9th ANNUAL REPORT
2004-2005

PNB GILTS LTD

(An ISO 9001 : 2000 Company)

BOARD OF DIRECTORS

Sh. S.C. Gupta, Chairman
Sh. C.P. Swarankar, Director
Dr. O.P. Chawla, Director
Dr. Kamal Gupta, Director
Sh. S.K. Soni, Director
Sh. R.S. Lodha, Director
Sh. Sunil Kant Munjal, Director
Sh. Arun Kaul, Director
Sh. I.D. Singh, Managing Director

STATUTORY AUDITORS

Raj K. Aggarwal & Associates
Chartered Accountants
3072/41, Gola Market
Darya Ganj, New Delhi - 110 002

INTERNAL AUDITORS

KPMG
4B, DLF Corporate Park, DLF City,
Phase III, Gurgaon - 122002

BANKERS

Reserve Bank of India
Punjab National Bank

REGISTERED CUM CORPORATE OFFICE

5, Sansad Marg, New Delhi - 110 001.
Tel: 011-2332 5759/2332 5779
Fax: (011)-23325751
E-mail: pnbgilts@del2.vsnl.net.in
Website : www.pnbgilts.com

BRANCHES

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Fort, Mumbai - 400 001.
Tel: 022-22691812/22693314-17
Fax No. 022-22691811/22692248

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Chennai - 600 014.
Tel: 044-28591750/28547502/28418579
Fax No. 044-28591751

6A, Clive Row, Kolkatta - 700 001.
Tele. 033-22210394/22210395
Fax No. 033-22210378

Navdeep House, Near Income Tax Circle,
Ashram Road, Ahmedabad - 380 014.
Tel. No. 079-27582506/7
Fax No. 079-27541808

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2nd Floor, Hudson Circle,
Bangalore - 560 027
Tel.: 080-2212 7884
Fax: 080-2212 7883

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LETTER TO SHAREHOLDERS

Dear Shareholder,

The institution of Primary Dealers (PDs) has been in existence in India for about nine years now. In the initial eight years, there was almost a secular decline in interest rates. Given the inverse relation between interest rates and prices of debt securities, this initial period was a golden era for PDs and debt market. During this period, PDs contributed significantly to the depth of the government securities market, and also raked in huge profits.

The financial year 2004-05 was the first year of reversal of interest rate cycle since the inception of PD system. The benchmark 10-year yield rose by 215 basis points during 2004-05 before closing the year with a net increase of 152 basis points.

Increasing crude prices, global interest rate scenario, domestic inflationary pressures and unprecedented credit growth exerted an upward pressure on the domestic interest rates. The benchmark reverse repo rate was also hiked by RBI from 4.75 percent to 5 percent during the course of the year.

Given the sharp and sudden rise in market yields, most market players were caught off guard by the macroeconomic and market developments. The company has always acknowledged the strong correlation between its revenue streams and interest rate movements. In view of upward movements of interest rates and shrinkage of market volumes, there were very little trading opportunities. As a consequence, the company suffered setback leading to deterioration in financial performance.

During the year, the company expanded its fee-based business by undertaking newer activities while consolidating its presence in the existing segments. Project appraisals, Loan syndications and Mutual fund distribution are some of the new fee-based segments initiated during the course of the year. The company shall continue to nurture its fee-based business in the coming years in view of the relatively low volatility of income streams therein.

Looking ahead, the outlook on interest rates appears to be volatile with an upward bias. Global interest rates, crude prices and domestic inflation continue to cast a shadow on the domestic interest rates. The company however, is now better equipped to exploit the expected market volatility in future. Both trading strategy and risk management systems have been reworked to respond optimally in the emerging interest rate environment.

These improvements are reflected in the company's performance in the first quarter of 2005-06. During the quarter, the yield on 10-year benchmark paper touched a high of 7.38 percent from 6.67 percent as at March 31, 2005. Supply concerns on account of higher budgeted government borrowings, record crude prices and rising global rates were the major drivers for the bearishness during the quarter. Despite hardening of interest rates during this period, the company managed to post a profit of Rs 16.52 crore.

The current year shall no doubt bring newer unanticipated challenges for the company. I am, however, confident that the company will rise to the occasion and deliver the desired results for enhancing shareholders' value.

Thank you,

S.C.Gupta
Chairman

DIRECTORS' REPORT

Your Directors have pleasure in presenting the Ninth Annual Report together with the audited accounts of the company for the year ended March 31, 2005.

