


Q2FY12 Result Update

November 14, 2011

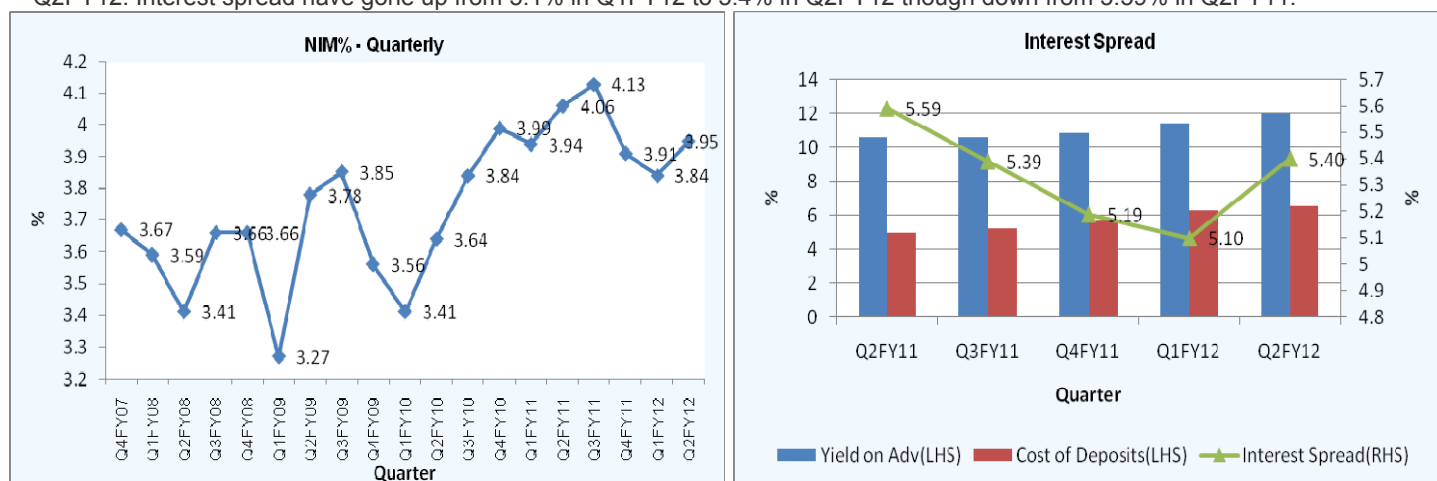
For the quarter end Q2FY12, Punjab National Bank (PNB) came up with a mixed performance with improved NII and profits but rising NPAs. It reported a 16% rise in NII to Rs 3,452.6 cr, 20.4% increase in Profit before provisions to Rs 2,527.8 cr and an increase of 12.1% in PAT to Rs 1,205 cr over corresponding quarter last year. However, Gross NPAs rose to 2.05% and Net NPAs to 0.84% from 1.91% and 0.69% a year ago. During the quarter, PNB restructured loans of Rs 4,563 cr with the bulk coming in from the power sector (Rs 2151 cr). The total loans restructured amounts to 7.93% of gross advances which is amongst the highest in the industry

