

02nd January 2024

HEG Ltd. – BUY

CMP : Rs. 1,881
Target Price : Rs. 2,448
Upside : ~30%
Stop Loss : Rs. 1,750(Closing Basis)

Investment Thesis

- HEG Ltd. (HEG) is in the space of producing graphite electrodes which is majorly used in electric arc furnaces (EAF). The decarbonisation process would make way for an increased EAF demand globally which will surpass that of blast furnaces demand putting HEG in a favourable position in the industry.
- Again, on the EAF demand front, HEG has managed to expand its capacity to 1,00,000 tons from a previous capacity of 80,000 tons per annum. This makes HEG the largest Graphite electrode plant under one roof in the world. This move will better prepare the company to meet the rising demand for EAF in the future which seems imminent at this point. Additionally, this capacity expansion has made the company the third largest producer of Graphite Electrodes in the world.
- HEG has a diversified customer base of the best steel companies around the world. It currently has a clientele span of 20 top steel companies.
- Pre-expansion, the company reported a strong utilization rate of ~90% in Q1, 85% in Q2 and are guiding for a 75% utilization rate for the next two quarters of FY24. Robust utilization augurs well for the company and indicates HEG's strength in order execution and sustained demand from clients.
- A new plant is upcoming for additional capacity of 10,000 ton which will cost around ~Rs.1,000 crores. This is going to lead to a savings in power costs, and other processes. The new capacity expansion plant will also be able to generate an EBITDA margin of ~25% to 35%.

Financials

- Total Revenue declined by 8.5% in Q2FY24 compared to Q1FY24 owing to a tougher market conditions globally and rate hike affecting the business in the countries like USA. However, there is a positive guidance from the management for an improvement in revenue owing to HEG's capacity expansion plans and a positive world steel outlook. Additionally, the decarbonization efforts globally would increase demand for electric arc furnaces that puts HEG in a very robust position.

Particulars	FY20	FY21	FY22	FY23	FY24E
Revenue (Rs in Crs)	2,144.76	1,254.27	2,200.53	2,462.56	2,782.69
EBITDA (Rs in Crs)	-4.95	-53.24	530.03	618.74	730.11
Adj. PAT (Rs in Crs)	67.63	-17.94	431.04	532.41	590.81
Adj. EPS (Rs.)	17.52	-4.65	111.67	137.93	153.06
PE Multiple (x)	27.62	--	12.32	6.68	16.00
RoE (%)	1.93%	-0.51%	11.01%	12.44%	10.93%

Stock Data

Market Cap (Rs. Crs)	7,386
Market Cap (\$ Mn)	886.5
Shares O/S (in Mn)	38.6
Avg. Volume (3 month)	3,61,080
52-Week Range (Rs.)	1,966 / 918

Shareholding Pattern

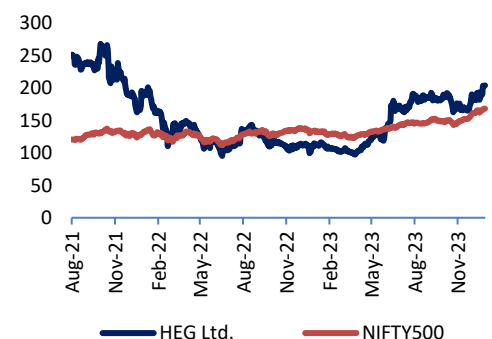
Promoters	55.77%
FII's	6.81%
Institutions	7.21%
Others (incl. body corporate)	30.21%

Key Ratios

Div Yield	2.28%
TTM PE	16.9x
ROE	13.0%
TTM EPS (Rs.)	114

Stock Performance

Performance (%)	1M	6M	1Yr
ABSOLUTE	16.0	18.0	78.2
NIFTY500	8.5	0.2	52.8



- Consequently, this led to a QoQ decline in the margins by 600 bps in Q2FY24.
- With the upcoming anode plant expansion, the company is expecting a ~30% EBITDA margin from that plant thereby improving the overall EBITDA profile.

