



IN SOLVENCY



INSOLVENCY PROFESSIONAL AGENCY
OF INSTITUTE OF COST ACCOUNTANTS OF INDIA

PERFORMANCE ANALYSIS OF ESSAR STEEL LIMITED

**PRE, DURING AND Post CIRP
A CASE STUDY**



Performance Analysis of Essar Steel Limited

Pre, during and post CIRP

A case study

Company Profile

Essar was incorporated in 1976 as Essar Steel Ltd (ESL). According to analysts, the Ruia family played a significant role in the development of the industry. Essar was the first private sector company, which was permitted by the government to set up a 2-million tonne steel plant.

ESL is a fully integrated flat carbon steel manufacturer--from iron ore to ready-to-market products. Its products find wide acceptance in highly discerning consumer sectors, such as automotive, white goods, construction, engineering and shipbuilding. It is the India's largest exporter of flat steel products and aims to reach 25 MTPA capacity.

It is the India's largest exporter of flat products, selling almost one-third of our production to the highly demanding US and European markets, and to the growing markets of South East Asia and the Middle East. A number of major client companies have approved its steel for their use, including Caterpillar, Hyundai, Swaraj Mazda, the Konkan Railway and Maruti Suzuki. Essar Steel has acquired extensive quality accreditations. Its lean team gives it one of the highest productivities and lowest manpower costs among steel plants internationally. It is totally integrated - from raw material to finished products, adding value at every stage of the manufacturing process. It is the first Indian company to brand flat products, under the name '24-carat steel'.

Company's plants include-

Hazira Steel Complex- Essar Steel operates the world's largest gas-based hot briquetted iron (HBI) plant with a production capacity of 5.1 million tonnes per annum (MTPA). The plant uses state-of-the-art technology, which ensures high quality raw material for the steel plant. Essar Steel is one of the world's lowest cost producers of HBI on a per tonne basis. The plant is supported by a captive power plant of 32MW, which operates at 100% capacity. The complex includes two flying shear lines of capacity 0.2 MTPA each, and two slitting lines of capacity 0.2 MTPA each, catering to the market of plates and sheets.

Essar Steel Algoma Inc- Established in 1901, Essar Steel Algoma Inc. is an integrated steel producer based in Sault Ste. Marie, Ontario, Canada. Formerly operating as Algoma Steel, it was acquired in June 2007 by Essar Steel Holdings Limited. Its current production capacity is 2.4 million tonnes per annum (MTPA). Algoma's cornerstone asset, the Direct Strip Production Complex (DSPC) is the newest continuous, thin slab caster in North America, positioning Algoma as a leading supplier of high strength, light gauge steel. In addition, Algoma's heat-treat plate facility provides a full range of quality steel grades for abrasion resistant, ballistic and other specialty plate applications. Other key mills at the plant include a slabcaster, a 106-inch strip mill (one of the widest in North America), a 166-inch plate mill, a cold mill, a just-in-time blanking facility and a welded shapes and profiles division.

PT Essar Indonesia- It commenced its commercial operations in 1997. With a current rolling capacity of 400,000 MT per annum, PT Essar has a state-of-the-art galvanizing line with a capacity of 150,000 metric tonne per annum. The company focuses on manufacturing value-added soft cold rolled products.

Visakhapatnam Complex- Essar Steel has built an 8.0 MTPA iron ore pelletisation plant in Visakhapatnam, Andhra Pradesh, India with technology supplied by Lurgi GmbH of Germany.

Essar Steel Minnesota LLC- It has access to iron ore resources of over 1.4 billion tonnes. The plant will have an annual capacity of 2.5 million tonnes per annum (MTPA) when completed.

Essar Steel Caribbean Limited(ESCL)- It is a 2.5 million tonnes per annum (MTPA) integrated steel plant for flat products in the strategically located Point Lisas Industrial Zone, Couva, Trinidad.

Paradeep facility- It is a 6 MTPA integrated steel project located in Orissa, India.

Essar Steel is the first steel company to set up the only retail chain for steel products under the brand name Essar Steel Hypermart. It has a strong network of over 60 Steel Hypermarkets. The outlets are conveniently located across the length and breadth of the country to cater to the customised requirements of small and medium enterprises. The hypermarkets offer a comprehensive range of flat steel products for a variety of applications. Other product lines, like longs, structural, and tubular, are also being developed to make Essar Steel Hypermart a one-stop-shop for steel products.

Product range of the company includes:

Hot rolled products-

Coils- In raw as well as pickled and oiled form of 180 mm - 2000 mm/7.08' - 78.74' width, 1.60 mm - 20.00 mm/0.063' - 0.79' thickness and 25 MT (max) weight.

