

## Will the Bad Bank make PSBs Good Banks?

We hosted a call with Mr R K Bansal, veteran stress management expert and MD & CEO of Edelweiss ARC (also ex-ED of IDBI Bank engaged in SASF/CDR management) to understand his views on the recent budget proposal to create a Bad Bank (ARC) for PSBs.

- **Government proposes a 'Bad Bank' for PSBs, late though in the cycle:** The Bad Bank concept was explored two years back by the govt with a 3-Tier structure of ARC + AMC + AIF but did not fructify due to issues relating to funding, structure and valuations. However, the govt has finally announced the creation of a Bad Bank to move corporate stress out from PSBs and ready them for growth to boost the economic engine. Under this structure, ARC will act as a warehouse, to which stressed assets will be transferred on net book value (GNPA-Provisions) against the issuance of Security Receipts (SRs), which will be later sold to AIFs/other investors. However, the regulatory mandated upfront cash consideration of 15% by ARC needs to be either waived off by the RBI or needs to be guaranteed by the govt. However, the govt is unlikely to provide any capital (even the initial proposed capital of Rs200bn) and will have to be pooled from banks/financial investors.
- **ARC structure could speed up resolutions, releasing management bandwidth to focus on growth:** The ARC structure has its own advantages such as debt aggregation (at least for PSBs), faster resolution due to better focus/dedicated legal support and better chances of resolution of long-geostationary cases in sectors such as Infra/Power/EPC which otherwise is difficult with individual banks. He believes that faster/better resolution of Essar Steel was possible due to debt aggregation by an ARC. That said, the restricted mandate of the ARC to acquire assets only from PSBs could be a hurdle as some assets would have large private lenders who may not be cooperative as has been the case in the past.
- **Sizeable stress could be moved out by ARC; IBC-based resolutions need to be accelerated:** According to Bansal, systemic corporate stress would be Rs5-6tn, of which ~Rs4tn will be with PSBs and of which cases >Rs5bn o/s will be ~Rs2-2.5tn being eligible for transfer to ARC. However, many large exposures are now well-provided with banks, and thus they would be reluctant to transfer those assets at nominal book value, particularly where resolution is in sight. Thus, the ultimate voluntary asset transfer could be lower unless the concerns of banks are addressed or are directed by the regulator/govt in which case there will be little choice for banks. The expert believes that the removal of stress from banks' book will be a first step, but the ultimate resolution will need better functioning of NCLT/IBC and investor interest to take up assets.
- **Will separate ARC for PSBs pave the way for private ARC for banks like Yes Bank?** As per expert, PFC had earlier sought permission for in-house private ARC to warehouse power stress but the RBI denied it and the central bank was not ready to waive off the upfront 15% cash consideration. The recently bailed-out Yes Bank too plans to create an ARC to warehouse stressed assets with a different structure under which non-bank investors would have a majority stake and thus possibly could get the RBI permission. As an exception, Yes Bank too could be allowed to access this new proposed ARC for PSBs.
- **Our View:** A separate 'Bad Bank for PSBs, though late in the cycle, will ease-up capital/management bandwidth to some extent and allow them to focus on growth, which in turn will arrest their market share loss to some extent. Optically, better b/s will also improve their prospects for raising capital. However, a partial stress-removal cannot make these banks good (e.g., IDBI) as they are in need of radical institutional/governance reforms, apart from privatization. Further, the success of ARC/resolution of assets will be important, as the IDBI-SASF experience and other similar ARCs outside India have not been inspiring confidence. Among PSBs under our coverage, Union/Canara could be the key beneficiaries of the creation of ARC, followed by others.

Please see our sector model portfolio (Emkay Alpha Portfolio): [BFSI-Banks \(Page 3\)](#)

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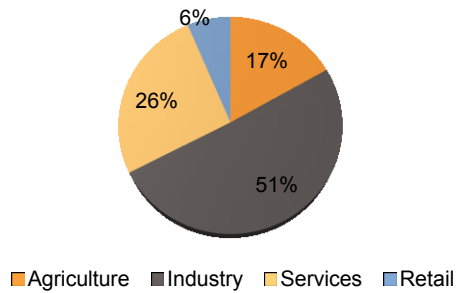
**Exhibit 1: As per the expert, the assets will be transferred at Net Book Value (GNPA – Provisions). Banks may transfer assets where resolution is not in sight against SRs, which will be redeemed by the ARC based on record of recovery**

Banks	GNPA (Rs bn)	GNPA (%)	NNPA (Rs bn)	NNPA (%)	PCR (%)	Corporate GNPA (Rs bn)	Corp NPA % of NPA	Net Book Value (Rs bn)	As a % of Advances	As a % of Networth	As a % of RWAs
SBI	1,172	4.8	290	1.2	75	594	51	147	0.6	6	0.7
BOB	632	8.5	167	2.4	74	347	55	92	1.3	12	1.4
PNB	945	13.0	266	4.0	72	523	55	147	2.2	17	2.4
Canara	498	7.5	168	2.6	66	310	62	104	1.6	18	2.1
Indian	352	9.0	85	2.4	76	192	55	47	1.3	13	1.5
Union	880	13.5	191	3.3	78	594	67	129	2.2	20	2.4
Total	4,479		1,167			2,560	57	666	1.3	12	1.4