1. FINANCIAL RESULTS

The financial results for the year ended March 31, 2005 along with comparative figures for the previous year, are given below:

(Rs in lacs)

	31.3.2005	31.3.2004
Total Income	1127.67	23794.16
Total Expenditure	7940.68	6929.36
Profit/(loss) before tax	(6813.01)	16864.80
Less : Provision for Income Tax (including deferred tax)	12.42	6168.96
Profit /(loss) after Tax	(6825.43)	10695.84
Add: Balance in Profit & Loss Account brought forward	7046.45	6968.26
Amount available for Appropriation	221.02	17664.10
Proposed Appropriations		
Transfer to Statutory Reserve	-	2410.00
Transfer to General Reserve	-	1070.00
Dividend	-	3375.20
Dividend tax	-	432.45
Market Fluctuation reserve	-	3600.00
Balance carried forward	221.02	7046.45

The Indian Debt Market faced difficult challenges during 2004-05. The acceleration of head-line WPI inflation, high volatility in crude oil prices, international commodity prices besides hardening of global interest rates were the key factors driving the bearish sentiments leading to rise in yields. The 10 year government security yield inched up by 152 basis points from 5.16% in March' 2004 to 6.68% in March' 2005 as against a fall in yield by 105 basis points during 2003-04.

These adverse factors had an impact on the company's operations resulting in reduced income during the current financial year. On the other hand, the increase in call money rates coupled with hike in reverse repo rate resulted in increased cost of borrowing. As a result the net loss for the current year amounted to Rs. 68.25 crore.

The company has always realised that its operating results are a function of movement in market rate of interest. Accordingly, to absorb the impact of future adverse movement in interest rates, the company had, when the interest rates were favourable created market fluctuation reserves to the extent of Rs.63 crore apart from keeping un-appropriated profits to the tune of Rs.70.46 crore. The loss for the year has been adjusted against the un-appropriated balance in Profit and Loss Account and Market Fluctuation Reserve of Rs.63 crore remains intact. The tangible net-worth of the company as on March 31, 2005 stood at Rs.471.51 crore.

2. CAPITAL ADEQUACY

Capital adequacy ratio as on March 31, 2005 stood at 62.97 per cent against the RBI stipulation of 15 per cent.

3. DIVIDEND

Since inception, the company has had a record of consistent dividend payments. During 2004-05; in view of bearish market trends, the company incurred a net loss of Rs.68.25 crore. Pursuant to RBI guidelines for Primary Dealers restricting payment of dividend out of current year's profit only, the Board has not recommended any dividend for the financial year 2004-05.

4. **OTHER MATTERS**

4.1. Directors

During the year, the Board of Directors met eight times to review strategic, operational, technological and financial matters besides laying down policies and procedures for operational management of the company, compared to the required minimum of 4 meetings in a year. The Audit Committee of the Board met four times and the Share Transfer Committee met thirty two times.

Changes since last Annual General Meeting

The following changes took place in the Board of Directors of the company since the date of last Annual General Meeting

Sh. S.S.Kohli, Chairman has resigned from the Chairmanship of the Board of the company on completion of his term as Chairman and Managing Director of the parent bank, Punjab National Bank.

Sh. S.C.Gupta, Chairman and Managing Director of Punjab National Bank has joined as the Chairman of the company in place of Sh.S.S.Kohli.

Dr. K.C.Chakrabarty, earlier Executive Director of Punjab National Bank was inducted as Additional Director on the Board of the company in October, 2004. However, consequent upon his elevation as Chairman and Managing Director of Indian bank, Sh. C.P. Swarankar has joined as Executive Director of Punjab National Bank and an Additional Director on the Board of the company in place of Dr. K.C. Chakrabarty.

Retirement of Directors by Rotation :

As per Article 99 of the Articles of Association of the company Dr.O.P.Chawla, Sh. Arun Kaul and Sh.R.S.Lodha retire by rotation in the forthcoming Annual General Meeting and are eligible for reappointment.

4.2. Corporate Governance

Corporate Governance for the company means achieving high level of accountability, efficiency, responsibility and fairness in all areas of operation. Our workforce is committed towards the protection of the interest of the stakeholders viz a viz shareholders, creditors, investors, customers, employees, etc. Our policies consistently undergo improvements keeping in mind our goal of maximisation of value of all the stakeholders. The Corporate Governance practices followed by the company are given in the Annual Report. A certificate from M/s Raj K Aggarwal, Statutory Auditors of the company regarding compliance of conditions of corporate governance stipulated by stock exchanges is enclosed to the report of corporate govenance.

