"Grasim Industries Limited Q2 FY 2020 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY 2020 Earnings Conference Call of Grasim Industries Limited.

We have with us today from the management Mr. Dilip Gaur – Managing Director; Mr. Kalyan Ram – Business Head for CFI; Mr. Ashish Adukia – CFO and other senior management team.

As a reminder, all participant lines will be in listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded.

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

Ashish Adukia: Before I get into the presentation, I would like welcome Kalyan Ram and Jayant Dua. Kalyan is Business Head for the chemical, fertiliser and insulator business. Jayant Dua has joined as Chemicals CEO in place of Raj Narayanan who has now joined our subsidiary UltraTech. He has been with the Group for many years handling various leadership roles. I request Dilip, Kalyan and Jayant to take up your questions on their respective sectors.

On a Consolidated basis, Grasim EBITDA grew by 7% YoY due to volume albeit a slow quarter given monsoon. The standalone results were muted as the quarter witnessed declining realisation in most of our businesses. This is primarily the result of global capacity overhang, demand slowdown and continuing US-China trade war, which we had all highlighted in the previous quarter as well.

However, in the long run, we strongly believe that it is cyclical and we are well positioned to capture the upcycle with our planned capacity expansion.

Grasim balance sheet continues to be strong. As you will notice on page 8, despite comparatively muted earnings, continuing capex plan and one-time dividend payment, we have been able to maintain our net debt position at 0.5x to EBITDA.

In pages 9 and 10, our capex plan has remained largely unchanged and we are closely monitoring the same given these are critical capacity enhancing capex. Other than capacity enhancing capex, we have maintenance and modernisation capex. It constitutes number of items including environment related capex such as Zero Liquid Discharge, carbon activated plant to reduce emissions, organic fertiliser plant to utilise phosphate, small debottlenecking opportunities etc. Our focus on sustainability in all our businesses is one of the pillar to add longevity and reduce regulatory cost over longer term

On page 11, we welcome the reduction in tax rates by the Govt. but we will take until the end of the year to take a decision on the preference of the beneficial regime. The difference in the old and new rate is 9.77% which should justify giving up the incentives that we have. We enjoy three kind of incentives: 1st Weighted deduction on R&D 2nd Accelerated additional depreciation of 20% and 3rd 80IA benefits

These incentives are significant enough to continue in the old regime. However, there are many factors such as profit for the year, one-off incomes/expenses for the balance year which will eventually help us determine tax regime to follow.

On page 13 of Investor Presentation, in case of Viscose, there has been some correction in the domestic realisation based on declining global prices. We have been able to maintain premium over landed cost through better customer service, brand and marketing, product innovation, and differentiating ourselves through more sustainable products. The domestic VSF demand also got impacted by rise in the yarn imports. On the cost side, we got some benefit of pulp prices partially mitigated by rupee depreciation however we are likely to get more visible benefits over next two quarters due to carrying cost of current inventory.

On page 17, in case of chemicals, we have now added the new chart clearly stating the ECU realisation. As you can notice that there has been a sharp decline in the global prices over last few quarters. In line with global prices, our ECU realisation has also corrected due to demand slowdown and excess supply. Chlorine continues to yield negative realisation given new capacity additions domestically. Moving to page 19, we have been able to reduce the power cost through change in source mix and we are focused on increasing share of renewable power which also is a cheaper source.

In our insulator business, recently we executed a JV agreement with MR from Germany to manufacture Composite Hollow Core Insulator. MR is one of the world leaders in this segment. The project cost is around Rs. 100 cr. and it will be met through mix of debt and equity. Equity will be shared in the ratio of 51% and 49%.

This year we participated in Dow Jones Sustainability Index and obtained a score well above the global industry average. The details on areas where we scored high are mentioned on page 22.

Our endeavour will be to better our score with the objective to improve business resilience through sustainability.

Back to business front, over long run, we are focused on what we believe has helped us in the past. We will continue to add downstream products either directly or through partnerships. We will continue to evaluate avenues to reduce costs through backward integration and other sources.

Over short term, until the US China trade war is resolved and industry balance is restored, we cannot be sure of reversal of downward trend of realisation.

I would now like to open up for questions. We would endeavour to answer all your questions and to the extent we cannot we will revert to you subsequent to the call.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin with the question-and-answer session. We have our question from the line of Gunjan Prithyani from JPMorgan. Please go ahead.

Gunjan Prithyani: I have three questions. Firstly, on the VSF business, if I look at the realizations, your realization adjusted for VFY have come down by about 7%. And similar has been the kind of decline that we have seen in the Grey VSF. So now the VSF is also seeing a steep hit pricing pressure. And in terms of your mix, also, I noticed that it is less of Specialty fibre in this quarter, from 35% if I recall correctly, it has come down to about 20%. Any specific reason for that?

Dilip Gaur: Gunjan, your observations is perfect. But the good news is that it has held on. So the delta between specialty and grey has in fact stayed on, in fact has gone up. There was a peculiar case because the domestic demand was been unusually good. If you look at the domestic market, it has gone up by almost 16% - 17% demand for VSF. And we are falling short on the VSF Grey capacity for the domestic market. So as a result of that, we have temporarily shifted one of the lines to the viscose at Vilayat. And that is where we were seeing the specialty has come down to 20%, it should going forward come back to the old levels. So it is basically a production planning issue.

