HEG Ltd (HEG)

ICICI direct Research

CMP: ₹ 2,100 | Target: ₹ 2,520 (20%) | Target Period: 12 months

BUY

September 17, 2024

Company Update

Structural tailwinds in place for long term growth...

About the stock: HEG is one of the leading graphite electrode manufacturers in India and a key exporter with ~65%- 70% of production exported to global markets.

- Graphite electrode production capacity of 100,000 ton in Madhya Pradesh.

Q1FY25 Results: HEG reported muted performance in Q1FY25. On standalone basis, Topline for the quarter stood at ₹ 572 crore. Adjusted EBITDA came in at ₹70 crore with EBTDA margins at 12.2%. PAT stood at ₹2.6 crore. It approved 1:5 stock split; i.e. 1 share of face value of ₹ 10 will be split into 5 shares of face value of ₹ 2.

Investment Rationale:

- **HEG to benefit from global shift towards EAF route:** As the global steel industry progresses decarbonization, it is increasingly adopting Electric Arc Furnace (EAF) route of steel making, which emits ~75% less carbon vs. traditional steelmaking (BOF) and also reduces production costs. EAF share in total crude steel production (ex-China) is expected to rise from ~50% in 2023 to ~55% in next 3 to 4 years. By 2030, more than ~170 million tons of EAF capacity (ex-China) is expected to be added, leading to an incremental demand for graphite electrodes by ~2 lakh tons vs. present industry size of ~8 lakh tonne. HEG, being amongst the top 5 graphite electrodes producer globally, is poised to benefit from this transition. With structural tailwinds, we expect demand and pricing recovery in graphite electrode space from H2FY25 onwards & we bake in capacity utilisation of ~75% for FY25E and ~80% for FY26E, on expanded base (1 lakh tonne).
- **Promising opportunities lies ahead in new venture- graphite anode:** Transition towards E-mobility space and rise in use of stationary applications will drive demand for Li-On batteries domestically to ~150-160 GWh by 2030, resulting in need for ~1.5 lakh tons graphite anode. With government's aim to localize battery components, HEG plans to seized the opportunity by setting up a 20,000 tons capacity of graphite anode at a capex of ~₹1,800 crore. This venture is anticipated to offer value addition benefits with targeted EBITDA margins & RoCE pegged at 20%+. The company is fine tuning plan of action in this space (location etc., amid falling battery prices globally) with likely commissioning in FY27E.
- **Unlocking value by demerging graphite electrode business:** HEG plans to segregate itself into two entities i.e. (i) Pure play Graphite Electrode business and (ii) Greentech which includes power business by merger of Bhilwara Energy (owning 100% stake) and TACC (anode material business) thereby creating two listed entities i.e. HEG Graphite & HEG Greentech. Existing shareholders will receive one share of each entity for every share held in HEG ltd. This move aims to unlock business potential by prioritizing core business strength. Transaction looks fair to us.

Rating and Target Price

- We have a positive view on HEG amid of ongoing global shift towards EAF route and expansion led volume growth in offering. We assign **BUY** rating with a target price of **₹2,520** thereby valuing it on SoTP basis on FY26E.

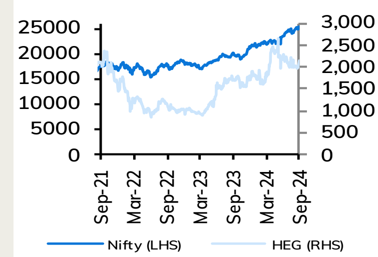
Particulars

Particulars	₹ crore
Market Capitalisation	8,106
Total Debt (FY24)	619
Cash & Investments	990
EV (₹ crore)	7736
52 Week H/L (₹)	2,745 / 1,462
Equity Capital (₹ crore)	39
Face Value (₹)	10.0

Shareholding pattern

	Sep-23	Dec-23	Mar-24	Jun-24
Promoter	55.8	55.8	55.8	55.8
FII	6.8	6.9	6.9	6.1
DII	7.2	8.9	10.4	13.1
Other	30.2	28.5	27.0	25.1

Price Chart



Recent event & key risks

- Posted muted performance in Q1FY25 with MTM impact on certain long-term investments.
- Key Risk: ((i) delay in global transitioning to EAF route, affecting demand (ii) More than-expected rise in needle coke prices impacting margins.

