

**Punjab National Bank****Rs448**  
**OUTPERFORMER**

## RESULT NOTE

Mkt Cap: Rs141.3bn; US\$3.1bn

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**Result:** Q4FY06

**Comment:** MTM losses take the toll

**Last report:** 18 February 2006 (Price Rs426.3; Recommendation: Outperformer)

## Key valuation metrics

Year to March 31	2004	2005	2006	2007E	2008E
Net profit (Rs mn)	11,087	14,101	14,393	19,746	22,938
yoy growth	31.6	27.2	2.1	37.2	16.2
Shares in issue (mn)	265.3	315.3	315.3	315.3	315.3
EPS (Rs)	41.8	48.6	45.6	62.6	72.7
EPS growth (%)	31.6	16.2	(6.0)	37.2	16.2
PE (x)	10.7	9.2	9.8	7.2	6.2
Book value (Rs/share)	188.9	258.8	297.4	354.0	420.3
Adjusted BV (Rs/share)	224.8	290.6	320.6	380.0	451.7
P/ Adjusted Book (x)	2.0	1.5	1.4	1.2	1.0
RoAE (%)	24.5	21.4	16.4	19.2	18.8

PNB has reported 20% yoy decline in net profit driven by large amount of mark-to-market losses on its bond portfolio. Although the bond losses were not unexpected, the quantum of the same is higher than our estimates. We believe that with the recent transfer of about Rs61bn securities to HTM, PNB's investment portfolio is now considerably derisked. In a rising interest rate scenario, PNB with its 49% CASA ratio and conscious management focusing on margins rather than high loan growth is one of the best bets among PSU banks. Valuations at 1.0 x FY08E adjusted book are also quite attractive considering 14.4% CAGR in earnings over FY05-08E and 19% average RoE over next two years. Maintain Outperformer and 12-month price target of Rs575, which is equivalent to 1.3 x FY08E adjusted book.

## KEY ISSUES

## □ Marginally lower than expected NII

PNB has reported 10% yoy growth in NII for Q4FY06, which is somewhat lower than our expectations. However, for the entire year of FY06, NII growth at 16.5% is broadly in line with our estimates of 19% growth. The lower than expected NII growth for the quarter is attributed to the fact that on the one hand, the investment portfolio has shrunk sequentially (from Rs455.6bn to Rs410.5bn) due to both redemption as well as sale of excess SLR, the loan growth was skewed more towards the end of the quarter and hence the bank did not earn interest income on advances for the full quarter.

The loan book of PNB has grown at 23.5% yoy for FY06, which is in line with PNB's stated philosophy that it would not chase excessive loan growth at the cost of margins. Loan growth is driven by retail assets (53% yoy growth), agriculture and SSI sector. Within retail too, PNB is focusing on small traders segment, which provides attractive yields. Retail, agri and SSI together constitute almost 55% of PNB's total advances.

### □ .. while spreads have improved over the year

PNB has almost 49% of its deposit base in the form of CASA deposits. High CASA along with its conscious decision of not going for very high loan growth has helped the bank in making do with lower deposit growth and consequently containing cost of deposits. PNB's deposits grew by 16% yoy for FY06. Along with improving loan yields and sustained higher yield on investments, spreads have improved to almost 4.0% in Q4FY06. However, NIMs calculated on average assets basis, have shown decline as low yielding assets (cash and bank balances) are relatively higher on the day of balance sheet.

#### Movement of yields and cost of deposits

For the quarter ended	Mar-2005	Dec-2005	Mar-2006
Yield on advances (%)	7.74	8.50	8.26
Yield on investments (%)	8.33	8.19	8.90
Cost of deposits (%)	4.38	4.55	4.48
Spread (%)	3.63	3.82	4.02
NIM (%)	3.59	3.73	3.43

Source: SSKI Research

### □ Fee income growth is disappointing

Fee income (CEB and income on forex transactions) have grown at just about 4.8% for FY06, which is somewhat disappointing. PNB has been taking steps to rectify this by focusing on newer areas such as cash management, mutual fund distribution and insurance broking, which would help accelerating the growth of fee income in the future.

### □ Operating expenses sharply lower

PNB's operating expenses have declined 34% yoy decline for Q4FY06 driven by 43% decline in employee related expenses and 16.4% decline in other operating expenses. The sharp decline in employee related expenses is mainly due to write-back of excess pension provisions while other operating expenses have declined due to high base effect (in Q4FY05, other operating expenses had gone up by 61% yoy due to higher technology related spends).

