"Cosmo Films Limited
Q2 FY21 Earnings Conference Call"

November 11, 2020

MANAGEMENT:	**MR. PANKAJ PODDAR – CEO, COSMO FILMS LIMITED** **MR. NEERAJ JAIN – CFO, COSMO FILMS LIMITED**
MODERATOR:	**MR. DHIRAL SHAH – PHILLIPCAPITAL (INDIA) PRIVATE LIMITED**

Moderator: Good afternoon all. On behalf of PhillipCapital PCG Desk, welcoming you all to Cosmo Films Limited Q2 FY21 earnings conference call. Today we have with us Mr. Pankaj Poddar – CEO of the company, Mr. Neeraj Jain – CFO of the company. I would like to hand over this call to Mr. Neeraj Jain for his opening remark followed by a Q&A session. Thank you.

Management: Company has posted highest ever quarterly EBITDA of Rs. 99 crores on the back of higher specialty sales having double digit growth Y-o-Y and improved operating margins. Sales is higher by 16% primarily due to higher volume. The company's volume was normalized during the Quarter 2 FY21 which was impacted in the Q1 temporarily due to COVID-19 impact. In Quarter 2 capacity was running close to full utilization. BOPP Films margins has been running at Rs. 26 per kg compared to Rs. 28 per kg in Quarter 1. We believe the margin should sustain more particularly as a flexible packaging demand is expected to continue to increase in India and the world. We do also believe that there is enhanced shift in consumer preference towards the packaged product more particularly in the food category.

Companies 100% subsidiary has started commercial production of specialty master batches from the Quarter 2 onwards. We do expect volume to pick up in the second half of the year. We do also expect the subsidiary to start making textile chemicals and adhesives from the FY22 onwards. Subsidiaries are back on the track post COVID-19 temporary impact in the Quarter 1. EBITDA taken together for the subsidiary for this quarter is about Rs. 5 crores as against Rs. 1.5 crores of the Quarter 1.

Company is set to grow its specialty further as we are enabling some large production lines to manufacture specialty products from the Quarter 4, FY21 although it may have some marginal impact on the Quarter 3 volume. The company continuous to work on its sustainability project like power consumption, water consumption, gas consumption, waste elimination or the recycling of the waste. Beside environmental positive impact these will also start rationalizing the cost from the coming quarters. Company's continuous to focus on this special difference supporting brands and building recyclable packaging structures that focus will continue.

Specialized BOPET project is progressing well as per the schedule and is schedule to start commercial production from second quarter of FY22-23. Activities are on track for pet care as well including IT infrastructure, brand strategy, resource building for the vertical. We are expecting pilot launch to be kicked off in NCR in Quarter 1 of FY22.

Equity shares buyback announced in October 22 reflect management confidence in the business strategy and growth prospects. Beside these it will also facilitate improved EPS, ROC and ROE. Our dividend policy should remain intact it won't be impacted because of the buyback.

The company is also investing in several new initiatives including moving to SAP HANA one of the most advanced ERP available. The paperless office AI and data mining related projects is taken together will automate processes in coming quarter and will also have favorable impact on the operating cost with superior customer experience.

Company net debt at the end of September 20 is Rs. 485 crores which is 1.4 times of net debt to EBITDA ratio and 0.6 times of net debt to equity so fairly healthy financials. The company is operating close to 20% return on equity and 18% return on capital employed on trailing 12 months basis. I think these were the few updates I had on the quarter. Now we would like the concall to open for questions please.

Question: I wanted to know if you expect these gross margins of Rs. 26/-kg to sustain or is there any new line that is coming up which might lead to little bit more suppression on these gross margins? What will be size of these lines?

Management: There are two parts of our business one is the Specialty films, where we continuously grow Q-o-Q. It constitute 55% of our total sales the remaining 45% business is Commodity BOPP films which everybody supplies and it is linked to the nuances of demand and supply. Having said that we do not expect any reduction due to any new lines coming up by next year. As demand is also expected to grow in the similar range to supply, but there could be some challenge in one or two quarters as supply comes up as a step growth while the demand grows as a trend line. In terms of Capacity addition they should add put together 70,000 to 80,000 tons, one line is expected to come early next year and the second line is expected to come by mid of next year.

