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10th July, 2020

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Sub: Conference call Transcript

Dear Sirs,

With reference to captioned subject, we hereby enclose the transcript of conference call regarding Q4FY2020 and FY2019-20 results which was hosted by the Company on Monday, June 22, 2020 at 14:30 hours IST.

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

Thanking you,

Yours faithfully,
For HEG Limited

Vivek Chaudhary
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“HEG Limited Q4 and FY '20 Earnings Conference Call”

June 22, 2020



MANAGEMENT: MR. RAVI JHUNJHUNWALA – CHAIRMAN, MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER, HEG LIMITED

MR. MANISH GULATI – EXECUTIVE DIRECTOR, HEG LIMITED

MR. OM PRAKASH AJMERA – GROUP CHIEF FINANCIAL OFFICER, 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 Q4 and FY '20 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. Ravi Jhunjhunwala – Chairman, Managing Director and CEO of HEG Limited; along with his colleagues; Mr. Manish Gulati – Executive Director; Mr. Om Prakash Ajmera – Group CFO; Mr. Gulshan Kumar Sakhuja – CFO. We shall have the opening remarks from Mr. Ravi Jhunjhunwala, followed by a question-and-answer session.

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

Ravi Jhunjhunwala: Thank you. And good afternoon, friends. And welcome to our Q4 and full year 2019-2020 con-call. Our results in this quarter, although lower than previous quarter, still remain one of the better ones in the industry. However, as you would have noticed, we had to take abnormal hit on the account of recognition of inventory at NRV in accordance with the applicable IndAS accounting laws. This is typical of our industry, which has a very long production process cycle of anywhere between 6 to 24 weeks. And due to this, at any particular time, we would always carry substantially large stocks of WIP at different stages of processing. On top of this, our main raw material, needle coke, which is imported, adds another six to eight weeks to the cycle, due to the distance and some stocks that we have to keep. We enjoyed its resulting gains when we were carrying very low-price inventory, WIP, and finished inventories, and electrode prices kept going up at regular intervals a couple of years ago. And now it's just the opposite, so we have to pay for that.

The current COVID-19 pandemic, other than being a huge threat for public health, has also pushed the world economy towards the worst ever slow down. Even worse than the Great Depression of 1930, and also the last one of the financial crises in 2008-2009. As per the latest IMF announcements, the global economy is projected to contract sharply to minus 3% in 2020, and it expects to grow by 5.8% in 2021, as some economic activity normalizes. We see more on the similar figures from different agencies, but at the end of the day, these are just best guesstimates from different people. And only time will tell what's in store.



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Last year, the electric arc furnace steel production was down in some of the large steel-producing regions like Europe, Japan, CIS and Turkey, mainly resulting from slowdown in demand. Trade tension between U.S. and China and all other geopolitical tensions in some parts of the world that all of us are witnessing. Now, due to COVID crisis, World Steel Association in its recent short-range outlook forecast for the current year 2020, the world steel demand is likely to contract by 6.4%, and the recovery in 2021 will be to the extent of about 3.8%. Since the past year, as you have witnessed, the electrode prices have been sequentially dropping quarter after quarter to reflect the market conditions. And many of our customers have reduced or suspended operations, both of this has resulted in contracting the electrode demand.

As you also know, given what happened to the electrode prices in 2017 and 2018, the customers had substantially overbought the electrodes till the first half of 2019, and were obviously carrying this extra inventory. And with the current pandemic, this has further slowed down the rate of inventory destocking and fresh purchases. The needle coke availability has substantially eased, and accordingly the prices of the needle coke have also come down substantially. Due to our industry being a process industry, we were able to run part of our processes even when the first lockdown was announced on the 24th of March. In fact, we never closed down the plant completely and we were lucky that we were only 40, 45 minutes away from the main city of Bhopal. And within four to five hours of lockdown being announced in the afternoon of the 24th of March, we were able to mobilize about 150 workers and about 25 of our senior executives, who stayed inside the premises for the next 30, 35 days to keep running the plant, and at least recoup all the in-process work-in-process which was lying in the furnaces. By the end of April, the Madhya Pradesh Government gave permissions to most of us to restart at about 50% of its operations. And these restrictions kept getting more and more eased to mid-May onwards; subject to following, obviously, the required precautions to deal with the COVID at the plant and office premises.

