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India Financials

RBI's MSME restructuring drive – a dicey move

The RBI has allowed banks to restructure MSME loans up to Rs 250mn which are under overdue category, by devising a corrective action plan (CAP) and opting for the rectification/restructuring/recovery of such stressed accounts. While with this move, the RBI is looking at faster resolution of stress in MSME accounts, we think the impact would be starkly opposite to the central bank's AQR drive which aimed at cleaning up bank books. Banks may also witness a surge in MSME restructuring, making it difficult to keep a tab on such loans.

➔ **The process:** The RBI has issued guidelines for restructuring of MSME accounts with outstanding debt up to Rs 250mn. Banks have been directed to form a committee and devise a corrective action plan (CAP) for all stressed MSME loans, of which accounts with loan limits up to Rs 1mn have to be dealt with at the branch level. Moreover, a stressed MSME with debt in excess of Rs 1mn can directly apply for a CAP. The committee, within 30 days of convening its first meeting, has to zero in on any one of the following three options to be adopted under CAP:

- (a) **Rectification (fresh loan disbursement to stressed MSME accounts):** Banks can grant MSME borrowers additional funding for six months in order to revive the account, while ensuring there is no NPV hit on their books. While such accounts would retain their existing classification, fraud cases would fall under the restructured category if rectification along with the six-month funding option is availed more than once during a year. Only in exceptional cases, banks would be allowed to fund the working capital requirement of MSMEs, while in the normal course, an account would directly slip into NPA in case of diversion of funds.
- (b) **Restructuring of existing loans:** This applies to standard accounts, special mention accounts or sub-standard accounts with one or more lenders (but not majority of lenders). The moratorium for restructuring would be six months and the restructuring package should outline the milestones to be achieved after this period. No timeline however has been prescribed for attending full normalcy with respect to MSME loans. Also, restructuring can be done only if the borrower is not a wilful defaulter and if majority of creditors approve the same. In addition, MSME promoters would have to extend personal guarantees for restructuring.
- (c) **Recovery:** Banks can resort to the recovery of loans if either rectification or restructuring is not found viable, and initiate the process at the earliest.

➔ **Our view:** RBI's AQR was a master stroke to clean bank books and stop the ever-greening of stressed loans. However, the move to restructure MSME loans can have an opposite effect. The volume of loans under MSME restructuring will be large vs. corporate debt restructuring (CDR), making it difficult to monitor them. We think even standard accounts will opt for this scheme (as done by many corporates earlier) since it eases the interest and debt repayment burden in the near term. Note that lower provisions on stressed loans don't go down too well with investors.

Loans to MSME sector form 12-15% of total system loans. It is difficult to ascertain the exact impact of the RBI's move, as MSME exposure already classified as NPAs in the books of banks is not known. However, we believe PSBs are likely to offer this scheme to a large number of MSMEs.



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Proportion of SME/MSME loans in banks

Bank	As of Q3FY16 (%)
CBK	20.0
UNBK	18.6
BOB	14.2
AXSB	13.1
SBIN	12.7
PNB	12.5
BOI	12.4
HDFCB	6.2
ICICIBC	4.6

Source: Company, RCML Research



Other highlights

- In case of restructuring/rectification of MSME loans, promoters have to bring in a proportionate amount equal to the lender which should not be less than the proportion at the time of the original sanction of loans.
- Additional finance will be given priority in repayment over repayment of existing debts.
- The committee may allow the MSME to raise secured or unsecured loans if the promoter is unable to commit his contribution of additional funds.
- Under restructuring, lenders can insert a clause of transferring the promoter's equity in the MSME to the lenders to compensate for their sacrifices.
- A clause for sale of non-core assets/other assets may be set as a condition for restructuring, if lenders think hiving off non-core assets can revive the account.
- For listed companies, lenders may be compensated upfront for their loss or sacrifice by way of issuing equities of the company.

Fig 1 - Valuation summary

Valuation Matrix	P/E (x)			P/BV (x)			ROA (%)			ROE (%)		
	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E
Private sector banks												
Axis Bank	13.7	12.3	10.3	2.3	2.0	1.7	1.7	1.6	1.6	17.8	17.2	17.7
HDFC Bank	24.5	20.4	17.0	4.1	3.5	3.0	1.9	1.9	1.9	19.4	18.7	19.3
ICICI Bank	11.8	10.9	9.3	1.6	1.5	1.3	1.8	1.8	1.8	14.5	14.2	14.8
IndusInd Bank	26.8	21.7	17.7	4.7	3.5	3.0	1.8	1.9	2.0	18.2	17.7	17.6
YES Bank	15.5	13.5	10.8	2.9	2.4	2.1	2.0	1.8	1.9	21.3	19.5	20.6
Kotak Bank	32.1	31.3	23.0	4.0	3.7	3.2	2.2	1.9	1.8	15.1	13.9	14.7
Public sector banks												
Bank of Baroda	9.1	NM	10.1	0.8	0.9	0.8	0.5	-0.2	0.4	9.0	-3.6	8.1
Bank of India	3.6	NM	4.5	0.2	0.2	0.2	0.3	-0.0	0.2	5.6	-0.7	4.9
Canara Bank	3.2	4.2	3.4	0.3	0.3	0.3	0.5	0.4	0.4	8.8	6.7	8.2
PNB	5.0	8.8	5.6	0.4	0.4	0.4	0.5	0.3	0.4	8.2	4.5	6.9
SBI - Consolidated	7.9	10.8	8.3	0.9	0.8	0.8	0.7	0.5	0.6	11.3	7.7	9.4
Union Bank	4.5	6.0	5.0	0.4	0.5	0.4	0.5	0.3	0.4	9.3	6.9	8.3
NBFCs												
Mahindra & Mahindra Fin Secs	14.5	20.0	13.4	2.2	2.0	1.8	2.5	1.6	2.2	16.2	10.7	14.4
Shriram Transport Finance	16.2	15.1	11.8	2.2	2.0	1.7	2.4	2.2	2.5	14.6	14.0	15.8
Shriram City Union Finance	16.9	14.7	12.4	2.4	2.1	1.8	3.2	3.4	3.5	15.9	15.3	15.8
Chola Finance	22.4	19.8	15.4	3.7	2.9	2.5	1.9	2.1	2.5	17.5	16.9	17.5
Power Finance Corp	3.8	3.4	3.0	0.7	0.6	0.5	2.8	2.7	2.7	20.0	19.1	18.7
Rural Electrification	3.2	2.8	2.5	0.7	0.6	0.5	3.4	3.0	3.0	25.1	21.8	21.1
SKS Microfinance	34.9	25.6	20.2	6.3	5.0	4.0	5.2	4.4	3.8	24.9	21.8	22.2

Source: Bloomberg, Company, RCML Research

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