

3rd July 2012

Mcleod Russel (India) Ltd.

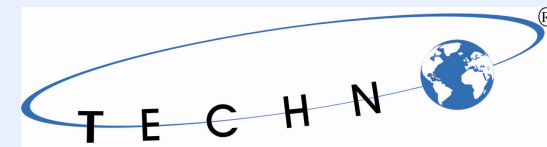




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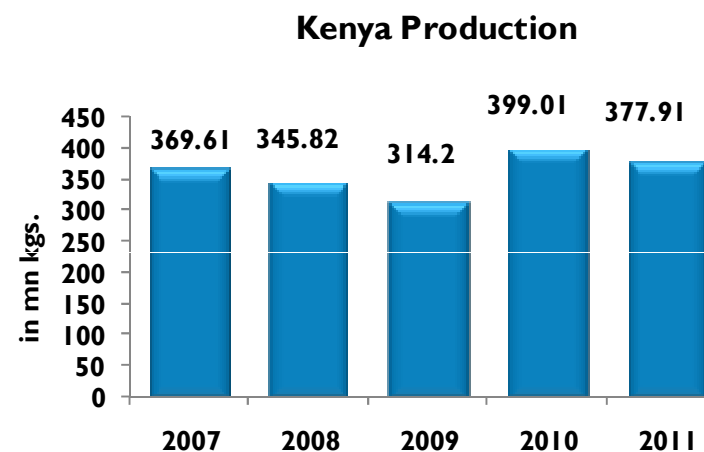
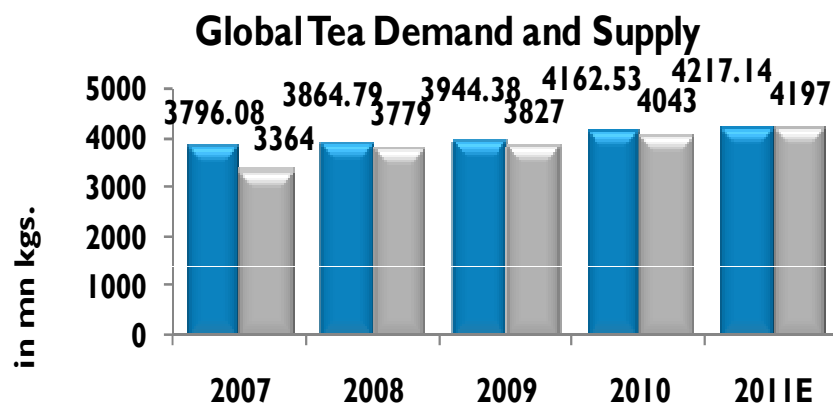
CMP	₹295.5/-
BSE SENSEX	17508
NSE NIFTY	5279
EQUITY CAP	₹54.73crs.
FACE VALUE	₹5/-
MARKET CAPITALIZATION	₹3234.54crs.
BSE CODE	532654
NSE CODE	MCLEODRUSS
BLOOMBERG CODE	MCLR IN
P/E (FY13E)	9.4x
52 WEEK HIGH/LOW	₹302.75/165.50

SHARE HOLDING PATTERN AS ON 31.03.12

PROMOTERS	45.71%
INDIAN INSTITUTIONAL	38.21%
PUBLIC & OTHERS	16.08%

- World's largest tea plantation company with 39,318 ha. dedicated tea plantations spread across 47 tea estates in Assam, 5 in West Bengal, 4 in Vietnam, 5 in Uganda and 1 in Rwanda. Aggregate production capacity stands at ~100 mn kgs - 82.6mn kgs in India, 4.5mn kg in Vietnam, 15mn kg in Uganda and 1.7 mn kgs in Rwanda.
- Forayed globally with its first acquisition of 100% stake in Phu Ben Co. in Vietnam in 2008, having a capacity of 4.5 mn kgs . In 2010, Mcleod acquired Rhwenzori Tea Investments Ltd. in Uganda having a capacity of 15 mn kgs. And the latest acquisition was of 1.7mn kg Gisovu Tea Garden, in Rwanda in 2011.
- Accounts for ~7.8% of India's total tea production and ~2% of the global tea production.
- Industry outperformer

