"Cosmo Films Limited
Q3 FY2022 Earnings Conference Call"

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MANAGEMENT: **MR. PANKAJ PODDAR – CEO– COSMO FILMS LIMITED**
MR. NEERAJ JAIN – CFO - COSMO FILMS LIMITED

MODERATOR: **MR. BHAVYA SHAH - S-ANCIAL SOLUTIONS PRIVATE LIMITED**

Moderator: Good afternoon, everyone. I welcome you all to Cosmo Films Limited Q3 FY2022 Earnings Conference Call. From the management, we have, CEO, Mr. Pankaj Poddar; and CFO, Mr. Neeraj Jain. Starting off with the statutory declaration, certain statements in the conference call may be forward-looking. These statements are based on management's current expectations and are subject to uncertainties and changes in circumstances. These statements are not guarantees of future events. Now, may I request Mr. Neeraj Jain to take us through his opening remarks subsequent to which we can open up the floor for the Q&A. Thank you, and over to you Mr. Neeraj.

Management: Thank you. A very good afternoon, ladies and gentlemen. I am Neeraj Jain, CFO at Cosmo Films and joined by my colleague, Mr. Pankaj Poddar, Group CEO at Cosmo Films. Our financial results for Dec'21 quarter and investors presentation are already available on company's website.

Dec '21 quarter, company had posted record consolidated quarterly EBITDA of INR 161 crores. This is as against INR 152 crores in previous quarter and INR 112 crores last year same quarter. With this quarter results, company has posted uptick performance continuously in a row from last 12 quarters now. In fact, this is the first quarter when the company has posted more than INR 100 crores quarterly PAT i.e. Rs INR 104 crores for the quarter.

Consolidated sale for the quarter was INR 771 crores, which is higher by 35% compared to the December'20 quarter. Couple of factors worked behind this including higher specialty sales which has been growing more than 20% y-o-y basis, higher overall volume by 4%, higher margins and the raw material price increase which got passed on to the customers.

EBITDA has increased to INR 161 crores during the quarter which is 44% higher as compared to Dec '20 quarter. The enhanced performance is on the back of a couple of factors including higher specialty sales, better operating margins (BOPP margins has been running close to INR 42 per kg during Dec '21 quarter compared to INR 30 per kg in Dec '20 quarter), uptick performance by the subsidiaries which have posted INR 29 crores EBITDA during Dec '21 quarter. The corresponding figures in last year same quarter was INR 11 crores. Subsidiaries performance is better due to higher sales, specialty films growth and better margins.

Enhanced EBITDA together with lower finance cost and lower effective tax rates led to increase in PAT by 65%. Increase in EBITDA is 44% against which PAT increase is by 65%. Increase in EPS is by 75%, which is higher than even the PAT increase due to impact of buyback of shares in Dec' 2020.

On a trailing 12 months basis, EPS stands at INR 203 per share compared to INR 127 per share for financial year 2021. Based on the trailing 12 months basis, ROCE stand at 28% and return on equity at 37%, which in fact is one of the best in the industry.

The Board of Directors has declared second interim dividend of INR 10 per equity share together with the first interim dividend of INR 25 per share. Now, total dividend for FY22 stand at INR 35 per equity share compared to INR 25 during FY21.

Moving to balance sheet side. The net debt to EBITDA now stands at 0.6 times and net debt to equity at 0.3 times which reaffirms the strong financials of the company. The company is looking at close to INR 200 crores of Capex during next 6 to 9 months and, which will be largely on specialized BOPET line, value-add Capex to further enhance our specialty films sales and Capex on sustainability and specialty chemical division.

The financials are expected to remain strong even with this Capex considering robust cash generation from operations. The bottom-line impact of this Capex will start from FY23, although full year impact will be in FY'24.

During the quarter, the company has received sanction under PLI scheme for production of a specialty film to be used in electronic products. Incentive under the scheme will be for 5 years on 100% production of new plant. In Phase 1, the company is planning to put 1,200 MT annual capacity with Capex of about INR 32 crores. The Capex is expected to generate 2 to 2.5 times asset turnover ratio.

The company has published its first report on sustainability and ESG initiatives on its website. You are requested to refer the same. In fact, the company is working on a sustainability plan for the coming years, which shall further enhance and create favorable environmental impact beside cost optimization. Details of the plan will be announced very soon.

