



“HEG Ltd. Q3 FY18 Results Conference Call”

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**Moderator:** Ladies and gentlemen, good day and welcome to the HEG Limited Q3FY'18 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. 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 now hand the conference 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 and welcome to HEG's Third Quarter Conference Call.

I would like to start by talking a bit about the recent developments primarily led by China which have had a positive impact on our industry. As shared with you in our last concall, the Chinese government early last year decided to drag down on some of the highly polluting industries due to serious environmental concerns. It is reported that somewhere in the region of 125-140 mt of steel capacities, primarily Induction Arc Furnaces, Mini Blast Furnaces and some very old blast furnaces have been shut down since then. Further, temporary closures of about 35-40 mt were also announced during the beginning of winter months in October-November '17 onwards. These closures have led to a sudden large drop of export of finished steel from China to the rest of the world. This has dropped from a level of about 150 mt per year that China was exporting to rest of the world in the last couple of years to about 75 mt in 2017 which is a drop of something like 35, 40%. In addition to this, China's exports of semi-finished steel has also dropped from a level of 30, 35 mt in 2016 to as low as below 10 mt in 2017. All this has helped the other countries of the world to increase their own production of steel which has led to a sudden increase in the demand of Electrodes outside of China.

Friends, all this has happened at the time when due to overcapacity in the Electrode industry, six plants mainly in Europe and Americas had to be closed down over the last three to four years bringing down the Electrode capacity by around 200,000 tons.

Effective, 1<sup>st</sup> of January in this year, Chinese Ministry of Industry & Information Technology came out with the new policy to ensure zero growth of steel capacities in 2018. Some new measures require capacity of replacement in Beijing and six other nearby provinces which account for a very large steel production in China to keep the ratio at 1.25 against 1 level or more. Other regions are also likely to see this ratio becoming higher than 1:1 effectively reducing steel capacities. In effect, what it means is that in order to have a new capacity of a million ton, you are required to close a capacity of 1.2, 1.25 mt of the old environmentally unfriendly way of producing steel. The new rules also encourage the replacement of old converters with new Electric Arc Furnaces which would result in net Electric Arc Furnace steel capacity expansion in China in a significantly large way in the near future. China is rapidly increasing its Electric Arc Furnace capacities which is much more environment-friendly compared to some other routes of steel making. There are as many as 54 new Electric Arc Furnaces under installation amounting to an additional capacity of somewhere in the region of 60-70 mt which is likely to come on stream within the next few months. They believe that most

of these capacities will be in production by end of this year. Here it is worthwhile to once again remind us that while the rest of the world produces approximately 45% of the total steel through Electric Arc Furnace rules, China till recently has been producing just about 7-8%. So insofar as China is concerned, they are just about starting to catch up with the rest of the world in this environmental friendly way of producing steel. China has announced its intentions to produce about 20% of its steel through Electric Arc Furnace by 2020 which is 3x more than what it used to be only one year ago which means that their Electrode requirements could go up by as much as 3x over the next three, four years. Again, due to the same environmental concerns around 250,000-300,000 tons per annum of Electrode capacity in China have also been shutdown since the beginning of last year which has led to a shortage of the low grade “Non-UHP Electrode” as we call which China was supplying in a significant manner to rest of the world.

Due to the world economy is being in a better shape in the last 12 months or so, world’s steel production for the calendar year 2017 have gone up by whopping 5.3% after a continuous negative or near zero growth in the past three, four years. So this 5.3% jump or let us say negative or 0% in the last three, four years also means about 15-20 mt of additional steel.

India’s own steel production grew by 6.2% to cross 100 mt for the first time in the calendar year 2017. All this augurs well for our industry which is directly connected with the Electric Arc Furnace industry. We expect the strong demand growth for our products in the near future to continue. However, Needle Coke supply continues to be tight as a part of this Coke have now found a new application in the field of lithium ion batteries mainly in China and all the Electrode producers are unable to find enough Coke to produce Electrodes at full capacities.

Friends, all the above has enabled HEG to report a fairly healthy result for the third quarter. In the past few years when the industry was facing difficulties, your company concentrated heavily on cutting costs, rationalizing manpower and other resources, using all the machinery and equipments in a very competitive manner in addition to very strong quality control measures. All these are now showing positive results and our operating margins are to-date amongst the best in the industry worldwide.

As we complete our old price legacy orders taken at low prices early last year, our sales realizations continue to creep higher QoQ. We see this trend continuing in the current quarter as well.

Another issue which has been of serious concern to our investors since yesterday is that of a proposed export duty on Electrodes. Let me categorically state that as of today there is absolutely nil duty on export of Electrodes. Typically, an export duty has put on a product to protect the Indian industry and to ensure continuous supply of goods in the domestic market instead of profiteering on its back from the exports. The government looking at the current and expected demand/supply investments of Electrodes which we believe is expected to last for the next few years simply wanting to ensure continuous supply of Electrodes to the Indian steel industry. As you know, the total Indian graphite production capacity is about 160,000 tons, out

of which the Indian market is just about 60,000 tons. Hence there is absolutely no reason for us to worry about not being able to supply the 100% of the domestic market before we start looking at the exports. What the government has done is simply to take a provision and to make sure that the above happens which has been happening in any case for a number of years. There is absolutely no export duty on Electrodes. We have exported, we have taken bill of lading, we have taken out lots of containers this morning out of the plant just as we have been doing in the past and nobody is asking for any duties on that. There is no reason for the domestic industry to worry about non-availability because it is not that we have suddenly open up to the fact of exporting Electrodes. As you know, the Indian industry has been exporting about two-thirds of its total production for more than 15-20 years because the Indian demand can only take about one-third of what we can produce.

So in summary, I would like to state that we continue to remain optimistic about our industry. We expect to run our operations this quarter in the region of little over about 85% of our capacity and expect to continue to deliver better results.

I would now request Mr. Rustogi to take you through the financials and then we will be happy to answer any of your questions. Thank you.

**Raju Rustogi:**

Thank you, sir. Good Afternoon, friends. I would quickly share the overview of Q3 FY'18 numbers and then we will take your questions. For the quarter ended September 2018, HEG recorded net operating income of Rs.843 crores as against Rs.409 crores in the previous quarter, a jump of nearly 106%. EBITDA including other income which stood at Rs.192 crores in the previous quarter had increased to Rs.563 crores, a jump of nearly 193% in the quarter. Company reported net profit of Rs.342 crores as against profit of Rs.113 crores in the previous quarter.

