Management Meet Update

CCL Products (India)

5 January 2017

Reuters: CCLP.BO; Bloomberg: CCLP IN

Business Backed By Strong Fundamentals

We had a meeting recently with Mr. Challa Rajendra Prasad, executive chairman of CCL Products (India) or CCL to understand the next growth phase of the company. Management reiterated its volume growth target of 12%-15% over the period of FY16-FY19E. Greenfield expansion in Chittoor, Andhra Pradesh and brownfield expansion in Vietnam gives strong earnings visibility for FY19 and onwards. CCL management is actively working to do pan India expansion of Continental brand and is positive to clock sales of Rs3000mn-Rs4000mn in next three to four years. CCL is expected to clock revenue/EBITDA/PAT CAGR of 21%/25%/29%, respectively, over FY17-FY19E. CCL stock currently trades at P/E of 24.7x FY17E, 19.0x FY18E and 14.9x FY19E earnings. We have valued the stock based on 21x September 2018E earnings with target price of Rs329 and upside of 26%.

Capacity expansion to drive long-term growth: Current capacity of CCL in India is 20,000tn while its capacity in Vietnam is 12,000tn. CCL's Indian plant is running at ~80%of its capacity, while Vietnam plant runs at ~50%. Looking at the decent freeze dried coffee demand, CCL decided to expand its freeze dried coffee capacity from 5,000tn to 10,000tn. CCL acquired land in Chittoor district of Andhra Pradesh, which is economically a highly backward area, for ~Rs230mn. The area has proximity to ports and airports, making it a viable location. A sum of Rs~2,500mn (US$40mn) is the capex that will be incurred of which US$15mn will be financed from internal accruals and the rest through debt. The plant is expected to be operational in FY19. Also, CCL will be setting up a 10,000tn brownfield plant in Vietnam once the capacity utilisation of its existing plant touches peak level (~80%-85%). Therefore, the benefits of both expansions will be visible from FY19/FY20.

Mining of existing clients to help sustain 12-15% volume growth: CCL's relationships with most of its clients extend to as long as 20 years. The company has been able to get incremental volume from its existing clients because of its ability to deliver consistent quality, correct blend as demanded by clients and on-time delivery. CCL has grown its volume at a steady pace of ~15% CAGR over FY12-FY16. Volume growth can be mainly attributed to new capacity addition at Vietnam plant in FY14. We expect the volume to post a CAGR of 14% over FY16-FY19E.

Pan-India penetration of Continental Coffee brand: Instant coffee market size in India stands at ~Rs13bn with Hindustan Unilever or HUL's Bru and Nestle India's Nescafe being the key players. The management is currently in talks with a couple of experts, of which eventually one will be responsible for managing the distribution of CCL products in India. Despite selling its product well below the price of Nestle India's spray dried coffee, CCL manages to enjoy a margin of above 30% in B2C business. CCL intends to float a 100% subsidiary which will be responsible for entire Indian retail operations. Pan-India expansion is expected to take place in the next three years. Management expects sales from retail operations to reach Rs3000mn – Rs4000mn post pan India expansion.

Complete implementation of Food Safety Modernisation Act (FSMA) to open US market: FSMA law has been partially implemented in the US. Of the five points in FSMA, three have been already implemented while the rest are still at the discussion stage. As per the 4th point, if coffee contains any kind of economic adulteration, then it has to be clearly mentioned on the coffee pack. This will allow consumers in the US to know if the coffee is pure or not. CCL, being a pure coffee manufacturer, full implementation of FSMA will create a level-playing field for all coffee manufacturers. The US is the world's second-largest importer of instant coffee at 1.4mn bags i.e. ~85,000tn. CCL is the largest independent instant coffee supplier globally with historically strong emphasis on quality and the ability to create the blend as required by clients. Thus, the total implementation of FSMA can offer a huge opportunity for CCL.

Y/E March (Rsmn) Cons.	FY14	FY15	FY16	FY17E	FY18E	FY19E
Revenues	7,168	8,806	9,321	9,497	11,577	13,793
YoY (%)	*10.2*	*22.8*	*5.9*	*1.9*	*21.9*	*19.1*
EBITDA	1,431	1,712	2,036	2,177	2,770	3,399
EBITDA (%)	*20.0*	*19.4*	*21.8*	*22.9*	*23.9*	*24.6*
Adj PAT	644	940	1,221	1,408	1,838	2,331
FDEPS (Rs)	4.8	7.1	9.2	10.6	13.8	17.5
YoY (%)	*35.8*	*45.8*	*30.0*	*15.3*	*30.5*	*26.8*
RoE (%)	*20.4*	*24.3*	*26.2*	*25.5*	*27.8*	*29.0*
RoCE (%)	*12.3*	*16.0*	*19.7*	*20.3*	*21.6*	*23.1*
RoIC (%)	*12.0*	*15.9*	*19.4*	*19.9*	*21.4*	*23.3*
P/E (x)	54.1	37.1	28.5	24.7	19.0	14.9
P/BV (x)	9.9	8.3	6.8	5.8	4.8	3.9
EV/EBITDA (x)	26.1	21.5	17.8	16.7	13.5	10.7

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: Beverages

CMP: Rs262

Target Price: Rs329

Upside: 26%

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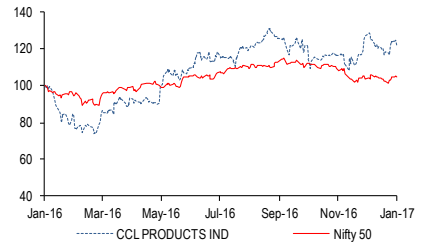
Key Data

Current Shares O/S (mn)	133.0
Mkt Cap (Rsbn/US$mn)	34.9/511.6
52 Wk H / L (Rs)	286/154
Daily Vol. (3M NSE Avg.)	164,407

One-Year Indexed Stock



Price Performance (%)

	1 M	6 M	1 Yr
CCL Products	(4.0)	5.6	22.2
Nifty Index	1.3	(2.2)	5.1

Source: Bloomberg

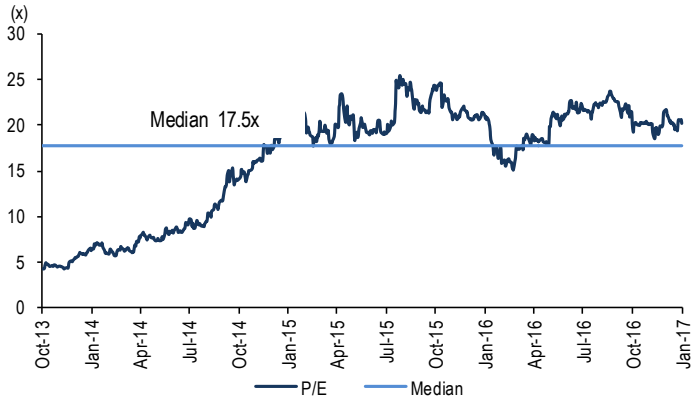
Investment rationale

We reiterate our Buy rating on CCL with a 12-month target price of Rs329, up 26% from the current market price. Our growth estimates are driven by the following key factors: 1) Incremental demand from existing clients driving volume growth of 14% CAGR over FY16-FY19E. 2) Capacity expansion in India and Vietnam giving sufficient demand visibility. 3) Concrete steps taken by the management to perform pan-India expansion of retail business. 4) Strong clientele with long-term relationship providing sufficient earnings visibility. CCL is expected to clock revenue/EBITDA/PAT CAGR of 21%/25%/29%, respectively, over FY17-FY19E. CCL stock currently trades at P/E of 24.7x FY17E, 19.0x FY18E and 14.9x FY19E earnings. We have valued the stock based on 21x September 2018E earnings.

Exhibit 1: One-year forward P/E band

Source: Nirmal Bang Institutional Equities Research

Exhibit 2: P/E median band



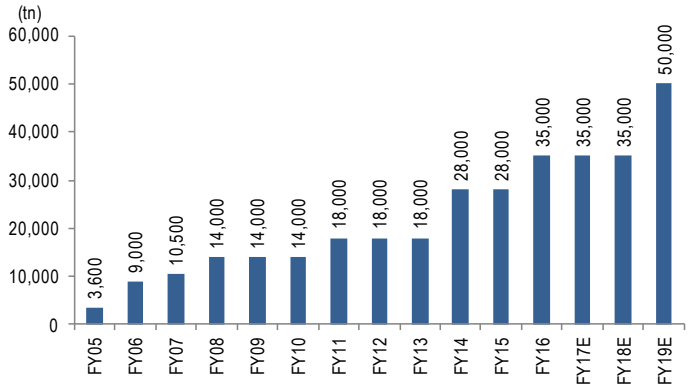
Source: Nirmal Bang Institutional Equities Research

Economic moat

CCL, having started its operations in 1995 with a capacity of ~3,500tn, expanded its capacity 10 times to 35,000tn. The expansion was mainly funded through internal accruals without going for significant debt. The company has stayed away from diluting equity. No fresh equity has been issued since 1995. In the past five years, CCL's net sales posted a CAGR of 21% while EBITDA/PAT grew 26% and 38%, respectively. During the past 10 years, global coffee market posted a CAGR of 2%-3%, much lower than the rate at which CCL grew. Growth usually attracts competition and lowers margins. However, in case of CCL this does not hold true. Despite growing at a healthy pace of 21% over the past five years, its operating margin expanded from 17.9% in FY11 to 21.8% in FY16. CCL's pre-tax RoCE and RoE increased from 12.6%/11.9% in FY11 to 19.7%/26.9%, respectively. This ability of the company to continually generate high returns on its invested capital YoY is because of the sustainable competitive advantage which the company enjoys over its competitors. CCL's economic moat comes from the following sources:

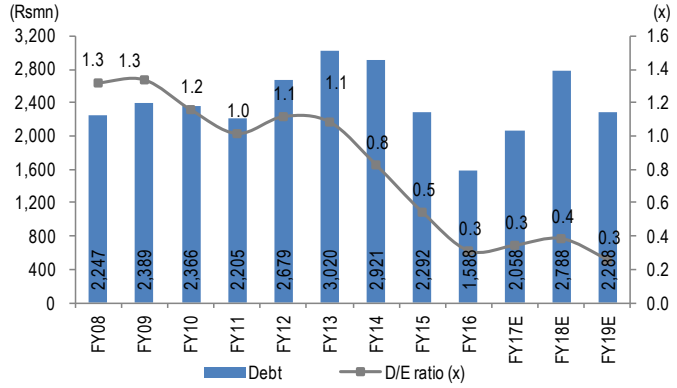
Economies of scale

Exhibit 3: Capacity expansion by CCL



Source: Company, Nirmal Bang Institutional Equities Research

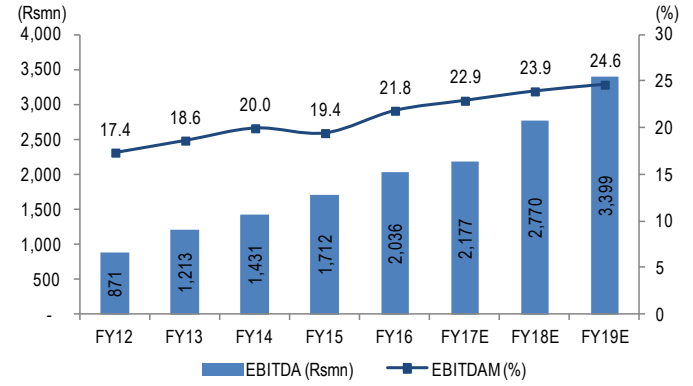
Exhibit 4: Falling Debt to Equity ratio



Source: Company, Nirmal Bang Institutional Equities Research

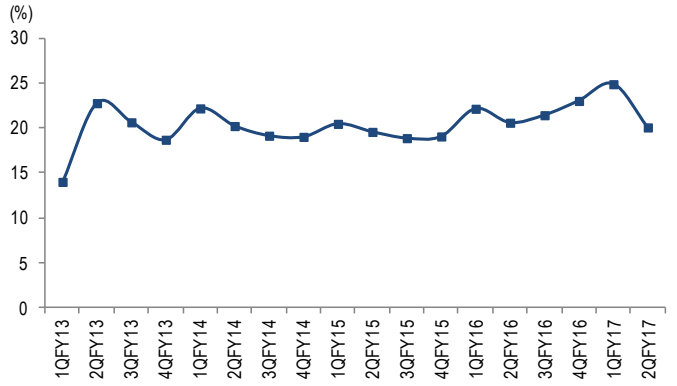
Even though setting up a plant for instant coffee manufacturing is a relatively easy process, scaling it up to produce high quality consistent quality coffee is extremely tedious. ***One of the most critical aspects of instant coffee manufacture is creating the right blend as per customer preferences and then producing that blend in high volume.*** CCL has become one of the largest green coffee bean processors in the world after a humble beginning in 1995. CCL, having started its operations with ~3,500tn in 1995, has expanded its capacity to 32,000tn. During this journey, CCL has not taken the route of excessive leverage and mainly funded the expansion through internal accruals. Despite the expansion, CCL has been able to bring down its debt/equity ratio from 1.1 in FY13 to 0.3 at the end of FY16.

