

Sector: Banks & Finance
Result Update

| | |
|----------------------|--------|
| | Change |
| Reco: Buy | ↔ |
| CMP: Rs. 67 | |
| Price Target: Rs. 85 | ↓ |

↑ Upgrade ↔ No change ↓ Downgrade

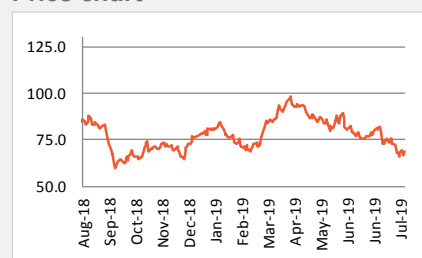
Company details

| | |
|----------------------------|---------------|
| Market cap: | Rs. 30,962 cr |
| 52-week high/low: | Rs. 100/59 |
| NSE volume: (No of shares) | 305.0 lakh |
| BSE code: | 532461 |
| NSE code: | PNB |
| Sharekhan code: | PNB |
| Free float: (No of shares) | 113.2 cr |

Shareholding (%)

| | |
|-----------|------|
| Promoters | 75.4 |
| FII | 0.0 |
| DII | 12.5 |
| Others | 12.1 |

Price chart



Price performance

| (%) | 1m | 3m | 6m | 12m |
|--------------------|-------|-------|-------|-------|
| Absolute | -13.0 | -18.5 | -10.7 | -18.7 |
| Relative to Sensex | -8.8 | -15.7 | -14.4 | -19.4 |

Sharekhan Research, Bloomberg

Punjab National Bank (PNB) reported weak quarterly numbers but lower provisions aided profitability. In absolute terms, GNPA and NNPA were stable but in percentage terms, they deteriorated due to muted advances. Net interest income (NII) declined by 11.7% y-o-y driven by muted loan growth and a decline in margins. However, by virtue of lower provisions (declined by 65% y-o-y) PNB reported a net profit of Rs. 1018.6 crore. While the overall loan book grew by 8% q-o-q, the management's guidance of 10% loan growth for FY20E looks achievable, contingent upon funds being raised. Much depends on the bank's plan to raise funds (via Equity issue / monetizing non-core assets / stake sale etc) since its capitalization (Tier1 at 7.64%) is weak. The management expects recovery of Rs 7,000 crore in near term from resolution of 2-3 NCLT exposure accounts which given the high provisions (~88% cover on NCLT accounts) will be positive. However, the pace of slippage is still a concern, and the overhang of pension related provisions indicate risks to profitability. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 85.

Key positives

- The management expects recovery of Rs 7000 crore in the near term from NCLT accounts
- Bank has made ~88% provisions on NCLT accounts so going forward, as and when resolution happens, it can be positive for earnings and margins.

Key negatives

- Weak capital position necessitates capital raise, which at present valuations will be book value dilutive

Our Call

Valuation – PNB is available at reasonable valuations of <1x its FY2021E book value. Even though there are challenges, the overhang of high slippages is diminishing, with a possibility of recovery from NCLT exposures being a positive. However, there is an overhang too of book value dilutive equity infusion. Considering the scenario, we maintain our Buy rating on the stock with an revised price target (PT) of Rs. 85.

Key Risks

Further deterioration in its Corporate / CRE continues to be a major overhang on the stock.

| Valuation Particulars | FY18 | FY19 | FY20E | Rs cr FY21E |
|-----------------------------|---------|--------|--------|-------------|
| Net interest income (Rs cr) | 16,058 | 17,156 | 18,341 | 20,515 |
| Net profit (Rs cr) | -11,575 | -9,975 | 3,507 | 4,221 |
| EPS (Rs) | -41.9 | -46.9 | 16.5 | 19.8 |
| EPS growth (%) | -773.5 | 11.8 | -135.2 | 20.4 |
| PE (x) | -1.6 | -1.4 | 4.1 | 3.4 |
| Book value (Rs/share) | 136.9 | 89.5 | 112.4 | 128.5 |
| P/BV (x) | 0.5 | 0.7 | 0.6 | 0.5 |
| RoE (%) | -27.9 | -23.2 | 9.7 | 14.6 |
| RoA (%) | -1.5 | -1.3 | 0.4 | 0.4 |