Since turnover is a factor of both volume and prices, we are happy to inform that the company has been able to achieve a healthy growth in both the aspects. So the supplies are a mix of old and new orders, the weight of the new prices in the mix is ever increasing and is increasing QoQ. There has been a significant change in the industry scenario as a result of China development which were explained by our Chairman just now.

On the cost front, though the impact of increased sizes of Needle Coke, Indian Coke and other domestic inputs have started to come in, their full impact is expected in Q4. This happens because our manufacturing process for making Electrode is as long as 2.5-years. So the cost increase or price increase takes at least 2.5-3 months to take full impact. Net sales and also the segment results in power segment have increased primarily due to full operation of Tawa Hydro Power Plant during Q3 FY'18 which is majorly rain-dependent. Total debt as on 31<sup>st</sup> December 2017 stands at Rs.575 crores as against Rs.686 crores as on 31<sup>st</sup> March 2017. This Rs.575 crores comprises of Rs.90 crores only of term debt and the balance is on account of working capital loans. Now as we stand today, as on 31<sup>st</sup> January, this total debt of Rs.575 crores has also again been reduced to Rs.375 crores. The company has prepaid term loans to the extent of Rs.114 crores during Q3 of FY'18.

With these numbers and state of the financials of our company, we would invite questions from the analysts. Please come up.

**Moderator:** Sure. Thank you very much. We will now begin with the Question-and-Answer Session. We will take the first question from the line of Dhaval Shah from Girik Capital.

**Dhaval Shah:** I want to understand regarding the nature of contracts for calendar year 2018 and '19 with the clients?

**Ravi Jhunjhunwala:** As you know, in the past year, there has been a tradition that a lot of export orders mainly were being done on an annual basis and lot of orders were on a spot basis, some of them were on quarterly, six monthly basis. So it is really dependent on what a particular client wanted in a particular area of the world. But given the problems in the availability and the pricing of Needle Coke, so similarly as Electrodes the Needle Coke prices were also being frozen for about a year at the beginning of the year normally. So given that issue, obviously, the Indian industry for that matter or any other industry is not able today to give 12-months pricing because as you know Needle Coke is a very significant cost of our production. So currently this is an area which is not very-very clear, but what I can say is that there are more or less I would say very-very few annual contracts because the industry is not in a position to give that price, so the annual contracts have actually gone, so there are mostly either quarterly or at the most six monthly kind of contracts which are happening. In case of a lot of Indian supplies, they are going on a monthly basis because as you know lots of steel industries are in a stress and they themselves are not keen to talk about the longer than a month contract.

**Dhaval Shah:** So your export contracts you mentioned will be around maybe a quarter or six months max versus which you used to do one year?

**Ravi Jhunjhunwala:** Yes, instead of one year and six months is also becoming less and less because as of today we still do not have firm contract for Needle Coke in hand, we do not know whether this Needle Coke contracts will be on a quarterly basis or a six-monthly basis but all we know is it is not going to be annual.

**Dhaval Shah:** This GrafTech SEC filing where you mentioned it is done 3-5-year contract with some customers on take or pay basis, so what is that?

**Ravi Jhunjhunwala:** GrafTech is the only exception in this industry who are in a privilege position because they have an equivalent capacity of Needle Coke under their own belt. They have 150,000 tons Needle Coke plant in US which is exactly matching with the requirement of Electrode which is currently around the same level. Unlike let us say at least in case of India in America you can hedge and the raw material for Needle Coke is mainly a particular kind of oil. In that part of the world one is able to hedge your cost of oil for the next more five years. Again in America or in Europe, the second largest cost of our production is electrical power which also is possible to hedge for three to five years time. So they have that advantage that they have their own Coke production and they can hedge their raw material, they can hedge their electrical power which

they buy from the grid. So once you have hedged your 60, 70% of cost for the next three to five years, then you know what your costs are on day one and then you can go for the three, five years contract because you know your margins get frozen at those levels.

**Dhaval Shah:** Since Needle Coke as you mentioned is so much tight in supply, so you think that whatever orders come to you, you will be able to satisfy them without letting customers go to your competitor?

**Ravi Jhunjhunwala:** This position that one graphite company has its own Coke only applies to GrafTech, other major players not too many left, there are only two Japanese companies in this business now and then there are two of us in India. So the other companies which constitute about 80% of the world's graphite production GrafTech is about 20%. So the other 80% constituents of the Graphite industry which is basically the two Japanese and two Indians, we do not have that luxury of having our own Coke. So we are in the same boat as the other 60%.

**Dhaval Shah:** So the nature of contracts the other 60% would be making with the Needle Coke suppliers would be same for you as well?

**Ravi Jhunjhunwala:** Yes, will be similar to ours. Again now, GrafTech is currently owned by very large fund and they have recently also announced that they are going for an IPO. So probably the fact that they are going for an IPO and six months ago they did this three to five years contract, probably tells something why they would like to go for a three to five years.

**Dhaval Shah:** Is there a revision of rates coming up in this month with the Needle Coke supplier for supply for next three to six months?

**Ravi Jhunjhunwala:** This will come from April, I mean, our contracts are ending in March and the new rates will come into force from April onwards.

**Dhaval Shah:** Currently, the contracts which are ending in March, so roughly what would be the cost for what will be supplied till March?

**Ravi Jhunjhunwala:** As Mr. Rastogi explained the process of Electrodes is pretty long, the quickest or the easiest Electrodes takes anywhere between six to seven weeks to produce and the longest one take as much as four to five months to produce. So there is a lot of work in process, there is a lot of raw material which is lying in the furnaces midway or 70% of the way in terms of finished products. So the impact of the higher price Coke will start coming in let us say three to four months after we have exhausted our old price contract. As I said, up till March, we are getting the Coke at the old price. So considering 45, 50-days period for transit, and then adding about two to four months time that it takes to produce Electrodes out of that, so the next quarter which is going to be let us say April-June will not see the impact of the higher prices because we will be using the same Coke.

