IBC Quarterly Flash

2Q CY2019 insights on default conundrums, performance analysis of CIRPs and recoveries in India

August 2019

Valuation | Research
A Registered Valuer Entity with Insolvency and Bankruptcy Board of India

Foreword

"Growth is not inevitable and firms may not remain as going concerns. In fact, even large publicly traded firms sometimes become distressed for one reason or the other and the consequences for value can be serious." – Aswath Damodaran, The Cost of Distress: Survival, Truncation Risk and Valuation, January 2006.

But what if the firm could stay afloat post-default and hence shouldn't the system peddle for more resolutions versus liquidations? And, shouldn't such resolutions be time-bound? Answer to all these questions is an obvious "yes".

However, we note that a mere 20% of total cases resulted in resolution plans and the rest 80% closed through liquidation. We believe that the percentage of resolution cases should meaningfully increase because in most cases going concern value is usually higher than net asset value.

Further, in more than 33% of total ongoing Corporate Insolvency Resolution Process (CIRP), the proceedings are more than 270 days old (deadline for closure) from the date of admission. Considering large delays happening in every one out of three cases, the authority recently passed a bill to increase the deadline to 330 days, providing an additional 60 days for litigations.

The progress and agility of IBC has been good versus older restructuring regimes in India where the average time taken was around 4 years, but more work must be done on the ground to create path for more resolution plans and less of liquidations plus faster timeframe to ensure value is not meaningfully eroded for the underlying asset

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QUICK UPDATES ON CIRPs DEFAULTS AND RECOVERIES

- 2,162 cases have been admitted till date
- 870 cases have been closed of which 120 cases have approval of resolution plan
- 475 cases (representing 22% of the total cases admitted) have moved to liquidation stage
- Real estate and Construction sector has highest realization of c.78% of the claim value admitted
- Q2CY2019 witnessed significant decline in expected recoveries (14%) versus sequentially earlier quarter (44%)
- Average realizable value by FCs since inception around 2 years ago is c.43% of the claim admitted and approximately 2x the liquidation value

Note: a) The data used in this publication are provisional and are subject to revision by IBBI.
b) Segregation of data by sector/industry has been performed based on the business description of the company under default
c) The data is updated up to 30 June 2019

Source: IBBI and Incwert Analysis

Background

- The Insolvency and Bankruptcy Code, 2016 was introduced to create a time-bound resolution process for defaulted loans and bonds in India. A year later, in May 2017, the Reserve Bank of India (RBI) was vested with legislative powers to initiate proceedings to recover bad loans for effective use of IBC.
- We believe that success of IBC will help in several ways like i) building the foundation for a healthy credit market in India, ii) eventually create liquidity for debt instruments (though this could be a long haul) and iii) improve the attractiveness for global investors to invest in the Indian debt market. Resolving Insolvency is one of the parameters of the World Bank ranking of 'Ease of Doing Business'. India's ranking was at 137th position in 2015 (across 190 countries), and since then it has substantially improved to 77th rank as of 2018.
- The Code provides an overall timeline of 330 days (recently increased from 270days) to conclude a corporate insolvency resolution process, including time spent on litigation, in contrast with the previous regime where processes took about 4.3 years (1).
- Considering the importance of progress updates on IBC, we will come up with periodic publication every quarter to provide updates on the defaults, claim admissions and recoveries under the name "IBBI Quarterly Flash" which will be a part of our overall Incwert Valuation Chronicles monthly publications.
- This is our second publication in the periodic series of IBBI Quarterly Flash. Our previous series can be downloaded from http://www.incwert.com/publications/

Insolvency and Bankruptcy Code (Amendment) Bill, 2019

"On 17 July 2019, the Union cabinet cleared major changes to the bankruptcy law that will enforce a strict 330-day timeline for the insolvency resolution process, including any legal challenges, and uphold secured creditors' priority right on the sale or liquidation proceeds of bankrupt companies. The earlier deadline had been 270 days, starting from the day when a case had been admitted to bankruptcy..."

