Stock Update

Canara Bank

February 07, 2022

RETAILRESEARCH

Canara Bank

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
PSU Banks	Rs.261	Buy between Rs.258-263 & add more on dips of Rs.231	Rs.290	Rs.318	2 quarters

HDFC Scrip Code	CANBANEQNR
BSE Code	532483
NSE Code	CANBK
Bloomberg	CBK IN
CMP Feb 4, 2022	261
Equity Capital (Rs Cr)	1814
Face Value (Rs)	10
Equity Share O/S (Cr)	181.4
Market Cap (Rs Cr)	47,330
ABook Value (Rs)	159
Avg. 52 Wk Volumes	22338612
52 Week High	272.8
52 Week Low	124.4

Share holding Pattern % (Dec, 2021)	
Promoters	62.9
Institutions	21.5
Non Institutions	15.6
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

Post the amalgamation with Syndicate Bank, Canara Bank has become third largest public sector bank in terms of total business. With over a century of banking operations in the India, it has become an established player in the south region. Apart from banking, it also has presence across various financial services via Subsidiaries and JVs. The bank has well-balanced asset mix and it has started focusing on retail, agriculture and MSME (“RAM”) sectors which will lead to better risk diversification, increased revenue and improved margins. The quality of the loan book is also improving with lower SMA and lower share of BB& below rated corporates. Management has also guided for strong credit growth in coming quarters. The corporate segment has shown good recovery in Q3 and Q4 being seasonally strong quarter the trend could continue. The Capital Adequacy Ratio (CAR) is strengthening gradually with improved earnings and steady risk weighted assets with a modest increase in advances along with recent fund raise and utilisation of deferred tax assets.

Industry tailwinds like PSB privatization theme, accelerated resolution program through IBC and improved scenario for credit growth could keep the public sector banks in lime light. The asset quality challenges of the previous corporate cycles are behind us and recoveries cycle has started. The balance sheet quality across the banking sector has improved. Strong credit growth rebound along with lower need for credit cost could inflate the earnings for PSBs.

We had issued Initiating Coverage report on Canara Bank on 18th October, 2021 and recommended Buy at LTP of Rs.139.6 and add further on dips to Rs.169 band, for base case target of Rs.216.5 and bull case target of Rs.228.5 over the next two quarters. The bull case target of Rs.228.5 was achieved on 4th November 2021, yielding return of 18%. Looking at inexpensive valuation and growth expectation along with industry tailwinds, we feel that there is still some room left for upside. We have also added FY24E estimates.

Link for the Initiating Coverage:
https://www.hdfcsec.com/hsl.research.pdf/HSL_Initiating%20Coverage%20Canara%20Bank%20Ltd%20-18102021.pdf

Valuation & Recommendation:

The bank has reported strong set of earnings during Q3FY22 supported by improved credit growth and lower slippages. The bank has made additional 25% provisioning for SREI. Going forward, we expect Canara Bank to grow its loan book at 11.5% CAGR while NII and Net profit are expected to grow at 13% and 58% (due to lower base) CAGR respectively over FY21-24E. ROAA is estimated to improve to 0.74% in FY24E from current 0.3% in FY21 and RoE could rise to 12.6% in FY24 from 5.2% in FY21. Management has guided for higher recoveries and lower slippages. Canara Bank is trading at an inexpensive valuation of 0.86xFY24E P/ABV. We are not separately ascribing any value to the subsidiaries/associates of Canara Bank while valuing the stock.

We feel investors can buy Canara bank between Rs.258-263 (0.9x Dec-23 ABV) & add more on dips of Rs.231 (0.8x Dec-23 ABV) for the base case fair value of Rs.290 (1x Dec-23 ABV) and for the bull case fair value of Rs.318 (1.1x Dec-23 ABV) over the next two quarters.

