

December 13, 2010

Punjab and Sind Bank (PSB), the only unlisted nationalized bank with an asset size of Rs580bn (as on Sep'10), is raising Rs26.7bn to fund its growth plans and shore up capital adequacy. The bank improved its asset quality and brought down the gross NPLs from 9.6% in FY06 to 0.9% as on Sep'10. Bank realized the growth in loan book (41% CAGR during FY07-10) at the cost of profitability. The ROAs moderated from 1.9% in FY07 to 1% in FY10 due to a) falling margins and b) higher provisioning cost. The issue is attractively priced (band of Rs113-120) at FY11E P/BV of 0.8-0.9x. But, we believe, there are multiple challenges that the bank need to deal with such as a) lower CASA ratio at 25%, b) improvement in technology (2% branches on CBS), c) expanding and diversifying in other states (currently 43% of branches are in Punjab) and d) improving the ROAs.

Capital Structure

Pre Issue Equity	Rs1.8bn
Post issue Equity	Rs2.2bn

Shareholding Pattern	Pre issue (%)	Post issue (%)
Promoters & Promoter Group	100	82.07
Public (incl Institutions and Employees)	-	17.93
Total	100	100

Issue Snapshot

Size (Shares in millions)	40
Price Band	Rs113-120
Issue opens	13-Dec-10
Issue closes	16-Dec-10
Market cap (Rsbn)	26.7*
P/BV Band (1HFY10)	0.9-1.0
P/E Band (Ann. 1HFY10)	3.7-4.0

* At Rs120/share

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Background

PSB is the only unlisted nationalized bank in the country with an asset size of Rs580bn. Having founded in 1908, PSB is mainly concentrated in the north and western belts of the country as more than 62% of its loan book and 54% of its deposit base comes from northern India and Punjab. The bank operates with 926 branches and 63 ATMs; 43% of its distribution network is in Punjab. The bank is mobilizing funds to expand its footprint in Punjab and across the country which we believe is important given the intense competition in the region it operates and to shore up the capital adequacy ratio. Post the capital raising we estimate the tier I ratio of the bank would be upwards of 9% from 8% as on Sep'10.

Gained market share at the cost of profitability; Operating efficiency improved

PSB has realized 41% growth in loan book and 37% in deposits during FY07-10 as against systems' growth of 20% CAGR during the same period. PSB has been gaining market share in the system but at the cost of profitability. The core spreads (calculated) during the period declined by 120bps; margins during the same period contracted 126bps from 3.7% to 2.5%. As a result of lower profitability on lending business and higher loan loss provisioning (avg. of 0.6% between FY07-10), the net profit growth was lower at 10% therefore, the ROAs moderated from 1.9% to 1%. The bank also reported a sharp reduction in cost/income ratio (ex treasury) from 67% in FY06 to 48% in FY10 as bank contained growth in operating expenses at 10% as compared to a core operating revenue growth of 20% over FY06-10. The estimated second pension liability is at around Rs8bn, 34% of Sep'10 networth (pre issue).

Improved asset quality, but concern remains

PSB has turned around its asset quality over FY06-10 by a combination of containing fresh slippages, writing-off bad loans and improving risk management practices. The proportion of gross NPLs declined from 9.6% in FY06 to 2.4% in FY07 and 0.9% in Sep'10; bank contained the fresh slippages at around 0.7% over FY07-10 despite growing loan book at a rapid pace. The restructured book stood at Rs9.7bn, 2.7% of loan book as on Sep'10 and the proportion of total stressed asset stood at 3.6% - as compared to an industry average of c.6%. Bank prudently utilized higher treasury gains to provided for loan losses and write off the bad loans, as a result the coverage (including technical write offs) stood higher at 87% - one of the highest among the PSU banks. However, we maintain our concern on the asset quality as the proportion of unseasoned book (during Mar'08-Sep'10) is higher at 49%. Bank has 20% of its total book in real estate portfolio, of which 1% is already slipped into NPAs. We estimate an increase of gross NPLs for the system at 38% CAGR over FY10-12E.

