"UFlex Limited Q3 FY 2021 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to UFlex Limited Q3 FY 2021 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Ms. Shalini Gupta from Quantum Securities. Thank you and over to you, ma'am.

Shalini Gupta: Thank you, Bikram. On behalf of Quantum Securities, we welcome you all to the Q3 FY 2021 results conference call of UFlex Limited. We thank the management for giving us the opportunity to host this call. The management is represented by Mr. Rajesh Bhatia – Group CFO, and Mr. Yusuf Nasrulla –Investor Relations. I now hand over the call to Mr. Yusuf Nasrulla. Over to you, Yusuf.

Yusuf Nasrulla: Thank you, Ms. Shalini, for hosting the call. Good afternoon everyone and a very warm welcome to all of you who have joined us today for quarter three earnings call of FY 20-21 UFlex Limited.

On the call today we have a Group CFO, Mr. Rajesh Bhatia, who will be sharing his assessment of the performance we posted yesterday. Please note that today's discussions may include predictions, estimates or other information that might be considered forward-looking. While these statements represent our current judgment on the future holds, they are subject to risks and uncertainties that could cause actual results to differ materially. You are cautioned not to place undue reliance on these forward-looking statements, which reflects our opinion only on the date of this presentation. I would also like to emphasize that the call should not be broadcasted or reproduced in any form or manner. We will open the floor to Q&A towards the end.

Let me now briefly take you through the key highlights of Q3 FY 2021:

The numbers posted yesterday marked another strong quarter for us as our PAT and EBITDA grew by 89% and 50.8% year-on-year. We have announced domestic expansion with Greenfield packaging films plant set up in Karnataka. A Brownfield CPP line to be set up in UAE and a BOPET line in Poland has been commissioned.

I would now like to invite Mr. Bhatia, to address the participants. Over to you, sir.

Rajesh Bhatia: Okay, thank you. Thanks all the participants and Happy New Year to you because it is the first time we are interacting in this year, so I must wish you all a Happy 2021. And we hope that you all are safe, you all are keeping yourself, taking enough precautions against this pandemic and keeping the safe distance and keeping the mask, washing your hands.

So, I will strongly urge that we should have a strict discipline on this because leniency could be quite sort of have huge ramifications. I have personally suffered on this account, so that is why my recommendation and my request to all is to sort of maintain the protocols as to what the government has been telling us.

So, as Yusuf said that there has been again a quarter where on a Y-on-Y basis we had all parameters in green, whether it was the production volumes or the sales volume or the sales value, EBITDA, PAT, everything was in the green. Yes, as this quarter was sort of as compared to the sequential quarter was a bit down, mainly on account of because we had started sort of the trial runs from our Poland plant, given that there was a huge requirements of the packaging films in the Q1 and Q2 and we were actually sort of running the plant, albeit we had to do some work there to complete the plant.

So, we have done those works in Q3 and that is where in Q4 currently we have announced the commissioning of the Poland BOPET facility. But yes, we did delay it by a couple of months, because of the huge customer demand due to which it was more prudent to keep on operating, though everything was not according to what the way we wanted. But all of that has been set right. And as we speak, the day before is the first time we crossed 1,000 tonnes for the group as a whole daily production of the BOPET films. And with all the plants, now, more or less coming on stream, we will surely see a larger volumes in the quarters and the years to come.

And now when our overseas expansion is complete, we have announced commissioning of Poland. Russia was already commissioned earlier, Nigeria and Hungary are completed, trial runs are going on. So, any day we can look at announcing, depending on the machines, the plants operating at a guaranteed performances. Surely we are on course to sort of commission them. But yes, both the plants in Nigeria as well as Hungary, now the trial runs are happening, the production is happening. There are a few hiccups as what happens in everything that we set up new, but those are surmountable challenges and these we will soon announce the commissioning of these facilities as well.

So, having done a commendable job by our team in terms of taking four simultaneous projects at the same time, and that too in different territories, with all of them now getting completed and with our aseptic business also now almost operating at full capacity levels. And in India, where we have not set up any packaging films facility for the last 16 years, this period is even more than the period during which Lord Rama was in exile. So, we have now decided to set up a Greenfield in southern part of India in the state of Karnataka, where we are setting up a BOPET facilities similar to what we had set up in Nigeria.

And a CPP facility, because currently we are buying a lot of CPP films from the market and our existing plants are fully utilized. So, we have decided to embark upon this expansion, which cost us about Rs. 850-odd crores. We have also taken up now a smaller expansion of CPP facility in our Dubai plant where we had our entire infrastructure available there, because we had moved one line to Russia earlier this year, and then the whole utilities and other infrastructure was lying unutilized So, we are spending about another $15 million to set up a CPP line there itself, which will help us to utilize the whole infrastructure and also add to the volumes and profitability.

The, the margins in the packaging films business during this quarter were a bit lower as compared to the sequential quarter, mainly because the raw material prices which had fallen quite steeply in the Q1 and Q2, they came back. And with our economies opening up and the demand coming back, I think there had to be readjustment of prices. And accordingly, we see that during this period, Q3, the margins on the packaging films line was less as compared to Q2. As compared to Q1, it was almost at par. But yes, going forward, as I said that these times were a bit extraordinary, so now with the normalcy returning, we are looking at more of a value added as well as increasing our throughputs from the newly commissioned capacities.

