NIRMAL BANG
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Institutional Equities

CCL Products

Brewing Hot!

CCL Products (India)

27 August 2014

Reuters: CCLP.BO; Bloomberg: CCLP IN

Initiating Coverage

Brewing Hot!

CCL Products (India), or CCL, is among the world's leading and India's largest processor and exporter of instant coffee with exports to more than 67 countries. It has ~10% global market share in instant coffee exports, if one excludes Nestle's captive consumption. CCL is one of the very few companies globally that have successfully scaled up this business and increased its capacity ~10 times since inception in 1995, and that too without equity dilution. With the ramp-up at its Vietnam plant, revenue/ EBITDA are likely to post 22.1%/20.3% CAGRs, while with zero tax facility in Vietnam and lower debt, net profit would grow at 38.6% CAGR over FY14-FY16E. CCL stock trades at an attractive valuation of 9.7x/6.3x FY16E P/E and EV/EBITDA, respectively. Market leader status with a strong free cash flow of Rs3.4bn, a likely 1,097bps rise in RoCE at 23.3% from 12.3% over FY14-FY17E and a debt-free status by FY17 are likely to result in a strong re-rating. We have assigned Buy rating to it with a TP of Rs140 based on 15.0x/9.5x FY16E P/E and EV/EBITDA, respectively, up 56% from the CMP.

Newly commissioned plant at Vietnam to drive growth: CCL commissioned its 10,000tn instant coffee plant in Vietnam in 2HFY14, which will drive consolidated volume by 28.2%/11.4% in FY15E/FY16E versus 3.3%/13.0% in FY13/FY14, respectively. The Vietnam plant offers four benefits: 1) Logistical advantage of ~US$150/tn because of proximity to coffee-growing zone, 2) Better raw material availability, with lead time lower by one-and-a-half months as Vietnam is the second-largest green coffee grower, 3) Favourable duty structure and close proximity to coffee-consuming ASEAN nations like Japan, Korea, China, etc, and 4) No income-tax for first four years and tax exemption of 50% for next nine years.

Working capital cycle improves: Higher working capital needs of the Indian plant at 36.1%/29.0% are mainly on account of higher inventory at 128/115 days in FY13/FY14, respectively, as a significant portion (~65%) of green coffee beans is imported. CCL can source green coffee beans in 24 hours for its Vietnam plant, while in India it takes two months for raw material transit and import clearance, and, therefore, the working capital cycle for the Vietnam plant is likely to be at least six weeks lower than its Indian plant. In the wake of faster ramp-up of its Vietnam facility likely from FY15, we expect consolidated working capital needs to reduce from 39.7%/32.4% in FY13/FY14 to 27.7%/26% in FY16E/FY17E, respectively.

Lower capex, better working capital to drive healthy cash flow/return ratios: Following healthy revenue CAGR of 22.1%, EBITDA is likely to post a 20.3% CAGR, while with zero tax facility at the Vietnam plant and lower debt, net profit is likely to register a 38.6% CAGR over FY14-FY16E. As CCL has completed a major portion of its capex, it is likely to incur only maintenance capex. With strong profitability, lower capex and improving working capital cycle, free cash flow generation is likely to be very healthy. We expect CCL to generate free cash flow of Rs3,405mn over FY14-FY17E, which will be utilised to repay its Rs2,921mn debt and also improve dividend payout. Despite better volume and strong profitability, capital employed may remain flat over FY14-FY17E, leading to a healthy improvement in RoCE from 11.2%/12.3% in FY13/FY14 to 20.2%/23.3% in FY16E/ FY17E, respectively.

Foray into retailing of instant coffee: CCL ventured into branded coffee market with launch in Andhra Pradesh (AP) and aims to achieve revenue of Rs3bn/Rs5bn in the next three/five years, respectively. We contacted few department stores in AP and found out that its branded coffee gets sold in less than 15 days, which itself speaks for the quality and value offering.

Y/E March cons. (Rsmn)	FY12	FY13	FY14	FY15E	FY16E	FY17E
Net sales	5,022	6,507	7,168	9,496	10,682	11,432
Growth (%)	*38.0*	*29.6*	*10.2*	*32.5*	*12.5*	*7.0*
EBITDA	871	1,213	1,431	1,805	2,070	2,258
EBITDA margin (%)	*17.4*	*18.6*	*20.0*	*19.0*	*19.4*	*19.8*
Net profit	363	474	644	920	1,237	1,498
EPS (Rs)	2.7	3.6	4.8	6.9	9.3	11.3
EPS growth (%)	*46.2*	*30.8*	*35.8*	*42.8*	*34.4*	*21.1*
RoE (%)	*15.9*	*18.3*	*20.4*	*23.6*	*25.8*	*25.1*
RoCE (%)	*9.8*	*11.2*	*12.3*	*16.4*	*20.2*	*23.3*
PE ratio (x)	33.0	25.2	18.6	13.0	9.7	8.0
EV/EBITDA (x)	16.7	12.3	10.2	7.8	6.3	5.2

Disclaimer: Nirmal Bang Financial Services owns 1.36mn shares (1.02% stake) in CCL
Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: Beverages

CMP: Rs90

Target Price: Rs140

Upside: 56%

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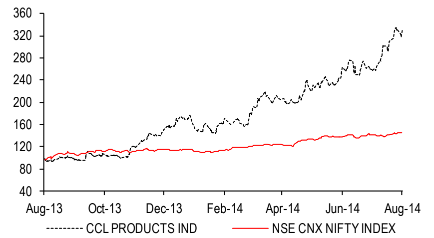
Key Data	
Current Shares O/S (mn)	133.0
Mkt Cap (Rsbn/US$mn)	11.4/187.9
52 Wk H / L (Rs)	92/24
Daily Vol. (3M NSE Avg.)	717,934

Share holding (%)	1QFY15	4QFY14	3QFY14
Promoter	44.5	44.5	44.5
FII	-	-	4.4
DII	9.2	9.6	9.7
Corporate	7.8	6.7	5.7
General Public	38.5	39.2	35.7

One-year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
CCL Products	22.6	85.5	220.9
Nifty Index	1.5	26.7	49.5

Source: Bloomberg

Valuation

CCL is among the world's leading and Indian's largest processor and exporter of instant coffee, with exports to more than 67 countries. If one excludes Nestle's captive consumption, CCL has ~10% global market share in instant coffee exports. Coffee processing is a niche and highly profitable industry, but has high entry barriers. Coffee processing is not an easy business, as it is very important to get the right blend. Further, the taste and preference varies region-wise and culture-wise. Experience and relationships are key to success, and the model is not easily replicable. It takes three to five years to win over a client and establish one's credentials. CCL is one of the very few companies globally that have successfully scaled up this business. CCL's USP is its technology, which it acquired from Brazil, allowing it to use low grade of green (or raw) coffee beans to produce very high quality instant coffee. As stated above, coffee business is very tough to scale up, and the profitability, return ratios and cash flow of CCL remained subdued until FY11, adversely impacting its valuation. Therefore, its historical valuation is not the right benchmark.

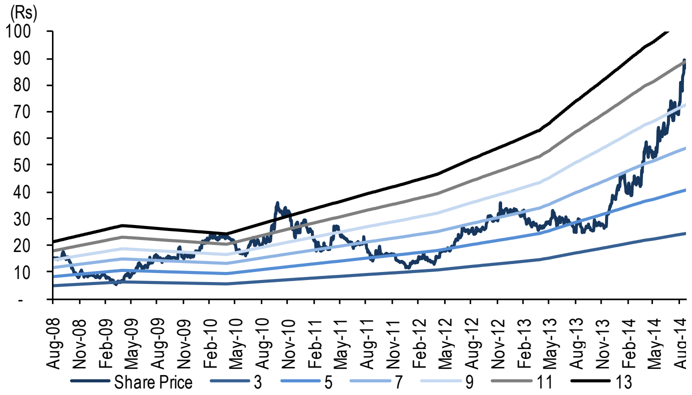
CCL has increased its capacity ~10 times since inception in 1995 (~3,500tn) and more than three times in the past six years at 33,000tn currently. The expansion was funded mainly through internal accruals, and without recourse to significant debt. CCL has not raised any fresh equity since its listing in 1995. In addition, its debt profile is conservative with peak D/E ratio of ~1.6x and current D/E ratio of 0.8x. The benefit of the work done by CCL until FY11 was visible in the past three years, with net sales/EBITDA/PAT CAGRs at 25.4%/30.1%/37.5%, respectively, over FY11-FY14, leading to a re-rating of CCL stock after November 2013.

