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STEEL
Shines Again

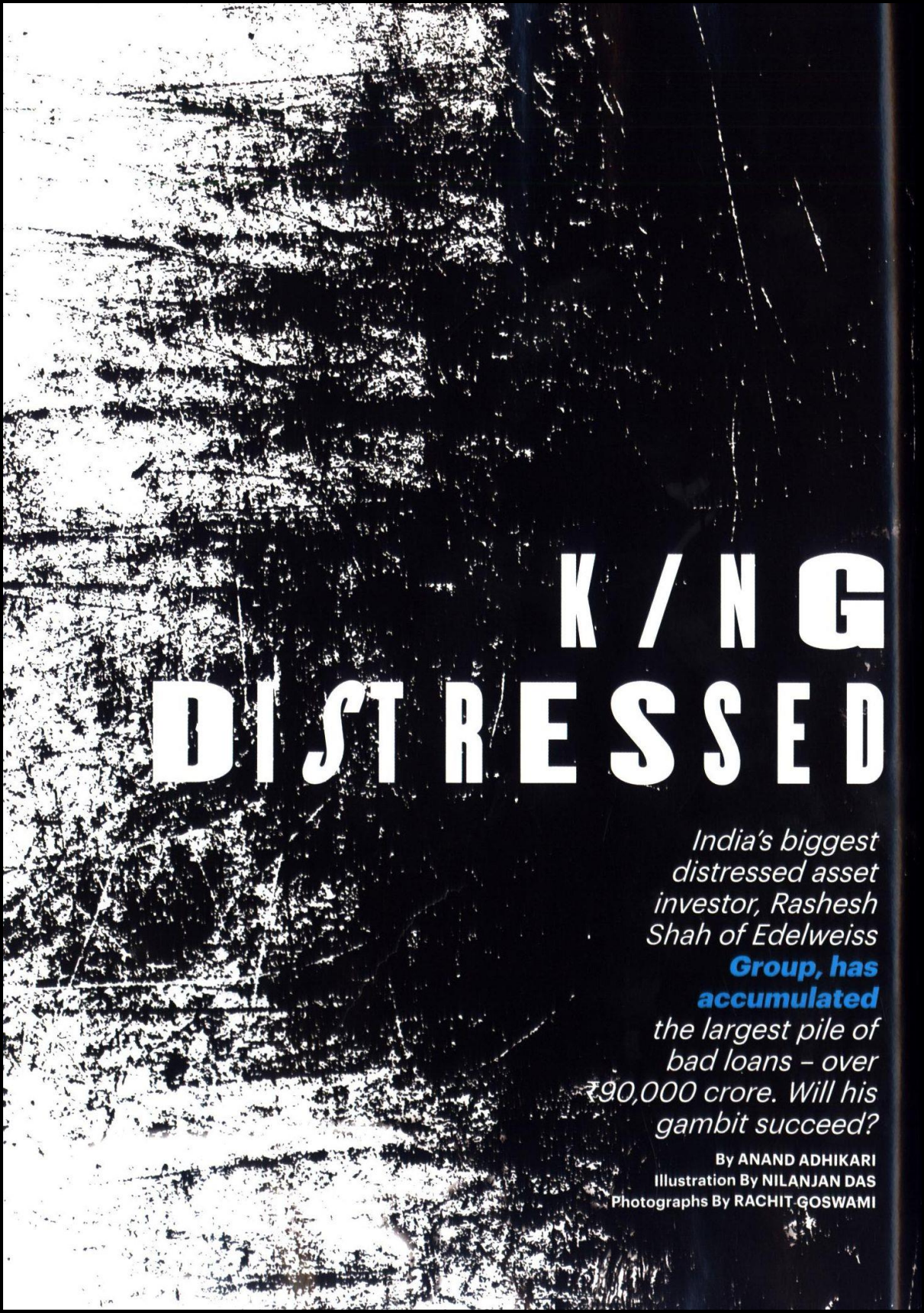
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Edelweiss
ARC King of
Distressed
Assets



