



“Hindalco Industries Limited Q2 FY19 Earnings Conference Call”

November 02, 2018



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Moderator: Ladies and Gentlemen, Good Day and Welcome to the Hindalco Industries Limited Q2 FY19 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. Subir Sen from Investor Relations. Thank you and over to you, Mr. Sen.

Subir Sen: Thank you, and good evening. And a very good day to everyone. On behalf of Hindalco Industries, I welcome you all to this earnings call for the second quarter and the first half of FY19. On this call, we will be referring to the investor presentation that we had already uploaded in our company website.

Some information on the call may be forward-looking in nature. And will be covered by the safe harbor language on Slide #2 of the investor presentation. As you know, the financials include some relevant numbers of Hindalco's 100% subsidiary, Utkal Alumina International Limited to present the comprehensive view of the business. For this purpose, standard principles of consolidation have been applied by the elimination of inter-company transactions and unrealized profit or loss in the inventory. For comparison, the previous year's numbers have also been presented in this similar manner.

On today's call, we have with us Mr. Satish Pai –Managing Director; along with Mr. Praveen Maheshwari – Chief Financial Officer; and Mr. J.C. Laddha – CEO, Birla Copper. And from the Novelis management, we have Mr. Steve Fisher – President and CEO; and Mr. Devinder Ahuja – CFO.

Let me hand over this call to Mr. Pai for his opening remarks. Thank you, and over to you, sir.

Satish Pai: Thank you, Subir. And good day to everyone. Welcome to our earnings conference call for the second quarter of FY19 of Hindalco Industries Limited. Let me move on to Slide #3.

I will start by giving you the key highlights of the company's performance in Q2 FY19. This will be followed by an update on macroeconomic and the industrial environment. And I will then be covering the operating performance for all our business segments in more detail. And Praveen will elaborate on our financial performance in this quarter.

So, let me start with the key highlights, starting with Slide #5. So, Hindalco has put up another strong quarterly performance, despite headwinds in terms of costs. Our Indian businesses have achieved the highest quarterly EBITDA of Rs. 1,922 crores versus Rs. 1,825 crores in the corresponding quarter, up 5% despite rising input costs, particularly coal and furnace oil. Profit before tax was up 22% at Rs. 968 crore on the back of lower interest outgo and higher EBITDA



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during the quarter. Profit after tax at Rs. 725 crores this quarter was up 54% year-on-year, reflecting an excellent financial performance.

Net debt to EBITDA continues to be below 3, at 2.47x as on 30 September 2018, versus 2.67 at the end of March 2018. This shows our continued focus towards strengthening our balance sheet.

Let me also share one piece of good news. Hindalco won back the Krishnashila coal mine linkage of 3.1 million tons for the next five years in the auction conducted in September 2018.

As part of our continued deleveraging exercise, we have further prepaid Rs. 1,575 crores of our long-term loans in India in October 2018. This will further bring down our finance cost and will also increase our leverage.

Let me now come to our Indian aluminum business updates. In Q2 FY19 our Aluminium EBITDA, including Utkal, was at Rs. 1,364 crores, up 13% versus the corresponding quarter. EBITDA margin was 22% in Q2 FY19, and this was despite the fact that the business is facing headwinds on account of an oversupplied domestic market due to continued surge in imports and rising input costs, particularly that of coal and furnace oil.

Aluminum metal production was 326 Kt, same as in the last year. Alumina production was a little bit lower at 701 Kt compared to the corresponding quarter last year on account of some operational issues due to heavy rains during the quarter.

Moving on to Slide #6. Our Copper business also reported a good set of numbers despite lower volumes on account of the planned maintenance shutdown of 31 days in the month of July and 2 days in August 2018. This plant is now fully operational.

EBITDA for the Copper business was at Rs. 388 crores in Q2 FY19, down 17% year-on-year, mainly due to the planned maintenance shutdown and lower copper realization. This was partially offset by higher realization of by-products like DAP and Sulfuric Acid. As I mentioned earlier, because of the shutdown of one of the smelters, the cathode production was lower at 72 Kt versus 96 Kt in Q2 FY18.

Our value added copper rod production was, however, higher by 24% at 49 Kt due to the ramping up of the new CCR-3 that added around 23 Kt this quarter. So, the overall share of VAP, value added products, in copper in the total sales volume have reached 70% in Q2 FY19 versus 43% in the corresponding quarter last year. VAP production was up 73% at 88 Kt in Q2 versus 51 Kt in the corresponding period.



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Coming to Novelis' performance for the quarter, I hope you have seen and heard the financial results that were declared earlier today. We will just share with you some of the key highlights of their performance.

Novelis reported yet another excellent performance this quarter as well. The overall shipments in Q2 FY19 have gone up by 1% year-on-year. Automotive shipments were up 9% in Q2 FY19 versus the corresponding quarter. Novelis achieved the highest ever quarterly adjusted EBITDA of US\$ 355 million, with the highest ever quarterly EBITDA per ton reaching US\$ 440. This demonstrates consistent growth in its operational performance.

