

Restructuring corporate debt

February 27, 2009

Agenda

Concepts of restructuring

Restructuring overview – Indian laws

Restructuring overview – English laws

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Causes and signs of distress

- **Causes of distress**
 - Liquidity crises
 - Drop in asset values
 - Impact of economic downturn
 - Fraud / mismanagement
 - Unprofitable business
 - Unavailability of finance
- **Signs of distress**
 - Inadequate financial information
 - Covenant waiver requests
 - Cash flow problems
 - Abnormal pensions activity
 - Deteriorating market confidence
 - Litigation/creditor action
 - Adverse public announcements

Concepts of restructuring

- **Rearrangement of a debtor's financial commitment**
 - **Consensual process without supervision**
 - **Involvement of all lenders (some cases even creditors) essential**
- **Triggered by an actual or potential default**
- **Typical steps include**
 - **Entering of standstill agreement** 
 - **Negotiation on restructuring package**
 - **Approval of restructuring package**
 - **Negotiation/implementation of restructuring package**
- **Restructuring may include interest funding, conversion of debt to equity/convertible**

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Restructuring in India

Contracted

CDR



- **Forum of lenders**
- **For debt > INR 100.0 million**
- **Restructuring to be approved within 90 days**
- **To be approved by 75% lenders by value, 60% in number**
- **Standstill period - 90 days (only for CDR lenders)**
- **CDR organization – CDR standing forum, CDR empowered group, CDR cell**

Court approved

SICA + companies act



BIFR

CLB

High Court

Failure to agree contractual restructuring

Scheme of arrangement

- **Described in companies act**
 - **Compromise among lender & borrower**
- **Creditors must be divided in classes**
- **75% of each class must vote in favor**
- **Court must sanction the scheme**
- **Binding on all after HC approval**
- **Standstill period can be allowed while approvals are pending**

Sick company re-structuring

- **SICA applies to certain companies only**
- **For BIFR companies - BIFR operates a restructuring agent**
- **BIFR schemes binding on all lenders**
- **To prevent abuse of SICA, SARFAESI was passed**
- **Under SARFAESI secured creditors can have certain self help remedies**

Else liquidation

RBI restructuring guidelines

- **No account to be taken up for restructuring till financial viability is established**
 - **If done otherwise the same is treated as ever-greening and is punishable**
- **Banks can restructure assets classified as ‘standard’, ‘sub-standard’, ‘doubtful’**
- **Restructuring cannot be with retrospective effect**
 - **Asset classification independent of restructuring**
- **BIFR cases not eligible for restructuring without BIFR approval**

Asset classification

- **Restructuring of advances can be done**
 - **Before commencement of production**
 - **After commencement of production but before asset is classified as sub-standard**
 - **After commencement of production and asset is sub-standard or doubtful**
- **Standard assets immediately classified as sub-standard on restructuring**
- **NPAs eligible for upgrade on satisfactory performance for 1 year (specified period)**
- **Additional finance is treated as standard for one year**
 - **If asset was sub std. or doubtful income to be recognized on cash basis only**
- **Income on NPAs is recognized on cash basis only**



Provisioning and loss calculations

- Banks to maintain provision against restructured advances
- Provision for diminution in fair value ('RBI loss')
 - Arising out of reduction in interest rate/rescheduling of principal which leads to fall in value of the advance
 - Economic loss to the bank to be debited to P&L
- Calculated as Principal – PV (future cash flows as per restructuring package)
 - Discounting rate = PLR on restructuring date + term premium + credit spread as applicable on restructuring date (min quote to client as per calc)
- Any security for RBI loss to be valued at Re 1/-
- RBI loss to be calculated on each balance sheet date
- Total provisions capped at 100% of the outstanding debt amounts

Case study – Loss calculation for rupee loans

Changed Repayment Schedule of a short term demand loan of Rs 34.9 mn resulted in a loss of Rs 0.12 mn

Moratorium Period (Monthly) :	0
Collection Period (Monthly):	35
Future interest if any¹ :	13.5%
Discounting Rate²:	13.7%

Gross Principal :	34.9
Uniform 35 installments each of :	1.00

NPV	34.78
Gain / (Loss)	-0.12

¹ As per IBAR

² As per price calculator (Minimum quote to client)

Conversion of debt to equity

- Any instrument converted from debt will bear the same asset classification as asset
- Income from NPAs will be only on cash basis
- Should be held in AFS category
- Equity classified as standard asset should be either at market value, if quoted, or break up value, if not quoted
- Equity classified as NPA should be either at market value, if quoted, or Re. 1/- if not quoted
 - Depreciation on these investments should not be offset against appreciation on other securities

