Banks and Financials: Slippages – On the road to recovery

Fiscal 2015 appears to be a landmark year in terms of the efforts made by banks to recover loans

By: Kotak Institutional Equities | Updated: January 4, 2016 1:06 AM

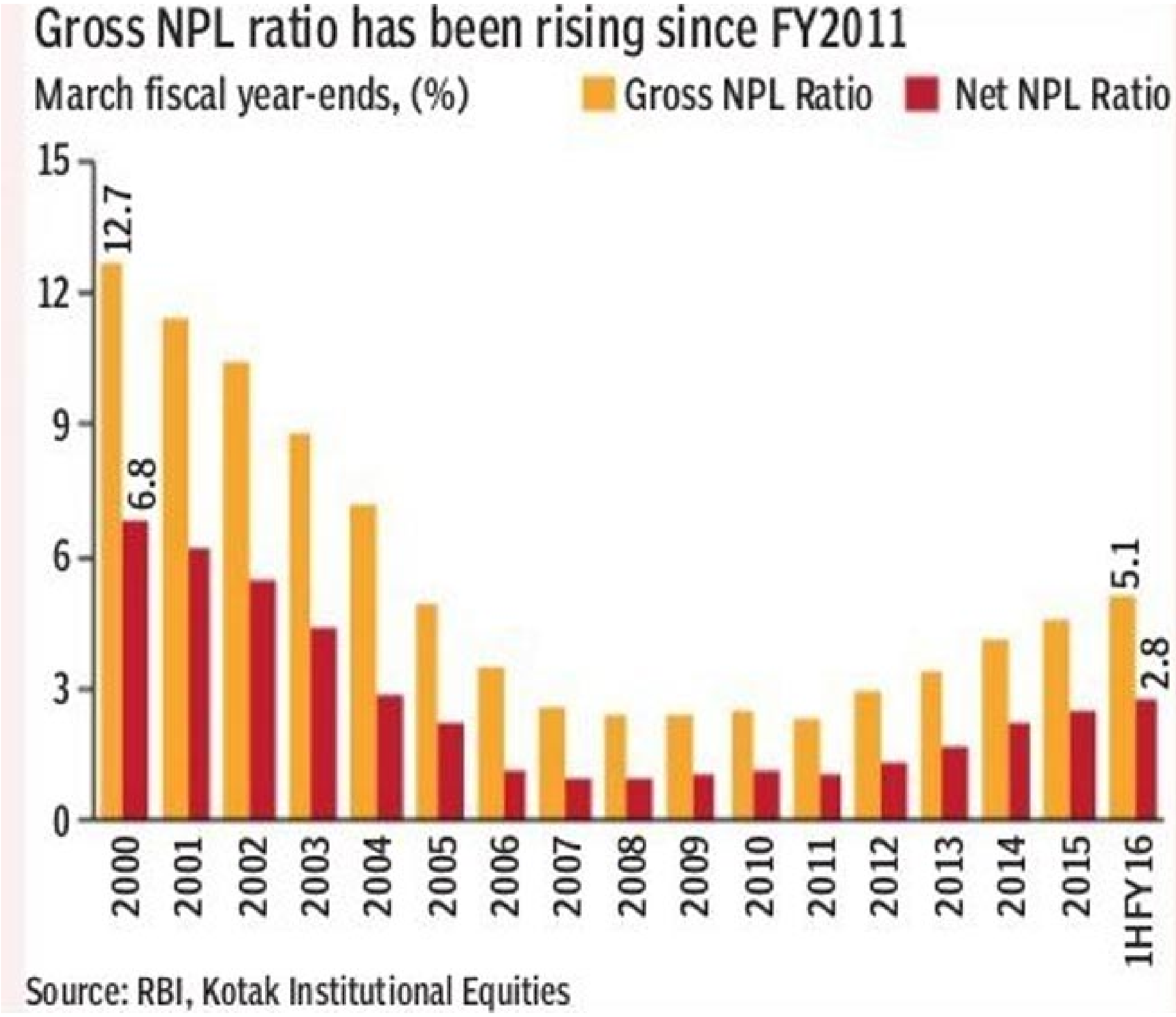
In pursuit of defaulters: Data from Reserve Bank of India's recent report shows a few interesting trends: (i) 5X increase in defaulter claims and amount collected by banks (ii) slippages show marginal improvement after consistently deteriorating since FY2011 (iii) large corporate book stress levels are high, but default rates are still low. In the previous cycle, FY2002 was the peak period of stress (slippages) post which banks started seeing an easing of slippages. FY2015 is showing a similar trend. We are probably still a bit watchful as the large corporate book is yet to be reported as NPLs (non-performing loans) for the system.

5X jump in claims and recovery: functioning of DRT has improved in FY2015

FY2015 appears to be a landmark year in terms of the efforts taken by banks to recover loans. The exhibit below shows that the number of cases filed, amount claimed and recovered have increased by 5X. Gross NPLs continue to increase as we saw in the first half of FY 2016, but it is driven more by weaker recovery trends and slower loan growth rather than a rise in slippages ratio. This is the best we have seen since data became available in the public domain. After a long time, we have seen an improvement in the functioning of DRT, which has been a familiar bottleneck of the banking system. While we are not sure of the recovery rates, it does give some comfort that the banking system is now looking to pursue NPLs a lot more aggressively than before.