Financial Summary

	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	FY20	FY21	FY22E	FY23E	FY24E
NII	6945.0	6080.9	14.2	6273.8	10.7	13123.9	24062.2	26357.2	30139.2	35162.0
PPP	4447.7	5381.5	-17.4	5603.6	-20.6	9359.8	20009.3	21495.6	22770.2	24536.1
PAT	1502.7	696.1	115.9	1332.6	12.8	-2235.7	2557.6	5803.7	8065.5	10110.8
EPS (Rs)						-21.7	15.5	32.0	44.5	55.7
ABV						142.8	158.9	208.9	247.6	302.5
P/E (x)						-12.0	16.8	8.2	5.9	4.7
P/ABV (x)						1.8	1.6	1.2	1.1	0.9
RoAA (%)						-0.3	0.3	0.5	0.6	0.7
RoAE (%)						-5.9	5.2	9.2	11.3	12.6

(Source: Company, HDFC sec)

Change in Estimates

	FY22E			FY23E			FY24E
	Old	New	% Change	Old	New	% Change	
Advances	683782.0	709983.4	3.8	752161.0	790211.6	5.1	885037.0
NII	26673.0	26357.2	-1.2	29605.0	30139.2	1.8	35162.0
PPOP	22171.0	21495.6	-3.0	24198.0	22770.2	-5.9	24536.1
PAT	5013.0	5803.7	15.8	7579.0	8065.5	6.4	10110.8
EPS	27.6	32.0	15.9	41.8	44.5	6.4	55.7

Recent Developments

Q3FY22 Result Update

Net Interest Income (NII) came at Rs. 6946 Cr, up 11% QoQ and 14% YoY. Reported NIM improved by 6bps qoq to 2.83%, led by better loan yields, higher interest on the IT refund and continued moderation in CoF. Pre provisioning Operating profit de-grew by 17% YoY. Other income dipped by 13% YoY due to lower treasury gains. Cost to Income ratio came at 45% vs 48% QoQ. During the quarter, the bank has made Rs.1355 Cr special provision for the pension of the staff, which otherwise as per the permission of the RBI can be done in five years. Net profit for the quarter came at Rs.1503 Cr up 116% YoY and 12.8% QoQ.

The bank has reported recovery in loan growth during the quarter due to strong growth from the corporate book side. Domestic deposit grew by 6.5% YoY with CASA growth of 10.3% YoY. CASA Ratio stood at at 34.6%, up 119 bps YoY. Also the bulk deposits have been brought down further. As per the management, Canara Bank is very aggressive in HAM projects, sectors like steel, cement and healthcare. With regards, to Real Estate the Bank is taking exposure to Residential Real Estate projects which are RERA compliant and backed by strong promoters.

The Bank has achieved Targets in Priority Sector at 48.33% and Agricultural Credit at 21.55% of Adjusted Net Bank Credit (ANBC) as at Dec 2021, as against the norm of 40% and 18% respectively. Credit to small and marginal farmers stood at 14.31% of ANBC, against the norm of 9%. Credit to Weaker Sections stood at 20.75% of ANBC, against the norm of 11%.

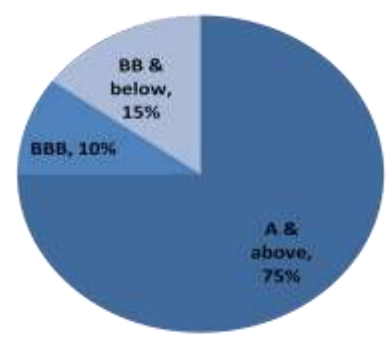
Asset Quality

The Gross Non-Performing Assets (GNPA) ratio stood at 7.8% vs 8.4% QoQ and 7.5% YoY, while the Net Non-Performing Assets (NNPA) stood at 2.86% vs 3.21% QoQ and 2.64% YoY. Provision Coverage Ratio (PCR) improved to 83.3% as at December 2021 from 82.4% as at September 2021. Slippage ratio stood at 0.43% vs 1.04% (slippage was higher die to SREI) QoQ. The bank has already provided 75% for this account. There was healthy recoveries and upgrades during the quarter. The restructuring book slightly increased QoQ to 3% of loans. Exposure towards Air India stood at ~Rs.200 cr and has been fully recovered. While commenting on exposure towards future group, management has stated that they are confident that the exposure would remain standard. The restructuring book stands at Rs.18100 Cr (2.8% of loans). SMA 0, 1 & 2% to gross advances are now at minimal level of 1.76% compared to 3.22% in Mar-21. BB& Below rated corporates share to total corporate book is also going down. The bank has identified ~Rs.4000 to be transferred to NARCL. The management has guided for 2.5% slippage ratio for FY22.