Funded interest term loans

- **FITL debt / equity to have same asset classification as restructured advance**
- **Income on accrual basis only for standard assets**
 - **Cash basis for all other assets**
- **Unrealized income represented as Sundry Liabilities Account**

Parameters for restructuring

- **Promoter background**
 - **No willful default- debt servicing in the past**
 - **Adherence to key covenants stipulated**
- **Project viability based on current market conditions**
- **Financial closure of the Project**
- **Physical and financial performance progress in last 6 months**
- **Acceptable security cover on revised valuation**
- **All regulatory approvals to be in place**

Key deliverables from sponsors

- **PoA to the Lenders to sell**
 - **Non achievement of sales estimate**
 - **In the event of subsequent default**
- **100% mandatory prepayment from project cash-flows after meeting balance construction cost**
- **In case of SPV, explore pledge/ comfort upto 100% of the SPV shares**
- **Personal guarantee from key promoters**
- **Sponsor Group to take prior approval before launching new projects**
- **Explore improvement in interest rate**
- **Possible upside sharing**

Key terms in restructuring

- **Cut off date**
 - **Not to be retrospective**
- **Clear mechanism of appropriation of receipts to lenders after cut off date**
 - **Security tightening**
 - **Between term and w.cap lenders**
 - **Pledge of entire sponsor holding**
- **Equity infusion from sponsors**
- **Divestment of non core assets**

Key terms in restructuring (2)

- **Restriction on future borrowings / capex**
- **Concurrent auditor for future operations**
- **Independent directors on boards**
- **Right of recompense for sacrifices undertaken by lenders**
- **Right to accelerate the facility if cash flows improve**
- **Right to securitize loan assets**
- **Commitment from sponsor to unlock value (in unlisted companies / subsidiaries)**
- **Modifications in concessions to the company**

Key points in restructuring note

- **Proposal must clearly state**
 - **Standard / substandard restructuring**
 - **Asset classification pre and post restructuring**
 - **Incremental impact on P&L post restructuring**
- **List of assistances must reflect provisions against each assistance**
- **Pricing must reflect existing pricing and restructuring pricing**
- **Executive summary must establish financial viability for restructuring**
- **Information on restructuring must include**
 - **Date since irregularity**
 - **Residual value of security = Total value of security - Other bank's exposures**
 - **RBI loss and calculation**

Key points in restructuring note

- Information on restructuring must include
 - Promoter personal guarantee and net worth
 - Total provisions = provisions for unsecured asset in WCTL + provisions for inadequate security + RBI loss
 - Income reversal, impact on P&L
- Comparison of existing and proposed security – establishing why it is still beneficial for the bank to continue with the company
- Status of project implementation
- Dues position with ICICI bank and other lenders
 - Term debt dues
 - Working capital lenders dues
 - Unsecured loans, lease, corp g'tee, other obligations
- Details of financial viability (must include cash flow statement)

Case study: ABC XYZ

- **Operational restructuring**
 - Change in management of ABC to XYZ Group
 - Increase capacity to 0.6 mtpa, captive coke oven unit
 - ABC and XYZ to merge in 3 years
- **Financial restructuring**
 - Senior debt at 9.0% p.a. (Rs. 2.80 bn)
 - Restructured debt (Rs. 8.35 bn)
 - Rs. 4.40 bn – to be paid over 2+3 years, interest holiday for 18 months
 - Rs. 3.95 bn – OCL to convert over 3rd, 4th and 5th year at Rs. 52/- per share, OCL to have ballooning interest rate
 - Preference shares of ICICI and XYZ to convert to equity
 - Need based working capital at 9.0%
 - Accrued dividend on preference shares waived

I Textiles

- **Total debt of Rs. 5.50 bn with ICICI Bank share at 46%**
- **An interested hedge fund proposes to take equity stake in the company at low valuations**
- **The fund facilitates OTS negotiations between ICICI Bank and other lenders (who may take hair cuts)**
 - **ICICI Bank's exposure to the company remains unchanged**
- **ICICI Bank refinances this OTS debt and derives comfort from the foreign fund**
 - **ICICI Bank's exposure is credit enhanced**
 - **ICICI Bank has facilitated change in management**

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Restructuring overview – Indian laws

