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Punjab National Bank PNBK.NS PNB IN

BANKS

Downgrade to Reduce and TP cut to INR680

Impaired book still a risk

August 14, 2012

Rating Down from Neutral	**Reduce**
Target price Reduced from 965	INR 680
Closing price August 13, 2012	INR 719
Potential downside	-5.4%

Action: Downgrade to Reduce and cut TP to INR680

We downgrade PNB to Reduce from our earlier Neutral rating and cut our TP to INR680 as we believe loan delinquency will continue to increase for PNB over the next few quarters. The high proportion of restructured loans on which the delinquency ratio is currently running at 18% is an added risk. We are factoring in loan delinquencies of INR98.3bn for FY13F, compared with INR72.9bn earlier.

We expect a delinquency ratio of 3.99% for FY13F

We expect the asset quality pain to continue for PNB in the face of slowing economic growth. The incremental delinquency ratio has increased from 1.81% in FY10 to 2.73% in FY12, and the annualized delinquency ratio was 3.77% in 1QFY13. PNB has cumulatively restructured loans of INR311bn and has an outstanding restructured loan book of INR255bn (which is 8.7% of its loan book). The delinquency ratio from this restructured book is currently trending at 18%. We are factoring in a incremental delinquency of 3.99% for FY13F.

Catalysts: Continued slowdown in corporate capital spending and increasing delinquency

Valuation: Our TP implies 0.8x FY13F ABV and 4.5x FY13E EPS.

PNB currently trades at 0.82x FY13F ABV of INR875, 2SD below its historical mean of 1.3x one-year forward ABV. At our TP of INR680, PNB trades at 0.8x FY13F ABV and 4.5x FY13F EPS for an FY13F ROA of 1.05% and ROE of 18.5%.

31 Mar	FY12	FY13F		FY14F		FY15F	
Currency (INR)	Actual	Old	New	Old	New	Old	New
PPOP (mn)	106,143	124,448	118,466	144,006	136,624		165,182
Reported net profit (mn)	48,842	54,020	51,602	63,721	57,679		78,404
Normalised net profit (mn)	48,842	54,020	51,602	63,721	57,679		78,404
FD normalised EPS	143.37	156.37	151.47	184.45	169.31		231.16
FD norm. EPS growth (%)	2.0	15.7	5.6	18.0	11.8		36.5
FD normalised P/E (x)	5.0	N/A	4.7	N/A	4.2	N/A	3.1
Price/adj. book (x)	0.9	N/A	0.8	N/A	0.7	N/A	na
Price/book (x)	0.9	N/A	0.8	N/A	0.7	N/A	na
Dividend yield (%)	3.5	N/A	5.0	N/A	6.1	N/A	na
ROE (%)	19.8	17.9	17.3	18.4	17.0		20.1
ROA (%)	1.2	1.1	1.0	1.1	1.0		1.2

Source: Company data, Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*

Anchor themes

Asset quality will likely continue to deteriorate for India's banking sector over the next several quarters, especially for PSU banks. We see limited catalysts to boost banks' earnings growth in the face of slowing loan growth and rising loan loss provisions.

Nomura vs consensus

Our PAT is 2% below consensus for FY13F on higher loan loss provisions. We are building in LLPs of 1.15% for FY13F.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

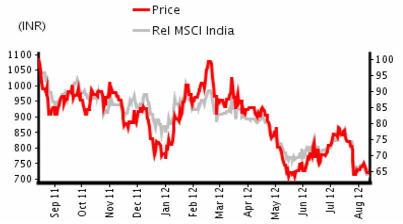
Key data on Punjab National Bank

Profit and Loss (INRmn)

