

Equities

8 November 2011 | 14 pages

Punjab National Bank (PNBK.BO)

Sell: Asset Quality Remains a Concern

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

■ **Introducing CIRA's New Stock Rating System** — Citi Investment Research and Analysis (CIRA) recently announced its new stock rating system. CIRA's investment ratings are Buy, Neutral and Sell. Our ratings are a function of analyst expectations of expected total return ("ETR") and risk. Risk rating takes into account both price volatility and fundamental criteria. Stocks will either have no risk rating or a High risk rating assigned. The sidebar and table on this page show our new rating, target price, and estimates for PNB. See "Guide to Citi Investment Research & Analysis (CIRA) Fundamental Research Investment Ratings" in the Important Disclosures section of Appendix A1 of this report for a description of our rating system.

■ **Reducing earnings 5-8%, TP to Rs930, maintain Sell** — We reduce FY12-14E earnings 5-8% on higher-than-expected operating and credit costs. PNB's asset quality has remained under higher pressure than peers and is likely to limit valuations. We maintain our Sell with a revised EVA-based TP of Rs930 (prev. Rs1,100), benchmarked to 1.1x 1Yr Fwd P/BV. We remain near-term cautious on the sector given macro uncertainty, and prefer private banks over public sector (top picks Axis, ICICI, SBI).

■ **Asset quality concerns higher than peers** — Asset quality remains our key concern for PNB given its higher mid-market exposures and relatively high loan growth in FY07-11 vs. industry (26% CAGR vs. 20% for industry). Over the last 18 months, its incremental slippages have been high – 3.4% of loans cumulatively, with quarterly trends going up. Moreover, its Gross NPLs have increased 60% during this period and Net NPLs by 113% – significantly higher than peers. Our comparative analysis suggests PNB's asset quality has been closer to mid-cap PSU banks than other large cap peers.

■ **High restructured assets, could see continued slippages** — PNB's restructured assets are not only high (8% of loans), but also ongoing – cumulative restructuring in last 18 months is 3.1% of total loans vs. 1.3% peer average. Of total restructured loans, 11% have slipped to NPLs so far, however a vintage analysis of the slippages shows slippages increase rapidly with age (28% slippage from loans restructured in FY09 vs. 5% from those in FY11), which suggests continued caution ahead.

Sell	3
<i>from Sell/Medium Risk</i>	
Price (04 Nov 11)	Rs978.45
Target price	Rs930.00
<i>from Rs1,100.00</i>	
Expected share price return	-5.0%
Expected dividend yield	2.4%
Expected total return	-2.6%
Market Cap	Rs309,985M US\$6,333M

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



Figure 1. Statistical Abstract

Year to 31 March	Net Profit (RsM)	EPS (Rs)	EPS Growth (%)	P/E (X)	P/BV (X)	RoAE (%)	ROAA (%)	Yield (%)
FY09	30,909	98.0	50.9	10.0	2.3	22.9	1.4	2.0
FY10	39,054	123.9	26.4	7.9	1.9	24.1	1.4	2.2
FY11	44,335	140.3	13.3	7.0	1.5	22.6	1.3	2.2
FY12E	50,507	159.4	13.7	6.1	1.3	21.4	1.2	2.4
FY13E	60,420	190.7	19.6	5.1	1.1	21.4	1.3	2.5
FY14E	72,653	229.3	20.2	4.3	0.9	21.3	1.3	2.6

