Management Discussion & Analysis

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ECONOMIC OVERVIEW

Global Economy - at a Threshold

Global economic growth remained sluggish and erratic for the first six months of FY 2013. However, the later months witnessed strengthening of global business, with much of the growth impetus flowing from advanced economies. Global growth averaged at about 3.67% in the second half of FY 2013, a marked uptick from 2.67% recorded during the previous six months. Improved growth in the US was largely due to strong exports and temporary increase in inventory demand. In the EU, growth turned positive in a select few economies; however, stress continued in countries outside the core EU regions as they slowly moved out of the long recessionary phase. In contrast to the advanced economies, many emerging market economies faced an unfavorable external financial environment even as they dealt with domestic challenges such as structural bottlenecks in infrastructure, labor market rigidities and a worsening investment outlook, which derailed growth. Yet, despite lower growth rates, the emerging economies continued to contribute more than two-thirds of the global growth.

Although downside risks have diminished overall, they continue to dominate the global growth outlook, notwithstanding positivity in the US, the UK and Germany. Major concerns include risks from low inflation and possibility of protracted low growth, especially in the EU and Japan. Increased financial volatility in emerging market economies, and increase in the cost of capital is likely to dampen investment prospects and weigh on their growth, moving forward. Growth in emerging market economies too is projected to pick up only modestly. Overall, global growth is projected to be slightly higher in FY 2014 at around 3.6% and rise to 3.9% in FY 2015.[1]

Indian Economy - in need of Transformation

FY 2014 was yet another challenging year for the Indian economy. Internal challenges, inflation, rupee depreciation and consequent hike in interest charges contributed to current account deficit. This, along with threat of a sovereign downgrade by rating agencies and global headwinds, impacted business sentiments and resulted in muted GDP growth. For the second year in a row, annual GDP was sub 5% (4.7%)[2], amongst the lowest in this decade. The sluggishness in the economy and delayed clearance of projects, adversely impacted fresh project investment as well as consumption.

High Inflation Leads to Tight Monetary Stand

Inflation ruled high for most part of FY 2014. Growth in the consumer price index (CPI), one of the risk factors to value of the rupee, averaged around 10% from April 2013 to December 2013. It was only in January 2014 that consumer inflation moved marginally below 10%. However, core inflation, excluding food and fuel, continued to be high. Since taming inflation remained a priority over promoting growth, RBI did not change its tight monetary policy stance. In its latest bid to curb inflation, RBI, in January 2014, increased the policy repo rate by 25 basis points - from 7.75% to 8.0%, a move which increased borrowing cost. It helped reduce the CPI inflation to 8.3% as on end-March 2014[3].

INDIA'S HOUSING FINANCE SECTOR

The fast growing housing finance sector in India is served by multiple institutions, comprising banks, housing finance companies (HFCs) and non-banking finance companies (NBFCs). The volume of housing loans has witnessed sustained multi-fold growth, from ₹ 0.43 lac crores as on March 2000 to ₹ 9.03 lac crores as on March 2014[4].

At present, about 65-66% of total home funding is contributed by banks and the rest comes from HFCs and NBFCs. The number of housing finance institutions registered with National Housing Bank (NHB) has grown at a significant pace and currently stands at 57.

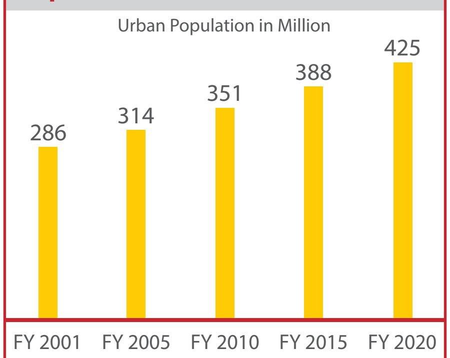
Demand for Housing Finance

Growth of housing finance sector in India can be attributed to multiple factors, some of which are:

- **Burgeoning Population** – India is likely to reach a population of 1.4 billion by FY 2026, with a significant proportion of the populace belonging to young and working category. According to the census of FY 2011, India has more than 50% of its population below the age of 25 and more than 65% below the age of 35. It is expected that, in FY 2020, the average age of an Indian will be 29 years, compared to 37 years for China and 48 years for Japan; and by FY 2030, India's dependency ratio should be just over 0.4. The rising population, accompanied by an increase in the proportion of working population, is likely to precipitate high demand for housing finance[5].

- **Urbanization –** With rapid industrialization and development of Tier II and Tier III cities, growth in urban population is likely to outpace overall growth in population. Growth in urbanization is estimated at a CAGR of 2.1% over the period FY 2012-50.

Rapid Urbanization in India



(Source: Census of India, Housing Microfinance)

- **Improved Affordability** – Over last two decades, average cost of buying a property has reduced to 4-5 times of annual income. This is due to rising disposable income supported by various tax incentives, such as deductions for payment of interest on housing loans and rebate on repayment of principal, under the Income Tax Act. The concept of nuclear family is picking up with young urban population who now avail housing finance to actualize their dream of home ownership.

- **Low Penetration –** Mortgage lending has significantly contributed to the growth of housing and construction. Outstanding mortgage loans contribute only 8% to India's GDP, which is a very low number when compared to the GDP of many other countries. There is an adequate headroom for increasing mortgage lending penetration in Tier II and Tier III cities in India.

