Punjab National Bank

March 13, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Basel III Compliant Tier II Bonds	1,000.00	1,000.00	[ICRA]AA-(hyb) (Stable); reaffirmed and outlook revised to Stable from Negative
Infrastructure Bonds Programme	3,000.00	3,000.00	[ICRA]AA- (Stable); reaffirmed and outlook revised to Stable from Negative
Fixed Deposit Programme	-	-	MAA (Stable); reaffirmed and outlook revised to Stable from Negative
Certificates of Deposit	60,000.00	60,000.00	[ICRA]A1+; reaffirmed
Total	**64,000.00**	**64,000.00**	

**Instrument details are provided in Annexure-1*

ICRA has reaffirmed the long-term rating for the Rs. 1,000-crore[1] Basel III Tier II bonds and Rs. 3,000-crore infrastructure bonds programme of Punjab National Bank (PNB)[2] at [ICRA]AA- (hyb) (pronounced as ICRA double A minus hybrid) and [ICRA]AA- (pronounced as ICRA double A minus). ICRA has also reaffirmed the medium-term rating for the bank's fixed deposits programme at MAA (pronounced as M double A) and the short-term rating for its Rs. 60,000-crore certificates of deposit programme at [ICRA]A1+ (pronounced as ICRA A one plus). The outlook on all the long-term ratings and the medium-term rating has been revised to Stable from Negative.

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 revision in the outlook factors in the sizeable capital infusion of Rs. 14,156 crore by the Government of India (GoI) in FY2019 as a part of its recapitalisation programme for public sector banks (PSBs). Following this, ICRA expects PNB's capital ratios (including the capital conservation buffer - CCB[3]) to remain above the regulatory requirement as on March 31, 2019. Further, the bank's asset quality profile is expected to improve with net non-performing assets (NNPAs) expected to decline to ~7.5% as on March 31, 2019 from 11.22% as on March 31, 2018, and the provision coverage ratio (PCR)[4] expected to improve to ~58% from 43.8% as on March 31, 2018. The bank also demonstrated a decline of 11% in risk-weighted assets (RWAs) between March 2018 and December 2018 by focusing on better-rated customers while maintaining the level of advances, which also led to an improvement in the capital ratios. Fresh slippages continued to decline on a sequential basis every quarter and are expected to decline further as PNB focuses on better-rated customers. With declining slippages and improving provisioning cover and without factoring in any divestments, ICRA

[1] 100 lakh = 1 crore = 1 million
[2] For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating publication
[3] CCB as on March 31, 2019 = 1.875%; this will increase to 2.5% as on March 31, 2020
[4] PCR value is excluding technical write-offs

expects PNB to report profitable operations in FY2020. However, the return on net worth (RoNW) may remain low at 3-5% as the credit provisions will remain elevated in FY2020.

Though the slippages and NNPAs continue to decline, the asset quality and solvency (net NPA/net worth) are expected to remain weak as on March 31, 2019 with estimated NNPAs of ~7.5% and solvency of ~74%. However, these will continue to improve with declining slippages and improved net worth as internal accruals improve. The NNPAs and solvency are expected to improve further to below 5% and 45%, respectively, by March 2020 compared to 8.22% and 87.14%, respectively, as on December 31, 2018.

Further, the bank is expected to start pursuing credit growth in FY2020. Considering this along with 5-7% growth in RWAs, ICRA estimates PNB's capital requirement at Rs. 4,500-6,500 crore (14-20% of the current market capitalisation) in FY2020, assuming it maintains a cushion of 50 basis points (bps) over the regulatory Tier I of 9.50% as on March 31, 2020. If the bank pursues higher credit growth, its capital requirement would increase. To raise capital, the bank has stated its plans to divest its non-core assets, PNB Housing Finance Limited (rated [ICRA]AA+(Stable)) and PNB MetLife, which can meet a sizeable portion of the estimated capital requirement. If the bank is able to raise the requisite capital, the solvency levels will improve further by March 2020.

The ratings continue to be supported by PNB's sovereign ownership, its established presence and branch network along with its strong deposit profile. PNB is the second-largest PSB and the fourth-largest bank in the Indian banking sector in terms of asset size as on December 31, 2018. With a well-established retail franchise, it continues to maintain a stable and high CASA deposit base. As a result, the cost of interest-bearing funds remains below the PSB average.

