# CCL Products (India) Ltd. BUY

## Brewing volumes

| | |
|---|---|
| TP | Rs363 |
| CMP | Rs287 |
| Potential upside / downside | +26% |

**V/s Consensus**

| EPS (Rs) | FY20E | FY21E |
|---|---|---|
| IDBI Capital | 15.0 | 18.2 |
| Consensus | 16.1 | 19.0 |
| *% difference* | *(6.5)* | *(4.4)* |

**Key Stock Data**

| | |
|---|---|
| Bloomberg / Reuters | CCLP IN / CCLP.BO |
| Sector | Tea & Coffee |
| Shares o/s (mn) | 133 |
| Market cap. (Rs mn) | 38,199 |
| Market cap. (US$ mn) | 541 |
| 3-m daily average value (Rs mn) | 287 |
| 52-week high / low | Rs320/225 |
| Sensex / Nifty | 36,213 / 10,880 |


### Summary

**CCL Products (CCL) is one of the largest instant coffee manufacturers in the world. The company's key strength lies in its long-standing relationships with clients, expertise in coffee blends, cost efficiency and its pass-through mechanism to ensure margin protection. Over FY03-18, CCL has successfully scaled up its total capacity from 3,600 tonnes to 30,000 tonnes. Looking ahead, CCL remains well-poised to ramp up volumes from its recently set up 5,000 tpa freeze dried plant in Andhra Pradesh. We expect CCL's sales to grow at a CAGR of 17% over FY18-21E. We initiate coverage on the stock with a BUY rating and a target price of Rs363.**


### Key Highlights and Investment Rationale

- **Strong moat with resilient margins:** Over last two decades, CCL has developed a sound business model which is not easy to replicate. CCL's expertise lies in making consistent coffee blends which has resulted in long standing relationships with clients and stickiness in business. Moreover, the volatility in prices of raw coffee does not impact CCL's profits as it works on a pass-through model. With capacity expansion, it has scaled up EBITDA margins from 11% in FY09 to average 21% during FY14-18. Also, its ROE has expanded from 10% in FY09 to average 22% during FY14-18.
- **Greenfield expansion complete, volumes to grow from FY20:** CCL's sales growth of 17% over FY18-21E is likely to be led by its recently set up 5,000 MT freeze dried unit in Andhra Pradesh. We expect plant to operate at 50% utilization in FY20 given strong order backlog. In FY21, volume growth is likely to be further boosted by upcoming capacity (3,500 MT) in Vietnam.
- **Initiate coverage with a BUY rating; target price of Rs363:** CCL has successfully scaled up its coffee processing capacity by nearly ~7x over the last 15 years. Over FY14-18, it's EBITDA/net profit has grown at a CAGR of 14%/26% without equity dilution alongside healthy return ratios. Looking ahead, we estimate CCL's EBITDA/net profit to grow at a CAGR of 16%/18% over FY18-21E. We expect the company to generate free cash flows of ~Rs2,500 mn over FY20-21. We value the stock at a Price-to-earnings multiple of 20x (10% discount to its last five year average) on our FY21E EPS and derive a target price of Rs363.

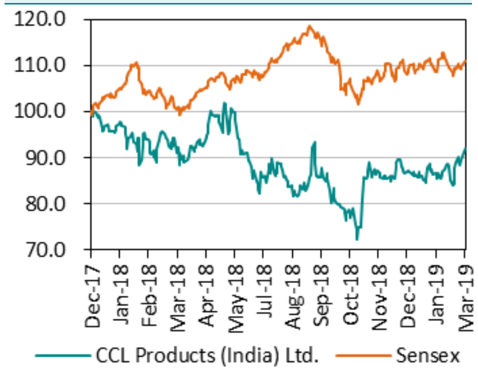
**Shareholding Pattern (%)**

| | |
|---|---|
| Promoters | 45.3 |
| FII | 26.8 |
| DII | 0.7 |
| Public | 27.2 |

**Price Performance (%)**

| | -1m | -3m | -12m |
|---|---|---|---|
| Absolute | 6.5 | 8.3 | (3.5) |
| Rel to Sensex | 7.0 | 6.8 | (11.5) |

**Relative to Sensex (%)**




**Financial snapshot** (Rs mn)

| Year | FY2017 | FY2018 | FY2019E | FY2020E | FY2021E |
|---|---|---|---|---|---|
| Net sales | 9,832 | 11,380 | 13,594 | 15,804 | 18,397 |
| EBITDA | 2,333 | 2,437 | 2,927 | 3,380 | 3,793 |
| EBITDA (%) | 23.7 | 21.4 | 21.5 | 21.4 | 20.6 |
| Adj. PAT | 1,346 | 1,481 | 1,785 | 1,993 | 2,417 |
| EPS (Rs) | 10.1 | 11.1 | 13.4 | 15.0 | 18.2 |
| EPS Growth (%) | 10.2 | 10.1 | 20.5 | 11.6 | 21.3 |
| PE (x) | 28.4 | 25.8 | 21.4 | 19.2 | 15.8 |
| Dividend Yield (%) | 0.4 | 1.0 | 0.9 | 1.0 | 1.4 |
| EV/EBITDA (x) | 16.3 | 16.2 | 13.6 | 11.6 | 10.2 |
| RoE (%) | 23.6 | 21.7 | 22.1 | 20.9 | 21.6 |
| RoCE (%) | 32.0 | 25.7 | 24.6 | 24.3 | 25.8 |

*Source: Company; IDBI Capital Research*

## Investment thesis

*CCL's business model is not easy to replicate*

### CCL's business enjoys strong moat; resilient margins

There are several challenges to enter coffee processing business. Creating right blends is extremely critical for a coffee processor as coffee is a very personal product and change in taste is not acceptable to customers. It takes several years to ace the process of manufacturing right blends of coffee. Secondly, it takes over 2-5 years to establish credentials with the client. Lastly, there are challenges in terms of technology and scale of operations.

Over the years, CCL has successfully developed many blends as per client requirement. It can make over 1,000 blends of coffee and t can challenge to make any blend based on customer requirements.

CCL's relationships with clients spans decades which ensures continuity of business. This is apparent from the fact that over the last five years there is hardly any change in its top clients. Lastly, CCL's technology (imported from Brazil) can efficiently process low grades of green coffee. These factors are difficult to replicate for its competitors.

**Exhibit 1: CCL has a sound business model**

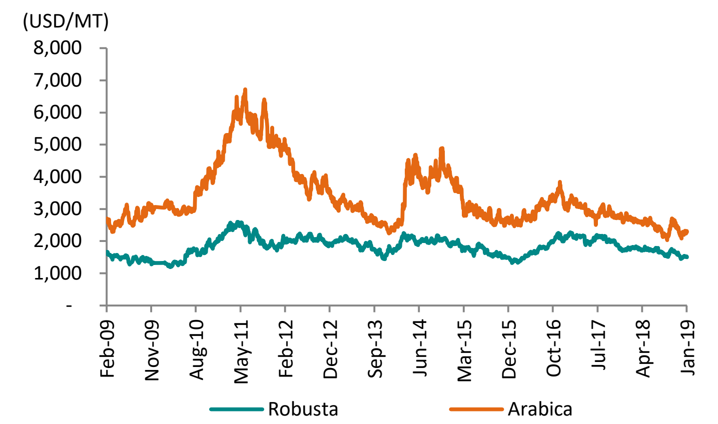
| | |
|---|---|
| Expertise in creating right blends | CCL has aced the process of creating blends to suit client requirements. It can manufacture over 1,000 blends of coffee. |
| Long-standing relationships | Over the years, CCL's has developed strong relationships with clients; there has hardly been a churn in its top clients during the last five years. |
| Economies of scale | Being one of the largest instant coffee producers in the world, CCL enjoys cost advantages. |
| Technology | Imported technology from Brazil ensures CCL can manufacture high quality coffee even with low grades of green coffee. |
| Resiliient margins | CCL follows the standard process of procuring raw material only after it receives order; hence, its margins (EBITDA/ kg) remains stable. |

*Source: Company, IDBI Capital Research*

*CCL's margins are immune to volatility in coffee prices; natural hedge*

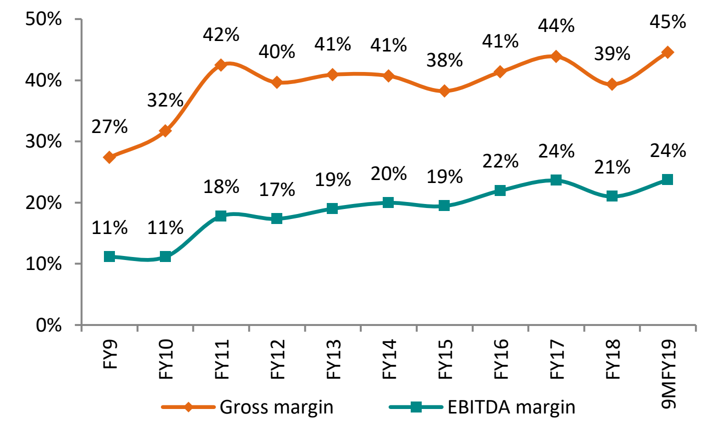
The volatility in green coffee prices does not impact CCL's profits as it works on pass-through model. CCL procures its raw material only after it receives an order from its client, thus locking the required spread. Since CCL has been in this business for 25 years, it has established strong relationships with coffee bean vendors. Although green coffee prices are at historical lows, we do not expect CCL's margins to be affected in case green coffee prices recover.

