Strategic Debt Restructuring

- Valuation
- Investment Banking
- Advisory Services

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RBSA
Research Initiative

RBSA Advisors

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1. Non Performing Assets, Standard Restructured Advances and Debt Restructuring

Non Performing Assets (NPA)

- Non Performing Assets or NPA means a loan or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by the RBI.

Standard Restructured Advances

- A standard restructured account is one where the bank, grants to the borrower concessions that the bank would not otherwise consider. A restructured advance would normally involve modification of terms of the advances/securities, which would generally include, among others, alteration of repayment period/repayable amount/ the amount of installments and rate of interest. It is a mechanism to nurture an otherwise viable unit, which has been adversely impacted, back to health.

Debt Restructuring

- Debt restructuring is a method used by companies to avoid default on existing debt by altering terms & conditions of the existing debt issue or to take advantage of a lower interest rate by taking a new debt after settling the previous one.

2. Why Debt Restructuring

Why Debt Restructuring?

Debt restructuring is required when a debtor is experiencing financial difficulties because of default on any of its debt, is in bankruptcy, has securities that have been delisted, cannot obtain funds from other sources, projects that it cannot service its debt, or there is significant doubt about whether it can continue to be a going concern.

Debt restructuring can be of two kinds:

- **General**

  Under the terms of general debt restructuring, the creditor incurs no losses from the process. The lender decides to extend the loan period, or lowers the interest rate, to enable the debtor to recover from a temporary financial difficulty and pay the debt later.

- **Troubled**

  Troubled debt restructuring refers to the process where the lender incurs losses in the process. This happens when it leads to a reduction in the accrued interest, a dip in the value of the collateral, or conversions to equity.

➢ Debt restructuring is meant to help both the parties. It involves compromises made by the lender as well as the debtor to ensure that the loan is repaid in full to the creditor without too much of a financial loss to the debtor.

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3. Corporate Debt Restructuring (CDR)

A method used by the companies with outstanding debt obligations to alter the terms of the debt agreements in order to achieve some advantage.

The system got evolved and detailed guidelines were issued by RBI on August 23, 2001 and were revised on February 5, 2003.

Objective is to support continuing economic recovery, enabling viable debtors to continue business operations and promoting fair and equitable debt repayments to creditors.

The CDR mechanism will cover only multiple banking accounts/syndication/consortium accounts with outstanding exposure of Rs. 20 Crore and above by Banks and Institutions.

It has a three tier structure including the CDR Cell which is the third tier that makes the initial scrutiny of the proposals, the Empowered Group (EG) which decides whether to take up the restructuring or not and afterwards approves the restructuring plan prepared by the CDR Cell. The top tier is the Standing Forum which lays down the policies and guidelines to be followed by the EG & CDR Cell for Debt Restructuring.

4. Status of Corporate Debt Restructuring (CDR) and Non Performing Assets (NPAs)

NPAs

Worrying Signs*		
	Estimated as on March 2015	Projected by March 2016
Gross NPAs	Rs.3.1 lakh crore (4.4% of total loans)	Rs.4.2-4.7 lakh crore (5.-5.9% of total loans)
Standard Restructured Advances	Rs.4.3 lakh crore (6.2% of total loans)	-
Gross NPAs + Standard Restructured Advances	Rs.7.4 lakh crore (10.6% of total loans)	Rs.7.4-8 lakh crore (9.5-10.5% of total loans)
*ICRA estimate on banks' gross NPAs and restructured advances (PSBs+ Private Banks)		

CDR

- CDR packages of 44 firms with a debt of Rs.27,015 crore failed in FY 2015
- Only 5 firms with debt of Rs.1,399 crore managed to exit the CDR successfully. Outstanding CDR failures almost doubled to Rs.56,995 crore in March 2014
- In a bold move, the RBI empowered banks to take control of a company if it fails to meet specific milestones under the corporate debt restructuring (CDR) plan.
- To achieve the change in ownership, the lenders under the Joint Lender's Forum (JLF) should collectively become the majority shareholder by conversion of their dues from the borrower into equity

5. Strategic Debt Restructuring Scheme

- **Introduction**

i. The concept of Strategic Debt Restructuring ("SDR") has been introduced by the Reserve Bank of India (the "RBI") in the SDR Scheme (the "Scheme") to help banks recover their loans by taking control of the distressed listed companies.
ii. The Scheme has been enacted with a view to revive stressed companies and provide lending institutions with a way to initiate change of management in companies which fail to achieve the milestones under Corporate Debt Restructuring ("CDR").
iii. The Scheme is subsequent to CDR or any other restructuring exercise undertaken by the companies.