Gunjan Prithyani: But from a realization perspective, did not it make sense to just stick to the specialty, because, I mean, as you say that specialty has not seen as much rise, I mean, if you could give me some sense how our specialty prices declined in sequential versus 8% Grey VSF that has been there?

Dilip Gaur: Gunjan, you have to see in a business we have a long-term partnership with our customer. If we have committed to service a grey customer, we have to service them. And because they had an unusual surge in demand. So you have to meet the demand. In terms of the delta, the modal has almost stayed where it was. So if the grey price is 1.75, the modal is about 2.6 - 2.7, so almost 90 cents premium. So the premiums on the specialties have been better. So it was basically, I think it is not a loss, it is basically a planning issue. So I think this ultimately will make it up going forward.

Gunjan Prithyani: And in terms of visibility, as I see the exit prices have been even weaker, right? If I recollect, Chinese, we had mentioned are not really making money or are in losses and there was lesser risk to the realizations. But the way I see it, it has only been coming down. So is there no base or no visibility yet on the business, given the way whole demand scenario and the trade risks are panning out? I mean, how do we think about realizations from here on?

Ashish Adukia: See, between last quarter and this quarter I think what has happened is the trade war got intensified. See, till the time when we met last time the textile was not a part of the Trump's duties. On 1st August he announced that $300 billion worth of goods will impose duty from 1st September. And that is why because no U.S. guys renewed the contracts from the Chinese suppliers. And that led to a lot of ambiguity in China in terms of where would they sell their product from. So today the prices what are ruling in China, 1.3 are as we saw last time is below their variable cost also. So, I mean, one cannot predict what will happen going forward but it is kind of a little bottoming out now more or less. Now, the issues are, as I told you one is the issue of China price, second is the currency issue. The Chinese currency was 7.14 - 7.15. Now, if the trade war is resolved and the currency goes back to the old level, at the same price level you can get a better realization in the global market.

Gunjan Prithyani: Okay, got it. Second question on the chemical business. Now this steep decline in realization, could you throw some more light on it? Like what really happened, because within a span of a quarter it seems very steep, and are we seeing any stabilization there?

Jayant Dua: Gunjan, this is Jayant this side. So clearly, the prices have got corrected because on the international front the caustic soda prices have remained weak in China and Asia. And even in India it actually got compounded with two aspects, one was the fact that large crunch of capacity scale, and there was a slowdown in some of the consuming markets. Particularly if you look at pulp, paper, textiles, they have all had a substantial slowdown. And the pressure of demand came onto the business. And with international prices, as well as couple of new capacities coming, I think this quarter has been a fairly substantial decrease in the ECU prices.

However, I think you need to look at a long-term story here rather than a quarter, because as we move along, the historic average if you look at it over the last decade or so in this business has been around 29,000 - 30,000 is an ECU, with an aberration in the last couple of years where it went as high as 36,000. And I think as we go forward, the whole cycle will come back and we expect over the next couple of quarters now, very difficult to say will it happen the next quarter or two quarters later, but we expect the global averages to stable down and come back to the 30,000 - 31,000 levels.

Gunjan Prithyani: Okay. And last question on the balance sheet. Now if I look, we have gone from net cash from end of last year to almost Rs. 1,800 crores of net debt now. And we have about Rs. 800 crores infusion which happens in Aditya Birla Capital, and we continue to have fairly aggressive capacity expansion plan on the core business. Now, given the way the cyclicality in the business, there is clearly pressure on the operating cash flow that is visible, that has been visible for last one quarter or two quarters.

So, what is the flexibility to reassess or push back some of this CAPEX? Or is there any net debt to EBITDA in mind on the standalone business that you know we are not going to push the leverage beyond these levels? Because clearly this business is very cyclical. So, at some point if CAPEX is going to continue on these levels and we see realizations coming off the balance sheet will look you know, it looks a bit concerning.

Ashish Adukia: So Gunjan, I can just comment on balance sheet before I would request Dilip, Kalyan or Jayant to comment on whether the CAPEX can be deferred or not. In terms of balance sheet, we are very comfortable at even these levels that you have seen. We have met some significant capital requirement of both the investment in VIL, in Aditya Birla Capital as well as the CAPEX of the business in the first-half without significantly increasing the debt level. So that is out of the internal cash generation, out of the working capital release. We have got some good inflows that we have received through government subsidies in fertilizer, etc., as well that has helped us to meet these obligations.

Going forward, yes, we have some CAPEX plan. But, depending on EBITDA, it depends on where we land up at the end of the year. I think my sense is that there is enough headroom that is available without impacting the rating that we have, you can take an example of UltraTech, they are quite comfortable at these leveraged levels as well. We are far from our target that we have in mind. But I do not see by the year end or anything or we will easily be able to meet these CAPEX commitments for the next two years.

Gunjan Prithyani: Is there any leverage ratio in mind that you guys target internally that we do not want to breach this in terms of net debt to EBITDA or any other ratio?

Ashish Adukia: Sure. See, if I call out that number, it is a very fairly comfortable ratio that I have. You know, up till almost, 2.5x - 3x there will be no impact at all in the financial health and the ratings of the company. But we will end the year far lower than that, less than half of that ratio.

