

ADD

TP: Rs 120 | ▲ 10%

CANARA BANK

| Banking

| 25 June 2020

Core operating performance remains weak

Canara Bank (CBK) reported a Rs 32.6bn loss as the bank consciously made higher wage and NPA-related provisions due to amalgamation. Operating performance remained weak as NII declined 5% YoY due to subdued loan growth while NIM dropped 8bps QoQ to 2.3%. The bank has 17% of its portfolio under moratorium. Headline NPAs continued to decline but the slippage ratio at 3.7% stayed high. We expect sustained weak profitability due to sticky credit cost. Recommend ADD with a Mar'21 TP of Rs 120.

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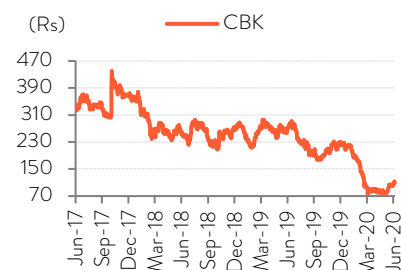
Headline NPAs still elevated: CBK highlighted that 17% of its customers have availed of the moratorium and have not paid three installments. Segment-wise, ~22%/8%/3% of the bank's MSME/corporate/retail portfolio is under moratorium. Asset classification benefit was extended to accounts worth ~Rs 19bn but the slippage ratio remained high at 3.7%. CBK's headline GNPA/NNPA ratios continue to show a declining trend but still remain elevated at ~8%/4%. The bank has ~Rs 18bn of exposure to Bhushan Power and Steel which it expects to be resolved in Q2/Q3.

Ticker/Price	CBK IN/Rs 110
Market cap	US\$ 1.5bn
Shares o/s	1,030mn
3M ADV	US\$ 18.4mn
52wk high/low	Rs 297/Rs 74
Promoter/FPI/DII	79%/3%/18%

Source: NSE

Retail growth remains strong: Overall loan growth was muted at 1% YoY as MSME loans declined by 7.5% while the corporate/other loan book was flat. Retail loan growth was better at 12% YoY aided by an 18%/11% uptick in home/vehicle loans. The bank participated in TLTRO-1/2 and extended funds worth Rs 15bn/Rs 8.5bn mostly to NBFCs. CASA ratio improved to 32.6% and management aims to shore this up to ~35% by Q4.

STOCK PERFORMANCE



Source: NSE

Recommend ADD: We believe Covid-19 and merger-related challenges will weigh heavy on CBK's profitability. We introduce post-merger financials and recommend ADD with a Mar'21 TP of Rs 120, valuing the stock at 0.4x FY22E P/BV.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Net interest income	121,633	144,781	131,239	210,969	225,968
NII growth (%)	23.2	19.0	(9.4)	60.8	7.1
Adj. net profit (Rs mn)	(42,222)	3,470	(22,356)	1,129	8,393
EPS (Rs)	(63.5)	4.7	(25.1)	0.9	5.8
P/E (x)	(1.7)	23.5	(4.4)	120.4	19.0
P/BV (x)	0.2	0.2	0.3	0.3	0.3
ROA (%)	(0.7)	0.1	(0.3)	0.0	0.1
ROE (%)	(12.2)	1.0	(5.9)	0.2	1.6

