Stock Update

Punjab National Bank

High Risk

5-July-2021

Punjab National Bank

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Red flag*	Time Horizon
PSU Banks	Rs.42.1	Buy at LTP and add more at Rs.36.5	Rs.54.8	Rs.65.8	Rs.32.5	2 quarters

*Investor may sell 60-65% of their holding on first target being achieved and later keep a stop loss of first target for balance holding, in case the second target takes time to be achieved. Investor may also maintain Rs.32.5 as red flag level below which investment position needs to be reviewed, including the possibility to exit.

HDFC Scrip Code	PUNNATEQNR
BSE Code	532461
NSE Code	PNB
Bloomberg	PNB IN
CMP July 02, 2021	42.1
Equity Capital (RsCr)	2202.2
Face Value (Rs)	2
Equity Share O/S (Cr)	1101.1
Market Cap (Rs Cr)	46,356.4
Adj. Book Value (Rs)	50
Avg. 52 Wk Volumes	110590633
52 Week High	46.4
52 Week Low	26.3

Share holding Pattern % (May, 2021)	
Promoters	73.2
Institutions	14.9
Non Institutions	11.9
Total	100.0

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Our take

Punjab National Bank (PNB) has a vast history of banking experience & resilience and post the merger it has become systematically important 2nd largest public sector bank in the country. Over the years, the Bank has been scaling up its market position to emerge as a major 'Financial Conglomerate'. PNB's large and granular deposit base is backed by low-cost CASA and this gives it access to low cost funds which is the biggest competitive advantage. Management has strategically focused on creating granular deposit base; as a result there has been a significant reduction in bulk deposits. It is well placed in terms of capital positioning as compared to other PSB peers and its stake in various subsidiaries provides cushion for further fund raise. However, continuous fund raise or capital infusion by government is earnings dilutive and posts negative impact on the stock price.

Despite huge NPA recognitions, we are still worried about asset quality due to poor quality of corporate book and high SMA-2. PNB has a history of poor credit underwriting. Its asset quality is still lagging behind peers. Management has guided for decent recovery of bad asset in FY22, this will be the key thing to watch out for. On the profitability side, management expects Rs. 6000Cr PAT on a conservative basis while on loan growth, they have guided a 8% growth for FY22 which is based on an underlying assumption of Indian GDP growing at 9.5%.
Inexpensive valuation gives us comfort for long term investment. It is a play on the gradual recovery in the Indian economy. In the first tranche, the bank has identified NPAs worth Rs. 8,000 cr to be transferred to the National Asset Reconstruction Company (NARCL). Setting up of NARCL, the proposed bad bank for taking over stressed assets of lenders, was announced in the Budget for 2021-22. In the initial phase, Indian banking association (IBA) has identified NPAs worth Rs 89,000 cr across 22 accounts which will be transferred to NARCL. Any progress on the rollout of the proposed ARC/ bad bank would be positive for large PSU banks like PNB. Privatization buzz has kept the PSU bank sector hot and we believe acquisition of some players by the any prestigious corporates/Institutions – local or foreign - at a good valuation may rerate the sector.

Valuation and recommendation:

PNB has reported weak performance compared to other peers in Q4FY21. However, continuous CASA improvement is noteworthy. We expect PNB to grow its loan book at 8.7% CAGR while NII and Net profit are expected to grow at 8.4% and 108.3% (due to lower base)

CAGR respectively over FY21-23E. ROAA is estimated to improve a bit to 0.62% in FY23E from current 0.19% in FY21. We expect a healthy recoveries and upgrades in next two years. Asset quality trend of corporate and MSME would be crucial monitorable. In FY22, we may witness a fight between higher restructured loans and lower NPAs, if there is a turn in corporate NPA cycle. This may lead to moderation in credit costs, however the extent will depend on duration of existing/new Covid-19 waves. The recent Supreme Court ruling allowing banks to invoke personal guarantees provided by promoters and KMPs (key managerial personnel) in the event of default by the borrowing company could pressurize a lot of promoters to come up with settlement terms, leading to faster and bigger recoveries. This judgment gives NCLTs the jurisdiction to deal with personal guarantors of corporate debtors alongside the CIRP proceedings of corporate debtors/principal borrowers, thereby having a more comprehensive system in place for recovery of debts.

