

June 22, 2021

## 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
<b>Total</b>	<b>1,000.00</b>	<b>1,000.00</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The rating reaffirmation continues to factor in PNB Gilts Limited's strong parentage in the form of Punjab National Bank (PNB; rated [ICRA]AA(hyb) (Stable)/[ICRA]A1+) and the continued support as depicted in the managerial support received from the bank. The rating reaffirmation also factors in PNB Gilts' strong capitalisation position and large net worth, which provides a satisfactory cushion against adverse interest rate movements given the inherent nature of the primary dealer (PD) business. The rating is also supported by the company's superior liquidity profile, as reflected in the high share of liquid Government securities (G-Secs) in the overall assets and access to call money and borrowings under repo from the market, apart from access to a standing liquidity facility (SLF) from the Reserve Bank of India (RBI) for participating in primary auctions. The share of non-statutory liquidity ratio (SLR) securities has also remained restricted to highly rated corporate bonds. Further, the company has adequate safeguards, as mentioned in the business policy document, to monitor interest rate, liquidity and credit risks.

ICRA, however, notes the less-diversified revenue stream of the company and its high reliance on interest income and trading income with fee income largely comprising underwriting fee on G-Secs. ICRA further notes the susceptibility of the company's overall profitability and capitalisation profile to interest rate movements. With a sharp decline in bond yields in FY2021, PNB Gilts reported a significant improvement in trading profits. This, along with higher leverage (and in turn, a higher investment portfolio) and a decline in funding cost supported by cuts in the reverse repo rate by 155 basis points (bps) to 3.35% during March 2020-May 2020, boosted the overall net interest income (NII) in FY2021. As a result, PNB Gilts' profitability improved in FY2021 with a return on net worth of 35.5% (17.8% for FY2020 and 5.9% for FY2019).

During the last few years, as per the board-approved policy, the leverage limit has increased, which could add to the volatility of the profits. While the stance of the monetary policy is likely to remain accommodative in calendar year (CY) 2021, the scope of decline in policy rates and bond yields remains limited, given the inflationary pressure as well as the large sovereign borrowing programme. Thus, PNB Gilts' ability to adhere to its risk management policies as described by the business policy will remain critical to minimise the impact of adverse interest rate movements. This, along with continued linkages with the parent, and the ability to withstand any regulatory changes for PDs will remain key monitorables.

### Key rating drivers and their description

#### Credit strengths

**Subsidiary of PNB with strong linkages** – As on March 31, 2021, PNB held a 74.07% stake in PNB Gilts. Strong managerial linkages exist between PNB Gilts and the parent. Its board of directors consists of members who had previously served at PNB and includes the Group's Chief Risk Officer for PNB. The bank's liquidity support is reflected in the sanctioned bank lines of Rs. 1,000 crore along with an intraday facility that is available to the PD. 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 for PDs, as set by the RBI, PNB Gilts achieved a success ratio<sup>1</sup> of 42.55% in the treasury bills (T-bills) market in H1 FY2021 and 41.98% in H2 FY2021, above the regulatory requirement of 40%. It achieved an outright turnover ratio<sup>2</sup> of 52.03 times for dated G-Secs in FY2021, above the regulatory requirement of 3 times for outright transactions (and 5 times overall).

**Strong capitalisation profile** – PNB Gilts' capital adequacy remains strong with its capital to risk weighted assets ratio (CRAR) at 45.9% as on March 31, 2021 (32.5% as on March 31, 2020 and 36.6% as on March 31, 2019), well above the regulatory minimum of 15% for PDs. Despite an increase in the leverage, the increase in the CRAR in the last fiscal was mainly due to the decrease in the market risk on the investment portfolio, which, in turn, resulted from a decrease in the duration. The leverage increased in FY2021, in line with the outlook on the interest rates of the PD and the increase in the maximum permissible leverage as per the business policy.