As you are aware, we have always when exporting about two-thirds of our production to more than 30 countries around the globe, and that helped us during this time to hold our ground. While we have seen the domestic market drop by about 50% in April and May, it is now set to improve with major steel companies increasing their production. What we also saw was that some of the large customers kept operating at between 80% to 90%, while many of the smaller customer more or less didn't start at all. So overall, we saw a drop of about 50%, 55% in the purchase of electrodes at least in April and May. But now we are seeing an uptick as most of the other smaller countries have also started production, though at a smaller rate. Whereas the large steel companies are surprisingly still operating at more than 75%, 85%. We see a gradual improvement, both in domestic and export market going forward for the next quarter. However, the situation in the international market was not as bad as India. And to that extent, since we export about two-thirds of our production, we were not as badly impacted as some of the other international players are.



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With our four decades of experiences in business, we expect to be supplier of choice to all our global and Indian customers. We have taken significant measures to manage our operation in this COVID-19 crisis and ensure the health and safety of our workers and team members. We have taken enough steps to contain our fixed cost. And as you have been following our company, you would have also noticed that in this particular product the fixed cost doesn't amount to a very large amount. But given this current situation, obviously, we have looked at each and every aspect of our cost and we have been able to make substantial savings, which we believe is now going to be a permanent features, we are not going to go back to the olden days in terms of our fixed cost. And as I said, the needle coke and other raw materials have come off substantially from what they used to be at, let say, about 12 months ago.

Friends, with this, I would now hand over the floor to CFO, Gulshan Sakhuja, to take you through the financial numbers. And then, I along with my colleague Manish, and Group CFO, Mr. Ajmera, will be very happy to answer any queries that you may have. Thank you. Over to Manish and Gulshan.

Gulshan Kumar Sakhuja: Thank you, sir. Good afternoon. During the year, the company's performance was affected due to lower volumes and realizations. Furthermore, the profitability declined mainly due to recognition of inventory at net realizable value as per IndAS by Rs. 427 crores in quarter four FY '20 and Rs. 459 crores in the year ended FY '20. For the quarter ended 31 March, 2020, HEG recorded revenue from operations of Rs. 374 crores as against Rs. 394 crores in the previous quarter, and Rs. 1,347 crores in the corresponding quarter of the last financial year. Further, revenue from operations for FY'20 stood at Rs. 2,149 crores as against Rs. 6,593 crores in FY '19. EBITDA including other income stood at Rs. 138 crores in FY '20 versus Rs. 4,767 crores of previous financial year.

The company reported a net profit of Rs. 53 crores in FY '20, as against profit of Rs. 3,050 crores in FY '19. Further, in light of the heightened concern on the spread of COVID-19 pandemic, Government of India announced a lockdown to contain the spread of disease. Thereafter, on announcement of lockdown, there was no operating business activity except in case of some specific processes which are of continuous in nature. We started again from 23rd April of 2020, but at a lower capacity. Presently, it is very early to assess the future impact of COVID-19 with reasonable certainty. However, the company is operating its business by optimal utilization of available financial resources. And also implemented stringent cost control measures across the organization to conserve cash. The company is long-term debt free and having treasury size of nearly Rs. 1,250 crores, yielding and average return of approximately 7% per annum.

Our working capital is in line with the historical cycle with customers paying us as per the terms. We continue to make payments to our vendors as per our obligations and all payments were being paid on respective due dates, hence there is no liquidity concern. The company has not opted for the option provided by RBI of deferred payment of interest on working capital



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facilities. The company has adequate internal financial reporting and control systems, and also having a mechanism to continuously review and monitor its policies and procedures to adopt with a dynamic environment.

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

Moderator: Sure. Thank you very much. We will now begin the question-and-answer session. The first question is on the line of Sonali Salgaonkar from Jefferies. Please go ahead.

Sonali Salgaonkar: Sir, thank you for the opportunity. Sir, my first question is from the industry perspective. What is the level of inventory of finished goods and needle coke that the industry is carrying currently?

Ravi Jhunjhunwala: So, Manish, will you take it up?

Manish Gulati: Sure. I will take it up, sir. Sonali, did you mean what is the level of inventory of electrodes the steel companies have?

Sonali Salgaonkar: Yes. And separately, needle coke as well with us? With us as in the graphite electrode companies from the industry.

Manish Gulati: Yes. See, I can answer this question in a way that, first, we will exclude India out of this, because in India they have brought down their inventory levels. But globally, still people are caught with contracts with extra electrode. So, you must have heard our competitors also, that they were saying that this inventory correction should have taken place by end of 2019, and then they pushed to H1 2020, and then that's when the COVID struck. And now we believe that more or less inventory correction should take place by the end of this year totally out of the system.

And about your second question of how much needle coke we have, I mean, because our product is such that we always have two months with us in the factory and two months on the way from high seas, but just because we had bought and committed extra needle coke last year, I think we can really say that depending upon the level of production, we are probably having around six to seven months of needle coke inventory with us. And it is quite a similar situation with many companies, I am would not say all, but many.

