Vardhman Textiles

Operator: Ladies and gentlemen, good day and welcome to the Vardhman Textiles Ltd. Q1 FY25 earnings conference call hosted by 361 Capital Market. As a reminder, all participant lines will be in listen-only mode, and there will be an opportunity to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal the operator by pressing star and then zero on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Aradhana Jain. Thank you, and over to you, ma'am.

Aradhana Jain – 361 Capital: Thank you, Sonya. Good evening, everyone. On behalf of 361 Capital, I welcome all participants and the management of Vardhman Textiles Ltd. to the Q1 FY25 conference call. From the management, we have Mr. Neeraj Jain, Managing Director; Mr. Sushil Jhamb, Director—Raw Materials; Mr. Rajiv Thapar, CFO; and Mr. Varun Malhotra, Head of Finance. Without further ado, I would like to hand over the call to Mr. Neeraj Jain for his opening remarks, after which we can open the floor for the Q&A session. Thank you, and over to you.

Management: Good afternoon, everyone. The results for Vardhman Textiles Ltd. are already out. There has been an improvement in the numbers, both in percentage terms and in absolute terms.

The major difference in the spinning business has been some improvement in yarn prices. There has also been a partial advantage from the raw material that was available earlier and from the increase in raw material prices that occurred as yarn prices were adjusted to the new raw material prices. Therefore, there has been a kind of partial trading gain in raw materials as well.

On the fabric side, the improvement has not been to the extent that it should have been for 2 reasons. First, during last year, because of the US tariff, there was an issue: we missed the sampling for a particular season, and as a result, during that period, all the US orders did not come to India. However, for the last month or so, things have started improving, and we are expecting much better business from US customers over the next 2-3 months as well. Therefore, hopefully, utilization in the fabric business will start improving.

In terms of absolute numbers, on the fabric side, we are almost comparable to what we did in the first quarter last year. We are a little lower than the fourth quarter of this year, but we are hoping that this will start improving. In terms of percentage utilization, it was lower because we also added a new line in March, which could not be fully utilized.

On the spinning side, utilization has been full, margins have been good, and overall demand is also good. This demand was initially driven by China.

Our expectation on the various fronts, including raw materials and yarn prices, is as follows. First, raw material prices have stabilized in the international market in the range of about 78-81 US cents per pound. If you take the average, it has been about 80 cents most of the time. This was primarily almost comparable to what it was when we made the last call, except for a few days when the July New York future was much higher, whereas the December and subsequent months were inverse. This was a clear signal that the July New York future might not be sustainable. As of now, there is no inverse situation in any of the months, so there could be a possibility that these levels could be sustained.

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Second, if we look at raw material availability across the globe, particularly in India, the rainfall pattern has been very different. First, it is an El Niño situation, so there could be a reduction in overall rainfall. Also, the variation across areas has been significant. The rains started a little later, and although they have picked up on an overall average basis, the situation has still been different from one area to another.

As of now, cotton sowing is almost comparable to the previous period, with a gap of only 1-2% according to our estimate. However, we are yet to understand and assess what kind of growth and crop quality there will be, since rainfall scenarios have been very different across various areas. Generally, whenever we see these kinds of variations, there are quality concerns, and crop size also comes down because of the quality. However, it is very early to say anything at this stage, and we have to monitor the situation for the next 2-4 weeks to get a better estimate and understanding of how Indian cotton develops.

In Brazil, there has been a reduction in area of about 5%, so there could be a corresponding reduction in the crop there. In Australia, there has been a major drop in crop size. Last year's figures were much higher; this year, we are expecting it to be about {? 3.5 million bales ?}, and based on the water situation, next year could be even lower, at around {? 2.5 million bales ?}.

The next major cotton-growing area is the USA. In West Texas, drought conditions are still being reported, which means that the crop there could also be affected. China has announced a planned reduction in its cotton-growing areas because it wants to focus more on food products.

Therefore, if we look at all the areas, there is hardly any area that appears likely to increase its cotton production. As of now, there are indications that production could decline. Based on this, our view is that cotton prices may not decline significantly and may instead increase, as consumption across the border is increasing. That is our view regarding cotton sowing area, cotton growth, and production possibilities.

