IIFL Premia Research

Prataap Snacks

CMP: ₹1,399: 1-year target: ₹1,720

Sector	FMCG
Recommendation	BUY
Upside	23.0%

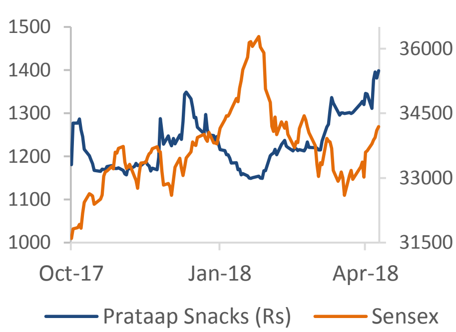
Stock Data	
Sensex	34,193
52 Week h/l (₹)	1,450/1,102
Market cap (₹ Cr)	3,277
BSE code	540724
NSE code	DIAMONDYD
FV (₹)	5
Div yield (%)	NA

Shareholding Pattern

	Jun-17	Sep-17	Dec-17
Promoters	95.05	71.43	71.43
DII+FII	0	10.20	19.35
Individuals	4.95	18.36	9.22

Source: www.bseindia.com

Share Price Trend



Prices as on 13/04/2018

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Prataap Snacks (Prataap), popularly known for its brand *Yellow Diamond*, is an emerging player in the Indian Snacks industry with ~6% market share. It is attractively placed to tap the huge opportunity in ₹22,000cr organized snacks industry given the scale of business. We estimate Prataap to report revenue and PAT CAGR of 19% and 107% respectively over FY17-20E with an EBITDA margin expansion of ~520bps. Encouraged by strong traction in profitability led by gross margin improvement, introduction of premium products and strong expansion in footprints, we recommend BUY on Prataap Snacks with target price of ₹1,720, valuing at 2.5x FY20E EV/Sales.

Enough revenue drivers in sight: With both, scalability and market opportunity in place, we are factoring 19% revenue CAGR over FY17-20E. This would be driven by (a) premium product launches (in sweet and healthy categories), (b) market share gain through geographical expansion and its value offering proposition and (c) increased exposure to the high growth categories (focus on extruded snacks and namkeens).

Premium & aspirational products to aid operating margin: Prataap has witnessed drastic swing in EBITDA margin over years; it nosedived in FY14 and in FY17 to 4.5% in both these years. However, the company has undertaken various initiatives to support profitability. We are estimating ~520bps EBITDA margin expansion over FY17-20E led by (a) access to dynamic grammage offering, (b) long term raw material contracts, (c) benefit of scaling up of newly launched products, (d) favorable product mix, and (e) rationalization of dealers' margin.

Attractively placed at 2.0x FY20E EV/Sales: We believe company's current profitability doesn't capture its true potential given the wide range of offerings and opportunity to rationalize cost structure. At an EV/Sales of 2.0x for FY20E, Prataap is attractively valued vis-à-vis its nearest listed competitor, DFM Foods (refer Exhibit 6).

Financial Summary

Consolidated (₹ cr)	FY17	FY18E	FY19E	FY20E
Revenue	904	1,056	1,256	1,518
YoY growth (%)	*19.4*	*16.8*	*18.9*	*20.9*
EBITDA Margin (%)	4.5	8.4	8.8	9.7
EPS (₹)	4	20	27	37
EPS growth (%)	*-69.1*	*378.3*	*32.5*	*39.2*
RoE (%)	4.3	13.1	12.4	15.7
P/E (x)	NA	69	52	38
EV/Sales (x)	NA	3.0	2.4	2.0

Source: Company, IIFL Research

Prataap's revenue growth to continue in high double digit

Prataap has a total market share of 6%; enjoys leadership in Rings category, 5-6% in potato chips and 1-1.5% in namkeen

On industry level, Potato chips, extruded snacks and namkeen segments are expected to report CAGR of 10.4%, 15% and 17.8% respectively over FY16-21E

Prataap has reported 27% revenue CAGR over FY13-17 primarily on the back of regular product launches and we expect the company to maintain its high double digit growth going forward. We are factoring in 19% revenue CAGR over FY17-20E led by:

(a) **Increase in product offerings/categories:** So far, company has witnessed strong growth led by its traditional snacks. In order to tap the health conscious people, Prataap has added healthy snacks under brand *Seven Wonders* and is expanding sales through the Modern Trade too. Further, the entry into sweets category will also be a key driver. The company is targeting ~₹50cr revenue in FY19E and further doubling it in FY20E for the sweets category. We believe, the major boost to the company would be from scaling up of newly launched products and becoming a Pan-India player.

