



“HEG Limited Q2 FY20 Results Conference Call”

November 19, 2019



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Moderator:

Ladies and gentlemen, good day and welcome to the HEG Limited conference call to discuss the company's Q2 FY20 results. Joining us on the call today are Mr. Manish Gulati – COO & CMO, HEG Limited; Mr. Gulshan Sakhuja – CFO, HEG Limited; and Mr. Om Prakash Ajmera – Group CFO, HEG Limited.

As a reminder, for the duration of this conference, all participants' 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. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touch-tone phone. Please note that this conference is being recorded.

At this time, I would now like to hand the floor over to Mr. Manish Gulati for his opening remarks. Thank you and over to you, sir.

Manish Gulati:

Good morning friends and welcome to our Q2 FY19-20 con-call. Comparing the first 9 months of this calendar year over last year, world crude steel production including China registered a growth of 3.9% on the back of a very strong 8.4% growth coming from China alone, but if you look at the steel production in the rest of the world without China after 2 years of positive growth, it was a negative 1%.

Now, coming specifically to the electric arc furnace steel production, the steel production was down by 5% in the first 9 months of calendar year 2019. In the rest of the world without China, it was down by 2% approximately after having grown at a very healthy pace in the last 2 years of 2017 and 2018. Some of the large steel producing regions like Europe, Japan, Russia, and Turkey registered a decline mainly resulting from slowdown in demand due to an overall sluggishness of the global economy, trade tensions between the US and China and other geopolitical tensions in some parts of the world. The trade sanctions on Iran and uncertain economic and political developments in Turkey and some other countries with a large electric arc furnace base also have had an impact on demand of electrodes.

In the past 2 years, 2017 and 2018, and lasting up to first quarter of 2019, we saw an unprecedented tightness of supply of electrodes and that fear resulted in surge of buying, and many large steel companies overbought electrodes resulting into excess inventories in the pipeline. Amid steel market getting tough starting this year impacting their production and resultant decrease in the demand of electrodes coupled with excess inventory of electrodes in the system which the customers had built last year resulted into a drop-in sales and stabilization of prices. However, we believe that the inventory correction should be completed by the end of H1 2020 and then we can expect normalcy restored in the market.

Due to reduced demand of needle coke, the availability has somewhat eased compared to last year due to which today, there is no constraint in producing ultra-high-power grade electrodes.



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However, in the long run, supply of needle coke is expected to remain tight due to rising demand from electrode segment and competing demand from lithium ion batteries. As you are aware, earlier this year, we had started our expansion from current level of 80,000-ton capacity to 100,000-ton capacity.

We wish to update that the construction activities are in full swing and we should be ready by the 3rd quarter of 2020-21. And after a stabilization period of say 3 to 6 months, we should be in the market with these additional products from early 2022. We do believe that with this new capacity coming on stream, the quality of our products will see a marked improvement due to state-of-the-art equipment that we are currently installing. This will also enable us to do some cost savings and achieve better efficiencies.

Our results in this quarter, although lower than the previous quarters, still remain one of the strongest in the industry. We remain optimistic about our industry and we view the current level of sales and pricing to be a correction and we expect normalcy to be restored by H2 2020 by then we expect the excess inventories to be cleared. With our 4 decades of experience in business, we expect to be a supplier of choice to all our global and Indian customers.

With this, I would now hand over the floor to our CFO, Mr. Gulshan Sakhuja to take you through all the financial numbers and then we will be very happy to answer any questions that you may have.

Gulshan Sakhuja:

Good morning friends. For the quarter ended September 2019, HEG recorded revenue from operations of Rs. 564 crore as against Rs.817 crore in the previous quarter and Rs. 1794 crore in the corresponding quarter of the last financial year. EBITDA including Other Income stood at Rs. 174 crore in Q2 versus Rs.387 crore of previous quarter and Rs.1389 crore in the corresponding quarter of last financial year. The company reported a net profit of Rs.179 crore in Q2 as against profit of Rs. 234 crore in the previous quarter and Rs.889 crore in the corresponding quarter of last financial year.