TRADE WARS

AS US AND CHINA CLASH,
WHY INDIA SHOULD WORRY



K / N G DISTRESSED

*India's biggest
distressed asset
investor, Rashesh
Shah of Edelweiss*

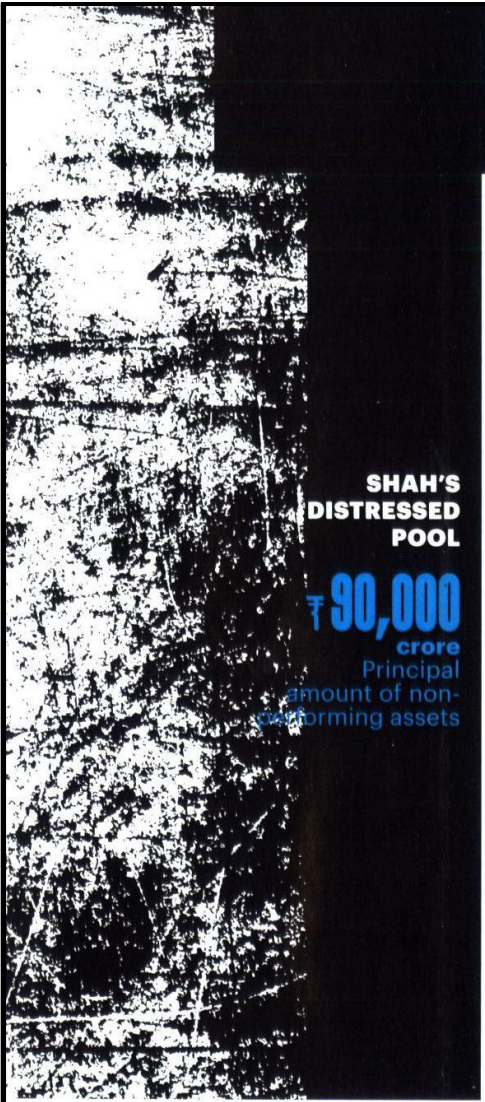
**Group, has
accumulated**
*the largest pile of
bad loans – over
₹90,000 crore. Will his
gambit succeed?*

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THE HUB CORPORATE

OF ASSETS



**SHAH'S
DISTRESSED
POOL**

₹90,000

crore
Principal
amount of non-
performing assets

₹42,000

crore
AUM of total
SRs issued
to acquire
the loan

\$1.5

billion
War chest for
restructuring
distressed assets

₹5,000

crore
The approx
amount
paid for it

₹90,000 crore is the gross value of principal. It is the loan amount due in the books of the borrower. ₹42,000 crore is the consideration paid by the ARC to acquire the assets. Consideration is in the form of cash plus SRs issued to banks; Figures for Dec 2017

THEY HAVE CLAWED back from the brink. A few distressed companies have achieved significant operational turnaround recently with the help of an asset reconstruction company (ARC). Already, suitors have emerged for them. Two strategic players – Mumbai-based Aditya Birla Group and Dalmia Bharat-led consortium – are slugging it out in the open for acquiring mid-sized Binani Cement, a company facing bankruptcy proceedings. Ruia's Essar Steel is yet another high-

profile bankruptcy case where two big players – Tatas and ArcelorMittal – recently made an unsuccessful bid. Chennai-based Karaikal Port, logistic player Arshiya Ltd, and BILT Graphic Paper are other such prominent examples.

And, yes, there is a common thread amongst them. There are many actually. First, they all share a common lender, Edelweiss Group, which has bought substantial debt in all these companies from banks via its ARC. In Essar Steel, Edelweiss is the second-largest lender. In Karaikal Port, it owns a majority 96 per cent of the debt. In Binani, it had aggregated 69 per cent of the debt. In Arshiya, it has 90 per cent of debt bought from various banks and financial institutions. Bankers are eventually going to

get their money back as security receipts (SRs) issued by the Edelweiss ARC will be redeemed in the near future. There will be upside for both bankers as well as Edelweiss ARC.

In less than a decade, Rashesh Shah, Chairman and CEO of Edelweiss Group, has emerged as the largest stressed asset investor in India. Shah, 54, is indeed trying hard to position ARCs as a revival agent rather than being seen as 'asset strippers'. Shah is currently sitting over distressed assets under management of over ₹42,000 crore. What distinguishes Shah from other

600
Portfolio of
distressed
assets

18-20%
Returns
expected from
stressed assets

players is the diversified platform of an ARC, third-party funds of close to \$1.5 billion, a non-banking finance company with net worth of close to ₹7,595 crore and a high-quality turnaround management platform with industry experts. Shah, along with Canadian pension investor CDPQ, has a war chest of funds – over ₹10,000 crore – ready for deployment over the next three-four years. Clearly, Shah has cast his net wide in the distressed assets market.

