



“HEG Limited Q4 and FY16-17 Earnings Conference Call”

June 06, 2017



**MANAGEMENT: MR. RAVI JHUNJHUNWALA - CHAIRMAN AND
MANAGING DIRECTOR, HEG LIMITED
MR. RAJU RUSTOGI - COO AND CFO, HEG LIMITED
MR. MANISH GULATI - VICE PRESIDENT –
MARKETING, HEG LIMITED**

Moderator: Ladies and gentlemen, good day, and welcome to the HEG Limited Q4 and FY16-17 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. In case you need assistance during the conference call, please signal an operator by pressing * then 0 on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Ravi Jhunjhunwala, Chairman and Managing Director, HEG Limited. Thank you, and over to you, sir.

Ravi Jhunjhunwala: Thank you, and good afternoon, friends for joining us for HEG's quarter four and financial year 2016-17 conference call. I would start with sharing some recent positive developments in the steel industry worldwide, which has had a direct bearing on our company. In a major development recently, the Chinese government has clamped down heavily on some environmentally polluting industries in China, which includes some of the highly polluting steel and also some of the very old graphite electrode plants. This seems to have resulted in some major closures of both very old environmentally unfriendly steel plants as well as graphite plants.

On the steel front, lots of induction furnaces have been asked to shut down, resulting into starting up of many Hitherto electric arc furnaces, and seemingly some kind of shortage of steel in China has erupted. This has also resulted into a spurt in steel prices in China. The closures of induction furnaces has also increased the availability of steel scrap in addition to a reduction in the prices of steel scrap, which is obviously beneficial for electric arc furnaces, and consequently for the electrode industry. All these have not only led to an increase in demand for electrodes in China but has also led to a sharp drop in export of electrodes in China to most of the Western world countries, including India, thus opening the doors to compete like us and others in than the graphite industry. This obviously augurs well for companies like ours.

Now turning to some steel statistics. World Steel Association has reported a growth of a healthy 5.2%, in total, world crude steel production for the period January to April 2017 to a little over 550 million tonnes as compared to 524 million tonnes in the same period in 2016. This is a very large increase compared to last few years when the steel industry growth was highly muted. All the steel producing regions registered positive growth, except the CIS region. Asia and North America both grew by 5.1%; EU grew by 4.5%; Middle East, South America and Africa grew by a whopping 11.8%, 11.5% and 12.5% respectively. China, however, grew by about 4.6% only. CIS saw a minor decline of 0.3%.

And now coming to the Indian steel scenario. Crude steel production in 2016-17 was a little over 97 million tonnes, an impressive growth of 8.5% over last year. Exports were up 8.2 million tonnes, which is a 100% jump over previous year, while imports declined by 37% to about 7.5 million tonnes. India emerged as a net exporter of steel during 2016-17, and also became the second largest stainless steel producer globally after China, overtaking Japan. In a major relief to domestic steel industry, the government imposed anti-dumping duties on cold-

rolled steel products from Korea, Japan, China and Ukraine, and also on 47 hot-rolled steel products from half a dozen countries. The Government of India also announced a National Steel Policy 2017, charting out a roadmap to enhance our per capita steel consumption to 160 kilos by 2031 from a very meager 61 kilos in 2015, a growth of more than 2.5 times from current levels per capita.

On the negative side, the costs for all major raw materials for electrodes have gone up steeply for the first half of current year 2017, and we expect them to go up further in the second half. We however expect these cost increases to be more than offset by the corresponding increase in the price of electrodes over the next few quarters. The future outlook is, due to impact of developments in China as outlined above, there has been an uptrend in demand for graphite electrodes. Our order book is fairly healthy, but we have a drag of carrying over many electrode contracts at old prices, which has seen a practice of booking orders early in the year at fixed prices.

As you know, in our industry, it has been a practice that by December, January, February, we more or less book 65%, 70%, 75% of our entire 12-month order book. So this year was no exception. Today, the demand and supply of electrodes is well balanced and the consolidation of electrode industry, where Showa Denko, Japan is acquiring the second largest graphite producer, SGL Germany's entire graphite assets should help in price recovery and margin improvement. Our efforts on gaining new territories and new customers in exports have paid off in 2016 and will benefit us in the future years as well. We expect an increase in domestic as well as export sales volumes in the current year.

With these positive comments, I would now turn over to our COO, Mr. Rustogi, to take you through the operations. And after that, we will be glad to answer all your questions. Thank you.

Raju Rustogi:

Good afternoon, friends. I am Chief Operating Officer as well as Chief Financial Officer. So I will brief you on the numbers first for the quarter ending financial year '17, last quarter, and also the full year numbers.

For the quarter ended March '17, HEG recorded net operating income of 267 crores as against 246 crores in the previous quarter, an increase of about 8.5%. EBITDA including other income which stood at 31 crores in the previous quarter was maintained at similar levels in spite of increase in turnover, and this is primarily due to servicing of orders being carried at old prices. The company reported a net loss of 3.86 crores, which was more or less similar to that of the preceding quarter. Now coming to the annual numbers, HEG recorded net operating income of 896 crores as against 910 crores in the previous financial year. EBITDA including other income, which stood at 140 crores in the previous year, dropped to 88 crores in this year. Now year as a whole, the company witnessed its biggest ever loss of Rs. 50 crores as the graphite electrode market has passed through its toughest phase ever due to over-capacity coupled with subdued demand. This resulted in industry witnessing significant sale price drop during the

year. This period has also forced large graphite manufacturers to shut shops. In last 36 months, as we know, around 200,000 tonnes of capacity have been taken out of the system.

If we reflect on the year's performance as a whole for HEG, I would say on the cost front, there is a significant increase in cost of materials as a percentage to sale wherein the fall in prices of raw material could not compensate adequately for the fall in sale prices during the year 2016-17. On all other costs front, including conversion cost, fixed cost and interest, the company has been able to bring about a significant cost reduction. Net sales in power segment is higher than previous quarter due to the enhanced requirement in the graphite segment, which more or less offset the reduction cost due to seasonal closure of our hydroelectric generating facility in Tawanagar in early March 2017. With increased level of operation progressively over last three quarters, reflected by diminishing losses, we strongly believe that the lowest in the industry is over.

