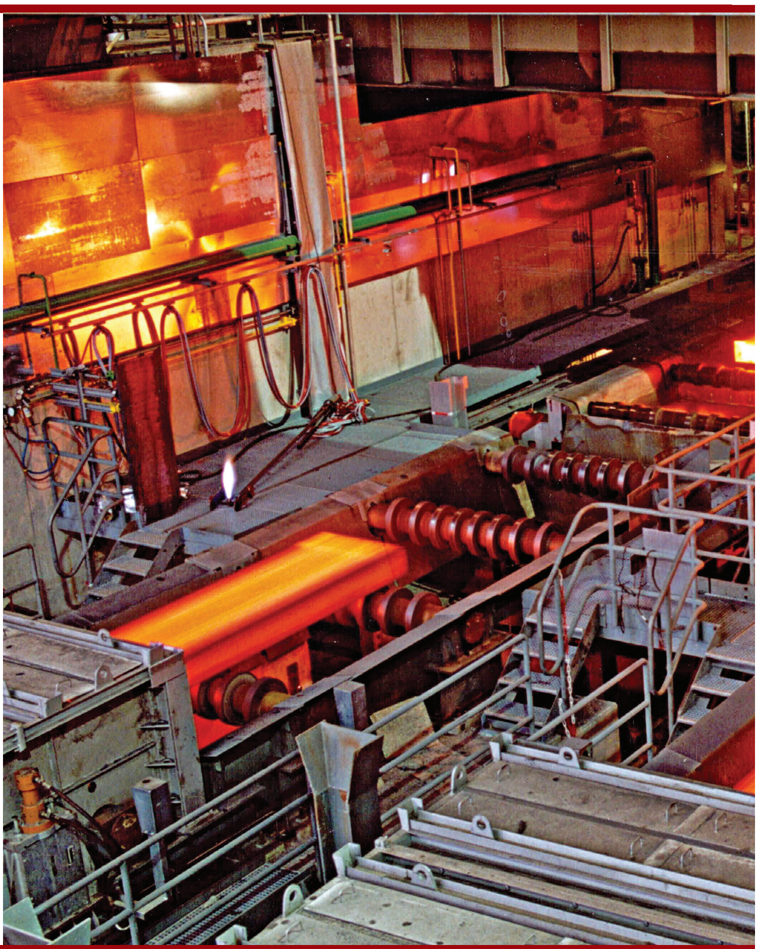
The Need to Relook the Stressed Asset Scheme for the Steel Industry



Nature of Debt in the Steel Industry

The steel industry has been facing crisis due to increased amount of debt and lower demands resulting into lesser profitability and stress in its accounts. Demonetisation has also acted as a double whammy to the steel industry, which was already in bad shape.

At present, the steel companies are not even able to service the interest portion of the debt. The non-payment of interest to the banks has resulted into a default and consequently the account(s) of such steel companies have been classified as 'non-performing assets' ("NPA"). As per the news articles, the stressed assets of steel sector out of the gross NPAs comprise around 29.38% and stands at ₹ 1.5 lakh crore.

By virtue of the amendment to the Banking Regulations Act, 1949, the Reserve Bank of India ("RBI") has come out with a press release dated May 22, 2017 read with another press release dated June 13, 2017, modified by corrigendum dated July 08, 2017, inter-alia outlining the action plan in relation to implementation of the banking regulation ordinance. Pursuant thereto, top 500 accounts of the banking system having highest exposure and converted into NPAs, whether wholly or partly, were considered for review and twelve largest defaulters having 25% of the total gross NPAs were referred for expeditious actions.