Initiatives Proposed in Union Budget 2014-15

- Deduction of interest on housing loans to be raised to ₹ 2 lacs from ₹ 1.5 lacs previously.
- The total deduction allowed for repayment of principal amount has been increased from ₹ 1 lac to ₹ 1.5 lacs.
- Allocation to Rural Housing Fund, run by National Housing Bank (NHB), to be increased to ₹ 8,000 crores this fiscal.
- An additional ₹ 4,000 crores earmarked for NHB to enable it to increase the flow of cheaper credit towards affordable housing for urban poor.
- Government to spend ₹ 7,060 crores on developing 100 smart cities as satellite towns of larger cities and by modernizing existing mid-sized cities.

TRENDS IN THE HOUSING SECTOR

Despite huge potential in housing finance sector, there has been a stagnant growth rate due to high inflation and slower real income growth (real income = nominal income/price level).

Twin Concerns of High Inflation and Slow Income Growth

The high interest rate environment and lower income growth has adversely impacted purchasing power of consumers and lower discretionary spending. The prevailing sentiment has resulted in prospective buyers withholding big ticket purchases, particularly homes, in expectation of some correction in prevalent realty prices. Consequently, property demand has been sluggish, with oversupply situation prevailing in some micro markets.

Mixed Trends in Property Prices

In FY 2014, housing prices continued to rule high, except in a few pockets, probably due to holding power of real estate developers. NHB Residex, an index that tracks movement of residential prices across 26 cities, indicated that for the period October 2013 to December 2013, the prices marked an increase in 16 cities. The increase ranged from 8% in Nagpur to 1.1% in Dehradun. For Delhi, it was 3.2%, Patna 6% and Faridabad 2.5%. Prices declined in only 8 cities, including Lucknow 3.2% and Chandigarh 2%. Prices in Mumbai and Ludhiana have remained stagnant.

Low Demand for Housing Impacts Disbursements

Faced with lower demand and oversupply, the real estate developers delayed launch of new projects during first half of the year. This has checked downward spiral of housing prices, but it has resulted in slower growth in home purchases. HFCs have reported moderate growth in FY 2014.

The total outstanding amount of home loans was ₹ 9.03 lac crores as on March 2014 as compared to ₹ 7.51 lac crores as on March 2013[6]. The growth rate of HFCs and NBFCs has declined from 28% in FY 2013 to 23% for FY 2014. Banks have witnessed growth rate of 18% over the same period.

POLICY INITIATIVES

Major part of FY 2014 has been characterized by high rate of interest and a depreciating rupee. The liquidity across sectors was tight.

In order to check depreciating rupee, the RBI clamped down on foreign exchange outflows. It only allowed banks to undertake gold imports, on consignment basis, specifically to meet genuine needs of exporters of gold jewelry. It also reduced the limit for remittances made by resident individuals under the liberalized remittances scheme (LRS), from $200,000 to $75,000 per year.

NHB gave some relief to HFCs after relaxing provisioning norms and reduced risk weightage for property and housing loans. This has eased requirement of fresh capital to meet capital adequacy norms.
RBI allowed HFCs to raise funds through ECB route for affordable housing segment. HFCs have raised a sum of $600 million through this route during FY 2014. The Government has allowed NHB to raise tax free bonds, which will ease refinance rates.

RESPONSE TO POLICY INITIATIVES

These favorable policy initiatives have resulted in easing fund crunch and enabled HFCs to grow steadily despite difficult macroeconomic conditions.

Besides these positive developments, there were some adverse developments, such as, increase in the number of balance transfer cases in the industry. Some lenders have lured existing customers by offering discounts on processing fee and offering lower rates of interest to them. For HFCs, whose loans are being taken over, this is a big loss as they have to bear high boarding cost besides losing on business.

PRICING AND PROFITABILITY

Expected Movement of Growth Rate

The overhang of slowing economy of last two years will continue in FY 2015 even though marginal recovery is expected. Moderation in growth is expected due to stress in the overall economic environment, high rate of interest, price corrections etc.

However, long-term prospects for business continue to be encouraging. The growth rate is estimated to go up to 24% for HFCs and 14% for banks over the next few years. Large part of growth is expected to emanate from Tier II/III locations and affordable housing segment.

ASSET QUALITY

Asset quality of HFCs has been largely stable with gross NPAs of 0.73% as on March, 2014 as against 0.72% as on March, 2013.

Industry Growth Trends – Quick Facts FY 2014

- Overall Gross NPA% of HFCs: 0.73%
- Marginal decline in NIMs and stable operating expense levels
- RoTA level 2.29%
- RoE level 20.54%

(Source: ICRA's Indian Mortgage Finance Market, FY2014).

EMERGING STRONGER THROUGH TRANSFORMATION

In FY 2011, PNB HFL embarked on a transformation. Accordingly, it designed a multi-faceted business process re-engineering program as a roadmap.

Despite macro economic environment challenges, the implementation of this program has restructured PNB HFL into a contemporary HFC with robust top line growth and sound portfolio quality.
PNB HFL has been able to improve its earlier track record and consolidate its position in the industry through transformation, encompassing its entire business landscape - from people, infrastructure, IT, risk management, and to delivery model.

Restructuring Benefits

Post restructuring, the Company has been transformed from a low volume boutique player to the 5th largest HFC in India. Its organizational change story has been well appreciated and its efforts have been recognized by various prestigious organizations.

Higher Growth and Expansion

In FY 2014, PNB HFL registered a top line growth of 68%, besides sustaining healthy growth momentum of the previous years. The Company has built a solid asset base of over ₹ 10,000 crores which has more than doubled over the last 2 years. The Company is expected to maintain its growth at a level that is significantly higher than the industry average in medium term. In terms of geographical expansion, the Company has expanded across India with new branches being opened in South and West India. In North, where brand PNB is very strong, the Company's operations continue to be on a rapid growth trajectory.

