



# Restructuring of Corporate Debts

*Way Forward*



## Message

### Message from the desk of the Secretary General, ASSOCHAM

The economy is passing through one of the most difficult times with all ammunition with the global regulators and governments catching moisture, to put the economies on rail. The falling growth rates, persistently high inflation, exchange rates creating unmanaged volatility, increasing cost of commodities, policy paralysis at home and politics superseding the economics, have showed up large challenges to manage the stability of financial markets as well as continue to maintain viability of the businesses.

Under such testing times with unexceptional stress building up in the banking sector, this is the opportune time to have a peep into the working of the sector, find out the reasons and put them on bed for treatment before they go into ICU reducing chances of recovery.

Against this backdrop, ASSOCHAM jointly with Resurgent India have come out with a Study on **Restructuring of Corporate Debts** to act as a warning bell so that the matter is addressed at the earliest. The study is timely and would definitely be useful for policy makers, Bankers and all stake holders. Any suggestion to improve the study is welcome.

ASSOCHAM acknowledges the good work done by Resurgent India research team in bringing out this exhaustive and referral study.

With Best Wishes,

D. S Rawat  
Secretary General  
ASSOCHAM

31<sup>st</sup> Oct., 2012  
New Delhi

## Preface

*Corporate Debt Restructuring will soar to INR 3.25 Lakh Cr this fiscal, about 13 times the annual budget for building roads, as companies come under stress due to the worsening economic slowdown, threatening to weaken the banking system - Rating company CRISIL*

*CRISIL has raised the CDR estimate for this fiscal by 63% in just about five months from its previous estimate of INR 2.00 Lakh crore, reflecting the fast deterioration in the financial health of companies.*

Due to economic slowdown, deteriorating asset quality and liquidity concerns, the Global Banking Industry has been under stress over the past years. On the other hand, the Indian Banking industry has grown consistently at a healthy pace. In 2012, the banking system faces tough environment both at home and abroad. The increase in asset restructuring is becoming a major cause of concern for Indian Banks. As per data released by Corporate Debt Restructuring Cell, total debt restructuring by Indian companies shows a 42% y-o-y growth in June 2012. Correspondingly, details available from 41 banks show standard asset restructuring increasing by more than two and a half times, during FY12 on a y-o-y basis.

At present, the Indian banking industry is at defining moment, with reforms, innovation and new drivers expected to power its next phase of growth in the coming years. Reserve Bank of India has taken number of initiatives in the past years such as deregulating saving interest rates, a new bank licensing policy for the private sector and CDS (Credit Default Swap) are expected to make the banking industry more efficient and competitive. With such prudent measures from Reserve Bank of India it will help strengthen the banks, despite the asset quality concerns.

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# Section 1

## A Overview

The global financial crisis has distressed the corporate sector in a number of countries, affected both by a tightening of credit and weaker consumer demand. One of the most daunting challenges faced by economic policymakers is on the large scale corporate restructuring. The objectives of large-scale corporate restructuring are in essence to restructure viable corporations and liquidate nonviable ones, restore the health of the financial sector, and create the conditions for long-term economic growth.

Usually a sequence is followed in a successful government-led corporate restructuring policy:-

- Formulation of macroeconomic and legal policies that lay the foundation for successful restructuring.
- Financial restructuring must start to establish the proper incentives for banks to take a role in restructuring and get credit flowing again
- Only then can corporate restructuring begin in earnest with the separating out of the viable from nonviable corporations—restructuring the former and liquidating the latter.

The main government-led corporate restructuring tools are mediation, incentive schemes, bank recapitalization, asset management companies, and the appointment of directors to lead the restructuring. After achieving its goals, the government must cut back its intervention in support of restructuring.

As stated by Dr. K. C. Chakrabarty (Deputy Governor, RBI) “Restructuring refers to several related processes: recognizing and allocating financial losses, restructuring the financial claims of financial institutions and corporations, and restructuring the operations of financial institutions and corporations.”

The genesis of the current scenario, in which a large number of restructuring cases are been referred to the CDR cell, goes way back to 2006 through 2008 following rapid economic cycles of boom, recession and stimulus-driven revival bringing it now to sheer stagflation accentuated by total policy paralysis.

The boom in period after 2006 gave a kick-start to the demand for risk equity capital when investment and merchant bankers had field day raising initial public offerings, follow-up on public offers, qualified institutional placements, private equity investments and foreign institutional investors that flooded eastwards from the Western financial markets consequent upon the Western meltdown.

Following the post-Lehman crisis, beginning 2009 the markets lost their euphoria. Raising equity at high EVs became difficult and capital-intensive industries in engineering, procurement, realty, infrastructure and power had to go in for large-scale debt-funding via term borrowings from commercial banks and developmental finance institutions, increasingly present NBFCs and also external commercial borrowings.

The Reserve Bank of India (RBI), concerned with high inflation resorted to raising the key repo and reverse repo rates a record 13 times since March 2010 only to slow down in last few quarters. This made debt servicing for the industries more expensive. Suffocated with high interest rates, defaults in interest and instalments began to become the order of the day. The heady boom having come to an abrupt end, the focus has now shifted to numbers of bad loans or distressed assets as they are termed in the West.

