



**“Cosmo Films Limited
Q4 FY2020 Earnings Conference Call”**

June 05, 2020

MANAGEMENT:

**MR. PANKAJ PODDAR - CHIEF EXECUTIVE OFFICER
MR. NEERAJ JAIN - CHIEF FINANCIAL OFFICER**

MODERATOR:

**MR. SAURABH BHAVE - S-ANCIAL TECHNOLOGIES PRIVATE
LIMITED**

Saurabh Bhave: On behalf of S Ancial Technologies, I welcome you all to Cosmo Films Limited Q4 FY2020 earnings conference call. From the management, we have Mr. Pankaj Poddar, CEO and Mr. Neeraj Jain, CFO. Now 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 session. Thank

Management: Due to lockdown announced by Government of India caused by COVID-19 pandemic, operations of the company were temporarily suspended in Gujarat and Maharashtra plant for the few days in March & April and operations resumed in the first half of April 2020.

We believe flexible packaging demand should increase in India and the world post COVID-19 due to shift happening in the consumer preference towards the packaging products, particularly in food items, increased concern among the people about the cleanliness and hygiene which would help the flexible packaging industry. So far, there is minimal impact of the COVID-19 pandemic on the business operations. The company runs adequate liquidity to address uncertainties, if any, in future due to Covid-19.

The company's subsidiary project relating to master batches is progressing well as per the schedule and we expect to commence the operations from Q2 FY2021. Company's focus shall continue on specialty films, more particularly supporting the brands on building the recyclable packaging structures.

In March 2020 Company's consolidated net revenue at Rs.524 Crores is 5% lower on Y-o-Y basis primarily because of the lockdown due to Covid-19 as we discussed. If we exclude the

lockdown period, the company's capacity was running more than 95% utilization. Company has posted highest ever consolidated EBITDA of Rs.78 Crores in Q4 which is 34% higher on Y-o-Y basis. Primarily three factors contributed to it i.e. better margins, better operational efficiencies and improved performance by the subsidiary operations.

BOPP film gross margin has been running Rs.23 per kg during March 2020 quarter compared to Rs.15 per kg during last year. PBT and PAT were impacted by onetime provisioning of Rs.11 Crores due to impairment in the market value of some of the assets in overseas subsidiaries. Management does not foresee any further provisioning requirement for the subsidiaries. PAT also got impacted by deferred tax provisioning for SEZ operations. I would also like to indicate here that from the cash flow perspective Company is paying MAT rate which is 17.5% only. It is just on the face of the P&L you might be noticing around 30% effective tax rate due to deferred tax. If we remove the one off items normalized effective tax rate is around 27%- 28%.

Overseas subsidiaries have done well. There is improvement in margins of overseas subsidiary besides the volume increase.

For full year performance for the FY2020, EBITDA is 55% higher compared to last year primarily four factors contributed to it due to higher specialty sales which we could grow by 11% Y-o-Y, BOPP margin are better due to balanced demand-supply scenario in the BOPP industry, better operational efficiency and improved performance for the subsidiaries. EPS grew by 86% Y-o-Y. Company's net debt is Rs.584 Crores at the end of March 2020, which is 2.1 times of the net debt to EBITDA ratio and 0.8 times of

the debt equity ratio. We foresee cash generation from operations will be sufficient to address the debt obligation as and when due. If required, company is running cash and liquid investments of close to Rs.170 Crores.

This was brief on operations performance. Now, we would like to open the call for the questions please.

Question: I wanted to know what the global capacity is currently. What kind of capacity additions do we expect globally in the next two years?

Management: Global capacity is around 8 million tons. Actually, many projects now especially with COVID are expected to get delayed as well. Earlier majority of the capacity addition was happening in China and what we are seeing now is that for the last two years, China had slowed down a lot. So, we do not expect more than 200k tons of capacity addition in the next two years.

Question: I also wanted to know what is our current value add and what was it in Q4 and Q3? What was the gross margin for the value added products?

