Corporate Debt Restructuring, A Case of Wockhardt

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It was a typical rainy morning of Mumbai in 2012. Mr. Habil Khorakiwala, the Chairman of generic drug maker, Wockhardt Limited was lost in thoughts over a cup of coffee. The company promoted by him had just come out of an almost insolvency situation which he recalled as a 'near death experience'. Not too long ago he had envisioned his company to be the most admired health care company from India with a mission of making it USD 1 billion company by 2009.[1] To accomplish his mission, he focused on both organic and inorganic growth and went on with aggressive acquisitions. However the company's financial health started deteriorating post 2008. Steady fall in financial health of the company because of foreign exchange derivative losses, mounting debt and falling share prices gave him sleepless nights.[2] Declining profitability and increased debt almost pushed the company to bankruptcy. The company restructured its loan and made a dramatic turnaround. Coming out of the debt debacle was a great experience for him. It probably was the right time to reflect as to what went wrong and what lesson can be drawn for the future.

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[1] Corporate presentation, Wockhardt Ltd, 2008

[2] Divya Rajagopal, M Sabarinath and Satish John , "Hard work pays off for Wockhardt: Habil Khorakiwala, Chairman, Wockhardt," The Economic Times July 30, 2012

About Wockhardt

Wockhardt Limited was formed in early 1960 as Worli Chemical Works by Dr. Habil Khorakiwala, a pharmacy graduate from Purdue University, US. He believed that the only way to fast growth was to be customer focussed. He encouraged an open culture, empowered his people, focused at continuous improvement and wanted his people to enjoy their job.[3] By 2012, Wockhardt was a global pharmaceutical and biotechnology organisation based in 21 different nations with 7900 employees. It had 3 research centres globally and 12 manufacturing plants. The research centers had more than 578 scientists of which 80 were doctorates. The company had it's headquarter in Mumbai, India and with its operations spread out through the globe in USA, UK, Ireland and France. It had marketing offices in Russia, Brazil, Mexico, Vietnam, Philippines, Nigeria, Kenya, Ghana, Tanzania, Uganda, Nepal, Myanmar, Sri Lanka, Mauritius, Lebanon and Kuwait. It was the first pharmaceutical company to raise funds through Global Depository Receipts (GDR) and first Asian company to launch recombinant insulin from concept to market stage.[4]

It was truly global in nature as three-fourth of the business came from outside India. The global ERP software installed in the company integrated the various activities of the company worldwide through which its people had access to real time data and information. When Wockhardt entered the other parts of the globe as a step towards their mission of growth, they saw that their work culture, management philosophy and scientific skills were just perfect to provide for the health needs of the world. Wockhardians said, "It is one world, one value system." The company was passionately involved in innovation through

[3] http://www.wockhardt.com/who-we-are/chairmans-profile.aspx
[4] Annual Report 2005, Wockhardt

research which results in creating Intellectual Property.[5]. The company's shares were listed on the Stock Exchange, Mumbai (BSE), National Stock Exchange (NSE) and Luxemburg Stock Exchange in the form of GDR. Promoter's holding was 73.54 percent of the total paid up capital of the company. General public held 12.04 percent. Rest of the shares are held by Banks, Financial Institutions and others. Research, Operational excellence and globalisation linked together created a sustainable business model of Wockhardt.

However the growth journey was not without its hiccups. The company suffered losses from the year 2008 to 2010 and was facing the prospects of defaulting on its loans. It entered into a corporate debt restructuring arrangement with its bankers in 2009 and was able to make a remarkable turnaround averting the possibility of default.

Wockhardt's Growth: Organic and Inorganic

The company had a remarkable growth track record both in revenue and profits till 2007. The growth was achieved both organically and inorganically. Wockhardt acquired UK-based Wallis Laboratory in 1997 for USD 5 million[6], CP Pharmaceuticals in 2003 for 10.5 million pound sterling or INR 860 million. This was the largest ever overseas acquisition of any Indian pharmaceutical company.[7] In May 2004, Wockhardt acquired Germany based company Espharma for USD 11 million or INR 550 million.[8] In October 2004, Wockhardt issued 110,000 zero coupon foreign currency convertible bonds (FCCB) of USD 1000 each

[5] http://www.wockhardt.com/who-we-are/overview.aspx

[6] Wockhardt UK sells Luton unit to Bristol Labs for £2m. The Economic Times, October 8, 2004

