Cosmo Films Limited

"Q2 FY2017 Earning Conference Call"

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Moderator: Ladies and gentlemen good day and welcome to the Cosmo Films Limited Q2 FY2017 Conference Call hosted by Systematix Shares & Stocks Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ankit Gor from Systematix Shares and Stock. Thank you and over to you Sir!

Ankit Gor: Good morning all. On behalf of Systematix Shares, I welcome all the participants to Cosmo's 2Q FY2017 results conference call. From the management, we have Mr. Pankaj Poddar, CEO and Mr. Neeraj Jain, CFO of the Company. I would now request Mr. Neeraj Jain to provide details about Q2 results and then this call will be followed by Q&A session. Thank you and over to you Sir!

Management: Thank you Ankit. Very good morning ladies and gentlemen and welcome to Q2 FY2017 Cosmo Films earning concall. I am Neeraj Jain, CFO at Cosmo Films and I am joined by my senior colleague, Pankaj Poddar, CEO of the Company.

Our financial results and investor presentation both have been uploaded on our website and I hope all of you had a chance to go through it. I will start with some of the key updates on the business and then we will move to the financial performance.

During Q2, there has been pressure on the gross margins both in the domestic and export. This was largely due to subdued demand in some of the overseas market and commissioning of new capacity. The Company could compensate impact of reduction in margins with higher sales of the specialty films and improved operational efficiencies largely in the power cost. The BOPP margin I believe has almost bottomed out and there are enhanced chances for margins to improve from here. In Q2, we could beat industry cyclability to a large extent by increase in the specialty sales.

As previously informed, the company has entered into a definite MoU for the purchase of the 34 acre adjoining land for the upcoming expansion.

Our new project on the BOPP film is going on track and expected to start commercial production in Q4 of the current year. This new capacity expansion will increase our capacity from 136k metric tonnes to close to 200k tonnes. We are also installing new metalizer which will add our metalizing capacity from 10K metric tonnes to close to 17k metric tonnes. Both of these capacities are expected to start commercial production in Q4. Our coal heating unit in Waluj plant has started full operation in Q2, which was under implementation in the Q1.

During the quarter, we also have launched BOPP based black velvet lamination film with enhanced aesthetics. The product provides velvet finishing in the black colour and is a wonderful product even for post lamination processes like hot stamping, foiling etc.

Coming to the quarter's financial results, on QoQ basis, our topline is higher by close to 6%, which is largely driven by 5% volume increase in India location. On YoY basis, there is a drop in sales value by close to 7%, which is largely due to fall in the raw material prices, which were passed on to the customers.

As mentioned earlier on India operations, there has been pressure on the gross margins during the quarter, which resulted about 250 bps margin reduction. We could compensate the same by increase in the specialty films and the operational efficiencies. Despite the decline in the margins, EBITDA and PBT both have been stable in India although PAT is favorably impacted during the quarter due to SEZ tax exemption in the Q2 of FY 2017, which was not there in the corresponding period last year.

On subsidiaries side, we continued to be on improvement trend operationally although there is a reduction in the reported YoY PBT due to non-operating and non-recurring exceptional items which mainly includes close to Rs.3.5 Crores of the forex hedging loss in Japan subsidiary. Against this non-recurring loss in the Q2 FY2017, there was a gain of close to Rs.2 Crores in the corresponding period last year.

On consolidated QoQ basis, both consolidated EBITDA and consolidated EPS have improved. EBITDA and consolidated EPS growth has been close 4% and 12% respectively. On a YOY basis, there is a drop in the reported consolidated EBITDA; however, if we remove the impact of the exceptional items, EBITDA growth would have been close to Rs.2 Crores and the PAT growth would have been in the double-digits.

These are few updates on business and the results. Now, we would like to open the concall for the questions please.

Moderator: Thank you very much. We will now begin the question and answer session. We have the first question from the line of Dixit Mittal from Subkham Ventures. Please go ahead.

Dixit Mittal: Good morning Sir. Can you tell us about the nature of this forex loss, because I think you do not have any operation in Japan in terms of substantial operation? So why have we hedged in Yuan?

