"Cosmo Films Limited
Q3 FY2021 Earnings Conference Call"

January 28, 2021

MANAGEMENT:	**MR. PANKAJ PODDAR – CEO, COSMO FILMS LIMITED** **MR. NEERAJ JAIN – CFO, COSMO FILMS LIMITED**
MODERATOR:	**MR. SAURABH BHAVE- S-ANCIAL SOLUTIONS PVT LTD**

Moderator: Welcome to Cosmo Films Limited Q3 FY2021 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 the floor for the Q&A session. Thank you and over to you Sir!

Management: A very good afternoon ladies and gentlemen. I am Neeraj Jain, CFO at Cosmo Films and joined by my colleague, Mr. Pankaj Poddar, CEO at Cosmo Films. The company posted yet another spectacular performance achieving highest quarterly EBITDA of Rs.112 crores in-spite of volume drop by 7% primarily due to one of our production line upgradation. Couple of factors contributed to it. First, our speciality sales has increased by 13% Y-o-Y basis. Within specialty, we are trying to increase sales of high end specialty products. The Company is running a strong pipeline of specialty products. Second, improved operating margins by Rs. 3 to 4 per kg in domestic market compared to the previous quarter. BOPP Films overall margins were about Rs.29 per kg as against Rs.26 per kg of previous quarter on account of strong domestic demand. Third, there is inventory gain of Rs.7 Crores in Q3 due to raw material price increase.

Our consolidated sale is higher by 2% despite the lower volume by 7%. The subsidiaries have posted Rs 11 Crores EBITDA on back of higher demand and Japanese Yen and Korean Won appreciation against US Dollar in Q3 which is helpful for the company.

Company's 100% subsidiary specialty chemical had picked up volume during the quarter and it is expected to run close to full capacity from next year. At that stage, we should be having close to Rs.100 crores of revenue. We will soon start the commercialization of textile chemicals developed through in-house R&D. We have plans to launch antiviral and antibacterial wash for the garment industry. Many of these products will help customers to reduce energy and water consumption. India textile chemical industry is more than Rs 10,000 Crores industry and mostly dominated by MNC players.

The specialized BOPET project is progressing as per plan and is scheduled to start commercial production from the Q2, FY 22-23.

Company continues to work on several sustainability projects, including water, power, gas consumption restoration and waste recycling. These will rationalize the cost in coming quarter besides lowering environmental impact.

Board of Directors has declared an interim dividend of Rs.25 per equity share for FY 2021. This is on back of a strong financial performance by the company. During the quarter, the company has also bought back 12.67 lakhs equity share at a price of Rs.576 per share which actually reflects management confidence in the company's business strategy and growth perspective. Improvement in ROE or ROCE starts predominantly from coming quarter because buyback was concluded at the end of Dec'20.

Net Debt is close to Rs.444 Crores, which is 1.2 times of net debt to EBITDA and 0.6 times of net debt to equity. The company is operating at 23% Return on Equity and 20% ROCE and is running strong financials.

Company's focus shall continue to be on specialty films, brand building of recyclable packaging structures, R&D and textile chemical commercialization in coming quarters.

These are few updates from the company's side for the quarter. Now we would like to open the call for questions.

Question: What is contribution of new products in current sales that we have launched in last three years?

Management: It is continuously going up. Obviously we do not have numbers for the last two, three years specifically. What we can tell you is that two-third of our sales have now started to come from specialty products in value terms. From a margin perspective obviously it is also dependent on how the margins of the other BOPP Films remain but currently almost three-fourth of the margin comes from specialty films. We have a very strong pipeline of products and the products that we have developed in last five years are doing very nicely.

Question: On Textile chemical is there any ballpark target that we have, CAPEX that we have done so far, what kind of topline we will generate over a period of next two, three years?

Management: Textile solution will be sold completely outside, it will start to scale up from Q1 of next financial year. The product developments of 12 textile chemicals are already complete and we can proudly say that four to five products are very unique and they are not available anywhere. In the first phase we are launching chemical for cotton textile processing, in second phase, we will launch chemicals for nylon and polyester processing. We expect that the Cosmo specialty chemical subsidiary will have a capexof Rs 100 crores in about four years and it should generate revenue of Rs 400 crores over a period of four years. We will invest around Rs 45 crores by next year out of which about Rs 15 crores has already been spent.

Question: In financial results higher employee expense & other income are reported, is it related to the pet care division or is there any reason on core business side?

Management: Firstly it's due to expansion in Petcare and Cosmo specialty chemical business. Second reason is that salary for senior staffs is linked with profitability and given that this year profitability is good and therefore variable element is also higher.

Higher other income is coming on grounds of higher treasury income, as we invested at right time, so interest income is higher. Second thing is we had sold one treasury instrument last quarter which generated mark-to-market gain. Third we also had a positive forex gain in last quarter.

Question: This interim dividend which is announced, is it regarded as a special one or you have chalked out any dividend specific policy?

Management: Historically, we are trying to give 20% to 25% of profits and board members have taken a view accordingly given the performance they wanted to share wealth with investors and therefore this interim dividend has been devised.

