Stock Update

CCL Products Ltd.

December 10, 2021

RETAILRESEARCH

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CCL Products Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Coffee	Rs.389	Buy in Rs 385-393 and add on dips to Rs. 352	Rs.431	Rs.478	2 quarters

HDFC Scrip Code	CCLROEQNR
BSE Code	519600
NSE Code	CCL
Bloomberg	CCL IN
CMP (Dec 09, 2021)	389
Equity Capital (RsCr)	26.6
Face Value (Rs)	2
Equity Share O/S (Cr)	13.3
Market Cap (RsCr)	5174
Book Value (Rs)	81.7
Avg. 52 Wk Volumes	607480
52 Week High	494
52 Week Low	226

Share holding Pattern % (Sept, 2021)	
Promoters	46.19
Institutions	26.94
Non Institutions	26.87
Total	100.0

* Refer at the end for explanation on Risk Ratings

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Our Take:

CCL Products Ltd. (CCL) is in the business of converting raw coffee beans into instant coffee granules/powder. The company is not only India's largest coffee processor, but it has the world's largest single location plant and has top private label instant coffee manufacturers across the globe as its clients. While prima facie it looks like a commodity conversion business, unlike tea or other commodities, coffee processing is a specialist job as the flavour and consistency has to be maintained batch after batch irrespective of the input quality or grade. Not many companies have been successful in doing this and hence, globally, coffee business has very little competition and high profitability.

Worldwide CCL's coffee is being consumed at the rate of 1,000 cups per second. CCL exports its processed coffee to more than 90 countries and supports more than 250 brands with sustainable supplies — both quality and quantity. CCL has on offer more than 1000 recipes for the clients to choose from. It has a combined state-of-the-art manufacturing capacity of ~38,500 MTPA, which is spread over Duggirala (Guntur District of AP), Kuvvakolli (Chittoor District, AP), Switzerland, and Vietnam. Having succeeded in placing their coffee on the world markets, CCL launched its 'Continental Coffee' brand for the Indian market, which should act as a major growth catalyst, going ahead. With the help of its rich experience in the international markets, it has developed 250+ blends, claiming they are superior to its competitors' blends.

On May 27, 2021, we had initiated coverage on the stock (Link) with a recommendation to 'Buy at LTP and add on dips to Rs 289-295 band' for base case fair value of Rs 376 and bull case fair value of Rs 405. The stock had achieved our base case target on July 02, 2021 and bull case target on July 05, 2021.

Valuation & Recommendation:

CCL is amongst the largest green coffee bean processors globally. It is India's largest exporter of instant coffee (38% market share) and world's leading supplier to private labels (~10% global market share). Over the past two decades, it has increased its capacity by 10x without diluting equity and has also managed to keep its debt in check. Its business model is strong and robust, by virtue of it being a sticky business; it has the best-in-class technology, superior economies of scale and resilient margins. The management has revised its volume guidance from 10-15% given earlier to above 15% now for FY22. The revision in guidance came on the back of strong order booking, the upcoming peak season for Q3 & Q4 and the commissioning of 3,500 MT of Vietnam facility in Q2FY22. The company is on the track to double its Vietnam capacity by Q2FY23 (from 13,500 MT currently). It has sold entire capacity for FY22 and is now booking orders for FY23 which has been an exceptional situation. We expect earnings CAGR of ~24% over FY21-24E on the account of a) doubling of Vietnam Capacity (company enjoys tax break here), b) higher share of small packs & packing capacity ramp-up, and c) increasing share of India branded business in the overall revenue mix. On the back of strong operating performance coupled with better working capital cycle, we expect superior FCF generation and gradual expansion in RoCE by 591 bps over FY21-24E. With enhanced revenue growth visibility, the stock is likely to re-rate if the company continues to maintain a strong margin profile. **We think the base case fair value of the stock is Rs 431 (19x Sept'23E EPS) and the bull case fair value of is Rs 478 (21x Sept'23E EPS). Investors can buy the in stock Rs 385-393 band (17x Sept'23E EPS) and add more on dips to Rs 352 (15.5x Sept'23E EPS). At LTP of Rs 389, it quotes at 17x Sept'23E EPS.**

