PROUD TO BE INDIAN
PRIVILEGED TO BE GLOBAL

HEG/SECTT/2018

20th April, 2018

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

Dear Sir,

This is to inform you that India Ratings and Research (Ind-Ra) has upgraded HEG Limited's (HEG) **Long-Term Issuer Rating to 'IND AA'** from 'IND A+'. 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.

India Ratings & Research
A Fitch Group Company

India Ratings Upgrades HEG to 'IND AA'/Stable; Limits Enhanced

20
APR 2018

By Akash Krishnatry

India Ratings and Research (Ind-Ra) has upgraded HEG Limited's (HEG) Long-Term Issuer Rating to 'IND AA' from 'IND A+'. 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 working capital limits	-	-	-	INR5,690 (increased from INR5,050)	IND AA/Stable/IND A1+	Long-term rating upgraded; Short-term rating affirmed
Non-fund-based working capital limits	-	-	-	INR2,133 (increased from INR1,950)	IND AA/Stable/IND A1+	Long-term rating upgraded; Short-term rating affirmed

The upgrade reflects favourable industry dynamics that led to a strong profitability in FY18 that resulted in significant balance sheet deleveraging. Moreover, the upgrade reflects Ind-Ra's expectations of continued strong profitability in FY19.

KEY RATING DRIVERS

Favourable Industry Dynamics: High graphite electrode prices have been witnessed since the second half of 2017, as the electric arc furnace (EAF) route steel production drastically increased, supported by China's steel capacity rationalisation. Given China's steel exports reduced to 70 million tonnes (mt) in 2017 (2016: 110mt), importing nations ramped up their EAFs. This is likely to have led to a 75-80 kilotonnes per annum increase in graphite electrode demand in FY18.

Global demand-supply dynamics continue to remain favourable for graphite electrode players, as capacity closures have reduced the overall ultra-high powered graphite electrode capacity to 717,000 tonnes per annum. Ind-Ra expects robust graphite electrode demand to sustain, as the environmentally superior EAF route steel production's share would gradually improve, in addition to overall steel demand growth. Moreover, the supply side has become consolidated, considering the top three players accounted for nearly 67% of the capacity in 2017. Although global players have announced capacity expansion by restarting shutdown units/brownfield expansion, Ind-Ra believes that such capacity could take time to come up and would hinge on the availability of needle coke, which is currently limited. Thus, the overall capacity utilisation levels could remain restricted.

Strong Profitability: HEG's EBITDA rose to INR5.6 billion in 3QFY18 and INR1.9 billion in 2QFY18 from INR0.2 billion in 1QFY18, driven by favourable industry dynamics. Ind-Ra expects HEG's profitability to remain robust in FY19, given the company has made capacity tie-ups with customers at healthy realisations for 1HFY19 and Ind-Ra's expectations of continued healthy realisation in 2HFY19. This would be despite high needle coke prices, as the company expects the absolute change in graphite electrode prices to be higher than the change in needle coke prices. Furthermore, as capacity utilisation improves (3QFY18: 84%; 3QFY17: 75%), operating leverage would have a positive impact on EBITDA. However, given the short supply of needle coke, a higher-than-expected rise in prices could lead to lower-than-expected gross margins in the long term. Ind-Ra believes that the prevalent high margins would moderate in the long term but would still remain healthy as fresh capacities would come up to meet incremental demand.

Significant Deleveraging: HEG has significantly deleveraged its balance sheet on account of estimated strong cash flows from operations totalling INR5-6 billion in FY18 (FY17: INR1 billion). In FY18, all term loans were prepaid (FY17: INR2.7 billion) and working capital borrowings stood lower at INR3.0 billion (FY17: INR4.1 billion) despite an increase in working capital requirements, driven by an increase in raw material and graphite electrode prices.

Ind-Ra estimates HEG to have strong net adjusted leverage and gross interest coverage levels at 0.2x and 3.8x, respectively, for FY18 (FY17: 8.4x; 1.4x). HEG could consider increasing the capacity of its existing plant to nearly 100,000 tonnes per annum (tpa) in 2HFY19 (FY18: 80,000tpa); this is contingent on needle coke supply. Towards this, any debt-led capex, if undertaken, could result in a slightly higher leverage. Ind-Ra expects HEG to maintain a liquid balance sheet and have a low reliance on external debt and, thus, the credit metrics to remain commensurate with the rating level. However, any unrelated diversification or leveraged inorganic growth would be key rating monitorables.

Strong Liquidity: HEG's average fund-based working capital limit utilisation was about 65% for the 12 months ended March 2018. Ind-Ra estimates HEG to generate strong free cash flow over FY18-FY19 to continue supporting the liquidity.

Working Capital-Intensive Operations: HEG's business is working capital-intensive because of graphite electrode manufacturing involves a large processing period and a moderate to long credit period to customers. This is inherent in the graphite electrode manufacturing space. Its working capital cycle improved to around 180 days in FY18 from 230 days, as the graphite electrode market transforms 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 revenues. However, it is well diversified in terms of markets and customers across geographies.

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, further elongation of the working capital cycle and/or adverse profitability resulting in net leverage exceeding 1.5x on a sustained basis would result in a negative rating action.

COMPANY PROFILE

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

FINANCIAL SUMMARY

Particulars	9MFY18	FY17	FY16
Revenue (INR billion)	14,660	8,600*	8,695*
EBITDA (INR billion)	7,706	807	1,365
EBITDA margin (%)	52.6	9.3	15.7
Gross interest coverage (x)	19.9	1.47	2.26
* Net of excise duty Source: Ind-Ra, HEG			

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (million)	Rating	11 December 2017	16 November 2016	2 November 2015
Issuer rating	Long-term	-	IND AA/Stable	IND A+/Positive	IND A/Stable	IND A+/Stable
Fund-based working capital limits	Long-/short-term	INR5,690	IND AA/Stable/IND A1+	IND A+/Positive/IND A1+	IND A/Stable/IND A1	IND A+/Stable/IND A1+
Non-fund-based working capital limits	Long-/short-term	INR2,133	IND AA/Stable/IND A1+	IND A+/Positive/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 levels 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.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

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

Analyst Names

Primary Analyst

Akash Krishnatry

Senior Analyst

India Ratings and Research Pvt Ltd 601-9 Prakashdeep Building 7 Tolstoy Marg New Delhi 110001

+91 11 43567263

Secondary Analyst

Vivek Jain

Director

+91 11 43567249

Committee Chairperson

Salil Garg

Director
+91 1143567244

Media Relation

Namita Sharma

Manager – Corporate Communication
+91 22 40356121 >