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Key Financial Summary

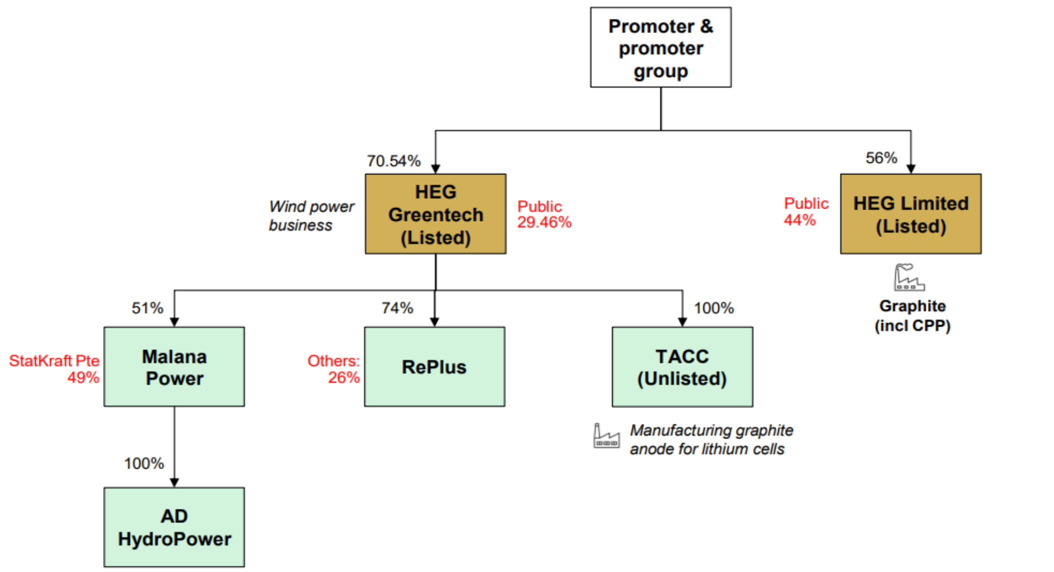
Key Financials (₹ Crore)	FY20	FY21	FY22	FY23	FY24	4 year CAGR (FY20-24)	FY25E	FY26E	2 year CAGR (FY24-26E)
Net Sales	2,149.0	1,256.2	2,201.6	2,467.2	2,394.9	2.7%	2,288.7	2,994.9	11.8%
Reported EBITDA	-5.8	-59.1	527.2	619.7	384.0	NA	340.5	700.4	35.0%
Adjusted PAT	53.4	-25.3	390.6	455.5	231.6	44.3%	149.2	419.3	34.6%
Adjusted EPS (₹)	13.8	-6.5	101.2	118.0	60.0		38.7	108.6	
EV/EBITDA (x)	NA	NA	14.6	12.9	20.6		23.3	12.0	
RoCE (%)	1.6	-0.5	11.9	13.0	7.4		4.6	11.7	
RoE (%)	1.6	-0.7	10.3	11.2	5.6		3.6	9.3	

