Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

# Punjab National Bank

## Strong Q2, raising hopes for faster RoA improvement

| Banks | Sharekhan code: PNB | |
|---|---|---|
| **Reco/View: Buy** ↔ | CMP: **Rs. 70** | 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

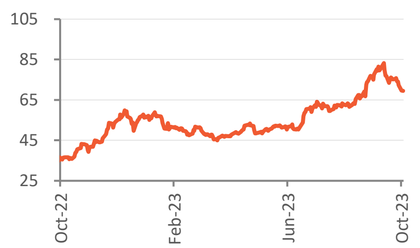
**Company details**

| | |
|---|---|
| Market cap: | Rs. 76,868 cr |
| 52-week high/low: | Rs. 83 / 39 |
| NSE volume: (No of shares) | 585.2 lakh |
| BSE code: | 532461 |
| NSE code: | PNB |
| Free float: (No of shares) | 297.3 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 73.2 |
| FII | 2.7 |
| DII | 13.8 |
| Others | 10.4 |

**Price chart**




**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | -11.4 | 11.1 | 40.0 | 62.8 |
| Relative to Sensex | -7.0 | 15.9 | 35.0 | 56.7 |

Sharekhan Research, Bloomberg


**Summary**

- PNB reported PAT of Rs. 1,756 crore in Q2FY2024, which was significantly ahead of our expectations, led by lower credit cost and higher PPoP. Core credit cost stood at 1.4% vs 2.1% q-o-q.
- Core PPoP grew by 13% y-o-y/6% y-o-y, led by strong NII growth (~6% above estimates), driven by stable NIMs (+3 bps q-o-q) and contained opex growth. Advances grew by 3% q-o-q, led by continued acceleration in retail advances (+6% q-o-q). Deposit growth remained muted at 1% q-o-q.
- Asset quality improved sharply with GNPA and NNPA ratios falling by 77 bps/51 bps q-o-q to 6.96%/1.47% on the back of lower slippages (0.9% bps vs. 1.3% q-o-q annualised calculated as a percentage of 12M trailing loans) and higher recoveries and upgrades along with contained write-offs. PCR stood at ~80% vs. 76% q-o-q.
- The bank has guided for the exit RoA in FY2025E closer to ~1%, driven by strong asset quality and, in turn, lower credit cost as net NPAs are likely to decline steadily in FY2024E to below ~ 1%, which should boost return ratios. At the CMP, the stock trades at 0.8x/ 0.7x its FY2024E/FY2025E BV. We maintain our Buy rating with an unchanged PT of Rs. 86.


**Punjab National Bank (PNB) reported a strong performance with all-round beat in NII/PPoP/PAT in Q2FY2024. Net interest income (NII) grew by 20% y-o-y/4% q-o-q. Net interest margin (NIM) improved by 3bps q-o-q to ~3.11% vs. expectation of a marginal decline on a q-o-q basis. Cost of deposits increased by 14bps q-o-q, which was fully offset by the increase in yield on assets. The bank maintained its NIM guidance at 2.9-3.0% despite higher NIM reported as deposits amounting to Rs. 1 lakh crore would be repriced in H2FY2024. Core fee income grew by 5% y-o-y/down 23% q-o-q. The bank reported a treasury profit of Rs. 136 crore vs. gain of Rs. 308 crore q-o-q and Rs. 160 crore gain in Q2FY2023. Total operating expenses grew by 21% y-o-y/down 3% q-o-q. Wage revision provisions were higher at Rs. 684 crore vs Rs. 283 crore q-o-q, but pension costs as per AS15 were lower at Rs. 580 crore vs. Rs. 1,240 crore. Operating profit grew by 12% y-o-y/4% q-o-q. Core PPoP grew by 13% y-o-y/6% q-o-q. Total provisions declined by 30% y-o-y/down 13% q-o-q. Core credit costs stood at 1.4% annualised vs. 2.1% q-o-q. PBT reported at Rs. 2,772 crore grew by 320% y-o-y/38% q-o-q. Net advances and deposits grew by 15% y-o-y/3% q-o-q and 10% y-o-y/1% q-o-q, respectively. CASA deposits grew by 3% y-o-y/1% q-o-q. Advances growth continued to be driven by retail advances (excluding agri and MSME), which grew by 40% y-o-y/6% q-o-q. The agri loan and MSME book grew by 4% and 6% y-o-y, respectively. Overseas book, which grew by 10% y-o-y/6.5% q-o-q, accounts for only ~4% of gross advances. The domestic corporate book grew by 8% y-o-y/1% q-o-q. The bank's asset quality improved sharply with GNPA and NNPA ratios falling by 77 bps/51 bps q-o-q to 6.96%/1.47%. PCR stood at ~80% vs. 76% q-o-q. Net slippages continued to remain negative at Rs. 1,672 crore, led by lower slippages and higher recoveries and upgrades along with contained write-offs. Total restructured book forms 1.1% of net advances vs. 1.2% q-o-q.**

