"Hindalco Industries Limited Q1 FY18 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the Hindalco Industries Q1 FY18 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. Abhishek Rungta**.** Thank you and over to you, sir.

Abhishekh Rungta: Thank you. Good evening or good morning, everyone. On behalf of Hindalco Industries Limited, I welcome all the participants to the Earnings Call for the First Quarter Fiscal 2018. On this call, we will be referring to the presentation that is available on our website. Some of the information on the call may be forward-looking in nature, and will be covered by the Safe Harbor language on Page 2 of the presentation.

On this call, we have with us Mr. Satish Pai – our Managing Director; along with Mr. J. C. Laddha – Head for Copper Business; and Mr. A. R. Das – Deputy Chief Financial Officer.

So let me turn the call over to Mr. Pai.

Satish Pai: Thank you, Abhishekh. Good evening, good morning, everyone. Welcome to the First Quarter Fiscal 2018 Earnings Call for Hindalco Industries Limited.

Let us move on to Slide #3. I will start by giving you the key highlights of the various strategic initiatives and segment wise performance. This will be followed by update on economic and industrial environment and highlights of the results. Later, I will be covering operating performance for all our segments in more detail. And then A. R. Das will cover the financial performance.

Let me start with the key highlights, starting with Slide #5. Hindalco's strong financial performance in Q1 FY18 is the result of stable operations and supportive macros in the Aluminium segment. As committed during QIP, we continue to focus on deleveraging our balance sheet. We have made further prepayment of Rs. 894 crores in July 2017 at Utkal against outstanding long-term loans. In FY18, till date, total prepayment of long-term loans stand at Rs. 5,399 crores. Further, we have already sent notice to prepay Rs. 1,386 crores in August 2017 at Utkal.

During Q1 FY18, coal security further improved with additional new yield linkages of 2.9 million tons. The additional quantities secured to this linkage equals to about 18% of our annual coal requirement. Coal security helps us with adequate visibility on power cost, which is very critical for aluminum smelting operations. With this, significant quantity of our coal requirements are covered either through linkage or captive coal mine. Coal supplies from new linkages in Q1 FY18 is expected to commence from Q3 of FY18.

The aluminum business delivered solid operating performance, with aluminum production at 321 KT and alumina, including Utkal, at 724 KT. All three new plants continue to run at their rated capacity. Aluminum business EBITDA was in line with that of last year at Rs. 875 crores on the back of supportive macros, offset by increase in input cost, which was mostly alumina. Additional electricity duty by Orissa government also impacted the cost of production at Hirakud and Aditya.

Utkal EBITDA year-on-year grew by 207% to Rs. 291 crores versus Rs. 95 crores, mainly due to higher realization. Though, the higher realization is positive for Utkal, it results in higher input cost for the stand-alone aluminum business.

Moving to Slide #6. In our copper business cathode production was up 67% year-on-year at 109 KT due to planned maintenance shutdown that was undertaken in the previous year. During the quarter, strong financial performance was driven by higher sales volume, partly offset by lower by-product realization and increase in input cost.

Novelis, as you know, continues to deliver solid operational and financial performance. In Q1 FY18 Novelis achieved a record Q1 shipment of 785 KT, up 4% year-on-year, including a 16% increase in automotive shipments. Adjusted EBITDA increased from US$268 million year-on-year to US$289 million, mainly due to increase in total FRP shipments. Reported net income of US$101 million is significantly up from US$24 million in the previous year, driven by higher adjusted EBITDA and as well as a US$19 million reduction in interest expense as a result of various debt refinancing actions in the last year.

Let us understand the broader economic environment in Slide #8. Global economy for the first half of calendar year 2017 was stable and economies across geography showed signs of gaining momentum. However, the strength is still lacking. The US economy in the first half of 2017 grew at an average rate of 2%. Q2 of CY 2017 witnessed faster growth as compared with Q1 of CY 2017, on the back of steadily improving labor market conditions, increasing consumer spending, upbeat consumer confidence, supported by lower inflation and improving industrial production.

The Eurozone also showed signs of improvement in first half of 2017. PMI in major economies is in the expansionary phase. Employment rates and consumption are also on the rise. China registered a growth of 6.9% in the first half of 2017, supported by strong demand in industrial production. Going forward, due to tightening of financial conditions and slowdown in real-estate sector may impact Chinese growth.

Given the recovery in global economic conditions, IMF has maintained its growth forecast for CY 2017 at 3.5% as against 3.2% in CY 2016. On the domestic front, inflation rate is below the targeted level of RBI and touched historic lows of 1.5% in June 2017. Further, monsoon in India is expected to be at normal levels, which may help to keep inflation under control in FY18.

Hence, RBI slashed key policy rates by 25 basis points to 6% in their recent monetary policy in order to support growth in the economy. During Q1 of the current financial year, demand was subdued due to the apprehensions on the impact of GST rollout. However, in the long run, as we all know, that it would put us on a faster growth path in a formal economy. As for the RBI's latest estimate, Indian economy is likely to grow around 7.3% in FY18.

