



## Punjab National Bank

STOCK INFO.	BLOOMBERG
BSE SENSEX: 13,024	PNB IN
	REUTERS CODE
S&P CNX: 3,769	PNBK.BO

30 October 2006

Buy

Rs519

Previous Recommendation: Buy

Equity Shares (m)	315.3
52-Week Range	544/300
1,6,12 Rel.Perf.(%)	-6/12/-37
M.Cap. (Rs b)	163.5
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	11.4	1.8	12.0	16.4	1.1	1.8
3/07E	61,883	17,136	54.3	19.1	9.5	1.6	10.4	17.0	1.1	1.6
3/08E	74,199	21,492	68.2	25.4	7.6	1.3	10.3	18.4	1.2	1.4

Punjab National Bank (PNB) reported earnings growth of 20% for 2QFY07, driven by higher margins and business growth. NII grew 14% YoY, with improvement in margins. Business growth remained strong, with a focus on CASA deposits. Asset quality continued to improve and net NPAs are now at 0.18%.

- Steady business growth; advances up 29% YoY, deposits up 17% YoY
- Margins improve on back of rising yields and largely stable cost of deposits
- Core fee income increases by 18% YoY
- Net NPAs at 0.18%, down QoQ

Given that the bank is sustaining its strong margins and loan growth, we upgrade our earnings estimates by 9% for FY07 and by 3% for FY08. Also, we are not assuming higher pension costs through the opex line now. We expect PNB to report EPS of Rs54 in FY07 and Rs68 in FY08. The stock trades at 7.6x FY08E earnings and 1.3x FY08E book value, with an estimated RoE of 18% in FY08. We maintain **Buy**.

## QUARTERLY PERFORMANCE

	(RS MILLION)									
	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Interest Income	22,899	23,705	24,548	24,689	26,405	27,643	28,230	29,580	95,841	111,858
Interest Expense	12,016	11,797	12,474	12,887	13,476	14,015	14,469	15,607	49,174	57,568
<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>13,760</b>	<b>13,973</b>	<b>46,667</b>	<b>54,290</b>
% Change (YoY)	16.3	22.8	17.3	10.1	18.8	14.4	14.0	18.4	16.5	16.3
Other Income	2,528	3,123	2,445	4,215	-1,055	2,840	2,519	3,289	12,312	7,593
<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>16,279</b>	<b>17,262</b>	<b>58,978</b>	<b>61,883</b>
% Change (YoY)	-3.2	-4.3	13.7	10.5	-11.5	9.6	12.1	7.8	3.8	4.9
Operating Expenses	6,966	8,195	9,036	6,034	6,969	7,580	8,100	8,854	30,231	31,503
<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>8,179</b>	<b>8,407</b>	<b>28,748</b>	<b>30,380</b>
Provision & Contingencies	1,162	94	1,032	6,111	-230	1,018	2,200	2,911	8,399	5,900
<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>5,979</b>	<b>5,496</b>	<b>20,348</b>	<b>24,480</b>
Tax Provisions	1,701	2,522	747	985	1,460	2,820	1,674	1,390	5,955	7,344
<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>4,305</b>	<b>4,106</b>	<b>14,394</b>	<b>17,136</b>
% Change (YoY)	11.0	2.3	17.9	-19.9	2.6	19.7	16.2	42.2	2.1	19.1
Cost to Income Ratio (%)	51.9	54.5	62.2	37.7	58.7	46.0	49.8	51.3	51.3	50.9
Int exp/ Int Earned (%)	52.5	49.8	50.8	52.2	51.0	50.7	51.3	52.8	51.3	51.5
Other Income / Net Income (%)	18.9	20.8	16.8	26.3	-8.9	17.2	15.5	19.1	20.9	12.3

E: MOST Estimates;

Punjab National Bank (PNB) reported earnings growth of 20% for 2QFY07, driven by higher margins and business growth. NII grew 14% YoY, with improvement in margins. Business growth remained strong, with a focus on CASA deposits. Asset quality continued to improve and net NPAs are now at 0.18%.

