

Inventory write-downs adversely impact bottomline...

HEG reported a disappointing set of Q4FY20 numbers wherein it reported a loss at the EBITDA and PAT level. During the quarter, the performance was impacted by inventory write down taken by the company. Topline came in at ₹ 374.4 crore (down 72% YoY, 5% QoQ). Reported EBITDA loss was at ₹ 497.4 crore (positive EBITDA of ₹ 4.7 crore in Q3FY20 and ₹ 788 crore in Q4FY19) while net loss was at ₹ 366 crore (net profit of ₹ 5.9 crore in Q3FY20, ₹ 524.4 crore in Q4FY19). During the quarter, HEG had recognised its carrying inventory on net realisable value (NRV) basis to the extent applicable and has accordingly written down the cost of inventory by ₹ 427 crore [included in cost of raw material consumption (RM) ₹ 321 crore and in changes in inventories of finished goods and work-in-progress (FG & WIP) ₹ 106 crore]. This resulted in negative EBITDA and net loss for the quarter.

Revise down capacity utilisation levels on subdued demand...

On account of subdued demand from the steel sector (especially in H1FY21), we downward revise our capacity utilisation estimates for FY21E. For FY21E, we model capacity utilisation of 50% (downward revise from 75% earlier). We also introduce FY22E capacity utilisation levels. For FY22E, we model capacity utilisation of 60%.

Covid-19 related concerns to impact Q1FY21...

On account of the nationwide lockdown, HEG closed its Mandideep facility from March 24, 2020 and restarted operations on April 23, 2020 at a lower capacity utilisation of 50%. On account of Covid-19 related concerns, HEG witnessed lower offtake during April and May 2020. As a result, the Q1FY20E performance is also likely to be significantly impacted. As there was lockdown for a major portion of Q1FY21, revenue and profitability are expected to be lower during the quarter.

Valuation & Outlook

HEG reported a muted performance in Q4FY20 on the back of weak demand from the steel sector. Furthermore, it reported a loss at the EBITDA as well as PAT level on account of inventory write downs. Going forward, over the near term, demand for graphite electrodes is expected to remain subdued due to partial closure of steel capacities globally, lower steel production and de-stocking of electrode inventory at the customer end at a slower pace than anticipated, thereby adversely impacting demand prospects. We value the stock at 6x FY22E EPS and arrive at a target price of ₹ 900. We have a **HOLD** recommendation on the stock.



Particulars

Particulars	Amount
Market Capitalisation	3,573.2
Debt in ₹ crore (FY20)	666.4
Cash & Cash Eq. in ₹ crore (FY20)	1,594.0
EV	₹ 2572 crore
52 Week H / L (₹)	1568 / 410
Equity Capital (₹)	38.6
Face Value	₹ 10

Key Highlights

- Capacity utilisation at 50% for Q4FY20
- Capacity expansion from 80000 tonnes to 100000 tonnes progressing as per schedule. Capex is expected to be ~₹1000 crore, out of which it has spent ~₹ 200-250 crore in FY20
- Change recommendation on stock from REDUCE to HOLD

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Key Financial Summary

(₹ Crore)	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	2,750	6,593	2,149	2,048	2,447
EBITDA	1,722	4,658	(6)	415	734
EBITDA Margin (%)	62.6	70.7	(0.3)	20.3	30.0
Adj PAT	1,081	3,050	53	332	579
EPS (₹)	270.6	790.2	13.8	85.9	150.0
EV/EBITDA (x)	2.2	0.8	(409.5)	6.3	3.6
RoCE (%)	78.9	107.1	1.6	12.0	19.8
RoE (%)	59.8	82.0	1.6	9.2	14.6