Slippages ratio shows stable trends; rising NPL ratios reflect mismatch in recovery, slippage trends

Another interesting trend is that the slippage ratio has declined for the first time since FY2011. Slippages have stabilised (or showed a marginal decline of 10bps y-o-y) to 3% in FY2014 after consistently increasing since FY2007. We would probably need to wait for another year to confirm this trend though activity levels are improving on the ground. Another way to confirm this hypothesis is to look at the quality of slippages. The share of slippages explained from restructured loans is at 26% as compared to 16% in FY2015 and 11% in FY2014. This implies that slippages from the non-restructured loan portfolio were broadly flat on absolute basis in FY2015, which is a positive.



Slippages hard to extrapolate; many weapons and channels to address asset quality issues exist

As highlighted in our previous report of December 08, 2015 "Breaking the gridlock", there is probably steady recovery in overall macro trends. However, there is still trouble with the large corporate book. RBI's latest data shows that the stress level in this segment is still uncomfortably high.

India is probably still a tale of two halves; macro has improved but the weakness in the large corporate segment has only intensified. Banks have been working with them, giving them headroom by taking fresh exposure in Joint Lenders Forum (JLF) through Corrective Action Plan (CAP), converting to equity the existing debt through Strategic Debt Restructuring (SDR) or otherwise, adopting 5:25 scheme which allows longer repayment schedule and an asset monetisation programme. This makes it challenging to predict NPLs as they are large and chunky making it difficult to predict the recovery of the corporate cycle.

However, one of the key positives today is the active involvement of various stakeholders. The government is clearing a lot of bottlenecks across various sectors, especially power. RBI and banks are working with the borrowers though various measures mentioned previously and corporates are looking at many measures to actively deleverage their balance sheets.

There has been a sharp rise on all parameters: cases referred, amount involved and recovered

March fiscal year-ends, 2004-15

	SARFAESI (1)			DRT			Lok Adalat		
	No. of cases referred ('000)	Amount involved (₹ bn)	Amount recovered (₹ bn)	No. of cases referred ('000)	Amount involved (₹ bn)	Amount recovered (₹ bn)	No. of cases referred ('000)	Amount involved (₹ bn)	Amount recovered (₹ bn)
2004	3	78	12	8	123	21	186	11	1
2005	39	132	24	5	143	27	185	8	1
2006	41	85	34	4	63	47	268	21	3
2007	60	91	37	4	92	35	160	8	1
2008	84	73	44	4	58	30	187	21	2
2009	62	121	40	2	41	33	548	40	1
2010	78	142	43	6	98	31	779	72	1
2011	119	306	116	13	141	39	616	53	2
2012	141	353	101	13	241	41	476	17	2
2013	191	681	185	13	310	44	841	66	4
2014	195	953	253	28	553	53	1,637	232	14
2015	1,241	4,705	1,152	171	3,789	531	9,131	887	43

Notes: (a) SARFAESI cases referred are the total notices issued (b) Amount recovered includes amount from prior years

Source: RBI, Kotak Institutional Equities

FY2015 marks the first year of stability of slippages since FY2011

After seeing ~40% CAGR in slippages between FY2011 and 2014, there appears to be some stability in performance in FY2015 with overall increase at 10% for FY2015. From a ratio perspective, there is a decline of 10bps in FY2015 to 3% of loans as compared to 3.1% in FY2014. As indicated in our previous report of July 7, 2015 “Steady rise in slippages from restructured loans”, the share of slippages explained from restructured loans increased to 25% in FY2015 from 16% in FY2014. The only key comforting factor is that slippages outside the restructured loan portfolio have been fairly stable y-o-y. Data on slippages in first half of FY16 has not seen any marked deterioration barring that of a few banks which took fairly aggressive calls on some of their exposures in the balance sheet.

Are we closer to the end of a rise in slippages? Unlikely, but probably nearing it

Chunky exposures within the banking system are still at risk of being declared impaired, making it difficult to time the call of improvement. Power sector is yet to see any meaningful impairment so far, while there is a fair bit of stress within a few groups when we look at their annual performance across various projects. These companies, with meaningful assets, are actively selling wherever possible, but challenges remain on how companies can survive with limited impact. Banks have been working with them, giving them headroom by taking fresh exposure in JLF through CAP, converting to equity the existing debt through SDR or otherwise, adopting 5:25 scheme which allows longer repayment schedule and an asset monetisation programme or looking at refinancing in other schemes. While many of these actions have come under scrutiny, if they represent another medium to delay recognition, we do believe that a recovery in economy should assuage these concerns unlike in the previous few years where the slowdown accentuated the various measures announced.

However, there is a fair possibility that a few exposures could be declared impaired by the banking system as the regulator has taken a strong opinion on the stress levels of a few corporates and the differential treatment of accounts across banks. It is quite likely that a few of these large accounts could be identified as impaired. While the loss given default may not be as high it nevertheless points to weak near-term performance for banks in the medium term.

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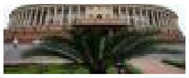

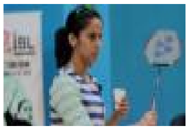

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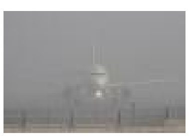

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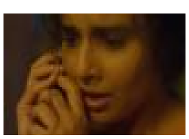

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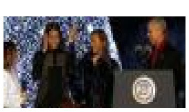

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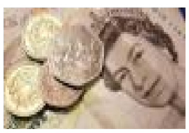

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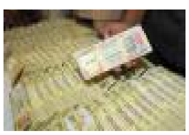

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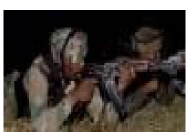

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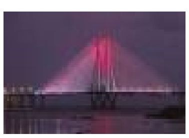

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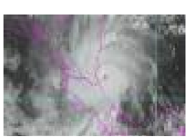

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