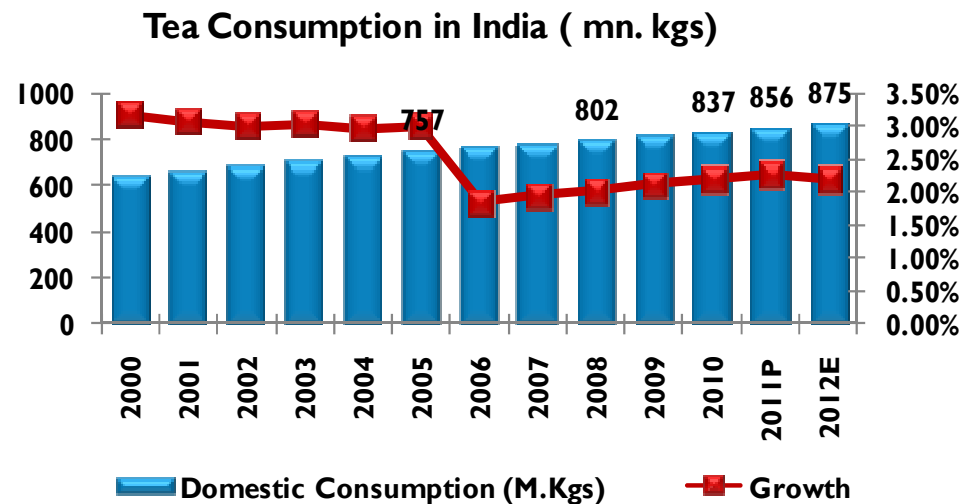
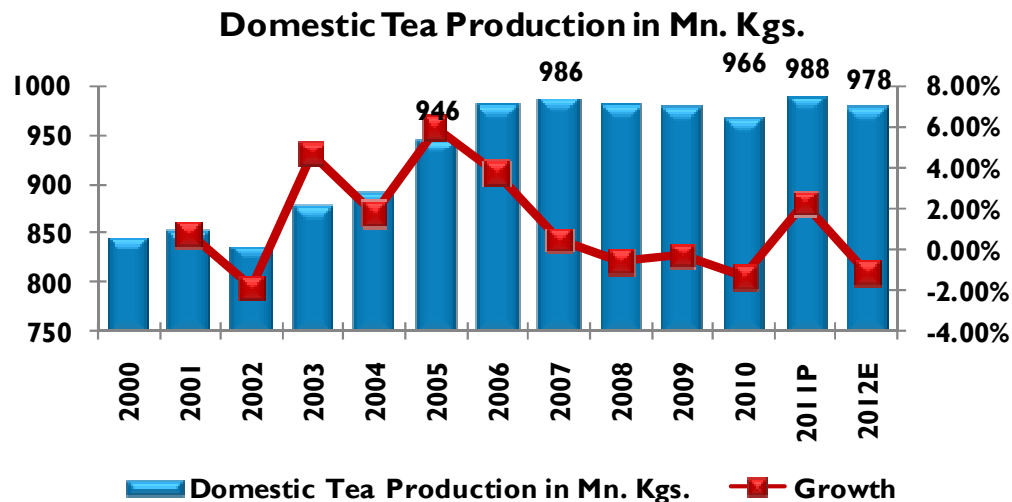
- Continuous reduction in global carry forward inventory during CY08 and CY09 lead to higher tea prices internationally. CY10 saw a good crop with Kenya (world's largest exporter) reporting highest ever production at 399 mn kgs. But globally still the prices remained firm on the back of strong demand for black tea.CY11 followed as a stagnant to lower production year.