Valuations attractive but challenges ahead

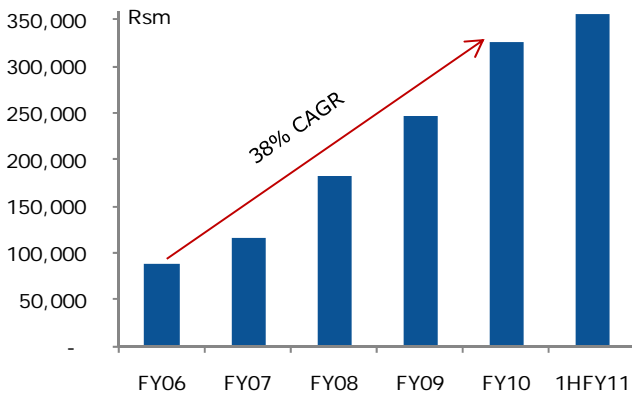
While the issue is attractively priced in the band of 0.8-0.9x FY11 estimated book value, 25-35% discount to the peer banks, bank needs to address multiple concerns such as a) lower CASA ratio at 25%, b) improvement in technology (only 2% branches on CBS), c) expanding and diversifying in other states (43% in Punjab) and d) improving the ROAs by a combination of better margins, good asset quality and improving operating efficiency.

Table 1: Financial summary

(Rsm)	FY06	FY07	FY08	FY09	FY10
Total net income	9,595	10,949	13,954	15,761	9,969
PAT	2,681	3,777	4,021	4,302	5,054
EPS	3.6	5.1	5.4	23.5	27.6
EPS growth (%)	Na	40.9	6.5	334.2	17.5
RoAE (%)	35.0	39.3	29.6	28.8	30.2
RoAA (%)	1.4	1.9	1.5	1.2	1.0
Gross NPLs	9,415	2,908	1,355	1,610	2,062
Coverage ratio (ex tech. w/o)	95%	79%	51%	52%	43%

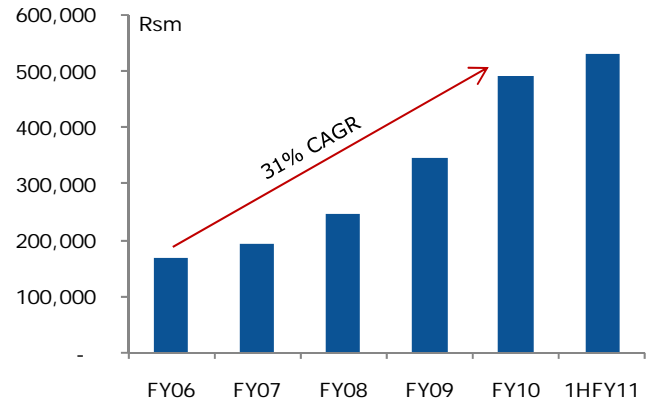
Source : HDFC Securities Institutional Research

Chart 1: Advances grew at 38% CAGR over FY06-10



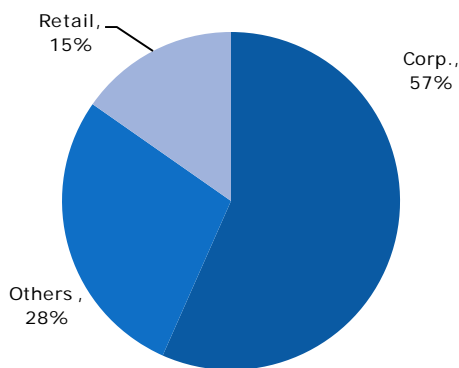
Source : Bank , HDFC Securities Institutional Research

