

2Q earnings in line; comfort on asset quality; Reiterate Buy

2Q: Earnings exactly in line, but +5-6% better than Street

PNB reported earnings of Rs12.1bn (exactly in line), up +12% yoy. This is after PNB made higher-than-required MTM provisions on its investment book. The book is now hedged up to 8.7% yields. Top line grew 16% yoy (7% ahead), driven by 19% loan growth. However, margins are down 11bps yoy (up 11bps qoq) to 4.0%. Disappointment was fee growth (core), which grew only 6% yoy, and CASA, which is down 430bps yoy (100bps qoq) to ~36%. Tier 1 is comfortable at ~9.3%.

Restructured loans shoot up, but slippage (net) trend down

While the bank's restructured loans showed a +25% jump qoq (by Rs41bn), we believe asset quality is very manageable. The bulk of the restructured increase qoq came from the power sector (Rs18bn is restructuring of Tamil Nadu Electricity Board) and Rs6.5bn from Aban. But reported slippages (net of recoveries) came in below our run-rate (~Rs7bn/qtr) and also down ~50% qoq, to Rs2.7bn (~0.5% of 1-yr lag loans). We still est. net slippages at ~Rs28/37bn in FY12/13, but asset quality should remain manageable, with provision cover est. at +74-75%.

Risk-return very attractive; Preferred pick

We have marginally tweaked our earnings (<1%) for FY12/13; hence, we still estimate PNB's earnings growth to sustain at +16/22% through FY12/13. Risk-return remains very attractive, with PNB trading at 1.2x FY13 book, with RoEs of ~22%. Hence, We reiterate Buy and PO; Preferred pick (ex SBI) in govt. space.

Estimates (Mar)

(Rs)	2010A	2011A	2012E	2013E	2014E
Net Income (Adjusted - mn)	39,053	44,335	51,426	62,879	81,663
EPS	123.86	139.94	162.32	198.48	257.76
EPS Change (YoY)	26.4%	13.0%	16.0%	22.3%	29.9%
Dividend / Share	22.00	22.00	27.00	33.00	42.00
Pre-exceptional EPS	123.78	139.84	162.32	198.48	257.76
Pre-exceptional EPS Change (YoY)	26.3%	13.0%	16.1%	22.3%	29.9%
Book Value / Share	562.09	678.91	810.85	972.20	1,183

Valuation (Mar)

	2010A	2011A	2012E	2013E	2014E
P/E	8.2x	7.2x	6.2x	5.1x	3.9x
Dividend Yield	2.17%	2.17%	2.67%	3.26%	4.15%
Pre-exceptional PE	8.18x	7.24x	6.24x	5.10x	3.93x
Price / Book	1.81x	1.49x	1.25x	1.04x	0.856x
RoE / PB	13.33x	15.15x	17.45x	21.37x	27.94x
Price / Pre-Provision Profit	4.45x	3.54x	3.07x	2.60x	2.22x

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Stock Data

Price	Rs1,013
Price Objective	Rs1,200
Date Established	21-Aug-2011
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs871.00-Rs1,400
Mrkt Val / Shares Out (mn)	US\$6,588 / 316.8
Market Value (mn)	Rs320,820
Average Daily Volume	332,136
BofAML Ticker / Exchange	PUJBF / BSE
Bloomberg / Reuters	PNB IN / PNBK.BO
ROE (2012E)	21.8%
Total Dbt to Cap (Mar-2010A)	NA
Est. 5-Yr EPS / DPS Growth	18.0% / 15.0%
Free Float	20.0%

Key Changes

(Rs)	Previous	Current
2012E EPS	161.10	162.32
2013E EPS	196.77	198.48
2014E EPS	257.38	257.76

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Refer to important disclosures on page 6 to 8. Analyst Certification on Page 4. Price Objective Basis/Risk on page 3. Link to Definitions on page 4. 11104502