Management: In Japan subsidiary, we sell in the JPY and import in US Dollar. In order to address this exposure, we do hedging between JPY and US Dollar on a rolling basis in advance considering Company's risk management hedging policy. Due to this, we have hedged JPY versus dollar at close to 120 levels as against current rate of close to 103-104. Since we took the hedges at close to Rs.120 level, there is hedging loss in Q2. If we take out impact of hedging loss, operationally Japan operation is in profit.

Dixit Mittal: You sell from US to Japan?

Management: We import in USD in Japan from our Korea operations. Our Korea operation is largely production location, which serves to the Japan market in terms of the production requirement.

Dixit Mittal: Sir what is the scale of sale that we do annually in Japan?

Management: It is close to US $10 million annually.

Dixit Mittal: So we have US $10 million. Sir, secondly you mentioned that you have signed MoU for new land, so can you throw some light on this land purchase and what is the new project that you are looking to set up?

Management: This is about 34 acre adjoining land next to our existing Waluj Plant in Aurangabad. We have entered into definite MoU for the purchase of this land and MoU is expected to be executed in next few months. This land purchase is largely for the upcoming growth plans of the company. Once we have final approval on capex plan we will come out with more detail on the upcoming projects on this land.

Dixit Mittal: Last question, you mentioned that margins seemed to have bottomed out on commodity films, so what gives you confidence that margin will end to further drop from here on?

Management: The value addition running on commodity films in Q2 has been close to lowest level of last few years which do not survive for long period based on our previous experience. This is why we feel that there is remote chance of margin to drop from now onwards.

Dixit Mittal: Sir what was the utilisation level in this quarter?

Management: Utilization in terms of the capacity?

Dixit Mittal: Yes Sir?

Management: It is full capacity utilisation.

Dixit Mittal: Around 80%?

Management: In our industry there is a concept of name plate capacity, which is calculated, based on standard micron output under ideal standard running condition although in practice customer's orders for different micron films.

In simple words, general thumb rule is if production output is 70%-75% of name plant capacity, it is considered full capacity utilization.

Dixit Mittal: Thank you Sir.

Moderator: Thank you. The next question is from the line of Karthik Gada from Val-Q Investment Advisory. Please go ahead.

Karthik Gada: Thank you. Good morning Neeraj. So on the margin bottoming out, just one clarification, you are referring to the gross margin right?

Management: Yes, that is right.

Karthik Gada: And this MoU for the purchase of 34 acre land, so any timelines we have in mind for this and this is over and above the expansion, which is coming up in Q4, is it?

Management: Last year we announced one capacity expansion of 60k metric tonnes which is coming in Gujarat plant in Q4, FY2017. The new land purchase is altogether different. This is adjoining land with our existing Aurangabad plant which will be utilized for upcoming projects.

Karthik Gada: Adjustments for this forex loss so if I just add that back, I am getting EBITDA margin of around 12.1% is that the fair number for the quarter?

Management: As we indicated in past also, percentage do not provide complete margin picture in our Industry as selling price to a large extent depends on raw material price. You should also refer EBITDA or operating results in terms of the absolute value. So if we add back exceptional items, absolute value

EBITDA in Q2 is higher by about Rs.2 Crores compared to last year same quarter.

Karthik Gada: Thanks.

Moderator: Thank you. The next question is from the line of Vipul A Shah: from Sumangal Investments. Please go ahead.

Vipul A Shah: Good morning. Sir, can you quantify the SEZ related gain that you mentioned in your opening remarks?

Management: We are running a plant in SEZ area in India. As you know, there is full income tax exemption for first five years and then 50% for next 10 years for SEZ units. Currently, our SEZ unit is running 100% income tax exemption. This is why our effective tax rate in India has come down to 20%-22%.

Vipul A Shah: Sir, can you tell me when your total capacity will become 2 lakh tonne at the end of fourth quarter, how much will be value added specialty films and how much will be the commoditized business?

Management: Currently we are running about 40% business in volume terms from specialty products. After the new line is going to be functional, initially it will be addition largely on the BOPP films side but slowly then it will pick on the specialty products. In long term, we would like to maintain close to 50% volume from specialty products.