Special Mention Accounts (SMA)

	Mar-21		Jun-21		Sep-21		Dec-21	
	No of Accounts	% to Gross Advances	No of Accounts	% to Gross Advances	No of Accounts	% to Gross Advances	No of Accounts	% to Gross Advances
SMA 2	126	0.7	234	1.06	240	0.7	218	0.28
SMA 1	261	1.47	164	0.59	139	0.28	199	0.39
TOTAL SMA 1 & 2	**387**	**2.17**	**398**	**1.65**	**379**	**0.98**	**417**	**0.67**
SMA 0	383	1.05	378	1.38	423	0.99	356	1.08
TOTAL	**770**	**3.22**	**776**	**3.04**	**802**	**1.97**	**773**	**1.76**

Rating Mix of Domestic Credit



Guidance for FY22

Parameters	Guidance	Actuals as on Dec-21
Business Growth (Global)	7.90%	8.06%
Advances Growth (Global)	7.50%	9.28%
Deposits Growth (Global)	8.20%	7.23%
CASA (Domestic CASA to Domestic Deposit)	36.50%	34.60%
NIM (Global) (Annualized)	2.75%	2.79%
Gross NPA (Global)	7.90%	7.80%
Net NPA (Global)	2.80%	2.86%

PCR (Global)	83.95%	83.26%
Slippage Ratio (Global) (Annualized)	2.25%	0.43%
Credit Cost (Global)(Annualized)	2.10%	1.75%
Return on Equity(RoE)	11.00%	12.10%
Earnings per share (EPS) (Annualized)	28	30.85
Return on Average Assets (RoA)	0.40%	0.45%

CAR improved further

The bank has seen some improvement in the Capital Adequacy Ratio (CAR) in 9MFY22 aided by fund raise, improved earnings, steady risk weighted assets with a modest increase in advances and utilisation of deferred tax assets. It has raised Rs.2500 Cr at the price of Rs. 149.3 per share via QIP in Aug-21. As of Q3FY22, the CAR stood at 14.8% with Tier-1 at 11.6% compared to 13.7% and 10.5% respectively in Q3FY21. The management has planned to raise total Rs.9000 Cr in FY22; so far only 8000 Cr has been raised. The bank has for now revoked its plan to sell its stake in its subsidiary, Can Fin Homes. But it gives cushion to raise capital in case of emergency need.

Capital Raising Plan:

Particulars	Guidance for FY22 (Rs. Cr)	Raised as of H1FY22 (Rs. Cr)
QIP Equity	2500	2500
Additional Tier-I Bonds	4000	1500
Tier-II Bonds	2500	2500
Total	**9000**	**8000**

Deposit profile

The CASA ratio of the bank is subpar with other PSB peers. It has to keep high rate on its term deposit compared to some other PSBs to compete with a few other south-based banks. High term deposits rate and lower CASA ratio into total deposit is bringing in high cost of funds for the bank. Canara Bank has high concentration in deposit base compared to other peers; top 20 depositors accounted for 9.6% of the total deposits as on March 31, 2021. However, management has been constantly trying to improve the scenario. CASA ratio as of Q3FY22 stood at 34.6% (up 119 bps YoY). Since last four quarters there has been steady improvement. During the quarter, deposits grew ~7% YoY with CASA growing by 10% YoY. Management has informed that they will continue to focus on premier CASA products, such as 'Canara Galaxy', 'Canara Privilege', 'SB Powerplus' and NRI accounts to improve the average balances under CASA. They have also launched CASA CONNECT campaign for enriching CASA. Reduction of dependence in bulk deposit and increase in CASA deposits will bring the competitive advantage to the bank by bringing in low cost of funds.

