Cosmos Film Limited
Dec 2018 Quarter Conference Call
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Management: Mr. PANKAJ PODDAR – CHIEF EXECUTIVE OFFICER

Mr. NEERAJ JAIN – CHIEF FINANCIAL OFFICER

Moderator: Good afternoon ladies and gentlemen, I am Janis, the moderator for this conference. Welcome to the conference call of Cosmos Films Limited arranged by Concept Investor Relations to discuss its Q3 FY19 results. We have with us today, Mr. Neeraj Jain – Chief Financial Officer. At this point all participant lines will be in the listen only mode. Later we will conduct the question and answer session. At that time if you have a question please press "*" and "1" on your touch tone telephone. Please note that this conference is being recorded. I would now like to hand the floor over to Mr. Neeraj Jain- Chief Financial Officer of Cosmo Films. Thank you and over to you sir.

Management: Thank you and a very good afternoon ladies and gentlemen. I am Neeraj Jain, Chief Financial Officer, Cosmo Films. I am also joined by my senior colleague Mr Pankaj Poddar, Chief Executive Officer, Cosmo Films. We will first discuss the key highlights for the December'18 quarter, which may be followed by the questions.

During December'18 quarter, we have been running close to 95% capacity utilization on our production lines. We shifted US thermal lamination plant to India during the quarter. This relocation will help us in two ways. One is to optimize the cost of running this plant, second is the better capacity utilization on this plant. Whatever thermal film we have been selling in the US operations we will cater to that sale from India now. The new specialty line which we planned about a year back or so is expected to commence commercial production from Q1FY19-20. This will add close to 5,000 (+) tonnage of specialty products in our specialty products capacity. We continue to deliver the better margin compared to the key competitors during the quarter. We have also done re-organization during the quarter in our domestic sales. This re-organization is primarily to focus on the corporate customers and the speciality vertical. In a way it will ramp up our speciality sales portfolio further deep driven. The company's consolidated net revenue increased during the quarter by about 22% Y-o-Y basis and this was primarily because of the two factors i.e. one is the 9% volume increase and second is close to 13% raw material prices, and as you know in our industry it is largely a pass through of raw material price.

The company has achieved close to Rs. 36 crore EBITDA during the December'18 quarter, which is broadly similar to the corresponding quarter last year. These results actually have two one-time items. One is the one-time inventory revaluation loss of close to Rs. 9 crore which has happened primarily because of the sudden sharp drop in the polypropylene prices, which is our key raw material. Besides this, there is a one-time gain Rs. 8 crore from the sale of land and building in our US subsidiary, following the decommissioning of plant in the US which we just discussed. You noticed that these two impacts, one-time items impact is adverse Rs. 1 crore on the December 18 quarter. Profit for the quarter has also impacted adversely by the hedging cost of close to Rs. 4.5 crore during December'18 quarter. In fact, there was a Rs. 3.5 crore gain during the corresponding year as against the hedging cost.

The domestic film margins continued to decline till November although we started witnessing some recovery of margins from December 2018 onwards and primarily, the reason for the recovery is the demand supply situation is getting little better and towards the balancing. So, we also do not expect any further BOPP production supply to add during FY19-20 which will also help in a way to reach towards the further balancing of demand supply situation in the domestic industry. As we have already, we are running close to 95% capacity utilization even on the new capacity which we added in February 2017, so we are well positioned basically to take the advantage of the domestic pricing increase. Despite these two key adverse factors actually and partly because of the one-time adverse factors, the company could maintain the EBITDA largely because of two factors. 1) Better realization in the export and 2) tax incentives from the new investment which we did in February 2017. Speciality continue to grow for the company on YTD basis we are growing early double-digit number compared to last year. In terms of the balance sheet we are running close to Rs. 720 crore on that net debt level at December end which is close to 1:1 of the debt/equity ratio. The company shall very clearly focus on reduction of net debt position in FY19-20 and perhaps that's the reason why we deferred our BOPPET project for the time being. Tax expense for the quarter is inclusive of Rs. 3.7 crore of net tax reversal related to FY17-18. During the quarter, we received couple of prestigious awards such as CEO Young Business Leader award 2018, presented by Zee Business, SAP Ace Award and HR Value Creator Award 2018.

