"Vardhman Textiles Q1 FY2020 Earnings Conference Call"

August 14, 2019

ANALYST: **MR. AVI MEHTA - IIFL CAPITAL LIMITED**

MANAGEMENT: **MR. NEERAJ JAIN - JOINT MANAGING DIRECTOR & HEAD (YARN BUSINESS) – VARDHMAN TEXTILES**
MR. RAJEEV THAPAR - CHIEF FINANCIAL OFFICER VARDHMAN GROUP
MR. MUKESH BANSAL – VICE PRESIDENT - VARDHMAN TEXTILES
MR. AKSHAY JAIN – INVESTOR RELATIONS - VARDHMAN TEXTILES
MR. LALIT MAHAJAN – HEAD (RAW MATERIAL) - VARDHMAN TEXTILES

Moderator: Ladies and gentlemen, good day, and welcome to the Vardhman Textiles Q1 FY2020 Earnings Conference Call, hosted by IIFL Capital Limited. 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. Avi Mehta from IIFL Capital Limited. Thank you, and over to you, Sir!

Avi Mehta: Thank you. Good afternoon everyone. We welcome you all to the Vardhman Textiles 1Q FY2020 conference call. From the management we have the key senior management including Mr. Neeraj Jain, Joint Managing Director, Mr. Mukesh Bansal, Mr. Rajeev Thapar, CFO and Mr. Akshay Jain. I would now like to hand over the call to the management for their opening comments. Over to you Sir!

Akshay Jain: Welcome to the first quarter concall for Vardhman Textiles. We will just take you through the numbers and then hand over to the senior management for comments on the market scenario and the raw material scenario and then open the call to questions.

Q1 we had indicated in our past communications has been a slightly weak quarter. From a topline perspective, fairly flat on a YOY basis even though we have seen a significant drop in our PBDIT or operating margins. This is predominantly due to drop in prices or a squeeze in margins due to the trade war that is happening between US and China.

From a YOY perspective, we have seen an increase in raw material cost as compared to Q1 last year in spite of a flat topline. This has led to compression in our EBITDA margins. Also we have seen a slight drop in our other income due to movements in interest rates as compared to the last quarter 2019.

Overall, we have declared a PAT of about 100 Crores on a standalone basis. We anticipate this situation to continue maybe in Q2 and things to improve in the second half of this year as we have previously intimated on our previous calls. Now for outlook on the cotton and other raw material we hand over to Mr. Lalit Mahajan

Neeraj Jain: On the business side, before we move to the raw materials, this period has been very challenging. There are lots of issues, which started with the trade war between US and China and which had an impact on lots of garmenting for the textile countries.

Since the trade war was started, China reduced their import of yarn which they used to do both from India and Pakistan and other parts and as a result of that the overall international trade of cotton yarn came down in this period. India who is the second largest country for the yarn exports after Vietnam the exports of yarn also got a big hit in India, which led to oversupply situation of yarn in the Indian market and since the Indian market could not absorb the entire yarn which was available the prices came down in domestic market as well.

India normally do about 100 to 110 million kg of yarn export every month and this period April, May, June it came down to an average of about 78 to 79 million kg, a drop of 26% whereas if you look at month-on-month, so the June was the lowest figure of about 57 million to 58 million kg as against 100 million kg or 200 million kg or 300 million kg of the corresponding period. So, April was comparable, May was a little low, June there was a major drop and July also looks like the same, which means the additional capacity about 40 to 45 million kg came to the domestic market starting June. That is one.

Second, the biggest hit has come from the demand from China only. China used to import close to about 45 million kg to 47 million kg from India and in this period the average last year three months was close to about 46 million kg. This period it came down to 24 million kg, but if you look at month-on-month, the June figure was miserable against a 45 million kg, 46 million kg which they bought last year. This year they bought only about 10 million kg as a result this entire drop has happened primarily from China and a little bit from Bangladesh as well.

The total yarn production in India is close to about 350 million kg out of that we used to export close to about 110 million kg. So our domestic consumption was 235 million kg, 240 million kg. Since this additional 40 million kg, 50 million kg was available for the domestic market, which was almost 15% to 18% of our domestic consumption India puts all the entire part and as a result the market became very tight in India as well.

Also, because lots of banks had lots of NPA issues, IBC processes were on against many companies, so as a result of that the banking channel became very, very choosy in terms of lending money to the people, so the money market was very, very tight even today in the domestic market, which is further hurting the business as such, but I think over a period of time, after GSTs implementation everyone is trying to reorganize themselves, all the textile players, textile chain especially the garmenting side or the retailing side, but I think in between there were lots of issues and concerns in terms of this parallel economy which people are converting or regulating themselves to the new rules of business, but I think in between the challenges continue in our belief. I do not have a data for that, but I believe what we understand from various parts of the market that people are reorganizing themselves which is taking some time before it gets readjusted to the new regime of business but definitely there seems to be quite a good progress on to that, but I think in between there are some small issues, sometimes here and there.

Domestic market because of all these reasons became challenging. The entire output company absorbed here as a result, the spinners started reducing the production capacities. As per the social media information, as per our estimates, I believe close to about 2 million spindles have already been stopped, some partial, some maybe a weekend, some maybe over time the people have reduced, so there is definitely a drop in production as of now by about 2 million spindles, but again a significant improvement in the supply chain is not looking like even today also with the closure of 2 million spindles, which means I think the pain is still there and unless the export picks up, it looks very, very difficult with this condition also that mills will be in a position to continue to run the equal capacity.