Quarterly Financials

Particulars (Rs in crs)	Q2FY12	Q2FY11	% Chg	Q1FY12	% Chg	H1FY12	H1FY11	% Chg	FY11
Interest/Discount on Adv/Bills	7044.8	5035.2	39.9	6575.9	7.1	13620.6	9711.1	40.3	21104.6
Interest on Investment	1852.4	1397.2	32.6	1685.8	9.9	3538.2	2672.5	32.4	5637.6
Int on bal - RBI & inter bank funds	48.4	20.5	136.4	33.7	43.6	82.0	36.5	125.0	84.2
Other Interest	6.5	2.6	150.2	19.9	-67.2	26.4	7.0	276.5	160.2
Interest Earned	8952.0	6455.4	38.7	8315.2	7.7	17267.3	12427.1	38.9	26986.5
Other Income	888.9	718.2	23.8	1083.7	-18.0	1972.5	1610.0	22.5	3612.6
Total Income	9840.9	7173.7	37.2	9398.9	4.7	19239.8	14037.1	37.1	30599.1
Payments / Provs. for employees	1240.4	1113.1	11.4	1212.6	2.3	2453.1	2108.3	16.4	4461.1
Other operating expenses	573.2	481.8	19.0	512.4	11.9	1085.6	878.5	23.6	1903.1
Total Operating Expenses	1813.7	1594.9	13.7	1725.0	5.1	3538.7	2986.8	18.5	6364.2
Interest Expended	5499.4	3478.7	58.1	5200.0	5.8	10699.4	6852.0	56.1	15179.1
TOTAL EXPENSES	7313.1	5073.6	44.1	6925.0	5.6	14238.1	9838.8	44.7	21543.4
Net Interest Income	3452.6	2976.7	16.0	3115.3	10.8	6567.9	5575.0	17.8	11807.3
Profit Before Prov. & Cont.	2527.8	2100.1	20.4	2473.9	2.2	5001.7	4198.3	19.1	9055.7
Provisions & Contingencies	710.3	516.0	37.7	893.5	-20.5	1603.8	1050.2	52.7	2492.0
Provision for Taxes	612.4	509.5	20.2	475.3	28.8	1087.8	1005.3	8.2	2130.2
Net Profit	1205.0	1074.5	12.1	1105.1	9.0	2310.1	2142.8	7.8	4433.5
EPS	38.0	34.1	11.6	34.9	9.0	72.9	68.0	7.3	139.9
Equity	316.8	315.3	0.5	316.8	0.0	316.8	315.3	0.5	316.8
PATM (%)	13.5	16.6	-19.1	13.3	1.3	13.4	17.2	-22.4	16.4
Capital Adequacy Ratio (Basel II)	12.23	12.60	-2.94	12.40	-1.37	12.23	12.60	-2.94	12.42
Gross Non Performing Assets	5150.1	4024.8	28.0	4893.6	5.2	5150.1	4024.8	28.0	4379.4
Net Non Performing Assets	2088.5	1425.5	46.5	2090.8	-0.1	2088.5	1425.5	46.5	2038.6
(%) Gross Non Performing Assets	2.05	1.91	7.33	2.00	2.50	2.05	1.91	7.33	1.79
(%) Net Non Performing Assets	0.84	0.69	21.74	0.86	-2.33	0.84	0.69	21.74	0.85

(Source: Company, HDFC Sec)

- Net Interest Income (NII) during Q2FY12 showed a growth of 16% y-o-y and 10.8% q-o-q to Rs 3,452.6 cr. NIMs during the quarter stood at 3.95% compared to 3.84%, an increase of 11 bps sequentially with an improvement in interest spreads. NIMs y-o-y has fallen by 11 bps from 4.06% in Q2FY11. After witnessing sequential falls from Q4FY11, NIMs of PNB have stabilized this quarter. The bank has been able to maintain its NIMs in the 3.3% to 4% band over the last 19 quarters and has amongst the highest NIMs in the public sector space. Interest earned q-o-q have risen 7.6% while interest expenses have risen by 5.76% leading to an improvement in margins sequentially. The yield on advances in Q2FY12 stood at 11.92% from 11.38% in Q1FY12 (54 bps up) and 10.55% in Q2FY11 (137 bps up). Costs of deposits have gone up from 4.96% in Q2FY11 and 6.28% in Q1FY12 to 6.52% in Q2FY12. Interest spread have gone up from 5.1% in Q1FY12 to 5.4% in Q2FY12 though down from 5.59% in Q2FY11.



(Source: Company, HDFC Sec)

- Overall Advances of PNB as on Sep 2011 stood at Rs 2,51,705 cr, a growth of 19.4% y-o-y and 3.2% over FY11. Overseas Advances grew 66.7% to Rs 16,511 cr y-o-y while the domestic advances were up 17% y-o-y to Rs 2,35,194 cr. Among the domestic gross advances, the industry segment has grown 21.2% y-o-y while the retail loan segment has grown 20.2% over last year.