Turning to the aluminum industry update on Slide #9. Aluminum remains the top performer amongst LME metals in 2017. Aluminum LME is mainly driven by enhancement of supply-side measures and environmental lead closures in China, along with a weak US dollar and surging input cost. Recent rally in aluminum LME is largely due to implementation of supply-side reforms in China. Xingfa and Hongqiao have announced production cuts, and provincial governments have instructed smelters to curtail production. Recently, cuts occurred in Xinjiang, Inner Mongolia, and Shandong provinces.

Overall, buoyant demand outlook and lower inventory base may continue to support higher-priced outlook for aluminum. Given the above scenario, market balance in China is expected to be in surplus at around 1.8 million ton in CY 2017, despite capacity curtailment. Whereas the world, excluding China, is likely to be in deficit of around 1.5 million tons during the same period on account of increase in demand and likely production disruptions.

In Slide #10, we will discuss about the aluminum industry drivers and factors which affect the industry in Q1. Implementation of reform in China coupled with weak US dollar and surge in input cost helped industry players to improve their realization. LME in Q1 FY18 grew by 3.3% over previous quarter and 21.6% year-on-year. However, for domestic players, rupee appreciation of around 4% negated the impact as compared to the previous quarter. Continuous declines in LME stock and firm global demand supported the premium in Q1 FY18.

On the domestic front, demand from the user industries was subdued in the first quarter of FY18. On the other hand, market remains oversupplied due to increased imports. Market share of imports touched 53%, and domestic players are losing market share against low cost imports coming from FTA countries.

Slide #11 captures the state of the copper industry and the major external value drivers of the copper business. LME in copper was majorly driven by series of disruptions during first few months of CY 2017 and unexpected expansion in Chinese growth. Moreover, weak US dollar also supported copper LME to move upwards. China has announced a ban on level seven grade scrap imports by end of CY 2018, including copper. This gives momentary support the copper LME.

On the supply side, mine production is expected to decline marginally in CY 2017 due to major disruptions from January to April 2017. On the other hand, global demand for refined copper is expected to grow by 1.7% in CY 2017. Emerging economies are expected to drive refined corporate demand.

However, a series of disruptions have had an adverse impact on TCRC. It has faced significant moderation by end June 2017 as compared to January 2017. But the high number of smelter maintenances across geographies in H1 CY2017 provided handy support to TCRC. Birla Copper TCRC impacted by reduction in global benchmarks by about 5% during CY 2017 over previous year.

Coming to the domestic market, copper demand remained subdued in Q1 FY18. However, we are expecting it to bounce back post Q2 FY18 on the back of various infra initiatives by the Government of India.

Let me take you through the key highlights for the results.

Coming to Q1 FY18 results highlights for Hindalco standalone business in Slide #13. As compared to Q1 FY17, the company's top-line grew by 28%, driven by higher aluminum and copper volumes and increase in average realizations for copper and aluminum segment. Year-on-year EBITDA for Q1 FY18 was higher by 4% at Rs. 1,404 crores, driven by steady operations, higher volumes in copper and aluminum segment, supportive macros for aluminum, partially offset by higher input cost. Net profit for the quarter was down by 2% at Rs. 290 crores, mainly on account of an exceptional provision of Rs. 104 crores. Details for the exceptional provision will be shared in the later part of the presentation.

Let me now turn to the operating performance for the aluminum business in India on Slide #15. Turning to the operational performance covered in Slide #15, alumina production, including Utkal, increased 2% year-on-year, and metal production increased by 4%. All new plants continue to operate at their designed capacities. In line with our focus on value-added production, value-added product included wire rod registered 15% growth in Q1 FY18 over the previous year. Against the total production of 321 KT in Q1 FY18, metal sales in all forms was at 299 KT, mainly impacted by the subdued demand in the market and also about 7 KT of metal that was stuck at the port due to late arrivals of shipment.

Slide #16 talks about Utkal performance. Production at Utkal Alumina increased by 3% year-on-year to 384 KT, it is now operating at its designed capacity and continues to be among the lowest cost refineries in the world. We also plan to execute long-term tariff contract with railways for transport of inward raw material and outward finished products for the period of four years. This will help us to strengthen the logistic at Utkal, and will provide visibility of cost for the next few years.

Moving to operating performance of our copper business in Slide #18. During Q1 FY18, as compared to last year's production of cathodes was higher by 67%, mainly due to lower base, planned maintenance shutdown in the previous year. Copper rod production was higher by 7%. DAP production was down 29% as compared to last year due to operational issues. Total copper sales for the quarter was at 105 KT. In line with our long-term strategy, we continue to invest in value-added product facilities. Investments in CC rod facility is moving as per our plan. Production from the new capacity is expected to commence from Q4 FY18.