Most of the concerns arising out of pending writeoffs out of restructured/SMA accounts are already in the price. We have assumed higher recoveries and lower slippages than the street going forward. NIMs may also start to rise going forward due to lower interest reversals.

We believe that investors can buy PNB at LTP (0.58xFY23E ABV) and add more at Rs.36.5 (0.5xFY23E ABV) for the base case fair value of Rs.54.8 (0.75xFY23E ABV) and for the bull case fair value of Rs.65.8 (0.9xFY23E ABV) over the next two quarters. PNB is a high risk high reward stock. We have assigned “high risk” rating.

Financial Summary (Standalone)

Particulars (Rs.Cr)	Q4FY21	Q4FY20	YoY-%	Q3FY21	QoQ-%	FY20	FY21	FY22E	FY23E
NII	6937.6	4677.5	48.3	8313.0	-16.5	17437.8	30477.0	32134.1	35827.0
PPoP	5634.3	3932.3	43.3	6390.8	-11.8	14738.6	22980.0	21941.1	24891.0
PAT	586.3	-697.2	LP	506.0	15.9	336.2	2021.5	4755.4	8769.7
EPS (Rs)						0.5	1.9	4.3	8.0
ABV						52.2	50.0	62.3	73.1
P/E (x)						84.4	21.8	9.7	5.3
P/ABV (x)						0.8	0.8	0.7	0.6
RoAA (%)						0.0	0.2	0.4	0.6
RoAE (%)						0.6	2.6	5.0	8.6

Punjab National Bank

Recent Developments

Q4FY21 Result Update

Net Interest Income grew by 1.9% YoY to Rs.6938 Cr during Q4FY21. It was down by 16.5% QoQ. Net Interest Margin (NIM) contracted 41bps QoQ to 2.7% despite lower cost of funds. Operating profit was up 43% YoY but down 11.8% QoQ. PAT came in at Rs 586 Cr, up 15.9% QoQ supported by higher other income. In Q4FY20, there was a huge loss due to large provision. Domestic CASA Share improved by 347 bps on YoY basis to 45.5 % in Mar-21. Gross loan book was down 3% while deposits were up 3%. This has resulted in significantly lower business growth compared to other peers. Domestic Advances stood at Rs.719138Cr as of Q4FY21 as against Rs.741952Cr in Mar-20. In terms of assets, growth in retail has been 9.5%, MSME has been 7.5% and agriculture was around 6%. The bank has guided for 8% credit growth in FY22 on the back of improved secured retail momentum and some back-end support from corporates. For FY21, Cost to Income Ratio improved to 46.91% vs 56.47% in FY20.

Asset Quality

PNB has reported highest ever quarterly slippages of Rs.24,172 cr (which contains majority in retail and MSME) compared to Rs.1,150 Cr in Q3FY21. This was due to the impact of restructuring not happening in several accounts. Around Rs.2000 Cr is expected to be upgraded by Q1FY22. For FY21, slippages are at 4.2% and credit cost is at 2.8%. Gross NPAs deteriorated sharply and stood at Rs. 1,04,424 cr v/s Rs. 94,479 cr (+11% QoQ) while Net NPA were at Rs. 38,576 cr vs Rs. 26,598 cr (+45% QoQ). GNPA and NNPA for the quarter stood at 14.12% and 5.73% from 12.99% and 4.03% in Q3FY21. The Provision Coverage Ratio (PCR) deteriorated to 80.14%, down 502 bps QoQ. Sub-Standard loans stood at Rs. 22,980 cr vs Rs. 4,220 cr which is at 3.11% vs 0.58% (+253% QoQ). Further Rs. 60,382 cr was classified as Doubtful (Huge 8.2% of Loan Book). The bank has 4.46% of loans under SMA-2 compared to just 1.98% last year. In absolute terms, SMA 2 accounts are at Rs, 33,007 cr v/s Rs. 15,078 cr (+119%). This indicates huge stress in loan books.

We remain cautious on the asset quality front due to high corporate book. Even the retail and MSME segments have also seen large slippages during the quarter. PNB's loan book as on March-21 has a very high exposure to corporate and MSME segment which comprised of ~47.8% and 17.5% of its total domestic advances. In the corporate space it has high exposure to core economy sectors like Infrastructure (47.7%) followed by Metals (10.3%) and Textiles (6%). Out of the total, almost 10% of the borrowers (O/s above Rs.100 Cr) are from the category of BB & below rating. Management has informed that MSME stress majority is already identified and retail segment is expected to settle in terms of NPLs by September. Further, they have indicated that collections in May are at 91% vs 84% in April.

