

Input costs, forex loss weighed on margins

November 8, 2011

Reco	Previous Reco
Accumulate	Accumulate
CMP	Target Price
Rs 209	Rs 224
EPS change FY12E/13E (%)	NA/NA
Target Price change (%)	-14
Nifty	5,289
Sensex	17,570

Price Performance

(%)	1M	3M	6M	12M
Absolute	1	(5)	(7)	(27)
Rel. to Nifty	(7)	(8)	(3)	(14)

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Graphite
Bloomberg	HEG@IN
Equity Capital (Rs mn)	428
Face Value(Rs)	10
No of shares o/s (mn)	43
52 Week H/L	310/176
Market Cap (Rs bn/USD mn)	9/182
Daily Avg Volume (No of sh)	33911
Daily Avg Turnover (US\$m)	0.1

Shareholding Pattern (%)

	Sep-11	Sep-11	Jun-11
Promoters	55.3	55.0	54.1
FII/NRI	10.5	10.8	11.1
Institutions	10.9	10.9	11.1
Private Corp	7.4	7.4	7.5
Public	15.9	15.9	16.2

Source: Capitaline

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- **Q2FY12 topline above estimates at Rs 3,192, up 7% YoY and 14% QoQ, primarily driven by higher volume and INR depreciation that improved realizations in INR term**
- **EBITDA in line with estimates at Rs 442 mn, down 27% YoY and flat QoQ due to increased domestic input costs and also weak INR that raised landed cost of needle coke**
- **Reported PAT stood at Rs 135 mn, down 32% QoQ, however, adjusted for forex loss of Rs 116 mn, APAT came at Rs 251 mn, up by 27% QoQ**
- **Adjusted for share buy back, our FY12E and FY13E EPS stand at Rs 22.5 and Rs 32.9 respectively; Revising our SOTP target price to Rs 224; Maintain Accumulate**

High input costs and rupee depreciation weighed heavy on margins

Increase in raw material costs continues to dent the margins of the company. Despite the main raw material i.e. needle coke has been booked for entire CY11, sharp depreciation in INR during end of the quarter raised the landed cost of needle coke. In addition to this, firm crude oil prices continue to make prices of domestically sourced inputs viz. CT pitch, LDO, furnace oil dearer. Both of these increased the raw material costs as a percentage to sales 580 bps QoQ and thereby brought down EBITDA margin by 625 bps and 195 bps respectively YoY and QoQ to 13.8%. On a positive note power and fuel expenses as a percentage to revenue fell QoQ by 401 bps, which restricted further pressure on the margins. We believe, margin pressure would continue due to weak INR and stable crude oil prices. Slowdown in demand in steel industry might add further pressure on the realizations going forward.

Power operations partly offset weak performance in graphite segment

Power operations turned around from the dismal performance during Q1FY12 due to improvement in seasonal factors, as the hydro power plant at Tawa restarted on time and two thermal power plants at Mandideep also operated efficiently. Despite higher input costs on account of higher coal prices, the power EBIT margin of the power operations improved by 548 bps QoQ to 21.7% offsetting a fall of 248 bps fall in EBIT margins in graphite electrode business. Improved performance in power business also helped in lower tax rate for the quarter.

Volumes to improve going forward, realizations remain a question

The management continues to maintain that the phase- II of the final capacity addition (66 ktpa to 80 ktpa) has been progressing well and is expected to be fully commissioned by Q3FY12. We believe the full and proper impact of higher volume would come in FY13 only. There could be some improvement in the realizations, however, only from Q4FY12.

Outlook and Valuations

At the CMP of Rs 209, the stock trades 6.4x FY13E earnings and is available at 7x FY13E EV/ EBITDA. On SOTP basis, we value the core business at 6x FY13E EV/ EBITDA, giving a 22% discount to the global peers and applying 20% discount to the attributable Bhilwara Energy value to arrive at a target price of Rs 224/ share. We maintain Accumulate rating on the stock.