■ Total Production
 ■ Total Consumption
 Source: Tea Board of India

- We believe that we are in a structural shift with a rising demand and supply gap, which is not likely to get resolved over the next few years, unless crop from Kenya increases substantially which is unlikely.This can lead to price rise which can last for few years.

- The country has witnessed stagnant production over the last 4-5 years while domestic consumption has been growing at a CAGR of 2.5%+ over the last 10 years.
- India has been witnessing falling yields over the last 5 – 7 years due to the aging of bushes. Of the 11th Plan target there was 66 per cent shortfall in sanctions against a target of 54,524 ha area for replanting in the first four years (April 2007 - March 2011) as only 18,642 ha area was sanctioned for replanting. The impact of replantation efforts will be visible from FY14-15 as the pace of it picks up, however by that time domestic consumption too would have grown resulting in no major buffer.
- Consolidation initiatives by Mcleod have started contributing from FY11. Improved profitability and return ratios to enable the company to increase its operating cash flows and hence reduce leverage.



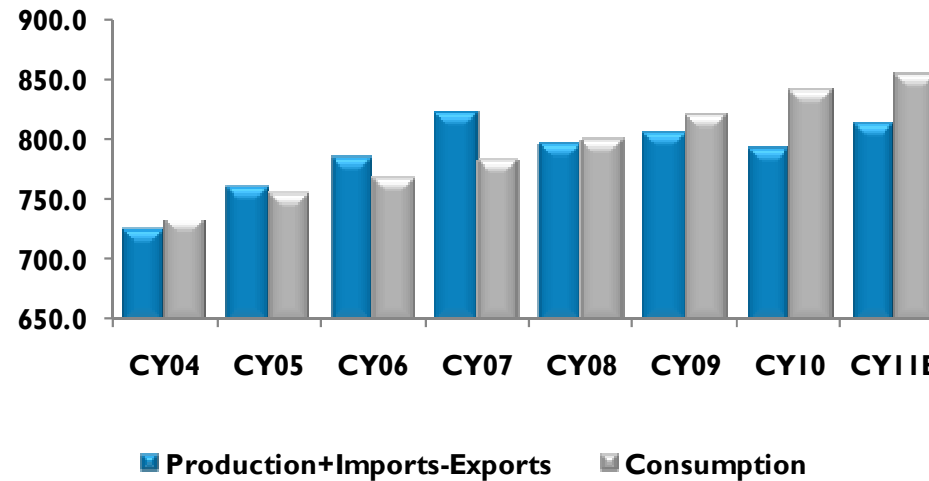
Source: Tea Board of India

- Domestic tea consumption is increasing at a faster pace than production. The country has witnessed stagnant production over the last 4-5 years while consumption has been growing at a CAGR of 2.5%+ over the last 10 years.
- Mcleod accounts for ~7.8% of the total domestic production and ~ 10.6% of North India production. Over the years it has acquired quality fields and enjoys one of the highest realization and yield per hectare.



