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INDIAN TRANSFORMER INDUSTRY

Favourable demand prospects aided by large RE capacity addition and grid strengthening; challenges remain on working capital cycle

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Key Highlights

Healthy demand prospects for transformers driven by large renewable capacity addition and planned transmission and distribution capex.

High working capital cycle led by stretched receivable cycle. High inventory-holding requirement remains a concern.

The transformation capacity (220KV ≥) for the country stood at ~1104 GVA as of March 2022. It grew at a CAGR of ~10% over 2012-2022 in line with the growth in the power generation and expansion of transmission and distribution network. In the current fiscal, till October 2022, the transformation capacity addition was about ~51 GVA and it is expected to grow by ~7-8% in FY2023 YoY.

The generation capacity has grown at a CAGR of ~7% over the last decade. The capacity addition in the power sector is expected to be driven by the renewable energy segment, given the Government's intent to increase the share of RE in the energy mix. Generation capacity addition is expected to rebound to 23-24 GW annually in FY2024 and FY2025 from 18-19 GW in FY2022 and FY2023.

Large RE capacity addition, industrial expansion, public infrastructure development like Metro lines, electrification of the railway lines, EV charging stations etc. and overall grid-strengthening requirements would be the key demand drivers for transformers going forward.

Order backlog, a key indicator for revenue expectation, increased to Rs. 5,343 crore (as on March 31, 2022) for the ICRA sample set, was up by 19% from the previous fiscal. The closing order book is estimated to be around Rs. 6000 crore as on March 2023 end (OB/OI of 1.1 times), which provides near-term revenue visibility.

The revenues of ICRAs sample companies witnessed a contraction in FY2020 and FY2021 on a YoY basis, respectively, owing to slowdown in demand and pandemic-induced disruptions. However, with the reopening of the economy and traction in the new generation and T&D capex, the revenues exhibited a ~61% growth in FY2022, albeit on a lower base. Going forward, the growth is expected to be in the range of ~15-18% in FY2023 and ~10-12% in FY2024 for ICRA's sample, aided by favourable demand and orders in hand.

Transformer players witnessed some pressure on margins in FY2021 and FY2022 due to decline in volumes and escalation in raw material prices. However, in FY2023 the margins are expected to be slightly better YoY owing to scale benefit and relatively stable RM prices.

Delayed payments from clients including state power utilities with weak liquidity position along with delays in project execution results in stretch in payment cycle for the transformer players. The operations are dependent on the imported raw material along with the relatively long manufacturing process. Correspondingly, the overall working capital cycle for the industry players remains high, being one of the key credit challenges.

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Thank You!