

Tata Tea

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Not Rated / Rs 638

Brewing better numbers

Tata Tea reported its FY06 results and also held an analyst meet. Adjustments to reported numbers hold the key to understanding its performance evaluation, as there have been several one-offs and non-recurring items.

Key headline numbers:

- Consolidated sales grew 2.1% yoy, while standalone sales were up 9%. Tetley sales were up 4.8%, which included £3.8mn from the Good Earth acquisition.
- Consolidated operating margins were up 40bps to 18%, while standalone margins moved up 200bps to 17.9%. Consolidated operating profits grew 4.2%, while standalone operating profits were up 22.6%.
- Consolidated net recurring profits grew 21.5%, while standalone profits moved up 30.3%, driven by higher other income and lower interest charge.

Future plans...

- Tata Tea is looking at completely exiting its plantations business and driving growth in the non-black specialty-tea business. Inorganic acquisitions, including Jemca, are expected to drive topline growth in the medium-term. Commodity prices and declining black tea market are the biggest concerns.

Valuation

- The stock is trading at 11.6x FY07E and 10.6x FY08E earnings. On an EV/EBITDA basis, it is trading at 8.6x and 7.9x FY07E and FY08E, respectively. These are close to the long-term historical average multiples that the stock has enjoyed. Tata Tea has significantly underperformed the broader market in the last year.

Bloomberg code : TT IN
Reuters code : TTTE.BO
www.tata tea.com

BSE Sensex : 9296
NSE Nifty : 2724

Company data

O/S shares :	56mn
Market cap (Rs) :	36bn
Market cap (USD) :	780mn
52 - wk Hi/Lo (Rs) :	1078 / 565
Avg. daily vol. (3mth) :	333,813
Face Value (Rs) :	10

Share holding pattern, %

Promoters :	28.6
FII / NRI :	18.5
FI / MF :	27.0
Non Promoter Corp. Holdings :	3.2
Public & Others :	22.6

Price performance, %

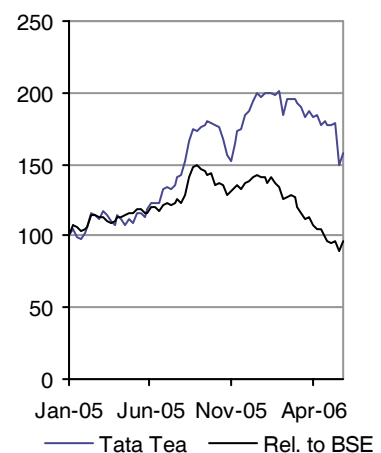
	1mth	3mth	1yr
Abs	(24.1)	(29.7)	7.0
Rel to BSE	1.3	(18.2)	(28.6)

Valuation summary (Consolidated)

Y/E Mar, Rs mn	FY04	FY05	FY06*	FY07E	FY08E
Net Sales	30,496	30,413	31,116	34,307	35,992
Core EBIDTA	4,543	5,192	5,502	5,931	6,224
EBIDTA margins, %	14.9	17.1	17.7	17.3	17.3
Net profit	1,773	2,539	2,912	3,265	3,575
EPS, Rs	31.6	45.3	51.9	58.1	63.6
EPS Growth, %	66.8	43.5	14.5	11.9	9.5
PER, x	21.3	14.8	13.0	11.6	10.6
EV/EBIDTA, x	12.3	10.4	9.6	8.6	7.9
EV/Net Sales, x	1.8	1.8	1.7	1.5	1.4
Price/Book Value, x	2.7	2.4	1.9	1.7	1.5
ROIC, %	9.0	11.5	12.2	13.4	14.1
ROE, %	13.9	17.3	16.5	15.3	14.8
Dividend Yield, %	1.6	2.1	2.3	2.7	2.9

Source: Company, Man Financial Research Estimates. * Provisional numbers.