Source: Company Data, Citi Investment Research and Analysis Estimates

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	7.9	7.0	6.1	5.1	4.3
P/E reported (x)	7.9	7.0	6.1	5.1	4.3
P/BV (x)	1.7	1.4	1.2	1.0	0.8
P/Adjusted BV diluted (x)	1.9	1.5	1.3	1.1	0.9
Dividend yield (%)	2.2	2.2	2.4	2.5	2.6
Per Share Data (Rs)					
EPS adjusted	123.86	140.28	159.42	190.71	229.32
EPS reported	123.86	140.28	159.42	190.71	229.32
BVPS	562.09	678.91	811.53	974.29	1,174.49
Tangible BVPS	562.09	678.91	811.53	974.29	1,174.49
Adjusted BVPS diluted	514.77	632.48	765.11	927.86	1,128.06
DPS	22.00	22.00	23.00	24.00	25.00
Profit & Loss (RsM)					
Net interest income	85,229	118,073	139,460	160,328	185,174
Fees and commissions	16,822	20,452	22,497	24,747	27,222
Other operating Income	18,831	15,674	16,018	18,286	20,938
Total operating income	120,882	154,199	177,975	203,361	233,334
Total operating expenses	-47,619	-63,642	-71,429	-81,385	-92,746
Oper. profit bef. provisions	73,263	90,557	106,546	121,976	140,588
Bad debt provisions	-10,536	-23,335	-26,010	-29,993	-30,348
Non-operating/exceptionals	-3,679	-1,585	-5,152	-1,803	-1,803
Pre-tax profit	59,048	65,637	75,384	90,180	108,437
Tax	-19,994	-21,302	-24,877	-29,759	-35,784
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	39,054	44,335	50,507	60,420	72,653
Adjusted earnings	39,054	44,335	50,507	60,420	72,653
Growth Rates (%)					
EPS adjusted	26.4	13.3	13.7	19.6	20.2
Oper. profit bef. prov.	27.5	23.6	17.7	14.5	15.3
Balance Sheet (RsM)					
Total assets	2,966,328	3,783,252	4,390,613	5,119,158	5,973,184
Avg interest earning assets	2,660,450	3,299,963	4,004,035	4,677,911	5,473,644
Customer loans	1,895,330	2,454,031	2,939,778	3,476,671	4,105,375
Gross NPLs	32,144	43,784	54,634	64,805	76,635
Liab. & shar. funds	2,966,328	3,783,252	4,390,613	5,119,158	5,973,184
Total customer deposits	2,493,298	3,128,987	3,684,714	4,350,143	5,127,145
Reserve for loan losses	29,318	32,965	48,029	64,363	78,509
Shareholders' equity	177,229	215,086	257,104	308,666	372,092
Profitability/Solvency Ratios (%)					
ROE adjusted	24.1	22.6	21.4	21.4	21.3
Net interest margin	3.20	3.58	3.48	3.43	3.38
Cost/income ratio	39.4	41.3	40.1	40.0	39.7
Cash cost/average assets	1.8	1.9	1.7	1.7	1.7
NPLs/customer loans	1.7	1.8	1.9	1.9	1.9
Reserve for loan losses/NPLs	91.2	75.3	87.9	99.3	102.4
Bad debt prov./avg. cust. loans	0.6	1.1	1.0	0.9	0.8
Loans/deposit ratio	76.0	78.4	79.8	79.9	80.1
Tier 1 capital ratio	9.2	8.4	7.7	7.5	8.2
Total capital ratio	15.2	12.4	11.2	10.8	11.2

For further data queries on Citi's full coverage universe please contact CIRA Data Services Asia Pacific at CIRADataServicesAsiaPacific@citi.com or +852-2501-2791



Figure 2. Comparative Analysis: Restructured Assets and Slippages for Select India Banks (Rupees Million, Percentage)

	SBI*	PNB	BOB	Canara	Union	Bank of India*
Standard restructuring as % of loans	4.4%	8.0%	3.3%	3.9%	4.5%	5.2%
Cumulative Slippage out of restructuring	17%	11%	12%	9%	24%	na
Slippage in Loans Restructured During:						
FY09	NA	28%	NA	NA	20%	NA
FY10	NA	12%	17%	NA	24%	35%
FY11	NA	5%	25%	27%	80%	21%
1H12	NA	1%	13%	32%	NA	39%
Avg ticket size of restructuring (Rs mn)						
FY09	3.3	3.3	0.7	0.3	0.3	1.3
FY10	43.6	31.7	1.2	1.8	3.3	7.3
FY11	4.4	40.5	1.6	13.6	7.6	1.0
1H12	NA	302.2	1.8	1.6	37.2	NA
Split of Restructured Loans (%)						
Wholesale	72%	73%	58%	61%	38%	NA
SME	16%	8%	23%	9%	17%	NA
Retail	5%	11%	8%	6%	14%	NA
Agriculture	0%	1%	11%	7%	2%	NA
Others	7%	8%	0%	17%	28%	NA
Total	100%	100%	100%	100%	100%	

