Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Punjab National Bank

Tide turning positive; upgrade to Buy

Bank	Sharekhan code: PNB	
Reco/View: Buy ↑	CMP: Rs. 51	Price Target: Rs. 64 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

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

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS	Positive	↔	Positive
RQ	Negative	↑	Neutral
RV	Positive	↔	Positive

ESG Disclosure Score NEW

ESG RISK RATING 51.06

Updated Oct 10, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 55,936 cr
52-week high/low:	Rs. 51/ 28
NSE volume: (No of shares)	465.6 lakh
BSE code:	532461
NSE code:	PNB
Free float: (No of shares)	297.3 cr

Shareholding (%)

Promoters	73.2
FII	1.2
DII	12.3
Others	13.4

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	24.4	59.4	70.0	27.5
Relative to Sensex	20.3	54.0	54.8	20.8

Sharekhan Research, Bloomberg

Summary

- We upgrade PNB to buy from hold rating with a revised TP of Rs.64. We expect RoAs (return on assets) of 0.7% for FY24E and 0.8% for FY25E, driving RoE (return on equity) of 10% and 12% for the respective years going ahead.
- We believe valuations are cheap for PNB as compared to return ratio profile expected, as Bank is likely to deliver strong earnings growth and higher RoA/RoE led by healthy loan growth, margin improvement & lower credit cost (RoA from 0.3% in FY22 to 0.4%/0.7% /0.8% inFY23E/24E/25E).
- Lower slippages trend are expected in near to medium term because of improvement in corporate credit cycle. Moreover, trailing loan growth in corporate segment has been muted. Thus, NPA formation should moderate further.
- A combination of the above factors, along with improving loan growth trajectory and higher coverage on bad loans, should bode well for good compounding in earnings going ahead. The stock currently trades at 0.7x/0.6x/0.5x its FY2023E/24E/25E ABV.

PNB's balance sheet has improved – capital ratios are healthy with Tier-1 Capital at 12.2%. It has healthy CASA share (~44%), higher liquidity (liquidity coverage ratio of 160%). A higher LCR will boost margins further as lending picks up. Asset quality has improved sharply in the past quarters and lower slippages along with healthy recoveries going forward in near to medium term likely to improve asset quality further due to benign credit cycle. PPoP growth should improve as loan growth and margins improve. Overall, the earnings trajectory should also be strong led by benign credit cost as it has higher PCR. Strong PPoP growth along with low credit costs should drive a strong improvement in return ratios over the medium term.

Strong PPoP growth expected: The bank has reported healthy loan growth (of 15% y-o-y / 4% q-o-q) in Q2FY23 on the back of broad-based growth in retail & corporate book. Margins are expected to improve further as the loan book is yet to get the full benefit of the rising interest rate cycle. Moreover, higher LCR likely to boost margins further as lending picks up. PPoP growth is expected to improve driven by healthy loan growth and margin improvement.

Lower credit costs to drive earnings growth: Overall PSU banks have emerged stronger after the COVID crisis and the corporate NPL cycle. These banks have improved capital ratios, increased coverage on bad loans, and have higher liquidity ratios. Moreover, trailing loan growth in riskier segments was muted due to the pandemic. Thus, NPA formation should moderate further. This implies that credit costs could remain below normalised levels. For PNB, NNPA is at 3.8% multi quarter low led by lower slippages in corporate book. Lower slippages trends are expected in the near to medium term because of improvement in corporate credit cycle. Provision coverage ratio stands at ~66%. Lower credit costs are likely to support earnings trajectory in the medium term. SMA 2 loans stand at ~0.27% of loans. Key monitorable would-be slippages from restructured book (1.8% of loans).

Revision in estimates – We have increased our FY2023E/24E earnings estimates, factoring in higher margins & lower credit cost. We have added FY25E.

Our Call

Valuation – We upgrade PNB to buy from hold rating with a revised TP of Rs.64. We expect RoAs (return on assets) of 0.7% for FY24E and 0.8% for FY25E, driving RoE (return on equity) of 10% and 12% for the respective years going ahead. We believe valuations are cheap for PNB compared to return ratio profile expected, as the bank is likely to deliver strong earnings growth and higher RoA/RoE led by healthy loan growth, margin improvement & lower credit costs (RoA from 0.3% in FY22 to 0.4%/0.7% /0.8% inFY23E/24E/25E).

