Khambatta Securities Ltd.

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Prataap Snacks Limited

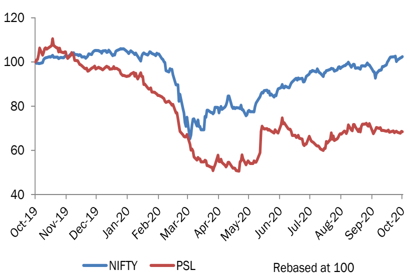
22 October 2020

Strategic positioning and initiatives are its key strengths

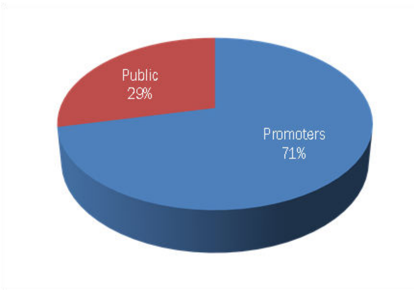
BUY

Sector	: FMCG – Food
Target Price	: Rs 835
Current Market Price	: Rs 598
Market Cap	: Rs 1,403 crore
52-week High/Low	: Rs 989/435
Daily Avg Vol (12M)	: 26,354
Face Value	: Rs 5
Beta	: 0.72
Pledged Shares	: 0%
Year End	: March
BSE Scrip Code	: 540724
NSE Scrip Code	: DIAMONDYD
Bloomberg Code	: DIAMOND IN
Reuters Code	: PRAT.NS
Nifty	: 11,938
BSE Sensex	: 40,707
Analyst	: Ritwik Bhattacharjee

Price Performance



Shareholding Pattern



Introductory Note

Investment Summary

- Prataap Snacks Limited (PSL) has a diverse packaged snacks portfolio with strategic price points and pack sizes. With over 100 SKUs, the company caters to different market segments while positioning itself as a value-for-money brand targeting the value-conscious consumer.
- PSL acquired Avadh Snacks in 2018 with the objective of gaining a strong foothold in Gujarat, India's highest snack-consuming state. With 55 SKUs, Avadh is the fastest growing and fourth-largest snacks brand with a market share of 6% in Gujarat. The company plans to launch the Avadh brand across the country by leveraging Yellow Diamond's manufacturing and distribution setup.
- PSL distributes its products through more than 240 stockists, >4,100 distributors and over 17 lakh retail touchpoints across the country, selling more than 1.1 crore packets a day on average.
- India's demographic profile, rising consumerism in non-metro cities, and increasing rural income bode well for the growth of packaged snacks.
- PSL's manufacturing setup is strategically located across geographies in order to reach products from the manufacturing facilities to the retail touchpoints with maximum efficiency. The company follows an asset-light model with a combination of owned and contracted facilities.
- PSL looks to enhance margins through strategic initiatives in product mix and cost optimisation.
- 1Q FY21 was affected by restrictions due to COVID-19, resulting in a 41% y-o-y degrowth in revenues and 70% decline in EBITDA. With production returning to 80% of pre-COVID levels in June, we expect sequential improvements in revenues and profitability through FY21. We anticipate healthy sales growth, driven by strong revival of demand with cost optimisation initiatives driving margin accretion from FY22 onwards. We value PSL at a target P/E multiple of 32.0x FY22E EPS. This generates a price target of Rs 835 with an upside of 40% and informing a BUY rating.