Credit growth set to pick up

In Q3FY22, the bank has reported revival in loan book growth largely due to pick up in corporate book (mainly NBFCs). Domestic gross advances grew by 8.8% YoY and 5.9% QoQ, while Global gross advance was up 9.3% YoY. Retail lending Portfolio increased 10% YoY / 3.3% QoQ to Rs. 123098 Cr on the back of strong housing loan growth of 15% YoY and Education loan growth of 8.8% YoY. Advances to Agriculture grew by 11.9% YoY. Corporate book was up by 11%/9% YoY/QoQ. Within corporate book, growth in the infrastructure, NBFC and Textile segment was robust (+20% YoY). Management has guided that they expect the credit growth for FY22E to be 7.5% and going further they are targeting to achieve a double-digit loan growth. There was strong traction in corporate book in Q3 and Q4 is typically seasonally best quarter for corporate loan segment so we expect this trend to continue in Q4 as well. Management has informed that there are good deals in the pipeline for next quarter in corporate segment. Moreover, management has also apprised that focus of lending for the corporate book will be towards the Health, Steel, Cement and HAM sectors, while in the Real estate, the focus area will be residential real estate.

Loan Book Mix

	Q3FY21	Q2FY22	Q3FY22	QoQ%	YoY%
Retail	111883	119138	123098	3.3	10.0
Housing Loans	61607	67386	70735	5.0	14.8
Vehicle Loans	13401	13697	14036	2.5	4.7
Education Loan	11917	12719	12965	1.9	8.8
Other Personal Loans	24958	25336	25362	0.1	1.6
Agriculture	150652	161632	168569	4.3	11.9
MSME	113718	110055	115180	4.7	1.3
Corporate	291308	295988	322659	9.0	10.8
Domestic Gross Advances	**644826**	**662991**	**701859**	**5.9**	**8.8**
Global Gross Advance	**667561**	**686813**	**729506**	**6.2**	**9.3**

PSB on the verge of re-rating

The successful divestment of Air India has reignited the confidence in the capability as well as intention of the Government to execute complex transactions in order to walk the talk in terms of its divestment agenda. Furthermore, the Q2FY22 and Q3FY22 numbers from most of the PSU banks were better, indicating that the clean-up of the books has progressed well and shall be underpinned further by the transfer of toxic assets to National Asset Reconstruction Company Limited which would release capital for boosting loan growth. Both of these developments augur well for the prospects of PSU banking stocks as they provide higher margin of safety in terms of valuation in an otherwise over-heated market.

We have been observing a gradual re-rating in the PSU banking space lately. Privatization theme is keeping them in the lime light and now the hope of earnings as well as asset quality recovery would further sustain the rally. Some of the good quality names within the PSBs with loan book or CASA ratio as good as some top tier private banks, are available at less than the book value of FY23E; as against about 2x to 3x Price-to-Book Value for private players.

The accelerated resolution program through IBC has helped to bring down NPAs. The PSU banking sectors' lending quality seems to have improved, which has been reflected with no major NPA surge seen post COVID waves. Now with the asset quality challenges of the previous cycles behind us, we feel that the valuation gap between the private Banks and PSBs will start to narrow gradually. Faster resolution by the IBC could also help in recoveries and bring down slippages in future. We believe that the PSU banks might see good addition to the book value per share in the next year mainly on account relatively lower credit costs and recoveries. We further believe acquisition of some PSU Banks by the any prestigious corporates/Institutions – local or foreign - at a good valuation may further re-rate the sector.

Improved scenario for credit growth

India has so far administered 169 Cr does and has 52.5% population fully vaccinated as of Jan-22 end. This could help the nation contain new covid-19 cases and hospitalisations. Economy has started opening up gradually, which is evident from the strong growth in economical head line numbers (IIP, eight core infra, manufacturing PMI etc.). Indian GDP has been expected to grow by 8-8.5% CAGR in FY23. In the latest budget, the outlay for the capital expenditure has been stepped up sharply by 35.4% for FY23. This increased capex could push pedals of virtuous cycle of consumption led growth. This could not only improve the economy growth but it could also revive private investments, which ultimately could bring credit growth for the banking system. While the NPA problems of previous corporate credit cycle is over, the only issue the banking industry facing is credit demand.

