Grasim Industries Limited

Q1 FY2021 Earnings Conference Call

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Moderator: Ladies and gentlemen, good day, and welcome to the Q1 FY 2021 Earnings Conference Call of Grasim Industries Limited. We have with us today from the management Mr. Dilip Gaur, Managing Director; Mr. Kalyan Ram, CEO, Global Chemicals and Group Business Head Fertilizers and Insulators; Mr. Jayant Dua, Chief Executive Officer, Chemicals Division; and Mr. Ashish Adukia, CFO. (Operator Instructions)

I now hand the conference over to Mr. Ashish Adukia, CFO. Thank you, and over to you, sir.

Ashish Adukia: Good afternoon to all the participants. So as the virus spreads across the country and has now started reaching hinterlands, the health and safety of our employees have gained even priority and especially at the plants. At our plants, social distancing, rigorous screening and health checks have become preset norms. In fact, we've initiated automatic detection system in one of our plants, which would enable detection of face masks, body temperature, and social distancing norms remotely anywhere in the plant.

So now coming to the quarter, Q1 FY2021. We have followed four key themes for the management in this quarter. These are all mentioned on Page 5 of the presentation, which you must have all got. The first theme is demand creation; the second theme is cost rationalization; third theme innovation and agility; and the fourth theme cash flow focus. So in our first theme, we have actually reoriented our portfolio for the quarter depending on the demand. The concerns around health and hygiene have assumed primacy in light of the current pandemic, which uplifted the demand for chlorine and VAP (value-added products). We witnessed VAP realization improving and chlorine turning positive in this quarter due to increased demand. The lockdown severely impacted our operational and financial performance in the month of April. The operational performance improved in June, as majority of our plant resumed their operations leading to better capacity utilization for the month of June and for the quarter.

As highlighted on Page 6, the capacity utilization of VSF business improved from low single digit of 6% to 48% in June, and now in July, it is actually running at 79%. The capacity utilization of our caustic soda plant improved from sub-25% level in April to 70% utilization level in June '20 and 78% now in July. We're not providing any guidance for August and September, but the fact is that we're gradually reverting to normalcy.

On Page 7, our share of value-added products have improved across our businesses. The share of VAP in the overall VSF volume increased by 25% quarter-on-quarter to about 30% of the overall volume. Similarly, for fertilizer business, the PURAK, which is the non-urea sales revenue, have registered a double-digit sequential increase.

In our second theme, we have been at the forefront of innovation. Grasim's Liva brand has launched antimicrobial fiber, the fabric produced using the special fiber inherently possess antimicrobial properties, which inhibits the growth of microbes on apparel and home textiles.

We also saw emerging opportunity in the nonwoven segment, and therefore, we were nimble in tapping this opportunity by commencing nonwoven production on our existing lines.

In our third theme, our approach has been to reduce costs. Across our businesses, we have reduced fixed costs by 35%, which amounts to savings of Rs. 256 crore compared to FY '20 quarterly average. Please note that not all of it is a permanent saving. However, we are targeting more actions on cost savings, which will be more permanent in nature. So of course, this fixed cost has, for example, repairs and maintenance, which has come down because of the lockdown as well.

Lastly, as a fourth theme, we continue to maintain cash flow-focused approach, and we continue to maintain a healthy liquidity level. We have calibrated our Capex plan based on demand outlook and cash flows. Our interest cost has been most comparative in the market, the benefits of which is visible in this quarter with low interest costs and higher treasury income because of MTM gains. Part of interest cost was capitalized to the VSF Vilayat project.

On Page 8, stand-alone revenue and EBITDA witnessed a month-on-month improvement, driven by underlying business performance of VSF, chemicals and fertilizers. The month of June contributed almost 45% of quarterly revenue, up from about 23% in May. Our EBITDA number turned positive in month of May and June after reporting a negative number in the month of April. And if you see in June, we have Rs. 51 crore of EBITDA, and that has COVID-related expense sitting out there of about Rs. 25 crore. So June number would have been higher by Rs. 25 crore on a monthly basis. Given exceptional circumstances, we've shared month-on-month breakup of financials and key performance indicators for better understanding. These details will not be shared from the subsequent quarters.

Moving on to the next page. The consolidated revenue and EBITDA for the quarter stood at Rs. 13,621 crore and Rs. 2,613 crore for the quarter. On a stand-alone basis, the reported EBITDA was negative Rs. 46 crore. However, there's onetime cost of COVID-related CSR expense of about Rs. 40 crore sitting out there, adjusting for which the EBITDA would have been negative Rs. 6 crores.

Moving on to Page 11. The Board has approved the Capex of Rs. 1,615 crore for FY21, and our Capex spend for the quarter stood at Rs. 131 crore. As of now, we have decided to continue the Vilayat VSF project and brownfield project, with revised time lines. We'll keep reviewing the balance amount of the Capex on quarter-on-quarter basis based on business outlook. The other Capex -- so Vilayat project is about Rs. 818 crore plus Rs. 46 crore this year. And the balance amount is mainly towards the upkeep of plant and environment-related Capex as well as some of the commitments that were already made of payments, et cetera, that are being made now.

Moving on to business performance, Page 13. Viscose segment financial performance was impacted by lower sales volume and weak pricing environment. The weak operational performance of VFY weighed on the overall segmental performance. The capacity utilization of VFY has been low, given the weak demand condition in domestic as well as overseas markets. VFY sales was about Rs. 56 crore and EBITDA loss was about Rs. 81 crore out of the Rs. 113 crore negative that you see on the slide.

The domestic VSF realization, which is in the next page, were impacted by global VSF prices, which were at historic lows. The domestic demand for VSF remained low due to extension of local lockdowns in key manufacturing hubs, non-availability of workforce and with malls and shopping centers being nonoperational. Our cost focus gained traction during the quarter. Our fixed cost reduced by Rs. 186 crore in comparison to average FY '20 cost.

