stock idea

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April 24, 2012

Mcleod Russel India

Ugly Duckling

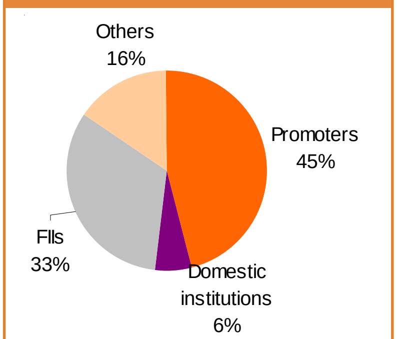
Take a sip when it is hot

Buy; CMP: Rs267

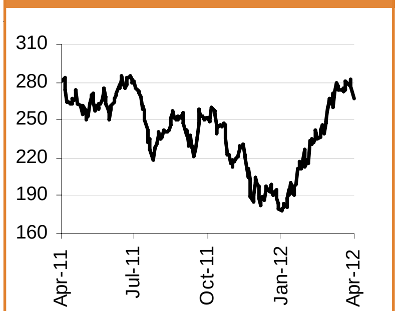
Company details

Price target:	Rs339
Market cap:	Rs2,922.6 cr
52-week high/low:	Rs290/166
NSE volume: (no. of shares)	417,898
BSE code:	532654
NSE code:	MCLEODRUSSEQ
Sharekhan code:	MCLEODRUSS
Free float: (no. of shares)	5.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.0	50.7	6.2	-1.0
Relative to Sensex	1.6	47.5	4.0	11.9

Key points

- **Favourable global demand-supply scenario:** Another year of a production shortfall in the key tea exporting countries (including Kenya) has widened the demand-supply gap in the global tea markets in CY2011. In India too the demand exceeded the supply with the black tea production increasing by 2.3% YoY to 988.3 million kg in CY2011 against a 3% growth in tea consumption. This resulted in a deficit of 55 million kg in the Indian market in CY2011. The scenario is favourable for the tea producers as their realisation would continue to improve due to the demand-supply mismatch globally. We expect a growth of Rs10-15 per kg in the realisation in the next two years.
- **Mcleod Russel—the largest black tea producer:** Mcleod Russel India (MCR) is the world's largest tea producer with an annual tea production of close to 100 million kg. This is close to 5% of the global black tea production of around 1,945 million kg. The company has 62 tea estates covering a total area of 38,758 hectares (1.1% of the world's total area under tea cultivation). With a domestic production capacity of close to 92 million kg MCR is well poised to capitalise on the growing demand for Indian black tea in the global markets.
- **Higher realisations to boost margins:** Tea manufacturing companies have a higher operating leverage, as any significant improvement in their realisation results in a strong improvement in their profitability. MCR's consolidated OPM improved from 10.3% in FY2008 to 26.8% in FY2011. What's more, we expect its blended realisation to go up by Rs11-12 per kg annually over the next two years which will keep the margins firm and leave scope for another 120-130-basis-point improvement going ahead.
- **Cash inflows to remain robust:** Keeping in view its robust performance in the last couple of years, MCR has reduced its debt-equity ratio to 0.1x. With expectations of strong cumulative operating cash inflows of around Rs730 crore over the next two years, MCR is expected to improve the dividend pay-out and/or build a cash war chest for potential inorganic initiatives in future.
- **Outlook and valuation:** MCR, which has tea estates in India and Africa, is well poised to take advantage of the current favourable global demand-supply scenario. With the expectations of a substantial improvement in its sales realisation and a volume growth in mid to high single digits (in the domestic market and the international subsidiaries), MCR's consolidated top line and earnings are expected to grow at CAGR of 16% and 21% respectively over FY2011-14. Even after excluding the upside from the treasury shares (25% of the outstanding shares), the stock's valuations are attractive as it is trading at 8.5x its FY2013E EPS of Rs31.4 and 7.1x its FY2014E EPS of Rs37.7. We initiate coverage on the stock with a Buy recommendation and a price target of Rs339.

Valuations	FY2010	FY2011	FY2012E	FY2013E	FY2014E
Net sales (Rs cr)	1,106.2	1,241.2	1,454.6	1,681.4	1,932.8
Operating profit (Rs cr)	332.2	332.7	393.7	465.8	542.8
PAT (Rs cr)	224.7	231.9	281.0	344.2	412.1
EPS (Rs)	20.5	21.2	25.7	31.4	37.7
OPM (%)	30.0	26.8	27.1	27.7	28.1
PE (x)	13.0	12.6	10.4	8.5	7.1
EV/EBIDTA (x)	9.9	9.6	8.0	6.5	5.4
RoE (%)	17.8	16.3	17.6	18.9	19.7
RoCE (%)	18.8	17.5	19.8	21.9	23.4

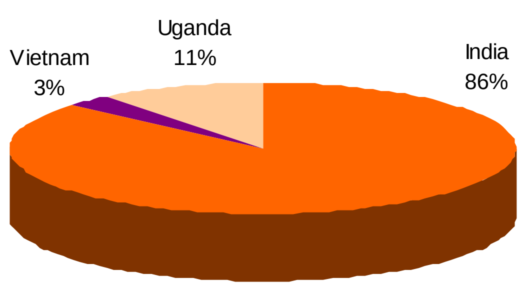
Company background

MCR, the flagship tea company of the BM Khaitan group, has been in the business of tea plantation in India since 1869. It is the world's largest tea plantation company with annual tea production of close to 100 million kg having an area of 38,758 hectares under tea cultivation globally. The company is enhancing its presence in the world's largest tea exporting continent, Africa, through the inorganic route. MCR has a blending capacity of 40 tonne per day at Nilpur in India (it blends both orthodox and crush, tear, curl [CTC] varieties of tea). The sustained buoyancy in the tea prices aided the company to achieve a compounded annual growth rate (CAGR) of 23.5% in the top line and that of 140% in the bottom line over FY2008-11.