Advances – Split (Rs in cr)	H1FY12	H1FY11	% chg	FY11	% chg
Overseas Advances	16511	9907	66.7%	12904	28.0%
Domestic Gross Advances	235194	200949	17.0%	231094	1.8%
Food Credit	4214	3436	22.6%	4421	-4.7%
Non Food Gross Bank Credit	230980	197513	16.9%	226673	1.9%
Of which Agriculture and allied	35076	32274	8.7%	35462	-1.1%
Industry	116463	96129	21.2%	114072	2.1%
-MSME	27643	23472	17.8%	26848	3.0%
-Large Industry	88820	72657	22.2%	87224	1.8%
Retail Loans	24732	20570	20.2%	23621	4.7%
-Housing/Mortgage Loans	11920	10160	17.3%	11816	0.9%
-Other Retail Loans	12812	10410	23.1%	11805	8.5%
Commercial Real Estate	10353	9870	4.9%	9731	6.4%
-Lease Rental	4803	3682	30.4%	3839	25.1%
Services & Others	44355	38670	14.7%	43787	1.3%
Global Gross Advances	251705	210856	19.4%	243998	3.2%

(Source: Company, HDFC Sec)

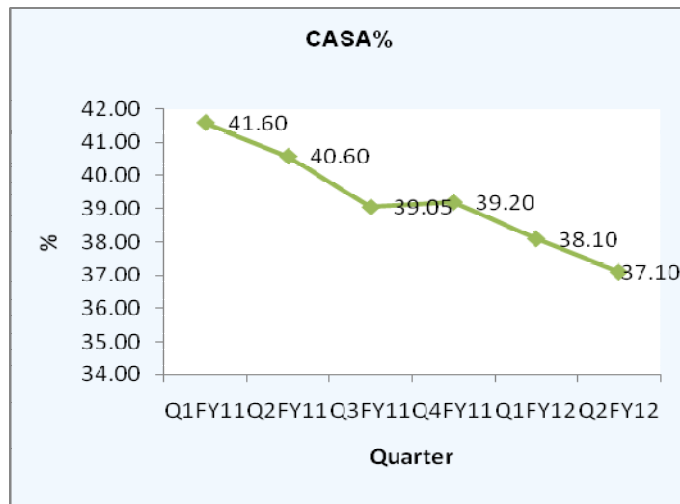
Shares of loans given to Agriculture stood at 14.9% of domestic gross advances in H1FY12 against 16.1% in H1FY11. Industry loans have increased to 49.5% from 47.8% over last year (share to the power sector is the highest at 13.3%). Share of retail loans have been stable around 10.5%. Share of overseas advances have grown to 6.6% in H1FY12 from 4.7% in H1FY11.

Advances Mix (%)	H1FY12	H1FY11	FY11
Overseas Advances	6.6%	4.7%	5.3%
Domestic Gross Advances	93.4%	95.3%	94.7%
Food Credit	1.8%	1.7%	1.9%
Non Food Gross Bank Credit	98.2%	98.3%	98.1%
Of which Agriculture and allied	14.9%	16.1%	15.3%
Industry	49.5%	47.8%	49.4%
-MSME	11.8%	11.7%	11.6%
-Large Industry	37.8%	36.2%	37.7%
Retail Loans	10.5%	10.2%	10.2%
-Housing/Mortgage Loans	5.1%	5.1%	5.1%
-Other Retail Loans	5.4%	5.2%	5.1%
Commercial Real Estate	4.4%	4.9%	4.2%
-Lease Rental	2.0%	1.8%	1.7%
Services & Others	18.9%	19.2%	18.9%
Global Gross Advances	100.0%	100.0%	100.0%

(Source: Company, HDFC Sec)

- Deposits as on Sep 2011 has grown 25% y-o-y to Rs 3,41,783 cr. The Credit Deposit Ratio have come down to 72.86% compared to 74.95% in June 2011 and 77.38% in March 2011. CASA has come down sequentially to 37.1% of the total deposits in Sep 2011 compared to 38.10% in June 2011 and 39.20% in March 2011 while in Sep 2010, share of CASA stood at 41.3%. Savings deposits have risen 15.1% y-o-y to Rs 10,0491 cr while current account deposits showed a de-growth of 0.7% to Rs 23,531 cr.

