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Prataap Snacks Ltd

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Date: 2nd May 2019

Long Term Recommendation
Prataap Snacks Ltd

Set for a crunchy bite!

Prataap Snacks – a key player in the Organized Snacks market, has transformed itself from a regional snacks player to a PAN India player, with its market share quadrapulating from <1% in 2008 to 4%+ in 2018 (*Market leader with 100+ years in market - Haldiram has a 20% market share*) fuelled by: a) unique value-for-money proposition b) Expanding and diversified product portfolio—potato chips, extruded snacks, namkeen) and c) robust distribution reach . Going forward, we expect Prataap's revenue to grow at 21.5% over FY19-21E driven by it's (a) Increasing distribution reach via acquisition and deepening reach. (b) Introduction of new products and (c) Foray into high growth sweet segment. Strong revenue growth coupled with lean working capital cycle and improving asset turns would result in RoCE expansion from 9% in FY19E to ~18% in FY21E. Given the huge opportunity size, strong execution track record and high quality of earnings, we believe Prataap Snacks is one of the best plays to ride the high growth snacks category in India hence initiate with Buy with price target of INR 1250.

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CMP INR: 928

Rating: BUY

Target Price INR 1250

Upside: 35%

Bloomberg:	DIAMOND:IN
52-week range (INR):	1414 / 800
Share in issue (cr):	2.34
M cap (INR cr):	2,204
Avg. Daily Vol. BSE/NSE :('000):	6.5
Promoter Holding (%)	71.4

Fastest-growing value-for-money player in attractive snacks market

Prataap Snacks is one the fastest-growing players in the attractive savoury segment. It has made a mark in this high growth, but intensely competitive, space by (a) establishing itself as a value-for-money player—it provides high grammage compared to leaders in each of the product categories. (b) Introduction of new and innovative products (Starting with potato chips, the company has expanded its product basket in 4 sub-categories—potato chips, extruded snacks, namkeen and sweets) (c) along with expansion of its distribution footprint (*serving 27 states, and 17 lac retail touch points- which is around 60% of PepsiCo and 35% of Britannia's reac***h**). Thus in a short time span of 12-13 years the company features amongst the top 5 organised players, and has witnessed its market share catapulting 4x from less than 1% in 2010 to 4% plus in 2018. This is commendable as many of its peers, despite being in the business for over 20-30 years, have failed to transcend regional boundaries.

Prataap to continue to outpace industry growth; with enhanced margins

We estimate Prataap to clock 21.5% revenue CAGR over FY19-21E aided by (a) Expanding and deepening distribution reach on the core portfolio of Namkeen & Chips (b) increasing contribution from the acquired Avadh business and (c) increased revenue from the launch of new products. Going forward with expanding scale, increasing outsourcing (from current 12% to reach 20%), and improving product mix, coupled with stabilizing raw material cost, margins are expected to expand by 100 bps from 7.2% in FY19E to 8.2% in FY21E

High Quality earnings coupled with rising share of outsourcing to drive ROCE

Prataap Snacks is a high quality cash generating business as it operates on cash-and-carry basis. This leads to extremely low cash conversion cycle of 7-9 days and high quality earnings. (Prataap Snacks CFO/EBITDA is as high as 90%.-(comparable to the best of consumer players) . We believe, this high cash conversion ratio mirrors Prataap's high earnings quality rendering the business extremely compelling from the investment perspective. Expanding margin coupled with improving asset turns would result in RoCE expansion from 9% in FY19 to ~18% in FY21E

Outlook and valuation: Crunchy bite; initiate with 'BUY'

Prataap Snacks possess the key elements of growth, efficiency and longevity, but as it is in the early growth phase, the current as well as near term margins would be sub-optimal. Thus we believe that such companies like Prataap Snacks which has strong and long growth prospects are best valued on DCF. Our three stage DCF with 15% WACC leads to a price target of INR 1250. At our price target, the company would be trading at an implied PER of 42xFY21 and at 1.7xEV/Sales. We initiate coverage on the stock with 'BUY' recommendation.

Year to March	FY17	FY18	FY19E	FY20E	FY21E
Revenues (INR Cr)	894	1,037	1,167	1,486	1,723
Rev growth (%)	18.1	16.0	12.6	27.3	15.9
EBITDA (INR Cr)	42.2	86.9	83.8	118.2	141.6
PAT (INR Cr)	11.2	44.2	42.6	54.6	69.7
EPS (INR)	4.8	18.9	18.2	23.3	29.8
EPS Growth (%)	-	295.0	- 3.5	28.0	27.7
EV/EBITDA (x)	52.8	22.6	25.1	17.2	14.0
P/E (x)	167.3	47.8	53.3	43.5	33.2
P/B (x)	7.8	4.1	3.8	3.5	3.1
Adjusted RoACE (%)	9.6	18.3	8.9	14.1	17.8
RoAE (%)	4.9	11.7	7.3	8.3	10.0

Date: 2nd May 2019

Table of Contents

How we have arrived at the value

Prataap Snack is estimated to clock 28% earnings CAGR over FY19-21. This will be driven by 21.5% revenue spurt and 100bps operating profit margin expansion from 7.2% in FY19 to ~8.2% by FY21E.

The 28% PAT CAGR will be driven by healhty reveue growth of 21.5% over FY19-21E riding expansion of core snacks portfolio coupled with Avadh's portfolio.

(INR cr)	FY18	FY19E	FY20E	FY21E
Revenue	1,037	1,167	1,486	1,723
EBITDA	8.39	7.18	7.95	8.22
PAT	44.2	42.6	54.6	69.7

Prataap has a high quality business with cash conversion ratio of 90-100% on account of lean working capital requirement of 7-8 days. This, along with robust balance sheet and zero debt, renders the business compelling.

(INR cr)	FY18	FY19E	FY20E	FY21E
EBITDA	86.9	83.8	118.2	141.6
CFO	96.9	72.8	85.6	135.3
CFO/EBITDA	111%	87%	72%	96%

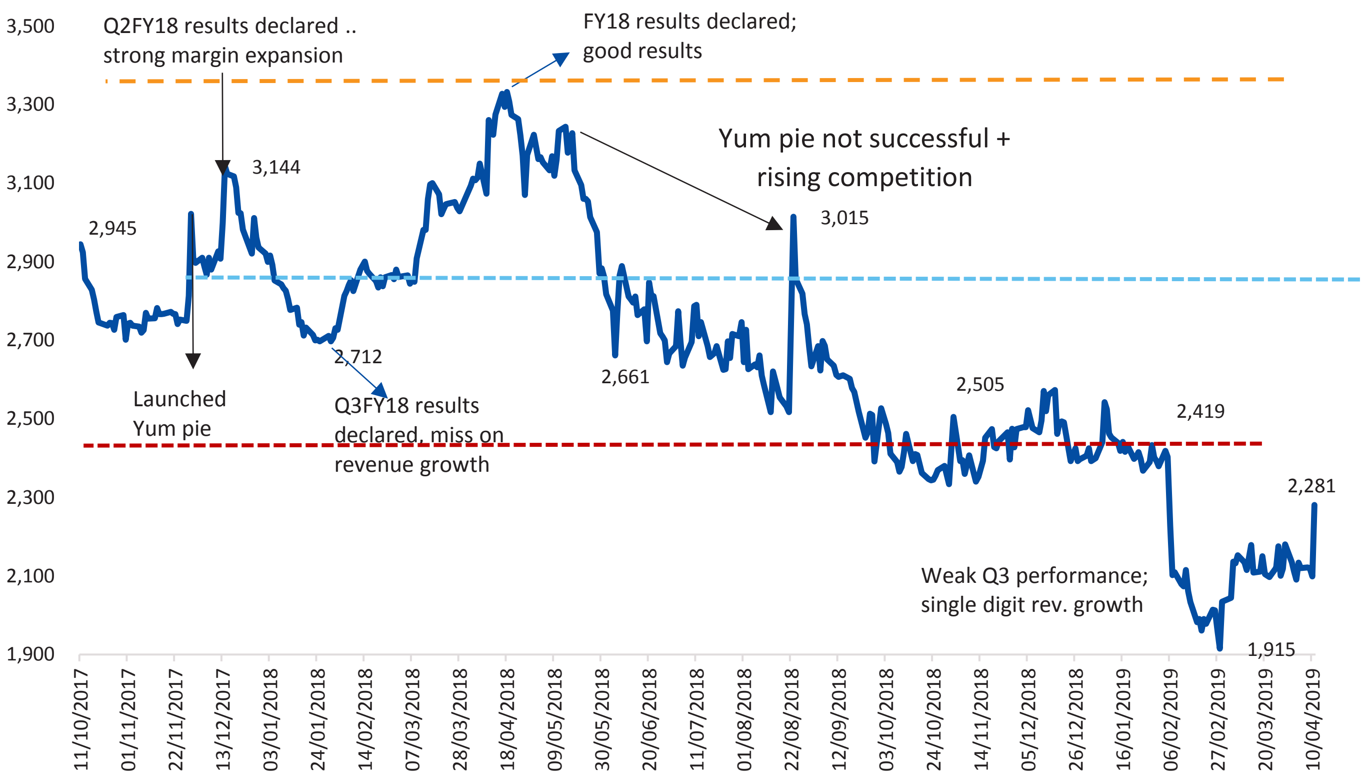
A fast growing player in a high opportunity food snacking industry with a strong exectution track record is expected to trade at a higher multiple as current margin and profitablity do not adequately capture the company's long-term potential.

DCF	Revenue CAGR	EBITDA margin
Stage 1	19%	10%
Stage 2	12%	14%
Stage 3	10%	14%
Terminal growth		5%
WACC rate		15%

EPS growth of 26% over FY17-21E + **Healthy Cash Conversion cycle** + **Three Stage DCF**

Upside of 35%

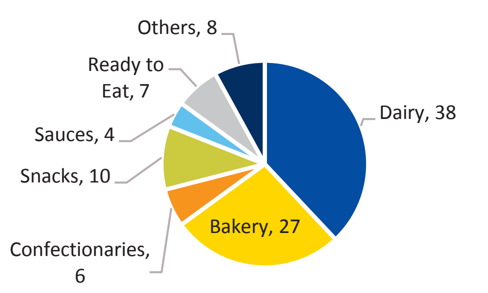
Prataap Snacks share price performance since listing



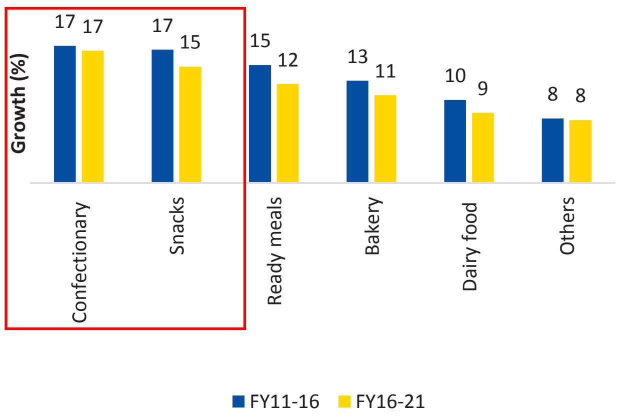
Source: Edelweiss Professional Investor Research

Part I: Story in a Nutshell

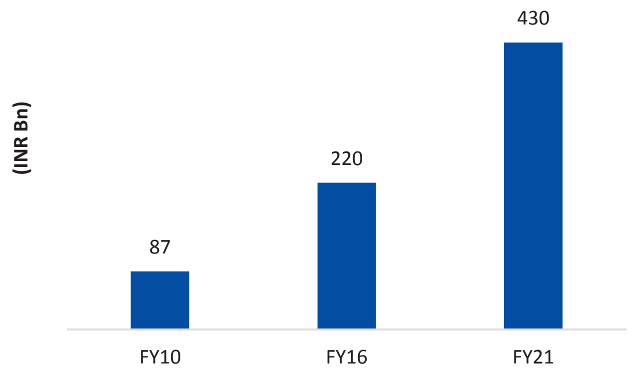
Indian packaged food – INR 280 bn



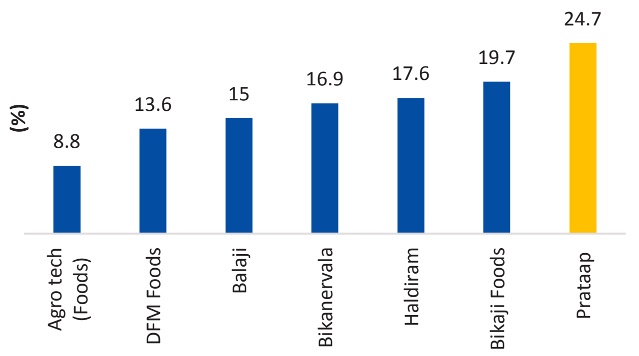
Prataap is present in fastest growing snacks & sweets segment



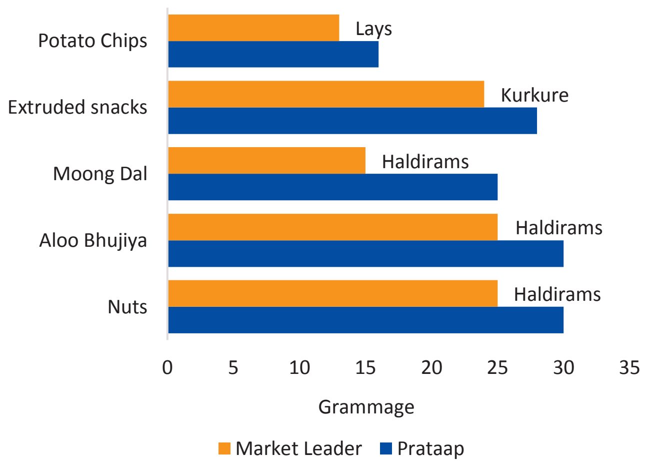
Organised snacks market to grow at 14.6% over FY16-21



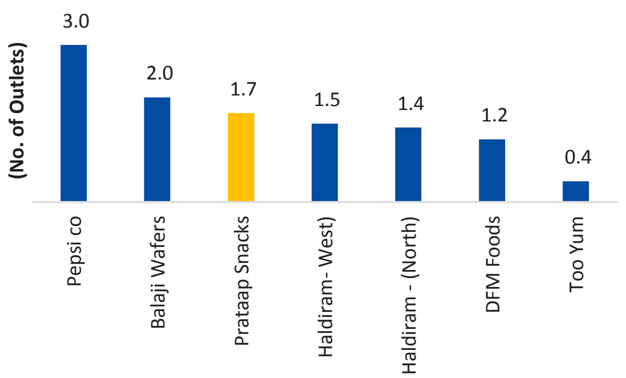
Prataap fastest growing player in the organised sector (FY13-18)