**Restructuring overview – English
laws**

English law concepts

- **London approach**
 - **Leadership – lead bank, steering committee**
 - **Lending standstill**
 - **Investigations**
 - **New money (on priority security)**
 - **Loss sharing**
- **Promises creditors higher rate of recovery than insolvency**
- **INSOL Global principles for multi creditor workouts**
- **Steering committee**
 - **Agents of banks in syndicates will be part of this team**
 - **Generally includes agents of various classes of lenders**
 - **Ensures geographic spreads on agents**
 - **Role includes following London approach**

Structuring concepts

- **Contractual subordinations**
 - **Contingent debt subordination**
 - **Turnover subordination**
- **Structural subordination**
- **Inter-creditor agreements**
 - **Payment block**
 - **Standstill on junior enforcement**
 - **Subordination on insolvency**
 - **Notification**
- **Security trust deed common to senior and junior lenders**

Commercial upsides

- **Success fees**
- **Equity kickers**
- **Warrants**

Security creation and enforcement

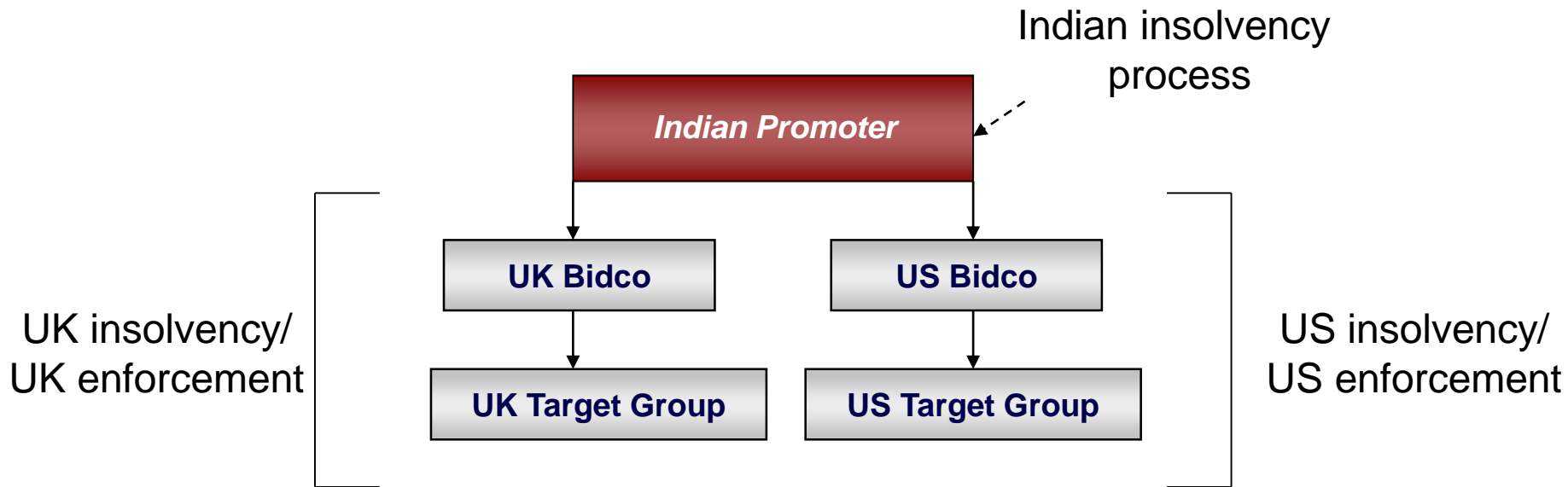
- **Immovable property**
 - Legal mortgage
 - Equitable mortgage
- **Movable property**
 - Legal security and equitable security
 - Fixed charge
 - Floating charge
 - Universal corporate security
 - Possessory pledge
 - Non-possessory charge (IPRs)
 - Assignment

Enforcement

- **Lenders free to enforce security even at single day's delayed payment**
 - **English courts do not grant relief unless expressly grace period is expressly contracted**
- **Following methods are available for enforcement**
 - **Private sale**
 - **Possessory management and receivers, Qualifying floating charge**
 - **Foreclosure**
- **Liabilities of lenders**
 - **Restricted if day to day management control is avoided**
 - **Indirect liabilities and indemnities of receivers**

Insolvency

- **Generally two types**
 - **Cash flow insolvency – unable to pay debts when due**
 - **Balance sheet insolvent – liabilities > asset**
- **Cross border insolvency issues**
 - **Location of commencement of insolvency**
 - **Recognition across jurisdictions**
 - **Lender's liability**





