# Cosmo Films Limited
# Q1 FY2020 Earnings Conference Call

**August 06, 2019**

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| **MANAGEMENT:** | **MR. PANKAJ PODDAR - CHIEF EXECUTIVE OFFICER**<br>**MR. NEERAJ JAIN - CHIEF FINANCIAL OFFICER** |
| **MODERATOR:** | **MR. SAURABH BHAVE - S-ANCIAL TECHNOLOGIES PRIVATE LIMITED** |

**Moderator:** Ladies and gentlemen good day and welcome to the Cosmo Films Q1 FY2020 Earnings Conference Call hosted by S-Ancial Technologies Private Limited. As a reminder, all participant lines will be in the listen-only mode. From the management, we have CEO, Mr. Pankaj Poddar and CFO, Mr. Neeraj Jain. May I now request management to please take us through his initial remarks, after which we can open the floor for the Q&A session. Over to you Sir!

**Management:** Company's strategy continues to be focused on specialty films having high margins. Typically, the capital expenditure is lower here; however, it requires high level of R&D. Since last few quarters, we continue to focus on research and development adding new R&D assets hiring seasoned people, PhD's and post doctorates in our team. Most of them have global experiences. As a resultant**,** we launched many sustainable projects with multiple large food and non-food brands. I think we are very well poised to continuously launch new segments and new products and help our customers. We had many new successful product launches like improved synthetic paper which will be a sustainable product because one it is from plastic and it can be recycled multiple times, so it's better option versus paper where we need to cut trees. Synthetic paper globally is a very large market, it is a very niche market and it is largely dominated by few large players.

Our new speciality film coating line has started commercial production, however it is still under stabilization, it would take another 10-15 days more to fully stabilize and start commercial production. This should help company augmenting specialty sales in the coming quarters.

The company's consolidated net revenue increased by 5% on Y-o-Y basis primarily due to increase in sale volume by 6%. During June quarter BOPP lines have been running close to 95% capacity utilization. The company achieved EBITDA numbers of Rs.60.6 Crores, which in absolute terms is one of the highest ever during last few quarters and it is 40% higher on Y-o-Y basis. This is backed by higher specialty sales, continued improvement in operational efficiencies, improvement in US operations, which has reported positive profit after tax and better BOPP film margins.

BOPP margins continue to remain subdued though from a last year's perspective they have improved to some extent. Given that now demand is almost matching supply we expect that the normalized levels of BOPP margins should not be away for too long within next few quarters we expect the margin should continue to improve. BOPP margins on the base commodity films are running close to Rs.14-15 per Kg during the last quarter, which was earlier as low as even Rs.5 while the normalized margins are anywhere between Rs.20-25 per Kg.

The company is running close to Rs.630 Crores of net debt level, which is close to 1:1 of debt equity and about little higher than 3 times of Net Debt/EBITDA levels. The company shall continue to focus on net debt rationalization during the current year. Capex during current year will primarily focus on specialty films. These are some of the updates for the quarter. Now we would like to open the concall for the questions, please.

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**Moderator** We will now begin the question and answer session.

**Question:** Can you give the volumes breakup of specialty and commodity films in general for this quarter?

**Management:** Company's overall volumes have also grown by 6%. For specialty films, we are maintaining an average of 40% to 45% share of overall sales since last few year.

**Question:** I wanted to understand the demand supply dynamics currently in the BOPP market in India and how has that improved in the past two quarters? Is there any major supply coming up?

**Management:** Demand is continuously going up by 10% to 15% per annum. BOPP is one of the very good materials from sustainability or recycling perspective and off late we are seeing that many larger brands are preferring BOPP films over many other films which further boost growth. The other thing is as far as the supply is concerned, there is one line expected somewhere in the middle of next year. There could be another line which may come next financial year (FY21). So as far as we understand these are the only two lines, which are due to be executed in next two years.

**Question:** What is per line capacity of 2 lines which is expected to start in coming few years?

**Management:** Both lines have capacity of 36,000-50,000 MT each of name plate capacity. Actual production in this Industry is close to 70% of name plate capacity. Let us say today's domestic consumption is Rs.4 lakhs Mt, even if it grows at a very nominal rate of 10%, so in two years we will be requiring roughly 80,000, 90,000 MT.

**Question:** What is the absolute amount of demand supply in India? What is the total market size?

**Management:** Domestic demand is now close to 40,000 MT per month and Exports is around 10,000 MT per month, closures are hardly 1000 to 2000 MT a month. At times closures would be due to preventive maintenance or somebody stressing not to export or they are not able to export.

**Question:** The privilege slowdown that we are seeing in the economy will that be a deal breaker for you to get to the normalized BOPP margins by any chance?

**Management:** As far as our industry is concerned we do not see a slowdown in fact from sustainability perspective we see a lot of domestic demand getting generated, things are only getting better in the short-term. Moreover some international brands are also looking India as a case study, so many projects that we did in India are expected to grow in international markets.

