"Vardhman Textiles Q2 FY2020 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the Vardhman Textiles Q2 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 Securities Limited. Thank you, and over to you, Sir!

Avi Mehta: Thank you, Bikram. Good afternoon everyone. On behalf of IIFL, I would like to welcome all of you all to the Q2 FY2020 conference call of Vardhman Textiles. From the company, we have with us the key senior management including Mr. Neeraj Jain, Joint Managing Director, Mr. Sushil Jhamb, Director, Raw Materials, Mr. Rajeev Thapar, CFO, Mr. Mukesh Bansal, Senior Vice President, Fabric Marketing and Akshay Jain, Finance Head. I would now like to hand over the call to the management for their comments. Over to you Sir!

Akshay Jain: I will just go through the numbers before we hand over for management commentary. On a sequential basis, we had a flattish quarter. Topline was flat, up about 14 basis points. EBITDA came in slightly better, up about 8% sequentially and PAT up sequentially about 15%, but from a year-on-year perspective, we are still slightly behind where we were similar to last year, with PAT dropping around 40%. This is in line with the commentary that we have been sharing with our investors about this being a slightly tougher year than the one we experienced last year. To take you through how this year is shaping up, I will hand over call now to Mr. Neeraj Jain.

Neeraj Jain: Good afternoon, everyone. This has been a very different year where we saw lots of rough road in the last couple of months. The basic difficulty started when there was a trouble between trade war between U.S.A. and China that got lots of uncertainty in the world market, and because of that, the raw material prices started coming down so the New York Future from $0.77, $0.78 came down to as low as $0.60, $0.59, $0.60 as well so on one hand, where the prices dropped for the raw material and the yarn also got readjusted because of the raw material prices, so that was one factor. Second factor was on the demand and supply. Since China was a little uncertain on the trade between them and U.S.A., so they dropped their internal productions. As a result of that, they lowered their total imports of yarn into the country, and that had a direct impact and a hit on Indian spinners.

Just to give you some numbers, India's first six months exports last year of yarn was 102 million kg average per month. Within this first six months came down to 74 million kg, so a drop of almost 27%, 28%. The largest import of yarn from India is China so the last year of first six months, they imported almost 40 million kg per month from India, which in this year came down to 20 million kg so out of the 27 million, 28 million kg reduction per month, 20 million was only on account of China.

The Indian yarn production total is close to about 350 million kg per month. Out of that, 100 million kg we export; 240 million kg, 250 million kg is the domestic consumption. When the export dropped, then all that material was dumped to the Indian market, and Indian market could not also absorb the same. As a result, there was a price drop in the Indian market as well, which eroded the margins so we are looking at a couple of factors. One is less demand from China, which caused lots of concerns. It became a overcapacity situation all that dumped into the Indian market. Indian market prices came down. On the other hand, because of lower New York Future, the expectation of the customer was the lower yarn prices, which also gave impact on the yarn prices, internationally so the prices of yarn kept on coming down.

The bigger challenge for the Indian spinner was a little different. Though the international cotton came down, the international prices also came down, domestic prices came down in line with the international priority, yarn, but the cotton was a different scenario for Indian situation. Since we were short on the capacity on the crop last year, our crop was much lesser and we exported a lot in the initial couple of months so there was a shortage of crop in this period. As a result, our cotton prices are much higher so we looked at a situation where the New York Future cost as low as $0.60, whereas the Indian cotton was as high as $0.80, $0.75, $0.77, $0.78 or $0.80, even going up to $0.83, $0.84 also so this was a unique situation where our cotton prices were higher, yarn got readjusted to the new prices. As a result, the Indian spinner started losing money in this period, which has caused a big issue to the Indian spinning market.

It had couple of effects: one, the capacity utilization in India started coming down so there is no authentic data available how many spindles are stopped or running, but there are most of the mills started, I mean, they stopped one shift or partial spindles or one holiday in a week and so on and so on so as per the industry estimate, almost close to about 20%, 22% capacity is shut down in this period of last two, three, and four 4 months. As you can imagine, these numbers are after so much of capacity shut down. Had it been running fully, so the situation could have been even worse than this so this was another issue which is related with Indian spinning mills. Third was a very tight liquidity position into the country. Because of various reasons, there was couple of banks, especially nationalized banks, which went into a PC arrangement. They could not lend and since the textile was not doing good, so I think there were lots of money which could not be delivered to the textile companies. As a result of that, the liquidity kept on shrinking a lot into this system and people could not do the normal business also. As a result, the buying power kept on coming down, which further aggravated the situation and the overall textile business was not very good. This was the third reason.

Fourth was some uncertainty in between because of auto component or other industries where, I think, in the times of uncertainty, people have tendency to postpone their requirements, especially textiles and all, because it is not that you require to consume it on a daily basis, but I think that also gives some impact and if the shifting happens, a postponement happens, that further reduce the demand so this could have been the cause, in my view, is the fourth reason.

Having said that, there was another worry in the mind of people was on the minimum support price because the minimum support price was announced by the government, Rs.5500 for the yarn, and it was expected that, in case, the international prices are subdued then what kind of situation will emerge into the Indian scenario, which, fortunately, as of now, is not that big a concern, which I will explain to you a little later. I will request Mr. Sushil Jhamb to explain that phenomenon a little later.