During the quarter, the company has elected to exercise the option permitted under the section 115BAA of the Income Tax Act 1961 as introduced by the Taxation Laws (Amendment) Ordinance 2019. Accordingly, the company has recognized provision for income tax for the 6 months period ended 30th September 2019 and remeasured its deferred tax liability on the basis of rate prescribed in the said section. The impact of this change has been recognized in the statement of profit & loss for the quarter ended 30th September 2019. It has resulted in reduction of current tax liability amounting to Rs. 47.55 crore and also resulted in reversal of deferred tax liability amounting to Rs. 34.11 crore. The full impact of this change has been recognized in the statement of profit & loss for the quarter ended 30th September 2019.

Operations at our hydropower plant at Tawa are seasonal in nature. The plant generally remained closed in the 1st quarter, starts operating in the 2nd quarter, and peaks in the 3rd



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quarter before tapering down in the last quarter. The operations at Tawa plant had been started from 14th August 2019.

The company is debt-free and has been handling treasury operations to the tune of nearly Rs.1000 crore as on date and the average return has been around 8% per annum on the same. For the quarter ended 30th September 2019, the company has presented the consolidated financial results along with standalone financial results as a part of the compliance with the SEBI circular. The company aims to further strengthen its balance sheet through effective working capital management, thereby creating a value for its shareholders.

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

Moderator: Ladies and gentlemen, we will now begin with the question & answer session. The first question is from the line of Dewang Sanghavi from ICICI. Please go ahead.

Dewang Sanghavi: My question is regarding the utilization levels. For Q1, we reported 85% and for Q2, we reported 73%. What would you be guiding for the full year FY20?

Manish Gulati: The full year, I believe, by the time we complete the 2 quarters, it should be in the range of between 70- 75%.

Dewang Sanghavi: My second question is on the needle coke. Can you please provide some update on the pricing for the contracts which you will be negotiating currently?

Manish Gulati: This is about to be done. We are expecting a reduction but let's say in a month or 45 days from now, we expect to conclude the needle coke contracts for next year and we are expecting some decline. We do look forward to some correction in their prices.

Dewang Sanghavi: Any ballpark number on the decline? Would that be possible?

Manish Gulati: Not at this stage. But we will share it with you later, maybe in the next con-call. But right now, it is not clear how much the price level is going to be.

Dewang Sanghavi: My third question is regarding the prices. On a quarter-on-quarter, we see a declining trend. Do you think we have bottomed out the pricing side or maybe some pain is still left?

Manish Gulati: Maybe a slightly more correction. And this all is happening because of these inventories we have in the system and everybody wanting to run their plant and sell any incremental ton. The non-UHP side is more under pressure compared to the ultra-high-power grade side.

Dewang Sanghavi: I was seeing August export data from China has witnessed a month-on-month decline in trend on the graphite electrodes exported from China. Is that trend going to be continued or it is a one-time blip? What ways of understanding on the same?



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- Manish Gulati:** I think since the pricing of non-UHP has also become quite competitive, I don't think that Chinese electrodes more import should come into India because earlier our pricing was much higher than this but now we are competing at that level. I don't think it should increase more from here. What you are seeing from the data is either should remain at that level or should go further down. That's what we hope.
- Dewang Sanghavi:** A couple of quarters back, we were discussing regarding the EAF production in China. That was coming slow and graphite capacity was coming faster and we wanted like there should be some couple of quarters of gap so the EAF production picks up. Has Chinese EAF production picked up or what sort of sense on the same?
- Manish Gulati:** In fact, that was the plan. We thought that when the electric arc furnace plants come up in China, the electrodes will get consumed internally but I think there has been a lot of time lag between the new plants coming in, and the graphite electrode plants' capacities were probably ready on the ground, which they have just refurbished and restarted. That imbalance still continues. We still see a lot of Chinese exports into the other parts of the world.
- Dewang Sanghavi:** H2 2020 is the time we expect this excessive inventory to kind of being depleted from the market? Is the understanding correct?
- Manish Gulati:** Yes, you are right. That is what we hope that by H2 2020, the balance should be restored. Right now, we see some excess electrodes in the market. That should get completed by H2 2020 when normal pace of the EAF growth picks up. Right now, you see that it was a double whammy. There were electrodes in the system already and then the steel production started to go down. So, anybody who had procured electrodes for, let's say, a certain number of days or months, automatically got extended resulting in reduction of fresh buying. That's what exactly what has happened. This timeline what we were expecting that by the end of 2019 or let's say early 2020 for inventories to get corrected is actually pushed back by, let's say, another quarter or 6 months to H2 2020.
- Dewang Sanghavi:** So, maybe June 2020 is the number which we are looking at? H1 2021 calendar year?
- Manish Gulati:** I think so Dewang.
- Moderator:** The next question is from the line of Abhijeet Dey from BNP Paribas Mutual Fund. Please go ahead.
- Abhijeet Dey:** Just wanted to understand in terms of your volume breakup between domestic and exports, how has that changed, sir, this year compared to the previous fiscal?
- Manish Gulati:** It still continues to remain the same, like 75:25 ratio, still the same.