Question: In Overseas Subsidiaries as we have put a lot of effort in last two years, and results are quite visible. Is there a further potential to increase our profitability from our overseas subsidiary?

Management: We would like to remind that hardly three-four years back, we had made highest loss of around Rs 30 Crores and now in last quarter alone, we have made EBITDA of Rs 11 Crores. We feel that we have just begun our journey. The potential is much large. In all markets whether it is Japan, Korea or USA we have a very strong pipeline of products and they will continue to show a very good growth in profitability.

Question: Can throw some light on some milestones that we are looking in FY2022 relating to new products pipeline in BOPP, specialty BOPET as well as special specialty chemical divisions that we have formed?

Management: There are three big buckets on which our R&D is working on. First there is a very strong pipeline of specialty BOPP products. Second as polyester line is about to come in 18 months from now so team is now working to develop right/high margins polyester products. Third area where R&D is working is Cosmo Specialty Chemicals (master batches, textile chemicals & adhesives). We now have more than 20 R&D resources with eight to 10 resources with PHD and four to five are post doctoral, many of them have international exposure as well.

Question: By when will we have commercialized Masterbatches & Textile Business, How many products are under development?

Management: In Masterbatch we had targeted to develop 12 products and out of that 6 have been commercialized very nicely while the other six are in pipeline and we expect them to pass through the development stage by March-April for all of them. So, we are happy with the progress on master batches. Similarly again on textile chemical over a period of three years, we had decided to develop 50 products, which we have identified, out of which 12 main products have already been developed and are under testing stages with customers and their internal reports are extremely good for those products.

Question: As you have announced CAPEX of Rs 300 to 350 Crores of which 75% will be done by debt financing. So, have we already taken any loan or entered into some sort of a banking arrangement and what is rate of interest?

Management: Company's balance sheet is very strong. We will indeed finance mostly internally. But given that these kinds of capex entails loan at a very low rate and therefore we have decided to take 70% loan. Most of the imported machinery it is financed at EUBIBOR/LIBOR plus 0.5% pa.

Question: Currently net to EBITDA of around 1.2. So, in next two or three years, what will be peak debt to EBITDA levels that you would like to keep?

Management: On the current commitments our peak debt would happen next year, which should be close to 1.5 to 2 levels and then it will start falling again. We are in a very comfortable zone.

Question: What is outlook on basic investment in terms of the spread, how we are looking at least for a couple quarters in domestic as well as the export market?

Management: As we have said in the past, this is least thing that we can control and therefore this does not remain our focus area. Within the calendar year 2021 two new lines are going to be added to Indian capacity and therefore margins can be impacted in at least a couple of quarters, however, we are expecting that within a year's time, specialty numbers will start to touch 65% to 70% in volume terms and approximately 75% to 80% in value terms and therefore we are looking for a strong journey even in next year.

Question: In Petcare division any development that has happened in last couple of quarters?

Management: As far as I understand, during COVID period, Petcare industries grew about 30%. It is a phenomenal growth and the fastest growth in any category. We have already created a team of 15 people and by the end of the next financial year we will be looking at 65 people. We have already decided on the brand strategy and we look to pilot launch first phase from July onwards in Delhi. The moment the pilot launch is successful, and we take care of small,

small nitty-gritty's and then start to scale up over next two years in five cities. So, there will be two types of scale up; one would be offline scale up and customer service to be provided at residence and other is online services where we will be able to scale up at country levels' very fast while offline scale up will happen from city to city basis. The good part is the 70% of the Petcare business has been in top 10 cities and therefore it will be far easier for us to scale up having said that, adoption of pets is really growing at a phenomenal pace across the country.

Question: Are you facing any container issue because currently there are a lot of articles floating around and given that we export a substantial amount of our turnovers?

Management: November and December was a challenge. Our logistics team has done a phenomenal work in signing up of one year contracts at very big prices and therefore we do not see a concern Moreover customers are ready to pay more freight than what we normally pay incase of price escalation. However, the challenge is coming when it is coming to imports because our windows are not able to manage the same way and therefore, we are finding some material shortages from time to time and then we have to change our lines depending on what material is available. So, I would day on export side we are doing a phenomenally good job. There are minor hiccups on the import side.

Question: Are we looking at any reduction in our net debt levels and is there any particular target? I know that we are expanding our capacity but are there any plans of reduction in our debt levels?

Management: If you already see, quarter-on-quarter there is a big reduction in the net debt level. So, answer is yes and given that we have a very limited capex next year, obviously there will be a polyester capex, I think next year also we should be maintaining close to 2 net debt to EBITDA levels.

Question: First of complements for completing your buyback programme, it is observed promoter stake in the company is relatively on lower side, I would say compared to companies that you are predicting. It is about 44% or 45%. My question is with such a promising outlook why does the promoters not consider strengthening their stake in the company by way of creating acquisition growth or in fact, in the recently concluded buyback, if promoters would have not participated maybe their stake would have effectively gone up closer to 50-60%, so what signal does it send if the promoters also took part in the recently concluded buyback? Why would not they prefer to actually augment their stake in the company because of the promising business might look?