Coming back from this situation where most of the spinning mills were covered end of October-middle of November. A much higher cotton price is almost in the range of about Rs.42000 to Rs.44000 a candy so since the prices of yarn came down, so I think lots of them started losing money on the cotton, which was available to them. As a result, the margin eroded. The new crop has started. We just started getting the arrivals, which is close to about 100,000 bales as of now because most of the states the arrival starts in the first week of October and we started getting close to about 100,000 bales, and I am sure this is likely to pick up soon, go to about 2 lakh bales and so. But the prices as of now are comparable to the international prices so I think that is the parity of spinning mills, definitely a little better compared to what it used to be.

We will talk on the next year's prices expectation, our view, or the MSP issues a little later. Before that, I will request Mukesh Bansal to give some brief, but before that, I think, though, I mentioned, almost 20%, 22% capacity estimation is there, which is not under utilization as of now. As Vardhman, we have been running our full spinning capacity, so the margins could be lower or sometimes not there. But in terms of the selling, I think, thanks to all the customer base and the product portfolio, we never had any issue any day so we have done our full capacities and all our internal efficiencies, etc, there is absolutely no issues and concerns.

We completed our expansions also in this period so all three units were fully commissioned, which was Vardhman Yarn unit #6, 52,000, 53,000 spindles; Vardhman Fabric, Budhni, 27,000, 28,0000 spindles; and the Vardhman Yarn 7, which is the vortex unit, all those units got fully operation in this period. Of course, Vardhman Yarn 6 was commissioned on September 1st 2019, so I think the full capacity utilization will come in this quarter so all those capacity utilizations or all those products probably could also sell, which where the production increased though it is linked back-to-back with our fabric division, but fabric generated a little more time because it is all make-to-order so in the meantime, we started selling yarn to the market and as the fabric capacity utilization will improve, probably they will be consuming a little more of yarn so to that extent, our marketing of yarn will get readjusted.

So I will request Mukesh to give some brief on the fabric what is happening over there, and then we will come back to the cotton and the future scenario. Over to you, Mukesh!

Mukesh Bansal: Thank you, Neeraj Ji. A very good afternoon to all of you, on the fabric side, the Q1 and Q2 is the period where you have larger demand from the Indian vested market because we have a sizable presence in the Indian domestic market. But then this year, we have seen a lot of liquidity issues in the Indian market. As a result, there were kind of stockpiles and the payments not really coming on time so and new order booking was also little bit slower so as a result, we had a tough period as compared to what we would have at the sales otherwise. And Q3 and Q4 are relatively good figures for the fabric business because during this time, we have the larger booking from the export segments for this premier summer season and there is no exception this year, also, we are expecting a better Q3 as compared to the Q2 that we recently had. But during this time because of the yarn prices went sluggish, so that helped us continue our sales, and thanks to the customer base that we have, we could also broaden the customer base as well, so we could maintain our operations as per the guidance that we would have all earlier given.

Last call, we had given guidance that the new expansions that they have come up, so we will have better capacity utilization during the second half of current fiscal so we are maintaining that guidance, and we will continue to do that and on our products, the new expansion that we had, on the shirting side yarn has increased so those have been absorbed very well. We are explaining to our existing customers the full basket as well as we could also pick up some new customers on the new product segmentation so we have received a good feedback as well as support from all our customers to whomsoever we have supplied, and we are seeing good Q3 and Q4 that is coming up.

Thank you very much. That is on from my side on the fabric market.

Neeraj Jain: Yes. Now I request Mr. Sushil Jhamb. He has joined us in the raw material department as a Director, Raw Material. He has worked earlier also in Vardhman. He is an old employee of Vardhman. Then in between, he started his own business, was out for a couple of years, but he has been with the group for the last couple of years so he has been the company's CFO, also, historically, in, I think, maybe early 1990s or so I will request him to introduce himself as well as to give you some idea on the quarter.

Sushil Jhamb: Good afternoon. I am Sushil Jhamb. I started my career with Vardhman in 1978, and I have spent most of the time with Vardhman only. Earlier, I was working in their finance department and have recently taken over their raw material department. As far as total scenario is concerned, last year, our total production in India was 335 lakh bales. And this year, we are expecting bumper crop, probably the highest ever in India. It would be around 370 lakhs bales, as per our estimate. Even the Cotton Association of India, they released their numbers day before yesterday. They have also given the similar numbers. World over also the production of cotton is going to be higher. Last week, U.S. has reduced their production of the current year, but even after a reduction of tax, they are going to have the highest production of the decade and as Mr. Neeraj explained earlier that because of trade war between India or U.S. and China, that demand is not picking up. In view of that, the prices of cotton had come down, and we expect that those prices would not go up in near future also. As far as even they find trade agreement, still the demand of cotton may not go up because China has already covered their cotton from Brazil, and they may not immediately require U.S. cotton. Therefore, we do not expect that prices would go up. At the moment, the price of cotton is almost 10% to 12% less than last year, and we expect the same to continue.

