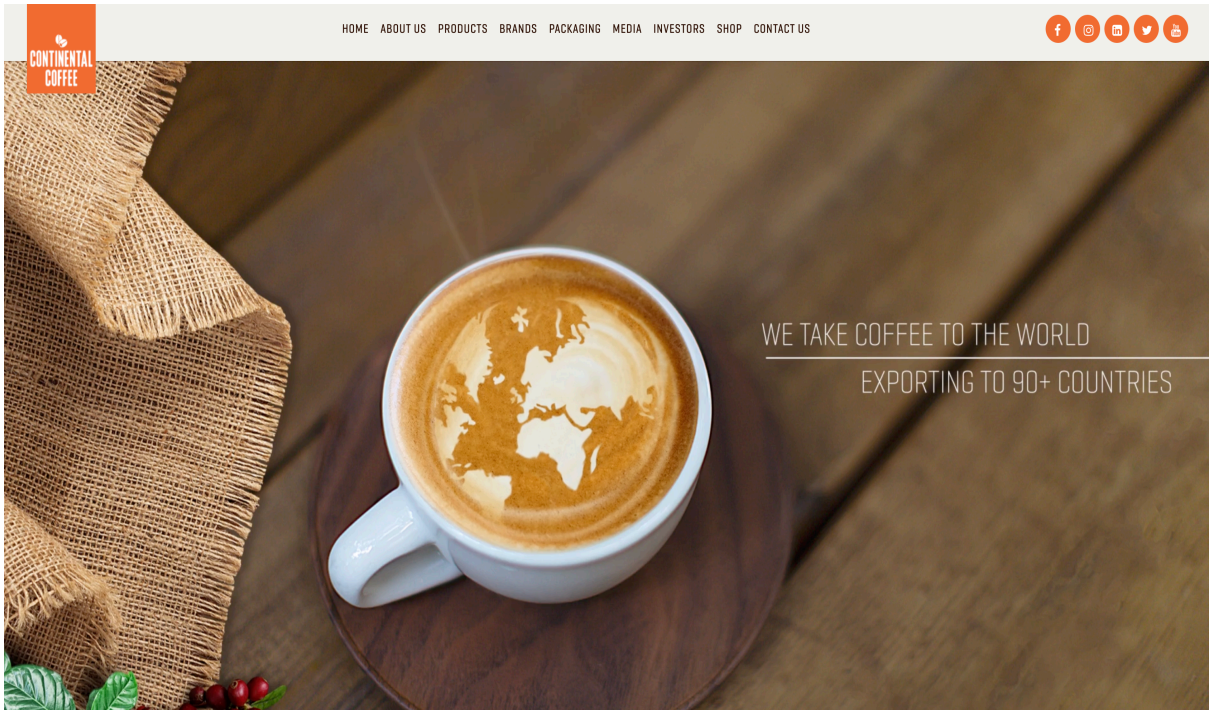


INTRODUCTION OF CONTINENTAL COFFEE LIMITED

CCL Products (India) Limited, established in 1994, is a publicly listed company with a mission to produce the world's finest and richest coffee. Guided by a strong sense of integrity, dedication, and a customer-first approach, CCL Products has built a reputation for upholding the highest quality standards in the industry. With robust infrastructure and a presence in over 90 countries, the company has grown into the largest exporter of instant coffee and a leading private label manufacturer globally. CCL's commitment to excellence continues to drive its success and global reach in the coffee market.

INTRODUCTION OF COFFEE DAY GROUP

Coffee Day Group, founded by V.G. Siddhartha in 1993, is known for its flagship brand *Café Coffee Day (CCD)*, one of India's largest coffee chains. The group operates across coffee production, retail, real estate, technology, and financial services. Despite challenges, it's restructuring to stabilize operations and focus on core business.

