

## Company

31 July 2009 | 8 pages

# Punjab National Bank (PNBK.BO)

 Equity 

## 1Q10 Result – Profits Don't Hide Pain

- Profits look great – Asset quality does not** — The quarter has its hits, but the misses are big. A 62% profit growth (27% est. – trading gain boost) is simply not enough to cover the balance-sheet crack that chunky restructured assets (unexpected and far worse than peers) have opened up. Management's relatively inconsistent disclosure and defense does not help either. While the restructured assets wound might not necessarily be deep, it will hurt.
- The P&L is quite good** — PNB has done a lot of things right in this quarter – margins have held up well and are now even higher than industry averages, fee growth has been robust (45%+), PNB continues to build on its operating/technology platform, and asset and liability pricing is robust. Bottom line, PNB has been disciplined and effective on the P&L front.
- But balance-sheet bravado appears to have caught up** — Fortune doesn't always favor the brave – PNB stood tall as a liquid and aggressive lender in the credit crunch (Nov-Dec 2008); this has possibly contributed to a doubling of restructured assets (6% of loans) in the current quarter (not flagged in March 09). This is well ahead of peers, is stark for a bank that had made strong asset quality gains in the recent past, and inconsistency in its disclosure is disappointing. This does not necessarily mean long-term pain or even near-term P&L pressures, but raises questions on quality and credibility.
- Maintain Buy, though near term stock performance will likely be muted** — We expect the stock to face near term pressures, but with a strong P&L, good franchise & a still fairly robust Balance-sheet, a reversal to its premium valuations clearly remains a possibility. New Mgmt (currently head-less, CEO expected soon), better disclosure & progress on fixing asset quality pressures, could be catalysts for a reversal to premium valuations.

<b>Buy/Medium Risk</b>	<b>1M</b>
Price (30 Jul 09)	Rs704.80
Target price	Rs780.00
Expected share price return	10.7%
Expected dividend yield	2.8%
<b>Expected total return</b>	<b>13.5%</b>
Market Cap	Rs222,225M
	US\$4,603M

### Price Performance (RIC: PNBK.BO, BB: PNB IN)



### Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2008A	20,488	64.98	33.0	10.8	1.8	18.0	1.8
2009A	30,909	98.03	50.9	7.2	1.5	22.9	2.8
2010E	34,185	108.42	10.6	6.5	1.3	21.3	2.8
2011E	39,293	124.62	14.9	5.7	1.1	20.7	3.0
2012E	48,479	153.75	23.4	4.6	0.9	21.5	3.1

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
<b>Valuation Ratios</b>					
P/E adjusted (x)	10.8	7.2	6.5	5.7	4.6
P/E reported (x)	10.8	7.2	6.5	5.7	4.6
P/BV (x)	1.8	1.5	1.3	1.1	0.9
P/Adjusted BV diluted (x)	2.1	1.7	1.4	1.2	1.0
Dividend yield (%)	1.8	2.8	2.8	3.0	3.1
<b>Per Share Data (Rs)</b>					
EPS adjusted	64.98	98.03	108.42	124.62	153.75
EPS reported	64.98	98.03	108.42	124.62	153.75
BVPS	390.68	465.41	550.53	650.69	778.81
Tangible BVPS	390.68	465.41	550.53	650.69	778.81
Adjusted BVPS diluted	341.98	416.71	501.83	601.98	730.11
DPS	13.00	20.00	20.00	21.00	22.00
<b>Profit &amp; Loss (RsM)</b>					
Net interest income	55,342	70,309	82,328	96,367	113,901
Fees and commissions	11,062	13,766	16,244	18,518	20,740
Other operating Income	8,913	16,431	12,222	13,592	15,047
<b>Total operating income</b>	<b>75,317</b>	<b>100,506</b>	<b>110,793</b>	<b>128,477</b>	<b>149,688</b>
Total operating expenses	-35,255	-42,062	-47,364	-52,554	-58,312
<b>Oper. profit bef. provisions</b>	<b>40,062</b>	<b>58,444</b>	<b>63,429</b>	<b>75,923</b>	<b>91,376</b>
Bad debt provisions	-5,156	-9,620	-13,343	-18,540	-20,870
Non-operating/exceptionals	-1,947	-1,154	-1,250	-1,250	-1,250
<b>Pre-tax profit</b>	<b>32,959</b>	<b>47,669</b>	<b>48,836</b>	<b>56,133</b>	<b>69,256</b>
Tax	-12,472	-16,760	-14,651	-16,840	-20,777
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
<b>Attributable profit</b>	<b>20,488</b>	<b>30,909</b>	<b>34,185</b>	<b>39,293</b>	<b>48,479</b>
Adjusted earnings	20,488	30,909	34,185	39,293	48,479
<b>Growth Rates (%)</b>					
EPS adjusted	33.0	50.9	10.6	14.9	23.4
Oper. profit bef. prov.	13.4	45.9	8.5	19.7	20.4
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>1,990,204</b>	<b>2,467,696</b>	<b>2,878,821</b>	<b>3,376,009</b>	<b>3,969,642</b>
Avg interest earning assets	1,774,641	2,183,938	2,625,933	3,084,971	3,635,951
Customer loans	1,226,422	1,578,616	1,883,731	2,275,102	2,710,288
Gross NPLs	33,193	27,674	45,885	72,621	92,148
<b>Liab. &amp; shar. funds</b>	<b>1,990,204</b>	<b>2,467,696</b>	<b>2,878,821</b>	<b>3,376,009</b>	<b>3,969,642</b>
Total customer deposits	1,664,572	2,097,600	2,472,317	2,927,290	3,468,749
Reserve for loan losses	31,407	31,586	42,161	56,113	69,721
Shareholders' equity	<b>123,183</b>	<b>146,746</b>	<b>173,585</b>	<b>205,164</b>	<b>245,562</b>
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	18.0	22.9	21.3	20.7	21.5
Net interest margin	3.12	3.22	3.14	3.12	3.13
Cost/income ratio	46.8	41.9	42.8	40.9	39.0
Cash cost/average assets	2.0	1.9	1.8	1.7	1.6
NPLs/customer loans	2.7	1.8	2.4	3.2	3.4
Reserve for loan losses/NPLs	94.6	114.1	91.9	77.3	75.7
Bad debt prov./avg. cust. loans	0.5	0.7	0.8	0.9	0.8
Loans/deposit ratio	73.7	75.3	76.2	77.7	78.1
Tier 1 capital ratio	8.5	9.0	9.1	9.1	9.3
Total capital ratio	13.0	14.0	13.6	13.2	13.1