[7] Wockhardt Acquires CP Pharma of UK, The Hindu, July 9th, 2003

[8] Wockhardt sells its German firm Espharma to Nova, The Financial Express, June18, 2009,

redeemable at 129. 578 percent of its principal in case the bonds are not converted before five years.[9]

The company made another acquisition by acquiring Pinewood Healthcare in Ireland in 2006 for USD 150 million or INR 6,860 million. In 2006 it acquired Dumex India to add brands like Protinex and Farex to its portfolio which doubled Wockhardt's nutrition business. It also acquired fourth largest pharmaceutical company, Negma Laboratories in France in May 2007 for an all cash deal of USD 265 million or INR 11,000 million. In the same year in November, Wockhardt acquired Morton Grove Pharmaceuticals in USA for USD 38 million (INR 1460 million).[10] This was a leading liquid generic and speciality dermatology company in US. The motives for these acquisitions were to enter a particular geography or segment.

Wockhardt needed funds to expand and as the cash flow from operations were not enough; they had to resort to borrowings. Borrowed funds increased from INR 498 million to INR 42,351 million in 2008. In an attempt to raise equity, Wockhardt Hospitals went for an initial public offer in February 2008 but only 20 percent of the shares were subscribed. This was due to the financial turmoil and the company had to finally withdraw the offer.[11]

After a great run in the profitability till 2007, the company suffered a loss of INR 1.39 billion in the year 2008 that jumped to over INR 10 billion loss in the succeeding accounting period. Though the revenue continued to grow, the profitability declined partially because of increased interest cost and also due to recognition of exceptional expenses. Wockhardt had raised secured and unsecured loans from domestic and international markets including

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[9] Annual Report 2008, Wockhardt , page 46

[10] Wockhardt acquires US firm Morton Grove, The Financial Express, October 25, 2007

[11] Wockhardt Hospital's Public Issues Bombs, The Financial Express, February 8th, 2008

foreign currency convertible bonds (FCCB). 73 percent of the company's total revenue was contributed through international operations because of which the company had to enter into complicated derivative products which unfortunately resulted in a negative profit before tax and after exceptional items of INR 2,510 million in 2008. Exceptional items in 2008 were INR 5,820 million that were due to hedging losses on foreign exchange currency and volatility in currencies and interest rates. In the same year, interest expenses of the company were INR 2703 million, representing 65 per cent increase in interest cost over 2007.[12] (See Exhibit 01 for the summary of the financials of the company and Exhibit 02 for the details of the exceptional items.)

Company's FCCB of USD 110 million was due for payment in October 2009 but the company did not have enough cash to redeem FCCB and was already sitting on pile of debt. These FCCB were issued at a time when the shares of the company were trading at INR 355 per share. The FCCB were convertible at the option of the holder at INR 486.075 per share by 25th December 2009. However as the share price of the company fell to around INR 180, the investors were looking for repayment rather than conversion.

To avert the possibility of default, entering a corporate debt restructuring arrangement with its bankers was probably the only option. Earlier companies like India Cements Limited, Kingfisher Airlines Limited and Vishal Retails Limited had entered similar arrangements with varying degree of success. The CDR arrangement of India Cements Limited was successful whereas the other two cases were not.

[12] Annual report, Wockhardt Limited, 2008, Page 27

About Corporate debt Restructuring

Corporate debt restructuring involved negotiating with the creditors to enable the financially distressed company to repay its loans. A distressed company had options of converting debts into equity, converting unserviced portion of interest into term loan or go for a one time settlement. In case the company felt that it was unable to repay the loan leading to possible bankruptcy, it could negotiate with the lenders for restructuring of debts to remain a going concern. A financially distressed company had high chances of becoming target of another company. CDR was done through a properly coordinated plan in order to protect the interest of the company shareholders and the lenders. If successful CDR could be a win -win situation for both the lenders and the borrower.

In India, the CDR Scheme was sponsored by Reserve Bank of India in 2002. The main features of CDR Scheme were:[13]

- It was a voluntary system based on debtor-creditor agreement and inter-creditor agreement.
- Legal basis for the mechanism was provided by Inter-Creditor Agreement (ICA). All participants in the CDR mechanism entered into a legally binding ICA with necessary enforcement and penal clauses.
- The scheme applied to accounts involving multiple banking accounts/ syndication/consortium accounts with outstanding exposure of INR 200 million and above by banks and institutions.