I will now cover the operational performance of Novelis in brief, many of you have already heard the Novelis earnings call for Q1 FY18. Coming to Slide #20, we achieved a record Q1 shipments level, up 4% year-on-year. Excluding 6 KT from the previous year related to the divested Alcom business in Asia, shipments were up by 5%. Total FRP shipments grew largely due to the 16% increase in automotive shipments and a 2% increase in local can shipments. Strong financial performance in the first quarter is a result of our successful automotive strategy, our continued drive towards operational excellence and strong customer partnerships. Our focus across key metrics of safety, recovery, metal mix, customer satisfaction and quality have helped us drive these strong results. We achieved a strong adjusted EBITDA per ton of US$368 in the first quarter.

With that, I would now like to turn the call over to A.R. Das for a more detailed review of our financials.

Alphonso Richard Das: Thank you, Mr. Pai. We go to Slide #22. Revenue from operations for Q1 FY18 at Rs. 10,407 crores was higher by 28% over the previous year, driven largely by increase in average realization and sales volume for both the Aluminum and the Copper business. However, when compared to the previous quarter, the sales volume was lower due to subdued demand in the market. EBITDA at Rs. 1,404 crores was up 4% compared to the previous year, supported by stable operations, higher aluminum and copper volumes and supportive aluminum macros, partly offset by increased input costs. Depreciation increased over the previous year due to progressive capitalization. As compared to the previous year, the interest expense is lower by Rs. 112 crores, largely due to the prepayment of our rupee term loans from Indian banks.

The Board today approved borrowing of Rs. 4,400 crores by way of commercial papers, etc., to finance our working capital needs. This will now allow us to tap both the bank loan market and the bond market to meet our working capital needs, helping us thus to drive down interest costs. We would like to clarify that this approval will not lead to any increase in our overall borrowings.

Earnings before tax and exceptional item for the quarter is at Rs. 537 crores and net profit at Rs. 290 crores. The net profit for the quarter factors the exceptional provisioning of Rs. 104 crores, which is on the basis of a recent Supreme Court judgment in a matter relating to mining regulation to which the company is not a party. The company anticipates that the judgment may have an implication on its existing litigation, which is sub judice. The provision has been made as a matter of abundant caution.

Moving to Slide #23. The standalone aluminum revenue for Q1 FY 2018 was Rs. 5,008 crores, a 9% increase year-on-year. This was driven by increased realization and higher sales volume, 299 KT versus 290 KT in Q1 2017. EBITDA at Rs. 875 crores in Q1 FY 2018 as compared to Rs. 871 crores in Q1 2017 is, as we have explained on the back of a supportive macros, higher volumes, and stable operations, offset by higher input costs.

We move now to Slide #24, which covers Utkal. Coming to the financials performance of Utkal on Slide #24, Q1 2018 EBITDA was higher by 207% on a year-to-year basis. This was largely due to higher realizations on the alumina prices to Hindalco. As explained earlier, higher alumina prices result in higher input costs for Hindalco's standalone operating results.

Moving to Slide #25, on our Copper business. Revenue at Rs. 5,430 crores was up 51% vis-à-vis the previous year due to higher copper volumes, 105 KT this year vis-à-vis 61 KT in Q1 FY 2017 and higher copper LME. EBITDA stood at Rs. 322 crores, significantly higher than the previous year on the back of higher volumes offset by lower by-product prices and higher input costs.

Finally, moving to Slide #26, Novelis. The financial highlights of Novelis Q1 FY2018 results are as follows. Net sales increased by 16% to US$2.7 billion, driven by higher shipments and higher average aluminum price. Adjusted EBITDA at US$289 million was 8% up, mainly due to, A, higher shipments; B, favorable scrap spreads; and C, the efficiency improvements today covering areas of high recovery and freight optimization.

With this, I would hand this over back to Mr. Pai to give his closing remarks.

Satish Pai: So in line with our commitment we continue to focus on accelerated deleveraging and bringing down the overall net debt to EBITDA ratio. Till date, the total prepayment of about Rs. 6,430 crores since September 2016 has been done. Our strong results in the first quarter is a tribute to our continued drive towards operational excellence. All new plants continue to operate at their designed capacity. We have also further improved our coal security via new linkages. The total new linkage coals, including the linkages awarded in Q1 FY18, stand at 7.6 million tons. By virtue of being the strong aluminum integrated player, it provides us overall cost benefit for the company. At Novelis, strong balance sheet and financial position has provided us with the flexibility to evaluate potential growth opportunities. We maintain a positive view of the growing demand for automotive aluminum shipped globally, and we aim to reinforce our market-leading position by adding capacity to meet customer needs. Further, we maintain a positive view on the global can market, with steady low single-digit growth over the next few years. The story is pretty consistent on a regional basis as well.

Going forward in India, we see positive growth momentum to continue, although there are some key concern areas like continued low-cost imports in Aluminum and Copper segment, which is hurting the domestic players. And also there is an increase in domestic aluminum production.

Further, any delay in pickup of domestic demand will hamper overall growth. We are also keeping a close eye on input cost movements, as it may affect us adversely.

Thank you very much for your attention. The forum is now open for Q&A.

Moderator: Sure. Thank you very much. We will now begin with the question-and-answer session. We have the first question from the line of Sumangal Nevatia from Macquarie.

