Rating Rationale for Punjab National Bank's Innovative Perpetual Debt Instrument (IPDI) Issue of INR 700 crore or INR 7 billion

Issue Rating: BWR AAA+	**Outlook: Stable**

Brickwork Ratings has assigned BWR AAA+ (Pronounced BWR Triple A Plus) for Punjab National Bank's (PNB) Innovative Perpetual Debt Instrument (IPDI) issue of INR 700 crore or INR 7.00 billion. Brickwork Ratings' 'BWR AAA+' stands for an instrument that is considered to offer the BEST credit quality in terms of timely servicing of debt obligations. The rating factored consistently strong performance of the bank, comfortable capital adequacy, low leverage, higher operating profits, substantial access to low cost deposits, improving asset quality, well diversified credit portfolio, healthy earning assets, and the Government of India's ownership stake.

Despite economic slow down in the domestic market and financial crises in the international market, the bank has performed very well during the financial year 2009. As a result, PNB has posted a robust growth in total business coupled with improving assets quality during FY 09. With a growth rate of 27.50%, the bank has reached INR 3644.63 billion total business as on 31st March 2009. The bank managed to achieve this result by suitably modifying its existing products and services and leveraging technology platform.

PNB's total deposits grew by 26.01% to reach a level of INR 2097.60 billion in FY09. Similarly, the bank's advances increased by 29.45% to INR 1547.03 billion. The bank has taken concerted efforts to build diversified credit portfolio to ensure the credit quality. As a result, the bank's asset quality has improved during FY09. The bank's gross and net NPAs stood at 1.77% and 0.17% respectively lower than the previous year figure of 2.74% and 0.64% and also 6 and 51 bps lower than that of peers' gross (1.83%) and net NPAs (0.68%).

During FY 09, the bank's capital adequacy ratio stood at 14.03% under Basel II, which is 52 bps higher than its peers' average of 13.51%. Similarly, Tier I capital at 8.98%, which is 72 bps higher than its peers' average of 8.26%. Overall, the bank's capitalization has been stable and should enable the bank to sustain its growth momentum in the near term.

PNB's low cost deposits mix, (CASA) at 38.82% was highest among its peers, mainly driven by the bank's aggressive savings and current account marketing and branch expansion in rural and semi urban areas. As a result, the bank's CASA was 6.85% higher than its peers' average of 31.87%.

A special feature of Brickwork analysis is the assessment of leverage of the bank to assess its relative strength. Brickwork calculates leverage that assesses bank's capital adequacy with reference to both on and off balance sheet exposures. PNB's lower leverage of 18.81 is positive compared to its peer group's 22.81 as on 31st March 2009.

Table I: Punjab National Bank's Growing Strengths

Criteria (INR Billion)	FY 09	FY 08	FY 07
Total Assets	2469.18	1990.20	1624.22
Deposits	2097.60	1664.57	1398.59
Advances	1547.02	1195.01	965.96
Investments	633.85	539.91	451.86
Income			
Net Interest Income	70.31	55.34	52.13
Non-Interest Income	29.19	19.97	10.42
Profit			
Operating Profit	57.44	40.06	36.17
Net Profit	30.90	20.64	15.40
Non-Performing Assets			
Gross NPAs	1.77%	2.74%	3.45%
Net NPAs	0.17%	0.64%	0.76%
CRAR	14.03%	13.46%	12.29%
Tier I	8.98%	8.97%	8.93%
ROA	1.39%	1.15%	1.03%
ROE	23.52%	19.00%	15.19%
Cost to Income Ratio	42.27%	46.81%	47.90%

Despite many challenges witnessed in the domestic market such as interest rate volatility and subdued credit growth, PNB managed to sustain its growth momentum during FY09. As a result, the bank reported asset base of INR 2,469.18 billion and off-balance sheet exposure of INR 1036.50 billion as on 31st March 2009. The bank has been showing progressive growth in asset base over the years, aided by a robust growth in deposits. Consequently the bank has achieved 24.06% growth in total assets and had share of 5.2% of the total business done by scheduled commercial banks in FY 09.

PNB has the second largest distribution channel in the country next only to SBI. Two thirds of distribution channels are located in the rural and semi-urban areas, which provide excellent reach to less banked areas. Aided by this, the bank's total deposits have increased to INR 2097.60 billion, a growth of 26.01% as on 31st March 2009, compared to INR 1664.57 billion, a year ago. While the bank's low cost deposits base have increased (in absolute terms) to INR 814.39 billion in FY 2009 from INR 714.60 billion in FY08. However, the share of low cost deposits base have decreased in percentage terms to 38.82% in FY09 as against 42.99% a year ago. PNB's term deposits account only for 61.18% of total deposits, a positive factor vis-a vis the peers.

The bank has achieved impressive credit growth of 29.45% to reach INR 1547.02 billion in FY09 from the previous level of INR 1195.01 billion. The bank has created specialized credit disbursement channels such as large corporate branches, SME branches, retail loan hubs, agriculture finance and trade finance to speed up the loan processing and delivery. Besides, it was actively monitoring the interest rate movements and was aligning the interest rate on loans with market strategy.

