Markets

WEDNESDAY, JANUARY 16, 2019

LENDING SPREE

Rajiv Kumar, financial services secretary

"The growth of NBFCs was exponential when banks were cleaning themselves and a kind of a similar situation what happened to the banks in aggressive lending happened to NBFCs."

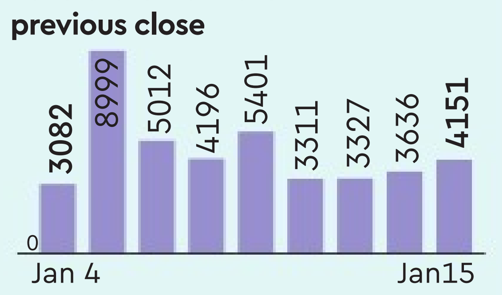
Money Matters

G-SEC

Benchmark yield falls due to buying support **0.565%**

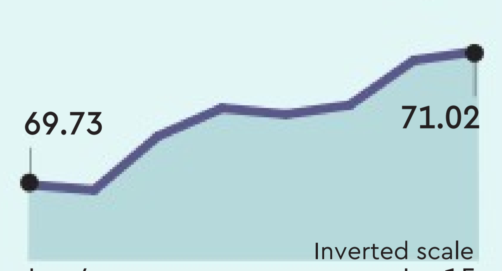
LAF

Banks' borrowing under RBI's short-term window rises by ₹515 crore from the previous close **14.16%**



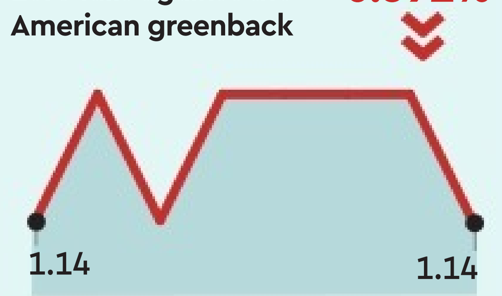
₹/$

Rupee depreciates due to global cues **0.132%**



€/$

Euro falls against the American greenback **0.392%**



LANCO INFRATECH LIQUIDATION

Bankrupt EPC firms under IBC feel heat

Already heavily indebted to lenders during bankruptcy, such firms are left with almost nothing under insolvency process

MITALI SALIAN
Mumbai, January 15

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 August 27 last year, a little over a year after the corporate insolvency resolution process (CIRP) was initiated on an application by IDBI Bank. However, the liquidation of Lanco Infratech would come as no surprise to anyone who has been tracking the fate of EPC companies under the Insolvency and Bankruptcy Code, 2016.

Unlike asset-heavy businesses such as power companies or in case of stressed hotels and restaurants where the land is owned or leased by the companies, the value of EPC firms is derived from intangibles like current order book and ongoing infrastructure projects, none of which survive intact once bankruptcy proceedings are initiated, anecdotal evidence suggests.

The Lanco Infratech counsel made a similar point as part of argument during the hearings to determine whether the corporate debtor should be admitted for proceedings under IBC. These arguments are laid out in an order dated Aug 7, 2017, admitting the debt-heavy company for CIRP that reads, "It is contented that the respondent/corporate debtor is the only holding company and EPC contractor for SPVs and others. So, Lanco has little value as it derives majority of its value from the investment it holds in the SPVs and EPC work it undertakes for its SPVs. Therefore, it is contented if under-construction SPVs are themselves stressed, the CIRP of LITL will not yield insolvency resolution, and it would lead to liquidation only."

As is known, soon after the Reserve Bank of India's February 12 circular, several of Lanco's subsidiaries, including Lanco Amarkantak Power, Lanco Anpara Power and Lanco Babandh Power, have since been referred to the NCLT for initiation of insolvency proceedings.

According to a banker at a large state-run bank, "In the case of Lanco Infratech, the only silver lining is that banks expect to get at least the equity value out of Lanco Amarkantak and Lanco Anpara."

Among major challenges facing EPC firms and their RPs is to keep the company alive as an on-going concern. The firms, already heavily indebted to lenders at the start of the bankruptcy process, have questionable future receivables despite several ongoing or near-completion projects, as these payments are usually guaranteed at the completion of specific stages of the projects.