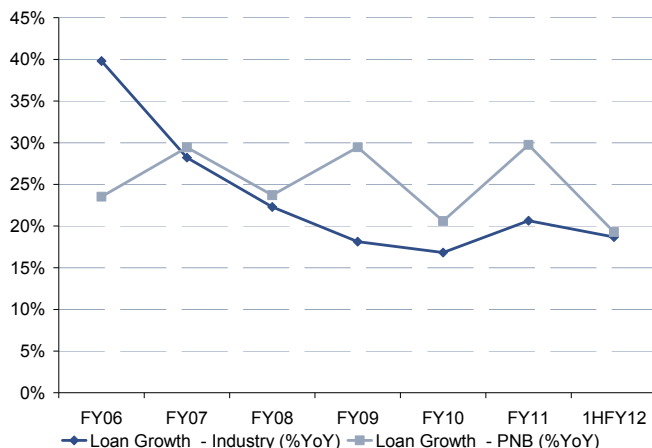
Source: Citi Investment Research and Analysis and Company Reports; Note: * Numbers for 1H12 refer to 1QFY12

Figure 3. Asset Quality Parameters for Select India Banks over March 2010 – September 2011

	SBI*	PNB	BOB	Canara	Union	Bank of India*
Cumulative Restructuring (% of loans)	0.7%	3.1%	1.1%	1.3%	1.1%	1.4%
Cumulative Slippages (Rsm)	268,290	65,230	30,643	61,170	55,110	30,397
Cumulative Slippages (% of loans)	4.2%	3.4%	1.7%	3.6%	4.5%	1.8%
Increase in Gross NPLs (% Change)	42	60	42	46	92	19
Increase in Net NPLs (% Change)	14	113	86	73	206	22

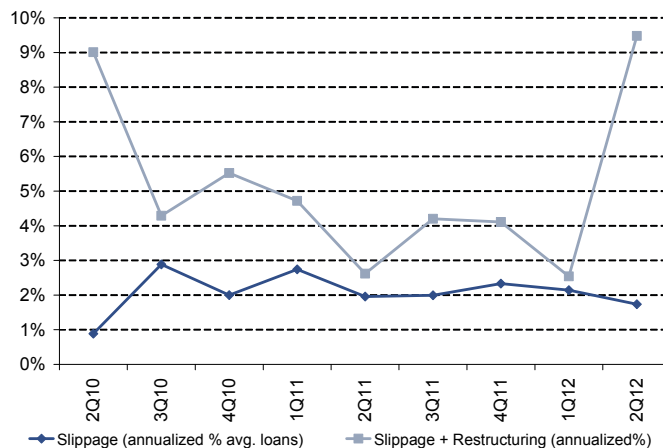
Source: Citi Investment Research and Analysis and Company Data; Note: * Numbers refer to period from March 2010- June 2011

Figure 4. Loan Growth – PNB and Industry (% YoY)



Source: Citi Investment Research and Analysis, RBI, Company Data

Figure 5. PNB: Quarterly Slippages, Slippage + Restructured Loans (% Average Loans, Annualized)



Source: Citi Investment Research and Analysis and Company Data

Figure 6. Slippage + Incremental Restructured as % of Average Loans (Annualized)

