

Steady operational performance...

About the stock: HEG is one of the leading graphite electrode manufacturers and exporters globally.

- HEG has a graphite electrode manufacturing plant of 80000 tonnes per annum at Mandideep in Madhya Pradesh
- HEG has a captive power generation capacity of ~76.5 MW (two thermal power plants and one hydro power plant)

Q2FY23 Results: HEG reported a steady operational performance in Q2FY23.

- For Q2FY23, total operating income was at ₹ 598 crore, up 16% YoY but down 17% QoQ
- Reported EBITDA for the quarter was at ₹ 179 crore, up 26% YoY but down 3% QoQ. EBITDA margin for the quarter was at 29.9%, up 250 bps YoY, 440 bps QoQ
- Standalone PAT for the quarter was at ₹ 130 crore, up 15% YoY but down 3% QoQ. During the quarter, share of profit from associates was at ₹ 39 crore, up 111% YoY, 53% QoQ. Consolidated PAT for the quarter was at ₹ 169 crore, up 28% YoY, 6% QoQ

What should investors do? HEG's share price has given a return of ~45% over the last two years (from ~₹ 717 in November 2020 to ₹ 1042 in November 2022).

- Countries across the world are moving towards their carbon neutrality goals. Hence, corporates are adopting environment friendly manufacturing processes. Steel manufacturers are gradually moving towards the EAF process, auguring well for graphite electrodes demand over the medium to long term horizon. This is likely to support an uptick in graphite electrode prices. Hence, we upgrade the stock from HOLD to **BUY**

Target Price and Valuation: We value HEG at ₹ 1225, 6x FY24E EV/EBITDA.

Key triggers for future price performance:

- HEG's capacity expansion from 80000 tonnes to 100000 tonnes per annum is going on in full swing. The commercial production of the new 20000 tonne graphite electrode capacity is expected by early CY23
- Over FY22-24E, we expect topline to grow at 21.5% CAGR while EBITDA and PAT are expected to register a CAGR of 22.0% and 18.3%, respectively

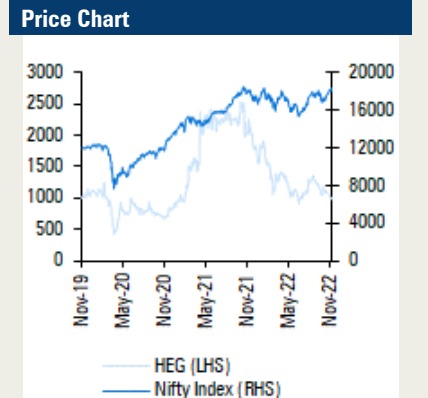
Alternate Stock Idea: In our metal coverage, we also like Jindal Stainless (JSL).

- Jindal Stainless (JSL) has a 1.1 million tonnes per annum (MTPA) integrated stainless steel facility at Jajpur, Odisha.
- BUY with a target price of ₹ 180



Particulars	
Particulars	Amount
Market Cap (In ₹ crore)	4,035
Debt in ₹ crore (FY22)	663
Cash & Cash Eq. (FY22) (in ₹ crore)	1,272
EV	₹ 3426 crore
52 Week H / L (₹)	2125 / 891
Equity Capital (₹)	38.6 crore
Face Value	₹ 10

Shareholding pattern				
(in %)	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	55.1	55.1	55.1	55.1
FIs	13.4	8.9	6.8	5.7
DIs	7.5	8.2	8.4	8.5
Others	24.0	27.8	29.7	30.7
Total	100.0	100.0	100.0	100.0



- Key Risks**
- Lower-than-expected increase in graphite electrodes realisation
 - Higher-than-expected increase in operating cost

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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	FY22	CAGR (FY17-22)	FY23E	FY24E	CAGR (FY22-24E)
Net Sales	6,593	2,149	1,256	2,202	21%	2,573	3,251	22%
Reported EBITDA	4,658	-6	-59	527	46%	664	785	22%
Adjusted PAT	3,050	53	-25	391	LP	476	547	18%
Adjusted EPS (₹)	790.2	13.8	(6.5)	101.2		123.2	141.7	
EV/EBITDA (x)	0.9	NA	NA	6.5		5.3	4.9	
RoCE (%)	107.1	1.6	(0.5)	11.9		14.2	15.4	
RoE (%)	82.0	1.6	-0.7	10.3		11.7	12.5	

Key Highlights on conference call and other highlights...