Source: Company, Sharekhan Research

Weak operating performance: Though Punjab National Bank (PNB) reported weak numbers in Q1FY20, lower provisions aided profitability. Net interest income (NII) declined by 11.7% y-o-y to Rs. 4141.4 crore, driven by muted loan growth and declined in margins. Non-interest income grew slower by 5.9% y-o-y to Rs. 2075.3 crore. Due to lower operating expenses cost-to-income ratio (C/I) declined to 44% Q1FY20 from 53% in Q4FY19. The provisions declined by 65% y-o-y to Rs. 2023.3 crore due to lower NPA provisions. As a result of lower provisions, the bank reported a net profit of Rs. 1018.6 crore for Q1FY20 as compared to loss of 940 crore in Q1FY19. However, the provision coverage ratio (PCR) has largely remained stable at 74.63%, mainly as the bank continues its balance sheet clean up. Domestic advances grew by 7.3% y-o-y to Rs. 453,099 crore, wherein retail advances grew by 22.1% y-o-y to Rs. 91,248 crore. Overall loan book de grew by 8% q-o-q largely due to de growth in agri and MSME loan book which de grew by 7.7% and 5.6% respectively. Domestic net interest margin (NIM) declined by 9 bps y-o-y to 2.36% (decline by 3 bps q-o-q), due to weak growth in advances and stable yields on advances. The management has guided for 10% loan growth, which we believe is not too difficult to achieve as this number to be fairly close to the FY20E system growth. Deposits grew by 6.7% y-o-y to Rs 672,471 crore, where the low-cost deposits grew at a faster 8.7% y-o-y, especially in the present competitive scenario for retail business.

Asset quality deteriorates due to muted loan growth: In absolute terms GNPA, and NNPA has largely remain stable but in percentage terms it has deteriorated due to muted advances. The gross non-performing asset (GNPA) ratio increased by 99 bps q-o-q to 16.5%, whereas net NPA ratio increased by 61 bps q-o-q to 7.2%. Fresh stress accretion reduced sequentially as accounts worth Rs 5412 crore turned NPAs, as against Rs. 7302 crore in Q4FY2019. The bank has guided for Rs. 12,000 crore of fresh slippages in FY20E (as against Rs 16,616 crore in FY2019). While we believe the bank has factored in most major stressed accounts, overall slippages and recoveries would be key monitorables. Recoveries and upgrades amounted to Rs. 2305 crore and Rs. 1554 crore, respectively. Total exposure to accounts under the National Company Law Tribunal (NCLT) amounts to Rs. 42502 crore, including list 1, list 2 and other accounts. The bank has provision coverage of 78.2% and 91.3% on list 1 and 2 of NCLT accounts, respectively, whereas overall coverage stands at 88.3%. The management expects recovery of Rs 7000 crore in the near term from NCLT accounts. Also the bank has made higher provisions on NCLT accounts so going forward, as and when resolution happens, it can be positive for earnings and margins. The bank has been able to slow the growth in risk-weighted assets by tweaking its portfolio mix towards better rated and less risky assets. We believe that bank needs capital and/or requires to sell non-core assets in the near to medium term. The management expects proceeds from sale of non-core assets to fetch Rs. ~1,000 crore, which will help its capital position and allow reasonable balance sheet growth.

Results

| Particulars | Rs cr | | | | |
|--------------------------------|--------------|--------------|--------------|---------------|-------------|
| | Q1FY20 | Q1FY19 | YoY % | Q4FY19 | QoQ % |
| Interest income | 13,086 | 13,113 | -0.2 | 12,836 | 2.0 |
| Interest expense | 8,945 | 8,421 | 6.2 | 8,635 | 3.6 |
| Net interest income | 4,141 | 4,692 | -11.7 | 4,200 | -1.4 |
| Non-interest income | 2,075 | 1,959 | 5.9 | 1,889 | 9.8 |
| Net total income | 6,217 | 6,651 | -6.5 | 6,090 | 2.1 |
| Operating expenses | 2,735 | 2,456 | 11.4 | 3,229 | -15.3 |
| Pre-provisioning profit | 3,481 | 4,195 | -17.0 | 2,861 | 21.7 |
| Provisions | 2,023 | 5,758 | -64.9 | 10,071 | -79.9 |
| Profit before tax | 1,458 | -1,563 | NA | -7,210 | NA |
| Tax | 439 | -623 | NA | -2,460 | NA |
| Profit after tax | 1,019 | -940 | NA | -4,750 | NA |

