Less bang for buck ahead

Next round of stressed assets could see lower recovery rates

June 2019

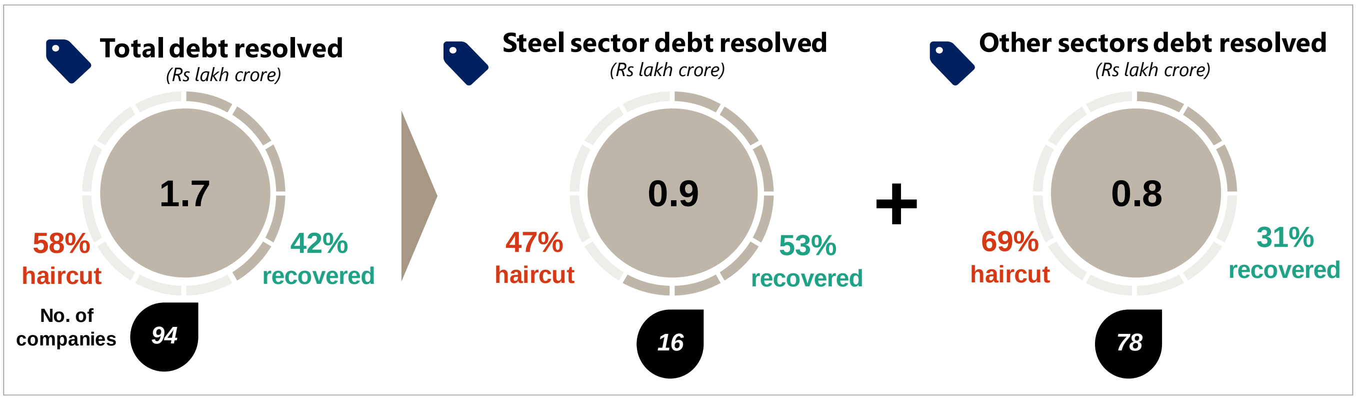
Tracing the clean-up so far

The Insolvency and Bankruptcy Code, 2016 (IBC) has made good progress by resolving the cases of ~94 companies with stressed liability of Rs 1.7 lakh crore as of March 2019. The recovery amounted to ~Rs 0.7 lakh crore, translating into a haircut of ~58% for financial and operational creditors.

The disaggregation of these numbers throws up an interesting aspect: Just 16 steel assets had more than half – Rs 0.9 lakh crore to be exact – of the overall stressed debt, and the haircut required was 47%.

The balance stressed debt worth Rs 0.8 lakh crore involved 78 assets spanning textiles, construction, and auto components, among others. The haircut here was around 69%.

Status of debt resolved under IBC as of March 2019

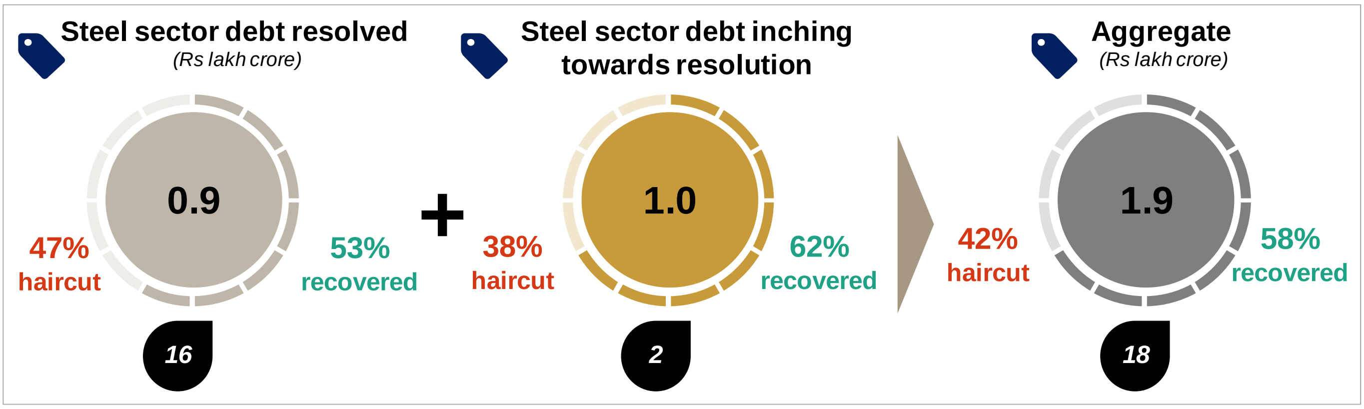


Source: Insolvency and Bankruptcy Board of India, CRISIL Research

Further, if we consider two steel assets from the National Company Law Tribunal-I (NCLT-I) list that are inching towards resolution / closure, the total liability resolved in the steel sector will double to Rs 1.9 lakh crore. Here, as much as Rs 1.1 lakh crore would be recovered, which translates into a haircut of 42%.