Improved NPAs

PNB HFL has put in place robust tools for credit underwriting, monitoring and collection processes. There has been a steady decline in Gross NPAs from 0.56% as on March 31st, 2013 to 0.32% as on March 31st, 2014. It was driven by strong focus on curbing delinquencies in the erstwhile portfolio. In addition, the Company has focused on improving quality vectors of its portfolio and built a balanced portfolio mix. The pre-BPR portfolio has been cured of its delinquencies and now is at par with the industry.

Diversified Borrowing Profile

PNB HFL has a well-diversified resource profile, comprising bank loans, retail deposits, NCDs and NHB refinance. The Company has also successfully increased its focus on relatively stable retail deposits and has managed to sustain its borrowing at competitive rates of interest and repayment terms that match its inflows.

Financial Edge

PNB HFL is adequately capitalized with a net worth and capital adequacy ratio (CAR) of ₹ 919.96 crores and 13.39%, respectively as on March 31st, 2014. Ample net worth coverage of Net NPAs provides a cushion against asset-side risks. Further, the Company has a comfortable asset liability management (ALM) ratio with manageable negative cumulative mismatches.
PNB HFL also has adequate bank lines and overdraft facilities and a favorable policy of maintaining unutilized bank lines and liquidity. These attributes contribute to the strong financial profile of the Company.

Professional Management

PNB HFL draws strength from extensive domain knowledge and credible insights of its managers. The management's proven track record of excellence has played an invaluable role in the transformation journey and will define the contours of the Company's success in the coming years.

HUMAN RESOURCE

Building a Competency Driven Organization

The Company's growth ambitions are greatly facilitated by its vision to be a credible and preferred employer brand and ability to institutionalize a strong performance culture. Success in future will depend on the Company's ability to proactively adapt to the changing

environment and its being lean and competitive in a resource constrained environment.

The Company's innovative human resource management strategies have supported its business growth in today's competitive business environment. The strategic initiative to recruit, integrate and retain a diverse workforce in "One PNB HFL" culture and build a competency-driven organization has helped it retain its competitive edge.

In line with its core value of 'People First', PNB HFL's focus has been to create an environment where performance is rewarded, individuals are respected and people are given opportunities to realize their potential.

The Company continued to invest in updating and upgrading employee skills through multiple functional and behavioral-trainings, external certifications and on-the-job-training. PNB HFL follows a holistic 70:20:10 learning approach across functions. The Company believes that 70% of all capability is built on the job, 20% through coaching and 10% through classroom learning.

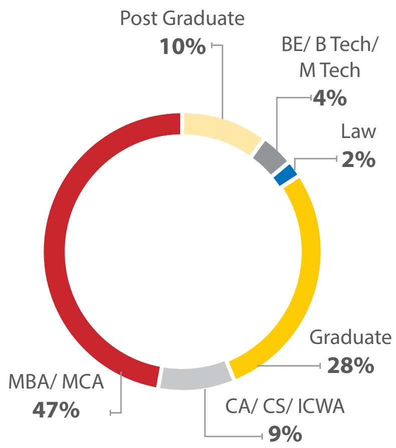
PNB HFL has been successful in building a motivating culture through a systematic performance appraisal process, which impacts compensation. Leadership development programs are conducted across management levels – for middle and senior management; and the Company accesses programs offered by reputed management institutes in India.

Continuous employee engagement through town hall get-togethers, one-on-one meetings, regular communication and other modes have helped the Company foster an open and transparent culture. To ensure a healthy work-life balance, the Company keeps organizing fun events and cultural activities, and provides opportunities to volunteer for social causes. Employees are always encouraged to involve their families in these activities.

The Company draws talent from diverse, reputed organizations, with competency based hiring as the focus. A comprehensive induction and orientation program is in place to enable smooth transformation. The Company's talent acquisition plan includes an optimal mix of fresh and experienced hires with diverse educational, cultural and organizational backgrounds.

As on March 31st, 2014, the total employee strength was 469, majority of whom are post graduates from various faculties including MBA, MCA, M Tech, Law, CA, CS and ICWA.

Education Mix



The diversity broadens the talent pool available to the Company and, at the same time, enriches quality of the workforce with different skill sets and outlooks, which contributes to innovation and improved productivity.

During FY 2014, the Company expanded its team by recruiting a total of 192 new employees. A substantial number of people who have joined the team are professionally qualified with extensive and relevant industry experience.

The Company continued its endeavor to encourage and recognize excellent performance and achievement through rewards that are creative, flexible and meaningful. Formal rewards and recognition (R&R) programs have been instituted across functions, locations and teams.
The R&R programs have been aligned with organizational goals and have brought about cross-functional synergy.

The compliance cell within HR continues to track employment and labor laws.
HR compliance is approached from both reactive and proactive standpoints.

DEVELOPING INTERNAL OPERATIONAL ROBUSTNESS

The operations function is central to any mortgage company, given the complex product structure and long tenure of loans. Operational robustness, a must to enhance efficiencies and effectiveness, is being developed through use of technology and centralization of back-end activities.

Closer to Customer via Technology

Through implementation of an online service request tracking system and customer care window on the website, PNB HFL has increased its proximity to consumers. The customer care window allows customers to put in service requests and register complaints, thus enabling them to perform key activities remotely. The online service request tracking system captures all service requests received through customer walk-ins, e-mails, letters and telephone. Apart from increasing effectiveness of customer services, it also helps measure service delivery turnaround time and productivity of employees.

