

Weak Earnings and Merger challenges ahead

- Canara Bank reported a loss of Rs 32bn in 4QFY20 led by higher loan loss provisions as the bank provided more for existing NPAs, raising its PCR by 900bps QoQ to 51%.
- Despite asset classification benefit extended to Rs20bn of loans, slippages at 3.7% were elevated during the quarter.
- Moratorium at 17% of advances is lower than peer banks, however the approach to moratorium number makes it less comparable to peers
- Sub-par core earnings (PPoP/assets at 1.5%), elevated credit costs, and focus on merger could continue to pressurize earnings over the medium term. **We have a REDUCE recommendation on the stock with a TP of Rs108, valuing it at 0.6x of FY22E P/ABV.**

Slippages High, provisions higher

Gross NPAs declined by 15 bps QoQ to 8.2% partly driven by higher sequential growth in advances at 2%. If not for the standstill benefit, slippages would be high at ~5.4% against the reported 3.7%. While the bank provided 5% towards standstill accounts, higher credit costs were owing to increased provisions made towards specific NPAs, which aided its PCR. With 36% of corporate loans in the 'BBB and below' category, we expect slippages to remain elevated in FY21E, though rise in credit costs may be less given a high base.

Weak earnings profile & merger impact could hurt capital position

Reported NIM at 2.3% for FY20 remain very weak. We see margins settling at 2.5-2.6% over the medium term, not enough to take on the pressure of high credit costs, especially as fee lines and recovery prospects could remain weak. This, along with merger related challenges including HR/IT synchronisation, branch rationalisation and streamlining of the processes could impact near term profitability and weaken the bank's CET1 levels, at 9.4% currently. With the stock trading below book, dilution risk remains high in case of any equity capital raise.

Q4FY20 Result (Rs Mn)

Particulars	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)
Net interest income	33,185	35,002	(5.2)	34,350	(3.4)
Other income	21,750	18,620	16.8	17,067	27.4
Total Net Income	54,935	53,621	2.5	51,418	6.8
Operating expenses	34,526	23,886	44.5	28,074	23.0
Pre-provision profits	20,409	29,735	(31.4)	23,343	(12.6)
Provisions	53,754	55,235	(2.7)	18,029	198.2
Tax expense	(752)	(19,985)	NA	2,018	(137.3)
Reported Net Profit	(32,593)	(5,515)	NA	3,296	(1,088.8)
			(bps)		(bps)
Advances Growth (%)	1.0	12.1	(1,102)	1.3	(25)
NIM (%)	2.3	2.8	(48)	2.4	(8)
RoA (%)	(1.8)	(0.3)	(150)	0.2	(202)
RoE (%)	(34.5)	(6.1)	(2,840)	3.3	(3,784)
Gross NPA (%)	8.2	8.8	(62)	8.4	(15)

CMP	Rs 105
Target / Upside	Rs 108 / 3%
BSE Sensex	34,820
NSE Nifty	10,289

Scrip Details

Equity / FV	Rs 10,302mn / Rs 10
Market Cap	Rs 108bn
	USD 1bn
52-week High/Low	Rs 297/Rs 74
Avg. Volume (no)	15,374,200
NSE Symbol	CANBK
Bloomberg Code	CBK IN

Shareholding Pattern Mar'20(%)

Promoters	78.6
MF/Banks/FIs	9.8
FIs	2.6
Public / Others	9.1

Valuation (x)

	FY20A	FY21E	FY22E
P/E	(4.8)	(7.7)	6.8
P/ABV	0.8	0.8	0.6
ROAA	(0.3)	(0.2)	0.2
ROAE	(5.9)	(3.7)	4.2

Estimates (Rs mn)

	FY20A	FY21E	FY22E
NII	131,240	149,087	156,514
PPOP	93,599	110,902	120,094
PAT	(22,356)	(14,040)	15,880
Adj BV	134.2	123.6	179.3

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Other Important Highlights:

- Moratorium book stands @ 17% by value and 19% by customer base as of 31st March. Only accounts where 3 or more instalments have not been paid have been considered as a part of the moratorium book.
- The bank expects ~Rs 9,000-10,000 crs of recoveries (including Rs 1,800crs from Bhushan Power) going forward, of which Rs 3,700crs is expected from accounts under NCLT
- Divestment of stake in Canfin Homes is not in consideration at this point, the decision will be taken by the board.
- Capital raising plans will be discussed in the upcoming board meeting, intend to raise both equity and AT1 capital from the market.
- While the bank did not disclose details for the merged entity, it qualitatively indicated that NNPA ratio would be similar levels as standalone entity

