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Ajmera House, Pathakwadi,
L.T. Marg,
Mumbai - 400002. INDIA

Tel: +91 22 4062 8853
Email: broking@ajmera.co.in
Website: www.ajmerax-change.co.in

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Transmission & Distribution: *Tariff-based competitive bidding to grow*

In order to promote competitive procurement of transmission services and have competitive tariffs, the power ministry has laid out a road map to award power transmission projects worth Rs 1,00,000 Cr through the tariff-based competitive bidding route (TBCB). With increased awarding of projects under TBCB in the future, private participants shall also be key in driving domestic demand.

Industry Overview

After facing a slow demand over the last few years, the market for high-voltage transmission equipment is expected to grow significantly over the coming decade, driven by the expected increase in investment in transmission infrastructure expansion, and upgradation of projects. It is estimated that over USD 640 billion is planned or proposed to be invested in the global transmission industry by 2025. The demand for equipment has already started picking up, as is indicated by the improvements in the order inflow and financial performance of major equipment manufacturers in 2015 and in the first half of 2016.

FY 16 saw an addition of around 28,114 ckm of transmission lines (220kV and above) and in FY 17 another 23,384 ckm of transmission lines (220kV and above) is expected to be further added. Even though, the overall number is lower than the previous fiscal, mainly due to balance targets of 12th Plan left to be achieved, the pace of line additions are so robust that the actual line additions up to December 2016 have exceeded the planned programme. The central sector had planned to add 9,751 ckm of lines over the course of FY 17, and 8,609 ckm up till December 2016. Actual line additions by the central sector up till December 2016 have been 9,301 ckm. Similarly, the private players have also achieved 3,148 ckm of transmission line addition as compared to the planned 2,075 ckm for 2016-17. This outlines the impetus to the sector, where private entities are also actively participating through the tariff based competitive bid (TBCB) route and gradually increasing their share in the transmission sector.

At the end of the 11th Plan, the inter-regional transmission capacity (132kV and above) stood at 27,750 MW. During the XII Plan, (April 2012 to March 2016), 29,700 MW of inter-regional transmission capacity has been added, taking the total inter-regional transmission capacity (132kV and above) to 57,450 MW as on March 31, 2016. The total inter-regional capacity addition planned in the 13th Plan (2017-18 till 2021-22) is 47,500 MW, to increase the present inter-regional capacity of 63,650 MW (as on November 2016) to 1,18,050 MW by 2021-22. This is to be done through several inter-regional corridors and system strengthening projects.

As a consequence, the sector should see sustained investments from PGCIL and the state transmission utilities. PGCIL has incurred a sustained annual capital expenditure between Rs 20,000 - 22,000 Cr since FY 13 until FY 16. The recent budget has revised the current fiscal capital expenditure allocation from the erstwhile Rs 22,500 Cr to Rs 24,000 Cr and another Rs 25,000 Cr is planned over FY 18 for the construction of transmission lines. In contrast to the previous few years, where the central sector used to drive investments in the sector, focus has now increased on intra-state transmission additions.

Consequently, state transmission utilities are expected to incur a capex of ~Rs 98,000 Cr under the 'Power for All' Scheme planned by the Ministry of Power. Several states like Andhra Pradesh, Telangana, Tamil Nadu, Rajasthan, UP and Gujarat are already active in this regard. Similarly, in order to increase competitiveness in the sector, tariff based competitive projects have propelled the private sector additions as well. So far 35 projects have been put up for bidding through this route and a further four projects are expected to be bid out soon.

Moreover, development of green transmission corridors as outlined by the National Green Corridor Programme will provide further impetus for the sector as it envisages transmission network for renewable energy. Additionally, 25-26 GW of solar and 8-9 GW of wind over 2017-19 will propel incremental demand in the transmission tower space over the next few years as state transmission utilities connect this new energy capacity to the grid.

State transmission investments to provide impetus to demand with increased focus on intra-state transmission

Investment of Rs 98,000 Cr is planned by state transmission utilities of 17 states over the next three years. Additionally, transmission companies, particularly those in the South such as Andhra Pradesh, Karnataka, Telangana and Tamil Nadu, which are also expected to add renewable energy capacities, reflect a high potential for transmission line investments over the next few years. System strengthening initiatives by Haryana, north-eastern states, UP and MP will further boost demand. Demand from Maharashtra and Gujarat are expected to remain stable as these states continue to upgrade their transmission & distribution infrastructure.

