

# Insolvency Code Seeks to Consolidate Existing Bankruptcy Laws

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Primary base metals producers have changed their strategy after the Indian Parliament approved the Insolvency and Bankruptcy Code (IBC) last year. Metal producers have repaid a major part of their loans to lenders in order to escape from the IBC which empowers lenders to enforce recovery of loan advanced to metal companies. Since metal companies go on long term capital investment for its returns in 4-5 years, they are often trapped in the cycle of price volatility resulting into repeated revisions in their strategic planning. Interestingly, when base metals' price declines sharply in the downward cycle; financial health of primary producers gets impact badly. In many cases, service debt for borrowers become difficult due to the environment beyond their control. While lenders had been offering financial restructuring package as a major tool for metal companies for revival, many of them went on accumulating debt and therefore, worsening repayment possibility even remotely.

## Introduction of IBC

The Insolvency and Bankruptcy Code, 2016 (IBC) is the bankruptcy law of India which seeks to consolidate the existing framework by creating a single law for insolvency and bankruptcy. The Insolvency and Bankruptcy Code, 2015 was introduced in the Lok Sabha in December 2015. It was passed by it on May 5, 2016. IBC got Presidential assent

in May 2016 and was put into effect after that.

Certain provisions of the act were imposed in August in the same year. Of late,

the IBC has been in news as the issue of how to

tackle \$150 billion bad loans has taken a centre point in the what-to-do-list of India's financial sector, particularly the ailing banking sector. Here are key facts that you should know as to how and for who a proceeding under IBC is initiated.

The Insolvency and Bankruptcy Code, 2016 (IBC) is the bankruptcy law of India which seeks to consolidate the existing framework by creating a single law for insolvency and bankruptcy. It was passed by Lok Sabha on 5 May 2016. The Code received the assent of the President of India on 28 May 2016. Certain provisions of the Act have come into force from 5 August and 19 August 2016. The Code was passed by parliament in May 2016 and became effective in December 2016. It aimed to repeal the Presidency Towns Insolvency Act, 1909 and Sick Industrial Companies (Special Provisions) Repeal Act, 2003, among others. The first insolvency resolution order under this code was passed by National Company Law Tribunal (NCLT) in the case of Synergies-Dooray Automotive Ltd on 14 August 2017. The plea for insolvency was submitted by company on 23 January 2017. The resolution plan was submitted to NCLT within a period of 180-day period as required by the code, and the approval for the same was received on 2 August 2017 from the tribunal. The Code outlines separate insolvency resolution processes for individuals, companies and partnership firms. The process may be initiated by

either the debtor or the creditors. A maximum time limit, for completion of the insolvency resolution process, has been set for corporates and individuals. For companies, the process will have to be completed in 180 days, which may be extended by 90 days, if a majority of the creditors agree. For start ups (other than partnership firms), small companies and other companies (with asset less than Rs 1 crore), resolution process would be completed within 90 days of initiation of request which may be extended by 45 days.

The IBC envisages a "creditor in control" regime with financial creditors exercising control through IPs in the event of a single default in repayment of any loan or interest. This can be effected without any notice and the law is very stringent as compared to the SARFAESI Act, 2002. As a result, stressed/ distressed corporates need to implement an accurate cash flow forecasting mechanism to identify mismatches of inflows with commitments on a timely basis. If there is a possibility of a potential default that can trigger IBC, an effective turnaround plan should be devised and communicated to all stakeholders in advance – including financial and operating creditors, employees, etc. Such a plan should include aspects of financial restructuring, operational improvement and sale of assets which can be monetized.

The Code seeks to achieve certainty for recovery and enforcement proceedings and to this extent, it will specifically be a useful tool for creditors and investors. It would be of specific interest to international creditors and investors, who are generally looking at Indian opportunities. Global institutions are continuing to grow their investments in India and in this context they are increasing their exposure to Indian

entities. Over the years, many concerns have been existing and / or raised amongst international investors on the regulatory and country risks while providing financing to and/or investing in India. The time taken for resolution has been a major point of debate. This Code in specific will, when implemented in letter and spirit, provide a major boost to the India economy, especially on account of timely resolution and certainty in recovery. In contrast to the current regulatory landscape, the Code does not make any distinction between the rights of international and domestic creditors or between classes of financial institutions. Specific attention is to be drawn to the rights of unsecured and secured creditors in the priority of their claims and therefore the level playing field for their access to an effective insolvency resolution. The strict timelines for resolution of insolvency and liquidation proceedings would definitely be an incentive and provide the requisite impetus for economic growth. The Code as a new law, replacing over a dozen laws, when implemented post the infrastructure being put in place, will prove to be the most important step in changing the legislative landscape of India by removing the negativity attached to litigation time and ease of recovery.