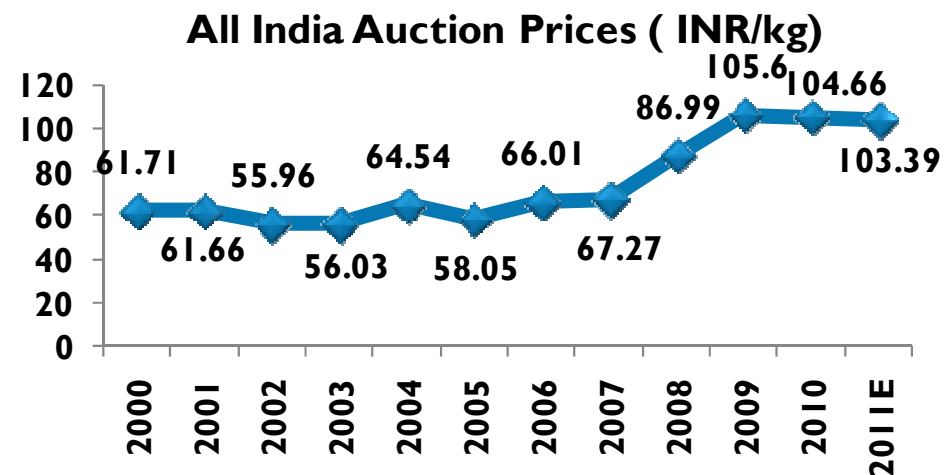
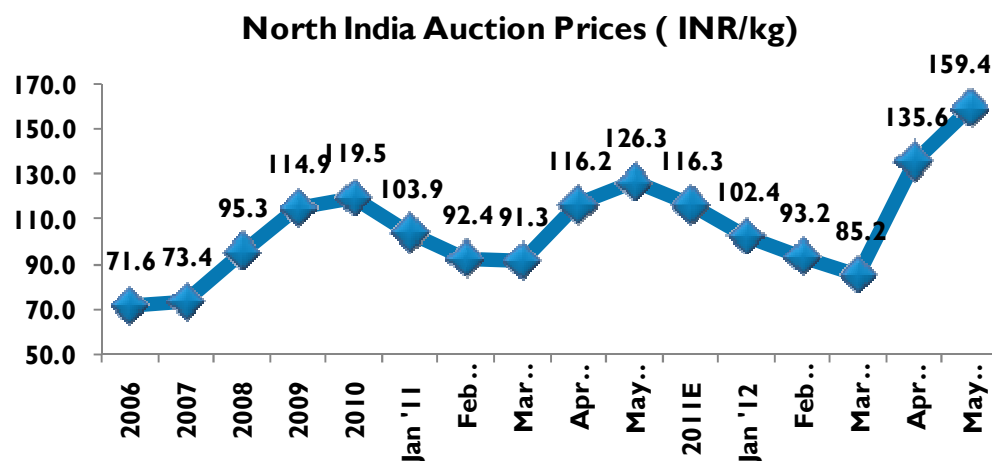
- From 2008 to present the industry inventory levels have fallen from 55-60 days of consumption to near about 40 days of consumption. Overall surplus in the system has been coming down as supply is short of demand. Since 2008 the industry has been having to dip into their surplus to meet demand.
- As per the industry sources, there has been a gradual depletion in carry forward inventory of tea in the country.

Domestic Demand & Supply Dynamics



Source: Tea Board of India

- The current average auction prices for May in North India is ruling at ₹159.4 (₹33/- above 2011 prices). For the period April-May 2012, the average auction price in North India is ₹147.5 which is higher by ₹26.25 vis-à-vis 2011.
- We expect the average prices to currently stabilize at ₹110-112 at all India level (₹128-130 in North India) in FY12. Further rise in tea prices from FY12 levels will be determined by the future cropping patterns in Kenya & India.



Source: Tea Board of India

- Over the last 2 to 3 years, McLeod has followed the inorganic route & doubled the plantation capacity to 87mn kgs currently from 42mn kgs in FY05 domestically and has further consolidated its position globally by adding 20.2 mn kgs.
- Through a series of acquisitions, McLeod acquired high quality plantations in the Assam (North Indian) belt.
- Forayed globally in 2011. recently with purchase of 100% stake in Phu Ben Co. in Vietnam in 2008 having a capacity of 4.5 mn kgs , In Uganda in 2010 acquiring Rhwenzori Tea Investments Ltd. having a capacity of 15 mn kgs and the latest acquisition of 1.7mn kg Gisovu Tea Garden, in Rwanda
- We believe these acquisitions have helped strengthen McLeod's position in the industry. McLeod is favourably placed to take advantage of the industry uptrend.
- McLeod produces superior quality tea from its north India plantations which commands higher prices over the average tea auction prices.