Earnings recovery

The asset quality outlook seems promising as majority of the NPAs from the previous corporate cycle have been recognised and moved to resolution faze. Most of the provisioning have also been done. The BB & Below rated corporates are shrinking from the overall corporate book of PSBs. In Q2FY22 and Q3FY22, SMA books across banks saw moderation. This augurs well for incremental slippage to remain controlled. We expect lower slippages and higher resolutions and recoveries in the coming quarters. The public sector banks are now well provided for, which place them in line with private players. The balance sheet quality has become more resilient with Provision Coverage Ratio (PCR) at 68% in FY21 (even more improved as of 9MFY22) v/s 47% in FY18. With the slippages trending lower, we expect the credit cost to remains modest. This could help the banks improve the return ratios.

Risks & Concerns

- Any unfavorable change in rules and regulatory policies can have a negative impact on earnings outlook of the Bank.
- Lower than expected business growth or sharp rise in slippages due to COVID-19 could result in deterioration in capital. Progress on recoveries will be important point to watch out in coming quarters.
- A sharp rise in interest rate could also result in MTM losses on its investment portfolio.
- Any further delay in the resolution of large assets due to current uncertainties and extension granted under IBC can postpone recoveries.
- The bank has lower than industry average CASA ratio, which is hurting the NIM. However, the management has changed focus towards building CASA and has guided that margin will improve going ahead.
- Canara Bank is an established payer in the southern region, a major part of the bank's branches are concentrated in southern India, making it vulnerable to risks associated with having geographically concentrated operations.

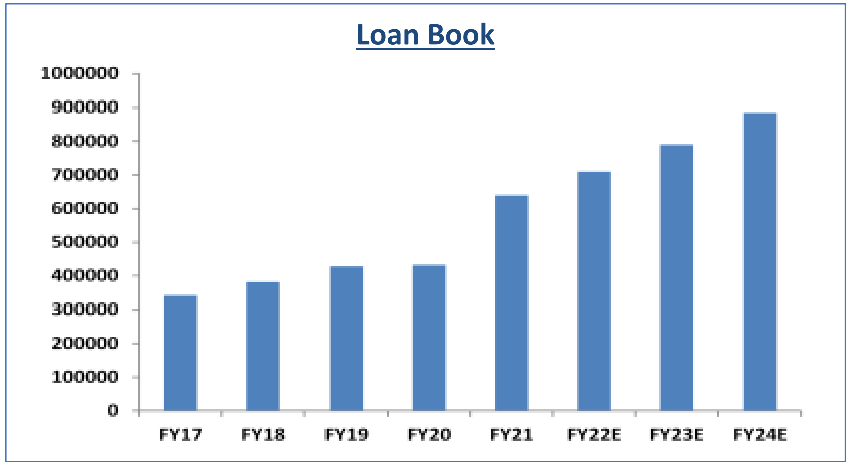
Company Background:

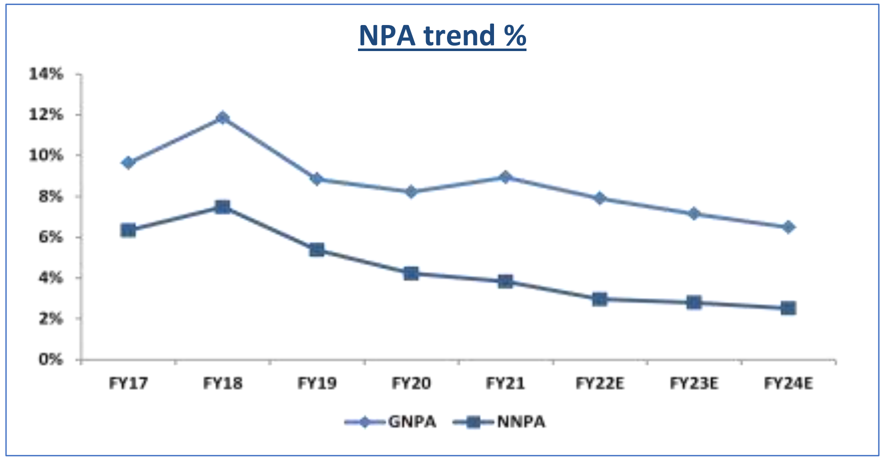
Canara Bank is among the leading scheduled public sector commercial banks in India. It was found in 1906 as a private entity and became a nationalized bank in 1969. Recently, the Government of India approved the scheme of amalgamation of Syndicate Bank into Canara Bank with effect from April 1, 2020. As a result, as of Sep-21, it is the third largest public sector bank in India in terms of total business.

