

August 31, 2017

PNB Gilts Limited

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Commercial Paper programme	500.00	[ICRA]A1+; assigned
Total	500.00	

*Instrument details are provided in Annexure-1

Rating action

ICRA has assigned the short-term rating of [ICRA] A1+ (pronounced ICRA A one plus) to the Rs. 500 crore commercial paper programme of PNB Gilts Limited¹ (PNB Gilts).

Rationale

The rating factors in PNB Gilts' strong net worth, comfortable capitalisation, adequate internal prudential norms and risk management policies to mitigate the market risks arising out of interest rate movements intrinsic to the primary dealer (PD) business. PNB Gilts' liquidity is supported by a highly liquid portfolio of government debt securities and its access to money market for call money and repo borrowings, apart from the access to the liquidity adjustment facility (LAF) of the Reserve Bank of India (RBI) allowed to PDs. The rating factors in PNB Gilts' ownership, with Punjab National Bank (PNB, rated [ICRA]AA+(stable)/[ICRA]A1+) as its largest shareholder, and the managerial, operational and financial support received by PNB Gilts from PNB.

ICRA takes note of the low diversity in the company's revenues with interest income and trading income being the major sources. ICRA also notes that the company's overall income, profitability and capitalisation are subject to volatility because of interest rate movements; however, strong capitalisation provides the entity an ability to absorb shocks from large adverse movements in interest rate while continuing to maintain regulatory capitalisation levels. Going forward, PNB Gilts' ability to maintain and adhere to prudent risk management policies; the impact of regulatory changes for PDs; and continuity of management control by PNB will be the key rating sensitivities.

Key rating drivers

Credit strengths

- **Majority ownership and control by PNB** - PNB is the majority shareholder in PNB Gilts, with a 74.07% stake as on June 30, 2017). The board of directors of PNB Gilts is headed by PNB's MD & CEO. PNB Gilts has unsecured bank facilities from PNB and also receives operational and managerial support from the parent, as required. Given the shared brand name, ICRA expects PNB to continue to support PNB Gilts.
- **Strong capitalisation profile** – Albeit a sharp reduction from 54.48% as on March 31, 2017, the company's capital adequacy ratio remains strong at 30.34% as on June 30, 2017 as against the regulatory requirement of a minimum 15%. With trading in debt securities being a core activity of a PD, its profitability and capitalisation is highly impacted by interest rate movements. The company's ability to absorb losses on account of such movements is of considerable significance. As on June 30, 2017, PNB Gilts had a net worth of Rs. 869 crore, as against a price value of basis point (PVBP)² of

¹ For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications

² PVBP measures the gain/loss on the entire portfolio for 1 bps (0.01%) movement in interest rate.

Rs. 2.56 crore, indicating an ability to absorb a shock of up to 339 bps adverse movement in interest rates. During FY2017, the company's maximum and minimum ability to absorb adverse interest rate movements stood at 1,085 bps (at the end of Q3FY2017) and 404bps (at the end of Q4FY2017) respectively.

- **Adequate risk management systems** – Given the significant risks on account of market movements and counter party exposures³, prudent risk management policies and adherence to these policies is critical for a PD. ICRA takes comfort from PNB Gilts' strong risk management policies, approved by the its board, with well-defined limits for various exposures and loss mitigation measures; and the proper monitoring and adherence to these policies. As per the company's internal risk management policy, non-SLR investments are only allowed in AAA, AA+ and A1+ rated debt instruments, thereby reducing credit risks. The extent of interest rate shock that can be absorbed by the company is also a function of its portfolio duration and leverage levels. ICRA notes that PNB Gilts has consistently maintained its portfolio duration and leverage levels within the limits approved by the board.
- **Strong liquidity and matched borrowings** – PNB Gilts' liquidity profile is comfortable with funds parked in liquid instruments like G-Secs and T-Bills. In case of need, PNB Gilts would be able to borrow easily against these liquid instruments. For FY2017, SLR investments accounted for 79% of its total investments, on a daily average basis. Given the company's access to money market for call and repo borrowings, in addition to the RBI's LAF, ICRA expects its liquidity position to remain strong. PNB Gilts continues to fulfil its regulatory bidding commitments at the primary auctions with minimum success and turnover ratio requirements for Government Dated Securities and Treasury Bills (T-Bills).

Credit weaknesses

- **Low diversification of revenues** – The revenues of PNB Gilts mainly consist of trading income and interest income from its portfolio, with fee income accounting for less than 1% of total revenues during FY2017.
- **Volatility in profits arising out of interest rates** – Debt securities accounted for more than 99% of PNB Gilts' portfolio during FY2017 and hence its financial profile is exposed to adverse interest rate movements. The volatility in profitability is reflected in the sizable trading gains (Rs. 185.50 crore) made following the decline in interest rates during FY2017 as compared with a trading loss (Rs. 16.90 crore) during FY2016. With higher trading profits and stable operating expenses, the company's net profit increased to Rs. 167.17 crore during FY2017 (return on net worth, RONW of 18.75%) as compared with a net profit of Rs. 34.50 crore during FY2016 (RONW of 4.71%).
- **Regulatory framework for primary dealers:** Apart from seeking an underwriting commitment for G-Secs and T-Bills and achieving turnover ratios, the regulatory framework favourably allows PDs to access the money markets and the LAF of the RBI. However, any adverse changes in the regulatory framework may have an adverse impact on the operations and credit profiles of PDs.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

[Rating Methodology for Primary Dealers](#)

About the company:

PNB Gilts Ltd was incorporated in 1996 as a wholly owned subsidiary of Punjab National Bank with an initial paid up capital of Rs. 50 crore. In 1998, the company was registered as an NBFC with the RBI. In

³ On non-SLR debt investments

July 2000, the company issued an Initial Public Offer, resulting in the shareholding of Punjab National Bank reducing to to 74.07%.

