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Stock Update

Result Update

Punjab National Bank

Mixed quarter; Valuation attractive

Banks	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		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING	51.06
Updated Dec 08, 2022	

Severe Risk

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

Source: Morningstar

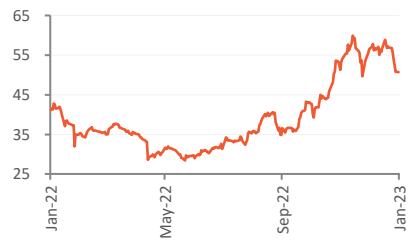
Company details

Market cap:	Rs. 55,826 cr
52-week high/low:	Rs. 62 / 28
NSE volume: (No of shares)	692.2 lakh
BSE code:	532461
NSE code:	PNB
Free float: (No of shares)	297.3 cr

Shareholding (%)

Promoters	73.2
FII	1.7
DII	13.0
Others	12.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-8.9	18.6	64.5	21.4
Relative to Sensex	-6.3	19.4	61.2	17.4

Sharekhan Research, Bloomberg

Summary

- Despite reporting strong net operating revenue growth of 19% y-o-y/11% q-o-q, PPoP growth moderated to 13% y-o-y/3% q-o-q, led by one-off amounting to Rs. 909 crore included in employee benefit expenses (up 35% y-o-y/38% q-o-q). Besides this, additional Rs. 181 crore on account of bipartite agreement on wage revisions (starting from November 2022 for two months) was also included, but it is recurring in nature.
- Total provisions were higher by 41% y-o-y, led by higher NPA provisions (mainly related to the back book) to further strengthen PCR and higher standard asset provisioning offset partly with the write-back of provisions on the investment book. Thus, PAT reported at Rs. 629 crore was down 44% y-o-y, but PAT was up 53% q-o-q. Overall, PAT missed consensus and our estimates due to increased opex and provisions.
- Slippages were lower at 2.4% (annualised cal. as a % of 12m trailing loans) vs. 3.6% q-o-q coupled with contained recoveries and upgrades along with higher write-offs. Asset quality saw sharp improvement with GNPA and NNPA ratios falling by 72 bps/50 bps q-o-q to 9.76%/3.30%. PCR stood at ~69% vs. 66% q-o-q.
- The stock currently trades at 0.7x/0.6x/0.5x its FY2023E/FY2024E/FY2025E ABV estimates. We remain positive on PNB as the bank is likely to deliver strong earnings, driven by loan growth acceleration and normalisation of credit costs in FY2024E/FY2025E. We expect RoAs of 0.7% for FY2024E and 0.8% for FY2025E, driving RoE of 10% and 11% for the respective years going ahead. We maintain our Buy rating on the stock with an unchanged PT of Rs. 64.

Punjab National Bank (PNB) reported muted operational performance in Q3FY2023 mainly led by one-off item in employee expenses. Net interest income (NII) grew strongly by 18% y-o-y/11% q-o-q, driven by sharp margin improvement and healthy loan growth. Net interest margin (NIM) improved by 16 bps q-o-q/23 bps y-o-y to 3.16%. However, there was a positive impact on NIM due to interest on IT refund of Rs. 355 crore along with interest income on account of recovery from NPA accounts of Rs. 593 crore vs. Rs. 652 crore q-o-q. Core fee income grew by 9% y-o-y/2% q-o-q. The bank reported treasury profit of Rs. 131 crore vs. Rs. 102 crore q-o-q and Rs. 821 crore in Q3FY2022. Total operating expenses were higher by 25% y-o-y/23% q-o-q mainly on account of increased employee benefit expenses. There were one-off items amounting to Rs. 909 crore included in employee benefit expenses (up 35% y-o-y/38% q-o-q). Besides this, additional Rs. 181 crore on account of bipartite agreement on wage revisions (starting from November 2022 for two months) was also included, but it is recurring in nature. Operating profit grew by 13% y-o-y/3% q-o-q. Total credit cost stood at 2.4% vs. 2.6% of average advances q-o-q. PBT declined by 42% y-o-y but grew by 52% q-o-q. Net advances and deposits grew by 16% y-o-y/3% q-o-q and 7% y-o-y/1% q-o-q, respectively. CASA deposits grew by 2% y-o-y, with overall CASA ratio at ~43% vs. 44% q-o-q. Advances growth was driven by retail (excluding agri and MSME), which grew by 33% y-o-y, and wholesale domestic corporate book, which grew by 13% y-o-y. Overseas book grew by 70% y-o-y; however, it constitutes only 4% of total gross advances. The bank's asset quality improved, with GNPA and NNPA ratios declining by 72 bps q-o-q and 50 bps q-o-q, respectively, to 9.76% and 3.30%. PCR stood at ~69% vs. 66% q-o-q. SMA-2 book (for exposure greater than Rs. 5 crore) stood at 0.22% of advances vs. 0.27% q-o-q. Total restructured book forms 1.7% of the book versus 1.8% q-o-q.