A sizeable net worth provides PNB Gilts with a comfortable cushion to absorb any significant shocks in the interest rates. As on March 31, 2021, the company had a net worth of ~Rs. 1,337 crore (NOF of ~Rs. 1,320 crore) and the price value of basis point (PVBP)<sup>3</sup> stood at ~Rs. 1.1 crore, indicating its ability to absorb large adverse movements of 1,200 bps in interest rates.

**Superior liquidity** – The company has a large portfolio of highly liquid G-Secs (G-Secs, state development loans (SDL) and Govt T-bills). On a daily average, investment in G-Secs comprised ~87% of the total assets in FY2021 against ~86% in FY2020. The other assets include investments in highly rated corporate bonds.

PNB Gilts' non-SLR or corporate debt investment portfolio has also remained well diversified across highly rated corporates and limited in relation to its NOF. Typically, the corporate debt investments have remained limited in relation to its NOF of ~Rs. 1,320 crore as on March 31, 2021 and can be easily funded through call/notice money, commercial paper, inter-corporate deposits or bank lines. These investments can also be sold off to generate liquidity if required. With funds parked in highly liquid investments, the overall liquidity of PNB Gilts remains superior.

PNB Gilts' liquidity is also supported by its access to the money market for call and repo borrowings, in addition to the RBI's liquidity adjustment facility (LAF). Additionally, the company has sanctioned bank limits of Rs. 1,000 crore from PNB (including intraday facility of Rs. 600 crore). 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. PNB Gilts continues to fulfil its regulatory bidding commitments at the primary auctions with minimum success and turnover ratio requirements for dated G-Secs and T-bills.

**Adequate risk management systems** – As it is a PD, 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, value at risk (VaR) limits, stop-loss limits, mark-to-market (MTM) loss limits and profit-booking limits apart from proper monitoring and adherence to these policies.

During the last few years, as per the board-approved policy, the leverage limit has increased, which could add to the volatility of the profits. 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 limits approved by the board. Along with this, the actual VaR largely remained within the approved limits in FY2021 and FY2020.

## Credit challenges

**Low diversity in revenue streams** – 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 FY2021. In FY2021, PNB Gilts reported an uptick in underwriting and other income at Rs. 21.8 crore against Rs. 4.6 crore in FY2020 (mainly attributed to an increase in the underwriting income generated because of the higher Government borrowing programme). With Government borrowing for

<sup>1</sup> **Success ratio** - Bids accepted/Bidding commitment

<sup>2</sup> **Outright turnover ratio** - Total purchase and sales during the year in the secondary market/Average month-end stock

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

FY2022 expected to be elevated, underwriting and other income could remain high, though its share in the total revenue would remain low.

**Profitability susceptible to volatility in interest rate movements and quality of non-SLR book** – PNB Gilts' total portfolio mainly comprises debt securities. As a result, its profitability profile is highly dependent on interest rate movements. This is reflected in the sizeable variation in trading profits (including MTM gains/losses) during FY2019-FY2021 because of the difference in the variation of bond yields (trading profit of Rs. 252.6 crore in FY2021, Rs. 111.5 crore in FY2020, and Rs. 9.0 crore in FY2019). Along with this, non-SLR investments have credit risk, which can adversely impact profitability. For instance, the company had to write off Rs. 75 crore of exposure in the bonds of Dewan Housing Finance Limited (DHFL) and Reliance Home Finance Limited (RHFL) in FY2020. ICRA notes that the vulnerable non-SLR investments are very limited in PNB Gilts' overall investment book.

Apart from trading income, the profitability remains dependent on the NII, which is driven by the interest rate environment. As borrowing costs declined in FY2021, PNB Gilts increased its borrowings and leverage, thereby generating an NII of Rs. 384 crore on the investment portfolio (Rs. 247.2 crore for FY2020). With the sharp increase in the NII and attractive opportunities to generate trading gains, PNB Gilts generated a net profit of Rs. 474.4 crore in FY2021, more than double compared to the previous fiscal (Rs. 185.2 crore in FY2020, Rs. 52.3 crore in FY2019).