Tea estates under MCR group

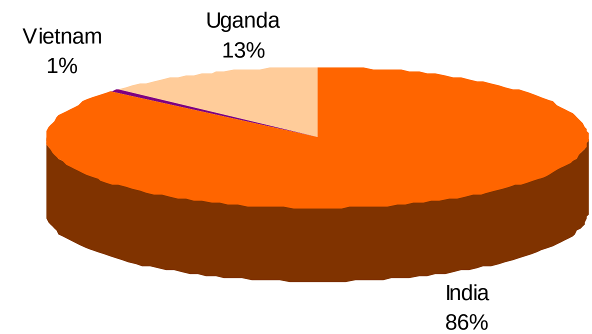
Region	No. of estates	Est. crop 2011 (ton)	Area under tea (ha)
22 North Bank estates	22	37,595	13,737
25 South Bank estates	25	38,295	16,667
47 MCR Assam estates	**47**	**75,890**	**30,404**
5 MCR Dooars estates	5	6,325	3,374
52 MCR (stand-alone) estates	**52**	**158,105**	**33,778**
4 Phuben estates	4	5,300	1,675
5 Uganda estates	5	17,325	2,956
1 Rwanda estates	1	2,313	350
62 MCR (consolidated) estates	**62**	**24,938**	**38,759**

Geography-wise revenue break-up



Source: Company

Geography-wise PBIT break-up



Source: Company

Industry snapshot

Global tea production was down by around 1.5% in CY2011. In the same year India's tea production was up by just 2.2% year on year (YoY) to 988.3 million kg while domestic consumption of tea grew by 3.0% and tea exports remain almost flat. This led to a supply shortfall of 50-55 million kg at the start of CY2012. The current year started with a flattish production trend in the key black tea producing countries. Kenya's tea production in January 2012 stood flat at around 36 million kg. Severe frost affected tea production in the key growing areas in Kenya. On the other hand, Sri Lanka witnessed just a 5% increase in tea production over the period of January-February 2012. With a deficit of around 55 million kg and flattish trend of production in the key black tea producing countries, we expect the tea prices in India to remain high in the coming months (the domestic tea industry expects the prices to be higher by Rs10-15kg in this year). This is positive for the black tea producing companies in India (including MCR). With the growth in the realisation likely to be higher than the growth in the cost, we could see a substantial improvement in the profitability of the black tea producing companies in India.

(For a detailed overview of the global tea industry refer annexure.)

India's demand-supply scenario (in million kg)

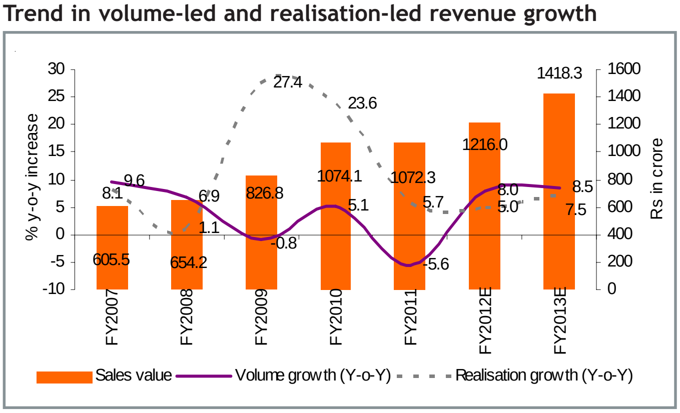
Particulars	CY2004	CY2005	CY2006	CY2007	CY2008	CY2009	CY2010	CY2011P
Tea production	893.0	946.0	981.8	986.4	980.8	979.0	966.4	988.3
Tea exports	197.7	199.1	218.7	178.8	203.1	197.9	193.3	186.7
Tea consumption	735.0	757.0	771.0	786.0	802.0	822.1	838.5	855.3
Supply shortfall	**-39.7**	**-10.1**	**-7.9**	**21.7**	**-24.3**	**-41.0**	**-65.4**	**-53.6**

Source: Sharekhan Research

Investment arguments

- **Top line growth to sustain at mid teens:** With the domestic consumption of tea likely to grow by 3.0-3.5%, the volume of MCR's domestic business is expected to grow at a CAGR of about 6% over FY2011-14. On the other hand, with the production expected to be muted in the key tea exporting countries like Kenya and Sri Lanka, we expect the Indian tea to gain favour amongst the key tea importing nations. Hence we expect MCR's export volumes to grow by 15-16% in the coming years. The global demand-supply mismatch is likely to keep the tea prices buoyant in the domestic as well as the international markets. Hence, we expect the average realisation of MCR to be Rs11-12 per kg higher in FY2013 and FY2014. Further, the recently acquired tea estates in Vietnam, Rwanda and Uganda will boost the top line in the coming years. Overall, we expect MCR's consolidated top line to grow at a CAGR of 16% over FY2011-14.