Recent updates

PNB hopes to make good recovery of its exposure in crisis-hit DHFL by H1FY22, which has recently completed its resolution process. Also it has made a recovery of Rs.3,017 cr from Bhushan Power and Steel under debt resolution in NCLT.

The company in the month of May ’21, had garnered Rs. 1800 cr via QIP offering shares at a price of Rs. 33.75. Post this issue the stake of FPIs has increased to 4.97% from 2.94%, while that of Insurance companies has risen from 8.08% to 8.79%. Overall in FY21, it had made a QIP placement of Rs. 3,788.04 cr v/s initial target of Rs. 7000Cr. In FY21, PNB issued Basel III compliant additional tier-I bonds of Rs. 495 cr through private placements.

PNB plans to monetize its stake in associate company Canara HSBC OBC Life Insurance where it holds 23% stake. This is likely to happen in next 12-18 months. As per IRDAI guidelines a bank cannot hold more than 10% in 2 insurance companies. PNB is also a promoter of another insurer PNB Metlife Insurance, owning a higher stake of 30%. It also aims to exit its 10% stake in Asset Reconstruction Company (India) Limited (Arcil). It expects to realise Rs. 50-60 cr from its stake sale in ARCIL based on current valuations.

Long-term triggers

Established franchise

PNB has history of over 125 years of banking experience & resilience and post the merger it has become systematically important 2nd largest public sector bank in the country. It has a pan-India network with semi urban and rural area as the key focused regions. Bank also has an overseas presence in Hong Kong, Dubai, Bhutan, United Kingdom, Nepal, Bangladesh and Myanmar. PNB merged with OBC and United Bank of India from 1st Apr, ’20. The merged entity enjoys the benefits of larger balance sheet size and wider geographic reach leading to deeper penetration. Over longer run, merger will help in improving the efficiency of operations, increasing economies of scale, better management of risk, improved professional standards, savings on cost, etc.

Total loan book for the merged entity stood at Rs.7.39 lakh Cr. It has diversified loan book mix where corporate is 48%, Agriculture contributes 16%, MSME is 17% and 19% is contributed by retail segment. Long presence and wide geographic presence has helped the bank in building low cost liability profile. CASA ratio for the bank stood at 45.5% against the average CASA share of ~40% for PSBs. 60 Lakh new deposits customers were added during FY21. The deposit base of the merged entity also remains granular as management has reduced bulk deposits significantly.

Capital Adequacy

The bank is well placed in terms of capital positioning as compared to other PSB peers. The Capital Adequacy Ratio as on March-21 stood at 14.32% with Tier-1 at 11.5%. Improvement in CAR was mainly driven by capital infusion by government and fund raises by the bank. In May-21, PNB has raised Rs.1800 Cr by selling 53 Cr shares at Rs.33.75 per unit via Qualified Institutional Placement (QIP). Post this there would be around 30bps increase in Tier-1/CAR. As per management, there is further headroom to raise capital through issuance of AT1 Bonds but the call in this regard would be taken after first quarter numbers. In the Q4FY21 concall, management has indicated plan to offload its stake in Canara HSBC OBC Life Insurance Company. Further, the bank also has stake in various subsidiaries; via stake sale it can raise funds.

Focus on digitization and technology

The bank has started focusing on building digital infrastructure which will help them in achieving cost efficiency. The endeavour will be to migrate customers to digital channels and move transactions away from branches to contactless banking modes. With this strategy the bank intends to leverage its digital channels to source business, and in particular, grow CASA and advances. It will further improve client and transaction management and achieve enhanced efficiency and productivity levels. The Bank has launched the 'Digital Apnayen' campaign to encourage customers to increasingly use its digital assets. Since its launch on August 15, 2020, more than 25 lakh customers have been onboarded by the Bank on its digital platforms. The Bank has also launched a digital customer assistant, 'PIHU'. Internet Banking Services users increased to 256 Lakhs in Mar-21 from 221 Lakhs YoY. UPI transactions increased by 123% YoY and NACH transactions increased by 49.2 % YoY.