Exhibit 5: Operating profit and margin profile



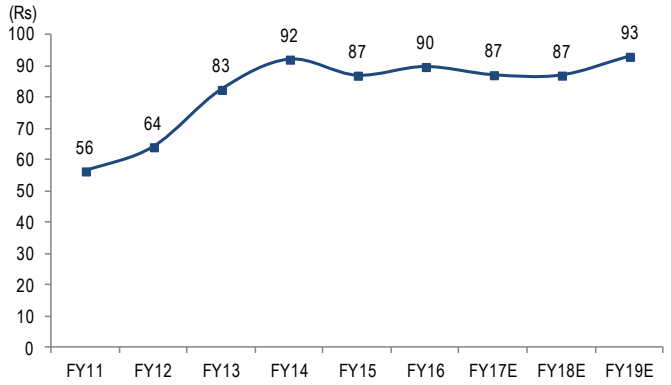
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Operating margins - Quarterly



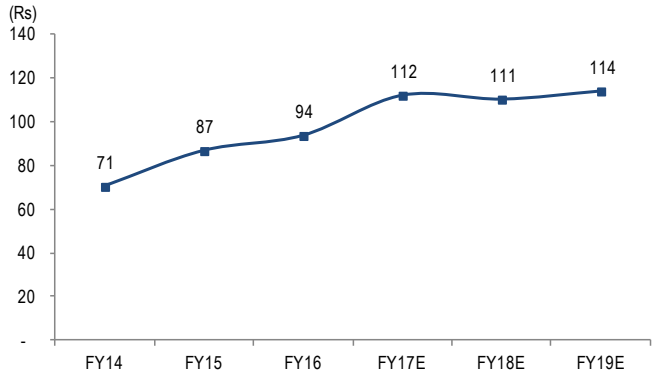
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: EBITDA per kg – Indian operations



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: EBITDA per kg – Vietnam operations



Source: Company, Nirmal Bang Institutional Equities Research

With economies of scale, CCL consistently improved its per unit profitability. CCL's EBITDA/kg improved from Rs58/kg in FY07 to Rs87/kg in FY16 at its Indian operations. Vietnam operations' per unit profitability also improved from Rs71/kg in FY14 (start of Vietnam operations) to Rs112/kg in FY16. As a result, CCL's blended operating margin steadily improved from 13.5% to 21.8% over FY07-FY16.

Strong clientele

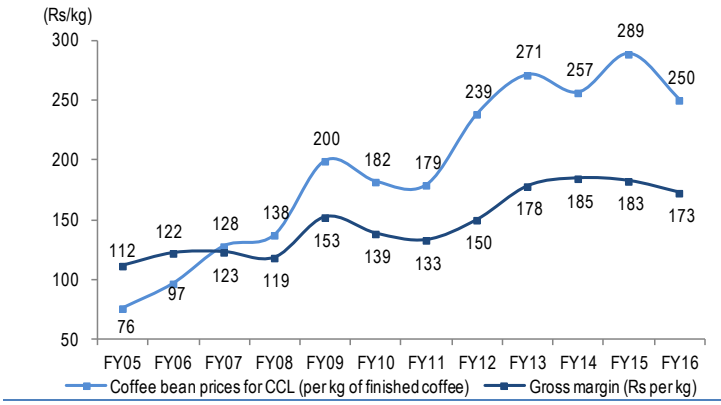
Coffee is a highly personal product: Customers do not change a particular coffee brand once they are used to it. A small change in taste because of change in the blend can sever the relationship with customers. Further, the taste preference varies region-wise and culture-wise. Strong expertise is required to customise the coffee as per client needs. CCL has been successful in doing so. It is one of the very few global manufacturers who have been able to produce all four variants of coffee mainly – spray dried granule, spray dried powder, freeze dried and liquid coffee. It manufactures over 200 different varieties of coffee for clients present across the globe. Hence, experience and relationships are keys to success in this business and the business model is not easily replicable. CCL has well established clientele and its relationship with some is since the past 20 years. CCL has built long-standing relationships with several private-label marketers across more than 60 countries, many of whom entered the business only after partnering with CCL. CCL is one the very few companies globally that have successfully scaled up this business. CCL's one of the largest clients based in Israel, who contributes ~10% to its sales, buys coffee only from CCL since the past 20 years. Relationship plays a very crucial role in the coffee business. To cite an example, an Israeli client was buying 200tn of coffee from CCL 18 years ago but now the same client is buying more than 2000tn of instant coffee from the company. CCL's sales have posted a CAGR of 21% over FY11-16. One of the key reasons behind CCL's strong growth has been its ability to mine existing clients. More than 60% of incremental volume growth comes from existing clients and the rest from new clients.

Business model isolated from volatility in coffee bean prices

CCL has two types of customers - direct consumers and bulk buyers. Direct consumers are brand owners and private labels which buy directly from CCL (packaging is also taken care of by CCL). Sales to these consumers increased from 20%-25% of total sales to 35%-40% of total sales. Sales to direct consumers command higher margins as against the sales to bulk buyers.

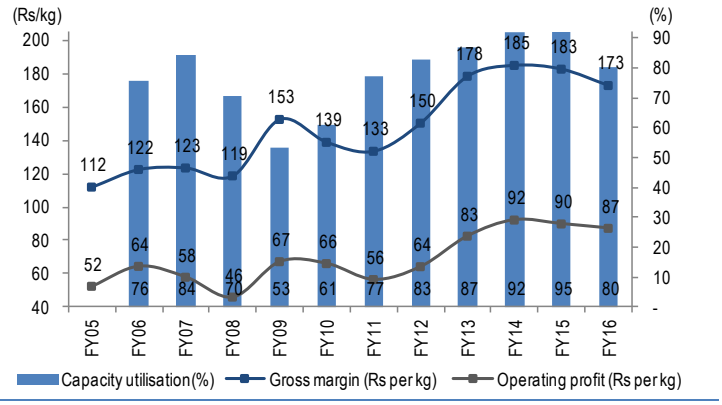
CCL remains reasonably less affected by fluctuations in green coffee bean prices or coffee prices as it places order for green coffee only on receiving order for instant coffee and makes back-to-back arrangement for green coffee beans. In other words, CCL operates on cost plus basis without carrying the risk of coffee price volatility. As CCL is the processor, EBITDA per kg increases with the rise in realisation (because of the rise in coffee prices) while EBITDA per kg will not decline by a similar amount as the drop in raw material prices because of a higher proportion of direct sale coffee – which enjoys higher margin - offsetting bulk buying. Key business of CCL is to develop private label for clients rather than bulk sales. CCL procures green coffee beans by importing them (~65%) from global markets (Vietnam, Indonesia, African countries) as well as from domestic market (~35%), primarily from Chikmagalur in Karnataka.

Exhibit 9: Coffee bean prices versus operating margin



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Product mix driven by constantly improving margins

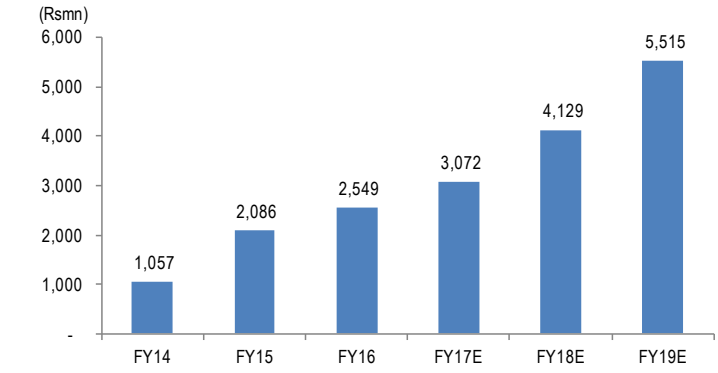


Source: Company, Nirmal Bang Institutional Equities Research

Vietnam operations a strategic asset for CCL

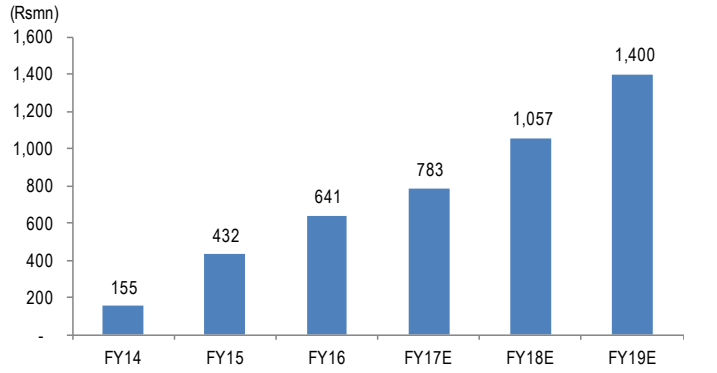
CCL acquired land bank of 25 hectares (~60 acres) to set up its spray dried plant in Vietnam. It commissioned the 10,000tn project in April 2013 for manufacturing instant coffee at a total investment of US$40mn (including working capital). The company took a long time to commence commercial production because of adoption of latest technology and synchronisation of the plant. Commercial production from the plant started in 2HFY14. CCL also shifted its 5,000tn liquid coffee plant from India to Vietnam at a total cost of ~US$10mn.

Exhibit 11: Sales from Vietnam operations



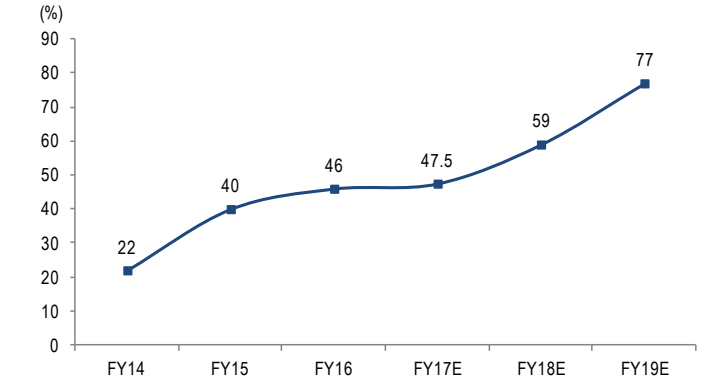
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Operating profit – Vietnam operations



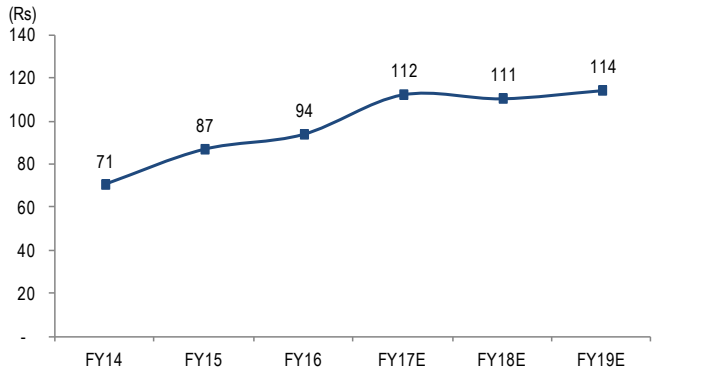
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Capacity utilization level – Vietnam plant



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: EBITDA per kg – Vietnam operations



Source: Company, Nirmal Bang Institutional Equities Research

With the Vietnam plant coming on stream, CCL is strategically located in terms of:

a) **Logistical advantage:** Vietnam is the second-largest green coffee bean producer in the world. The plant is located in a coffee production zone in Vietnam which provides logistics benefit to CCL. We believe the company will enjoy savings of US$150/tn on the logistics front.

b) **Raw material availability:** The plant is located in Dak Lak province which is the highest green coffee bean-producing area in Vietnam (Vietnam is the second-largest green coffee bean grower after Brazil, accounting for 18.3% of the world's coffee production). As a result, the plant will have easy access to raw materials, thereby reducing the lead time to a great extent (1.0-1.5 months).

c) **Market proximity:** Owing to the Vietnam plant, CCL can easily cater to coffee requirements of ASEAN countries and those in close proximity like Japan, Korea, China, etc. In addition, Vietnam enjoys the 'most favoured nation' status with many countries, thereby enjoying reduced or nil duty structure. The Vietnam plant caters to domestic as well as overseas markets.

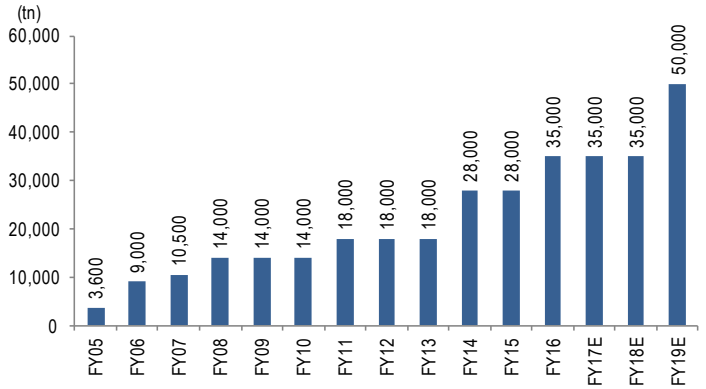
d) **Tax benefit:** The Vietnam plant enjoys nil income-tax benefit for first four years and tax exemption of 50% for the next nine years.

Capacity utilisation level of Vietnam plant steadily increased since its inception in FY14. Utilisation level increased from 22% in FY14 to 48% in FY16 and is expected to touch 60% by the end of FY17E. Sales at Vietnam operations posted a CAGR of 55% from Rs105mn in FY14 to Rs255mn in FY16. EBITDA per kg from Vietnam plant improved from Rs71/kg to Rs112/kg over FY14-FY16.