Year-end 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
Interest income	269,865	364,280	434,319	502,949	590,456
Interest expense	-151,791	-230,136	-277,568	-323,458	-378,913
Net interest income	118,073	134,144	156,751	179,491	211,543
Net fees and commissions	21,930	25,370	28,486	33,206	39,135
Trading related profits	5,151	5,390	5,768	6,113	7,116
Other operating revenue	9,044	11,266	13,396	17,856	21,879
Non-interest income	36,126	42,026	47,650	57,175	68,131
Operating income	154,199	176,170	204,401	236,666	279,674
Depreciation	0	0	0	0	0
Amortisation					
Operating expenses	-19,031	-22,793	-25,430	-29,857	-35,236
Employee share expense	-44,611	-47,235	-60,504	-70,186	-79,256
Op. profit before provisions	90,557	106,143	118,466	136,624	165,182
Provisions for bad debt	-20,037	-24,030	-33,719	-39,726	-35,126
Other provision charges	-4,882	-11,743	-7,799	-9,506	-11,262
Operating profit	65,637	70,370	76,948	87,392	118,794
Other non-operating income					
Associates & JCEs					
Pre-tax profit	65,637	70,370	76,948	87,392	118,794
Income tax	-21,302	-21,528	-25,347	-29,713	-40,390
Net profit after tax	44,335	48,842	51,602	57,679	78,404
Minority interests					
Other items					
Preferred dividends					
Normalised NPAT	44,335	48,842	51,602	57,679	78,404
Extraordinary items	0	0	0	0	0
Reported NPAT	44,335	48,842	51,602	57,679	78,404
Dividends	-8,101	-8,594	-12,075	-14,846	-20,181
Transfer to reserves	36,234	40,248	39,527	42,832	58,223
Valuation and ratio analysis					
Reported P/E (x)	5.1	5.0	4.7	4.2	3.1
Normalised P/E (x)	5.1	5.0	4.7	4.2	3.1
FD normalised P/E (x)	5.1	5.0	4.7	4.2	3.1
FD normalised P/E at price target (x)	4.8	4.7	4.5	4.0	2.9
Dividend yield (%)	3.6	3.5	5.0	6.1	na
Price/book (x)	1.1	0.9	0.8	0.7	na
Price/adjusted book (x)	1.2	0.9	0.8	0.7	na
Net interest margin (%)	3.85	3.48	3.44	3.41	3.42
Yield on interest earning assets (%)	8.81	9.46	9.54	9.56	9.54
Cost of interest bearing liabilities (%)	4.95	6.05	6.21	6.24	6.22
Net interest spread (%)	3.86	3.42	3.33	3.32	3.32
Non-interest/operating income (%)	23.4	23.9	23.3	24.2	24.4
Cost to income (%)	41.3	39.7	42.0	42.3	40.9
Effective tax rate (%)	32.5	30.6	32.9	34.0	34.0
Dividend payout (%)	18.3	17.6	23.4	25.7	25.7
ROE (%)	22.6	19.8	17.3	17.0	20.1
ROA (%)	1.31	1.17	1.05	1.01	1.17
Operating ROE (%)	33.5	28.5	25.8	25.8	30.5
Operating ROA (%)	1.94	1.68	1.56	1.53	1.77
Growth (%)					
Net interest income	39.3	13.6	16.9	14.5	17.9
Non-interest income	0.1	16.3	13.4	20.0	19.2
Non-interest expenses	16.0	19.8	11.6	17.4	18.0
Pre-provision earnings	23.6	17.2	11.6	15.3	20.9
Net profit	13.5	10.2	5.6	11.8	35.9
Normalised EPS	13.5	2.0	5.6	11.8	36.5
Normalised FDEPS	13.5	2.0	5.6	11.8	36.5

Source: Company data, Nomura estimates

Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (INR)	-14.7	-3.5	-33.7
Absolute (USD)	-14.9	-6.6	-45.8
Relative to index	-17.3	-11.3	-38.3
Market cap (USDmn)	4,110.7		
Estimated free float (%)	36.6		
52-week range (INR)	1092.45/703.5		
3-mth avg daily turnover (USDmn)	9.66		
Major shareholders (%)			
Govt. of India	58.0		

Source: Thomson Reuters, Nomura research

Notes

Balance Sheet (INRmn)

