

## Punjab National Bank

STOCK INFO.	BLOOMBERG
BSE SENSEX: 9,849	PNB IN
	REUTERS CODE
S&P CNX: 2.975	PNBK.BO

30 January 2006

Buy

Previous Recommendation: Buy

Rs457

		YEAR	NET INCOME	PAT	EPS	EPS	P/E	P/BV	CAR	ROE	ROA	P/ABV
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	(%)	(X)
Equity Shares (m)	315.3	3/05A	56,824	14,101	44.7	7.0	10.2	1.8	14.8	21.4	1.2	1.9
52-Week Range	521/338	3/06E	58,669	16,138	51.2	14.4	8.9	1.6	14.8	18.2	1.2	1.6
1,6,12 Rel.Perf.(%)	-7/-21/-38	3/07E	67,933	19,181	60.8	18.9	7.5	1.3	14.4	18.5	1.3	1.3
M.Cap. (Rs b)	144.1											
M.Cap. (US\$ b)	3.3											

Punjab National Bank (PNB) reported 17% NII growth in 3QFY06, driven by steady loan growth and higher margins. NIMs have improved from 3.9% in 9MFY05 to 4.02% in 9MFY06. However, operating expenses have increased sharply during the quarter largely on account of higher employee expenses post the wage settlement. Nevertheless, PNB witnessed an earnings growth of 18%, with an improvement in asset quality.

- ⚡ Steady business growth; advances up 31% YoY
- ⚡ Other income excluding bond gains up 18% YoY
- ⚡ Operating expenses increase sharply on higher pension provisions
- ⚡ Net NPAs at 0.25%

While core earnings growth is likely to be steady, we believe that steady operating expenses and lower provisioning (possibly write-backs) will impact earnings positively going forward (as net NPAs are just 0.25%). PNB could also emerge as one of the gainers of the higher interest rate regime, as nearly 48.5% of its deposits are low cost deposits. Further, the bank has networked 1,753 branches under the core banking solution, covering 69% of the total business (largest network of connected branches in India). We expect earnings to grow by 14.4% in FY06 and by 18.9% in FY07. The stock trades at a P/E of 7.5x and at P/BV of 1.3x FY07E. We maintain **Buy**.

### QUARTERLY PERFORMANCE

	(RS MILLION)									
	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Interest Income	20,447	20,984	21,321	21,847	22,899	23,705	24,548	25,065	84,599	96,216
Interest Expense	11,091	11,288	11,026	11,126	12,016	11,797	12,474	12,611	44,531	48,898
<b>Net Interest Income</b>	<b>9,356</b>	<b>9,696</b>	<b>10,295</b>	<b>10,720</b>	<b>10,883</b>	<b>11,908</b>	<b>12,074</b>	<b>12,453</b>	<b>40,067</b>	<b>47,318</b>
% Change (YoY)	13.1	7.3	17.4	5.4	16.3	22.8	17.3	16.2	10.5	18.1
Other Income	4,498	6,005	2,480	3,774	2,528	3,123	2,445	3,254	16,757	11,351
<b>Net Income</b>	<b>13,854</b>	<b>15,701</b>	<b>12,775</b>	<b>14,494</b>	<b>13,411</b>	<b>15,031</b>	<b>14,519</b>	<b>15,707</b>	<b>56,824</b>	<b>58,669</b>
% Change (YoY)	24.8	-6.0	-2.1	3.0	-3.2	-4.3	13.7	8.4	3.5	3.2
Operating Expenses	6,705	7,352	8,468	8,366	6,966	8,195	9,036	8,615	29,752	32,811
<b>Operating Profit</b>	<b>7,150</b>	<b>8,349</b>	<b>4,308</b>	<b>6,128</b>	<b>6,445</b>	<b>6,836</b>	<b>5,484</b>	<b>7,092</b>	<b>27,072</b>	<b>25,857</b>
Provision & Contingencies	2,424	2,890	186	1,379	1,162	94	1,032	1,462	8,016	3,750
<b>PBT</b>	<b>4,726</b>	<b>5,459</b>	<b>4,121</b>	<b>4,750</b>	<b>5,283</b>	<b>6,742</b>	<b>4,451</b>	<b>5,630</b>	<b>19,056</b>	<b>22,107</b>
Tax Provisions	1,499	1,332	979	1,145	1,701	2,522	747	999	4,955	5,969
<b>Net Profit</b>	<b>3,227</b>	<b>4,127</b>	<b>3,143</b>	<b>3,605</b>	<b>3,582</b>	<b>4,220</b>	<b>3,704</b>	<b>4,631</b>	<b>14,101</b>	<b>16,138</b>
% Change (YoY)	28.2	37.7	21.0	21.2	11.0	2.3	17.9	28.5	27.2	14.4
Cost to Income Ratio (%)	48.4	46.8	66.3	57.7	51.9	54.5	62.2	54.8	52.4	55.9
Int exp/ Int Earned (%)	54.2	53.8	51.7	50.9	52.5	49.8	50.8	50.3	52.6	50.8
Other Income / Net Income (%)	32.5	38.2	19.4	26.0	18.9	20.8	16.8	20.7	29.5	19.3