Management: Q4 gross margin on the BOPP front Rs.23 w.r.t Rs.15 in Q4 last year. In Q3 it was Rs 20.

Question: What was debt repayment in FY2021? What is the effective interest rate? As our interest costs did decline significantly. What kind of interest costs do we envisage for FY2021?

Management: Debt repayment was about Rs.120 Crores. Effective interest rate for the company is about 6% pa. We are running cash and cash equivalent treasury of around Rs.170 Crores which comes under other income in the P&L (for ex investment in highly rated bonds

like the perpetual bond of the State Bank of India) so if you net it off against the interest cost then there is a reduction of about Rs.13 crores in net interest cost compared to last year. We foresee significant net debt reduction in next year.

Question: Currently in Q1 FY2021, what would be our value add?

Management: It has been volatile and April because many players had not started and raw material was very low, it was Rs.35 plus in the month of April. In May it came down to Rs.30 and then there was again a price increase in June and in between also it has been changing many times upward and downward because the whole industry is trying to restart their lines and demand is also continuously ramping up, Some element of textile sector is yet to pick up, which covers 20% of the total demand. Having said so, almost all the players are doing much more export than what they have been doing earlier. Given that western region based players can do it much better than the north region players and therefore they have an advantage. Especially Cosmo given the specialty that we do, it is very easy to ramp up the export for us. So, we have been able to do that quite successfully in April and May. It is very difficult to give one number, but April and May put together is better than Q4.

Question: What is the potential annual turnover from master batches. I do understand that Rs 75 Crores is what you mentioned for FY2021?

Management: It is difficult to project because gradually we will try and do more specialty in those, but I would say that around Rs 100 Crores could be a number that can be looked at, but this is an icing on the cake because it is just the beginning of our chemical division. We are also in the process of ordering the chemical line, which should be done in a month or so, which will allow us to get into chemical and beyond

that then we are looking to get into adhesives. So, within the specialty chemical division, we are looking at three different business verticals with a very significant focus on chemicals and adhesives in the times to come. So, this should be exciting for us in the years to come.

Question: What is the percentage of sale we do to converters like Amcor and Huhtamaki. What is it directly to brands like say ITC or Hindustan Lever? What is with these companies do which we cannot and why we cannot move up in value chain and do directly to all those branded guys?

Management: We do very limited sales directly to the brands. Only film sold directly to brands is overwrap film which is unprinted; however, there are lot of brand specified businesses that we do for customers like Britannia, Unilever, Nestle, Mondelez, so on and so forth where we have got our film approved for their packaging structures and that goes to their converters. Prices & technical specification are decided by the brand, and the contract is entered by the brand though the supply happens to the converters. We do not intend to become a converter for sure at least in India because then we will start competing with our customers and given that we are such a significant producer we have no intention to do any competition with our customers.

Question: If I do the math on 75% effective capacity I am looking at 45,000 tons p.a of capacity and I put Rs.20 as the gross margins, I am looking at 90 Crores. Now from there basis the historic and if I look at the average gross margins to your EBIT margins basis your last four five years, it is around 22% to 25%. So, I am looking at

somewhere from Rs 18 to 25 crores on a 200 crores investment that translates to only 10%, 11% ROIC. Is it accurate?

Management: You are right that our new line can produce 45,000 tons; however, the value add or the contribution that you make continuously varies. The contribution could be anywhere between Rs.10 to Rs.25. Assuming an average of Rs.15 to Rs.20 the line can make 60 Crores to 80 Crores, so it will have a 3-4 years payback kind of a scenario for a new line and if somebody has to look at the dynamics of the last line, we did that. Now obviously a new player cannot match these dynamics because for them the capex would be more and the return would not be similar, but for an established player like Cosmo those dynamics definitely hold true.

Question: What is the nature of onetime impairment in the value of assets in overseas subsidiary between standalone and consolidated there is difference of 12 Crores to 13 Crores extra impairment has been written off?

Management: Well, it is a provision for the onetime impairment in the market value of the assets in overseas subsidiaries.