We have done wonderfully well in America, in North America where we are constantly utilizing our capacities now fully. We had earlier achieved higher capacity utilization, but we couldn't maintain them. But now in this current fiscal, we are doing quite well in in North America. And the both Mexico and American facilities are almost being at a 100% utilization levels. We will have now additional outputs in the coming quarter coming from our Poland facility. Our Hungary, Nigeria, Russia is also ramping up, but they will also do better than what they do in terms of their output in the coming quarters. And we are looking at, at least 25% volume and value growth over the next couple of years at least, which is which is because of this capacity that we have now set up.

We also told you last time that the expansion at our aseptic packaging facility is also likely to happen, so we are going ahead with that expansion also. It doesn't cost much, as I have been saying, it's only adding one printing line. But given that we are now fully sold out this season, so before the next season commences we will ensure that we have the added capacity in place so that we can serve more number of customers and exist higher volumes to the existing customers.

So, this pretty much sums up our performance in this quarter. India business has done well, overseas had done well, and that's why the leveraging ratios are now extremely comfortable. In India business, today, if I see long-term debt to EBITDA, it's almost at a 1:1 level which is very healthy for the business, and as we are expanding, spending another Rs. 850 crores in setting up the new facility, I think we are absolutely comfortable in terms of liquidity or leveraging for setting up this capacity. And we are sure that we will be able to ramp up to the moment after we commission this in the next 18 months period, we will be able to ramp up to a higher level of capacity utilizations within the first year itself. So, much so is the market. And we have deliberately chosen South India as a market because we are not present there. So, for this, we are clear, the message is, we are looking at not a capital consumption from this plant, even if it is there it will be much less, but a larger production will be available to be sold to the third party customers for this.

So, overall, a very satisfying quarter. Yes, we have done about 20% volume growth in both production and the sales volume. 17% top-line growth. EBITDA and the profitability, PAT is much higher at about 51% and 90% over the last same period last year. But what we are guiding is that this trend of every quarter-to-quarter higher throughputs, both volumes production as well as sales volumes, that's what our endeavor is to keep on delivering those with the new capacities getting commissioned now.

Thank you. That is what was my take on these results what I had to communicate to you. And we can have any questions now on the performance and India overseas, whatever you want to ask.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. We have a first question from the line of Saurabh Sharma, an investor. Please go ahead.

Saurabh Sharma: Sir, I wanted to know in comparison to our competitors, Polyplex, SRF all of the other competitors, Ester, Garware, you look at everyone, your margins have reduced quite substantially in this quarter versus the last quarter. You did mention it passingly but it's now been two quarters in a row. Last quarter I had asked the same question and you told me that there was a charge-off, bad debts and you had done excessive provisioning, and the amount of that was around Rs. 100 crores in the cash flow. And so I wanted to ask, it's now two quarters in a row that you have been lagging the competitors, so when do you expect this to reverse? That is my first question.

Rajesh Bhatia: So, I don't think so we lag at any competitive levels, because if you compare us with Polyplex, SRF, they are doing a pure packaging films business, where because of the higher demand and everything else the commodity market, so the prices were higher during the pandemic, at least in the first two quarters. And that's where you see higher margins for us as well as for them. But we don't have only that business, we have aseptic packaging, we have packaging, we have engineering, we have chemicals. So, our business is much more complex than they are complex. So, when we compare ourselves only with a competitive business with them, I think our margins are pretty much almost the same. They are not less as compared to any of the competitors.

Saurabh Sharma: Sir, looking at just the bottom-line numbers, our margins are sub 20% for two quarters in a row, while the competitor is doing around 25%.

Rajesh Bhatia: Yes, but that's what I said that you are comparing apples with oranges, then. Yes, in the films business the margins are higher today, the packaging drags the margins a bit down that is why our blended margins are lesser than the competitors' margins.

Saurabh Sharma: If I were to turn this question around and ask it another way, not just the operating margins, can you just talk about what are the return metrics that you evaluate before putting up a new plant? What are the long-term return metrics, ROE, ROCE that you are looking at when you are looking at your business?

Rajesh Bhatia: I think what are we looking at equity IRR of about 20% when we look at investments what we need to do. But short-term blips, again some sort of a situation where everybody tries to set up more capacity and all that, there could be situations where the margins get squeezed for a limited period of time, and we saw that in our BOPET after 2011 boom, then for a few years there was a lull totally, and then 2017 onwards the capacity utilization, there were hardly any capacity additions and the markets got consolidated, the capacity utilization increased. And today, in 2020-2021, we found that the margins were so robust that everybody thought of expanding, including us, someone who had not thought of any capacity expansion on the packaging films side in the last 16 years, and we have been expanding that business only overseas, but not in India. But we can't be remaining too far behind. If packaging is today a bit subdued, it will bounce back, it has bounced back in the last two years, it will take a couple of years more for it to get to the normalized returns. I see that globally all the peers are doing about 16% to 18% kind of EBITDA margins. But in India, if I see my competitors, if I see ourselves, everybody is working at 10%, 11% kind of margins in this industry, which will not sustain for long. But yes, today, they are a bit drag on higher margins in the packaging films business.

Saurabh Sharma: So, sir, you talked about 2011, the period after 2011 there are a lot of capacity got added. And right now, I mean, correct me if I am wrong, but the way I see at it, look at it as an outsider, it is exactly in the same situation as it was in 2011.

Rajesh Bhatia: No, 2011 was a different time where the plant capacity that you put up, the paybacks were about a year. So, we are not in a same situation at present. Today, when we still look at any expansion, we are looking at about four to five years kind of a payback period. So, the situation is not the same.

