

**2QFY08 results – ahead of expectations**

31<sup>st</sup> Oct 2007

**BUY**

Price Target Price

**Rs292 Rs410**

**Sensex – 19,784**

**Price Performance**

(%)	1M	3M	6M	12M
Absolute	33	29	59	112
Rel. to Sensex	16	(1)	11	39

Source: Bloomberg

**Stock Details**

Sector	Metals& Mining
Reuters	HEGL.BO
Bloomberg	HEG@IN
Equity Capital (Rs mn)	403
Face Value (Rs)	10
52 Week H/L (Rs)	308/138
Market Cap (Rs bn)	11.8
Daily Avg Vol (No of shares)	57243
Daily Avg Turnover (USD mn)	0.3

**Shareholding Pattern (%)**

(30th Sep.'07)

Promoters	56.4
FII/NRI	10.5
Institutions	13.9
Private Corp.	5.7
Public	13.5

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HEG announced their 2QFY08 results yesterday. The company reported strong volume growth coupled with margins expansion. During the quarter, the company reported net sales of Rs2.8bn (yoy up 39%, qoq up 24%), EBITDA of Rs0.72bn (yoy up 59%, qoq up 52%). The company report PAT of Rs0.42bn (yoy up 156%, qoq up 48%). HEG reported FDEPS of Rs8.96 during the quarter. During the quarter, the company reported significant EBTIDA margin expansion with EBITDA margin reported during the quarter at 15% from 8.2% in 2QFY07, a significant increase of 686bps on yoy basis and from 12.7% in 1QFY08, an increase of 235bps on sequential basis. We maintain a BUY on the stock with a target price of Rs410 which is aggregate of (a) Rs312 for the core business at 9x our FY09 FDEPS estimate of Rs34.7 and (b) Rs98 per share as the value of the stake of HEG in group company Bhilwara Energy Limited (BEL)

**Results – significantly ahead of expectations**

**Graphite business exceeds expectations**

The company reported results significantly ahead of our expectations mainly due to surge in graphite electrode business. With a production of 13,542t during the quarter, the graphite division is now running in excess of 100% capacity utilization. Its ramp up to the full capacity has been faster than our expectations.

**Steel business – end of pain**

During the last quarter, the company had reported selling its steel division to Jai Balaji Group for a cash consideration of Rs1.2bn. However, since the sale was effective from 1<sup>st</sup> Aug 2007, the company reported results from the steel division for 1month during the reported quarter. The steel division reported an EBIT loss of Rs7mn despite strong pricing environment.

**Interest cost significantly lower**

The company has paid Rs122mn (yoy down 25%, qoq down 15%) as interest expense during the quarter. The reduction in interest expense is mainly as a result of repayment of Rs1bn of debt from the proceeds of the sale of steel division.

**Other income – mainly operational**

The company reported other income of Rs144mn (yoy up 274%, qoq down 29%). Out of the total Rs144mn, Rs100-110mn was on account of forward cover taken earlier on sales made during the quarter, resulting in a profit of Rs100-110mn. Balance Rs300-400mn was on account of re-statement of liabilities in foreign currency. Due to significant appreciation of INR against USD during the quarter, the company has benefited from the same as its repayment obligation on foreign currency loans/convertible loans has reduced to the extent of appreciation of INR vis-à-vis USD.

**Valuation**

At the CMP of Rs292, the stock trades at 8.5x our FY09 FDEPS estimate of Rs34.4. However, HEG holds 40% stake in Bhilwara Energy Ltd (BEL), which is a group company engaged in power business. We estimate the value of the stake of HEG in BEL at Rs98/sh of HEG based on the last private equity placement that BEL has done with 2 US based funds. Excluding the value of the stake in BEL from the CMP, the stock currently trades at 5.4x FY09 FDEPS estimate of Rs34.4. We believe the company will report strong operational result going forward coupled with margin expansion as the next quarter will not have any element from the steel business. We maintain a BUY on the stock with a target price of Rs410.

