Business Standard

SHOULD YOU INVEST IN FIRMS UNDERGOING DEBT REVAMP?

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The article gives an insight into the companies which are being reffered for CDR. What all things an investor have to look while investing in their stocks with a quote by **Mr. Laxman Kumar Nasarpuri, Partner, Financial Pundits.**

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While shares of companies going for corporate debt restructuring are attractively priced, investors need to be watchful, as potential turnarounds may hit roadblocks
Jitendra Kumar Gupta / Mumbai April 19, 2012, 0:25 IST

Statistics suggest about 85 per cent of the loan restructuring cases referred to corporate debt restructuring (CDR) cells are able to meet their obligations. And, almost 45 per cent of these cases (or four of every 10) are successfully revived.

Statistics are just an indication but provide enough hope for some companies recently referred to/or have announced their plans to undergo CDR. Already under severe pressure from mounting debt, these are potential turnaround cases — many trade in the market at life-time lows. Examples like that of Wockhardt — its shares were trading at Rs 75 when it was referred to CDR in April 2009, while they are presently at Rs 560, up more than seven times, led by the successful debt restructuring – only provide confidence. However, experts warn that not all can turn around. Hence, investors need to be careful.

“The purpose of CDR is that a company has gone into a phase not on account of reasons which are directly attributed to the company — external factors which are not in its control. The company’s fundamentals have to be very strong and the business should be sustainable. The management has to be good in terms of technical and managerial competencies. And given the chance, the management should have the ability to turn around operations. In those cases, CDR could be a fruitful exercise,” says Laxman Kumar Nasarpuri, partner at Financial Pundit, a corporate financial-advisory firm.

Sandeep Desai, director at debt and corporate restructuring firm Brescon Corporate Advisors, has a three-layered strategy to assess the viability of a CDR candidate. “First, we assess and estimate the future while looking at factors, such as the industry the company operates in, demand for the product, the company’s positioning in the industry, among other things, to have a rough assessment of what the future would look like,” he says. This will give an idea of future profitability of the company. He adds, “Second, is to assess the past. We try to address questions like what went wrong and why those things cannot repeat, which leads us to think how we can safeguard them now. Third, and the most critical, assessing the current situation (financial condition of the company). The assessment of the present will provide a roadmap for actions, which can be taken to help the company revive.”

Hotel Leela Venture
Its aggressive expansion, starting 2008-09, particularly in Delhi, which analysts believe was expensive at Rs 3 crore per room, led to accumulation of huge debt without corresponding revenue and profits. While its consolidated debt had risen sharply to Rs 3,800 crore in FY11 and further to Rs 4,295 crore as on September 30, 2011, revenue remained almost flat and profitability fell significantly. For nine months ending December 2011, its interest outgo was Rs 206.29 crore (up 405 per cent y-o-y) on profit before interest, depreciation and tax (PBIDT) of Rs 71.7 crore, leading to losses and raising doubts about its ability to service debt.

HOW THEY STACK UP

	3i Infotech	Bharati Shipyard	HCC	Hotel Leela	ICSA (India)
FY11 financials					
Total equity (Rs cr)	1,290	1,065	1,194	2,103	845
Total debt (Rs cr)	2,535	3,884	7,382	3,803	837
Debt-equity (x)	2.1	3.1	4.5	3.9	0.9
Interest cover (x)	2.5	1.5	0.9	2.0	2.8
PBIDT margin (%)	21.1	31.6	9.6	34.7	21.2
PAT margin (%)	9.9	5.7	-0.2	7.2	8.9
ROCE (%)	12.4	11.9	0.0	2.7	18.9
RONW (%)	23.6	9.1	0.0	4.4	16.1
CAGR (FY08-11) (in Rscrore)					

Equity	20.1	22.5	8.5	31.2	31.2
Debt	24.9	108.0	39.8	23.2	60.8
Sales	28.7	31.7	33.7	0.7	27.8
Interest	49.1	135.3	47.2	16.0	53.7
PAT	12.7	-1.0	-158.4	-36.1	4.7
Valuations					
PE (x) *	11.86	2.65	154.87	0.00	2.12
P/BV (x) *	0.19	0.22	0.67	1.28	0.11

* Based on trailing 12 months figures; PAT margins are adjusted for exceptional items
P/BV is price to book value; RONW & ROCE is return on networth and capital employed, respectively
Source: Capitaline

The progress on the CDR front and its plans to monetise land, such as sale of the Kovalam hotel and residential property in Bangalore, will be key. If it is able to address the liquidity and interest cost issues through CDR, it will prove helpful given that business is improving. Notably, contribution from the properties for which the debt has been raised is also expected to rise. While operational improvement may not be enough to cover the estimated interest cost of Rs 260-270 crore, in FY13 the situation is improving.