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	FY22	FY23E	FY24E	FY25E
Net Interest Income	28,694	34,507	41,519	47,569
Net profit	3,458	5,992	10,324	13,924
EPS (Rs.)	3.2	5.4	9.4	12.6
P/E (x)	16.1	9.4	5.4	4.0
P/BV (x)	0.8	0.7	0.6	0.5
RoE	3.7	6.1	9.7	11.7
RoA	0.3	0.4	0.7	0.8

Source: Company; Sharekhan estimates

Healthy advances growth likely to sustain, led by strong demand in retail as well as corporate

Net advances grew by 15% y-o-y during Q2FY23. Retail advances rose by 17% y-o-y and 6% q-o-q. Retail book growth was primarily aided by strong growth in the vehicle book (increased by 35% y-o-y) and personal loans (up by 36% y-o-y). As far as the corporate book is concerned, it grew by 14% 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 12-13% in FY2023E. We believe there is an upside risk in loan growth trajectory.

Strong PPoP growth expected

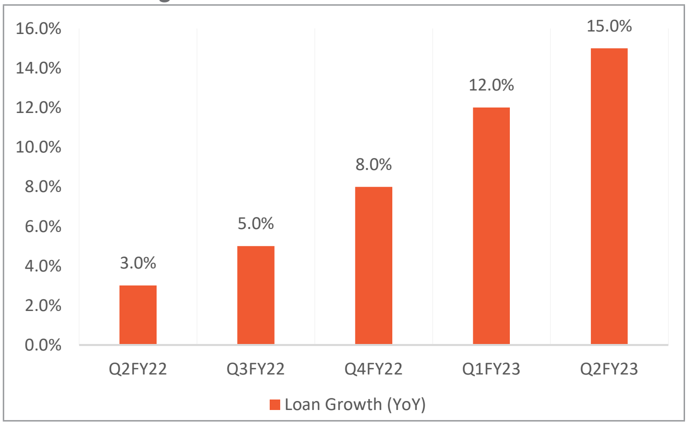
The bank has reported healthy loan growth (of 15% y-o-y / 4% q-o-q) in Q2FY23 on the back of broad-based growth in retail & corporate book. Margins are expected to improve further as the loan book is yet to get the full benefit of the rising interest rate cycle. Moreover, higher LCR likely to boost margins further as lending picks up. PPoP growth is expected to improve driven by healthy loan growth and margin improvement.

Lower credit costs to drive earnings growth

Overall PSU banks have emerged stronger after the COVID crisis and the corporate NPL cycle. These banks have improved capital ratios, increased coverage on bad loans, and have higher liquidity ratios. Moreover, trailing loan growth in riskier segments was muted due to the pandemic. Thus, NPA formation should moderate further. This implies that credit costs could remain below normalised levels. For PNB, NNPA is at 3.8% multi quarter low led by lower slippages in corporate book. Lower slippages trends are expected in the near to medium term because of improvement in corporate credit cycle. Provision coverage ratio stands at ~66%. Lower credit costs are likely to support earnings trajectory in the medium term. SMA 2 loans stand at ~0.27% of loans. Key monitorable would-be slippages from restructured book (1.8% of loans).