- **Eligibility**

i. Conversion of outstanding debts can be done by a consortium of lending institutions. Such a consortium is known as the Joint Lenders Forum ("JLF").
ii. The JLF may include banks and other financial institutions such as NBFCs.
iii. The Scheme will not be applicable to a single lender.

> **"It will be useful in cases where the borrower has been non-compliant and the bank is confident that a new promoter or buyer can turn things around. In other cases, the existing managements are better equipped to grapple with the situation"**
>
> **- Jaideep Iyer, Group President, Financial Management, YES Bank**

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5. Strategic Debt Restructuring Scheme

- **Conditions**

i. At the time of initial restructuring, the JLF must incorporate an option in the loan agreement to convert the entire or part of the loan including the unpaid interest into equity shares if the company fails to achieve the milestones and critical conditions stipulated in the restructuring package.
ii. This option must be corroborated with a special resolution since the debt-equity swap will result in dilution of existing shareholders.
iii. Such a mandate will result in the lenders acquiring a majority (51%) ownership.
iv. If the company fails to achieve the milestones stipulated in the restructuring package, the decision of invoking the SDR must be taken by the JLF within thirty (30) days of the review of the account during the restructuring.
v. The JLF must approve the debt to equity conversion under the Scheme within ninety (90) days of deciding to invoke the SDR.
vi. The JLF will get a further ninety (90) days to actually convert the loan into shares.

- **What Happens after the Debt-Equity Swap?**

i. On completion of conversion of debt to equity as approved under the Scheme, the JLF shall hold the existing asset status of the loan for another eighteen (18) months.
ii. The JLF must divest their holdings in the equity of the Company. If the JLF decide to divest their stake to another Promoter, the loan will be upgraded to 'Standard'. The 'new promoter' should not be a person/entity from the existing promoter/promoter group. However, the quantum of provisions held by the bank as on the date of the divestment will not be reversed.

"The measure is welcome in so far as it does create a sense of fear amongst borrowers, resulting in better credit compliance and responsible behavior"

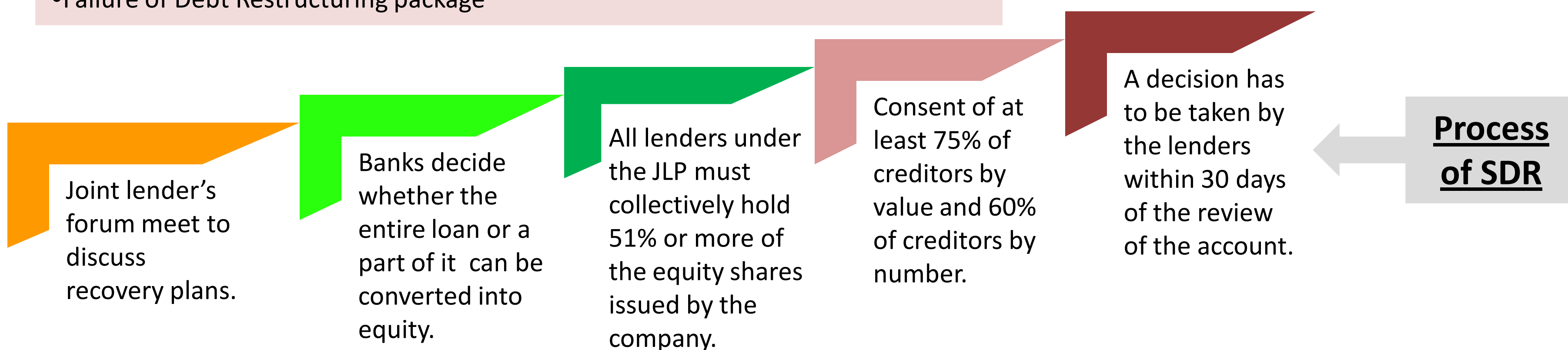
- Diwakar Gupta, former MD and CFO of the State Bank of India