METHODOLOGY

This analysis follows a structured approach to gather and evaluate financial data for **CCL Products Ltd.** and its peer, **Coffee Day Enterprises**, with the goal of calculating the Weighted Average Cost of Capital (WACC). This helps us better understand the cost structure and financial health of both companies. Here's how the process was carried out

1. **Data Collection**

We collected key financial data from reliable sources like stock exchanges, company reports, and market research websites. The following data points were gathered for both companies.

- **Stock Price**: Retrieved from NSE/BSE databases.
- **Market Value of Equity**: Calculated by multiplying the current stock price by the number of outstanding shares.
- **Market Value of Debt**: Total debt from balance sheets, including short- and long-term liabilities.
- **Cost of Equity**: Derived using the Capital Asset Pricing Model (CAPM), with inputs like the risk-free rate, beta, and market return sourced from financial reports.
- **Cost of Debt**: Estimated using the yield to maturity (YTM) on existing debt or by dividing interest expense by total debt.
- **Tax Rate**: The corporate tax rate was sourced from official tax regulations or company filings.

2. Cost of Equity Calculation

We applied the **CAPM formula** to determine the cost of equity for both companies:

$$Cost\ of\ Equity = Risk\text{-}Free\ Rate + \beta \times (Market\ Return - Risk\text{-}Free\ Rate)$$

- The risk-free rate was based on government bond yields.
- Beta, which measures the stock's volatility compared to the market, was taken from financial databases.
- The market return was calculated using historical data from major indices like the Nifty 50 or Sensex.

3. Cost of Debt Calculation

Two methods were used to calculate the cost of debt:

- Yield to Maturity (YTM) was sourced from bond market data, representing the effective interest rate on the company's bonds or loans.
- Alternatively, we estimated the cost of debt by dividing the company's interest expense by its total debt. This information was extracted from the company's financial statements, where we analysed the interest paid during the fiscal year.

4. Weighted Average Cost of Capital (WACC) Calculation

Once the cost of equity and cost of debt were obtained, the **Weighted Average Cost of Capital (WACC)** was calculated using the formula:

$$WACC = (E/V \times Ke) + (D/V \times Kd) \times (1 - Tc)$$

Where:

- E = Market value of equity
- V = Total value of equity and debt
- Ke = Cost of equity
- D = Market value of debt
- Kd = Cost of debt
- Tc = Tax rate

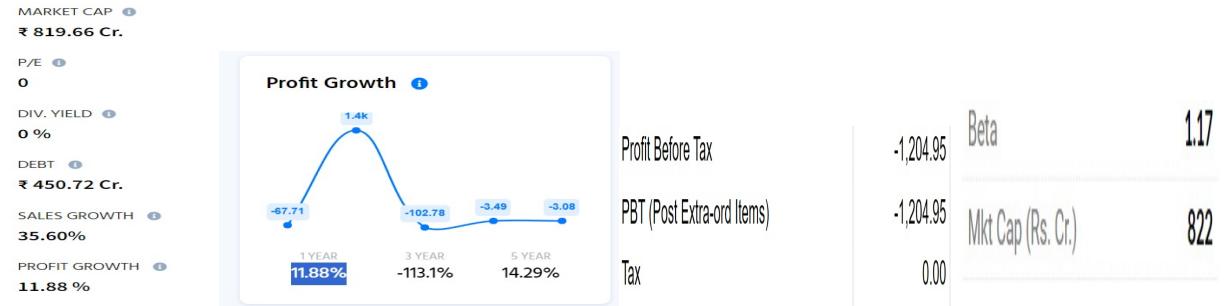
DATA COLLECTION

CCL PRODUCTS INDIA

S.NO	COMPONENT	VALUE (₹)	COLLECTED FROM
1.	Current Stock Price	724	moneycontrol
2.	Market Value of Equity	9327.60 crore	Guru Focus
3.	Market Value of Debt	781.95 crore	Guru Focus
4.	Beta (β)	0.5	Guru Focus
5.	Risk free Rate (Rf):	7.01%	Guru Focus
6.	Expected Market Return (Rm)	10.47%	Guru Focus
7.	Tax Rate	20.68%	Guru Focus

