June 15, 2017

Punjab National Bank

Summary of rated instruments

Instrument *	Rated Amount (Rs. crore)	Rating Action
Infrastructure Bonds Programme	3,000	[ICRA]AA+ (Stable); reaffirmed
Lower Tier II Bonds	2,149	[ICRA]AA+ (Stable); withdrawn
Basel III Compliant Tier II Bonds	1,000	[ICRA]AA+ (hyb) (Stable); reaffirmed
Certification of Deposits Programme	60,000	[ICRA]A1+ ; reaffirmed
Fixed Deposit Programme	-	MAAA (Stable); reaffirmed

*Instrument details in annexure 1

Rating action

ICRA has reaffirmed the rating of [ICRA]AA+ (pronounced ICRA double A plus)[†] for the Rs. 3,000 crore infrastructure bonds programme of Punjab National Bank (PNB). ICRA has also reaffirmed the [ICRA] AA+ (hyb) rating for the Rs. 1000 crore Basel III compliant Tier II bonds of PNB. ICRA has withdrawn the rating assigned earlier to the Rs. 2,149 crore lower Tier – II bonds of the bank, as there is no amount outstanding against the rated instrument as these have been redeemed.

ICRA has also reaffirmed the rating of MAAA (pronounced M triple A) for the fixed deposits programme and of [ICRA]A1+ (pronounced ICRA A one plus) for the Rs. 60,000 crore certificate of deposits programme of PNB. The outlook on the long term and medium term ratings is stable.

The letters “hyb” in parenthesis suffixed to a rating symbol stand for “hybrid”, indicating that the rated instrument is a hybrid subordinated instrument with equity-like loss-absorption features; such features may translate into higher levels of rating transition and loss-severity vis-à-vis conventional debt instruments. The rated Tier-II bonds are expected to absorb losses once the point of non-viability (PONV) trigger is invoked.

Rationale

The ratings derive comfort from PNB’s majority sovereign ownership, its strong franchise translating into a healthy and stable deposits base, its comfortable liquidity profile, and adequate current capitalisation. The ratings also take into account the bank’s relatively better core operating profitability[1] in comparison with other public sector banks (PSBs) driven by its higher fee income and lower operating costs, which provides some cushion to absorb higher credit provisioning given the elevated level of its stressed assets.

The ratings are however constrained by the continued weakness in the bank’s asset quality, with the high fresh non-performing assets (NPA) generation during Q4FY2017 and FY2017 resulting in high level of stressed advances despite an improvement in recoveries and upgrades during FY2017. Weak asset quality also translates into a weak solvency profile. Hence, despite its better operating profitability than peers, the bank’s net profitability is expected to remain under pressure because of the elevated credit provisions. ICRA expects the bank’s credit costs to remain high during the next two years, given the high levels of

[†] For complete rating scale and definitions, please refer to ICRA’s website (www.icra.in) or other ICRA rating publications.
[1] Core operating profitability before treasury gains and credit provisions as % of average total assets (ATA)

stressed assets currently and aging of these NPAs; while the bank is likely absorb these credit costs through internal accruals, its net profitability will remain under pressure over the next two years.

PNB's deposit profile is characterised by a stable and healthy CASA base which results in a lower cost of funds. The bank's strong retail franchise also results in a granular deposit base with limited concentration on top depositors. Backed by the strong franchise, deep geographic penetration, competitive cost of funds and adequate capital levels, PNB is well placed to grow its advances while maintaining profitability. While the bank's credit growth remained lower than the industry average in FY2017, it was higher than the PSB average.

With the expectation of profitability pressures and increasing capital requirements under Basel III regulations, PNB would need to raise substantial equity capital (estimated at ~20-30% of its current market capitalisation) over the next two years. However, with enough headroom available to dilute the Government of India's (GoI's) stake, ICRA expects PNB to not be entirely dependent on the GoI to meet its capital requirements. During FY2017, the bank received Rs. 2,112 crore of equity from the GoI and raised Rs. 2,250 crore of Additional Tier I bonds (AT-I bonds).

