

HEG Ltd (HEG)

₹3961

Industry outlook remains buoyant...

HEG has been one of the good wealth creators for investors with the stock price nearly multiplying ~9x since our [Company Update](#) in August-2017. Strong demand for graphite electrodes from the EAF steel making route amid supply constraints has led to a sharp increase in graphite electrodes prices thereby resulting in healthy profitability. The continued favourable operating environment puts domestic player like HEG in a sweet spot.

Key takeaways from Q1FY19 conference call

- China's focus on cleaning up the environment is further strengthening. The government is likely to clamp down on 82 steel producing cities during the winter in the later half of the year reducing some more environmentally unfriendly steel capacity
- The management has noticed EAF, which were earlier constrained to produce certain auto and other special grade steel have also entered the segment with technological advancement
- The management is evaluating de-bottlenecking of the plant to increase the production capacity to 100000 tonnes from 80000 tonnes currently and has appointed a reputed consultant for the same. Availability of needle coke would be one of the key factors for capacity expansion
- The company is debt free and has no long term or short-term debt
- The company's consumption cycle for imported needle coke is 2.5 months of shipment, 2.5 months to convert the raw material into finished goods. The company also keeps a month's inventory in the plant. Hence, the impact of change in prices comes with a lag of six months
- For Q1FY19, ~33% of volumes catered to the domestic market while the balance ~67% catered to the exports market. The management expects this trend to continue, going forward
- The company is currently committed in terms of needle coke supplies for the current quarter and subsequent Q3 and Q4 as well. The company has half yearly contracts for needle coke with Conoco Phillips
- The management continues to guide capacity utilisation of high eighties for FY19
- The company is producing non UHP grade electrode by choice. Currently, the mix is at 70% UHP and 30% HP. The price differential has narrowed down due to capacity shutdowns in China

Healthy performance to continue, maintain BUY

We believe HEG will to continue to benefit from the global demand-supply imbalance in the graphite electrode sector. Thus, we expect the topline, EBITDA and PAT to increase 47%, 32% and 36%, respectively, in FY18-20E. The EBITDA margins are, however, likely to moderate from 62.6% in FY18 to 50-52% in FY19-20E on account of higher needle coke cost. HEG is currently trading at 7.9x FY20E P/E. We continue to value the stock at 10x FY20E EPS of ₹ 500 and arrive at a target price of ₹ 5000. We maintain our **BUY** rating on the stock. A strong balance sheet and robust cash flow generation and a healthy dividend payout, going forward, reiterate our positive stance on the company.

Rating matrix	
Rating	: Buy
Target	: ₹ 5000
Target Period	: 12 months
Potential Upside	: 26%

What's Changed?	
Target	: Unchanged
EPS FY19E	: Unchanged
EPS FY20E	: Unchanged
Rating	: Unchanged

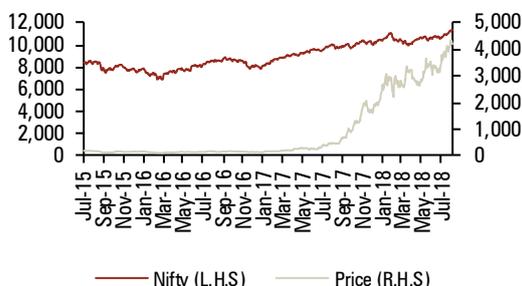
Key Financials				
	FY17	FY18E	FY19E	FY20E
Net Sales	860.0	2,750.0	5,730.1	5,957.9
EBITDA	80.6	1,721.6	2,953.9	2,999.6
Adjusted PAT	(50.1)	1,081.3	1,938.4	1,997.9
Adjusted EPS (₹)	(12.5)	270.6	485.1	500.0

Valuation summary				
	FY17	FY18E	FY19E	FY20E
PE (x)	NA	14.6	8.2	7.9
Target PE (x)	NA	18.5	10.3	10.0
EV/EBITDA (x)	204.7	9.4	5.3	4.9
P/BV (x)	18.2	8.8	5.2	3.6
RoE (%)	(5.7)	59.8	63.2	45.8
RoCE (%)	0.9	78.9	94.4	68.4

Stock data	
Particulars	Amount
Market Capitalisation	₹ 15828 crore
Debt (FY18P)	₹ 297 crore
Cash (FY18P)	₹ 8 crore
EV	₹ 16117 crore
52 Week H / L (₹)	3515 / 233
Equity Capital	40.0
Face Value	₹ 10

Price performance (%)				
Return %	1M	3M	6M	12M
HEG	16.8	47.0	89.5	780.8
Graphite India	12.9	49.3	72.0	385.1

Share Price Graph



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Financial summary

Profit and loss statement		₹ Crore			
(Year-end March)	FY17	FY18	FY19E	FY20E	
Total Operating Income	860.0	2,750.0	5,730.1	5,957.9	
Growth (%)	3.9	219.8	108.4	4.0	
Raw Material Expenses	443.9	478.0	1,695.1	1,826.1	
Employee Expenses	58.9	112.6	286.5	297.9	
Other expenses	276.6	437.9	794.5	834.3	
Total Operating Expenditure	779.4	1,028.5	2,776.2	2,958.3	
EBITDA	80.6	1,721.6	2,953.9	2,999.6	
Growth (%)	(35.2)	2,034.9	71.6	1.5	
Depreciation	73.9	72.6	73.6	80.8	
Interest	54.7	56.7	1.5	0.7	
Other Income	7.1	12.4	14.2	63.9	
PBT	(40.9)	1,604.7	2,893.1	2,981.9	
Exceptional Item	-	-	-	-	
Total Tax	9.2	523.4	954.7	984.0	
Reported PAT	(50.1)	1,081.3	1,938.4	1,997.9	
Adjusted PAT	(50.1)	1,081.3	1,938.4	1,997.9	
Growth (%)	230.7	LP	79.3	3.1	
EPS (₹)	(12.5)	270.6	485.1	500.0	