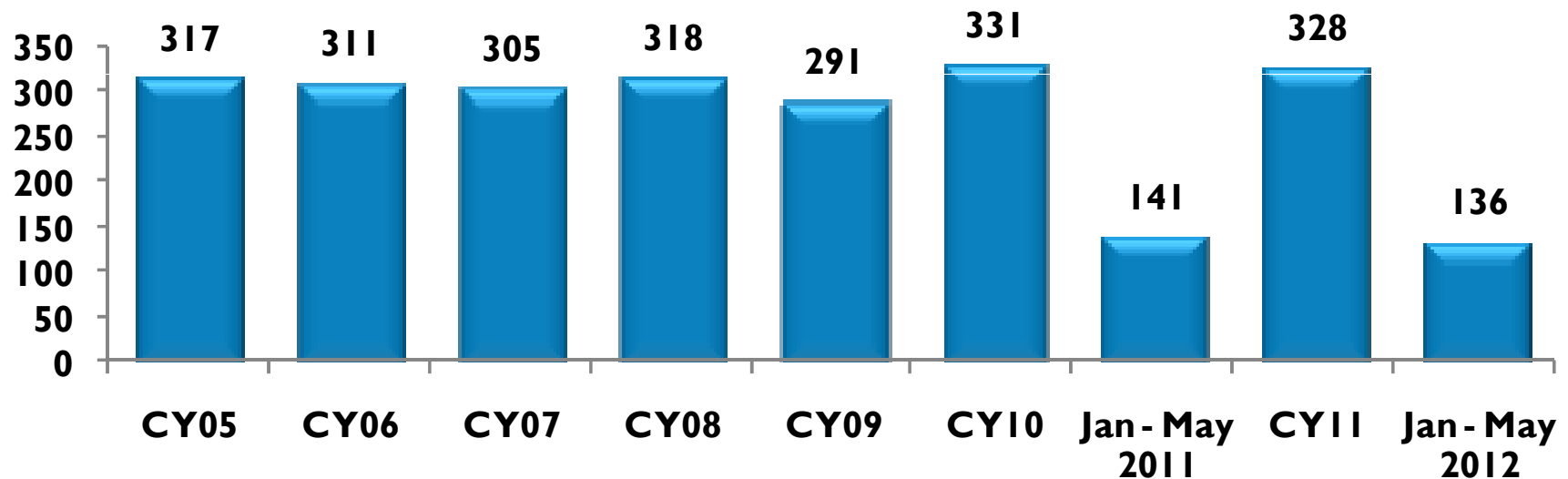
	Prodn (mn Kgs.)	Cost (₹ crs)	Valuation / kg	Plus points
Williamson Tea	20.0	168.0	120.0	Gives scale to Mcleod, ease of integration, leveraging management staff
Doom Dooma Tea	6.5	69.0	106.2	Opportunity to get improved realization by leveraging on quality expertise
Moran Tea Co.	4.0	47.8	165.1	
Phu Ben, Vietnam	4.5	33.6	74.7	Diversifies geographical risk, opportunity for production scale-up as well as quality improvement
Rwenzori Tea Investments Ltd., Uganda	15	150	100	
Gisovu Tea Garden, Rwanda	1.7			

Countries	Types of Tea	Target Geographies	Share in Global Trade	Avg. yield (kg/ha)	(4Yr CAGR) Production Growth Rate
India	89% CTC, 10% Orthodox & 1% Others	CIS, Iraq, UAE & UK	11.2%	1,713	0.05%
China	71% Green Tea, & 29% Orthodox	USA, CIS and Japan	18.7%	775	8.0%
Kenya	99% CTC, 0.5% Packaged Tea	Pakistan, UK, Egypt, Afghanistan & Sudan	24.5%	2,470	0.6%
Sri Lanka	94-96% Orthodox, & Balance CTC	CIS, UAE, Syria, Iran and Turkey	17.5%	1,633	1.9%

- Four nations namely, China, India, Kenya and Sri Lanka dominate the global tea Industry. They contribute approximately 73- 75% of the total tea production.
- China is mainly a green tea grower while Kenya & India are CTC growers and Sri Lanka is orthodox tea grower. India is a major producer of CTC tea, the orthodox variety accounting for a meager 10% of the total production.
- CTC accounts for a major proportion (67-70%) of the total global demand. Globally demand for tea has been growing at a healthy CAGR of 3-3.5% (black tea + green tea) since last 4 years.
- Consumption trends show that approximately 55-57% of the tea is consumed by the producer nations while the rest is imported by other consuming nations.