Source: Company, ICICI Direct Research

Recent Developments: Demerger Announcement

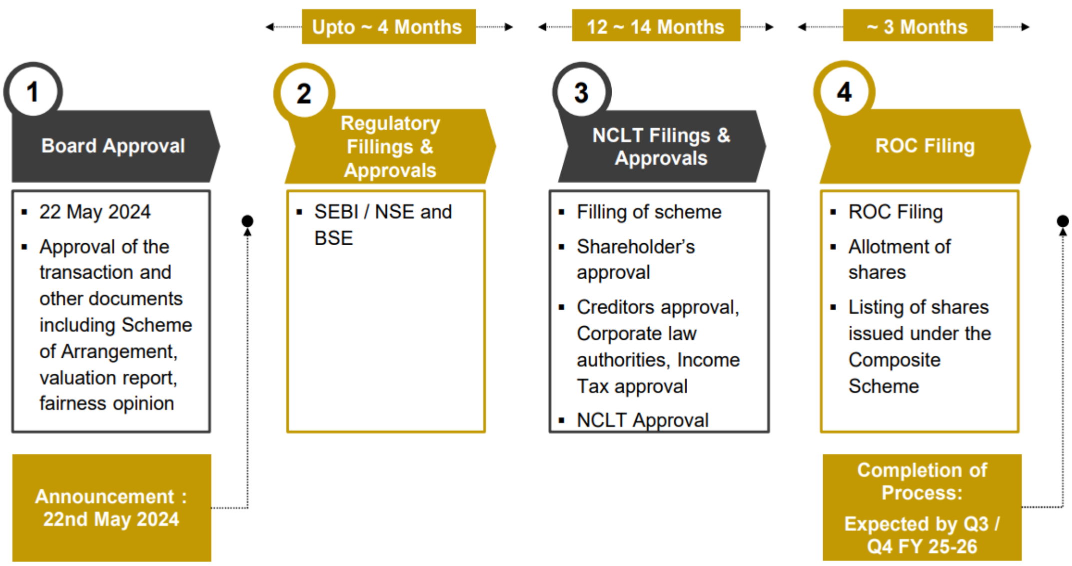
- HEG has announced a corporate action to demerge its graphite electrode business into a new listed entity named as HEG Graphite Ltd. This new listed entity will have an identical shareholding (mirror) as of existing HEG Ltd, with the promoter holding a 56% stake and the remaining 44% held by public shareholders.
- The existing HEG ltd will be renamed as HEG Greentech Ltd, which owns 49% stakes in Bhilwara Energy (BEL; operates in hydro power generation) and 100% stakes of TACC, a graphite anode business for lithium-ion cells. It plans to acquire remaining 51% stakes of BEL from the promoter group, thereby merging it with this entity and owning 100% of BEL. Consequently, the promoter shareholdings will increase from 56% to 70.5% in in HEG Greentech.
- The transaction appears to be fair in nature with BEL possessing operating renewable energy assets and net cash positive B/S. The entire process is expected to complete by the mid of FY26.

