McLeod Russel India Ltd.

EQUITY REPORT

Indbank Merchant Banking Services Ltd (A Subsidiary of Indian Bank)

November 22, 2013

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McLoed Russel India Ltd (MRIL) was incorporated as Eveready Company India Private Limited on 5th May 1998. The company is engaged in the cultivation, processing and marketing of tea for more than 140 years. Headquartered in Kolkata, the company owns 38,758 hectares of land under global tea cultivation. The company has presence in four countries, namely, India, Vietnam, Uganda and Rwanda and is the largest private sector tea plantation company in the world accounting for 8% of India's output and 2% of all black tea grown in the world. Apart from the tea, MRIL has been closely working with local towns and villages throughout North East India with the cultivation of Jatropha (Jatropha curcas) under Agricultural project, which is used to make D1 Oil - Bio Diesel.

Investor's Rationale

- For the quarter ended September 2013, the company registered a 6.5% YoY increase in net profit to ₹2.5 bn as against ₹2.3 bn primarily due to higher revenues during the quarter. Revenues during the quarter grew 11% YoY to ₹4.9 bn. After witnessing a decent performance in the quarter, the management of the company seems quite optimistic for the rest of the year. Even in overseas operations, there has been a good increase in production, prices remained stable and cost was manageable.

- The company expects a volume growth of 13-14% in FY'14 on account of expectations for favourable weather for the rest of the year. Further, the company expects quality tea prices to be higher by ₹5-10 a kg, this year. So, the profitability for the current year looks better. We expect the company's net profit to grow at a CAGR of ~18% in FY'13-FY'15E.

- In order to expand its presence in the overseas market, MRIL has acquired a tea processing plant in Vietnam for USD 2.75 mn with annual production capacity of 1.2 mn kg. Further, the company plans to achieve a total of 140-150 mn kg of consolidated production in the next 3-4 years, out of which 40-45 mn kg of production is to be derived from the overseas market. The acquisition was in line with its steps towards achieving its decided target.

- With an expected 5% pick up in domestic tea production and rise in exports in CY'13, we expect the company to be well placed to achieve good growth in the coming quarter and in FY'14 as a whole. It was reported that domestic tea production has risen by 6.2% YoY to 705 mn kg during January to August 2013 and is further expected to increase. Depreciation in Indian currency resulted in good gains from exports; the results may be reflected in the balance sheet in the peak seasons of second and third quarter of this fiscal. The world's largest tea producer is targeting to increase its exports to 27 mn kg in the year ending 2013, as against the exports of 25 mn kg last fiscal.

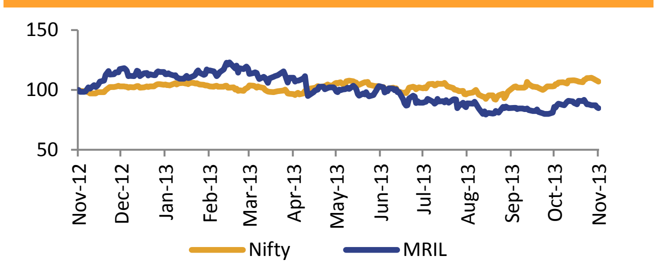
Market Data

Rating	**BUY**
CMP (₹)	277.3
Target (₹)	**320**
Potential Upside	~15.4%
Duration	Long Term
Face Value (₹)	5.0
52 week H/L (₹)	287.0/240.4
Adj. all time High (₹)	386.5
Decline from 52WH (%)	28.3
Rise from 52WL (%)	15.4
Beta	0.4
Mkt. Cap (₹bn)	30.4
Enterprise Value (₹bn)	31.7

Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
Revenue (₹bn)	14.5	16.7	19.0	21.1
EBITDA (₹bn)	3.9	3.8	4.6	5.0
Net Profit (₹bn)	2.9	2.7	3.5	3.8
Adj EPS (₹)	26.3	25.0	31.6	34.3
P/E (x)	10.5	11.1	8.8	8.1
P/BV (x)	1.7	1.6	1.4	1.2
EV/EBITDA (x)	8.2	8.3	6.7	6.0
ROCE (%)	15.4	14.0	15.8	15.6
ROE (%)	16.5	14.0	15.8	15.3

One year Price Chart



Shareholding Pattern	Sep'13	Jun'13	Diff.
Promoters	45.7	45.7	-
FII	35.6	36.0	(0.4)
DII	3.9	3.2	0.7
Others	14.8	15.1	(0.3)

McLeod Russel India Ltd – the largest private sector tea plantation company in the world.

Mcleod Russel India Ltd is engaged in the cultivation, processing and marketing of tea.

With global presence in four countries, namely, India, Vietnam, Uganda and Rwanda, MRIL owns 63 tea estates, 62 factories and 87,000 employees.