**Dhaval Shah:** My point was to understand till when will this such large delta last for you guys, the end price you do not have a control on, the prices of Electrodes which are still higher I assume, so till when because even this 20% duty factor which has come in the budget has just come for the first time and there has to be a reason behind it. So for an investor to get a visibility for earnings at least for one or two years, so how should we understand that, how will the contracts be or how will the pricing happen?

**Ravi Jhunjunwala:** These two things are very independent of each other what you just mentioned. So to take the first question first, as I said, the supply of Coke which is going to be shipped between January and March will be used to produce Electrodes and sell Electrodes at least till July, August of this year given the long cycle. So until that time we know what the cost of Electrode is, we know what the cost of the sales realizations will be. Going forward, obviously we have some idea, we have some indication of what could the Needle Coke prices be it will onwards. So obviously when we start talking to customers for our supply starting from let us say July-August-September, we will have to factor in that increase of the Needle Coke cost in any case.

**Dhaval Shah:** So that Needle Coke the new price would be at what premium versus the existing contracted price at what you have got, any rough indication can you give?

**Ravi Jhunjunwala:** I cannot give you the exact number, I can give you let us say in terms of percentages, in the first calendar year of 2017, the difference between the first half and the second half was about 100% and what we believe is likely to happen in the next six months starting from let us say April onwards it would be somewhere in the region of maybe 100% to 150% on the current prices.

**Dhaval Shah:** Which was there in second half 2017 calendar year?

**Ravi Jhunjunwala:** Yes, if you put any number, let us say if you put 100 as the base for January, June last year, we are talking of 200 up till March, and then we are talking of something like 400-450 in the next six months.

**Dhaval Shah:** But at the same time your end product prices will not see jump or your contract builds 100% appreciation or is a complete pass-through, how will your contract then shape up?

**Ravi Jhunjunwala:** As I said, you have seen the results from the second quarter to the third quarter and in my opening remarks I did say that we have seen a substantial jump in the realization as an average because the old price contracts, the legacy order as we call them, are getting over quarter-on-quarter, so the percentage of high priced orders or let us say short-term priced orders or spot orders whatever you want to call it, so the percentage of these high priced orders are becoming higher and higher every quarter. So in the current quarter as I indicated we still expect the realization of Electrodes to be higher than the previous quarter of October-December and we think that whatever cost increase of Needle Coke and other things we are likely to see starting from July-August, we should be able to more than pass it on given the market conditions because you yourself seen, I am not talking something which is so confidential but from the

public data of the other two international companies I believe their average price for last year was like \$4500, \$5000 and as you yourself mentioned that it is a public data which is available on the website, the three to five year contracts which GrafTech has signed and they have signed as much as 60-65%, about two-thirds of their sale they have already committed for the period of next three to five years in a price range of \$10,000 to \$12500. Even if you take the 100% increase in the Needle Coke cost in the previous six months and take another 150% in the next six months, and given the base of Needle Coke is much different than the base of Electrode, they are able to pass on all this increase of Needle Coke cost, so that is built into the price of \$10,000 to \$12,000.

**Dhaval Shah:** You just mentioned in a TV interview that your board will be deciding something on the buyback or dividend. So by when would that announcement should we expect?

**Ravi Jhunjunwala:** They asked me for three, four, five options as to what are we thinking about and what are we going to do. All that I said is all of these options are under consideration. We recently had a board meeting only two, three days back and we are absolutely glued to the question that you just asked, and we are looking at all these options. So I cannot give you timeframe but we are considering everything that you just mentioned.

**Moderator:** Thank you. We will take the next question from the line of Manmohan Toshniwal, who is an individual investor. Please go ahead.

**Manmohan Toshniwal:** You mentioned about China cracking down on graphite Electrode capacity due to pollution concerns. Does those concerns apply even to other plants as well or it is just the different grade of Electrodes that is produced in your company?

**Ravi Jhunjunwala:** The major impact on the Graphite Electrode industry worldwide has not been because of the closures of the Electrode plants in China, that is one part...I will answer your question, but this is necessary to understand the background. So the major impact on the Electrode industry worldwide and the prices and everything has been more on the crack down on our user industry, which is Electric Arc Furnace and the blast furnaces. So what you need to understand is China has closed about 140-150 mt of mostly induction and blast furnace steel capacities, which did not use Electrodes. That has forced them to reduce their export of steel and semi-finished steel to the extent of 40%-50%, and that has helped other parts of the world, the western world as we call to produce more steel because until last year, they were facing dumping of steel which is now stopped. So that part of the world outside of China produces 45% of the steel through Electric Arc Furnace where Electrodes are used. So, lot of these capacities have we started in the western part of the world which produces 45% of the steel through Electric Arc Furnace where these capacities were idling for last four, five years. So now those capacities have come back into stream and they all want Electrodes. So that has been a sudden surge in the demand and as I said this has happened at a time when the last three, four years as you know in this industry have not been very good, and because of that over-capacity about six plants in Europe and America had to close down. So the demand/supply imbalance was taking care by the graphite industry by closing these plants, and suddenly when this



imbalance had been taken care of, the demand of Electrodes has suddenly increased. To answer your second question about Electrode, yes, China has closed about 250,000–300,000 tons of Electrode capacity because of environment. China does not have the correct technology to produce Graphite Electrodes as the two Indian companies have, and they are not able to produce the high end of Electrodes which is what 80-90% of our production is. That is where this issue of environment comes in, because of the lack of technology, and a very different grade of Electrodes that they produce, their Electrodes plants are extremely old fashioned, so they have been closed because of the environment issues.

**Manmohan Toshniwal:** Because the trend has been obviously on upside. In terms of new capacities across the industry, can you just please provide us an update across the industry – are there any new capacities that are coming up and so on if that is possible?

**Ravi Jhunjhunwala:** HEG came into production in 1977, exactly 40 years ago and since then there has been no new entrant in this area for the last 40-41 years. So we were absolutely the last new entrant in this industry in the world, so that is # 1; #2, in these 40-years, a new Greenfield plant was made by the German company which has now been acquired by a Japanese was about six, seven years ago in Malaysia, so that is the only Greenfield plant, it is a small 30,000 ton plant which came in 2010-11, and they closed couple of their European plants because they did not want to add capacities, so they just balance their capacities by closing two or three plants in Europe, and creating a new 30,000 ton plant in Malaysia. Apart from that there has been no new expansion, there has been no new green plant in this field at all.