As per the Draft National Electricity Plan released by the CEA in December 2016, several states have proposed significant transmission line additions till March 2022. E.g. Gujarat plans to add another 5,150 ckm of 400 kV and 5,311 ckm of 220 kV transmission lines and Telangana is targeting 3916 ckm of 400 kV and 1,148 ckm of 220 kV of transmission line additions by 2022.

PGCIL TLT order finalization down 16% in Q1FY18

Indian transmission sector that witnessed to strong order placement in 2016-17 witnesses strong traction in order inflow from state and TBCB segment even while the order finalization activity of PGCIL is somewhat subdued so far in current fiscal. The order placement of PGCIL, the single largest customer for the Indian transmission and distribution sector in Q1FY18 was down by 72% to Rs 3148 crore. This follows the 70% jump in order placement witnessed in 2016-17.

Transmission Line Tower orders finalized by PGCIL in first three months period of current fiscal was down by 16% to Rs 1950 crore compared to Rs 2312 crore placed in 3mFY17. PGCIL has finalized further orders worth Rs 277.67 crore till July 28, 2017, there by taking the overall TLT orders finalized in current fiscal to Rs 2228 crore, a fall of 4%yoy.

Share of top 7 players in PGCIL TLT orders stands at 66% so far in FY18

The top seven TLT EPC players have accounted for about 72% of the TLT orders placed by PGCIL in FY17. However the share of top 7 players in the PGCIL TLT orders so far placed in current fiscal (till Jul 28, 2017) declined to 66%. While Kalpataru Power Transmission (KPTCL) that just got one TLT order and account for modest 3% of the total orders placed by PGCIL in FY17 has accounted for 20% of the TLT orders so far place in current fiscal. Similarly Gammon India accounted for a share of 11% as against 8% in entire FY17. KEC International accounted for 17% share so far in current fiscal as against 19% in FY17. Larsen & Toubro is having a share of 11% in current fiscal compared to 11% in FY17.

Despite changed dynamics of transmission sector with introduction of tariff based competitive bidding, the PGCIL continues to be the single largest player and have not desist from developing new vendors and continue to provide business for smaller players with trial orders. Simplex Infrastructure one of the constructions major has bagged orders worth Rs 470 crore in FY17 including one large order worth Rs 311 crore for 765 KV Ajmer Bikaner Transmission Line project. Similarly IL&FS Engineering Construction and C&C Construction have bagged orders worth Rs 136.27 crore and Rs 73.61 crore respectively so far in FY17. The same trend continues in FY18 as well with Angelique International has bagged orders worth Rs 128.79 crore and EMCO orders worth RS 199.74 crore so far in FY18.

KEC International bagged Rs 1684 crore of T&D orders

The industry majors have reported strong order inflow so far in Q1FY18 despite lower TLT order finalization by PGCIL so far in current fiscal. Strong order inflow announcement by industry majors so far in current fiscal are largely from state sector, private and overseas.

Order inflow of KEC International in Q4FY17 was higher by 77.8%yoy to Rs 4564 crore and that for FY17 was up by 41.8% to Rs 12358 crore. Skipper booked orders worth Rs 900 crore and Rs 1400 crore respectively for Q4FY17 and FY17. Similarly the order intake of Kalpataru Power Transmission (KPTL) was higher by 6.3% to Rs 2850 crore and for FY17 was up by 12.2% to Rs 8460 crore. KPTL has bagged orders worth Rs 1450 crore in Q1FY18 and in addition it was L1 in orders worth Rs 2000 crore. Similarly KEC International has started FY18 with an L1 order book of Rs 3300 crore and of which the company has already announced orders worth Rs 945 crore on May 19, 2017.

KEC international on July 10, 2017 has announced that it has bagged orders worth Rs 1684 crore in transmission and distribution sector. This includes an EPC order for construction of 765 kv and 400 kv transmission line from a TBCB developer in Western & Southern India, a turnkey contract for construction of 400 kv transmission line in south India from PGCIL and a order for 400 kv and 220 kv substation in South India. Similarly KPTCL on June 30, 2017 bagged orders worth Rs 676 crore including substation orders worth Rs 237 crore, Railway electrification order worth Rs 152 crore, tower supply cum transmission line order worth Rs 153 crore from various customers.

