LNJ Bhilwara Group Company

PROUD TO BE INDIAN
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HEG/SECTT/2024

31st May, 2024

1	**BSE Limited** 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: Update on Credit Rating.

Dear Sirs,

This is to inform you that India Ratings and Research (Ind-Ra) has placed HEG's Bank Facilities on Rating Watch with Developing Implications as per attached rationale.

Kindly take the same on record.

Thanking you,

Yours faithfully,
For **HEG Limited**

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Encl : as above.

HEG LIMITED

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India Ratings Places HEG and Its Bank Facilities on Rating Watch with Developing Implications

India Ratings and Research (Ind-Ra) has placed HEG Limited's Long-term Issuer Rating and its debt instruments on Rating Watch with Developing Implications as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating assigned along with Outlook/Watch	Rating Action
Issuer rating	-	-	-	-	IND AA-/Rating Watch with Developing Implications	Placed on Rating Watch with Developing Implications
Commercial paper*	-	-	30-365 days	INR1.00	IND A1+/Rating Watch with Developing Implications	Placed on Rating Watch with Developing Implications
Fund-based working capital limits	-	-	-	INR9.50	IND AA-/Rating Watch with Developing Implications/ IND A1+/Rating Watch with Developing Implications	Placed on Rating Watch with Developing Implications
Non-fund-based working capital limits	-	-	-	INR4.95 (reduced from INR5.35)	IND AA-/Rating Watch with Developing Implications/ IND A1+/Rating Watch with Developing Implications	Placed on Rating Watch with Developing Implications

*Carved out of working capital limits

Analytical Approach: Ind-Ra continues to take a standalone approach to arrive at the ratings of HEG. The company has no significant linkages with its subsidiary/associates, which form a small part of the group operations.

Detailed Rationale of the Rating Action

Ind-Ra has placed the ratings on Rating Watch with Developing Implications in view of the scheme of arrangement announced by the company on the stock exchange on 22 May 2024.

As per the scheme of arrangement, HEG's graphite electrode (GE) business and the captive power plants will be demerged into a new entity. The original nominal share capital of HEG will be cancelled and new shares will be issued by the new entity to the shareholders of HEG in a 1:1 ratio as a mirror shareholding. Hence, the promoter to the public shareholding in the new entity will remain same as that of HEG, i.e., 56:44. Further, Bhilwara Energy Limited (BEL), which was held 51% by the promoters and promoter-held company and 49% by HEG, will be merged with HEG to form HEG Greentech. Pursuant to the merger with HEG to form HEG Greentech, the 49% shareholding of BEL held by HEG will be cancelled. BEL has a 74% stake in Replus Engitech Private Limited (RePlus) and a 51% stake in Malana Power Company Limited, which in turn held 100% in AD Hydro Power Limited; TACC Limited is a 100% subsidiary of HEG. With the merger of BEL with HEG, the subsidiaries under BEL will now be subsidiaries of HEG Greentech. After the approval of the scheme of arrangement, HEG Greentech will hold a 74% stake in RePlus and 51% in Malana Power Company, which in turn will hold 100% in AD Hydro Power. TACC will become a 100% subsidiary of HEG Greentech. For every 35 shares of BEL, eight shares of HEG Greentech will be given to the shareholder. The promoters will hold 70.54% in HEG Greentech with the remaining being held by public.

As per the management, the working capital debt under HEG for GE operations would get transferred to the new entity. Given no clarity currently on how the treasury, other assets and liabilities will be apportioned among the entities, the ratings have been put on Rating Watch with Developing Implications. Ind-Ra will monitor the developments regarding the regulatory approval, along with finer details and clarity on the apportioning of treasury, assets, and liabilities among the businesses.

List of Key Rating Drivers
Strengths

- Likely improvement in revenue and profitability over FY25-FY26
- Strong demand fundamentals in medium to long term.
- Ramp up in capacities and robust demand to support operational performance in FY25.
- Likely improvement in spreads.