Moderator: Thank you. We have next question from the line of Rajesh Lachhani from HSBC. Please go ahead.

Rajesh Lachhani: Sir, my question is with regards to the exit prices of both caustic soda and VSF and with the pulp prices coming down. Can you throw some light on how could the margins pan out in the coming quarter, that is the December quarter? That would be question number one. And my second question would be, what are our plans with regards to further capital infusion in Vodafone Idea, if push comes to we have to infuse something?

Dilip Gaur: See, the good news is, while the VSF price have come down, the input prices from come down also almost in tandem. So the pulp if you look at it historically, I mean, if you take a spot pulp prices, they have also come down by 22%. And as I had explained to you last year, the problem in our case is, it is not reflecting in the bottom-line because we have this system where we get our pulp from Canada and Sweden and South Africa where there is a 45 days to 50 days transit time, and there our pricing is previous quarter. So we carry a lag of about six months. So the consuming cost of pulp is much higher than the spot price of the pulp, and that is where you are seeing the results are looking, the EBITDA is looking low but there are the time lag effect for quarter two alone is about Rs. 106 crores. So, that is the kind of inherent EBITDA which has been because of the time lag. So actually, if you look at even at these input prices, the business is pretty healthy

Ashish Adukia: Rs. 106 crores that Dilip mentioned, if you see on Page #14, the average consumption price for us was Rs. 62,620 which is a red line. And we mentioned that number in the box was well. And if you see the spot price average that was 727, right? And then plus there will be some small duty for importing the pulp and then there is some logistics cost from the port to the plant. So, including all that if we just multiply the difference by the sales quantity, you will get somewhere around Rs. 100 crore kind of figure, which we will recover over next maybe quarter four or something.

Dilip Gaur: Yes, quarter four, so it will reflect in next two quarters or so. And basically in the context of the margin question which you are talking about, we expect the margin to stabilize because you have also had a quarter which you had an extended monsoon. And I think it is only recently now a lot of capacities which had because of monsoons slowed down had started coming up. Our guesstimate is that your margin which we had in Q1, margin we have got in Q1 similarly have gone down in Q2. But Q3 margin would be in a similar range which we are currently operating in on that particular front. Now, also with the winter coming in the western part of the world or the other parts of the world, normal tendency of the global prices rising up also comes through. If that seasonality holds through, you could see an upside, but that time will tell us.

Rajesh Lachhani: Understood, that is quite clear. And to my next question on the capital infusion in Vodafone Idea?

Ashish Adukia: So there I think situation has not changed. VIL has it's call tomorrow, so we have to wait and see how the situation is evolving. So, there is no comment on that front'.

Rajesh Lachhani: So we might infuse capital, that is what is required?

Ashish Adukia: See, these are hypothetical questions today. So as the situation stands today, there is no new development that I had explained in the last call. And, just to clarify, a few questions that have come after that call on the guarantee, etc, we have no guarantee, no letter of comfort, or no sponsor undertakings of any sort out from Grasim to VIL, I just want to clarify that point.

Moderator: Thank you. We have our next question from the line of Akshay Ajmera from Nizar Securities. Please go ahead.

Akshay Ajmera: I also wanted to add on the previous question that, group has recently clarified that they are not obligated to fund the losses of Vodafone Idea. Are we, by any chance, in any capacity obligated to fund the losses that might occur at Vodafone Idea in any capacity? Or we want to take any...?

Ashish Adukia: So we are an equity holder, right? So our exposure is nothing beyond the equity that we have invested. And like I said, either through an agreement or through corporate guarantee or through anything of that sort, there is no guarantee or any undertaking out of them.

Akshay Ajmera: And there are no plans as of now to give any corporate guarantee or infusion?

Ashish Adukia: Absolutely not.

Akshay Ajmera: No launch, nothing that sort?

Ashish Adukia: We don't give to any of our associate JV investment or subsidiary any corporate guarantees.

Akshay Ajmera: Okay. So we don't want to give any corporate loans also, nothing of that sort?

Ashish Adukia: No.

Moderator: Thank you, sir. We have next question from the line of Prateek Kumar from Antique Stockbroking. Please go ahead.

Prateek Kumar: Sir, a few questions. Firstly, on global capacity, is there any change in outlook in terms of any new capacity? You mentioned about 0.4 million tonne last quarter, including 0.23 million in Indonesia and another 0.2 million elsewhere. So is there a new capacity addition outlook globally?

Dilip Gaur: No material change, I think, in that space more or less.

Prateek Kumar: And what would be global operating rates now? It fell to like 65% like last quarter.

Ashish Adukia: It's 78%. It varies from 75% to 80% kind of a thing.

Prateek Kumar: So it has actually improved versus Q1 because of closure of capacity?

Ashish Adukia: Yes, slightly.

Prateek Kumar: Okay. And regarding the pulp prices, the chart on Page 14, as you mentioned, so there is this pulp price already has, I mean, for our consumption, has already seems fallen from Rs. 66,000 to Rs. 62,000. So to that extent, benefit is visible in our numbers, but that Rs. 62,000 falling to Rs. 52,000 per tonne, is 15% fall is something which we should expect in Q3, Q4?

Dilip Gaur: And it is further falling. So the price today is now $640 per tonne spot prices. So pulp is right now at the lowest historic low.