Risks to the View: Higher-than-estimated credit loss from corporate and retail segments, integration related challenges, higher than anticipated stress on macro-economy from COVID-19

Exhibit 1: Actual v/s estimates

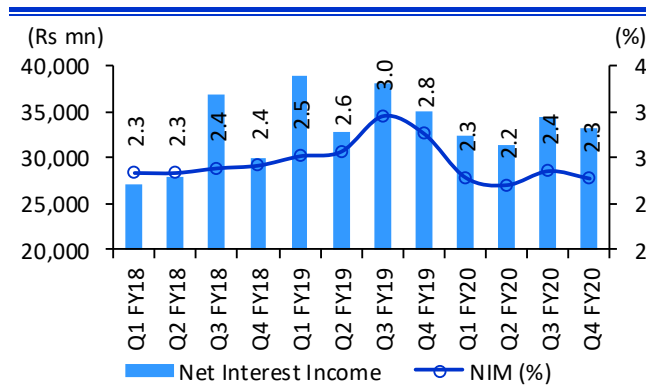
Particulars (Rs mn)	Actual	Estimated	% Variance	Comments
NII	33,185	33,306	(0.4)	
Operating Profit	20,409	24,578	(17.0)	
PAT	(32,593)	3,068	(1,162.5)	Due to higher loan loss provisions

Source: Company, DART

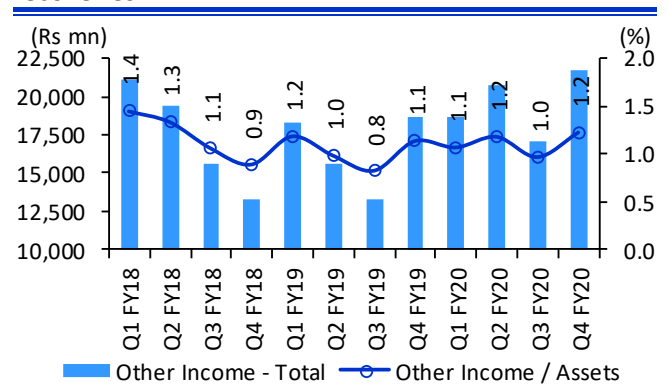
Exhibit 2: Change in estimates

Particulars (Rs mn)	Previous		Revised		Change %	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Net Operating Revenue	2,29,683	2,51,751	2,32,463	2,47,733	1.2	(1.6)
Pre Provision Profits	1,07,401	1,17,241	1,10,902	1,20,094	3.3	2.4
PAT	(11,171)	17,350	(14,040)	15,880	NA	(8.5)