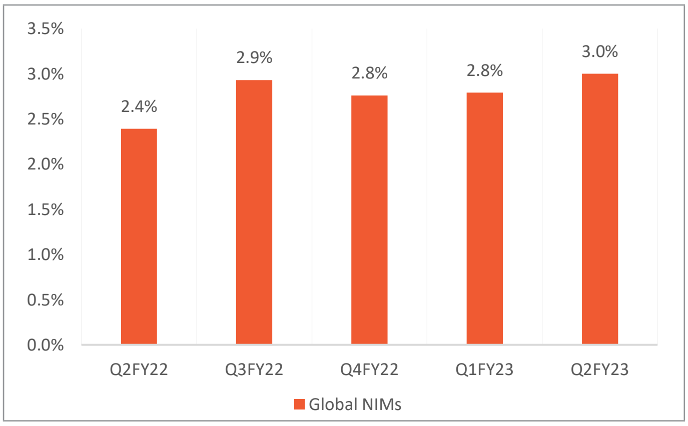
Financials in charts

Trend in Loan growth



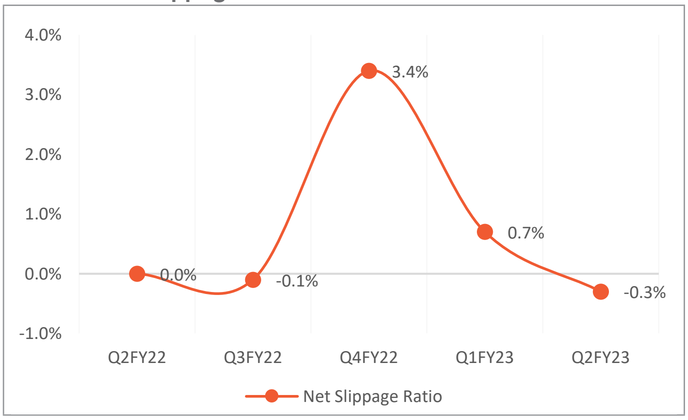
Source: Company, Sharekhan Research

Trend in NIMs



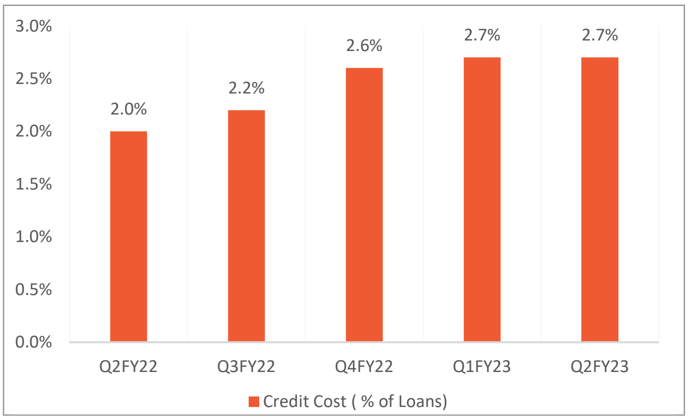
Source: Company, Sharekhan Research

Trend in Net Slippage Ratio



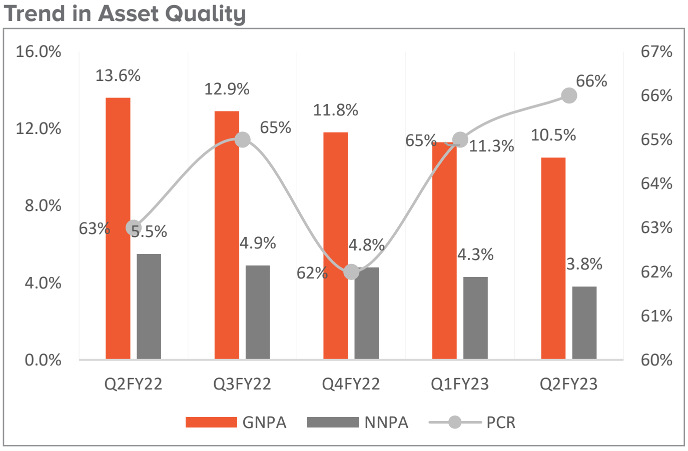
Source: Company, Sharekhan Research

Trend in Credit Cost



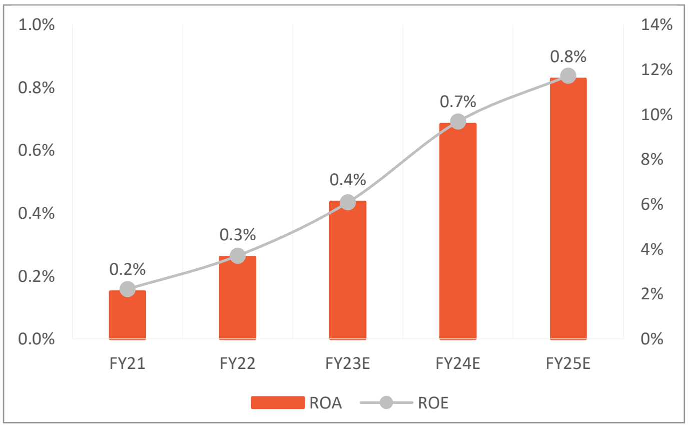
Source: Company, Sharekhan Research

Trend in Asset Quality



Source: Company, Sharekhan Research

Trend in Return Ratios



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Strong credit offtake and benign credit cost; Banks placed well amid sector tailwinds

System-level credit offtake grew by ~17% y-o-y in the fortnight ending November 4, 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 ~8% but are trailing advanced growth. We should see loan growth acceleration sustaining. Margins are likely to improve in a higher interest-rate cycle. Asset quality is not a big issue on the corporate lending end, as only de-leveraging is observed. From the retail side, there could be some pressure, but nothing is significant. Asset quality is likely to remain stable in the medium term. Banks are in a sweet spot in terms of fundamentals and reasonable valuations. In the past two years, lenders have been cautious about lending to the 'BB and below' category, thus the general risk, which they are carrying on the 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 costs. In terms of the MSME book, 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 – Benefiting from sectoral tailwinds

Public sector banks are an attractive play on strong sectoral tailwinds in the banking sector due to cheap valuations owing to expected improvement in the earnings profile. The bank has reported healthy credit growth. Improving asset quality, moderation in slippages and credit cost would likely augur well for the bank going ahead along with higher PCR and higher capital adequacy buffers. We believe credit growth would be driven by both retail and corporate segments (as private capex increases). We see upside risk to margins due to a higher rate cycle and lower credit cost given the benign credit cycle which should lead to improvement in the return ratio profile.