Total debt as on date stands at 684 crores vis-à-vis 782 crores as on 31st March 2016, and this 684 comprises of 272 crores of term debt and the rest is working capital loans. This entails a reduction of about 98 crores of total debt, and primarily on account of better management of working capital and inventories.

So, I would throw open this forum to questions being asked on the performance and outlook of the segments. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin with the question-and-answer session. We have the first question from the line of Sanjay Dam from Old Bridge Capital. Please go ahead.

Sanjay Dam: Sir, you mentioned in the call that there have been some changes in the cost of needle coke that you have contracted for the current year and prices of electrodes have bottomed out and have started going up. So by this time, both the visibility of most of the capacities at the finished goods as well as the raw material is available to you. Would it be a good assumption to make that the gross profit per tonne or gross margin that is visible to us is a sustainable level, or do you think that there could be some improvement from what we have done in December and March quarter?

Ravi Jhunjhunwala: I'm glad you didn't ask for the quantum of increase in the sales prices and the coke prices because at this moment, we are in a very tricky situation and we will not be able to answer that question even in terms of percentages, leave alone the exact figures. But yes, your assumption is absolutely correct. Given the price increase in the electrode, and we know what the cost increases on the coke and other raw materials are, it's a very safe assumption to assume that our margins in the next 12 months, in the current year, let's say, the whole of 2017-18 will be much higher than the previous years.

- Sanjay Dam:** So on the average, whatever you did for FY '17 sir, for that, so do you think that it would be significantly better than the 48%- 49% gross margin that you have done for FY17 or would it be in similar lines?
- Raju Rustogi:** See, the gross margin is a factor of sale and material cost as well as inventories. So I would say definitely, if we are at 48% for gross margin, we would be better than this number in '17-'18.
- Sanjay Dam:** Okay. And your utilization for FY17 was somewhere around probably 65%, if you were to do 80% in FY '18, I don't know if that is achievable. Do you see room for operating leverage or there is not much scope at the operating level, EBITDA level?
- Ravi Jhunjhunwala:** It will be safe to assume that we will be in that region of 75% to 80%.
- Sanjay Dam:** Sure. You have already effected a lot of cost efficiencies and savings. So would 65% and 80% make any difference, post the gross margin level?
- Ravi Jhunjhunwala:** Yes, surely, it will make a difference, but the main difference will be the differential between the prices of electrodes and the cost to margins.
- Raju Rustogi:** See, one thing to add to what Chairman has said, the basic difference in our industry is about the electrode prices and the raw material price, which is needle coke. Now that being the case, that price widening is going to define whether our margins are going to be better. Second is about the volume impact, definitely when the fixed costs are fixed, the margins are only going to be broader, if the volume increases.
- Moderator:** Thank you. We have the next question from the line of Abhisar Jain from Centrum Broking. Please go ahead.
- Abhisar Jain:** Sir, on the China related comment that there has been closure of graphite electrode capacities also leading to some reduction in graphite electrode exports from there, can you quantify some bit of this sir, if possible? That what could be the reduction?
- Ravi Jhunjhunwala:** Very difficult to get any authentic figure from China.
- Abhisar Jain:** True sir.
- Ravi Jhunjhunwala:** So it's really very difficult. I mean, I could be 100% wrong, if I give you any figures.
- Abhisar Jain:** Okay. But sir, what could be the total exports of graphite electrodes from China, say, in the last couple of years? If any idea on that?
- Ravi Jhunjhunwala:** See, between the really what we call the high grade electrode and the low grade electrode, it could be anywhere in the region of 100,000 to 150,000 tonnes.

- Abhisar Jain:** Okay, but this will be basically both varieties combined?
- Ravi Jhunjhunwala:** Yes.
- Abhisar Jain:** Okay. And the UHP will be the lower portion of this, right?
- Ravi Jhunjhunwala:** Yes, it will be much lower than the lower category, yes. But it does have an impact, even if the non-UHP is a substantial part, see, what you call non-UHP kind of electrodes are also used by the same companies, the same customers for some of their, what you call ladle furnaces. So any company, which uses, let's say, 100 tonnes of UHP, it also uses, let's say, anywhere between 20 tonnes and 30 tonnes of non-UHP. So if China's majority of export is of non-UHP, it does have an impact directly on the availability of UHP also.
- Abhisar Jain:** Right, understood. And sir, also just one more question with regards to China. Like, you know, the Indian regulatory measures had come in for protecting the Indian graphite electrode makers against the cheap Chinese imports on the electrode side into India. Have we seen similar measures in other markets also, in developed world also, sir?
- Ravi Jhunjhunwala:** Yes. I mean, in India, the duties are like \$300 to \$800 - \$900 per tonne. I think if I'm not wrong, US has imposed something like 150%, 150% of duty.
- Abhisar Jain:** Okay. And sir, any other region, which is also not allowing Chinese electrode imports?
- Ravi Jhunjhunwala:** US is of course very major. I believe Mexico has a duty. I'm not aware about Europe. I'm not sure if Europe has any duty or not. India has.
- Abhisar Jain:** Right. And sir, see, as you mentioned on the previous question that you might not be having the right idea on the percentages increase for needle coke as well as for electrode prices, but just from a directional point of view, sir, because the needle coke prices had been going down very significantly over last 4-5 years, is the quantum of increase for this year from the last year level even higher than 50%?
- Ravi Jhunjhunwala:** I would not like to specifically comment on that. As I said, we are in a very tricky situation currently when we are negotiating the contracts for, let's say, the next six to nine months. But your observation is correct that the needle coke prices had dropped to extremely low levels, given the market situation of electrode industry in the last 3-4 years. So percentages can be very misleading. So if the drop has been like 300%, 400% over the last 4-5 years then even a 40% - 50% - 60% increase means very little.
- Abhisar Jain:** Right. Sir, I understand that point completely. And basically the contracts is still not finalized for the year. That understanding is correct, right? Still getting negotiated?