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Figure 1. PNBK: 1Q10 Highlights (Rupees Million, Percent)

	1Q10	1Q09	YoY %	4Q09	QoQ%	CIRA Comments
Interest Income	52,074	41,385	25.8	52,426	-0.7	
Interest Expense	-33,456	(26,937)	24.2	(33,360)	0.3	
Net Interest Income	18,618	14,448	28.9	19,065	-2.3	Strong show - slight dip in QoQ margins, but distinctly better than peers, and commendable given high margin levels
Fee-Based Income	6,153	4,432	38.8	6,172	-0.3	Strong show - an area in which PNB is increasing consistency
Other Non-Interest Income	3,549	129	2650.9	2,384	48.9	Primarily trading gains, which is the key driver of strong profit expansion
Non Interest Income	9,702	4,561	112.7	8,556	13.4	
<b>Operating Income</b>	<b>28,320</b>	<b>19,009</b>	<b>49.0</b>	<b>27,621</b>	<b>2.5</b>	
Operating Expenses	(12,626)	(9,185)	37.5	(11,740)	7.6	Significant increase, and relatively surprising
Pre-Provision Profit	15,693	9,824	59.7	15,882	-1.2	
Charges for Bad Debts	(3,018)	(595)	407.0	(4,686)	-35.6	In Sync with restructuring pain, though partly offset by portfolio write-backs
Other Operating Items	0	(1,510)	NM	2,008	NM	
Pre-Tax Profit	12,676	7,719	64.2	13,203	-4.0	
Tax	(4,355)	(2,595)	67.8	(4,548)	-4.2	
<b>Net Profit</b>	<b>8,321</b>	<b>5,124</b>	<b>62.4</b>	<b>8,656</b>	<b>-3.9</b>	<b>Well ahead of our 28% expectations</b>
EPS	26.4	16.3	62.4	27.5	-3.9	
DPS	0.0	0.0	NM	20	NM	
Customer Loans	1,579,794	1,144,300	38.1	1,547,030	2.1	Continues to grow - after a spurt in the second of the more challenging year that was 2009
Customer Deposits	2,189,597	1,730,740	26.5	2,097,600	4.4	Has also been aggressive with deposit pricing
AIEA	2,206,831	1,763,855	25.1	2,167,673	1.8	
Total Assets	2,459,397	2,064,580	19.1	2,469,190	-0.4	
Avg Assets	2,464,293	2,035,071	21.1	2,392,427	3.0	
Non-Performing Loans (NPL)	28,647	32,647	-12.3	27,675	3.5	Remain well in check - with deterioration largely offset by upgrades - standalone, is quite an impressive number
Restructured Loans	94,000			44,000	113.6	A big disappointment - well ahead of guidance, significantly weaker than peers, and very poorly disclosed by management
Loan Loss Reserves (LLR)	(25,675)	(25,499)	0.7	(25,036)	2.6	
Shareholders' Funds	147,056	112,951	30.2	138,735	6.0	Comfortable with Capital, at over 14% cap adequacy
Book Value Per Share	466	358	30.2	440	6.0	
<b>Key Ratios (%)</b>	<b>1Q10</b>	<b>1Q09</b>	<b>Bps Δ YoY</b>	<b>4Q09</b>	<b>Bps Δ QoQ</b>	
ROAA (annualized)	1.35	1.01	34	1.45	-10	
ROAE (annualized)	22.63	18.15	449	24.96	-232	High on profitability - though trading gain boosted
Net Interest Margin (bps)	337	328	10	352	-14	Remains among the highest in the sector, and well managed over the quarter
Fee Inc/Operating Income	21.7	23.3	-159	22.3	-62	Strong performance on core fee growth
Other Non-Interest Inc/Op Inc	34.3	24.0	1026	31.0	328	
Op. Cost/ Operating Income	44.6	48.3	-373	42.5	208	
Loan-to-Deposit Ratio (LDR)	72.1	66.1	603	73.8	-160	
NPL/Loan Ratio	1.8	2.9	-104	1.8	2	Headline NPL's and coverage amongst the best in the sector, though rapid escalation of restructured loans takes the sheen of asset quality
LLR/NPL Ratio	90	78	1,152	90	-84	
Restructured % of loans	6.0%			2.8%		Almost twice the level of peer banks