### □ Mark-to-market losses leads to higher provisions and lower profits

PNB has made provisions of Rs6.11bn during Q4FY06, out of which Rs1.6bn are for NPA coverage and remaining about Rs4.5bn provisions are towards MTM losses booked on its bond portfolio in AFS segment. We had expected MTM losses to the tune of about Rs4.0bn. However, after the date of balance sheet in April 2006, PNB has transferred almost Rs61bn worth bonds to HTM category. As yields at the time of transfer from AFS to HTM were lower than yields at the end of March, PNB would actually see some release of depreciation provisions in Q1FY07. Asset quality continues to remain one of the best in the Indian banking industry with just about 0.29% net NPAs.

### □ Marginal downgrade in estimates, maintain Outperformer

Although PNB has shown 20% yoy decline in Q4FY06 profits, its full year profit at Rs14.39bn are just about 4.2% lower than our estimates. We have downgraded our FY07 and FY08 EPS estimates by 3.4% and 3.8% to Rs62.6 and Rs72.7 respectively to take into account following factors

- Higher estimates of NII driven by improving loan yields and lesser decline in investment yields.
- Largely stable net interest margins over FY07 and FY08 helped by high CASA ratio.
- Lower growth projections on fee and other income
- Marginally higher provisions driven by standard assets and amortization expenses.

As vulnerability of PNB's investment book has reduced with recent transfer to HTM, further mark-to-market losses are projected sharply lower, which would lead to higher profitability growth for FY07. We believe that PNB is best placed in a rising interest rate scenario and with lower risk on investment book, the only major concern is also now behind us. Valuations are quite attractive at 1.0 x FY08E adjusted book considering 14.4% CAGR in earnings over FY05-08E and average RoE of 19% over next two years. Maintain Outperformer and 12-month price target of Rs575, which corresponds to 1.3 x FY08E adjusted book.

#### Quarterly results

Year to March 31 (Rs m)	Q4FY05	FY05	Q1FY06	Q2FY06	Q3FY06	Q4FY06	FY06	FY07E	FY08E
Total intt income	21,847	84,599	22,900	23,705	24,548	24,689	95,842	113,767	132,772
Interest expense	11,126	44,531	12,016	11,797	12,474	12,887	49,174	60,923	71,361
Net interest income	10,721	40,067	10,884	11,908	12,074	11,802	46,668	52,844	61,411
yoy growth (%)	5.4	10.5	16.3	22.8	17.3	10.1	16.5	13.2	16.2
Other income	3,774	16,757	2,528	3,123	2,445	4,215	12,312	12,446	13,793
yoy growth (%)	(3.3)	(10.2)	(43.8)	(48.0)	(1.4)	11.7	(26.5)	1.1	10.8
Trading gains	1,420	5,322	1,060	1,340	780	1,360	4,580	1,000	1,000
Non trading income	2,354	9,958	2,098	2,413	2,285	3,475	10,202	11,446	12,793
Net revenue	14,494	56,824	13,412	15,031	14,519	16,017	58,979	65,290	75,204
Operating expenses	9,225	29,752	6,967	8,195	9,036	6,034	30,232	33,213	36,215
Operating profit	5,270	27,072	6,445	6,836	5,484	9,983	28,748	32,076	38,989
yoy growth (%)	(24.6)	(13.3)	(9.9)	(18.1)	5.8	124.0	6.2	11.6	21.6
Total provisions	-	8,016	1,162	94	1,032	6,111	8,399	5,393	7,992
PBT	4,743	19,056	5,283	6,742	4,451	3,871	20,348	26,684	30,997
Tax	1,137	4,955	1,702	2,522	747	985	5,955	6,938	8,059
PAT	3,606	14,101	3,582	4,220	3,704	2,887	14,393	19,746	22,938
yoy growth (%)	21.2	27.2	11.0	2.3	17.9	(20.0)	2.1	37.2	16.2
Ratios (%)									
Int.inc./avg assets	7.3	7.4	7.4	7.6	7.6	7.2	7.1	7.3	7.5
Int. exp/avg assets	3.7	3.9	3.9	3.8	3.9	3.7	3.6	3.9	4.0
Net interest margin/Average assets	3.6	3.5	3.5	3.8	3.7	3.4	3.4	3.4	3.5
Non fund revenues/Avg assets	1.3	1.3	0.8	1.0	0.8	1.2	0.8	0.8	0.7
Core fee inc/Avg assets	0.8	0.6	0.7	0.8	0.7	1.0	0.6	0.5	0.5
Operating expenses/avg assets	1.5	2.6	2.3	2.6	2.8	1.8	2.2	2.1	2.0
Tot prov/avg assets	3.6	0.7	0.4	0.0	0.3	1.8	0.6	0.3	0.5
PBT/avg assets	0.2	1.7	1.7	2.2	1.4	1.1	1.5	1.7	1.8
PAT/ avg assets	0.2	1.2	1.2	1.4	1.1	0.8	1.1	1.3	1.3
Tax/PBT	1.4	26.0	32.2	37.4	16.8	25.4	29.3	26.0	26.0

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2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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