Key positives

- Healthy advances growth driven by retail along with margin improvement
- Lower slippages

Key negatives

- Weak CASA mobilisation
- Higher write-offs
- Weak return profile (ROA ~13 bps in 9MFY2023)

Management Commentary

- The bank expects credit cost to fall below ~2% of average advances in Q4FY2023. NIM is expected to be ~3.0% for FY2023E. In terms of asset-quality matrix, it expects GNPA at ~9% and NNPA below ~3% at the end of FY2023.
- The bank has guided for loan growth of 13-14% for FY2023E vs. earlier guidance of 12-13% with a higher share of RAM advances taking to 55% of gross domestic advances vs. 54% currently. We believe there is an upside risk in loan growth guidance.

Our Call

Valuation – Maintain Buy on PNB with an unchanged PT of Rs. 64: We expect return on assets (RoA) of 0.7% for FY2024E and 0.8% for FY2025E, driving return on equity (RoE) of 10% and 11% for the respective years going ahead. We believe valuations are cheap for PNB as compared to an improvement in return ratio profile expected going ahead, as the bank is likely to deliver strong earnings growth and in turn higher RoA/RoE, led by increased loan growth and lower credit costs (RoA from 0.2% in FY2023E to 0.7%/0.8% in FY2024E/FY2025E). The stock has witnessed ~20% correction from its recent highs. We believe risk reward is more favourable from here on. The stock currently trades at 0.7x/0.6x/0.5x its FY2023E/FY2024E/FY2025E ABV estimates.

Key Risks

Economic slowdown due to higher-than-anticipated credit cost; slower loan growth; and lower-than-expected margins.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Net Interest Income	28,694	34,507	40,619	45,945
Net profit	3,458	2,907	10,871	13,032
EPS (Rs.)	3.2	2.6	9.9	11.8
P/E (x)	16.0	19.2	5.1	4.3
P/BV (x)	0.8	0.7	0.6	0.5
RoE	3.7	3.0	10.5	11.3
RoA	0.3	0.2	0.7	0.8