Riding on strong order intake in Q4FY17, the order book of KPTL stood in excess of Rs 9000 crore with 52% of order book from international markets. Similarly the order book of KEC International stood at Rs 12600 crore and of which about 52% is international orders. Skipper has now an order book of Rs 2600 crore as end of March 2017.

On June 19, 2017, L&T's power T&D business has announced that it has bagged a transmission line orders worth Rs 540 crore including one large order from PGCIL to build a section in the 800 kv HVDC bipole link between the Western & Southern Regions. This follows another stretch of the same corridor bagged earlier. Of the Rs 1950 crore worth of TLT order so far finalized by PGCIL about Rs 1382 crore is made up finalization of tower orders for various stretches of Raigarh Pugalur HVDC transmission line. Apart from L&T that bagged two stretches/packages the other beneficiaries are KPTCL with orders worth Rs 445 crore, Gammon with RS 244 crore, Unitech & Skipper JV with RS 241 crore and EMCO with Rs 199.7 crore.

Tractions for T&D orders are largely from South Indian states, Odisha and UP. In next couple of years the orders pipeline of UP and Bihar will also grow strongly.

Though some improvement in order finalization in Middle East market that is not in the range/level witnessed 3 years back. So, traction in international order flow is expected in CIS, Africa and SEA markets.

TBCB project pipeline is strong in excess of Rs 10000 cr

Dynamics of Indian transmission sector has changed with introduction of tariff based competitive bidding (TBCB) for selection of project developer for interstate/central sector transmission projects. The inter-state transmission projects of national importance or critical or complex in nature are continue to be assigned to central transmission utility i.e. PGCIL.

Till November 2016, about thirty four projects (excluding the one cancelled) were awarded under TBCB method and of which PGCIL won only about nine projects with balance twenty six projects bagged by private players. Of these thirty four projects about nine were already commissioned or completed and the construction work is under way in case of seventeen projects. For about eight projects, the developer is identified and construction is yet to be commence. In addition about ten projects with an aggregate estimated project cost in excess of Rs 8900 crore are under various stages of bidding process. Further another four transmission projects with an estimated project cost of Rs 1261 crore are to be taken up for execution under TBCB but are yet to be notified.

Some of the projects which was decided to be taken up for execution under TBCB by the Empowered committee on transmission of Central Electricity Authority on its meeting on August 9, 2016 but yet to be notified are where bidding work of any sort is yet to start numbers about four projects with an estimated project cost of Rs 1261 crore.

Further the EC on transmission has decided to take up five projects are under regulated tariff mechanism. This projects are to be taken up by PGCIL, the CTU on nomination basis.

The Northern Region System Strengthening Scheme XXXV (Mohindergarh-Bhiwani 400 kv D/C Line of 55 KM) which was notified for implementation through TBCB route vide Gazette notification dated July 15, 2014 has now been de-notified to be executed by Central Transmission Utility on regulated tariff mechanism. De-notification comes after completion of RFQ stage and identification of 3 bidders including PGCIL, KPTCL, and EIL. This de-notification and subsequent allotment to CTU was warranted as only PGCIL has bought RFP document despite time extension. Similarly the Transmission system for LTA of 400 MW for 2x500 MW NLC project which was notified to be executed under TBCB vide Gazettee notification dated July 22, 2015 is now de-notified and to be executed by regulated tariff mechanism.

Delay in signing of TSA delays transmission projects under tariff based competitive bidding process

The tariff based competitive bidding transmission projects are getting delayed largely due to difficulties in signing of Transmission Service Agreements (TSA). According to RECTPCL and PFCCL , the two bid process coordinators (BPC) for the transmission projects nominated to be taken up under tariff based competitive bidding process the difficulty in signing of TSA by the Long Term Transmission Customers (LTTCs) is largely in case of transmission projects related to generation projects. There are instances that the TSA was signed after approximately 4 months after completion of bidding process.

In few cases, the transmission scheme has been approved despite LTA has not been signed between central transmission utility (CTU) and the LTTCs. Due to non-signing of the LTA between CTU & LTTCs, the LTTCs are not willing to sign the TSA.

