India Midcaps

RESULT UPDATE

CCL PRODUCTS INDIA

Focus on volumes; margins to take a hit

India Equity Research| Miscellaneous

Edelweiss
Ideas create, values protect

CCL Products India's (CCL) Q1FY18 results came below our estimates, both on top-line/bottom-line fronts. This was mainly due to high base and as CCL focused on strategy of increasing volumes by compromising on margins to gain new customers. Further, supply of agglomerated coffee from India to Vietnam impacted profitability as seen in Q4FY17. Led by the strategy change, the company has revised upwards its volume growth guidance to 15-20% for FY18, while maintaining bottom-line growth at 10-15%. CCL's agglomerated coffee capacity is expected to commission in Q2FY18 post which margins should improve. However, focus on volumes will lead to lower blended margins versus last year. Factoring in the above, we have lowered our FY17/18E EPS by 7%/2%. However, we maintain 'BUY' with revised TP of INR291 (INR296 earlier), based on 20x FY19E EPS. Higher contribution from value-added segment and timely commissioning of agglomerated capacity is key in near term.

Q1FY18: Key highlights

(1) Subsidiary revenues fell 13% YoY while gross margins dipped by 1,050bps YoY as CCL supplied Vietnam's customer requirement from Indian market; (2) Standalone revenues grew by mere 3% YoY mainly on account of high base; (3) Standalone margin dipped by ~400bps as the company changed its focus to higher volume growth with low margins; (4) Management has revised its volume growth guidance upwards to 15-20% versus 10% in last quarter while maintaining bottom-line growth guidance at 10-15% mainly as CCL will now concentrate on volumes to acquire new customers.

Disappointed at both top line and bottom-line

Consolidated revenues declined 2% YoY due to fall in subsidiary revenues by 13%, while standalone sales grew by only 3% due to high base. EBITDA margin fell by 630bps YoY and 300bps QoQ, mainly due sharp fall in gross margins by 580bps YoY and 230bps QoQ. Owing to lower operating profitability, PAT fell by 28% YoY to INR270mn.

Outlook and valuations: Focus shifts to volumes; maintain 'BUY'

We believe a resilient business model, rising utilisation rate, increasing focus on market share and capacity expansion in value-added segment places CCL in a sweet spot to post sales /PAT CAGR of 17%/20% over FY17-19E. Thus, despite lowering our FY18/19 estimates, we maintain **'BUY'** with TP of INR291 (20x FY19E EPS).

Financials (INR mn)

Year to March	Q1FY18	Q1FY17	*% Chg*	Q4FY17	*% Chg*	FY17	FY18E	FY19E
Net revenues	2,454	2,506	(2.1)	2,970	(17.4)	9,765	11,538	13,424
EBITDA	457	624	(26.8)	642	(28.8)	2,320	2,548	3,136
Adjusted Profit	270	403	(32.9)	354	(23.6)	1,343	1,525	1,936
Adjusted Diluted EPS	2.0	3.0	(32.9)	2.7	(23.6)	10.1	11.5	14.6
Diluted P/E (x)						27.9	24.6	19.4
EV/EBITDA (x)						16.5	15.2	12.2
ROAE (%)						23.4	22.1	24.0

EDELWEISS RATINGS

Absolute Rating	**BUY**
Investment Characteristics	Growth

MARKET DATA *(R: CCLP.BO, B: CCLP IN)*

CMP	INR 279
Target Price	INR 291
52-week range (INR)	372 / 229
Share in issue (mn)	133.0
M cap (INR bn/USD mn)	37 / 575
Avg. Daily Vol. BSE/NSE ('000)	117.6

SHARE HOLDING PATTERN (%)

	Current	Q2FY17	Q1FY17
Promoters *	44.8	44.8	44.7
MF's, FI's & BKs	5.1	3.6	2.5
FII's	22.2	23.0	22.5
Others	27.9	28.6	30.3

* *Promoters pledged shares (% of share in issue)* : *NIL*

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	1.9	(1.1)	(3.1)
3 months	5.1	(18.2)	(23.3)
12 months	24.5	12.5	(12.0)