Net income was \$116 million in Q2FY19. Excluding special license, net income increased 56% year-on-year. Novelis had earlier announced its CAPEX line of \$180 million in China. I am happy to tell you that that has broken ground for the new automotive finishing line in Changzhou, China, to take the total capacity to 200 Kt. This will be operational by CY20.

On the Aleris acquisition, Novelis has secured firm commitments from banks for financing this acquisition.

Let us now look at the broader economic environment on Slide #8. Overall, global economic activity continues to remain strong despite challenges from surging crude oil prices, geopolitical uncertainties and continuing trade tensions among major economies. The US economy performed strongly in Q3 CY18 on the back of strong consumer demand and government spending. During this period GDP grew by 3.5% year-on-year as against 2.8% year-on-year in Q3 CY17.

In the Euro area, economic growth moderated in Q3 CY18 to 1.7% versus 2.2% in Q3 of CY17. In China, GDP growth also witnessed moderation in Q3 CY18 to 6.5% year-on-year, falling from 6.7% in the previous quarter. The slowdown was largely due to the ongoing trade war with the US, however, the Chinese government is taking measures to support the economic growth.

In the current scenario emerging markets are likely to face headwinds due to the ongoing trade tension, volatile financial market conditions and risk of capital outflow. Therefore, the IMF has downward revised its global economic forecast to 3.7% for CY18 compared to 3.9% as reported earlier. The occurrence of unfavorable trade conditions and geopolitical issues are posing risks to global economic growth.

On the domestic front, economic growth continues to accelerate in the current financial year. The GDP growth surged to a nine quarter high of 8.2% in Q1 FY19, majorly driven by a surge in consumption in both rural and urban segments, manufacturing activities and investments. The index of industrial production also strengthened during April to August 2018 to 5.2% year-on-year as against 2.3% year-on-year in the corresponding period of the last year. This was on the back of strong production of capital goods, infrastructure and construction and consumer durables.



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The PMI manufacturing index is also indicating growth in the economy, as the index remains in expansionary phase in September 2018. The RBI has maintained the growth forecast at 7.4% for FY19. However, depreciating rupee, inflationary pressures, elevated crude oil prices and geopolitical tensions are the risk factors for the domestic growth.

Now, I move on to the aluminum industry overview in the next slide.

Year-to-date, that is January to September CY18, global consumption of aluminum is around 4% year-on-year versus 6% during the same period last year. This was majorly on account of moderation in demand from China. Consumption in China grew by 5% in January to September of CY18 as compared to a growth of around 9% in the corresponding period last year. However, the recent policy stimulus, thrust on infrastructure, increase in the VAT rebates by the Chinese government are some of the key measures that are likely to support the Chinese aluminum industry going forward. We are expecting overall demand for CY18 to grow 4% year-on-year versus 6% in CY17.

Global production is likely to grow marginally at the range of 1% to 2% in CY18. The production growth will lag the demand growth this year, as against the growth of 8% in CY17, thereby creating a deficit of around 2 million tons in the global market, including China.

In order to improve its air quality, China has recently revised the policy of winter cuts for the period, November 2018 to March 2019. According to this policy, China has waived off specific winter cut percentages which were applicable to highly polluting industries, and now local governments are required to submit their plan. Local governments will set their own target for emission cuts based on the level of pollution in their region.

So, far this year Shandong and Xinjiang have reported drops in primary aluminum production. It is expected, however, that there will be a marginal impact on winter cuts as capacity curtailments have already taken place. In the current scenario, production in China is plateauing around the 3 million tons per month.

In the domestic market, demand continues to accelerate due to robust consumption from user industry. In Q2 FY19, demand witnessed a growth of 16% year-on-year to 847 Kt, against 732 Kt in the corresponding period last year. Year-to-date consumption of aluminum registered a growth of 14% to 1.6 million tons. However, the increase in low cost imports of fake semis, wire rods from ASEAN and China, coupled with surge in scrap imports from the US impacted domestic demand of primary metal. Estimated fixed semis import from China increased 13 times to 66 Kt in H1 FY19 compared to the corresponding period last year.

Scrap imports in H1 FY19 grew by 19% year-on-year to 644 Kt, posing a threat to domestic manufacturers. Cost of smelting in India is constantly rising due to increase in coal prices and



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constrained availabilities. Further, due to elevated oil prices, mainly furnace oil and other carbon-related input costs are also on the rise. This surge in cost is putting the pressure on domestic producers.

I will now move to Slide #10 on the copper industry overview.

CY18 started with supply side concerns due to labor negotiations. However, major negotiations at the mines for the year were completed successfully without any disruption. Global copper concentrate output is expected to grow by 1.8% to 17 million tons in CY18 and is likely to witness a marginal surplus of 150 Kt for CY18.

Global demand conditions are broadly supported, especially after the cumulus announced by the Chinese government. We are expecting global demand for refined copper to grow around 3% to 23.6 million tons in CY18, and the market is likely to be in balance in CY18.