In some cases, the LTA has been signed between CTU & LTTCs for more quantum than the PPA entered between Generator & LTTCs. This mismatch in quantum is also causing significant delay in signing of the TSA by the LTTCs.

Further non-signing of TSA results in delay in transfer of SPV to the successful bidders. In case of ATS for Tanda Expansion TPS (2x660) MW project the non signing of TSA by the LTTCs namely (i) Punjab State Power Corporation Ltd (PSPCL) (ii) Tata Power Delhi Distribution (iii) BSES Rajdhani Power delays transfer of SPV to the successful bidder i.e. Essel Infraprojects, who was issued with an letter of Intent (LoI) on Oct 09, 2015 after successful completion of bidding process. In case of this project out of 11 LTTCs, 8 LTTCs has executed the TSA except for three LTTCs. These three LTTCs wanted MoP to divert/re-allocate their share from Tanda TPS stage II to other bulk power customer and hence not willing to sign the TSA for this project.

According to the Empowered Committee on transmission projects the modification in the Standard Bidding Document for procurement of transmission services would overcome these issues. According to it, as far as non-signing of TSA for projects as per the existing bidding documents are concerned, BPC has to pursue with LTTCs and also through CEA/MoP. Further, issue of non-signing of TSA needs to be discussed on case to case basis.

Mid teen growth in revenue expected by industry majors for FY18

Sitting on strong order book KPTL has guided that its revenue is expected to grow by 15-20% in FY18 and its EBITDA margin is expected to be at about 10.5%-11%.

Given strong firm order book as well as L1 order book, KEC International expects 15% growth in top-line for FY18 and an EBITDA margin of about 9.5% (up from 9.3% in FY17.

Market overview

T&D EPC services in the country for long has been dominated by handful of players such as Larsen & Toubro, KEC International, Gammon, Jyoti Structures, Kalpataru Power Transmission, Tata Projects and EMC. This is partly due to the user industry structure and strong prequalification criteria warranted by the user industry as well as their strong project management bandwidth. Majority of the investment in T&D network is driven by either central or state power utilities for long time. But now with Power Grid Corporation of India (PGCIL) in its pursuit to expand the vendor base allotted certain number of trial orders and that along with advent of PPP projects and Independent Power Producers have opened up opportunity for newer players. Resultantly domestic players engaged in construction services, stand alone tower manufacturers or those engaged in conductors and International players have got into the sector in consortium. For instance players such as Deepak Cables entered this segment by acquisition of a PGCIL approved tower manufacturing capacity in Eastern part of the country. Similarly overseas players as well as domestic companies such as IVRCL and other have entered this space by joining hands with domestic tower manufacturing companies. The Indian power transmission & distribution EPC majors are globally competitive with significant presence in overseas markets such as Middle East, Central & South East Asia as well as Africa.

The industry comprise of three set of players offering turnkey/ EPC project solution in T&D space backwardly integrated with tower manufacturing facility or other T&D equipments, standalone EPC players and standalone tower/other T&D equipment manufacturers. Leading players such as Larsen & Toubro, KEC International, Gammon, Jyoti Structures, Kalpataru Power Transmission and EMC are all backwardly integrated players with own tower manufacturing capacity. Project management bandwidth is the crucial factor often determines the number of transmission line projects, a company can handle rather than the tower manufacturing capacity as the EPC players can tap on the surplus capacity available in the domestic tower manufacturing industry.

Demand Drivers

The demand for Power Transmission & Distribution EPC service is strongly correlated to investments in power sector especially setting up of new power generation capacities as well as modernization of existing transmission and distribution networks with an object to improve efficiency.

Strong fresh capacity addition target of about 88 GW in 12th plan period along with consistent growth in demand for power on the back drop of economic growth, lower per-capital consumption of power as well as lower penetration of electricity. This along with investment towards improving the stability and efficiency of the transmission and distribution grid as well as green energy transmission corridor are to drive the demand for the sector going forward.

The T&D segment of Indian power sector is expected to witness a capex of about Rs 180000 crore during twelfth five year plan period with major junk of it amounting Rs 100000 crore to come from Central sector (i.e. PowerGrid) with the state and private account Rs 55000 crore and Rs 25000 crore each.