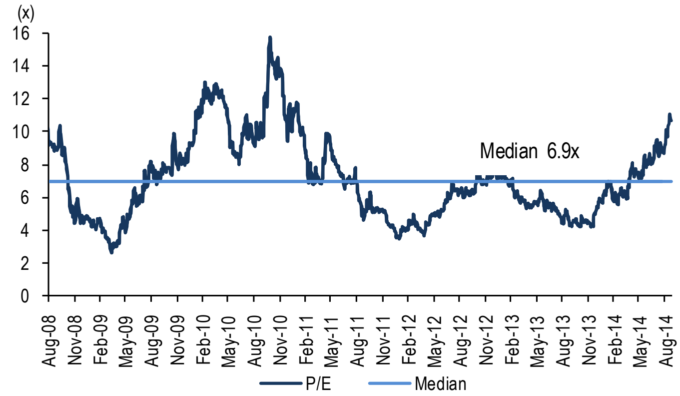
Global green coffee market size is estimated at US$6-7bn at farm-grade cost, which eventually translates into retail sales of ~US$90bn-100bn globally. Significant value is captured in the coffee processing stage and this make companies like CCL an important and integral part of the value chain; however it is not yet reflecting in the valuation. In the roasted coffee market, Nestle and Kraft are major players along with Sara Lee, Ichibo, Starbucks etc. Nestle dominates the instant coffee retail market, while CCL is among the large players in processing green coffee to make instant coffee. Given the dominance of a few players (especially in instant coffee - Nestle), coffee is an extremely profitable business across the value chain. Every country has some local/international challenger brand to Nescafe (Nestle), which figures in CCL's target client list. CCL has now diversified operations in three countries - India, Switzerland and Vietnam - and plans to set up a plant in Africa. The diversified presence will help CCL to gain access to new markets and also exploit arbitrage opportunities between different manufacturing plants to its advantage which would also improve valuation due to lower volatility in earning profile. To cite an example, CCL will leverage the lower duty structure available for its Vietnam plant in several Asian markets and also leverage extended tax benefit.

Following a healthy revenue CAGR of 22.1%, EBITDA is expected to post a 20.3% CAGR, while with zero tax at Vietnam plant and lower debt, net profit is likely to register a 38.6% CAGR over FY14-FY16E. As CCL has completed a major portion of its capex, it is likely to incur only maintenance capex. With strong profitability, lower capex and improving working capital cycle, free cash flow generation is expected to be very healthy. We expect CCL to generate free cash flow of Rs3,405mn over FY14-FY17E which will be utilised to repay its entire debt of Rs2,921mn and also improve dividend payout. Despite healthy volume and strong profitability, capital employed is likely to remain flat over FY14-FY17E, leading to a healthy improvement in RoCE from 11.2%/12.3% in FY13/FY14 to 20.2%/23.3% in FY16E/ FY17E, respectively.

Market leader status with a strong free cash flow of Rs3.4bn, RoCE likely to improve by 1,097bps at 23.3% from 12.3% over FY14-FY17E and a free cash flow yield of 13.6% with a debt-free status likely by FY17 are expected to result in a strong re-rating of CCL stock price. We have assigned Buy rating to CCL with a target price of Rs140 based on15.0x/9.5x FY16E P/E and EV/EBITDA respectively, up 56% from the current market price.

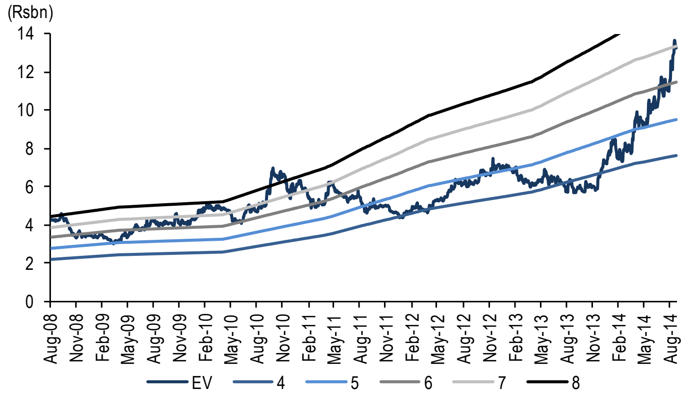
Exhibit 1: P/E band

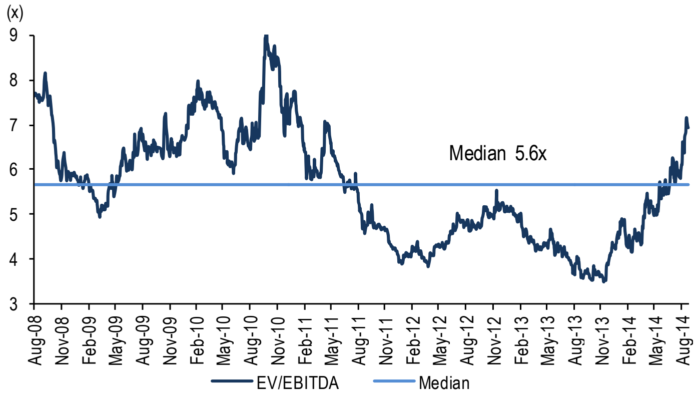




Source: Company, Industry, Nirmal Bang Institutional Equities Research

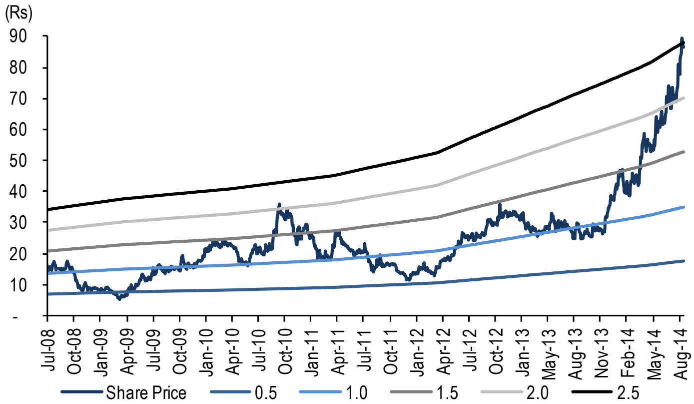
Exhibit 2: EV/EBITDA band

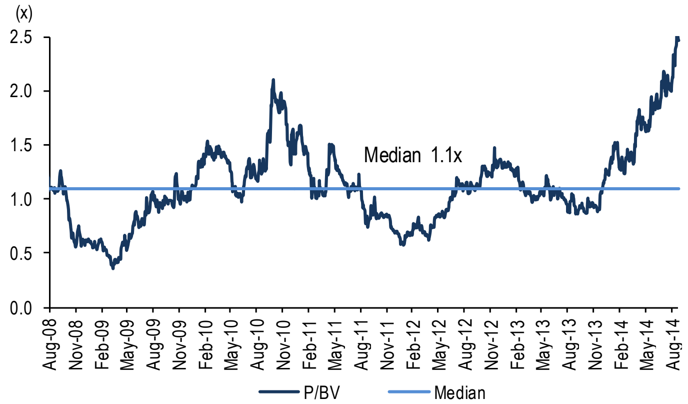




Source: Company, Industry, Nirmal Bang Institutional Equities Research

Exhibit 3: P/BV band





Source: Company, Industry, Nirmal Bang Institutional Equities Research

Source: Company, Industry, Nirmal Bang Institutional Equities Research

Investment Rationale

Newly commissioned plant in Vietnam to drive growth

CCL has a plant in India having production capacity of 15,000tn at Guntur in Andhra Pradesh. This plant operated at 88% of its capacity in FY14 and registered volume growth of a mere 1.5%, leading to standalone revenue growth of 4.5%. CCL has improved its product mix, which resulted in a 253bps improvement in operating margin and, consequently, EBITDA growth was healthy at 18.9%.

CCL commissioned its greenfield 10,000tn project in April 2013 for manufacturing instant coffee in Vietnam at a total investment of US$40mn (including working capital). The company took a long time to commence commercial production because of adoption of latest technology and synchronisation of the plant. Commercial production from the plant started in 2HFY14. We believe the full benefit of this facility will be visible from FY15. We expect the Vietnam plant to achieve 55%/75% capacity utilisation rates in FY15E/FY16E, respectively, resulting in consolidated volume growth of 28.2%/11.4% in FY15E/FY16E as against 3.3%/13% in FY13/FY14, respectively. In addition, CCL has also shifted its 5,000tn liquid coffee plant from India to Vietnam at a total cost of ~US$10mn. We believe the company completed a major portion of its capex and, therefore, cash flow generation is expected to be healthy.

With the Vietnam plant coming on stream, CCL is strategically located in terms of:

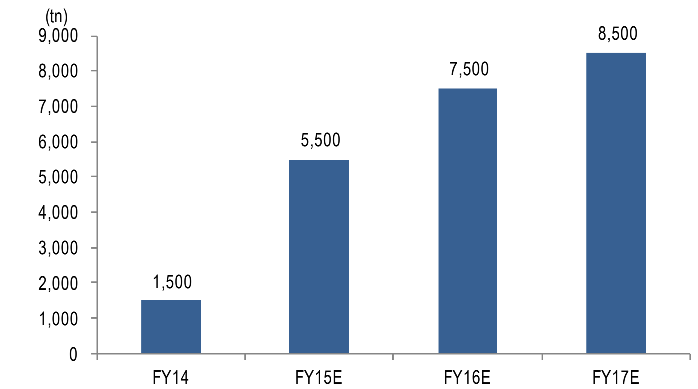
a) **Logistical advantage:** The plant is located in a coffee production zone in Vietnam, which provides logistics benefit to CCL. We believe the company will enjoy savings of US$150/tn on the logistics front.

b) **Raw material availability:** The plant is located in Dak Lak province, which is the highest green coffee bean-producing area in Vietnam (Vietnam is the second-largest green coffee bean grower after Brazil, accounting for 18.3% of the world's coffee production). As a result, the plant will have easy access to raw materials, thereby reducing the lead time to a great extent (1.0-1.5 months).

c) **Market proximity:** Owing to the Vietnam plant, CCL can easily cater to the coffee requirements of ASEAN countries and those in close proximity like Japan, Korea, China, etc. In addition, Vietnam enjoys the 'most favoured nation' status with many countries, thereby enjoying reduced or nil duty structure. The Vietnam plant will cater to domestic as well as overseas markets.