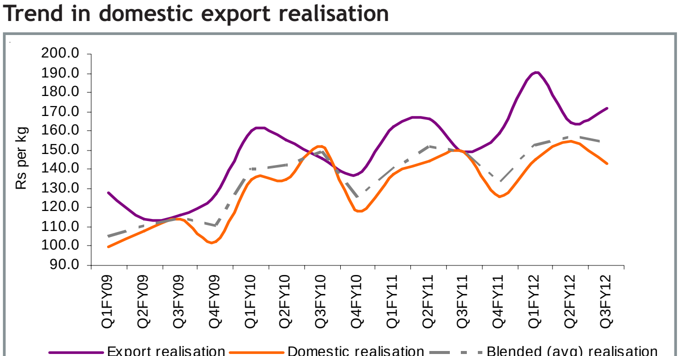
Trend in volume-led and realisation-led revenue growth



Source: Sharekhan Research

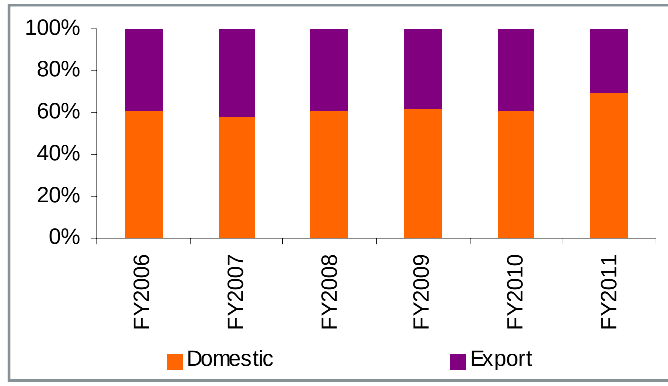
- **Higher exports to improve the average realisation:** The export realisation for Indian tea producers improved in the recent past on the back of the acceptance of quality tea by the key tea importing countries. MCR's export realisation currently stands at around Rs170 per kg (improved from Rs120 per kg in FY2008). The exports currently contribute close to 35% of MCR's total turnover. A higher contribution from the exports would improve the average sales realisation of the company in the coming years.

Trend in domestic export realisation



Source: Sharekhan Research

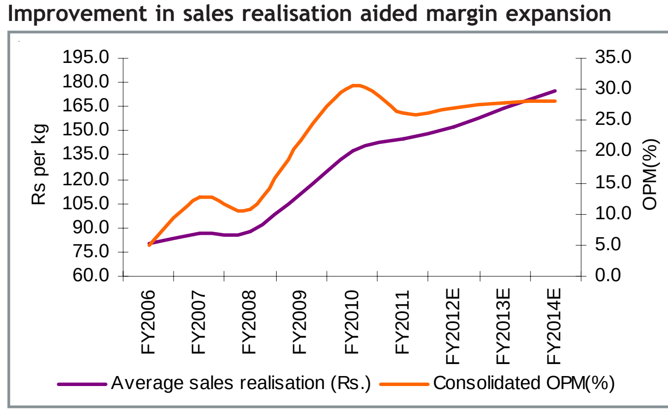
Trend in exports' contribution to revenues of MCR



Source: Sharekhan Research

- **Higher realisation would lead to margin improvement:** Tea manufacturing companies have a higher operating leverage, as a significant improvement in their realisation results in a strong improvement in their profitability. MCR's consolidated operating profit margin (OPM) improved from 10.3% in FY2008 to 26.8% in FY2011. The sales realisation grew at a CAGR of ~19% over FY2008-11 while the operating cost grew at a CAGR of 16% over the same period. Hence, the operating profit grew at a CAGR of 70% over FY2008-11. With the realisation expected to improve in the coming years, we expect the OPM to expand to 28% by FY2014. Thus we expect the operating profit of the company to grow at CAGR of ~18% over FY2011-14.

Improvement in sales realisation aided margin expansion



Source: Sharekhan Research

- **Cash flows to remain strong:** The increase in the sales realisation has resulted in a strong improvement in the operating cash flows of the company. This has helped MCR to strengthen its balance sheet in the last three fiscals. The debt on its consolidated books reduced from Rs457.0 crore in FY2008 to Rs316.3 crore in FY2011. The reduction in the debt lowered the interest cost of the company over the same period. The strong improvement in the operating performance and the reduction in the interest cost caused the profit after tax (PAT) to increase by six times in FY2011 in comparison to the PAT of Rs47.0 crore reported for

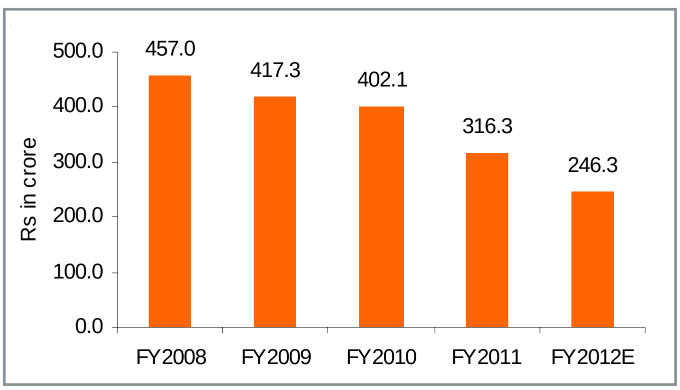
Improvement in free cash flow Rs (cr)

Particulars	FY2009	FY2010	FY2011	FY2012E	FY2013E	FY2014E
Net income	70.9	224.7	231.9	281.0	344.2	412.1
Add: Depreciation	32.7	32.3	38.2	38.9	40.4	42.0
Less: Capex	64.7	153.3	24.9	75.0	115.0	50.0
Less: Changes in working cap	-43.2	26.8	97.4	73.4	37.5	67.6
Free cash flow (FCF)	**82.2**	**76.8**	**147.8**	**171.5**	**232.1**	**336.6**