5. Strategic Debt Restructuring Scheme

- **The scheme that will give lenders the right to convert their outstanding loans into a majority equity stake if the borrower fails to meet conditions stipulated under the restructuring package.**
- **SEBI allowed conversion of loans to shares on 22nd March, 2015 while RBI formalized the proposal on 8th June, 2015.**

Need for Strategic Debt Restructuring

- According to Fitch, stressed assets of Indian lenders set to rise 13% of total advances by March, 2016 from 10.73% as at December, 2014
- CRISIL ratings & S&P' Indian arm estimates the total bad loans to reach Rs.5.3 trillion by March, 2016
- Failure of Debt Restructuring package



Pros:

- Possibility to recover bad loans.
- Possibility for companies to restructure.

Cons:

- Banks lack in-depth knowledge for operations.

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5. Strategic Debt Restructuring Scheme

▪ Valuation for Conversion of Debt into Equity

i. The adjustment of equity against outstanding debt (principal as well as unpaid interest) would be at a 'Fair Value' which will not exceed the lowest of the following:

   a) **Market value (for listed companies only)**: Average of the closing prices of the instrument on a recognized stock exchange during the ten trading days preceding the 'reference date'.

   b) **Break-up value (for unlisted companies)**: Book value per share to be calculated from the company's latest audited balance sheet (without considering 'revaluation reserves', if any) adjusted for cash flows and financials post the earlier restructuring; the balance sheet should not be more than a year old. In case the latest balance sheet is not available this break-up value shall be Rs.1.

Restructuring Game

The Conversion of out-standing debt should be at "Fair Value", and can't be lower than the "Face Value" for shares

▪ Open Offer or Not?

i. The pricing formula stated above has been **exempted** from the Securities and Exchange Board of India (SEBI) (Issue of Capital and Disclosure Requirements) Regulations, 2009.

ii. Further, the acquiring lender on account of conversion of debt into equity will be exempted from making an open offer under Regulation 3 and Regulation 4 of the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

6. Difference between Corporate Debt Restructuring(CDR) and Strategic Debt Restructuring(SDR)

Sr No.	Corporate Debt Restructuring (CDR)	Strategic Debt Restructuring (SDR)
1	The reorganization of a company's outstanding obligations by reducing the burden of the debts on the company by decreasing the rates paid and increasing the time the company has to pay the obligation back.	SDR scheme allows banks to convert their outstanding loans into equity in a company if even restructuring has not helped.
2	The CDR system got evolved and detailed guidelines were issued by RBI on August 23, 2001.	SDR was announced on 8th June, 2015 by the RBI.
3	It has a three tier structure which includes CDR Cell, Empowered Group and a Standing Forum. The Standing Forum is the top tier which decides on the restructuring.	A consortium of lending institutions namely Joint Lender's Forum is formed which will decide on the conversion of debt into equity.

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7. Advantages to Banks

Advantages for Bankers under the SDR Scheme

Conversion of debt into equity in an enterprise by a bank may result in the bank holding more than 20% of voting power, which will normally result in an investor-associate relationship under applicable accounting standards. However, as the lender acquires such voting power in the borrower entity in satisfaction of its advances under the SDR, and the rights exercised by the lenders are more protective in nature and not participative, such investment may not be treated as investment in associate.

On conversion of debt to equity as approved under SDR Scheme, the existing asset classification of the account, as on the reference date will continue for a period of 18 months from the reference date.

Acquisition of shares due to the execution of strategic debt restructuring scheme will be exempted from regulatory ceilings or restrictions on capital market exposures, investment in para-banking activities and intra-group exposure. Equity shares acquired and held by banks under the SDR scheme will be exempt from the requirement of periodic mark-to-market.

On divestment of holding of banks in favour of a new promoter, the asset classification of the account may be upgraded to Standard. Further, at the time of divestment of their holdings to a new promoter, banks may refinance the existing debt of the company considering the changed risk profile of the company without treating the exercise as restructuring subject to banks making provision for any diminution in fair value of the existing debt on account of the refinance.