- Ravi Jhunjhunwala:** No. It is not like that. Most of the needle coke suppliers this year have restricted their contracts for 6 months. So instead of a 12-month contract, which is what we normally have, this time, I believe all of us have a half yearly contract.
- Abhisar Jain:** Okay. And that contract price could be even above \$600 as such maybe?
- Ravi Jhunjhunwala:** You are asking me the same question, but my answer is exactly the same. I will not be able to comment. I'm sorry about that.
- Abhisar Jain:** No worries. And sir, on the electrode price itself, there were certain stray deals which were happening at quite substantially higher prices to the lowest price level. Lowest price level, I believe, was somewhere in the vicinity of say \$1,800 - \$1,900. Have we seen, sir, I'm not asking you, because the price might be volatile and nothing might have just got stabilized, but have we seen deals above \$2,500 sir in the recent months?
- Ravi Jhunjhunwala:** Yes. If you're asking me to confirm 2,500, yes.
- Abhisar Jain:** Right, sir. Because sir, you are not able to say provide a direction, but sir do you believe that there is some more room for the electrode prices to increase, considering how the needle coke is moving and the contract has been shrink to 6 months instead of 12 months, which effectively is giving an indication that the next 6 month contract, the suppliers feel they can get a better price right?
- Ravi Jhunjhunwala:** I think directionally, you are right. We do see prices going beyond the level that you just spoke about. Because 70,000 - 80,000 - 100,000 tonnes of exports more or less has disappeared from China. The closures of electrode capacity in China have actually created a shortage of electrodes within China. So the Chinese electrode prices have jumped up by, let's say, 50%, 60%. Obviously they have no interest in exporting anymore. **Abhisar Jain****Sir, there is a shortage in China, you just said, is it?** Ravi Jhunjhunwala Yes, because a lot of plants have closed down.
- Abhisar Jain:** Okay. And then sir in that scenario can we have a utilization, which can be higher than 80%, right? We can go to 85%, 90% also if the demand comes up?
- Ravi Jhunjhunwala:** I mean, we can obviously, but you have to appreciate that in the last 6-7 years, the kind of days that we have seen, we don't want to be over-optimistic at this stage, but of course, given the market situation, you can go up higher than 80%.
- Ravi Jhunjhunwala:** Whether it is practical to assume it today, I am not sure.
- Moderator:** Thank you. We have the next question from the line of Saket Kapoor from Kapoor & Company. Please go ahead.

- Saket Kapoor:** Sir, first is that I was coming to the point that you briefed that we have about 65% of our capacity being forward booked. So sir, for the raw material basket, how is the same then? You were telling that the raw material prices have not been fixed, the contract is due, whereas 65% of our total capacity has been sold forward. So just explain, sir, how that works?
- Ravi Jhunjunwala:** See, as far as the Indian coke is concerned, I mean, we are only talking about needle coke when we are talking about an annual contract. So that, as I said, has changed to 6 monthly this time. As far as the Indian coke is concerned, that changes every month. The Indian coke's raw material is controlled by Indian Oil, and they auction this raw material every month. So price changes every month based on the auction price.
- Ravi Jhunjunwala:** As for the needle coke, yes, as I said, this is the first time that we have seen a 6 monthly contract instead of 12 monthly contract. And obviously, we were taken by surprise, but it has nothing to do with specifically for us, but by January-February, this has been a practice for last many years. So not just HEG, but I believe most of the electrode producers had booked 60%, 65%, 70% of their order book for this year without knowing the fact that needle coke pricing will be only for 6 months. So this year, we just have to live with it because we followed the tradition, which has been going on for last many years, and certainly the needle coke purchasing pattern changed.
- Saket Kapoor:** Sir, what kind of margins can be then created just on account of not having booking our raw material, needle coke, but if you give the idea what does the total raw material basket constitute of? How much is the needle coke percentage? How much is the coke part, and then something on that?
- Ravi Jhunjunwala:** See, very roughly speaking, needle coke will be somewhere in the region of 40%, 45%.
- Saket Kapoor:** Okay. And the balance?
- Ravi Jhunjunwala:** Balance is all other costs. I mean, needle coke is only one. Power is another very major contributor in that. Then we have something called windup pitch.
- Ravi Jhunjunwala:** And there is a lot of fuel oil and gases and things like that.
- Saket Kapoor:** Okay. So this 40% will be the escalation part, that will surely going to happen for the order, which we have taken in hand?
- Ravi Jhunjunwala:** Yes.
- Saket Kapoor:** The variation will be on that only?
- Ravi Jhunjunwala:** Exactly. And also the Indian coke part, which I said, keeps going up or keeps going down depending upon the auction price of Indian Oil.

- Saket Kapoor:** Sir, what has been the trend over the last quarter, the Jan, Feb, March quarter? What has been the trend for the coke prices?
- Ravi Jhunjhunwala:** Last 3 to 6 months, the auction price has been going up every month.
- Saket Kapoor:** Okay. In percentage terms, sir? And what is the absolute price now, sir in dollar pattern?
- Ravi Jhunjhunwala:** I don't have that number, but the prices have been going up every month as I said.
- Saket Kapoor:** Okay sir. Sir, just coming to that, we can conclude in such a way that even though the prices of electrodes firming up, the full advantage of this price rise will not be reflected in the numbers considering we operate at a 65% to 70% of utilization level. If the utilization levels improve, then the bottom line could look much better since your fixed cost would be covered. Is it fair to assume this?
- Ravi Jhunjhunwala:** Not accurately, because as we said, our last year's annual plant load, I mean, our annual capacity utilization for last year was about 65%. So we are surely going to go to somewhere in the region of 75% to 80%, so which is a big jump over 65%, and secondly, in answer to one of the questions earlier, I had also said that, despite the coke prices going up, and despite the Indian coke prices going up and everything, we believe that the margin improvement is surely taking place right now. So you will see an improvement in the margins quarter-to-quarter. Of course, it will also be safe to assume that this will be more back-ended. So the margin improvement will be the highest, let's say, in the fourth quarter and then the third and then the second because whatever percentage of open position that we have in the order book is more towards the second half. So those orders will be taken at a higher price, much higher price.
- Saket Kapoor:** Sir, just a very brief understanding between these two grades of electrodes and their applications, both are for the steel Industry, that, the UHP and the HP?
- Ravi Jhunjhunwala:** Correct.
- Saket Kapoor:** And what is the price differentiation and any utility difference also in them? Why are they...?
- Ravi Jhunjhunwala:** Price differentiation is normally, let's say, in the region of 20%, 25%. Non-UHP is about 25%, 30% cheaper.
- Saket Kapoor:** Okay. That is you are telling about the HP part, high power is 20% cheaper than UHP?
- Ravi Jhunjhunwala:** Yes, exactly.
- Saket Kapoor:** Okay. But both are for the same applications, I mean, I just wanted to understand why are they clubbed like this? What is the reason, sir?