Source: Company; Sharekhan Research

Loan Mix (%)

| Particulars | Q1FY18 | Q2FY18 | Q3FY18 | Q4FY18 | Q1FY19 | Q2FY19 | Q3FY19 | Q4FY19 | Q1FY20 |
|------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Foreign | 9.7 | 8.9 | 8.7 | 8.0 | 7.0 | 5.4 | 3.5 | 3.0 | 3.3 |
| Domestic | 90.3 | 91.1 | 91.3 | 92.0 | 93.0 | 94.6 | 96.5 | 97.0 | 96.7 |
| - Large industry | 31.8 | 45.4 | 35.1 | 35.3 | 34.0 | 52.9 | 47.7 | 52.4 | 46.1 |
| - SME Advances | 20.5 | 20.8 | 23.2 | 22.8 | 21.4 | 23.8 | 23.3 | 22.0 | 20.8 |
| - Agriculture Advances | 17.2 | 17.7 | 18.7 | 18.1 | 18.2 | 19.2 | 20.4 | 21.4 | 19.7 |
| - Retail Advances | 17.8 | 18.7 | 19.6 | 20.0 | 19.6 | 21.3 | 22.5 | 24.3 | 23.9 |

Source: Company; Sharekhan Research

Reported Margins, Cost of Funds, Cost of deposits and Yields on advances

| Particulars | Q1FY18 | Q2FY18 | Q3FY18 | Q4FY18 | Q1FY19 | Q2FY19 | Q3FY19 | Q4FY19 | Q1FY20 |
|-------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| NIMs | 2.6% | 2.6% | 2.6% | 1.9% | 2.4% | 2.5% | 2.6% | 2.5% | 2.4% |
| Cost Of Funds | 4.4% | 4.4% | 4.4% | 4.2% | 4.3% | 4.2% | 4.3% | 4.2% | 4.4% |
| Cost of Deposits | 5.1% | 5.0% | 5.0% | 4.8% | 5.0% | 5.1% | 5.1% | 5.2% | 5.2% |
| Yield on Advances | 7.9% | 7.9% | 7.8% | 6.5% | 7.3% | 7.5% | 7.8% | 7.5% | 7.6% |

Source: Company; Sharekhan Research

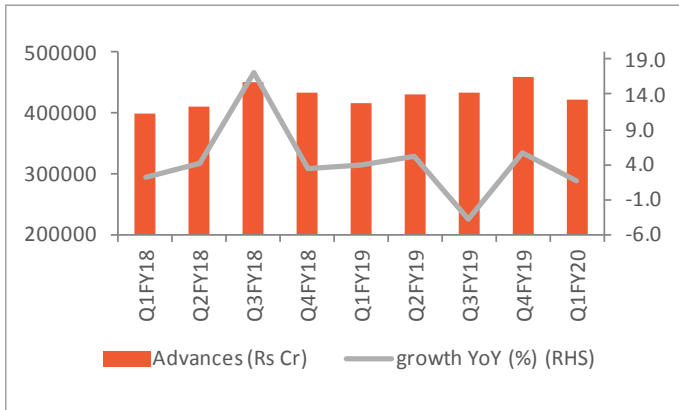
Movement in GNPA

| Particulars | Q1FY18 | Q2FY18 | Q3FY18 | Q4FY18 | Q1FY19 | Q2FY19 | Q3FY19 | Q4FY19 | Q1FY20 |
|------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Opening | 55,371 | 57,720 | 57,631 | 57,520 | 86,621 | 82,891 | 81,253 | 77,735 | 78,475 |
| Slippages during the quarter | 6,649 | 3,460 | 3,174 | 30,991 | 7,363 | 5,644 | 3,988 | 7,302 | 5,412 |
| Reductions | 4,300 | 3,549 | 3,285 | 1,890 | 11,093 | 7,282 | 7,506 | 6,562 | 6,610 |
| Cash Recovery | 1,856 | 963 | 901 | 723 | 5,519 | 2,321 | 2,967 | 2,518 | 2,305 |
| Upgradation | 885 | 367 | 34 | (112) | 2,926 | 1,418 | 1,457 | 1,064 | 1,554 |
| Write Off | 1,559 | 2,219 | 2,350 | 1,279 | 2,648 | 3,543 | 3,082 | 2,981 | 2,758 |
| Closing | 57,720 | 57,631 | 57,520 | 86,621 | 82,891 | 81,253 | 77,735 | 78,475 | 77,277 |

