

Resolving NPA with Bad Banks : A report on Financial Distress Management

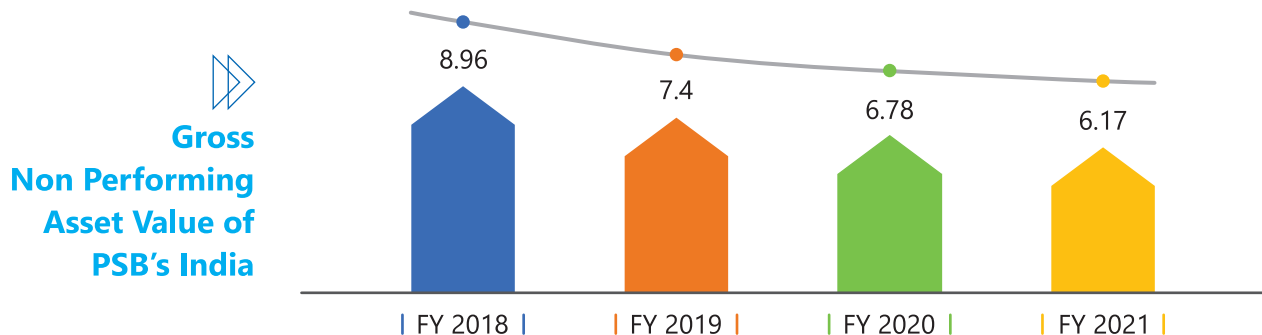
Prologue

- Stressed loans to MSMEs expected to remain high, while gross NPAs of Indian banks projected to decline to a decadal low of 4% by fiscal year 2023–24.
- Corporate segment's NPAs anticipated to drop from a peak of 16% in March 2018 to 2% by the end of fiscal year 2023–24.
- Post-pandemic economic recovery and increased credit growth contribute to the anticipated decline in gross NPAs for banks.

Asset Quality and Growth in India's Banking Sector

Stressed loans to MSMEs are anticipated to remain high, gross NPAs of Indian banks are expected to fall to a decadal low of 4% by the end of fiscal 2023–24 from a peak of 11.5% in March 2018. This decline will be aided by a sharp improvement in the corporate segment.

NPAs in the corporate segment are expected to drop from a peak of 16% as of March 31, 2018, to 2% by the end of the fiscal year 2023–24.

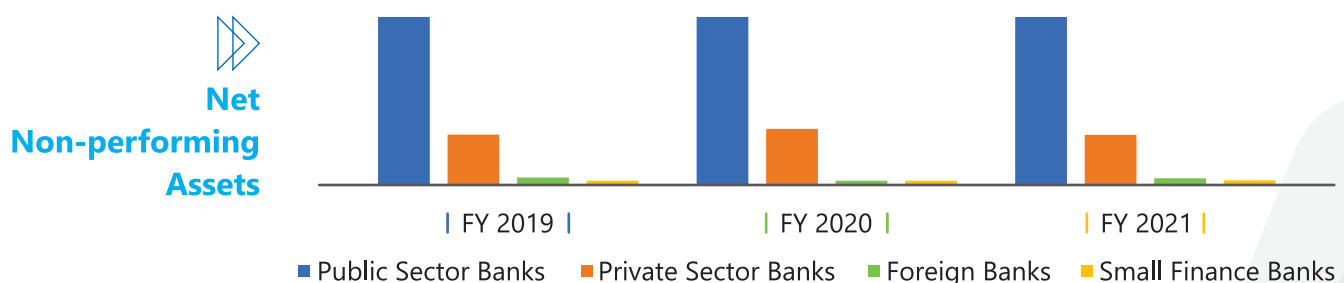


The asset quality of banks has significantly improved in the first half of FY23, which ended on September 30, 2022. NPA and GNPA for scheduled commercial banks have both decreased to decade low levels. Additionally, banks' asset quality for the industrial sector has increased, while by the end of September 2022, the shares of major borrowers drastically decreased.

The RBI stated that the improved asset quality, return to profitability, and robust capital and liquidity buffers of SCBs are contributing to the brisk demand for bank credit and early indications of a revival in the investment cycle. This was stated in RBI's financial stability report for December 2022.

GNPA, as declared by India's public sector banks, totalled more than 1 lakh crore in the fiscal year 2021. From the ₹730 crores in 2019, this was a decline. In contrast, private sector banks stated that their gross NPAs increased from ₹18 thousand crores in the fiscal year 2019 to ₹2 lakh crores in the fiscal year 2021.

The asset quality of India's SCB's saw a considerable improvement during the first half of FY23, with NPAs and GNPA's falling to their lowest levels in ten years. By September 2022, the industrial sector had improved asset quality together with a noticeable drop in the shares of big borrowers.

