

McLeod Russel (MCLRUS)

Rs 190

WHAT'S CHANGED...

PRICE TARGET Changed from Rs 334 to Rs 272.9
 EPS (FY11E) Changed from Rs. 24.7 to Rs. 24.1
 EPS (FY12E) Changed from Rs.27.8 to Rs.27.3
 RATING..... Unchanged

Volumes to drive growth...

McLeod Russel reported results in line with our expectation with the topline during the quarter being Rs 305.8 crore surging by 47.2% YoY. The company, however, posted an EBITDA loss of Rs 36.7 crore in Q4FY10 on the back of higher employee costs compared to a loss of Rs 52.4 crore in Q4FY09. Depreciation declined from Rs 12.9 crore in Q4FY09 to Rs 11.8 crore in Q4FY10. The company reported a net loss of Rs 130.4 crore in the present quarter in contrast to a loss of Rs 91.8 crore in the corresponding quarter last year. The increase in loss can be attributed to the higher taxes paid for the year shooting up to Rs 71.4crore against Rs 15.6 crore in FY09.

Highlights of the quarter

The company acquired Rwenzori Tea Investments Limited in Uganda for US\$25 million in January 2010. Through this acquisition it gained control over James Finlay Uganda Limited (JFUL), the 100% subsidiary of Rwenzori. This acquisition would increase the company's production capacity by about 15 million kg annually.

Valuation

At the current market price of Rs 190, the stock is trading at 7.9x its FY11E EPS of Rs 24.1 and 6.9x its FY12E EPS of Rs 27.3. With the company's plans to boost its sales volumes by acquisition of estates in Africa, Vietnam and India in the coming years coupled with the increase in realisations we expect the company to post better earnings in the coming quarters. Hence, we are valuing the stock at 10x its FY12E EPS and assigning it a target price of Rs 272.9. Our rating on the stock would, hence, be **STRONG BUY**.

Exhibit 1: Performance Highlight

(Rs Crore)	Q4FY10	Q4FY10E	Q4FY09	Q3FY10	YoY(%)	QoQ(%)
Net Sales	305.8	237.1	207.8	335.8	47.2	-8.9
EBITDA margin (%)	-0.1	-0.1	-31.3	0.4	3116bps	-56bps
Depreciation	11.8	9.2	6.3	6.9	86.8	70.4
Interest	3.6	22.7	10.3	4.6	-65.3	-22.3
Other Income	0.0	4.9	0.1	0.6	-100.0	-100.0
Reported PAT	-130.4	-128.5	-88.6	137.9	47.1	-194.5
EPS (Rs)	-11.9	-11.7	-8.1	12.6	NA	-194.5

Source: Company, ICICIdirect.com Research

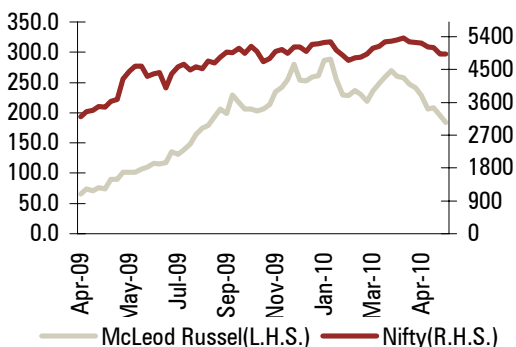
Rating matrix	
Rating	: Strong Buy
Target	: Rs 273
Target Period	: 12 months
Potential Upside	: 43.6%

Key Financials				
Rs Crore	FY09	FY10	FY11E	FY12E
Net Sales	828.9	1,106.2	1,385.2	1,543.6
EBITDA	209.4	362.7	391.5	440.0
Net Profit	85.6	230.9	264.2	298.7
EPS (Rs)	7.6	21.1	24.1	27.3

Valuation summary				
	FY09	FY10	FY11E	FY12E
P/E	24.9	9.0	7.9	7.0
Target P/E	35.8	12.9	11.3	10.0
EV / EBITDA	11.9	6.4	5.6	4.7
Price to Book Va	1.7	1.5	1.3	1.1
RoNW(%)	7.1	16.4	16.0	15.6
RoCE (%)	10.6	18.9	18.7	18.8