These were the few updates from the company's side for the quarter. Now, we would like the conference call to open for the question please.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question answer session. Anyone who wishes to ask a question, may press "*" and "1" on their touch tone telephone. If you wish to withdraw yourself for the question queue you may press "*" and "2". Participants are requested to use handsets while asking a question. Ladies and gentlemen, we will wait for a moment while the question queue assembles.

Question: Yes, good afternoon. My question is, currently what are the BOPP spreads?

Management: BOPP prices, right?

Question: The spread. Basically, between the raw material and finished goods.

Management: The spread keeps on moving. Right now, the spread depending on the film to film is hovering from Rs. 24 to Rs. 60 per kg.

Question: The plant I think you mentioned that the expansion, we have deferred it for some time, right?

Management: Yes. As far as the expansion is concerned for the polyester line, the same has been deferred atleast for next 3-4 quarters.

Question: Okay, and what about these closure notices which come from some pollution board and all that. What is the status on that? There was some closure notice some time back, from Maharashtra Pollution Control Board or something. Is that resolved?

Management: There were some closure notices to couple of the customers in Maharashtra. One or two customers were again given permission after 10 to 15 days and one of the customers have actually contested this in the high court and there are not further additions on it. I think lot of independent research analysts are also helping the government understanding that poly-propylene and poly ethylene are the best recyclable materials and they help reduce the carbon foot print. So, they are trying to eliminate any confusion whatsoever, Government has also made a committee of experts to look into the subject of understanding the various polymers, whether PVC, polyester, Nylon, Poly-propylene, poly-ethylene and come out with clear guidelines in terms of how the way this entire thing should be managed. But, as of now, whatever had closed down, all our customers have restarted and functioning well and I think that was another reason for too much pressure in the November month when couple of these plants had been shut down.

Question: So, these EPR guidelines, it is Maharashtra Government are planning to implement and have started implementing, does that affect the producers? I mean, is there a cost for this?

Management: There should not be significant cost to manufacturers to this but there could be cost to the brand and our customers. However, given that there are many things under question mark, I am not sure whether lot of converters or customers have anything about it as yet. However, some brands have taken the initiative in terms of started doing EPR which is Extended Producer Responsibility. So, they have started getting the waste collected and are disposing it. Cosmo, as a responsible citizen, we have also started doing some EPR. This is a very small cost actually but we felt that it's good for us. So, we are also doing some EPR as such.

Question: Hello sir, could you repeat the net debt figure.

Management: Debt is at around Rs. 720 crore.

Question: Have we repaid anything during the quarter?

Management: So, the debt has actually come down from the last quarter by more than Rs. 40 crores. It is an impact of reduced working capital because towards the end the raw material prices went down, secondly, we have been controlling our capital expenditure as well as trying to improve our cash flow situation so, net debt we were able to reduce Rs. 40 crore of debt in the last quarter.

Question: Correct and in the next 2 years you plan to repay around Rs.180 to Rs. 200 crore.

Management: Our repayment obligations are around Rs. 200 crore and yes that should help us reduce the loan position as such. But we have to also realize that at some point in time we may start polyester project though given that we have deferred it by a year; so that means that polyester capital expenditure would not come in next 1.5 years. So, there is a good likelyhood that in the next 2 years we would be able to bring down our debt by around Rs. 200 crore.

Question: Sir, how is the synthetic paper division doing?

Management: Synthetic paper is catching up, you know. Now, we have started exporting it to the developed markets also. In the last quarter we had started exporting it to America, and for a very nice application of restaurant menu cards, there was a very big chain in US which liked our product and they shifted away from paper to synthetic paper. So yes, we are making progress and as we continue to develop more products and improve our product characteristics, we expect this product to do even better in the future quarters.