COFFEE DAY

S.NO	COMPONENT	VALUE (₹)	COLLECTED FROM
1.	Current Stock Price	38.39	moneycontrol
2.	Market Value of Equity	819.66 crore	Guru Focus
3.	Market Value of Debt	450.57 crore	Guru Focus
4.	Beta (β)	1.17	Guru Focus
5.	Risk free Rate (Rf):	7.01%	Guru Focus
6.	Expected Market Return (Rm)	11.88%	Guru Focus
7.	Tax Rate	0%	Guru Focus

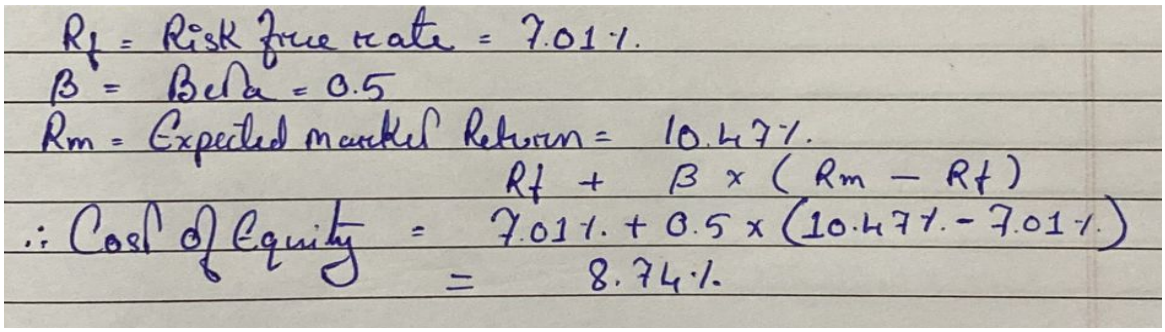


CALCULATIONS

CCL PRODUCTS LTD.

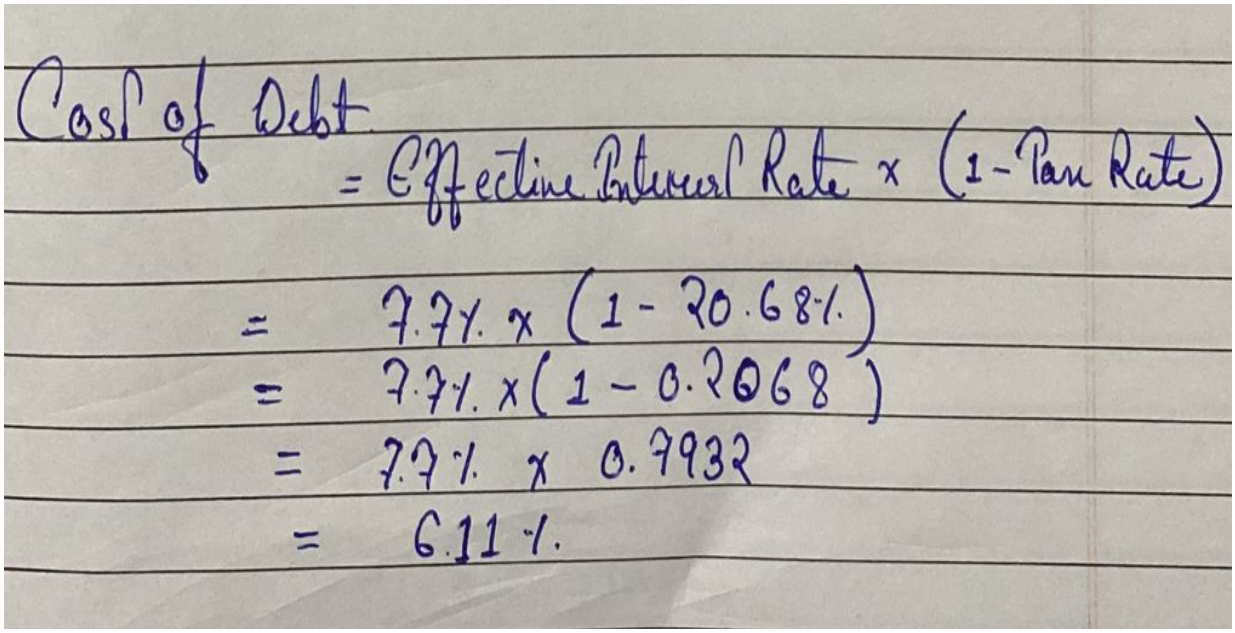
1. Cost of Equity (using CAPM):
Where:

- Rf = Risk-free rate (usually, 10-year government bond yield)
- β = Beta of the stock (a measure of volatility)
- Rm = Expected market return (usually taken as the average market return)



2. Cost of Debt: Calculate the company's cost of debt by using the yield to maturity (YTM) on existing debt or the interest expense on debt.

- Cost of Debt=Interest Rate× (1−Tax Rate)

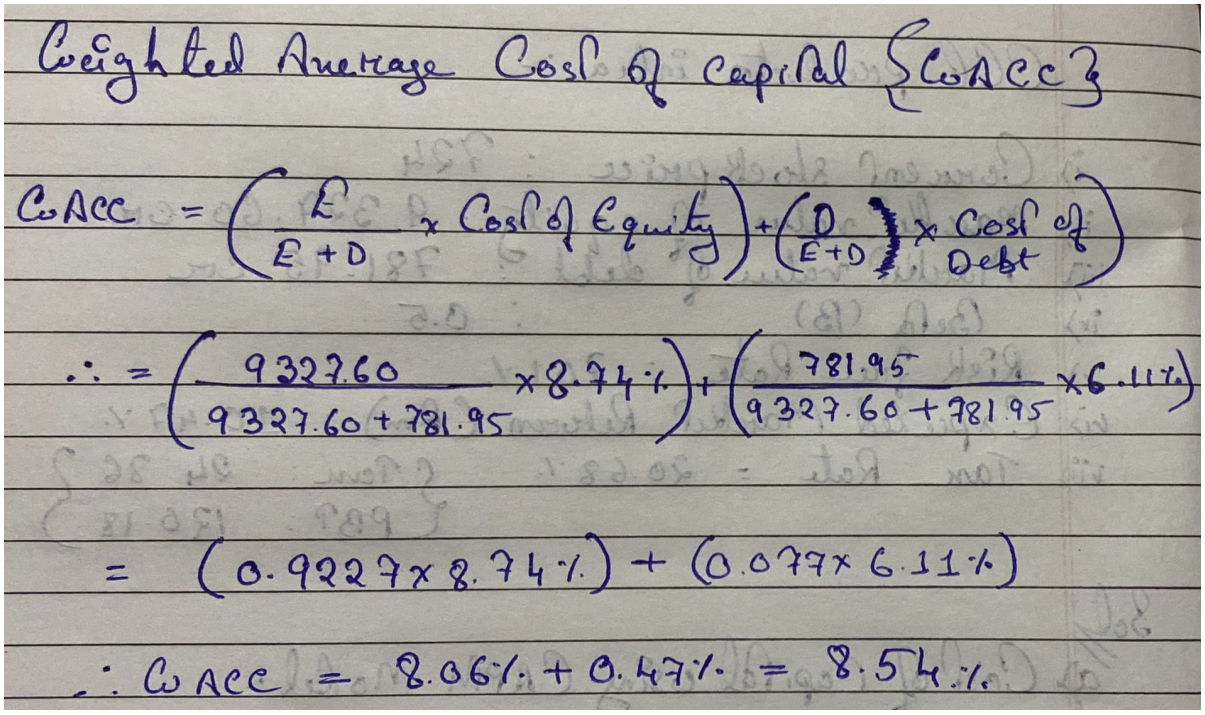


3. Weighted Average Cost of Capital (WACC):

The WACC formula is: = (E/V× Ke) + (D/V× Kd) × (1−Tc)