Stock price vs. Sensex



Source: Bloomberg, Man Financial Research

Consolidated revenue up on acquisition; standalone sales affected

In FY06, consolidated sales grew 2.1% yoy, while standalone sales were up 9%. Consolidated growth was inflated by Good Earth's £3.8mn contribution. Excluding this, organic growth would have been 5.6% (in pound sterling terms). The sales growth also looks better since it is compared with a 2.6% decline in FY05 (adjusted for lower number of weeks).

Tata Tea acquired US-based tea Good Earth Corporation, which owns the Good Earth speciality tea brand in October 2005

Consolidated sales numbers do not include Czech company Jemca and the two joint ventures in Pakistan and Bangladesh. Jemca, which was acquired by Tata Tea late in FY06, expects annual sales of £10mn. Tetley recorded its highest growth of 7.6% in pound sterling terms, although adverse currency movements chopped off almost Rs700mn from the consolidated numbers. This growth was the highest ever since its acquisition by Tata Tea.

Tata Tea's domestic brand sales grew 12%, while underlying volumes were up 8% for the year. For Q4FY06 though, brand sales growth was weak compared with last year's strong growth that was led by brand re-launches.

Key brand performance

<i>Tata Tea Gold</i>	Double-digit growth
<i>Agni</i>	14% growth, leaf element has grown faster
<i>Tetley Tea bags</i>	30% growth
<i>Kanan Devan Red</i>	Launched in Kerala to fight a local competitor. Strong performance.
<i>Chakra Gold</i>	Gained a 17.1% market share in the premium dust category in its key market from 15.7%
<i>Gemini</i>	Maintained its market leadership in Andhra Pradesh

Source: Company, Man Financial Research

Reported standalone sales growth was affected by:

- sale of 25 tea estates of its south Indian plantations, and
- amalgamation of Tata Tetley Ltd

Overall market share rising

Tata Tea's overall tea market share moved up by 80bps to 20.6% from 19.8%. Hindustan Lever and other strong regional brands brands, which include *Wagh Bakri* and *Society*, gained market share at the cost of smaller loose/unorganised players.

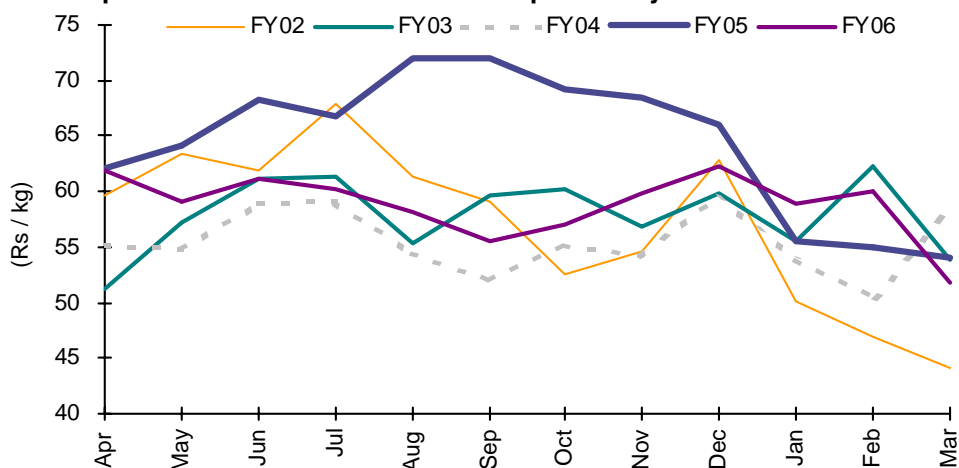
Margins improvement driven by the domestic business

Consolidated operating margins were up 40bps to 18% largely driven by the domestic business, where operating margins were up 200bps to 17.9%. Domestic business benefited from:

- Improved brand realisations
- Savings from exiting the south Indian plantations business (estimated Rs150mn). The cost mix for the domestic business has changed after the sale, as raw material purchases have increased while labour costs have gone down.
- Lower commodity prices

Brand realisations have increased by around 4% in FY06 both due to price hikes and higher growth in some of its premium products. Average domestic market auction prices for the year were generally lower by approximately 9.5%.