Moving to growth projects. In coming years, I think very clearly B2B segment and B2C segment will drive the growth. When we say B2B segment, here we are referring a specialized BOPET line which is expected to commence operation in Q2 of FY23 and the BOPP line which is world's largest BOPP line. In B2C segment, pet care and specific specialty textile chemicals will drive the growth.

Specialized BOPET line will add close to 20% capacity. The company is targeting complementary growth of shrink label and other higher specialty products which will partially substitute imports and provides excellent opportunity to convert known recyclable PVC film market of about 30,000 MT in India.

The company has placed order for the new BOPP line which will be as I said, the world's largest production capability line and it will increase the production capability of the company by close to 1/3. The line is expected to commence operation from FY25. Both the new capacity plant will allow the company to further expand its specialty sales in coming years.

The launch of our Pet Care division under brand name Zigly has delivered better than forecasted results. Now, the company is looking forward to rolling out its digital first Omni channel business model. In fact, parallel to this, we have also rolled out mobile van service in NCR and launch of e-commerce platform. Company is now planning to expand Zigly's business both in the digital and offline model over the coming quarters, which will obviously include the experience centers, retail stores, vans etc.

Now, moving to textile chemicals. Textile chemicals business which started in the Q2 of FY22 has taken off very well. Within the first 3 months, the company has commercialized 40 plus products and has started supplying to more than 40 customers. The company continues to conduct extensive trials with the customers and expect to further add more products in the coming months.

I think these are the updates for the quarter. Now we would like to open the call for the questions please.

Question: In initial remarks you mentioned that our subsidiaries have been showing very healthy growth Q-o-Q every quarter from last 3, 4 quarters. So, what has actually changed in last 4, 5 quarters where our EBITDA in absolute amount or in percentage terms have been moving higher? Are there new products which we have introduced there? Or, have we done some cost rationalization there? Or, are we supplying the products here from India keeping India as a manufacturing base? So, what has actually changed from FY21 which has really helped to show this improved performance?

Management: We have been winning a lot of new businesses in our subsidiaries and majority of it is of specialty films where the margins are much better. And in general, we have also been able to keep our price tables at a strong level in the subsidiaries.

Question: In terms of capacity utilization, do we have some leeway from the current levels where we can further improve our utilization or are we planning some capacity expansions there to fund the future growth?

Management: Currently we're fully utilized. In Q3, we had a plant shut down during Diwali for annual maintenance. So, we do see some upswing in the volumes in Q4, but that will be hardly 3% to 5% of our total volumes. The growth now will come from the polyester line which will come in the Q2 FY23 and then the new BOPP line that we've announced. Business growth will also come from the Cosmo specialty chemicals. Their Q-o-Q, we are seeing growth in the numbers and the textile business is also expected to start post the necessary government approvals in this quarter itself.

Question: As you mentioned that we will be doing a Capex of INR 200 crores over next 6 to 8 months, where some of the Capex would be for that specialty BOPET line and some for expanding our specialty BOPP capacity. So, how much of those Capex would be for taking our specialty sales from 62% to 80% of overall capacities? And, if you can also help us understanding that which category of specialty films would help us to grow?

Management: Majority of Capex that has to happen will be in specialty polyester business. As far as specialty BOPP is concerned, there's not as much Capex happening other than building some new barrier options for our customers. The growth is likely to happen in multiple segments whether it is a specialty packaging where our focus is on heat resistant and barrier films which help in being far more recyclable and sustainable. The growth is also happening on specialty label films, synthetic paper, high end films in the lamination segment & Industrial film.

Question: In Company Presentation you've given since Sept'18, Net Debt of INR 759 crores has come all the way down to INR 455 crores. Do you feel that the company has moved to the level where the debt levels will keep coming lower? Is Capex becoming more self-sustaining with the cash flows? And, what would your financial policy be given the fact that ratings have gone into the high safety category?

Management: As you rightly said, net debt has come down significantly. The latest Net Debt number is close to INR 350 crores. We do believe that Cosmo will definitely remain focused on the growth. So, some Capex will keep on happening, while we are not looking to be debt free immediately. But yes, cash generation is happening very fast. So, to sum up while some debt level will remain in the company, but the financials are expected to be very robust.

Question: My question was regarding rational behind our optimism on specialized BOPET line where we are putting a large Capex and way you've been citing the future. Can you elaborate on that?