This brought in an era of corporate debt restructuring (CDR), now denoted Greening of loans. It seeks to recognize impairment by allowing the reorganization of outstanding debt obligations by bringing about reductions in the burden of the mounting/compounding debts—lessening in the interest rates and rescheduling the instalments by extending the term of repayment. This enables increase in the ability of the borrower to meet debt obligations by letting the lender waive in part or forgive or convert a part of debt into equity.

*The restructured standard assets at the end of March 2012 have increased by 46 per cent to INR 1,55,000 crore and are poised to go up to INR 2 lakh crore, - Crisil Forecasts*

According to the CDR Cell, during fiscal 2012 banks have restructured INR 64,500 crore—an increase of 156% over the previous year— when the banks filed 84 cases. This makes restructuring the highest since its launch in 2001. It has helped revive the macro-economic conditions for both the banks by promptly recognizing and providing for the impairment of their non-performing assets well in time.

The borrowers are also able to reduce their interest and principal debt burdens by providing for sufficient breathing space to genuinely viable units to enable them to bring about a turnaround without having to resort to tedious DRT and court procedures or end in winding up proceedings.

## Section 2

### CDR Analysis

#### Introduction

A Corporate Debt Restructuring mechanism was first introduced in 2001. It is a voluntary, non-statutory system that allows a financially troubled company with multiple lenders and loans of more than INR 20 crore to restructure those loans to a plan approved by 75% or more of its lenders.

#### Need for Corporate Debt Restructuring

Banks have to face various difficulties while restructuring their large exposures specially which are involving more than one lender, under consortium / multiple banking arrangements. In the background of these difficulties, need for such a specialized institutional mechanism arose. If a restructuring involve a single bank, it becomes easier for the banks to negotiate the terms of restructuring of their own exposure with the customers but where a restructuring involved multiple lenders, banks find it difficult to co-ordinate their individual negotiation and monitoring efforts with the other banks involved.



Keeping in mind the above facts, Reserve Bank of India put in place the scheme of CDR in August 2001 based on the mechanism prevalent in countries like the seized of the matter U.K., Thailand, Korea, Malaysia, etc. These guidelines were finalized after extensive discussion between Government of India, Reserve Bank, Banks and FIs.

The main objective of the CDR framework was to ensure timely and transparent mechanism for restructuring the corporate debts of viable entities facing problems, outside the purview of BIFR, DRT and other legal proceedings, for the benefit of all concerned.

#### Recent Statistics

CDR Cell – Performance Report (As on March 31, 2012)							
Total References Received		Cases Rejected/ Closed		Cases under finalization of Restructuring packages		Total Cases Approved (including cases withdrawn/ Exited)	
No. of cases	Agg Debt	No. of cases	Agg Debt	No. of cases	Agg Debt	No. of cases	Agg Debt
365	182611	53	17571	36	22525	276	142515

\*Agg: Aggregate

Source: [www.cdrintia.org](http://www.cdrintia.org)

As shown in the above table, In the last financial year ending on 31<sup>st</sup> March 2012, of the 392 cases worth INR. 2.06 Lakh crore referred to the CDR Cell, 292 have been approved or resolved i.e. 1.50 Lakh crore of debt restructured under the CDR mechanism.

However we can see also see the performance of the CDR cell in the first quarter of the current financial year 2012-13 i.e. from April 2012 to June 2012 in the below mentioned table:

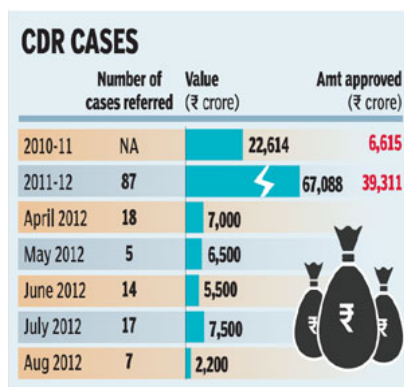
CDR Cell – Performance Report (As on June 30, 2012)							
Total References Received		Cases Rejected/ Closed		Cases under finalization of Restructuring packages		Total Cases Approved (including cases withdrawn/ Exited)	
No. of cases	Agg* Debt	No. of cases	Agg Debt	No. of cases	Agg Debt	No. of cases	Agg Debt
<b>433</b>	<b>227021</b>	<b>63</b>	<b>21377</b>	<b>61</b>	<b>37172</b>	<b>309</b>	<b>168472</b>

\*Agg: Aggregate

Source: [www.cdrindia.org](http://www.cdrindia.org)

In the first quarter of the current FY 12-13, CDR has received total 433 cases worth INR 2.27 Lakh crore of which 309 cases worth INR. 1.68 has been approved / resolved under CDR mechanism.

A report from Standard & Poor's talked about Indian bank's weaker asset quality and earnings across the sector in 2012, with credit growth predicted to fall to 16%, from 23% the year before.



India's banks weakening asset quality is also clear from the marked rise in debt restructuring agreements, a halfway house between payment and default used by the banks for struggling businesses such as Kingfisher Airlines. Taken together, HCC's mix of bad and restructured loans rose to 4.3% of overall lending in the third quarter, up from 25 in the same period last year.

