



CORRECTIVE POWERS

RBI revises supervisory action framework for UCBs

An urban co-operative bank may be placed under supervisory action framework when its net NPAs exceed 6% of its net advances

FE BUREAU
Mumbai, December 6

IN A BID to keep a check on urban co-operative banks (UCBs), Reserve Bank of India (RBI) has revised supervisory action framework (SAF) for urban co-operative banks. A UCB may be placed under supervisory action framework when its net non-performing assets (NPAs) exceed 6% of its net advances. As soon as this threshold is breached, the regulator may initiate multiple actions, depending on severity of stress. The central bank can ask UCB to submit a board-approved action plan for reducing its net NPAs below 6%. RBI can also order curtailment of sanction or renewal of credit facilities to sectors having high proportion of defaults after threshold is breached. RBI can also put restrictions on declaration or payment of dividend without prior approval. The regulator also has option of putting restriction on fresh loans and advances carrying risk-weights more than 100% after net NPAs of UCB cross 6%. The supervisory action framework seeks an expeditious resolution of UCBs



experiencing financial stress. Earlier on December 31, the regulator released final guidelines for setting up a board of management (BoM) for UCBs. According to the guidelines, UCBs, with deposits of ₹100 crore and above, will constitute the BoM, which will be a mandatory requirement for opening new branches. The main functions of the Board of Management (BoM) include recommending action for recovery of NPAs, One Time Settlement and assisting the board in monitoring the same. On December 30, RBI proposed reduction in loan amount an urban co-operative

bank can lend to a single entity and a group of borrowers to 10% and 25%, respectively, with an aim to prevent PMC Bank-like scams, caused by large exposure to one group. Punjab and Maharashtra Co-operative (PMC) Bank collapsed due to its huge exposure to Housing Development and Infrastructure Group companies, totaling ₹6,226.01 crore. The central bank had earlier found irregularities in PMC Bank, including major financial violations, failure of internal controls and systems, wrongdoing and under-reporting of its lending exposure.

US-Iran standoff to pull down equities: ICICI Pru

FE BUREAU
Mumbai, January 6

ON A DAY the Sensex recorded its highest fall in six months, ICICI Prudential Asset Management Company's chief investment officer S Naren said that the US-Iran standoff could drag the equity markets down. He said Iran's retaliation would decide the direction in which the markets would move and that it was hard to predict what will happen next because of geopolitical uncertainty. Speaking about the outlook for markets in 2020, Naren said that after under-performing for two years, small caps could fare better in the new year. Addressing the media on the outlook for 2020 on Monday, he said that the polarisation in the market would not sustain for a long time and that small cap stocks and mid cap

stocks would eventually do well. He said: "In three to five years, the polarisation will go away. Again the top 10 stocks, their PE is 38.5x." As many experts have also said, the richly valued top ten stocks are in for some time correction as the rally in quality stocks have resulted in very rich valuations. Naren also added that small cap stocks could prove to be a good asset class over a three-to-five year horizon. The share of small cap stocks was 10.5% till December 2019 of the overall market capitalisation of the market. After under-performing the benchmarks and a handful of large cap stocks, the share of mid and small caps in the overall market cap of equities has come down to 10% levels, indicating that the tide could turn. Over the years, the share of the small cap universe has varied from 6% in 2013 to

18% in 2017, when the small and mid caps rallied sharply. Even as the valuations of the broader markets continue to be rich, the value and special situations stocks are expected to come back into focus. A key indicator of this is weak credit growth. Naren said that when credit growth was typically really low, investors need to start investing in risky assets. "Now people ask what is it that you should invest in, we say that small cap is right," Naren added. These stocks have been underperformed by 52% for the last two years compared to large caps. "The beauty of small cap investing is that when we should be taking out money, money will come in and when you have to invest, people won't invest," S Naren said. The asset management company reiterated that the best strategy for turbulent times was an asset allocation strategy.

INTERVIEW: VINAY KHATTAR, EDELWEISS BROKING

‘Need to have a focused, time-bound resolution plan for realty, NBFC sectors’

THE YEAR 2020 could be good for investors as central banks across developed countries are expanding balance sheets and the commodity cycle has bottomed out. In a free-wheeling chat with Yashasvini Razdan and Vivek Kumar Jain, Vinay Khattar, head of research at Edelweiss Broking, says that, for any meaningful recovery in India, builders need to be put back on their feet. Excerpts:

What can investors expect from the market in 2020?

Our broad thinking is that 2020 is going to be a good year for investors, a predominant reason for this being the change in the global macro economy. We have seen significant expansions in the balance sheets of most developed countries. The second big factor, if you look at the entire commodity space, as per Bloomberg's commodity indices for the past 20 years, we are at a level of commodity prices which existed close to what it did in 2001-02. Almost 18-20 years have passed, and commodity prices are still at a level that indicates contraction in pricing that has happened in past few years. Our hypothesis is that, with the expansion of balance sheets and pickup in demand, and with commodity cycles bottoming out, commodities may begin to pick up, and you get automatic inflation which acts as a trigger because then, prices begin to go up. Inflation sets in, which causes the economic activity to pick up as commodity producers will now have more money. The third big factor, which is playing out, according to us, is that the Fed has realised that the dollar needs to go down. More the dollar depreciates, more the commodities begin to go up, in absolute terms. Thus, a pickup in the commodity cycle, leads to a pickup in economic activity across the world and is also beneficial for India. So, our sense is that this is one of the core things that will play out and will be positive, not only for the economy but also for the markets.