Saurabh Sharma: So, our ROE currently is sub 15%, 12% to 13% currently, ROE, Rs. 800 crores of PAT, around Rs. 8,000 crores net worth, right, so that is barely touching even double-digits. So, that is something that I wanted to point out. I mean, you are free to not answer this any further…

Rajesh Bhatia: No, we are free to answer this because when you take that all this recent capacity expansions, aseptic packaging and all that, so let's talk of a situation when all these get ramped up and operate at a reasonable capacity utilization levels, vis-à-vis, and then then when you look at that these will look more meaningful at that point in time. But today, having done a substantial CAPEX in the last two years, and the commensurate revenues and the profitability only coming in the future years, I think that would be wrong to look at from a perspective of today's returns. Because equity is already spent in those projects also, equity and debt both are taken for those projects also. And for us, for our size of the organization, let me tell you, this was quite a substantial expansion that we undertook. Four plants at a same time, with an outlay of close to about $400 million was very substantial in relation to our size. So, today, when you talk about those returns, the equity earned has been reinvested into those businesses, and we will wait for the revenues and profitability to shore up as we increase the throughput from these plants.

Saurabh Sharma: Right. Sir, capital allocation primarily is one of the major concerns, I believe, in the market, with respect to UFlex, and that clearly reflects in the price-to-earnings and the price-to-book and everything, all of the other market ratios of our company that clearly reflects in the market ratios and that is all I wanted to bring attention to once again. It has been brought into focus on every single call that I am sure that you would have attended by now. And the return ratios and the capital allocation is something that is something that the market is clearly discounting very highly with UFlex.

The second question, again it is an extension of the first, sir, is about the dividend policy. Polyplex has done Rs. 100 dividend just a while ago, you have seen Cosmo doing a Rs. 25 dividend on Rs. 500 share price or less than Rs. 500 share price. So, what is the company policy, because this new CAPEX was never under discussion up till now, up till just yesterday when the results were announced this new CAPEX was never in discussion at all, even in the prior conference calls. So, what really is the company's capital allocation policy in terms of distributing some earnings to the shareholders versus taking care of the management? That is the second question, sir.

Rajesh Bhatia: So, I think, as of now, the endeavor is that you should look at flowing back that capital into growing the business. And yes, there are clear opportunities in the markets to grow that business. So, we are today focused on that rather than huge distribution to the shareholders. Having said that, it's not that we will not be shareholders friendly from that perspective, I think it's just a matter of time, somebody is doing it today, a larger distribution, we may be doing a few years down the line as and when this capacity expansion gets completed, depending on as to what are the opportunities to grow in our line of business at that point in time. So, I think we remain very, very focused on increasing the shareholder returns, and that is where, yes, if there is some past because of which we are seeing today the ROCE and some of the other return ratios are bit subdued, I think the idea is to correct them with the new incremental investments. And aseptic packaging foray is one of that where we are looking at a much higher EBITDA margins, double of what we today have in the flexible packaging business. And by growing that business, we are looking at a huge export potential in that business as such.

So, obviously, in one segment today the margins are a bit subdued, the packaging films margins are reasonable right now, another two years down the line there may be some effect on these margins as more capacities come up. But aseptic packaging business, where you don't find the smaller players, will remain growth focus area. And after this expansion, where we are spending close to about I think Rs. 60 crores to Rs. 80 crores kind of a CAPEX, not much, I think the revenues will clearly double. We are looking at about Rs. 500 crores top-line from this business in FY 2022. And the capacity that we are setting up will give us another Rs. 500 crores top-line. It will not happen immediately, it will take a couple of years before we are able to ramp-up the additional capacity as well. But yes, the top-line and the margins in that business are definitely better as compared to the packaging business. The packaging business also, today if you ask me, we are running at a very high-capacity utilization levels. But there is no point in investing in that business at this point in time, given that when you are allocating your capital, I think, in terms of the returns from that capital, the packaging films and aseptic packaging are in the top tier, and the flexible packaging business commands lower margins, and that's why that that investment is not today planned.

You said that it was not on horizon and all that, disinvestment. I think any progressive company like us, we are not giving some advanced one-year notice to shareholders or to other stakeholders that we are looking to expand. We will continue to look to expand as and when there are opportunities. And we are clearly focused on growth at this point in time.

Moderator: Thank you. We have next question from the line of Shalini Gupta from Quantum Securities. Please go ahead.

Shalini Gupta: Very nice results. I just wanted to ask you couple of questions. Basically, the volumes have increased by around 21%, sales have increased by around 17%, so there is some pressure on realizations. So, if you could just explain why is that?

Rajesh Bhatia: No, it depends on the product mix, actually as to your volumes are more in the packaging films side, so where the value-add is not there. But if you sell more of the packaged products, then the volume and the value increases are commensurate. So, I think it's very difficult to give one answer to that, but because we have a bouquet of different products which we sell, so that's where the volume growth and the value growth may be different at some point in time.

Shalini Gupta: And, sir, I mean, also an associated question, basically we have seen an increase in gross margin by 500 bps. So, on the one hand your realizations have gone up like this is really very difficult to really connect to lot of things. But on the other hand, your gross margins are sort of indicating that your raw material prices have gone down. So, if you could just talk about this.

