

PUNJAB NATIONAL BANK

INR 689

Turnaround in asset quality

BUY

We met the management of Punjab National Bank (PNB) to get an update on its latest developments. We believe that the bank has a well chalked-out strategy to focus on profitable growth with moderate 20% growth in loan book and emphasis on recoveries. Asset quality which has been a major bugbear for the stock is witnessing a turnaround due to which the valuations will undergo a rerating in our view. Moderate loan growth target with strong liability franchise will augur well for the margins going forward. We expect 23% growth in earnings with RoE in the range of 17-18%. Adjusting for value of its stake in UTI AMC, the stock trades at 1.5x FY09E book. We reiterate 'BUY'.

Key takeaways of the meeting are as follows:

* **Asset quality to improve tremendously**

Over the past three rolling quarters, PNB's recoveries were waning with the bank's prime focus on credit growth (30%+ credit growth over the past three years) to retain market share. However, with the new chairman Mr. K. C. Chakraborty at the helm of affairs now, **PNB's priority on recoveries has returned. The bank's asset quality is therefore expected to improve in this quarter.**

Its NPAs had increased by 44% on the gross level. Further, a bulk of PNB's incremental NPAs (around INR 10-14 bn) is technical in nature. This means, even if an account is serviced regularly (on both interest and principal payments), it has to be categorised as an NPA if it does not start operations within six months of disbursal. However, these accounts will be upgraded as the project is likely to take off, improving the bank's asset quality tremendously.

Financials

Year to March	FY06	FY07	FY08E	FY09E
Revenues (INR mn)	56,933	62,488	73,993	86,290
Rev growth (%)	(2.9)	9.8	18.4	16.6
Net interest income(INR mn)	44,198	52,066	55,153	65,824
Net profit (INR mn)	14,395	15,400	18,773	23,414
Shares outstanding (mn)	315.3	315.3	315.3	315.3
EPS (INR)	45.7	48.8	59.5	74.3
EPS growth (%)	2.0	7.0	21.9	24.7
P/E (x)	14.1	13.1	10.8	8.6
Price to book (x)	2.2	2.0	1.7	1.5
Price to PPOP (x)	8.2	6.2	5.8	4.5
ROE (%)	17.0	16.0	17.3	18.8

* price adj. for value of UTI AMC



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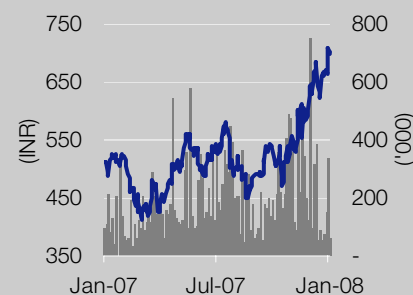
Reuters : PNBK.BO
Bloomberg : PNB IN

Market Data

52-week range (INR) : 721 / 400
Share in issue (mn) : 315.3
M cap (INR bn/USD mn) : 217.2 / 5,459.7
Avg. Daily Vol. BSE/NSE ('000) : 824.2

Share Holding Pattern (%)

Promoters : 57.8
MFs, Fls & Banks : 16.0
FII : 20.1
Others : 6.1



* **Likelihood of stable and profitable growth**

PNB's target of growing its loan book moderately at 20% Y-o-Y, coupled with a strong deposit franchisee (44% CASA ratio), is likely to help it maintain one of the highest NIMs in the sector. The CASA ratio has declined on the back of: 1) Industry-wide phenomenon of savings deposits converting into term deposits and 2) 9.5% special deposit schemes (SDS). With deposit rate cuts happening across board (SBI hike of 25bps a one-off in our view, a strategy to maintain market share and ALM rather than an indicator of interest rates), the CASA ratio is expected to remain at the current levels. ***A major portion of SDS will be maturing beginning this month, full benefit of which will be observed in Q4FY08 and Q1FY09. With CD rates moderating, NIMs are likely to improve slightly over Q2FY08. The strategy of moderately growing the loan book allows the bank to retain pricing power and does not put undue pressure on resource mobilisation.***

* **Q3FY08 results to be buoyed by treasury profits and write back of investment depreciation**

Treasury profits have been robust during the quarter with strong contribution from equity and forex markets. The bank maintains INR 3-4 bn of active equity book. With strong capital markets and IPO fillip book, equity profits are expected to be the prime contributor. With benign interest rates, ***write back of investment depreciation*** is also expected to boost profits.