Stock data	
Market Capitalization	2,079.7
Total Debt (FY09)	103.6
Cash and Investments (FY09)	44.7
EV	2,489.2
52 week H/L	311.5 / 90.0
Equity capital	54.7
Face value	5.0
MF Holding (%)	10.1
FII Holding (%)	27.6

Price movement (Stock vs. Nifty)



Analyst's name

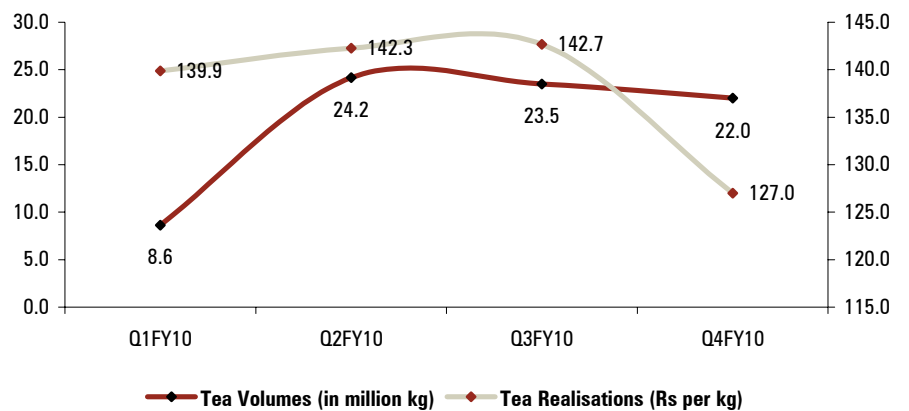
Sanjay Manyal
sanjay.manyal@icicisecurities.com

Parineeta Poddar
parineeta.poddar@icicisecurities.com

Operating Performance

During the year the company sold a total of 78.3 million kg of tea at an average realisation of Rs 137.3 per kg compared to 74.5 million kg and Rs 111 per kg, respectively, during FY09. The operating profit for the year zoomed by around 74% in FY10 and stood at Rs 362.7 crore mainly on account of higher realisations. The total costs, however, increased by Rs 7.6 per kg during the year. There was also an additional provision of Rs 15 crore during the year for change in actuarial valuation of gratuity and staff pension due to increase in wages and salaries. Further, the interest cost was lower by Rs 18.7 crore during the year due to a decrease in interest rate and lower borrowings.

Exhibit 2: Volume and realisation (quarterly for FY10)



Source: Company, ICICIdirect.com Research

Tea prices to remain firm

Despite higher production in Kenya and Sri Lanka, the global shortfall of tea would prevail at around 140 million kg. Hence, prices would remain firm. Moreover, the consequent increase in consumption in India and the stagnant production would carry forward shortage, thereby tightening prices in the country too.

Exhibit 3: Production in key exporting countries

	Jan-Mar-2010	Jan-Mar-2009	% increase
Kenya	111.7	65.8	69.8
Sri-Lanka*	102.3	80.5	27.1
India	94.1	81.88	14.9

*Data is for Jan-April

Source: Company, ICICIdirect.com Research

Revising estimates

Going forward, we believe tea prices would not rise to the extent expected. Hence, realisations may be lower than our earlier estimates. However, an increase in volumes would help to sustain earnings. Therefore, we are revising our estimates.

Exhibit 4: Revising estimates

Particulars	FY11E			FY12E		
	Old	New	% Change	Old	New	% Change
Revenue	1,446.1	1385.2	(4.2)	1,581.6	1543.6	-2.4
EBITDA	420.5	391.5	(6.9)	466.4	440.0	-5.7
EBITDA Margin (%)	29.1	28.3	-81 bps	29.5	28.5	-98 bps
PAT	270.7	264.2	(2.4)	304.7	298.7	-2.0
EPS	24.7	24.1	(2.4)	27.8	27.3	-2.0

Source: Company, ICICIdirect.com Research

Inorganic expansion to drive volumes

The company is aggressively looking for inorganic expansion in Africa, Vietnam and India to increase its current production from 102 million kg to around 200 million kg by FY15. With a current market share of 4% in the world's black tea market, the group plans to double it in the next five years provided it gets estates at the right prices and, hence, helps it to enhance profitability.