Outlook: Stable

The Stable outlook factors in ICRA's expectations of reduced asset quality pressure, improving solvency levels and expectations of improved earnings indicators in FY2020. The outlook will be revised to Positive if the bank is able to demonstrate an improvement in the asset quality, capitalisation and solvency levels, as per ICRA's estimates, by limiting fresh slippages. The outlook will, however, be revised to Negative on weaker-than-expected performance because of higher-than-estimated slippages, which may lead to weak profitability and capital erosion, and if the same is not restored by sufficient capital infusion.

Key rating drivers

Credit strengths

Sovereign ownership with demonstrated capital support from GoI – PNB has a majority sovereign ownership with the GoI's shareholding standing at 70.22% as on December 31, 2018, up from 62.2% as on March 31, 2018. The increase in the GoI's shareholding was on account of the capital infusion of Rs. 8,248 crore in 9M FY2019 (the GoI had earlier infused Rs. 5,473 crore in FY2018). With PNB receiving additional capital of Rs. 5,908 crore in February 2019 (total GoI capital infusion of Rs. 14,156 crore in FY2019), the GoI's shareholding should go up further from the December 31, 2018 level. As the bank has sizeable non-core assets which can be monetised, ICRA expects limited dependence on the GoI for capital support in FY2020. However, given the demonstrated funding support in the past, ICRA expects the GoI to provide capital support in FY2020 as well, in case of any shortfall in meeting the regulatory capital ratios as on March 31, 2020.

Established franchise with widespread branch network aids in high and stable CASA deposits; cost of funds lower than PSB average – PNB is the second-largest PSB and the fourth-largest bank in the Indian banking system, aided by its strong franchise, including a large network of branches across India. Supported by an established retail franchise, PNB has maintained a stable and high CASA deposit base. CASA deposits accounted for 43.42% of total domestic deposits as on December 31, 2018 against 41.31% as on December 31, 2017 and were higher than the PSB average of ~39%. The vast retail franchise also results in granularity in the deposit base, as reflected by the bank's top 20 deposits accounting for 4.91% of total deposits as on March 31, 2018 (3.29% as on March 31, 2017). Supported by a high CASA share and a granular deposit base, the bank's cost of interest-bearing funds in 9M FY2019 stood at 4.91% against 5.07% for PSBs, which is a positive.

Credit challenges

Despite declining slippage rate, asset quality remains weak; incremental stress expected to reduce going forward – The annualised slippage rate continued to decline with annualised fresh slippages of 4.1% and 5.9% in Q3 FY2019 and 9M FY2019, respectively, compared to 11.45% in FY2018. Supported by improved recoveries and upgradation of Rs. 16,608 crore (Rs. 5,617 crore in FY2018) and sizeable write-offs of Rs. 9,274 crore, the gross NPA reduced to Rs. 77,733 crore (16.31%) as on December 31, 2018 from Rs. 86,620 crore (18.36%) as on March 31, 2018. Supported by a large capital infusion from the GoI, the bank also improved the PCR to 54.1% as on December 31, 2018 from 43.8% as on March 31, 2018, thereby reducing its NNPAs to 8.21% from 11.22% during the abovementioned period. Going forward, ICRA expects the NNPAs to decline further to 7.5% and the PCR to improve to a level of ~58% by March 2019. Assuming a slippage rate of 2-3% and a provision cover of 70-72% by the end of FY2020, ICRA estimates the NPPA to fall below 5% by March 31, 2020. With lower NPAs and higher net worth (due to improved internal capital generation), the solvency is expected to improve to ~74% as on March 31, 2019 and to ~45% by March 2020 from 87.14% as on December 31, 2018. If the bank can raise the additional capital or undertakes divestments in FY2020, the solvency levels will improve further by March 2020.

9M FY2019 profitability impacted by upfront provisioning on GNPA; expected to improve but remain weak in FY2020 – PNB's profitability profile remained weak with the bank reporting a loss before tax of Rs. 8,137 crore in 9M FY2019 against a loss before tax of Rs. 19,575 crore in FY2018. The bank has fully provided for the large fraud that occurred in February 2018. As a result, the credit provisions remained high at Rs. 15,266 crore (4.69% of ATA) in 9M FY2019.

Despite reporting a loss before tax, PNB's operating profit[5] improved in 9M FY2019 to Rs. 9,540 crore (1.69% of ATA) from Rs. 7,702 crore for 9M FY2018 (1.39% of ATA) aided by recoveries from NPA accounts. The improvement in the operating profitability was supported by growth in the bank's net interest income (NII) to Rs. 12,956 crore in 9M FY2019 from Rs. 11,859 crore in 9M FY2018, the decline in its operating expenses and the lower cost of interest-bearing funds. As a result, net interest margins (NIMs[6]) improved to 2.30% in 9M FY2019 from 2.14% in 9M FY2018.