What about growth? Do you expect the growth to revive in the next fiscal year?

Our sense is that some of the earlier tell-tale signs are beginning to play out. These are very short-term so we would want these trends to mature to a certain extent before we can comment that these green shoots are genuine. Recently, considering data from November, the services PMI has shown a clear uptake. Services constitute almost 60% of India's GDP. That is going to be the first tell-tale sign whether economic activity is going to pick up. Secondly, we see that credit to services is beginning to pick up. One of the key factors which will determine how strongly growth will come back is how much money the government can put in the hands of the average citizen. By this, I don't mean the citizens only at the bottom of the pyramid. In terms of opinion-making and ability to spend capital, the activity always starts from the top to bottom. The sentiment, too, starts from top to bottom. If income tax benefits come in across all categories of people you could see a feel-good factor come in, which is a powerful precursor to any demand pickup across the globe. If income tax cuts are announced in February's Budget, I think that will provide a lot of impetus given that we have already received a supply-side boost by cutting corporate tax rates. So, these two things can revive economic activity in a meaningful manner.

What are the few things that the government could consider doing to clear certain bottlenecks that have impacted growth? Approaching this by spending on infrastructure and causing fiscal deficit is not the right way of doing this, given two reasons. First being that the impact of infrastructure spending takes a prolonged period to take effect. What we need is more of a boot or catalyst, not something that takes over 15-20 years to play out. Secondly, while infrastructure spends by the government are good in the long term, the marginal impact of a massive infrastructure spend on steel and cement is relatively low given the size of these sectors today. We believe the government has the right idea, however, needs to spend the money judiciously by cutting income tax rates and putting more money in the hands of the people across all segments. Consider the economy as a ship that has developed two holes; one being real estate – which is the most dominant sector in any economy across the world – and the second is NBFCs. We need to have a focused, time-bound resolution plan around these two segments, which goes beyond trying to address the demand-side problem in real estate. We need to find a way to get builders back on their feet. We need to change perception in banking and non-banking circles about builders and developers and their credit worthiness. Till we manage to do so, setting this ship upright and on course, would prove to be difficult. Adding more power in terms of spending, will not add more speed to the process of economic revival, unless we restore balance. Do you see any hope for the mid and small caps? Our sense is that mid and small caps will revive, and the triggers are going to be led by the pickup in economic activity and change in the current negative discourse. We must also realise some things have gone right but have their own gestation period.

NSE'S IPO MOVE

Vikram Limaye, MD & CEO, NSE

We have approached Sebi to seek its approval for the IPO and after that we will start the process of appointing merchant bankers, which will help the exchange file draft prospectus for the IPO.

OMO: RBI buys ₹10k cr of long-term securities, sells short-term bonds

PRESS TRUST OF INDIA
Mumbai, January 6

IN THE THIRD special open market operation in as many weeks, Reserve Bank of India (RBI) on Monday bought ₹10,000 crore of three long-term securities while selling a same amount of three short-term bonds. The RBI had announced to simultaneous purchase and sale of government securities (G-Secs) under open market operations (OMOs) for ₹10,000 crore each, last week. Like last week, though the RBI offered to sell four securities in the auction, it accepted bids for three bonds. In the current OMO purchase auction, the RBI offered to purchase three securities including 10-year benchmark government bond, against just one bond in the previous two auctions. It got bids worth ₹64,505 crore for the three bonds but choose to accept only ₹10,000 crore of bids under the OMO purchase auction. It got 198 bids for 7.32%-2024 but accepted 12 bids and for 7.27%-2026 bonds the RBI received 163 bids and

accepted only two bids. The RBI received 224 bids for 6.45%-2029 security but accepted only 22 bids. It offered to sell four government securities: 6.65%-2020; 7.80%-2020; 8.27%-2020 and 8.12%-2020 through OMO sale. These securities were offered by the RBI in the previous two OMO sale auctions. It received ₹47,540 crore of bids but accepted to sell ₹10,000 crore of bids. In terms of number of bids, the central bank received 26 bids for 6.65%-2020; 40 for 7.80%-2020 and 35 for 8.27%-2020 but accepted 7, 3 and 4 bids, respectively. For 8.12%-2020 bond, it received 41 bids but did not accept any of them. In the previous two similar auctions, the RBI had purchased ₹20,000 crore and sold ₹15,326 crore of bonds. These special OMO auctions are similar to the US Federal Reserve's Operation Twist aimed at faster transmission of policy rates, an analyst said. RBI has reduced the repo rate by 135 basis points between February and October 2019 but there has been a delay in passing on the cut in repo rate by lenders.