Auction prices in FY06 were lower than in previous year



Source: Carritt Moran, Man Financial Research

Tetley's operating margins were lower due to:

- Higher spending on new plans for long-term sales growth
- Various product initiatives
- One-off spending on migration to flip-top packs from cartons in Canada.

However, such expenses were offset by benefits from another one-off item — migration to FRS17 (related to accounting policy for pension costs) in the UK, where it is no longer required to expense the pension cost in its P&L statement.

Interest costs and investment income boost consolidated recurring net profits

Higher income from investments (up 55%), lower financial charges (down 16.6%), and lower effective tax rates (down 150bps) drove consolidated net profit up 21.5%, while standalone profits moved 30.3% higher in FY06. Consolidated profits were Rs50-60mn lower due to adverse currency movements.

Tetley's total debt has remained flat at around £ 194mn. Reduction in interest costs by £ 5.8mn yoy I skewed due to a one-time refinancing charge of £ 3.1mn in FY05.

What's in store?

Exit plantations completely

The company sold 17 of its south Indian plantations to Kanan Devan Hill Plantations Co. (owned largely by its employees) and another six to Tata Coffee (an associate company) in FY06, booking an exceptional profit of Rs 409mn. The company treats Kanan Devan as a preferred supplier and continues to buy tea from it on an arms-length basis. It is looking at unlocking value from its north Indian plantations, too, and is considering various options including alternate cropping, developing tourism infrastructure, etc.

Tetley — Investing in the faster-growing, non-black-tea segment

Tetley is looking at driving growth in its non-black specialty tea business (fruit and herb, ready-to-drink iced tea, etc.), as this business is growing much faster than black tea in most markets. The US tea market is divided equally between black and specialty. In East European markets, specialty tea is small, but growing at a much faster rate than black tea. In fact, black tea business continues to shrink in almost all of Tetley's key markets, even while the company has managed to maintain or gain market share. This year will see the national launch of its iced tea in Australia, and few other markets and also in the UK, where it has been test marketing for the last year or so. Acquisition of Good Earth is also going to help the company in the US market.

Expanding geographically for incremental growth

Tetley continues to expand geographically on its own or through acquisitions and other vehicles such as joint ventures. Recently, it strengthened its position in the Czech market where it acquired Jemca, one of the leading tea companies with around 27% market share. It also entered the Pakistan and Bangladesh markets through JVs. The Pakistan market has become the fifth-largest volume market in Tetley's portfolio and the company expects strong growth to continue there. Currently, its market share in this market would be around 5%. We expect more acquisitions in European, South African, and other North American markets.

Market share improvement across key markets

Markets	Market growth	Market Share	Share growth
UK – Total	Flat	26.2%	1.0%
- Fruit & herbs	14.0%	34.0%	36.0%
- Green	29.0%	7.2%	50.0%
US – Tetley	-1.0%	4.5%	5.0%
- Good earth	-1.0%	2.2%	Flat
Canada - Total	-1.0%	36.0%	2.0%
- Specialty	4.0%	24.0%	4.0%

Source: Company, Man Financial Research

Jemca to drive topline growth in FY07E

We see a consolidated topline growth of 10.3% in FY07E and 4.9% in FY08E. Almost 26% of the incremental sales will come from Jemca's £ 10mn annual sales. Launches of new products such as ready-to-drink tea in the UK, Australia, and a few other markets, and entry into new markets will account for the rest. Domestic sales growth is expected to be 7.6% and 5.6% for FY07E and FY08E, respectively.

Blend changes and low-cost inventory to insulate margins in the short-term

Operating margins will depend on domestic and international commodity price movements in the year. Higher Kenyan tea prices due to loss of tea production in Kenya in early 2006 have not affected margins in the last quarter of FY06, as blend changes and lower-cost inventory came to rescue. However, pressure on gross margins is likely with inventory depletion and buying at higher costs. In the domestic market, there has been some pricing power improvement in the last year and this could partially offset any raw material pressure. FY06 saw Tata Tea benefiting from cost savings by exiting some of its plantations. However, the advantage has been more or less captured and further benefits are not expected.

