Cosmo Films Limited
Q1 FY19 Earning Conference Call
August 13, 2018

Moderator: Welcome to the conference call of Cosmo Films Limited arranged by Concept Investor Relations to discuss its Q1 and FY19 Results. We have with us today Mr. Pankaj Poddar – CEO and Mr. Neeraj Jain – Chief Financial Officer. At this moment all participants are in the listen-only mode. Later we will conduct a question and answer session. At that time if you have a question, please press '*' and '1' on your telephone keypad. Please note this conference is being recorded. I would now like to hand the conference over to Mr. Snighter of Concept IR. Thank you and over to you, Sir.

Snighter A: Good afternoon everyone and thank you for joining us on the Cosmo Films Limited Q1 FY19 earnings conference call. We will begin the call with the opening remarks from Mr. Poddar followed with a forum of a Q&A session. Before we start, I would like to point out that certain statements made in today's call may be forward-looking in nature and a disclaimer to this effect has been included in the earnings presentation shared with you earlier. I would like to invite Mr. Poddar to make his opening remarks. Over to you, Sir.

Management: A very good afternoon everyone. I am Pankaj Poddar, CEO, Cosmo Films and I am joined by Neeraj Jain, CFO at Cosmo Films. I hope you could go through our financial results and investor presentation which have already been uploaded on our website.

First the key highlights for the June quarter. In June 2018 our Company's consolidated net revenue increased by 24% on year-on-year basis largely backed by 5% growth in volumes and 15% change due to increase in raw material prices which has been passed to the customers. We have been running close to 95% capacity utilization on new BOPP line commissioned in February 2017 in spite of the fact that there were multiple lines which came up later on and I think a lot of it was made possible because of significant increase in our exports that we could achieve. Company has also launched improved synthetic paper and multiple films like improved barrier films as well as films which are heat resistant. All these films continue to help improve the pipeline of specialty films. As far as synthetic paper is concerned this helps in giving a non-tear-able paper which is quite durable and has a longer shelf life and has capability to be used in several applications, be it labels, tags, maps, ID cards, tickets for adventure parks, certificates, etc. In real sense it can replace paper wherever paper is used it is recyclable in nature and at the same time it is quite durable. The global market for synthetic paper is fairly large. There are some 5 or 7 companies in the world which specializes in synthetic paper and we are the only company who manufactures synthetic paper in India. So right now, our efforts are one is channelized towards expanding the Indian market for which synthetic paper is still quite a small market but also participate in the global markets for synthetic paper which is quite a niche product for the market. We have also set up office in Poland, Europe which is a growing market and would ensure that we are closer to our customers in Europe. Earlier we had also started stocking in Germany to start ensuring that we give very quick dispatches to our customers specially for packaging labels in that market.

The company achieved Rs 43.3 crore EBITDA which is 19% higher on year-on-year basis. Commodity margins continue to be challenging. However, better EBITDA is achieved largely through volume increase, better sales mix and enhanced operational efficiencies. We were also able to improve our sourcing and reduce our wastages, all this contributed to better EBITDA. We have been focusing on operational improvement in overseas subsidiaries from last few quarters and that has started yielding some results and we posted positive EBITDA of subsidiaries operations by Rs 2 crore in June quarter as against negative EBITDA of Rs 3.6 crore last year. We continue to see a positive momentum in USA market i.e. USA has put 25% custom duty on films coming in from China, which should have positive impact on Company’s margin in USA. We are already seeing a very positive momentum coming up from that market and as we move along we should see a very healthy growth in the volume numbers as well as our EBITDA numbers coming from US.

It is very difficult to exactly estimate when commodity margins would normalize. One good part is that for the next two years we do not expect any volume or any significant volume to start and therefore as we move along the commodity margins should improve. It's a matter of time before they should start improving. And obviously the volume growth is very nice especially in the converting segment.

The company is consistent in approach and would continue to focus on improving specialty sales mix and internal efficiencies and that would facilitate more stable margins and de-commoditize the business model.

Interest expense for the quarter includes foreign exchange fluctuation of Rs 5 crore on foreign currency borrowing and therefore you could see that our interest cost has gone up since last year. As per applicable accounting norms, major part of foreign exchange loss is getting deflected in interest cost. The company has implemented foreign exchange risk management policy and part of the exposure is maintained unhedged while other part is hedged. We expect the Dollar may weaken further and therefore in July month we have hedged a fairly large part of our Dollar risk that was there in the Balance Sheet. So, the numbers that we see in the June were basically a reflection of the closing balance that we had in the numbers while in early July we were able to take hedges. So, I think now a fair amount of our foreign currency for the short term is hedged.

So, these are the few updates on the quarter. 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. The first question is from the line of Ritesh Poladia from Girik Capital. Please go ahead.