Centralization of Operations

Retail finance is not only very competitive business but is also prone to errors and is thus exposed to financial risks. Given these risks, the industry has garnered maximum efficiencies by moving towards centralization of many important activities. In order to achieve the objective of making branches the point of sale and service, it is necessary to increase focus on customer service. Accordingly, PNB HFL identified back-end activities such as loan account closure, sourcing channel pay-out processing, handling customer letters and interest warrants for deposit accounts etc., which could be centralized and shifted to Central Operations.

Central Processing Center

In order to align with best practices in the industry relating to control and standardization of operating procedures, a central processing center (CPC) has been set up to store customer loan files, original title documents and loan repayment instruments. After disbursement, loan files are moved to centralized storage. Similarly, centralization of repayment instruments, ECS or post dated cheques has been achieved and the entire process of banking, monitoring and exchange of instruments is done from a central operations shop. These activities have brought in standardization and predictability in the system.

EXPANDING PRODUCT PORTFOLIO

PNB HFL is focusing on retail loans.
The Company's bouquet of products now encompasses loans for purchase of homes, self-construction, home extension and residential plots. The Company has also introduced new loan eligibility programs and mark-to-market products to expand its product portfolio and meet customer's need. The Company has identified urban middle and upper middle class as its target group of customers, within the age group of 30-45 years.

The housing portfolio further includes construction finance to real estate developers, which currently constitutes only a small proportion of total assets. The Company is presently testing response in the prevailing difficult macroeconomic scenario in order to create the necessary robustness and platform for leveraging opportunities in this customer segment. Non housing loans include loan against property (LAP), loan for purchase of office space and lease rental discounting.

PNB HFL continuously enhances its customers' experience by delivering innovative products that are tailored to fit emerging needs of the customers.
The 10-year pure fixed rate scheme was introduced last year across all products, to insulate customers from macroeconomic volatility and sudden rate of interest fluctuations. The range has been widened with the introduction of other fixed rate variants for 3 and 5 years.

The Company has developed processes that fulfill the customer's expectations of speedy approvals and has also introduced doorstep services. All customer communications have been created in simple, lucid language, totally shorn of technicalities and easily understood by all.

PROACTIVELY STRENGTHENING THE DELIVERY MODEL

Customer connect is the new norm and every business thrives on customer delight and satisfaction. There has been a paradigm shift in the new age marketing initiatives, with a slew of new techniques and distribution channels - ranging from digital media marketing, e-medium, SMS, toll free help lines and awareness campaigns. PNB HFL has been forging a greater bond with customers by making the Company's services available in a simple and easily accessible manner.

DISTRIBUTION NETWORK

PNB HFL has a network of branches spread across the country, which helps its customers to avail of financial services (loans and deposits) conveniently. Today, the Company has a strong network of in-house sales people and sourcing channel partners, which enables it to provide doorstep service to its customers. Besides the branch delivery model, the Company has created meaningful channels of distribution like the e-medium, toll free helpline and contact center to make its services easily available.

Strengthening Distribution Channels

The Company has a well networked distribution set-up, with strong in-house distribution channels. During the year, 47% of sourcing was done by in-house channels. As part of the Company's long-term strategy, the in-house channel would play a significant role in future.

Extending Frontiers of Growth

The Company is de-risking its geographical profile by expanding its presence across India. Earlier, the Company's presence was concentrated in the Northern region. In order to ensure well-balanced growth, PNB HFL is fast spreading to the Western and Southern regions as well. The existing network of 32 branches will expand to 38 branches during FY 2015. The expansion would enable PNB HFL to achieve balanced regional growth.

FOCUSED NEW-AGE MARKETING INITIATIVES

Post BPR, the Company has positioned itself as a young, customer-centric and trustworthy partner. The Company's core message to its customers is centered on comfort, ease and convenience of partnering with PNB HFL in pursuit of home ownership.

During the year, the Company, through its marketing plan and advertising campaigns, leveraged a mix of various mediums, including print, radio, television, digital and direct marketing to reach out to the target audience. The Company rolled out various promotional activities to engage with prospective customers. It participated in different trade shows and exhibitions. The new marketing collaterals and campaigns across different medium assertively promoted the Company's core positioning - Ghar Ki Baat, while reinforcing the promise of customer-centricity.

Radio and TV Campaign

A radio campaign enabled the Company to create awareness and generate consumer interest in its 10-year fixed rate product category. The Company also sponsored the CNBC Awaaz property show which enhanced visibility of its brand amongst potential customers, real estate developers and channel partners.

Digital Media Marketing

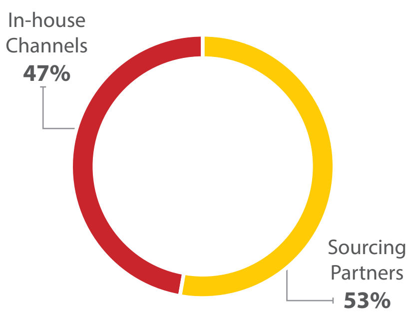
PNB HFL has entered into new age marketing to connect directly with target customers through digital marketing and mobile devices. These initiatives included search engine marketing, search engine optimization, e-mail campaigns, digital advertisements, affiliate marketing and remarketing to optimize the Company's online presence. These activities supported the lead generation process through an integrated lead management system (LMS) to deliver leads on a real time basis and enable monitoring of marketing campaigns across branches.

Enhancing Customer Engagement

PNB HFL is committed to building complete transparency with its customers. The Company's products have no hidden charges. The Company has also introduced various customer-friendly offerings to scale up customer engagement.