Sumangal Nevatia: First question is with respect to the Copper division. Margins we read were impacted by lower by-product credits and increasing input cost. Can you elaborate what are the recent price trends and what is the contribution of by-product credits in 1Q versus, say, last quarter?

Satish Pai: So when you look at the by-products, the one that affected us the most was that… you are talking about year-on-year or sequential quarter first?

Sumangal Nevatia: Any comparison is fine.

Satish Pai: Okay. So really for us, from a by-products point of view what impacted us is the sulfuric acid was slightly positive. But it was the DAP sales that were down for us, and that impacted the by-product realization. And the other part to add on the copper side is also both aluminum and copper, our sales were a little bit impacted by the GST rollout. So, in the month of June we ended up in copper by having to export more cathode than sell copper rod domestically. So even that had a negative impact.

Sumangal Nevatia: Okay. What the contribution is of DAP in overall Copper division, is it possible to give?

Satish Pai: DAP's contribution is around Rs. 40 crores.

Sumangal Nevatia: Understand. Next question is, again, we are hearing a lot of cost pressures on the raw material side for aluminum coming from caustic soda and carbon products, so can you discuss what are the recent price trends in the last couple of months? And how much of it is captured in 1Q, given some inventory lag and what will be the impact in coming quarters?

Satish Pai: Yes, that is a good question. Actually, in Q1 the only impact we had on our input cost that was really meaningful was alumina, and that is why you can see the results of Utkal were very high. In fact, we do Utkal transfer pricing and actually the transfer price of Alumina for Q1 was at $339 per ton. And the second thing that impacted us was the Orissa electricity duty going up, which had a negative impact of Rs. 36 crores on Hirakud and Aditya. The caustic impact was there in the alumina side, and you are right, CP coke and pitch. But in Q1, it was not meaningful. I think that in Q2 we may see a little bit more of the impact of the carbon products. But in the grand scheme of things, the alumina and the electricity duty had a much bigger impact than CP coke and caustics.

Satish Pai: Understand. Is it possible to quantify what could be the cost inflation from these two things, caustic and carbon products?

Satish Pai: From caustic and carbon products, it is less than 5% - 6%.

Moderator: Thank you. The next question is from the line of Pinakin Parekh from JPMorgan. Please go ahead.

Pinakin M. Parekh: So just three quick questions. The first is, if you look at the aluminum cost segment, and as you highlighted that there is going to be some more flow through in the second quarter, how much of the overall cost increases can we further see from where we are in 1Q? Can it be an overall cost increase from aluminum COP by 3%, 5%, 7%? Just trying to understand what kind of further cost increases can we see from here?

Satish Pai: Look, the sort of governmental regulations like the Orissa electricity duty is pretty hard for us to predict. But the ones that we know, so alumina keeps going up and down, I mean, in fact, alumina is now around $300 versus $330 in Q1. So in Q2, you are going to get on the standalone side a benefit. But I think I urge everybody now to add Utkal and Hindalco standalone, so the alumina part need not be discussed. Now if you look at CP coke and pitch, I think, as I said, maximum another 4% to 5% inflation can be seen. The coal cost for us now are under control because coal, alumina, these are the two biggest ones. So I am left with CP coke, pitch, which are the only things that will impact the cost going forward.

Pinakin M. Parekh: Sure. Secondly, sir, in terms of the Rs. 104 crores of provision bills, can you elaborate on whom case does it relate to and which Supreme Court judgment has the company considered for providing this provision?

Satish Pai: So the Supreme Court judgment is the one that was pronounced for the manganese and iron ore mines in Orissa. That was the judgment that came out, where they actually clarified certain Acts in the MMRD. I cannot because it is sub-judice to talk about the exact case on our side, but it is nothing related to us, and as we said, it is not with the company. But I think we took a legal opinion, and out of caution we have taken a provision.

Pinakin M. Parekh: So does this relate to bauxite mining or does it, I am just trying to understand that is this Rs. 104 crores based on some kind of notice that has been sent by any of the state governments or any of the Shah Commission Reports?

Satish Pai: No. Pinakin, there is no notice come to us yet, and it is not related to bauxite.

Pinakin M. Parekh: Okay. So just trying to understand that can this liability eventually can be higher or lower or do you think this is something which is maximum that the company would have to pay for?

Satish Pai: Well, I would hesitate to give you, but on this particular matter we are quite confident that this is the max. Hopefully, we may even get it lower. But as I said, governmentally what can happen in other things, God only knows.

Pinakin M. Parekh: Sure. And sir, so Novelis in the call did highlight a few times and they are looking at strategic opportunities and that they are reworking their capital expenditure plan, they would come back with a detailed capital expenditure plan and in fact did guide that FY19 CAPEX should be higher than FY18 CAPEX. Coming to Hindalco, sir, are we relooking at some of the projects in terms of pushing them forward or do we have a sense of how next year's CAPEX would move vis-à-vis this year's CAPEX?