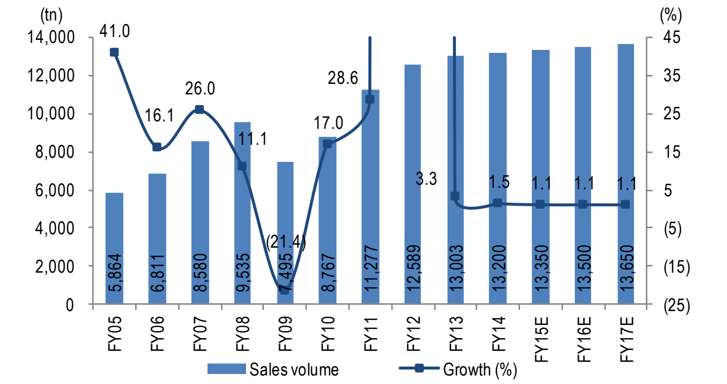
d) **Tax benefit:** The Vietnam plant enjoys nil income-tax benefit for first four years and tax exemption of 50% for next nine years.

Exhibit 4: Sales volume - Vietnam plant



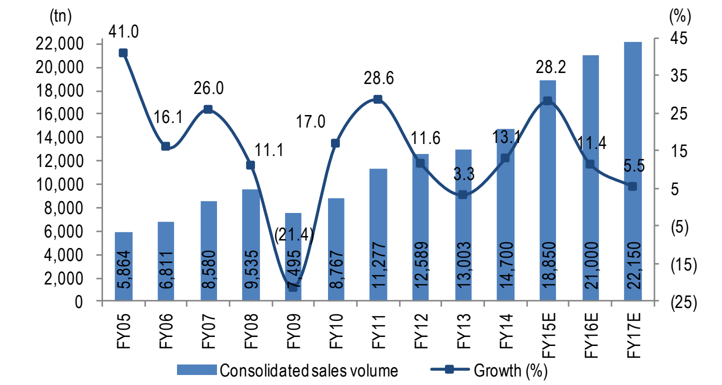
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Sales volume - Indian plant



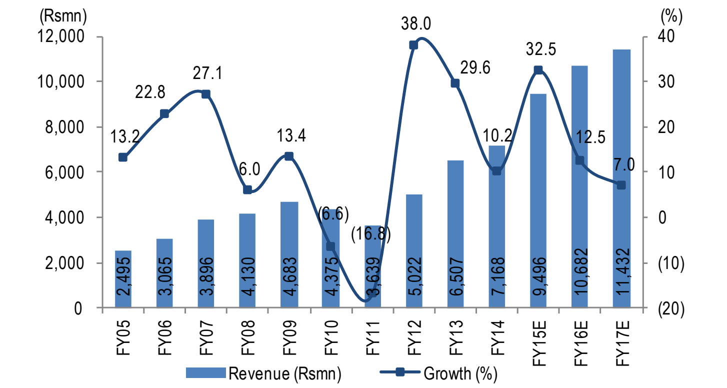
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Consolidated sales volume



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Revenue CAGR of 22.1% likely over FY14-FY16E

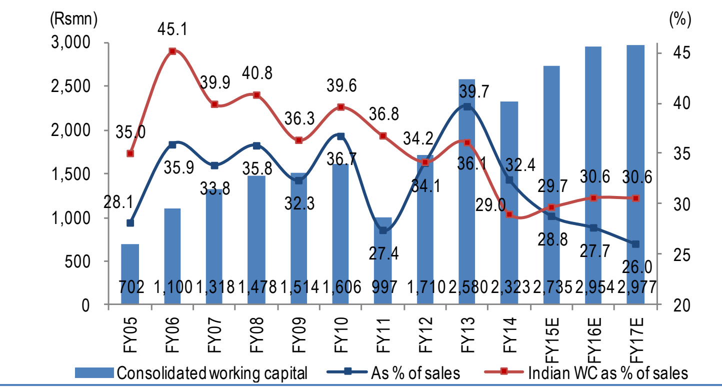


Source: Company, Nirmal Bang Institutional Equities Research

Working capital cycle improves

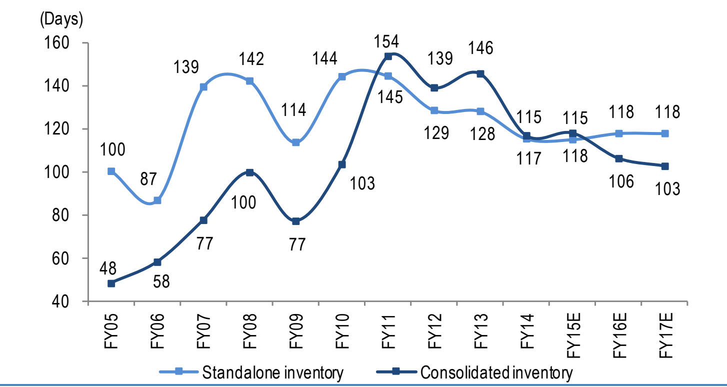
Working capital requirement for CCL's Indian plant stood at 36.1%/29.0% in FY13/FY14, respectively. Higher working capital at the Indian plant is mainly on account of higher inventory at 128/115 days in FY13/FY14, respectively, as a significant portion (~65%) of green coffee beans is imported. Working capital cycle for its Vietnam plant is expected to be at least six weeks lower compared to the Indian plant, as the transit time for raw materials and finished goods is likely to be significantly lower compared to the Indian plant. The company can source green coffee in 24 hours for its Vietnam plant, while in India it takes two months for raw material transit and import clearance. With faster ramp-up of its Vietnam facility likely from FY15, we expect consolidated working capital requirement to reduce from 39.7%/32.4% in FY13/FY14 to 27.7%/26% in FY16E/FY17E, respectively.

Exhibit 8: Working capital requirement moderates



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Consolidated inventory days moderate



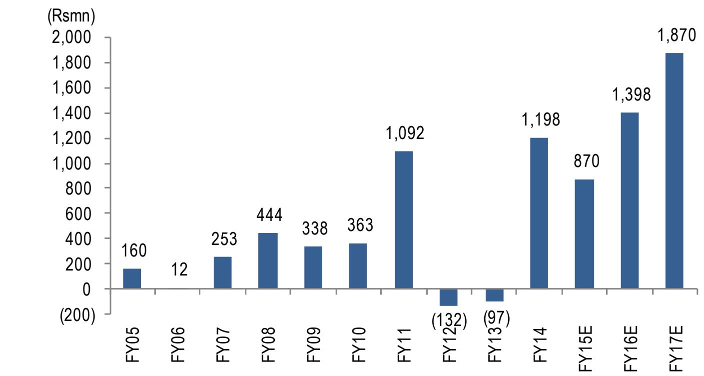
Source: Company, Nirmal Bang Institutional Equities Research

Lower capex, better working capital to drive healthy cash flow/return ratios

CCL increased its revenue at a strong pace of 25.4%/8.9% CAGRs over the past three/five years, respectively, on the back of healthy volume growth and a better product mix. Following healthy revenue CAGR of 22.1%, we expect EBITDA to post a 20.3% CAGR over FY14-FY16E. With zero tax at its Vietnam plant for next four years and lower debt, net profit is expected to post a healthy 38.6% CAGR over the same period.

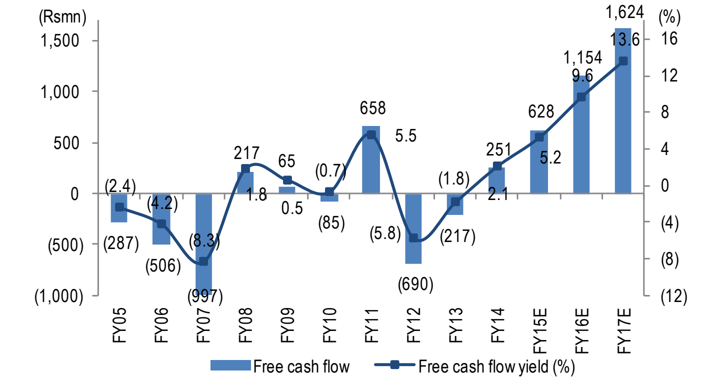
As CCL has completed a major portion of its capex, we don't expect any significant capex in FY15/FY16. CCL is likely to incur only maintenance capex at its Indian plant. With lower inventory days at its Vietnam facility, its consolidated working capital position is likely to improve from 39.7%/32.4% in FY13/FY14 to 27.7%/26% in FY16E/FY17E, respectively. With strong profitability, lower capex and improving working capital cycle, free cash flow generation is expected to be very healthy. We expect CCL to generate free cash flow of Rs3,405mn over FY14-FY17E and generate free cash flow yield of 9.6%/13.6% in FY16E/FY17E, respectively.

