



“HEG Limited Q4 & FY19 Results Conference Call”

May 24, 2019



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Moderator:

Ladies and gentlemen, good afternoon. And welcome to the HEG Limited Conference Call to discuss the company's Q4 & FY19 Results. Joining us on the call today is Mr. Ravi Jhunjhunwala – Chairman and Managing Director and CEO, HEG Limited; Mr. Manish Gulati – COO and CMO, HEG Limited; the Group CFO – Mr. Ajmera; and Mr. Gulshan Sakhuja – CFO, HEG Limited.

As a reminder, for the duration of this conference all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions at the end of today's presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “*” then “0” on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ravi Jhunjhunwala. Thank you and over to you, sir.

Ravi Jhunjhunwala:

Good afternoon, friends. And welcome to our Q4 and full year 2018-19 con-call. In line with Q3 Results, our Q4 performance continued to be robust. However, international global steel markets got off to a tepid start in early 2019 compared to the last eight quarters. In the January-March quarter, the international steel production, minus China, showed a negative growth of 0.8% after three years of growth, while the Chinese steel production grew by a very healthy 9.5%. And since China produces practically half of the total world's steel, the entire world's steel production still grew by about 4.5%.

The geopolitical conditions in the world remain confusing due to the growing protectionism and prospects of a trade war between some of the larger economies of the world. The trade sanctions on Iran and uncertain economic developments in Turkey also have had an effect on our business.

Along with a large growth of 9.5% in steel production in China, their electric arc furnace steel production growth remains strong in line with their government's push to replace polluting blast furnace steel capacities by electrical arc furnaces. China, which used to produce no more than about 6% of its steel through electrical arc furnace till 2016, now is at a level of around 11% and is likely to reach about 20% by the middle of 2021. This is a staggering growth of more than 3x from about 50 million tons to 160 million tons in the short period of four years.

China was sitting with electrical arc furnace production of just about 6%, only two years ago, while if you look at this figure for the rest of the world, it was about 47-48%. Obviously, a country which is more than tripling their electrical arc production in a very short time would also need to add similar 3x capacity of graphite electrodes. And this is exactly what is happening there. We believe there has been some sort of timing mismatch here. While some of the new brownfield graphite capacities have come up a bit earlier than the new greenfield capacities of electricity arc furnace steel. And that has probably given rise to a higher than required graphite electrodes availability in China, and thus China's ability to export these electrodes at dumping prices. We believe it is a short-term phenomenon. And as they start



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operating the new electrical furnaces, which are in the pipeline, all these additional electrode capacities will start getting used up within China.

Friends, while I have tried to explain this issue in some detail, preempting some of the questions that you may have in your mind, I need to further clarify that China only produces what we call non-UHP, non ultra high power electrodes, and they do not produce any UHP, ultra high power, which is what the 80% of the rest of the world market is. China is not competing with us in the UHP segment, either in India or elsewhere in the world. And they are adding new capacities of electrode is of little concern to us, as they continue to add more and more capacities for what we call the non-UHP electrodes.

While we produce between 75- 80% of our production in the UHP segment, and only the balance 20- 25% in the non-UHP segment where we do compete with China. We are looking at the possibilities of producing more and more of UHP products and reduce our business of non-UHP. We have been exporting our products to more than 30 countries around the world for a very long time. And we are fairly well entrenched to export more of the UHP products.

Chinese export of steel started declining since 2017 due to large capacity shutdowns initiated by the Chinese government two years ago. Their exports came down from about 115 million tons per annum in 2015-16 to about 75 million tons in 2017, and further down to about 69 million tons in 2018. In the first four months of 2019, their actual export figure is about 23 million tons, which on an annualized basis, again, comes to 69 million tons.

So, all in all, China has reduced their export of steel from about 115 million tons to somewhere in the region of 69-70 million tons, a reduction of about 45 million tons. Obviously, this has helped our business immensely as the rest of the world now produces 45-50 million tons of additional steel as compared to the pre-2017 time. And given that the rest of the world produces a significant part of its steel through the electrical arc furnace route, and this is how the electrode demand has shot up over the last two years.

As you know, we had announced our capacity expansion from current levels of 80,000 tons to about 100,000 tons about six months ago. We have already ordered all the long delivery equipments and the construction activities at the site is progressing as per schedule. As we mentioned earlier, we should be ready by mid-2021. And after a stabilization period of about four to six months, we should be in the market with these additional products from early 2022. We continue to believe that the current world demand and capacity of graphite electrodes is more or less in balance, and even considering a very modest growth of about 2% per annum in the world steel, we should be able to sell all our additional volumes of electrodes when we are ready in 2021-2022. More so, as it takes a minimum time of three years for any brownfield expansion, and no other country in the world has announced any expansion of their graphite capacities in the world.



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Scrap prices have shown a decline of about 5% since January, whereas iron ore prices have suddenly jumped up by about 40-45% in the same four months, which helps large electrical arc furnace steel producer to make a switch from blast furnaces to electrical arc furnace. India's demand for steel is expected to be firm in the immediate future. Indian Steel Association expects construction sector growth of about 6.5-7% per annum in India. And the similar growth in the capital goods and the railway sectors are also projected. So, we believe that there will be healthy growth of domestic demand for graphite electrode.

The UHP electrode demand as well as prices still remain strong, which is approximately 80% of our production. However, the non-UHP electrode prices have been impacted by the fall of prices and imports coming in from China since the removal of anti-dumping duty in September 2018.

With this I would now hand over the floor to our CFO, Gulshan, to take you through all the financial numbers. And then we will be very happy to answer any queries that you have. Thank you.

