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INSOLVENCY AND BANKRUPTCY CODE

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Timely resolution of stressed assets stuck in IBC would help reduce dependence on steel imports

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Steel sector, a major beneficiary of the Insolvency and Bankruptcy Code (IBC)

The steel sector has been one of the most prominent sectors to have been impacted by the introduction of the Insolvency and Bankruptcy Code (IBC) two years ago. Of the 40 large defaulting accounts identified by the Reserve Bank of India (RBI) in June 2017 (12) and August 2017 (28), 11 entities are associated with the steel sector, and eight of them have steel-manufacturing capacities[1]. Details of these eight entities are provided in Exhibit 1.

EXHIBIT 1. Steel-manufacturing entities from RBI's list of 40 large defaulting accounts

Company	Claims by FCs (Rs. billion)	Claims realised by FCs (Rs. billion)	Haircut (%)	Capacity (million tonnes per annum, mtpa)	Remarks
Bhushan Steel Ltd	560	356	36%	5.7	Acquired by Tata Steel Ltd
Essar Steel Ltd	492	NA	NA	10.0	CoC-approved resolution plan submitted; NCLT approval awaited
Bhushan Power and Steel Ltd	473	NA	NA	3.0	JSW Steel recently received letter of intent from Committee of Creditors
Electrosteel Steels Ltd	132	29	78%	1.5	Acquired by Vedanta Ltd
Monnet Ispat & Energy Ltd	110	24	78%	1.5	Acquired by JSW Steel-Aion Investments consortium
Visa Steel Ltd	NA	NA	NA	0.5	Under litigation; Court stay order in place
Jayaswal Neco Ltd	NA	NA	NA	1.0	Under litigation; Court stay order in place
Uttam Galva Metallics Ltd	36	36	0%	0.6	Withdrawn from process after repayment of pending dues
Total				**23.8**	

Source: ICRA research; FC: Financial Creditor

Of the above eight entities, four corporate debtors have already completed the corporate insolvency resolution process (CIRP) with the financial creditors realising about Rs 444 billion from them with an average haircut of about 47%. This amount corresponds to about 73% of the total amount realised by the financial creditors so far from all those CIRPs that have yielded a resolution plan. Needless to say, the steel sector has been the key driving force in ensuring that the IBC moves towards its goal of maximising the value of the assets and maintaining the corporate debtor's going-concern status. The realisation for the financial creditors would have been even higher, but for the delays seen in concluding the CIRP for two large entities, viz. Essar Steel Limited and Bhushan Power and Steel Limited, both of which have attracted interest from domestic and foreign entities. These two entities have been enveloped in legal wrangles due to which their CIRPs have now exceeded 500 days. We expect both the CIRPs to be concluded some time in CY2019, which should help the financial creditors realise at least an additional Rs 600 billion.

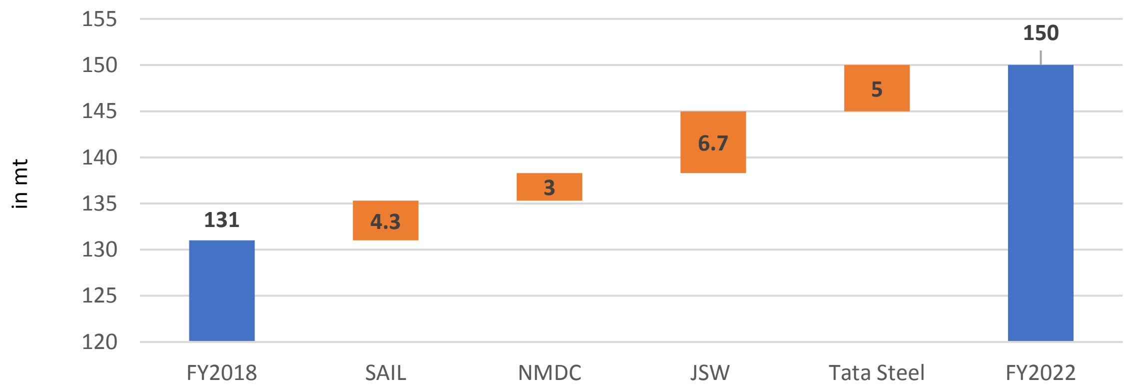
[1] Balance three companies are Uttam Galva Steels, Uttam Value Steels and Asian Colour Coated Ispat Ltd, which have only downstream operations

We feel that the turnaround seen in the steel sector over the past couple of years, following the imposition of trade remedials like minimum import price and anti-dumping duty on certain steel products by the Central Government, along with the increase in international steel prices, have been crucial in reviving bidders' confidence. The above-mentioned steel companies cumulatively form about 18% of the total domestic steel capacity and make for good candidates for acquisition by other large players who are looking to improve their market share and cater to the favourable domestic demand. Acquisition of these debt-ridden companies would provide the stronger entities with operational plants that would immediately contribute to their operating profits, compared to the setup of a greenfield project, which typically would have a gestation period of three to four years at least.

Timely resolution of stressed assets would help reduce dependence on steel imports

India's total installed steelmaking capacity as on March 31, 2018 increased to 131 mtpa from 128 mtpa as on March 31, 2017. Some of the large steel producers - including JSW Steel, Tata Steel, SAIL and NMDC - are already in the process of enhancing their combined capacities to the tune of 19 mtpa by the end of FY2022 as per the exhibit below.

EXHIBIT 2. Future capacity addition by domestic mills till FY2022



Source: Company data, ICRA research; capacity ramp-up plans of the recently acquired steel assets under IBC are not included here

In line with the growth rates registered in FY2018 and FY2019, if we assume domestic steel consumption to grow at a CAGR of 7% during FY2019-FY2022 period, the requirement of steel in India is likely to go up from 91 mt in FY2018 to 119 mt in FY2022, implying incremental volumes of around 28 mt. Even if we consider the capacity utilisation of these upcoming capacities at 90% (combined capacity utilisation of SAIL, Tata Steel and JSW Steel stood at about 91% in FY2018), there would be a supply deficit of about 10.9 mt, which would have to be met through imports. The import requirement would be significantly higher than the levels seen in recent years, with 7.5 mt of steel imports seen in FY2018.

Given this context, ICRA believes that the successful resolution of stressed steel assets under the IBC would provide some respite to the domestic steelmakers by reducing the supply deficit in the next three years. As against an installed capacity of 131 mtpa, the domestic crude steel production stood at 102.3 mt in FY2018, implying average capacity utilisation of 78% during FY2018. Considering that the top three steel producers in India comprising about 37% of the total installed capacity, operated at 91% capacity utilisation, other steel producers are estimated to have operated at about 72% capacity utilisation during FY2018. Assuming similar capacity utilisation rates for the stressed steel assets undergoing the IBC process as per Exhibit 1, the cumulative production of these assets in FY2018 is likely to have stood at about 17 mt. If we consider a gradual ramp-up of these assets in the first year (80% capacity utilisation) and a further ramp-up in the second year (90% capacity utilisation), post successful CIRP, ICRA expects the incremental production of about 1.9 mt and 4.3 mt to come on stream in the first and second year, respectively. The additional production would thus help in reducing the steel supply deficit to 6.6 mt from 10.9 mt in FY2022. Hence, ICRA feels that successful resolution of stressed steel assets under the IBC mechanism would be crucial to contain India's dependence on steel imports[2] in the medium term.

[2] Even though steel produced from the ramped up stressed capacities may not be fully import substitution products, higher supply would control import of commodity steel of flat category

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ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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