The hair cut would be significantly lower than any other sector's debt that got resolved under IBC as of March 2019.

Status of steel sector debt resolved/ inching towards resolution under IBC



Source: Insolvency and Bankruptcy Board of India, Industry, CRISIL Research

Note: Essar Steel and Bhushan Power & Steel (BPSL) are inching resolution under NCLT-I. Highest last bid has been considered for recovery

However, the matrix of debt resolved/ inching towards resolution in steel space is fairly skewed, with 84% of the Rs 1.9 lakh crore of liability being held by 3 large integrated steel players, 14% by 6 long integrated players (sponge iron, billets, and TMT-thermo-mechanically treated), and the balance by 9 players operating in the sponge iron, alloy steel, and re-rolling business.

Further, recovery is way higher for large integrated steel players (ISP) at ~63%, compared with 32-33% for long integrated players and small sponge iron and alloy steel makers.

This is largely to do with attractive demand-supply dynamics and higher realisations in the flat steel space, which is the key segment of operation for large integrated steel players. Location, integration across the value chain, and scale of operations were the additional advantages.

Status of steel sector debt resolved/ inching towards resolution under IBC

	Large ISP resolved: Bhushan Steel	Large ISP resolving BPSL and Essar	Long integrated players	Sponge iron	Alloy steel
Liability Rs bn	575	1000	279	12.1	5.1
Realised	368	617	91	4.8	0.9
Haircut	36%	38%	68%	61%	83%
No. of companies	1	2	6	3	2

Source: Insolvency and Bankruptcy Board of India, Industry, CRISIL Research

For large ISP resolving (i.e. BPSL and Essar Steel), we have considered the highest amount in the final bids.

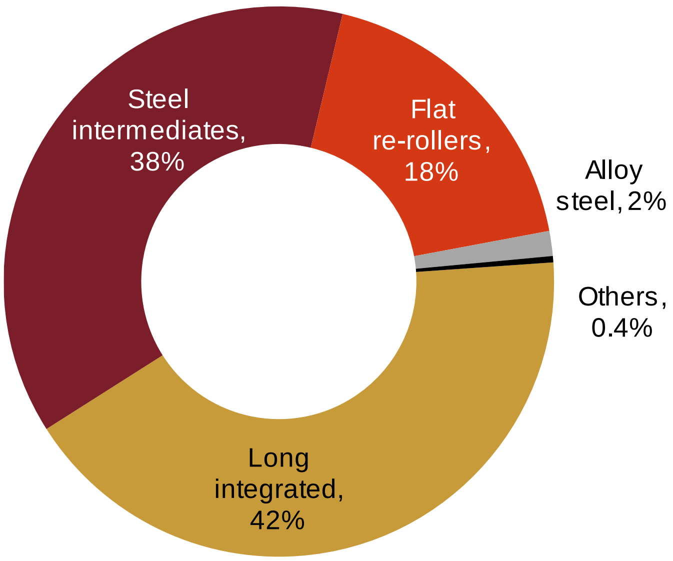
Others would include 1 alloy steel player that got liquidated and 3 re-rollers

Next lot with debt outstanding of ~Rs 62,000 crore could see lower recovery rates

With an outstanding liability of ~ Rs 62,000 crore as on March 2019, the top 17 stressed assets in the steel sector today are expected to seek or are seeking resolution through the IBC. This would include five steel assets referred by the Reserve Bank of India as part of NCLT-II round earlier.

Unlike the first wave of debt clean-up the upcoming resolution cases shall largely be smaller assets concentrated in the long integrated, sponge iron, and flat-rerolling space. Of the Rs 62,000 crore outstanding liability, 42% resides with 6 long integrated players, 38% with 6 sponge iron / pig iron players, 18% with 3 flat re-rollers, and the balance with alloy steel and other players.