## Quarterly results summary

	2QFY08	2QFY07	% yoy	1QFY08	% qoq
Production (t)	13,542	10,923	23.9%	12,100	11.9%
Sales (t)	13,700			12,200	12.3%
<b>Net Sales</b>	<b>2,797</b>	<b>2,011</b>	<b>39.1%</b>	<b>2,248</b>	<b>24.4%</b>
Expenditure					
Consumption of raw material	1,254	1,033	21.3%	1,091	14.9%
Change in stock	48	-93	-152.1%	-63	-176.3%
Total cost of goods sold	1,302	941	38.4%	1,028	26.6%
<b>Gross profit</b>	<b>1,495</b>	<b>1,070</b>	<b>39.8%</b>	<b>1,220</b>	<b>22.6%</b>
<b>Gross margin</b>	<b>53.5%</b>	<b>53.2%</b>	<b>26 bps</b>	<b>54.3%</b>	<b>-80 bps</b>
Personnel exp	97	84	16.1%	98	-0.9%
Power and fuel	178	138	28.9%	219	-18.7%
Other exp	501	395	26.8%	431	16.3%
Total operating exp	776	617	25.8%	747	3.8%
<b>EBITDA</b>	<b>720</b>	<b>453</b>	<b>58.8%</b>	<b>473</b>	<b>52.3%</b>
<b>Ebitda margin</b>	<b>25.7%</b>	<b>22.5%</b>	<b>319 bps</b>	<b>21.0%</b>	<b>471 bps</b>
Depreciation & amortization	126	117	7.6%	126	0.2%
<b>EBIT</b>	<b>594</b>	<b>336</b>	<b>76.7%</b>	<b>347</b>	<b>71.2%</b>
<b>EBIT margin</b>	<b>21.2%</b>	<b>16.7%</b>	<b>452 bps</b>	<b>15.4%</b>	<b>580 bps</b>
Interest	122	163	-25.1%	144	-15.0%
Other income	144	39	274.1%	203	-28.8%
PBT	616	211	191.3%	406	51.7%
Provision for tax	195	47	311.6%	121	61.2%
As a % to PBT	31.7%	22.4%	41.3%	29.8%	
- Current tax	177	6	3066.1%	114	55.3%
- Deferred tax liability	17	44	-60.4%	6	200.0%
- Fringe benefit tax	0	1		1	
- Earlier Years		-3			
<b>PAT</b>	<b>420</b>	<b>164</b>	<b>156.1%</b>	<b>285</b>	<b>47.5%</b>
<b>Net margin</b>	<b>15.0%</b>	<b>8.2%</b>	<b>686 bps</b>	<b>12.7%</b>	<b>235 bps</b>
Equity capital (basic)	403	403	0.0%	403	0.0%
Equity capital (Fully diluted)	469	403		469	
Reported EPS					
- Basic	10.44	4.07	156.6%	7.07	47.8%
<b>- Diluted</b>	<b>8.96</b>	<b>4.07</b>	<b>120.1%</b>	<b>6.07</b>	<b>47.5%</b>

All fig. in Rs mn except percentage and per share data

## Common size ratios

	2QFY08	2QFY07	% yoy	1QFY08	% qoq
Net Sales	100%	100%	-	100%	-
Raw material cost	45%	51%	-658 bps	49%	-373 bps
Change in stock	2%	-5%	632 bps	-3%	453 bps
Total cost of goods sold	47%	47%	-26 bps	46%	80 bps
Personal expenses	3%	4%	-69 bps	4%	-89 bps
Power & Fuel	6%	7%	-51 bps	10%	-337 bps
Other expenses	18%	20%	-174 bps	19%	-125 bps
EBITDA	26%	23%	319 bps	21%	471 bps
Depreciation	5%	6%	-132 bps	6%	-109 bps
Interest expense	4%	8%	-374 bps	6%	-203 bps
Other income	5%	2%	324 bps	9%	-386 bps
PAT	15%	8%	686 bps	13%	235 bps

## Segmental Results

	2QFY08	2QFY07	% yoy	1QFY08	% qoq
<b>Segment Revenue</b>					
Graphite	2,429	1,596	52%	2,037	19%
Steel	469	358	31%	365	28%
Power	343	325	6%	239	44%
Others	30	54	-44%	36	-17%
Less: inter-segment sales	-330	-284	16%	-227	46%
<b>Total Revenue</b>	<b>2,942</b>	<b>2,049</b>	<b>44%</b>	<b>2,451</b>	<b>20%</b>
<b>Segment EBIT</b>					
Graphite	598	219	173%	444	35%
Steel	-1	-17	-96%	34	-102%
Power	135	131	3%	47	186%
Others	6	41	-85%	25	-75%
Less: Interest and Finance Charges	-122	-163	-25%	-144	-15%
<b>Total</b>	<b>616</b>	<b>211</b>	<b>192%</b>	<b>406</b>	<b>52%</b>
<b>Segment Capital Employed</b>					
Graphite	5,821	5,035	15.6%	5,559	4.7%
Steel	235	714	-67.1%	777	-69.8%
Power	1,312	1,499	-12.4%	1,455	-9.8%
Others	980	1,641	-40.3%	1,042	-6.0%
<b>Total</b>	<b>8,348</b>	<b>8,888</b>	<b>-6.1%</b>	<b>8,832</b>	<b>-5.5%</b>