**Manmohan Toshniwal:** The question was two concalls back you mentioned around if any one were to add capacity takes around 18-months sort of minimum, is that understanding right?

**Ravi Jhunjhunwala:** If anybody would add any capacity it would be Brownfield capacity, new capacity will take much-much longer than what you have just said. Anybody who will expand will expand on our Brownfield basis, and in all likelihood it would be one of the two, or maybe both Indian companies will do, because it is only the two Indian companies in the last 20-25 years, who have been expanding, let us say 20-years ago, both the Indian companies were 15,000 tons each and today, between the two of us, we can produce 160,000 tons, so from 30,000 tons the two Indian companies have grown to 160,000 tons. That has been the only expansion which has happened in this Graphite world in the last 40 years. So, it is not an aberration to say that in the last 20-years, every incremental demand of Electrodes which has come up from any part of the world has only been met by the two Indian companies, because as I just mentioned, six plants have been closed in the last three, four years, while others have reduced their capacities, shutting down the plants, and the Indian companies have grown from 30,000 tons to 160,000 tons now.

**Manmohan Toshniwal:** My last question was around the hedging you mentioned in US around the raw material oil. Why Indian companies and other companies are not able to do the hedging, it does not happen on exchange which is open to international markets?

**Ravi Jhunjunwala:** What I mentioned was GrafTech is the only company in the graphite world where they have their own Needle Coke plant, the raw material. That raw material happens to be oil based raw material and oil based raw materials are freely hedged in America. So first of all, we or the Japanese do not have the captive Needle Coke plant which they have. So I am not sure if I have answered your question, but we buy Needle Coke from three different people in the world, there are only three people who have technology to produce Coke. If they hedge at all or they leave it open to the world forces, but we do not come into the picture of hedging the oil cost.

**Manmohan Toshniwal:** Where I was coming from more was because if they can hedge their raw material products, why cannot Needle Coke companies offer long term contracts by hedging it... do you know what I mean?

**Ravi Jhunjunwala:** I understand what you are saying, but I cannot answer that question very clearly because up until now they were offering 12-months price, and except the last 12-months when the Electrode prices has gone through the roof, and the Needle Coke prices have gone through the roof, the Electrode prices dropping every six months so was the Needle Coke prices dropping. So, in a situation when the Needle Coke prices were dropping because there was not enough demand for Needle Coke, it would not be in our interest also to take Needle Coke contracts on a long-term basis, because the prices were dropping. So the situation has only come up very recently where the Needle Coke prices have gone up and the Electrode prices have gone up. So I am sure our supplies of Needle Coke would be looking at these options of hedging their cost so that they can also offer us if not longer at least 12-months pricing.

**Moderator:** Thank you. We will take the next question from the line of Karan Thakkar from PM Securities. Please go ahead.

**Karan Thakkar:** Sir, my first question would be on the variety of the cokel and the pitch that we use on the quantum per ton just from a calculation, how much cokel we use per ton of Needle Coke production?

**Ravi Jhunjunwala:** If you are talking of Needle Coke or let us say the Indian Coke we need more or less one ton, so it is one-to-one.

**Karan Thakkar:** One ton is our Needle Coke, right?

**Ravi Jhunjunwala:** Needle Coke or let us say we also produce 20-25% of our Electrodes with Indian Coke.

**Karan Thakkar:** Pitch?

**Ravi Jhunjunwala:** Pitch is about 40%.

**Karan Thakkar:** So, 0.4 per ton of Graphite Electrodes.

**Ravi Jhunjunwala:** Yes.

- Karan Thakkar:** Is there any particular variety of coal offers that we should look at if we want to look at the prices, quality of the Indian Coke or of the pitch, any particular grade that we use?
- Ravi Jhunjunwala:** There are three, four suppliers for both these products and they produce the same thing. There is no particular grade that we have.
- Karan Thakkar:** What is the price of Needle Coke contracted until March if you could share?
- Ravi Jhunjunwala:** We would not like to divulge that number because of competitive reasons, but I gave a ratio and what I said was let us say if the first six months of 2016-17 prices were 100, now it is 200, now we expect, it to be in the region of 400 or 500, something like that.
- Karan Thakkar:** As of the entire China market stall on the growth of capacity is concerned and shift to EU is concerned, have you by any means been able to understand what would be the graphite electrode global demand in the next 1, 1.5-years?
- Ravi Jhunjunwala:** I was talking about China where I said that they have added about 30-35 mt of Electric Arc Furnace capacity in 2016, they are likely to add about 60 to 70 mt in the current year 2017, and the Chinese government has announced their intent to produce about 20% of the total steel by 2020 from the Electric Arc Furnace.
- Karan Thakkar:** Trying to understand what would be the impact on the graphite electrode demand, of course, it would be three-fold of what was in china, but globally could you just give me one number that say if China goes to 20%, what would be the global graphite electrode market become?
- Ravi Jhunjunwala:** If we exclude China for one minute for this discussion, because as I also said that Chinese do not have the technology to produce what we call the “Ultra High Power.”
- Karan Thakkar:** No-no, I am asking from the steel manufacturers, how many graphite electrodes a year would they be buying in tonnage ex-China and entire world together?
- Ravi Jhunjunwala:** More or less you can say China does not import, and China does not export higher grade, and higher grade is about 75-80-85% of the total market of Electrodes, so the lower grade is only about 15-20% which China has been exporting partly, but again because the Chinese demand for Electrodes has risen so rapidly in the last 12-months and is going to be even more rapidly in the next two, three years. So China has also more or less withdrawn from the export market for the low end. So we are not actually concerned or we are not actually competing with China in China or outside China.
- Karan Thakkar:** The total steel industry put together which is producing through EAF route, how many tons of graphite electrodes are they procuring a year?
- Ravi Jhunjunwala:** In the last 12-months, given the data of China and what has happened because of the Chinese export of steel and semi-finished steel dropping, our estimate is in the last 12-months, the

Electrode demand without China has suddenly jumped by about 100,000 tons. This was 600,000 tons a year or year and a half ago. Now it has currently gone up to about 700,000 tons. This has happened at a time, when the Graphite Electrode capacity ex-China used to be about 900,000 tons three years ago. Demand was 600, so obviously with 600,000 tons demand and 900,000 of capacity, there was an imbalance, so that capacity of 900 was brought down to 700 by closing six plants in Europe and America and the demand was 600, now the demand has shot up to 700. There is absolutely no room for any complacency at any graphite plant to produce less than that. On top of that, if we look at the data of world steel production in 2017 calendar year without China, that has grown by about 5.3% Vs either zero or (-1%) or (-2%) which we have seen over the last 3-4 years. So that 5% increase suddenly in last one year ex-China on 800 mt thumb rule kind of a basis, ex-China the total world production of steel is 800 million. So 40, 45 mt of additional steel is now being produced by the world which has not happened in the last five years. And 45% of that is produced by Electric Arc Furnace, where the Electrode requirement is there.

