45 Years of Leadership

M&A in Distress Sector (May, 2017)

RBSA Advisors

TABLE OF CONTENT

RBSA Advisors

INTRODUCTION

RBSA Advisors

Merger and Acquisition Situation in India

- Merger and Acquisition (M&A) activity scaled a six-year high in 2016, with deal value at a record high of $56.2 billion, up 87% over a year before. The year also saw the largest ever inbound investment, of $12.9 billion.
- M&A activity was driven by increased consolidation across sectors as various companies divested distressed assets, to reduce debt. On the other hand, corporates with stronger balance sheets were seen deploying funds towards acquisitions and consolidating their market positions.
- In 2016 restructuring also emerged as an important factor, with companies' focus on optimizing their portfolio with 60 restructuring deals with an aggregate disclosed value of $7.7 billion were recorded.

What is Distress?

- 'Distress' generally means that the company is having difficulty dealing with its liabilities. Before a crisis erupts and thoughts turn to formal bankruptcy proceedings, a distressed company may try to mitigate its exposure by seeking amendments or waivers to its credit facilities or debt securities.
- If above options are not sufficient, then it may take other measures, for example seeking to sell assets as part of its plan to improve its financial condition.

Reasons for Distressed Acquisitions

- Distressed companies can be attractive acquisition targets, as their price often reflects the difficulties the company faces, it also offers more significant opportunities than in non-distressed M&A transactions.
- As per a study by the London School of Economics, firms that buy distressed and bankrupt companies earn excess returns that are at least 1.6% points higher than what they make from regular acquisitions.

INTRODUCTION

RBSA Advisors

Returns to Acquirers are higher when

> Fewer large firms operate in the target firm's industry

> Firms in target industry have lower liquidity, and are financially constrained, limiting the potential buyers

Returns to Acquirers are lower when

> The M&A market in the target firm's industry is more vibrant

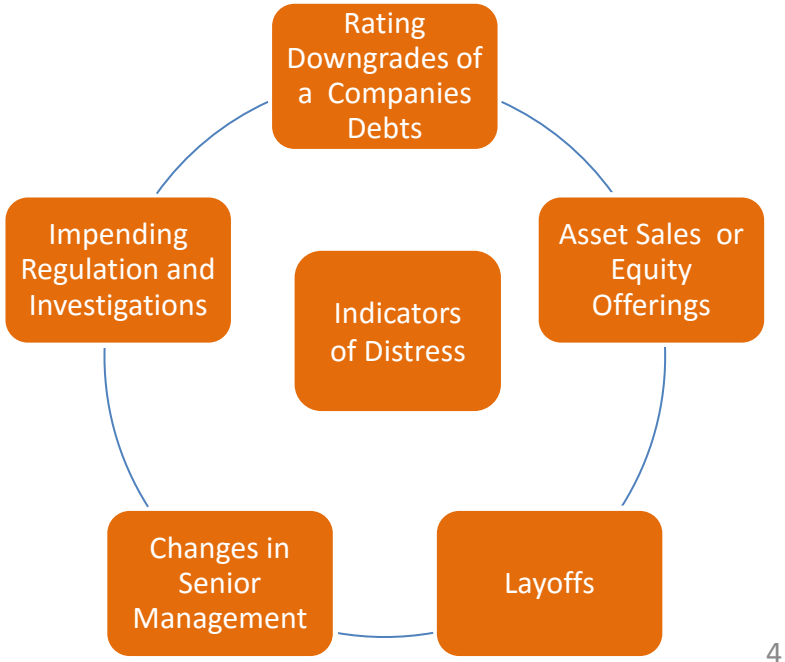
> The target's assets have more alternative uses

> The economy is doing well.

