



## Punjab National Bank

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,091	PNB IN
	REUTERS CODE
S&P CNX: 4,083	PNBK.BO

31 January 2007

Buy

Previous Recommendation: Buy

Rs508

Equity Shares (m)	315.3
52-Week Range	585/300
1,6,12 Rel.Perf.(%)	-2/3/-33
M.Cap. (Rs b)	160.2
M.Cap. (US\$ b)	3.6

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)
3/06A	58,979	14,393	45.6	2.1	11.1	1.8	12.0	16.4	1.1	1.8
3/07E	63,607	17,045	54.1	18.4	9.4	1.5	10.3	16.9	1.1	1.6
3/08E	75,710	21,909	69.5	28.5	7.3	1.3	10.2	18.8	1.2	1.3

Punjab National Bank (PNB) reported earnings growth of 16% YoY for 3QFY07, driven by higher margins and business growth. NII grew 20% YoY, with improvement in margins. Business growth remained strong, with loans growing 30% YoY and deposits growing 23% YoY. Asset quality deteriorated, with NPAs at 0.45%.

- ⚡ Steady business growth – advances up 30% YoY, deposits up 23% YoY
- ⚡ Margins improve on back of rising yields and largely stable cost of deposits
- ⚡ Core fee income increases by 19% YoY
- ⚡ Net NPAs increase QoQ to 0.45%

We have upgraded our earnings estimate by 2% for FY08 on the back of better margins and lower provisioning, going forward. The stock trades at 7.3x FY08E EPS and 1.3x FY08E BV, with an expected RoE of 19% for FY08. Consistent growth in core earnings, along with reduced risk on bond portfolio could result in higher valuations for PNB. We maintain that PNB is the best bet amongst the larger state-owned banks. **Buy.**

### QUARTERLY PERFORMANCE

	(RS MILLION)									
	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Interest Income	22,899	23,705	24,548	24,689	26,405	27,643	29,483	30,440	95,841	113,971
Interest Expense	12,016	11,797	12,474	12,887	13,476	14,015	15,024	15,893	49,174	58,408
<b>Net Interest Income</b>	<b>10,883</b>	<b>11,908</b>	<b>12,074</b>	<b>11,802</b>	<b>12,929</b>	<b>13,628</b>	<b>14,459</b>	<b>14,547</b>	<b>46,667</b>	<b>55,563</b>
% Change (YoY)	16.3	22.8	17.3	10.1	18.8	14.4	19.7	23.3	16.5	19.1
Other Income	2,528	3,123	2,445	4,215	-1,055	2,840	3,231	3,027	12,312	8,044
<b>Net Income</b>	<b>13,411</b>	<b>15,031</b>	<b>14,519</b>	<b>16,017</b>	<b>11,874</b>	<b>16,468</b>	<b>17,689</b>	<b>17,575</b>	<b>58,978</b>	<b>63,607</b>
% Change (YoY)	-3.2	-4.3	13.7	10.5	-11.5	9.6	21.8	9.7	3.8	7.8
Operating Expenses	6,966	8,195	9,036	6,034	6,969	7,580	8,123	8,484	30,231	31,156
<b>Operating Profit</b>	<b>6,445</b>	<b>6,836</b>	<b>5,484</b>	<b>9,983</b>	<b>4,906</b>	<b>8,888</b>	<b>9,567</b>	<b>9,090</b>	<b>28,748</b>	<b>32,451</b>
Provision & Contingencies	1,162	94	1,032	6,111	-230	1,018	3,577	3,735	8,399	8,100
<b>PBT</b>	<b>5,283</b>	<b>6,742</b>	<b>4,451</b>	<b>3,871</b>	<b>5,135</b>	<b>7,870</b>	<b>5,990</b>	<b>5,356</b>	<b>20,348</b>	<b>24,351</b>
Tax Provisions	1,701	2,522	747	985	1,460	2,820	1,691	1,334	5,955	7,305
<b>Net Profit</b>	<b>3,582</b>	<b>4,220</b>	<b>3,704</b>	<b>2,887</b>	<b>3,675</b>	<b>5,050</b>	<b>4,299</b>	<b>4,022</b>	<b>14,394</b>	<b>17,045</b>
% Change (YoY)	11.0	2.3	17.9	-19.9	2.6	19.7	16.0	39.3	2.1	18.4
Cost to Income Ratio (%)	51.9	54.5	62.2	37.7	58.7	46.0	45.9	48.3	51.3	49.0
Int exp/ Int Earned (%)	52.5	49.8	50.8	52.2	51.0	50.7	51.0	52.2	51.3	51.2
Other Income / Net Income (%)	18.9	20.8	16.8	26.3	-8.9	17.2	18.3	17.2	20.9	12.6