**Karan Thakkar:**

As china is increasing their EAF route steel production, is there any understanding on your end that have they planned any UHP grade capacity, I understand that as of today they are not able to make it, but if they are planning to go the EAF way in such a big way, and they know the current market of Graphite Electrode, are there any progresses in that geography for ultra high powered electrodes trying to acquire their technologies or any players trying to manufacture the same in China?

**Ravi Jhunjhunwala:**

This is a very obvious question anybody would ask and we have not been able to answer this question for the last 20-25 years, and we have been watching the situation and every time we have expanded our capacity from 10,000 tons currently to 80,000 tons, we have debated that question and ultimately we have gone ahead and expanded and it is basically an issue of technology, there is nothing else except technology. They have not been able to catch up in the last 20-25 years, and given the very complex nature of the technology in the industry and given that there are only five or six players in the industry worldwide which are left in the Electrode industry, likelihood of China coming even close to what the other five of us produce, obviously, I cannot say it will not happen ever, but chances of this happening any time soon looks very remote.

**Karan Thakkar:**

20,000 tons of capacity expansion planning that we had for the last one, two quarters, is there any further firming up of a plan on that?

**Ravi Jhunjhunwala:**

We are looking at the situation extremely closely which is obvious because given the profitability, given the demand, given the shortage of Electrodes, we have the space, we have the capability, and we have everything to increase from 80,000 to 100,000 tons. In the last three, four months, we have started looking everything that will take us to 100,000 tons. So, that process of thinking and that process of evaluation and the cost it will take to increase the plant capacity is already on the table. The million dollar question that we cannot answer is the Coke. As we keep saying in every concall we are able to produce at 85%, 90% and all that. So

long as we are not able to produce at 100% of our existing capacity, very difficult to take a decision and go to 100,000 tons.

**Karan Thakkar:** All of that is because of Needle Coke, there is...?

**Ravi Jhunjhunwala:** Currently, there is no issue except Needle Coke, there is demand, there is profit, and there is margin.

**Karan Thakkar:** April onwards when the renegotiating of the Needle Coke contracts will come in, even if it happens at higher price, understanding that there are a very few suppliers of Needle Coke in the world and lithium ion has a big application now, will it mean that in any way there will be an issue in procuring Needle Coke for any logistical reasons or having said that you give the price that is asked for?

**Ravi Jhunjhunwala:** These 2-3 companies were in this business are extremely large companies; they are like \$50 to \$100 billion companies, for them Needle Coke is very small part of their business, they have been extremely fair all the time in the past... of course, they know what the market is, they know what kind of Electrode prices they are looking at, they know the demand, they know the shortages in the Electrode industry, so obviously the prices will keep going up, but so long as we are able to pass on and get that price increase in the Electrode pricing, that is what we are looking at. As I said, despite an increase from maybe \$100 to \$400 or \$450 that we are talking about in the coming 6-9 months, we do not see a problem in being able to pass it on given that specially now Graphtec has taken the step and they have already taken up the price of \$10000 to \$12500.

**Karan Thakkar:** Also contracting will happen from 3-6 months for both of these so pass on will also be a fair possibility on the timeframe, then it will not be an issue?

**Ravi Jhunjhunwala:** Exactly.

**Karan Thakkar:** From calculations, if you are not able to share the Needle Coke pricing right now, could you just give me what is the Needle Coke price in financial year '16 a very broad number that you might have procured at?

**Ravi Jhunjhunwala:** That number unfortunately we cannot give, but as I said, I have given you the proportions.

**Moderator:** Thank you. We will take the next question from the line of Aditya Wagle from Aequitas Investment. Please go ahead.

**Aditya Wagle:** I just like to ask what is the percentage of your capacities currently tied for long-term contracts and what is available in the spot market?

**Ravi Jhunjhunwala:** As I just mentioned, there is nothing called 12-month or long-term contract these days, because, there is nobody who can give that 12 months price except Graphtec which has handle

on the cost of Coke. Older contract as I said, more or less, everything will be finished by this March end this year. That is why I said our average realization QoQ has been increasing because every quarter we have been selling more and more of spot prices or short-term price, and the long-term contract which we sign about a year ago are now getting over.

**Aditya Wagle:** In percentage terms, realization in JFM quarter, Q4 over Q3?

**Ravi Jhunjunwala:** I cannot divulge that number, all I can say is that our realization in the current quarter is surely going to be higher than third quarter because of only one thing that our low price contract percentages are coming down very rapidly and by end of March it will practically become zero.

**Aditya Wagle:** What level of debt we will see by end of Q4FY'18?

**Raju Rastogi:** I have clarified that our long-term debt as on today is Rs.90 crores and by end of Q4 we should be zero.

**Moderator:** Thank you. We will take the next question from the line of Anubhav Sahu from MC Research. Please go ahead.

**Anubhav Sahu:** I just wanted to understand about the Needle Coke supply thing. Is there an estimate that how much percentage of that is being used for lithium ion battery? So is there any new supply coming on Needle Coke side?

**Ravi Jhunjunwala:** Answer to your first question would probably be in the region of 10-15% and no more. Secondly, so far as the capacity expansions are concerned, the largest player in the Needle Coke industry as you know is the company called ConocoPhillips, they have about 60-65% of the total world market share, and they have two refineries where they produce Coke -- one is in UK, the other one is in US. Given that there is such a strong demand on Needle Coke for the last 12-months, they have taken the initiative and they are expanding or they are de-bottlenecking both of their refineries currently. So their production capacity should increase by about 15-20% of their total capacity which was available last year let us say. This should be on stream by second half of this year.

