



# Investment Opportunities in M&A and Stressed Assets and Management Buyouts under IBC

June 2019



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# Stressed Assets - Overview

# Overview of Stressed Assets - Indian Banking System

**Stressed assets in India have seen a significant increase over the years**

> ₹ 1,020,000 crores  
(> US\$ 140 billion)

of stressed assets in the  
Indian Banking System

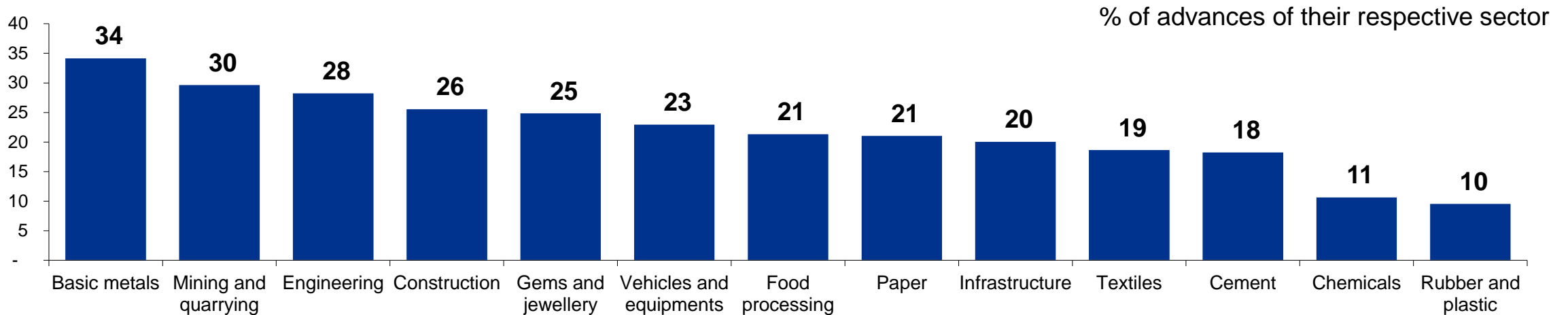
~ 10.8 %

of total advances are gross  
non-performing assets

~ 0.5 %

of additional advances are  
restructured standard in nature

**Metals, mining, engineering and construction are some sectors witnessing high levels of stress**



Data is as of September 2018 | Source: RBI Financial Stability Report



# Insolvency & Bankruptcy Code, 2016 (IBC)

# Resolution through IBC - A Game Changer

1	<ul style="list-style-type: none"><li>• Overhauls multiple legacy laws – validity upheld through various rulings</li><li>• Framework for comprehensively addressing all stakeholders</li></ul>	<b>Comprehensive Legislation</b>
2	<ul style="list-style-type: none"><li>• Court-supervised process; plan is binding on all stakeholders</li><li>• Various judgments and rulings have aided practical implementation of the law</li></ul>	<b>Wide Acceptance</b>
3	<ul style="list-style-type: none"><li>• Restriction on existing sponsor participation encourages third party interest</li><li>• Diverse set of opportunities; growing participation from investors</li></ul>	<b>Highly Impactful</b>
4	<ul style="list-style-type: none"><li>• Ability to address legacy issues &amp; claims of various stakeholders using one platform</li><li>• Wide auction process with structuring flexibility not available outside NCLT</li></ul>	<b>Opportunity for Value</b>
5	<ul style="list-style-type: none"><li>• Investors gaining comfort on the process given number of successful closures</li><li>• Control with RP gives confidence on management of operations &amp; resolution process</li></ul>	<b>Greater Investor Participation</b>
6	<ul style="list-style-type: none"><li>• Well defined process with key milestones and timelines laid down in the regulations</li></ul>	<b>Time - Bound Resolution</b>

IBC: Insolvency and Bankruptcy Code, 2016 | NCLT: National Company Law Tribunal | RP: Resolution Professional