(b) **Market share gains through capacity and geographical expansion:** Prataap has successfully increased its market share in Indian snacks industry from just ~1% in 2010 to ~6% in 2018. In order to tap growing demand, it is planning to expand its potato chips capacity by 50% and namkeen capacity by 100% at Indore plant (capex of ₹65-70cr, funded from the IPO proceed). Further, in order to increase its presence in the south market (current revenue contribution at 9.4%), company has entered into third party manufacturing for potato chips and extruded snacks in Bengaluru. It is focusing on its most successful brand *Rings* to gain market share in the south market. Moreover, in order to penetrate the existing markets further, it has entered into 3P manufacturing in Kolkata and Ahmedabad too.

(c) **Increased exposure to high growth categories:** As per industry reports, namkeen and extruded snacks will be the fastest growing categories in snacking industry (Exhibit 1). Prataap has successfully tapped on the growing category trend and has increased the revenue share of extruded snacks significantly from 44.5% in FY13 to 62.5% in FY17. It has decreased the potato chips contribution from 42.4% in FY13 to 22.2% in FY17. Further, it is focusing on fastest growing namkeen segment through capacity expansion and 3P manufacturers (exploring options for regional manufacturers).

Exhibit 1: Increasing revenue share of high growth categories

	Revenue contribution (%)		Growth CAGR (%)*
	FY13	FY17	FY16-21E
Potato chips	42.4	22.2	10.4
Extruded snacks	44.5	62.5	15.0
Namkeen	8.0	12.3	17.8

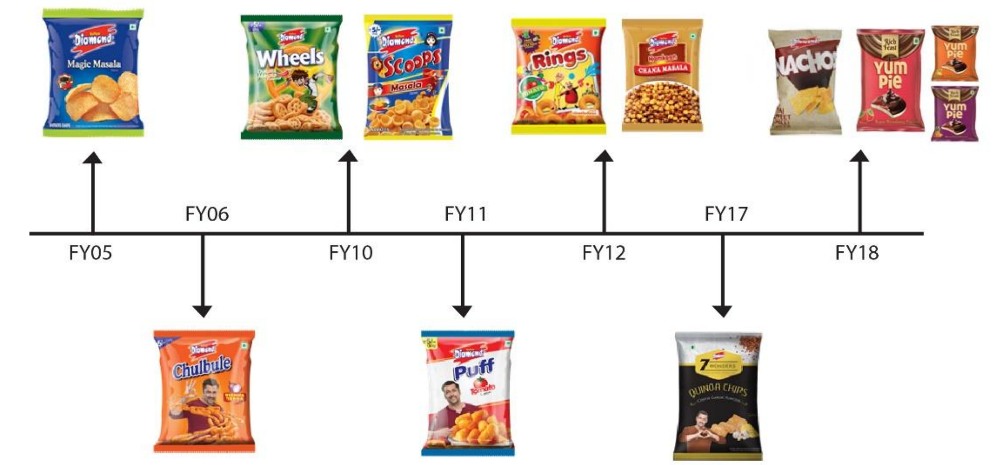
*Source: Company, IIFL Research; *Industry expectation*

Continuous product innovation; next focus is premiumisation

Market share of the company in the organized snacks category has grown from ~1% in 2004 to ~6% at present driven by its product innovations and value offerings in form of grammage and toys

Continuous product innovation since its inception has helped Prataap raise its market share to ~6% at present in the snacks industry (from ~1% in 2004). Currently, it has 60+ SKUs, which we believe lowers the risk of any significant volatility in revenues due to (a) change in consumer taste/preferences and (b) market trends**. It has roped in Bollywood star, Salman Khan, as the brand ambassador, which bodes well with the company's proposition as a product for the mass market.**

