

May 18, 2006

Stock Rating  
**Overweight**

Industry View  
**Attractive**

## Tata Tea

### Cost Pressures; But Long-Term Story Intact

**Cost pressures as tea cost rise:** We were on a conference call with the management of Tata Tea to discuss their outlook on tea prices and potential impact on the company's businesses. We conclude that, although there some medium-term tea cost pressures, particularly for Tetley, the structural story in Tata Tea – i.e. potential gain in global market share in branded teas and restructuring of its plantations businesses – remains intact.

**Tea prices expected to soften from the current levels:** Considering that tea is an agri commodity, predicting its price is often fraught with risk. However, Tata Tea management expects tea prices in India to soften from the current levels with fresh increase in supply over the next 2-4 weeks. Domestic prices are expected to end the year around 5% higher than last year, however. Kenyan tea prices have risen sharply by 29% YTD (Source: Indian Tea Association) on drought concerns and crop shortfall. Although drought concerns have mitigated, crop shortfall remains high, at around 40mn kgs. Kenyan tea prices are expected to soften from current levels, with fresh supply of crop as rainfall has improved. Kenyan tea prices are, however, expected to be around 10-15% higher during C2006 yoy.

**Price hikes to mitigate cost pressures:** Tata Tea has already taken a price hike of around 1-2% (weighted average) in its domestic business, in line with competition, to offset its cost pressures. Management is not averse to taking further price hikes in case cost pressures escalate. In its international business, the company typically manages with a couple of months of tea stocks. According to last published annual report, total raw material stock for the consolidated business is around 110 days. Tetley has not yet taken a price hike for its consumers, as it is mitigating its cost pressures partly by using cheaper blends of tea. But, if the auction tea prices in Kenya remain high, it is likely to take price hikes.

#### Key Ratios and Statistics

Reuters: TTTE.BO Bloomberg: NTT IN

##### India Consumer

Price target	Rs975.00
Shr price, close (May 17, 2006)	Rs830.05
Mkt cap, curr (mn)	Rs46,665
52-Week Range	Rs1,047.00-523.75

Fiscal Year (Mar)	2005	2006e	2007e	2008e
ModelWare EPS (Rs)*	45.61	51.94	58.47	64.75
Rev, net (Rs mn)	30,413	30,309	31,869	33,577
ModelWare net inc (Rs mn)	2,564	2,920	3,287	3,640
P/E	11.5	16.0	14.2	12.8
P/BV	2.0	2.7	2.4	2.1
EV/EBITDA	8.3	9.8	8.7	7.6
Div yld (%)	1.9	1.3	1.4	1.6

\* = Please see explanation of Morgan Stanley ModelWare later in this note.  
e = Morgan Stanley Research estimates

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**Plantation restructuring on track:** Tata Tea management continues to pursue restructuring of its North Indian plantations. It is likely that some developments will materialize in F2007. In our view, restructuring (hive-off) of their plantation business should free management resources for further strengthening of the branded tea business globally and reduce the overall volatility in earnings of its domestic business. The market is likely to view this development positively, in our opinion.

**Inorganic growth likely to continue:** Tata Tea has made two acquisitions in the recent past, firstly Goodearth in the US and secondly Jemca in the Czech Republic. However, both these together contribute less than 5% of the company's consolidated revenues. The company continues to pursue its global acquisition strategy to gain market share and consolidate the highly fragmented global tea industry. The company will continue to seek global opportunities both large and small. In our view, it is likely that the company will make some more progress in F2007.

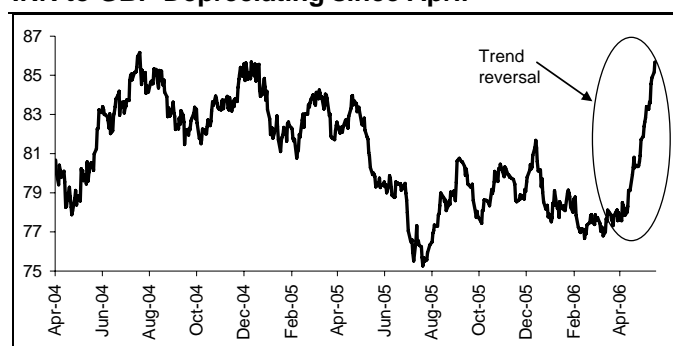
#### Q3F2006 margin pressures in Tetley exceptional:

Management reiterated that the 35% decline in Tetley's PBT in Q3F2006 was largely exceptional marketing investments which are unlikely to recur. Tetley has been awarded best beverages brand in the UK in C2005. Also the Good Earth acquisition is performing ahead of expectations.