The term loan component at 52.60% (FY09) is higher than the previous year figure of 49.53%. However, the bank managed to reduce unsecured loan exposure as a percentage of total loans by 2.94% during the year from 16.82% in FY08 to 13.88%. The bank has posted decent retail credit growth of 16.2% to reach INR 250.12 billion. While, the priority sector credit increased to INR 507.93 billion and its agriculture loan-book stood at INR 240.57 billion with a growth rate of 19.72%.

As on 31st March 2009, the bank's investment portfolio stood at INR 633.85 billion with a growth rate of 17.39% despite the turbulent financial environment. With 86% of investments in government and approved securities, the bank's investment portfolio looked stable during FY09. The bank has streamlined the investment appraisal for non-SLR investments and has put in place requisite risk management systems for investment operations. Despite the volatile investment climate in FY09, judicious handling of investment portfolio resulted in a good 7.1% yield on investments.

With total income of INR 222.45 billion during FY 09 (as against INR 162.62 billion in FY08), reflecting the considerable improvement in core banking operations (35.4%), strong growth in treasury income (50.5%) and significant fee based activities(24.5%). The bank's net interest income has registered an impressive growth rate of 27.05% to reach INR 70.31 billion during FY09.

Table II: Punjab National Bank Financials

Financials (INR Billion)	2008-09	2007-08
Interest Income	193.26	142.65
Interest Expenses	122.95	87.30
Net Interest Income	**70.31**	**55.35**
Non-interest Income	29.19	19.97
Operating Income	**99.50**	**75.32**
Employee Expenses	29.25	24.62
Other Operating Expenses	12.82	10.64
Operating Profits	**57.43**	**40.06**
Provisions & Contingencies	26.53	19.58
Profit After Tax	**30.90**	**20.48**

The bank's profitability has increased during FY09, which is largely driven by robust growth in the core banking operations, healthy earning assets and a robust growth in non-interest income. As a result, the bank's net profit also increased to INR 30.90 billion from INR 20.48 billion during FY 08, with an impressive growth of 55.85% over the previous year.

With appropriate credit risk management practices, the bank's asset quality has been improving over the years. As a result, the bank's gross NPAs had come down to 1.77% as on 31st March 2009 from 2.74% for the same period a year ago. Similarly, the net NPAs declined to 0.17% in FY09 from 0.64% in FY08. The declining trend in the non-performing assets was seen not only in percentage terms, but also in absolute level. The bank's gross NPAs stood at INR 27.67 billion in FY09, lower by a significant 16.63% compared to INR 33.19 billion in FY08. The net NPAs had come down significantly by 64.98% in FY09 to INR 2.64 billion in FY09 from INR 7.54 billion in FY08. While containing the fresh slippages, the bank also provided better provisions of 90.47% for non-performing assets during the year. Specialized recovery branches, account-specific strategies, and continuous monitoring have yielded appreciable results with the bank making cash recovery of INR 13.68 billion in FY09.

With effect from 31st March 2008, the bank has migrated to Basel II norms. The bank has registered total capital adequacy ratio of 14.03% under Basel II as on 31st March 2009 compared to 13.46% for the same period a year ago. Further, the bank's tier-I capital ratio has marginally increased to 8.98% from the previous year figure of 8.97%.

During FY 09, the bank's Return on Assets (ROA) had improved significantly to 1.39% as compared to 1.15% in FY08. The bank's Return on Equity (ROE) has shown a similar trend, which has increased to 23.52% as on 31st March 2009 as against 19.00%. The bank has been growing its overseas business presence judiciously. As on 31st March 2009, the bank has presence in 8 countries.

PNB is the first public sector bank to implement core banking solution on Finacle. Further, the bank has covered all the branches under CBS platform including extension counters. As a result, 38 million PNB's customers are enjoying the facility of "one bank – one account". In addition, the bank has intended to build a data center capable of handling business of 6000 branches and 1 lakh terminals. The bank was awarded "IBM green award" for adopting environment friendly technology for data warehouse implementation during the year.

Table III: Punjab National Bank Vs Peer Group

Key Ratios	PNB	Peers
Capital Adequacy		
CRAR (Basel II)	14.03%	13.51%
Tier I (Basel II)	8.98%	8.26%
Asset Quality (As % of Advances**)**		
Gross NPAs	1.77%	1.83%
Net NPAs	0.17%	0.68%
Loan Loss Coverage	90.47%	72.54%
Earnings		
NIM	3.62%	2.77%
Non-Interest Income (INR Billion)	29.20	21.34%
ROA	1.39%	1.07%
ROE	23.52%	22.30%
Cost to Income Ratio	42.27%	44.68%
Liquidity		
CASA	38.82%	31.87%
Credit Deposit Ratio	73.75%	72.65%
Operating Ratios		
Cost of Deposits	6.25%	6.37%
Yield on Advances	11.46%	9.73%

BWR has made a study of the performance of Punjab National Bank vis-à-vis its peers in certain key parameters as given in the table above. BWR rating methodology has defined peer banks as those with closely similar size/operation as the Punjab National Bank.