Exhibit 10: Healthy operating cash flow



Source: Company, Nirmal Bang Institutional Equities Research

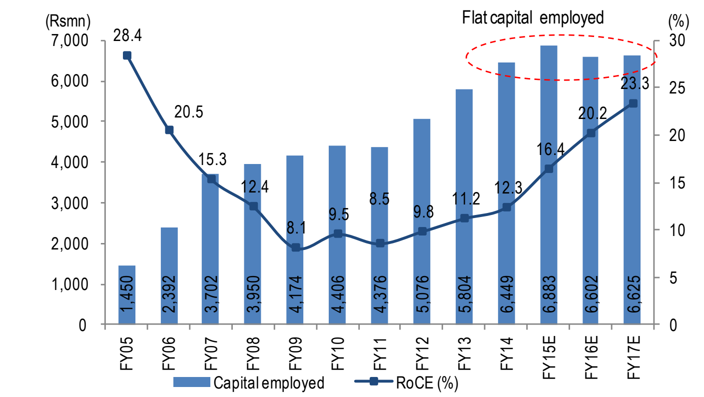
Exhibit 11: Strong free cash flow and free cash flow yield



Source: Company, Nirmal Bang Institutional Equities Research

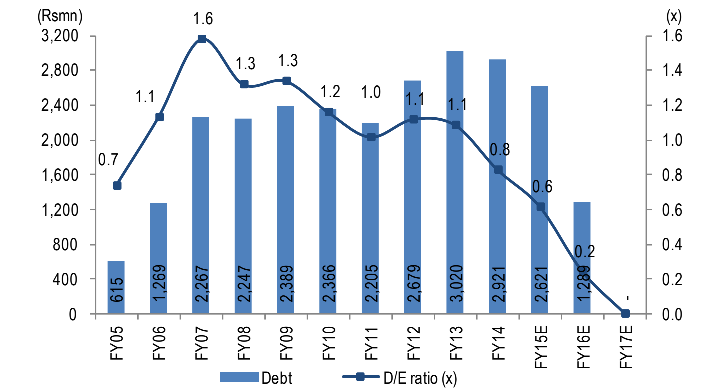
Despite healthy volume and strong profitability, capital employed may remain flat over FY14-FY17E, leading to a healthy improvement in RoCE from 11.2%/12.3% in FY13/FY14 to 20.2%/23.3% in FY16E/FY17E, respectively. Healthy free cash flow and robust return ratios are likely to result in strong re-rating of CCL stock.

Exhibit 12: Healthy operating cash flow



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Debt-free status likely by FY17



Source: Company, Nirmal Bang Institutional Equities Research

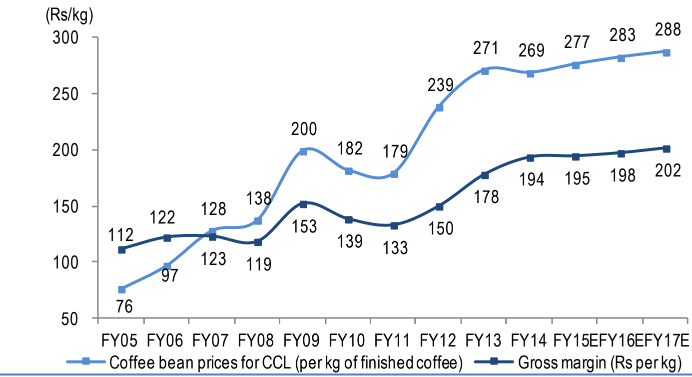
Debt-free balance sheet likely by FY17

Currently, CCL has debt of Rs2,921mn with the D/E ratio at 0.83x. Out of Rs2,921mn debt, Rs1,180mn is of Indian operations while the balance Rs1,741mn is of overseas operations, mainly pertaining to the Vietnam plant. We expect CCL to generate a healthy free cash flow of Rs3,405mn over FY14-FY17E, which is likely to be utilised to repay the entire debt and also improve dividend payout.

Business model isolated from volatility in coffee bean prices

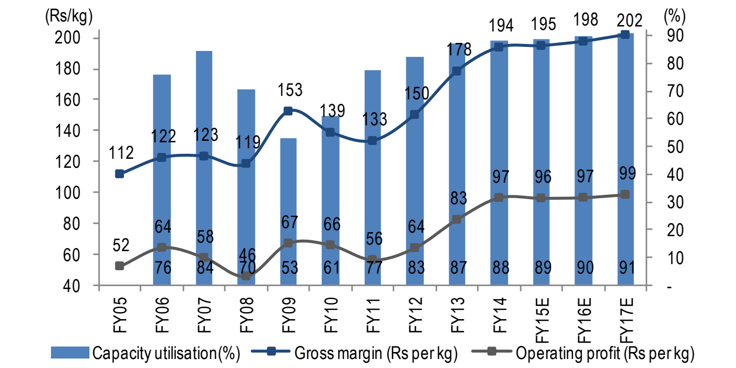
CCL remains unaffected by fluctuations in green coffee bean prices or coffee prices as it places orders for green coffee only on receiving an order for instant coffee and makes back-to-back arrangements for green coffee beans. In other words, CCL operates on fixed margins without carrying the risk of coffee price volatility. In India, CCL procures green coffee beans by importing them (~65%) from global markets (Vietnam, Indonesia, African countries) as well as from the domestic market (~35%), primarily from Chikmagalur in Karnataka.

Exhibit 14: Coffee bean prices versus operating margin



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Product mix driven by constantly improving margins



Source: Company, Nirmal Bang Institutional Equities Research

Sustainable improvement in gross/EBITDA margins on the back of better product mix

CCL improved its capacity utilisation level from 70.5% in FY08 to 88.0% in FY14. Earlier, to utilise its capacity, the company was producing more vanilla coffee, although the margins were low. As CCL was able to secure more clients and increase off-take per client gradually, it increased the proportion of value-added coffees like double filter coffee, triple filter coffee etc. With the rising share of value-added coffee, gross margin improved continuously from Rs119/Rs153 per kg in FY08/FY09 to Rs178/Rs194 per kg in FY13/FY14, respectively. With the commissioning of its Vietnam facility, CCL is expected to shift a part of bulk plain vanilla orders from its Indian operations to the Vietnam plant and focus more on value-added products locally, consequently, its gross margin per kg is expected to improve further.

Exhibit 16: Per kg coffee analysis-standalone operations

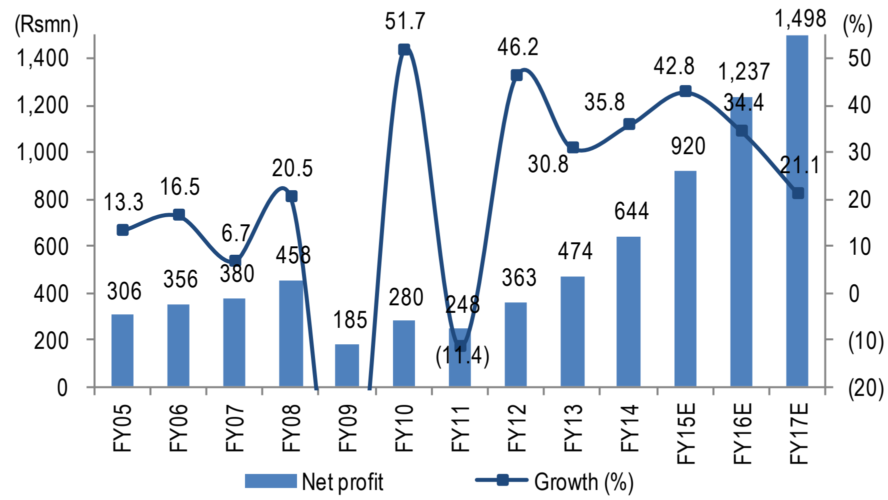
(Rs per kg of coffee)	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
Revenue	188	220	252	256	352	321	313	389	450	463	471	481	490
Raw material costs	76	97	128	138	200	182	179	239	271	269	277	283	288
Gross margin	**112**	**122**	**123**	**119**	**153**	**139**	**133**	**150**	**178**	**194**	**195**	**198**	**202**
Power & fuel costs	7	6	9	14	14	19	21	20	29	26	30	31	32
Employee costs	3	4	4	4	7	6	7	10	13	17	15	15	15
Other expenses	50	48	53	55	65	48	49	56	54	55	54	55	56
Total other costs	**59**	**58**	**66**	**73**	**85**	**73**	**77**	**86**	**96**	**97**	**99**	**101**	**103**
EBITDA	**52**	**64**	**58**	**46**	**67**	**66**	**56**	**64**	**83**	**97**	**96**	**97**	**99**
Growth (%)													
Revenue	*3.2*	*16.6*	*14.6*	*1.9*	*37.3*	*(8.8)*	*(2.5)*	*24.3*	*15.6*	*2.9*	*1.8*	*1.9*	*1.9*
Raw material costs	*14.2*	*27.0*	*32.1*	*7.3*	*44.9*	*(8.7)*	*(1.5)*	*33.0*	*13.7*	*(0.8)*	*2.8*	*2.3*	*1.7*
Gross margin	***(3.2)***	***9.4***	***0.7***	***(3.8)***	***28.5***	***(9.0)***	***(3.9)***	***12.6***	***18.7***	***8.7***	***0.5***	***1.4***	***2.2***
Power & fuel costs	*(30.2)*	*(4.8)*	*39.7*	*54.0*	*0.2*	*37.9*	*10.0*	*(2.6)*	*42.8*	*(10.6)*	*16.2*	*2.7*	*4.3*
Employee costs	*(28.7)*	*16.7*	*9.8*	*6.8*	*68.5*	*(12.7)*	*16.8*	*46.4*	*29.2*	*23.3*	*(8.9)*	*0.3*	*0.3*
Other expenses	*61.7*	*(3.2)*	*9.5*	*4.1*	*17.7*	*(26.0)*	*2.8*	*13.0*	*(3.2)*	*2.3*	*(2.5)*	*2.8*	*1.9*
Total - other costs	***(6.6)***	***(2.4)***	***12.8***	***11.0***	***17.3***	***(14.7)***	***5.8***	***11.9***	***11.4***	***1.4***	***1.3***	***2.4***	***2.4***
EBITDA	***1.0***	***22.8***	***(10.1)***	***(20.6)***	***46.2***	***(1.7)***	***(14.5)***	***13.7***	***28.5***	***17.1***	***(0.3)***	***0.4***	***1.9***

Source: Company, Nirmal Bang Institutional Equities Research

PAT expected to grow faster than net sales

While net revenue is expected to post a CAGR of 22.1% over FY14-FY16E, we expect PAT to witness a CAGR of 38.6% on the back of lower interest costs and tax exemption for the Vietnam plant (no income-tax for first four years and a 50% tax exemption for next nine years).