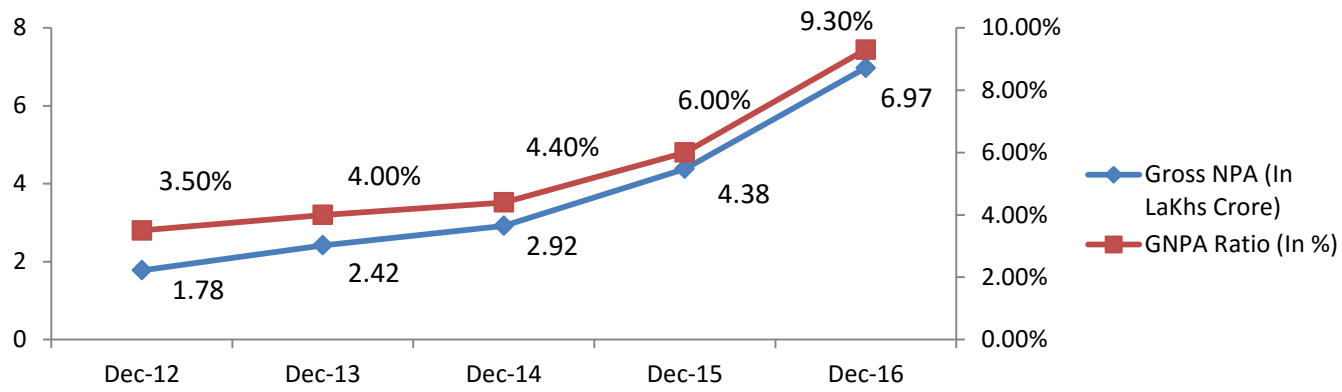
Distressed investors uncover potential targets through a number of channels, including investment banks, bankruptcy courts/filings, turnaround specialists, law firms and other advisors.

Financial distress may not solely be caused by a company taking on too much debt. In reality, most troubled companies become distressed through a combination of factors.

In contrast to a healthy M&A transaction, a distressed M&A transaction is not only a transaction between a seller and a purchaser, often the purchaser will be required to negotiate with senior and junior lien holders and lenders, secured and unsecured creditors and a bankruptcy judge.



Overview Of Distress Industries



GROSS NPAs & ADVANCES
(Public + private)

Year	Gross NPAs*	GNPA ratio
Dec '12	178,460	3.5
Dec '13	242,609	4.0
Dec '14	292,193	4.4
Dec '15	437,860	6.0
Dec '16	697,409	9.3

**In Rupees crore*
Compiled by Care Ratings

Gross non-performing assets (NPAs), of state owned banks surged 56.4% to INR 614,872 crore during the 12 month period ended December 2016, and is expected to rise further in the next two quarters with many units, especially in the small and medium sectors, according to figures compiled by Care Ratings for The Indian Express.

In its various publications, most notably in the Financial Stability Report (FSR), the RBI has said five sectors - Infrastructure, Steel, Textiles, Power and Telecom have contributed to more than 60% of bank stress.

240 of the Top 500 borrowers who hold around 42% of the total outstanding debt of INR 28.1 trillion belong to the stressed and ERR (Elevated Risk of Refinance) categories, says a report published by Live Mint dated June, 2016.

The Reserve Bank of India's (RBI) through Asset Quality Review and different Restructuring Mechanisms has decided to clean up the Balance Sheets of Indian banks, this has created pressure on Distressed Borrowers to Sell Core/Non-Core assets to repay their ballooning debts.

Overview Of Distress Industries

RBSA Advisors

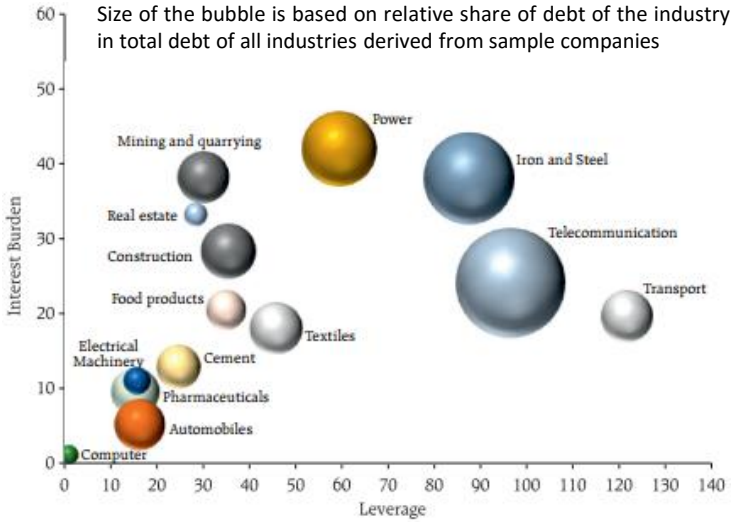
Risk Profile Leveraging

- According to Financial Stability Report (FSR) on select industries, at the end of September 2016, the Iron & Steel, Power, Telecommunication and Transport had high leverage.

Interest Burden

- According to Financial Stability Report (FSR) on select industries, at the end of September 2016, the Iron & Steel, Power, Mining and Real Estate had relatively high interest burden.