Key Financial Metrics (Consolidated)

Rs crore	FY18A	FY19A	FY20A	FY21E	FY22E
Operating revenue	1,002.7	1,164.1	1,386.5	1,301.9	1,610.4
Growth		*16.1%*	*19.1%*	*-6.1%*	*23.7%*
EBITDA	86.9	83.2	93.7	79.4	116.0
EBITDA margin	*8.7%*	*7.1%*	*6.8%*	*6.1%*	*7.2%*
PAT	44.2	44.6	46.9	26.0	61.2
PAT margin	*4.4%*	*3.8%*	*3.4%*	*2.0%*	*3.8%*
Diluted EPS (Rs)	19.92	19.03	20.01	11.10	26.09

Source: Bloomberg; Khambatta Research

Company Profile

Established in 2003, Prataap Snacks Limited (PSL) manufactures and markets packaged snacks. The Indore-headquartered company's brand philisophy emphasises the delivery of "maximum value to consumers" based on the three pillars of quality, tatse and quantity. PSIL's key brands include the flagship Yellow Diamond, Rich Feast, and Avadh comprising a portfolio of products that include potato chips, namkeens, cup cakes and other packaged snacks. The company has a pan-India presence with its products marketed across 27 states and 3 union territories. Its 14 production units are spread across the country, which include both owned and contracted facilities.

PSL has a pan-India presence across 27 states and 3 union territories

Investment Thesis

A diverse product portfolio in the packaged snacks segment with strategic price points and pack sizes targeting the large lower end of the market. PSL's portfolio comprises the 3 broad categories of salty snacks, sweet snacks, and Avadh. The salty snacks portfolio includes potato chips, extruded snacks, namkeen and pellets. All products of the segment are marketed under the Yellow Diamond brand name. The sweet snacks portfolio (marketed under the Rich Feast brand) comprises cakes such as cupcake, tiffin cake, and sandwich cake. The Avadh portfolio comprises products marketed under the Avadh brand, which PSL acquired in 2018. The Avadh portfolio compliments PSL's salty snacks portfolio through offerings in the namkeen and fryums categories. The company has over 100 SKUs and is a market leader in the rings category. With its breadth of offerings in terms of pack size and price point ranging from Rs 5 to Rs 100, PSL caters to different market segments while positioning itself as a value-for-money brand targeting the value-conscious consumer. The company is a leading player in the Rs 5 price-point segment, which accounts for >50% of the organised snacks market.

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The Avadh acquisition adds a strong local namkeen and fryums brand to PSL's portfolio. PSL acquired Avadh Snacks in October 2018 with the objective of gaining a strong foothold in the Gujarat market which has India's highest per capita snacks consumption. With 55 SKUs, Avadh is the fastest growing and fourth-largest snacks brand with a market share of 6% in Gujarat, one of India's largest packaged snacks markets. Avadh has a manufacturing facility at Rajkot and a well-established direct distribution network in Gujarat. PSL concluded the first phase of capacity expansion (by 50%) at Avadh in June 2020 with further plans of doubling the capacity (from pre-expansion levels) in a second phase. The company is working on increasing Avadh's touchpoints in Gujarat and neighbouring markets and subsequently plans to launch the Avadh brand across the country by leveraging Yellow Diamond's manufacturing and distribution setup. We expect Avadh to be a leading contributor of growth for PSL going forward.

Avadh is the fastest growing and fourth-largest snacks brand with a market share of 6% in Gujarat, which has India's highest per capita snacks consumption

PSL looks to continue delivering healthy growth with a strong distribution setup helping to generate solid sales volumes. PSL distributes its products through more than 240 stockists, >4,100 distributors and over 17 lakh retail touchpoints across the country. Selling more than 1.1 crore packets a day on average, the company has registered a revenue CAGR of approximately 21% in the last 5 years. The proximity of Avadh's facilities to key markets in Gujarat facilitates direct supply to distributors bypassing super-stockists and helps reduce distribution costs. PSL is also looking to utilise Avadh's distribution network to cross-sell Yellow Diamond products.

PSL sells more than 1.1 crore packets a day on average

India's demographic profile, rising consumerism in non-metro cities, and increasing rural income and consumption bode well for the growth of packaged snacks. India's young population with a rising consumerist culture in lower-tier cities present a fertile ground for healthy growth of packaged snacks. A large unorganised market and rapid urbanisation offer solid potential for expansion of the addressable market and penetration of packaged snacks in the medium-to-long term. Rising farm income and increasing disposable income in rural and semi-urban areas present robust future potential for PSL with its strong presence at the lower (value) end of the market.