"For such companies, the ability of banks to find buyers will be critical because the regulation clearly states that banks will take control only to cede control to another promoter"

- Diwakar Gupta, former MD and CFO of the State Bank of India

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8. Banks can bring in Foreign Promoters after taking over defaulting companies

EASING NORMS
➢ Banks can convert shares at prices prevailing during time of restructuring, subject to floor of face value.
➢ New RBI guideline will help banks avoid a "Kingfisher type Situation" where banks were compelled by the old SEBI pricing formula to convert loans at a 60% premium to market value although the airline was on the verge of bankruptcy.
➢ New Indian promoters should hold at least 51%, foreigners can acquire control with 26% as long as they are largest shareholders.
➢ Banks need not mark to market converted shares, nor do they have to follow investor-associate norms

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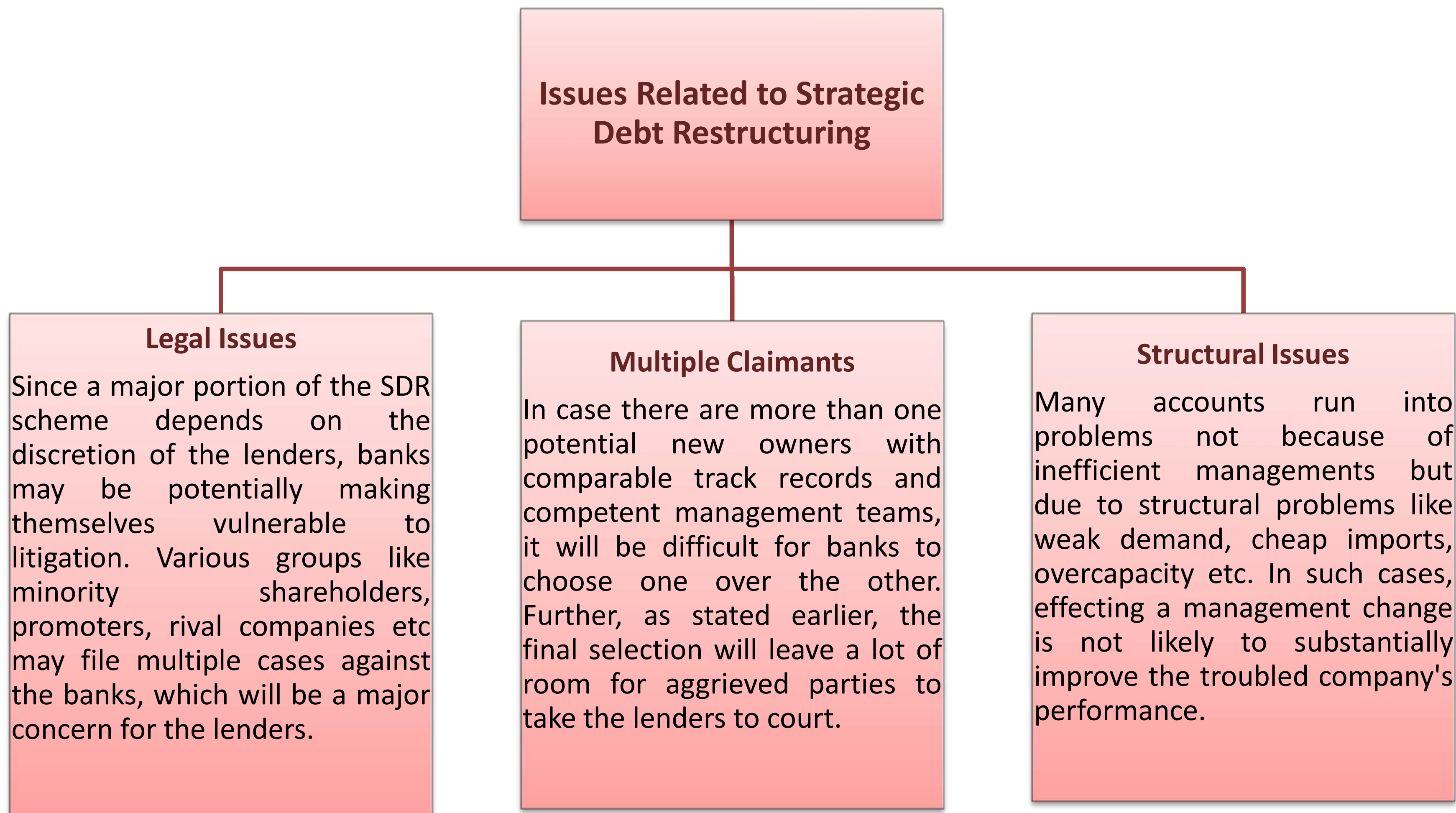
9. Proposed Application of Strategic Debt Restructuring Scheme

