Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Punjab National Bank

RoA on improvement path

Banks	Sharekhan code: PNB
Reco/View: Buy ↔	CMP: Rs. 74	Price Target: Rs. 86 ↑

↑ 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 40.46
Updated Aug 08, 2023

Severe Risk

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

Source: Morningstar

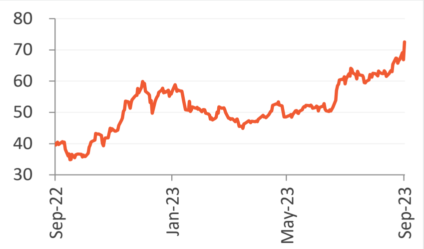
Company details

Market cap:	Rs. 81,184 cr
52-week high/low:	Rs. 74/ 34
NSE volume: (No of shares)	491.9 lakh
BSE code:	532461
NSE code:	PNB
Free float: (No of shares)	297.3 cr

Shareholding (%)

Promoters	73.2
FII	1.8
DII	13.5
Others	11.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	18.9	41.7	53.5	84.3
Relative to Sensex	15.7	35.0	37.0	72.4

Sharekhan Research, Bloomberg

Summary

- Strong asset quality to boost RoA closer to ~1% in FY25E, which is driving strong outperformance. We reiterate a Buy on PNB with a revised PT of Rs. 86.
- Asset quality trend is quite encouraging and will help in faster normalization of credit cost for the bank in FY25E. Recoveries have already started to outpace slippages in the last 2 consecutive quarters.
- Provisions are largely related to back book (Net NPL 1.98% & Restructured book 1.2%) which would be accounted for in 9MFY24.
- We expect credit cost to fall significantly as net NPAs decline steadily in FY24 to ~ 1% along with opex cost to fall substantially led by lower pension-related provisions as bond yields stabilise that should boost the return ratios in FY25E. Stock currently trades at 0.8x/0.7x its FY2024E/25E ABV

PNB's balance sheet has strengthened – capital ratios are healthy, with Tier-1 Capital at ~12.3%. The bank's excess liquidity profile (CD ratio ~67%, LCR ~160%) in an environment of deposit growth challenges, places it well to grow the book without worrying about deposit growth. The bank is eyeing credit growth of 12-13% for FY24E. However, the bank is likely to deliver higher growth in FY24E as balance sheet strength improves further going ahead. Healthy loan growth, stable margins and lower opex growth is expected to lead strong PPoP growth. Overall, the asset quality outlook continues to remain stable to positive. Lower slippages formation and healthy recoveries are likely to boost asset quality further and will help in faster normalization of credit cost. Healthy PPoP growth along with normalisation of credit costs should drive a strong improvement in return ratios in FY25E. Currently, we have built in RoA estimates of ~0.5%/0.8% in FY24E/25E which should drive RoE of ~7/11% for the respective periods.

Strong asset quality outlook: The management is guiding for strong cash recoveries amounting to Rs. 22,000 crore in FY24 vs Rs. 14,570 crore in FY23 which would result in recoveries outpacing slippages in FY24 driven by resolution of some of the accounts under NCLT and NARCL. Total slippages are expected to be around Rs. 11,000 crore (~1.3%) and in turn credit cost at 1.5-1.8% bps as % of Avg. advances largely related to the back book in FY24. Improvement in corporate credit cycle along with the fact that trailing loan growth in corporate segment has been muted in the past few years should keep low fresh NPL formation. Provision coverage ratio stands at ~76%. The bank is expected to further increase the coverage in 9MFY24. Provisions are largely related to back book (Net NPAs are at 1.98% & the restructured book 1.2%). Thus, credit costs are expected to normalise in FY25E. The Bank also guided that for all loans disbursed amounting to Rs. 5.63 trillion from July 2020 to June 2023, slippages are at just ~0.22%. Overall, asset quality outlook remains stable to positive.