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12
State Bank of India	2.8%	5.6%	3.1%	4.1%	3.7%	NA
Punjab National Bank	4.7%	2.6%	4.2%	4.1%	2.5%	9.5%
Bank of Baroda	1.4%	1.7%	2.0%	2.6%	2.0%	2.3%
Canara Bank	5.1%	4.6%	2.3%	2.6%	3.7%	2.6%
Union Bank Of India	2.3%	4.5%	3.0%	2.2%	2.9%	7.6%
Oriental Bank of Commerce	-0.2%	2.3%	-0.6%	3.5%	-1.4%	4.8%
Andhra Bank	4.4%	-3.0%	3.1%	0.6%	0.8%	2.1%
Bank of India	0.4%	0.6%	2.4%	2.2%	2.8%	NA

Source: Citi Investment Research and Analysis, Company Data

Figure 7. PNB: Top 5 Sectors in Restructured Assets (As on 30 September, 2011, Rupees Million, Percent)

	Amount Outstanding (Rsm)	Percentage of Restructured Loans (%)
Retail	21,830	10.9%
Iron & Steel	26,760	13.4%
Power	25,530	12.8%
Infrastructure	18,860	9.4%
Drilling	17,300	8.7%
Total	103,730	52.0%

Source: Citi Investment Research and Analysis, Company Data

Figure 8. PNB: Earnings Revisions Summary

	Net Profit (RsM)			EPS (Rs)			DPS (Rs)	
	Old	New	% change	Old	New	% change	Old	New
FY12E	55,185	50,507	- 8.5	174.2	159.4	- 8.5	23.0	23.0
FY13E	63,882	60,420	- 5.4	201.6	190.7	- 5.4	24.0	24.0
FY14E	76,510	72,653	- 5.0	241.5	229.3	- 5.0	25.0	25.0

Source: Citi Investment Research and Analysis Estimates

Figure 9. CIRA Valuation Summary

	RIC Code	Price (Rs) 8-Nov	TP (Rs)	CIRA Rating	P/E		P/B		ROE (%)	ROA (%)	Div. Yld	M-Cap US\$M
					(x) 2012E	(x) 2013E	(x) 2012E	(x) 2013E	2012E	2012E	2012E	
Private Sector Banks												
ICICI Bank	ICBK.BO	885.2	1000	1	16.1	13.3	1.7	1.6	11.1%	1.4%	1.8%	20,840
HDFC Bank	HDBK.BO	482.1	500	2	22.5	17.5	3.7	3.1	18.1%	1.7%	0.7%	23,038
AXIS Bank	AXBK.BO	1128.9	1400	1	12.3	10.1	2.1	1.8	19.3%	1.5%	1.4%	9,511
Kotak Mahindra Bank	KTKM.BO	502.3	490	2	19.6	16.4	2.9	2.5	15.9%	2.4%	0.2%	7,576
Yes Bank	YESB.BO	316.6	345	1	11.5	9.1	2.4	1.9	22.7%	1.4%	0.9%	2,273
Federal Bank	FED.BO	417.9	460	1	10.4	8.7	1.3	1.1	12.7%	1.2%	1.4%	1,460
Govt. Banks												
State Bank of India	SBI.BO	1964.3	2500	1	10.6	8.0	1.7	1.4	16.9%	0.9%	1.5%	25,481
SBI - Consolidated	SBI.BO	1964.3	2500	1	8.0	6.4	1.4	1.2	17.3%	0.9%	1.5%	25,481
Punjab National Bank	PNBK.BO	978.5	930	3	6.1	5.1	1.3	1.1	19.6%	1.2%	2.4%	6,333
Bank of Baroda	BOB.BO	814.4	820	2	6.2	5.3	1.3	1.1	22.2%	1.3%	2.1%	6,514
Canara Bank	CNBK.BO	492.4	375	3	5.4	4.3	1.0	0.8	18.6%	1.1%	2.2%	4,456
Union Bank Of India	UNBK.BO	227.0	200	3	6.0	5.3	0.9	0.8	14.7%	0.8%	3.5%	2,432
Diversified Financial Services												
Infrastructure Development Finance	IDFC.BO	129.2	135	1	14.1	11.6	1.6	1.4	11.7%	2.6%	1.5%	3,861
LIC Housing Finance	LICH.BO	239.3	188	3	10.9	8.8	2.3	1.9	22.7%	1.8%	1.5%	2,320
L&T Finance Holdings	LTFH.BO	51.7	54	2	16.5	12.0	1.7	1.5	13.4%	2.3%	0.0%	1,811
Shriram Transport Finance	SRTR.BO	602.7	660	2	9.6	8.2	2.2	1.8	25.8%	4.0%	1.2%	2,785
SKS Microfinance	SKSM.BO	209.0	200	3H	NM	NM	1.0	1.1	-20.6%	-8.9%	0.0%	313
Mahindra And Mahindra Financial Services	MMFS.BO	668.5	610	3	11.3	9.6	2.3	1.9	21.7%	3.7%	1.6%	1,420
Edelweiss Capital	EDEL.BO	25.8	24	3	12.5	10.1	0.8	0.8	6.6%	1.0%	1.9%	398
Motilal Oswal Financial Services	MOFS.BO	85.9	77	3	12.2	10.2	1.1	1.0	9.2%	5.2%	1.5%	255
Reliance Capital	RLCP.BO	374.1	455	1	18.0	15.2	1.1	1.1	6.4%	1.5%	1.7%	1,877