Financial Summary

Particulars (Rs cr)	Q2FY22	Q2FY21	YoY-%	Q1FY22	QoQ-%	FY19	FY20	FY21	FY22E	FY23E	FY24E
Net Revenues	337	322	4%	326	3%	1081	1139	1242	1457	1669	1917
EBITDA	82	78	6%	72	14%	245	286	298	353	417	485
APAT	49	47	4%	44	13%	155	166	182	219	268	337
Diluted EPS (Rs)	3.7	3.6	4%	3.3	12%	11.6	12.5	13.7	16.4	20.2	25.3
P/E (x)						33.4	31.2	28.4	23.7	19.3	15.4
EV/EBITDA						22.4	19.3	18.6	15.5	12.7	10.5
RoE-%						19.6	18.8	18.1	18.6	19.5	20.9

(Source: Company, HDFC sec)

Q2FY22 Result Update

CCL reported a 4% topline growth in Q2FY22 to Rs 337 Cr, due to impact on dispatches of processed coffee beans as lockdown restrictions hindered transportation to Ho Chi Minh City (port city of Vietnam). Also, the reported revenue growth was lower as the company did not realize MEIS (Merchandise Exports from India Scheme) incentives in Q2FY22 (vs. Rs 8.5 Cr in Q2FY21); expects MEIS incentives of ~Rs 15 Cr in H2FY22. Gross margins expanded 300 bps to 52.7% on account of higher realization and a higher proportion of premium Freeze Dried Coffee (FDC) volumes. EBITDA margin expanded 38bps to 24.4%, offset by higher freight and employee costs. Vietnam operated at peak utilisation levels of 95-100% in Q2 while India capacity operated at 90%. India branded sales grew 38% YoY to ~Rs 52 Cr in Q2FY22 driven by growth in retail consumption; growth was 40% (45% excluding Army sales) at Rs 85 Cr in H1FY22.

Mr. Praveen Jaipuriar is appointed as the CEO of the company w.e.f. 29th Oct'21 while Mr. KVLN Sarma (COO) resigned w.e.f. 27th Oct'21.

Key Triggers

Doubling of the Vietnam capacity is the biggest trigger

CCL has already commercialized its 3,500 MT incremental capacity in Vietnam (previously 10,000 MT) in Q2FY22 and is further expanding the same by additional 13,500 MT, which will take the company's cumulative capacity to ~26,500 MT in Vietnam by Q2FY23. Key factors driving the expansion plans include; a) strong demand visibility, b) its ability to customize blends from the most economical to most premium products backed by strong R&D, which helps in getting more business from existing clients, c) addition of new clients across USA and Europe, d) to free up India capacity as it scales up its domestic branded business. The capex for the expansion is likely to be USD 20 million (~ Rs 150 Cr) partly funded by debt and rest from internal accruals.

As explained in our initiating coverage report (Link), Vietnam gives an unbeatable advantage to CCL given its proximity to key markets, access to raw materials and most importantly it enjoys tax break (0% tax) there. With the entire incremental capacity coming up in Vietnam, the PAT growth will largely outpace the topline growth as management expects the blended tax rate of ~15% in long term.

Increasing contribution from Small packs and higher freeze-dried volume to drive profitable growth in India: CCL predominantly sells coffee in bulk to resellers. However, the company has been focussing on increasing the share of small packs sold directly to the customers than to the packers, which aids in expanding its margins and deepen its relationships with the existing customers. The total small packs capacity for FY22 would be ~12,000 MT, of which 7,000MT could be utilized, which translates into ~40% growth. The company has the potential to increase overall small packs capacity to 25,000MT in future. Also, higher sale of freeze dried coffee or FDC (fetches 60-70% higher realization than spray dried coffee) could drive the growth in profitability.

Increasingly focused on high margin B2C business:

CCL has always been identified as a global B2B player; however, over the past few years, the company has been increasingly focusing on its B2C play in India, given the robust growth opportunities and lucrative margins. The domestic branded business revenue saw 40% YoY growth for H1FY22 at Rs 85 Cr. The company has a target revenue of Rs 200 Cr for FY22 (vs Rs 150 Cr in FY20, Rs 55 Cr in FY19) and plans to maintain its robust growth rate for next 3-4 years. It is planning to ramp up capacity to meet the pan-India demand (current presence in 4 states) by further deepening the domestic market. The company has also launched a new product (3-in-1 coffee with various flavour and variants) targeting the younger generation in the age group of 18-35 years vs. other players who are largely present and cater to consumers above 35 years age, thus creating a new base of customers. Further, to drive brand and product visibility, CCL plans to install premix coffee dispenser and premium coffee dispensers at high-end places for freeze-dried products. CCL appointed Mr. Pravin Jaipuriar as new CEO of the company w.e.f 29th Oct, 2021. He was previously the CEO of Continental Coffee Pvt. Ltd. (branded coffee division of CCL) and his appointment as the CEO of CCL comes as a boost to the company's ambition of being a B2C business over long term.