# Resolution Process - Current Status (1/2)

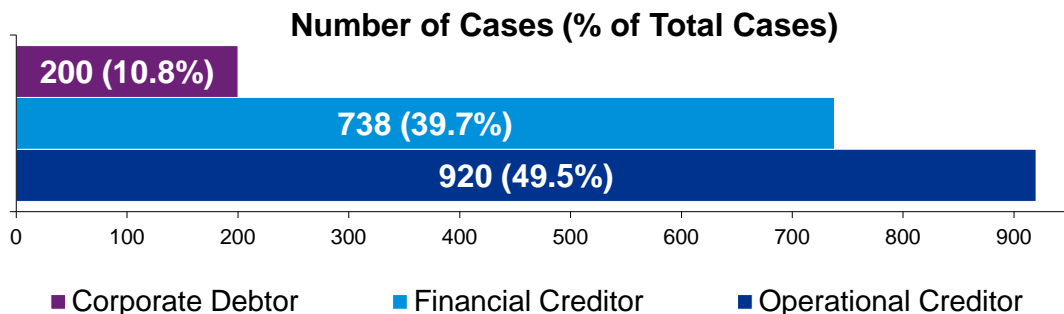
## Large number of cases admitted in IBC

Total Cases Admitted - 1,858



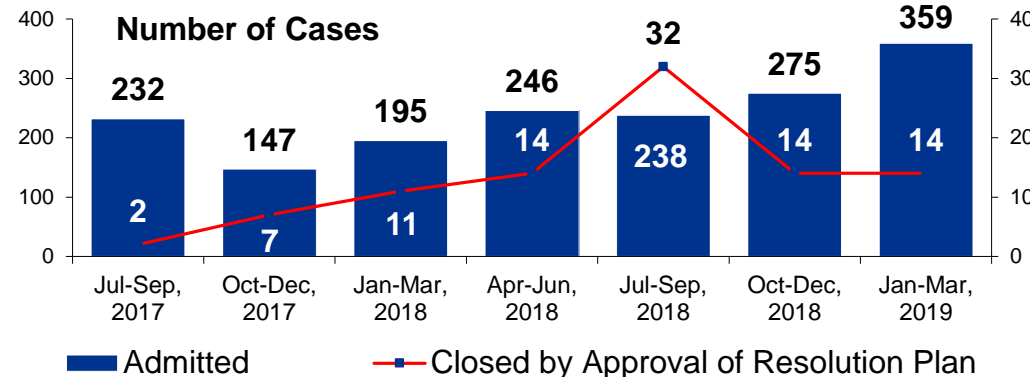
➤ Of the 378 cases under liquidation, ~75% were either earlier in BIFR and / or defunct

## Most Resolution Processes triggered by Operational Creditors



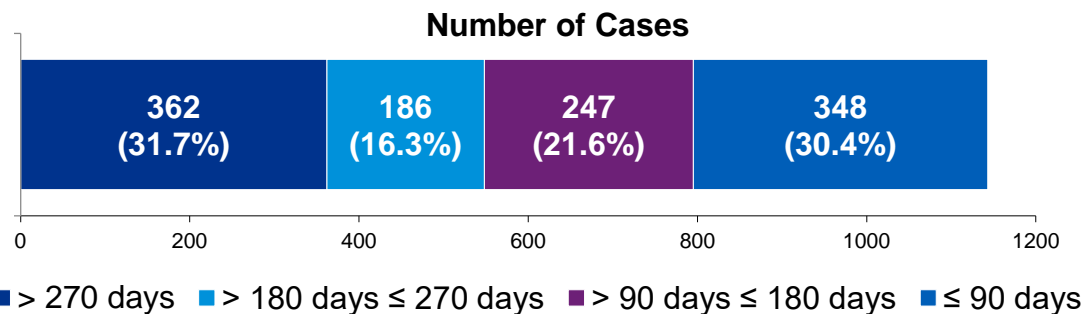
➤ Of the 1,858 cases admitted, ~50% have been filed by Operational Creditors

## Resolution under IBC is gathering pace



➤ Of the 94 cases closed by NCLT's approval of Resolution Plan, >75% have been in the last 1 year