Source: Sharekhan Research

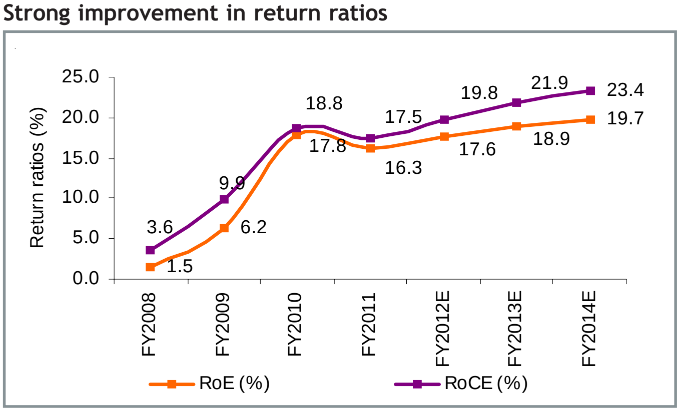
FY2008. The return ratios of MCR have improved significantly with the return on equity (RoE) and the return on capital employed (RoCE) improving from 1.5% and 3.6% in FY2008 to 16.3% and 17.5% in FY2011 respectively. With expectations of a strong improvement in the operating cash flows over the next two years, MCR is expected to improve the dividend pay-out and/or build a cash war chest for potential inorganic initiatives in future. We could also see the debt portion reducing substantially from the current level over the next two to three years.

Reduction in consolidated debt



Source: Sharekhan Research

Strong improvement in return ratios



Source: Sharekhan Research

- **To gain from acquisitions in Africa in the long run:** Africa is one of the largest exporters of tea globally. MCR has acquired six tea estates in Africa in the past two to three years. Mcleod Russel Uganda (MRU; a 100% subsidiary of MCR) has five tea estates in Uganda which together manufacture around 16 million kg of tea per annum. MRU enjoys an OPM in the range of 36-38%. On the other hand, Gisovu Tea Company in Rwanda has one tea estate and produces close to 2.0 million kg of tea per annum. It has an OPM of close to 60%. The company has bid for new tea gardens in Rwanda which will enhance its yield to about 7 million kg per annum. Since these African subsidiaries are clocking much better margins in comparison to MCR's consolidated OPM of about 27.0%, the increase in the scale of production from these subsidiaries would help MCR to achieve an OPM of above 30% over the next three to five years.

Key concerns

- **Tea is a labour intensive industry:** The tea industry in India is labour intensive and is exposed to stringent labour laws. The employee cost accounts for around 50% of the operating cost for the domestic tea producing companies. Any disruption in the labour supply or any labour unrest in the peak season would be a key risk for the industry. Also a substantial hike in the labour cost might affect the profitability of the tea industry. It is necessary for companies like MCR to be on good terms with the labourers to keep tea production steady.

- **A significant improvement in the key tea exporting nations:** Any significant improvement in the production of tea in the key tea producing countries like Kenya and Sri Lanka will improve the supply of tea in the global markets. This will not only affect the demand for Indian tea in the global markets but also adversely affect the export realisation of the domestic companies.

Outlook and valuation

MCR, which has tea estates in India and Africa, is well poised to take advantage of the current favourable global demand-supply scenario. With the expectations of a substantial improvement in its sales realisation and a volume growth in mid to high single digits (in the domestic market and the international subsidiaries), MCR's consolidated top line and earnings are expected to grow at CAGR of 16% and 21% respectively over FY2011-14. Even after excluding the upside from the treasury shares (25% of the outstanding shares), the stock's valuations are attractive as it is trading at 8.5x its FY2013E EPS of Rs31.4 and 7.1x its FY2014E EPS of Rs37.7. We initiate coverage on the stock with a Buy recommendation and a price target of Rs339.

Financials

Profit & Loss Account

Rs (cr)

Particulars	FY10	FY11	FY12E	FY13E	FY14E
Net sales	**1106.2**	**1241.2**	**1454.6**	**1681.4**	**1932.8**
Raw material cost	91.3	103.7	113.5	131.1	151.1
Employee cost	365.8	425.2	509.1	588.5	676.5
Power & fuel	95.2	112.3	131.6	151.4	174.1
Other operating expenses	221.8	267.3	306.7	344.6	388.4
Total expenditure	**774.1**	**908.5**	**1060.9**	**1215.6**	**1390.0**
Operating profit	**332.2**	**332.7**	**393.7**	**465.8**	**542.8**
Other income	29.6	32.9	36.3	41.0	46.6
Interest expense	29.6	29.1	28.8	22.7	16.1
Depreciation	32.3	38.2	38.9	40.4	42.0
PBT	**299.9**	**298.3**	**362.3**	**443.7**	**531.3**
Tax	71.4	63.6	77.9	95.4	114.2
Adjusted PAT	**228.5**	**234.7**	**284.4**	**348.3**	**417.0**
Minority interest / Share of profit from assoc.	-2.8	-2.7	-3.3	-4.1	-4.9
Adjusted PAT	**225.7**	**231.9**	**281.0**	**344.2**	**412.1**
Extraordinary gain / (loss)	5.2	14.5	0.0	0.0	0.0
Reported PAT	**230.9**	**246.5**	**281.0**	**344.2**	**412.1**

Balance Sheet

Rs (cr)

