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Sub: Conference call Transcript

Dear Sirs,

With reference to captioned subject, we hereby enclose the transcript of conference call regarding Q2FY2021 results which was hosted by the Company on Wednesday, 18th November, 2020 at 15:00 hours IST.

Kindly take the above information on record and acknowledge the same.

Thanking you,

Yours faithfully,
For **HEG Limited**



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“HEG Limited Q2’FY 2021 Earnings Conference Call”

November 18, 2020



MANAGEMENT: **MR. MANISH GULATI – EXECUTIVE DIRECTOR, HEG LIMITED**
MR. GULSHAN KUMAR SAKHUJA – CHIEF FINANCIAL OFFICER, HEG LIMITED

MODERATOR: **MR. NAVIN AGARWAL – HEAD, INSTITUTIONAL EQUITIES, SKP SECURITIES LIMITED**



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Moderator: Good day, ladies and gentlemen. And welcome to the HEG Limited Q2' FY 2021 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 over to Mr. Navin Agarwal – Head, Institutional Equities at SKP Securities Limited. Thank you and over to you, sir.

Navin Agarwal: Good afternoon, ladies and gentlemen. On behalf of all of us at SKP Securities, it is my great pleasure and privilege to welcome you to this financial results conference call with the leadership team at HEG Limited.

We have with us Mr. Manish Gulati – Executive Director; Mr. Gulshan Kumar Sakhuja – CFO. We shall have the opening remarks from Mr. Gulati, followed by a question-and-answer session.

Over to you Mr. Gulati for your opening remarks. Thank you.

Manish Gulati: Yes. Good afternoon, friends. And welcome to our Q2 financial results 2021 con-call. Mr. Ravi Jhunjhunwala, our Chairman, Managing Director and CEO, could not join unfortunately because something very urgent came up. So, he got occupied with that. So, me, along with our CFO, Mr. Gulshan Sakhuja, we will be handling this call. This is Manish Gulati, Executive Director, HEG. So, I will begin.

More than 1 million lives have been lost due to COVID since the start of the year, and the toll continues to rise. In HEG, we have given top priority to the safety of our employees and put stringent controls at workplaces, including social distancing, use of mask, sanitizing, extensive use of online interactions and work from home, etc.. These are difficult times, yet there are some reasons to be hopeful. Testing has been ramped up, as you know. Treatments are improving. Vaccine trials have proceeded at aprecedented pace, with some now in the final stage of testing. As per the recent data from IMF, which suggests that many economies have started to recover at a faster pace than anticipated after reopening from the lockdown. Hence, we can expect a less severe, though still deep recession in 2020.

The World Steel Association in its recent short-range outlook forecasted that in the current year 2020, the world steel demand will contract by 2.4% due to COVID pandemic, and 2021 steel demand is expected to recover with an increase of 4.1% over 2020. The post lockdown recovery in steel demand in the rest of the world has been stronger than earlier expected, but it still marks a deep contraction in 2020, both from developed and emerging economies. There is only a partial recovery expected in 2021.



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In the first nine months of the current year, the group's steel production has dropped by almost 12%, excluding China, which is having an impact on graphite electrode demand. The electric arc furnace steel production was down in some of the large steel producing regions like Europe, U.S., Japan, South Korea, besides India, mainly resulting from slowdown in demand. The graphite electrode inventory adjustment, which was supposed to get over by the end of this year, COVID has de-accelerated the rate of depletion of these accumulated stocks. Our results in this quarter were impacted due to lower sales and lower graphite electrode prices, due to reduced EAF steel production in the rest of the world, except China. Capacity utilization for Q2 was about 74%.

Since the past year, as you know, the electrode prices have been sequentially dropping quarter after quarter to reflect the market conditions. We now expect the pricing to remain stable and improve from the current levels in the next two, three quarters. We expect resurgence in demand from 2021 onwards, once the impact of COVID subsides, hopefully, and the remaining electrode inventories get consumed. The needle coke availability has substantially eased. And accordingly, the prices of needle coke have come down substantially. We have always been exporting about two-thirds of our production to more than 30 countries, which helps us in diversifying the market risks. We have seen some recovery in the domestic electrode demand in Q2, which dropped by about 50% in April to June period, with improved production levels at major steel companies. We see a gradual improvement both in domestic and export markets going forward into the next quarter.

Electric arc furnace production has seen an approximately 2% to 3% compounded average growth rate over the long-term, and we expect this to continue as EAF becomes the preferred choice of steelmaking due to its inherent advantages over blast furnaces, like environmental considerations, low carbon emissions, low capital costs, ease of operations, etc. With our four decades of experience in business, we expect to be a supplier of choice to all our global and Indian customers. We have taken significant measures to manage our operations in this COVID crisis and ensure the health and safety of our workforce and team members.

With this, I will now hand over the floor to our CFO, Mr. Gulshan Sakhuja, to take you through the financial numbers. And then I, along with our CFO, will be very happy to answer any queries that you may have. Thank you.

