

CANARA BANK

BANKS & FINANCIAL SERVICES

Slippages climb, downgrade to HOLD

Canara Bank (CBK) reported a weak set of numbers (Q4 PAT of Rs 2.1 bn, down 33% QoQ) despite ~Rs 7 bn profit from stake sale in CanFin Homes (high trading profits at Rs 11.3 bn). Provisions (Rs 27 bn, up 82% QoQ) dragged the performance lower. Headline GNPA's improved marginally (down 34 bps QoQ at 9.6%) but were led by write-offs (Rs 24.7 bn) and not reduction in slippages (slippage ratio at 3.8% in Q4 vs. 2.7% last quarter).

Operating metrics were weak as well, with a few silver linings. Advances were up 5% YoY after 4 quarters of consolidation. Domestic CASA (%) improved to ~33% (up ~75 bps QoQ) supported by ~23% YoY growth in SA deposits. NIM was flat QoQ at 2.2% benefitting from higher CASA share. CBK raised ~Rs 11 bn via rights issue during the quarter, raising Tier-1 capital by 76 bps QoQ to 9.8%.

CMP : Rs 396
Potential Upside : -1%

MARKET DATA

No. of Shares : 597 mn
Free Float : 34%
Market Cap : Rs 236 bn
52-week High / Low : Rs 415 / Rs 171
Avg. Daily vol. (6mth) : 3.6 mn shares
Bloomberg Code : CBK IB Equity
Promoters Holding : 66%
FII / DII : 5% / 21%

Key highlights: (a) Advances growth was muted, explained by consolidation in corporate loan book (down ~2% YoY and flat QoQ). Retail, SME and Agri segments grew 9-11% YoY; (b) Housing loan and vehicles loans – a focus area for the bank – grew in high teens; (c) FY18 targets: 7-8% deposits growth (3% achieved in FY17), 11-12% advances growth (5% achieved in FY17) and domestic CASA ratio improvement to ~35% (33% in FY17). It also targets slippage ratio of ~1.5% (2.3% in FY17), with an expected decline in credit costs.

Downgrade to HOLD given 30% run up in stock price in the past month: We cut our FY18E earnings by 31% to factor in lower advances growth, higher credit cost and margin pressure due to recent cut in MCLR rates. The stock has run up 30% in the past month – we downgrade to **HOLD with revised SOTP-based TP of Rs 390 (1% downside from CMP)** vs. Rs 330 earlier. We maintain target multiple of 1.1xP/ABV and roll forward to FY19E on the core book. At CMP, the stock trades at 1.3x/1.1x FY18E/FY19E ABV (adjusted for cost and value of investments).

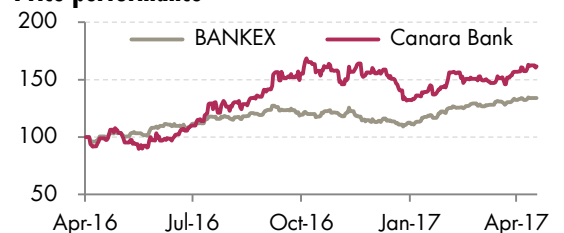
Financial summary (Standalone)

Y/E March	FY16	FY17	FY18E	FY19E
PAT (Rs mn)	(28,128)	11,219	21,739	29,870
EPS (Rs)	(52)	19	36	50
EPS chg (%)	(191.1)	(136.3)	-	37.4
Book value (Rs)	482	474	507	553
Adj. BV (Rs)	225	231	275	335
P/ABV (x)*	1.8	1.6	1.3	1.1
P/ABV (x)	1.8	1.7	1.4	1.2
RoE (%)	(10.7)	4.1	7.4	9.4
RoA (%)	(0.5)	0.2	0.4	0.5
Net NPA (%)	6.4	6.3	5.5	4.5

Source: Company, Axis Capital * P/ABV – adjusted for cost and value of investments