As at 31 Mar	FY11	FY12	FY13F	FY14F	FY15F	Notes
Cash and equivalents	237,769	184,932	238,805	283,666	324,507	
Inter-bank lending	59,143	103,351	95,231	113,593	134,153	
Deposits with central bank						
Total securities	951,623	1,226,295	1,317,765	1,504,081	1,741,854	
Other interest earning assets						
Gross loans	2,444,474	2,980,401	3,490,965	4,145,180	4,909,044	
Less provisions	-23,408	-42,654	-63,669	-82,668	-91,791	
Net loans	2,421,067	2,937,748	3,427,296	4,062,511	4,817,253	
Long-term investments						
Fixed assets	31,056	31,689	40,702	53,038	65,374	
Goodwill	441	370	370	370	370	
Other intangible assets						
Other non IEAs	82,154	97,558	135,716	156,779	184,466	
Total assets	3,783,253	4,581,943	5,255,885	6,174,040	7,267,978	
Customer deposits	3,128,987	3,795,887	4,384,528	5,165,593	6,128,281	
Bank deposits, CDs, debentures	203,994	260,740	260,740	260,740	260,740	
Other interest bearing liabilities	111,903	111,903	131,903	166,903	201,903	
Total interest bearing liabilities	3,444,884	4,168,530	4,777,171	5,593,235	6,590,923	
Non interest bearing liabilities	123,283	135,242	161,060	220,319	258,346	
Total liabilities	3,568,167	4,303,772	4,938,231	5,813,554	6,849,270	
Minority interest						
Common stock	3,168	3,392	3,392	3,392	3,392	
Preferred stock						
Retained earnings	211,917	274,779	314,262	357,094	415,317	
Reserves for credit losses						
Proposed dividends						
Other equity						
Shareholders' equity	215,086	278,171	317,653	360,486	418,709	
Total liabilities and equity	3,783,252	4,581,943	5,255,885	6,174,040	7,267,978	
Non-performing assets (INR)	43,794	87,196	132,956	178,518	204,785	
Balance sheet ratios (%)						
Loans to deposits	78.1	78.5	79.6	80.2	80.1	
Equity to assets	5.7	6.1	6.0	5.8	5.8	
Asset quality & capital						
NPAs/gross loans (%)	1.8	2.9	3.8	4.3	4.2	
Bad debt charge/gross loans (%)	0.82	0.81	0.97	0.96	0.72	
Loss reserves/assets (%)	0.62	0.93	1.21	1.34	1.26	
Loss reserves/NPAs (%)	53.4	48.9	47.9	46.3	44.8	
Tier 1 capital ratio (%)	8.4	9.3	9.5	9.2	9.1	
Total capital ratio (%)	12.4	12.6	13.4	13.5	13.6	
Growth (%)						
Loan growth	29.7	21.3	16.7	18.5	18.6	
Interest earning assets	27.4	24.3	13.4	17.4	17.8	
Interest bearing liabilities	28.3	21.0	14.6	17.1	17.8	
Asset growth	27.5	21.1	14.7	17.5	17.7	
Deposit growth	25.5	21.3	15.5	17.8	18.6	
Per share						
Reported EPS (INR)	140.60	143.37	151.47	169.31	231.16	
Norm EPS (INR)	140.60	143.37	151.47	169.31	231.16	
Fully diluted norm EPS (INR)	140.60	143.37	151.47	169.31	231.16	
DPS (INR)	25.57	25.34	35.60	43.77	na	
PPOP PS (INR)	287.18	311.58	347.75	401.05	487.01	
BVPS (INR)	678.91	820.13	936.54	1,062.82	na	
ABVPS (INR)	619.32	762.21	878.74	1,005.03	na	
NTAPS (INR)	677.52	819.04	935.44	1,061.73	na	

Source: Company data, Nomura estimates

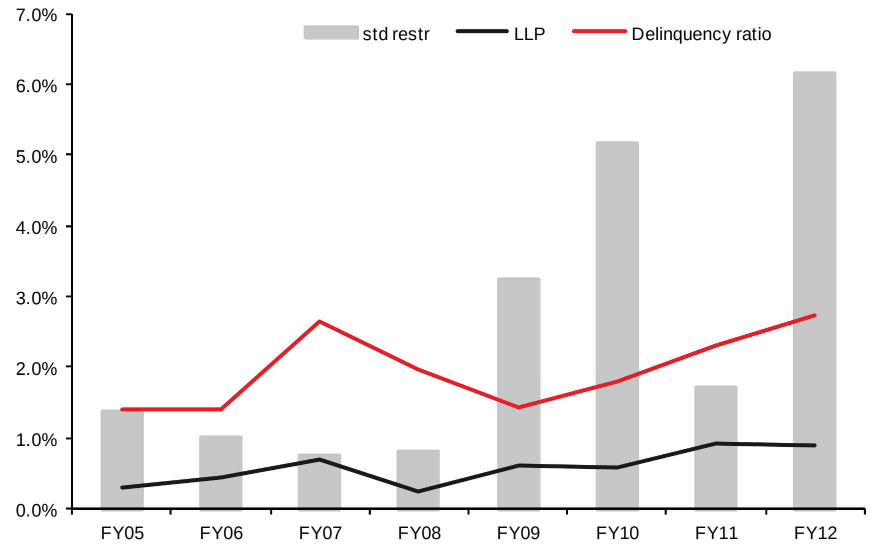
Further deterioration in asset quality likely

Asset quality should continue to be a millstone for PNB, in our view. The incremental delinquency ratio has increased from 1.81% in FY10 to 2.73% in FY12, and the annualized delinquency ratio was 3.77% in 1QFY13. We believe slowing economic growth will continue to pressure asset quality and we expect incremental delinquency to close FY13F at the 3.99% level.