E: MOST Estimates;

Punjab National Bank (PNB) reported earnings growth of 16% YoY for 3QFY07, driven by higher margins and business growth. NII grew 20% YoY, with improvement in margins. Business growth remained strong, with loans growing 30% YoY and deposits growing 23% YoY. Asset quality deteriorated, with NPAs at 0.45%.

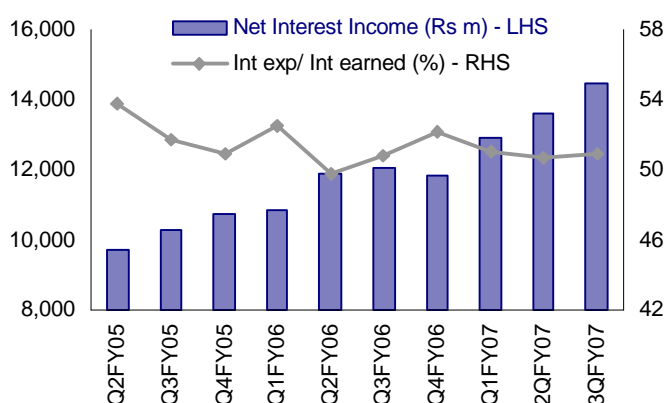
### Steady business growth – advances up 30% YoY, deposits up 23% YoY

PNB's deposits grew 23% YoY in 3QFY07 to Rs1.3t, while its loan book grew 30% YoY to Rs876b. The proportion of CASA deposits declined, as the bank built up the term deposit base during the quarter (28% YoY growth). CASA deposits declined to 47.3% as compared to 48.5% in 2QFY07.

Retail loans have grown 37% YoY and constitute 22% of total gross loans. Loans to agriculture grew 33% YoY and constitute 19.9% of net loans. Loans to the SSI sector grew 31% YoY.

Growing loan book coupled with largely contained deposit cost has resulted in NII growing by 20% YoY. We expect NII to increase by 19% in FY07 on the back of robust loan growth and stable margins.

#### INCREASING NII



Source: Company/ Motilal Oswal Securities

### Margins improve on back of rising yields and largely stable cost of deposits

NII grew 20% YoY (against expectation of 16% growth) in 3QFY07, with margins improving from 4.02% in 3QFY06

to 4.21% in 3QFY07. In fact, margins have increased by 5bp QoQ. Yield on advances increased by 73bp YoY to 9.1%, while cost of deposits increased by only 8bp YoY to 4.4%, as the proportion of CASA deposits remained at 47.3%.

#### INCREASING NIMS

NIMS BREAKDOWN (%)	9MFY06	FY06	1QFY07	1HFY07	9MFY07
Yield on Advances	8.4	8.3	8.8	9.0	9.1
Yield on Investments	8.1	8.2	7.9	7.8	7.8
Cost of Deposits	4.3	4.3	4.4	4.4	4.4
<b>NIMS</b>	<b>4.0</b>	<b>4.0</b>	<b>4.1</b>	<b>4.2</b>	<b>4.2</b>

Source: Company/Motilal Oswal Securities

### Core fee income increases by 18% YoY

Core fee income increased by 19% YoY in 3QFY07, on the back increase in service charges, credit related fees and higher LC commissions/ bank guarantees. PNB is consistently growing its fee income at a strong rate over the last few quarters. Management has guided that the growth will remain strong going forward. Treasury income was Rs1.5b during the quarter. PNB provides amortization through the other income line, which was Rs750m during the quarter.