* **Outlook and valuation: Attractive, after adjusting for stake value in UTI AMC; maintain 'BUY'**

We expect 23% CAGR growth in earnings over next two years with 17-18% RoE. We value its stake in UTI AMC at INR 47 per share, adjusting for *which, the stock is trading at 1.5x FY09E*. We believe the concerns on street regarding PNB's asset quality will turnaround post its results in this quarter. Hence, the stock could undergo a rerating. We reiterate our 'BUY' recommendation on the stock.

Financial Statements

Income statement					(INR mn)
Year to March	FY05	FY06	FY07	FY08E	FY09E
Interest income	84,599	93,372	112,295	139,125	163,824
Interest expenses	44,531	49,174	60,229	83,972	98,000
Net Interest income	40,067	44,198	52,066	55,153	65,824
Non interest income	18,552	12,736	10,423	18,841	20,466
- <i>Fee & forex income</i>	8,522	8,860	11,701	14,041	16,428
- <i>Misc. income</i>	4,707	1,739	1,866	1,800	2,037
- <i>Investment profits</i>	5,322	2,137	(3,145)	3,000	2,000
Net revenues	58,619	56,933	62,488	73,993	86,290
Operating expense	29,752	30,232	33,263	36,406	39,566
- <i>Employee exp</i>	21,212	21,150	23,525	25,554	27,478
- <i>Other opex</i>	8,540	9,082	9,738	10,852	12,088
Preprovision profit	28,867	26,702	29,226	37,587	46,724
Provisions	9,805	6,352	7,535	10,575	13,035
- <i>Loan loss provisions</i>	2,821	888	7,518	10,105	12,535
- <i>Investment depreciation</i>	1,305	6,430	(199)	470	500
- <i>Other provisions</i>	5,680	(966)	217	0	0
PBT	19,062	20,350	21,691	27,012	33,689
Taxes	4,955	5,955	6,291	8,239	10,275
PAT	14,107	14,395	15,400	18,773	23,414
Reported PAT	14,107	14,395	15,400	18,773	23,414
EPS	44.7	45.7	48.8	59.5	74.3
DPS	6.0	6.0	10.0	12.0	15.0
Payout ratio (%)	13.4	13.1	20.5	20.2	20.2

Growth ratios (%)					
Year to March	FY05	FY06	FY07	FY08E	FY09E
Nil growth	10.6	10.3	17.8	5.9	19.3
Fees growth	41.7	4.0	32.1	20.0	17.0
Opex growth	25.5	1.6	10.0	9.5	8.7
PPOP growth	23.0	4.3	31.8	6.8	29.3
PPP growth	(8.4)	(7.5)	9.5	28.6	24.3
Provisions growth	(33.3)	(35.2)	18.6	40.3	23.3
PAT growth	38.1	2.0	7.0	21.9	24.7

Operating ratios (%)					
Year to March	FY05	FY06	FY07	FY08E	FY09E
Yield on advances	7.9	7.9	8.9	9.9	10.0
Yield on investments	8.6	8.8	8.3	7.6	7.5
Yield on assets	7.7	7.1	7.5	8.2	8.4
Net interest margins	3.6	3.4	3.5	3.3	3.4
Cost of funds	4.1	3.9	4.2	5.1	5.2
Cost of deposits	4.4	4.1	4.3	5.3	5.3
Cost of borrowings	6.7	4.5	5.7	7.0	7.2
Spread	3.5	3.2	3.4	3.1	3.2
Cost-income	50.8	53.1	53.2	49.2	45.9
Tax rate	26.0	29.3	29.0	30.5	30.5