Exhibit 1: Post restructuring Corporate Structure



Source: Company, ICICI Direct Research

Exhibit 2: Indicative Timeline

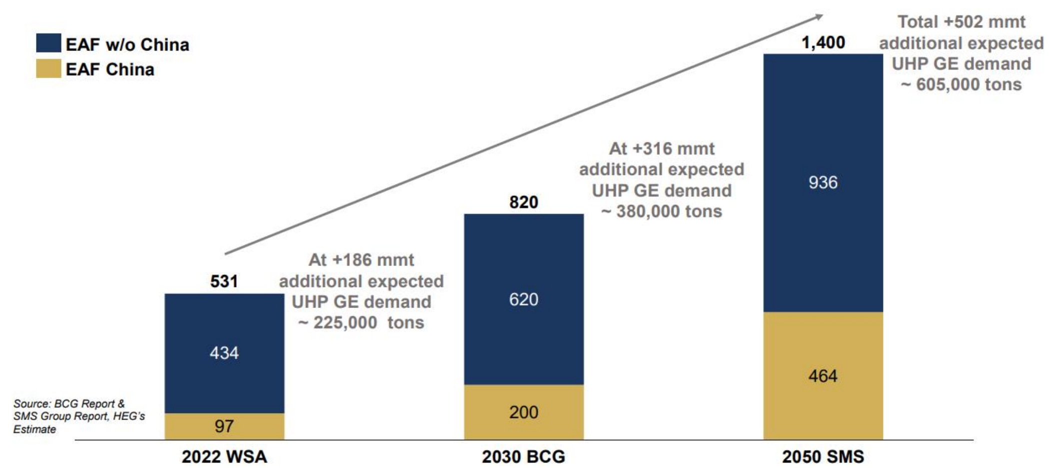


Source: Company, ICICI Direct Research

Q1FY25 Earnings Conference Call Highlights

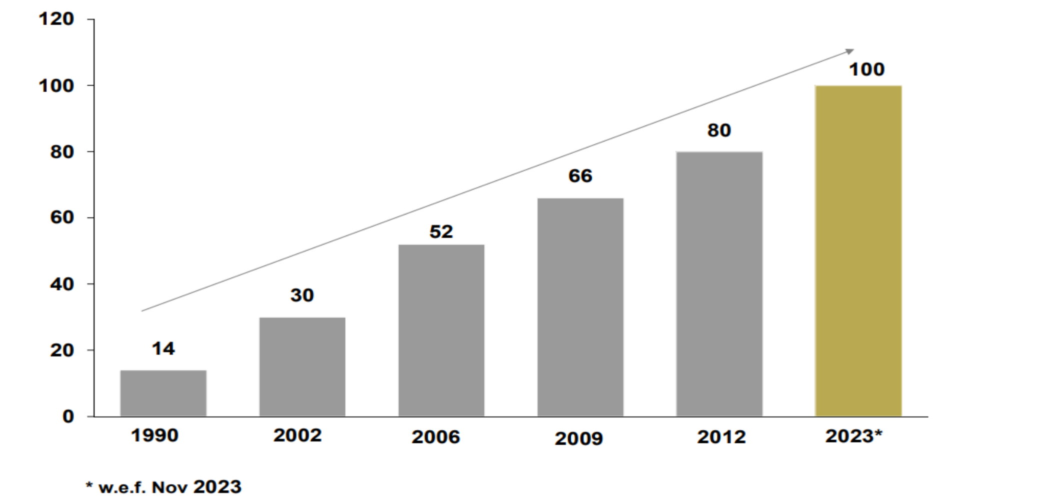
- **Graphite Industry:** In line with decarbonization efforts, ~100 million tonnes (MT) of new greenfield capacities for Electric Arc Furnaces have been announced globally (Ex China), expected to become operational between 2024 and 2030. Of this, 60 to 65 million tons are likely to be operational by early of 2027, which will likely increase the electrode demand by 100,000 to 125,000 tons over the next 3 years.
- **Graphite Electrodes:** Capacity utilisation for Q1FY25 was at 80%, with a target of around 75% utilisation level for FY25 amid a sluggish global demand environment. Additionally, graphite electrodes realisation has been under pressure, with expectations that prices will remain muted over the next 2 to 3 quarters.
- **TACC:** HEG's upcoming graphite electrode capacity of 20,000 tons, originally schedule to be operational by mid of 2025, has now been delayed by two more quarters, pushing the timeline to FY27. The postponement was due to delays in the commissioning of lithium-ion battery production, with prices declining from $90 per kwh to $55 per kwh, as well as renegotiation with state governments for lower power prices. It has invested ₹60 crores of capex till date, out of which ₹30-35 crores was allocated for land purchase. It expects project RoCE, margins to be 20%+.
- **Others:** As of 31st June 2024, Cash balance stood at ₹917 crores. Malana Power business posted an EBITDA stood at ₹350 crores in FY24. Other Expenses for the quarter was higher due to one-time adjustment of treasury-related investments in equity shares, where the company booked a mark-to-market loss of ₹ 30-31 crores on certain long-term investment.

Exhibit 3: EAF Steel Forecast Trend -BCG/SMS Group in million MT



Source: Company, ICICI Direct Research

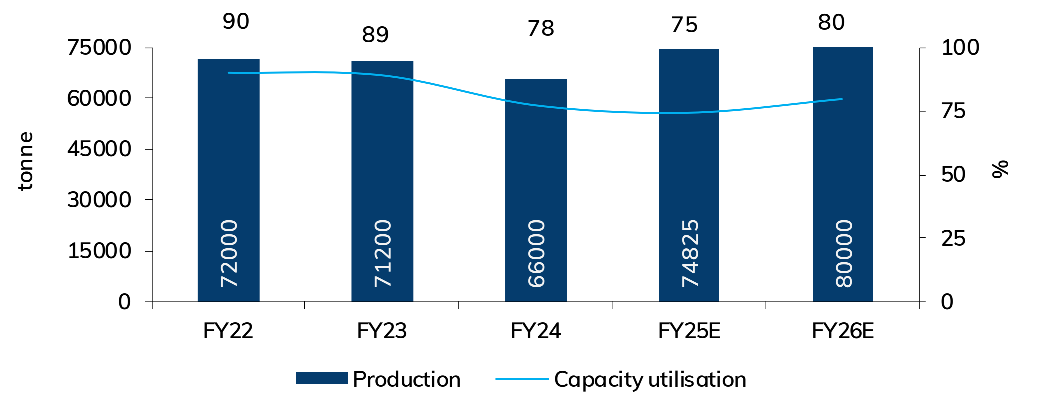
Exhibit 4: Graphite Electrode Capacity Build Up at HEG (in '000 MT)



