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India Ratings Downgrades Sterlite Power Transmission and its NCDs to 'IND BBB'; Places on RWE

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India Ratings and Research (Ind-Ra) has downgraded Sterlite Power Transmission Limited's (SPTL) Long-Term Issuer Rating to 'IND BBB' from 'IND A-' and placed the rating on Rating Watch Evolving (RWE). The instrument-wise rating actions are as follows:

Instrument Type	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating/Rating Watch	Rating Action
Term loan	-	-	-	December 2022	INR3,672	WD	Withdrawn (paid in full)
Fund-based limits	-	-	-	-	INR2,500 (reduced from INR5,500)	IND BBB/RWE	Downgraded; placed on RWE
Non-fund-based limits	-	-	-	-	INR 20,810 (reduced from INR23,720)	IND A3+/RWE	Downgraded; placed on RWE
Non-convertible debentures (NCDs)	INE110V07012	29 March 2019	12.5	29 March 2022	INR3,500	IND BBB/RWE	Downgraded; placed on RWE

Analytical Approach: Ind-Ra continues to factor in the financial support available from SPTL's 100% subsidiary Sterlite Power Grid Ventures Limited (SPGVL, 'IND A+'/Stable) by way of upstreaming of cash when required, for the ratings purpose.

Ind-Ra has placed the ratings of SPTL on RWE as the company's board of directors has approved a scheme of its merger with SPGVL and the same is awaiting approval from the National Company Law Tribunal (NCLT).

KEY RATING DRIVERS

Weak Operational Performance: The downgrade reflects SPTL's lower-than-expected operating performance in 1HFY20 against Ind-Ra's expectation. The company's revenue and EBITDA for 1HFY20 declined to INR9,192 million (1HFY19: INR11,910 million; FY19: INR24,470 million; FY18: INR23,743 million) and negative INR82 million (INR489 million; INR1,217 million; INR1,269 million), respectively. The decline in operational performance was due to delay in the execution of Master System Integrator (MSI) business order book of INR1,000 million-1,500 million given the floods in Kerala and heavy rains in Bihar and West Bengal in 2QFY20; decline in sales of conductors due to lower execution of projects by SPGVL in Brazil, and increase in fixed costs due to a significant increase in employee expense to INR720 million in 1HFY20 (1HFY19: INR440 million).

Ind-Ra expects the company's operating performance to recover to some extent in 2HFY20 on account of progress in SPGVL's projects, along with likely progress in the execution of MSI order book. Further, SPTL intends to start supplying conductors for the Brazil projects won by SPGVL from 1QFY21. However, due to the major decline in operational performance in 1HFY20, the company's revenue and EBITDA for FY20 is expected to be significantly lower than Ind-Ra's expectations. Further Ind-Ra believes the EBITDA for FY21, too, could remain lower than the previous expectations given the challenging macro-environment and an increased fixed cost base due to increased employee expenses.

Higher-than-expected External Debt: SPTL's external borrowings declined to INR8,342 million in 1HFY20 (FYE19: INR11,117 million) but remained materially higher than Ind-Ra's articulated gross debt level of INR6 billion. SPTL's debt comprised bonds of INR3,496 million as at 1HEFY20 (FY19: INR7,044 million) and short-term debt of INR4,846 million (INR4,073 million). The decline in the external debt was driven by cash upstreaming from SPGVL post the sale of assets to India Grid Trust (IndiGrid; 'IND AAA'/Stable). However, SPTL took on additional short-term debt through letter of credit discounting facility for working capital requirements. The overall high debt was also a result of SPTL's EBITDA losses in 1HFY20, which consequently lowered the available cash flows for SPTL's deleveraging in 1HFY20. Ind-Ra expects SPTL's net leverage (net debt/EBITDA) on external loans in FYE20 (FY19: 8.2x; FY18: 13,2x) to be significantly higher than the previous expectations (below 4x by FYE20).

Ind-Ra now expects the net leverage on external loans to remain contingent upon the prepayment of its NCDs by cash upstreaming through SPGVL and its ability to reduce the working capital loans in FY21 based on the expected improvement in in EBITDA. Any delay in cash upstreaming from SPGVL or lower-than-expected improvement in EBITDA would be credit negative. SPTL's total debt, including related-party debt of INR19,887 million as of 1HFY20 (FY19: INR18,466 million) stood at INR28,229 million at 1HFY20 (FYE19: INR29,583 million).

Dependence on SPGVL for Continued Deleveraging: During FY18, SPTL raised INR10.1 billion debt to buy-back its 28.4% stake from Standard Chartered Financials Holdings. The servicing of the long-term debt was always dependent on cash upstreaming from SPGVL (in the form of interest-free loans and advances) post the sale of completed assets to IndiGrid, as SPTL's low cash flows can only service the interest on the working capital loans. Over FY18 andFY19, SPGVL upstreamed INR8.2 billion and INR10.2 billion, respectively, through the sale of assets to IndiGrid and from the debt top-up carried out at Northern Region Strengthening Scheme (NRSS-29) in November 2018 to repay debt and retire the long-term debt at SPTL.

