

**Q2FY07 result**

# Punjab National Bank

**BUY**

 Bloomberg: PNB IN  
 Reuters: PNBK.NS  
 Mkt cap: Rs163.5bn/US\$3.6bn

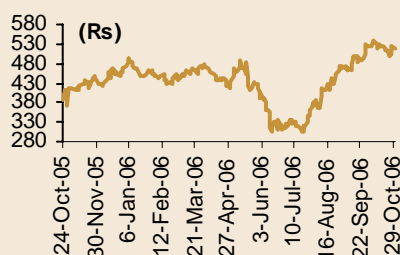
**Current price: Rs519\***
**Target price: Rs580**
**Solid quarter**

\* As on 30 October 2006

We raise EPS estimate to factor in lower operating costs

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**Stock performance**


(%)	Absolute	Relative
3 months	44.1	18.8
6 months	19.8	10.7
12 months	39.5	(17.7)

**Key financials**

Y/E 31 Mar	FY06	FY07E	FY08E
Adj net profit (Rs bn)	12.9	19.0	24.2
EPS (Rs)	45.6	56.0	72.6
Adj. EPS (Rs)	40.9	60.2	76.8
BVPS (Rs)	297.4	340.6	396.7
Adj. RoE (%)	15.0	18.9	20.8
Adj. RoA (%)	1.0	1.3	1.5
<b>PER (x)</b>	<b>11.4</b>	<b>9.3</b>	<b>7.1</b>
Adj. PER(x)	12.7	8.6	6.8
Price/Book (x)	1.7	1.5	1.3
Dividend yield (%)	1.8	2.2	2.8
Consensus EPS (Rs) *		51.6	65.9

\* Bloomberg

**Strong NII growth as margins move even further up**

PNB has reported a 14.4% YoY growth in net interest income in Q2FY07, on the back of a 16bp YoY increase in margins. More importantly, NIM for H1FY07 is 6bp higher than that in Q1FY07, indicating that margins improved on a QoQ basis. PNB is the only major PSU bank to have enjoyed a sequential margin improvement this quarter.

**Fee income growth robust, but not as strong as in Q1FY07**

Fee income growth at 18%, while being robust, does represent a slowdown from the 52% growth rate seen in Q1FY07. We note that we are building a full-year growth of 18% in fee income. Hence, there could still be an upside to our forecasts.

**Low operating cost seen in Q1FY07 not an aberration; we cut our cost estimates**

Operating expenses declined by 8% after being flat in Q1FY07. We hadn't extrapolated the cost trend seen in Q1FY07 to the entire year, as we were not confident about its sustainability. However, the bank has surprised us again in Q2FY07. Consequently, we are now reducing our operating cost assumption by ~10% for FY07 and FY08.

**Writeback of investment provisions shores up bottomline**

The bank made a writeback of investment provision of Rs1.45bn in Q2. However, the bank made much higher than expected NPA provision of Rs1.89bn (vs. expectation of Rs0.98bn). Consequently, net NPA ratio has come down to 0.18% from 0.34% in Q1FY07. We note that the net inc. NPA ratio was better than expected at 0.3%.

**Top-of-the line results – PNB remains our top pick in banking**

Along with HDFCB, PNB is the best positioned bank in a rising rate environment, thanks to its high-quality deposit franchise, in our view. The result for Q2FY07 lends further credence to this view, with PNB being almost the only bank to have enjoyed a QoQ increase in margins. Operating costs and asset quality came in above expectations. In addition, we believe that PNB is relatively very well placed vis-à-vis AS-15 implementation. We are increasing our EPS estimates by 15% for FY07 and 6% for FY08, on lower operating costs. FY07 EPS is also boosted because of the Rs1.45bn writeback of investment provision recorded in Q2FY07. PNB is clearly our top pick in the banking space. Maintain Buy with an end-FY07 price target of Rs580/shr.