Deposits (Rs in cr)	Sep 2011	Sep 2010	June 2011
Total Deposits	341783	273394	324097
Bulk+CD	81117	55611	77796
Bulk	19249	11311	18671
CD	61868	44300	59125
Core Deposit	260666	217783	246301
Core Deposit to Total %	76.3	79.7	76
SB Deposit	100491	87296	94875
Current deposit	23531	23687	26384
CASA Deposit	124022	110983	121260
Share of CASA %	37.1	41.3	38.1



(Source: Company, HDFC Sec)

- PNB's core noninterest income has risen to Rs 688 cr in Q2FY12, an increase of 27.1% y-o-y and 13.3% q-o-q. The increase q-o-q was largely driven by higher exchange profit and bill & remittances. Exchange profit has gone up from Rs 29 cr in Q2FY11 to Rs 132 cr in Q2FY12. Bill & remittances have gone up 50.8% y-o-y and 15.3% q-o-q to Rs 98 cr.

Fee Based Income (Rs in crs)	Q2FY12	Q2FY11	% chg	Q1FY12	% chg	H1FY12	H1FY11	% chg
Processing Fees	108	148	-27.0%	247	56.3%	355	358	-0.8%
LC/LG Income	158	141	12.1%	165	-4.2%	323	272	18.8%
Bills and Remittance	98	65	50.8%	85	15.3%	183	131	39.7%
Incidental Charges	33	26	26.9%	35	-5.7%	68	49	38.8%
Income from ATM Operations	72	54	33.3%	63	14.3%	135	86	57.0%
Income from Insurance Business	5	4	25.0%	3	66.7%	8	7	14.3%
Misc Income	83	75	10.7%	65	27.7%	148	131	13.0%
Exchange Profit	132	29	355.2%	131	0.8%	263	143	83.9%
Core Non Interest Income	688	543	27.1%	795	13.3%	1483	1177	26.0%

(Source: Company, HDFC Sec)

- Operating expenses (excluding provisions) have gone up 13.7% y-o-y and 5.1% q-o-q to Rs 1,813.7 cr. The increase has been mainly because of higher other expenses which have gone up 19% y-o-y and 11.9% q-o-q. Employee expenses y-o-y has gone up by 11.4% to Rs 1,240.4 cr and by 2.3 % q-o-q. The bank made ~Rs 170 cr of employee provisions for second pension liability in Q2FY12. Cost to Income ratio has gone up and stood at 41.78% in Q2FY12 compared to 41.08% in Q1FY12 and 39.93% in Q4FY11, however it is down y-o-y from 43.16% in Q2FY11.
- Provisions (excluding tax) have gone up 37.3% y-o-y to Rs 711 cr though provisions sequentially have come down by 20.4%. During the quarter, provisions for depreciation on investments have gone up to Rs 161 cr from Rs 67 cr in Q2FY11 and Rs 134 cr in Q1FY12 while provisions towards standard assets have gone up 137.5% y-o-y but come down q-o-q by 40.3% to Rs 95 cr. Provisions for NPAs have come down by 11.1% y-o-y and 43.6% q-o-q to Rs 319 cr.