Corporate debt has spiked by over 300% this fiscal, already touching INR76,251 Crores, against INR 25,054 crore in the previous fiscal. This brings the overall CDR assets in the system to over INR 19 Lakh Crore. This is alarming.

Credit rating agency Standard & Poor's, in a recent conference call with the media, said that restructured loans were expected to increase to around 4% of advances (of the banking system) at this financial year-end, from 2.6% a year ago. In 2012-13, restructured loans are expected to be 4-5% of advances. The S&P analyst also said that 25-50% of restructured loans may slip into NPAs



“In the April-June quarter of 2011-12, the cell received 16 corporate restructuring cases with debt of INR 4,682 crore. In the July-September quarter, it received 19 cases (with debt of INR23,071 crore); in the October-December quarter, 25 cases (INR 22,497 crore); and in the January-March quarter, 23 cases (INR 26,001 crore). Corporate sickness seems to be spreading. Earlier, an average bank would have not more than 3-4 corporate debt restructuring cases at a time. But now an average bank deals with about 30 cases.

Loans worth INR 19000 crore were referred for corporate debt restructuring in the 1st quarter of 2012-13 showing 30% higher than the previous quarter. As many as 37 accounts were referred to the CDR Cell.

Visa Steel (INR 3,000 crore), Tayal Group (INR 2,811 crore) and Indu Projects (INR 2,800 crore) were among the biggest loans restructured in the quarter.”

*Source - NDTV News- July 8, 2012*

### **Companies trapped in high debt**

India needs infrastructure such as roads and utilities and that is the reason that such companies are better positioned because of their experience. But the debt they have accumulated over the years is an albatross around their necks. At that time, companies more than tripled their debt, bidding for projects much bigger than what their equity could support. Indiscriminate lending by banks, prodded by the government, is back to haunt these companies as most lenders have hit their limits and are staring at defaults.

A few recent reports highlighted more than two dozen highly-leveraged large borrowers, including Adani Power, Essar Oil, Tata Communications, Electrotherm India and Jai Balaji, many of which may require future debt-restructuring.

During the period from 2007 to 2011, the debt of GMR Infra (operates the New Delhi airport) jumped 6.7 times, BGR Energy and IVRCL (contractor of road and water projects) had a 5.4 fold jump in its debt. Apart from them there is GVK Power (which runs Mumbai airport) had its debt climb by 3.59 times. Also Jaypee Infratech (which built India's only Formula 1 race track in New Delhi suburb) had a debt jump by 31 times in three years from INR200 crore in fiscal 2008.

Since March 2011, nine new iron and steel sector cases valued at R3,041 crore were approved by the CDR cell.

#### **Sectors more prone to CDR**

- *Iron & Steel*
- *Textiles*
- *Telecoms*
- *Fertilizers*
- *Sugar*
- *Cement*
- *Petrochemicals & Refineries*

#### **New Sectors emerging for CDR**

- *Infrastructure and*
- *NBFCs*

Telecom infrastructure service providers like ICOMM Tele were also approved for restructuring. Telecom sector loan accounts worth INR 4,459 crore were approved for restructuring during the period March 2011 to June 2012.

Many are headed for debt restructuring where lenders may impose strict conditions and dilute equity that could hurt stockholders' interests.

### **CDR – A helping hand to Indian Companies**

During the period from 2001 to 2005, when the total debt was more than INR 75,000 crore, about 138 cases has been dealt by CDR cell out of which 75% of the cases were successfully completed with the companies able to meet their debt obligations.

In 2009, by December-end the cell had received 208 cases where the total amount stood at INR 90,888 crores. From this 29 cases, which had a total tally of 5018 crores were not accepted – 173 cases where the aggregate amount was INR 84,510 crores were executed as per the program. These proposals were from various industries. There was a 3 times increase in the number of cases the cell got in 2009-10 from 2008-09.

CRISIL states that by March 2013 the banks might have to issue such loans worth INR 2 trillion. During April 2012, the CDR cell has got 14 proposals for restructuring debts. Eight of these companies are textile organizations from the Tatal Group. The other companies are ICOMM Tele Limited, PCH Retail, and Surya Alloy Industries Ltd.

Following are some companies who have received CDR benefits:

- GTS Infrastructure – a group specializing in telecom towers
- Deccan Cargo and Express Logistic – set up by Captain Gopinath
- BASIX – microfinance organization
- Bharati Shipyard

The companies mentioned below are waiting to receive approval for their CDR applications:

- Hotel Leelaventures
- Lavasa
- HCC

Hotel Leela venture Ltd had applied for CDR in February 2012. At the September 2012 CDR meeting held with the banks, Leela venture was told to repay its entire outstanding principal amount in 8 years from January 2014. It also has to pool in all its hotel properties (other than

*Restructuring of INR 1.9 Lakh crore debt of state electricity board is approved on 24<sup>th</sup> Sep' 2012 in a move to turnaround the near-bankrupt power distribution companies.*

*Under the scheme approved by the Cabinet Committee on Economic Affairs, 50 per cent of the short-term outstanding liabilities would be taken over by state governments. Balance 50 per cent loans would be restructured by providing moratorium on principle and best possible terms for repayments, an official statement said.*

*Source: News, Times of India, India Business*

the Bangalore hotel) as security against the loan amount from the CDR lenders.

