

UBS Investment Research

Punjab National Bank

Disappointing 2Q

■ Earnings weaker than expected

PNB's 2Q net profit of Rs5,385MM grew 7% Y/Y and 27% Q/Q. Core earnings were weak for the third quarter in a row with pressure on NIMs and sharp rise in NPLs. NIM declined 18 bps Q/Q to 3.4% in 2QFY08, gross NPLs rose sharply by 27% Q/Q and 53% Y/Y and operating expenses growth remained high at 19% Y/Y. The key reason for the decline in NIM Q/Q is the reversal of interest on new NPLs. The key reason for the Y/Y decline in NIM is the increase in rates on term deposits and lower CASA.

■ NPLs continue to rise for the third quarter due to infra, small loans

PNB has attributed the sharp rise in NPLs to delay in the implementation of infra projects and small loans. Of the total new NPLs of Rs17bn, around 40% are from infrastructure. The chairman clarified that infra NPLs are mainly technical. While these projects continue to repay interest, extension of the loan tenor due to delayed implementation requires these loans to be classified as NPLs. The chairman also clarified that of the NPLs of 4.57%, the potential loss loans are 0.5% of total loans, the others NPLs are mainly technical and will be recovered.

■ Management sees earnings recovery in 4Q08 and in FY09

The chairman guided that NPLs will come down by Mar-08 driven by the bank's recovery drive. Margin pressure will also ease in FY09 as the high cost special deposits mature.

■ PT of Rs620 based on 1.6x P/BV FY09E

With weak core results, we expect PNB to underperform the banking sector. PT is based on 1.6x P/BV FY09E.

| Highlights (Rsm) | 03/06 | 03/07 | 03/08E | 03/09E | 03/10E |
|-------------------|--------|--------|--------|--------|--------|
| Revenues | 58,979 | 65,569 | 70,308 | 83,732 | - |
| Pre-tax profits | 19,915 | 21,678 | 25,549 | 29,913 | - |
| Net income | 13,969 | 15,401 | 16,956 | 19,759 | - |
| EPS (UBS, Rs) | 44.30 | 48.84 | 53.78 | 62.67 | - |
| Net DPS (UBS, Rs) | 5.00 | 10.00 | 10.00 | 10.00 | 0.00 |

| Profitability & Valuation | 5-yr hist av. | 03/07 | 03/08E | 03/09E | 03/10E |
|---------------------------|---------------|-------|--------|--------|--------|
| ROE % | - | 16.0 | 16.1 | 16.9 | - |
| P/Op x | - | 4.5 | 5.0 | 3.8 | - |
| P/BVPS x | - | 1.4 | 1.5 | 1.3 | - |
| PE (UBS) x | - | 9.3 | 9.7 | 8.4 | - |
| Net dividend yield % | - | 2.2 | 1.9 | 1.9 | 0.0 |

Source: Company accounts, Thomson Financial, UBS estimates. (UBS) valuations are stated before goodwill, exceptional and other special items. Valuations: based on an average share price that year, (E): based on a share price of Rs524.05 on 26 Oct 2007 23:39 HKT

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Global Equity Research

India

Banks, Ex-S&L

12-month rating **Buy ***
Unchanged

12m price target **Rs620.00/US\$15.73**
Unchanged

Price **Rs524.05/US\$13.29**

RIC: PNBK.BO BBG: PNB IN

29 October 2007

Trading data (local/US\$)

| | |
|--------------------------|--------------------------------|
| 52-wk range | Rs580.70-412.25/US\$14.42-9.26 |
| Market cap. | Rs139bn/US\$3.53bn |
| Shares o/s | 265m (ORD) |
| Free float | 20% |
| Avg. daily volume ('000) | 152 |
| Avg. daily value (Rsm) | 76.7 |

Balance sheet data 03/08E

| | |
|------------------------|---------|
| Shareholders' equity | Rs109bn |
| P/BVPS x | 1.5 |
| Tier one capital ratio | 7.0% |

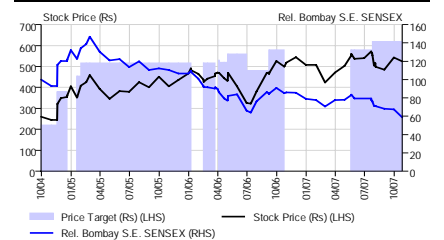
Forecast returns

| | |
|-----------------------------|--------|
| Forecast price appreciation | +18.3% |
| Forecast dividend yield | 1.9% |
| Forecast stock return | +20.2% |
| Market return assumption | 11.9% |
| Forecast excess return | +8.3% |