**Exhibit 2: Coffee prices have remained volatile…**




*Source: Bloomberg, IDBI Capital Research*

**Exhibit 3:…but CCl's margins have steadily improved**




*Source: Company, IDBI Capital Research*

Also, at its India operations, CCL imports ~85% of its raw materials and exports ~90% of finished products. Hence, exchange rate fluctuations do not have a meaningful impact on its financials.

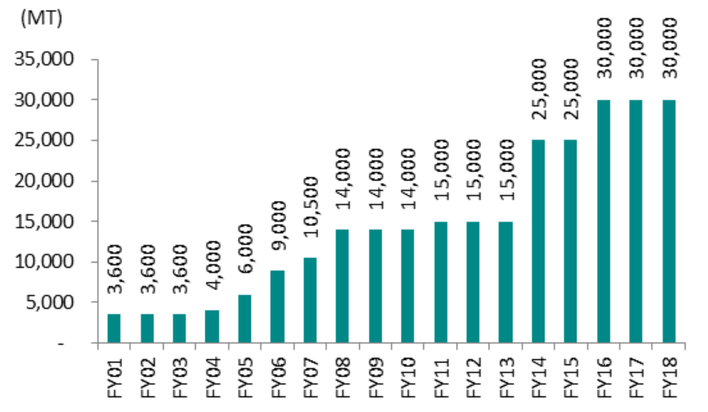
*CCL has demonstrated strong growth in profits without diluting equity*

### Proven history of consistent growth in profits alongside strong return ratios

Coffee processing industry has over capacity to the extent of 50% as per the company. Nevertheless, CCL has developed the requisites over the last two decades - standard blends, strong relationships and right technology. Hence, despite over capacity, the company has witnessed strong growth in top and bottom line. It is noteworthy that over the past decade, the company has used modest leverage to grow, not diluted equity and still maintained healthy return ratios.

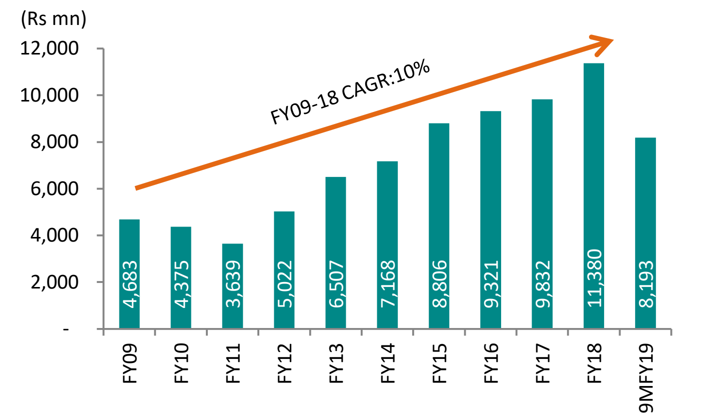
Over the past decade, CCL's sales grew at a CAGR of 10%. During the same period, its EBITDA and net profit have grown at a CAGR of 18% and 26% respectively. EBITDA margins have improved steadily over the last decade.

