India Ratings Affirms PNB Gilts' Short-Term Debt at 'IND A1+'

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India Ratings and Research (Ind-Ra) has affirmed PNB Gilts Limited's short-term debt as follows:

Details of Instruments

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating	Rating Action
Short-term bank loans	-	-	-	INR20	IND A1+	Affirmed
Short-term loan (inter-corporate deposits)	-	-	-	INR10	IND A1+	Affirmed

Analytical Approach

Ind-Ra continues to factor in the financial support available to PNB Gilts from its parent, Punjab National Bank (PNB; 'IND AAA'/Stable; holds 74.07% stake), if required.

Detailed Rationale of the Rating Action

The affirmation takes into consideration PNB's credit profile and Ind-Ra's assessment of the parent's willingness and capacity to provide timely support to PNB Gilts, if required. The agency considers PNB Gilts to be a strategically important subsidiary of PNB. The affirmation also reflects PNB Gilts' adequate risk management practices which are critical for managing market and credit risks. The ratings also factor in adequate capitalisation. Given the nature of interest-sensitive business model and lack of revenue diversification, profitability remains volatile.

List of Key Rating Drivers

Strengths

- Strategically important to parent
- Adequate risk management
- Adequate capitalisation

Weaknesses

- Volatile profitability
- Lack of revenue diversification

Detailed Description of Key Rating Drivers

Strategically Important to Parent: The ratings are driven by PNB's credit profile and Ind-Ra's assessment of the parent's willingness and capacity to provide timely support to PNB Gilts, if required. The agency considers PNB Gilts to be a strategically important subsidiary of PNB, given the majority ownership, sharing of brand name, managerial oversight and track record of liquidity support from the parent. PNB has extended a credit facility of INR19 billion (increased from INR10 billion in March 2021) to PNB Gilts for contingent liquidity needs. Moreover, PNB's executive director is on PNB Gilts' board.

Adequate Risk Management: Given PNB Gilts is a primary dealer, it faces significant market risk on its fixed income (government securities, treasury bills and corporate bonds) and derivative (interest rate swaps) portfolio. The company's credit risk is limited to investments in corporate bonds and commercial papers. PNB Gilts, as per its policy, plans to invest only in 'AA' and above-rated corporate bonds. It carries out stress testing on a monthly basis and scenario analysis on a quarterly basis to assess the impact of interest rate shocks. The company has set up adequate risk management practices, with well-defined limits around market and credit risks. PNB Gilts continued to comply with operational guidelines defined by the Reserve Bank of India, by achieving success ratio of 42.6% in treasury bills market in 2HFY24, as against the regulatory minimum of 40%. Also, the outright turnover ratio stood at 4.48% for dated government securities in FY24, above the mandatory requirement of 1.5% of the average dated government securities outright market turnover during the previous three financial years.

Adequate Capitalisation: PNB Gilts' capital adequacy ratio (CAR) stood at 34.0% at FYE24 (FYE23: 31.8%; FYE22: 66.4%). The company intends to maintain CAR of 25%-30% in the medium term. The company's tangible net worth increased to INR13.1 billion at FYE24 (FYE23: INR12.4 billion; FYE22: INR14.3 billion) with a net profit of INR0.69 billion (net loss INR0.77 billion; INR1.66 billion). PNB Gilts' investment portfolio grew at a CAGR of 28% to INR230.0 billion over FY21-FY24. As a result, the leverage (debt-to-tangible equity) deteriorated to 17.0x in FY24 (FY23: 15.5x; FY22: 10.2x).

Volatile Profitability: PNB Gilts' profitability is dependent upon market dynamics and other macro factors and is vulnerable to volatility resulting from its trading positions in fixed-income securities and interest rate swaps. The company reported a profit of INR0.69 billion in FY24 (FY23: net loss of INR0.77 billion; FY22: profit of INR1.66 billion). The company posted a trading profit of INR0.5 billion in FY24, against a loss of INR2.0 billion in FY23 due to unfavourable market conditions during FY23. The net interest income to average assets ratio remained under pressure at 0.5% in FY24 (FY23: 1.3%; FY22: 3.2%), reflecting the pressure on net interest income due to rise in cost of funding. Given the dependence of the business model on the interest rate environment, the return on average assets remained volatile (FY24: 0.3%; FY23: negative 0.4%; FY22: 1.1%).

Lack of Revenue Diversification: The company's operating revenue primarily comprises of net interest income and trading income, stemming from primary dealer activities. The fee-based income performance remained muted at 0.5% of the operating revenue in FY24 (FY23: 0.7%). This leads to higher variation in profitability, depending on market conditions. During FY24, with the receipt of license as an Authorized Dealer Category III, PNB Gilts seeks new opportunities in foreign exchange markets, which will enable some revenue diversification in the long term.

Liquidity

Adequate: Being a primary dealer, the company's balance sheet is highly liquid, with government securities, state development loans and treasury bills accounting for about 89% of the total investment portfolio at FYE24. As a primary dealer, the company largely relies on secured (repo, refinance and triparty repo dealing and settlement and unsecured money market borrowings such as notice, term, call money, inter-corporate deposit and commercial paper) for its funding needs. Moreover, PNB Gilts has a line of credit of INR19 billion from PNB at end-March 2024. Ind-Ra expects the parent to provide liquidity support, if required.

Rating Sensitivities

Positive: Not applicable

Negative: The ratings are contingent on the rating of the parent, given the strong linkages between them. Any deterioration in the parent's rating or weakening of the linkages in the form of dilution of ownership, reduced management oversight or otherwise will be negative for the ratings. Also, a sustained track record of weak financial performance by PNB Gilts or the CAR falling below 20%, on a sustained basis, could lead to a negative rating action.

About the Company

PNB Gilts is a primary dealer engaged in underwriting and trading of government securities, treasury bills, corporate bonds and interest rate swaps. It was incorporated in 1996, as a wholly-owned subsidiary of PNB. Following a public issue in July 2000, PNB's stake in the subsidiary declined to 74.07%.

Key Financials Indicators

Particulars	FY24	FY23
Total tangible assets (INR billion)	245.2	214.8
Total tangible equity (INR billion)	13.1	12.4
Net income (INR billion)	0.7	-0.8
Return on average assets (%)	0.3	-0.4
CAR (%)	34.0	66.4
Source: Ind-Ra, PNB Gilts		

Status of Non-Cooperation with previous rating agency

Not applicable

Rating History

Instrument Type	Current Rating			Historical Rating		
	Rating Type	Rated Limits (billion)	Rating	23 March 2023	28 December 2021	14 October 2021
Short-term bank loan	Short-term	INR20	IND A1+	IND A1+	IND A1+	IND A1+
Short-term loan (inter-corporate deposit)	Short-term	INR10	IND A1+	IND A1+	IND A1+	

Complexity Level of the Instruments

Instrument Type	Complexity Indicator
Short-term bank loan	Low
Short-term loan (inter-corporate deposits)	Low

For details on the complexity level of the instrument, please visit https://www.indiaratings.co.in/complexity-indicators.

APPLICABLE CRITERIA

Rating FI Subsidiaries and Holding Companies

Non-Bank Finance Companies Criteria

Evaluating Corporate Governance

The Rating Process

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