Investment thesis

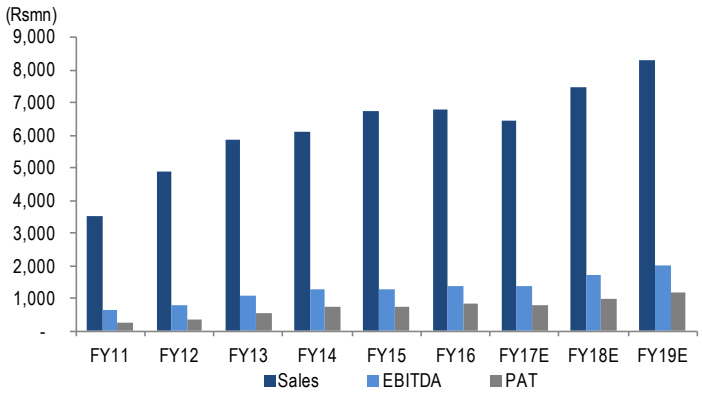
Capacity expansion to drive future growth

Exhibit 15: Capacity expansion by CCL



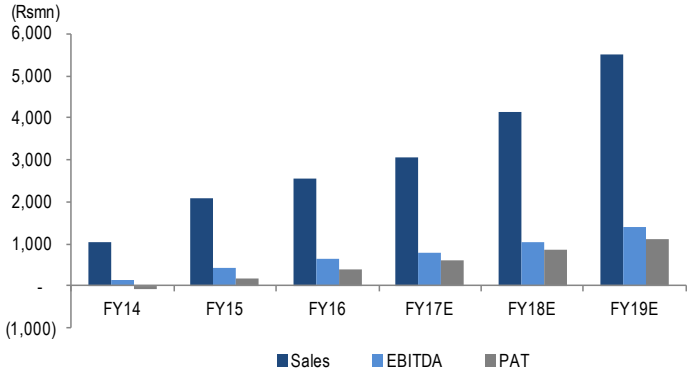
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Sales/EBITDA/PAT – Indian operations



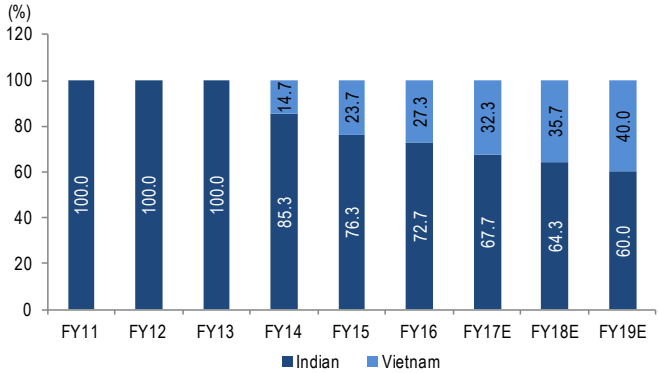
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 17: Sales/EBITDA/PAT – Vietnam Operations



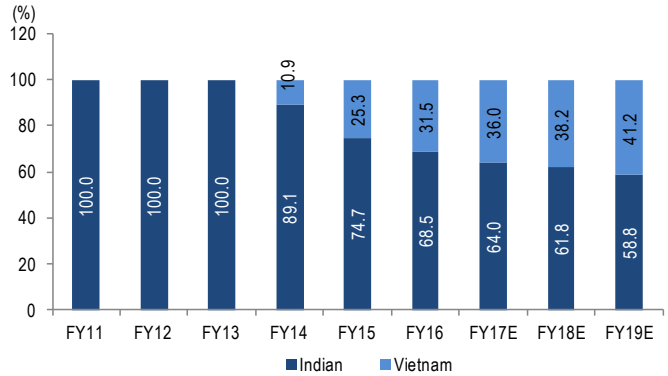
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 18: Sales contribution – India vs. Vietnam operations



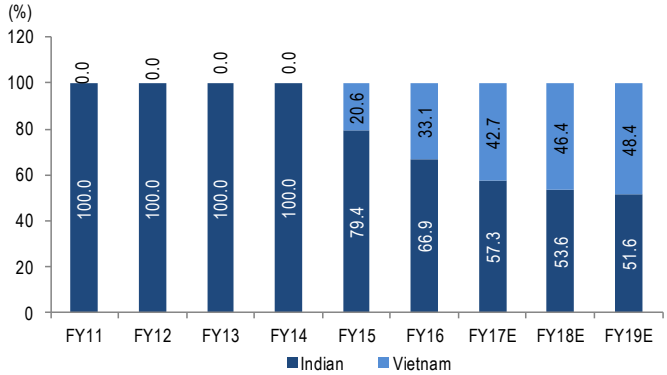
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 19: EBITDA contribution – India vs. Vietnam



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 20: PAT contribution – India vs. Vietnam



Source: Company, Nirmal Bang Institutional Equities Research

Greenfield expansion in India: CCL bought 10 hectares (~25 acres) of land in Chittoor district of Andhra Pradesh for ~Rs230mn. Chittoor has been declared as one of the most backward places in Andhra Pradesh. CCL decided to set up a greenfield 5,000tn freeze dried coffee plant in India, and for that Rs2,500mn (US$40mn) will be the capex that will be incurred of which US$15mn will be financed through internal accruals and the rest by debt. Engineering drawings of the plant's plan and foundation are ready. As per the management, Chittoor plant will be highly automated.

Plant is expected to be operational by 2HFY19*:* CCL has received government approval for setting up the plant under SEZ. This new plant's is in close proximity to Chennai port (~2-hour drive). This will help save logistic costs for CCL. The second key reason behind selecting this location has been possible tax benefits that CCL may receive given that it will be under SEZ rules and also it happens to be an economically backward area. State government may give some economic incentives to CCL for setting up the plant there. The third reason behind setting up the plant in Chittoor as against Guntur is that land in Vijayawada has become expensive. Land in Vijayawada costs ~Rs15mn/acre against ~Rs9mn/acre in Chittoor. Full benefits from this plant will be enjoyed by CCL from FY20.

We expect sales at Indian operations to post a CAGR of 10.9% over FY17-FY19E. Sales are expected to grow from Rs6,735mn in FY17 to Rs8,278mnin FY19E. EBITDA is expected to grow from Rs1,463mn to Rs1,984mn at a CAGR of 16.5% and EBITDA margin expected to improve from 20.6% to 24.0% over FY17-19E. PAT from Indian operations is expected to touch Rs1,192mn by FY19E, clocking a CAGR of 18% over FY17E-FY19E.

Brownfield expansion in Vietnam: CCL has ~25 hectares (60+ acres of land) in Vietnam. There is sufficient land available at Vietnam plant which can be easily utilised. CCL will take only six to eight months to expand its capacity in Vietnam. It intends to expand the capacity once Vietnam plant touches 75%-80% utilisation level. We expect CCL to top 75% utilisation level at Vietnam plant by FY18E and capacity addition to happen in FY19. CCL has plans to add another 10,000tn of spray dried coffee capacity. Estimated cost to expand the capacity at Vietnam plant will be ~US$10mn-US$12mn against the initial cost of setting up the plant of US$32mn. This will lead to healthy improvement in RoCE.

Management also plans to set up agglomeration unit at Vietnam plant: During agglomeration, spray dried coffee powder is converted into soluble (instant) granules. Bigger sized porous granules are formed with higher instant ability of the coffee. Granule coffee commands a slightly better price compared to powdered coffee. CCL has gone for a tie-up with an UK-based company and expects it to be operational in the next six months. Likely costs to set up agglomeration unit in Vietnam will be ~Rs200mn-Rs250mn.

Sales/EBITDA/PAT at Vietnam operations expected to post CAGR of 34.0%/33.7%/37.1%, respectively, over FY17E-FY19E. Operating margin of Vietnam plant is expected to stay at 25.5% level over the three-year period.

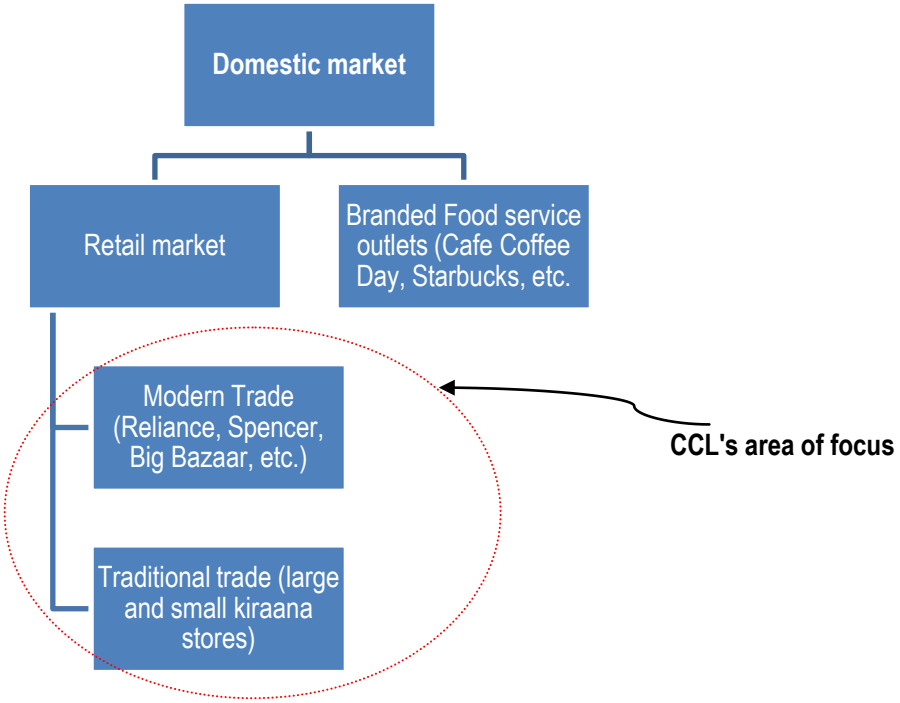
Vietnam plant is highly profitable mainly because its coffee commands higher prices and further no tax is to be paid till FY19. With rising contribution from Vietnam, we expect consolidated operating margin to improve to 24.5% from 21.8% in FY16.

Pan-India expansion of Continental Coffee brand

Branded coffee market in India: India is the seventh largest producer of coffee after Brazil, Vietnam, Columbia, Indonesia, Ethiopia and Honduras, with production of 0.31mt in 2015-16 (October – September). Robusta coffee accounted for 70.3% at 0.25mt while Arabica variant accounted for the balance 29.7% i.e. 0.103mt. For 2016-17, coffee production is estimated at 0.32mt (0.1mt Arabica versus. 0.220mt of Robusta).

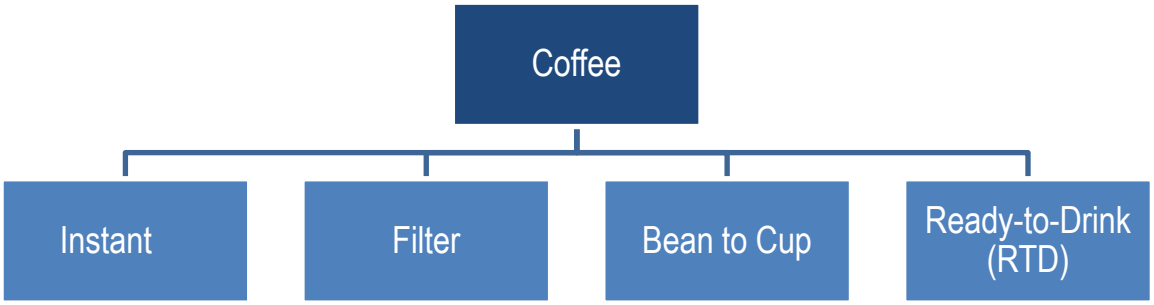
Traditionally, coffee consumption in India has been largely concentrated in the southern region which also contributes ~90% to total domestic production. The availability of fresh coffee, at an affordable price, is the major driver for high level of domestic consumption in South India. However, in the past two decades, coffee consumption spread to other parts of India, largely urban areas The increase in disposable income, higher number of double-income households, more global exposure, rising media penetration and attention to food, rapid urbanisation and changing lifestyle preferences influenced by the western world along with a greater number of modern retail outlets stocking a larger variety and more variants of coffee, and also new product developments from national and international players boosted the consumption of coffee in other parts of India.

Exhibit 21: Domestic coffee market



Source: Nirmal Bang Institutional Equities

Exhibit 22: Retail coffee market in India



Source: Nirmal Bang Institutional Equities

Filter coffee is predominantly consumed in South India and the market is dominated mainly by regional/local players. These players sell pre-packed or customised variants of pure coffee or coffee-chicory mix. On the other hand, instant coffee is popular in the rest of the India. Nestle India and HUL dominate the instant coffee segment in India while Tata Global Beverages forayed into this segment last year. CCL, through its Continental Coffee brand, forayed into this segment albeit at a much smaller scale. However, going forward, CCL intends to expand its instant coffee brand across India.

The increased acceptance and appreciation of coffee as a beverage in all parts of the country has encouraged the established brands in this category to launch exotic ranges in order to provide heightened experience to their patrons. HUL has launched different flavours like Bru Exotica Brazil, Bru Exotica Columbia, and Bru Exotica Kilimanjaro as an extension of its product offerings to capitalise on a premium range. HUL and Nestlé India together have a wide range of coffee powders, varying from Nescafé Gold (priced between Rs4,000-Rs4,500 per kg) to Bru (Green Label, at Rs250-Rs275 per kg) to cater to all classes of consumers.

The Ready-To-Drink or RTD market in India is at a nascent stage, accounting for less than 1% of total coffee consumption in India. It is largely serviced by international brands – Nescafe Cappuccino packs and café chains like Starbucks.