Key Business Highlights

- HEG Ltd. is India's largest manufacturer and supplier of graphite electrodes. It operates the world's largest single-site integrated graphite electrodes facility.
- It is a subsidiary of the LNJ Bhilwara Group, which also has interests in IT-enabled services, power generation, and textiles.
- The company provides graphite electrodes of various lengths and diameters, including ultra-high power (UHP), high power (SHP), and regular power (HP). It specialises in graphite electrodes, power division goods, and carbon specialty items.
- Company earns major revenue from Electrodes (~92%) followed by Mix Graphite Product (~7%).
- The geographical split of the company's revenue is as follows: India - ~31%, Exports - ~69%. Bhilwara Infotechnology Limited and Bhilwara Energy Limited, the Company's two affiliates, contribute 15% of the consolidated earnings.

Valuation

HEG Ltd. is currently trading at a TTM PE of 16.9x compared to the industry PE of 16.9x making the valuation of the company at par with that of the industry standard. Additionally, EV/EBITDA of the company is at 11.8x compared to its median of 5.1x. The future growth prospects of the steel industry as well as a collective global move towards decarbonization will aid for an increased demand for Electric Arc Furnaces which augurs well for HEG Ltd.

Therefore, in light of above, we are ascribe a **BUY** rating for **HEG** with a **target price** of **Rs.2,448.00**, translating to an **upside** of **~30%**.

Risk & Concern

- Increased steel exports from China due to reduced domestic demand in the country could exert an ongoing pressure on the production in India.

Graphs & Charts

Figure 1: Net Sales Trend (Rs. in Crs)

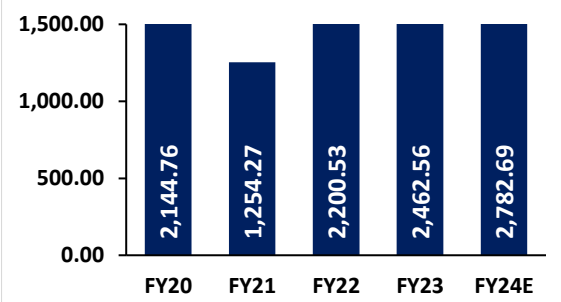


Figure 2: EBITDA & EBITDA Margin Trend

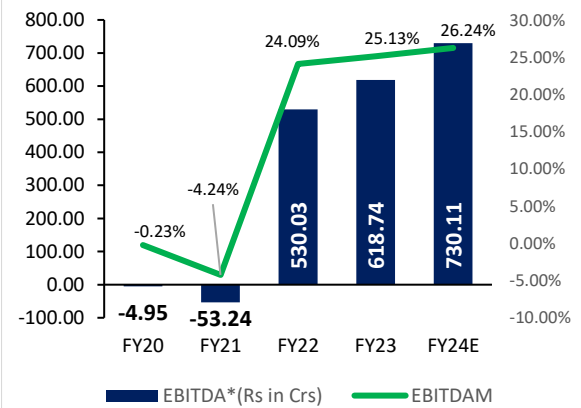


Figure 3: ROE Profile

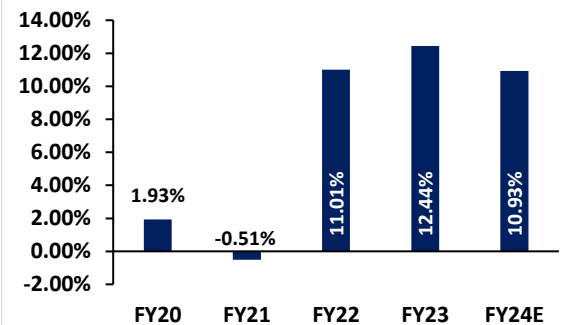
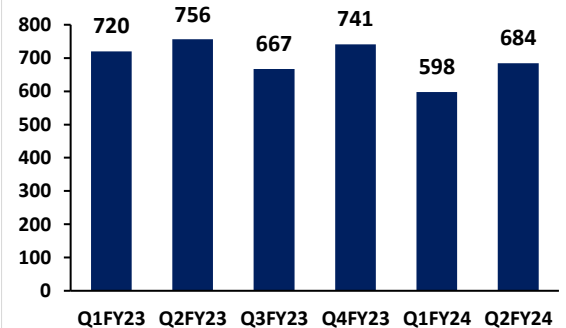


Figure 4: Quarterly Short term working capital borrowings (Rs. in Crs.)



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