Moving on to the next page on VSF on Page 15. The VSF business switched their focus from domestic market to export markets and dedicated few production lines to cater to the export demand of specialty products. This actually led to 26% rise in share of exports to 38% in June '20 and improved the capacity utilization for overall VSF business as well.

I'll move now to the Chemical business performance, which is next page onwards. The operational and financial performance of Chemical was better than some of the other businesses. The capacity utilization ramped up to 70% in June, closer to March utilization level. And please, if you recall, March utilization level was lower because we lost the last 1 week of March. The Chemical business reported EBITDA of positive Rs. 41 crore in the quarter despite challenging market conditions. The caustic soda demand remained weak on account of lower demand from user base industry. Chlorine value-added products demand remained strong and touched pre COVID levels during the month of June '20. The chlorine realization turned positive in the quarter, driven by demand from disinfectants and hygiene-related products.

On Page 17, you will see that the global caustic prices were at almost 4-year low and weakened to sub-$300 level during the quarter. The ECU prices were influenced by weakness in caustic soda prices, but were partly compensated by positive chlorine prices. The domestic caustic prices continue to be impacted by excess supply situation and continuous inflow of imports.

On Page 19, fertilizer business was one of the bright spots in the company's performance. The demand for urea remains strong on back of normal monsoon and advance crop sowing. The Y-o-Y improvement in EBITDA was driven by lower fixed cost of about Rs. 3.6 crore, onetime gain pertaining to freight subsidy arrears of about Rs. 12 crore and improved PURAK sales by about Rs. 4.6 crore. PURAK, which is essentially non-urea products sold through our distribution channel, contributed almost 24% of the overall fertilizer EBITDA for the quarter.

If I take you to Page 27, on sustainability, our VSF business has collaborated with other global viscose players in formulating the zero discharge of hazardous chemicals (ZDHC), ZDHC guidelines for manmade cellulosic fiber players, covering responsible production as well as waste water and air emission standards. We are committed to implementing ZDHC standards at all the fiber manufacturing units.

In terms of outlook for the business, with the easing of lockdown conditions and gradual resumption of economic activities, demand for the company's products is expected to increase in the coming quarters. We have initiated measures to optimize operations across plants, reduce fixed costs and conserve cash. We continue to maintain a very comfortable level of liquidity to navigate any uncertain business environment. Our inherent financial strength, our operational excellence and diverse product portfolio with cement, financial services, viscose, chemicals, et cetera, makes us prepared to withstand temporary disruptions and sustain the leadership across these businesses.

So that's it from my side. I will now hand over back to the operator for Q&A.

Operator: The first question is from the line of Gunjan Prithyani from JP Morgan.

Gunjan Prithyani: Just 2 questions from my side. Firstly, on the VSF side, if you can just share the broader market position. Where is it globally? How you're seeing things normalizing? I mean I don't want to read too much into this quarter, but what is happening really in terms of both realization and the normalization, particularly the domestic normalization for Grasim?

And secondly, this Capex which has been approved, I mean, given that we are still not sure of how things normalize, why are we going ahead with Rs. 1,600-odd crores Capex in this year? Is there a rationale to push it out right now and maybe look at it later because cash flows clearly may be an issue this year given the overall market dynamics?

Dilip Gaur: Gunjan, I will try to respond to both your queries and then maybe Ashish can chip in. The global viscose prices continue to remain under pressure, what I told you last quarter continued because still because of the COVID, the demand side of the textile hasn't picked up as well. So China still continues to have a very low operation rate for the yarn manufacturing as also for the VSF manufacturing. So the VSF OR was more 64% - 65%. Yarn is even less than that, 50%. So the textile recovery has not been as good in China as for the other sectors, but it is slowly ramping up.

So the viscose prices touched the historic low during the quarter and largely not because of anything else, but because they have inventory and there is no demand. This quarter, I think the industries with the opening up of the European market, opening of the U.S. market, I think the recovery in the global markets has been significantly better than we expected. So even in India also, what has picked up is the export from India to rest of the world, not only in textile, but in fiber, in downstream, in apparel, everywhere. So I think the U.S. and European economy and the consumption of textile, et cetera, is picking up significantly better than what the domestic has picked up. So that is one part of it.

Good thing is because of the low OR, operation rate, in the VSF plant, the inventory has started coming down. They are still high, but they are trending low. And we are seeing there's effort being made to increase the prices by the Chinese player. It's early days, but there is an effort on the part of Chinese players to take up the prices. So there could be perhaps a bottom or near bottoming out of the prices. So that is one part on the global prices.

Indian demand, I think the good thing about Indian demand is 80% to 90% of the fiber demand in India is from unorganized sector. It is not from the branded retail. So while the branded retail hasn't started the way it should have started, but I think because a good rural incomes, the Tier 2, Tier 3 towns economy doing better, the demand in that segment is picking up better. And that is the reason why we found, after June, a good uptick in the demand part of it. In fact, as we speak, all my plants are running at 80% capacity, the shortfall also only because of one segment, and that segment is the dope dyed. The dope dyed segment goes into the suiting industry, suiting and formal shirts and trouser.

The only segment of the market which has not picked up is this segment because offices are closed, people are still working from home, and the marriages are not taking place. So we believe this part of this segment will start looking up once the festive comes. So maybe in a month or month or 2, when the festive season is around the corner, we believe this demand also should pick up. As we speak, the trend on the Indian demand is healthy. We are running our plants full blast, barring the dope dyed part of it. Perhaps the derailer could be the COVID spreading into hinterland, COVID getting into the rural part of the India, which was not affected. So why the demand became so good is because the smaller towns are not impacted by COVID, while the metro cities were impacted, where there is not much demand in terms of our products.

Second, during this lockdown, what is doing well is what they call seat-to-street clothing, so the casual closing, the pajamas kind of this thing and where lot of viscose goes, so low-cost clothing. So I think the demand outlook for viscose looks to be good for 2 reasons: one is the kind of clothing, which is involved. Second is if you see the global prices of cotton and viscose, the gap has come to almost RMB 3,500, the Chinese currency. It is widening. Now these are the times when the shift starts happening. At this kind of high deltas, technically, the downstream guy should start moving from cotton to viscose. Now how and when, I think we'll have to watch for it, but directionally, I believe there's suspicion to start going forward. So that is the viscose supply-demand balance enterprising scenario what we can't crystal gaze. I'm just give you the leading indicator what you can and then you can make your conclusion based on that.