As far as MSP is there, but Cotton Corporation of India, yes, they will come in but education of farmer happens, they may come into the market, but we do not think that they will be able to cover the excess cotton, which we are going to have. This year, we are going to have a stock of around 65 lakh bales at the end of the year. And yesterday, we had some contracts therefore the CMD of Cotton Corporation of India, she was also not very optimistic about covering the whole cotton. Whenever people were asking her a question that how much cotton are you going to cover, she was just saying that, we will cover quality cotton, and we have infrastructure. Therefore, even if CCI comes in the market, still the prices would remain lower than last year. At the moment the Indian prices are comparable with the world market. They are a little lower than the world market.

Akshay Jain: So I think as management commentary, we are concluded the same. I will request for the question-and-answer session and the QA whatever are the other questions or other issues, we can reply at that stage.

Moderator: Thank you very much Sir. Ladies and gentlemen we will now begin the question and answer session. We have our first question from the line of Nagraj Chandrasekar from Laburnum Capital. Please go ahead.

Nagraj Chandrasekar: Couple of questions. One is, could you give us some volumes on yarn, gray fabric and processed fabric and secondly, if we had to look at the pause you expect to that the market will take to spread normalization? How much of it do you expect from the fall in cotton prices versus the rise in yarn prices and finally, the industry has obviously been in dialogue with the government asking for a number of policy changes. India is at least right now looks like we are not signing the RCEP agreement, which is one thing the industry had been advocating. But are there any tangible changes that we can expect from a policy environment in the next 6 to 12 months that might make things better for the industry?

Neeraj Jain: Okay. First of all, in terms of the volume separately for fabric and spinning, I am sorry, we do not share those numbers so the production numbers are already shared on the stock exchange. If you want, we can repeat the same. On the margins around the raw material versus the finished product rates, as of now, our cotton prices are close to about $0.69, $0.70 per pound, and we have to compare and relate it with international prices, so with the New York Future as of now, it is close to about $0.64, $0.65 and the physical market, which is determined or which is looked at by the Cotlook, that is close to about $0.74, $0.75 so with $0.69, $0.70, we are $0.04 to $0.05 lower than the international market. And historically, in the season, we can be lower by anything between $0.05 to about $0.08, $0.09 so which means the Indian cotton is competitive as of now at this stage. The yarn prices may not really improve in a big way unless the demand/supply gets readjusted. Unless our exports can go to about 100 million kg, which last month also was only 72 million, 73 million or 74 million kg, I do not foresee the normalization on the yarn prices so the yarn prices may not really improve in a big way. But even then with this cotton prices and the current yarn prices, the parity definitely will be far better as Mr. Jhamb mentioned. Last year, our cotton prices were as high as almost about Rs.44000 a candy, which as of now is close to about Rs.39000 so you can imagine the kind of difference we are talking of and to that extent because in this period, there were lots of products which were being sold in losses. At least to that extent, there will be relief in the system. Two, I think another important factor, there are 3, 4 factors, how the U.S. cotton will behave to whether the government comes for buying under the MSP; third, what happens to all the spinning capacity, which is closed as of now so there could be out of these 20%, if we are talking about the total industry level closure, maybe some percentage can come back to the production if the margins improve and maybe some would have lost permanently so it is very difficult to estimate it as of now. But assuming even 50%, 50%, so there could be another 8%, 10% capacity, which can come back to the system, provided the demand is there. But if the demand is not there, then even if these guys come in, they will not be in a position to sell so I think this is the current margins, but considering the existing yarn and existing cotton prices, situation is definitely better than what it was a month or two months before. Third question, please.

Nagraj Chandrasekar: So you are saying the safest way to look at it going forward, assuming nothing major changes on the macro in yarn or cotton is, spreads are last year due to normalization of cotton prices. And then beyond that, if things stay the way they are, there probably would not be a lot of new capacity or rather much of the shattered capacity coming back so we should hope for your ability to push through the existing capacity based on your own credibility with individual customers and gaining a little bit of share so can I assume a spread normalized relative to last year's levels because of cotton price fall and then some ramp-up in production and ability to place with customers. Is that a fair summary?

Neeraj Jain: That is a reasonable assumption to take it. Also, the advantage of these kind of difficult times and these kind of tightness in the system, there is hardly any new expansion coming in. India has been expanding a lot on the spinning capacity. Maybe there was a business case or not because we had lots of subsidies available to us in India, especially Gujarat so lots of spinning capacity has come into that system. But as of now, since neither there are not many subsidies nor there are any good business scenarios, where, as a result, the new expansions are not coming in. If a partial capacity slows down or close down, demand will definitely improve over a period of next one to two years. The normalization of business, the normalization of margin will surely happen. Your third question was whether we are expecting something from the government so our biggest issue with the government has been, we have been requesting to them for the refund of all the duties which we are paying so all the state levies and duties, which we have been paying, so we have been requesting them to refund the same for the spinning and fabric also. They have already refunded the same to the home textiles as well as the garmenting so the fabric and the spinning industry has been requesting for the same that whatever are the levies or the duties or the indirect costs, which we are incurring in the system, that must be refunded to us. In case they agree to that, then that will definitely improve the overall situation because ultimately, we are competing in the world market and any amount of tax is not getting exported, that is becoming a part of our cost so other than that, I do not think there is any major dialogue or discussion with the government to give any big incentive as of now so our only request is the refund of the taxes, which we are paying in the system should be given to us.