**Anubhav Sahu:** We also source domestic Needle Coke. So what percentage that would be and compared to what we get it from outside, how is the quality of Indian Coke -- is it suitable for all the grades which we manufacture or for the limited ones?

**Ravi Jhunjunwala:** No-no, Indian Coke is nowhere close to Needle Coke, it is just called Coke but it is totally a different product and it is only used for the low grade what we call "Non-Ultra High Power Electrodes" which we do to the extent of about 20-25%.

**Anubhav Sahu:** That 20-25% we get it entirely from the Indian Coke?

**Ravi Jhunjunwala:** Yes.

- Anubhav Sahu:** Do we also source Needle Coke through the carbon route, coal tar route or it is only through the petroleum route?
- Ravi Jhunjhunwala:** More than 90% is produced through the oil route, there is about 10-15% of the Coke which is also getting produced through the coal tar route.
- Anubhav Sahu:** But do we use it or?
- Ravi Jhunjhunwala:** We do.
- Anubhav Sahu:** There also qualitatively it is more or less on par with what oil derivatives give us or?
- Ravi Jhunjhunwala:** They are more or less similar, we use it like the replacement of any Coke.
- Anubhav Sahu:** I heard that they had papered done on the Needle Coke thing. Is there any push from the government side that the Needle Coke could be manufactured from India by any of these and is it not feasible, any idea on that?
- Ravi Jhunjhunwala:** It is again basically an issue of technology, raw material can be imported, that is not a problem but like as we said in case of Electrodes is about the technology which we have and Chinese do not have. That is the same thing here, the technology is in the hands of three, four people in the world and obviously they would not like to share this with anybody else. IOC has been trying to produce something which is close to the Needle Coke that we need to for our Ultra High Power, but they have not succeeded up till now... those discussions and those trials keep happening, but they are not able to succeed.
- Moderator:** Thank you. We will take the next question from the line of Payal Goenka from Ratanami Investments Private Limited. Please go ahead.
- Payal Goenka:** Sir, my question is relating to the power cost. So we are seeing that the power cost has increased substantially QoQ. Can you give us reasons and how do you see this cost in the future?
- Raju Rastogi:** Power cost if you see is a mix of three or four sources of power that we source for producing these high electrodes. If you see QoQ, only for the current quarter which is December 2017 quarter, you will see a sharp increase in power cost and that is primarily due to one-time provisioning of litigation legal case that we have and our auditors suggested that we need to provide as a one-time cost for perceiving a risk of decision against us. This is not related to the running cost of making Electrodes, but this is pertaining to a legal case which is under litigation which has not yet been decided, but our auditors perceive risk and hence we have provided for it.
- Payal Goenka:** So this is one-time basically?

- Raju Rastogi:** This is one-time cost and not going to be there every quarter.
- Payal Goenka:** Same thing with the employee cost, that has again also risen very substantially. So is it one-time or recurring, what numbers should we assume?
- Raju Rastogi:** In employees cost, in fact, there is something called fixed element of employee cost and there is a variable element of employee cost. Something which is related to profitability is paid when profits are significant and significantly higher. So if you see the quarter-wise employee cost, it is higher only in the current quarter primarily due to variable part of the salary which is incentive-based on profits.
- Payal Goenka:** So, in the future when the profits are higher, so the employee costs in line with the profit, right?
- Raju Rastogi:** Yes, it is.
- Moderator:** Thank you. We will take the next question from the line of Naveen Tkumani from Equityfanatics. Please go ahead.
- Naveen Tkumani:** I want to know the cost break up in the manufacturing of the Graphite Electrodes in terms of percentage like Needle Coke how much, power how much percentage, overheads how much percentage, selling expenses how much, other materials how much, depreciation how much?
- Ravi Jhunjhunwala:** I can give you a rough number, depending upon the cost of Needle Coke, it is in the region of 40-50%, all sorts of fuel which includes, furnace oil, gas, LPG and everything, is another 15-20%. These are two major costs and in the balance 30-40% you have everything else.
- Naveen Tkumani:** Are we incurring any selling expenses and how much?
- Raju Rastogi:** There is selling expense of transportation of rake and then you have commission to overseas agents, all that comes up to about between 5-6%.
- Naveen Tkumani:** What is other material like process, costing manufacturing, I needed cost breakup?
- Raju Rastogi:** For cost breakup, friend, you will have to visit our plant to understand the manufacturing process, besides the Coke, we have three more raw materials which is binder pitch, impregnator pitch, and certain fillers, and then you have fuel which are met Coke and gases. There are all kind of materials which are used, which is part of other material.
- Naveen Tkumani:** What is this cost sir, like other material constitutes how much percentage?
- Ravi Jhunjhunwala:** Let us not go into a specific detail. As I said, our cost between Needle Coke and all sorts of gases and power is in the region of 65-70% and in the rest 30% you can take everything else, including the fixed cost, including the labor cost, selling cost, all other raw material cost and everything.



**Moderator:** Thank you. We will take the next question from the line of Formal Mehta from BNP Mutual Fund. Please go ahead.

**Formal Mehta:** My first question is, is it possible to quantify what percentage of old contract we had in this quarter, very rough range?

**Ravi Jhunjhunwala:** Again, we would not like to talk about that number, I can only repeat what I have just said that by March of this year in the two months, more or less 100% of the old price contracts will be out of the window. It has been coming down every quarter for the last three quarters. That is the main reason of the increase in the profitability because larger and larger percentage of Electrodes are now being sold at a higher price.

**Formal Mehta:** I just missed out on the net debt number as on December and what was that number as on September end?

**Raju Rastogi:** Net Debt as on 31<sup>st</sup> Dec is Rs.575 crores and as on 31<sup>st</sup> January it is Rs.375 crores, September was Rs.680 crores.

**Formal Mehta:** I just missed out the cost of production on a per ton basis, assuming employee expense did not had much of one-off, the cost of goods sold on a per ton has increased by about \$450, so is it fair to assume a large part would be because of Needle Coke and some of the other raw materials or there are certain costs which are not recurring in this?

**Raju Rastogi:** I think you are right in assuming that it is primarily the material component which is Coke of all kinds and other raw materials of all kinds.

