mint

Thu, 19 Jul-18; Mint - Delhi; Size : 168 sq.cm.; Circulation:75000; Page : 4

Power sector bad loans are set to bite banks

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The Allahabad high court has refused to stay the application of the central bank's February circular on the power sector. Power firms were hoping to escape the NPA (non-performing asset) tag by seeking exemption from this circular, which forced banks to label restructured accounts as bad loans.

Media reports say the high court has asked the government to file an assessment report in two weeks. If power companies are not exempt, the impact on banks will be severe.

Assuming a capital cost of ₹7-8 crore for stressed power capacity estimated at 55,000-60,000 megawatts (MW), the potential stressed debt works out to ₹2.5-2.8 trillion, says Girishkumar Kadam, vice president and sector head (corporate ratings) at Icra Ltd. The calculation is based on debt assumption of ₹4.5-5 crore per MW.

Kadam points out that these stressed power plants will have to take a haircut in the range of 20-70% (averaging about 35%) to make themselves financially appealing, given the issues they face—lack of long-term purchase contracts, unviable tariffs, high cost overrun and lack of domestic fuel availability. Are banks prepared to deal with such kind of write-offs? A 35% haircut on ₹2.5 trillion worth of stressed loans works out to ₹87,500 crore.

A 35% haircut on ₹2.5 trillion worth of stressed loans is ₹87,500 crore. Are banks ready to deal with such write-offs?

A note by Bank of America Merrill Lynch is even more pessimistic. It says, "Our analysis suggested that 81GW (gigawatts) of thermal power capacity (or 19% of India's power capacity) remains stressed—of which only 7-22GW has the potential of being taken over. The remaining 59-74GW of capacity may not find bidders immediately given weak power demand, fuel shortages, etc., and face risk of scrappage if referred to NCLT. The aforesaid would have impacted US$50bn of bank loans to the power-gen sector & led to US$38bn of write-offs." NCLT stands for the National Company Law Tribunal.

The Reserve Bank of India's financial stability report had also pointed to the risk of a substantial rise in bank bad loans from the power sector.