Rajesh Bhatia: So, definitely on a Y-o-Y basis, the packaging films margins are much higher in Q3 of FY 2021 as compared to FY 2020. And that's where you see that the margin have expanded from the same period last year. And primarily when you ask me the question about volumes, the volumes for us have grown in the side of the packaging films business. If the packaging film sells for Rs. 100 a kg, the packaged material sells for Rs. 250 a kg. So, there is a value addition there. So, that is why when you say the volumes have increased by this percent, but the value has increased by only this percent, that's because of the composition mix is now changing.

Shalini Gupta: Okay. And sir, you have been speaking about the BOPP, BOPET price spread. Now, where do we stand vis-à-vis that?

Rajesh Bhatia: So, we had a bit of a dip in the month of November in the margins for the BOPET because usually I have been saying that we find that our post Diwali period is the lull period. And that is why November the margins were bit less. But December and January, I think they are back to, again, the numbers which we had in October. Obviously, the July and August numbers were bit of different because given the huge demand created by a pandemic, but yes, the numbers today when we look at, I think, they are quite satisfactory, and they indicated stable margins.

Shalini Gupta: Sir, what was it that caused this spread to increase? If you can just talk about that.

Rajesh Bhatia: So, two things led to that huge spread, one is the demand for the packaging films, and during the pandemic times everybody was like all of us as individuals were trying to hoard more and more of the food items at home. Similarly, all the packaging companies had a huge demand, the shelves were empty so obviously there was a huge demand for the brands also for the food, and they wanted in turn more packaging. With the result, the demand going up and the prices going up all of a sudden. Secondly, there was a raw material price correction, given that during this period the petrochemical demand fell very, very steeply. And the oil came down to much lower level, today it's about $58 to $60, but we had in March the oil coming down to even $20 levels also. So, the raw material prices came down drastically, and the finished goods prices because of increased demand went up. So, that led to much higher margin, which are sort of a one-off kind of an effect. But thereafter, except for the month of November where the margins were a bit lower, all other months are quite reasonable now. So, December and January and February, they are all at a reasonable levels, what we had either in the month of pre-COVID or post August.

Shalini Gupta: And sir, my last question, I mean, you have expanded in a lot of countries overseas, particularly Eastern Europe. So, if you could just explain the rationale for choosing Eastern Europe.

Rajesh Bhatia: See, Eastern Europe in terms of the cost of manufacturing operations probably gives you an advantage rather than setting up a plant in Germany or Italy, and then supplying to the local market there. So, it's an EU, so it does not actually make a difference whether where are you making. But if the cost of transporting that to the consumption centers is lower than the cost of operations on a constant basis, then some of these Eastern Europe countries give you that advantage. They give you also the advantage in terms of having the flexibility of the labour and the manpower coming from India. And on top of that, they give you a lot of fiscal incentives to set up the capacities over there. So, the infrastructure developed by them is, again, the word-standard, you are still catering to Germany, Italy and other consumption centers, which are the markets. And your cost of operations is much lower. And on top of that, they are giving you kind of fiscal incentives in terms of the tax benefits or even in terms of subsidizing a part of your investment, which actually helps you lower your capital cost.

Moderator: Thank you. We have the next question from the line of Sunny Gosar from M.K. Ventures. Please go ahead.

Sunny Gosar: I have a couple of questions. The first one is that, in the last two quarters we have done about 1.1 lakh tonnes of volume. So, once all these capacities in Nigeria, Hungary, Poland and Russia are operational, what kind of peak volumes on a quarterly basis can we look at?

Rajesh Bhatia: So, I think, so overseas itself we have added about 125,000 tonnes in terms of the capacity. So, that 125,000 tonnes translates into about 30,000 tonnes a quarter, so those are the additional volumes we should be looking at a peak capacity utilization levels, which will happen over a two year period.

Sunny Gosar: Right. That's helpful. And then other question that I want to understand is, considering Rs. 850 crores of CAPEX for the India plant, plus about Rs. 130 crores to Rs. 150 crores for Dubai, and aseptic plant expansion, plus some maintenance CAPEX. So, what kind of CAPEX numbers on an annual basis are we looking at for FY 2022 and FY 2023?

Rajesh Bhatia: So, FY 2022 and 2023, apart from this CAPEX that we have announced, there is normally about Rs. 100 crores to Rs. 150 crores of the normal CAPEX that we do normally.

Sunny Gosar: So, effective, Rs. 1,000 crores between India plus Dubai, plus Rs. 200 crores on maintenance CAPEX for two years, and plus the aseptic. So, on an annual basis, we are looking at about Rs. 600 crores to Rs. 700 crores of CAPEX for the next two years?

Rajesh Bhatia: You can say so.

Sunny Gosar: Right. And sir, one adjacent question to that, so assuming we have about Rs. 800 crores of PAT and about Rs. 450 crores of depreciation, so that is about Rs. 1,250 crores of cash profit. So, is it safe to assume that going forward our debt will not go up from the current levels?

Rajesh Bhatia: So, I think, so this question is very difficult to answer because the ideal situation is that if you are not growing, if you are not expanding you have no option but to return the debt first and then give some extraordinary dividend to the shareholders. So, depending on the situation at that point in time, yes, we will look to lower the debt. But today also, as I said, the debt today when I look at, like India debt currently is about Rs. 750 crores and India annual EBITDA is also about Rs. 750 crores to Rs. 800 crores now, so we have 1:1 kind of a level, which is extremely, extremely conservative kind of a situation.