PNB has cumulatively restructured loans of INR311bn (of which INR150bn was in FY12, with Air India and the State Electricity Boards comprising INR92bn) and has an outstanding restructured loan book of INR255bn (which is 8.7% of its loan book). The delinquency ratio from this restructured book is currently trending at 18% and we believe the loans restructured in FY12 are yet to show up in the delinquency numbers reported so far. This is a double whammy to deal with – fresh delinquencies and delinquency from the restructured book. We are factoring in a delinquency ratio of 3.99% for FY13F. As detailed in the chart below, loans restructured and classified as 'standard' increased significantly in FY12. We believe this further signals the continued deterioration in asset quality we anticipate over the next few quarters. The delinquency ratio has been on a steady climb since FY09, increasing from 1.42% in FY09 to 3.77% in 1QFY13. Loan loss provisions have not kept pace, however, as PNB has cut back on provision cover from 90.5% to 50.8% during this time.

According information released by the Press Information Bureau of the Government of India, the government has issued directions to banks for restructuring of textile industry loans on a case-by-case basis in accordance with the RBI's prudential guidelines. It has been reported that loans of INR360bn are in need of restructuring. PNB has a fund based exposure of 1.5% (as a % of FY12 loan book) to the textiles sector. We believe this indicates the wider nature of slowdown plaguing Indian corporate sector and we expect loan delinquency to continue to increase for PNB.

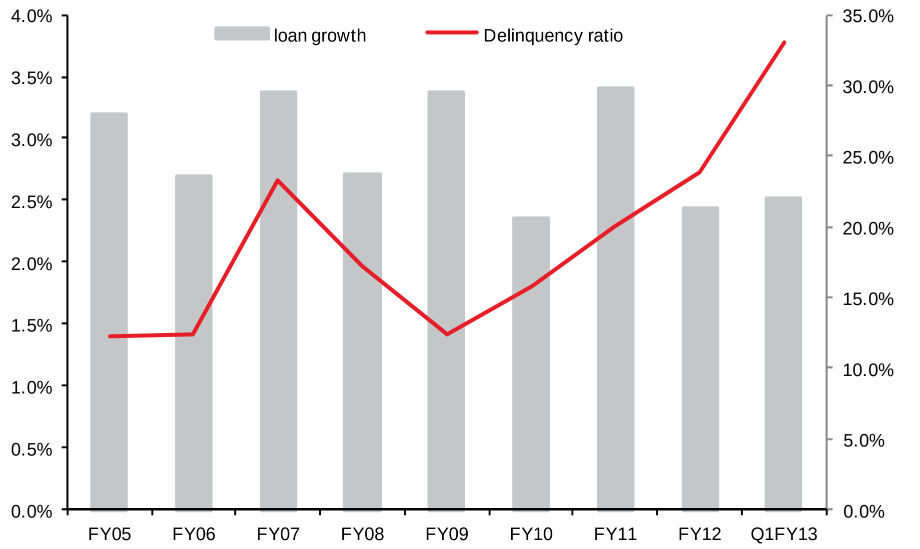
Fig. 1: Risk of rising delinquencies from the restructured book



Source: RBI, Nomura research

The following chart highlights the rising incidence of delinquencies in periods of slowing loan growth. In a period of slowing growth, we expect delinquencies to continue to increase to 3.99% by FY13F.

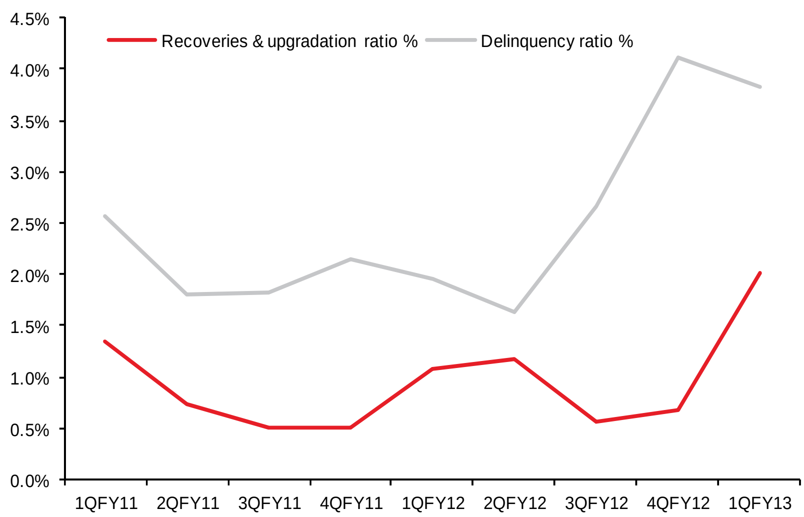
Fig. 2: Delinquencies rising on slowing loan growth



