

## Company

26 July 2010 | 9 pages

# Punjab National Bank (PNBK.BO)

 Equity   
 Estimate change 

## 1Q11 Results: In-line, but Asset Quality Concerns Outlined

- 1Q11 profits up 28% yoy; in-line with estimates** — PNB's 1Q11 profits were up 28.4% yoy and mainly driven by a healthy loan growth and expansion in NIMs, though partly moderated by an increase in credit costs. Overall the P&L was healthy, but our niggling concerns on PNB's asset book remain - NPLs were up 12% qoq, delinquencies increased further to about 3% annualized and restructured book increased further to 6.6% of loans.
- P&L: NIM expansion offset by lower trading gains and higher credit costs** — PNB's NIMs expanded 57bps qoq to 394bps (down 5bps qoq) and were better than our estimates. Core fee growth was, however, relatively slow at 11% yoy and remains well below asset expansion. Operating costs grew modestly (+10% yoy) despite additional provisions for employee benefits. Core profitability therefore remained strong with pre-provision profits (ex trading gains) up 63% yoy. This was, however, mostly offset by lower trading gains (-66% yoy) and rising credit costs (+88% yoy).
- Balance sheet: Reasonable growth, but watch the quality** — PNB's loan growth was healthy at 25% yoy and broad-based (less from short-term lending to telecom). Deposit franchise continues to remain strong with close to 41% CASA. However, higher delinquencies and restructured book are a concern, coverage levels declined further (78% now) and management guidance (below 2% NPLs) failed to suggest the peak was past. We expect NPLs to be watched keenly and any rise in slippages could hurt earnings as cushion from higher LLR has reduced.
- Maintain Sell: Strong franchise but expensive valuations leave little room for downsides** — While PNB continues to deliver superior returns than most peers, we believe its higher than peers valuations (1.7x 1yr Fwd P/BV) and concerns on asset quality will likely be a drag on the stock price. We revise FY11/12E earnings by 3%/2% to incorporate FY10 actuals. Maintain Sell.

<b>Sell/Medium Risk</b>	<b>3M</b>
Price (26 Jul 10)	Rs1,038.80
Target price	Rs950.00
Expected share price return	-8.5%
Expected dividend yield	2.2%
<b>Expected total return</b>	<b>-6.3%</b>
Market Cap	Rs327,536M
	US\$6,981M

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

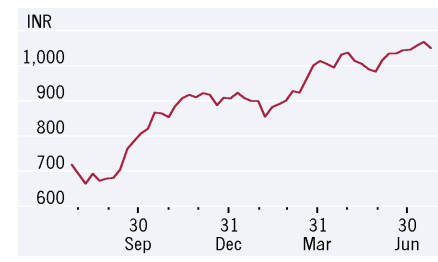


Figure 1. Statistical Abstract

Year to March	Net Profit (Rs Mils.)	FD EPS (Rs)	EPS Growth (%)	P/E (X)	P/BV (X)	RoAE (%)	ROAA (%)	Div Yld (%)
FY08	20,488	65.0	33.0	16.2	3.1	18.0	1.1	1.2
FY09	30,909	98.0	50.9	10.7	2.5	22.9	1.4	1.9
FY10	39,054	123.9	26.4	8.5	2.0	24.1	1.4	2.1
FY11E	44,367	140.7	13.6	7.5	1.7	22.7	1.4	2.2
FY12E	52,090	165.2	17.4	6.4	1.4	22.2	1.4	2.3
FY13E	63,148	200.3	21.2	5.2	1.1	22.3	1.4	2.4