Source: Company; Sharekhan estimates

Key result highlights

- **NII growth continues to remain strong:** NII grew strongly by 18% y-o-y/11% q-o-q, driven by sharp margin improvement and healthy loan growth. NIM improved by 16 bps q-o-q/23 bps y-o-y to 3.16%. However, there was a positive impact on NIM due to interest of Rs. 355 crore on IT refund along with interest income on account of recovery from NPA accounts worth Rs. 593 crore vs. Rs. 652 crore q-o-q. The bank has guided that NIMs are expected to be ~3.0% for FY2023E.
- **Higher opex due to one-off item in employee expenses:** Total operating expenses were higher by 25% y-o-y/23% q-o-q mainly on account of increased employee benefit expenses. There were one-off items amounting to Rs. 909 crore (Rs. 830 crore due to the impact of wage revision on pension liabilities and Rs. 79 crore due to PLI employee benefits) included in employee benefit expenses (up 35% y-o-y/38% q-o-q). Besides this, additional Rs. 181 crore on account of bipartite agreement on wage revisions (starting from November 2022 for two months) was also included, but it is recurring in nature.
- **Advances growth guidance revised marginally upwards:** Net advances grew by 16% y-o-y during the quarter. Retail advances rose by 33% y-o-y and 16% q-o-q, driven by secured (mortgages and vehicle loans), unsecured (personal loans), and purchase of IBPC. As far as the corporate book is concerned, it grew by 13% y-o-y. Management has guided for overall credit growth of 13-14% in FY2023E with a higher share of RAM advances.
- **Asset quality and credit-cost scenario guidance:** GNPA ratio and NNPA ratio improved by 72 bps q-o-q and 50 bps q-o-q to 9.76% and 3.30%, respectively, in Q3FY2023. Slippages for the quarter stood at Rs. 4,072 crore versus Rs. 5,979 crore q-o-q. Total recoveries and upgrades stood at Rs. 3,148 crore versus Rs. 6,497 crore q-o-q. Write-offs stood at Rs. 4,375 crore versus Rs. 2,614 crore q-o-q. Management intends to bring down GNPA ratio to ~ 9% and NNPA ratio below 3.0% at the end of FY2023. The bank expects its credit cost to fall below ~2.0% of average advances in Q4FY2023. The bank is on track to target more recoveries than additions and does not forsee slippages from large accounts. The bank is expecting ~Rs. 10,000 crore recovery in Q4FY2023. With regards to the Adani group exposure, the total sanctioned exposure is ~Rs. 7,000 crore, out of which outstanding is Rs. 3,000 crore as fund-based; Rs. 700 crore as non-fund based and Rs. 42 crore in investment book. The bank has guided that the exposure is well diversified across group companies, backed by strong cash flow generating assets.

Result table (standalone) Rs cr

Particulars	Q3FY23	Q2FY23	Q3FY22	y-o-y	q-o-q
Interest Income	22,384	20,154	19,325	16%	11%
Interest Expenses	13,205	11,883	11,522	15%	11%
Net Interest Income	**9,179**	**8,271**	**7,803**	**18%**	**11%**
NIM (%)	3.16	3.00	2.93		
Core fee Income	1,331	1,307	1,224	9%	2%
Other Income	2,007	1,540	1,477	36%	30%
Net Operating Revenue	**12,517**	**11,118**	**10,504**	**19%**	**13%**
Employee Expenses	4,460	3,233	3,311	35%	38%
Other Opex	2,341	2,318	2,117	11%	1%
Total Opex	6,801	5,551	5,428	25%	23%
Cost to Income Ratio (%)	**54.3%**	**49.9%**	**51.7%**		
Pre-Provision Profits	**5,716**	**5,567**	**5,076**	**13%**	**3%**
Provisions & Contingencies - Total	4,713	4,906	3,354	41%	-4%
Profit Before Tax	**1,003**	**661**	**1,723**	**-42%**	**52%**
Tax	374	250	596	-37%	50%
Effective Tax Rate (%)	37.3	37.8	34.6		
Reported Profits	**629**	**411**	**1,127**	**-44%**	**53%**
Basic EPS (Rs.)	0.6	0.4	1.0	-44%	54%
Diluted EPS (Rs.)	0.6	0.4	1.0		
RoA (%)	0.2	0.1	0.3		
Advances	8,00,412	7,73,403	6,92,807	16%	3%
Deposits	12,10,359	11,93,501	11,27,317	7%	1%
Gross NPA	83,584	87,035	97,259	-14%	-4%
Gross NPA Ratio (%)	9.8	10.5	12.9		
PCR (%)	68.5	66.3	65.2		
Net NPA	26,363	29,348	33,879	-22%	-10%
Net NPA Ratio (%)	3.3	3.8	4.9		

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Deposit mobilisation to be in focus; Banks with strong deposit franchise placed better