Sonali Salgaonkar: And from when did the prices of needle coke start coming off materially?

Manish Gulati: Coming up or going down?

Sonali Salgaonkar: Coming off, going down?



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Manish Gulati:

Yes. Yes.

Ravi Jhunhunwala:

See, I will answer this in a simple manner. See, it is a very theoretical question, because not just us, all the other graphite manufacturers are holding such large stocks of needle coke. Because if you remember just about 12 to 18 months ago, the needle coke availability was so poor that everybody was buying whatever was available at whatever price, because the electrode prices reached so high that nobody cared. And everybody was expecting the needle coke to be not available at any particular time. So everybody kept buying more and more, pushing the prices even higher. So to that extent, it's probably similar situation with everybody that everybody was caught unaware with the sudden drop and then whatever has happened in the world in the last three, four months. So each one of us were sitting with a fairly large inventory.

Sonali Salgaonkar:

Sure. Sir, and since when did the needle coke cost started dropping off?

Ravi Jhunhunwala:

It started dropping off from February, March onwards. But one thing which I forgot to mention, to finish my description of coke, to the extent I said it's a theoretically question, I mean, nobody's buying. The prices have dropped a lot, but even at those very low prices nobody is interested to buy any coke. I mean, given the stock position that everybody has.....

Sonali Salgaonkar:

Understand sir. Sir, and my second question is, I mean, you mentioned in your starting remarks that the electrode realization has been sequentially dropping off for the industry as a whole. So where do you envisage the electrode realizations kind of stabilizing around, at what level?

Ravi Jhunhunwala:

See, again, this number will not give you anything, because everybody is carrying such huge stocks of inventory, somebody bought more coke at \$4,000, somebody bought little less coke at \$5,000. So it's such a big mix of different type of coke purchase at different times in the last six to nine months. So, I can understand what you are trying to get at, but the question is so difficult to answer that, it's all a mix of everything. So probably an easier way to answer will be, what is the spread from the selling price to the needle coke price. Probably that is a much easier way to understand what you are asking for. Because, if I give you the selling price of electrode today, you will not be able to make out anything, because price maybe x, but you are needle coke cost in some cases maybe more than that x price of selling price, in some case it maybe similar, in some case it may be lower.

Sonali Salgaonkar:

Got it. So sir, any ballpark number that you would like to share, where you think the spreads could normalize or stabilize?

Ravi Jhunhunwala:

See, I can only tell you that having taken the hit on account of the NRV accounting, obviously, whatever stock of coke we had at a higher price versus whatever is the currently available price of needle coke, it has taken that entire hit in one go in January-March quarter. So going forward, the margins and spread and everything have to only improve. Whatever be the



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electrode price, that margin has to only improve; it cannot deteriorate compared to what we have gone through in the last quarter. And especially with the timing of the COVID and the demand going down further and people not being able to produce more electrode and things like that.

Sonali Salgaonkar: Understand. Sir, my next question is, what was our capacity utilization in Q4 FY '20 and for FY '20 as a whole? And what is this current utilization that we are working at, amidst COVID?

Manish Gulati: Yes, I will take this question. For the Q4, if you look at in terms of black and white, it was in 50s, but we sold more than that. So sales wise, it was in a mid-60s for Q4. And for whole of the year, it was a lower 60s, both by capacity wise and sales wise, it was in 60s.

Sonali Salgaonkar: Sure. Sir, and amidst COVID right now, I mean, in the resumption status, what is the current capacity utilization that we are looking, say, on an average in May and mid of June?

Ravi Jhunjhunwala: See, currently if we talk about the quarter, because this quarter was kind of imbalanced because we had a lockdown and then we started the full plant around 23rd April, and then there is the process time also. So if you look at April, May, June put together, it's close to 50%.

Sonali Salgaonkar: Sure. Sir, my next question is, which are our key current geographies? And any key risk particular to any countries that we are witnessing right now?

Ravi Jhunjhunwala: Sonali, we were very well diversified as far as customer base is concerned, I mean, we are fortunate to have done that in the past for many, many years. So we are quite evenly placed between India and the Middle East and the Southeast Asian countries and Europe and Turkey. So we are not as heavily dependent on one, two or three countries. And as you know, these geopolitical things keep changing all the time, I mean, if we just put the country count, it's around 30-plus countries where we export. And region wise, it's quite evenly between all the five continents. So we are not endangered by any trade barrier or anything coming of one-off countries per se.

Sonali Salgaonkar: Sure. Sir, and my last question, any comments or updates on your CAPEX front of 20,000 metric tonnes?