Size of the bubble is based on relative share of debt of the industry in total debt of all industries derived from sample companies



Source: RBI (Half-yearly statements of select NGNF listed companies). Interest burden is interest expense as a percentage of EBITDA

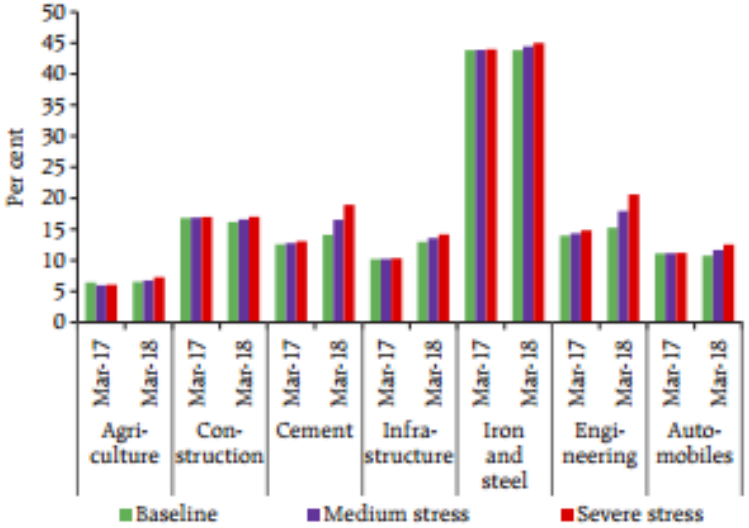
Projected Sectorial NPAs Under Various Scenarios

Risk Profile Leveraging

- A Macro stress test of sectorial credit risk reveals that among the select seven sectors, Iron and Steel is expected to register the highest GNPAs followed by Construction and Engineering.

Interest Burden

- 10 debt-heavy corporate groups listed in the Credit Suisse House of Debt report have sold and announced the sale of assets adding up to INR 1.33 trillion since 2012, according to Mint research.



Source : Financial Stability Report December 2016

Power Sector

Power Sector Overview

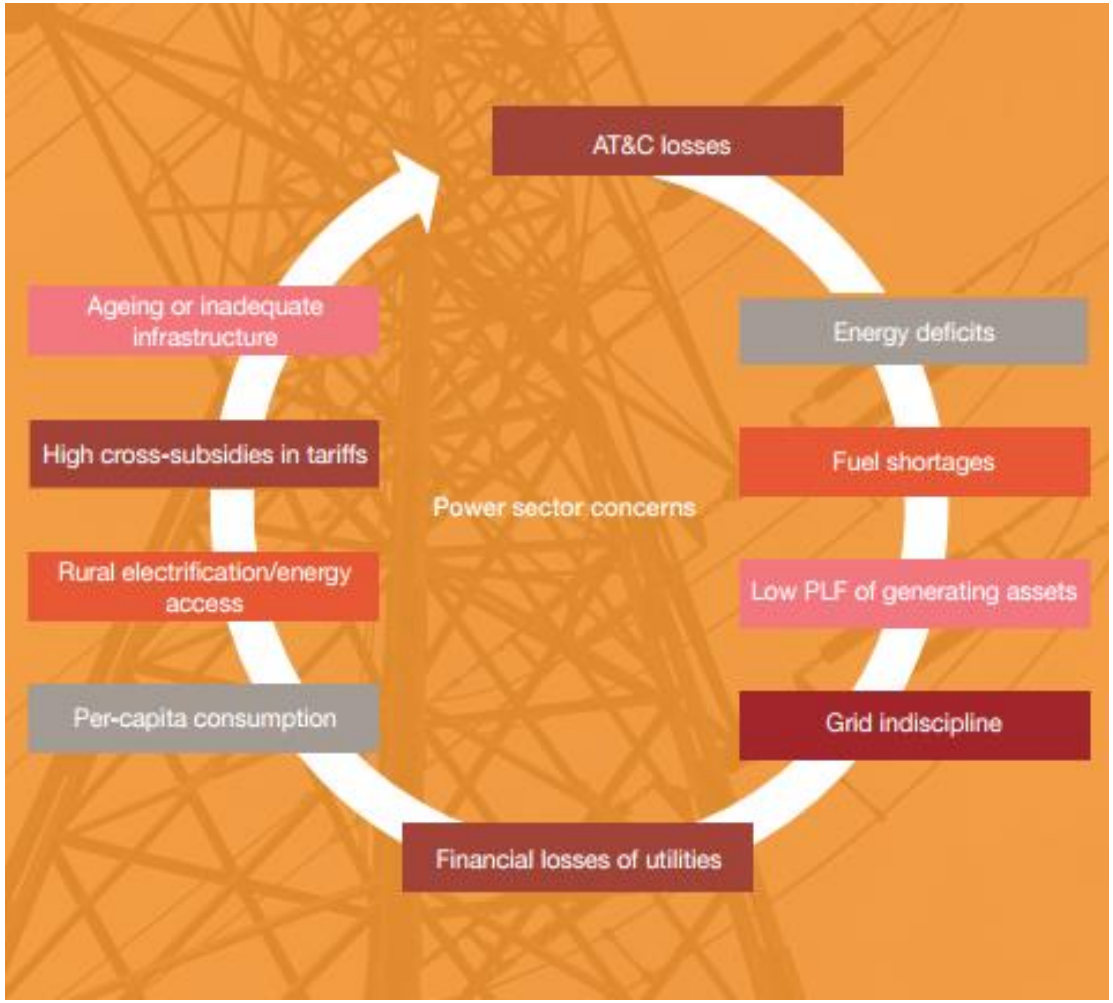
India is the 3rd largest producer & 4th largest consumer of electricity in the world, with the installed power capacity reaching 305.55 GW by September 2016. The country also has the 5th largest installed capacity in the world.