Bharati Shipyard
A combination of industry downturn and acquisition of Great Offshore, funded largely through debt, took a toll on Bharati Shipyard, leading to a high debt of over Rs 3,300 crore. This has come at a time when there is pressure on margins and revenue visibility has weakened due to absence of new orders.

Based on estimates, in FY12 and FY13, the company could make a PBIDT of Rs 500-600 crore — enough to cover the interest cost of about Rs 400 crore. However, pressure remains on the repayment side, given the weak internal cash-generation. The company has filed for CDR, which analysts believe could ease some pressure on these fronts, providing relief in the near term. Even a percentage point reduction in interest rate could add Rs 30-35 crore to its profits.

However, business prospects are unlikely to improve in a hurry, because industry demand and new orders for ships are yet to pick up. And, if the shipping and the offshore industries remain weak, it will continue to cast its shadow on shipbuilders. To overcome this situation, the company is also looking for orders from the defence sector.

HCC
HCC accumulated huge debt as a result of funding for its build-operate-transfer (BOT) assets, real estate business and increase in working capital needs. The rapid rise in its debt led to a spike in interest costs and impacted profitability. For the nine-month period ended December 2011, HCC reported standalone PBIDT of Rs 183.6 crore, which did not even cover the interest cost of Rs 305 crore (up 52.8 per cent y-o-y), leading to loss at the net level.

Hereon, though HCC has a strong order backlog, it is also important to monitor order inflows and execution at ongoing projects. The incremental growth in revenues and bidding for new projects might require additional working capital. Analysts believe the near-term growth in turnover could remain flat or marginally higher. Hence, worries over interest cost and repayments may not ease soon. The company, in a filing to the exchanges, said a lack of cash flow has forced it to take the CDR route. Investors also need to monitor the company in terms of stake sale in its BOT assets, which could help improve liquidity.

3i Infotech
A mid-sized IT company, 3i Infotech, largely relied on growth through acquisitions, which saw revenues go up four times in the last four years, but debt too grew in the same fashion. As on September 2011, it had Rs 2,081 crore of debt or about twice its equity. The situation is not encouraging as revenues are falling. Based on the annualised nine months results, 3i could report a PBIDT of Rs 280 crore a little more than the annualised interest cost of Rs 235 crore for FY12. In this scenario of high debt, analysts believe it is going to be tough to generate new business as clients might view with scepticism the company's ability to service contracts. Hence, FY13, too, could remain constrained in terms of revenue and profitability.

Thankfully, there are hopes from CDR, which 3i proposed and signed an agreement with the lenders recently. "This will surely save some interest cost and improve liquidity, but could result in large equity dilution, the quantum of which will be known after the details are out," says Hardik R Shah, research analyst at KR Choksey Shares and Securities.

ICSA

ICSA has seen 86 per cent erosion in earnings during the first nine months of 2011-12. More than the 13 per cent fall in revenue, the erosion in earnings was due to 65 per cent increase in interest costs. ICSA, which has presence in infrastructure (mainly power transmission and distribution or T&D), provides embedded technology solutions for various sectors, including power, oil, gas and water.

"The company suffered both in terms of slowdown in business, largely influenced by power sector woes, as ICSA generates almost 70 per cent from T&D. The issue of debt is more from the liquidity perspective," says Rohit Agarwal, an SPA Securities analyst. The pressure on debt was severe. Almost all the shares held by the promoters are pledged. ICSA had to restructure its FCCB, which were due for redemption in March.

If the company, now in CDR, can address the debt issue, it is a good turnaround candidate, given good business prospects.