Since substation and rural electrification has become significant business for the Transmission EPC players, the country's plan to add additional substation capacity of 270000 MVA during 12th plan period compared to actual addition of about 134026 MVA in 11th plan period also to boost order inflows of the industry players.

The National Electricity Plan of Dec 2016 targets a transmission system capacity addition of 62800 ckt/km and 128000 MVA with distribution capacity addition of about 110000 MVA during 2017-22 to support the target generation capacity addition of 187821 MW during this five year period.

Increases focus on new geographies and diversify into similar cross country construction jobs

Unlike Larsen & Toubro and Gammon India, who are a reputed and large construction business and T&D EPC business is an extension of that, players such as KEC International, Kalpataru Power Transmission and Jyoti Structures, EMC have largely relied on power sector and more particularly on T&D EPC jobs. Having acquired strong project management/ EPC skill across various terrains across various geographies across the world these players are now slowly focusing on cross country jobs such as railway electrification/signaling/track laying etc., cross country pipeline orders etc. While KPTCL have a small infra division engaged in laying of pipelines it has acquired JMC projects which was into civil construction especially Factories & Buildings and roads. KEC International has also organically expanded its business to Railway orders such as track electrification, rail track laying etc. Currently about 5% of its order book comes from Railway business. Apart from that the company (KEC International) has got the Telecom tower business with the merger of group company RPG Towers with itself and got into cable business with merger of RPG Cables. In Q2 FY'13, about 30% of the revenue of KEC International came from new division comprising of Power systems, cables and Railways contributed as compared to 22% in corresponding previous period.

The players are also start focusing on entering newer geographies hitherto not focused much such as Americas etc as the domestic as well as overseas market, where they currently have presence turn highly competitive. KEC International & Jyoti Structures have established presence in American market with former acquiring SAE Towers which has 100000 MT of lattice tower manufacturing plant and the latter set up a green-field tower facility with a capacity of 34000 MTPA in USA.

Jyoti Structures which commissioned its green-field US plant set up through 100% subsidiary in March 2012. The company has already bagged couple of orders in USA and expects to close the current fiscal ending Dec 2012 with a sales of about USD 16 million and no profits.

Currently the industry players are faced with slowdown in domestic order inflow given slowdown in power sector investment as well as execution delays due to issues ranging from approvals, land acquisition to off-take issues. Similarly the political uncertainties in Middle East & North Africa have slowed down project tenders and awards. Further with global slowdown result in increased competition from large Korean and European players as their home market start drying up. On limited pie coupled with heightened competition as well as forex volatility start squeezing the margin of the industry players.

Country still with surplus tower capacity and lower utilization levels

Tower manufacturing capacity in the country considering the capacity additions of the key players, has doubled since FY 2008 to roughly about 1686000 metric tones per annum. The project management bandwidth being the crucial element determining the capacity of the industry the limiting factor T&D projects largely capacity expansion came from integrated EPC players as well as standalone tower companies who cater to large EPC players either as subcontractor or as consortium partners in tenders.

Inabensa Bharat, the 100% subsidiary of Abengoa SA, the Spanish infrastructure conglomerate is embarked on setting up a greenfield steel fabrication plant in the state of Gujarat, near the city of Vadodara with an annual capacity of 25000 tons at a cost of Rs. 100.2 crore. The plant will manufacture equal quantity of steel structures for transmission & distribution (T&D) projects and metallic support structures for the cylindrical parabolic solar collectors (CPC) and heliostats in concentrated solar power (CSP) projects that will be developed globally, including in India and neighboring countries.

Strong renewable power generation addition target requires augmenting transmission capacity

Government of India has fixed a mammoth target of achieving 175 GW of renewable power generation capacity by 2022 up from around 46-47 GW as of now. The Solar and Wind map of India indicates that the potential of solar and wind power is concentrated mostly in few solar and wind rich States. Thus it is forecasted that about 9 States of the country to account for more than 77% of the RE capacity addition by 2022. The solar and wind power generated by these States may not be consumed fully by these States. Power generated from RES by these States needs to the transported to the load centers through transmission networks. Moreover given the infirm nature of the RE power makes grid integration of RE capacity a challenging task. This requires strengthening of existing networks of the grid. The country has already proposed setting up of Green Corridor for evacuation of power from the regions having high concentration of RES. The implementation of green corridor is already under implementation.