Gulshan Sakhuja:

Thank you, sir. For the quarter ended March 2019, HEG recorded revenue from operations of rupees Rs. 1,347 crore as against Rs. 1,865 crore in the previous quarter, and Rs. 1,292 crore in the corresponding quarter of last financial year. EBITDA including other income stood at Rs. 830 crore in quarter four as against Rs. 1,351 crore of previous quarter and Rs. 954 crore in the corresponding quarter of the last financial year.

The company reported a net profit of Rs. 524 crore in quarter four as against profit of Rs. 867 crore in the previous quarter, and Rs. 634 crore in the corresponding quarter of last financial year. Company has reported its highest ever turnover and profit after tax during the financial year 2019, we stood at Rs. 6,593 crore as turnover, and Rs. 3,050 crore as net profit for the financial year 2018- 19. Net sales and also the segment results in our power segment are lower in FY19 verses FY18, as we have been able to negotiate on mutually beneficial terms with a government utility company and replace part of the high cost self generated power, which is thermal, with a power purchase from the state electricity board. This step has not only reduced the volume of captive generation and transfer to graphite, but also reviewed the average realization in power segments as our revenue in power segment is booked based on the corresponding rate of power as defined by the state-run utilities.

While this step has reduced revenue and bottom-line in the power segment, it has had a very favorable impact on the overall power cost of graphite electrode making. The increase in annual employee benefit expenses over FY18 is primarily on account of payment of one-time incentive to employees and provisioning of profit related commission payable to the Chairman of the company at a rate of 2.5% under the contractual terms of his appointment. Increase in an absolute value of power and fuel over FY18 is attributed to increased level of production.



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The company is debt-free and have been handling treasury operations to the tune of nearly Rs. 1,400 crore as on date, and average return has been around 8% per annum on the same.

As on 31st March, 2019, the company's held 29.48% in the Bhilwara Energy, an associate company of HEG Limited. The company acquired additional shares based on the fair valuation done by the independent valuer. The fair valuation of BEL is Rs. 50.09, which was determined by the independent valuer and which was done based on the operating assets of the BEL. The material uncertainty relating to the going concerns of one of the subsidiaries of BEL on consolidated financial statement of HEG have been reported as there are no operations under the above stated subsidiary. Non operating assets of the said subsidiaries have been written-off in the books of BEL.

With this background, I would request questions which we can clarify more. Thank you.

Moderator: Thank you very much. We will now begin with the question and answer session. The first question is from the line of Sonali Salgonkar from Jefferies. Please go ahead.

Sonali Salgonkar: My first question is, would you be able to share your average selling price(ASPs) for Q4 and FY19 for the electrodes as well as needle coke cost?

Ravi Jhunjunwala: As you are aware, I mean, we don't talk of very specific numbers, obviously, because it's a competitive market and we would not like to share this information publicly. But all I can tell you is that in the current quarter, i.e. the January-March quarter that we are talking about, as I said the prices of electrode and prices of **our main raw material coke have been more or less has grown, a little over compared to previous quarter.**

Sonali Salgonkar: Okay. This question is more so from the industry perspective, looking at the current situation and as you explained about China and many other moving parts around here, going forward say in the next two to three quarters how do you foresee the prices of electrodes and needle coke? Should we expect some softening or more softening of needle coke prices, or how would the electrode prices behave going on from here?

Ravi Jhunjunwala: I will take up the needle coke question which is easier to answer. Our needle coke is more or less decided on a semi-annual basis. So, our prices for January-June half, the first half, are already frozen. And as you know, the electrode production cycle is anywhere between two and five months, so whatever shipments which will happen up till June will take let's say 45-50 days to reach and then depending upon the product mix takes anywhere between two to five months to produce. So, more or less, whatever we are getting in the first half for which we have frozen the prices, we know the prices, it will more or less take us through up till November-December of this year- number one. And number two, in the next two to three weeks we would know what the needle coke price is likely to be in the second half. Those discussions are just about to start and given the softening of the market, as we as we are aware



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about, I hope that at least there should not be any increase on the prices, if there is no decrease at least I am hoping that there will be no further increase on the coke cost.

Sonali Salgonkar: Globally are the needle coke supplies shrinking or have the players deferring their capacity additions in needle coke?

Ravi Jhunjunwala: Just like electrode it's a technology issue. There are no more than let's say two to three large player main producers of needle coke. And to the best of my remembrance, probably the last needle coke plant which would have been put up in the world must have been about 25, 30 years ago. It's more or less the similar situation in graphite, we came in 1977 and we have been the last new entrant in the graphite business in the world. So, it's not a question of supply shrinking, suppliers have not increased, there have been little increases in their capacities over the last 20-25 years. So, the suppliers are restricted. And whatever capacities they have is all that they have. And a new needle coke plant will take, my guesses is, minimum six to seven years' time to rebuild, even if one of these existing players wanted to put up a greenfield plant. So, that is a kind of timeline that we are talking about. And a new capacity in the graphite electrode business similarly would take anywhere between five to six years. And as I said, simple 20,000 tons brownfield expansion for somebody like us is going to take us about 3 – 3.5 years time.

Sonali Salgonkar: My last question, coming to the graphite electrode prices, I understand that again there are a lot of moving parts around here. But in your view, should we expect the firming up of realizations going forward or we could expect some weakness in the coming quarters?