Valuation

At the current market price of Rs 190, the stock is trading at 7.9x its FY11E EPS of Rs 24.1 and 6.9x its FY12E EPS of Rs 27.3. With the company's plans to boost its sales volumes by acquisition of estates in Africa, Vietnam and India in the coming years coupled with the increase in realisations, we expect the company to post better earnings in the coming quarters. Therefore, we are valuing the stock at 10x its FY12E EPS and assigning it a target price of Rs 272.9. Hence, our rating on the stock would be **STRONG BUY**.

Exhibit 5: Valuation Matrix

	Sales (Rs cr)	Growth (%)	EPS (Rs)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY10	1106.2	33.5	21.1	176.7	9.0	6.4	16.4	18.9
FY11E	1385.2	25.2	24.1	14.4	7.9	5.6	16.0	18.7
FY12E	1543.6	11.4	27.3	13.1	7.0	4.7	15.6	18.8

Source: Company, ICICIdirect.com Research

Exhibit 6 : Coverage Universe

McLeod Russel				Sales (Rs crore)	EPS (Rs)	PE (x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	MCLRUS	CMP	190 FY10	1106.2	21.1	9.0	6.4	16.4	18.9
		Target	273 FY11E	1385.2	24.1	7.9	5.6	16.0	18.7
MCap	2079.7	Upside	43.6 FY12E	1543.6	27.3	7.0	4.7	15.6	18.8
Jayshree Tea				Sales (Rs crore)	EPS (Rs)	PE (x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	JAYTEA	CMP	235.9 FY10	406.0	52.1	4.5	5.7	31.7	22.8
		Target	366.0 FY11E	491.4	58.4	4.0	4.0	28.8	24.8
MCap	318.47	Upside	55.2 FY12E	562.6	65.1	3.6	2.7	26.5	28.2
Harrison Malayalam				Sales (Rs crore)	EPS (Rs)	PE (x)	EV/E (x)	RoNW (%)	RoCE (%)
Idirect Code	HARMAL	CMP	118.5 FY10	326.4	6.3	18.8	10.5	4.1	7.0
		Target	122 FY11E	353.1	10.2	11.6	9.6	6.4	9.2
MCap	218.7	Upside	3.0 FY12E	384.4	13.6	8.7	7.0	8.2	11.2

Source: Company, ICICIdirect.com Research

RATING RATIONALE

ICICIdirect.com endeavours to provide objective opinions and recommendations. ICICIdirect.com assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Strong Buy, Buy, Add, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Strong Buy: 20% or more;
 Buy: Between 10% and 20%;
 Add: Up to 10%;
 Reduce: Up to -10%
 Sell: -10% or more;

Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICIdirect.com Research Desk,
 ICICI Securities Limited,
 7th Floor, Akruiti Centre Point,
 MIDC Main Road, Marol Naka,
 Andheri (East)
 Mumbai – 400 093**

research@icicidirect.com

ANALYST CERTIFICATION

We */I, Sanjay Manyal MBA (FINANCE) Parineeta Poddar MBA (FINANCE)* research analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts aren't registered as research analysts by FINRA and might not be an associated person of the ICICI Securities Inc.

Disclosures:

ICICI Securities Limited (ICICI Securities) and its affiliates are a full-service, integrated investment banking, investment management and brokerage and financing group. We along with affiliates are leading underwriter of securities and participate in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their dependent family members from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on reasonable basis, ICICI Securities, its subsidiaries and associated companies, their directors and employees ("ICICI Securities and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities is acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and may not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return of investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities and affiliates accept no liabilities for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities and its affiliates might have managed or co-managed a public offering for the subject company in the preceding twelve months. ICICI Securities and affiliates might have received compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. ICICI Securities and affiliates expect to receive compensation from the companies mentioned in the report within a period of three months following the date of publication of the research report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. It is confirmed that *Sanjay Manyal MBA (FINANCE) Parineeta Poddar MBA (FINANCE)* research analysts and the authors of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months. Our research professionals are paid in part based on the profitability of ICICI Securities, which include earnings from Investment Banking and other business.

ICICI Securities or its subsidiaries collectively do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

It is confirmed that *Sanjay Manyal MBA (FINANCE) Parineeta Poddar MBA (FINANCE)* research analysts and the authors of this report or any of their family members does not serve as an officer, director or advisory board member of the companies mentioned in the report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. ICICI Securities and affiliates may act upon or make use of information contained in the report prior to the publication thereof.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.