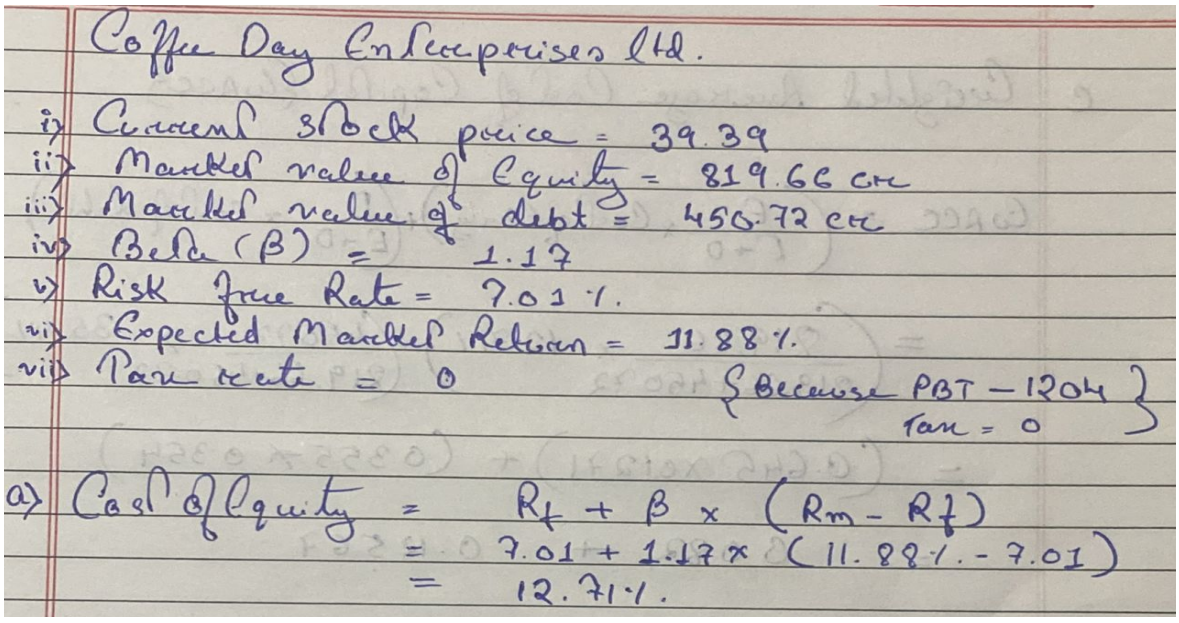
Where:

- E = Market value of equity
- V = Total value of equity and debt
- Ke = Cost of equity
- D = Market value of debt
- Kd = Cost of debt
- Tc = Corporate tax rate



COFFEE DAY

1. **Cost of Equity (using CAPM):**
   - Rf = Risk-free rate (usually, 10-year government bond yield)
   - β = Beta of the stock (a measure of volatility)
   - Rm = Expected market return (usually taken as the average market return)



2. **Cost of Debt: Calculate the company's cost of debt by using the yield to maturity (YTM) on existing debt or the interest expense on debt.**
   - Cost of Debt=Interest Rate× (1−Tax Rate)

Cost of Debt (Kd):

Cost of Debt.

The Cost of debt can be calculated using the effective interest Rate, which is 35.4%. Since there is no tax impact (Tax rate = 0) the Cost of debt will be same as the effective interest Rate.

Thus, Cost of Debt = Effective Interest Rate = 35.4%

3. Weighted Average Cost of Capital (WACC):

$$WACC = (E/V \times Ke) + (D/V \times Kd) \times (1 - Tc)$$

- E = Market value of equity
- V = Total value of equity and debt
- Ke = Cost of equity
- D = Market value of debt
- Kd = Cost of debt
- Tc = Corporate tax rate

- **Market Value of Equity (E)**: ₹ 819.66 crore
- **Market Value of Debt (D)**: ₹450.72 crore
- **Total Market Value (V)**: ₹1270.38 crore
- **Cost of Equity (Ke)**: 12.71%
- **Cost of Debt (Kd)**: 35.4%
- **Tax Rate**: 0%