Source: Citi Investment Research and Analysis Estimates

Quants View – Contrarian

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Data as of: 28-Oct-11

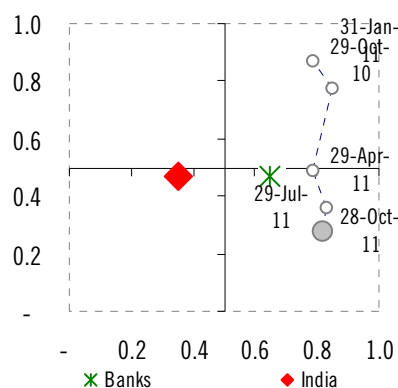
Punjab National Bank currently lies in the Contrarian quadrant of our Value-Momentum map with relatively weak momentum but strong value scores. It has been a resident there for the past six months. Compared to its peers in the Banks sector, Punjab National Bank fares better on the valuation metric but worse on the momentum metric. Similarly, compared to its peers in its home market of India, Punjab National Bank fares better on the valuation metric but worse on the momentum metric.

From a macro perspective, Punjab National Bank is likely to benefit from falling Commodity (ex-oil) prices, falling EM yields, and a weaker US dollar.

Radar Screen Quadrant Definitions

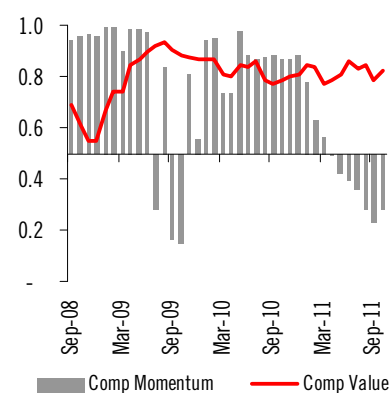
Glamour Poor relative value but superior relative momentum	Attractive Superior relative value and superior relative momentum
Unattractive Poor relative value and poor relative momentum	Contrarian Superior relative value but poor relative momentum

Figure 10. Radar Quadrant Chart History



Source: CIRA

Figure 11. Radar Valuation and Momentum Scores



Source: CIRA

Figure 12. Radar Model Inputs

IBES EPS (Actual and Estimates)

FY(-2)	101.40	Implied Trend Growth (%)	15.50
FY(-1)	125.99	Trailing PE (x)	6.63
FY0	145.08	Implied Cost of Debt (%)	6.73
FY1	163.40	Standardised MCap	(0.02)
FY2	196.19		

Note: Standardised MCap calculated as a Z score – (mkt cap - mean)/std dev – capped at 3