Source: Company, ICICI Direct Research

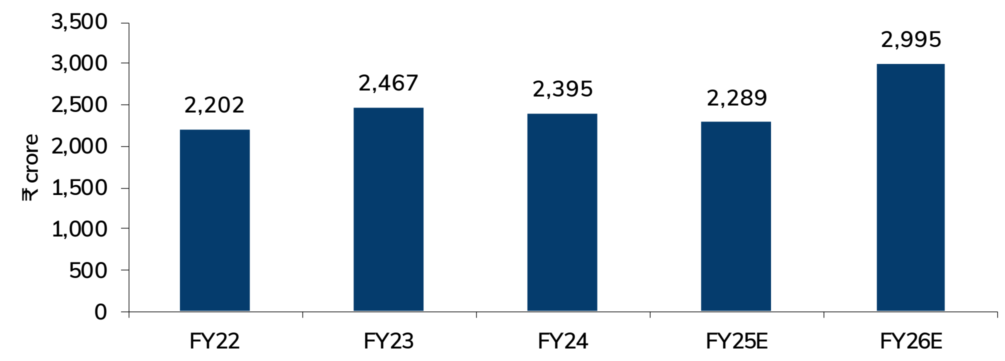
Financial Story in Charts

Exhibit 5: Capacity Utilisation trend at HEG



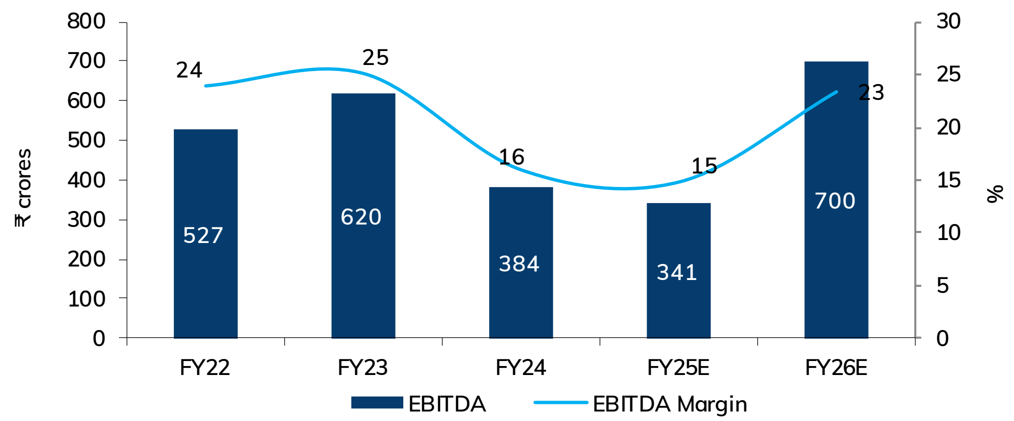
Source: Company, ICICI Direct Research; for FY24 the capacity is weighted average for 80,000 – 9M'24 and 1,00,000 – 3M'24

Exhibit 6: Topline trend



Source: Company, ICICI Direct Research

Exhibit 7: EBITDA and EBITDA margins trend



Source: Company, ICICI Direct Research

Exhibit 8: Valuation table

Particulars	Amount
FY26E EBITDA (₹ crore)	700
EV/EBITDA Multiple (x)	10
EV (₹ Crore)	7,004
Net Debt (₹ crore)	82
2x P/B Bhilwara Energy Equity Invst. (₹ crore)	614
2x CWIP to new Anode Plant (2x P/B, ₹ crore)	2,189
HEG Implied Equity Value (₹ crore)	9,724
No. of Shares (crore)	3.9
Target Price (₹)	2,520
CMP (₹)	2,100
Upside (10%)	20.0%

Source: Company, ICICI Direct Research

We have a positive view on HEG amid of ongoing global shift towards EAF route and expansion led volume growth in offering. We assign BUY rating at a target price of ₹2,520 thereby valuing it on SoTP basis, i.e. 10x EV/EBITDA on core graphite electrode business, 2x P/B on equity investment in BEL and 2x CWIP to graphite anode business, all on FY26E.