Source: RBI, Nomura research

Most of the PSU banks have guided towards strong recoveries and upgradations from the non-performing loans in the coming few quarters. The chart below shows the incremental delinquency ratio (as a % of average loan book) and the incremental recovery ratio (recoveries and upgrades as a % of average loan book) for PNB for the past eight quarters. The incremental recovery ratio generally lags by around a quarter. The gap between incremental delinquencies and incremental recoveries has been widening over the past four quarters and we believe it is too early to conclude that this gap may have peaked. While delinquencies should continue to increase due to slowing growth, incremental recoveries and especially upgrades may take a while longer to close the gap with the delinquencies. Moreover, historically, recoveries and upgrades comprise only 40% of the incremental delinquencies. Upgrades are also more volatile and lumpy in nature, in our opinion, further adding to the potential earnings volatility profile for the next few quarters.

Fig. 3: Delinquencies vs recoveries



Source: Company data, Nomura research

PNB has guided towards recoveries and upgradations of INR40bn for FY13, broadly in line with our forecast.

We expect loan growth of 16.7% for FY13F

We are factoring in loan growth of 16.7% y-y for FY13F, with growth contributions coming from domestic corporate loans (+12.3% y-y), international loans (+14.2%), mortgages (+15.3%), other retail loans (+16.3%), SME loans (+18.3%) and rural/agri loans (+16.3%). We expect core fee income growth of 12.3% for FY13F. We estimate GNPL ratio will inch up to 3.8% in FY13F, from 3.33% in 1QFY13. NIMs will likely face further pressure, leading to a marginal compression in margins. We expect PNB to clock FY13F NIM of 3.47%, down slightly from 3.6% in 1QFY13. We expect non-interest income to remain weak on the back of slower fee income growth.

Fig. 4: Key changes in assumptions

Assumptions changes	Old	New
Loan growth - FY13	16.9%	16.7%
Non-interest income growth - FY13	22.8%	13.4%
PAT - FY13 (INRmn)	54,020	51,602
Cost-income ratio - FY13	40.8%	42.0%
Slippages for FY13 (INRmn)	72,912	98,264
LLPs for FY13	1.26%	1.15%
GNPL (INRmn)	105,642	132,956
GNPL ratio	3.11%	3.81%
Provision coverage ratio	59.0%	47.9%
RoA - FY13	1.10%	1.05%
RoE - FY13	19.1%	18.5%

Source: Nomura research

Key highlights from 1QFY13

PNB registered 1QFY13 PAT of INR12.5bn, marginally lower than our estimate of INR12.95bn and consensus of INR12.7bn. Asset quality remains the weak link for the bank, with its GNPLs rising by 14.5% q-q (GNPL ratio up 40bps q-q to 3.34%) and fresh restructuring of INR 12.39bn for the quarter, taking the outstanding restructured book to 8.7% of the total loans. PAT missed our estimates despite higher-than-expected NII growth (+11.6% q-q on a 10bp margin expansion) due to higher provisions and employee expenses (pension-related provisions).

Key notes from discussion with management:

- Asset quality deteriorated further with slippage in 1QFY13 of INR27.7bn leading to a 14.5% q-q increase in GNPL (GNPL ratio at 3.34%) despite much stronger recoveries and upgradations of INR14.7bn (INR 4.8bn in 4QFY12). Provision coverage ratio is at 51% (62.8% including technical writeoffs). PNB clocked LLP of 123bps during the quarter.
- The bank restructured loans to the tune of INR12.4bn in 1QFY13, taking the restructured loans as a proportion of the loan book to 8.7%. Of the outstanding restructured book of INR255bn, INR22bn was for Air India while INR70bn was for the Rajasthan and UP SEBs. The bank has protected its NPV on SEB restructuring by increasing the coupon by 100-125bps.
- We believe asset quality will continue deteriorate for PNB over the next several quarters. PNB restructured INR311bn of standard assets over FY09-12, of which INR150bn was restructured in FY12. While 18% of the loans restructured over FY09-11 have slipped into NPLs, the stress from the other half restructured in FY12 is yet to show up in its books. We believe this represents a continued asset quality risk for the bank.
- NII was 4% above our estimate on the back of strong loan growth and 10bps expansion in margins to 3.6%. Loan growth remained strong (up 21% y-y), supported largely by agri and priority sector related loans and international loans (due to INR depreciation).

International book grew 21% q-q. PNB's crop loan portfolio was INR180bn (6% of overall loan book) out of its total agriculture portfolio of INR446bn.