However, it has got a breather to pay its debt; the restructured repayment plan of the company has finally been accepted by the lenders. It has received a 24-month moratorium for the outstanding principal amount of INR 3,000 crore it borrowed from a consortium of 17 banks.

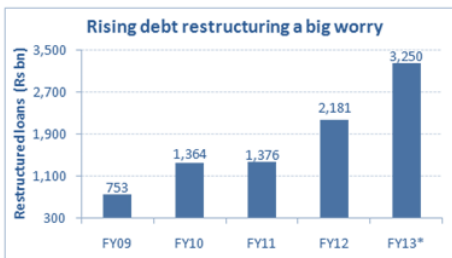
*Source: Indian hospitality Review, News dated 25<sup>th</sup> September 2012*

Apart from above, Moser Baer Solar has recently applied to the CDR Cell with a debt of INR 739 crores.

### Why CDR is worrying - Key Issues / Observations

Rapid rises in the quantum of restructured loans is becoming a matter of worry. It indicates the deterioration in the quality of loans given by lenders (mostly banks).

As per credit rating agency Crisil, corporate debt restructuring is likely to surge to INR 3,250 bn in financial year 2012-13 (FY13), an estimated rise of 49% over the previous year. While restructured debt accounted for about 4.7% of total advances in FY12, the same is expected to increase to 5.7% in FY13.



The main reason for this is the increasing financial stress on account of the prevailing slowdown in the economy. State utility boards, construction and infrastructure companies will account for a significant chunk of the restructured loans. Public sector lenders are expected to be the worst hit, accounting for about 80% of the total restructured debt.

*Data Source: Business Standards  
\* Crisil Estimates*

### Current News

*Since restructuring cases are increasing in the country amid a slowly economy and higher interest rate regime, Indian private sector lender Banks are planning to exit the corporate debt restructuring mechanism created to provide relief to financially troubled companies. Yes Bank has already written a letter to the CDR (corporate debt restructuring) cell regarding its decision to withdraw. Earlier in 2011, small financial institutions like IFCI Ltd and Development Credit Bank had also opted out of the mechanism.*

*Source- Contify Banking*

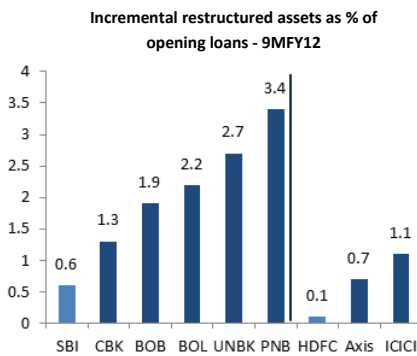
In a report, research firm Macquarie says stressed assets are likely to touch a decade-high level in fiscal 2012-13. Listed below are few issues / observations of the firm are:

1. Of the cases referred to the CDR cell, the Iron & Steel and Textile sector has contributed the most. Out of 37 cases, 7 cases were from these sectors. Though the flow of big ticket cases has slowed down, entry of more small and medium-sized companies is there. The issue is also of moral hazard, as corporate have been misusing the CDR facility.
2. The report says stressed assets to reach decade –high by the end of the fiscal year. Most credit rating agencies are estimating

that restructured loans could rise to 6-7% by the end of 2012-13, Macquarie says.

3. As per Macquarie’s report, default rates from core restructured assets could be higher this time (excluding state electricity boards, or SEBs, and Air India).
4. Macquarie estimates that approx. 30% of outstanding assets (and more than 50% of incremental restructured assets) currently are exposure to SEBs and Air India, where loss rates are difficult to predict.

Source: NDTV News dated July 8, 2012



### Current Trend

Everyone agrees that corporate debt restructuring has proven to be a helping tool for Indian companies at the time of their financial crisis. However, on the other hand it cannot be denied that it has affected Banking Sector the most which resulted in decrease in NPA accounts and profitability of the banks.

Surprisingly, the SBI and the HDFC Bank, two of the country’s largest lenders, have undertaken relatively little restructuring this financial year, than other banks. But private lenders are better off than PSUs in terms of NPAs as well as regarding debt restructuring.

3 °±±° °°±±#		Mar' 09	Mar'10	Mar' 11	Mar' 12
<b>Gross Advances</b>	Gross Advances ( Cr)	27,53,365	32,27,287	39,82954	46,55,271
	Growth Rate (5%)		17.21	23.41	16.88
	Compound annual growth rate (2009-2012)(%)				19.13
<b>Restructured Standard Advances</b>	Restructured Standard Advances (Cr)	75,304	1,36,426	1,37,602	2,18,068
	Growth Rate (%)		81.17	0.86	58.48
	Compound annual growth rate (2009-2012) (%)				42.54
<b>Restructured Standard to Gross Advances</b>	Ratio (%)	2.73	4.23	3.45	4.68

Source: RBI Website

From the data available with RBI (Table 1), it is observed that between March 2009 and March 2012, while total gross advances of the banking system grew at a compound annual growth rate of less than 20 per cent, restructured standard advances grew by over 40 per cent. Resultantly, the proportion of Restructured Standard Advances to Gross Total Advances increased from 3.45 per cent in March 2011 to 4.68 per cent in March 2012.