(1) Source – Business Line, https://www.thehindubusinessline.com/opinion/our-bankruptcy-code-is-world-class/article26822267.ece

Insolvency – trends and our views

- Since its inception, a total of 2,162 cases have been admitted under IBC.
- Closure of cases under IBC, could be either through Appeal/Review/Settlement, Withdrawal under section 12A, Approval of resolution plan or through the commencement of liquidation. Out of total admissions around 870 cases (representing 40%) of the cases have been closed till now. (Refer to Chart 1)
- Real Estate and Construction has been a sector where highest number of Insolvency is admitted. (Refer to Chart 2)
- Further, out of total admissions, in 120 cases (i.e. 6% of cases admitted and 14% of cases closed), resolution plan has already been approved.

Chart 1

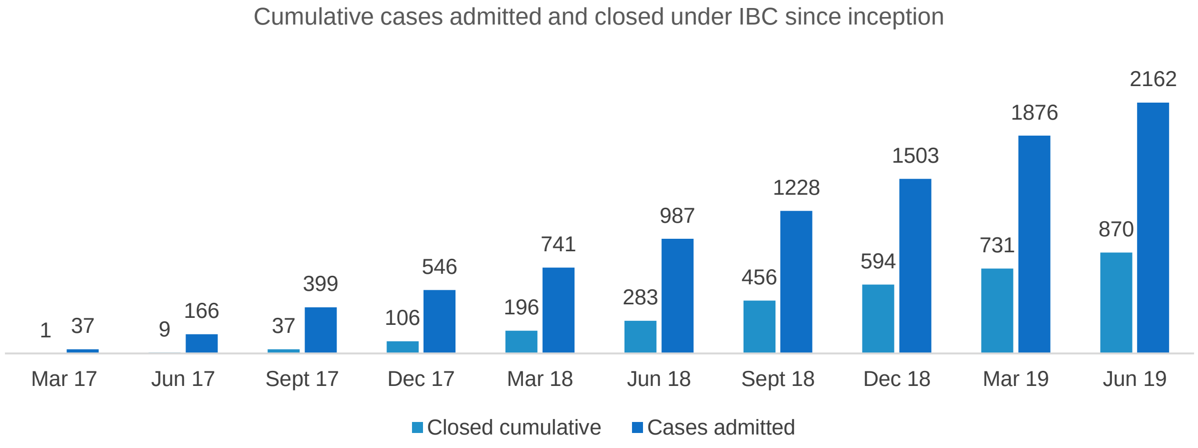
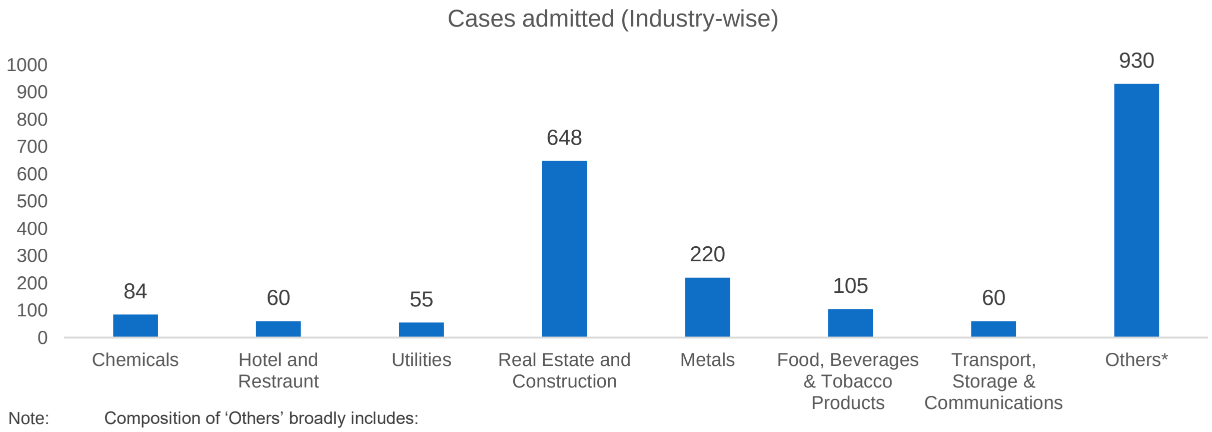


Chart 2



Note: Composition of 'Others' broadly includes:
1) Wholesalers and Retail traders,
2) Manufacturers of
   a) Electrical Machinery and Apparatus products
   b) Auto ancillary
   c) Textiles, Leather and Apparel Products
   d) Agricultural Products
   e) Others
3) Pharmaceuticals, and
4) Hospitals and Diagnostic Centres.