Gulshan Kumar Sakhuja: Thank you. Good afternoon everyone. I will now briefly take you through the company's operating and financial performance for the quarter under review.

The second quarter started on a positive note with a relaxation in lockdown and gradual resumption of business activities. The company gradually increased its capacity utilization to 74% in quarter 2 FY 2021 as compared to 45% in the previous quarter. For the quarter ended September 2020, HEG registered revenue from operations of Rs. 323 crores as against Rs. 233



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crores in the previous quarter, an increase of 38% Q-on-Q basis, and Rs. 564 crores in the corresponding quarter of the last financial year.

EBITDA, including other income, stood at negative Rs. 25 crores in Q2 FY 2021 vs positive Rs. 35 crores in the previous quarter; and Rs. 174 crores in the corresponding quarter of the last financial year. The company reported a net loss of Rs. 34 crores in Q2 FY 2021 as against a net profit of Rs. 11 crores in the previous quarter. The performance was encouraged by improvement in the business activity, which was offset by the lower realizations as pricing continued to remain under pressure. Our balance sheet remains robust with a treasury size of about Rs. 1,400 crores at the end of September 2020.

The company has made a detailed assessment of its liquidity position and the recoverability and carrying value of its assets, comprising property, plant and equipment, intangible assets, right of use of assets, investments, inventory and trade receivables. Based on the current indicators of future economic condition, the company expects to recover the carrying amount of these assets. The company is operating its business by optimal utilization of eligible financial resources and also implemented stringent cost control measures across the organization to conserve cash.

The company is long-term debt-free and having a treasury size of nearly Rs. 1,400 crores, yielding an average return of approximately 6.5% per annum. The company has adequate internal financial reporting and control system. The company is having a mechanism to continuously review and monitor its policies and procedures to adopt with the dynamic environment.

Now we would now like to address any questions or queries you may have in your mind. Thank you.

Moderator: Thank you very much. We will now begin the questions-and-answer session. The first question is from the line of Ujwal Agarwal from New Horizons Finservice. Please go ahead.

Ujwal Agarwal: Now, my question is that when I look at the consolidated results of the company for this quarter, the cost of materials consumed has actually increased for this quarter. I would like to know the reason for that.

Gulshan Kumar Sakhuja: Yes. If you see in this quarter, we have taken an Inventory write down, and that forms a part of the material consumption. Therefore, you are observing the material consumption on the higher side.

Ujwal Agarwal: Okay. So, that has not been included in the other expenses, but it has been added to the cost of material consumed?



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Gulshan Kumar Sakhuja: It is a part of cost of material, yes.

Moderator: Thank you. The next question is from the line of Bhavesh Chohan from IDBI Capital. Please go ahead.

Bhavesh Chohan: Sir, just wanted to know, today as I see in SteelMint, UHP prices of India are at 35% premium to Chinese prices. So, does it indicate that Indian UHP prices should fall hereon?

Manish Gulati: See, I would like to answer this in this way that they are taking Chinese as a benchmark, that is where the adoption gets wrong because, of course, Chinese electrodes are definitely available at a price of 35% lower than HEG prices. But first of all, they are not two UHP products, they are using all kinds of raw materials, blending this, that. So, I don't know since when Chinese became a benchmark for all the electrode industry. But probably, they are the only people and one of the websites and SteelMint, and there's some site called Buy Information, so they all keep publishing data, but they are all just comparing Chinese prices with our prices of Indian electrodes, which is not correct, actually. It's not a apple-to-apple comparison. So, the price is still under pressure, but that doesn't really mean that it is going to go down, and we don't have to actually match the Chinese price for our product because it's not the same product actually. And customers do understand this. Of course, these kinds of news, this was a dampener and confusion in the minds of customers. But all the customers who have used both the electrodes, our electrodes and Chinese electrodes, they know what is what. So, we are not unduly concerned about that. We are very much aware that they are selling at this price gap, which you mentioned.

Bhavesh Chohan: Okay. Sir, that's helpful. And sir, secondly, what is the trend in needle coke prices in the last one quarter? Are they going up, flattish?

Manish Gulati: See, they have been going down in the last, let's say, now if we count by almost a year, it started early this year, and the prices have been going down. But that is actually not helping us much at this time because we are still holding sizable inventories of material bought in the past. If we were to get needle coke at today's prices and sell the electrodes at today's prices, there would be decent margins. Our problem is that till this inventory gets flushed out of the system, which includes raw material, also work in progress, also finished goods. Our processing cycle is so long, I mean, it takes two months to make electrodes and five months to make the connecting pins. So, till all this gets flushed out from the system, we will continue to see this pain, which might last for another quarter or so. I mean, this quarter, October to December, and one more. And from April, from next fiscal, it should correct.

Moderator: Thank you. The next question is from Anuj Sharma from M3 Investment. Please go ahead.

Anuj Sharma: Yes. My first question is, if I just look at the realization of our company versus our competitors, our realization seems to be low. What would be the reason for that?



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Manish Gulati: No, I don't think so. I mean if you are looking at our Indian competition, no, it's not low. It also depends on the prodigies, but it is not low. You have to look at the figures and maybe Gulshan can explain this better.

