

Canara Bank Ltd.



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Strategy paying off

CMP INR 352	Target INR 377	Potential Upside 7%	Market Cap (INR Mn) 221594.6	Recommendation ACCUMULATE	Sector BFSI
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Result highlights

As against the management's guidance of improved asset quality for FY18, Q1FY18 saw further deterioration with gross NPAs inching up to 10.56% (versus 9.71% for Q1FY17, 9.63% for Q4FY17). In absolute terms, gross NPAs grew by 16% yoy and 10% qoq. While total interest income stayed flattish on yoy basis, it de-grew by 2.8% on qoq basis. Despite the weak interest income performance, the Bank managed to expand its NIMs to 2.34%, 11 bps qoq and 19 bps yoy. Pre-provisioning profit saw a strong growth of 35.9% yoy on account of improved operational efficiency (cost/income was 48.7% versus 53.3% for Q1FY17). However, PAT was up only 9.9% yoy (up 17.5% qoq) on account of extra provisioning in general and with respect to the 12 identified accounts identified by the RBI. Provisioning expense was up 47.6% yoy (down 18.6% qoq). The Bank has delivered calculated annualized RoA of 0.17% against 0.15% for Q4FY17 and 0.17% for Q1FY17.

MARKET DATA

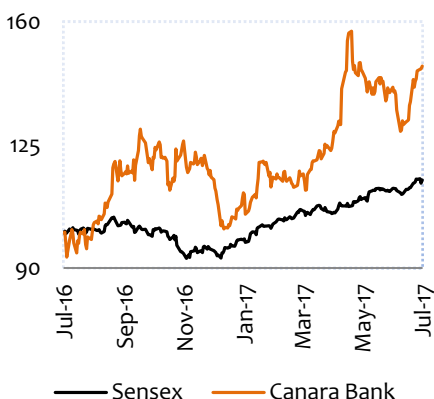
Shares outs (Mn)	597
EquityCap (INR Mn)	5973
Mkt Cap (INR Mn)	221595
52 Wk H/L (INR)	415/231
Volume Avg (3m K)	3771.8
Face Value (INR)	10
Bloomberg Code	CBK IN

KEY FINANCIALS

Particulars (INR Mn)	FY15	FY16	FY17	FY18E	FY19E
Net Interest Income	96,636.7	97,633.6	98,717.8	1,03,651.1	1,08,375.9
Pre-provision profits	69,503.7	71,466.6	89,138.9	98,156.0	1,12,508.5
Net Profit	27,026.5	(28,128.2)	11,219.2	12,649.1	16,949.6
EPS (₹)	56.9	(51.8)	18.8	21.2	28.4
BVPS (₹)	670.4	582.0	564.0	585.2	613.5
ABVPS (₹)	486.5	198.3	201.5	227.8	301.5
P/ABV (x)	0.79	1.00	1.51	1.55	1.17

Source: Company, KRChoksey Research

SHARE PRICE PERFORMANCE



The management has claimed that the deterioration in asset quality, of 85 bps yoy and 93 bps qoq, was on accounted on resolutions timelines getting stretched. For FY18, as outlined in the previously as well, the Bank will be focusing on recovery, growth and improving the financial health. On the recovery front, the bank has created a restructuring post as it anticipates inflow of a number of restructuring cases on account of recent measures taken by the RBI. On the income side, the Bank will be focusing on growing non-interest income.

Focus on CASA growth, along with increasing share of retail loans should aid NIM improvement. Over the next few years, although the Bank expects to grows it advances by 10-11%, it will also carry out higher provisioning in order to strengthen its balance sheet. As a result of this, the management has guided for profitability to remain subdued, without any major uptick. The Bank also plans to augment its capital base by raising Rs. 35,000 mn worth of equity capital. In addition to this, the Bank also plans to raise funds through Tier III bonds. Such measures to raise capital are in line with the bank's aim of improving its CAR to more than 13% by FY18. We expect prudent provisioning policy, conservative lending and augmented capital base to strengthen the bank's balance sheet.

MARKET INFO

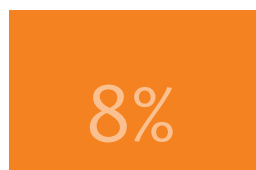
SENSEX	31904
NIFTY	9873

Prudent provisioning to help strengthen the balance sheet

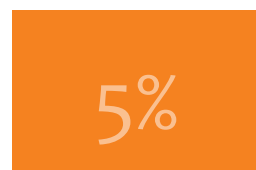
Provisioning was up 47.6% on yoy basis (down 18.6% qoq) at Rs. 22,038 mn, as the bank continues to follow on its strategy of strengthening the balance sheet against future asset quality pressures. PCR was 54.25%, up from 50.82% over same quarter last year. As per the management, PCR is likely to increase further and provisioning will stay elevated for another year or two, thus dampening profitability, while balance sheet strengthens.