On the domestic front there was a shortage of refined copper in the market. It impacted consumption as the market was not able to cater the existing demand. Resulting consumption grew to 170 Kt in the current quarter versus 163 Kt last year. We are expecting the demand for refined copper to continue at this momentum in the second half of FY19. Due to production disruptions in the domestic market share of imports touched around 40% in H1 FY19. LME prices of copper moderated by 11% from US\$ 6,872 in Q1 to US\$ 6,105 in Q2 FY19., That is actually due to trade tension globally and concerns over Chinese growth.

Let me now come to the operating performance of each of the businesses for the quarter on Slide #13.

The Alumina production was marginally lower in Q2 FY19 at 701 Kt on account of operational issues due to heavy rains this year. Utkal continues to perform well as the most economical alumina producer globally. In the first half of this year, overall production for alumina was 1.4 million tons. Aluminum metal production was consistent at 326 Kt in Q2 FY19. It was the same as the corresponding quarter as well as the previous quarter. For H1 of this year, metal production was 649 Kt.

On the value added side, production was higher at 123 Kt in Q2 FY19 despite challenges with respect to a continuous surge in the flow of imports, especially scrap, fake semis and also primary VAP, i.e. wire rods. In H1 FY19 VAP production was 240 Kt, which was in line with H1 of last year.

Moving on to the operating performance of our Copper business in Slide #15. Production of cathodes was marginally lower due to the planned maintenance shutdown of total 33 days during the quarter. On the value added side, our new copper CCR-3 plant is ramping up well and achieved



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a production of 23 Kt in Q2. The overall CC rod production was 49 Kt, up 24% year-on-year. DAP production was also higher by 74% and reached 88 Kt in Q2 FY19 compared to 51 Kt in Q2 FY18.

I will now move on to the operational performance of Novelis in Q2 briefly, and then cover the financial performance of all the businesses.

Coming to Slide #17. Novelis reported a record quarterly performance on the back of increased asset optimization, better product mix and favorable market conditions. Demand for aluminum FRP remains strong across the end markets, but particularly in the automotive industry where lightweight, high-strength aluminum sheets is a growing material of choice. Overall, FRP shipments grew to 807 Kt in Q2 FY19 and 1.6 million tons in H1 FY19. Automotive shipments in Q2 FY19 grew by 9% compared to the corresponding quarter last year. The beverage can market continues to remain strong in the near and long-term.

Novelis has broken ground for its new automotive finishing line in Changzhou, China to double its capacity to 200 Kt in CY20. As you know, this will be at a CAPEX of \$180 million. This facility has a proud history of serving the Asian automotive market, and will continue to partner with customers to launch the high performance aluminum intensive vehicles in Asia.

The regulatory steps for our Aleris acquisition are at various stages of approval. These are expected to close in about 9 to 15 months from the date of announcement of the transaction, as was communicated earlier. Novelis has secured firm commitments from the banks for financing this acquisition.

With that, I will now hand over the call to Praveen for a more detailed review of the financial performance.

Praveen Maheshwari:

Thanks, Satish. Coming to Slide #19, this slide gives a brief snapshot of the key numbers for our financial performance during Q2 FY19, and its corresponding quarters for Hindalco standalone plus Utkal.

As we informed earlier, this presentation includes the financials of Utkal Alumina, which is 100% subsidiary of Hindalco.

Revenue in Q2 FY19 stands at Rs. 10,833 crores versus Rs. 10,313 crores in Q2 FY18. EBITDA stood at Rs. 1,922 crores, which is higher by 5% year-on-year, despite increasing input costs. Profit before tax and before exceptional items in this quarter jumped to Rs. 968 crores, showing a significant increase of 22% compared to the last year, due to strong overall business performance and savings in interest cost. As compared to the previous year the interest expense was lower by 16% due to the prepayment and repricing of long-term loans in India. As a result, profit after tax grew by 54% at Rs. 725 crores in Q2 FY19 over the last year.



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Now I will move on to segment wise performance on Slide #20. I will share with you the performance of our Indian aluminum business, which includes the financials of Utkal Alumina.

Revenue for this segment for this quarter was Rs. 6,135 crores versus Rs. 5,218 crores in Q2 of FY18, which was higher by about 18% on account of better macros and stable operations. EBITDA was up 13% at Rs. 1,364 crores compared to Q2 FY18 on account of better macros and better realizations, despite pressure on the input costs. EBITDA margin was at 22%. If you wish to know separate Hindalco standalone results, they are available in the appendix to this presentation.

Coming to the financial performance of the Copper business on Slide #21, revenues in Q2 FY19 were at Rs. 4,710 crores versus Rs. 5,097 crores in Q2 FY18. They were lower due to lower volumes on account of planned maintenance shutdown in this quarter in one of the smelters. EBITDA was Rs. 388 crores in Q2 FY19 versus Rs. 467 crores last year. This is also lower by 17% due to the planned maintenance shutdown and because of lower copper realization in this quarter. However, byproduct realization was up in Q2 FY19.

I will now take you through the financial highlights of Novelis on Slide #22. Novelis revenues were up by 11% to \$3.1 billion in Q2 FY19 versus \$2.8 billion in Q2 of last year. This was mainly driven by high average aluminum prices, record shipments and favorable product mix. Novelis has achieved the highest-ever adjusted EBITDA of \$355 million in this quarter, up from the \$302 million in the last year. This is mainly on account of better product mix, effective cost management, better efficiencies and favorable market conditions. Novelis also reported highest ever quarterly adjusted EBITDA per ton at \$440 in this quarter versus \$377 last year on account of favorable product mix, better utilizations and recycling benefits.