Source: Company, ICICI Direct Research

Balance sheet		₹ Crore			
(Year-end March)	FY17	FY18	FY19E	FY20E	
Liabilities					
Equity Capital	40.0	40.0	40.0	40.0	
Reserve and Surplus	831.8	1,768.7	3,026.7	4,323.3	
Total Shareholders funds	871.8	1,808.6	3,066.6	4,363.2	
Total Debt	684.0	297.5	0.0	0.0	
Deferred Tax Liability	60.9	119.2	116.7	104.2	
Non Current Liabilities	4.7	5.9	6.4	4.4	
Total Liabilities	1,621.3	2,231.2	3,189.8	4,471.9	
Assets					
Gross Block	1,672.5	1,693.4	1,768.4	1,843.4	
Less: Acc Depreciation	787.5	860.0	933.6	1,014.4	
Net Block	885.0	833.4	834.8	829.0	
Capital WIP	1.2	1.6	76.7	196.7	
Total Fixed Assets	886.2	835.0	911.5	1,025.7	
Investments	149.8	149.3	149.3	399.3	
Inventory	257.8	511.5	1,026.8	1,134.7	
Debtors	360.8	972.7	1,569.9	1,795.5	
Loans and Advances	31.9	36.4	29.9	38.4	
Other Current Assets	76.9	123.2	116.2	120.2	
Cash	8.3	7.6	131.6	776.7	
Total Current Assets	735.7	1,651.3	2,874.4	3,865.5	
Creditors	86.5	246.4	557.3	600.4	
Other Current Liabilities (incl Pi)	63.9	158.0	188.1	218.2	
Current Liabilities & Prov	150.4	404.4	745.4	818.5	
Net Current Assets	585.3	1,246.9	2,129.0	3,046.9	
Others	-	-	-	-	
Application of Funds	1,621.3	2,231.2	3,189.8	4,471.9	

Source: Company, ICICI Direct Research

Cash flow statement		₹ Crore			
(Year-end March)	FY17	FY18	FY19E	FY20E	
Profit/(Loss) after taxation	(50.1)	1,081.3	1,938.4	1,997.9	
Add: Depreciation & Amortization	73.9	72.6	73.6	80.8	
Net Increase in Current Assets	38.0	(916.3)	(1,099.1)	(346.0)	
Net Increase in Current Liabilities	(75.8)	254.0	341.0	73.2	
CF from operating activities	(14.0)	491.6	1,253.8	1,805.8	
(Inc)/dec in Investments	(0.3)	0.6	-	(250.0)	
(Inc)/dec in Fixed Assets	2.0	(21.3)	(150.1)	(195.1)	
Others	-	-	-	-	
CF from investing activities	1.7	(20.7)	(150.1)	(445.1)	
Inc / (Dec) in Equity Capital	-	-	-	-	
Inc / (Dec) in Loan	53.7	(386.6)	(297.4)	-	
Dividend & Dividend Tax	-	(374.0)	(680.4)	(701.3)	
Others	(38.2)	289.1	(2.0)	(14.5)	
CF from financing activities	15.4	(471.5)	(979.8)	(715.8)	
Net Cash flow	3.2	(0.7)	124.0	645.0	
Opening Cash	5.1	8.3	7.6	131.6	
Closing Cash	8.3	7.6	131.6	776.7	

Source: Company, ICICI Direct Research

Key ratios					
(Year-end March)	FY17	FY18	FY19E	FY20E	
Per share data (₹)					
EPS	-13	271	485	500	
BV	218	453	767	1,092	
DPS	0	80	146	150	
Cash Per Share	2	2	33	194	
Operating Ratios (%)					
EBITDA margins	9.4	62.6	51.6	50.3	
PBT margins	-4.8	58.4	50.5	50.0	
Net Profit margins	-5.8	39.3	33.8	33.5	
Inventory days	121	182	135	140	
Debtor days	153	129	100	110	
Creditor days	71	188	120	120	
Return Ratios (%)					
RoE	-5.7	59.8	63.2	45.8	
RoCE	0.9	78.9	94.4	68.4	
RoIC	0.4	78.6	98.1	81.4	
Valuation Ratios (x)					
P/E	NA	14.6	8.2	7.9	
EV / EBITDA	204.7	9.4	5.3	4.9	
EV / Revenues	19.2	5.9	2.7	2.5	
Market Cap / Revenues	18.4	5.8	2.8	2.7	
Price to Book Value	18.2	8.8	5.2	3.6	
Solvency Ratios					
Debt / Equity	0.8	0.2	0.0	0.0	
Debt/EBITDA	8.5	0.2	0.0	0.0	
Current Ratio	4.9	4.1	3.9	4.7	
Quick Ratio	3.2	2.8	2.5	3.3	

Source: Company, ICICI Direct Research

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Buy: > 10%/15% for large caps/midcaps, respectively;

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Sell: -10% or more;



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