Despite the encouraging growth trajectory in the energy space over the last few years, the Indian Power sector has still not been able to induce and sustain the required capacity addition matching the ever growing power demand of the country.

As much as 59% of the generated power in India comes from coal-based thermal power plants. Although India has the 3rd largest coal reserves in the world, most of the domestic requirements are met through imports

Years of populist tariff schemes, mounting AT&C losses and operational inefficiencies have adversely affected the financial health of State Discoms, which are currently plagued with humongous outstanding debts.

As much as 25% of the generated power is lost in transmission in India as compared to a maximum of 5% in other Asian countries like China and South Korea. This is mainly due to lack of state-of-the-art infrastructure.



Case Study: Adani Transmission – Reliance Infrastructure

RBSA Advisors

adani Transmission

Transmitting Power • Distributing Hope

Adani Transmission Ltd. (ATL) has entered into a definitive share-purchase pact with Reliance Infrastructure (R-Infra) for acquiring power transmission assets of 3,100 circuit km at an enterprise value of INR 1,000 crore.

As per the deal, R-Infra will sell its Western Region Transmission Gujarat project (WRTG) and the Western Region Transmission Maharashtra project (WRTM) to ATL.

R-Infra will also sell its 74% stake in Parbati Koldam Transmission Company (PKTCL) in Himachal Pradesh and Punjab to ATL. In October last year, the company announced the signing of a binding term sheet with ATL for 100% stake sale of its transmission assets.

RELIANCE Infrastructure

The deal was aimed at cutting consolidated debt of R-Infra, which stood at over INR 25,000 crore as on March 31, 2016. R-Infra owns two electricity transmission lines spanning Maharashtra, Gujarat, Madhya Pradesh and Karnataka and has a 74% stake in PKTCL covering Himachal Pradesh and Punjab.

Source:- Economic Times

Case Study: JSW Energy – Jindal Steel & Power

RBSA Advisors

Sajjan Jindal's JSW Energy will acquire a 1,000 MW power plant in Chhattisgarh from Jindal Steel and Power Ltd (JSPL), controlled by younger brother Naveen.

According to the deal, JSW Energy will pay at least INR 4,000 crore, excluding net current assets, and an additional INR 2,500 crore if JSPL's 1,000 MW power plant in Raigarh, Chhattisgarh secures a long term power purchase agreement.

The power plant was originally a division of Jindal Power Ltd, of which JSPL owns a little over 96%. For the purpose of the deal, the power plant is being transferred to Everbest Steel & Mining Holdings Ltd., a special purpose vehicle (SPV), in which JSPL holds 99%. Under the terms of the agreement, JSW Energy will acquire 100% of the SPV. Once the transaction is complete, the aggregate installed and operational capacity of JSW Energy will rise to 5,531 MW.

JSPL's financials have been hit by the cancellation of coal blocks and payment of additional levies on coal of more than INR 3300 crore in FY14-16 as a result of a Supreme Court order. The profitability at both its key steel and power businesses have been hit because of acute coal shortages, falling realization and no material improvement in utilization of recently commissioned assets.

For JSPL, with a net debt of INR 46,000 crore, the divestment is part of its asset monetization plan to generate stable cash flows to be in a position to meet all liabilities.

