VISIT NOTE

PUNJAB NATIONAL BANK

Consolidation on cards; asset quality key monitorable

India Equity Research| Banking and Financial Services

We recently met the senior management of Punjab National Bank (PNB). Management reiterated its focus on consolidating balance sheet growth given the uncertain business environment, where focus on containing asset quality will take precedence over growth. The bank believes challenges on slippages persist(lumpy gems& jewellery account to elevate Q1 slippages) however; focus on recoveries will offset pressure from slippages. Deliberate efforts towards conservative growth will help stabilise asset quality, though current level of stressed pool at 15% remains a key monitorable (GNPLs of 4.3% + restructured pool of 9.9%). Maintain 'HOLD' with TP of INR875.

Pursuing consolidation strategy

Management stated that it continues to pursue the strategy of consolidating balance sheet in uncertain times. It believes, in the interim, loan growth will come in below industry growth. PNB will continue to focus on average advance growth during Q1FY14 against the peer set trend of period end growth. Building retail assets will be a key focus area, but PNB believes the result will be slow and steady given the competitive pressures and the bank's culture of focusing more on corporate; introduction of retail asset branches will help in this direction. Reclassification of indirect agriculture has resulted in PNB not meeting its priority sector requirements.

Anticipating robust treasury performance

Treasury performance will be better in Q1FY14 than Q4FY13. However, the reversal in yields over the past couple of weeks has restricted some gains. In Q4FY13, bank positioned its bond portfolio for yield rally -inching up duration of its AFS portfolio to 4.4years. 28% of investment in AFS should help post a strong treasury performance.

Outlook and valuations: Asset quality key; maintain 'HOLD'

In FY13, the bank treaded the conservative growth path with focused efforts on recoveries and managing asset quality. While it can reap the benefits of consolidation in terms of moderation in high level of stress pool, asset quality performance will be a key. Trading at 0.7x FY15E P/ABV, we maintain '**HOLD/SP**'.

Financials

Year to March	FY12	FY13	FY14E	FY15E
Net revenues (INR mn)	176,170	190,724	216,875	245,783
Net rev growth (%)	*14.2*	*8.3*	*13.7*	*13.3*
Net profit (INR mn)	48,842	47,477	56,106	65,791
Shares outstanding (mn)	339	353	353	353
EPS (INR)	144.0	134.3	158.7	186.1
EPS growth (%)	*2.9*	*(6.7)*	*18.2*	*17.3*
PE (x)	5.2	5.5	4.7	4.0
Price to adj. book (x)	1.1	1.0	0.9	0.7
ROE (%)	21.1	16.5	16.8	17.3

EDELWEISS 4D RATINGS

Absolute Rating	**HOLD**
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Equalweight

MARKET DATA *(R: PNBK.BO, B: PNB IN)*

CMP	: INR 742
Target Price	: INR 875
52-week range (INR)	: 922 / 659
Share in issue (mn)	: 353.5
M cap (INR bn/USD mn)	: 262 / 4,546
Avg. Daily Vol.BSE/NSE('000)	: 810.3

SHARE HOLDING PATTERN (%)

	Current	Q3FY13	Q2FY13
Promoters *	57.9	56.1	56.1
MF's, FI's & BK's	19.0	19.8	20.6
FII's	18.0	17.9	17.4
Others	5.2	6.1	5.9

** Promoters pledged shares (% of share in issue) : NIL*

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	(11.1)	(5.5)	2.3
3 months	(6.9)	(0.4)	6.0
12 months	(6.3)	13.8	33.1

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Asset quality challenges remain

Management believes challenges on slippages persist. However, focus on recoveries will offset pressure from slippages. The upgradation/recoveries of ~48% slippages during FY13 is a vindication of the bank's strong focus on recoveries. The bank believes that movement of slippages and recoveries and upgrades will continue to be lumpy given that PNB gets no leeway under system-based NPL recognition. Specifically on the gem & jewellery account, the bank has an exposure of INR20bn, which devolved on May 7. In all likelihood it will be classified as an NPL by June 30. Management believes that outside of specific gems & jewellery account the stress has been lower than the Q4FY13.The bank has INR 2 bn exposure to the stressed NAFED account which has been fully provided for. Hence, any recovery will be directly taken to income. On restructuring, PNB believes incremental numbers should be lower given the stringent conditions put by RBI on personal guarantees, and also promoter contribution increased to 20%. In Q4FY13, restructuring came in higher at INR64bn—power at INR37bn.