Chart 2: Deposits grew at 31% CAGR over FY06-10



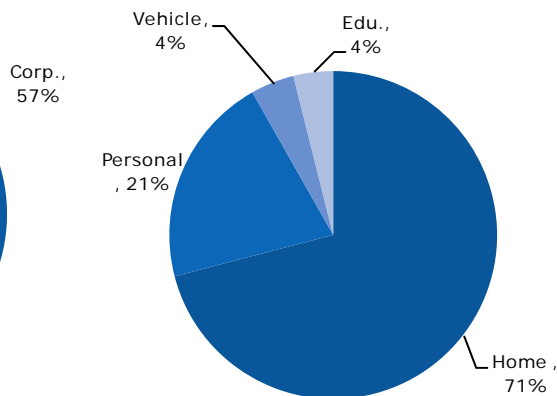
Source : Bank , HDFC Securities Institutional Research

Chart 3: Advances break-up



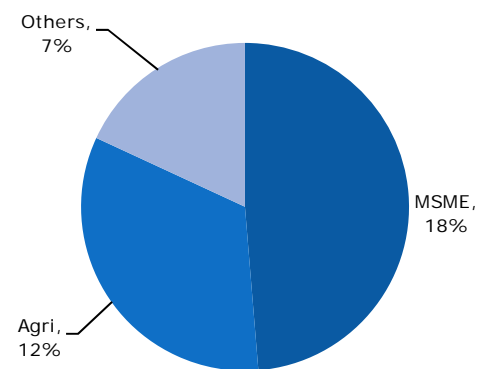
Source : Bank , HDFC Sec Inst Research

Chart 4: Retail advances break-up



Source : Bank , HDFC Sec Inst Research

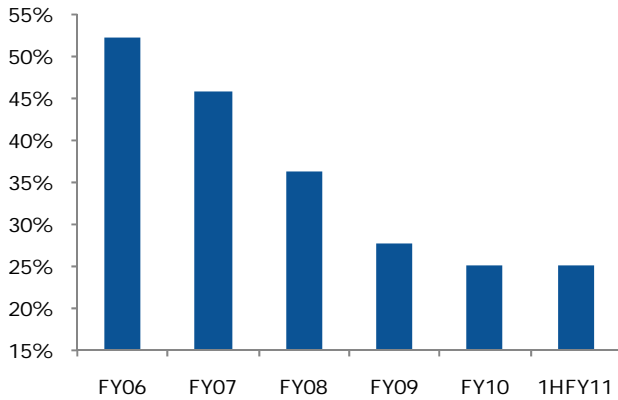
Chart 5: Priority sector break-up



Source : Bank , HDFC Sec Inst Research

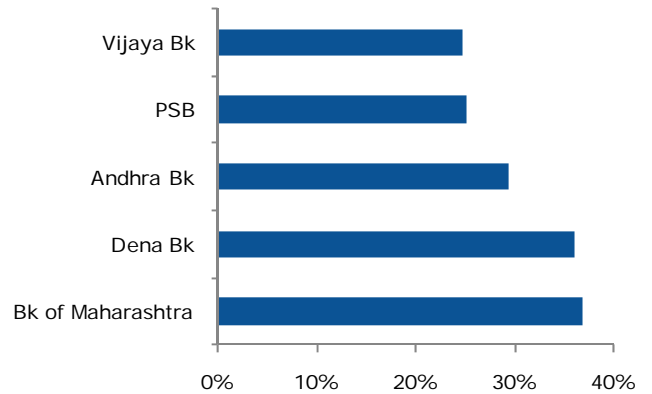
Institutional Research

Chart 6: CASA ratio at 25% (Sep'10)...