Second, this has been a period of considerable uncertainty because of the Russia-Ukraine war. We saw crude prices touch $100. Of course, they have now come down to about $87-$88. As crude prices increased, all intermediate products became more expensive, which also led to an increase in polyester prices and, especially, acrylic prices. As a result, those prices are much higher than they were before the war. This has also caused some increase in raw material prices across fibers, in sympathy with those fibers.

To that extent, if acrylic and polyester prices continue to increase in this manner, there could be some possibility of an increase in cotton demand in various parts of the world. Considering these factors, our view is that prices may not decline significantly. Of course, the future will tell whether our thoughts are right or wrong.

That is our current view, based simply on the demand-supply situation, where supply is expected to decline and demand is expected to increase. As I mentioned in the last call, it appears that after 3 years, this will be a year in which production could be lower than consumption. This scenario may continue for the next 2-3 years, during which we could see a 2-3% annual decline in the cotton crop and perhaps 2-3% annual growth in cotton consumption. This would mean a gap of 3-4% for the next 1-2 years, which should be sufficient to support reasonably good cotton prices.

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Coming to Indian cotton, the New York future increased from almost 67-68 US cents to about 80 cents at present. Of course, during most of this quarter, it was in the range of about 75, 76, and 78 US cents per pound. Indian cotton, which was trading at about Rs.55,000 per candy, has also increased, with the CCI price today close to about Rs.64,000. Therefore, there has been a corresponding increase. Whatever increase has occurred in the New York future, along with the change in the dollar-rupee exchange rate, has also been reflected in Indian prices.

In US cents, Indian cotton prices today are close to about 87-88 US cents. If you look at the {? Cotlook ?}, which is about 91-92 cents, there is practically an alignment today between international prices and Indian prices. This was a significant disadvantage during the last 2 years. Therefore, over the last 3-5 months, the situation has improved to that extent.

Another change or event taking place on the cotton side is that the Chinese government has started selling reserve cotton. It is issuing a quota of about 8,000 tons per day—8,000 tons per day. They have sold close to, I think, about 10 sessions so far, and they have been able to sell 100% of the cotton allocated under the quota. The average price of the cotton sold in China so far is close to about 115-116 US cents. Even after reducing the VAT from that, it would still be more than $1.

This means that prices in China are much higher than prices elsewhere. If Chinese spinners are obtaining cotton at more than $1, the margin available to them at today's yarn prices will not be more than 65-70 US cents per kilogram of yarn. This also gives us the feeling that they will continue to buy yarn from outside China, whether from India, Vietnam, or any other country.

In our day-to-day experience since November-December last year, we have found that Chinese demand has continued to be good. Based on these cotton prices, we feel that this demand may continue. Total yarn exports from India, which used to be about 95-97 million kilograms, or less than 100 million kilograms, have increased to about 110 million kilograms at present. This is a net increase of about 15 million kilograms, which primarily comes from China. I think this can continue if Chinese cotton prices remain within this range.

In case India continues to export 105-110 million kilograms, it is important to note that capacity closures in India were also significant during the last 3 years because of the losses suffered by all the spinning mills. Our industry estimate was that almost 12-13 million spindles were closed permanently. We still feel that this figure is unchanged, as hardly any capacity has been revived during this period.

Considering the overall situation, not many projects have been announced even now on the spinning side. Last year, I think, additional or new capacity of only about half a million spindles was added. This year also, if we look at the projects announced so far, it will not be more than 700,000-800,000 spindles on the expansion side.

Of course, there has been a slight improvement in machinery orders from all machinery manufacturers, but that is primarily on account of modernization projects announced by some of the mills.

That is the position on the spinning side, both in terms of cotton and yarn sales. The current ruling prices in the international market for {? 30s combed ?} yarn are close to about $3.20-$3.30. Indian

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prices are also aligned on an ex-mill basis in India, at almost the same prices, plus or minus Rs.2-Rs.3, which is the normal gap we always see.

On the fabric side, we had 2 issues. First, as I mentioned, because of the US tariff, we skipped a particular season for sampling, and as a result, those orders did not come to India. Second, there is always a lag on the fabric side in passing on yarn prices to customers.

Whenever yarn prices decline, it is an advantage to the fabric division, and vice versa. This was a period in which yarn prices increased sharply, and it always takes some time for us to pass on those prices. Even today, we feel that about 60-70% of the increase in yarn prices has been passed on to consumers, while 20-30% has not yet been passed on.

