

Financing of Stressed Assets

**Institute of Chartered
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Need for corrective action ignored

Sponsors

- Resistance to change
- Lack of ability/inclination to induct additional funds
- Aversion to surgery

Banks

- Unwillingness to confront sponsors
- Impact of additional provisioning/asset classification

Games Sponsors Play

- Rob Peter, Pay Paul
- Alienate assets of company, guarantors
- BIFR reference to fend off coercive action by Lenders

Games Bankers Play

- Deny Existence of Problem
 - Evergreening
 - Provide Additional Funding
 - CDR reference to preserve asset classification

CDR Mechanism - Incentives

- Regulatory Forbearance
 - Classification on date of reference maintained
 - Discontinuity of regulatory forbearance likely to restrict fresh references
- Accountability issues resolved
- Borrowers exploited Lender concerns on asset classification

CDR Packages - Limitations

- Early warnings ignored
 - Problems acknowledged on the verge of default
- Inadequate diligence while preparing viability studies
- Small Lenders report Borrower as Wilful Defaulter
 - Seek exit
- Inadequate monitoring
 - Conversion of unsecured loans to equity allowed as Promoters Contribution
 - No additional funds injected

Indicators of Incipient Sickness

- Higher Gearing levels
- Higher incidence of interest
 - Higher debt not reflected at year end
- Decline in interest coverage ratio
- Delayed payments to creditors
- Failure of MIS systems

Indicators of Incipient Sickness

- Mounting Inventories
- Delayed collections, Higher receivables
- Strained liquidity ratios
- Unrealised advances
- Unexplained Capital Work in Progress
- Declining outlay on repairs & maintenance
- Declining Capacity utilisation

Some nostrums

- Strained current ratio suggests
 - Large repayments in the short term
 - Diversion of funds
 - Project under implementation may need financial support
- **Remedies**
 - Investigate diversion
 - Insist on induction of long term funds
 - Revise repayment schedules

Some nostrums

- Declining outlay on repairs indicates
 - Liquidity pressures
 - Quality issues could surface
 - Lower sales realisation likely
 - Need for long term funds
- Higher gearing levels suggest
 - Unsustainable debt levels
 - Need for induction of equity to replace debt
 - Conversion of debt to equity

Some nostrums

- Mounting inventories/receivables reflect
 - Non moving stocks
 - Sticky receivables
- **Remedies**
 - Recognise inherent losses
 - Offload non moving stocks
 - Amicably settle payments from debtors

Some nostrums

- Declining capacity utilisation suggests
 - Non-availability of working capital
 - Provide additional funds for working capital
 - Non availability of raw materials
 - Ensure raw material tie up through long-term contracts

Company in Distress-Typical story

- Losses exceed equity
- Current assets with little realisable value
- Unsustainable levels of Debt
- Strained liquidity position
- Poor controls over cash flows
- Low levels of capacity utilisation
- Accumulation of statutory dues
 - PF, Sales Tax, Income tax

Company in Distress-Typical story

- Legal action initiated against company, promoters
 - Winding up, Sec 138, attachment of assets
- Promoters plead inability to induct funds
- BIFR reference restricts Lenders' ability to take swift action
- Lack of consensus amongst Lenders

Resolution Options

Business Potential	High	<p>Regenerating value by</p> <ul style="list-style-type: none"> • One time settlement • Change in Management <ul style="list-style-type: none"> – Restructuring – Transparency & Governance 	<p>Regenerating value by</p> <ul style="list-style-type: none"> • Restructuring • Funding • Induction of Strategic investor
	Low	<p>Encashing investments through</p> <ul style="list-style-type: none"> • Hard litigation • Personal Guarantee enforcement • Sale of assets • Sale to ARCs <p style="text-align: right;"> SARFAESI </p>	<p>Regenerating value by</p> <ul style="list-style-type: none"> • Critically review operations • Restructuring • Sale of business <p style="text-align: right;"> Settlement Scheme </p>
		Management Quality	
		Low	High

Restructuring

Objectives

- Correction of existing capital structure
- Ensure servicing of residual liabilities over reasonable time frame
 - Augment capacity utilisation
 - Capture cash Flows
- Enable recompense for existing sacrifices

Restructuring

- Undertaken when business potential exists
 - Entails sacrifices from all stake holders
 - Promoters
 - Lenders
 - Employees
 - Other creditors
 - Fresh funding required to
 - complete project under Implementation
 - Augment capacity utilisation
 - Pay pressing creditors

Restructuring

- Repayments matched to potential inflows
- Option to convert debt to equity retained
 - Enables upside capture
- Tight enforceable contracts executed
- Receivables trapped in T&R account

Restructuring

- Close monitoring through
 - Periodic reporting
 - Appointment of
 - Nominee Directors
 - Key personnel
 - Statutory/Internal Auditors

Restructuring-Case Study

North India based hospital

- Pros
 - Good brand equity
 - Reputed doctors
 - Ability to attract patients
- Cons
 - Unsustainable debt levels
 - Cash flow leakages
 - Working capital constraints
 - Adverse capital structure
 - Losses exceeded equity

Restructuring-Case Study

Corrective action taken

- Unsustainable debt levels
 - Aggregation of debt
 - Reduction of overall debt
- Cash flow leakages
 - Appointment of independent CFO
 - Cash flows trapped
 - Escrow agent's branch set up at Hospital

Restructuring - Case Study

- Working capital constraints
 - Maintenance of critical equipment neglected
 - No timely payments to doctors
 - Additional funding provided for
 - Payment to pressing creditors
 - Maintenance of critical equipment
- Adverse Capital structure
 - Write down of existing capital
 - Induction of existing capital by promoters
 - Conversion of part debt into equity

Restructuring-Case Study

- Over four year time frame
 - All debts repaid by company
 - Promoters acquired equity capital from Lenders
 - Exit at preferred returns

**Thank you
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