Rohan Gupta
+91 22 4040 7416
rohan.gupta@edelweissfin.com

Sneha Talreja
+91 22 4040 7417
sneha.talreja@edelweissfin.com

July 12, 2017

Q1FY18 conference call: Key highlights

1. **Revenue guidance:** Management has revised top line guidance upwards to 15-20% versus earlier revenue guidance of 10% for FY18. The growth in volumes will be led by:
   - Focus on higher capacity utilisation. Company has scope to increase sale from spray dried capacity (currently booked 65-70%).
   - Commissioning of aglomarated capacity at Vietnam in Q2FY18 will free-up Indian capacity and lead to higher volumes from both India and Vietnam.
   - Further, growth in FY19 will be supported by commissioning of the 5,000MT freeze dried coffee plant at the Andhra Pradesh SEZ by Q2FY19. Company is targetting 50% utilisation in first year of operation and is expects utilisation rate to reach 80% in next 3 years.
2. **Margin guidance:** Despite upward revision in revenues, company has maintained bottom-line guidance of 10-15%. This is mainly because of its new strategy that will lead to higher focus on volume growth while compromising on margins mainly for acquisition of newer customers. Further, in near term margins will remain impacted because of supply of agglomerated capacity from India to Vietnam. However, margins should improve in FY19, led by commissioning of high-margin freeze dried capacity in FY19 and supply of agglomerated capacity from Vietnam.
3. **Standalone revenues:** Standalone sales increased by mere 3% YoY to INR1.78bn mainly because of high base. In Q1FY17, CCL had reported exceptional revenues as some volumes of Q2FY17 were pre-booked in Q1 FY17. This is mainly because company had planned annual shutdown during Q2FY17. Further, 1-2% of revenues were impacted because of GST that led to deferment of orders.
4. **Subsidiary revenues**: Revenues declined by 13% YoY to INR0.67bn as company continued to supply its Vietnam based customer from Indian company. This order was for agglomerated coffee which is currently not manufactured in Vietnam and was thus supplied from India. Agglomerated capacity in Vietnam is expected to commission in Q2FY17 post which volume growth should again see pick-up.
5. **Margin analysis:** Gross margins dipped by 580bps YoY and 230bps QoQ. This also led to the fall in EBITDA margin to 18.6% versus 24.9% in Q1FY17 and 21.6% in Q4FY17. The sharp fall in margins was on account of:
   - Supply of agglomerated coffee from India to Vietnam based customer, which led to sharp fall in gross margin.
   - Focus on volume growth, which led to higher sales from spray dried capacity which fetches lower margins than freeze dried capacity. CCL's freeze dried capacity is working at optimum levels and is already booked 100% for the current year. However, since spray dried capacity was booked for 65-70%, company decided to sell low-margin base spray dried products to acquire new customers which led to fall in blended margins. However, for existing customer base margins continued to remain at similar level as quantities were booked well in advance.
   - Higher spend on branding (company has decided to invest INR300mn on brand building in M/s Continental Coffee Private Limited over next 3 years (CY17-19).

6. **Volume:** For Q1FY18, volume declined 4-5% YoY mainly because of high base of last year. Further, 1-2% growth was also impacted due to GST implementation.

7. **US markets**: Current government is planning to impose 10% border tax for imports from Mexico. This will severely impact imports from Mexico and could lead to a greater opportunity for exporters from India like for CCL. If this scenario pans out, company could clock much higher top line and bottom-line growth than currently expected.

8. **Branded business**: CCL has appointed Mr Praveen Jaipuriar as the Chief Executive Officer (CEO) of M/s. Continental Coffee Private Limited. His last designation was Head of Marketing of Home & Personal Care division in Dabur India and at CCL he is taking charge of the India Retail business. During FY17, had clocked revenues of INR500mn in branded sales business and company is targeting INR850-1000mn revenues from this business in FY18. Of this, INR350mn will be contributed by B2C segment (FY17 revenues of B2C business was INR120mn). To focus on this business, the company has decided to invest INR300mn on brand building in the M/s Continental Coffee Private Limited, a wholly-owned subsidy of CCL Products Limited which will focus on the marketing under the *Continental* brand. This investment shall be done over next 3 years (CY17-19).

