August 22, 2023

PNB Housing Finance Limited: Rating reaffirmed; outlook revised to Positive

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible debentures	600.0	600.0	[ICRA]AA (Positive); reaffirmed and outlook revised to Positive from Stable
Tier II bonds	200.0	200.0	[ICRA]AA (Positive); reaffirmed and outlook revised to Positive from Stable
Total	**800.0**	**800.0**	

**Instrument details are provided in Annexure I*

Rationale

The revision in the outlook on PNB Housing Finance Limited's (PNBHFL) long-term rating reflects ICRA's expectation of a further improvement in the company's asset quality indicators and profitability metrics, while it scales up with primary focus on the retail portfolio. ICRA notes that the company completed its rights issue of ~Rs. 2,494 crore in Q1 FY2024, which has improved its capitalisation profile and solvency ratio (Net non-performing advances (NNPA)/Net worth). ICRA expects the company's overall credit profile to continue improving, aided by its experienced board and management.

The rating continues to factor in PNBHFL's established track record in the mortgage finance industry and its diverse funding profile. It also factors in the improvement in the capitalisation profile. The managed gearing[1] is estimated to have reduced to 4.3 times as on June 30, 2023 (5.6 times as of March 2023) from 6.3 times as on March 31, 2022, supported by the rights issue. PNBHFL has a well-diversified funding profile comprising funding from banks, National Housing Bank (NHB), non-convertible debentures (NCDs) & bonds, deposits and external commercial borrowings (ECBs).

ICRA also notes that PNBHFL has reduced its wholesale exposure over the past few years, which accounted for ~5% of its assets under management (AUM) as on June 30, 2023, down from ~11% in March 2022 (~21% as on March 31, 2019). This was supported by write offs, accelerated prepayments, run-down and settlements in the corporate book. ICRA expects that the company will continue to benefit from the shared brand name with its promoter, i.e. Punjab National Bank (PNB; rated [ICRA]AA+ (Positive)/[ICRA]A1+, [ICRA]AA (Positive) for Basel III Tier I Bonds), which helps it leverage its franchise and raise funds, thereby supporting its financial flexibility.

The rating, however, remains constrained by the moderate, albeit improving, asset quality indicators and profitability metrics. PNBHFL reported gross NPAs (GNPAs) of 3.8% as on June 30, 2023 against 8.1% as on March 31, 2022. It wrote off ~Rs. 1,738 crore in FY2023 and sold stressed assets of Rs. 249 crore to an asset reconstruction company (ARC). This, along with net recoveries via legal course and one-time settlements (OTS), has helped the company reduce its stressed book. Nevertheless, relatively higher credit costs kept its profitability moderate in FY2023 though the same improved in comparison to FY2022 on account of the higher net interest margin (NIM).

ICRA, however, notes that the risks are partly mitigated by the good collateral cover maintained by the company and the adequate provision coverage ratio (PCR) as on June 30, 2023. Its overall PCR has declined over the last few quarters, with the reduction in NPAs, and stood at 2.5% of the total loan book as on June 30, 2023 against 4.4% in March 2022. The PCR on GNPAs stood at 32% as on June 30, 2023 (29% as of March 2023) vis-à-vis 38% in March 2022.

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[1] *Managed gearing = (on-book debt + off-book portfolio)/net worth*

The Positive outlook reflects ICRA's opinion that the company would be able to improve its credit profile further, while expanding its scale of operations and improving its asset quality and profitability.

Key rating drivers and their description

Credit strengths

Established player in mortgage lending market – PNBHFL has an established presence and a long track record of operations in the housing finance industry with a presence in 19 states/Union Territories (UTs) in India. It also has a seasoned management team with sound knowledge of the mortgage industry and its board has prior experience in banking, insurance, retail lending, technology and economic policy. Over the last few years, it increased its focus on the retail segment and started reducing its wholesale exposure, which led to a decline in the AUM, though the AUM grew in Q1 FY2024. The AUM stood at Rs. 67,340 crore as on June 30, 2023 compared to Rs. 66,617 crore as on March 31, 2023 (Rs. 65,977 crore as on March 31, 2022 under IGAAP valuation), registering an annualised growth of 4% in Q1 FY2024 (degrowth of 0.5% in FY2023). In terms of the on-book portfolio, the company reported an annualised growth of ~8% in Q1 FY2024. ICRA expects PNBHFL's on-book portfolio to continue growing with focus on the retail segment.

