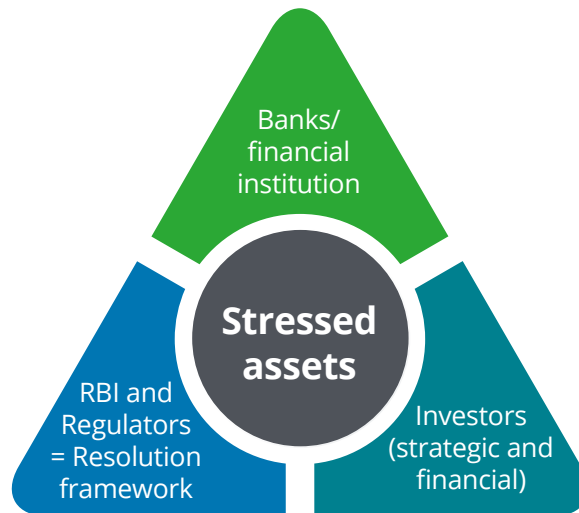




Impact of COVID-19 on Stressed Assets

Impact of COVID-19 on key stakeholders

Stressed assets - Key stakeholders



Impact of COVID-19 on the stressed assets

India had four phases of lockdown until 31 May 2020. On 1 June 2020, lockdown was extended until 30 June 2020 in containment zones, with services resuming in phased manner starting from 8 June 2020 (Unlock 1.0).

• Impact of lockdown

- Increased number of Non-performing Assets (NPA)
- Potential of defaults going up further

• Policy and regulatory measures

- RBI has announced a package to mitigate negative effects of COVID-19, revive growth, and preserve financial stability.
- Expanding liquidity in the system to restore normalcy (Cash Reserve Ratio [CRR], policy rate cuts, etc.)
- Reinforcing monetary transmission for smooth credit flow
- Easing financial stress caused by COVID-19 (moratorium on debt repayment and asset classification norms)
- Supporting measures help exports and imports (liquidity facility for export credit and extension of time for import payments)
- Improving the functioning of financial markets
- Central Government has increased the threshold limit for triggering the insolvency process from INR 1 lakh to INR 1 crore for Micro, Small and Medium Enterprises (MSMEs).
- Faster clearance of tax refunds and directive to PSU's to clear outstanding dues of vendors.
- SEBI has eased fundraising, open offer norms for distressed companies.

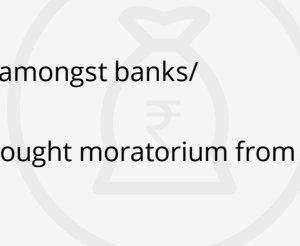
• Additional steps anticipated

- Increasing the number of National Company Law Tribunal (NCLT) members, benches, and infrastructure
- Relaxing rules for categorisation of NPAs (90 days to 180 days)
- Clarification on interest charged during moratorium period, a petitioner had moved to Supreme Court (SC) seeking an interest waiver.

Key challenges for stakeholders

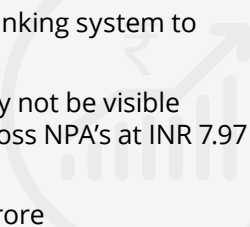
Stressed asset

Stress on cashflows

- Cash flows and earnings significantly impacted due to lockdown
 - Facing difficulties in raising interim finances given the risk aversion amongst banks/ financial institutions
 - According to a report by ICRA Limited, about 328 companies have sought moratorium from banks
 - Possible defaults once moratorium provided by RBI gets over
- 

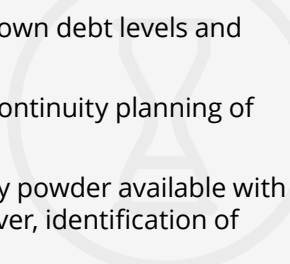
Bankers /financial institutions

Increase in NPAs

- Moody's Investors Service has revised the outlook for the Indian banking system to negative from stable earlier
 - Bankers and analysts expect significant spike in NPAs. The pain may not be visible immediately since the RBI has extended regulatory relaxations. (Gross NPA's at INR 7.97 lakh crore as at 31 December 2019)
 - In FY21, bad loans in banking sector may increase by INR 5.5 lakh crore
- 

Strategic and financial investors

Delay in investments

- Strategic investors will have their primary focus on managing their own debt levels and liquidity positions
 - Lack of interest in bidders mainly as they are involved in business continuity planning of their own
 - Adequate fund raise in the past 12-18 months ensures adequate dry powder available with financial investors (Private Equity [PE] and distressed funds). However, identification of opportunities may take time
- 

Impact assessment - Stressed assets

Impact during COVID-19

Piling up of Insolvency and Bankruptcy Code (IBC) cases

Interim finance is difficult: Risk averse bankers/lenders

Lockdown period is to be excluded from computation of various statutory timelines under IBC (effectively increases the time period and will have an impact on liquidity/ future cashflow)

Considerable fall in value of assets

In prevailing situation, revival of assets and assessment of valuation is very challenging



Impact post COVID-19

Increased number of NPAs once the moratorium provided by RBI ends

Delay in closure of IBC cases

No new cases to be referred to NCLT for next one year under IBC (on an average, every year financial creditors have dragged approximately 500 cases to IBC)

Banks and promoters are likely to agree on a resolution plan outside of IBC (this may not be as effective as IBC due to certain limitations as experienced in the past)

One-time debt restructuring window under RBI may see traction

Value of assets may decrease

Impact assessment - banks/ financial institutions

Impact during COVID-19

Increase in stress

Banks have approached Ministry of Corporate Affairs (MCA) to expedite approval for resolved cases

Despite reduction in reverse repo rate, banks are parking surplus funds with RBI rather than lending due to fear of bad loans

Coronavirus-related debt will be excluded from the definition of default

Lenders will get additional 90 days to resolve stressed assets cases due to COVID-19



Impact post COVID-19

Asset quality risk to increase across all sectors (including personal loans, vehicle loans, and home loans)

Setting up of National Investment Management Company and National Asset Reconstruction Company (NARC) (likely to be capitalised by government to the extent of INR 10,000 crore)

NARC would pay 15 percent of loan amount upfront and balance in the form of security receipts

RBI extension of moratorium period until August 2020 will adversely impact liquidity of Non-Banking Financial Company (NBFC), considering NBFCs do not have substantial on-balance sheet liquidity

Lower Net Interest Income (NII), higher credit cost may push banking sector in a negative zone

Impact assessment - Potential investors

Impact during COVID-19

Winning bidders will invoke the force majeure or material adverse effect clauses to wriggle out of deals or lower the price they are paying to buy companies

Approved resolution plans, face a test as funding for assets committed before COVID-19 may never come through with NBFCs facing liquidity issues

Mark downs/impairment on existing portfolio companies



Impact post COVID-19

Potential investors with cash on hand will be actively looking for assets at lower prices

Implication of suspension of new insolvency cases for one year

- Asset Reconstruction Companies (ARCs) would be used as intermediaries to resolve bad loans
- ARCs will find it difficult to sell security receipts due to drop in valuation as redemption prospects and timeline stretch at least next three to four years
- Banks will actively approach the potential investors for improvement in recovery
- Increase in Corporate Insolvency Resolution Process (CIRP) costs would directly impact the recovery

Investors may lower the bids significantly in anticipation of diminution in value of these companies/assets

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