ANANDRATHI

India I Equities

Consumer

Company Update

Change in Estimates ☑ Target ☑ Reco ☐

30 October 2018

Agro Tech Foods

Strong traction to persist in its foods business; maintaining a Buy

Rating: **Buy**
Target Price: ₹700
Share Price: ₹512

With its innovations gaining traction and Agro Tech's foray into new categories, we expect the share of its foods business to rise from 29% now to over 35% by 2021, driving operating synergies and volume growth. Moreover, no major capex planned, distribution expansion, its wider geographic footprint and lower interest outgo would result in accelerated earnings growth. Thus, we retain a Buy.

Greater contribution from its foods portfolio. With the share of its foods business climbing from 24% in FY18 to 29%, we believe strong traction in its foods business would continue, aided by bagged snacks, peanut butter and launches in new categories. Further, the company made a foray into the growing cereal market, valued at ₹25bn and growing 20%, while management talked about entering the chocolate market, valued at ₹135bn and growing ~12% a year. The inherent category margins (higher in chocolates and snacks) and leverage of its distribution infrastructure would further its volume growth.

Operating leverage to kick in over FY18-21: Though the H1 FY19 gross margin was under pressure, the EBITDA-margin contraction was arrested by effective cost controls. We believe margin pressure ahead would ease due to the rising share of its foods business and its foray into higher-margin categories. We expect the share of its foods business to increase from 29% to >35% by 2021. Further, its wider geographic footprint and distribution expansion would save freight costs, leading to a 135bp margin expansion over FY18-21.

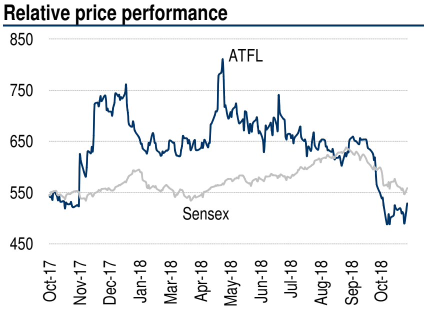
Valuations. Factoring in the higher contribution from the margin-accretive foods business and given its strong brand equity and bright prospects in snacks, we build in 9.5% and 19% CAGRs over FY18-21 for respectively revenue and earnings. We roll forward our price target to Sep FY20 and retain our Buy recommendation with a lower price target of ₹700 based on 35x Sep FY20e EPS. **Risks:** New and keener competition in its categories and rise in cost of inputs.

Key data	ATFL IN / AGRO.BO
52-week high / low	₹820 / 451
Sensex / Nifty	33891 / 10198
3-m average volume	$0.2m
Market cap	₹13bn / $175.6m
Shares outstanding	24m

Shareholding pattern (%)	Sep-18	Jun-18	Mar-18
Promoters	51.8	51.8	51.8
- of which, Pledged	-	-	-
Free float	48.2	48.2	48.2
- Foreign institutions	6.6	6.6	6.5
- Domestic institutions	4.9	4.9	8.5
- Public	36.7	36.7	33.2

Estimates revision (%)	FY19e	FY20e
Sales	(1.8)	(4.4)
EBITDA	(11.2)	(15.2)
EPS	(15.0)	(20.7)

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY17	FY18	FY19e	FY20e	FY21e
Sales (₹ m)	8,082	8,117	8,763	9,592	10,645
EBITDA (₹ m)	612	661	743	860	1,008
Net profit (₹ m)	264	316	370	442	533
EPS (₹)	10.8	13.0	15.2	18.1	21.9
PE (x)	50.0	48.7	33.7	28.2	23.4
EV / EBITDA (x)	21.8	22.9	16.1	13.6	11.3
PBV (x)	4.3	4.5	3.4	3.1	2.8
RoE (%)	9.0	9.8	10.4	11.4	12.4
RoCE (%)	8.2	9.3	10.1	11.0	12.0
Dividend yield (%)	0.4	0.4	0.5	0.5	0.5

Source: Company, Anand Rathi Research

Sonam Somani
Research Analyst

Darshan Parekh

Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY17	FY18	FY19e	FY20e	FY21e
Net revenues (₹ m)	8,082	8,117	8,763	9,592	10,645
Growth (%)	*3.3*	*0.4*	*8.0*	*9.5*	*11.0*
Direct costs	5,329	5,390	5,823	6,326	6,915
SG&A	2,141	2,066	2,197	2,405	2,722
EBITDA	**612**	**661**	**743**	**860**	**1,008**
EBITDA margins (%)	*7.6*	*8.1*	*8.5*	*9.0*	*9.5*
Depreciation	165	180	199	209	221
Other income	3	9	10	11	13
Interest expenses	44	3	-	-	-
PBT	406	488	554	663	799
Effective tax rate (%)	*34.9*	*35.2*	*33.3*	*33.3*	*33.3*
+ Associates / (Minorities)	-	-	-	-	-
Net income	277	316	370	442	533
Adjusted income	264	316	370	442	533
WANS	24	24	24	24	24
FDEPS (₹ / sh)	10.8	13.0	15.2	18.1	21.9
Gross margins (%)	*33.9*	*33.5*	*33.5*	*34.0*	*35.0*