Recoveries – trends and our views

- 43% average recoveries over the last 2 years with 14% in the most recent quarter. A sharp decline in recoveries versus last quarter was driven by a dip in IBC cases in the metal and other industries where it reduced to 36% in the current quarter (2QCY19) versus 78% in 1QCY2019.
- Recoveries are almost 2x the liquidation value, with lowest in Apr-June 2019 quarter (1.1x) and highest in Oct-Dec 2018 quarter (2.5x). (Refer to Chart 3)
- Recoveries in the Real Estate and Construction sector is highest, followed by the Hotel Industry and Food and Beverage industry. But if we further dig onto the data, we could find that resolution plans yielded (as a multiple of liquidation value) lowest in the Chemicals sector (0.93x) in comparison to other sectors. (Refer to Chart 4)

Chart 3

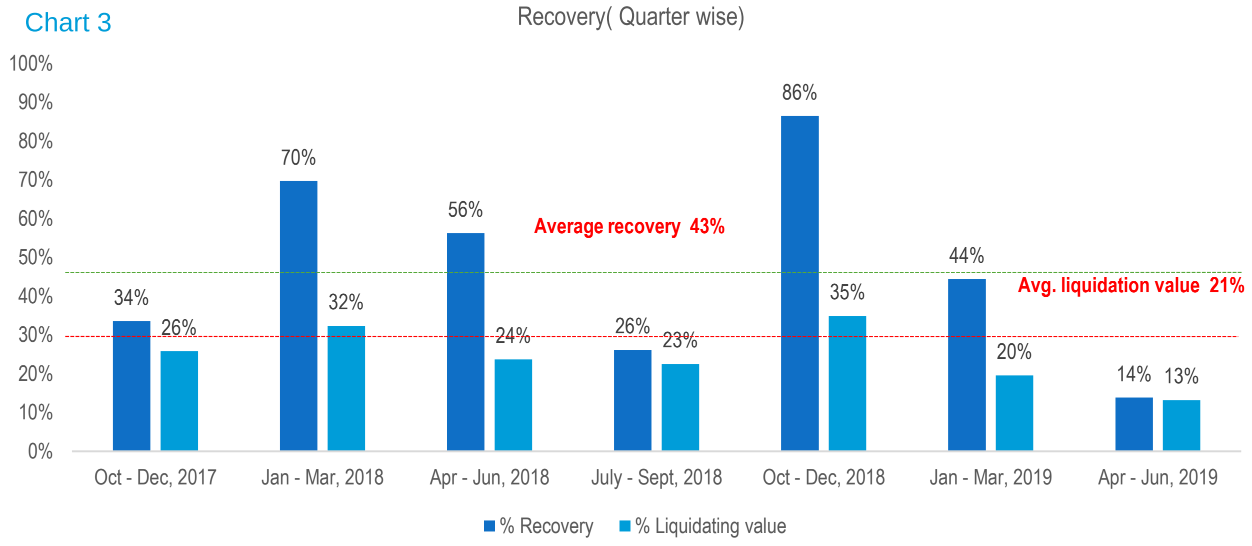
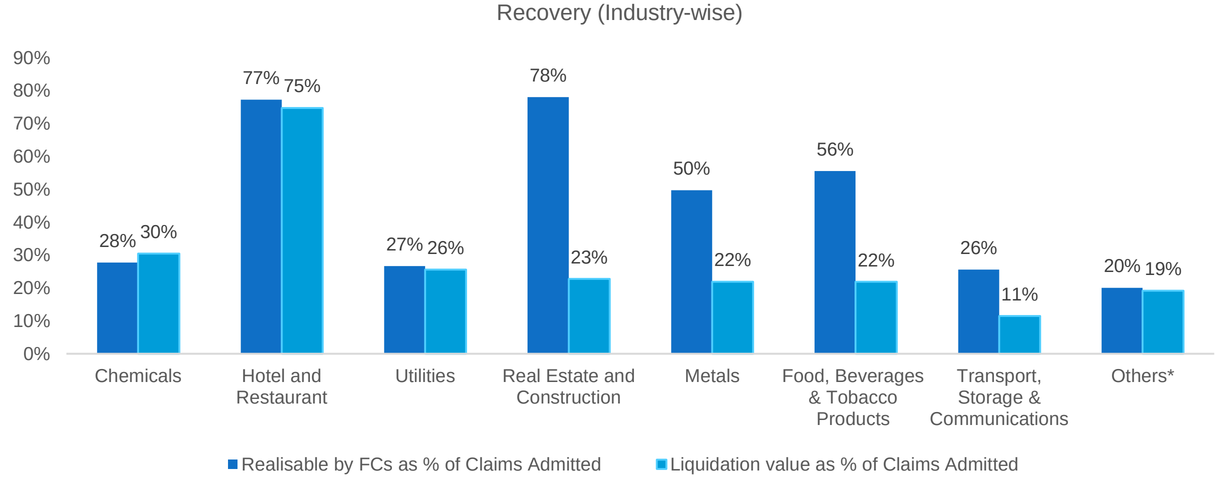