Valuation — Almost touching historical averages

The stock is trading at 11.6x FY07E and 10.6x FY08E earnings. On an EV/EBITDA basis, it is trading at 8.6x and 7.9x FY07E and FY08E, respectively. These are closer to the long-term historical average multiples the stock has enjoyed. While Tata Tea's growth outlook looks better due to the increased likelihood of acquisitions, adverse raw material prices and declining global black tea market are key concerns. Also, the company's low return on capital employed and high leverage would be deterrents to multiple-expansion. The stock has significantly underperformed the broader market in the last year.

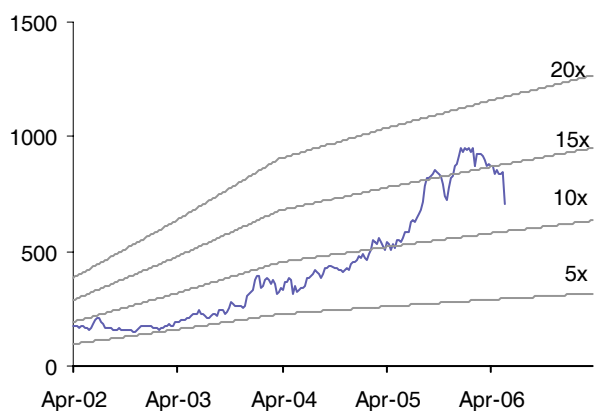
Quarterly Financials

	Consolidated				Standalone			
	Q4FY06	Q4FY05	FY06	FY05	Q4FY06	Q4FY05	FY06	FY05
Net sales	8167	7899	31239	30591	2,191	2,204	9,821	8,996
<i>Growth</i>	3.4		2.1		-0.6		9.2	
Total income	8167	7899	31239	30591	2191	2204	9821	8996
Operating expenses	6956	6880	25615	25194	2079	2146	8063	7563
EBITDA	1211	1019	5625	5397	112	59	1758	1434
<i>Growth</i>	18.8		4.2		90.8		22.6	
<i>Margin</i>	14.0	12.9	18.0	17.6	5.1	2.7	17.9	15.9
Depreciation	210	195	758	779	52	60	194	220
EBIT	1001	824	4866	4619	60	-2	1564	1214
<i>Growth</i>	21.5		5.4				28.8	
<i>Margin</i>	12.3	10.4	15.6	15.1	2.7	-0.1	15.9	13.5
Interest paid	237	282	1024	1228	17	15	90	85
Other income	50	33	270	174	245	290	580	504
Pre-tax profit	813	574	4112	3565	287	273	2054	1633
Extraordinary items: Gains/(Losses)	-24	-487	73	-410	-23	-12	252	-12
Tax provided	246	57	1179	939	71	3	436	332
Profit after tax	543	30	3006	2217	193	258	1869	1289
Associate Company Profit	20	51	117	98	0	0	0	0
Minority Interest	49	60	131	160	0	0	0	0
MAN Net profit	532	337	2941	2421	209	266	1693	1299
<i>Growth</i>	57.8		21.5		-21.3		30.3	

