

Asset quality pressures as expected

Quick Note

January 31, 2012

Rating Remains	Neutral
Target price Remains	INR 1070
Closing price January 30, 2012	INR 955

Key Highlights:

PNB's 3QFY12 PAT of INR 11.5bn was in line with our expected INR11.38bn (Street at INR12.6bn). Total provisions for the quarter at INR9.46bn were in line with our estimate of INR9.60bn. Loan growth was 18.7% y/y and deposit growth was 23.4% y/y. The key contributions to the loan book growth came from large & mid-corporates, MSME and retail loans. On the deposit side, CASA deposits grew at 11.7% y/y and term deposits grew at 30.9% y/y. NIM for 3QFY12 was 3.88% compared with 3.95% in 2QFY12 (4.13% in 3QFY11) and the cost-income ratio declined to 40.4% versus 41.78% in 2QFY12. Sequentially, the GNPL ratio increased to 2.42% from 2.05% and the NNPL ratio increased to 1.11% from 0.84% as core provision cover declined to 54.96% from 59.45%. Incremental delinquency ratio was 2.13% and LLPs were at 0.9%. Tier-1 capital was at 7.85% and ROA was 1.12% (1.23% in 2QFY12).

Key notes from management discussion & outlook:

- PNB set aside INR5.79bn as specific loan loss provisions during the quarter, compared with our estimate of INR8.7bn.
- The bank restructured INR19.84bn during 3QFY12 including INR10bn for the GTL group. No SEB account was restructured during 3QFY12. In the past one year, PNB has not taken any additional exposures to SEBs. Management guided towards restructuring Rajasthan SEB in Q4FY12 while it indicated the possibility of two additional SEBs getting restructured during the coming 1-2 quarters.
- Of the outstanding restructured loans, power exposures were at 15.15%. Management guided towards a slippage ratio of 15% from the restructured book. The restructured book at the end of 3QFY12 was INR168.88bn, representing 6.43% of the 3QFY12 closing loan book. Cumulative slippage from the restructured book classified as standard has been 10.9% and cumulative upgradations from the restructured book classified as NPA has been 19.9%.
- As seen across the sector this quarter upgradations & recoveries tracked strongly, a trend we had highlighted in our 14 December 2011 note, 'We met with an asset reconstruction company'.
- Management reiterated its NIM guidance of 3.5% for FY12F and a cost-income ratio in the range of 41-42%. ROA for FY12F is expected to be around 1.2% as per management. We are currently factoring in loan growth of 18.3% for FY12F, NIM of 3.6% and a cost-income ratio of 40%. For FY13F, our expectations are: loan growth of 19.1%, NIM of 3.6% and cost-income ratio of 40%.

Valuation

Our TP of INR1,070 implies 1.3x FY13F ABV and 7.0x FY13F EPS for an FY13F ROA of 1% and adjusted ROE of 19.5%. PNB is currently trading at 1.1x FY13F ABV and 6.1x FY13F EPS.

Research analysts

India Banks

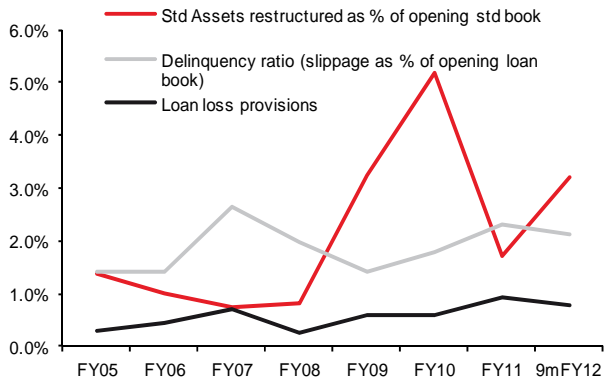
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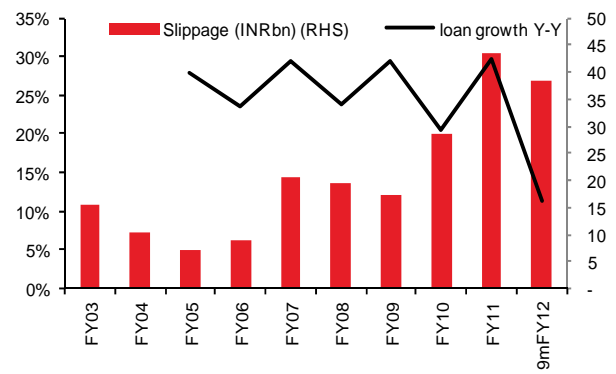
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Fig. 1: Asset quality trends