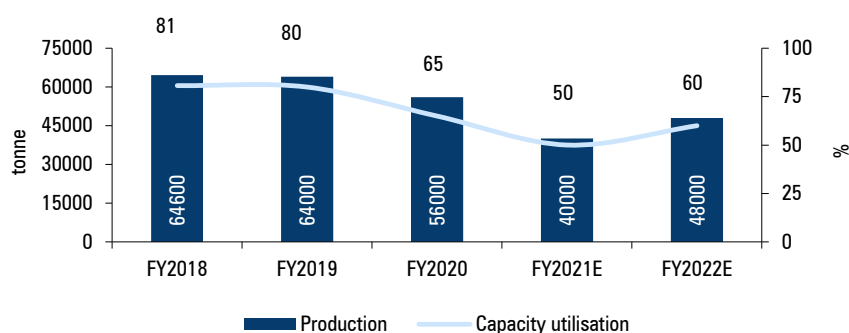
Exhibit 1: Variance Analysis

	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Comments
Total Operating Income	374.4	1,346.7	(72.2)	393.7	(4.9)	Topline lower than previous quarters due to lower volume and realisation
Other Income	42.3	42.3	0.0	27.3	55.0	
Raw Material Expense	763.4	346.7	120.2	268.3	184.6	Raw material came in higher on account of inventory write-down
Employee Expense	(3.8)	43.2	(108.7)	17.5	(121.5)	
Power & Fuel Expense	34.6	46.6	(25.8)	39.9	(13.4)	
Other Expenses	77.6	122.3	(36.5)	63.3	22.7	
Total Operating Expenses	871.9	558.7	56.1	389.0	124.2	
EBITDA	(497.4)	788.0	(163.1)	4.7	(10,594.3)	
EBITDA Margin (%)	(132.8)	58.5	-19136 bps	1.2	-13405 bps	
Depreciation	18.9	18.2	3.7	17.8	6.1	
Interest	8.6	5.9	46.4	8.7	(1.7)	
Exceptional Items	-	-	-	-	-	
PBT	(482.6)	806.2	(159.9)	5.5	(8,874.5)	
Tax Outgo	(116.6)	281.8	(141.4)	(0.4)	NA	
PAT	(366.0)	524.4	(169.8)	5.9	(6,261.8)	Net loss for the quarter
Key Metrics						
Capacity Utilisation (%)	50	80		50		