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY17	FY18	FY19e	FY20e	FY21e
Share capital	244	244	244	244	244
Net worth	3,063	3,397	3,695	4,066	4,528
Total debt (incl. pref)	176	-	-	-	-
Minority interest	-	-	-	-	-
DTL / (asset)	109	128	128	128	128
Capital employed	**3,348**	**3,525**	**3,824**	**4,194**	**4,656**
Net tangible assets	1,695	1,692	1,745	1,686	1,645
Net Intangible assets	271	240	240	240	240
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	164	152	50	50	50
Investments (strategic)	-	-	-	-	-
Investments (financial)	-	-	-	-	-
Current assets (excl.cash)	1,919	1,961	2,167	2,399	2,700
Cash	44	308	488	763	1,039
Current liabilities	744	829	867	944	1,019
Working capital	1,175	1,133	1,300	1,455	1,682
Capital deployed	**3,348**	**3,525**	**3,824**	**4,194**	**4,656**

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY17	FY18	FY19e	FY20e	FY21e
PBT (adj. for int.exp./otherinc.)	447	481	544	651	787
+ Non-cash items	162	180	199	209	221
Oper. prof. before WC	609	661	743	860	1,008
- Incr. / (decr.) in WC	-479	-84	167	155	227
Others incl. taxes	93	141	185	221	266
Operating cash-flow	995	604	391	485	515
- Capex (tang. + intang.)	141	173	150	150	180
Free cash-flow	853	430	241	335	335
Acquisitions					
- Div. (incl. buyback & taxes)	56	56	71	71	71
+ Equity raised	-	-	-	-	-
+ Debt raised	-719	-150	-	-	-
- Financialinvestments	-	-2	-	-	-
- Misc. items (CFI + CFF)	41	146	(10)	(11)	(13)
Net cash-flow	-25	265	180	275	276

Source: Company, AnandRathi Research

Fig 4 – Ratio analysis

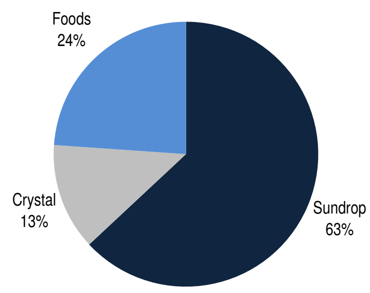
Year-end: Mar	FY17	FY18	FY19e	FY20e	FY21e
P/E (x)	50.0	48.7	33.7	28.2	23.4
EV / EBITDA (x)	21.8	22.9	16.1	13.6	11.3
EV / sales (x)	1.7	1.9	1.4	1.2	1.1
P/B (x)	4.3	4.5	3.4	3.1	2.8
RoE (%)	9.0	9.8	10.4	11.4	12.4
RoCE (%) - after tax	8.2	9.3	10.1	11.0	12.0
Fixed asset T/O (x)	3.8	3.9	4.3	4.9	5.5
DPS (₹ / sh)	2.0	2.5	2.5	2.5	2.5
Dividend yield (%)	0.4	0.4	0.5	0.5	0.5
Div. payout (%) - incl. DDT	22.2	22.5	19.3	16.1	13.4
Net debt / equity (x)	0.0	-0.1	-0.1	-0.2	-0.2
Receivables (days)	18	22	21	21	21
Inventory (days) (on CoGS)	80	64	66	67	70
Payables (days) (on CoGS)	36	44	42	42	42
CFO : PAT %	377.0	190.8	105.7	109.7	96.5

Source: Company, AnandRathi Research

Fig 5 – Price movement

Source: Bloomberg

Fig 6 – Revenue break-up (FY18)



Source: Company, Anand Rathi Research

Q2 FY19 Result highlights and Concall takeaways

- **Margins under pressure.** Agrotech's revenue rose 7% in the quarter to ₹2.1bn (we estimated 8%), driven by sturdy volume growth in its foods business. The gross margin contracted more than 360bps to 32.4% and other overheads were higher (up 70bps y/y). Yet the EBITDA margin contraction was restricted to 50bps due to lower ad-spend (down 340bps y/y) and lower employee expenses (down 35bps y/y). (The EBITDA margin came at 8.4%.) EBITDA increased 1% y/y to ₹178m. Thus, adj. PAT increased 5.6% y/y to ₹91m, impacted by lower-than-anticipated operating efficiency, offset to an extent by higher other income.