Source: Emkay Research

**Exhibit 2: Corporate (Industry + services) contribute nearly 77% of NPAs**

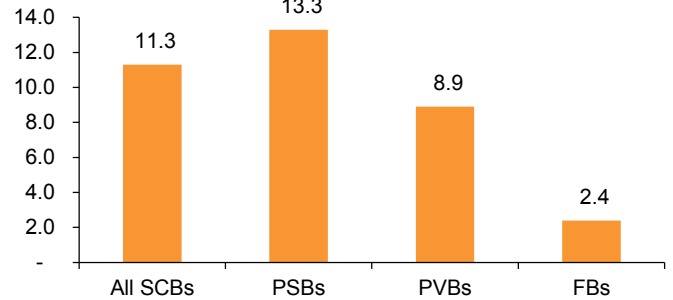
Segment-wise share in NPAs (%)



Source: RBI, Emkay Research

**Exhibit 3: GNPA ratio - Large corporate borrowers**

GNPA ratio - Large corporate borrowers (%)



Source: RBI, Emkay Research

## Emkay Alpha Portfolio – BFSI-Banks



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#### Sector

Banks

#### Analyst bio

Anand Dama is a CA, CPM (ICFAI) with total 12 years of research experience, in addition to 3 years in the finance/rating industry. His team currently covers 21 banks and 15 stocks in the NBFC/Insurance space.

### EAP sector portfolio

Company Name	BSE200 Weight	EAP Weight	OW/UW (%)	OW/UW (bps)	EAP Weight (Normalised)
<b>BFSI-Banks</b>	<b>22.15</b>	<b>22.15</b>	<b>0.0%</b>	<b>0</b>	<b>100.00</b>
Axis Bank	2.36	2.55	8%	19	11.53
AU Small Finance Bank	0.24	0.21	-13%	-3	0.95
Bandhan Bank	0.30	0.36	18%	5	1.61
Bank of Baroda	0.13	0.13	-1%	0	0.57
Canara Bank	0.10	0.00	-100%	-10	0.00
City Union Bank	0.16	0.15	-1%	0	0.70
DCB Bank	0.00	0.00	NA	0	0.00
Equitas Small Finance Bank	0.00	0.00	NA	0	0.00
Federal Bank	0.21	0.21	0%	0	0.93
HDFC Bank	7.75	7.90	2%	15	35.67
ICICI Bank	5.23	5.43	4%	21	24.53
Indian Bank	0.00	0.00	NA	0	0.00
Indusind Bank	0.71	0.84	19%	13	3.80
Karur Vysya Bank	0.00	0.00	NA	0	0.00
Kotak Mahindra Bank	3.01	2.39	-21%	-63	10.78
Punjab National Bank	0.12	0.00	-100%	-12	0.00
RBL Bank	0.16	0.16	0%	0	0.71
State Bank of India	1.64	1.82	11%	17	8.21
Ujjivan Small Finance Bank	0.00	0.00	NA	0	0.00
Union Bank of India	0.03	0.00	-100%	-3	0.00
Yes Bank	0.00	0.00	NA	0	0.00
<b>Cash</b>	<b>0.00</b>	<b>0.00</b>	<b>NA</b>	<b>0</b>	<b>0.00</b>

Source: Emkay Research

\* Not under coverage: Equal Weight

■ High Conviction/Strong Over Weight ■ High Conviction/Strong Under Weight

### Sector portfolio NAV

	Base					Latest
	1-Apr-19	6-Feb-20	6-Aug-20	5-Nov-20	5-Jan-21	4-Feb-21
EAP - Auto & Auto Ancillaries	100.0	94.7	85.0	92.3	109.4	129.6
BSE200 Neutral Weighted Portfolio (ETF)	100.0	95.8	87.8	94.4	111.5	129.5

\*Performance measurement base date 1<sup>st</sup> April 2019

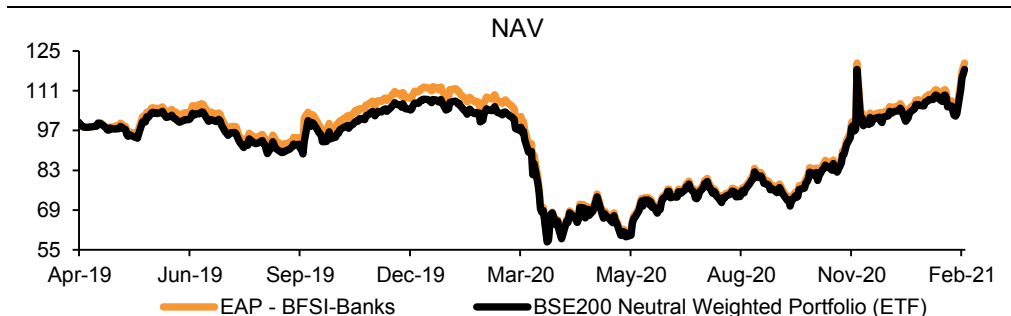
Source: Emkay Research

### Price Performance (%)

	1m	3m	6m	12m
EAP - Auto & Auto Ancillaries	18.5%	40.4%	52.5%	36.9%
BSE200 Neutral Weighted Portfolio (ETF)	16.1%	37.1%	47.4%	35.1%

Source: Emkay Research

### NAV chart



Source: Emkay Research

Please see our model portfolio (Emkay Alpha Portfolio): [Nifty](#)

Please see our model portfolio (Emkay Alpha Portfolio): [SMID](#)

“Emkay Alpha Portfolio – SMID and Nifty are a supporting document to the Emkay Alpha Portfolios Report and is updated on regular intervals”

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Ratings	Expected Return within the next 12-18 months.
<b>BUY</b>	Over 15%
<b>HOLD</b>	Between -5% to 15%
<b>SELL</b>	Below -5%

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