Source: Company, ICICI Direct Research

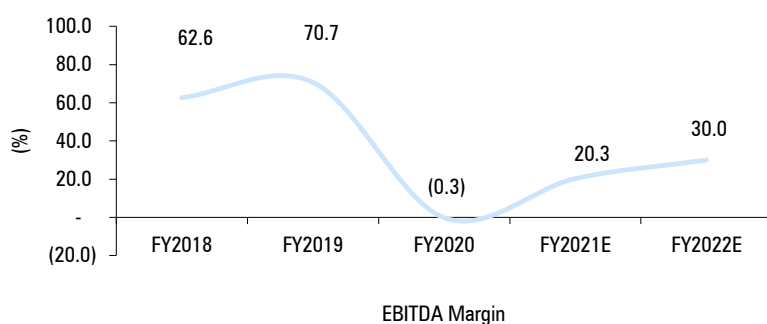
Financial story in charts

Exhibit 2: Trend in production and capacity utilisation level



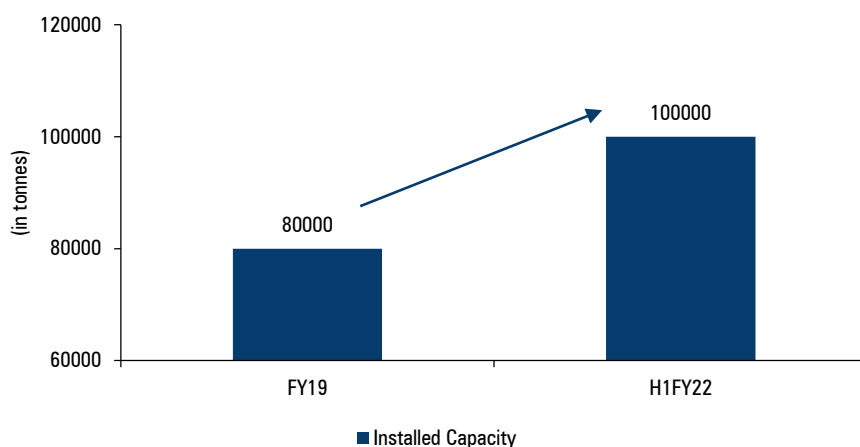
Source: Company, ICICI Direct Research

Exhibit 3: EBITDA margins trend



Source: Company, ICICI Direct Research

Exhibit 4: Chalks out capacity expansion plan



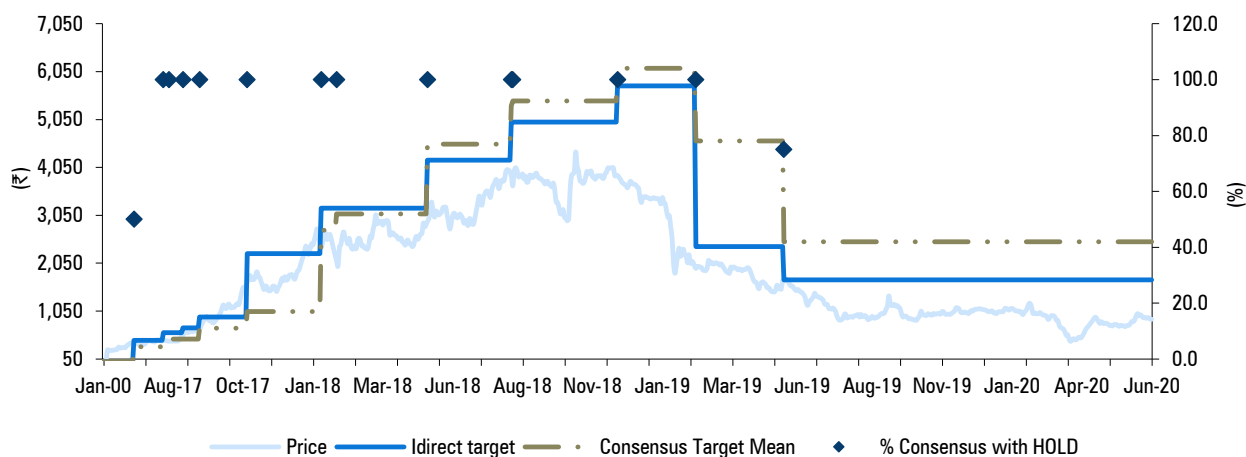
Source: Company, ICICI Direct Research

Exhibit 5: Valuation

	Sales (₹Cr)	Growth (%)	EPS (₹)	Growth (%)	PE(x)	EV/EBIDT A(x)	P/BV(x)	RoE(%)	RoCE(%)
FY18	2750	220	271	LP	3.3	2.2	1.9	59.8	78.9
FY19	6593	140	790	192	1.1	0.8	0.9	82.0	107.1
FY20	2149	-67	14	-98	63.7	-409.5	1.0	1.6	1.6
FY21E	2048	-5	86	522	10.2	6.3	0.9	9.2	12.0
FY22E	2447	19	150	522	5.9	3.6	0.9	14.6	19.8

Source: Company, ICICI Direct Research

Exhibit 6: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 7: Top 10 Shareholders

Rank	Name	Latest Filing	% O/S	Position (m)	Change (m)
1	NORBURY INVESTMENTS	31-03-2020	13.9	5.4	0.0
2	MICROLIGHT INVESTMEN	31-03-2020	12.1	4.7	0.0
3	BHARAT INVESTMENTS G	31-03-2020	6.4	2.5	0.0
4	LIFE INSURANCE CORP	31-03-2020	6.3	2.4	-0.8
5	MEKIMA CORPORATION	31-03-2020	4.5	1.7	0.0
6	PURVI VANIJYA NIYOJA	31-03-2020	4.3	1.6	0.0
7	RAGHAV COMMERCIAL LT	31-03-2020	3.8	1.4	0.0
8	LNJ FINANCIAL SERVIC	31-03-2020	3.5	1.3	0.0
9	SHASHI COMMERCIAL LT	31-03-2020	1.8	0.7	0.0
10	STICHTING DEPOST APG	31-03-2020	1.5	0.6	0.6

Source: Reuters, ICICI Direct Research

Exhibit 8: Shareholding Pattern

(in %)	Sep-19	Dec-19	Mar-20
Promoter	59.6	59.6	59.6
Public	40.4	40.4	40.4
Total	100.0	100.0	100.0