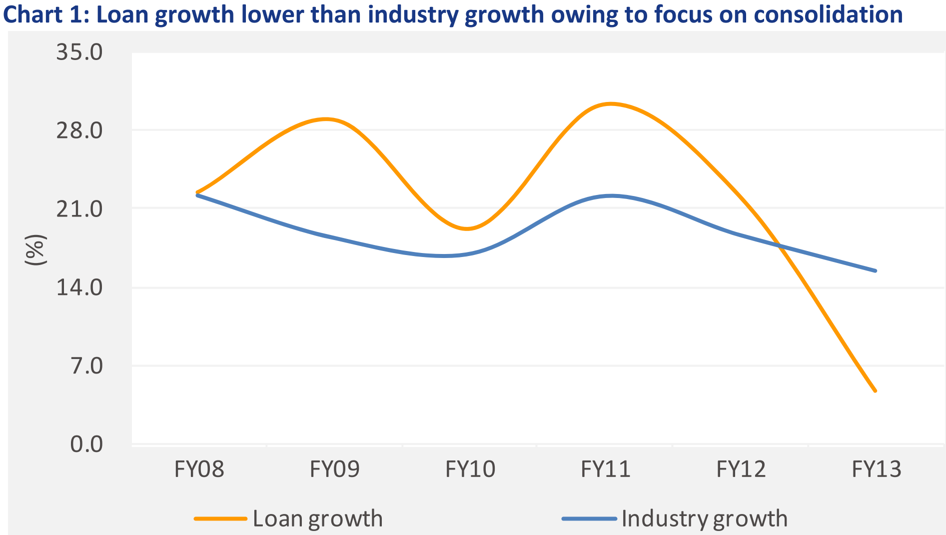
SEB restructuring to be implemented by July; No NPV hit to be taken

PNB is the lead banker for UP SEB. The bank believes that the SEB's restructuring will be completed by July. As per the terms of the package, there will be no NPV on conversion as per RBI clarification. Bonds will be subject to MTM; however, pricing ensures that chances of hit are minimal. Post the issue of bonds, special securities of the state government will be issued over three-five years. Funding of losses—FY13: 100%, FY14: 75%, FY15: 50%. No funding of losses from FY16.

Key highlights of annual report

- ALM profile- Widened mismatch within 1 yr maturity bucket
- NPLs rise more prominent in agriculture and Industrial segments
- Unable to meet PSL requirement due to reclassification by RBI
- Exposure to Infrastructure segment inched up as exposure to power segment increases

Chart 1: Loan growth lower than industry growth owing to focus on consolidation



Source: company

Table 1: Slippages likely to be elevated; upgrades/recoveries to boost performance

(INR mn)	Q412	Q113	Q213	Q313	Q413
Opening GNPA	64,432	87,204	99,882	140,239	139,978
Addition	28,190	27,680	51,510	29,687	29,570
Reductions	5,418	15,002	11,153	29,948	34,890
-Cash recovery	4,100	5,702	5,570	11,540	14,105
-Upgradation	650	8,960	5,410	18,010	11,725
-Write off	660	340	173	398	9,060
Closing GNPA	87,204	99,882	140,239	139,978	134,658

Chart 2: Restructured book movement in FY13; incremental restructuring to be lower