Exhibit 17: PAT to post a 38.6% CAGR over FY14-FY17E



Source: Company, Nirmal Bang Institutional Equities Research

Foray into retailing of instant coffee to be beneficial in the long run

Domestic market of CCL can be classified into three segments: 1) In-house brand – mostly operative in AP, 2) Private label sales mostly through tie-up with modern trade like Reliance, Spencer, etc, and 3) Sales to ice-cream manufactures, coffee shops etc.

CCL plans to launch its own products in India under the brand name Continental (Spéciale, Premium and Supreme) and has already made a soft launch in AP. We contacted a couple of department stores in AP and found that currently its branded coffee is sold in less than 15 days, which itself speaks for the quality and value offering.

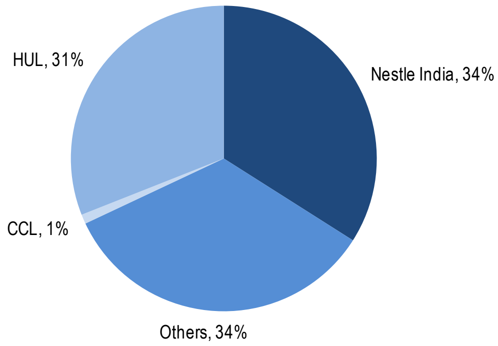
CCL competes with the likes of Nescafe (Nestle India or NIL) in the instant coffee market. Competitors' brands like Bru and Sunrise are chicory coffees and the company is not competing with them. CCL had a bad experience in 1997 in its branded coffee business, when CCL launched only pure vanilla coffee on a pan-India basis, which resulted in lower volume and higher advertisement and other costs. Therefore, CCL is not rolling out its coffee brand national-wide and is doing a soft launch state-wise with a bouquet of products. CCL started doing private labeling for Reliance, Spencer and other super markets, which also helped CCL to get space for the Continental brand in these super markets, thereby increasing its visibility. It will take two more years for CCL to roll out its own brand nationally. As CCL is rolling out state-wise with a bouquet of products with greater space in department stores, its advertisement costs are expected to remain under control. In addition, we expect, CCL to generate Rs3.4bn free cash flow over FY14-FY17E, which will also support brand-building activity, if required.

Domestic instant coffee opportunity is as big as Rs30bn and coffee consumption in India is expected to post a 6% CAGR over CY13-CY15E at 145,185tn. NIL and HUL dominate the branded coffee market in India with a combined organised market share of more than 65%.

Unlike NIL, which sells only spray dried coffee, CCL has a wider portfolio comprising premium freeze dried coffee, pure vanilla coffee products, etc. In addition, competitors (NIL and HUL) do not have manufacturing capacities (for freeze dried instant coffee) and CCL has been manufacturing value-added coffee like single filter, double filter, freeze dried, etc at a much lower cost. Hence, CCL is able to offer better products at prices lower than its competitors.

CCL's management aims to achieve revenue of Rs3bn/Rs5bn from branded coffee in the next three/five years, respectively, with a market share of ~20%. As of now, we haven't factored in any revenue from branded coffee in our estimates and if CCL is able to achieve the target set by the management, then there will be upside risk to our estimates and target price.

Exhibit 18: Market share of key players



Source: Fair Trade Foundation, Nirmal Bang Institutional Equities Research

Exhibit 19: Various coffee brands

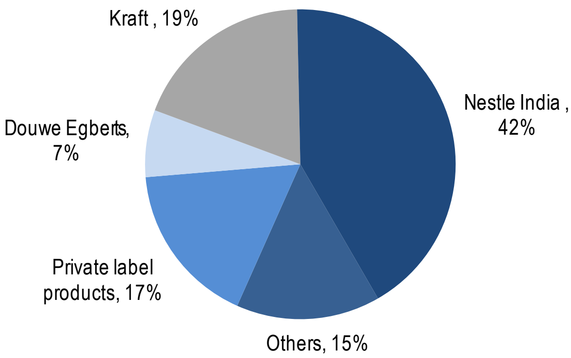
Company	Brands
NIL	Nescafe Classic, Nescafe Mild, Sunrise
HUL	Bru, Delux Green Label
Tata Coffee	Mr Bean, Tata Café, Mysore Gold Coffee, Tata Kaapi
CCL Products	**Continental Speciale, Continental Premium, Continental Supreme**

Source: Fair Trade Foundation, Nirmal Bang Institutional Equities Research

Competitive landscape and strategy – international business

International market of CCL can be classified into two segments viz. 1) Private label (70% of exports) and 2) Bulk (30% of exports). Global market is dominated by large corporates - Nestle, Kraft, Procter & Gamble, Sara Lee and Tchibo - which control half of the global retail market for coffee. CCL indirectly competes with these large corporates through private label brands of its customers. The rising share of private labels globally is because of increased dominance of modern trade. To cite an example, in the UK, large corporates control around 68% of the retail coffee market and private labels have also made their mark with a dominant share of 17%.

Exhibit 20: Market share of key players



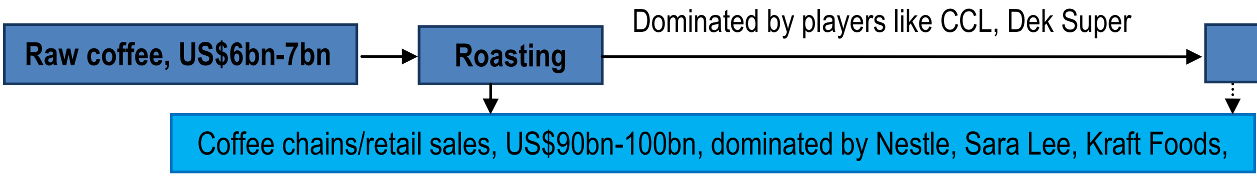
Source: Fair Trade Foundation, Nirmal Bang Institutional Equities Research

Exhibit 21: Various coffee brands and CCL's key customers

Company	Brands
Nestle	Nescafe 3in1, Nescafe Cappuccino, Nescafe Classic, Nescafe Decaf, Nescafe Dolce Gusto
Kraft Foods	Gevalia coffee
Sara Lee	Merrild, Douwe Egberts, Café Damasco, Café do Ponto, Café Pilao, Cafitesse, Cain's Coffee
Global private labels (CCL customers)	**JFK International, Mirador, Fort Coffe, Brazilian Gold Coffee, Unicafe, Grand, Café Royale**

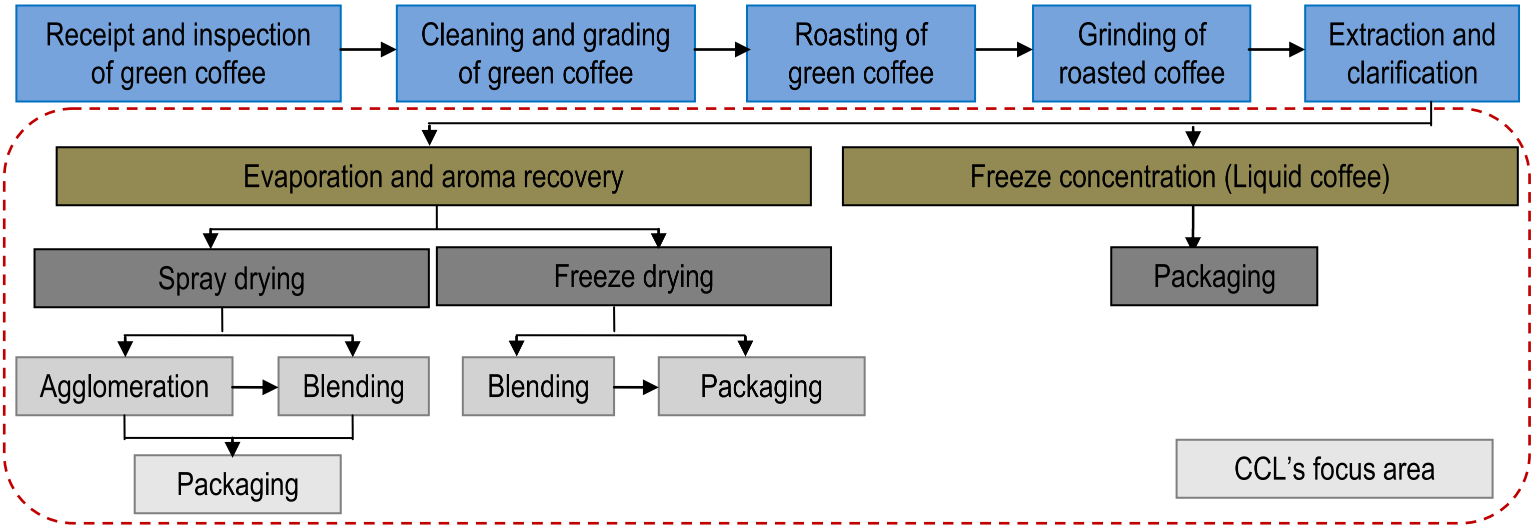
Source: Fair Trade Foundation, Nirmal Bang Institutional Equities Research