Satish Pai: So if you remember, right from the QIP, I have been persistently saying that Hindalco's strategy in India is around doubling our downstream capacity and expanding Utkal Alumina by another 500 KT. So these projects, we are kicking off. And I had also said that we will be spending around Rs. 4,000 crores to Rs. 5,000 crores over the next five years. And it is not that it is going to be evenly distributed over the next five years; there will be ups and downs as these projects comes to fruition. So, I think that nothing has changed over there, Pinakin, it is still the same plan, we are going to double our downstream capacity and expand Utkal Alumina from 1.5 million to 2 million. So you will see CAPEX going up from next year, but it is not going to be a smooth one, because once the alumina project comes in there will be a little spike, the downstream is a little bit much smoother.

Pinakin M. Parekh: Understood. Then sir, lastly, of the 16 million ton coal requirement that we have now, what is the latest linkage plus captive coal security that the company has?

Satish Pai: So on paper now, the total capacity we have is 15.5 million of the 16 million. Now, what I have to tell you is the reality is that in the monsoon especially we never get 100% of our linkages, so we have been getting around 70% to 75%. So on paper we have 15.5 million between captive, new and old linkages of our 16 million, but I think in reality we are more like 11 million or 12 million of the 16 million, the rest which we will buy from the option.

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

Sanjay Jain: In your opening remarks, you were mentioning about something about 5% decline in TCRC in CY17. Did I hear it correct or…?

Satish Pai: Yes, you heard that correct. I think the TCRCs have declined. Let me give you the exact numbers. In FY17 Q1, it was Usc 26/lb, I am just rounding it up, and Q1 FY18 is around Usc 25/lb.

Moderator: Thank you. The next question is from the line of Nitesh Jain from Axis Capital. Please go ahead.

Nitesh Jain: I have two questions. Number one, can you share what are the current spot prices of caustic soda, CP coke, CP pitch and aluminum chloride, please?

Satish Pai: Oh, my God. The current spot prices, I do not have the list in front of me. I will have to...

Nitesh Jain: Any, I do not want the exact numbers, like we have seen like caustic price has gone up, so is it like Rs. 45,000 - Rs. 46,000?

Satish Pai: No, no, it is not Rs. 45,000, it is Rs. 35,000, Rs. 32,000 actually. It depends on where you take it, so it is not in the 40s.

Nitesh Jain: Okay. And similarly for the CP coke, CP pitches?

Satish Pai: I think CP coke, CP pitch, okay; I will try to get you the numbers as we go ahead. It is around Rs. 32,000.

Nitesh Jain: Okay. All right. And sir, my second question is on the alumina pricing. So we have seen like LME aluminum price has now basically crossed $2,000. So have you seen like the spot alumina has also moved along with the LME aluminum or is it at the same level like $280 - $300?

Satish Pai: Look, there is no connection between alumina and LME aluminum for the last, I do not know, more than a year or plus. So if you look at it now, current spot alumina prices around $300. It is down compared to the previous quarter. So there is no connection between LME and alumina right now, alumina depends on its own supply and demand. There are only two places in the world that buy alumina, that is China and the Middle East right now.

Nitesh Jain: Sure. Okay. So you mean to say, basically, the alumina pricing trend will be driven more by its own demand supply?

Satish Pai: Right.

Nitesh Jain: And perhaps, it will catch up at some point in time along with the aluminum market?

Satish Pai: Yes.

Nitesh Jain: Okay. And sir, lastly, if you can just share, I know it is a difficult number, but the overall India aluminum demand and copper demand growth for the industry as a whole for Q1, if you have any approximate number?

Satish Pai: We have the exact number. In fact a few quarters that been, the copper market, I am now talking year-on-year, it de-grew by about 10% and the aluminum market, it de-grew by 4%. So this is compared to quarter one of last year. So, as I was talking even in my prepared remarks, a little bit of worry here because we finished in Q3 the demonetization that had an impact on Q3 sales;

Q4 it picked up. Then Q1 we had the GST impact, where everybody was destocking. And hence, the sales in June also came down. Now in July and August, the pickup is there but not to the extent we are expecting. So both the domestic markets remain weak. We are hoping now that by September, October these are normally Q3, Q4 are the highest sales markets in India, that demand will pick up.

Nitesh Jain: Sure. So sir, for Hindalco like we are doing almost 1.2 million ton - 1.3 million ton kind of run rate production, so how much is like is the domestic sale and how much is the export or outside India sale?

Satish Pai: So look, when we made the plan for the year we wanted to sell about 60% domestically and 40% by export. What happened in Q1 is more like a 50-50. Because as soon as domestic demand goes down we end up exporting, even though it is at a lower price, because we don't get the duty differential.

Moderator: Thank you. The next question is from the line of Bhaskar Basu from Jefferies. Please go ahead.

Bhaskar N. Basu: Just a couple of questions. Firstly, on the linkage coal of 2.9 million tons, could you share some or give some details around what kind of cost or pricing would this coal be sourced at?

Satish Pai: This coal is more or less at the same. Let's put it that way, hardly any premium above the base price that it goes on auction. So, it is in line with the linkage prices that we are getting before.