Nagraj Chandrasekar: And any programming we have seen the Finance Minister and the Prime Minister make a lot of statements in this respect so far have we seen anything change on the ground in that respect or no?

Neeraj Jain: No, the discussions are on. I would not say anything good or bad so I think the industry is making all their efforts to convince the government.

Nagraj Chandrasekar: Understood thank you.

Moderator: Thank you. The next question is from the line of Amit Doshi from the line of Care PMS. Please go ahead.

Amit Doshi: Congratulations for a good set of numbers despite the challenging scenarios that cotton had.

Neeraj Jain: We rarely listen to these kinds of comments nowadays. Thanks anyway.

Amit Doshi: No, I think it was required. In this, you mentioned that 20%, 22% of the industry has kind of cut their production or shut their production. How easy it is for them to come back, you mentioned that there is a possibility that 8% to 10% would come back. And think that we have operated at full capacity or best utilization of capacity that we have, what is the portion that we have gained from there, if you can throw some light on that?

Neeraj Jain: Let us look at it, there are a couple of difficulties these companies will have: one, the financial position in this period would have become even worst from what it was; two, the working capital erosion would have already happened; third and without the money, it is going to be very, very difficult for them to restart the operation for all of them. Now there are two kind of capacities available in the country. One is, which is relatively good in terms of the modernization or in terms of the utilizations of productivity, etc so if any capacity is stocked out of that, it may start back. But there are lots of spinning capacity, which are relatively older into the country, having much lesser productivities or the utility cost would be higher. The quality can be a concern so even if those guys start, I think it is going to be very, very difficult for them to sell the product at a right pricing so even if the start becomes, big marginal players still keep on losing money so permanently for them to run efficiently will be very, very big job, and then it is going to be very difficult for them to get funding organized from the bank so for their capacity to modernize themselves will also not be there so my fair belief is, even if 7%, 8%, 10% capacity is not working, I think they will get some relief, though it is not good from the industry's perspective to stop so much of capacity. But I think if some consolidation happens by way of some capacity getting out of the system because virtue of this situation is happening, and demand will keep on increasing in India, also the outside also will normalize so I am sure the things could be or would be better than what it is today. The only factor which is still uncertain, no clarity that what happens between U.S. and China, any truce happening over there will have suddenly a big impact in terms of the overall business sentiments getting changed.

Amit Doshi: Okay. Sir, my extension of the question was that what is our share in the recent that out of 20%, 22% of reduction, what we gain out of those...?

Neeraj Jain: So whatever is there are two kinds of gains. One, we were running full capacity earlier also. In between, there has been some small expansions which have come in for us so we have been utilizing that capacity also on a fully basis so it is not that out of those 22%, I would have taken something. But my customer base, my product mix is definitely better so to that extent, we had no issues in at least selling the products. The margins could be a question because our cotton was much higher prices in India compared to the other players. But in terms of selling the products, we did not have any difficulty so thanks to all these product market, quality and the customer profile we have.

Amit Doshi: Okay and Sir, of course, Indian spinning industry had its own tough time because of the higher cotton prices and lower yarn prices. How are other textile countries fairing, considering this U.S.-China trade war, Bangladesh or Vietnam and other countries who are good, who are kind of competitors to India, per se?

Neeraj Jain: India, there are only two competitors to India in the spinning at a bigger way: one is the Pakistan, second is the Vietnam now so Vietnam's exports are even increasing compared to us so Vietnam, they buy all the cotton from outside only. For them, it was almost similar situation, little better because they could import the U.S.A. cotton also at cheaper prices, whereas the Pakistan was also passing through a very, very difficult time. Their cotton prices, even today's cotton prices are higher than India so if you look at the international trade of cotton yarn, India and Pakistan share close to about 40%, 45% of the total trade so both these countries had a tough time so as a result, I think most spinning companies they were losing money. Indonesia also is a bigger player. Vietnam is a bigger player, but they are more on the polyester cotton and the synthetics as well so they did not have so much of direct 100% cotton yarn, which India and Pakistan are the biggest players so both the countries have lost in this period.

Amit Doshi: Okay so in terms of inventory of the cotton that we hold, we generally hold around three to six months of inventory, depending on situation to situation so if we also have a lower cotton inventory and the current crop season that is coming up is, as Mr. Jhamb mentioned, that is one of the bumper crop India will witness. So that would see a further decline? Or how do you see for you, Vardhman, as in particular?

Neeraj Jain: See, we were also covered on the cotton till almost middle of November so now the new crop has started coming in. We have started buying as I mentioned earlier, with our cotton prices, with our costs coming down, and if yarn prices can be stable, definitely, the margins are likely to improve compared to the losses or compared to the lower margins in the previous period so the new season of cotton will be till March or April, where we have to cover ourselves for the next couple of months and it is just the starting of the season, so as on today's situation, I do not know what happens in next couple of weeks, couple of months so I think if this situation continues, our prices are lower than the international prices, definitely the industry will do better than what they have done.

Amit Doshi: Okay and one thing you mentioned with the government refund of taxes is one of the concern or the area that you have been discussing so in case that comes up, what portion or what kind of relief you are likely to see?