This was on the supply chain of yarn. On the other hand, there were different dynamics which were working on the international prices of yarn because of the changes happening on the raw material prices. Since the announcement of the war between US and China continued and sometimes whenever it looks like that there is no settlement happening as of now, the near future came down in a big way. The New York Future which was 77 cents to 78 cents in the month of April as of now it is close to about 58 cents, 59 cents per pounds, so there is a drop of almost 24% in the last three months.

The yarn prices internationally gets readjusted to the new cotton prices so the yarn which at some stage was close to about $3.35 cents came down to about $3, but at the same time the Indian situation was different because our overall balance sheet of cotton was tight. The export of cotton stock was much less, as a result, there is a huge shortage of cotton in the Indian market. So, the prices drop was not on the same lines what happened in the international market. The international market prices came down by 24% whereas in India prices came down by only 5% to 7% from a high of Rs.46000 a candy came down to about Rs.42000, Rs.45000 in this period showing a decrease of about 6% to 9%. So Indian spinner came into a situation where our cotton prices today are higher than the international prices so the delta which we used to get is negative as of now, as a result the Indian spinners came into a tremendous pressure and the margins eroded. So I think this situation surely will continue for the next one or two months till the new arrival comes in.

On the cotton front, I think in terms of since last year crop was very less. As per our estimate, CIA estimate I think it is only about 312 lakhs bales of cotton and against that an export of 46 lakh bales and the closing stock is expected to be not more than 15 lakh bales, which will be one of the lowest in the last maybe a decade or so and so many mills, so many trades is going to manage only the 15 lakh bales is a huge question which means the balance sheet of cotton may get worsen next month where the availability can be a big challenge.

So, I think till next month if the situation does not look like a major change or improvement happening there are two positive factors, which get rolled in between, one the rupee moved from Rs.68.50 to about Rs.71, which has given some relief, because definitely being the exporting product gets some relief available to that extent. That is one. Two, the next year cotton crop looks like very good. So, last year the crop was bad in India as well as USA because of the deficient rains. Both the places USA and India on the cotton price side they rains are adequate, the crop condition looks like very good as of now and we are expecting a bumper crop this year, we are expecting a bumper crop because the area has also increased from about 7% compared to the last year and the crop also is looking good because of the sufficient rains, so India the early estimate could be the crop can go up to 380 lakhs bales to 390 lakhs bales as well as compared to 312 lakhs last year.

In USA also I think the condition of the crop is quite good and we are expecting 22 million bales this year against last year 18.5 million bales, so I think both in terms of quality as well as quantity it looks like the cotton should be sufficient next year across various parts of the world.

Another challenge, which may continue for the Indian spinners could be the operation of Minimum Support Price. Government has increased Minimum Support Price by 2% so from Rs.5450 it has gone to Rs.5505 per quintal. So if we translate into the cotton based upon the average yield price of the season then it comes to close to about Rs.42500 or so. So with Rs.42500 and with the current dollar rupee will be close to about 76 cents or so whereas the imported cotton today New York Future is 58 or 59 and with the carry of about 1500 points for the physical deliveries. It is as of now in the range of about 74 cents or 75 cents, which means our cotton is either comparable or a little expensive as of now compared to the USA cotton, which used to be always 5 cents lower compared to the Mot Cotton, USA Cotton. So I think that advantage, which always used to be available as of March it looks like if the MSP keeps on working, but the kind of crop which is there, we are not very sure how the CCI and government is going to work on that and because typically to handle so much of cotton it is going to be a challenge for any agencies but at the same time, depending upon the government policy to buy or to support volume which is not very sure as of now. I think definitely some relief will come to the Indian spinners and the prices will come down, but how much can they really make money based upon their previous delta which used to be available to them over and above the American cotton is yet to be seen in the season depending upon the quality, quantity, and government action on that.

Other than this I think as I mentioned since there a lots of spinners who reduced their capacities, we are running our full capacities as of now. We have not stopped any capacity and in between our expansion which was planned are also coming up, so Vardhman Yarn Vortex expansion is fully operational. We started it somewhere towards the end of March and the partial productivity has come in the first quarter as of now it is running full capacity.

Another same plant of about 52000 spindles I think that has also partially started in the first quarter and I expect it by the end of August or first week of September. This plant will also be fully operational. As of now it is I think about 60% or 70% production is already on, and another one month or so we will be running full capacity for this plant also.

The third spinning plant at Vardhman Fabrics Budni, they also started in the month of I think first week of July and by next month or so they will also be running the full capacities of about 26 tons or 27 tons per day. So by the middle of September I expect all three plants to be fully commissioned, fully established and will be running at a full capacity.

For the fabric I will request Mukesh to give some brief to the investors on what is happening on the fabric side. Mukesh to you.