Thank You

Standstill agreement

- **Agreement between borrower and lenders**
 - Defaults and payment obligations (sometimes) temporarily suspended
 - No acceleration of loans (but placed “On-demand”)
 - No set-off or unilateral enforcement of security
- **During standstill following activities take place**
 - New business plan, capex
 - Cost cutting or asset sale measures
 - Review of existing management



Asset classification benefits

- **Special classification benefits to CME and real estate loans also**
- **Either of the following**
 - **Dues are fully secured**
 - **Unit viable in 7 years (10 years for infrastructure)**
 - **Restructured loan repayment not to exceed 15 years**
 - **Promoter's sacrifice should be minimum 15% of bank's sacrifice**
 - **Personal guarantee is offered by the Promoter**
 - **No a repeated restructuring**



Buying corporate assets

- **Due diligence**
 - **Ownership of assets**
 - **Real estate**
 - **Key contracts**
 - **Licenses**
 - **Employee issues**
- **Structuring the sale**
 - **Identification of assets and liabilities to be transferred**
 - **Non transferable assets**
 - **Warranty or indemnity protection**
 - **Completion accounts**
 - **Competition law requirements**
 - **Insolvency law requirements**

Illustrations on asset classification

	Particulars	Case 1	Case 2	Case 3	Case 4
I	Assumed due date of payment	31.01.2007	31.01.2007		
	Assumed date of restructuring	31.03.2007	31.03.2007	31.03.2007	31.03.2007
	Period of delinquency as on the date of restructuring	2 months	2 months	18 months	18 months
	Asset Classification (AC) before restructuring	'Standard'	'Standard'	'Doubtful - less than one year'	'Doubtful - less than one year'
	Date of NPA	NA	NA	31.12.05 (Assumed)	31.12.05 (Assumed)

Illustrations on asset classification

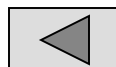
II Asset classification (AC) on restructuring					
Assumed status of the borrower	Eligible for special regulatory treatment	Not eligible for special regulatory treatment	Eligible for special regulatory treatment	Not eligible for special regulatory treatment	
AC after restructuring	'Standard'	Downgraded to 'Sub-standard' w.e.f 31.03.07 (i.e., on the date of restructuring)	'Doubtful - less than one year'	'Doubtful - less than one year'	
Assumed first payment due under the revised terms	31.12.07	31.12.07	31.12.07	31.12.07	

Illustrations on asset classification

III	Asset classification after restructuring				
A	The account performs satisfactorily as per restructured terms				
(a)	AC during the specified one year period (i.e., from 31.12.07 to 31.12.08)	No change (i.e., remains 'Standard')	'Doubtful - less than one year' w.e.f. 31.03.08 (i.e. one year after classification as 'Substandard')	No change (i.e., remains 'Doubtful - less than one year')	'Doubtful - one to three years' w.e.f. 31.12.07 (i.e., one year after classification as 'Doubtful less than one year')
(b)	AC after the specified one year period	Continues in 'Standard' category	Upgraded to 'Standard' category	Upgraded to 'Standard' category	Upgraded to 'Standard' category

Illustrations on asset classification

B	If performance not satisfactory vis-à-vis restructured terms				
(a)	AC during the specified one year period (in case the unsatisfactory performance is established before completion of one year period)	Treated as sub-standard w.e.f 30.4.2007 and downgraded to 'Doubtful less than one year' with effect from 30.04.08.	'Doubtful - less than one year' w.e.f. 31.03.08 (i.e. one year after classification	'Doubtful one to three years' w.e.f. 31.12.07	'Doubtful - one to three years' w.e.f. 31.12.07 (i.e., one year after classification as 'Doubtful less than one year' (on 31.12.06)
(b)	AC after the specified one year period, if the unsatisfactory performance continues	Will migrate to 'Doubtful - one to three years' w.e.f. 30.04.09 and 'Doubtful more than three years' w.e.f. 30.04.2011.	Will migrate to 'Doubtful - one to three years' w.e.f 31.03.09 and 'Doubtful more than three years' w.e.f. 31.03.2011.	Will migrate to 'Doubtful - more than three years' w.e.f 31.12.09	Will migrate further to 'Doubtful more than three years' w.e.f. 31.12.09



Restructuring of real estate loans

- **RBI has ammended restructuring guidelines for Commercial Real Estate exposures**
- **Key highlights**
 - **Standard asset as on Sep 1st, 2008 can be restructured up to June 30th, 2009**
 - **Application from borrower to be received by March 31st, 2009**
 - **Assets to be classified under standard asset category**
 - **120 days available for implementation of package**