Key drivers

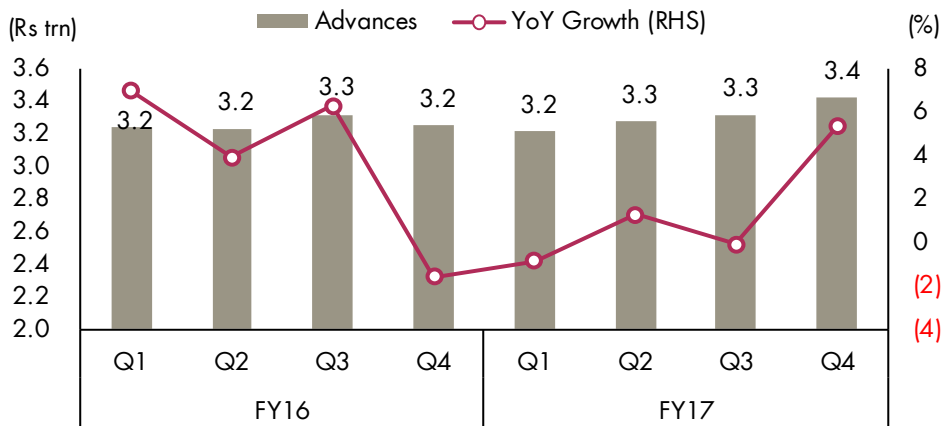
(%)	Q1'17	Q2'17	Q3'17	Q4'17
Loan growth YoY	(1)	1	(0)	5
NIM	2.2	2.2	2.2	2.2
Dom. CASA	29	29	32	33
GNPA Ratio	9.7	9.8	10.0	9.6

Price performance


Growth outlook

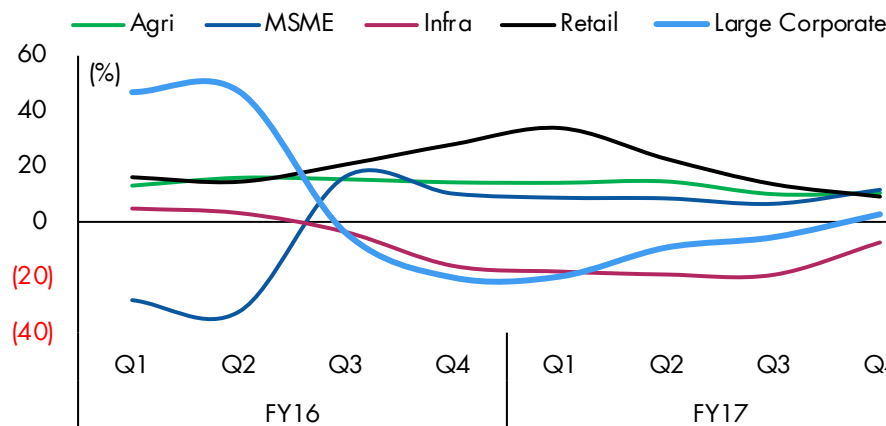
- ◆ Management has consciously kept deposit rates low to manage credit-deposit ratio(69% in FY17) and is focusing on redeployment of resources
- ◆ Sharp decline in the indirect housing segment was due to a lumpy repayment from an HFC. Direct housing however continued to grow at a healthy clip of ~19% and remains a focus area for the bank
- ◆ Management targets 7-8% deposits growth (3% achieved in FY17), 11-12% advances growth (5% achieved in FY17) and domestic CASA ratio improvement to ~35% (33% in Q4FY17)
- ◆ Bond conversion under UDAY scheme is now behind