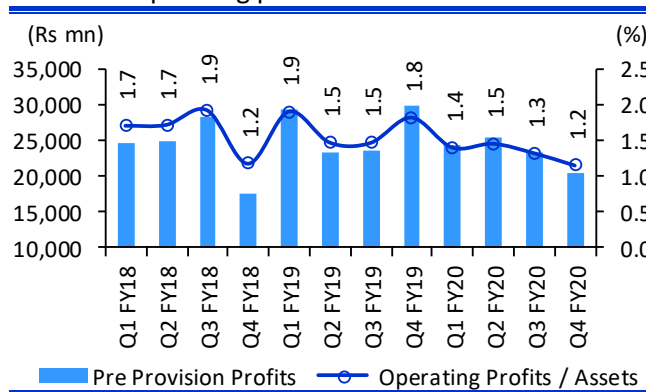
Source: Company, DART

Exhibit 3: Margins continue to remain weak


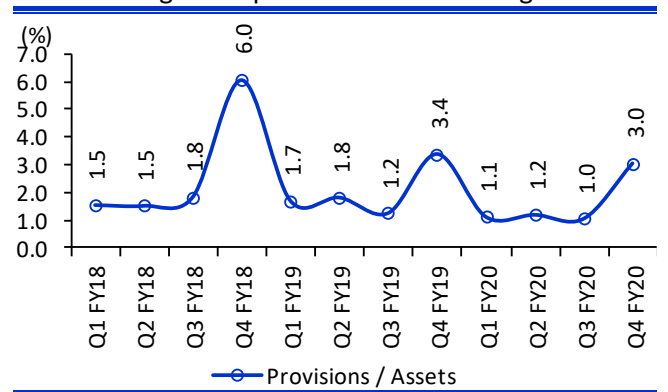
Source: Company, DART

Exhibit 4: Improvement in Other Income led by higher recoveries


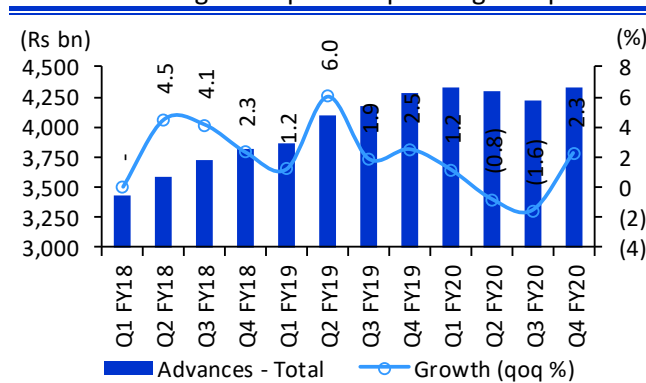
Source: Company, DART

Exhibit 5: Operating profit remains weak


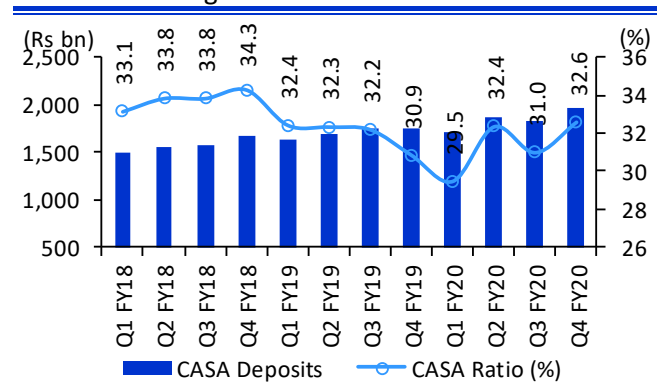
Source: Company, DART

Exhibit 6: High NPA provisions dent earnings


Source: Company, DART

Exhibit 7: Loan growth picked up during the quarter


Source: Company, DART

Exhibit 8: CASA gained traction


Source: Company, DART

Quarterly Financials

Profit and Loss (Rs mn)	Q4FY20	Q4FY19	% yoy / bps	Q3FY20	% qoq / bps
Interest Inc.	1,20,474	1,21,385	(0.8)	1,22,949	(2.0)
Yield on Advances (%)	7.97	8.39	(42)	8.22	(25)
Yield on Invt. (%)	-	7.62	-	7.42	-
Yield on Assets (%)	6.84	7.59	(75)	7.14	(30)
Interest Expenses	87,289	86,383	1.0	88,599	(1.5)
Cost of Dep. (%)	5.38	5.66	(28)	5.57	(19)
Cost of Fund (%)	4.95	5.24	(29)	5.14	(19)
Net Interest Income	33,185	35,002	(5.2)	34,350	(3.4)
NII to Net Operative Income	60.41	65.28	(487)	66.81	(640)
NIM (%)	2.28	2.76	(48)	2.36	(8)
Adjusted NII	32,769	30,948	5.9	34,099	(3.9)
Fee Income	5,740	5,130	11.9	5,660	1.4
Profit on Sale / Rev of Investments	1,830	2,420	(24.4)	1,600	14.4
Recovery in w/off A/cs	5,540	1,110	399.1	2,510	120.7
Other Misc. Income	8,640	9,960	(13.3)	7,300	18.4
Non Core Other Income	16,010	13,490	18.7	11,410	40.3
Other Income - Total	21,750	18,620	16.8	17,067	27.4
Other Inc to Net Oper. Income (%)	39.6	34.7	487	33.2	640
Net Operating Revenue	54,935	53,621	2.4	51,418	6.8
Employee Expenses	21,752	10,399	109.2	15,969	36.2
Empl. Cost/Oper. Exps. (%)	39.6	19.4	2,020	31.1	854
Other Opex	12,774	13,488	(5.3)	12,106	5.5
Other Opex/ Assets (%)	0.2	0.2	(3)	0.2	1
Total Opex	34,526	23,886	44.5	28,074	23.0
Cost to Income Ratio (%)	62.8	44.5	1,830	54.6	825
Pre Provision Profits	20,409	29,735	(31.4)	23,343	(12.6)
Provision towards NPAs	48,753	51,209	(4.8)	12,014	305.8
Provisions & Contingencies - Total	53,754	55,235	(2.7)	18,029	198.2
NPA Provisions as % PPP	263.4	185.8	7,763	77.2	18,615
Profit Before Tax	(33,345)	(25,500)	30.8	5,314	(727.5)
Tax	(752)	(19,985)	(96.2)	2,018	(137.3)
Effective Tax Rate (%)	2.3	78.4	(7,612)	38.0	(3,571.9)
Reported Profits	(32,593)	(5,515)	491.0	3,296	(1,088.8)
RoA (%)	(1.85)	(0.36)	(149)	0.19	(204.0)
Basic EPS (Rs)	(31.16)	(7.40)	321.1	4.22	(838.4)
Diluted EPS (Rs)	(31.16)	(7.40)	321.1	4.22	(838.4)