Weighted Average Cost of Capital (WACC)

$$WACC = \left(\frac{E}{E+D} \times \text{Cost of Equity}\right) + \left(\frac{D}{E+D} \times \text{Cost of debt}\right)$$

$$= \left(\frac{819.66}{819.66+450.72} \times 12.71\%\right) + \left(\frac{450.72}{819.66+450.72} \times 35.4\%\right)$$

$$= (0.645 \times 0.1271) + (0.355 \times 0.354)$$

$$= 0.082 + 0.12567$$

$$= 0.20767$$

$$= 20.76\%$$

ANALYSIS

Analysis of CCL's WACC Calculation

The WACC for CCL (Continental Coffee Limited) is essential to understanding how the company balances its financing sources—equity and debt—and the cost associated with each. By analysing the WACC, CCL can make informed decisions regarding investments, ensuring they meet or exceed this benchmark to create value.

1. Cost of Equity (Ke = 8.74%):

The cost of equity represents the return shareholders expect for the risk of investing in CCL. Using the CAPM formula, you've calculated a cost of equity of 8.74%. This means shareholders demand a return of 8.74% to compensate for the risk they take on. Since the company's beta is 0.5 (indicating lower volatility compared to the market), the cost of equity is relatively moderate. However, it's still higher than debt due to the higher risk equity holders face.

2. Cost of Debt (Kd = 6.11%):

The cost of debt is lower at 6.11%, reflecting the tax advantage from debt financing (interest payments are tax-deductible). Debt is less risky for investors since they are paid before equity holders in the event of liquidation, which is why it's a cheaper source of finance. For CCL, this effective interest rate of 7.7% after taxes results in a lower overall cost for debt, helping reduce WACC.

3. WACC Calculation:

The formula for WACC combines the costs of both equity and debt, weighted by the proportion of each in the company's capital structure.

- **Market Value of Equity (E):** ₹9,327.60 crore
- **Market Value of Debt (D):** ₹781.95 crore
- **Cost of Equity (Ke):** 8.74%
- **Cost of Debt (Kd):** 6.11%
- **Tax Rate (Tc):** 20.68%

The WACC is calculated as:

$$WACC=(EV\times Ke)+(DV\times Kd\times(1-Tc))WACC=(VE\times Ke)+(VD\times Kd\times(1-Tc))$$

Where:

- **E/V:** Equity as a proportion of total value = ₹9,327.60 / (₹9,327.60 + ₹781.95) = 92.26%
- **D/V:** Debt as a proportion of total value = ₹781.95 / (₹9,327.60 + ₹781.95) = 7.74%
- **Ke:** 8.74%
- **Kd (after tax):** 6.11%

Analysis of WACC (8.53%):

1. **Investment Decisions:** The WACC of 8.53% acts as a benchmark for CCL. For any new project or investment to create value, it should deliver a return higher than 8.53%. If an investment's return falls below this, it could erode shareholder value, making this rate a crucial factor in project evaluation.
2. **Cost Structure:** The lower cost of debt (6.11%) relative to the cost of equity (8.74%) shows that debt is a cheaper source of finance for CCL, largely due to the tax shield. However, because CCL's capital structure heavily relies on equity (92.26%), the overall WACC remains on the higher side.
3. **Sensitivity to Market Changes:** Since the WACC is sensitive to fluctuations in interest rates and market risk, any increase in interest rates could raise the cost of debt, pushing WACC higher. Similarly, market volatility that increases the equity risk premium would drive up the cost of equity.

Recommendations for CCL:

1. **Consider Leveraging More Debt**: With a debt-to-equity ratio that heavily Favors equity, CCL could benefit from slightly increasing its use of debt. Since debt financing is cheaper, moderate increases can lower the WACC, providing more flexibility for investment while still maintaining financial stability.