Ravi Jhunjunwala: Not exactly. The UHP is mostly used in the main electric arc furnace where you are melting steel, whereas the HP or the lower category of electrodes are used in what you call ladle furnaces, which are only used for refining. So the consumption of ladle furnace electrode is much lower than that for the UHP.

Saket Kapoor: And sir, our order booking split up between HP and UHP is how much?

Ravi Jhunjunwala: Roughly speaking, we are normally in the 60-40 kind of a range.

Saket Kapoor: You mean the UHP 60% and HP 40%?

Ravi Jhunjunwala: Yes. Around that.

Saket Kapoor: Okay. Sir, you talked about the steel policy, which the government has announced and all those stuff, but sir, what is the total percentage of EAF route through which steel is produced in the country? And the additional capacity that the government is planning to build up, what percentage are you seeing will come through the EAF route, sir?

Ravi Jhunjunwala: I will pass on this question to Manish, our Marketing Head.

Manish Gulati: Yes. I will take this question. The total steel production for India is 97 million tonnes, and out of that approximately 30 million tonnes is made from electric arc furnaces. And the steel policy, which they have announced does not necessarily mean that all capacities would come up through the electric arc furnace route because they may as well come through the blast furnace route, the policy which says that by 2030, the country would be producing 300 million tonnes of steel.

Moderator: Thank you. We have the next question from the line of Dewang Sanghavi from ICICI Securities. Please go ahead.

Dewang Sanghavi: My question is regarding the recent rise we see in needle coke prices. So do we expect some more capacity to be shut down in the high cost European belt?

Ravi Jhunjunwala: You mean on the electrode side or what?

Dewang Sanghavi: Yes. On the electrode side, because we are seeing cost pressures still building up. So do we expect some more capacities to be shut down or just...?

Ravi Jhunjunwala: I don't personally see that because if you look at the last 2 to 3 years, almost 200,000 tonnes or 6 to 7 plants have closed down. And given the current consolidation, which is likely to happen between a Japanese and a German company, the supply-demand balance is more or less now come to an equilibrium. Very roughly speaking, my guess is that all the 20, 22 plants between, let's say 6-7 companies, there would be about 18 to 22 plants around the world minus China. So all the electrode plants will have to run at 80% - 85% to meet the current demand of

electrodes. And it's safe to assume that anything, when the world operation is at 80%-85%, it's a fairly high number, I mean, to assume that all the 20 plants in the world will always operate at 80%-85% is probably very optimistic. So now, after all these closures, probably we have reached an equilibrium between demand and supply.

Dewang Sanghavi: Okay sir. And secondly, you also mentioned that we have some old price contracts. So what could be the quantum for the same and when would that be executed?

Ravi Jhunjhunwala: As I said, this has been the trend in the electrode industry forever that sometimes by November, December, January, every electrode producer books anywhere between 60% - 75% - 80% of the order book. But most of the very large consumers of electrodes, especially in US, Middle East and even in Europe, they buy against an annual tender. And it is more or less frozen by January - February. It starts in September - October, it gets done by January, February.

Ravi Jhunjhunwala: So until that time, this development that we just spoke about in China had not probably taken place. So nobody in the graphite industry had any inkling about what was happening. So in that background, my guess is everybody would have booked anywhere between 50% to 75% of, let's say, the whole of the next 12 months' requirements.

Dewang Sanghavi: With these Chinese capacities going out of market, have we seen some movement in needle coke prices on the upside? With this 1 lakh tonne Chinese capacity moving out of the market.

Ravi Jhunjhunwala: No, I didn't say 1 lakh tonnes. I had said it could be anywhere in that region of 50,000 to 100,000 tonnes. So China has too many very, very small plants also. I mean, their plants, which were as small as 5,000 - 6,000 - 7,000 tonnes also. So it could be anywhere in the region of 40,000 - 50,000 tonnes to 100,000 or maybe 100,000 plus.

Dewang Sanghavi: Okay. So what I was asking that have we seen some uptick in the prices in the spot prices, on the spot graphite electrode market?

Ravi Jhunjhunwala: Yes. Surely. I mean, I said that today in China, there is a huge shortage of electrodes. And Chinese prices have absolutely gone out of the roof, and that is the major factor, which is affecting everybody else. But all said and done, whether UHP or non-UHP, China was exporting about 100,000 tonnes or maybe a little more than 100,000 tonnes. So that is gradually more or less coming down to nothing now.

Dewang Sanghavi: Correct. And our 75% to 80% guidance is slightly on a conservative side. We expect globally plants to be operating at 85%, and we are at the kind of level that we have some low-cost in terms of, we are the one of the lowest cost producers. So maybe 85% to 90% would be a fair assumption, if the demand picks up?

Ravi Jhunjhunwala: No, of course, we are being conservative. I mean, but as I said, having seen very bad days in the last 5-6-7 years, we don't want to be sounding very optimistic. So give us some more time.