System-level credit offtake grew by ~17.4% y-o-y in the fortnight ending December 16, 2022, indicating loan growth has been sustaining, given distinct signs of an improving economy and revival of investments and loan demand. On the other hand, deposits rose by ~9.4% but are trailing advances growth. We should see sustained acceleration in loan growth. Margins are likely to improve, but momentum is expected to moderate and margins are expected to peak out by H1FY2024. 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. In the past few years, lenders have been cautious about lending to the 'BB and below' category, thus the general risk, which they are carrying on the corporate loan 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, strong deposit franchise, and asset quality (with high coverage and provision buffers) are well placed to capture growth opportunities.

■ Company Outlook – Benefiting from sectoral tailwinds

PSU 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. For PNB, loan growth is expected to accelerate from here on. Improving asset quality, moderation in slippages, and lower credit cost would likely augur well for the bank going ahead along with higher PCR and increased capital-adequacy buffers. We believe credit growth would be driven by both retail and corporate segments (as private capex increases). We see upside risk in loan growth along with lower credit cost, given the benign credit cycle, should lead to improvement in the return ratio profile.

■ Valuation – Maintain buy on PNB with an unchanged PT of Rs. 64

We expect return on assets (RoA) of 0.7% for FY2024E and 0.8% for FY2025E, driving return on equity (RoE) of 10% and 11% for the respective years going ahead. We believe valuations are cheap for PNB as compared to an improvement in return ratio profile expected going ahead, as the bank is likely to deliver strong earnings growth and in turn higher RoA/RoE, led by increased loan growth and lower credit costs (RoA from 0.2% in FY2023E to 0.7%/0.8% in FY2024E/FY2025E). The stock has witnessed ~20% correction from its recent highs. We believe risk reward is more favourable from here on. The stock currently trades at 0.7x/0.6x/0.5x its FY2023E/FY2024E/FY2025E ABV estimates.

Peer Comparison

Particulars	CMP (Rs / Share)	MCAP (Rs Cr)	P/E(x)		P/BV(x)		RoE (%)		RoA (%)	
			FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Punjab National Bank	51	55,826	19.2	5.1	0.7	0.6	3.0	10.5	0.2	0.7
Bank of India	78	32,151	8.2	6.2	0.6	0.6	7.0	8.7	0.5	0.6

Source: Company, Sharekhan research

About company

PNB is a government-owned bank with a network of 10,049+ domestic branches, 12,957+ ATMs, and 22,607 business correspondents. More than 60% of its branches are in rural and semi-urban areas. PNB's global deposit stood at Rs. 12,10,359 crore and global credit stood at Rs. 8,56,757 crore as of December 2022. Capital adequacy ratio (CAR) stands at 15.15%.

Investment theme

PSU 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. For PNB, loan growth is expected to accelerate from here on. Improving asset quality, moderation in slippages, and lower credit cost would likely augur well for the bank going ahead along with higher PCR and higher capital adequacy buffers.

Key Risks

Economic slowdown due to higher-than-anticipated credit cost; slower loan growth; and lower-than-expected margins.

Additional Data

Key management personnel

Mr. Arun Kumar Goel	Managing Director and CEO
Mr. M. Paramasivam	Executive Director
Mr. Vijay Dube	Executive Director
Mr. Kalyan Kumar	Executive Director
Mr. Binod 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	QUANT MONEY MANAGERS LTD	1.07
4	KOTAK MAHINDRA ASSET MANAGEMENT CO LTD	0.71
5	SBI FUNDS MANAGEMENT LTD	0.66
6	NIPPON LIFE INDIA ASSET MANAGEMENT LTD	0.45
7	VANGUARD GROUP INC	0.32
8	ADITYA BIRLA SUN LIFE ASSET MANAGEMENT CO LTD	0.24
9	ICICI PRUDENTIAL ASSET MANAGEMENT CO LTD	0.19
10	DIMENSIONAL FUND ADVISORS LP	0.18

Source: Bloomberg

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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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