Neeraj Jain: The home textile or the government people, they have got close to about 8% as the refund of the duties and taxes, which has been paid in the system so I think it could be anything between 5% to

6% in my view, which would be the duties we are paying directly, indirectly to the system, which is not ratable or not getting refunded so in case the government agrees to that, of course, they have to calculate it finally. The industry keeps on giving their own estimates, but finally government has to look at so the only authentic data today available is that they have given almost 8% to the home textile at the government.

Amit Doshi: Okay so if that comes through for even textile spinning industry, then that 5%, 6%, whatever estimate that you have would directly improve the margin to that extent?

Neeraj Jain: Yes, that is true. But I mean, we have been talking to the government for last almost 1, 1.5 years so I am not very sure what their view finally would be.

Amit Doshi: Okay, we do not sure what would happen and there is no time line for that, basically?

Neeraj Jain: No. Government has to take a view on that.

Amit Doshi: Okay. Thank you Sir. Thank you so much. Wish you all the very best.

Moderator: Thank you Sir. We have next question from the line of Chetan Thacker from ASK Investor Managers. Please go ahead.

Chetan Thacker: Sir, I just wanted to check on the net debt figure. Where do we expect that to end at FY2020 end?

Neeraj Jain: So our net debt number should be around Rs.2200 Crores to Rs.1400 Crores figure by FY2020. This includes both long-term and short-term debt.

Chetan Thacker: And going forward for 2021, we just have maintenance capex, right no other capex. No other for company capex?

Neeraj Jain: As of now, no other capex is planned so if the maintenance capex happen, assuming we get a EBITDA of Rs.1000 Crores or so, so practically, we are talking about FY2021 and there will be...

Rajeev Thapar: Should be in the range of Rs.500-odd Crores.

Neeraj Jain: Rs.500-odd Crores.

Chetan Thacker: Of maintenance capex?

Rajeev Thapar: No, net debt.

Chetan Thacker: Of net debt. Okay so maintenance capex is generally how much in a year?

Neeraj Jain: Rs.300 Crores to Rs.350 Crores.

Chetan Thacker: Okay Sir thank you so much all the best.

Moderator: Thank you. We have next question from the line of Nihal Jham from Edelweiss Financial Services. Please go ahead.

Nihal Jham: Sir, my first question was on the industry situation that you mentioned at the start of the call, where our exports to China specifically have fallen by more than 30% since the start of the financial year. However, if you look at the data for import of yarn into China that has more or less remained flat so actually, India, as a whole, has been facing a market share loss so just wanted your comments on because there have been certain articles which have put the reason to the new FDA they would have signed with Vietnam and other countries increasing share so first, wanted your thoughts on this?

Neeraj Jain: Yes so the Vietnam has the biggest advantage where they can supply to the goods to China by road, which is very near to them so there are two countries are Vietnam and Pakistan. Both these country have the advantage of an FDA so they get their yarn imported into China duty-free, which is almost 3.5% so to the number of days from Vietnam to China is the minimum compared to any other country, which includes Pakistan and India so the Vietnam has that advantage. Third, Pakistan is on a coaster ride so like 20s, 21 so they do lots of that weaving yarns or the knitting yarn on a coaster ride so Pakistan is definitely better compared to us. Whereas the China their own spinning mills started producing the final count, which is 30s, 32s and 40s, which are the bigger basket for India since their own capacity utilizations have been coming down, so they reduce their coarse count from earlier so they produce lots of 30s and 40s, which they earlier used to import from India so to that extent, the Indian imports came down so definitely, both in terms of number of days and in terms of the duty-free advantage, these countries of course, number of days Pakistan, India a bit similar, but Vietnam has an advantage and in terms of duty, both Vietnam and Pakistan has an advantage so that is why they could still maintain their exports to China.

Nihal Jham: Sure Sir if we look at our export data, it is specifically suddenly since March this year that exports have started falling off, so anything specifically which happened...?

Neeraj Jain: No, that is only their trade concern between U.S.A and them, that is all. Otherwise, nothing wrong was from Indian side.

Nihal Jham: Okay. But in this situation, then maybe...

Neeraj Jain: The consumptions came down because of this uncertainty so their import of yarn came down.

Nihal Jham: Sure but if this is a situation, then I think the current kind of volumes which you are doing of 74 million, 75 million kgs per month, will be the kind of run rate or the new normal going forward also?

Neeraj Jain: No, ultimately, U.S.A. has to buy the government so as of now, since this uncertainty was there, the entire pipeline was getting thinner and thinner so starting from brands to the manufacturers, the pipeline has been coming down only. Number two, finally, once the decision happens, what happens to their final arrangement, U.S.A. versus China, if there is no truce between U.S.A. and China, then the garmenting will start coming up in some different countries. As of now, no new country will be taking up these capacities, because if the truce happens, then what happens to the new capacity which others will be creating so I think this uncertain period is causing more concerns. Once the decision happens that whether the concern is there or not and whether this duties will be levied or not, based upon that, the new capacities will start coming up, if not in China, somewhere else and I think to that extent, the yarn demand will start happening once again so this is the period where because of this uncertainty, the entire pipeline has been becoming more and more thin, and that is the also reason why the demand was much lower.

Nihal Jham: Sir, the second question was, what is the current cotton yarn spread that we had for this quarter? And how does it compare to last year?