Gulshan Sakhuja: The CAPEX plan is very much there, it's very much on. However, there are bound to be some delays because of this COVID which we are assessing. A lot of equipment have to come from overseas and lot of things had to be procured locally also. So the plan is very much on, but there might be delays.

Sonali Salgaonkar: Got it, sir. So our date of commissioning, our estimated date of commissioning is the first quarter of 2022?

Gulshan Sakhuja: Yes. That is correct. That is what we had originally given. That's right.



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- Ravi Jhunjhunwala:** That's not. That was the original date.
- Gulshan Sakhuja:** That was the original date, yes.
- Ravi Jhunjhunwala:** We had always said January, March 2022 should be the time when we will come out with the new production from that expansion. But given the situation where most of the suppliers are not able to work, and we have more than 30, 40 very major suppliers from different parts of the world. So even one or two of them getting delayed by three months or six months, will impact the entire sales.
- Sonali Salgaonkar:** Understand sir. Sir, and what would be our estimated outgo towards this CAPEX?
- Gulshan Sakhuja:** It's around Rs. 1,000 crores actually.
- Ravi Jhunjhunwala:** About Rs. 1,000 crores.
- Gulshan Sakhuja:** It was Rs. 1,000 crores.
- Sonali Salgaonkar:** Rs. 1,000 crore. Got it. All right. Thank you so much sir for this and very helpful.
- Moderator:** Thank you. The next question is from the line of Sandeep N. from HEG. Please go ahead.
- Sandeep N:** Yes. I just have a question that Chairman sir told that steel demand is likely to go down by 6.5%. And he said that the electrode prices are also dropping down in last one or one and half years. So whether that trend still continues or you expect that electrode prices to stabilize or something like that?
- Ravi Jhunjhunwala:** See, as I just said, I mean, we think that probably the worst is over. What we have seen in terms of pricing and the sales in April, May, June, we only see an upside from July onwards.
- Sandeep N:** Okay. So given the issue that your main raw material prices are also going down, so that would be a better thing for the company?
- Ravi Jhunjhunwala:** Yes. But again, to again clarify, I mean, we still are carrying large stocks of finished products and needle coke, as Gulshan just explained, which is typical of this industrial or any industry, which is a very long process time. So that impact will continue for at least two more quarters.
- Moderator:** Thank you. The next question is from the line of Akhil Jalan from Kamal Jalan Securities. Please go ahead.
- Akhil Jalan:** You mentioned, sir, that you were using Rs. 1,000 crores for expansion. Wanted to just understand how much of that Rs. 1,000 crores has already been used? And what is the deployment charts for the same?



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- Gulshan Sakhuja:** We have already spent about Rs. 200 crores to Rs. 250 crores. Obviously, lot of actual construction activities have already begun middle of last year. So some money has gone in to that. And as I said, a very large part of this Rs. 1,000 crores is against imported equipments. So, several letter of credits have been established, advances have been paid to international suppliers. So in total, it in that region of Rs. 200 crores to Rs. 250 crores.
- Akhil Jalan:** And is there any plan for backward integration in terms of setting up a needle coke plant in future or something like that, which is a part of this Rs. 1,000 crores expansion unit?
- Ravi Jhunjhunwala:** No. That is not. It is simply the 20,000 tonnes expansion of electrode. And as far as the backward integration is concerned, it's very, very difficult, because this technology is extremely complicated. In the sense, the technology has been in the hands of three or four international companies, and that scenario hasn't changed over last 50, 70 years.
- Moderator:** Thank you. The next question is from the line of Bhavesh Chauhan from IDBI Capital. Please go ahead.
- Bhavesh Chauhan:** Sir, just wanted to know where are we in terms of spreads, gross spreads? So electrode prices minus the raw materials, based on current prices, so I am not taking about the inventory that you carry historically, just based on, are we near to that 2015-2016 lows or we are better than that or even lower?
- Ravi Jhunjhunwala:** No, we are certainly better, certainly better than if you are comparing with 2015-2016.
- Bhavesh Chauhan:** Okay. How much sir, if you can quantify it slightly better or maybe far better?
- Ravi Jhunjhunwala:** Somewhat better.
- Bhavesh Chauhan:** Okay. That help, sir. And sir, secondly, what is the price differential between UHP and HP today? Have the spreads between both these products came off?
- Manish Gulati:** See, let me take this question. See, the ultra-high power grade uses the needle coke which has a completely different pricing, and the HP grade uses our Indian coke which has a completely different pricing. Although, the cost of conversion would be the same, but you start with a completely different raw material price base. So it will be difficult to compare the two spreads, but normally speaking, the HP always remains under more pressure because of Chinese competition. Because Chinese are not as much of a competition in UHP, but HP they do are. So, I mean, historically also speaking, the HP prices have are more under pressure compare to the UHP pricing.
- Moderator:** Thank you. The next question is from the line of Chandramauli Shrinivasan, who is an Individual Analyst. Please go ahead.