Led by value for money offerings ... and



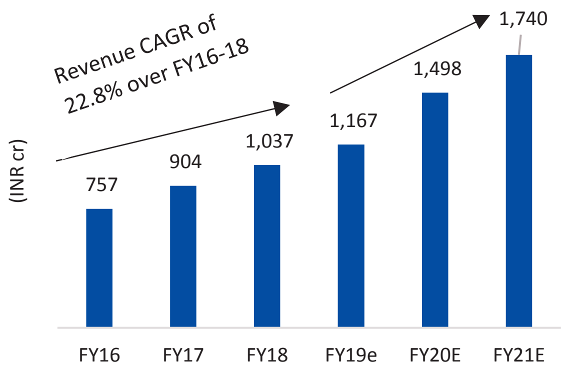
One of the widest distribution reach in a short time frame



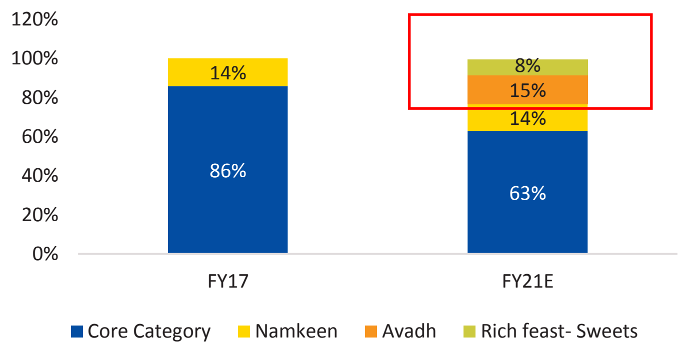
Source: Edelweiss Professional Investor Research

Part II Praaap Snacks initiatives to drive growth and margin

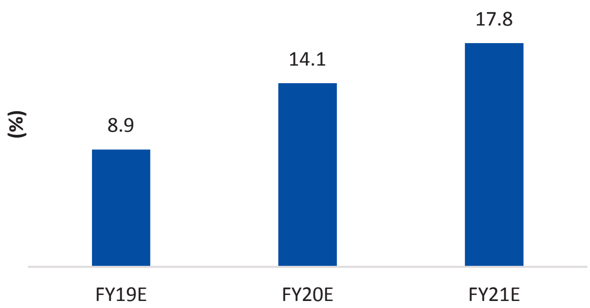
Revenue expected to clock 21.5% CAGR...



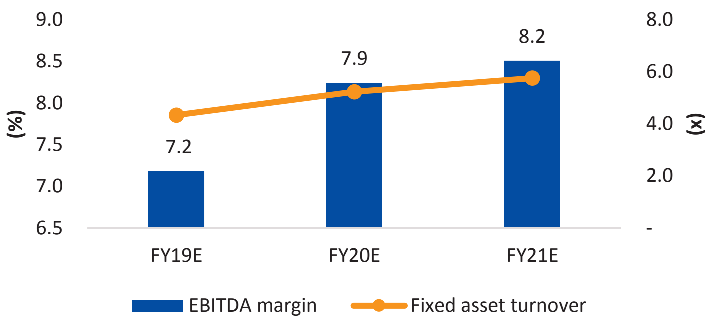
...driven by rising share of Sweet and Avadh's portfolio



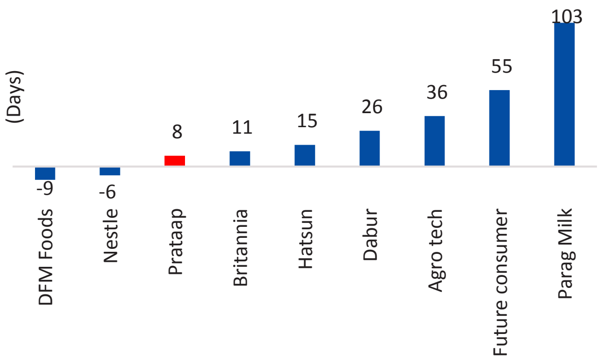
Adjusted ROCE to expand ~900 bps



led by rising margin and higher asset turnover



With best cash conversion ratio (Avg FY15-18)



Inherent business strength to keep the valuations at elevated levels

Companies	FY21 Mcap/sales	FY21 EV/EBITDA	FY21 PER
Britannia Industries	5.2	28.9	44.4
Dabur India	6.6	28.7	34.3
Hindustan Unilever	7.0	30.6	42.3
Marico	5.0	26.2	37.7
Nestle	7.3	28.9	48.0
Future Consumer	1.3	2.8	96.6
Median	**5.3**	**27.5**	**42.3**
DFM Foods	1.8	16.6	29.5
Prataap Snacks	**1.2**	**14.4**	**33.7**

Source: Edelweiss Professional Investor Research

I. Prataap Snacks: Fastest growing player in snacks market

The organised packaged snacks market is pegged at ~INR 280 bn; it has posted a robust 16% plus CAGR over the past 7 years from INR 87 bn in FY10. Despite this healthy spurt, organised players' share stands at mere 40-45%, entailing humungous growth opportunity. As per industry estimates, this category is likely to register ~15% CAGR to INR 430 bn by FY21.

Unlike biscuits, wherein large players such as Britannia, Parle and ITC control more than 80% of the market, the snacking segment has been dominated by regional and state-specific players with lower priced products eating away share of large companies. Regional snack brands offer 30% higher volume for similar price points, especially the highest selling packs of INR 5 and INR 10.

Prataap Snacks- Fastest growth in the snacking category

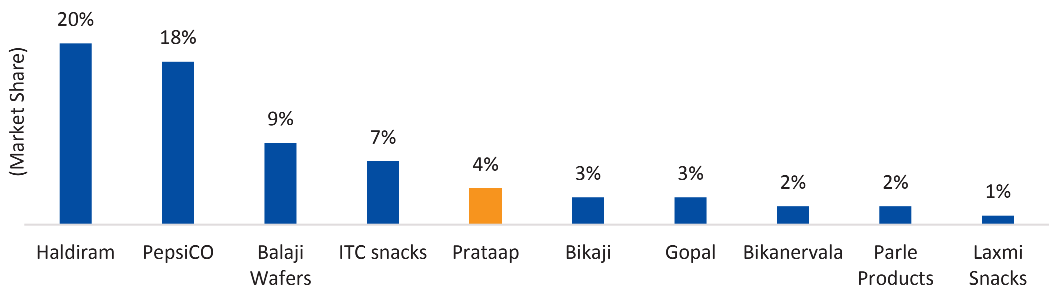
INR crore	FY13	FY14	FY15	FY16	FY17	FY18	CAGR FY13-18
Pepsi Co	2550	2719	3109	3076	3214	3612	7.2
Haldiram (North + West)	2237	2895	3187	3595	4564	5039	17.6
Balaji wafers	914	1044	1246	1415	1635	1840	15.0
Bikanervala	350	421	493	532	663	763	16.9
Bikaji Foods	326	400	468	554	611	800	19.7
DFM Foods	225	263	289	390	345	425.31	13.6
Agro tech (Foods)	128	139	161	173	175	195	8.8
Prataap Snacks	**344**	**446**	**559**	**757**	**904**	**1037**	**24.7**

Source: Industry, ROC, Edelweiss Professional Investor Research

In the snacks category, Prataap Snacks is the fastest growing player. The company has posted revenue CAGR of 25.0% over FY13-18 compared to leader Haldiram's (North + West) 17.6%.

Prataap Snacks sells its products under the *Yellow Diamond* brand and within a short span of 13 years, the company features amongst the top 5 organised players, each of which have 20-30 plus years' presence in the market. Prataap's market share has grown from less than 1% in 2010 to 4% plus in 2018.

Prataap has quardapulated its market share to 4%+ in a industry marked by regional plays

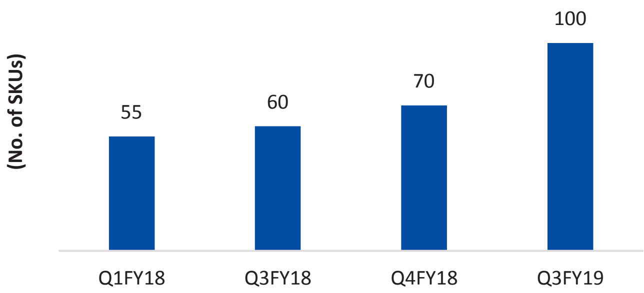


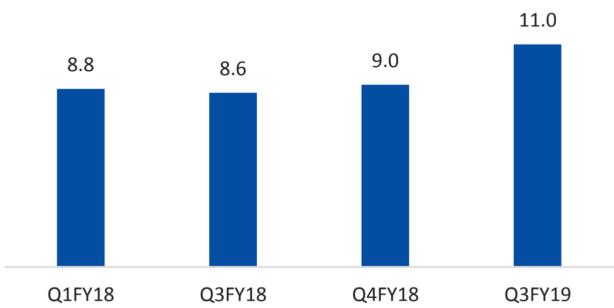
Source: Edelweiss Professional Investor Research

II. Prataap Snacks' fast success: New launches, value for money strategy & strong execution

(a) New product launch, enhanced product offerings Prataap Snacks debuted in the market with potato chips in 2005. Sensing the opportuntity in the extruded snacks segment, the company ventured in to the segment with the lauch of Chulbule targeting youth and kids and later ventured into *Rings* with a unique proposition of putting a toy in to packs and targeting kids to drive demand. The product gained strong acceptance in the market and within two years crossed turnover of over INR 100 crore. The company continued to launch new products/flavours and innovations in the market.

Currently, the company sells around 11mn packets per day spread over 100 SKUs, reflecting volume growth and the company's vibrant product offerings.





Source: Company, Edelweiss Professional Investor Research

Going forward, the company is planning to add new products in the salty snack segment: (a) Omega fortified potato chips; (b) multi-grain Chulbule; and (c) new varieties in the sweets category

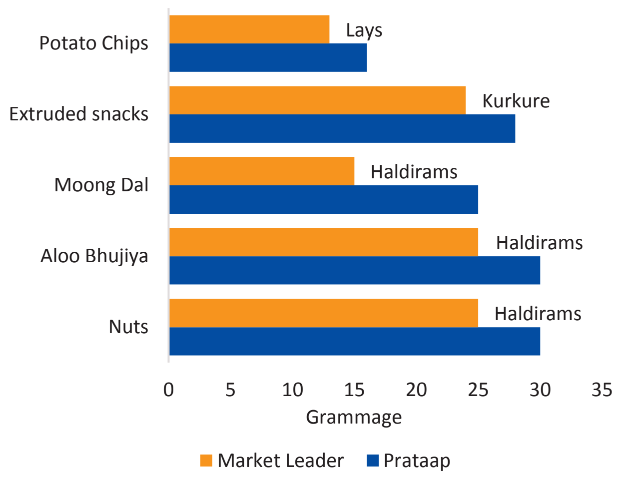
(b)Value-for-money proposition, unique advertising strategy driving growth

Along with lauch of new products/categories, Prataap Snacks has made a mark in this high growth, but intensely competitive space, by establising itself as a value-for-money player. It provides high grammage compared to leaders in each of the product categories it has ventured in to and also marketed the same via increased spent advertisments .Its advertisment spent has increased by 34% over FY15-19E, ranging between 3-4%

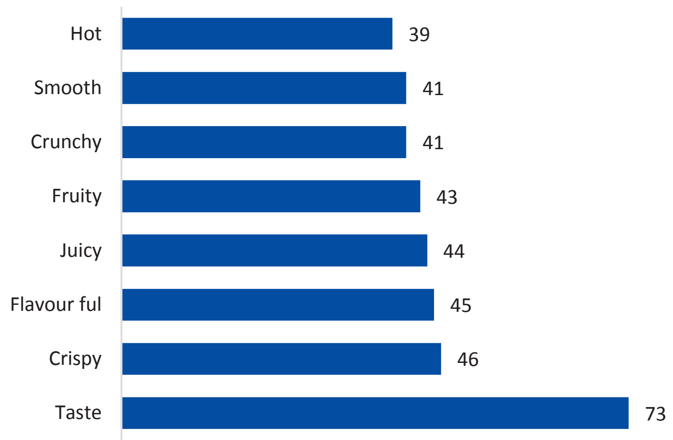
Categories	Prataap's Brands	Competitors
Extruded Nacks	Chulbule, Rings, Puffs, Wheels, Scoops	Kurkure (PepsiCo), DFM, Balaji, Bingo (ITC)
Potato Chips	Yellow Diamond	Lays (PepsiCo), Balaji, Bingo (ITC), Parle's Wafers, Haldirams
Namkeen	Yellow Diamond	Haldiram, Lehar(Pepsico), Balaji Wafers, Bikaji Foods, Bikano
Nachos	Yellow Diamond	Doritos (PepsiCo), Act II (Agro Tech Foods), Cornitos
Sweet	Rich Feast (Yum Pie)	Britannia, Pillsbury, Lotte Chocopie, Monginis, Honey bell

Source: Edelweiss Professional Investor Research

Prataap's USP - Value for Money Offerings



Consumers Preference in Snacks (%)



Source: Edelweiss Professional Investor Research

Prataap Snacks, in order to create brand pull, has enhanced its advertisment spending from 2.2% p.a. in FY15 to 3.5-4.0% in FY18 . It has licensed Nickeldon characters *Motu Patlu* for its flagship product Rings and regularly advertises on the Nickeladon channel which targets kids

Prataap snacks- a key player in the organized snacks market

	Market Share	Geographical Reach	Variety	Homogeneity
Prataap	4.5%	100%	100%	100%
DFM Food	2%	25%	25%	100%
Agrotech Food	0.7%	25%	25%	100%
Haldiram	20%	100%	50%	50%
Pepsi	18%	100%	50%	100%
Balaji	9%	25%	50%	100%
ITC	7%	100%	50%	100%

100% **50%** **25%**

Source: Edelweiss Professional Investor Research

III. Pan-India manufacturing & distribution in a category dominated by regional player

In the chips/ salted snacks business, wherein freight cost constitutes ~8-10% of overall revenue and constant replenishment at the shelf level is mandatory, it's challenging to take products to a national level. Hence, apart from players with deep pockets and a pan-India presence, a large part of the market is still regional in nature with players concentrated in a few pockets/regions. Cases in point are Balaji Wafers, DFM Foods, Gopal Snacks, among others.

In this market, Prataap has a pan-India distribution reach via: (a) three-tier distribution structure of stockists, distributors & retailers; (b) gaining critical revenue base in each area/geography via smartly using the reverse logistics route; and (c) then expanding the manufacturing base in those areas. Currently, the company's products reach 17 lakh retail touch points (almost 60% of PepsiCo's and 35% of Britannia's reach) served by 13 manufacturing plants with a combination of owned as well as outsourcing facilities.