2. **Monitor Market Conditions**: Interest rates and market conditions can affect both debt and equity costs. CCL should actively monitor these factors and adjust its capital structure accordingly, particularly if borrowing becomes more attractive due to lower interest rates.

3. **Focus on High-Return Projects:** To ensure growth and shareholder value, CCL should prioritize investments with expected returns higher than the WACC of 8.54%. This will help maintain strong stock performance, potentially lowering the cost of equity over time.
4. **Maintain a Balanced Capital Structure:** While increasing debt could lower WACC, it's essential not to over-leverage, as that could increase financial risk and raise the cost of equity. A balanced approach would optimize financing costs without exposing the company to excessive risk.

COMPARISION WITH ITS PEERS:

WACC Analysis for Coffee Day and Comparison with CCL

1. **Coffee Day's WACC (Weighted Average Cost of Capital):**

- **Cost of Equity (Ke):** Using the CAPM, Coffee Day's cost of equity is 12.71%. This represents the return expected by shareholders for the risk they take in investing in the company.

- **Cost of Debt (Kd):** Coffee Day's cost of debt is quite high at 35.4%, suggesting that borrowing is significantly expensive for the company.

- **WACC:** At 20.76%, Coffee Day's WACC is exceptionally high, indicating that the company needs to generate very high returns to meet the expectations of both its equity

investors and debt holders. A WACC this high can pose challenges for investing in projects, as the hurdle rate is very steep.

2. **Comparison with CCL (Continental Coffee Limited):**

- **CCL's WACC:** Assuming that CCL's WACC is lower (likely below 10%), it suggests that CCL has a more favourable cost of capital structure compared to Coffee Day. CCL's more efficient financing mix, potentially due to a lower cost of debt and possibly lower financial risk, makes it easier for CCL to undertake profitable projects.

- **Cost of Debt and Equity Comparison:**

  - Coffee Day's cost of debt at 35.4% is significantly higher than what would be expected for a company in this industry. CCL, on the other hand, likely benefits from lower borrowing costs, which makes debt financing more attractive and sustainable.
  - Coffee Day's cost of equity, while comparable to industry norms, is still higher than CCL's (based on market data). This suggests that investors perceive more risk in Coffee Day compared to CCL, likely due to its debt-heavy structure and higher financial instability.

3. **Recommendations for Coffee Day:**

- **Reduce Debt Reliance:** With such a high cost of debt, Coffee Day should aim to reduce its reliance on debt financing. This could involve refinancing at lower rates or paying down existing debt to reduce interest expenses.
- **Improve Credit Rating:** Improving its financial stability and credit rating could help Coffee Day access debt at lower interest rates, bringing down its cost of debt and overall WACC.
- **Focus on Equity Financing:** Given the excessive cost of debt, Coffee Day might want to focus more on raising funds through equity, especially if it can offer favourable returns to shareholders.
- **Operational Efficiency:** Coffee Day should prioritize improving its operational efficiency to ensure that it can generate returns above its high WACC, making sure any investments or expansions are profitable.

4. **Why CCL is in a Stronger Position:**

- **Lower WACC Advantage:** CCL's likely lower WACC gives it an advantage when competing in the market. With a lower hurdle rate, CCL can take on more investment opportunities and grow with a better financial cushion.
- **Efficient Use of Capital:** CCL appears to have a more balanced capital structure, with lower risk from debt and a more manageable cost of equity. This means CCL can maximize shareholder value with less financial strain compared to Coffee Day.

Conclusion

CCL (Continental Coffee Limited) is in a stronger financial position compared to its peer, **Coffee Day**, largely due to a lower WACC. CCL's balanced capital structure, lower cost of debt, and more manageable cost of equity allow it to pursue investments with greater flexibility and reduced financial strain. The company can capitalize on growth opportunities while maintaining shareholder value. By focusing on operational efficiency and a more efficient capital structure, CCL can continue to outperform peers like Coffee Day, which struggles with high debt costs and a steep WACC.

References

1. Moneycontrol
2. Guru Focus