Lately a lot of VC funded start-ups (Sleepy Owl, Rage Coffee, Blue Tokai, etc.) have emerged in the B2C coffee space given the massive potential the domestic market offers. We don't view them as threat to CCL as they would rather expand the market which will benefit larger player like CCL. Also, CCL being the market leader in instant coffee with strong expertise in premium coffee range, it is the biggest supplier to most of such start-ups.

In Q2FY22 earnings concall, management also informed that the company has launched its brand in select overseas markets in the last 2 months (taking care of not competing with its customers in the same product or SKUs) and plans to scale up in the long run in domestic as well as international markets. Successful scale up the branded business will not only lead to significant margin improvement for CCL but will eventually lead to structural re-rating of the stock.

Revenue likely to grow by ~16% over FY21-24E

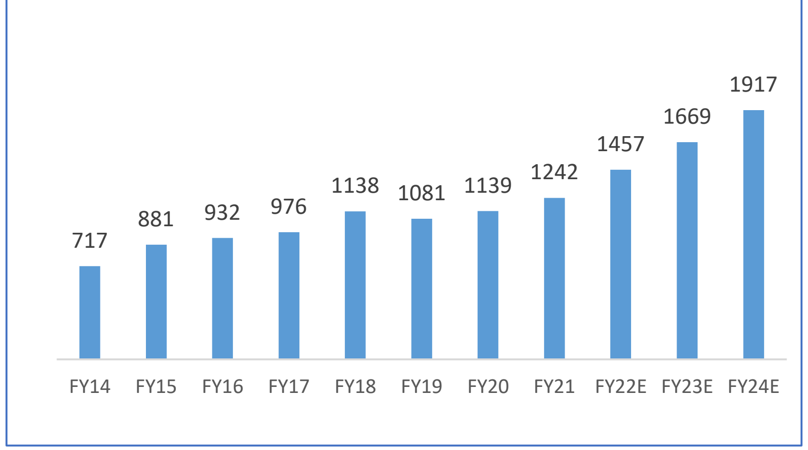
We expect CCL to report topline growth of ~16% CAGR as we revise our estimates for FY22 and FY23E with upward revision in volume guidance by management to 15% from 10% previously. The growth in topline to be driven by a) production from the expanded capacity of 3,500 MT in Vietnam by Q3FY22 and additional capacity expansion of ~13,000 MT by next year, b) rise in green coffee prices which would reflect from Q4FY22 for new orders, c) revival in FDC (freeze-dried coffee) demand, d) higher share of small packs & packing capacity ramp-up, and e) increasing share of India branded business in the overall revenue mix.

As the company follows a cost-plus model (and hence is least impacted by the fluctuations/rise in coffee prices), EBITDA margin in percentage terms could look low sequentially given the sharp rise in coffee prices in recent months, however, EBITDA/kg is likely to remain intact and would likely increase with rising contribution from premium products. CCL's margins have structurally improved with EBITDA per kg of Rs 85-95 over FY15-FY16 to above Rs 105 during FY19-FY21. The management expects the EBITDA per kg to improve to Rs 130-135 in the medium term.

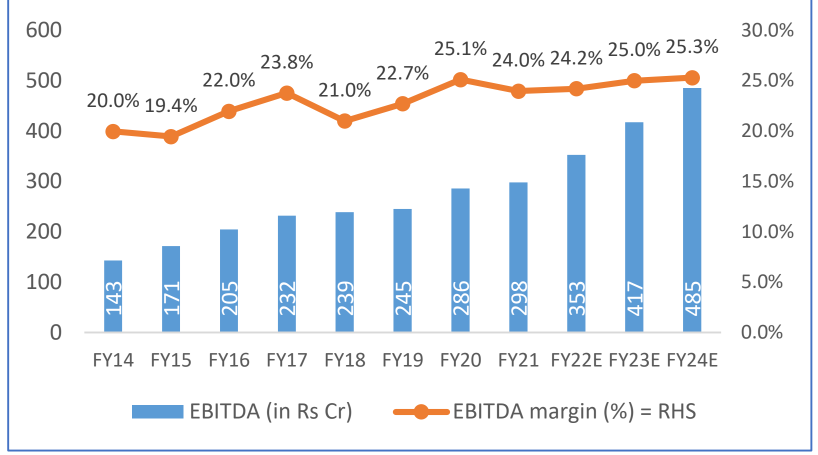
Expect earnings CAGR of ~23% over FY21-24E on the back of robust topline growth, as discussed above, and increasing contribution from Vietnam where company enjoys a tax break.