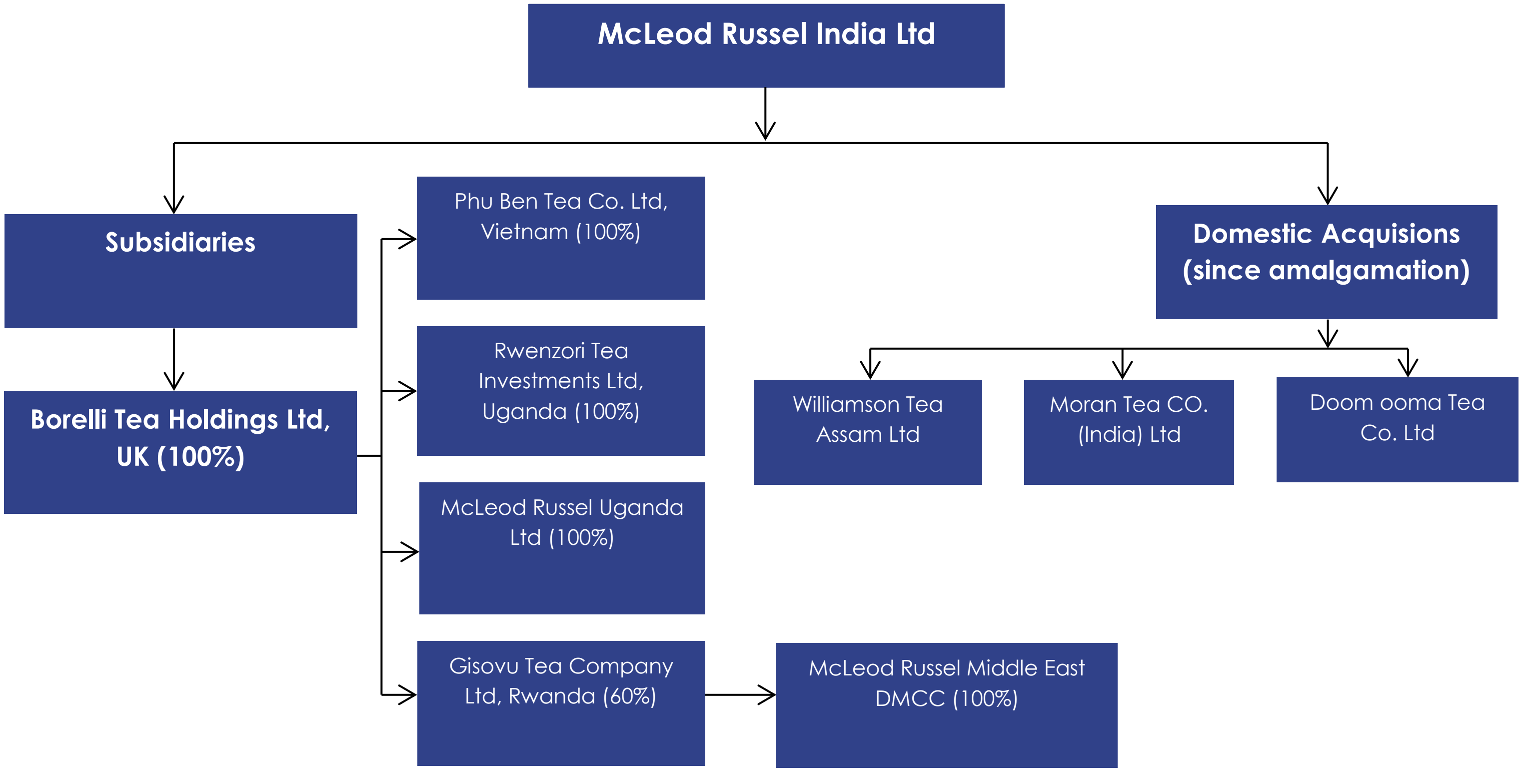
We believe that the company is well positioned to consolidate its position by acquiring quality land globally to drive growth.

McLoed Russel India Ltd (MRIL), the world's largest tea plantation company, is a part of Williamson Magor Group engaged in the business of tea production for over 140 years. In order to enhance its focus on tea plantation business, one of the group’s subsidiaries, Eveready Industries India Limited, demerged to become MRIL. The company is engaged in the cultivation, processing and marketing of tea. MRIL primarily produces crushed, torn and curled (CTC) tea, accounting for 90% of the production, the rest being the Assam orthodox variety. The company produces over 70 mn kilos of high quality tea from 53 tea estates in Assam and West Bengal. The company’s tea is marketed under the registered Elephant Trademark. With headquarter in Kolkata, the company owns 38,758 hectares of land under global tea cultivation.

With global presence in four countries, namely, India, Vietnam, Uganda and Rwanda, MRIL owns 63 tea estates, 62 factories and 87,000 employees. This combination makes the company the largest private sector tea plantation company in the world accounting for 8% of India’s output and 2% of all black tea grown in the world. As India’s largest tea exporter, the company maintains strong connections with buyers in the United Kingdom and Europe. During FY’13, the company along with its subsidiaries has produced 102 mn kgs of tea, making it one of the largest global black tea exporters. All in all, the company and its subsidiaries export tea to 23 countries covering all continents.