However, with an increase in volume, hopefully those numbers will also improve, costs will continue to decline, and margins could probably be restored. As I mentioned, we are comparable to the first-quarter numbers of last year, but about 3-4% lower than the fourth quarter. Based on the situation in the current quarter, it appears that we are definitely better than in the first quarter.

Management: In terms of capex, most of the capex is on schedule. We started one biomass boiler in Baddi last week. Another one in Madhya Pradesh is expected to start in about a month. Most of the modernization projects have been completed.

We have also started work on the open-end project, with a capacity of about 55-60 tons per day. Construction started only last week, and I expect that this capacity will also be available in about 10 months.

At the new site in Dhar, the government is still developing the land. Based on the physical progress on the land, I expect it to be available to us by December. Once it is available, we are in the process of completing our plans regarding what we intend to do and when we want to start construction.

Hopefully, by the time the land is handed over to us, we will be ready to start at least the first construction phase, perhaps with the spinning project. Later, we could add whatever other products we want to add there.

In terms of committed expenditure, most of it is on schedule. Hopefully, with all these boilers coming up and the biomass facilities becoming operational, there will be cost-reduction benefits. We have also invested significantly in solar power and wind power. The benefits from those investments will also start coming in partially.

I think that month after month, over the next 6 months, more and more benefits will start coming in. Those are my initial comments on the performance and our view of the industry. We can discuss the remaining matters during the question-and-answer session.

Operator: Thank you very much. We will now begin the question-and-answer session. Anyone who wishes to ask a question may press star and one on their touchtone telephone. If you wish to remove yourself from the question queue, you may press star and two. Participants are requested to use handsets while asking questions. Ladies and gentlemen, we will wait for a moment while the question queue assembles. The first question is from the line of Prerna Jhunjhunwala from Elara Capital. Please go ahead.

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Prerna Jhunjhunwala – Elara Capital: Thank you for the opportunity, and congratulations on a good set of numbers. It is good to see a recovery after a long time. I wanted to understand the current order-book situation in the spinning segment.

Management: Normally, in the export market, we are always sold for about 3 months. In the domestic market, by design, we will never be sold for more than 45 days. If we look at the history of the last 5 years, the average would be 90-95 days in exports and 45-50 days in the domestic market. Even today, we are sold for those many days.

Prerna Jhunjhunwala – Elara Capital: So, does that mean that the bulk of the improvement in prices that occurred in April and May should be visible in Q2? Is that the right way to look at it?

Management: Yes, that is correct.

Prerna Jhunjhunwala – Elara Capital: Understood. My second question is about the fabric business. I wanted to understand the progress in the new synthetic fabric business and your experience with it. Would you be looking at expanding it further? What product segments are you looking at, and what kind of margin profile are you expecting in that segment?

Management: Our first objective is to utilize that capacity. Sampling is taking place for various customers because these are all products that are new to us. We are also learning, and we need to conduct sampling to give customers confidence because these products would mostly replace imported fabrics.

The project started sometime in February-March, and as of now, we have a capacity of 15 lakh meters per month. Our utilization is only about 15-20% at present.

However, I am happy to share that in the last month, we received 2 major approvals from 2 major brands, and production is starting this month itself, within August. Our objective is to reach at least 70-80% capacity utilization within the next 6 months, compared with 20% at present.

This business has 2 aspects. One is the basic product, and the second is the value-added product, which can partly be considered technical textiles. At present, we are starting only with the basic products. Once we are in a position to utilize that capacity, I am sure value addition will also start happening.

The initial parameters, in terms of quality and acceptability, are very good, and I am happy to share that. Once we make a success of this business, we will definitely look at expanding it as we approach capacity utilization, because I believe India has a significant capacity shortage for this product.

Prerna Jhunjhunwala – Elara Capital: Understood. Based on your current experience, what do you think about the margins and ROCE here? Do you think the margins or ROCE will be much better than in your existing fabric business, or will they be equivalent?

Management: Prerna, it is too early to say because utilization is only 15-20%. This is all about what kinds of products we can replace from the external market. As fashion cycles are becoming shorter, everyone wants immediate delivery.

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I am sure that anything produced in India for the Indian market would enable us to obtain some premium compared with the external market. Therefore, based on the per-meter cost of this product, my belief is that the margin as a percentage of sales, as well as the return as a percentage of capital employed, could be better compared with the existing product line.