**Exhibit 4: CCL's capacity growth**



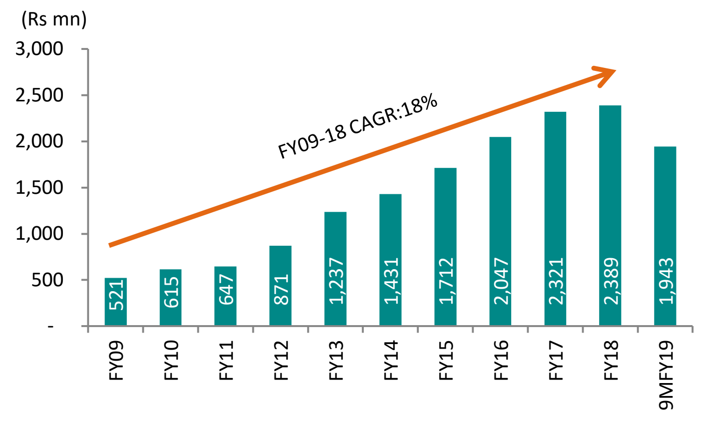

*Source: Company; IDBI Capital Research*

**Exhibit 5: Sales growth**



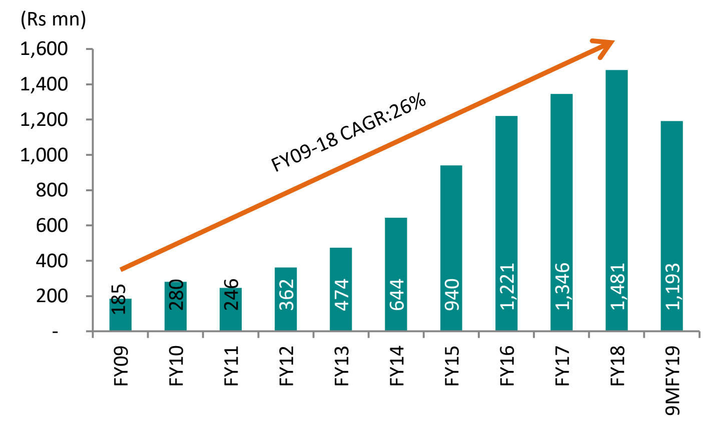

*Source: Company; IDBI Capital Research*

**Exhibit 6: EBITDA growth**



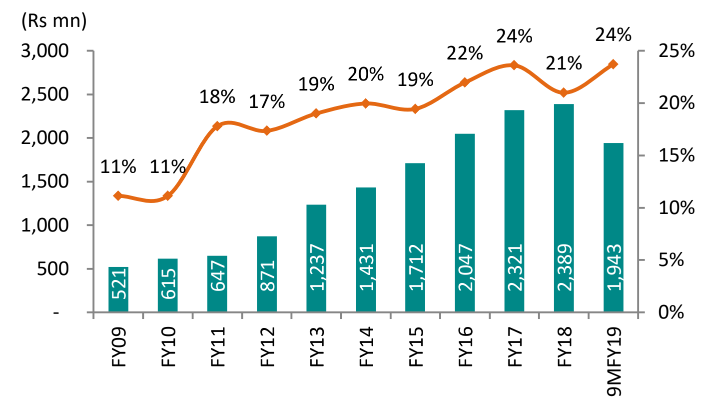

*Source: Company; IDBI Capital Research*

**Exhibit 7: Net profit growth**



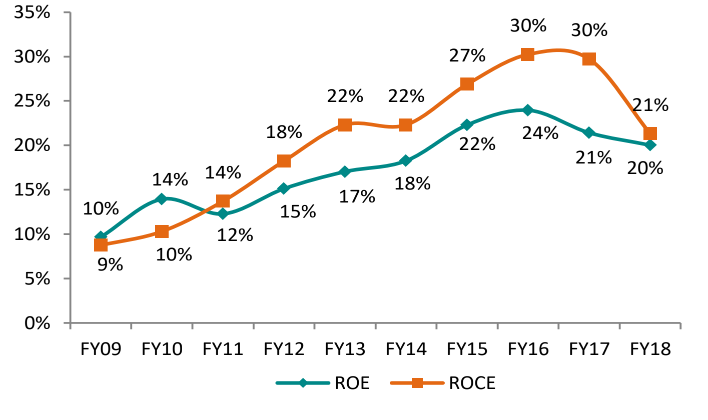

*Source: Company; IDBI Capital Research*

**Figure 8: EBITDA margin trend**




*Source: Company, IDBI Capital Research*

**Figure 9: ROE and ROCE trend**




*Source: Company, IDBI Capital Research*

## Indian greenfield expansion to drive volume growth

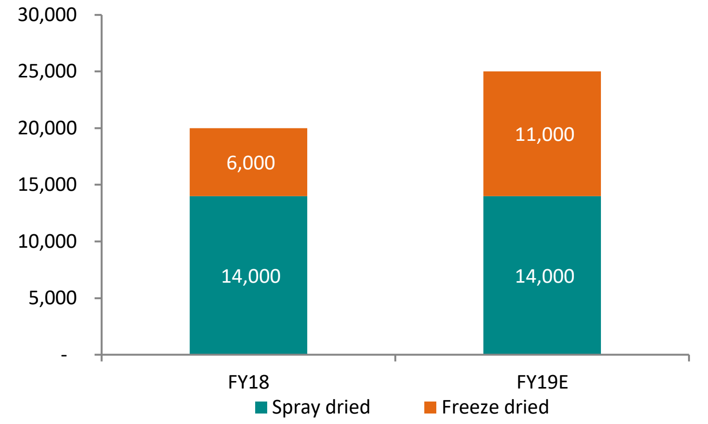
*CCL is on the verge of commissioning its new freeze dried facility*

CCL has successfully scaled up its Indian capacity from 3,600 tonnes in FY03 to 20,000 tonnes in FY18. In FY19, it has set up another 5,000 tonnes freeze dried unit with a capex of Rs3,500 mn at Chittor, Andhra Pradesh. Freeze dried coffee is a superior product compared to spray dried coffee and enjoys relatively higher margins (2-3x higher than spray dried).

The new plant will have tax benefits for five years and is at proximity of 160 km from the Chennai port ensuring low logistical costs.

The plant is likely to commence operations in Q1FY20 and it has enough order backlog to operate it at 50% utilization in FY20. We expect project ROCE to be high (20%) on full ramp-up (likely 3 years) even though the company has spent an additional Rs700 mn to develop infrastructure for future expansions.

**Exhibit 10: Indian capacity ramp up (tonnes p.a.)**




*Source: Company; IDBI Capital Research*

**Exhibit 11: Project ROCE to be high**

| | |
|---|---|
| Capacity (tonnes) | 5,000 |
| Sales (Rs mn) | 3,000 |
| Volumes (tonnes) | 5,000 |
| Realization (Rs/kg) | 600 |
| EBITDA (Rs mn) | 875 |
| Depreciation (Rs mn) | 175 |
| EBIT (Rs mn) | 700 |
| | |
| Capex (Rs mn) | 3,500 |
| ROCE (pre-tax) | 20% |
| Asset turns (x) | 0.9 |

*Source: Company; IDBI Capital Research*

### Successfully established and scaled up Vietnam capacity

*CCL has successfully scaled up Vietnam operations*

In CY13, CCL strategically set up a 10,000 tpa spray dried plant in Vietnam with a capex of $40 mn. Vietnam is the second largest producer of green coffee in the world after Brazil, with robusta coffee accounting to 97% of Vietnam's total output. There are several benefits of setting up a coffee processing plant in Vietnam.

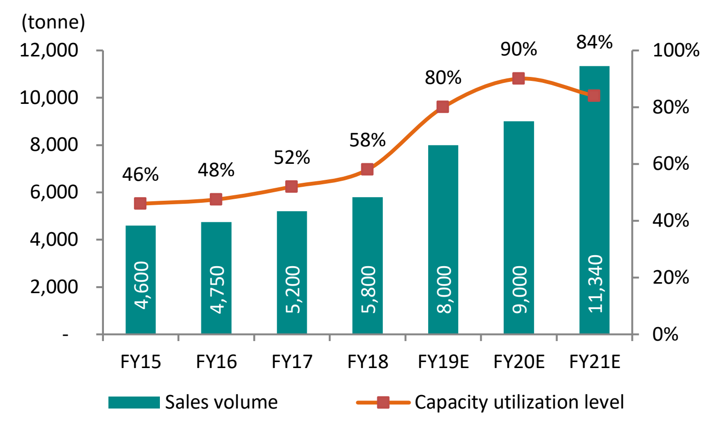
**Exhibit 12: Advantages of setting up facility in Vietnam**

| | |
|---|---|
| **Access to raw materials** | **Vietnam is one of the largest producers of robusta coffee and hence, there is assured supply of raw materials.** |
| **Tax breaks** | **Initially, CCL had tax break (0% tax) for five years which has now been extended to "no tax" for lifetime as CCL meets some stuipulated conditions.** |
| **Strategically located facilities** | **Since the plant is located in Vietnam's coffee processing zone, logistics costs are low.** |
| **Market proximity** | **Some critical markets such as China, Japan, etc are in close proximity to Vietnam.** |

*Source: Company, IDBI Capital Research*

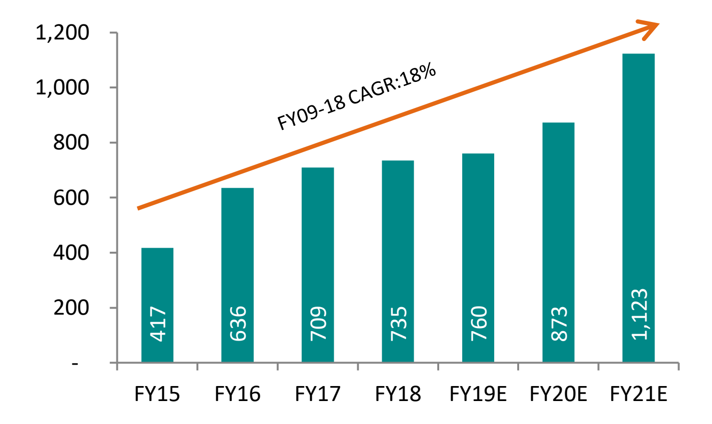
The company has readily available infrastructure for further brownfield expansions which will require only modest capex. The company is now increasing its Vietnam capacity by a further 3,500 MT with a modest capex of $8 mn in FY20.

**Exhibit 13: Vietnam sales and utilization levels**




*Source: Company; IDBI Capital Research*

**Exhibit 14: Vietnam EBITDA growth (Rs mn)**




*Source: Company; IDBI Capital Research*

## Margins to improve with rising small sized packet sales and agglomeration capacity

At its Indian operations, CCL aims to increase its products in favour of small packets vis-a-vis bulk. It is setting up a packaging capacity of 3-5k tonnes. Small packets have 5-10% higher realizations vis-à-vis bulk. For the client, it ensures products are directly shipped from CCL to the client rather than CCL shipping to different suppliers who then package the products and transport back to client. Currently, 10-15% of sales in India are in small packets which the company aims to increase to 30% in two-three years.

Also, CCL is setting up 5,000 tonnes of agglomeration capacity. Agglomeration improves the quality of coffee and hence fetches realizations which are higher by 5-10%. Both these expansions (packaging and agglomeration) will entail a capex of $12 mn.

### Focusing to create a brand – a directionally right move towards B2C business

*CCL is taking several initiatives to crack B2C business in India*

CCL's B2B export volume growth is likely to slow down in the coming 4-5 years. Hence, the company aims to drive next leg of growth through its B2C venture in India. CCL has ventured into India's branded instant coffee market through its *Continental* brand. It is advertising aggressively to increase its visibility in the retail instant coffee market where two leaders (Nescafe and Bru) jointly have over 90% market share, third one being CCL (3% market share).

CCL offers diverse range of products (freeze-dried coffee, pure vanilla coffee products, etc) compared to the two established brands. To grow this business, CCL has roped in Mr. Praveen Jaipuria who has two decades experience in marketing FMCG products. Initially, it has launched its products in southern markets where coffee consumption is higher compared to other regions.