With this, let me hand over back to Satish for his comments on the overall business performance and key takeaways.

Satish Pai:

So, on Slide #23, let me summarize our overall business performance and some key risks. In Q2 FY19 we achieved excellent business performance across all our Indian businesses, i.e. aluminum and copper, despite challenges in terms of high input costs. We reported a strong growth and profitability this quarter, aided by reduction in interest outgo. Novelis reported record performance in Q2 with the highest EBITDA and EBITDA per ton on the back of increasing automotive share, recycling benefits and overall favorable market conditions. We continue to strengthen our balance sheet with our consolidated net debt EBITDA well below 3, at 2.84x, at the end of September 2018.

Moving ahead, with this deleveraging focus, we prepaid Rs. 1,575 crores of long-term loans in October 2018. If I recall correctly now, in the last 3 years, we have prepaid project loans of more than Rs. 10,000 crores, bringing down our finance cost and significantly improving on leverage. On growth opportunities, our 500 Kt Utkal Alumina expansion is on schedule and is expected to



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be commissioned in FY21. This will take our Alumina capacity to 2 million tons. The value-added CCR-3 expansion in Copper is ramping up as per schedule. This will further help to capitalize on opportunities in the domestic market and meeting customer demand.

Novelis has firmly secured financing for its recent acquisition of Aleris, which we announced in July 2018. This acquisition will strengthen Novelis' leadership position in the fast growing automotive segment, with best-in-class assets, technology capabilities, and manufacturing and R&D. It will solidify our position as the world's #1 value added products player.

Our key risks are the following: rising input costs mainly of coal and furnace oil; rising imports of aluminum into India, including scrap, fixed semis and other value added products from ASEAN FTA countries and China; a slowing growth in China, which is leading to moderation in consumption growth for both aluminum and copper.

With that, I thank you very much for your attention, and we will now open up for questions that you may have.

Moderator: Thank you very much. We will now begin the question-and-answer session. We have the first question from the line of Pinakin Parekh from JPMorgan.

Pinakin Parekh: Sir, my first question is on coal. Can you give us a sense of how much coal the company had to purchase outside of linkage supply from Coal India and its own captive? And how does the company see those trend going forward, given what we are hearing on Coal India's inability to meet demand?

Satish Pai: Okay. So, I think that, first, during this monsoon quarter the coal was probably our toughest challenge. On the overall coal cost numbers, Pinakin, the cost per rupee per million kilocalorie, Q1 to Q2 sequentially was up 12%. And then I look at e-auction, I think in e-auction we purchased about, e-auctions and washeries put together. Out of the 4 million we consumed in the quarter, we purchased about 1 million tons. And that was really the higher cost one, because e-auction and the trade prices of coal have sharply gone up, whereas, our linkage and our own mines we know the cost.

Pinakin Parekh: Understood. And my second question is likely medium term on Alumina. Now we understand that Hindalco has a practice of hedging aluminum prices, and given where aluminum is in terms of demand supply dynamics and the certain cost curve position, does it make sense for the company to hedge aluminum production at current prices? Or stock hedging, given that the current pricing most of the global spend is anyways loss making and medium-term demand and outstrip supply?

Satish Pai: Yes, so Pinakin, I think last quarter itself I made the comment that we, at this stage, have not taken any more position. With aluminum at around \$2,000, we are not going to hedge next year anymore.



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And I am actually also talking about an outlook for LME now, I really believe that at \$2,000 a ton, we are probably at the bottom. Why do I say that? Because inventories are at all-time low, the aluminum market is nearly a 1.6 million - 1.7 million deficit. In India the growth has been 12% to 13%, but generally growth is quite strong, and the production in China is flat from last year. So, all that points, as most analysts are saying, that the LME prices should be higher. I think it is the trade war tension that are holding it down. So, at this stage we have no plans to take further positions on hedging because, to put it frankly, until it reaches \$2,300 we will not take any positions anymore.

Moderator: Thank you. We move to the next question. The next question is from the line of Rajesh Lachhani from HSBC. Please go ahead.

Rajesh Lachhani: Sir, my question is, we have seen the domestic premiums in this quarter coming down. So, I believe, this is due to the increased amount of imports. And we have also heard media reports about the industry pitching for increased import duty. Sir, just wanted to understand where are we in this process, and how hopeful are you about these barriers arising? That is question number one.

Satish Pai: Okay. So, let us talk about imports. So, I think just to give you an overall number, the primary production grew by 15%, this is us, NALCO, Vedanta put together, whereas, the sales grew only by 2%, and that is largely because interest grew by 22%. And I think that the downstream imports actually grew by 26%, and imports from China actually grew by 53%. So, really this is a big concern because of the trade war I think most of the Chinese imports are now coming into India. So, we have made the case to the government and I think the government is quite open and understands the situation. So, all I can say is we are hopeful that at least the import duty levels on the downstream products should go up, to stop the surge of imports coming in from China.