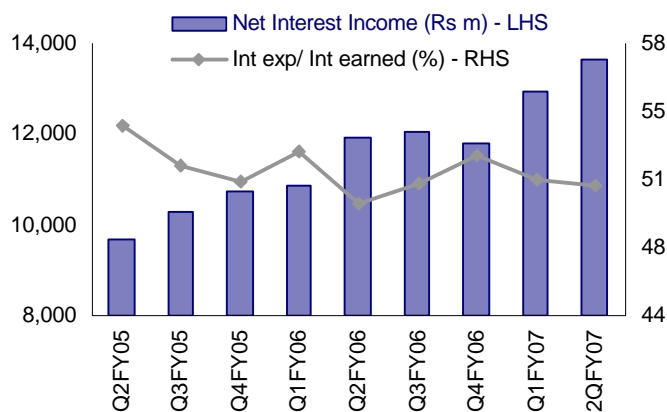
### Steady business growth; advances up 29% YoY, deposits up 17% YoY

PNB's deposits grew by 17% YoY in 2QFY07 to Rs1.28t, while its loan book grew by 29% YoY to Rs823b. CASA deposits have grown faster, and the proportion of CASA deposits has increased from 46% in 2QFY06 to 49% in 2QFY07.

Retail loans have grown 48% YoY and constitute 24% of total gross loans. Loans to agriculture grew by 33% YoY and constitute 19.4% of net loans. The SSI sector grew by 30% YoY. Growing loan book has resulted in NII growing by 14% YoY. We expect NII to increase by 16% in FY07 on the back of robust loan growth and stable margins.

Growth is likely to moderate going forward, as the management expect advances growth of ~20% in FY07 and deposit growth of 17-18%. However, low cost deposits are likely to grow faster and the management expects CASA ratio to improve to 51% by end-FY07.

#### INCREASING NII



Source: Company/Motilal Oswal Securities

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

Loan yields have increased from 8.35% in 2QFY06 to 8.97% in 2QFY07, while deposit cost has remained relatively flat YoY, given the high CASA component in the bank's overall deposits. Almost 49% of PNB's deposits are at fixed rates (CASA) and the bank has been able to maintain its cost of deposits at 4.4%.

NIMs have improved from 4% in 1HFY06 to 4.16% in 1HFY07. In fact, on a QoQ basis, margins have increased from 4.1% to ~4.2%, a 10bp improvement. With the full effect of August lending rate hike still to come in, coupled with a high CASA component, margins are likely to remain stable for PNB over the next couple of quarters.

#### INCREASING NIMS

NIMS BREAKDOWN (%)	1HQFY06	FY06	1QFY07	1HFY07
Yield on Advances	8.4	8.3	8.8	9.0
Yield on Investments	7.9	8.2	7.9	7.8
Cost of Deposits	4.3	4.3	4.4	4.4
NIMs	4.0	4.0	4.1	4.2

Source: Company/Motilal Oswal Securities

### Core fee income increases by 18% YoY

PNB's core fee income has increased by 18% YoY, on the back of increase in service charges, credit-related fees and higher LC commissions/bank guarantees. The management has mentioned that on account of implementation of the CBS network, revenue leakages have declined, resulting in higher revenues. Treasury income has declined 53% YoY to Rs630m.

### Operating expenses decline 7.5% YoY

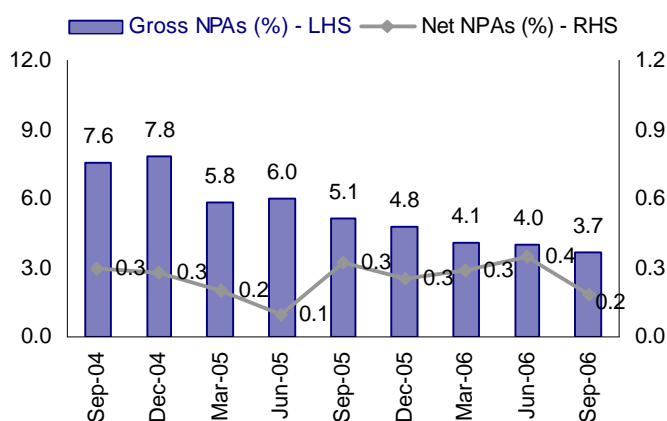
Operating expenses have declined by 7.5% YoY. This is largely due to the fact that in 2QFY06, the bank had effected a wage revision resulting in higher operating expenses during that quarter. On the AS-15 impact, PNB has already started making higher provisions as per actuarial valuations (~Rs1.5b in 1HFY07). On the past arrears, the management indicated that the gap is likely to be in the range of Rs4-5b (~4% of FY07 book value).

### Net NPAs at 0.18%, down QoQ

PNB's asset quality continued to improve, with gross & net NPAs declining by 33bp & 17bp QoQ to 3.7% & 0.2%, respectively in 2QFY07. The management has guided for gross NPAs of 2.5% by FY08. Net NPAs are likely to remain low, going forward.

With a coverage ratio of 95%, we expect PNB to 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.

#### STABLE ASSET QUALITY



Source: Company/Motilal Oswal Securities

### Investment provisions written-back

For the quarter, the bank has written back Rs1.5b of marked-to-market (MTM) provisions, which it had made in 1QFY07 due to rise in yields. NPA provisions are Rs1.9b in 2QFY07, higher than in 1QFY07 and 2QFY06, resulting in net NPAs declining to 0.2% from 0.4% QoQ.

### Comfortable capital adequacy

Capital adequacy is 12.7% (Tier-1 is 9.6%). Basel-2 operational risk impact on PNB is likely to be ~90bp in FY07. Post Basel-2 impact, management stated that by FY07 they would like to maintain a capital adequacy ratio (CAR) of over 12%.

### Valuation and view

Given that the bank is sustaining its strong margins and loan growth, we upgrade our earnings estimates by 9% for FY07 and by 3% for FY08. Also, we are not assuming higher pension costs through the opex line now. We expect PNB to report EPS of Rs54 in FY07 and Rs68 in FY08. The stock trades at 7.6x FY08E earnings and 1.3x FY08E book value, with an estimated RoE of 18% in FY08. We maintain **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 0.2%, 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	9.5	13.3	10.8
	FY08E	7.6	11.2	8.7
P/ABV (x)	FY07E	1.6	2.1	1.3
	FY08E	1.4	1.8	1.1
RoE (%)	FY07E	17.0	14.8	11.5
	FY08E	18.4	15.6	12.9
RoA (%)	FY07E	1.1	0.8	0.8
	FY08E	1.2	0.9	0.9

### SHAREHOLDING PATTERN (%)

	SEPO6	JUN.06	SEPO5
Promoters	57.8	57.8	57.8
Domestic Institutions	13.6	12.5	10.6
FII/DFIs	20.1	20.1	20.1
Others	8.5	9.6	11.5

### 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 7.6x FY08E earnings and 1.3x FY08E BV. We 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.

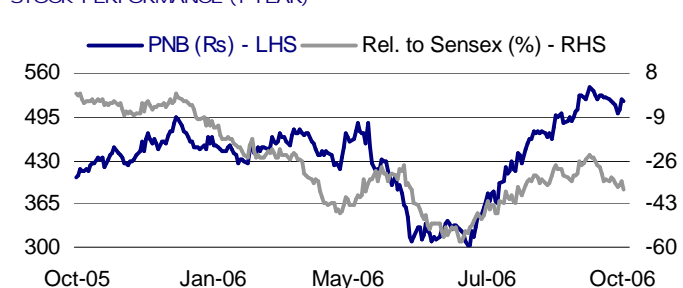
### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	54.3	51.6	5.2
FY08	68.2	65.9	3.5

### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
519	582	12.2	Buy

### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						RATIOS					
(Rs Million)											
Y/E MARCH	2005	2006	2007E	2008E	2009E	Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	84,599	95,842	111,858	133,407	158,021	<b>Spreads Analysis (%)</b>					
Interest Expended	44,531	49,174	57,568	70,511	83,974	Avg. Yield - Earning	7.7	7.3	7.7	8.1	8.2
<b>Net Interest Inco</b>	<b>40,067</b>	<b>46,668</b>	<b>54,290</b>	<b>62,896</b>	<b>74,047</b>	Avg. Cost-Int. Bear. l	4.6	4.2	4.3	4.7	4.8
Change (%)	10.5	16.5	16.3	15.9	17.7	Interest Spread	3.2	3.1	3.4	3.4	3.4
Other Income	16,757	12,312	7,593	11,302	13,724	Net Interest Margin	3.7	3.6	3.7	3.8	3.9
Bond Gains	3,528	2,109	-5,170	-2,000	-500	<b>Profitability Ratios (%)</b>					
<b>Net Income</b>	<b>56,824</b>	<b>58,979</b>	<b>61,883</b>	<b>74,199</b>	<b>87,771</b>	RoE	21.4	16.4	17.0	18.4	19.7
Change (%)	3.5	3.8	4.9	19.9	18.3	RoA	12	1.1	1.1	1.2	1.3
Operating Expenses	29,752	30,232	31,503	35,296	38,961	Int. Expended/Int.Ear	52.6	51.3	51.5	52.9	53.1
<b>Operating Incom</b>	<b>27,072</b>	<b>28,748</b>	<b>30,380</b>	<b>38,903</b>	<b>48,810</b>	Other Inc./Net Incom	29.5	20.9	12.3	15.2	15.6
Change (%)	-13.3	6.2	5.7	28.1	25.5	<b>Efficiency Ratios (%)</b>					
Other Provisions	8,016	8,399	5,900	8,200	10,300	Op. Exps./Net Incom	52.4	51.3	50.9	47.6	44.4
<b>P B T</b>	<b>19,056</b>	<b>20,348</b>	<b>24,480</b>	<b>30,703</b>	<b>38,510</b>	Empl. Cost/Op. Exps	71.3	70.0	69.4	68.8	68.4
Tax	4,955	5,955	7,344	9,211	11,553	Busi. per Empl. (Rs r	25.6	30.9	37.5	45.4	54.5
Tax Rate (%)	26.0	29.3	30.0	30.0	30.0	NP per Empl. (Rs lac	2.4	2.5	3.0	3.8	4.9
<b>P A T</b>	<b>14,101</b>	<b>14,393</b>	<b>17,136</b>	<b>21,492</b>	<b>26,957</b>	<b>Asset-Liability Profile (%)</b>					
Change (%)	27.2	2.1	19.1	25.4	25.4	Adv./Deposit Ratio	58.6	62.4	69.4	72.4	74.9
Proposed Dividend	1977	2,838	3,153	3,784	4,730	Invest./Deposit Ratio	49.1	34.3	32.8	31.1	29.5
<b>BALANCE SHEET</b>						<b>VALUATION</b>					
(Rs Million)											
Y/E MARCH	2005	2006	2007E	2008E	2009E	Book Value (Rs)	249	288	332	388	459
Capital	3,153	3,153	3,153	3,153	3,153	Price-BV (x)	2.1	1.8	1.6	1.3	1.1
Reserves & Surplus	78,460	90,611	104,594	122,302	144,529	Adjusted BV (Rs)	246	283	326	380	450
<b>Net Worth</b>	<b>81,613</b>	<b>93,764</b>	<b>107,747</b>	<b>125,455</b>	<b>147,682</b>	Price-ABV (x)	2.1	1.8	1.6	1.4	1.2
<b>Deposits</b>	<b>1,031,669</b>	<b>1,196,850</b>	<b>1,376,378</b>	<b>1,596,598</b>	<b>1,852,054</b>	EPS (Rs)	44.7	45.6	54.3	68.2	85.5
Change (%)	17.3	16.0	15.0	16.0	16.0	EPS Growth (%)	7.0	2.1	19.1	25.4	25.4
Borrowings	27,183	66,872	18,000	18,000	18,000	Price-Earnings (x)	11.6	11.4	9.5	7.6	6.1
Other Liabilities & Pr	121,948	95,188	110,188	125,188	140,188	OPS (Rs)	85.9	91.2	96.4	123.4	154.8
<b>Total Liabilities</b>	<b>1,262,413</b>	<b>1,452,674</b>	<b>1,612,312</b>	<b>1,865,241</b>	<b>2,157,924</b>	OPS Growth (%)	-27.0	6.2	5.7	28.1	25.5
Current Assets	110,890	247,917	148,172	153,541	159,381	Price-OP (x)	6.0	5.7	5.4	4.2	3.4
Investments	506,728	410,553	451,608	496,769	546,446	<b>E: MOST Estimates</b>					
Change (%)	20.3	-19.0	10.0	10.0	10.0						
Advances	604,128	746,274	955,230	1,155,829	1,386,994						
Change (%)	27.9	23.5	28.0	21.0	20.0						
Net Fixed Assets	9,652	10,302	12,302	14,102	18,102						
Other Assets	310,15	37,628	45,000	45,000	47,000						
<b>Total Assets</b>	<b>1,262,414</b>	<b>1,452,674</b>	<b>1,612,313</b>	<b>1,865,241</b>	<b>2,157,924</b>						
<b>ASSUMPTIONS</b>											
(%)											
Deposit Growth	17.3	16.0	15.0	16.0	16.0						
Advances Growth	27.9	23.5	28.0	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						
GRR	5.0	5.0	5.0	5.0	5.0						

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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