EPS (UBS, Rs)

| | 03/08E | | 03/07 Actual |
|--------|--------|-------|--------------|
| | UBS | Cons. | |
| Q1E | 13.44 | - | 12.21 |
| Q2E | 13.44 | - | 12.21 |
| Q3E | 13.44 | - | 12.21 |
| Q4E | 13.44 | - | 12.21 |
| 03/08E | 53.78 | 53.23 | |
| 03/09E | 62.67 | 61.13 | |

Performance (Rs)



Source: UBS

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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 5. * Exception to core rating bands; See page 7

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Table 1: NIM adjusted for amortisation

| | |
|------|------|
| 2Q08 | 3.49 |
| 1Q08 | 3.58 |
| 2Q07 | 3.80 |

Source: Company data

Table 2: Non Performing Assets

| | 2Q08 | 1Q08 | 4Q07 | 3Q07 | 2Q07 | 1Q07 |
|------------------------|------|------|------|------|------|------|
| Gross NPAs, Rs. bn | 47.2 | 37.1 | 33.9 | 32.7 | 30.9 | 31.6 |
| % Q/Q | 27% | 9% | 4% | 6% | -2% | |
| Net NPAs, Rs. bn | 18.7 | 9.3 | 7.3 | 3.7 | 2.0 | 2.7 |
| % Q/Q | 102% | 28% | 99% | 81% | -24% | |
| % Gross NPLs | 4.7 | 3.8 | 3.5 | 3.7 | 3.7 | 4.0 |
| % Net NPLs | 1.9 | 1.0 | 0.8 | 0.4 | 0.2 | 0.4 |
| Provision coverage (%) | 60 | 75 | 79 | 89 | 93 | 92 |

Source: Company Data

Table 3: Quarterly provisions for retirement benefits

| Rs. MM | FY07 | FY08E | % Y/Y |
|-----------|-------|-------|-------|
| 1Q | 933 | 2,000 | 114 |
| 2Q | 933 | 2,000 | 114 |
| 3Q | 933 | 2,000 | 114 |
| 4Q | 3,701 | 2,000 | (46) |
| Full year | 6,500 | 8,000 | 23 |

Source: Company Data, UBS Estimates

Table 4: CASA ratio (%)

| | |
|---------|-------|
| 2Q FY08 | 43.91 |
| 1Q FY08 | 44 |
| 2Q FY07 | 48.71 |

Source: Company data

Table 5: 2Q FY08 profit and loss account

| Rs. MM | Q208 | Q108 | Q207 | %Y/Y | %Q/Q |
|-------------------------------------|---------------|---------------|---------------|--------------|--------------|
| Interest on advances | 25,126 | 24,109 | 18,351 | 36.9% | 4.2% |
| Interest on investments | 8,983 | 8,943 | 8,738 | 2.8% | 0.4% |
| Income on RBI | 320 | 529 | 474 | -32.4% | -39.4% |
| Others | 201 | 52 | 81 | 149.5% | 286.0% |
| Interest earned | 34,631 | 33,633 | 27,643 | 25.3% | 3.0% |
| Interest expended | 21,716 | 19,850 | 14,015 | 54.9% | 9.4% |
| Net interest income | 12,915 | 13,782 | 13,628 | -5.2% | -6.3% |
| Total Non interest income | 4,678 | (659) | 2,840 | 64.7% | -810.2% |
| Total income | 39,309 | 32,974 | 30,483 | 29.0% | 19.2% |
| Employees expenses | 6,418 | 6,411 | 5,108 | 25.6% | 0.1% |
| Other operating expenses | 2,625 | 2,359 | 2,472 | 6.2% | 11.3% |
| Operating expenses | 9,043 | 8,770 | 7,580 | 19.3% | 3.1% |
| Total expenditure | 30,759 | 28,620 | 21,595 | 42.4% | 7.5% |
| Operating profit | 8,550 | 4,354 | 8,888 | -3.8% | 96.4% |
| Operating profit excl trading gains | 8,550 | 3,034 | 8,208 | 4.2% | 181.8% |
| Loan loss provisions | 779 | 1,379 | 1,895 | -58.9% | -43.5% |
| Provisions & contingencies | 779 | (1,905) | 1,018 | -23.5% | -140.9% |
| PBT | 7,771 | 6,259 | 7,870 | -1.3% | 24.2% |
| Provision for taxes | 2,386 | 2,009 | 2,820 | -15.4% | 18.8% |
| Net profit | 5,385 | 4,251 | 5,050 | 6.6% | 26.7% |

