Sterlite Power Transmission Ltd

Capital Goods | Company Update

Not Rated

October 07, 2023

Proposed demerger to help unlock value; Products business visibility remains strong

Key Points

- We recently interacted with the management of Sterlite Power Transmission Ltd. (SPTL), represented by Mr Manish Agrawal, Director & CEO – Global Products & Services and Mr Ashok Gandhi, CFO (Interim) to gain insights into the current business environment and the company's overall business prospects.
- On 28th Sept, 2023, SPTL's Board approved the demerger of the Power Transmission Infra business (BOT model) into a separate entity SGL5. The demerged SPTL will house the Products business (Conductors, OPGW and Power Cables), Specialized EPC services business (MSI) and Neutral Independent Fiberco business. We believe this process will help in value creation for the Global Products and Service business.
- In Conductors space, SPTL is a direct competitor of Apar Industries Ltd and both companies have sizable market share in India besides strong presence in export markets too. In Cables, while Apar has a diversified portfolio of LDC, Elastomeric Cables, OFC and Power Cables, SPTL has a strong portfolio of MV, HV and EHV Power Cables and is expanding its portfolio to include Solar Cables as well.
- Overall, we believe that demand for Conductors and Cables is expected to remain strong over the medium term on the back of healthy demand amid aggressive capex globally for RE capacity addition, T&D expansion, HSR up-gradation, benefits from 'China+1' theme and favourable tariff structures in the US.

Overhead Conductors/OPGW business: SPTL is a leader in HPC Conductors with a 70% market share. It has undergone a 5-year premiumization journey and realizations on Conductors (excl. Services margins) have improved to ~Rs29.3k EBITDA/MT in FY23 from ~Rs13k EBITDA/MT in FY19. It expects realizations to improve further going ahead as HPC realizations continue to improve. To cater to robust demand, SPTL is planning to virtually double its Conductors capacity to 200k MT by 2HFY25. It continues to remain leader in OPGW with a 50% market share and outlook is strong owing to complete market access.

Cables business: SPTL is present largely in MV, HV and EHV space. It has a 26% market share in EHV Cables up to 220kV and has 22% market share in EHV Cables up to 400kV. The performance of the Cables business was sub-optimal up until FY22 due to lower operating leverage. But, profitability improved significantly in FY23.

Solutions business: MSI business has been conceptualized to address capacity issues of existing power transmission lines by increasing ampacity by 2-3 times without shutdowns within existing ROW, boosting power flow by 20-30 times, replacing existing power conductors with HPC etc. MSI business offers Uprate, Upgrade and OPGW solutions. SPTL's overall market share stood at 38% at the end of FY23. SPTL's market share in Uprate/OPGW/Upgrade stood at 36%/53%/28%. Margins in the MSI business are much higher than the EPC business owing to the focus on Innovation-Technology-Solutioning.

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Sterlite Power Transmission Ltd. (SPTL) Demerger:

- Apart from being a leading player in Private Power Transmission Infra business (which is operated under the BOT model), SPTL has wide portfolio offerings in the form of Conductors, OPGW and EHV Power Cables (in its Products business). It also provides solutions to address capacity issues of existing power transmission lines through the MSI business. SPTL also has presence in utility grade Optical Fiber Infra Leasing space.
- Under its Transmission Infra business, SPTL has developed/is developing a robust portfolio of 15,000 circuit kms of transmission under the 'BOT' model. The company leads the 5-6 player market, with a market share of 25% among the private players and has an Order book of Rs 80Bn
- On 28th Sept, 2023, SPTL's Board approved the demerger of the Power Transmission Infra business (BOT model) into a separate entity SGL5. The demerged SPTL will house the Global Products business (Conductors, OPGW and Power Cables), Solutions Specialized EPC Services business (MSI) and Neutral Independent Fiberco business. The company is to file the Demerger application with NCLT.
- We believe this proposed demerger will lead to better value unlocking for its Products and Specialized EPC Services businesses.
- The demerged entity will also own Neutral Independent Fiberco business in India. Currently, SPTL has 29% market share in utility grade Optical Fiber Infra Leasing space. It has an existing portfolio of ~5,500 rkms of fiber network and has monetization rights for an additional ~2,100 rkms. The management is targeting to be a pan-India 'Alternate FiberCo' with OPGW portfolio of 50,000 rkms by FY25-end through PPPs.