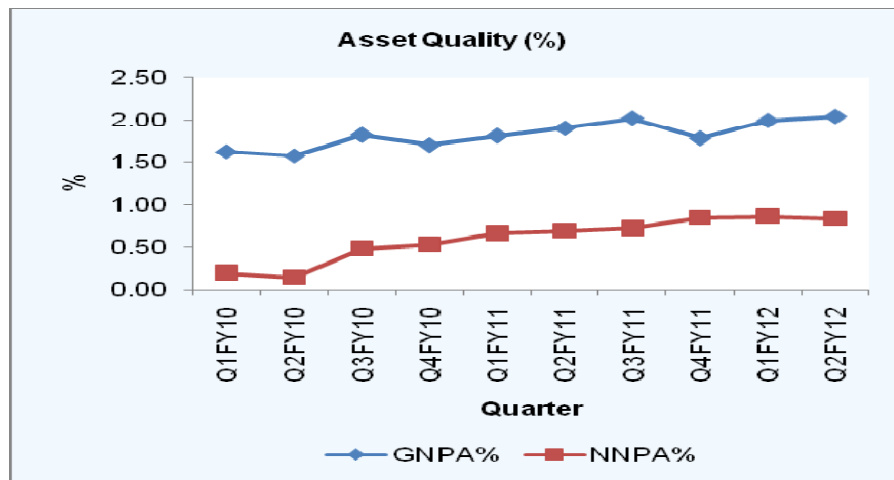
Provisions and Contingencies (Rs in crs)	Q2FY12	Q2FY11	% chg	Q1FY12	% chg	H1FY12	H1FY11	% chg
Provisions for Depr on Investment	161	67	140.3%	134	20.1%	294	81	263.0%
Net Provision towards NPAs (Net of floating provisions)	319	359	-11.1%	566	-43.6%	885	907	-2.4%
Provision towards Standard Assets	95	40	137.5%	159	-40.3%	255	79	222.8%
Others	136	52	161.5%	35	288.6%	170	-16.0	NC
Provisions excluding Tax	711	518	37.3%	894	-20.5%	1604	1051	52.6%
Tax Provisions(including FBT & Wealth Tax)	612	510	20.0%	475	28.8%	1088	1005.0	8.3%
Total Provisions	1323	1028	28.7%	1369	-3.4%	2692	2056	30.9%

(Source: Company, HDFC Sec)

- Asset quality of PNB has been under stress last couple of quarters with further increase as on Sep 2011 whereby Gross NPA have risen to 2.05% and Net NPAs to 0.84%, up from 1.91% and 0.69% respectively in June 2011. However, slippages were down to 2.1% in Sep 2011 from 2.4% in June 2011 and 2.6% from Sep 2010 inspite of the switch to the new system based recognition of bad loans. Recoveries improved to Rs 189 cr in Sep 2011 from Rs 169 cr in Sep 2010 and Rs 109 cr in June 2011. During H1FY12, PNB restructured loans worth Rs 4,563 cr with the bulk coming in from the power sector (Rs 2151 cr). The total loans restructured

amounts to 7.93% of gross advances which is amongst the highest in the industry. Loans include Rs 1,750 cr pertaining to Tamil Nadu Electricity Board which has been converted from a short term bullet loan into a long term five year loan with no moratorium. PNB has a total loan exposure of nearly Rs 7,800 cr to SEBs. Given the restructuring, PNB had to make a one-off provision of Rs 95 cr, leading to higher provisioning costs. PNB has also restructured Rs 635 cr of loans given to Aban Offshore as also another Rs 650 cr towards Iron & Steel sector. Roughly 28% of loans restructured in FY09 have been converted into NPA. If such a thing continues in future it could mean further slippage into NPAs going ahead. NPA coverage ratio stood at 75.08% as on Sep 2011 as against 77.13% in Sep 2010 and 74.27% in June 2011.

