

Canara Bank (CBK IN)

Asset-quality concern persists

INDIA | BANKING | Quarterly Update

4 November 2015

Top takeaways from Q2FY16

- ✗ Earnings lower than expected due to weak credit growth and high provision.
- ✗ Though slippage was lower vs. Q1, addition to GNPA was high due to subdued recovery and upgradation.
- ✓ Increase in credit offtake and consequent improvement in credit-to-deposit ratio should enable the bank to maintain NIMs, despite the cut in the base rate.
- ✓ Management expects to contain slippage and focus on recovery, resulting in a decline in GNPA to ~4% and NNPA to ~2.5% by FY16.

Key highlights

- Loan-book growth remained weak (+4% yoy) due to fall in corporate loans (-7%). Retail loan book grew 14% while agri/SME were up 16%/23%.
- Non-interest income growth was 18% yoy due to trading gains of Rs 2.95bn (+105% yoy) and recovery from written-off assets of Rs 1.6bn (+79%). Core-fee declined to Rs 3.9bn (-10% yoy).
- NIMs improved 9bps yoy and qoq to 2.3%; yoy improvement was due to low interest reversal. Cost of deposits fell 33bps yoy to 7.07% and yield on advances by 51bps qoq to 10.18%, due to a 30bps decline in base rate in H1.
- Slippage was high (Q2 at Rs 22bn, Q1 was Rs 25bn). Weak upgrades of Rs 6bn added to GNPA. It restructured Rs 6bn, taking the outstanding restructured book to Rs 229bn.

Management comments / concall takeaways

- ✓ Aims to bring GNPA/NNPA to 4%/2.5% by the end of FY16. Restructured loan pipeline is Rs 2bn. Quarterly slippage run rate in H2 to be contained at 0.5% vs. 0.68% in Q2FY16.
- ✗ Initiated SDR in four accounts amounting to Rs 10bn; pipeline is three accounts worth Rs 7bn. Refinanced Rs 5bn (Q1 Rs 8.8bn) under the 5:25 scheme; no visible pipeline.
- ✓ Focus on credit growth driven by retail and SME. Expects full-year credit growth to touch ~12%. Efforts are on to improve CD ratio – this will have positive impact on NIMs.

Outlook and valuation: The loan book will see some momentum as the bank aims to improve its CD ratio (currently at 67%). This may aid NIM, but given the cut in base rate, we expect NIM to remain under pressure. Stress in the corporate book continues and its course depends on a turnaround in the corporate-credit cycle. Hence, credit cost may remain elevated. We expect earnings decline of 9% in FY16 followed by 43% earnings growth in FY17. At CMP of Rs 274, the stock trades at 0.75x our FY16 ABVPS of Rs 371 and 0.67x our FY17 ABVPS of Rs 424. We maintain Neutral with a PT of Rs 320 (Rs 350 earlier).

Neutral (Maintain)

CMP RS 274/ TARGET RS 320 (+17%)

COMPANY DATA

O/S SHARES (MN) :	543
MARKET CAP (RSBN) :	151
MARKET CAP (USDBN) :	2.3
52 - WK HI/LO (RS) :	479 / 251
LIQUIDITY 3M (USDMN) :	16.9
PAR VALUE (RS) :	10

SHARE HOLDING PATTERN, %

	Jun 15	Mar 15	Dec 14
FII / NRI :	64.5	69.9	69.0
FI / MF :	8.6	10.9	11.5
NON PRO :	20.7	13.2	13.2
PUBLIC :	0.7	0.5	0.5
GOVT :	6.0	5.8	6.1

Key Financials

Rs mn	FY15	FY16E	FY17E
Pre-prov ROE (%)	27.5	25.6	26.0
Pre-prov ROA (%)	1.4	1.3	1.3
Net Profit	27,026	24,390	34,837
% growth	10.8	-9.8	42.8
Adj BVPS (Rs)	356.8	371.7	423.6
ROE (%)	10.7	8.8	11.3
P/E (x)	4.9	5.8	4.3
Adj P/BV (x)	0.8	0.75	0.66
EPS (Rs)	56.9	48.1	65.1
BLM Cons EPS	58.6	53.8	66.8

