

Equity | India | Banks-Retail
03 November 2008

Good 2Q; Maintain Buy

2QFY09 earnings ahead of MLe on strong core performance

PNB's 2QFY09 earnings came in at Rs7.1bn (31% yoy growth; 16% above MLe) owing to much stronger topline and other income. Topline growth came in at 33% yoy driven by 29% loan growth and 37bps yoy (50bps qoq) improvement in margins. However, concern is decline in CASA ratio by 500bps yoy (+200bps qoq) to 39% and rise in bulk deposits (+25% of total). Core fees (CEB) grew by 17% yoy, while other income, ex treasury grew by +75% yoy driven by recoveries.

Opex higher; Asset quality improvement continues

Opex grew by 11% yoy (6% higher than MLe) as the bank provided Rs1bn towards impending wage revisions (v/s. Rs250mn in 1QFY09). Asset quality concerns have reduced significantly with gross NPAs declining by 4% qoq to 2.4%. Net NPAs too decreased 24% qoq (at 0.4%). Stringent recovery efforts and controlled fresh delinquencies (2% in H1FY09; 2% in FY08; 2.8% in FY07) have led to significant improvement in asset quality. NPL coverage improved to 83%.

Raise earnings by 4-7%; Maintain PO and Buy

We have raised our earnings forecast by 4-7% for FY09-10 to factor in strong non-int. income. We estimate earnings CAGR of +19% over FY08-10 driven by topline and controlled costs. We are building in +90% rise in credit cost over FY08-10 and NPL accretion by +60% over same period. We believe the stock could trade at 1.3x FY10E book, given earnings CAGR of +19% over FY08-10; RoE of 18-19%; and comfortable asset quality, Maintain Buy and PO of Rs600.

Estimates (Mar)

(Rs)	2007A	2008A	2009E	2010E	2011E
Net Income (Adjusted - mn)	15,401	20,488	24,751	28,788	33,814
EPS	48.84	64.98	78.50	91.30	107.24
EPS Change (YoY)	7.0%	33.0%	20.8%	16.3%	17.5%
Dividend / Share	13.00	13.00	14.00	15.00	16.00
Pre-exceptional EPS	48.82	64.94	78.50	91.30	107.24
Pre-exceptional EPS Change (YoY)	-8.6%	33.0%	20.9%	16.3%	17.5%
Book Value / Share	330.97	390.68	453.43	527.86	617.10

Valuation (Mar)

	2007A	2008A	2009E	2010E	2011E
P/E	9.3x	7.0x	5.8x	5.0x	4.2x
Dividend Yield	2.87%	2.87%	3.09%	3.31%	3.54%
Pre-exceptional PE	9.27x	6.97x	5.77x	4.96x	4.22x
Price / Book	1.37x	1.16x	0.998x	0.857x	0.733x
RoE / PB	11.37x	15.54x	18.63x	21.70x	25.54x
Price / Pre-Provision Profit	4.42x	3.56x	3.04x	2.61x	2.21x



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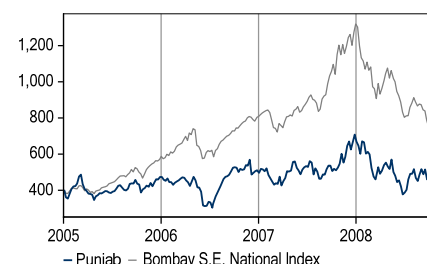
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Stock Data

Price	Rs452.60
Price Objective	Rs600.00
Date Established	31-Jul-2008
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs330.10-Rs721.00
Mrkt Val / Shares Out (mn)	US\$2,886 / 315.3
Average Daily Volume	1,186,787
ML Symbol / Exchange	PUJBF / BSE
Bloomberg / Reuters	PNB IN / PNBK.BO
ROE (2009E)	18.6%
Total Dbt to Cap (Mar-2006A)	NA
Est. 5-Yr EPS / DPS Growth	20.0% / 12.0%
Free Float	20.0%



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Refer to important disclosures on page 6 to 7. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4.