As on June 30, 2023, ~67% of the on-book portfolio was towards individual housing loans (HLs), ~23% towards retail loan against property (LAP), ~5% towards retail non-residential premises loans (NRPLs), and ~6% towards the corporate book (which includes construction finance, corporate term loans and corporate lease rental discounts). The company also reported an off-book portfolio of Rs. 6,945 crore as on June 30, 2023 against Rs. 7,345 crore as on March 31, 2023 (Rs. 9,088 crore as on March 31, 2022).

Shared brand name and benefits with PNB as the promoter – PNBHFL has completed its rights issue and raised fresh capital of ~Rs. 2,494 crore in Q1 FY2024. Following this, PNB's stake declined to 28.2% as on June 30, 2023 from 32.5%. Nonetheless, it remains the promoter entity of PNBHFL, which provides competitive advantage to the company. PNBHFL's board comprised two directors from PNB as on June 30, 2023. Further, the common brand name supports its financial flexibility and deposit mobilisation. As per the revised trademark agreement between PNBHFL and PNB, entered in May 2021, PNBHFL would have to pay a royalty to PNB for using the brand name as PNB's stake has declined below 30%. Nevertheless, PNB's stated intent to maintain its stake above 26% provides comfort that PNBHFL would be able to use the brand going forward as well.

Diversified funding mix and demonstrated refinancing ability – PNBHFL has managed to maintain a healthy funding mix comprising NCDs (8% of the funding mix as on June 30, 2023), deposits (28%), bank borrowings (37%), NHB (5%), ECBs (9%) and off-book exposure (direct assignment and co-lending; 11%). The cost of average borrowings increased to 7.3% in FY2023 from 7.2% in FY2022 owing to higher interest rates in FY2023.

Credit challenges

Moderate asset quality but expected to continue improving – PNBHFL's overall asset quality metrics remain moderate with reported gross and net NPAs of 3.8% and 2.6%, respectively, as on June 30, 2023, though the same improved over the past few quarters (GNPA and NNPA of 8.1% and 5.1%, respectively, as on March 31, 2022). The reduction in the GNPAs was on account of the resolution of a few large wholesale exposures (via sale to an ARC, project transfer to another developer, etc), net write-offs of Rs. 1,738 crore in FY2023, recoveries and OTS for some stressed exposures. ICRA notes that the management is committed to bring down the remaining stressed book. However, the same remains relatively high, with cumulative GNPAs and security receipts (SRs) of 3.9% as on June 30, 2023. Additionally, PNBHFL had a standard restructured book of 3.1% of its loan book as of March 2023. Further, its solvency {(NNPA + Net SRs)/Net worth} improved to 12.0% as on June 30, 2023 from 30.8% as of March 31, 2022 (15.8% as of March 2023), supported by the reduction in the NNPAs and increase in the net worth.

The risk is partly mitigated by the good collateral cover maintained by the company and the adequate PCR as on June 30, 2023. Its overall PCR declined in FY2023, with the reduction in the NPAs, though it remains adequate at 2.5% of total loan book. The PCR on GNPAs stood at 32% as on June 30, 2023 vis-à-vis 38% in March 2022. ICRA notes that the collateral cover maintained on corporate exposures and the loan-to-value (LTV) at origination for the retail segment (~71% in HL and ~49% in LAP) mitigate the risk to some extent. The management's ability to arrest further slippages and make healthy recoveries shall remain critical from a credit perspective.

Moderate, albeit improving, profitability – PNBHFL reported a profit after tax (PAT) of Rs. 1,046 crore in FY2023 (Rs. 347 crore in Q1 FY2024), translating into a return on average managed assets (RoMA) of 1.4% and a return on average net worth (RoNW) of 10.0% against Rs. 836 crore, 1.0% and 8.9%, respectively, in FY2022. The improvement was on account of the higher NIM as the company was able to improve its yield while keeping the cost of borrowings under control. While PNBHFL's operating profitability improved in FY2023, the same was somewhat negated by the higher credit cost of 0.9% with respect to average managed assets (AMA) against 0.7% in FY2022. Though PNBHFL's profitability remains moderate, going forward, ICRA expects the credit cost to decline on account of the reduced stressed book and the expected recoveries from the written-off accounts, which should improve the overall profitability.

Environmental and social risks

Environmental – While housing finance companies (HFCs) like PNBHFL do not face material physical climate risks, they are exposed to environmental risks indirectly through their portfolio of assets. If the borrowers, to which such HFCs have an exposure, face livelihood disruption because of physical climate adversities, it could translate into credit risks for the HFCs. However, such risk is not material for PNBHFL as it benefits from portfolio diversification.

Social – With regard to social risks, data security and customer privacy are among the key sources of vulnerability for HFCs as material lapses could be detrimental to their reputation and invite regulatory censure.

