

Canara Bank (CBK IN)

High provision requirement to keep earnings at bay

INDIA | BANKING | Quarterly Update

30 October 2017

Top takeaways from Q2FY18

- ✓ Net profit was marginally ahead of our expectation at Rs 2.6bn (-27% yoy), driven by better-than-expected non-interest income.
- ✓ NII at 27.8bn (+14% yoy) improved, driven by 10% yoy loan growth (qoq +4.5%) and 15bps yoy improvement in NIM to 2.34% (stable qoq).
- ✗ Asset-quality remained stressed. Although slippage of Rs 33.4bn was lower qoq (Rs 55bn in Q1FY18), it was higher than our expectation of Rs 25bn. Consequently GNPA/NNPA declined 5/7bps qoq to 10.51/7.02%. PCR was stable at 54.75%.
- ✓ Non-interest income at Rs 19.4bn (+9% yoy) was driven by better-than-expected treasury gains and recoveries from written-off accounts (Rs 3.6bn vs. 1.6bn in Q2FY17). Core fee income was weak at Rs 3.1bn (-7% yoy).
- ✓ Loan-book growth at 9.5% yoy and (+4.5% qoq) was driven by retail +21%, SME +11%, agri +8%, overseas +21%. Corporate loan growth remained weak at +4.5% yoy.

Management comments / concall takeaways

- SMA-2 loans including SDR and 5:25 restructuring stood at Rs 152bn.
- Unrecognised stressed portfolio (standard restructured + SMA2 + 5:25 + SDR + S4A) was Rs 230bn (6.4% of loan book) vs. Rs 243bn (7.1% of loan book) in Q1FY18.
- The bank has an exposure of Rs 102bn in the first list of NCLT and Rs 49bn in the second list with outstanding provision of Rs 60bn. The additional provision required is Rs 20bn, which will be done in the next two quarters.
- Intends to sell stake in Canbank Factors and some fixed assets.
- Guidance: NIM at current level of 2.3%, credit cost of 3%, normal slippage run-rate of Rs 25bn per quarter. Few stressed large accounts are on the verge of slipping.

Outlook and valuation: The recent run up in the stock price factors various NPA resolutions and recapitalisation of banks announced by the government. However, the bank continues to report weak operating metrics coupled with elevated slippages. The unrecognized stressed portfolio of Rs 230bn (6.4%) is high enough, considering earnings profile. Risk of a haircut due to resolution in various NPAs and stressed assets will keep credit cost elevated in FY18, adding pressure on return ratios and overshadowing cheap valuations. Recapitalisation will improve the adjusted book value by 30% each for FY18/19. The stock currently trades at 1.90x/1.35x our FY18/19 ABVPS of Rs 191/265 (factoring Rs 60 per share of subsidiary and associates). We maintain SELL with a revised target of Rs 325 (factoring change in adjusted BV due to recap), thus valuing the banking business at 1x FY19 ABVPS.

SELL (Maintain)

CMP RS 420/ TARGET RS 325 (-23%)

COMPANY DATA

O/S SHARES (MN) :	597
MARKET CAP (RSBN) :	189
MARKET CAP (USDBN) :	2.9
52 - WK HI/LO (RS) :	416 / 245
LIQUIDITY 3M (USDMN) :	9.6
PAR VALUE (RS) :	10

SHARE HOLDING PATTERN, %

	Sep 17	Jun 17	Mar 17
FII / NRI :	66.3	66.3	66.3
FI / MF :	6.0	5.9	5.3
NON PRO :	21.4	21.3	21.2
PUBLIC :	0.7	0.9	0.9
GOVT :	5.6	5.7	6.3

Key Financials

Rs mn	FY18E	FY19E	FY20E
Pre-prov ROE (%)	29.4	25.0	24.9
Pre-prov ROA (%)	1.6	1.5	1.5
Net Profit	11	15	28
% growth	-31.7	35.6	0.0
EPS (Rs)	14.8	16.9	31.5
Adj BVPS (Rs)	191.0	265.1	314.8
ROE (%)	3.5	3.9	6.5
P/E (x)	28.4	24.9	13.3
Adj. P/BV (x)	2.20	1.58	1.33

