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Kotak Mahindra, CPPIB launch stressed assets fund

To invest \$525 million in NPAs, structured debt

By: [FE Bureau](#) | Mumbai | Updated: March 15, 2016 1:55 AM



With the new fund, Kotak Mahindra and CPPIB join early movers like KKR, AION Capital (a joint venture between ICICI Ventures and Apollo Global) and the Ajay Piramal Group. (Reuters)

The Kotak [Mahindra](#) Group and Canada Pension Plan Investment Board (CPPIB) on Monday announced a \$525-million fund, joining the growing tribe of stressed assets players in India. Senior executives said the fund, to be called Kotak Special Situations Credit Fund, would have a mandate to invest in bank non-performing assets (NPAs) as well as structured debt extended to companies directly. The government recently raised the foreign direct investment (FDI) in ARCs to 100% via the automatic route. Foreign portfolio investors are now allowed to invest up to 100% of each tranche in securities receipts issued by ARCs subject to sectoral caps.

At a time when the banking sector is seeing a sharp increase in non-performing assets and with very few investors willing to buy these, such funds could help relieve banks of some of these loans. Collectively, the 14 asset reconstruction companies (ARCs) in India have a total capital of just R3,000 crore (approximately \$450 million).

Transactions have been few and far between primarily for two reasons: ARCs need to pay 15% of the debt value upfront which they perceive is high and moreover, banks typically are reluctant to offload assets at lower valuations.

In other words, they are not willing to take too much of a haircut. ARCs charge between 1.5% and 2% of the asset value as the annual management fee. However, not too many transactions have turned out to be profitable for them.

P Rudran, former MD&CEO of ARCIL, had observed that only four out of every 10 deals had seen profitable recoveries.

In the first six months of FY16, banks sold Rs 7,000 crore of NPAs to ARCs. The total NPAs of banks is currently R4.43 lakh crore as at the end of December 2015; at the end of FY15 this was Rs 3.06 lakh crore.

Among the deals that have taken place over the last couple of years include Edelweiss ARC buying exposures to Binani Cement, Electrotherm, Karaikal Port, JM Financial ARC buying the debt of Hotel Leela Venture and ARCIL buying assets of the Abhijeet Group. The discounts typically are in the region of 30-40% although a couple of transactions have taken place at 60-70%.

“We see enough opportunities in both the segments,” said S Srinivasan CEO, Kotak Special Situation Credit fund. 

“The corporate sector is faced with rising financial stress and we hope to work with them directly, while buying NPAs from banks alongside through our asset reconstruction company,” Srinivasan added.

With the new fund, Kotak Mahindra and CPPIB join early movers like KKR, AION Capital (a joint venture between ICICI Ventures and Apollo Global) and the Ajay Piramal Group. In January, global buyout fund KKR along with Bharti Group veteran Akhil Gupta picked up a majority International Asset Reconstruction Co (IARC), which was set up by [Tata Capital](#) and HDFC Bank in 2002. During the same month, Ajay Piramal Group, announced a \$1 billion stressed asset fund in association Brescon Corporate Advisors.

AION Capital with a committed capital of \$825 million is the oldest in the lot and has invested in six companies so far.

Kotak Mahindra Group owns 49% stake in Phoenix ARC and the new fund is poised to become one of the largest subscriber of Security Receipts (SRs) of Phoenix ARC. “The problem with ARCs is that they simply don’t have the money to meet capital adequacy requirement leave aside making upfront payments to banks and that’s exactly where the new fund comes in,” Srinivasan told FE, adding, “But a lot depends on whether and how much haircut the banks are willing to take”. ARCs were formed after the enactment of the SARFAESI Act in 2002 but they have largely remained ineffective in the wake of burgeoning NPAs in the banking system and suffered from a low capital base.

But going forward ARCs are likely to see their capital base go up manifolds with the easing of foreign ownership norms announced in the Union Budget and several global funds are expected to acquire stakes in them.

Once the changes in the regulations become effective, industry sources say that large stressed asset funds like Oak Tree Capital, Blackstone, Lone Star Funds and Brookfield Asset Management are the likely contenders to buy stakes in Indian ARCs since they have explored similar options in the past but haven’t invested yet. Under existing regulations, while foreign sponsors are allowed 100% ownership of an Indian ARC

through the FIPB route, no single foreign shareholder can own more than 50%; which is something the foreign funds are not comfortable with, given the risks involved. 

Mounting stressed assets

	Gross NPA (₹ cr)			Gross NPA ratio (%)	
	Q3 FY16	Q2 FY16	% chg	Q3 FY16	Q2 FY16
State Bank of India	72,792	56,834	28.1	5.1	4.15
Bank of Baroda	38,934	23,710	64.2	9.68	5.56
Bank of India	36,519	29,894	22.2	9.18	7.55
Punjab National Bank	34,338	24,945	37.7	8.47	6.36
IOB	22,672	19,424	16.7	12.64	11
ICICI Bank	21,149	15,858	33.4	4.72	3.77
Canara Bank	19,813	14,021	41.3	5.84	4.27
IDBI Bank	19,615	14,758	32.9	8.94	6.92
Union Bank of India	18,495	15,541	19.0	7.05	6.12
Central Bank	17,564	13,358	31.5	8.95	6.86
Axis Bank	5,724	4,451	28.6	1.68	1.38
Kotak Mahindra Bank	2,690	2,655	1.3	2.3	2.35

Source: Capitaline