



“Cosmo Films Limited
Q3 FY18 Earnings Conference Call”

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MANAGEMENT: **MR. NEERAJ JAIN – CHIEF FINANCIAL OFFICER**
 MS. JYOTI DIXIT - COMPANY SECRETARY
 MR. PIYUSH MALIK - INVESTORS RELATIONSHIP

MODERATOR: **MR. ANKIT GOR - SYSTEMATIX SHARES & STOCKS LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the Cosmo Films Limited Q3 FY18 Earnings Conference Call hosted by Systematix Shares & Stocks Limited. Please note that this conference is being recorded. I now hand the conference over to Mr. Ankit Gor from Systematix Shares & Stocks Limited. Thank you and over to you, sir.

Ankit Gor: Good morning, everyone and welcome to the quarterly concall of Cosmo. I request Mr. Neeraj Jain to give us the introductory remarks on the call and his outlook and then we can start with Q&A. Over to you, sir.

Management: Thank you, Ankit. Good morning, ladies and gentlemen. I also have Jyoti Dixit, Company Secretary and Piyush Malik from Investors Relations with me on this call. Well, first we will discuss about the key highlights for the December 2017 quarter which may be followed by questions.

December 2017 quarter top line has been at INR 481 crores which is about 33% higher on YoY basis. Sales growth is backed by the volume increase by almost similar 33% which is primarily driven by new capacity expansion which was commissioned in February 2017. The new capacity has been running at more than 90% capacity utilization during December 2017 quarter. The specialty sales has also grown by more than 30% YoY basis which is important for the business. Favorable impact of these two factors i.e. higher volume and better specialty sales got compensated by the subdued margins in the commodity film business. The BOPP film commodity margin witnessed high volatility during the quarter and remained fairly low till mid of the December month. Second half of December month witnessed some stability in the BOPP commodity business margins.

During this period now, we are focusing on expanding our specialty business and looking at new opportunities in export sales business to ensure that we run all our production lines on the full time basis which is working due to which we could do one of the highest quarterly volumes. However EBITDA for the December 2017 quarter was almost similar to last year in absolute value as favorable impact of volume increase and specialty sales got largely compensated by commodity margins impact. PAT and EPS were lower on YoY basis due to new capacity related depreciation and interest. You would also notice in the Quarter 3 of FY17 there was a tax reversal of Rs. 6.2 crores which is not there in the current period.

Going forward we expect BOPP commodity margin to move towards some stability however may take time to get normalized.

Our new CPP production line has started production since beginning of February. It may result volume increase by 3%-4% at full capacity utilization. Company's new Metalizer having annual capacity of 7,500 Mt has also started production from late December 2017 which would result Metalized volume to increase.

These were key updates for the quarter. Now we would like the calls to open for the questions pls.

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

Question: If you could tell margin per kg, what is the trend now and in past on the base films?

Management: Broadly commodity films margins were running close to Rs. 10 per kg. It has dropped at one point of time to even Rs. 7-8 per kg. Now it recovered back to Rs. 10-11 per kg. In a normalized period, one can expect commodity margins between Rs. 16-17 per kg.

Question: How is the demand supply situation now and when do you see the normalized Rs. 15-16 per kg coming in?

Management: Supply in Domestic Industry appears in excess of demand by about 10%. India supply is estimated to be close to between 600k Mt as against domestic demand of close to 420-440k Mt and export has been in range of about 110-120k Mt. From a larger perspective, there are hardly shutdowns happening in the industry. So industry is able to sell most of its producing however at lower margins. The BOPP commodity films margin witnessed high volatility during the quarter and remained fairly low till mid of the December month. Second half of December month witnessed some stability in the BOPP commodity business margins. We hope this stability to remain however may take some more time to get normalized.

Question: What kind of capacity addition is coming for the industry and what is incremental volume capacity expected?

Management: We expect two production lines to start commercial production in next 12 months which may add close to 50k Mt new production. If the Industry is back to normalized growth of close to 10%-12% which it has been witnessing except last one year, the same should get absorbed.

Question: So Industry capacity addition will be 50,000 MT and there is one line of yours also which is supposed to come up?