Exhibit 1: Advances growth finally picked up after several quarters



Source: Company, Axis Capital

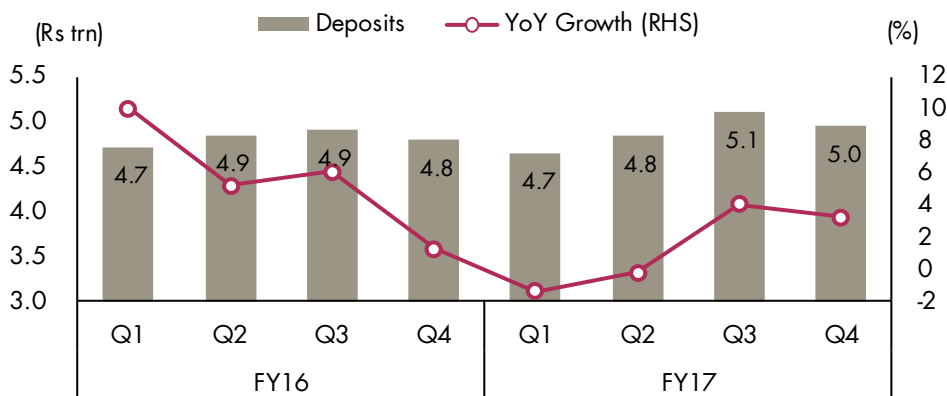
Exhibit 2: Retail, SME and agriculture segments continue to witness healthy growth



Source: Company, Axis Capital

Retail growth has been sliding QoQ. CBK stated that this phenomenon was due to intense competition on yields in some retail sub-segments

Exhibit 3: Management choosing to discourage high cost deposits to manage LDR (%)

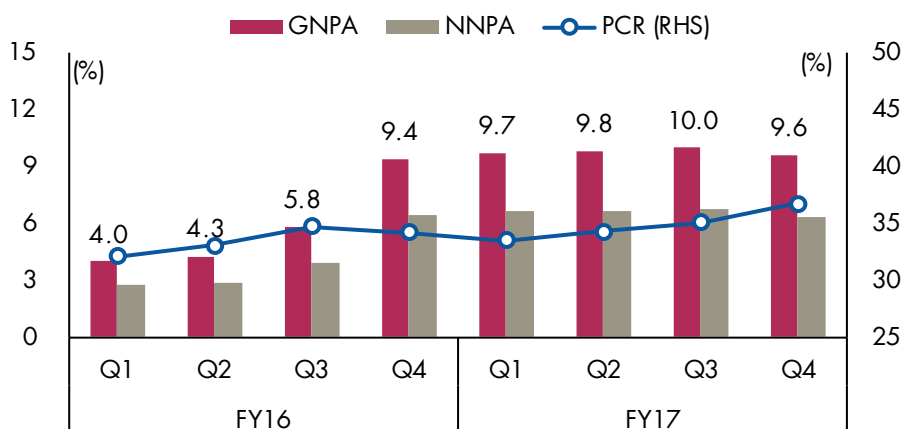


Source: Company, Axis Capital

Asset quality

- ◆ Management targets slippage ratio of ~1.5% for FY18. Credit costs may come off too (2.3% in FY17 attributed primarily to ageing of NPAs)
- ◆ CBK saw lumpy slippages in 3 accounts from infra, roads and steel sector, which coupled with Rs 5 bn of RBI-directed divergence recognition caused the rise in slippages during Q4
- ◆ CBK has o/s SDRs of Rs 70 bn and S4As of ~Rs 40 bn, which it believes may be difficult to resolve in near term
- ◆ Some visibility exists in a few large NPAs in D1 category (attracting 35% provisions) but these too may require 10-15% of additional provisions in case of solutions/ restructurings in coming fiscal
- ◆ SMA-2 accounts reduced materially YoY from ~Rs 180 bn to ~Rs 80 bn in Q4FY17
- ◆ The bank has not sold any account to ARCs during FY17, nor has witnessed any deterioration in NAVs of o/s SRs