It targets sales of Rs800 mn (Rs550 mn in 9MFY19) in FY19 (out of this nearly 75-80% is B2C). CCL expects the business to exhibit strong growth in the coming two-three years on a smaller base. The company will plough back all the profits from this business towards branding exercise for the coming 4-5 years.

However, we believe it will be challenging for the company to successfully establish brand, develop distribution network, etc.

**Exhibit 15: Price comparison of some of the branded coffee products in India**

| | 50 gm | Price | 100gm | Price | 200gm | Price | 500 gm | Price | 1 kg | Price | Description |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Nestle** | Nescafe coffee classic | 130 | Nescafe coffee classic | 265 | Nescafe coffee classic | 440 | Nescafe coffee classic | 950 | Nescafe coffee classic | NA | 100% pure coffee |
| | Nescafe gold blend instant coffee | 265 | Nescafe gold blend instant coffee | 420 | Nescafe gold blend instant coffee | 900 | Nescafe gold blend instant coffee | NA | Nescafe gold blend instant coffee | NA | Freeze dried coffee |
| **Filter coffee** | Nescafe sunrise premium | 75 | Nescafe sunrise premium | 140 | Nescafe sunrise premium | 300 | Nescafe sunrise premium | 605 | Nescafe sunrise premium | NA | 70:30 coffee chicory |
| | | | | | | | | | | | |
| **Bru** | Instant coffee | 85 | Instant coffee | 165 | Bru instant coffee | 345 | Bru instant super strong coffee | 320 | Bru instant super strong coffee | NA | |
| | Bru gold instant coffee | 120 | Bru gold instant coffee | 245 | Bru gold instant coffee | NA | Bru gold instant coffee | 1350 | Bru gold instant coffee | NA | 100% granulated coffee |
| **Filter coffee** | Bru green label filter coffee | NA | Bru green label filter coffee | NA | Bru green label filter coffee | 68 | Bru green label filter coffee | 160 | Bru instant coffee premix | 500 | 57/43 coffee |
| | | | | | | | | | | | |
| **Continental** | Continental special | 110 | Continental special | NA | Continental special | 470 | Continental special | 970 | Continental special | NA | Arabica and washed robusta beans |
| | Continental strong | 70 | Continental strong | NA | Continental strong | NA | Continental strong | NA | Continental strong | 549 | Arabica coffee beans |
| | Continental xtra | 90 | Continental xtra | NA | Continental xtra | 325 | Continental xtra | 650 | Continental xtra | NA | 70:30 coffee chicory |
| | Continental freeze dried | 150 | Continental freeze dried | 400 | Continental freeze dried | NA | Continental freeze dried | NA | Continental freeze dried | NA | 100% Premium freeze dried coffee |
| | | | | | Malgudi filter coffee | 100 | | | | | 80:20 coffee chicory |

*Source: Company; IDBI Capital Research; Note: Price in rupees*

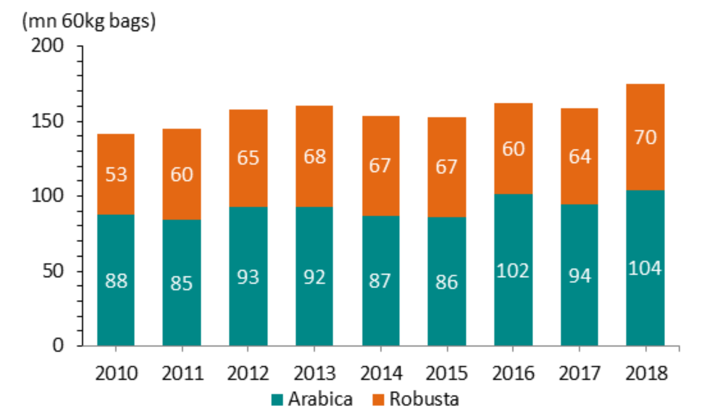
It is interesting to note that the company is not competing with the two established brands based only on pricing. Small sachets of *Continental* coffee are priced cheaper compared Nescafe which is considered a premium brand although they are slightly expensive compared to Bru. However, CCL's large packets (above 200 gms) are expensive compared to peers. CCL has also entered the filter coffee market with *Malgudi*.

## Industry overview

### Coffee plantation

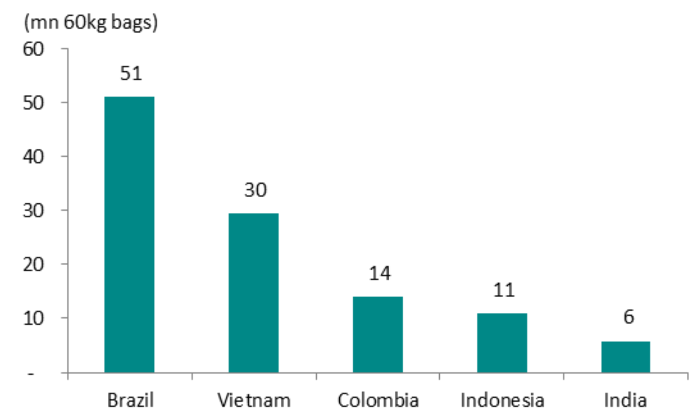
Coffee plant grows in tropical as well as sub-tropical climates. There are basically two types of coffee consumed: arabica and robusta. Arabica coffees have a delicate flavor and balanced aroma coupled with a sharp and sweet taste. Robusta coffee has strong taste, a grainy essence and an aftertaste of peanuts. Robusta have better yield and take less time to bear fruit than Arabica. The Arabica variety is preferred in international markets. Nearly 60% of world's coffee production is Arabica. Brazil and Vietnam are the two largest producers of raw (green) coffee in the world.

**Exhibit 16: World coffee production**




*Source: Bloomberg, IDBI Capital Research*

**Exhibit 17: Major coffee producing countries (CY18)**



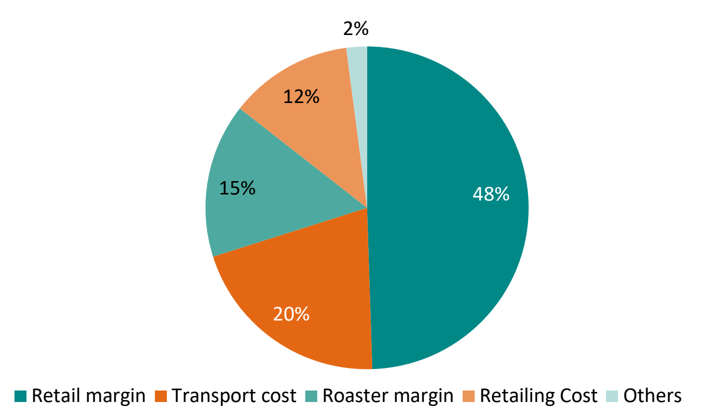

*Source: ICO, IDBI Capital Research*

### Instant coffee market to exhibit higher growth

According to Business Insider, coffee is the second most traded commodity in the entire world, with global industry size of ~$100 bn. Of this, instant coffee market is nearly $28bn. In terms of volumes, instant coffee market is nearly 850,000 tonnes. On an average, 500 bn cups of coffee are consumed on earth annually. Retailers enjoy significant portion of the margin in the whole value chain comprising of coffee growers, coffee processors and retailers.

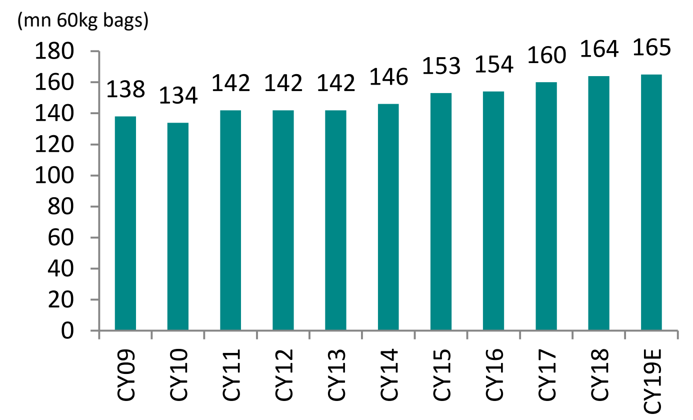
The major consumer demographics of this industry represent people ages 19 to 34, and a large reason for the expanding coffee market is due to rising demand from millennial. Also, it is noteworthy that instant coffee is gaining market share from roasted coffee. Hence, instant coffee market is likely to grow at a faster pace vs. overall coffee market. The instant coffee market is expected to grow at a CAGR of 4.8% over CY17-25.