Mukesh Bansal: Thank you Neeraj Ji. Very good evening to you all. By and large the textile industry Mr. Neeraj has already covered and the challenges that the Yarn Business was facing in terms of the mucification more or less this is aligned to the fabric business has well, one thing that I can add is the Q1 April to June this period typically for the International market for textile it is the fall winters season. So fall winter in any case is a smaller season for Indian subcontinent because we are predominantly cotton based manufacturers which is a spring season for the fall winters. So from International perspective which is the smaller season for us, but one thing particular to this year is the order position has been pretty weak whether we talk about the US market or the European market and whatever order placement happened there was a time lag at least three weeks to five weeks between the order placement. So, that means whatever time lag has gone to that extent the demand is going to be reduced because the retail shelves like in any case is limited and that window is gone so that demand is shrunk forever.

Secondly this year particularly used to be good for the Indian domestic market because the retail time in India is the season time which is month of September, October and November when all the festivals and the marriage season also happens during that time so textile goods manufacturing happens during the month of April to August, but this year particularly because of the sluggishness in the market as well as the tightness in the money market so nobody was ready to invest into these stocks. And then in the month of February, March and April the yarn prices were also higher at that time particularly January, February, March, so everybody was expecting the prices to go down before they start billing for the stockings for the season. This added to the worseness of the situation for the period April to June also. These two factors which affected the demand from the international market as well as the domestic market, but going forward when we are entering into the Q3 and Q4 the sales seems to be better. People are seeing that the orders whatever delay has happened, has happened now we are gearing up for the next season to come up and we hope that the coming quarters could be better in terms of the order placement, order quantity, but the margins need to be seen related to the quantum of the individual orders that we receive. Over to you, Neeraj Ji!

Neeraj Jain: I think from the business side, I have completed my talk. So, I just wanted to share the bad news with all our investors that Mr. Dhuria our Director (Raw Material) he passed away last month. Unfortunately, he was otherwise a cancer survivor but was perfectly all right for last couple of years, but small interactions and he was hospitalized for about three months in three different hospitals which included the two hospitals, at Ludhiana and one in Delhi, but could not diagnosed of the issue and unfortunately he left us. Since he has been interacting with all of you quite often and he has been a great individual, he was a great friend, just to share this bad news with all of you. So, I now ask for the questions and answers for the next course of action.

Moderator: Thank you Sir. Ladies and gentlemen we will now begin the question and answer session. We have our first question from the line of Gagan Thareja from Kotak Investments. Please go ahead.

Gagan Thareja: Good evening Sir. First of all heartfelt condolences Mr. Dhuria's demise. My question pertains to the Chinese procurement situation which you said is a consequence of the trade war. You have also at the same time indicated that the situation in aggregate for the company will improve for the second half of the year. Given the current situation of the trade war between US and China do you see procurement of Yarn picking up from China because unless that situation improves it looks very difficult to come to the conclusion that things can improve in the second half?

Neeraj Jain: There are three factors to this point, which you mentioned. First is the improvement in the sentiment between US and China. Anyone's guess. So, I do not think I am the right person to give me the comment or any answer on that, so it is very difficult for me to say whether it happens or not, but the way I am looking at the improvement to happen, there are two other factors. One, this period when the uncertainty happens people kept on reducing the stocks and the inventory pipeline as of now is one of the lowest across chains. So, I think the demand was less because of that also but now going forward even if the people have to continue buying for their operations the demand should be relatively high compared to the last two three months because at that stage they were reducing the inventory and they were ordering less than what they have been consuming. Now since the pipeline as of now is too thin, so which means there could be a possibility that they keep on ordering at least to the extent of what they are consuming, so which could be a little better than the previous exports happen. Two, when I say there could be an improvement in the business the second presumption I have because in this period of last two, three months and maybe the next one month or so the cotton prices in India were very high, so it was on an average about 78 cents to 80 cents per pound and with the new crop coming in we are expecting that the international price drop, we were expecting the prices of cotton available will be cheaper. The yarn prices already got adjusted with the new cotton prices because of the New York Future, so hopefully with the drop in cotton prices especially in India the drop in the yarn prices may not happen, so which means from this perspective situation could be a little better, but it is only I am saying the situation could get a little better because fundamentally the major improvement will happen only once the export picks up, if the situation improves again the spindles which have stopped partially will start running back again. So, I think unless the exports be reached in the normal export figures without that a full recovery may not happen, but yes from the current situation it could be definitely better. It looks like that.

Gagan Thareja: You also have indicated that in the domestic market 2 million spindles have been stopped. How much of the total capacity was that for and also do you foresee a situation I understand this sort of cycle might happen every few years but do you foresee that eventually when things return back to normal this might lead for Vardhman to gain market share because some companies might shut down?

Neeraj Jain: In India the total spinning capacity as of now is close to about 50 million spindles but again there are some of the spindles which are inefficient are not running fully, so the effective spindles maybe as close to about 44 million to 45 million spindles of that is close to about 4% to 5% capacity as of now. Two, for Vardhman to regain or to gain the share may not be that possible because in any case we are running at a full capacity so since had it been a case where capacity utilisation is less and someone is closing so we take that position it could have been different. Since we are running at a full capacity at least on the spinning side for us to regain that market share to that extent may not be possible, but in any case whatever we can produce we are producing that. Yes, with increased capacity which is coming in now last month or maybe the next month, so to that extent our production will increase and we will gain some market share. I think more opportunity I am looking at rather than the spinning side is on the fabric side, because we have expanded our capacity both on the weaving as well as on the processing side, and once the business becomes normalized I am sure there is definitely a scope for us to take a bigger market share and since we have made up for that already have good relations with customers, probably in case we are in position to take advantage on that side then definitely will be much bigger claim for us.