4.3. Directors' Responsibility Statement

Pursuant to Section 217(2AA) of the Companies (Amendment) Act 2000, the Directors confirm that in the preparation of the annual accounts:

- the applicable accounting standards have been followed.
- Appropriate accounting policies have been selected and applied consistently, judgements and estimates made are reasonable and prudent so as to give true and fair view of the state of affairs of the company at the end of the financial year ended March 31, 2005 and the profit and loss account for the year ended March 31, 2005.
- Proper and sufficient care has been taken for the maintenance of adequate accounting records in accordance with the provisions of the Companies Act 1956 for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.
- The annual accounts have been prepared on a going concern basis.

DIRECTORS' REPORT Contd...

4.4. Internal Control Systems & their adequacy

M/s Raj K Aggarwal and Associates, Chartered Accountants, Delhi were appointed as the Statutory Auditors of the company by the Comptroller & Auditor General of India for the financial year ended 31st March 2005. The report of the auditors is self-explanatory.

The company considers Internal Audit to be a very significant part of its corporate governance practices. For the year 2004-05, the Board appointed M/s KPMG as the Internal Auditors of the company. The scope of Internal Audit included audit of treasury transactions on a monthly basis and reporting to the Audit Committee of the Board that the company has operated within the limits of various risk parameters laid down by the Board, Reserve Bank of India and other statutory authorities. Besides, they also audited other key business operations of the company on quarterly basis. All the reports of the Internal Auditors were submitted to the Audit Committee and the monthly audit reports were submitted to Reserve Bank of India as well. The company has also evolved an in-house internal audit system whereby a senior and independent official of the company performs this function.

4.5. Human Resources

Total number of employees of the company as on March 31, 2005 is 38. The company has maintained peaceful and harmonious relations with its employees.

The information required under the Section 217 of the Companies Act , 1956 read with the companies (Particulars of Employees)(Amendment) Rules, 2002 be treated as NIL as none of the employees of the company draws remuneration in excess of Rs 2,00,000 /- p.m. No employee is related to any director of the company.

4.6. Particulars required to be furnished by the Companies (Disclosure of particulars in the report of the Board of Directors/Rules, 1988).

a) Part A pertaining to the conservation of energy are not applicable to the company.

With regard to Part B pertaining to technology absorption, the company has installed the integrated treasury management software and RBI's Negotiated Dealing System with the help of IDRBT and reputed IT companies. The company recognizes the growing importance of Information Technology in the emerging business environment. The company, therefore, intends to draw a long-term IT plan so as to position itself in a strategically advantageous position in the future.

b) Foreign Exchange earnings and outgoing :

The company has neither used nor earned any foreign exchange during the year under review.

4.7. Public Deposits

During the year ended March 31, 2005, your company has not accepted any deposits from the public within the meaning of the provisions of the Non- Banking Financial Companies (Reserve Bank) Directions, 1977 and circular dated 31st January 1998.

4.8. Acknowledgement

Your directors thank Government of India, Reserve Bank of India, Punjab National Bank, Commercial, Cooperative & Regional Rural banks, Financial institutions, PF trusts, public sector undertakings and private sector corporate bodies and other valued clients for their whole- hearted support. We acknowledge the sincere and dedicated efforts put in by employees of the company at all levels.