Source: Company, ICICI Direct Research

Financial summary

Exhibit 9: Profit and loss statement				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Total Operating Income	6,593	2,149	2,048	2,447
Growth (%)	140	(67)	(5)	19
Raw Material Expenses	1,114.8	1,621.1	1,152.5	1,213.5
Employee Expenses	197.6	65.6	81.9	85.6
Other expenses	622.2	468.2	398.4	414.2
Total Operating Expenditure	1,935	2,155	1,633	1,713
EBITDA	4,658	(6)	415	734
Growth (%)	171	(100)	LP	77
Depreciation	72	72	76	79
Interest	18	37	30	20
Other Income	109	144	134	140
PBT	4,677	29	443	774
Exceptional Item	0	0	0	0
Total Tax	1,627	(24)	112	195
Reported PAT	3,050	53	332	579
Adjusted PAT	3,050	53	332	579
Growth (%)	182	(98)	522	75
EPS (₹)	790	14	86	150

Source: Company, ICICI Direct Research

Exhibit 10: Cash flow statement				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Profit/(Loss) after taxation	3050	53	332	579
Add: Depreciation & Amortization	72	72	76	79
Net Increase in Current Assets	-1194	927	2	17
Net Increase in Current Liabilities	148	-327	-25	34
CF from operating activities	2076	726	385	709
(Inc)/dec in Investments	-718	-290	200	500
(Inc)/dec in Fixed Assets	-44	-111	-445	-475
Others	0	0	0	0
CF from investing activities	-762	-400	-245	25
Inc / (Dec) in Equity Capital	-1	0	0	0
Inc / (Dec) in Loan	369	-74	-266	-266
Dividend & Dividend Tax	-1139	-113	-136	-237
Others	7	-260	-14	-15
CF from financing activities	-764	-447	-417	-518
Net Cash flow	550	-121	-277	216
Opening Cash	8	558	437	161
Closing Cash	558	437	161	377

Source: Company, ICICI Direct Research

Exhibit 11: Balance sheet				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Liabilities				
Equity Capital	39	39	39	39
Reserve and Surplus	3680	3384	3580	3922
Total Shareholders funds	3719	3423	3619	3961
Total Debt	666	593	326	60
Deferred Tax Liability	126	102	90	77
Non Current Liabilities	6	7	5	3
Total Liabilities	4518	4124	4039	4100
Assets				
Gross Block	1721	1749	1824	1899
Less: Acc Depreciation	932	1005	1080	1160
Net Block	788	745	744	740
Capital WIP	19	101	471	871
Total Fixed Assets	807	845	1214	1610
Investments	867	1157	957	457
Inventory	1308	1005	895	821
Debtors	1187	399	477	503
Loans and Advances	68	306	315	323
Other Current Assets	274	200	222	244
Cash	558	437	161	377
Total Current Assets	3396	2348	2069	2268
Creditors	380	134	79	83
Other Current Liabilities (incl Pr	172	91	121	151
Current Liabilities & Prov	552	225	200	235
Net Current Assets	2844	2122	1868	2034
Others	0	0	0	0
Application of Funds	4518	4124	4039	4100

Source: Company, ICICI Direct Research

Exhibit 12: Key ratios				
	₹ crore			
(Year-end March)	FY19	FY20	FY21E	FY22E
Per share data (₹)				
EPS	790	14	86	150
BV	963	887	937	1,026
DPS	80	25	30	53
Cash Per Share	145	113	42	98
Operating Ratios (%)				
EBITDA margins	70.7	-0.3	20.3	30.0
PBT margins	70.9	1.4	21.6	31.6
Net Profit margins	46.3	2.5	16.2	23.7
Inventory days	247	170	200	175
Debtor days	66	68	85	75
Creditor days	124	30	25	25
Return Ratios (%)				
RoE	82.0	1.6	9.2	14.6
RoCE	107.1	1.6	12.0	19.8
RoIC	119.8	-2.2	9.0	18.0
Valuation Ratios (x)				
P/E	1.1	63.7	10.2	5.9
EV / EBITDA	0.8	-409.5	6.3	3.6
EV / Revenues	0.5	1.7	1.7	1.3
Market Cap / Revenues	0.5	1.6	1.7	1.4
Price to Book Value	0.9	1.0	0.9	0.9
Solvency Ratios				
Debt / Equity	0.2	0.2	0.1	0.0
Debt/EBITDA	0.1	-101.3	0.8	0.1
Current Ratio	6.2	10.4	10.3	9.7
Quick Ratio	3.8	6.0	5.9	6.2

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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