- There is ~ 20-25 million tonnes (MT) greenfield EAF steelmaking capacity likely to come on stream in the US over the next two to three years. Of this ~6.5 MT of EAF capacity is likely to come in two to three months. Another 11.5 MT of EAF steelmaking capacity is likely to be added by the end of 2024-end and balance EAF capacity likely to be added by first half of 2025. Also, European Union (EU) has plans to convert ~16 MT of blast furnace capacity to Electric Arc Furnace (EAF) capacity starting from 2023-end
- During Q2FY23, graphite electrode realisations have been flattish QoQ
- Needle coke pricing has almost remained unchanged over the last three quarters, with adequate supplies available in the market

Adoption of new line of business

- HEG is entering into manufacturing of graphite anodes for lithium-ion cells and its allied and ancillary products through the incorporation of a subsidiary company
- The subsidiary company would manufacture graphite anode for lithium-ion cells. The plant would be made in two phases, spending ₹ 1000 crore in Phase 1 over the next three years, which would cater to 10-12 GWH of cell manufacturing capacity. In Phase 2, the company plans to double the capacity with another ₹ 1000 crore approximately catering to a total of 20-22 MWH of cell manufacturing capacity. The company aims to finish both the phases in five to seven years
- The ₹ 1000 crore for the first phase is likely to be incurred between March 2023 and March 2025, with commercial production likely to start from April 1, 2025
- During the first phase production, volume is expected to be ~10000 tonnes while asset turnover for the new upcoming facility is expected to be 1:1. The operating margin of the graphite anode is expected to be higher than that of the existing graphite electrode business. The payback for the first phase of ₹ 1000 crore is expected to be about five to six years
- The raw material for graphite anode powder is similar to that used for graphite electrodes i.e. needle coke and Indian pitch coke

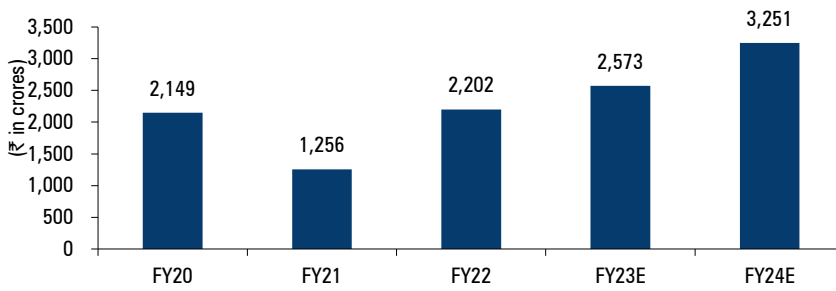
Exhibit 1: Variance Analysis (Standalone Performance)

	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Total Operating Income	598	518	16	722	-17	Standalone topline for the quarter was at ₹ 598 crore, up 16% but down 17% QoQ
Other Income	20	25	-23	21	-8	
Raw Material Expense	181	191	-6	283	-36	
Employee Expense	22	21	4	23	-4	
Power & Fuel Expense	80	61	31	86	-7	
Other Expenses	137	102	34	146	-6	
Total Operating Expenses	419	376	12	538	-22	
EBITDA	179	142	26	184	-3	Standalone EBITDA for the quarter increased 26% YoY but declined 3% QoQ to ₹ 179 crore
EBITDA Margin (%)	29.9	27.4	247 bps	25.5	440 bps	
Depreciation	23	18	28	21	10	
Interest	7	1	498	4	71	
Exceptional Items	-	-	-	-	-	
PBT	168	148	14	180	-7	
Tax Outgo	38	35	10	47	-18	
PAT	130	113	15	134	-3	Standalone PAT for the quarter increased 139% YoY and 18% QoQ to ₹ 134 crore

Source: Company, ICICI Direct Research.