Gagan Thareja: Final question. The impact of Chinese exports to US coming off certain portion would have been picked up by some other countries and I understand that the overall procurement from EU and US itself came down somewhat as your colleague commented, but the drop from China is much sharper in which case, some other countries would have gained market share would you not be an active supplier to those countries and in future would not that be possible for you to develop as a base?

Neeraj Jain: There are two factors in that. One, as I mentioned temporarily that advantage could not be taken because everyone was reducing the pipeline, so there was overall reduction in this pipeline starting from weaving or the knitting because that is the processing garmenting involved with the brand so this period the demand was less. And the major biggest country after China are now coming up, one is the Bangladesh and other is Vietnam, so both the countries are having the spinning capacities as well, so both of them are becoming vertically integrated. China for example last four years have added close to 4 million to 5 million spindles. Vietnam has also added another 1.5 million to 2 million spindles. In India another difficulty which we have created in the last four years because of this subsidiary has been incentive which were available from the various state governments, we have added close to about 5 million spindles in the last four years, five years. And that was something which we created only because the subsidiaries were available and not on a business model or in business cases in most of the cases, so the overcapacity which we created, I mentioned, it in the last call also it will take us maybe one or two years before this gets adjusted to the increased demand in India. Unfortunately, in between the trade war movement has created a bigger chaos and as a result excess the capacity which got created because of that I think the entire industry also came under pressure as well.

Gagan Thareja: Finally, the financial situation in terms of the banking and NBFC crisis you said has impacted. Have you seen any fallouts on that in terms of your own working capital and otherwise also?

Neeraj Jain: In fact, at Vardhman, I do not think there is any negative impact on us as of now both in terms of working capital cycle or otherwise availability of funding or money, but yes, this could be an opportunity for the stronger players to have a better stand and they can consolidate this position. The weaker players once they have the loss and the banking is not even in a position to fund them further I think it is going to be very, very challenging and difficult for them to do the monetization or to survive the occupation or to have the right working capital so I think to that extent my belief is this continues probably right or wrong, we may like, we may not like, there could be some consolidation that the industry may happen and some of the weak players will become very, very challenging for them to revise their operations and continue profitably.

Gagan Thareja: Thank you Sir. That is all from my side. I will join back the queue.

Moderator: Thank you. The next question is from the line of Kunal Shah from IIFL. Please go ahead.

Kunal Shah: Thank you for the opportunity. Sir my first question is with respect to the cotton imports. You have said that cotton balance sheet in India remains tight, so what is the constraint on as importing more cotton and the parity getting achieved faster than it will have otherwise?

Neeraj Jain: One is the driving and second is the time lag. In terms of time lags suppose US cotton is available, so even someone wants to decides to import it today, it is going to take at least two and a half, three months before the cotton plant typically arrives here and you can use that and that kind of many people will be in a position to take, but they are more comfortable taking cotton on a day-to-day basis. So that is one. Two, the blended cost of cotton will always be expensive compared to the historic price in the Indian markets. As a result, the margins will be further impacted to that extent. Third, even having said that still the import in India are much higher, so this year we are expecting the total import to be about 3.1 million bales against 1.5 million bales last year so we will be doubling the quantity in India, but again at a higher cost compared to what other OFC we could have or we can get in the Indian market since the crop sizes are lower, the prices in the season were definitely lower, so lots of cotton got exported, and by the time the mills had to use they started importing with a much higher prices. So I think these are the two factors that is why there is, otherwise it is under OGL, you have no restriction to import, or anything that you want to do, but the historic advantage of the lower cotton prices in India will not be available to that extent.

Kunal Shah: My second question is on what is the status of our prefacing capacity expansion? By when is that likely to come and in that context what would be the capex in this year?

Akshay Jain: The processing capacity which is line 3 is already operational. It was capitalized, I think, late March 2019. So, there is not much capex or some balancing equipments is expected in that particular quarter. But the expansion that Mr. Jain has mentioned in his update will total roughly 800 Crores for this year, this will include the capacity expansions for yarn, some balancing equipments for processing and some weaving capacity, it will trickle and it will also include the modernization and rebalancing continuously keeps going on. And I think that will bring us to the end of this capex cycle that started last year with a total of roughly 1500 Crores being spent.

Kunal Shah: Can I know the utilization is this new line III running at, I mean what is the likely trajectory that you expect?

Mukesh Bansal: In Q1 there has not been much of utilization of the third line. We will start some utilization in Q2 and Q3 and Q4 we expect to make a substantial utilization of that line.

Kunal Shah: That is all from my side. Thank you.

Moderator: Thank you. The next question is from the line of Saurav Patwa from HDFC Mutual Fund. Please go ahead.

Saurav Patwa: Thanks for taking my question. Just wanted to as you mentioned in the earlier Q2 call about the vertical integration and other things globally, and I believe few companies large garment manufacturer in India are also getting vertically integrated, so do we have thoughts more on the garmenting units which we have started long back, but as a small unit do we have any plans or rethought on that business?

Neeraj Jain: No major change in our thought process as of now, so we have not made up any plans to expand this business as of now. There are lots of changes are happening in the country so that is compliance, new rules and regulations are coming in for the industrials, since they have got the business not doing good, so I think everyone has taken a little back step and everyone is waiting and watching what happens. But at the same time in between since we were to prepare ourselves so we are merging this company into garment textile, so that tomorrow anytime if we want to expand this business, at least on the funding side, there should not be any big issue.