Chart 4



Analysis by initiators

- Under Insolvency Bankruptcy Code (IBC), insolvency can be initiated by either financial creditors (FC) or operational creditors (OC) or corporate debtor (CD).
- CIRP initiated majorly by FCs (53%) followed by OCs (31%) and remainder by CDs (16%) (Refer Chart 5)
- Recoveries were highest in CIRPs initiated by FCs at 44% followed by situations in which OCs initiated (34% recovery) and lowest at 30% recovery when CDs themselves filed for insolvency. (Refer to Chart 6)

Chart 5

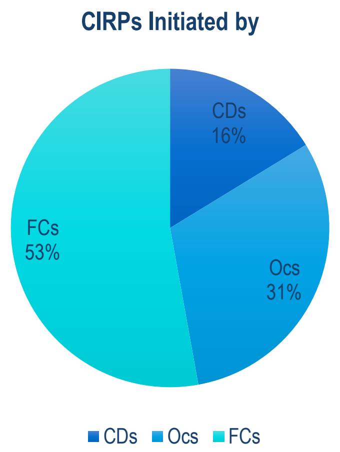
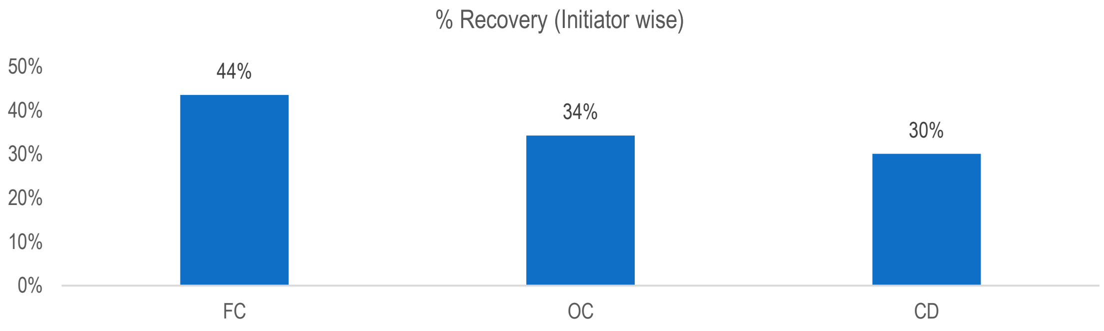


Chart 6



Twelve Large Accounts

- In the year 2015, the Indian Government introduced IBC, a tailor-made code for the resolution of bad loans in the winter session of the Parliament. The code was passed by Lok Sabha and got President's nod in May 2016. A year later, in May 2017, the RBI was vested with legislative powers to initiate proceedings to recover bad loans for effective use of IBC.

- Thereafter, on 13 June 17, RBI released a list of 12 companies constituting 25% of India's total NPAs (Non-Performing Assets) under the name 'Dirty Dozen'. Together they had an outstanding claim of Rs 3.45 lakh crore as against their liquidation value of Rs 73,220.23 crore

- These 12 shortlisted companies under the IBC that have fund/non-fund exposure of above Rs 5,000 crore where 60 per cent or more has turned bad.