PNB Gilts achieved a success ratio⁴ of 44.23% and 56.07% in H1FY2017 and H2 FY2017 respectively against the regulatory requirement of 40%. For FY2017, the company's total turnover ratio⁵ stood at 104 times for T-Bills and 511 times for government-dated securities as against the minimum RBI stipulation of 10 times and 5 times respectively for the year. During FY2017, PNB Gilts reported a net profit of Rs. 167.17 crore on an average net worth of Rs. 814.79 crore as compared with a net profit of Rs. 34.50 crore on an average net worth of Rs. 724.64 crore during FY2016. During Q1FY2018, company reported a net profit of Rs. 25.11 crore on an average net worth of Rs. 884 crore as against a net profit of Rs. 19.37 crore on an average net worth of Rs. 740 crore in Q1FY2017.

Key Financial Indicators (Audited)

	FY2016	FY2017
Net Interest Income	83.45	89.35
Trading Income	-16.90	185.50
Fee based and other income	1.23	1.30
Operating Expenses	16.33	18.29
Profit before tax	51.47	256.54
Profit after tax (PAT)	34.50	167.17
Net worth	731.22	898.36
Borrowings	4920.68	3513.93
Stock in trade	4960.58	3885.35
Investments	640.47	442.54
Total assets	5,769.81	4,565.51
PAT/Average total assets	0.66%	3.26%
PAT/Net worth	4.71%	18.75%
Total Debt/Net worth (times)	6.73	3.91

Note: Amount in Rs. crore

Source: PNB Gilts & ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

⁴ Success Ratio is defined as total bids accepted/bidding commitment.

⁵ Turnover ratio is defined as total purchase and sales during the year in the secondary market to average month-end stocks.

Rating history for last three years:
Table:

S. No.	Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years	
		Type	Amount Rated (Rs. crore)	August 2017	FY2017	FY2016
1	Commercial Paper Programme	Short Term	500.00	[ICRA]A1+ Assigned	NA	NA

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	Date of Issuance / Sanction	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating
NA	Commercial Paper	-	-	7-365 days	500.00	[ICRA]A1+

Source: PNB Gilts

Contact Details

Analyst Contacts

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

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

Anurag Pushp
+91 124 4545815
anurag.pushp@icraindia.com

Relationship Contact

L. Shivakumar
+91 22 6114 3406
shivakumar@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

© Copyright, 2017, ICRA Limited. All Rights Reserved
Contents may be used freely with due acknowledgement to ICRA

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.

**Registered Office****ICRA Limited**

1105, Kailash Building, 11th Floor, 26, Kasturba Gandhi Marg, New Delhi 110001
Tel: +91-11-23357940-50, Fax: +91-11-23357014

Corporate Office**Mr. Vivek Mathur**

Mobile: +91 9871221122

Email: vivek@icraindia.com

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon 122002
Ph: +91-124-4545310 (D), 4545300 / 4545800 (B) Fax; +91- 124-4050424

Mumbai**Mr. L. Shivakumar**

Mobile: +91 9821086490

Email: shivakumar@icraindia.com

3rd Floor, Electric Mansion
Appasaheb Marathe Marg, Prabhadevi
Mumbai—400025,
Board : +91-22-61796300; Fax: +91-22-24331390

Kolkata**Mr. Jayanta Roy**

Mobile: +91 9903394664

Email: jayanta@icraindia.com

A-10 & 11, 3rd Floor, FMC Fortuna
234/3A, A.J.C. Bose Road
Kolkata—700020
Tel +91-33-22876617/8839 22800008/22831411,
Fax +91-33-22870728

Chennai**Mr. Jayanta Chatterjee**

Mobile: +91 9845022459

Email: jayantac@icraindia.com

5th Floor, Karumuttu Centre
634 Anna Salai, Nandanam
Chennai—600035
Tel: +91-44-45964300; Fax: +91-44 24343663

Bangalore**Mr. Jayanta Chatterjee**

Mobile: +91 9845022459

Email: jayantac@icraindia.com

'The Millenia'
Tower B, Unit No. 1004, 10th Floor, Level 2 12-14, 1 & 2,
Murphy Road, Bangalore 560 008
Tel: +91-80-43326400; Fax: +91-80-43326409

Ahmedabad**Mr. L. Shivakumar**

Mobile: +91 9821086490

Email: shivakumar@icraindia.com

907 & 908 Sakar -II, Ellisbridge,
Ahmedabad- 380006
Tel: +91-79-26585049, 26585494, 26584924; Fax:
+91-79-25569231

Pune**Mr. L. Shivakumar**

Mobile: +91 9821086490

Email: shivakumar@icraindia.com

5A, 5th Floor, Symphony, S.No. 210, CTS 3202, Range
Hills Road, Shivajinagar, Pune-411 020
Tel: + 91-20-25561194-25560196; Fax: +91-20-
25561231

Hyderabad**Mr. Jayanta Chatterjee**

Mobile: +91 9845022459

Email: jayantac@icraindia.com

4th Floor, Shobhan, 6-3-927/A&B. Somajiguda, Raj
Bhavan Road, Hyderabad—500083
Tel:- +91-40-40676500