Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)			✓
Right Valuation (RV)		✓	

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS	+	↑	+
RQ	+	↓	-
RV	+	↔	=

ESG Disclosure Score NEW

ESG RISK RATING Updated Jul 08, 2022				51.06
Severe Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

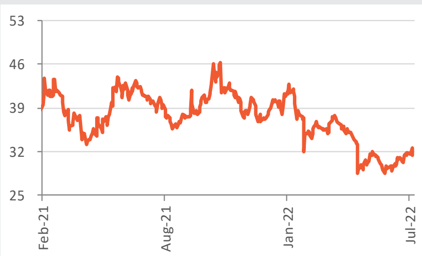
Company details

Market cap:	Rs. 34,520 cr
52-week high/low:	Rs. 48/ 28
NSE volume: (No of shares)	400.96 lakh
BSE code:	532461
NSE code:	PNB
Free float: (No of shares)	298.2 cr

Shareholding (%)

Promoters	73.2
FII	1.0
DII	11.5
Others	14.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.3	-11.4	-24.4	-20.5
Relative to Sensex	-5.2	-12.3	-25.0	-29.9

Sharekhan Research, Bloomberg

Punjab National Bank

Higher credit cost continues to dampen earnings

Bank	Sharekhan code: PNB	
Reco/View: Hold ↔	CMP: Rs. 31	Price Target: Rs. 33 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Punjab National Bank (PNB) reported PAT at Rs. 308 crore (-70% y-o-y/+53% q-o-q), which was significantly below street's expectations (65%) mainly on account of higher credit cost (2.6% of average advances).
- However, asset quality improved with GNPA/NNPA ratios falling by 51 bps/52 bps q-o-q, at 11.27%/4.28%. Slippages were down 38% q-o-q to Rs. 6,468 crore. Although slippage ratio was reported at 3.9% (annualised), it is still very high compared to peers.
- NII grew mutedly by 4% y-o-y/3% q-o-q, trailing advances growth of 12% y-o-y. NIM improved by 3 bps q-o-q, reported at 2.79%. Operating profit declined by 12% y-o-y and grew by 2% q-o-q.
- The stock currently trades at 0.5x/0.5x its FY2023E/FY2024E BV, which reflects weak business franchise and below-par return profile. We believe higher stress in books compared to peers and lower operating profit would keep returns ratio below par. We maintain our Hold rating with an unchanged PT of Rs. 33.

Punjab National Bank (PNB) reported sub-par performance for Q1FY2023. Net interest income (NII) grew by 4% y-o-y/3% q-o-q, trailing advances growth. Net interest margin (NIM) improved by 3 bps q-o-q to 2.79%. Core fee income grew robustly by 26% y-o-y/34% q-o-q. Other income was lower by 75% y-o-y/47% q-o-q due to treasury losses. There was net treasury loss of Rs. 836 crore. However, recovery from written-off account was strong, up 59% y-o-y/51% q-o-q. Total operating expenses were flat y-o-y and higher by 5% q-o-q. Cost-to-income ratio was reported at 46.6% versus 46% in the last quarter and 43.6% in Q1FY2022. Operating profit declined by 12% y-o-y and grew by 2% q-o-q. However, core PPoP grew by 2% y-o-y/58% q-o-q. Provisions were higher by 2% y-o-y/-1% q-o-q. Credit cost stood at 2.6% of average advances for the quarter. PAT declined by 70% y-o-y but grew by 53% q-o-q. Net advances and deposits grew by 12% y-o-y/4% y-o-y and 2% q-o-q/-1% q-o-q, respectively. CASA grew by 6% y-o-y, with overall CASA ratio at 46% versus 47% in the last quarter. Retail (excluding agri and MSME), agri, and MSME book grew by 11% y-o-y, 4% y-o-y, and 3% y-o-y, respectively. Wholesale corporate book grew by 12% y-o-y. The bank's asset quality improved, with GNPA and NNPA ratios declining by 51 bps q-o-q and 52 bps q-o-q, respectively, to 11.27% and 4.28%. PCR stood at 65% versus 63% qoq. SMA 2 book stood at 0.26 of domestic advances in Q1FY2023. Covid restructured book higher by 10% q-o-q to Rs. 18,901 crore forms 2.55% of book versus 2.36% q-o-q.

Key positives

- Advances growth accelerated during the quarter.
- Strong core fee income.

Key negatives

- Higher slippages and credit cost compared to peers.
- Despite net advances growing by 12% y-o-y, NII growth was muted.
- Covid restructured book higher by 10% q-o-q.