iQprofileSM Punjab National Bank

Key Income Statement Data (Mar)	2010A	2011A	2012E	2013E	2014E
(Rs Millions)					
Net Interest Income	84,781	118,073	139,675	162,136	188,277
Net Fee Income	16,822	20,452	23,520	27,048	31,375
Securities Gains / (Losses)	6,505	2,992	2,000	2,600	2,400
Other Income	11,246	12,682	13,944	15,890	17,732
Total Non-Interest Income	34,573	36,126	39,463	45,538	51,508
Total Operating Income	119,354	154,199	179,138	207,674	239,785
Operating Expenses	(47,619)	(63,642)	(74,659)	(84,368)	(95,564)
Pre-Provision Profit	71,735	90,557	104,479	123,306	144,221
Provisions Expense	(9,994)	(20,037)	(23,043)	(27,652)	(20,739)
Operating Profit	59,456	72,410	84,686	95,555	123,582
Non-Operating Income	(2,693)	(4,882)	(5,250)	(2,500)	(2,500)
Pre-Tax Income	59,048	65,637	76,186	93,155	120,982
Net Income to Comm S/Hold.	39,053	44,335	51,426	62,879	81,663
Adjusted Net Income (Operating)	39,053	44,335	51,426	62,879	81,663

Key Balance Sheet Data

Total Assets	2,966,328	3,783,252	4,489,477	5,079,847	5,833,968
Average Interest Earning Assets	2,616,634	3,248,942	3,973,088	4,591,281	5,246,932
Weighted Risk Assets	1,891,032	2,487,600	3,060,094	4,004,252	5,241,226
Total Gross Customer Loans	1,888,339	2,444,474	2,901,873	3,364,630	3,943,687
Total Customer Deposits	2,493,298	3,128,987	3,737,856	4,213,869	4,829,203
Tier 1 Capital	172,273	209,789	256,888	308,006	374,700
Tangible Equity	172,273	209,789	256,888	308,006	374,700
Common Shareholders' Equity	177,229	215,086	256,888	308,006	374,700

Key Metrics

Net Interest Margin	3.24%	3.63%	3.52%	3.53%	3.59%
Tier 1 Ratio	9.1%	8.4%	8.4%	7.7%	7.1%
Effective Tax Rate	33.9%	32.5%	32.5%	32.5%	32.5%
Loan / Assets Ratio	63.7%	64.6%	64.6%	66.2%	67.6%
Loan / Deposit Ratio	75.7%	78.1%	77.6%	79.8%	81.7%
Oper Leverage (Inc Growth - Cost Growth)	7.4%	-4.5%	-1.1%	2.9%	2.2%
Gearing (Assets / Equity)	16.7x	17.6x	17.5x	16.5x	15.6x
Tangible Common Equity / Assets	5.8%	5.5%	5.7%	6.1%	6.4%
Tangible Common Equity / WRAs	9.1%	8.4%	8.4%	7.7%	7.1%
Revenue Growth	20.6%	29.2%	16.2%	15.9%	15.5%
Operating Expense Growth	13.2%	33.6%	17.3%	13.0%	13.3%
Provisions Expense Growth	13.4%	100.5%	15.0%	20.0%	-25.0%
Operating Revenue / Average Assets	4.4%	4.6%	4.3%	4.3%	4.4%
Operating Expenses / Average Assets	1.8%	1.9%	1.8%	1.8%	1.8%
Pre-Provision ROA	2.6%	2.7%	2.5%	2.6%	2.6%
ROA	1.4%	1.3%	1.2%	1.3%	1.5%
Pre-Provision ROE	44.3%	46.2%	44.3%	43.7%	42.2%
ROE	24.1%	22.6%	21.8%	22.3%	23.9%
RoTE	22.7%	21.1%	20.0%	20.4%	21.8%
RoWRAs	2.1%	1.8%	1.7%	1.6%	1.6%
Dividend Payout Ratio	20.7%	18.3%	18.7%	18.7%	18.3%
Efficiency Ratio (Cost / Income Ratio)	42.2%	42.1%	42.1%	41.1%	40.3%
Total Non-Interest Inc / Operating Inc	29%	23%	22%	22%	21%
Market-Related Revenue / Total Revenues	8.3%	4.4%	3.5%	3.7%	3.4%
Provisioning Burden as % of PPP	13.9%	22.1%	22.1%	22.4%	14.4%
NPLs plus Foreclosed Real Estate / Loans	1.7%	1.8%	2.5%	3.2%	3.4%
Loan Loss Reserves / NPLs	69.5%	53.4%	63.1%	66.2%	66.5%
Loan Loss Reserves / Total Loans	1.2%	1.0%	1.6%	2.2%	2.3%
Provisions Expense / Average Loans	0.6%	0.9%	0.9%	0.9%	0.6%

Other Metrics

Income / Employee	2.10	2.70	3.17	3.72	4.33
(Operating Expenses) / Employee	0.836	1.12	1.32	1.51	1.73
Pre-Provision Profit / Employee	1.26	1.59	1.85	2.21	2.61
Net Profit / Employee	0.686	0.778	0.911	1.13	1.48

Company Description

Punjab National Bank (PNB), established in 1894, is the second largest state-owned bank based in north India with a balance sheet size of over Rs3trn and +5000 branches. Over the past three years, PNB has been one of the fastest growing state-owned banks, and has displayed a marked improvement in asset quality. It is also the leader among all state-owned banks in terms of technology implementation.