Healthy loan growth likely to sustain: The bank is guiding for a 12-13% loan growth in FY24. Excess liquidity profile (CD ratio ~67%, LCR ~160%) in an environment of deposit growth challenges, places it well to grow the book without worrying about deposit growth. However, the bank is likely to deliver higher growth in FY24E as balance sheet strength improves further going ahead. In Q1FY24, loan growth was healthy at (+4% q-o-q). The RAM (Retail, agri & MSME) segment is expected to grow faster which is currently ~52.7% of loans and bank aims to take it to ~55% in the near to medium term.

NIMs & opex outlook: The bank is guiding for a marginal compression in NIMs from Q1FY24 levels by 8-10 bps and targets ~2.9-3.0% NIMs in FY24 due to repricing of deposits at higher rates in the coming quarters. Operating expense growth is currently higher mainly on account of increased employee benefit expenses led by wage revision provisions and pension cost. Opex cost is expected to fall led by lower pension-related provisions as bond yields stabilize going forward

Our Call

Valuation – Maintain Buy on PNB with a revised PT of Rs. 86: Asset quality trends is quite encouraging and will help in faster normalization of credit cost for the bank. Lower slippages trends likely to narrow the perceived gap in underwriting with respect to peers. Provisions for the remaining 9 months of FY24 would be largely related to back book (net NPLs & restructured book). Thus, we should see return ratios staying subdued for a few more quarters on the back of high credit costs but the market may look through a one-time book-value adjustment. We expect opex costs to fall substantially led by lower pension-related provisions as bond yield stabilises and credit costs to fall significantly as net NPAs decline steadily in FY24 to ~ 1% that should boost the return ratios in FY25. At CMP, the stock trades at 0.8x/ 0.7x FY24E/FY25E BV estimates.

Key Risks

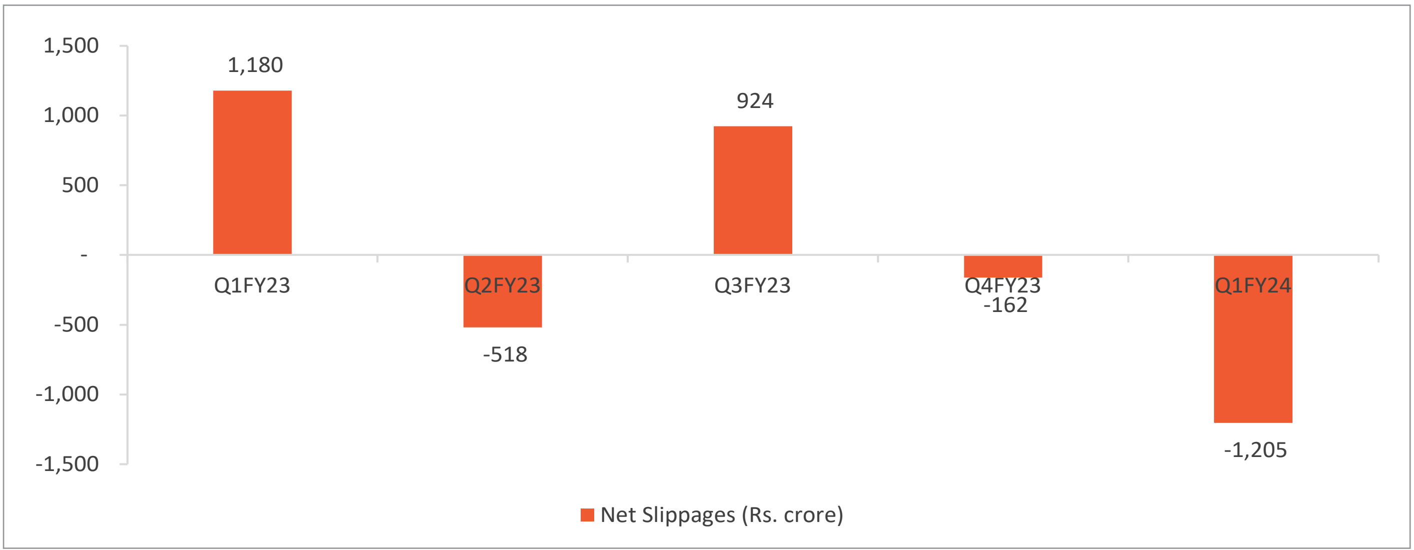
Economic slowdown due to higher-than-anticipated credit cost; slower loan growth; and lower-than-expected margins.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Net Interest Income	28,694	34,492	37,560	43,671
Net profit	3,458	2,507	6,951	12,865
EPS (Rs.)	3.2	2.3	6.3	11.7
P/E (x)	23.4	32.5	11.7	6.3
P/BV (x)	1.2	1.0	0.8	0.7
RoE	3.7	2.6	6.7	11.4
RoA	0.3	0.2	0.5	0.8