### Operating expenses higher QoQ

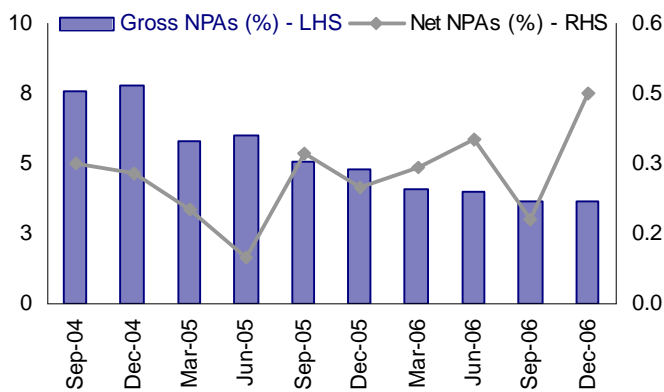
On the AS-15 impact, PNB has already started making higher provisions as per actuarial valuations, resulting in higher opex costs. However, employee expenses have increased by 14% QoQ, implying higher retirement benefits provisions. However, we need management clarification on the exact nature of these additional expenses.

### Net NPAs at 0.45%, up QoQ

Asset quality has worsened QoQ as gross NPAs increased by 6% QoQ, but declined YoY. While there have been some delinquencies, the management did not resort to any write-off during the quarter. Net NPAs increased from Rs1.5b to Rs3.7b QoQ, as the bank reclassified some NPA provisions as investment-related provisions. Net NPAs increased from 0.2% to 0.5% QoQ, despite making Rs2.2b of NPA-related provisions.

Despite the higher NPAs, we believe that with a coverage ratio of ~90%, PNB could be a significant beneficiary of the recovery cycle. PNB has enough floating provisions on its books (Rs9.8b as of FY06) as against its actual net NPAs, resulting in lower provisioning and possible write-back in future.

#### TREND IN NPAs



Source: Company/Motilal Oswal Securities

#### Higher provisions due to NPAs and investments

Provisions were higher on account of higher NPA provisions and investment-related provisions. The bank made marked-to-market provision of Rs1.25b towards its AFS portfolio, as shorter-end yields were higher in 3QFY07 than in 2QFY07.

#### Valuation and view

We have upgraded our earnings estimate by 2% for FY08 on the back of better margins and lower provisioning, going forward. The stock trades at 7.3x FY08E EPS and 1.3x FY08E BV, with an expected RoE of 19% for FY08. Consistent growth in core earnings, along with reduced risk on bond portfolio could result in higher valuations for PNB. We maintain that PNB is the best bet amongst the larger state-owned banks. **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 ~Rs1.3t and a network of over 4,500 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 30% in FY06, likely to remain strong.
- ✍ Net NPAs of 0.4%, gross NPAs on a decline.
- ✍ Transfer of bonds to HTM will protect from interest rate volatility.
- ✍ Has networked 2,171 branches under core banking solution, covering 76% of the business.

### 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)	FY07E	9.4	14.9	8.5
	FY08E	7.3	12.6	7.1
P/ABV (x)	FY07E	1.6	2.2	1.1
	FY08E	1.3	2.0	1.0
RoE (%)	FY07E	16.9	14.2	13.0
	FY08E	18.8	15.0	14.0
RoA (%)	FY07E	1.1	0.8	0.8
	FY08E	1.2	0.8	0.8

#### SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	57.8	57.8	57.8
Domestic Inst	14.0	13.6	11.7
Foreign	20.1	20.1	20.1
Others	8.1	8.5	10.4

### Recent developments

- ✍ PNB has recently raised Rs15b in Tier-2 bonds.
- ✍ Standard & Poor's, a leading index provider, recently released the global challengers list in which PNB is featured as one of the major challengers to the world's leading blue chip companies.