Bhaskar N. Basu: And so it would be definitely at a discount to the auction prices, at which you...

Satish Pai: Absolutely.

Bhaskar N. Basu: Okay. And now what would be the coal mix in terms of that 4.5 million ton of original linkage coal which you had won one last year, how much of it actually you are seeing in terms of actual supply? And of course, you mentioned that this one, the new 2.9 million ton will kick in, in the second half. And captive, how much are you actually producing right now?

Satish Pai: So, let me start, it is a fairly detailed answer in the sense that 3.9 million is the Krishnashila linkage that we are picking up nearly 90% of that. The captive mines, we have started IV/4, IV/5 and now Kathautia. So out of the 4 million, we should be producing about 3 million this year. Only Dumri has not started yet. And then in the new linkages, which is probably now the 2.9 million has just to be added on, that will only start, but of the 4.8 million, as I said told you, we are getting about 70% to 75% of what we are supposed to get.

Bhaskar N. Basu: Okay. 70% of that 4.8 million which you won last year is already coming?

Satish Pai: Yes.

Bhaskar N. Basu: And this new 2.9 million will come in the second half?

Satish Pai: Yes, it will come from Q3.

Moderator: Thank you. The next question is from the line of Anshuman Atri from Haitong Securities. Please go ahead.

Anshuman Atri: Sir, my question is regarding the sales. So this 22 KT additional you have built in the inventory and the sales versus production, so this sales will be in the next quarter or will it be gradually over the next six months?

Satish Pai: No. You see that shipped, as I mentioned in my prepared remarks, we had about 7.8 KT that was supposed to go on the ship, the ship docked late, it has already left. So the sales should be pretty clear now, we produce about 320 KT, we should be selling plus, minus some quarters at least 310 KT, 314 KT every quarter. Of course, Q4, we clean up the inventory and sell quite a lot. So we sold 299 KT. So in Q2 we should be selling about 325 KT, 328 KT because that 8 KT from Q1 just goes into Q2. In fact, the 8 KT has already, on the 1st and 2nd of the July, it has already left.

Anshuman Atri: Okay, sir. Sir, my second question is regarding the imports as well as the scrap. So, despite increase in domestic production, the imports continue to come into India. So what is the government position on both copper as well as aluminum for the domestic players to make investments? Because if the imports continue to increase, then it will be difficult for the domestic players.

Satish Pai: Yes, it is a very good point. I think the government has realized that the FTAs that were signed in the past are actually the problem now. The problem is that you cannot just go back on the agreements you have already signed. So, the good news is the new agreements that are coming like RCEP, and we are actually participating or advising the government on many of them. I think they are going to be a lot more cautious going forward in signing free trade agreements.

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

Amit A. Dixit: My first question is a little bit macro on the aluminum supply in China, particularly in view of the announced capacity cuts. So, there have been a number of news, announcements, etc., but can you please give your take on how you see the supply constrain shaping up?

Satish Pai: So look, I mean, many of you who have been listening to me on this call, I was always a little bit skeptical. But in the last few months, there have been lot of announcements of cuts both by Wenzhou and Xinfa, and all of that has led to the SHFE price in China going up. In fact, the LME-SHFE gap is less than $50 right now. So, it does look like the fact that Chinese production is being curtailed. Though the only thing that worries me, if I look at the last production numbers that came out, they are still around 35 million tons. So I suppose that will take some time for the cuts to show up in the production. But I think that the market certainly believes that the cuts are happening, which is why the LME has shot up to 2,000 right now. And in China, the market believes that the cuts are happening because the SHFE has shot up, and the gap is at less than $50 now. So, I guess now the winter is going to come in a few months, and I guess the thing to watch will be the production numbers coming out of China.

Amit A. Dixit: Okay. Sir, second question is on the capital expenditure in this quarter. How much did we spend? And can you talk about the value-added step in copper, how about aluminum; is it also progressing as per schedule?

Satish Pai: So we spent about Rs. 300 crores in capital expenditure in Q1. And your second part of the question?

Amit A. Dixit: The second part of the question is that you talked about the value added production capacity increase in copper. But in aluminum also we are planning to increase it. So is it also growing as per the schedule that was originally envisaged?

Satish Pai: Yes, it was. Just to make it clear. We did the QIP in February, March and post the successful QIP we talked about the downstream expansion project. So this year's CAPEX is still at the Rs. 1,000 crore that I had committed. So this year's CAPEX does not have a lot of the new projects that we talked about, that you will only see from next year onwards.

Moderator: Thank you. The next question is from the line of Abhishek Poddar from Kotak Securities. Please go ahead.

Abhishek Poddar: Sir, regarding the copper TCRC, you mentioned about $0.25 a pound for this quarter. There are some reports in the market which indicate the fall has been more in the spot markets, and some of the reports even getting about $0.19 - $0.20 per pounds. So how do you see, is it mostly contracted for us? Or you think that there might be some pressure here?