Privatization buzz, bad bank creation and NPA recovery to keep PSB sector in lime light

In FY21, bank credit growth was lowest since last four years as lenders and borrowers remained risk averse due to the pandemic-led uncertainty. However, the PSU Banks have reported net profits in FY21 after five consecutive years of losses, supported by treasury gains and lower provisions. We expect low double digit credit growth in FY22. PNB has guided for 8% for the same in FY22.

After a prolonged period of stress, Indian banking sector had finally entered into resolution and recovery phase. With this, corporate facing banks like PNB with huge corporate book size had a lot to gain. The pandemic effect has impacted the resolution process in FY21 also due to increased operational challenges. Total resolution amount of ~Rs.260 bn in FY21 is almost a quarter of the realisations in FY20. However, now as the situation has improved, the financial creditors could realise Rs.550-600 bn in FY22 through successful resolution plans from the IBC, as per ICRA's estimates. In the case of PNB, the management expects recovery from DHFL in H1FY22 and additional cash recovery of Rs.11 bn from the NCLT accounts while general recovery will be around Rs.30 bn minimum in every quarter.

As proposed by Finance Minister in the Union Budget, the bad bank will help in aggregating the loan book of stressed assets from all banks, and facilitate an easy process of auctioning through the Swiss challenge method. Public sectors banks will be its promoters, who will collectively hold 51% while PNB will have little less than 10% stake. In the first tranche, the bank has identified non-performing assets worth Rs 8,000 cr to be transferred to the National Asset Reconstruction Company (NARCL). These assets have already been written off in the books and hence the consideration would boost its profits/capital.

Government is also planning to privatize a few PSU bank in the near term as part of the government's broader divestment goals. This has created a lot of buzz in the sector. Acquisition of these banks by the big corporates/institutions at a good valuation may re-rate the sector.

Risks and concerns

- Any unfavorable change in rules and regulatory policies can have a negative impact on earnings outlook of the company.
- The second wave and subsequent lock down has impacted overall India including rural areas also this time. This is major cause of worry as new uncertainties have emerged. Further lockdowns on the back of 3rd wave can derail the process of recovery. Slower than expected pickup in the economy may impact the loan book growth for the bank.
- A sharp rise in interest rate could also result in MTM losses on its investment portfolio.
- A higher-than-expected deterioration in the asset quality could result in the erosion of the Tier I capital. Fresh formation of bad loans could keep provision high and return ratio compressed for a long time.
- Any further delay in the resolution of large assets due to current uncertainties and extension granted under IBC can postpone recoveries.
- The continuous fund raise and capital infusion by government will be EPS dilutive and it might impact the stock price in negative way.

About the company

Punjab National Bank (PNB) was incorporated in 1894 with the distinction of being the first Swadeshi Bank to have been started with Indian capital. It is one of India's largest nationalized banks in terms of business and number of branches. As per Ministry of Finance directive, Oriental Bank of Commerce (OBC) and United Bank of India (UBI) have been merged into PNB effective from April 1, 2020. The amalgamated bank is the 2nd largest public sector bank in the country. The GoI owns 73.15% of the merged bank as on May-21. Post amalgamation, PNB has a pan-India network of 10769 branches and 13781 ATMs as on March 31, 2021. Bank also has overseas operations.

Principal business operations are broadly categorized into following segments: corporate/wholesale banking, retail banking, treasury operations, and other banking operations comprising primarily of rural business and agri-business. The range of products and services offered by the Bank includes loans and advances, deposits, foreign exchange products, retail lending and deposits and fee and commission-based products and services.

Subsidiaries, Joint Venture and Associates

Over the years, the Bank has been scaling up its market position to emerge as a major 'Financial Conglomerate'. PNB also has presence, through its Subsidiaries, Joint Venture and Associates, in diverse segments of the Indian financial sector, including housing finance, life insurance, corporate advisory, merchant banking and trustee services. This diversification could help in hedging against downturns in specific segments and gives access to multiple growth avenues. Via stake sales the bank can also raise money, this provides additional cushion.

The bank has domestic subsidiaries; PNB Gilts Ltd (74.07% stake) and PNB Investment Services Ltd (100% stake). Additionally, PNB has two international subsidiaries, namely, PNB (International) Ltd., UK (100% stake) and Druk PNB Bank Ltd., Bhutan (51% stake) as on March 31, 2021.