That is my feeling at present, but there is still a long way to go. Perhaps over the next 6 months, we will have greater certainty on this.

Prerna Jhunjhunwala – Elara Capital: That is fantastic to hear because we were wondering what was happening in that business and how we were evaluating it. This appears to be a good opportunity.

My last question is about the cotton outlook that you discussed. Do you see an opportunity to import cotton at current prices, or would you still wait for the new season to arrive? We currently have duty-free cotton imports.

Management: We are evaluating this on a daily basis because there are 2 factors we have to consider. First, what is the likely price in India even in the next season once it arrives? The government has already announced a 6-7% increase in the MSP.

If I go by the MSP and procurement by the CCI, it practically appears that cotton will not be available below {? 65,000-66,000 rupees ?} even in the next season. Therefore, if one gets an opportunity to buy imported cotton at a cost within this level while the duty is zero, we are definitely evaluating it, and wherever there is a possibility, we are taking those decisions.

We are not waiting only for Indian cotton, because in any case, we have to buy Indian cotton. However, since this window is available only for the next 2-3 months, we are certainly evaluating whatever can be done, including importing at these prices.

Prerna Jhunjhunwala – Elara Capital: Understood. Thank you. I will come back if I have any further questions.

Operator: Thank you. The next question is from the line of Avnish Chandra from SMIFS. Please go ahead.

Avnish Chandra – SMIFS: Congratulations to the management team on a stellar set of numbers. My first question is on margins. We delivered a very strong margin this quarter, and it appears that Q2 could be better since we must have some more cotton inventory at a lower cost. After Q2, will this kind of strong margin continue, or will it moderate?

Management: It will definitely moderate, so there is no doubt about that. However, my belief is that it may not come down to the levels that existed before this increase began.

The industry was going through a very difficult period during the last 2 years. Spinning margins had come down to as low as 9-10%, and the available margin, or conversion, was only about 65-70 US cents. Given that demand continues to be strong and the Chinese demand and overall demand-supply situation remain favorable, it could be in the range of about 85-90 US cents.

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Those who have inventory at lower prices will continue to have that advantage. As those inventories are consumed, there will definitely be some reduction, but margins may not come down to the levels seen during the last 2-3 years. That is what I feel at present.

Avnish Chandra - SMIFS: Could there be moderation of 100-150 basis points or more?

Management: I cannot comment on the specific number, but I can definitely say that it will depend on the inventory position and on how yarn prices move. There are many uncertain factors that we have to incorporate.

I can only say that these are {? high-grade ?} margins, which may not be available once we move to market prices for cotton, unless yarn prices increase further.

Avnish Chandra - SMIFS: Understood. What is our current inventory level on the cotton side?

Management: Sorry?

Avnish Chandra - SMIFS: Our current cotton inventory level—sorry, that is something you do not share. Moving on to the technical textile side, is the technical textile capacity we have integrated with our grey fabric capacity, or is it an entirely different line from spinning?

Management: Our existing lines are primarily based on starting with yarn, producing spinning yarn, and then producing fabric from it. These are all filament-based products, so this is an entirely different product.

Avnish Chandra - SMIFS: So, from start to finish, it is not connected in any way with the cotton line?

Management: No, it is not linked. However, the customers could be common if they want 100% synthetic materials. These are all 100% synthetic materials. Therefore, the only commonality, in my view, could be the customers.

Avnish Chandra - SMIFS: My last question is on the new capacity. We are undergoing significant capex, and a few things are still pending. Now that margins are improving, do we plan to invest in additional capacity that could lead to top-line growth? The capex we are currently undertaking is for modernization or power, which will not contribute significantly to top-line growth. Are we considering that now that margins are better?

Management: On the top line, you are right. Top-line growth will essentially come from the unutilized capacity we have on the fabric side, both cotton fabric and synthetic fabric. That is one area where expansion can happen.

The new capex for the open-end project, which will increase our production by about 50-55 tons, will also provide some addition. However, as I mentioned earlier, we have acquired a new piece of land under the PM MITRA Park project. Over the next 3-5 years, we have several projects in mind, and depending on how the business develops, there is an intention to establish capacities at that project. This will also provide top-line growth to the company for at least the next 3-5 years.

Avnish Chandra - SMIFS: Thank you very much for answering my questions. I will come back in the queue.