Source: Citi Investment Research and Analysis, Worldscope, I/B/E/S

Figure 13. Stock Performance Sensitivity to Key Macro Factors

Region	1.15	Commodity ex Oil	(0.49)
Local Market	1.05	Rising Oil Prices	(0.08)
Sector	1.14	Rising Asian IR's	(0.01)
Growth Outperforms Value	(0.61)	Rising EM Yields	(0.35)
Small Caps Outperform Large Caps	0.76	Weaker US\$ (vs Asia)	2.36
Widening US Credit Spreads	0.00	Weaker ¥ (vs US\$)	(0.02)

Source: Citi Investment Research and Analysis

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 58% 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 5,315 branches.

Investment strategy

We rate PNB as Sell with a target price of Rs930. It 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. However, we expect the positives are likely to be offset by: a) Relatively higher asset quality deterioration over the past 18 months, with sharp increases in both NPLs and restructured assets; b) Its aggressive loan growth stance, especially in the mid-market segments, which increases its leverage to the broader economy; and c) Higher sensitivity to a rising interest rate environment – could hurt NIMs if funding costs rise.

Valuation

Our target price for PNB of Rs930 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 8.5% in line with the current interest rate environment; b) longer-term loan loss provisions of 110bps, slightly higher than peers (100bps), c) loan spreads of 200bps, in line with industry levels, and d) long-term fee income growth of 7%. We also benchmark our valuation multiples at 1.1x 1Yr Fwd P/BV (Rs931) (previously 1.5x, at par with best of breed) – slightly lower than best of breed public sector banks due to its higher asset quality deterioration, which is more in-line with smaller PSU banks than its larger peers. We use EVA as our preferred valuation methodology as we believe it better captures the long-term value of the business

Risks

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 / non-performing assets; (2) Easy liquidity and a low interest rate environment, which would be likely to support loan growth and net interest margins; and (3) A strengthening of the bank's deposit franchise.

Appendix A-1

Analyst Certification

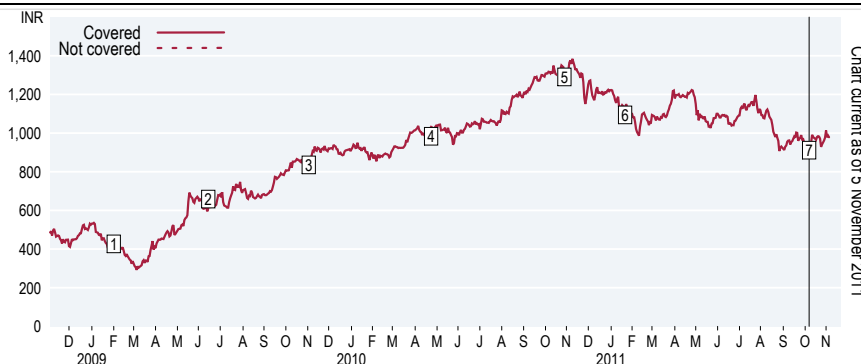
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IMPORTANT DISCLOSURES

Punjab National Bank (PNBK.BO)

Ratings and Target Price History Fundamental Research

Analyst: Manish Chowdhary, CFA
Covered since November 11 2009



	Date	Rating	Target Price	Closing Price
1	1-Feb-09	3M	*420.00	400.35
2	14-Jun-09	*1M	*780.00	594.95
3	3-Nov-09	*3M	*830.00	836.35

	Date	Rating	Target Price	Closing Price
4	23-Apr-10	3M	*950.00	1,032.20
5	28-Oct-10	3M	*1,275.00	1,309.95
6	21-Jan-11	3M	*1,100.00	1,122.55

