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ESSAR STEEL executive vice-chairman **Firdose Vandrevala** says company is seeking to strengthen its working capital needs by selling assets and raising equity from promoters in addition to dollarising its existing rupee debt while focusing on the completion of the "last mile" of its capacity expansion by 2014

'We're Ready to Win, But Not Ready to Roll Out for Want of a Shoe Nail'

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Essar Steel is focusing on the completion of the "last mile" of its capacity expansion by 2014, a critical element of its plan to boost earnings three-fold and stave off a liquidity crisis.

That's not all — the company is also seeking to strengthen its working capital needs by selling assets and raising equity from promoters in addition to dollarising its existing rupee debt, said Firdose Vandrevala, who took over as executive vice-chairman in August.

He referred to the lack of time at his disposal in an interview to ET, referring to a management study that says a new CEO has about 100 days to settle down.

"But I think the nature of the industry and the nature of change is such that I gave myself 50 days. I can't say I'm new anymore. So I have half the time," he said.

Circumstances outside his control mean he doesn't have much time. Last Tuesday, CARE Ratings surprised Essar Steel by lowering its ₹525 crore non-convertible debentures to default grade due to certain payment delays. The steel maker's total bank loans stood at ₹31,500 crore as of March 2013.

Vandrevala summed up his company's predicament. "This (Essar Steel) is like an army ready to win but the army is not ready to roll out for want of a shoe nail. The last mile of these projects is like a fulcrum tilting the company. Once that is complete, we are home." The money that the company is raising is essential to travel this last mile.

An equity infusion from the promoters, apart from the asset sales and the dollarising of debt to the extent of $3 billion, will enable the company to reduce interest costs that have ballooned to ₹2,955 crore.

Vandrevala, a Tata Group veteran, who served the conglomerate for three decades before he joined real estate developer Hirco, turned metaphorical when trying to explain Essar Steel's debt. "Suppose I say I'm 80 kg, do you say I am heavy or light? It depends on my height, right?" In other words, the debt should be considered in the context of the new capacity Essar Steel has created at Gujarat, Odisha and Andhra Pradesh.

It has steadily increased capacity at Hazira in Gujarat to 10 million tonnes, with downstream steel units, which includes a heavy steel plate mill and greater steel tube making capacity. In addition, by November, he expects the pellet plant capacity in Odisha to have risen to 12 million tonnes from 6 million tonnes and the plant in Vizag in Andhra Pradesh to have expanded to 8 million tonnes taking the company's annual pellet making capacity to 20 million tonnes. "It is the lowest debt per tonne of capacity," Vandrevala said.

The Ruia family owns 97% of Essar Steel through Mauritius-based holding company Essar Steel Holdings (ESHL). The remaining shares are with those members of the public who didn't subscribe to the company's open offer at the time of delisting in 2007. Essar Steel posted earnings before interest, tax, depreciation and amortisation (EBITDA) of ₹1,822 crore for the year ended March 2013, according to its annual report. But it incurred a net loss of ₹2,785 crore on a total income of ₹19,190 crore. On a consolidated basis, the net loss widened more than 2.5 times to ₹5,105 crore.

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For Essar Steel, and in particular the group led by the Ruia brothers Shashi and Ravi, the current situation mirrors similar encounters with lenders in the past. The company was forced to enter corporate debt restructuring in 2002, emerging from it in 2006 by repaying ₹2,600 crore in four years against the specified period of 12 years. The company was much smaller then in terms of capacities and revenues.

Vandrevala admits mistakes were made as the investment climate was different then. "The nature of the expansion, the moratorium should have been longer. The repayment of loans was triggered before the EBIDTA growth happened."

EBIDTA is a key measure of profitability and reveals the capacity of a business to repay loans and interest.

on Putting the Co Upstream

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"Our plan is multi-pronged. It is a lifestyle change to reduce weight," said Vandrevala, reverting to the weight-loss metaphor. "We are looking at a lifestyle change at Essar Steel. And it has many components."

The company aims to step up production with the current project expansion getting completed by November 2014.

"Once I finish my capital investments, my EBIDTA will improve," he said. "The two major investments are the 1.5 million tonne steel unit and 6 lakh tonne pipe mill. You have to see debt in that context. The debt per tonne is not the issue. The issue is the ability to service the debt."

The company can sort out the debt issue with existing lenders and the default rating can be addressed quickly, said an investment banker who didn't want to be named. Essar Steel can also put together a structure that can lead to a better rating. A differentiation needs to be made between the underlying company rating and the structured rating, he said.

The company recently raised $1 billion by converting its rupee debt into dollars. It hopes to reduce interest rates by 4.5% through this measure. In addition, it has RBI approval to dollarise another $2 billion of debt. The promoters are expected to bring in ₹1,600 crore as equity and an asset sale will generate about ₹2,100 crore. Vandrevala declined to name the strategic investors and the assets earmarked for sale.

"Once the projects come in, it will be about three times our current earnings. That amount will be more than enough to meet our debt obligations," Vandrevala said.

The target is achievable, said Bhavesh Chauhan, senior analyst, metals and mining at Angel Broking.

"Tripling EBIDTA looks realistic. A steel plant takes about three years to reach full capacity, so in absolute terms, Essar Steel's EBIDTA will go up," he said, referring to the Hazira plant.

However, Chauhan added that lack of captive mines would mean lower profitability. "Essar Steel does not have its own iron ore and coking coal mine. This could cause a difference in margins of about 10-12% compared to a company which has these mines."

This was also cited by Rakesh Valecha, senior director — head of corporate ratings at India Ratings and Research.

"Even though raw material prices have come down internationally, Indian companies have not benefitted on account of the rupee depreciation, given that most steel manufacturers import coking coal and the challenge in passing on price increases to the consumer in a slowing economy," said Valecha, whose company doesn't rate Essar Steel. "All Indian steel makers import coking coal except Tata Steel, which sources 50% of its coking coal requirements from its captive mines."

Vandrewala referred to a memorandum of understanding (MoU) with Odisha, under which the state government has promised to allocate iron ore mines to the company. While that may take time, Vandrevala is eyeing the huge dumps of (low grade) iron ore that could be used as Essar has beneficiating plants. These are "national assets" and Odisha has 100 million tonnes of such dumps, which he hopes the government will allocate to companies like Essar soon.

Valecha cautioned that the prospects for the steel industry are difficult.

"The industry is going through a challenging time, globally and in India as well. Overall, demand-supply imbalances exist across most markets. For industry players who invested in large capital expenditures, the benefits post completion have been lower than anticipated, resulting in cash-flow pressures and higher leverage," he said.

Without referring to Essar Steel, Valecha pointed to a general rule of thumb in the steel industry. "Pricing pressures are likely to continue till capacity utilisation reaches a level of about 80%." With Essar Steel's capacity utilisation below 55% currently, Vandrewala will be hoping that the economy picks up enough to turn all that fresh production capability coming on stream can be put to good use, and get the cash flowing again.

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