**Figure 1: Quarterly result**

	(Rs m)					
	Q2FY06	Q1FY07	Q2FY07A	Q2FY07E	YoY	QoQ
Net interest income	11,908	12,929	13,628	13,359	14%	5%
Non-interest income	3,123	2,813	2,840	2,783	-9%	1%
Trading gains/(losses)	128	(219)	(130)	0	-202%	-41%
Operating income	15,031	15,742	16,468	16,142	10%	5%
Core operating income	14,904	15,961	16,598	16,142	11%	4%
Operating expenses	(8,195)	(6,969)	(7,580)	(8,317)	-8%	9%
Operating profit	6,836	8,773	8,888	7,825	30%	1%
Provision Charges	(94)	(3,638)	(1,018)	(1,880)	983%	-72%
Profit before tax	6,742	5,135	7,870	5,945	17%	53%
Tax provided	(2,522)	(1,460)	(2,820)	(1,784)	12%	93%
Net profit	4,220	3,675	5,050	4,162	20%	37%
Tax rate	37%	28%	36%	30%		
Net advances	638,682	775,460	823,400		29%	6%

**Income statement**

	<i>Rs bn</i>				
Year ended 31 Mar	FY04	FY05	FY06	FY07E	FY08E
Net interest income	36.2	40.1	46.7	53.9	63.5
<i>growth (%)</i>	(99.9)	10.6	16.5	15.5	17.9
Non-interest income	18.7	16.8	12.3	10.0	11.3
Fee/Commission income	5.5	6.9	7.5	8.9	10.0
Operating income	54.9	56.8	59.0	63.9	74.9
Core operating income	43.7	53.3	56.9	65.8	76.7
Operating expenses	(23.7)	(29.8)	(30.2)	(31.2)	(35.3)
Employee expenses	(16.5)	(21.2)	(21.1)	(21.2)	(24.0)
<b>Operating profit</b>	<b>31.2</b>	<b>27.1</b>	<b>28.7</b>	<b>32.7</b>	<b>39.6</b>
Provision Charges	(13.5)	(8.0)	(8.4)	(7.5)	(6.9)
Bad and doubtful debts charge	(11.9)	(1.7)	(3.2)	(4.2)	(6.1)
<b>Profit before tax</b>	<b>17.7</b>	<b>19.1</b>	<b>20.3</b>	<b>25.2</b>	<b>32.7</b>
Tax Provided	(6.6)	(5.0)	(6.0)	(7.6)	(9.8)
Profit after tax	11.1	14.1	14.4	17.7	22.9
<b>Adj Net Profit</b>	<b>4.1</b>	<b>11.5</b>	<b>12.9</b>	<b>19.0</b>	<b>24.2</b>
No. of shares outstanding(Rs Mn)	265.3	315.3	315.3	315.3	315.3
Adj Net Pat Growth(%)	(1.4)	181.7	12.3	47.1	27.6

**Balance sheet**

	<i>Rs bn</i>				
Year ended 31 Mar	FY04	FY05	FY06	FY07E	FY08E
Cash and equivalents	88	111	248	88	98
Net advances	472	604	746	925	1,092
Retail assets	92	116			
Investments	421	507	411	412	419
Investments in government securities	354	434	346	350	353
Interest earning assets	982	1,222	1,405	1,425	1,609
Other assets	41	40	47	52	57
<b>Total assets</b>	<b>1,023</b>	<b>1,262</b>	<b>1,452</b>	<b>1,478</b>	<b>1,666</b>
Deposits from banks	9	21	22	19	21
Deposits from customers	871	1,011	1,174	1,216	1,369
Demand deposits	98	112	153	153	176
Savings deposits	304	353	419	490	564
Time deposits	469	545	603	573	630
Borrowings	13	27	67	31	36
Other interest bearing liabilities	24	23	19	21	23
Interest bearing liabilities	916	1,082	1,283	1,287	1,450
<b>Total liabilities</b>	<b>973</b>	<b>1,181</b>	<b>1,358</b>	<b>1,370</b>	<b>1,541</b>
Shareholders funds	46	78	94	107	125
Capital	3	3	3	3	3
Reserves and surpluses	44	75	91	104	122
<b>Total liabilities and equity</b>	<b>1,020</b>	<b>1,259</b>	<b>1,452</b>	<b>1,478</b>	<b>1,666</b>