Table 1: First twelve defaulters as notified by RBI

Sl. No	Company	Sector
1	Alok Industries	Textile
2	Amtek Auto Ltd	Auto Components
3	ABG Shipyard Ltd	Ship Building
4	Bhushan Steel Ltd	Steel
5	Bhushan Power and Steel Ltd	Steel & Power Generation
6	Electrosteel Steels Ltd	Steel
7	Era Infra Engineering Ltd	Infrastructure Construction
8	Essar Steel Ltd	Steel
9	Jyoti Structures Ltd	Power Transmission
10	Jaypee Infratech Ltd	Infrastructure Construction
11	Lanco Infratech Ltd	Power Generation
12	Monnet Ispat and Energy Ltd	Steel

Resolution yielded

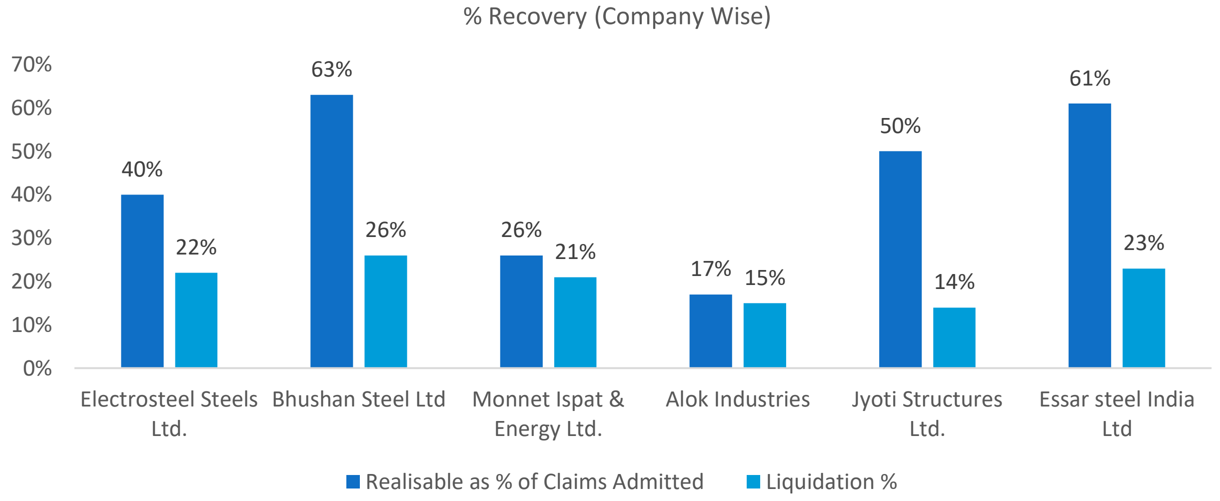
- As on 30th June 2019, of these 12 accounts resolution process, six Corporate Debtors have been approved. Due to failure of implementation of the approved resolution plan in Amtek Auto Limited, the process has restarted. Other accounts are at different stages of the process.
- The below six corporate debtors represent 76% of total claims realised under IBC and 66% of total claims admitted under Corporate Insolvency Process.
- Recovery percentage for the six accounts was approximately 50%, in comparison to liquidation percentage of 23 %.

Table 2 : Debtors Yielding resolution

Amount in INR crores	Date of conclusion	Total Admitted Claims of FCs	Liq. Val	Realisable by FCs	Realisable as % of Claims Admitted	Liquidation %	Realisable as times of Liq. Val
Electrosteel Steels Ltd.	17-Apr-18	13,175	2,900	5,320	40%	22%	1.8x
Bhushan Steel Ltd	15-May-18	56,022	14,541	35,571	63%	26%	2.5x
Monnet Ispat & Energy Ltd.	24-Jul-18	11,015	2,365	2,892	26%	21%	1.2x
Alok Industries	8-Mar-19	29,524	4,433	5,052	17%	15%	1.1x
Jyoti Structures Ltd.	27-Mar-19	7,365	1,023	3,684	50%	14%	3.6x
Essar Steel India Ltd.	8-Mar-19	49,473	11,324	30,030	61%	23%	2.7x
Total		**166,574**	**36,586**	**82,549**	**49.56%**	**21.96%**	**2.3x**

Note: 1) Apportionment between FCs and OCs of Essar Steel India Ltd. is under consideration by NCLAT.

