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Tata Bhushan Steel Acquisition

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ABSTRACT

This is a case study of mergers and acquisitions both in the steel industry. Tata Steel Ltd. (TSL) acquired Bhushan Steel Ltd in the year 2018 under the Insolvency and Bankruptcy Code (IBC) of 2016 and renamed it Tata Bhushan Steel Ltd. (TBSL). Tata Steel has acquired a 72.65% share in BSL and paid the accepted corporate bankruptcy expenses as well as employee dues, as required by the IBC. Bhushan Steel was one of the few companies among the 12 recommended by the RBI under the Insolvency and Bankruptcy Code to be resolved. In a general sense & in the context of doing business in India, it is always in the best interest of a corporate to acquire an asset rather than build it from scratch, especially for a greenfield project.

I. WHY COMPANIES GO BANKRUPT?

(A) Various reasons and what's most prevalent prompting companies to file bankruptcy?

Market Conditions That Are Difficult

Bankruptcy is frequently caused by poor economic conditions in general and in the specific market in which a company works. The economy has a boom-bust cycle, with fast expansion followed by lulls or recessions. If the condition of market is good then it becomes easy for companies to float.

Decision Making Errors

Hasty judgments and company failure might result from a lack of planning and level-headed thinking. For example, a company owner could invest time and money in producing a product she believes in without first polling customers or analyzing manufacturing costs to see if the idea is viable.

Even though the product is beneficial, it may not be financially feasible in the long run. Poor judgments can be exacerbated by a lack of financial and management knowledge and experience, but no organization is immune to making mistakes.

Trouble Finding Financing

To help fund their operations, many business owners take out loans. If a company experiences

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financial difficulties, its lender may refuse to provide more funds, potentially leading to bankruptcy.

Viability

Economic viability refers to a company's capacity to generate consistent earnings over time. It doesn't imply the firm will be successful every quarter, but it will be profitable over time, providing cash for emergencies and solvency for present demands.

(B) Why did Bhushan steel go bankrupt?

Bhushan steel came into business in the year of 1987 when the steel industry was rising, and the steel was at its peak. Bhushan steel used to import most of their steel and just to get rid of that problem they undertook a loan of about 20000 crores for setting up their new plant within the country itself (Odisha) to increase their production capacity and to reduce dependency.

However financial crisis of 2008 led to huge disaster for the company. Due to crisis price of steel fell from 1200 to 300 dollars per ton. Also, the plant never completed and before that bank also started demanding their money back. Due to huge debt also the stock price of Bhushan steel fell rapidly and after some time the company declared bankruptcy.

(C) Recent examples of successful resolution of bankrupt companies?

II. DEWAN HOUSING FINANCE LIMITED (DHFL)

- The DHFL saga surfaced in 2019 with reports of alleged frauds and financial mismanagement by promoters Kapil and Dheeraj Wadhawan and went on to become a fierce battle between bidders Oaktree Capital and Piramal Capital & Housing Finance in the past few months.
- While the Wadhawans remain lodged in jail on money laundering charges, RBI referred the financial services company to NCLT for resolution back in November 2019.
- Over one and a half years later, the Piramal Group has emerged as a successful bidder with a Rs 37,250 crore offer after NCLT's nod on June 7.
- The company owes a massive Rs 87,082 crore to creditors including banks, financial institutions, NCD and FD holders.
- That means lenders will take a haircut of 57% on the bankrupt financial services company's debt. Lenders though are envisaging a recovery much lower than 43% after distribution of the funds.

III. VIDEOCON INDUSTRIES

The three-year-long resolution process of Videocon Industries and 12 other group companies ended with lenders taking a giant haircut of almost 96%, the biggest haircut on this list. Creditors lost out on almost Rs 62,000 crore after NCLT approved Vedanta Group-led Twin Star Technologies' Rs 2,962 crore bid on June 8 this year.

Essar Steel

- From the worst to the best recovery - Essar Steel not only became a landmark IBC case but the bidding race fetched the lenders 85% in returns on the steelmaker's debt of Rs 49,000 crore.
- Essar Steel was part of the first list of 12 companies identified by the Reserve Bank of India (RBI) to refer to NCLT for resolution of their mounting debts. Admitted to NCLT in August 2017, European steel giant, Laxmi Mittal-led ArcelorMittal finally got hold of the asset after a Supreme Court judgement in November 2019.
- The company's erstwhile promoters Sashi and Ravi Ruia left no stone unturned to get the asset back - be it bidding via Numetal or making a Rs 54,000 crore settlement offer.
- While the courts rejected all attempts by the Ruias, the 10 mtpa steel plant became the perfect vehicle for Mittal's entry into India. ArcelorMittal revised its offer in the second round of bidding to Rs 42,000 crore, fetching banks the best deal yet under IBC.

Bhushan Steel

- Another landmark case from RBI's first dozen, the resolution of Bhushan Steel was completed in a record 10 months with NCLT admitting the company for resolution in July 2017 and Tata Steel's bid receiving NCLT's approval in May 2018.
- The fastest resolution in the high profile list of IBC cases, the bidding war between steel giants Tata Steel and JSW Steel fetched lenders a 63% recovery. Tata Steel bid Rs 35,200 crore against Bhushan Steel's debt of Rs 56,051 crore for the 5.6 mtpa steel-making facility.