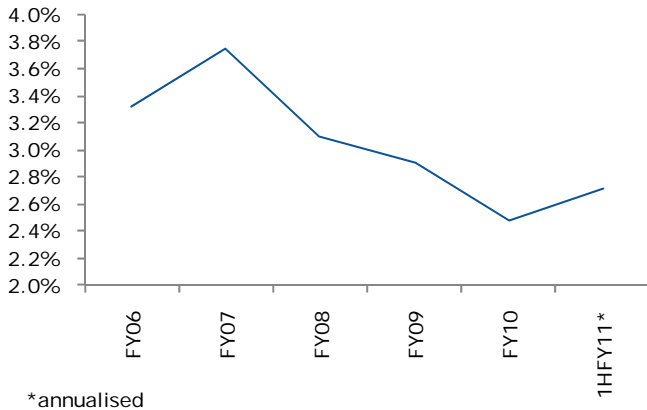
Source : Bank , HDFC Securities Institutional Research

Chart 7: ...is one of the lowest among peer banks



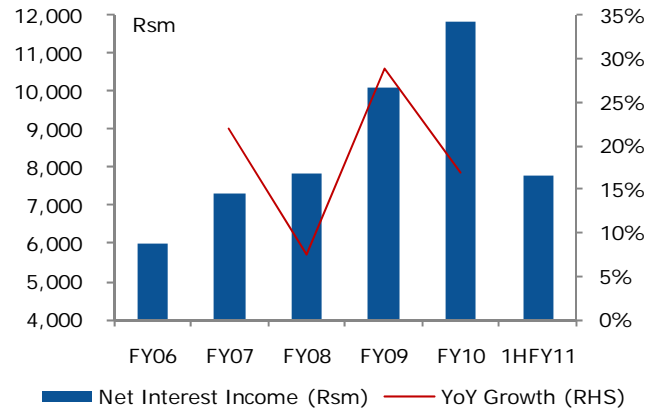
Source : Bank , HDFC Securities Institutional Research

Chart 8: NIMs have moderated at 2.7% for 1HFY11



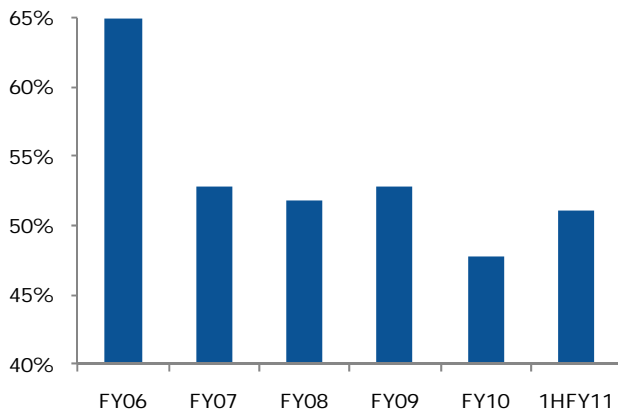
Source : Bank , HDFC Securities Institutional Research

Chart 9: NII grew at 17% CAGR over FY07-10



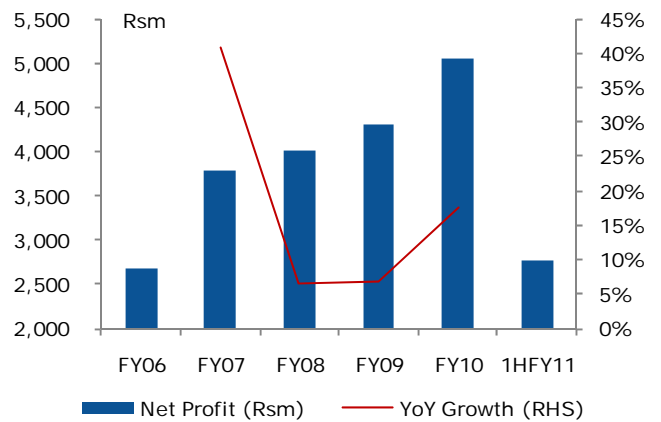
Source : Bank , HDFC Securities Institutional Research