Satish Pai: No. For us, we don't buy; we have about 80%, 90% locked in. So we only buy 85% locked in, and 15%, we buy on the spot market. So the gyrations in the spot market do not affect us that much. So for us now, the next TCRC setting time is in Shanghai in November when we will get to know the TCRC for next year. But this year, we do not anticipate too much changes from the $0.25 levels.

Abhishek Poddar: Okay. And sir, on the other by-products and all, how do you see the copper earning trajectory for the next couple of quarters? Do you think that the DAP realization and all will improve or do you believe that it will be the….

Satish Pai: Yes, I think we certainly think so, because international prices have gone up. We had some operational problems this quarter, that is why our DAP production was low. But we certainly think the copper performance during the coming quarter is going to be much better than the Q1.

Abhishek Poddar: Okay. Sir, second question is, if you could please give the consolidated net debt numbers for June compared to March?

Satish Pai: June compared to March. So this number that I have is June. Now when you say consolidated, are you talking with Novelis or just Hindalco plus Utkal?

Abhishek Poddar: Including Novelis, entire.

Satish Pai: Then the net debt number is Rs. 47,381 crores, right now.

Abhishek Poddar: So it has not moved much in this quarter, is it, sir?

Satish Pai: No, if you take this quarter, the only thing we did was pay down Rs. 4,400 crores.

Abhishek Poddar: Right, fair enough.

Abhishek Poddar: Yes. Because my belief is that even in March it was about Rs. 47,000 crores. So, has it remained flat quarter-on-quarter, in this quarter as well?

Satish Pai: What is it? Sorry?

Abhishek Poddar: So my point was that your net debt was about Rs. 47,000 crores in March quarter also and in June also you are saying it is Rs. 47,381 crores. So, has it remained flat in this quarter? And is it because the working capital has gone up?

Satish Pai: Yes, exactly. From Q4 to Q1, our working capital goes up a little bit.

Abhishek Poddar: Okay. And sir, just a last question. Because you have repaid your Rs. 4,000 crores of total loans, what is your borrowing cost now for the repayment? And do you expect further decline in the borrowing cost?

Satish Pai: Well, the borrowing cost, look we are on the SBI thing, so that is correct. Right now, the average borrowing cost for us in India is 7.81%. But in November our interest rates will now reset to the new one, so we expect this to come down then.

Abhishek Poddar: So any expectation of the, what, 20 - 25 basis points correction or it could be different?

Satish Pai: It is much more than that. Alphonso, do you want to?

Alphonso Richard Das: Yes, it will come down by about 80 basis points.

Moderator: Thank you. The next question is from the line of Ashish Jain from Morgan Stanley. Please go ahead.

Ashish Jain: Sir, firstly, can you give me the net debt number as in June, excluding Novelis?

Satish Pai: So the net debt number excluding Novelis is Rs. 19,336 crore.

Ashish Jain: Okay. Sir, secondly on aluminum business, as per my calculation, your cost per ton on a sequential basis was actually flattish in spite of the increase in alumina price; I am obviously not including Utkal here. What has driven that because Alumina for sure has gone up on a sequential basis quite meaningfully?

Satish Pai: The coal cost has come down for us. We started to get more of the linkage coal that we had won in the last auction. So, our coal on a rupees per million kilocal came down in Q1 versus the previous quarters.

Ashish Jain: Sir, is it possible to quantify how much has coal cost come down there?

Satish Pai: So, our coal cost is, quarter-on-quarter if I look at it, is around Rs. 904 in quarter one versus Rs. 918 in quarter four. So that is the exact number on the rupees per million kilocal. But for you now, you have to go to a kilowatt hour per ton of aluminum to calculate the exact.

Ashish Jain: Okay. But sir, is that all or there is something else? Because sir, the cost decline that I am seeing seems to be much higher than that. Do you think all of it could be explained by coal itself or there's something else here as well?

Satish Pai: I do not think we have seen anything else. The biggest drivers for us are always Alumina, coal and then the CP coke, pitch and caustic. So, I guess the only thing is the operations are running very stable. So otherwise, there is no real plus or minus that much. In fact, in quarter one of this year, I got the full impact of the Orissa electricity duty, Rs. 33 crores.

Ashish Jain: Yes. Okay, got it. And sir, just in second half, as you start getting coal from the new auctions you have won, assuming alumina remains where it is this number will go down meaningfully from here or?

Satish Pai: Sorry?

Ashish Jain: In the second half, as you start getting the new linkage auctions that you have won, can December go down meaningfully from here?

Satish Pai: No. I don't think, when you are running at about Rs. 900 per million kilocal, this is quite low already. And for me, I think that more linkage coal will probably offset a little bit the CP coke, pitch type of prices that are going up a bit.

Moderator: Thank you. The next question is from the line of Ritesh Shah from Investec Capital. Please go ahead.

Ritesh Shah: Sir, you detailed about the aluminum capacity shutdowns in China. Sir, would you be able to provide some color on the capacity swap arrangement which the smelters currently are executing? And is there any number that you have wherein this capacity swaps have actually happened?

