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HEG/SECTT/2017

30<sup>th</sup> June, 2017

1	<b>BSE Limited</b> 25 <sup>th</sup> Floor, P J Towers Dalal Street MUMBAI - 400 001. Scrip Code : 509631	2	<b>National Stock Exchange of India Limited</b> Exchange Plaza, 5th Floor Plot No.C/1, G Block, Bandra - Kurla Complex Bandra (E), MUMBAI - 400 051. Scrip Code : HEG
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**Sub: Affirmation of credit Rating of HEG Limited by India Ratings & Research as IND A'; Outlook Stable.**

Dear Sir/Madam,

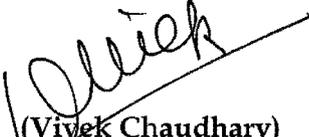
This is to inform you that India Ratings & Research (Ind-Ra) has affirmed the credit rating of HEG Limited's as as IND A'; Outlook Stable.

A copy of the credit rating letter issued by Ind-Ra in this connection 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](mailto:heg.investor@lnjbhilwara.com)

Encl : as above.

## HEG LIMITED

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Website : [www.hegltd.com](http://www.hegltd.com)

ISO 9001  
BUREAU VERITAS  
Certification



ISO 14001  
BUREAU VERITAS  
Certification



Corporate Identification No.: L23109MP1972PLC008290

## India Ratings Affirms HEG at 'IND A'; Outlook Stable

30

By [Vivek Jain](#)

JUN 2017

India Ratings and Research (Ind-Ra) has affirmed HEG Limited's Long-Term Issuer Rating at '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
Term loan	-	9.9%-10.05%	March 2022	INR2,347.0 (reduced from INR2,371.2)	IND A/Stable	Affirmed
Commercial paper	-	-	30-210 days	INR1,000	IND A1	Affirmed
Fund-based working capital limits	-	-	-	INR5,050 (reduced from INR6,550)	IND A/Stable/IND A1	Affirmed
Non-fund-based working capital limits	-	-	-	INR1,950 (reduced from INR2,600)	IND A/Stable/IND A1	Affirmed

### KEY RATING DRIVERS

**Industry Scenario Turns Favourable:** The affirmation reflects 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 260,000tpa. Additionally, Brookfield Asset Management took over Graf-tech International Limited (160,000tpa), thus 60% of the global 697,000tpa of ultra-high powered graphite electrode capacity is concentrated in the hands of two players. Also, steel manufacturing through the electric arc furnace route has again turned favourable compared to the blast furnace route, given the global fall in scrap prices and the rise in the iron ore and coking coal prices, thus increasing the demand for graphite electrodes which are used in the electric arc furnace route. Lastly, China has closed down 25-30 million tonnes of polluting steel manufacturing capacity and graphite electrode capacity, resulting in a shortage of graphite electrodes even in the country.

**Graphite Electrode Prices Rise:** With the tightness on the supply side, given the change in the industry structure and demand remaining healthy, the demand-supply balance has shifted in the favour of the suppliers. This has resulted in a significant increase in graphite electrode prices to nearly USD4,000/t from USD2,000/t in the spot market. However, most players have not been able to take the full benefit of the price increase, given that the graphite electrode industry contracts for 60%-70% of the capacity at the beginning of a calendar year. The benefit of the increased prices will largely be realised in 2HFY18, given that capacities in these quarters would have been contracted at higher prices.

**Liquidity Remains Comfortable:** HEG has term loan repayments of INR1.4 billion in FY18, which it will meet through fresh borrowings and operational cash flows. Post the additional term loan, Ind-Ra expects HEG's repayment profile to be comfortable at INR380 million and INR664 million in FY19 and FY20, respectively, thus resulting in comfortable DSCR of 1.9x and 1.7x. Given the improvement in EBITDA and lower incremental borrowings, Ind-Ra expects HEG's interest coverage to increase to about 2.5x in FY18 (FY17: 1.5x, FY16: 2.3x). HEG also has fund-based limits of INR5.05 billion which on average were utilised 83% over the 12 months ended March 2017. Moreover on the export packing credit, the company has an interest subvention of 3% till FY21, thus lowering the effective rate of interest. On a blended basis, the company pays 7.75%-8% on its working capital loans.

**Leverage to Remain High in FY18, Despite Improvement:** Ind-Ra expects HEG's leverage to remain high in FY18, despite the likelihood of an improvement below 4.0x (FY17: 8.4x) on a strong improvement in EBITDA, a stable working capital cycle (FY17: 226 days) and repayment of part of the term loans from cash flows. Ind-Ra further expects HEG's capacity utilisation rates to improve to 75%-80% in FY18 (FY17: 62%, FY16: 57%) and result in positive rub-off of operating leverage. The EBITDA at INR0.8 billion in FY17 (FY16: INR1.4 billion) was significantly lower than Ind-Ra's expectation of INR1.2 billion, on account of the higher-than-expected fall in the graphite electrode prices. During FY17, the company reduced its borrowings by INR1 billion to INR6.8 billion using healthy free cash flows of INR1 billion (FY16: INR1.5 billion).

**Needle Coke Prices Also Rise:** The prices of needle coke have also increased 50%-60% yoy. Though the prices are set annually, this time around they were set on a half yearly basis which exposes the company to the risk of a price hike in 2HFY18 while the pricing of electrodes has been almost frozen for the full year. The impact on the profitability, however, would be limited, as the manufacturing cycle of the company is three to four months, thus the prices which would be reflected in FY18 operations would be lower as needle coke would have been procured during 2QFY18 and early 3QFY18.

**Capex Likely as Capacity Utilisation Improves:** The industry might also look at fresh capex, as capacity utilisations reach 80%-85% in FY19. HEG could also look at fresh capex in FY19 at the existing plant location to increase the capacity to nearly 1,00,000tpa (FY17: 80,000tpa). This though remains contingent on the company achieving higher capacity utilisation rate, the same if done, would result in a higher leverage ratio.

## RATING SENSITIVITIES

**Positive:** A significant improvement in the capacity utilisation levels, EBITDA and working capital cycle leading to lowering of net financial leverage below 3.5x on a sustained basis would be positive for the ratings.

**Negative:** Deterioration in the capacity utilisation levels, a further decline in EBITDA a stretch in the working capital cycle and/or debt-led capex resulting in net leverage sustaining above 5x would be negative for the ratings.

## 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. HEG reported revenue of INR8.96 billion in FY17 (FY16: INR9 billion) and a net loss of INR493 million in FY17 (net loss INR78 million).

## RATING HISTORY

Instrument Type	Current Rating/Rating Watch			Historical Rating/Outlook		
	Rating Type	Rated Limits (million)	Rating/Outlook	16 November 2016	2 November 2015	27 March 2014
Issuer rating	Long term	-	IND A/Stable	IND A/Stable	IND A+/Stable	IND A+/Stable
Term loans	Long term	INR2,347.0	IND A/Stable	IND A/Stable	IND A+/Stable	IND A+
Fund-based working capital limits	Long term/Short term	INR5,050	IND A/Stable/IND A1	IND A/Stable/IND A1	IND A+/Stable/IND A1+	IND A+/IND A1+
Non-fund-based working capital limits	Long term/Short term	INR1,950	IND A/Stable/IND A1	IND A/Stable/IND A1	IND A+/Stable/IND A1+	IND A+/IND A1+
Commercial paper	Short term	INR1,000	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

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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.

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## Applicable Criteria

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### Corporate Rating Methodology

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## Analyst Names

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