Source: Company, DART

Balance Sheet Analysis	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	QoQ % / bps	YoY % / bps
Net Worth	3,61,772	3,66,056	4,35,850	4,40,612	3,92,930	(10.8)	8.6
CET1 (%)	8.3	8.2	10.4	10.3	9.4	(90)	108
Tier 1 (%)	9.0	8.9	11.1	11.1	10.1	(93)	108
Total CAR (%)	11.9	11.7	14.0	13.9	13.6	(21)	175
RWA - Total	35,24,550	36,30,530	35,27,490	35,87,490	36,09,060	0.6	2.4
Advances - Total	42,77,273	43,27,681	42,93,186	42,26,080	43,21,752	2.3	1.0
Investments	15,29,853	15,39,233	16,12,335	16,50,508	17,62,449	6.8	15.2
Total Assets	69,47,667	70,03,226	70,74,235	71,80,928	72,38,748	0.8	4.2
RoA (%)	(0.36)	0.19	0.21	0.19	(1.85)	(204)	(149)
Deposits	59,90,333	61,06,738	60,94,365	62,52,404	62,53,512	0.0	4.4
Saving Deposit	15,15,350	14,85,290	15,32,350	15,87,540	16,97,490	6.9	12.0
Current Deposit	2,32,740	2,17,900	3,24,990	2,41,090	2,64,580	9.7	13.7
CASA Deposits	17,48,090	17,03,190	18,57,340	18,28,630	19,62,070	7.3	12.2
CASA Ratio (%)	30.9	29.5	32.4	31.0	32.6	159	173
Term Deposits	39,11,083	44,03,548	38,83,760	40,70,620	40,54,572	(0.4)	3.7
Interest Bearing Liabilities - Total	64,00,256	64,93,296	64,50,609	65,89,620	66,81,130	1.4	4.4

Source: Company, DART

Movement of NPA (Rs mn)	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	QoQ % / bps	YoY % / bps
Gross Advances	44,42,143	44,92,477	44,59,831	43,83,370	45,11,711	2.9	1.6
Gross NPA	3,92,241	3,93,990	3,87,113	3,66,450	3,70,412	1.1	(5.6)
Gross NPA Ratio (%)	8.83	8.77	8.68	8.36	8.21	(15)	(62)
PCR - Calculated (%)	41.5	41.2	42.9	41.8	50.7	896	925
PCR - Inc. Tech w/o (%)	68.13	68.62	70.11	70.97	75.86	489	773
Net Advances	42,74,695	43,27,028	42,89,328	42,25,295	43,24,870	2.4	1.2
Net NPA	2,29,551	2,31,496	2,20,900	2,13,377	1,82,510	(14.5)	(20.5)
Net NPAs Ratio (%)	5.37	5.35	5.15	5.05	4.22	(83)	(115)

Source: Company, DART

Loan Book Analysis (Rs mn)	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	YoY % / bps
Agriculture	9,05,430	9,26,890	9,58,340	9,90,320	9,60,430	6.1
MSME	8,51,680	8,88,510	8,68,470	9,04,630	7,87,730	(7.5)
Retail Credit	7,11,850	8,39,180	8,80,170	9,61,020	7,98,000	12.1
Corporate Advances	19,73,200	18,38,320	17,55,190	15,26,130	19,66,070	(0.4)
Advances - Total	44,42,160	44,92,900	44,62,170	43,82,100	45,12,230	1.6