Exhibit: 23: Different coffee brands in India

Variant	Brands	Price Range
Instant coffee	Nescafe - Sunrise, Classic, Gold Bru - Green Label, Instant, Super StringGold, Exotica Continental - Premium, Speciale and Supreme Tata Grand Illy Lavazza	Rs250-4500/kg
Premixes	Nescafe Cappucino, Vanila Latte, Choco Mocha Bru	Rs60-Rs75 per pack of 5
Pods	Nespresso, Lavazza, Fresh n Honest	Rs30 onwards
Beans	Illy, Lavazza, Coffee Day, Starbucks, Coffee Bean n Tea Leaf, Fresh & Honest	Rs 500-Rs5,000 per kg
Ready-to-Drink (RTD)	Starbucks, Nescafé Amul, Mother Dairy	Rs 20-Rs75 per bottle
Filter Coffee	Kaapi	Rs 750-Rs800 per kg

Source: *Nirmal Bang Institutional Equities*

Coffee variants: CCL launched its own brand called Continental Coffee with three different variants – Continental Premium (freeze dried), Continental Spéciale (spray dried), and Continental Supreme (chicory). CCL's brand is mainly available in Andhra Pradesh and Telangana. CCL also sells its coffee to private labels, mostly through tie-ups with modern trade entities like Reliance, Spencer, Big Bazaar etc.

Learning from past mistakes: CCL wants to roll out Continental Coffee brand in a staggered manner across India in the next three to four years. The management wants to avoid the mistake that it committed way back in 1997. In 1997, CCL launched only pure vanilla coffee on a pan-India basis, which resulted in lower volume and higher advertisement and other expenses. Therefore CCL is not rolling out its coffee brand national-wide and is doing a soft launch state-wise with a bouquet of products. CCL has been doing private labels for Reliance Industries, Spencer and other super markets, which has helped it to get shelf space and thereby increase its visibility. It will take two more years for CCL to roll out its own brand nationally.

Competitive landscape: CCL competes with the likes of Nescafe (Nestle India or NIL) in the instant coffee market. Competitors' brands like Bru and Sunrise are chicory coffees, which is not the key focus area for CCL. NIL manufactures spray dried coffee but imports freeze dried coffee in India. CCL, on the other hand, is the sole manufacturer of freeze dried coffee in India. With 100% import duty on NIL's freeze dried coffee (Nestle Gold instant coffee), its retail price is at least 50% more than that of CCL's freeze dried coffee (CCL Premium). We believe that because of high-cost differential between NIL's and CCL's freeze dried coffee, CCL should be able to gain some traction once its brand is launched on a pan-India basis. CCL also has a wider product portfolio compared to its competitors (HUL and NIL). CCL manufactures value-added coffee like single filter, double filter, etc.

Market size: Instant coffee market's size in India is currently at Rs13bn. Domestic market is dominated by NIL's Nescafe and HUL's Bru, each accounting 51% and 49% intermittently. Last year, Tata Global Beverages too forayed into this segment with its brands - Tata Coffee Grand. TCG and Bru Gold Instant (chicory) coffee's 50gm jar priced at Rs130 while Nestle Gold instant coffee (freeze dried) 50gm pack is priced at Rs270. CCL's premium (freeze dried) 50g jar is priced at ~Rs160 (68% lower than that of NIL).

Target: CCL aims to achieve revenues of Rs3bn-Rs4bn from branded coffee in the next three/four years, respectively, with a market share of ~20%.

North American market to be future growth driver of CCL

Although Americans prefer freshly brewed pod coffee and less than 7% of the population drinks instant coffee daily, the instant coffee market is too big to ignore. Instant coffee market accounts for 19bn cups a year with sales amounting to US$5.7bn. The US is the second-largest importer of instant coffee at 1.4mn bags (~85,000tn). As of now, CCL sells between 2,000tn – 3,000tn and mostly in bulk quantity. CCL has not been able to tap the North American market in a big way because of increased availability of adulterated coffee from Brazil and Mexico. ***The adulterated coffee is available at ~US$4.0/tn with a 90-day credit period whereas CCL's coffee is available at ~US$8.35/tn with zero credit.*** There are strict regulations on coffee adulteration in the EU and Russia, but it is not the case in the US. Following increased availability of adulterated coffee, Nestle has approached National Coffee Association (NCA) in the US to curb the supply of adulterated coffee. Mr.Jonathan T Feuer, non-executive director of CCL, served as a director of NCA for 15 years. National Health Association is striving to bring such regulations in the US, similar to ones in the EU.

CCL feels that it will be one of the beneficiaries once the law is formally in place in North America which will curb the supply of adulterated coffee (from Brazil and Mexico), as it happened in Russia and the EU earlier.

In the US, laws against adulteration are a bit lax where coffee manufacturers are not required to mention in the product labels the type of coffee used. As a result, adulterated coffee comes from Brazil, Mexico, and Ecuador etc to the US market. CCL, on the other hand, has been pressing the US government to change its labeling laws where the manufacturers are required to mention the coffee mix on product labels. Once such legislation is in place, CCL is set to gain market share in North America.

Exhibit 24: Assumption sheet

Blended numbers –consolidated

	FY14	FY15	FY16	FY17E	FY18E	FY19E
Total volume (mt)	16,040	18,850	21,700	23,080	27,640	32,100
Growth (%)	**23.4%**	**17.5%**	**15.1%**	**6.4%**	**19.8%**	**16.1%**
Total capacity (mt)	25,000	25,000	32,000	32,000	32,000	47,000
Blended utilisation (%)	**64.2%**	**75.4%**	**67.8%**	**72.1%**	**86.4%**	**68.3%**

Note: We haven't accounted for Switzerland unit's capacity of 3,000tn

Source: Nirmal Bang Institutional Equities

India operations

Exhibit 25: Per kg coffee analysis-standalone operations

Standalone per kg analysis	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E	FY19E
Revenues	256	352	321	313	389	450	442	472	423	402	405	414
Raw material costs	138	200	182	179	239	271	257	289	250	225	219	219
Gross Profit	**119**	**153**	**139**	**133**	**150**	**178**	**185**	**183**	**173**	**177**	**186**	**195**
Power & fuel costs	14	14	19	21	20	29	24	24	21	22	24	24
Employee costs	4	7	6	7	10	13	16	16	17	18	19	19
Other manufacturing expenses	55	65	48	49	56	54	53	53	47	50	51	52
Total other costs	**73**	**85**	**73**	**77**	**86**	**96**	**93**	**93**	**86**	**90**	**93**	**95**
EBTIDA	**46**	**67**	**66**	**56**	**64**	**83**	**92**	**90**	**87**	**87**	**93**	**100**
Growth (%)												
Revenues	1.9	37.3	(8.8)	(2.5)	24.3	15.6	(1.8)	6.8	(10.2)	(5.1)	0.8	2.3
Raw material costs	7.3	44.9	(8.7)	(1.5)	33.0	13.7	(5.4)	12.6	(13.3)	(10.3)	(2.6)	0.1
Gross profit	**(3.8)**	**28.5**	**(9.0)**	**(3.9)**	**12.6**	**18.7**	**3.7**	**(1.2)**	**(5.4)**	**2.4**	**5.1**	**4.8**
Power & fuel costs	54.0	0.2	37.9	10.0	(2.6)	42.8	(14.7)	(2.3)	(10.3)	5.0	5.0	4.0
Employee costs	6.8	68.5	(12.7)	16.8	46.4	29.2	17.6	3.2	3.3	5.0	5.0	1.0
Other manufacturing expenses	4.1	17.7	(26.0)	2.8	13.0	(3.2)	(2.4)	0.3	(10.0)	5.0	2.0	2.0
Total other costs	**11.0**	**17.3**	**(14.7)**	**5.8**	**11.9**	**11.4**	**(3.3)**	**0.1**	**(7.8)**	**5.0**	**3.3**	**2.3**
EBITDA	**(20.6)**	**46.2**	**(1.7)**	**(14.5)**	**13.7**	**28.5**	**11.7**	**(2.6)**	**(2.9)**	**(0.2)**	**6.9**	**7.4**

Source: Nirmal Bang Institutional Equities Research

Exhibit 26: Capacity and utilisation levels in India

(mt)	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E	FY19E
Installed capacity	14,000	14,000	15,000	15,000	15,000	15,000	15,000	20,000	20,000	20,000	25,000
Production	**7,448**	**8,510**	**11,607**	**12,392**	**13,045**	**13,808**	**14,250**	**16,000**	**16,000**	**18,400**	**20,000**
Utilisation (%)	*53.2%*	*60.8%*	*77.4%*	*82.6%*	*87.0%*	*92.1%*	*95.0%*	*80.0%*	*80.0%*	*92.0%*	*80.0%*
Sales (Rs/kg)	**356**	**322**	**314**	**391**	**440**	**431**	**458**	**417**	**388**	**395**	**405**

Source: Nirmal Bang Institutional Equities Research

Vietnam operations

Exhibit 27: Per kg coffee analysis-Vietnam operations

(Rs per kg of coffee)	FY14	FY15	FY16	FY17E	FY18E	FY19E
Revenues	481	453	447	434	447	456
Raw material costs	318	288	258	244	251	256
Gross profit	**163**	**166**	**190**	**190**	**196**	**200**
Power & fuel costs	21	17	32	34	35	37
Employee costs	18	10	11	11	11	11
Other manufacturing expenses	53	45	34	35	35	36
Total other costs	**92**	**72**	**77**	**79**	**82**	**84**
EBTIDA	**71**	**94**	**112**	**111**	**114**	**116**
Growth (%)						
Revenues	-	(5.6)	(1.4)	(3.0)	3.0	2.0
Raw material costs	-	(9.5)	(10.4)	(5.4)	2.9	2.0
Gross profit	-	**1.8**	**14.3**	**0.2**	**3.2**	**2.0**
Power & fuel costs	-	(20.1)	91.6	5.0	5.0	5.0
Employee costs	-	(43.2)	5.3	2.0	2.0	2.0
Other manufacturing expenses	-	(15.7)	(23.5)	1.0	1.0	2.0
Total other costs	-	**(22.1)**	**7.3**	**2.8**	**2.8**	**3.3**
EBTIDA	-	**33.0**	**19.6**	**(1.6)**	**3.4**	**1.1**

Source: Nirmal Bang Institutional Equities Research

Exhibit 28: Capacity and utilisation levels at Vietnam plant

	FY14	FY15	FY16	FY17E	FY18E	FY19E
Installed capacity	10,000	10,000	12,000	12,000	12,000	22,000
Production	**2,200**	**4,600**	**5,700**	**7,080**	**9,240**	**12,100**
Utilisation (%)	*22.0%*	*46.0%*	*48.0%*	*59.0%*	*77.0%*	*55.0%*
Sales(Rs/kg)	**481**	**453**	**447**	**434**	**447**	**456**

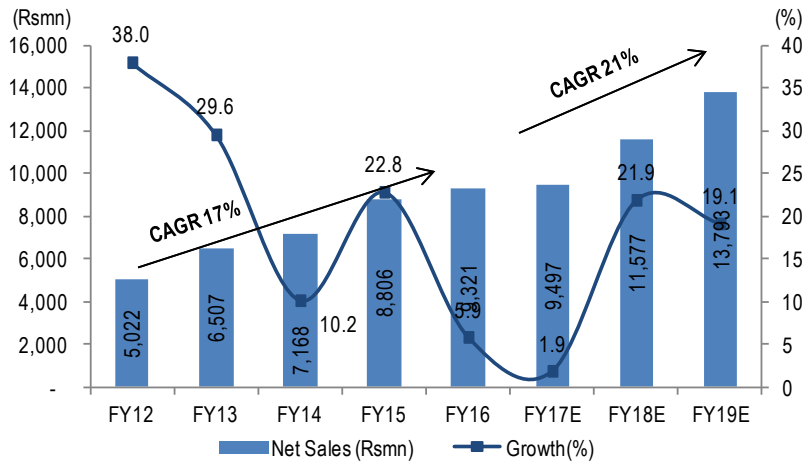
Source: Nirmal Bang Institutional Equities Research

Financial analysis

Revenue CAGR of 21% likely over FY17E-FY19E

CCL clocked strong growth of 17% at a consolidated level over FY12-FY16 aided by superior growth from Vietnam operations. Sales from Vietnam operations grew almost doubled over FY12-FY16. Sales from Indian operations grew at a moderate rate of 4% over the same period. We expect sales from Vietnam operations to post a CAGR of 34% and Indian operations to register a CAGR of 14% over FY17E-FY19E. At a consolidated level, sales are expected to grow 21% over same period.

Exhibit 29: Sales growth

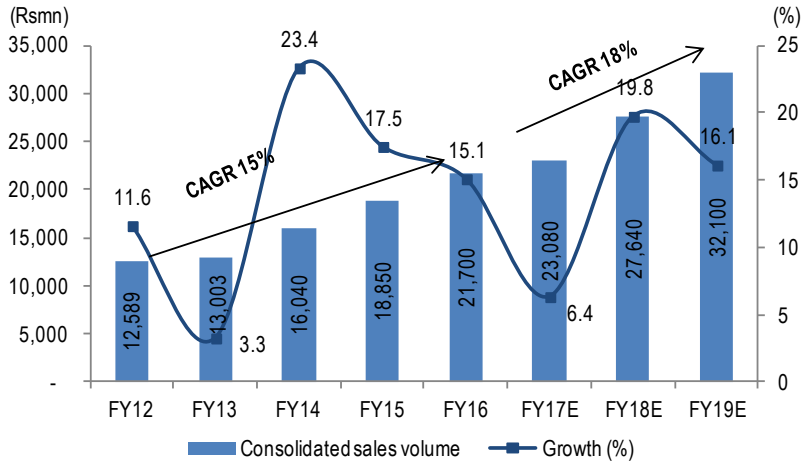


Source: Nirmal Bang Institutional Equities Research

Healthy volume growth led by Vietnamese operations

CCL's consolidated volume grew 15% over FY12-FY16. Volume growth has been led by Vietnam operations which posted a CAGR of 61% (over FY14-FY16) and 6% growth in Indian operations over the past five years. We expect volume from Indian and Vietnam plants to grow 12% and 31%, respectively, with overall growth of 18% at a consolidated level over FY17E-FY19E.