Satish Pai: So look, I also can only actually read the same reports that probably you are reading. And the presses or the analysts' reports I think are mentioning Hongqiao, which is the largest aluminum company in the world is talking about 2 million ton shutdown. Xinfa has announced about 500 KT. Xinjiang they have declared another 300 KT, 400 KT. I think hope Aluminum has cut about 200 KT - 300 KT. So I am reading in the press as the same as you are doing. So we are expecting about 2 million tons to 3 million tons of aluminum capacity to be shut down during this winter.

Ritesh Shah: Okay. And sir, secondly, how do you look at the alumina pricing going forward, given if there are shutdowns on aluminum as well as you have shutdowns on alumina as well? But given China is a net importer of alumina, does it mean that alumina prices will eventually go down for, say, next six months, how should one look at it?

Satish Pai: That is a good question. I think that the alumina prices, I mean if the demand from the aluminum smelters in China goes down, then it is fair to say that probably the alumina prices also should go down. But we will have to wait and see. I mean, either way, for us it does not make a big impact because we look at it from a fully integrated point of view. We are not selling alumina on the third-party market.

Ritesh Shah: Okay. Sir, just taking alumina further, can we have a break between specialty alumina and the normal alumina that we have on capacity?

Satish Pai: The specialty alumina we sold about 90 KT in Q4. So we sell about 350 KT to 360 KT of specialties during the year.

Ritesh Shah: Okay. And sir, what will be the realization over here? I understand it will be significantly higher.

Satish Pai: Yes. These depends. An average will not make sense because there are numerous products that go into refractory, ceramics, glass, etc. So, an average realization will really not make sense. But you are right to say that this is far, far higher than metal-grade alumina.

Ritesh Shah: Okay. Sir, just last one question. You indicated because of this carbon product prices you expect another 4% to 5% inflation incrementally. So, what is the base that we should look at for this 4% to 5%, is it like $1,500 or something lower than that?

Satish Pai: Two things to first watch. One thing I told you is that more linkage means my coal prices will come down. The second thing that is helping me mitigate this CP coke prices is the rupee strengthening. So, I personally believe that Q2 to Q1 the cost of productions of aluminum should not change too much. So, what I have seen from July, the prices will not be very different.

Moderator: Thank you very much. Due to time constraints, we will be able to take one last question. Last question is from the line of Abhisar Jain from Centrum Broking. Please go ahead.

Abhisar Jain: Sir, my question is related to now Hindalco COP for aluminum, how is it placed in the overall global cost curve?

Satish Pai: So, I think that you know that our average still continues to be in Q1, first quartile. The Aditya and Mahan are of course at the leftmost side. Then Renukoot comes in somewhere towards the top end of Q1. And then, of course, Hirakud is the most expensive that goes in to quartile two.

Abhisar Jain: Right. And sir, in the past, you had indicated that on an overall basis, combination of all four assets, we were in somewhere between 10% to 15% range within the first quartile. Will that assessment still hold?

Satish Pai: Yes, that still holds. I do that with an integrated cost. Meaning, I take Utkal cost.

Abhisar Jain: Sure. And sir, the other question is on the contribution of the logistic cost in the COP. In the past, you had been indicating that Hindalco would be focusing on this aspect quite a bit in the coming few years and reduce this cost from maybe a 15% of COP to the world's best standard of close to 7% - 8%. Now with GST getting implemented, I believe there could be some opportunity and benefits from there. So sir, how are we moving on that aspect?

Satish Pai: We have Started, I mean, the rationalization of the godowns has started. We have signed for Utkal a long-term trade tariff with the railways, which should give us a 1.5% reduction in costs. So we have already started on the various measures post-GST to optimize our logistic. So, I think that over the coming quarters we should start to see the logistics costs going down. So, the biggest part for us, if you remember, I used to tell you that in aluminum we are running 40-odd godowns just to optimize the sales tax of each state. So, now post-GST, we are optimizing the number of godowns we will run. Larger logistics companies are also coming up in India now because it will make sense, and we will hopefully tie up with a few large players. And then of course railways is probably our most important partner, because the more we can move by rail versus road it brings the logistics cost down. So all those three we are working on now.

Abhisar Jain: And so, sir, if I may ask, in the next two years, sir, what could be the percentage point reduction on the logistic front?

Satish Pai: Look, I think we should at least get to about 10% in the next two years.

Abhisar Jain: Okay, sir. That helps. And sir, just one last question related to the Utkal debottlenecking from 1.5 million to 2 million ton. So what is the CAPEX just for that? And by when would you be completing this expansion, sir?

Abhisar Jain: Yes. I now have exact number for the CAPEX because we have done the technical engineering. It will be around Rs. 1,200 crores, and it will take us about 30 months to complete.

Abhisar Jain: So, the volumes from this would be expected sometime in late FY20?

Satish Pai: Yes.

Moderator: Thank you very much. We will take that as the last question. On behalf of Hindalco Industries Limited, that concludes this conference. Thank you for joining us, Ladies and Gentlemen. You may now disconnect your lines.