[13] RBI Notification, "Corporate Debt Restructuring" August 23rd 2001

- The CDR system was applicable to standard and substandard accounts, with potential cases of non-performing assets (NPAs) getting a priority.

CDR Structure

The CDR mechanism consisted of three layers – CDR Standing Forum, CDR Empowered Group and CDR Cell.

1. CDR Standing Forum was a self empowered body consisting of representatives of all financial institutions and banks participating in CDR system. This body laid down policies and guidelines and was responsible for guiding and monitoring the progress of corporate debt restructuring.
2. CDR Empowered Group - The individual cases of corporate debt restructuring were decided by the CDR Empowered Group (EG). The borrowers were classified into four categories. Class–A comprises of companies that were affected by macroeconomic factors. Class–B borrowers were not only affected by macroeconomic factors but also had weak resources, inadequate vision and did not have the support of professional management. Class-C borrowers were over ambitious who had diversified into related/unrelated fields with/without lenders' permission and those classified in Class-D were financially undisciplined borrowers. If restructuring of debt was found to be viable and feasible and approved by the EG, the company was put on the restructuring mode. If restructuring was not found viable, then the creditors were free to take necessary steps for immediate recovery of dues and/or liquidation or winding up of the company, collectively or individually.

3. CDR Cell - CDR cell assisted CDR standing forum and CDR Empowered Group in their functions. CDR cells made scrutiny of information received from borrowers / lenders and put up the matter in front of CDR (EG). If found feasible, the CDR Cell proceeded to prepare detailed rehabilitation plan with the help of lenders and, if necessary, experts were engaged from outside. If not found prima facie feasible, the lenders were allowed to start action for recovery of their dues.

Debt Restructuring at Wockhardt

Auditors' Report to the Board of Directors of Wockhardt Limited on the Consolidated Financial Statements for 2008 stated that **"**Without qualifying our opinion, we draw attention to Note 34 to the consolidated financial statements with regard to the Company's ability to repay its loan and related liabilities falling due up to December 31, 2009 being dependant on the Company being able to successfully implement the actions proposed therein. These liabilities due for repayment in 2009 amounts to approximately INR 14,414 million, which is greater than the currently expected cash flows from business and any committed or contracted sources of funds of the Company. As informed by management, the Empowered Group (EG) of Corporate Debt Restructuring (CDR) Cell has admitted the Company to the CDR Scheme. The Company's ability to continue as a going concern is dependent on the successful outcome of its application to CDR Scheme."[14]

CDR is an exercise where lenders to a financially disturbed company came together to work out an easier deal for the borrower. This might include extending the payment period and adjusting the interest rate. CDR mechanism also put restrictions on the powers of the management to take strategic and operational decisions.

[14] Annual Report 2008, Wockhartd, page 25

Restructuring package approved by CDR provided that the existing loan would continue at a concessional rate of interest of 10% p.a. in two parts, where 8% p.a. shall be paid on monthly basis while 2% p.a. shall be converted into preference share capital redeemable in 2018. It was decided that priority loans would be made available to the company to repay to the creditors, meet the operational requirements and settle the derivative losses which would be repaid in 8 equal quarterly instalments commencing September 15, 2010. There was a commitment from the management to sale/divestment of non-core business estimated over a stipulated schedule from 2009 to 2015. Also promoters agreed to bring in their contribution over the next one year in addition to the divestment proceeds. CDR scheme instructed the company to pay the existing Rupee term loans in 24 quarterly instalments commencing July 15, 2010. Secured Working capital loans outside the consortium were proposed to be converted into a working capital term loan to be paid in 24 quarterly instalments commencing July 15, 2010 and short-term loans would be paid in 20 quarterly instalments commencing January 15, 2014. The company was instructed not to execute any new derivative transaction (excluding forwards strictly for hedging purposes for a maximum period of 180 days) without prior approval of CDR EG.

The company took necessary steps in accordance with the CDR package. During the year 2010-2011, the Company allotted 130,888,983 Non-Convertible Cumulative Redeemable Preference Shares of INR 5 each and 22,386,344 Optionally Convertible Cumulative Redeemable Preference Shares of INR 5 each aggregating to INR 666.38 millions in terms of approved CDR package.

In August 2009, the company sold 10 out of its 17 hospitals to Fortis chain of hospitals for INR 9,190 million.[15] During 2009-2010 the company divested its Animal Health care Business to French company Vétoquinol.[16] The sale consideration was used to pay off debts of the company.