Question: You mentioned that because of shifting your line to India now, you will be able to improve the capacity utilization. So, what was it before and now going ahead how much can it increase to?

Management: It was a 50% utilization and given that we have a very nice asset in US, we would like to use it fully and we would be able to use it 100%.

Question: From India right? And sir, for the year, subsidiaries over all contributing positively this year?

Management: Actually last to last quarter, we did make money in these subsidiaries while in this quarter there was a loss. The primary reason, one is we had taken a very conservative view on our inventory and had taken certain provisions in this quarter and otherwise as well and secondly, typically the third quarter is always a very tough season for us because of the Christmas season, there is a closure of almost fifteen days in most of the developed markets. Yes, we are continuously improving on the subsidiary side. As we move along, we should continue because the sales are continuously going in these markets and we have been able to cut down our fixed cost. So, the major challenge which was there with us was, smaller operations and high fixed cost. We have been able to address both, yes, we are reducing our fixed cost and at the same time we are increasing our sales. So, the margins from increased sales will show through in the P&L.

Question: What is our speciality to commodity mix in terms of value?

Management: In terms of value, it is almost 60%-65% of our total sales. But, obviously these numbers keep changing depending on the commodity pricing. What we really monitor is the volumes part.

Question: Then volume, what is the proportion sir?

Management: It is around 40% right now.

Question: 40% is speciality?

Management: Yes.

Question: So, after this quoted line actually which has been set up in April, how much that would be after the commercial production takes place?

Management: I think in a phased manner Q-o-Q, we continue to grow and this year also we made quite a reasonable growth in this. I think we should again continue to see our target is to have kind of a double-digit growth Y-o-Y on the speciality side.

Question: But the problem is sir, is not about the top line. The problem for Cosmo Films is the bottom line actually. In Topline the company is growing every year. We have been monitoring for several quarters now. But the problem is the bottom line.

Management: You have a very valid question. See, in last 3 years, value addition for a very basic commodity film went down by almost let's say 33 to 35 levels to as low as 12 to 13 levels. Therefore, for certain months, in fact it was not even possible to recover the fixed overhead cost. So, I think, one side we continue to improve our operations on the speciality mix as well as cutting down our cost. But, at the same time the pressure from the drop-in commodity margins impacted us adversely. It was also to some extend impacted by multiple lines that came in last 18 months as Neeraj has already talked about that for next one – one and a half year there is no new line which has been announced. Therefore, now given that demand has almost caught up with supply, we are already witnessing an improvement in price and that trend should continue. Even later on, I mean, we do not think many players would be ordering the lines so well you know because everybody would like to conserve cash. Therefore, for next couple of years this situation should continue to get better, and as we will see that the domestic margins will improve as well as you know a mix will play, I think you will start seeing them in the numbers in the times to come.

Question: Okay. But, I want to understand one thing actually. That as you rightly pointed out, the commodity margins are getting subdued. But, what I want to understand is, in speciality you have your own pricing power, right? It doesn't depend on the commodity basis. It is not a normal commodity BOPP film you are producing on the commodity speciality line. So why is the speciality portfolio even though it consists 60% of your total value not contributing to the bottom line.