Investment Thesis

Strong liability franchise: CASA make up about 40 percent of total deposits resulting in a low cost of deposits. Strong presence in North India, which has a strong deposit base, should see strong earnings growth. Big beneficiary of agriculture uptick. Increasing NPLs and declining coverage ratio can become a concern.

Stock Data

Price to Book Value 1.2x

2QFY12 Results Summary

Table 1: 2QFY12 Results Summary

(Rs mn)	2QFY11	2QFY12	yoy	Remarks
Interest earned	64,554	89,521	38.7%	
- on Advances / Bills	50,352	70,448	39.9%	Led by 19% yoy loan growth. Yield expanding +135bps
- Income on investments	13,972	18,524	32.6%	Yield on Investment up by +100bps
- on bal with RBI	205	484	136.4%	
- Others	26	66	154.0%	
Interest Expended	34,787	54,994	58.1%	Cost of Funds up by 115bps yoy. CASA down 430bps yoy to -36%
Net Interest Income	29,767	34,527	16.0%	7% ahead of estimates. Margins down 10bps yoy but up 10bps qoq
Other income	7,183	8,889	23.8%	Core fee income growth muted
Operating income	36,950	43,415	17.5%	
Employee expenses	11,131	12,404	11.4%	
Other Operating expenses	4,818	5,732	19.0%	
Total Operating expenses	15,949	18,137	13.7%	
Operating profit	21,001	25,279	20.4%	7% ahead of estimates on topline
Provisions	5,160	7,103	37.7%	
- NPL Provisions	3,590	3,190	-11.1%	Gross NPLs (at 2.05%) up 5% qoq and Net (at 0.84%) flat qoq. Cover at +75%. 2Q Slippages at Rs9.9bn vs Rs11.8bn in 1Q. Restructured loans now at -8% of loan book; total slippage to NPLs from restructured at -11%.
- Investment Provisions	670	1,610	140.3%	
- Other Provisions	900	2,303	155.8%	
PBT	15,841	18,176	14.7%	
Provision for Tax	5,095	6,124	20.2%	
PAT	10,745	12,051	12.2%	Earnings exactly in-line with estimates
PPP, ex treasury	20,621	24,749	20.0%	
Margin analysis- %	2QFY11	2QFY12	+/- bps chg.	
Yield on Loans	10.55	11.92	137	
Yield on funds	8.15	9.01	86	
Yield on Investments	6.69	7.78	109	
Cost of Deposits	4.96	6.52	156	
Cost of Funds	4.39	5.54	115	
Spreads	5.59	5.40	-19	
Net Interest Margins	4.06	3.95	-11	

Source: BoFA Merrill Lynch Global Research Estimates

Price objective basis & risk Punjab (PUJBF)

We set our PO for PNB at Rs1200. Our PO is based on average historical PB multiples. Our PO is still at a 5% discount to theoretical multiples owing to PNB's exposure to possible problem sectors (Power, textiles, Steel, Comm. Real Estate, etc.) at +20%. But we maintain our Buy owing to PNB still delivering +21-22% RoEs and +16/22% earnings growth through FY12-13 and the stock trading at 1.2x FY13 book. Downside risks to our PO are a further rise in NPLs and slower asset growth, leading to a weak earnings outlook, higher exposure to commercial real estate could lead to an increase in NPLs and a sharp rise in interest rates at the sector level could lead to a slowdown in growth and earnings.

Link to Definitions Financials

Click [here](#) for definitions of commonly used terms.