Particulars	FY10	FY11	FY12E	FY13E	FY14E
Equity capital	54.7	54.7	54.7	54.7	54.7
Res. & surplus	1315.4	1461.8	1662.7	1907.7	2207.8
Net worth	**1370.1**	**1516.5**	**1717.5**	**1962.4**	**2262.5**
Def. tax liabilities	71.6	72.3	72.3	72.3	72.3
Total loans	402.1	316.3	246.3	196.3	121.3
Capital employed	**1843.8**	**1905.0**	**2036.0**	**2231.0**	**2456.0**
Net block	1763.5	1746.5	1777.9	1852.5	1885.5
Capital WIP	16.6	20.3	25.0	25.0	0.0
Investments	35.0	33.6	50.0	100.0	200.0
Current assets	**361.4**	**423.9**	**512.0**	**644.0**	**820.9**
Inventories	80.0	96.8	113.4	131.1	150.7
Sundry debtors	27.3	22.4	26.3	30.4	42.4
Cash and bank balance	52.6	31.2	36.2	69.1	118.6
Loans and advances	137.0	215.7	269.6	337.0	421.2
Other current assets	64.5	57.8	66.5	76.5	87.9
CL & provisions	**332.7**	**319.3**	**328.9**	**390.5**	**450.3**
Sundry creditors	140.6	142.8	166.8	191.1	218.5
Other current liabilities	2.9	3.6	4.2	4.8	5.5
Provisions	189.2	172.8	157.9	194.6	226.3
Net current assets	**28.7**	**104.6**	**183.1**	**253.5**	**370.6**
Capital deployed	**1843.8**	**1905.0**	**2036.0**	**2231.0**	**2456.0**

Cash flow snapshot

Rs (cr)

Particulars	FY10	FY11	FY12E	FY13E	FY14E
Operating cash flow before working capital changes	257.0	270.1	319.9	384.6	454.2
Changes in working capital	-26.8	-97.4	-73.4	-37.5	-67.6
Cash flow from operating activities	230.2	172.7	246.5	347.1	386.6
Cash flow from financing activities	-47.8	-170.6	-150.0	-149.2	-187.1
Cash flow from investing activities	-168.5	-23.6	-91.4	-165.0	-150.0
Net change in cash and cash equivalents	**13.8**	**-21.5**	**5.0**	**32.9**	**49.6**
Opening cash balance	38.8	52.6	31.2	36.2	69.1
Closing cash balance	**52.6**	**31.2**	**36.2**	**69.1**	**118.6**

Key ratios

Particulars	FY10	FY11	FY12E	FY13E	FY14E
OPM (%)	30.0	26.8	27.1	27.7	28.1
NPM (%)	20.7	18.9	19.5	20.7	21.6
Adjusted EPS (Rs)	20.5	21.2	25.7	31.4	37.7
P/E (x)	13.0	12.6	10.4	8.5	7.1
Price / Book value (BV)	2.1	1.9	1.7	1.5	1.3
Debt / Equity (x)	0.3	0.2	0.1	0.1	0.1
EV / EBIDTA (x)	9.9	9.6	8.0	6.5	5.4
EV / Sales (x)	3.0	2.6	2.2	1.8	1.5
Market cap / Sales (x)	2.6	2.4	2.0	1.7	1.5
RoE (%)	17.8	16.3	17.6	18.9	19.7
RoCE (%)	18.8	17.5	19.8	21.9	23.4
Dividend pay-out (%)	19.0	22.2	24.3	24.6	23.2

Turnover ratios

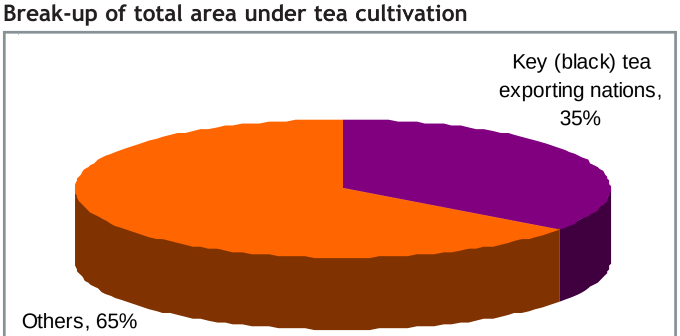
Particulars	FY10	FY11	FY12E	FY13E	FY14E
Debtors (days)	9	7	7	8	8
Creditors (days)	66	57	57	57	57
Inventory (days)	26	28	28	28	28
Cash conversion cycle	**-31**	**-22**	**-22**	**-21**	**-21**

Annexure: An overview of the global tea sector

Area under tea cultivation in the key exporting nations has remained stagnant over the last five years

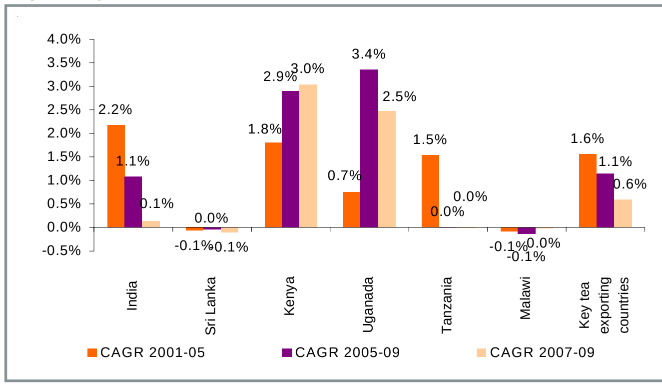
Globally, the area under tea cultivation stood at 35.6 lakh hectares in CY2009, that is a growth of only 4.3% during CY2005-09. The area under tea cultivation in China (the largest producer and exporter of green tea) grew by 8.1% over the same period. Out of the total area under tea cultivation globally, the major black tea exporting nations (including Kenya, Sri Lanka and India) account for around 35% of the total global output. Kenya (the largest producer of CTC tea) has seen an increase of 2.9% in the area under tea cultivation whereas Sri Lanka (the largest producer of orthodox tea) has not seen any increase in the area under tea cultivation over CY2005-09. Though the area under tea cultivation in India has increased by 1.1% over the same period, but the same has remained stagnant in recent times. With suitable land (appropriate soil) not available, India is unlikely to see any significant increase in the area under tea cultivation in the coming years.