Ritesh Poladia: I missed your volume growth and price growth in this quarter?

Management: There is a 5% volume growth versus last year. There is roughly 4% improvement in mix and there is roughly 15% increase in sales because of increase in raw material prices.

Ritesh Poladia: Can you comment on the utilization?

Management: There is close to 95% capacity utilization.

Ritesh Poladia: Can you also comment on the average utilization for entire FY18?

Management: FY18 close to 90% average utilization.

Moderator: Next question is from Ameya Mahurkar from Emkay Global. Please go ahead.

Ameya Mahurkar: How much is export volume as a percentage of overall volume?

Management: In volume terms close to 40%-45% exports.

Ameya Mahurkar: Value added products, Sales as a percentage of total volumes?

Management: That’s around 40% right now.

Ameya Mahurkar: State tax incentives quantum in profitability?

Management: Close to Rs 4 crores.

Moderator: Next question is from Jiten Parmar from Aurum Capital. Please go ahead.

Jiten Parmar: My question is basically on the capacity utilization. You said it's 95%. That is name plate, right?

Management: No, this is not name plate capacity utilization. Name plate capacity is normally very high because it's calculated on a certain micron, while in reality we produce many different types of microns. So therefore, those numbers are never achievable because there are a lot of thin microns also being produced. Now, these have a potential to increase further because government is saying that the minimum micron which is to be used at 50. If at all this has to happen across the country, then you can certainly expect that name place capacity moving up. But right now, given that there are a lot of thin microns, 8, 9, 10, 12, 15, 18, lot of different microns are being produced in the country, therefore, its never close to the name plate capacity numbers.

Jiten Parmar: This Q1 what were the EBITDA margins?

Management: It was around 8.5% roughly.

Jiten Parmar: There was some MPCB closure notice which was sent. What is the status on that?

Management: There is a lot of confusion going on in Maharashtra because Maharashtra has come out with the new notification in terms of recycling and we had been telling them that BOPP is one of the best plastics because it is completely recyclable in nature and company also does recycle whatever waste it produces. The same has been clarified to the Govt.

Moderator: Next question is from Pritesh Chedda from Lucky Investment Managers. Please go ahead.

Pritesh Chedda: When you gave capacity utilization at 95%, what was your reference capacity, it was 1, 36,000 or the expanded capacity of 1,96,000?

Management: The same is 95% of micron adjusted name plate capacity i.e. between 70%-75% of name plate capacity.

Pritesh Chedda: What are the current realizations running around in the commodity product and the specialized product?

Management: Commodity, there are two types of commodities. One is, the tape and textile and the second one is non-tape textile. So, when you talk about tape and textile the prices obviously are changing a lot because the raw material is changing quite a bit in the last quarter. But you can assume that the value additions are anywhere hovering between Rs. 14 to Rs. 18 per kilo on the raw material. While if you talk about the non-tape and textile there the value additions are hovering at Rs. 22-26 a kilo. This is value addition over and above the raw material price.

Commodity margins are really running very tight. I am not sure whether all the companies in BOPP are even able to recover their overheads properly. If somebody has to sell only tape and textile the margins are running very tight and it's obviously a demand and supply situation and as we see some of this situation balancing out I am sure the margins should improve. I think the other thing which should improve is that US has imposed customs duty on China and therefore there should be some opportunity exporting these films to America as well.

Pritesh Chedda: How is the supply-demand balance looking like and what are your comments there?

Management: As far as what we understand is most of the players are running their lines to full. It is just that everybody is selling in export also. Now what is happening is manufacturers who are in North they are not able to export efficiently because their freight cost to the port is very high and therefore they are trying to push everything to the domestic market itself, or let’s say, a large quantity of their volumes. While the western players are able to export, specially Cosmo, which is always the front run in this. So, I think as far as demand supply is concerned there is not too much of a gap. Its still a small gap. But definitely there is a gap and as we move along some of this export would then get converted into domestic sales. So, manufacturers in central and western are may be exporting anywhere between 8,000-10,000 tons outside of India.

Pritesh Chedda: What are our CAPEX plans?

Management: As far as our Capex is concerned, we are coming up with another coating line which is going to increase our value add further. This line should come somewhere early next year within the first half of next year and that CAPEX should be in the range of a little less than Rs 30 crore. And other than that, we had also announced the PET line on which right now we are going a little slow because we want to make sure that unless the BOPP margins improve we do not do assertive capex. So as far as the CAPEX is concerned the immediate CAPEX is only the coating line.

Pritesh Chedda: You are not adding any new BOPP line as of now?

Management: As of now no, nothing.

Moderator: Next question is from Mohammed Mohsin, who is an individual investor. Please go ahead.