Still, it is not an easy business to be in. "One swallow doesn't make a summer," says the CEO of a rival ARC. There are also longer term challenges of dealing with rogue promoters, invoking guarantees, reviving demand, financial restructuring and also providing additional capital. While the development at the National Company Law Tribunal (NCLT), an adjudicating authority for bankruptcy cases, is mostly around steel companies – such as Essar Steel, Bhushan Steel and Electro-steel – because of an upturn in the steel cycle, the interest in other sectors is a bit muted at the moment. Steel, power, textiles, shipping and EPC are the top five sectors in the Edelweiss stable. The bankruptcy proceedings at NCLT are already heading towards litigations. Last but not least, the Edelweiss ARC

will also have to redeem a large number of security receipts (SRs) to banks for the 600-odd portfolio companies. A bulk of ₹42,000 crore comprises SR receipts issued to banks. It's not small change.

Proof of Concept

Shah, an ICICI banker-turned entrepreneur, has faced challenges aplenty in the past three decades. His distressed assets journey started in the midst of the global financial meltdown. "We like to be counter-cyclical. When the environment is bad, we are happy making investments. Those (bad times) are the best times to incubate new businesses," says Shah. A marathon runner, Shah has already covered a decade-long journey in the newest asset class. He had a good ring-side view of stressed assets when he was working for ICICI Ltd, a development financial institution at the time. "I had seen two economic cycles of 1991/92 and 2001/02 where the stressed assets in the system rose and later institutions benefitted by restructuring the loan and the upturn in the economic cycle," says Shah. His stack of businesses now also include mutual funds, wealth management, insurance, housing finance, SME financing, besides stressed assets in the post 2008 period.

While cases like Essar and Binani will bring upside for Shah, he actually tasted success much earlier. Way back in 2009, the first few acquisitions of Shah were a Hyderabad-based hatchery unit, a dairy from Chandigarh and a denim manufacturer from Ahmedabad. That was the time banks were a bit reluctant to sell bad loans. The initial experience with Asset Reconstruction Company (India) Limited (Arcil), promoted by big banks and institutions, wasn't very good because of poor recovery of SRs. The ARC used to pay upfront 5 per cent cash to banks while the balance 95 per cent was in the form of SRs that they treated as investments in the books. "We had to use our relationships



Our focus has shifted from distressed assets to stressed assets. We are looking for companies that are primarily EBITDA-positive with some cash flows

Venkat Ramaswamy
Executive Director & Co-founder, Edelweiss Group

THE STRATEGY

Debt aggregation from multiple banks, acquire majority stake in debt

Provide financial support through NBFC, third-party funds, etc

Advise sale of non-core assets

Help in project implementation and completion

Help businesses find strategic partners

Put turnaround teams in large cases

to get some assets," remembers Siby Antony, Chairman of Edelweiss ARC. Shah and Antony worked together to create a proof of concept for the fledgling business. In fact, a separate seed fund was created where Shah put in ₹50 crore. The banks were more than willing to deal entirely in cash.

Edelweiss bought the first three stressed cases at a hefty discount of 30-40 cent to a dollar. Shah was heavily banking on Antony's experience who had earlier managed the country's first ₹9,000 crore Stressed Assets Stabilisation Fund that took over the loans of erstwhile IDBI Ltd. The going was not easy. For example, Hyderabad-based hatchery's plant was not operational. But what attracted Shah to the asset was the technocrat promoter, automated chicken-processing plant and 130-acre land on the Hyderabad-Mumbai highway. As part of the resolution, Shah restructured the debt, provided additional working capital to run the plant and also assisted in connecting the promoter with KFC and McDonalds for supplying chickens. "The ARC giving fresh money was itself new in the industry," says Amit Agarwal, Head, Edelweiss Stressed Assets Strategy. In just two years, the hatchery unit was back on its feet. Shah also managed to get the full loan refinanced from a private sector bank. Shah made returns of over 35 per cent on that investment. The investments in dairy and denim units also made 30 per cent plus returns over a two-three year time horizon. "The proof of concept was established," says Antony. Then came the task of building scale in the business.

The Pool System

The period from 2009 to 2013 was difficult and challenging. But the banks resumed the sale of bad loans in a big way in the post-2014 period. The only chal-

AND THE CHALLENGES

Banks not aggressive in selling to ARCs

The cash component has increased substantially

Any creditor can drag the company to NCLT

Global funds trooping in with domestic partnerships

Many SRs will come up for redemption, banks to see track record

Not enough buyers in market under NCLT

lenge for ARCs was the sale of assets in a basket or pool of 30 to as high as 50 assets. There were only a handful of good assets in a pool that everyone wanted to buy and the balance were almost 'written off' cases with negligible value. There was no option but to buy the entire pool. Insiders say Shah, however, had identified some several good assets to chase in a pool.