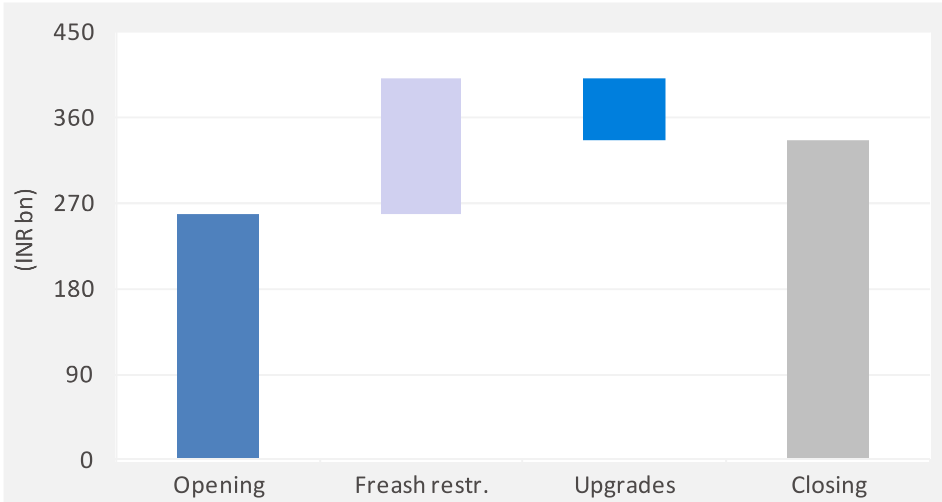


Table 2: Power contributing to restructuring in Q4FY13

	(INR mn)
CDR	
Konaseema	680
Vandana Vidhyut	3,680
Moser baer solar	2,220
Total	**6,580**
Non-CDR	
TNEB	16,350
Jindal India thermal	3,670
Testa urja	8,490
Total	**28,510**
Other Lumpy accounts	
Lavasa	2,000
Sujana Metals	3,500