- Dewang Sanghavi:** Right. Sure, sir. Secondly on the export market, we had 60% volumes going to export this particular FY17. So do we expect a similar trend in FY18?
- Ravi Jhunjhunwala:** Yes, more or less. I mean, that number more or less remains same every year, every time.
- Dewang Sanghavi:** And EBITDA, do we book something like an hedging cost in other expenses? Is that the case? And if that's the case, what is the amount?
- Raju Rustogi:** See, this year 2016-17, most of our borrowing is in rupees. So we have not incurred anything called a hedging cost except forward selling of US dollars for our export realization. And there also, we have booked zero cost, zero income. So we are balanced in terms of any loss or gain on account of foreign currency this year.
- Dewang Sanghavi:** Okay, sir. Thank you, sir. And secondly, the debt repayment schedule we have for FY18, we have repaid 98 crores somewhere in FY17.
- Raju Rustogi:** See, FY18, our commitment is 150 crores of repayment for FY18.
- Moderator:** Thank you. We have the next question from the line of Harsh Vardhan K from Nayan M Vala Securities. Please go ahead.
- Harsh Vardhan:** Most of my queries are already answered, but I have just few more. Sir, you gave a guidance of nearly 75% to 80% for the H1 of this year right, capacity utilization?
- Ravi Jhunjhunwala:** For the whole year. We are gradually ramping up.
- Harsh Vardhan:** So if you look at the order book, what percentage of that is from like previous order, as in like before the prices were going up?
- Ravi Jhunjhunwala:** As I said, we have booked to the extent of in the region of 60%-70% at earlier prices. And that's how I responded in answer to another question that, so this will be back-ended. I mean, obviously, we are more or less 100% booked for the first half. So whatever is left is more or less in the third and the fourth quarter.
- Harsh Vardhan:** Okay. So the numbers will start to get better post the second quarter as in like the...
- Ravi Jhunjhunwala:** Yes. Second half, let's say.
- Harsh Vardhan:** Okay sir. And sir, what are your export percentage for this year at?
- Ravi Jhunjhunwala:** As I said, it's always in the region of 60% to 70%.
- Harsh Vardhan:** Okay. This year is also 60% to 70%?
- Ravi Jhunjhunwala:** Yes, it won't be different than that.

Harsh Vardhan: Okay. Do you see any domestic demand increasing as such because now with Chinese steel and all being, or say duties being imposed?

Ravi Jhunjhunwala: Yes, there is a major uptick, because about 2 – 2.5 years ago, Government of India has imposed an anti-dumping duty on Chinese electrodes in India. So since then, we surely we have been selling more in India. And with this recent event that we spoke about in China, so whatever little import was happening, that is also likely to not happen anymore.

Harsh Vardhan: Okay. Alright. And sir, can you say to which region do we export the most to, like percentage terms if it's possible?

Ravi Jhunjhunwala: Basically, we export everywhere. We export a lot to North America, Europe, **Far East**, Middle East. It's more or less in equal proportion. It's not very heavily skewed in favor of any one region.

Harsh Vardhan: Okay. Why I asked is like US and allied North American countries seem to have a duty on Chinese and even Japanese imports, but Middle East doesn't have, right?

Ravi Jhunjhunwala: No, there is no duty even in US.

Harsh Vardhan: But they have on Chinese steel, right? They have put an import...

Ravi Jhunjhunwala: Yes. That is an anti-dumping duty. I mean, obviously, China has been exporting at ridiculous prices. Our prices are no different than the Japanese or American prices.

Moderator: Thank you. We have the next question from the line of Kunal Mehta from Vallum Capital. Please go ahead.

Kunal Mehta: Sir, so I just wanted to understand, post this China event, the outlook on scrap prices worldwide, if you can just guide us through.

Ravi Jhunjhunwala: What was the question?

Kunal Mehta: I wanted to understand, post the China event, which has happened, I wanted to understand the scenario with respect to scrap prices.

Ravi Jhunjhunwala: See, the major closures because of pollution in China has happened on the induction furnace, which are extremely highly polluting. And induction furnace uses a lot of scrap. So those closures have made a lot of scrap available and only other alternate best use for this scrap is in the electric arc furnace. Because of that, availability of scrap has become much larger, and obviously with that, the scrap prices have dropped. And as we have been talking for the last many years, Chinese collection of scrap has been gradually increasing. So China is making more and more scrap available also for reuse, which was not happening, let's say, 5 years ago. And typically most of the steel plants have a blast furnace as well as electric arc furnace. So

whenever they have to choose between what to use which route to use 100%, and which route to use, let's say 75%, 80%, the only trigger for that is the price of scrap for electric arc furnace versus the price of iron ore and coal for blast furnace. For last many years, this has always been in the favor of iron ore and coal because the scrap prices were higher than that. The last one year or so, that gap started shrinking, and in the last 3-4-6 months, it has gone in favor of scrap. So what I am trying to explain is that, because of this scrap prices coming down and scrap availability coming up, blast furnaces are probably also getting idled whereas electric arc furnaces are more used.

Kunal Mehta: Right. Sir, another thing I wanted to understand was that recently Brookfield had its conference call, whereby, it had given a fairly optimistic outlook on graphite electrode prices. So just wanted to understand whether excluding China, the overall scenario, especially in North America and Middle East with respect to electrode prices is improving as is directed by Brookfield and what was the reasons for better steel production in those areas?

Ravi Jhunjhunwala: See, Brookfield conference call and Brookfield has also sent out a circular, an indicative circular to all its customers about what do they expect in terms of electrode pricing next year. If this is what you're referring to, of course, it's a public knowledge, and I believe the circular talks about \$4,000 and things like that. And as you said, in their conference call, they have given a very optimistic scenario. So are we doing that? I mean, we are also saying the same thing that things are changing, there is a lot of demand for electrodes, the prices are going up, the capacity utilization is increasing. So it is more or less in the similar vein that we are also speaking about.

Moderator: Thank you. We have the next question from the line of Raj Gandhi from Sundaram Mutual Fund. Please go ahead.

Raj Gandhi: Sir this year when you mentioned that you booked about 60%, 70% for next year volumes, is it on that higher utilization, 60% - 70% or 60% - 70% of this year production has been booked?