iQprofileSM Punjab National Bank

Key Income Statement Data (Mar)	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Net Interest Income	52,132	55,342	66,082	75,650	86,777
Net Fee Income	9,700	11,062	13,054	15,403	18,176
Securities Gains / (Losses)	(138.91)	4,419	1,600	1,000	800.00
Other Income	3,875	4,494	5,957	6,853	7,883
Total Non-Interest Income	13,436	19,976	20,611	23,256	26,858
Total Operating Income	65,569	75,317	86,693	98,905	113,635
Operating Expenses	(33,262)	(35,255)	(39,729)	(44,138)	(49,037)
Pre-Provision Profit	32,306	40,062	46,964	54,768	64,598
Provisions Expense	(7,518)	(5,160)	(7,482)	(10,101)	(12,929)
Operating Profit	28,025	32,426	40,422	45,367	52,069
Non-Operating Income	(3,098)	(1,943)	(2,540)	(1,700)	(1,200)
Pre-Tax Income	21,691	32,959	36,942	42,967	50,469
Net Income to Comm S/Hold.	15,401	20,488	24,751	28,788	33,814
Adjusted Net Income (Operating)	15,401	20,488	24,751	28,788	33,814

Key Balance Sheet Data

Total Assets	1,624,225	1,990,204	2,318,458	2,638,270	3,018,643
Average Interest Earning Assets	1,057,436	1,252,872	1,512,035	1,767,719	2,048,100
Weighted Risk Assets	1,086,101	1,334,810	1,600,595	1,853,392	2,148,557
Total Gross Customer Loans	999,904	1,220,671	1,479,628	1,721,807	2,005,515
Total Customer Deposits	1,398,597	1,664,572	1,944,905	2,208,860	2,523,754
Tier 1 Capital	104,355	123,183	142,969	166,436	194,574
Tangible Equity	104,355	123,183	142,969	166,436	194,574
Common Shareholders' Equity	104,355	123,183	142,969	166,436	194,574

Key Metrics

Net Interest Margin	4.93%	4.42%	4.37%	4.28%	4.24%
Tier 1 Ratio	9.6%	9.2%	8.9%	9.0%	9.1%
Effective Tax Rate	29.0%	37.8%	33.0%	33.0%	33.0%
Loan / Assets Ratio	61.6%	61.3%	63.8%	65.3%	66.4%
Loan / Deposit Ratio	71.5%	73.3%	76.1%	78.0%	79.5%
Oper Leverage (Inc Growth - Cost Growth)	1.1%	8.9%	2.4%	3.0%	3.8%
Gearing (Assets / Equity)	15.6x	16.2x	16.2x	15.9x	15.5x
Tangible Common Equity / Assets	6.4%	6.2%	6.2%	6.3%	6.4%
Tangible Common Equity / WRAs	9.6%	9.2%	8.9%	9.0%	9.1%
Revenue Growth	11.2%	14.9%	15.1%	14.1%	14.9%
Operating Expense Growth	10.0%	6.0%	12.7%	11.1%	11.1%
Provisions Expense Growth	-934.6%	-31.4%	45.0%	35.0%	28.0%
Operating Revenue / Average Assets	4.3%	4.2%	4.0%	4.0%	4.0%
Operating Expenses / Average Assets	2.2%	2.0%	1.8%	1.8%	1.7%
Pre-Provision ROA	2.1%	2.2%	2.2%	2.2%	2.3%
ROA	1.0%	1.1%	1.1%	1.2%	1.2%
Pre-Provision ROE	32.6%	35.2%	35.3%	NA	NA
ROE	15.5%	18.0%	18.6%	18.6%	18.7%
RoTE	14.8%	16.6%	17.3%	17.3%	17.4%
RoWRAs	1.4%	1.5%	1.5%	1.6%	1.6%
Dividend Payout Ratio	30.7%	22.5%	20.1%	18.5%	16.8%
Efficiency Ratio (Cost / Income Ratio)	50.6%	49.7%	46.7%	45.1%	43.5%
Total Non-Interest Inc / Operating Inc	20%	27%	24%	24%	24%
Market-Related Revenue / Total Revenues	2.5%	8.7%	4.8%	4.0%	3.7%
Provisioning Burden as % of PPP	23.3%	12.9%	15.9%	18.4%	20.0%
NPLs plus Foreclosed Real Estate / Loans	4.1%	2.7%	2.6%	2.8%	3.3%
Loan Loss Reserves / NPLs	82.0%	77.3%	67.6%	48.7%	32.5%
Loan Loss Reserves / Total Loans	3.5%	2.1%	1.8%	1.4%	1.1%
Provisions Expense / Average Loans	0.8%	0.5%	0.6%	0.6%	0.7%