Management Commentary

- The bank expects slippages less than Rs. 6,000 crore in the coming quarters for FY2023 along with healthy recoveries and credit cost at ~2.25% for FY2023E. NIM is expected to be in the range of 2.85-3.0% for FY2023E. In terms of asset-quality matrix, it expects GNPA to fall below ~10% and NNPA below ~3.5% in FY2023E.
- The bank is targeting loan growth of 11-12% for FY2023E versus 8% in FY2022.

Our Call

Valuation – PNB currently trades at 0.5x/0.5x its FY2023E/FY2024E book value, which reflects weak business franchise and below-par return profile. Although higher slippages and credit cost are expected to normalize as compared to FY2022, we believe its return profile would be below par compared to peers. We expect weak trends in operating profitability as compared to peers and higher credit cost would likely keep earnings under pressure going ahead. We maintain our Hold rating with an unchanged price target (PT) of Rs. 33.

Key Risks

Economic slowdown due to higher-than-anticipated credit cost especially from the corporate book and SME portfolio could affect earnings.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net Interest Income	43,289	41,014	41,506	43,535
Net profit	2,022	3,458	3,413	3,734
EPS (Rs.)	2.1	3.2	3.1	3.4
P/E (x)	15.1	9.9	10.1	9.2
P/BV (x)	0.5	0.5	0.5	0.5
RoE	2.2%	3.7%	3.5%	3.7%
RoA	0.2%	0.3%	0.3%	0.3%

Source: Company; Sharekhan estimates

Key result highlights

- **NII growth remained muted but core fee income growth was strong:** NII growth was muted at 4% y-o-y/3% q-o-q, trailing healthy advances growth. NIM improved by 3 bps q-o-q to 2.79%. However, core fee income grew strongly by 26% y-o-y/34% q-o-q. NIM guidance for FY2023E stands at 2.85-3.0%.
- **Higher advances growth likely to sustain led by robust demand in retail as well as corporate:** Net advances grew by 12% y-o-y during the quarter. Retail advances rose by 11% y-o-y and 5% q-o-q. Retail book growth was primarily aided by strong growth in the vehicle book (increased by 34% y-o-y) and personal loans (up by 26% y-o-y). As far as corporate book is concerned, it grew by 12% y-o-y, led by robust demand across sectors. There was strong credit demand across the NBFC, road, and infra projects sectors. Management has guided for overall credit growth of 11-12% in FY2023E.
- **Asset quality and credit-cost scenario guidance:** GNPA ratio and NNPA ratio improved by 51 bps q-o-q and 52 bps q-o-q to 11.27% and 4.28%, respectively, in Q1FY2023. Slippages for the quarter stood at Rs. 6,468 crore versus Rs. 10,506 crore in the past quarter. Total recoveries and upgrades stood at Rs. 5,288 crore versus Rs. 4,769 crore in the past quarter. Write-offs stood at Rs. 3,461 crore versus Rs. 10,548 crore in Q4FY2022. Management intends to bring down GNPA ratio to less than 10% and NNPA ratio below 3.5% in FY2023E. The bank expects its credit cost at ~2.25% in FY2023E, up from the earlier guidance of ~2%. With respect to slippages going ahead, the bank targets to have more recoveries than additions and does not see slippages from large accounts.

Results (Standalone) — Rs cr

Particulars	Q1FY23	Q4FY22	Q1FY22	Y-o-Y %	Q-o-Q %
Interest Income	18,757	18,645	18,921	-1%	1%
Interest Expenses	11,214	11,341	11,694	-4%	-1%
Net Interest Income	**7,543**	**7,304**	**7,227**	**4%**	**3%**
NIM (%)	2.79	2.76	2.73		
Core fee Income	2,055	1,532	1,635	26%	34%
Other Income	482	918	1,959	-75%	-47%
Net Operating Revenue	**10,080**	**9,754**	**10,821**	**-7%**	**3%**
Employee Expenses	2,547	2,158	2,956	-14%	18%
Other Opex	2,154	2,331	1,766	22%	-8%
Total Opex	**4,701**	**4,489**	**4,722**	**0%**	**5%**
Cost to Income Ratio (%)	**46.6%**	**46.0%**	**43.6%**		
Pre-Provision Profits	**5,379**	**5,265**	**6,099**	**-12%**	**2%**
Provisions & Contingencies - Total	4,790	4,851	4,678	2%	-1%
Profit Before Tax	**589**	**413**	**1,421**	**-59%**	**43%**
Tax	281	212	397	-29%	33%
Effective Tax Rate (%)	47.6	51.2	28.0		
Reported Profits	**308**	**202**	**1,023**	**-70%**	**53%**
Basic EPS (Rs.)	0.3	0.2	1.0	-71%	40%
Diluted EPS (Rs.)	0.3	0.2	1.0		
RoA (%)	0.1	0.1	0.3		
Advances	7,42,643	7,28,186	6,61,289	12%	2%
Deposits	11,36,747	11,46,218	10,97,649	4%	-1%
Gross NPA	90,167	92,448	1,04,076	-13%	-2%
Gross NPA Ratio (%)	11.3	11.8	14.3		
PCR (%)	64.8	62.2	62.9		
Net NPA	31,744	34,909	38,576	-18%	-9%
Net NPAs Ratio (%)	4.3	4.8	5.8		

