January 29, 2025

PNB Gilts Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous rated amount (Rs. crore)	Current rated amount (Rs. crore)	Rating action
Commercial paper programme	1,000.00	1,000.00	[ICRA]A1+; reaffirmed
Inter-corporate deposits	1,000.00	1,000.00	[ICRA]A1+; reaffirmed
Total	**2,000.00**	**2,000.00**	

**Instrument details are provided in Annexure I*

Rationale

The rating for PNB Gilts Limited's debt programme continues to factor in its superior liquidity profile, as reflected by the significant share of liquid Government securities (G-Secs) in the overall assets, and its access to call money and repo borrowings from the market, apart from access to a standing liquidity facility (SLF) from the Reserve Bank of India (RBI). The share of non-statutory liquidity ratio (SLR) securities has also remained restricted to highly rated corporate bonds. Further, PNB Gilts has adequate safeguards, as mentioned in the business policy document, to monitor interest rate, liquidity and credit risks. Given its sizeable net worth, the company also has a satisfactory cushion to withstand the impact of any adverse interest rate movements, resulting in a strong capitalisation profile. PNB Gilts has strong parentage in the form of Punjab National Bank (PNB; rated [ICRA]AAA (Stable)/[ICRA]A1+ for its Basel III Tier II bonds).

ICRA notes the susceptibility of PNB Gilts' overall profitability and capitalisation profile to interest rate movements, given its business and the high share of debt securities in the overall assets. Additionally, the company has kept its leverage above the peer average during the last few years, which increases its vulnerability to market risks. This was the case for PNB Gilts, particularly when interest rates were rising, leading to trading losses during FY2022-FY2023. Meanwhile, its net interest income (NII) moderated in FY2024 on account of the increase in the borrowing cost after the hikes in the monetary policy rates.

The debt securities purchased in the low-interest rate environment after the onset of the Covid-19 pandemic started maturing from the end of FY2024, leading to an increase in the NII in H1 FY2025 compared to FY2024. Nevertheless, the short-term rates are expected to remain elevated in H2 FY2025 due to tight liquidity, leading to a high cost of funds for the company. Consequently, the overall NII for H2 FY2025 is likely to moderate compared to H1 FY2025, keeping the overall net interest margins thin in FY2025. Nevertheless, the expected rate cut in H1 CY2025 is expected to provide trading opportunities and mark-to-market (MTM) gains for the company, supporting its profitability.

While PNB Gilts' income remains less diverse and its earnings profile remains susceptible to adverse interest rate movements, as the portfolio largely comprises debt securities, its ability to adhere to its risk management policies, as described by the business policy, will remain critical for the overall profitability. This, along with continued linkages with the parent, and the ability to withstand any adverse regulatory changes for primary dealers (PDs) will remain key monitorable factors.

Key rating drivers and their description

Credit strengths

Subsidiary of PNB with strong linkages – PNB has continued to hold a 74.07% stake in PNB Gilts, even after its listing in FY2001. Strong managerial linkages exist between PNB Gilts and the parent. Its board of directors consists of members who had previously served at PNB and currently includes the bank's Executive Director. PNB's liquidity support is reflected in the sanctioned bank limits of Rs. 1,900 crore. Further, given the shared brand name with the parent, ICRA expects support from the parent to be forthcoming, if required.

Regarding adherence to the operational guidelines set by the RBI for PDs, PNB Gilts achieved a success ratio[1] of 50.34% in the Treasury bills (T-bills) market in H1 FY2025 (44.14% in H1 FY2024 and 40.96% in H1 FY2023), above the regulatory requirement of 40%. It achieved an outright turnover ratio[2] of 4.14% for dated Government securities (G-Secs) in H1 FY2025 (4.48% in FY2024), above the regulatory requirement of 2% (1.5% for FY2024) of the average dated G-Sec outright market turnover during the previous three financial years.

Strong capitalisation profile – PNB Gilts' capital adequacy remains strong with its capital-to-risk weighted assets ratio (CRAR) at 41.75% as on September 30, 2024 (34.02% as of March 2024 and 29.36% as of September 2023), well above the regulatory minimum of 15% for PDs. The daily average leverage was 18.05 times in H1 FY2025 (18.69 times in FY2024).

Given the susceptibility of the profitability and capital profile to interest rate movements, PNB Gilts has a board-approved one day value at risk (VaR) limit of 7.5% of its net owned funds (NOF) for its consolidated fixed income portfolio. The company remained within this limit in H1 FY2025 and FY2024.

The sizeable net worth provides PNB Gilts with a comfortable cushion to absorb any significant shocks in the interest rates. As on September 30, 2024, the company had a net worth of ~Rs. 1,480 crore (NOF of ~Rs. 1,453 crore) and the price value of basis point (PVBP)[3] stood at Rs. 3.8 crore, indicating its ability to absorb adverse movements of 244 basis points (bps) in interest rates while maintaining the CRAR above the regulatory requirement.