Chart 10: C/I (ex-treasury) at 51% for 1HFY11



Source : Bank , HDFC Securities Institutional Research

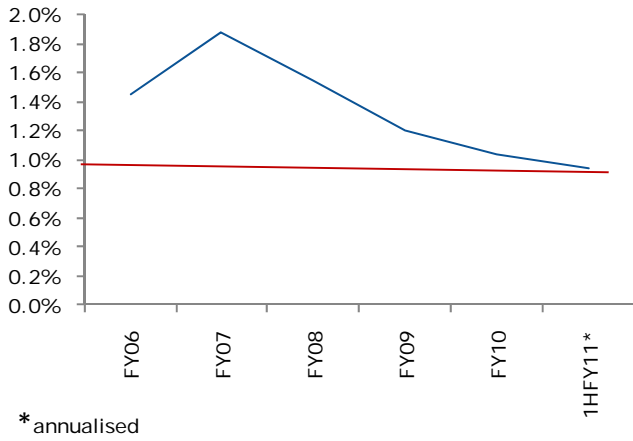
Chart 11: Net Profit grew at 10% CAGR over FY07-10



Source : Bank , HDFC Securities Institutional Research

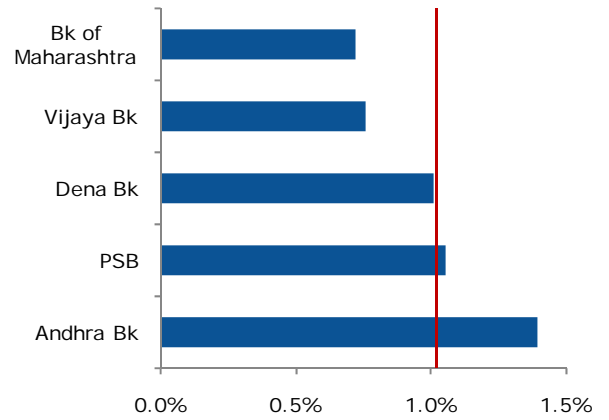
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Chart 12: ROAs moderated from 1.9% in FY07 to 1% in FY10



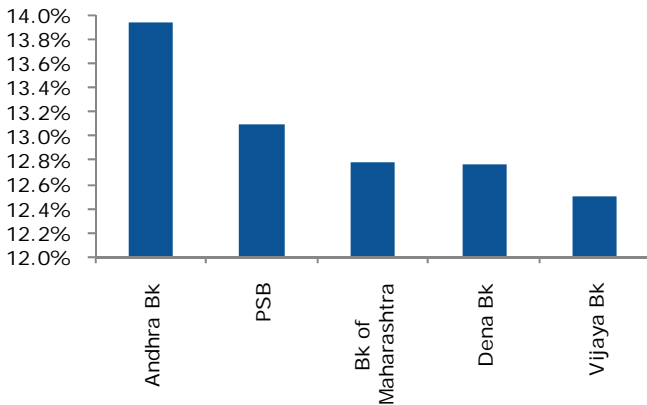
Source : Bank , HDFC Securities Institutional Research

Chart 13: Comparative ROA- FY10



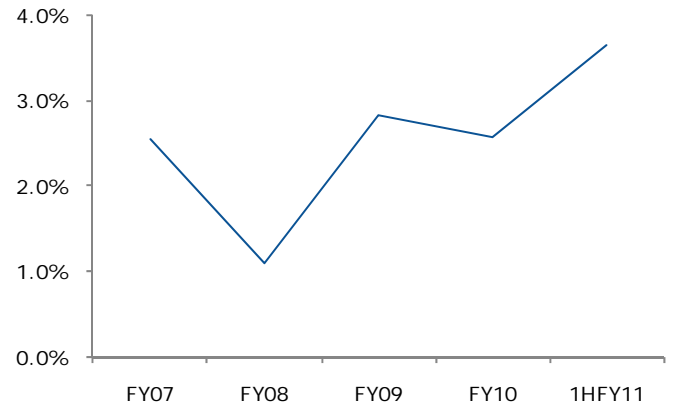
Source : Bank , HDFC Securities Institutional Research