Source: Company data, Nomura estimates

Fig. 2: Slippage vs loan growth



Source: Company data, Nomura estimates

Fig. 3: Earnings summary

Earnings summary (INRmn)	3QFY12	2QFY12	3QFY11	%y/y	%q/q	3QFY12F	Variance
Interest Income	94,810	89,520	71,191	33.2	5.9	92,318	2.7
Interest on advances	73,314	70,448	54,894	33.6	4.1	71,332	2.8
Income on investments	20,271	18,524	14,926	35.8	9.4	20,424	(0.7)
Interest on balances with RBI	808	484	255	216.6	67.1	378	113.7
Others	417	65	1,116	(62.6)	538.7	184	126.4
Interest expended	59,444	54,994	39,158	51.8	8.1	57,960	2.6
Net Interest Income	35,366	34,526	32,033	10.4	2.4	34,358	2.9
Non-interest income	9,541	8,889	8,572	11.3	7.3	10,284	(7.2)
Fees	6,140	5,560	5,010	22.6	10.4	6,184	(0.7)
Trading gains	870	530	870	-	64.2	1,237	(29.7)
Total Operating expenses	18,143	18,137	17,106	6.1	0.0	17,533	3.5
Employee expenses	12,636	12,404	12,235	3.3	1.9	11,984	5.4
Other Operating expenses	5,507	5,732	4,871	13.1	(3.9)	5,549	(0.8)
Operating Profit	26,764	25,278	23,499	13.9	5.9	27,109	(1.3)
Core operating profit	25,894	24,748	22,629	14.4	4.6	25,872	0.1
Total Provisions	9,461	7,103	7,139	32.5	33.2	9,604	(1.5)
Loan loss Provisions	5,790	3,190	5,550	4.3	81.5	8,754	(33.9)
PBT	17,303	18,175	16,360	5.8	(4.8)	17,505	(1.2)
Core PBT	16,433	17,645	15,490	6.1	(6.9)	16,268	1.0
Tax	5,803	6,124	5,463	6.2	(5.2)	6,127	(5.3)
Net profit	11,500	12,050	10,898	5.5	(4.6)	11,378	1.1
EPS	36.3	38.0	38.0	(4.6)	(4.6)	35.9	1.1

Source: Company data, Nomura estimates

Fig. 4: Loans & Deposits

Loans & Deposits (INRmn)	3QFY12	2QFY12	3QFY11	%y/y	%q/q
Advances	2,626,052	2,490,196	2,212,520	18.7	5.5
Total Deposits	3,565,167	3,417,832	2,888,730	23.4	4.3
CASA Deposits	1,259,650	1,240,220	1,128,050	11.7	1.6
Savings Account Deposits	1,027,050	1,004,910	898,600	14.3	2.2
Current Account Deposits	232,600	235,310	229,450	1.4	(1.2)
Term Deposits	2,305,517	2,177,612	1,760,680	30.9	5.9
Investments	1,167,486	1,106,425	883,780	32.1	5.5
Total Assets	4,218,736	4,029,526	3,435,978	22.8	4.7

Source: Company data, Nomura research

Fig. 5: Breakup of loans

Breakup of loans (INRmn)	3QFY12	2QFY12	3QFY11	%y/y	%q/q
Large and Mid corporate	1,405,572	1,355,786	1,170,010	20.1	3.7
MSME	523,090	494,190	441,250	18.5	5.8
Agriculture & Allied	383,060	350,760	339,090	13.0	9.2
Food Credit	54,240	42,140	44,850	20.9	28.7
Retail Loans	260,090	247,320	217,320	19.7	5.2
Housing/Mortgage	123,730	119,200	110,080	12.4	3.8
Total Loans	2,626,052	2,490,196	2,212,520	18.7	5.5

Source: Company data, Nomura research

Fig. 6: Key Ratios

Key Ratios	3QFY12	2QFY12	3QFY11	y/y bps	q/q bps
Net Interest Margin, %	3.88	3.95	4.13	(25)	(7)
Cost/Income Ratio, %	40.40	41.78	42.13	(173)	(137)
Cost/Asset Ratio, %	0.43	0.45	0.50	(7)	(2)
CASA, %	35.33	36.29	39.05	(372)	(95)
Tier I, %	7.85	8.37	7.58	27	(52)
Total CAR, %	11.48	12.23	11.90	(42)	(75)
RoE (annualised), %	22.07	24.59	25.78	(370)	(252)
RoA (annualised), %	1.12	1.23	1.23	(11)	(11)