The Company also introduced online promotional programs such as 25% discount on processing fees on loans to mark the silver jubilee year of the Company.

Distribution Channel Mix



MANAGING GROWTH - RISK MANAGEMENT

The Company had entered FY 2014 with an important task to sustain good quality of portfolio and also sustain high growth momentum of FY 2013. Despite tough macro environment conditions and competition, the Company was able to achieve its targets set out at the beginning of the year. The risk management unit enabled a balanced growth of business by ensuring constant underwriting support. Risk management team's interventions ascertained good health of the overall portfolio.

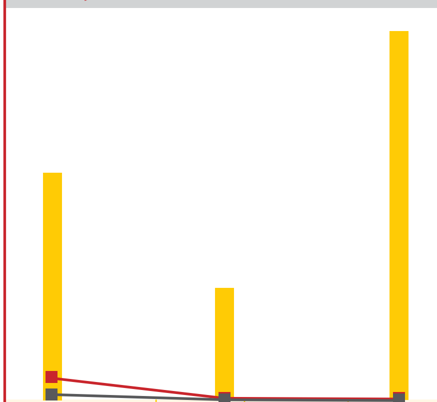
Underwriting and Operating Model

The Company enhanced its risk management capabilities and processing capacity and created a specialized team for underwriting high-value and complex loans. It improved data analytics and embedded operational rigor in work flows and underwriting. The business maintained healthy acceptance rates of approximately 80% in the salaried segment and 57% in the self-employed segment. The Company achieved a turn-around time of 3 days for about 72% of the salaried cases and 7 days for about 85% of the self-employed cases. The Company also hired experienced underwriters and provided them on-the-job training besides recognizing good performance. The Company has an application tracking system (ATS) to provide enhanced monitoring of processes – from data capturing of application, decision making to appraisal module and disbursement initiation. The system can be interfaced with full-fledged enterprise core business suite (ECBS), being implemented in FY 2015.

Portfolio Vintage and Delinquencies

Post execution of new credit policies and processes, there is considerable reduction in delinquencies and NPAs. As on March 31st, 2014, more than half (52%) of the retail portfolio had a weighted average month on board (MoB) of less than or equal to 12 months. This segment had a delinquency rate of merely 0.06% and nil NPAs.

Vintage and Delinquency Analysis – Retail Portfolio

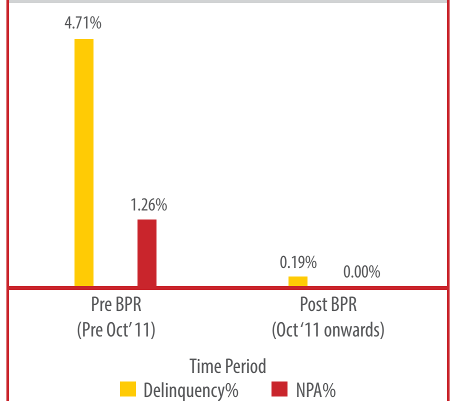


	MoB >= 20	12 < MoB < 20	MoB <= 12
Portfolio %	32%	16%	52%
Delinquency %	3.23%	0.08%	0.06%
NPA %	0.85%	0.00%	0.00%

In comparison, 32% of retail portfolio was greater or equal to 20 MoB and has a delinquency rate of 3.23% and NPAs of 0.85%.

For loan portfolio with MoB greater than or equal to 20 months, the delinquency rate in the pre-BPR period was 4.71% and NPAs were at 1.26%. For the same vintage, in the post-BPR period, the delinquency was 0.19% with nil NPAs - indicating robust underwriting operations.

Portfolio MOB > = 20 months



Better Control on Processes

PNB HFL has developed a Hub and Spoke model for underwriting to ensure better control on processes, standardization and customer selection. Prior to FY 2014, the Company had three Hubs - in Delhi, Mumbai and Bengaluru, headed by experienced underwriters for end-to-end credit processing of all the branches in their zones. They were supported by a team of specialists managing fraud control, legal and technical functions. The model has been very successful, hence, during FY 2013-14, three more extensions of these hubs were added at Jaipur, Chandigarh and Indore to support smaller upcountry branches. Given the diversity of issues across different cities in terms of property norms and local practices, there is a need for local specialists. Developing of risk infrastructure in Tier II and III markets by establishing more Hubs supported by local expertise will remain an area of focus in FY 2015.

Wholesale Finance

PNB HFL has created a new specialized wholesale finance vertical, underwriting of wholesale construction finance applications undergoes intense credit checks and multiple levels of evaluation before sanction and is supported by an experienced technical team. This team is responsible for origination and monitoring of loan portfolio comprising many large real estate developers. The quality of portfolio generated so far has zero delinquency. PNB HFL is planning to geographically expand its reach to new cities and real estate developers.

Approved Project Funding (APF)

PNB HFL has made it easy for its customers to choose properties for purchase and has increased number of approved projects. A project approved by the Company increases customer's confidence. At the same time, the Company's tie-up with the developer helps to access loans originating from that project. Business under APF has increased to a significant level as on March 31st, 2014 and the focus on this initiative will continue to further augment the penetration.

Technical Services Group

This is a newly developed specialized vertical in the Company and is a critical part of risk management function. This team ensures policies for property valuations, management of valuers, approvals of developers' projects and monitoring of processes in the approved projects. The team ensures that the property being funded is appraised completely and comprehensively beforehand. A key initiative for FY 2015 will be to integrate reporting by external valuers with the enterprise system. This would make work flow smooth and improve turn-around time, with regards to submission of valuation reports.

