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Performance Analysis of Electrosteel Steels Limited

Pre, During and Post CIRP
A case study

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Abstract

The Corporate Insolvency Resolution Process (CIRP) of ESL was commenced on 21st July, 2017 and the resolution was approved on 17th April, 2018. India's dedicated bankruptcy resolution programme, which seeks to untangle billions of dollars stuck in bad loans, recorded its second-biggest successful recovery to date after global resources major Vedanta acquired management control of Electrosteel Steels Ltd (ESL) and named a new board to run the distressed steelmaker. This paper provides the analysis of operational and financial performance of the company pre, during and post Corporate Insolvency Resolution process.

Company Profile

Electrosteel Steels Limited (ESL) was originally incorporated as Electrosteel Integrated Limited as a subsidiary company of Electrosteel Castings Ltd.on December 20th, 2006 as a Public Limited Company which commenced its business on January 5th, 2007 and has been listed on the Indian stock exchanges since 2010.The name of the Company was changed from Electrosteel Integrated Limited to Electrosteel Steels Limited and a fresh certificate of incorporation was granted to the Company on May 5, 2010. The main reason for the change in the name of the Company was that the new name would convey the business of the Company in a better manner, which would help the Company enjoy better market reputation and customer's reliance.What started off as Electrosteel Castings, a Steel Castings and Cast Iron Spun Pipe manufacturing company, evolved in time into a pioneer in manufacturing Ductile Iron Pipes and FittingsESL is an integrated steel producer primarily in the long product segment.

Company's Plant

ESL has set up 2.51 Million Ton Per Annum (MTPA) planned capacity integrated Steel Plant near Siyaljori village, in the Bokaro district of Jharkhand which is currently commissioned at 1.5 MTPA capacity.The plant is located in Siyaljori Block, Bokaro District of Jharkhand State. The nearest town Bokaro, on the western side, is 22 kms away from the site. The land comprises mostly of barren land with small undulation. Source of water for the plant is the Damodar river and the location of the in-take pump house is will be near the bank of Damodar river, which is about 10 kms away from the plant site.The nearest railway station Talgheria, which is about 12 kms away from plant site, has single line electrified traction system.

ESL has tied up with leading Chinese Consultation Agency for supply of technology & engineering based on successfully operating Integrated Steel Plants in various locations in China. The Group has been allotted Parbatpur captive mine block for coking coal in Jharia Coalfield, near Bokaro. Total geological coal reserves is 231 MT. Iron Ore mine at Kodolibad near Barajamda and mine block for non-coking coal at Northdhadu, in the state of Jharkhand.

This integrated facility includes a Sinter Plant, Coke Oven, Blast Furnace, Basic Oxygen Furnace, Billet Caster, Wire Rod Mill, Bar Mill, DI Pipes Plant and Power Plant. It is one of the largest manufacturers of Ductile Iron (DI) Pipes in the Indian sub-continent, having a production capacity of 280,000 MT per annum.

About 50% of Ductile Iron Pipes and Fittings produced by Electrosteel Steelsis exported to various countries in Europe, USA, South America, South East Asia, Middle East, North and South African Countries. A number of overseas offices and subsidiary companies have been established in France, Spain, United Kingdom, United States, Singapore and Algeria.

Accreditations

ESL has established excellence at every stage of production by bringing international expertise and solutions from reputed manufacturers. Along with the latest technology, the plant operates in synchronization with the highest ecological standards. Electrosteel Steelsproduces ductile iron pipes and fittings as per the international benchmark and its quality is approved in various countries. The Company obtained KITEMARK License from the British Standards Institute ("BSI") for its DI Spun Pipes & Fittings. In addition, it received accreditations from (Germany), BSI (UK) and various Government approval in Middle East. It also secured approvals from NSF, UL and FM from USA and ACS/NF from France. Its products are also certified by Drinking water Inspectorate (DWI) and Water Regulation Advisory Scheme (WRAS) of UK. Electrosteel Steelsis an ISO 9001 and ISO 14001 certified organization and has SA8000 certification as a socially responsible organization.

Product Range of the company includes:

TMT

TMT are basically thermo mechanically treated steel bars which are produced by controlled quenching & self-tempering process. V-Xega TMT bars are produced in Fe550D, CRS variety as per IS 1786/2008 grade. Carbon & Carbon Equivalent levels are kept to a lower level than as specified in the standards to attain better properties.V-Xega Fe550 D is ideal for dams, bridges, high rises or any critical structure where high yield strength is required without compromising on elongation properties.

