

## Margins to moderate...

HEG reported a steady Q4FY19 performance wherein the topline came in marginally lower than our estimates while EBITDA and PAT came in higher than our estimate. The company reported a capacity utilisation of ~80% (lower than our estimate of 85% in Q4FY19, 84% in Q4FY18 and 82% in Q3FY19). HEG reported a topline of ₹ 1346.7 crore (down 27.8% QoQ, up 4.2% YoY, marginally lower than our estimate: ₹ 1393.6 crore). EBITDA for the quarter was at ₹ 788 crore (higher than our estimate of ₹ 695.7 crore). EBITDA margin was at 58.5% (higher than our estimate of 49.9% in Q4FY19, 62.6% in Q3FY19, 73.6% in Q4FY18). The company reported PAT of ₹ 524.4 crore (higher than our estimate of ₹ 444 crore).

## Graphite electrode prices witnessing softening trend...

Graphite electrodes are used in the EAF route of steelmaking. Global steel demand has been negatively impacted by an industrial slowdown due to a volatile geopolitical and economic environment. In China, a slowdown in steel consumption demand has resulted in an oversupply of steel, which has negatively impacted both steel as well as graphite electrode prices. On the domestic front, India removed antidumping duties on graphite electrodes imported from China in September 2018. This led to increased imports. All the above factors put downward pressure on graphite electrode prices.

## Needle coke prices remain elevated; to impact margin profile...

Needle coke is a key raw material used in the manufacture of UHP grade graphite electrodes. As needle coke is scarce in supply, its prices are on a sustained uptrend. In a scenario of softening graphite electrode prices, an uptick in needle coke costs is likely to impact the margin profile of HEG.

## Valuation & Outlook

While global graphite electrode prices have witnessed a softening trend, the uptick in prices of key raw material (viz. needle coke) is likely to impact the company's margin profile. We have modelled capacity utilisation of 85% for both the years FY20E and FY21E. We value the stock at 6x FY21E EPS and arrive at a target price of ₹ 1700. We have a **REDUCE** recommendation on the stock.



### Particulars

Particulars	Amount
Market Capitalisation	₹ 7333 crore
Debt in ₹ crore (FY19)	666.4
Cash & Cash Eq. in ₹ crore (FY19)	1,395.9
EV	₹ 6603 crore
52 Week H / L (₹)	4950 / 1542
Equity Capital (₹)	38.6
Face Value	₹ 10

### Key Highlights

- The company reported capacity utilisation of 80%
- It proposed a final dividend of ₹ 50 per share
- We downgrade the stock to **REDUCE**

### Research Analyst

Dewang Sanghavi  
dewang.sanghavi@icicisecurities.com

### Key Financial Summary

(₹ Crore)	FY17	FY18	FY19	FY20E	FY21E
Net Sales	860	2,750	6,593	4,914	4,926
EBITDA	81	1,722	4,658	1,618	1,629
EBITDA Margin (%)	9.4	62.6	70.7	32.9	33.1
Adj PAT	(50)	1,081	3,050	1,083	1,094
EPS (₹)	(12.5)	270.6	790.2	280.5	283.3
EV/EBITDA (x)	99.3	4.4	1.6	4.1	3.9
RoCE (%)	0.9	78.9	107.1	35.5	32.9
RoE (%)	(5.7)	59.8	82.0	24.7	21.7