Gulshan Kumar Sakhuja: For making this comparison, you have to make the adjustment in the competitor results given the fact that they are into the other segments also. Their Graphite and carbon segment includes revenue from specialties and other products. You have to make an adjustment to that figure and then you have to arrive at a GE sales revenue. Their Graphite and carbon electrode revenue comprises of other products also, the same has to be eliminated to derive the Graphite Electrode sales revenue.

Anuj Sharma: Okay. In terms of pricing, it seems that we are roughly \$3,000 per tonne of realization, which we are quoting. You believe that this was the bottom or the spot prices are materially different than the realized prices?

Manish Gulati: First of all, the average realization which you are taking, the revenue by tonnage, please remember there's a portion of non-UHP electrodes also in this. So, that you are dividing. But I do hope sincerely that these prices should not go down any further because the spread between the current prices of needle coke and the current prices of electrodes is now enough for all companies to at least have some decent margins and survive and do good for themselves and survive for servicing the steel industry. So, this should not go down, I think, because needle coke pricing has also now reached a level where further major decline is not possible. They already went down to the levels which we had seen before they started to increase. So, there should not be further decline in prices of electrodes, which you are seeing.

Anuj Sharma: Okay. And in terms of needle coke, how more can you expect the costing to go down? In other words, you would be operating on an incremental basis, not on the historic basis because I account there will be historical cost. On an incremental basis, you said you make decent margins. What would that number be? Would that be around \$500 per tonne or...

Manish Gulati: No, we will decline to state the specific number because this is confidential, not only to us, but also to the needle coke suppliers. So, I am very sorry, but we cannot give out that number. All I am saying is that there has been a decline in needle coke prices, and further major decline doesn't seem possible because they are already reaching quite a low level.

Anuj Sharma: Sorry, this, you are talking about the raw material, the needle coke prices is it, or the realization?

Manish Gulati: I am talking about needle coke first. And of course, the spread between the current prices of needle coke and current prices of electrodes is also now at a level that it should not go beyond this. So, that means I am expecting that this electrode prices will now start bottoming out.



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Anuj Sharma: Sure. And in terms of our raw material, is our inventory now marked to the current prices? Or there is some more to go? So, is our inventory now completely marked down to the current realization level?

Gulshan Kumar Sakhuja: If you see, as on 30th September, the inventory has already been written down to the current selling prices. NRV is a factor of future selling prices. What would be the selling prices for fourth quarter or first quarter of next financial year would determine the actual impact of NRV in the books of accounts. But if I talk about the second quarter, it has already been marked down, the inventory has already been written down as per the current selling prices. But in case there is any further deterioration of selling price in the fourth quarter or further, then there might be a possibility that some impact would come.

Anuj Sharma: As per current prices, there is no marked deterioration now in the inventory, that's all marked up?

Gulshan Kumar Sakhuja: For September quarter, we have already taken that hit. If you see the notes to the results, we have already shown the hit on account of NRV and write down of inventory.

Moderator: Thank you. The next question is from the line of Rajesh Majumdar from B&K Securities. Please go ahead.

Rajesh Majumdar: I just wanted to know something on the new Chinese policy for steel scrap imports, which is expected by the end of the year. What do you mind is expectation on the new policy? Is it going to go back to the old policy? It's not going to go back to the old policy fully, right, so there will still be restrictions on low-quality scrap imports. How is that expected to affect the industry over the longer run?

Manish Gulati: No. India was not a net exporter of scrap anyway. So, this Chinese policy doesn't really impact much. What they are trying to do, I mean, they are trying to use their own scrap and stop low quality scrap from coming in. So, that way, I mean, India as a country, we won't be impacted much.

Rajesh Majumdar: No, I am not talking about the scrap price. I am talking about the impact of the graphite electrode exports that China is doing right now. So, if they are importing more scrap, naturally their domestic industry would consume more of electrodes. So, the export pressure, which is there right now might ease with the scrap imports. That's what I was getting at.

Manish Gulati: Not exactly. Actually, you see if China has not kept up the promise of taking the EAF share to 20%. You remember, three years back they were talking that, okay, our EAF steel portion is going to be 20% by year 2020. And we are already done with 2020, and they are still at that 104 million, 105 million level. Actually, they should have been at 200 million this year, which would have really eased a lot of problems, their own internal electrodes would have got



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consumed there. But still for them, somehow blast furnace gives them better economies. So, they did start with a bang, they did increase from a level of 51 million tonnes production from EAF route in 2016. And in two years, they came to 108 million, then in 2019 it was 104 million. And the way they are going in this year, the steel production is increasing. But again, I mean, their reliance is still on the blast furnace route. Which just goes against conventional logic because now when the countries develop, the recycling of steel increases. But despite having their scrap, their electric arc furnace production is still at 10%, 12%, although it should have been 20%.

Rajesh Majumdar: Right. So, if there is a change in the scrap import policy, you don't expect a significant change in that in terms of the...