Exhibit 2: Product innovation helped build the brand equity



Source: Company, IIF Research

At present, ₹5 pack contributes ~80% of Prataap's sales and company is targeting it to bring down to 70-75% in next 3-4 years

At present, ₹5 pack contributes ~80% of Prataap's sales and company is targeting it to bring down to 70-75% in next 3-4 years. The company has recently entered into aspirational and premium products, yet maintaining its value proposition. It ventured into the fast-growing sweet category through its brand *Rich Feast*. The first product launched under the brand is *Yum Pie* (a three layered treat with sponge cake, jam and chocolate) at ₹5 per pack. It has also launched Nachos at a price point of ₹10 for 25gms, under the flagship brand Yellow Diamond, at ~37% discount to the market leader (*Doritos* by Frito Lays).

Exhibit 3: Prataap's brands and their key competitors

Categories	Prataap's brands	Competitors
Extruded Snacks	Chulbule, Rings, Puffs, Wheels, Scoops, Seven Wonders	Kurkure (PepsiCo), DFM, Balaji, Bingo (ITC)
Potato Chips	Yellow Diamond	Lays (PepsiCo), Balaji, Bingo (ITC), Parle's Wafers, Haldirams
Namkeen	Yellow Diamond	Haldirams, Leher (PepsiCo), Balaji Wafers, Bikaji Foods
Nachos	Yellow Diamond	Doritos (PepsiCo), Act II (Agro Tech Foods), Cornitos
Sweet	Rich Feast (Yum Pie)	Britannia, Pillsbury

Source: Company, Industry, IIFL Research

EBITDA margin to improve led by RM cost saving and favorable mix

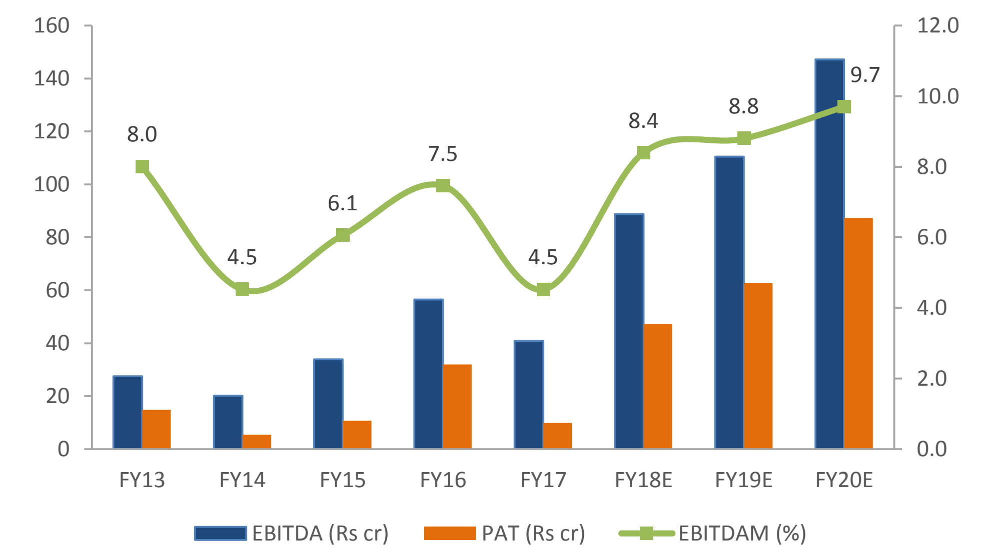
Prataap has witnessed drastic swing in its EBITDA margin over years; it has nosedived in FY14 (raw material inflation) and in FY17 (raw material inflation and increase in employee, freight and promotional cost), to 4.5% in both these years.

In order to tackle sharp fluctuation in gross margin, the company has now resorted to long-term contracts for raw material sourcing. Further, the current product mix (~80% revenue from ₹5 pack) caps EBITDA margin expansion, as it gives very limited scope to play with the grammage offerings. Hence, the company is now focusing more on premium products viz. S*even Wonders, Rich Feast, Nachos,* etc. **We believe that the entry into new product categories would require high advertisement spend; we are factoring ad spend at 4% of net sales for each year over FY17-20E.** Further, we expect the company's operating profitability to improve with the economies of scale in the long term.