Management: If you really compare our results with some of our other BOPP players in the industry, you would see that Cosmo is the clear leader as far as the margins are concerned. I can understand that from an investor perspective that 8% EBITDA is not good enough. But, at the same time, when we review the numbers, we see that way we are performing better, and that is a pure play and this is in spite of the fact that Cosmo has actually been able to make one of the weakness areas into strength. Today, we are carrying the older assets in the industry we being the pioneer in this industry. And, some of the very old and inefficient lines have actually now been converted into speciality film. Where, though the cost is higher. But we are able to make speciality films in those lines. So, therefore one side, with a higher cost based on the old lines we are able to make much better margins which is a power play from the speciality mix. Now, the other thing is, obviously some specialities you have a complete power while some specialities over the period the margin come down a little bit. Especially, when the commodity market is so compressed and where ever you have some competition on the speciality, the margins get pressurized because everybody tends to try and sell that, who so ever is making it. You know, we can categories our films into 3 areas. One is where, Cosmo is kind of the leader worldwide. There may be one supplier or hardly 3 or 4 suppliers worldwide. There we are able to command much better margins and it is visible in the numbers. Then, there are other I would say, specialities where there could be more suppliers let's say 15 to 20 to 30 suppliers worldwide. Where everybody in a dull market tries to sell that more. Therefore, to some extent those margins also get impacted. With the commodity margins remaining so low. The third category is where everybody needs that film and therefore the margins are completely driven by demand and supply situation. I think one side the margins are not as yet that healthy. But, the way we are progressing, one side we are expecting the commodity margins we should see an improvement, it has already started showing an improvement in overseas market. And, for last few months it is also showing an upswing in the domestic market. But at the same time our target is in our worst market we should start making double digit EBITDA numbers and I think that way, we are progressing very well. Unfortunately, investors are not able to see it because every quarter whatever improvement is happening, a similar kind of decline is also happening in the commodity margins. So, if we improve the speciality mix and that contributes additional 0.5% point to EBITDA, the unfortunate part is every Q-o-Q for last many quarters the commodity margin just kept on going down and therefore that was not as clearly visible to the investors. But, they can to some extend get to see this when they will compare Cosmo with its peers.

Question: Hi sir, I just want to know volume wise what is the break up between specialty and commodity?

Management: Here speciality volume is 40%.

Question: Okay. There are one off items like inventory loss and those are sitting in which line items in your results?

Management: Stock loss will appear in COGS. So, you will notice our COGS as a percentage to sale go up. Other income will include Rs. 8 crores of one-time gain of the sale of asset in the US.

Question: But your inventory loss will appear in raw material cost, under which head will it appear?

Management: As I indicated Cost of Goods Sold will be the head.

Question: So, at least for Poly-Propylene price, can you tell me what was the price decline per kg in last quarter?

Management: There was 14% decline in the Poly-Propylene price in the one quarter. You know every month it was coming down so it came down in October then it went down in November, then there was as sharp fall in December.

Question: Just a question regarding this thermal line which you have shifted from the US. Is it operational in India now? Or will it take some time?

Management: It has just been dispatched in the last quarter and it should be up and running in the first quarter of the next financial year.

Question: So, basically, you mentioned that volume wise 40% is speciality. Now, there are many people doing the same things. How do we say that it is speciality or how do we differentiate ourselves? Yes, Margins will be a bit higher but there are other places to right in this quarter, in this segment.

Management: I think, in India we really do not think that there is anybody who is there competing with us on the speciality. Though every player would like to improve their mix, but Cosmo definitely has many different types of specialities which could not be replicated by its competition as yet. However, for many of the specialities there could be one or 2 or 5 or at times even more players doing it or for some products there may not be any one actually. But as far as India is concerned, we feel that we definitely have the clear distinct advantage within the industry.

Question: So, it would be pertinent to look at the volume. What is the volume guidance, I mean how much would you be able to grow volume wise in the next year FY20? Can you give us the guidance for it?

Management: As far as volume is concerned, we are almost fully utilizing our lines. So, we expect that we should still be able to improve our efficiencies and increase the volume by 5% next year.

Question: So, this 95% of actual production able output?

Management: Yes.

Question: Over the next 2 years and not much capacity is coming up what would be our top line guidance like volume you mentioned is 5%, but overall do you think we can grow at 10% to 15%.

Management: Sales wise, its slight difficult to give a number because the raw material comes down. Then sales price may also comedown and vice-a-versa. What we normally tell in this industry is that the margins are expected to go up. See, EBITDA as a percentage to also to that extend is impacted by the Raw material prices. Because you know if the raw material prices go very high, you know then the EBITDA percentage as a percentage looks down, and then the Raw material comes down, at the same EBITDA number the percentage looks better. However, given the demand and supply will be better balanced that should help improve the margins in the domestic market, and so in the export market.