**Exhibit 18: Coffee value chain**




*Source: UNCTAD; IDBI Capital Research*

**Exhibit 19: Coffee demand growth**

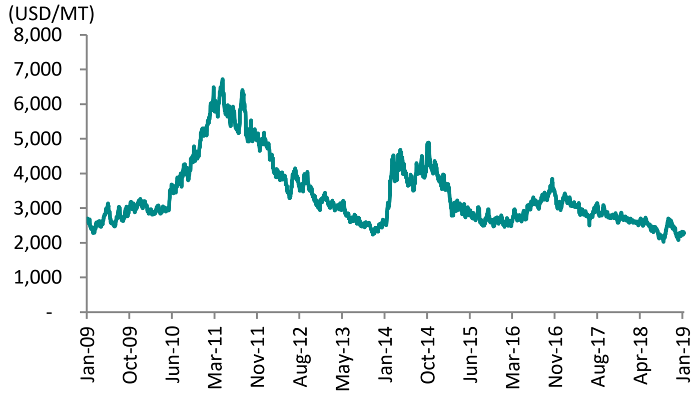



*Source: ICO; IDBI Capital Research*

## Coffee prices at multi-year lows

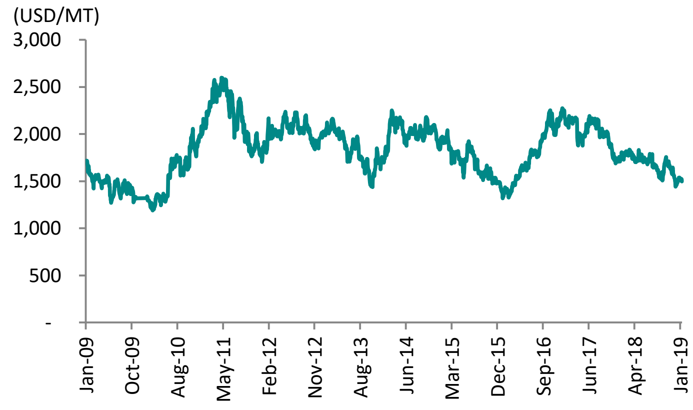
Weather situations in major coffee producing nations such as Brazil and Vietnam have a meaningful impact on coffee prices. Coffee prices were higher in FY11-12 as supplies were affected due to adverse weather conditions in Brazil and Vietnam. Since then, coffee prices have gradually fallen to decade lows due to bumper global coffee crop in the world. For 2018/19 season world coffee output is estimated 165 mn 60 kg bags, an increase of 1.5% over coffee year 2017/18.

**Exhibit 20: Arabica coffee prices**




*Source: Bloomberg, IDBI Capital Research*

**Exhibit 21: Robusta coffee prices**



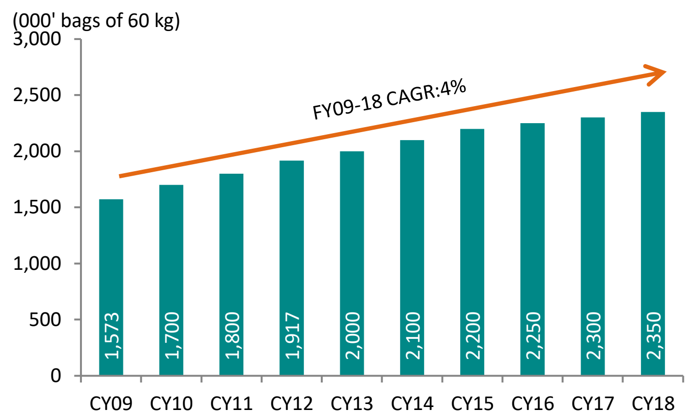

*Source: Bloomberg, IDBI Capital Research*

### Indian coffee market – huge potential

Over CY09-18, India's coffee consumption has grown at a CAGR of 4%. However, the instant coffee market in India is growing at a rate of more than 15% as per CCL Products. In India, southern region consumes more coffee than other regions. Higher disposable incomes and the growing number of young professionals are driving higher coffee consumption in India. Further, increased access to coffee machines in offices and institutions is leading to interest in coffee among consumers, which in turn is driving sales in households.

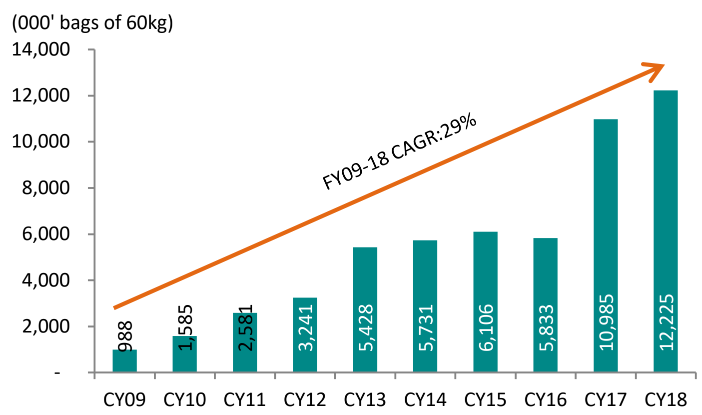
In China, coffee consumption picked up in CY17-18, although the growth trend has remained strong in the past decade. Rapid increase in coffee consumption in China particularly from 2005 to 2013 can be compared to a similar trend in Japan from the years 1964 to 1973. For Japan, it took 30-40 years total to become a recognizable coffee consumer and become the world's fourth largest coffee consumer.

**Exhibit 22: Coffee consumption in India**




*Source: ICO; IDBI Capital Research*

**Exhibit 23: Coffee market in China has exploded lately**

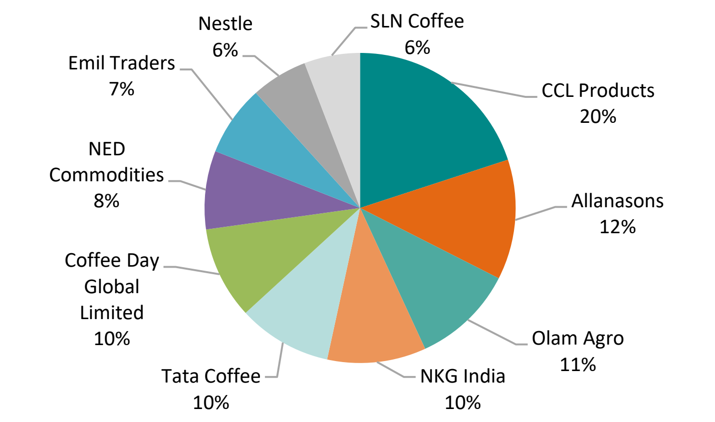



*Source: Bloomberg; IDBI Capital Research*

## Major Indian coffee exporters

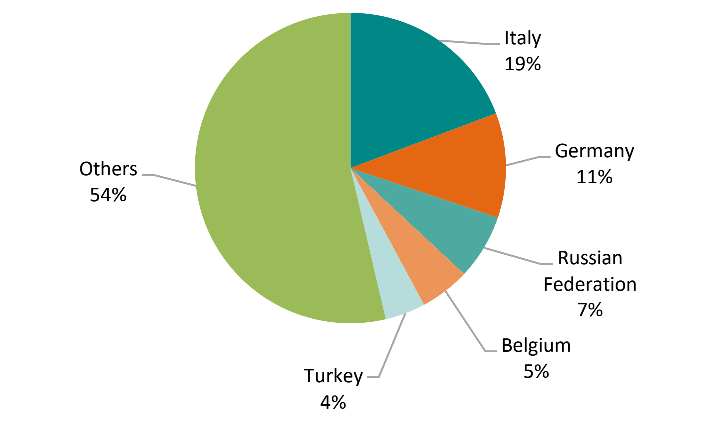
CCL is the biggest exporter of coffee from India. The other major coffee exporters are Allanasons , Coffee Day Global, Tata Coffee, etc. The major export destinations are Italy, Germany, Russia and Belgium.