Source: Citi Investment Research and Analysis estimates

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
<b>Valuation Ratios</b>					
P/E adjusted (x)	10.6	8.4	7.4	6.3	5.2
P/E reported (x)	10.6	8.4	7.4	6.3	5.2
P/BV (x)	2.2	1.8	1.5	1.3	1.1
P/Adjusted BV diluted (x)	2.5	2.0	1.7	1.4	1.1
Dividend yield (%)	1.9	2.1	2.2	2.3	2.4
<b>Per Share Data (Rs)</b>					
EPS adjusted	98.03	123.86	140.71	165.21	200.28
EPS reported	98.03	123.86	140.71	165.21	200.28
BVPS	464.75	562.09	676.01	813.26	984.41
Tangible BVPS	464.75	562.09	676.01	813.26	984.41
Adjusted BVPS diluted	416.74	514.77	628.69	765.94	937.09
DPS	20.00	22.00	23.00	24.00	25.00
<b>Profit &amp; Loss (RsM)</b>					
Net interest income	70,309	85,229	102,226	117,781	138,339
Fees and commissions	13,766	16,822	18,840	21,101	23,633
Other operating Income	15,430	18,831	15,380	16,893	18,558
<b>Total operating income</b>	<b>99,505</b>	<b>120,882</b>	<b>136,446</b>	<b>155,775</b>	<b>180,531</b>
Total operating expenses	-42,062	-47,619	-52,835	-58,622	-65,044
<b>Oper. profit bef. provisions</b>	<b>57,443</b>	<b>73,263</b>	<b>83,611</b>	<b>97,153</b>	<b>115,487</b>
Bad debt provisions	-8,853	-10,536	-14,894	-16,909	-18,739
Non-operating/exceptionals	-922	-3,679	-2,498	-2,498	-2,498
<b>Pre-tax profit</b>	<b>47,669</b>	<b>59,048</b>	<b>66,220</b>	<b>77,747</b>	<b>94,251</b>
Tax	-16,760	-19,994	-21,852	-25,656	-31,103
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
<b>Attributable profit</b>	<b>30,909</b>	<b>39,054</b>	<b>44,367</b>	<b>52,090</b>	<b>63,148</b>
Adjusted earnings	30,909	39,054	44,367	52,090	63,148
<b>Growth Rates (%)</b>					
EPS adjusted	50.9	26.4	13.6	17.4	21.2
Oper. profit bef. prov.	43.4	27.5	14.1	16.2	18.9
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>2,469,186</b>	<b>2,966,328</b>	<b>3,438,183</b>	<b>4,032,029</b>	<b>4,740,051</b>
Avg interest earning assets	2,182,382	2,660,450	3,138,102	3,669,484	4,317,561
Customer loans	1,575,858	1,895,330	2,247,618	2,674,747	3,182,300
Gross NPLs	25,069	32,144	44,407	52,056	60,130
<b>Liab. &amp; shar. funds</b>	<b>2,469,186</b>	<b>2,966,328</b>	<b>3,438,183</b>	<b>4,032,029</b>	<b>4,740,051</b>
Total customer deposits	2,097,605	2,493,298	2,917,286	3,454,368	4,093,282
Reserve for loan losses	28,829	29,318	36,176	41,983	47,707
Shareholders' equity	<b>146,536</b>	<b>177,229</b>	<b>213,148</b>	<b>256,422</b>	<b>310,387</b>
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	22.9	24.1	22.7	22.2	22.3
Net interest margin	3.22	3.20	3.26	3.21	3.20
Cost/income ratio	42.3	39.4	38.7	37.6	36.0
Cash cost/average assets	1.9	1.8	1.6	1.6	1.5
NPLs/customer loans	1.6	1.7	2.0	1.9	1.9
Reserve for loan losses/NPLs	115.0	91.2	81.5	80.6	79.3
Bad debt prov./avg. cust. loans	0.6	0.6	0.7	0.7	0.6
Loans/deposit ratio	75.1	76.0	77.0	77.4	77.7
Tier 1 capital ratio	9.0	9.2	9.5	9.8	10.1
Total capital ratio	14.0	15.2	15.1	14.9	14.8

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Figure 2. PNB: 1Q11 Results – Key Highlights (Rupees Million, Percent)