The net realisation for the company stands at ₹3.25-3.30 for ₹5 pack

Hence, we are estimating ~520bps EBITDA margin expansion over FY17-20E led by (a) access to dynamic grammage offering, (b) long term raw material contracts, (c) benefit of scaling up of newly launched products, (d) favorable product mix (towards premium and higher SKUs), and (e) rationalization of dealers' margin (it has lowered the total trade margin by 1% compared to FY17, and is further exploring areas to rationalize it). PAT for the company is estimated at ₹87cr for FY20E against ₹47cr in FY17 (107% CAGR over FY17-20E) led by strong revenue growth and EBITDA margin expansion.

Exhibit 4: Improvement in EBITDA margin to drive profitability



Source: Company, IIFL Research

Scaling up of sweets category to be margin accretive

Yum Pie enjoys (a) ~10% higher gross margin and (b) lower freight cost due to favorable transportation value to volume ratio vis-à-vis other salty snacks (~3% of cost against 8%)

The recently launched sweet product, *Yum Pie*, has been received well by the consumers. Moreover, company plans to launch two more products under the category – *Berry Pie* (₹5/pack) and *Choco Pie* (₹10/pack). *Yum Pie*, is a high gross margin product for the company (~10% higher than other salty products) and has a favorable transportation value to volume ratio (~3% of cost against 8% for other salty snacks), which will aid company's operating margin going forward. Company is targeting ~₹50cr revenue from the category in FY19E and further doubling it in FY20E. We believe scaling up of the category will provide big margin expansion opportunity for the company in next 3-4 years.

Third party manufacturing paves way for geographic expansion

The company has three owned and six third-party (3P) manufacturing units. The 3P units are present in Ahmedabad, Gujarat, Bengaluru, Karnataka and Kolkata, West Bengal. 3P manufacturing currently contributes ~8% of the current revenue and is expected to reach 25-30% in next 3-4 years. At present, the 3P manufactures are for potato chips and extruded snacks. Company is exploring options to decentralize the production its third major category, Namkeen, which is currently produced only at its Indore plant. In order to make all geographies self-sufficient, company is exploring 3P manufacturers for namkeen who are well versed with the local flavors.

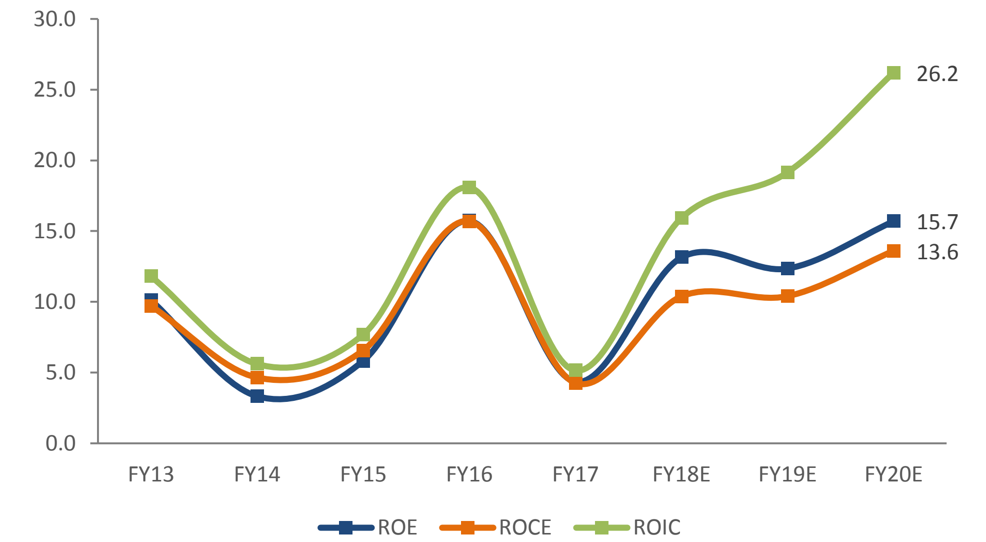
The primary idea behind using 3P manufacturing by the company is logistic benefit to service different/new markets

The primary idea behind using 3P manufacturing by the company is logistic benefit to service different/new markets. Though this doesn't provide any major benefit on the operational cost front, it is economical vis-à-vis setting up and operating own factory in new geographies. Further, this manufacturing arrangements gives the company benefits of (a) lower freight cost, as the manufacturing units are closer to the market and (b) adjusting the production based on demand outlook, as the company doesn't have any minimum order commitments for minimum orders. We believe this model will help the company in improving its ROIC, as the investment in 3P manufacturing is much lower. Company is also open to investing in plant and machinery for a manufacturer who meets company's criteria, e.g, it invested ₹10-12cr in plant and machinery for the Bengaluru manufacturer.