9. **Switzerland plant:** The company has appointed a local person to look into the prospects of selling coffee in Switzerland. This business has grown led by restructing activities during the quarter. CCl is targetting break-even in this geography in current year.

Financial snapshot **(INR mn)**

Year to March	Q1FY18	Q1FY17	% change	Q4FY17	% change	FY17	FY18E	FY19E
Net revenues	2,454	2,506	*(2.1)*	2,970	*(17.4)*	9,765	11,538	13,424
Raw material	1,538	1,425	*7.9*	1,793	*(14.2)*	5,519	6,747	7,690
Staff costs	100	87	*16.1*	106	*(5.4)*	404	466	539
Other expenses	359	370	*(3.2)*	429	*(16.3)*	1,521	1,776	2,059
Total expenditure	1,997	1,882	*6.1*	2,328	*(14.2)*	7,445	8,990	10,288
EBITDA	457	624	*(26.8)*	642	*(28.8)*	2,320	2,548	3,136
Depreciation	83	84	*(1.0)*	76	*9.0*	333	381	444
EBIT	374	540	*(30.8)*	565	*(33.9)*	1,988	2,168	2,692
Other income	26	4	*519.5*	3	*867.1*	12	24	49
Interest	18	29	*(38.8)*	37	*(51.8)*	112	159	159
Add: Exceptional items								
Profit before tax	382	515	*(25.9)*	531	*(28.2)*	1,888	2,033	2,582
Provision for taxes	111	112	*(0.7)*	178	*(37.3)*	545	508	645
Minority interest								
Associate profit share								
Profit- Discontinued Ops								
Reported net profit	270	403	*(32.9)*	354	*(23.6)*	1,343	1,525	1,936
Adjusted Profit	270	403	*(32.9)*	354	*(23.6)*	1,343	1,525	1,936
Diluted shares (mn)	133	133		133		133	133	133
Adjusted Diluted EPS	2.0	3.0	*(32.9)*	2.7	*(23.6)*	10.1	11.5	14.6
Diluted P/E (x)	-	-		-		27.9	24.6	19.4
EV/EBITDA (x)	-	-		-		16.5	15.2	12.2
ROAE (%)	-	-		-		23.4	22.1	24.0
As % of net revenues								
Raw material	62.7	56.9		60.4		56.5	58.5	57.3
Employee cost	4.1	3.5		3.6		4.1	4.0	4.0
Other expenses	14.6	14.8		14.4		15.6	15.4	15.3
EBITDA	18.6	24.9		21.6		23.8	22.1	23.4
Reported net profit	11.0	16.1		11.9		13.8	13.2	14.4

Change in Estimates

	FY18E			FY19E			
	New	Old	% change	New	Old	% change	Comments
Net Revenue	11,538	10,942	*5.4*	13,424	12,464	*7.7*	Led by change in strategy as CCL will focus on higher volumes in order to gain market share
EBITDA	2,548	2,712	*(6.0)*	3,136	3,176	*(1.3)*	
EBITDA Margin	*22.1*	*24.8*		*23.4*	*25.5*		Higher volumes will be supported by compromising on margins
Adjusted Profit After Tax	1,525	1,648	*(7.5)*	1,936	1,966	*(1.5)*	
Net Profit Margin	*13.2*	*15.1*		*14.4*	*15.8*		
Capex	2,000	2,000	*0.0*	800	800	*0.0*	

Company Description

CCL was formed set up in 1994 and commenced commercial operations in 1995. It is a profit making, export oriented unit (EoU) with the ability to import green coffee into India from any part of the world and export the same to any part of the world, free of all duties.

The company is in a position to offer a range of in-house products to customers. Its state-of-the-art soluble instant coffee manufacturing plant is located at Duggirala Mandal, Guntur District, Andhra Pradesh, with current combined capacity of 15000MT/PA. CCL has adapted Brazilian technology, purchased from world renowned pioneers in turnkey instant/soluble coffee technology at its plant. This adaptation of technology has enabled CCL to produce international quality soluble coffee. To cater to specific markets, the company has expanded capacity in Switzerland and Vietnam during FY11 and FY14, respectively.