Rajesh Lachhani: Okay. And sir, the second question is on the copper premiums in the domestic markets, are you seeing these premiums increase significantly due to the closure of one of the domestic smelters? So, if you can give us some comment on the trend. And also, how are the DAP realizations, if you quantify then, this year and last year?

J C Laddha: The first question about the premium from copper, in fact, the premiums in Q2 were a little lower as compared to Q2 of the last year. However, from November 2018, they have reduced a little bit. However, because of the closing of Sterlite, again, the demand has gone up and that is why the premiums had gone up slightly.

Rajesh Lachhani: Sir, can you quantify them?

J C Laddha: Basically, when we sell in the domestic market generally a premium is one element, and there is a customs duty element as well. So, these have gone up by about 20% roughly as compared to November 2018.



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- Satish Pai:** So, I think, Rajesh, what he is saying is that compared to Q2 of last year the premium still looks slightly lower. But as the imports were going up, from Q3 of last year the premiums in the domestic market have come down. And now because of the Sterlite closure, they have picked back up again. So, they are quite strong now.
- J C Laddha:** DAP pricing, because of the international prices moving up, the prices have now stabilized . So, DAP prices are also quite healthy compared to previous quarter.
- Rajesh Lachhani:** Right. And sir, what was the last year against last year, DAP pricing?
- Satish Pai:** Last year, the prices were in the range of about Rs. 24,000 a ton.
- Moderator:** Thank you. The next question is from the line of Anuj Singla from Bank of America. Please go ahead.
- Anuj Singla:** Sir, I have one follow-up question on coal. You mentioned that the coal cost on a kilocalorie basis was around 12% up QonQ. So, I think given the scenario we are seeing in the domestic market, are we going to see some more cost pressure? Should we be building in some more cost pressure going into 3Q and 4Q?
- Satish Pai:** And the second part of your question is that, no, I think that Q4, actually we should be modeling that the coal cost will remain flat. For me that is actually that is worst case scenario because normally, after the monsoon quarter I expect coal availability to go up. But I think in the current situation where the coal demand is so high from the power sector, what we are internally modeling is that coal prices should remain flat Q2 to Q3.
- Anuj Singla:** Okay. So, basically, you are not expecting any further price escalation from here? This is a kind of peak we should be expecting, the worst case kind of scenario?
- Satish Pai:** Yes, that is correct because now the amount of coal that we need is largely procured for Q3. So, we know what the Q3 coal price will be.
- Anuj Singla:** Okay, wonderful. And secondly, we get this question quite frequently from investors. So, there is a view that the deleveraging has been, we have already done a lot of that and like you mentioned, Rs. 10,000 crores over the last four years. Now what are company thoughts on capital return or higher dividends? Is there a thought process around that, some kind of benchmark you are looking at before we see a higher payout?
- Satish Pai:** Look, Anuj, the dividend policy we have been very consistent, and if you see in our last AGM as well we increased the dividend to 12%. So, the dividends we are steadily increasing, and I think that our policy is to give, what I would call, as a steadily increasing dividend. So, I don't think we



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are going to do any sharp move there. The second part, I think, is that we will be generating cash, and we have a growth CAPEX plan in India, which I have mentioned before on the downstream side. And I think that any excess cash from that point onwards, we will probably use to deliver more because the interest rates are quite high. So, I think that it is much better to sort of pay down your loans to cut your interest costs even further. So, I think that is what we will do, a steadily increasing dividend, doing your CAPEX plan and then remainder being used to deleverage more.

Moderator: Thank you. The next question is from the line of Sanjay Jain from Motilal Oswal Securities. Please go ahead.

Sanjay Jain: My question is on the aluminum segment. Actually, you seems to be doing pretty much better than I was actually expecting, and that is where I am trying to reconcile. When I take EBITDA per ton for aluminum segment, and here I am talking, including Utkal, on a sequential basis it is down only \$166 to \$596. But at the same time, that LME is down by around \$198, average LME, and the cost of production seems to be going up by \$24. So, I mean, the gap must be because of the hedging or something. So, can you help reconcile the factors driving this outperformance?

Satish Pai: Yes. So, it is good, Sanjay, that you are trying to reconcile why we are doing better. So, I think the only thing you missed, actually, is the rupee depreciation. So, the rupee has also depreciated, so that has an impact. The second thing is that the volumes that we sold in Q2 are about 26 Kt higher than Q1. If you remember, the production is flattish, but in Q1, our sales numbers were only 300 Kt, because we adapted the new IndAS, so in the last three days sales we could not take. So, the sales this quarter have been higher, the rupee depreciation has helped. And I think that the coal prices have gone up, but CP coke and pitch prices actually went down a little bit. So, overall, along with the efficiency, actually your EBITDA per tons numbers are spot-on.

Sanjay Jain: Actually, when I do this analysis on a dollar per ton basis, basically, I am taking out the effect of rupee depreciation. And secondly, when I do per ton, then also the volume effect is also isolated. Because your production is same, so in terms of the cost of production there shouldn't be any more operating leverage because you sold more. So, still I fee, cost actually has gone up, still why the margins? So, there are definitely movements in the hedging, so would you like to share this like...