Financial story in charts

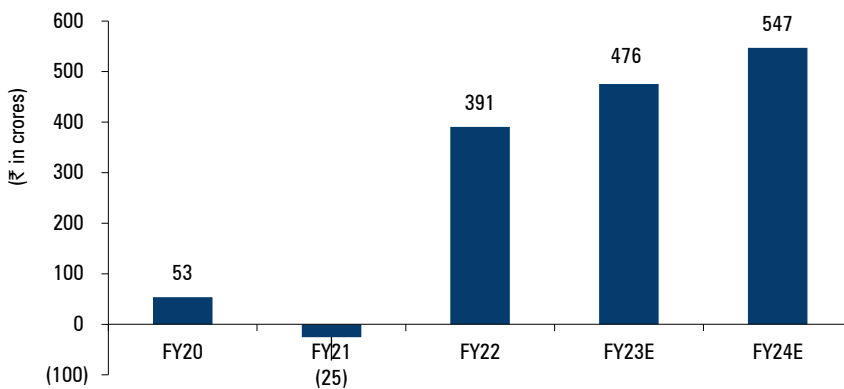
Exhibit 2: Trend in topline (In ₹ crore)



We expect topline to grow at a CAGR of 22% during FY22-24E

Source: Company, ICICI Direct Research

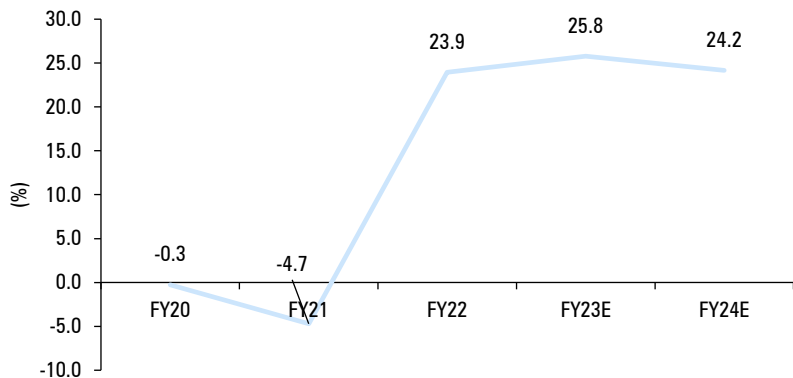
Exhibit 3: Trend in PAT (in ₹ crore)



We expect standalone PAT to grow at a CAGR of 18% during FY22-24E

Source: Company, ICICI Direct Research

Exhibit 4: Trend in EBITDA margin (in %)



We expect HEG to report EBITDA margin of 25.8% for FY23E and 24.2% for FY24E

Source: Company, ICICI Direct Research

Exhibit 5: Valuation Matrix

	Sales (₹ Crore)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBIDTA (x)	P/ BV (x)	RoE (%)	RoCE (%)
FY20	2149	-67	14	-98	75.4	NA	1.2	1.6	1.6
FY21	1256	-42	-7	PL	NA	NA	1.2	-0.7	-0.5
FY22	2202	75	101	LP	10.3	6.5	1.1	10.3	11.9
FY23E	2573	17	123	22	8.5	5.3	1.0	11.7	14.2
FY24E	3251	26	142	15	7.4	4.9	0.9	14.2	15.9

Source: Company, ICICI Direct Research

Financial summary (Standalone)