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Operator: Thank you. The next question is from the line of Roshan from Antique Stock Broking. Please go ahead.

Roshan – Antique Stock Broking: Thank you for the opportunity, and congratulations on a good set of numbers. I wanted to understand how you are seeing demand trends across the domestic and export markets today. Could you highlight which geographies are seeing the strongest recovery? That is my first question.

Management: In terms of garmenting and exports, there appears to be decent demand. It is not that we are finding it difficult to sell the product.

India has a significant natural advantage, which has been created with the support of the Government of India through the FTAs with the UK and the EU. I am sure that garment manufacturers and home-textile companies can do a significant amount of business in these countries.

Since we supply textile materials to different garment producers and home-textile producers, our belief is that over the next 2 years, there is a genuine opportunity for India and Indian manufacturers to export to these countries.

Demand is already good. With these 2 markets becoming available to us, I am sure this will be a much bigger opportunity for the Indian market. To that extent, I think all manufacturers, starting from spinning through home textiles and garmenting, will benefit and should benefit.

This is in addition to the strong domestic market, which is also improving as per-capita income increases every year.

Roshan – Antique Stock Broking: To continue with the update that was given, are you seeing any changes in customer ordering patterns?

Management: A couple of things have been happening very clearly over the last 2-4 years, and these trends are actually increasing.

First, the fashion cycle is becoming shorter. Everyone wants to maintain minimum inventory so that their working-capital requirements are reduced and the risk of obsolescence is also reduced. Any customer dealing with us wants yarn delivered in, say, 20 days; fabric delivered in about 40-45 days; and garments delivered within 60-70 days. Therefore, that cycle will continue to shorten, and whoever is in a position to deliver will be a winner. That is the first factor.

Second, the market is moving much more significantly toward new products. Innovation and new-product development, including colors and variations in products, are definitely being appreciated by customers. It is not that 100% of products will come from these new products, but even if 5%, 7%, or 10% comes from them, 80-90% will continue to come from the existing product range. Therefore, the capability to develop these products will provide an initial advantage and enable that business to move forward.

Third, recycling is still in fashion, especially in the sports market. Some customers, particularly European customers, are more interested in buying recycled yarn or fabric made from recycled

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materials.

Fourth, customers are looking for environmentally responsible companies. Whether it is power or the use of coal as a fossil fuel, nobody wants fossil-fuel use to continue at the same level. This may not provide a direct advantage, but it is a positive feature to have. Customers definitely appreciate it and are more willing to work with a company that is in a position to provide it.

Fifth, compliance and ESG are important. All social compliance requirements and fair practices with all stakeholders are very important.

Now, customers want all these things in addition to the product, and they will not be in a position to work with 10, 20, or 30 vendors. They want everything to be handled by the vendor. Therefore, any vendor that has the capacity and the strength to meet the customer's requirements and deliver all these things will have a clear advantage.

I am finding that this is why organized players have an advantage. When these brands come in and want all these kinds of facilities, their first preference goes to the organized sector.

At times, we feel that size is a disadvantage, but I think this is a time when size is becoming an advantage. Customers want all kinds of products, they want all requirements to be managed by the vendor, and they want everything delivered within a minimum number of days.

These are the changes that we have been seeing over the last 3-4 years, and they are increasing every year, both as an improvement and as an increasing requirement every year.

Roshan – Antique Stock Broking: That is very helpful. My final question is regarding the doubling of garment capacity from 2.2 million to 4.5 million. Could you elaborate on how things are progressing in terms of customer tie-ups, along with some quantitative details such as expected asset turns or margins?

Management: Our existing capacity is only about 7,000 shirts per day, which is too small. The business is doing well. Since we do not sell the product under our own brand, we supply it to customers under their own brands. A capacity of 7,000 shirts is really insignificant from the perspective of any customer.

We get 2 advantages from our fabric and garmenting businesses. First, we are in a position to receive product development support from the customer side, which helps us in both the fabric and spinning businesses.

Second, there are certain issues that can be addressed in this business. Our view was that the cost structure we have for only 7,000 shirts is not viable, and 7,000 shirts is too small a capacity to serve any customer. Therefore, the first step was to increase the capacity at least twofold and make it a viable unit.

Our costs are currently much higher, and consequently, margins are much lower. Once we double this capacity, the value and overhead costs will increase, and I am sure we can then evaluate the margins in this business on a standalone basis. This will allow us to take a future decision on whether we really want to expand significantly in this business.