Steady improvement in return ratios: In H1FY22, inventories decreased by 3% to Rs 310 Cr (vs. Mar'21) while receivables increased 9% to Rs 326 Cr (vs. Mar'21). The management highlighted its focus on reducing receivables to lower its working capital requirement with internal deadline to maintain the working capital cycle at 90 days over a medium term. With strong operating performance, a better working capital cycle and, limited capex requirement on the account of brownfield expansion in Vietnam between FY22-23E, we expect CCL to generate a free cash flow of ~Rs 620 Cr between FY21-24E, potentially driving debt reduction. This would likely result in healthy expansion in RoCE of 591 bps over FY21-24E.

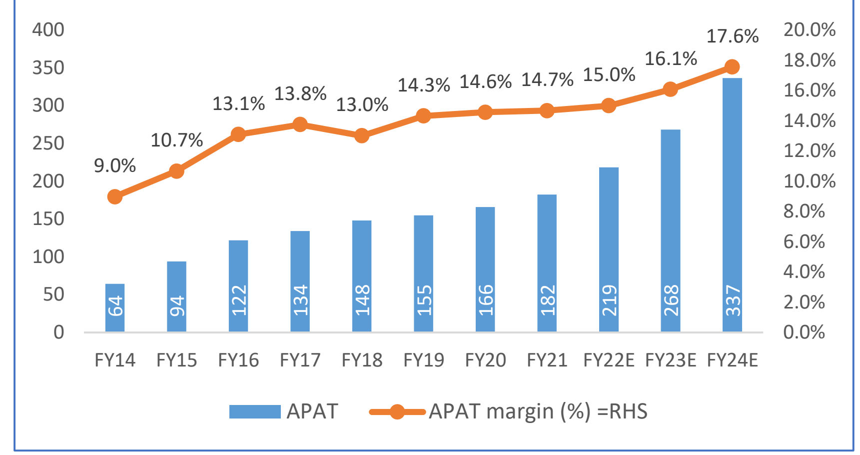
CCL Products Ltd.



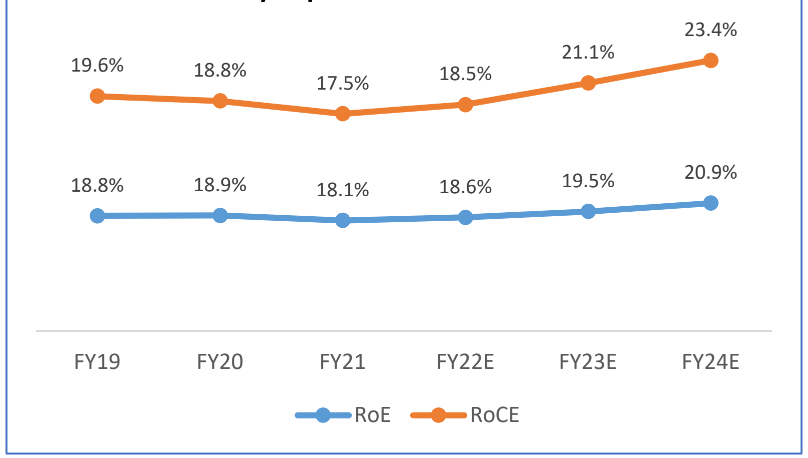
Revenues to grow at ~16% CAGR over FY21-24E