Ravi Jhunjunwala: Your question is let's say connected very, very closely with what happens with China. And when I mean what happens with China, I mean, how much of steel exports they do. As I said in my remarks, Chinese exports of steel have come down by about 45 million tons to 50 million tons and they are more or less stable at about 65 million tons, 70 million tons, which used to be as much as 115 million tons, 120 million tons three years ago. So, this 50 million tons of steel exports which has dropped has meant the rest of the world, everybody except China, needs to produce this 45 million tons, 50 million tons of steel. And in that part of the world, close to 50% of steel is produced through the electric arc furnace, where the electrodes are required. So, that 50 million tons of drop of export of steel in the last two, three years, has suddenly given rise to an additional production of 25 million tons, 30 million tons of electric arc furnace-based steel which is where more electrodes are going. So, given the last three years data, which we have shared with you, China has now more or less stabilized their export to steel at about 65 million tons, 70 million tons and that is not growing. And that is also not growing because on one hand China has also closed about 150 million tons of the blast furnace capacity. So, they have closed 150 million tons of capacity, Chinese economic growth still continues to be very robust, which means that their demand for steel internally is growing by about 6-7%, while capacities have been shut. So, all this indicates that their export of steel is not going to go up anymore. I mean, it will be more or less in the region of 65 million tons, 70



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million tons, which is what we have seen. So, to that extent, it gives us some confidence to say that we don't see any drop in the electric arc furnace production outside of China, which is directly connected to the demand of electrodes.

Moderator: Thank you. The next question is from the line of Lalit Kariwala from BS Securities. Please go ahead.

Lalit Kariwala: My question is, now when do you see the operating profit margin which have shrunk from last year to this year, moving ahead, where do you see operating profit margins, how much you will be able to maintain, company can be able to maintain? Percentage of OPMs?

Ravi Jhunjhunwala: Obviously, it is a matter of sales price and the cost, which in our case the major cost is needle coke and power. So, to the extent that we produce our own power, practically everything that we use is produced internally. So, we have a fairly strong handle on the cost of power. The only other major cost is needle coke. And in response to my earlier question where I gave a very lengthy explanation about needle coke, and I am hoping that there is no change in the needle coke price from July onwards. And as I said also that given that it is imported and given that our process itself is two to five months, more or less even if there is a decrease or an increase in the price of needle coke, its impact will only be felt after about six months or so, because our prices for January-June are known and they are all frozen.

Lalit Kariwala: So, for this year we were able to have this operating profit margin at 61.22%. So, do you think we will be able to maintain that same levels or you expect a further reduction in OPMs?

Ravi Jhunjhunwala: No, answer to that question is very simple, no. I mean, obviously, we will not be able to maintain a 60-65% kind of margin, I mean, we got this bonanza in the last four, five, six quarters. And as I said, the market is now stabilizing. There was a lot of panic buying when suddenly a very major thing happened because of China, we suddenly raise the demand of electrodes, by 60,000 tons, 70,000 tons. So, there was a lot of panic buying because of the sudden event which took place. Now, as I mentioned in my remarks, given that the demand supply situation is almost in balance, we don't see or we have not seen the demand of electrode falling, because the electric arc furnace steel production has not gone down. And we don't see any increase in the production of graphite electrodes, we don't see any new expansion of capacities coming up, at least till early 2022, which is where our additional 20,000 tons will come in. So, it's a very difficult question to answer, I mean, it's almost impossible to give you a number about the OPM, but the easy answer was that, no, I don't think we will be able to maintain that level of 60% that you mentioned.

Lalit Kariwala: You can expect it to correct it to somewhere near say around 25% or so, or better?

Ravi Jhunjhunwala: No, I don't see this going down as much to 25%, I mean, 60% to 25% is drastic. But again, you are trying to push me into giving a number, which unfortunately is not possible. I am not



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shying away from that answer, but it's all market dynamics. I mean, electrodes are sold and bought either on a quarterly or a six-monthly basis. So, nobody can predict what happens after six months in this world.

Lalit Kariwala: Just one more question. We have stopped the exports to Iran?

Ravi Jhunjhunwala: Yes.

Lalit Kariwala: Which were around 8-9% of your exports?

Ravi Jhunjhunwala: Correct.

Lalit Kariwala: So, which markets do you see where you will be able to penetrate to be able to maintain that loss on exports from Iran market?

Ravi Jhunjhunwala: Our exports are fairly well spread over, we are exporting to all the five, six zones of the world North America, South America, Asia, Middle East. So, finding that 8-9% market which we have lost because of the sanctions on Iran, its difficult, but it is not very difficult. So, it will all be scattered in the rest of the world, it is not one specific country or one specific area, we are talking about 5,000 tons, 6,000 tons, 7,000 tons. So, in a market of about 650,000 tons – 700,000 tons of electrodes, we have to find a market of 7,000 tons – 8,000 tons minus Iran, which is not which is not a huge lot.

Moderator: Thank you. The next question is from the line of Atul Mehra from Motilal Oswal Securities.

Atul Mehra: Just one thing. You spoke about you substituting non-UHP with UHP. So, how is this likely to materialize? In the sense that this 75:25 mix that we have, so how will this work out in your opinion going forward?

Ravi Jhunjhunwala: Let me clarify. I mean, I was not talking about that somebody who can use...

Atul Mehra: No, not that. I mean, your production mix, I meant that.

Ravi Jhunjhunwala: I mean, I as I explained, we are competing with China in the non-UHP segment. And that is where the electrode prices have dropped because of the mismatch in timing that I spoke about. Because China suddenly has excess of electrodes, and obviously, they have to find the market, until the time their new steel capacity comes up. So, that's where the prices have dropped. So, we are trying to increase our percentage of 75%, 80% of UHP to the extent that we can find export market for that. And to that extent, we will keep reducing the non-UHP. And then, of course, there is a question of availability of coke, because a UHP requires needle coke. So, we are trying to find that additional coke. I mean, as far as production is concerned, as far as the plant equipments are concerned, we can change it very fast, we don't require any new equipment for that. So, product mix change doesn't take too much of effort or too much of a



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problem. So, we are gradually trying to increase UHP, which means we are gradually trying to export more and more of UHP and less and less of non-UHP.