Source: Company, ICICI Direct Research

**Exhibit 1: Variance Analysis (Consolidated Performance)**

	Q4FY19	Q4FY19E	Q4FY18	YoY (%)	Q3FY19	QoQ (%)	Comments
Total Operating Income	1,346.7	1,393.6	1,292.5	4.2	1,865.0	(27.8)	Topline came in lower than our estimate on the back of lower-than-expected capacity utilisation levels
Other Income	42.3	20.4	3.8	1,015.6	37.2	13.7	Other income came in higher than our estimate
Raw Material Expense	346.7	464.8	146.0	137.5	344.7	0.6	
Employee Expense	43.2	54.5	48.6	(11.2)	56.6	(23.7)	
Power & Fuel Expense	46.6	51.0	54.0	(13.7)	49.8	(6.4)	
Other Expenses	122.3	127.6	92.9	31.5	100.5	21.6	
Total Operating Expenses	558.7	697.9	341.5	63.6	551.5	1.3	
EBITDA	788.0	695.7	951.0	(17.1)	1,313.5	(40.0)	EBITDA came in higher than our estimate
EBITDA Margin (%)	58.5	49.9	73.6	-1506 bps	70.4	1191 bps	EBITDA margin came in higher than our estimate
Depreciation	18.2	20.0	17.7	2.9	18.5	(1.7)	
Interest	5.9	5.4	17.9	(67.3)	3.6	64.1	
Exceptional Items	-	-	-	-	-	-	
PBT	806.2	690.7	919.2	LP	1,328.6	(39.3)	
Tax Outgo	281.8	246.7	285.2	NA	461.8	NA	
PAT	524.4	444.0	634.0	LP	866.8	(39.5)	PAT came in higher than our estimate
<b>Key Metrics</b>							
Capacity Utilisation (%)	80	85	84		82		Capacity utilisation came in lower than our estimate

Source: Company, ICICI Direct Research

**Exhibit 2: Change in estimates**

( ₹ Crore)	F20E			FY21E	Comments
	New	Old	% Change	Introduced	
Revenue	4,914	5,747	-14.5	4,926	Downward revise FY20E and introduce FY21E estimate
EBITDA	1,618	2,348	-31.1	1,629	
EBITDA Margin (%)	32.9	40.9	-793 bps	33.1	
PAT	1,083	1,599	-32.3	1,094	
EPS (₹)	280	400	-29.9	283	

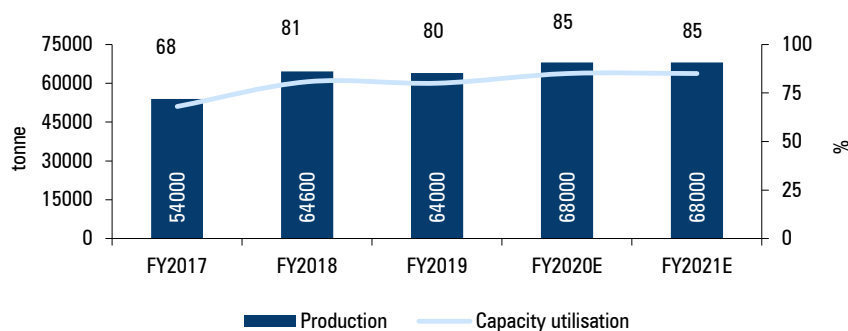
Source: Company, ICICI Direct Research

## Conference Call highlights

- Currently ~11% of steel produced in China is through EAF, up from ~6% in CY16. This is expected to increase to ~20% by the middle of CY21
- Approximately 75-80% of HEG's production is of UHP grade electrode while balance 20-25% is of non-UHP grade electrode. In the non-UHP segment, the company competes with Chinese peers
- With respect to capacity expansion from 80000 tonnes to 100000 tonnes, construction activity at the site is progressing as per schedule. The capacity should be ready by mid-2021. After a stabilisation period of four to six months, additional volume would be available for sales by early 2022
- Price of UHP grade graphite electrodes are firm while the price of non-UHP grade graphite electrodes was impacted by imports from China since the removal of anti-dumping duty in September 2018
- Capacity utilisation for both Q4FY19 and FY19 was at ~80%. Going forward, the management expects capacity utilisation of ~85-90% levels in FY20
- During FY19, HEG, after obtaining shareholder approval, had bought back 13,63,636 equity shares of ₹ 10/- each at a price of ₹ 5500 per share, from all the eligible shareholder as on the record date i.e. February 9, 2019. The shares bought back had been extinguished on March 29, 2019 while the paid-up capital of the company was reduced from ₹ 39,95,91,420/- (3,99,59,142 equity shares) to ₹ 38,59,55,060/- (3,85,95,506 equity shares)