Chart 14: Comparative CAR – FY10



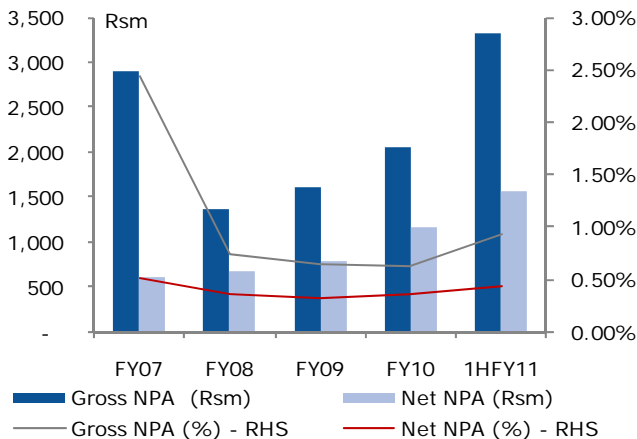
Source : Banks , HDFC Securities Institutional Research

Chart 15: Stressed assets at 3.6% (Sep'10)



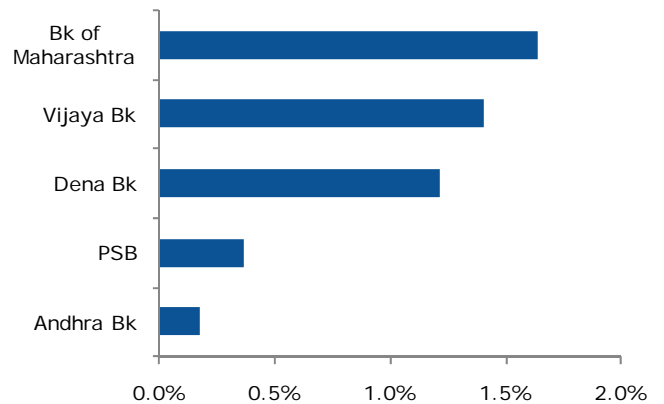
Source : Bank , HDFC Securities Institutional Research

Chart 16: Gross NPLs at 0.9% (Sep'10)



Source : Bank , HDFC Securities Institutional Research

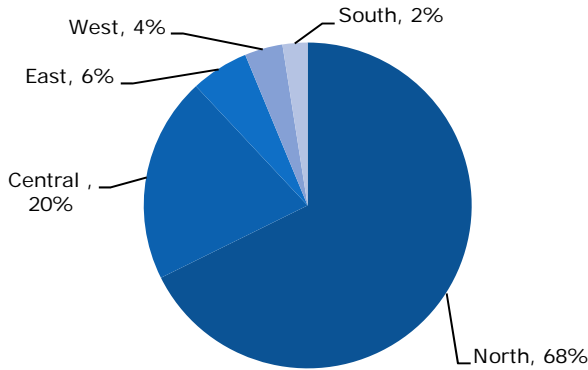
Chart 17: Comparative Net NPAs – FY10



Source : Banks , HDFC Securities Institutional Research

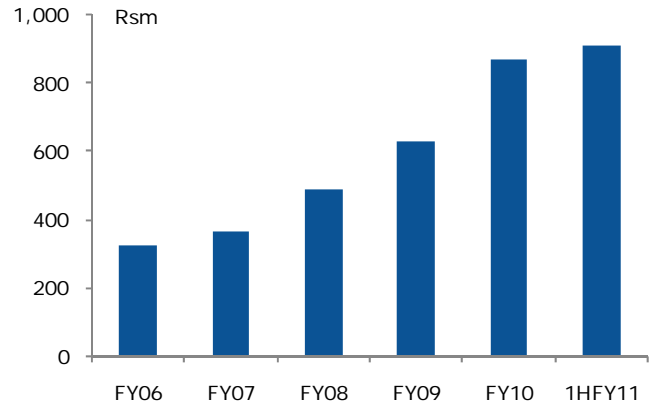
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Chart 18: 68% of the branches located in North India