CCL‘s 3,000MT plant in Switzerland is facing issues on account of unfavorable European Union regulations. This has so far acted as a roadblock for growth and profitability of Swiss operations. Management is exploring options to turn the plant profitable. In FY17, the Swiss operations made an EBITDA loss of INR5.4mn.

Investment Theme

CCL Products (CCL) is India’s largest manufacturer and exporter of instant coffee. The company’s cost-efficient business model, rich experience and long-standing relationships with customers give it an edge over competitors. Coffee processing is a challenging business wherein getting the perfect blend is crucial, which the company has successfully mastered. The Vietnam facility with proximity to raw material and customers as well as tax benefits is expected to propel growth and lead to significant cost savings. Moreover, the company’s entry in the domestic branded coffee segment via Continental is bound to aid margin expansion. Resilient business model, capacity augmentation in Vietnam and sharpening brand focus in India place CCL in a sweet spot to post sales and PAT CAGR of 17% and 20% over FY17-19E, respectively. We estimate RoE to improve from 23% in FY17 to 24% in FY19E.

Key Risks

Sharp currency movement. However, it imports ~75% of raw material, which provides natural hedge.

Change in duty structure: Unfavourable change in duty rates in any country could impact the competitiveness of supply from Vietnam/India.

Swiss plant duty issue: CCL’s Swiss plant is operating at sub-optimal utilisation level because of non-competitive pricing of supplies from Switzerland to the EU. Import duty levied by the EU on Swiss coffee is 9.0%, whereas only 3.3% is charged on coffee supplies from India. However, CCL has taken steps to avoid the adverse duty impact.

Ramp up of Continental brand: FY14 was the first year of Continental brand and adverse customer response could impact the growth prospects as well as financials.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.8	5.0	5.2
Repo rate (exit rate)	6.8	6.3	6.3	6.3
USD/INR (Avg)	65.0	67.5	67.0	67.0
Company				
Capex (INR mn)	522	94	2,000	800
Debtor days	50	61	50	50
Inventory days	99	121	105	105
Payable days	8	8	15	15

Income statement **(INR mn)**

Year to March	FY16	FY17	FY18E	FY19E
Net revenue	9,321	9,765	11,538	13,424
Materials costs	5,475	5,519	6,747	7,690
Gross profit	3,847	4,246	4,791	5,733
Employee costs	331	404	466	539
Other Expenses	1,468	1,521	1,776	2,059
Operating expenses	1,799	1,925	2,243	2,598
Total operating expenses	7,274	7,445	8,990	10,288
EBITDA	2,047	2,320	2,548	3,136
Depreciation	284	333	381	444
EBIT	1,763	1,988	2,168	2,692
Add: Other income	12.25	12.25	24.49	48.99
Less: Interest Expense	108	112	159	159
Profit Before Tax	1,668	1,888	2,033	2,582
Less: Provision for Tax	446	545	508	645
Reported Profit	1,221	1,343	1,525	1,936
Adjusted Profit	1,221	1,343	1,525	1,936
Shares o /s (mn)	133	133	133	133
Adjusted Basic EPS	9.2	10.1	11.5	14.6
Diluted shares o/s (mn)	133	133	133	133
Adjusted Diluted EPS	9.2	10.1	11.5	14.5
Adjusted Cash EPS	11.6	12.8	14.3	17.9
Dividend per share (DPS)	2.5	2.5	3.0	4.0
Dividend Payout Ratio(%)	32.8	29.8	31.5	33.1

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	19.3	19.7	19.4	19.4
Gross margin	41.3	43.5	41.5	42.7
Interest Expense	1.2	1.1	1.4	1.2
EBITDA margins	22.0	23.8	22.1	23.4
EBIT margins	18.9	20.4	18.8	20.1
Net Profit margins	13.1	13.8	13.2	14.4