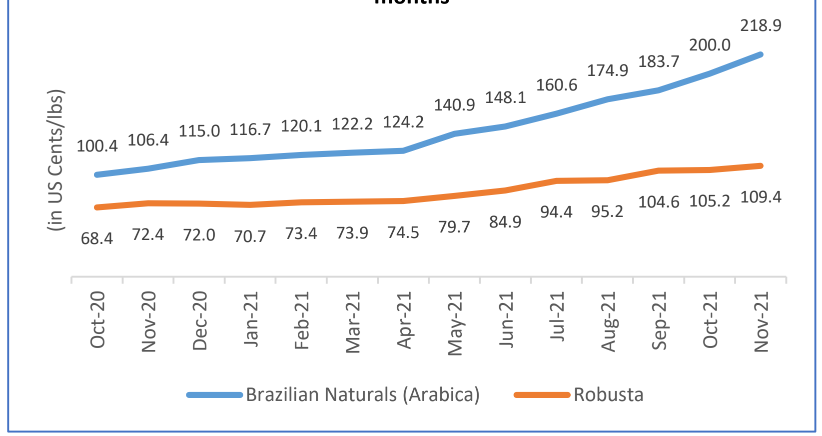
EBITDA margins to remain stable



PAT to grow at ~23% CAGR over FY21-24E



Steady improvement in return ratios



Coffee Prices have witnessed inflationary trends in recent months

(Source: Company, ICO, HDFC sec)

Key Risks

Currency volatility: CCL derives ~90% of its revenue through exports, thus being exposed to currency fluctuations. However, ~75% of its raw material is also imported and hence it creates a natural hedge for all transactions taking place in US dollars.

Duty changes across operating countries: CCL supplies coffee to over 90 countries from India and Vietnam. Any unfavorable change in import or export duty rates in any country or imposition of non-tariff barriers could impact the competitiveness of supply from Vietnam and/or India.

Slower ramp-up in branded business: The company is cautiously expanding its Continental brand in the domestic market. Although it has been well-received so far, any adverse customer response could impact the growth prospects and financials.

Credit risk: With ~95% of CCL's business being B2B in nature, the company is exposed to credit risks. However, most of the business is repetitive and through established clientele. The company does not have record of any major bad debts in its history.

Supply chain disruptions: In a year of high uncertainty in the macro environment and geopolitical relations, disruptions in the supply chain are an important risk to monitor.

Covid recurrence could impact demand for coffee while Vietnam supplies could also get impacted due to lockdowns, etc.

Company Background

CCL was formed in 1994 and commenced its commercial operations in 1995. It is an 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. CCL has adopted Swiss and Brazilian technologies at its plants, which have been purchased from world renowned pioneers in turnkey instant/soluble coffee technologies. This has enabled it to produce international quality soluble coffee with over 250 blends, which are currently being exported to more than 90 countries worldwide. Today, the company is India's largest manufacturer and exporter (36% market share) of instant coffee and the largest player in the private label market (with 10% market share). CCL operates through four plants: two in India and one each in Vietnam and Switzerland.

Financials

Income Statement

Particulars (Rs Cr)	FY19	FY20	FY21	FY22E	FY23E	FY24E
Net Revenues	**1081**	**1139**	**1242**	**1457**	**1669**	**1917**
Growth (%)	-5.0%	5.3%	9.1%	17.3%	14.5%	14.9%
Operating Expenses	836	853	945	1105	1252	1432
EBITDA	**245**	**286**	**298**	**353**	**417**	**485**
Growth (%)	2.8%	16.5%	4.2%	18.4%	18.3%	16.3%
EBITDA Margin (%)	***22.7%***	***25.1%***	***24.0%***	***24.2%***	***25.0%***	***25.3%***
Depreciation	32	47	49	61	67	74
Other Income	3	4	3	6	7	8
EBIT	**217**	**243**	**252**	**298**	**357**	**419**
Interest expenses	8	18	17	17	13	7
PBT	209	225	235	280	344	412
Tax	54	59	53	62	76	75
APAT	**155**	**166**	**182**	**219**	**268**	**337**
Growth (%)	14.3%	14.6%	14.7%	15.0%	16.1%	17.6%
EPS	**11.6**	**12.5**	**13.7**	**16.4**	**20.2**	**25.3**

Balance Sheet

As at March	FY19	FY20	FY21	FY22E	FY23E	FY24E
SOURCE OF FUNDS						
Share Capital	27	27	27	27	27	27
Reserves	812	902	1061	1239	1455	1711
Shareholders' Funds	**839**	**928**	**1087**	**1266**	**1481**	**1738**
Borrowings	416	392	475	395	245	120
Net Deferred Taxes	40	46	49	49	49	49
Other Non-Current Liabilities	3	9	5	6	7	8
Total Source of Funds	**1298**	**1376**	**1617**	**1715**	**1781**	**1914**
APPLICATION OF FUNDS						
Net Block	383	724	798	879	929	984
CWIP	424	100	149	74	37	19
Investments	1	1	0	0	0	0
Long Term Loans & Advances	42	48	50	55	60	69
Total Non-Current Assets	**851**	**873**	**997**	**1009**	**1026**	**1071**
Inventories	202	260	320	351	389	420
Trade Receivables	235	268	299	347	389	399
Cash & Equivalents	97	39	120	110	104	178
Other Current Assets	37	69	52	67	82	88
Total Current Assets	**571**	**636**	**791**	**876**	**964**	**1085**
Trade Payables	57	25	20	48	50	53
Other Current Liab & Provisions	66	109	151	135	172	203
Total Current Liabilities	**123**	**134**	**171**	**183**	**223**	**255**
Net Current Assets	448	502	620	692	741	830
Total Application of Funds	**1298**	**1376**	**1617**	**1715**	**1781**	**1914**