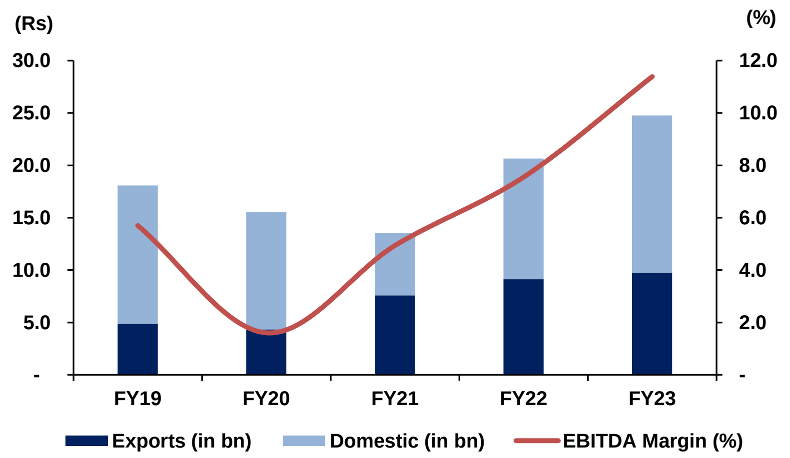
Demand Environment:

- The management expects power transmission network to double over the next 8 years to meet aggressive RE addition and it highlighted that projected investment for the same is ~Rs5tn.
- The management highlighted that demand for Conductors is expected to remain strong on the back of aggressive RE addition, transmission line expansion, 'China+1' benefits, favorable duty structure in the US etc.
- Transmission line expansion is expected to remain aggressive due to higher gestation period vis-à-vis power generation expansion. Gestation period for Domestic/Overseas transmission lines is ~2-3 years/7-8 years.
- The management highlighted that it is witnessing strong demand for new transmission lines in Rajasthan and Gujarat under TBCB. The management remains optimistic about demand for new transmission lines in Karnataka, AP and Telangana.
- The management highlighted that it is witnessing significant demand for conductors in the US due to aggressive addition in RE power to meet climate goals committed by the Federal and State governments.

Products Segment:

- Products segment consists of Conductors & OPGW businesses and Cables business.
- SPTL manufactures various Power Conductors (including High Performance Conductors) and OPGW. SPTL has a wide range of HPC offerings. Product offerings under HPC include HTLS, ACCC, Gap Conductors, ACSS, AL-59, etc. SPTL was the first player to introduce HTLS conductors in the India market. It continues to maintain a leadership position in HTLS conductors.
- SPTL is into engineering, manufacturing & supply of MV, HV, EHV cables up to 220kV and associated solutions business up to 400kV. SPTL also undertakes UG turnkey solutions, including other elements like GIS, Bay Augmentation & substation solutions.

Exhibit 1: Product Segment Trend



Source: Company, Nirmal Bang Institutional Equities Research

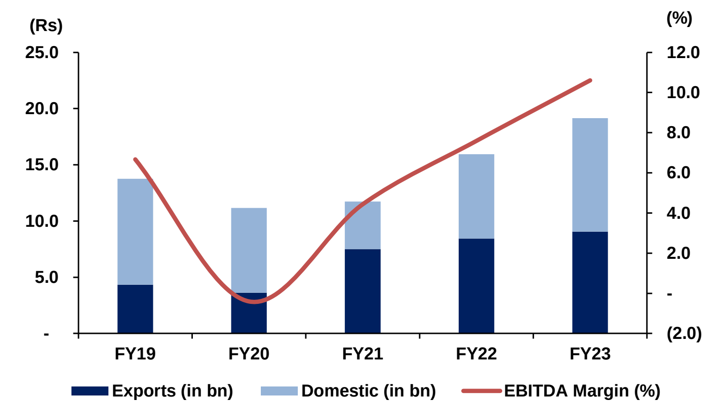
Conductors & OPGW Business:

- Conductors& OPGW business revenue stood at Rs16.1bn/Rs20bn in FY22/FY23. EBITDA margin stood at 7.6%/10.6% for FY22/FY23. Conductors segment PAT stood at Rs700mn/Rs1.3bn for FY22/FY23. Revenue contribution from HPC stood at ~25%.
- In FY23, SPTL's market share in Power Conductors/OPGW stood at 21% (market share in premium HPC sub-segment stood at 70%)/50%.
- SPTL exports conductors to over 70 countries, mainly to North America, South America, Europe and Oceania regions. Revenue contribution from exports stood at ~53%/~47% in FY22/FY23.
- SPTL expects significant growth from India, North America, South America, Oceania, SAARC, Africa, CIS and the Middle East regions over the next 5-10 years on the back of RE capacity addition.
- Addressable market in exports for Conductors is 1.2mn MT. SPTL's market share in exports stood at 9% in FY23.
- The management highlighted that SPTL has undergone a 5-year premiumization journey. It further highlighted that domestic utilities had some reservations about HPC initially. However, acceptance for HPC in the domestic market is quite good now. SPTL continues to maintain a leadership position in premium HPC segment with a 70% market share.
- Conductors segment EBITDA/MT stood at Rs29,284 at the end of FY23, led by better realisations amid growing premiumization and better realisation in exports. The management expects realisations to improve going ahead as realisations for premium conductors continues

to improve (like AL-59). The management highlighted that it is witnessing demand for premium conductors in Africa. It expects demand for premium conductors from the US in future.

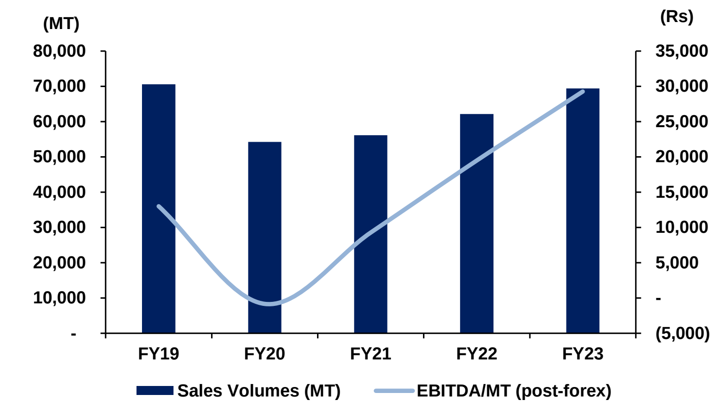
- SPTL has three manufacturing facilities in India with an annual installed capacity of 132k MT (effective capacity 110k MT) for conductors. It is planning to virtually double its capacity to 200k MT through expansion in India and overseas and capex for the same is expected to be completed by 2HFY25. SPTL is in final stages of getting approval for setting up a Conductor plant overseas which will also have OPGW line. The management expects to benefit from the BABA (Build America, Buy America) theme. It expects profitability of the overseas plant to be similar to its India plants.
- The management highlighted that tariffs on Chinese conductors are 15-20% higher than tariffs on Indian conductors. It further highlighted that Indian players are also witnessing surge in demand for conductors from the US on the back of ‘China+1’ benefits. It further highlighted that the tariff structures in several geographies are at par with the Chinese players.
- Competitive intensity in HPC conductors is low due to fewer players (5-6 major players). Major players in HPC conductors are SPTL, Apar Industries, ZTT (Chinese player), South Wire (USA) and Lamifil (Europe).
- Captive Sales of Conductors are ~5-7% of total conductor sales.
- SPTL does not have a presence in Railway Conductors as margins are not attractive.

Exhibit 2: Conductors Segment Trend



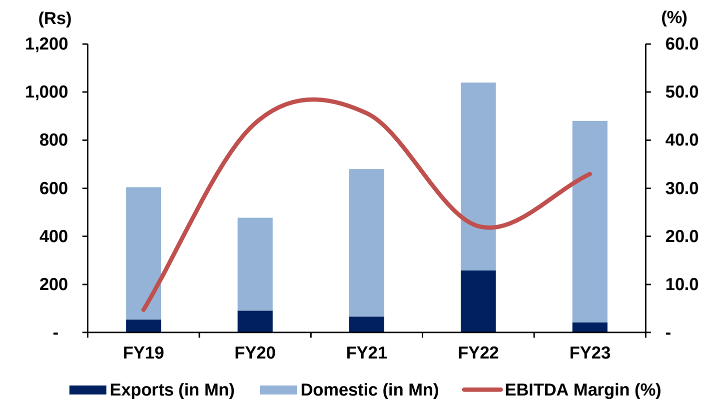
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Conductors Volume and Realizations Trend