Ashish Adukia: I would just clarify that I think the more visible benefit will be in Q4 rather than Q3.

Dilip Gaur: That's right. So thereafter it will continue, it will stabilize hopefully, there's no more or less.

Prateek Kumar: But as you mentioned, in our per tonne profitability probably should remain similar in Q3, similar to Q2?

Dilip Gaur: Probably, yes. It's difficult to say but there are so many factors in profitability, pulp is one part of it. The realization issues are there, the other inputs are there. But I think the benefit of pulp you can presume will come in Q4, let's take it that way.

Ashish Adukia: It's 15% of what you are seeing, that should come in Q4.

Prateek Kumar: Okay. And sir, can you give this VFY segment revenue and EBITDA?

Ashish Adukia: It's already there on Page #15, if you see Rs. 443 crores, and Rs. 80 crores is the EBITDA, Rs. 443 crores is the revenue.

Prateek Kumar: Got it. And sir, just one question on this domestic business. You mentioned that domestic business is growing at like 16%, 18%. So our business in domestic grew by 9%. So there's penetration of Chinese in domestic market as well probably taking share?

Dilip Gaur: No. What happened, there is the inventory in the system, so there destocking happens. There is no fiber, fiber imports have not happened, that's remained there. Instead of that, yarn imports are happening, and that is where the trouble is. The yarn imports have increased, that is where I think the spinners are now trying to work on the pricing to make sure this is an import stock.

Prateek Kumar: Okay. And just on this capital to Vodafone, just another question there. So there were like a few credit rating agencies have come out with revised rating for that company. Which mentions that they are resuming likely support from Aditya Birla Group to VIL, it's their treatment, obviously, it is something they are resuming. I mean, but as we mentioned, we are not looking to have any corporate guarantee?

Ashish Adukia: We have not given any such communication to rating agency or any such comfort either verbally or written on supporting VIL to them.

Moderator: Thank you very much, sir. We have next question from the line of Tanuj Mukhija from Bank of America. Please go ahead.

Tanuj Mukhija: Just one question from my end. The PPT mentions that the chlorine realization in India have been on negative for two quarters. Could you give us some more color about the additional chlorine supply utilization levels and your outlook for chlorine prices?

Jayant Dua: So Tanuj, chlorine prices continue to be negative as of now. And going forward, we do not see any material change in that. If you look at it, chlorine prices, historically, have been negative, except for the last quarter, in last financial year when they turned positive after a long time. The current scenario in chlorine is there's a fair amount of capacity additions which has happened in the industry, which has put a temporary kind of gap between what was the consumption of chlorine to chlorine production today. And we expect over the next about a year or so that will ease out to an extent.

But I think the question leads to another point in terms of what is the way we are looking at chlorine consumption in our own business, which gives us a value addition proposition of increasing and improving our numbers, and that is something. So in 2017, we were internally consuming about 26% of our own chlorine, which has gone up to 28% in this year, expected to hit about 30% to 32% in the coming years. I think that's the journey which we are going through of fool-proofing the business on chlorine going forward. And that, I think, in the next couple of years, you will see that this business actually has a different perspective on chlorine of what currently it is being seen today.

Tanuj Mukhija: Got it. That's helpful. Just a follow-up on that. What are your margins on chlorine VAP products? And what's your negative margin on chlorine realizations?

Kalyan Ram: Chlorine is negative. And it comes under the ECU as a formula. So I think that's where the stress has come, both on the caustic and chlorine. But in terms of VAP EBITDA per tonne, it has seen a gradual increase going upwards quarter-on-quarter, and the volumes are also increasing quarter-on-quarter.

Tanuj Mukhija: Sir, can you give the exact number of your VAP EBITDA margin? That would help us understand better how your margin trajectory will improve with the increasing VAP.

Ashish Adukia: It is quite integrated with the business. So because you have to see the entire chain to determine what the EBITDA, etc., is. So it's needless to say that instead of realizing negative EBITDA in chlorine, if you consume it and create derivative and then sell it, it's an additional margin that you get in the business over and above what you are getting anyways in your chemical business.

Kalyan Ram: And one thing, since in your new value-added products, the basket of products is such a large basket, you really can't do a summation of all of them to come out with a number. But the trend line is positive, both in terms of consumption and in terms of the EBITDA margins over there.

Moderator: Thank you very much, sir. We have next question from the line of Sumangal Nevatia from Kotak Securities. Please go ahead.

Sumangal Nevatia: Sir, first question on the VSF spreads. Just to clarify your previous answer, you said in 3Q the spread should be stable versus 2Q levels and then start improving from 4Q onwards. Is that the right understanding?

Dilip Gaur: That was for pulp?

Jayant Dua: Fiber or pulp, I guess. Is that what you are saying, Sumangal?

Sumangal Nevatia: Yes, yes.

Dilip Gaur: So the difference will get equalized by Q4, and thereafter, we believe, pulp also like viscose is bottoming out now, it is 630, 640, even the best of the mills are not making money. So it has to either flatten or maybe improve after that. So hopefully this should stay on after that.

Sumangal Nevatia: Okay. But sir, earlier you said, given the spot prices, they continue to fall, so just wanted to understand, I mean, I understand the lag benefit on VSF spreads. But is falling pulp prices comforting or it's more a sign of further downside risk to VSF prices, because of cost support is, I mean, it continues to fade?