**Exhibit 24: Top ten exporters of coffee (CY18)**




*Source: Coffee Board of India, IDBI Capital Research*

**Exhibit 25: Exports from India (CY18)**




*Source: Coffee Board of India, IDBI Capital Research*

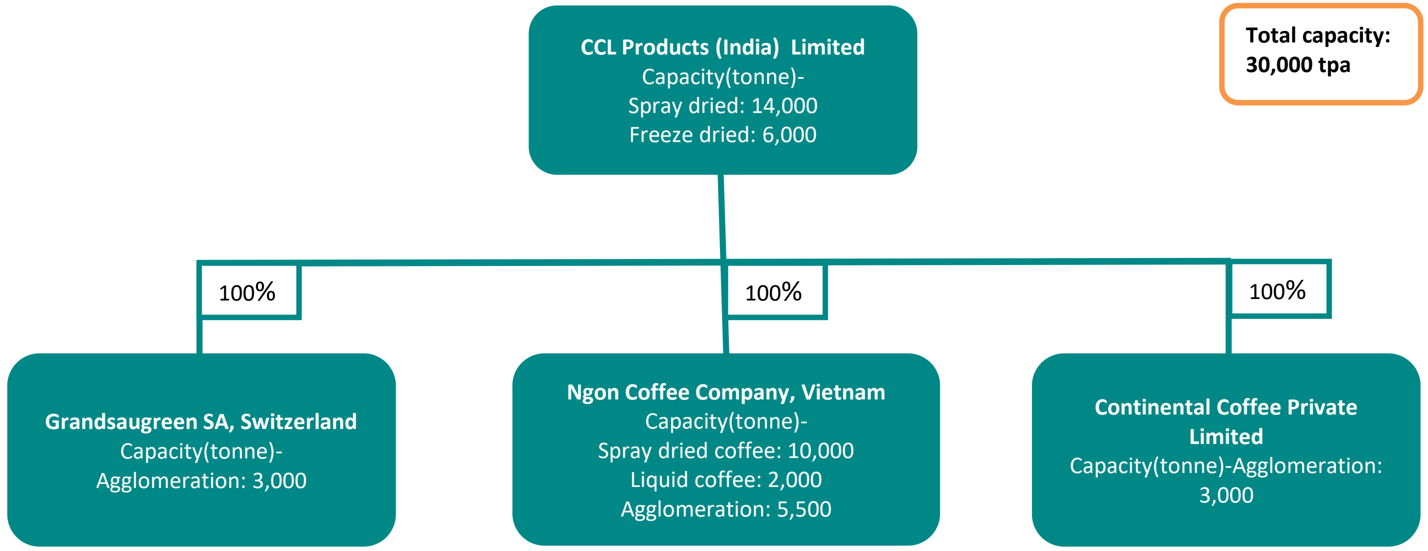
## About the Company

*CCL is one of the largest instant coffee producers in the world*

Incorporated in 1994, CCL is one of the largest instant coffee processing companies in the world. It manufactures varieties of coffee including spray dried coffee, freeze dried coffee, roasted and ground coffee. CCL's instant coffee manufacturing plant is located in Guntur District, Andhra Pradesh (capacity of 20,000 tpa). In 2013, it set up a coffee processing plant in Vietnam (current capacity 10,000 tpa).

CCL has adapted Swiss and Brazilian Technology, purchased from world renowned pioneers in turnkey Instant/ soluble coffee technology at its plant. This technology has enabled CCL Products to produce international quality soluble coffee, which is currently being exported to more than 80 countries. CCL also has a 3,000 tpa agglomeration unit in Switzerland.

## Company structure and capacities




*Source: Company; IDBI Capital Research* Agglomeration capacity is not included in calculation of total capacity*

# Corporate governance check

### Independent directors' representation on the board

Family owned businesses that have independent board members are frequently among the best managed funds and best governed. Independent Directors constituted 62% of CCL's Board of Directors in the last five years indicating higher role of professionals compared to the promoters.

**Exhibit 26: Representation of independent directors and promoters**

| | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 |
|---|---|---|---|---|---|---|
| Promoters group Directors | 6 | 6 | 6 | 6 | 6 | 6 |
| Independent Directors | 10 | 10 | 10 | 10 | 10 | 10 |
| **Total Directors** | **16** | **16** | **16** | **16** | **16** | **16** |
| *Share of promoter directors (%)* | *38* | *38* | *38* | *38* | *38* | *38* |
| *Share of independent directors (%)* | *62* | *62* | *62* | *62* | *62* | *62* |

*Source: Company; IDBI Capital Research*

**Exhibit 27: Independent directors' profile**

| Independent director's name | Profile |
|---|---|
| Mr. Vipin K. Singhal | Associated with travel and tourism industry for the last 3 decades |
| Mr. K. Chandrahas | Working as Insurance Ombudsman, Hyderabad having jurisdiction over Andhra Pradesh and Karnataka, with Governing Body of Insurance Council, Mumbai. |
| Mr. J. Rambabu | Member of Indian Administrative Services served at the Top Management levels of the Organizations and held various responsible positions in the Government of Andhra Pradesh and other PSU |
| Mr. K.K. Sharma | Played an active role in implementing and setting up an Instant Coffee Manufacturing Unit for Asian Coffee Ltd, in Andhra Pradesh. |
| Mr. GV. Krishna Rau | Member of Indian Administrative Services served at the Top Management levels of the Organizations and held various responsible positions in the Government of Karnataka and other PSU |
| Ms. Kulsoom Noor Saifullah | Established UCC India and was appointed as advisor and sole representative of the Donetsk Regional Administration |
| Mr. Lanka Krishnanand | Professor at NIT Warangal and has written several articles on Supply Chain Inventory Management |

*Source: Company data, IDBI Capital Research*

### Promoter group compensation analysis

CCL's promoters' compensation as a percentage of net profits was on the higher side during FY13-14. Nevertheless, over FY13-18, with rise in profits, the compensation of promoters as a percentage of net profits has declined from 12% to 8%.

**Exhibit 28: Promoters group compensation**

| | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 |
|---|---|---|---|---|---|---|
| Mr. Challa Rajendra Prasad | 37 | 54 | 57 | 63 | 77 | 74 |
| Mr. Challa Shrisant | 22 | 33 | 34 | 38 | 46 | 44 |
| **Total compensation** | **59** | **87** | **92** | **101** | **122** | **118** |
| *Total compensation as a percentage of net profit* | *12* | *13* | *10* | *8* | *9* | *8* |

*Source: Company data, IDBI Capital Research*

### Contingent liability

We do not find evidence to infer that there could be substantial liability in the future which could effectively lead to a change in the structure of the financials or emerge as a significant risk to CCL's net worth. We do not see any significant risk with respect to the materialization of CCL's liabilities. Also, the promoters have not pledged any their shares as of December 31, 2018.

**Exhibit 29: Contingent liability trend**

| (Rs in mn) | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 |
|---|---|---|---|---|---|---|
| Contingent liability | 253 | 58 | 58 | 288 | 288 | 288 |
| *Percentage of net worth* | *9* | *2* | *1* | *6* | *5* | *4* |

*Source: Company data, IDBI Capital Research*

### Related party transactions

We do not find significant related party transactions with the promoter group entities. The company pays rent to the promoter; however it is not material.