Legal Appraisal

Legal evaluation is an important function of the risk management unit to establish clear titles of the properties being financed. The Company has an internal team of legal experts located at all the hubs. These experts appoint local lawyers in the cities where the Company operates and takes their opinions on the properties being mortgaged. The Company has state-wise procedures and drafts (P&D) checklist to standardize legal practices.

For properties financed in the past, the Company has completed an intense exercise to ensure security perfection; this includes complete collateral legal review of close to 36,000 accounts booked before March 31st, 2013.

The Company organizes regular training by renowned legal experts who provide useful insights to the team on the intricacies in legal appraisals.

Over the last one year, the Company has built in-house capacity and acumen for drafting transaction and security documents for the wholesale business.

Fraud Control

The fraud control unit (FCU) was another new initiative started in FY 2012. The core team of FCU educated other business verticals about effective checks required to identify new trends in the types of frauds and other available market intelligence. The FCU took various measures in terms of conducting root-cause analysis for loan declines on account of frauds and identified fraud perpetuation point. These initiatives ensured strong deterrents against frauds.

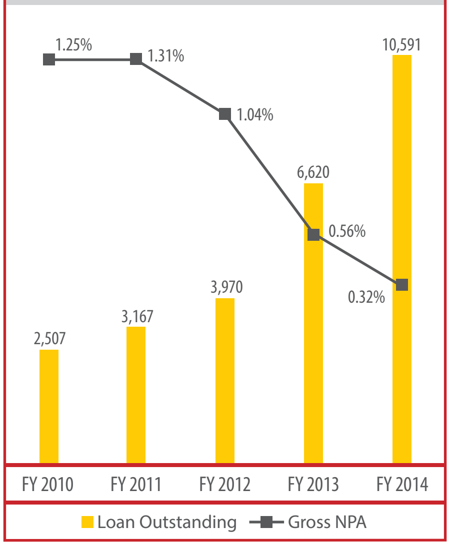
Recoveries

During FY 2014, there was a marked reduction in collection inventories in all delinquent buckets, both in percentage terms and in value. Gross NPAs and total delinquencies were reduced to ₹ 33.72 crores and ₹ 117 crores, respectively from ₹ 55.25 crores and ₹ 185.79 crores, respectively, at the beginning of the year.

Various initiatives were taken during FY 2014 such as rigorous implementation of the collections and foreclosure standard operating procedures (SOPs) and processes, prompt action under SARFAESI Act for improved collection, MIS with early warning trends to enable timely action to restrain delinquent accounts, efficient operational processes to ensure timely and prompt calling to replenish exhausted post-dated cheques (PDCs), replacement of external agencies with in-house collection resources at many locations, active follow-up to convert cases with PDCs to ECS, making the repayment process more customer-friendly, smoother and cost effective. The Company has created specialized cadre to steer the NPAs control process, with strong oversight and qualitative checks to maintain NPAs at industry-best levels. The Company has in place a formal training program and a well-structured system that consists of detailed manuals for training, processes and procedures.

The Company promotes relationship-based lending where initial delinquent customers are counseled and educated on the importance of maintaining a clean track record. These are followed by telephonic conversations and personal visits from employees. The Company has ensured fair standards to deal with delinquent customers. Legal recourse is taken with fair means. During such proceedings, PNB HFL ensures that its interactions with the customers remains professional, transparent and respectful. The team puts in sincere efforts to understand core issues causing delinquencies and explores various solutions within the ambit of law to help customers.

Gross NPA as a %age of Outstanding Loans (₹ Crores)



Trends in Net NPAs (As a % of Net Advances)

Mar 2010	Mar 2011	Mar 2012	Mar 2013	Mar 2014
0.96	0.94	0.67	0.35	0.16

GOOD PERFORMANCE IN CHALLENGING TIMES

Loan Approvals

The Company has achieved sustained growth in loan sanctions over the last 4 years. When compared with the figures at the end of March 2010, the Company has grown at CAGR of 43.37%. Fresh loans approved during FY 2014 increased to ₹ 8,840 crores as against ₹ 6,091 crores in the previous fiscal, a growth of 45%.

Loan Disbursements

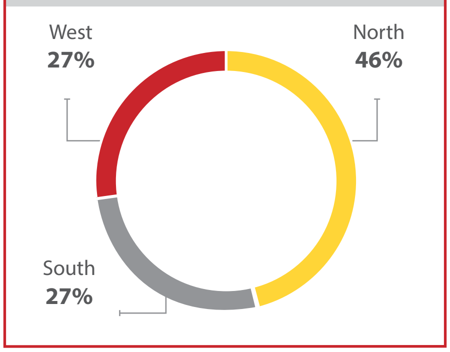
During FY 2014, total disbursements grew by 49% in value terms. Total disbursements in FY 2014 were ₹ 5,500 crores as against ₹ 3,682 crores in FY 2013. When compared with the figures at the end of March 2010, the loan disbursements have grown at a CAGR of 61.67%. Disbursement as a percentage of loans sanctioned during FY 2014 amounts to 62.22%.

Incremental Disbursements	FY 2014 (₹ in Crores)
Housing loans	3,138
Non-housing loans	1,802
Construction finance	560
Total	5,500

Growth in construction finance remained muted in line with the Company's cautious approach towards this segment.