Saurav Patwa: Thanks for the questions and all the very best.

Moderator: Thank you. The next question is from the line of Pawan Ahluwalia from Laburnum Capital. Please go ahead.

Pawan Ahluwalia: Thank you. Could you just explain a little bit how we are exporting cotton in India but we are also importing cotton, is it in different grades where there is greater demand in the export side whereas we are importing different grades, because if the world price of cotton has collapsed so much how come it is viable for us to be exporting cotton?

Neeraj Jain: There is not much of a difference on the quality of cotton. So, there are some specialized cotton, which we import but that percentage is very, very less. So this import and export both is happening on the timing gap. So, we exported cotton when the arrival of cotton was coming in India which was the demand from January, February and March. So those were the four months where we export cotton and since the export was much bigger the overall balance sheet was not getting, so the month of May, June, July and August, we started importing. So similar cotton, first we exported at a cheaper price and later on we started importing at expensive prices, so it is all timing gap, nothing to do with the quality on this. The specialized cotton comes with long staples but in any case, the country imports, but those are very small quantities.

Pawan Ahluwalia: When you say **(inaudible) 39.04** from the overall economic standpoint and the only answer that can be that as you said the balance sheet is not supporting the working capital needed to carry it for a few months, is that just because the banking system and the fact that most players are not getting credit, there is credit in the system what is happening?

Neeraj Jain: There are two, three factors to that. One is the rate taking capacity. Not every mill is in a position to buy cotton for six to eight months, so both because the funding is a question mark or the risk taking capacity is also a question mark. So there are many number of mills in India that buy on a daily or on a weekly or on a month-to-month basis only. So these grades typically depend upon the mill they keep on a month-to-month basis and off season also they will keep on buying on a month-to-month basis and since for the off season the overall quantum was not there, they had to import and then they distribute it to them. So there are three factors. One, is whether we want to buy it or not. Two, your financial ability you want to bid this, but you have the resources or not. Third category is where the finance go with take a view also and you would have the financial strength also to buy it otherwise most of the industry, almost 70% to 80% industry depends upon the take relatively lower amount of cotton rather than coming before the season and the trade will be in a better position so trade will have stocked and help to the spinners on a month-to-month basis. But this time since the overall quantum of cotton was much less in India, so I think the prices did not drop to the level of international prices.

Pawan Ahluwalia: Does this mean, sorry my connection was cut when was someone was asking this question, if you could just quickly repeat the answer. Are you seeing shutdowns or closures of mills or do you expect to see that be going forward in this situation because you said the current 2 million idle capacity would not be enough to do it, do you see more kind of smaller, lesser guys just closing down or idling capacity of the current situation?

Neeraj Jain: Again, the factors would be the financial strength where the people will be in a position to continue to ground their full operations or not. Two, inefficient capacity which is both in terms of productivity or in terms of the later efficiencies they are not going, until the margins are very good, even a slight inefficient capacity will also keep on making money, but when the market becomes competitive or people start losing then only I think the closure starts happening in a bigger way, so lots of players who are marginal players, they may decide or they may get a possibility of closing their mills by closing as best compared to why running it. So, I think whenever the market becomes very competitive those couple of months, this issue always happens where the marginal players or the weaker players pretend to lose their share and at times reduce their capacities rather than running it. So, depending upon how the next three months goes, I think this trend will continue to be there, but I think it is always has been better in that also once the weaker players are relatively much weaker, I think whenever the industry bounces back then the advantage comes to the people who could consolidate in this period as well.

Pawan Ahluwalia: Last question where do you see yourself on the global cost, you know we hear a lot about Bangladesh, Vietnam, how do we look at ourselves both as converters and fully integrated suppliers of cotton yarn factoring in both the Indian cotton cost plus our conversion capabilities where would we be roughly speaking on the global cost curve?

Neeraj Jain: In terms of our spinning capability as a company we are quite competitive except for small portion of the duties which we are paying which are not getting refunded so all the items which are out of the purview of GST we are consuming those as a part of our cost which we are not in a position to export, so I think that is a small portion which is a concern, but other than that in terms of the conversion cost I think India is quite competitive on the spinning side, so no issue on that. Our bigger concern comes on the garmenting side where Bangladesh because of the wait differential is too competitive compared to any other part of the world as of now, so I think, over there, yes these challenges are much bigger because of the wage cost is high, our productivity is less, runs are very short and on top of that Bangladesh has got a huge advantage of the duty free as such to the Europe, so I think those are the challenges where on the garmenting side, relatively much less compared to others.

Pawan Ahluwalia: Thank you.

Moderator: Thank you. The next question is from the line of Anchal Agarwal from Care Portfolio. Please go ahead.

Anchal Agarwal: This quarter we have achieved an operating margins just below 18%, what is the guidance for Q2?

Neeraj Jain: We have never given a guidance on a quarter-to-quarter basis, but historically we said our guidance is always between 18% and 22%, but I think this is definitely an exceptional year and maybe we might be falling under short of the band which we have given.

Anchal Agarwal: Sir, this year the demand from China is much less and still we are operating at full capacity so how we have plans for the future to operate at full capacity?