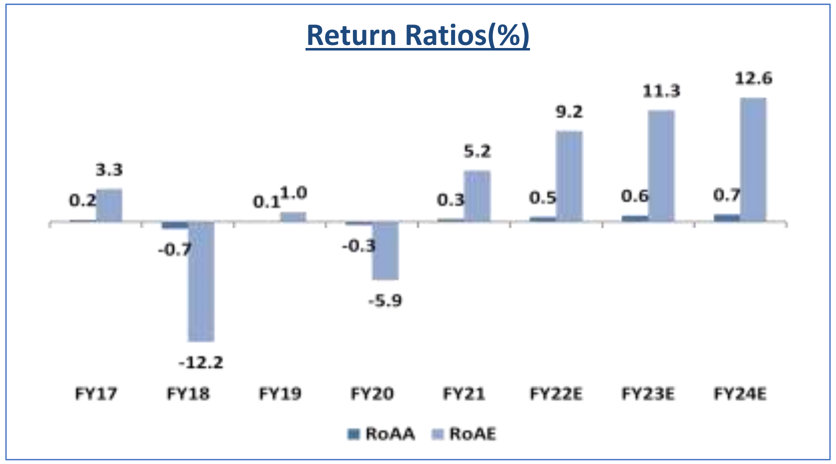
The bank offers a wide range of banking and financial products and services to both large and mid-sized corporates and micro, small and medium enterprises ("MSME") as well as retail and agriculture customers. The operations are internally aligned into distinct business lines for (i) wholesale banking operations, (ii) retail banking operations, (iii) treasury operations, and (iv) other banking operations (through the subsidiaries, associates and joint ventures).

Peer comparisons

		P/ABV				P/E				FY21						
	CMP	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	ROAE (%)	ROAA (%)	NIM %	GNPA %	NNPA %	CASA %	Loan Book (Rs. Bn)
PNB	41.5	0.83	0.67	0.63	0.57	21.8	9.7	5.8	5.2	2.6	0.2	3.2	14.1	5.7	45.9	6,742
BOB	106.7	1.00	0.69	0.61	0.53	66.7	7.1	4.9	4.0	1.1	0.1	2.7	8.9	3.1	40.2	7,063
INDIAN	168.5	0.73	0.65	0.55	0.50	6.3	4.7	3.6	3.3	9.9	0.6	2.9	9.9	3.4	42.3	3,640
Canara	261	1.64	1.25	1.05	0.86	16.8	8.2	5.9	4.7	5.2	0.3	2.9	8.9	3.8	32.7	6,390







Financials

Income Statement

(Rs Cr)	FY20	FY21	FY22E	FY23E	FY24E
Interest Income	48935	69240	71499	80260	88788
Interest Expenses	35811	45178	45141	50121	53626
Net Interest Income	**13124**	**24062**	**26357**	**30139**	**35162**
Non-interest income	7813	15285	15514	15002	14240
Operating Income	**20937**	**39347**	**41871**	**45141**	**49402**
Operating Expenses	11577	19338	20376	22371	24866
PPP	9360	20009	21496	22770	24536
Prov & Cont	11115	16302	13205	12016	11055
Profit Before Tax	-1756	3707	8291	10754	13481
Tax	480	1150	2487	2688	3370
PAT	**-2236**	**2558**	**5804**	**8065**	**10111**

