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WHERE RISK MEETS ITS MATCH

Falling rupee adds to the woes of firms with foreign currency loans: Jamal Mecklai to Live Mint

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The weakening rupee has made life even more difficult for Indian companies whose books are already loaded with debt. Companies with foreign currency loans are seeing an increase in interest payouts on account of a weaker rupee.

A Mint analysis of 14 companies from the top 10 corporate groups that have amassed an uncomfortable level of debt over the past three financial years shows that nine of these have more than 30% of their total debt denominated in foreign currencies. In the case of some companies such as Essar Oil Ltd, Reliance Communications Ltd and Adani Ports & Special Economic Zone Ltd (APSEZ), the share of dollar debt is more than 50%.

Among these 14 companies are also GMR Infrastructure Ltd, JSW Steel Ltd, Essar Ports Ltd and Lanco Infratech Ltd. These firms are part of the top 10 stressed groups highlighted by brokerage Credit Suisse in its House of Debt report.

With stress levels at these firms already high, an increase in repayment obligations in rupee terms will add to the pressure, at least in the case of companies that don't earn in dollars.

Companies such as those mentioned above would typically borrow at about 300 basis points over the prevailing London Interbank Offered Rate, which was at about 0.5% last year.

This would imply an annual interest rate of approximately 3.5%, leading to an interest outgo of $3.5 million on $100 million on debt.

With the rupee depreciating about 6% between last year's average and the current prevailing rate, this interest outgo gets marked up by Rs.1.4 crore. Still worse, analysts are now talking of the rupee at Rs.70 to the dollar.

In the October edition of its House of Debt report, Credit Suisse flagged these concerns and said that the high forex debt poses an additional problem for these companies.

"For some of these companies, a large share of their debt is forex denominated. This also has been one of the reasons for the sharp cost overruns in some of the projects," the report said.

Rakesh Valecha, senior director and head of credit and market research at India Ratings, believes that the repayment capacity of companies has worsened since fiscal year 2015.

“The fall in rupee adds another layer of challenge to the highly leveraged companies who are either net importers and/or have foreign currency debt liability,” he said.

In an August 2015 report, India Ratings noted that 234 listed companies have a negative sensitivity to a falling rupee. The rupee was trading at around 65.10 per dollar at that time and weakened 5.17% between January and August 2015.

The rating agency said in its report that a 1% fall of the rupee would erode 0.19% of absolute earnings before interest, tax, depreciation and amortization (Ebitda, a measure of operating profit) of these companies. Valecha said that things haven’t changed materially since that report.

Reliance Group, Lanco Infratech, GMR Infrastructure, JSW Steel, Adani Power Ltd, Adani Enterprises Ltd, Vedanta Ltd, Videocon Industries Ltd, Essar Oil and Essar Steel did not respond to emails seeking comment.

Many of the 14 companies studied are present in sectors such as refineries, iron and steel, fertilizers, aluminium and power, which are most vulnerable to swings in the exchange rate, said Credit Analysis and Research Ltd in a 25 August report.

To be sure, not all of the 14 companies have the same degree of vulnerability.

Companies such as Essar Shipping Ltd and APSEZ earn in dollars, which offers a natural hedge against currency fluctuations. And some corporate groups are known to have sophisticated treasury management that can handle the impact of currency fluctuations.

“The company enjoys a natural hedge as its marine income as well as container income is linked to the US dollar. Approximately 35% at the revenue level and approximately 50% at Ebitda-level income is linked to the dollar. With this, the total debt is almost 100% hedged naturally. Therefore, we do not see any negative impact of the dollar’s appreciation,” a spokesperson for APSEZ said in an email.

As on 30 September 2015, the consolidated gross debt of APSEZ was Rs.21,612 crore, out of which Rs.12,199 crore (56%) was foreign currency denominated debt, the spokesperson said.

“Shipping is a dollarized business. The bulk of the business is billed and paid for in US dollars. In such a situation, if the debt is largely in dollars, the impact is minimal as the receivables are in dollars as well. Given that there may be a timing mismatch in the flows, there may be some impact in the short term, but in the longer term, the impact will net out,” said a spokesperson for Essar Shipping.

However, analysts are not entirely convinced about the immunity that many of these companies have against a depreciating rupee.

Forex advisers said that despite repeated warnings by the Reserve Bank of India (RBI), the extent of hedging remains low.

"Hedging hasn't improved materially. Also, hedging is not an easy business and you need to have a structured approach. There should be a system you have, which will make you see triggers and people should have discipline. We provide tools to clients, but a very small percentage of companies are disciplined," said Jamal Mecklai, founder and chief executive officer of Mecklai Financial Services, a forex brokerage and risk management firm.

According to Mecklai, the unhedged exposure hasn't materially reduced from the levels in early 2015, when RBI had indicated that about 41% of forex loans are hedged. "I am talking of imports and exports, not just ECB (external commercial borrowings)," added Mecklai.

So, why are companies willing to take a hit and not hedge? Two reasons are the cost of hedging and sheer complacency.

Abhishek Goenka, founder and CEO of forex risk solutions firm IFA Global, said that paying a premium is a deterrent for companies. "Companies are hedging their interest rate risk, but they are keeping their principal open to currency risk. Going and booking forward and paying premium is not what companies are doing," said Goenka.

The one-year forward dollar/rupee premium has averaged around 6.50% in the current fiscal year, largely similar to that in 2014-15. In the past two weeks, when the rupee dropped more than 2%, forward premiums slipped 10 basis points. One basis point is one hundredth of a percentage point.

Goenka pointed out that most forex loans are long-term, which makes companies think that the impact of currency volatility will even out over the entire loan tenure. The rest are mostly sure that RBI will keep the currency in a range. "Until the rupee depreciates annually by 6%, companies won't be serious about hedging," said Goenka.

The rupee has depreciated by 7.87% thus far in 2015-16.

Signs of trouble on foreign currency loan payouts emerged in 2015 when Jaiprakash Power Ventures Ltd deferred its repayment of foreign currency convertible bonds (FCCBs) on 13 February 2015.

The company arrived at an agreement with its bondholders to extend the repayment of the FCCBs and also managed to refinance part of the maturing bonds. About $200 million worth of FCCBs are due for repayment this month.

Companies that have not hedged their foreign currency exposure are not just trouble for themselves but for banks as well. RBI has mandated banks to keep aside provisions for unhedged position of borrowers. Axis Bank provided Rs.77 crore for such exposures in the three months ended 31 December 2015.

It is no surprise that in the absence of adequate hedging, banks mark such loans to market and ask borrowers to keep additional margins.

"This is usually done so that we don't bear the cost of provisioning alone," said an executive at a public sector bank requesting anonymity. The Economic Times first reported this practice of margin calls on 21 January.

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