"The 5:95 asset sale were mostly in a pool," remembers Agarwal. After getting the pool, Edelweiss ARC used to segregate the assets into two buckets - 'value cases' and 'non-value cases'. The idea was to drive value through 'value cases' by restructuring, says Agarwal. In fact, there are some success stories in the complex pool mechanism. For example, Edelweiss acquired Bangalore-based Vega City Mall that was partially complete. The promoters were finding it difficult to complete the project and hence the assets became NPAs in the books of the banks. Edelweiss was quick to spot the assets in the pool of various banks and started aggregating the debt - it managed to get almost 55 per cent of the debt. Edelweiss, along with other stakeholders, started working with the existing management to complete the mall. "We also funded the mall," says Agarwal. They also took responsibility of project monitoring and evaluation. Today, this mall is 80 per cent leased out. There are good footfalls. Now the banks will also get their money back and probably there will be write-back of profits. The non-value cases go for recovery by way of invoking SARFAESI (Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002), sale of assets, one-time settlement or eventual liquidation.

Around that time, the NPAs in the system had also started moving up because of the economic slowdown. Raghuram Rajan, the then RBI Governor who took charge in September 2013, also nudged the banks for early identification of stressed assets. Rajan also saw the regulatory arbitrage game played by banks by taking SRs



route with very little upfront cash. Rajan changed the rule to 15:85 for ARCs to have more skin in the game.

The Big Strategy Change

Even as regulations were being tightened, Shah was going through a steep learning curve during 'the proof of concept' phase to picking winners in a pool mechanism. "The opportunity was turning out to be bigger than what I thought initially," says Shah. As deals started shifting to higher cash, Shah needed third-party funds for acquisitions. The initial 'proof of concept' success helped in raising ₹90 crore through Edel-

weiss, says the focus has shifted from distressed assets to stressed assets. "We are looking for companies that are primarily EBITDA-positive with some cash flows," says Ramaswamy, who is also the Co-founder of Edelweiss.

Shah puts the entire stressed opportunity in three buckets: credit opportunity of taking over debts, equity investment and turnaround cases. More than 60 per cent of the opportunities are in the first bucket where the returns expectation is 15-18 per cent. "We will do 18-20 credit deals," says Shah. Out of the credit deals, there will be opportunity to invest equity in some 4-5

THE DISTRESSED ASSET TEAM

Rashesh Shah has the most diversified platform to turn around stressed companies



SIBY ANTONY
Chairman,
Edelweiss ARC



R.K. BANSAL
MD & CEO,
Edelweiss ARC



NITIN JAIN
CEO, Edelweiss
Global Wealth and
Asset Management



AMIT AGARWAL
Head, Edelweiss
Stressed Assets
Strategy



SUMANTH CIDAMBI
CEO, Turnaround
Strategy Business

weiss Asset Reconstruction Fund (EARF-1), in 2010, from domestic banks and institutions. Two years later, Shah mobilised money through offshore Edelweiss India Special Asset Fund - 1 (EISAF-1) with a corpus of \$77 million. In 2016, EISAF - 2 was created for Canadian pension fund CDPQ and Edelweiss Fund with a \$350-million corpus. "The closure of this fund is expected in June 2018 with a targeted investment of \$1.5 billion, including \$600 million from CDPQ," says Nitin Jain, CEO, Edelweiss Global Wealth and Asset Management. CDPQ also has a 20 per cent stake in Edelweiss ARC and a minority stake in the parent Edelweiss Financial Services.

The asset acquisition strategy has also undergone a change post the higher cash deals. The asset sale by banks were on 15:85 basis. Venkat Ramaswamy, Ex-

TURNAROUND ADVISORS

The team comprises professionals with decades of experience in steel, power, infrastructure, etc.



SUSHIL ROONGTA
Former Chairman,
SAIL



T. SANKARALINGAM
Former CMD,
NTPC



M.S. MEHTA
Former CEO,
Reliance Infrastructure
& Vedanta Resources

deals where the returns could be as high as 25 per cent." It's purely an equity risk and reward model," explains Shah. The third bucket - turnaround opportunity - is where the biggest returns are expected. "We believe 10 per cent of the opportunities will be of turnaround nature," believes Shah.

Shah will be using the newly set up turnaround team and also the advisory board to take over. Sumanth Cidambi, a former Alvarez & Marsal professional, joined Edelweiss some 18 months ago. Cidambi heads a team of professionals who are tasked with operational turnaround. "Our approach is to do two-three turnaround deals in a year. You have to target it (turnaround) at the right opportunity," stresses Shah. Insiders say that Edelweiss has some 100 stressed cases identified in advance in the current stressed assets in the banking

system where they want to negotiate with banks for a debt buyout.