3 °B±° °°B±	2009-10		2010-11		2011-12	
	Gross Advances	Restructured Standard Advances	Gross Advances	Restructured Standard Advances	Gross Advances	Restructured Standard Advances(*)
\$ °B± °1B±	17.21	81.17	23.41	0.86	16.88	58.48 (42.54)
3 °, °B± °1B±	19.81	96.59	22.98	3.86	16.02	58.33 (47.86)
3B± °1B±	12.80	5.60	26.60	(-)28.48	20.65	67.35 (8.12)
) ±B± °1B±	(-)1.38	(-) 25.06	19.06	(-)27.56	16.35	(-)23.76 (-) 25.48)

**\*Figures in brackets are the compound annual growth rates between 2009 and 2012**

Source: RBI Website

3 °B± ° °°B±	March 2009	March 2010	March 2011	March 2012
\$ °B± °1B±	2.73	4.23	3.45	4.68
3 °, °B± °1B±	3.03	4.97	4.20	5.73
3B± °1B±	2.19	2.05	1.16	1.61
) ±B± °1B±	0.73	0.55	0.34	0.22

Source: RBI Website

## THE LENGTHENING QUEUE

■ Major CDR cases referred in April-June quarter

Company	Amt (₹ cr)	Main bankers
Tayal Group	2,811	BOI, UCO Bank
Moser Baer Solar	740	PNB, Central Bank of India, BOB
ICOMM Tele	1,354	Axis Bank, Syndicate Bank
Indu Projects	2,800	BOI, State Bank of Hyd, PNB
Varun Inds	1,755	Indian Bank, United Bank, CBI
VISA Steel	3,000	SBI, Corporation Bank

■ Major CDR cases approved in April-June quarter

Company	Amt (₹ cr)	Main bankers
HCC	3,300	ICICI Bank, PNB, SBI
Bharti Shipyard	2,850	SBI, CBI, IDBI Bank
Hotel Leelaventure	4,300	SBI, Syndicate Bank, IOB

Further from the above table 2 and 3, it can also be seen that in public sector banks, compound annual growth rate of restructured accounts is 47.86% against growth rate of credit of 19.57%.

Whereas corresponding figures for private sector and foreign banks are 8.12 per cent (restructured advances) and 19.88 per cent (credit growth) and (-) 25.48 per cent (restructured advances) and 10.96 per cent (credit growth) respectively.

Further, as on March 2012, the ratio of Restructured Standard Advances to Total Gross Advances is highest for PSBs at 5.73 per cent, while the ratio is significantly lower for private and foreign banks at 1.61 per cent and 0.22 per cent respectively.

## Section 3

# Regulatory Developments

### **Constitution of Working Group by Reserve Bank of India**

In the light of the key issues discussed in the previous section, the need for one more review of RBI guidelines on restructuring arose. Therefore in the Second Quarter Review of Monetary Policy 2011-12 announced on October 25, 2011, it was proposed to constitute a Working Group to review the existing prudential guidelines on restructuring of advances by banks/financial institutions and suggest revisions taking into account the best international practices and accounting standards. Accordingly a Working Group (WG) was constituted on January 31, 2012 under the Chairmanship of Shri B. Mahapatra, Executive Director of RBI, to review the existing guidelines on restructuring of advances.

### **Key Recommendations of the Working Group**

#### **RBI releases Report of the Working Group to review the existing prudential guidelines on restructuring of advances by banks/financial institutions on 20<sup>th</sup> July 2012**

The Working Group has examined the issues confronting the restructuring of advances by banks both under CDR and non-CDR mechanisms. Its recommendations are in the right direction and forward looking. It has recommended the withdrawal of regulatory forbearance on asset classification on restructuring; but considering the current domestic macroeconomic situation as also global situation, this step is suggested, say, after a period of two years. During the interregnum, it has recommended increasing the provision on accounts which get the asset classification benefit on restructuring. These are right steps towards discouraging the banks from taking up the cases of unviable accounts as they will be compelled to use their resources judiciously and only for viable accounts. In remaining cases, deleveraging should be the correct option.

The Working Group has also made its recommendations for putting a cap on conversion of debt into preference shares; increasing the promoters' stake in restructured accounts; making the right of recompense' mandatory, bringing more clarity in calculation of diminution in fair value, disclosure of only 'material' information, etc. These recommendations, once accepted, will remove the incentives for 'adverse selection and moral hazard'. Regulatory forbearance and Government incentives will not be available on 'tap' but only in cases of a severe economic crisis.