Improving profitability to aid return ratios

The company's return ratios were subdued in FY17 due to lower profitability. However, with strong expansion in EBITDA margin, we estimate the PAT to grow from mere ₹10cr in FY17 to ₹86cr in FY20E. Led by strong traction in profit, we expect the company to report ROE and ROCE of 15.7% and 13.6% in FY20E respectively. Further, led by strong sales growth and working capital efficiency, the ROIC of the company is also expected to improve drastically from 5.2% in FY17 to 26.2% in FY20E.

Exhibit 5: Return ratios to improve with profitability



Source: Company, IIFL Research

Exhibit 6: Attractively placed on EV/Sales vs. DFM Foods

	Mcap (₹cr)	Sales (₹cr)	EBITDAM (%)	PAT (₹cr)	PE (x)	EV/Sales (x)
FY18						
Prataap	3,266.0	1,055.8	8.4	47.3	69.0	3.0
DFM*	1,503.3	456.8	12.6	25.6	58.0	3.3
FY19						
Prataap	3,266.0	1,255.8	8.8	62.7	52.1	2.4
DFM*	1,503.3	520.8	11.9	29.5	50.4	2.9

Source: Company, IIFL Research; Bloomberg estimates*

Company Overview

Prataap Snacks, an Indore based foods company, was incorporated in 2009 and it acquired the business and brand, 'Yellow Diamond', from group company Prakash Snacks. The company manufactures and distributes its products under three categories – (a) extruded snacks (63% of revenue in FY17), (b) Potato Chips (23.9%) and (c) Namkeen (12.2%). Company has more than 60 SKUs present across brands i.e. Yellow Diamond (*Chulbule, Rings, Wheels, 7 Wonders, Fungroo* and *Scoops*) and Rich Feast (*Yum Pie*). Currently, company derives majority of its revenue from East (33.5%), West (33.1%) and North (24.1%) followed by South at 9.4%.

Prataap has a strong and growing distribution channel comprising 3,500 distributors and ~220 super stockists. With a direct reach of 7 lakh outlets and indirect reach of 5 lakh outlets, Prataap's products reach to 27 states in India. Company plans to double its coverage reach in next 3-4 years. Further, company is trying to improve its visibility in Modern Trade through its newly launched healthier snack portfolio under brand i.e. *Seven Wonders*, Nachos and high value SKUs; currently present in DMart, Star Bazaar and Spencers.

Strategically located manufacturing units: Prataap has total nine manufacturing units (three owned and rest third-party facilities), strategically located to optimize the cost, distribution and production rationalization. Company has an installed capacity of 80,500MT, as on FY17 with an average blended capacity utilization at ~70%.

In addition, company has six third party manufacturers for potato chips and extruded snacks in Kolkata, Bengaluru and Ahmedabad, which currently contribute ~8% of the current revenue. The contribution from 3P manufacturing is expected to reach 25-30% in next 3-4 years.