Key Rating Drivers

Credit Strengths

- Majority GoI ownership (65.03% as on March 31, 2017) provides implicit sovereign support
- Standing in the Indian financial system, by virtue of being among the largest PSBs in terms of total asset base
- Retail franchise with widespread branch network strengthens the deposit profile; healthy proportion of CASA deposits leads to lower cost of funds
- Healthy fee income supports profitability
- Comfortable liquidity backed by the high proportion of retail deposits

Credit Weaknesses

- Continued weakness in asset quality with high fresh NPA generation during Q4FY2017 and FY2017
- Weak solvency profile; profitability to remain under pressure over the next two years
- Sizeable capital required to meet the regulatory requirements under Basel III, given the profitability pressures

Description of key rating drivers:

PNB is the second largest PSB and the fourth largest bank in the Indian banking sector, accounting for 5.4% of the advances and 5.9% of the deposits as on March 31, 2017. PNB's market position is supported by its strong franchise, including a large network of 6,937 branches across India. Given the majority sovereign ownership (65.03% shareholding by the GoI as on March 31, 2017), the GoI has consistently provided capital support to the bank in the past. Most recently, PNB received equity capital of Rs. 2,112 crore in FY2017 and Rs 1,732 crore in FY2016 from the GoI. ICRA notes that there is a strong likelihood of the GoI continuing to support the bank going forward as well, if required.

Supported by its wide branch network, PNB has a stable and high CASA deposit base. The bank's CASA deposits accounted for 42% of its total deposits as on March 31, 2017, which is higher than the PSB aggregate of 37%. The vast retail franchise also results in granularity in the deposit base, as reflected in the bank's top 20 deposits accounting for 3.29% of total deposits as on March 31, 2017 (4.12% as on March 31, 2016), which compares favourably with peers. Granular deposit base and high share of CASA also result in a lower cost of interest bearing funds for the bank; PNB's cost of funds stood at 5.06% in FY2017 (5.54% in FY2016) as compared with 5.66% for the banking sector during FY2017.

During FY2017, PNB's credit growth remained subdued at 2.0%, which though better than the 0.5% growth for PSBs, was considerably lower the industry average of ~4.0%. The bank's gross advances stood at Rs. 4.41 lakh crore as on March 31, 2017 (Rs. 4.32 lakh crore as on March 31, 2016). The growth remained muted on account of a degrowth in advances to large industries, in line with industry trends. Large industries accounted for ~27% of the bank's gross advances as on March 31, 2017 as compared to 28.5% of the advances as on March 31, 2016, resulting in a ~2.1% decline in advances to this segment. Other segments like agriculture, micro-small and medium enterprise, retail and other advances witnessed healthy growths of 6.9%, 1.5%, 14.2% and 1.3% during FY2017 and accounted for 15%, 18.5%, 15% and 12.8% respectively of gross advances as on March 31, 2017 (14.5%, 18.6%, 13.4% and 13% as on March 31, 2016). Given its strong franchise, deep geographic penetration, competitive cost of funds and adequate capital levels, ICRA believes that PNB is better placed to expand its advances while maintaining profitability, in comparison with other PSBs.

Despite the lower cost of deposits, the bank's net interest margins (NIMs) declined in FY2017 to 2.18% of ATA (2.42% in FY2016) mainly on account of interest reversal on NPA accounts. With limited growth in advances and lower NIMs, the bank's net interest income declined marginally by 2% in FY2017. PNB's operating profitability (excluding treasury gains and credit provisions) however remains better than other PSBs because of its higher share of fee based income and lower operating expenses. However, given the elevated credit provisions, the bank's net profitability remains under pressure with return on net worth of 3.73% for FY2017 (-10.66% during FY2016).

PNB's asset quality remained weak with high fresh NPA generation during Q4FY2017 and FY2017. Fresh slippages during Q4FY2017 and FY2017 stood at 7.87% (annualised) and 6.29% during FY2017 and despite an improvement in recoveries and upgrades during the year, the bank's gross and net NPAs stood at 12.53% and 7.81% respectively as on March 31, 2017 (12.90% and 8.59% respectively on March 31, 2016). PNB's NPA levels are higher than those of similarly rated banks. The bank's solvency profile is also weak, with net NPA/net worth[2] of 92% as on March 31, 2017 (100% as on March 31, 2016). With the bank's net NPAs being higher than the risk threshold level of 6% under the prompt corrective action (PCA) framework of the Reserve Bank of India (RBI), PNB is likely to be included in the PCA framework, if decided by RBI and the bank may be required to take corrective actions including raising capital from promoters and increasing the provision cover ratio against NPAs among others.

The marginal reduction in the bank's NPAs during FY2017 was supported by the high level of credit provisioning, write-offs, sale to asset reconstruction companies as well as the marginal increase in advances. The bank's credit provisions stood at 3.1% of average total assets (ATA) during FY2017 (4.31% of ATA in FY2016) and its provision coverage ratio (including technical write-offs) improved to 58.6% as on March 31, 2017 (53.85% as on March 31, 2016). The sale to ARCs stood at Rs. 631 crore during FY2017 as compared with Rs. 734 crore in FY2016. With limited resolution in stressed accounts and aging of the existing NPAs, ICRA expects the bank's credit costs to remain elevated over the next two years, . PNB is likely to absorb these credit costs through internal accruals, its net profitability will remain under pressure. PNB's ability to resolve existing NPAs speedily while containing fresh slippages would remain critical for its credit profile.