Mohammed Mohsin: I have heard many times from you and Mr. Jain and Mr. Ashok Jaipurai in interviews that oil prices doesn't affect your margins. But now you are saying oil prices are affecting our bottom-line. So, I am confused a little bit, please clarify.

Management: We continue to maintain that oil prices do not impact our margin. I think what we were discussing was that our sales went up because the oil prices went up and therefore the raw material cost went up. Because the raw material cost went up accordingly the sales price went up. Really speaking the impact of oil is largely on our working capital. There can always be a little lag in terms of either the decrease in sales price or an increase in sales price.

Moderator: Next we have a follow-up question from Jiten Parmar from Aurum Capital. Please go ahead.

Jiten Parmar: Basically, what I understand of the industry is that around 12% EBITDA margin is a comfortable situation. Now, when do we see basically the difference between demand and supply narrowing where we can get to this particular range of around 12%

Management: It is difficult to predict but all I can say is that Indian demand is growing anywhere between 10-15% and at least for the next 10 years it should continue to grow like that. And I think the other important element is supply. So, all we know is that for the next two years there is no new supply expected to come other than the one Chiripal line which is kind of on-hold for quite some time now. So, the supply is getting controlled now while demand continues to grow, so there has to be some inflection point where the margins has to improve. Now whether it is two quarters, three quarters, four quarters, is very difficult to comment from our side.

Moderator: Next question is from Navneet, who is an individual investor. Please go ahead.

Navneet: I wanted to check what portion of your plastic is recyclable in nature and this entire drive of anti-plastic going on, do you see that as a headwind for your business in the medium term?

Management: BOPP as such is completely recyclable and it consumes very less power both at the time of producing BOPP and at the time of recycling it. It's also a very light material because it has a very low density of only 0.9. So, one is that, yes, it is recyclable and then the other thing is polypropylene and polyethylene are the only two materials which can provide all different type of solutions for flexible packaging. So definitely I think we are going to see a significant upswing in the consumption for polypropylene where it is going to replace a lot of other materials in the times to come and this is not just an India specific movement, I think we are seeing a very global movement for this when I was there last time in the global conference one of the players very large well-known players who is largely a polyester driven player they themselves clearly said that world is going to move much more towards BOPP and polyethylene films and more towards polypropylene because polyethylene also has some challenges of printing and other things. So, I think the biggest advantage should come from BOPP segment as such.

Moderator: Next question is from Hitesh Shah, who is an individual investor. Please go ahead.

Hitesh Shah: I need a short update on the upcoming BOPET project. Like, what is the market scenario at the moment in BOPET industry, when are we expected to go into commercial production, total how much CAPEX and what are the expected level of utilization in 2019-2020 if it goes, say, you told somewhere that it is going to go into commercial operation in last quarter of current financial year.

Management: See, as far as PET film is concerned, PET is having a nice run right now because of the fact that JBS had to shut down their operations abruptly and JBS had seven PET lines and therefore that is resulting in some kind of shortage in the polyester and therefore it is a very good going for the polyester. Now as far as our polyester line is concerned we are kind of staying very conservative and do not want to get very aggressive on capital expenditure right now. So, we have been kind of differing this polyester line for the moment. Lot of our working background work has been done so the moment we restart our initiative it should happen fairly fast but at this stage it looks like that we should be able to commission the polyester line by early 2020.

Moderator That was the last question in queue. I would now like to hand the conference back to the management for closing comments.

Management: I think as we move along you should see Cosmo continue to put very special focus on all the value-added films. Packaging segment we are looking to provide sustainable recyclable structures to the market. We already have very good solutions in hand with us and we are talking to a lot of big size brands and converters to help them have recyclable structures. On the labels segment, we continue to grow fairly well both in the domestic market and the export market and it's a matter of time where we take a very significant share on some of the niche label segments as such. On the new product development front, we are putting a lot of focus on synthetic paper which can work for multiple applications. Synthetic paper is roughly a 0.5 million tons market globally at quite reasonable margins and that is one area where we are putting a lot of research effort right now to provide a very good synthetic paper to the market. So, I think these are the core areas for us. We continue to de-commoditize our company and I think it's a matter of time before the commodity margins would get better which had been only going down and now we have reached a level where at least they are not going down and therefore you are able to see some impact of all the improvements we are able to bring in the operations. So, we continue to improve and in the times to come you would see Cosmo being a more and more de-commoditized company as such. So, thank you for attending once again.

Moderator: Thank you very much sir. Ladies and gentleman, thank you for being a part of this conference call. If you need any further confirmation or clarification please mail pratik@conceptpr.com. or ankita@conceptpr.com. Ladies and gentleman that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

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