Source: Company, DART

Conference Call Highlights

Asset Quality:

Moratorium:

- most clients have not opted as they are well placed.
- Moratorium book stands @ 17% by value and 19% by customer base as of 31st March. Only accounts where 3 or more instalments have not been paid have been considered as a part of the moratorium book.
- Level of moratorium remains the same as of May end. While the proportion of moratorium was higher initially, it has come off.
 - Moratorium availed as of 31st May: Corporate Rs 16,000crs, Retail Rs 2,300crs, MSME Rs 17,000crs
 - Agri – no moratorium as payments are made on a quarterly/bi-annual/ seasonal basis

Provisions:

- Taken a call to provide proactively leading to higher provisions across the merged entities
- Adequate provisions made for wage revision hike @ 13%
- Provisions to the tune of Rs 432crs have also been made with respect to pension (133crs), leave encashment (40crs), gratuity (106crs) and settlements (153crs).

Large Exposures:

- Jet Airways o/s of Rs 525crs. Bank has made 100% provisions of which Rs 393crs provided for in 4Q
- Aban – O/S Rs 220crs, 100% provided
- Additional provisions of Rs 94crs for COVID and Rs 127crs for other miscellaneous.
- The bank has made Rs 512crs of provisions against large exposures to shore up PCR (incl. tech w/o) to 76%

Corporate asset quality:

- ~Rs 20,000-30,000crs of the corporate portfolio is guaranteed by state governments and ~Rs 5,000crs by the central government
- 63% of the portfolio rated A and Above
- The bank will be monitoring the corporate asset quality closely
- Exposure to Air India is insignificant.
- The bank does not foresee any large slippages in the coming quarters, while significant recoveries are expected from resolutions.
- On account of Rs 2350crs classified as fraud, the bank has provided Rs 497crs
 - Of the total fraud amount, Rs 2000crs pertains to DHFL, on which Rs 440crs has been provided as of 4QFY20. DHFL has been classified as fraud in 1QFY21, the account will be provided fully over the next 3 quarters.

Recoveries

- Recoveries from TWO were high during the quarter (~Rs 1470crs), and should remain elevated in coming quarters.
- The bank expects ~Rs 9,000-10,000 crs of recoveries (including Rs 1,800crs from Bhushan Power) going forward, of which Rs 3,700crs is expected from accounts under NCLT

Segment wise slippages breakup:

- MSME – Rs 3,900crs
- Agri – Rs 3,000crs
- Corporate/Large Industry – Rs 2,000crs
- Retail – Rs 400crs

Business and Earnings:

- Focus on reducing operating costs by ~20% in FY21. While government has come out with guidelines on reducing opex, the bank has taken a conscious call to reduce opex in other segments as well.
- **Advances** - Credit growth to be concentrated on retail (NPAs <2%) with incremental focus on housing loans; and corporate segments. Management expects 7-8% YoY growth in the total retail and corporate book
- **Deposits** – The bank is focusing on retail term deposits (60% share) rather than bulk deposits (40% share) and has been sensitive to rates
- Capital raise and divestment of stake in Canfin Homes to be discussed in the next board meeting on July 2nd.
- Under the TLTRO window, the bank raised Rs 1500crs in TLTRO 1 and Rs 850crs in TLTRO 2, most which has been deployed with NBFCs
- Amalgamation, cost rationalization and branch harmonization:
 - Identified ~1100 branches within a 250m radius for each other for rationalization. The process is expected to start by 4QFY21. Central offices have already been amalgamated
 - Top management transition has been completed.
 - Infra harmonization also underway
 - 350crs of additional provisions made and ~Rs 553crs NPAs reclassified as fresh NPAs
 - Staff costs have also been provided for sufficiently (~1142crs provided for wage hike so far)
- Synergies arising from amalgamated entities:
 - Higher CASA traction expected due to Syndicate Bank's strong CASA book. In terms of geography, Karnataka, Tamil Nadu and Uttar Pradesh are the top contributors.
 - The bank has a combined presence of ~5000 branches in Karnataka and Tamil Nadu

Profit and Loss Account (Rs Mn)