**Currency impact in Q4:** On our estimates, Tata Tea's consolidated numbers are likely to be impacted negatively in Q4 due to 5.5% YoY appreciation of the Indian Rupee vis-à-vis the GBP. Also, its tea sourcing costs will be positively impacted during the same period as the USD has depreciated by 5.3% vis-à-vis the GBP. However, both of the above-mentioned currency trends appear to have reversed in the first six weeks of F2007.

Exhibit 1

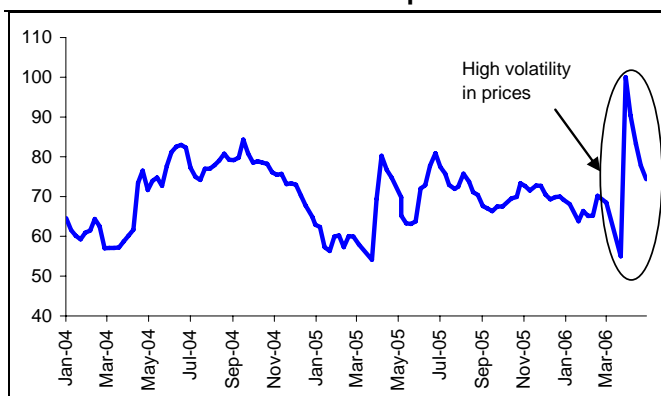
#### INR to GBP Depreciating since April



Source: Bloomberg, Morgan Stanley Research

Exhibit 2

#### CTC Tea Leaf Auction Prices: Spot



Source: Calcutta Tea Traders Association, Morgan Stanley Research

Exhibit 3

#### Tea Prices Comparison

Centre	Jan-March		YoY
	2006	2005	
Kolkata	63.7	59.9	6.3%
Guwahati	58.0	54.7	6.1%
Cochin	53.6	54.7	-1.9%
Chittagong	63.5	78.8	-19.4%
Jakarta	115.9	103.3	12.1%
<b>Mombasa</b>	<b>202.0</b>	<b>157.0</b>	<b>28.7%</b>
Limbe	115.0	89.8	28.0%
Colombo	197.4	193.5	2.0%

Source: Indian Tea Association, Morgan Stanley Research

#### Company Description

Tata Tea is the largest integrated tea company in the world. After its recent acquisition of the Tetley Group, Tata Tea is second only to Unilever in the branded tea market. The company enjoys a 19% value share of the Indian packaged tea market. It also has a presence in the coffee business through its subsidiary, Tata Coffee.

#### Industry View: Attractive

We believe the industry is on a recovery path driven by a pick-up in rural and urban demand and an improving pricing environment

#### MSCI Country: India

Asia Strategist's Recommended Weight: 1.8%  
MSCI Asia/Pac All Country Ex Jp Weight: 6.3%



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	Count	% of Total	Count	% of Total IBC	% of Rating Category
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<b>Underweight/Sell</b>	<b>367</b>	<b>19%</b>	<b>84</b>	<b>13%</b>	<b>23%</b>
<b>Total</b>	<b>1,963</b>		<b>640</b>		

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**Industry Coverage: India Consumer**

Company (Ticker)	Rating (as of)	Price (05/17/2006)
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Hindustan Lever (HLL.BO)	O (08/01/2005)	Rs275.35
ITC Ltd. (ITC.BO)	O (03/12/2004)	Rs204.85
Marico Limited (MRCO.BO)	O (03/07/2006)	Rs521.65
Nestle India (NEST.BO)	O (05/02/2002)	Rs1181.85
Tata Tea (TTTE.BO)	Overweight (04/08/2004)	Rs830.05

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