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE

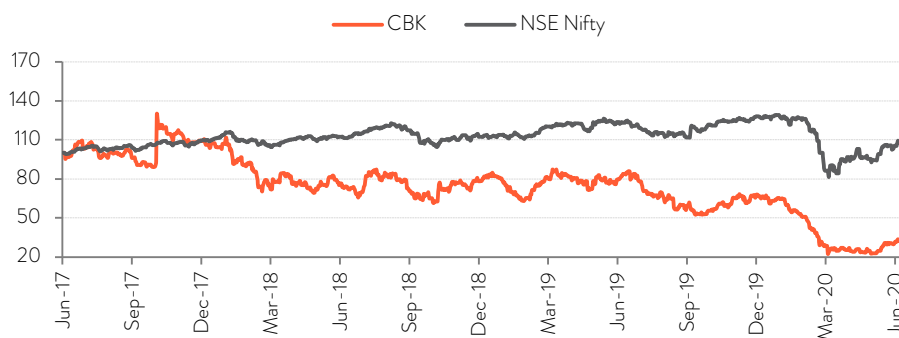
(Rs mn)	Q4FY20	Q4FY19	Q3FY20	YoY (%)	QoQ (%)	FY20P	FY19	YoY (%)
Income Statement								
Interest income	120,474	121,385	122,949	(0.8)	(2.0)	489,350	468,103	4.5
Interest expense	87,289	86,383	88,599	1.0	(1.5)	358,111	323,322	10.8
Net interest income	33,185	35,002	34,350	(5.2)	(3.4)	131,239	144,781	(9.4)
Non-interest income	21,750	18,620	17,067	16.8	27.4	78,132	65,750	18.8
Net total income	54,935	53,621	51,418	2.4	6.8	209,371	210,531	(0.6)
Staff expense	21,752	10,399	15,969	109.2	36.2	68,525	56,751	20.7
Other operating expenses	12,774	13,488	12,106	(5.3)	5.5	47,247	47,871	(1.3)
Operating expenses	34,526	23,886	28,074	44.5	23.0	115,772	104,622	10.7
Pre-provisioning profit	20,409	29,735	23,343	(31.4)	(12.6)	93,598	105,909	(11.6)
Total provisions	53,753	55,235	18,029	(2.7)	198.1	111,153	129,183	(14.0)
Profit before tax	(33,344)	(25,500)	5,314	NM	NM	(17,555)	(23,274)	(24.6)
Tax	(752)	(19,985)	2,018	NM	NM	4,802	(26,744)	NM
Profit after tax	(32,592)	(5,515)	3,296	NM	NM	(22,356)	3,470	(744.2)
Balance Sheet								
Advances	4,321,752	4,277,273	4,226,080	1.0	2.3	4,321,752	4,277,273	1.0
Deposits	6,253,512	5,990,333	6,252,404	4.4	0.0	6,253,512	5,990,333	4.4
CASA ratio (%)	32.6	30.9	30.9	173bps	166bps	32.6	30.9	173bps
Yields and margins (%)								
Net interest margin	2.3	2.8	2.4	(48bps)	(8bps)	-	-	-
Yield on advances	8.0	8.4	8.2	(47bps)	(25bps)	-	-	-
Cost of Deposits	5.4	6.1	5.6	(69bps)	(19bps)	-	-	-
Key ratios (%)								
Cost/Income	62.8	44.5	54.6	1830bps	825bps	55.3	49.7	560bps
Loan to Deposit ratio	69.1	71.4	67.6	(229bps)	152bps	69.1	71.4	(229bps)
Capital adequacy ratios (%)								
Tier 1	10.1	9.0	11.1	108bps	(93bps)	10.1	9.0	108bps
Total CAR	13.7	11.9	13.9	175bps	(21bps)	13.7	11.9	175bps
Asset quality (Rs mn)								
Gross NPAs	370,412	392,241	366,450	(5.6)	1.1	370,412	392,241	(5.6)
Net NPAs	182,510	229,551	213,377	(20.5)	(14.5)	182,510	229,551	(20.5)
Gross NPA ratio (%)	8.2	8.8	8.4	(62bps)	(15bps)	8.2	8.8	(62bps)
Net NPA ratio (%)	4.2	5.4	5.1	(115bps)	(83bps)	4.2	5.4	(115bps)
NPA coverage (%)	50.7	41.5	41.8	925bps	896bps	50.7	41.5	925bps

Source: Company, BOBCAPS Research

Valuation methodology

We introduce post-merger financials and value CBK at 0.4x FY22E P/BV using the two-stage Gordon Growth Model. We believe Covid-19 and merger-related challenges will weigh heavy on the bank's profitability while credit costs are expected to remain sticky. Recommend ADD with a Mar'21 target price of Rs 120.

FIG 2 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Stronger-than-expected improvement in economic activity can drive higher loan growth.
- Below-expected slippage risk plus sharp improvement in corporate asset quality can impact our credit cost assumptions.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net interest income	121,633	144,781	131,239	210,969	225,968
NII growth (%)	23.2	19.0	(9.4)	60.8	7.1
Non-interest income	69,429	65,750	78,131	116,839	125,123
Total income	191,062	210,531	209,371	327,808	351,091
Operating expenses	(95,579)	(104,622)	(115,772)	(178,920)	(191,087)
Operating profit	95,482	105,909	93,598	148,889	160,004
Operating profit growth (%)	7.1	10.9	(11.6)	59.1	7.5
Provisions	(161,091)	(129,183)	(111,153)	(147,371)	(148,724)
PBT	(65,609)	(23,274)	(17,555)	1,518	11,280
Tax	23,386	26,744	(4,802)	(389)	(2,888)
Reported net profit	(42,222)	3,470	(22,356)	1,129	8,393
Adjustments	0	0	0	0	0
Adjusted net profit	(42,222)	3,470	(22,356)	1,129	8,393

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Equity capital	7,332	7,532	10,302	14,543	14,543
Reserves & surplus	348,716	354,240	382,627	517,498	525,125
Net worth	356,048	361,772	392,930	532,041	539,668
Deposits	5,247,719	5,990,333	6,253,512	8,760,283	9,134,173
Borrowings	521,231	537,416	555,111	766,994	821,464
Other liabilities & provisions	43,863	58,146	37,195	50,214	56,304
Total liabilities and equities	6,168,861	6,947,667	7,238,748	10,109,532	10,551,609
Cash & bank balance	499,123	661,527	682,715	873,369	914,077
Investments	1,440,537	1,529,853	1,762,449	2,422,507	2,520,405
Advances	3,817,030	4,277,273	4,321,752	6,523,378	6,815,283
Fixed & Other assets	412,171	479,014	471,831	290,277	301,844
Total assets	6,168,861	6,947,667	7,238,748	10,109,532	10,551,609
Deposit growth (%)	6.0	14.2	4.4	40.1	4.3
Advances growth (%)	11.6	12.1	1.0	50.9	4.5