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Roshan – Antique Stock Broking: Thank you for the detailed answer. I will join the queue.

Operator: Thank you. The next question is from the line of Shirish Pardeshi from Motilal Oswal. Please go ahead.

Shirish Pardeshi – Motilal Oswal: Sahiba, good evening. Thank you for the opportunity, and congratulations. With reference to the previous participant's question, with a capacity of 4.5 million, what would be the peak revenue at 100% utilization?

Management: {? 300 to about 350 crores ?} would be the total revenue for the fabric and garment business.

Shirish Pardeshi – Motilal Oswal: Will this be fully operational by the end of March 2027, or will it be in Q1 FY28?

Management: Q1, no—March-June 2027. Generally, it takes 7-8 months, but I feel that because a lot of workers need to be trained, it could take 1 year from today before we obtain the full benefit of actual utilization.

Shirish Pardeshi – Motilal Oswal: Are the current customers primarily domestic, or do you also have international customers?

Management: It is a mixture. About 30% is exports, and 70% would be domestic brands.

Shirish Pardeshi – Motilal Oswal: That helps. When I look at our product segment, yarn is 69%. I was curious about the extent of China exports within this.

Management: From the Indian market, if India is exporting about 105-108 million kilograms per month, China is typically buying about 30%. In general, it would be about {? 20-25% ?} to China, of whatever yarn India exports.

The yarn business has 3 segments: exports, domestic sales, and captive consumption. All 3 segments are practically one-third each of the yarn we produce. Therefore, one-third, or 33%, of 20% means that about 7-8% of our total production goes to China.

Shirish Pardeshi – Motilal Oswal: The reason I ask is that if China is going to continue buying, I am sure that over the next 6 months you will have clear visibility on your yarn requirement from China. Will this cycle of growth that you have envisaged in Q1 continue for at least the next 2-3 quarters?

Management: In terms of yarn demand and prices, it can continue, hopefully. The only difference in margins will depend on when our old cotton inventory is exhausted and when the new cotton starts being consumed. That is the gap that could emerge.

Other than that, in terms of top-line or sales growth, visibility appears to be available for at least the next 3-4 months.

Shirish Pardeshi – Motilal Oswal: When you say one-third is China, which are the other 2 countries that have shown this kind of resilience?

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Management: China and Bangladesh are practically taking 60% of the yarn exported from India.

Shirish Pardeshi – Motilal Oswal: My last question is about the 3,600-crore capex that we are planning. What will be undertaken, and which segments will receive the investment in FY27 and which will be carried forward to FY28?

Management: Of this capex, only about 800-900 crores will go into the next year. The rest will either be completed, already completed, or completed within this year.

The majority has been allocated to modernization and power, and all the power projects will be completed within the next 3 months. Most of the modernization has been completed. There is one open-end project and some additional modernization that may carry forward to the first quarter of next year. Other than that, everything will be completed within this financial year.

Shirish Pardeshi – Motilal Oswal: What will be the total capex for Dhar, from land to building and machinery?

Management: For which financial year?

Shirish Pardeshi – Motilal Oswal: FY27.

Management: Are we talking about Dhar?

Shirish Pardeshi – Motilal Oswal: Yes, the entire Dhar project at PM MITRA Park—the project that you are planning.

Management: Whatever capex has been announced does not include any expenditure on Dhar as of now.

Shirish Pardeshi – Motilal Oswal: So the Dhar project is still under consideration?

Management: It is still under consideration. We are waiting for the land to become available to us because the government has to provide power, and it expects power to be available no earlier than June 2027.

We do not want to rush because this could be delayed further. We will start construction only once we are very clear on the situation, because construction and project implementation will take about 10-12 months.

We will start only once we have greater visibility that the government will be in a position to provide power within this timeframe.

Shirish Pardeshi – Motilal Oswal: Understood. My last question is on margins. We have discussed this extensively, but where do you think margins will be resilient? You would obviously have some cover for cotton prices, but I am asking not about the period up to December, but about the period after December. Cotton sowing is currently lower, and we are not sure what will happen because of the El Niño effect.

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In that context, do you think margins may not deteriorate to the 11% level that we have seen in the past, or could they be in the range of about 13–13.5%? I am not asking for guidance, but for the direction.