Question: As you mentioned we are converting one of our lines into specialty in Q3, so how many days of down time do you expect and post this conversion should we be able to take our specialty mix towards the 70% or more of overall sales? How much CAPEX would be incurred in this project?

Management: After modification in two lines, it shall be good enough to take us to 70% specialty of our total sales and as far as the shutdown is concerned the two lines which are undergoing shutdown will have an impact of roughly 2,500 tons on total sales. CAPEX will be little less than Rs 20 crores.

Question: On gross margin side does the spread comes through more on the procurement side i.e are we procuring at a cheaper level with lower procurement per kg or is it better realization per kg that we are having higher specialty sales price ?

Management: In FY21 there are three factors which impacted gross margin. The first one is specialty film sales grew 16% Y-o-Y and made a significant impact on the P&L. The second one is Commodity BOPP margins are also better versus last year and the third one is that in the Quarter 1 we were able to get a reasonable deal on raw material and even our full year deal is marginally better but that impact is not as sizeable. Most of the impact is coming from the specialty sales growth and some improvement in the BOPP margins on an overall basis.

Question: One of your two largest competitors have declared large CAPEX of Rs 450 crores for installing BOPP line in 24 months, but they have not mentioned about the product, so do you see this may lead to oversupply situation?

Management: We are not much concerned because within two years our Specialty film will constitutes 70% of total sales, it is very high end specialty and within five years we will be sitting on a very different game plan. So I mean we are not really as much bothered in terms of which line is coming and when they are coming because they are largely on the commodity side. Moreover our significant research in Specialty films which nobody is investing on will always keep us as a leader in the segment.

Question: How is momentum in export market, are there other players who are also targeting export market? Is margin in export market bit better than domestic market?

Management: In commodity films margins in domestic are better than export unless the domestic margin suppresses a lot. As far as competitors are concerned most of their export is limited to commodity films, but at Cosmo majority 80-85% of our export are specialty films which differentiate in from competitors. We export to more than 100 countries we know virtually small to large customer in every market, when you try to generalize it for all the players in the market for them export is kind of a dumping round and for Cosmo we are very selective to which customer we sell, which product we sell and at what price we sell

Question: Does our overseas subsidiaries still have some potential to make large contribution to our bottom line and what are key initiatives that we have taken to achieve those milestone?

Management: We have very high hopes from America market. In fact I would like to recall in one of the years we incurred $5 million losses while this year we project profit of $2 million in America and I think we are no way close to full potential, within two years we should easily double it if not more and the other important thing is that it is all tax free because we have $17 million of accumulated losses which are actually written off in the books. So whatever profit that we are going to make in America will be totally tax free.

Question: Are we looking to adding another BOPP line in future?

Management: Right now we have announced a polyester line we are sticking to our plan for next six month there is no new CAPEX that we are likely to announce it. We have chemical project in pipeline for which line has been ordered and it should be up and running from next calendar year. Then we are going to order an adhesive line in Q4 which should be up and running in the Q2 FY22.

Question: We are going to diversify in textile chemical from next year, what is the vision for that segment we are going to diversify in this segment?

Management: The textile segment has huge potential because if you see the cotton clothes every year innovations are happening whether it is in terms of crease less, virus free, better feel of the cloth etc. So this is an area where with the help of chemicals we can make lot of innovations and improve the quality of cloth and given our R&D strength we identify this is a very good growth area and therefore we enter this segment.

Question: In chemical space what is revenue target. Do you have any major CAPEX plans in mind for new products in future other than textile chemical and masterbatches?

Management: Within a period of five years we are looking at Rs 400 to 500 crores revenue potential from chemical and masterbatch business. Currently we are looking at backward integration of some chemicals and textile chemicals and after this we are looking to manufacture adhesives which also broadly categorized under chemical space.