Fig 7 – Quarterly result summary (₹ m)

Quarterly results (YE Mar)	Q2 FY18	Q2 FY19	% Y/Y	H1 FY18	H1 FY19	% Y/Y
Sales	1,972	2,109	7.0	3,827	4,080	6.6
Gross margins (%)	*36.0*	*32.4*	*-361bps*	*35.2*	*30.9*	*-431bps*
EBITDA	176	178	1.0	322	319	-0.9
EBITDA margins (%)	*8.9*	*8.4*	*-50bps*	*8.4*	*7.8*	*-59bps*
Interest	0	0	-	2	0	-85.7
Depreciation	44	45	2.3	87	90	3.1
Other income	1	8	541.7	1	14	885.7
PBT	133	141	5.5	235	243	3.7
Tax	47	50	5.3	84	87	4.4
Tax rate (%)	*35.5*	*35.5*	*-7bps*	*35.6*	*35.9*	*26bps*
Adj. PAT	86	91	5.6	151	156	3.2

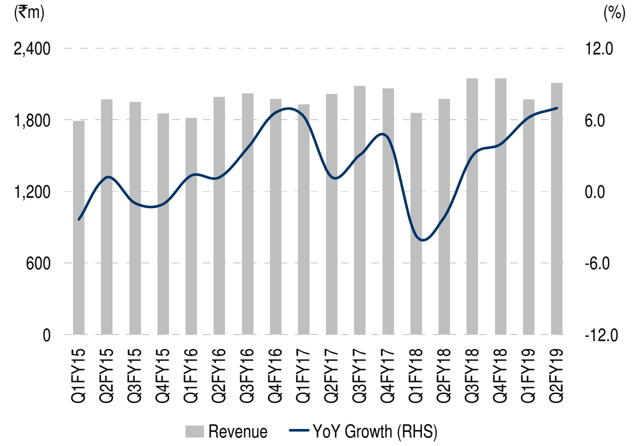
Source: Company

- **Edible oils**: Price-driven growth was seen in its edible-oils business. Following 2% volume growth, Sundrop oil grew 2% y/y (by value).But in Crystal, driven by 2% volume growth, value growth came at 20% y/y due to higher commodity prices on the imposition of tariffs and on currency movements. Margins in edible oils, overall, were compressed, hence, expenses were reduced.
- **Foods business**: The foods business (29% contribution) grew 17% to ₹620m, boosted by the greater investment in distribution expansion and by a favourable base. The gross margin in the foods business was 25-30%.
- **Overall growth**: Peanut butter revenue grew a robust 27%, powered by 41% volume growth, while revenue from ready-to-cook popcorn grew 5%, helped by 4% volume growth. Bagged snacks reported 79% growth (by value), aided by 97% volume growth.
- **Gross margin.** The gross margin was impacted by compression in the edible-oils margin due to the pricing impact in connection with the anti-profiteering clause.
- **Reach:** The number of retail outlets was 400,000, of which ~320,000 were dedicated to ready-to-cook popcorn, 80,000 to peanut butter.
- **Launches.** The company entered the cereal market with the launch of *Choco Pops* priced at ₹10 (₹400 a kg).
- **Innovations.** The recently launched diet pop, Caramel Bliss (in popcorn) and Juicy Tomato Puffs (in extruded snacks) are gaining

traction while peanut butter in jelly form and the sugar-free range reported robust growth.

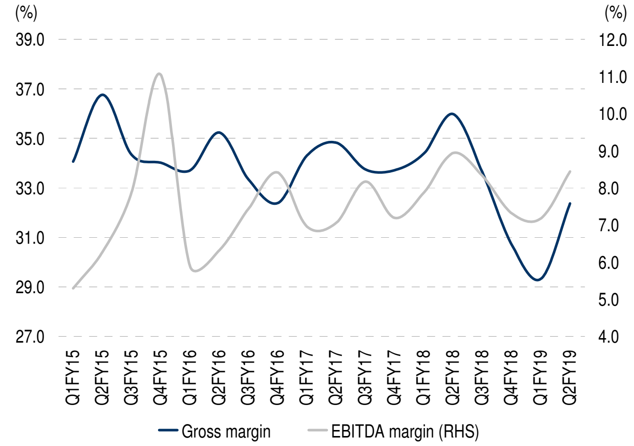
- **Ad-spend**: To counter the margin compression in edible oils, ad-spend was reduced.
- **Other income** increased on the inclusion of income of ₹5.6m from investment in mutual funds.
- The company has a strong **distribution network** in the South and East for ready-to-eat popcorn while the West is its weakest for its edible-oils business and for its distribution network.