On the product per se, see, one is the current prices, the current impact, what is happening. Second is long-term drivers for the business. I think viscose, whatever you may say, will remain the fastest growing fiber because for the reasons we have been telling you. So the implicit demand for viscose has to be there. And in India, we are the dominant player. The demand must come to us. So we believe, as per our projection, by Q4, the textile demand in the country should come to normalcy or 90% - 95% of normal levels.

By middle of FY '22, the demand will start growing significantly, and we anticipate there'll be a shortage of Grey fiber, what capacity we have and what demand will be available. And this project, when I had shared with you earlier, has 3 advantages. It has got the largest capacity lines. So we've given a very low cost of production. So I have a consistent advantage in variable cost from this plant.

Second, this plant is sharing the site with the existing plant. So it will become the largest single location plant. So fixed cost will be very less. Thirdly, the quality of products from this plant will be world-class (the machines are the latest generation machine). It's will be of very good quality, both for the domestic and the international market. So we believe this project is the right thing for the business to do to grow its competitiveness. And based on the projections, we believe there will be enough demand.

And even if there is an issue on demand, there are other operations with a high cost which we need to scale down rather than letting this suffer. So to our mind, this is a good investment, which has a very strong case for early commissioning. In fact, by mid-August, by the time this comes up next year, I think the demand will be running. We'll have pressure on the supply-demand situation. That's the rationale from our side.

And Ashish will share with you, there won't be an impact on our balance sheet because of this as much.

Ashish Adukia: Yes. Absolutely. I think out of Rs. 1,615 crore of Capex that I mentioned for the year, almost the take-up by Vilayat project itself is above the Rs. 860 crores to Rs. 865 crores, somewhere around that. So a substantial part of it is that. Now you would appreciate that at Grasim in stand-alone level, we are running almost 15-plus units. Now to keep the upkeep of all these units, et cetera, that are certain Capex, and there is also increased environment-related Capex that we are incurring. So just to make sure that the upkeep and environment-related Capex are spent, that itself overall adds up to the balance. And plus, in the projects, other projects that we have completely put on hold, in Chemical side. Some of those projects, there are commitments that we have to fulfill which may relate to MSME, et cetera, as well.

So therefore, there's small part of Capex is also towards that. So really speaking, other than for Vilayat, which is a strategic Capex, rest all of them are bare-minimum Capex. And of course, what Dilip had said, the balance sheet of Grasim is strong enough. We don't know yet where we're going to land up at the end of the year because we don't have visibility on it, but nevertheless, we're strong if we have to take more debt to take care of this Capex.

Operator: Thank you. The next question is from the line of Gaurav Rateria from Morgan Stanley.

Gaurav Rateria: Firstly, any color on what the current run rate for export market is there in July? And how are you able to compete with the Chinese players in the export market? And is profitability very different from what it is in domestic market?

Dilip Gaur: Yes. Ashish, I'll go and then you can add later on. See, as you always know, the profitability in export market is not as good as domestic. And that's why our effort has always been to maximize the domestic sale and the export becomes an overflow kind of (inaudible). In the domestic, you have the logistics cost advantage, and you provide extra services to people which are awarded to you from the branding point of view.

But the good thing is our cost of production in the Indian plants from where we export, the Kharach and Vilayat, are one of the lowest in the world. We are there sub-$1. So even in a very competitive export prices, we do make positive money in this. So to that extent, it's adding value to the portfolio. We're not doing export just to fill up capacity.

And there are 2 types of export. One is export of Grey fiber; other, the export of value-added products, so things Modal which we are exporting. It has got a very good realization. In fact, in this market where the grade prices are very low, the delta between specialty Modal price and Grey has been highest ever. It's more than $1.20. So we make far more money in exporting a value-added product from Grasim than we'll do even in selling in local markets. So what we are doing in export is there are 3 parts to export, which is Modal, which is a very high value-added product. Second, nonwoven. Again, as we told you last time in our call, because of the hygiene impact, there is lot of demand for the nonwoven fiber. And nonwoven fiber has about $0.15 to $0.20 more premium over the Grey textile fiber. So that is bulk of the export.

Remaining overflow is on the textile. And that also there are geographies which are better-paying business in world. We focus on high-paying geographies from India. So that's the kind of a thing. So I think while it is not as profitable as the local market, but if you look at it, my overall realization, blended realization is much higher than my India Grey prices.

Gaurav Rateria: And sir, what is the current run rate at which you are doing export right now?

Dilip Gaur: 40% of my portfolio was export in June, but now it is coming down, and we are doing more of this thing. So about 230 - 240 tons per day kind of a thing.

Ashish Adukia: But I think we should not assume exports. I think we should go assume the levels to be back to FY '20 levels.

Dilip Gaur: By Q4, Yes.

Ashish Adukia: Yes, by Q3 or Q4 we should.

Dilip Gaur: This is transient to make sure because you see, when you use assets fully, you will reduce the cost of production, and your operating efficiencies go up. So this helps you in 2 ways: improving operating efficiencies and getting you some positive EBITDA

Gaurav Rateria: Sure. So second question is for Ashish specifically. I know it's difficult, but what is the peak net debt you have in mind beyond which you would like to flex your Capex plan so that you don't kind of go beyond that levels? I know net debt to EBITDA comfortable level is to 2.5x, which you had shared in the past, but any peak net debt number you have in mind for FY21?

Ashish Adukia: Yes. So see, I think the net debt to EBITDA is not the right metric to look at for this year. I think if I look at last 12-month EBITDA and try to calculate the net debt at this stage, it comes to somewhere around 1.65x to 1.7x. But really speaking, one quarter out of that is actually less than 0 of EBITDA. So you're really calculating that on 3 quarters. So I would ideally look at more annualizing the subsequent quarters that keep coming with an improvement, et cetera, to look at net debt to EBITDA.

