

November 1, 2011

Reco	Previous Reco
Accumulate	Accumulate
CMP	Target Price
Rs1,013	Rs1,270
EPS change FY12E/13E (%)	NA
Target Price change (%)	NA
Nifty	5,258
Sensex	17,481

Price Performance

(%)	1M	3M	6M	12M
Absolute	6	(9)	(7)	(23)
Rel. to Nifty	0	(5)	(2)	(10)

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Banks
Bloomberg	PNB@IN
Equity Capital (Rs mn)	3168
Face Value(Rs)	10
No of shares o/s (mn)	317
52 Week H/L	1,395/872
Market Cap (Rs bn/USD mn)	321/6,514
Daily Avg Volume (No of sh)	366431
Daily Avg Turnover (US\$m)	7.3

Shareholding Pattern (%)

	Sep-11	Jun-11	Mar-11
Promoters	58.0	58.0	58.0
FII/NRI	18.8	19.3	19.4
Institutions	17.8	17.4	17.5
Private Corp	1.4	1.3	1.2
Public	4.0	4.0	4.0

Source: Capitaline

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- **PNB reports stellar results with NII (Rs34.5bn) and PAT (Rs12.1bn) sharply ahead of our/street estimates. Improved reco/upgrades (60% of op GNPA) remain stand-out points**
- **Loan growth at 2.5% qoq remained broad based; deposits up 5.5% qoq largely in the nature of term deposit. CASA eases to 37%, but NIMs still expand 11bps qoq led by better yields**
- **Asset quality surprised +vely with slippages at Rs9.9bn. Major restructuring in troubled segments of Power (SEB) and drilling – a prudent step**
- **With material improvement in asset quality, we are now factoring in lower credit cost (avg 81bps). Valuations at 1.4x FY12E/1.1x FY13E ABV appear reasonable**

Results materially above expectations; +ve surprises on NPLs front

PNB's Q2FY12 results were significantly ahead of our/street estimates with NII at Rs34.5bn (up 16% yoy) and PAT at Rs12bn (up 12.1% yoy). NII growth was aided by well-diversified loan mix and improved yields. Non-int inc too came in higher at Rs8.9bn (up 24% yoy). With lower than expected slippages and improved cash recoveries and up-gradation, GNPA grew by mere 5% qoq. **This is commendable as all loans below Rs1mn were migrated to system based NPA recognition during Q2.**

Loan portfolio expanded 2.5% qoq with growth witnessed across all segments of credit. Resultant, margins expanded 11bps qoq to 3.95%. On the deposit front, CASA deposits grew 4.6% qoq. However, CASA ratio eased by 430bps yoy to 36.3% (37.1% if calculated only on domestic deposits).

Yield analysis

%	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (bps)	QoQ (bps)
Yield on advances*	9.9	10.2	10.2	10.8	11.5	153	61
Yield on investments*	6.7	6.8	6.4	6.9	7.0	32	13
Yield on assets*	8.1	8.5	8.2	8.7	9.1	99	37
Cost of funds*	4.4	4.7	4.9	5.4	5.6	122	13
NIM*	3.7	3.8	3.4	3.3	3.5	-23	24
Yield on Fund#	8.2	8.3	8.3	8.7	9.0	86	31
Yield on advances#	10.6	10.6	10.8	11.4	11.9	137	54
Cost of Fund#	4.4	4.5	4.9	5.4	5.5	115	10
NIMs#	4.1	4.1	3.9	3.8	4.0	-11	11

Source: Company, Emkay Research Note: * Calculated on basis of average quarterly balances # reported

Valuation table

Y/E March 31	Net income	Net profit	EPS (Rs)	ABV (Rs)	RoA (%)	RoE (%)	PE (x)	P/ABV (x)
FY2010	120,882	39,054	123.9	489.8	1.4	24.1	8.2	2.1
FY2011	154,199	44,335	139.9	568.1	1.3	22.6	7.2	1.8
FY2012E	180,006	53,490	168.8	711.5	1.3	22.5	6.0	1.4
FY2013E	208,410	65,632	207.2	902.7	1.3	22.8	4.9	1.1