E: MOST Estimates; Numbers have been re-stated by the management for 3QFY05 and hence quarterly numbers will not match will full year nu

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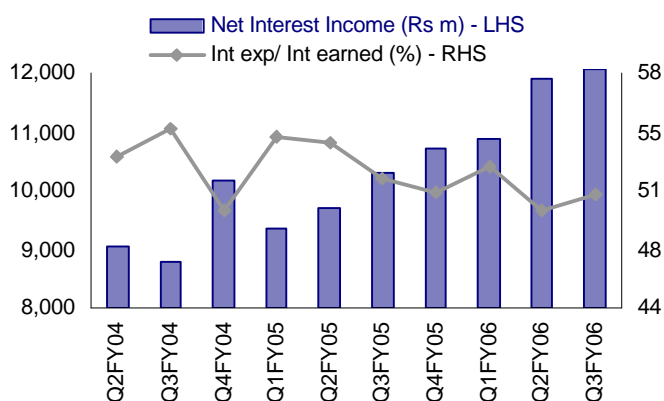
### Steady business growth; advances up 31% YoY

PNB's deposits grew by 10% YoY to Rs1057b in 3QFY06 while its loan book grew by 31% to Rs672b. As the bank has shed some high cost deposits, the proportion of low cost deposits has increased to 48.5%, resulting in a decline in its cost of funds. With interest rates hardening, PNB would have a significant advantage – almost 48% of its deposits are at fixed rates. Cost of deposits has fallen from 4.39% in 3QFY05 to 4.35% in 3QFY06.

Retail loans have grown 36% YoY and constitute 21% of total loans. Loans to agriculture grew by 26% YoY and constitute 19% of total loans. The SSI sector, which constitutes 11.7%, grew by 27% YoY. All these three segments, which collectively account for >50% of the loan book, have yields of >9%. As a result, loan yields have increased from 8.1% in FY05 to 8.38% in 9MFY06. As of 3QFY06, the loan yields were at 8.43% (as against 8.22% for 3QFY05).

Net interest income (NII) increased by 17% in 3QFY06, in line with our expectations. NIMs have improved from 3.9% in 9MFY05 to 4.02% in 9MFY06 (1HFY06 margins at 4%).

INCREASING NII



Source: Company/Motilal Oswal Securities

### Other income flat

The total other income has remained steady at Rs2.4b in 3QFY06 as against Rs2.5b in 3QFY05. Net treasury gains have declined from Rs1.1b in 3QFY05 to Rs850m in 3QFY06. Other income excluding bond gains has increased by 18% YoY in 3QFY06. Going forward, fee income should pick up, in line with the balance sheet growth. Superior technology platform along with a strong focus on retail products should enable PNB to benefit significantly from the increasing opportunities in the fee income business.