Neeraj Jain: The current cotton yarn prices are in the range of about $2.80 to a kg for 30s coarse and last year, in the same period, it was close to about $3.10 so we are lower by close to about $0.30 as of now. Of course, part of that will get covered maybe by the dollar, rupee. But I think in terms of rate per kg, we are lower almost by $0.30 as of now.

Nihal Jham: Absolutely and with our expectation that the current cotton prices are, say, 10% lower at Rs.29000 a candy, do you think that the cotton yarn spreads could improve or the yarn prices will correct to keep the cotton yarn...?

Neeraj Jain: No, yarn prices may not get corrected because yarn prices already got corrected because of the international prices of cotton so it was only our cotton in India was much expensive. That is why this concern was there, but going by the $0.64, $0.65 New York Future, I think the yarn price in my view, may not correct further and to that extent, the Indian spinners, which were losing in this period may start having a better situation.

Nihal Jham: So then the spread could go above $3 starting next quarter, if that is the fair way to look at it?

Neeraj Jain: May or may not be. But yes, your question was whether the yarn prices can get corrected further, to me, may not be.

Nihal Jham: Absolutely. Just one last question, Sir on the processed fabric side, I was checking the volume data, the 6% growth that we have shown for the quarter even for H1 is being pretty reasonable and better than what was contributed so is it that this is being driven by exports? Or we managed to get more customers on the domestic side?

Neeraj Jain: I think Mukesh, can you answer that?

Mukesh Bansal: Yes, it is primarily driven from exports so it could be direct exports, fabric exported out of India or even to the garment exporters in India. The final Indian domestic consumption, the demand has been sluggish.

Nihal Jham: Okay Sir that answered my question. Thank you so much.

Moderator: Thank you Sir. We have next question from the line of Prerna Jhunjhunwala from B & K Securities India Private Limited. Please go ahead.

Prerna Jhunjhunwala: Thank you for the opportunity Sir. I would like to understand the current scenario in the supply chain of domestic market. How is the supply chain right now and what is the cotton price start increasing because of the current trends that are happening? Do we see any increased demand coming into secure cotton yarn from the domestic market?

Neeraj Jain: In terms of prices, domestic is always offshore of the international prices of yarns. As I mentioned, since the international prices are close to about $2.80, the equivalent prices in India are close to about Rs.195, Rs.196 a kg and the Indian prices are always generally plus/minus Rs.1, Rs.2 from the international prices so Indian market prices are also in line with the international prices. To the demand in domestic market cannot improve than what it is already there so I think if a momentum has to come, that has to come only from the export because the Indian demand is normal so it is not reduced in a bigger way so we have been consuming 230 million, 240 million kg per month in India as a yarn, which continues in my view so I think there has not been any reduction of yarn in the domestic market so any momentum or any increased demand comes in, they will come only from the export and then only the margin or the overall situation could improve. I think that is your question?

Prerna Jhunjhunwala: Yes and Sir just a small clarity on that, how is the supply chain in terms of the middlemen? Because of tight liquidity situation, they might be holding only hand-to-mouth kind of a...?

Neraj Jain: So the supply chain in India is really one of the thinnest and because of two factors: one is the very tight liquidity position; second is since the prices have been coming down, so nobody was ready to have a bigger risk in terms of holding on to the inventory so everyone is working practically on a hand-to-mouth basis so I think the liquidity position, in my view, may not improve significantly in a very short period of time. But at the same time if the business sentiments improve, definitely supply chain would improve from what it is today. It is one of the thinnest as of now.

Prerna Jhunjhunwala: And in fabric business, Sir, when can we achieve full utilization, like FY2021 and/or FY2022, is something that I was trying to understand?

Mukesh Bansal: Yes. In FY 2021, we will reach a optimal level. If it is, say, 94%, 95%, we call it full capacity utilization so FY 2021, we will reach that level.

Prerna Jhunjhunwala: Okay thank you. That is it from my side.

Moderator: Thank you. We have next question from the line of Keshav Garg from Counter Cyclical Investments. Please go ahead.

Keshav Garg: Sir, my question is to Mr. Neeraj Jain. Sir, we are merging our listed subsidiary Vardhman Acrylics as a valuation of around Rs.290 Crores whereas the cash in the balance sheet is over Rs.300 Crores and company does Rs.30 to Rs.50 Crores operating profit every year. Sir, so by going ahead with this, not only will you lose your reputation but the valuation of Vardhman Textiles itself will permanently come down. Sir because if the corporate governance issue is there with the company, the same set of promoters, if they can cheat one set of shareholders in Vardhman Acrylics, then the same can be expected in Vardhman Textile also in a future date so what do you have to say on this?

Neeraj Jain: Yes. I think we will have to appreciate the processes of the entire merger, which is very, very transparent so there has been a valuer who has based upon and that they will do a valuation what I want the evaluation to happen so they have their own procedure and the processes of doing a fair valuation, which they have done. Also, you are looking at only the cash or the intrinsic value of Vardhman Acrylics. There are lots of assets where the intrinsic value of even Vardhman Textiles is much higher as this company is much older so based upon the market prices, based upon the earning potential and based on the competitor's analysis, I think they have taken all these approaches and the valuation has been done by KPMG, which has been further validated by a merchant banker. And to that extent, I do not think there is any intention of the Vardhman Textiles promoter or the Vardhman Acrylics promoter that this should be the valuation or this is what you are talking about so they are simply talking of making the business simple so to that extent, we want to have a merger. We appointed a merchant banker, and based upon their own judgment, they have done this valuation. It has nothing to do with Vardhman Textile that is good or bad, so it is neither in my hand. Based upon all the principles of valuation, they have done that. And it is primarily, I think, we will appreciate both the market prices and the earning potential will decide what kind of valuation should be there and please bear in mind, Vardhman Textiles being a 54 years old company, the intrinsic value of the asset could be much, much, much better compared to what it is being looked into the books of accounts.