PSL's strategically-distributed manufacturing plays a key role in catering to local demand. PSL has a distributed manufacturing setup with production facilities strategically located across geographical zones in order to reach products from the manufacturing facilities to the customer touchpoints with maximum efficiency. Localisation of manufacturing with facilities located in proximity to major markets enables more efficient local distribution with better supply chain management, leading to lower time to market, better shelf availability, and lower cost of transportation. The company has 14 production units – 5 owned plants and 9 third-party (3P) contract manufacturing facilities across India (5 in the Western region, 4 in the East, 3 in the South, and 2 in the North). PSL follows an asset-light strategy with an increasing proportion from sales generated from 3P facilities (from 11% in FY19 to 18% in FY20), which allows it to pursue growth while conserving capital at the same time. The company has a capex plan of Rs 120 crore over the next 3 years, which it expects to fund through internal accruals.

PSL's revenues from contracted facilities increased from 11% in FY19 to 18% in FY20

PSL looks to enhance margins through strategic initiatives in product mix and cost optimisation. While PSL continues to strengthen its savoury snacks portfolio both organically and inorganically, the company aims to increase the share of revenues from higher-margin sweet snacks. To this end, the company launched 3 new products in the cakes category and commissioned 2 new lines for cakes in FY20 as it looks to increase the revenue share of sweet snacks from 3% currently to 10% over the next 3 years. PSL is undertaking initiatives to improve operational efficiency and streamline costs with the objective of enhancing profitability. Amongst these are decentralising 3P facilities to optimise logistic cost by reducing the distance between the source of supply and the market, reducing raw material costs by enhancing storage facilities to hedge price fluctuations, rightsizing of packaging resulting in reduction of packaging costs, and reengineering product propositions to drive better performance. The company is also looking to keep A&P spend in tight control. These strategic initiatives are expected to boost the overall margin profile of the business.

Valuation

1Q FY21 operations were significantly affected by COVID-19, resulting in a 41% y-o-y degrowth in revenues and 70% decline in EBITDA

At 32.0x FY22E EPS, we rate PSL a BUY with a target price of Rs 835 and an upside potential of 40%. PSL recorded robust revenue growth while margins came under some pressure due to raw material cost inflation in FY20. The company's 1Q FY21 operations and performance were significantly affected by the nationwide lockdown and restrictions on movement of goods on account of the COVID-19 outbreak, resulting in a 41% y-o-y degrowth in revenues, 70% decline in EBITDA, and a net loss of Rs 6 crore. With production returning to 80% of pre-COVID levels in June, we expect sequential improvements in revenues and profitability (driven by operating leverage) through FY21. Thereafter, we anticipate healthy sales growth, driven by strong revival of demand. PSL's cost optimisation initiatives are expected to show margin accretion from FY22 onwards. Based on our expectation of robust revenue growth and improved profitability translating into solid earnings growth, we value PSL at a target P/E multiple of 32.0x FY22E EPS. This generates a price target of Rs 835 with an upside of 40% and informing a BUY rating.

Abridged Profit & Loss Account (Consolidated)

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*Source: **Bloomberg; Khambatta Research***

Key Risks

- High volatility in raw material (especially palm oil) prices can result in margins straying from forecasted levels.
- PSL's products compete with other brands as well as those from the unorganised segment. Any significant loss of market share or the inability to expand market opportunities contrary to our expectations will result in underperformance of our forecasts.
- An extended economic downturn, especially continued demand slowdown in the real estate sector, owing to / as a fallout of the COVID-19 pandemic may lead to underperformance of our forecasts.

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Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

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Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

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Sell recommendations are expected to improve up to 5% or deteriorate, based on consideration of the fundamental view and the currency impact (where applicable).

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