IDBI capital

PICK OF THE WEEK

Mcleod Russel India Ltd.

Rs. 93 | Buy

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Nifty: 4109; Sensex: 14218

Key Stock Data

Sector	Tea
Bloomberg/Reuters	MCLR@IN/MCLE.BO
Shares o/s (m)	108.3
Market cap (Rs m)	10,032
Market cap (US$ m)	226
3-m daily average vol.	157,555

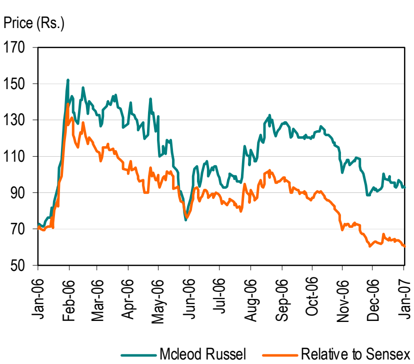
Price Performance

52-week high/low			Rs160/70
	-1m	-3m	-12m
Absolute (%)	(0.1)	(23.6)	32.0
Rel to Sensex (%)	(3.6)	(34.2)	(21.9)

Shareholding Pattern (%)

Promoters	45.78
FIIs/NRIs/OCBs/GDR	18.85
MFs/Banks/FIs	11.58
Non Promoter Corporate	7.09
Public & Others	16.71

Stock vs Relative to Sensex



Source: Capitaline

Summary

McLeod Russell India Ltd. (MRIL), the largest tea producer in the country has been formed by demerger of bulk tea division of Eveready Industries India Ltd. Being it the largest player, the company will get immensely benefited by the expected up move in the tea prices. It has 52 tea gardens with aggregate area of more than 18,805 hectares located in Assam and Dooars producing around 74m Kg of tea on consolidated basis. The company is open for further acquisition across the globe in order to become a global player.

Going forward, we expect the PAT to increase more than 5 folds over next two fiscals induced by top line CAGR of 17% over FY06 through FY08. The current market price is 5.3x the FY08E EPS of Rs.17.4. Assuming a conservative P/E, we expect MRIL to trade at 7x its FY08E EPS. We recommend 'Buy' with the target price of Rs.120, which is 10% discount to our DCF valuation.

Investment highlights

- **Acquisition**

  MRIL's capacity has increased from 45m Kg in FY05 to 70m Kg in FY06 and further to 74m Kg in FY07E following the acquisition of Williamson tea, Doom Dooma and Moran tea. Increasing production owing to increased capacity along with increasing tea price would give tremendous boost to the top line. The merger would also result into economies of scale improving the profit margin significantly and leading to increased production of high quality premium tea for exports.

- **Higher realizations**

  Company management, which is pretty bullish on unit realizations, expects it to increase to Rs.95/Kg by FY07. But to be on conservative side, we have assumed a realization of Rs.88/Kg in FY07 and Rs.93/Kg in FY08. This will be on account of tea shortage globally as well as increased quality tea production by the company commanding higher premium in the market. The company is continuously into modernization and up-gradation of its facilities.

- **Modernization and up-gradation**

  The age composition of the tea bushes is healthy on account of the uprooting and replanting programme, which ensures the quality of tealeaves. During the year, the company had undertaken extensive up gradation of machinery at three of its Assam tea estates and also extended and improved upon the withering facilities at another four estates. As a result, Doom Dooma tea estate that fetched as low as Rs.56/Kg has turnaround with average realisation of Rs.80/Kg.

- **Robust performance**

  MRIL has shown a robust performance in FY06. Revenues at Rs.5,115m were up 60% YoY on account of merger of Williamson Tea with MRIL. EBIDTA margins have improved by 506bps YoY to 6.1%. PAT at Rs.198m against a loss of Rs.168m in FY05.