More importantly, given the way several EPC firm contracts are designed, the initiation of CIRP gives the principal employer an opportunity to terminate the contract, disrupting the so-called order book, and in the process making the company less lucrative to prospective future investors. The lack of funds can prove a major road block to well-meaning RPs who take over management of the company. Bidding on fresh projects following the initiation of CIRP is also avoided, further hurting chances of the company with a prospective investor.

The major reason is that there are no major assets available with these EPC companies like other companies. Secondly, it is very difficult for banks to take a huge haircut on the loans. At times, the resolution applicants for the reasons like number of projects available, work in progress are not able to give even the liquidation value because some of the assets more particularly intangible one, won't fetch any value.

According to a banker at a large state-run bank, "Banks are fairly worse off in case of EPC companies where we have investors invoking guarantees even where projects are almost 90% complete. Banks are bleeding on these companies and someone needs to come up with a solution that can help these companies survive and help banks get a decent recovery out of the same."

A bank guarantee is a financial instrument and represents a bank's promise to take on liabilities on behalf of a particular debtor in the event that it fails to meet specified contractual obligations. The bank issues these guarantees for a fee that is a percentage of the amount of the entire contract.

According to Ashish Pyasi, principal associate with Dhir and Dhir associates, invocation of bank guarantees is employed by the principal employer as a means to secure the project and its investments. The bank guarantees, which are largely performance bank guarantee or guarantees that can be invoked even during the moratorium, are utilised to pay vendors and to complete the project by the principal employer.

He adds, "The bank guarantees are encashed even in cases where the project was completed 90% because after the CIRP, it's a herculean task for professional to complete the project without paying the previous dues of the vendors. If these vendors withdraw their support, the project cannot be completed. Till date there is no suggestion discussed at the policy or legislation level on a solution to salvage EPC firms during CIRP. But if these companies could go into liquidation as a going concern then the various projects can still be completed by the investors and various licences and experience which is available with the EPC can be utilised by the investor company."

In a nutshell, as Ajay Shaw, partner at DSK Legal, surmised, the value of the business of EPC firms as a going concern depends on three core assets of technical credentials commonly knows as pre-qualifications (PQs), order book and key skilled personnel.

An immediate fallout of an EPC company going under IBC is generally termination and termination-related disputes by the counterparts of underlying project agreements and invocation of performance bank guarantees, depletion of its order book size for various reasons such as EPC companies not bidding for fresh projects during the insolvency period and termination of engagement by the key skilled personnel.

These reasons majorly contribute to value deterioration of the assets of EPC companies under IBC which in turn reduces bidder participation and bidder interest such as in past instances of IVRCL, Unity Infraprojects, Lanco Infratech, etc.

Shaw elaborates, "Therefore, I do not believe the IBC is the best solution for EPC firms if one wishes to salvage the firm with any value and, if not all, in most cases EPC companies going through IBC are being pushed towards liquidation. If no bidders are in sight to acquire EPC companies under bankruptcy law at value required by lenders, as such resolution cannot be achieved. It may thus be advisable to seek a resolution for stressed EPC firms outside the aegis of the IBC by way of formal restructuring being invoked by bankers or under a compromise/arrangement with creditors with the blessing of the NCLT under Section 230 of the Companies Act, 2013, or through the security enforcement mechanism."

Role of credit rating agencies needs to be introspected: Kumar

PRESS TRUST OF INDIA
New Delhi, January 15

IN THE WAKE of IL&FS crisis, there is a need to review role of rating agencies as they continued to rate the NBFC at top notch investment grade even a day before it defaulted on its payment obligation, a top finance ministry official said.

IL&FS, a large systemically important non-deposit accepting core investment company, sent markets into tizzy with series of default beginning August last year. Rating agencies failed to see the financial troubles brewing and judge the ballooning debt of IL&FS. Following the series of defaults, the credit rating industry came under scrutiny.

While banks were busy with the clean up exercise, NBFCs went on aggressive lending spree, financial services secretary Rajiv Kumar said. "The growth of NBFCs was exponential when banks were cleaning themselves and a kind of a similar situation what happened to the banks in aggressive lending happened to NBFCs.

"Some of the NBFCs which have grown more than the normal needs a correction in terms of the asset quality management and at the same time needs to be regulated more intensely than what have been. Also the role of credit rating agencies need to be introspected and looked at as to how entities can remain AAA and suddenly can come 8 notches down in a day. So, these roles have to be seen," he said.