Atul Mehra:

And in the past you had mentioned that both of them are very complimentary in the sense that customers are asking for UHP, you want to give them non-UHP as well, because he has a plan of that kind as well. So, doesn't that hold true even now that he would require those supplies from you only to come by?

Ravi Jhunjhunwala:

Probably what you are meaning is that most of the large steel producers when they buy UHP they also buy a certain amount of non-UHP. So, we cannot give them more of UHP than they want and we cannot give them less than what they want of non-UHP, I mean, that percentage as far as the customer is concerned is not going to change, if he wants to buy let's say 80:20 mix of UHP and non-UHP, that we cannot change. But obviously, if the electrode prices of non-UHP segment have come down because of China, the customer is also happy to source more of non-UHP from China rather than buying the non-UHP electrodes from us for the time being. So, that interchange can happen.

Atul Mehra:

Just one final question in terms of UHP prices, not the non-UHP, just the UHP prices. So, how have they been trending, say if you could talk about how they would have trended for the last financial year in terms of along the way, like say 1Q, 2Q, 3Q, 4Q, how would they have panned out for us over the year?

Manish Gulati:

You wanted to have some flavor of the pricing, is that correct?

Atul Mehra:

Yes, that's right.

Manish Gulati:

Actually it will be not right on my part to disclose the number, but it's not difficult also for you, if you make some back of the envelope calculations, from our turnover, from our capacity utilization, you will reach very close, you will get a good estimate.

Atul Mehra:

Right. And similarly needle coke, how would that have moved in terms of say between the first half of last year and now? Because obviously profitability is compressed in the last quarter, and it has to do with all the three elements, UHP pricing, non-UHP pricing and needle coke. So, which of them, apart from the non-UHP, has UHP prices also declined and have needle coke prices also moved up in that proportion to impact profitability?

Manish Gulati:

If you if you look back one year, of course, the pricing of needle coke has been increasing every six months and that is what is reflecting in the margins. About the UHP, UHP pricing is still holding on, whatever impact we are feeling is for the pricing on non-UHP because of influx of cheap electrodes from China. And this is what we think also would happen this year that your UHP pricing is likely to stay firm, while whatever impact will be felt will be on account of non-UHP pricing.



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- Moderator:** Thank you. The next question is from the line of Madan Gopal from Sundaram Mutual Fund. Please go ahead.
- Madan Gopal:** My question was on the inventory built up news that we keep hearing in the electrode space. And also, ex-China, what is the kind of capacity utilization that you have seen with the EAF capacity globally? Was there any disappointment on that front in the last six months?
- Ravi Jhunjhunwala:** On the question of inventories, what happened last year was because when liquid was short, all the customers wanted to have some safety stock. So, there was such a big lull of the bad market conditions that people were not maintaining more than 15 days or a month, depending upon where they are geographically located. So, everybody suddenly started to shoot up their safety stocks from one to three to four or five months. And which is what is being felt in this quarter, there is going to be a brief period of correction, because the EAF production, electrical arc finance production continues to be stable, even slightly growing. And all the electrode people industry wide are working at 90% average. So, this we have to give time to customers to come to the regular inventory levels. And then the demand and supply of graphite electrodes, particularly UHP is very well balanced.
- Madan Gopal:** What does the time period looking for this normalization of inventory?
- Ravi Jhunjhunwala:** Maybe another quarter or so.
- Madan Gopal:** In the meantime, do you expect the UHP prices, because you mentioned UHP prices might remain firm, are you factoring this quarter of normalization?
- Ravi Jhunjhunwala:** Yes. Right. Because there was a period when UHP prices continued to grow and grow rapidly. What I am trying to say is, we are trying to be more on a plateau and staying firm.
- Moderator:** Thank you. Next question is from the line of Sonali Salgonkar from Jefferies India. Please go ahead.
- Sonali Salgonkar:** Thank you for the follow-up question. Just one question, what were our average capacity utilization in Q4 FY19 as well as for FY19 as a whole?
- Ravi Jhunjhunwala:** For the Q4 it is 80% and also for the year it is also 80%, because in the earlier quarters it was few points above 80%, below 80%. But when we look at the whole year, it's 80%. And for the quarter four it was also 80%.
- Sonali Salgonkar:** And if you could share similar numbers for Q4 FY18 and FY18 as a whole.
- Ravi Jhunjhunwala:** That was also 80%. I think we said in the concall, I think we have the figures. Yes, they were also 80% FY18 as a whole.