Plates- of 5-20mm thickness, 750-2000 mm width, 2500-12000 mm length, and as per DIN 1016 (in mm) thickness tolerance.

Sheets- Essar Steel's high precision shearing line (Bronx-UK) turns out top quality steel sheets meeting demanding international standards.

Shot Blasted and Primed- Shot blasted and painted steel from Essar offer the cleanest surfaces and a comprehensive environment protection to its steel.

Cold rolled products- Hot rolled coils from Essar Steel are used to produce cold rolled products in the coils/ plates and sheets form. Cold Rolled Closed Annealed (CRCA)/Cold Rolled Full Hard (CRFH) type, of 600 mm - 1525 mm/23.63' - 60.04' width, 0.14 mm - 3.175 mm/0.0055' - 0.125' thickness with Matte, Bright, Dull surface finish.

Galvanized products- Galvanized Plain (GP)/Galvanized Corrugated (GC) type, 600 mm - 1370 mm/23.62' - 53.94' width, (BMT) 0.14 mm - 3.175 mm/0.0055' - 0.125' thickness, with Regular spangle, Minimised Spangle, Zero Spangle surface finish.

Essar Global Limited is a diversified business corporation with a balanced portfolio of assets in the manufacturing and services sectors of Steel, Energy, Power, Communications, Shipping Ports & Logistics, and Construction. Essar Global has offices in Asia, Africa, Europe and the America.

Essar Steel Limited : Strategic Target Positioning

Segment	Hot rolled steel, chequered plates, Shot blasted plates, Cold rolled steel, TMT Bars, Galvanised corrugated sheets
Target Group	Sectors such as automotive, white goods, construction, engineering and shipbuilding
Positioning	Company having value added segments in the steel industry, a diversified distribution network & integrated nature of operations

ESL –Performance analysis

Pre CIRP

The financial health of Essar Steel Limited (ESL) deteriorated from 2015 onwards due mainly to high cost of operations, mismanagement of resources, and external business environment impacting the steel sector. However, the signs of decay did not appear suddenly. Over the years, the decline in business became more prominent. Indian promoters have historically relied on debt to grow, and the Ruia's were no different. Its statement of indebtedness showed a principal outstanding of Rs. 50,786 crore as of 31 March 2017, of which Rs.5,016 crore was interest outstanding. Essar's cash flows were not enough to repay its outstanding debt. With little or no remedial measure undertaken by the management, the rot became sustained, forcing the company to bankruptcy. The Corporate Insolvency Resolution Process (CIRP) of ESL was commenced on 2nd August 2017, and the resolution was approved on 8th March 2019.

The key performance indicators reflecting the operational and financial position of the company during the period 2015 to 2017 are as under :

Performance indicators	2015	2016	2017
Current Ratio	0.61	0.23	0.18
Interest Coverage Ratio	1.20	0.27	0.20
Inventory days	60.67	58.79	40.10
Return on Assets (%)	0.78	- 6.91	- 9.55
Return on capital employed (%)	12.95	- 3.48	- 3.12
Assets turnover	0.30	0.25	0.40
Sales / working capital (%)	-2.13	- .52	0.62
EBITM (%)	- 6.18	-8.72	-5.09
Altman Z Score- is a predictability ratio that indicates future possibility of bankruptcy of the company	.30	- .83	- .77
Du Pont Ratio- The Du Pont ratio gives a			

comprehensive view of company's performance. Du Pont ratio = (Net Profit/sales) x (Sales/Asset) x (Asset/Equity) NP/Sale			
Sale/Asset	-0.37	-0.78	-0.76
Asset/Equity	0.25	0.26	0.40
Du Pont	21.07	19.26	18.38
	-2.01	-3.89	-5.65

From the above analysis it is apparent that the Essar Steel Limited had a poor operational and financial position during the period 2015 to 2017 with all financial indicators including Altman Z score and Du Pont ratios pointing towards impending distress in the company.

During CIRP

Heads	Pre CIRP % change (March 2017)	Pre-during CIRP % change (March 2018)	Reasons for Change
			Income
Sales	48	25	Declined due to overall decline in demand for steel products, both globally and domestically.
			Expenses
Material Cost	36	28	Material cost reduced due to decline in output.
Employee Cost	-5	5	Manpower cost increased due to resumption and scaling up of production.
Other Expenses	91	52	Other expenses which includes power and fuel, administrative expenses, selling and distribution expenses decreased due to improved efficiency and better expenses control.
Finance Expenses	16	33	Finance expenses increased due to increased current liabilities consequent upon increased volume of output.
Depreciation	1	-7	Depreciation amount declined due to decrease in net block including impaired assets.
			Profitability
EBITDA margin %	14	12	Margins remained almost similar in pre and during CIRP
PBT Margin	-34	-35	Margins remained almost similar in pre and

(%)			during CIRP
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From the above analysis it appears that the performance of the company during the period of CIRP was more or less the same as in pre CIRP period. Though the rot was stemmed to some extent due mainly to deep rooted operational and financial inefficiencies and bottlenecks compounded by the external environment including government policies regarding Steel sector and the demand and prices of the steel products.