PNB Gilts Ltd., a subsidiary of the Bank, is engaged in the business of trading in Govt. securities, treasury bills and Non SLR Investments. It is also engaged in dealing in Money Market Instruments and Mutual Funds Distribution.
PNB Investment Services Ltd, a wholly owned subsidiary, has been set up by the bank for carrying out merchant banking business. It provides services for project appraisal, loan syndication, debt placement and to executes IPOs/FPO/QIPs.

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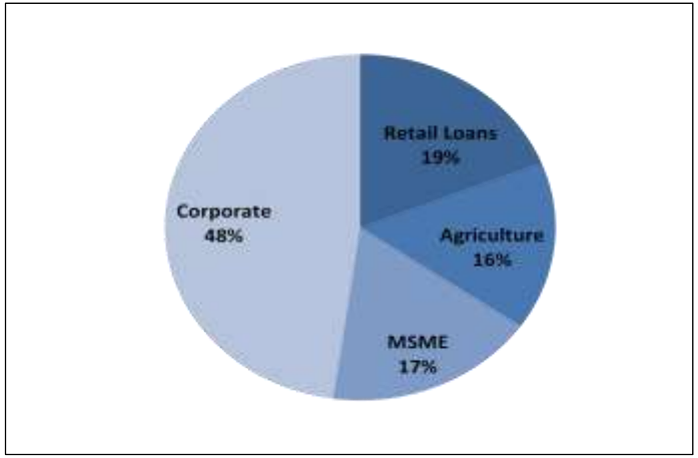
The bank also has certain domestic associates like many Gramin Banks, PNB Housing Finance Ltd. (32.6% stake), PNB Metlife India Insurance Co. Ltd. (30% stake), Canara HSBC OBC Life Insurance Co. Ltd. India (23% stake) and SME Asset Reconstruction Co. Ltd. (21% stake).

Peer Comparison:

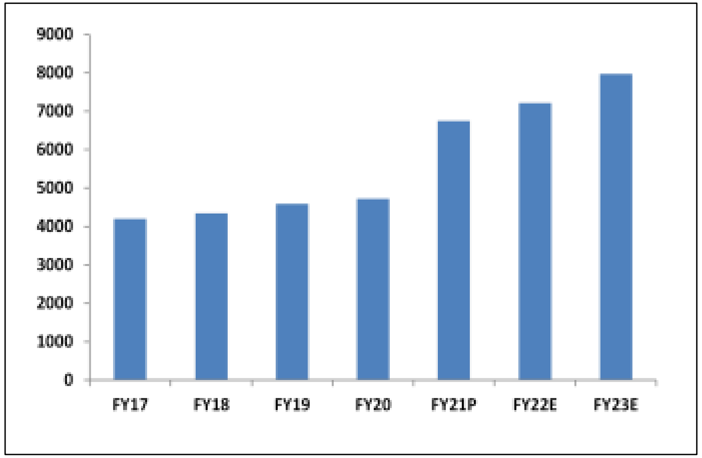
	CMP	P/ABV			P/E			FY21						
		FY21	FY22E	FY23E	FY21	FY22E	FY23E	ROAE (%)	ROAA (%)	NIM %	GNPA %	NNPA %	CASA %	Loan Book (Rs. Bn)
PNB	42.1	0.84	0.68	0.58	21.8	9.7	5.3	2.64	0.19	3.23	14.12	5.73	45.94	6,742
BOB	85.2	0.77	0.74	0.67	50.1	9.5	5.6	12.8	1.9	4.4	3.3	1.2	60.4	7,063
SBIN	425	2.0	1.7	1.5	18.6	12.1	9.8	8.8	0.5	3	5	1.5	44.7	24,495

(Source: Company, HDFC sec Research)

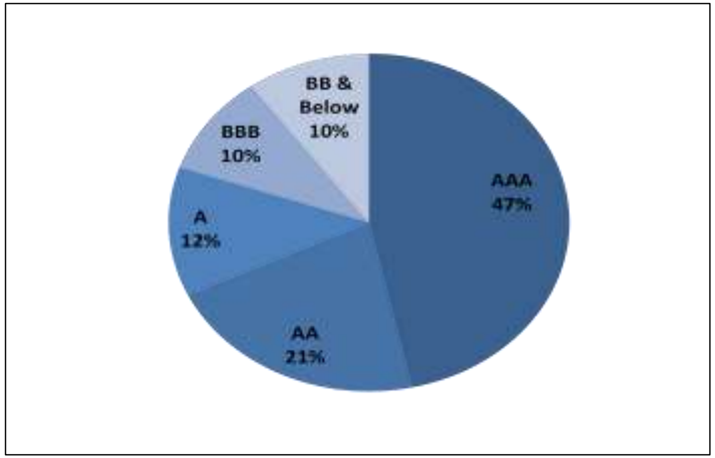
Loan Book Mix (%)