Going forward, ICRA expects credit costs to moderate to ~1.9-2.3% of net advances (~1.1-1.4% of ATA) in FY2020 with a provision cover of 70-72% by March 2020. The operating profits are expected to improve, supported by an increase in earning assets and a decline in fresh slippages, which shall result in net profits. However, return on assets (RoA) and RoNW are expected to be weak at 0.1-0.4% and 3-5%, respectively, in FY2020. These estimates do not factor in the gains that can be made by the bank if it is able to divest some of its identified non-core assets.

Capital profile still weak with regulatory as well as growth capital required in FY2020; however, this is expected to be manageable – Upon capital infusion by the GoI, PNB's capital profile improved with capital ratios, i.e., CRAR, Tier I and CET I of 10.52%, 8.25% and 6.93%, respectively, as on December 31, 2018 against the regulatory requirement of 10.875%, 8.875% and 7.375%, respectively, as on March 31, 2019, though the same remained below the regulatory ratios. With additional capital infusion of Rs. 5,908 crore in Q4 FY2019, ICRA expects PNB to be able to meet the

[5] *Operating profits exclude trading profits*
[6] *NIM = Net interest income/Average total assets*

regulatory capital ratios (including CCBs) as on March 31, 2019. However, the capital cushion may not be meaningful as the credit cost can surpass the operating profits.

With expectations of limited capital cushion as of March 2019, increasing regulatory requirements for March 2020 and weak internal accruals for FY2020, PNB will require regulatory as well as growth capital next year, in our view. We also expect the bank to pursue credit growth. With 5-7% growth in RWA and provision cover of 70-72%, ICRA estimates PNB's overall equity capital requirement at Rs. 4,500 – Rs. 6,500 crore (14-20% of the current market capitalisation) in FY2020, so that it can maintain a capital cushion of 50 bps over the regulatory Tier I of 9.50% as on March 31, 2020. If the bank pursues higher credit growth, its capital requirement would increase. To raise capital, PNB has stated its plans to divest non-core assets, especially PNB Housing Finance Limited and PNB MetLife, which can meet a sizeable portion of the estimated capital requirement. If the bank is able to raise the required capital, the solvency levels will improve further by March 2020. Upon divestment of these assets, the remaining capital requirement should be manageable through markets, given the expectation of improved performance going forward. Even in a scenario wherein PNB is unable to raise the required amount, it can conserve capital consumption by keeping the provision cover below the ICRA-assumed level stated earlier and by curtailing growth. Additionally, it should be noted that if the RWA growth is higher or profitability is lower than the above estimates, the capital requirement shall increase and vice versa.

Liquidity position

Supported by its established retail franchise and hence, the high share of stable deposits, PNB's liquidity coverage ratio (LCR) remained adequate at 138.14% as on December 31, 2018 (on a consolidated basis) against the regulatory requirement of 100% as on January 01, 2019. As per the structural liquidity statement as on March 04, 2019, the bank had positive cumulative mismatches across most of the maturity buckets and the negative cumulative mismatch was limited at ~2% (of the total outflows) in the up to 1-year bucket. ICRA expects PNB to maintain satisfactory liquidity, given the steady core deposit base of CASA and retail deposits. Moreover, the bank has been holding excess SLR of ~5% of the net demand and time liability (NDTL) on an average fortnightly basis in 9M FY2019, which provides further liquidity cushion. The bank can also avail liquidity support from the RBI (through reverse repo against excess SLR investments and the marginal standing facility scheme) in case of urgent liquidity needs.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for Banks Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	The ratings factor in PNB's sovereign ownership and demonstrated track record of capital infusion by the GoI. ICRA expects the GoI to support PNB with capital infusions, if required
Consolidation/Standalone	To arrive at the ratings, ICRA has considered the standalone financials of PNB

About the company

Punjab National Bank (PNB) was incorporated as Punjab National Bank Limited in 1894 and commenced operations in Lahore in April 1895. Upon nationalisation in 1969, the bank was renamed Punjab National Bank. As on December 31, 2018, the GoI held 70.22% equity in the bank. As on December 31, 2018, PNB had 7,001 domestic branches and 9,326 ATMs. The bank has a strong presence in rural and semi-urban areas, where around 62% of its branches were located as on December 31, 2018. The bank reported a loss before tax of Rs. 8,137 crore in 9M FY2019 on a total asset base of Rs.