IL&FS, which has been downgraded to junk status by rating agencies, is sitting on a debt pile of around ₹91,000 crore. Of this, ₹57,000 crore are bank loans alone, most of which are from state-owned lenders. State-owned LIC is the largest shareholder with a fourth of the firm's equity, while Orix Corporation of Japan owns 23.5%.

Other shareholders include Abu Dhabi Investment Authority with a 12.5% stake, IL&FS Employees Welfare Trust with 12%, HDFC with 9.02%, Central Bank of India with 7.67% and State Bank of India with 6.42% at the March-end 2018.

In a bid to align with the best corporate practices, the finance ministry has asked PSBs to gradually bring down the government's equity to 52%.

Quick View

Cabinet may consider capital infusion plan for Exim Bank today

THE UNION CABINET on Wednesday is likely to consider fund infusion in Export-Import Bank of India (Exim Bank). The Cabinet meeting may take up a host of issues including a capital infusion of ₹500 crore in Exim Bank. The infusion would help the bank expand its business. The government infused ₹500 crore in Exim Bank last financial year. Exim Bank commenced operations as a purveyor of export credit, mirroring global export credit agencies.

Maha to invest ₹100 cr more in MSC Bank

THE MAHARASHTRA GOVERNMENT has decided to invest an additional ₹100 crore towards the paid-up share capital in Maharashtra State Cooperative Bank. The government had earlier invested ₹100 crore. For the last 5 years, the bank has given a dividend of 10% to the state government which is ₹10 crore per year. Considering this, the state government has decided to invest the additional ₹100 crore, Vidyadhar Anaskar, chairman, board of administrators, said. The state government has directed the state bank to review the financial condition of District Cooperative Bank of Vidarbha, Nagpur, Wardha and Buldana.

Rupee plunges further, settles below 71-level

PRESS TRUST OF INDIA
Mumbai, January 15

THE RUPEE ON Tuesday plunged by another 13 paise to close at one-month low of 71.05 against the US dollar amid strengthening greenback and surging crude oil prices.

At the Interbank Foreign Exchange, the rupee opened weaker at ₹70.79 then lost further ground and fell to a low of 71.15 against the American currency. The domestic unit, however, gained some strength and finally settled at 71.05 a dollar, down 13 paise over its previous close.

This was the third straight session of loss for the rupee. The domestic currency on Monday plunged by 43 paise to close at nearly one-month low of 70.92 against the US dollar. The rupee has lost 64 paise in these three sessions.

Forex traders attributed the rupee plunge to rising crude prices. However, heavy buying in domestic equities and fresh foreign fund inflows restricted the fall in the local unit to some extent. Stronger dollar against its key rival currencies impacted the rupee trading pattern, they said.

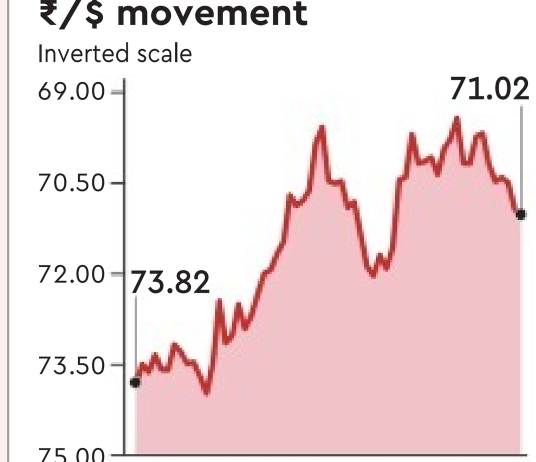
The dollar index, which gauges the greenback's strength against a basket of six currencies, was higher by 0.22% to 95.81 in the late afternoon trade. Brent crude, the global benchmark, was trading at $59.81 per barrel, higher by 1.39%.

Foreign funds bought shares worth ₹159.60 crore from the capital markets on a net basis and domestic institutional investors purchased shares worth ₹417.44 crore on Tuesday, provisional data showed.

The Financial Benchmark India Private (FBIL) set the reference rate for the rupee/dollar at 71.0298 and for rupee/euro at 81.5048. The reference rate for rupee/British pound was fixed at 91.6242 and for rupee/100 Japanese yen at 65.37.

The 30-share index on Tuesday settled 464.77 points, or 1.30%, higher at 36,318.33, while the broader NSE Nifty rallied 149.20 points, or 1.39%, to finish at 10,886.80.