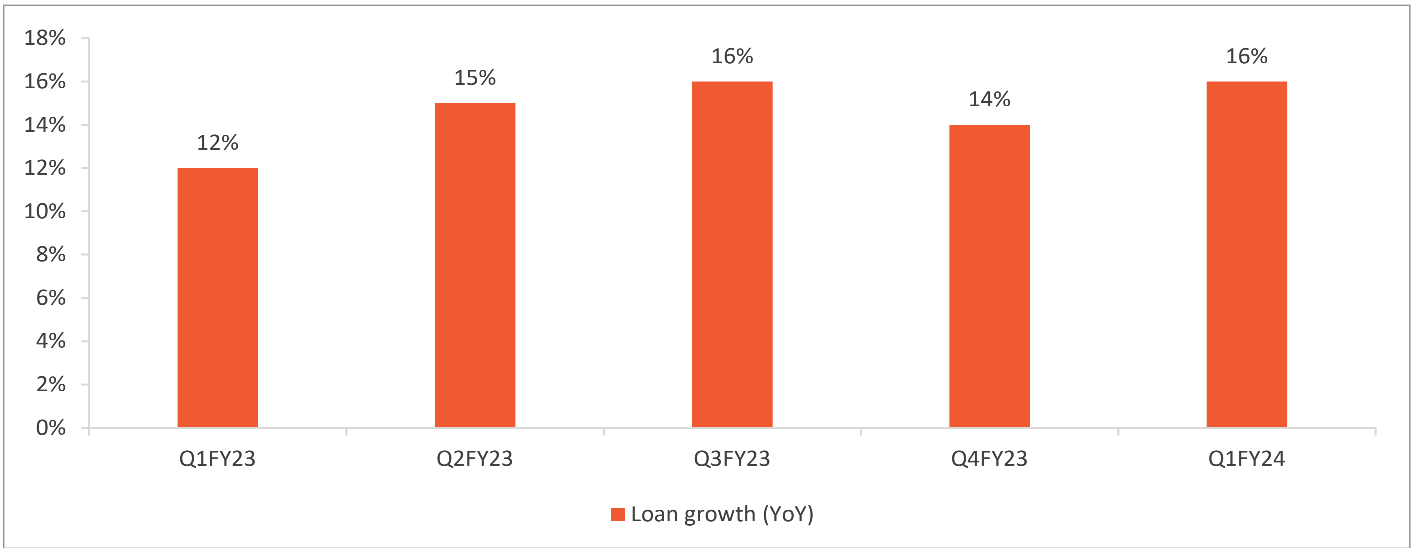
Source: Company; Sharekhan estimates

Trend in net slippages



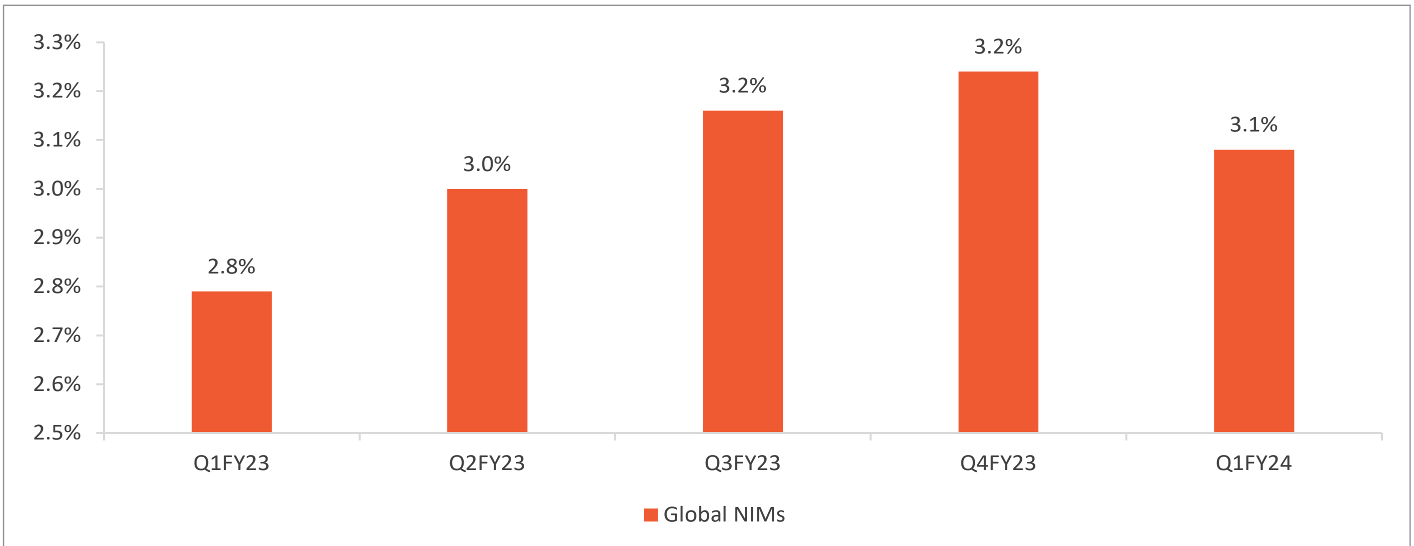
Source: Company, Sharekhan Research

Trend in Loan growth



Source: Company, Sharekhan Research

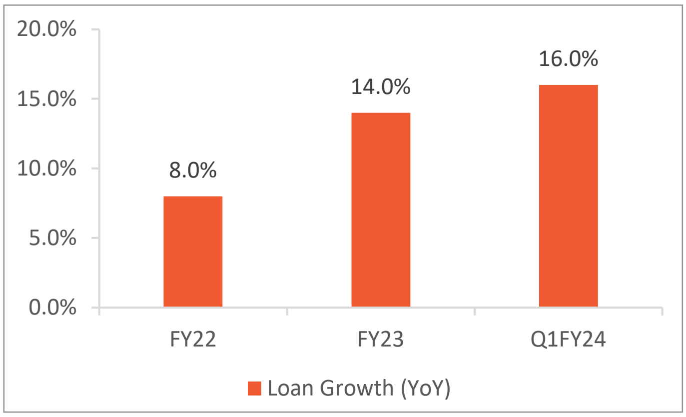
Trend in NIMs



Source: Company, Sharekhan Research

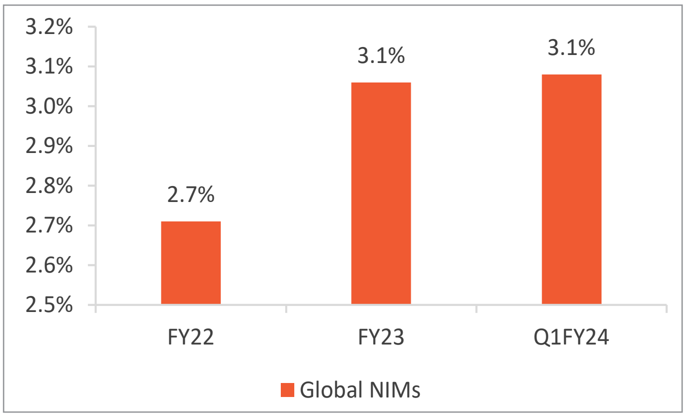
Financials in charts

Trend in Loan growth



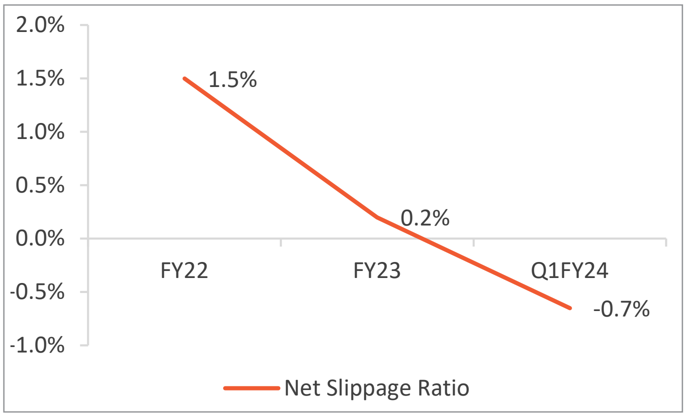
Source: Company, Sharekhan Research

Trend in NIMs



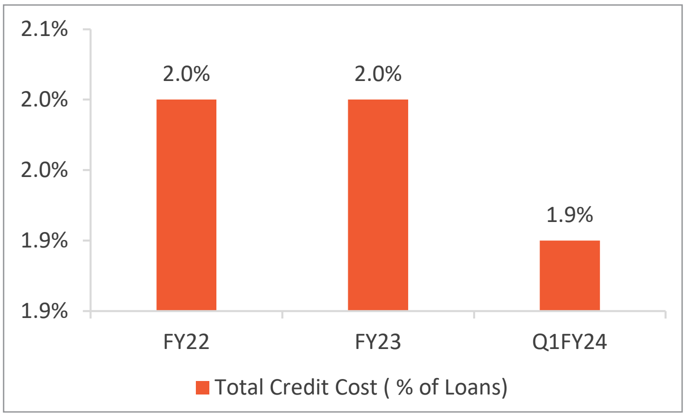
Source: Company, Sharekhan Research

Trend in Net Slippage Ratio



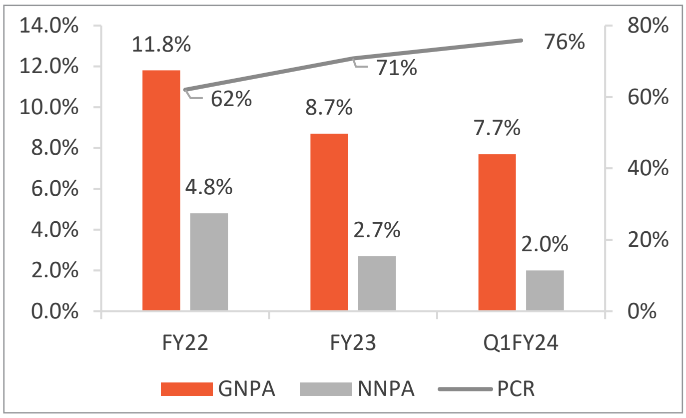
Source: Company, Sharekhan Research

Trend in Credit Cost



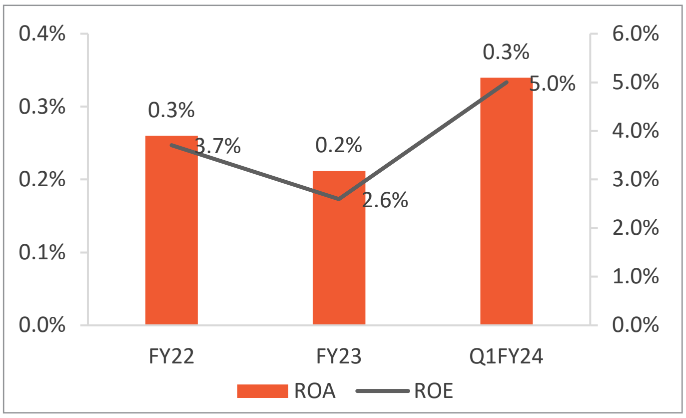
Source: Company, Sharekhan Research

Trend in Asset Quality



Source: Company, Sharekhan Research

Trend in Return Ratios



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Deposit mobilisation to be in focus; banks with a superior liability franchise placed better