Source: Company

Chart 3: > 65% of restructuring is done through Non-CDR route

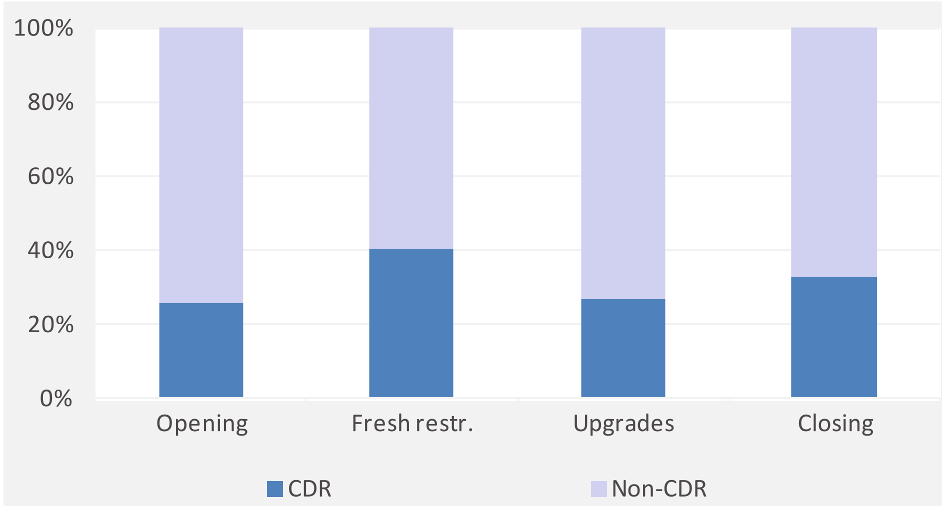


Chart 4: ~ 6% of restructured book has slipped into NPLs

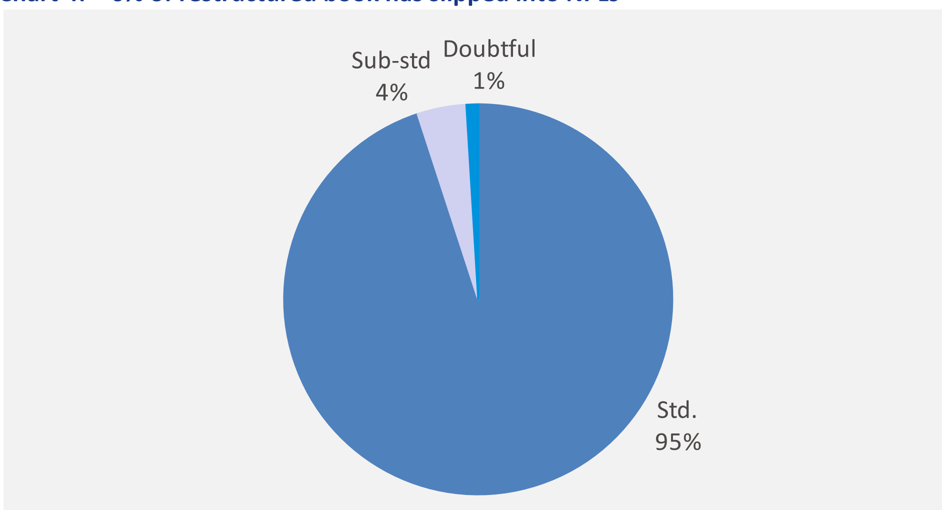
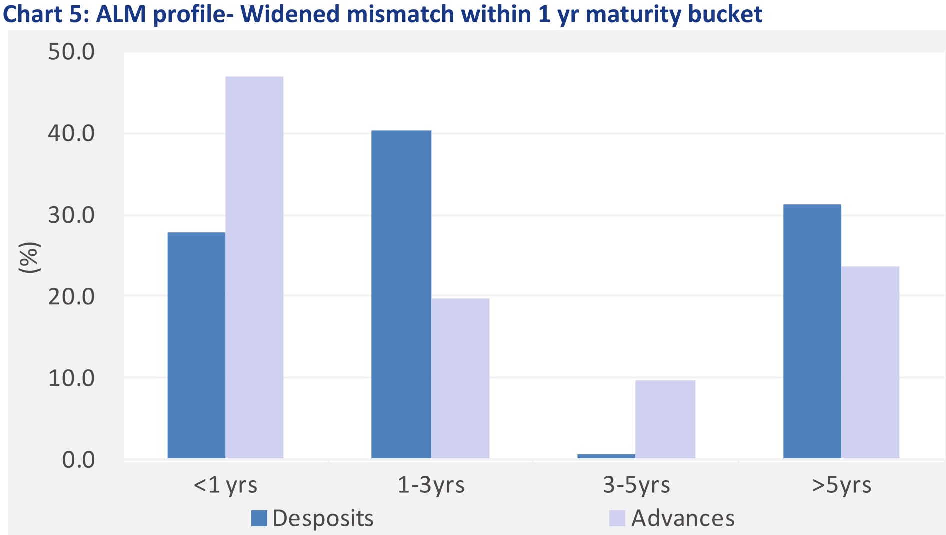


Chart 5: ALM profile- Widened mismatch within 1 yr maturity bucket



Source: Company

Chart 6: NPLs rise more prominent in agriculture and Industrial segments

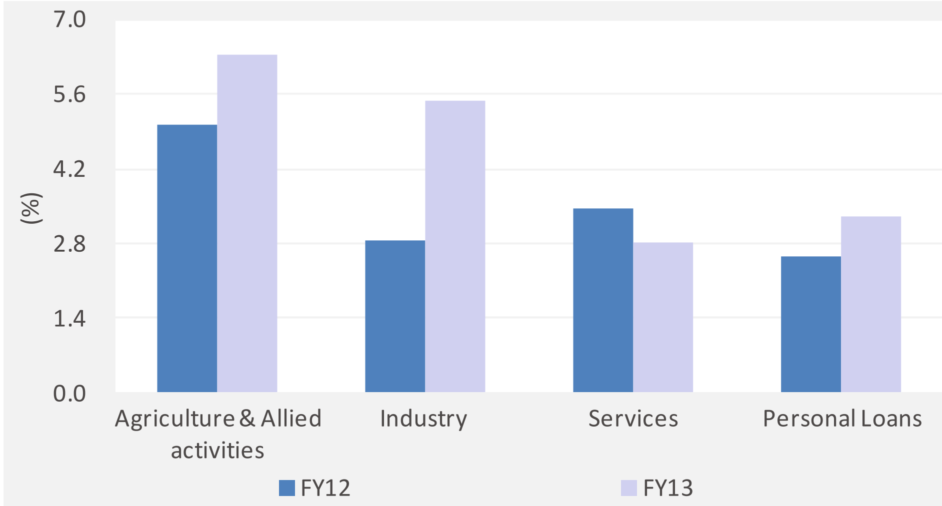


Table 3: Unable to meet PSL requirement due to reclassification by RBI

	FY11	FY12	FY13
Priority Sector	40.7	40.7	33.2
Agri Priority Advances	19.3	19.3	13.8
-Direct Agri Advances	14.8	14.8	12.6
Weaker Section	10.1	10.4	10.0
Women Beneficiaries	5.1	5.1	5.1