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Chandramauli Shrinivasan: So, how is the competitive intensity now on the pricing stance from China? Because in between there was a lot of selling at low prices by China is what we had heard.

Ravi Jhunjunwala: See, as Manish just explained, we compete with China only on that non-ultra-high power. And if my memory serves me right, I mean, that is about one-third of our total production, about 35% to 40%. So we do compete with China on that 30%, 35% kind of non-UHP. On the major part which is the UHP, and which is where we are exporting more than two-thirds of our products, we don't compete with China.

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

Anuj Sharma: Actually, I joined in the call late, so I don't know if this question has been answered. But is there a positive contribution between incremental revenue and incremental cost of raw material today?

Ravi Jhunjunwala: Gulshan, will you take this?

Gulshan Sakhuja: Yes, there is an incremental contribution to that, because already we have taken a hit on our inventory that is sitting on our books on 31 March, 2020.

Anuj Sharma: Okay. So the new material which comes into our factory and the new realization which you see, there is a positive contribution. And does it absorb the fixed cost as well?

Gulshan Sakhuja: Yes, definitely it would absorb the fixed cost as well. Because we have already taken a major hit in our books of accounts in last year.

Anuj Sharma: Okay. And what is the broad range of realizations which you are looking at the UHP Market?

Ravi Jhunjunwala: That is a difficult question to answer actually, you see, it's a basket actually, so there are some more businesses, pre-COVID contracts still continuing, new ones getting filled. So, today's price, if you see, it is a very difficult question to answer, what is the price realization. So in every quarter, there is a mix of some carryover contracts, some new orders being booked. And I would not like to mention a particular price, because of competitive reasons.

Anuj Sharma: Sure. And in terms of needle coke pricing, how is the pricing behaving? That's my last question. Again, I don't know if this has been answered, but how is that cost of raw material behaving? You think in terms of our booking the high cost inventory is completely over and we are realizing the new cost? Or that will, again, take some more time for us to realize?

Ravi Jhunjunwala: See, I had answered this question exactly about five minutes ago. See, this is a very typical kind of an industry where our process time is very long. I mean, once we get the raw material, the easiest product takes about six to eight weeks to produce, while some of the difficult ones



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take as much as five to six months. So given this long production cycle, at any particular time we do have to carry lot of inventory, whether it was lower cost coke or a higher price coke. So that is going to be there in any case at any time. And in addition to that, because of our main raw material is imported, so obviously one has to keep a margin of two months in terms of carry stock, which one would not normally carry if it was an Indian stock. So that's number one.

Secondly, talking about the needle coke price, the needle coke price has also come down substantially, pretty substantially in the last three, four months. Again, given the scenario where everyone, not just us, practically every graphite supplier in the world is also sitting with very large stocks of needle coke. Because in the last two, three years, needle coke was in such a short supply that everybody bought whatever was available to him to buy. So, everybody is carrying a large stock.

But again, as Gulshan just explained, having taken the hit on the NRV, we have taken all that into account while giving the results for the whole year. So going forward, we expect that probably the worst is over and the margins and everything should hopefully improve, the markets are also improving. Indian market was more or less down by about 50% in April and May, which is now increasing; it has probably gone up to about 60%, 65%. International market was down by about 15%, 20%, so it was much better than the Indian market. And to that extent, because we have been exporting about two-thirds of our productions, so that obviously helped. So our overall production and sales for this quarter is in the region of about 50% to 55%.

Moderator: Thank you. The next question is from the line of Manish Kayal from Nippon India. Please go ahead.

Manish Kayal: Sir, I have two questions. First is related to your competitor. So a couple of months ago, GrafTech mentioned in their PPT that some of their customers are renegotiating the past contracts which were made at very high prices. So is there any benefit that would accrue to us? Because as you mentioned earlier that there are only three, four players who do UHP products, so any color on that?

And second is related to scrappage policies. So I am not sure when the scrappage policy would be announced, but whenever it's announced in India, what would be the opportunity for graphite electrode players? And whether it's for the UHP, HP or any other category of HP, which would benefit? So if you can give some color on that opportunity, volume wise, realization, margins, so that would be very helpful sir. Thank you.

