3 August 2009

BSE Sensex: 15924

INDIA RESEARCH

Punjab National Bank

Rs705

UPGRADING TO OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs222.3bn; US$4.6bn

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Result: Q1FY10

Comment: Operating metrics robust…restructurings surprise

Revision: Upgrading earnings by 6.1% for FY10 and 7.5% for FY11

Key valuation metrics

Year to March 31 (Rs m)	NII	yoy chg (%)	Net profit	yoy chg (%)	EPS (Rs)	P/ Adj.Bk (x)	PER (x)	RoE (%)
FY07	52,132	18.0	18,522	32.6	59	2.1	12.0	19.3
FY08	55,342	6.2	20,488	10.6	65	2.0	10.8	19.6
FY09	70,309	27.0	30,909	50.9	98	1.6	7.2	25.8
FY10E	82,708	17.6	36,623	18.5	116	1.3	6.1	25.0
FY11E	95,526	15.5	42,441	15.9	135	1.1	5.2	23.7

HIGHLIGHTS OF Q1FY10 RESULTS

Punjab National Bank ('PNB') delivered strong net profit growth of ~62.4% yoy to Rs8.32bn in Q1FY10, ahead of our estimates of Rs7.0bn. The outperformance was driven by strong core performance and robust treasury gains.

- **Incremental restructurings surprise at ~3% of the book…:** PNB incrementally restructured ~Rs50bn of advances during Q1FY10 (as against pending application worth ~Rs8bn in March 2009), amounting to 3.2% of net advances. This takes the cumulative restructuring to ~6% of the loan book. PV loss provisions of Rs1.3bn were made during the quarter, amounting to ~2.6% of restructured loans.
- **…while Gross NPAs remain steady:** Gross NPAs remained steady at 1.8% in Q1FY10, and Net NPAs at 0.19%. Provision coverage ratio came in at 89.6% as against 90.5% in Q4FY09. The bank continues to deduct floating provisions of Rs10.8bn from NPAs by RBI's permission. (Exhibit 5)
- **Healthy NII growth led by improving CD ratio:** NII came in at Rs18.6bn, (in line with our estimates of Rs18.5bn), a 28.9% yoy growth, buoyed by an improving CD ratio and yoy improvement in margins.
- **Margins expand on a yoy basis:** In Q1FY10, NIMs held up – an increase of ~15bp yoy to 3.41% - owing to rapid re-pricing of bulk deposits and contained sub PLR lending. Yields on advances declined by ~50bps qoq owing to PLR cuts affected in the quarter while average cost of deposits declined by ~30bp qoq to 5.94%. Sub-PLR proportion of the book has declined to ~30% as against ~60% earlier. (Exhibit 1)
- **Robust non-fund income; stellar treasury gains:** Non-interest income grew by 113% yoy to Rs9.70bn, buoyed by strong treasury profits of Rs3.59bn (~23% of operating profit) and traction in CEB (~45% yoy growth). (Exhibit 3)
- **Strong deposit growth; CASA slips:** Growth in total deposits was strong at 27% yoy and 4.4% qoq. PNB's CASA ratio declined by ~70qoq and ~300bp yoy to 38.3%.(Exhibit 2)
- **Provisioning expenses in line**: The bank made provisions of Rs3.0bn, of which Rs2.7bn are specific loan loss provisions (including provisions on restructured assets of Rs1.3bn). The bank booked write-back of MTM

provisions of Rs500mn in the quarter as the total write-back of Rs2.4bn was set off against a loss of Rs1.9bn on transfer of securities from AFS to HTM category. (Exhibit 6)

- Expenses rise in line: Expenses grew by ~38% yoy to Rs12.6bn, driven by ~41% yoy growth in employee costs. During Q1FY10, an ad-hoc wage hike provision of Rs1.5bn was made (cumulative provision of Rs7.5bn).
- **Comfortably capitalized:** PNB's CRAR stands at 14.45% as of Jun '09, with a Tier-I ratio of 9.1%. Tier-II CRAR has increased by ~30bp qoq aided by Tier II bond issue of Rs10bn during the quarter. The bank also redeemed Tier II bonds worth Rs950mn during the quarter