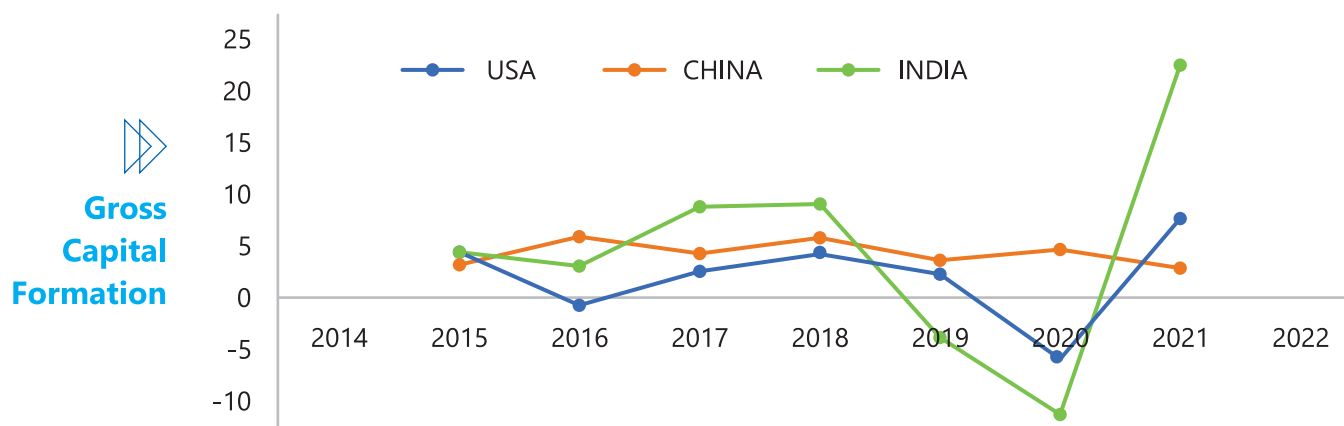


The gross capital formation data for the years 2015 to 2021 in the United States, China, and India unveils notable trends. In the United States, there has been a consistent growth pattern in gross capital formation, with rates ranging from -3.8% in 2020 to 6.9% in 2021. China experienced significant growth rates, ranging from 2.6% in 2021 to 7.2% in 2016, indicating a robust investment climate. India exhibited substantial fluctuations, witnessing a decline of -11.4% in 2020 followed by a remarkable growth rate of 21.7% in 2021, showcasing a volatile investment landscape. These variations reflect the distinctive stages of economic development and policy priorities within each country.

According to the FSR, banks' gross NPA kept dropping and reached a seven-year low of 5% in September 2022. Private bankers' net NPA was below 1% while the net NPA was at a ten-year low of 1.3%.

According to the RBI's FSR, major borrowers' percentage of gross SCB advances has been on the decline, and their proportion of the entire GNPA has decreased from 75.6% in September 2017 to 62.2% in September 2022. Large debtors' Gross NPA ratio decreased from 10% in March 2021 to 6.4% in September 2022.

Regarding credit expansion, banks' credit began to increase in the second half of FY22 and maintained its momentum, but also accelerated further to reach a decadal high of 17.4% as of December 16, 2022.



India's banking industry is showing signs of growth and recovery, propelled by strong loan demand and preliminary indications of a resurgence of the investment cycle. The asset quality and profitability of Scheduled Commercial Banks have improved, and they have kept solid capital and liquidity reserves. Notably, in September 2022, the GNPA ratio for SCBs fell to a ten-year low of 1.3% while the NNPA ratio rose to a seven-year low of 5.0%. Credit risk stress studies show that SCBs can fulfil minimal capital requirements even in extremely stressful situations, with the system-level CRAR anticipated to be higher than the permitted levels. The open-ended debt mutual funds' and insurance firms' strong financial positions are also shown by the stress tests, supporting their solvency and stability.

Initiative and Its Inaugural Year Performance

This NARC will function as a firm that reconstructs assets. In order to relieve the banks of their NPA, it will purchase their poor loans. The stressed loans will subsequently be put up for sale by NARC to distressed debt purchasers. distressed bonds issued by insolvent businesses. They might also be employed by businesses that are about to file for bankruptcy.

For the purpose of selling these distressed assets on the market, the government has previously established India Debt Resolution Company Ltd. IDRCL will consequently make an effort to sell them on the market.

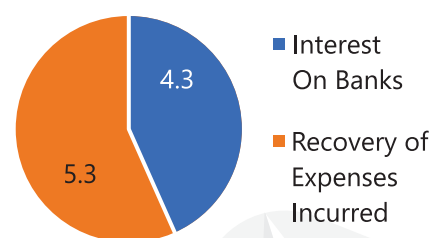
The selling of the stressed asset will result in a partial payment to the involved bank. However, the government guarantee will only apply if the Indian bad bank is unable to sell the stressed credit for a profit or at all.