## Resolution timelines in ongoing cases

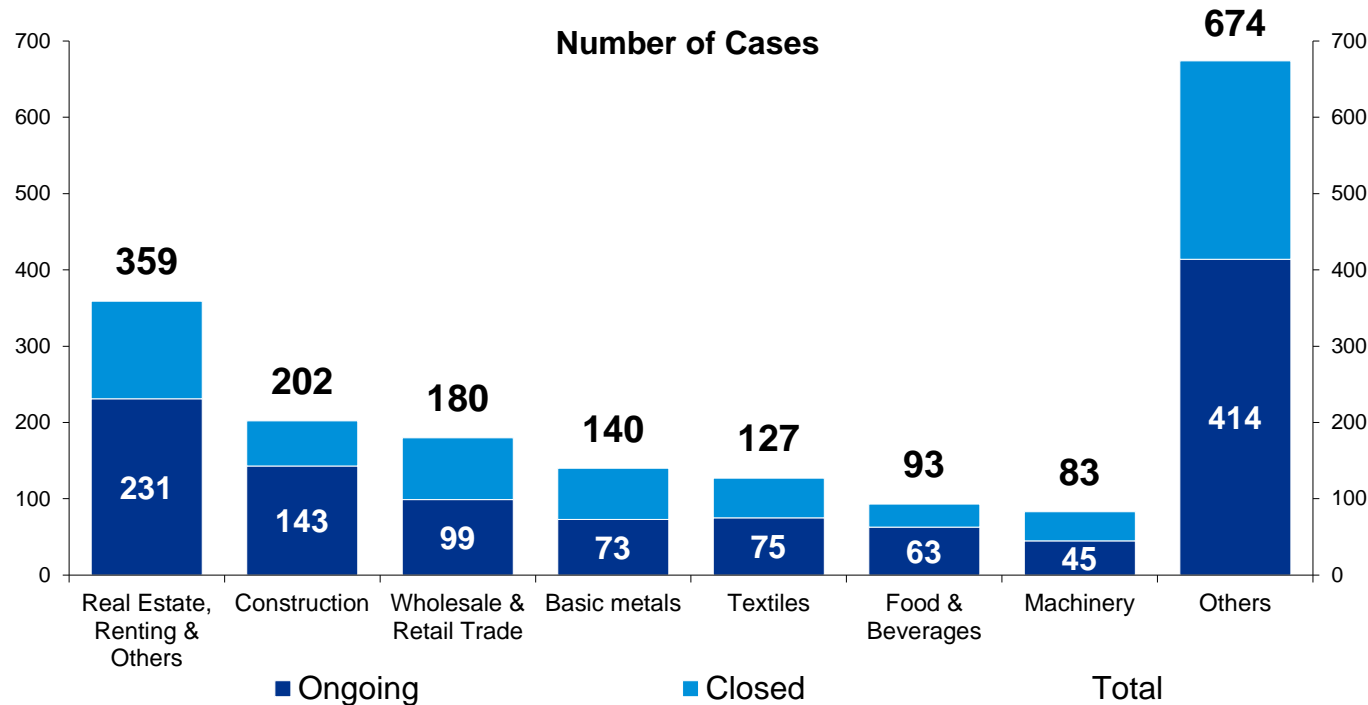


➤ Of the 1,143 ongoing cases, >50% have been admitted within the last 6 months

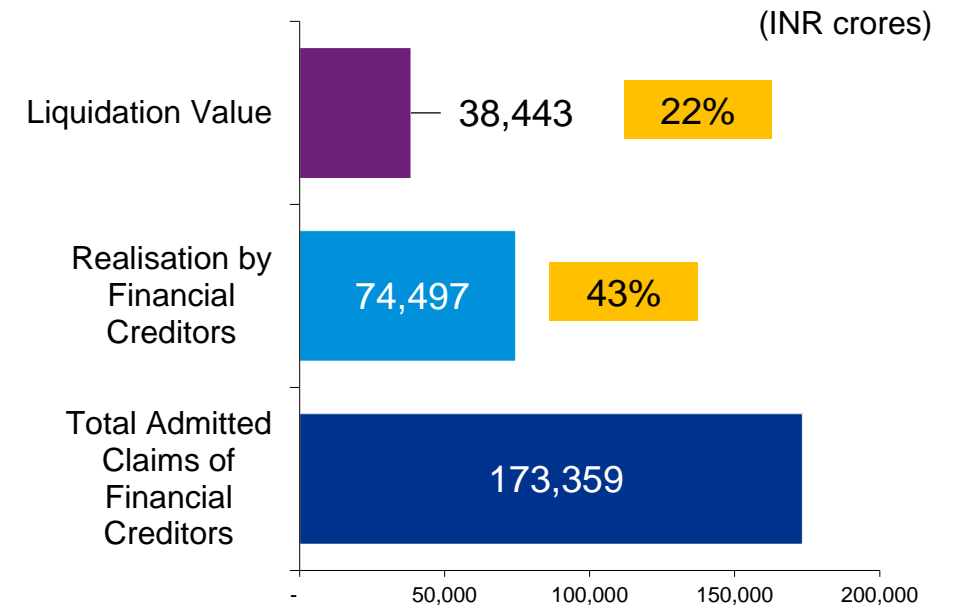
RP: Resolution Plan | Data is as of March 2019 | Source: Insolvency and Bankruptcy Board of India (IBBI)