**Key positives**

- Strong retail advances growth of 40% y-o-y/6% q-o-q.
- NIMs were stable q-o-q vs. expectations of a marginal decline.
- Strong asset quality led by lower slippages and higher recoveries. Net slippages continued to remain negative.
- Core credit cost was lower and stood at 1.4% vs. 2.1% q-o-q.

**Key negatives**

- Weak deposit growth (3% y-o-y/1% q-o-q); however, the bank continues to maintain an excess liquidity buffer in terms of excess SLR and LCR.

**Management Commentary**

- The bank has guided for the exit RoA in FY2025E closer to ~1%, driven by strong-asset quality and, in turn, lower credit cost as net NPAs declined steadily in FY2024E to below ~ 1%, which should boost return ratios. ROA guidance for FY2024E is stable at 0.5-0.6%.
- The bank maintained its NIM guidance at 2.9-3.0% for FY2024E.
- Overall asset-quality outlook continued to remain stable to positive, thus slippages and credit cost are expected to see a declining trend going forward. The bank expects GNPA to fall below ~6% and NNPA to be below ~1% at the end of FY2024E.

**Our Call**

**Valuation – Maintain Buy on PNB with an unchanged PT of Rs. 86:** Asset-quality trend is quite encouraging and will help in faster normalisation of credit cost for the bank. Lower slippages trends are likely to narrow the perceived gap in underwriting with respect to peers. Provisions are largely related to the back book (Net NPL and restructured book), which would be accounted for in FY2024E. Thus, credit cost is expected to fall significantly in FY2025E, as net NPL declines steadily in FY2024E to below ~1% along with the rundown of the restructured book, which should significantly boost the return ratios. The bank has guided for the exit RoA in FY2025E closer to ~1%. At the CMP, the stock trades at 0.8x/ 0.7x its FY2024E/FY2025E BV. The stock has corrected by more than 20% from its recent peak despite improvement in ts outlook, which we believe is a good opportunity to enter.

**Key Risks**

Higher-than-anticipated credit cost 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 | 13,484 |
| EPS (Rs.) | 3.2 | 2.3 | 6.3 | 12.2 |
| P/E (x) | 22.2 | 30.7 | 11.1 | 5.7 |
| P/BV (x) | 1.1 | 0.9 | 0.8 | 0.7 |
| RoE | 3.7 | 2.6 | 6.7 | 11.9 |
| RoA | 0.3 | 0.2 | 0.5 | 0.8 |