CHANGE IN ESTIMATES

Rs bn	Revised Est.		% Revision	
	FY18E	FY19E	FY18E	FY19
NII	115.0	133.6	1.0	2.7
PPP	93.5	97.5	1.2	3.7
Core PAT	11.2	15.2	2.0	2.1
EPS (Rs)	14.8	16.9	-18.2	-30.2
BV (Rs)	466.7	473.8	-4.5	-6.9
Adj. BV (Rs)	191.0	265.1	31.2	29.1

Manish Agarwalla, Pradeep Agrawal,
Paresh Jain

(Rs bn)	Q2FY18	Q2FY17	yoy %	Q1FY17	qoq %	vs. expect. %	Comments
Net interest income	27.8	24.4	14.0	27.1	2.6	1.8	NII improved due to pick up in loan growth and yoy improvement in NIM
NIM (%)	2.3	2.2	15bps	2.3	0	(1bps)	NIM Improved yoy due to decline in cost of deposit by 55bps yoy
Advances	3582.6	3271.3	9.5	3428.2	4.5	3.9	Marginal pick up was due to growth in SME (11%), agri (8%), retail (22%)
Corporate advances	1356.5	1298.0	4.5	1308.8	3.6		Domestic corporate remain weak, but overseas loan was at +20% yoy
Retail advances	663.2	545.0	21.7	608.4	9.0		Housing +18% yoy; other personal +28% yoy, vehicle +26% yoy
Deposit	4964.4	4843.2	2.5	4859.1	2.2		Term deposits declined 3.2% yoy, CASA deposits 17% yoy
CASA	1550.8	1317.4	17.7	1490.8	4.0		Savings and demand deposit grew 18% and 14% respectively
CASA %	33.8	29.1	472bps	33.1	69bps		
Core fee	4.5	6.5	-31.8	5.0	-11.0	-15.8	
Trading gain	5.7	4.7	20.7	8.8	-36.0		
Operating expenses	22.4	20.8	7.5	23.5	-4.7	-3.5	Employee expenses +13% yoy, other opex declined -0.5% yoy
Cost to income ratio (%)	53.9	55.5	(156bps)	59.7	(574bps)		
Provision	21.6	15.9	36.0	22.0	-2.1	16.6	NPA Rs 19.5bn; invested Rs 2.9bn, std. Rs (150mn), rest. & others Rs (640mn)
PAT	2.6	3.6	-27.1	2.5	3.1	6.0	Pat in line with expectation
Slippage	33.7	24.5	37.5	55.1	-38.9		
GNPA	10.5	9.8	70bps	10.6	(5bps)		
NNPA	7.0	6.7	33bps	7.1	(7bps)		PCR remained flat at 54.75% qoq
Tier 1 Capital %	9.5	8.9	63bps	9.6	(7bps)		CET-1 at 8.68%

Result update

(Rs mn)	Q2FY18	Q2FY17	YoY growth	Q1FY17	QoQ growth
Interest earned	1,00,585	1,04,054	-3.3	1,01,956	-1.3
Interest expended	72,751	79,630	-8.6	74,824	-2.8
Net interest income	27,834	24,424	14.0	27,132	2.6
Net interest margins	2.34	2.19	0.2	2.34	0.0
Non-interest income	19,362	17,818	8.7	21,085	-8.2
Total Income	47,196	42,241	11.7	48,218	-2.1
Total operating expenses	22,397	20,834	7.5	23,494	-4.7
Payroll costs	13,773	12,169	13.2	13,518	1.9
Others	8,625	8,664	-0.5	9,976	-13.5
Pre-provision Profit	24,798	21,408	15.8	24,724	0.3
Provisions & Contingencies	21,566	15,857	36.0	22,030	-2.1
% Operating income	87.0	74.1	12.9	89.1	-2.1
PBT	3,232	5,550	-41.8	2,694	20.0
Provision for Taxes	630	1,981	-68.2	170	270.6
% of PBT	19.5	35.7	-16.2	6.3	13.2
Net Profit	2,602	3,569	-27.1	2,524	3.1
Equity	5,973	5,430	10.0	5,973	0.0
EPS, Rs	4.4	6.6	-33.7	4.2	3.1
Advances	35,82,552	32,71,293	9.5	34,28,156	4.5
Deposits	49,64,398	48,43,213	2.5	48,59,052	2.2
Advances / Deposits (%)	72.2	67.5	4.6	70.6	1.6
Gross NPAs	3,91,641	3,33,154	17.6	3,76,578	4.0
Gross NPAs (%)	10.5	9.8	0.7	10.6	-0.1
Net NPAs	2,51,650	2,18,871	15.0	2,43,006	3.6
Net NPAs (%)	7.0	6.7	0.3	7.1	-0.1
CAR – Total	12.5	12.2	0.3	12.6	-0.2