- Non-interest income was weak (increasing 7.6%y-y) as trading gains of INR0.9bn came in much lower than our expectations of INR2.4bn.
- The bank received a capital injection of INR22.45bn from GOI and LIC in the quarter, taking the tier-1 ratio to 9.28% and total CAR to 12.63%.
- PNB has started recognizing AS15 provisions on a quarterly basis and it expects wage hikes in November 2012. PNB expects pension liability to reduce going forward as an increasing mix of employees are on defined contribution plans.

Fig. 5: Earnings summary

Earnings summary (INRmn)	1QFY13	4QFY12	1QFY12	%y/y	%q/q	1QFY13F	Variance %
Interest Income	105,450	96,798	83,152	26.8	8.9	102,594	2.8
Interest on advances	81,965	74,947	65,759	24.6	9.4	79,425	3.2
Income on investments	22,831	21,270	16,858	35.4	7.3	22,459	1.7
Interest on balances with RBI	544	497	337	61.5	9.4	505	7.7
Others	110	84	199	(44.6)	31.8	205	(46.2)
Interest expended	68,498	63,698	52,000	31.7	7.5	67,096	2.1
Net Interest Income	36,951	33,100	31,153	18.6	11.6	35,498	4.1
Non-interest income	11,660	12,760	10,837	7.6	(8.6)	12,204	(4.5)
Fees	7,310	7,040	6,630	10.3	3.8	7,100	3.0
Trading gains	880	1,590	480	83.3	(44.7)	2,384	(63.1)
Total Operating expenses	20,203	16,498	17,250	17.1	22.5	18,719	7.9
Employee expenses	14,197	10,068	12,126	17.1	41.0	12,546	13.2
Other Operating expenses	6,005	6,430	5,124	17.2	(6.6)	6,173	(2.7)
Operating Profit	28,409	29,362	24,739	14.8	(3.2)	28,982	(2.0)
Core operating profit	27,529	27,772	24,259	13.5	(0.9)	26,599	3.5
Total Provisions	10,325	10,273	8,935	15.6	0.5	9,936	3.9
Loan loss Provisions	9,000	9,390	5,660	59.0	(4.2)	8,685	3.6
PBT	18,084	19,089	15,804	14.4	(5.3)	19,046	(5.1)
Core PBT	17,204	17,499	15,324	12.3	(1.7)	16,663	3.2
Tax	5,627	4,848	4,753	18.4	16.1	6,095	(7.7)
Adjusted Net profit	12,457	14,241	11,051	12.7	(12.5)	12,951	(3.8)
EPS	36.7	44.8	34.9	5.3	(18.0)	38.0	(3.4)

Source: Company data, Nomura estimates

Fig. 6: Key ratios

Key ratios	1QFY13	4QFY12	1QFY12	y/y bps	q/q bps
Net Interest Margin, %	3.60	3.50	3.84	(24)	10
Cost/Income Ratio, %	41.56	35.97	41.08	48	558
Cost/Asset Ratio, %	0.44	0.36	0.45	(1)	8
CASA, %	34.55	35.34	37.41	(286)	(78)
Tier I, %	9.33	9.28	8.51	82	5
Total CAR, %	12.57	12.63	12.40	17	(6)

Source: Company data, Nomura research

Fig. 7: Loans and deposits

Loans and deposits (INRmn)	1QFY13	4QFY12	1QFY12	%y/y	%q/q
Advances	2,944,679	2,937,748	2,429,080	21.2	0.2
Total Deposits	3,853,547	3,795,885	3,240,965	18.9	1.5
CASA Deposits	1,331,480	1,341,290	1,212,590	9.8	(0.7)
Savings Account Deposits	1,074,250	1,056,570	948,750	13.2	1.7
Current Account Deposits	257,230	284,720	263,840	(2.5)	(9.7)
Term Deposits	2,522,067	2,454,595	2,028,375	24.3	2.7
Investments	1,206,674	1,226,295	1,009,920	19.5	(1.6)
Total Assets	4,592,338	4,581,940	3,857,160	19.1	0.2

Source: Company data, Nomura research

Fig. 8: Loan breakdown

Loan breakdown (INRmn)	1QFY13	4QFY12	1QFY12	%y/y	%q/q
Large and Mid corporate	1,576,139	1,561,208	1,331,240	18.4	1.0
MSME	563,680	573,550	467,140	20.7	(1.7)
Agriculture & Allied	445,910	459,170	341,530	30.6	(2.9)
Food Credit	66,150	51,860	48,060	37.6	27.6
Retail Loans	292,800	291,960	241,110	21.4	0.3
Housing/Mortgage	140,620	138,080	118,350	18.8	1.8
International Loans	259,870	217,550	143,180	81.5	19.5
Domestic Loans	2,684,809	2,720,198	2,285,900	17.5	(1.3)
Total Loans	2,944,679	2,937,748	2,429,080	21.2	0.2