Moderator: Thank you Sir. We have a next question from the line of Nagraj Chandrasekar from Laburnum Capital. Please go ahead.

Nagraj Chandrasekar: I had just a quick followup. I wanted to ask whether we would take advantage of the tax rate reduction dispensation? And what our effective tax rate should be going forward?

Neeraj Jain: We are evaluating the same because there are some tax-free zones we have so we are taking a final view whether we should move into this or not so our effective rate as of now is 27%, 28% so I think our taxation team is working on them. I hope by the end of the next quarter or in the results of the third quarter, the Board will be in a position to take a final view on that. But yes, we are surely examining it and whatever decision happen, we will be taking maybe in the next or the next quarter after that.

Nagraj Chandrasekar: And just any thoughts on capital allocation after the current financial year, now that we have done with this Rs.800 Crores, remaining portion of our capex programs?

Neeraj Jain: See, the situation as of now is really, really was a very tough time last couple of months so we have not drawn up any major plan for expansion as of now so the only thing we are looking at whether we can enhance or increase the pace of monetization if the opportunities are there so I think there are lots of ideas in mind. But as of now, no firm plan that this is a capital allocation for the next year. But I think once the situation becomes a little normal, probably we will start thinking on that also because in this kind of tough time, it was better to hold on to the cash and pass through this difficult time in a better or in a good way.

Nagraj Chandrasekar: Thank you.

Moderator: Thank you. We have a next question from the line of Avi Mehta from IIFL Securities Limited. Please go ahead.

Avi Mehta: Sir, I just wanted to understand, this realization, if you could just help explain the MSP part I am not very clear on that. Why do you believe that the MSP is not kind of suggest that cotton prices will not see further I mean, if you could help explain that, I was not very clear on that part, Sir.

Neeraj Jain: The MSP is always announced for the raw cotton, which is called narma and this has 2 components: one is the lint, which is basically the material to be used by the spinning company; and second is the seed, which goes in for the soil or as a food alternatives for the animals. Now the prices of cotton will depend upon all these three factors that what is the prices for the raw cotton, which is narma, what is the prevailing prices of seed and finally, what is the derived minimum support price for the lint to be used for the cotton spinning industry. Going by the today's calculations, I think the MSP comes to close to about Rs.41000 or so since there are some limitations, there are some challenges for the MSP because there are some conditions that the payment will be given to the farmer after 15 days, 20 days, there are some system procedures. Where farmer feels better to sell directly to the market at a little lower prices so I do not think there is any big difference between the MSP and the market prices as of now but yes, if tomorrow the seed prices comes down in a bigger way, then the MSP could be much higher so as of now, it is comparable. As of now, it is workable so I do not think there is a big issue. But yes, if the difference comes in, at that stage, the government may decide to intervene and they may buy some of the material to give that kind of support to the farmer.

Avi Mehta: And the second bit, Sir, there is recently the unseasonal rains in parts of India. Is that likely to impact cotton availability and in turn inflate cotton prices, Sir?

Neeraj Jain: Not really so when we are talking of crop size of 37 million, 37.5 million bales, this is already taken into account. Some industry estimates, there still people are talking about 38 million, 39 million bales also so I do not think with it because this impact was only 0.5 million bale or so, so as of now, there is no concern. And the crop quality, size looks quite good as of now so there could be even a possibility that it may go beyond 38 million as well so some of the industry people are even estimating that also. But I think 37 million, 37.5 million bales are a very, very safe kind of crop estimation as of now.

Avi Mehta: Okay and Sir, so in terms of realizations, would it be fair to argue that yarn realization is currently at the bottom probably remain at current levels and hence, the negative realization that we saw in this quarter would probably continue in next half. Is that a fair understanding?

Neeraj Jain: As of now, yes again, it is a business, so you do not know what part of the business happens, what where happens so as of now, it is a fair estimation. Going by the today's position, I can only say, as on date, the worst is over.

Avi Mehta: In that case, Sir, would percentage margin be the right metric or would the margin per kg be relatively okay or because you said spreads will move up?

Neeraj Jain: Both, if margin per kg improves, percentage will also improve and also our utilization on the fabric side has started improving in last two, three months and I am sure if they are in a position to utilize it better, the overall margin as a percentage to sales will keep on improving only.

Avi Mehta: Sir, in this year, you had indicated it will be FY2020 was likely to be lower than 18%, 18% to 22% range that we have in a steady state. Is it what would you like to...?

Neeraj Jain: We are only about 1% short of 18% as of now and maybe if the things goes well, there could be a possibility even to recoup that part as well.

Avi Mehta: Okay so you will still be in that range is what we are kind of probably that is how we should see it?

Neeraj Jain: It could be a possibility.