Management: I can answer this in two ways. First is we maintain a very high level of corporate governance and second is that the promoters can also have their personal commitments and therefore due to those commitments they may have to take out some money, but you have to appreciate the fact that promoters have actually increase their stake over the last two-three years period.

Question: Does this specialty films sales happen directly or they go through the converters.

Management: It depends on the channel. We have four, five large buckets of specialty films. The first bucket is sustainably solutions and packaging wherein most of the developments happen with brands. Second is thermal lamination films which are sold through channel partners all around the world. Third segment is labels and within labels there are three segments (self-adhesive labels- largely happens through converters, wraparound labels- happen through brand, but in some cases through converter & injection molded labels- happens through printers,). Synthetic paper normally goes to distributors and in many cases the brand approves the synthetic paper but in many cases distributors work with the printers and the brands to get the formal approvals. There are industrial films which are supplied directly to the various B2B channels basically various industries as such.

Question: If spreads in whole industry reduce then how much will our profitability reduce and how much would specialty film portfolio insulate us from industry wide reduction in margins?

Management: The normal BOPP film margins are not in our control. This is decided by supply and demand. What we are working throughout is to insulate ourselves from these impacts and as we have said before that almost 65% in value terms of our sales is specialty and then intent to make this 75% in value within a year's time. Until the time that we still have some commodity in our portfolio so margins can get impacted by the domestic movements; however, the impact will continuously decrease because if we see three years back, we had a much lesser specialty numbers and it has grown significantly in the last three years. So, it will be a mix of that. The second thing is many of the film players are into BOPP and polyester and as investors know that polyester had gone through an excellent run unlike BOPP and therefore we request the investors to compare against BOPP players and not as much against polyester players. Polyester typically has a better EBITDA margin because the raw materials cost is only Rs.55 and sales price is close to Rs.100 and therefore polyester historically has a high EBITDA percentage, but lower ROCE while in the case of BOPP because the raw material itself is around Rs.90 to Rs.100 a kg it has a low EBITDA percentage but better ROCE and therefore you must when you compare Cosmo you must look at ROCE for Cosmo Films.

Question: Other companies are also talking about increasing value added proportion, is there any difference in our value add film portfolio with our competition? Are there unique products that we have that others do not have?

Management: First of all, we have comparatively stronger R&D. Second thing is metallization for us is a pure play commodity business as there is nothing to do with specialty. Thirdly there is difference between value add and specialty films. What we are saying is products, which are made either by only Cosmo Films or there are not more than five suppliers in the world. So, we are not talking about small value adds. We are talking about products, which differentiates itself, command a premium, have stable margins, which are linked to raw material prices and not linked to demand and supply dynamics.

Question: Is there a possibility if after two to three years some of the competitors can also copy our specialty products, will it no longer remain a specialty and can hamper our efforts?

Management: It differs from product to product and the complexity of research and processes that go into it. We have a semiannually review process and any product which we feel that now can be made by more suppliers; we shift it to either a semi specialty bucket or a commodity bucket. So we do regular exercise and if we find that some products are not earning margins which we aspire then we shift them to other buckets. In some cases we even discontinue them.

Question: In FMCG sector how correlated are your volumes with FMCG majors like HUL, Britannia or Nestle because in last few quarters companies like HUL has reported 4% volume growth Marico has reported 13% growth. So, do you think that as we are left behind Covid pandemic period, will there be some increase in volume growth for your company as well?

Management: Yes all three customers that you had named are our respectable customers and we enjoy growth that is enjoyed by them. However, it is not just FMCG (where we have exposure of 35% to 40%), we sell across many different segments and therefore we are quite insulated from the black swan that happened in terms of COVID.

Question: On raw material perspective in previous conference you had mentioned that lot of capacity has been put up by some players so you anticipate that in next 2-3 years raw materials will on a lower side and hence the margins will improve?

Management: Lot of capacities are coming in China. Some of the capacities are getting delayed because oil is at very low price and new capacities were going to polyester films. However, there is no challenge on demand and supply side when it comes to raw material we have never expected polypropylene to reach to $1,200 levels and now they have come back to $1,150 levels. Which is a very high level and it is not because of demand and supply. What is really happening is because oil is not being consumed and produced and therefore petrochemical companies do not have enough raw materials to make polypropylene. So, this is a very exceptional scenario which none of us had predicted but because of COVID the prices will go up. We had anticipated that the prices will go down, which actually went down in the Q1 but it started going up from Q2. So it was a kind of black swan moment for all of us. Going forward it should come down as oil consumption goes up, there will be more raw materials for the petrochemical companies and ideally speaking that should reduce PP prices.

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

Management: Clearly what is coming out from our discussion is that the Company's focus on specialty packaging and chemical business shall continue. All our ambitious growth projects covering master-batches, specialty chemicals, specialty BOPET line & increase in specialty packaging films are progressing well and in line with the plan. 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. Ladies and gentlemen on behalf of S-Ancial Technologies that concludes this conference.