CHANGE IN ESTIMATES

Rs bn	Revised Est.		% Revision	
	FY16E	FY17E	FY16E	FY17E
NII	107.2	122.5	0.0	0.0
PPP	71.0	80.4	0.0	0.0
Core PAT	24.4	34.8	0.0	0.0
EPS (Rs)	48.1	65.1	0.0	0.0

Manish Agarwalla, Pradeep Agrawal, Paresh Jain

(Rs bn)	Q2FY16	Q2FY15	yoy %	Q1FY16	qoq %	vs. expect. %	Comments
Net interest income	26.5	23.7	11.7	25.2	5.2	4.7	Due to yoy improvement in NIM despite weak loan book.
NIM (%)	2.3	2.2	9bps	2.2	9bps	(10bps)	Driven by lower cost of funds and lesser interest reversal vs. last year
Advances	3230.8	3108.6	3.9	3240.6	-0.3	-4.7	Advance growth was muted due to weak growth in corporate loan book
<i>Corporate advances</i>	1503.4	1620.8	-7.2	1593.6	-5.7		Exposure to HFC saw 25% decline yoy
<i>Retail advances</i>	444.5	388.8	14.3	419.8	5.9		Home loan 28% yoy; education loan 19% yoy
Deposit	4852.1	4611.9	5.2	4718.8	2.8		Term deposits grew 3.4% yoy, CASA deposits grew 11.5% yoy
CASA	1160.0	1040.3	11.5	1096.8	5.8		Savings and Demand deposit grew 12% and 8.5% respectively
CASA %	25.5	23.7	178bps	24.6	87bps		CASA improvement due to moderate 3.4% growth in term deposit
Core fee	3.9	4.3	-10.0	3.2	22.5		Fee income remains muted due to lack of pick up in corporate activity
Trading gain	3.0	1.4	104.9	2.0	49.0		
Operating expenses	19.1	17.6	8.5	16.3	17.6	2.0	Employee expenses grew 7% yoy, other opex grew 11% yoy
Cost to income ratio (%)	53.7	54.3	(63bps)	47.4	632bps		
Provision	12.1	8.1	49.0	13.6	-10.8	15.5	NPA Rs 9bn; invest. dep. Rs 0.6bn; FITL Rs 0.9bn & superannuation Rs 1bn
PAT	5.3	6.3	-15.8	4.8	10.4	-4.3	PAT was lower than expectation due to high provision
Slippage	22.0	31.8	-30.7	25.2	-12.6		Recovery Rs 3.3bn; upgrade Rs 2.7bn
GNPA	4.3	2.9	135bps	4.0	29bps		Despite lesser slippage; GNPA was high due to weak recovery
NNPA	2.9	2.3	59bps	2.7	16bps		PCR ratio improved +81bps qoq to 59.81%
Tier 1 Capital %	8.6	7.4	122bps	8.3	35bps		

Result Update

(Rs mn)	Q2FY16	Q2FY15	YoY growth	Q1FY16	QoQ growth
Interest earned	112,675	108,949	3.4	111,397	1.1
Interest expended	86,210	85,261	1.1	86,232	0.0
Net interest income	26,465	23,688	11.7	25,165	5.2
Net interest margins	2.30	2.21	0.1	2.21	0.1
Non-interest income	12,105	10,213	18.5	11,130	8.8
Total Income	38,570	33,901	13.8	36,295	6.3
Total operating expenses	19,129	17,636	8.5	16,259	17.6
Payroll costs	11,078	10,358	7.0	10,588	4.6
Others	8,050	7,278	10.6	5,672	41.9
Pre-provision Profit	19,441	16,265	19.5	20,036	-3.0
Provisions & Contingencies	12,123	8,137	49.0	13,597	-10.8
% Operating income	62.4	50.0	12.3	67.9	-5.5
PBT	7,318	8,128	-10.0	6,438	13.7
Provision for Taxes	2,029	1,850	9.7	1,650	23.0
% of PBT	27.7	22.8	5.0	25.6	2.1
Net Profit	5,289	6,278	-15.8	4,788	10.4
Equity	5,430	4,613	17.7	5,152	5.4
EPS, Rs	9.7	13.6	-28.4	9.3	4.8
Advances	3,230,775	3,108,596	3.9	3,240,629	-0.3
Deposits	4,852,055	4,611,930	5.2	4,718,767	2.8
Advances / Deposits (%)	66.6	67.4	-0.8	68.7	-2.1
Gross NPAs	140,213	91,643	53.0	130,806	7.2
Gross NPAs (%)	4.3	2.9	1.4	4.0	0.3
Net NPAs	93,825	71,703	30.9	88,881	5.6
Net NPAs (%)	2.9	2.3	0.6	2.7	0.2
CAR – Total	11.0	10.2	0.9	10.8	0.3

