# Cosmo Films Limited
# Q2 FY18 Earnings Conference Call

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**MANAGEMENT:** **MR. NEERAJ JAIN - CHIEF FINANCIAL OFFICER**
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**MR. PIYUSH MALIK - INVESTORS RELATIONS**

**ANALYST:** **MR. ANKIT GOR- SYSTEMATIX SHARES & STOCKS**

**Moderator:** Ladies and gentlemen good day and welcome to the Cosmo Films Q2 FY18 Earnings 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 the 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 & Stocks. Thank you and over to you Mr. Gor.

**Ankit Gor:** Thank you. I welcome all in Q2 FY18 Earnings Conference Call of Cosmo Films. I would like to thank Mr. Neeraj Jain to be present on this call. I would like to hand over the call to Mr. Jain and post which we can start our Q&A. Thank you sir and over to you.

**Neeraj Jain:** Thank you Ankit. Good afternoon ladies and gentlemen. I am Neeraj Jain, CFO at Cosmo Films. I am joined by my colleagues Jyoti Dixit, Company Secretary and Piyush Malik from Investors Relationship.

We will first start on the key highlights for the September '17 quarter.

September '17 quarter top line has been at INR 488 crores which is about 20% higher on YoY basis and 11% higher on QoQ basis. Higher sales revenue is primarily driven by the higher volume which has increased by 26% on YoY basis and 10% on QoQ basis. The volume growth is primarily result of new 10.4 meter width BOPP line which got commissioned in February 2017. The Company has already crossed 90% capacity utilization during the quarter for the new production line on saleable capacity basis.

Specialty sale has grown by 25% YoY basis and 5% QoQ basis, which is important for the Company from the perspective of de-commoditizing the business model.

There has been unfavorable impact of fall in commodity margins substantially which is largely due to demand growth not in line with expectation during last 3-4 quarters. If we look history of the domestic BOPP industry during last one decade, the same has been growing between 10% to 12%. This demand growth reduced to 2%-3% post demonization period. Very clearly, the demand growth has not been in line expectation during last 12 months. Hence, there appears to be temporary gap between the demand and supply which is impacting commodity margins. Volume growth and specialty increase, the two factors helped the company to partly offset the unfavorable impact of the fall in the commodity margins.

We shall continue to focus on growing our speciality film as well as improving the internal operational efficiencies which should be visible in our results in coming quarters. These factors will help the company in building a long-term sustainable growth and improving the business model.

During the quarter and the other income include Rs. 12 crores on account of re-computation of sales tax exemption benefit which is related to past years. This is related to a favorable judgment from the Sales Tax Tribunal on packaged scheme of incentive in Maharashtra.

Now, we would like the concall to open for the questions please.

**Moderator:** Thank you. Ladies and gentlemen, we will now begin the question and answer session.

**Question:** If you could give me volume sold for Quarter 2 and H1.

**Management:** For the quarter, we did close to 34k Mt. H1 volume is close to 64k Mt.

**Question:** EBITDA per KG seems still closer to the lower end of Rs. 12 odd number at 34,000 ton volume, if you could give some direction when do you start seeing the numbers improving on the EBITDA side?

**Management:** We see our business broadly into parts, commodity business and the speciality business. Commodity margins were running substantially low during last few quarters which is almost half of the normalized commodity margins in the industry. Specialty margin also marginally got impacted however not so much as demand elasticity is different in case of the speciality products compared to the commodity products. It's fairly difficult to project whether the commodity margin would improve in one quarter or may take couple of quarters however current lower margins would not sustain for long and we see the same to improve in medium term.

**Question:** Are we at the lower end of the EBITDA on the commodities films and if you could provide a range as to where we are today and what is normal range per KG?

**Management:** Commodity margin on an average per KG has been running at Rs. 10 per KG which has been probably one of the lowest of large 5-7 years. Average normalized margin in the BOPP has been in range of Rs. 16-20 per KG.

**Question:** As we are mostly catering to the FMCG customers and pharmaceutical customers, so if they see something like volume growth on their behalf, so are we seeing some good demand from their side for flexible packaging products?

**Management:** We supply to FMCG Companies either directly or through converters. Beside this tape and textile sectors are major consumers of the Industry products in which sales is generally though dealers and distributors. A major part of drop in demand has been witnessed in dealers & distributor channel. One of the reasons for the lower demand is working capital issues at the dealers & distributor for which we recently started providing channel financing scheme. In the medium to long term we see demand growth coming in all channel i.e. FMCG, Converters, Dealers and Distributors as basic factors working on the demand remain robust such as increase in disposable income of consumers, higher usage of flexible packaging etc.

**Question:** Do you have any further expansion plans? What will be size of that capacity?

**Management:** Yes, as we announced sometime back, we are going to add a specialized BOPET line. The capacity should come sometime in FY 2020 and it would be about 35,000 MT annual capacity.

**Question:** In the domestic market is there any other capacity that is likely to come in next 1-1.5 years from the industry side? What is that capacity addition is?