Geographical Mix: The Company has also corrected disbursement skewness towards North and has expanded new business in Southern and Western regions of the country, as under:

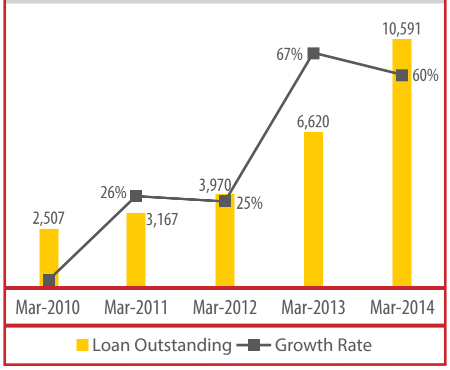
Geographical Mix



Outstanding Loan Book

In the last 4 years, the Company's loan book has grown four times and crossed ₹ 10,000 crores in the silver jubilee year. At the end of FY 2014, the loan book stands at ₹ 10,591 crores, a growth of 60%. When compared with the figures at the end of March 2010, the loan book has grown at a CAGR of 43.36%.

Growth in Outstanding Loans (₹ in Crores)



Loan Book Composition (%)

	%	₹ in Crores
Housing loans	65	6,850
Non-housing loans	28	2,966
Construction finance	6	633
Securitized book	1	142

Disbursement Trends

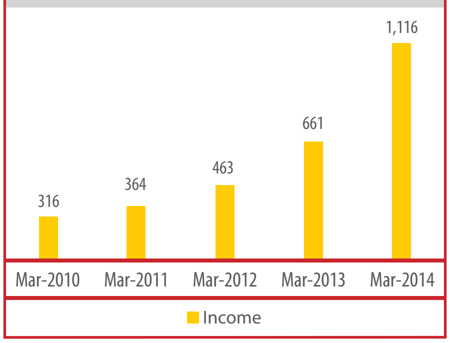
	FY 2010	FY 2011	FY 2012	FY 2013	2014
Loans Sanctioned (₹ in Crores)	850	1,391	1,668	6,091	8,840
Actual Disbursement (₹ in Crores)	805	1,267	1,508	3,682	5,500
Disbursement/Sanction (%)	94.71	91.09	90.41	60.45	62.22

FINANCIAL PERFORMANCE

Income and Profitability

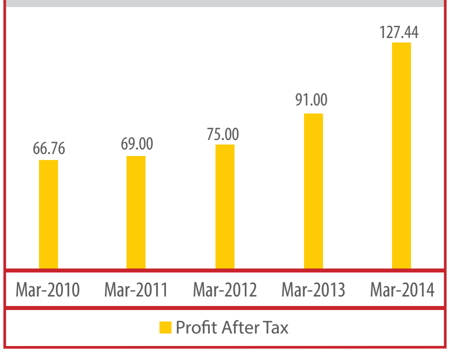
Total income for the year crossed ₹ 1,000 crores for the first time, to reach ₹ 1,116 crores. The Company has achieved a growth of 68% over FY 2013. Over the years, the income has been rising steadily at a CAGR of 36.96% (trend from March 2010).

Income Growth Trend (₹ in Crores)



During FY 2014, the Company crossed ₹ 100 crores of profit after tax (PAT) at ₹ 127.44 crores i.e. 39% over FY 2013. Over the years, the PAT has been rising steadily at a CAGR of 17.54% (trend from March 2010).

PAT Growth Trend (₹ in Crores)



The return on assets (RoA) as on FY 2014 was 1.39%, compared to 1.71% in FY 2013. The decline in RoA was due to high operating expense incurred in setting up brick and mortar and IT infrastructure. The management of the Company is aware of this compulsion and is confident that the future benefits will accrue from these investments to reinstate RoA to healthy levels in 3-4 years. Post fresh equity infusion, the return on average equity (RoE) has declined moderately to17.09%.

The Company continued to offer competitive rates of interest to its customers, with moderate processing fees. In spite of rising rate of interest, the Company did not put fresh burden (except 0.25% increase in reference rate) on its existing customers which is in line with the Company's philosophy of passing minimum macro economic shocks to its customers.

FUNDING AND RESOURCE PROFILE

Managing Financial Risks

FY 2014 was a challenging year for raising resources at competitive rates especially after Q1, when RBI tightened liquidity. However, advance planning ensured sustained inflow of funds at the right price. Despite many challenges, the net interest margin was maintained at above 3% throughout the year aided by judicious resource planning and resource mix.

PNB HFL has established internal capabilities to manage financial risk through diversified borrowings mix. The Company raises financial resources from banks, bond market, NHB refinance and public deposits. It has an adequate proportion of wholesale and retail borrowings. The Company benefits from the strong brand of the parent bank, which provides stable credit pipelines from institutions as well as retail investors.

There is a growing investor confidence in the Company's issuances. Many of the Company's investors are reputed pension funds, provident funds and mutual funds for varying maturity period ranging between 3, 5 and 10 years.

With a prudent pricing policy that combines lending on fixed and floating rates of interest, the Company is able to cater to different customer segments in a manner that maintains overall portfolio yield and spreads.

CREDIT RATING

Over the years, PNB HFL has been perceived by investors as a capable entity to manage its assets and liabilities prudently. This is also endorsed by the high ranking of the Company's borrowings by rating agencies.

The Company's long-term borrowings are CRISIL AA+, CARE AA+ and ICRA AA+ with stable outlook. The Company's commercial paper has been rated CRISIL A1+ and its Fixed Deposit program is CRISIL FAAA with stable outlook.

- Rating agencies have positively looked at extensive revamp of PNB HFL's business model, which has resulted in substantial improvement in its scale and processes across functions, including human resources, back-office operations and most importantly, across the entire credit chain.

