ON BORROWED TIME

Why Vijay Mallya's default on loan payments is just the tip of a rapidly melting iceberg

:: Suman Layak

September 1, 2014, was a fateful day for Kingfisher Airlines (KFA). That was the first time a bank in India, the Kolkata-based United Bank of India (UBI), declared the airline and its chairman, Vijay Mallya, wilful defaulters.

It was also a day of high drama. The grievance redressal committee (GRC) of the bank that had to decide on the issue was to meet at 10 am. A special leave petition filed by KFA, seeking a stay on the GRC meeting, was likely to be mentioned at the Supreme Court at 11 am. There was just a one-hour window.

UBI, at the point, did not have a chairman and was being led by two executive directors. The senior of the two, Deepak Narang, was pursuing Mallya over a ₹6 crore loan. A chronicle of the three days leading to September 1 reads like a financial thriller. The climax, though, left both bank and borrower in pain, and none the richer for their efforts.

With banks in distress and borrowers in doldrums, this is a story that may repeat itself in India a thousand times. The questions are: how long will this phase last; and can the Indian corporate sector emerge stronger out of this quagmire?

Wild Money Chase

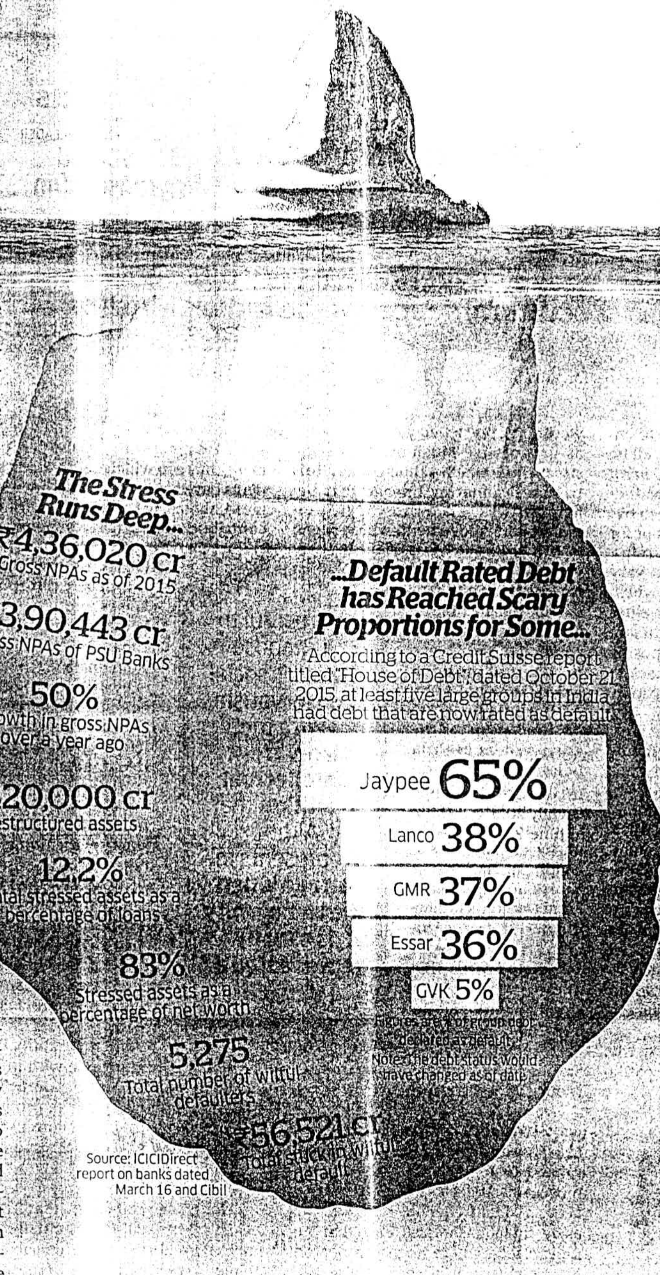
With mounting losses over three quarters and a chairman who suddenly opted for voluntary retirement, UBI's board in 2014 was focusing on recovery of bad loans to erase the red ink on its books. The bank first issued notices to KFA in May 2014 to appear before the committee. The company approached the Calcutta High Court, requesting permission to send its lawyers. The court declined and, on August 28, a division bench asked the bank to set KFA a 72-hour deadline to appear before the bank's GRC. The order said that either Mallya or a company employee had to be present at the hearing.