# Resolution Process - Current Status (2/2)

## Maximum admissions in the Resolution Process are from manufacturing



## Recovery higher than liquidation value



➤ **Of the 1,858 cases admitted, 772 cases (> 40%) pertain to the manufacturing sector – of which 448 are currently undergoing CIRP**

➤ **In the 94 resolved cases, average recovery by financial creditors is ~ 43%**

➤ **Of the 772 manufacturing cases admitted, maximum number of cases (about 18%) are from basic metals, followed by textiles (about 16%)**

➤ **This recovery is significantly higher than the liquidation value of ~ 22%**

Manufacturing includes food & beverages, chemicals, electrical machinery, fabricated metal products, machinery, textiles, wood, rubber, plastic & paper products, basic metals and others | Data is as of March 2019 | Source: IBBI



# Key Events Impacting Resolution Processes

Since the enactment of IBC, there have been a number of changes based on ongoing learnings and through various judgments

IBC amended to give **homebuyers** the status of **financial creditors**

Supreme Court ruled that **creditors of a similar type** should be treated **similarly**

IBC amended to bring down voting threshold from **75% to 66%** for approval of a resolution plan

IBC amended to include **Section 29A**, restricting defaulting promoters from participating

NCLT ruled that **contractual commitments** (put option, non-disposal undertaking, etc.) be treated as **financial debt**

IBC amended to include **Section 12A**, allowing withdrawal of case post admission on obtaining 90% CoC approval

SEBI **exempted IBC acquisitions** from making the mandatory open offer and from delisting regulations

IBC amended to accord **priority** in payment for unsecured **operational creditors** ahead of financial creditors

NCLAT ruled that **statutory liabilities**, including income tax, be treated as **operational debt**

CoC: Committee of Creditors | SEBI: Securities and Exchange Board of India | NCLAT: National Company Law Appellate Tribunal



# Stressed Assets - Trends

# Expected Trends in Resolution Going Forward

1

## More mid-market cases expected in IBC

- Larger cases (first list of 12 cases and second list of ~ 25 cases) are already resolved / undergoing resolution in NCLT
- **More mid-market cases** across various sectors expected to be referred for resolution in NCLT
- Opportunity for strategic investors to **pursue inorganic growth and consolidate assets**

2

## Debt aggregation and COC composition

- Growing trend of **lenders selling their NPA portfolios** to ARCs/funds given time taken for resolution in NCLT
- **Debt aggregation** expected as banks sell exposure to ARCs
- COC's to have **more diverse composition** including ARCs & SSFs

3

## New trends in resolution

- **Section 12A:** Invocation of IBC; however can withdraw if resolution plan is accepted by 90% creditors
- **Pre-Packaged Insolvency: Pre-negotiated corporate reorganization plan before** approaching NCLT, reducing the costs and time taken for resolution
- **RBI Circular:** With greater flexibility (30 days buffer, 75% voting threshold through ICA, etc.), RBI's recent circular will aid in **timely resolution** by introducing disincentives for delays through higher provisioning

ARC: Asset Reconstruction Company | SSF: Special Situations Fund | ICA: Inter-Creditor Agreement



# Investment Avenues - Strategic & Financial Investors

# Investment Avenues for Corporates

Multiple avenues possible for investment depending on financial capability, mode of resolution and investment preferences

## Bid Alone

- Corporates with resources can **bid alone** for stressed companies, either in NCLT or outside NCLT, enabling them to acquire assets at discount to replacement cost
- Number of **assets are operational**, with approvals in place and good prospects for revival
- Opportunity in a number of sectors to **aggregate capacity through consolidation theme**

## Partner with a Financial Investor





- Partner with ARCs and Special Situation Funds to **bid jointly** for stressed companies, either in NCLT or outside NCLT
- Financial investors have a limited **investment horizon of 3-5 years** and would seek exit
- **Diversification of risk**, with ability to avoid exposure to parent balance sheet