Source: Company data, Nomura research

Fig. 9: Fee income breakdown

Fee income breakdown (INRmn)	1QFY13	4QFY12	1QFY12	%y/y	%q/q
Collection & Remittances	1,120	1,490	850	31.8	(24.8)
LC/LG	1,750	1,990	1,650	6.1	(12.1)
Processing Fees	2,620	1,300	2,470	6.1	101.5
Incidental Charges	290	300	350	(17.1)	(3.3)
Income from Insurance business	130	190	30	333.3	(31.6)
ATM Charges Recovered	750	810	630	19.0	(7.4)
Commission, Exchange & Brokerage	7,310	7,040	6,630	10.3	3.8
Exchange Profit	2,120	1,600	1,310	61.8	32.5
Misc Fee Income	650	960	650	-	(32.3)
Core Fee Income	10,300	11,050	9,030	14.1	(6.8)
Dividend Income MF	480	60	1,260	(61.9)	700.0
Trading Profit	880	1,590	480	83.3	(44.7)
Total non-interest income	11,660	12,760	10,837	7.6	(8.6)

Source: Company data, Nomura research

Fig. 10: Movement in NPLs

Movement in NPLs (INRmn)	1QFY13	4QFY12	1QFY12
Opening NPLs	87,196	64,418	43,794
Add new NPLs	27,690	28,190	11,770
Less write offs	340	660	110
Less recoveries	5,700	4,100	4,180
Less up-gradations	8,960	650	2,340
Total reduction	15,000	5,410	6,630
Closing NPLs	99,882	87,196	48,936

Source: Company data, Nomura research

Fig. 11: Asset quality

Asset Quality (INRmn)	1QFY13	4QFY12	1QFY12	%y/y	%q/q	
Gross NPL	99,882	87,196	48,936	104.1	14.5	
Net NPL	49,170	44,542	20,908	135.2	10.4	
Gross NPL, %	3.34	2.93	2.00	134	41	bps
Net NPL, %	1.68	1.52	0.88	80	16	bps
Provision cover, %	50.8	48.9	57.3	(650)	185	bps
Provision Coverage % (incl. technical w/o)	62.8	62.7	74.3	(1,146)	8	bps
LLP, %	1.23	1.36	0.94	29	(13)	bps

Source: Company data, Nomura research

Valuation methodology

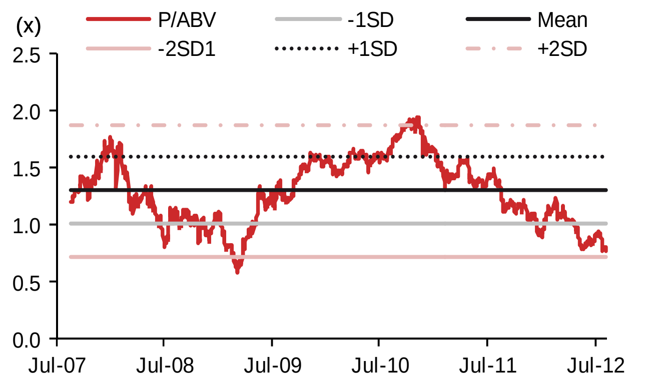
We downgrade PNB to Reduce, from Neutral, and cut our TP to INR680 to reflect the changes to our estimates and a lower multiple. We arrive at our target price of INR680 using a three-stage residual-income valuation method that assumes the following: 1) 15.1% CAGR over FY12-15F, 10.4% CAGR over FY15-20F and a terminal growth rate of 4% beyond that for interest-earning assets; 2) average ROE of 16.3% over FY12-20F and a 7.4% terminal value ROE; and 3) discount rates ranging from 15.4% (current cost of equity) for FY12-15F, to 12.8% for FY15-20F and a 10% terminal rate. At our TP of INR680, PNB trades at 0.8x FY13F ABV and 4.5x FY13F EPS for an FY13F ROA of 1.05% and ROE of 18.5%.