Date: 27th July, 2005
Place: New Delhi

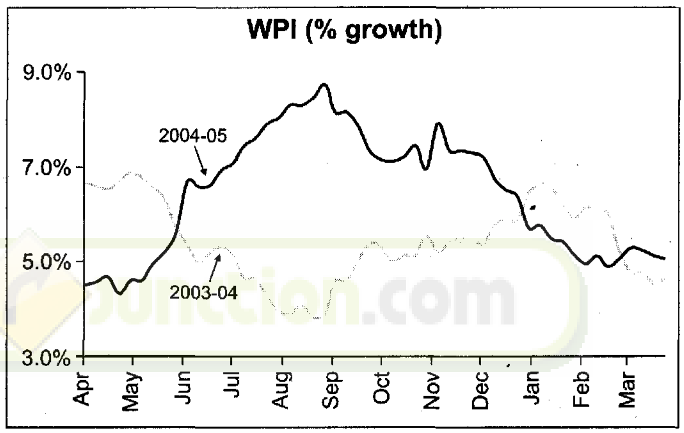
S. C.Gupta
Chairman

MANAGEMENT DISCUSSION AND ANALYSIS

MACROECONOMIC REVIEW

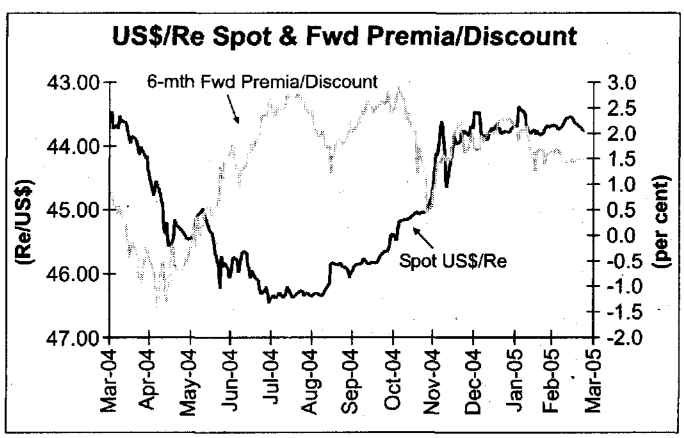
The fiscal year 2004-05 witnessed a marginal slowdown in GDP growth to 6.9 percent from the 8.5 percent growth achieved in 2003-04. While industry and services sector continued to post robust growth rates, agriculture sector was a laggard on account of indifferent monsoons. As per CSO estimates, industry sector was the best performer with a strong acceleration in growth to 8.3 percent in 2004-05 compared to 6.5 percent in 2003-04. Services sector too grew by a healthy 8.6 percent - almost unchanged from 8.9 percent achieved in 2003-04. Poor monsoons and base effect of seven-year peak growth of 9.6 percent achieved in 2003-04 pulled the agriculture sector growth down to 1.1 percent in 2004-05.

Driven by strong forex inflows, domestic monetary conditions remained easy during the fiscal 2004-05. However, the expansionary impact of forex inflows was to a large extent neutralised by RBI's intervention through LAF and MSS. As a consequence, the annual growth in money supply (M3) on point-to-point basis at 12.8 percent was lower than 16.9 percent in 2003-04. The increase in reserve money at 12.1 percent during 2004-05 was also lower than that of 18.3 percent during 2003-04.



In the first 5 months of the fiscal, domestic inflation rose sharply to touch the peak of 8.7 percent in August'04. The increase was primarily driven by high commodity prices in global markets. Metals and crude oil prices touched new multi-year highs during the year. In addition, poor north-west monsoon pushed up prices of agricultural commodities too. In the second half of the fiscal, inflationary pressures started receding on account of a combination of fiscal and monetary measures to rein in inflation. In addition, the high base effect also had a salutary impact on inflation in the second half.

The annual rate of inflation, measured as point-to-point variations in the wholesale price index (WPI), rose from 4.5 percent in April 2004 to 8.7 percent in August 2004, then declined steadily to 5.0 percent by March-end 2004. On a weekly average basis, WPI inflation stood at 6.4 percent during 2004-05 against 5.4 percent during 2003-04.



The Indian forex market witnessed bi-directional volatility during the year. Led by a slowdown in FII inflows and rising crude prices, the domestic currency depreciated by 4.5 percent against the US dollar during May-July 2004. Later, the resumption of FII inflows and the weakness of US dollar against major currencies led to the rupee appreciating by 6.6 percent in August-December 2004. On a full-year basis, the rupee depreciated by 0.7 percent against the US dollar in 2004-05 against an appreciation of 9.3 percent in 2003-04. Forward rates began the year at a discount, reflecting the excess supply conditions in the spot market. They, however, turned into premia from June 2004 again tracking the movements in the spot market. Despite the appreciation of rupee in the spot market during August-December 2004, forwards continued to remain in premia during this period.