So ideally, when we reach quarter 4, which we believe is probably going to be normalized quarter, the EBITDA in that quarter should be annualized to calculate net debt to EBITDA. And I think we'll be below our threshold, et cetera, based on that number.

Operator: The next question is from the line of Raashi Chopra from Citigroup.

Raashi Chopra: Just some bookkeeping questions. The global VSF realizations are down about 6% sequentially. But the last quarter, the domestic realizations got a benefit, right, because of China closure. So for you, what has been the realization decline sequentially, one? And second is, where are those realizations now versus the April to June quarter? That's one question. And second, just wanted to check how much you have put in the rights issue for Aditya Birla Fashion so far?

Dilip Gaur: I couldn't understand the question. You are saying the 6% Q-o-Q reduction that's over the last quarter because of the last...

Raashi Chopra: No. The 6% is a global decline or is it your decline as well? That was my question.

Dilip Gaur: No. Ours is lesser. Ours is much less. Ours is I think 3%, if I'm not wrong. Yes. Ours is 3%.

Raashi Chopra: Okay. And the spot realization versus the June quarter?

Dilip Gaur: They are broadly in line, I think. See, it's only issue of the mix now. Otherwise, broadly, we are the in line with quarter 4.

Raashi Chopra: Got it. And just on the rights issue for Aditya Birla Fashion...

Ashish Adukia: Yes. So we have put only the calls. We put only our share of amount. So our commitment to them is somewhere around Rs. 100 crore out of the Rs. 1,000 crore rights that they did. And the first call is about, I think, Rs. 54 crore or something. So we've put only that much amount. And as the calls come is when we will be paying the balance amount.

Raashi Chopra: Got it. And at least in the imminent future, there is no proposal to invest any further in the group companies, right?

Ashish Adukia: Yes, absolutely. No proposal to put other than the calls that will come from Aditya Birla Fashion

Operator: The next question is from the line of Vivek Ramakrishnan from DSP Mutual Fund.

Vivek Ramakrishnan: More or less the questions have been asked. But just to clarify, you have 2 purposes which you do. The way I see it is that the cash flows from the business will be enough to take care of the Capex, fingers crossed, the EBITDA kind of at least keeps the June numbers. And then you have the holding company kind of role also which you do. How do you see the debt in relation to both these things? Because, like, for example, financial services business, you can't anticipate how much capital it will need and so on. So how do you see that panning on to the year? That's the only question that I have.

Ashish Adukia: Sure. So I think investments in subsidiaries or group companies, okay, the way we look at it is that the stand-alone businesses of Grasim, which is Chemicals, VSF, fertilizer, et cetera, always takes precedence over the investments in the subsidiaries or group companies. So first, we look at that when we're looking at cash flow and cash allocation, first priority is given to that. And then if there is a requirement in the subsidiary business, the strategic subsidiary business, then we look at those on the basis of return, et cetera, is going to be. So it's always a second priority to Capex.

Vivek Ramakrishnan: Okay, sir. So we can broadly expect that it will be around current level of debt only, right, because you earlier answered that there's not major investments in group companies and your Capex seems to be within -- more or less within your cash flow numbers, assuming that things normalize a little at least?

Ashish Adukia: Yes. So I think it's tough for us to say that where we land up on EBITDA and whether it'll be able to cover the Capex or not, it's tough to say today for the entire year. We know our Capex, but EBITDA is unknown. So to that extent, if the EBITDA takes care of it, then we should be okay, we should be lining up at the net -- same levels of net debt to EBITDA. And as a sake of repetition, there is no further investment plan on the group companies’ side.

Operator: The next question is from the line of Bhavin Chheda from Enam Holdings.

Bhavin Chheda: Sir, 2 questions. First, on the fixed cost, you have done excellent job in reducing and you gave in the opening comments also. But as you said, not all is recurring in nature. So what number should we assume that could be recurring in nature, considering difficult times, and you would have reduced it? Because as you said, the repairs would come in the upcoming quarters. So that wouldn't be permanent in nature. So out of this Rs. 256 crores, how much portion can we assume on a quarterly run rate basis for this fiscal, which would be lower?

Ashish Adukia: It's difficult to determine a more sustainable number. I think this quarter was tumultuous, and this quarter, we've taken measures, but some of those cost-cutting measures, et cetera, we will know the amount, what benefits we will get when the operations normalize, whether some (technical difficulty) which may sustain. So therefore, it's difficult to determine that number. But what we are doing is we're looking at each and every cost item each business is doing so to figure out what is the scope of reduction in those -- all those items, which can be in the manpower. We are looking at manpower at all levels to see where the reductions can be made. So in manpower, especially, there will be some permanent reductions. When I say permanent, it means that at least you'll see that in this year as well as in the next year. In repair, some of it can reverse. In others category, which is advertising and admin, et cetera, we'll see some reduction. But generally, we are looking at across all levels to see where permanent changes can be made.

Bhavin Chheda: Okay. And regarding the Capex slide, basically the completion time line, so this VSF thing, which was earlier to get over before the end of this fiscal, so what would be your completion or what I can say a commencement date of this incremental capacity of VSF? Because as you said, obviously, you're completing the Capex this year only, but these are 2 lines of 300 tons. So are you phasing it one by one line? How does that start up?

Dilip Gaur: You want me to respond, Ashish?

Ashish Adukia: Sorry, I lost my collection for a bit. Can you please repeat?

Bhavin Chheda: This is regarding the VSF expansion. So you are doing 2 lines of 300 tons per each, which was as per the original schedule was going to get completed in the second half of FY21. So what's the revised date of either completion or starting this line?

Ashish Adukia: Yes. Sure. So like Dilip had said, middle of August next year is when we expect to at least to one of the lines to start. And second line will be possibly a quarter after that. Dilip?

