



“HEG Limited Q1 FY-16 Earnings Conference Call”

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Moderator: Ladies and gentlemen good day and welcome to the HEG Limited Q1 FY16 Earnings Conference Call. As a reminder all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should 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 would now like to hand the conference over to Mr. Ravi Jhunjhunwala, Chairman & Managing Director, HEG Limited. Thank you and over to you, sir.

Ravi Jhunjhunwala: Thank you and good afternoon to all of you and thank you for joining us for HEG's quarter 1 2016 conference call. First I would like to share some details about the global steel industry and its resultant impact on graphite electrode industry.

According to the World Steel Association, world crude steel production declined by 2% to 813 million tons in the first half of 2015 versus 830 million tons in the equivalent period last year. US saw the largest drop by about 8.6% while CIS countries dropped by 6.9% and Asia, without China declined by 2.1% and China probably for the first time has declined by about 1.3%. Whereas the steel production in South America was stagnant while EU grew by a paltry 0.5%.

The only region which registered a moderate growth was the Middle East at about 2.9%. And if we look at the world steel production excluding China the production was about 403 million tons in the first half which is 2.9% lower than the equivalent of last year.

All these has obviously impacted the graphite electrode industry as well. The electric arc furnace segment of steel which is our major consumer base had a more severe impact due to a negative correlation between the prices of iron ore and coke, the two main raw materials to blast furnace industry as compared to steel scrap, the main raw material to the electric arc furnace steel industry. As you are all aware iron ore and scrap prices have seen a drastic decline in the recent times and they are more or less at their lowest ever.

World electric arc furnace steel production declined by 4.6% in the first half versus first half of 2014. There have been a significant decline in some of the major electric arc furnace steel producing countries in the first half of 2015. The drop in US which produces almost two-thirds of its total steel through the electric arc furnace was about 9% while Korea dropped by about 18%; Brazil by 16%; Turkey by 12%; Japan 6% and Germany 5%.

Friends, graphite electrode industry is passing through a challenging environment due to negative growth of steel industry and the steel pricing has worsened recently due to China aggressively exporting about 100 million tons which is about 15% of their total production to all parts of the world forcing the steel prices to drop everywhere and resulting in consequent decline in steel production in the rest of the world.

According to the best estimates the world steel industry is plagued by an overcapacity which is said to be anywhere between 400 million and 600 million tons with very large part being in China. However, in the backdrop of all these negatives there are also some positive signs over the previous quarter which I would like to place before you.

Number one – since middle of July, post reaching of an agreement between Iran and US we are seeing a continuous drop in the crude oil prices from the then stabilized levels of about \$60 per barrel which is expected to have a positive impact on fuel prices and to some extent our inputs like needle coke.

Secondly, as you are aware we have tied up all our current year's needle coke purchases at significantly reduced prices compared to last year but given a fairly long production cycle of our products, till now we have been consuming all old high-priced needle coke which is likely to be exhausted by end of this month and from September onwards we will start consuming low-priced needle coke purchased at current prices.

Thirdly, a significant improvement in the availability of linkage coal in the country would not only reduce our dependence on market coal but also reduce our cost of power generation.

Fourthly, most importantly our operating parameters are consistently improving and so are our quality parameters of the finished products which are working extremely well at most of our customers.

Now coming to our operations:

We achieved a capacity utilization of around 60% in this quarter. We are continuously working on building our order book position which is slower than the previous year more prominently in the export market. Antidumping duty on import of Chinese electrodes into India effective February 2015 has now started showing signs of a sharp drop in the Chinese imports in the last few months. This has resulted in shoring up our domestic sales and we expect to see a significant increase in the next couple of quarters.

The company has already repaid about Rs. 50 crores against our long term loans, out of a total of Rs. 89 crores which is due this year.

Our short term credit rating of commercial papers has been upgraded to A1+ which will help us in cost leveraging our working capital finances going forward as we float more and more commercial papers. As I explained, lower volumes and high cost inventories of needle coke has largely impacted our margins during this quarter. We will exhaust all these inventories this quarter and start using much lower priced needle coke now onwards which along with higher sales volumes more or less because of the drop in the Chinese imports in India as explained above, should have positive impacts on our results going forward.