The trading profits and NII will remain susceptible to any probable volatility in short-term interest rates, which would then impact the overall profitability. With broad market expectations of an increase in the interest rates over the medium term, the profitability will now hinge upon the NII as trading opportunities dry up.

**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 ratio for T-bills, the achievement of minimum turnover ratios and funding support in the form of LAF/standing liquidity facility (SLF). Therefore, any significant change in the regulatory framework for PDs, which adversely impacts the company's operational and financial profile, can impact its funding costs and profitability.

## Liquidity position: Superior

As PNB Gilts is a PD, the majority of its investments are in highly liquid G-Secs (Gov bonds, SDLs and T-bills). On a daily average, investments in G-Secs comprised ~87% of the total assets in FY2021 against ~86% in FY2020 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/LAF funding. Moreover, PNB Gilts has sanctioned bank limits of Rs. 1,000 crore from PNB, including a Rs. 600-crore intraday facility. Further, ICRA expects support from the parent to be forthcoming, if required, to support 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
<b>Applicable Rating Methodologies</b>	<a href="#">Rating Methodology for Primary Dealers</a> <a href="#">Impact of Parent or Group Support on an Issuer's Credit Rating</a>
<b>Parent/Group Support</b>	Parent/Group Company – Punjab National Bank The rating factors in the operational, managerial and liquidity support provided by the promoter – Punjab National Bank
<b>Consolidation/Standalone</b>	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 primary dealers in the Indian Government Securities (G-Secs) market. It was incorporated as a wholly-owned subsidiary of Punjab National Bank 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%.

In FY2021, the company reported a profit after tax of Rs. 474 crore on total income of Rs. 1,053 crore compared to a profit after tax of Rs. 185 crore on total income of Rs. 883 crore in FY2020. PNB Gilts achieved a success ratio (ratio of bids accepted to bidding commitment) of 42.55% in the T-bills market in H1 FY2021 (41.10% in H1 FY2020) and 41.98% in H2 FY2021 (40.24% in H2 FY2020), just above the regulatory requirement of 40%.

Further, it achieved an outright turnover ratio (ratio of total sales and purchases during the year in the secondary market to average month-end stocks) of 52.03 times for dated G-Secs and 26.05 times for T-bills in FY2021, above the regulatory requirement of 3 times and 6 times, respectively.

## Key financial indicators

PNB Gilts Limited	FY2020	FY2021
Net Interest Income	247	384
Trading Profits (including MTM gain/loss)	112	253
Income from Services, Dividend & Other Income	5	22
Operating Costs	34	39
Profit before Tax (PBT)	248	620
Profit after Tax (PAT)	185	474
Net Worth	1,043	1,337
Borrowings	12,164	9,863
Stock-in-Trade	12,965	10,883
Total Assets	14,249	11,199
PAT/ATA	1.6%	3.8%
PAT/Net Worth (RoNW)	17.8%	35.5%
Leverage Ratio (daily average; times)	10.4	12.2

**Note:** Figures for FY2020 are based on audited numbers while figures for FY2021 are provisional based on PDRs  
Amounts in Rs. crore

**Source:** PNB Gilts, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

### Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the Past 3 Years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019	
					Jun-22-2021	Jun-18-2020	May-15-2020	Aug-23-2019	Sep-21-2018	
1	Commercial Paper	ST	1,000.00	0.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	

\*As on June 07, 2021

### Complexity level of the rated instrument

Instrument	Complexity Indicator
Commercial Paper	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: [www.icra.in](http://www.icra.in)

## Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Commercial Paper	Yet to be placed	-	7-365 Days	1,000.00	[ICRA]A1+; reaffirmed

\*As on June 07, 2021

Source: PNB Gilts

## Annexure-2: List of entities considered for consolidated analysis

Name	Ownership
NIL	NIL

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### Branches



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