**Formal Mehta:** With respect to our utilization rate compared to Graphite or some of the other companies, we are still at about 80-85% while there has been some improvement, but are there certain operational issues or we can expect that number to go to 95% or maybe full utilization starting FY'19?

**Ravi Jhunjhunwala:** In the next year, we are pretty confident of improving close to 90% I would say.

**Formal Mehta:** On the Needle Coke, just to be clear, the new contracts which you will sign, those will be mostly 100% of what the existing contracts are?

**Ravi Jhunjhunwala:** No-no, what I said was, if the number was 100 in the first six months of last calendar year, that number was about 200 in the second half and that number will continue to be 200 until shipments in March. With the new negotiations which are likely to happen, my guess is again we do not have that figure right now, but my guess is that number will be in the region of 400 to 450.

**Formal Mehta:** So for Q2 CY18 which will be about 4 times of Q1 CY17 for Needle Coke right, is that a fair assumption?

- Ravi Jhunjhunwala:** Up till the first quarter of next year, which is April-May-June, we will still have the old Coke which is let us say priced at 200, from July onwards it will be in the range of 400 to 450.
- Moderator:** Thank you. We will take the next question from the line of Rahul Murkya from Jefferies.. Please go ahead.
- Rahul Murkya:** In the last question you just mentioned that your net debt position was Rs.575 crores. Just wanted to clarify, is this net debt or the debt position?
- Raju Rastogi:** We do not have lot of cash in our books, so this is actually net debt and debt which is same as on today.
- Rahul Murkya:** Can you tell me what was the cash position as of end of third quarter?
- Raju Rastogi:** We still are a borrower, so we do not have surplus cash at this point of time.
- Rahul Murkya:** Your cash profit for this quarter was adding your profit and depreciation which gives me around Rs.360 crores and we have reduced our debt which was Rs.680 crores to Rs.575 crores by around Rs.105 crores in this quarter?
- Raju Rastogi:** In this third quarter we have not enclosed the balance sheet of the company but the working capital engagement due to debtors and price increase of sales of material has really gone up. So that profit you are talking about has been consumed by increase in debtors.
- Rahul Murkya:** How much increase could be because like if I see the second quarter the debtor position was approximately Rs.452 crores?
- Raju Rastogi:** This number would be visible after two months, but I can only say that this number has gone up by Rs.300 crores.
- Rahul Murkya:** There would be no problems in acquiring or the money would be safe, right?
- Raju Rastogi:** The turnaround time of the debtors has come down vis-à-vis Q2 of 2018, we are able to realize faster today.
- Rahul Murkya:** In this power and fuel cost, you mentioned that there was one-time legal settlement. Could you quantify what amount it was that we have taken up?
- Raju Rastogi:** This is a sum of two legal cases and the amount is Rs.30 crores plus.
- Rahul Murkya:** On this employee cost, you mentioned that it was basically because of the higher profits that we have done, we have given away higher variable incentives. So would this be a one-time or it would continue going forward because what my understanding was like it would have been basically the December quarter where you would have given bonuses and all?

- Raju Rastogi:** This is an ongoing practice in our company. If we generate lot of profit, our incentives are linked to the profits.
- Rahul Murkya:** If we generate Rs.340 crores kind of number, similar number in 4Q, we would have the similar range for the employee cost going forward, the same as Rs.33 crores?
- Raju Rastogi:** You can say so, yes.
- Rahul Murkya:** If you can just give me, as the Needle Coke prices are increasing, for this quarter how much were the cost of material consumed would be needle Coke cost in percentage wise?
- Raju Rastogi:** At the cost of repeating what our chairman has been quoting, we do not specify the number but yes, the percentage has been lower, general percentage is 35%-40% but this period has been lower because the sale prices are double of last quarter prices. So I can say it could be much lower than 35% that we generally used to have in Q3.
- Rahul Murkya:** No, that I was trying to understand of the total cost of material consumed, the share of Needle Coke and Indian Coke combined would have increased because their prices are increasing in the cost of material consumed, not as a percentage of sales?
- Raju Rastogi:** You can safely assume that it is 20% higher than the previous quarter.
- Rahul Murkya:** Can I safely take around 70% of the total material cost consumed would be attributable to Needle Coke and Indian Coke?
- Raju Rastogi:** Yes, our material cost primarily is Coke of all kinds and something called other raw materials, so, yes all our raw materials summed up together 70% is Coke, so that you can safely assume.
- Rahul Murkya:** So 70% of Rs.115 crores, I can safely assume it is Needle Coke?
- Raju Rastogi:** All kinds of Coke, whether Indian Coke or...
- Moderator:** Thank you. We will take the next question from the line of Devang Sanghvi from ICICI Direct. Please go ahead.
- Devang Sanghvi:** Just wanted a small clarification; are we guiding 90% utilization for both Q4 as well as FY'19 sir?
- Raju Rastogi:** Yes, that is what it is.
- Devang Sanghvi:** What could be the differential between UHP grade and HP grade -- has it narrowed significantly of late?
- Ravi Jhunjhunwala:** Yes, it has significantly lowered currently.

- Devang Sanghvi:** If we do not get sufficient amount of Needle Coke going forward, is the HP proportion going to increase is just a good assumption to take or no?
- Ravi Jhunjhunwala:** Logically what you are saying is right, but we do not expect any substantial difference in the availability and we do not expect any substantial difference in that proportion.
- Devang Sanghvi:** Currently 75-80% is UHP and balance is HP, right?
- Ravi Jhunjhunwala:** Exactly.
- Devang Sanghvi:** Our 80,000 capacity can go to what level in terms of Brownfield -- can it go to 120 or do we have enough land and stuff?
- Ravi Jhunjhunwala:** In the first phase we are talking about 100,000 tons.
- Devang Sanghvi:** But in case of a good scenario and if we have a good visibility of Needle Coke what kind of max limit that single plant capacity can go through, that is what I am asking?
- Raju Rastogi:** There are certain statutory restrictions on the usage of land that is made available by the government for industrial purpose. So based on that going above 100,000 in one single location looks to be difficult.
- Ravi Jhunjhunwala:** Just to say the same thing in a different manner, with 80,000 tons we are by far the single largest plant anywhere in the world, the second largest plant is about 60,000 tons, average plant in Europe and America is no more than 40,000-45,000 tons. We are already 2x bigger than the average plant that you can talk about anywhere in the world. So if we reach 100,000 tons we will already be 2.5x larger than average plant.
- Moderator:** Thank you. We will take the next question from the line of Vikas Singh from B&K Securities. Please go ahead.
- Vikas Singh:** I just wanted to understand one thing. You have talked about six plants have been closed in the last three, four years in US and Europe. So is there any possibility that some of these plants may come back because the market has been very good and outlook is also very rosy?
- Ravi Jhunjhunwala:** Yes, theoretically, what you are saying is possible, but in the European and the western background, it is extremely unlikely, it is extremely difficult to restart a closed plant because of again one of the major concerns is the environment issue, and secondly, as I said it is an issue of technology, so the plant which have been closed, the people have gone, these plants were closed more than two, three years ago, so to collect that same team which has gone three years ago and they started doing something else, but more important in that is the environment concern. At lot of these locations, the plants have been dismantled, some real estate person is already building something there, but yes theoretically may be one or two plants may come back, but it is highly unlikely.