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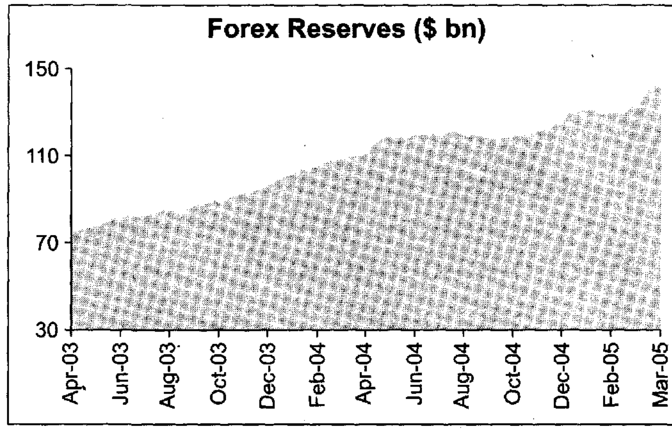
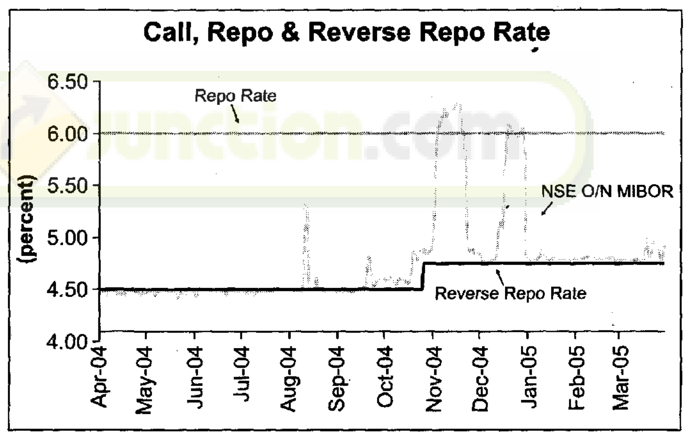


India's forex reserves increased by 25 percent to US $ 141.5 billion by March-end, 2005 from US $ 113 billion at March-end 2004. The increase in reserves was entirely on account of strong capital inflows. Portfolio flows continued to be the single largest contributor to the capital account. As per SEBI, net purchases by FIIs stood at Rs.44,123 crore during 2004-05 compared with Rs. 39,959 crore during the previous year. The current account went into deficit during the year after a 3-year run of surpluses from 2001-02 to 2003-04. Despite the support from invisible earnings, a record level of the trade deficit led to a current account deficit to the tune of US $ 7.4 billion during the first three quarters of 2004-05.

Money Markets



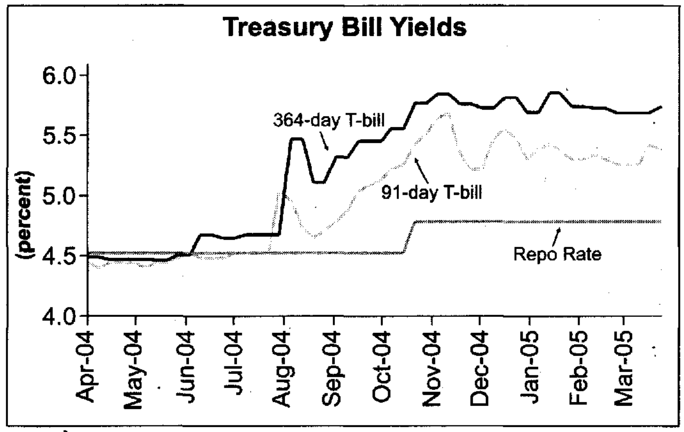
Reflecting the easy liquidity conditions, call rates remained marginally below the reverse repo rate during the first half. There were occasional spikes in rates on account of liquidity mismatches. The liquidity scenario deteriorated in the second half. A hike in the reverse repo rate by 25 basis points to 4.75 percent effective October 27, 2004 raised the floor in the money markets. Besides, robust expansion of non-food credit, slowdown of capital inflows and an increase in reserve requirements drove the call rates above the reverse repo rate in the second half of October. Festival cash demand and scheduled Government securities auctions drove call rates beyond the repo rate to a peak of 6.30 percent in November'04. RBI injected liquidity through LAF repo operations in mid-November'04 to calm the market sentiment. Call rates firmed up again in December'04 on account of advance tax payments. The last quarter of the fiscal was relatively calm with call rates remaining tied around the reverse repo rate of 4.75 percent.