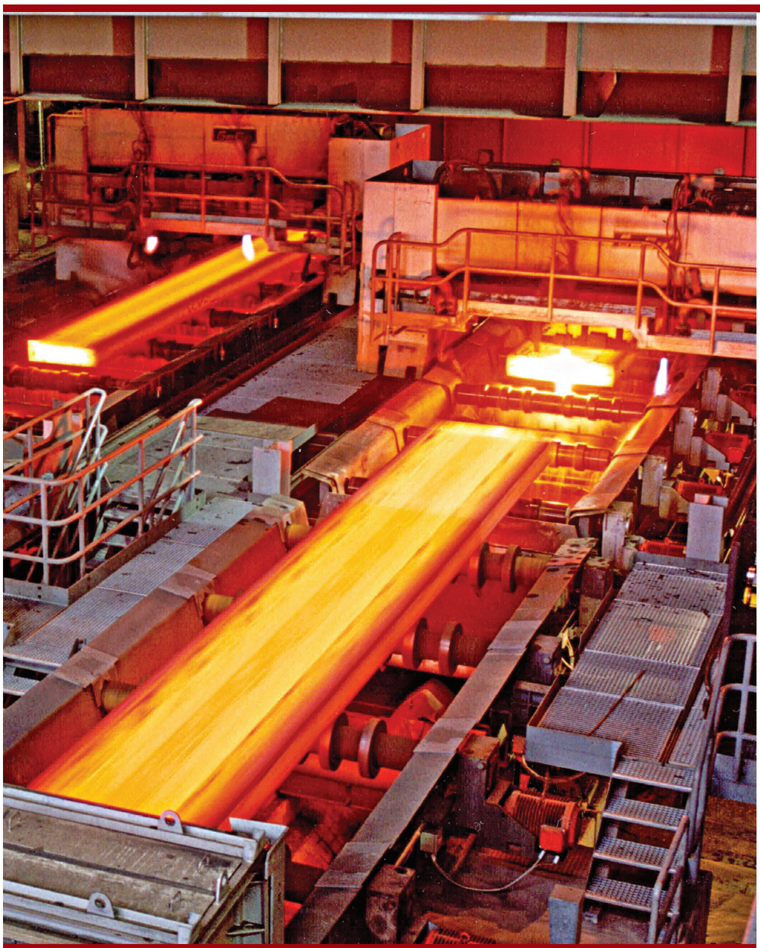
Five out of the aforesaid twelve largest defaulters belong to the steel industry. The total amount of debt belonging to such five steel companies as on March 31, 2016 stood at ₹ 1.4 lakh crores and the present position of debt, net sales and corresponding profit after tax is as follows:

Consolidated figures in Rs. Crore

		Total Debt	Net Sales	PAT
Bhushan Power	FY 16	37.248	7,700	-2,436
	FY 17	NA	NA	NA
Bhushan Steel	FY 16	44,478	11,803	-2,911
	FY 17	42,356	13,249	-3,127
Electrosteel Steel	FY 16	10,274	2,598	-327
	FY 17	7,505	2,541	-1,463
Essar Steel	FY 16	37,284	14,381	-5,795
	FY 17	NA	NA	NA
Monnet Ispat	FY 16	12,115	1,843	-1,856
	FY 17	10,333	1,238	-2,132

*FY 17 figures are as per unaudited results filing

*Source: Business Standard – Kolkata Edition (July 03, 2017



S4A Mechanism not in line with Debts faced by the Steel Sector in 2017

The RBI has from time to time been issuing certain guidelines and prudential norms for the purpose of resolution of the stressed assets. Stressed assets are loans where the borrower has defaulted in repayment. One of the guidelines issued for resolution of large stressed accounts is the Scheme for Sustainable Structuring of Stressed Assets (the "S4A Mechanism"), which was introduced in June, 2016. It is an optional mechanism available with the lenders for resolving the issue of bad loans in large projects and to reinforce the ability to the lender to deal with the stressed assets.

The eligibility criteria under the S4A mechanism is (a) the project should have commenced commercial operations; (b) the aggregate exposure (inclusive of accrued interest) of all the institutional lenders in the account should exceed ₹ 500 crores; and (c) the concerned account should meet the test of debt sustainability.

The concerned banks will have to bifurcate the total debt into 'sustainable' and 'unsustainable' part. Briefly, the debt sustainability test means the sustainable portion of the debt should not be less than 50% of the current funded liabilities, even if the future cash flow remains at the current level.

Due to the lower demands and the shrinking margins in the steel industry from 2008 onwards, the leverage level increased year by year. The practice of leveraging resulted into enhancement of total debts and eventually, the steel sector companies started utilizing the debt for financing their operations as well.