₹/$ movement



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Syndicate Bank eyes 10% rise in advances under Mudra scheme

FE BUREAU
Ahmedabad, January 15

DESPITE THE RESERVE Bank of India's (RBI) concern over the NPAs under the Modi government's flagship scheme to support micro enterprises in India — Pradhan Mantri Mudra Yojana — public sector lender Syndicate Bank is eyeing at least 10% growth in advances under Mudra scheme.

"Syndicate Bank is primarily lending money to small businesses. The bank's NPA in the Mudra Yojana is around 10% compared to gross NPA of the bank which is 12.98%," said the bank's executive director Ajay Kumar Khurana.

According to Khurana, the bank has already financed around ₹7,100 crore through 4.45 lakh accounts. Of these, NPA in Mudra advances is around ₹700 crore, he added. Against the total advances of ₹2,10,000 crore, the bank currently has a gross NPA of around ₹27,100 crore.

The Syndicate Bank management was proactive to reduce the NPA significantly, he said, adding, "As part of it a vertical called Stress Asset Management (SAM) has been created during the first week of 2019. A dedicated workforce containing 1,200 personnel would work for the recovery and constantly followup NPA accounts."

The team members working under SAM would be trained by the experts to tackle the NPA accounts and force them to repay loans as quickly as possible, said Khurana. They would approach the National Company Law Tribunal and other legal bodies apart from door-to-door visits for fast recoveries.

ANALYST CORNER

Retain 'hold' on Jet Airways, maintain target price at ₹235

EDELWEISS

PRESS REPORTS INDICATE that Jet Airways' lenders have proposed a restructuring plan involving a fresh infusion of ₹1,500 crore by Etihad, ₹400 crore by Naresh Goyal and conversion of ₹600 crore debt to equity (at current market price) by lenders. If accepted, the plan will lead to: 1) dilution of Goyal's equity to 34%, implying loss of majority stake & control over the board of directors; and 2) complete pay-off of ₹3,000-crore debt maturing towards FY19-end with zero haircut for lenders. Implementation of this plan, however, is contingent on Jet getting a clean chit in the SBI-ordered forensic audit, outcome of which is expected by January-end. That said, we have incorporated our revised SOTP factoring in the proposed restructuring. Given high uncertainty surrounding this plan, we retain 'Hold' and target price at ₹235.

Based on this plan, we expect Jet to generate a positive cash flow of ₹300 crore over FY19-21 versus our previous estimate of a negative cash flow of ₹2,870 crore. Interest coverage will improve to 1.2/2.2x in FY20E/FY21E versus our earlier estimate of 0.9/1.6x owing to lower interest outgo on account of the reduction in debt as well as borrowing cost (down 50bps due to repayment of costlier debt). Z-score (an indicator of bankruptcy risk) for FY20 will thus improve to 2.35 from 0.15.

Factoring in FY20-FY21E oil prices at $65-75/bbl and PAX growth of 2-5%, we estimate Jet to generate positive operating cash flow of ₹2,700 crore over the next two years. We, therefore, believe Jet will scale up its fleet capacity, which has been stagnant (100-110 planes) since 2012. An uptick in PAX growth will drive a significant re-rating of the stock—5% change in PAX growth will lead to a 17% earnings revision.

Lower L&T estimates by 3-4%

KOTAK INSTITUTIONAL EQUITIES

ORDERS FROM STATES/PSUs should continue based on past history of capex spending by states (fiscal targets a limited constraint) and reasonable leverage/capex plans of PSUs. The same has helped L&T grow business levels despite a slowdown in private sector investments and lack of support from the Centre. We note enabling conditions for a revival of private corporate capex and profitability that can meaningfully aid L&T's PAT growth over time. We lower estimates by 3-4% on weak near-term order prospects; maintain fair value on roll-forward.

States and PSUs account for two-thirds of L&T's order backlog. States' spending has been less governed by fiscal deficit targets in the past and capex share in overall spending has been consistently increasing. Even PSUs, given their capex plans and limited leverage, should continue to order at a steady pace. Current fiscal constraints may limit orders in the near term from the Centre (15% share of the order backlog). Private sector's share (both domestic and overseas) has reduced to 20% over the last three years, reflective of deterioration in demand conditions in core industries (power, steel) and later in services (real estate, IT, healthcare).