Manish Gulati: No. Actually, that's what I was trying to say. Actually, this policy has lesser of an impact rather than somehow in China they still find the blast furnace route to be more economical, even if it is environment unfriendly. But probably around \$30, \$40 a tonne, there is still per tonne of steel made, we still find it more cost competitive making it through blast furnace route, defying all their earlier policy which they had made that they want to take the production to 20%. They have not done so. While the rest of the world is around 50% or rather to give a very specific number, it's 48%. So, excluding China, 48% steel made in the world is made through the electric arc furnace route. And that is what was expected out of China, to take it from 10%, if not 40% long way off because that is a country still relying more on blast furnace production. But 20% was not difficult to achieve, and they were putting up a lot of electric arc steel furnaces. So, I don't know, they are not keeping up with their plan, the Blue Sky policy, which they were talking about.

Rajesh Majumdar: Right. Could that also be because of the fact that scrap prices are very high, the current spreads are not practically enough for the EAF route because...

Manish Gulati: Yes, that is what I was saying. If you look at the cost of making steel from the both routes, the current scrap prices are still not economical for them. Although it was expected that as an economy, when they are maturing and there is a life cycle to steel, as steel comes in a market in form of scrap, it should have come. But still the scrap prices are such that they still find blast furnace route more economical.

Moderator: Thank you. The next question is from the line of Anuj Sharma from M3 Investment. Please go ahead.

Anuj Sharma: Yes. My question is, while the UHP technology was with few players, we heard that China, some players were trying. Any success in China-based players of successful UHP implementation or capacities coming up?



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Manish Gulati: See first, I will answer the technical part. Then, yes, of course, everybody knows that there is a big learning curve in this and even the same company, I mean, I am just giving you an example, even one of our multinational competitors, the world leaders, they set up a new plant in Malaysia. And that plant still gives them a lot of trouble as far as quality is concerned. So, this process is such that it takes a while for each company to perfect that with the available raw materials, whatever they have. The needle coke is fine, then the pitches are mostly local, the binder pitches, etc. So, it takes a while. But the Chinese progress, if you ask me on the technical front has been, there are about five integrated producers in China. Out of them, one or two are able to make electrodes, let's say, up to a certain size, let's say, I will give you a best size up to 24 inches. But it is going to take time, if they really make a true UHP product, they have to use 100% needle coke, take it through a certain process and then make a product which is equal to that of HEG or other world majors. And that is where they cannot fight on price. The fight comes when we are making different things. If they are using other kind of raw materials or using them in a blended way or something, then they, of course, cannot make the same product. See, our target is to remain cost competitive. See, these pressures will be there forever. But it's just a pricing pressure, not a technical pressure that, okay, they have made a product that we cannot match up with on the quality point. So, we have to make a good quality product and stay competitive in our costs. So, that is going to be the mantra for the future.

Anuj Sharma: Sure. And what is the amount of quantum of capacity you are talking about in Chinese expansion in UHP space?

Manish Gulati: See, UHP space if I hazard a guess, they were putting up a lot of, I don't know, brownfield, greenfield type of expansions. I don't know if, let's say, let me put it this way that UHP capacity out of the total, I think, they have about, among the five players itself about 6 lakh is what they have. But about, let's say, 80,000 tonnes to 100,000 tonnes capacity would be of UHP. But just having a UHP capacity doesn't mean nothing, they have to use the right raw materials, and they need to have the right technology.

Anuj Sharma: Sure. You explained that earlier. And one last question is, needle coke has always been supplied by very few concentrated guys. Is there any thoughts or any expansion or diversification in the supply source? Or that still remains concentrated? And is expected to remain concentrated in the next three, five years?

Manish Gulati: The major players in the industry, which is like the likes of Showa Denkos and Tokais, these two Japanese companies; and GrafTech which is an American company, and HEG and our Indian competitor, all of these companies are using this standard, proven, year-long history of needle coke from these three suppliers. One of them is an American company, P66, and two of them are Japanese. Now when it comes to Chinese, they have their own raw materials. They are putting up a lot of, it's not needle coke as such, it's coal tar based, it's pitch based needs needle coke. So, in Inner Mongolia they are putting up a lot of these plants, which are going to make this needle coke or the substitute of petroleum-based needle coke from the coal tar based



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pitch coke route. So, that they are going to do because if they have to service their own electrode to meet their own demand, they are ramping up their local supplies. But that's not petroleum-based needle coke. So, these companies who have been in the business for 40, 50, 60 years, they are still using the proven suppliers. But yes, new capacities which are based out of coal tar based pitch coke are coming up in China.

Moderator: Thank you. The next question is from the line of Kriti Jain from Sundaram Mutual Fund. Please go ahead.

Kriti Jain: Sir, in terms of utilization, how you see our utilization expected to move over the next one or two quarters? Given that the demand is improving for the steel sector, how you see our utilization moving up?

Manish Gulati: See, our expectation for the next two quarters, by the October to December quarter and January to March, we are expecting to be around 70%.

Kriti Jain: Okay. What is currently, sir, what was it in July to September quarter?