Chart 7



Debtors in process (1/2)

Sl. No	Corporate Debtor	Sector	Date of commencement of CIRP	Claims admitted	Status	No. of Days since admission
1.	Lanco Infratech Ltd	Utilities	7-Aug-2017	51,505	Auction under process	360 (Since the company went on liquidation on 27 August 2018)
2.	Bhushan Power & Steel Ltd	Metals	26-Jul-2017	48,524	Matter Pending with NCLT	757
3.	Amtek Auto Ltd	Others	24-Jul-2017	12,605	Resolution process restarted	759
4.	Era Infra Engineering Ltd	Real Estate and Construction	8-May-2018	11,785	Extension for resolution plans	471
5.	Jaypee Infratech Ltd	Real Estate and Construction	9-Aug-2017	13,322	Resolution plan put to vote	743
6.	ABG Shipyard Ltd	Others	1-Aug-2017	18,539	In the process of liquidation	119 (Since the company went on liquidation on 25 April 2019)

Lanco Infratech - *Auction under process*

Lanco Infratech, the flagship company of the Lanco Group and once among the larger private players in the field of power and infrastructure engineering, procurement and construction (EPC), was posted for liquidation by the Hyderabad bench of the National Company Law Tribunal (NCLT) on 27th August 2018, a little over a year after the corporate insolvency resolution process (CIRP) was initiated on an application by IDBI Bank.

Bhushan Power & Steel Ltd - *Matter Pending with NCLT*

In February 2019, the committee of creditors of Bhushan Power and Steel Ltd (BPSL) has issued a letter of intent to India's largest private steelmaker JSW Steel Ltd, thus approving the latter's resolution plan for the distressed steel mill. JSW steel offered Rs 19,700 crore to lenders and infuse Rs 350 crore to revive the business. But the matter was taken to High court by the promoters of Bhushan Power & Steel Ltd. who claimed that the lenders did not provide them with the details of a resolution plan involving JSW Steel's offer for the company. The court passed ex-parte orders on 18 April 2019, directing the National Company Law tribunal to hear the plea of the BPSL promoters.

Amtek Auto Ltd - *In the process of liquidation*

The resolution plan was earlier concluded on 25th July 2018, with UK-based Liberty House Group's (LHG) offer of Rs 4,400, representing a recovery of about 34% of admitted FC claims. But the committee of creditors had approached NCLT after Liberty House failed to honor its payment commitments despite receiving the tribunal's approval. Whereas Liberty House had, on its part, alleged "misrepresentation of facts" and discrepancies in valuation of the stressed asset.
The NCLT, in its final order on February 13, 2019, allowed the committee of creditors of Amtek Auto to start the resolution process from scratch. Further, NCLT said that the process should be completed within 150 days. The NCLT on August 16, 2019 ordered liquidation of debt-ridden Amtek Auto as it declined lenders' request for extension of the insolvency resolution process deadline.

Debtors in process (2/2)

Era Infra Engineering Ltd - Extension for resolution plans

In March 2019, Lenders of Era Infra Engineering have got a 215-days extension from the National Company Law Tribunal (NCLT), which agreed to exclude those days from the stipulated duration of the insolvency process in response to an appeal, to prevent the company from going into liquidation.

The creditors approached the NCLT on the grounds that the insolvency process faced several stumbling blocks on account of investigations by the income tax authorities, making it difficult for prospective bidders to examine the company's books of accounts, which were in the custody of the authorities.

The lenders so far received only one bid from Sun Pharmaceuticals, which was rejected by the lenders. The options now being examined include clubbing the insolvency process of some of the company's subsidiaries with the parent in order to create a more valuable proposition for prospective buyers.

Jaypee Infratech Ltd - *Extension for resolution plans*

Jaypee Infratech Ltd. offers construction services. The Company is in the business of constructing highways and commercial, industrial, institutional, residential and amusement complexes along the road. In 2017, the NCLT had admitted the application by an IDBI Bank-led consortium seeking resolution for Jaypee Infratech under the IBC. At that time, the company was expected to deliver residential apartments to homebuyers in Delhi prior to the insolvency move; the homebuyers approached the Apex Court seeking relief. While the Apex Court did not stop the insolvency proceedings, it did order that the committee of creditors must have representatives from the homebuyers, so that their interests are taken care of.

The newly constituted COC, received various bids from NBCC, Kotak Investment, L&T Infrastructure, Singapore-based Cube Highways and Suraksha group, recently.

All the bids were initially rejected. But the proposal of NBCC was revised during the current year; further COC decided to put it for a vote. As on date, the NBCC bid is on e-vote. On July 30, NCLT had allowed extension of the corporate insolvency resolution process of the realty firm by 90 days, clearing the decks for calling fresh bids.