Exhibit 30: Volume growth

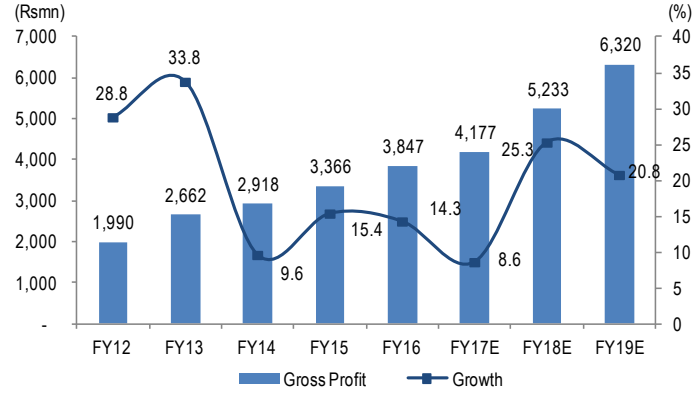


Source: Nirmal Bang Institutional Equities Research

Gross margins expected to improve 450bpsover FY16 to FY19E

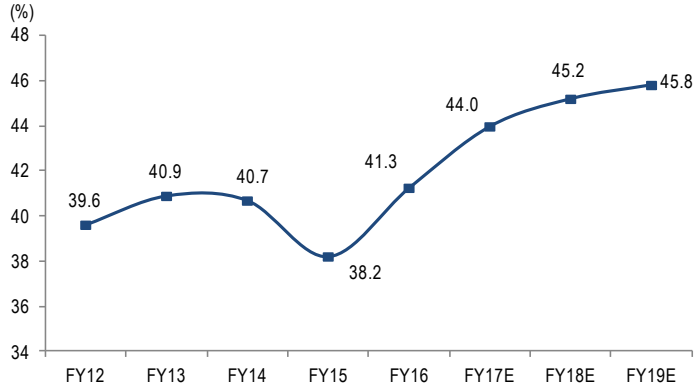
We expect gross profit per kg to improve from Rs173/kg in FY16 to Rs195/kg in FY19E in case of Indian operations while gross profit from Vietnam operations is likely to witness improvement from Rs190/kg to Rs200/kg over FY16-FY19E. ***Improvement in gross profit is mainly on account of higher contribution of coffee sales from Vietnam plant, which commands better realization.*** As a result of this, we forecast an improvement of 450bps in gross margin over FY16-FY19E i.e. an increase from 41.3% to 45.8%.

Exhibit 31: Gross profit



Source: Nirmal Bang Institutional Equities Research

Exhibit 32: Gross margins

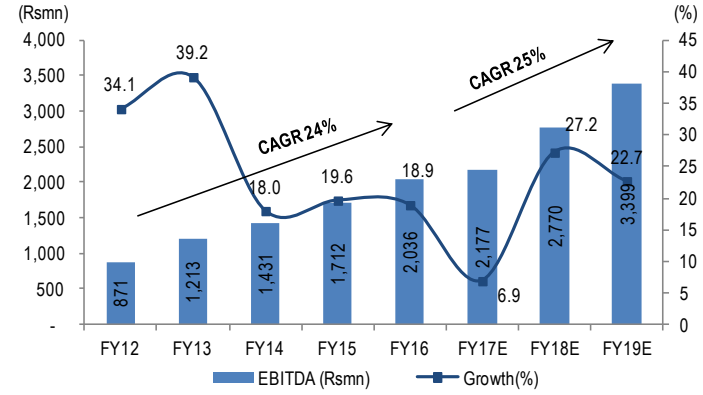


Source: Nirmal Bang Institutional Equities Research

Expansion in EBITDA margin

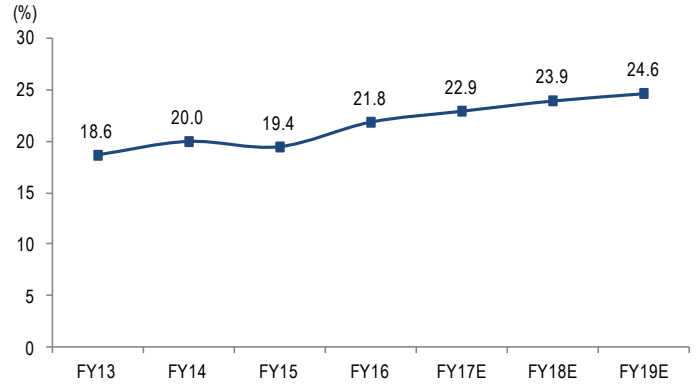
We believe that EBITDA margin will expand from 21.8% in FY16 to 24.6% by FY19E. Expansion in operating margin will mainly come on account of improvement in gross margin.

Exhibit 33: Operating profit



Source: Nirmal Bang Institutional Equities Research

Exhibit 34: Operating margins

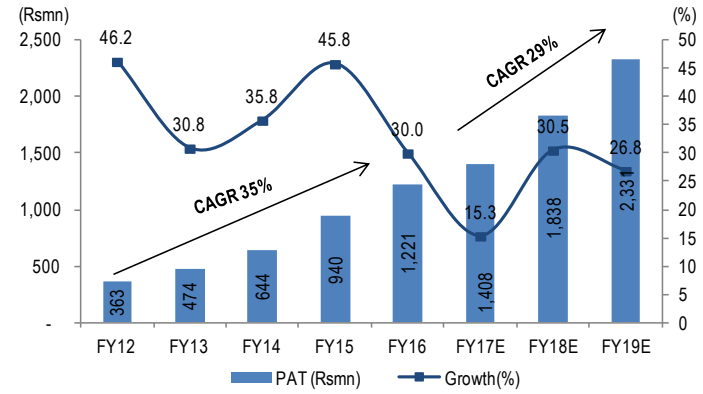


Source: Nirmal Bang Institutional Equities Research

Net profit expansion of 24% over FY16-FY19E

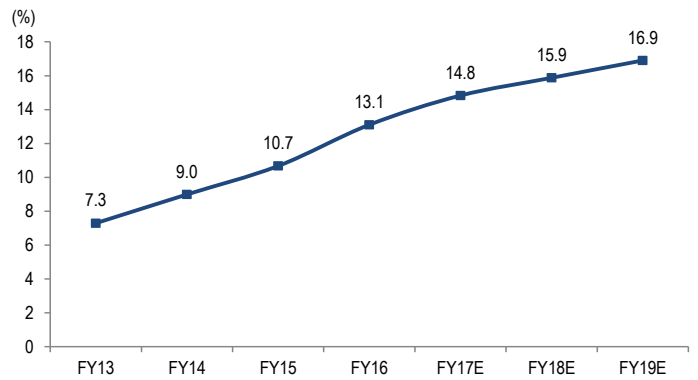
Net revenues from operations are likely to post a CAGR of 21% and EBITDA margin to expand 280bps over FY17E-FY19E which is expected to result in PAT CAGR of 29% over the same period. PAT margin is going to get a further boost on account of higher contribution from Vietnam operations (32.1% in FY16 to 41.8% in FY19E). PAT margin is expected to touch 16.9% by FY19E.

Exhibit 35: PAT growth



Source: Nirmal Bang Institutional Equities Research

Exhibit 36: PAT margin

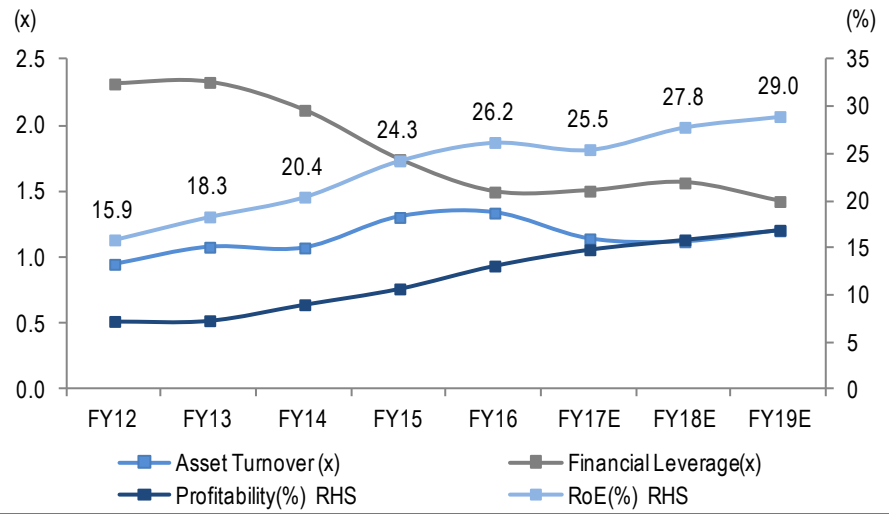


Source: Nirmal Bang Institutional Equities Research

Improvement in profitability and declining financial leverage to improve RoE over FY16-FY19E

The rise in PAT margin from 7.2% to 16.8% aided by declining financial leverage (total asset / average equity) from 2.3x to 1.4x over FY12-FY19E will lead to improvement in RoE from 15.9% to 29.0% over the same period.

Exhibit 37: Du Pont formula - RoE

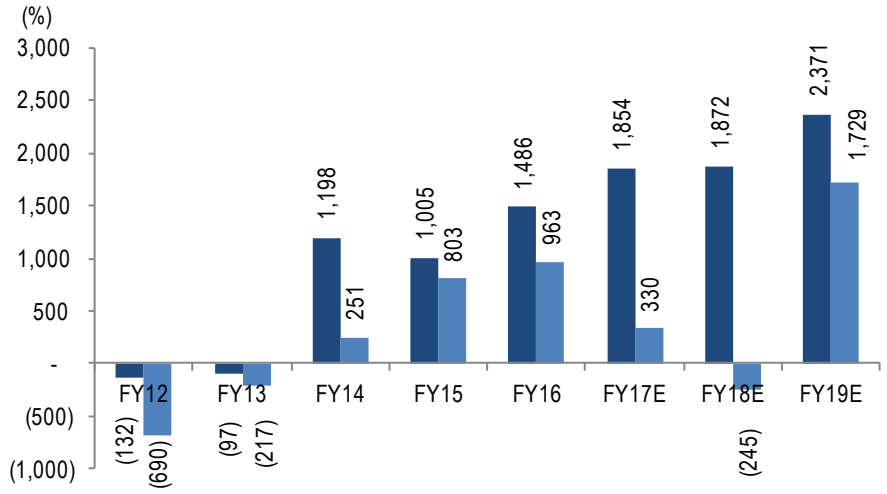


Source: Nirmal Bang Institutional Equities Research

Healthy cash flow from operations likely over FY17E – FY19E

Despite a capex of Rs4,300mn over FY17E-FY19E for greenfield expansion in India and brownfield expansion in Vietnam, we expect healthy free cash flow generation of Rs1,851mn over the same period.

Exhibit 38: Cash flow from operations (CFO) & free cash flows (FCF)

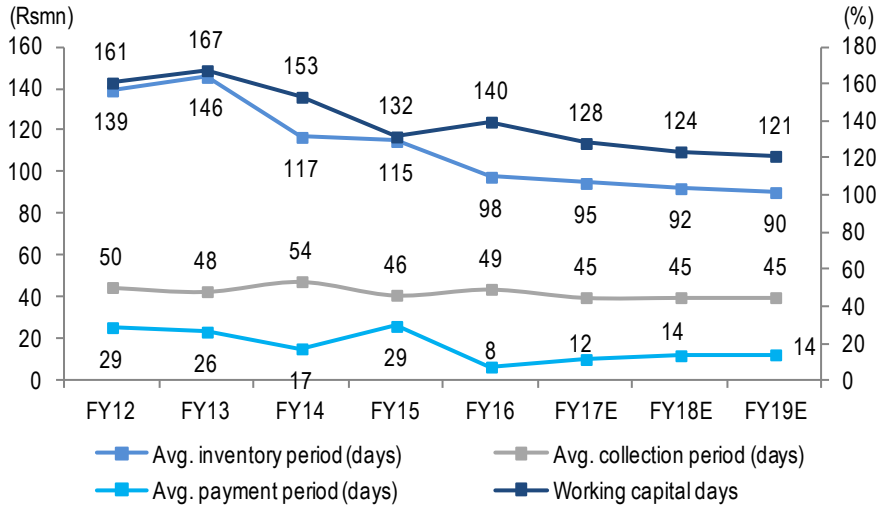


Source: Nirmal Bang Institutional Equities Research

Working capital days expected to improve from 140 days to 121 days over FY16-FY19E

We expect working capital or WC days (cash conversion cycle) for CCL to improve from 140 days in FY16 to 121 days in FY19E. We expect a small improvement in payment days from 8 to 14.