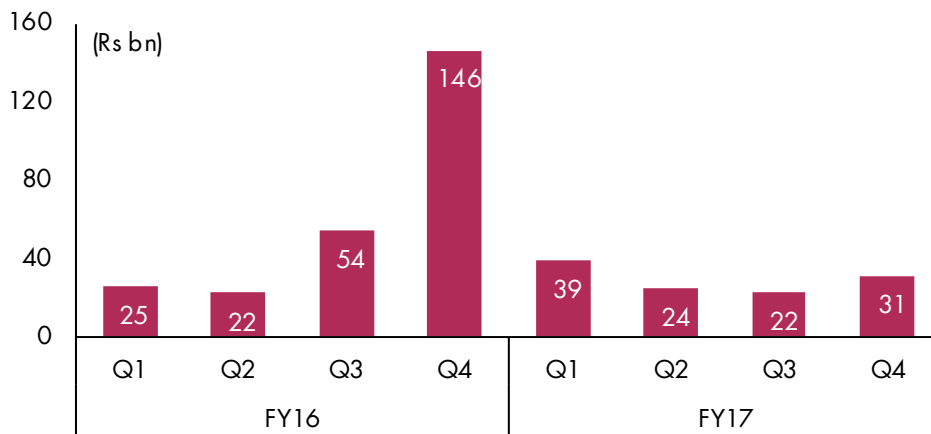
Exhibit 4: Headline asset quality improvement optical



Large w/off's help the headline ratio improve, but slippages increase QoQ (2.7% to 3.8%)

Source: Company, Axis Capital

Exhibit 5: Slippages include ~Rs 5 bn of RBI-directed divergence recognition



Source: Company, Axis Capital

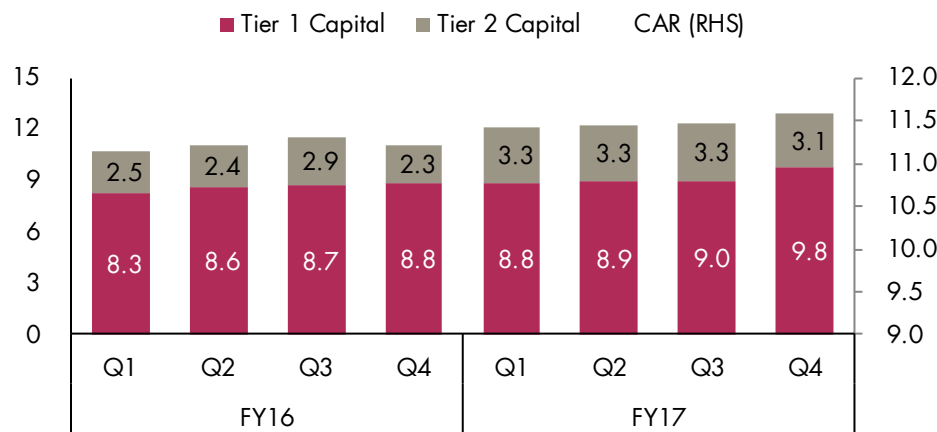
Exposure to risky sectors

- ◆ ~68% of steel exposures are already recognized as NPAs, whereas ~11% of power generation exposures have slipped into NPAs
- ◆ Telecom sector exposures are to large companies, and management does not see any significant risk to this in the near term
- ◆ Overall cement exposure (Rs 20 bn) is standard and management doesn't see any stress here

Non-interest income

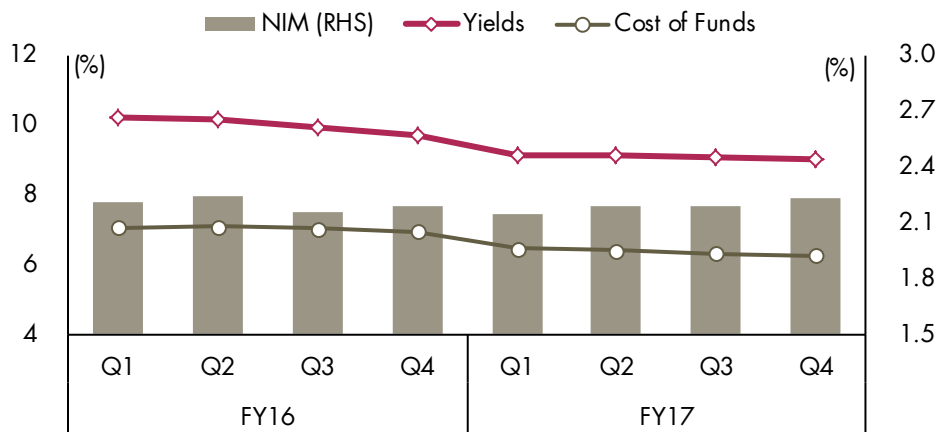
- ◆ Non-Interest income for Q4 includes ~Rs 7 bn of profit from sale of stake in CanFin Homes – its HFC arm (no further plans to sell any more stake in CanFin Homes)
- ◆ ~Rs 850 mn of fees was earned from sale of PSL certificates during the quarter (Rs 2.2 bn for FY17) – a benefit of complete PSL compliance