Key Recommendations are as under:

- The RBI may do away with the regulatory forbearance regarding asset classification, provisioning and capital adequacy on restructuring of loan and advances in line with the international prudential measures. However, in view of the current domestic macroeconomic situation as also global situation, this measure could be considered say, after a period of two years.
- In the interregnum, in order to prudently recognize the inherent risks in existing assets classified as standard on restructuring (stock), the provision requirement on such accounts should be increased from the present 2% to 5% in a phased manner over a two-year period, i.e. 3.5% in the first year and 5% in the second year. However, in cases of new restructuring of standard asset (flow), provision of 5% should be made with immediate effect.
- Notwithstanding the recommendation for progressively doing away with the asset classification benefit on restructuring, the WG felt that extant asset classification benefits in cases of change of date of commencement of commercial operation (DCCO) of infrastructure project loans may be allowed to continue for some more time in view of the uncertainties involved in obtaining clearances from various authorities and importance of the sector in national growth and development.
- Accounts classified as NPAs upon restructuring are presently eligible for up-gradation to the 'standard' category after observation of 'satisfactory performance' during the 'specified period'. The specified period has been defined as a period of one year from the date when the first payment of interest or installment of principal falls due under the terms of restructuring package. The WG has recommended that the 'specified period' should be redefined in cases of restructuring with multiple credit facilities as 'one year from the commencement of the first payment of interest or principal, whichever is later, on the credit facility with longest period of moratorium.
- Conversion of debt into preference shares should be done only as a last resort. Also, conversion of debt into equity/preference shares should be restricted to a cap (say 10% of the restructured debt). Further, conversion of debt into equity should be done only in the case of listed companies.
- A higher amount of promoters' sacrifice in cases of restructuring of large exposures under CDR mechanism needs to be

considered. Further, the promoters' contribution should be prescribed at a minimum of 15% of the diminution in fair value of the restructured account or 2% of the restructured debt, whichever is higher.

- As stipulating personal guarantee will ensure promoters' "skin in the game" or commitment to the restructuring package, obtaining the personal guarantee of promoters be made a mandatory requirement in all cases of restructuring, i.e., even if the restructuring is necessitated on account of external factors pertaining to the economy and industry. Further, corporate guarantee should not be considered as a substitute for the promoters' personal guarantee.
- RBI may prescribe the broad benchmarks for the viability parameters based on those used by CDR Cell; and banks may suitably adopt them with appropriate adjustments, if any, for specific sectors. The WG also felt that the prescribed time span of seven years for non-infrastructure borrowal accounts and ten years for infrastructure accounts for becoming viable on restructuring was too long and banks should take it as an outer limit. The WG, therefore, recommended that, in times when there is no general downturn in the economy, the viability time span should not be more than five years in non-infrastructure cases and not more than eight years in infrastructure cases.
- In terms of present guidelines, banks are required to disclose annually all accounts restructured in their books on a cumulative basis even though many of them would have subsequently shown satisfactory performance over a sufficiently long period. The WG has, therefore, recommended that once the higher provisions and risk weights (if applicable) on restructured advances (classified as standard either *abinitio* or on upgradation from NPA category) revert back to the normal level on account of satisfactory performance during the prescribed period, such advances should no longer be required to be disclosed by banks as restructured accounts in the "Notes on Accounts" in their Annual Balance Sheets.
- The WG observed that there were cases which were found to be viable before restructuring but the assumptions leading to viability did not materialise in due course of time. There were also cases where the approved restructuring package could not be implemented satisfactorily due to external reasons or due to promoters' non-adherence to the terms and conditions. The WG recommended that in such cases, banks should be advised to



assess the situation early and use the exit options with a view to minimize the losses. The WG also recommended that the terms and conditions of restructuring should inherently contain the principle of 'carrot and stick', i.e. while restructuring being an incentive for viable accounts, it should also have disincentives for non-adherence to the terms of restructuring and under-performance.

- Due to the current guidelines issued by CDR Cell that recompense be calculated on compounding basis and that 100% of recompense so calculated is payable, exit of companies from CDR system was not happening. Therefore, the WG recommended that CDR Standing Forum/Core Group may take a view as to whether their clause on 'recompense' may be made somewhat flexible in order to facilitate the exit of the borrowers from CDR Cell. However, it also recommended that in any case 75% of the amount of recompense calculated should be recovered from the borrowers and in cases of restructuring where a facility has been granted below base rate, 100% of the recompense amount should be recovered. The WG also recommended that the present recommendatory nature of 'recompense' clause should be made mandatory even in cases of non-CDR restructurings.

## Section 4

### Way Forward

Corporate Debt Restructuring has been playing a very vital role in the economy as well as society. We can't say that restructuring of accounts should not be allowed since it plays a valuable role both for the borrower and the banks at the times of economic downturns and financial crisis. However, CDRs should be allowed only under certain specific conditions as mentioned below:

1. Restructuring should be allowed only if the circumstances are beyond the control of the borrowers and are not due to general errors / mismanagement by them.
2. A uniform approach should be adopted for both standard and NPA accounts while examining the restructuring proposal.
3. The proposal should be firstly tested / evaluated upon its viability then only it should be considered for restructuring. For this, finance professional needs to examine the effective levels of leveraging in the project. Higher leveraging raises the risks of a project especially in an uncertain environment. There are many instances in which promoter's equity component has been financed out of debt, or debt flows being structured as equity etc. Thus it should be ensured at the time of restructuring that projects are not over leveraged.
4. It must be ascertain before restructuring that borrowers or senior management are sincere about the project and are ready to take responsibility and share the burden of restructuring.
5. Most important, lenders must ascertain the amount of the sacrifice required to be made on their part. A restructuring proposal is most favorable if there is zero sacrifice on the part of lender except postponement of the repayment schedule. Of course, there are prudential provisions which have to be built up to protect the lender in case of the failure of the restructured unit.
6. Small customers such as SMEs and priority sector advances are an important segment of the economy and viable accounts facing temporary problems therefore these sectors must not be

discriminated against when they request for restructuring even lenders must show more compassion towards such small customers. Also there must be a structured mechanism for considering restructuring of retail, SME and agricultural loans just as in the case of larger accounts, since nurturing of viable accounts is in the long term interest of both lenders and borrowers.