Exhibit 39: Working capital days



Source: Nirmal Bang Institutional Equities Research

Exhibit 40: Result analysis of Indian operations – 1HFY17

Y/E March - standalone (Rsmn)	2QFY16	1QFY17	2QFY17	YoY (%)	QoQ (%)	1HFY16	1HFY17	YoY (%)
Net sales	**1,781**	**1,733**	**1,000**	***(43.8)***	***(42.3)***	**3,359**	**2,733**	***(18.7)***
Net raw material & purchase of finished goods	1,069	970	568	*(46.9)*	*(41.4)*	2,033	1,538	*(24.4)*
% of sales	*60.0*	*56.0*	*56.8*	-	-	*60.5*	*56.3*	-
Employee cost s	65	72	53	*(17.9)*	*(26.4)*	123	126	*2.4*
% of sales	*3.6*	*4.2*	*5.3*	-	-	*3.6*	*4.6*	-
Other expenses	294	294	199	*(32.4)*	*(32.5)*	521	493	*(5.4)*
% of sales	*16.5*	*17.0*	*19.9*	-	-	*15.5*	*18.0*	-
Total expenditure	**1,428**	**1,337**	**820**	***(42.6)***	***(38.7)***	**2,677**	**2,157**	***(19.4)***
Operating profit	**353**	**396**	**180**	***(49.0)***	***(54.5)***	**682**	**576**	***(15.6)***
OPM (%)	***19.8***	***22.8***	***18.0***	-	-	***20.3***	***21.1***	-
Interest	12	16	11	*(5.8)*	*(30.5)*	21	27	*31.0*
PBDT	**341**	**380**	**169**	***(50.5)***	***(55.5)***	**661**	**549**	***(17.0)***
Depreciation	25	25	28	*10.2*	*13.2*	49	53	*8.0*
Other income	3	4	4	*25.8*	*(3.8)*	4	7	*78.9*
PBT	**319**	**359**	**145**	***(54.6)***	***(59.7)***	**617**	**504**	***(18.4)***
Tax	107	112	53	*(50.3)*	*(52.7)*	203	165	*(18.7)*
Effective tax rate (%)	*33.5*	*31.2*	*36.7*	-	-	*32.9*	*32.8*	-
Reported PAT	**212**	**247**	**92**	**(56.7)**	**(62.9)**	**414**	**338**	**(18.2)**
NPM (%)	***11.9***	***14.2***	***9.2***	-	-	***12.3***	***12.4***	-
EPS (Rs)	**1.6**	**1.9**	**0.7**	***(56.7)***	***(62.9)***	**3.1**	**2.5**	***(18.2)***

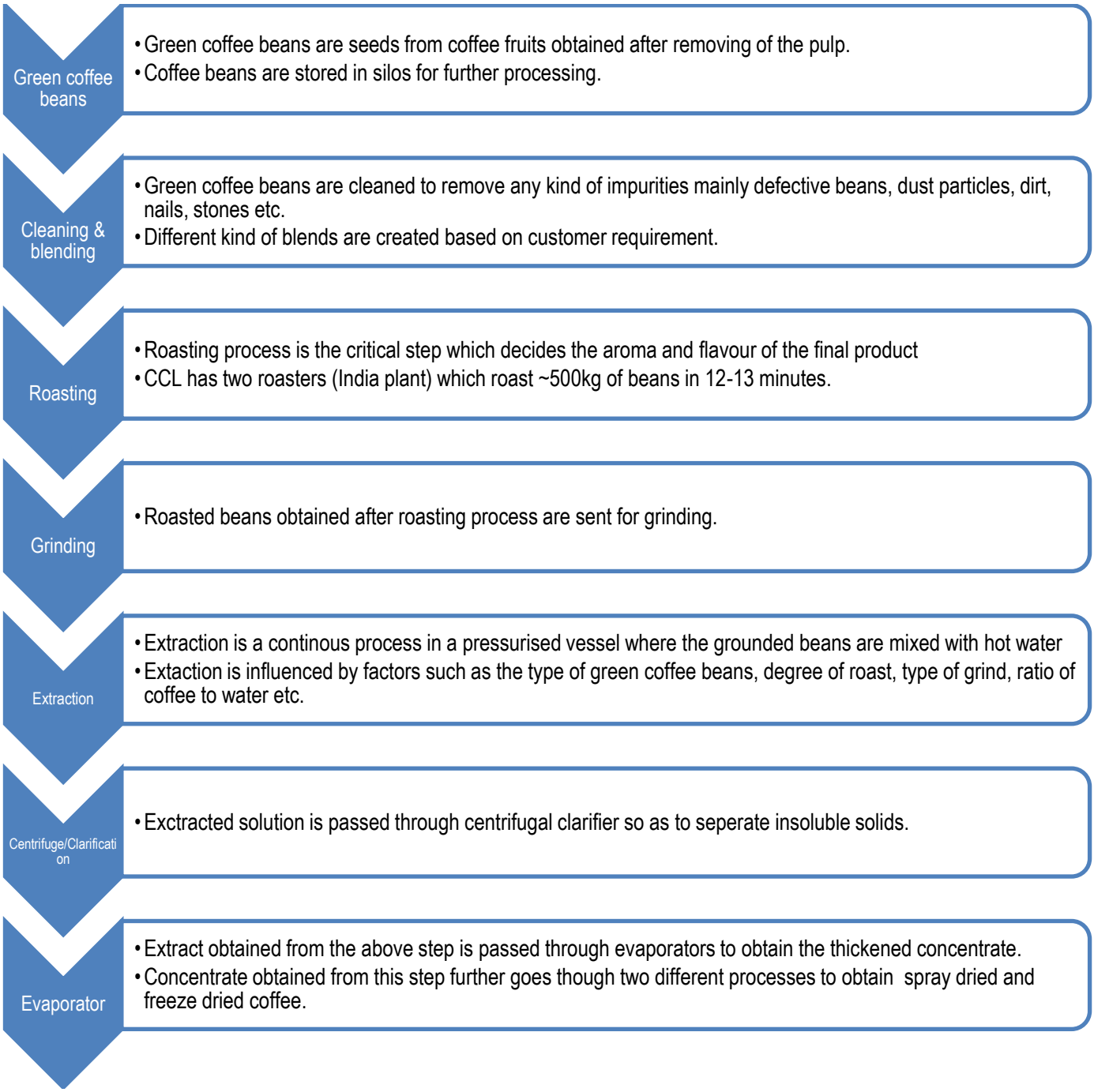
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 41: Result analysis of Vietnam unit and other subsidiaries – 1HFY17

Y/E March - (Rsmn)	2QFY16	1QFY17	2QFY17	YoY (%)	QoQ (%)	1HFY16	1HFY17	YoY (%)
Net sales	**570**	**773**	**423**	***(25.7)***	***(45.3)***	**1,188**	**1,196**	***0.7***
Total expenditure	**426**	**531**	**302**	***(29.1)***	***(43.2)***	**873**	**833**	***(4.5)***
Operating profit	**131**	**228**	**106**	***(19.6)***	***(53.6)***	**289**	**333**	***15.5***
OPM (%)	***23.1***	***29.4***	***25.0***	-	-	***24.3***	***27.9***	-
Interest costs	15	13	10	*(32.6)*	*(22.7)*	32	23	*(28.1)*
PBDT	**117**	**215**	**96**	***(17.9)***	***(55.4)***	**257**	**311**	***20.8***
Depreciation	45	59	58	*28.2*	*(2.5)*	90	117	*29.6*
Other income	9	0	0	*(99.8)*	*(93.1)*	14	0	*(97.5)*
PBT	**81**	**153**	**38**	***(53.1)***	***(75.2)***	**181**	**191**	***5.5***
Reported PAT	**81**	**153**	**38**	***(53.1)***	***(75.2)***	**181**	**191**	***5.5***
NPM (%)	***14.2***	***19.8***	***9.0***	-	-	***15.2***	***15.9***	-
EPS (Rs)	**0.6**	**1.2**	**0.3**	***(53.1)***	***(75.7)***	**1.4**	**1.5**	***7.1***

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 42: Instant coffee manufacturing process



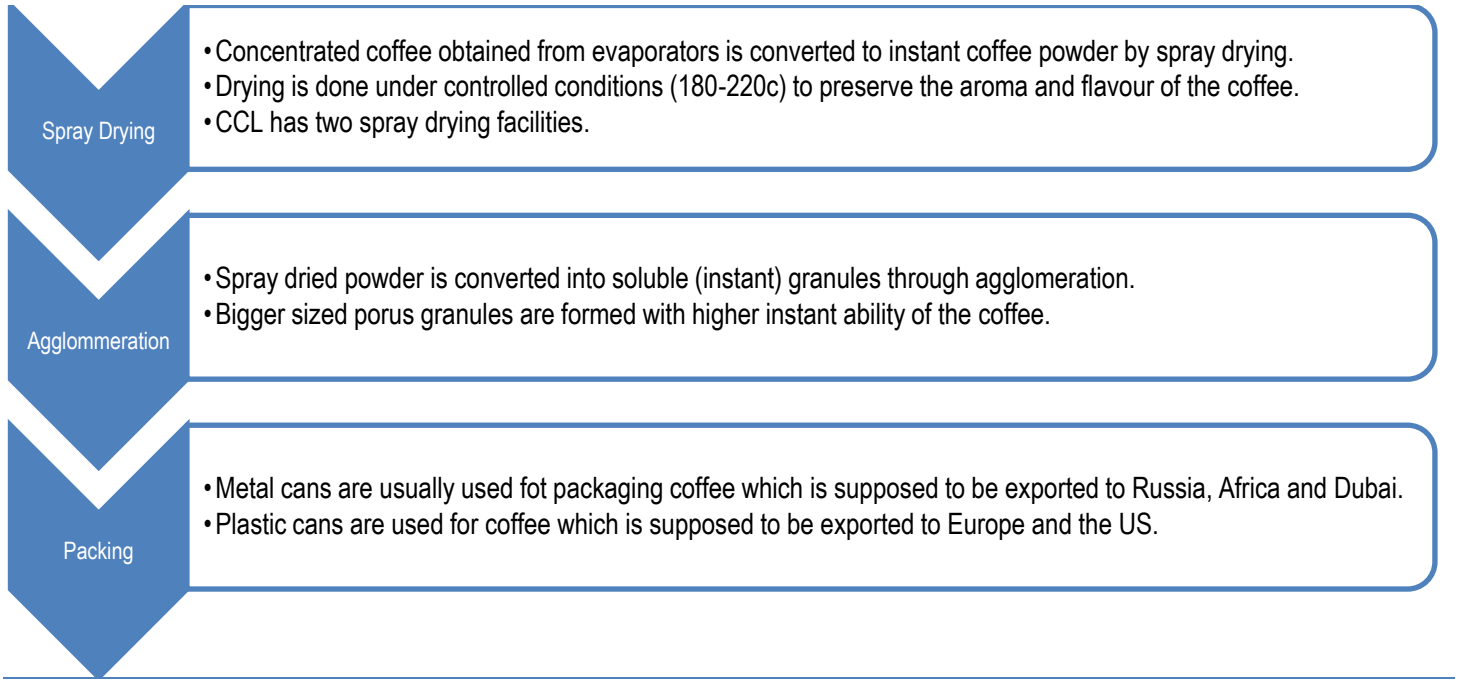
Source: Company, Nirmal Bang Institutional Equities

In the manufacture of spray dried coffee, extract from the evaporator is heated at 180C-220C. This results in change in appearance, colour, loss of aroma and taste. However, the use of freeze dryer retains the aroma, improves appearance and taste because freeze drying takes place at a low temperature which minimises heat damage and retains volatile components (aroma). It also increases the shelf life of the dried product as compared to standard drying practices.

Freeze-drying involves dehydration of food products at low temperature and pressure. As a result, only the moisture is removed, leaving the molecular structure intact. The end product is light in weight with least or no change in volume. Worldwide freeze-drying technology is considered as the ultimate among all other dehydration methods. Hence this technique is currently being used for the production of instant coffee.

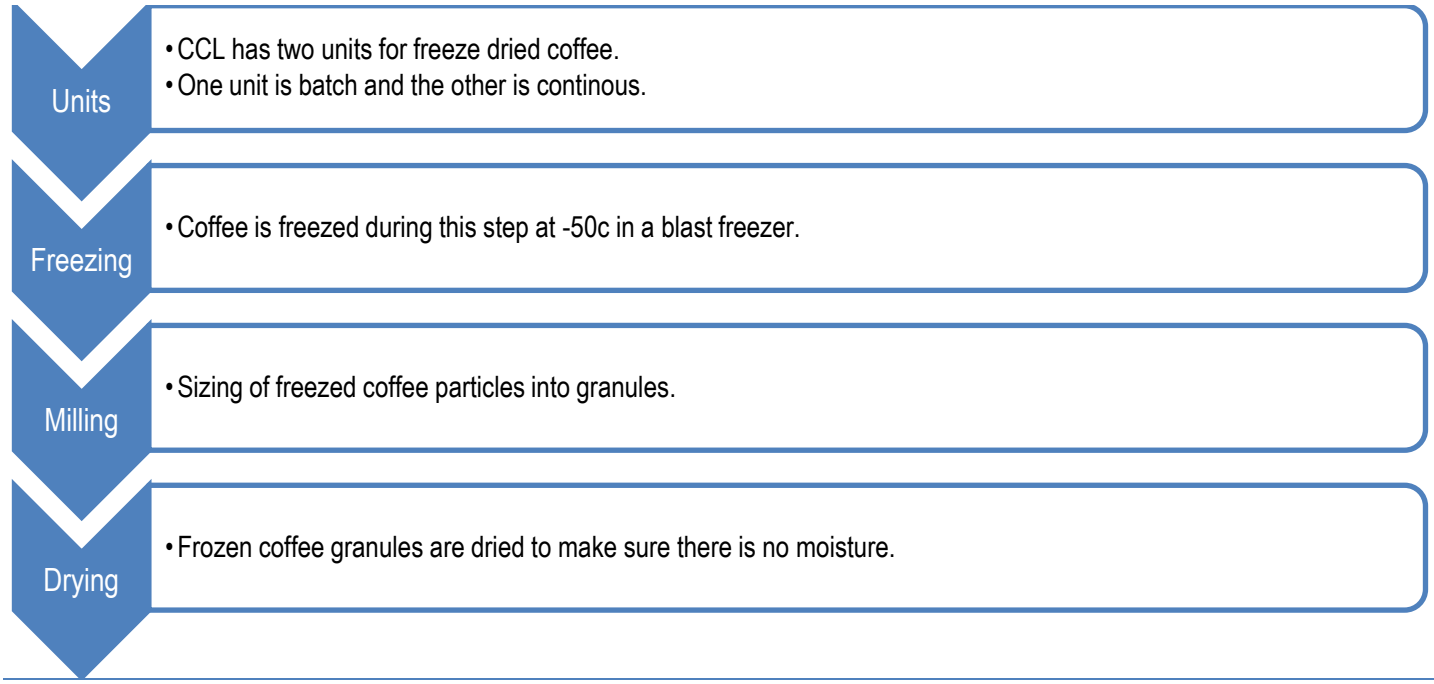
In a freeze drying system, concentrated coffee (42-45%), is first freezed and then exposed to low partial pressure (4.6 mmHg) of water vapour when ice sublimes directly to vapour leaving behind dried coffee. Freeze drying is a capital-intensive process entailing higher operating cost, but results in excellent product quality.