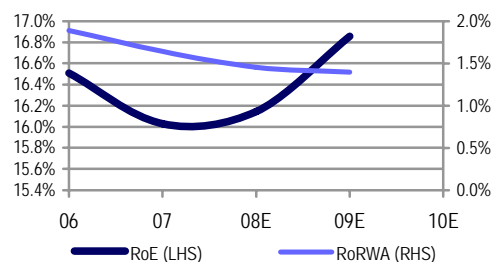
Source: Company data

Punjab National Bank

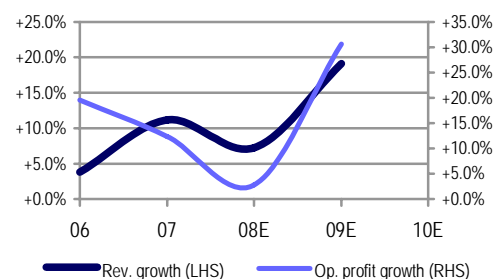
| Per share (Rs) | 3/06 | 3/07 | 3/08E | 3/09E | 3/10E |
|-----------------------------------|-----------|-----------|-----------|-----------|---------|
| EPS (stated) | 44.30 | 48.84 | 53.78 | 62.67 | |
| EPS (UBS adjusted) | 44.30 | 48.84 | 53.78 | 62.67 | |
| GOPS | 91.18 | 102.46 | 105.35 | 137.62 | |
| DPS | 5.00 | 10.00 | 10.00 | 10.00 | 0.00 |
| BVPS (stated) | 288.06 | 321.65 | 344.82 | 399.40 | |
| BVPS (adjusted) | 281.40 | 298.64 | 308.95 | 359.30 | |
| Profit & Loss (Rsm) | | | | | |
| Net interest income | 46,668 | 55,146 | 61,106 | 70,849 | |
| Other income | 12,735 | 10,423 | 9,203 | 12,884 | |
| Total revenues | 59,403 | 65,569 | 70,308 | 83,732 | |
| Expenses | (30,232) | (33,262) | (37,091) | (40,339) | |
| Operating profit | 28,748 | 32,306 | 33,217 | 43,393 | |
| Provisions and other items | (8,833) | (10,629) | (7,668) | (13,480) | |
| Profit before tax | 19,915 | 21,678 | 25,549 | 29,913 | |
| Pre-exceptional net income | 13,969 | 15,401 | 16,956 | 19,759 | |
| Capital dynamics (Rsm) | | | | | |
| Risk-weighted assets | 856,637 | 1,015,362 | 1,318,061 | 1,512,644 | |
| Tier one capital | 81,895 | 90,367 | 92,014 | 108,002 | |
| Total capital | 92,393 | 124,483 | 131,917 | 155,887 | |
| Tier one ratio | 9.6% | 8.9% | 7.0% | 7.1% | |
| Total capital ratio | 10.8% | 12.3% | 10.0% | 10.3% | |
| Net profit after tax | 13,969 | 15,401 | 16,956 | 19,759 | |
| <i>Tier 1 requirement</i> | | | | | |
| Less: Working capital requirement | | | | | |
| Less: Dividends | 1,892 | 3,153 | 1,742 | 2,371 | |
| Surplus capital generated | | | | | |
| Surplus capital generation ratio | | | | | |
| Balance sheet (Rsm) | | | | | |
| Assets | 1,223,244 | 1,507,200 | 1,910,222 | 2,196,916 | |
| Customer loans | 746,274 | 965,965 | 1,159,158 | 1,356,215 | |
| Customer deposits | 1,283,071 | 1,455,033 | 1,727,689 | 1,989,059 | |
| Funds under management | | | | | |
| Loans : assets | 61.0% | 64.1% | 60.7% | 61.7% | |
| Deposits : assets | 104.9% | 96.5% | 90.4% | 90.5% | |
| Loans : deposits | 58.2% | 66.4% | 67.1% | 68.2% | |
| Shareholders funds : assets | 7.42% | 6.73% | 5.69% | 5.73% | |
| Asset quality (Rsm) | | | | | |
| Non-performing assets | 31,383 | 33,907 | 35,227 | 40,410 | |
| Total risk reserves | 25,360 | 22,801 | 23,916 | 27,766 | |
| NPLs : loans | 4.21% | 3.51% | 3.04% | 2.98% | |
| NPL coverage | 81% | 67% | 68% | 69% | |
| Provision charge : average loans | 0.49% | 0.88% | 0.89% | 0.97% | |
| Net NPLs : shareholders' funds | 6.6% | 11.0% | 10.4% | 10.0% | |
| Profitability | | | | | |
| Net interest margin (avg assets) | 3.76% | 4.04% | 3.90% | 3.45% | |
| Provisions : operating profit | 30.7% | 32.9% | 23.1% | 31.1% | |
| RoE | 16.5% | 16.0% | 16.1% | 16.9% | |
| RoAdjE | 16.5% | 16.0% | 16.1% | 16.9% | |
| RoRWA | 1.89% | 1.65% | 1.45% | 1.40% | |
| RoA | 1.06% | 1.00% | 0.96% | 0.96% | |
| Productivity | | | | | |
| Cost : income ratio | 51.3% | 50.7% | 52.8% | 48.2% | |
| Costs : average assets | 2.4% | 2.4% | 2.4% | 2.0% | |
| Compensation expense ratio | 42.4% | 42.1% | 43.7% | 38.3% | |
| Momentum | | | | | |
| Revenue growth | +3.8% | +11.2% | +7.2% | +19.1% | NM |
| Operating profit growth | +19.6% | +12.4% | +2.8% | +30.6% | NM |
| Net profit growth | -0.9% | +10.2% | +10.1% | +16.5% | NM |
| Dividend growth | +11.1% | +100.0% | +0.0% | +0.0% | -100.0% |
| Value* | | | | | |
| UBS bank valuation | | | | | |
| Leveraged P/E | | | | | |
| Risk tendency P/E | | | | | |
| Merger P/E | | | | | |
| Market capitalisation (Rsm) | 111,775 | 121,098 | 139,030 | 139,030 | 139,030 |
| Conventional valuation | | | | | |
| Market cap./Revenues | 2.4x | 2.1x | 2.0x | 1.7x | |
| Market cap./Operating profit | 4.8x | 4.3x | 4.2x | 3.2x | |
| P/E (stated) | 11.8x | 10.7x | 9.7x | 8.4x | |
| P/E (UBS adjusted) | 11.8x | 10.7x | 9.7x | 8.4x | |
| Dividend yield (net) | 0.95% | 1.91% | 1.91% | 1.91% | 0.00% |
| P/BV (stated) | 1.8x | 1.6x | 1.5x | 1.3x | |
| P/BV (adjusted) | 1.9x | 1.8x | 1.7x | 1.5x | |