- **SRI LANKA** - Tea production of 290 mn. kgs in CY09, was 9% below its CY08 production levels of 318.4 mn. kgs. Production returned to above its 4 yr average (312 mn kgs) to 331 mn kgs in CY10. With stagnant production in CY11 at 328 mn kgs; CY12 proves to be a crucial year for the Sri Lankan tea industry. Preliminary data shows a shortfall of 5 mn kgs for the time period of Jan to May 2012. Prices are expected to trend upwards as production plays catch up with demand.

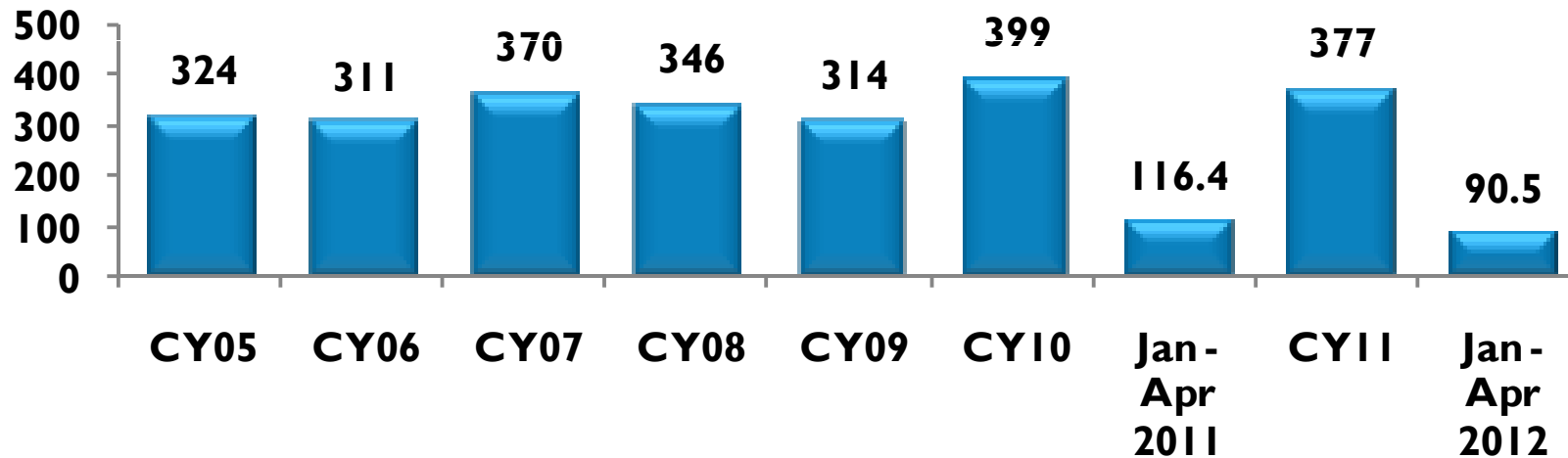
Sri Lanka Tea Production in mn kgs.