Question: Okay, so the EBITDA margins that we have currently, you are saying that it will only go upwards from here?

Management: Yes, that's what we feel.

Question: So, current margins, we can assume that it won't go below the current margins including any one-off or other items?

Management: Yes, we expect them to go up.

Question: Sir my question is, if we transfer the line from US, the thermal line to India, suppose if we operate at full capacity, from next quarter, then something like are we seeing any hopes of increase or improvement in the bottom line?

Management: Yes, it will make some difference. But, it will not be very significant. But yes, there will be some improvement in the numbers because of the better utilization of that line. But, what will really help us is that US had much higher overheads. Those overheads we have been able to cut down that will be a much major impact rather than, you know a better utilization of the line.

Question: So, that will be positive in terms of cost savings you are saying.

Management: Cost savings will be quite a good number.

Question: Okay. Sir my next question is on the raw material front. If I calculate your RMC to Sales, it has increased in this quarter. Obviously, you said it was because of one-off of Rs. 9 crore inventory loss, but as we are seeing the group prices stabilizing from next quarter onwards are, we seeing any reduction in RMC to sales?

Management: Yes.

Question: So that will improve our EBITDA front right or only up to a certain extent?

Management: Yes

Question: Yes, so my question is last year if we see tax rates have come down. Can you explain why, and when it will again start going up?

Management: No, tax rates, as Neeraj has already explained that in the last quarter, we had a reversal of tax relating to previous year deferred tax credit and actually, the return is filed in the third quarter and earlier we had taken certain conservative estimates which where actualized and there for we had a tax reversal in this quarter. Otherwise, we have tax liability at the rate of 25% and we expect that to continue.

Question: I think in good time the EBITDA margin goes to 13% or something. When do you see this kind of situation happening if at all?

Management: See, It is a purely a play of demand and supply and given that demand and supply is getting better balanced, the situation should improve. Now, when they will reach at that level, is anybody's guess. I don't think I can predict many things in the world and I cannot predict this thing also. But, in general things are expected to improve.

Question: Hi sir, I wanted to understand the industry dynamics better. I believe the last year, the supply was about 580 tons whereas the demand was about 410. So, it was a gap of 170 where as currently in your presentation you have mentioned that the supply is about 610. Whereas the demand is 440. So, 2 things related to this; the gap has increased although very marginally over the past 1 year. Second, you have also mentioned, the demand increases by double the GDP rate in your presentation, where are it is increased by only about 5% over the last 1 year. So, is there a temporary slowdown in the demand growth and do you see that increasing over the next few years, is what I want to check with you.

Management: Very relevant question. See, one is, this year the demand has been low because of multiples one off factors. In the month so July we have the transport strike. And in the month of November there where disturbances in Maharashtra, because of some policy divisions by government which government realized that they need to reverse. So, there were multiple one-off's features which affected the demand. Otherwise, demand should have grown in double digit numbers. So, next year again the demand should continue to grow and I hope there will be no one-off's factors next year. So, over all I think we are seeing a very positive demand growth happening from December onwards. So, we are back to normal situation.

Management: Thanks to all the participants. So, going forward, while our focus shall very clearly on the growth of the speciality film and better utilization of our current assets. So, what will happen with the higher growth coming from the speciality to a large extend, the business module would get de-commoditized in years to come and that's what we look forward to. We are also adding speciality line which will start commercial production from first quarter of next year and this will enhance our speciality vertical capacity by close to 5,000(+) tonnage annually. So, going forward these are the few things to look forward to. The domestic film margin in India, in all logic should improve in coming quarters. That's all from the company side. Thank you for joining in.

Moderator: Thank you very much. Thank you, ladies and gentlemen for being a part of this conference call. If you need any further information or clarification, please mail at gaurav.g@conceptpr.com. Thank you for joining us and you may now disconnect your lines.