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	5.9	4.8	18.2	16.3
EBITDA	19.6	13.3	9.8	23.1
PBT	24.6	13.2	7.7	27.0
Adjusted Profit	29.9	10.0	13.5	27.0
EPS	29.9	10.0	13.5	27.0

Balance sheet				(INR mn)
As on 31st March	**FY16**	**FY17**	**FY18E**	**FY19E**
Share capital	266	266	266	266
Reserves & Surplus	4,832	6,097	7,140	8,435
Shareholders' funds	5,098	6,363	7,406	8,701
Short term borrowings	1,660	987	1,987	1,987
Long term borrowings	443	26	-	-
Total Borrowings	2,103	1,013	1,987	1,987
Def. Tax Liability (net)	285	308	308	308
Sources of funds	**7,486**	**7,683**	**9,701**	**10,996**
Gross Block	6,364	6,457	8,457	9,257
Net Block	4,172	3,932	5,551	5,907
Capital work in progress	-	2	2	2
Intangible Assets	1	1	1	1
Total Fixed Assets	4,173	3,934	5,554	5,910
Non current investments	15	15	15	15
Cash and Equivalents	187	165	653	1,131
Inventories	1,486	1,828	1,941	2,212
Sundry Debtors	1,281	1,632	1,581	1,839
Loans & Advances	864	907	998	1,097
Other Current Assets	7	5	5	5
Current Assets (ex cash)	3,638	4,372	4,524	5,153
Trade payable	121	122	277	316
Other Current Liab	406	681	768	897
Total Current Liab	527	804	1,045	1,214
Net Curr Assets-ex cash	3,111	3,568	3,479	3,940
Uses of funds	**7,486**	**7,683**	**9,701**	**10,996**
BVPS (INR)	38.3	47.8	55.7	65.4

Free cash flow				(INR mn)
Year to March	**FY16**	**FY17**	**FY18E**	**FY19E**
Reported Profit	1,221	1,343	1,525	1,936
Add: Depreciation	284	333	381	444
Interest (Net of Tax)	72	75	107	107
Others	(50)	(26)	(107)	(107)
Less: Changes in WC	(83)	674	(89)	461
Operating cash flow	1,610	1,050	1,995	1,920
Less: Capex	539	183	2,000	800
Free Cash Flow	**1,070**	**868**	**(5)**	**1,120**

Cash flow metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating cash flow	1,610	1,050	1,995	1,920
Investing cash flow	(870)	(197)	(2,000)	(800)
Financing cash flow	(820)	(874)	493	(641)
Net cash Flow	(80)	(21)	488	478
Capex	(539)	(183)	(2,000)	(800)
Dividend paid	(399)	(133)	(400)	(533)

Profitability and efficiency ratios

Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	26.2	23.4	22.1	24.0
ROACE (%)	25.9	27.4	26.1	27.3
ROA	17.2	17.7	17.5	18.7
Inventory Days	107	110	102	99
Debtors Days	47	54	51	46
Payable Days	19	8	11	14
Cash Conversion Cycle	136	156	142	131
Current Ratio	7.3	5.6	5.0	5.2
Gross Debt/EBITDA	1.0	0.4	0.8	0.6
Gross Debt/Equity	0.4	0.2	0.3	0.2
Adjusted Debt/Equity	0.4	0.2	0.3	0.2
Interest Coverage Ratio	16.3	17.8	13.6	16.9
LT debt /Cap empl. (%)	28.1	13.2	20.5	18.1
Debt / Cap employed (%)	38.9	27.6	34.4	31.9

Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	1.3	1.3	1.3	1.3
Fixed Asset Turnover	2.5	2.4	2.4	2.3
Equity Turnover	2.0	1.7	1.7	1.7

Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	9.2	10.1	11.5	14.5
Y-o-Y growth (%)	*29.9*	*10.0*	*13.5*	*27.0*
Adjusted Cash EPS (INR)	11.6	12.8	14.3	17.9
Diluted P/E (x)	30.4	27.6	24.4	19.2
P/B (x)	7.3	5.8	5.0	4.3
EV / Sales (x)	4.2	3.9	3.4	2.9
EV / EBITDA (x)	19.1	16.4	15.1	12.1
Dividend Yield (%)	0.9	0.9	1.1	1.4

