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HEG/SECTT/2019 24th June, 2019

| 1 | **BSE Limited**<br>25th Floor, P J Towers<br>Dalal Street<br>MUMBAI - 400 001.<br>**Scrip Code : 509631** | 2 | **National Stock Exchange of India Limited**<br>Exchange Plaza, 5th Floor<br>Plot No.C/1, G Block, Bandra - Kurla Complex<br>Bandra (E),<br>MUMBAI - 400 051.<br>**Scrip Code : HEG** |
|---|---|---|---|

**Sub: Affirmation of credit Rating of HEG Limited**

Dear Sir,

This is to inform you that India Ratings and Research (Ind-Ra) has affirmed HEG Limited's (HEG) **Long-Term Issuer Rating as 'IND AA'** . The Outlook is Stable. A detailed rationale is attached herewith for your reference.

Kindly take the same on record.

Thanking you,

Yours faithfully,
For **HEG Limited**

**(Vivek Chaudhary)**
**Company Secretary**

heg.investor@lnjbhilwara.com

Encl : as above.

**HEG LIMITED**

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India Ratings & Research
A Fitch Group Company

# India Ratings Affirms HEG at 'IND AA'/Stable; Limits Enhanced

24
JUN 2019

By Akash Krishnatry

India Ratings and Research (Ind-Ra) has affirmed HEG Limited's Long-Term Issuer Rating at 'IND AA'. The Outlook is Stable. The instrument-wise rating actions are as follows:

| Instrument Type | Date of Issuance | Coupon Rate | Maturity Date | Size of Issue (million) | Rating/Outlook | Rating Action |
|---|---|---|---|---|---|---|
| Commercial paper | - | - | 30-365 days | INR1,000 | IND A1+ | Affirmed |
| Fund-based limits | - | - | - | INR12,000 (increased from INR5,690) | IND AA/Stable/IND A1+ | Affirmed |
| Non-fund-based limits | - | - | - | INR9,200 (increased from INR2,133) | IND AA/Stable/IND A1+ | Affirmed |

## KEY RATING DRIVERS

**Strong Industry Dynamics:** Ind-Ra expects the global demand-supply dynamics to remain healthy for graphite electrode (GE) players owing to a reduction in the overall ultra-high powered GE capacity to 725,000 tonnes per annum (tpa) in 2018 from 810,000tpa in 2014, resulting from capacity closures. Also, low capacity additions by 2022 and limited availability of needle coke, would restrict new supplies and overall capacity utilisation levels. Moreover, the agency expects robust GE demand to sustain, as the environmentally superior electric arc furnace (EAF) route steel production's share would gradually improve, along with the overall steel demand growth.

HEG has been witnessing higher GE prices since 2HFY18 owing to a surge in EAF route steel production, supported by China's steel capacity rationalisation. Ind-Ra expects China's steel exports to remain around 70 million metric tonnes (mmt) in the medium term as capacities are unlikely to grow considerably and the global large consumers of steel are likely to continue protectionist regime. China's exports reduced to 69mmt in 2018 (2017: 75mmt, 2016: 110mmt), while global importing nations ramped up their EAFs, thus supporting strong GE demand over 2018. Ind-Ra expects ultra-high power GE demand to remain stable at around 700,000 over the short-to-medium term. During 2017-2018, the demand for GE increased 35-40 kilo tonnes per annum, leading to panic in the markets and abnormal realisations of around USD20,000/tonne from the long-term average of around USD4,000/tonne.

**Healthy Revenue and Profitability:** HEG's revenue increased to INR65.9 billion in FY19 (FY18: INR27.5 billion), EBITDA to INR46.5 billion (INR17.2 billion) and EBITDA margins to 71% (63%), driven by a sudden demand-supply gap amid favourable industry dynamics. Considering the healthy balance in the medium term, Ind-Ra expects HEG's profitability to stabilise at INR12 billion-15 billion over FY20-FY21. Moreover, the company ties up capacity with customers according to the available needle coke prices, thus partially mitigating price shocks in the commodities.

Ind-Ra's expects continued healthy realisation in FY20-FY21 owing to the healthy demand-supply scenario in the steel industry and EAF route of production. The agency expects the needle coke prices to stabilise to about USD4,000/tonne owing to the destocking of the higher inventories held by GE producers during FY19. Furthermore, capacity utilisation of GE producers should stabilise at 80%-85% in FY20-FY21. However, given the constrained supply of needle coke and the alternative use in LI-ion batteries, a higher-than-expected rise in prices could lead to lower-than-expected gross margins for the GE producers in the long term.