The bank's capital adequacy has been improving over the years. During FY 09, the bank's capital adequacy ratio under Basel II stood at 14.03%, which is 52 bps higher than its peers' average of 13.51%. Similarly, the bank's Tier I capital stood at 8.98%, which is significantly (72 bps) higher than its peers' average of 8.26%. The bank's proposed IPDI issue of INR 7 .00 billion would improve the capital adequacy further.

In a disturbed financial environment, asset quality is concern for the banks. During FY09, the PNB made sustained efforts not only to reduce the NPAs in the percentage terms, and also reduce it in the absolute terms. As a result, the bank's gross and net NPAs have reduced to 1.77% and 0.17% respectively during the year. Further, the bank's gross NPAs were lower (6 bps) than its peers' average of 1.83%. Similarly, the net NPAs were 51 bps lower than its peers' average of 0.68%. The bank has consistently maintained better NPAs provisions over the years. During FY 09, the bank's loan loss provision stood at 90.47%, which is 17.93% higher than its peers.

PNB's net interest margin is one of the best in the Industry. Net interest margin (NIM) was significantly (85 bps) higher than its peers' average of 2.77%.

The bank has posted an impressive non-interest income during the year. As a result, the bank's non-interest income grew by 46.22% to INR 29.20 billion, which is INR 7.86 billion higher than its peers.

The bank's return on assets (1.39%) and return on equity (23.52%) were 32 bps and 132 bps higher than its peers' average of 1.07% and 22.30% respectively. Further, the cost to income ratio stood at 42.27% during the year, which is 241 bps higher than its peers' average.

With two-third of branches in rural and semi-urban areas, the bank was able to generate more low cost deposits than its peers over the years. Nevertheless, the bank's low cost deposits had come down to 38.82% in FY 09 as against 42.98% for the same period a year ago, however, the bank low cost of deposits still best among its peers which is 6.95% higher than its peers. As a result, the bank's yield on advances was 173 bps higher than its peers' average of 9.73%. Overall, PNB has outperformed the peers in all key parameters considered by Brickwork

Other Observations:

Keeping in view the global economic crisis, RBI permitted banks to restructure loan accounts which face temporary cash flow problems. Accordingly the bank has restructured nearly 11,850 accounts, involving amount of INR 36.50 billion during FY09. The restructured loan is about 2.36% of the total advances. The extent of restructuring is in line with prevailing trend in the industry.

The bank has appropriate risk management practices in place for containing NPAs and improving credit quality and take steps to protect the asset quality with continuous monitoring on loan origination, pre and post disbursement exercises.

Bank Profile:

Incorporated in 1895, the bank continues to have frontline position in the Indian banking industry. Punjab National Bank is ranked 190th among world's top financial brands by 'The Banker'. As on 31st March 2009, the bank's distribution channel consists of 4,427 domestic branches, 238 extension counters, 3 overseas branches, and 2150 ATMs. During the year, the bank has opened 163 branches and 634 ATMs. With 100% CBS branches, the bank provides 'anytime anywhere' banking facility to all the customers.

Table IV: PNB Shareholding Pattern:

Shareholders	Stake
Government of India	57.80%
Financial Institutions	21.05%
Foreign Institutional Investors	14.86%
Retail	6.29%

Industry Snapshot:

Over the years, Indian banking sector has benefited from a stable macro economic environment with unparallel systemic support from the Indian government. Financial year 2009 witnessed deterioration in the global financial condition, which tightened the liquidity position and affected the credit off-take. Nevertheless, Indian banking sector has skillfully tided over the crises with ample support and measures to stimulate the economy from the government and RBI.

As scheduled, the banks have successfully implemented the Basel II norms during financial year 2009 in spite of financial crises in the domestic market. The public sector banks especially have shown a positive growth on account of proactive measures taken by the government during the year.

While economic activity seems to be picking up, Indian banking industry is gearing for a notable operational growth. Nonetheless, continuous monitoring and timely corrective action would be necessary as the crises have not been fully blown over and weakness felt earlier could have repercussion on growth, margins etc. for some more time to come. While leveraging the banking technology, the banks will also resort to cross-selling and up-selling of various products and services to increase their revenues.

Rating Outlook:

Brickwork Ratings (BWR) issue rating is based on CAMEL-TP framework, which is used to assess the bank's financial fundamentals and risk exposures. The BWR AAA+ (Stable) rating assigned is specific to the Innovative Perpetual Debt Instrument (IPDI) issue of INR 700 crore or INR 7.00 billion. The rating factored consistently strong performance of the bank, comfortable capital adequacy, low leverage, higher operating profits, strong low cost deposits, improving asset quality, well diversified credit portfolio, healthy earning assets, and the Government of India's ownership. Brickwork expects that the on going economic crises in the domestic market, restructured assets quality, tightening liquidity condition and worsening financial crises in the international markets could put pressure and impact margins of the banking industry in the near term. However, PNB's improving assets quality, earnings, wide spread distribution channel, strong base of advances and deposits, comfortable capital adequacy, and efficient risk management practices are positive factors, which are expected to help the bank to maintain its current growth momentum. As such, Brickwork has assigned **"Stable"** Outlook for the bank's proposed issue.

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