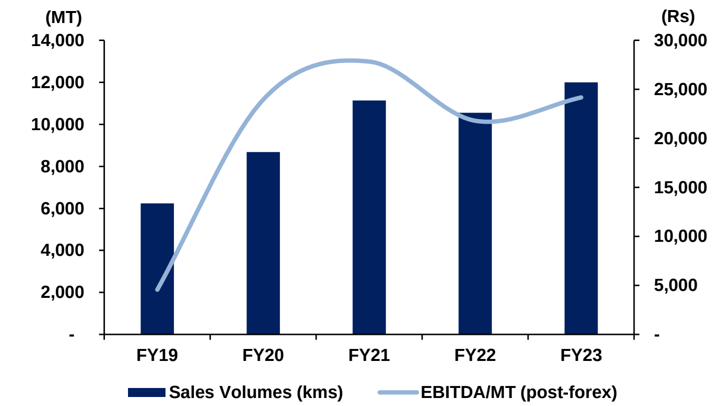
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: OPGW Segment Trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: OPGW Volume and Realizations Trend

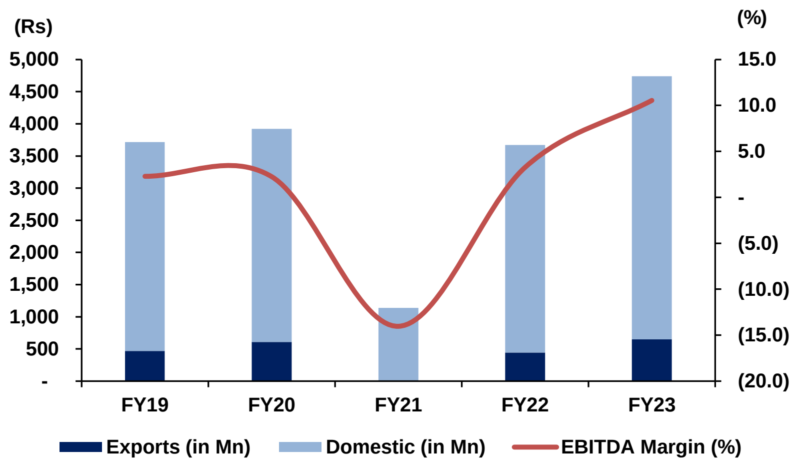


Source: Company, Nirmal Bang Institutional Equities Research

Cables Business:

- Cables revenue stood at Rs3.7bn/Rs4.7bn in FY22/FY23 while EBITDA margin stood at 3.3%/10.5%. Cables business PAT stood at (Rs70mn)/Rs230mn for FY22/FY23.
- SPTL has 26% market share in EHV Cables up to 220kV. SPTL's overall market share in EHV Cables up to 400kV stood at 22%.
- SPTL currently exports cables and revenue contribution from exports stood at ~12%/~14% in FY22/FY23. It plans to expand its export presence to the North America, Australia, etc. The management highlighted that there is a huge demand-supply gap in the US for cables.
- SPTL expects Power Cables to grow by 14% annually on the back of strong demand from national as well as state power utilities, metro companies, renewable energy companies and infra push.
- SPTL's overall production capacity stood at 3,600km/annum at the end of FY23.
- Total order book for Products business (Cables + Conductors & OPGW segment) stood at Rs39.31bn at the end of 2QFY24.
- SPTL is expanding its portfolio to include Solar Cables and is planning to offer turnkey solutions for EHV Cables. Major domestic players in Solar Cables are Apar, KEI and Universal Cables.

Exhibit 6: Cables Segment Product Financials

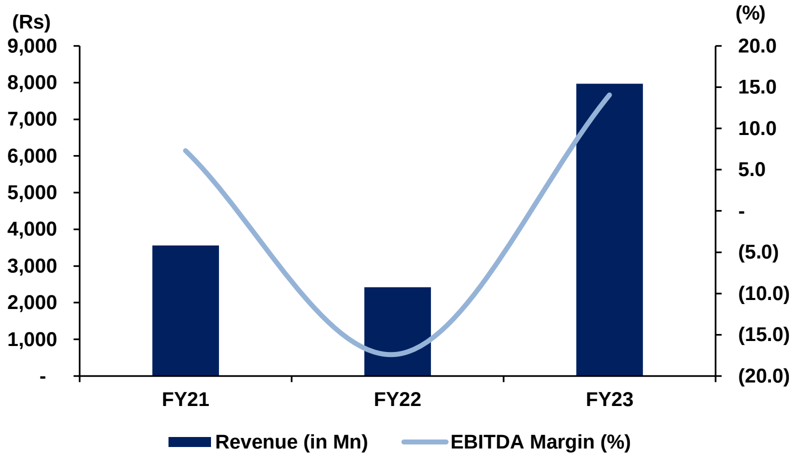


Source: Company, Nirmal Bang Institutional Equities Research

Specialized EPC Services Segment:

- MSI business has been conceptualized to address capacity issues of existing power transmission lines by increasing ampacity by 2-3 times, boosting power flow by 20-30 times, replacing existing power conductors with HPC etc. by building solutions around minimizing:(a) Time for engineering & execution of new line (b) Space by using existing corridor, thereby reducing ROW (c) Capital by infusing less capex against new corridors.
- MSI division offers Uprate, Upgrade and OPGW solutions.
    - **Uprate:** Replacement of existing power conductors and Engineering, Supply, Erection & Commissioning of HTLS conductors and associated Hardware & Accessories (H&A).
    - **Upgrade:** Upgradation of transmission line and Engineering, Supply, Erection & Commissioning Tower, HTLS Conductor & associated H&A and materials; Delivering higher voltage in same ROW, reducing investment in Time, Space & Capital.
    - **OPGW:** Engineering, Supply, Erection & Commissioning of OPGW and associated H&A on existing transmission lines by replacing earth wire. Solutions developed from 24F to 96F OPGW cable for replacement of earth wire from 66kV voltage to 400kV voltage level transmission corridors & further monetization of connectivity by utility.

Exhibit 7: MSI Business Financials



Source: Company, Nirmal Bang Institutional Equities Research

Master System Integration (MSI) business:

- MSI business revenue stood at Rs2.4bn/Rs8bn in FY22/FY23 while EBITDA margin stood at (17.4%)/14.1%. MSI business PAT stood at (Rs660mn)/Rs720mn for FY22/FY23. The management highlighted that margins in the MSI business are much higher than the EPC business owing to niche and specialized nature of offerings.
- SPTL maintains its market leadership in the niche MSI space in India. SPTL's overall market share stood at 38% at the end of FY23. SPTL's market share in Uprate/OPGW/Upgrade segment stood at 36%/53%/28%.
- SPTL expects strong Uprate/Upgrade demand on the back of large investments in T&D sector by GOI, accelerated rollout of OPGW networks by State Transmission Utilities, aggressive RE capacity addition, replacement of existing transmission with high-speed catenary & uprating existing catenary conductors.
- SPTL is planning to expand into new geographies and the power distribution sector. It is also targeting the opportunity arising from new railway business and evacuation & greenfield

corridors by Independent Power Producers (IPP) and Independent Power Transmission Companies (IPTC).

- Earth Wire to OPGW replacement (for transmission lines up to 132kV) across India has been accelerated on the back of PSDF scheme rollout. The management highlighted that 40% of transmission lines (up to 132kV) are yet to replace earth wire to OPGW. The management highlighted that there will be strong demand for OPGW if GOI includes OPGW replacement for transmission lines up to 66kV under PSDF scheme rollout.
- SPTL does 80-90% business with state power transmission companies. Exposure to power distribution companies remains low. SPTL remains very selective when dealing with power distribution companies. The management highlighted that payment receivables days generally range around ~60-90 days. It further highlighted that there are no bad debts.
- SPTL's MSI order book stood at Rs17.26bn at the end of 2QFY24.

Guidance:

- The management expects Products business revenue (Cables + Conductors & OPGW) to grow at 49.1% CAGR over FY23-FY26E with EBITDA margin improvement of 60bps.
- The management expects Specialized EPC Services business (MSI) revenue to grow at 27.5% CAGR over FY23-FY26E with EBITDA margin improvement of 310bps.

Others:

- SPTL undertakes complete hedging of its Copper and Aluminum requirements to mitigate commodity price fluctuation risks.
- The management highlighted that Conductors and Cables capacities are currently running at 90%+ utilization levels.

Annexure

Annexure – 1: Important Terminology

Abbreviation	Full Form
MSI	Master System Integration
LDC	Light Duty Cables
OFC	Optical Fiber Cables
MV	Medium Voltage Cables
HV	High Voltage Cables
EHV	Extra High Voltage Cables
RE	Renewable Energy
HSR	High Speed Rail
HPC	High Performance Conductors
OPGW	Optical Ground Wire
rkms	Route Kms
TBCB	Tariff Based Competitive Bidding
HTLS	High Temperature Low Sag Conductors
ACCC	Aluminum Conductor Composite Core
ACSS	Aluminum Conductor Steel Supported
GIS	Gas Insulated Switchgear
PSDF	Power System Development Fund
ROW	Right-of-way

Source: Company, Nirmal Bang Institutional Equities Research

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