

Tata Tea

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Definitely worth a sip, after the slip

Lack of information hurting stock price: Tata Tea's stock has underperformed the broader market since it announced its Glaceau stake acquisition. We believe that the underperformance has more to do with lack of consensus on its recent acquisitions rather than any concern about the business performance of either the parent or any of its subsidiaries. Lack of information on large acquisitions like Glaceau and Eight O'clock make it difficult to arrive at the intrinsic value of the stock easily.

Likely risks overshadowing any positives: We feel that the stock does not build any of the likely positives, while discounting many of the risks/costs of these recent announcements. We valued the company using sum-of-the-parts, after accounting for the various financial costs and discounting risks and concluded that the current market price do not fairly reflect the intrinsic value. We are not yet building any business synergy benefits from these acquisitions.

Upgrading to Outperformer: We are upgrading our rating to Outperformer from Neutral while retaining our 12-month price target of Rs 880. Based on the recent price correction and our understanding of the fair value, we find the stock now attractively priced.

Risks/concerns: Due to the absence of any immediate trigger (except quarterly results), the stock price may not see any sharp movements. Concerns about Glaceau's and Eight O'clock Coffee's valuations will continue until Tata Tea discloses more information. We believe it will disclose Eight O'clock numbers in detail, but only some headline numbers like margins and growth for Glaceau, as the latter continues to remain a private company. Management's ability and inclination to disclose details will continue to be monitored. We have worked our estimates based on comparables such as Hansen. It could well be that Glaceau's numbers are way off these estimates.

Outperformer / Rs 729
Target Rs 880 (+21%)

Sector (Relative to market)

OW	N	UW

Stock (Relative to market)

B	OP	N	UP	S
> 10%	5% to 10%	5% to -5%	-5% to -10%	< -10%

Bloomberg code : TT IN
Reuters code : TTTE.BO
www.tatatea.com

BSE Sensex : 12353
NSE Nifty : 3558

Company data

O/S shares : 56mn
Market cap (Rs) : 41bn
Market cap (USD) : 895mn
52 - wk Hi/Lo (Rs) : 1078 / 555
Avg. daily vol. (3mth) : 351,621
Face Value (Rs) : 10

Share holding pattern, %

Promoters : 29.0
FII / NRI : 17.3
FI / MF : 28.9
Non Promoter Corp. Holdings : 1.8
Public & Others : 23.0

Price performance, %

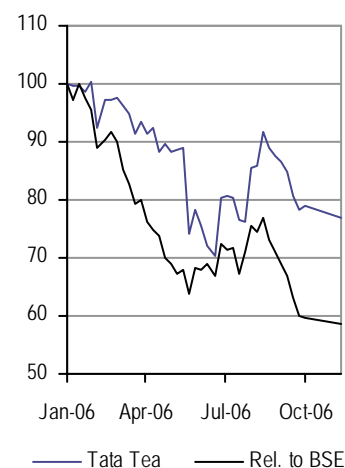
	1mth	3mth	1yr
Abs	(8.2)	(2.9)	(10.2)
Rel to BSE	(12.0)	(18.6)	(55.9)

Valuation summary (Consolidated)

Y/E Mar, Rs mn	FY04	FY05	FY06	FY07E	FY08E	FY09E
Net Sales	30,496	30,413	31,065	33,538	35,318	37,005
Growth, %	6.2	-0.3	2.1	8.0	5.3	4.8
Core EBIDTA	4,543	5,192	5,448	5,952	6,236	6,494
EBIDTA margins, %	14.9	17.1	17.5	17.7	17.7	17.5
Net profit	1,870	2,404	2,941	3,303	3,600	3,922
EPS, Rs	30.3	41.2	48.5	52.1	56.8	62.0
EPS Growth, %	155.2	35.8	17.8	7.4	9.1	9.2
PER, x	24.1	17.7	15.0	14.0	12.8	11.8
EV/EBIDTA, x	13.0	11.0	10.6	9.8	9.0	8.2
EV/Net Sales, x	1.9	1.9	1.9	1.7	1.6	1.4
Price/Book Value, x	3.0	2.6	2.5	2.2	1.9	1.7
ROIC, %	27.6	36.1	38.8	39.1	36.0	37.6
ROE, %	14.7	16.4	18.5	18.9	17.8	17.0
Dividend Yield, %	1.4	1.6	1.7	1.9	2.1	2.1

Source: Company, Man Financial Research Estimates.

