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HEG/SECTT/2017

11th December, 2017

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

Sub: Upgradation of credit Rating of HEG Limited by India Ratings & Research as 'IND A+'; Outlook Positive from 'IND A"; Outlook Stable.

Dear Sir,

This is to inform you that India Ratings & Research (Ind-Ra) has upgraded the credit rating of HEG Limited's as **'IND A+; Outlook Positive** from 'IND A"; Outlook 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

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Encl : as above.

HEG LIMITED

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India Ratings & Research
A Fitch Group Company

India Ratings Upgrades HEG to 'IND A+'; Outlook Positive

11
DEC 2017

By Vivek Jain

India Ratings and Research (Ind-Ra) has upgraded HEG Limited's (HEG) Long-Term Issuer Rating to 'IND A+' from 'IND A'. The Outlook is Positive. The instrument-wise rating actions are given below:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Term loans	-	-	March 2022	INR2,347	WD	Withdrawn (paid in full)
Commercial paper	-	-	30-365 days	INR1,000	IND A1+	Upgraded
Fund-based working capital limits	-	-	-	INR5,050	IND A+/Positive/IND A1+	Upgraded
Non-fund-based working capital limits	-	-	-	INR1,950	IND A+/Positive/IND A1+	Upgraded

KEY RATING DRIVERS

Supply Consolidation: The upgrade reflects the consolidation in the graphite electrode industry with the merger of Showa Denko K.K. and SGL Carbon SE to create the world's largest graphite electrode manufacturing company with a capacity of 225ktpa. Moreover, private equity group Brookfield Asset Management Inc acquired Graf-tech International Limited (160ktpa) in August 2015. These transactions have led to 53% of the global ultra-high powered graphite electrode capacity being concentrated in the hands of three players. The overall capacity of the graphite electrode manufacturers declined to 718ktpa in 2017 (2014: 808ktpa), thus reducing the demand-supply gap. Also, capacity closures during 2010-2016 for almost all the players excluding Indian manufacturers aided towards restoring the demand-supply balance.

Leverage to Moderate Significantly in FY18: The Positive Outlook reflects Ind-Ra expectation of HEG's leverage to remain below 2.5x in FY18 (FY17: 8.4x, FY16: 5.7x) given the strong improvement in EBITDA (1HFY18: INR2.13 billion, FY17: INR 807 million, FY16: INR1,365 million) coupled with the company's ability to improve its working capital cycle (FY17: 5.9% of net sales, FY16: 7.0% of net sales) as the graphite electrode market transforms to a supplier's market from a buyer's market. Moreover, with the strong cash flows, the company repaid most of its long-term loans until November 2017, further aiding the leverage profile. Ind-Ra expects the utilisation rates to improve to nearly 78% in FY18 (FY17: 62%, FY16: 57%), which would also result in a positive rub-off of operating leverage. The agency expects HEG to have only short-term borrowings on its book by FYE18 with an average interest cost of 5.5%-6% as the company enjoys an interest subvention of 3% on the export packing credit till FY21.

Increase in Demand: Industry feedback suggests that China closed down 100-150 million tonnes of induction and mini blast furnaces between January and June 2017 to curb industrial pollution. Given the demand of steel in China has remained healthy despite a reduction in steel production in China due to the capacity closures, China's exports are likely to decline to 60mt in FY18 (FY17: 110mt). Moreover, the exports of Chinese steel billets are likely to decline to about 7 million tonnes in FY18 (FY17: 35 million tonnes). As a result, the importing countries have restarted their electric arc furnaces, resulting in a likely 75ktpa-80ktpa increase in graphite electrode demand.

Rise in Graphite Electrode Prices: The change in the industry structure, increased demand of graphite electrodes due to the closure of the induction/mini blast furnaces in China and recommencement of electric arc furnaces have resulted in a significant increase in prices of graphite electrode. However, given the graphite electrode industry contracts 70%-80% of the capacity at the beginning of the calendar year, most players were unable to take full benefit of the price increase as they were already locked in prices and quantity. The benefit of the increased prices would largely be realised in 3QFY18 and 4QFY18 as capacities in those quarters would be contracted at higher prices. Ind-Ra expects this demand-supply situation to continue for at least one year and HEG to have a strong average realisation in both FY18 and FY19, resulting in strong cash flow from operations.

Rise in Needle Coke Prices Could Compress Gross Margins: An increase in the price of graphite electrode along with the increase in the price of needle coke, although at a lower rate, has resulted in a significant expansion in gross margins to 64.6% in 1HFY18 (FY17: 48.4%%, FY16: 54.5%). Ind-Ra expects the same to continue in 2HFY18. However, given the needle coke manufacturers have found an alternate use of the product in lithium ion batteries, the prices of needle coke and its availability in FY19 could become a challenge, leading to an increase in the prices. Despite this, Ind-Ra believes the gross margins to remain healthy.

Capex Likely as Capacity Utilisation Improves: The industry might undertake fresh capex, as capacity utilisations reach 80%-85% in FY19. HEG could consider increasing capacity of its existing plant to nearly 1,00,000tpa in FY19 (FY17: 80,000tpa); although, this remains contingent upon the supply of needle coke. The capex, if undertaken, could result in a slightly higher leverage.

RATING SENSITIVITIES

Positive: An ability to demonstrate continued strong profitability in FY19 driven by healthy electrode price realisations given the demand-supply environment coupled with an ability to manage the input costs leading to expected net leverage below 2.5x would result in a positive rating action.

Negative: Deterioration in the capacity utilisation levels, a lower than expected EBITDA, debt-led capex or acquisition along with the elongation of the working capital cycle resulting in net leverage sustaining above 2.5x would result in the Outlook being revised to Stable.

COMPANY PROFILE

HEG, set up in 1977, is a flagship company of the LNJ Bhilwara Group. It manufactures graphite electrodes at its 80,000tpa facility in Madhya Pradesh. During 1HFY18, HEG reported revenue of INR6.2 billion, EBITDA of INR2.13 billion and profit after tax of INR1.05 billion.

Particulars	FY17	FY16
Revenue (INR billion)	8,600	8,695
EBITDA (INR billion)	807	1,365
EBITDA margin (%)	9.3	15.7
Gross interest coverage (x)	1.47	2.26
Source: Ind-Ra, HEG		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (million)	Rating	30 June 2017	16 November 2016	2 November 2015
Issuer rating	Long-term	-	IND A+/Positive	IND A/Stable	IND A/Stable	IND A+/Stable
Term loans	Long-term	INR2,347	WD	IND A/Stable	IND A/Stable	IND A+/Stable
Fund-based working capital limits	Long-term/Short-term	INR5,050	IND A+/Positive/IND A1+	IND A/Stable/IND A1	IND A/Stable/IND A1	IND A+/Stable/IND A1+
Non-fund-based working capital limits	Long-term/Short-term	INR1,950	IND A+/Positive/IND A1+	IND A/Stable/IND A1	IND A/Stable/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

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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ABOUT INDIA RATINGS AND RESEARCH

India Ratings and Research (Ind-Ra) is India's most respected credit rating agency committed to providing India's credit markets accurate, timely and prospective credit opinions. Built on a foundation of independent thinking, rigorous analytics, and an open and balanced approach towards credit research, Ind-Ra has grown rapidly during the past decade, gaining significant market presence in India's fixed income market.

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

Ind-Ra 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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