SPTL further reduced its long-term external debt to INR3,496 million as on 1HFY20 (FYE19: INR 7,044 million; FYE18: INR12,270 million) through cash upstreaming of additional INR1,500 million from group company PTC Cables and redemption of SPTL's investment in SPGVL in the form of redeemable preference shares worth INR2,600 million. SPGVL is expected to further upstream INR3,500 million in 1QFY21 to prepay SPTL's existing NCDs. Post this transaction, SPTL has no plans to raise any fresh long-term loans in FY21. As a result, Ind-Ra expects SPTL to only have working capital borrowings for its business operations as debt by FYE21.

Increased Focus on Solutions Business: SPTL has shifted its focus to the higher-gross margin MSI business (vis-s-vis competitive product business previously). While the power conductor business continues to be the main revenue contributor, accounting for 53% of sales in 9MFY20 (FY19: 58%; FY18: 71%), the share of MSI business has increased to 23% (25%; 11%). SPTL's focus on the MSI business is also visible in the order book, in which MSI's share increased to 28% in 9MFY20 (FY19: 17%; FY18: 27%). SPTL's total order book increased to INR33 billion by end-December 2019 (FYE19: INR 26.3 billion; FYE18: INR21 billion) to maintain a comfortable order book-to-revenue ratio.

Although Ind-Ra expects the margins to improve on the increasing share of MSI business in the revenue, the segment could witness increased competition given the large opportunity size, thereby resulting in lower-than-expected margins expansion. Further, the MSI order book of INR9,230 million at end 9MFY20 has state distribution companies as counterparties, which exposes the company to longer receivables due to the distribution companies' weak financial profile. MSI business also carries the risk of cost and time overruns due to the engineering procurement construction nature of business, which may lead to lower-than-expected margins in the future.

Liquidity Indicator –Stretched: SPTL had cash balances of INR766 million at end-1HFY20 (FY19: INR1,061 million; FY18: INR854 million). SPTL's operations are working capital intensive, as reflected in its long debtor collection period of 110 days in FY19 (FY18: 140 days). However, its net working capital cycle was short at 39 days in FY19 (FY18: 29 days), owing to a long payable period of 108 days (145 days). SPTL's average use of its fund-based and non-fund-based limits was 88% and 85%, respectively, for the 12-months ended January 2020. Cash flow from operations (post interest expenses) continued to be negative at INR2.3 billion in FY19 (FY18: negative INR2.3 billion), due to elevated receivables and high interest outflow.

Although according to the repayment schedule of NCDs, SPTL has to repay INR1.5 billion and INR2 billion in FY21 and FY22, respectively, SPTL is expected to repay the entire amount in FY21 through the upstreaming of cash from SPGVL. The weak operating performance leads to concern on the interest coverage ratios even on the external debt as Ind-Ra had factored in interest servicing through the cash flows of the business. However, the agency believes if the company's weak performance were to continue, interest servicing could also lead to additional borrowing or increased support from SPGVL. SPTL's interest coverage (EBITDA/interest expense) is expected to be below one for FY20 (FY19: 0.4x) on account of weak EBITDA. However, the interest coverage is likely to improve to 1x-1.2x for FY21 on likely prepayment of the NCDs and expected improvement in the EBITDA. Any delay/mismatch between the timing of cash upstreaming from SPGVL and interest servicing can put pressure on SPTL's liquidity.

RATING SENSITIVITIES

Ind-Ra is likely to resolve the RWE once there is more clarity on the proposed merger with SPGVL. The RWE indicates that the ratings may be upgraded, affirmed or downgraded.

COMPANY PROFILE

SPTL manufactures and supplies power conductors, power cables and optical ground wires. It is a part of the Sterlite Group, which has interests in power transmission (assets, equipment and engineering procurement construction). It has manufacturing facilities in Silvassa, Dadra and Nagar Haveli (conductors and optical ground wire), Jarsuguda, Odisha (conductors), and Haridwar, Uttarakhand (cables).

FINANCIAL SUMMARY

Particulars	**FY19**	**FY18**
Revenue (INR million)	24,470	23,743
EBITDA (INR million)	1,217	1,269
EBITDA margin (%)	5.0	5.3
Interest coverage (x)	0.4	0.8
Source: Ind-Ra, SPTL		

RATING HISTORY

Instrument Type	**Current Rating/Rating Watch**	**Historical Rating/Outlook**

	Rating Type	Rated Limits (million)	Rating	12 April 2019	25 March 2019	30 November 2017
Issuer rating	Long-term	-	IND BBB/RWE	IND A-/Stable	IND A-/Stable	IND A-/Stable
Fund-based limits	Long-term	INR2,500	IND BBB/RWE	IND A-/Stable	IND A-/Stable	IND A-/Stable
Non-fund-based limits	Short-term	INR20,810	IND A3+/RWE	IND A2+	IND A2+	IND A2+
NCD	Long-term	INR3,500	IND BBB/RWE	IND A-/Stable	Provisional IND A-/Stable	-
Term loan	Long-term	INR3,672	WD	INDA-/Stable	IND A-/Stable	IND A-/Stable

COMPLEXITY LEVEL OF INSTRUMENTS

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Applicable Criteria

Corporate Rating Methodology
Parent and Subsidiary Rating Linkage

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