Tata Tea vs. Sensex



Source: Bloomberg, Man Financial Research

VALUING TATA TEA USING SUM-OF-THE-PARTS

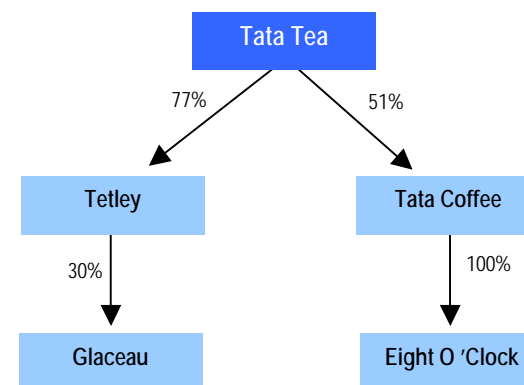
	Holding (Direct/Indirect)	Assumptions	Basis	Valuation	Basis	Remarks
Glaceau	23%	Sales growth at 100% and 70% for CY06E and CY07E, PAT margin of 16.3%	Category and own historical growth 150bps below Hansen's	20x CY07E PAT (US\$ 95mn)= US\$1.9bn	Hansen is a close comparable	IPO in future could unlock more value
Tetley	77%	Additional debt of US\$ 350mn at 7.5%, PAT of US\$ 25mn	Based on financing requirement and likely interest cost	13x FY08E PAT (US\$ 25mn)= US\$ 325mn		No dilution. Fund infusion of \$250mn by Tata Tea and Tata Sons
Eight O'clock Coffee	51%			US\$ 220mn	Same as acquisition price. Had paid around 8x CY05 EBIT	Medium-term upside from synergies with Glaceau and Tata Coffee plantations.
Tata Coffee	51%	Debt financing of US\$ 100mn at 7.5%, PAT of US\$ 25mn	Based on financing requirement and likely interest cost	US\$ 90mn	Current Mcap	Partly convertible in 1:2 ratio at Rs400. Tata Tea to invest additional \$20mn besides in convertibles
Tata Tea (Standalone)	100%	Equity dilution of 20% to raise atleast US\$ 170mn, around US\$ 40-50mn internally and similar from debt		14x FY08E PAT (US\$38 mn)= US\$ 532mn	Standalone valuations	Enjoyed better valuations even when it was largely a plantations play.

* After accounting for the stakes in subsidiaries

Parts	Discount applied	Discounted Value (\$mn)
Glaceau	20%	350
Tetley	0%	250
Eight O'clock	10%	81
Tata Coffee	0%	45
Tata Tea (Standalone)	0%	532
Total		1,258
Current price (Rs)		729
Assuming 20% dilution, share price (Rs)		865
Upside		18.5%

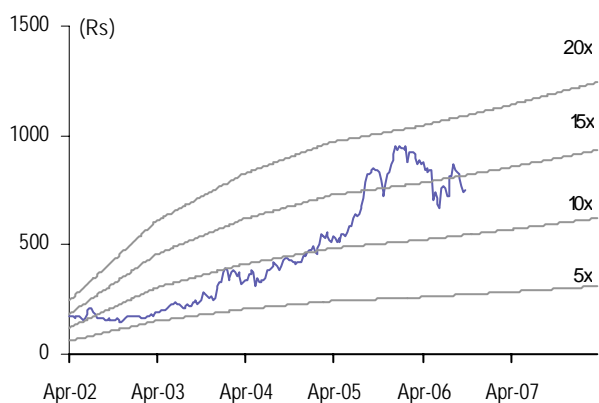
Source: Man Financial Research Estimates