Other Metrics

Income / Employee	1.16	1.35	1.57	1.80	2.09
(Operating Expenses) / Employee	0.589	0.630	0.717	0.805	0.903
Pre-Provision Profit / Employee	0.572	0.716	0.848	0.999	1.19
Net Profit / Employee	0.273	0.366	0.447	0.525	0.623

Company Description

Punjab National Bank (PNB), established in 1894, is the second largest state-owned bank based in north India with a balance sheet size of over Rs1.25trn. Over the past three years, PNB has been one of the fastest growing state-owned banks, and has displayed a marked improvement in asset quality. It is also the leader among all state-owned banks in terms of technology implementation. Rising bond yields remains a key challenge.

Investment Thesis

Strong liability franchise – CASA make up about 43 percent of total deposits resulting in a low cost of deposits. Strong presence in North India, which has strong deposits base should see strong earnings growth. Big beneficiary of agriculture uptick. Increasing NPLs and declining coverage ratio is a big concern.

Stock Data

Price to Book Value 1.0x

2QFY09 Result Snapshot

Table 1: 2QFY09 Result Summary

(Rs mn)	2QFY08	2QFY09	yoy grth	Remarks
Interest earned	34,631	46,504	34.3%	
- on Advances / Bills	25,126	35,314	40.5%	Loan growth at 29% yoy
- Income on investments	8,983	10,284	14.5%	
- on bal with RBI	320	681	112.5%	
- Others	201	225	11.8%	
Interest Expended	21,716	29,382	35.3%	CASA down 200bps qoq and 500bps yoy, putting pressure on int. costs
Net Interest Income	12,915	17,123	32.6%	NII 12% above estimates driven by 30bps yoy (50bps qoq) margin expansion
Other income	4,678	6,628	41.7%	Core fee income growth of 17% yoy; Strong recoveries driven other income
Operating income	17,593	23,750	35.0%	Provided Rs1bn towards impending wage revisions v/s. Rs250mn in 1QFY09
Employee expenses	6,418	6,898	7.5%	
Other Operating expenses	2,625	3,174	20.9%	
Total Operating expenses	9,043	10,072	11.4%	
Operating profit	8,550	13,679	60.0%	Driven by strong topline and other income
Provisions and contingencies	779	3,177	308.1%	Provision expense 100% above expectation. Asset quality improved with gross NPL decreasing by 4% qoq in absolute term and net NPL decreased by 24% qoq. Cover at 83%, slippages maintained at 2%
PBT	7,771	10,501	35.1%	
Provision for Tax	2,386	3,430	43.7%	
PAT	5,385	7,071	31.3%	Earnings 16% higher than MLE on strong topline and other income

Source: Merrill Lynch Research

Price objective basis & risk

Punjab (PUJBF)

Our PO of Rs600 captures the +19-20% CAGR earnings growth over FY08-10 driven by topline and fees, controlled opex and higher NPL provisions- insync with our macro call for an up tick in NPL cycle. We believe the stock could trade at 1.3x FY10E book, given earnings CAGR of +19% over FY08-10, RoE of 18-19%, and comfortable asset quality, underpinning our PO of Rs600. On a PE basis we believe the bank can continue to trade at least at 6.6-6.8x FY10E earnings, as banks' net NPL's shrink. Sharp rise in rates/NPLs and inability to manage growth are risks. Also, inability to maintain margins in the event of rate cut mismatch remains a risk to our PO.