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- Abhijeet Dey:** Are you looking to sell more now that the steel production ex-China as you have highlighted in your presentation has actually declined. So, are you looking to actually find more customers in the Indian market going ahead?
- Manish Gulati:** We were not selling to China. I don't know how you are linking the two things. But yes, we are wanting to sell more not only in India but everywhere where it is possible. There are inventories in the system; with us, with others, in the market. So, we are wanting to spread our base in India as well as elsewhere.
- Abhijeet Dey:** And in terms of how things have gone in this quarter, i.e., Q3, more than half the quarter is almost over, any signs of any green shoots you are seeing in the overall market? Because the Indian steel industry in terms of demand continues to remain subdued. Are you seeing any green shoots there?
- Manish Gulati:** Not yet actually. I think we have to wait for another quarter.
- Abhijeet Dey:** One last question from my side. Any update on restarting exports to Iran in the near term?
- Manish Gulati:** No, we are not planning for that because it still remains under sanctions. So, there is no plan from our side to try and attempt some business in Iran, we won't be doing it.
- Moderator:** The next question is from the line of Payal Goenka from Ratnabali Investments. Please go ahead.
- Payal Goenka:** Sir, my question is regarding the IMO 2020. What should be the impact of IMO 2020 on the NC prices and its availability?
- Manish Gulati:** This maritime thing which is going to come which is going to be a competing demand for low-Sulphur crude, we have checked with a couple of people. Although it will create a tightness, but people say there is sufficient low-Sulphur crude available in the world or refineries have to put in some extra equipment to make it low-Sulphur. So, yes, it does compete with the same kind of product, low-Sulphur, which is needed for needle coke as well as for maritime operations. But it is not going to be something like a catastrophe as such when it comes in because I think everybody, all the refineries, etc., are all gearing up to produce this low-Sulphur oil.
- Moderator:** The next question is from the line of Manoj Gandhi, an individual investor. Please go ahead.
- Manoj Gandhi:** I just wanted to know what is the average realization for the UHP per tonne at this moment for this 2nd quarter.



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- Manish Gulati:** Mr. Gandhi, that unfortunately we will not be able to disclose the specific level of pricing. You will have to make your own estimates from our figures. Just for competitive reasons, I cannot be doing that.
- Manoj Gandhi:** If I can ask, is the trend for the 3rd quarter, you expect an increase in the trend, the prices to stabilize, and go up now?
- Manish Gulati:** I think it will need another quarter or two more because unless these excess inventories are flushed out of the system, we cannot get that tightness back again. Right now, there is a lot of inventories.
- Moderator:** The next question is from the line of Hemanth Venkateswara, an individual investor. Please go ahead.
- Hemanth Venkateswara:** There were a lot of things on the radar. There were some professionals who had been looking at the new business to set up. Anything on that you are looking now or it is all cooled down now?
- Manish Gulati:** We had evaluated a lot of opportunities in the market at that point in time and didn't really find any worthwhile opportunity which had some synergies with our kind of business. At present, we are not looking at any new venture or something. We are just proceeding wholeheartedly with our expansion because we hope that this graphite electrode business is something which we know very well. That's our core competence, so we are doing that instead.
- Hemanth Venkateswara:** But there was a lot of traction on the creation of anode. I think Ravi had mentioned that we are almost positive, and we are looking for that opportunity because of the EV market is picking up and....
- Manish Gulati:** You also know as good as I know that all this lithium anode business is linked to the growth of expected growth of electrical vehicles in India. Of course, we are working on it but we have to see the timing. We had said it is at the research stage, pilot stage, whatever, but this demand has to eventually come in the market. The moment you see some electrical vehicles in the country, then that's the time for this business to grow. We have looked at this product and we understand this product and we are working on it at a pilot level only at this stage. And it depends.... If the market grows in India, if the government policies are supportive, if really there are vehicles on the roads, certainly this is a good business to be.
- Hemanth Venkateswara:** And the scrapping policies have been introduced by the government. Is there any impact on our EAF route which makes much competitive for us or it's going to be again the same story?
- Manish Gulati:** The scrapping policy which has been overdue in this country for the last more than 10-15 years. We keep talking about it but you still see junk vehicles on the roads. The scrap



