January 23, 2023

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 highest short-term rating assigned to 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 borrowings under repo 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, the company has adequate safeguards, as mentioned in the business policy document, to monitor interest rate, liquidity and credit risks. PNB Gilts continues to maintain strong capitalisation and net worth, despite the recent moderation due to the losses in H1 FY2023 and the increase in the risk-weighted assets (RWAs) on account of the higher market volatility. The current capitalisation levels remain well above the regulatory levels and provide adequate cushion against adverse interest rate movements. PNB Gilts has a strong parentage in the form of Punjab National Bank (PNB; rated [ICRA]AA+ (Stable)/[ICRA]A1+).

ICRA further notes the susceptibility of the company's overall profitability and capitalisation profile to interest rate movements, as seen in H1 FY2023. Additionally, during the last few years, the company has maintained its leverage at a level higher than the peer average, which increases its vulnerability to market risks, particularly when interest rates are rising. Accordingly, PNB Gilts reported a loss in H1 FY2023 because of trading losses. Meanwhile, as short-term borrowing costs have risen after the tightening of the monetary policy, the net interest income (NII) also declined in H1 FY2023.

The short-term rates are expected to rise in the near term and continue to result in a moderation in the NII. Trading income is also expected to remain moderate as monetary conditions are expected to remain tight for some time. As a result, the profitability levels are likely to remain moderate in the near future vis-à-vis FY2021-2022. Thus, PNB Gilts' ability to adhere to its risk management policies, as described by the business policy, will remain critical for minimising the impact of adverse interest rate movements. This, along with continued linkages with the parent, and the ability to withstand any adverse regulatory changes for primary dealers (PDs) will remain key monitorables.

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, post 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 PNB's Executive Director. The bank's liquidity support is reflected in the enhanced sanctioned bank lines 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 40.96% in the treasury bills (T-bills) market in H1 FY2023 (42.29% in H1 FY2022 and 40.78% in H2 FY2022), above the regulatory requirement of 40%. It achieved an outright turnover ratio[2] of 41.35 times for dated G-Secs in H1 FY2023 (36.84 times in FY2022 and 52.03 times in FY2021), above the regulatory requirement of 3 times for outright transactions (and 5 times overall).

Despite moderation, capitalisation profile remains strong – Increased market volatility led to a sharper rise in the market risk-weighted assets. As a result, the capital-to-risk weighted assets ratio (CRAR) moderated to 21.65% as on September 30, 2022 from 66.41% as on March 31, 2022 although it remained well above the regulatory minimum of 15% for PDs. Furthermore, given the interest rate trajectory seen so far, incremental hardening in yields and policy tightening are unlikely to remain as sharp as in H1 FY2023. Accordingly, the current net worth provides a comfortable cushion to absorb any shocks in the interest rates. As on September 30, 2022, the company had a net worth of ~Rs. 1,241 crore (net owned funds (NOF) of ~Rs. 1,218 crore). The price value of basis point (PVBP)[3] stood at Rs. 6.1 crore, indicating its ability to absorb adverse movements of 200 basis points (bps) in interest rates.

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 ~92% of the total assets in H1 FY2023 (~88% in FY2022). 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), 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, PNB Gilts' overall liquidity 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), 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, 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 added to the volatility in 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. The actual VaR largely remained within the approved limits in H1 FY2023 and FY2022.

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 rated entities accounted for around 91% of the total non-SLR portfolio by value as on September 30, 2022.

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 ~99% of its total revenue in H1 FY2023 (98% in FY2022 and 98% in FY2021). Underwriting and other income stood lower at Rs. 3 crore in H1 FY2023 (Rs. 21 crore in FY2022 and FY2021) because of lower

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

devolvement of G-Secs. Going forward, revenue and profitability will remain linked to the quantum of government borrowing as well as the extent of underwriting commissions.

Profitability impacted by steep rise in interest rate – 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 loss of Rs. 275 crore in H1 FY2023 and Rs. 234 crore in FY2022, trading profit of Rs. 252.6 crore in FY2021 and Rs. 111.5 crore in FY2020). Over and above this, PNB Gilts has written off exposures in its non-SLR investments, which also impacted its profitability in those years (Rs. 81 crore write-off/provision in FY2020 and Rs. 17 crore in FY2022). However, the current vulnerable non-SLR investments are limited in PNB Gilts' overall investment book as on September 30, 2022.

Apart from trading income, the profitability remains dependent on the NII, which is driven by the interest rate environment. In contrast to last year, a sharp increase in the overnight short-term rates drove down the NII to Rs. 177 crore in H1 FY2023 (Rs. 230 crore in H1 FY2022 and Rs. 384 crore in FY2021) on the investment portfolio. Hence, trading income and NII will remain susceptible to volatility in interest rates. The short-term rates are expected to rise in the near term and continue to result in a moderation in the NII. Trading income is also expected to remain moderate as monetary conditions are expected to remain tight for some time.

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 LAF/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.

Environment and Social Risks

Given that 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 on this dimension pertains to the ability to attract and retain specialised talent— for which the PDs compete with other financial sector companies. This risk apart, other sources 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 ~92% of the total assets in H1 FY2023, 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, apart from bank limits of Rs. 1,900 crore from PNB. 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 FY2023, the company reported a net loss of Rs. 96.8 crore on total income of Rs. 348 crore compared to a profit after tax of Rs. 122.56 crore on total income of Rs. 421 crore in H1 FY2022. PNB Gilts achieved a success ratio (ratio of bids accepted to bidding commitment) of 40.96% in the T-bills market in H1 FY2023 (42.29% in H1 FY2022), significantly above the regulatory requirement of 40%.

Key financial indicators

PNB Gilts Limited	FY2021	FY2022	H1 FY2022	H1 FY2023
Net interest income	384	460	230	177
Trading profit (including MTM gain/loss)	253	(234)	(65)	(275)
Income from services, dividend & other income	21	21	15	5
Operating costs	35	44	20	22
Profit before tax (PBT)	614	210	166	(114)
Profit after tax (PAT)	454	166	122	(97)
Net worth	1,316	1,427	1,384	1,241
Borrowings	9,863	14,530	17,753	15,524
Stock-in-trade	10,907	15,267	18,488	15,385
Total assets	12,140	16,750	20,003	18,839
PAT/ATA	3.44%	1.15%	1.33%	-1.09%
PAT/Net worth (RoNW)	34.50%	11.61%	17.63%	-15.63%
Leverage ratio (daily average; times)	11.83	11.33	11.06	12.54

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

		Current Rating (FY2023)				Chronology of Rating History for the Past 3 Years				
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021		Date & Rating in FY2020
					Jan-23-2023	Jan-06-2022	Jun-22-2021	Jun-18-2020	May-15-2020	Aug-23-2019
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	42.00	[ICRA]A1+	[ICRA]A1+	-	-	-	-

**As on September 30, 2022; ST – Short term*

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
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+

Source: PNB Gilts

Annexure II: List of entities considered for consolidated analysis

Name	Ownership
NIL	NIL

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