Particulars	FY19A	FY20A	FY21E	FY22E
Interest Income	468,103	489,350	515,826	539,756
Interest expenses	323,320	358,110	366,740	383,242
Net interest income	144,783	131,240	149,087	156,514
Other incomes	65,750	78,132	83,376	91,219
Total expenses	104,622	115,772	121,561	127,639
- Employee cost	56,751	71,342	74,909	78,654
- Other	47,871	44,431	46,652	48,985
Pre provisioning profit	105,911	93,599	110,902	120,094
Provisions	129,183	111,154	129,664	98,872
Profit before taxes	(23,272)	(17,555)	(18,762)	21,222
Tax provision	(26,744)	4,802	(4,722)	5,342
Profit after tax	3,472	(22,356)	(14,040)	15,880
Adjusted profit	3,472	(22,356)	(14,040)	15,880

Balance Sheet (Rs Mn)

Particulars	FY19A	FY20A	FY21E	FY22E
Sources of Funds				
Equity Capital	7,532	10,302	10,302	10,302
Reserves & Surplus	354,240	382,627	363,866	377,423
Minority Interest	0	0	0	0
Net worth	361,772	392,930	374,168	387,725
Borrowings	409,923	427,618	411,912	400,133
- Deposits	5,990,333	6,253,512	6,453,290	6,875,011
- Other interest bearing liabilities	0	0	0	0
Current liabilities & provisions	185,639	164,688	194,555	213,213
Total Liabilities	6,947,667	7,238,748	7,433,925	7,876,083
Application of Funds				
Cash and balances with RBI	661,527	682,715	660,858	701,017
Investments	1,529,853	1,762,449	1,842,483	1,957,861
Advances	4,277,273	4,321,752	4,451,405	4,718,489
Fixed assets	84,102	82,763	82,330	85,993
Other current assets, loans and advances	394,912	389,069	396,850	412,724
Total Assets	6,947,667	7,238,748	7,433,925	7,876,083

E – Estimates

Important Ratios

Particulars	FY19A	FY20A	FY21E	FY22E
(A) Margins (%)				
Yield on advances	8.5	8.4	8.5	8.5
Yields on interest earning assets	7.7	7.4	7.5	7.5
Yield on investments	7.4	6.9	7.0	7.0
Costs of funds	5.4	5.5	5.4	5.4
Cost of deposits	5.4	5.5	5.4	5.4
NIMs	2.4	2.0	2.2	2.2
(B) Asset quality and capital ratios (%)				
GNPA	8.8	8.2	9.0	7.8
NNPA	5.4	4.2	4.2	3.0
PCR	41.5	50.7	55.0	62.0
Slippages	4.1	3.5	4.8	3.3
NNPA to NW	77.2	55.4	59.5	43.8
CASA	30.9	32.6	32.0	32.0
CAR	11.9	13.7	13.0	12.9
Tier 1	9.0	10.1	9.2	9.0
Credit - Deposit	71.4	69.1	69.0	68.6
(C) Dupont as a percentage of average assets				
Interest income	7.1	6.9	7.0	7.1
Interest expenses	4.9	5.0	5.0	5.0
Net interest income	2.2	1.9	2.0	2.0
Non interest Income	1.0	1.1	1.1	1.2
Total expenses	1.6	1.6	1.7	1.7
- cost to income	49.7	55.3	52.3	51.5
Provisions	2.0	1.6	1.8	1.3
Tax	(0.4)	0.1	(0.1)	0.1
RoA	0.1	(0.3)	(0.2)	0.2
Leverage	23.4	22.0	23.7	24.0
RoE	1.0	(5.9)	(3.7)	4.2
RoRwa	0.1	(0.6)	(0.4)	0.4
(D) Measures of Investments				
EPS - adjusted	4.6	(21.7)	(13.6)	15.4
BV	394.7	319.9	305.1	318.7
ABV	78.9	134.2	123.6	179.3
(E) Growth Ratios (%)				
Net interest income	19.0	(9.4)	13.6	5.0
PPoP	10.9	(11.6)	18.5	8.3
Adj PAT	(108.2)	(743.9)	(37.2)	(213.1)
Advances	12.1	1.0	3.0	6.0
Total borrowings	5.6	4.3	(3.7)	(2.9)
Total assets	12.6	4.2	2.7	5.9
(F) Valuation Ratios				
Market Cap (Rs. mn)	107,968	107,968	107,968	107,968
CMP (Rs.)	105	105	105	105
P/E (x)	22.7	(4.8)	(7.7)	6.8
P/BV (x)	0.3	0.3	0.3	0.3
P/ABV (x)	1.3	0.8	0.8	0.6

E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

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