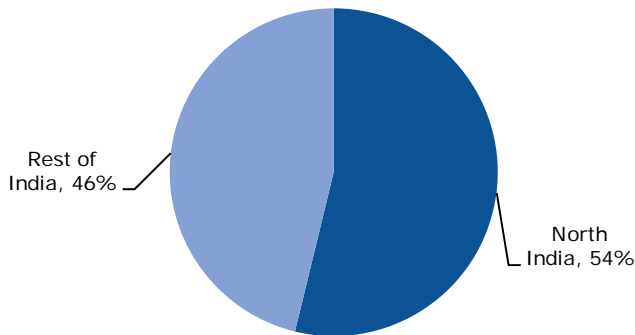
Source : Bank , HDFC Securities Institutional Research

Chart 19: Business per branch



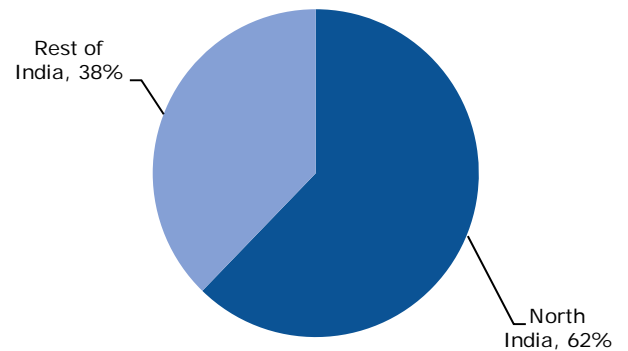
Source : Bank , HDFC Securities Institutional Research

Chart 20: North India contributes 54% of the deposits...



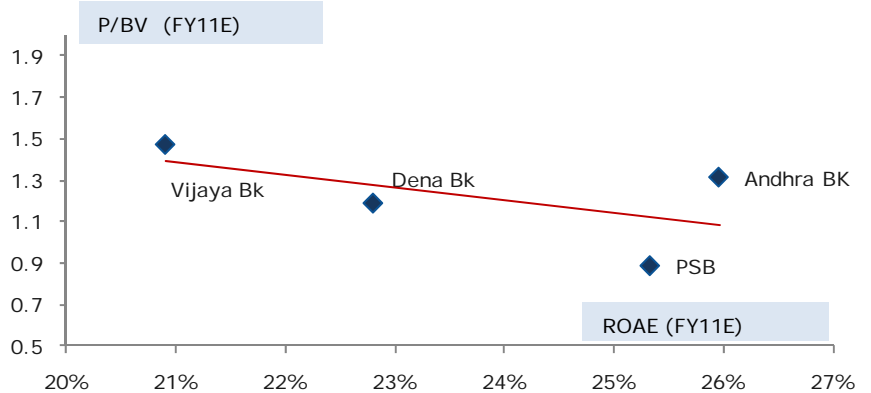
Source : Bank , HDFC Securities Institutional Research