**Management:** In next two years, there expect 2-3 new capacity addition. Broadly, it will add between 60k to 90k annual capacity. If Domestic Industry grow at previous one decade growth rate (about 10%-12% pa), these capacities should get absorbed in Domestic Industry.

**Question:** What is the margin difference between the scenarios in export market versus domestic market?

**Management:** India exports close to 100k-120k Mt BOPP on annual basis. Margin pressure has been there in both markets on commodity products.

**Question:** There is one confusion which I have, so our EBITDA is 34 crores and tonnage is 34,000 as you mentioned, so Rs. 10 per KG of EBITDA, does that mean even specialized was under tremendous pressure this quarter?

**Management:** There was some pressure on these specialized margins as well but larger part of this margin drop is into the commodity. Rs 10/- per kg has been gross margin, not EBITDA margin on commodity products. Hope this clarifies.

**Question:** And what was the mix between commodity and specialized this quarter?

**Management:** About 40% was specialized products sale in volume terms and remaining commodity products.

**Question:** I just wanted to know about rise in the crude oil prices and will it lead to further deterioration of margin or we will be able to pass on this increase in the raw material?

**Management:** Generally in a stable market, change in raw material prices gets passed on to customers broadly on fortnightly basis. However in a scenario when demand is not growing as per expectation, there could be situation of raw material increase not fully gets passed on to the customers leading to margin pressure. This is what Industry has been witnessing during last couple of quarters. Such low margin situation should not sustain for long. We expect demand to pick in coming quarters leading to stability in margins.

**Question:** What is the demand scenario in this specialty films and can some part of our existing commodity films lines be converted into specially film line, means if there is a demand there? I am sure you would be looking in that direction but is it a possibility or the lines are fixed for commodity and specialty film and what is the demand scenario in specialty film?

**Management:** There are two ways specialty products can be produced i.e. first on the BOPP line itself by changing recipe and second to convert commodity films into specialty films by putting a layer or multiple layers. You need separate production lines for production of second type of specialty films. To address your question, yes, there remains the flexibility that some of the specialty films can be produced on BOPP commodity line itself but for other kind of specialty films different production lines are required. Generally, demand growth for specialty films takes time as different tests are required to be performed and films need to be customized to specific requirements. In India specialty has been growing 20% YoY since or growth broadly represent Domestic specialty market growth.

**Question:** One small question I had, volume breakup was 40% specialized, 60% commodity and blended gross margin was 10% and the realization of specialized was 4x that of commodity that means the max you are getting around Rs. 18 gross margins on this specialized, and 4.5 on the commodity, is this math correct to certain extent ?

**Management:** No, let me clarify this. When I said margin actually I was referring gross margin before the fixed cost. So when I said Rs. 10 margin I referred actually the gross margin for the commodity. Average realization has been close to Rs. 100-110 on base commodity film and close to Rs.190-200 on specialty films. Hope it clarifies.

**Question:** Another thing the cost of goods consumed as a percentage of sale has moved up from 63% to 68%, so is it that you are not able to pass on the impact of higher raw material cost which could be a function of higher crude prices in the commodity film space?

**Management:** As I explained earlier, it's broadly due to drop in the margins on the commodity films side.

**Question:** But in this quarter in the month of October how have we seen the outlook, is it better than the last two quarters, the demand outlook from the dealer and distributors? In the March quarter do you see its stabilizing at least or we can't judge that?

**Management:** The margin pressure on commodity films remains in October as well. In the medium-term it has to stabilize. As I explained at the beginning of concall, it's very difficult to quantify when margin would improve and get normalized however we expect it to happen in coming quarters.

**Question:** You see it actually stabilizing or we will see higher realizations for our commodity films going ahead, at least if not in the near term but at least in the medium-term?

**Management:** If you look at the long-term averages margins has to improve and gets to normalized level. It's more a matter of time.

**Question:** As you said the utilization for the new line is already 90%, so now going further in future we do not see any further volume increase or volume improvement, correct?

**Management:** We generally run close to 95%-98% of the salable capacity depending on micron of film, so from that perspective 5%-8% volume growth on new production line is yet to come.

**Question:** How much percentage of total sales is to Tape & Textile sector?

**Management:** Broadly one third of volume.

**Question:** Regarding performance of CFI at Cosmo USA, any comment on that? And by when do you expect CFI to post positive EBITDA?

**Management:** As you see subsidiaries EBITDA is about Rs. (-2) crores in the Quarter 2 and if you look at the last quarter it was negative by about Rs. 4-5 crores. Operationally the subsidiaries are improving. We have done additional $1.5 million sales in the US subsidiary over last year, so I think step-by-step the subsidiaries are improving. Nevertheless, we expect FY 18-19 subsidiaries to be in positive EBITDA.

**Moderator:** Thank you. Ladies and gentlemen on behalf of Systematix Shares & Stocks that concludes today's conference. Thank you for joining us and you may now disconnect your lines.