If S4A Mechanism could have been introduced in the year 2010 or 2011, the steel sector participants in India could have taken the benefits of the same, in order to avoid the present fiasco of the steel sector. Post 2010, the debt level of the steel sector companies have risen multifold resulting into a situation where such companies are not even able to service the interest of the principle debt. The interest costs of the debt have gone much beyond the margins of such steel companies.

In view of the aforesaid difficulties, coupled with the fact that all the steel sector companies having stressed assets could not and even presently, cannot fit in the strict eligibility criteria of S4A Mechanism, the said mechanism seem to be unhelpful to resolve the issue of bad loans.

The Need to Amend the S4A for cases of debt below 50%

The present S4A Mechanism does not extend to those stressed account, where the cash flows are not able to service at least 50% of the principal debt. Even, it is so inflexible that it does not allow to alter the existing repayment schedule and the interest rate for the sustainable debt. It is also not applicable to the stressed accounts, having projects not commenced commercial operations. Further, it is not necessary that every steel company having stressed assets will have an aggregate exposure of debt exceeding ₹ 500 crores.

Keeping in view the eligibility criteria under S4A Mechanism, the eligibility criteria of S4A Mechanism should be amended and liberalized in a manner where the steel industry can take its advantage to revive themselves.

Amongst the top twelve defaulters, the insolvency petitions have been admitted against 5 defaulters belonging to the steel industry viz. Bhushan Power, Bhushan Steel, Electrosteel Steel, Essar Steel and Monnet Ispat. The much sought amendment to the S4A Mechanism might have saved all or any of above steel companies from the harsh repercussions of the Insolvency and Bankruptcy Code, 2016 ("IBC").

Setting up a Sector Specific Oversight Committee

As stated hereinabove, the present position of the steel industry is quite critical. Five top players in the steel industry have already been directed to undertake insolvency resolution process.

The existing committees established under the various

guidelines issued by RBI, for resolving the problem of bad loans, do not seem to be helpful, as evident from the present state of the steel industry.

Since the debts of the steel companies have risen multifold during last 7-8 years and they are still lacking cash flows, it is necessary that a sector specific oversight committee is established for the revival and well-being of the steel industry. It is high time that a committee is established to take fearless decision to resuscitate the steel industry.

The Need to Avoid Liquidation of Good Assets while Resolving IBC matters in a Time Bound Manner

The entire procedure of IBC adheres to a stringent timeline. Upon admission of an insolvency petition, the management of the corporate debtor vests into an interim resolution professional, who takes decision on behalf of such corporate debtor. Such interim resolution professional ("IRP")/ resolution professional ("RP") may or may not have expertise of the business affairs of such corporate debtor.

IRP/ RP have been mandated to continue the business while resolving insolvency of the corporate debtor, however, IRP/ RP may not possess sufficient knowledge of business. It may also result into erosion in the value of good assets.

The Committee of Creditors ("CoC"), while deciding on the resolution plan (either by existing promoters or by third party bidders) should consider the principal business or good or revenue generating assets of the corporate debtor. If CoC believes that repayment of debt of the corporate debtor is not possible without disposing of certain assets/business, then CoC may, subject to commercial feasibility, approve a plan which will ideally transfer the certain business of the corporate debtor as a whole or part rather than opting for transfer of individual or core assets of the corporate debtor. Under such circumstances, an endeavor should also be made to sell the business/assets at the fair r ealizable value and not at distressed value.

In the end, it may be correct to state that IBC is thwarting all the available opportunities to the steel companies having stressed assets to revive themselves, as evident from the case of Essar Steel. Essar Steel was in advanced stage of negotiation with its lenders for restructuring of its debt and had in fact paid approximately ₹ 3400 crores in last 15-16 months and despite of the above, an insolvency resolution process has been admitted against it.

The Government of India has announced National Steel Policy, 2017 to revive the steel sector inter-alia by (a) providing an environment to attain self-sufficiency in steel production; (b) identifying bad assets and encouraging them to lower their debt by adopting appropriate debt restructuring scheme as per RBI guidelines etc. However, the IBC provisions are presently overriding the intent and objectives of introducing National Steel Policy, 2017. Now, it has to be seen as to how the National Steel Policy, 2017 will provide benefits to the steel companies, especially those having stressed assets. EPC World

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