Exhibit 22: Industry overview



Source: Industry, Nirmal Bang Institutional Equities Research

Exhibit 23: Coffee manufacturing process



Source: Industry, Nirmal Bang Institutional Equities Research

Key concerns

- **Swiss plant duty:** CCL's Swiss plant is operating at sub-optimal utilisation level because of non-competitive pricing of supplies from Switzerland to the EU. Import duty levied by the EU on Swiss coffee is 9.0% whereas only 3.3% is charged on coffee supplies from India. However, CCL has taken steps to avoid the adverse duty impact.
- **Currency fluctuations:** Exports contribute almost 90% to CCL's total revenue and it is thus exposed to currency fluctuations. However, CCL imports ~65% of its raw material requirements, which acts as a natural hedge.
- **Competition from new players:** Despite having strong entry barriers in the coffee business (capital intensity, brand image, goodwill, quality, consistency in flavours and taste to remain competitive in the business), there is no denying the fact that the rise in competition from existing or new players can spoil CCL's grand party and also affect our estimates.
- **Moderation in consumption:** Because of economic slowdown, coffee consumption can be negatively impacted globally, which in turn may slow down sales and profitability of CCL and affect our estimates.
- **Change in duty structure:** Any adverse change in the duty structure in Vietnam and India, as it happened in Switzerland post commissioning of CCL's plant, may impact profitability of the company.

Key upside Risks

Some of the recent strategic initiatives of CCL are yet to bear fruit and provide upside to our estimates/target price like:

- Its Swiss operations are yet to make profit because of certain problems. However, the same are likely to be resolved in FY15, providing a further boost to earnings, which we haven't factored in our estimates.
- CCL has shifted 5,000tn capacity of liquid coffee from India to Vietnam. However, we have not factored any profitability from the same in our estimates.
- CCL has also ventured into in-house brand which is majorly operative in AP and is aiming to achieve revenue of Rs3bn/Rs5bn from branded coffee market in next three/five years. As of now, we haven't factored in any revenue from branded coffee in our estimates and if CCL is able to achieve the target set by the management, then there will be upside risk to our estimates and target price.

Coffee industry structure and developments

Global production of coffee in the 2013-14 season is estimated at 145.7mn bags and consumption at 145.8mn bags. The world's top coffee producer, Brazil, has reported lower output because of drought conditions, which caused significant fluctuations in coffee prices globally. As per ICO (International Coffee Organisation) estimates, total coffee consumption grew 2.7% in 2013-14. Coffee consumption in exporting countries continues to increase significantly.

Domestic coffee consumption has also been growing steadily over the years. With the decline in production of Robusta coffee in 2013-14 across Karnataka, Kerala and Tamil Nadu, their prices are expected to go up. The market for certified coffee continues to grow at a good rate with a healthy premium.

Market conditions were challenging for instant coffee because of a fall in Russian volume. To counter this, CCL embarked on dynamic marketing strategies and made successful foray into African and Middle East markets. It is confident of posting better sales volume in the coming year.

The global soluble coffee market size is around 710,000 tn and is expected to touch 820,000tn by 2017. Spray and agglomerated coffee markets are expected to post a CAGR of 2.7% each and freeze dried coffee market to register a CAGR of 5.2% until 2017. Most of the projected growth is expected to come from the emerging markets like Eastern Europe, Africa, Russia and CIS which continue to yield volumes, although the prices are much lower.

Exhibit 24: Production and exports - India and the world

Crop year	Production (tn)		India's share (%)	Exports (tn)		India's share (%)	Production growth (%)		Export growth (%)	
	World	India		World	India		World	India	World	India
2006-07	7,692,540	288,000	3.74	5,741,940	249,000	4.34	-	-	-	-
2007-08	7,002,780	262,020	3.74	5,738,280	218,880	3.81	(9.0)	(9.0)	(0.1)	(12.1)
2008-09	7,718,220	262,320	3.40	5,855,580	212,820	3.63	10.2	0.1	2.0	(2.8)
2009-10	7,376,460	289,620	3.93	5,772,300	180,300	3.12	(4.4)	10.4	(1.4)	(15.3)
2010-11	8,001,420	301,980	3.77	5,815,620	278,820	4.79	8.5	4.3	0.8	54.6
2011-12	8,048,400	313,980	3.90	6,274,380	319,620	5.09	0.6	4.0	7.9	14.6
2012-13	8,676,660	318,180	3.67	6,789,420	307,800	4.53	7.8	1.3	8.2	(3.7)

Note: Crop year is from October to September

Source: Coffee Board of India, Nirmal Bang Institutional Equities Research

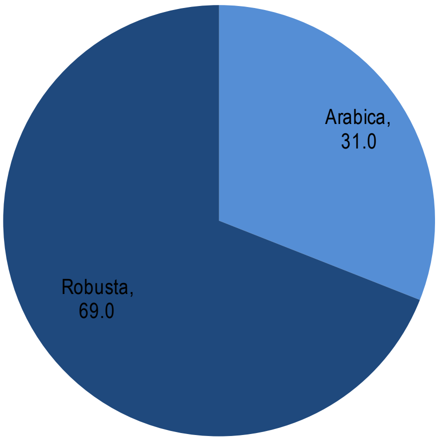
Exhibit 25: Review and outlook on country-wise production

Country	Production (mn kg)						Growth (%)				Share (%)			
	2009-10	2010-11	2011-12	2012-13	2013-14P	2014-15P	2010-11	2011-12	2012-13	2013-14P	2009-10	2010-11	2011-12	2012-13
Brazil	2,688	3,270	2,952	3,366	3,006	3,072	21.7	(9.7)	14.0	(10.7)	36.4	40.9	36.7	38.8
Vietnam	1,110	1,165	1,560	1,590	1,710	1,590	4.9	33.9	1.9	7.5	15.0	14.6	19.4	18.3
Central & South America	1,087	1,181	1,354	1,215	1,153	1,095	8.6	14.6	(10.3)	(5.1)	14.7	14.8	16.8	14.0
Indonesia	540	560	498	630	570	534	3.6	(11.0)	26.5	(9.5)	7.3	7.0	6.2	7.3
Colombia	486	512	459	596	648	690	5.2	(10.2)	29.7	8.8	6.6	6.4	5.7	6.9
India	290	302	314	318	312	319	4.1	4.0	1.3	(1.9)	3.9	3.8	3.9	3.7

Note: Crop Year - October to September, E: Estimated, P: Projected

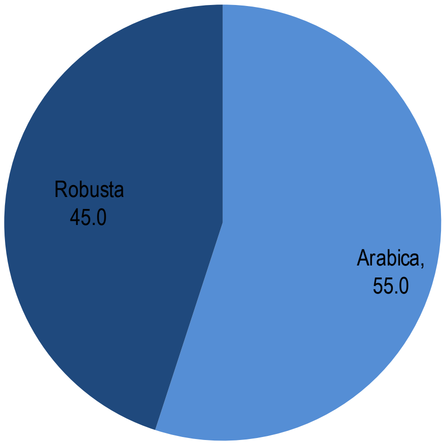
Source: Coffee Board of India, USDA, Crisil Research, Nirmal Bang Institutional Equities Research

Exhibit 26: Production break-up of Robusta/Arabica coffees - India (%)



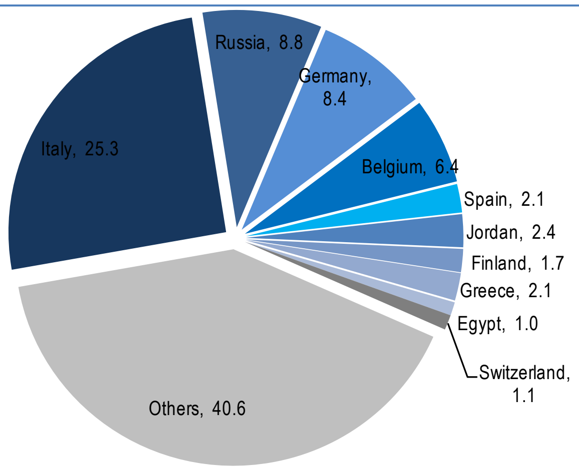
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 27: Consumption break-up of Robusta/Arabica coffee- Global (%)



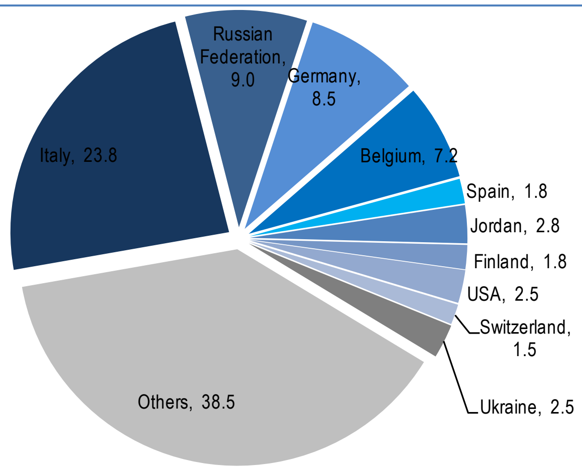
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 28: Key export destinations for India – volume terms (%)