■ Valuation – Upgrade to buy with a revised PT of Rs. 64

We upgrade PNB to Buy from Hold with a revised PT of Rs.64. We expect RoAs (return on assets) of 0.7% for FY24E and 0.8% for FY25E, driving RoE (return on equity) of 10% and 12% for the respective years going ahead. We believe valuations are cheap for PNB compared to return ratio profile expected, as Bank is likely to deliver strong earnings growth and higher RoA/RoE led by healthy loan growth, margin improvement & lower credit cost (RoA from 0.3% in FY22 to 0.4%/0.7% /0.8% inFY23E/24E/25E).

Peer Comparison

Particulars	CMP (Rs / Share)	MCAP (Rs Cr)	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
			FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Punjab National Bank	51	55,936	9.4	5.4	0.7	0.6	6.1	9.7	0.4	0.7
Bank of India	81	33,341	9.0	6.5	0.7	0.6	6.6	8.7	0.5	0.6

Source: Company, Sharekhan research

About company

PNB is a government-owned bank with a network of 10,038+ branches, 12,966+ ATMs, and 20,447 business correspondents. The bank is majorly present 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. 11,93,501 crore and global credit stood at Rs. 8,30,212 crore as of September 2022.

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. Public sector banks are an attractive play on strong sectoral tailwinds in the banking sector due to cheap valuations owing to expected improvement in the earnings profile.

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 Sa-ha	Executive Director
Mr. Kalyan Kumar	Executive Director

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	REPUBLIC OF INDIA	73.15
2	LIFE INSURANCE CORP OF INDIA	8.34
3	KOTAK MAHINDRA ASSET MANAGEMENT CO. LTD.	0.74
4	NIPPON LIFE INDIA ASSET MANAGEMENT LTD.	0.56
5	SBI FUNDS MANAGEMENT LTD.	0.51
6	VANGUARD GROUP INC.	0.38
7	ICICI PRUDENTIAL ASSET MANAGEMENT CO. LTD.	0.25
8	ADITYA BIRLA SUN LIFE ASSET MANAGEMENT CO. LTD.	0.25
9	EDELWEISS ASSET MANAGEMENT LTD.	0.21
10	UTI ASSET MANAGEMENT CO. LTD.	0.19

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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