Ravi Jhunjhunwala: Yes, I will take the first one, and Manish will answer the second one probably. See, on the first one, if I take you back into history, about the three, four years ago when the electrode prices had suddenly shot up to very abnormal levels, GrafTech being the only company out of the



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five or six that we are in the world, who has needle coke backing with them, they have more or less 75% to 80% of their own coke, that is the only company which has backward integration into coke. And major raw material for producing the needle coke is a very high quality of oil. And in U.S., as you know, you can hedge your oil, you can book your oil for the next five to seven years if you want. So when they came out with this policy and they went around committing for five years, so they had a policy of five years take-or-pay kind of contract at a fixed price. So they had this luxury because they had their own needle coke and they hedged their oil, their raw material for the next five years at a particular price.

So given that, they more or less fixed their margins because their needle coke cost got fixed for five years, which was not the case for anybody else in the graphite industry except themselves. So what you just mentioned is happening to them because contracts for five years are still due for the next 18 months. I think, three and a half years have passed out of five years, up till December of 2021 they are fully booked at the take-or-pay contract. So their margins are obviously much, much better than anybody else. They are still able to sell at about \$10,000 against their take-or-pay contract. So what you mentioned is probably what you probably meant was a lot of the customers who had booked for five years at \$9,000, \$10,000, so some of them are trying to renegotiate with them because the electrode prices have dropped substantially below \$10,000.

Manish Kayal:

Okay. And whenever that comes for renegotiation, do we have a chance to get in front of those clients?

Ravi Jhunjhunwala:

No, there is no renegotiation. You see, in America when you have a take-or-pay kind of contract of five years, I mean, you have to buy x quantity at a y price, which is pre-decided for five years. But now that the electrodes prices have dropped much below \$10,000, so those customers are renegotiating with GrafTech to get a cheaper price compared to \$10,000, which is probably being discussed between the customer and the supplier, we would not know what is happening. So obviously they are looking at maybe \$500, \$1,000, \$2,000, so it is up to GrafTech to accept or not accept. So we are not affected by that, we are not impacted in any case.

Manish Gulati:

And about your second question about scrappage policy. See, this is running delayed by at least two, three years now. So once it comes, it will certainly be helpful bigger to the electric arc furnace production in the country. Because you see, if you look at Americans, they all used shredded cars and nobody uses DRI in steel-making. So when the scrap policy finally comes, there will be lot of scrap which will be available in house, because India is still a net importer of scrap. So once they have it, the EX-way of steel production will be more viable in India once they actually give the go-ahead for this policy.

Ravi Jhunjhunwala:

See, what Manish is trying to say is, about 30% of India's total steel is produced through the electric arc furnace where electrodes are used. While the international average is about 50%.



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So if you look at the total steel production of the world minus China, close to 50% of the still is produced through the electric arc furnace where the electrodes are used. And in India, that number is 30%. So one of the reason is scrap, non-availability of scrap.

Moderator: Thank you. The next question is from Ajay Mehta, who is an Individual Investor. Please go ahead.

Ajay Mehta: Sir, the query is basically on the quarter results which you have given. In December 2019, we have shown that the cost of material consumed has been about Rs. 260 crores. The same situation if we go forward March 2020, it is showing cost of material consumed as Rs. 458 crores. Can you please elaborate?

Ravi Jhunjhunwala: Gulshan, will you take that?

Gulshan Sakhuja: Yes. This is on account of NRV hit that we have taken in the last financial year.

Ajay Mehta: Sorry.

Gulshan Sakhuja: This is on account of inventory recognition at net realizable value that we have done in the last quarter.

Ajay Mehta: Okay. The one you were talking about that Rs. 400 crores which we have taken itself. So that is reflecting in this this particular...

Gulshan Sakhuja: Yes. If you see our results, it is clearly mentioned in the note Number 5 of the result that will clearly resolve your queries.

Ajay Mehta: Fine, sir. Thanks. That answers my queries in a big way. Coming back, second query is about, what is the breakeven sales? As a shareholder you would like to know that you have been performing very well and you have rewarded the shareholders for the last two years, and we are thankful for that. But going forward, we just would like to know what is the breakeven sales which you would achieve so that there is no loss in the company? For example, in the December 2020, probably because of the NRV, we are showing a Rs. 400 crores loss. But going forward, can you please quantify what would be the breakeven sales which will let us know that there will be no loss in the company going forward?

Gulshan Sakhuja: If you see, breakeven is the factor where my contribution and fixed costs, both are equal. And contribution is again the factor of my selling price and my coke price. Now due to this COVID situation that is going on, it is very difficult to comment where this selling price would go in future. So right now, it's not possible to give you this breakeven point as on date, because it is a factor of only two things, my contribution and fixed, and my contribution is a factor of my selling price and that coke price. So currently it's not that feasible to provide this number to you.



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Ajay Mehta: Sir, if you could highlight on your fixed cost, we could walk backwards and check on what it's...