Exhibit 43: Spray dried coffee manufacturing process



Source: Company, Nirmal Bang Institutional Equities

Exhibit 44: Freeze dried coffee manufacturing process



Source: Company, Nirmal Bang Institutional Equities

Company background

CCL Products (India) or CCL was founded in 1994 with the vision of creating only the finest and richest coffee in the world. It is engaged in the manufacture of soluble instant spray dried coffee powder, spray dried agglomerated / granulated coffee, freeze dried coffee, roasted coffee, roast & ground coffee, as well as freeze concentrated liquid coffee. CCL's instant coffee is prepared from carefully chosen Arabica and Robusta coffee beans, roasted and processed to perfection, for an aroma and flavour that brings real satisfaction instantly. In addition to this, CCL has the ability to supply flavoured coffee, decaffeinated coffee, organic coffee, rainforest coffee, fair trade coffee, dual and triple certified coffee as well as chicory-coffee mix as per the specifications of the customer, and can also offer customers the option of highest quality customised products. CCL is also in a position to offer a range of in-house products to its customers.

CCL's state-of-the-art soluble instant coffee manufacturing plant is located at Duggirala Mandal in Guntur district of, Andhra Pradesh with a current capacity of 35,000mt per annum. CCL has the distinction of setting up India's first freeze dried instant coffee manufacturing plant in 2005. It is expected to set up another freeze dried plant with a capacity of 5,000mt in Chittoor district of Andhra Pradesh by mid-FY19.

CCL has adapted Swiss and Brazilian technology, acquired from world renowned pioneers in turnkey instant/soluble coffee technology, at its plant. This adaptation of this technology has enabled CCL to produce international quality soluble coffee, which is currently being exported to more than 80 countries.

CCL is BRC, IFS certified having quality management system (QMS) and has achieved 'Two-Star Export House' status. CCL is certified to produce Organic Coffee, Rain Forest Alliance Coffee and Fair Trade Coffee, in any combination, by the relevant organisations. CCL also holds Kosher and HALAL certifications.

CCL has been successively recognised with awards for its outstanding contribution to global coffee market by the commerce ministry Coffee Board of India, Andhra Pradesh government and other organisations.

Promoter's background

CCL was set up by Mr. Rajendra Prasad, a technocrat entrepreneur with over 30 years of industry experience. Mr. Prasad was the promoter and former managing director of Asian Coffee, the first 100% EOU in India, which was subsequently sold to Tata Coffee. He was the first recipient of financial assistance from the UK-based Commonwealth Development Corporation (CDC) in India. Mr. Prasad is currently a member of the Coffee Board of India. CCL's other promoter is Mr. Jonathan T. Feuer, who is into coffee trade since generations and provides marketing support through his UK-based company. He owns a 5% equity stake in CCL and is a member of the board of directors of the company.

Key strengths of CCL

- CCL is among the world's leading and Indian's largest processor and exporter of instant coffee, with exports to over 67 countries. If one excludes Nestle's captive consumption, CCL has ~10% global market share in instant coffee exports.
- Coffee processing is a niche and highly profitable industry, but with high entry barriers. Coffee processing is not an easy business as it is very important to get the right blend. Further, the taste preference varies region-wise and culture-wise. Experience and relationships are key to success, and the model is not easily replicable. It takes three to five years to win a client and establish one's credentials. CCL is one the very few companies globally that have successfully scaled up this business. CCL's USP is its technology, which it acquired from Brazil, allowing it to use low grade green (raw) coffee beans to produce very high quality instant coffee. Coffee is the world's second-most traded commodity, and the global coffee retail market is estimated at more than US$100bn. CCL is uniquely positioned to benefit from further growth in coffee processing.
- CCL has increased its capacity 10 times since inception in 1995 (~3,500tn) and more than three times in the past six years at 33,000tn currently. The expansion was funded mainly through internal accruals, and without recourse to significant debt. CCL has not issued any fresh equity since its listing in 1995. In addition, its debt profile is conservative, with peak D/E ratio of ~1.60x and current D/E ratio of 0.3x.

- With Nescafe being a global leader in almost all countries, coffee is an extremely profitable business. Whole coffee chains reap the benefits. Every country has some local/international challenger brands to Nescafe, and this is CCL's target client list.
- CCL has now diversified operations in three countries - India, Switzerland and Vietnam - and plans to set up a plant in Africa. The diversified presence will help CCL gain access to new markets and also exploit arbitrage opportunities between different manufacturing plants to its advantage. To cite an example, CCL will leverage the lower duty structure available in Vietnam in several Asian markets and also leverage extended tax benefit.
- Global green coffee market size is estimated at US$6bn-7bn at farm-grade cost, which eventually translates into retail sales of ~US$90bn-US$100bn globally. Significant value is captured at the coffee processing stage, which makes companies like CCL and Dek Super an important and integral part of the value chain. In the roasted coffee market, Nestle and Kraft are major players along with Sara Lee, Ichibo, and Starbucks etc. Nestle dominates the instant coffee retail market, while CCL is among the large players in the business of processing green coffee beans to make instant coffee. Given the domination of a few players (especially in instant coffee - Nestle), coffee is an extremely profitable business across the value chain.

CCL brands

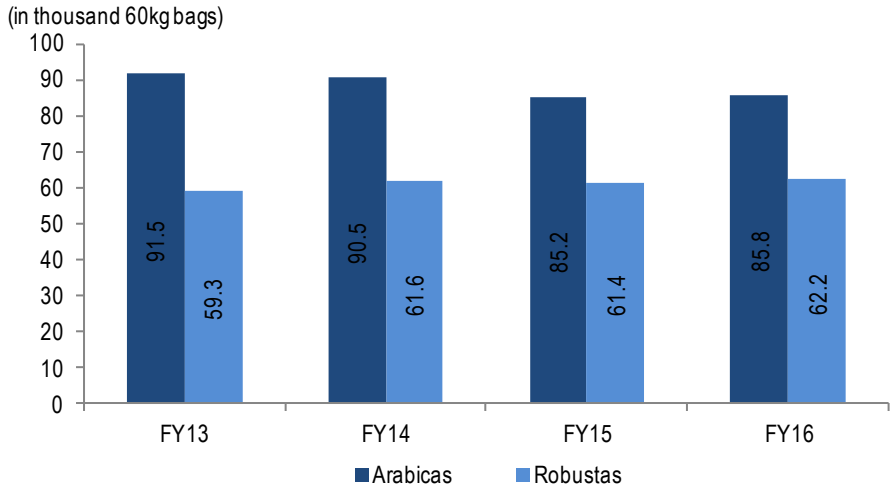
Continental Speciale - Continental Spéciale is 100% pure, granulated soluble instant coffee processed from carefully selected plantation Arabica and washed Robusta beans blended to perfection for complete satisfaction, instantly. ***This is spray dried coffee.***

Continental Premium - Continental Premium is a distinctive blend of carefully selected plantation Arabica coffee beans, processed to perfection to give an aroma and taste for real satisfaction instantly. The flavour of this unique blend will linger long after the coffee is consumed. ***This is freeze dried coffee that sales at premium than that of other two variants.***

Continental supreme - Continental Supreme is made from carefully chosen coffee beans ***blended with roasted chicory*** to provide a strong cup of rich tasting coffee.

Coffee market overview

Exhibit 45: Arabica versus Robusta coffee beans



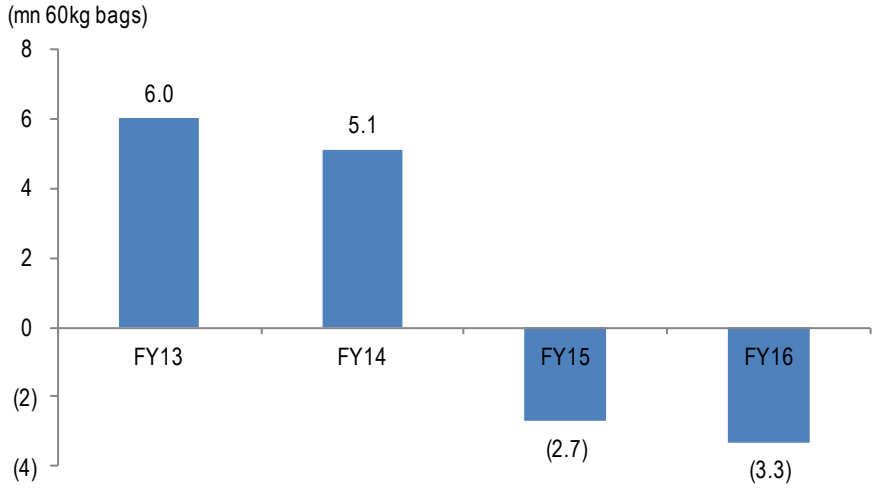
Source: International Coffee Organization (ICO), Nirmal Bang Institutional Equities

Arabica and robusta coffee beans are two of the most popular coffee beans used commercially for consumption. The main difference between these two types of beans is the elevation at which they are grown. Robusta is a hearty plant that is grown at reduced elevation while Arabica is the one that is grown at higher elevation (3,000+ ft). Robusta coffee beans are the ones with high caffeine content and are used mainly for commercial purposes. Coffee found in grocery and convenience stores is usually robusta coffee. Arabica coffee, which is grown at higher elevation, is considered to be rich and of much superior quality.

Coffee production declined by 0.6% over the past four years, FY13-FY16. In FY16, global coffee production was 148mn bags (60kg each) of which 85.8mn bags were of Arabica and 62.2mn bags of Robusta. Of the 85.8mn bags of Arabica coffee, 71.93mn bags were exported while out of 62.2mn bags of robusta coffee, 40.46mn were exported.

Arabica coffee production declined 2.1% while that of robusta coffee posted 1.6% CAGR over FY13-FY16 (coffee year is October – September). The coffee market ended FY16 in deficit for the second consecutive year, but stocks accumulated in FY13 and FY14 allowed the market to remain well supplied.

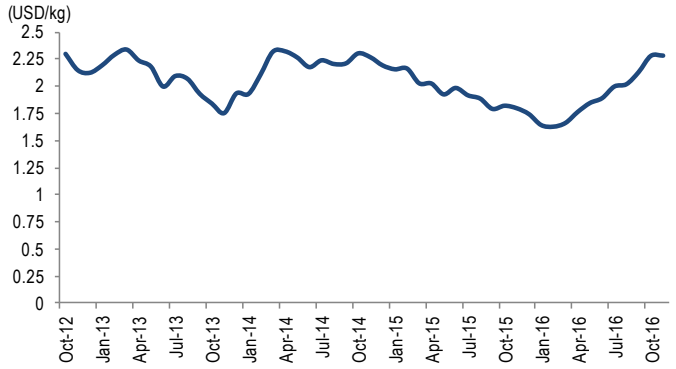
Exhibit 46: Production vs. Consumption deficit



Source: International Coffee Organization (ICO), Nirmal Bang Institutional Equities

Global coffee consumption posted a CAGR of 1.3% over FY13-FY16. In FY16, 151.3mn bags of coffee were consumed (148mn bags production) and 69% of total world coffee consumption was in coffee-importing counties mainly the EU, US, Japan and Russia while the balance 31% was consumed by coffee-exporting countries, mainly Brazil, Philippines, Ethiopia and Indonesia.