Management: As I mentioned earlier, margins had come down to 10–11%, which was really a desperate situation. However, my belief is that 13–14% could be the right way of looking at it. This could translate into margins available per kilogram of yarn and provide a conversion of about 80, 85, or 90 cents.

Shirish Pardeshi – Motilal Oswal: Understood. That was very helpful. Thank you.

Operator: Thank you. The next question is from the line of Phalguni Dutta from Mansarover Financials. Please go ahead.

Phalguni Dutta – Mansarover Financials: What were the cotton-yarn spreads for us in Q1?

Management: For me, the cotton-yarn spread is normally calculated using the market prices of cotton and yarn. During this period, it was in the range of about 90 US cents per kilogram of yarn.

Phalguni Dutta – Mansarover Financials: So, if we compare spot cotton and spot yarn, the spread was 90 US cents per kilogram?

Management: Correct. Per kilogram.

Phalguni Dutta – Mansarover Financials: Do you broadly think it should remain in the range of 85–90 cents per kilogram going forward?

Management: Historically, it has been in the range of about 85 cents to about $1, except during the last 2–3 years, when it came down to 60, 65, or 70 cents in the Indian market.

Phalguni Dutta – Mansarover Financials: Thank you. That is all from my side.

Operator: Thank you. Before we take the next question, we would like to remind participants that they may press star and one to ask a question. Reminder to all participants: please press star and one to ask a question. The next question is from the line of Anil Kumar Sharma, an individual investor. Please go ahead.

Anil Kumar Sharma: Congratulations on the good set of numbers. My first question is: where do you see our company over the next 5 years?

Second, our return on capital employed and return on equity are on the lower side. I know that you do not provide guidance, but how can return on capital employed and return on equity be increased, and where do you see our company over the next 5 years?

Management: As I mentioned, over the next 5 years, we are hopeful that opportunities will arise in India because of the FTAs and increasing Indian consumption. There could be a possibility that we look at some of the larger projects in Dhar, as the government is also promising significant growth in these kinds of areas.

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I do not have an exact answer because we have many ideas in mind that I hope to implement over the next 2-3 years. However, this could definitely be positive in terms of overall top-line growth.

ROCE basically has 2 factors. The first is the return on capital employed by the business. The second is that we have significant investments available to us, which were retained as a possibility for future expansion, and that money is available with the company.

If I look at the return on the business side, it is still reasonably good. Whenever the right opportunity arises and the company invests on a larger scale, as we intend to do at the right time, the treasury investments will decline. That is the only way in which return on capital employed will improve.

Anil Kumar Sharma: Can we expect it to improve to a reasonable level over the next 2-3 years?

Management: I am not saying 2-3 years, but definitely 5 years is a period in which, based on my personal belief, it could improve.

Anil Kumar Sharma: Thank you, and congratulations on the good set of numbers.

Operator: Thank you. The next question is from the line of Prerna Jhunjhunwala from Elara Capital. Please go ahead.

Prerna Jhunjhunwala – Elara Capital: I wanted to understand why China was not buying from India for a long time but has recently started buying. What could be the reason? Are they focusing to a greater extent on cotton yarn and cotton businesses?

Management: I think they are still very strong on the garmenting side. The expectation that companies would adopt a China Plus One strategy or that China would be removed from the supply chain is not correct. Given the kind of capacities they have, I think they will continue to dominate.

My thought process is as follows. First, the Chinese government has announced that it wants to reduce cotton-spinning areas that may become increasingly dependent on imported cotton in the future.

Second, costs are also increasing in China, especially in southern China, where there was originally significant industrialization. Of course, they are trying to develop the Xinjiang area, where a significant amount of capacity has already been shut down or costs have increased substantially. Therefore, they may have to consider how to replace that capacity or reduce capacity.

If cotton prices are above $1 in China while cotton prices in the rest of the world are in the range of about 89-90 cents, a 10-12% increase represents a significant cost for them.

Rather than focusing on basic yarn production, they may prefer to import yarn because they are very strong in garmenting and fabric finishing. Part of their strategy could be to import yarn so that the first stage of production is completed, convert it into finished fabric, and also reduce the risk associated with Xinjiang cotton, which is banned by many countries, especially the USA.

Whenever they buy local yarn, there is always a challenge and concern about whether it has been made from Xinjiang cotton. When the yarn comes from India or Vietnam, at least that risk is eliminated for them.