DI Pipes

Ductile Iron is considered the most preferred pipe material for water supply and pressure sewerage application all over the world. V-Ducpipe ensures good health flows to every home. Known for its high Tensile Strength and inherent corrosion resistance of Cast Iron.

Wire Rods

V-Wirro Comes in Low Carbon, Medium Carbon & High Carbon grades to fit a wide range of applications in the Engineering, Construction, Power & Automobile Industry. With feature like uniform mechanical properties, excellent surface finish and close dimensional tolerance, each wire rod is free from surface defects and inclusions.

Billets

Cast through 5 strand casters integrated with Basic Oxygen Furnace linked to a Blast Furnace ensuring consistent quality steel. Suitable Grades for General Engineering, Structural, Rerolling & High Tensile Applications. Raw Material for Angles & Channels for High Tensile applications in Towers & Power Transmission industry. High applicability in construction industries also. Suitable for making consistent quality TMT with corrosion resistance and good seismic properties. Suitable for making fabricated products for various General Engineering Applications.

Pig Iron

An excellent charge mix for EAF's, IF's & Foundries. Clean Steel ensuring quality of finished product. Consistent quality ensuring consistency in the liquid steel.Better Surface finish in Castings.

Electrosteel Steels Limited – Performance analysis

The Corporate Insolvency Resolution Process (CIRP) of ESL was commenced on 21st July, 2017 and the resolution was approved on 17th april, 2018. India's dedicated bankruptcy resolution programme, which seeks to untangle billions of dollars stuck in bad loans, recorded its second-biggest successful recovery to date after global resources major Vedanta acquired management control of Electrosteel Steels Ltd (ESL) and named a new board to run the distressed steelmaker.

The key performance indicators reflecting the operational and financial position of the company during Pre, During and Post Corporate Insolvency Process period (2017 to 2019) are as under

Performance indicators	**2017**	**2018**	**2019**
Current Ratio	1.27	1.57	1.72
Interest Coverage Ratio	0.35	0.82	0.93
Inventory days	178.66	164.71	131.23
Return on Assets (%)	1.33	1.83	3.03
Return on capital employed (%)	6.86	7.79	9.66
Assets turnover	0.32	0.36	0.55
Sales / working capital	3.99	8.63	9.44
EBITDA Margin %	14.37	15.06	17.18
Profit after tax margin %	3.5	4	6
Average collection period (Days)	116	97	78
Altman Z Score	1.05	1.47	2.43
Du Pont Ratio			
Du Pont ratio = (Net Profit/sales) x (Sales/Asset) x (Asset/Equity)			
NP/Sale	4.21	2.32	6.44
Sale/Asset	0.32	0.36	0.48
Asset/Equity	2.01	1.94	2.09
Du Pont	2.70	3.62	6.48

Source : Annual Report 2016-17. 2017-18, 2018-19

Heads	Pre-During % change (2016-17 to 2017-18)	During to Post % change (2017-18 to 2018-19)	Reasons for Change
			Income
Sales	11	18	Increased due to increased capacity utilization and ramp up of production
			Expenses
Material Cost	17	17	Material cost as a percent of sales revenue remained constant though there was an increase in output.
Employee Cost	-1	7	Manpower cost increased due to resumption and scaling up of production.
Other Expenses	19	10	Other expenses which includes administrative expenses, commission, selling and distribution expenses decreased due to improved efficiency and better expenses control.
Finance Expenses	1	11	Finance expenses increased due to increased current liabilities consequent upon increased volume of output

The Lenders had invoked Strategic Debt Restructuring pursuant to RBI Circulars dated 8 June 2015 and 24 September 2015 and implementation thereof is in progress. Lenders of the Company are proposing to change the Management of the Company, in accordance with RBI Circular on Prudential Norms on change in Ownership of Borrowing entities (Outside SDR Scheme). As reported last year, since accumulated losses resulted in erosion of over 50% of peak net worth during the immediately preceding four financial years, your Company continues as a "Sick Company", the fact of which has already been reported to erstwhile Board for Industrial and Financial Reconstruction (BIFR). During the period under review, your Company, in spite of financial constrains as stated earlier, had been able to maintain its overall revenue. However, due to insufficient funds for completion of remaining modules of the Plant, the Company is not able to operationalize to its envisaged capacity. The total secured outstanding indebtedness (including interest) as on 31st March 2017 is Rs. 1,237,661.53 lakhs out of which the long term borrowings is Rs. 1,168,032.26 lakhs and short term borrowings (including interest) is Rs.69,629.27 lakhs. (Source : Annual Report 2016 - 17 Pre CIRP)