Punjab National Bank (PNB) is India's second-largest state bank. It has an asset base of Rs1,259bn. Its business is concentrated in north India. The government holds 57.8% of PNB. It made an IPO in March 2002 and a follow-on offer in March 2005. PNB has more than 4,400 branches in India.

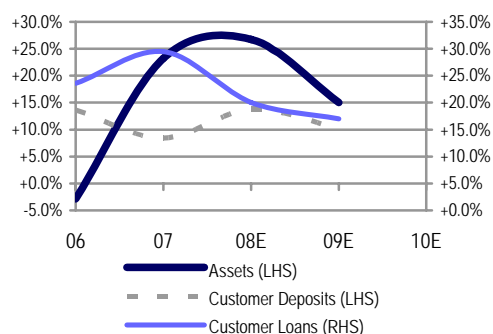
Profitability (RoE & RoRWA)



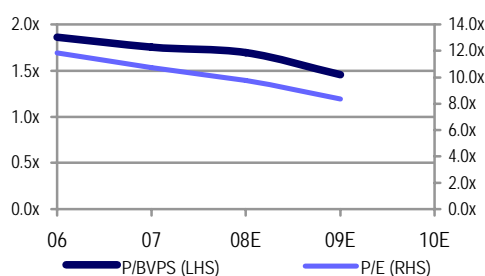
Momentum (Revenue & Operating profit growth)



Balance Sheet Growth



Value (P/Adj. BVPS & P/Adj. EPS)



Source: UBS estimates, * Historical, current, & future valuations are based on a share price of Rs524.05 as at close on 26 Oct 2007

■ Punjab National Bank

Punjab National Bank (PNB) is India's second-largest state bank. It has an asset base of Rs1,259bn. Its business is concentrated in north India. The government holds 57.8% of PNB. It made an IPO in March 2002 and a follow-on offer in March 2005. PNB has more than 4,400 branches in India.