1. GTL Infrastructure Limited, a telecom tower company, builds, owns, operates, and maintains passive telecom infrastructure sites in India. The company provides telecom towers on a shared basis to various telecom operators to host their network components on cell site.
2. GTL Infrastructure owes its lender more than Rs.5000 crore.
3. Lenders of GTL Infrastructure such as State Bank of India, IDBI Bank, United Bank of India and Dena Bank are planning to takeover its ownership and management by invoking SDR.

1. Electrosteel Steels Limited is an India-based company engaged in the manufacture of steel. The Company's products include pig iron, billets, thermo mechanically treated (TMT) bars, wire rods and ductile iron pipes.
2. Lenders to the Kolkata-based Electrosteel Steels Ltd have taken 'in-principle' decision to take over the management control of the company by acquiring majority stake in equity by invoking Strategic Debt Restructuring (SDR), in line with RBI's guidelines on SDR issued on 8th June, 2015
3. Electrosteel Steels Ltd is a chronic defaulter with exposure of Rs.9500 crore to the banks. It is first large publicly known case where lenders are using the new SDR rules to wrest management control from the company.

10. Issues related to Strategic Debt Restructuring Scheme



11. RBSA's Analysis

Resistance from Shareholders

- Getting the required authorization from shareholders is expected to be a time consuming process. This might also prove to be a major bottleneck in the lenders' plans to operationalize the SDR scheme. Further, the shareholders may want a say in selecting the new promoters, which might impinge on the lenders' discretionary powers.

Resistance from Workers' union

- Unions might protest the change in management as it may effect their pension or bonuses.