Dilip Gaur: Yes. Because see, what happened, we had stopped work on this line during the last 4 months. And now the monsoon time is there, so once (technical difficulty) first line commissioning and 1 quarter later the second line.

Bhavin Chheda: So you're saying August '20 and December '20, right?

Dilip Gaur: '21.

Bhavin Chheda: August '21 and December '21. Okay. And...

Dilip Gaur: Maybe late October. Yes, that's right. Yes.

Ashish Adukia: Yes. Yes. October or something like that.

Bhavin Chheda: So basically, next year, quarter 2 and quarter 3, so full impact could come maybe more in quarter 4, okay? And if I add the capacity to this -- so 566,000 and 219,000 gets added. So where is that -- your presentation says 801,000. So where is that 16,000 additional coming from?

Dilip Gaur: Some debottlenecking must be there.

Bhavin Chheda: Sorry, is it the Kharach line? Kharach is included in 566,000, right?

Ashish Adukia: Yes. Kharach is included, everything is included. The only capacity expansion that...

Bhavin Chheda: So higher than more of 566,000 to 788,000. So I think your presentation shows 801,000.

Ashish Adukia: Yes. So there is a small debottlenecking that we keep doing, which is in Kharach as well as in Harihar, if I'm not mistaken?

Dilip Gaur: Yes. That's right.

Ashish Adukia: So those 2 will take it to 801,000. So...

Bhavin Chheda: Yes. That should happen this year, that also next year?

Ashish Adukia: See the debottlenecking also requires approvals, et cetera. So it won't entail much of Capex, but it just that you need to get approval for the enhanced capacity and then you can...

Dilip Gaur: And that should happen this year, yes, right.

Bhavin Chheda: Right. And regarding the chemical thing, if you can guide on the similar dates when the project would get completed to 1.45 million?

Ashish Adukia: No. So Chemical, like I said, they're on hold. We are not incurring anything other than the commitment -- committed payment that we have to make in that fund. So we will review these -- we'll continuously review this project based on the performance of EBITDA and then decide when to pick up these projects.

Bhavin Chheda: So and -- so chemical also, if I'm not mistaken, it was broken into 2 parts. First, that was 400 ton per day, which was getting expanded, which you have taken your capacity to close to 1,200,093 and the second stage, it would have been taken to 1.45 million. So both are on hold? Or...

Ashish Adukia: Yes. Both are on hold. There are totally -- in caustic side, there are 2 projects. There is one in Rehla and there is Balabhadrapuram that we had acquired. Balabhadrapuram was also in 2 phases. So that's on the chlor alkali side. Then there was also certain VAP projects that we were undertaking, value-added products. There was also a power plant. So it contains multiple projects in strategic Capex side.

Bhavin Chheda: Okay. Just a continuation on this. Since actually, the Chemical business recovery looks to be faster seeing the chlorine side of the business and even caustic soda is not big negative, and you have always been operating at a full utilization level. So will you not be short on capacity, especially the demand return? Or is it just to match cash flow with the Capex you are postponing it, on the Chemical part? Or is it the approval process, which has been taking time?

Kalyan Ram: Yes. So let me add here. I think we have a structure in terms of looking at all our Capex into 3 or 4 levels. One is we focus on first, EHS and sustainability and sustenance Capex. And the second one is around, as Ashish mentioned, the commitments that we already made for these projects, majority of these projects were to be completed this year. Third, we started to look at what is the demand situation in the market and which ones can be postponed for a while, where we manage the balance between the demand and supply. Fourth group is those which will make us competitive, whether it is power plant, whether it is VAP's investment. We have taken all of them. I think we're going in phases.

After the first quarter, VSF has made some choices. In Chemicals, what we intend to do is to also see the second quarter how it pans up, and we want to then activate some Capex activities, if it makes sense. So this is actually a developing story. So every quarter, we might actually come up with some development. In the case of chemicals, we want to take another 1 or 2 months to actually see symptomatically because Chemicals is a lot affected by international markets. So we are closely monitoring international markets. If you know, caustic prices are significantly lower across Asia. And China is quite strong and then dominating much of Asia. So we are closely monitoring that, too. So we need to balance that. We'll come back to you. I think it's exactly how you said we are closely monitoring, and then we don't want to be again [caught]. But as of now, we have enough capacity. Even if it goes up to 90% - 95% of normalcy by quarter 4, we will have enough capacity.

Operator: The next question is from the line of Prateek Kumar from Antique Stockbroking.

Prateek Kumar: First question is, so in VSF segment, so like have we attempted taking price hike in the domestic market like we mentioned, some of the domestic -- international, the Chinese players are attempting in their markets. So is there any price hike that's taken by us in the domestic market?

Dilip Gaur: See, the prices follow the international prices. So if it happens there, it'll happen here also automatically. So there is -- so right now, they are trying it. It has not happened. There are no deals happening. There's announcement. So let's see how it goes.

Prateek Kumar: So there's not been any price hike by us till now?

Dilip Gaur: So this -- because what happened right now, we are coming out of a shutdown. So right now, we are sustaining the same prices what were happened pre-shutdown. Let the normalcy come and then we'll see where the demand-supply balance and what the international price is because the international price reflects the domestic price status.

Prateek Kumar: Okay. And sir, regarding the additional duties on imports of yarn on VSF has been slow. Has there been any update on that front from government side?

Dilip Gaur: It is still work in progress. We have no date right now. There is investigation going on right now.

Prateek Kumar: Investigation related to the Chinese dumping players?

Dilip Gaur: Yes. It is antidumping investigation on the yarn side, yes.

Prateek Kumar: Right. And pricing in the caustic segment, we don't see that recovering in next 6 months? Or there is any sign that is there also will pick up?

Jayant Dua: So in the caustic recovery, on prices, clearly, there is a demand-supply, which is impacting at the moment plus the imports because of South East Asia. As Kalyan quoted, there is a fair amount of capacity there. So as the demand picks up, like clearly, we are seeing textile demand coming up, which is a large consumption center for caustic. I think over the next couple of quarters, if the demand-supply starts coming up then maybe we could see some changes, but it's too early to say anything on the price front.