Satish Pai: In terms of hedging, the only thing, Sanjay, remember that in Q1 we still had a negative because of the hedging, because the LME at that time was \$2,200. And this quarter, actually, when we come down to \$2,000, we actually have a little positive from hedging. But Praveen wants to say something...

Praveen Maheshwari: Sanjay, the way you should look at it, when you say \$200 down LME compared to last quarter, and if you are say 40% hedged, the effective impact will be only 60% of the \$200, you can look at it either way. That is one point. And second, when you say you have taken out, when you are calculating dollar per ton, so rupee impact is taken out. Yes, it is taken out from the realization



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side. But on the cost side, therefore, the impact in dollar per ton is much lower than what it looks in rupee terms. So, both ways, you can count it either way, but this is how the math is going to work out.

Sanjay Jain: Okay. Would you like to share the hedging gains in this quarter?

Praveen Maheshwari: So, hedging gain, of course, compared to previous quarters because the LME has come down, you can count it either way that when the LME is up your hedge loss or gain is accordingly different. And when the LME is lower, it looks much better than the previous quarter. But I think the better way to look at it is what I just said. So, if the LME moved down to \$200, and you have 40% hedged, the impact is lower LME was only, let's say 60% of that, so \$120 on an average. So, that will give you a clearer picture, because hedging gain and loss is always versus the macroeconomic profit or loss. So, if you have lost on LME you will show gain in hedging. So, I think the better way to do it is to take the net open position and multiply the movement of LME of currency on that basis.

Sanjay Jain: Okay. Got it. And secondly, similarly on copper. Copper also has done pretty well. One of the reasons could be good realization in DAP. And in the past you have highlighted that the accounting also plays a role. So, is there anything we should think as a non-sustainable part of this copper EBITDA?

Satish Pai: I think, Sanjay, you said DAP, you missed sulfuric acid, sulfuric acid prices have also been very strong. We are also benefiting from the Gold sales. And the fourth thing that we are taking is the premium, which was the previous question. So, I think that the premium, I am now comparing with the previous quarter, the premiums have been higher because the market is not supplied enough. So, that is why the copper numbers are quite good. It is over 72 Kt, so next quarter we should be back with more or less 100 Kt output as normal.

Sanjay Jain: Right. So, next quarter we should benefit from operating leverage and continue the strong...

Satish Pai: Byproduct, yes. Absolutely.

Sanjay Jain: So, basically, nothing on account of accounting...

Praveen Maheshwari: There is no accounting net impact.

Moderator: Thank you. The next question is from the line of Amit Dixit from Edelweiss. Please go ahead.

Amit Dixit: First question is on aluminum. Is it fair to assume since alumina prices have also been coming down. And on coal, you only mentioned that it is fair to assume flat prices, CPC etc is coming down. So, is it safe to assume that aluminum cost has peaked, probably?



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- Satish Pai:** Yes. I think, absolutely correct. I have also made my plan, so Q3 costs are flat with Q2.
- Amit Dixit:** Okay, great. And the second question is, there is a news in media that we have signed an MoU with Odisha government for Rs. 5,000 crores investment in VAP, aluminum VAP. So, I just wanted to understand if it is true then how this investment is going to pan out?
- Satish Pai:** So, this is a part of the broader strategy of Hindalco downstream that I have articulated. We said we will be spending Rs. 5,000 crores, Rs. 6,000 crores over the next few years to double our downstream capacity. Now, the MoU is actually covering a much longer period. So, both in Gujarat, which if you remember, I think I signed that about 1 - 1.5 months ago. The first step in any project is to sign MoUs with the government so that I can begin the land procurement. So, that is the reason why we do these MoUs. But it is broadly both, the Odisha one is for the expansion of the Hirakud downstream plant and the Gujarat one was for extrusions. So, it is within the plan of Rs. 5,000 crores, Rs. 6000 crores over the next three to five years that I have been saying.
- Moderator:** Thank you. The next question is from the line of Sumangal Nevatia from Macquarie. Please go ahead.
- Sumangal Nevatia:** First, on the Krishnashila linkage renewal, can you share what premium we have got it renewed at? And also, how is the process? I mean, do the existing owners get the right to match the highest bid or are we participating in the bidding?
- Satish Pai:** No, we participate and we won it in a completely open auction. And I cannot talk about the premiums and costs because that is a confidential information. But all I can tell you is that it is exactly at the same price at which we had it before.
- Sumangal Nevatia:** Okay. So, there is no increase in premium despite all the current tightness in the market is?
- Satish Pai:** No, actually on the long-term linkages if you have monitored, all the long-term linkage auctions that happen, because you are taking a five-year commitment there, it is only, and it is fairly restricted because traders are not allowed into these auction. Whereas on a spot auction a trader can bid, here you have to have an end use. So, the premiums are far more controlled than in spot auctions where they can jump up very high.
- Sumangal Nevatia:** No, because from what we understand from Coal India, I mean, in the previous three tranches premiums were around 10%, and this fourth tranche it is around 30%-odd. So, there is something which does not match with what you are suggesting.
- Satish Pai:** No, I think the NCL sites have a lot more competition than in northern coal fields. If you remember in Krishnashila we have a conveyor belt linked to mines and with our plant, so we are like next door.