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availability locally should increase and it should be helpful to the electric arc furnace industry and it should kind of bring them on the little more cost advantage because still India remains a net importer of scrap. So, that will be a good thing to happen actually. It is beneficial for the electric arc furnace people.

- Moderator:** The next question is from the line of Dewang Sanghavi from ICICI. Please go ahead.
- Dewang Sanghavi:** Just wanted to know about the CAPEX what we have done for H1 and the full year guidance for FY20 and FY21 if possible.
- Gulshan Sakhuja:** This year in FY 19-20, we are planning to spend approximately 400 crore and in 20-21, it would be approximately 500 to 600 crore, and the balance in the 21-22.
- Dewang Sanghavi:** And in H1, how much we have incurred? Of this 400, what we have planned?
- Gulshan Sakhuja:** It is approximately 150 crore in H1.
- Dewang Sanghavi:** Is Chinese EAF production on a declining trend for VY19? Any idea on the same?
- Manish Gulati:** We noticed that actually. Instead of from 100, we noticed that there is a slight decline this year. Probably they are going to be doing 90 compared to 100+ what they did last year. Probably the blast furnaces, etc., it is just a combination of their own blast furnace versus EAF and when the iron ore gets cheaper or the scrap gets cheaper. But the long-term growth, it will go back. Next year, probably you will see it going back again because it is a very clear policy that they have to switch, and if you compare China with the rest of the world, they are way behind on the portion of electric arc furnaces. It will catch up in a natural course. It has to come to where the developed world is, where the rest of the world is, which comprises 45% of the production through electric arc furnace route. But this year, we did notice a slight decline.
- Dewang Sanghavi:** They were targeting around 20% by 2020. Do you think they will be in line with their target or maybe....? They had some target sometime back.
- Manish Gulati:** No, 20% by 2020 looks way too ambitious for them. I think maybe it happens a year later or year and a half later. But getting to that 20% level on a base of 900 million tons is like 180. That looks slightly a tall order because 2020 is just a few months away.
- Dewang Sanghavi:** So, let's not give any specific number, but then the trend is that we expect them to increase EAF if not this particular year, maybe next 3-4 years down the line.
- Manish Gulati:** No, the trend will be increasing for sure. We do not have any doubt about it that there is no reversal neither in their policy nor I think the way the scrap is getting generated there. So, the path is upwards only. It is only a matter of time by what their benchmark is reached when we



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were talking about 20% and this is not what we were talking about. It is the Chinese own government who was talking about that.

Dewang Sanghavi: Regarding the scrappage policy, if it takes the full phase, do we expect any additional steel produced in India through the EAF route? Because scrappage will lead to a higher scrap generation in the country. And that will encourage the EAF production route.

Manish Gulati: This scrapping thing, if you look at the numbers, it is not something phenomenal to make some radical change, but it is, yes, a very welcome thing to happen for electric arc furnace people. That something which they have to import can be sourced locally, I believe, at a better cost also. But it is not that much that it is going to result in new electric arc furnace being put up, but, yes, the existing ones will be happy.

Moderator: As there are no further questions, I now hand the conference over to the management for their closing comments.

Manish Gulati: Thank you very much friends for sparing time for this con-call, and we look forward to speaking to you again in the next quarter. Have a good day.

Moderator: Ladies and gentlemen, on behalf of HEG Limited, that concludes today's conference. Thank you for joining us, and you may now disconnect your lines.