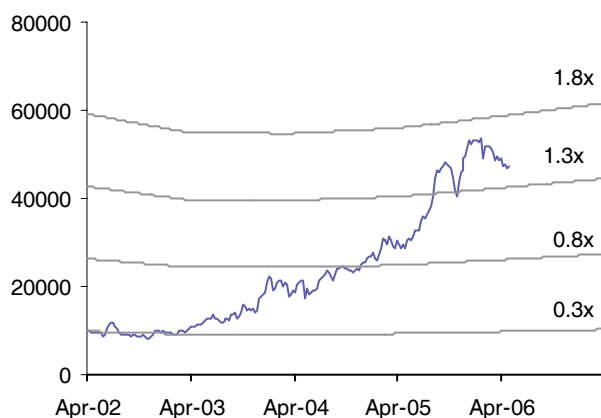
Source: company, Man Financial Research

RELATIVE AND ROLLING ABSOLUTE VALUATION

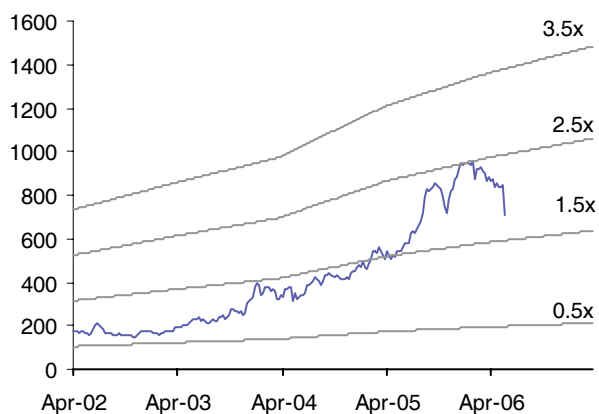
PE band



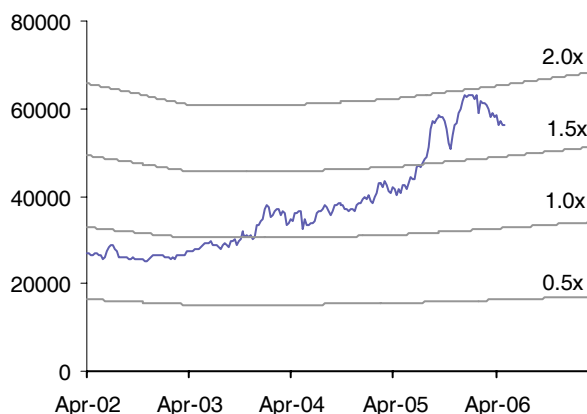
Mkt cap to sales band



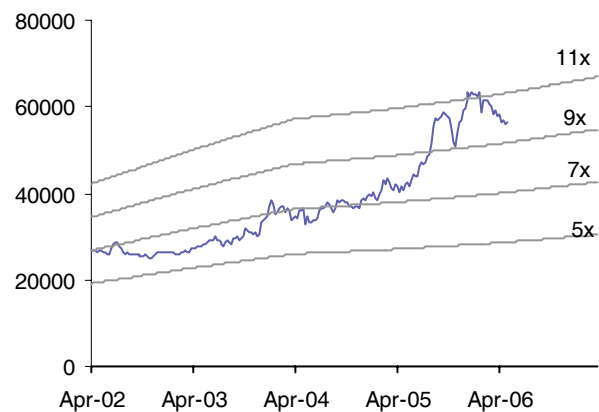
PBV band



EV/Sales band



EV/EBIDTA band



FINANCIALS

Income Statement

Y/E Mar, Rs mn	FY03	FY04	FY05	FY06*	FY07E	FY08E
Net sales	32,922	30,496	30,413	31,116	34,307	35,992
<i>Growth, %</i>	8.7	-7.4	-0.3	2.3	10.3	4.9
Operating expenses	-29,100	-25,953	-25,221	-25,614	-28,377	-29,768
EBITDA	3,822	4,543	5,192	5,502	5,931	6,224
<i>Growth, %</i>	2.1	18.9	14.3	6.0	7.8	4.9
<i>Margin, %</i>	11.6	14.9	17.1	17.7	17.3	17.3
Depreciation	-888	-827	-779	-758	-785	-792
EBIT	2,934	3,716	4,413	4,744	5,145	5,432
<i>Growth, %</i>	3.9	26.7	18.8	7.5	8.5	5.6
<i>Margin, %</i>	8.9	12.2	14.5	15.2	15.0	15.1
Interest received/(paid)	-1,333	-1,320	-1,228	-1,024	-943	-835
Other Income	230	401	354	386	430	478
Income from Associates	-41	-33	98	117	117	123
Pre-tax profit	1,790	2,763	3,638	4,222	4,749	5,197
Tax provided	-618	-906	-938	-1,179	-1,320	-1,446
Profit after tax before MI	1,172	1,857	2,699	3,043	3,429	3,751
Minority Interest/Associates	-107	-84	-160	-131	-164	-176
PAT after MI & Extra-ordinary Items	833	2,050	2,155	2,985	3,265	3,575
MAN Net profit	1,065	1,773	2,539	2,912	3,265	3,575
<i>Growth</i>	-15.5	146.0	5.1	38.5	9.4	9.5
Extraordinary items: Gains/(Losses)	-231	277	-384	73	0	0
Wtd avg shares (m)	56	56	56	56	56	56