Question: Last year employee benefit expenses was Rs.91 Crores full year vis-à-vis 125 Crores it is almost an increase of 36% whereas our sales is almost stagnant to 212 Crores. Is there any onetime item has been debited in this head Sir?

Management: Increase is due to one-time provisions and variable pay structures.

Question: How much capex the company is expected to incur in FY2021 and FY2022?

Management: For FY20-21 Capex is estimated to be between Rs 30 to 40 crores.

Question: Company has invested some surplus funds in the mutual fund units giving 4-5% return, if fund is not required for CAPEX should it be refunded because when the time is going good it is prudent to refund the loan and make the balance sheet neat and clean. When the tough time will come that it will help us to do the business better is my opinion. Any comment on this?

Management: We are building this company into a specialty company and as investors must already be seeing that we are doing and going in the right course. Other thing is that we have built this asset base to look at opportunities at the right time. So, I think we will continue to build the treasury and we feel that there will be plenty of opportunities which will come our way due to the various circumstances prevailing in the world so at that point in time we will take suitable decisions.

Question: As we have developed new products like synthetic paper, soap wrapper, can you give us some idea about the scalability of that product and what kind of contribution that we would be having of that product?

Management: Synthetic paper may have a very big demand worldwide because it has many applications, menu cards, the posters and there are so many applications, it is a replacement of paper. It is more expensive but far more durability, far more shelf life, so it has many applications and it will involve lot of customer education and marketing which Cosmo is doing, last year we had a very good growth on synthetic paper. Obviously, this year with COVID some of the things have been getting delayed but we see a huge potential for the growth of this product.

Question: Sir regarding this educational certificate specialized paper, so how many initiative we have added?

Management: See this happens time to time. I believe two to three large universities have shifted towards it but it requires lot of customers knowledge sharing. We have put lot of efforts like one of the very large clothing brand have shifted their paper labels into synthetic paper label because earlier they had to use three different labels and with synthetic paper they could do the same thing in one label on a cost effective basis and it had much longer shelf life. Similarly, in the America market, somebody who was into menu card they shifted to this because they found that the shelf life of the product which has one month became six months. We see there is a huge potential and as we continue to ramp up our entire bouquet of products.

Question: My question is regarding capacity utilization levels, can you reconfirm the levels is it 90% for the month of April-May that is Q1 of FY2021 and if you can share the how has been the performance of the thermal lamination business?

Management: Just to clarify April and May put together capacity utilization had gradually ramped up to 90%. As such thermal lamination business is concerned, it is impacted adversely due to Covid although it is a very small part of our total business now than it used to be earlier. This business has been impacted by COVID in the month of April and May and even June. However, we do expect that a ramp up would happen because already most of the countries in the world have started to open, so yes there is definitely a temporary impact from thermal lamination business.

Question: Can you share some the steps that the company has taken regarding the cost reduction for no operating?

Management: On fixed overheads, we have not done anything on the employee cost because employees are very important asset to Cosmo and we have not done any downsizing there. Some of the overheads have come down on its own like travel cost, print and stationery cost etc For most of our raw material cost has come down because crude oil is down, as most cost of it is linked to an index.

Question: What will be the contribution of specialty films volume wise two years, three years down the line.

Management: We wanted to take it to 70% within next two years to three years.

Question: Market is giving very low valuation to this industry because of inconsistency in performance but recently we see the last four years we have some consistent performance at least in case of Cosmo Films, so will that be maintained in future ?

Management: We stand committed by it and we are moving in the right direction. Now, it is up to investors how to value Cosmo. Definitely, we feel that we are extremely undervalued and I do hope that some correction would happen at some point in time for Cosmo Film.

Question: What is the kind of competition you have faced in the specialty segment when you try and sell these products, do you see even other companies coming up in that segment. When you go and interact with your customers for the selling of specialty, do you see lesser competition as compared to what do you see in terms of commodity just in terms of the large players that are playing in this market?