Outlook for the rest of 2015:

As you know the IMF has revised the global growth downwards by about 0.2% to 3.3% in its July edition. Advanced economies led by US and Canada are expected to perform weaker at 2.1% down from the last estimates of 2.4%. EU growth is expected to remain unchanged at 1.5% for the entire 2015. There is also a continued growth slowdown in emerging economies. The pricing of electrodes remain under pressure both for electrodes as well as needle coke.

While we continue to face considerable industry challenges, we have made significant progress in quality of our products, freed cash from working capital elements and there is a continued focus on management of variable and fixed costs.

Given the positives that I narrated earlier - antidumping duties on Chinese electrodes, a weakening rupee making imports of electrodes more expensive, reduced needle coke and other domestic input prices and better plant operating parameters should help us in sailing through these challenging times. However, the price of electrodes still remains a concern and we would have to wait and see how it pans out over the next couple of quarters.

With these comments, I would now turnover to our CFO, Mr. Rustogi. Thank you.

Raju Rustogi:

The quarter ended June 2015 actually recorded net operating income of Rs. 249 crores as against Rs. 290 crores in the immediately preceding quarter. The EBITDA, including other income and excluding exceptional items, witnessed a decrease from Rs. 43 crores in Q4 FY15 to now of Rs. 25 crores. EBITDA margins also reduced to around 10% as compared to 15% in this preceding quarter. PAT also declined from the level of a profit of Rs. 4 crores in Q4 of FY15 to now a loss of Rs.10 crores.

Say low EBITDA vis-à-vis last quarter is a factor of both weak demand and electrode prices. Besides, we are also impacted in the quarter by carrying value of high cost inventories due to our long manufacturing cycles. Material under the new contract for imported needle coke are now getting consumed, the prices of which were negotiated substantially lower than that of previous year.

Net sales in the power segment were lower than previous quarter, as our hydro facility did not operate during this quarter. Margins on the other hand improved in power segment with the improved availability of linkage coal in this period of first quarter and the availability of linkage coal is expected to remain good in the rest of 2015-16.

With the improved short term rating of commercial papers, the company has been able to achieve significant reduction in its borrowing cost and this trend of reduction is sustainable, looking at the continuous reduction in our debt position and repayment of high cost rupee debt during 2015-16. Volumes are expected to move up in the coming quarters, which along with factors listed above, would help us in reversing this instance of loss and becoming profitable, going forward.

The company's strong balance sheet with low long term debt equity ratio being low and stable cash flows, it has put us in to a comfortable position in seeing through this challenging times.

With this I would request questions to be answered from our side. Thank you so much.

- Dewang Sanghvi:** Just wanted to have a color regarding the realizations. There has been a steep fall witnessed in realization so do we expect that now this would be a bottom and we can see some upside on there is a large number of pressure coming from the global players?
- Manish Gulati:** Yes, there is pressure from global players because everybody is trying to shore up their capacity utilizations. Yes, compared to last year there is almost a 10% reduction in pricing.
- Dewang Sanghvi:** And regarding needle coke this would be last month of high cost inventory and we will be using the lower cost inventory from the next month, right sir?
- Manish Gulati:** Yes, that is right.
- Dewang Sanghvi:** What will be the differential in percentage terms?
- Manish Gulati:** In percentage terms if you compare to the last year to this year let us say around 38% to 40%.
- Dewang Sanghvi:** And current challenging scenario are we expecting what kind of utilization will be targeting for the current year?
- Manish Gulati:** For the current year it should be close to 70% to 75%.
- Dewang Sanghvi:** And what will be our debt repayment schedule?
- Raju Rustogi:** See debt repayment is we have entire commitment of Rs. 89 crores during 2015-16 out of which as we stand today we have repaid Rs. 50 crores out of this Rs. 89 crores. And the majority of the remaining will be paid in the last quarter of 2015-16.
- Jigar Bhagat:** The question was regarding could give us the breakup of volume and price mix for the quarter I mean how did the volume fair and what was the pressure on the pricing?
- Raju Rustogi:** Volume was very much quite the same. And if you say 60% was the capacity utilization vis-à-vis 70% in the previous quarter. So this is the drop we have seen in this quarter in terms of volume.
- Jigar Bhagat:** And regarding the duty hike on Chinese imports so this was the first full quarter for which it was applicable so comparing it with June 2014 so did we see any quantum of new orders replacing the Chinese orders?
- Ravi Jhunjhunwala:** Yes, you see the Chinese imports to the best of our knowledge last year were like somewhere in the region of 12,000 tons to 14,000 tons and the duty was imposed in the middle of February

so obviously there were some imports in the pipeline which came in the first quarter and we believe that all that pipeline products have more or less already arrived. So going forward we do not see much of Chinese imports happening. So that is the reason that we are projecting a substantial jump in our domestic sales in the next 9 months and that is how we are saying that our last quarter capacity utilization was something in the region of 60% and we do expect this capacity utilization for the whole year to be close to 70%.