Financials

(Rs mn)

YE-	Net	EBITDA		EPS	EPS	RoE	EV/			
Mar	Sales	(Core)	(%)	APAT	(Rs)	% chg	(%)	P/E	EBITDA	P/BV
FY10	11,314	3,474	30.7	1,711	39.9	60.0	25.9	5.2	4.7	1.2
FY11	11,137	2,471	22.2	1,289	30.1	-24.7	15.7	6.9	7.2	1.0
FY12E	12,850	2,201	17.1	909	22.5	-25.2	10.1	9.3	8.9	0.9
FY13E	15,829	2,928	18.5	1,328	32.9	46.1	14.1	6.4	7.0	0.9

Key Financials – Quarterly (Consolidated)

(Rs mn)	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	YoY (%)	QoQ (%)	H1FY12	H1FY11	YoY (%)
Revenue	2,996	3,103	2,816	2,795	3,192	6.5	14.2	5,987	5,218	14.7
Expenditure	(2,395)	(2,407)	(2,234)	(2,354)	(2,750)	14.9	16.8	(5,104)	(4,045)	26.2
<i>as % of sales</i>	<i>88.1</i>	<i>87.6</i>	<i>79.4</i>	<i>84.2</i>	<i>86.2</i>			<i>85.3</i>	<i>77.5</i>	
Consumption of RM	(1,328)	(1,541)	(1,199)	(1,318)	(1,690)	27.3	28.2	(3,008)	(2,210)	36.1
<i>as % of sales</i>	<i>44.3</i>	<i>49.7</i>	<i>42.6</i>	<i>47.2</i>	<i>52.9</i>			<i>50.2</i>	<i>42.4</i>	
Employee Cost	(105)	(108)	(131)	(113)	(107)	2.5	(5.3)	(220)	(207)	6.6
<i>as % of sales</i>	<i>3.5</i>	<i>3.5</i>	<i>4.7</i>	<i>4.0</i>	<i>3.4</i>			<i>3.7</i>	<i>4.0</i>	
Other expenditure	(962)	(758)	(904)	(923)	(953)	(0.9)	3.3	(1,876)	(1,629)	15.2
<i>as % of sales</i>	<i>32.1</i>	<i>24.4</i>	<i>32.1</i>	<i>33.0</i>	<i>29.9</i>			<i>31.3</i>	<i>31.2</i>	
EBITDA	602	697	581	441	442	(26.6)	0.1	883	1,173	(24.7)
Depreciation	(136)	(143)	(137)	(137)	(140)	3.6	2.3	(278)	(290)	(4.3)
EBIT	466	554	444	304	301	(35.4)	(0.9)	605	882	(31.5)
Other Income	44	30	76	25	38	(14.1)	48.8	63	64	(1.1)
Interest	(86)	(100)	(90)	(79)	(78)	(8.9)	(1.4)	(157)	(176)	(11.0)
PBT	425	484	430	250	261	(38.5)	4.4	511	770	(33.6)
Total Tax	(127)	(102)	(85)	(52)	(10)	(92.1)	(80.7)	(63)	(207)	(69.8)
Adjusted PAT	297	382	344	198	251	(15.6)	26.9	449	563	(20.3)
(Profit)/loss from JV's/Ass/MI			-	-	-	-	-	-	-	-
Adj.PAT after MI	297	382	344	198	251	(15.6)	26.9	449	563	(20.3)
Extra ordinary items	-	-	-	-	(116)	-	-	(116)	-	-
Reported PAT	297	382	344	198	135	(54.5)	(31.5)	333	563	(40.8)
Reported EPS	6.9	8.9	8.0	4.7	3.3	(52.5)	(29.2)	8.0	13.1	(39.4)

Margins (%)						(bps)	(bps)			(bps)
EBIDTA	20.1	22.4	20.6	15.8	13.8	(625)	(195)	14.7	22.5	(773)
EBIT	15.6	17.8	15.8	10.9	9.4	(613)	(143)	10.1	16.9	(681)
EBT	14.2	15.6	15.3	8.9	8.2	(600)	(77)	8.5	14.8	(622)
PAT	9.9	12.3	12.2	7.1	7.9	(206)	79	7.5	10.8	(330)
Effective Tax rate	30.0	21.1	19.9	21.0	3.9	(2,610)	(1,708)	12.2	26.9	(1,467)