As per the decision of the lenders of the Company at their meeting held on 22nd June, 2017, State Bank of India ("SBI"/ Financial Creditor), the Lead Banker, filed an application before the Hon'ble National Company Law Tribunal (NCLT), Kolkata, under Section 7 of the Insolvency and Bankruptcy Code, 2016 ("Code") and rules and regulations made there under, for initiation of Corporate

Insolvency Resolution Process(“CIRP”) against the Company. NCLT vide its Order dated 21st July, 2017 (“CIRP commencement date) admitted the application of the Financial Creditors. Wide fluctuation in raw material prices, especially imported coking coal, also had a negative impact. Effective steps towards implementing better guidelines for operational procedure and precautionary measures thereto have been put in place. Continuous efforts were initiated to improve performance of the Company in both, quantitative and qualitative terms. Despite operational and funding challenges of working capital, the Company was able to improve turnover vis-a vis previous financial year.(Source : Annual Report 2017 -18 During CIRP)

The Fiscal year 2019 has been transformational year for the Company, where significant progress has been made in various fronts such as enhanced capacity utilisation, restarting of Blast furnace #3, improvement in cost through commercial and operational excellence, enhanced production of value added product (VAP) etc. These accomplishments set up strong momentum to aspire for robust growth for Fiscal Year 2020. In June 2018, Vedanta Limited acquired a 90% stake in Company, a primary producer of steel and downstream valueadded products. The Company was acquired under the Insolvency and Bankruptcy Code (IBC) 2016 in line with Resolution Plan approved by Hon'ble National Company Law Tribunal (NCLT), Kolkata Bench. Subsequent to the acquisition, Vedanta Limited, through its wholly owned subsidiary, Vedanta Star Limited, took over control and management of Electrosteel Steels Limited and acquired 90% shares of the Company. FY2019 recorded annual steel production at 1.2 million tonnes up 17% on year to year basis. The Company achieved hot metal production run rate of c.1.5mtpa in FY2019. The production ramped up substantially and other operational efficiencies has resulted in record EBITDA margin. Under Vedanta’s management, the business has seen significant operational improvements leading to healthy financial position. (Source : Annual Report 2018 -19 Post CIRP)

Analytical Review

From the above analysis it appears that the performance of the company consistently improved over the pre CIRP to during the period of CIRP and thereafter post CIRP periods due mainly to operational and performance efficiencies coupled with strategic actions taken by the management

India’s dedicated bankruptcy resolution programme, which seeks to untangle billions of dollars stuck in bad loans, recorded its second-biggest successful recovery to date after global resources major Vedanta acquired management control of Electrosteel Steels Ltd (ESL)Vedanta has deposited Rs 5,320 crore in an escrow account of ESL for 90 per cent equity in the bankrupt alloy maker. This is the second successful resolution of a stressed steel asset after Tata Steel acquired Bhushan. The transaction will complement Vedanta group’s existing iron ore business through vertical integration of steel manufacturing. It will pay for the acquisition using existing cash resources. The company is charting out its growth trajectory, in the second phase of expansion, it is likely to move to flat products. The products would include hot-rolled, cold-rolled coil, and galvanised. ESL would work closely with the Vedanta group companies that are in zinc, aluminium and copper sectors, to come up with new products and for better synergies.

Vedanta’s move followed the National Company Law Appellate Tribunal (NCLAT) order which allowed Vedanta to acquire ESL by depositing the upfront payment to the Committee of Creditors (CoC). ESL has outstanding dues of Rs 14,177.3 crore. According to the resolution plan, A wholly-owned subsidiary of Vedanta will subscribe to the share capital of Electrosteel for Rs 1,805 crore and provide additional funds of about Rs 3,515 crore by way of debt. Vedanta will hold about 90% of the paid-up share capital of Electrosteel while the remaining 10% will be held by Electrosteel's existing shareholders and the financial creditors, who will receive shares in exchange for the debt owed to them. In all, Electrosteel's creditors will receive dues to the tune of Rs 5,320 crore, The company owes lenders more than Rs 13,000 crore. Of the 13,000 cr. the banks would have provisioned 6500 cr. already, due to RBI rules stating that if an account goes to bankruptcy, banks have to take a 50% provision. But now, they'll have an additional Rs. 1300+ cr. as a further hit to be taken.

This acquisition marks Vedanta's entry in the ferrous space and gives it a foothold in the niche ductile iron pipes used for water transmission and distribution. Vedanta has some iron ore leases in eastern India and the steel plant acquisition would strengthen the company's bid for captive mines.