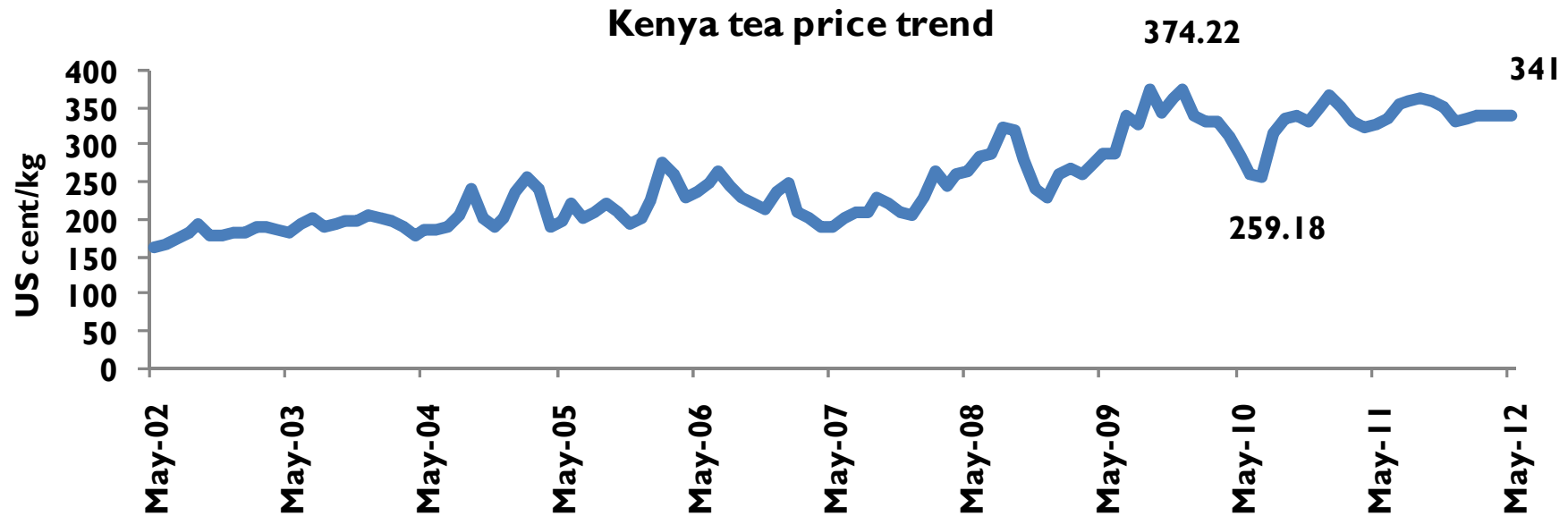
Source: Sri Lanka Tea Board

- **KENYA** - Due to poor weather conditions Kenyan tea production took a hit in CY09 with production at 314 mn kgs vs. 346 kgs in CY08. Production gained pace in CY10 with record production of 399 mn kgs. This was followed by another year of fall in production to 377 mn kgs. in CY11 though the production was higher than the normal average for the country. Irrespective of that prices remained high as the carry forward stock remained low. Production in CY12 seems to have had a bleak start with production lower by 26 mn kgs at 90.5 mn kgs. for the period of Jan – Apr 2012.

Kenya Tea Production in mn kgs.



Source: Kenya Tea Board



Source: Index Mundi

The auction prices are a proof of strong upturn in demand even though the industry witnessed a bumper crop. We believe any small supply disruption will lead to higher prices. Out of India plantation's now contributes 15% to Mcleod's total production.

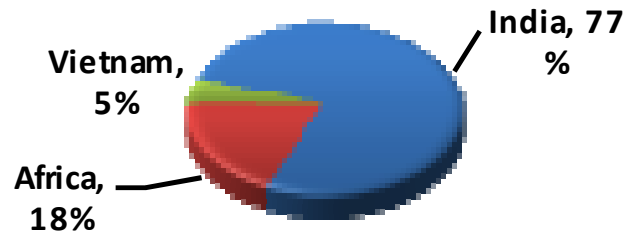
As per industry reports black tea production has recorded a shortfall in production of ~ 50 mn. kgs till year to date (2012).