Dilip Gaur: Yes, so the issue is, in case of pulp, the only buyer is VSF. If the VSF doesn't have ability to pay, the pulp cannot come on that price. We believe that both of them now should turnaround, hopefully.

Sumangal Nevatia: Okay, understood. Just one question to Ashish. I mean, just in a hypothetical situation, in case VIL defaults, I wanted to understand, is there any impact on the group credit rating and cost of debt?

Ashish Adukia: See. I think it, again, should be directed to the Group rather than to Grasim. But each of our businesses, we don't fund the other businesses. So it's unlikely that if there is an impact in one business, it has an impact on the other businesses. We will continue to enjoy and retain the ratings, etc., that we have at Grasim and UltraTech.

Moderator: Thank you very much, sir. We have a next question from the line of Rishabh Parekh from Sunidhi Securities. Please go ahead.

Rishabh Parekh: I just wanted to get a little more perspective on Vodafone Idea. So typically, historically, what you guys have been saying is that it represents an interesting opportunity, and you would participate in any fundraising with the aim of maintaining your stake. This was what was communicated to investors during the rights issue.

Where does that stand right now? Hypothetically, should there be a fundraise? Would Grasim still participate to maintain its 11.5% holding? Because there is no clarity on the use from Grasim's balance sheet anymore. So I just wanted to get a sense of where you stand philosophically on maintaining a stake in Vodafone.

Ashish Adukia: Sure. First of all, I would like to correct that statement. I think in the last quarter call, I had very clearly stated the order of preference in terms of capital allocation, I have said the first call for the money goes to the businesses of Grasim itself, which is VSF, Chemicals and allied businesses that are there. The second call of money goes to the consolidating subsidiaries, which is ABCL and UltraTech. And there, I had very clearly said that we would like to maintain the consolidating stake with some cushion, so that if they raise money independently, and if we get diluted, we are not going below 51. And then there is non-consolidating investments and VIL is part of that. And there, frankly, we will take a call when any such proposal would come. And there is no compulsion to maintain stake out there at all.

Rishabh Parekh: So, from what I understand is, should the target of debt-to-EBITDA that you spelt out earlier in the call, if that is not met despite funding all of the other priorities that you listed out and there is still some headroom left, you would be open to fund Vodafone Idea?

Ashish Adukia: It's a very hypothetical question. I don't think we can comment on that.

Moderator: Thank you very much, sir. We have next question from the line of Swagato Ghosh from Franklin Templeton. Please go ahead.

Swagato Ghosh: I have a question on Vodafone Idea. I just want to understand your thoughts around. if there is a capital infusion, to put that proposal to vote for minority shareholders, even if the materiality of the transaction might not require that. But as a good governance practice, can we like do that, put it to vote?

Ashish Adukia: Yes. Again, it's a hypothetical question, whether it will be put to vote or not. I think you have an example in the past where the rights was done. There is no regulatory requirement as such to put to vote. Again, it's a hypothetical question. And I don't think I will be able to comment on a question like this.

Swagato Ghosh: Okay. No, I totally understand there's no regulatory requirement, but we have seen companies like before on their own put certain important strategic decisions to vote to minority shareholders. I am just thinking, is that option open? I, obviously, don't expect you to comment anything as of now, because, as you said, the situation is hypothetical. But because this is extraordinary circumstances and you have seen how the stock has reacted post the last infusion also, the Grasim stock. Hence, can we keep that as an option? That's my question.

Ashish Adukia: There is Management and Board of the company that takes decisions, okay? And there is also shareholders on certain matters that take decision. So wherever in whichever category it falls, that authority will take decision on that matter.

Moderator: Thank you very much. We have next question from the line of Deepak Malhotra from PPG Consultancy. Please go ahead.

Deepak Malhotra: My question is, again, actually on Vodafone Idea itself, because at the end of the day, if you see, I mean, the group has 27% stake in Vodafone Idea. And you are the single largest promoter shareholder in the group. So first of all, this is the only forum available to us to understand that what the group thinking on the investment going forward is.

Secondly, my question is that, at the end of the day, when we look at it from the credit rating agencies point of view, definitely the support from group companies is taken in consideration when arriving at a credit rating profile. Now in case, as you said it's a hypothetical situation, but if we see the track record in the past, the Grasim as part of the group has contributed to its share of putting in money into Vodafone Idea.

So if push comes to shove, I mean, as it may happen. In that case, it may impinge basically on the financial flexibility of Grasim itself and also on the CAPEX program, which you alluded to in the sense that although Grasim would may have its first right, but in the past, if the track record is to be seen, then you ended up supporting Vodafone Idea. So the question is that, how is this issue genuinely be resolved, because this is really a concern for us as investors?

Ashish Adukia: Sure. I think whatever you have said just now we have already in the last two, three questions answered those questions. What I would request is that if there are questions pertaining to Grasim's performance and business, happy to take that. In Vodafone Idea, whatever I have said is what stands. And we really don't have anything additional to add out there. And I would appreciate if you guys understand that.

Moderator: Thank you very much. We have next question from the line of Saket Kapoor from Kapoor & Co. Please go ahead.

Saket Kapoor: Sir, I am coming in the queue.