Source:- Economic Times

Telecom Sector

Telecom Sector - Overview

RBSA Advisors

The year 2016 is a landmark year in the Indian telecoms industry. The much awaited sector consolidation set-in. Some of the key drivers for market consolidation include increasing pressure on profitability, hyper-competition, spectrum trading and sharing guidelines and favorable M&A policy. In addition, the sector also witnessed a number of spectrum trading and sharing deals.

In August 2016, spectrum auction took place with the largest quantum of spectrum being made available by the Government of India. However, the auctions witnessed muted response, primarily on account of high reserve prices. Of the 2,355 megahertz (MHz) total spectrum across seven bands put up for auction, only 40% of the spectrum got sold with no activity seen in 700MHz and 900MHz band.

The country's telecom sector is saddled with a debt burden of over INR 4.6 lakh crore. With a subscriber base of over 1.1 billion, it is passing through one of its toughest phases, having to contend with dwindling revenues and high debt burden to service, leading to accelerated phase of mergers in the sector.

About three years ago, there were 12-14 operators in each circle. This has come down to five and shrinking due to consolidation moves. Reliance Communications is already on the verge of finalizing the agreement to merge Aircel Ltd into its own business. It will also soon be merged with Systema Shyam Teleservices, the owner of MTS services. Shareholders have approved the merger of Reliance Communication's wireless business with Aircel.

Meanwhile, Idea Cellular and Vodafone India are reportedly looking to seal their proposed merger. The merged entity of Vodafone-Idea has potential to emerge as the market leader in terms of wireless subscribers. Following Reliance Jio's announcement of a tariff war, other telecom operators like Airtel, Vodafone, Idea and Idea Cellular rushed to match its offers. Consequently, the revenues have fallen.

Case Study: Reliance Communication - Aircel

RBSA Advisors

Reliance Communications
Anil Dhirubhai Ambani Group

In September last year, Reliance Communication (RCom) and Aircel had announced merger talks to create an entity with an asset base of more than INR 65,000 crore and a net worth of INR 35,000 crore. Besides, it will help trim RCom's overall debt by INR 20,000 crore and that of Aircel by INR 4,000 crore.

The shareholders of RCom at their meeting convened pursuant to the order of the National Company Law Tribunal (NCLT), have approved with 99.99% majority for the Scheme of Arrangement for demerger of the wireless division of the company and Reliance Telecom Limited (RTL), a wholly-owned subsidiary of the company, into Aircel Ltd. and Dishnet Wireless Ltd.

AIRCEL

RCom sold 51% of its tower business to Brookfield Group in December. The telecom towers will be demerged into a separate new entity that will be 100% owned and independently managed by the Canadian company. The Brookfield and Aircel transactions will help RCom reduce debt by 70% by 2018. RCom's debt stood at INR 42,800 crore as of December 31, 2016.

The merged company will also have a total subscriber count of more than 177 million.

Source:- Economic Times

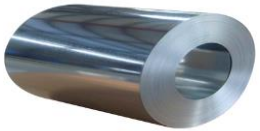
Steel Sector

Steel Sector Overview

RBSA Advisors

Steel plays a major role in the growth of a developing economy and is extensively used in a variety of areas such as social and economic infrastructure, defense, automobiles etc.

Value of Industry	Contribution to GDP	Current Position of India	Production		CAGR Production & Consumption	
100 billion	2%	3rd Largest	89 MT	China (804 MT) and Japan (105.2 MT)	Production - 7.2%	Consumption - 3.6%



The decline of steel sector in the past 4-5 years can be attributed to many factors, inter alia,

- Global overcapacity leading to cheap exports into India
- Demand deficiency of steel, poor per capita Consumption
- Declining competitiveness of Indian steel manufacturers, owing to import duty on Coke, Royalty on Iron ore, transport cost
- Intermittent supply of raw materials, land acquisition etc.
- Deteriorating Financial health of steel industries

The government has stepped up infrastructure spending from the current 5% of GDP to 10% by 2017, and the country is committed to investing USD1 trillion in infrastructure during the 12th Five Year Plan. Considering 15% as steel component in the total investment, the initiative has a potential to generate an additional demand for steel of 18.75mtpa

Case Study: JSW Steel – Bhushan Steel

RBSA Advisors

JSW Steel

Sajjan Jindal owned JSW Steel, as per reports that surfaced in Jan'17, was on the verge of finalizing a deal with bankers to take over Bhushan Steel's debt of INR 30,000-33,000 crore and acquire majority stake in the company.