SHARE HOLDING PATTERN (%)

Particulars	Jun 17	Mar 17	Dec 16
Promoters	66.3	66.3	66.3
FIIIs	5.85	5.28	5.94
DIIIs	21.33	21.23	20.48
Others	6.53	7.19	7.29
Total	100	100	100



Advances CAGR between FY 17 and FY 19E



NII CAGR between FY 17 and FY 19E

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During the quarter, of the total provisions, Rs. 4000 mn could be attributed to the 12 accounts identified by the RBI for proceedings under IBC. As of now, the Bank has made provisions of Rs. 35000 mn against these 12 accounts against a requirement of Rs. 56000 mn by FY18. Having carried out approximately Rs. 4000 mn worth of provisioning during the quarter, there is another Rs. 20000 to be carried out over the next 3 quarters. We expect credit costs in the range of 2.2% for FY18E with a gradual decline towards FY20E.

Strong improvement in operational efficiency

Operating expenses grew 13.3% yoy and 10.2% qoq with cost/income ratio improving by ~450 yoy. Operating expenses were mainly driven by growth in other expenses (15.3% yoy, 5.3% qoq). Going forward, the management has guided for cost/income to stay below 50%.

Advances growth closer to industry average; focus on growing CASA

Advances grew 6.7% yoy, in line with recent industry average, while total assets grew by 7.4% yoy (flat qoq). Within the advances mix, retail grew at 8.3% yoy, while MSME grew at 12.2%. Within the corporate book, exposure to infrastructure loans reduced by 11.2% yoy. We believe the Bank to maintain its cautious stance on lending to the corporate sector while simultaneously increasing share of retail loans in the total mix as it expects retail category to be buoyant on account of good monsoon. On the corporate side, the growth was tepid on account of less demand, competition from the bond market and access to cheaper sources of funding. For FY18, the Bank aims to grow its advances by 10-11%.

On the liability side, deposits grew by 4.4% yoy, down 1.9% qoq, while CASA ratio improved to 33.1% versus 29.3% for Q1FY17 and 32.9% for Q4FY17 (CA grew at 10.1% yoy, SA grew at 17.4% yoy). We attribute part of NIM improvement to increase in CASA ratio and expect NIMs to improve further as the Bank targets to reach 35% CASA by FY18. Going forward, we expect deposits growth to be slower than the advances growth as improving the CD ratio (credit/deposit) is a part of the Bank's future business strategy. During the quarter, CD ratio improved to 70.6% versus 69% for Q1FY17 and 69.1% for Q4FY17.

Asset quality stays worrisome; guidance for lower slippages and improvement in the vicinity

Absolute slippages were Rs. 55110 mn, of which Rs. 20020 mn were normal slippages (across 4 accounts; 50% from EPC and others from steel and consumer goods), Rs. 7920 mn were one-time slippages as communicated by the management and Rs. 27170 mn were slippages from large corporate accounts. The last two categories have been addressed as non-recurring in nature and therefore, normal annualized slippages for the quarter were 2.6% versus 3.8% for FY17 and 7.7% for FY16. Going forward, the management has guided for slippages to be contained below 2% and Net NPA to be below 6% (7.09% for Q1FY18 versus 6.69% for Q1FY17 and 6.33% for Q4FY17).

With respect to the 12 accounts identified by the RBI, the Bank has exposure of 102000 mn (~30% of total GNPA's; 3% of total advances) of which 98% are secured, hence the provisioning impact will not be as bad as for the unsecured part. The Bank expects NCLT cases to be resolved by March 2018 as these have been filed and are in progress.

Despite a better guidance/outlook by the management (NIM improvement, lower slippages, containment of NPAs, strengthening of balance sheet), we remain cautious on the Bank until more clarity emerges with respect to resolution of the NPAs and earnings pick up.