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Sumangal Nevatia: That is very clear. Sir, second question, now Utkal expansion, as you said, is going as per plan, maybe in 2.5 years you will be net long in alumina. So, I mean in the coming 12 months-odd, do we expect any evaluation or adding upstream capacity? Or that is like, at least for a couple of years, completely out?

Satish Pai: I think that I can actually be quite clear that unless we see availability on quantity and pricing on coal, it is unlikely we will make any more new commitments on smelting, because that is my largest 40% cost. And if you look at the current situation on coal in India, I think nobody will invest in smelting capacity.

Sumangal Nevatia: Understood. Just one last question, there has been a lot of talk about potential increases in import duty for scrap and downstream aluminum. I understand downstream aluminum we directly benefit with the import duty, at least for our domestic volumes. But can you explain how the dynamics will work if the government goes ahead and increases scrap duty from, say, 2.5 to exactly match with aluminum to 7.5? So, I mean, that is going to be a bit more indirectly, our primary aluminum will become more competitive and the premiums might get support a little bit. Is that the right understanding?

Satish Pai: Yes, but let me give you a broader perspective, at least from a Hindalco point of view. As I said, our view is that scrap is generally good for the overall aluminum cycle. Our problem in India is that the scrap is coming in, in an unregulated manner. So, the most important thing we are telling the government is that there is a standard on scrap that most countries use, and it should be implemented. The scrap should have a designated end use. There has to be the proper analysis that comes. Because what is happening in the Indian market is 60% of the scrap goes to the auto industry, which is a perfectly legitimate use of the scrap. But there is a lot of scrap going into electrical conductors, household utensils, and this is where the uncontrolled use of scrap is actually having a detrimental effect on the growth of aluminum, because if you are seeing newspaper articles saying that aluminum vessels and cookers are not good for health, that is happening because of uncontrolled use of aluminum alloys to make these things. So, our biggest point to the government, first, is to implement the standard on scrap. And the duty thing has been put in because why is it going into the electrical sector and why is it going into the utensil sector, it is because people are pale, where they should be using a primary, it is just because of the cost difference. So, that is clearly the reason for asking a duty increase. But the first and fundamental thing that we are asking as an association is, implement the regulatory framework first, because that itself will curtail the imported scrap for the wrong reasons.

Sumangal Nevatia: So, do we expect then this in the coming month, or directly maybe in the budget?

Satish Pai: I don't know, because as you can see there is a lot of to and fro on this with lot of, so-called MSME, shouting on the scrap side. So, I am not sure.



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- Moderator:** Thank you. The next question is from the line of Ritesh Shah from Investec Capital. Please go ahead.
- Ritesh Shah:** Sir, my first question is, how is the hedge position strength right now? Because in the prior call, you had indicated that the core hedging should share 20% to 30% of the volumes for FY19?
- Satish Pai:** So, let me give you the hedge position for the remaining six months of FY19. So, for the remaining six months, 27% of the rupee LME at Rs. 1,40,800, this is only LME and rupee, no premium, anything else. That is our position. And 11% only commodity at US\$ 2,277 a ton. So, that's our outstanding position for the next six months.
- Ritesh Shah:** Sir, my second question is, if you could please highlight on the coal sourcing mix and the bauxite sourcing mix? Coal sourcing, I understand, last quarter you gave a number of 92 paisa per kcal, and you just indicated around a 12% increase going forward. So, do we still look at that? And if you could just broadly give a split between captive linkage auctions, that will be quite useful, sir.
- Satish Pai:** So, let me just say, in Q2, we used about 4.1 million tons of coal. Our captive was about 1.2 million tons. The linkage was 2.6 million tons. And the remainder was e-auction and washeries and traders, etc. And I think you got the numbers wrong on the rupee per million kilocalories, it was not 92, it was in the Rs. 900 per million kilocalories...
- Ritesh Shah:** Rs1. per kilocalorie. Sorry.
- Satish Pai:** And it has gone up to around 1,000-odds in Q2.
- Ritesh Shah:** Sir bauxite sourcing, is that something that we are getting from merchant markets or is it entirely 100% captive that what we procure?
- Satish Pai:** Utkal is 100% captive, Muri and Renukoot is 100% captive. The only place where we buy some bauxite is for the Belagavi specials refinery, that is about more than 50% that which is bought from the market.
- Ritesh Shah:** Sir, I just wanted to understand the hedging policy, specifically for forward sales and specifically on scrap sourcing. So, in the prior call it was mentioned that we have some inventory which is lying, and it is going to give us some tailwinds in Q3 as well. So, I was just trying to understand what is our hedging strategy and sourcing strategy for scrap, please?
- Devinder Ahuja:** As far as metal and LME goes, we do off that hedge so therefore they always stay in a fully hedged position. And as far as premiums are concerned, that is a portion that we cannot hedge, and that is what basically results in positive or a negative metal price lag. So, this year, we are enjoying the benefits of a positive metal price lag, and we will have to see how that goes further. As far as scrap



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is concerned, we are not building a long-term scrap inventory, as you know scrap is a dynamic market and we don't hold inventories for too long. Having said that, in North America we did build some opportunistic inventory, due to the market condition. But when it comes to scrap, again, maybe about 70% to 80% scrap hedges, they sort of start at the fiscal year, and we chose the right time when we think that there is a bit favorability in the metal price. Again, what does not therefore gets hedged is premium. And as I tried to say on the previous call, that because of the run-up in premiums, particularly mid-west, we gained because of wider spreads. So, that is really the hedging policy.