Structure of the Tata Tea group

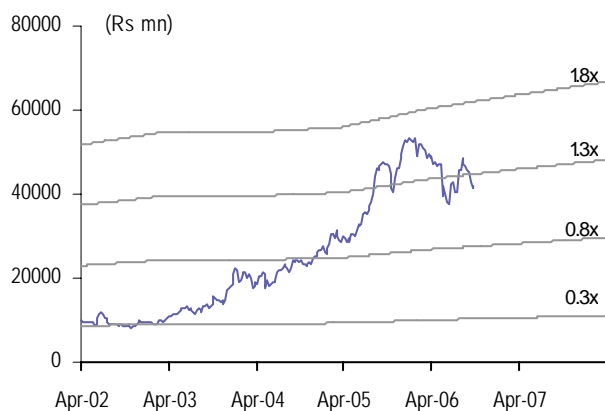


ABSOLUTE ROLLING VALUATION BAND CHARTS

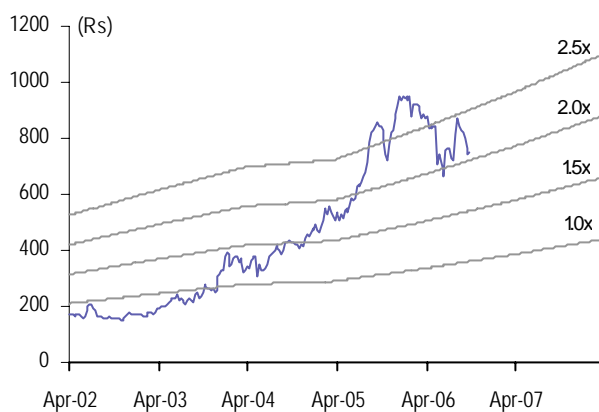
PE band



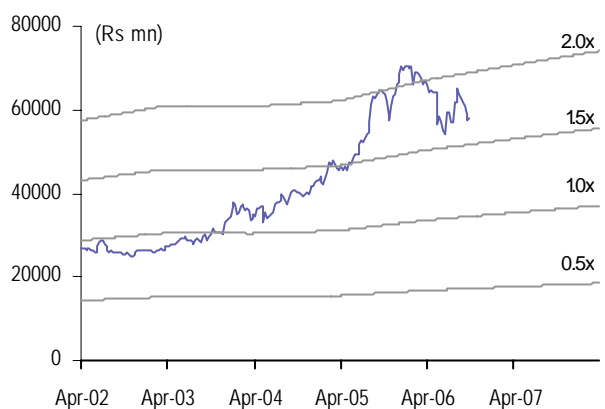
Mkt cap to sales band



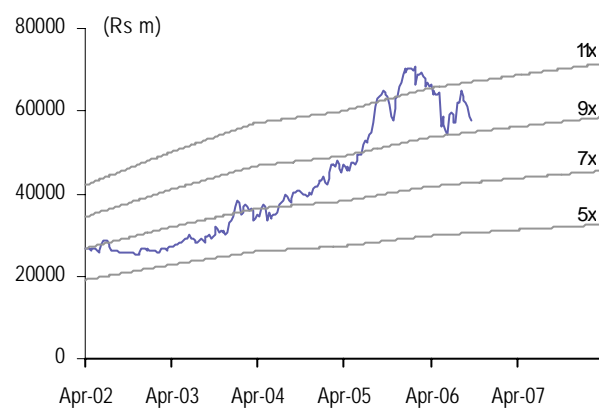
PBV band



EV/Sales band



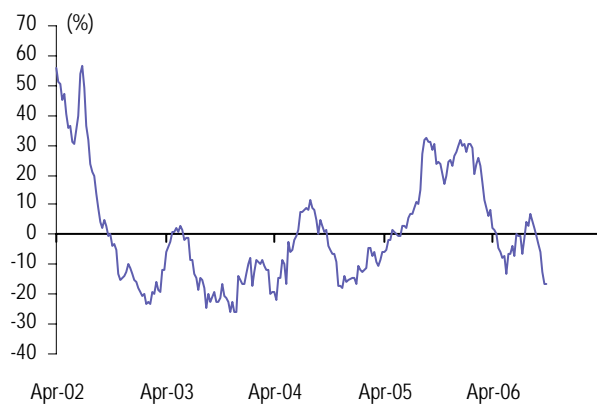
EV/EBIDTA band



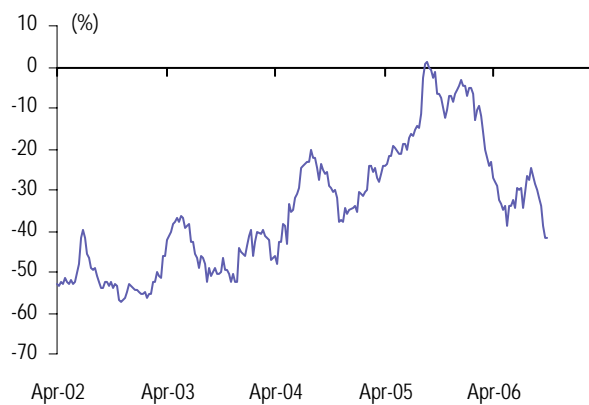
Source: Man Financial Research Estimates

PREMIUM / DISCOUNT TO SENSEX

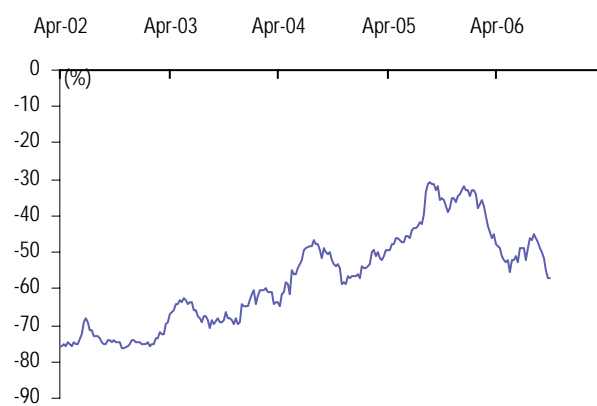
PE band



PBV



Mcap/Sales



Source: Man Financial Research

FINANCIALS – TATA TEA

Income Statement

Y/E Mar, Rs mn	FY03	FY04	FY05	FY06	FY07E	FY08E
Net sales	28,725	30,496	30,413	31,065	33,538	35,318
<i>Growth, %</i>	<i>-5.1</i>	<i>6.2</i>	<i>-0.3</i>	<i>2.1</i>	<i>8.0</i>	<i>5.3</i>
Total income	28,725	30,496	30,413	31,065	33,538	35,318
Operating expenses	-24,917	-25,953	-25,221	-25,617	-27,586	-29,083
EBITDA	3,807	4,543	5,192	5,448	5,952	6,236
<i>Growth, %</i>	<i>1.7</i>	<i>19.3</i>	<i>14.3</i>	<i>4.9</i>	<i>9.2</i>	<i>4.8</i>