Source: Company, Emkay Research

Key financials – Quarterly

Rs mn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)	YTD' 12	YTD' 11	YoY (%)
Net Interest Income	29,767	32,041	30,290	31,152	34,526	16.0	10.8	65,679	55,956	17.4
Other Income	7,183	8,573	11,454	10,837	8,888	23.7	-18.0	19,725	15,897	24.1
Fee Income	4,740	3,940	4,710	5,630	5,550	17.1	-1.4	11,180	9,700	15.3
Net Income	36,950	40,614	41,744	41,989	43,414	17.5	3.4	85,404	71,853	18.9
Total Operating Expenses	15,949	17,106	16,668	17,250	18,137	13.7	5.1	35,387	29,868	18.5
<i>As % Of Net Income</i>	<i>43.2</i>	<i>42.1</i>	<i>39.9</i>	<i>41.1</i>	<i>41.8</i>			<i>41.4</i>	<i>41.6</i>	
Employee Expenses	11,131	12,235	11,293	12,126	12,404	11.4	2.3	24,531	21,083	16.4
<i>As % Of Net Income</i>	<i>30.1</i>	<i>30.1</i>	<i>27.1</i>	<i>28.9</i>	<i>28.6</i>			<i>28.7</i>	<i>29.3</i>	
Other Expenses	4,818	4,871	5,376	5,124	5,732	19.0	11.9	10,856	8,785	23.6
<i>As % Of Net Income</i>	<i>13.0</i>	<i>12.0</i>	<i>12.9</i>	<i>12.2</i>	<i>13.2</i>			<i>12.7</i>	<i>12.2</i>	
Operating Profit	21,001	23,508	25,076	24,739	25,278	20.4	2.2	50,017	41,986	19.1
<i>As % Of Net Income</i>	<i>56.8</i>	<i>57.9</i>	<i>60.1</i>	<i>58.9</i>	<i>58.2</i>			<i>58.6</i>	<i>58.4</i>	
Provisions	5,160	7,140	7,279	8,935	7,103	37.7	-20.5	16,038	10,501	52.7
Prov for NPA	3,590	5,550	5,440	5,660	3,190	-11.1	-43.6	8,850	9,090	-2.6
PBT	15,841	16,368	17,796	15,804	18,175	14.7	15.0	33,978	31,484	7.9
Total Tax	5,095	5,463	5,787	4,753	6,124	20.2	28.8	10,878	10,053	8.2
Adjusted PAT	10,746	10,906	12,009	11,050	12,050	12.1	9.1	23,101	21,432	7.8
Extra Ordinary Items	0	0	0	0	0			0	0	
Reported PAT	10,746	10,906	12,009	11,050	12,050	12.1	9.1	23,101	21,432	7.8
Reported EPS	34.1	34.6	37.9	34.9	38.0	11.6	9.1	72.9	68.0	7.3

Source: Company, Emkay Research

NIM expansion aided by better yields...

PNB's Q2FY12 NIM at 3.95% was up 11bps qoq. Despite volatile interest rate regime, margins for PNB have held up in a narrow range of 3.8%-4.1% for past several quarters. This has been on the back of a) regular lending rate hikes b) well-diversified loan mix and c) strong core deposit franchise.

During the quarter, despite 200bps qoq contraction in LDR, NIM improved 11bps qoq largely due to improved yields on advances (up 54bps qoq) and on investments (up 13bps qoq) and broad based loan growth. NIM expansion was also aided by 75bps increase in base rate implemented in August 2011. Cost of deposits was up by 24bps qoq.

... and broad based loan growth

Loan portfolio expanded 2.5% qoq with growth witnessed across segments of – retail (up 2.4% qoq), agri (up 2.7% qoq) and SME (up 5.8% qoq) and large corporates including others (up 1.4% qoq). Amongst large industries, exposures was - Metals Rs138bn (5.5% of total loan portfolio), infrastructure at Rs362bn (14.5%) and Power Rs 155bn (6.2%).