Manish Gulati: It was 74%. And prior to that it was 48%.

Kriti Jain: So, you expect to come down, sir?

Manish Gulati: No, no. In total we are expecting to go up. In the first half, it is 60%, and we are talking about 70% for the second half.

Kriti Jain: No, sir, from second quarter to third and fourth, sir?

Manish Gulati: Second quarter, third and fourth, that's very marginal. Actually, I am just giving an estimate, it should be around 70%.

Kriti Jain: Okay. Sir, like any destocking or stocking will happen, sir, given that prices are expected to move, that relate to volume ramp up, anything do you see or your customers are ordering you more economic ordering quality?

Manish Gulati: See now one positive sign, which we have started to notice in the last one month is that the customers who were absolutely shy of just taking more than three month call, they are now slowly coming out of their insecurity and trying to take a six month call on prices. Earlier, they were just not hazarding I mean their purchase beyond three months, which actually means that the steel companies probably now have better visibility of demand. So, they are able to or they are trying to get in the position to take a call on tying up their raw materials for, let's say, six months. Now these are early indications, and I hope they will sustain. Because once we come back to our earlier modules of at least being six months the three companies used to order six



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months at a time, we used to contract the needle coke six months at a time. So, that is actually a much better, much more stable environment rather than just selling three months at a time for a product whose cycle itself is two months. So, there are positive indications. But then, again, the current time and era which we are going through, this COVID thing is so confusing, Europe comes out of lockdown then again goes back into lockdown. So, a lot of things are happening. Let's see, let's hope, by March, I think the situation will become much more clearer about steel demand of 2021, how COVID unfolds. Let's see.

Kriti Jain: Okay. Sir, in terms of our RM bucket, from, say, January to March to July to September, is the raw material price decline very substantial, sir?

Manish Gulati: Yes, it has, but it doesn't help us actually because still we are holding our stocks, you have seen NRV hit we took in the quarter closing March and, again, the preceding quarter ending September. So, we would have been very happy to get those raw materials at the prices of today and sell electrodes at prices of today, and we would have made good margins. So, the same which we have, I am just repeating myself, it takes two months to make electrodes and five months to make the connecting pins. So, it's really natural and all these raw material getting imported because always we have two months of the electrodes actually in the furnaces, two months of raw materials in our silos, two months on high seas, and two months to finish inventory gone, so it's eight months. So, whenever there is fluctuation in the market prices, this is a minimum which we have to contend with. The reverse had happened when the prices had shot up, we had these raw materials, I mean, we had this needle coke as raw material, we had work in progress, we had finished goods. So, we have enjoyed that time. So, it's kind of somewhat a reversal of what is happening.

Kriti Jain: So, the current inventory, suppose say if you buy today's inventory, we would be getting the benefit in next year, April to June, correct, sir?

Manish Gulati: Yes, yes. By the time majority of our inventory, which is in all forms, would have been consumed and sold.

Kriti Jain: Because when we see our inventory, it is like roughly Rs. 750 crores. Our quarterly consumption is roughly Rs. 250 crores of inventory. So, it takes three quarters to consume the inventory, right, sir?

Manish Gulati: That's correct. Two quarters for sure. And then the third quarter, what happens is that we have already started buying a particular grade. So, it becomes a blend actually. The new prices of needle coke starts flowing in and then some which is outgoing, and it's mix of blend actually. But you have very rightly noticed, and yes, so that's why we are saying two quarters for sure. In the third quarter, the new prices will take over and, let's say, then we will be selling two-third of the electrodes made out of needle coke at current prices and one-third out of the inventory. So, that will be the return to profitability.



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Kriti Jain: Sir, my last question is, sir, given that to earlier one of the participant you told that a large capacities are being created in Chinese markets, and government is looking for self-reliance for the resources. Sir, have we along with our industry partners, have we gone for some antidumping relief or something, sir?

Manish Gulati: No. Antidumping relief on electrodes, which are coming from China to India?

Kriti Jain: Yes, sir.

Manish Gulati: So, far, our answer is, no because when the electrodes were very tight in India, we were actually supporting the steel industry in India, and we volunteered and said, okay, these are very trying times and we supported the removal of antidumping with the hope that actually Chinese will stop this. But if let's say, we will watch this situation for another six months and if they continue to do so, then at the appropriate time we will do that.

Kriti Jain: But sir, you know the government process, it takes its own time and again then the injury to us and the industry will be very high, sir. I mean once they start the investigation process goes on for year or two, then outcome comes and then it will be very long. So, shouldn't we try now itself, sir.

Moderator: Thank you. Next question is from the line of Rahul Jain from Anand Rathi. Please go ahead.

Rahul Jain: Sir, I just wanted to ask that how much does the needle coke constitute to the total RM consumption?

Manish Gulati: It actually depends upon the selling prices. But as a very rough benchmark, it should be 30% of the total cost.

Rahul Jain: Okay. And which other major raw material would be using in production?

Manish Gulati: See, in this business, our next important constituent is power. So, first is needle coke, second is power.