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs bn	FY16	FY17	FY18e	FY19e	FY20e
Interest on Loans	314	296	315	350	399
Interest on Investments	114	107	116	130	140
Others	12	11	12	12	13
Total Interest Earned	440	414	442	492	552
Total Interest Expended	343	315	327	358	395
Net Interest Income	98	99	115	134	157
Total noninterest income	49	76	73	68	70
Total Income	146	174	188	201	227
Personnel Expenses	44	49	55	61	69
Other Expenses	30	36	39	43	49
Total Op expenses	75	85	94	104	118
Net Inc (Loss) before prov	71	89	93	97	110
Provision and contingencies	103	68	81	80	72
Net Inc (Loss) before tax	-32	22	12	18	38
Provision for Income Tax	-4	5	1	3	9
Net Profit	-28	16	11	15	28

Balance Sheet

Y/E Mar, Rs bn	FY16	FY17	FY18e	FY19e	FY20e
Assets					
Cash & Bal with RBI	567	588	653	725	805
Loans, Adv & Int accrued	3,247	3,420	3,762	4,207	4,796
Investments	1,423	1,503	1,690	1,902	2,003
Fixed Assets (Net)	72	72	79	87	95
Other assets	220	253	254	275	384
Total Assets	5,530	5,835	6,438	7,196	8,083
Liabilities					
Share capital	5	6	8	9	9
Reserves and Surplus	256	277	346	417	444
Borrowing	132	255	293	337	388
Total Deposits	4,817	4,972	5,432	6,035	6,829
Other liab incld prov	128	132	145	159	175
Total Liabilities	5,530	5,835	6,438	7,196	8,083

Source: Company, PhillipCapital India Research Estimates

Valuation Ratios

	FY16	FY17	FY18e	FY19e	FY20e
Earnings and Valuation Ratios					
Pre-provision Operating RoAE (%)	27.2	32.7	29.4	25.0	24.9
RoAE (%)	(10.7)	6.0	3.5	3.9	6.5
Pre-provision Operating ROA (%)	1.3	1.6	1.5	1.4	1.4
RoAB (%)	-0.54	0.31	0.19	0.24	0.39
EPS (Rs.)	(51.8)	27.5	14.8	16.9	31.5
Dividend per share (Rs.)	0.0	1.0	1.0	2.0	2.0
Book Value (Rs.)	481.7	474.0	466.7	473.8	502.9
Adj BV (Rs.)	151.0	163.7	191.0	265.1	314.8

Revenue Analysis

Interest income on IBA (%)	8.4	7.7	7.6	7.6	7.6
Interest cost on IBL (%)	6.8	6.0	5.8	5.8	5.7
NIM on IBA / AWF (%)	1.9	1.8	2.0	2.1	2.2
Core fee Inc / AWF (%)	0.3	0.4	0.4	0.4	0.4
Portfolio gains / Total Inc (%)	7.3	20.6	11.9	5.2	3.2
Op.Exp / TI (%)	54.9	58.9	56.2	54.3	53.4
Op.Exp / AWF (%)	1.4	1.6	1.6	1.6	1.6
Employee exps / Op exps (%)	59.3	57.7	58.4	58.2	58.7
Tax / Pre-tax earnings (%)	11.7	24.1	10.0	15.0	25.0