Neeraj Jain: For Vardhman I think thanks to our customer base, product mix. I still do not have any issue in terms of selling yarn though the overall demand is less, but I think our customer base the relations we have still as of now at least as of now there is no issue in terms of selling the product.

Anchal Agarwal: Thank you. Sir, is there any incentive from government on the yarn price?

Neeraj Jain: No, there is only a duty drawback, which is less than 2% but the industry has been demanding the refunds of state on the taxes. So I think they have already given it to data sent to the government. The industry is talking for the spinning as well as target person.

Anchal Agarwal: These are the tax paid to exporting countries where we export?

Neeraj Jain: China would be still number one and Bangladesh and EU.

Anchal Agarwal: Bangladesh and Europe. So the drop in imports from China will it be replaced by Vietnam and Bangladesh?

Neeraj Jain: No, we have not replaced. At Vardhman as of now no other countries would replace it. So that is why they export from India as well, but for us even whatever we are supplying to China, we are continuing this.

Anchal Agarwal: Okay. Thank you.

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

Prerna Jhunjhunwala: Thank you for the opportunity. Sir, just wanted to understand the future prospects for second half? Basically since cotton position is not changing much even in the second half due to higher MSP level, what makes you confident that second half will be better than the first half?

Neeraj Jain: Cotton position is definitely changing. Last year since the cotton crop was very less that is why the prices were very high. So, last year the average price for the season was almost close to Rs.43500 to Rs.44000 a candy, which we are expecting maybe come down to about Rs.42000 or so including the MSP operations as of now.

Prerna Jhunjhunwala: So that makes us a little better competitive to export it to China or how does it happen?

Neeraj Jain: Yes, raw material cost is better compared to the world market, definitely the industry is doing better.

Prerna Jhunjhunwala: Sir, is there any possibility because most of the players who resort to imports and since the prices are cheaper is there any possibility that government may impose a duty on the cotton imports to protect farmers?

Neeraj Jain: They have always been saying it is under OGL, you can export or import whatever you want to do. So I do not think the government is looking at any kind of this kind of a restriction, rather the industry has been talking to the government why do not you give a direct benefit transfer to the farmers, so we want to support farmers and we give it to them, but why you want the industry to get that cost, so government wants to give them whatever is the market prices, let them sell at the market prices to the users and if there is any differential the government can refund to them directly. So, this is what the industry has been talking to the government, but the government has neither responded to that as of now because it is a huge infrastructure, I mean, practically how they are going to do, so it is a huge issue, but at the same time, personal belief is putting up a duty on cotton etc., look possible and then the rules of the game is spinning forever, they are saying import cannot be done, so you buy at a much higher prices, which means the job loss likely which is already started and I do not know where we are going to then finish it. So, I do not think the government's intention would be to do that.

Prerna Jhunjhunwala: Sir, like higher MSP has the cotton prices historically gone down below MSP for mills or it has historically as remained above MSP?

Neeraj Jain: Most of the time when the season comes in at that stage, there is always a possibility because the arrival price is very high so many of the farmers are then waiting in the queues or going to be CCI to deliver the cotton. It is better to set the mills directly or to the trade directly is a matter for lower price also. So, there have been cases where they will be willing to sell it directly to be paid maybe 2% to 5% lower than what the others will get into the MSP. So historically we have seen this kind of things happening?

Prerna Jhunjhunwala: Sir last question is directionally I know you do not give numbers, but directionally can you guide the profitability in yarn and fabric segment in 1Q and currently?

Neeraj Jain: I am sorry. As a matter of policy we will be in a position to say.

Prerna Jhunjhunwala: Even directionally like how it has been better or lower or at par?

Neeraj Jain: Both are comparable. The job is comparable in both the businesses comparatively.

Prerna Jhunjhunwala: I am just talking about fabric business profitability compared to last quarter and last year and directionally?

Neeraj Jain: They both are a little down so I think the reduction is comparable so in terms of percentage of both it could be common by and large.

Prerna Jhunjhunwala: Thank you Sir.

Moderator: Thank you. The next question is from the line of Dhiral Shah from PhillipCapital. Please go ahead.

Dhiral Shah: Good evening Sir. Thanks for the opportunity. Sir, you talked about cotton prices. So how is the yarn prices right now?

Neeraj Jain: The yarn prices have been coming down, so from a high of about $3.25 or $3.30 cents in the month of April as of now ranging in between $2.85 cents to about $3. So there has been a drop of almost 12% to 15% on the yarn prices.

Dhiral Shah: In terms of kg Sir, Indian Rupee?

Neeraj Jain: So, $3 the current local prices are close to about Rs.200 plus GST at a discount.

Dhiral Shah: What was it in Q1?

Neeraj Jain: Not Q1, it is starting of the season. It had gone up to Rs.220 a kg or so.

Dhiral Shah: So, it has come down to Rs.200.

Neeraj Jain: Yes.

Dhiral Shah: Whether the season starting do you think this will further go down as cotton prices let us say come down in the future?

Neeraj Jain: As I mentioned because the international prices of cotton has come down and I believe the prices of yarn has already got adjusted internationally, so the domestic prices always is off shoot of what is happening internationally. So, our domestic prices are generally will be Re.1, Rs.2, Rs.3 plus minus compared to the international prices since the prices got adjusted internationally, so the domestic is already taken care off.

Dhiral Shah: So, this will fairly remain stable?