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY14	FY15	FY16e	FY17e
Interest on Loans	284,573	320,661	350,483	392,541
Interest on Investments	102,511	109,238	122,346	135,804
Others	8,392	7,602	8,058	8,541
Total Interest Earned	395,476	437,500	480,887	536,886
Total Interest Expended	306,032	340,864	373,665	414,423
Net Interest Income	89,444	96,637	107,221	122,463
Total non interest income	39,328	45,503	45,434	49,971
Total Income	128,772	142,139	152,655	172,434
Personnel Expenses	36,724	42,743	48,299	54,578
Other Expenses	24,086	29,893	33,342	37,472
Total Op expenses	60,810	72,636	81,641	92,050
Net Inc (Loss) before prov	67,962	69,504	71,014	80,383
Provision and coningencies	37,330	34,527	38,495	33,935
Net Inc (Loss) before tax	30,632	34,976	32,520	46,449
Provision for Income Tax	6,250	7,950	8,130	11,612
Net Profit	24,382	27,026	24,390	34,837

Balance Sheet

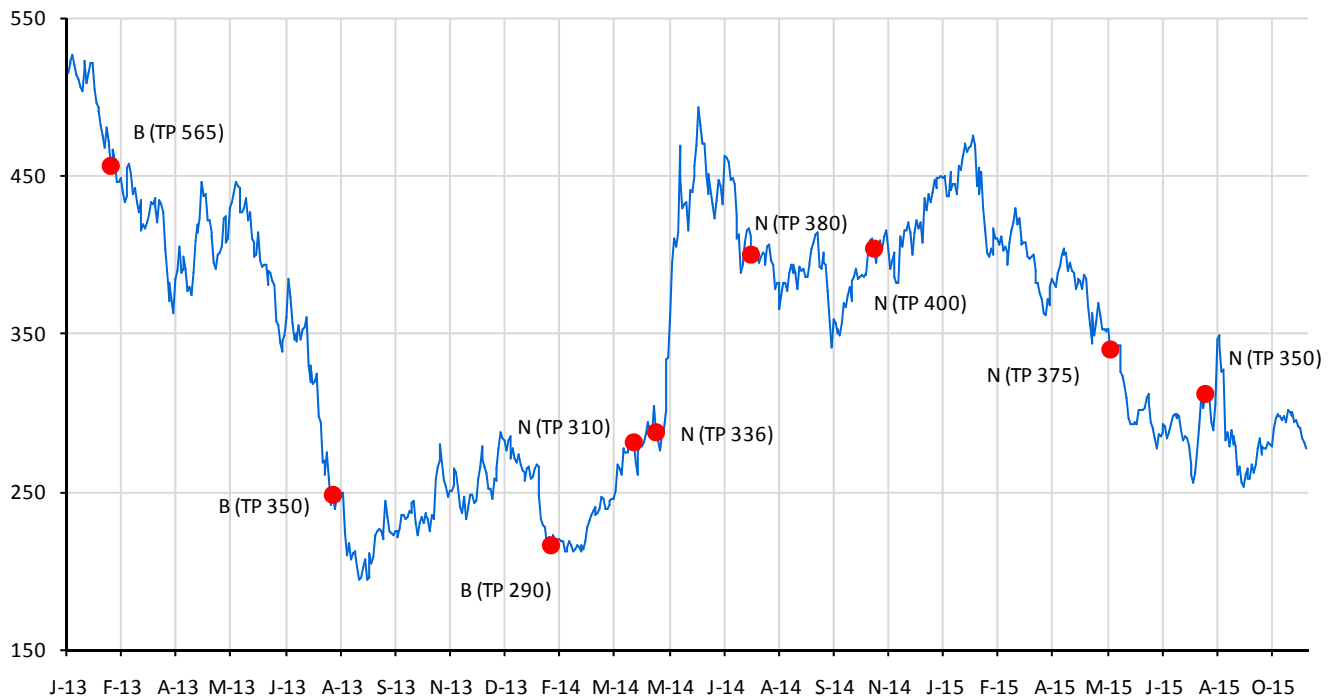
Y/E Mar, Rs mn	FY14	FY15	FY16e	FY17e
Assets				
Cash & Bal with RBI	448,287	486,411	544,780	604,706
Loans, Adv & Int accrued	3,010,675	3,300,355	3,715,240	4,235,374
Investments	1,268,283	1,453,462	1,622,148	1,832,079
Fixed Assets (Net)	66,416	69,494	76,444	84,088
Other assets	125,558	170,283	208,811	252,164
Total Assets	4,919,219	5,480,006	6,167,423	7,008,412
Liabilities				
Share capital	4,613	4,752	5,068	5,349
Reserves and Surplus	236,606	259,785	286,214	322,104
Hybrid Capital	16,685	19,187	21,682	24,500
Debt	81,900	90,090	100,900	114,017
Borrowing	173,722	147,439	172,504	198,379
Total Deposits	4,221,940	4,755,517	5,362,901	6,109,498
Other liab incld prov	128,772	149,181	164,099	180,509
Total Liabilities	4,919,219	5,480,006	6,167,423	7,008,412