Table 4: Salary escalation rate lower than 5.5% (proposed by IBA)

	PNB			PSU peers		
	FY11	FY12	FY13	FY11	FY12	FY13
Discount Rate	8.45	8.80	8.45	8.45-8.50	8.50-8.80	8.00-8.50
Expected Rate of return on Plan Asset	8.56	8.61	8.61	8.00-8.60	8.00-8.60	8.00-9.20
Salary Escalation	5.00	5.00	5.00	4.00-5.00	4.00-6.00	4.00-5.50

Table 5: Exposure to Infrastructure segment inched up as exposure to power segment increases

	Fund Based			Non Fund Based			Combined		
	FY11	FY12	FY13	FY11	FY12	FY13	FY11	FY12	FY13
Power	6.7	7.8	8.8	8.4	8.1	9.1	15.1	15.9	17.8
Roads and Poarts	2.7	2.4	3.5	0.4	1.7	1.6	3.1	4.1	5.2
Telecom	3.4	2.7	2.6	3.4	3.2	2.9	6.9	5.9	5.4
Infrastructure	14.6	15.4	16.9	13.0	12.4	14.8	27.6	27.8	31.7
Textile	2.7	1.5	2.3	1.1	0.9	1.0	3.8	2.4	3.3
Basic Metals	7.1	6.4	6.3	15.6	13.7	15.4	22.7	20.1	21.7
Construction	1.6	1.2	1.4	0.5	0.4	0.2	2.1	1.6	1.6
Gems and Jewellery	0.7	0.3	0.8	3.3	0.3	0.6	4.0	0.6	1.4

Source: Company

Company Description

PNB is northern India-based bank with over 5,800 branches, most of which are in the states of Punjab, Haryana, Uttar Pradesh, Madhya Pradesh and Bihar. More than 50% of its branches are in rural and semi- urban areas. The bank's balance sheet stands at around ~INR 4.7tn and has one of the highest CASA ratio among nationalized banks. The government's shareholding, at 56%, leaves little scope for significant dilution/capital rising hereon. Foreign holding too is nearing maximum permissible of 20%.

Investment Theme

With its strong franchise and diversified loan book, PNB's margins continue to remain well above the industry average. Elevated levels of restructuring and consistently high slippages (despite an improvement this quarter) are key reasons straining the earnings growth and keeping the profit around INR 11-12 bn for the last eight quarters. We expect headwinds namely the elevated credit cost to continue for FY14E but may ease with the GDP improvement anticipated in FY14E. However, we are cautious of the impending wage hike because of which benefit of operating leverage may not come through.

Key Risks

Any downturn in agricultural growth will hurt the bank's asset quality

Given the pace of expansion delinquencies can rise faster than expected. Higher than expected slippages from restructured assets can risk asset quality.

Management is a key factor for the bank to sustain premium valuations (among PSU banks). The key risk to our recommendation is replacement of present management by a weaker business manager