Source: Company; Sharekhan Research

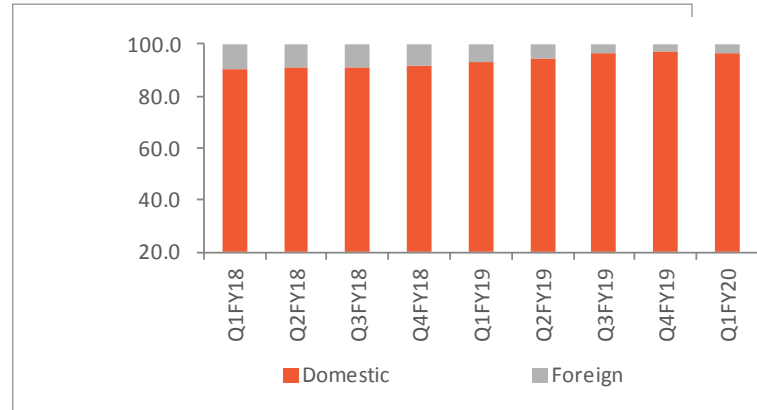
Financials in charts

Advances trend



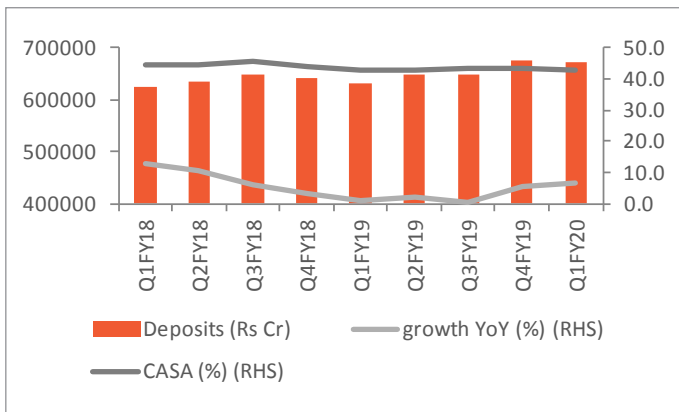
Source: Company, Sharekhan Research

Loan Mix



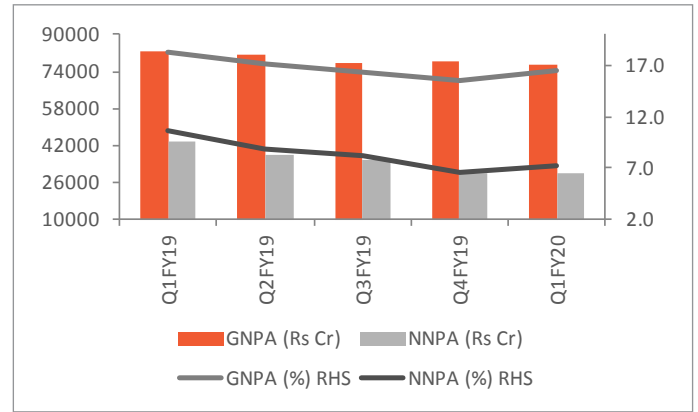
Source: Company, Sharekhan Research

Deposits trend



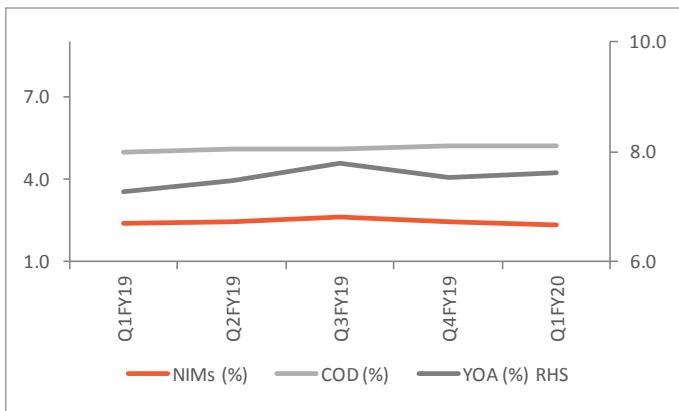
Source: Company, Sharekhan Research

Asset Quality Movement



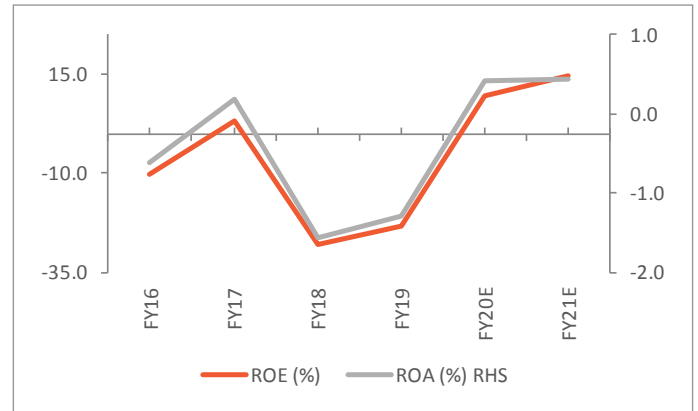
Source: Company, Sharekhan Research

NIMs, Yields on Advances, Cost of Deposits



Source: Company, Sharekhan Research

Return Ratios (Calc.)



Source: Company, Sharekhan Research

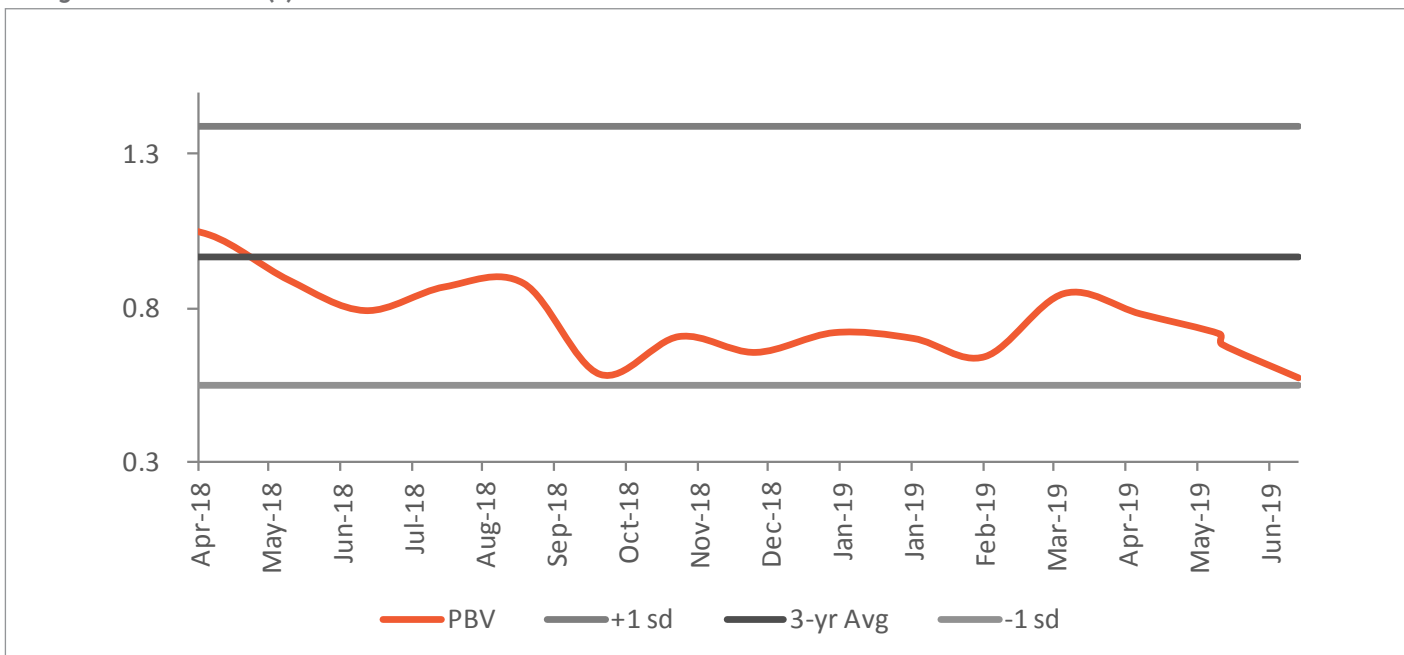
Outlook

We believe further resolution or recovery in NCLT exposures as well as other corporate/infrastructure exposures may be positive triggers for the banking industry as a whole, including PNB. However, we expect margins to remain range bound for the medium term. While, on one side, reducing stress asset and MCLR hikes would help, we believe the risks of chunky slippages/haircuts remain for PNB. Also, the pace of slippage is still a concern, and the overhang of pension related provisions indicate near term risks to profitability. The management’s guidance of 10% loan growth for FY20E is achievable, contingent upon funds being raised. Much depends on the bank’s plan to raise funds (via Equity issue / monetizing non-core assets / stake sale etc) since its capitalization (Tier1 at 7.64%) is weak. The management expects recovery of Rs 7,000 crore in near term from resolution of 2-3 NCLT exposure accounts which given the high provisions (~88% cover on NCLT accounts) will be positive.