Ravi Jhunjunwala: It is a very difficult question to answer, because it's purely a matter of cost of needle coke. Needle coke accounts for more than 50% of our total cost, including fixed cost and energy. And needle coke went up by 5x to 6x in the last three years, so that the electrode prices go up. So that spread as the electrode prices went up by 5x, 6x, the needle coke prices went up by 5x to 6x, so the differential margin was much larger in case of graphite, because in the worst case, in the worst days the electrode prices had dropped to something like \$2000 and the needle coke prices had dropped to something like \$500. So I was talking about the spread that in the electrode, rather than talking about the margins at what price in this entire, it is more important to understand the differential between the electrode selling price and needle coke price. So in the worst scenario, in the worst case about three, four years ago, the needle coke prices were about \$500 and the electrode prices were like \$2,000, so giving a spread of \$1,500. And in the best case scenario two years later, the electrode prices went up to \$14,000, \$15,000, and the needle coke prices went up to like \$4,000 and \$4,500. So that spread of \$1,500 suddenly went up to about \$10,000 to \$11,000.

And needle coke is, let's say, practically 50%, 55% of our total cost. So giving it a number that at x price we are breaking even, it's not very easy. And you probably joined the discussion later; here is an industry where that process time is very, very long. Once we put the needle coke into operation, it takes anywhere between two months to five to six months to process those electrodes. So given very long production cycle, whatever coke we purchase at \$500, and maybe sold at \$10,000, you carry it for like four to six months. So that huge inventory profit came to us two, three years ago, and now we have to pay for that. I mean, our inventory is all very high price coke whereas the electrode prices have dropped.

Ajay Mehta: Fair enough. I get the broad idea of the whole thing. Coming back, last two years we have been doing very well, why is still a loan figure coming in our balance sheet, is there any particular reason? Though we have reduced our loan, but why are we not totally loan free, sir?

Ravi Jhunjunwala: No. Actually there's no loan, the loan is because we still do get a cheaper interest loan because of exports.

Ajay Mehta: Okay. So the interest cost which is there is basically the arbitrage cost?

Ravi Jhunjunwala: Sort of.

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

Anuj Sharma: Yes. Thank you again. Sir, just wanted your thoughts on this industry. Now, for a very long time before 2016, approximately 10 to 12 years ago, for duration of 10 to 12 years the industry



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was pretty much flat, ranging from flat profits in a bit cyclical way. We had three exceptional years, 2016, 2017, 2018. Just when you think out, you think the industry will go back to the decade of slight volatility or you think the exceptional years of the last two, three years can be repeated? How do you think through this scenario going forward?

Manish Gulati:

Yes. These two years you were referring to are very exceptional years, this is a once in a lifetime event which happen suddenly, of course, we don't expect that we will go back to those kind of levels. But if you look at historical data, this is an industry which has had healthy EBITDA for most of the years, for majority of the years, except that there were like four, five dips in between if you consider the last 30 year history of this industry. So what happened in the last two years is very difficult to replicate. But the industry should return to healthy EBITDA levels.

Anuj Sharma:

Okay. Do you think anything has changed in the last few years which can have very different dynamics or economics then the past decade of 2006 to 2016? Any fundamental change in the business, competitors or the way the business has evolved?

Ravi Jhunjhunwala:

I will take this question, Manish. See, two things I will tell you. What happened about three years ago, which increased the prices from maybe \$2,000 to \$10,000, \$12,000, \$14,000, it was very simple that China decided that they will close down about 150 million tonnes of steel making, which was all through the blast furnace. As you know, 50% of the steel is produced through the blast furnace and the other 50% is through electric arc furnace, where electrodes are used. And it's a very well documented information that for every tonne of steel that you produce through the blast furnace route, you are polluting the atmosphere about the 3x compared to electric arc furnace. So China decided three, four year ago that they need to take care of the environment. And China was producing 95% of the steel through the blast furnace. Whereas the rest of the world was only producing 50% through the blast furnace.

So they decided to stop 150 million tonnes, and that suddenly meant that China which was exporting about 120 million tonnes of steel all over the world, so having the stock 150 million tonnes of capacity, their capacity to dump steel all over the world went down substantially. So from 120 million tonnes in the last three, four years, China has now settled at about 60 million tonnes. That 60 million tonnes of dumping of steel which stopped from China three, four years ago, meant that the other part of the world, which was everybody minus China, had to produce about 60 million tonnes of addition steel, which was coming from China to up till that time. And that changed the picture of this industry, because suddenly 30 million tonnes, 35 million tonnes of additional electric arc furnace steel started getting produced which you needed electrodes.