Analyst Certification

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Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY	Axis Bank	UTBKF	AXSB IN	Rajeev Varma
	Axis Bank - GDR	UTIBY	AXB LI	Rajeev Varma
	Bank of India	XDIIF	BOI IN	Rajeev Varma
	Corporation Bank	XCRRF	CRPBK IN	Veekesh Gandhi
	HDFC	HGDFE	HDFC IN	Rajeev Varma
	HDFC Bank	HDB	HDB US	Rajeev Varma
	HDFC Bank	XHDFE	HDFCB IN	Rajeev Varma
	ICICI Bank	ICIJF	ICICIB IN	Rajeev Varma
	ICICI Bank - A	IBN	IBN US	Rajeev Varma
	IndiaBulls Finan	IBLFF	IBULL IN	Rajeev Varma

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India - Financials Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
	Indian Bank	INDIF	INBK IN	Rajeev Varma
	Max India	XMIF	MAX IN	Rajeev Varma
	Punjab	PUJBF	PNB IN	Rajeev Varma
	Reliance Capital	RLCCF	RCFT IN	Rajeev Varma
	SBI	SBINF	SBIN IN	Rajeev Varma
	SBI -G	SBKFF	SBID LI	Rajeev Varma
	Union Bank India	UBOIF	UNBK IN	Rajeev Varma
	Yes Bank Ltd	YESBF	YES IN	Veekesh Gandhi
NEUTRAL				
	Bank of Baroda	BKBAF	BOB IN	Rajeev Varma
	Infrastruct Dev	IFDFF	IDFC IN	Rajeev Varma
UNDERPERFORM				
	Canara Bank	CNRKF	CBK IN	Rajeev Varma
	Federal Bank	XFDRF	FB IN	Veekesh Gandhi
	IDBI	XDBIF	IDBI IN	Veekesh Gandhi
	ORBC	ORBCF	OBC IN	Rajeev Varma
	Vijaya Bank	VJYAF	VJYBK IN	Rajeev Varma

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

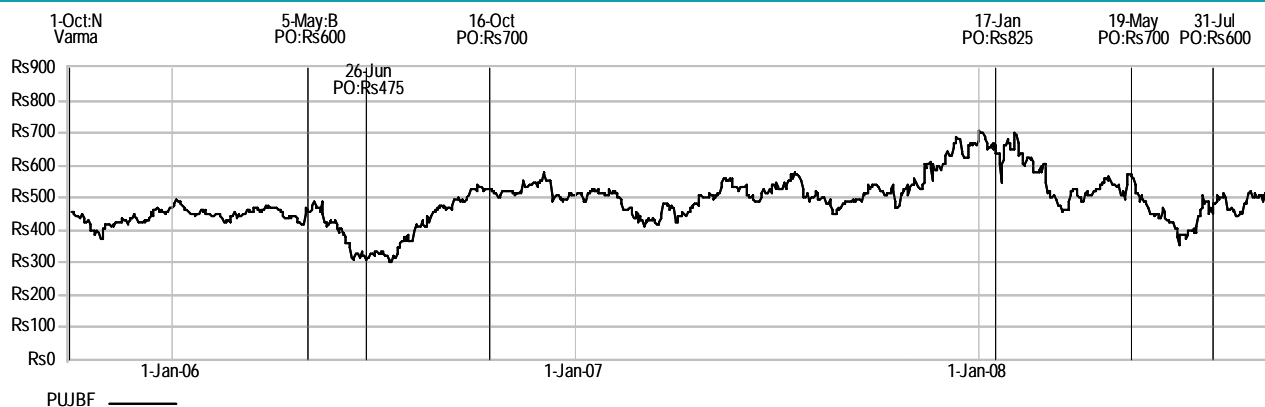
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Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of September 30, 2008 or such later date as indicated.

Investment Rating Distribution: Banks Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	99	33.33%	Buy	45	55.56%
Neutral	76	25.59%	Neutral	33	47.83%
Sell	122	41.08%	Sell	54	51.92%

Investment Rating Distribution: Global Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1647	45.31%	Buy	429	28.83%
Neutral	858	23.60%	Neutral	240	31.41%
Sell	1130	31.09%	Sell	227	22.02%

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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