System-level credit offtake grew by ~19.7% y-o-y in the fortnight ending August 11, 2023, indicating loan growth has been sustaining, given distinct signs of an improving economy, revival of investments, and strong demand. On the other hand, deposits rose by ~13.5%. The gap between advances and deposits growth is narrowing and is expected to further narrow as real deposit rates increase gradually. We should see some moderation in loan growth due to a higher base in FY2024, but loan growth is expected to remain healthy. Margins have likely peaked out in Q4FY2023. The overall asset-quality outlook stays stable to positive for the sector. We believe banks with a robust 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

Improving asset quality trend led by lower slippages and strong recoveries would likely augur well for the earnings trajectory driven by lower credit costs. Increased capital-adequacy buffers is also a key positive, which has low probability of capital dilution. Once the provisions are absorbed on the back book, we should see improvement in the return ratio profile led by lower credit cost.

■ Valuation - Maintain Buy on PNB with a revised PT of Rs. 86

Asset quality trends is quite encouraging and will help in faster normalization of credit cost for the bank. Lower slippages trends likely to narrow the perceived gap in underwriting with respect to peers. Provisions for the remaining 9 months of FY24 would be largely related to back book (net NPLs & restructured book). Thus, we should see return ratios staying subdued for a few more quarters on the back of high credit costs but the market may look through a one-time book-value adjustment. We expect opex costs to fall substantially led by lower pension-related provisions as bond yield stabilises and credit costs to fall significantly as net NPAs decline steadily in FY24 to ~ 1% that should boost the return ratios in FY25. At CMP, the stock trades at 0.8x/ 0.7x FY24E/FY25E BV estimates.

Peer Comparison

Companies	CMP (Rs/ Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Punjab National Bank	74	81,184	11.7	6.3	0.8	0.7	6.7	11.4	0.5	0.8
Bank of India	107	44,011	5.9	5.5	0.7	0.6	11.9	11.4	0.9	0.9

Source: Company; Sharekhan Research

About company

PNB is a government-owned bank with a network of 10,080+ domestic branches, 12,820+ ATMs, and 25,115 business correspondents. Around 63% of its branches are in rural and semi-urban areas. PNB's global deposit stood at Rs. 12,97,905 crore and global advances stood at Rs. 9,16,836 crore as of June 2023. Capital adequacy ratio (CAR) stands at 15.54%.

Investment theme

Benefiting from sectoral tailwinds, improving asset quality trend led by lower slippages and strong recoveries would likely augur well for the earnings trajectory driven by lower credit cost. Increased capital-adequacy buffers is also a key positive which has low probability of capital dilution. Once the provisions are absorbed on the back book, we should see improvement in the return ratio profile led by lower credit cost.

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

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	1.09
4	SBI FUNDS MANAGEMENT LTD	0.74
5	KOTAK MAHINDRA ASSET MANAGEMENT CO LTD	0.68
6	NIPPON LIFE INDIA ASSET MANAGEMENT LTD	0.61
7	ADITYA BIRLA SUN LIFE ASSET MANAGEMENT CO LTD	0.38
8	VANGUARD GROUP INC	0.38
9	Edelweiss Asset Management Ltd	0.20
10	ICICI PRUDENTIAL ASSET MANAGEMENT CO LTD	0.18

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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by BNP PARIBAS

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