Break-up of Rs 62,000 crore of stressed debt (upcoming resolution cases)



Source: Industry, CRISIL Research

Considering the benchmarks of similar assets that have been resolved over the past three years, the recovery rates are expected to be lower, driven by specific factors in each major segment:

- **Long integrated:** Long steel demand is expected to be healthy at 6-7% over fiscals 2020 and 2021, driven by government-led initiatives in affordable housing, railway, MRTS, and road investments. However, with large players such as SAIL, RINL and JSPL ramping up capacities this fiscal, competition would intensify for smaller players. Also, earlier, benchmarks for recovery for similar cases under IBC was estimated at just 32%.

- **Steel intermediates-Sponge iron:** Sponge iron demand is expected to moderate to 3-4% over the next two fiscals despite healthy demand for long steel. Scale-up by larger players and substitution by scrap and pig iron would curb growth for sponge iron players.

- **Flat re-rollers:** The flat steel segment's growth is expected to moderate to 5-5.5% over the next two fiscals from 7% over previous two fiscals because of a slowdown in automotive sales and sedate demand for capital goods. Further this is a highly consolidated market, with large players commanding high market share. Global trade barriers would also curb exports for flat re-rollers. The top two cases under resolution have received bids indicative of 29-31% recovery only.

- **Alloy steel:** Special alloy steel demand is expected to slow-down to 4.5-5.5% over the next two fiscals from 7-7.5% over previous two fiscals because of a slowdown in automotive sales. Further it is a highly fragmented market fortunes of which is primarily linked to Auto sector's performance.

The next round of stressed assets resolution in the steel sector

	Liability Mar 2019	No. of companies	Segment demand growth FY20 &FY21	Competitive position FY20 & FY21	Recovery for the segment in earlier IBC
Long Integrated	**42%**	**6**	**6-7%**	Scale-up by large players (SAIL, RINL, JSPL)	32% recovery in earlier IBC cases for long integrated players
Sponge Iron	**38%**	**6**	**3-4%**	Scale-up by large players; substitution by pig iron and scrap	39% recovery in earlier IBC cases for sponge iron players
Flat Re-rollers	**18%**	**3**	**5-5.5%**	Ramp-up by resolved ISPs and trade barriers	30% recovery (highest bids for 2 re-rollers)
Alloy steel	**1.5%**	**1**	**4.5-5.5%**	Largely fragmented leading to increased competition	17% recovery in earlier IBC cases for alloy steel players
Total	**Rs. 62000 crore**				

Source: Insolvency and Bankruptcy Board of India, Industry, CRISIL Research

Remaining 0.5% resides with long re-rollers

Clean-up to infuse investments; under-utilised capacities resolved through the NCLT-I process will also ramp up

As acquired capacities change hands and large groups take over their reins, there would be higher capital expenditure. Capacities of five steel assets that are under the NCLT-I process now can (also because of land availability), nearly double from the current 22 million tonne (MT) to 41 MT. Further, large players such as Tata Steel and JSW are also on an expansion spree. JSW is increasing capacity by 11.7 MT and Tata by 6 MT by fiscal 2024.

Overall, the steel sector is set to see 28-30 MT capacity addition, apart from ramp-up of under-utilised capacities (resolved NCLT-I cases). All that would keep utilisation levels at 80-82% -- the same as now – by fiscal 2024.

These developments would, in turn, curb aggressive bidding during the next round of stressed assets resolution.

Analytical contacts

Hetal Gandhi
Director-CRISIL Research
CRISIL Limited
B: +91 22 3342 3000
hetal.gandhi@crisil.com

Isha Chaudhary
Associate Director-CRISIL Research
CRISIL Limited
B: +91 22 3342 3000
isha.chaudhary@crisil.com

Sushmita Vazirani
Analyst-CRISIL Research
CRISIL Limited
B: +91 22 3342 3000
sushmita.vazirani@crisil.com

Media contacts

Saman Khan
Media Relations
CRISIL Limited
D: +91 22 3342 3895
M: +91 95940 60612
B: +91 22 3342 3000
saman.khan@crisil.com

Hiral Jani Vasani
Media Relations
CRISIL Limited
D: +91 22 3342 5916
M: +91 982003 9681
B: +91 22 3342 3000
hiral.vasani@crisil.com

Parmeshwari Bhumkar
Media Relations
CRISIL Limited
D: +91 22 3342 1812
M: +91 841184 3388
B: +91 22 3342 3000
parmeshwari.bhumkar@ext-crisil.com

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CRISIL Limited: CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400076. India

Phone: + 91 22 3342 3000 | Fax: + 91 22 3342 3001 | www.crisil.com

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