Superior liquidity – The company has a large portfolio of highly liquid G-Secs (Central/state government and Government of India (GoI) T-bills). On a daily average basis, investment in G-Secs comprised ~87% of the total assets in H1 FY2025 (~87% in FY2024). Other assets include investments in highly rated corporate bonds. PNB Gilts' corporate debt investment portfolio has also remained well diversified across highly rated corporates and limited in relation to its NOF. The corporate debt investments can be funded through call/notice money (subject to daily average of 225% of NOF at the end of the previous fiscal), commercial paper, inter-corporate deposits (150% of NOF at the end of the previous fiscal) or bank lines. These investments can also be sold to generate liquidity, if required. With funds parked in highly liquid investments, PNB Gilts' overall liquidity remains superior.

PNB Gilts' liquidity is also supported by its access to the money market for call and repo borrowings, apart from sanctioned bank limits of Rs. 1,900 crore from PNB. Though the company's liabilities are largely short term in nature compared to the long tenure of the assets, the liquid nature of the assets mitigates the asset-liability risk.

Adequate internal prudential norms and risk management systems – PNB Gilts faces significant risks because of adverse interest rate movements as well as the exposure to credit risk in non-SLR debt instruments. In this regard, prudent risk management policies and adherence to the same are critical for a PD. ICRA takes comfort from the strong risk management policies as described by the business policy document approved by the company's board with well-defined norms for investments, leverage, portfolio mix, funding, PVBP, VaR limits, stop-loss limits, MTM loss limits and profit-booking limits apart from proper monitoring and adherence to these policies. In addition, as stated by the management, the oversight by the parent in terms of risk management and compliance has increased, which indicates a higher level of integration with the parent's policies.

During the last few years, the leverage limit had increased as per the board-approved policy, adding to the volatility in the profit. Further, the company uses VaR and stress testing tools to monitor and measure the impact of interest rate movements on its portfolio to assess the market risk and ensure that it is within the board-approved limits. The actual VaR largely remained within the approved limits in H1 FY2025 and FY2024.

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[1] ***Success ratio*** *– Bids accepted/Bidding commitment*

[2] ***Outright turnover ratio*** *– Total Company's purchase and sales during the year in the Central G-secs secondary market/ Average Dated G-Sec outright market turnover during the previous three financial years*

[3] ***PVBP*** *measures the gain/loss on the entire portfolio for a 1 bps (0.01%) movement in the interest rate*

As per the risk management policy, investment in non-SLR securities is allowed only for AAA to AA (with reducing limits for lower rating levels) and A1+ rated entities, which mitigates any credit risk. AAA/A1+ rated entities accounted for around 79% of the total non-SLR portfolio by value as on September 30, 2024.

Credit challenges

Low diversity in revenue stream – PNB Gilts' revenue stream is relatively less diversified compared to other PDs, with interest income and trading income accounting for almost 98% of its total revenue in H1 FY2025 (92% in FY2024 and 99% in FY2023). Underwriting and other income was Rs. 4 crore in H1 FY2025 (Rs. 12 crore in FY2024 and Rs. 16 crore in FY2023) because of the lower devolvement of G-Secs on PDs. Going forward, other income will remain linked to the quantum of government borrowing as well as the extent of underwriting commission.

Profitability impacted by steep rise in cost of funds – As PNB Gilts' total portfolio mainly comprises debt securities, its profitability is highly dependent on interest rate movements and the ability to predict the same correctly. This is reflected in the sizeable variation in trading income (including MTM gains/losses) during the past few fiscals because of the movement in bond yields (trading profit of Rs. 142 crore in H1 FY2025 against trading profit of Rs. 14 crore in H1 FY2024, Rs. 50 crore in FY2024 and loss of Rs. 303 crore and Rs. 101 crore in FY2023 and FY2022, respectively).

Apart from trading income, the profitability remains dependent on the NII, which is driven by the interest rate environment. The NII rose to Rs. 105 crore in H1 FY2025 (Rs. 40 crore in H1 FY2024 and Rs. 105 crore in FY2024) on account of the increase in the investment book, the softening of yields, and the maturity of low-yielding short-tenured G-Secs. Hence, trading income and NII will remain susceptible to the volatility in interest rates. Given the higher reduction in the yield on assets compared to the cost of funds, the overall NII for H2 FY2025 is expected to moderate compared to H1 FY2025, keeping the overall net interest margins thin in FY2025. Nevertheless, the likely rate cut in H1 CY2025 is expected to provide trading opportunities and MTM gains for the company, supporting its profitability.

Adverse developments in regulatory framework for PDs – The RBI is the regulatory authority for PDs and has prescribed operational guidelines for underwriting commitments for G-Secs, bidding commitments and success ratios for T-bills, the achievement of minimum turnover ratios and funding support in the form of liquidity adjustment facility (LAF)/SLF. Therefore, any significant change in the regulatory framework for PDs, which adversely impacts the company's operational and financial profile, can affect its funding costs and profitability.