VALUATIONS & VIEW

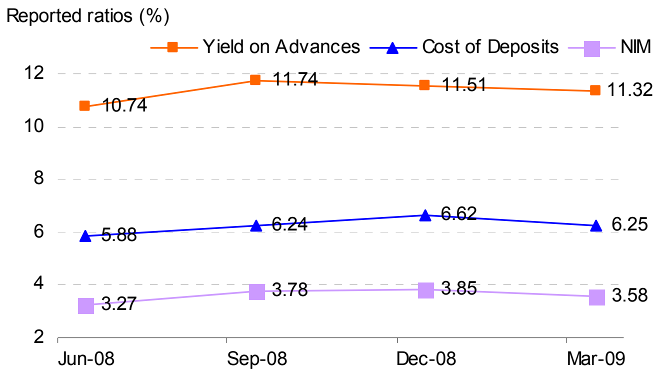
Punjab National Bank (PNB) reported net profit of Rs8.3bn in Q1FY10, ahead of our estimates on the back of strong core performance – namely, sustained traction in NII and strong fee income – as well as robust trading gains. The bank continues to grow in a calibrated manner reflected in improving CD ratio and steady margins. While the rise in restructurings has surprised negatively, we believe that the market concerns are exaggerated, further accentuated by lack of clear disclosures. However, a potential recovery in the economy, along with PNB's coverage ratio at ~90% (highest amongst peers) offer comfort on the asset quality. Conservatively, our estimates factor in ~35% rise in credit costs in FY10. We expect the bank to benefit from the revival in credit demand, and factoring in higher fee income and trading gains we are upgrading our earnings estimates by 6.1% for FY10 and 7.5% for FY11. We expect the bank to report 17% CAGR in net profit over FY09-11E and an average RoE of 24% over the period. The stock is currently trading at 1.3x FY10E and 1.1x FY11E adjusted book. We expect improving fundamentals, coupled with clarity on asset quality concerns to serve as positive triggers for the stock in the near term. Upgrade to 'Outperformer', with a revised price target of Rs875.

Quarterly results

Rs mn	Q1FY09	Q2FY09	Q3FY09	Q4FY09	Q1FY10	FY09	FY10E	FY11E	Comments
Total intt income	41,385	46,504	52,947	52,426	52,074	193,262	223,063	258,867	
Interest expense	26,937	29,382	33,273	33,360	33,456	122,953	140,355	163,341	
Net interest income	**14,448**	**17,122**	**19,674**	**19,065**	**18,618**	**70,309**	**82,708**	**95,526**	Better than peers- buoyed by an improving CD ratio and yoy improvement in margins
yoy growth (%)	11.0	32.6	38.1	25.7	28.9	27.0	17.6	15.5	
Other income	4,561	6,628	9,452	8,556	9,702	29,197	34,653	35,465	Buoyed by strong treasury profits and fee income growth
yoy growth (%)	(10.4)	41.7	95.5	59.3	112.7	46.2	18.7	2.3	
Trading gains	129	723	3,412	2,384	3,585	6,647	6,500	3,500	
Non trading income	3,754	3,904	4,465	1,580	5,199	22,257	28,153	31,965	CEB exhibits strength
Net revenue	19,009	23,750	29,127	27,621	28,320	99,505	117,361	130,990	
Operating expenses	9,185	10,072	11,066	11,740	12,626	42,062	49,386	55,586	Includes Rs1.5bn of wage hike provisions
Operating profit	**9,824**	**13,678**	**18,060**	**15,882**	**15,693**	**57,443**	**67,975**	**75,404**	
yoy growth (%)	5.3	60.0	82.2	29.5	59.7	43.4	18.3	10.9	
Total provisions	2,105	3,177	1,813	2,678	3,018	9,774	11,632	10,110	Elevated owing to asset quality stress; supported by MTM write-backs
PBT	**7,719**	**10,501**	**16,247**	**13,203**	**12,676**	**47,669**	**56,343**	**65,294**	
Tax	2,595	3,430	6,188	4,548	4,355	16,760	19,720	22,853	
PAT	**5,124**	**7,071**	**10,059**	**8,656**	**8,321**	**30,909**	**36,623**	**42,441**	Well ahead of expectations of 37% yoy growth
yoy growth (%)	20.5	31.3	85.8	59.2	62.4	50.9	18.5	15.9	
Ratios (%)									
Net interest margin*	2.9	3.2	3.5	3.2	3.0	3.2	3.1	3.1	slight qoq decline, but remains ahead of peers
Non fund rev/Avg assets	0.9	1.2	1.7	1.4	1.5	1.3	1.3	1.1	
Core fee inc/Avg assets	0.7	0.7	0.8	0.3	0.8	0.6	0.7	0.7	
Op expenses/avg assets	1.8	1.9	2.0	2.0	2.0	1.9	1.9	1.8	
Tot prov/ avg assets	0.4	0.6	0.3	0.4	0.5	0.4	0.4	0.3	Expected to stabilize
PBT/avg assets	1.5	2.0	2.9	2.2	2.0	2.1	2.1	2.1	
PAT/ avg assets	1.0	1.3	1.8	1.4	1.3	1.4	1.4	1.4	
Tax/PBT	33.6	32.7	38.1	34.4	34.4	35.2	35.0	35.0	
CRAR	12.3	13.6	13.9	14.0	14.5				Comfortably capitalized to sustain growth
Tier- I CRAR	8.3	9.2	9.4	9.0	9.1				
CD Ratio	66.1	70.0	71.8	73.8	72.1				Improvement - a distinct improvement as against a decline for the industry
Balance Sheet (Rs bn)									
Credit	1,144	1,304	1,415	1,547	1,580				Strong growth continues
yoy change (%)	*19.6*	*28.5*	*39.4*	*29.5*	*38.1*				
Deposits	1,731	1,863	1,971	2,098	2,190				Remains robust; CASA slips
yoy change (%)	*21.4*	*24.2*	*29.1*	*26.0*	*26.5*				