## Mode of Partnership

- Partner with financial investor to set up a stressed asset platform to bid for assets, either in NCLT or outside NCLT
  - **Committed Partnership:** All opportunities in the sector to be jointly evaluated by the platform; useful where there are larger number of mid-size assets for consolidation
  - **Deal-specific Co-investment:** Deal-to-deal partnership for specific cases

# Investment Avenues for Financial Investors

Multiple avenues possible based on investment preferences

Deal Type	Opportunity Size	Timelines	Due Diligence	Investment Horizon	Expected Returns
Loan Buyouts					
Portfolio Investments					
Financing Sponsors					
Financing Strategic Buyers esp. in NCLT					
Structured Credit					
Priority Financing					

Legend:  Very High  High  Medium  Low  Very Low



# Key Considerations for Financial Investors

*Choice of local partner is key*

- Existing promoters are largely restricted in NCLT due to Section 29A
- Most assets require turnaround expertise as they are operating sub-optimally

*Opportunity for serious bidders*

- Assets available at attractive prices vs. time and cost of greenfield buildout
- Ability to dilute existing sponsors and take control
- Legal framework to address claims and liabilities, including legacy matters

*Lender driven process*

- Strong relationship with creditors is important
- Managing interests of all stakeholders and equitable resolution is key

*Limited time for due diligence*

- Auction process with limited time for diligence; typically data limitations as well
- Needs significant management bandwidth and attention
- Process has to be completed in a time-bound fashion



# Management Buy-outs

# Management Buy-outs

*Management buy-outs – **management teams can partner with financial investors** wherein financial investor provides the acquisition capital and the management team is focused on turnaround and revival of the business*

## **Key Considerations**

- Management has demonstrated **ability to operate and turnaround** assets in the domestic market
- **Incentive alignment** through some initial capital infusion & earn-out based on milestones
- Especially suitable for sectors where there is **consolidation at play** and opportunity to build up platforms (such as steel) with exit through capital markets or trade sale
- Suitable for situations where deep **value creation** is possible through **operational turnaround** of the asset besides financial restructuring
- Existing management could also play a role provided **Section 29A considerations** are addressed

**Management teams are suitable for smaller acquisitions where larger strategic investors may not be interested**



# Select Cases

# Select Cases

	Case 1	Case 2	Case 3
Service	<b>Financial Investor:</b> <i>Buy-side Advisory</i>	<b>Strategic Investor:</b> <i>Buy-side Advisory</i>	<b>Resolution Professional:</b> <i>Resolution Process Advisory</i>
Opportunity	<i>Bid for an education <b>infrastructure</b> company in IBC</i>	<i>Bid for a <b>food processing</b> company in IBC</i>	<i>Assist with the resolution process of a <b>wind energy company</b> in IBC</i>
Key Challenges	<ul style="list-style-type: none"><li>• Finding the <b>right local</b> partner with the financial investor given niche space</li><li>• Determining <b>business value</b> given complex operations with a mix of core and non-core assets</li><li>• Balancing <b>lender expectations</b> through appropriate structuring given potential future upside vs. low current value</li></ul>	<ul style="list-style-type: none"><li>• Gathering <b>market intelligence</b> to understand potential interest from other strategic investors</li><li>• Constant dialogue with the RP and creditors to understand <b>asset and process nuances</b></li><li>• Navigating the <b>intricacies of the IBC process</b> being a first-time bidder in IBC with specific needs</li></ul>	<ul style="list-style-type: none"><li>• Ensuring <b>competitive bidding</b> and maximizing participation in the process</li><li>• <b>Positioning the asset</b> on its merits and sustaining investor interest given asset complexities</li><li>• Ensuring <b>fair and transparent process</b> while meeting stakeholder objectives</li></ul>



# Key Takeaways



# Key Takeaways

**1**

- **Advent of IBC has resulted in growing investor interest in stressed assets**
- **Size of market opportunity and capital availability is driving this interest**

**2**

- **Optimum resolution method is situation-specific, based on sector, etc.**
- **Some assets are better suited for resolution under IBC than others**

**3**

- **Financial investors are seeking returns with downside protection**
- **Strategic investors are exploring inorganic growth with best fit and have longer investment horizon**

**4**

- **Growing investor comfort with larger number of resolution cases closed**
- **However, quick decision making by stakeholders, equitable resolution minimizing challenges & disputes, and time-bound implementation is key**

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