The promoters brought in their share of contribution of INR. 800 million as part of the package. Priority loans of INR 2,160 million were disbursed to Wockhardt as part of this package.[17] In July 2012, the company sold off its nutrition business for INR 1,280 crore to French dairy giant Danone and the proceeds were utilised for pay off its debts.[18]

Turnaround of Wockhardt Limited

The concessions given by the lenders and the commitment showed by the promoters and management showed results. The promoters fulfilled its commitments of bringing additional capital. The company divested its non-core businesses and used the cash so generated to pay off debts. Renewed focus on improving operational efficiencies, cost reduction and research and development did result in improved performance. The company turned around and reported a net profit of INR 905 million in 2011 which increased to INR 3.4 billion the next year. The company further wrote off INR 5.8 billion and INR 5.3 billion respectively in the year 2011 and 2012 towards exceptional items. The borrowed funds declined from INR 42 billion in 2008 to less than INR 30 billion in 2012 resulting in the interest costs coming down to INR 2.1 billion in the year 2012 from its peak of INR 3.4 billion

[15] C.H.Unnikrishnan, Wockhardt to sell 10 Hospitals to Fortis, Live mint, August 24th, 2009

[16] French co acquires Wockhardt's vet biz, The Economic Times, Jun 29, 2009,

[17] http://www.wockhardt.com/Files/Investor-Communication.pdf

[18] Deepali Gupta and Jyoti Vyas, Wockhardt to receive Rs 1280 crore from Danone on sale of nutrition brands like Dexolac and Farex, The Ecomonic Times, July 26th, 2012

in 2010. The Debt: Equity ratio looked much healthy at around 2:1 compared to 6:1 in 2010 (See Exhibit 03).

Habil Khorakiwala said, "The vision for New Wockhardt is "More & More with Less & Less". We have enormous strength in the organization, in technology, in people, in our manufacturing facility and in our geographical reach. This year and in the years ahead, we are determined to use our strengths to the utmost and create a new future and a New Wockhardt for all of us."[19] He never felt that he must pack up and call it a day. The chairman did not deal with the challenges in totality but broke it in components to tackle with it. "Khorakiwala feels that if the business model is strong, the CDR is a good mechanism to deal with on a short-term basis. "It did help us to stabilise the company, so we could focus on our operations, and that's what resulted in the turnaround situation.", said the Chairman.[20]

The turnaround also was reflected in the performance of its stock in the stock market. The market price of each share which was at INR 85.50 in March 2009, when CDR was announced went up to INR 1,223 on August 31st, 2012 (Exhibit 04). Khorawala said, "Had those who refused to take stock in CDR mechanism or when IPO was floated, taken them, would have been richer by now."[21]

No doubt entering into the CDR mechanism was difficult with all the covenants imposed as a part of the package. However commitment from the lenders and the company did help in a quick turnaround. This was a good time to look back, learn from the experience and decide about the future growth strategy and financing mix to fund the growth.

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[19] Annual report, Wockhardt, 2009-2010

[20] http://in.reuters.com/article/2012/08/19/india-wockhardt-debt-stock-idINDEE87I05U20120819

[21] Divya Rajagopal, M Sabarinath and Satish John , "Hard work pays off for Wockhardt: Habil Khorakiwala, Chairman, Wockhardt," The Economic Times July 30, 2012

Exhibit 01 : Summary of Financial Position

INR Million

Profit & Loss Statement

Particulars	2011-12	2010-11	2009-10	2008	2007	2006	2005	2004	2003	2002
Total Income	46,373	39,039	45,309	36,359	27,313	17,863	14,550	12,897	9,647	7,709
Operating Expenditure	33,179	29,520	38,792	30,468	20,935	13,910	11,343	10,191	7,893	6,455
Interest	2,144	2,671	3,425	2,591	1,638	409	261	200	156	96
Profit Before Taxation & Exceptional Items	11,049	6,849	3,093	3,300	4,741	3,545	2,945	2,506	1,597	1,159
Exceptional Income / Expenses	-5,282	-5,805	-12,949	-5,810		-604				
Profit Before Tax	5,767	1,043	-9,856	-2,510	4,741	2,942	2,945	2,506	1,597	1,159
Profit After Tax	3,416	957	-10,023	-1,593	3,825	2,413	2,571	2,135	1,426	1,051
Consolidated Net Profit	3,427	905	-10,007	-1,389	3,858	2,413	2,571	2,135	1,426	1,051