Table 1: Financial snapshot (Rs. m)

Year-end: March	FY05	FY06	FY07E	FY08E
Gross sales	3,215	5,115	6,474	6,980
PAT	(198)	221	1,406	1,881
OPM (%)	1.1	6.1	26.9	29.9
NPM (%)	(6.2)	4.3	21.7	27.0
EPS (Rs.)	(3.0)	2.0	13.0	17.4
P/E (x)	(30.7)	46.0	7.1	5.3
ROCE (%)	(4.1)	(0.4)	8.6	11.0
ROE (%)	(4.8)	2.3	12.4	13.9

Source: Company reports; IDBI Capital Market Services

Investment arguments

Increasing size

MRIL has attained burgeoning size following the recent acquisitions with its capacity of 74m Kg p.a. In FY05, it had capacity of 44m Kg that increased to 66m Kg with the acquisition of Williamson Tea, to 70m Kg with Doom Dooma and further, finally, to 74m Kg with acquisition of Moran Tea. This is expected to lead to 17% growth in revenues from tea division for the next two years. The company intends to grow further through acquisitions across the globe.

All the acquisitions are majorly funded through borrowings taking the total debt level to Rs.5,658m in FY06. This has lead to increase in interest cost in FY06 and FY07E. But the same is expected to reduce in FY08E as MRIL is has raised around Rs.1.2bn through QIP (Qualified Institutional Placement) route, which will be utilized to retire part of debt. This will results in equity dilution of around 10% in FY07E.

Table 2: Tea segment performance

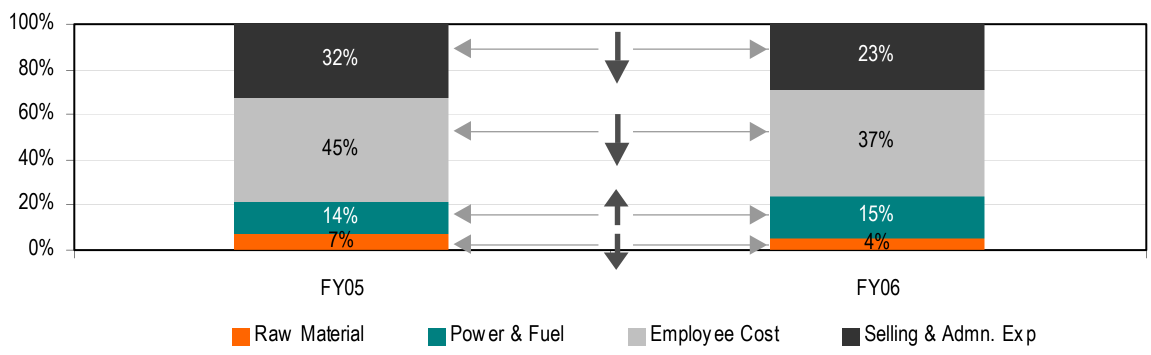
		FY05	FY06	FY07E	FY08E
Capacity	**Kgs**	**44,762,000**	**70,000,000**	**74,200,000**	**74,200,000**
Tea purchased	Kgs	0	4,960	4,960	4,960
Tea produced	Kgs	40,114,220	70,880,030	73,458,000	74,942,000
Total tea available	**Kgs**	**40,114,220**	**70,884,990**	**73,462,960**	**74,946,960**
Turnover	Kgs	40,032,300	69,622,020	73,462,960	74,946,960
Unit realisation	**Rs/Kg**	**80**	**73**	**88**	**93**
Tea revenue	**Rs. m**	**3,209**	**5,108**	**6,465**	**6,970**

Source: Company reports; IDBI Capital Market Services

Improving profitability

Williamson Tea acquisition results in synergy generating cost savings to the tune of Rs.250-300m. This is basically on account of savings in administrative cost like salaries, commission, offices, etc. This has resulted in increase in EBIDTA margins in FY06 by 506bps. Going forward, the administrative expenses are expected to remain flat against growing revenues giving further fillips to the margins.

Figure 1: Expenditure breakup



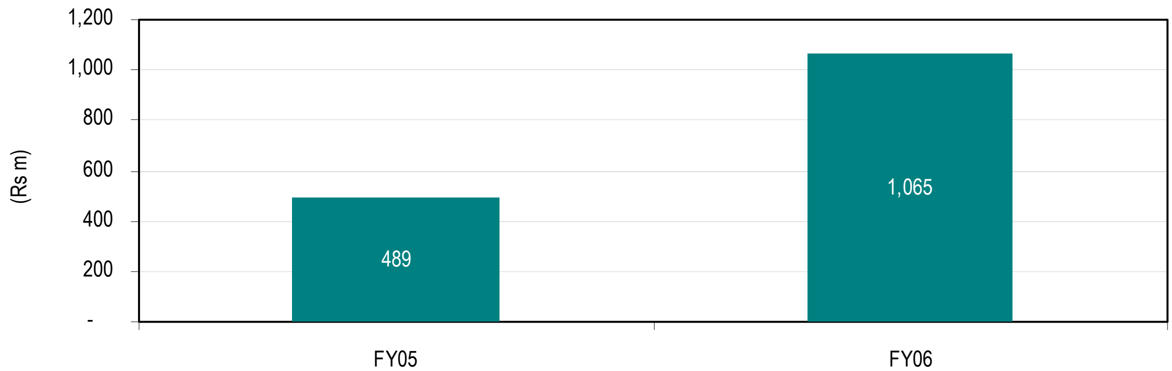
Source: Company reports; IDBI Capital Market Services