- Jigar Bhagat:** Okay so in Q1 we did no gain any major?
- Manish Gulati:** We did see a spurt in sales in domestic to the extent of if we compare to the quarter of last year same quarter it was close to 50%. That was the jump in sales in domestic market we saw.
- Pritesh Ajani:** I am little new to your company if you can just tell me how are our spreads that is finished products and the main raw material needle coke what was it during the quarter if you can state that on a per ton basis? And with the expectations from September onwards that the high cost inventory will go out what could be the spread post that?
- Raju Rustogi:** You said spread should I take the EBITDA as the margin or you are referring to something else in terms of a definition perse?
- Pritesh Ajani:** EBITDA per ton should be fine enough.
- Raju Rustogi:** See EBITDA would definitely improve and comeback to our normal levels as you may have seen in past many quarters so this is an exceptional quarter we are as low as 10% but definitely north of 15% is what we are looking at.
- Pritesh Ajani:** Can you share those numbers on tonnage basis on per ton how is your EBITDA currently and if you can share that?
- Raju Rustogi:** No, currently I have said already it is 10% in Q1 of 2015-16.
- Pritesh Ajani:** So when you say 10% average selling price should be how much, sir?
- Raju Rustogi:** No, selling prices we do not specify in terms of per ton but definitely the two things that we have shared earlier is our selling prices are lower by 10% vis-à-vis last year and our needle coke prices would be lower by 38% post Q2 which is already shared in the con call. That is what we have said. So you can work out in terms of the differential.
- Ravi Jhunjunwala:** Just to explain to since you are new to this company. Around 40% to 45% of our direct cost is a product called needle coke which is imported, it is not available in the country. And because it is imported so obviously there is some stock which is in the pipeline at all the times. And secondly the production cycle of graphite electrode is fairly long. I mean by saying fairly long I mean the quickest product that we produce after feeding the raw materials in to the circuit is about eight weeks. And the longest can be as much as 6 months. So with such a large

production cycle and with an imported product so there is always a lag of this 5 to 6 months. So whenever the raw material prices drop we suffer because of this high cost inventory and vice-a-verse when it goes up then we end up we have on the positive side because of a large inventory at low price.

Pritesh Ajani: So these finished goods prices will they also get revised post September, post October or is it like kind of contractual or how does that?

Ravi Jhunjunwala: What normally have been happening in this industry traditionally is that 60%, 70%, 80% of the international business is done at a fixed prices once a year. And that starts getting negotiated any time in the last quarter of the calendar year for the whole of next year. But in the last three, four years because the steel business has not been in very good shape and because our customers are themselves not very sure about their capacity utilizations and things like that. So very few companies still follow that system of once a year. So lot of changes have taken place and lot of people are doing it twice a year; a lot of people are doing thrice a year. So there is no fixed norm anymore.

Pritesh Ajani: Sir, would that mean that say from September onwards the benefit that we would get due to lower needle coke prices will stay for September, October, November, and December and probably come next new calendar year wherein fresh contracts will be signed. Would that consider the lower needle coke prices and then we will see a further cut in the finished products prices, would that be a fair assumption?

Ravi Jhunjunwala: No, you see it is a fair assumption that at least for the next 3-4 months as far as our own products are concerned we know what the prices are. Let us say more or less 70% to 80% of our order book is in our hand at least for the next 4 to 5 months. So your assumption is right. Once we have exhausted our old price needle coke by end of this month then that impact will come and that impact is pretty substantial because as we said the new prices are around 40% lower than last year. And given that our electrodes selling prices would not change much between the April-June quarter and let us say the current quarter or let us say the October-December quarter. So a large part of that drop in the needle coke prices that inventory exhaustion will reflect in the P&L.