Cash Flow Statement

Particulars (Rs Cr)	FY19	FY20	FY21	FY22E	FY23E	FY24E
Reported PBT	208.6	225.3	234.8	280.3	344.0	411.6
Interest Expenses	31.7	47.1	49.4	60.8	67.1	73.9
Depreciation	45.8	65.6	53.5	73.6	76.0	73.2
Working Capital Change	-35.9	-147.1	-91.5	-80.0	-54.3	-14.0
Tax Paid	-57.1	-53.5	-25.9	-61.7	-75.7	-74.9
OPERATING CASH FLOW (a)	**161.5**	**90.3**	**170.9**	**212.3**	**290.1**	**395.9**
Capex	-241.3	-63.8	-154.6	-85.0	-80.0	-110.0
Free Cash Flow	-79.9	26.5	16.3	127.3	210.1	285.9
Investments and Others	58.0	-24.8	1.8	0.0	0.0	0.0
INVESTING CASH FLOW (b)	**-174.8**	**-88.4**	**-152.8**	**-85.0**	**-80.0**	**-110.0**
Debt Issuance / (Repaid)	105.4	52.6	90.3	-80.0	-150.0	-125.0
Interest Expenses	56.8	-40.8	155.0	-25.0	-80.0	-95.0
Share Capital Issuance	0.0	0.0	0.0	0.0	0.0	0.0
Dividend	-56.5	-89.8	-26.6	-39.9	-53.2	-79.8
Others	-6.8	0.0	0.0	0.0	0.0	0.0
FINANCING CASH FLOW (c)	**42.1**	**-37.2**	**63.7**	**-137.3**	**-216.0**	**-212.1**
NET CASH FLOW (a+b+c)	**28.7**	**-35.3**	**81.8**	**-10.0**	**-5.9**	**73.8**

Key Ratios

Particulars	FY19	FY20	FY21	FY22E	FY23E	FY24E
Profitability Ratios (%)						
EBITDA Margin	22.7	25.1	24.0	24.2	25.0	25.3
EBIT Margin	20.1	21.4	20.3	20.4	21.4	21.8
APAT Margin	14.3	14.6	14.7	15.0	16.1	17.6
RoE	19.6	18.8	18.1	18.6	19.5	20.9
RoCE	18.8	18.9	17.5	18.5	21.1	23.4
Solvency Ratio (X)						
Net Debt/EBITDA (x)	1.3	1.2	1.2	0.8	0.3	(0.1)
Net D/E	0.4	0.4	0.3	0.2	0.1	(0.0)
Per Share Data (in Rs)						
EPS	11.6	12.5	13.7	16.4	20.2	25.3
CEPS	14.0	16.0	17.4	21.0	25.2	30.9
BV	63.1	69.8	81.7	95.2	111.3	130.7
Dividend	3.5	4.3	2.0	3.0	4.0	6.0
Turnover Ratio						
Cash Conversion Cycle (days)	142.6	186.8	203.6	187.3	183.7	169.7
Debtor days	79.4	85.9	87.7	87.0	85.0	76.0
Inventory days	88.2	111.4	123.5	116.1	113.3	107.1
Creditors days	24.9	10.5	7.7	15.8	14.7	13.4
Valuation (x)						
P/E	33.4	31.2	28.4	23.7	19.3	15.4
P/BV	6.2	5.6	4.8	4.1	3.5	3.0
EV/EBITDA	22.4	19.3	18.6	15.5	12.7	10.5
EV / Revenues	5.1	4.9	4.4	3.7	3.2	2.7
Dividend Yield (%)	0.9%	1.1%	0.5%	0.8%	1.0%	1.5%

(Source: Company, HDFC sec)

HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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