<i>Margin, %</i>	<i>13.3</i>	<i>14.9</i>	<i>17.1</i>	<i>17.5</i>	<i>17.7</i>	<i>17.7</i>
Depreciation	-888	-827	-779	-758	-763	-772
EBIT	2,920	3,716	4,413	4,690	5,189	5,464
<i>Growth, %</i>	<i>3.4</i>	<i>27.3</i>	<i>18.8</i>	<i>6.3</i>	<i>10.7</i>	<i>5.3</i>
<i>Margin, %</i>	<i>10.2</i>	<i>12.2</i>	<i>14.5</i>	<i>15.1</i>	<i>15.5</i>	<i>15.5</i>
Interest received/(paid)	-1,333	-1,320	-1,228	-1,024	-949	-849
Other Income	230	401	354	446	410	436
Income from Associates	-231	-33	98	117	125	131
Pre-tax profit	1,587	2,763	3,638	4,228	4,776	5,183
Tax provided	-626	-906	-938	-1,179	-1,349	-1,465
Profit after tax before MI	960	1,857	2,699	3,050	3,427	3,718
Minority Interest/Associates	-107	-84	-160	-131	-124	-118
Profit after tax after MI & Extra-ordinary Items	825	2,050	2,155	2,991	3,303	3,600
MAN Net profit	853	1,773	2,539	2,919	3,303	3,600
<i>Growth, %</i>	<i>-16.3</i>	<i>148.4</i>	<i>5.1</i>	<i>38.8</i>	<i>10.4</i>	<i>9.0</i>
Extraordinary items: Gains/(Losses)	-28	277	-384	73	0	0
Unadj. shares (m)	56	56	56	56	56	56
Wtd avg shares (m)	56	56	56	56	56	56