Overseas, yes, we have recently done some of the capacity expansion, so will take us a couple of years to digest that. But, overall, I think even if we take that into account, what we are expecting is that next year that we should have at least an EBITDA of about Rs. 2,000 crores, with the debt even including the new debt which we are taking for the expansion, I don't think so we will have more than a leveraging of two to EBITDA. Which is again extremely comfortable situation to be in. And thereafter, if there are no further plans to sort of grow, then, obviously, the debt will go down over a period of time. The good part for us is that the overseas debt is at a very cheap pricing, even the debt we are going to tie-up now for this India facility, it's going to be ECA facility, which is that Euribor plus 0.65%. So, it's so competitive that the additional burden on account of the CAPEX in the form of interest and servicing also is spread over say 10 to 12 years. So, you will never have a situation where there is a huge bundling of your repayments or your cost of money is humongous, which when in a down cycle it starts sort of pinching you.

Sunny Gosar: Right. Sir, I appreciate that. So, your point about doing about Rs. 2,000 crores of EBITDA makes this question even more pertinent, because then you will have a lot of free cash flow even after that Rs. 700 crores CAPEX. So, either that gets allocated towards a higher shareholder payout or some debt repayment, because this year even if you do Rs. 800 crores PAT, that will be at about Rs. 1,600 or Rs. 1,700 crores of EBITDA, so your cash flows will be even higher for the next year.

Rajesh Bhatia: So, you are right, but now we have the new debt. So, see, when we started the CAPEX for overseas business, they were virtually debt free. The total debt on overseas business on an EBITDA of about $85 million to $90 million was only about $30 million, at that point in time, which has been also paid off. So, whatever we have in the overseas business is now only the current debt which has been taken for this expansion. So, what I am trying to say is that at a debt to EBITDA of 2 today when you have just installed the projects, to say another a year down the line you will be still left under 1.5 debt to EBITDA. But there is no incentive for us to prepay that debt, because that debt is at such a cheap cost that it does not make sense to prepay that particular debt. So, if there are surpluses, we will evaluate at that point in time what is the best course for the company, if there is a growth available we will go for that. If there is no growth available, then obviously that makes sense to retire some of the high cost debt. And then eventually if still there are no growth opportunities and there are no debt bearing opportunities, then return that money to the shareholders.

Sunny Gosar: Right. So, sir, we will look forward to a bigger payout to the shareholders from what you are explaining. And sir, one last bookkeeping question. Sir, the tax rate in this quarter was slightly higher, at about 34% versus earlier quarters at 25%. So, was there some one-off? And going forward, what is the tax rate that we should look at?

Rajesh Bhatia: I think I will have to answer that offline. But all that I can say is, in this quarter we had also profitability from our Mexican as well as U.S. operations where we are paying the full rate of tax, and probably because of that, overall tax liability is a bit higher. Even for our new facility now, in the south we are doing it in UFlex, we are not taking advantage of setting up another company to lower the tax burden, because the depreciation benefits that we will get versus the new rate of lower tax, I think that itself will take care of sort of. And the interest costs that we save because of doing this project in UFlex will also make up for a lower rate of the tax, if we would have set up a separate company to the south project.

Sunny Gosar: Sir, but I remember that you had said that your expansion in Poland and Hungary have some tax holidays. So, what should be the sustainable tax rate that we should look at for next…

Rajesh Bhatia: Sunny, we will have to address that offline.

Moderator: Thank you. Sir, we have next question from the line of Rahul Soni from Smith's Limited. Please go ahead.

Rahul Soni: Sir, a couple of questions from my side. I want to understand what portion of your flexible packaging revenues are coming from direct supplies to the end customers, FMCG players like HUL or Nestle or Britannia?

Rajesh Bhatia: We sell directly to the brands only, to Procter & Gamble or Nestle or Cadbury, we sell directly to them only, we don't sell to any distributors.

Rahul Soni: Okay. You are not selling to any other player who is a converter?

Rajesh Bhatia: No. Packaging material goes to the end customer only. The packaging film goes to the converter.

Rahul Soni: So, what percentage, if I ask for the breakup for the flexible films or the packaging films?

Rajesh Bhatia: I will not have that for you. But largely what we say is that the business in India should be taken as a flexible packaging business and not a packaging films business, because we have this plant in the packaging films is only catering substantially to the internal customer, which is the packaging business. And yes, they sell to the outside parties also, but largely this should be construed as a capital business only. And the little bit extra capacity that we have, that we sell to the third parties. As we expand our capacity on the packaging business, I think that will also get taken up, the capital consumption only. So, the India business, largely we say it's a packaging business, which is an integrated packaging business. Leave aside the engineering business which we report separately, but the other piece is just the packaging business.

Rahul Soni: Okay. And second question is on your CAPEX. Sir, as you said, you are doing the India CAPEX after a gap of 16 years, so just want to understand why there was a gap of so long period? Because, obviously, there was a growth in demand for the flexible packaging.

Rajesh Bhatia: So, I think, what we decided, because the capital was limited so what we decided that we concentrated more on the packaging business rather than the packaging films business. If you have heard me now, what I have tried to convey is that the flexible packaging business today is low on the margins, low on returns. And as such, if we have to consider any growth plan, so that stands last in the queue vis-à-vis the investment in the packaging films, investment in aseptic. So, we have only three lines to grow, aseptic, packaging films and packaging. So, if I look at today in this order, yes, the aseptic packaging business was the lowest hanging fruit that with an investment of within Rs. 100 crores we can double up the capacity, which can throw an additional top-line of about between Rs. 400 crores to Rs. 500 crores in the two years. So, that's the lowest hanging fruit, so have that first. And then when you have the resources to expand, given that your leveraging is extremely, extremely comfortable. So, in that pecking order then you have the packaging films business which today, yes, talks of 24%, 25% kind of an EBITDA margins. But even if you plan that business based on 18% to 20% kind of EBITDA margins, so that business will give you good returns. The flexible packaging business will count when there is a further consolidation in the industry, the India margins for the flexible packaging players move up in line with what are the margins there in the overseas, in the rest of the world. And that's where if you need to grow in that business, then those investments will kick in.