Management: Broadly what we are targeting is the specialized products in the BOPET line and to a large extent, some of these will substitute the imports happening in India. Some of it will also substitute captive consumption, because earlier we were buying some BOPET films from outside which it will substitute.

Many of these segments are similar to BOPP. And, given that Cosmo is in top 3 in many specialty segments worldwide. We will be able to take benefit of getting into these segments faster. The only effort that we were supposed to do is to work on the machine design, which we worked along with the machine supplier for a good period of 1 year. And, second is to work on the product recipes, which we have been working for last 2, 2.5 years and will continue to work for another 2, 3 years to make sure that we supply the right products to the market. And obviously, we have enlarged our research team, we have hired some consultants to make sure that we are able to bring these innovative solutions to the market.

Question: In Investor Presentation you've mentioned about partnering with some of the best global brands to offer structural rationalization, will it be possible to elaborate on that, sir?

Management: We're working with some of the largest FMCG players to help them with the recyclable packaging. Just to let you know lot of large brands have made commitments to their stakeholders that they will shift to recyclable packaging either by 2025 or by 2030. Cosmo had always been at the forefront in providing these innovative solutions. These FMCG players are looking at very select players in the world who have the research capability to help them with these solutions. We were the first ones to come up with heat resistant films, ultra-high barrier films in the world. There are lot of other solutions we provide to our customers for recyclable packaging.

Question: Regarding your specialty films that you will produce under PLI scheme. Will you set up a new facility for this, or it's a brownfield expansion?

Management: We will set a new capacity in Maharashtra. This film is largely imported. Hence, we are putting new line at our facility to cater electronic industry. As we learn more about this industry, we will be then evaluating whether we should put larger Capex on this. Having said that, to begin with it's a value-addition that we are going to do.

Question: Regarding your adhesive products which you're are planning to introduce. Are these adhesive tapes only or are you planning to introduce some Fevicol and glue sort of products also?

Management: There are 5-6 segments that we are going to enter. Three segments are related to our current business which is packaging, lamination and labels. These are very large markets and some of these segments are very niche, where very few players are there worldwide. There are two more adhesives. One is for automotive industry, other is for electronic industry that we are planning to come. So, there are five, B2B solutions that we are going to come up in the Phase 1. Obviously, as we start, getting larger, we'll certainly evaluate other segments because as we understand adhesive itself is a very large industry. And, we are making a humble beginning in the coming quarter.

Question: Regarding your textile chemicals business. So, a lot of textile chemicals that you have launched are they in pilot stages? How much Capex do you think you will need to spend to take these capacities to commercial scale production?

Management: We had put up our plant in September and started our pilot facility in February, March. So, in this period we kept on doing trials with various customers. And the good part is that the moment we are able to start our facility, we have started gaining customers. So, till now we have already commercially invoiced to 40 plus customers and we have launched 40 plus products. Next year again, our effort will be to launch another say 30, 40 more chemicals. Some of the larger players in the industry have close to 300 to 400 products. Having said that, we are also innovating some very unique solutions for our customers which we have identified as unmet needs. And, as and when we will launch new products, we'll let our investors know in terms of what is so unique about such products.

Question: Can you have share buyback instead of giving dividend?

Management: See this is a subject beyond myself, to be honest. This has to be decided by the Board of Directors. This is something which they keep evaluating. One thing I can tell you for sure that our entire Board and Chairman is very sensitive towards making sure that the shareholders are rewarded handsomely.

Question: How much top line growth we may expect in next 3 to 5 years in the company?

Management: Post our BOPP line stabilization, we feel that we will be close to INR 5,000 Crore Company.

Question: In earlier calls, you've indicated that the specialty margins are in the range of INR 50 to 60. And, now with the commodity margins nearing INR 40 to 42, do the specialty margin still hold or will they move higher?

Management: Specialty margins do not change upwards or downwards, because they are not dependent on raw material price movement. Last quarter, commodity and specialty margins, were all hovering at a very similar number as a percentage to sales. The sales price, for specialty was obviously much higher than commodity price but percentages margins were very similar because commodity margins itself right now are at a very good level.

Question: As you set 10% overall revenue target each for specialty chemicals and Master batches business, would we need to do any further Capex to achieve these goals or will present capacity would suffice?

Management: The beauty about chemical business is, it's more about innovation than Capex. But yes, you're right. We will have to invest another INR 50 to 60 crores in our chemical business, but it is not going to be significant.