Ravi Jhunjhunwala: I mean, you can take it either way. It really doesn't make too much of a difference. I mean, safely speaking, yes, it will be about two-third of the higher capacity.

Raj Gandhi: Okay. And sir, just possible to give average realization and average needle coke cost for '17, back to the year gone by, the full year average?

Ravi Jhunjhunwala: No, I'm sorry. It's a highly competitive market, and because of that competition, we are just not prepared for that number.

Raj Gandhi: Okay. And sir, just when you're guiding on margin improvement, will it also improve at the gross margin level Y-o-Y or only at the EBITDA level because of the operating leverage coming in?

- Raju Rustogi:** See, this is again based on the earlier clarification that we are seeing price movement upwards. And the H2 of '17-'18, since it is open for us, we believe that the price realization would be better than the current trend that we are noticing, and that is the basis of saying that the gross margin overall for the year as a whole would be better than '16-'17.
- Raj Gandhi:** Okay. And for the first half that you have mentioned you are locked in, will it be at least equal to FY '17 or there are chances that intermittent it might dip below the FY17 levels?
- Raju Rustogi:** See, I would not like to comment at this point of time in terms of the first half. As the input prices, the bigger element is of course the raw material, which is needle coke, but then you have other consumables, which are also part of production process. And there we are seeing a big increase or volatility in the purchase prices.
- Raju Rustogi:** So all in all, I would say it all is dependent on how much the realization improves for the year as a whole.
- Raj Gandhi:** Got it. But for the first half, given that you are close to completing the negotiation there and product realization of extent, some bit on the other raw materials and all, assuming the prices stay where they are today, so in H1, will you be able to maintain the FY17 average margins or intermittent...?
- Raju Rustogi:** I think you can safely say so. We definitely hope that it will be equal to '16-'17.
- Moderator:** Thank you. We have the next question from the line of Suyash Kapoor from Kapoor & Company. Please go ahead.
- Suyash Kapoor:** My question is regarding the financial year statement. I want to ask the power costs, sir. Year-on-year, power costs have increased. Sir, what is the key reason for an increase from 47.69 crores to 71.98 crores because the turnover has not increased, rather it has decreased. So if you can please give your views.
- Ravi Jhunjhunwala:** See, what comes in the P&L, if you are a chartered accountant, you would understand that whatever is consumed in the year for manufacturing goes into P&L debit side. And then some of that cost is getting added to inventories as well. So since you are not seeing the inventory part of the power, that you are seeing it as being higher. The second part is, since our volume in terms of quantity is 20% higher than '15-'16, the cost of making that 20% is always going to be added to my cost. And third is, in terms of coal, which we use for power generation, that is you can safely assume that there is 5% to 7% cost increase in the purchasing cost of coal that we buy for power generation.
- Suyash Kapoor:** Okay. Sir, in the past, there were announcement that, it is a bit of a 5 or 6 years before that Bhilwara Power IPO would hit the market. That was also being displayed by our Chairman, while he used to give his interview on CNBC, that this will come in power IPO, our

hydropower business either will be hived off. Any views on it, sir? What are we looking on that front, if any?

Ravi Jhunhunwala: See, what is happening in the power industry is, you are fully aware about that. So it's a totally impractical question today to think about an IPO of a power company. I can only say that that luckily because all our investments are in hydro sector.

Suyash Kapoor: Yes sir.

Ravi Jhunhunwala: I mean, we are still afloat and we are still doing reasonably well compared to most of the other ways of making power like thermal, because our revenue is more or less stable, our generation is very stable, and our costs are coming down year-after-year, because in hydro, as you know, a huge chunk, maybe 75%, 80% of the cost is nothing but interest.

Ravi Jhunhunwala: And interest cost keeps coming down as we keep repaying our debt for that year.

Suyash Kapoor: Yes. That's true.

Ravi Jhunhunwala: The company is doing fairly okay, but whatever is happening in the power sector, I mean, there is absolutely no demand, there is absolutely no growth. If you are tracking the exchange price, you will know whatever is happening.

Suyash Kapoor: Yes, I did track it. Yes, the price has come down. That's true.

Ravi Jhunhunwala: But even at these exchange prices, in the hydro sector, we are doing fairly okay because all these companies are now very well established. One of the company is more or less debt free, the Malana Company, this 100 megawatt plant which started about 15, 16 years ago. The second plant is also about 6-7-8 years old now. So a lot of debt has been repaid. So as the debt keeps coming down, our profitability keeps increasing, even if the tariff doesn't increase.

Suyash Kapoor: Yes. Your cost gets reduced.

Ravi Jhunhunwala: The bottom line keeps increasing to the extent that we are reducing our interest.

Suyash Kapoor: Sir, in the way, if you can be kind enough to give a presentation, while explaining whatever you have explained, if you can mention it categorically, it will give a lot of confidence to investors. Like it is very difficult to sum up the numbers and to understand. Now you have been very kind enough to explain in a lucid manner that what are the chief areas of power, where you are producing power, and what is the component of debt involvement and you are repaying the debt. This is my request, if you can put an investor presentation explaining this point?

Ravi Jhunhunwala: So if you want to understand more about power, we will welcome you. I mean, if you want to have a one-to-one discussion, we can meet in Delhi or Bombay wherever.