Neeraj Jain: Everything else depends upon the demand supply as I said is in a position to get back and the price should come back.

Dhiral Shah: Thank you Sir. That is it from my side.

Moderator: Thank you. We have a follow on question from the line of Gagan Thareja from Kotak Investment. Please go ahead.

Gagan Thareja: Sir, you indicated that the margins were impacted because of the adverse cotton yarn spread in the by gone quarter. Will it also be reasonable to infer that the new capacity has come on stream and which probably at this point in time is not at optimal utilization? Would that also have impacted your margins and if so to what extent?

Neeraj Jain: On the spinning side may be the margins are lower, but at the same time we are in a position to utilize the capacities so I think to that extent the additional fixed cost or the interest depreciation is not coming to the business. On the fabric side, I may agree with you because of the fact always there is a lag time when we complete the new plant by the time we are in a position to get, so it always takes between two and four quarters before we are in a position to utilize the full capacity and I think that is where we are passing through this time because we started the production somewhere towards the end of March and practically we could not utilize much in the first quarter of this year. I think another two, three quarters slowly we will build up the capacities so to that extent our fixed cost, our interest and depreciation would have hit the P&L, which I am sure as new capacities comes back it will start giving us margins.

Gagan Thareja: Is it possible to understand ceteris paribus what could be the impact on margins when this capacity is optimally utilized?

Neeraj Jain: I think the amount will not be that large that you can have a fairly big proportion of that on the overall margins reductions, so I think it is a small portion I am saying but yes, once we are in a position to utilize that capacity and then the margins would improve as the new capacity would also be on stream. I do not think that is really a big concern because of that our margins were down, but basically the margins were down because as I mentioned that is not the reason here that exports is not happening, the prices have been coming down, raw material was higher in India so those are the major factors across India.

Gagan Thareja: Also if I could gather it correctly, this year capex would be in the order of 800 Crores and that sort of completes that 1600 Crores of capacity expansion plan that you had so going into the future what could be the magnitude of maintenance capex? I presume you would not add capacity thereafter at least for some time to come and if that is the case is where the debt repayment from your side? And what are the current gross debts in books?

Neeraj Jain: Maintenance capex generally is in the range of about both the business together will be in the range of about 300 Crores per year.

Gagan Thareja: So at the end of the financial year 2019 we had about 1350 Crores of long-term on our books and roughly 850 Crores of short-term debt. All of the debt except for 500 Crores NCD was under either state or central subsidy so we will not be looking to expedite any repayment of this debt.

Under the capex that we are undergoing this year, I think our peak debt will rise to around 1600 Crores of long-term and when all the incremental debt is under the state subsidy in MP, so we will not look to expedite any debt payments because the cost of it after subsidy is pretty substantially low, but we will definitely the businesses will pickup and we continue to generate the kind of cash, we will add cash to our balance sheet reducing net debt in general?

Neeraj Jain: On the working capital, working capital utilization cycle has always been under rating due to the cotton inventory that we saw on our books. So if you look at our September 30 balance sheet our working capital utilization will be next month. So that is going to be and I think we will continue to repay at whatever scheduled timeframe that we have.

Gagan Thareja: Finally, you talked about the cotton season having improved and I think you also indicated that cotton prices might go to 42000 a candy versus 45000, 46000 that you are seeing currently. I think given the ASP is whatever 45000 as you indicated, would you be able to realize the full advantage of lower cotton prices at 42000 once the cotton comes in October onwards and would that normalize your yarn cotton spread for the period thereafter.

Neeraj Jain: It will be better from the present level. I do not think that it will really normalize. The normalization will happen only once you have the lower demand as well because of the lower demand the prices should be different, so I am only saying in India since the prices are much higher in terms of raw cotton prices so if that comes down it will be better relief and available to Indian spinners, but I do not think that is going to give us a normal margins till the time we are looking at the exports to have normal volumes.

Gagan Thareja: So, what I therefore infer is that you already said that this year it would be difficult for you to maintain your 18% to 22% probably lower than 18% and going forward there will be some improvement, but the margins would be closer to the lower edge of the band rather than the middle of the band?

Neeraj Jain: Going by today’s industry situation, if any changes or improvement on debtor days happen, so this is what we are expecting as of now. Decrease has also come because of the dollar rupee so that is probably the issue. So, I think some small advantages are also coming in here and there but in spite of that I think since the demand is not there, the industry is passing through definitely a tough time.

Gagan Thareja: Additionally, I think, just one more sort of question, the US policy usually India under WTO has changed, I presume does that also somehow impact us as part of the supply chain?

Neeraj Jain: Not really because the government is looking at an alternate scheme, which should be WTO competitors so we are talking of the ROSL which is the refund of the duties we have paid is comparable to the WTO, so whatever way the government wants to give or reimburse for the duties which they have paid and we are not getting it reimbursed since we are not in a position to explore those duties. I think whatever way the government gives which is the WTO comparable it should not be an issue so I do not think there is a big issue.

Gagan Thareja: Thank you Sir.

Moderator: Thank you. The next question is from the line of Avi Mehta from IIFL Capital. Please go ahead.

Avi Mehta: I could see that there is some sense of ESOPs have been given or announced in this quarter. Is this a start of a scheme that you are turning or it is one-off if you could give any clarity?