### Valuation and view

- ✍ We expect a loan growth of 28% and earning growth of 19% in FY07.
- ✍ Improvement in core RoE, significant clean up in balance sheet and superior technology platform will drive re-rating.
- ✍ The stock trades at 7.3x FY08E EPS and 1.3x FY08E BV, with an expected RoE of 19% for FY08. **Maintain Buy.**

### Sector view

- ✍ YTD loan growth of 30%+, highest in the last 12 years.
- ✍ 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.

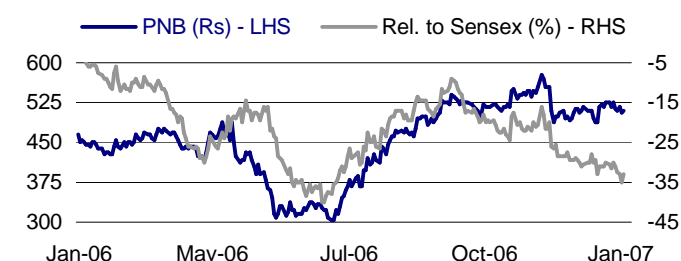
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	54.1	52.9	2.3
FY08	69.5	66.2	4.9

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
508	660	29.9	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	84,599	95,842	113,971	136,557	160,807
Interest Expended	44,531	49,174	58,408	72,308	86,419
<b>Net Interest Inco</b>	<b>40,067</b>	<b>46,668</b>	<b>55,563</b>	<b>64,250</b>	<b>74,381</b>
Change (%)	10.5	16.5	19.1	15.6	15.8
Other Income	16,757	12,312	8,044	11,461	13,895
Bond Gains	3,528	2,109	-4,870	-2,000	-500
<b>Net Income</b>	<b>56,824</b>	<b>58,979</b>	<b>63,607</b>	<b>75,710</b>	<b>88,276</b>
Change (%)	3.5	3.8	7.8	19.0	16.6
Operating Expenses	29,752	30,232	31,156	35,012	38,634
<b>Operating Income</b>	<b>27,072</b>	<b>28,748</b>	<b>32,451</b>	<b>40,698</b>	<b>49,642</b>
Change (%)	-13.3	6.2	2.9	25.4	22.0
Other Provisions	8,016	8,399	8,100	9,400	11,200
<b>PBT</b>	<b>19,056</b>	<b>20,348</b>	<b>24,351</b>	<b>31,298</b>	<b>38,442</b>
Tax	4,955	5,955	7,305	9,389	11,533
Tax Rate (%)	26.0	29.3	30.0	30.0	30.0
<b>PAT</b>	<b>14,101</b>	<b>14,393</b>	<b>17,045</b>	<b>21,909</b>	<b>26,909</b>
Change (%)	27.2	2.1	18.4	28.5	22.8
Proposed Dividend	1,977	2,838	3,153	3,784	4,730