Moderator: Thank you. We have a next question from the line of Gunjan Prithyani from JPMorgan. Please go ahead.

Gunjan Prithyani: I just wanted one clarification from you, Ashish. Essentially, on some of the holdings that you have, let's say, the Hindalco and the Aditya Birla Fashion, even UltraTech. I mean, these stakes have been there at these levels for a long time. Now when you look at these businesses, when you are looking at some capital infusion or CAPEX program internally, is there any relook or revisiting like where do we want these stakes to be? Like Aditya Birla Fashion has been at 11% or Hindalco at 3.9% or 4%. Can some of these, is that something you looked at that you can monetize these to fund or whatever, I mean, I don't want to drag on Voda Idea, because this is more from a clarification what is the thought process around keeping the stakes where they are? I mean, for that matter, even in UltraTech at 60%, do we stick with 60% assuming there is no cap raise from UltraTech? Do we stay at 60% or could we look to bring this down also?

Ashish Adukia: Sure. Gunjan, first of all, all these stakes that are lying with Grasim is due to historical reasons. And as a Group, we have substantially tried to resolve some of these cross-holdings over a period of time. And at least we have been following a philosophy of not adding to these cross-holdings. And if they exist, if there is no compulsion to monetize these stakes, then we don't need to, because Grasim is generating cash on a standalone basis, the debt-to-EBITDA is very, very comfortable. So really there's no compulsion to do so.

Gunjan Prithyani: Specifically on UltraTech, I mean, we are at 60%, and you did mention that we will try to keep a cushion over 50% level so that if there is a fundraise there, we don't want to go below 50% level. But let's say, there is no cap raise, as I see it at UltraTech right now, so at 60% we don't intend to change this holding at all, right? I mean, I am just trying to get comfort around UltraTech stake holding, where do we stay?

Ashish Adukia: So there is no need to do so. If there's no need to do so, then UltraTech is actually performing extremely well. So there is no reason to actually. If you see the performance of the company, it has done extremely well in the last four, five years. There is no reason to do that. And in fact, they are quite acquisitive, they use their stock also to acquire, and we are no more 60%, we have come down to 57% already after further acquisitions.

In fact, I have many avenues for cash, if I need to. We still have some stake in L&T that is lying with us. We can monetize that. So we will look at other avenues to do so. But frankly speaking, I don't see in foreseeable future for us having to touch some of our investments to actually generate cash when our businesses are actually at these levels also generating cash.

Gunjan Prithyani: Fair enough. Thanks for that clarification. I mean, so my understanding is that if at all there is need also, there is enough that you can look at before touching UltraTech or Aditya Birla Capital, right? Because those are more core to you than the others, which are at, let's say, below majority.

Ashish Adukia: Absolutely right.

Moderator: Thank you very much. We have a next question from the line of Amit Murarka from Motilal Oswal. Please go ahead.

Amit Murarka: Just on the CAPEX, I wanted to understand that your breakup on CAPEX is basically growth CAPEX and modernization CAPEX. So how should we see the modernization CAPEX, like what kind of margin improvement will it bring along?

Ashish Adukia: So like I said, some of the examples of modernization CAPEX, a lot of them are sustainability in nature, some of them are debottlenecking so it will help increasing the capacity as well. So, like we have zero liquid discharge, which we are implementing across all plants and chemicals and in VSF, that itself could be somewhere in the range of Rs. 100 crores plus. Then in VSF, we have the carbon activated plant, which we will be implementing I think in two plants this year. So that's another Rs. 100-plus crores. There is some debottlenecking possibility that is there at Kharach VSF facility, that will entail some CAPEX. There is water recycle/reuse schemes that we are looking at. There is also some CAPEX out here which involves using seawater because the water consumption is high. So we are anyway reducing the water consumption from sustainability target point of view. But also look at alternate use. So if we are looking at seawater intake and how we can desalinize and use that, even that is included in normal modernization that we talk about.

So it's a large number of items of small amounts, which totals up to this CAPEX. But if you notice, out of Rs. 3,800 crores, about Rs. 2,600 crores is actually going towards capacity enhancement, and only about Rs. 1,000 crores is towards such cases of modernization and maintenance. And sustainability, we can't understate how important it is becoming and your longer-term cost on sustainability will increase. So therefore, if you take steps today, you will be far ahead of your competition. And in fact, it will help you in reducing loss as well. And Dilip and Kalyan, please feel free to add.

Dilip Gaur: And it includes the margins also, like you may know we have launched the product called Livaeco, it's basically on sustainability platform, a green product, and it gives you premium over the normal products. So that's how we are adding value to the conventional grey viscose. Sustainability is now a big idea in the fashion industry.

Kalyan Ram: I think even within chemicals, we strongly believe that sustainability will become competitive advantage. What we have seen in China with the closures and all that, I think we believe that being ahead and being competitive, it's not just about investing in more capacity, but making the existing businesses robust and sustainable.

Amit Murarka: Sir, why I asked that question was, basically if I try to calculate an ROCE of the expansion that is going on, so it gives about roughly 12% to 13% pretax ROCE for VSF and sort of about 18-odd percent on chemical, and is based on the long-term EBITDA margin that I am assuming for those two segments. But if I load up the modernization CAPEX, then it just declines to about 8% to 9%. So that is the context I was trying to understand. Like, will there be an instrumental EBITDA benefits also coming through from the modernization CAPEX or not?