Pritesh Ajani: So may be the 10% to 15% numbers that we shared is to the fact that it is limited towards December quarter or probably little bit to march because from March onwards it will again start to show a little bit of pressure?

Ravi Jhunjunwala: No, we do not know. And your needle coke is a oil based product so this 30% to 40% drop that we saw this year was on account of the oil prices which came down from something like \$100 to \$60 to \$65 in the beginning of the year and with this current oil prices coming down to \$50 region you do not know I mean there could be another 15%, 20%, 30% decline next year.

Pritesh Ajani: How much did you is the I mean I heard that our order book has been lower than the previous year so do we kind of share the order book in tonnage or in value terms or how is it?

- Ravi Jhunjunwala:** We normally talk in terms of capacity utilization. Our capacity utilization in the next three quarters or let us say for the whole of this year we are still projecting in the region of 70% although this current quarter has been about 60%. The current quarter meaning the first quarter that we are discussing was at about 60%.
- Pritesh Ajani:** And there is no one off in that 60% that we kind of started some facilities or?
- Ravi Jhunjunwala:** No, nothing like that.
- Pritesh Ajani:** Purely based on demand and production schedule?
- Ravi Jhunjunwala:** Right, so the next three quarters our capacity utilization should be much higher than the current quarter and the reason as we explained was about more than let us say 20% of Indian demand was being met last year by the Chinese imports. So which has more or less come down to zero because of the Antidumping. So that 20% to 25% of the Indian demand would obviously come back to the Indian producers.
- Pritesh Ajani:** Sir, post that levy now how is the difference between the land rate and the domestic price?
- Ravi Jhunjunwala:** The antidumping duty which China is now paying they have not done it on a percentage basis they have done it on a per ton basis and these are different number for different suppliers. So if you roughly convert that in to percentages it is something like 15% to 50%. In some cases that duty will amount to about 15% to 18%. In the worst cases it is as much as 50%.
- Pritesh Ajani:** So there is still a gap?
- Ravi Jhunjunwala:** Basically that number is basically determine by the government based on the past data of each of those suppliers.
- Pritesh Ajani:** So you are saying on a conservative basis you are saying there are products getting imported at a 20% lower price than the domestic?
- Ravi Jhunjunwala:** What we are saying is the reason the government has imposed that duty was in the last two to three years these imports were coming at a price which were let us say 20% to 50% below the Indian price. So in order to compensate that they have imposed the duty of between 20% and 50% on different suppliers and different slabs.
- Pritesh Ajani:** So is the import still happening?
- Ravi Jhunjunwala:** No.
- Pritesh Ajani:** It is absolutely stopped, is it?

- Ravi Jhunjhunwala:** I would not say it has 100% stopped but we are to a very large extent and that impact is going to come now because this duty came in to force in the middle of February. So obviously one can assume that there was something in the pipeline which came in April or May. But now it is virtually not happening.
- Pritesh Ajani:** So your trade sources indicate that there is negligible imports currently in to the country?
- Ravi Jhunjhunwala:** Correct.
- Gurvinder Vasan:** Sir, you mentioned about this antidumping duty helping increase the domestic demand for your products. Is it also beneficial in terms of either the margins or working capital days or better debtor days? And what is likely to be mix from domestic versus exports compared to last year?
- Manish Gulati:** I would say last year it was 75:25 and this year it is going to be 65:35.
- Gurvinder Vasan:** And is there any other benefit out of it in terms of margins or working capital or they are neutral?
- Manish Gulati:** See the segment of the market which the non-UHP segment mainly which we call the Chinese were catering to. We had actually vacated a couple of customers where did not want to drop our prices to that extent that we do not even cover our variable cost. So we have trying to regain back those customer and that is going to help with the volumes. We were not competing with Chinese in those customers where they were supplying products at 50% lower prices it was just not worth it. And we could not even be covering our cost to do that which is now coming back.
- Gurvinder Vasan:** Should I understand net-net the EBITDA margins of 15% at which roughly 15% to 16% at which you were doing your overall mix you are likely to achieve that range again it is not going to add or reduce your margins?
- Raju Rustogi:** See margins as a factor of uncertainty in terms of the price trend as well. So definitely on the buying side we are more than we are aware of the trend but on the selling side as of today we see the EBITDA improving but the price fall of the finished product is more than our expectation the trend could change.
- Gurvinder Vasan:** And on the overall balance sheet basis you said Rs. 90 crores was repayable of it Rs. 50 crores is gone in to first quarter itself?
- Raju Rustogi:** No, if it is gone up to to-date not up to first quarter, till today it is Rs. 50 crores.
- Gurvinder Vasan:** And there is unlikely any other term loans you are going to borrow during this year and we do not have any capacity to expansion or and other major CAPEX to be done?