Question: I believe for our Capex in Aurangabad, we are entitled to some tax benefits. So, if you can just highlight what are they and when should we expect them to start flowing in?

Management: They will start to come once the polyester line is commissioned and we had put up an investment application under mega scheme where we see certain amount, we'll get the entire investment back over a period of 20 years.

Question: In our Pet Care business, I wanted to understand on our online side, would this be more of a market place or would we be stocking the inventories that we're going to sell over here? And our priority is going to be whether on scaling this online first and then through the data gathered, we will use that data to increase our offline presence in the target cities? Or if you could highlight a little bit on that side as well?

Management: There are two things. As far as the products are concerned, we will have our model of stock and sell. But, when it comes to services online, we're going to follow a market place model. And, we are one of those companies which are doing Omni channel growth at the same time. So, we're going to scale-up both online as well as the offline at the same time. So, from our revenue perspective, we are going to be online, we're going to be on our experience centers and we will also evaluate whether we should scale-up our van business.

We are also going to follow Urban Clap model, of standalone, trainers and groomers and the booking can be done only through our app. Pet parents can book the services of a groomer or a trainer on our app and these are certified Zigly trainers who have gone through rigorous trainings and a standardized method of training and they will then visit the pet parent and take the services with any of you are from Delhi, you can already start using this services at your residence and you can very well feel the difference in terms of how professionally we've done this. Till now, all our customers have given us 5-on-5 rating. There are more than few thousand customers who have already tried us.

Question: I didn't follow why would you not do a market place model for the inventory? As in, why would you have inventory on your books and take the inventory risk? And second, when you refer simple Google online like you do for pet food and stuff like that, there are at least

5-6 options which come up plus you've Amazon and Flipkart. So, is there already enough competition in this segment?

Management: First of all, this market is already close to INR 6,000 crores. And, there's hardly any large player in this segment. All the players that are there are unorganized until now. There is only one company which has already been valued at INR 750 crores, while as per the unofficial sources, their turn-over was still less than INR 100 crores. So, you can understand the kind of interest which PE firma are having in this sector. There are couple of others very small players who have already got few million dollars of investment from the PE funds. This segment is expected to cross INR 10,000 crores within next 3 to 4 years. Now to answer your question, why are we not selecting a market place model for products? See market place model is already there with Amazon and Flipkart. We're right now trying to create a niche for ourself where we will be doing both online and offline, create a very large sale, start commanding the purchase power with the suppliers and also create a brand name for ourselves. At the right time, in the right segments, we might also see whether we need to build our own brands but it's too early to comment anything on that site. Our initial focus is to start scaling up both our online presence and our experience centers. And, we want to give a very differentiated, unique experience to our customers which we've already started proving in the initial pilot scale start-up that we've done.

Question: In your presentation you put up a Capex figure of INR 15 crores in Pet care Business, but would that be sufficient as this business grows up?

Management: This is the only, the first estimate that we had made for the next year. Seeing our success, we're evaluating whether we should scale up faster. But, even if this changes, it can change from INR 15 crores to INR 25 crores and not to INR 100 crores, because we're largely operating on a lease model where all the new experience centers are on lease. So, our investment is limited to the leasehold improvements that we do in any new site. As far as online is concerned, we've already built up our website, again our warehouse are on lease model. Majority of the investments on the online, I would say 40%, 50% of investments have already happened. So, majority of our new investments will largely be happening on the scale up of experience centers.

Question: In your presentation you have planned to demerge this business in the medium terms. So, are we looking at any fund raising in the near-term for this business, so that we can accelerate the pace of our growth?

Management: That is something we continuously evaluate. With the right time, we will see whether we need to take investment from outside. But, more than investment, some of these key investors have lot of wealth of knowledge. They are able to bring the best practices followed all over the world that can help us grow faster and so on, so forth.

Question: Are we over diversifying, from a films company to chemicals and pets business, there is no correlation beyond the limit between the three businesses. So, first is, is the company diversifying far too much into varied segments? And the second one as of today almost 100% revenue is from the film segment. But, if you take a 3-year view, what could be the segmental breakup across the three segment from a top line & EBITDA perspective?