Break-up of total area under tea cultivation



Source: Industry report

Trend in growth in area under tea cultivation in the key tea exporting countries

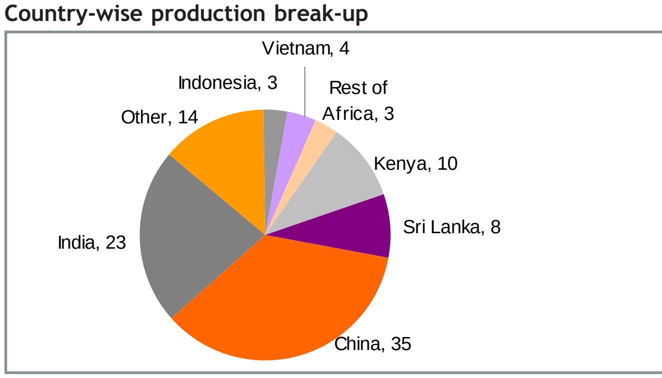


Source: Industry report

Tea production in the key exporting countries remained subdued due to unfavourable weather

More than 4,100 million kg of tea is produced in different parts of the world every year. China and India together produce around 60% of the total world tea production

Country-wise production break-up



Source: Industry report

Area under tea cultivation (in hectares)

Countries	2001	2002	2003	2004	2005	2006	2007	2008	2009
India	509,806	515,832	519,598	521,403	555,611	567,020	578,458	579,337	580,000
Sri Lanka	188,971	187,971	188,199	188,720	188,480	188,554	188,570	188,323	188,175
Kenya	131,581	139,976	131,419	131,418	141,315	147,076	149,196	157,720	158,394
Uganda	20,870	21,170	21,570	21,720	21,500	22,045	23,360	23,800	24,530
Tanzania	21,371	21,316	21,984	22,287	22,715	22,715	22,722	22,722	22,721
Malawi	18,761	18,800	18,694	18,663	18,700	18,766	18,606	18,600	18,600
Vietnam	82,000	85,000	93,000	101,000	111,000	119,000	126,000	131,487	133,000
Indonesia	150,938	150,723	143,620	142,782	138,659	136,281	134,000	132,439	127,411
Key (black) tea exporting countries	**1,124,298**	**1,140,788**	**1,138,084**	**1147,993**	**1,197,980**	**1221,457**	**1,240,912**	**1254,428**	**1252,831**
Zimbabwe	6,800	6,850	6,850	6,800	6,500	62,000	6,000	6,000	5,700
Turkey	76,653	76,600	76,639	77,000	78,000	78,000	79,000	78,000	77,000
Argentina	36,600	36,600	36,870	36,960	36,900	36,900	37,200	38,000	38,900
Bangladesh	49,313	49,500	50,000	51,265	51,000	52,000	52,300	54,106	54,700
Black tea exporting nations	1,293,664	1,310,338	1,308,443	1,320,018	1,370,380	1,450,357	1,415,412	1,430,534	1,429,131
Global area under cultivation	**2,724,694**	**2,734,281**	**2,804,231**	**2,863,340**	**3,004,985**	**3,159,677**	**3,314,464**	**3,431,176**	**3,557,169**

Source: Industry report

Trend in production in the key black tea producing nations (in million kg)

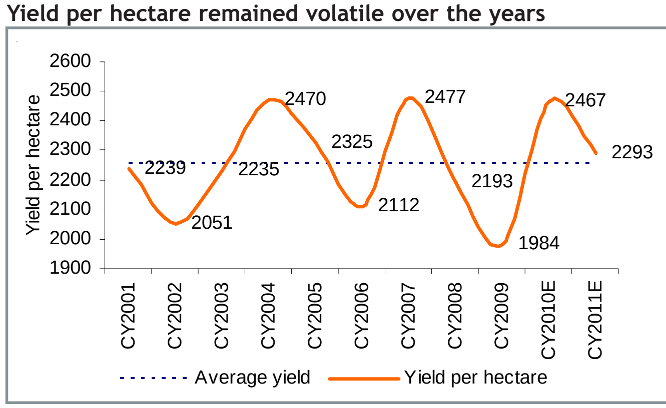
Countries	CY2004	CY2005	CY2006	CY2007	CY2008	CY2009	CY2010	CY2011
India	893.0	946.0	981.8	986.4	980.8	979.0	966.4	988.3
Sri Lanka	308.1	314.8	310.8	304.6	317.7	281.4	331.4	328.3
Kenya	324.6	328.6	310.6	369.6	345.9	314.2	398.5	377.9
Uganda	35.7	37.7	36.7	44.9	42.8	51.0	47.2	40.3
Tanzania	30.7	30.4	31.3	34.9	31.6	32.1	29.3	30.0
Malawi	50.1	38.0	45.0	48.1	41.6	52.6	51.6	47.1
Key tea exporting countries	**1,642.1**	**1,695.4**	**1,716.3**	**1,788.6**	**1,760.4**	**1,710.3**	**1,824.4**	**1811.9**
Zimbabwe	18.7	14.9	15.7	13.5	8.3	12.1	10.5	10.3
Indonesia	164.8	156.3	140.0	149.5	148.3	136.5	129.2	118.5
Bangladesh	55.4	59.6	53.4	58.0	58.8	59.2	59.3	59.2
Tea exporting countries	**1,881.1**	**1,926.2**	**1,925.5**	**2,009.5**	**1,975.8**	**1,918.1**	**2,023.4**	**1999.8**
Y-o-Y change in production		2.4	0.0	4.4	-1.7	-2.9	5.5	-1.2

Source: Industry report

while Africa (including Kenya) contributes around 13% of the total world tea output. Except for CY2010, the global tea production from CY2007 to CY2011 remained subdued due to unfavourable climate, labour unrest, stagnant area under tea cultivation and pest attacks in the key tea producing areas. The tea production in the key tea exporting countries (including Kenya, Sri Lanka and India) declined by 1.1% YoY in CY2011.