NPA (Rs in cr)	Sep 2011	Sep 2010	June 2011
NPA at the beginning of the year	4379	3214	4379
Cash Recovery	931	482	418
Agri Debt Waiver/Relief	0	232	0
Upgradation	440	198	234
Write Off	29	405	11
Total Reduction	1400	1317	663
Fresh Addition	2170	2127	1177
Gross NPA	5150	4025	4894
Eligible Deductions	3062	2599	2803
Net NPAs (Closing balance)	2089	1426	2091
Recovery in written off Debt a/cs	189	169	109



(Source: Company, HDFC Sec)

- The capital adequacy ratio stands at 12.23% (Tier I - 8.37%) in Q2FY12 vs 12.40% in Q1FY12 (Tier I = 8.51%). The CAR of the bank is on the borderline and is therefore a concern for the bank at the moment especially if one focuses on its Tier 1 ratio (though this is more than the minimum 6%, but less than the 9% preferred by most banks). The bank might need to raise more funds in order to improve its CAR going ahead and increase its lending book.
- Total business of PNB as on Sep 2011 stood at Rs 5,90,803 cr, up 22.5% y-o-y. The deposit market share has gone up to 5.65% from 5.40% y-o-y while the credit market share stood at 5.55%, up from 5.45% over last year.
- Investments at the end of Q2FY12 stood at Rs 1,11,010 cr, up 28.2% y-o-y and 9.9% q-o-q. Of the total investments, HTM was 72.3% of the total investments at Rs 80,250 (77.1% in Q2FY11), AFS stood at 24.5% at Rs 27,174 cr (20.8% in Q2FY11) and HFT constituted 3.2% at Rs 3,586 cr (2.1% in Q2FY11).

Investments (Rs in cr)	Q2FY12	Q2FY11	Q1FY12
Gross Investment	111010	86575	100992
HTM	80250	66712	77469
AFS	27174	18034	22212
HFT	3586	1829	1310
Duration (AFS)	2.90	2.64	3.35
Modified Duration (AFS)	2.74	2.51	3.21
Duration (Total Portfolio)	4.51	4.78	4.65
Modified Duration (Total Portfolio)	4.32	4.59	4.45
Net Demand & Time Liabilities	326952	274581	325872
SLR %	28.41	23.66	26.07
HTM to SLR %	86.00	87.85	88.00
HTM to Gross Investment %	72.29	77.06	76.71

(Source: Company, HDFC Sec)

- ROA though on the lower side has picked up in Q2FY12 and stood at 1.21% compared to 1.16% in Q1FY12 (which was lowest in at least 9 quarters). ROE for Q2FY12 stood at 21.57% compared to 20.91% in Q1FY12.
- PNB's branch network stands at 5315 with 5619 ATMs. It has added 51 new branches and 244 new ATMs during Q2FY12.
- Management has guided an advance growth of 1-2% more than the industry, Gross NPAs of ~2% and NIMs of 3.5%. It also expects fee income to be higher in H2FY12 on back of insurance tie up with Met Life which happened in October 2011. It has started a corporate agency of selling insurance products of Metlife and is awaiting approvals for the 30% stake in Metlife India from the regulators.

Concerns

- Even though the bank has been able to manage asset quality over the previous years, Q2FY12 saw the asset quality deteriorate further. The fresh restructuring during Q2FY12 to the tune of Rs 4563 cr is quite significant on an already high base and may pose possible risks to the asset quality in the coming quarters.
- PNB's exposure to the power sector poses asset quality risk and could result in higher NPAs even though the management expects the restructuring done in this quarter should suffice for the coming quarters.
- The bank is growing rapidly on the international front and plans to continue its growth globally. Although it is a positive sign, there is a concern of losses (NPA, translation etc) that could be reported by the bank in the future quarters. Further spreads in countries abroad may not be as healthy as in India and asset quality concerns could continue to weigh in overseas branches.
- The CASA has shown sequential and y-o-y fall during the quarter to 37.1 %. Further deterioration may impact margins of the bank in the coming quarters.
- Cost to Income ratio of the bank has seen a rise over sequential quarters to 41.78% though it still remains at reasonable levels.
- Provision coverage ratio in FY11 had declined to 53.45% from 69.46% in FY10. In FY12, it has inched up to 57.28% in Q1FY12 and 59.45% in Q2FY12 but still remains below FY10 which could be a concern.
- After sequential falls in last two quarters, NIMs have steadied a bit at 3.95%. However, margins may come under pressure during H2FY12 on account of deregulation of savings bank rate and term deposit repricing. Recently, RBI had deregulated savings deposits rates and with nearly 29% of savings deposits, this may impact PNBs margins unfavourably.