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- Moderator:** Thank you. The next question is from the line of Parthiv Jhonsa from NVS Brokerage. Please go ahead.
- Parthiv Jhonsa:** I just wanted to ask, a lot of EAF capacity are non-China based. So, what is expected growth in demand? Once a lot of these Chinese facilities start coming on stream and they start converting to EAF, so what is the kind of growth demand you are looking over next maybe say two years or three years kind of time span?
- Ravi Jhunjunwala:** China is witnessing a huge growth of EAF. And the way they are working is they are kind more in a replacement mode, they are replacing blast furnaces and induction furnaces with more efficient and less polluting electrical arc furnaces. So, this is what is happening in China, they are undergoing a rapid growth of electrical arc furnace steel production. And the rest of the world, I believe 1-2% is a very conservative estimate that is what is expected to grow in the rest of the world.
- Parthiv Jhonsa:** So, there is one more technical question. So, just to understand, how much of the product would be used to make say about 1 ton of steel? How much graphite would we used basically?
- Ravi Jhunjunwala:** It depends upon the furnace to furnace, country to country. But let's say if one were to put a furnace today, which is using a supersized highest diameter of electrode, the consumption in that particular furnace, one of the best, would be let's say 1 kg a ton. And let's say if you take a global average, I think it should be, we should have an estimate of 1.8, because if you see there are furnaces which came 40 years back, there are furnaces which came few years back, there are furnaces which are coming today. So, if you club all of them together and make an average of that, probably it should be 1.8.
- Parthiv Jhonsa:** And sir, on one of your slides you had mentioned that there is a bit of a slowdown in some parts of the globe when it comes to the steel production, apart from China and India. So, we have a lot of exposure to other parts of the globe as well, so how do you look at how you try to tackle it going forward if the demand and the demand scenario from these kinds of countries remain the same?
- Ravi Jhunjunwala:** The figures you are looking at are only for the first quarter, and it's showing that rest of the world the steel production declined by 0.8%. So, as we go through the year, I think it should be a positive growth, because that's what we believe. Because 0.8% is not as big a number, for example, had it been, let's say 4% or 5% that would have raised an alarm that probably this is going to be a negative growth whole of this year. But 0.8% doesn't really give as much of an indication that its going to stay this way.
- Parthiv Jhonsa:** And last question, I believe we have a capacity utilization of about 80% as on date. Can we grow or is this a calculated move of just based on the demand? Or is there more demand and we can grow and produce more capacity?



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- Ravi Jhunjhunwala:** Our plan for a FY19-20 is to be at 90%. As I was sharing with you, it is both ways, its availability of needle coke also, also some inventory correction happening in the market. So, that is how we landed up at 80%.
- Moderator:** Thank you. The next question is from the line of Rahul Murkya from Sumitomo. Please go ahead.
- Rahul Murkya:** Just wanted to understand, are we still going on quarterly based contracts or we are changing that and planning to go for annualized contract?
- Ravi Jhunjhunwala:** We have not yet reverted to yearly based contracts, because as you know, Rahul, it has to be linked with the needle coke tenure of contract. If needle coke suppliers give us six months, we offer six months. And for a period before let's say six months, we were not taking a chance beyond a quarter, but now let's say between a quarter or two quarters, but not beyond still.
- Rahul Murkya:** And if possible, can you tell me like how much capacity we have already booked for the current quarter and for the first quarter of fiscal year 2020?
- Ravi Jhunjhunwala:** It's ongoing actually. And it is difficult to say, Rahul, because we have Indian market as well as overseas markets and have different cycles, lot of inquiries in the market and we are offering, quoting and receiving orders, it is almost a daily based activity. So, we are going with it, I mean, we are just in the process of booking. Because as you know, if we go quarter by quarter then all orders also come like that the whole tenure has shortened.
- Rahul Murkya:** But I believe that for first quarter we would have bought something in 4Q?
- Ravi Jhunjhunwala:** Yes, of course.
- Rahul Murkya:** So, you are saying that we are still getting orders for the first quarter?
- Ravi Jhunjhunwala:** Yes, absolutely.
- Rahul Murkya:** And can you give us sense like what we hear from Tokai Carbon and Showa Denko is like they are still able to get those realizations of 13,000 plus for UHP, while for us also on UHP we are seeing some decline? So, where is the disconnect, I mean, like why they are able to still secure it and we are not?
- Ravi Jhunjhunwala:** The kind of pricing they are talking about, if you look at it closely, they are getting these kinds of prices in Japan, from Japanese customers, not from overseas markets. And Rahul, you are in Sumitomo, you will be the best to answer this question to them. But the 13,000, etc, is happening in Japan.



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Rahul Murkya: And just last bit, you mentioned that you are looking for utilization of a FY20 above 85%, between 80% to 90%. There was this talk when we were saying that we have got extra needle coke when Phillips 66 have done debottlenecking and all. So, I mean, is the needle coke a problem or is the demand a problem?

Ravi Jhunjhunwala: As I said, both actually. The external needle coke, you are talking about is what something happened last year. Last year we could get out of the debottlenecking operations something extra. For this year, we are not clear, I mean, it's the same quantity which they gave last year which we will get this year. So, it's not more for this year, this came out of the debottlenecking which they did for last year. It's both actually. So, there is a constraint from the needle coke side as well as there is some inventory correction going on here. So, both of them together, there is a price target. So, all of them together brings us to this level of this 80%.

Moderator: Thank you. The next question is from the line of Jinish Sanghvi from Principal Asset Management. Please go ahead.

Jinish Sanghvi: Could throw some light on the overall demand for electrodes in Iran and Turkey? And how confident are you in terms of achieving the 84%, 85% kind of utilization for FY20, considering that our supplies to Iran and Turkey could get impacted because of various reasons?

Manish Gulati: Yes, Iran annually consumes about 40,000-45,000 tons of electrodes, that's the total market size. Turkey is also about the same. So, these two have been our good markets, both. And unfortunately, both are impacted. Iran exports have stopped, key mills are working at half of capacity utilization. It does have an impact, but as Chairman said, we are very well diversified to 30 countries. Yes, we have to look for other markets, there is no doubt about it. And we hope, and we are reasonably confident that we will achieve the level which you were mentioning.

Jinish Sanghvi: No, so the basic kind of query arises from the point that if your global steel production is growing at around 1-2% and if in that it's only China which is kind of increasing the EAF capacity, so for this 85,000-90,000 tons of incremental electrodes to find various markets, whether it will continue to put further pressure on electrode prices in the international market, despite kind of getting to that kind of a utilization for ourselves?

Manish Gulati: We will see how it pans out. See, these are the total markets. And what is our exposure there? Our exposure is like 10% in Iran and 5% in Turkey, something like that. So, we have to look at other markets, it should not be difficult. But yes, these things are always there, these macro things. But there is still sufficient growth actually, it's just a matter of absorption and some patience to let that growth come in the market.