Rahul Jain: How much that would constitute to the total raw material cost?

Gulshan Kumar Sakhuja: Rahul, these are the things which are confidential in nature. So, if you see our financial statements, you can work out the bifurcation between raw material, other material and power costs and all such things. We cannot speak specific numbers on costing part.

Moderator: Thank you. The next question is from Dewang Sanghvi from ICICI Securities. Please go ahead.



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Dewang Sanghvi: My question is regarding the destocking trend. Can you just throw some light sir what is the pace that is going on? And can we expect that to be over at the customers end by, say, this fiscal year end?

Manish Gulati: See, now we are almost reaching the end of it. And whatever the commitments some of the customers had made, actually, their own steel production dropped by about 25%. So, that is why it caused them a lot of problems. So, I think by March we should have majority of the situation behind us, majority of it. Actually, it should have been done by now, honestly speaking. By September, we were expecting that this inventory overhang should be out of the market. But because of this COVID thing, it's taking longer.

Dewang Sanghvi: Right, sir. And this Indian demand has picked up quite a bit of last, say two, three months in terms of steel production in India. So, has that helped off late?

Manish Gulati: Yes, it has helped some of the volumes. But India is only, let's say, out of 100 million tonnes is only 30 million tonnes from electric arc furnace route and rest are still blast furnaces. However, electrodes are also used in them for the refining in the furnaces. But as the capacity utilizations have improved in India from a level of, let's say, 60% in April to June to about 80% plus, now 80% to 85%, certainly we have seen a growth in electrode demand in India also.

Dewang Sanghvi: Right, sir. That was helpful. And on your capacity expansion plan from 80,000 tonnes to 1 lakh tonnes, are we delaying this particular expansion maybe by six months or so?

Manish Gulati: We just put a temporary hold on it, I mean, of course, the equipment has been ordered, everything is on the way. We just stopped the work for a few months. One reason was COVID. We were getting about 1,000 workers inside the premises every day. So, that was increasing a lot of risk as we don't know where they come from. So, that was one major reason because we were having a lot of issues with the government rules that work with 50% people. So, we had to just put civil work at stop. Rest of it, all the long lead equipments, which were ordered, are very much on the way. So, we will just look at the right timing and rebegin.

Dewang Sanghvi: Right, sir. So, how much CAPEX you have incurred in H1? And what is the plan for the full year, FY 2021, sir?

Gulshan Kumar Sakhuja: Dewang, if I talk about till date, we approximately spent Rs. 180 crores plus on that. Since we have already opened the LC's, the amount has already been committed, we are expecting, the cash outflow would be in the range of around Rs. 200 crores or Rs. 225 crores in the next 18 months. Total spend would be around Rs. 400 crores, means Rs. 180 crores already spent and Rs. 200 crores or Rs. 225 crores in the pipeline, and that will be spent over the period of next, you can say, 18 months. And we have been reviewing the situation. And on the basis of that, then again, we will take the call that how we have to proceed further. Based on that, we will



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see the market situation, demand, supply capacity utilization of all electrode players. Then we would again assess as to how we have to proceed further to spend more.

Dewang Sanghvi: Right, sir. And on YTD, how much you have spend on the expansion till date in terms of total CAPEX?

Gulshan Kumar Sakhuja: Yes, please come again.

Dewang Sanghvi: YTD total CAPEX on the expansion plan from 80,000 to 1 lakh, how much you will have spent up till now?

Gulshan Kumar Sakhuja: Around Rs. 180 crores. We have already spent it.

Dewang Sanghvi: Rs. 180 crores.

Gulshan Kumar Sakhuja: We already spent it. Yes.

Moderator: Thank you. The next question is from Kriti Jain from Sundaram Mutual Fund. Please go ahead.

Kriti Jain: Sir, just one clarification. In the inventory, which has been marked in the books, is to the extent of net realizable value or marked near to the current purchase price?

Gulshan Kumar Sakhuja: We have done it as per that Ind AS and accordingly we have to write down inventory to its net realizable value. So, for all the WIP and FG, the hit that we have taken in the books of account in the first half, has been written down to the level of selling price.

Kriti Jain: Okay. And RM would be at the near to the current price as on the September 30, sir? RM would be marked to that?

Gulshan Kumar Sakhuja: For RM, we have already taken the hit in the last financial year. But now the question comes if there would be a further deterioration in selling price, then based upon accounting standard we would access, how much hit would come into the profit and loss account. But as of September, means whatever amount we have taken, around Rs. 32 crores, is based on our cost of production vs selling price. The amount that we have already taken the hit of Rs. 32 crores in first two quarters.

Kriti Jain: No, no, sir. What I meant, sir, RM would have fallen from, say, June 30 to, say, September 30, RM would have fallen right, sir? But we would have purchased suppose say, in July.

Gulshan Kumar Sakhuja: I understand. I have bought RM at x price, and it has come x minus delta on 31st of March. We have already taken a hit of x minus delta on 31st of March. And again, there is a further downward revision in the raw material prices, so that has not been accounted so far because



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the NRV does not trigger at that particular price. But that is going to affect that EBITDA margin because still that raw material is on the higher side what we valued on 31st of March 2020.