Financial Statements

Key Assumptions

Year to March	FY12	FY13	FY14E	FY15E
Macro				
GDP(Y-o-Y %)	6.2	5.0	6.0	7.0
Inflation (Avg)	8.9	7.4	5.2	6.0
Repo rate (exit rate)	8.5	7.5	6.8	6.0
USD/INR (Avg)	48.0	54.5	55.0	53.0
Sector				
Credit growth	17.1	14.7	15.0	16.0
Deposit growth	13.4	13.5	15.0	16.0
CRR	4.8	4.3	4.0	4.0
SLR	24.0	23.0	23.0	23.0
G-sec yield	8.5	7.8	7.6	7.5
Company				
Operating metric assumptions (%)				
Yield on advances	10.6	10.6	10.3	10.1
Yield on investments	7.1	7.7	7.5	7.3
Yield on asset	9.0	9.2	9.0	8.8
Net interest margins	3.3	3.3	3.4	3.3
Cost of funds	6.0	6.4	6.1	5.9
Cost of deposits	6.2	6.6	6.2	6.1
Cost of borrowings	4.7	4.5	4.5	4.5
Spread	2.9	2.8	2.9	2.9
Tax rate (%)	30.6	27.2	30.5	30.5
Balance sheet assumption (%)				
Credit growth	22.0	4.7	16.0	16.5
Deposit growth	21.3	3.2	16.8	16.6
SLR ratio	24.6	25.6	25.5	25.0
Low-cost deposits	35.3	39.2	37.3	37.2
Gross NPA ratio	2.9	4.3	4.1	4.0
Provision coverage	48.9	53.7	55.4	57.2
Incremental slippage	2.7	2.9	2.7	2.7
Net NPA / Equity	16.9	23.2	18.9	17.8
Capital adequacy	12.6	12.7	12.9	11.6

Income statement (INR mn)

Year to March	FY12	FY13	FY14E	FY15E
Interest income	364,280	418,933	451,785	511,354
Interest expended	230,136	270,368	282,630	318,808
Net interest income	134,144	148,565	169,155	192,546
Non interest income	42,026	42,159	47,720	53,237
- Fee & forex income	31,717	30,789	35,408	40,011
- Misc. income	6,798	6,500	7,313	8,227
- Investment profits	3,511	4,870	5,000	5,000
Net revenue	176,170	190,724	216,875	245,783
Operating expense	70,028	81,651	94,538	107,007
- Employee exp	47,235	56,747	66,718	75,204
- Other opex	22,793	24,903	27,820	31,803
Preprovision profit	106,143	109,074	122,338	138,775
Provisions	35,773	43,856	41,609	44,111
Loan loss provisions	24,031	42,106	40,609	43,111
Investment depreciation	2,351	1,090	500	500
Other provisions	9,391	660	500	500
Profit before tax	70,370	65,218	80,728	94,664
Provision for tax	21,528	17,741	24,622	28,872
Profit After Tax	48,842	47,477	56,106	65,791
Reported PAT	48,842	47,477	56,106	65,791
Diluted EPS (INR)	144.0	134.3	158.7	186.1
Dividend per share (INR)	22.0	27.0	32.0	37.0
Dividend payout (%)	15.3	23.4	23.5	23.1

Growth ratios (%)

Year to March	FY12	FY13	FY14E	FY15E
NII growth	13.6	10.8	13.9	13.8
Fees growth	19.0	(2.9)	15.0	13.0
Opex growth	10.0	16.6	15.8	13.2
PPOP growth	17.2	1.5	12.6	14.0
PPP growth	17.2	2.8	12.2	13.4
Provisions growth	43.6	22.6	(5.1)	6.0
Net profit	10.2	(2.8)	18.2	17.3

Operating ratios

Year to March	FY12	FY13	FY14E	FY15E
Yield on advances	10.6	10.6	10.3	10.1
Yield on investments	7.1	7.7	7.5	7.3
Yield on assets	9.0	9.2	9.0	8.8
Net interest margins	3.3	3.3	3.4	3.3
Cost of funds	6.0	6.4	6.1	5.9
Cost of deposits	6.2	6.6	6.2	6.1
Cost of borrowings	4.7	4.5	4.5	4.5
Spread	2.9	2.8	2.9	2.9
Cost-income	39.7	42.8	43.6	43.5
Tax rate	30.6	27.2	30.5	30.5