**Comfortable Liquidity:** HEG had unrestricted cash and bank balances, and liquid investments of INR9.3 billion at FYE19 (FYE18: INR52 million). The average utilisation of the fund-based working capital limits was around 50% during the 12 months ended May 2019. Despite the capex execution, the agency expects the company to have positive free cash flow from operations over FY20-FY21. Although fund flow from operations are likely to moderate to around INR12 billion from the abnormally high levels of around INR35 billion over FY19, cash flow from operations shall be supported through release of working capital as the average finished good prices normalise around USD8,000/tonne from the highs of USD15,000/tonne in FY19. HEG has no term loans outstanding and Ind-Ra does not expect any term loan requirements over FY20-FY21. HEG's gross interest coverage was comfortable at 259x in FY19 (FY18: 30x). The company had a net cash position in FY19 (FY18 net adjusted leverage: 0.2x).

**Ongoing Capex:** HEG is undergoing fully equity-funded capex of INR12 billion towards brownfield capacity expansion of 20,000mt over FY20-FY22. The project execution and stabilisation risks are limited because of the debt-free capex funding, five-decade-long experience of the company's management in the existing business and the expected growth in EAF steel production. However, the capex stabilisation may have moderate risks on feedstock availability and plant ramp up. Ind-Ra expects HEG to maintain a liquid balance sheet and have a low reliance on external debt; thus, the credit metrics will remain commensurate with the rating level. However, any unrelated diversification or leveraged inorganic growth would be key rating monitorables.

**Working Capital-Intensive Operations:** The manufacturing of GE involves a large processing period and a moderate-to-long credit period to customers. Its working capital cycle improved to around 150 days in FY19 from 220 days in FY18, as the GE market has transformed to a supplier's market from a buyer's market.

**Industry Risks:** HEG is exposed to cyclicality in the steel business, as well as to risks arising from the volatility in the costs of raw materials, mostly crude/coal derivatives. HEG has a single manufacturing unit and its cash flows are dependent on single product revenue. However, it is well diversified in terms of markets and customers across geographies, which mitigates this risk to some extent.

## RATING SENSITIVITIES

**Positive:** The sustenance of the strong liquidity position through business cycles, continued favourable industry dynamics and the company's ability to successfully compete globally leading to healthy returns on capital, and/or diversification of cash flows would be positive for the ratings.

**Negative:** Any debt-led capex and/or acquisition, elongation of the working capital cycle and/or adverse profitability resulting in net adjusted leverage exceeding 1.5x on a sustained basis would result in a negative rating.

## COMPANY PROFILE

Formed in 1977, HEG is a flagship company of the LNJ Bhilwara Group. It manufactures GE at its 80,000tpa facility in Madhya Pradesh.

**FINANCIAL SUMMARY**

| Particulars | FY19 | FY18 |
|---|---|---|
| Revenue (INR million) | 65,928 | 27,501* |
| EBITDA (INR million) | 46,582 | 17,216 |
| EBITDA margin (%) | 70.7 | 62.6 |
| Gross interest coverage (x) | 259 | 30 |
| Net leverage (x) | n.m. | 0.2 |
| * Net of excise duty<br>Source: Ind-Ra, HEG | | |

## RATING HISTORY

| Instrument Type | Current Rating/Outlook | | | Historical Rating/Outlook | | |
|---|---|---|---|---|---|---|
| | Rating Type | Rated Limits (million) | Rating | 20 April 2018 | 11 December 2017 | 16 November 2016 |
| Issuer rating | Long-term | - | IND AA/Stable | IND AA/Stable | IND A+/Positive | IND A/Stable |
| Fund-based limits | Long-term/Short-term | INR12,000 | IND AA/Stable/IND A1+ | IND AA/Stable/IND A1+ | IND A+/Positive/IND A1+ | IND A/Stable/IND A1 |
| Non-fund-based limits | Long-term/Short-term | INR9,200 | IND AA/Stable/IND A1+ | IND AA/Stable/IND A1+ | IND A+/Positive/IND A1+ | IND A/Stable/IND A1 |
| Commercial paper | Short-term | INR1,000 | IND A1+ | IND A1+ | IND A1+ | IND A1 |

## COMPLEXITY LEVEL OF INSTRUMENTS

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

## SOLICITATION DISCLOSURES

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## ABOUT INDIA RATINGS AND RESEARCH

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Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

India Ratings is a 100% owned subsidiary of the Fitch Group.

For more information, visit www.indiaratings.co.in.

## DISCLAIMER



## Applicable Criteria

Corporate Rating Methodology

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