Exhibit 6: Capital adequacy boosted by rights issue during the quarter



Source: Company, Axis Capital

Exhibit 7: Trend in NIM – stable despite a world of slippages and interest reversals



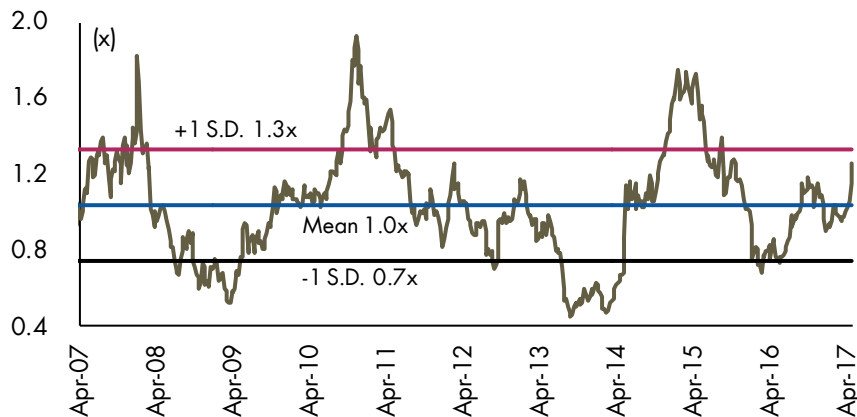
Source: Company, Axis Capital

Exhibit 8: SOTP

	Valuation basis	Value per share
Subsidiaries & Associates		
Canfin Homes	At CMP (with 20% HoldCo discount)	31
CanaraRobeco AMC	5% of AUM	4
Canara HSBC Life Insurance	14x FY19E NBAP (14%) + trailing EV	22
Value of Subsidiaries and Associates		57
Standalone book of Canara Bank	1.1x FY19E P/ABV	333
Total Value per share for Canara Bank		390

Source: Company, Axis Capital

Exhibit 9: 10 years P/ABV movement



Source: Bloomberg, Axis Capital

Exhibit 10: Results update

(Rs mn)	Quarter ended					12 months ended		
	Mar-17	Mar-16	% Chg	Dec-16	% Chg	Mar-18E	Mar-17	% Chg
Interest income	104,929	107,329	(2)	102,877	2	436,507	413,876	5
Interest expended	77,847	83,592	(7)	78,739	(1)	324,771	315,159	3
Net interest income	27,082	23,738	14	24,138	12	111,736	98,718	13
Non-interest income	23,963	13,832	73	17,917	34	69,020	75,544	(9)
Net income	51,045	37,570	36	42,055	21	180,756	174,262	4
Operating expenses	21,316	21,104	1	22,242	(4)	90,784	85,123	7
Operating profit	29,729	16,466	81	19,813	50	89,972	89,139	1
Provision & Contingencies	27,087	63,315	(57)	14,846	82	58,002	72,720	(20)
PBT	2,642	(46,850)	(106)	4,968	(47)	31,970	16,419	95
Tax	500	(7,795)	(106)	1,749	(71)	10,230	5,200	97
Net profit	2,142	(39,055)	(105)	3,219	(33)	21,739	11,219	94
Yields & Margins (%)								
Net interest margin	2.2	2.2	4 bps	2.2	4 bps	2.0	1.8	13 bps
Cost to income ratio	42	56	(1,441)bps	53	(1,113)bps	50.2	48.8	138 bps
Asset quality								
Gross NPAs (Rs bn)	342	316	8	343	(0)	346	342	1
Gross NPAs (%)	9.6	9.4	23 bps	10.0	(34)bps	8.8	9.6	(87)bps
Net NPAs (Rs bn)	216	208	4	223	(3)	207	216	(4)
Net NPAs (%)	6.3	6.4	(9)bps	6.7	(39)bps	5.5	6.3	(87)bps
Provisioning coverage (%)	37	34	255 bps	35	163 bps	40	37	330 bps
Capital (%)								
Tier-I	9.8	8.8	97 bps	9.0	76 bps	9.3	9.8	(44)bps
CAR	12.9	11.1	178 bps	12.3	58 bps	12.2	12.9	(63)bps
Balance sheet (Rs bn)								
Advances	3,420	3,247	5	3,316	3	3,797	3,420	11
Deposits	4,953	4,798	3	5,103	(3)	5,264	4,953	6