NSE approaches Sebi for IPO

PRESS TRUST OF INDIA
New Delhi, January 6

THE NATIONAL STOCK Exchange (NSE) on Monday said it has approached capital markets regulator Sebi for its initial public offering (IPO) and hopes to launch the public issue by September this year subject to approvals. "We have approached Sebi to seek its approval for the IPO and after that we will start the process of appointing merchant bankers, which will help the exchange in filing draft prospectus for the IPO," NSE MD and CEO Vikram Limaye told PTI. He further said that the exchange is

hoping to float the IPO by the third quarter of the calendar year and the launch is subject to approval from the Securities and Exchange Board of India (Sebi). The entire IPO would be offer-for-sale (OFS), wherein existing shareholders will sell NSE's shares. The country's largest lender, SBI, earlier this month announced that it is looking to sell 50 lakh shares representing 1.01% stake in the NSE as part of its capital raising exercise. Currently, State Bank of India (SBI) holds 5.19% stake in the exchange. The NSE has revived its listing plans, which were on the backburner following a probe by Sebi against the exchange and some of its top officials.

ANALYST CORNER

Future Retail: Equity dilution a major step for cost saving

MOTILAL OSWAL

RECEIVES ₹15 BN from FCL against equity issuance. In a much-awaited development, Future Retail (FRL) has received ₹15 bn from Future Coupons (FCL) as part of the 39.6 m equity warrants issued in April '19 (₹5 bn received earlier). Against the warrants, FRL has allotted 24.8 million equity shares, while the balance 14.8 m shares will be allotted by Oct '20 upon receiving the balance 0.2% amount, i.e. ₹11 m. This will dilute equity by 7.3% with total FCL holding of 9.7% and Amazon's (49% stake in FCL) effective holding of 4.9% in FRL. FRL has also announced raising \$500m (~₹35.7 bn) in dollar-denominated bonds. This, along with the equity warrant issue, should fund the purchase of ~₹40 bn infrastructure assets from FEL. In the interim, this could increase net debt to ₹19.6 bn with net debt/Ebitda of 1.4x/1.5x in FY21/22E; RoCE may decline by ~500bp to ~13%. However, FRL should be able to reduce leverage with adjustment of ₹6.2 bn advances held with FEL and ~₹3.8 bn potential gains from claw-back clauses with Bharti Retail and Heritage Foods. We believe this as a major step

toward saving cost and creating a transparent balance sheet (v/s earlier cross holdings of assets amongst group companies). This is because post completion of the asset purchase, FRL would save ~₹6.5-7 bn toward lease rentals to FEL and nearly ₹1.5 bn on PBT. The stock trades attractively at EV/Ebitda and P/E of 14x and 23x, respectively. Receives ₹15 bn from FCL toward warrant issuance – much-awaited deal comes to fruition In Apr'19, FRL had allotted 39.6 m equity warrants to Future Coupons at ₹505/share, of which 25% amount (₹125.25/share) – i.e. ₹5 bn – was paid by FCL in advance. FRL has now allotted 24.8 m equity shares upon receiving the balance amount of ₹9.4 bn (@ ₹378.75/share) against 24.8 m equity warrants issued to FCL in Apr'19. Also, FCL has paid 99.8% of the amount on remaining 14.8 m warrants (₹5.6 bn) but still continues to hold 14.8 m equity warrants, which can be converted into equity by 22nd Oct'20 upon payment of the balance 0.2% amount i.e. ₹11 m (0.2% amount pending in order to avoid Sebi takeover regulations). Thus, overall, FRL has received a total of ₹14.99 bn from FCL against warrants issued.

‘Buy’ on Bharat Forge; revised TP at ₹625

EDELWEISS SECURITIES

WE UPGRADE BHFC to 'Buy' and add it to our Industrials portfolio as, new capacities/shift to platform-based model enhances revenue visibility – 10% plus revenue from new products by FY22-23E – and bolsters capability-led growth in domestic industrials; exports are approaching bottom levels & so are consensus downgrades – 20% from peak, in line with past cycles; and track record of presciently identifying/scaling up high-value add products is envisaged to further drive returns/valuations. Risks: Faster disruption in conventional products (crankshafts etc), delay in new product ramp up and US industrial growth. We revise TP to ₹625, assigning low-end of peak cycle of 28x (₹355 earlier at 18x) given back-ended returns and visible exports stabilisation. With limited downside (refer to sensitivity table), we believe investors need to take risk (1 year forward PE above long-term average). Diversified play: Platform-based

revenue stream boosts potential BHFC has transitioned from a plain-vanilla auto forgings company supplying to limited domestic and global CV OEMs to one of the most diversified forgings players with marquee global clientele. Sustained investments in large capacity forging press lines and focus on right segments have aided solid diversification. While recent investments add ₹20 bn plus worth of new revenue, business is shifting towards platform-based with co-development for OEMs further strengthening its relationships. Capability/execution key MOATs; earnings cycle bottoming out. Identifying high-scale/ value-add segments, prescient investments and market share ramp up have underpinned BHFC's superior capability/ execution. Diversification and prudent investments across fungible manufacturing assets have moved overall bottom cycle OPMs/returns higher across cycles, reflecting in upward shift in valuation band.