	1Q11	1Q10	YoY %	4Q10	QoQ%	CIRA Comments
Interest Income	59,919	52,074	15.1	56,076	6.9	
Interest Expense	-33,733	(33,456)	0.8	(31,097)	8.5	
Net Interest Income	26,186	18,618	40.6	24,980	4.8	Strong growth, has seen margins improve yoy as funding costs have fallen meaningfully
Fee-Based Income	7,505	6,153	22.0	7,152	4.9	Fee growth is reasonable, though excluding recoveries is much more modest at 11% yoy
Other Non-Interest Income	1,210	3,549	-65.9	2,195	-44.9	Continues to decline and could be a significant factor going forward to overall earnings
Non Interest Income	8,715	9,702	-10.2	9,346	-6.7	
<b>Operating Income</b>	<b>34,901</b>	<b>28,320</b>	<b>23.2</b>	<b>34,326</b>	<b>1.7</b>	
Operating Expenses	(13,919)	(12,626)	10.2	(11,001)	26.5	Management has started to amortise costs for the additional pension option - one of few banks doing this
Pre-Provision Profit	20,982	15,693	33.7	23,325	-10.0	
Charges for Bad Debts	(5,671)	(3,018)	87.9	(6,260)	-9.4	Credit costs have remained high - and so have delinquencies - we expect credit costs to continue to remain at elevated levels near term
Other Operating Items	330	0	NM	41	697.1	
Operating Profit	15,640	12,676	23.4	17,106	-8.6	
Pre-Tax Profit	15,640	12,676	23.4	17,106	-8.6	
Tax	(4,958)	(4,355)	13.8	(5,756)	-13.9	
<b>Net Profit</b>	<b>10,683</b>	<b>8,321</b>	<b>28.4</b>	<b>11,350</b>	<b>-5.9</b>	<b>In-line with estimates - better than expected NIMs though largely offset by higher credit costs</b>
EPS	34	26	28.4	36	-5.9	
DPS	0.0	0	NM	22	NM	
Customer Loans	1,968,700	1,579,794	24.6	1,866,010	5.5	Reasonable and healthy growth, unlike most banks reporting so far
Customer Deposits	2,553,350	2,189,597	16.6	2,493,300	2.4	Deposit franchise continues to be strong with CASA ratio of 41%
AIEA	2,505,292	2,206,831	13.5	2,503,663	0.1	
AIBL	1,927,070	1,647,069	17.0	1,889,285	2.0	
Total Assets	3,100,010	2,459,397	26.0	2,966,330	4.5	
Avg Assets	2,890,891	2,464,293	17.3	2,822,648	2.4	
Non-Performing Loans (NPL)	36,138	28,647	26.1	32,144	12.4	Key weakness this quarter, delinquencies continue to increase (4th quarter in a row)
Loan Loss Reserves (LLR)	(23,304)	(25,675)	-9.2	(22,327)	4.4	
Shareholders' Funds	172,995	147,056	17.6	162,309	6.6	
Book Value Per Share	549	466	17.6	515	6.6	
<b>Key Ratios (%)</b>	<b>1Q11</b>	<b>1Q10</b>	<b>Bps Δ YoY</b>	<b>4Q10</b>	<b>Bps Δ QoQ</b>	
ROAA (annualized)	1.48	1.35	13	1.61	-13	
ROAE (annualized)	24.70	22.63	207	27.97	-327	
Net Interest Margin (bps)	394	337	57	399	-5	Better than anticipated, does not seem to have participated meaningfully in the telecom lending spree
Fee Inc/Operating Income	21.5	21.7	-22	20.8	67	Has remained steady - not likely to change near term
Other Non-Interest Inc/Op Inc	25.0	34.3	-929	27.2	-226	
Op. Cost/ Operating Income	39.9	44.6	-470	32.0	783	Costs have been a bit more volatile, though with the amortisation of pension costs, will likely remain high
Loan-to-Deposit Ratio (LDR)	77.1	72.1	495	74.8	226	Close to peak levels - will possibly moderate from current levels
NPL/Loan Ratio	1.8	1.8	2	1.7	11	
LLR/NPL Ratio	64	90	-2,514	69	-497	
Reported LLR (Incl Technical w/o)	78	94	-1,590	83	-530	Coverage levels continue to head south - could become a source of concern as historical cushion on asset has reduced meaningfully
Amount of Technical w/o's included	21,180	17,145	23.5	25,298	-16.3	
Restructured Loans	129,734	40,750	218.4	120,960	7.3	Increasing steadily - no signs of reducing restructured assets
Restructured % of loans	6.6	2.6	401	6.5	11	Amongst the highest in the sector and much higher than other larger PSU banks