Balance sheet				(INR mn)
As on 31st March	**FY12**	**FY13**	**FY14E**	**FY15E**
Equity capital	3,392	3,535	3,535	3,535
Reserves & surplus	260,284	308,739	351,656	402,247
Net worth	263,676	312,274	355,190	405,782
Sub bonds/pref cap	111,903	109,543	114,543	119,543
Deposits	3,795,885	3,915,601	4,571,654	5,329,067
Borrowings	260,740	286,667	291,709	296,757
Other liabilities	135,523	150,192	165,844	182,709
Total liabilities	**4,567,726**	**4,774,275**	**5,498,939**	**6,333,857**
Loans	2,937,748	3,087,252	3,581,212	4,172,113
Cash and equivalents	288,280	271,354	304,321	346,968
Gilts	999,827	1,076,962	1,242,407	1,408,706
Others	226,467	222,000	242,050	264,343
Fixed assets	17,193	19,082	21,149	22,966
Other Assets	98,210	97,626	107,800	118,763
Total assets	**4,567,726**	**4,774,275**	**5,498,939**	**6,333,857**
Credit growth	22.0	4.7	16.0	16.5
Deposit growth	21.3	3.2	16.8	16.6
EA growth	21.3	4.6	15.3	15.3
SLR ratio	24.6	25.6	25.5	25.0
C-D ratio	79.8	81.0	80.4	80.3
Low-cost deposits	35.3	39.2	37.3	37.2
Gross NPA ratio	2.9	4.3	4.1	4.0
Net NPA ratio	1.5	2.3	1.9	1.7
Provision coverage	48.9	53.7	55.4	57.2
Incremental slippage	2.7	2.9	2.7	2.7
Net NPA / Equity	16.9	23.2	18.9	17.8
Capital adequacy	12.6	12.7	12.9	11.6
- Tier 1	9.3	9.8	9.1	8.4

RoE decomposition (%)

Year to March	FY12	FY13	FY14E	FY15E
Net interest income/assets	3.3	3.3	3.4	3.3
Fees/Assets	0.9	0.8	0.9	0.8
Investment profits/Assets	0.1	0.1	0.1	0.1
Net revenues/assets	4.3	4.2	4.3	4.3
Operating expense/assets	(1.7)	(1.8)	(1.9)	(1.9)
Provisions/assets	(0.9)	(1.0)	(0.8)	(0.8)
Taxes/assets	(0.5)	(0.4)	(0.5)	(0.5)
Total costs/assets	(3.1)	(3.1)	(3.2)	(3.1)
ROA	1.2	1.0	1.1	1.1
Equity/assets	5.7	6.3	6.7	6.6
ROAE (%)	21.1	16.5	16.8	17.3

Valuation parameters

Year to March	FY12	FY13	FY14E	FY15E
Diluted EPS (INR)	144.0	134.3	158.7	186.1
Y-o-Y growth (%)	*2.9*	*(6.7)*	*18.2*	*17.3*
Book value per share (INR)	777.4	883.5	1,004.9	1,148.0
Adjusted book value per share	685.5	740.1	872.2	1,005.2
Diluted PE (x)	5.2	5.5	4.7	4.0
Price/ Adj. BV (x)	1.1	1.0	0.9	0.7
Dividend yield (%)	3.0	3.6	4.3	5.0
Price to income (x)	4.1	4.2	3.7	3.3

Peer comparison valuation

	Market cap	Diluted PE (X)		Price/ Adj. BV (X)		ROAE (%)	
Name	**(USD mn)**	**FY14E**	**FY15E**	**FY14E**	**FY15E**	**FY14E**	**FY15E**
Punjab National Bank	4,546	4.7	4.0	0.9	0.7	16.8	17.3
Allahabad Bank	968	3.1	2.4	0.6	0.5	15.9	18.2
Axis Bank	10,555	9.5	7.8	1.6	1.4	18.2	18.9
Bank of Baroda	4,635	4.7	3.7	0.8	0.7	17.3	18.6
Federal Bank	1,258	7.8	6.5	1.1	1.0	14.1	15.1
HDFC Bank	27,556	19.6	15.7	3.8	3.2	20.7	21.8
ICICI Bank	22,069	13.9	12.4	2.1	1.9	13.1	13.3
Indian Overseas Bank	940	5.2	4.5	0.6	0.5	8.3	8.9
ING Vysya	1,719	12.9	10.3	1.9	1.7	15.7	17.1
Karnataka Bank	457	6.2	5.2	0.9	0.8	14.1	15.2
Oriental Bank Of Commerce	1,198	3.7	3.1	0.6	0.5	14.6	15.6
South Indian Bank	572	5.8	4.8	1.0	0.9	18.5	19.1
State Bank of India	24,280	9.4	7.9	1.5	1.3	14.3	15.1
Union Bank Of India	2,199	6.1	5.3	0.8	0.7	15.1	15.6
Yes Bank	2,984	10.5	8.5	2.4	2.0	25.4	25.4
Median	-	6.2	5.3	1.0	0.9	15.7	17.1
AVERAGE	-	8.2	6.8	1.4	1.2	16.1	17.0