**Key ratios**

Year ended 31 Mar	FY04	FY05	FY06	FY07E	FY08E
<b>Per-share data (Rs)</b>					
EPS	41.8	44.7	45.6	56.0	72.6
Adj. EPS	15.4	36.4	40.9	60.2	76.8
DPS	3.8	4.4	9.1	11.2	14.5
BVPS	174.7	248.9	297.4	340.6	396.7
<b>Profitability (%)</b>					
RoE	26.8	22.6	16.7	17.6	19.7
Adj. RoE	9.9	18.4	15.0	18.9	20.8
RoA	1.2	1.2	1.1	1.2	1.5
Adj. RoA	0.4	1.0	1.0	1.3	1.5
<b>Growth ratios (%)</b>					
Core operating income growth	15.9	21.9	6.7	15.7	16.6
Operating profit growth	34.7	-13.3	6.2	13.7	21.0
Net profit growth	31.7	27.2	2.1	22.7	29.6
EPS growth	31.7	7.0	2.1	22.7	29.6
Adj. EPS growth	-1.4	137.1	12.3	47.1	27.6
BVPS growth	27.1	42.5	19.5	14.5	16.5
Advances Growth	17.4	27.9	23.5	24.0	18.0
<b>Yields (%)</b>					
Yield on advances	8.9	7.9	7.9	8.7	8.9
Yield on investments	9.7	8.2	8.2	8.3	8.0
Cost of liabilities	4.9	4.5	4.2	4.3	4.5
NIM	4.0	3.6	3.6	3.8	4.2
Interest spread	3.7	3.2	3.1	3.4	3.7
<b>Efficiency ratios (%)</b>					
Cost-income ratio	43.2	52.4	51.3	48.9	47.1
Core cost-income ratio	54.2	55.8	53.2	47.5	46.0
Operating costs to assets	2.5	2.6	2.2	2.1	2.2
<b>Asset quality</b>					
Gross NPLs (%)	9.9	6.2	4.2	3.9	4.1
Net NPLs (%)	1.0	0.2	0.3	0.3	0.5
PL provisions/avg. loans	2.7	0.3	0.5	0.5	0.6
<b>Capitalisation ratios (%)</b>					
Tier 1 ratio	7.0	8.9	10.1		
Tier 2 ratio	6.1	5.9	0.0	0.0	0.0
CAR	13.1	14.8			
<b>Liquidity Ratio</b>					
Loans/Deposits	53.5	58.2	60.1	74.2	77.7
Investment/Deposits	47.7	48.8	33.1	33.1	29.8
Inc. loans/deposits ratio	55.9	85.3	69.9	432.9	108.3
<b>Valuations</b>					
PER (x)	12.4	11.6	11.4	9.3	7.1
Adj. PER(x)	33.7	14.2	12.7	8.6	6.8
Price/Book (x)	3.0	2.1	1.7	1.5	1.3
Dividend yield (%)	0.7	0.9	1.8	2.2	2.8

**Punjab National Bank: Recommendation history**

Date	Stock price (Rs)	Recommendation	Price target (Rs)	Report
15-May-06	470	BUY	580	Interesting times
19-May-06	448	BUY	580	Q4FY06 result: Weak numbers - Significantly higher MTM losses
10-Jul-06	326	BUY	580	Nothing to fear - Recent correction in bank stocks is a great buying opportunity
1-Aug-06	369	BUY	580	Q1FY07 result: Strong NII growth - Fee income could potentially provide an upside
<b>30-Oct-06</b>	<b>519</b>	<b>BUY</b>	<b>580</b>	<b>Q2FY07 result: Solid quarter - Increasing EPS estimated to factor in lower operating costs</b>

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In the interest of timeliness, this note was not edited.

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