Asset Quality

GNPAs / Gr Adv (%)	9.4	9.6	10.7	9.7	8.7
NNPAs / Net Adv (%)	6.4	6.3	6.6	5.2	4.0

Growth Ratio

Loans (%)	(1.6)	5.3	10.0	11.8	14.0
Investments (%)	(2.1)	5.6	12.5	12.5	5.3
Deposits (%)	1.3	3.2	9.3	11.1	13.2
Networth (%)	(0.8)	6.6	20.9	17.9	5.5
Net Int Income (%)	1.0	1.1	16.5	16.2	17.4
Non-fund based income (%)	14.2	17.7	15.5	9.5	9.6
Non-Int Exp (%)	3.1	13.6	10.8	10.2	13.1
Profit Before Tax (%)	(191.1)	(167.8)	(42.3)	43.6	111.5
Net profit (%)	(204.1)	(158.4)	(31.7)	35.6	86.6

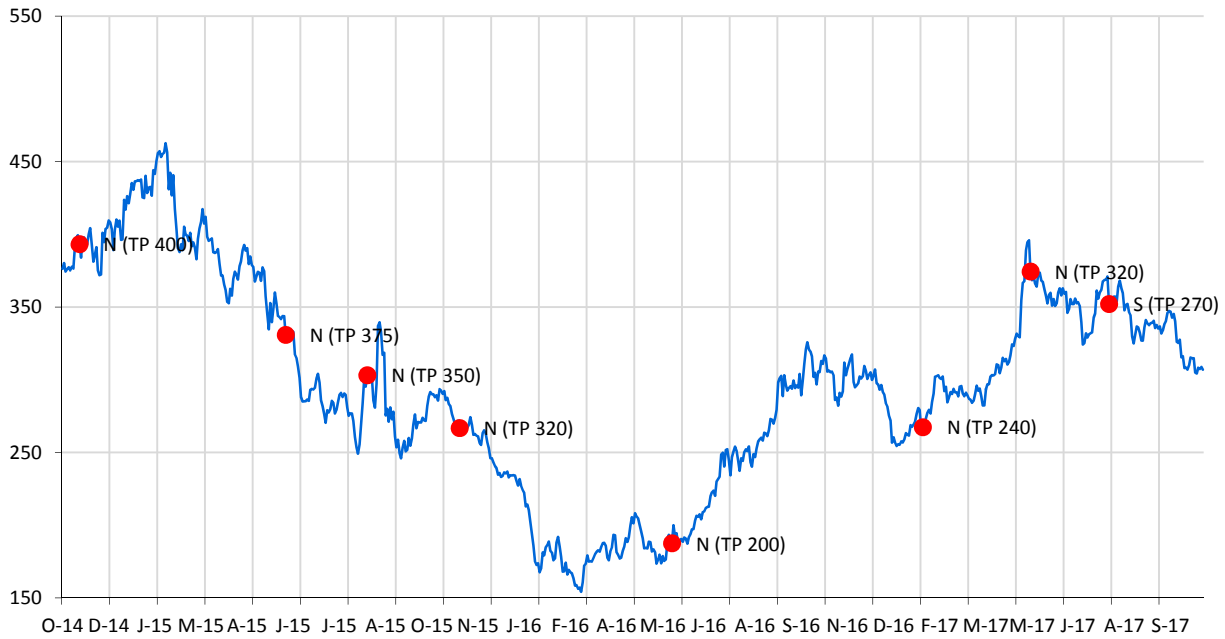
Asset / Liability Profile

Avg CASA / Deposits (%)	24.8	27.9	30.4	30.6	30.4
Avg Adv / Avg Dep (%)	63.7	61.4	61.7	62.1	63.3
Avg Invst / Avg Dep (%)	30.1	29.9	30.7	31.3	30.4
Incr Adv / Deposits (%)	(87.0)	111.7	74.3	73.8	74.2
Avg Cash / Avg Dep (%)	11.0	11.8	11.9	12.0	11.9

Capital Adequacy Ratio:

Tier I (%)	8.8	9.8	10.7	11.6	10.9
CET I (%)	8.2	8.9	9.8	10.3	9.7
NNPAs to Equity (%)	65.9	64.3	61.4	45.8	38.2

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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