Source: Company; Sharekhan estimates

## Key result highlights

- **NIM outlook maintained despite higher NIM reported:** NII grew by 20% y-o-y/4% q-o-q (6% above estimates). NIM improved by 3bps q-o-q to ~3.11% vs. expectation of a marginal decline on a q-o-q basis. Cost of deposits increased by 14bps q-o-q, which was fully offset by increased yield on assets. The bank has maintained its NIM guidance at 2.9-3.0% despite higher NIM reported as term deposits amounting to Rs. 1 lakh crore would be repriced in H2FY2024.
- **Cost-to-income ratio moderated:** Total operating expenses grew by 21% y-o-y/down 3% q-o-q. Wage revision provisions were higher at Rs. 684 crore vs. Rs. 283 crore q-o-q, but pension costs as per AS15 were lower at Rs. 580 crore vs. Rs. 1,240 crore. Cost-to-income ratio stood at 52.0% vs. 53.9% q-o-q.
- **Credit cost to be on a declining trend:** Total provisions declined by 30% y-o-y/down 13% q-o-q. Core credit costs stood at 1.4% annualised vs. 2.1% q-o-q. Provisions are largely related to the back book (Net NPL and restructured book). The bank expects credit cost to fall steadily on a q-o-q basis.
- **Business momentum led by retail:** Net advances grew by 15% y-o-y/3% q-o-q. Advances growth continued to be driven by retail advances (excluding agri and MSME), which grew by 40% y-o-y/6% q-o-q. The agri loan and MSME book grew by 4% and 6% y-o-y, respectively. The overseas book, which grew by 10% y-o-y/6.5% q-o-q, accounts for only ~ 4% of gross advances. The domestic corporate book grew by 8% y-o-y/1% q-o-q.
- **Deposits growth muted:** Total deposits grew by 10% y-o-y/1% q-o-q. CASA deposits grew by 3% y-o-y/1% q-o-q, with overall CASA ratio stable q-o-q at ~41%. Domestic term deposits grew by 15% y-o-y/1% q-o-q. The bank need not worry about lower deposit growth, as it has increased liquidity in the form of higher SLR, LCR, and lower domestic CD ratio.
- **Asset quality shines:** Asset quality improved sharply with GNPA and NNPA ratios falling by 77 bps/51 bps q-o-q to 6.96%/1.47% on the back of lower slippages (0.9% bps vs. 1.3% q-o-q annualised calculated as a percentage of 12M trailing loans) and higher recoveries & upgrades along with contained write-offs. PCR stood at ~80% vs. 76% q-o-q. Net slippages continued to remain negative at Rs. 1,672 crore, led by lower slippages and higher recoveries & upgrades along with contained write-offs. Total restructured book forms 1.1% of the net advances vs. 1.2% q-o-q. Overall asset-quality outlook continues to remain stable to positive, thus slippages and credit cost are expected to see a declining trend going forward. It expects GNPA to fall below ~6% and NNPA below ~1% at the end of FY2024E.
- **Return ratio guidance:** The bank has guided for the exit RoA in FY2025E closer to ~1%, driven by strong asset quality and, in turn, lower credit cost as net NPAs decline steadily in FY2024E to below ~1%, which should boost return ratios. ROA guidance for FY2024E is stable at 0.5-0.6%.

**Results (Standalone)** Rs cr

| Particulars | Q2FY24 | Q1FY24 | Q2FY23 | Y-o-Y % | Q-o-Q % |
|---|---|---|---|---|---|
| Interest Income | 26,355 | 25,145 | 20,154 | 31% | 5% |
| Interest Expenses | 16,432 | 15,641 | 11,883 | 38% | 5% |
| **Net Interest Income** | **9,923** | **9,504** | **8,271** | **20%** | **4%** |
| NIM (%) | 3.11 | 3.08 | 3.00 | | |
| Core fee Income | 1,375 | 1,785 | 1,307 | 5% | -23% |
| Other Income | 1,653 | 1,649 | 1,540 | 7% | 0% |
| **Net Operating Revenue** | **12,951** | **12,938** | **11,118** | **16%** | **0%** |
| Employee Expenses | 4,200 | 4,487 | 3,233 | 30% | -6% |
| Other Opex | 2,535 | 2,483 | 2,318 | 9% | 2% |
| **Total Opex** | **6,735** | **6,970** | **5,551** | **21%** | **-3%** |
| **Cost to Income Ratio (%)** | **52.0%** | **53.9%** | **49.9%** | | |
| **Pre Provision Profits** | **6,216** | **5,968** | **5,567** | **12%** | **4%** |
| Provisions & Contingencies - Total | 3,444 | 3,965 | 4,906 | -30% | -13% |
| **Profit Before Tax** | **2,772** | **2,003** | **661** | **320%** | **38%** |
| Tax | 1,016 | 747 | 250 | 307% | 36% |
| Effective Tax Rate (%) | 36.7 | 37.3 | 37.8 | | |
| **Reported Profits** | **1,756** | **1,255** | **411** | **327%** | **40%** |
| Basic EPS | 1.6 | 1.1 | 0.4 | 330% | 39% |
| Diluted EPS | 1.6 | 1.1 | 0.4 | | |
| RoA (%) | 0.5 | 0.3 | 0.1 | | |
| Advances | 8,89,920 | 8,63,732 | 7,73,403 | 15% | 3% |
| Deposits | 13,09,910 | 12,97,905 | 11,93,501 | 10% | 1% |
| Gross NPA | 65,563 | 70,899 | 87,035 | -25% | -8% |
| Gross NPA Ratio (%) | 7.0 | 7.7 | 10.5 | | |
| PCR (%) | 80.0 | 75.8 | 66.3 | | |
| Net NPA | 13,114 | 17,129 | 29,348 | -55% | -23% |
| Net NPAs Ratio (%) | 1.5 | 2.0 | 3.8 | | |