	Date	Rating	Target Price	Closing Price
7	7-Oct-11	Stock rating system changed		

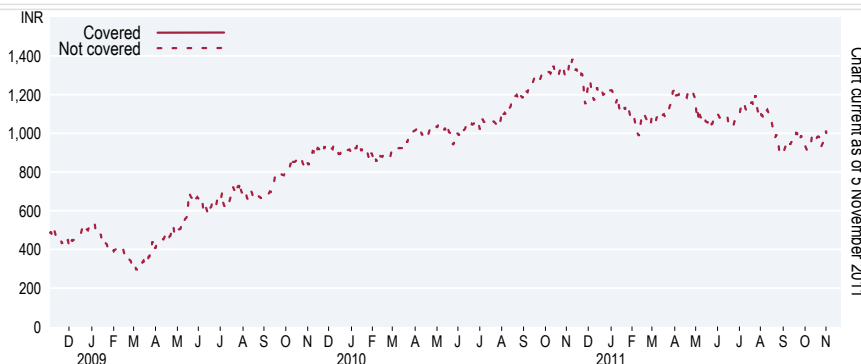
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Punjab National Bank (PNBK.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Manish Chowdhary, CFA
Covered since November 11 2009



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Punjab National Bank (PNBK.NS)

Rating History Global Quantitative Research Asia Radar Screen

Analyst: Paul R Chanin



	Date	Rating	Target Price	Closing Price
1	4-Sep-09	*2	-	681.35
2	4-Feb-11	*1	-	1,059.25

	Date	Rating	Target Price	Closing Price
3	8-Apr-11	*2	-	1,188.70
4	19-Aug-11	*5	-	991.60

	Date	Rating	Target Price	Closing Price
5	26-Aug-11	*2	-	909.20
6	9-Sep-11	*3	-	966.60

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Punjab National Bank (PNBK.BO)

Rating History
Global Quantitative Research
World Radar Screen

Analyst: Chris Montagu
Covered since May 23 2009

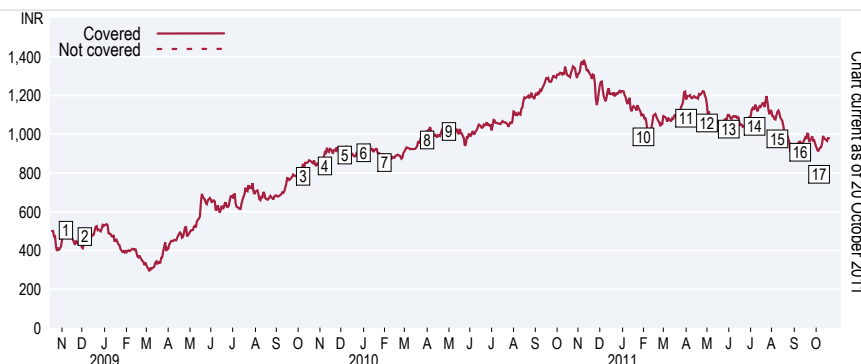


Chart current as of 20 October 2011

Date	Rating	Target Price	Closing Price
1 7-Nov-08	*3	-	496.30
2 4-Dec-08	*1	-	451.15
3 8-Oct-09	*3	-	847.15
4 9-Nov-09	*2	-	907.40
5 7-Dec-09	*1	-	918.25
6 1-Jan-10	*2	-	906.85

Date	Rating	Target Price	Closing Price
7 1-Feb-10	*1	-	886.70
8 1-Apr-10	*3	-	1,014.60
9 1-May-10	*1	-	1,037.70
10 1-Feb-11	*2	-	1,099.85
11 1-Apr-11	*5	-	1,179.45
12 1-May-11	*1	-	1,185.85

Date	Rating	Target Price	Closing Price
13 1-Jun-11	*2	-	1,100.10
14 7-Jul-11	*4	-	1,143.25
15 9-Aug-11	*5	-	1,116.05
16 9-Sep-11	*6	-	961.90
17 6-Oct-11	*3	-	911.60

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Citi Investment Research & Analysis Quantitative World Radar Screen Model Coverage	30%	40%	30%			
<i>% of companies in each rating category that are investment banking clients</i>	28%	21%	20%			
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