■ Statement of Risk

We believe a faster than expected increase in interest rates is the key risk to our rating and price target for PNB.

■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

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UBS Investment Research: Global Equity Rating Allocations

| UBS 12-Month Rating | Rating Category | Coverage ¹ | IB Services ² |
|-----------------------|-----------------|-----------------------|--------------------------|
| Buy | Buy | 55% | 40% |
| Neutral | Hold/Neutral | 36% | 35% |
| Sell | Sell | 9% | 22% |
| UBS Short-Term Rating | Rating Category | Coverage ³ | IB Services ⁴ |
| Buy | Buy | 0% | 29% |
| Sell | Sell | 0% | 0% |

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 30 September 2007.

UBS Investment Research: Global Equity Rating Definitions

| UBS 12-Month Rating | Definition |
|-----------------------|---|
| Buy | FSR is > 6% above the MRA. |
| Neutral | FSR is between -6% and 6% of the MRA. |
| Sell | FSR is > 6% below the MRA. |
| UBS Short-Term Rating | Definition |
| Buy | Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event. |
| Sell | Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event. |

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Short-Term Ratings reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.

UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.

Core Banding Exceptions (CBE): Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned or Company Disclosure table in the relevant research piece.

Company Disclosures

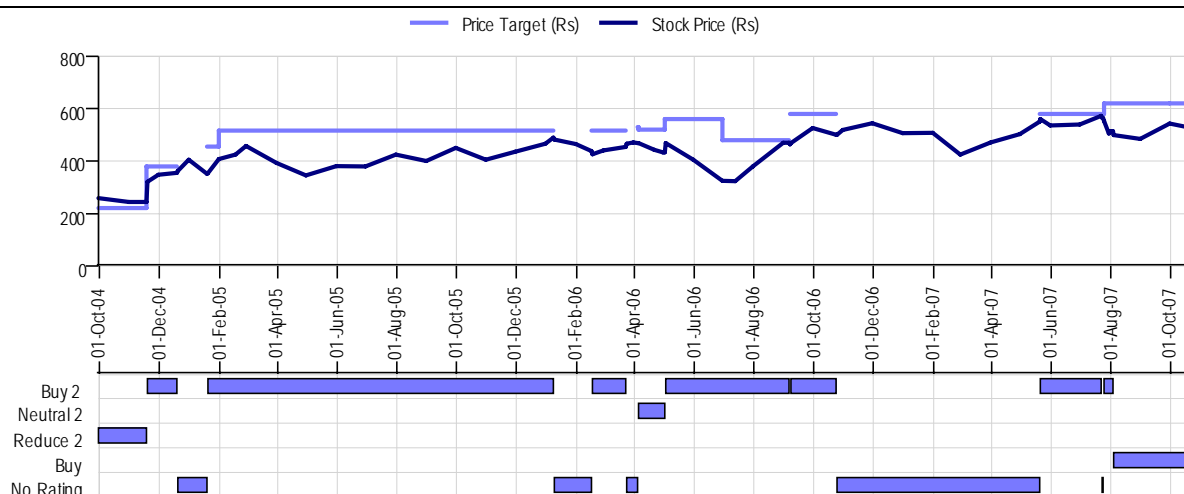
| Company Name | Reuters | 12-mo rating | Short-term rating | Price | Price date |
|----------------------|---------|--------------|-------------------|----------|-------------|
| Punjab National Bank | PNBK.BO | Buy (CBE) | N/A | Rs524.05 | 26 Oct 2007 |

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Punjab National Bank (Rs)



Source: UBS; as of 26 Oct 2007

Note: On August 4, 2007 UBS revised its rating system. (See 'UBS Investment Research: Global Equity Rating Definitions' table for details). From September 9, 2006 through August 3, 2007 the UBS ratings and their definitions were: Buy 1 = FSR is > 6% above the MRA, higher degree of predictability; Buy 2 = FSR is > 6% above the MRA, lower degree of predictability; Neutral 1 = FSR is between -6% and 6% of the MRA, higher degree of predictability; Neutral 2 = FSR is between -6% and 6% of the MRA, lower degree of predictability; Reduce 1 = FSR is > 6% below the MRA, higher degree of predictability; Reduce 2 = FSR is > 6% below the MRA, lower degree of predictability. The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities. From October 13, 2003 through September 8, 2006 the percentage band criteria used in the rating system was 10%.

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