We see enabling conditions for recovery in private sector capex in (1) improving capacity utilisation, (2) modest leverage for BSE-500 (private sector) and (3) steady growth trends in demand (PMI). Our assessment of BSE-500 (private sector) suggests strong capex potential if the fixed asset base of ₹29 lakh crore starts growing fast. L&T presently gets ~₹20,000 crore of annual run-rate ordering from the private sector in a recurring capex of ₹2.5 lakh crore per annum for the BSE-500 private sector companies. This capex is a derivative of an 11% CAGR in gross fixed assets over the past six years versus a 30% CAGR seen in the last upcycle (FY2005-12).

The incremental benefits of digitisation (tracking machine utilisation) should reflect in margin from hereon; benefits thus far have helped negate the impact of hardening commodity prices and worsening mix of revenues. (2) steady profitability at a double-digit revenue growth and 20% working capital would suffice to take care of dividends, capex and investments. (3) We also note the potential reduction in total tax outgo for the consolidated-ex services business if the loss-making Shipbuilding business gets merged into the parent.

Global funds sell India sovereign bonds, buy company debt

BLOOMBERG
Mumbai, January 15

OVERSEAS INVESTORS ARE selling India's government bonds, but they still have faith in the nation's corporate debt.

Global funds cut holdings of the nation's sovereign securities by ₹3,350 crore ($472 million) in the first two weeks of this year after selling ₹1,100 crore in December, data from the Clearing Corporation of India showed. They snapped up a net ₹1,490 crore of corporate bonds after buying ₹8,600 crore last month.

Investors are being attracted by the extra yields on company paper, which compensate for the extra risk being taken on. The spread over 10-year sovereign debt jumped to 128 basis points in early January, the most in almost a year, from 83 basis points at the end of September.

"Buying corporate paper provides some cushion and better carry," said Vivek Rajpal, a rates strategist at Nomura Holdings in Singapore. Even though spreads have started to come back down, they still remain relatively wide on a historical basis, he said.

The extra yield on corporate bonds expanded last quarter as sovereign securities rallied following a slide in oil prices that eased the threat of inflation and as the central bank bought debt through its open-market operations. Government 10-year yields fell 66 basis points, the biggest drop in four years, while those on corporate bonds slid 34 basis points.

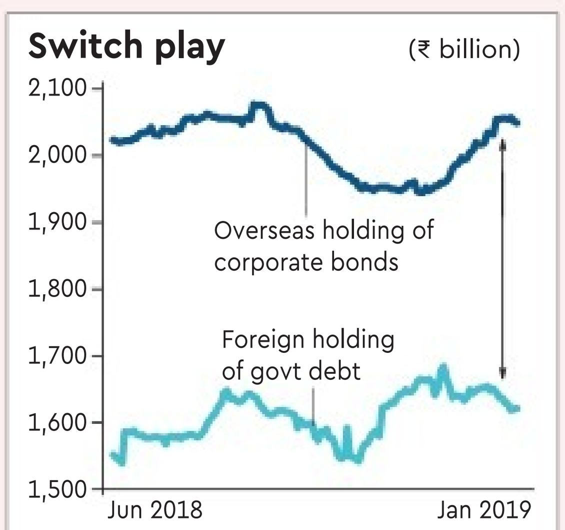
Aberdeen Standard Investments has advised investors to sell India's government bonds due to concern about fiscal slippage as the ruling party gears up for an election this year. At the same time, it is buying quasi-sovereigns and corporate debt because of the high spreads, investment manager Lin Jing Leong said last week.

Aviva Investors, which limits its bond investment in India to government debt, said it is not looking at add to its holdings just now. "There are a number of favorable factors including lower oil prices, declining inflation and the ongoing open-market purchases, but fiscal risks are rising ahead of the election," said Stuart Ritson, portfolio manager for emerging-market debt at Aviva in Singapore.

The yield on India's most-traded 7.17% bonds due in January 2028 bonds has climbed to 7.47% from an eight-month low of 7.22% last month. Yields rose four basis points on Tuesday after core inflation continued to remain sticky in December, despite easing in headline print.

"The view late last year was that the Indian fiscal situation was projected to deteriorate and government bonds haven't adjusted to the reality of a worsening fiscal situation," said Manu George, director of fixed income at Schroder Investment Management in Singapore. "So relatively speaking, corporates look better than government bonds."

Switch play (₹ billion)



Source: National Securities Depository, Bloomberg