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Credit growth accelerating; Top private banks placed better

System-level credit offtake grew by ~13.3% y-o-y in the fortnight ending June 17, 2022, indicating loan growth has been sustaining, given distinct signs of improving economy and revival of investments and loan demand. On the other hand, deposits rose by ~9.8%, which also reflects a healthier economic scenario but are trailing advanced growth. The bottom-up story is intact and we should see loan growth accelerate, while margins would continue to expand in a higher interest rate cycle. Asset quality is not a big issue from the end of the corporate loan, as only de-leveraging is being observed. From the retail side, there could be some pressure but nothing is significant. Asset quality is likely to remain stable except for the MFI segment. Banks are in a sweet spot in terms of fundamentals and reasonable valuations. In the past two years, banks have been cautious on lending to BB and below, thus general risk, that they are carrying on corporate portfolio is low. On the retail loans front, due to COVID-19, banks have already seen one downcycle. Most of the exposure has been taken into credit cost. In terms of MSME, we need to be watchful. At present, we believe the banking sector is likely to see higher risk-off behaviour, with tactical market share gains for well-placed players. We believe large banks with a strong capital base and asset quality (with high coverage and provision buffers) are well placed to capture growth opportunities.

■ Company Outlook – Long road to normalcy

PNB posted weak performance and below-par returns ratios, which remain a challenge and key monitorable. Higher slippages, increased credit cost, improved restructured book, and weak business traction failed to enthuse. We believe improvement in operating performance and asset-quality matrix with higher return ratios are yet to be seen. We believe the road to normalcy is still a long one for PNB.

■ Valuation – Maintain Hold with unchanged PT of Rs. 33

PNB currently trades at 0.5x/0.5x its FY2023E/FY2024E book value, which reflects weak business franchise and below-par return profile. Although higher slippages and credit cost are expected to normalise as compared to FY2022, we believe its return profile would be below par compared to peers. We expect weak trends in operating profitability as compared to peers and higher credit cost would likely keep earnings under pressure going ahead. We maintain our Hold rating with an unchanged PT of Rs. 33.

Peer valuation

Particulars	CMP (Rs / Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Punjab National Bank	31	34,520	10.1	9.2	0.5	0.5	3.5	3.7	0.3	0.3
State Bank of India	528	4,71,398	8.4	7.3	1.1	1.0	13.3	15.5	0.7	0.8
Bank of Baroda	116	60,117	8.5	6.2	0.7	0.6	7.8	9.8	0.5	0.7

Source: Company, Sharekhan estimates

About company

PNB is a government-owned bank with a network of ~10,058+ branches, 13219+ ATMs, and 18,857 business correspondents. The bank's majority presence is in Punjab, Haryana, Uttar Pradesh, Madhya Pradesh, and Bihar. More than 60% of its branches are in rural and semi-urban areas. PNB's global deposit stood at Rs. 11,36,747 crore and global credit stood at Rs. 8,00,177 crore as of June 2022. The bank has been rationalising its overseas operations, which have resulted into shrinking of its overseas business.

Investment theme

PNB has been working upon bringing significant improvement in its internal systems and processes over the last few years. The bank has restructured its processes, with a focus on recovery and resolution. Hence, it is taking steps such as creating a stressed asset-management vertical with a dedicated team of over 2,700 employees, along with creating dedicated branches to focus on SME and retail disbursements. However, we believe improvement in operating performance and asset-quality matrix with higher return ratios are yet to be seen.

Key Risks

Economic slowdown due to which higher-than-anticipated credit cost especially from the corporate book and SME portfolio could affect earnings.

Additional Data

Key management personnel

Mr. Arun Kumar Goel	Managing Director and CEO
Ms. Sanjay Kumar	Executive Director
Mr. Vijay Dube	Executive Director
Mr. Swarup Kumar Saha	Executive Director
Mr. Kalyan Kumar	Executive Director

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	8.3
2	Kotak Mahindra Asset Management Co	0.7
3	Nippon India Life Asset Management	0.6
4	SBI Funds Management Pvt. Ltd.	0.5
5	Vanguard Group Inc.	0.4
6	ICICI Prudential Asset Management	0.3
7	UTI Asset Management	0.2
8	Dimensional Fund Advisors LP	0.2
9	Aditya Birla AMC	0.1
10	Edelweiss AMC	0.1

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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