- India, world's largest black tea producer has started the year with lower production and is expected to be stagnant with a downward bias on account of weather conditions. South India production is also lower by 9% at 44.7 mn kgs vs. 48 mn kgs till Mar 2012. North Indian production for the industry is estimated at 37.5 Million kgs upto Mar as compared to 40.7 Million kgs last year. We expect domestic prices to stay firm in the wake of a third year of stagnant 975-985 mn kgs of production in 2012 and rising consumption.
- Kenya production is also lower due to adverse weather conditions.
- Sri Lanka also has gone into CY12 with lower than expected production.
- With carry forward inventory reducing on the back of higher demand and stagnant supply, we expect prices to stay firm and increase further. The tea industry is on the verge of the long term structural upward trend & Mcleod is the player with significant scale in the industry.

- Seasonal fluctuations: The production is dependent on the climatic conditions & hence susceptible to vagaries of weather. Any unexpected further shortfall in production will neutralise the impact of rising prices on the bottomline front.
- Labour cost is a major component for the integrated tea players and is governed by the Plantation Act & includes high social costs. In other tea producing nations labour cost is productivity driven. This drawback in the domestic tea industry cost structure makes Indian tea unremunerative vis-a-vis Kenyan tea in the export markets. If the company is forced to make unreasonable increases in the labour spend, the benefits of the increased prices & cash flows can be blunted.
- With fall in production, labour cost remains firm. This can impact the cost & hence trickle down profitability.

- With structural shift towards rising demand and supply gap year over year due to steadily rising global consumption, the tea prices are set to rise over long term.
- With all 3 main country producers of CTC reporting lower production going into CY12 there will be continued pressure on carry forward stocks and hence exert upward pressure on auction prices.
- We expect group consolidated production of 104.5 mn kgs (incl Vietnam, Uganda and Rwanda assets of McLeod) for FY13. Domestic & export realizations which had softened due to the normal production in all 3 producing countries in 2011 has again started to harden due the adverse weather conditions in North India.

Mix for Consolidated Group Production



- We expect operating margins to remain high in FY13 at about ~30% on the back of the crop shortfall. This is already evident from the 26% increase in prices of North India tea and rising prices.
- **At the CMP ₹295.5/- the stock trades at 9.4x our revised 1-year forward FY13E EPS estimate of ₹31.4. We recommend investors can “Accumulate” the stock at current market price.**

Profit & Loss (Cons.)

(₹Cr.)

	FY11A	FY12A	FY13E
Net sales	1237.86	1411.99	1563.8
Other Operating Income	31.3	33.33	38.4
Expenditure	908.82	1055.94	1085.8
OP	360.34	389.38	480.67
OPM	28.4%	26.9%	30%
Other Income	32.34	41.07	25
Interest	41.7	56.74	52
Depreciation	38.17	36.97	35
PBT	312.81	336.74	418.67
Exceptional	-	8.68	-
Tax	63.61	33.81	75.36
PAT	246.47	294.25	343.3
PATM	19.4%	20.4%	21.4%
EPS	22.52	26.3	31.4

Balance Sheet (Cons.)

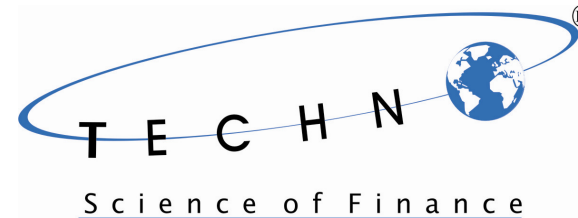
	(₹ Cr.)		
Balance Sheet	FY11A	FY12A	FY13E
Share Capital	54.7	54.7	54.7
Reserves & Surplus	1461.75	1691.92	2006.4
Net Worth	1516.45	1746.65	2061.1
Minority Interest		11.74	14.0
Total Debt	284.36	242.77	192.8
Current Liabilities & Prov.	428.17	460.05	484.0
Sources of fund	2229.01	2461.21	2751.9
Fixed Assets	1746.48	1859.95	2004.0
CWIP	20.32	35.39	33.0
Other Non Current Assets	180.13	199.47	215.0
Current Assets	251.06	332.99	445.0
Cash & Bank	31.02	33.41	54.9
Uses of Funds	2229.01	2461.21	2751.9

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