Advances mix

Rs bn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)
Retail	217	192	236	242	247	13.8	2.4
Agriculture	323	302	355	342	351	8.7	2.7
SME	403	441	453	467	494	22.7	5.8
Others	1,145	1,277	1,377	1,379	1,398	22.1	1.4
Total	2,088	2,213	2,421	2,429	2,490	19.3	2.5

Source: Company, Emkay Research

CASA eases sequentially; albeit remains second best in PSU space

As against 25% yoy (5.5% qoq) growth in total deposits, term deposits were up 32.4% yoy (6.0% qoq). Resultant, CASA ratio has eased by 430bps yoy to 36.3%. On the flip side, proportion of core deposits has remained relatively higher at 76%, clearly reflecting sticky nature of deposits. Further, CASA ratio at 37% (of domestic deposits) is second best to SBI in the PSU space.

PNB has 30% of its savings deposits below Rs0.1mn. While the management is yet to make any decision on deregulation of interest rate on savings deposits, we expect minimal impact on margins as deposit rate hike will be compensated in form of higher lending rates.

CASA Mix

Rs bn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)
Current Deposits	237	229	268	264	263	11.1	-0.3
Savings Deposits	873	899	935	949	1,005	15.1	5.9
CASA	1,110	1,128	1,203	1,213	1,268	14.3	4.6
Term deposits	1,624	1,761	1,926	2,028	2,150	32.4	6.0
Total Deposits	2,734	2,889	3,129	3,241	3,418	25.0	5.5
Demand/Total	40.6	39.1	38.5	37.4	37.1	-349	-31

Source: Company, Emkay Research

Strong non-int income compensated for higher employee cost

Non-interest income at Rs8.9bn was up 24% yoy. Amongst non-int income, core fee income at Rs5.5bn was up 17% yoy (down 1.4% qoq). Income from sale of TPP remained muted during the quarter. The bank has entered into tie-up with Metlife and has guided for substantial fee income beginning Q3FY12. Forex gains came in at Rs13bn.

Employee expenses at Rs12.4bn were up 11.4% yoy and 2.3% qoq. In addition to pension and gratuity liability of Rs1.7bn under existing scheme, the bank has taken a conscious step and provided additional to the tune of Rs3bn towards pension and gratuity.

Other income

Rs mn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)
Fee/Commission income	4,740	3,940	4,710	5,630	5,550	17.1	-1.4
Trading gains/(losses)	380	870	530	480	530	39.5	10.4
Forex gains/(losses)	310	1,250	1,090	1,670	1,330	329.0	-20.4
Dividend income	890	1,230	2,210	1,090	800	-10.1	-26.6
Other non int income	863	1,283	1,714	707	158	-81.6	-77.6
Total	7,183	8,573	11,454	10,837	8,888	23.7	-18.0
Total fee income	5,913	6,473	7,514	8,007	7,038	19.0	-12.1

Source: Company, Emkay Research

Core operating profit growth

Rs mn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)	YTD' 12	YTD' 11	YoY (%)
Reported operating profit	21,001	23,508	25,076	24,739	25,278	20.4	2.2	50,017	41,986	19.1
Less: Treasury gains	380	870	530	480	530	39.5	10.4	1,010	1,595	-36.7
Pension/gratuity	4,400	3,600	4,170	5,040	5,190		3.0	10,230	7,870	30.0
Core operating profit	25,021	26,238	28,716	29,299	29,938	19.6	2.2	59,237	48,261	22.7

Source: Company, Emkay Research

Provisions higher driven by one-offs

Despite a lower net additions to GNPA's and consequent lower NPA provisions, the total provision costs remained higher during the quarter for two reasons (1) PNB has provided additional Rs1.1bn on investment depreciation and protected the investment portfolio upto 8.62% yields (vs 8.44% closing on Sep-11) and (2) it has also done Rs950mn of provisions for the standard assets restructured during the quarter.