If the deal goes through JSW Steel would get to own 55% stake pledged by the company's promoters to avail bank loans, according to The Hindu.

Banks have been struggling with Bhushan Steel's debt, ever since the company defaulted on its interest payment in August 2014. Further lenders led by State Bank of India and Punjab National Bank, were trying to restructure Bhushan Steel loan even while considering the option to carve out some parts of the business for sale.

BHUSHAN

With debt of more than INR 40,000 crore as reported by Mint in April 16, Bhushan Steel has been among the larger stressed accounts for domestic banks. Banks have been struggling with the account since August 2014, when they first formed a joint lenders forum (JLF) to monitor the company. After working on a number of options, including refinancing debt under 5/25 scheme which allows firms to extend the duration of loans, banks finally had to classify the loan as a bad one.

JSW Steel, acquisition of Bhushan's Odisha Steel unit having capacity of 5.6 million tonnes would mark the company entry into the mineral rich state and further increase JSW's manufacturing capacity. However there has been no further developments reported on the said front post January'17 when it was first reported.

Case Study: Other JSW Steel Acquisitions

RBSA Advisors

JSW Steel

JSW Steel Limited acquired 99.85% stake in JSW Steel (Salav) Limited (formerly known as Welspun Maxsteel Limited) on October 31, 2014.

WELSPUN STEEL
DRY BILLETS REBARS

WMSL, a unit of Welspun Enterprises Ltd, had long-term debt of INR 1,087 crore.

Moreover WMSL is situated in close proximity to company's Dolvi unit (in Maharashtra), offering complementary infrastructure and location to augment the current envisaged expansion. Moreover it had a captive jetty and railway sliding giving JSW Steel a strategic advantage.

JSW Steel

JSW Steel had acquired 41% stake in debt-ridden Ispat Industries from Pramod and Vinod Mittal, in December 2010 for about INR 2,157 crore. Ispat Industries was subsequently named as JSW Ispat. Later, it increased its stake to 46.75% in JSW Ispat and is the single-largest shareholder of the company.

ISPAT

In 2012, Sajjan Jindal led JSW Steel, announced the merger of renamed JSW Ispat with itself, 20 months after acquiring a controlling stake in Ispat Industries.

According to a report published in the Hindu, the integration was expected to bring significant advantages, particularly in alternative steel making technologies and pan India market reach. It would also yield considerable financial benefits to JSW Steel, which would utilise JSW Ispat's unabsorbed tax losses of INR2,000 crore, besides making optimal use of depreciation on further capital investments.

Cement Sector

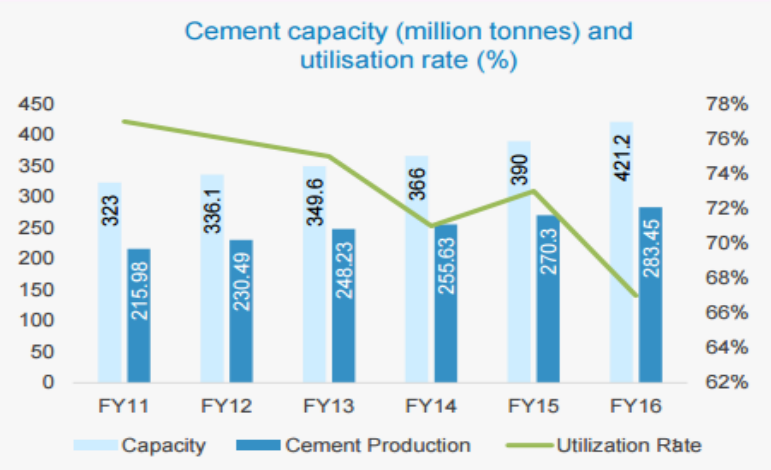
Cement Sector Overview

RBSA Advisors

Value of Industry	CAGR Growth in Production	Current Position of India	Production		Composition	
100 billion	6.44% (2007-16)	2nd Largest	395 MT	550 MT (2025E)	Private - 98% Public - 2%	20 Co. with 70% of Prod

Reasons for distress in Cement Sector

- Rise in pet coke prices coupled with increase in diesel prices and Power Costs
- High freight costs and Low Per Capita consumption
- The higher input cost and lower demand
- Housing and construction effected on account of demonetization
- Poor capacity utilization is expected to touch around 67% in FY16

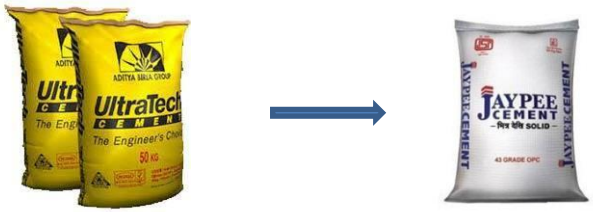


India Ratings and Research however expects the cement industry to grow 4%-5% YoY in FY18, driven largely by the demand stemming from infrastructure activities and a revival in housing demand in rural areas, both led by government spending.