**Exhibit 30: Related party transactions (other than with subsidiary companies)**

| (Rs in mn) | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 |
|---|---|---|---|---|---|---|
| Rent | 3 | 3 | 3 | 4 | 4 | 5 |
| *Rent as a percentage of net profit* | *0.7* | *0.5* | *0.4* | *0.3* | *0.3* | *0.3* |

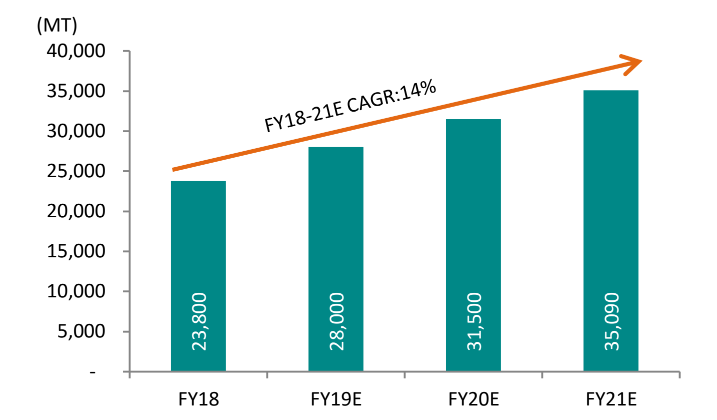
*Source: Company data, IDBI Capital Research*

## Financial forecast (FY18-21E)

- **Top line and EBITDA to see a CAGR growth of 17% and 16% respectively over FY18-21E**

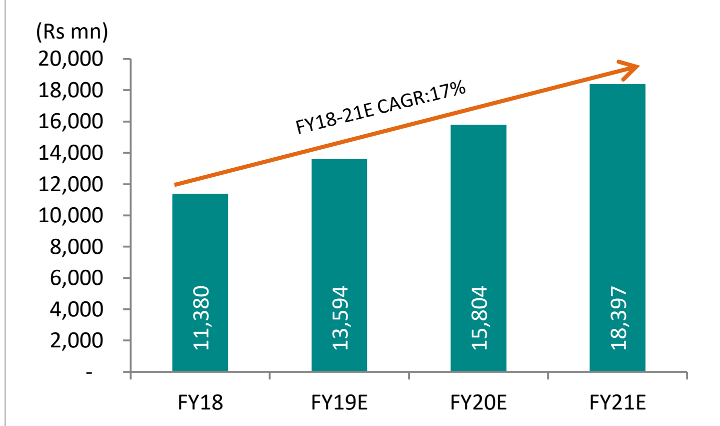
We expect net sales to grow at a CAGR of 17.4% over FY18-21E mainly driven by higher sales from newly set-up freeze dried plant in India and higher utilizations at Vietnam.

**Exhibit 31: Volume growth trend**




*Source: Company; IDBI Capital Research*

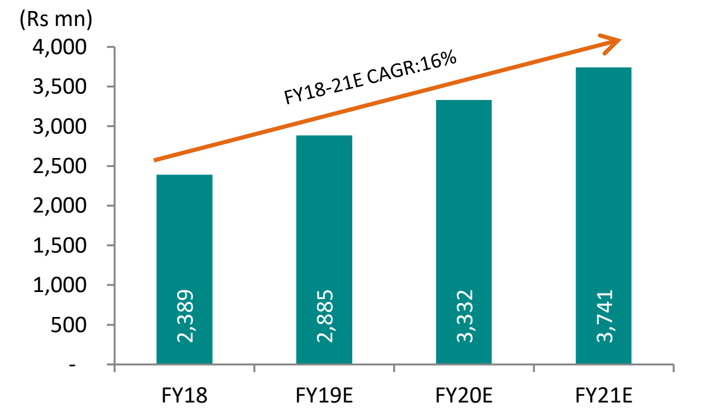
**Exhibit 32: Sales growth trend**




*Source: Company; IDBI Capital Research*

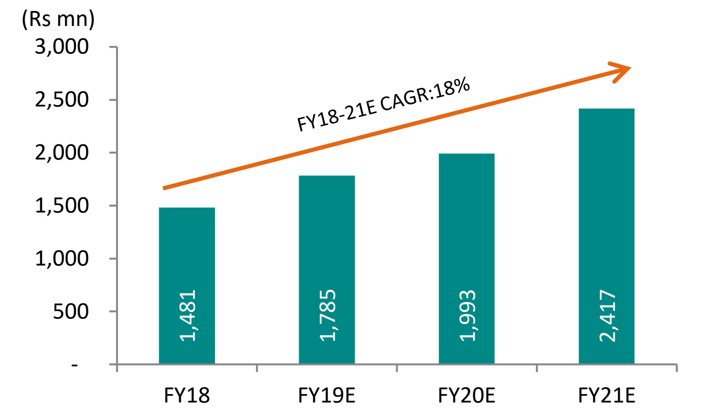
We expect EBITDA to grow at a CAGR of 16.1% in line with growth in sales. CCL's net profit is forecasted to grow at a CAGR of 17.7% over FY18-21E in line with growth in EBITDA.

**Exhibit 33: EBITDA growth trend**




*Source: Company; IDBI Capital Research*

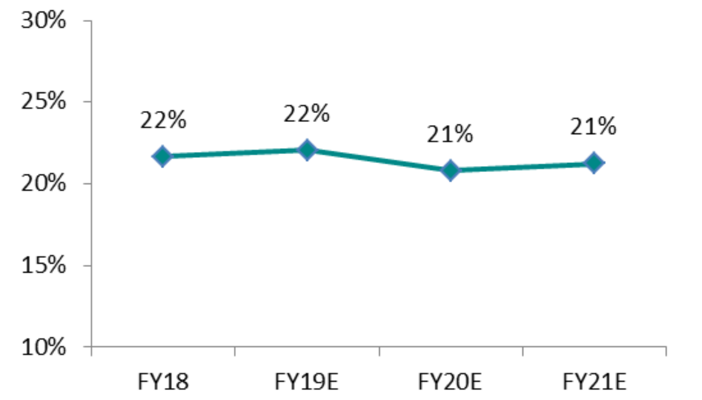
**Exhibit 34: Net profit growth trend**




*Source: Company; IDBI Capital Research*

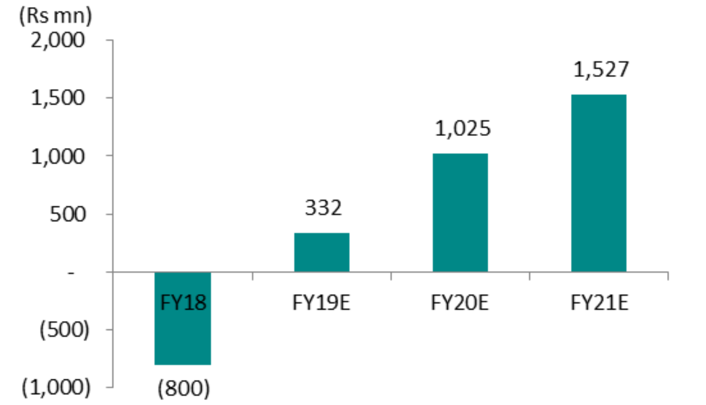
We expect company's ROE to remain stable (over 20%) over FY18-21E. CCL's free cash flows are expected to rise from FY20 as it ends its major capex in FY19.

**Exhibit 35: ROEs to remain stable over FY18-21E**




*Source: Company; IDBI Capital Research*

**Exhibit 36: FCFF to rise over FY20-21E**



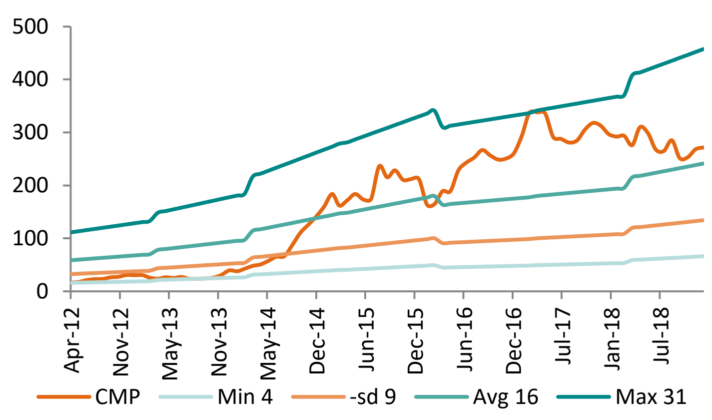

*Source: Company; IDBI Capital Research*

## Valuation and Outlook

- **Initiate coverage with a target price of Rs363**

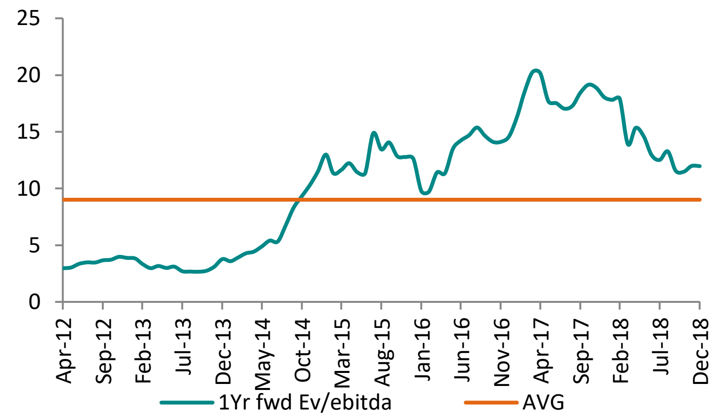
CCL has successfully scaled up its coffee processing capacity by nearly ~7x over the last 15 years. Over FY14-18, it's EBITDA/net profit has grown at a CAGR of 14%/26% without equity dilution alongside healthy return ratios. Looking ahead, we estimate CCL's EBITDA/net profit to grow at a CAGR of 16%/18% over FY18-21E. During FY20-21, we expect the company to generate free cash flows of ~Rs2,500 mn. We value the stock at a Price-to-earnings multiple of 20x (10% discount to its last five year average) on our FY21E EPS and derive a target price of Rs363.