* Provisional numbers

Cash Flow

Y/E Mar, Rs mn	FY03	FY04	FY05	FY06*	FY07E	FY08E
Pre-tax profit	1,790	2,763	3,638	4,222	4,749	5,197
Depreciation	140	675	744	659	808	681
Chg in working capital	-435	32	-354	-199	-4	-151
Total tax paid	-618	-906	-938	-1,179	-1,320	-1,446
Other operating activities	-231	277	-384	73	0	0
Cash flow from operating activities	645	2,841	2,705	3,575	4,233	4,281
Capital expenditure	-729	-1,479	-1,048	826	-1,231	-259
Chg in investments	-88	-50	-50	-50	-50	-50
Chg in marketable securities	-22	-672	-259	-1,611	-64	-58
Cash flow from investing activities	-839	-2,201	-1,357	-836	-1,345	-367
Free cash flow	-193	640	1,348	2,739	2,888	3,914
Equity raised/(repaid)	100	644	416	2,008	1,004	-5
Debt raised/(repaid)	403	257	-1,649	-1,236	-2,040	-1,815
Dividend (incl. tax)	-487	-656	-871	-990	-1,157	-1,235
Cash flow from financing activities	22	147	-2,099	-299	-2,262	-3,134
Net chg in cash	-171	787	-751	2,440	626	780

* Provisional numbers

Balance Sheet

As at 31st Mar, Rs mn	FY03	FY04	FY05	FY06*	FY07E	FY08E
Cash & bank	605	1,393	642	3,082	3,708	4,488
Marketable securities at cost	347	1,019	1,277	2,888	2,952	3,010
Debtors	2,788	2,711	2,981	2,613	2,851	2,994
Inventory	3,482	3,765	4,378	4,622	4,817	5,041
Loans & advances	1,729	1,861	1,515	996	1,097	1,203
Other current assets	471	32	30	474	473	477
Total current assets	9,422	10,780	10,823	14,676	15,898	17,213
Investments	1,921	1,971	2,021	2,071	2,121	2,171
Gross fixed assets	30,420	31,970	32,851	32,087	33,318	33,577
Less: Depreciation	4,645	5,319	6,063	6,722	7,530	8,211
Add: Capital WIP	141	71	238	176	176	176
Net fixed assets	25,917	26,721	27,026	25,541	25,964	25,542
Goodwill	18,868	20,041	20,630	20,041	20,745	20,828
Total assets	37,260	39,472	39,870	42,288	43,984	44,927
Current liabilities	5,917	5,883	6,092	5,771	6,107	6,317
Provisions	1,060	1,072	1,202	1,046	1,250	1,363
Total current liabilities	6,977	6,955	7,295	6,817	7,356	7,681
Non-current liabilities	18,543	18,754	16,948	15,790	13,740	11,927
Total liabilities	25,521	25,709	24,242	22,608	21,096	19,607
Paid-up capital	562	560	560	562	562	562
Reserves & surplus	10,349	12,390	14,089	18,090	21,201	23,537
Shareholders' equity	10,911	12,950	14,650	18,652	21,764	24,099
Total equity & liabilities	37,260	39,472	39,870	42,288	43,984	44,927