And going back from 2010 to 2015-2016, because the market was not improving for the steel industry all of the world, at least to 200,000 tonnes of electrode capacity were shutdown, mostly in Europe and U.S. So somebody had to close down the capacity to bring some sanity



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in the business in terms demand and supply. So, while on the one side 200,000 tonnes of capacity went down by closure of six to seven plants, and suddenly this thing which I just explained about China added to it. So there was suddenly a mismatch between demand and supply, which changed the total dynamics. And in the last six months, I mean, I am only talking from public information, if you read scripts of conference call in the public presentation that some other companies have made, they have already closed down two plants, one plant has been closed down in Germany, another plant has been closed on in Austria, in last six to nine months.

So that has also brought down the capacity in the last six months or so. Now it only depends upon how the world is going to change over the next 12 months, whether it will take six months for a normal world economy to come back to the normal levels in nine months or 12 months, that is anybody's guess. But some capacities have shutdown in the last six months. To that extend, the electrodes capacity has come down. So once we get back to the normal situation we saw about the year or two years before, probably it should look up.

Anuj Sharma: Okay. And sir, my last question is, is this net reduction in capacity or there were new plants which also came up, so net-net there is no capacity reduction?

Ravi Jhunjunwala: No. No.

Anuj Sharma: There is net capacity reduction?

Manish Gulati: So this is net because there has been no new greenfield graphite plant which was established. I mean, we started production in 1977, and in 1977 there was only one small plant which started, a new plant started in Malaysia about 15 years ago. So in the last 10 to 15 years, there has been no new plant at all.

Anuj Sharma: Okay. And what is the net capacity reduction in terms of percentage? Or if it is in terms of tonnes also that will be helpful, the two shutdowns.

Ravi Jhunjunwala: Between 2013 and 2016, about 200,000 tonnes of capacity went out of circulation. And I think the last six months, about 50,000 tonnes to 55,000 tonnes of further closures have happened.

Moderator: Thank you. The next question is from the line of Ritwik Sheth from One-Up Financial. Please go ahead.

Ritwik Sheth: Just one clarification from an earlier question. You mentioned that peak spread two years ago was around \$10,000 to \$11,000 per tonne at EBITDA level for us, which is usually \$1,000, \$1500 per tonne, did I get these figures right?

Manish Gulati: See, you are comparing the spread, what Chairman said was one of the worst year, that is the lowest it had gone, and this is the best it went two years back. So this is just a range which he



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was mentioning. Of course, that \$1,500 spread is not good enough at all, because those were one of the bad years for the company. But since from earlier question was asking was what was the lowest it went, so that is what the Chairman answered, actually.

Ritwik Sheth: Okay. That was the lowest and not...

Manish Gulati: Yes, but that is not sustainable level of EBITDA, \$1,500 is not sustainable anyway. That is what made so many plants in the world closed down actually.

Ritwik Sheth: Right. So what would be the current spread if I take spot price for graphite electrodes and spot price for needle coke currently? If you can highlight that.

Ravi Jhunjhunwala: I mean, without giving any numbers, it is much higher than \$1,500. If we were to compare with our today's cost of purchase versus today's cost of sale.

Ritwik Sheth: Right. And sir, just one, what would be the peak prices for needle coke and graphite electrodes, and what would be the prices today? If you could just highlight that.

Ravi Jhunjhunwala: See, I would not like to give any numbers for today, because, obviously, we don't want to let others know about it. But the older numbers we have been speaking for last one hour, I mean, the highest electrode price was about \$14000, \$15000, \$16000. And the highest needle coke price is was in the range of \$4,000 to \$4,500.

Moderator: Thank you. The next question is from Chandramauli Shrinivasan, who is an Individual Analyst. Please go ahead.

Chandramauli Shrinivasan: Sir, you very beautifully gave us the example of the comparison between the electrode price and needle coke price, say \$2,500, and in the peak \$16,000 and \$4,500 or \$5,000. So I wanted to know, what is that difference today roughly? I think probably the same question was asked before me but you didn't give an exact number, you said it was substantially better. I know that you said that you are not buying needle coke at today's price because we have inventory, but since you've probably brought all that inventory down for today's buying price of needle cokes, so going forward in your cost you should be able to see the lower cost. Therefore, what's that difference in between the electrode price and needle coke price? That was my question.

Manish Gulati: Yes, you are right. You are absolutely right. I mean, that is what I said. I mean, going forward that is exactly what I said that probably the worst is over, as we have taken a fairly large hit on the stocks.

Moderator: Thank you very much. That was the last question in queue. I will now hand over...

Ravi Jhunjhunwala: Thank you. Manish, will you make the closing remarks?



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Manish Gulati:

Yes, sir. So, thank you very much for listening to our Q4 con-call. And we hope to speak to you again with our quarter one results and hopefully with better set of numbers. Thank you so much.

Moderator:

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