Management: Our BOPP line has already started production in Feb 2017. Now there is no immediate plan to add BOPP capacity. As announced earlier, we are planning a Specialized BOPET line which is expected to start commercial production sometime in late FY 19-20.

Question: Can you share updates on our subsidiaries, how they are panning out and what is the company's focus towards improving their profitability?

Management: If you look at last few quarters subsidiaries except US subsidiary are making profit. For US there are several initiatives taken both on increasing topline primarily by launching new products and cost rationalization. You would notice US subsidiary topline has started increasing. We expect significant improvement in US subsidiary during FY 18-19.

Question: What is the raw material homopolymer price which was there in Q3 and what is the situation right now with the increasing crude prices? How it impacts your margins?

Management: Although crude has slightly moved up as you would have noticed during the last few quarters, however polypropylene prices have not moved in same proportion as this is not a liners co-relationship. If you look at the history of crude pricing internationally and polypropylene pricing, there is strong correlation between the two, but it is not a linear correlation. During Dec 2017 quarter, it was between Rs. 82 to 85 per Kg.

In general scenario, change in prices of polypropylene gets passed on to customers on fortnightly pricing basis. So, majority of polypropylene price change either side gets passed on to the customers. However, this may not hold fully in a scenario of temporary demand supply gap.

Question: As you have said passing on is possible typically margins should have remained stable and if you say that from Rs.10 per kg it came down to Rs. 7- 8 kg it is like 30% drop. Was any specific reason behind this dip, as there was no demonetization or GST? Is there a huge inventory in the pipeline or what is the reason for huge volatility in the commodity film margins?

- Management:** One key reason which we explained earlier is about 10% gap currently between demand and supply scenario in the domestic industry. Part of our business which is BOPP commodity is similar to any other commodity business such as cement industry, steel or so. There are some periods when there is temporary imbalance between demand and supply which gets normalized over a period of time. I think it is very similar to any other cyclic business however as a company we are trying to reduce its impact on our business by shifting business model from commodity to specialty which will bring lot more stability in margins. Specialty is growing for us more than 20% Y-o-Y from more than last two years. Few years down the line, we expect major part of our business coming from Specialty.
- Question:** As you have said that every 15 days the price of polypropylene is revised, and we can pass on the increase or decrease what so ever is the case to our customers. So, that means that we can change our pricing according to increase or decrease of our raw material which means that our margins don't really get that much of variations but this variation is only because of this 8% to 10% of excess supply. I really could not understand those terms, so I was just asking that what you are going to do with it?
- Management:** As we indicated, in the normal scenario passing raw material price increase holds however may not hold in demand-supply gap scenario. This is why pressure on margins. This is why if the raw material price is increasing then some part of it may not get passed on to the customers. This is what has been happening in last few quarters. This is more because of the competition to sell the full volume among the players. Hope this addresses your question.
- Question:** Yes. So, basically the situation is that if there is an increase in raw material price industry will be able to pass it to customer, but if there is any cut throat competition margin will spiral down. So, that was my worry that in such situation it should not come back to Rs. 5-6 a Kg type of situation.
- Management:** Well, your question is very relevant however if one look at from medium to long term perspective, such lower margins are not sustainable in the Industry and has to bounce back. Industry has to and has been running sustainable margins in medium to long term.
- Question:** What is the kind of margins we have in this CPP and metalized film. By adding new Metalizer and CPP line will they offset some of the margin drop in commodity films, will they kick in additional margins into overall margins. As these lines come into play will additional capacities absorbed immediately.
- Management:** Metallized and CPP films gross margin varies between 12%-15%. These margins are better than today's commodity films margins. It may be noted that these are not substantial capacity addition from Company's overall capacity perspective. Out past experience suggest that within few months of such capacity addition we reach close to two/third utilization.
- Question:** Capacity expansion that we have seen in the last one year and what we are about to see in the next 12 months. Is this as per your expectation or is it being faster than what you thought?
- Management:** Capacity addition that is happening is as per estimation. Only thing which has not happened during last 12 months was the demand growth due to factors such as Demonetization and GST impact. This Industry generally witness 10%-12% growth which has not come during last 12 months.
- Question:** What was specialty margin in this quarter versus Q2? On per kg basis when you say specialty what is the level that you generally refer to?