Additional Data

Directors Data

Challa Rajendra Prasad	Chairman	Challa Srishant	Managing Director
I J Rao	Director	K Chandrahas	Director
Vipin K Singhal	Director	K K Sarma	Director
B Mohan Krishna	Director	J. Rambabu IAS	Director
G.V. Krishna Rau	Director	Ms. Shantha Prasad Challa	Director
Ms. Kulsoom Noor Saifullah	Director	Dr. Lanka Krishnanand	Director

Auditors - M.Anandam

**as per last available data*

Holding Top -10

	Perc. Holding		Perc. Holding
Capital Research Global Investor	8.00	Canara Robeco Asset Management	1.18
FIAM Group Trust	3.96	Schroder Investment Management	1.05
Malabar India Fund	1.43	Dimesnional Fund Advisor	0.82
Value Quest Moat Fund	1.41	GMO	0.78
Fund India Whizdom	1.29	DNB Asset Management	0.63

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
13 Dec 2016	Chandrahas Kata	Buy	15185.00
09 Dec 2016	Challa Rajendra Prasad	Buy	38308.00
26 Jul 2016	SMALLCAP World Fund Inc	Buy	2668138.00

**as per last available data*

Edelweiss Securities Limited, Edelweiss House, off C.S.T. Road, Kalina, Mumbai – 400 098.
Board: (91-22) 4009 4400, Email: *research@edelweissfin.com*

Aditya Narain
Head of Research
aditya.narain@edelweissfin.com

ADITYA NARAIN

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Coverage group(s) of stocks by primary analyst(s): Miscellaneous

AIA Engineering, Apar Industries Ltd, Aarti Industries, Agro Tech Foods, Balkrishna Industries, CCL Products India, Essel Propack, Orient Refractories, Supreme Industries, Solar Industries, SRF, Vesuvius India, VIP Industries

Recent Research

Date	Company	Title	Price (INR)	Recos
21-Jun-17	**Vesuvius India**	Robust exports spur stellar show; *Result Update*	1,232	Buy
15-Jun-17	**Aarti Industries**	Multi-year deal bolsters visibility; *Event Update*	938	Buy
05-Jun-17	**Orient Refractories**	DeMon impacts; strong capex ahead; *Result Update*	137	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

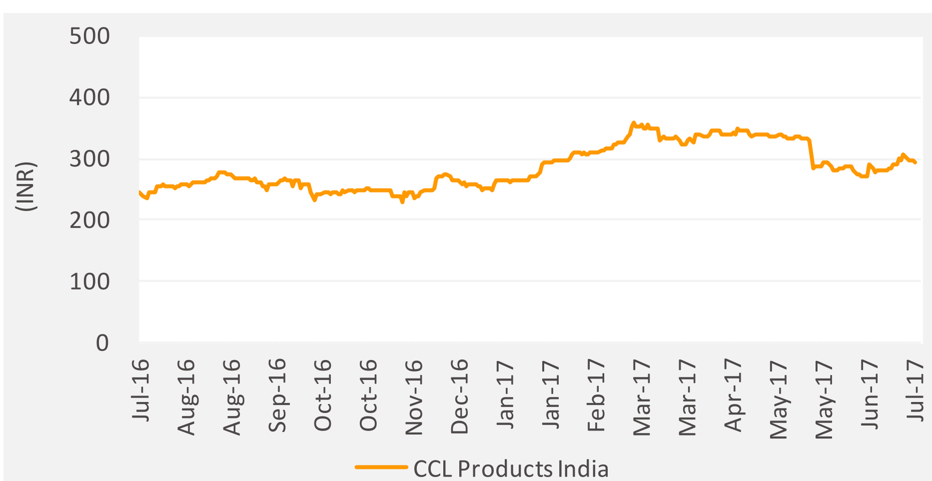
	Buy	Hold	Reduce	Total
Rating Distribution* * 1stocks under review	161	67	11	240

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	156	62	11

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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