That was a Thursday. To take advantage of the weekend, the bank sent a fresh notice to KFA on Friday, August 29, at 10 am. The deadline would expire on Monday, exactly 72 hours later. It left KFA with limited options – whether it wanted to appeal the high court order or stay the committee meeting, it could only do so on Monday when the Supreme Court convened at 11 am (as UBI had filed a caveat in the apex court against KFA soon after the division bench delivered its judgment).

A determined Narang posted men at the Kolkata and Bengaluru airports on the morning of Monday, September 1, to watch out for either Mallya or his senior officers setting off for or landing in Kolkata. Narang, who was also the head of the bank's GRC, had a draft order ready, declaring KFA and Mallya wilful defaulters. The meeting began at 10 am sharp and the draft order was passed – in the absence of any KFA official, none of whom turned up. By 10.30 am, a scanned copy of the order was with the bank's counsel Mukul Rohatgi in Delhi. Media was also informed that UBI has declared KFA and Mallya wilful defaulters. The KFA special leave petition was rendered infructuous by the time the Supreme Court convened at 11 am.

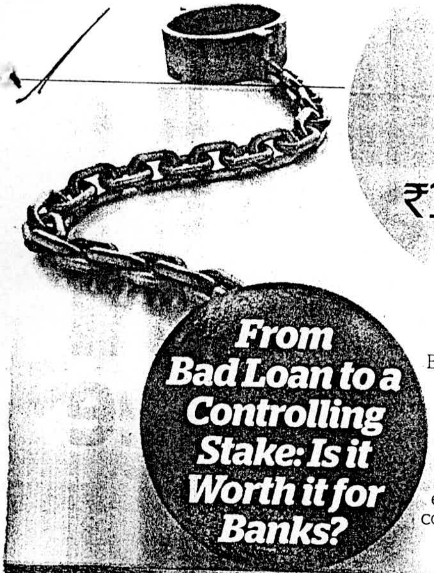
A bank had its first victory against Mallya. However, despite the liquor baron getting blacklisted for a while, subsequent events show that his new title yielded nothing much. By December 2014, a Calcutta High Court bench had set aside the committee's order. UBI's appeal against it is still with a division bench of the high court. A KFA official, contacted for this story, refused to comment on the issue.

Mallya didn't gain anything much, either. Within a year, Mallya was again declared a wilful defaulter, this time by State Bank of India (SBI) and Punjab Na-



...and Operation Cleanup that's Underway

RBI has pushed banks to clean up balance sheets by 2017	Banks allowed to convert debt to 51% equity and take control of defaulters	Large groups under pressure are selling assets to repay debt	Economic factors have prevented banks from going ahead with management change	RBI governor Raghuram Rajan wants all bad loans acknowledged



From Bad Loan to a Controlling Stake: Is it Worth it for Banks?

Banks have evoked a 'strategic debt restructuring' mechanism against **17 defaulting companies,** giving them the right to convert debt to equity and take controlling stakes

Company	No. of lenders/leader	Debt
Alok Industries	SBI	₹15,350 cr
Gammon India	19/ICICI	₹14,810 cr
Monnet Ispat	16	₹12,500 cr
Electrosteels Steel	27/ SBI	₹10,990 cr
Coastal Projects	SBI-led consortium	₹5,810 cr
Transstory	14	₹4,300 cr
IVRCL	21/SBI	₹10,340 cr
Shiv Vani Oil & Gas	ICICI+3	₹4,010 cr
Adhunik Power	12/SBI	₹3,120 cr
Visa Steel	20/SBI	₹3,090 cr
Jyoti Structures	21/SBI	₹2,640 cr
Rohit Ferro Tech	SBI	₹2,630 cr
Lanco Teesta	ICICI	₹2,400 cr
GOL Offshore	Axis and ICICI	₹2,000 cr
AMW Motors	9/IDBI	₹1,430 cr
Ankit Metal	14/SBI	₹1,280 cr
Tilaknagar Industries	BOI & SBI+3	₹800 cr

Source: Religare Research Report dated February 26, 2016

tional Bank.

