



## Our Take

HEG Reported robust top-line and bottom line growth in Q3 FY18 however what is note worthy is that the realizations at \$ 7731 / Tonne were significantly higher than than its peer graphite India at \$ 6900 /Tonne. On our correspondence with the steel manufacturers we've reconfirmed the continuation of higher realizations and expect the coming quarters to be incrementally better. At a realization of \$ 10500 we expect HEG to report a top-line of Rs. 4880 Crs. in FY19E, EBIDTA of Rs. 2881 Crs. and a PAT of Rs. 1762 Crs.

At CMP 2639 HEG is trading at an EV/EBIDTA to 3.78x FY 19E and P/E of 6.0x FY19E.

We recommend to **ADD** the stock at current levels and assign an EV/EBIDTA multiple of 5.0x FY19E to arrive at a target price of Rs.3453 /share implying an upside of 31% from current levels.

	Q3 FY18	Q3 FY17	Y-o-Y Growth %	Q2 FY18	Q-o-Q Growth %
HEG Ltd Q3 FY18 Abridged Results (In Rs Cr)					
Net Revenue	848.01	243.56	248.17%	412.09	105.78%
Expenses	285.20	213.12		219.80	
EBITDA	562.81	30.44	1748.92%	192.29	192.69%
EBITDA %	66.37%	12.50%		46.66%	
Depreciation	18.89	18.32		18.20	
EBIT	543.92	12.12		174.09	
Interest	12.68	13.83		12.94	
PBT	531.24	-1.71 *		161.15	229.66%
Tax	189.13	1.81		47.48	
PAT	342.11	-3.52 *		113.67	200.97%
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* Turnaround, % growth cannot be calculated.					

## Earnings Call KTA

**Provision Export Duty** – The Finance Bill of 2018 proposed to levy 20% tariff on exports of graphite electrode. As on date, the **export duty remains nil**, but the government can implement a duty at any point it deems necessary up to maximum of 20%.

The graphite demand in India remains at 60,000 tons a year whereas the combined production capacity of both HEG and Graphite India remains at 160,000 with HEG exporting ~60% of its production. An export duty is put on a product to protect the Indian industry and to ensure continuous supply of goods in the domestic market instead of profiteering on its back from the exports. The government has imposed to ensure the above mentioned happens and the management is confident that the duty is not worrisome and can be passed on to customers if it is implemented.

In any given case the export duty is levied on electrode producers, HEG will be able to pass on the rise in prices to electrode buyers.

**Needle Coke Industry/Prices** – Needle Coke is a significant cost of the production with only 3 major players producing the required needle coke with ConocoPhillips producing ~65% of the world's production. ConocoPhillips is debottlenecking their refineries to increase the production capacity by 15% - 20% which would be commissioned by the second half of 2018.

HEG's 90% of the needle coke requirement comes through the oil route whereas 10% of it is produced through coal tar route. HEG also uses Indian Coke to an extent of 20% - 25% of its coke requirement and is only used for production of Non-Ultra High Power Electrodes.

If the base price of needle coke is assumed to be 100 in June of 2017, the prices had gone up to 200 by August, 2017 and by February, 2018 they are expected at 400-450. Up till Q1 FY18 management has guided the coke prices will be realised in the region of 200 (Notional price) due to old contracts however, from Q2 FY18 the price of needle coke will be in the range of 400-450. We have taken needle coke price at Rs. 2886 /tonner in our FY19 Estimates after our analysis.

With the increasing prices of needle coke management is confident that in the coming 6 months it will be able to pass on the needle coke prices to electrode buyers especially when Graftech has set the base price of electrodes in the range of \$10,000 - \$12,000 for the coming few years.

**Debt Repayment** – Total debt as on Q3 FY18 stands at ₹ 575 Cr as against ₹ 686 Cr as on FY17. ₹ 575 Cr comprises of ₹90 Cr of term debt and the balance is on account of working capital loans. As on 31<sup>st</sup> January, 2018 the total debt of ₹ 575 Cr has been reduced to ₹ 375 Cr with term load being nil by the end of Q4 FY18.

**Nature of Contracts** – The graphite electrode industry is not able to give 12 month pricing because of the significant increase in the needle coke prices. Standard contracts which were happening on annual basis till last year have been changed to majorly quarterly contracts and some semi-annual contracts.

In case of Indian electrode demand, the contracts are predominantly happening on monthly basis because a lot of steel manufacturers are in stress and are not keen to talk more than a month contract.

**Increase in Other Expenses & Employee Cost** – There was a onetime settlement expense of ₹ 30 Cr for two legal cases which was accounted in Q3 FY18 in the power and fuel cost. Power and fuel cost increased to ₹ 61.66 Cr in Q3 FY18 from ₹ 27.36 Cr in Q2 FY18.

Employee expense has gone up to ₹ 33.14 Cr in Q3 FY 18 from ₹ 16.98 Cr in Q2 FY18 due to ongoing practice in the company. The employee incentives are linked to profits and a similar number for employee expense can be expected for Q4.

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