RBI actively used LAF to manage the money market liquidity conditions. The decline in the surplus liquidity during the year was reflected in the daily LAF operations. The average daily oustandings in LAF reverse repo declined from Rs 75,006 crore in April'04 to Rs 10,805 crore by October'04. Given the tight liquidity conditions in November'04, RBI injected Rs 5,066 crore - on daily average basis - through LAF repo. Thereafter, liquidity conditions steadily improved and the average outstandings in LAF reverse repo in the month of March'05 amounted to Rs 29,809 crore.

The gradual exit of non-bank participants from the call money market led to the increased activity in the repo (other than with the RBI) and CBLO segments of the market. The rates in CBLO and market repo moved largely in alignment with call rates.

PNB GILTS

Treasury Bills Market

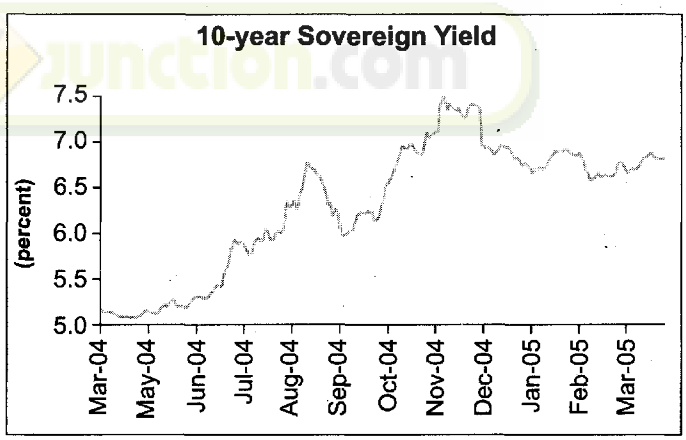


Excess liquidity conditions at the beginning of 2004-05 led to a good market response to Treasury Bill auctions. This was reflected in an increase in bid-cover ratios. Primary yields of 91-day and 364-day Treasury Bills fell below the reverse repo rate during April-May 2004. Domestic inflationary pressures pushed up 91-day Treasury Bill yields in the primary market beyond the reverse repo rate in August 2004. Yields started declining from December 2004 with the easing of headline inflation. The yield spread between the 91-day and 364-day Treasury Bills widened from six basis points in April 2004 to 39 basis points in March 2005.

During the year, the 91-day treasury bills yield increased by 94 bps to 5.32 percent. The 364-day treasury bills yield increased by 121 bps to 5.66 percent.

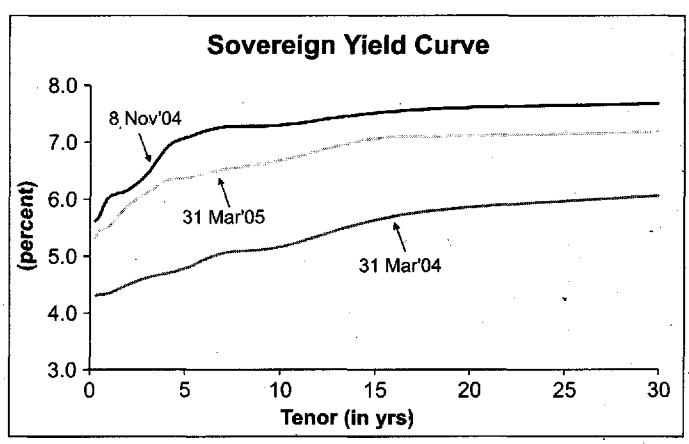
Government Dated Securities

Domestic inflation, crude prices, global interest rates and liquidity conditions governed the movements in the Government securities markets during 2004-05. Yields began to firm up from May 2004 onwards, driven by expectations about reversal of the accommodative monetary policy stance by the US Federal Reserve and the upturn in domestic inflation. A mix of higher credit offtake and slowdown in capital inflows led to contraction in surplus liquidity and reduced market appetite for Government paper.



The 10-year benchmark yield moved up to 6.73 percent in mid-August'04 before retreating to 6.16 percent by end-August'04 with the reintroduction of one-day reverse repos in place of 7-day and 14-day reverse repos, announcement of fiscal measures to rein in inflation, lower than anticipated hike in the MSS ceiling (Rs.80,000 crore) and moderation in global oil prices.

Gilt yields began to harden in the third quarter of the year. Although domestic inflation softened from the peak of 8.7 percent in August'04, higher inflation expectations fuelled by the spurt in international oil prices drove the 10-year yield up to a peak of 7.31 percent in November'04. Strong festival demand in the wake of a hike in the CRR by 50 basis points in two stages added to market pressures.