Volatility in commodity prices not to benefit/hit much in case of fixed price contracts

Raw materials required for fabrication of towers are steel (angles, channels, rounds, pipes and plates of various specifications & sizes as well as fasteners) and zinc. The raw materials are largely procured locally by the tower manufacturers. Since major part of the domestic transmission line orders are having price variation clause (PVC) or players enter into back to back contracts the commodity price fluctuation either way not to impact much at bottom-line.

About 60% of order book of KEC International though is of fixed price contract with balance being with PVC. In case of KPTL about 30% of the current order book is fixed price and balance is with price variation clause. The recent weak commodity prices on year on year basis though impact the topline in case of orders with price variation clause the impact of the same is minimal at bottom-line. Even in case of fixed price contracts the benefit will not be much as the companies used to enter back to back contracts for material immediately after signing the contract. The lower raw material prices will benefit only in case of order where the company bided at high cost and yet to receive the contract and no back to back contract for material is entered.

Outlook

The prices of transmission equipment have been declining for the past few years due to declining raw material costs. This seems to have stabilised now and prices are expected to rise again in the coming decade. The industry is very price-sensitive as utilities are now more cost conscious. While procurement processes and criteria vary across regions and across utilities, there is an increased focus on centralised supply chain management (both in public and private utilities) through the greater use of information technology tools.

Many global players are now facing threats from manufacturers in countries like China and India offering cheaper products and services. To deal with the competition, manufacturers are focusing on streamlining operations and on research on differentiated products.

Equipment manufacturers are also facing several other challenges. Economic volatility and financial market disruptions adversely impact the demand for their products. Political or social instability, such as those in Northern Africa and the Middle East, impact businesses as customers become less willing to make investments in such regions.

Strong order book on hand and large L1 order book provides both sales as well as order inflow visibility for the industry majors. As PGCIL is in the process of finalization of large TLT order that it has won under TBCB as well as nominated, the pipeline of orders is strong in medium term. This along with orders from private developers and SEBs augurs well for the sector in domestic market.

Though PGCIL started current fiscal with a dry month in terms of TLT order finalization it has gathered momentum in May 2017 with TLT order finalization stand higher by 93.4%. With PGCIL capital expenditures for FY2018 pegged around 24000 crore, strong finalization of award by it is expected in current fiscal as well. In domestic market with strong addition in renewable power generation capacity, the investment in transmission sector to handle increased mix of infirm power is expected to sustain with increased focus on intelligent grid. With transmission sector open up for private sector and projects are awarded under TBCB mode, there is steady growth in PPP orders in transmission sector and that is expected to improve the supply orders for industry majors even though they are not equity investors in the projects. Similarly with under investment in T&D network at state sector for long time is pushing the state utilities to increase investment in augmenting and modernization of intra state transmission network.

Order finalization in Middle East market though improved that is not at the level of 2-3 years back and this has forced the industry majors to look for newer geographies or strengthen its focus on non MEA other geographies where it is already present. This strategy has started yielding results for the industry majors with the orders from newer markets such as ASEAN region increasing substantially in FY17 and this trend is expected to continue going forward. The industry majors who are also forayed into railway electrification sees strong pipeline of orders under tendering given strong investment in railway sector reiterated by recent clearance of Rs 27000 crore worth of railway projects by Government of India.

While strong order book on hand and accelerated burnout of the same is expected to provide strong support for top line the fluctuating commodity prices have an impact on the revenue given the fact of significant portion of the order book being covered under price variation clause. Though profitability is not hurt this impacts the topline growth.

As most of the domestic contracts are with price variation clause linked to IEEMA formula/index, the current volatility in prices of metals such as steel and zinc will be passed on to customers thus protecting the margin. Similarly the industry enters with back to back contracts for materials there will not be much benefit/damage in case of fixed price contracts.

Overall the revenue growth will be largely taken care by burnout of healthy order book. On profitability front despite recent hardening trend in commodity prices, the completion/ reduction of legacy orders and increased contribution from high margin orders are expected to ease the profit pressure and improve margin gradually going forward.