**Question:** So you feel because in last couple of preceding quarters we have seen a bad overall growth, but now things are looking normal and it can get improved further?

**Management:** Yes, that is right. In last two, three years four events disturbed our industry. The first event was demonetization, the second event was GST, third small event was transport strike and fourth where there was a lot of confusion in Maharashtra relating to plastics ban, last two events were 15 days each while the first two events were impacting for two to three months each.

**Question:** Is there any plan to reduce debt in the next two years, what is comfortable level or are we planning to reduce this by the internal cash flows?

**Management:** Our net debt is Rs.630 Crores. We are carrying a very strong cash balance in our balance sheet. In last one year we have already reduced net debt by more than Rs.100 Crores of debt and we will continue to be on this path to reduce it further.

**Question:** In last call you have mentioned that we are planning to repay Rs.100 to Rs.150 Crores debt in FY2020, so we are on track to do that?

**Management:** I am not sure if we have projected this kind of a number before, yes, we are continuously reducing our debt number and we will continue to reduce our debt number. Giving a forecast is difficult, but at the same time we do expect that our Net Debt/EBITDA ratio should be between 2 to 2.25 times at FY20.

**Question:** Can you throw some color on Subsidiary Operations what is really happening there? How do we see EBITDA trend, as it has been a little volatile over the last six quarters, there has been a couple of quarters where you have a negative EBITDA, couple of quarters where you are breaking even, this quarter you have done about Rs.6 Crores positive EBITDA

**Management:** Subsidiary operations in general is continuously improving. There could be one or two quarters typically Q3 which are lagging due to seasonal nature of industry. In general, if you see the trend line for last 3 to 4 years results are improving every year. There could again be quarterly ups and downs little bit here and there, but again if you draw one year line you would again find that next year will be better than the previous year.

**Question:** On a PAT level how much the subsidiary is contributed during the quarter?

**Management:** PAT is about Rs.4 Crores for June 2019 quarter.

**Question:** For last year full year I believe subsidiaries have achieved Rs.12 Crores PAT, for this year could be to Rs.15 Crores PAT on subsidiaries level?

**Management:** Last year we had about Rs 3 crores PAT in subsidiaries. This year we are seeing that the general trend line is continuously improving, so this year we are expecting a reasonable PAT coming from subsidiaries.

**Question:** **L**amination films, label films and industrial films, they all are specialty or those vertical also there can be commodity films?

**Management:** Label, lamination and industrial have mostly specialty (60% to 65%), but in those segments also there are some commodity films.

**Question:** What exactly we do in US and Korea, do we have a line there, is there any value addition happeing there?

**Management:** Yes, in Korea we have a value addition line and US we used to have a line, which we shifted to India now. In US & Japan we basically do stocking for our customers, we have a dedicated sales team present in these countries focusing on stock & sell.

**Question:** With upcoming coating capacity of 6000 MT, how much additional revenue can we generate from that?

**Management:** New line will basically help us in value addition rather than altogether new sales, so you can assume safely that coating would help us improve our sales price by Rs.60 to Rs.70 per kg even if you say Rs.70 per kg on that 6000 MT it would be roughly Rs.42 Crores as a minimum jump in revenue.

**Question:** In how many months new coating line will be fully utilized?

**Management:** It is very difficult to project because these are very specialized businesses and it does take time to get the approval with the customers, so some customers have already approved it while some customers are in the pipelines and some customers are still under approaching, but we expect that within next 12 to 18 months we should be able to fill up this line.

**Question:** Apart from new coating line is there any further capex planned for new products or R&D? Can you suggest new products which are in the pipeline?

**Management:** We are converting one of the BOPP lines into more specialized product, which should happen in 9 to 12 months, then we are also doing some backward integration for ourselves that should also happen over next 9 months and we are also looking at a small related packaging project, which will take 12 to 18 months. We are also looking at one or two related assets. I think capex for all these things is not expected to exceed Rs.70 to Rs.80 Crores over next 12 to 18 months. Our focus is more and more on specialty businesses rather than commodity, so the company shall continue to invest more on R&D and specialty related assets.

**Question:** What would be backward integration which you mentioned?

**Management:** All I can tell you is that it will help company to become a more research focused company, it will enable us to ensure that our raw material composition cannot go to competition that easily, so it will strengthen our research capabilities and it will ensure that our IP rights stay within the company.

**Question:** Is there any overcapacity in the global market and is there any threats of cheaper imports coming into India?

**Management:** Indian prices are one of the lowest in the world; However China have also kept prices very low for most parts of the year, so threat of import is not there. The importing prices were lower last year because of some capacities coming up in Europe, but Europe has shown improvement in last 3-4 months and we expect it should continue to improve. There is no capacity issue in other markets they are largely balanced.

