	22
Yield on Investments	7.61	7.68	7.72	7.86	7.89	28	3
Yield on Funds	8.12	8.12	8.13	8.66	8.76	64	10
Cost of Deposits	5.69	5.66	5.80	7.05	7.13	144	8
Cost of Funds	5.30	5.26	5.37	6.50	6.55	125	5

Source: Company, Emkay Research

**Advance growth slower at just 1.4%qoq as the corporate book shrinks**

The advances grew by a moderate 1.4%qoq to Rs2.2tn, primarily led by 2.6% decline in corporate and other loans. Consequently, the proportion of corporate book shrank by 226bps to 55.2% of the total advance book. However other segments like SME, Retail and Agri reported a healthy increase of 5-8%qoq in loan book.

**Advance Break Up**

Rs bn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)	% of total
SME	328	353	377	370	398	21.2	7.5	18.2
Agriculture	239	271	297	305	328	37.3	7.7	15.0
Retail	260	289	316	240	251	-3.6	4.4	11.5
Mortgages	117	143	152	152	158	35.7	3.9	7.3
Others	934	985	1,136	1,235	1,203	28.8	-2.6	55.2
<b>Total</b>	<b>1,761</b>	<b>1,899</b>	<b>2,125</b>	<b>2,150</b>	<b>2,179</b>	<b>23.8</b>	<b>1.4</b>	<b>100.0</b>

Source: Company, Emkay Research

**CASA mix improves slightly despite aggressive deposit growth**

Despite 4.1%qoq growth in deposits, the bank's CASA mix improved by 50bps to 25.8%. Higher growth in CASA deposit at 6%qoq, as against 3.5%qoq growth in term deposits helped in slight improvement in CASA mix. Nonetheless, CBK's CASA mix still remains one of the lowest in the industry.

**Deposit mix**

Rs bn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)
Current Deposits	177	179	245	152	167	-5.3	10.1
Savings Deposits	543	586	586	609	640	17.9	5.1
CASA	720	765	831	761	808	12.2	6.1
Term deposits	1,772	1,870	2,109	2,240	2,318	30.8	3.5
Total Deposits	2,492	2,635	2,940	3,002	3,126	25.4	4.1
CASA (%)	28.9	29.0	28.3	25.4	25.8	-305	49

Source: Company, Emkay Research

**Higher recovery and trading gains boosted other income**

The banks other income reported a robust growth of 57.2%qoq to Rs8.3bn, primarily led by higher trading gains and recoveries during the quarter. While, trading gains stood higher at Rs1.5bn as against loss of Rs770mn in the preceding quarter, recoveries were also robust at Rs1.4bn as against 663mn in the previous quarter.

The management has attributed the higher trading gains to higher churning of portfolio during the quarter, which may not be repeated.

**Fee income**

Rs mn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)	YTD'12	YTD'11	YoY (%)
Fee/Commission income	1,740	1,690	2,490	1,739	2,040	17.2	17.3	3,779	3,378	11.9
Trading gains/(losses)	16	290	-180	-770	1,490	9,330.4	-293.6	720	2,255	-68.1
Forex gains/(losses)	710	1,200	1,160	960	1,070	50.7	11.5	2,030	1,454	39.7
Dividend income	400	360	1,720	625	200	-50.0	-68.0	825	754	9.4
Recovery	650	720	3,270	663	1,350	107.7	103.7	2,013	1,530	31.6
Other	1,480	1,116	870	2,052	2,133	44.1	3.9	4,185	2,965	41.1
<b>Total</b>	<b>4,996</b>	<b>5,376</b>	<b>9,330</b>	<b>5,268</b>	<b>8,283</b>	<b>65.8</b>	<b>57.2</b>	<b>13,551</b>	<b>12,336</b>	<b>9.9</b>

Source: Company, Emkay Research

**Slippage rate may fall back to normal levels...**

The bank slippage rate remains higher at 2.4%, with slippages of 12.4bn during the quarter. However half (Rs6.2bn) of the slippages accrued on account of migration to system based NPA recognition. Of the remaining slippages, around Rs3bn were borderline cases, which could be upgraded in the upcoming quarters.

**Asset quality**

Rs mn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)
Gross NPAs	26,361	27,533	30,892	36,063	37,933	43.9	5.2
Net NPAs	18,597	19,910	23,473	28,711	31,170	67.6	8.6
Gross NPAs (%)	1.5	1.4	1.5	1.7	1.7		
Net NPAs (%)	1.1	1.1	1.1	1.3	1.4		
Net NPAs/Net worth (%)	11.1	11.4	11.7	13.8	14.5		
Provision cover (%)	29.5	27.7	24.0	20.4	17.8		
Provision cover incl tech write off (%)	77.1	75.9	73.0	69.5	68.6		

Source: Company, Emkay Research

**... And alongwith better recoveries/upgrades may surprise on provisions**

CBK's recoveries and upgradation rate has also gone up significantly over last two years with H1FY12 rate at 80% of the opening GNPA's (annualized). If slippages fall back to a normalized level of Rs6bn/quarter, our numbers may see significant revisions due to lower provisions costs.