Exhibit 6: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Total Operating Income	1,256	2,202	2,573	3,251
Growth (%)	-42	75	17	26
Total Operating Expenditure	1315	1674	1910	2465
EBITDA	-59	527	664	785
Growth (%)	PL	LP	26	18
Depreciation	73	79	97	128
Interest	11	7	22	24
Other Income	113	80	91	98
PBT	-31	520	636	731
Exceptional Item	0	0	0	0
Total Tax	-5	129	160	184
Reported PAT	-25	391	476	547
Adjusted PAT	-25	391	476	547
Growth (%)	PL	LP	22	15
EPS (₹)	-7	101	123	142

Source: Company, ICICI Direct Research

Exhibit 7: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit/(Loss) after taxation	-25	391	476	547
Add: Depreciation & Amortization	73	79	97	128
Net Increase in Current Assets	642	-807	-245	-284
Net Increase in Current Liabilities	26	276	159	186
CF from operating activities	716	-61	486	577
(Inc)/dec in Investments	-105	227	0	0
(Inc)/dec in Fixed Assets	-295	-471	-400	-450
Others	0	0	0	0
CF from investing activities	-400	-244	-400	-450
Inc / (Dec) in Equity Capital	0	0	0	0
Inc / (Dec) in Loan	-296	367	-100	-50
Dividend & Dividend Tax	-12	-154	-190	-221
Others	105	144	0	0
CF from financing activities	-203	357	-290	-271
Net Cash flow	114	52	-204	-144
Opening Cash	437	551	602	398
Closing Cash	551	602	398	254

Source: Company, ICICI Direct Research

Exhibit 8: Balance sheet				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Liabilities				
Equity Capital	39	39	39	39
Reserve and Surplus	3360	3738	4024	4349
Total Shareholders funds	3399	3777	4062	4388
Total Debt	297	663	563	513
Deferred Tax Liability	97	96	96	96
Non Current Liabilities	8	10	10	10
Total Liabilities	3799	4547	4732	5008
Assets				
Gross Block	1771	1920	2920	3090
Less: Acc Depreciation	1078	1157	1254	1381
Net Block	694	763	1666	1708
Capital WIP	373	696	96	376
Total Fixed Assets	1067	1459	1762	2084
Investments	1262	1035	1035	1035
Inventory	581	978	1125	1452
Debtors	289	589	705	668
Loans and Advances	305	339	347	355
Other Current Assets	94	169	143	129
Cash	551	602	398	254
Total Current Assets	1819	2677	2719	2858
Creditors	257	448	577	733
Other Current Liabilities (incl Pro	91	177	207	237
Current Liabilities & Prov	348	624	783	970
Net Current Assets	1471	2053	1935	1889
Others	0	0	0	0
Application of Funds	3799	4547	4732	5008

Source: Company, ICICI Direct Research

Exhibit 9: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS	-7	101	123	142
BV	880	978	1,052	1,137
DPS	3	40	49	57
Cash Per Share	-103	156	103	66
Operating Ratios (%)				
EBITDA margins	-4.7	23.9	25.8	24.2
PBT margins	-2.4	23.6	24.7	22.5
Net Profit margins	-2.0	17.7	18.5	16.8
Inventory days	161	213	215	215
Debtor days	84	98	100	75
Creditor days	116	197	195	195
Return Ratios (%)				
RoE	-0.7	10.3	11.7	12.5
RoCE	-0.5	11.9	14.2	15.4
RoIC	-3.2	14.1	15.9	15.5
Valuation Ratios (x)				
P/E	NA	10.3	8.5	7.4
EV / EBITDA	NA	6.5	5.3	4.9
EV / Revenues	3.8	1.9	1.6	1.3
Market Cap / Revenues	3.2	1.8	1.6	1.2
Price to Book Value	1.2	1.1	1.0	0.9
Solvency Ratios				
Debt / Equity	0.1	0.2	0.1	0.1
Debt/EBITDA	NA	1.3	0.8	0.7
Current Ratio	5.2	4.3	3.5	2.9
Quick Ratio	3.6	2.7	2.0	1.5

Source: Company, ICICI Direct Research

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