**Vikas Singh:** Secondly in terms of Needle Coke which we import and the domestic procured Coke, what would be the price differential between the two?

**Ravi Jhunjhunwala:** Again, we would not like to go into the pricing aspect specifically, but as I said, these are totally two different kinds of products, and the selling price of Electrodes are different, the production costs are different. So, it is not fair to compare just the price of Coke.

**Vikas Singh:** No, I do not want the specific price of these two kinds, just the difference between the two, so let us say the higher grade needle Coke comes at...?

**Ravi Jhunjhunwala:** Let us say if you are talking about the margins, there is more or less no difference in the margin between the UHP and non-UHP currently. Probably that answers your question.

**Vikas Singh:** Okay. Sir, this 20,000 tons CAPEX which we are contemplating, what can be the amount which we need to invest for that?

**Ravi Jhunjhunwala:** I did not say we are not contemplating, I only answered your question when you said at this location what can you do, and that is where I said that we could probably go to about 100,000 tons, we have started looking at it, but at a very-very initial stage. Unless we have some very clear visibility on the Coke, our first target is to achieve close to 80% utilization, only then we can at least start talking and thinking about going to 100,000 tons, but we do not have the visibility of the entire Coke that is required for 80,000 tons.

**Vikas Singh:** In case of this contract for Needle Coke is it only the timing of the quantity can also be fixed?

**Ravi Jhunjhunwala:** Today the problem is more on the quantity than pricing. Availability is the issue.

**Moderator:** Thank you. We will take the next question from the line of Jimesh Sanghvi from Principal Mutual Fund. Please go ahead.

**Jimesh Sanghvi:** Just wanted to have your sense on this export duty which is kind of a tariff imposition at this point of time. Do by any chance we foresee that the government is kind of putting some sort of indirect pressure on us in terms of supplying the electrodes at a discount in the domestic market vis-à-vis the global prices, is this a kind of a lead indicator to us that if we do not kind of cut down our domestic pricings, probably the government might come and impose some kind of export duty?

**Ravi Jhunjhunwala:** I do not think the government is trying to control prices in this country anymore. We have gone much beyond those days, which used to happen 30-40 years ago. We are living in a free world, anybody can import, there is practically zero duty on import of Electrodes, just like we can export at any price, somebody can import at any price, and it is a free world, free market. I do not think that is the concern. The concern of the government obviously will be in the current scenario we should be able to first feed the entire Indian market and as I started talking in my opening remarks our capacity of the two Indian companies is about 160,000 tons, the Indian

demand itself is not more than 60,000-65,000 tons currently. So, there should not be any anxiety on that score that we will not be able to supply in the Indian market and then export. As I also said that it is not that we have suddenly started exporting, our proportion of exports has been about two-thirds for more than 15-20 years.

**Jimesh Sanghvi:** We understand that, but domestic steel industry is also facing a lot of pressure in terms of the NCLT cases and the profitability part. So, just trying to understand your thought process that suddenly out of the blue why has this come -- is that the government trying to take a share of the huge profits when the company has been making with the kind of Electrode prices which are there?

**Ravi Jhunjhunwala:** I do not think so, they are already getting that share in terms of income tax, you can either have income tax or you can have an export duty, you cannot have both.

**Jimesh Sanghvi:** Maybe if I can try and ask in different sense is asking tomorrow if hypothetically there is 10% or 15% export duty, does the company then plan to come and sell a lot of electrodes in domestic market, will the company try and do that?

**Ravi Jhunjhunwala:** We cannot sell more than 60,000 tons in any case. The demand itself in India is not more than 60000 tons. Even today that is what is happening; we are selling 60,000 tons in India first. There is practically no import happening in the last two, three years, because like in our case, we are taking care of the whole Indian market, first before exporting, similarly for an American producer, or a Japanese producer, he has the same situation, I mean, he would like to take care of his domestic market first before he starts exporting anything abroad.

**Jimesh Sanghvi:** But what we understand as of today is probably the domestic pricing being more of spot prices, selling price is much higher than what we export today?

**Ravi Jhunjhunwala:** That is not a correct assumption.

**Jimesh Sanghvi:** You have said utilization rate will be 90% for FY'19, is that what I have understood right?

**Ravi Jhunjhunwala:** We should be close to that.

**Jimesh Sanghvi:** So, we are confident about the Needle Coke procurement for FY'19 as well now, earlier we used to say it would be somewhere around 75-80%?

**Ravi Jhunjhunwala:** As I said, we are hoping that this expansion which is happening at the two refineries in UK and US, in all likelihood, that should be on the ground in the second half of this year, so that should ease little bit on the Needle Coke quantities.

**Moderator:** That was the last question in queue. I would like hand the conference back to Mr. Ravi Jhunjhunwala for closing comments.

*HEG Ltd.*  
*February 02, 2018*

**Ravi Jhunjhunwala:** Thank you, friends and thank you for taking so much of interest, and I look forward to speaking to you in three months, and I hope I can talk about in the same manner as I did today, I hope that we are able to maintain this performance, and I hope to speak with better results next time.

**Moderator:** Thank you very much. On behalf of HEG Limited, that concludes this conference. Thank you for joining us ladies and gentlemen. You may now disconnect your lines.