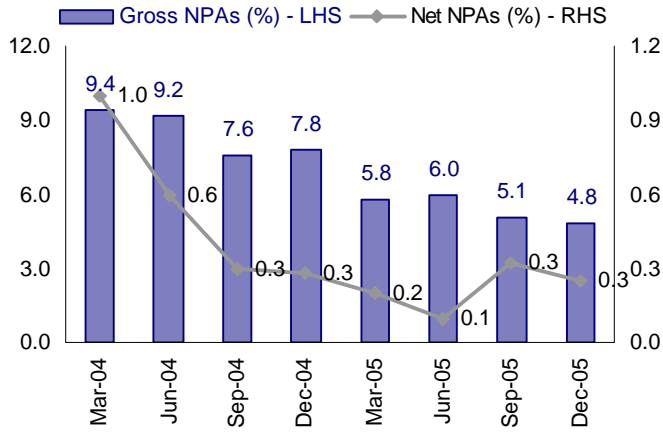
### Operating expenses grow sharply

Operating expenses have increased sharply during the quarter. This is on account of higher employee expenses post the wage settlement, as the bank started reporting higher wages from 2QFY06. The management mentioned that it has provided for an additional ~Rs1b as pension provisions. PNB has also restated the past figures classifying the wage arrear provision as a part of wage costs. Other operating expenses (apart from employee expenses) have increased by 20%, as the bank is aggressively implementing CBS (operational in 1,753 branches, 69% of its network), opening new ATMs and higher deposit insurance premium.

### Net NPAs at 0.25%, gross NPAs decline to Rs33b

One of the key features of PNB's earnings has been its asset quality. Gross NPAs have continued to decline QoQ from Rs33.6b to Rs33.2b, as PNB is recovering more than its slippages. Net NPAs have reduced QoQ from 0.3% to 0.25%. During 9MFY06, PNB has recovered (cash recovery, upgradations and write-offs) Rs9.3b, while incremental slippages have been only Rs5.1b. With a coverage ratio of 95%, we expect PNB to be a significant beneficiary of the recovery cycle. PNB has enough floating provisions on its books (Rs9.8b) as against its actual net NPAs being at just 1.6b, resulting in lower provisioning and possible write-back in future.

IMPROVING ASSET QUALITY



Source: Company/Motilal Oswal Securities

**Maintain Buy with a target price of Rs560**

While core earnings growth is likely to be steady, we believe that steady operating expenses and lower provisioning (possibly write-backs) will impact earnings positively going forward (as net NPAs are just 0.25%). PNB could also emerge as one of the gainers of the higher interest rate regime, as nearly 48.5% of its deposits are low cost deposits. Further, the bank has networked 1,753 branches under the core banking solution, covering 69% of the total business (largest network of connected branches in India). We expect earnings to grow by 14.4% in FY06 and by 18.9% in FY07. The stock trades at a P/E of 7.5x and at P/BV of 1.3x FY07E. We maintain **Buy**.

## Punjab National Bank: an investment profile

### Company description

Punjab National Bank (PNB) is the second largest state-owned bank with a very strong presence in North and Central India. Established in 1894, it has a balance sheet size of Rs1,263b and a network of 4,512 branches. The bank has been one of the most consistent performers on loan growth and earnings momentum has been strong for last few years. It is the most technologically advanced public sector bank with government owning 57.8% of its equity.

### Key investment arguments

- ✍ Loan growth of 25-30%, earnings growth of 14%
- ✍ Net NPAs of 0.3%, gross NPAs on a decline
- ✍ Transfer of bonds to HTM will protect from interest rate volatility
- ✍ Has networked 1500 branches under core banking solution

### Key investment risks

- ✍ Huge workforce resulting in higher wage bill
- ✍ In the past, has been involved in bailouts. Any such event in future will impact valuations

#### COMPARATIVE VALUATIONS

		PNB	SBI	BOB
P/E (x)	FY06E	8.9	10.0	22.3
	FY07E	7.5	8.6	17.8
P/ABV (x)	FY06E	1.6	1.8	2.6
	FY07E	1.3	1.5	2.3
RoE (%)	FY06E	18.2	17.8	14.1
	FY07E	18.5	17.9	13.2
RoA (%)	FY06E	1.2	1.0	1.2
	FY07E	1.3	1.0	1.1

#### SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	57.8	57.8	80.0
Domestic Institutions	11.7	10.6	1.8
FIIs/FDIs	20.1	20.1	14.2
Others	10.4	11.5	4.0

### Recent developments

- ✍ PNB has transferred Rs99b of bonds from AFS to HTM category in FY05
- ✍ Has raised Rs19.5b in March 05, by issuing 50m shares at Rs390 per share
- ✍ Mr. S.C. Gupta has been appointed as Chairman and Managing Director

### Valuation and view

- ✍ We expect a loan growth of 30% and earning growth of 14% in FY06.
- ✍ Improvement in core RoE, significant clean up in balance sheet and superior technology platform will drive the re-rating.
- ✍ The stock trades at 7.5x FY07E earnings and 1.3x FY07E BV. PNB continues to be amongst our top picks in the sector. We re-iterate **Buy**.

### Sector view

- ✍ Loan growth of 30% at the beginning of the capex cycle.
- ✍ Volatility in interest rates would impact treasury.
- ✍ Benefits of significant improvement in asset quality not yet factored in earnings, valuations.
- ✍ We maintain an overweight stance on the sector

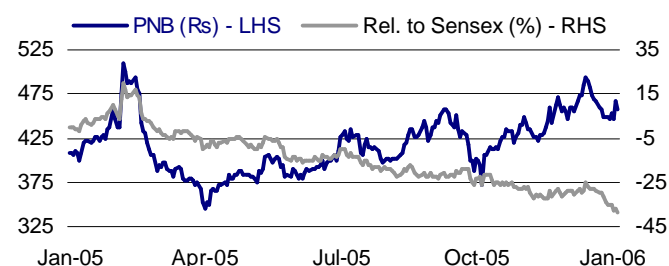
#### EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	51.2	50.4	1.6
FY07	60.8	56.8	7.0

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
457	560	22.5	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Interest Income	77,797	84,599	96,216	110,860	127,226
Interest Expended	41,550	44,531	48,898	55,864	63,462
<b>Net Interest Income</b>	<b>36,247</b>	<b>40,067</b>	<b>47,318</b>	<b>54,995</b>	<b>63,764</b>
Change (%)	16.0	10.5	16.1	16.2	15.9
Other Income	18,669	16,757	11,351	12,938	14,449
Bond Gains	11,186	3,528	1,250	1,500	1,500
<b>Net Income</b>	<b>54,916</b>	<b>56,824</b>	<b>58,669</b>	<b>67,933</b>	<b>78,214</b>
Change (%)	25.6	3.5	3.2	15.8	15.1
Operating Expenses	23,707	29,752	32,811	33,593	36,904
<b>Operating Income</b>	<b>31,209</b>	<b>27,072</b>	<b>25,857</b>	<b>34,341</b>	<b>41,310</b>
Change (%)	34.7	-13.3	-4.5	32.8	20.3
Other Provisions	13,514	8,016	3,750	7,700	9,500
<b>PBT</b>	<b>17,695</b>	<b>19,056</b>	<b>22,107</b>	<b>26,641</b>	<b>31,810</b>
Tax	6,608	4,955	5,969	7,459	8,907
Tax Rate (%)	37.3	26.0	27.0	28.0	28.0
<b>PAT</b>	<b>11,087</b>	<b>14,101</b>	<b>16,138</b>	<b>19,181</b>	<b>22,903</b>
Change (%)	31.6	27.2	14.4	18.9	19.4
Proposed Dividend	1,197	1,977	2,207	2,522	2,680