Cash Flow

Y/E Mar, Rs mn	FY03	FY04	FY05	FY06	FY07E	FY08E
Pre-tax profit	1,587	2,763	3,638	4,228	4,776	5,183
Depreciation	140	675	744	-278	763	772
Chg in working capital	-418	15	-353	718	-878	-241
Total tax paid	-626	-906	-938	-1,179	-1,349	-1,465
Other operating activities	-28	277	-384	73	0	0
Cash flow from operating activities	655	2,823	2,705	3,562	3,312	4,248
Capital expenditure	959	-228	-717	641	-2,591	-450
Chg in investments	-127	-150	-116	-1,092	90	0
Chg in marketable securities	17	-572	-192	-1,444	0	0
Cash flow from investing activities	850	-949	-1,026	-1,894	-2,501	-450
Free cash flow	1,504	1,874	1,679	1,668	811	3,798
Equity raised/(repaid)	143	609	-455	-2,440	-799	-882
Debt raised/(repaid)	385	258	-1,632	661	700	-2,500
Dividend (incl. tax)	-487	-656	0	0	0	0
Cash flow from financing activities	13	148	-2,082	-1,861	-173	-3,451
Net chg in cash	1,517	2,022	-403	-193	638	347

Balance Sheet

As at 31st Mar, Rs mn	FY03	FY04	FY05	FY06	FY07E	FY08E
Cash & bank	605	1,376	642	221	299	646
Marketable securities at cost	309	880	1,072	2,516	2,516	2,516
Debtors	2,788	2,711	2,981	3,458	3,389	3,559
Inventory	3,482	3,765	4,378	4,241	4,703	4,912
Loans & advances	1,729	1,424	1,515	1,817	1,813	1,828
Other current assets	471	469	30	64	69	74
Total current assets	9,384	10,625	10,618	12,318	12,790	13,536
Investments	1,960	2,110	2,226	3,318	3,228	3,228
Gross fixed assets	11,552	11,851	12,401	11,624	14,215	14,665
Less: Depreciation	4,645	5,319	6,063	5,785	6,547	7,319
Add: Capital WIP	141	71	238	373	373	373
Net fixed assets	7,049	6,602	6,576	6,213	8,041	7,719
Goodwill	18,868	20,119	20,450	20,678	21,238	21,238
Total assets	37,260	39,456	39,870	42,527	45,297	45,721
Current liabilities	5,969	5,883	5,901	7,418	6,856	7,002
Provisions	296	222	297	230	242	254
Total current liabilities	6,995	6,955	7,295	8,784	8,400	8,656
Non-current liabilities	18,526	18,738	16,948	17,515	18,115	15,515
Total liabilities	25,521	25,693	24,242	26,299	26,514	24,171
Paid-up capital	793	813	978	1,028	1,078	1,128
Reserves & surplus	560	560	560	560	560	560
Shareholders' equity	10,386	12,390	14,089	14,641	17,145	19,862
Total equity & liabilities	10,946	12,950	14,650	15,201	17,705	20,422