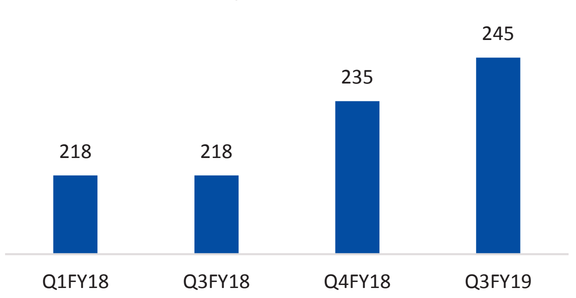
Prataap Snacks employed reverse logistics to create market & critical mass

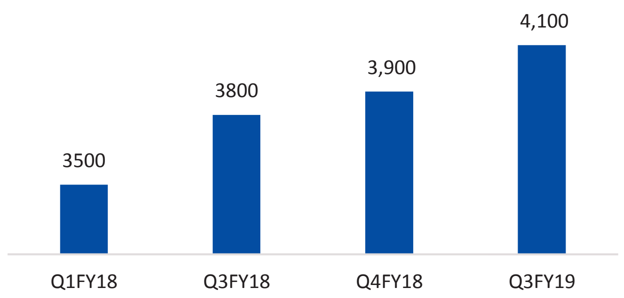
Prataap entered the domestic snacks market in 2005 with a facility in Indore. Instead of restricting its presence to a limited area (like other regional players Balaji and Gopal Snacks), the company, sensing a big market opportunity, it penetrated in to the West market of Mumbai and North market of Delhi by taking advantage of reverse logistics. Indore being a consumption state, vehicles would come down and instead of going empty, were loaded with company's products, resulting in lower freight cost.

Once it achieved critical scale and with an eye on further expansion, the company set up a new facility in East (Guwahati) and then via outsourcing ventured in to South India as well.

In a span of 10 years, Prataap has 13 manufacturing facilities across India, of these 4 are owned, 1 has been acquired, while the balance 8 are third party outsourcing plants. For a product like chips, being present closer to consuming centres improves distribution reach as well as aids margin. Prataap scores high on expanding its manufacturing base, which other players, despite having presence in the market for over 20-30 plus years, have not been successful in—while DFM's facilities are restricted to the North, Balaji's is in Gujarat.

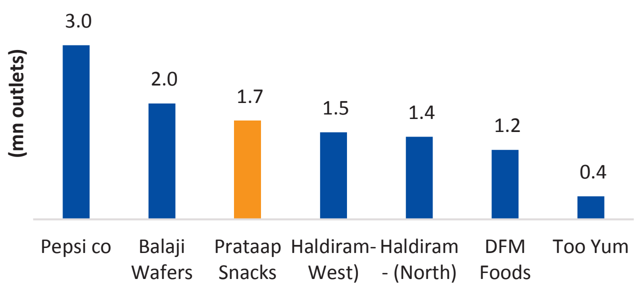
Increasing distribution footprint (Nos)

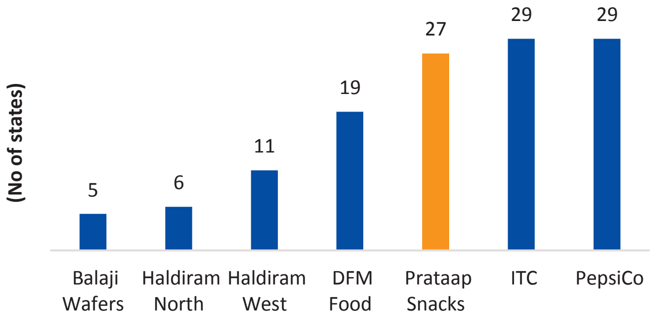




Source: Company, Edelweiss Professional Investor Research

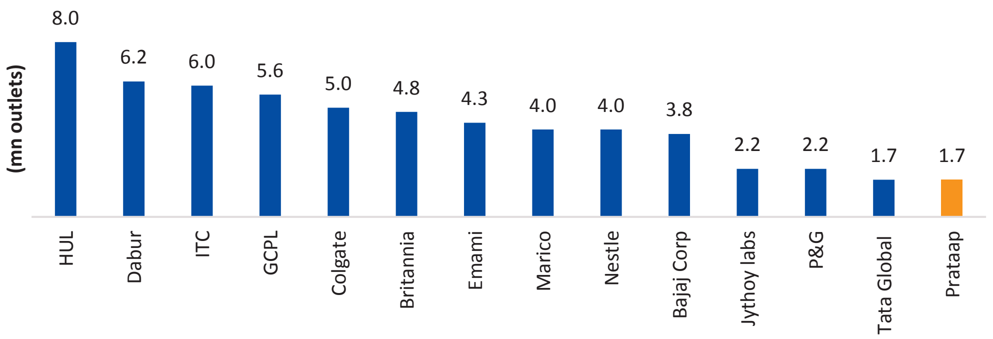
In terms of distribution - Prataap is one of the leading player in the domestic savoury segment





Source: Industry, Edelweiss Professional Investor Research

Comparing with FMCG biggies, it has captured 60% of PepsiCo's and around 35% of Britannia distribution reach



Source: Edelweiss Professional Investor Research

Going forward, Prataap aims to drive its growth via penetrating deeper in to North and West markets, while expanding its footprint in South India as well. Currently, ~11% of its revenue comes from the Southern market.

Apart from general trade, Prataap Snacks is also looking to have presence in modern trade, which currently contributes less than 1% to the company's overall sales; for the packaged foods industry, the share ranges between 8% and 10%. Going forward, with sharpening focus on this channel, growth is expected to accelerate. In the modern retail format, Prataap Snacks is making efforts to boost sales of larger size SKUs.

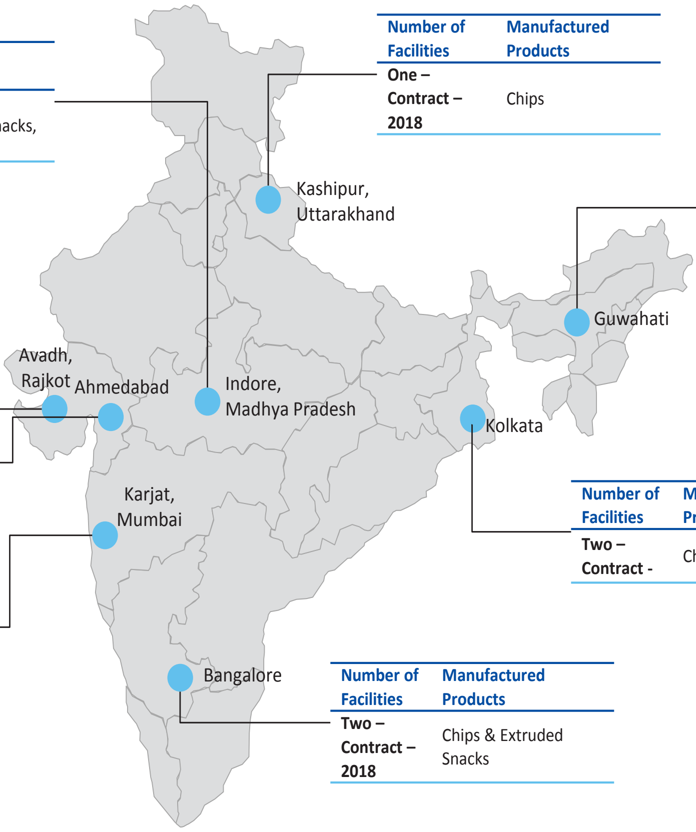
From a single location to a PAN India manufacturing base

Number of Facilities	Manufactured Products
Two – Owned	Chips, Extruded Snacks, Sweet Snacks, Namkeen

Number of Facilities	Manufactured Products
One – Contract – 2018	Chips

Number of Facilities	Manufactured Products
Two – Owned	Extruded Snacks

Number of Facilities	Manufactured Products
One – Acquired– Oct 2018	Namkeen & Pellets



Number of Facilities	Manufactured Products
Two – Contract – 2018	Chips & Nachos

Number of Facilities	Manufactured Products
Two – Contract -	Chips

Number of Facilities	Manufactured Products
One- Contract- 2018	Pellets, Fryums

Number of Facilities	Manufactured Products
Two – Contract – 2018	Chips & Extruded Snacks

IV. Future Growth Drivers

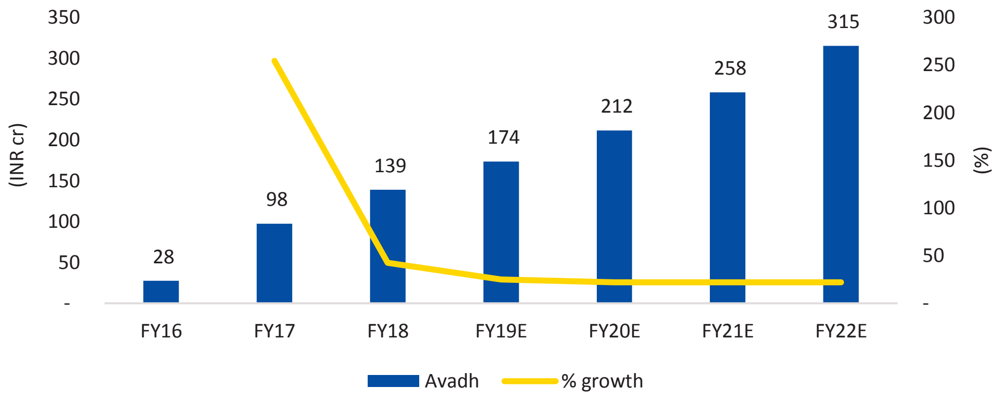
a). Inorganic growth expansion

- **Avadh's acquisition gives entry in large and fast growing Gujarat market:** The domestic snacks market is characterised by strong regional tastes and preferences. Hence, regional players thrive given their strong connect with regional tastes, habits and preferences and pan-India players find it difficult to crack these strong markets. In order to gain access to the fast growing and big savoury Gujarat market, Prataap ventured via the inorganic route by acquiring Avadh. Avadh is the fourth-largest player in Gujarat, which is highly regional and with no presence of any national player. On the opportunity dynamics front, Gujarat is home to 4% of India's population, but consumes ~13% of packaged snacks. We believe, this acquisition is a great fit for Prataap, providing breakthrough in this market.

- **Strong connect with direct distributors makes Avadh a super value for money player:** Avadh has a strong presence in Gujarat and it sells directly to distributors (unlike Prataap, which has a three-tier system of sub-stockiests, distributors and then retailers). Hence, Avadh's distribution cost is lower and this benefit the company passes on to consumers with its super premium value for money offering (around 35- 40% higher grammage than competitors).

- **Avadh complements Prataap's products; aims to double revenue in 3 years:** Avadh has a portfolio of , pellets (fryums) and namkeens which complements the overall portfolio of Prataap. The latter has a portfolio ranging from chips, extruded snacks, sweets and namkeens. Avadh posted a turnover of around INR 140 crore in FY18 and has grown at a robust 20% plus over the past 3 years. Going forward, it expects to double its revenue from Avadh. The company has paid INR 148 crore for the acquisition, of which INR 25 crore will be fresh investment in the company to double the capacity of the plant.

Avadh's revenue base to double in the next three years' time frame



Source: Edelweiss Professional Investor Research

b). Entry in rapidly growing sweet category to accelerate growth by sweating assets

The overall market for western sweets, especially chocolate-based confectionaries, is pegged at INR 2,800-3,000 crore and the same is expected to grow ~15-18% over the next 4-5 years. Sensing the opportunity, big players like Pillsbury, Lotte, Bauli as well as Britannia have ventured in to the segment and are extremely buoyant on demand and growth potential. In a bid to expand its product basket and venture in to adjacent categories, **Prataap too has entered this segment with the launch of three products under the *Rich feast* brand.– (a) Yum Cake (b) Choco Vanilla Cake and (c) Cookie cakes** in three different flavor- (chocolate, Vanilla and Tuti fruity)

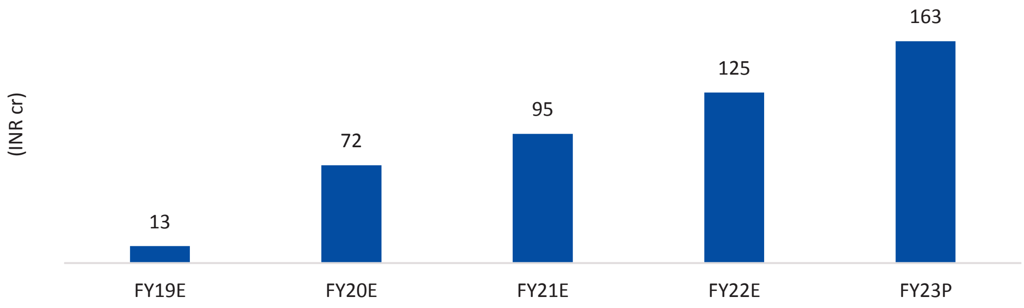
The product has evinced good response and demand is picking up. To enhance its sweet product basket Prataap is the process of launching 3-4 new products in the market.

Akin to its strategy in the snacks segment, Prataap is harnessing its strengths of: (a) **value-for-money brand**–While Pillsbury offers 11gm for INR 5, Prataap offers 16 gm for INR 5; (b) **execution capability**- The company has already invested INR 60 crore in land, building and production line for the sweets category. And, it is planning to incur additional INR 20 crore to expand and introduce new lines. All these efforts have been undertaken in a short time span, reflecting the company's execution heft; (c) **distribution might**-The sweet segment has a potential to reach across all touch points (~17 lakh currently). We believe, that though currently the sweet product is available at selective outlets, but has the potential to reach all the company's current touch points of 17 lac retail outlets.

Company	Brand	Product
General Mills	Pillsbury	 
Britannia	Treat	 
Bauli	Moonfills	
Lotte	Lotte Choco pie	
Prataap	Rich Feast	 

We believe, entry in this nascent, but fast-growing, category will add another leg of growth to Prataap. Currently, this category is clocking monthly turnover of INR 2.0-2.5 crore. Going forward, management aims to launch new versions and flavours of cookie cake, cookie biscuits and layer cake, which will propel monthly turnover to ~INR 5-8 crore over the next 4 years. Prataap aims to increase the share of sweets in its overall portfolio to ~10% over the next 3 years.

Sweets category- A new leg of growth to reach INR 160 crore in next 4 years' time frame



Source: Edelweiss Professional Investor Research

Sweets, as a category, is a high gross margin business—overall gross margin is >40% versus 30-35% in the snacks category. Along with higher gross margin, the volume weight ratio for sweets is favourable, leading to lower logistics cost for the company as well as distributors (logistics cost for chips is ~7-8%, while for sweets it is ~5%). A combination of higher gross margin and lower freight cost results in higher EBITDA margin for the sweets category. Which is almost is 2x salty snacks' margin. Thus, with rising contribution of the sweets business, we believe Prataap's overall margin is likely to improve.

