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# Six months on, 'Mission IL&FS' is proving to be more difficult than thought

BY SHILPY SINHA, ET BUREAU | APR 10, 2019, 07.15 AM IST

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A week before [Lehman Brothers](#) foundered in the autumn of 2008, the US Treasury had stepped in to bail out [Fannie Mae](#) and [Freddie Mac](#), the ultimate backstops in America's mortgage-lending market. Initially, \$100 billion was the authorized bailout package that surged to \$187 billion over time. And the Treasury's emergency intervention was based on the premise that Washington must do its bit to reconstruct a financing ecosystem underpinned by trust.

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Exactly ten years later, Mumbai's policy and money-market mavens sat around oak-panelled boardrooms to decide the fate of a troubled financier that, although nowhere as large as the embattled leaders in US housing securitisation, owns and runs arterial roads, ports and warehouses across India. Hence, reviving IL&FS and shepherding its turnaround is as crucial to infrastructure - and capital-deficient India as was Washington's challenge to reengage the mortgage securitisation market stateside.

By way of federal intent and urgency, the similarities are evident. But that is where they appear to have ended, at least for now. Fannie Mae and Freddie Mac earned the Treasury \$58 billion in profits over the next decade, on tax-dollar investments of \$187 billion in bailouts.

To be sure, New Delhi has not promised a bailout package or forgiven loans to the defaulting group, replacing instead the management at IL&FS with a new board. The premise here is that IL&FS owns sufficiently attractive assets that could be sold to help retire liabilities and enhance recoveries. While the first part of the argument is not in question, at least in theory, the second seems to have been rather optimistic – especially in the light of about Rs 1 lakh crore in outstanding debt.

## THE INTRICATE WEB

So, six months later, IL&FS remains as much an enigma as it was in the autumn of 2018. It has high gearing, with consolidated debt to equity of 10:1, and glaring asset liability mismatches, pointing to the likelihood of significantly lower loan recoveries than earlier thought.

Of course, the subprime reference has never been too far away from IL&FS. In August, when it ran out of money and was unable to repay debt obligations, it drew comparisons with the Lehman crisis. From an original debt burden of Rs 91,000 crore, the situation has worsened because of delays in infrastructure projects, eroding the value of many operating assets. Earlier, the assessment was that special purpose vehicles (SPVs) were covered by their own cash flows, but now banks are making provisions on SPVs as well.

"I am not sure if the whole episode was handled well after and prior to the crisis," said TT Ram Mohan, professor, IIM Ahmedabad. "The new board and management are taking very long to get a grip on the numerous businesses of the group. To some extent, this is, perhaps, inevitable since they are new to the businesses. It would have been helpful if the board had quickly prioritised 10-12 assets that could be sold off so that liquidity could be infused into the other businesses."

IL&FS Financial Services, with a loan book of over Rs 18,000 crore, saw non-performing loans reach 90%. The management has recovered 10% of the doubtful exposure in six months.

## RECOVERIES IN DOUBT

"The recoverability of the loans either by IFIN or to third party is posing a challenge both in terms of timelines and the amount of money that can be possessed," said N Sivaraman, a member of the new board. "Clients IFIN lent to are weak, which could have an impact on what we recover."

The management is trying to address operational challenges such as securing the release of O&M payments, termination notices from authorities, coercive action from international creditors, and litigations renewing critical bank guarantees. It has developed a liquidity management framework using a 12-month, cash flow based solvency test.

The management has its hands full with 169 entities in various stages of resolution. It needs time to comprehend, develop and implement resolution plans. One of the many reasons valuations are falling is the government's reluctance to provide indemnity and warranties to potential buyers.

A case in point is the IL&FS energy business. Although the company received around a dozen initial bids from investors, including global infra partners, KKR, Brookfield, I Squared Capital and Macquarie, to buy more than 1,000-megawatt of renewable energy assets, the number of binding bids was minuscule. The company had pencilled in recoveries of Rs 8,000 crore from the sale of energy assets, although it may end up getting Rs 6,000 crore.

The group has several types of creditors. They include banks, NCD holders, provident funds, mutual funds, foreign banks and financiers that funded ECBs. The company has more than 150 intervening applications from companies across sectors.

It has appointed Cyril Amarchand Mangaldas and Shardul Amarchand Mangaldas as its legal advisors.

### **ASSET-LIABILITY MISMATCHES**

IL&FS is involved in long-term infrastructure projects. Most projects have cost overruns and are funded through external credit. These assets generate cash over a long period. In one of the verticals, the cash flow comes in 7-8 years while average maturity of loans is between 3 and 5 years. The solvency requirement is met out of fresh debt with the support of high credit rating.

Of course, that lifeline did not exist the day the company logged its first default.

"You have a situation that unless you continuously create value at SPVs and creditworthiness in the minds of creditors, your ability to raise fresh debt to sustain the current debt will be very difficult," said N Sivaraman, a member of the board.

The company has prepared a list of companies under the Red category, where liquidation appears to be the most appropriate goal. It has decided to pay creditors under the Green category, while exposure under the Amber category is under dispute.

"If we do not have a calm period, we will not have the management bandwidth for the task because we would not know whether to handle litigation or resolution," said Sivaraman.

The management wants IL&FS to be maintained as a going concern. It has received binding bids for the energy business. Between the energy and road verticals, the company plans to recover Rs 30,000 crore of debt. A large number of road assets are part of the sale process.

If the resolution process is allowed to stretch beyond a particular point, bankers and other creditors are going to see a steep value erosion. The new management can now only do the best of a bad job and minimise the loss to creditors.

"Beauty lies in the eyes of the beholder," said [Uday Kotak](#), non-executive chairman at IL&FS. "Where we think we may not recover value, somebody may find value. Similarly, where we think there is value, there may not be any. In a competitive bidding process, it is important to not give away your cards before they are played out."

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