Break up of provisions

Rs mn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)	YTD' 12	YTD' 11	YoY (%)
On NPL	3,590	5,550	5,440	5,660	3,190	-11.1	-43.6	8,850	9,090	-2.6
As % of advances	0.17	0.25	0.22	0.23	0.13			0.36	0.44	
On Standard Assets	780	1,090	1,000	1,590	950	NA	-40.3	2,540	951	167.1
Investment Depreciation	650	440	470	0	1,610	147.7	-	1,610	790	103.8
Others	140	60	369	1,685	1,353	NA	-19.7	3,038	-330	NA
Total	5,160	7,140	7,279	8,935	7,103	37.7	-20.5	16,038	10,501	52.7

Source: Company, Emkay Research

Slippages surprise +vely; PCR comfortable 75% level

GNPA at Rs51bn (up 5.2% qoq) were lower than our/street estimates. This is commendable as the bank has migrated all its accounts to system based NPA recognition during the quarter and still the gross slippage number stood stable at Rs9.9bn. The management has guided for average slippage run-rate at Rs10bn in coming quarters

NPA profile

Rs bn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)
Gross NPA (Rs bn)	40,248	45,411	43,794	48,936	51,501	28.0	5.2
Net NPA (Rs bn)	14,255	15,751	20,387	20,908	20,885	46.5	-0.1
Gross NPA (%)	1.9	2.0	1.8	2.0	2.1		
Net NPA (%)	0.7	0.7	0.9	0.9	0.8		
Net NPLs/Net worth (%)	7.2	7.5	9.5	9.2	8.8		
Provision cover (%)	64.6	65.3	53.4	57.3	59.4		
Provision cover incl tech write off (%)	77.1	77.2	73.2	74.3	75.0		

Source: Company, Emkay Research

Slippages

Rs mn	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)
Cumulative (Rs mn)	21,270	31,040	43,530	11,770	21,700	2.0	NA
Quarterly (Rs mn)	9,110	9,770	12,490	11,770	9,930	9.0	-15.6
Cumulative (%)	1.0	1.4	1.8	0.5	0.9		
Quarterly (%)	0.4	0.4	0.5	0.5	0.4		

Source: Company, Emkay Research

Improved reco/upgrades can surprise positively on credit costs

Slippages during the quarter stood at Rs9.9bn (significantly lower than our/street estimates). Also with improved cash recoveries and up-gradations, GNPA rose by mere Rs2.5bn qoq.

However, the recoveries and upgrades at 60% (annualized) of the opening GNPA for H1FY12 clearly stand out as positive. PNB's recoveries and upgradation pace has clearly picked up over last two years with 46%/50% of opening GNPA for FY10/FY11 and now reaching upto 60%. We are still building in slippage rate of 1.5%/1.4% for FY12/FY13 and 80bps of credit costs (vs 90bps earlier). However, if the slippage rate slows down in FY13, it could give significant positive surprises to our numbers.

Management has emphasized that the recoveries/upgrades numbers for H1FY12 could be repeated in H2FY12 too.

Restructured assets move up on SEB loans and offshore drilling segment

The bank has restructured loans to the tune of Rs45.6bn in H1FY12 and largely comprises of Tamil Nadu SEB (Rs17.5bn), Infra (Rs2.2bn) and drilling (Rs6.4bn). Total restructured loan portfolio stood at Rs200bn (8% of advances).

Valuations and view

Three issues have clearly dragged PNB's financial and stock performance over past few quarters – (1) exposure to sensitive sectors like CRE and power (2) high slippage rates and consequent credit costs and (3) risks to margins due to it being the highest amongst PSU banks. Clearly the NIM performance during the quarter and the ability to push up recoveries and upgradations rates put the later two concerns to the rest. Amongst the power sector exposure, ~50% of the exposure is to SEBs and central government utilities and 50% (2.9% of loan book) to the private entities.

We have now factored marginally lower credit cost (avg 81bps over FY11-13E). Valuations at 1.4x FY12E/1.1x FY13E ABV appear reasonable given superior return ratios, strong CASA franchise, stable NIM and fading risk of asset quality deterioration. Retain ACCUMULATE rating on the stock with price target of Rs1270.