Moderator: Thank you. The next question is from the line of Suraj Singh Thakur, who is an individual investor. Please go ahead.



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- Suraj Singh Thakur:** Iran is not taking any graphite electrodes from anywhere in the world, right?
- Manish Gulati:** Yes, electrodes are finding their way into Iran from all sorts via, via places. But as a company we decided not to do that. So, I mean, something comes from here and there, they sprout it from here and there, but we don't want to do that.
- Suraj Singh Thakur:** But sir if Iran is getting electrode from some other places, then in those places we can move some other as the deficiency of electrode is there, so why is not HEG getting benefit from that deficiency?
- Manish Gulati:** That is actually a good question, you asked. But you see, mostly it is the Chinese who are catering to now Iranian market, that is what we believe. So, the kind of the question you are saying is correct, that maybe there is space and go sell in China? Then I would say, no, that won't be possible because that kind of quality we are neither making nor we have intention to going inside China and competing with them.
- Suraj Singh Thakur:** But China is not into UHP market, and Iran are non-UHP from them?
- Manish Gulati:** Yes, one who doesn't have anything will take anything. So, if Iranians are not finding electrodes, whatever best they are able to source they are sourcing from the market, it may not be the right and the best product, but yes they have to run their plant somehow. It may not be the most efficient way of doing it, but that's okay, what else they can do.
- Moderator:** Thank you. The next question is from the line of Pralad Jain, who is an individual investor. Please go ahead.
- Pralad Jain:** My first question is that, we have seen a 40% drop in net profit, and our sales have also been affected overall. Do we have a guidance in terms of what is going to be our net profit figure quarter on quarter for the next one year? Would it be Rs. 300 crore, Rs. 400 crore, Rs. 500 crore that we are looking at?
- Manish Gulati:** So, that is not something which we will be able to provide. And when you say drop, I mean, it's very ironic to hear, how many industries are really having these kinds of margins. But anyway, it's indeed a drop. But so we will not be able to provide any specific numbers like the ones you are asking. But surely, please, look ahead to a year of very healthy profits.
- Pralad Jain:** Right. So, we have actually done very good in terms of profits in 2018. Now, what is the reason for the 40% drastic drop in one quarter?
- Manish Gulati:** It's both basically. As I said, there is a portion of our business which is non-UHP grade which has been impacted by fall in prices from China. Also, sequentially the high price needle coke has come in, for the last three, four quarters it was coming in because you book as you



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consume. So, that is both of them put together. These are the reasons; volumes are more or less the same and that is what has caused an impact.

Pralad Jain: Right. But our overall production of HP Electrodes is quite low. So, are we seeing a drastic drop in UHP pricing as well?

Manish Gulati: No, not as drastic. In non-UHP, yes you can determine it drastic, but not as much as in UHP. See, in the last two quarters Q2 and Q3 we benefited from very high spot level of pricing. I mean, electrodes went above \$20,000. So, that was some kind of spot prices available at those times. But those are not ones on which the long-term contracts were made.

Pralad Jain: Right. So, you said that you will not be able to provide us the guidance in terms of the net profit or the EBITDA margins as well. There are companies like Infosys who can give a forward guidance, there is no penalty in terms of giving a forward guidance. So, from the market, overall market research that you have, and the demand and supply, is there any guidance that you can provide to the investors?

Manish Gulati: No sir, Infosys can maybe, but I am not in Infosys. We cannot. Because, I mean, you see Infosys can, because see we do not have full order book, Infosys can because there are certain contracts with they have already tied with those American companies. Our both sides are open, we are booking orders as well, as you know we don't know yet what the needle coke prices are going to be for the next half. So, with both ends open we cannot commit without any basis. But yes, when we talk we look at the fundamentals, the fundamentals are intact, there is growth in steel, electrode companies are working at high capacity utilization, needle coke is tight. Till anything of this doesn't get disturbed, you can look forward to healthy margins.

Pralad Jain: Okay. So, in terms of healthy margins is there any range that you can provide from an EBITDA margin perspective?

Manish Gulati: No, you can have your own definitions of healthy.

Pralad Jain: Let's say 40% reduction in a quarter is not healthy, so that is the reason I am asking what is your definition of healthy?

Manish Gulati: But then how many other companies have 70% margins?

Pralad Jain: No, they don't. So, that's the reason we are asking for a guidance. Because you are there in the market, you are talking to your customers, you understand the demand and supply?

Manish Gulati: Yes. Sorry, I cannot hazard any such guidance where orders and costs both are moving.

Pralad Jain: Okay. So, last quarter we took a 15-20% reduction in prices. The channel just confirmed there is another 10% reduction in prices for Q1 2020 as well, which we have supplied to the Indian



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steel manufacturers. Do we see this 10% quarter-on-quarter reduction going forward? Or is this the last reduction that we are looking at?

Manish Gulati:

No, it's so difficult to answer this, this is such a dynamic marketplace. It's such a dynamic marketplace. When we are talking about a quarter, we are talking to customers every day, up and down, and we will not be able to comment more on this pricing part, unfortunately.

Pralad Jain:

Okay. Now, in terms of Iran, last concall we actually talked about Iran and we were told that you would be looking at other markets as well, that the company is looking at the markets. And it should not be a problem in terms of getting that produced to other markets. However, what we are hearing is, we are still looking at other markets. So, is that capacity being taken up in the other markets? Are we able to find other customers or no?

Manish Gulati:

We are trying actually, we are trying. Here every day we continue to try because we have to find sufficient other markets to be able to relocate this displacement.