Weaknesses

- Limited geographical and product diversification
- Inherent industry risks

Detailed Description of Key Rating Drivers

Likely Improvement in Revenue and Profitability over FY25-FY26: HEG's revenue dipped 3% yoy to INR23.95 billion in FY24 (FY23: INR24.67 billion), despite 13% higher volumes, due to falling GE prices and needle coke prices falling with a time lag. Its margins also dipped to 16% in FY24 (FY23: 25%), due to the slowdown in the global market. GE demand was impacted due to lower steel demand because of the weak global economic outlook, elevated inflation pressures and high input costs. Ind-Ra expects an improvement in the company's operational performance, with stabilisation of prices and additional capacity to meet demand over FY25-FY26. HEG's absolute EBITDA decreased to INR3.84 billion in FY24 (FY23: INR6.19 billion), due to lower realisations of graphite electrode. The capacity utilisation moderated to 80% in FY24 (including added capacity of 20,000 tonnes that became operational from November 2023; FY23: 89%). Ind-Ra expects demand to recover in FY25-FY26, driven by growth in electric arc furnace (EAF) over the traditional blast furnace/basic oxygen furnace following the developed world's focus on substantial decarbonisation measures.

Strong Demand Fundamentals in Medium to Long term: With EAF production being used for around 50% of the total ex-China steel production, Ind-Ra expects GE demand to become stable over FY25. China's steel production through EAF is likely to increase to 15% by 2025 and 20% by 2030 for decarbonisation. Also, the US and Europe's focus on decarbonisation would accelerate the GE demand. Hence, global steel industry's efforts to decarbonise will drive a continuous shift to EAF steelmaking which supports the long-term GE demand growth.

Ind-Ra believes China's GE overcapacity will continue to be a risk for the company's non-ultra-high power (UHP) GE. This risk, however, will be alleviated with the Chinese government announcing the replacement of 236 million tonnes inefficient capacities with EAF by 2025, leading to higher domestic consumption of GE. For every tonne of steel produced, EAF production emits one fourth of total carbon emitted by a blast furnace. Ind-Ra expects domestic steel demand to be healthy in FY25 and improve over FY24 levels. Furthermore, there is neither any new entrant in the GE segment nor any capacity enhancement announced in the western markets over the past 25 years.

Ramp-up in Capacities and Robust Demand to Support Operational Performance in FY25: HEG has completed the capex of INR12 billion in November 2023 towards a brownfield capacity expansion of 20,000 tonnes per annum (taking the total installed capacity of GE to 100,000 tonnes at a single plant location) and a separate complex for nipple manufacturing. The capex, which was funded through its internal accruals, was spread over FY20-FY24. The gradual ramp-up of capacity and the expectation of strong medium to long-term demand fundamentals are likely to support its improvement in the operating performance in FY25.

Spreads likely to Improve in FY25: HEG's profitability is susceptible to price volatility in GE. Ind-Ra believes that while demand could face intermediary headwinds, it is likely to remain stable in FY25. Accordingly, the spreads are likely to sustain at near-similar levels over FY25. The gross margin in FY24 stood at 52% (FY23:

63%; FY22: 62%). As per the management, GE prices have fallen below sustainable levels and should stabilise after two-to-three quarters and then start increasing once the demand kicks in.

Ind-Ra expects the global steel output to sustain in FY25, with an improvement in the eurozone and India demand; however, China production in 2024 would be lower than that in 2023 as it has started to shift its focus to EAF.

However, HEG's management stated that the capex announcements by some large steel companies in the US and Europe and other countries to increase the capacities by around 90 million tonnes through establishing new EAF-based steel capacities would support the medium-term demand. Out of this, 10 million tonnes have already come on stream and about 30 million tonnes would come on stream by FY26 and the rest by 2030.

Limited Geographical and Product Diversification: The company operates through a single plant at Mandideep in Madhya Pradesh. While the single plant supports better operational efficiencies and absorption of fixed costs, it may lead to impact on operations in the possibility of any unforeseen event such as natural calamity, political unrest, or others. While demand seems robust in the medium to long term, any geopolitical events leading to demand sluggishness or any unfavourable changes in raw material prices could impact the single product and hence the operations of the company.