Per-share data

	FY03	FY04	FY05	FY06	FY07E	FY08E
MAN EPS (INR)	11.9	30.3	41.2	48.5	52.1	56.8
Growth	-31.3	155.2	35.8	17.8	7.4	9.1
Book NAV/share (INR)	209.2	245.7	279.0	289.7	335.3	384.7
FDEPS (INR)	11.9	30.3	41.2	48.5	52.1	56.8
CEPS (INR)	30.5	51.4	52.4	66.9	72.6	78.0
CFPS (INR)	11.0	40.3	46.1	71.7	48.4	65.7
DPS (INR)	7.6	10.0	12.0	12.0	14.0	15.1

Financial structure

	FY03	FY04	FY05	FY06	FY07E	FY08E
Total debt/Equity (%)	150.8	130.5	104.5	104.7	94.2	70.5
Net debt/Equity (%)	145.6	120.5	100.3	103.3	92.6	67.5

Profitability, Productivity, Liquidity and Valuation Ratios

	FY03	FY04	FY05	FY06	FY07E	FY08E
Return on assets (%)	4.9	7.0	8.8	9.1	9.3	9.4
Return on equity (%)	7.4	14.7	16.4	18.5	18.9	17.8
Return on Invested capital (%)	19.2	27.6	36.1	38.8	39.1	36.0
RoIC/Cost of capital (x)	1.5	2.5	3.4	3.5	3.3	3.0
RoIC - Cost of capital (%)	6.8	16.5	25.4	27.7	27.3	23.8
Return on capital employed (%)	6.1	8.6	10.7	11.3	11.5	11.6
Cost of capital (%)	12.5	11.0	10.7	11.1	11.7	12.2
RoCE - Cost of capital (%)	-6.4	-2.5	0.0	0.1	-0.2	-0.6
Asset turnover (x)	3.1	3.4	3.4	3.6	3.5	3.2
Sales/Total assets (x)	0.8	0.8	0.8	0.8	0.8	0.8
Sales/Net FA (x)	3.8	4.5	4.6	4.9	4.7	4.5
Working capital/Sales (x)	0.05	0.05	0.05	0.03	0.05	0.05
Fixed capital/Sales (x)	1.06	1.02	1.08	0.67	0.63	0.60
Receivable days	35.4	32.4	35.8	40.6	36.9	36.8
Inventory days	44.2	45.1	52.5	49.8	51.2	50.8
Payable days	87.4	82.7	85.4	105.7	90.7	87.9
Current ratio (x)	1.3	1.5	1.5	1.4	1.5	1.6
Quick ratio (x)	0.8	1.0	0.9	0.9	1.0	1.0
Interest cover (x)	2.2	2.8	3.6	4.6	5.5	6.4
Dividend cover (x)	2.0	3.3	3.6	4.4	4.2	4.3
PER (x)	61.4	24.1	17.7	15.0	14.0	12.8
PEG (x) - y-o-y growth	-2.0	0.2	0.5	0.8	1.9	1.4
Price/Book (x)	3.5	3.0	2.6	2.5	2.2	1.9
Yield (%)	1.0	1.4	1.6	1.7	1.9	2.1
EV/Net sales (x)	2.0	1.9	1.9	1.9	1.7	1.6
EV/EBITDA (x)	15.4	13.0	11.0	10.6	9.8	9.0
EV/EBIT (x)	20.1	15.8	13.0	12.3	11.3	10.3
EV/NOPLAT (x)	33.2	23.6	17.5	17.1	15.7	14.3
EV/CE	1.9	1.8	1.8	1.7	1.6	1.5
EV/IC (x)	6.4	6.5	6.3	6.6	6.1	5.2

Source: Company, Man Financial Research Estimates

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