Akshay Jain: In 2016, Vardhman Textile had announced an ESOP scheme in which some of the key management personnel who had shared in the journey of the company for a long period of time had been given these options. The vesting period of many of these options was two years plus so it is just an exercise of those options. No further option scheme has been announced by the company.

Avi Mehta: Secondly this announcement of merger that you are contemplating how does that kind of aid or what is the thought behind it. It is essentially is to kind of declutter is that how I should see it or if you can give us some clarity over there?

Akshay Jain: So Vardhman Textiles currently has four subsidiary companies, three of them are 100% wholly-owned subsidiaries and the fourth one is Vardhman Acrylics which is a listed entity with Vardhman Textiles owning about 70.75% of that company. Now the plan is to merge all these four subsidiaries. The reason for the subsidiaries to be separate initially was that most of them Vardhman Acrylics which is a completely different line of business but VMT, spinning and Vardhman Machine Garments were joint ventures where we have now bought out the JV partners and now they have become 100% sub. So for that now there is no reason for a small spinning company to exist outside the parent when it is in the same line of business. Also as Mr. Jain mentioned on the call that we want to merge the garmenting company since in case we want to scale that business up but it is a part of the parent to have access to larger resources, which it can use if it wants to scale up. For Vardhman Acrylics, Vardhman Textile is one of the largest buyers of the produce. It is a raw material for us hand making yarn product so for that case and again that company has a lot of accumulated cash on its balance sheet and there is no expansion that is planned for that so that cash is essentially lying idle in Vardhman Acrylics. So, as it becomes integrated with the parent there will be less related party transactions, which we feel is better. It will also allow their cash to get accumulated with the parent and may be put to better use and more productive use. So that is the rationale. There is another small company called VPL

Investments, which holds treasury stock to the tune of 1.75%. That was created during the past merger and demerger and that will be merged with the shares of this will be cancelled. So that will essentially clean up the structure. So that is what the contemplation and reason for the merger.

Avi Mehta: Lastly, we are now towards the end of our capacity expansion plan. Now most of these capacities will come start kind of contributing and correct me in the next year or year after, how would we kind of contemplate in next cycle of additions as we pursue growth or would this be a pause and the next one will probably take in the year after. Is that how I should see, just your thoughts on that?

Akshay Jain: I think we have not taken a final view of what we are going to do after this expansion so all our efforts are to look at if we remain efficient and we are in a position to utilize efficiently what we have already created and if you look at what kind of a cost initiative or what kind of product improvement initiatives could be taken, so as of now I think with the capacity we are quite happy with that and we are not looking immediately within the next one or two years to take up the capacity further. Once we are in a position to utilize it fully and the overall industry is also stabilized I think then we will take a final view on that.

Avi Mehta: Perfect Sir. That is all from my side. Thank you very much.

Moderator: Thank you. We have a follow on question from the line of Gagan Thareja from Kotak Investments. Please go ahead.

Gagan Thareja: Do you foresee any cost synergies from the planned merger and what would be the scale of these synergies if that is so?

Akshay Jain: I think the company that we are contemplating merger apart from Vardhman Acrylics are fairly small, so there are no synergies per se except for maybe easier administration, also VMT Spinning which is a standalone spinning company of course getting integrated with the parent will be far more efficient structure in terms of both customer servicing and allocation of raw material and other corporate services resources. So, Vardhman Acrylics will of course will be related party transactions, GST and so on that we have to file etc., for any buying and selling of fibre. That is a concern, but as such we do not. It is just more from administrative operational standpoint that we are going to merge these companies also the cash size in Vardhman Acrylics we want to put to better use. So that is one important area of consideration.

Gagan Thareja: Just to understand the spinning capex you said will be fully on-board and fully utilized by September this year. Have I understood correctly?

Akshay Jain: I think what was mentioned is that the capex will get completed by most likely this month or next month end and maybe use the next quarter to scale up to 100% utilization on the spinning side, and of course fabric which was started in March maybe take two to four quarters so I think you will see a full year impact of this capex by next year.

Gagan Thareja: Thank you. That is all from my side.

Moderator: Thank you. Ladies and gentlemen that was the last question. I now hand the conference over to the management for closing comments.

Neeraj Jain: Thank you all for the confidence on the management. It is really a tough time and in time I can assure you from the management side that we are really making all our efforts for the areas which are controlling by us and there are lots of initiatives going on in terms of how the efficiencies could be improved upon and the various initiatives being taken by the management. The only thing from the management perspective are till now has been very strong customer base, strong product base which is helping us to run at full capacity and I am sure these kinds of disruptions will always come every two three years, but at the same time, we are trying to look at more advantages we could create for our company in this kind of a tough time so that by the time the good times comes in, the company should be in a position to take more advantage of the same. So from management's perspective we are putting all our heads together to look at how this tough time can pass successfully and with some of the more and better initiatives for the overall long-term of the organization. Also at the same time our process of continuation of modernization and other things continue because in terms of the financial we continue to do good, so we are not looking at any and we are not taking any steps which can be detrimental for the medium term health of the organization so all that modernization plan or our internal capacities and other plans are continuing as it is. So I am sure as the industry revives little bit which should happen soon, I think will again take the full advantage of the same. Thank you once again for your continued support.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of IIFL Capital Limited that concludes this conference call. Thank you for joining with us. You may now disconnect your lines. Thank you.