Balance sheet

Year to March	FY05	FY06	FY07	FY08E	FY09E
Liabilities					
Equity capital	3,153	3,153	3,153	3,153	3,153
Reserves	75,335	87,587	98,263	112,610	130,490
Net worth	78,488	90,740	101,416	115,763	133,643
Sub bonds/pref cap	23,429	19,350	36,948	51,948	66,948
Deposits	1,031,669	1,196,849	1,398,597	1,611,607	1,856,428
Borrowings	27,183	66,872	19,489	13,521	13,559
Other liabilities	98,794	76,663	65,903	75,911	87,442
Total	1,259,562	1,450,474	1,622,353	1,868,750	2,158,020
Assets					
Loans	604,128	746,274	965,965	1,159,158	1,390,990
Investments					
<i>Gilts</i>	<i>434,120</i>	<i>346,410</i>	<i>376,207</i>	<i>412,799</i>	<i>427,594</i>
<i>Others</i>	<i>72,608</i>	<i>64,143</i>	<i>75,692</i>	<i>86,076</i>	<i>98,343</i>
Cash & equi	110,890	247,917	156,455	156,934	180,774
Fixed assets	6,527	7,279	7,160	6,683	6,065
Other assets	31,289	38,452	40,874	47,100	54,255
Total	1,259,562	1,450,474	1,622,353	1,868,750	2,158,020
Balance sheet ratios					
Credit growth	25.4	19.8	26.7	20.0	20.0
Deposit growth	17.3	16.0	16.9	15.2	15.2
EA growth	24.5	15.0	12.1	15.3	15.6
SLR ratio	41.0	27.4	26.5	25.0	22.5
C-D ratio	64.4	67.0	72.5	75.5	78.6
Low-cost deposits	46.3	49.0	46.2	44.2	44.4
Gross NPA ratio	5.8	4.0	3.4	3.3	2.5
Net NPA ratio	0.2	0.3	0.8	1.1	0.7
Provision coverage	96.8	93.3	78.6	66.0	71.8
Incremental slippage	1.4	1.4	1.9	2.5	1.5
Capital adequacy	14.8	12.0	12.3	10.0	10.0
- Tier 1	8.9	10.1	8.9	7.2	7.0

Ratios

Year to March	FY05	FY06	FY07	FY08E	FY09E
ROA decomposition (%)					
Net interest income/Assets	3.6	3.4	3.5	3.3	3.4
Fees/Assets	1.2	0.8	0.9	0.9	0.9
Investment profits/Assets	0.5	0.2	(0.2)	0.2	0.1
Net revenues/Assets	5.3	4.3	4.2	4.4	4.4
Operating expense/Assets	(2.7)	(2.3)	(2.2)	(2.1)	(2.0)
Provisions/Assets	(0.9)	(0.5)	(0.5)	(0.6)	(0.7)
Taxes/Assets	(0.4)	(0.5)	(0.4)	(0.5)	(0.5)
Total costs/Assets	(4.0)	(3.2)	(3.2)	(3.3)	(3.2)
ROA	1.3	1.1	1.0	1.1	1.2
Equity/Assets	5.7	6.4	6.5	6.4	6.4
ROE	22.5	17.0	16.0	17.3	18.8

Valuation metrics

Year to March	FY05	FY06	FY07	FY08E	FY09E
EPS	44.7	45.7	48.8	59.5	74.3
<i>EPS growth (%)</i>	<i>16.2</i>	<i>2.0</i>	<i>7.0</i>	<i>21.9</i>	<i>24.7</i>
Book value per share	248.9	287.8	321.6	367.2	423.9
Adjusted book value/share	246.3	283.1	305.5	337.8	401.4
Price/Earnings	14.3	14.1	13.1	10.8	8.6
Price/ BV	2.6	2.2	2.0	1.7	1.5
Price/ ABV	2.6	2.3	2.1	1.9	1.6
Dividend yield (%)	<i>0.9</i>	<i>0.9</i>	<i>1.6</i>	<i>1.9</i>	<i>2.3</i>
Price to income	9.3	10.3	8.7	7.6	6.6
Price to PPOP	8.6	8.2	6.2	5.8	4.5

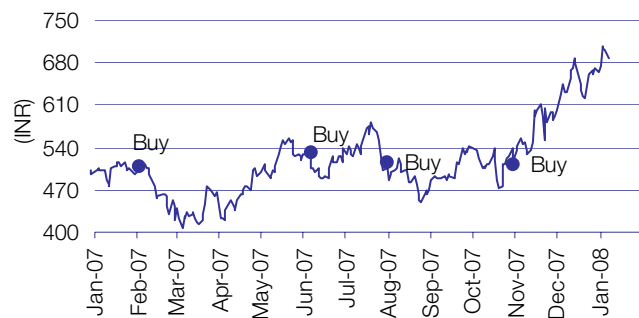
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Punjab National Bank



Recent Research

Date	Company	Title	Price (INR)	Recos
3-Jan-08	Geojit Financial Services	Building partnerships, discovering value <i>Visit Note</i>	98	Not Rated
31-Dec-07	Develop. Credit Bank	Improving fundamentals; <i>Visit Note</i>	143	Not Rated
28-Dec-07	BFSI-Brokerages	Surging volumes – advantage intermediaries <i>Sector Update;</i>		
27-Dec-07	SREI Infra Finance	Metamorphosis; <i>Company Update</i>	237	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	107	45	18	3	193

* 13 stocks under review / 7 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	104	69	20

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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