Liquidity position: Strong

While the company remains exposed to asset-liability related risks given the longer tenor of the assets, its liquidity is supported by the good share of long-term and short-term borrowings and its plans to keep adequate liquid investments and unutilised lines to meet the gaps. It had cash and cash equivalents of Rs. 5,236 crore as on June 30, 2023 and collections due {as per behavioural analysis of asset-liability management statement (ALM)} of Rs. 6,546 crore (excluding NPAs and including restructured book) against debt repayments of Rs. 12,965 crore till December 31, 2023. Further, PNBHFL had unavailed sanctions and working capital lines of Rs. 5,415 crore as on June 30, 2023. The company maintained a liquidity coverage ratio (LCR) of 96%, during the quarter ending June 30, 2023, against the regulatory requirement of 60%.

Rating sensitivities

Positive factors – PNBHFL's rating could be upgraded if it is able to grow its scale of operations, while improving its overall asset quality and profitability profile, and maintain a prudent capitalisation profile.

Negative factors – Pressure on the rating or outlook would arise in case of a deterioration in PNBHFL's asset quality and/or its inability to make a meaningful recovery out of its stressed assets. Pressure on its profitability (with RoMA <1% on sustained basis), a material decline in the scale of operations, higher gearing and challenges in fund raising, restricting PNBHFL's ability to lend or leading to a deterioration in its liquidity profile, could also exert pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for Non-banking Finance Companies (NBFCs) Rating Approach – Consolidation
Parent/Group support	Not applicable
Consolidation/Standalone	The rating is based on the consolidated financial profile of the company

About the company

Incorporated in 1988, PNBHFL is a deposit-accepting housing finance company. PNB and the Carlyle Group had a stake of 28.2% and 32.7%, respectively, as on June 30, 2023. The company offers home loans, LAP, builder loans and lease rental discounting. PNBHFL is geographically diversified with its portfolio spread across 19 states/UTs. As on March 31, 2023, it reported an AUM of Rs. 65,542 crore (IndAS valuation at Rs. 66,617 crore) against Rs. 65,977 crore in March 2022. Its AUM stood at Rs. 67,340 crore as on June 30, 2023.

Key financial indicators (audited)

PNBHFL	FY2021	FY2022	FY2023
Accounting as per	**IndAS**	**IndAS**	**IndAS**
Total income	7,624	6,201	6,530
Profit after tax	930	836	1,046
Net worth	8,923	9,872	11,014
Loan book	62,254	57,895	59,273
Total managed assets	86,150	77,377	75,730
Return on average managed assets	1.0%	1.0%	1.4%
Return on average net worth	11.0%	8.9%	10.0%
Managed gearing (times)	8.1	6.3	5.6
Gross stage 3	4.4%	8.1%	3.8%
Net stage 3	2.4%	5.1%	3.0%
Solvency (Net stage 3/Net worth)	17.0%	29.7%	14.7%
CRAR	18.7%	23.4%	24.4%

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore
Total managed assets includes ECL provision and off-book portfolio

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2024)					Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2023 (Rs. crore)	Date & Rating in FY2024		Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
					Aug 22, 2023	Apr 11, 2023	Apr 12, 2022	May 28, 2021	Apr 3, 2020
1	NCD programme	Long term	600	450	[ICRA]AA (Positive)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Negative)	[ICRA]AA (Negative)
2	Tier II bonds	Long term	200	200	[ICRA]AA (Positive)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Negative)	[ICRA]AA (Negative)
3	NCD programme	Long term	-	-	-	-	[ICRA]AA (Stable); withdrawn	[ICRA]AA (Negative)	[ICRA]AA (Negative)

Complexity level of the rated instruments

Instrument	Complexity Indicator
NCD programme	Very simple
Tier II bonds	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	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE572E09239	**NCD**	Jan-31-2014	9.48%	Jan-31-2024	300	[ICRA]AA (Positive)
INE572E07092	**NCD**	Mar-17-2023	8.70%	Sep-17-2024	150	[ICRA]AA (Positive)
Not issued	**NCD**	NA	NA	NA	150	[ICRA]AA (Positive)
INE572E09262	**Tier II bonds**	Nov-24-2014	8.70%	Nov-24-2024	200	[ICRA]AA (Positive)

Source: Company, ICRA Research

Annexure II: List of entities considered for consolidated analysis

Company Name	PNBHFL Ownership	Consolidation Approach
PHFL Home Loans and Services Ltd.	100.00%	Full Consolidation

Source: PNBHFL's annual report

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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.

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