Source: Edelweiss research

Additional Data

Directors Data

K R Kamath	Chairman & Managing Director	Mohinder Paul Singh	Director (Workman Employee)
Pradeep Kumar	Director (Officer Employee)	Rakesh Sethi	Executive Director
Mushtaq Ataullah Antulay	Director	Usha Ananthasubramanian	Executive Director
Anurag Jain	Nominee (Govt)	B B Chaudhry	Director
M N Gopinath	Director(Shareholders)	D K Singla	Director(Shareholders)
Sunil Gupta	Director(Shareholders)		

Auditors - G S Madhava Rao & Co

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Life Insurance corporation	12.79	Lazard Asset Management	4.09
Janus Capital Management	1.76	HDFC Asset Management	1.61
IDFC Mutual Fund	0.52	Sundaram Asset Management	0.41
UTI Asset Management	0.36	Alliance Bernstein LP	0.32
Vanguard Group	0.26	Bank of New York Mellon	0.22

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Allahabad Bank	BUY	SP	M	Axis Bank	BUY	SO	M
Bank of Baroda	BUY	SP	M	Federal Bank	BUY	SO	L
HDFC	HOLD	SP	L	HDFC Bank	HOLD	SP	L
ICICI Bank	BUY	SO	L	Indian Overseas Bank	HOLD	SU	M
IndusInd Bank	BUY	SP	L	IDFC	BUY	SO	L
ING Vysya	BUY	SO	L	Karnataka Bank	BUY	SO	M
Kotak Mahindra Bank	REDUCE	SU	M	LIC Housing Finance	BUY	SO	M
Mahindra & Mahindra Financial Services	BUY	SO	M	Manappuram General Finance	BUY	SP	H
Multi Commodity Exchange of India	BUY	SO	M	Muthoot Finance	BUY	SO	M
Oriental Bank Of Commerce	BUY	SO	L	Power Finance Corp	BUY	SO	M
Punjab National Bank	HOLD	SU	M	Reliance Capital	BUY	SO	M
Rural Electrification Corporation	BUY	SO	M	Shriram City Union Finance	BUY	SO	M
South Indian Bank	HOLD	SP	M	State Bank of India	BUY	SO	L
Union Bank Of India	BUY	SO	M	Yes Bank	BUY	SO	M

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services

Allahabad Bank, Axis Bank, Bank of Baroda, Federal Bank, HDFC, HDFC Bank, ICICI Bank, Infrastructure Development Finance Co Ltd, IndusInd Bank, Indian Overseas Bank, Karnataka Bank, Kotak Mahindra Bank, LIC Housing Finance, Multi Commodity Exchange of India, Manappuram General Finance, Mahindra & Mahindra Financial Services, Muthoot Finance, Oriental Bank Of Commerce, Punjab National Bank, Power Finance Corp, Reliance Capital, Rural Electrification Corporation, State Bank of India, Shriram City Union Finance, South Indian Bank, Union Bank Of India, ING Vysya, Yes Bank

Recent Research

Date	Company	Title	Price (INR)	Recos
05-Jun-13	**Banking**	Bank license: Sacrificing near term RoE for long term goals; *Sector Update*		
30-May-13	**MCX**	Dip in commodity prices, CTT levy key monitorables ; *Result Update*	889	Buy
30-May-13	**PFC**	Strong on core; GNPLs decline as expected; *Result Update*	191	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution* * - stocks under review	120	49	17	186

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	118	56	12

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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