Currently, at the net level, owing to lower asset turns (thereby lower capacity utilisation), the sweets business is earnings and ROCE dilutive. Over the medium term, with increase in asset turns (and in overall capacity utilisation) the overall ROCE is estimated to improve from the current low of 1% to ~22%.

Sweets business Performa over FY19-23E

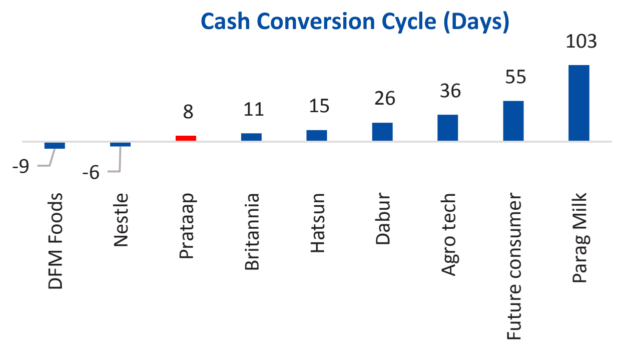
	FY19E	FY20E	FY21E	FY22E	FY22E	FY23E
Gross block	60	80	84	88	93	97
Net revenue	13	72	95	125	163	196
Gross asset turns	0.2	0.9	1.1	1.4	1.8	2.0
EBITDA	15%	15%	15%	15%	15%	15%
EBITDA	1.9	10.8	14.3	18.8	24.5	29.4
Depreciation	4.8	6.4	6.7	7.1	7.4	7.8
EBIT	-2.9	4.4	7.5	11.8	17.1	21.6
RoCE	-5%	6%	9%	13%	18%	22%

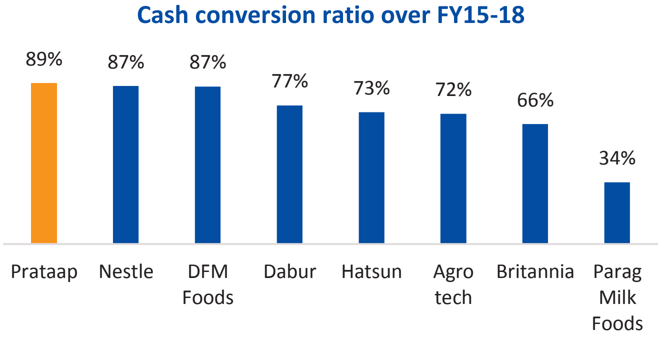
Source: Edelweiss Professional Investor Research

V. High Quality earnings coupled with rising share of outsourcing to drive ROCE

a) High quality cash generating business; 90% EBITDA flowing to cash from operations

Prataap Snacks is a high quality cash generating business as it operates on cash-and-carry basis. This leads to extremely low cash conversion cycle of 7-9 days, leading to high quality earnings. Prataap Snacks EBITDA to CFO is as high as 90%. This is in line with the best of consumer players like Nestle.





Source: Edelweiss Professional Investor Research

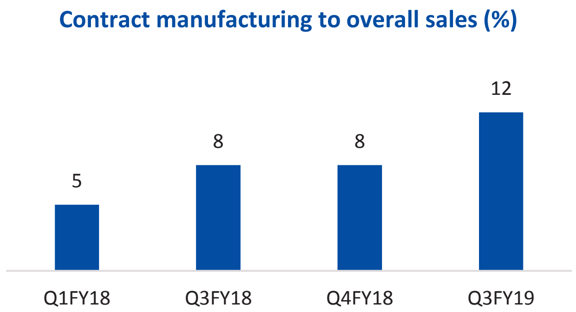
We believe, this high cash conversion ratio mirrors Prataap's high earnings quality rendering the business extremely compelling from the investment perspective.

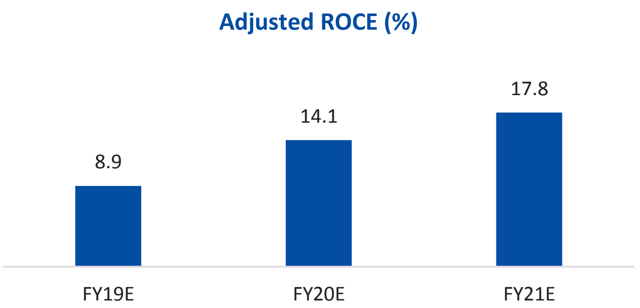
b) Outsourced model to drive higher asset turns and boost ROCE

In the snacks business, particularly chips and extruded snacks, it is imperative for manufacturing facilities to be closer to the market**.** This is largely to ensure freshness, high fill rate and also control freight cost as chips and snacks being light weight, the transportation cost is high. Hence, a successful pan-India player typically needs several small manufacturing facilities.

Hence, Prataap is gearing to expand its manufacturing base via the third-party outsourcing model. Currently, the company has around 13 manufacturing facilities spread across India, of which 5 are owned and balance 8 are outsourced. Contract manufacturing constitutes ~10-12% to total revenue, which is likely to increase to 20-25% over the next 3 years.

Along with lower logistics costs, outsourcing results in lower capex, thus leading to an asset-light model. This yields better margins and asset turns, thereby driving higher ROCE.



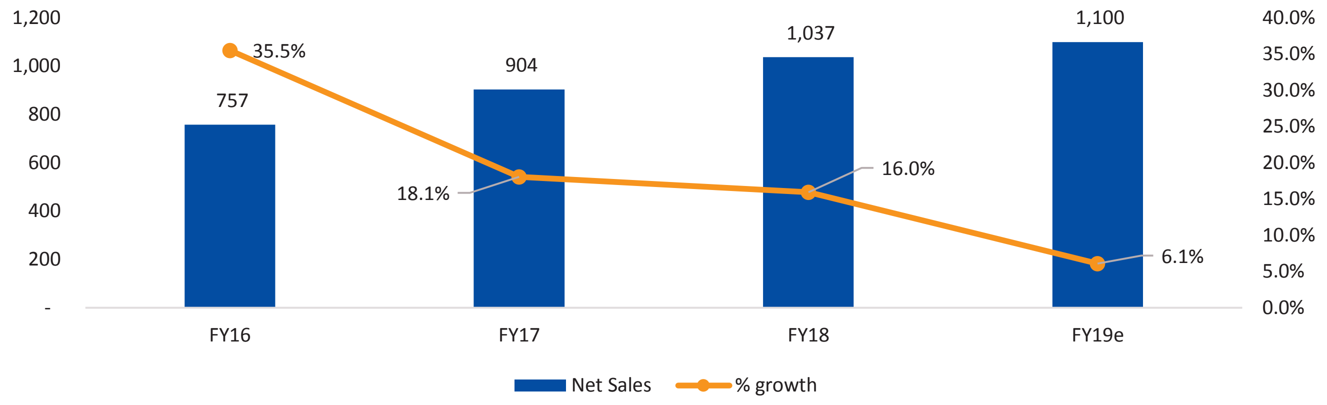


Source: Edelweiss Professional Investor Research

FY19: A challenging year; worst likely behind

Revenue growth lowest in past 10 years: FY19 has been a challenging year for the company with intense competition from regional players for its flagship product *Rings* (contributes 40% to turnover). While 9mFY19 revenue grew 9.6%, we estimate FY19 revenue to rise mere 6.1%.

Standalone Revenue performance (ex Avadh)



Source: Edelweiss Professional Investor Research

Despite improving product mix, surging cost of key raw material (laminate, potatoes, palm oil) along with rising competitive pressure resulted in lower gross margin and operating profit margin. Prataap posted 9mFY19 margin of sub-7%.

Lower margin as well as with asset turns (Prataap invested INR 60 crore in the sweets facility, which is underutilised), resulted in ROCE of mere 8-9%.

However, we believe the worst is behind as:

(a) To counter regional players' aggression and fill in white spaces, Prataap acquired controlling stake (80%) in Gujarat's fourth-largest organised player Avadh Snacks. The acquisition provides it access to rapidly-growing regional markets of Gujarat and Rajasthan. While Prataap's products can be leveraged in these markets via Avadh's distribution footprint, the latter's unique products like pellets and namkeen can be selectively extended to western and northern markets, thereby increasing Prataap's product width and driving the consolidated entity's revenue.

(b) The aggression at the company level too has sharpened with: (a) new versions of toys to woo kids to *Rings;* (b) enhanced ad time for promotion of its toys on kids channels; and (c) expansion of distribution field force to drive sales.

(c) The sweets business, wherein investments have largely been completed, will start yielding revenue and margin which will boost Prataap's financials.

(d) Stabilising raw material prices will positively impact margin.

Valuation & Peer comparison

Prataap Snacks possess the key elements of longevity of growth in the business (a) Present in high growth and underpenetrated category (b) Proven execution track record - The company has outpaced peers in terms of growth and market share gains (Currently at a market share of 4%+ Vs less than 1% in 2008). (c) Strong entrepreneurial spirit - clear strategy towards being “value for money”player, its continuous improvement and expansion and entry into newer product/categories (d) Ahead of time investment in distribution, brand building and facilities.

But as the company is in the early growth phase, the current as well as the near term margins would be sub-optimal, with scale entering into the business along with stabilisation of the distribution setup, we expect the margins to expand bringing disproportionate earnings growth, as well as ROCE expansion; which is not getting captured in the current earnings, hence optically the valuation would look high in the near term.

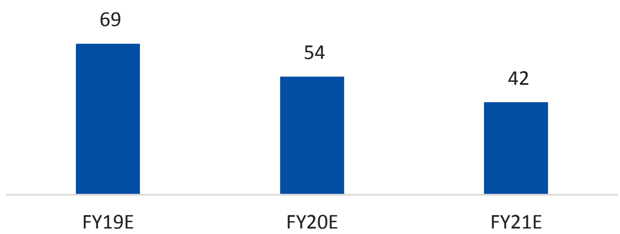
Given the dichotomy of Growth vs Scale, we believe that companies like Prataap Snacks which have sub optimal near term earnings, but strong and long growth prospects are best valued on DCF. Valuations based on near term multiples tend to undervalue the business as it does not take into account future growth which holds the true value accretion for these business.

Our three stage DCF model with 15% discount rate; leads to a price target of INR 1250, at which the company would be trading at implied PER of 42xFY21 earnings and at 1.7xEV/Sales.

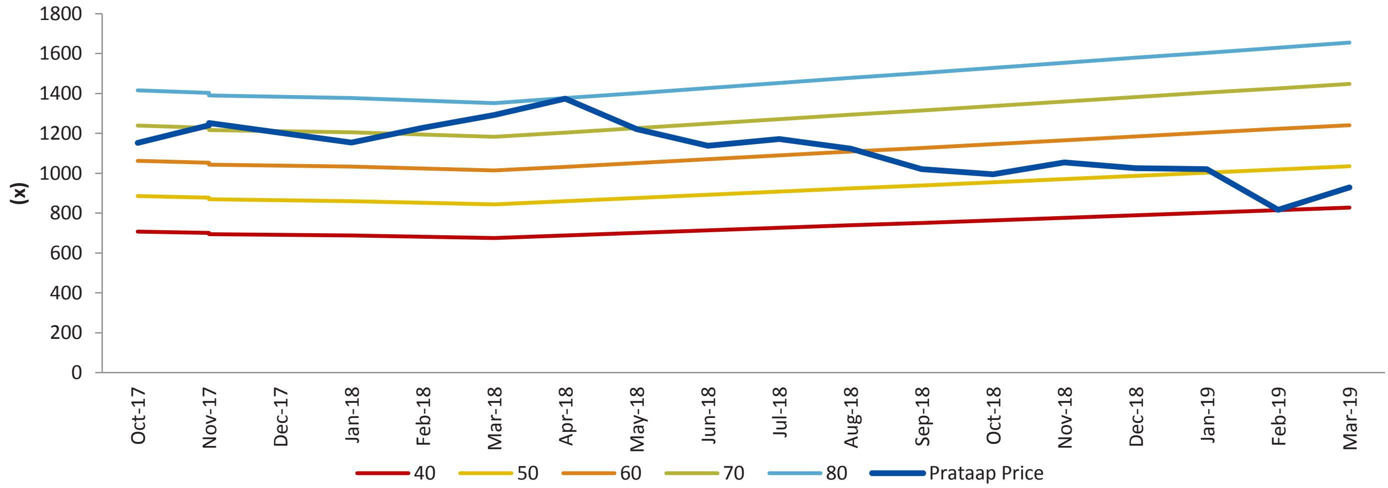
DCF Assumptions

	Revenue CAGR	EBITDA margin
Stage 1	19%	10%
Stage 2	12%	14%
Stage 3	10%	14%
Terminal growth		5%
WACC rate		15%

Implied PER on our Price Target



1 yr fwd P/E Band



Source: Edelweiss Professional Investor Research

Recent deals in the Indian Foods market

Year	Company	PE	Stake sale	Valuation	Mcap/Sales	Presence
2014	Bikaji Foods	Light house	13%	720	2x	Regional
2014	DFM Foods	West Bridge	25%	260	1.5x	Regional
2017	Apricot goods	CESC group- Sanjiv Goneka	70%	440	2.2x	Regional

Source: Industry Edelweiss Professional Investor Research

Peer comparison

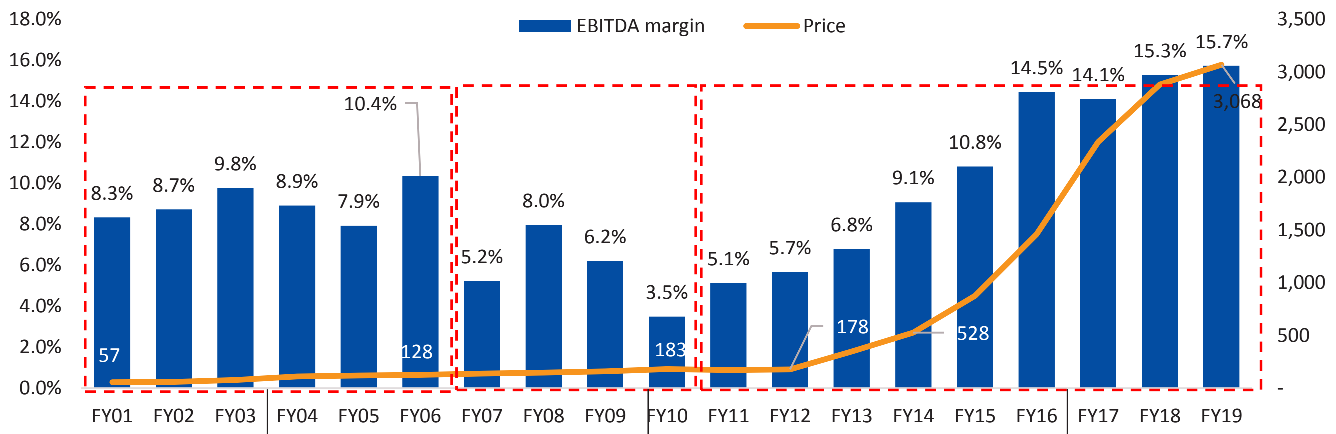
Companies	FY19-21 CAGR			FY21			
	Rev.	EBITDA	PAT	ROCE	EV/sales	EV/EBITDA	PER
Britannia Industries	14	18.3	19.1	47	4.9	28.9	44.4
Dabur	11.1	12.9	15.1	30.2	6.3	28.7	34.3
Godrej Consumer	9.7	11.6	12.5	21	5.3	25	35
Hindustan Unilever	18.3	21.5	24.8	52.6	7.3	30.6	42.3
Marico	12.3	15.2	15.1	48.6	4.8	26.2	37.7
Nestle	13.4	14.8	16.7	78.3	7.0	28.9	48
Future Consumer	30.5	55.6		11.9	1.3	28.0	96.6
DFM Foods	18.5	18.7	24.8	26	1.8	16.6	29.5
Median	**13.4**	**15.2**	**15.9**	**36**	**5.4**	**26.2**	**37.7**
Prataap	**21.5**	**30**	**27**	**19.4**	**1.2**	**14.4**	**33.7**

Key concerns

Volatile margins- Raw material forms around 67-68% of the total revenue for a value for money snacks player like Prataap foods. Any continuous upmove in the prices of the key raw materials would lead to impact on the Gross as well as EBITDA margin, impacting the profitability

High competition and fragmented market- Given the strong opportunity in the segment, any low entry barriers, the competition is high in the segment.