All fig. in Rs mn except percentage

## Financials

## Income Statement

	Rs mn			
	FY06	FY07E	FY08E	FY09E
Gross Sales	5,643	8,675	9,332	11,045
Less: Excise	-351	-497	-534	-632
Net Sales	5,292	8,179	8,798	10,413
Other Income	60	202	520	170
Total Income	5,352	8,381	9,318	10,583
Raw Material Consumption	2,153	3,738	3,948	4,749
As a % to Net Sales (%)	41	46	45	46
Power & Fuel	1,036	660	758	770
Staff Cost	327	352	365	352
Other Expenses	622	1,683	1,380	1,500
As a % to Net Sales	12	21	16	14
Total Exp	4,137	6,433	6,451	7,370
EBIDTA	1,214	1,948	2,867	3,213
EBIDTA (%)	23	24	33	31
Depreciation	396	487	500	550
EBIT	818	1,461	2,367	2,663
Interest	288	461	468	355
Misc. W/offs and E/O items	0	0	0	0
PBT	530	1,001	1,899	2,308
Tax	141	262	558	692
ETR (%)	27	26	29	30
A PAT	389	738	1,341	1,616
Pref. Div.	0	0	0	0
Net Income to Eq holders	389	738	1,341	1,616

## Cash Flow Statement

	Rs mn			
	FY06E	FY07E	FY08E	FY09E
PBT	530	1,001	1,899	2,308
Depreciation	396	487	500	550
Net Chg in WC	-1,827	-1,496	-580	-930
Others	-59	-123	-502	-623
CFO	-959	-131	1,317	1,305
Capex	-1,250	-371	-100	-300
Net Investments made	1	-1	0	0
Others Investing Activities	0	0	0	0
CFI	-1,249	-372	-100	-300
Change in Share capital	-45	0	1,251	0
Change in Debts	3,501	-5	-2,160	-400
Div. & Div Tax	-145	-183	-195	-274
Others	0	0	0	0
CFF	3,312	-187	-1,104	-674
Total Cash Generated	1,103	-691	113	331
Cash Opening Balance	203	1,305	674	787
Cash Closing Balance	1,305	674	787	1,118

## Balance Sheet

	Rs mn			
	FY06	FY07E	FY08E	FY09E
Equity Capital	403	403	469	469
Reserves & Surplus	2802	3406	5658	6999
Networth	3205	3809	6127	7468
Total Debts	8050	8045	5885	5485
Preference Shares	0	0	0	0
Net deferred lia	695	835	891	960
Capital Employed	11950	12689	12903	13913
Gross Block	8492	9222	8572	9372
Less Depreciation	-2214	-2703	-2953	-3503
CWIP	357	0	500	0
Net Fixed Assets	6635	6520	6120	5870
Investments	301	302	302	302
Inventory	2141	2241	2892	3424
Debtors	1240	1905	2049	2425
Cash and Bank	1305	674	787	1118
Loans & Advances	1125	2318	2308	2573
Other Current Assets	0	0	0	0
Total Curr. Assets	5811	7137	8036	9540
Current Liabilities	660	1120	1326	1569
Provisions	183	195	274	274
Total Curr. Lia & Prov.	843	1315	1600	1843
Net Current Assets	4968	5822	6436	7696
Misc. Assets	-45	-45	-45	-45
Total Assets	11950	12689	12903	13913

## Ratios

	FY06	FY07E	FY08E	FY09E
EBIDTA margin (%)	21.8	21.4	26.7	29.2
EBIT margin (%)	14.3	15.4	21.0	23.9
NPM (%)	7.4	9.0	15.2	15.5
Adj ROCE (%)	6.4	9.3	14.6	15.9
Adj ROE (%)	12.7	21.3	27.2	23.9
ROIC (%)	6.1	8.3	10.9	14.1
Adj EPS	9.7	18.3	28.6	34.4
Cash EPS	19.5	30.4	39.3	46.2
Book Value	78.4	93.4	129.7	158.3
DPS	3.0	4.3	5.0	5.00
Payout (%)	31.1	23.5	17.5	14.5
Net Debt to Equity (%)	213.4	195.9	83.8	58.8
PE (x)	22.1	11.7	7.5	6.2
P/BV (x)	2.7	2.3	1.6	1.3
EV/Sales (x)	2.3	1.6	1.5	1.1
EV/EBITDA (x)	10.7	7.7	5.5	3.9
Div Yield (%)	1.4	2.0	2.3	2.3

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