Financial Summary

Exhibit 9: Profit and loss statement ₹ crore

(Year-end March)	FY23	FY24	FY25E	FY26E
Total Operating Income	2,467	2,395	2,289	2,995
Growth (%)	12	-3	-4	31
Raw Material Expenses	915	1151	1066	1314
Employee Expenses	92	95	98	112
Other expenses	841	765	785	869
Total Operating Expenditure	1848	2011	1948	2295
EBITDA	620	384	341	700
Growth (%)	18	-38	-11	106
Depreciation	102	175	191	197
Interest	26	36	30	27
Other Income	109	142	69	84
PBT	600	315	189	560
Exceptional Item	0	0	-31	0
Total Tax	145	84	40	141
Reported PAT	456	232	118	419
Adjusted PAT	456	232	149	419
Growth (%)	17	-49	-36	181
EPS (₹)	118	60	39	109

Source: Company, ICICI Direct Research

Exhibit 10: Cash flow statement ₹ crore

(Year-end March)	FY23	FY24	FY25E	FY26E
Profit/(Loss) after taxation	456	232	149	419
Add: Depreciation & Amortization	102	175	191	197
Sub: Other Income	-109	-142	-69	-84
Net Increase in Current Assets	-231	247	67	-284
Net Increase in Current Liabilities	-48	-29	-1	122
CF from operating activities	169	483	337	370
(Inc)/dec in Investments	370	-332	45	490
(Inc)/dec in Fixed Assets	-478	-317	-300	-800
Add: Other Income	109	142	69	84
CF from investing activities	1	-507	-186	-226
Inc / (Dec) in Equity Capital	0	0	0	0
Inc / (Dec) in Loan	78	-122	-50	-50
Dividend & Dividend Tax	-164	-88	-60	-106
Others	-4	-64	-31	0
CF from financing activities	-90	-274	-141	-156
Net Cash flow	80	-298	9	-12
Opening Cash	602	681	383	393
Closing Cash	681	383	393	381

Source: Company, ICICI Direct Research

Exhibit 11: Balance Sheet ₹crore

(Year-end March)	FY23	FY24	FY25E	FY26E
Liabilities				
Equity Capital	39	39	39	39
Reserve and Surplus	4,039	4,106	4,164	4,478
Total Shareholders funds	4,077	4,145	4,203	4,516
Total Debt	741	619	569	519
Deferred Tax Liability	87	96	96	96
Non Current Liabilities	7	9	9	9
Total Liabilities	4,912	4,870	4,877	5,141
Assets				
Gross Block	2,545	3,128	3,228	3,328
Less: Acc Depreciation	1,183	1,346	1,536	1,733
Net Block	1,363	1,782	1,692	1,595
Capital WIP	472	194	394	1,094
Total Fixed Assets	1,835	1,977	2,086	2,690
Investments	666	998	953	463
Inventory	1,440	1,194	1,174	1,320
Debtors	489	508	470	615
Loans and Advances	268	167	177	187
Other Current Assets	109	190	171	154
Cash	681	383	393	381
Total Current Assets	2,988	2,442	2,385	2,657
Creditors	412	425	394	486
Other Current Liab. (incl Prov.)	165	122	152	182
Current Liabilities & Prov	576	547	546	668
Net Current Assets	2,411	1,895	1,839	1,989
Others	-	-	-	-
Application of Funds	4,912	4,870	4,877	5,141

Source: Company, ICICI Direct Research

Exhibit 12: Key ratios

(Year-end March)	FY23	FY24	FY25E	FY26E
Per share data (₹)				
EPS	118	60	39	109
BV	1,056	1,074	1,089	1,170
DPS	43	23	15	27
Cash Per Share	177	99	102	99
Operating Ratios (%)				
EBITDA margins	25.1	16.0	14.9	23.4
PBT margins	24.3	13.2	8.2	18.7
Net Profit margins	18.5	9.7	6.5	14.0
Inventory days	285	217	220	210
Debtor days	72	77	75	75
Creditor days	164	135	135	135
Return Ratios (%)				
RoE	11.2	5.6	3.6	9.3
RoCE	13.0	7.4	4.6	11.7
RoIC	15.6	5.8	4.4	14.4
Valuation Ratios (x)				
P/E	18.2	35.8	55.6	19.8
EV / EBITDA	12.9	20.6	23.3	12.0
EV / Revenues	3.4	3.6	3.7	2.8
Market Cap / Revenues	3.4	3.5	3.6	2.8
Price to Book Value	2.0	2.0	2.0	1.8
Solvency Ratios				
Debt / Equity	0.2	0.1	0.1	0.1
Debt/EBITDA	1.2	1.6	1.7	0.7
Current Ratio	5.2	4.5	4.4	4.0
Quick Ratio	2.7	2.3	2.2	2.0

Source: Company, ICICI Direct Research

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Reduce: -15% to -5%;

Sell: <-15%

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