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India - Financials Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY	Corporation Bank	XCRRF	CRPBK IN	Veekesh Gandhi
	Federal Bank	XFDRF	FB IN	Veekesh Gandhi
	HDFC	HGDF	HDFC IN	Rajeev Varma
	HDFC Bank	XHDF	HDFCB IN	Rajeev Varma
	HDFC Bank	HDB	HDB US	Rajeev Varma
	ICICI Bank	ICIJF	ICICIBC IN	Rajeev Varma
	ICICI Bank - A	IBN	IBN US	Rajeev Varma
	IndiaBulls Financial Services	IBLFF	IBULL IN	Veekesh Gandhi
	Indian Bank	INDIF	INBK IN	Rajeev Varma
	LIC Housing Finance, Ltd.	LHFLF	LICHF IN	Veekesh Gandhi
	Manappuram	XMGPF	MGFL IN	Veekesh Gandhi
	Max India	XMJIF	MAX IN	Rajeev Varma
	Power finance corporation Ltd	PWFEF	POWF IN	Veekesh Gandhi

India - Financials Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
	Punjab	PUJBF	PNB IN	Rajeev Varma
	Reliance Capital	RLCCF	RCAPT IN	Veekesh Gandhi
	Rural Electrification Corporation Ltd	XULEF	RECL IB	Veekesh Gandhi
	SBI	SBINF	SBIN IN	Rajeev Varma
	SBI -G	SBKFF	SBID LI	Rajeev Varma
	Shriram Transport Finance	SHTFF	SHTF IN	Veekesh Gandhi
	Yes Bank Ltd	YESBF	YES IN	Veekesh Gandhi
NEUTRAL				
	Axis Bank	XAXSF	AXSB IN	Rajeev Varma
	Axis Bank - GDR	XBKSF	AXB LI	Rajeev Varma
	Bank of Baroda	BKBAF	BOB IN	Rajeev Varma
UNDERPERFORM				
	Bank of India	XDIIF	BOI IN	Rajeev Varma
	Canara Bank	CNRKF	CBK IN	Rajeev Varma
	IDBI	XDBIF	IDBI IN	Veekesh Gandhi
	Infrastruct Dev	IFDFF	IDFC IN	Rajeev Varma
	Kotak Mahindra Bank	XXRVF	KMB IN	Rajeev Varma
	ORBC	ORBCF	OBC IN	Rajeev Varma
	Union Bank India	UBOIF	UNBK IN	Rajeev Varma

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

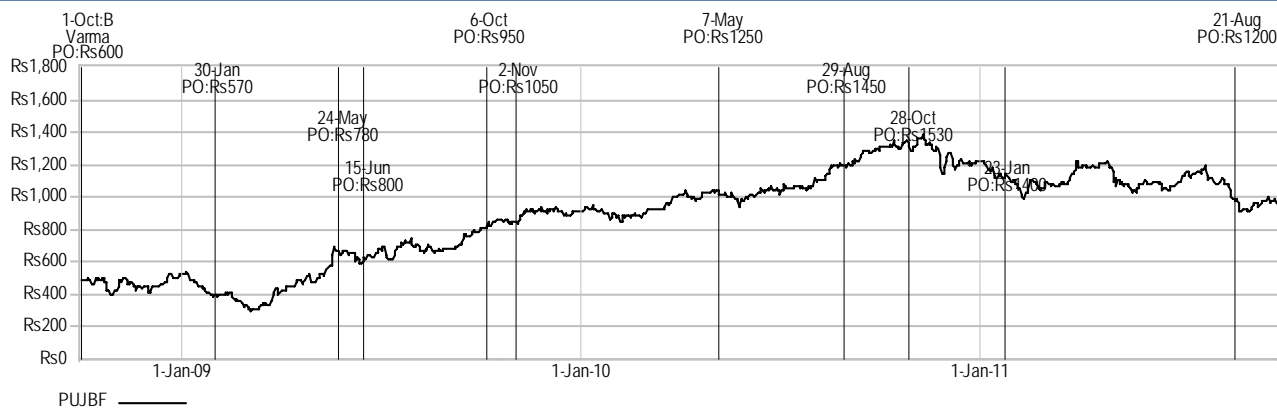
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PUJBF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	123	48.05%	Buy	63	63.00%
Neutral	76	29.69%	Neutral	41	65.08%
Sell	57	22.27%	Sell	27	49.09%

Investment Rating Distribution: Global Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2073	54.13%	Buy	923	49.12%
Neutral	961	25.09%	Neutral	460	52.57%
Sell	796	20.78%	Sell	287	38.32%

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