Valuation

Electrosteel Steels largely makes long steel products. Average EBITDA per tonne of its larger peers Steel Authority of India Ltd. and Jindal Steel and Power Ltd. Is around Rs 7,500. At these levels, enterprise value for the industry stands at 6 times the operating income. Given its capacity of 1.5 MTPA, derived EBITDA for Electrosteel Steels is Rs 1,155 crore. At the total deal value of Rs 5,320 crore (debt + equity), valuations for the asset work out to 4.8 times the EBITDA which is lower than the industry average.

Impact on shareholders

Essentially, Electrosteel Steels is getting a valuation of around Rs. 0.12 (12 paise) per share today, after lenders are issued shares for their hair cut, and then Vedanta is issued new shares. Even after it gets into enhanced production metrics, it's probably worth less than Rs. 0.30 per share.

ESL Turnaround

Acquisition of Electrosteel Steel Ltd (ESL) by Vedanta has led to a turnaround in the company in a space of eight months due to a combination of right people, higher volumes and tight cost control that led to the change. For the financial year ended March 2019, ESL achieved an EBIDTA of Rs. 9145 per tonne, as against Rs.4255 per tonne at the time of acquisition. Ramping up of production and improving operational efficiencies resulted in rise in EBIDTA The company posted record annual production at around 1.2 MTPA for FY19, registering a 17 per cent growth on a year-on-year basis. In eight months, Electrosteel Steel turned profit after tax (PAT)-positive. In 2018-19, Electrosteel's PAT stood at Rs 284 crore.The company is hoping to maintain its EBIDTA at the current levels given that the steel industry has been going through a "tough patch". The company has a strong order book position aggregating about Rs.800 crore as on June, 2019 comprising supply orders of about 1.5 lakh ton pipes. The orders are expected to be completed within next 7-8 months, indicating a satisfactory revenue visibility.The increasing level of gross cash accruals arising out of higher level of operating profit and significant amount of unavailed fund based working capital bank lines are matters of comfort for the company.

In view of the resolution plan approved by the NCLT, Kolkata and pursuant to issuance of additional equity shares by Electrosteel Steel Ltd. (ESL) for giving impact of resolution plan of the successful bidder, ESL had ceased to be an associate of ECL. In view of the above, the company has made a fair valuation of its investment in ESL and a sum of Rs. 578.68 crore representing the difference between the carrying value of the said investment and fair value as on the date of transfer has been written off in HY1FY19. Further, advances and trade receivable amounting to Rs.211.21 crore receivable from ESL has also been written off in HY1FY19

The cost of raw materials (i.e., coal, iron ore) is the largest component of total cost of sales (accounted for 45% in FY18). Due to de-allocation of coal mines and delay in clearance in iron-ore mine, ECL has to procure raw materials from the open market. It procures coaking coal mainly from Australia and iron ore from the domestic market. The prices of these raw materials are volatile in nature and hence, ECL's profitability is susceptible to fluctuation in raw material prices.

Favourable outlook for domestic D.I pipe market due rapid increase in population, urbanisation and industrialisation has led to a significant increase in water requirement, leading to demand overtaking the supply. Increased central government grants under JNNURM scheme, funding from developmental agencies and current Central Government additional impetus to this sector through the AMRUT (Atal Mission for Rejuvenation and Urban Transformation) scheme are matters for significant comfort for the D. I. pipe segment, as the investment in urban water supply and sanitation has increased manifold in the last couple of years.

Future plans

Having successfully turned around the operations of Electrosteel Steel Ltd (ESL) in less than a year post its acquisition, the Anil Agarwal-controlled Vedanta Ltd is now looking to scale up production capacity and revamp the product portfolio to improve profitability. Plans are also afoot to give the company an image makeover and rename it. There is a possibility of renaming ESL, and the board is likely to take a decision in this regard in the next three-to-six months.

Vedanta is looking forward to expand its steel business operations under Electrosteel Steel Limited and is planning to setup a new steel making plant in Jharkhand to increase the current steel production capacity from 1.5 MPTA to 10 million tonnes in the next five to six years through organic and inorganic options. Electrosteel's 1.5 MTPA capacity greenfield plant in Jharkhand's Bokaro will be scaled up to 3 MTPA over the next two years in the first phase of expansion. It is likely to cost Rs 4,000-5,000 crore. While the ramp-up from 3 million tonnes to 6 million tonnes will happen at Bokaro, for the next phase, the company could look at setting up a greenfield project at some other site or consider an acquisition. The growth plans are in sync with Vedanta's goal of making it one of the top three players in the industry.