- **Kenya:** Stagnant area under tea cultivation and adverse weather conditions have lowered the output of the key tea exporting countries in recent years. Kenya's tea production declined by 1.1% over CY2005-09 (production was down by close to 8% over CY2007-09). Kenya's yield has dropped mainly on account of unfavourable weather conditions in recent years. CY2010 was one of the best years for Kenyan tea industry with the production growing by above 25% on a year-on-year (Y-o-Y) basis. However, the production again saw a dip of 5% in CY2011. Stable weather and political environment would be the key determining factors for tea production in Kenya in the coming years.

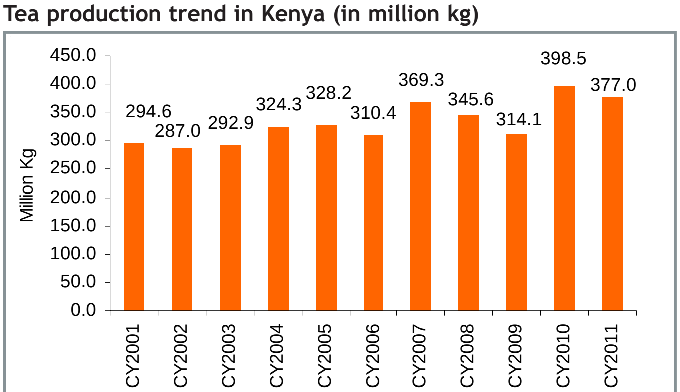
Yield per hectare remained volatile over the years



Source: Industry report

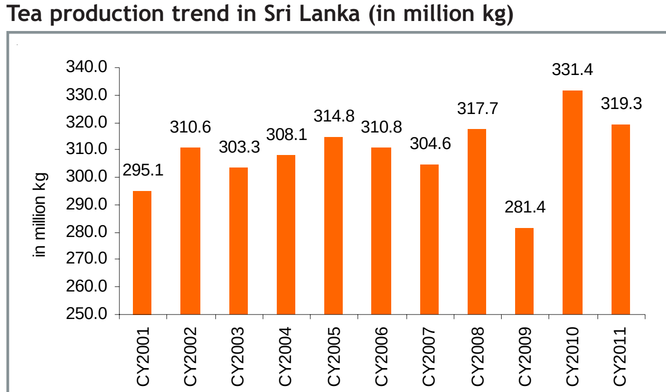
- **Sri Lanka:** Sri Lanka's tea production declined by 2.8% over CY2005-09 (down by around 4.0% over CY2007-09) largely because there was no increase in the area under cultivation and because more than 50% of the tea fields are above 80 years of age (old tea plants yield poor quality tea). The production went up by 18% YoY in CY2010, largely on account of better

Tea production trend in Kenya (in million kg)



Source: Industry report

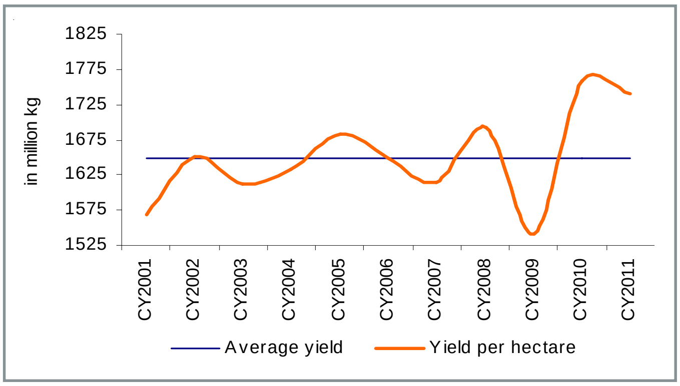
Tea production trend in Sri Lanka (in million kg)



Source: Industry report

application of fertilisers (due to government subsidy). However, CY2011 witnessed a drop of about 4% YoY in tea production. Though the government is supporting re-plantation and is providing incentives for the same, we don't expect any significant improvement as more than 50% of the tea bushes are old and there has been no substantial increase in the area under tea cultivation in Sri Lanka. The gestation period in the tea business is around five years which means the new crop will start yielding fruits after the fifth year of re-plantation.