[2] Net worth excluding revaluation reserves

Despite the weak profitability, supported by the capital infusion by GoI and the capital raising through AT-I bonds, PNB's capital levels (under Basel III regulations) remained adequate with Common Equity Tier – I (CET-I), Tier I and CRAR of 7.87%, 8.91% and 11.66% as on March 31, 2017 as against 7.87%, 8.41% and 11.28% levels respectively as on March 31, 2016. This is as compared to the minimum regulatory capital requirement of 6.75%, 8.25% and 10.25% respectively as on March 31, 2017. The regulatory capital requirements under Basel III are scheduled to increase in phases till March 31, 2019 and as per ICRA's estimates, PNB would need equity capital of around Rs. 6,500 - Rs. 10,500 crore during FY2018 and FY2019, assuming a 1% cushion over minimum regulatory CET levels and 5-10% growth in risk weighted assets. Additionally, PNB would also need to raise AT-I bonds of around Rs. 3,500 - 4,000 crore during FY2018 and FY2019 to meet the Tier-I capital levels. The equity requirements would increase if the bank maintains a higher capital cushion. The estimated capital required is around 20-30% of the bank's current market capitalisation. With enough headroom available to dilute the GoI's stake, ICRA expects PNB to not be entirely dependent on the GoI to meet the capital requirements.

PNB's liquidity profile is comfortable without any mismatches in the less than 1 year time buckets. Where there exist negative mismatches in the 1-3 year bucket, ICRA expects PNB to plug them comfortably.

Analytical approach:
For arriving at the ratings, ICRA has assessed that standalone credit profile of the bank and has also taken into account its majority sovereign ownership.

Links to applicable criteria
Bank Credit Rating –A Note on Methodology
Basel III Compliant Non Equity Rating - A Rating Methodology

About the bank

Punjab National Bank (PNB) was incorporated as Punjab National Bank Limited in 1894 and commenced operations from Lahore in April 1895. Upon nationalisation in 1969, the bank was renamed as Punjab National Bank. As on March 31, 2017, GoI held 65.03% equity in the bank. PNB operated 6,937 domestic branches and 10,681 ATMs as on March 31, 2017. The bank has a strong presence in rural and semi-urban areas, where around 63% of its branches were located as on December 31, 2016. During FY2017, the bank reported a net profit of Rs. 1,325 crore on a total asset base of Rs. 713,982[3] crore as on March 31, 2017 as against a loss of Rs. 3,974 crore on a total asset base of Rs. 665,818 crore as on March 31, 2016. PNB's gross and net NPAs stood at 12.53% and 7.81% as on March 31, 2017. The bank reported Tier I capital of 8.91% and CRAR of 11.66% as on March 31, 2017.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

[3] Total assets excluding impact of revaluation reserve

Rating History for last three years

Name of Instrument	Current Rating (FY2018)				Chronology of Rating History for the past 3 years			
	Type	Rated amount (Rs. crore)	Amount Outstanding (Rs. crore)	Month-Year & Rating	Month-Year & Rating in FY2018	Month-Year & Rating in FY2016		Month-Year & Rating in FY2015
Lower Tier II Bonds	LT	2,149	-	**June 2017**	**May 2017**	**Feb 2016**	**August 2015**	**Mar 2015**
				Rating Withdrawn	[ICRA] AA+ (Stable)	[ICRA] AA+ (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)
Infrastructure Bonds	LT	3,000	1,800*	[ICRA] AA+ (Stable)	[ICRA] AA+ (Stable)	[ICRA] AA+ (Stable)	[ICRA] AAA (Stable)	[ICRA] AAA (Stable)
Basel III compliant Tier II Bonds	LT	1,000	1,000	[ICRA] AA+ (hyb) (Stable)	[ICRA] AA+ (hyb) (Stable)	[ICRA] AA+ (hyb) (Stable)	[ICRA] AAA (hyb) (Stable)	[ICRA] AAA (hyb) (Stable)
Certificate of Deposits	ST	60,000	-	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+
Fixed Deposits Programme		-	-	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)

* balance Rs. 1,200 crore is yet to be placed

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1

Details of Instrument

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Current Rating and Outlook
Basel III compliant Tier II bonds	February 24, 2014	9.65 %	February 24, 2024	1,000.00	[ICRA]AA+ (hyb) (Stable)
Infrastructure Bonds	March 24, 2015	8.35 %	March 24, 2025	1,800.00	[ICRA]AA+ (Stable)
Lower Tier – II Bonds	Redeemed on Maturity			2,149.00	[ICRA]AA+(Stable) (Withdrawn)

Source: Punjab National Bank

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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