- Raju Rustogi:** From the projections and going by the present trend of the sale prices and the cost we believe we will not be borrowing any further during 2015-16 and that is what. It is a factor of our net profits at the end of the year. So we do not foresee any borrowings looking at the present trend.
- DewangSanghvi:** My question is more on the global front. I just wanted to know are there been capacities which are going to shutdown because of this lower prices? Are there any restricted capacities utilization by global companies like SGL and GrafTech?
- Ravi Jhunjunwala:** You see the capacities has been shutdown last year both there are two major players as you know one is GrafTech in the US and one is SGL in Germany both of these companies have announced and not only announced they have actually closed between them about 120,000 tons. And against that 120,000 tons closures SGL has added about 25,000 tons to 30,000 tons in Malaysia. So the net capacity closure is about 90,000 tons which is now on the ground. That is capacity is no more there. And GrafTech has just announced their results I think two, three days back and they are saying that on the whole year they talk in terms of the calendar year they have said that they have a capacity utilization for the whole of this year will be about 60% if I remember correctly of the reduced capacity. So if you take about 20% capacity which was already shut last year and on that on the reduced capacity they have publicly stated that the whole year they will be operating at about 60%. So that is what it is so obviously things are not very good it actually is under tremendous pressure. And we will just have to see what happens and what decisions will do these major players take.
- Dewang Sanghvi:** And with respect to the Japanese peers are they making decent money or they are also have a challenging times?
- Ravi Jhunjunwala:** No, they have capacity utilization I do not think is any better than anybody else. As far as the costs are concerned it is not very easy. Most of these Japanese companies are part of some very large group and there is a more or less no data available so to say. But given the power cost and the labor cost in Japan it is safe to assume that they would not be in any better shape than the Germans or Americans.
- Dewang Sanghvi:** And just one small clarification. We expect the mix to be 65:35 this particular, right sir for our exports and domestic as compared to 75:25 last year?
- Ravi Jhunjunwala:** Yeah, about two-third, one-third.
- Dewang Sanghvi:** 65% was exports?
- Ravi Jhunjunwala:** Correct.
- RukunTarachandani:** Sir, just wanted to get a sense on what was happening in the US steel market because the number of companies have filed the antidumpingcases there and month-on-month the steel imports have been down for about 4 or 5 months. So are you seeing anything structurally changing there on ground?

Manish Gulati: See US steel producers are very much concerned about the rise in Chinese imports in to that country. So yes, there are several applications pending and under scrutiny for filing antidumping against Chinese made steel. So we will see in the next few months if it is really impose antidumping duty and which grade they decide to impose upon and one important thing is that the shale gas industry which was developing in US is not going at the pace at which it was thought. So that has also impacted the steel production and their projections which they had two years back or let us say 2015 are not going as per their own forecast. So as we said there is a decline in steel production in US by 8.9%.

Ravi Jhunjhunwala: See a large part of US steel was projected to go in to the shield gas industry. And with the current oil prices obviously that industry is not doing very well. But the only good point in case of US is about two-thirds of the steel about 65% of the total steel production in US happens to the electric arc furnace which is a single largest percentage wise this is by far the single largest electric arc producer in the world and even in terms of absolute numbers they will probably come next to China only.

Rukun Tarachandani: So as of now things have not improved on ground?

Ravi Jhunjhunwala: No, in fact if we see this numbers the drop in US has been the maximum about 9% against the world average of 2% - 2.5%.

Moderator: Thank you. Sir, there are no questions from the participants so if you would like to add your closing comments before we conclude?

Ravi Jhunjhunwala: Thank you for joining us and I am sure you have disappointed as all of us are but given the scenario we are trying to do our best and our future the next three quarters surely look much better than the first one and I do hope to come back to you in three months with some positive news and positive numbers. Thank you.

Moderator: Thank you very much, sir. Ladies and gentlemen, with this we conclude today's conference call. Thank you for joining us and you may now disconnect your lines.