Fig. 12: Key changes in residual income valuation assumption

Assumptions changes	Old	New
Interest earning asset (FY12-20 CAGR)	13.2%	12.2%
Terminal NIM	2.4%	2.1%
Terminal cost to income Ratio	43.6%	44.0%
terminal P&L provisioning as % of int earning assets	0.9%	1.0%

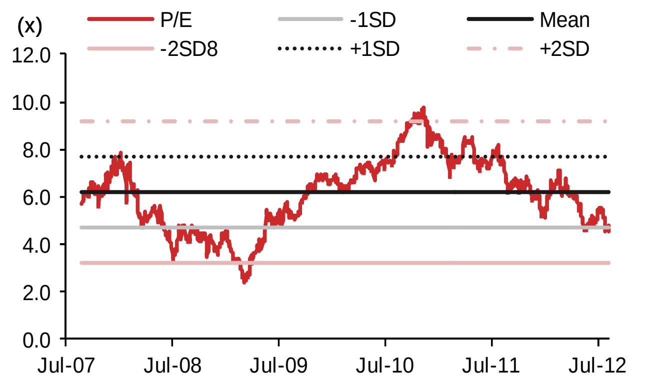
Source: Nomura estimates

Fig. 13: P/ABV



Source: Bloomberg, Nomura estimates

Fig. 14: P/E



Source: Bloomberg, Nomura estimates

Risks

Asset quality will likely continue deteriorate for the India banking sector over the next several quarters, especially for PSU banks. We see limited catalysts to boost banks' earnings growth in the face of slowing loan growth and rising loan loss provisions.

Appendix A-1

Analyst Certification

We, Vijay Sarathi, Abhishek Bhattacharya and Amit Nanavati, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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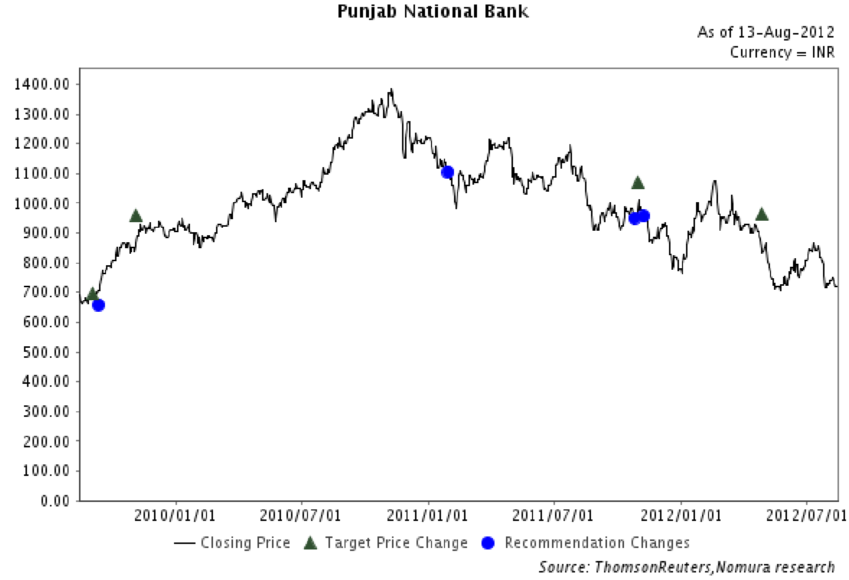
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Punjab National Bank	PNB IN	INR 719	13-Aug-2012	Reduce	Not rated	

Previous Rating

Issuer name	Previous Rating	Date of change
Punjab National Bank	Neutral	13-Aug-2012

Punjab National Bank (PNB IN) **INR 719 (13-Aug-2012)** Reduce (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
26-Apr-12		965.00	845.30
31-Oct-11	Neutral		976.25
31-Oct-11		1,070.00	976.25
17-Oct-11	Not Rated		969.80
21-Jan-11	Suspended		1,125.35
05-Nov-09		960.00	867.55
03-Sep-09	Neutral		678.40
03-Sep-09		695.00	678.40

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We arrive at our target price of INR680 using a three-stage residual-income valuation method that assumes the following: 1) 15.1% CAGR for interest-earning assets over FY12-15, 10.4% CAGR over FY15-20 and a terminal growth rate of 4% beyond that, 2) average ROE of 16.3% over FY12-20 and a 7.4% terminal value ROE, and 3) discount rates ranging from 15.4% (current cost of equity) for FY12-15, 12.8% for FY15-20 and a 10% terminal rate. At our TP of 680, PNB trades at 0.8x FY13F ABV and 4.5x FY13F EPS for an FY13F ROA of 1.05% and ROE of 18.5%.

Risks that may impede the achievement of the target price Asset quality will continue deteriorate for the Indian banking sector over the next several quarters, especially for PSU banks. We see limited catalysts to boost banks' earnings growth in the face of slowing loan growth and rising loan loss provisions.

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