- Suyash Kapoor:** Sir, very kind of you.
- Ravi Jhunjhunwala:** And explain to you and give you whatever papers, whatever data you want.
- Suyash Kapoor:** Yes. Okay. But if you can give it on as an investor presentation on the website itself, it will be very helpful, because I'm from Kolkata. It will be difficult to come. So this was a request, sir. That will give a more idea of what the company is doing, because for the past few years, this company, **is having** huge potential, but it is not coming to its full potential. So that was my request. If you can kindly put up categorically, if you can explain each and every point, it will give a lot of confidence to the investors, sir.
- Ravi Jhunjhunwala:** What we will do is we will send you a presentation on one-to-one.
- Suyash Kapoor:** Sir, what are we working on reducing our cost? Like, what I want to ask you is that, I was listening the commentary of management, and it is full of confidence. So my question was that, what is the management thinking as far as reducing its cost is concerned, because you have rightly said that now the prices are looking up, so volume will grow. So as far as cost front is to be taken into account, what is the company thinking in that account? How to reduce the cost? Are we having further avenue where we can reduce our costs, sir?
- Raju Rustogi:** Friend, if you have seen our annual results for '16-'17 vis-à-vis '15-'16, you would notice that the company has done significantly well in terms of minimizing or reducing its fixed cost. Now, with that being the case, further costs are variable costs, where also, if you see in terms of percentages to sale except material, the other variable costs are also lower as a percentage. Now what I am saying here is, if the fixed cost is lower than previous year, which is '15-'16 and the volume is growing, you can always expect that the bottom line is going to be healthier than '16-'17 for next year. So on the cost front, things are well in control. All the controllable costs are very tightly monitored, and whatever we had done in terms of reducing our cost in '16-'17 are going to sustain in '17-'18 and going forward as well.
- Suyash Kapoor:** Sir, and if you can kindly do a SWOT analysis, that will be very nice of you. That our company, if you can in nutshell give a SWOT analysis.
- Raju Rustogi:** See, SWOT analysis is always part of my balance sheet. So just wait for another couple of months, when my printed balance sheet would be available, and you can definitely get a chance to read it. It will be uploaded **on our website**
- Suyash Kapoor:** The numbers are out, sir. If you can give in five or ten lines, that will be very nice of you. That will give a confidence on sir, because your price as far as stock price is concerned, it is fluctuating to a great extent. So it's very difficult to analyze your company.
- Raju Rustogi:** No. See, please understand. The market itself is volatile. The input side, supply and demand is also volatile. The customer side, supply and demand is volatile. So now, under the circumstance, any company, whether if we give you a SWOT analysis, how does that give you

a comfort as the whole community of analyst to believe that the industry is stable and we are going to do better? So it's a matter of you keep interacting with us. We are available every quarter. We are available even on telephone. Keep interacting with us. It has to be experienced to believe that what we say is always true and we do not lout.

Suyash Kapoor: Sir, lastly, it's very nice of you. It's a very candid conversation, which we are having. Sir, is it to be assumed that, just an example, I want to convey my thoughts, what has happened in the automobile industry, like earlier, the cars used to be run on petrol, diesel and now the changes being going on into electric car, or the vehicles being run on solar. Similarly, can we assume that the steel sector is also now being changing itself for the better, for the better part of the contributing to the environment that the companies are moving from blast furnace to electric arc furnace, because it is less polluting? Is it fair to assume? Hello?

Ravi Jhunjhunwala: Yes. It is very safe to assume. I mean, this is what we have been talking about for a number of years that electric arc furnace share out of the total steel has to grow because of environment friendly, because of more and more scrap being available. You are absolutely right in that assumption.

Suyash Kapoor: Sir, just one humble commission. Since you are very close to industry, you are the leader, you are the pioneers. Apart from Graphite India, there are hardly any players. You are one of the players and Graphite India is the only player. And such a proactive government is in the center, is it feasible to assume that, if a recommendation is given to the government, since it is focusing on environment, to encourage companies like you, so that electric arc furnace, which is such a contributor to the environment as well as to the steel sector, is it fair to assume that Government of India will give more confidence or will size companies like you to prosper, so that environment as well as the industries develop on a sound footing?

Ravi Jhunjhunwala: See, it is happening automatically. You see until very recently, power was a very critical problem for electric arc furnace. The availability of power and the cost of power, it was **(59:33) particularly_ in our country** that there was no growth in the electric arc furnace. It was not making trend. The situation in the last 2-3-4 years has changed. I mean, there is so much of power that there are no takers.

Suyash Kapoor: That's true.

Ravi Jhunjhunwala: Lots of power is now virtually Rs. 2.50, Rs. 3. You can buy from exchange at Rs. 2.50, Rs. 3. So automatically these things are evolving. Like in America, more than 60% of the total steel of electric arc furnace.

Suyash Kapoor: Okay. And what is about India? India's situation?

Ravi Jhunjhunwala: It is less than 30%.

Suyash Kapoor: So there is a huge scope, almost double.

- Ravi Jhunjhunwala:** Yes. And Western Europe is more than 43% - 44%.
- Suyash Kapoor:** But sir, what are the key reasons there, that forced the government to take a such a step that the 60% was allowed to electric furnace? That encouraged, rather. I would not use the word forced, that encouraged them to go for electric arc furnace. And whereas in India, we are still focusing on blast furnace. Whether you look on to the expansion done by SAIL or TATA Steel, they are still preferring blast furnace. Why sir, why is it despite the scenario that's been?
- Ravi Jhunjhunwala:** You see, in America, it is very clear. I mean, for electric arc furnace, what do you need? You need basically a lot of scrap and lot of power. There is nothing more that you need to produce through electric arc furnace.
- Suyash Kapoor:** That's true. You are using scrap and you are using power. These are two chief raw materials.
- Ravi Jhunjhunwala:** Correct. So America, America being such a rich economy. There is huge amount of scrap, which gets generated every year. We don't have that kind of scrap. If we keep our car for 10 years - 12 years - 14 years, where is the scrap going to come from?
- Suyash Kapoor:** That's true. That's absolutely true.
- Ravi Jhunjhunwala:** Until 2-3 years ago, there was no power, and if the power is available, it was available at such a prohibitive cost. But gradually things are changing. Now the power is available, now scrap prices have dropped, environment has come into focus, which it was not until 5 years ago, which is happening automatically. That's the reason why America is more than 60% on electric arc furnace, why Europe is more than 45%. India is also moving in that direction. It is already close to 30%. Maybe in 15 - 20 years, it will catch up with US and Europe.
- Suyash Kapoor:** Okay. And maybe just final question, I would just like to conclude. I will not take much of your time. Sir, your company has presence in two states. If I am wrong, please correct me, that is in Madhya Pradesh and Rajasthan. So your other companies also, I am referring to the entire Bhilwara Group. Sir, these two states, this government are prospering to a very good extent. So you have mentioned about power, in today's contest, the power cost is at a lower level. Do you think that this position will prevail for the time to come? Because this is one of our chief raw materials. That's why I have asked this question. Do you think for 4 or 5 years coming down the line, do you think the same position will prevail that the power cost will be at this level? And to add to it, one of the reason is that, the power addition, which the government, which two states I mentioned, sir, Madhya Pradesh and Rajasthan is doing in the renewable sector, you are there in these two states. So please correct me that on ground, are this development going on that there has been serious investment in this renewable sector and the fruits will come?
- Ravi Jhunjhunwala:** See, as far as we are concerned, in Rajasthan and in Madhya Pradesh, we are practically generating our own power.