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I think this could be what they are genuinely considering, rather than taking a risk when the final garment shipments take place and testing reveals that something occurred at the local level. They may prefer to buy the yarn and then export the garments.

Prerna Jhunjhunwala – Elara Capital: In your opinion, is this sustainable going forward as well, meaning Chinese sourcing from India?

Management: It appears so. It appears so.

Prerna Jhunjhunwala – Elara Capital: Is spindle capacity being added anywhere in the world, or is India the only country adding spindles?

Management: That is a very interesting question. In China, some spinning capacity is being added in the Xinjiang area, but capacity is being shut down elsewhere. On a net basis, there is hardly any increase in China. From a peak of about 116–117 million spindles, they are down to about 84–85 million at present.

In Indonesia, capacity has declined and they are not adding capacity. In Vietnam, the market is almost saturated and they are not adding capacity. Turkey is in a very difficult condition, and it will slowly have to reduce capacity. Bangladesh is not adding anything.

Therefore, the only countries where a small increase may occur at present are Egypt and India. If people talk about developing Africa in the future, that remains to be seen. As of now, I do not think any existing spinning cluster is increasing capacity other than India and Egypt.

Prerna Jhunjhunwala – Elara Capital: In your opinion, is that positive for margins over the long term, or once margins begin to improve, will there be an increase in capacity? What is your view on the long-term profitability of the spinning business?

Management: It should be positive. My only concern has always been the availability of cotton at the right prices.

The government has now allowed imports for 4 months, but we are still requesting the government to provide greater visibility on a sustainable basis. If we look at the last 15–20 years, including the last 2–3 years, spinning margins have declined not because of the demand side, but only because our raw material cost was much higher than in the rest of the world.

If our raw material prices are aligned with the world market, I do not think there would be a significant competitive issue for India.

Prerna Jhunjhunwala – Elara Capital: Understood. Thank you, and all the best.

Operator: Thank you. The next question is from the line of Munish Godke from HDFC Mutual Fund. Please go ahead.

Munish Godke – HDFC Mutual Fund: Thank you for the opportunity. I have one question. What kind of opportunity do you see in recycled cotton yarn? With cotton prices remaining firm, I believe a significant amount of cotton will not be recycled. From a technology perspective, is it feasible in the medium term, and is it feasible on a larger scale in terms of ROCE and pricing?

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Management: If you look at the model, it has nothing to do with ROCE or with the availability of cotton. This idea essentially started in Europe, where the objective was to reduce the consumption of material and the dumping of material in order to protect the Earth. That is the motivation behind it.

In terms of cost parameters, return on capital employed, availability of fiber, and fiber spinning, there has been a dramatic improvement over the last 2–3 years. Today, it is possible to use up to 30–40% recycled fiber with virgin fiber in ring spinning. This is being done regularly.

In any case, through open-end spinning, it is possible to use an even higher proportion. Therefore, the issue is not return on capital employed. The idea was to reduce the landfilling of garments generated by garmenting. That was the original objective.

My belief is that this trend may continue for a few years until we also reach saturation in this area.

Munish Godke – HDFC Mutual Fund: From a technology perspective?

Management: From a technology perspective, it is viable. Mechanical recycling is already available. People are now also discussing chemical recycling, and a great deal of experimentation is taking place.

As far as cotton is concerned, mechanical recycling is reasonably good, and sufficient capacity is already available in the system.

Munish Godke – HDFC Mutual Fund: Thank you.

Operator: Participants who wish to ask a question, please press star and one. Reminder to all participants: please press star and one to ask a question. As there are no further questions from the participants, I now hand the conference over to the management for closing comments. Thank you, and over to you.

Management: Thank you to the entire investing community that has been with us for so many years. Whatever the results may be, we try to give our opinion as honestly as we can.

Of course, there could be differences of opinion, or things could develop differently, because this is a dynamic world. However, based on the current situation, it appears that conditions have improved in India for most textile players.

With all these FTAs and the opportunities available for the future, we definitely see much better times ahead. As I mentioned, the trading environment may not remain as favorable, but based on the overall opportunities, we feel that this could be the right time for India to demonstrate over the next couple of years that growth can take place in this industry.

Thank you very much.

Operator: On behalf of 361 Capital Market, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.

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Vardhman Textiles

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