Source: Citi Investment Research and Analysis

## Punjab National Bank

### Company description

Punjab National Bank (PNB) was established in 1943 and nationalized in the first round of nationalization in 1969. The bank is headquartered in Delhi, and the government has a 57.8% stake. PNB is among the top five banks in the country, with a 5% share of deposits and advances of the banking system. PNB has the second-largest branch network in the country with 4,668 branches including 238 extension counters.

### Investment strategy

We rate PNB Buy/Medium Risk (1M). PNB is one of India's largest government-owned banks, with good profitability (ROEs of 18-19%) and relatively high net interest margins. We believe: a) PNB has been able to maintain its growth along with its higher than industry NIMs (350bps), and while we expect NIMs to drift downwards, they are likely to remain significantly above industry; b) PNB has shown significant growth in fee income, led by its strong technology platform and greater management focus; and c) PNB's asset quality has held up reasonably well despite its greater mid-market and agricultural focus. We expect the current environment to be relatively beneficial for PNB due to: a) Its larger deposit franchise; b) The low interest rate environment should support its NIMs; and c) Stabilising economic growth should ease pressures on its asset book.

### Valuation

Our target price for PNB is Rs780, based on CIRA's EVA model, which captures the long-term value of the business, and is a standard valuation measure for the CIRA India Banking coverage. Our target price assumes: a) risk-free rate of 6.5% (in line with our assumptions for other banks); b) high longer term loan loss provisions of 125bps (given asset risk environment currently), c) loan spreads of 200bps which is in-line with industry levels, and d) long-term fee income growth of 9%.

### Risks

We rate PNB Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key downside risks to our target price include: (1) Adverse changes in the interest rate or liquidity environment; (2) Sharp asset quality deterioration; (3) Significant reduction in its low cost deposit ratios, which will increase pressure on margins; and (4) Modest growth in fee incomes, increasing its dependence on volatile treasury gains.

# Appendix A-1

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### Punjab National Bank (PNBK.BO)

#### Ratings and Target Price History

#### Fundamental Research

Analyst: Aditya Narain, CFA

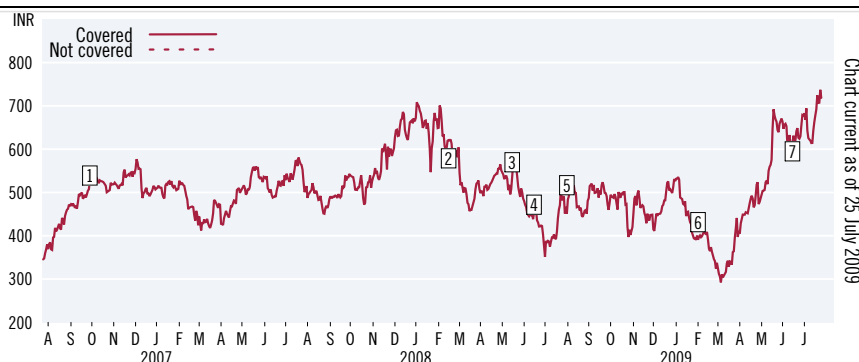


Chart current as of 25 July 2009

	Date	Rating	Target Price	Closing Price
1	28-Sep-06	1M	*608.00	527.05
2	15-Feb-08	1M	*775.00	621.00
3	15-May-08	1M	*685.00	537.05

	Date	Rating	Target Price	Closing Price
4	16-Jun-08	1M	*605.00	454.95
5	31-Jul-08	*3M	*455.00	451.25
6	1-Feb-09	3M	*420.00	400.35

	Date	Rating	Target Price	Closing Price
7	14-Jun-09	*1M	*780.00	594.95

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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