**Exhibit 37: One year forward P/E**




*Source: Bloomberg; IDBI Capital Research*

**Exhibit 38: One year forward EV/EBITDA**




*Source: Bloomberg; IDBI Capital Research*

## Key risks

- **Lower than expected volumes:** We expect CCL to commence its new freeze dried plant in Q1FY20. Delays in commercial production from the plant could pose a downside risk to our FY20/FY21 volume estimates.
- **Cut in export incentives:** CCL receives export incentives (7% of FOB value) on export sales from India. We expect these incentives to continue in the coming years. In case these export incentives are lowered, we expect CCL to raise prices. However, there could be some impact on its margins as it may not be able to raise prices adequately to pass on the impact of lower incentives.

# Financial Summary

## Profit & Loss Account (Rs mn)

| Year-end: March | FY 2018 | FY 2019E | FY 2020E | FY 2021E |
|---|---|---|---|---|
| **Net sales** | **11,380** | **13,594** | **15,804** | **18,397** |
| *Growth (%)* | *15.7* | *19.5* | *16.3* | *16.4* |
| Operating expenses | (8,991) | (10,709) | (12,472) | (14,656) |
| **EBITDA** | **2,437** | **2,927** | **3,380** | **3,793** |
| *Growth (%)* | *4.5* | *20.1* | *15.4* | *12.2* |
| Depreciation | (341) | (358) | (508) | (513) |
| **EBIT** | **2,097** | **2,569** | **2,872** | **3,279** |
| Interest paid | (78) | (117) | (197) | (137) |
| Other income | - | - | - | - |
| **Pre-tax profit** | **2,018** | **2,452** | **2,675** | **3,143** |
| Tax | (537) | (667) | (682) | (725) |
| *Effective tax rate (%)* | *26.6* | *27.2* | *25.5* | *23.1* |
| **Net profit** | **1,481** | **1,785** | **1,993** | **2,417** |
| **Adjusted net profit** | **1,481** | **1,785** | **1,993** | **2,417** |
| *Growth (%)* | *10.1* | *20.5* | *11.6* | *21.3* |
| *Shares o/s (mn)* | *133* | *133* | *133* | *133* |

## Cash Flow Statement (Rs mn)

| Year-end: March | FY 2018 | FY 2019E | FY 2020E | FY 2021E |
|---|---|---|---|---|
| Pre-tax profit | 2,018 | 2,452 | 2,675 | 3,143 |
| Depreciation | 344 | 358 | 508 | 513 |
| Tax paid | (528) | (667) | (682) | (725) |
| Chg in working capital | (68) | (621) | (620) | (727) |
| Other operating activities | (773) | (233) | (247) | (303) |
| **Cash flow from operations (a)** | **994** | **1,289** | **1,634** | **1,901** |
| Capital expenditure | (2,393) | (1,100) | (840) | (568) |
| Chg in investments | - | - | - | - |
| Other investing activities | - | - | - | - |
| **Cash flow from investing (b)** | **(2,393)** | **(1,100)** | **(840)** | **(568)** |
| Equity raised/(repaid) | - | - | - | - |
| Debt raised/(repaid) | 1,792 | 300 | (500) | (1,000) |
| Dividend (incl. tax) | (119) | (333) | (399) | (532) |
| Chg in minorities | - | - | - | - |
| Other financing activities | - | - | - | - |
| **Cash flow from financing (c)** | **1,673** | **(33)** | **(899)** | **(1,532)** |
| **Net chg in cash (a+b+c)** | **274** | **156** | **(105)** | **(199)** |

## Balance Sheet

(Rs mn)

| Year-end: March | FY 2018 | FY 2019E | FY 2020E | FY 2021E |
|---|---|---|---|---|
| Net fixed assets | 6,392 | 7,134 | 7,466 | 7,521 |
| Investments | - | - | - | - |
| Other non-curr assets | - | - | - | - |
| **Current assets** | **4,944** | **5,976** | **6,745** | **7,572** |
| Inventories | 1,832 | 2,188 | 2,544 | 2,961 |
| Sundry Debtors | 1,820 | 2,174 | 2,528 | 2,943 |
| Cash and Bank | 442 | 598 | 493 | 294 |
| Loans and advances | - | - | - | - |
| **Total assets** | **11,336** | **13,110** | **14,211** | **15,092** |
| | | | | |
| **Shareholders' funds** | **7,399** | **8,784** | **10,295** | **12,072** |
| Share capital | 266 | 266 | 266 | 266 |
| Reserves & surplus | 7,133 | 8,518 | 10,029 | 11,806 |
| **Total Debt** | **1,817** | **2,117** | **1,617** | **617** |
| Secured loans | 1,817 | 2,117 | 1,617 | 617 |
| Unsecured loans | - | - | - | - |
| Other liabilities | 392 | 392 | 392 | 392 |
| **Curr Liab & prov** | **1,727** | **1,817** | **1,906** | **2,011** |
| Current liabilities | 1,727 | 1,817 | 1,906 | 2,011 |
| Provisions | - | - | - | - |
| **Total liabilities** | **3,936** | **4,326** | **3,915** | **3,020** |
| **Total equity & liabilities** | **11,336** | **13,110** | **14,211** | **15,092** |
| **Book Value (Rs)** | **56** | **66** | **77** | **91** |

*Source: Company; IDBI Capital Research*

## Financial Ratios

| Year-end: March | FY 2018 | FY 2019E | FY 2020E | FY 2021E |
|---|---|---|---|---|
| Adj. EPS (Rs) | 11.1 | 13.4 | 15.0 | 18.2 |
| *Adj. EPS growth (%)* | *10.1* | *20.5* | *11.6* | *21.3* |
| *EBITDA margin (%)* | *21.4* | *21.5* | *21.4* | *20.6* |
| *Pre-tax margin (%)* | *17.7* | *18.0* | *16.9* | *17.1* |
| *ROE (%)* | *21.7* | *22.1* | *20.8* | *21.2* |
| *ROCE (%)* | *25.7* | *24.6* | *24.3* | *25.4* |
| **Turnover & Leverage ratios (x)** | | | | |
| Asset turnover (x) | 1.1 | 1.1 | 1.2 | 1.2 |
| Leverage factor (x) | 1.4 | 1.5 | 1.4 | 1.3 |
| *Net margin (%)* | *13.0* | *13.1* | *12.6* | *13.1* |
| Net Debt/Equity (x) | 0.2 | 0.2 | 0.1 | 0.0 |
| **Working Capital & Liquidity ratio** | | | | |
| Inventory days | 59 | 59 | 59 | 59 |
| Receivable days | 58 | 58 | 58 | 58 |
| Payable days | 4 | 4 | 4 | 4 |

## Valuation

| Year-end: March | FY 2018 | FY 2019E | FY 2020E | FY 2021E |
|---|---|---|---|---|
| P/E (x) | 25.8 | 21.4 | 19.2 | 15.8 |
| Price / Book value (x) | 5.2 | 4.3 | 3.7 | 3.2 |
| PCE (x) | 21.0 | 17.8 | 15.3 | 13.0 |
| EV / Net sales (x) | 3.5 | 2.9 | 2.5 | 2.1 |
| EV / EBITDA (x) | 16.2 | 13.6 | 11.6 | 10.2 |
| *Dividend Yield (%)* | *1.0* | *0.9* | *1.0* | *1.4* |

# Notes

| | | |
|---|---|---|
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**Key to Ratings Stocks:**

**BUY:** Absolute return of 15% and above; **ACCUMULATE:** 5% to 15%; **HOLD:** Upto ±5%; **REDUCE:** -5% to -15%; **SELL:** -15% and below.

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