Source: Company, Axis CapitalNote: For full year, margins and ratios are on calculated basis

Financial summary (Standalone)
Profit & loss (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Interest earned	440	414	437	471
Interest expended	(343)	(315)	(325)	(345)
Net interest income	98	99	112	126
Non interest income	49	76	69	76
Net income	146	174	181	202
Operating expenses	(75)	(85)	(91)	(98)
Staff expenses	(44)	(49)	(53)	(56)
Other operating expenses	(30)	(36)	(38)	(42)
Operating profit	71	89	90	104
Provisions & contingencies	(103)	(73)	(58)	(60)
Pre-tax profit	(32)	16	32	45
Tax expense	4	(5)	(10)	(15)
Profit after tax	(28)	11	22	30
Extraordinary item	-	-	-	-
Minority interest/Associates	-	-	-	-
Adj. PAT	(28)	11	22	30

Balance sheet (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Total assets	5,530	5,835	6,193	6,806
Cash & Balances with RBI	567	588	569	589
Investments	1,423	1,503	1,489	1,528
Advances	3,247	3,420	3,797	4,334
Fixed assets	72	72	73	73
Other assets	220	253	266	282
Total liabilities	5,530	5,835	6,193	6,806
Equity capital	5	6	6	6
Preference capital	-	-	-	-
Reserves & surplus	256	277	297	324
Networth	262	283	303	330
Borrowings	269	395	422	452
Deposits	4,798	4,953	5,264	5,746
Other liabilities & prov.	147	151	151	225

Source: Company, Axis Capital

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
Per share data				
FDEPS (Rs.)	(52)	19	36	50
BV (Rs.)	482	474	507	553
Adj. BV (Rs.)	225	231	275	335
DPS (Rs.)	-	1	3	4
Dividend payout (%)	-	5	7	8
Yields & Margins (%)				
Yield on advances	9.6	8.9	8.8	8.6
Cost of deposit	6.8	6.0	5.9	5.8
Net interest margin	1.9	1.8	2.0	2.1
Asset quality (%)				
Gross NPAs	9.4	9.6	8.8	7.7
Net NPAs	6.4	6.3	5.5	4.5
Credit cost	2.7	2.0	1.6	1.4
Provisioning coverage	34.0	36.7	40.0	44.0
Capital (%)				
Tier-I	8.8	9.8	9.3	9.2
CAR	11.1	12.9	12.2	11.9
Efficiency (%)				
ROA	(0.5)	0.2	0.4	0.5
ROE	(10.7)	4.1	7.4	9.4
Cost to income	51	49	50	48
CASA	26	30	34	34
Effective tax rate	12	32	32	33
Growth (%)				
Net interest income	1	1	13	13
Fee income	(7)	9	19	8
Operating expenses	3	14	7	7
Profit after tax	(204)	(140)	-	37
Advances	(2)	5	11	14
Deposits	1	3	6	9
Total assets	1	6	6	10

 Source: Company, Axis Capital
 FY17 Ratios are on calculated bases

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