Source: Company, PhillipCapital India Research Estimates

Valuation Ratios

	FY14	FY15	FY16e	FY17e
Earnings and Valuation Ratios				
Pre-provision Operating RoAE (%)	28.9	27.5	25.6	26.0
RoAE (%)	10.4	10.7	8.8	11.3
Pre-provision Operating ROA (%)	1.5	1.3	1.2	1.2
RoAB (%)	0.56	0.54	0.44	0.55
EPS (Rs.)	52.9	56.9	48.1	65.1
Dividend per share (Rs.)	11.0	11.4	10.0	11.0
Book Value (Rs.)	642.2	670.4	681.5	713.2
Adj BV (Rs.)	364.2	356.8	371.7	423.6
Revenue Analysis				
Interest income on IBA (%)	9.1	8.8	8.6	8.6
Interest cost on IBL (%)	7.4	7.2	7.0	6.8
NIM on IBA / AWF (%)	2.1	1.9	1.9	2.0
Core fee Inc / AWF (%)	0.4	0.3	0.3	0.3
Portfolio gains / Total Inc (%)	5.2	8.8	4.8	4.4
Op.Exp / TI (%)	49.7	55.6	56.1	55.7
Op.Exp / AWF (%)	1.4	1.5	1.5	1.5
Employee exps / Op exps (%)	60.4	58.8	59.2	59.3
Tax / Pre-tax earnings (%)	20.4	22.7	25.0	25.0
Asset Quality				
GNPAs / Gr Adv (%)	2.5	4.0	4.1	3.8
NNPAs / Net Adv (%)	2.0	2.7	2.7	2.3
Growth Ratio				
Loans (%)	24.3	9.6	12.6	14.0
Investments (%)	4.7	14.6	11.6	12.9
Deposits (%)	18.4	12.6	12.8	13.9
Networth (%)	19.1	7.6	8.4	10.5
Net Int Income (%)	13.5	8.0	11.0	14.2
Non-fund based income (%)	33.2	3.1	13.0	11.3
Non-Int Exp (%)	18.3	19.4	12.4	12.8
Profit Before Tax (%)	(16.6)	14.2	(7.0)	42.8
Net profit (%)	(15.1)	10.8	(9.8)	42.8
Asset / Liability Profile				
Avg CASA/ Deposits (%)	24.3	24.2	23.9	23.8
Avg Adv / Avg Dep (%)	68.0	68.0	66.5	66.6
Avg Invst / Avg Dep (%)	31.8	30.3	30.4	30.1
Incr Adv / Deposits (%)	89.9	54.3	68.3	69.7
Avg Cash / Avg Dep (%)	10.2	10.4	10.2	10.0
Capital Adequacy Ratio:				
Tier I (%)	10.6	10.6	10.4	10.3
	7.7	8.0	7.8	7.8
Internal Capital Generation rate (%)	8.5	9.0	6.9	9.6
NNPAs to Equity (%)	20.1	27.4	28.6	25.1

Stock Price, Price Target and Rating History



Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	$\geq +15\%$	Target price is equal to or more than 15% of current market price
NEUTRAL	$-15\% > \text{to} < +15\%$	Target price is less than +15% but more than -15%
SELL	$\leq -15\%$	Target price is less than or equal to -15%.

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