Avi Mehta: Okay Sir that is all from my side. Thank you.

Moderator: Thank you. We have next question from the line of Keshav Garg from Counter Cyclical Investments. Please go ahead.

Keshav Garg: Sir, again, on this Vardhman Acrylics question. Sir, first of all, Vardhman Textiles is not getting delisted. Vardhman Textiles will continue to be listed so where is the question of valuing Vardhman Textile. Maybe it is assets are undervalued. Sir, but Vardhman Acrylics is being merged. Vardhman Acrylics will no longer be in independent existence so you should just value Vardhman Acrylics and allot the number of shares of Vardhman Textiles at the prevailing market price?

Neeraj Jain: No, why prevailing so we cannot look at it that. On one hand, we take the market price of Vardhman Textiles, and on the other hand, we look at the cash and the valuation so we could look at it both ways, either we look at the market value of both the cases or we look at the intrinsic value or the asset value of both the assets. This cannot happen that I mean, in my view, what the KPMG would have taken or has taken that they take either a market price of both this case or they look at the intrinsic value or they look at the earning potential of both the companies, and that is how this ratio is decided.

Keshav Garg: Sir, now since anyway Vardhman Textiles own 3/4 of the company, and Sir, now so whatever merger ratio you decide, the 3/4 as it is will get treasury stock. Sir so please reconsider and I do not think, Sir, whatever extra Vardhman Textiles will have to pay will be less than 1% of the market capitalization so please reconsider the merger ratio.

Neeraj Jain: Yes again, I am saying it is not that Vardhman Textiles wants a lower or a higher ratio. It is a fair valuation. We have given an assignment to a third party. They have assigned. They have done that and whatever issues are coming in, both the companies are ours so we are only placing it before the shareholders that this is the valuation they have given and I do not have a control on the valuation, so whatever fair valuation they have given, we are going with that the same.

Keshav Garg: Thank you very much.

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

Gagan Thareja: Sir, you indicated that home textiles and garments have been given 8% refunds on the taxes. I presume it might improve their competitive situation, especially in exports to U.S. and you might be considerably unsupplied to them. Would it be fair to presume that because of the improvement in their prospects, possibly next year, it would have some benefit for you also?

Neeraj Jain: In terms of what?

Gagan Thareja: In terms of you being part of the same supply chain.

Neeraj Jain: No. Again, as I mentioned, the yarn prices will be determined by the international prices only so it is nothing...

Gagan Thareja: No, I am talking in terms of volume, Sir, not in terms of pricing. Simply in terms of the amount of sales that they could accrue, and therefore, you could accrue from supplying?

Neeraj Jain: Their consumption is miniscule as far as the total India's consumption is concerned so even a couple of companies doing very well, it can have an advantage to a particular company or not, but the overall yarn supply, if you look at the overall consumption, they will be consuming out of the total material produced in India, it will be miniscule so unless the overall demand improves, I do not think a particular company or a particular segment can offer a better price because everyone will be comparative so the overall demand increase, not only for the home textile but for everyone will definitely can definitely push the overall demand for yarn, which can definitely improve the margins for everyone.

Gagan Thareja: Are we in any way a significant suppliers of yarn to Bangladesh or suppliers to Bangladesh...?

Neeraj Jain: Bangladesh is one of a big country for us in terms of export. We export close to about 10% of our total export as Vardhman to Bangladesh so it is significant.

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

Moderator: Thank you Sir. We have a next question from the line of Venkat Raman from Orient Securities. Please go ahead.

Venkat Raman: I just wanted to know what is the status of the merger. Where do we stand?

Neeraj Jain: So we have already applied to stock exchanges. And in turn, they have applied to SEBI for the approval and once the SEBI gives the principal approval, then we will go to the NCLT and NCLT will call for all the shareholders meeting, creditors meetings, etc so the proposed date of merger as of now is April 1, 2020 so depending upon how the SEBI gives their consent, and after that, the NCLT process so as of now, the application is pending with SEBI with the stock exchange, which they are sending it to SEBI maybe in the next couple of days.

Venkat Raman: And second question is, I understand that the new export quality which is in the works by the government, do we have any expectations on this?

Neeraj Jain: From?

Venkat Raman: Central government is working out a new export policy.

Neeraj Jain: No I mean, our request to the government is only to refund us the taxes which we are paying into the system. That is all so in case, they can do that, that will be really, really very supportive for the industry.

Venkat Raman: Okay thank you.

Moderator: Thank you. As there are no further questions from the participants, I now hand the conference over to the management for closing comments. Sir, over to you!

Neeraj Jain: Yes. Thank you very much so it is a very, very challenging time for us, but I can only assure to all our investors that whatever is the best possible or controllable by the management, we are taking all those steps. There are lots of initiatives in terms of the cost reduction or in terms of the doing something different, so that the advantage of the same could be available to us in the long term as well so as I mentioned, this period has been very difficult, very different because of the reasons which were beyond control of the company, and it was more of a national or international issues. But whatever is controllable, we are all actively working on that, and I am sure as the overall situation improves, your company will also take a big benefit after the turnaround happens so from my side, thank you very much to all the investors who have been supporting us in thick and thin time and I am sure, as the situation becomes normalized, your company will again show much better performance. Thank you very much.

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