Moderator: Thank you. The next question is from the line of Saket Kapoor from Kapoor & Company. Please go ahead.

Saket Kapoor: Just to take forward the conversation from the previous speaker. Sir, if we take this written down part, then it is up to September. That is as on September 30, whatever inventory we were carrying, that gets marked down to the prices for both raw material as well as the finished goods?

Gulshan Kumar Sakhuja: Yes.

Saket Kapoor: And sir, what have been the trend, sir, for the month of October and November as of now? Has the prices declined further from whatever marked down we have taken?

Gulshan Kumar Sakhuja: Sir, if I talk about October or November, the prices are more or less similar. But now the question of inventory write down will arise when the expected selling prices for fourth quarter of this financial year or first quarter of next financial year would deteriorate further. In case if the prices deteriorates further, from what we have taken on 30th September, then the question of inventory write down comes into picture.

Saket Kapoor: Come again, sir, I just missed your part.

Gulshan Kumar Sakhuja: In case, if there would be a further deterioration of selling price in the fourth quarter of this financial year or a first quarter of next financial year, then there is a possibility that a further hit of NRV would come into play.

Saket Kapoor: No, sir. When you close the quarter in December, then also the NRV will definitely play as on 31st December. Whatever will be the selling price, you have to mark down or mark up the same?

Gulshan Kumar Sakhuja: Sir, NRV impact will be calculated on the closing stock which we would have on 31st of December vis-à-vis the selling price for the next quarter. Next quarter means for the fourth quarter or the first quarter of next financial year. In case if the prices of fourth quarter further deteriorates, then we have to take a further hit in the in third quarter, sir. But for now whatever the hit that we have taken in the books of accounts as on 30th September, is based on the selling price that we are having for this third quarter. We have to evaluate on quarterly basis what is the projected selling price for next quarter or next four months or five months. Because in the current market scenario, all the orders are in the range of two or three months, maximum four months. So, that's why we have to assess it on quarterly basis that this is projected selling



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price and this is the cost of production, we have to take this much of amount as inventory write down in the books of accounts in a particular quarter.

Saket Kapoor: Okay, sir. And sir, currently, I think as articulated by you, it is the needle coke prices that have corrected to a greater extent. So, sir, with this fall, has that depressed the graphite prices equivalently? Or the fall in the graphite prices have been somewhat less arrested than the impact of the fall in needle coke?

Manish Gulati: See, the electrode prices went skyrocketed. Of course, needle coke prices also. But the spread between the prices of needle coke and the price or electrode in 2018 was very high. Now that is getting corrected. That was peak spread at which we were at 75% margins, which is unheard of in any industry, which was unusual. And once in a blue moon type of an occurrence. So, of course, the needle coke prices have come down, but electrode prices have come down even further. But they are actually returning to reality. That is how it has been in the last so many years of our existence, that the spread between the needle coke prices and the electrode prices should be such to be able to be able to give us healthy margins and rest come from volumes. Where anywhere between 25%, 30% margins is considered good in our business. So, if you have the volumes after expansion, so that will give us good profits.

Saket Kapoor: That will play out only in the first half of next financial year. This benefit will not be attributed to our numbers for the December and the March quarter?

Manish Gulati: Absolutely. Absolutely. Absolutely correct. That's what I said in the beginning that there will be two more quarters.

Saket Kapoor: Two more quarters of pain.

Manish Gulati: Yes, two more quarters of pain. Exactly. You said it. Yes.

Saket Kapoor: And sir, for the electrode price trends, what have been the price trend for, say, for the month of September, October and as of November? If you take the spot prices into consideration, what are the trends indicating?

Manish Gulati: There is still a pressure. If you are talking about the trends in, let's say, between September, October, there's not much difference. But when we start booking further orders, there's going to be some more pressure on the price. But we cannot indicate the specific number. But of course, you can always make some estimate from our revenues and capacity utilizations. But please do remember that there's a product mix. We have certain non-UHP portion also in this.

Saket Kapoor: Correct. And for the sales mix part, sir, how much is domestic and export for the first half?



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Manish Gulati: It is one-third, two-third, it keeps varying. Sometimes it will become 35% India and 65% export. It keeps varying actually. Anywhere the Indian sales vary between 30% to 40% and correspondingly export sales between 70% to 60% depending quarter-on-quarter.

Saket Kapoor: And sir, for us, the key domestic players, our buyers are SR and the Bhushan?

Manish Gulati: Yes, SR, JSPL, Jindal Stainless, Tata Steel Authority and many alloy steel producers like Vardhman Steel, Mukund, Kalyani. Yes.

Saket Kapoor: All across the board, sir.

Manish Gulati: Yes. Anybody who has an electric arc furnace in India, is using electrodes, is our customer, almost everyone.