Key Financials

Income Statement (Rs. Mn)

(Year Ending Mar 31)	FY10	FY11	FY12E	FY13E
Net interest income	85,229	118,073	138,933	164,143
Other income	35,653	36,126	41,073	44,267
Net income	120,882	154,199	180,006	208,410
Operating expenses	47,619	63,642	71,403	79,966
Pre provision profit	73,263	90,557	108,602	128,444
PPP excl treasury	81,296	93,549	110,499	130,340
Provisions	14,237	24,920	28,767	30,485
Profit before tax	59,026	65,637	79,835	97,958
Tax	19,973	21,302	26,346	32,326
<i>Tax rate</i>	34%	32%	33%	33%
Profit after tax	39,054	44,335	53,490	65,632

Key Ratios (%)

(Year Ending Mar 31)	FY10	FY11	FY12E	FY13E
NIM	3.2	3.6	3.4	3.3
Non-ll/avg assets	1.3	1.1	1.0	0.9
Fee income/avg assets	0.6	0.6	0.6	0.6
Opex/avg assets	1.8	1.9	1.7	1.6
Provisions/avg assets	0.5	0.8	0.8	0.8
PBT/avg assets	2.0	1.7	1.7	1.8
Tax/avg assets	0.7	0.6	0.6	0.6
RoA	1.4	1.3	1.3	1.3
RoAE	24.1	22.6	22.5	22.8
GNPA (%)	1.9	2.0	1.9	1.8
NNPA (%)	0.4	0.8	0.7	0.4

Balance Sheet (Rs. Mn)

(Year Ending Mar 31)	FY10	FY11	FY12E	FY13E
Liabilities				
Equity	3,153	3,168	3,168	3,168
Reserves	174,076	211,918	256,570	312,629
Net worth	177,229	215,086	259,739	315,797
Deposits	2,493,298	3,128,987	3,809,362	4,635,800
Borrowings	296,052	439,180	503,129	566,677
Total liabilities	2,966,579	3,783,253	4,572,230	5,518,274
Assets				
Cash and bank	234,736	296,912	361,473	491,344
Investments	746,918	902,995	1,076,678	1,355,905
Customer assets	1,896,339	2,469,696	3,003,795	3,535,724
Others	88,587	113,650	130,284	135,295
Total assets	2,966,579	3,783,253	4,572,230	5,518,274

Valuations Table

(Year Ending Mar 31)	FY10	FY11	FY12E	FY13E
Net profit (Rs mn)	39,054	44,335	53,490	65,632
Shares in issue (mn)	315	317	317	317
EPS (Rs)	123.9	139.9	168.8	207.2
PER (x)	8.2	7.2	6.0	4.9
FDEPS(Rs)	123.9	139.9	168.8	207.2
FDPER (x)	8.2	7.2	6.0	4.9
Book value (Rs)	514.8	632.5	773.4	950.4
P/BV (x)	2.0	1.6	1.3	1.1
Adj book value (Rs)	489.8	568.1	711.5	902.7
P/ABV (x)	2.1	1.8	1.4	1.1
P/PPP (x)	4.4	3.5	3.0	2.5
Dividend yield (%)	2.2	2.2	2.4	2.6

Recommendation History: Punjab National Bank – PNB IN

Date	Reports	Reco	CMP	Target
28/07/2011	Punjab National Bank Q1FY12 Result Update	Accumulate	1,103	1,270
04/05/2011	Punjab National Bank Q4FY11 Result Update	Accumulate	1,129	1,300
21/01/2011	Punjab National Bank Q3FY11 Result Update	Buy	1,123	1,500
28/10/2010	Punjab National Bank Q2FY11 Result Update	Buy	1,310	1,500

Recent Research Reports

Date	Reports	Reco	CMP	Target
31/10/2011	Bank of Baroda Q2FY12 Result Update	Accumulate	772	950
31/10/2011	Canara Bank Q2FY12 Result Update	Hold	469	500
31/10/2011	Corporation Bank Q2FY12 Result Update	Accumulate	427	520
31/10/2011	ICICI Bank Q2FY12 Result Update	Accumulate	931	1,200

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