Inherent 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. Moreover, the company has a single manufacturing unit, and its cash flows are dependent on single product revenue. However, it is well diversified in terms of markets and customers across geographies, which mitigates this risk to some extent.

Liquidity

Adequate: HEG had healthy unrestricted cash and bank balances, investments, and unencumbered fixed deposits of INR9.66 billion at FYE24 (FYE23: INR9.85 billion). Given HEG's large cash balance and low debt of INR6.19 billion at FYE24 (FYE23: INR7.41 billion), the company earns a net interest income. The average utilisation of the fund-based working capital limits (based on lower of sanctioned limit and drawing power) was around 67% in over the 12 months ended March 2024. The working capital debt is in the form of export packing credit limits, which have an interest subvention, thus reducing HEG's cost of borrowings. Ind-Ra expects HEG to maintain a liquid balance sheet and low reliance on external debt, thus maintaining negative net debt in FY25. Any change in the balance sheet structure, which results in the net debt turning positive without a positive change in the GE cycle, could result in a negative rating action. HEG's cash flow from operations improved to INR6.25 billion in FY24 (FY23: INR1.37 billion), due to favourable working capital cycle. Ind-Ra expects HEG's free cash flow to remain positive in FY25 due to a likely improvement in operational performance and limited outlay on capex.

RATING SENSITIVITIES

The Rating Watch with Developing Implications indicates that the ratings could be upgraded, affirmed, or downgraded. Ind-Ra would resolve the Rating Watch upon the receipt of the requisite statutory and regulatory approval along with better clarity on the credit profile and liquidity of the entity from the management.

RATING CRITERIA

'Short-term Rating Criteria for Non-Financial Corporates', available at www.indiaratings.co.in.
'Corporate Rating Methodology', available at www.indiaratings.co.in.
'Evaluating Corporate Governance', available at www.indiaratings.co.in.
'The Rating Process', available at www.indiaratings.co.in.
'Policy for Placing Ratings on Rating Watch', available at www.indiaratings.co.in.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on HEG, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

About the Company

Formed in 1977, HEG is promoted by LNJ Bhilwara Group. It has a GE manufacturing unit with a capacity of 100,000 tonnes per annum in Madhya Pradesh. The company is promoted by Ravi Junjhunwala and the promoters held around 56% stake in the company, balance 44% as public shareholding.

KEY FINANCIAL INDICATORS

Particulars	FY24	FY23
Revenue (INR million)	23,949	24,672
Operating EBITDA (INR million)	3,840	6,197
Operating EBITDA Margin (%)	16.0	25.1
Interest coverage (x)	10.74	23.82
Net leverage (x)	-0.90	-0.39
Source: HEG, Ind-Ra		

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (billion)	Rating	11 July 2023	12 July 2022	13 July 2021
Issuer rating	Long-term	-	IND AA-/Rating Watch with Developing Implications	IND AA-/ Positive	IND AA-/ Stable	IND AA-/ Stable
Commercial papers	Short-term	INR1	IND A1+/Rating Watch with Developing Implications	IND A1+	IND A1+	IND A1+
Fund-based working capital limits	Long-term /Short-term	INR9.5	IND AA-/Rating Watch with Developing Implications/IND A1+ Rating Watch with Developing Implications	IND AA-/Positive/ IND A1+	IND AA-/Stable/ IND A1+	IND AA-/Stable/ IND A1+
Non-fund-based working capital limits	Long-term /Short-term	INR4.95	IND AA-/Rating Watch with Developing Implications/IND A1+ Rating Watch with Developing Implications	IND AA-/Positive/ IND A1+	IND AA-/Stable/ IND A1+	IND AA-/Stable/ IND A1+

Complexity Level of the Instruments

Instrument Type	Complexity Indicator
Fund-based working capital limits	Low
Non-fund-based working capital limits	Low
Commercial paper	Low

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

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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, and structured finance and project finance companies.

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