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	3,153	3,153	3,153	3,153	3,153
Reserves & Surplus	78,460	90,611	104,503	122,628	144,808
<b>Net Worth</b>	<b>81,613</b>	<b>93,764</b>	<b>107,656</b>	<b>125,781</b>	<b>147,961</b>
<b>Deposits</b>	<b>1,031,669</b>	<b>1,196,850</b>	<b>1,412,283</b>	<b>1,652,371</b>	<b>1,916,750</b>
Change (%)	17.3	16.0	18.0	17.0	16.0
Borrowings	27,183	66,872	18,000	18,000	18,000
Other Liabilities & Pr	121,948	95,188	110,188	125,188	140,188
<b>Total Liabilities</b>	<b>1,262,413</b>	<b>1,452,674</b>	<b>1,648,127</b>	<b>1,921,341</b>	<b>2,222,900</b>
Current Assets	110,890	247,917	168,961	191,481	202,585
Investments	506,728	410,553	451,608	496,769	546,446
Change (%)	20.3	-19.0	10.0	10.0	10.0
Advances	604,128	746,274	970,156	1,173,889	1,408,666
Change (%)	27.9	23.5	30.0	21.0	20.0
Net Fixed Assets	9,652	10,302	12,402	14,202	18,202
Other Assets	31,015	37,628	45,000	45,000	47,000
<b>Total Assets</b>	<b>1,262,414</b>	<b>1,452,674</b>	<b>1,648,128</b>	<b>1,921,341</b>	<b>2,222,900</b>

ASSUMPTIONS					
(%)					
Deposit Growth	17.3	16.0	18.0	17.0	16.0
Advances Growth	27.9	23.5	30.0	21.0	20.0
Investments Growth	20.3	-19.0	10.0	10.0	10.0
Dividend	60.0	90.0	100.0	120.0	150.0
CRR	5.0	5.0	5.0	5.0	5.0

E: MOST Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
<b>Spreads Analysis (%)</b>					
Avg. Yield - Earning	7.7	7.3	7.8	8.2	8.3
Avg. Cost-Int. Bear. I	4.6	4.2	4.3	4.7	4.8
Interest Spread	3.2	3.1	3.4	3.6	3.5
Net Interest Margin	3.7	3.6	3.8	3.9	3.8
<b>Profitability Ratios (%)</b>					
RoE	21.4	16.4	16.9	18.8	19.7
RoA	12	11	11	12	13
Int. Expended/Int. Ear	52.6	51.3	51.2	53.0	53.7
Other Inc./Net Incom	29.5	20.9	12.6	15.1	15.7
<b>Efficiency Ratios (%)</b>					
Op. Exps./Net Incom	52.4	51.3	49.0	46.2	43.8
Empl. Cost/Op. Exps	71.3	70.0	70.1	69.4	69.0
Busi. per Empl. (Rs r	25.6	30.9	37.9	46.5	55.9
NP per Empl. (Rs lac	2.4	2.5	3.0	3.9	4.9

Asset-Liability Profile (%)					
Adv./Deposit Ratio	58.6	62.4	68.7	71.0	73.5
Invest./Deposit Ratio	49.1	34.3	32.0	30.1	28.5
G-Sec/Invest. Ratio	85.7	84.4	85.9	87.5	89.1
Gross NPAs to Adv	5.8	4.0	3.3	3.1	2.9
Net NPAs to Adv.	0.2	0.3	0.2	0.2	0.2
CAR	14.8	12.0	10.3	10.2	10.2
Tier 1	8.9	10.1	8.6	8.5	8.6

VALUATION					
Book Value (Rs)	249	288	332	389	460
Price-BV (x)	2.0	1.8	1.5	1.3	1.1
Adjusted BV (Rs)	246	283	327	384	454
Price-ABV (x)	2.1	1.8	1.6	1.3	1.1
EPS (Rs)	44.7	45.6	54.1	69.5	85.3
EPS Growth (%)	7.0	2.1	18.4	28.5	22.8
Price-Earnings (x)	11.4	11.1	9.4	7.3	6.0
OPS (Rs)	85.9	91.2	102.9	129.1	157.4
OPS Growth (%)	-27.0	6.2	12.9	25.4	22.0
Price-OP (x)	5.9	5.6	4.9	3.9	3.2

E: MOST Estimates



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**Punjab National Bank**

- |                                                         |     |
|---------------------------------------------------------|-----|
| 1. Analyst ownership of the stock                       | No  |
| 2. Group/Directors ownership of the stock               | Yes |
| 3. Broking relationship with company covered            | No  |
| 4. Investment Banking relationship with company covered | No  |

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