Valuation & Recommendation: Although the declining trend of slippages is somewhat comforting, GNPA's of 7%+ still look worrisome and may have a long way to go before declining substantially. The management has a clear-cut strategy in place with priority over balance sheet strengthening over improving profitability. On the NII front, growth and NIM expansion should come on account of cautious lending to the corporate sector and increasing share of retail loans (sharp focus on direct housing) along with improvement in CASA to 35% by FY18 and beyond thereafter. While we believe the Bank's strategy to be a sound one, asset quality and earnings improvement still remain watchful. Hence, we maintain ACCUMULATE recommendation on the stock, valuing it at 1.25x FY19E ABV.

Key Ratios	Q1FY18	Q1FY17	Q4FY17	Y-o-Y	Q-o-Q
Yield on avg advances	8.5%	9.3%	8.4%	-80	1
NIM %	2.00%	1.82%	1.97%	18	3
Cost to income ratio	48.7%	53.3%	41.8%	-454	697
Effective tax rate	6.3%	29.8%	18.9%		
Gross NPAs	376578	323341	342020	16%	10%
Net NPAs	243006	214939	216490	13%	12%
GNPA %	10.56%	9.71%	9.63%	85	93
NNPA %	7.09%	6.69%	6.33%	40	76
Provision coverage %	54.52%	50.82%	55.62%		
CD ratio	70.6%	69.0%	69.1%	151	150
Capital adequacy ratio	12.61%	12.11%	12.86%	50	-25
Tier I	8.72%	8.21%	8.92%	51	-20

Source: Company, KRChoksey Research

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Income Statement (INR Mn)	Q1FY18	Q1FY17	Q4FY17	Y-o-Y	Q-o-Q
Interest income	101956	102017	104929	-0.1%	-2.8%
Interest expense	74824	78943	77847	-5.2%	-3.9%
Net interest income	27132	23074	27082	17.6%	0.2%
Noninterest income	21085	15847	23963	33.1%	-12.0%
Total income	48218	38921	51045	23.9%	-5.5%
- Employee costs	13518	12082	11842	11.9%	14.1%
- Other operating expenses	9976	8650	9473	15.3%	5.3%
Operating expenses	23494	20732	21316	13.3%	10.2%
Pre-provision profit	24724	18189	29729	35.9%	-16.8%
Provisions	22038	14929	27087	47.6%	-18.6%
Profit before tax	2686	3260	2642	-17.6%	1.7%
Tax expense	170	970	500	-82.5%	-66.0%
Net profit	2516	2290	2142	9.9%	17.5%

Source: Company, KRChoksey Research

Balance Sheet items	Q1FY18	Q1FY17	Q4FY17	Y-o-Y	Q-o-Q
Deposits	4859052	4653142	4952752	4.4%	-1.9%
Borrowings	439659	285449	395036	54.0%	11.3%
Investments	1478945	1306555	1502659	13.2%	-1.6%
Advances	3428156	3212833	3420088	6.7%	0.2%

Source: Company, KRChoksey Research

Key highlights from Q1FY18 earnings call:

- For FY18, focus will be on growth, recovery and balance sheet strengthening. For Bank has created a restructuring post as it anticipates a lot of restructuring cases to come.
- Net NPA guidance for FY18 is below 6%. Although provisioning will increase as the bank follows on its strategy to strengthen the balance sheet. RoA is unlikely to improve as provisioning will be accelerated; credit cost to be around 2%.
- Advances growth will mainly come from retail, agri and SME on back of good monsoon. Bank is expected to stay cautious on corporate lending, advancing loans only to good rated corporates. Guidance is for 10-11% growth.
- NIM is likely to improve on back of lower cost of funds. CASA is likely to improve as the bank is targeting 35% for FY18.
- Slippages to be contained within 2% along with most of the NCLT cases resolution by March 2018. Resolution on non-NCLT cases is in progress.
- Bank plans to raise capital to augment its capital base and reach 13% CAR by FY18. Currently, plans are to raise Rs. 35000 crore in equity offering.
- The bank has identified Rs. 20000 mn worth of non-core assets which it may look to divest; it will depend on market prices.

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Canara Bank Ltd				Rating Legend	
Date	CMP (INR)	TP (INR)	Recommendation	Our Rating	Upside
20-July-17	352	377	ACCUMULATE	Buy	More than 15%
23-Jan-17	272	350	ACCUMULATE		
27-Oct-16	310	350	ACCUMULATE	Accumulate	5% – 15%
05-Nov-15	274	289	HOLD		
26-May-15	336	340	HOLD	Hold	0 – 5%
13-Apr-15	393	400	HOLD		
6-Feb-15	415	410	REDUCE	Reduce	-5% – 0
7-Jan-15	438	400	SELL		
				Sell	Less than – 5%

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