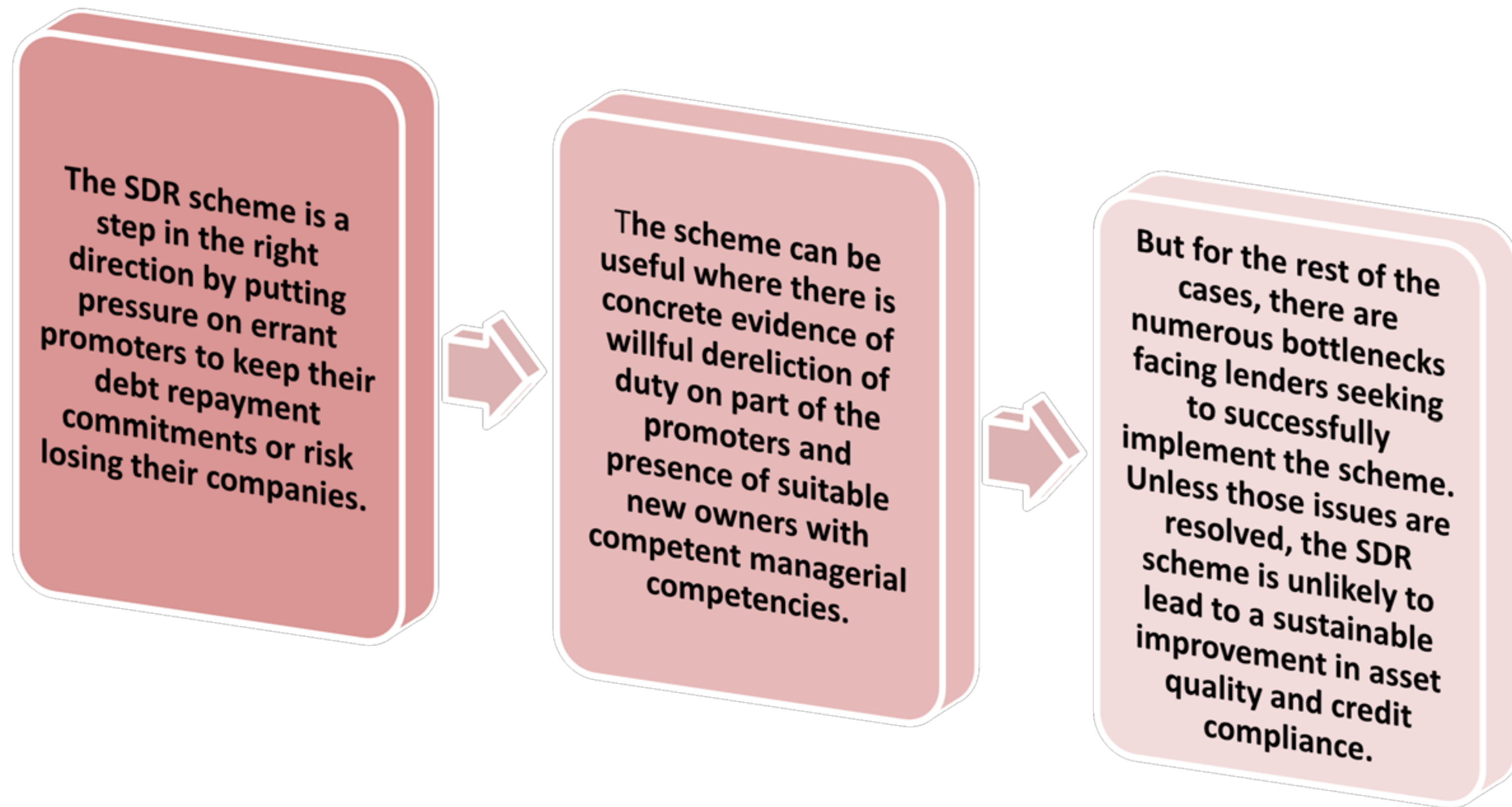
Continuous monitoring by lenders required

- It would be difficult for lenders to "closely monitor" the performance of the company, as the circular requires. Further, scouting, assessing and evaluating professional management across a wide spectrum of industries is outside the core competence of banks. The lenders will have to depend on outside agencies for this task, which will be time consuming and require a lot of oversight.

Resistance from new Promoters

- The new promoters may be unwilling to accept the existing terms on the debt. For example, they may argue for a reduced interest rate. In such a situation, the lenders stand to lose out on substantial revenues. This would translate into higher provisioning for banks, thus adversely impacting their bottom lines.
- The new promoters would expect the scheme to be back loaded rather than front loaded in order to retire debt at a later date and would expect higher moratorium period to turnaround the company.

12. Closing Comments



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Contact Us

Research Analysts		
Palak Sheth	Karan Sachdeva	Kunal Shah
+91 79 4050 6074	+91 11 2335 0635	+91 79 4050 6075
palak.sheth@rbsa.in	karan.sachdeva@rbsa.in	kunal.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 Fax: +91 22 6130 6001	Delhi Office : 1108, Ashoka Estate, 24 Barakhambha Road, New Delhi – 110 001 Tel : +91 11 2335 0635	Bangalore Office: Unit No. 104, 1st Floor, Sufiya Elite, #18, Cunningham Road, Near Sigma Mall, Bangalore- 560052 Tel : +91 8041128593 Tel : +91 9743550600
Ahmedabad Office: 912, Venus Atlantis Corporate Park, Anand Nagar Rd, Prahaladnagar, Ahmedabad – 380 015 Tel : +91 79 4050 6000 Fax : +91 79 4050 6001	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 : +91 141 233 5892 Fax : +91 141 233 5279

GLOBAL OFFICES:		
Singapore Office: 17,Phillip Street , #05-01,Grand Building, Singapore-048 695 Tel no: +65 3108 0250, 9420 9154	Dubai Office : ABCN, P. O. Box 183125 4th Floor, Block-B Business Village, Deira Dubai U.A.E. Tel : +971 4 230 6084 Fax : +971 4 230 6300 Mob.: +971 55 478 6464 Email : gautam.mirchandani@rbsa.in	