Prateek Kumar: And in terms of debt, which we have reported in the presentation, so there is an increase in gross debt as well as cash position. Any specific reason for that?

Ashish Adukia: Yes, sure. I think I can take that question. See, in case of when we started the quarter, there were a lot of uncertainties, and we had gone into lockdown. So we wanted to maintain strong liquidity. So we had borrowed money, both from the capital market as well as from the bank market just to maintain liquidity. But if you look at it more positively, so that's why there's an elevated debt as well as elevated treasury but if you look at it more positively, there is no negative arbitrage out here. In fact, treasury has done extremely well because the yield compression the capital gains on the bond side has been very good in this quarter. And the cost of debt also for us is very competitive because we get the best grades both in the capital market as well as in the bank market. But this quarter and subsequent quarter, whenever there are debt rollovers coming, we may use -- we're not too sure yet. We will keep continuing the situation, but we may use combination of treasury as well as new debt to repay the old debt.

Prateek Kumar: Sir, just last question. While you mentioned about debottlenecking in terms for increasing capacity, what are the financial chart in the last stage, last couple of stages? It's already showing higher capacity, like 578 ktpa from 566 ktpa for Viscose segment and likewise for VFY also. So this debottlenecking is already partly done?

Ashish Adukia: Yes. So we will reconcile the capacity numbers with you off-line. But some of these debottlenecking would have got done and some must be pending.

Dilip Gaur: Like Kharach was done, Vilayat was done, Harihar has been done. These are ongoing process. I mean it keeps on happening. The word bottleneck means when you remove one, the other one comes. So we keep on improving this. So this is a perpetual exercise.

Operator: The next question is from the line of Amit Murarka from Motilal Oswal.

Amit Murarka: Sir, my question is around margins. So the chlorine has turned positive in one quarter, but is it sustaining is what I was trying to understand.

Jayant Dua: So currently, Amit, it is clearly sustaining because of the entire focus on the health and hygiene aspect. And clearly, the segments of water for our VAPs, which take both chlorine and the value-added products, is doing very well.

Amit Murarka: Okay. And also in the price chart that you showed on VSF and the pulp price, so like it doesn't look like there is an uptick in either. So even though volumes are recovering, is it fair to say that the margins will be quite subdued at least in the near term?

Ashish Adukia: It's difficult to give any guidance out here. I think Dilip has shared some bit of price trend -- bottoming of the VSF price and how the cotton premium over VSF has increased. And therefore, there might be some recovery in the price of VSF. So there is possibility of some recovery in that. Pulp, we are continuing to get the lag benefit of pulp purchase, and pulp prices continuing to be under pressure. So we may benefit -- continue to get a benefit of that. So it's difficult to give that whether the margin that you're talking about will continue grow or decline, certainly not decline, it is more likely to grow.

Amit Murarka: Sure. And in one of the earlier calls, you had mentioned that imports have started coming in from China because of the oversupply over there. So what is the situation on that front?

Ashish Adukia: Import of VSF you're talking about? Or you're talking about...

Amit Murarka: Yes.

Dilip Gaur: Imports of yarns you are talking -- I think.

Amit Murarka: Yes. Sorry, the yarn.

Dilip Gaur: Yes. So, the import of Chinese yarn was coming in and then it stopped because China itself had a COVID. Then India got into a lockdown. But I believe now, again, the pressure on the import of yarn is happening again from this month onwards. So after the tensions on the border has eased out, there is threat of imports from China is happening. So it may start. So that we'll have to face as it comes.

Operator: The next question is from the line of Rajesh Lachhani from HSBC.

Rajesh Lachhani: Actually, most of my questions have been answered. Just one on capital allocation. I just want to understand what is the hurdle rate that you have internally when you decide for the projects, both for VSF and chemicals? And do you think the IRR that you have calculated earlier have now reduced due to this consistently low demand and pricing environment?

Ashish Adukia: Sure. So see, whenever we approve a project, we always do a full thorough exercise of looking at the IRR and whether it meets our hurdle rate or not. And hurdle rate is something that we calculate base at that time based on the industry classic WACC model. And we look at the beta in the textile industry, et cetera, and then arrive at the hurdle rate. And then you compare your IRR with the hurdle rate that you have got it.

And at that time, when we did, for example, Vilayat project, it was much ahead of the hurdle rate. And we look at the payback, et cetera, as well. So today, it's difficult to say whether you lay it -- in the current scenario, obviously, if you lay the numbers in the same model of VSF price, then the IRR may not be as attractive as it was at that time. But generally, when there is -- when these are commodity, these -- which is volatile and open to risks, there in the model itself, we take through the cycle realization, et cetera. So some bit of things would have already been factored in some compression in the price would have already been factored into the model at that time.

Today, while the VSF prices have come down, but pulp prices that may have been assumed in the model has also come down. So difficult to say the IRR levels of the project today. But at the time of approval, we had very good gap between the IRR and the WACC.

Rajesh Lachhani: Yes. Is it possible to quantify some of those ranges of hurdle rate and IRRs? And also since you are prioritizing the VSF Capex ahead of the Chemical, is it fair to assume that the IRR for the VSF project is much better than the caustic soda and that has been one of the factors for you prioritizing VSF Capex?

Ashish Adukia: No. So it's difficult to answer that question, frankly. I think there are a lot of factors that goes into deciding whether you do the Capex or not. IRR is, of course, one of them. There is also market outlook. See, in caustic, as you've seen that, there is an increase to supply from the domestic players, which has impacted the ECU, et cetera. And if you increase further supply in the market, it just not disrupts your business, but it also distorts the entire market, which means that it may disrupt your current capacity as well. So many such factors go into prioritizing one project over the other. VSF, we have leadership position, and we see the demand pick up that will come up once the market stabilizes and the lockdown is -- or COVID situation is over. So that was one of the few reasons on the basis of which we decided to go ahead.

Rajesh Lachhani: Understood. My question on quantification of the IRR and hurdle rate, if you can give us some numbers that would be great.