Ashish Adukia: I don't know how have you compute these numbers, because modernization has multiple elements to it. We are going in for bigger machines, which give better speed and lower cost of production. We are building a facility to produce grey and non-woven in that, so the product mix is going to be different. So I think we holistically...

Amit Murarka: No. That's what I was trying to understand.

Ashish Adukia: All these are very, very highly attractive IRR products. And you have to do over a 10 to 15 years. You can't take the current exit price of viscose. So you do the last 10 year viscose price and do IRR, it will be much more attractive.

Moderator: Thank you very much. We have next question from the line of Madhav Marda from Fidelity. We lost the line of Mr. Marda. Please go ahead. We lost the line of Mr. Marda. We have next question from the line of Prateek Kumar from Antique Stock Broking.

Prateek Kumar: Sir, I have a few follow-up questions. Firstly, sir in VFY segment also we have seen some compression of margins. So how do we understand this segment in terms of profitability?

Ashish Adukia: Yes. So in VFY, I think one of the key products that we have is tire cord, which is coming out of Century VFY business. And in case of tire cord, because of the slowdown in the auto sector, it's running at probably about 50% capacity utilization. So therefore, there has been impact in VFY as well. There is some realization pressure in VFY otherwise as well, other than the tire cord.

Prateek Kumar: But we are the only manufacturers of this product in India?

Ashish Adukia: Yes.

Prateek Kumar: I mean, because the volume number doesn't seem to be impacted generally within the range of 10,000, 11,000 per quarter. But the pricing has come down and profitability has come down.

Kalyan Ram: So VFY as a business is a niche business, in the sense we want to really compete with silk, closest to silk. So it's not like fiber, it's not about volumes. It's developing market in segments like chiffon and georgette. And as we plan to do that, we have created capacities for the future. And also we wanted to make sure that we unlock the latent demand. So there is a lot of demand where being a 2% or 3% of the market, it has a much bigger potential to grow up to 10% of the whole textile market.

So it's about then creating that new fashion element and the new opportunity. And it is a slow game, but it is a very high-margin game. And that's what we are playing there. And each time in every six months, you will see fashions changing. We are focusing on how do we really bring new fashion into the play and then new opportunities created. So what we will see in this is over a period of the next few years, this percentage going up in the textile market, and that's where the value unlocking will take place.

Ashish Adukia: And to just clarify quickly your volume question. There are four products out there and the product mix determines the profitability rather than the volume, because the margins of each of those products very, very different PSY, CSY, SSY, and tire cord, these would be the four broad product categories, and the margins are very different in those. So where the volume is coming from determines fee margin rather than it being a secular kind of movement.

Prateek Kumar: Tyre cord would be higher-margin segment?

Ashish Adukia: Tyre cord, and SSY. SSY is a very high margin business.

Dilip Gaur: I think another point which you need to remember is, the whole market here is around 57,000 tonnes for VFY, we may be the largest market share player. But the Chinese capacities are almost around 200,000 tonnes, and they export almost 100,000 tonnes. So there's been a lot of pressure even from China. And then earlier, there was also a question and it is very relevant, there are a lot of imports that are coming into the country. And so it's also balancing between keeping high margins. And at the same time, deflecting all the imports. I think that's the challenge there.

Prateek Kumar: And in terms of VSF capacity expansion, we are online to commission that in 3Q FY21?

Dilip Gaur: Yes. The first line in third quarter, second line fourth quarter.

Prateek Kumar: Okay. And just one thing on pricing. So our exit pricing both the segments is lower versus average. So how much would that be lower versus average in both segments?

Dilip Gaur: See the pricing, it is very difficult, hazardous to get any trend. Because I am telling you the effect of U.S. - China trade war, the day that vanishes you will see the market taking totally different shape. So we can't predict what's going to happen in that area. So I think let's see as it comes.

But at these prices, Chinese are losing RMB 2,000 per tonne. So they can't going any lower, I mean, logically. So the average loss is about RMB 2,000, that means about $250 per tonne, that's the kind of money they are losing.

Moderator: Thank you. We have next question from the line of Saket Kapoor from Kapoor & Co. Please go ahead.

Saket Kapoor: Sir, just to understand, what are the structural changes that has happened in the caustic soda market? And what have been the imports for the first half into the country?

Jayant Dua: The imports have substantially increased during the first half. And the reason being that in the first half particularly the first quarter the India prices were far more attractive than the global prices. So that has led to it. But with the currently the exports are kind of stabilizing, because price is at par with the global market. So I think going forward we expect that this parity would continue.

Saket Kapoor: Sir, is there some certification that was due from some countries I think, it was Japan and all they got the certification and now the major import are being from the Japanese itself?

Jayant Dua: No. Japan is one of the countries which is selling material to India. And there are also countries from Middle East and there are also countries like Bangladesh, but Japan is one of the larger ones, sure.

Saket Kapoor: Sir, I was just looking for the volumes. If you could, do you have the volume with you, what was the imported quantity for the last quarter or the first half in totality? And secondly, for negatives chlorine which you have mentioned, this means that we have to pay a price to evacuate chlorine, that is what you mean?

Jayant Dua: Yes.

Saket Kapoor: And this trend has happened for Q1 and Q2, both?