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
EPS	(63.5)	4.7	(25.1)	0.9	5.8
Dividend per share	0.0	0.0	0.0	0.0	0.0
Book value per share	485.6	480.3	381.4	365.8	371.1

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
P/E	(1.7)	23.5	(4.4)	120.4	19.0
P/BV	0.2	0.2	0.3	0.3	0.3
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Net interest income	2.0	2.2	1.9	2.4	2.2
Non-interest income	1.2	1.0	1.1	1.3	1.2
Operating expenses	1.6	1.6	1.6	2.1	1.8
Pre-provisioning profit	1.6	1.6	1.3	1.7	1.5
Provisions	2.7	2.0	1.6	1.7	1.4
PBT	(1.1)	(0.4)	(0.2)	0.0	0.1
Tax	(0.4)	(0.4)	0.1	0.0	0.0
ROA	(0.7)	0.1	(0.3)	0.0	0.1
Leverage (x)	17.3	18.3	18.8	18.8	19.3
ROE	(12.2)	1.0	(5.9)	0.2	1.6

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
YoY growth (%)					
Net interest income	23.2	19.0	(9.4)	60.8	7.1
Pre-provisioning profit	7.1	10.9	(11.6)	59.1	7.5
EPS	(422.5)	(107.4)	(637.0)	(103.6)	534.8
Profitability & Return ratios (%)					
Net interest margin	2.2	2.4	2.0	2.5	2.3
Fees / Avg. assets	0.2	0.2	0.2	0.2	0.2
Cost-Income	50.0	49.7	55.3	54.6	54.4
ROE	(12.2)	1.0	(5.9)	0.2	1.6
ROA	(0.7)	0.1	(0.3)	0.0	0.1
Asset quality (%)					
GNPA	11.8	8.8	8.2	7.7	7.0
NNPA	7.5	5.4	4.2	3.8	3.3
Provision coverage	39.9	41.5	50.7	52.6	55.0
Ratios (%)					
Credit-Deposit	72.7	71.4	69.1	74.5	74.6
Investment-Deposit	27.5	25.5	28.2	27.7	27.6
CAR	13.2	11.9	13.6	12.9	12.7
Tier-1	10.3	9.0	10.1	9.7	9.3

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

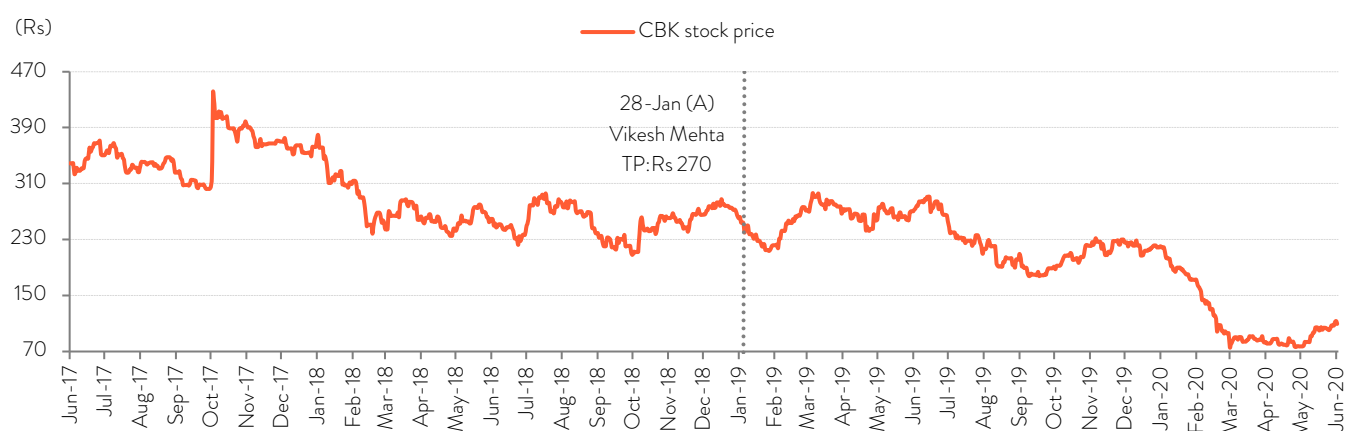
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: CANARA BANK (CBK IN)



B – Buy, A – Add, R – Reduce, S – Sell

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