Post CIRP

Debt-ridden Essar Steel has registered an EBITDA (earnings before interest, tax, depreciation and amortization) of Rs 4,229 crore during its Corporate Insolvency Resolution period (over 600 days).The company earned Rs 4,000 crore from its operations between August 2017 and February 2019. In addition, an earning of Rs 229 crore for March 2019.Moreover, this amount "excludes Rs 734 crore EBITDA utilised for Finance Costs (Financial Lease, LC/BG Charges to banks and finance charges on payables to suppliers etc) for maintaining the Corporate Debtor (Essar Steel) as a going concern.Crude steel production witnessed growth of 9.5% at 1.88 million tonnes and the company posted operating profit of Rs 1,120 crore in the quarter ending June 2019. This is more than twice Essar Steel had earned when Resolution professional took over the debt-laden alloy maker about two years ago. Net sales increased in the quarter by 3% at Rs 8,100 crore

Operating profit is also 2.5% higher than the same period last year and more than double of the March quarter, when low steel prices had hit realisations for the entire steel industry.The improvement has come due to cost efficiency and better inventory management, aided by better product mix.the company is meeting working capital requirements through internal cash and is not borrowing anymore from banks.Essar's performance was despite withdrawal of funding lines by MSTC to the tune of Rs 700 crore. MSTC used to provide funding lines for import.

At the end of March 2019, Essar's production stood at 6.78 million tonnes compared to 6.18 million tonnes in 2017-18 and 5.47 million tonnes in 2016-17.Essar recorded an 80 per cent capacity utilization in downstream units and a substantial increase in production of value added products comprising galvanising, colour coated products and pipes.Resolution professional ,who is now chairman of the monitoring committee is of the view that the performance of Essar was possible on account of support from the financial creditors and the management.It also establishes the plant capability.

The resolution of steel non-performing assets (NPAs) got a fillip after a series of government policy initiatives to support the domestic steel industry was followed by a sustained increase in steel prices. Together they have made steel a more viable business.Prices of hot rolled coil (HRC) had touched a low of about Rs 28,000 a tonne at the end of FY16 and then moved up to around Rs 46,000 in Q1FY19. After dipping in Q3 2018 to Rs 38,000

At the time of the first round of bidding, those interested had access to the January 2018 numbers, when Essar recorded an EBITDA (operating earnings) of Rs 1.9 billion, sales of Rs 23.8 bn and production of 540,000 tonnes.From there, it steadily moved to an EBITDA of Rs 3 billion, sales of Rs 25 billion and production of 550,000 tonnes in April 2018. Production in May 2018 was even higher at 580,000 tonnes.When the insolvency process started for Essar

in August 2017, the EBITDA was Rs 1.8 billion, sales at Rs 18.15 bn and production at 454,000 tonnes.

Even though the company demonstrated an improved performance post the CIR resolution, one of the concerns is, of course, weak demand outlook of steel industry. In India, the flat steel price has fallen steeply in recent years. India Ratings and Research (Ind-Ra) has also revised down its outlook on the Indian steel sector from 'stable-to-negative' for the remainder of FY20 owing to sluggish steel demand growth expectations. A Moody's Steel Asia Outlook has said that India's steel demand will slow to mid-single digit growth due to weak auto and manufacturing demand.

For Arcelor Mittal, which made a bid for ESL amounting Rs. 42000 crore successfully, there are several other costs need to be incurred. It has to spend another Rs. 2500 crore for the slurry pipeline in Odisha and will need to invest up to Rs. 15000 crore more for reducing dependence on gas usage in iron making. Arcelor Mittal's resolution plan for Essar Steel includes a capital expenditure plan of Rs 18,697 crore to take the finished steel goods capacity of the plant to 8.5 million tonnes by 2024. The long-term aspiration is to increase finished steel shipments between 12 and 15 million tonnes through the addition of new iron and steel-making assets.

Conclusion

Essar Steel Limited has shown significant improvement in operational and financial performance in post CIRP phase. Despite a sluggish demand growth in steel sector, the company has shown improvement in operations cash flow, efficiency and profitability. Essar Steel, one of the Reserve Bank of India's (RBI's) first 'Big 12' of non-performing assets to be auctioned under the Insolvency and Bankruptcy Code 2016, is likely to clock its best-ever performance this financial year. However, in future, how the company addresses the market and operational challenges need to be keenly observed.