Prataap Snacks Limited

15 June 2021

Long-term strategic initiatives hold promise amidst some near-term pains

BUY

4Q FY21 Update

Outlook & Valuation

A significant part of Prataap Snacks Limited’s (PSL’s) sales originates in catchment areas around schools and colleges, and the travel segment. As educational institutions stay shut and travel activities remain sluggish, strong growth revival is still some distance away. Having said that, PSL has undertaken a number of initiatives, which include (a) compressing the distribution structure to increase direct reach to distributors/mega-distributors by bypassing super-stockists with a potential of 200 bps to 300 bps margin accretion; (b) setting up a distributed manufacturing model comprising regional hubs across the country; (c) enhancing the distribution network through efforts such as tele-calling support to distributors to deepen their distribution reach; (d) strategic additions to the product portfolio suited to in-home consumption; and (e) cost rationalisation and efficiency enhancement. The company is also implementing steps towards deepening its rural distribution by appointing distributors at the taluka level. The sharp increase in edible oil prices dented PSL’s profitability in 4Q FY21 as palm oil prices moved up from Rs 70 to touch Rs 120 levels. It increased further to Rs 140 in early May to come down to around Rs 125 currently. We believe 1Q FY22 will be affected the most by the lockdown and high palm oil prices in FY22. We are revising our growth and profitability expectations owing to covid 2.0, a possible third wave and high palm oil prices, which we anticipate to normalise in 2H FY22. Consequently, we forecast mid-single digit growth in FY22, followed by a strong recovery in FY23 with healthy profitability gains. Management has set a target of 9% to 10% EBITDA margin in the mid-to-longer term (>3 years), driven by distribution restructuring and cost rationalisation. The PSL stock has appreciated by 16% since we initiated coverage on 22 October 2020. As the longer-term margin accretion is not captured in our forecasts, we assign a higher target P/E multiple of 32.0x (vs 30.0x is the last report) to arrive at a price target to Rs 801 with an upside of 15%, maintaining a BUY rating.

Key Financial Metrics (Consolidated)

<table>
<thead>
<tr>
<th></th>
<th>FY19A</th>
<th>FY20A</th>
<th>FY21A</th>
<th>FY22E</th>
<th>FY23E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>1,170.6</td>
<td>1,393.8</td>
<td>1,171.1</td>
<td>1,222.6</td>
<td>1,524.6</td>
</tr>
<tr>
<td>Growth</td>
<td>19.1%</td>
<td>-16.0%</td>
<td>-4.4%</td>
<td>24.7%</td>
<td></td>
</tr>
<tr>
<td>EBITDA</td>
<td>83.2</td>
<td>93.7</td>
<td>63.1</td>
<td>65.1</td>
<td>109.0</td>
</tr>
<tr>
<td>EBITDA margin</td>
<td>7.1%</td>
<td>6.7%</td>
<td>5.4%</td>
<td>5.3%</td>
<td>7.2%</td>
</tr>
<tr>
<td>PAT</td>
<td>44.6</td>
<td>46.9</td>
<td>14.2</td>
<td>22.0</td>
<td>58.7</td>
</tr>
<tr>
<td>PAT margin</td>
<td>3.8%</td>
<td>3.4%</td>
<td>1.2%</td>
<td>1.8%</td>
<td>3.9%</td>
</tr>
<tr>
<td>Diluted EPS (Rs)</td>
<td>19.03</td>
<td>20.01</td>
<td>6.04</td>
<td>9.38</td>
<td>25.03</td>
</tr>
</tbody>
</table>

Source: Company data; Khambatta Research
Prataap Snacks Limited

15 June 2021

Result Analysis
In 4Q FY21, PSL reported the lowest y-o-y decline in revenues during FY21, with marginally lower sales compared to 4Q FY20 levels in spite of schools and colleges remaining shut and travel yet to pick up significantly. Margins came under pressure in 4Q FY21 owing to higher raw material (primarily palm oil) prices and to a lesser extent due to increased freight cost.

Financial Performance (Consolidated)

<table>
<thead>
<tr>
<th>Rs crore</th>
<th>4Q FY20</th>
<th>4Q FY21</th>
<th>Y-o-y</th>
<th>FY20</th>
<th>FY21</th>
<th>Y-o-y</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating revenue</td>
<td>314.2</td>
<td>309.5</td>
<td>-1.5%</td>
<td>1,393.8</td>
<td>1,171.1</td>
<td>-16.0%</td>
</tr>
<tr>
<td>EBITDA</td>
<td>13.7</td>
<td>13.9</td>
<td>1.6%</td>
<td>93.7</td>
<td>63.1</td>
<td>-32.7%</td>
</tr>
<tr>
<td>EBITDA margin</td>
<td>4.4%</td>
<td>4.5%</td>
<td>14 bps</td>
<td>6.7%</td>
<td>5.4%</td>
<td>-134 bps</td>
</tr>
<tr>
<td>PAT</td>
<td>19.8</td>
<td>7.1</td>
<td>-63.9%</td>
<td>46.9</td>
<td>14.2</td>
<td>-69.8%</td>
</tr>
<tr>
<td>PAT margin</td>
<td>6.3%</td>
<td>2.3%</td>
<td>-399 bps</td>
<td>3.4%</td>
<td>1.2%</td>
<td>-216 bps</td>
</tr>
<tr>
<td>Diluted EPS (Rs)</td>
<td>8.42</td>
<td>3.04</td>
<td>-63.9%</td>
<td>20.01</td>
<td>6.04</td>
<td>-69.8%</td>
</tr>
</tbody>
</table>

Source: Company data; Khambatta Research
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.

Stock ratings

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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