Management: We intend to be a large Indian conglomerate and we realize that just being in films, it may not be possible and therefore we decided to diversify. Some of our diversifications definitely are not unrelated but some are related. So, adhesives and Masterbatches are related to us while being into Zigly business and textile chemicals to some extent are unrelated. Having said that, we've to understand that film itself is estimated to become close to INR 4,500 to INR 5,000 Crore business in 3 years from now. In Chemicals will contributing 10% to 15% of our revenue by then. Zigly being a consumer business, it will be lesser than 10% in 3 years. But we definitely intend to grow both the businesses at a fast pace.

Question: Can you share the financials of Masterbatch business till date, if it is possible? What is the top line and what is the EBITDA contribution? What kind of a Capex you see happening to ramp up to INR 500 to 600 crores revenue in our specialty chemical including Masterbatches?

Management: Masterbatch business we're doing in 100% subsidiary, in any case at the end of the year, separate results will be available on the company's website. But, very broadly, we have done INR 60 crores of sale for the CSC over 9 months. We are EBITDA positive in this segment.

Actually it's not CapEx centric business. The asset turn-over in this business is very good. So, we believe, we may spend another INR 50 to INR 60 crores on CapEx in next 3 years.

Question: How company goes about its R&D, Do we first identify a problem and then try and find a solution for that? Or do we get some lead from our customer or something that they are facing this particular problem and then we try and find a solution? If you can just throw some light on how we go about our research in developing new products?

Management: To begin with we do market research to understand the entire market. And then, we identified certain segments where we saw that there is growth opportunity and at the same time, customers have lot of unmet needs. So, initial work happened around that and obviously during that phase, lot of customers' interviews were also taken to understand the market better. Now, as we have our own set of R&D team and sales team, as we go to different customers, our first question always to them is, what are their unmet needs and we try to see whether is this large enough for us to do research upon. So, wherever we find that there is any attractive product, we try and make that. Having said that, textile chemical is one area where we have to make a bouquet of products. So, let's say, if we intend to get into cotton and cotton itself has many sub-segments, we have to understand that what is the entire bouquet of the products to be on cotton side. Now, we have started moving on the polyester side. So, one of the critical things that we found out during our research is that textile industry consumes lot of power and water. And therefore, our initial research efforts were, how can we reduce their power and water consumption. We came out with lot of innovative products which helped them doing so.

Question: What would be the opportunity size in terms of these products that you've developed? Any ballpark numbers you can give?

Management: You see the Indian textile chemical market is more than INR 10,000 crores. Maybe large part of this is currently serviced by Multinational players. While there are lot of small players especially in Gujarat who were also being part of this market. We feel that we will be within top 5 players in this segment within first 3 to 5 years. Our portfolio of 40 products is obviously much smaller there are paper, silk, nylon, rayon, wool, cotton, polyester and so many different sub-straits. And again, for different sub-straits there are different sub-processes. So, for each type there are different type of printing methods, dyeing methods. Therefore, the chemicals keep differentiating for each one of them. And, within every process itself, there are 10 to 12 chemicals being used. And therefore, the number of processes being used for this industry are close to 400 to 500 and they continue to evolve because every company or let's say the good players continue to research in terms of providing better solutions to the customers.

Within this let's say a large chunk is coming from dyes and we haven't entered into the dye segment. So, if we get only non-dye segment that would not be more than INR 4,000 to 5,000 crores. And, within that, yes, cotton chemicals maybe INR 1,500 crores, polyester chemicals maybe INR 1,000 crores so on, so forth. So, to begin with these 40 chemical segments is niche and market for them.

Question: Any comments on the China's role which leads to the contraction and expansion?

Management: China doesn't affect Indian market because there is a 10% custom duty and therefore, China doesn't export anything to India when it comes to films. In the international market, there are largely there in some commodity segments. Like, tape is one segment where China is very strong but again, we see that China is largely producing for their own consumption than to export as much.

Question: Regarding is bases for classification of specialty films?

Management: Specialty anything where there are not more than 3 to 4 suppliers worldwide. Minimum contribution that we expect is INR 50 per kg.

Moderator: Thank you. Ladies and gentlemen, this was the last question for today. I would now like to hand the conference over to the management for closing comments.

Management: Well, thank you. Company is taking all steps required to transform into a specialty packaging and specialty chemical company both in B2B and B2C segments. Specialized polyester lines and new BOPP line to be commenced in FY23 and FY25 respectively. Focus is on our growing specialty sales, diversifications into specialty chemical and pet care which will drive growth in coming years. The company's continues to take actions on R&D and sustainability which will continue to improve margins and will contribute in the long-term sustainable growth.