Ashish Adukia: Yes. So like I said, I think today, the risk-free, et cetera, so if you compare the hurdle rate of today versus the hurdle rate of when we approved the project, okay, those are 2 different rates because the risk-free has come down, the equity risk premium may have gone up slightly but not a lot. So it's any other way, how any analysts calculates the WACC is how we will look at it. And we look at more normalized WACC without the benefit of Aditya Birla Group so -- or Grasim cost of debt. So we take a normal cost of debt. So we would take a cost of debt at about 9% or so. We would take the risk-free return, what is prevailing in the market.

The beta could be whatever 1 to 1.2 range and the risk-free premium -- sorry, the market risk premium would be somewhere in the range of 5% to 6%. And that's how we would arrive at. The cost of equity could come to somewhere around 12%, 13%, roughly. And cost of debt, like I said, would be 9%. And then you take about typical funding structure of other 50-50 weight of debt and equity or 40-60 sometimes we take, which is 40% debt and 60% equity. The reason for that is that upfront, the debt might be higher in a typical project, but over a period of time, it normalizes.

Operator: The next question is from the line of Sumangal Nevatia from Kotak Securities.

Sumangal Nevatia: My question is with respect to operating margins of both the business. I mean you answered in bits and parts in the previous question. But just to summarize together, now if we look at historically, we used to maintain good comfortable 20-odd percent EBITDA margin or operating margin in both the business. And in the second half of last financial year, it reduced to around record lows of 10%. Now even if we exclude the first half of this year as a one-off, how do we see returning first to the last -- the second half of last year levels of around 10% in both the businesses? And then how do we see both the businesses returning to the historical mid-cycle range of 20-odd percent EBITDA or operating margin levels, in how many quarters?

Ashish Adukia: Difficult to say when we will reach those because, see, I think if you do it mathematically, okay, the realization plays a big factor in the margin, right, and it's kind of flows through as well. So any improvement in realization has a big bearing on improvement in margin. So difficult to say when will we go back to those levels. But we hope that through the cycle, like you said, we revert back to the margins that we were enjoying in the first half of previous year.

Sumangal Nevatia: But Ashish, is there any visibility on the 10-odd percent EBITDA margin, which you used to maintain in the second half of last year, any confidence that we will be returning back in the second half this year to those levels or it's too tough to say?

Ashish Adukia: No. I don't think we should say that it's too tough. I think there are few levers that we need to keep in mind, right, which is under our control. Certain things are not under our control and certain things are under our control. What is under our control is the conscious initiatives that we can take to reduce the costs that are under our control. So our raw material cost, which we are buying from the market, you may not have too much control over those. You can change the sourcing, et cetera, but you can't do much about it. You can change consumption norm, which can help you. So you can reduce costs. Fixed cost is another number that you can focus on. So that's one side of the story.

The second side of the story is how you improve your realization. So if you talk about just Grey. I think Grey, there is little leverage that you have in increasing realization given a certain market. But what you can always work on is a product mix. So you can look at specialty, you can look at value-added products, et cetera, which are less volatile, and they give you little bit more resilience in the price, which we have seen in this difficult quarter as well, where both specialty side of both VSF as well as chlorine derivatives have actually given us a good realization.

Dilip, Kalyan, please feel free to jump in if you want to add anything at this point.

Kalyan Ram: Yes. So from Chemicals point of view, I think maybe there were a couple of questions before also. I think what I can say is we have a portfolio of caustic, which is extreme commodity, which has a cyclical aspect of it. And then you have chlorine, which is now more and more looking like not typically like India but rest of the world, and then we have chlorine derivatives. And then we have epoxy resins.

So if you see our over Chemicals part in -- over the last 10 years, across 10 years, we had the highs of 20% plus. We came somewhere in between (inaudible) to 15%, went back to 20%, 25-plus percent EBITDA percentage. And we do expect this year and next year will not be 20-plus percent back. But we will still be strong enough. But what has happened in the last 3, 4 years when it was going to 20-plus percent, 25-plus percent EBITDA, there are more players in the market, the smaller players in the market, and there is more availability there, more investment, announcements, et cetera. And we would, in a typical commodity cycle, see announcements when markets are good and reserve not pushing ahead when the markets are not good.

From where we have looked at over the next 5- to 10-year strategy that we have just completed, we actually used the COVID time to actually review that. And we are very clear, we will have 1 or 2 disruptions like this over the next 10 years of strategy. We will have the highs and lows. And we believe the next 3, 4 years, we will need to continue our investment momentum exactly same as before. And we do think we would like to maintain the leadership position.

Only thing we would like to handle is facing it so that we will catch at least the few months of growth in demand. But structurally, these investments are over 30 - 40 years. So if we can catch exactly that moment of demand going up, it will be great. And that's what we try and then pace. Otherwise, structurally, we are very clear. The returns are there. The CAGR that we expect are there. The demand and application expectations are very clear to us, too. So we're quite confident. I think it's about being prudent about when do you start these plants? How do you make sure your volumes come out? And then ensure you catch when the demand is going up rather than when it is down. I think that's the pacing activity we are doing.

I think even choices that we are making internally, I think it's very clear we have a strategic approach to where we want to be in each of these products. And you can't compare apples to pears. These are different businesses. Each place, we want to have a leadership position, and we are taking a very pragmatic view on who should be doing when for catching the right kind of demand momentum.

Yes. Dilip?

Dilip Gaur: All I would like to add for VSF side is, see, if you talk of second half of last year and what we are today, the prices haven't changed much. So I think that part is, as I was telling you earlier, it is rightly bottoming out. What we are talking about is the demand. And if by Q4, we do get back to the demand, what was earlier there, then you are there. Second, what is missing out is, the business has built up huge resilience in these 2 quarters, the last quarter and now. The cost benefit which we have built in now will come in and add on to what was historically there. We never saved the kind of fixed costs we have saved in this quarter. So even if we say carryforward 50%, 60% of this to next quarter, for the same volume and same pricing, your margins could be better. So that's how we make the businesses more resistant to cyclical fluctuations. And that's what we are doing from our side of it. Rest all, the market will decide. But we believe that we the business is getting more and more resilient as we go along through product mix and cost mix.