7. In restructuring of a proposal, to be successful, it is very critical that the assessment of the proposal and its approval should be completed within a specific time frame, says 90 days, since time is very essence in ensuring turnaround of projects and a longer process of assessment can itself hamper the viability of the project.

## Section 4

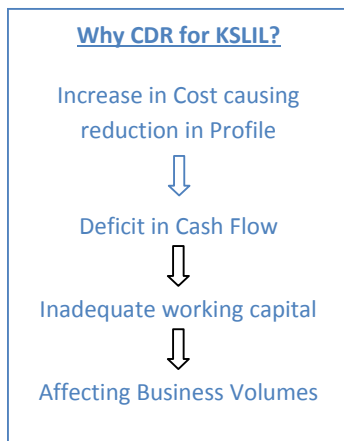
### Case Studies

#### Case Study – 1: KSL & Industries Limited

Financial Performance		(INR In Crores)			
Particulars	FY 09	FY 10	FY 11	FY 12	
Sales	819	1031	1306	740	
EBIDTA	158	157	187	121	
% EBDITA	19%	15%	14%	16%	
Interest	57	73	86	64	
PBT	30	(4.4)	2.1	8.00	
PAT	24.37	4.00	-3.42	6.38	
Cash Acc.	96.64	94.09	96.07	56.61	
Debts	860.27	897.28	867.02	839.38	

KSL Industries Limited (KSLIL), Flagship Company of Saurabh Tayal Enterprises (ex-major stake holder of Bank of Rajasthan) is Mumbai based company engaged in Textile and Real Estate Business. It is having spinning facility, knitting facility and processing facility in various part of the country i.e. Nagpur, Dombivali and Wada. It embarked an expansion project at its units located at Kamleshwar & Nagpur after due appraisal in FY 2010 & FY 2011

#### Why KSLIL has to go for CDR?



1. During the implementation of the above mentioned expansion project, textile industry underwent major changes which were different from the assumptions taken at the time of project appraisal. There was a major increase in the cost but commensurate increase in the income was not reflected causing a significant gap in the profit envisaged & actual profits earned
2. Due to industry downturn delay in receipt of receivables
3. Delay in receipt of TUFs subsidy
4. Changes industry dynamics - Past profitability not sustainable in prevailing circumstances

#### Borrower's initiatives

Management has to prepare an exhaustive restructuring plan to revive the operations & profitability. Also to improve the production and productivity, certain modification and up gradation to the machineries done in order to save labour cost and other overhead cost.

Debt Realignment Proposal  
(Holding on Operations)

*During the time of designing & implementation of restructuring following steps shall be taken*

- Lenders not to recover any Loan installments and interest*
- Lenders not to levy of any penal charges for delays / irregularities*
- Continuation of working capital limits at existing levels*
- Till implementation of restructuring package, cash / cheque deposits made in the KSL's accounts, would be allowed to be withdrawn, without any adjustment against any dues payable to the bank.*

Debt Realignment proposal

1. Term loans:
  - Repayable in 10 years
  - No moratorium period available in order to comply with subsidy guidelines
  - Interest to be charged at concessional rate of 10%
  - Waiver of the unpaid penal & compound interest
2. Working capital limits:
  - Working capital limit to be assessed based on FY13 numbers
  - Reduced rate of interest @10%
  - Reduction in working capital margins from earlier 25% to 10%
  - LC & BG margins also reduced
3. Funding of Interest:
  - Interest due upon the term loans & working capital loans to be converted into Funded interest term loan
  - Repayable in 2 years starting from 30th June 2015
  - Interest on FITL to be charged @5%
4. Foreign Currency convertible Bonds (FCCB's):
  - 25% of the FCCB amount to be paid within 6 months of restructuring
  - Reduced coupon rate @2%
  - Yield to maturity of 4%
5. Promoter's Contribution:
  - Promoter's to infuse fresh contribution to the extent of 15% of lenders sacrifice
  - 50% of the same to be infused immediately & remaining within 6 months

## Case Study – 2: Kingfisher Airlines

### Debt Recast Package

If we look at the books of Kingfisher, banks & FI's have taken the following CDR route:

- INR 750.10 Crores of loans were converted into 7.5% compulsorily convertible preference shares which thereafter converted into equity
- INR 553.10 Crores of Loans were converted into 8% Cumulative Redeemable preference Shares redeemable at par after 12 years.
- Repayment of the balance loans was rescheduled with a moratorium on repayment of principal of 2 years and step-up repayment over the subsequent 7 years
- Interest for the period July 1, 2010 to March 31, 2011 on loans from the banks was converted into a funded interest term loan repayable in 9 years including 2 years moratorium.
- Interest rate on loans reduced by over 300 bps
- Additional fund based loan facilities of INR 768.32 Crores and non-fund based facilities of INR 444.40 Crores sanctioned by the banks
- Part of the working capital limits of INR 297.40 crores converted into working capital term loans.