ABG Shipyard Ltd - *In the process of liquidation*

ABG Shipyard Ltd, once India's biggest private shipbuilder, is headed for liquidation after a lenders panel rejected the resolution plan submitted by London-based Liberty House for the debt-laden shipbuilder. NCLT vide order dated April 25, 2019...ordered commencement of liquidation of ABG.

Conclusion

We believe that though there have been significant delays in resolutions with 6 of the 12 large accounts still in progress, we need to appreciate that the development has been significantly better than earlier resolution regimes in India.

We see the below areas of improvement:

- Quicker time-bound resolutions
- More resolutions versus liquidations

Respect risk-reward principle and accordingly create waterfall payoffs for secured creditors ahead of unsecured creditors. Do not mix emotional quotient with economics – someone who is unsecured was already rewarded through higher yields and hence should be ready to take the risk of loss given default

Appendix

Reference Material:

- IBBI
- NCLT
- Moody's publication https://www.researchpool.com/download/?report_id=1751185&show_pdf_data=true
- Business Line, https://www.thehindubusinessline.com/opinion/our-bankruptcy-code-is-world-class/article26822267.ece
- Incwert in-house analysis

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Equity risk premium in India
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Perspective on valuation of DVRs
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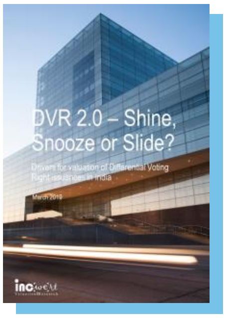
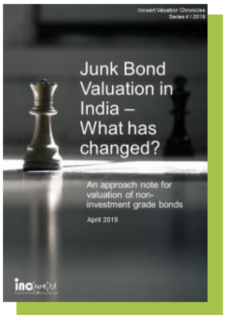


Junk bond valuation
- Apr 2019



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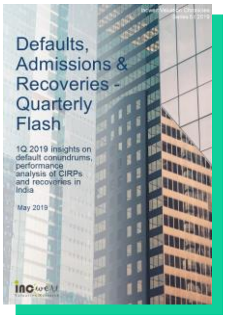

Income tax valuation
- July 2019

About Us

Sunit Khandelwal
Director

Sunit has worked across a range of sectors such as Infrastructure, real estate, FMCG, retail, engineering, clean energy, healthcare, IT/ ITeS, and other manufacturing industries.

Qualifications:
Chartered Accountant (ICAI)
B.Com (Hon.) – St. Xavier's College
Registered Valuer under IBBI

Sunit has an overall experience of over 13 years with over 12 years in valuation advisory, transaction advisory and M&A advisory.

As a valuation professional, Sunit has undertaken valuation of businesses for transactions, fund raising, strategic decision making, and corporate restructuring. He has also undertaken valuation of intangible assets, option valuation, litigation support, private equity portfolio valuation and valuation for reporting purposes such as purchase price allocation and impairment test under IFRS and Indian GAAP.

In past he has worked with KPMG India (as Associate Director), BDO, Grant Thornton, KPMG UK, and DBDBS a boutique M&A advisory firm.

Sunit is also an active speaker on valuation at National Institute of Finance Management (NIFM).

Punit Khandelwal
Director

Punit has worked across leveraged loans, distressed debt, insolvency/ bankruptcy situations and high-yield asset classes.

Qualifications:
Chartered Accountant (ICAI)
Chartered Financial Analyst (ICFAI)
CFA Level 2 (US)
MS in Finance (ICFAI)
B.Com (Hons.) – St Xavier's College
Registered Valuer

Punit brings with him 15 years of experience in sell-side and buy-side advisory across equity and fixed income. He has worked on several bespoke valuations and lent research support to dozens of asset managers/investment bankers/brokers/consulting firms across the globe.

In the fixed income segment, he worked as a fundamental analyst across the capital structure: leveraged loans, distressed debt, insolvency/bankruptcy situations and high-yield asset classes. He has also helped sell-side & consulting firms increase their market presence by coming up with thematic and white label papers.

He started his career as an analyst with Zacks Investment Research & then was a part of a UK based CLO manager's research team. Then he moved on to set up research practices for couple of startups before moving onto become Global Head of Research at Southerland and then finally co-founded Incwert.

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