#### Prepayment of loan

Although not remotely mentioned of linkage between insolvency code and prepayment of loan, base metals companies have advanced payments of their term loan to lenders. In this process, Hindalco Industries Ltd, as mentioned in its corporate presentation published on the Bombay Stock Exchange (BSE) has prepaid a rupee term loan of Rs 48 crore and Rs 4552.51 crore for the quarter and half year ended September 30, 2017 respectively. Hindalco has prepaid Rs 1000 crore in FY17 and another Rs 4500 crore in April 2017. Hindalco's consolidated gross debt : EBITDA as on March 31, 2017, stood at 5.1 times, lowest since FY12. Analysts estimate this to further improve to 3.6 times by FY19



due to stable stream of free cash flow generation on one hand and a clear intent to deleverage the balance sheet, on the other. Management indicated that it intends to prepay additional ~Rs 2200 crore term debt during FY18 (Rs 4500 crore already prepaid in April 2017). As a result, analysts estimate net debt of the company to fall 15 per cent to Rs 46,300 crore and free cash flow generation of Rs 5000 crore through to FY19.

Analysts are upbeat on the sustained performance of aluminium and copper divisions and Hindalco's intent to prepay debt and de-stress the balance sheet. With capex cycle behind and focus on high margin downstream products, the company's estimated consolidated EBITDA margin is likely to improve to 14.4% in FY19E (12.2% in FY17).

Similarly, gross debt of Vedant Ltd stood at Rs 55,798 crore as of September 30, 2017, including temporary in addition to a short term borrowings of Rs 593 crore at Zinc India and preference shares of Rs 3,010 crore issued pursuant to the Cairn merger. The company has reduced its gross debt by Rs 11,466 crore (excluding repayment of temporary borrowing by Zinc India) since March 2017. The company's net debt works out to Rs 15,592 crore as on September 30, 2017, lower on quarterly basis on account of improved operating performance resulting in higher free cash flows.

#### Insolvency account

The Reserve Bank of India (RBI) recently sought to address potentially about a fourth of the Rs 10,00,000 crore non-performing assets (NPAs) on the books of local lenders, mandating that a

dozen such accounts be taken to the bankruptcy courts. Although the RBI didn't name any defaulter, bankers say borrowers such as Bhushan Steel, Essar Steel, Lanco, and Alok Textiles may be the first set of companies facing proceedings under stringent recovery laws. The IAC, in the meeting, agreed to focus on large stressed accounts at this stage and accordingly took up for consideration the accounts which were classified partly or wholly as non-performing from amongst the top 500 exposures in the banking system," the RBI said in a statement. The Internal Advisory Committee of the RBI recommended referring to the Insolvency and Bankruptcy Court all accounts with total outstanding loans greater than Rs 5,000 crore, with at least three-fifths (60%) classified as non-performing by banks as on March 31, 2016. For other bad loans that do not fall in this category, banks will have six months to come up with a resolution plan, failing which they would also land up in the bankruptcy courts. The IAC also arrived at an objective, non-discretionary criterion for referring accounts for resolution under the IBC, the RBI said. Since the government came up with an ordinance that empowered the RBI to chalk out plans for addressing the bad-loans problem, there was speculation that the banking regulator would get entangled in commercial decisions. But today's notification shows that the regulator has kept away from specific cases, providing instead broad and directional guidelines to the lenders. The Indian banking system is saddled with sticky loans. Bad loans at state-run banks have increased by more than Rs 1 lakh crore since April 2016 to Rs 6 lakh crore as of December 31. This goes up to Rs 10 lakh crore when those of private and other lenders are added on. Finance minister Arun Jaitley has said that the RBI was at a fairly advanced stage of preparing a list of borrowers for which a resolution is required through the IBC process. The problem of bad loans is not systemic, but limited to 30-50 accounts, Jaitley has said on many occasions.