Sumangal Nevatia: Understand. And sir, with respect to the Chemical business, if you can share some intelligence as to where are we in terms of cost curve versus other players. And since we are making low single-digit margin, can we assume the other smaller players must be bleeding? And similar to our expansion plan, the overall industry will have a pause on the expansion and maybe naturally, the demand-supply dynamics will improve over maybe next 1-2 years. Is that a fair assumption?

Jayant Dua: I think that's a fair assumption that you have. On the cost curve, we are in the top quartile of the cost curve. Our scale is substantially different from the scale of (inaudible). In terms of further announcements coming, as Kalyan alluded to, I think you've already seen a pause there are quite a few projects which were announced, but which are not taking off. But I think it's too early to take that call. I think it's -- we're just coming out of Q1 of the first quarter, which it was impacted. I think as another 1 or 2 quarter goes through, the real situation will actually pan out then. And if the industry is back to its earlier levels, you might see, again the announcements coming back because then there is that demand, which is there to be caught up with.

Sumangal Nevatia: Understand. And if I can just squeeze in one last question to Dilip sir, so with respect to VSF, could you share what the capacity utilization, how the sequential movement is happening in China and the inventory levels. And I'm sorry if I missed this information earlier.

Dilip Gaur: As I told you China capacity utilization is about 64%, which is about 15% to 20% lower than what the historical was. That's a good sign. And we have stayed there for quite some time now. So a lot of the so-called low-cost and less-efficient players have either shaken out or have shut their operations. The inventory had gone to as high as 43-44 days is now at still high, about 34-35 days, but coming down.

So I think you never can predict what is happening in China. But I think I believe a new normal is emerging in VSF. And now the demand side will decide what happens. If this OR continues and if this inventory level is there, and now the textile demand picks up, then you will see the uptick. So now I think we have to watch how the China-U. S. relationship pan out, what happens to the demand for Chinese textiles, whether the footfalls in the China textile, which is improving. I think the July and August, August is better than what was July. So I think let's hope so. So we have -- we all are watching the demand part of it now in China. If the Chinese demand picks up, things should look up.

Operator: The next question is from the line of Nitin Shakdher from Green Capital Single Family Office.

Nitin Shakdher: My question pertains to the Capex for Viscose Staple Fiber. I think there is a fair amount of Capex, which you've outlined for the next 9 months. But the Capex for Q1 has been very low. How do you anticipate to do approximately Rs. 300 crores of Capex over the next 3 quarters on an average basis? If you could just highlight a bit of the Capex strategy.

Dilip Gaur: For the viscose project?

Nitin Shakdher: Yes.

Dilip Gaur See, viscose project what happened, we were already -- if COVID had not struck us, by now my first line would have got commissioned. So everything is there. Equipment are there. Building has been made. Civil foundries have been done. We just have to put people to erect them. We are in that final stage of the project where things go much faster than what has taken you so far. Because we paused the project because of the COVID crisis, I think we now have to regroup. Once the regrouping is done, I think August '21 is a very doable target. It should not be a problem at all. But there's nothing we're waiting outside. The equipment are with us. All the civil work has been over. Structures has been raised. Now issue is installation. And that also the bulk of the equipment's have been installed on one line. Now it's only the off sites and utilities and those kinds of things and getting back the labor, which we had -- there was a time when 8,000 guys working on my site. So we need to get those people back. So I think it's not a problem because it is not an issue of spending now. It's an issue of erecting and commissioning.

Nitin Shakdher: Okay. And my second question pertains to the sales volume mix. Do you anticipate the export sales to go higher or lower? And conversely we anticipate the domestic sales to go higher or lower over the next few quarters?

Dilip Gaur: As I told you, the export is not our priority volume. So I think as the quarters improve, as the demand in India improves, the export will come down and domestic volumes will go up. And these are overflow exports. Beg your pardon.

Nitin Shakdher: In Q1, your export sale for some reason was higher or did you increase the percentage of export sale?

Dilip Gaur: Yes. Because there was no demand in domestic market. But see, we are matching capacity with demand. So I have an x capacity which is fixed. If the Indian demand is matching that capacity, the x is equal to the local sales. Because the Indian demand went down because of lockdown and COVID, the global demand was still there. So there was no lockdown in Turkey. There was no lockdown in Indonesia. There was no lockdown in Pakistan. So to make sure that my capacity gets utilized, we started exporting. So it was more a tactical export than my long-term strategy.

My long-term strategy is to serve the Indian requirement. This Grasim has been set up to serve India's demand, and that's my first priority. And if the India demand is not there, then only I think of exporting it. So right now, we are doing more exports because Indian demand, as we shared with you, the textile markets are still opening up, it was only 30% - 36% end of the Q1. As we speak, it's about 60%. So one, when India demand comes to 90% - 95% of the old level, we'll go back to the historical export level. Historically, we used to export at 14% - 15% to 20% from Grasim and 80% was domestic. So we may go back to that ratio.

Operator: Ladies and gentlemen, due to time constraint, that was the last question. I now hand the conference over to Mr. Ashish Adukia for closing comments.

Ashish Adukia: Yes. So thanks a lot. There were many questions, so thanks for asking those questions. I think it has been a difficult quarter but we do -- altogether, the entire management feels that we've come out stronger from this quarter. We do hope that some of the cost measures, et cetera, that we are taking will make the company overall resilient and better shaped to grab the opportunity that comes both on the volume as well as the realization side in later quarters. So thanks, and wish you all, all the safety, et cetera. Thank you

Dilip Gaur: Thank you. Have a good day.

Kalyan Ram: Thank you. Good day. Stay safe.

Jayant Dua: Thank you. Okay. Bye.

Operator: Thank you. On behalf of Grasim Industries Limited, that concludes this conference. Thank you for joining us, and you may now disconnect your line.