In its inaugural year, the National Asset Reconstruction Co. Ltd (NARCL) reported a loss of ₹5.9 crore, despite earning interest from bank deposits and not having any bad loans to manage.

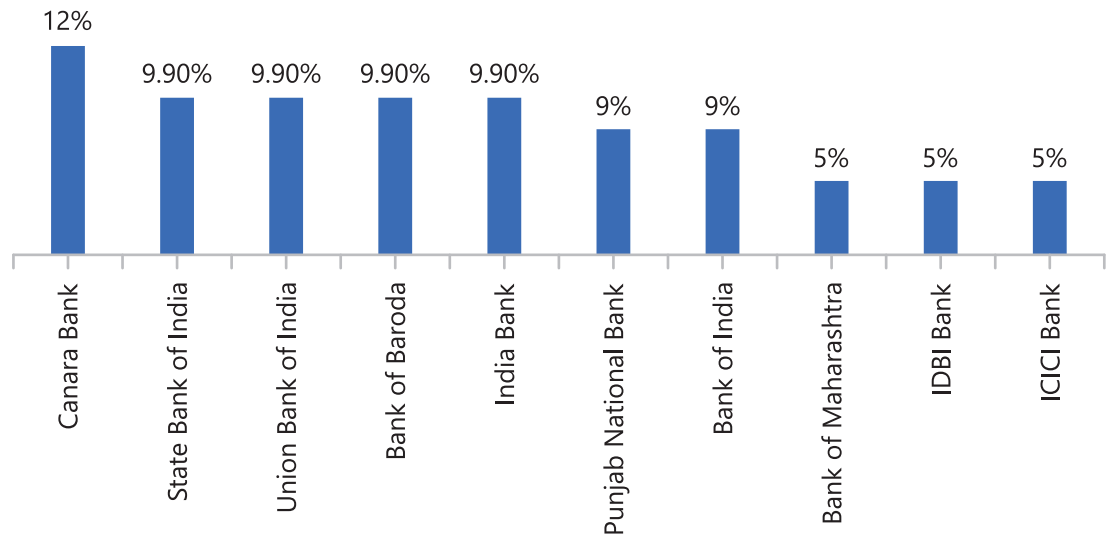
From the time of its incorporation on July 7, 2021, until March 31, 2022, NARCL generated revenues of ₹9.6 crore. Out of this total, ₹4.3 crore came from interest earned on bank deposits, and ₹5.3 crore was derived from the recovery of expenses incurred for setting up the business on behalf of IDRCL.

The capital base of NARCL, has been increased to Rs ₹1,500 crore. The infusion of funds from new lenders has bolstered NARCL's financial position.

This development signified a significant step in the establishment of the Bad Bank, to address the issue of non-performing assets in the Indian banking sector. The increased capital base will provide NARCL with the necessary resources to acquire and resolve stressed assets, contributing to the overall stability and health of the banking system.



Shareholders of NARCL



In its first year, NARCL focused on establishing the necessary infrastructure and obtaining regulatory approvals. It's worth noting that Asset Reconstruction company's revenues depend on management fees paid by lenders and the redemption of security receipts. ARCs purchase bad loans at a discount, either with cash or a combination of cash and security receipts, which can be redeemed upon loan recovery.

Analysts are optimistic that NARCL will assist banks in alleviating the burden of bad loans. Rating agency ICRA stated in December that the improved health of the corporate sector is a positive sign for the asset quality outlook, with gross non-performing assets (NPAs) projected to decrease to 3.9-4.3% by March 2024. The sale of NPAs to ARCs, including NARCL, could further improve these numbers.

Initiative and Its Inaugural Year Performance

India's banking sector is expected to witness a continued improvement in asset quality and growth. The decline in stressed loans to MSMEs and the projected reduction of gross NPAs to a decadal low of 4% by fiscal year 2023-24 indicate a positive trend. The corporate segment is anticipated to experience a significant decrease in NPAs, from 16% in March 2018 to 2% by the end of fiscal year 2023-24.

The post-pandemic economic recovery and increased credit growth are driving the sector's positive outlook. Gross NPAs are predicted to decline to 5% in the current fiscal year and reach a low of 4% by March 2024. This reflects the resilience of Indian banks in navigating challenging conditions.

Overall, the banking sector's improving asset quality, declining NPAs, and revitalized credit growth indicate a positive trajectory. This is likely to support the broader economy and facilitate increased lending for economic expansion in the years ahead.

Works Cited : 1) World Bank (Online) 2) Statista (Online) 3) ICRA (www.icra.in) 4) World Bank (Online)

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