Saket Kapoor: Correct, sir. And sir, for the utilization of cash, sir, since Ravi sir is not here today present. So, sir, what are we exactly will be doing to do with that cash? Definitely, expansion is there. We put money for the CAPEX. Other than that, any way in which we are trying to reward shareholders? Because right now, the business sentiments are sour for the industry. So, the investors who are there in the journey with you, in what way can they be rewarded?

Gulshan Kumar Sakhuja: Yes. From a reward point of view, if you see last two years, the company made a good profit and has rewarded that to all the shareholders in the form of dividend and also in the form of buyback. The payout ratio was in the range of 32% - 33%. And if you see the trend of last seven or eight years, the company has always rewarded to the shareholders and have made payout in the ratio of 30% - 32%. And once that we come into black, means once we come into profitability, definitely we would try to maintain the same payout ratio for the shareholders. If you see the first half, because of COVID coupled with high cost inventory, we are expecting this financial year to be a difficult year from profitability point of view. But from the balance sheet point of view, the overall treasury position has been strengthened by Rs. 300 crores from March to September. And going forward, by March 2021, it is going to be further strengthened. And as far as the other business parts are concerned that you just said, we have already evaluated at least two or three or four proposals. But ultimately, the management decided to go for expansion, but because of COVID and all such factors. that has been put on hold, and we have been reviewing that. And once the market comes into normal capacity utilization or steel company comes into the normal capacity utilization, then we would try to put this money for the expansion from 80,000 to 100,000 mt.

Moderator: Thank you. The next question is from Anubhav Sahu from MC Research. Please go ahead.

Anubhav Sahu: Sir, a couple of questions. One is regarding China's graphite electrode production; I think somewhere you mentioned that UHP grades from China production is roughly range of around 80,000 to 1 lakh tonnes. And of course, it has made from a different raw material. So, I wanted



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to comment on how is the acceptance of Chinese UHP grade in global market now? Is there any marked change perception over the years? The question is coming with the context that we saw, if I remember right, it was not seen as a key competitive product for us. So, is it that sir the UHP...

Manish Gulati:

I would say, because you see the steel companies need reliability of supply and a consistent quality performance over years. It's very difficult to change that. Normally customers, they need two, three years' worth of experience to just change and award a major business. Giving a 10% requirement or a 5% requirement, it doesn't mean much until the customers are sure and they know that they will get the same quality year after year that they can allocate 30%, 40%, 50% of their business. So, the acceptability of their product is still low, I would say. I mean, they are also an approved vendor. But yes, they go in the market with a 35% lower pricing. It does put some pressure on us as far as per only pricing is concerned, because customers do ask us and they also get down because they also call the UHP product, although we know for a fact that it's not a UHP product cannot be made at this price, made and sold at this price. If somebody has used prime needle coke from these primary suppliers, then they actually cannot make it at that price at which they are selling. So, we know that it's not that. And customers also somewhere. But at least customer give them a trial here and there. So, there is some limited acceptability in some furnaces, which are not as strong, weaker or customers who want some saving upfront. That's about it.

Anubhav Sahu:

Okay. So, sir, other than quality, is there any other requirement which the Chinese UHP warrant from the end client? For example, I mean, of course, it goes for electric arc furnace. But is it a different size of electric arc furnace, which is more suitable for what China caters to?

Manish Gulati:

For the lower diameters, they can still get their value proposition or sell at 35% cheaper and still give a 10%, 15% higher consumption. And for lower sizes, they still make it, but actually the world demand is more towards the bigger diameters. There they are still not as successful.

Anubhav Sahu:

And sir, just to bring a context. I mean, would you have a approximate number that what would be total global UHP grade production ex of China for capacity?

Manish Gulati:

It should be around, let's say, the capacity would be around 700,000 tonnes, excluding China of UHP electrodes. But again, at present, the industry is working at 50% capacity utilization. As an industry, I am saying I am counting all the suppliers put together.

Anubhav Sahu:

Right, right. But this is the total graphite you are talking about or the UHP grade? I mean can you make a distinction that way?

Manish Gulati:

No, I am talking about all the players, all the major UHP players.



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Anubhav Sahu: Okay. And sir, of course, China did mention about 20% target for steel production through EAF route, and there's up and delay in that. In percent is the how much is right now the production through EAF route in China?

Manish Gulati: It's about 105 million tonnes. When we close the year, we will get the figure. But I think it will be around 105 million tonnes, which is, let's say, 10%, 11% shouldn't be 2020. So, for 2020, it means we need a lot, another 100 million tonnes would have absorbed 200,000 tonnes of electrodes.

Anubhav Sahu: Okay. And about this, sir, again, coming back to the same figure, like, 100,000 UHP production from China, would you have an idea how much of that would be exported from China right now, given that there is a delay in EAF route production?

Manish Gulati: Must be around 50% to 60%. I don't have a hang of those figures from China really, but that should be about it.

Moderator: That was the last question in queue. I would now like to hand the conference back to Mr. Manish Gulati for closing comments.

Manish Gulati: Yes. Thank you for listening to us friends, and we look forward to speaking to you again with better visibility next quarter. Thank you very much.

Gulshan Kumar Sakhuja: Thank you.

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