R.K. Bansal, a former IDBI Bank professional, who has taken over as MD & CEO of ARC, says: "We will try to acquire a substantial debt at the first go itself. Today, we cannot take the risk of aggregating debt later because of NCLT," says Bansal. There are actually 30-35 companies that constitute 80 per cent of the capital deployed by Edelweiss. The big names are Essar Steel, Bharati Shipyards, Arshiya, Kairakal. (See *Turnaround Advisors*). Today, the turnaround team and the ARC work jointly to approach banks for buyout of distressed assets debt. "The idea is to see whether the asset has a potential for revival," says Cidambi. There is also an advisory board with industry experts like S.K. Roongta, former chairman, SAIL; T Sankaralingam, former chairman, NTPC; and M.S. Mehta, former CEO, Reliance Infrastructure and Vedanta Resources. They are just a phone call away for any technical guidance. Explaining the turnaround strategy, Cidambi says the three fundamental pillars are revenue management, cost optimisation and asset utilisation. The results have already started pouring in. In February last year, when Edelweiss entered BILT Graphic Paper, an Avantha Group company, it had zero EBIDTA. "We are currently running at around ₹44 crore EBIDTA annually. We plan to take it to ₹60 crore by next year," says Cidambi, whose team even suggested a better way of buying coal where savings were to the extent of 30-40 per cent lower than the market price.

The Big Challenges

The resolution of distressed assets is largely linked to the new bankruptcy code. But the biggest surprises are coming from the NCLT where legal challenges are becoming the order of the day. The operational creditors also have the power to drag a company to bankruptcy. "Once the company goes to NCLT, the stressed company is out of control of ARC or lenders," says an insolvency professional. Edelweiss has to tread carefully under the new system. Antony says they are also preparing for the NCLT risk in the existing cases. "Even for buying new stressed loans, we should be aware of what could go wrong at the NCLT," reasons Antony. There is also a huge risk of liquidation where the ARC won't make money - liquidation value is dirt cheap. "That is the worst thing for lenders, including ARCs," says a resolution professional.

Bankers are keenly watching the redemption of SRs by ARCs like Edelweiss. In fact, for Edelweiss ARC, a large part of SR redemption will be due in the next two-three years as bulk of the assets were acquired after 2014. The SRs are generally redeemed over a period of five to eight years. Last year, Edelweiss actually redeemed SRs worth ₹1,000 crore. Accord-



DRY POWDER

A war chest of third-party funds and internal resources

\$600 million

Global partner CDPQ's commitment; CPDQ also has a 20 per cent stake in Edelweiss ARC

\$260 million

Commitments under EIASF-2 fund's first closure in FY '17

₹7,595 crore

Group network

Source/Edelweiss

ing to sources, Edelweiss is expected to redeem more than ₹2,700 crore SRs in Binani Cement alone. If Essar Steel also sees a resolution, Edelweiss will redeem another ₹3,000 crore to ₹4,000 crore. There are some estimates that Edelweiss would redeem around ₹10,000 crore SRs in the current year. "This will be the highest by any ARC in India since its inception," say sources. But the proof of the pudding is in the eating and bankers would like to wait before any celebration.

Clearly, Shah is in for the long haul. "It's a very exciting time. There will be 10 large players in this business in India," believes Shah. Unlike other corporate and retail loans, the distressed assets business is a niche opportunity. "This requires lesser capital and more skills and capabilities," says Shah. Edelweiss already has a 30-35 per cent market share in terms of the AUM accumulated in the last decade. "We want to have 20-25 per cent market share in the next five years," says Shah. The Edelweiss model is akin to global distressed players like Apollo and Lone Star where they have a fund and also in-house turnaround teams. The global players, too, are trooping in. Going forward, there won't be any dearth of ARCs acquiring distressed assets. The banks are already in a cleaning up mode. The bankruptcy laws are also getting stabilised with every amendment. "In the Indian economy, 2-3 per cent gross NPAs are part of the business. That itself is a large opportunity in future," believes Shah, who will now be playing in select large assets to make money.

Shah asserts that understanding the underlying asset and pricing is very important. "It is not just the price risk you take, but you also take the time risk," he says while adding: "If recovery is going to be longer, there is a risk of returns reducing to half." That sums up the business that is the most difficult and challenging asset class. **BT**

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