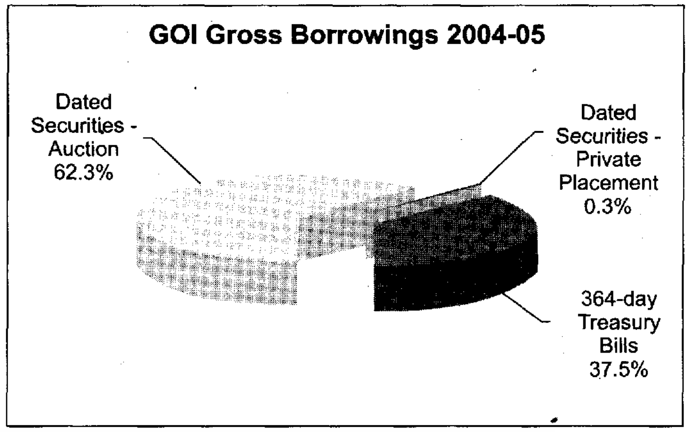


Yields softened during December'04 and January'05 with the easing of liquidity conditions resulting from the cancellation of scheduled auctions, a revival of capital inflows and a moderation of inflation expectations. The yields hardened again in the beginning of March on concerns about

MANAGEMENT DISCUSSION AND ANALYSIS Contd...

the higher than expected Government borrowing as announced in the Union Budget 2005-06. The yields hardened further during the month on concerns arising from persistent rise in the international crude oil prices. The 10-year yield stood at 6.65 percent on March 31, 2005.

The yield curve shifted upwards almost continuously throughout the year with the hardening of yields across the maturity spectrum. The spread between 1-year and 10-year yields more than doubled to 140 basis points by end-November 2004 from 61 basis points at end-March 2004. By end-March 2005, the spread moderated to 114 basis points with the easing of inflationary pressures and revival of capital inflows.



In primary market, the Central Government's net market borrowings at Rs.46,050 crore (gross Rs.1,06,501 crore) were significantly lower than such borrowings in the previous year. This could be partly attributed to receipts by the Centre from the States under the debt swap scheme (DSS). The state governments prepaid Rs.16,943 crore of central government debt through additional market borrowings over and above the prepayment from their small savings collection under DSS. Market borrowings by state governments under DSS were in addition to their normal market borrowings of Rs.15,649 crore (net) [Rs.20,772 crore (gross)] and Rs.1,387 crore for prepayment of RIDF loans to NABARD. During 2004-05, the combined market borrowings of the Centre and States were Rs.80,029 crore (net) [Rs.1,45,603 crore (gross)] with lower RBI support in the form of devolvement and private placement at Rs.1,197 crore due to comfortable liquidity conditions.

In addition to the normal market borrowings, the Central Government raised Rs.65,481 crore (face value) under MSS for sterilisation purposes. Overall, the net resources raised through government securities (Centre, States and MSS) amounted to Rs.1,45,510 crore during 2004-05 as compared with Rs.1,35,192 crore (Centre and States) in the previous year.

The weighted average yield on government borrowings through dated securities increased to 6.11 percent during 2004-05 from 5.71 percent during 2003-04. The weighted average maturity of borrowings reduced marginally to 14.13 years from 14.94 years in the preceding year. Given the lower than projected borrowings of Government, RBI did not get many opportunities for debt management through private placements, devolvement and open market operations. The total private placement of dated securities with the Reserve Bank amounted to just Rs 350 crore towards consideration for transfer of subordinate debt of IDFC. The aggregate devolvement on RBI during the year amounted to Rs 847 crore.

Interest Rate Derivatives

OTC Interest rate derivatives market gained further momentum during the year with the entry of many new players. Some of the larger PSU banks - hitherto absent from this segment - started making their presence felt.

NSE Overnight MIBOR and Reuters 6-month MIFOR continued as the two most liquid floating rate benchmarks. Trading activity largely remained in short tenors within very few deals being reported in more than 5 years segment.

The 5-year tenor Overnight Indexed Swap (OIS) closely tracked the movements in the government securities market. In the beginning of the year, the spread of 5-year OIS over the similar tenor government security increased steadily from zero in March'04 to a high of 95 basis points by June'04. Thereafter, it declined steadily to touch a low of negative 50 basis points in November'04. In the last 4 months of the