Conclusion:

PNB is India's second largest state owned bank based in North India with total business of Rs 5,90,803 cr and more than 5000 branches. PNB offers one of the best investment profiles in terms of its strong liability franchise, good earnings visibility and strong CASA ratio. It has been amongst the fastest growing state owned banks and is ahead of most PSUs banks in terms of technology. With a strong presence in North India it could gain from significant traction in the agriculture sector. It also has a strong presence in the Indo Gangetic plains, which helps the bank lend more to the MSME sector. CASA deposits at 37.1% have resulted in lower cost of funds for the bank.

In Q2FY12, PNB reported NII of Rs 3,452.6 cr, a growth of 16% y-o-y and 10.8% q-o-q. NIMs stood at 3.95% and PPP grew by 20.4% y-o-y and 2.2% q-o-q respectively to Rs 2,527.8 cr. However, increasing NPAs pose risks to the asset quality of the bank. Gross NPAs have gone up sequentially to 2.05% in Q2FY12 from 2% in Q1FY12 and 1.91% in Q2FY11. Net NPAs stood at 0.84% compared to 0.69% in Q2FY11 and 0.86% in Q1FY12. It restructured loans worth Rs 4,563 cr of which majority pertains to the power sector (Rs 2,151 cr).

PNB's loan book exposure to power sector is to the tune of Rs 15,482 cr which is 13.3% of its Industry exposure. This is followed by the iron & steel industry with a 11.1% exposure. Both these sectors have been under a lot of stress lately which may impact PNB's asset quality in the coming quarters. The management is going slow on credit growth as is reflected from the fall in the CD ratio.

As of now, the management has adopted a wait & watch policy and not increased its savings deposit rates. With the high proportion of savings deposits (nearly 29%) any increase may impact the cost of funds and NIMs of the bank going forward.

We maintain our FY12 estimates with NII of Rs 13,873.6 cr and PAT of Rs 5,126.1 cr. Rising NPAs are a concern and deteriorating asset quality would be an overhang on most PSU banks if NPAs continue to rise.

In our Q1FY12 result update in August 09 2011, we have mentioned that the stock could trade in the range of Rs 915 (1.25x FY12E Adj. BV) and Rs 1171 (1.6x FY12E Adj. BV) over the next quarter. Post the update the stock achieved a low of Rs 872 on 4th October 2011 and a high of Rs 1135 on 10th August 2011.

We feel that the stock could trade in the range of Rs 878 (1.2x FY12E Adj. BV) and Rs 1061 (1.45x FY12E Adj. BV) over the next quarter.

Quick Estimates

Particulars (Rs Crs)	FY07	FY08	FY09	FY10	FY11	FY12E
Net Interest Income	5303.29	5701.60	7201.29	8522.89	11807.34	13873.62
% growth	0.00	7.51	26.30	18.35	38.54	17.50
PBT	2268.80	3500.64	4916.99	5599.14	6563.72	7594.22
% growth	0.00	54.29	40.46	13.87	17.23	15.70
PAT	1634.19	2213.91	3200.10	3599.71	4433.50	5126.10
% growth	0.00	35.47	44.55	12.49	23.16	15.62
EPS	51.82	70.21	101.49	114.17	139.94	161.81
% growth	0.00	35.49	44.55	12.49	22.57	15.63
Adj. Book Value	318.18	341.82	408.38	501.00	596.85	732.06
% growth	0.00	7.43	19.47	22.68	19.13	22.65

(Source: Company, HDFC Sec Estimates)

Analyst: Siji A Philip (siji.philip@hdfcsec.com)

RETAIL RESEARCH Tel: (022) 6661 1700 Fax: (022) 2496 5066 Corporate Office

Corporate Office: HDFC Securities Limited, I Think Techno Campus, Building –B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Fax: (022) 30753435 Website: www.hdfcsec.com

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