Britannia India – A case study in the Indian foods space



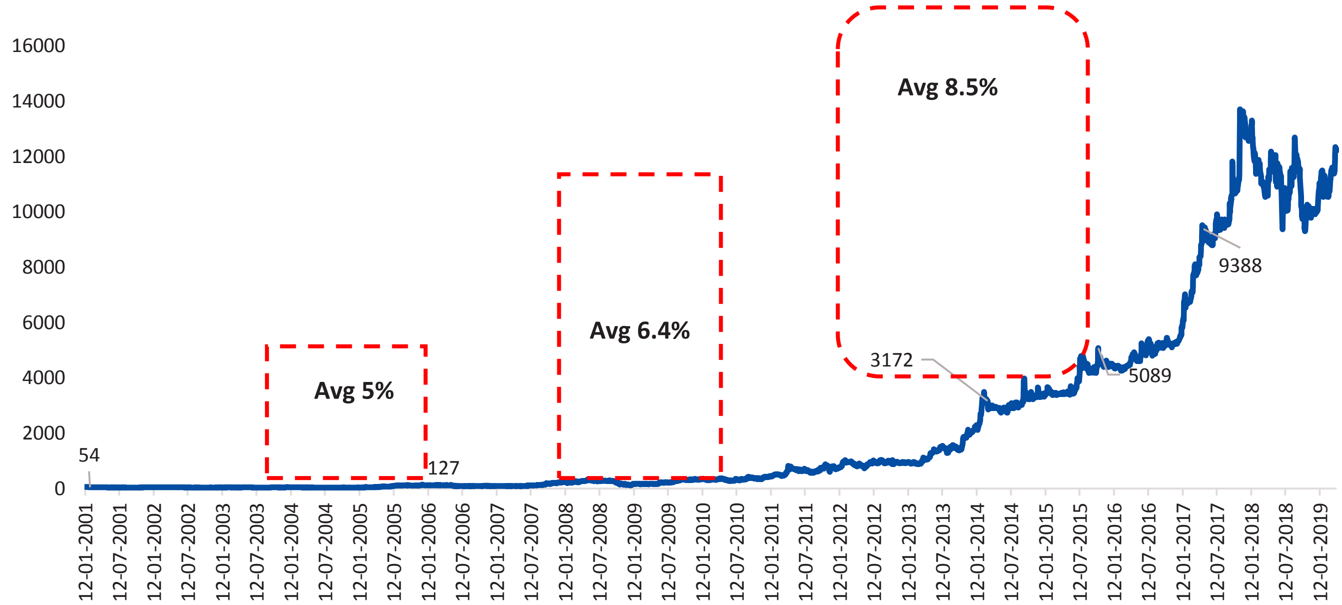
Over FY01-06, despite range bound margins, the higher growth clocked by the company drove the wealth creation for the investors and the stock more than doubled in 6 years.

Over FY07-FY10; The extreme swings in the margin; resulted in lower returns for the stock performance, During the said period, Britannia posted a mere 7.4%% CAGR

OverFY12-FY19; with aggression and scale benefits entering the system Steady improvement in margins was witnessed that resulted in complete re-rating of the stock. The margins improved from a low of 5.7% in FY12 to as high at 15.7% in FY19

Analysis of Britannia's journey over the past 19 years indicates that the company has provided a return of of 60x over this period. And, a large part of the wealth was created in the past 6 years, wherein the stock zoomed 6x from INR 520 to over INR 3000. This was largely led by EBITDA margin improvement. Over FY14-19, the company's EBITDA margin rose from high single digit to high mid-teens level and ended FY19 at 15.7%. We envisage similar trend in Prataap's case as well. While the overall sector is growing at 12-14%, the share of organised players is rising. The overall snacks category is expected to jump 2x over the next three years from INR 27,000 crore to INR 50,000 crore. Within this, even a 6-8% market share for Prataap will open huge opportunities for growth and margin expansion as the economies of scale enter in the business.

Hatsun India – A case study in the Indian Dairy space

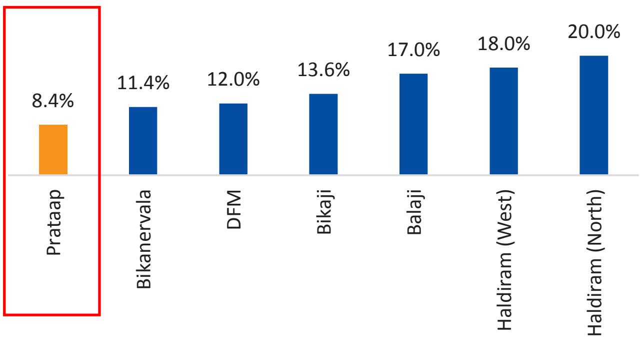


Source: Edelweiss Professional Investor Research

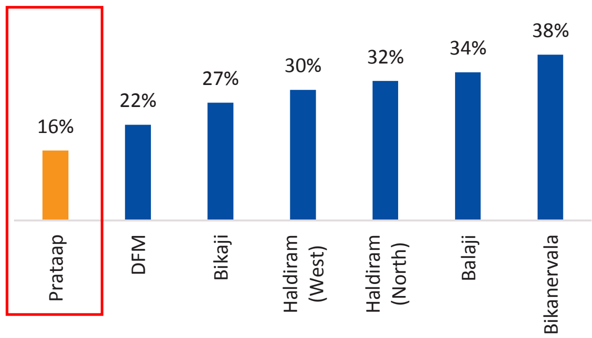
Similar trend played out for Hatsun India during 2001-07. With margin in the 4-5% range, the stock averaged a return of 15.3% CAGR over FY01-07. However, after FY07, with consistent growth and margin expansion, the stock continued to outperform and clocked a return of 53% CAGR over FY08-18.

We envisage similar inflection point for Prataap as the business scale, margin and ROCE expand in the long run.

FY18- EBITDA margin



FY18- ROCE (%)



Source: Edelweiss Professional Investor Research

Risk-reward favourable

Price Target	**INR 1250**	Based on three stage DCF of 18.8%, 12%,10% growth rate with a WACC of 15%
Bull Case	**INR 1700**	Based on three stage DCF of 18.8%, 12%,10% growth rate with a WACC of 12%
Base Case	**INR 1250**	Based on three stage DCF of 18.8%, 12%,10% growth rate with a WACC of 15%
Bear Case	**INR 740**	Based on three stage DCF of 15%, 10%,8% growth rate with a WACC of 18%

Company Description

- Based in Indore, Prataap was established in 2004 to manufacture potato chips by Mr. Arvind Mehta, Mr. Amit Kumat and Mr. Apoorva Kumat. While promoters own 23% of the company, private equity players—Sequoia holds 48% stake, while Faering hold 3% in the company
- The company manufactures and markets Potato Chips, Namkeen and Extruded Snacks. It sells its products under *Yellow Diamond*, *Chulbule* and *Rich Feast* brands.
- It has around 13 manufacturing facilities, of which 8 are outsourced and5 are owned.
- The brand and products are available pan-India, and are distributed via three-tier distribution network employing Super Stockists--→ Distributors--→ Retailers. As on 31st Dec 2018, the company has a total reach of 240+ superstockists, selling to around 4,100+ distributors and retail reach of around 17 lakh touch points.

Sustainability	Prataap Snacks is the youngest pan-India player in the fast-growing savoury market, selling products under the *Diamond* brand. The company has more than quadrupled its market share from less than 1% in 2008 to ~4% plus in 2018. The industry is expected to post 14% CAGR over the next three years. Strong execution track record of the promoter coupled with attractive dynamics is expected to render Prataap a sustainable play.
Disproportionate Future	The company has undertaken various initiatives to strengthen its product portfolio, along with expansion of distribution footprint, thus at the current juncture the company is in the investment phase. Going forward with the benefits of scale and reach flowing into the financials along with rising brand equity, the margins are expected to witness strong expansion. These are yet not built into financials.
Business Strategy & Planned Initiatives	Prataap Snacks aims to surpass industry growth to gain market share in the attractive, but competitive sub-segment, with a tight leash on cost along with a healthy balance sheet.
Near-Term Visibility	We estimate Prataap Snack to clock 21.5% revenue CAGR over FY19-21E, aided by spurt in core categories coupled with contribution from the acquired Avadh business and the new sweets segment. Improving product profile and stable raw material prices are expected to lead to margin expansion. We estimate 130bps margin expansion from 7.2% in FY19 to 8.2% in FY21.
Long-Term Visibility	Over the long term, given the aggression in growth and scale, along with rising contribution from the third party arrangement, we estimate Prataap Snacks margin at 10%. This will be led by (a) control on distribution & logistics cost (b) Improved product mix towards higher margin sweet, namkeen and (c) Moving towards direct sales to distributors.
Near Term Risk	Rising competitive intensity and mangement's inability to respond to it and market dynamics with respect to new product introduction/ expansion in new markets.
Long Term Risk	Exit of key managerial personnel, lack of focus.

Management Profile

Prataap Snacks is promoted by Mr. Amit Kumat and Mr. Arvind Mehta and Mr. Apoorva Kumat despite reaching INR 1,200 crore scale, the promoters' growth aspirations are still intact.
Mr. Kumat serves as Managing Director and brings more than two decades of snack industry and entrepreneurial experience. Having demonstrated a keen understanding of consumer tastes and preferences, he has been instrumental in deciding flavours and tastes of various product categories and also is the key decision maker in determining the nature of toys and characters to feature in packets (toy-based sales form ~80% of extruded snacks sales). We believe Mr. Kumat has been instrumental in driving the transformation of the company through various phases.

Mr. Arvind Mehta holds close to three decades of experience in the real estate sector, and 15 years experience in the snacks foods and financing business. The potent combination of marketing and finance has enabled Prataap Snacks to grow high without losing focus on profitability

The company has been funded by a renowned Private Equity player- Sequoia Capital (It has funded Prataap in three stages with the first investment in 2011). Currently Sequoia holds 48% in the company and is classified as a promoter, while other private equity firm Faering holds sub 2%.

The company also has robust Board of Directors

Board of Directors	Designation	Profile
Mr. G. V. Ravishankar	Non Executive / Non Independent Director	Has spent over 17 years in consulting and investing.
		Previously worked at Mckinsey & co and Wipro Technologies
Mr. V.T. Bharadwaj	Non Executive / Non Independent Director	Over 17 years' experience in management consultancy & PE investments, Previously worked with Mckinsey & Co
Mr. OM Prakash Manchanda	Independent Director	CEO & Ex director at Dr. Lal Pathlabs, and earlier with Hindustan Lever, Ranbaxy Labs
Mrs Anisha Motwani	Independent Director	Partner Storm the Norm ventures. Earlier associated with General Motors India & Max life insurance co
Mr. Vineet Kumar Kapila	Independent Director	COO- (RPC north of United Spirits) & Earlier MD (Spencers Retail)
Mr. Haresh Ram Chawla	Independent Director	Partner (India Value Fund) & earlier CEO (TV 18)
Mr. Chetan Kumar Mathur	Independent Director	Finance Professional with over 30 years experience in Food & Beverage segment and associated with PepsiCo for 23+ years

Timeline

- **2003** Prakash Snacks incorporated. Commenced trading in Cheese Balls
- **2005** Set up a plant to manufacture Potato Chips in Indore
- **2007** Installed Chulbule plant at Prakash Snacks in Indore
- **2010** Prataap Snacks incorporated and set up a Potato Chips plant in Indore
- **2011** Sequoia's initial investment of Rs. 620 mn Prataap Snacks Prataap Snacks took over the business of Prakash Snacks
- **2012** Commissioned Rings and Namkeen plant in Indore. Introduction of Rings, Namkeen and Wheels
- **2013** Doubled the capacity of Potato Chips plant at Indore from 6,000MT per annum to 12,000MT per annum
- **2014** Commissioned Guwahati plant for Rings, Chulbule and Pellets Introduction of Scoops
- **2015** Introduction of Yoodles and Creamy Sticks
- **2016** Guwahati new plant commissioned Increased the capacity of Chulbule and Rings plant at Indore
- **2017** Successful IPO – oversubscribed 47x; listed on NSE & BSE on Oct 5, 2017. Launched Yum-Pie, a variety of sweet snacks, under the brand name Rich Feast.
- **2018** Entered into 3P Contract Manufacturing for producing potato chips. Launch of Kurves, Nachos ,Yum Cake and Cookie Cake Acquired 80% stake in Avadh Snacks, a leading snacks player In Gujarat

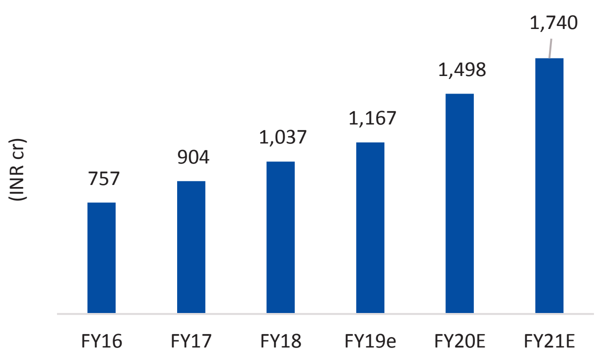
Improving Financials

Revenue to post 21.5% CAGR over FY18-21E driven by namkeen, pellets and core savoury portfolio

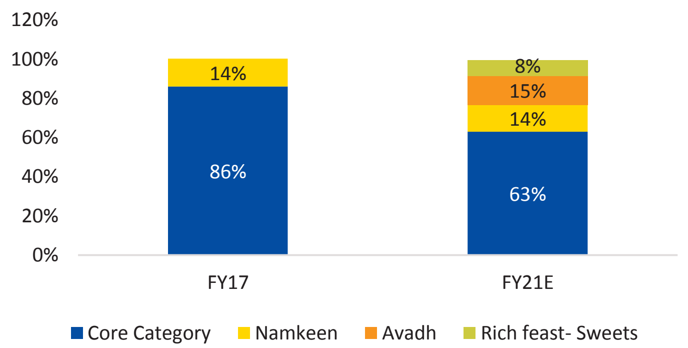
Namkeen currently constitutes ~13% of Prataap's total revenue and is estimated to clock CAGR of 20% plus to 15% of the overall portfolio by FY21. The acquired Avadh business is expected to grow at a strong pace on account of expanding the facility as well as increasing distribution network (sweating Prataap's existing network to sell Avadh's products).