Balance Sheet

Shareholder's Funds	14,710	9,431	6,717	10,178	12,736	10,663	8,161	6,166	4,626	3,467
Borrowed Funds	29,672	31,846	40,175	42,351	29,000	19,703	9,065	8,914	3,302	498
Other Liabilities and Provisions	19,990	17,532	8,729	14,752	9,795	6,776	4,263	4,108	3,200	1,815
TOTAL	64,372	58,809	55,621	67,281	51,531	37,142	21,489	19,188	11,128	5,780
Fixed Assets	34,736	34,429	32,370	36,297	30,713	17,068	7,881	6,617	5,364	2,692
Investments	908	896	948	932	709	3	3	3	0	0
Other Assets	28,728	23,484	22,303	30,052	20,109	20,071	13,605	12,568	5,764	3,088
TOTAL	64,372	58,809	55,621	67,281	51,531	37,142	21,489	19,188	11,128	5,780

Cash Flow Statement

Cash From Operating Activities	11,843	6,418	-1,987	1,245	3,772	1,885	2,047	2,093	1,733	832
Cash Flow from Investing Activities	-3,047	-2,766	7,043	-11,981	-16,677	-8,763	-1,456	-1,518	-1,972	-760
Cash from Financing Activities	-8,266	-3,730	-3,957	10,399	6,777	9,539	-871	5,198	1,651	-531
Net Cash Inflow / Outflow	531	-78	1,100	-337	-6,128	2,661	-281	5,772	1,412	-459
Translation/Consolidation Adjustment	1,595	1,483	-81	-1,314	-341	-9	-37	10	-2	23
Net Increase/Decrease in Cash	2,126	1,405	1,019	-1,651	-6,470	2,652	-318	5,782	1,410	-436

Note: The Company changed its accounting period from Calendar Year to Financial Year.

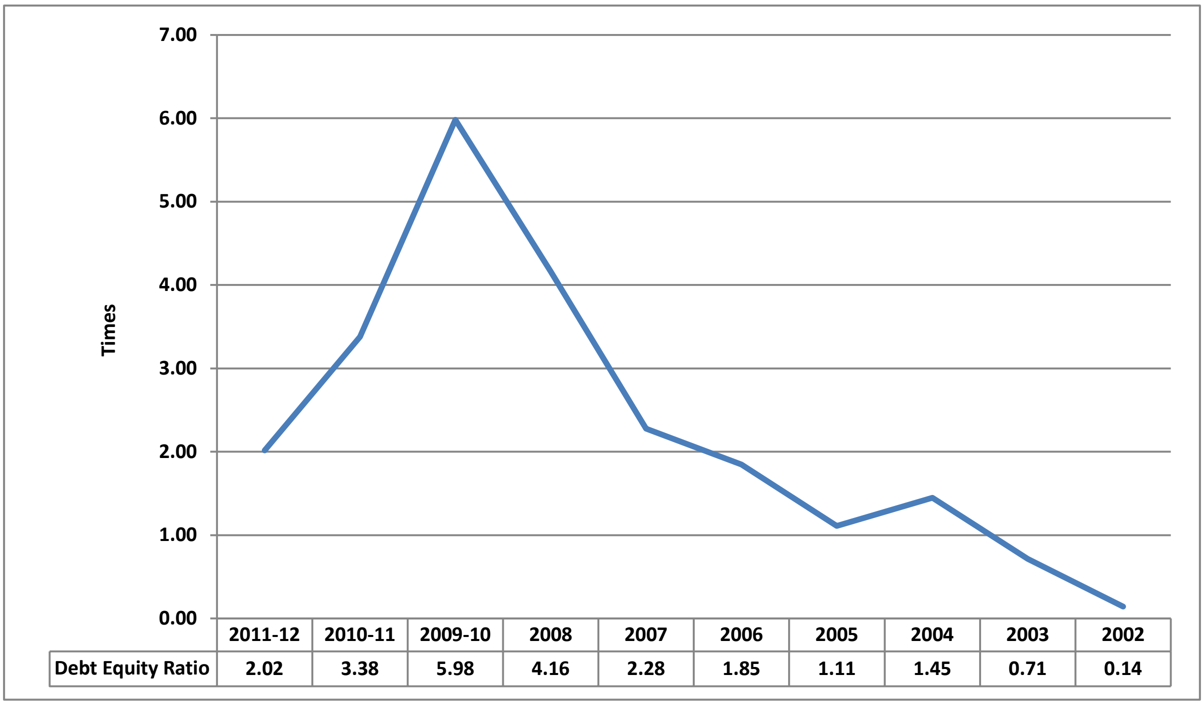
The figures for 2010 are for a period of 15 months.