### Analysis of the debt recast package

Action Taken	Impact upon Company
○ Conversion of loan into equity	Reduction of interest burden
○ Conversion of loan into cumulative redeemable preference shares	<ul style="list-style-type: none"> <li>• Reduces the interest burden, dividend is payable to shareholders only upon the generation of profits.</li> <li>• Company needs to pay dividend distribution tax , loss of interest deduction too</li> </ul>
○ Moratorium period of 2 years	<ul style="list-style-type: none"> <li>• Reduces the stress upon cash flow as there will be no repayment liability for 2 years</li> </ul>
○ Conversion of unserviced portion of interest into term loan	<ul style="list-style-type: none"> <li>• Reduces the penal interest liability</li> </ul>
○ Reduction in rate of interest	<ul style="list-style-type: none"> <li>• Reduces the cash outflow in terms of interest.</li> </ul>
○ Additional limits sanctioned	<ul style="list-style-type: none"> <li>• Will help the company to manage its operational expenses till the time it gets stabilized</li> </ul>
○ Working Capital limit converted into Working Capital term loan	<ul style="list-style-type: none"> <li>• The limit will not be affected by the net working capital of the company it will be intact inspite of the reduction in net working capital.</li> </ul>

## Conclusion

Corporate Debt Restructuring mechanism is a one stop forum for both lenders and borrowers to arrive at a mutually agreeable terms to secure their interest, however varied they may be. CDR has been in existence for more than a decade in India and this system has fulfilled its objectives to a large extent.

The need for constructing such a mechanism was arose when economic upturn and downturn comes in the way of business cycles of individual companies. The restructuring process is a tool for assisting distressed sections of the economy to tide over difficulties which are temporary in nature and due to circumstances beyond their control.

With the involvement of multiple lenders, there is every chance that any restructuring process would face obstacles and time delays. These are the very problems that the RBI's informal CDR system aims to address by setting up a framework for swift and timely action.

CDR is for larger benefit of economy and society and it must be available to all classes of borrowers and made available in timely and non – discriminate manner. And this will be possible only if we develop the necessary structures, systems and processes for restructuring.

It goes without saying that its future success and failure will depend upon the ethics and integrity of its members and the professionals involved in the restructuring process.

# About Resurgent India

## Equity | Debt | Advisory

Resurgent India is a full service investment bank providing customized solutions in the areas of debt, equity and advisory. We offer independent advice on capital raising, mergers and acquisition, business and financial restructuring, valuation, business planning and achieving operational excellence to our clients.

Our strength lies in our outstanding team, sector expertise, superior execution capabilities and a strong professional network. We have served clients across key industry sectors including Infrastructure & Energy, Consumer Products & Services, Real Estate, Metals & Industrial Products, Healthcare & Pharmaceuticals, Telecom, Media and Technology.

In the short period since our inception, we have grown to a 100 people team with a pan-India presence through our offices in New Delhi, Kolkata, Mumbai, and Bangalore. Resurgent is part of the Golden Group, which includes GINESYS (an emerging software solutions company specializing in the retail industry) and Saraf & Chandra (a full service accounting firm, specializing in taxation, auditing, management consultancy and outsourcing).

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ASSOCHAM is one of the oldest Chambers of Commerce which started in 1920. ASSOCHAM is known as the “knowledge chamber” for its ability to gather and disseminate knowledge. Its vision is to empower industry with knowledge so that they become strong and powerful global competitors with world class management, technology and quality standards.

ASSOCHAM is also a “pillar of democracy” as it reflects diverse views and sometimes opposing ideas in industry group. This important facet puts us ahead of countries like China and will strengthen our foundations of a democratic debate and better solution for the future. ASSOCHAM is also the “voice of industry” – it reflects the “pain” of industry as well as its “success” to the government. The chamber is a “change agent” that helps to create the environment for positive and constructive policy changes and solutions by the government for the progress of India.

The road is long. It has many hills and valleys – yet the vision before us of a new resurgent India is strong and powerful. The light of knowledge and banishment of ignorance and poverty beckons us calling each member of the chamber to serve the nation and make a difference.

ASSOCHAM derives its strength from the following Promoter Chambers: Bombay Chamber of Commerce and Industry, Mumbai; Cochin Chamber of Commerce and Industry, Cochin; Indian Merchant’s Chamber, Mumbai; The Madras Chamber of Commerce and Industry, Chennai; PHD Chamber of Commerce and Industry, New Delhi and has over 3 lakh members.

Together, we can make a significant difference to the burden that our nation carries and bring in a bright, new tomorrow for our nation.

**THE ASSOCIATED CHAMBERS OF COMMERCE &  
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