The company has already started distributing Avadh's products (pellets, fryums as well as namkeen) in the Maharashtra market. We expect Avadh to contribute 17% to consolidated sales by FY21 (Avadh has posted CAGR of 20% plus over FY15-18). The sweets segment under the *Rich feast* brand has been launched in FY19 and is gaining good traction. The company expects it to contribute 10% to the overall turnover over the next 4-5 years. We expect *Rich feast's* share to reach 6-8% of the consolidated portfolio.

Revenue expected to clock 21.5% CAGR...



...driven by rising share of Sweet and Avadh's portfolio

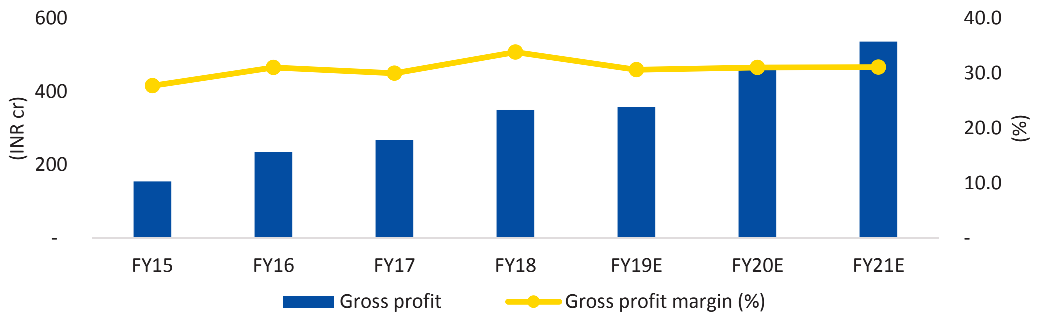


Source: Edelweiss Professional Investor Research

Improving product mix and stable raw material cost to boost margin

Packaged food players have low control on raw material cost, which is a combination of agri-led cost as well as crude linked. Crude-linked cost includes packaging film as well as palm oil, which together constitutes ~40-45% of the overall cost. Managing raw material cost is vital to maintain gross margin. Despite issues with potato availability, increase in its price, along with rise in the cost of other key raw material, the company has managed to keep margin resilient through proactive procurement and long-term contracts. Also, over the years, Prataap's product portfolio has expanded with the addition of high margin namkeen and sweets. Thus, lower-to-stable raw material prices are likely to flow in to the system. We estimate Prataap's consolidated gross margin to improve 50bps from 30.6% in FY19 to 31.1% in FY21.

Gross margins trend

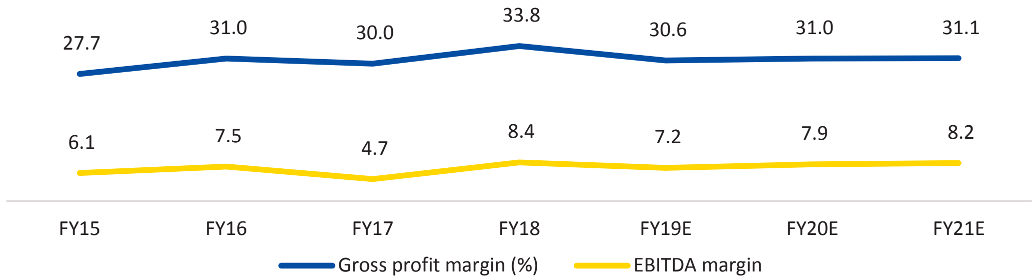


Source: Edelweiss Professional Investor Research

Scale benefits along with gross margin improvement to boost margin

Driven by gross margin improvement and benefits of scale playing out in the form of employee, logistics and advertisement costs, we estimate Prataap's EBITDA margin to expand 100bps from 7.2% in FY19 to 8.2% in FY21.

Margin profile



Source: Edelweiss Professional Investor Research

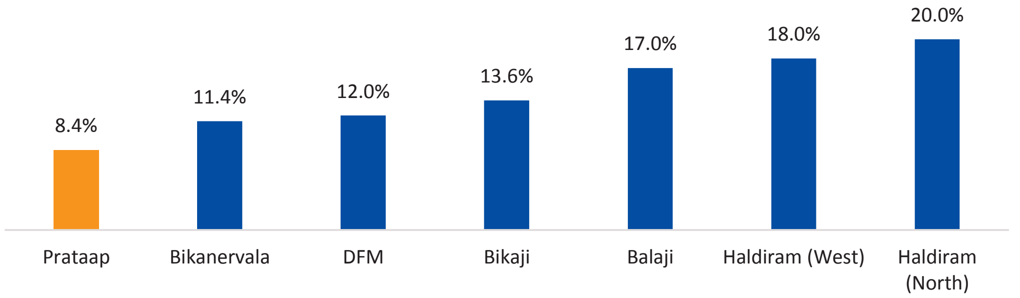
Laying roadmap for around 10% margin in next four years' time frame

We believe, Prataap has significant margin levers at gross and operating levels, over the next 3-4 years. Gross margin is expected to improve led by: (a) rising share of high margin namkeen, sweets & premium offerings in the portfolio; (b) enhanced brand strength by shifting from toy-led push to taste & brand-led pull; and (c) increasing scale from an INR 1,000 crore to INR 2000 crore company.

Operating margin levers are: (a) lower freight cost on account of limited movement; and (b) increased flexibility by harnessing direct distribution network (serving distributors directly) compared to current three-tier distribution network (stockiest--→Distributor--→Retailer) will lead to savings in distribution cost. Regional players like Balaji and Gopal Snacks follow the direct distribution model, which results in lower distribution cost and hence higher margins.

Bolstered by the above mentioned benefits, we estimate Prataap to clock 10% margin over the next 2-3 years.

Huge Scope for Margin expansion vis a vis peers, as the business scales

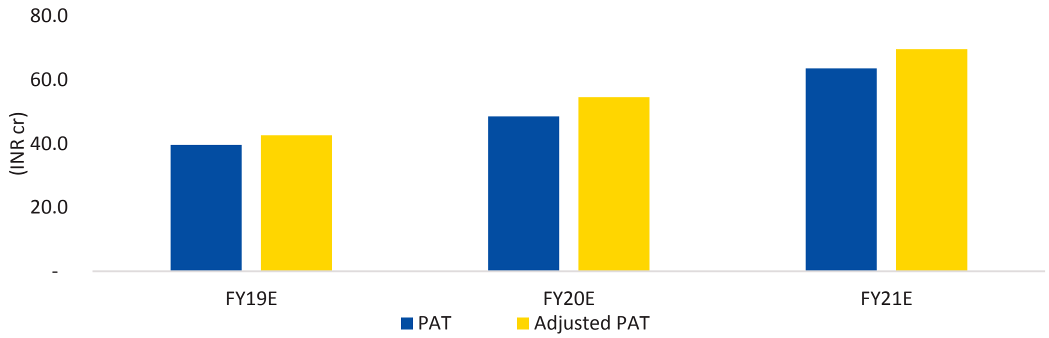


Source: Edelweiss Professional Investor Research

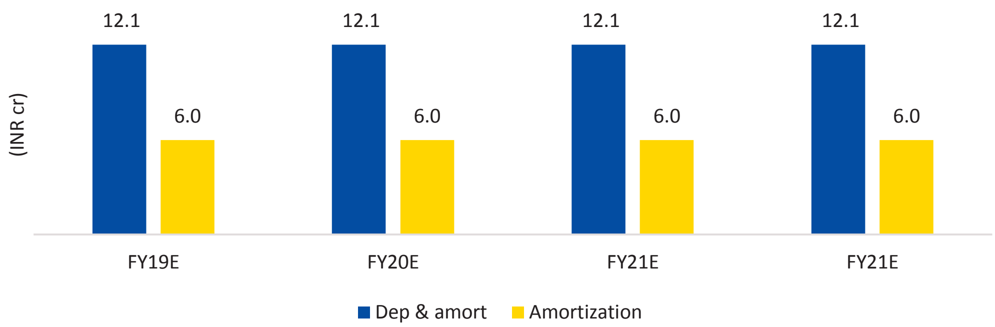
Adjusted PAT is expected to post 28% CAGR over FY19-21E

Driven by 21.5% growth in the revenue; coupled with expanding margins, we expect the adjusted net earnings to post 28% earnings CAGR over FY19-21E. Prataap Snacks acquired 80% stake in Avadh Snacks in September 2018, for INR 148 crore, of which around 50% is in the form of intangibles- Distribution reach, Trademarks and Goodwill. As per the accounting standard, the company would be amortizing distribution cost and trademarks over a period of 10-12; which is likely to accelerate the non-cash amortization charge, thus depressing the earnings. We have adjusted our earnings, adjusting for this non-cash charge, thus our adjusted earnings for FY21 is INR 70 crore vs reported earnings of INR 64 crore.

Adjusted PAT is expected to post 28% earnings CAGR over FY19-21E



Avadh's amortization of intangibles forms 50% of its Avadh's non-cash charge



Source: Edelweiss Professional Investor Research

Robust Balance sheet; lean working capital cycle and high operating cash flow- Prataap Snacks has a strong balance sheet with no debt in its books and net cash surplus. The company had raised INR 220 crore from the IPO and the same has been utilized for retiring debt as well as for investment in the sweets as well as acquisition of Avadh. With large capex already done, going forward with improving margins, lean working capital cycle the operating cash flow is expected to increase and reach INR 135 crore for FY21E

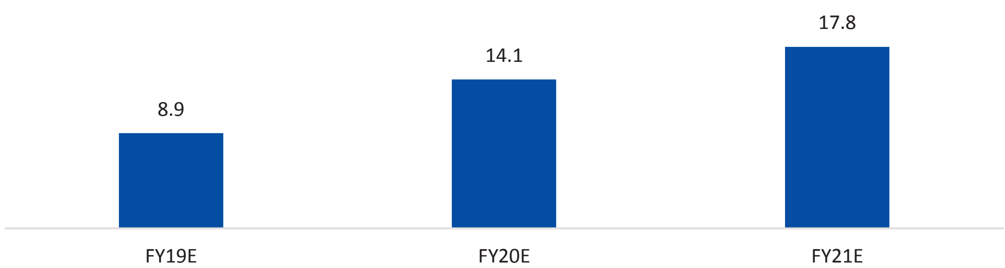
Free cash flow

Year to March	FY16	FY17	FY18	FY19E	FY20E	FY21E
Reported Profit	27.4	12.1	44.2	39.6	48.5	63.6
Add: Depreciation	18.0	25.0	30.4	39.6	48.8	50.7
Interest (Net of Tax)	5.9	3.5	2.2	-	-	-
Others	(1.9)	(3.0)	(7.4)	(10.0)	(0)	(0)
Less: Changes in WC	(12.8)	22.9	(27.5)	(3.7)	11.8	(20.9)
Operating cash flow	62.1	14.8	96.9	72.8	85.6	135.3
Less: Capex	46.3	58.6	(4.0)	220.0	50.0	50.0
Free cash flow	**15.8**	**(43.9)**	**100.9**	**(145.6)**	**36.1**	**85.8**

Improving margins along with asset turns to reflect in higher ROCE

The improvement in margins along with increase in asset turns (as substantial capex is already behind) in the system- the fixed asset turnover is expected to improve from 4.5x in FY18 to 6x in FY21. This, along with improving margins, is expected to result in ROCE expansion. We estimate Prataap's adjusted core ROCE to expand from current 10.6% to ~19.6% by FY21.

Adjusted ROCE (%)



Source: Edelweiss Professional Investor Research

Financials

Income statement					(INR cr)
Year to March	**FY17**	**FY18**	**FY19E**	**FY20E**	**FY21E**
Income from operations	894	1,037	1,167	1,486	1,723
Employee costs	25	37	40	52	60
Advertising expenses	37	37	40	46	55
Freight & forwarding	72	84	82	107	121
SG&A expenses	92	105	112	138	158
Total operating expenses	852	950	1,083	1,368	1,581
EBITDA	42	87	84	118	142
Depreciation and amortisation	25	30	40	49	51
EBIT	17	57	44	69	91
Interest expenses	4	3	0	0	0
Other income	2	8	10	0	0
Profit before tax	15	62	54	69	91
Provision for tax	3	17	15	21	27
Core profit	12	44	40	49	64
Extraordinary items	1	0	0	0	0
Profit after tax	11	44	40	49	64
Adjusted net profit	11	44	43	55	70
Equity shares outstanding (mn)	2	2	2	2	2
EPS (INR) basic	5	19	17	21	27
Adjusted EPS	4.8	18.9	18.2	23.3	29.8
Adjusted Cash EPS	17	32	34	42	49

Common size metrics- as % of net revenues					
Year to March	**FY17**	**FY18**	**FY19E**	**FY20E**	**FY21E**
Employee cost	2.8	3.5	3.5	3.5	3.5
Advertising expenses	4.1	3.6	3.4	3.1	3.2
Freight & forwarding	8.1	8.1	7.0	7.2	7.0
SG&A expenses	10.2	10.2	9.6	9.3	9.2
Depreciation	2.8	2.9	3.4	3.3	2.9
Interest expenditure	0.5	0.3	-	-	-
EBITDA margins	4.7	8.4	7.2	7.9	8.2
Net profit margins	4.9	4.1	3.7	3.7	4.0

Growth metrics (%)					
Year to March	**FY17**	**FY18**	**FY19E**	**FY20E**	**FY21E**
Revenues	(63.1)	16.0	12.6	27.3	15.9
EBITDA	(96.6)	16.4	(3.1)	31.0	12.7
PBT	(93.2)	306.0	(12.0)	27.7	31.2
Net profit	(94.9)	295.0	(10.3)	22.5	31.2
EPS	(51.5)	250.1	(10.3)	22.5	31.2