Judicious Mix of Borrowings

	March 2013 (₹ in Crores)	% share	March 2014 (₹ in Crores)	% share
Banks	2,916	41.85	4,083	39.87
NCDs	2,100	30.14	3,450	33.69
Refinance (NHB)	900	12.92	996	9.73
Deposits	1,051	15.09	1,712	16.72
Total	6,967	100.00	10,241	100.00

- There is steady improvement in asset quality over the past two years. There is expectation that the asset quality in its recently originated book should remain close to industry average – the monitoring mechanisms are in place and all delinquencies are seriously looked at.

INTERNAL AUDIT

The Company has put in place a strong system of internal control to commensurate with its growth and nature of its operations. It has developed internal controls to provide high degree of assurance regarding effectiveness and efficiency of operations, adequacy of safeguards for assets, reliability of financial controls and compliance with applicable laws and regulations.

The Company conducts risk-based internal audit of all its branches, hubs and central support office on a quarterly basis. Internal audit teams are supported by external chartered accountant firms while conducting transaction audits of its operations.

The Company has a system to bring important observations of audit reports to the notice of the Audit Committee of the Board. In order to ensure quality, audit reports are discussed with zonal functionaries to convey message at ground level. This has ensured improvement in overall quality of business.

CONTRIBUTING THROUGH CSR PROGRAMS

The Company is committed to serve the society's underprivileged. In its commitment to be engaged in a meaningful and business aligned CSR activities, the Company has joined hands with mobile crèches for providing day-care and schooling facilities to the children of construction-site workers. The Company has collaborated with Kids for Kids - an NGO - to help spread smiles among the citizens of tomorrow. The Company's annual calendars have been designed by Kids for Kids, using children's talent and creativity. The Company has also tied up with the Indian Medical Association (IMA) with a view to make meaningful contribution to the society at large. The Company has entered into an MoU with IMA, whereby it ploughs back 25% of the processing fee collected from IMA doctors and invests this amount in health camps organized for the underprivileged. The Company has also contributed to Sanjivni Society of Mental Health, an NGO that addresses mental health needs of the Indian society.

OUTLOOK AND FUTURE OPPORTUNITIES

The Indian economy is on the cusp of change and most economists expect it to expand in the coming quarters. Some of the measures taken by the earlier government to boost growth will start bearing fruit. It is also expected that the new government will take firm decisions to augment growth of the economy. The measures taken by RBI are expected to anchor inflationary expectations and cap inflation. While subsidies on fuel are gradually being trimmed through monthly and bi-monthly increase in diesel price, it is the new subsidy element on the food bill which will impact the economy. General view is that rate of interest will soften; that should improve demand and increase overall investments across segments, including housing sector.

Sustained Demand for Mortgage-based Borrowing in Housing Sector

The demand for housing is unlikely to slowdown in the foreseeable future. As per the 12th Five Year Plan Period (2012-2017) report by the technical group, the urban housing shortage is estimated to touch 18.78 million units over the next few years. Around 95% of this shortage will be in terms of housing for economically weaker section (EWS) and low income groups. The rural housing shortage is estimated at 43.9 million units. This translates into prolific opportunities for housing finance companies.

Transforming to Capture the Opportunity

Initiatives undertaken by the Company are geared to ensure that it does not only maintain growth momentum but also manages it well. The management is convinced that secure, efficient, scalable and cost effective infrastructure is required to manage accelerated growth momentum, hence a sizable amount of effort and capital (internal accruals) have been invested in building strong foundation of the Company. An important part of it is the enterprise core business suite which is being tested and will be implemented in FY 2015.

Low Penetration Indicates Great Potential

Given the low penetration level of mortgages at 8% to GDP, there is a huge potential for funding agencies. This can be observed from the growth in mortgage funding since FY 2000.

	Growth in Home Mortgages[7]			
	Year ended March 2000 (₹ in Crores)	Year ended March 2014 (₹ in Crores)	Year ended March 2000 (% to total)	Year ended March 2014 (% to total)
HFC	25,326	3,33,700	58	37
SCB	18,525	5,69,300	42	63
Total	43,851	9,03,000	100	100

The Company's endeavor in the coming years will be to increase retail business in approved real estate developer projects. With a view to deepen its commitment in the existing places of operation, it proposes to open six new intra city branches in FY 2015. With this expansion, the Company will be able to better serve customers in Delhi NCR, Bengaluru, Pune, Chennai and Mumbai.

Leveraging Technology to Boost Growth

Technology will play a pivotal role in shaping the distribution strategy, with greater emphasis on convenience, ease of information flow and building new customer touch points. The Company's marketing strategy is also inclined towards exploiting the potential of new-age digital media platforms. In its commitment to build stronger relationships and ensure client retention, the Company will look at various means to nurture customer relationships.

Casting the Die for the Future

Going forward, the management aims to build a smart, stable and sustainable business that is focused on quality, productivity and optimizing profitable growth opportunities from existing geographies. With well-equipped underwriting hubs to support business origination from branches and in-house subject matter experts to address local nuances and needs, the operating model for the coming years is going to be even more robust and customer-focused.

The thrust will be on better administration of credit processes, development of Tier II and III markets and catering to new/growing geographies, with increased focus on achieving economies of scale.

Strengthening partnerships shall be an important strategic agenda for growth, across retail and wholesale business.

The measures undertaken over the last few years will ensure sustained growth in the coming years. The Company will continue in its endeavor to be a good corporate citizen and will increase its focus on meaningful, sustainable CSR activities, which will provide a better future for the public at large.

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