Fate also had something tough planned for the hero of September 1, 2014 – Deepak Narang, who is credited with turning around the bank in quick time, with the bank showing a net profit of ₹256 crore in fiscal year 2015 as against a loss of ₹1,213 crore a year ago. However, after Narang's retirement in March 2015, the department of financial services of the Union finance ministry stopped his pension from UBI. A litany of charges were brought against him – including being too tough with a defaulting borrower, not objecting enough (his objections were recorded in writing) for a loan that was sanctioned by the earlier chairman, and not informing the bank that his brother-in-law was a CA. Narang today feels hounded for having taken on powerful borrowers. "I can challenge anyone to find a man in banking industry who is more honest," he says. Small wonder, then, as banks and borrowers on the verge of default come head-to-head, bankers worry if their decisions taken today will be challenged in future by police inspectors with little knowledge of the banking business.

> There are no easy solutions to the debt problem. Operating margins, which are strong enough to service existing debt, need structural changes in sectors like power and infra

A Battlefield of Debt

Wilful defaulters who do not pay back their loans and make timely interest payments add a layer of complexity to India's corporate debt problem, which is humongous even otherwise. The Reserve Bank of India defines a wilful defaulter as somebody who has not met his repayment obligations despite having the capacity to do so; or a borrower who has not utilised the funds for the purpose for which the finance was availed of; or a borrower who has siphoned off those funds.

Wilful defaults have crossed ₹50,000 crore in India, with more than 5,000 declared wilful defaulters, albeit most of them being small and medium businesses in stressed sectors like metals, textiles and chemicals. What is more, they are barely 5% of the bad loans problem in India. Most of the problematic loans are with apparently well-meaning businessmen, who have no intention of siphoning off funds.

At the same time Indian banks are being pushed by RBI governor Raghuram Rajan to recognise all their stressed assets and non-performing assets and clean up their balance sheets by 2017. Vaibhav Agarwal, banking analyst at Angel Broking, feels the main thrust of the RBI is to find problematic borrowers and mark them. "This will ensure that a borrower in trouble cannot borrow from one bank and repay another."

To help the banks, Rajan has also introduced new instruments. One of them is the mechanism of strategic debt restructuring (SDR), which allows banks to convert their debt into 51% equity and take control of the company. This came in July 2015. A year before that, in June 2014, the RBI had introduced a scheme called 5/25, which allowed banks to extend 25-year loans to match the cash flows of a stressed project and refinance them every five years. In the budget proposals this year, finance minister Arun Jaitley also announced measures to increase the number of presiding officers at debt recovery tribunals to help ease this burden of backlog of recovery.

Now, here is a measure of the debt problem. The total problematic assets of banks, loans where recovery has either become doubtful or has needed restructuring added to those assets under SDR or 5/25, is a whopping ₹10.31 lakh crore, according to a report by ICICI Securities dated March 16, 2015. For PSU banks, the picture is particularly grim. The report states that stressed assets (non-performing assets and restructured loans) for SBI are at 60% of its net worth. But SBI is one of the stronger PSU banks. For Indian Overseas Bank, the stressed assets now stand at 221% of its net worth.

In the current financial year, the Indian banks have "evoked" the SDR mechanism against 17 companies (see *From Bad Loan to a Controlling Stake: Is it Worth it for Banks?*), threatening to take over the management and bring in a new investor. However, the effort has not gone anywhere and not in a single case have the banks converted their debt to equity yet. In fact, many point out that once the SDR process was started, an 18-month window was provided to banks to solve the problem, either through change of management or by bringing in a new investor, or by selling assets. Beyond that period, the asset would have to be marked as non-performing, and banks opted for SDR to use this window to buy time and postpone marking an asset as bad. Last month, the RBI asked banks to mark assets as NPAs even if they were trying for an SDR.