IV. WHY ACQUIRER (TATA) BID FOR BANKRUPT COMPANY FOR ACQUISITION?

(a) Value seen by TATA steel in acquisition and Strategic Fit

Tata Steel's anticipated acquisition of Bhushan Steel was a good strategic fit for the country's largest steel producer. Tata Steel derived a lot of benefits from the current acquisition. Although its reported bid for the company's 5 million tonne capacity at Rs 35,000 crore plus

12.2 per cent equity is way higher than what JSW Steel has offered, the benefits for Tata Steel could derive from this is also much higher.

In the short term, the expected rise in debt was a point of concern for investors, but the acquisition had accrued strong synergies in the long run.

Despite being debt-ridden, Bhushan Steel's operations were stable, and a favourable steel market aided the company's operating profits. While it added additional revenue to the group and has the potential to move the margins of Tata Steel higher, it raised debt levels in the balance-sheet considerably.

With the objective to synergize manufacturing, commercials, network optimization, procurement, and S&GA of Bhushan Steel, Tata Steel had overpaid for this stressed asset. But the deal seems to bring synergy in Tata Steel Operations and will benefit in long term goals.

Why Bhushan Steel, a strategic fit?

- I. Matching downstream business output: Tata Steel is the lowest-cost iron ore producer in the world, thanks to its own mines. It can use that ore for Bhushan Steel's plants, thus generating higher profits from the same assets.
- II. Sustaining dominance in Auto Sector: The acquisition of Bhushan would strengthen Tata's foothold in the auto-grade steel industry and give it greater access to the Northern market. Auto steel, a high margin segment is around 20-25 per cent of the total Tata Steel revenues and with Bhushan's acquisition, it could go up significantly. Bhushan Steel's Ghaziabad plant supplies to clients such as Maruti Suzuki. It also has a plant at Khopoli, Maharashtra which has good proximity to auto manufacturing hubs such as Pune and Gujarat.
- III. Capacity expansion goals: The acquisition will allow the largest steel producer to achieve its ambitious target of doubling its capacity by 2022. Currently, Tata Steel has an operational capacity of 13 MTPA and the board has approved a brownfield expansion of another 18 MTPA. That could rise to 23 MTPA with the acquisition.
- IV. Commodity Cycle: Consolidation of firm occurs when the commodity cycle is at its peak. The cycle has seen a severe downturn in 2015-16 due to demand slowdown and predatory pricing strategies from a country like China. There was an upsurge in demand and prices of steel from 2017 onwards. Tata Steel could exploit this opportunity with bigger production capacity.
- V. Why not Greenfield project? As stated by Mr. Kushik Chatterji, CFO Tata Steel, a greenfield project of 5 million tonnes per annum (MTPA) hot rolled coils (HRC)

and 2 MTPA cold rolling (CR) mill will require a CAPEX of Rs 31,000 crore. In contrast Bhushan Steel's acquisition cost, TSL could be benefitted with a potential cash flow of 1300-1500 cr in present value. So the economic value of BSL was around 44000-46000 cr, favoring acquisition. Also, a new project requires 4-5 years to complete with all hurdles and project delay. And hence the idea of greenfield project was out of frame.

(b) Complete Acquisition Process Flow

Corporate Insolvency Resolution Process (CIRP) of Bhushan Steel was initiated on July 26, 2017, under the provisions of the IBC Code. Pursuant to the initiation of the CIRP, TSL submitted its resolution plan for the resolution of Bhushan Steel. Meanwhile, Neeraj Singhal, former vice-chairman and managing director of Bhushan Steel, has moved the National Company Law Appellate Tribunal (NCLAT) seeking a stay on the takeover by Tata Steel.

Also, Larsen & Toubro Ltd, one of Bhushan's operational creditors had filed litigation to prioritize its due payment. With fending these off, TSL was selected as the highest compliant resolution applicant by the committee of creditors constituted under the IBC Code. On 15th May 2018, National Company Law Tribunal (NCLT) approved TSL's resolution plan.

The acquiring entity would be called TBSL. BSL subscribed to 72.65% of the equity share capital of TBSL for an aggregate amount of Rs 158.89 crore and provided additional funds aggregating to Rs 35,073.69 crore to TBSL by way of debt/convertible debt. The remaining 27.35% of TBSL's share capital will be held by TBSL's existing shareholders and the financial creditors who received shares in exchange for the debt owed to them.

The acquisition has been funded by around Rs 18,000 crore of Tata Steel's own capital, including internal generation and around Rs 16,500 crore of debt drawn on the 100% owned subsidiary company Bamnipal Steel that holds the equity of Bhushan Steel.

Amalgamation:

On April 2019, the Board of Tata Steel have considered and approved a merger of Bamnipal Steel and TBSL into the Company by way of a composite scheme of amalgamation and have recommended a merger ratio of 1 equity share of 10/- each fully paid up of the Company for every 15 equity shares of each fully paid up held by the public shareholders of TBSL. As part of the scheme, the equity shares held by Bamnipal Steel and the preference shares held by the Company in Tata Steel BSL shall stand cancelled. The equity shares held by the Company in Bamnipal Steel shall also stand cancelled.

(c) Integration Process and outcome for various Functions

Any M&A comes with lot of Organizational Challenges post-merger. As a result of merger, resources in various functions such as Marketing, Finance become redundant. The Integration process would involve streamlining and cutting down on extra resources which may draw a flak or resistance or unrest from employees. On operational side, merger will bring operational efficiencies of scaling up and improving the margins.