Vipul A Shah: So once this line becomes operational, your value added percentage will come down initially, have I understood correctly?

Management: Yes, may be in percentage terms for initial quarters, but in terms of the absolute value specialty products should grow as is being witnessed currently.

Vipul A Shah: What is the value addition in terms of percentage you get for specialty films as compared to commodity BOPP films? If you can throw some light on that?

Management: **D**epending on the product as value additions are different on product to product basis. It is better for specialty products.

Vipul A Shah: Thank you Sir. All the best for the future.

Moderator: Thank you. The next question is from the line of Siddharth Mohta of Principal India. Please go ahead.

Siddharth Mohta: Sir two questions, you have mentioned that in the overseas market demand it was quite subdued and there was a commencement of new capacity in domestic market. So if you can just highlight in this particular point. That is number one. Second is regarding our SEZ taxation. So if you can also throw light in that. It is for how many years?

Management: On your first question, our key raw material is polypropylene for which price gets benchmarked in International market against index, which is called Platt. This Platt may defer depending on the geography/country. India is part of South-East Asia Platt. Similarly, there are European Platt and others. Generally, Platt rates are higher in European economies compared to India, which has been running reverse in Q2, FY2017 which impacted demand in some part of the world. Further, there has been capacity addition in India by one of the competitors during the quarter.

Siddharth Mohta: Regarding SEZ taxation?

Management: As indicated earlier, Currently, our SEZ unit is running 100% income tax exemption, which has caused effective tax rate in India to come down to 20%-22%.

Siddharth Mohta: The timeline it will be like for five years, or for seven years or how it is?

Management: For the first five years, which is going to expire in March 2018 it is 100% income tax exemption and for the next 10 years it is going to be 50% tax exemption on SEZ profit.

Siddharth Mohta: How about this new plant? Will it come under SEZ facility?

Management: No. that is capacity addition outside SEZ however there may be some exports from new capacity addition as well.

Siddharth Mohta: It will be in the domestic market. Sir, in your previous concall you have mentioned that our overseas entity will be positive EBITDA for FY2017, but it looks a little tough actually by seeing the numbers for the first half?

Management: Well, If you take out the exceptional items impact it is running close to EBITDA breakeven.

Siddharth Mohta: For H1 FY2017?

Management: Yes

Siddharth Mohta: Sir, regarding our gross debt if you can please highlight?

Management: Currently we are running at global net debt of close to Rs.480 Crores, which is close to one times of the debt equity ratio.

Siddharth Mohta: Is this peak debt actually of 480 to 490 Crores?

Management: Some loans related to new BOPP line Capex is yet to be disbursed hence debt level may peak out at March 2017. Even at that level, we expect debt-equity to remain close to 1.1 times.

Siddharth Mohta: Any update on the QIP, any plans?

Management: QIP enabling resolution is continuing. We are in process of studying specific Capex projects. Once the Company decides on the same, we should be able to get back with further update on QIP.

Moderator: Thank you. Next question is from the line of Shivani Viswanathan from Way2Wealth Realty Advisors Private limited. Please go ahead.

Shivani: Good morning. Most of my questions have been answered. I just have few questions. Sir what was the export number?

Management: Broadly in the range of 45% to 50% of the topline including for Q2.

Shivani: Okay and Sir when you talk about overseas market subdued demand, is this a concern with upcoming new capacity or something else?

Management: Commodity margins historically are at a point, which are quite low and obviously nobody can with 100% certainty can say that it can go down further or not, but given the way things have been there, we feel that it cannot go any further down because beyond this point most of the players will find it extremely tough to run their lines. I would certainly like to mention here is that our new line, which initially will be largely dedicated for commodity usage, will actually be at the lowest capex per tonne as well as operating cost per tonne, so that should provide us incremental benefit over competition when it comes to the competitive pricing, as such.

Shivani: Thank you so much. That answers my question.

Moderator: Thank you. The next, we have a follow up question from the line of Vipul Shah from Sumangal Investments. Please go ahead.