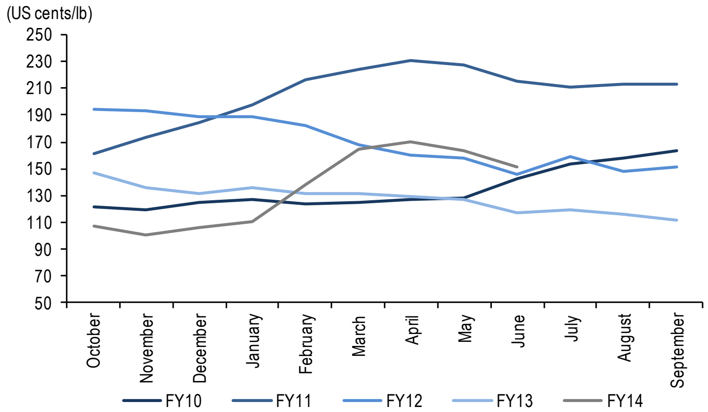
Source: Coffee Board of India, Nirmal Bang Institutional Equities Research

Exhibit 29: Key export destinations for India –revenue terms (%)



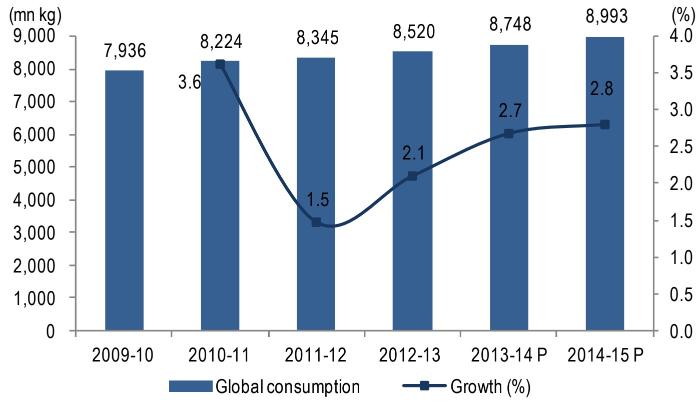
Source: Coffee Board of India, Nirmal Bang Institutional Equities Research

Exhibit 30: International coffee bean prices



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 31: Global consumption trend



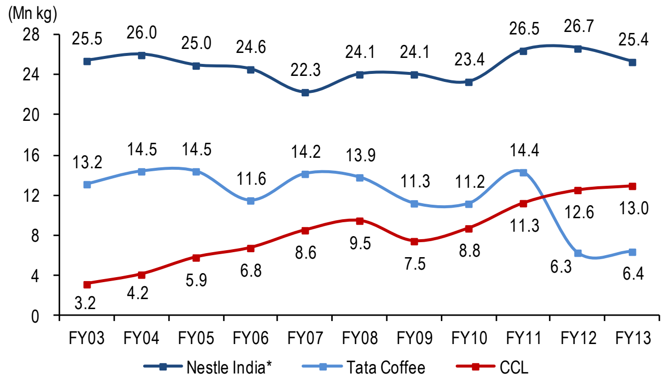
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 32: Export realisation of India compared to CCL's realisation

	FY08	FY09	FY10	FY11	FY12	FY13P
Indian Export (Rsmn)	20,447	22,384	20,707	33,654	46,628	46,807
Growth (%)	*-*	*9.5*	*(7.5)*	*62.5*	*38.6*	*0.4*
Indian Export realisation (Rs/tn)	**93,429**	**113,762**	**105,645**	**112,283**	**139,948**	**152,473**
CCL's realisation (Rs/tn)	**257,525**	**355,837**	**321,661**	**314,268**	**390,897**	**439,975**

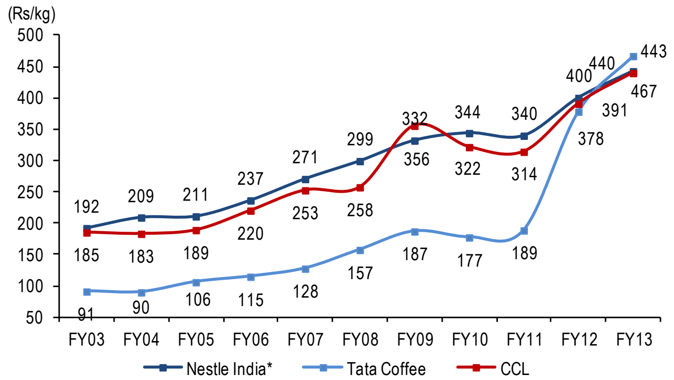
Source: Coffee Board of India, Company, Nirmal Bang Institutional Equities Research

Exhibit 33: Coffee sales compared with peers



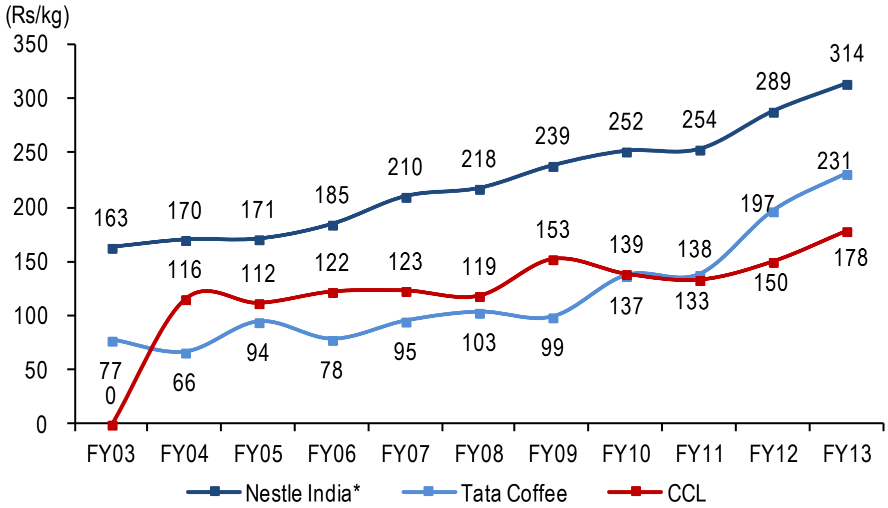
Source: USDA, Crisil, Nirmal Bang Institutional Equities Research

Exhibit 34: Realisation/kg compared with peers



Source: USDA, Crisil, Nirmal Bang Institutional Equities Research

Exhibit 35: Gross profit of various players



Note: Year end of Nestle India is December

Source: US Department of Agriculture or USDA, Crisil, Nirmal Bang Institutional Equities Research

Company background

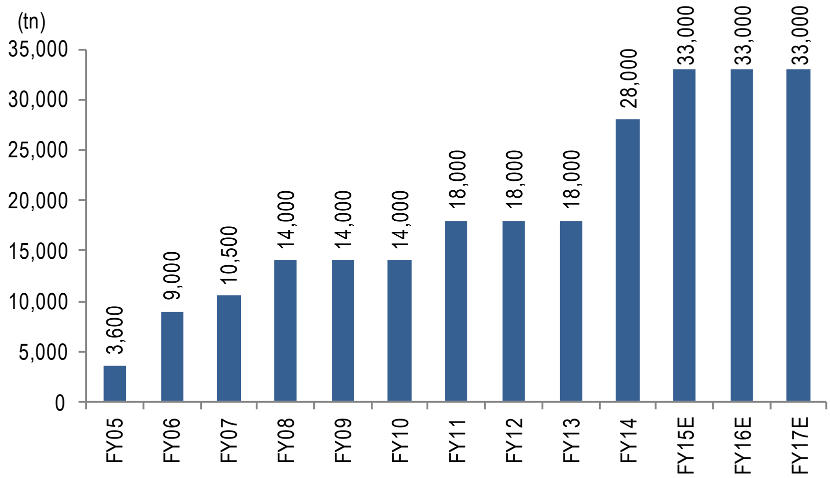
CCL is India's largest private label instant coffee company supplying to premium brands in over 67 countries. CCL has also one of the world's largest single-location plants and is among the top three private label global instant coffee manufacturers. CCL has a state-of-the-art soluble instant coffee manufacturing plant (Export-Oriented Unit) at Duggirala Mandal in Guntur district of Andhra Pradesh with a capacity of 15,000tn. Through its subsidiaries, CCL has also set up an agglomeration plant in Switzerland (to penetrate European markets), a spray dried plant having a capacity of 10,000tn and a concentrated liquid coffee plant in Vietnam having a capacity of 5,000tn. The Vietnam facility is expected to be the growth driver for the next couple of years.

Exhibit 36: Capacity in FY15E

Country	Installed capacity (tn)
India	15,000
Switzerland	3,000
Vietnam (Spray dried)	10,000
Vietnam (liquid coffee)	5,000
Total	**33,000**

Source: Company & Nirmal Bang Institutional Equities

Exhibit 37: Total capacity in tn



Source: Company & Nirmal Bang Institutional Equities

Promoter's background

CCL was set up in 1995 by Mr. Rajendra Prasad, a technocrat entrepreneur with over 30 years of industry experience. Mr. Prasad was the promoter and former managing director of Asian Coffee, the first 100% EOU in India, which was subsequently sold to Tata Coffee. He was the first recipient of financial assistance from the UK-based Commonwealth Development Corporation (CDC) in India. Mr. Prasad is currently a member of the Coffee Board of India. CCL's other promoter is Mr. Jonathan T. Feuer, who is into coffee trading since generations and provides marketing support through his UK-based company. He owns a 5% equity stake in CCL and is a member of the board of directors of the company.