Also, CBK has Rs62bn in the prudentially written off accounts which may help boost the other income through higher recoveries.

**Valuations and view**

We have cut earnings by 20%/7.6% for FY12E/FY13E for higher slippages and provisions. We are not changing our operating numbers like advances growth (18% yoy) and NIMs assumption (2.2%).

However, few factors which can give positive surprises to our numbers (1) better recoveries and upgrades alongwith lower than H1FY12 slippages (2) 30% of deposits are bulk in nature and any drop in wholesale deposit costs can give boost to our NIMs assumptions and (3) recoveries in the written off accounts could add further to other income. Maintain HOLD with TP of Rs500.

## Financials

### Income Statement (Rs. Mn)

(Year Ending Mar 31)	FY10	FY11	FY12E	FY13E
Net interest income	56,805	78,233	80,387	100,654
Other income	28,579	27,030	28,318	30,044
Net income	85,384	105,263	108,705	130,698
Operating expenses	34,776	44,193	45,129	51,230
Pre provision profit	50,608	61,070	63,576	79,468
PPP excl treasury	41,884	58,707	62,576	78,468
Provisions	12,394	10,811	22,822	23,351
Profit before tax	38,214	50,259	40,754	56,117
Tax	8,000	10,000	9,373	12,907
Tax rate	20.9%	20.9%	23.0%	23.0%
Profit after tax	30,214	40,259	31,380	43,210

### 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	221,129	257,601
Net worth	146,718	200,398	225,559	262,031
Deposits	2,346,514	2,939,726	3,509,396	4,216,234
Borrowings	157,285	220,663	225,163	229,663
Total liabilities	2,650,517	3,360,787	3,960,117	4,707,928
<b>Assets</b>				
Cash and bank	196,532	307,081	368,511	485,533
Investments	676,074	816,304	929,518	1,123,133
Customer assets	1,714,042	2,145,366	2,570,301	3,003,734
Others	63,869	92,035	91,788	95,529
Total assets	2,650,517	3,360,787	3,960,117	4,707,928

### Key Ratios (%)

(Year Ending Mar 31)	FY10	FY11	FY12E	FY13E
NIM	2.3	2.6	2.2	2.3
Non-Il/avg assets	1.2	0.9	0.8	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	0.8	0.7
PBT/avg assets	1.4	1.5	1.0	1.2
Tax/avg assets	0.3	0.3	0.2	0.3
RoA	1.2	1.3	0.9	1.3
RoAE	26.8	26.4	16.3	19.4
GNPA (%)	1.7	1.6	1.6	1.5
NNPA (%)	1.1	1.1	1.1	1.1

### Valuations Table

(Year Ending Mar 31)	FY10	FY11	FY12E	FY13E
Net profit (Rs mn)	30,214	40,259	31,380	43,210
Shares in issue (mn)	410	443	443	443
EPS (Rs)	73.7	90.9	70.8	97.5
PER (x)	6.3	5.1	6.6	4.8
FDEPS(Rs)	68.2	90.9	70.8	97.5
FDPER (x)	6.8	5.1	6.6	4.8
Book value (Rs)	277.2	379.5	436.3	518.6
P/BV (x)	1.7	1.2	1.1	0.9
Adj book value (Rs)	261.9	355.0	398.6	472.9
P/ABV (x)	1.8	1.3	1.2	1.0
P/PPP (x)	3.8	3.4	3.3	2.6
Dividend yield (%)	2.1	2.4	2.6	2.8

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

Date	Reports	Reco	CMP	Target
27/07/2011	<a href="#">Canara Bank Q1FY12 Result Update</a>	Hold	496	535
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

**Recent Research Reports**

Date	Reports	Reco	CMP	Target
24/10/2011	<a href="#">M&amp;M Financial Services Q2FY12 Result Update</a>	Buy	640	800
24/10/2011	<a href="#">Union Bank of India Q2FY12 Result Update</a>	Reduce	212	210
24/10/2011	<a href="#">Axis Bank Q2FY12 Result Update</a>	Accumulate	1,124	1,380
20/10/2011	<a href="#">Yes Bank Q2FY12 Result Update</a>	Accumulate	285	340

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