Export potential

MRIL's exports were up by 117% YoY at Rs.1,065m in FY06. The company accounts for 50% of the quality tea exports from Assam. Exports are expected to increase further on account of increasing world demand triggered by Kenyan drought, which would result into shortage in the global tea market. Ireland, Germany, Japan, UK would be the likely market where the exports would rise significantly. It also has definite plans of expanding its exports in the emerging markets of Iran, Pakistan, Egypt, Russia and the USA.

Through the recent acquisition MRIL would get access to Williamson Tea's markets. Moreover, the company will enjoy waiver of 10% commission in all sales through George Williamson, London.

Figure 2: Exports



Source: Company reports; IDBI Capital Market Services

Financial and valuation

MRIL is all set to take advantage of the improving tea industry scenario with its growing size and saving in costs. In Q2FY07 standalone, MRIL posted an impressive 92% YoY growth in gross sales at Rs.1,721m. This was on account of merger of Williamson Tea and increased realizations. EBIDTA margin at 60% have escalated by 11 percentage points YoY reflecting better realizations and reduced expenses, mainly due to the synergy on account of the merger. Due to lower than proportional increase in interests and depreciations, net profit margin has increased by 23 percentage points YoY to 58%.

Going forward, assuming a realization of Rs.93/Kg for FY08, we expect the PAT to grow more than 5 times over next two fiscals induced by top line CAGR of 17% over the period. The current market price is 7.1x FY07E EPS of Rs.13.0 and 5.3x FY08E EPS of Rs.17.4. Assuming a conservative P/E, we expect MRIL to trade at 7x its FY08E EPS of Rs.17.2. We recommend 'Buy' with the target price of Rs.120, which is 10% discount to our DCF valuation.

Table 3: Quarterly result (Rs. m)

Year-end: March	Q2FY07	Q2FY06	(% Var)	H1FY07	H1FY06	(% Var)
Gross sales	1,721	897	92	2,405	1,352	78
Other income	174	48	263	228	224	2
Operating profit	1,205	487	147	1,400	697	101
OPM (%)	60	49		49	35	
Interest	145	132	10	260	203	28
Depreciation	56	40	40	111	79	41
Tax	2	2		4	5	(20)
PAT	1,001	314	219	1,025	411	149
NPM (%)	58	35		43	30	
EPS (Rs.)	10.2	5.6		10.4	7.3	

Source: Company reports; IDBI Capital Market Services

Financial summary

Profit and loss account

(Rs m)

Year-end: March	FY05	FY06	FY07E	FY08E
Gross sales	**3,215**	**5,115**	**6,474**	**6,980**
Less: Excise	47	20	26	28
Net sales	**3,169**	**5,095**	**6,448**	**6,952**
Expenditure				
Change in stocks	(12)	(81)	0	0
Raw material	221	228	258	264
Power and fuel	449	800	996	1,074
Employee cost	1,450	1,924	1,539	1,616
Other admin. expenses	737	1,912	1,912	1,912
Stores, spare parts	291	0	0	0
Total expenditure	**3,135**	**4,782**	**4,706**	**4,866**
EBDITA	**34**	**312**	**1,742**	**2,086**
Interest/Financial charges	233	367	367	247
Gross Profit	**(199)**	**(55)**	**1,375**	**1,840**
Depreciation	138	(107)	229	230
EBT	**(337)**	**52**	**1,146**	**1,610**
Other income	98	336	291	314
Non recurring items		(62)		
PBT	**(239)**	**326**	**1,437**	**1,924**
Tax + Fringe benefit	0	7	32	43
Deferred tax	(41)	84	0	0
Other tax		13		
PAT	**(198)**	**221**	**1,406**	**1,881**