MR Umarji, a veteran banking professional who drafted the Securitisation Act and is a consultant for the Indian Banks Association (IBA), feels finding new promoters for companies under SDR will be difficult. "Any new promoter who comes in to take a stake will want minimum debt on the books," he says. Narang says: "For a wilful defaulter, a strategic debt restructuring proposal can be a blessing in disguise as he can get rid of his responsibilities."

A Hunt in the Dark

Last week bankers held marathon meetings with borrowers. Many among the 17 companies under SDR are steel makers, who invested in the sector a decade ago when prospects looked bright. However, the completion of some of these projects coincided with a downturn in this cyclical sector. Issues not related to steel prices also contributed to the woes, according to

Vishal Agarwal, managing director of Visa Steel. Visa has debt in excess of ₹3,000 crore and Agarwal met the consortium of banks in Mumbai last week. Agarwal points to factors like the environmental concerns around iron ore mines and the cancellation of coal block allocations as reasons for lack of sufficient margins in steelmaking. He also makes a pitch for refinancing.

"Margins of steel companies are not sufficient to service interest cost and loan repayments. However, with the amendment to the Mines and Minerals (Development and Regulation) Act in 2015 and the imposition of minimum import price on steel, we expect operating margins to improve to be able to service the loans if the debt is re-financed to sustainable levels," he says. A clause in the MMDR Act had barred transfer of mines that were not allotted via auctions.

Visa's debt pile is small compared with bigger infrastructure-focused conglomerates where the borrowings are 10 times larger. Credit Suisse, in an October 2015 update to a report first done in 2012, wrote about 10 such groups and pointed out that at least five of these already have debt on their books marked as default (see *Default Rated Debt has Reached Scary Proportions for Some*).

Five months on, many of these groups are pulling out all stops to reduce debt via asset sales. For instance, with the latest sale of its cement plants, the Jaypee group has been able to bring down its debt from roughly ₹75,000 crore (as per the Credit Suisse report) to ₹38,000 crore, says chairman Manoj Gaur (see interview "*I Have No Intention to Flee*"). And last week Videocon inked a deal to sell its 4G spectrum to Bharti for ₹4,000 crore. A similar deal with Idea Cellular and Videocon had fallen through.

"For a wilful defaulter, a strategic debt restructuring proposal can be a blessing in disguise as he can get rid of his responsibilities"

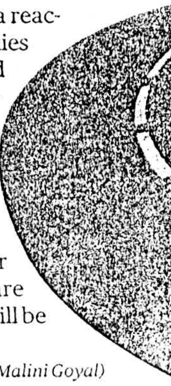
Deepak Narang, former executive director, UBI

A spokesperson of the Ruias' Essar Steel says it has repaid loans worth ₹20,000 crore in the last three years. It has further plans to sell three of its units, pipelines in Odisha and Visakhapatnam and a coke-oven plant, to bring down debt. It sold the Odisha pipeline and leased it back for its own use. However, the RBI has now prohibited such deals. The spokesperson said that Essar Steel would now not be able to sell its coke oven plant and the Vizag pipeline.

It is quite apparent that there will not be any easy solutions to the debt problem. Operating margins, which will be strong enough to service existing debt, need either structural changes in sectors like power and infrastructure – where the government is aggressively pushing through reforms – or global turnarounds in cyclical industries like steel. Umarji of IBA even suggests that the government take up all the infrastructure projects, complete them and pay off the banks.

Amit Tandon, managing director of proxy advisory firm IiAS, sees this phase as the end of an era. He says that while the licence-raj crony disappeared after 1991, the last decade saw the emergence of resource cronies. "This is a reaction to resource-based crony-capitalism. Companies that could manage local politicians could get hold of resources and enjoy the upsides. This went against the trend of entrepreneurship-led companies like Infosys. I feel a reset is taking place and this phase will end up raising the bar."

Prithvi Haldea, chairman of Prime Database Group, a firm monitoring primary markets, feels the debt quagmire will play out over another three to four years. "This is the first time we are seeing this kind of a clean-up," he says. "There will be more pain. The worst is yet to come." ■



(Additional reporting by Malini Goyal)