- Suyash Kapoor:** I agree.
- Ravi Jhunjhunwala:** And we will not be viable at all if we were going to buy the power from the grid because the grid prices are like Rs. 7 - Rs. 8.
- Suyash Kapoor:** Now the price has come down, sir. The exchange price is Rs. 4.
- Ravi Jhunjhunwala:** No, but the price, when you buy from the grid is not down. When you buy from the grid, it is still Rs. 7 - Rs. 8. Power prices are under check because at both the locations, we have more or less 100% captive. We are generating more or less 100% of our own requirement of power.
- Moderator:** Thank you. We had a follow-up question from the line of Sanjay Dam from Old Bridge Capital. Please go ahead.
- Sanjay Dam:** Sir, other operating income for the current quarter was about 10 crores, significantly higher than any earlier quarter and also Y-o-Y. Any particular reason, could you please explain, also some guidance on it?
- Raju Rustogi:** Yes. See, other operating income, we have started including the export incentives in this category with effect from 1st April '16 primarily due to Ind-AS. So we have adopted Ind-AS accounting standard effective 1st April '16, and that is a number, which you are seeing is a number higher. Earlier it used to be clubbed with raw material consumption.
- Sanjay Dam:** Okay. So it used to be reduced from raw material consumption, right?
- Raju Rustogi:** It used to be. So this year, there is a corresponding number for last year also, which has changed. That is one reason. And second is, this year's export in terms of volume is also higher vis-à-vis last year.
- Moderator:** Thank you. We had a follow-up question from the line of Raj Gandhi from Sundaram Mutual Fund. Please go ahead.
- Raj Gandhi:** On the end product side wherein the needle coke, the graphite electrode manufacturers are, everybody has locked in about 65%-70% of the volume in fixed price contracts. From what we hear, the industry is trying to renegotiate the fixed price contracts given the extent of rise in needle coke. So any comment on this, sir?
- Ravi Jhunjhunwala:** What do you mean industry is trying to negotiate the price of what?
- Raj Gandhi:** Of the electrodes given the rise in needle coke prices. Even in the fixed price contract, let's say that you have had, are you trying to go and renegotiate with the customers given the extent of increase in needle coke prices?
- Ravi Jhunjhunwala:** I will pass on this to Manish, Our marketing man.

Manish Gulati: Yes. You see this, all this steel industry, they negotiate, they negotiate on a annual contract basis, and this is not foreseen, this is not the practice in the industry. I mean, nobody does that. So we are not doing it. We can't do it, because ultimately, when we won over that business, we were part of four, five suppliers who were trying to bid for that business. So at that point, when that business was allocated, there were certain prices at which it was awarded to four, five companies, and one or two companies just can't go and ask for any price increase. This is not the practice.

Raj Gandhi: Okay, okay. Because when the electrode pricing were on the way down, did you face any markdowns by the customers when all contracts were honored on the way down?

Manish Gulati: Yes. It was always at the advantage of the buyer. So some of them did request us because there was a drastic drop in prices, some of them. I would say, let's say, maybe 15%, 20% of the customers asked us to reconsider, and whenever we could, we reconsidered. Otherwise, contracts are usually honored both ways because during the course of the year, prices do go up, up or down and costs also go up and down, normally start to renegotiate it.

Raj Gandhi: Okay. So at least for the customers, where they had requested and got the markdown benefit, at least those customers can accommodate us this time around or...?

Manish Gulati: I mean, we can try, but we're not sure about it, really. As I said, it always goes to the advantage of the buyer.

Raj Gandhi: Okay. And sir, just on the power side, possible to just throw some light on the kind of power capacity? Anything coming up? What are the kind of PPAs that we have on that front? And so in terms of visibility of PLF and revenue there, if you could just throw some light on that?

Ravi Jhunjhunwala: Which power plant you are talking about?

Raj Gandhi: The hydro power plants that we have.

Ravi Jhunjhunwala: No in hydro power, we don't have a PPA. We have a very short-term, one month, two month, three month kind of PPA. And rest, we sell on the exchange.

Raj Gandhi: Okay, okay. So sir, just previous year as a whole portfolio, what is the kind of capacity that we have and what was the PLF that we enjoyed over last 2-3 years, if you could just give the trend?

Ravi Jhunjhunwala: See, in hydro, any project is considered to be a viable good project with a plant load factor of anywhere like 45%, 50%, and that is where we are.

Raj Gandhi: Okay. And what is the total capacity that you would have on the hydro side?

Ravi Jhunjhunwala: In this Bhilwara Energy, it is close to 300 megawatt.

Raj Gandhi: Okay. And what is the debt, sir? Total net debt now under that Bhilwara Energy?

Ravi Jhunjunwala: I won't have the number in my mind right away.

Moderator: Thank you. Ladies and gentlemen, as there are no further questions from the participants, I would now like to hand the conference over to Mr. Ravi Jhunjunwala for closing comments. Thank you, and over to you, sir.

Ravi Jhunjunwala: Thank you. Thank you friends for taking so much of interest with so many questions and queries. And after a very long time, we are speaking in a positive tone, and I expect to come back to you in three months with some better news. Thank you very much.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of HEG Limited, that concludes this conference. Thank you for joining us. And you may now disconnect your lines.