Source: Company reports; IDBI Capital Market Services

Balance sheet

(Rs m)

Year-end: March	FY05	FY06	FY07E	FY08E
Sources of funds				
Total shareholders' fund	**7,047**	**10,041**	**12,635**	**14,517**
Equity	280	492	542	542
Reserves and surplus	6,768	9,549	12,094	13,975
Total debt	**2,562**	**5,658**	**3,800**	**2,547**
Total liabilities	**9,609**	**15,699**	**16,435**	**17,063**
Application of funds				
Gross block	**11,413**	**18,841**	**18,908**	**18,975**
Accum. depreciation	1,687	2,952	3,181	3,410
Net block	9,726	15,889	15,727	15,565
Capital work in progress	25	67	67	67
Investments	105	103	103	103
Current assets of which	1,437	2,372	3,723	4,642
Inventories	**210**	**420**	**383**	**383**
Sundry debtors	112	349	442	476
Cash and bank	17	97	1,126	1,912
Loans and advances	774	999	1,264	1,363
Other current assets	324	508	508	508
Less: Current liabilities and provisions	1,523	2,174	2,627	2,756
Net current assets	**(86)**	**198**	**1,096**	**1,886**
Miscellaneous expenditure not W/O	197	0	0	0
Net deferred tax	(359)	(559)	(559)	(559)
Total assets	**9,609**	**15,699**	**16,435**	**17,063**

Note: The consolidated accounts do not include Moran Tea. It is recently acquired due to which its latest balance sheet is unavailable.

Source: Company reports; IDBI Capital Market Services

Cashflow statement

(Rs m)

Year-end: March	FY06	FY07E	FY08E
PAT	**198**	**1,406**	**1,881**
Depreciation	(107)	229	230
Deferred tax	84	0	0
Other income	(336)	(291)	(314)
Inc/(Dec) in WC	**(21)**	**131**	**(4)**
(Inc)/Dec in receivables	(237)	(93)	(35)
(Inc)/Dec in inventories	(210)	36	0
(Inc)/Dec in loans and advances	(225)	(265)	(99)
Inc/(Dec) in current liabilities	651	453	129
Cash from operation	**(181)**	**1,475**	**1,793**
Other income	336	291	314
Net (Pur)/Sale of assets/Capex	(7,470)	(67)	(67)
Net (Pur)/Sale of investments	2	0	0
Cash from investing	**(7,132)**	**224**	**246**
Dividends and tax thereon	0	0	0
Net borrowing	3,096	(1,859)	(1,253)
Equity issue	213	50	0
Share premium		1,139	
Cash from financing	**3,309**	**(670)**	**(1,253)**
Adjustments/Extra income	4,084	0	0
Cash flow	80	1,029	786
Opening balance	17	97	1,126
Closing balance	**97**	**1,126**	**1,912**

Source: Company reports; IDBI Capital Market Services

Ratios

Year-end: March	FY05	FY06	FY07E	FY08E
Per share values				
EPS (Rs)	(3.0)	2.0	13.0	17.4
Cash EPS	(1.3)	1.8	15.1	19.5
Book value (Rs)	126.1	102.0	116.6	134.0
Sales per share (Rs)	57.5	52.0	59.8	64.4
Valuations				
P/E (x)	(30.7)	46.0	7.1	5.3
Cash P/E (x)	(72.6)	51.9	6.1	4.8
P/B (x)	0.7	0.9	0.8	0.7
P/S (x)	1.6	1.8	1.5	1.4
Price (Rs) year end	93	93	93	93
Profitability/returns/liquidity				
OPM (%)	1.1	6.1	26.9	29.9
NPM (%)	(6.2)	4.3	21.7	27.0
ROCE (%)	(4.1)	(0.4)	8.6	11.0
ROE (%)	(4.8)	2.3	12.4	13.9
Debt/Equity	0.4	0.6	0.3	0.2
Interest coverage (x)	0.1	0.9	4.7	8.5
Current ratio	0.9	1.1	1.4	1.7
Other ratios				
EV	5,133	10,118	7,690	5,650
EBITDA	34	312	1,742	2,086
EV/EBITDA	152	32	4	3

Source: Company reports; IDBI Capital Market Services

Notes

Equity Sales/Dealing

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