Pralad Jain:

And in terms of the Indian steel, wherein we heard RJ sir telling us that there is a 6-7% increase in the Indian steel manufacturing. Would you be able to provide guidance in terms of how is this going to affect our EBITDA as well as the realizations here? Because we are supplying quite heavily to the Indian steel market as well. And overall, how much of the UHP versus at HP is the Indian market using?

Manish Gulati:

About let's say, I would say this Indian market would be around 65,000 tons, about 25,000 tons of that would be the non-UHP segment and 40,000 tons would be UHP. So, let's say one-third, two-thirds; one-third of that in India would be non UHP, and two-thirds would be UHP.

Pralad Jain:

Right, okay. Now, in terms of, there is a large inventory build-up which is seen in your balance sheet. Would you be able to give us details about whether this is graphite electrode which is manufactured and kept with the company? Or is this MC that we see in the inventory?

Manish Gulati:

No, it's actually, as I said this quarter I would like to term as a quarter of inventory correction, because every customer has overbought in the last year, and even which continued till the January to March period also. And then everybody wants to normalize now that all the electrode companies have raised their production by whatever they could, subject to needle coke availability. So, now everybody in the world is trying to bring their inventories down to normal levels. And we need to have patience, and give customers time so that their piled up inventories get liquidated, and then supply should be equal to demand.

Pralad Jain:

And do you actually see that demand coming in? Do you actually see customers queuing up now in terms of the second half of the year?

Manish Gulati:

Certainly, demand is there, there is no doubt about it.



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- Pralad Jain:** Alright. So, what I am asking is, is the demand picking up? Picking up in the sense, quarter one yes we were still booking orders, and we saw lower demand there. But is the demand picking up would we see better realizations and better demand across the year?
- Manish Gulati:** See, better realization, we have had sensible realization in the last year. It should be contrary, because it's a more a period of stability where those sky high pricing and sport level of pricing is behind us. We are more in a stable regime on pricing for the UHP, at least. And with pressure on non-UHP pricing.
- Pralad Jain:** Right. So, this 10% reduction in the Indian market that we are hearing about for this quarter as well, are you looking at further reduction in the Indian market? Or when you say stable, are you looking at stable pricing?
- Manish Gulati:** No, I cannot say actually, unfortunately. I wish I had the answer. But I really don't have an answer myself, because this is something which is deliberated quarter-on-quarter, month-on-month with customers, I really cannot say. And it also has to factor in imports, and this and that, lot of things. So, I can't give any guidance on that.
- Pralad Jain:** Okay. I had another question, this was about UHP capacity additions by Fangda, Jilin and **Kaifeng** as well, in the Chinese market. Now the Chinese market for HP has actually ruined our market as well, because they are dumping a lot of electrodes in India. They are coming up with a lot of UHP-G capacity auditions, and how is that going to play out in a year or so?
- Manish Gulati:** We still believe, and if you hear the con-calls of our peer group also, they also say the same thing that it's about technology, it's still a long way to go. And we have also heard about some so called UHP capacities coming in China. But we strongly believe that that is not the product, merely by calling something as UHP doesn't really make it UHP. You need proper technology, you need the raw materials, everything. So, it's whatever they are saying. Yes, I do also here just like you that they are putting some UHP capacities, but it's easier said than done.
- Moderator:** Thank you. Our next question is from the line of Devang Sanghvi from ICICI Securities. Please go ahead.
- Devang Sanghvi:** Just wanted to know regarding the CAPEX number, how much of CAPEX we have spent in FY19 for the increasing capacity? And what would it be for the next couple of years?
- Manish Gulati:** We just started actually. When we placed orders and it was in the month of March that we actually placed all the orders. So, in this year, only about Rs. 50 crore have been spent on CAPEX. And the rest of it will be spent in another two, three years, two and a half years.
- Devang Sanghvi:** So, it will be more back-ended or it will be 50:50 types?



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- Manish Gulati:** No, it will be 50:50 types, in this year and the next, in 2019-2020 and 2020-2021 should see equally divided almost.
- Devang Sanghvi:** So, Rs. 1,200 crore is the growth CAPEX what we are planning. So, Rs. 600 crore is a good number to take?
- Manish Gulati:** Yes, leave something was a third year also.
- Gulshan Sakhuja:** In 2019-2020 we expecting a cash outflow of around Rs. 400 crore and in 2020-2021 it will be more than that or on similar lines of FY 2019-20. And the balance would be in 2021-2022.
- Moderator:** Thank you. Next question from the line of Jinish Sanghvi from Principal Asset Management. Please go ahead.
- Jinish Sanghvi:** Would you like to share in terms of gross margin how one should look at it, considering that we are seeing a fall in electrode prices wherein the needle coke prices are moving higher or kind of sustaining at higher levels? Are you guys working with any gross margin levels in your mind which you would like to maintain over a long-term business?
- Manish Gulati:** Again, I tried to answer this question a little while back. You see had the order book been fully booked for let's say at least one or two quarters, the way it used to be in the past, when we used to start the year we always started the year with 50% of the orders already committed. And we also had the back-to-back needle coke prices. It was easier for us to provide a guidance. Now with pricing also open and cost also open, it is very difficult to even comment on pricing. Except saying that the fundamentals are intact, we are going to have healthy margins. That's it. That's all what I can say. But we can we cannot provide the number actually, unfortunately. I wish we could, but we cannot.
- Jinish Sanghvi:** But can you provide a range as such, maybe between 30-40%, and 60%, something of that sort?
- Manish Gulati:** No, we will not hazard a guess actually, we would not like to do that.
- Moderator:** Thank you. The next question is from the line of Anubhav Sahu from MC Research. Please go ahead.
- Anubhav Sahu:** A couple of questions. One is, in financial year 2019 you had guided for 85% kind of capital utilization. What we achieved was 80%. So, want to understand the delta which is coming, is it mainly because of turkey and Iran or is there some other thing you want to highlight?
- Manish Gulati:** You can say that, you can say both. You are right, that delta is definitely coming mainly because of Iran and Turkey. But also, suppose I could have done this, sold this quantity elsewhere, but then rest of the world, rest of the companies are in the process of their inventory



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correction, so it could not be immediately diverted. So, you are right, you correctly remember we talked about 85% but it turned out to be 80%.