Exhibit 7: Expanding footprints through 3P manufacturing units

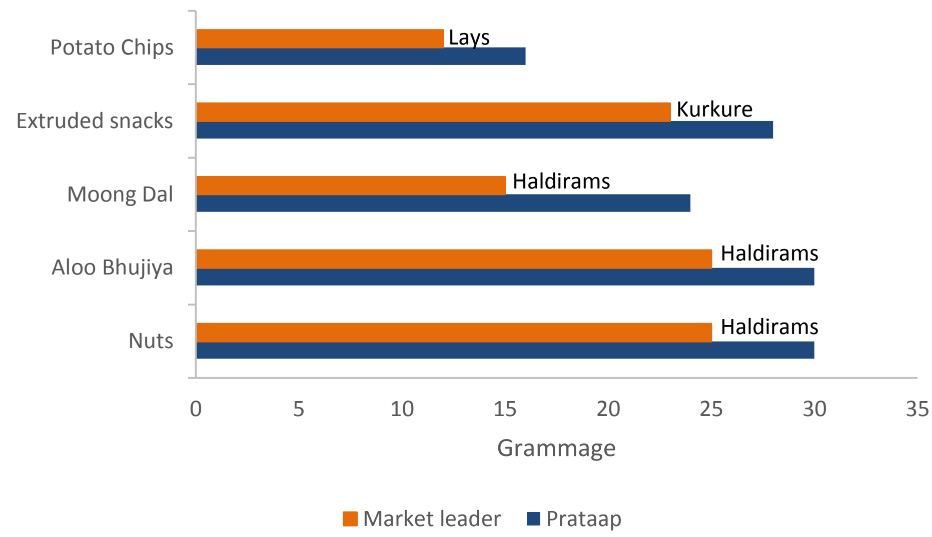
Location	Indore	Guwahati I & II	Kolkata I & II	Bengaluru I & II	Ahmedabad I & II
Markets	North & West	East	East	South	West
Products	Potato Chips, Namkeen, Extruded snacks	Potato Chips, Extruded snacks	Potato chips	Potato chips & Extruded snacks (Rings)	Potato Chips and Nachos
Benefits	Sourcing hub for Potato, Reverse logistic benefits	Reverse logistic benefits, Tax exemption	Third party manufacturing, no minimum commitment of quantity, flexibility on production quantity		

Source: Company, IIFL Research

Value proposition through higher grammage: Prataap has placed itself as a company offering value proposition to the price conscious consumers through providing higher grammage. Over the time, the company has got strong acceptance in the markets it operates. Company's ₹5 SKU, which contribute ~80% to total revenue, offers ~25% higher grammage than the competitors in respective categories. Moreover, it includes promotional items such as toys in *Rings* products (~40% of revenue), which offer more value to the younger consumer. The cost of the toys varies from 40-70paisa.

We believe that the higher grammage offering and wide price range of toy offering (in *Rings*) by the company provides it flexibility with the grammage, both in terms of competitive offering and passing on of raw material inflation.

Exhibit 8: Higher grammage offerings vis-à-vis competition



Source: Company DRHP, IIFL Research

PE investors hold more than the promoters in the company

Over the years, Sequoia, PE firm, has invested ₹129cr in the company in four tranches and holds 48.39% in the company, whereas the promoters hold 23.04% as on December 2017. We believe, given the high involvement of PE fund bodes well with the positive outlook of the company. The exit of the PE firm is due in FY21E and FY22E.

Exhibit 9: Utilization of IPO proceeds as at December 31, 2017

Particulars (₹cr)	Planned utilization	Utilized upto Q3FY18	Balance
Prepayment/pre-payment of borrowings	51.0	37.0	14.0
Funding capital expenditure requirements	67.0	0.0	67.0
Investment in subsidiary for repayment/pre-payment of borrowing	29.4	29.4	0.0
Marketing and brand building activities	40.0	0.0	40.0
General corporate purpose	48.8	0.0	48.8
Total	**236.2**	**66.4**	**169.8**

Source: Company, IIFL Research

Key risks

(a) A drastic shift in consumer preference to healthy snacks: Though the company has entered into the healthy snacking category, it is in a nascent stage. Any failure to develop, launch and market new products due to change in consumer preferences could dampen the company's future prospect.

(b) Increase in competition intensity: The categories in which Prataap is present, face competition from both organized and unorganized players. With scaling up of its operation, the company would face stiff competition from the larger players and any inability to maintain the competitive position would impact the profitability.