Exhibit 47: Robusta coffee prices

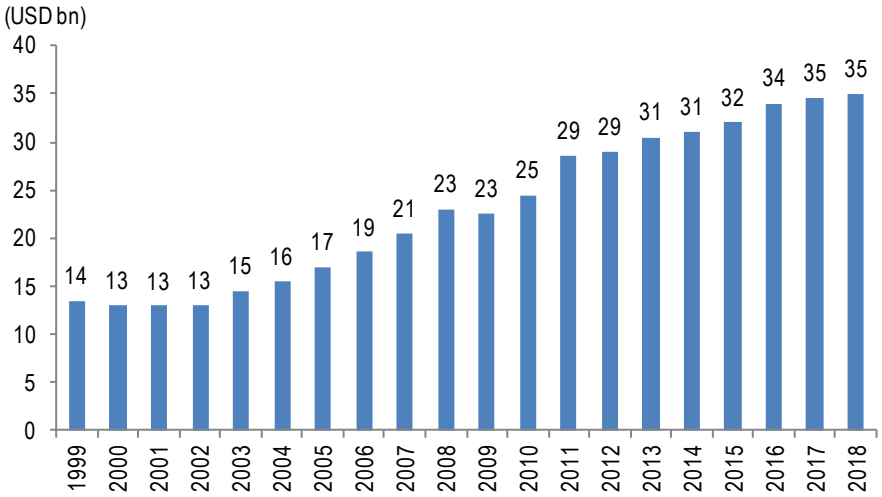


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 48: Arabica coffee prices

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 49: Instant coffee consumption



Source: Euromonitor, Nirmal Bang Institutional Equities

Instant coffee, often referred to as soluble coffee, includes spray-dried powder, freeze-dried powder, and liquefied forms of coffee, including liquid concentrate. Spray drying and freeze drying are the main methods of processing coffee that involves the dehydration of brewed, roasted, and ground coffee. The freeze-dried method produces superior products which are priced higher.

The growth of global instant coffee market remained steady as of 2016 because competition among vendors intensified. This could be attributed to the introduction of single-cup coffee brewing system and ready-to-drink coffee. The brewing segment has surpassed the sales of instant coffee owing to the growing preference for new flavours in mature markets such as Brazil and Vietnam. However, as instant coffee takes less time to prepare, the global instant coffee market is expected to grow continuously.

The global trade of instant coffee grew at an annual rate of 4%, which represented an increase from 360,000tn in 2005 to 514,000tn in 2015. Spray-dried products dominated the global instant coffee trade. In 2015 freeze-dried exports were close to 115,000tn a year, accounting for 22% of global instant coffee trade.

Sales of instant coffee nearly tripled since 2000 as per market research firm Euromonitor. In CY16, globally, ~USD31bn worth of instant coffee was consumed. Sales of instant coffee are expected to touch US$35bn by 2018. ***Instant coffee accounted for 34% of all retail brewed coffee consumed around the world.***

The markets in which instant coffee is most popular tend to be ones without a strong tradition of coffee-drinking. In newer coffee-drinking regions, instant coffee is appealing because of its ability to satisfy the needs of new coffee-drinkers and their evolving tastes. Unlike established coffee markets, where coffee is a product with well-defined perceptions of taste, strength and origin, in emerging coffee markets the coffee is viewed as a multi-purpose product with endless functional and flavour possibilities. This perhaps may be the reason why instant coffee is gaining traction in India and China.

Instant coffee has overall gained significant traction globally because it is easy to prepare. ***The shelf life of instant coffee is longer compared to ground coffee because it remains in powder form after the coffee extract is condensed during the drying process.*** **Also,** ***instant coffee costs less than ground coffee*** which has helped increase its consumption significantly among people of all age groups, especially the youth.

In Japan, the demand for instant coffee has increased. The demand for instant coffee is also increasing in non-coffee producing countries such as Russia and Ukraine for the same reason.

Australians and New Zealanders like instant coffee the most, accounting for 75% of total retail brewed coffee consumed. In Eastern Europe, instant coffee accounts for overall 50% of overall retail brewed coffee consumed while Western Europe accounts for just 25%. Overall, Europe consumes 40% of the world's instant coffee. The US, on the other hand, has been relatively small and a slow-growing market for instant coffee. Instant coffee market in the US accounts for US$960mn against its US$30bn total coffee market.

Financials (consolidated)

Exhibit 50: Income statement

Y/E March (Rsmn)	FY14	FY15	FY16	FY17E	FY18E	FY19E
Net Sales	7,168	8,806	9,321	9,497	11,577	13,793
% growth	*10.2*	*22.8*	*5.9*	*1.9*	*21.9*	*19.1*
Raw Material	4,251	5,440	5,475	5,319	6,343	7,473
Staff	258	279	331	361	445	513
Power cost	383	416	524	597	759	938
Others	845	958	955	1,043	1,259	1,470
Total Expenditure	5,737	7,093	7,285	7,320	8,807	10,395
EBITDA	1,431	1,712	2,036	2,177	2,770	3,399
% growth	*18.0*	*19.6*	*18.9*	*6.9*	*27.2*	*22.7*
EBITDA margin (%)	*20.0*	*19.4*	*21.8*	*22.9*	*23.9*	*24.6*
Other income	26	30	23	45	51	63
Interest	171	136	108	108	137	144
Gross Profit	1,287	1,606	1,951	2,113	2,684	3,318
% growth	*25.5*	*24.8*	*21.5*	*8.3*	*27.0*	*23.6*
Depreciation	291	268	284	325	404	449
Profit Before Tax	996	1,338	1,668	1,788	2,280	2,869
% growth	*34.8*	*34.4*	*24.6*	*7.2*	*27.5*	*25.8*
Tax	351	398	446	380	442	538
Effective tax rate (%)	*35.3*	*29.8*	*26.8*	*21.3*	*19.4*	*18.8*
Reported Net Profit	644	940	1,221	1,408	1,838	2,331
% growth	*35.8*	*45.8*	*30.0*	*15.3*	*30.5*	*26.8*
Dividends	187	187	401	481	561	721
Carried over to BS	458	753	821	928	1,277	1,610
EPS (Rs)	4.8	7.1	9.2	10.6	13.8	17.5
% growth	*35.8*	*45.8*	*30.0*	*15.3*	*30.5*	*26.8*
DPS (Rs)	1.2	1.2	2.5	3.0	3.5	4.5
Payout (%)	*24.8*	*17.0*	*27.2*	*28.3*	*25.3*	*25.7*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 52: Balance sheet

Y/E March (Rsmn)	FY14	FY15	FY16	FY17E	FY18E	FY19E
Equity	266	266	266	266	266	266
Reserves	3,262	3,950	4,832	5,698	6,975	8,585
Net worth	3,528	4,216	5,098	5,964	7,241	8,851
Short Term Loans	1,572	1,388	1,145	1,095	1,975	1,775
Long-term Loans	1,349	904	443	963	813	513
Total Loans	2,921	2,292	1,588	2,058	2,788	2,288
Deferred Tax Liability	233	243	285	297	311	328
Liabilities	**6,682**	**6,751**	**6,971**	**8,319**	**10,340**	**11,467**
Gross Block	5,252	5,307	6,364	7,834	9,938	10,575
Depreciation	1,640	1,907	2,191	2,516	2,920	3,369
Net Block	3,611	3,400	4,173	5,318	7,018	7,206
Capital work-in-progress	389	534	-	54	67	73
Long-term Investments	16	15	15	15	15	15
Inventories	1,379	1,735	1,486	1,400	1,625	1,876
Debtors	1,068	1,132	1,281	1,187	1,447	1,724
Cash	343	266	187	444	368	876
Other Current assets	444	534	870	462	513	552
Total Current assets	3,234	3,668	3,825	3,494	3,953	5,027
Creditors	205	445	115	172	241	294
Other current liabilities	363	421	927	390	473	561
Total current liabilities	568	866	1,042	562	714	854
Net current assets	2,666	2,802	2,783	2,932	3,240	4,173
Total Assets	**6,682**	**6,751**	**6,971**	**8,319**	**10,340**	**11,467**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 51: Cash flow

Y/E March (Rsmn)	FY14	FY15	FY16	FY17E	FY18E	FY19E
EBIT	1,140	1,444	1,752	1,851	2,366	2,949
(Inc.)/Dec in working capital	258	(213)	(60)	108	(384)	(426)
Cash flow from operations	**1,398**	**1,231**	**1,692**	**1,960**	**1,982**	**2,523**
Other income	26	30	23	45	51	63
Depreciation	291	268	284	325	404	449
Deffered Liabilities	4	10	41	12	14	17
Interest paid (-)	(171)	(136)	(108)	(108)	(137)	(144)
Tax paid (-)	(351)	(398)	(446)	(380)	(442)	(538)
Dividends paid (-)	(187)	(187)	(401)	(481)	(561)	(721)
Net cash from operations	**1,011**	**818**	**1,086**	**1,373**	**1,311**	**1,650**
Capital expenditure (-)	(947)	(202)	(523)	(1,524)	(2,117)	(643)
Net cash after capex	**64**	**616**	**563**	**(151)**	**(806)**	**1,008**
Inc./(Dec.) in short-term borrowing	(201)	(183)	(243)	(50)	880	(200)
Inc./(dec.) in long-term borrowing	101	(445)	(461)	520	(150)	(300)
Inc./(dec.) in total borrowings	(100)	(629)	(704)	470	730	(500)
(Inc.)/Dec. in investments	(1)	1	(0)	-	-	-
Equity issue/(Buyback)	-	-	-	-	-	-
Cash from Financial Activities	**(100)**	**(628)**	**(704)**	**470**	**730**	**(500)**
Others	287	(65)	62	(62)	0	(0)
Opening cash	93	343	266	187	444	368
Closing cash	343	266	187	444	368	876
Change in cash	250	(77)	(80)	257	(76)	508

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 53: Key ratios

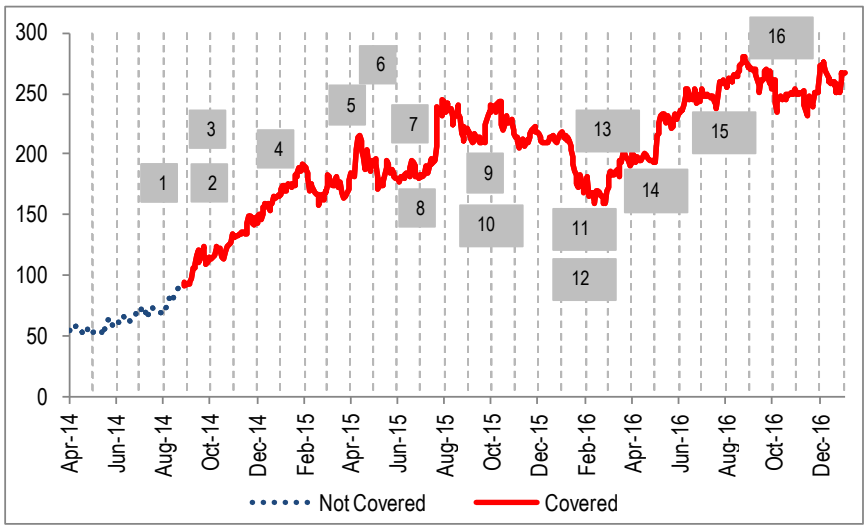
Y/E March	FY14	FY15	FY16	FY17E	FY18E	FY19E
Per share (Rs)						
EPS	4.8	7.1	9.2	10.6	13.8	17.5
Book value	27	32	38	45	54	67
Valuation (x)						
P/E	54.1	37.1	28.5	24.7	19.0	14.9
P/sales	4.9	4.0	3.7	3.7	3.0	2.5
P/BV	9.9	8.3	6.8	5.8	4.8	3.9
EV/EBITDA	26.1	21.5	17.8	16.7	13.5	10.7
EV/sales	5.2	4.2	3.9	3.8	3.2	2.6
Return ratios (%)						
RoIC	12.0	15.9	19.4	19.9	21.4	23.3
RoCE (post-tax)	12.3	16.0	19.7	20.3	21.6	23.1
RoCE (pre-tax)	19.0	22.8	26.9	25.8	26.8	28.5
RoE	20.4	24.3	26.2	25.5	27.8	29.0
Margins (%)						
Gross margin (%)	40.7	38.2	41.3	44.0	45.2	45.8
EBITDA margin	20.0	19.4	21.8	22.9	23.9	24.6
PBIT margin	15.9	16.4	18.8	19.5	20.4	21.4
PBT margin	13.9	15.2	17.9	18.8	19.7	20.8
PAT margin	9.0	10.7	13.1	14.8	15.9	16.9
Turnover ratios						
Asset turnover ratio (x)	1.1	1.3	1.3	1.1	1.1	1.2
Avg. inventory period (days)	117	115	98	95	92	90
Avg. collection period (days)	54	46	49	45	45	45
Avg. payment period (days)	17	29	8	12	14	14
Solvency ratios (x)						
Debt-equity	0.8	0.5	0.3	0.3	0.4	0.3
Interest coverage	6.7	10.6	16.2	17.1	17.3	20.6
Debt/EBITDA	2.0	1.3	0.8	0.9	1.0	0.7
Growth (%)						
Sales	10.2	22.8	5.9	1.9	21.9	19.1
EBITDA	18.0	19.6	18.9	6.9	27.2	22.7
PAT	35.8	45.8	30.0	15.3	30.5	26.8

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

	Date	Rating	Market price (Rs)	Target price (Rs)
1	27 August 2014	Buy	90	140
2	10 October 2014	Buy	123	140
3	30 October 2014	Buy	134	183
4	20 January 2015	Buy	174	245
5	13 April 2015	Buy	214	245
6	28 May 2015	Buy	187	272
7	10 July 2015	Buy	185	272
8	22 July 2015	Buy	207	272
9	13 October 2015	UR	241	-
10	16 October 2015	Buy	224	272
11	4 February 2016	Buy	180	250
12	17 February 2016	Buy	167	250
12	2 March 2016	Buy	172	219
14	3 May 2016	Buy	194	238
15	2 August 2016	Buy	259	307
16	5 October 2016	Buy	262	328

Rating Track Graph



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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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