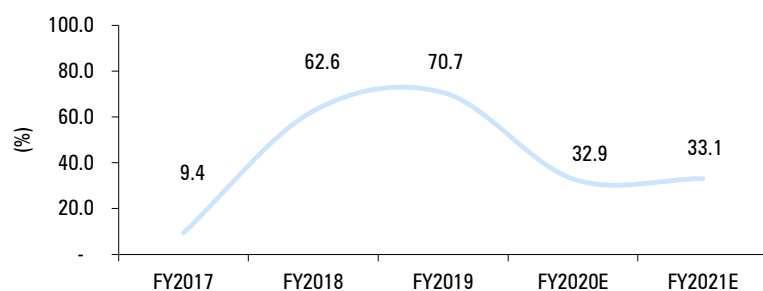
## Financial story in charts

Exhibit 3: Trend in production and capacity utilisation level



Source: Company, ICICI Direct Research

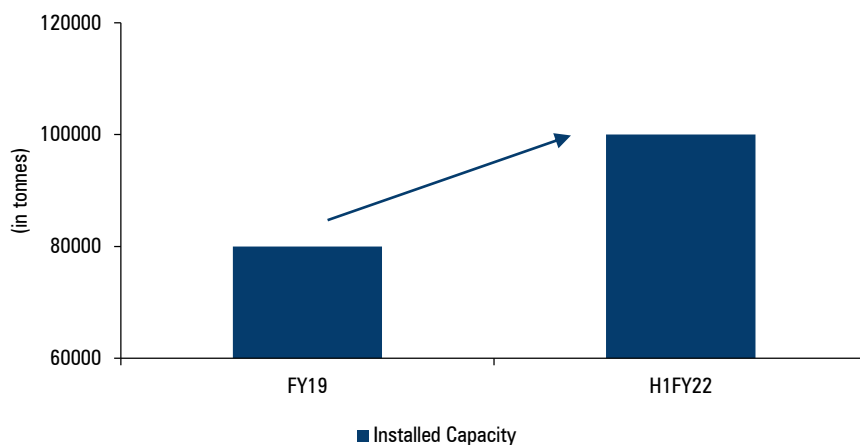
Exhibit 4: Trend in EBITDA margins level



Source: Company, ICICI Direct Research

Consolidated EBITDA margin expected to soften over the next couple of years on the back of subdued graphite electrode realisations and elevated needle coke costs

Exhibit 5: Capacity expansion plan chalked out



Source: Company, ICICI Direct Research

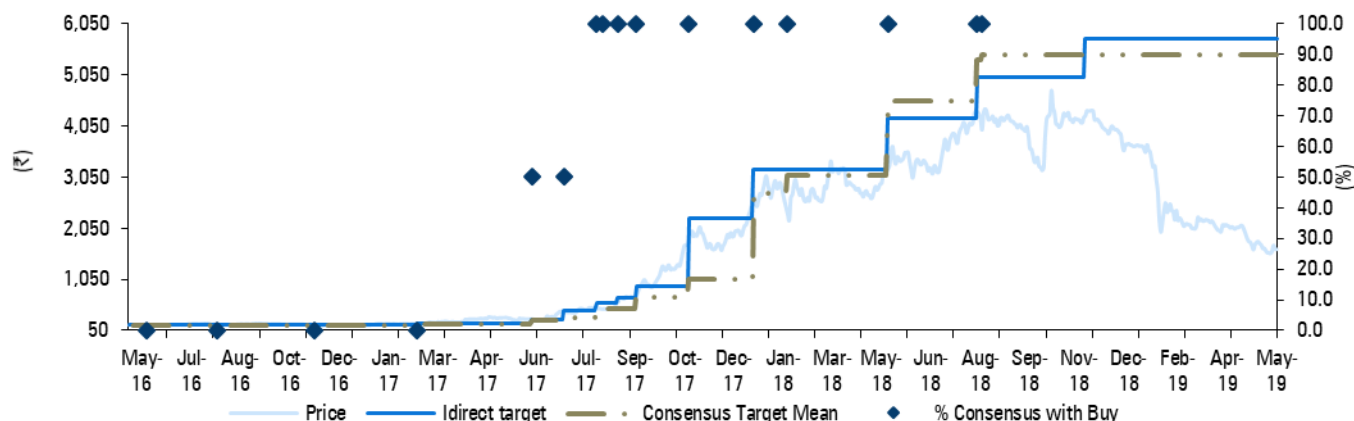
In November 2018, HEG had chalked out capacity expansion plans wherein it is planning to add capacity to the tune of 20,000 tonnes at a capex of ~₹ 1200 crore. The time frame for expansion is around 30 months. Post expansion, the company's installed capacity would increase to 1,00,000 tonne from 80,000 tonne currently