**Question:** Is there any benefit from the US, China trade war for us?

**Management:** There are two impacts. One side there is a 25% custom duty on China, which is helping us improve our prices in some of the businesses. At the same time for India also GSP benefits have been taken away and therefore now our industry also has to pay 4.2% duty in US. It is a very mixed bag for us. This duty has been levied from July'19. We have gone back to the customers in last 10 - 15 days requesting them to pay this duty, most of the customers have been receptive to it and they have agreed to pay for it, given that there is a very high duty on China; however, the exact position will emerge in coming next few month.

I believe that in packaging, customers will have multiple choices in US; however, in lamination, customers may not have those many choices and therefore on an overall basis we should be able to improve our margins in US further; however, increasing sales will happen largely in the specialty area, we may not be able to look at semi-specialty or any commodity business in US.

**Question:** As you mentioned that our EBITDA is a little bit affected by the Maharashtra plastic ban, is there any threat from that sort in the future, is there any substitute available for our product, which can maybe replace our product in the market, can throw some color on that?

**Management:** That was a very temporary threat which happened to the industry, BOPP is one of the most recyclable material and it gives more opportunity than a threat. The only one area where there was a very short blip was textile bags, now if you guys would have seen that all the shirts are packed in a textile bag, which is made out of BOPP, the government has notified they should be made in above 50 microns films; however, there is not enough clarity in some states customers have shifted to 50 microns, in some states they are yet to shift. We are also pushing it in a significant way to our customers to push to 50 microns, so that will become a very big opportunity rather than a threat.

**Question:** Sometime back you mentioned that BOPP films has been used in white cement (premium cement) is there any other areas where our product has been developed for new users needs?

**Management:** There is endless innovation that we have done in last one year. If you would have noticed soap was also always packed in a polyester film with a paper, it always used paper loop. Now for one for the very large brands, we have shifted into a BOPP film and all other brands are also coming to Cosmo to help them on this project. There are so many other areas Noodles, ketchup, coffee, washing powder, bars where we have already developed our market or it is partially commercialized or it is in final stages of commercialization, so there is a lot going on.

**Question:** Will short-term raw material challenge have any impact on margins, has price got adjusted in tune to the increase in the raw material prices to stabilize realization?

**Management:** Normally in our industry shortage is considered extremely good. So if there is a shortage then the margins will shoot up. So I hope raw material availability becomes a problem in which case prices will go up rather than coming down. We have made sure that there is no shortage for us, moment we got to know about it we booked in four consignments, so we are very well placed.

**Question:** Last year we have commissioned new synthetic paper line, so are you satisfied with the quality, is there any new contracts that you have won in this particular segment?

**Management:** We have established a very nice customer in US. Our sales in last year have grown by more than 100% on a run rate basis, not on an overall basis as we were not able to take increased orders because of capacity constraint. We have also developed two new products on synthetic paper, now we have a complete bouquet of synthetic paper. On Quality wise or product wise we are sitting on a very firm ground now and we expect that this product should grow for us in future.

**Question:** As there is new coating line coming, we are going to focus more on the value addition films, synthetic paper. Can you give some direction how much will absolute contribution margin improve in FY20?

**Management:** There are two parts to our business, one is the specialty business, there the margins remain fairly stable and volume are continuously going up, going forward we expect to improve our margins as well. At the same time, the other part is commodity business where margins are volatile. We are looking to become Specialty Company in next 18 to 24 months, by reducing commodity volumes to 40% or 45% of overall share making us far less dependent on commodity margins.

**Question:** In this particular quarter interest cost was around Rs.11 Crores as compared to Rs.17 Crores on consolidated level, shall we assume interest cost will be same for the remaining quarters, are we also repaying debt?

**Management:** Our monthly interest cost has came down to Rs.3.5 crores. We expect it to further go down. This however may get impacted if there is sharp adverse FX change.

**Moderator:** As there are no further questions, I will now hand the conference to the management for closing comments.

**Management:** Thanks to all the investors for showing confidence in Cosmo. Our company's focus is to improve the specialty sales, invest in R&D and help the consumers at large on the sustainability which shall continue to yield results in the coming quarters. These actions would also de-commoditize the company's business model and would contribute in the medium-term sustainable growth for the company. The new CPP line was not running fully earlier is now running to the full capacity and we are also expecting some more efficiencies enhancement on BOPP lines. Our specialty coating line has just started production and it will fully commercialize within August month. It would further expand the company's high-end specialty business. Net debt rationalization shall again continue to be a focus area and you would see quarter-on-quarter drop in our debt level. We will do our every bit to ensure that stakeholder's interest is continuously best serviced by Cosmo. Thank you very much.

**Moderator:** Thank you very much for joining us. On behalf of S-Ancial Technologies Private Limited that concludes this conference.