Rahul Soni: So, sir, as you said you are directly supplying to the end customers. So, if in that context I compare your business model for one of your peers like Huhtamaki, so your business model is more or less same, if you exclude your other business.

Rajesh Bhatia: So, between us and Huhtamaki, the only difference is, while we are an integrated player, Huhtamaki is not a fully integrated player. Like they buy packaging films from the market, they buy inks, adhesives from the market. So, all these facilities we have in-house and that is where our margins are better than them. Otherwise, we are in the same line of business. But if you look at Amcor, if you look at Constantia, Huhtamaki in their overseas balance sheets, you will find that their margins in those territories are much higher than the India margins.

Rahul Soni: Sir, one last question, if you allow. Have you also looked for any acquisition? Because if you are doing such a large CAPEX and packaging business, there are also unorganized players also there, the Huhtamaki they have a history of doing acquisitions only. So, have you also looked from that angle?

Rajesh Bhatia: If you see, acquisitions, what happens in the packaging business, they happen at an EBITDA multiples of 12x to 14x. Now, I think that is like paying a top dollar for that acquisition. But yes, then there are companies who do not have different use of capital, so they find it most efficient to acquire. So, clearly there are less of organic growth opportunities in the developed world, and that is why a lot of companies are wanting to acquire and become bigger. But, if we see today in India, all these companies did acquire smaller setups and all that, but the market itself is so small, there may be hundreds of small, small players which are there. But if you talk of any substantive players today, I don't think so you will have that in the Indian market. So, again a very fragmented market, yes, we are the market leaders, and though there are no confirmed numbers on what is the organized and unorganized market for the packaging industry, we can only take numbers from the consumption of the packaging films in the country. So, we will be almost close to between 20% to 25% kind of a stuff. So, we are not clearly looking at any acquisition in India, because if there are opportunities to grow in the packaging space, we will do a Brownfield expansion at any of our facilities to get to those markets. But today, given the return metrics, they do not qualify, the packaging business does not qualify for any additional investments today.

Moderator: Thank you. We have next question from the line of Chirag Singhal from First Water Capital. Please go ahead.

Chirag Singhal: Sir, a couple of questions on CAPEX and some financials. So, my first question is on your greenfield expansion in South India. Now, if I look on the similar lines, another Indian films manufacturer announced a greenfield expansion of 48,000 tonnes BOPET at Rs. 500 crores. So, why is there a variance between your CAPEX and the other player? And what is the split of CAPEX between CPP and BOPET films for the India plant?

Rajesh Bhatia: So, Chirag, first of all, I don't think so that it is a right question to be asking on this forum, because the dynamics are totally different. So, I think wherever we have been, we are quite competitive in terms of our capital cost, I think there may be very few players who match us on a capital efficiency. Because you may not have gone into much details as of now, I think the differences that when you compare only for a BOPET versus the BOPET then it's different. Somebody else may be setting up an 8.7-meter line, we are setting up the state-of-the-art, the latest 10.6 meter line, we are also setting up a CPP plant, we also have plans for the power also in-house, and somebody else may be depending on the outside source of power. But I think we don't need to justify any CAPEX because we know that we are the most efficient in the CAPEX planning.

Chirag Singhal: Okay. Because I was looking on the same line that's I just wanted to clarify on that part. But okay, I understand your point. Sir, my next question is, the Vice Chairman has stated in a couple of interviews about the Brownfield expansion, Poland and Egypt. Now the Egypt is supported by the CAPEX from the Egypt subsidiary, so what is the product we are going to manufacture over there and what is the expected date of commissioning?

Rajesh Bhatia: I don't think we are doing anything separate in Egypt as of now.

Chirag Singhal: No, as in, if I look at your Egypt subsidiary's financials for FY 2020…

Rajesh Bhatia: Whatever has been done is done in Egypt. We have done some CAPEX there in the last couple of years, so there is nothing more to be now added over there, except that we may end up buying some more land over there for any futuristic thing. But as of now, there is not any incremental planning that we have for Egypt at this stage.

Chirag Singhal: No, but if you look at your Egypt subsidiary financials for FY 2020, then there is a capital commitment shown of $59.7 million and amount spent is shown as $46.8 million. So, what would that be?

Rajesh Bhatia: So, that would have been some of the old CAPEX which got completed already, there is nothing more to be done on Egypt.

Chirag Singhal: Okay. All right. So, my third question is on the volume. So, now, if I look at your sales and production volumes, the sales volume was flat sequentially and the production volume declined, despite commissioning of the Poland operation. So, I just wanted to understand that what are the incremental volumes we achieved from the Poland facility, as well as Russia facility separately in the Q3?

Rajesh Bhatia: So, Q3 Poland was less, because I explained earlier that he had to do some balancing works in the plant, which we didn't do, because there was a huge demand. So, we deferred that. We have now done that in Q3, and that is why despite the fact that we may have started producing in Poland plant maybe in later part of the Q1 itself, but we did some balancing works there, and that's where the commissioning now. But Russia is what we have done in this quarter is about 6,500 tonnes, which was there in the last quarter also.