Question: How is Masterbatches line which got commissioned last quarter Q2 ramping up and what is the revenue potential in H2 ?

Management: Revenue potential is close to Rs 90 to 100 crores, but a significant part of it is internal because it is a backward integration that will help us improve more on the margin side than on revenue numbers, but we expect 25%, 30% of the sales to be build externally as well.

Question: In textile chemical business what is the CAPEX involved and what is revenue potential? Can you outline the same for the adhesive line also

Management: Right now we have done a small CAPEX of around 15 crores. For adhesive business we are yet to do assessment but again it would not be a very large CAPEX.

Question: What is the CAPEX plan for Pet care diversification we are doing?

Management: In Pet care we are anticipating to shelve around Rs 100 crores over a period of five years.

Question: Specialty portfolio which stands at 55% now has been gradually ramped up over the last 2-3 years or more, so despite having a specialty portfolio in 2018 & 2019 the operating margins had still gone down to single digits like 8% to 9% in some quarters, Can you explain why do you say that specialty portfolio is really insulated from the nuances of demand supply situation?

Management: 2-3 years back our total specialty in overall portfolio was hardly 35% and commodity films comprise 65% volume at that time, With such high portion of lower margin commodity films you can expect that the margins will fall down, but the good thing was that from 2017 to 2019 we maintained close to 200 crores of EBITDA. So the margins went down very significantly for the commodity margins however our overall EBITDA remained very similar and that was made possible because whatever was the loss happening from commodity business was we are getting recouped with the improvement that we are making in specialty growth. The second good thing is that in the first few years our growth in specialty was a single digit number. Every year the growth number itself has been growing faster. So first year we grew by 8%, next year we grew by 11% third year we grew by 13% and this year we are growing the 16%. So in spite of the fact that the base is getting bigger our growth rates are also growing and therefore we are already to a great extent insulated and within two years our insulation levels will be far higher.

Question: As per the specialty goes what is your spends on research, development and market development also?

Management: On the specialty packaging size we do have close to 20 number of ESGs and polymer scientist. This we expect further to increase to 30 number in year time. So this is very good amount of spending we are doing there and on the top of it some of the large R&D projects we do along with our customer. So part of the R&D cost is being shared with the customer. Our focus is very clear and you will notice that in last three years on BOPP base size whatever new products are getting launched in India almost two-third of these new products are only from Cosmo Films. So idea is to have a very wide range of the specialty products in the portfolio at the same time not to lose the focus.

Question: Regarding our BOPET line do you think that we are very strong on the BOPP segment so cross selling it will become low hanging fruit? Is there enough opportunity in the BOPET segment to cater to this value addition segment?

Management: Yes you are right it should be very easy because being an BOPP player cross selling is easier, In BOPET our entire focus is on specialty sales, segments that we are planning to come hardly have any players in the world.

Question: On raw material side Reliance & IOCL have put up additional capacities, will it will play out major role as there will be lost of supply in upcoming 18 to 24 months?

Management: Unfortunately right now there is shortage because Reliance and IOCL plants are in the shutdown, In future if more capacities comes up all petrochemical companies who are making tons of money will foresee their margin being reduce.

Question: What will be our rate of interest, are we making significant debt repayments as we are making quite handsome ROC, ROE ?

Management: Our Interest cost is nearly 6.5%. Our net debt to EBITDA figs are fairly healthy. We are not looking for significant debt reduction as there are many advantages associated with keeping the extra liquidity and that too is during the COVID period.

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

Management: The company is taking all steps required to transform into a specialty packaging and chemical company in years to come. All our new projects i.e master batch plant, specialized BOPET line, higher specialty project & Pet care are progressing well and in line with the plan. Company focus shall continue on improving specialty, R&D projects and sustainability projects as it will further yield results in years to come. These actions along with improved margins will contribute in our long term growth. I think these are the few things we are fairly excited about and look forward for. Thanks.

Moderator: Thank you. On behalf of PhillipCapital (India) Private Limited we conclude today's conference.