7.44 lakh crore as on December 31, 2018 against a net profit of Rs. 1,134 crore in 9M FY2018 on a total asset base of Rs. 7.61 lakh crore as on December 31, 2017. PNB's gross and net NPAs stood at 16.31% and 8.21%, respectively, as on December 31, 2018. The bank reported Tier I capital of 8.25% and CRAR of 10.52% as on December 31, 2018.

Key financial indicators (standalone)

	FY2017	FY2018	9M FY2018	9M FY2019
Net interest income	14,993	14,922	11,859	12,956
Profit before tax	2,011	-19,575	1,225	-8,137
Profit after tax	1,325	-12,282	1,134	-5,227
Net advances	4,19,493	4,33,735	4,52,110	4,34,399
Total assets	7,16,580	7,60,442	7,61,571	7,44,122
% CET 1	7.87%	5.95%	8.05%	6.93%
% Tier 1	8.91%	7.12%	9.16%	8.25%
% CRAR	11.66%	9.20%	11.58%	10.52%
% Net interest margin	2.17%	2.02%	2.14%	2.29%
% PAT / ATA	0.19%	-1.66%	0.20%	-0.93%
% Return on net worth	3.48%	-33.18%	3.69%	-17.79%
% Gross NPAs	12.53%	18.36%	12.10%	16.31%
% Net NPAs	7.81%	11.22%	7.54%	8.22%
% Provision coverage excl. technical write-offs	40.94%	43.80%	40.76%	54.11%
% Net NPA/ Net worth	85.84%	126.54%	78.10%	87.14%

Note: Amount in Rs. crore; Net worth and total assets exclude revaluation reserves
Source: PNB, ICRA research
All calculations are as per ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Sr. No.	Name of Instrument	Current Rating (FY2019)				Chronology of Rating History for the Past 3 Years							
		Type	Rated amount (Rs. crore)	Amount outstanding (Rs. crore)	Mar 2019	May 2018	FY2018				FY20		FY2015
							Mar 2018	Feb 2018	June 2017	April 2017	Feb 2016	August 2015	March 2015
1	Basel III Compliant Tier II Bonds Programme	Long Term	1,000	1,000	[ICRA]AA- (hyb) (Stable)	[ICRA]AA- (hyb) (Negative)	[ICRA]AA+ (hyb)@	[ICRA]AA+ (hyb)@	[ICRA]AA+ (hyb) (Stable)	[ICRA]AA+ (hyb) (Stable)	[ICRA]AA+ (hyb) (Stable) Downgraded	[ICRA]AAA (hyb) (Stable)	[ICRA]AAA (hyb) (Stable)
2	Infrastructure Bonds Programme	Long Term	3,000	1,800^	[ICRA]AA- (Stable)	[ICRA]AA- (Negative)	[ICRA]AA+ @	[ICRA]AA+ @	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable) Downgraded	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
3	Certificates of Deposit Programme	Short Term	60,000	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Term Deposits Programme	Medium Term	NA	NA	MAA (Stable)	MAA (Negative)	MAAA@	MAAA@	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)

^ Rs. 1,200 crore of bonds yet to be placed
@ Ratings on Watch with Negative Implication

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: Instrument details

ISIN No.	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE160A08019	Basel III Compliant Tier Bonds Programme	February 24, 2014	9.65%	February 24, 2024	1,000.00	[ICRA]AA- (hyb) (Stable)
INE160A08084	Infrastructure Bonds	March 24, 2015	8.35%	March 24, 2025	1,800.00	[ICRA]AA- (Stable)
-	Infrastructure Bonds	Not Placed	-	-	1,200.00	[ICRA]AA- (Stable)
NA	Certificates of Deposit Programme	-	-	7-365 days	60,000.00	[ICRA]A1+
NA	Term Deposits Programme	-	-	-	-	MAA (Stable)

Source: PNB

ANALYST CONTACTS

Karthik Srinivasan
+91 22 6114 3444
karthiks@icraindia.com

Anil Gupta
+91 124 4545 314
anilg@icraindia.com

Shashank Singh
+91 124 4545 386
shashank.singh@icraindia.com

Niraj Jalan
+91 33 7150 1146
niraj.jalan@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents