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Success of resolution plan critical for investors under Insolvency and Bankruptcy Code

With recovery rate of just 10-20 paise to a rupee, investors may not get anything if resolution fails and the company goes into liquidation

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Jyoti Structures, which was the first of the 12 big defaulters to be given the go-ahead by the National Company Law Tribunal (NCLT) for insolvency, has no doubt brought relief to lenders hoping for a quick resolution.

But for investors saddled with such stocks, the success of a resolution plan is the only hope to realise value from their dead investments.

At the Assocham's national conference on Insolvency and Bankruptcy Code (IBC) held recently, many bankers and resolution professionals felt that only 10-20 paise to a rupee could at best be recovered under liquidation.

Hence, investors may not get paid anything if the company goes into liquidation (on failure of a resolution), as they rank way down in the pecking order for distribution of proceeds.

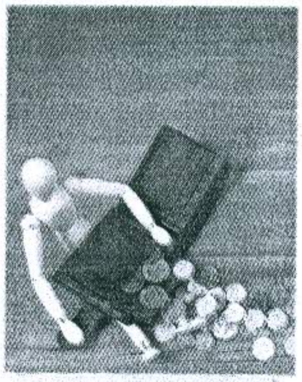
The IBC that opens up room for competing or hostile offers, can come to investors' rescue if the new management turns around the fortunes of the company.

Resolution possibilities

After the case is approved by the NCLT for insolvency, the resolution professional prepares a resolution plan within the stipulated time (180 days with 90 days extension). This has to be approved by the committee of creditors — 75 per cent of financial creditors by value.

So, what could the resolution plan entail?

"If it's a running company, not able to service its debt, the first step is to arrive at what the sustainable cash flow is and hence, the sustainable debt. The insolvency resolution professional will also prepare an information memorandum to seek potential acquirers. Depending on the best of these alternatives, the impairment that needs to be taken by various stakeholders will be determined," says Nikhil Shah, Managing Director at Alvarez and Marsal, an expert in turnaround management.



Under IBC, on liquidation, insolvency resolution and liquidation costs will be paid first, followed by secured creditors and workmen, employee dues, unsecured creditors, government dues and then shareholders, in that order

According to Pramod Jain, a chartered accountant, also an insolvency professional, "The resolution plan will essentially involve some haircut by the creditors and the promoters, so as to make the operations commercially viable whether through the exiting promoters/ management or through a new applicant."

Jain says that when, as per the resolution plan, a new investor infuses capital and the company starts to turn around, the value of shares can move up, though it could take two to five years.

Hostile offers

Given that most of the listed stocks are trading at very low prices in the secondary market, the new entity can acquire stake at dirt cheap price, say market players.

Among the cases that have been approved by the NCLT so far, many of the corporate defaulters are listed companies. Jyoti Structures, Monnet Ispat & Energy, KS Oils, Deccan Chronicle Holdings, Ennore Coke, Educomp Solutions, Gujarat NRE Coke, Unity Infraprojects, and Clutch Auto are some of them. Most of these stocks have already been beaten down by the market, quoting at less than ₹10.

"One of the most important aspects of the resolution process under IBC is that it opens up room for competing offers. What also makes the IBC extreme for the promoters is that a third party can come in and make a hostile offer," says Damini Marwah, Senior Vice President, General Counsel, Axis Bank.

Liquidation last resort

If the resolution fails, and the company goes into liquidation, in most likelihood, shareholders will not get anything, say experts.

"In foreign geographies, we have been able to recover every penny through liquidation. In India, though the situation may be different as companies are over-leveraged," says Farooque Shahab, Chief General Manager at SBI.

Under IBC, on liquidation, insolvency resolution and liquidation costs will be paid first, followed by secured creditors and workmen, employee dues, unsecured creditors, government dues and then shareholders, in that order.

At best, secured creditors and workmen may get paid to some extent, leaving investors in the lurch.

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RBI may cut repo rate today

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With latest macro-economic data showing inflation at a record low and fall in factory output, the Reserve Bank of India (RBI) is expected to reduce its repo, or short term lending rate, at its monetary policy review on Wednesday.

The 6-member Monetary Policy Committee (MPC) headed by RBI Governor Urjit Patel on Tuesday started two-day deliberations amid expectations of at least 0.25 per cent cut in the key lending rate as inflation has cooled to record low levels.

At its second bi-monthly monetary policy review of the fiscal on June 7, the RBI maintained status quo on its short-term rate for lending to commercial banks, at 6.25 per cent. In doing so, the policy statement said the six-member Monetary Policy Committee (MPC) was guided by the risks to inflation.

Retail inflation in India during June dropped to a record low of 1.54 per cent, while industrial production data showed that the growth in factory production fell to 1.7 per cent in May, from 8 per cent in the same month a year ago.

Industry chamber Assocham on Sunday urged the apex bank to cut interest rates in view of the latest macro data.

"Citing inflation at a five-year low and deceleration in the factory output, the

Assocham has written to RBI Governor Urjit Patel, making out a strong case for at least 25 basis point cut in the policy interest rate when the RBI Monetary Policy Committee meets on August 2," an Associated Chambers of Commerce and Industry of India statement said here.

"The wholesale price index (WPI) also eased to 0.9 per cent from 2.17 per cent. The case for rate-cut is additionally strengthened by easing of food inflation to (minus)2.12 per cent from 0.31 per cent. Good monsoon forecasts for the current financial year have additionally created a stance for further reduction in the food inflation," Assocham said.

With inflation in India falling dramatically, British financial services major HSBC said cut in key policy rates is likely as the country's inflation differential with the world is normalising, inflation expectation is cooling and food prices are also falling.

"All considered, we continue to expect a 25 bps (basis points) rate cut in the August 2 meeting. We expect the central

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bank to maintain its neutral stance, which we believe is consistent with moderate rate cuts," HSBC said in a research note.

"We've said this before, and we have found new evidence since India may have already become a 4 per cent inflation economy," it said. June was the fourth policy review in succession that the MPC had kept the repo rate unchanged.

Announcing status quo on the key interest rate, Patel said the abrupt fall in inflation in April "from the firming trajectory that was developing in February and March has raised several issues that have to be factored into the inflation projections. "Considering the high uncertainty clouding the near-term inflation outlook, there is a need to avoid premature policy action at this stage. Premature action at this stage risks disruptive policy reversals later and the loss of credibility," he said.