Fig 8 – Revenue growth trend



Source: Company, Anand Rathi Research

Fig 9 – Gross margin, EBITDA margin trends



Source: Company, Anand Rathi Research

Valuations

With bright prospects in snacks, we expect Agro Tech Foods to gradually transform from merely an edible-oils manufacturer into a foods company, aiming at a 50% share from foods (Q2 FY19: 29%). All its seven plants would be operational by FY20. It is expected to widen its footprint by improving its supply infrastructure and distribution set-up around the units. Moreover, extension of its products to newer categories would be margin-accretive, driving profitable growth overall.

To factor in the H1 FY19 performance and pressure on gross margins, we have tweaked our FY19e and FY20e revenue, down 2% and 4% respectively, while reducing PAT 15% and 21%.

We introduce FY21e and build in 9.5% and 19% CAGRs over FY18-21 for revenue and earnings respectively, bolstered by lower interest costs and margin expansion.

We roll forward our price target to Sep FY20 and retain our Buy recommendation, with a lower target price of ₹700 (earlier ₹800) based on 35x Sep FY20e EPS.

Fig 10 – Change in estimates

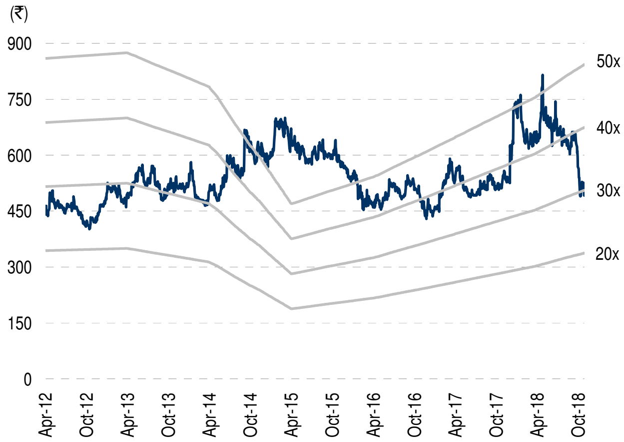
	Original estimates		Revised estimates		Change (%)	
(₹ m)	FY19	FY20	FY19	FY20	FY19	FY20
Revenue	8,923	10,034	8,763	9,592	(1.8)	(4.4)
EBITDA	836	1015	743	860	(11.2)	(15.2)
Adj. PAT	435	557	370	442	(15.0)	(20.7)
EPS (₹)	17.9	22.9	15.2	18.1	(15.0)	(20.7)

Source: Anand Rathi Research

Fig 11 – Standard deviation

Source: Bloomberg, Anand Rathi Research

Fig 12 – PE band



Source: Bloomberg, Anand Rathi Research

Risks

- **Competition in core categories:** New entrants or keen competition from operators in premium edible-oils, popcorn or peanut butter could lead to revenue contracting and margins shrinking.
- **Steep rise in input costs:** Agro Tech imports a considerable amount of its raw material (primarily corn). The cost of imports could be affected by currency movements, import regulations and a demand-supply mismatch, globally.

Appendix

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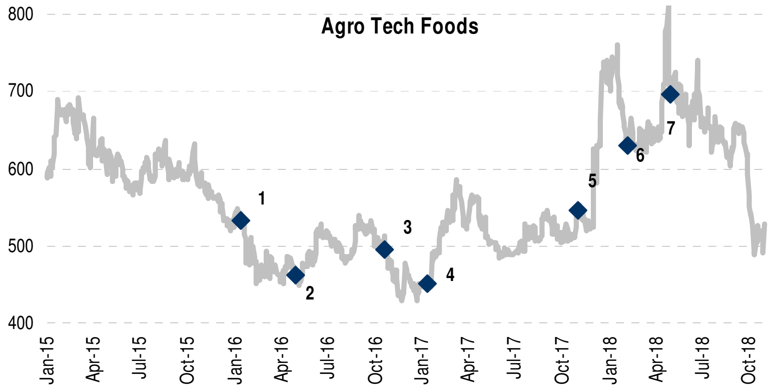

	Date	Rating	TP (₹)	Share Price (₹)
1	13-Jan-16	Buy	650	540
2	27-Apr-16	Buy	600	468
3	20-Oct-16	Buy	610	500
4	10-Jan-17	Buy	580	455
5	28-Oct-17	Buy	610	521
6	03-Feb-18	Buy	730	640
7	30-Apr-18	Buy	800	695

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