Balance sheet				(INR cr)
As on 31st March	**FY18**	**FY19E**	**FY20E**	**FY21E**
Equity share capital	12	12	12	12
Reserves & surplus	508	547	596	660
Shareholders funds	520	559	608	671
Long Term Borrowing	-	-	-	-
Short Term Borrowing	7	7	7	7
Sources of funds	**524**	**578**	**637**	**700**
Gross block	315	353	402	450
Depreciation				
Net block	266	272	286	297
Capital work in progress	-	-	-	-
Total fixed assets	271	442	440	435
Intangible Assets	4	170	154	138
Deferred tax assets				
Inventories	90	81	135	115
Sundry debtors	20	25	33	34
Cash and equivalents	214	79	145	191
Loans and advances	22	37	45	45
Other current assets	36	7	7	7
Total current assets	130	93	166	127
Sundry creditors and others	100	72	145	106
Provisions	30	21	21	21
Total CL & provisions	130	93	166	127
Net current assets	38	57	53	74
Uses of funds	**524**	**578**	**637**	**700**
Book value per share (INR)				

Cash flow statement				
Year to March	**FY18**	**FY19E**	**FY20E**	**FY21E**
Net profit	44	40	49	64
Add: Depreciation	30	40	49	51
Add: Deferred tax	2	0	0	0
Gross cash flow	-7	-10	0	0
Less: Changes in W. C.	-27	-4	12	-21
Operating cash flow	97	73	86	135
Less: Capex	-4	220	50	50
Free cash flow	101	(146)	36	86

Ratios

Year to March	FY17	FY18	FY19P	FY20P	FY20P
ROAE (%)	5.3	11.7	7.3	8.3	10.0
Adjusted ROACE (%)	9.6	18.3	8.9	14.1	17.8
Current ratio	1.5	2.9	2.5	2.2	3.1
Debtors (days)	7.6	7.0	7.0	7.0	7.0
Inventory (days)	42.4	38.0	38.0	38.0	38.0
Payable (days)	38.1	38.1	38.1	38.1	38.1
Cash conversion cycle (days)	7.6	7.0	7.0	7.0	7.0
Debt/EBITDA	1.6	0.1	0.1	0.1	0.1
Debt/Equity	0.3	0.0	0.0	0.0	0.0
Adjusted debt/Equity	0.3	0.0	0.0	0.0	0.0

Valuation parameters

Year to March	FY17	FY18	FY19E	FY20E	FY21E
Diluted EPS (INR)	5.4	18.8	16.9	20.7	27.1
Y-o-Y growth (%)	*(76.2)*	*250.1*	*(10.3)*	*22.5*	*31.2*
CEPS (INR)	17.4	31.8	33.8	41.5	48.8
Diluted P/E (x)	167.3	47.8	53.3	43.5	33.2
Price/BV(x)	7.8	4.1	3.8	3.5	3.1
EV/Sales (x)	2.5	1.9	1.8	1.4	1.2
EV/EBITDA (x)	52.8	22.6	25.1	17.2	14.0
Diluted shares O/S	2.1	2.3	2.3	2.3	2.3
Basic EPS	5.4	18.8	16.9	20.7	27.1
Adjusted EPS	4.8	18.9	18.2	23.3	29.8
Adjusted PE (x)	194	49	51	40	32

Food Category to grow at a higher clip than the Staples

Within India's consumer sector, we believe food companies offer more long-term growth visibility than staples companies focusing high on home & personal care (HPC) products. And, we envisage the former to spearhead the sector's growth over the next decade. **Intensifying competition, high price elasticity of demand and deep penetration imply that HPC's long-term growth will continue to lag the food sectors.**

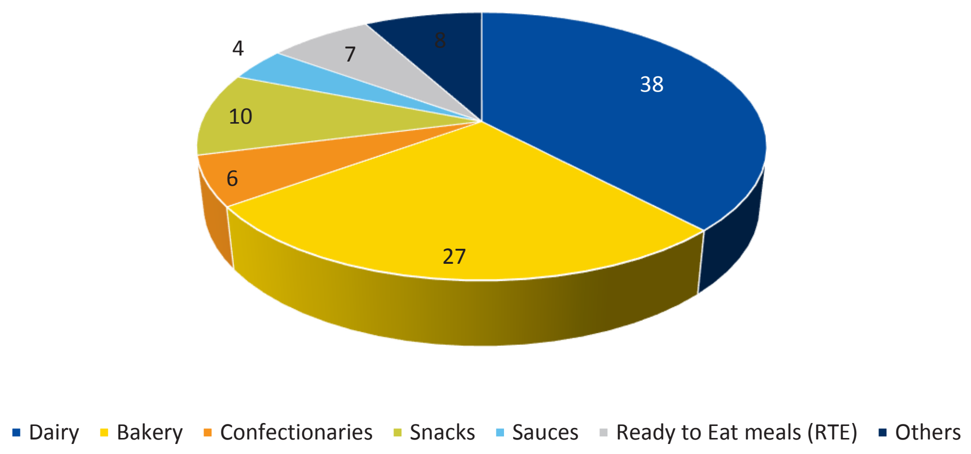
An analysis of past 5 years' revenue track record of listed packaged food and staples players indicates that listed food players have grown on an average at 1.5x staples players. This implies that the food sector has grown at a higher pace.

We believe, India's food sector will register steady sales growth in high teens over the next decade fuelled by rising penetration, increasing urbanisation and lifestyle changes. Over the medium term, the food sector is also likely to benefit from a shift towards branded and organised packaged foods.

Industry estimates peg India's organised packaged food market at ~INR 2,80000 crore and has grown at a CAGR of 10-12% over the past three years.

Dairy is the largest category, followed by bakery. Snacks and confectionaries constitute ~10% and 6% of the overall packaged food segment with an absolute size of INR 28,000 crore and INR 13,000 crore, respectively. These two categories have historically grown at a higher pace than other categories within the food universe. Going forward as well their growth is expected to surpass that of other categories.

Packaged Food Market size of INR 2,80,000 cr



Source: Edelweiss Professional Investor Research

India's food industry: How the dynamics are different from HPC segment

We believe, there are some structural differences in the operating environment between food and HPC industries.

We highlight a few of these differences below:

Easier to experiment with HPC items compared with food: Consumer habits, especially when it comes to food, are difficult to change. However, the willingness to try out a new product is far higher when it comes to HPC products, according to Marico. Deodorants, post wash hair care products and surface cleaners are classic examples of successes. When it comes to food, consumers are extremely reluctant to experiment. On-ground feedback suggests that it usually takes a long time to successfully make people change their food habits. This is also demonstrated by the fact that some of the now successful categories have been in existence for more than a decade. For instance, instant noodles were first introduced to India in the 1980s and breakfast cereals in the 1990s.

Brand loyalty is low in HPC space: In our opinion, brand loyalty in the HPC space is extremely low even in some mature HPC categories such as soaps and toothpastes. The best empirical evidence of this is the widely fluctuating market share among the three-four top players in soaps and shampoo and success of new entrants such as ITC.

Supply chain: Food and HPC have vastly different supply chain needs. Some of the typical examples of supply chain issues that F&B companies face are:

- Supply chain can be complicated **in perishable items such as dairy products**, for which cold storage facilities and temperature controlled vans are necessary.
- Another issue is that manufacturing facilities of some products, such as chips and salty snacks, **need to be closer to the market. This is largely because of the high freight cost involved**. Hence, these companies typically need several small manufacturing facilities and they need to be closer to the target market to ensure profitability.
- Another issue faced is that food items tend to have a significantly **shorter shelf life**. This means much quicker delivery systems, regular replenishment of products on the shelf and vastly different distribution and storage requirements. **In the F&B segment, shelf life can vary from 7 days to 3 months on an average, while in the HPC space the shelf life can be up to 3 years,** say if the product is hair oil.

Taste is an important determinant: Product taste in the F&B space is an important determinant for success. Even health products are made to satisfy a consumer's taste buds with "health" benefits offered as an add-on. We also see this holding true with the continued success of **Lays from PepsiCo and Bingo from ITC over the "healthier" Parle's baked chips**. Thus, the taste plank is winning over the health plank, certainly in the salted snacks segment, in our view. Companies have already learnt from these examples and are looking to pitch taste with wellness across new product offerings.

Organised food market still in infancy: We believe the food sector is likely to witness structural growth in high teens over the next few years. We expect growth drivers of:

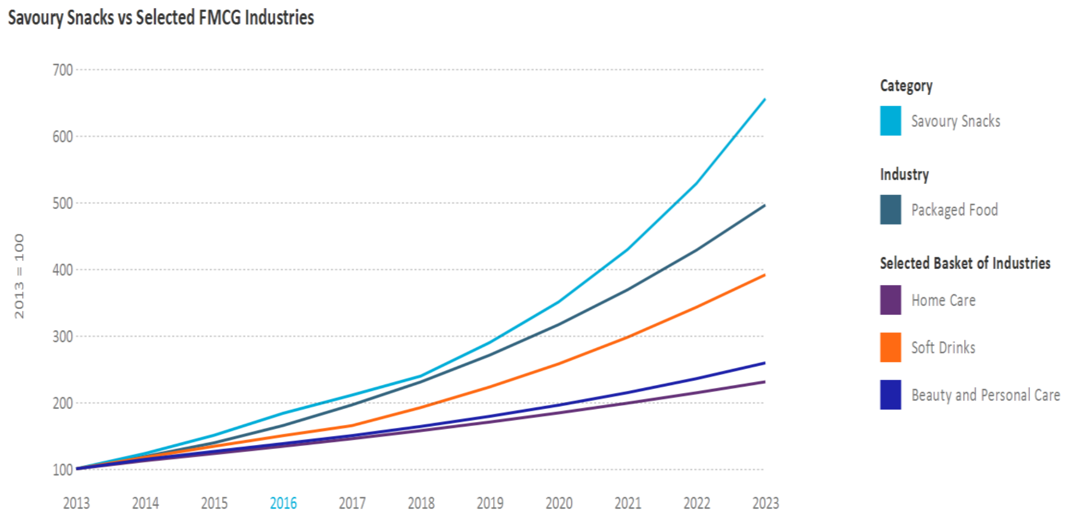
Increasing penetration: Penetration levels, across all categories, are still extremely low. While this is true for emerging categories, penetration levels are fairly low even for some of the larger and long standing food categories. For instance, chocolate as a category is worth INR 27 bn, but the penetration level in urban areas is 28% and below 10% in rural areas, according to Godrej Consumer. We continue to see food consumption rising over the next few years.

Shift from unorganised to organised: Although we agree that per capita consumption is now relatively high in some of the food categories such as dairy products, staples, edible oils etc., we believe this will continue to grow over the medium term as demand for food continues to grow and consumers move from the unorganised to organised segment. We have already seen this happen in urban areas, where packaged milk and other dairy products witnessed a marked shift from the unorganised to organised segment. We expect Nestlé and Marico to be biggest gainers from this shift.

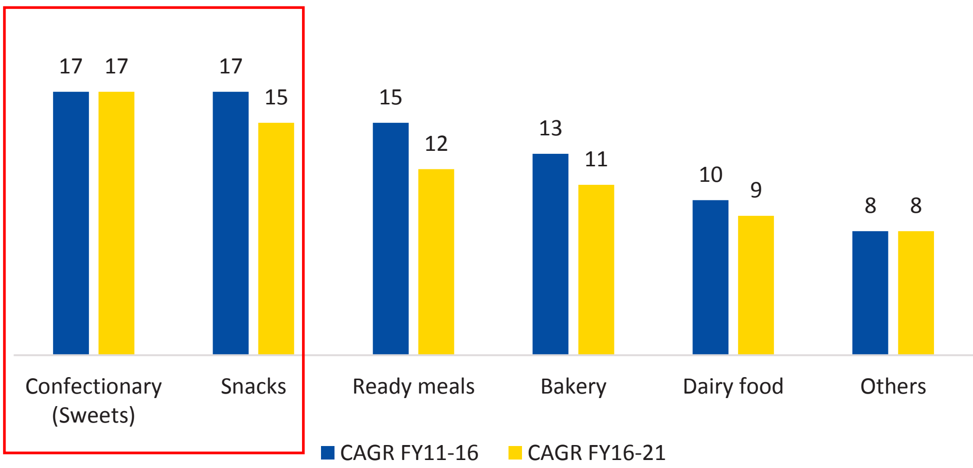
Consistency of growth food vs. HPC: A noticeable trend is that the consistency of growth has been much better in the food space vs that of the HPC segment. For instance, sales of the breakfast cereals market have grown >25% p.a. over the past 4 years. Even a long-existing and more mature category such as chocolates grew at an average 15% during the same period. This compares with HPC categories such as detergent cakes, where sales growth has been inconsistent over the past 3 years, growing by 9-25% p.a.