Loan Book Trend (Rs. bn)

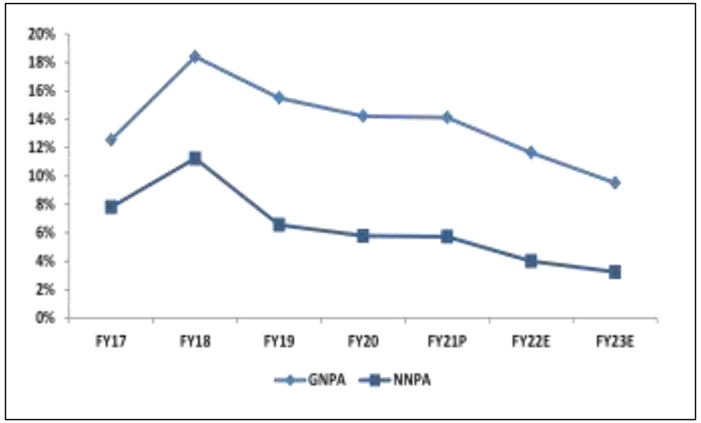


External Rating for o/s above Rs.100 Cr

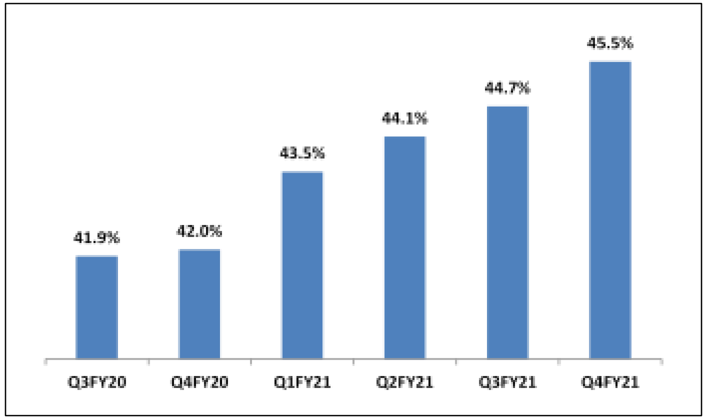


Punjab National Bank

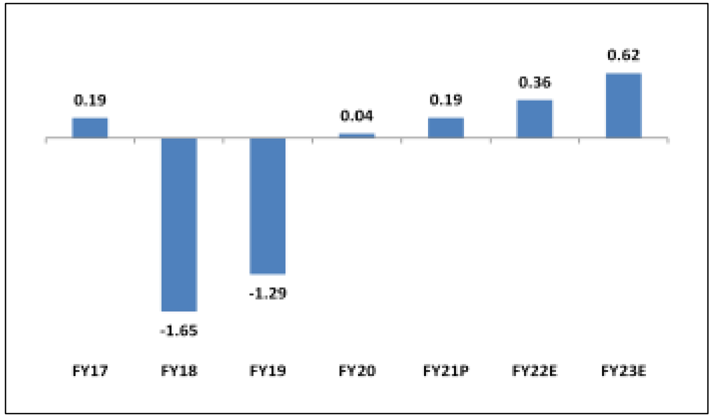
NPAs Trend(%)



Continuous CASA Improvement (%)



ROAA%



Financials

Income Statement (Standalone)

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
Interest Income	51310	53800	80750	84437	91116
Interest Expenses	34154	36362	50273	52303	55289
Net Interest Income	**17156**	**17438**	**30477**	**32134**	**35827**
Non interest income	7377	9274	12812	11863	12149
Operating Income	**24534**	**26712**	**43289**	**43997**	**47976**
Operating Expenses	11538	11973	20309	22056	23085
PPP	12995	14739	22980	21941	24891
Prov & Cont	28341	14000	19501	15601	13198
Profit Before Tax	-15346	739	3479	6341	11693
Tax	-5370	403	1458	1585	2923
PAT	**-9975**	**336**	**2022**	**4755**	**8770**

