FundsIndia

Equity Research Desk

# ALPHA

30 AUG 2022

## CCL Products (India) Ltd. – Instant Coffee Producer

| Market Data | |
|---|---|
| CMP | Rs. 480 |
| Date | 30-Aug-22 |
| Target Price | Rs. 565 |
| Upside Potential | 18.00% |
| 52 Week High/Low | 515/310 |
| Market Cap | Small Cap |
| Sector | FMCG - Beverages |
| Rating | Buy |

Continental Coffee (CCL Products India Ltd.) is a leading Indian coffee company in the global coffee market successfully operating businesses in Coffee Exports, Private Label Manufacturing, and Continental Coffee branded coffees. Established in 1994 on a modest scale with just one coffee blend, one factory in Duggirala, Andhra Pradesh, and exporting to one country, CCL has grown to become a leader in the industry globally offering more than 1000 finest quality coffee blends, manufactured across four state-of-the-art facilities (India, Vietnam & Switzerland) to customers across 90 countries. CCL coffee is customized to suit different palates and cater to the diverse needs of customers around the world leading to them becoming manufacturers for top players private label brands in India and globally. They are the largest instant coffee manufacturer in India and one of the largest instant coffee manufacturers in the world. Almost 1000 cups of CCL coffee are consumed every second across the globe.

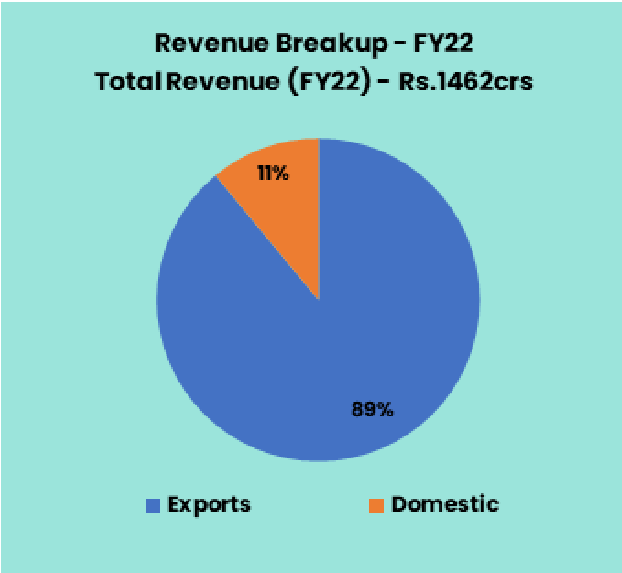
**Products & Services:** The company works under two types of business i.e. B2B and B2C. They have various products under these two types.

**B2B –** Under B2B, the company operates as a contract manufacturer and produce products such as Spray Dried Coffee Powder, Spray Dried Coffee Granules, Freeze Dried Coffee, Freeze Concentrated Liquid Coffee, Roasted Coffee Beans, Roast and Ground Coffee, Premix Coffee and Tea.

**B2C –** Under B2C, the company has its own brands of coffee powders such as Continental Xtra , Continental Speciale, Continental THIS, Continental Black Edition/Premium, Continental Malgudi, etc. Apart from foraying into consumer segment, Continental Coffee has also set up an institutional division and vending division (Vending Machines).

| SHP | Jun - 22 (%) | Mar - 22 (%) | Change |
|---|---|---|---|
| Promoters | 46.26 | 46.26 | 0.00 |
| FPI | 5.80 | 8.19 | -2.39 |
| DII | 22.34 | 19.45 | 2.89 |
| Public & Others | 25.59 | 26.10 | -0.51 |
| Pledged | 0.00 | 0.00 | 0.00 |

**Subsidiaries:** As on 31st Mar 2022, the company has 4 subsidiaries namely Continental Coffee Private Limited, Jayanti Pte. Ltd., Continental Coffee SA and Ngon Coffee Company Ltd.