* Provisional numbers

Per-share data

	FY03	FY04	FY05	FY06*	FY07E	FY08E
MAN EPS (INR)	18.9	31.6	45.3	51.9	58.1	63.6
<i>Growth</i>	<i>10.4</i>	<i>66.8</i>	<i>43.5</i>	<i>14.5</i>	<i>11.9</i>	<i>9.5</i>
Book NAV/share (INR)	208.8	245.2	279.0	350.7	407.1	450.4
FDEPS (INR)	14.8	36.6	38.5	53.1	58.1	63.6
CEPS (INR)	30.6	51.3	52.4	66.7	72.0	77.7
CFPS (INR)	24.1	42.7	50.5	53.8	65.3	67.4
DPS (INR)	7.6	10.4	13.9	15.8	18.4	19.6

* Provisional numbers

Financial structure

	FY03	FY04	FY05	FY06*	FY07E	FY08E
Total debt/Equity (%)	150.9	130.6	104.5	76.7	57.0	44.4
Net debt/Equity (%)	145.7	120.5	100.3	61.0	40.8	26.6

* Provisional numbers

Profitability, Productivity, Liquidity and Valuation Ratios

	FY03	FY04	FY05	FY06	FY07E	FY08E
Return on assets (%)	5.5	7.0	8.8	9.0	9.3	9.6
Return on equity (%)	9.3	13.9	17.3	16.5	15.3	14.8
Return on Invested capital (%)	7.2	9.0	11.5	12.2	13.4	14.1
RoIC/Cost of capital (x)	0.7	0.9	1.1	1.2	1.3	1.4
RoIC - Cost of capital (%)	-3.8	-1.4	1.1	1.8	3.1	3.8
Return on capital employed (%)	6.8	8.6	10.7	10.9	11.2	11.6
Cost of capital (%)	11.0	10.4	10.4	10.4	10.4	10.3
RoCE - Cost of capital (%)	-4.2	-1.8	0.3	0.5	0.8	1.3
Asset turnover (x)	1.2	1.1	1.1	1.1	1.2	1.3
Sales/Total assets (x)	0.9	0.8	0.8	0.8	0.8	0.8
Sales/Net FA (x)	1.3	1.2	1.1	1.2	1.3	1.4
Working capital/Sales (x)	0.05	0.05	0.05	0.06	0.05	0.06
Fixed capital/Sales (x)	0.92	1.02	1.08	0.64	0.60	0.58
Receivable days	30.9	32.4	35.8	30.7	30.3	30.4
Inventory days	38.6	45.1	52.5	54.2	51.2	51.1
Payable days	74.2	82.7	88.2	82.2	78.5	77.5
Current ratio (x)	1.4	1.5	1.5	2.2	2.2	2.2
Quick ratio (x)	0.9	1.0	0.9	1.5	1.5	1.6
Interest cover (x)	2.2	2.8	3.6	4.6	5.5	6.5
Dividend cover (x)	2.5	3.0	3.3	3.3	3.2	3.2
PER (x)	35.5	21.3	14.8	13.0	11.6	10.6
PEG (x) - y-o-y growth	3.4	0.3	0.3	0.9	1.0	1.1
Price/Book (x)	3.2	2.7	2.4	1.9	1.7	1.5
Yield (%)	1.1	1.6	2.1	2.3	2.7	2.9
EV/Net sales (x)	1.7	1.8	1.8	1.7	1.5	1.4
EV/EBITDA (x)	14.5	12.3	10.4	9.6	8.6	7.9
EV/EBIT (x)	18.9	15.0	12.3	11.2	9.9	9.0
EV/NOPLAT (x)	28.9	22.3	16.5	15.5	13.7	12.5
EV/CE	1.8	1.7	1.7	1.5	1.4	1.3
EV/IC (x)	2.1	2.0	1.9	1.9	1.8	1.8

Source: Company, Man Financial Research Estimates

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