Exhibit 6: Valuation

	Sales (₹ Crore)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	P/ BV (x)	RoE (%)	RoCE (%)
FY17	860	4	-13	-231	NA	99.3	8.4	-5.7	0.9
FY18	2750	220	271	LP	6.8	4.4	4.1	59.8	78.9
FY19	6593	140	790	192	2.3	1.6	1.9	82.0	107.1
FY20E	4914	-25	280	-65	6.5	4.1	1.6	24.7	35.5
FY21E	4926	0	283	1	6.5	3.9	1.4	21.7	32.9

Source: Company, ICICI Direct Research

Exhibit 7: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 8: Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position	Change
1	Norbury Investments, Ltd.	31-Mar-2019	13.9	5.36M	0
2	Microlight Investments, Ltd.	31-Mar-2019	12.1	4.67M	0
3	Life Insurance Corporation of India	31-Mar-2019	8.4	3.23M	-0.10M
4	Bharat Investments Growth, Ltd.	31-Mar-2019	6.4	2.46M	-0.14M
5	Mekima Corporation	31-Mar-2019	4.5	1.73M	-0.06M
6	Purvi Vanijya Niyojan, Ltd.	31-Mar-2019	4.3	1.65M	-0.10M
7	Raghav Commercial, Ltd.	31-Mar-2019	3.8	1.45M	-0.09M
8	LNJ Financial Services, Ltd.	31-Mar-2019	3.5	1.35M	-0.08M
9	LNJ Bhilwara Group	31-Mar-2019	2.4	0.92M	-0.05M
10	Shashi Commercial Co., Ltd.	31-Mar-2019	1.8	0.68M	-0.04M

Source: Reuters, ICICI Direct Research

Exhibit 9: Recent Activity

Buys			Sells		
Investor name	Value (M)	Shares (M)	Investor name	Value (M)	Shares (M)
India Textfab Marketing, Ltd.	6.26	0.21	Bharat Investments Growth, Ltd.	(4.38)	(0.14)
Jhunjhunwala (Ravi) HUF	6.14	0.20	Causeway Capital Management LLC	(4.36)	(0.14)
Jhunjhunwala (Rishabh)	5.32	0.18	Life Insurance Corporation of India	(3.08)	(0.10)
Jhunjhunwala (Lakshmi Niwas)	5.14	0.17	Purvi Vanijya Niyojan, Ltd.	(2.93)	(0.10)
Jhunjhunwala (Mani Devi)	2.95	0.10	Raghav Commercial, Ltd.	(2.57)	(0.09)

Source: Reuters, ICICI Direct Research

Exhibit 10: Shareholding Pattern

(in %)	Sep-18	Dec-18	Mar-19
Promoter	61.0	61.0	61.2
Others	39.0	39.0	38.8
Total	100.0	100.0	100.0

Source: Company, ICICI Direct Research

## Financial summary

Exhibit 11: Profit and loss statement				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Total Operating Income	2,750	6,593	4,914	4,926
Growth (%)	220	140	(25)	0
Total Operating Expenditure	1,028	1,935	3,296	3,297
EBITDA	1,722	4,658	1,618	1,629
Growth (%)	2,035	171	(65)	1
Depreciation	73	72	75	78
Interest	57	18	20	17
Other Income	12	109	103	110
PBT	1,605	4,677	1,627	1,643
Exceptional Item	0	0	0	0
Total Tax	523	1,627	544	550
Reported PAT	1,081	3,050	1,083	1,094
Adjusted PAT	1,081	3,050	1,083	1,094
Growth (%)	LP	182	(65)	1
EPS (₹)	271	790	280	283