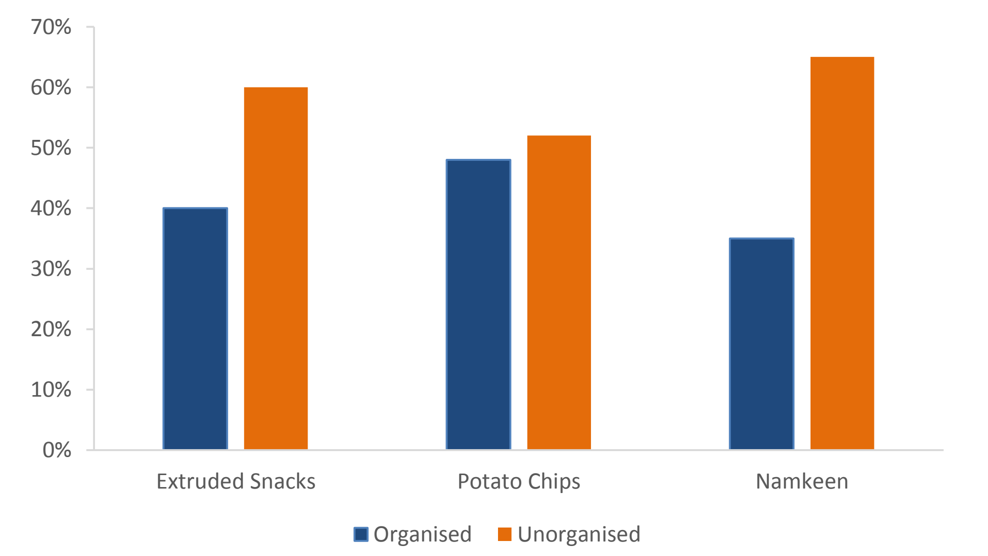
Indian Snacks Industry

Indian packaged snacks market (chips, extruded snacks and namkeen) is estimated at ₹55,000cr dominated by unorganised players. The organised market with a market share of 40%, is estimated at ₹22,000cr, witnessing a growth of 16.4% CAGR over FY10-16. It is estimated to grow at a CAGR of 14.6% over FY16-21E.

- ✧ **Namkeen & traditional snacks** category contributes 36% of the total organised market and is pegged at ₹7,848cr, dominated by Haldirams (48% market share). It is expected to grow at a CAGR of 18% over FY16-21E to ₹17,782cr category.
- ✧ **Extruded snacks** are the second largest contributors in the industry at 32%, dominated by PepsiCo. It is expected to grow at a CAGR of 15% over FY16-21E to ₹13,988cr category.
- ✧ **Chips** contribute 30% to the overall organised market, dominated by PepsiCo's Lays. It is expected to grow at 10% CAGR over FY16-21E to ₹10,619cr market.

The high share of unorganised market in the snacks industry provides a huge opportunity to the organised players. The shift from unorganised to the organised market is on cards given the increasing raw material cost, implementation of GST and increasing number of organised players.

Exhibit 10: High share of unorganized market - big opportunity



Source: Company DRHP, IIFL Research

The snack category is dominated by independent grocery stores, as they are the largest distributors and 75% sales happen through this channel. North and West are the largest consumers with 32% and 30% share respectively, followed by East and South at 19% each.

Exhibit 11: Balance sheet and ratios

Consolidated (₹cr)	FY17	FY18E	FY19E	FY20E
Liabilities				
Total Shareholders' funds	238	482	532	577
Total Borrowings	67	25	17	9
Other liabilities	10	10	10	10
Total Liabilities	**316**	**517**	**559**	**596**
Assets				
Net Block	201	245	240	251
Capital WIP	52	52	52	30
Inventories	79	87	104	124
Trade Receivables	20	23	27	33
Cash	11	168	212	256
Loans & Advances	12	13	16	19
Other current assets	6	7	9	10
Current Liabilities	111	126	149	179
Net Current Asset	16	174	219	263
Others	47	47	49	51
Total Assets	**316**	**517**	**559**	**596**
Ratios				
Return ratios (%)				
ROE	4.3	13.1	12.1	15.5
ROCE	4.3	10.4	10.2	13.4
ROIC	5.2	15.9	18.8	26.0
Valuation Ratios (x)				
P/E	331.6	69.3	52.3	37.6
P/BV	13.8	6.8	6.2	5.7
EV/Sales	3.7	3.0	2.5	2.0
EV/EBITDA	81.6	35.4	27.9	20.6

Source: Company, IIFL Research

Disclaimer

Recommendation Parameters for Fundamental/Technical Reports:

Buy – Absolute return of over +10%
Accumulate – Absolute return between 0% to +10%
Reduce – Absolute return between 0% to -10%
Sell – Absolute return below -10%

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