Balance Sheet

(Rs Cr)	FY20	FY21	FY22E	FY23E	FY24E
Share Capital	1030	1647	1814	1814	1814
Reserves & Surplus	38263	57238	65375	73440	83551
Shareholder funds	**39293**	**58885**	**67189**	**75254**	**85365**
Deposits	625351	1010875	1077418	1141998	1214861
Borrowings	42762	49984	51119	51364	61953
Other Liab & Prov.	16469	33932	37325	41058	45163
SOURCES OF FUNDS	**723875**	**1153675**	**1233051**	**1309674**	**1407342**
Cash & Bank Balance	68271	178408	168924	148797	126208
Investment	176245	261690	285243	302642	320801
Advances	432175	639049	709983	790212	885037
Fixed Assets	8276	11207	12103	12708	13344
Other Assets	38907	63321	56799	55315	61953
TOTAL ASSETS	**723875**	**1153675**	**1233052**	**1309674**	**1407342**

(Source: Company, HDFC sec)

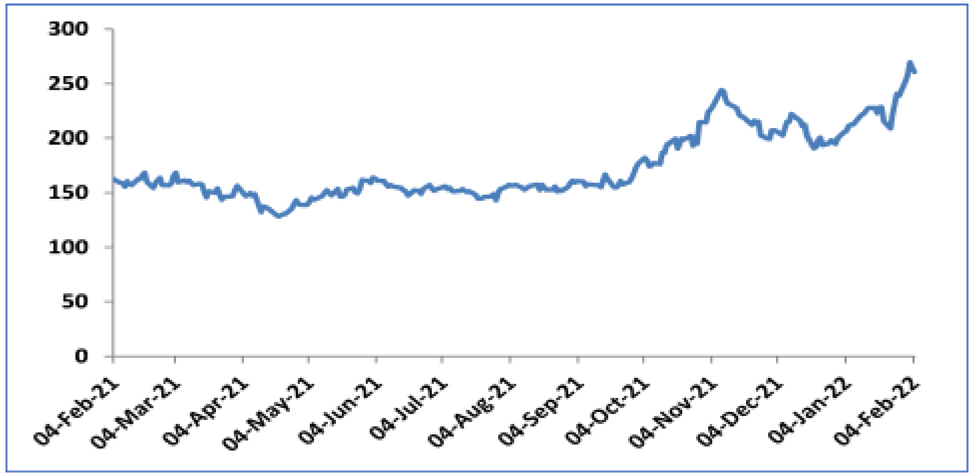
Key Ratios

	FY20	FY21	FY22E	FY23E	FY24E
Return Ratios					
Calc. Yield on adv	11.4%	10.8%	10.6%	10.7%	10.6%
Calc. Cost of funds	5.5%	4.3%	4.0%	4.2%	4.2%
NIM	2.1%	2.9%	2.4%	2.6%	2.8%
RoAE	-5.9%	5.2%	9.2%	11.3%	12.6%
RoAA	-0.3%	0.3%	0.5%	0.6%	0.7%
Asset Quality Ratios					
GNPA	8.2%	8.9%	7.9%	7.1%	6.5%
NNPA	4.2%	3.8%	3.0%	2.8%	2.5%
PCR	50.7%	59.5%	62.5%	60.9%	61.3%
Growth Ratios					
Advances	1.0%	47.9%	11.1%	11.3%	12.0%
Deposits	4.4%	61.6%	6.6%	6.0%	6.4%
NII	-9.4%	83.3%	9.5%	14.3%	16.7%
PAT	-744.3%	-214.4%	126.9%	39.0%	25.4%

Key Ratios

	FY20	FY21	FY22E	FY23E	FY24E
Valuation Ratios					
EPS	-21.7	15.5	32.0	44.5	55.7
P/E	-12.0	16.8	8.2	5.9	4.7
Adj. BVPS	142.8	158.9	208.9	247.6	302.5
P/ABV	1.8	1.6	1.2	1.1	0.9
Dividend per share	0.0	0.0	0.0	0.0	0.0
Other Ratios					
Cost-Income	55.3	49.1	48.7	49.6	50.3
CASA	31.4	32.7	35.6	36.8	38.3
CAR	13.7	13.2	13.5	13.7	14.3
Tier 1	10.1	10.1	10.7	11.1	11.8

One Year Price Chart



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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