Case Studies: Cement Sector

RBSA Advisors

UltraTech Cement – Jaypee Cement



- UltraTech the flagship cement company of Aditya Birla Group, has struck a deal to bag the cement assets of Jaypee Group. UltraTech as per reports would pay INR 16,189 crore to buy Jaypee Group's cement operations that have a total capacity of 17.2 million tonnes per annum (MTPA) spread across Uttar Pradesh, Madhya Pradesh, Himachal Pradesh, Uttarakhand and Andhra Pradesh.
- Jaypee Group has been passing through turbulent times caused by the economic slowdown hence is planning to reduce its overall debt through its proactive divestment initiative
- The lenders, led by ICICI Bank, also agreed to invoke the Strategic Debt Restructuring (SDR) mechanism, about 12,000 crore of debt will be cleared from the books of JP Associates. The deal also raises hopes for other Jaypee group firms too that are faced with debt burdens. The group had a consolidated debt of around INR 89,000 crore as on 31 March, 2016.

Birla Corporation – Reliance Infrastructure

- Birla Corporation is said to have completed acquisition of Anil Ambani's cement business - Reliance Cement Company Private Limited (RCCPL) , a wholly-owned arm of flagship R-Infra, for an enterprise valuation of about INR 4,800 crore. The acquisition, would catapults the company's cement production capacity to 15.4 MTPA from 9.8 MTPA.
- R-Infra plans to use the entire proceeds to reduce its debt in sync with its plan to monetize cement, roads and Mumbai power businesses to reduce its overall debt of INR 15,500 crore as on March 31, 2016.
- R-Infra has a consolidated debt of INR 25,800 crore at the end of the last FY 2015 and the sell off of the cement business is being seen as a move to improve the financial health of the company in order to be debt-free on a standalone basis. The company has been selling off capital-intensive businesses like cement and roads.

Government Initiatives

Power Sector – Government Initiatives

RBSA Advisors

Policy

- 100% FDI is allowed under the automatic route in the power segment & renewable energy. Restructured Accelerated Power Development and Reforms Programme (R-APDRP) was launched by Ministry of Power with the purpose of reducing AT&T losses up to 15% by up gradation of transmission and distribution network.
- To reduce dependency on imported coal, a Public Private Partnership (PPP) policy framework would be devised with Coal India Limited to increase coal production.

National Tariff Policy (2016)

- The National Tariff Policy for Electricity was amended by the Union Government on 20th January, 2016, and aims to achieve the objectives of UDAY scheme.
- Special focus on renewable energy has been laid. In order to promote use of renewable energy, solar Renewable Purchase Obligation (RPO) is proposed to increase to 8% by 2022.

Budget Policy

- Government to reintroduce 'generation-based incentives' for wind power projects to boost capacity addition in the sector; Cutting of excise duties by 2% on capital goods import.
- Benefit under section 35 (2AA) of the Income Tax Act to industry/private sponsored research programmers.

Telecom Sector – Government Initiatives

RBSA Advisors

Policy

- FDI cap in the telecom sector has been increased to 100% from 74%; out of 100%, 49% will be done through automatic route and the rest will be done through the FIPB approval route.
- FDI of up to 100% is permitted for infrastructure providers offering dark fiber, electronic mail and voice mail.

License Fees

- In January 2015, the Government of India recommended reduction in license fees of telecom operators by 6%, telecom operators currently pay 8% of adjusted gross revenue as license fee.
- The issuance of several international and national long-distance licenses has created opportunities and attracted new companies into the market.

Enhanced Spectrum Limit

- The prescribed limit on spectrum would be increased from 6.2MHz to 2x8 MHz (paired spectrum) for GSM technology in all areas other than Delhi & Mumbai, where it will be 2x10MHz (paired spectrum).
- The Government of India has liberalised the payment terms for spectrum auctions by allowing two options of payments to telecom companies for acquiring the right to use spectrum, which include upfront payment and payment in instalments.