Source: Company data, Nomura research

Fig. 7: Asset Quality

Asset Quality (INRmn)	3QFY12	2QFY12	3QFY11	%y/y	%q/q
Gross NPL	64,418	51,501	45,411	41.9	25.1
Net NPL	29,014	20,885	15,751	84.2	38.9
Gross NPL, %	2.42	2.05	2.03	39	37
Net NPL, %	1.11	0.84	0.72	39	27
Provision cover, %	54.96	59.45	65.32	(1,036)	(449)
LLP, %	0.91	0.52	1.04	(13)	39

Source: Company data, Nomura research

Fig. 8: Movement in NPLs

Movement in NPLs (INRmn)	3QFY12	2QFY12	3QFY11
Opening NPLs	51,501	48,936	40,248
Add new NPLs	16,830	9,930	9,770
Less write offs	310	180	1,850
Less recoveries	3,340	5,130	2,410
Less upgradations	250	2,060	340
Total reduction	3,900	7,370	4,600
Closing NPLs	64,418	51,501	45,411

Source: Company data, Nomura research

Appendix A-1

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Mentioned companies

Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Punjab National Bank	PNB IN	INR 955	30-Jan-2012	Neutral	Not rated	

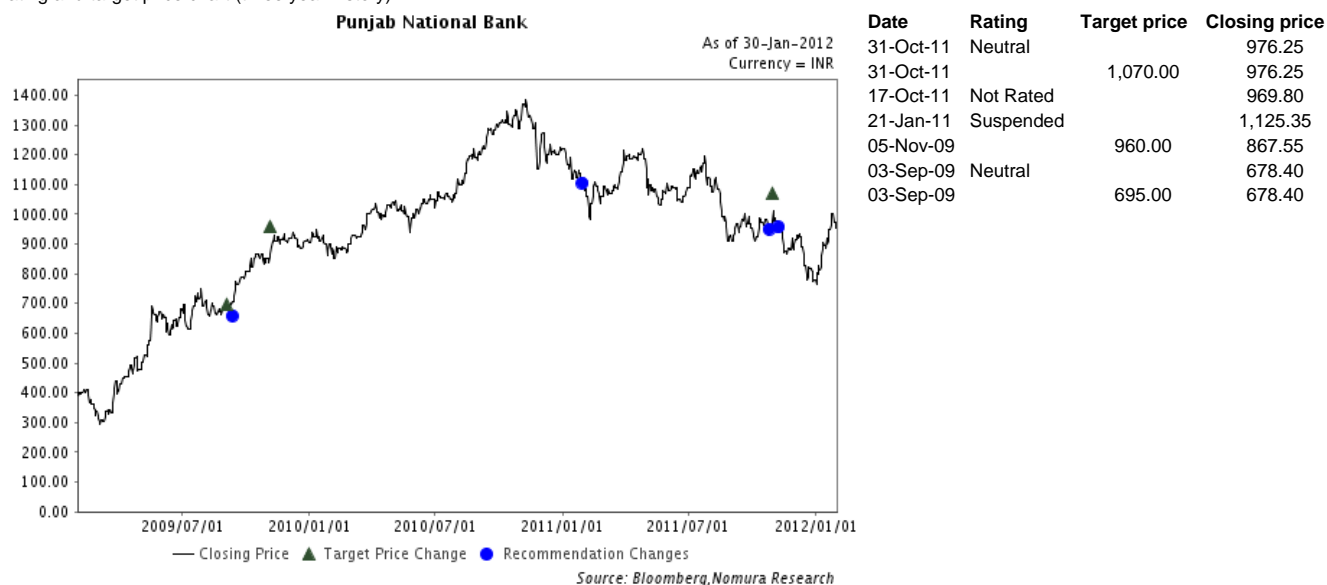
Previous Rating

Issuer name	Previous Rating	Date of change
Punjab National Bank	Not Rated	31-Oct-2011

Punjab National Bank (PNB IN)

INR 955 (30-Jan-2012) Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



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

Valuation Methodology We have arrived at our target price of INR1,070 using a three-stage residual-income valuation method that assumes the following: 1) 20.3% CAGR for interest-earning assets over FY11-14, 11.6% CAGR over FY14-20 and a terminal growth rate of 4% beyond that, 2) average ROE of 15.1% over FY12-20 and a 14% terminal value ROE, and 3) discount rates ranging from 14.7% (current cost of equity) for FY11-14, 12.5% for FY14-20 and a 10% terminal rate. Our book value estimates don't factor any equity dilution.

Risks that may impede the achievement of the target price Accelerated monetary policy easing, policy intervention to resolve power sector bottlenecks like fuel availability, and SEB (state electricity board) financial health are key upside catalysts. RBI persisting with a tight monetary policy, a policy logjam with respect to power-sector bottlenecks and continued global macro uncertainty are key downside risks.

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