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Capital	2,653	3,153	3,153	3,153	3,153
Reserves & Surplus	47,465	78,460	92,391	109,050	129,273
<b>Net Worth</b>	<b>50,118</b>	<b>81,613</b>	<b>95,544</b>	<b>112,203</b>	<b>132,426</b>
<b>Deposits</b>	<b>879,164</b>	<b>1,031,669</b>	<b>1,155,469</b>	<b>1,328,790</b>	<b>1,528,108</b>
Change (%)	16.0	17.3	12.0	15.0	15.0
Borrowings	12,891	27,183	17,500	18,000	18,000
Other Liabilities & Pro	81,145	121,948	128,948	143,948	158,948
<b>Total Liabilities</b>	<b>1,023,317</b>	<b>1,262,413</b>	<b>1,397,461</b>	<b>1,602,941</b>	<b>1,837,482</b>
Current Assets	88,204	110,890	13,677	11,502	15,799
Investments	421,255	506,728	547,267	591,048	650,153
Change (%)	23.8	20.3	8.0	8.0	10.0
Advances	472,247	604,128	785,366	942,439	1,112,078
Change (%)	17.4	27.9	30.0	20.0	18.0
Net Fixed Assets	8,998	9,652	11,152	12,952	14,452
Other Assets	32,612	31,015	40,000	45,000	45,000
<b>Total Assets</b>	<b>1,023,317</b>	<b>1,262,414</b>	<b>1,397,461</b>	<b>1,602,941</b>	<b>1,837,482</b>

ASSUMPTIONS					
(%)					
Deposit Growth	16.0	17.3	12.0	15.0	15.0
Advances Growth	17.4	27.9	30.0	20.0	18.0
Investments Growth	23.8	20.3	8.0	8.0	10.0
Average PLR	10.0	10.0	10.3	10.5	10.5
Chg. in Avg Dep. Rate	-0.5	-0.5	0.3	0.3	0.3
Dividend	40.0	60.0	70.0	80.0	85.0
CRR	4.5	5.0	5.0	5.0	5.0

E: Most Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
<b>Spreads Analysis (%)</b>					
Avg. Yield - Earning A	8.7	7.7	7.3	7.2	7.2
Avg. Cost-Int. Bear. Li	5.0	4.6	4.4	4.4	4.4
Interest Spread	3.7	3.2	2.9	2.8	2.9
Net Interest Margin	4.0	3.7	3.6	3.6	3.6
<b>Profitability Ratios (%)</b>					
RoE	24.5	21.4	18.2	18.5	18.7
RoA	12	12	12	13	13
Int. Expended/Int. Earn	53.4	52.6	50.8	50.4	49.9
Other Inc./Net Income	34.0	29.5	19.3	19.0	18.5
<b>Efficiency Ratios (%)</b>					
Op. Exps./Net Income	43.2	52.4	55.9	49.4	47.2
Empl. Cost/Op. Exps.	69.8	71.3	712	68.0	66.5
Busi. per Empl. (Rs m)	213	25.6	30.7	36.8	43.6
NP per Empl. (Rs lac)	19	2.4	2.8	3.3	4.1

Asset-Liability Profile (%)					
Adv./Deposit Ratio	53.7	58.6	68.0	70.9	72.8
Invest./Deposit Ratio	47.9	49.1	47.4	44.5	42.5
G-Sec/Invest. Ratio	84.1	85.7	88.8	92.1	93.8
Gross NPAs to Adv.	9.1	5.8	4.5	3.8	3.3
Net NPAs to Adv.	10	0.2	0.1	0.1	0.2
CAR	13.1	14.8	14.8	14.4	13.0
Tier 1	7.0	8.9	9.2	9.1	8.0

VALUATION					
Book Value (Rs)	175	249	293	346	410
Price-BV (x)	2.6	1.8	1.6	1.3	1.1
Adjusted BV (Rs)	164	246	292	343	407
Price-ABV (x)	2.8	1.9	1.6	1.3	1.1
EPS (Rs)	418	44.7	512	60.8	72.6
EPS Growth (%)	316	7.0	14.4	18.9	19.4
Price-Earnings (x)	10.9	10.2	8.9	7.5	6.3
OPS (Rs)	117.6	85.9	82.0	108.9	131.0
OPS Growth (%)	34.7	-27.0	-4.5	32.8	20.3
Price-OP (x)	3.9	5.3	5.6	4.2	3.5

E: Most Estimates



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**Punjab National Bank**

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| 3. Broking relationship with company covered | No |

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