Balance Sheet

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
Share Capital	921	1348	2096	2202	2202
Reserves & Surplus	43866	61010	88842	95290	104060
Shareholder funds	**44787**	**62357**	**90937**	**97493**	**106262**
Deposits	676030	703846	1106333	1194812	1276770
Borrowings	39326	50225	42840	50500	71746
Other Liab & Prov.	14806	14237	20523	22575	24832
SOURCES OF FUNDS	**774949**	**830666**	**1260633**	**1365380**	**1479611**
Cash & Bank Balance	75288	75993	111350	145985	116891
Investment	202128	240466	392983	428352	464762
Advances	458249	471828	674230	721426	797176
Fixed Assets	6225	7239	11021	11903	13093
Other Assets	33059	35140	71049	57714	87689
TOTAL ASSETS	**774949**	**830666**	**1260633**	**1365380**	**1479611**

(Source: Company, HDFC sec Research)

Punjab National Bank

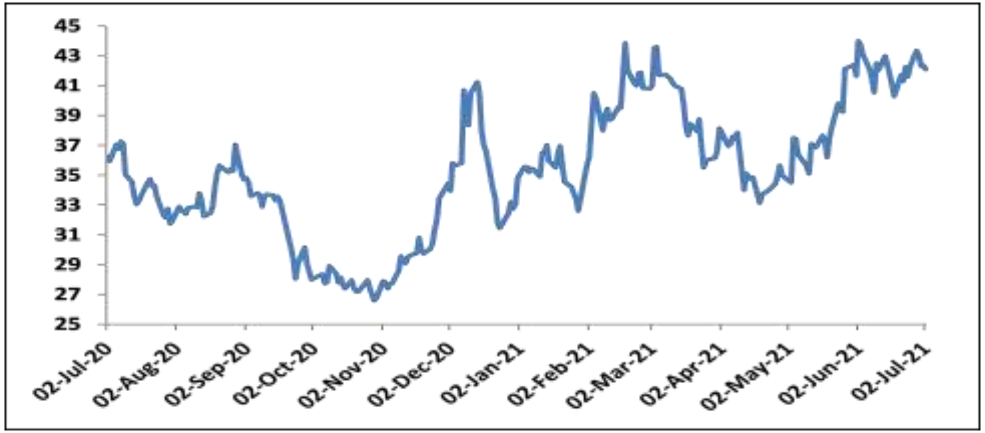
Key Ratios (%)

	FY19	FY20	FY21	FY22E	FY23E
Return Ratios					
Calc. Yield on adv	11.5%	11.6%	12.0%	12.1%	12.0%
Calc. Cost of funds	4.8%	4.9%	4.4%	4.2%	4.1%
NIM	2.4%	2.4%	3.2%	2.7%	2.8%
RoAE	-23.2%	0.6%	2.6%	5.0%	8.6%
RoAA	-1.3%	0.0%	0.2%	0.4%	0.6%
Asset Quality Ratios					
GNPA	15.5%	14.2%	14.1%	11.6%	9.5%
NNPA	6.6%	5.8%	5.7%	4.0%	3.2%
PCR	61.7%	63.0%	63.1%	65.6%	66.0%
Growth Ratios					
Advances	5.7%	3.0%	42.9%	7.0%	10.5%
Deposits	5.3%	4.1%	57.2%	8.0%	6.9%
NII	15.0%	1.6%	74.8%	5.4%	11.5%
PAT	-18.8%	-103.4%	501.3%	135.2%	84.4%

Key Ratios (%)

	FY19	FY20	FY21	FY22E	FY23E
Valuation Ratios					
EPS	-21.7	0.5	1.9	4.3	8.0
P/E	7.2	84.4	21.8	9.7	5.3
Adj. BVPS	32.0	52.2	50.0	62.3	73.1
P/ABV	0.4	0.5	0.5	0.5	0.4
Dividend per share	0.0	0.0	0.0	0.0	0.0
Other Ratios (%)					
Cost-Income	47.0	44.8	46.9	50.1	48.1
CASA	42.2	43.0	45.9	45.9	46.1
CAR	9.7	14.1	14.3	14.5	14.2
Tier 1	7.5	11.9	11.5	11.6	11.4

One Year Price Chart



RETAIL RESEARCH

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