## Key Rationale

- **Contract Manufacturer -** CCL is primarily a contract manufacturer for global instant coffee brand retailers or private label marketers and it has already established its longstanding presence in the international markets. The majority of CCL's customers have been with the company for >15-20 years, many of whom entered the business only after partnering with CCL, thus demonstrating the quality of their relationship with it. The top 15 clients contribute to 60% of the revenue with Strauss Coffee being the biggest client (10% revenue share). Jacobs Douwe Egberts (JDE, second largest coffee player), LMZ Soluble Coffee, and Extrakt Caffee are some of the other big clients.
- **B2C segment –** 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. CCL had ventured into domestic market in 2014 with the launch of Continental brand in Andhra Pradesh and Telangana. Post its successful launch, the product was rolled out in other states. Showcasing the management's willingness to make it big in India's instant coffee market, in 2016, Continental Coffee Private Limited, a 100% subsidiary, was setup for domestic marketing and brand building. The company has roped in professionals from top FMCG companies for this brand creation.
- **Q1FY23 –** CCL reported strong sales volume growth in Q1FY23 and maintained its spreads despite rising prices of green coffee (key raw material). Its sales grew by 56% YoY to Rs.509 crs led by strong growth in sales volumes (+25%) and also inflation in coffee prices. EBITDA increased by 23% YoY to Rs.88.5 crs. Although EBITDA margin contracted 469 bps YoY to 17.4%, it maintained its spread (on absolute basis) which is apparent from 23% growth in EBITDA. Net profit grew by 20% YoY to Rs.52.7 crs. During the quarter, other expense cost grew by 32% QoQ at consolidated level due to higher logistics cost led by Russia-Ukraine war.
- **Financial Performance –** The ten-year revenue and profit CAGR stand at 11% and 19% respectively. The balance sheet of the company is strong with a debt-to-equity ratio of 0.5x. The doubling of Vietnam capacity plant will get completed by Q3FY23. The commercial production will begin from Q4FY23. The company aims to set up a greenfield facility for spray dried instant coffee through its wholly owned subsidiary in Andhra Pradesh. The total capex outlay will be around Rs.320 crs. The plant is expected get commissioned by Q4FY24. With this and existing plants, company targets strong volume growth in coming 3-4 years.

| Ratios - FY22 | |
|---|---|
| ROE | 16% |
| ROCE | 14% |
| Div. Yield | 1.08% |
| PE Ratio | 31.00 |
| Face Value | 2.00 |
| EPS | Rs. 15.36 |

## Industry Analysis

India is among the top 10 coffee-producing countries, with about 3% of the global output in 2020. Indian coffee is one of the best coffees in the world due to its high quality and gets a high premium in the international markets. Robusta is the majorly manufactured coffee with a share of 72% of the total production. The industry provides direct employment to more than 2 million people in India. Since coffee is mainly an export commodity for India, domestic demand and consumption do not drastically impact the prices of coffee. Coffee is one of the world's most popular commodities, and as of 2020, the coffee market was valued at around US$ 466 billion. Indian coffee exports display a seasonality, with exports peaking from March to June. The country exports over 70% of its production. In 2021-22, the total exports recorded a 42% rise to US$ 1.04 billion from the previous year. Italy, India's largest export market, accounts for 20% of bean coffee exports. Europe, where people prefer the more bitter and stronger flavors of the Robusta blend, makes up 42% of India's exports.

## Growth Drivers

The Government of India took the initiative to provide subsidies to the farmers between US$ 2,500-US$ 3,500 per hectare for developing coffee in the traditional areas.

The changing lifestyles, increasing expenditure capacities and shifting dietary preferences of consumers are further providing a thrust to the market growth. Due to the increasing working population and hectic schedules, the consumption of Ready-To-Drink tea and coffee products has escalated significantly.

Despite being a tea-drinking nation, coffee has been growing in popularity over the past decade, fuelled by the local cafe culture scene.

## Peer Analysis

**Competitors:** Tata Coffee

Tata Coffee is the direct competition for the company and it is the second largest producer of instant coffee next to CCL products. The only difference is that the CCL is a pure play producer and Tata coffee is more than a producer. Tata possesses a risk of cultivating coffee plantations. In terms of financial performance, CCL products is way ahead of Tata coffee.

| Company | CMP | Mcap. | ROE | ROCE | P/E | EPS |
|---|---|---|---|---|---|---|
| CCL Products | 480 | 6375 | 16.00% | 14.00% | 31 | 15.36 |
| Tata Coffee | 235 | 4380 | 9.00% | 12.00% | 30 | 7.91 |

## Outlook

The Management remains confident of achieving its guidance of 20-25% volume, 20-25% bottom-line growth, sustaining healthy per/Kg EBITDA profitability driven by operating leverage, superior product mix and realization growth in FY23. Domestic branded business is expected to grow by 40% in FY23. Key volume growth drivers are 1) Robust order book, 2) Capex doubling production capability in Vietnam, 3) Elevated green coffee prices, and 4) Penetration-led gain in the domestic B2C business. The company currently commands a market share of 3.5% in Southern states of India namely Andhra Pradesh, Karnataka and Tamil Nadu. CCL has ventured into protein-based products with a brand name Continental green bird in B2C category. Chhattisgarh, Pune and Hyderabad were the key states where products are launched. Going ahead, focus will remain towards increasing their penetration in H2FY23.

| Margins - FY22 | |
|---|---|
| Gross | 51% |
| EBITDA | 23% |
| PAT | 14% |

## Valuation

The company is a pure play coffee processor and doesn't own any cultivations. The diversified offerings, Leadership status, inhouse packaging and a strong order book gives the company a competitive edge. We recommend a BUY rating in the stock with the target price (TP) of Rs.565, 23x FY24E EPS.

## Risks

- **Forex risk –** 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.

- **Regulatory Risk –** CCL supplies coffee to over 90 countries from India and Vietnam. Any unfavourable 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.

- **Credit Risk –** With more than ~85% 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.

Source – Tickertape, Company's Website, BSE Website.

**Thanks & Regards**

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