Vipul Shah: Sir you mention that your new line is at the lowest cost per tonne, so what is the capex per tonne and what is the overall capex for the 65000 to 66000 tonne line?

Management: The new line capex is close to INR 200 Crore and broadly should be able to provide between 44k to 47k tonnage at close to full capacity utilisation. Hence capex per tonne should be close to INR 4.5 crores.

Vipul Shah: So generally it takes means competitive, take how much capex to complete this line?

Management: This depends on the efficiency of each player, it could be even higher upto 25%.

Moderator: Thank you. Next we have a follow up question from the line of Mr. Siddharth Mohta from Principal India. Please go ahead.

Siddharth Mohta: Since you have mentioned that we have taken additional operational efficiency in power. If you can just help me what are those initiative and those are fully reflected in our numbers?

Management: Q2 include almost full impact of power cost saving initiatives. In the last quarter, we were in the process of implementing coal based heating unit in our Waluj plant, which has been running fully in Q2. Beside this there were several other power cost saving initiatives we implemented in FY 2016.

Siddharth Mohta: Sir for this particular quarter, I was doing consolidation minus standalone, so the difference it was coming around 4 Crores of loss at EBITDA level so this entire 4 Crore can be subscribed to forex loss?

Management: Q2 include close to Rs.3.5 Crore of forex hedging loss in Japan and gap between standalone and consolidated result is also close to the same.

Siddharth Mohta: Sir, leaving apart this particular forex, we can say that in FY2018 whether overseas entity will also contribute something to our EPS?

Management: Yes, there is operational improvement particularly in the US subsidiary. You may expect subsidiaries to make profit in FY 2018.

Siddharth Mohta: Okay and if you can also highlight some of the operational efficiency that you have taken in our US facility?

Management: There are two-three things which we have implemented during the last one year, one is the we have upgraded production line which reduced wastage from close to 25% to single digit number. Second, we launched new products on the distribution network of the US subsidiary. Earlier we were selling largely thermal lamination product in USA. Now, we are selling the BOPP and other specialty products. We are also looking forward further to add more products in USA.

Siddharth Mohta: Thank you Sir.

Moderator: Thank you. We have the next question from the line of Kartik Gada from Val-Q Investment Advisory. Please go ahead.

Kartik Gada: Thanks again. Just going back to this MoU for the line acquisition, so what is the kind of amount, which we can see for this?

Management: Broadly it is close to 40 Crores.

Kartik Gada: Okay and what will be the funding plan for this?

Management: Internal accrual of the company is sufficient to address this.

Kartik Gada: Okay, so you mentioned that the peak net debt to equity should be about 1.1, so it should also include this or any expansion related to this line?

Management: Yes

Kartik Gada: Okay and capex for this year and next year?

Management: For the current year, we are in process of implementing the project related to new BOPP line. Beside this land capex shall be there and some other minor Capex. It may be difficult to indicate capex figure for the next year as we are currently studying two-three different projects related to packaging. We would come out with more detail on this once decision is taken on the same.

Kartik Gada: All right. Thank you.

Moderator: Thank you. Next question is from the line of Mr. Hitesh Shah who is an individual investor. Please go ahead.

Hitesh Shah: You were planning some additional investment for our US operation. If we can throw some light on that and one more is we were targeting some cement bag industry as some new application, so is there any positive development on the same?

Management: As far as the cement bag is concerned, there is a good development i.e. three cement companies have started to buy such bags, so we are selling to two converters, who in turn are supplying to cement industry. We are trying to promote this concept with other cement companies as well. Right now, I would say only the premium cement brands are basically using this bag; however it is yet to percolate down to the commodity segment. I think sooner than later cement companies would realize that it is going to give them lot of benefits, so it might take a year or two years. We cannot put timeline as cement bags is a matter of cost for them as well. I think the advantages are huge and therefore look a matter of time for market to come up

In USA, we have not done any investment as of now, but we do look forward for the investment. We are studying a couple of projects for India and US. Once these are finalized and we have the necessary board approval, we would be able to come back with more detail.

Hitesh Shah: So positivity continues for US operation.

Management: Absolutely.

Hitesh Shah: Thank you so very much Sir.