Management: Within specialty sales in some products there is no competition, in some products there is limited competition. Most of this specialty products it is not easy to enter, you need to put lot of investments behind R&D before you can replicate it and I do not see most of the players doing that. Every company has its own game play. Some companies believe in doing more of commodity business and they are happy with that while there are select few who invest on R&D because research do not give initial returns, you have to have a very long period of waiting before it starts even requirement. Cosmo has been spending on research for last many years now and now it has started to give returns to Cosmo. Frankly speaking, as far as specialty products are confirmed we do not see that much of a competition.

Question: Just in terms of the variability of the prices, so commodity films are obviously directly linked to the index so their price also moves down along with the index but in terms of specialty films, it is a correlation not as much like do you have higher bargaining power or let us say pricing power in terms of the specialty films or you would say yes they are higher margins specialty films but the relation is similar in terms of how our raw material prices move?

Management: Variation is actually different. In some specialty it is linked completely, some specialty it is not linked at all, so there are both types of specialty that we are operate in. In some commodity, there is normally not a linkage between raw material and sales price, but in some there is some linkage and there is also a demand and supply pull along with raw material decides the commodity prices

Question: There is a lot of focus on sustainability in the industry with everybody talking about how products and plastic has to be sustainable, so any step with the complaints taking on that front?

Management: I would say that we are leading in the race worldwide. We have done so many developments and which are now commercialized and especially during COVID days customer got it a lot because earlier they had to procure three different material, pay to procure, they have to keep inventory for three different material and now they shifted to homogeneous structure, so they have to keep inventory of much lesser material. To give examples, we have converted soaps, shampoos, biscuits, there are lot of different things that the tea is in pipeline, the coffee is in pipeline, so there are so many products that had already been shifted or are in the process of shifting even spices and there were big pipeline of products obviously when new development has little bit slowed post COVID in last two months.

Question: The rupee depreciation in terms of exports we did not have a direct bearing on the margin expansion, or the customers expect lower side of price?

Management: Currency helps only if the currency of other exporting countries do not change along with it. In general, the margins definitely go up with INR deprecation.

Question: In current scenario, I understand there has been some delay in terms of payment receivables from your large clients, is that behind us, and has dues has been cleared but you have credit period this time right?

Management: Just to clarify, we do not give any credit to dealers, distributors segment. We do provide very selective credit to the large converters or the brands. There is some delay in payment by some of the

customers however is not significant in the overall scheme of things. The company also runs credit insurance cover.

Question: For FY 2021, do we expect our volumes to be flat or there might be a slight 5% to 10% decline in volume terms?

Management: Broadly, if you see our plants have started working from second week of April FY2021 if everything remains fine for the remaining part of the year, we do not see any drop in the volume compared to the last year but again this is an industry where you know volume is not only a number. You need to go into what microns films you are making and what is the mix. What we do internally is to focus more on the value add and we do track it on a hourly or a daily basis.

Question: For the next one to two years at least I can assume that there will be no commodity BOPP addition?

Management: We are not looking to commodity expansion in immediate future.

Question: Many of the migrant labors are moving to their hometowns are we facing any labor issues at our factories?

Management: No, we do not have that issue. I would say our employees are really good and we have an excellent culture in the company, obviously in COVID people had fear in their mind but once we could explain them and they realized that we will have to live with the pandemic. Having said so we also took lot of things to make sure that we take best care for them including providing the mask, sanitizers, social distancing with so many different things to make sure that they feel safe in the company and not just that we also made sure that in the nearby villages we continue to do lot of CSR activities so that

employees nearby or their villagers feel that confidence in Cosmo Films.

Moderator: Thank you very much. That was the last question in queue. I would now like to hand over the conference back to the management team for closing comments.

Management: Well, to summarize, Company's focus shall continue to be on specialty films, R&D and more particularly on the sustainable products. We are also looking for some margin expansion projects which will kick off in FY2021. The new coating specialty lines which have commenced operations from the Q2 of FY2020 it is picking volumes now and we understand it will further add to the specialty portfolio for the company. Thank you very much for joining the call.

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