Key takeaways from conference call:

- The management expects an improvement in volumes and in realizations going forward
- During the quarter, effective tax rate was low on account of higher contribution for power operations which enjoy tax holidays
- The capacity utilization for the quarter was in high 80s and is expected to remain at those levels for H2FY12 and for FY13
- As per the management, out of the total planned capex of Rs 2,250 mn for the year, the company has already spent about Rs. 1,500 mn. The capex guidance for FY13 is about Rs 500 mn on operational improvements and a similar amount on routine capex
- The management has informed that 99% of the buyback plan has been completed at an average price of Rs 234 per share. The remaining 1% of buyback is to be completed soon

Volume growth to be visible in FY13, costs continue to be concern

The company is hopeful to see significant volume growth of 20% YoY in FY12 itself after commissioning of 14000 tpa additional capacity during Q3FY12. We however, feel that it might take some time before the impact of volume growth is visible in the performance. Realizations are likely to remain flat at least till Q4FY12 and should improve after that if the company is able to negotiate for an increase with its key customers in select geographies. The company expects a portion of the rise in global graphite contract prices as announced by the global majors should be reflected in Q4FY12 and henceforth. Raw material prices on the other side continue to be the worry, as needle coke prices are also likely to increase when new contracts are signed during January 2012. The management is hopeful however, that despite the rise, there would be some room left for a stable margin. We believe pressure on margin would continue to be there in FY12 with slight improvement to be seen in FY13. On the cashflow side the company is likely to remain FCF negative for FY12 due to higher working capital expenses and lower margins. Inventory levels are expected to be higher due to increase in volume.

Taking into account the above scenario along with adjustment made for the buy- back of shares, we have revised our FY12E and FY13E EPS estimates to Rs 22.5 and Rs 32.9 respectively.

Valuation: maintain Accumulate

At the CMP of Rs 209, the stock trades 6.4x FY13E earnings and is available at 7x FY13E EV/ EBITDA. On SOTP basis, we value the core business at 6x FY13E EV/ EBITDA, giving a 22% discount to the global peers and applying 20% discount to the attributable Bhilwara Energy value to arrive at a target price of Rs 224/ share. We maintain Accumulate rating on the stock.

Financials (consolidated)

Income Statement

Y/E, Mar (Rs. mn)	FY10	FY11	FY12E	FY13E
Net Sales	11,314	11,137	12,850	15,829
Growth (%)	10	-2	15	23
Expenditure	7,840	8,666	10,649	12,901
Raw Materials	5294	5635	7077	8596
Employee Cost	390	441	512	665
Other Exp	2156	2590	3060	3641
EBITDA	3,474	2,471	2,201	2,928
Growth (%)	35	-29	-11	33
EBITDA margin (%)	30.7	22.2	17.1	18.5
Depreciation	524	573	634	726
EBIT	2,950	1,897	1,567	2,201
EBIT margin (%)	26.1	17.0	12.2	13.9
Other Income	102	149	150	150
Interest expenses	593	366	505	580
PBT	2,459	1,681	1,212	1,771
Tax	713	392	303	443
Effective tax rate (%)	29.0	23.3	25.0	25.0
Adjusted PAT	1,747	1,289	909	1,328
(Profit)/loss from JV's/Ass/MI	0.00	0.00	0.00	0.00
Adjusted PAT after MI	1,747	1,289	909	1,328
Growth (%)	60	-25	-29	46
Net Margin (%)	15.4	11.6	7.1	8.4
E/O items	-36	0	0	0
Reported PAT	1,711	1,289	909	1,328
Growth (%)	60	-25	-29	46