Food segment is nascent: We believe, the primary reason for consistently higher growth is that the processed and packaged food segment is still nascent. As incomes have grown over the past few years and as health consciousness has increased among urban consumers, this sector has witnessed acceleration in sales growth. We expect this trend to sustain over the next few years. On the contrary, large HPC categories are highly penetrated, especially in urban markets. Detergents, soaps and toothpastes have ~90% or more penetration in urban markets (*source: AC Nielsen*). This has led to structurally slower growth in these categories. Also, these categories have greater price elasticity, thus leading to lower brand loyalty. This impacts growth over longer periods

Within Foods; savoury snacks to grow at a higher clip



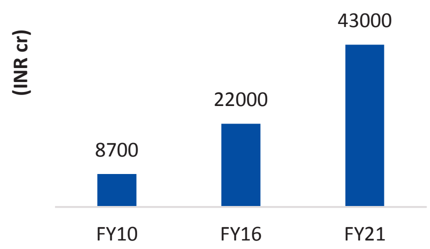
While Prataap is present in fastest growing snacks & sweets segment (%)



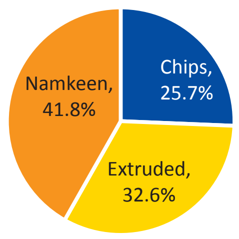
Source: Edelweiss Professional Investor Research

Overview of the Indian Snacks market

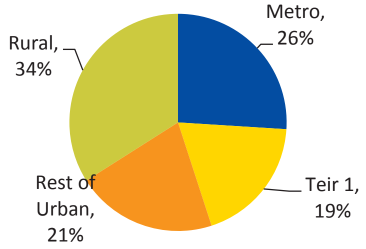
Organised Market to Grow at a CAGR of 14.6% Over 3 Years



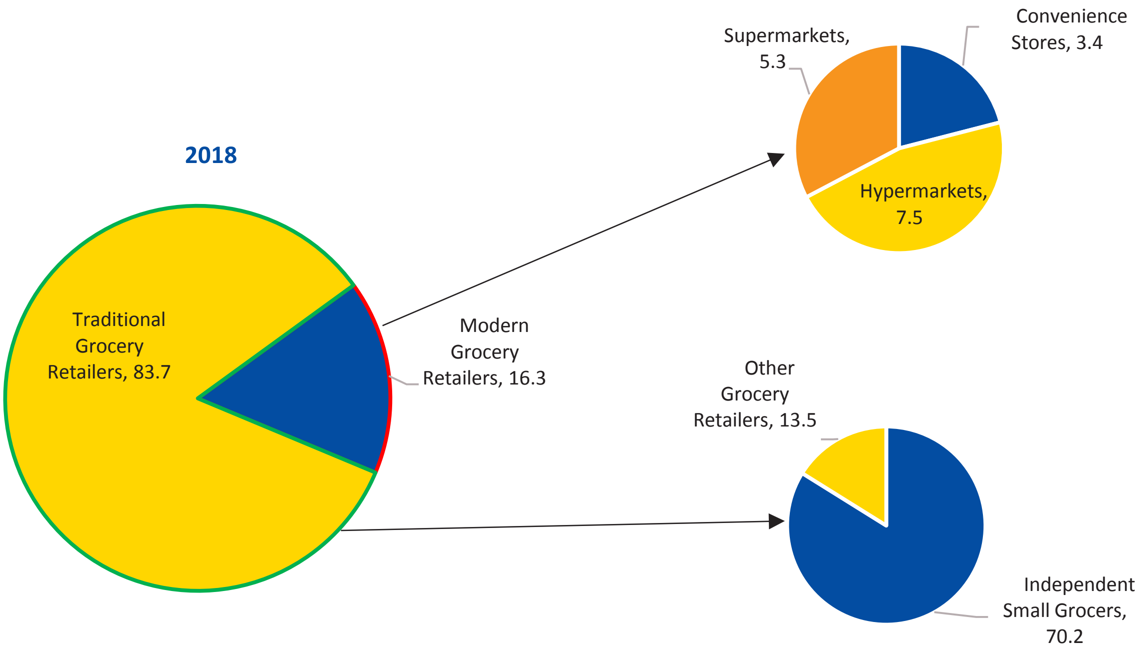
Still Namkeen Constitutes the Highest Share



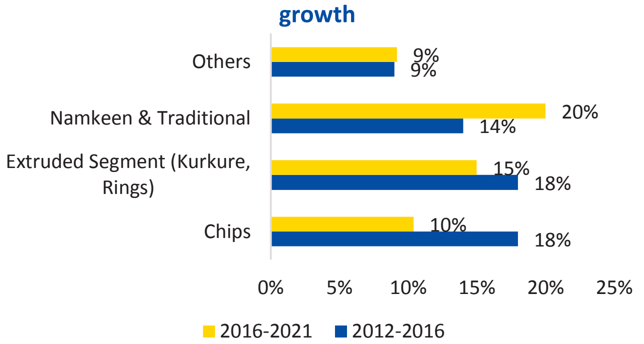
40% of the Revenue comes from Metro and Tier 1



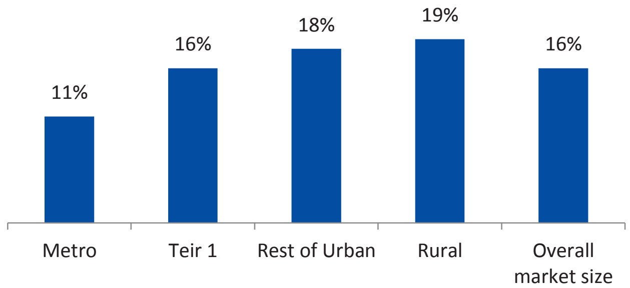
Traditional Channels continue to dominate the Distribution Mix



Namkeen & Tradtional snacks post the highest growth



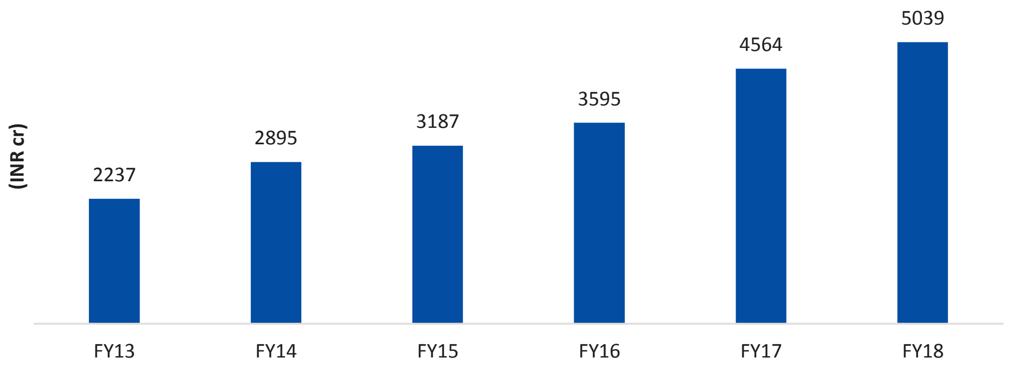
B and C towns of Urban India post the highest growth



Source: Edelweiss Professional Investor Research

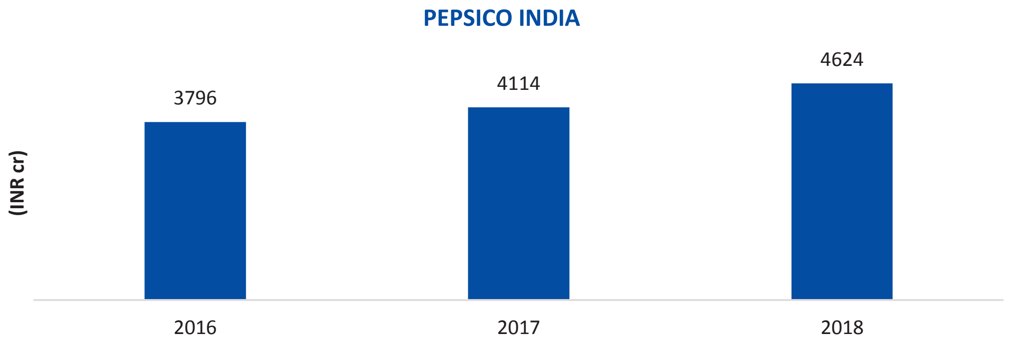
Key players in domestic organised snacks market: Brief profiles

1. **Haldiram (North + West):** Haldiram as a brand rules India's snacks market with an overall market share of 20%. This is driven by strong understanding of regional taste and preferences. Long-term presence through local operations in various parts of the country has enabled Haldiram to understand local tastes, develop products to cater to these and thereby establish strong brand equity. However, despite strong regional connect, the company has not succeeded at the national level in categories like chips and extruded snacks.



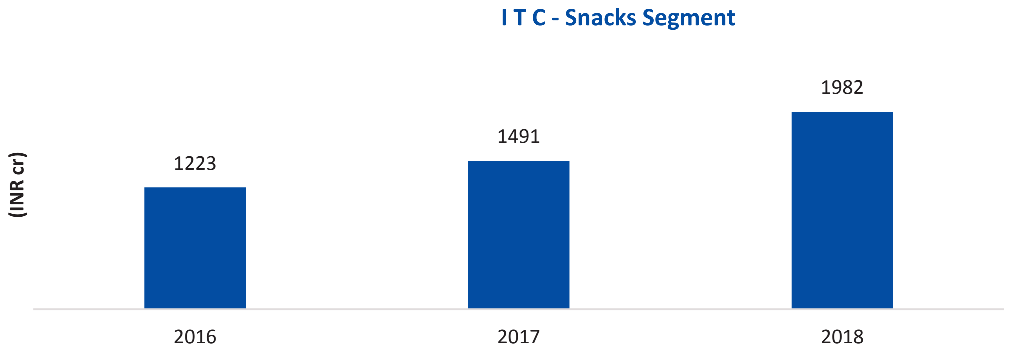
Source: Edelweiss Professional Investor Research

2. **PepsiCo:** The company employed multi-pronged strategy to grow the India business. It entered the Indian market with a homogenous product chips and followed it with another homogenous category of extruded snacks (by launching *Kurkure*); both categories and products have national acceptance. Despite having strong R&D capabilities, parent's support and deep pockets, it has not being able to crack the Indian namkeen market owing to high level of regional preference and taste**.**



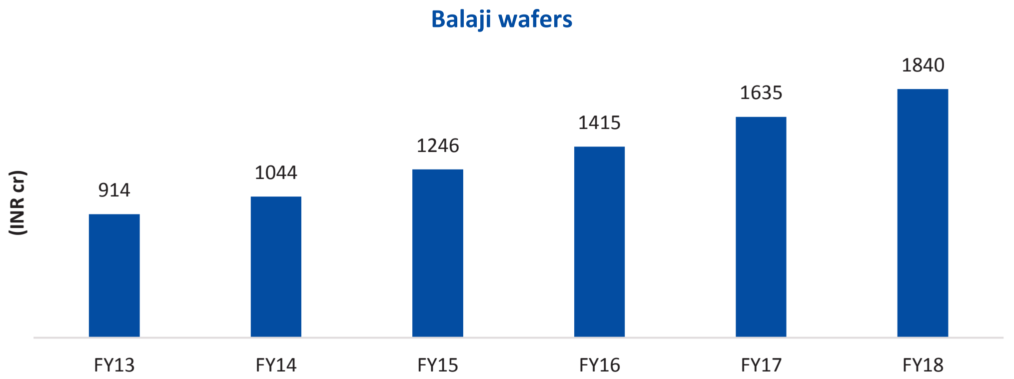
Source: Edelweiss Professional Investor Research

3. **ITC (Bingo+ No rulz):** ITC relied on extruded and chips/nachos products which have national and followed it up with national level media campaigns to establish national brand. Its existing distribution strength, riding other FMCG businesses, also helped it expand its reach nationally. However, despite being a player with deep pockets, innovation in the category has been weak and the company has been largely a follower in the space. Moreover, it has failed to enter the regional namkeen market, which entails better margins and is a high growing category.



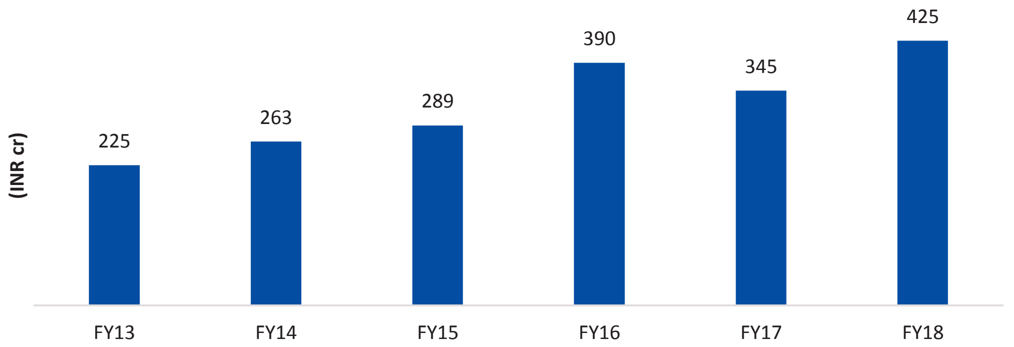
Source: Edelweiss Professional Investor Research

4. **Balaji Wafers:** The company started as a chips player, with strong value-for-money proposition in Gujarat and Rajasthan markets. After attaining critical mass in the segment, it ventured in to the namkeen category. Despite improving its product mix, the company has not been able to expand itself beyond western India. This is largely due to its strategy of directly dealing with distributors /running own logistics to cover a distance of 100-200 km of each of its factories. While till date this strategy has worked for the company both in terms of growth as well as margins, beyond a time we believe in order to grow and penetrate it will face challenges as it spreads its wings beyond its home market.



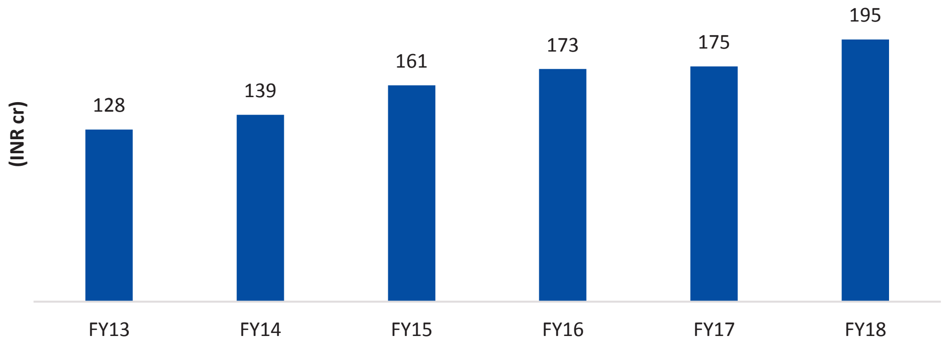
Source: Edelweiss Professional Investor Research

DFM Foods: DFM was one of the first few players to aggressively enter the extruded snacks market and it was the pioneer in bundling toys with snacks and targeting kids to drive growth. It sells its products under the *CRAX* brand. Despite a good start, the company was not able to scale neither in terms of products nor in geography. Around 80% of its revenue still comes from North and Delhi market. This was, we believe, on account of promoters' lack of innovation and ability/intent to invest in national brand building or distribution.



Source: Edelweiss Professional Investor Research

5. **Agrotech Foods:** Agrotech Foods is an offspring of MNC food giant Conagra and is present in India's edible oil as well as food business. In the foods category, the company is a market leader in the popcorn business with its brand *ACTII*. It has also ventured into nachos, peanut butter and other food ingredients. Despite having presence in the Indian market for over 30+ years, its food business has reached just INR 200 crore.



Source: Edelweiss Professional Investor Research

Annexure

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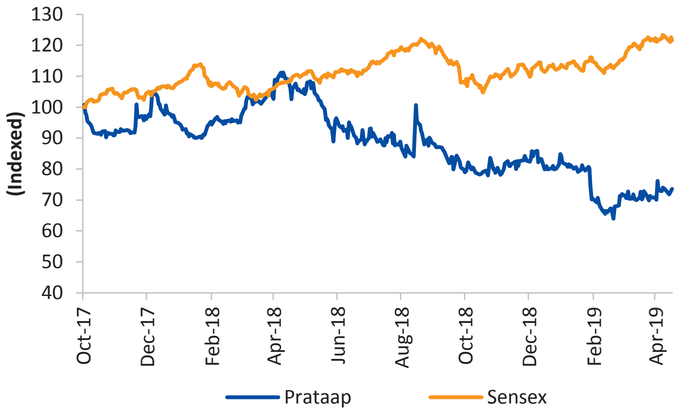
Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate between 5-15% over a 12-month period
Reduce	Return below 5% over a 12-month period



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