- Management:** It is running close to 20% both in Q2 and Q3 at average selling price of close to Rs. 200 per kg. Although there is some drop in Specialty margins from its peak, however delta of margin in this business is much lower. This is why specialty business is considered comparatively a more stable margin business.
- Question:** And you were looking to enter some new products, is there any development on that front?
- Management:** Yes, that is moving as per projection. We are trying to make sure every quarter we launch specific new products primarily on Specialty side.
- Question:** How much is Bopp film import in India? Have seen imports from China in BOPP and other films.
- Management:** It is very minimal may be at lower end of single digit. There is 10% import duty in India on BOPP and value-added films which primarily works as hindrance to imports beside factors such as freight cost and others.
- Question:** What is the amount of increase in PP prices let's say in last 3 months?
- Management:** Polypropylene price has been ranging between Rs. 82 - Rs. 85 during Q3.
- Question:** What I have observed is that till 2-3 quarters back BOPP prices had better realizations and better spread. But I think the things have changed now I see BOPET prices have increased more than the BOPP prices. What do you think will be the reason behind that? Is this basically due to over capacity, can have your view on that?
- Management:** I think this could be due to temporary gap between BOPP demand and supply scenario.
- Question:** Do we have any addition of clients? Do we give out such data I am not quite sure on quarterly basis or on 9-month basis any addition of clients to our portfolio?
- Management:** Close to one/fifth of our sales is from the new customers.
- Question:** Just wanted to understand more on our CAPEX part as you said you have Rs. 250 crores of CAPEX plan. Can you talk little bit more about this as you said your focus would be more on specialized product and you would keep launching new products every quarter. What will be new product applications, which industry you are targeting, what is growth rate and industry size of these products?
- Management:** Capex plan is for specialized BOPET line which will be done during next 2 years. Specialized BOPET line would facilitate from three angle i.e. first it would open up new product portfolio for the Company, second it would provide new range of specialty products and third it would reduce our dependence to buy BOPET film from outside for sale of BOPET based specialty hence captive consumption.
- Question:** Can you help us understand how would you fund this Rs. 250 crores of CAPEX in next 2 years, sir?
- Management:** CAPEX will be funded 75%-80% by debt and remaining by the company's internal accruals. Financial closure for the debt part is already obtained which is at a very competitive cost.
- Question:** Will you please share thought process of hedging your likely borrowing for BOPET expansion of Rs.200 crores?

- Management:** We have a board approved forex risk management policy. From time to time, we keep on hedging forex exposure particularly for payment obligations of next two years. It may also be noted that we have close to 50% of our sales in exports which provide a natural hedge to the company. If one look at the foreign currency cash flow perspective, we are a net foreign exchange earning company of close to Rs. 500 crores on yearly basis.
- Question:** In last quarter you mentioned in tape and textile, the dealer distribution had a significant drop. How is the demand panning out there and in the FMCG sector which is the convertor and direct sale, how is the demand there? Is it holding on or increasing? What is the distribution between the FMCG and tape and textile?
- Management:** For the FMCG whether directly or through the convertors the demand is more stable. The demand growth dropped largely in the tape and textiles sectors for which sales is through channel partners ie. dealers and distributors. The demand is yet to get normalized although is improving. Tape and textile is broadly one third of our total sales.
- Question:** What is volume split between your commodity and specialty products of this quarter? And the marginal split?
- Management:** 40% volume is from specialty and 60% in BOPP commodity. Specialty film has gross margin of about 20% & commodity average gross margin is close to 10%.
- Question:** In FY19 what will be the distribution between the commodity and specialty business say from 2 years from now once our new line comes off, what will be the distribution like currently it is 60-40.
- Management:** Our specialty volume is growing by more than 20% YoY basis. We are expecting similar kind of growth to remain in the next two years.
- Moderator:** Now I would like to thank the management for taking out the time and answering all the questions and I would like also to thank all the participants for attending the call. Final words from management. Over to you Sir.
- Management:** Thanks to all of you for joining the call. I think going forward key factors for us is continuing to work on de-commoditization of business model, specialty growth and improving operational efficiencies. Commodity margins may also move towards stabilization in quarters to come. We really look forward. Thank you very much.