January 06, 2022

PNB Gilts Limited: Rating reaffirmed; [ICRA]A1+ assigned to inter-corporate deposits programme

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	[ICRA]A1+; Assigned
Total	**1,000.00**	**2,000.00**	

**Instrument details are provided in Annexure-1*

Rationale

The highest short-term rating on PNB Gilts Limited's debt programme continues to factor in its strong parentage in the form of Punjab National Bank (PNB; rated [ICRA]AA+ (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 significant uptick in the bond yields in H1 FY2022, PNB Gilts reported losses in its trading operations, though this was offset by higher net interest income (NII). The NII was supported by the higher leverage (and in turn, a higher investment portfolio) and moderate funding costs amid the surplus liquidity environment, which boosted the company's overall NII. Even through the profitability moderated in H1 FY2022 compared to the previous year, it remained strong with a return on net worth of 18.1% (38.5% for FY2021 and 19.2% for FY2020).

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. The stance of the monetary policy is likely to be changed from 'accommodative' to 'neutral' in calendar year (CY) 2022 with the expected hike in the policy rates. Market rates and bond yields have already seen an upward movement, 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 September 30, 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 currently include PNB's Executive Director along with the PNB Group's Chief Risk Officer. The bank's liquidity support is reflected in the enhanced sanctioned bank lines of Rs. 1,900 crore including 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[1] of 42.29% in the treasury bills (T-bills) market in H1 FY2022, above the regulatory requirement of 40%. It achieved an outright turnover ratio[2] of 44.69 times for dated G-Secs in H1 FY2022, 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 34.7% as on September 30, 2021 (45.6% as on March 31, 2021 and 32.5% as on March 31, 2020), well above the regulatory minimum of 15% for PDs. With the leverage[3] remaining range-bound at a daily average of 11.1 times in H1 FY2022 compared to 11.8 times during FY2021, the decrease in the CRAR in the last six months was mainly due to the increase in the market risk on the investment portfolio. This, in turn, resulted from an increase in the duration of the bond portfolio. The leverage remained range-bound but at a higher level, given the increase in the maximum permissible leverage as per the business policy as well as the company's effort to maximise the NII.

The sizeable net worth provides PNB Gilts with a comfortable cushion to absorb any significant shocks in the interest rates. As on September 30, 2021, the company had a net worth of ~Rs. 1,384 crore (net owned funds (NOF) of ~Rs. 1,383 crore) and the price value of basis point (PVBP)[4] stood at ~Rs. 7.5 crore, indicating its ability to absorb adverse movements of 185 bps in interest rates.

Superior liquidity – The company has a large portfolio of highly liquid G-Secs (G-Secs, state development loans (SDL) and Government of India (GoI) T-bills). On a daily average, investment in G-Secs comprised ~88% of the total assets in H1 FY2022 (~87% in FY2021). The other assets include investments in highly rated corporate bonds.

PNB Gilts' non-statutory liquidity ratio (SLR) or 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 easily funded through call/notice money (subject to daily average of 50% of NOF), commercial paper, inter-corporate deposits (150% of NOF) 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. 1,900 crore from PNB (including intraday facility of Rs. 1,500 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

[1] ***Success ratio*** *- Bids accepted/Bidding commitment*
[2] ***Outright turnover ratio*** *- Total purchase and sales during the year in the secondary market/Average month-end stock*
[3] ***Leverage*** *– Total debt/Shareholder's equity*
[4] ***PVBP*** *measures the gain/loss on the entire portfolio for a 1 bps (0.01%) movement in the interest rate*

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 H1 FY2022 and FY2021.

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 H1 FY2022. In H1 FY2022, PNB Gilts reported higher underwriting and other income at Rs. 14.9 crore against Rs. 20.9 crore in FY2021 (mainly attributed to higher Government borrowing programme). With Government borrowing for FY2022 and FY2023 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 income (including MTM gains/losses) during the past few fiscals because of the difference in the variation of bond yields (trading loss of Rs. 64.9 crore in H1 FY2022, trading profit of Rs. 252.6 crore in FY2021 and Rs. 111.5 crore in FY2020). 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 and Rs. 23 crore of exposure to SREI in H1 FY2022. ICRA notes that the vulnerable non-SLR investments are very limited in PNB Gilts' overall investment book as on September 30, 2021.

Apart from trading income, the profitability remains dependent on the NII, which is driven by the interest rate environment. As borrowing costs remained low in H1 FY2022, PNB Gilts increased its borrowings, thereby generating an NII of Rs. 230 crore on the investment portfolio (Rs. 384 crore for FY2021). With the sharp increase in the NII despite the lack of attractive opportunities to generate trading gains, PNB Gilts generated a net profit of Rs. 122 crore in H1 FY2022 (Rs. 454 crore in FY2021, Rs. 185 crore in FY2020).

Hence, the trading income and NII will remain susceptible to any probable volatility in short-term interest rates, which would then impact the overall profitability. With the recent rise in short-term rates, the NII is likely to moderate in H2 FY2022 even as the ability to generate trading income amid rising long-term yields could become a challenge.

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 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 (GoI bonds, SDLs and T-bills). On a daily average, investments in G-Secs comprised ~88% of the total assets in H1 FY2022 against ~87% in FY2021 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. 1,900 crore from PNB, including a Rs. 1,500-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
Applicable Rating Methodologies	Rating Methodology for Primary Dealers Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	Parent/Group Company – Punjab National Bank The rating factors in the operational, managerial and liquidity support provided by the promoter – Punjab National Bank
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%.

In H1 FY2022, the company reported a profit after tax of Rs. 122 crore on total income of Rs. 241 crore compared to a profit after tax of Rs. 454 crore on total income of Rs. 1,052 crore in FY2021. PNB Gilts achieved a success ratio (ratio of bids accepted to bidding commitment) of 42.29% in the T-bills market in H1 FY2022 (42.55% in H1 FY2021), just above the regulatory requirement of 40%.

Key financial indicators

PNB Gilts Limited	FY2020	FY2021	H1 FY2022
Net Interest Income	247	384	230
Trading Profits (including MTM gain/loss)	112	253	(65)
Income from Services, Dividend & Other Income	5	21	15
Operating Costs	34	35	22
Profit before Tax (PBT)	248	614	166
Profit after Tax (PAT)	185	454	122
Net Worth	1,043	1,316	1,384
Borrowings	12,164	9,863	17,753
Stock-in-Trade	12,965	10,907	18,488
Total Assets	14,249	12,137	20,003
PAT/ATA	1.6%	3.4%	1.5%
PAT/Net Worth (RoNW)	19.1%	38.5%	18.1%
Leverage Ratio (daily average; times)	10.4	11.8	11.1

Note: *Amount 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
					Jan-06-2022	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+**	**[ICRA]A1+**
2	Inter-corporate Deposits	ST	1,000.00	-	**[ICRA]A1+**	-	-	-	-	-

**As on December 29, 2021*

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: 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+
NA	Inter-corporate Deposits	Yet to be placed	-	7-365 Days	1,000.00	[ICRA]A1+

**As on December 29, 2021*

Source: *PNB Gilts*

Annexure-2: List of entities considered for consolidated analysis

Name	Ownership
NIL	NIL

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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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