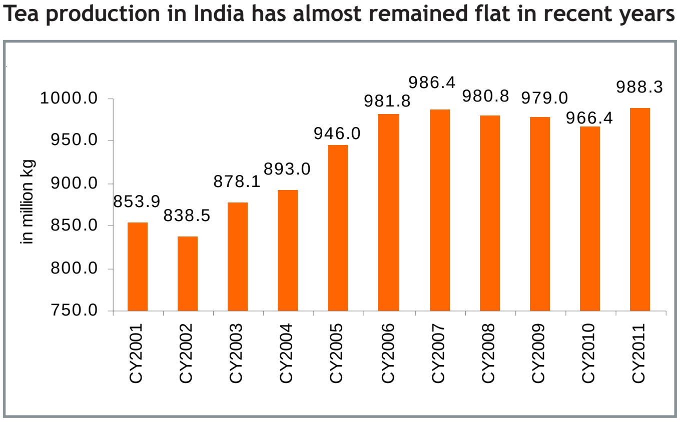
Trend in yield per hectare



Source: Industry report

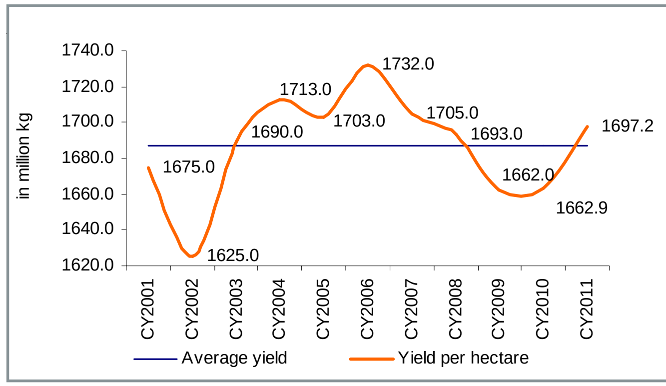
- **India:** With the average area under tea cultivation remaining flat at 5.8 lakh hectares, production of tea in India stood at 988.3 million kg in CY2011 (almost flat over CY2005-10). CTC tea accounts for around 90% of the total domestic tea produce. The area under tea cultivation is unlikely to grow significantly in the coming years. Further, tea re-plantation under the Special Purpose Tea Fund is taking place at a sluggish space due to the high cost of re-plantation. During the first phase of 2007-12 only 25,000 hectares of area under tea was re-planted as against the estimated re-plantation of 68,000 hectares. The tea producers in India do not expect any significant increase in the tea production, which is expected to remain in the range of 975-985 million kg in the coming years. Unfavourable climate or pest attacks could act as a key risk to tea

Tea production in India has almost remained flat in recent years



Source: Industry report

Yield per hectare stands low in comparison with the average yield in recent years



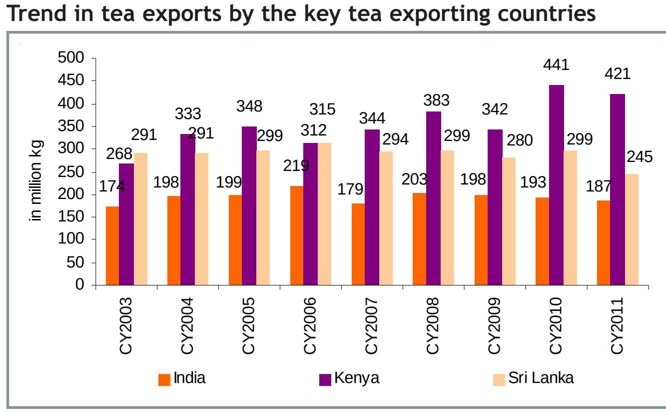
Source: Industry report

production in India. Hence, the tea processing companies are focusing on blending a little of low-quality tea with good quality tea to create a fine mix and improve the production volume in the coming years.

Supply disruption from Kenya and Sri Lanka—a win-win situation for India

Black tea accounts for 83% of the world tea exports. Kenya is the number one black tea exporter in the world, followed by Sri Lanka. Importers favour tea from Kenya and Sri Lanka. However, the supply shortage in the key black tea exporting nations has compelled tea importers to import tea from India. This has created a win-win situation for the Indian tea producers in the last few years as they have witnessed a substantial improvement in their profitability on the back of an improved realisation. Their realisation has improved on account of a higher export realisation and an increase in the domestic consumption (expected to grow by 3.0-3.5% YoY in the coming years).

Trend in tea exports by the key tea exporting countries

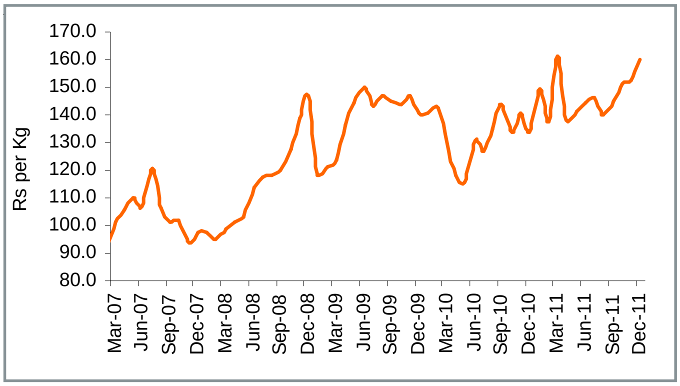


Source: Industry report

Outlook

The global tea production declined by around 1.5% in CY2011 and CY2012 due to a flattish trend in production in the key black tea producing countries. Kenya's tea production in January 2012 stood flat at around 36.0

Trend in export realisation for Indian tea companies



Source: Industry report

million kg. Severe frost has affected tea production in the key tea growing areas in Kenya. On the other hand, Sri Lanka has witnessed just a 5% increase in tea production over January-February 2012. With a deficit of around 55 million kg and flattish trend of production in the key black tea producing countries, we expect the tea prices in India to remain high in the coming months (the domestic tea industry expects the prices to be higher by Rs15-20kg). This is positive for the black tea producing companies in India (including MCR). With the growth in the realisation likely to be higher than the growth in the cost, we could see a substantial improvement in the profitability of the black tea producing companies in India.

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