Ritesh Shah: So, just a follow-up. What I didn't understand, as you have said, 70% to 80% of the scrap is hedged. So, exactly how does it work? And the second follow-up, if I just look at the appendix in the Novelis presentation on the second last slide, what it says, the metal price lag \$1 million as compared to \$33 million. So, I wanted to reconcile the EBITDA bridge which showed \$47 million of gains if understood from a quarter-to-quarter basis?

Devinder Ahuja: Well, let me try and give you some numbers here. So, basically, for this year we gained about \$40 million because of the swing in the metal price lag. Last year we had a negative metal price lag of roughly about \$10 million in the first half of the year. This year we had a gain of about \$30 million in the first half of the year. In the second quarter versus the first half there was very little metal price lag, only just \$1 million. So, that is really what the broad numbers are. And your other question was how the hedging on the spreads are like?

Ritesh Shah: Yes, sir, specifically on the scrap hedges. I understand the forward scale hedges, but I am not really familiar with the scrap hedges?

Devinder Ahuja: Yes. So, basically, we do forward sale of metals, to the extent to which we want to cover the dollar value of the spread. So, that's the calculation. In addition, conceptually, what we do is we do the forward scale of metals at the right opportunity to be able to secure the wanted dollar amount of the scrap hedge. So, it's kind of an offset hedging in some ways, and if you really want to get into plenty of details, it would be good to have it on a separate call with our Investor Relations.

Ritesh Shah: Thank you. The next question is from the line of Ashutosh Somani from JM Invest. Please go ahead.

Ashutosh Somani: Sir, my question is regarding imports. So, we have seen that the steel duties have got implemented very soon when there was lobbying. But for aluminum and other noncredit metals, we have seen that the government has not implemented it for a very long time despite lower returns on capital employed by various large players in India. So, what is the main logic behind not implementing it despite a sharp increase in imports?



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Satish Pai: I think that the dynamics of the steel industry versus aluminum industry is a bit different because steel is fairly large with large public sector companies in it, you may say. I think in aluminum, we are just us, Vedanta and NALCO. And I think so whatever reason, we have presented our case, but we have not been able to get the similar types of results that we have seen they've got. All I can assure you is not for a lack of effort. I think that you're spending a lot of time with the Niti Aayog and DIPP and all. We have managed to get out position papers on the aluminum, but the aluminum consumption in India is about, what is it, 3.8 million tons versus, I think is over a 100-odd million tons. I think we have been trying to convince them that the aluminum and copper, by the way, a lot of effort going on there. These are all metals for the future and hence, the Indian government should take steps to protect it. I still remain hopeful. Let's see what happens in the next month or so.

Praveen Maheshwari: I think one difference here is that Indian banking sectors have a lot of exposure to steel.

Ashutosh Somani: Yes. Sir, secondly, can you shed some light on the secondary project in Gujarat of some 350,000 tons? There are a few news reports around the Hindalco planning an MOU with the government. So, what kind of sourcing will we have on the raw material, and which industry it will cater to?

Satish Pai: So, we are planning in Gujarat an Extrusions farm, if I can use the word. And it will be supplied, some part of it will come from scrap that we will import, and some part of it will come from our own metal. And this is largely focusing on the building and construction segment.

Ashutosh Somani: Okay. Sir, lastly on the coal sourcing on the e-auctions of linkages. So, we are not seeing many linkages coming for the auction despite demand from the nonpower sector. So, where do you see as the challenges for the industry?

Satish Pai: Look, actually, there have been quite a lot of linkage auctions that have happened. The problem is not the linkage auctions happening. The problem is the materialization of your linkages. So, for example, if we got all what we had supposed to get from our linkage, then my coal cost would be much lower. I wouldn't go to the stock market at all. The linkages, they have a clause that says that as long as they provide 75%, they are making the condition. So, we are getting only 75% of the linkages. So, for the remaining 25%, you have to go to the Spot market. And in the spot market now, they are bidding less and less coal and less prices are going up in the spot market. So, the price difference between the linkage and the spot can be more than 25% to 30%, 40%.

Moderator: Thank you. That was the last question. I would now like to hand the conference over to Mr. Pai for his closing remarks.

Satish Pai: Yes. So, thank you, everyone for participating on this call. Hindalco and Novelis continues to work on and bring consistent results going forward as well. And what I think from a forward point of futuristic view, I hope that the world trade uncertainties are removed, because this is probably the



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one factor that can give a big flip to the aluminum and copper business going forward. So, with that, I thank you everyone and have a good day.

Moderator:

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