Other key strengths of CCL

- CCL is among the world's leading and Indian's largest processor and exporter of instant coffee, with exports to over 67 countries. If one excludes Nestle's captive consumption, CCL has ~10% global market share in instant coffee exports.
- Coffee processing is a niche and highly profitable industry, but with high entry barriers. Coffee processing is not an easy business as it is very important to get the right blend. Further, the taste preference varies region-wise and culture-wise. Experience and relationships are key to success, and the model is not easily replicable. It takes three to five years to win a client and establish one's credentials. CCL is one the very few companies globally that have successfully scaled up this business. CCL's USP is its technology, which it acquired from Brazil, allowing it to use low grade green (raw) coffee beans to produce very high quality instant coffee. Coffee is the world's second-most traded commodity, and the global coffee retail market is estimated at more than US$100bn. CCL is uniquely positioned to benefit from further growth in coffee processing.

- CCL has increased its capacity 10 times since inception in 1995 (~3,500tn) and more than three times in the past six years at 33,000tn currently. The expansion was funded mainly through internal accruals, and without recourse to significant debt. CCL has not raised any fresh equity since its listing in 1995. In addition, its debt profile is conservative, with peak D/E ratio of ~1.60x and current D/E ratio of 0.83x.
- With Nescafe being a global leader in almost all countries, coffee is an extremely profitable business. Whole coffee chains reap the benefits. Every country has some local/international challenger brand to Nescafe, this is CCL's target client list.
- CCL has now diversified operations in three countries - India, Switzerland and Vietnam - and plans to set up a plant in Africa. The diversified presence will help CCL gain access to new markets and also exploit arbitrage opportunities between different manufacturing plants to its advantage. To cite an example, CCL will leverage the lower duty structure available in Vietnam in several Asian markets and also leverage extended tax benefit.
- Global green coffee market size is estimated at $US6bn-7bn at farm-grade cost, which eventually translates into retail sales of ~US$90bn-100bn globally. Significant value is captured in the coffee processing stage, which makes companies like CCL and Dek Super an important and integral part of the value chain. In the roasted coffee market, Nestle and Kraft are major players along with Sara Lee, Ichibo, and Starbucks etc. Nestle dominates the instant coffee retail market, while CCL is among the large players in the business of processing green coffee beans to make instant coffee. Given the domination of few players (especially in instant coffee - Nestle), coffee is an extremely profitable business across the value chain.

Financials (consolidated)

Exhibit 38: Income statement

Y/E March (Rsmn)	FY12	FY13	FY14	FY15E	FY16E	FY17E
Net sales	5,022	6,507	7,168	9,496	10,682	11,432
Growth (%)	*38.0*	*29.6*	*10.2*	*32.5*	*12.5*	*7.0*
Raw material costs	3,032	3,845	4,251	5,453	6,084	6,491
Staff costs	146	212	258	458	519	549
Power costs	253	410	383	518	592	639
Other expenses	720	827	845	1,262	1,417	1,495
Total expenditure	4,151	5,295	5,737	7,691	8,612	9,174
EBITDA	871	1,213	1,431	1,805	2,070	2,258
Growth (%)	*34.1*	*39.2*	*18.0*	*26.2*	*14.7*	*9.1*
EBITDA margin (%)	*17.4*	*18.6*	*20.0*	*19.0*	*19.4*	*19.8*
Other income	20	19	26	41	49	53
Interest costs	149	207	171	236	157	53
Gross profit	743	1,025	1,287	1,611	1,962	2,259
Growth (%)	*26.3*	*38.0*	*25.5*	*25.2*	*21.8*	*15.1*
Depreciation	201	286	291	346	363	377
Profit before tax	542	739	996	1,265	1,598	1,881
Growth (%)	*37.1*	*36.3*	*34.8*	*27.0*	*26.4*	*17.7*
Tax	179	264	351	344	361	383
Effective tax rate (%)	*33.1*	*35.8*	*35.3*	*27.2*	*22.6*	*20.4*
Net profit	363	474	644	920	1,237	1,498
Growth (%)	*46.2*	*30.8*	*35.8*	*42.8*	*34.4*	*21.1*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 39 : Cash flow

Y/E March (Rsmn)	FY12	FY13	FY14	FY15E	FY16E	FY17E
EBIT	670	926	1,140	1,459	1,707	1,881
(Inc.)/dec. in working capital	(713)	(870)	258	(412)	(219)	(23)
Cash flow from operations	**(43)**	**56**	**1,398**	**1,047**	**1,488**	**1,857**
Other income	20	19	26	41	49	53
Depreciation	201	286	291	346	363	377
Deferred liabilities	18	12	4	16	17	18
Interest paid (-)	(149)	(207)	(171)	(236)	(157)	(53)
Tax paid (-)	(179)	(264)	(351)	(344)	(361)	(383)
Dividend paid (-)	(77)	(77)	(187)	(186)	(186)	(186)
Net cash from operations	**(209)**	**(174)**	**1,011**	**684**	**1,212**	**1,684**
Capital expenditure (-)	(559)	(120)	(947)	(243)	(244)	(246)
Net cash after capex	**(768)**	**(294)**	**64**	**441**	**967**	**1,438**
Inc./(dec.) in short term borrowings	376	156	(201)	(300)	(987)	(285)
Inc./(dec.) in long term borrowings	98	186	101	-	(345)	(1,004)
Inc./(dec.) in total borrowings	474	342	(100)	(300)	(1,331)	(1,289)
(Inc.)/dec. in investments	0	-	(1)	-	-	-
Equity issue/(buyback)	-	-	-	-	-	-
Cash from financial activities	**474**	**342**	**(100)**	**(300)**	**(1,331)**	**(1,289)**
Others	(60)	(11)	287	-	-	-
Opening cash	410	56	93	343	485	121
Closing cash	56	93	343	485	121	269
Change in cash	(354)	37	250	142	(364)	149

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 40: Balance sheet

Y/E March (Rsmn)	FY12	FY13	FY14	FY15E	FY16E	FY17E
Equity	133	133	266	266	266	266
Reserves	2,264	2,651	3,262	3,996	5,047	6,359
Net worth	2,397	2,784	3,528	4,262	5,313	6,625
Short term loans	1,617	1,773	1,572	1,272	285	-
Long term loans	1,062	1,248	1,349	1,349	1,004	-
Total loans	2,679	3,020	2,921	2,621	1,289	-
Deferred tax liability	217	229	233	249	266	284
Liabilities	**5,293**	**6,033**	**6,682**	**7,132**	**6,868**	**6,909**
Gross block	3,633	4,652	5,252	5,840	6,083	6,328
Depreciation	1,059	1,308	1,640	1,987	2,350	2,727
Net block	2,574	3,344	3,611	3,854	3,733	3,600
Capital work-in-progress	937	-	389	43	44	46
Long-term Investments	15	15	16	16	16	16
Inventories	1,171	1,555	1,379	1,787	1,794	1,850
Debtors	704	872	1,068	1,170	1,317	1,344
Cash	56	93	343	485	121	269
Other current assets	250	786	444	557	618	611
Total current assets	2,181	3,306	3,234	3,998	3,851	4,075
Creditors	243	282	205	254	281	299
Other current liabilities	172	350	363	524	495	529
Total current liabilities	415	632	568	778	776	828
Net current assets	1,767	2,674	2,666	3,220	3,075	3,247
Total assets	**5,293**	**6,033**	**6,682**	**7,132**	**6,868**	**6,909**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 41: Key ratios

Y/E March	FY12	FY13	FY14	FY15E	FY16E	FY17E
Per share (Rs)						
EPS	2.7	3.6	4.8	6.9	9.3	11.3
Book value	18	21	27	32	40	50
Valuation (x)						
P/E	33.0	25.2	18.6	13.0	9.7	8.0
P/sales	2.4	1.8	1.7	1.3	1.1	1.0
P/BV	5.0	4.3	3.4	2.8	2.3	1.8
EV/EBITDA	16.7	12.3	10.2	7.8	6.3	5.2
EV/sales	2.9	2.3	2.0	1.5	1.2	1.0
Return ratios (%)						
RoIC	9.6	10.7	12.0	16.4	19.8	22.4
RoCE	9.8	11.2	12.3	16.4	20.2	23.3
RoE	15.9	18.3	20.4	23.6	25.8	25.1
Margins (%)						
EBITDA margin	17.4	18.6	20.0	19.0	19.4	19.8
PBIT margin	13.3	14.2	15.9	15.4	16.0	16.5
PBT margin	10.8	11.4	13.9	13.3	15.0	16.5
PAT margin	7.2	7.3	9.0	9.7	11.6	13.1
Turnover ratio						
Asset turnover ratio (x)	0.9	1.1	1.1	1.3	1.6	1.7
Avg. inventory period (days)	139	146	117	118	106	103
Avg. collection period (days)	50	48	54	44	44	42
Avg. payment period (days)	29	26	17	17	17	17
Solvency ratios (x)						
Debt-equity	1.1	1.1	0.8	0.6	0.2	-
Interest Coverage	4.5	4.5	6.7	6.2	10.9	35.8
Debt/EBITDA	4.5	4.5	6.7	6.2	10.9	35.8
Growth (%)						
Sales	38.0	29.6	10.2	32.5	12.5	7.0
EBITDA	34.1	39.2	18.0	26.2	14.7	9.1
PAT	46.2	30.8	35.8	42.8	34.4	21.1

Source: Company, Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

Nirmal Bang Financial Services owns 1.36mn shares (1.02% stake) in CCL.

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