Anubhav Sahu: And sir for the current financial year, the hope for a high inflation also rests on this thing then, we would be able to deploy the sales which targeted to Iran?

Manish Gulati: Yes, you are right, that is the plan.

Anubhav Sahu: Secondly, on the EAF front target from China, in one of your earlier presentation you guided, you gave us an information that China could be or would be targeting about 20% of steel through EAF route by 2020. From your opening remarks, it looks like there has been a bit of a delay. At the same time, you also have an observation that they have also preponed some of EAF production which has been ahead of schedule.

Manish Gulati: No, that was for graphite. You misunderstood, what we are saying is that the graphic capacities were already there, so they started pumping electrodes. While it takes a while for the new steel companies to come up, new steel plants to come up, graphite companies which were already there, which were working at less than 50% percent capacity utilization, were very quick to start making electrodes. And then that is what caused an impact. So, there is a time mismatch, what Chairman tried to say, there is a time mismatch of new electric steel plants coming up and the electrodes. So, electrodes started getting produced before the EAFs demand could go up in China. So, it is a basically just a matter of timing. In a year from now, I mean, maybe by the end of this year or next year when the EAFs production will start to increase, some of these electrodes will get consumed in China itself.

Anubhav Sahu: And on the electrode prices, the back of the envelope calculation shows that even for us it is ranging around \$11,500 to \$12,000. Would you like to comment, as far as UHP is concerned, I mean, in the near term you think that it should stabilize around this level?

Manish Gulati: Your back of the envelope calculations is good.

Anubhav Sahu: Because most of your commentary was on the non-UHP, okay, there have been corrections. But on the UHP you think that it should stabilize at this level? Because even the international prices are little...

Manish Gulati: If you would have heard, somebody asked me this question a little while back. Japanese are talking about \$13,000 price levels. In Japan they have been able to do this booking, they are trying in overseas markets, HEG is also trying, others also trying. So, anyway, we will see where they are placed. So, that's why we expect, see if you hear ours and hear everybody else's, you will find more or less the same sentiment, because we are all in the same industry, we are standing by the same calculations and same projections, they also say the same that UHP pricing will stay firm.



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Anubhav Sahu: And on the needle coke prices. I think in one of your media briefing you said that as per the contract its coming around 4500 to 5000. So, just a contract which is already in the financial stream and has already come in the financial statement or it's something which will reflect six months from now?

Manish Gulati: These are the kind of pricing for the first half of 2019.

Anubhav Sahu: So, these are the contracted prices, but since it comes with a lag so it will reflect later on, right?

Manish Gulati: Yes, that's right.

Moderator: Thank you. We take the last question from the line of Payal Goinka from Ratnabali Investments. Please go ahead.

Payal Goinka: Actually as in we know in the product mix we have 75% UHP and 25% non-UHP. So, I want to know in that part, like in 75% in UHP how much do we supply in the Indian market?

Manish Gulati: Out of that 75% we are almost doing maybe 25% of that.

Payal Goinka: Okay, one more thing on the needle coke, like usage we always tell its like 1:1, right?

Manish Gulati: Yes.

Payal Goinka: So, like for last year our capacity utilization was around 80% and out of that 75% was UHP, so that means we are using like around 45,000 tons of needle coke for UHP?

Manish Gulati: Might be, yes. What is it that you are trying to say?

Payal Goinka: I am just trying to ask like how much the proportion of Indian needle coke is being used, as in the Indian needle coke is being mixed with imported needle coke?

Manish Gulati: I didn't get your question, how much you want to know the bifurcation, how much needle coke we use and how much Indian coke we use?

Payal Goinka: Yes, right.

Manish Gulati: That's what I told you, it is 75-25% of our production. And then what you are saying is right, okay, 80% of capacity utilization multiply by 75%, you are close to those figures, right.

Payal Goinka: One last one. We are talking about that China is moving towards 20% EAF capacity and all that. So, does in China the EAF use electrodes, the good quality UHP electrodes? Because the thing is, now also this...



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Manish Gulati:

Yes, you are right. See it is like this that you will notice this and you will find it from other sources also that most of the furnaces which are coming up are not using the super size or big size electrodes, so they don't really need those cutting edge UHP electrodes. So, it's all there, the chain is all well matched up, what the kind of coke they are making, the kind of electrodes they are making and then they are setting up new electric arc furnaces which are using maybe up to 20 inch or 22-inch electrodes, they are not setting up furnaces which are using highest size of electrodes like a 30 inch or 28 inches. Because probably they understand that the market of UHP electrodes is very tight, and they may not be able to find it in overseas markets.

Moderator:

Thank you very much. I would now like to hand the conference back to the management team for closing comments.

Manish Gulati:

Thank you, dear friends. We look forward to speaking to you in the next quarter. And we want to end this concall with our remarks that we feel that demand and supply situation of graphite electrodes is pretty much balanced. And we are in a stable environment in 2019-20. And we expect to post healthy profits this year as well. Thank you very much.

Moderator:

Thank you very much. On behalf of HEG Limited, that concludes the conference. Thank you for joining us, ladies and gentlemen.