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Profit/(Loss) after taxation	1081	3050	1083	1094
Add: Depreciation & Amortization	73	72	75	78
Net Increase in Current Assets	-916	-1223	-735	-34
Net Increase in Current Liabilities	254	148	489	30
<b>CF from operating activities</b>	<b>492</b>	<b>2047</b>	<b>911</b>	<b>1168</b>
(Inc)/dec in Investments	1	-718	300	200
(Inc)/dec in Fixed Assets	-21	-44	-695	-503
Others	0	0	0	0
<b>CF from investing activities</b>	<b>-21</b>	<b>-762</b>	<b>-395</b>	<b>-303</b>
Inc / (Dec) in Equity Capital	0	-1	0	0
Inc / (Dec) in Loan	-387	369	-400	-266
Dividend & Dividend Tax	-374	-1139	-424	-429
Others	289	7	-15	-15
<b>CF from financing activities</b>	<b>-471</b>	<b>-764</b>	<b>-839</b>	<b>-710</b>
Net Cash flow	-1	521	-323	155
Opening Cash	8	8	529	206
<b>Closing Cash</b>	<b>8</b>	<b>529</b>	<b>206</b>	<b>361</b>

Source: Company, ICICI Direct Research

Exhibit 13: Balance sheet				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
<b>Liabilities</b>				
Equity Capital	40	39	39	39
Reserve and Surplus	1769	3680	4339	5004
Total Shareholders funds	1809	3719	4377	5042
Total Debt	297	666	266	0
Deferred Tax Liability	119	126	114	101
Non Current Liabilities	6	6	4	2
<b>Total Liabilities</b>	<b>2231</b>	<b>4518</b>	<b>4762</b>	<b>5146</b>
<b>Assets</b>				
Gross Block	1693	1721	1796	1871
Less: Acc Depreciation	860	932	1007	1027
Net Block	833	788	789	844
Capital WIP	2	19	639	1009
Total Fixed Assets	835	807	1427	1853
Investments	149	867	567	367
Inventory	511	1308	2257	2258
Debtors	973	1187	942	945
Loans and Advances	36	68	77	85
Other Current Assets	123	303	325	347
Cash	8	529	206	361
Total Current Assets	1651	3396	3808	3997
Creditors	246	380	839	839
Other Current Liabilities (incl f	158	172	202	232
Current Liabilities & Prov	404	552	1041	1071
Net Current Assets	1247	2844	2767	2926
Others	0	0	0	0
<b>Application of Funds</b>	<b>2231</b>	<b>4518</b>	<b>4762</b>	<b>5146</b>

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
<b>Per share data (₹)</b>				
EPS	271	790	280	283
BV	453	963	1,134	1,306
DPS	80	80	94	95
Cash Per Share	2	137	53	94
<b>Operating Ratios (%)</b>				
EBITDA margins	62.6	70.7	32.9	33.1
PBT margins	58.4	70.9	33.1	33.4
Net Profit margins	39.3	46.3	22.0	22.2
Inventory days	182	247	250	250
Debtor days	129	66	70	70
Creditor days	188	124	125	125
<b>Return Ratios (%)</b>				
RoE	59.8	82.0	24.7	21.7
RoCE	78.9	107.1	35.5	32.9
RoIC	78.6	118.9	34.8	33.1
<b>Valuation Ratios (x)</b>				
P/E	6.8	2.3	6.5	6.5
EV / EBITDA	4.4	1.6	4.1	3.9
EV / Revenues	2.8	1.1	1.5	1.4
Market Cap / Revenues	2.7	1.1	1.4	1.4
Price to Book Value	4.1	1.9	1.6	1.4
<b>Solvency Ratios</b>				
Debt / Equity	0.2	0.2	0.1	0.0
Debt/EBITDA	0.2	0.1	0.2	0.0
Current Ratio	4.1	6.2	3.7	3.7
Quick Ratio	2.8	3.8	1.5	1.6

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



**Pankaj Pandey**

**Head – Research**

**pankaj.pandey@icicisecurities.com**

**ICICI Direct Research Desk,  
ICICI Securities Limited,  
1st Floor, Akruiti Trade Centre,  
Road No 7, MIDC,  
Andheri (East)  
Mumbai – 400 093  
research@icicidirect.com**

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