Chirag Singhal: Okay. And what was the exit run rate of the Russian plant, capacity utilization and exit run rate? Like, are we around 85%, 90%?

Rajesh Bhatia: Russia plant should do about 3,000 tonnes a month. So, about 9,000 tonnes a quarter. That's our capacity.

Chirag Singhal: Okay. Now, sir, one more question. This is on the other operating income for the quarter. If I look at your consolidated minus standalone, there is a negative other operating income of Rs. 520 crores. So, can you please explain what is this negative other operating expense?

Rajesh Bhatia: We have got to that offline.

Moderator: Thank you. Sir, we have next question from line of Ayush, an investor. Please go ahead.

Ayush: Sir, just wanted to confirm, you mentioned we have added 125,000 tonnes capacity over the past two years, right?

Rajesh Bhatia: Yes.

Ayush: So, what kind of additional revenues can this contribute over the next two years, like once they are running at peak capacity?

Rajesh Bhatia: So, I think we can look at from this incremental capacity about $300 million revenue.

Ayush: And EBITDA margins would be at average levels?

Rajesh Bhatia: EBITDA margins you can take it, today maybe bit higher 25% or so, but you can take it about 20% on a normalized basis to make your plans.

Ayush: So, 20% normalized basis you are seeing is sustainable average?

Rajesh Bhatia: Yes.

Ayush: Okay. And sir, you also mentioned that the current situation is not like 2011 situation, so can you just elaborate on it? Because right now also we are seeing a lot of capacity expansion happening.

Rajesh Bhatia: When I said that current situation is not 2011 situation, because 2011 the prices of the films went up so high that the payback period of setting up a new capacity was coming out to be a year, year and a half kind of stuff. But today when you look at 18% to 20% kind of an EBITDA margins, you will still get a four to five years kind of a payback. So, that's the difference. I am not saying that the new capacity will not come up and all that, that will all happen now. It's a commodity, it's a cycle, so this is inevitable, this will happen.

Ayush: So, basically can I infer from this that the margins will come under pressure over the next few years, but they won't decline to a level that they declined after 2011? Because after 2011 our EBITDA margins were around 12%, 13% for three, four years. At the point which our return ratios were quite subdued.

Rajesh Bhatia: Yes, because after 2011 there was so much capacity in the market based on those paybacks that the margins remained subdued for a very long period of time. But margins may be subdued a year or two years down the line, but they will not be as affected as sort of. Let's also face the fact that there is a lot of cheap money now available in the markets. There's a lot of money being printed. As I said that our South facility we have funding at Euribor plus 0.65%. So, when we look at that kind of interest cost, you feel that your risks to the market are minimal, because your cost of that capital is only under 1%. So, likewise, other people will also think, so investment cycles will go up. Now, whether it leads to a higher consumption, overall cycle turning, I think these are all the questions which are difficult to address at this point in time. But, yes, one thing that remains, the factual position is that these are all commodity businesses, they will have a commodity cycle up and down, and that's what is expected.

Ayush: Right. Okay. And sir last question is, so you mentioned that packaging business, like currently because of the return metric it does not qualify for additional investment, but then you also said that maybe over the next two years things should improve. So, basically, you also have spoken about the consolidation happening. So, how is that turning out to be? Like, do you still believe it will get over in the next two years or it has fastened because of COVID?

Rajesh Bhatia: I think it should happen in the next couple of years' time. And I think maybe that is how the MNCs also want to play out. So, they also do appreciate that their margins in India and their margins elsewhere are different. And that is why they are looking at probably sort of buying out some of some of the other distressed companies and all that. But we are clearly not there, I think we will be happy setting up any Brownfield capacity rather than getting into something which is taking up a small capacity here and there and then trying to find a way as to how do we make that profitable. I think we will do probably Brownfield capacity expansion as and when possible. See, please understand, that is our core business. If the aseptic packaging market is growing at say 20% or the flexible packaging market is growing at, say, 11% to 12%, so I have to invest to be on top of that. Once you do not have any kind of growth opportunities, then that's a different time when you can look at any other things. But today, if India we are all saying that is going to be a $5 trillion economy in the next five years or seven years, I will be a direct beneficiary of all that because that will spur consumption, that will mean that people will have more meals, today more packaged foods, the quality of life improvement will also mean that the quality of food the way we keep, the way wrap and the way we intake will also improve. So, all those factors are also going to help me increase the FMCG players' revenues. And if they have a higher business, higher volumes, obviously, they have to pack all that stuff and then I come into play, the largest player in the business in the country.

Moderator: Thank you. We have next question from the line of Rajendra Shah, an investor. Please go ahead.

Rajendra Shah: You are so confident about your business and for the profitability for the future, and you are doing the explanation, why you are not increasing your holding for the promoters at the correct rate to give the confidence for this?

Rajesh Bhatia: See, if the promoter has the money then they will do it. But today the promoter says that the company has enough money, so if I grow that pie, yes, I will get only a 44% share of that business, but that pie will grow. But if I take out that money, and I keep it and then I decide whether to invest back into this business or not, so then this pile will not grow, then this will remain where it is today. So, we have deliberated that a few times as to the way to increase, this is the opportunity to increase the promoters' holding, I think we keep on working on that. But as of now, there is nothing that happened there. In any case, even if you plan something, there are limitations under the laws as to what you can create and what you can acquire. But clearly, promoter being also a shareholder, he gets the same money as to what all of you also get by way of a distribution from the company. So, we have to grow that pie.