Jayant Dua: This trend has happened for Q1 and Q2, both.

Ashish Adukia: Yes. This trend has been for many years, historically. The situation had actually changed last year. So now, it's, again, negative. But as business, we are looking at many ways, like Kalyan and Jayant had pointed out, on how to increase either chlorine derivatives or to actually find other ways to evacuate chlorine and there are many such examples to make sure that we don't lose money on evacuation of chlorine.

Saket Kapoor: Sir, can you quantify how much it has been negative in the first half in chlorine?

Ashish Adukia: Typically, you can take the transportation cost to move to the customers is the negative that you have.

Saket Kapoor: Okay. How much it is?

Ashish Adukia: It could if we are moving it all the way to the South versus West, it could be anywhere between Rs. 500 to Rs. 4,000 a tonne. So I think we need to be careful. It is depending on which customer it is and which location it is that can change.

Saket Kapoor: Okay. Lead distance is there, but average price was how much, sir? We have the biggest share?

Kalyan Ram: No. But I think we need to be careful there. So when we provide ECU, what we say is still consolidated number between pulp and chlorine. So we don't try and then show you a huge price increase in caustic and then something else in chlorine. It's what you see as a number is a consolidated number. And it has to eventually somewhere be a byproduct for the other. I would also say that direction, I think one difference in India versus rest of the world is, in majority of rest of the world chlorine is consumed in some of the largest derivatives like PVC and TDI. Capacities are not much in India, and that's going to happen. And when large petrochemical players start to invest in PVC, this situation can change. The way we are looking (technical difficulty)

Moderator: Sir, kindly stay connected. We lost the line of the management. Please stay connected.

Sir, we are back in the call. Please go ahead.

Ashish Adukia: Yes. So I think I am not too sure where we lost you guys. But I think what Kalyan was trying to say that over a longer term, we will increase chlorine derivatives to ensure that we profitably evacuate chlorine.

Saket Kapoor: Fine. Today the mix of value-added products is 28% as of now?

Ashish Adukia: Yes, as of now.

Saket Kapoor: And with the CAPEX that will happen, what would be the value-added proportionate, let's say for March 2020 and 2021?

Ashish Adukia: Percentages will go up on value-added products. Our expectation in the next five years we will get closer to 43% to 45%.

Saket Kapoor: It's along five years project?

Ashish Adukia: But I think the other thing which we are doing actively, as I said earlier, is bringing customers next to our plant. And hence, we don't have to build on the transportation, etc. And majority of these space, we expect to help. And in the meantime, we are working with very large petrochemical majors to see whether they are putting up world-scale capacities on PVC and others. That continues to be our focus area.

Saket Kapoor: And lastly, sir, caustic soda prices have declined even for this 45 days of this quarter also or are they stabilize? If you can give you some color on the same?

Jayant Dua: At the moment, the spot prices on caustic soda continues to be on a decline.

Saket Kapoor: Even they are lower than what September was? How much is in the reduction, can you quantify it?

Jayant Dua: I guess, at this point of time we can't quantify that, but the trend is downwards.

Saket Kapoor: Trend is downwards. But utilization levels are in the high 90s for all our plants or we are also having problem in demand?

Jayant Dua: Not having substantial issues with demand. I see from demand front, we are fairly comfortable.

Saket Kapoor: Right. And sir, going forward also what factors will reverse this trend for caustic soda prices, sir? According to you what factors can be probably bring the changes.

Jayant Dua: So, a slump of capacities which have come in a short period of time, as they will stabilize in the market, we see stabilization of prices happening. The timing of that is not at the moment not correct.

Ashish Adukia: I think one of the ways we look at it strategically is not quarter-by-quarter. Our approach is, over a period of next few years, each year, the market is growing closer to 7% to 8%, in a 4 million tonne market or 3 million to 4 million tonne market we need capacities almost 300,000, 400,000 tonnes every year. And that's the basis based on which we grow, and we plan our growth. Quarter-to-quarter, we have seen this is one of the most cyclical businesses. And hence, it creates a huge barrier to entry for many, because it can be highs and lows. But we plan over a period of long-term.

Saket Kapoor: And sir, can you quantify the capacity addition? You articulated about huge capacities coming on-stream. So for first half how much has been the new capabilities that have been on-stream? And any new capabilities that will be going on-stream in the second half?

Ashish Adukia: So, I think it's all captured on Page #9, total monthly additions that we are doing.

Moderator: Thank you. We have next question from the line of Kevin Kuriakose from Alpha line Wealth Advisors. Please go ahead.

Kevin Kuriakose: Sir, just wanted to know what would be our capacity utilization, post the expansion in FY21 for the VSF?

Dilip Gaur: Look, as I have always told you, if you look at the history of VSF, we always have almost 100% capacity utilization. The only issue is how much is domestic in that. So what happens today is that my capacity is fully stretched, I have 88% domestic, from which 12% is value-added exports. Another new plant comes up, we will maximize the domestic sale, and whatever is remaining, we export. So plant will be fully utilized, because there's a huge global demand for the product.

Moderator: Thank you. As there are no further questions, we would like to close the call. Ladies and gentlemen, on behalf of Grasim Industries Limited, that concludes this conference call. Thank you for joining with us. You may now disconnect your lines.