Source: Company Reports, CIRA

Figure 3. Earnings Revision Summary

	Net Profit			EPS			DPS	
	Old	New	% change	Old	New	% change	Old	New
FY11E	43,084	44,367	3.0	136.6	140.7	3.0	21.0	23.0
FY12E	51,235	52,090	1.7	162.5	165.2	1.7	22.0	24.0
FY13E	NA	63,148	NA	NA	200.3	NA	NA	25.0

Source: Citi Investment Research and Analysis estimates

## 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 4,894 branches.

### Investment strategy

We rate PNB shares Sell / Medium Risk. PNB is one of India's largest government-owned banks, with good profitability (ROEs of 18-20%) and relatively high net interest margins. We believe: a) PNB has been able to maintain its growth along with its higher-than-industry NIMs, 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. However, we expect the positives are likely to be offset by: a) Its aggressive loan growth stance especially in the mid-market segments which increases its leverage to the broader economy; b) Higher sensitivity to a rising interest rate environment as yields on investment book have reduced sharply - which could hurt NIMs if funding costs rise; and c) Historically peak valuation multiples.

### Valuation

Our target price for PNB of Rs950 is 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 8.0% in line with our assumptions for other banks; b) longer-term loan loss provisions of 100bps in-line with sector averages, c) loan spreads of 200bps, in-line with industry levels, and d) long-term fee income growth of 9%. We also benchmark our valuation multiples at 1.5x 1Yr Fwd P/BV (Rs994) - at par with SBI due to its strong deposit franchise which acts as a cushion against a rising interest rate environment. We use EVA as our preferred valuation methodology as we believe it better captures the long term value of the business.

### Risks

We rate PNB shares Medium Risk, in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key upside risks which could sustain the shares above our target price include: (1) A strong

asset quality environment shoring up the status of restructured / substandard assets; (2) Continued easy liquidity and a low interest rate environment, which would be likely to support net interest margins; and (3) A strengthening of the bank's deposit franchise.

# Appendix A-1

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#### Fundamental Research

Analyst: Manish Chowdhary, CFA

Covered since November 11 2009

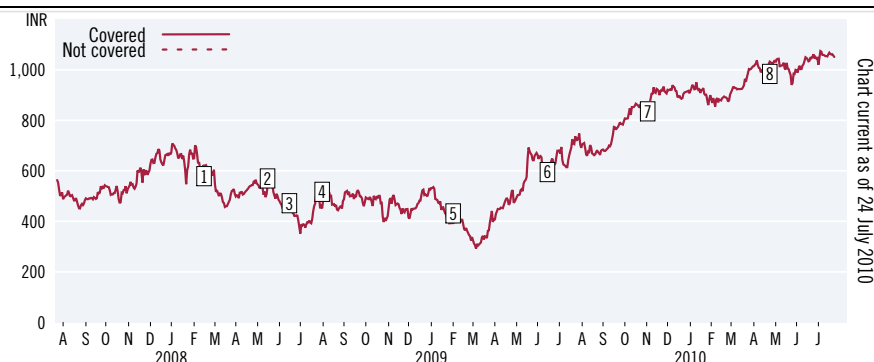


Chart current as of 24 July 2010

	Date	Rating	Target Price	Closing Price
1	15-Feb-08	1M	*775.00	621.00
2	15-May-08	1M	*685.00	537.05
3	16-Jun-08	1M	*605.00	454.95

	Date	Rating	Target Price	Closing Price
4	31-Jul-08	*3M	*455.00	451.25
5	1-Feb-09	3M	*420.00	400.35
6	14-Jun-09	*1M	*780.00	594.95

	Date	Rating	Target Price	Closing Price
7	3-Nov-09	*3M	*830.00	836.35
8	23-Apr-10	3M	*950.00	1,032.20

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2010

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