Rajendra Shah: It is right which you are explaining. See, before two years back, I think so promoters were willing to take at a rate of 390 or something, then the rate gone down and they had gone back. Afterwards, nothing has come.

Rajesh Bhatia: No, it was not because of the rate had gone down and they had backed out. See, in our business one thing we know, I think this pandemic has also taught us that, look, whatever may happen on this Mother Earth in terms of anything happening, the food business will survive. Because whether you are working or whether you are not working, you still need the food, you still need the food to be delivered. And if it is a pandemic kind of a situation or other mayhem, you want your food to be delivered, duly packed, because you now don't have the excess of going out and getting the food which is in the open packs and all that. So, one thing that stands clear with this pandemic is that, any food business company, whether it is packaging or manufacturing food and all that, they will be the last man kind of a standing situation.

Rajendra Shah: Sir, that I understood very well, but to give the confidence to the institution or anyone, if the promoter increases at this rate, it will help a lot for the valuation purpose.

Rajesh Bhatia: Yes, but then where does the promoter get the money from? He will have to take out the money by way of a higher distribution from the company.

Rajendra Shah: No, sir, before two years they were willing to do, at that time they were having the money, now they are not having the money I should say?

Rajesh Bhatia: I think there is no such planning regarding this.

Rajendra Shah: No, this is to give the confidence to the institution and to have a good valuation.

Rajesh Bhatia: Which institution?

Rajendra Shah: Domestic institution or any new investor, it will give the confidence.

Rajesh Bhatia: See, I don't think so I need to give that confidence by buying the things on my own. I think you all understand business, you all understand growth metrics, and you all understand as to what the company is delivering. And you invest based on that, you don't invest based on the fact whether promoter is buying your shares or not, is increasing its holding or not. I don't think so you have done that in any company, whether it is HDFC, or ICICI.

Rajendra Shah: That is right what you are talking about. But this is the one way when we were going to buy at the rate of Rs. 390, and now at this point of time…

Rajesh Bhatia: Sir, beyond a point I can't talk about the promoter, because he is as much as a shareholder as you are. So, let's concentrate more on the company operations.

Moderator: Thank you. We have next question from the line of Saurabh Sharma, an investor. Please go ahead.

Saurabh Sharma: Sir, you talked about the Karnataka expansion of Rs. 850 crores, and you have also talked about Brownfield expansions, the company being open to Brownfield expansions. So, connecting these two things together, was Brownfield expansion or an inorganic expansion, was that evaluated before taking a decision to go to a part of the country to set up a new greenfield plant?

Rajesh Bhatia: I think you have not understood my context in the Brownfield. When we were talking about the packaging films business, we were talking about Brownfield expansion or the greenfield expansion happening for us in that business. Now, clearly, today in the films business, there are no opportunities in India for any takeover, because all the companies in the segment are doing so well, and sort of doing something at the top of the cycle is also not a very good way. So, if there is a market that will grow at about 10% to 11% in the country, so might as well participate in that by doing a greenfield or Brownfield expansion rather than the opposite. See, the opportunity for M&A comes only because either there is a distress or there is a promoter who is a willing seller. But unfortunately, in our business line, today in India, none of these situations exist.

Saurabh Sharma: And what about the Brownfield expansion to our existing plant in India, was that a possible account instead of going to Karnataka and setting up a greenfield plant?

Rajesh Bhatia: So, today in the Brownfield in the packaging films business, we had no space. So, right now Noida, where our plant is today, that's in the middle of town now, so there is not even an inch of space over there now.

Saurabh Sharma: Sir, I come from Noida, so I do know about the UFlex plant in Noida.

Rajesh Bhatia: So, there was no space there.

Saurabh Sharma: Right. And sir, just a quick follow-up question to that. You mentioned 12x to 15x EBITDA levels at which acquisitions have been happening. So, that brings into question the market price of UFlex itself, and it is trading at less than 2x EBITDA right now in the market, almost 1.3, considering the 2,000 EBITDA that you mentioned. So, how likely do you think can UFlex be a target of acquisition at 1.3x EBITDA?

Rajesh Bhatia: See, unless the promoter is willing to sell out, there is no way UFlex can be targeted.

Saurabh Sharma: All right. So, would that be a function of the price, sir?

Rajesh Bhatia: No, not at all.

Moderator: Thank you. We have the last question from the line of Amit Trivedi, an investor. Please go ahead.

Amit Trivedi: **Sir, my question is an extension to previously asked question, you said that the promoters should not buy, I agree with you. But as a shareholder we are same way the owners of the company as the promoters are. Now you say that promoter doesn't have the money to buy the shares. The reason I am asking you this is because, you might not be knowing, but an individual investor has bought 10% stake in your company in last six quarters, because spending only Rs. 150 crores, he was already at 10%, so now he will probably go to 25%.**

Moderator: Sorry, your voice is not audible. Thank you. Ladies and gentlemen, that was the last question. I would like to hand the conference over to Mr. Yusuf Nasrulla for closing comments. Over to you, sir.

Yusuf Nasrulla: Thank you, everyone, for joining us today. And we look forward to staying in touch in future quarters. Have a nice day. Thank you.

Rajesh Bhatia: Thank you, everybody.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of UFlex Limited, that concludes this conference call. Thank you for joining with us. And you may now disconnect your lines.