Steel Sector – Government Initiatives

RBSA Advisors

Policy

- The Ministry of Steel has drafted a new National Steel Policy which plans investment of INR 10 lakh crore to build more production capacity. It mandates to give preference to domestically manufactured iron & steel products (DMI&SP) and will be applicable on all government tenders.
- The policy envisages a crude steel capacity of nearly 300 MT by 2030-31 . Steel consumption is poised to go up to 160 kg by 2030-31 from the present level of around 61 kg.

R&D

- The scheme for the promotion of R&D in the iron & steel sector', has been approved with budgetary provision of USD 24.6 million to initiate.
- The Make in India initiative & policy decisions taken under it are expected to augment the country's steel production capacity & resolve issues related to the mining industry.

FDI

- 100% FDI through the automatic route is allowed in the Indian steel sector.
- The government has reduced the basic custom duty on the plants & equipment's from 7.5% & 5% to 2.5%, on steel grade dolomite & steel grade limestone from 5% to 2.5% and on forged steel rings from 10% to 5%.

Cement Sector – Government Initiatives

RBSA Advisors

Policy

- The Union Budget proposed to assign infrastructure status to affordable housing projects and facilitate higher investments and better credit facilities, in line with the government's aim to provide housing for all by 2022 which will boost cement demand.
- The Government of India has decided to adopt cement instead of bitumen for the construction of all new road projects on the grounds.

MMDR Act (Amended)

- The Parliament of India has cleared amendments to the Mines and Minerals Development and Regulation (MMDR) Act, to allow the transfer of captive mines granted through non-auction routes, a move likely to spur mergers and acquisitions (M&As) in the cement industry.
- The amendment has created an exception for transfer of mining leases for mines, which are for captive use.

Developments

- India has joined hands with Switzerland to reduce energy consumption and develop newer methods in the country for more efficient cement production.
- The Finance Minister, Arun Jaitley, said that the National Housing Bank will refinance individual housing loans of about INR 20,000 crore (US$ 3 billion) in 2017-18. The Finance Minister proposed to complete 1 crore houses by 2019. All these developments are expected to boost cement demand.

Contact Us

Management:

Rajeev R. Shah | Managing Director & CEO
+91 79 4050 6070
rajeev@rbsa.in

Manish Kaneria | Director
+91 79 4050 6090
manish@rbsa.in

Gautam Mirchandani | Director
+91 22 6130 6000
gautam.mirchandani@rbsa.in

Research Analysts:

Krunal Dalwadi
+91 79 4050 6075
krunal.dalwadi@rbsa.in

Mahit Puri
+91 79 4050 6073
mahit.puri@rbsa.in

Deval Shah
+91 79 4050 6073
deval.shah@rbsa.in

Darshan Shah
+91 79 4050 6075
darshan.shah@rbsa.in

India Offices:

Mumbai Office:
21-23, T.V. Industrial Estate, 248-A,
S.K. Ahire Marg, Off. Dr. A. B. Road, Worli,
Mumbai - 400 030
Tel : +91 22 6130 6000

Delhi Office :
9 C, Hansalaya Building,
15, Barakhambha Road, Connaught place,
New Delhi -110 001
Tel : +91 11 2335 0635/37
+91 99585 62211

Bangalore Office:
Unit No. 104, 1st Floor, Sufiya Elite, #18,
Cunningham Road, Near Sigma Mall,
Bangalore - 560052
Tel : +91 80 4112 8593
+91 97435 50600

Ahmedabad Office:
912, Venus Atlantis Corporate Park,
Anand Nagar Rd, Prahaladnagar,
Ahmedabad - 380 015
Tel : +91 79 4050 6000

Surat Office:
37, 3rd Floor, Meher Park,
'A', Athwa Gate, Ring Road,
Surat - 395 001
Tel : +91 97243 20636

Jaipur Office:
Karmayog, A-8, Metal Colony,
Sikar Road,
Jaipur - 302 023
Tel : +91 97243 44446

Global Offices:

Dubai Office :
Office 2201-18, Level 22,
Millennium Plaza Hotel & Office Tower,
Sheikh Zayed Road, PO Box 414684
Dubai U.A.E.
Tel : +971 4506 9418
Mob : +971 55 478 6464
Email: dubai@rbsa.in

Singapore Office:
6001 Beach Road,
#22-01 Golden Mile Tower,
Singapore-199 589
Email: singapore@rbsa.in