Source: Company; Sharekhan Research

## Outlook and Valuation

### ■ Sector Outlook – Deposit mobilisation to be in focus; banks with a superior liability franchise placed better

System-level credit offtake grew by ~20% y-o-y in the fortnight ending September 22, 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%. The gap between advances and deposits growth has again widened. We are seeing strong traction in loan growth and overall deposit growth is challenging and is mainly led by time deposits rather than CASA. Margins are expected to be lower as deposits get repriced at higher costs to fund growth. The overall asset-quality outlook is stable to positive for the sector. We believe banks with a robust capital base and strong retail deposit franchise are well-placed to capture growth opportunities.

### ■ Company Outlook – Benefiting from sectoral tailwinds

Improving asset-quality trend led by lower slippages and strong recoveries is likely to augur well for the earnings trajectory, driven by lower credit costs. Higher net accretion to the tier-I capital is also a key positive, which has a low probability of capital dilution in the near term. Once the provisions are absorbed on account of the back book, we should see improvement in return ratios.

### ■ Valuation – Maintain Buy on PNB with an unchanged PT of Rs. 86

Asset-quality trend is quite encouraging and will help in faster normalisation of credit cost for the bank. Lower slippages trends are likely to narrow the perceived gap in underwriting with respect to peers. Provisions are largely related to the back book (Net NPL and restructured book), which would be accounted for in FY2024E. Thus, credit cost is expected to fall significantly in FY2025E, as net NPL declines steadily in FY2024E to below ~1% along with the rundown of the restructured book, which should significantly boost the return ratios. The bank has guided for the exit RoA in FY2025E closer to ~1%. At the CMP, the stock trades at 0.8x/ 0.7x its FY2024E/FY2025E BV. The stock has corrected by more than 20% from its recent peak despite improvement in its outlook, which we believe is a good opportunity to enter.

**Peer valuation**

| Particulars | 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 | 70 | 76,868 | 11.1 | 5.7 | 0.8 | 0.7 | 6.7 | 11.9 | 0.5 | 0.8 |
| Bank of India | 90 | 37,076 | 5.0 | 4.6 | 0.6 | 0.5 | 11.9 | 11.4 | 0.9 | 0.9 |

Source: Company, Sharekhan estimates

## About company

PNB is a government-owned bank with a network of over 10,092 domestic branches, more than 12,645 ATMs, and 20,447 business correspondents. Around 63% of its branches are in rural and semi-urban areas. PNB's global deposit stood at Rs. 13,09,910 crore and global advances stood at Rs. 9,41,721 crore as of September 2023. Capital adequacy ratio (CAR) stands at 15.09%.

## Investment theme

Benefiting from sectoral tailwinds, improving asset-quality trend led by lower slippages and strong recoveries is likely to augur well for the earnings trajectory, driven by lower credit cost. Once the provisions are absorbed on the back book, we should see improvement in the return ratio profile.

## Key Risks

Higher-than-anticipated credit cost and lower-than-expected margins.

## Additional Data

**Key management personnel**

| | |
|---|---|
| Arun Kumar Goel | Managing Director and CEO |
| Kalyan Kumar | Executive Director |
| Binod Kumar | Executive Director |
| M. Paramasivam | Executive Director |
| Bibhu Prasad | 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 | SBI FUNDS MANAGEMENT LTD. | 1.20 |
| 4 | QUANT MONEY MANAGERS LTD. | 0.98 |
| 5 | VANGUARD GROUP INC. | 0.76 |
| 6 | KOTAK MAHINDRA ASSET MANAGEMENT CO. LTD. | 0.48 |
| 7 | NIPPON LIFE INDIA ASSET MANAGEMENT LTD. | 0.47 |
| 8 | ADITYA BIRLA SUN LIFE ASSET MANAGEMENT CO. LTD. | 0.39 |
| 9 | ICICI PRUDENTIAL ASSET MANAGEMENT CO. LTD. | 0.22 |
| 10 | DIMENSIONAL FUND ADVISORS LP | 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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