Valuation

PNB is available at reasonable valuations of <1x its FY2021E book value. Even though there are challenges, the overhang of high slippages is diminishing, with a possibility of recovery from NCLT exposures being a positive. However, there is an overhang of book value dilutive equity infusion. Considering the scenario, we maintain our Buy rating on the stock with an revised price target (PT) of Rs. 85.

One year forward P/BV (x) band



Source: Sharekhan Research

Peer Comparison

| Particulars | CMP | P/BV(x) | | P/E(x) | | RoA (%) | | RoE (%) | |
|----------------------|----------|---------|-------|--------|-------|---------|-------|---------|-------|
| | Rs/Share | FY20E | FY21E | FY20E | FY21E | FY20E | FY21E | FY20E | FY21E |
| Punjab National Bank | 68 | 0.6 | 0.5 | 4.1 | 3.4 | 0.4 | 0.4 | 9.7 | 14.6 |
| Bank of India | 69 | 0.8 | 0.7 | 13.2 | 9.0 | 0.3 | 0.4 | 4.5 | 7.6 |
| Bank of Baroda | 103 | 0.8 | 0.7 | 7.1 | 5.8 | 0.6 | 0.7 | 9.6 | 11.5 |
| State Bank of India | 312 | 1.4 | 1.3 | 18.6 | 14.6 | 0.4 | 0.5 | 6.9 | 8.3 |

Source: Company, Sharekhan research

About company

Punjab National Bank is India's first Swadeshi Bank which commenced operations on 12th April, 1895 from Lahore. Punjab National Bank had a network of 7036 branches, 8906 ATM's and 7911 business correspondents as on June-19. The deposits and net advances as on 30th June, 2019 stood at Rs 6.4 trn and Rs 4.5 trn respectively. The Bank has been rationalizing its overseas operations which have resulted into shrinking of overseas business. As on 30th June 19, Bank is having 2 overseas branches in Hong Kong, Dubai and Offshore Banking Unit in Mumbai and Representative Office at Dubai (UAE).

Investment theme

Punjab National Bank is one of the largest PSU banks in the country with pan India spread with 7000+ branches and 8900+ ATMs. The bank has worked upon in bringing significant improvement in the internal systems and processes post the discovery of frauds in one of its branches in 2018. It has restructured its processes, with a focus on recovery and resolution, hence taking stapes like creating a Stressed Asset Management vertical with dedicated team of over 2700 employee, along with creating dedicated branches to focus on SME, Retail etc disbursments. It has seen results of them, in terms of improved recovery. The recent IBC amendment is a positive development and will aid recovery and resolution of the stressed assets. Also, the significant provision cover on its exposure to NCLT filed accounts, which as and when will see resolution, will be a positive for the bank.

Key Risks

Further deterioration in its Corporate / CRE continues to be a major overhang on the stock.

Additional Data

Key management personnel

| | |
|-----------------------------|------------------------|
| Mr Sunil Mehta | Non-Executive Chairman |
| Mr Sunil Mehta | MD & CEO |
| Dr. Rajesh Kumar Yaduvanshi | Executive Director |
| Mr Lingam Venkata Prabhakar | Executive Director |
| Mr Agyey Kumar Azad | Executive Director |

Source: Company Website

Top 10 shareholders

| Sr. No. | Holder Name | Holding (%) |
|---------|------------------------------------|-------------|
| 1 | Republic of India | 75.4 |
| 2 | Life Insurance Corp of India | 7.3 |
| 3 | HDFC Asset Management Co Ltd | 2.3 |
| 4 | Vanguard Group Inc/The | 0.6 |
| 5 | Kotak Mahindra Asset Management Co | 0.6 |
| 6 | FIL Ltd | 0.4 |
| 7 | Norges Bank | 0.4 |
| 8 | Dimensional Fund Advisors LP | 0.4 |
| 9 | SBI Funds Management Pvt Ltd | 0.3 |
| 10 | State of California | 0.3 |

Source: Bloomberg

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