Cash Flow

Y/E, Mar (Rs. mn)	FY10	FY11	FY12E	FY13E
PBT (Ex-Other income)	2,423	1,681	1,212	1,771
Depreciation	524	573	634	726
Interest Provided	593	366	505	580
Other Non-Cash items	0	0	0	0
Chg in working cap	204	-1,711	-765	-1,496
Tax paid	-713	-392	-303	-443
Operating Cashflow	3,037	526	1,307	1,164
Capital expenditure	-717	-816	-1,914	-1,000
Free Cash Flow	2,319	-289	-607	164
Other income	102	149	150	150
Investments	670	1,960	1,960	1,960
Investing Cashflow	-491	-1,432	-1,914	-1,000
Equity Capital Raised	-280	0	-24	0
Loans Taken / (Repaid)	-781	650	2,000	1,000
Interest Paid	593	366	505	580
Dividend paid (incl tax)	-501	-497	-501	-473
Income from investments	0	0	0	0
Others	-1,191	1,842	1,454	1,000
Financing Cashflow	-2,564	979	424	-53
Net chg in cash	-19	73	-183	111
Opening cash position	64	45	118	-65
Closing cash position	45	118	-65	46

Balance Sheet

Y/E, Mar (Rs. mn)	FY10	FY11	FY12E	FY13E
Equity share capital	428	428	404	404
Reserves & surplus	6880	8676	8567	9422
Net worth	7,309	9,104	8,971	9,826
Minority Interest	0.00	0.00	0.00	0.00
Secured Loans	7,161	7,683	9,183	9,683
Unsecured Loans	147	1,420	1,920	2,420
Loan Funds	7,308	9,103	11,103	12,103
Net deferred tax liability	749	736	761	786
Total Liabilities	15378	18944	20835	22716
Gross Block	9946	10442	12842	13842
Less: Depreciation	3368	3856	4489	5215
Net block	6,579	6,586	8,353	8,626
CWIP	581	786	300	300
Investment	670	1960	1960	1960
Current Assets	9120	11085	12368	14436
Inventories	3428	5095	5713	6867
Sundry debtors	4402	3953	4401	5204
Cash & bank balance	45	118	-65	46
Loans & advances	1245	1919	2319	2319
Other current assets	0	0	0	0
Current lia & Prov	1572	1473	2173	2634
Current liabilities	1013	1323	1422	1744
Provisions	559	150	751	891
Net current assets	7548	9612	10195	11801
Total Assets	15378	18944	20807	22687

Key Ratios

Y/E, Mar	FY10	FY11	FY12E	FY13E
Profitability (%)				
EBITDA Margin	30.7	22.2	17.1	18.5
Net Margin	15.1	11.6	7.1	8.4
ROCE	19.8	11.9	8.6	22.6
ROE	25.9	15.7	10.1	14.1
RolC	21.6	12.6	9.0	27.0
Per Share Data (Rs)				
EPS	39.9	30.1	22.5	32.9
CEPS	52.1	43.4	38.2	50.8
BVPS	170.5	212.5	222.0	243.1
DPS	10.0	10.0	10.0	10.0
Valuations (x)				
PER	5.2	6.9	9.3	6.4
P/CEPS	4.0	4.8	5.5	4.1
P/BV	1.2	1.0	0.9	0.9
EV / Sales	1.4	1.6	1.5	1.3
EV / EBITDA	4.7	7.2	8.9	7.0
Gearing Ratio (x)				
Net Debt/ Equity	0.9	0.8	1.0	1.0
Net Debt/EBITDA	1.9	2.8	4.2	3.4

Recommendation History: HEG – HEG IN

Date	Reports	Reco	CMP	Target
02/08/2011	HEG Q1FY12 Result Update	Accumulate	230	261
04/05/2011	HEG Q4FY11 Result Update	Buy	224	276

Recent Research Reports

Date	Reports	Reco	CMP	Target
25/10/2011	Sesa Goa Q2FY12 Result Update	Hold	211	239
24/10/2011	Sterlite Industries Q2FY12 Result Update	Accumulate	116	162
21/10/2011	JSW Steel Q2FY12 Standalone Result Update	UR	580	NA
19/10/2011	Hindustan Zinc Q2FY12 Result Update	Buy	121	159

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