Exhibit 02: Major Exceptional Items

Year ended	Nature of Exceptional Item	Amount (INR Million)
31st December 2008	Mark to Market/ Realized Loss on currency derivatives	(5,820)
31st March 2010	Mark to Market/ Realised Loss on currency derivatives Profit on Sale on Animal Health Division Profit on Sale of business of Esparma GmbH, Germany Impairment of Goodwill of Wockhardt, France	(11,571) 1,571 99 (2,662)
31st March 2011	Settlement of loans and disputed derivatives Crystallized derivative losses Reversal of marked to market provision Release of escrow on divestment of Animal Health Business Provisions, loss of assets and actuarial gain on pension scheme Restructuring cost of Wockhardt France (Holdings) S.A.S	(2,099) (1,967) 303 38 (223) (1,784)
31st March 2012	Settlement of loans and disputed derivatives Provision for CDR recompense Impairment of Goodwill Gain on restructuring of Wockhardt France (Holdings) S.A.S	(1,337) (1600) (3,335) 1,000

Source: Annual Reports, Wockhardt

Exhibit 03: Debt: Equity Ratio of Wockhardt



	2011-12	2010-11	2009-10	2008	2007	2006	2005	2004	2003	2002
Debt Equity Ratio	2.02	3.38	5.98	4.16	2.28	1.85	1.11	1.45	0.71	0.14

Exhibit 04: Share Price Movement Wockhardt Compared to The Market Index

Closing Price	Wockhardt (Rs.)	SENSEX		Closing Price	Wockhardt (Rs.)	SENSEX
31-Jan-08	360.15	17648.71		30-Sep-10	294.45	20069.12
29-Feb-08	336.80	17578.72		29-Oct-10	295.05	20032.34
31-Mar-08	266.20	15644.44		30-Nov-10	369.10	19521.25
30-Apr-08	297.20	17287.31		31-Dec-10	364.70	20509.09
30-May-08	297.60	16415.57		31-Jan-11	373.75	18327.76
30-Jun-08	184.50	13461.60		28-Feb-11	348.15	17823.40
31-Jul-08	186.85	14355.75		31-Mar-11	324.25	19445.22
29-Aug-08	199.05	14564.53		29-Apr-11	342.50	19135.96
30-Sep-08	155.65	12860.43		31-May-11	351.30	18503.28
31-Oct-08	109.90	9788.06		30-Jun-11	366.65	18845.87
28-Nov-08	92.95	9092.72		29-Jul-11	448.90	18197.20
31-Dec-08	108.25	9647.31		30-Aug-11	385.90	16676.75
30-Jan-09	103.10	9424.24		30-Sep-11	383.20	16453.76
27-Feb-09	80.45	8891.61		31-Oct-11	443.30	17705.01
31-Mar-09	85.50	9708.50		30-Nov-11	411.15	16123.46
29-May-09	120.60	14625.25		31-Jan-12	379.10	17193.55
30-Jun-09	136.10	14493.84		29-Feb-12	484.20	17752.68
31-Jul-09	141.75	15670.31		30-Mar-12	599.00	17404.20
31-Aug-09	162.15	15666.64		30-Apr-12	729.10	17318.81
30-Sep-09	194.60	17126.84		31-May-12	796.25	16218.53
30-Sep-09	194.60	17126.84		29-Jun-12	932.60	17429.98
30-Nov-09	175.55	16926.22		31-Jul-12	975.35	17236.18
31-Dec-09	172.20	17464.81		31-Aug-12	1223.10	17429.56
29-Jan-10	170.75	16357.96				
26-Feb-10	141.55	16429.55				
31-Mar-10	138.70	17527.77				
30-Apr-10	134.30	17558.71				
31-May-10	122.75	16944.63				
30-Jun-10	134.70	17700.90				
30-Jul-10	137.80	17868.29				
31-Aug-10	219.30	17971.12				

Source: www.bseindia.com