Chart 21: ... and 62% of the advances



Source : Bank , HDFC Securities Institutional Research

Chart 22: Scatter Chart



Source : Bloomberg , HDFC Securities Institutional Research

Table 2: Balance sheet

(Rsm)	FY06	FY07	FY08	FY09	FY10
Sources of funds:					
Share Capital	7,431	7,431	7,431	1,831	1,831
Reserves	237	4,140	8,161	12,431	17,382
Shareholder's funds	7,668	11,570	15,592	14,262	19,213
Preference Capital	-	-	-	2,000	2,000
Savings	60,426	67,033	69,501	74,774	91,513
Current	27,809	21,286	20,745	21,483	31,567
Term Deposit	81,012	104,869	158,068	250,500	368,470
Total Deposits	169,246	193,188	248,314	346,757	491,551
Borrowings	3,152	5,901	33,567	36,065	37,011
Other Liabilities & Provisions	5,702	6,393	6,512	8,710	11,228
Total Liabilities & Equity	185,767	217,051	303,985	407,792	561,002
Application of funds:					
Cash & Bank balance	21,471	26,477	29,399	28,404	47,553
Investments	69,556	66,931	84,736	126,274	178,868
Advances	89,350	117,212	183,433	246,154	326,391
Fixed Assets	344	353	399	509	527
Other Assets	5,046	6,075	6,012	6,445	7,656
Total Assets	185,767	217,051	303,985	407,792	561,002

Source : Bank , HDFC Securities Institutional Research

Table 3: Income statement

(Rsm)	FY06	FY07	FY08	FY09	FY10
Interest Earned	12,686	16,917	22,193	32,472	39,342
Interest expended	6,690	9,599	14,335	22,353	27,502
NII	5,996	7,318	7,858	10,119	11,839
Other Income	1,334	2,277	3,091	3,835	3,921
- Fee income (CEB)	441	493	519	588	541
- Treasury income	266	174	175	1,189	1,091
Total Income Earned	7,329	9,595	10,949	13,954	15,761
Total op exp	4,760	4,972	5,583	6,737	6,996
- Employee expense	3,626	3,801	4,266	5,252	5,296
Pre Provisioning Profit	2,570	4,624	5,367	7,217	8,765
Provisions & Contingencies	(69)	797	797	829	2,118
PBT	2,639	3,827	4,569	6,388	6,647
Provision for Tax	(42)	50	548	2,086	1,593
PAT	2,681	3,777	4,021	4,302	5,054

Source : Bank , HDFC Securities Institutional Research

Table 4: Key ratios

	FY06	FY07	FY08	FY09	FY10
EPS	3.6	5.1	5.4	23.5	27.6
Earnings growth (%)	Na	40.9	6.5	334.2	17.5
BVPS	10.3	15.6	21.0	77.9	105.0
Adj. BVPS	9.7	14.8	20.1	73.6	98.6
ROAA (%)	1.4	1.9	1.5	1.2	1.0
ROAE (%)	35.0	39.3	29.6	28.8	30.2
Profitability					
Yield on Advances (%)	7.4	10.0	10.2	11.6	9.6
Yield on Int. earning Inv. (%)	8.0	7.9	7.8	6.5	7.2
Cost of funds (%)	3.9	5.2	6.0	6.7	6.0
NIM (%)	3.3	3.7	3.1	2.9	2.5
Operating efficiency					
Cost / Avg. Asset Ratio (%)	2.6	2.5	2.1	1.9	1.4
Cost-Income ratio (Excl Treasury)	67.4	52.8	51.8	52.8	47.7
Balance sheet structure ratios					
Loan Growth (%)	Na	31.2	56.5	34.2	32.6
C/D ratio (%)	52.8	60.7	73.9	71.0	66.4
Equity / Assets (%)	4.1	5.3	5.1	3.5	3.4
Equity / Loans (%)	8.6	9.9	8.5	5.8	5.9
CASA (%)	52.1	45.7	36.3	27.8	25.0
Total Capital Adequacy Ratio (CAR)	Na	Na	Na	14.3	13.0
- Tier I CAR	Na	Na	Na	8.4	7.6
Asset quality					
Gross NPLs (Rsm)	9,415	2,908	1,355	1,610	2,062
Net NPLs (Rsm)	480	608	670	780	1,166
Gross NPLs (%)	9.6	2.4	0.7	0.7	0.6
Net NPLs (%)	0.5	0.5	0.4	0.3	0.4
Coverage Ratio (%)	94.9	79.1	50.6	51.5	43.4

Source : Bank , HDFC Securities Institutional Research

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