Environment and social risks

As the corporate investments by PDs are generally driven by market opportunities and are not based on lending decisions, a sizeable share largely relates to sovereign entities and service-oriented businesses. Accordingly, the direct exposure of PDs to environmental risks is not material. As for exposure to social risks, the most relevant risk pertains to the ability to attract and retain specialised talent, for which PDs compete with other financial sector companies. Other types of social risks emanating from concerns around responsible production, employee health or safety, labour relations issues, product mis-selling, etc, do not apply to PDs.

Liquidity position: Superior

As PNB Gilts is a PD, the majority of its investments are in highly liquid G-Secs. On a daily average basis, investments in G-Secs comprised ~87% of the total assets in H1 FY2025 (87% in FY2024) while the rest were in highly rated corporate debt securities, which can be liquidated if required. The liquidity is also supported by the company's access to the money market for call and repo borrowings, in addition to the RBI's SLF funding, apart from bank limits of Rs. 1,900 crore from PNB. ICRA expects support from the parent to be forthcoming, if required, to aid the company's liquidity profile.

Rating sensitivities

Positive factors – Not applicable

Negative factors – The rating can be downgraded in case of a dilution in the linkages with PNB and/or if sustained losses result in considerable erosion of the net worth. Moreover, any regulatory change adversely impacting the PD business will remain a key negative trigger.

Analytical approach

Analytical approach	Comments
Applicable rating methodologies	Rating Methodology for Primary Dealers
Parent/Group support	Parent/Group company – PNB The rating factors in the operational, managerial and liquidity support provided by the promoter – PNB
Consolidation/Standalone	To arrive at the rating, ICRA has considered the standalone financials of the company

About the company

PNB Gilts Limited is one of the seven standalone PDs in the Indian G-Secs market. It was incorporated as a wholly-owned subsidiary of PNB and undertakes most of its operations in G-Secs. The range of products and services offered by the company includes T-bills, Central Government dated securities, state government securities, public sector unit (PSU) bonds, inter-corporate deposits, gilt accounts, money market instruments and investment/trading in equity and equity derivatives. In addition, it offers advisory services to clients for managing their G-Sec portfolios. In July 2000, the company launched an initial public offering (IPO), thereby reducing PNB's stake to 74.07%.

The company reported a net profit of Rs. 168 crore in H1 FY2025 on total interest income of Rs. 796 crore compared to a net loss of Rs. 17 crore on total interest income of Rs. 719 crore in H1 FY2024. PNB Gilts achieved a success ratio (ratio of bids accepted to bidding commitment) of 50.34% in the T-bills market in H1 FY2025 (44.14% in H1 FY2024), significantly above the regulatory requirement of 40%.

Key financial indicators

PNB Gilts Limited	FY2023	FY2024	H1 FY2025
Profit after tax (PAT)	-77	69	168
Net worth	1,260	1,330	1,480
Total assets	21,497	24,540	23,198
PAT/Net worth (RoNW)	-6.10%	5.19%	22.70%#
Leverage ratio (daily average; times)	12.2	15.62	15.34

Amount in Rs. crore; # Annualised
Source: PNB Gilts, ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

		Current rating (FY2025)			Chronology of rating history for the past 3 years					
	Instrument	Type	Amount rated (Rs. crore)	Date & rating in FY2025 Jan-29-2025	FY2024		FY2023		FY2022	
					Date	Rating	Date	Rating	Date	Rating
1	Commercial paper	ST	1,000.00	[ICRA]A1+	Jan-19-2024	[ICRA]A1+	Jan-23-2023	[ICRA]A1+	Jan-06-2022	[ICRA]A1+
									Jun-22-2021	[ICRA]A1+
2	Inter-corporate deposits	ST	1,000.00	[ICRA]A1+	Jan-19-2024	[ICRA]A1+	Jan-23-2023	[ICRA]A1+	Jan-06-2022	[ICRA]A1+

Complexity level of the rated instrument

Instrument	Complexity indicator
Commercial paper	Very Simple
Inter-corporate deposits	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument name	Date of issuance/ Sanction	Coupon rate	Maturity date	Amount rated (Rs. crore)	Current rating and outlook
Yet to be placed	**Commercial paper**	Yet to be placed	-	-	1,000.00	[ICRA]A1+
NA	**Inter-corporate deposits***	Jan-22-2025	6.95	Jan-30-2025	25.00	[ICRA]A1+
NA	**Inter-corporate deposits**	Unutilised	-	-	975.00	[ICRA]A1+

*Source: PNB Gilts; *Outstanding as on Jan 29, 2025*

Annexure II: List of entities considered for consolidated analysis

Not applicable

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