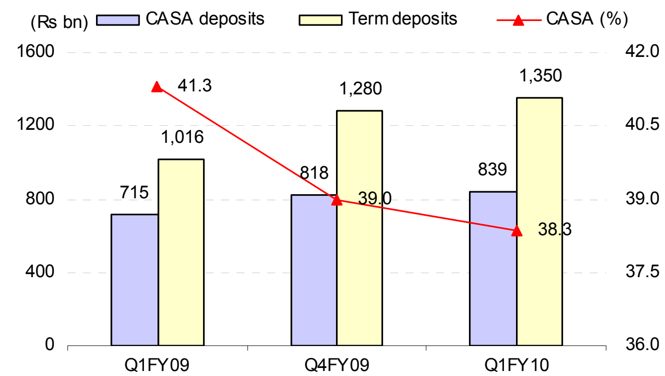
** Calculated ratios are on average quarterly balance*

Exhibit 1: Margins face pressure



- NIMs expand on a yoy basis, buoyed by an improving CD ratio
- Proportion of sub PLR loans in the book down to ~30% as against ~60% last year

Exhibit 2: CASA slips



- Sequential decline on ~70bps as year end current balances flow out
- CASA deposits grow by 17% yoy as against 33% growth in term deposits

** Calculated on average quarterly balances*

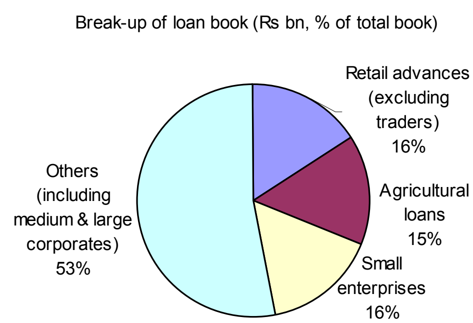
Exhibit 3: Non-interest income break up (Rs mn)

Rs mn	Jun-08	Mar-09	Jun-09	yoy chg (%)	qoq chg (%)
Forex	590	410	610	3	49
CEB	3,164	4,170	4,589	45	10
Fee income	*3,754*	*4,580*	*5,199*	38	14
Trading	129	2,384	3,585	2679	50
Others	679	1,592	918	35	(42)
Total	**4,561**	**8,556**	**9,702**	**113**	**13**

- Growth in CEB fees was strong driven by trade credit as well as government business
- Trading gains bolster the bottom-line

**NM = Not meaningful*

Exhibit 4: Composition of loan book



- Credit growth continued to be strong at 38%, with ~35% of incremental lending being to SME and ~60%% being corporate
- Retail continued to be ~16% of total book

Exhibit 5: Gross NPA's contained

Rs m	Jun-08	Mar-09	Jun-09	Incremental (Rs m/bp)
Gross NPAs	32,647	27,675	28,647	972
Net NPAs	7,148	2,639	2,972	333
Gross NPA (%)	2.82	1.77	1.80	3
Net NPA (%)	0.63	0.17	0.19	2
Provision Coverage (%)	78.1	90.5	89.6	(84)

- Gross NPAs rise qoq on the back of slippages of Rs53bn in the quarter. Coverage remains steady
- Restructured ~Rs50bn during Q1FY10 (3%+ of advances)

Exhibit 6: Provisioning expenses breakup

Rs m	Jun-08	Mar-09	Jun-09
Prov for NPA	480	1,520	2,690
Provision for depreciation	1,511	(420)	(500)
Other prov	115	1,578	828
Total provisions	**2,105**	**2,678**	**3,018**

- Specific loan loss provisions of Rs2.7bn; Rs1.3bn of restructuring prov
- MTM write-back restricted at Rs500mn, owing to Rs1.9bn loss on securities transferred from AFS to HTM

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