Moderator: Thank you. The next question is from the line of Mr. Ankit Gor from Systematix Shares. Please go ahead.

Ankit Gor: Thank you for taking my questions. Sir, one question with regards to power cost saving, which we are talking about. What is the quantum of that amount if you can just elaborate Sir? Thanks.

Management: In Q2, it is close to Rs.1 Crore over Q1.

Ankit Gor: What efficiency can come in, so are we efficiently enough in terms of operations and/or still there is enough room or some scale can come in from you know operation efficiency?

Management: Well in terms of operation, we are still looking at some small changes largely by increasing the speed of some of the existing lines, but most of the initiatives are already implemented in Q2, hence Q2 has major part of the savings already built in.

Ankit Gor: Sir with regards to income tax rate, we are getting some SEZ benefits that is for which plant? For new line saying the tax rate and it is still FY2018 right, so net tax rate should be assumed at 20%-23%?

Management: No, the existing tax rate in India operation is going to be between 20% and 22%, up to the March 2018, after March 2018 it will depend on ratio between the domestic and the SEZ profit, but broadly it should be between 27% and 28% effective tax rate..

Ankit Gor: Thank you.

Moderator: Thank you. Next, we have followup question from the line of Vipul A. Shah from Sumangal Investments. Please go ahead.

Vipul A. Shah: Can you give me a broad overview of Indian BOPP market and what is our market share?

Management: India Industry, India domestic demand is close to 400k-410k metric tonne annually, production capability in India is close to 525k-530k per annum. About 120k metric tonne is getting exported from India. There is broadly demand and supply balance in the Industry. Currently, we have close to 20 to 22% market share.

Vipul A. Shah: That is right, okay and our SEZ capacity is how much today out of total capacity?

Management: Very broadly one third of the capacity lies with the SEZ.

Vipul A. Shah: Thank you Sir.

Moderator: Thank you. Next question is from the line of Shivani Viswanathan from Way2Wealth Advisors. Please go ahead.

Shivani: Just one last question. What would be the impact of GST Sir?

Management: One positive which we see is currently we do not get tax credit on CST sales. Under GST regime, it will start happening. It is going to be positive but may not have very significant impact on bottom-line. Beside, flexibility of sales from one state to another would improve.

Shivani: Thank you Sir.

Moderator: Thank you. Next question is from the line of Dikshit Mittal from Subhkam Ventures. Please go ahead.

Dikshit Mittal: Sir Can you tell us what is the quantum of coal that you use per annum?

Management: So it is largely 70 tonnes a year.

Dikshit Mittal: Okay, so the efficiencies now we have seen recently that coal price is also raising, so will it have any impact on our saving that we have made till second quarter of this year?

Management: It will have impact, but very small. The big delta was coming because the power rates were much higher than the coal, so there can be some very small impact coming from the coal price increase, but I do not think it can wipe out the significant benefits that we got from changing the mode of heating.

Dikshit Mehta: Thank you Sir.

Moderator: Thank you. Next question is from the line of Siddharth Mohta from Principal India. Please go ahead.

Siddharth Mohta: Sir, apart from Cosmo Films, any other players are also putting up their capacity?

Management: Cosmo is coming up in the Q4 with the new capacity enhancement and some more players have announced the capacity expansion, but there is a good amount of time gap expected between new capacity additions. I think next line will come may be around 8-10 months from our line and India would actually require about 50k tonne capacity addition each year just to sustain growing domestic demand.

Siddharth Mohta: Thank you.

Moderator: Thank you. As there are no further questions, I would like to hand the conference back to Mr. Ankit Gor for closing.

Ankit Gor: Thank you for attending the conference. I would like to hand over the call to management for final remarks if any. Thank you.

Management: Thank you very much. I think that was all from the management side. Broadly this quarter was quarter for us. Important factor is we could beat industry cycle to a large extent in Q2 by focusing on specialty and internal efficiencies. Thank you very much for joining the concall.

Moderator: Thank you very much on behalf of Systematix Shares and Stock that concludes this conference. Thank you for joining us ladies and gentlemen. You may now disconnect your lines.