Apart from the tea, MRIL has over the past five years been closely working with local towns and villages throughout North East India with the cultivation of Jatropha (Jatropha curcas) under Agricultural project, which is used to make D1 Oil - Bio Diesel. We believe that the company is well positioned to consolidate its position by acquiring quality land globally to drive growth.

Organisation Structure



The company registered an increase in net profit by 6.5% YoY to ₹2.5 bn as against ₹2.3 bn primarily due to higher revenues during the quarter.

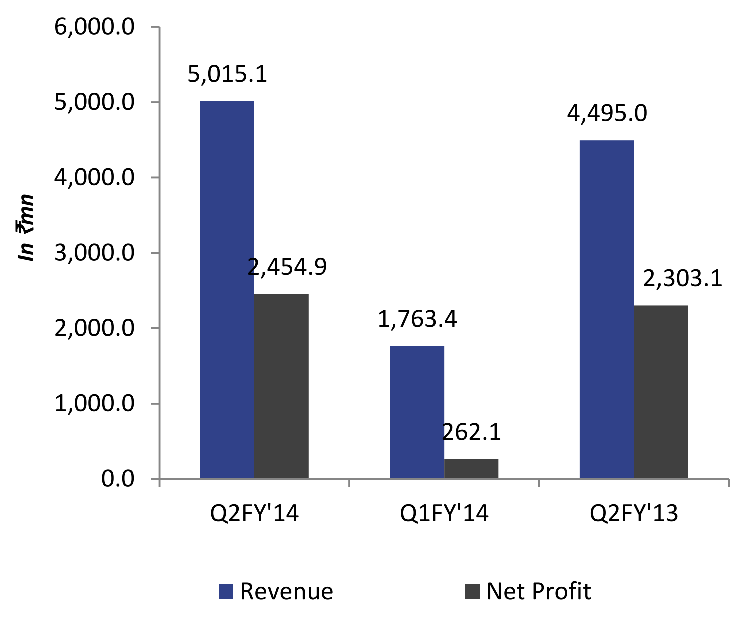
Revenues for Q2FY'14 grew 11% YoY to ₹4.9 bn.

Despite of a slow-down, MRIL posted decent gains in Q2FY'14

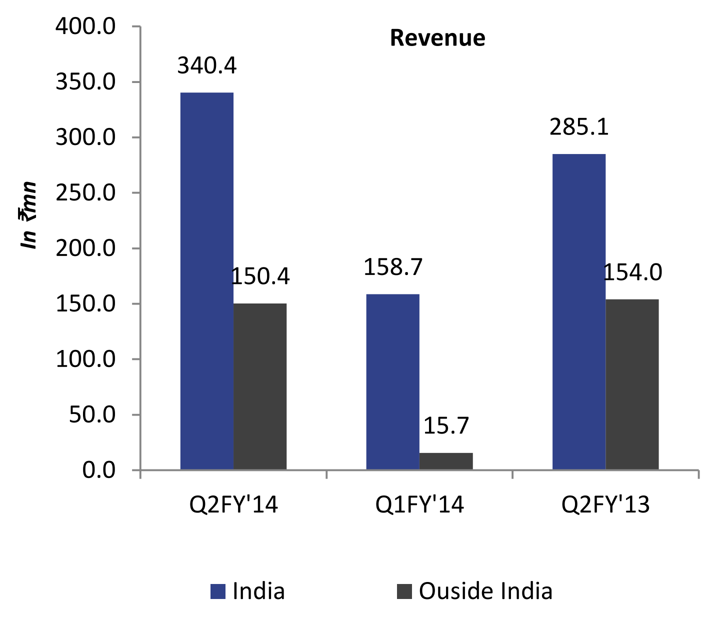
McLeod Russel India Ltd, the world's largest producer of tea, witnessed a healthy performance in Q2FY'14, as operating wise there has been good increase in production, stable prices and very benign cost. With the best ever six months result, the company is well placed among its peers.

For the quarter ended September 2013, the company registered an increase in net profit by 6.5% YoY to ₹2.5 bn as against ₹2.3 bn primarily due to higher revenues during the quarter. Revenues during the quarter grew 11% YoY to ₹4.9 bn. According to the company's management, the profitability could have been substantially higher if the mark-to-market losses on account of foreign currency fluctuation were adjusted. During the quarter, the company had been able to register forex gain of ₹0.08 bn, however, the six-month loss for the company stood at ₹0.14 bn. The management stated that the company's own teas fetched a higher price, while the combined average (including leaves outsourced from small growers) was down by ₹2.8 a kg. In a final analysis, however, a bumper crop resulting in 3.3 mn kg higher sales had more than compensated the drop in prices. The company reported a reserve trend in the export market, where volumes dropped to 7.3 mn kg (7.8 mn kg), but realisation has gone up by ₹9 a kg due to the firming up of orthodox tea prices.

Improved performance in Q2FY'14



India performed well in Q2FY'14



During H1FY'14, in overseas operations, there has been a good increase in production, prices remained stable and cost was manageable.

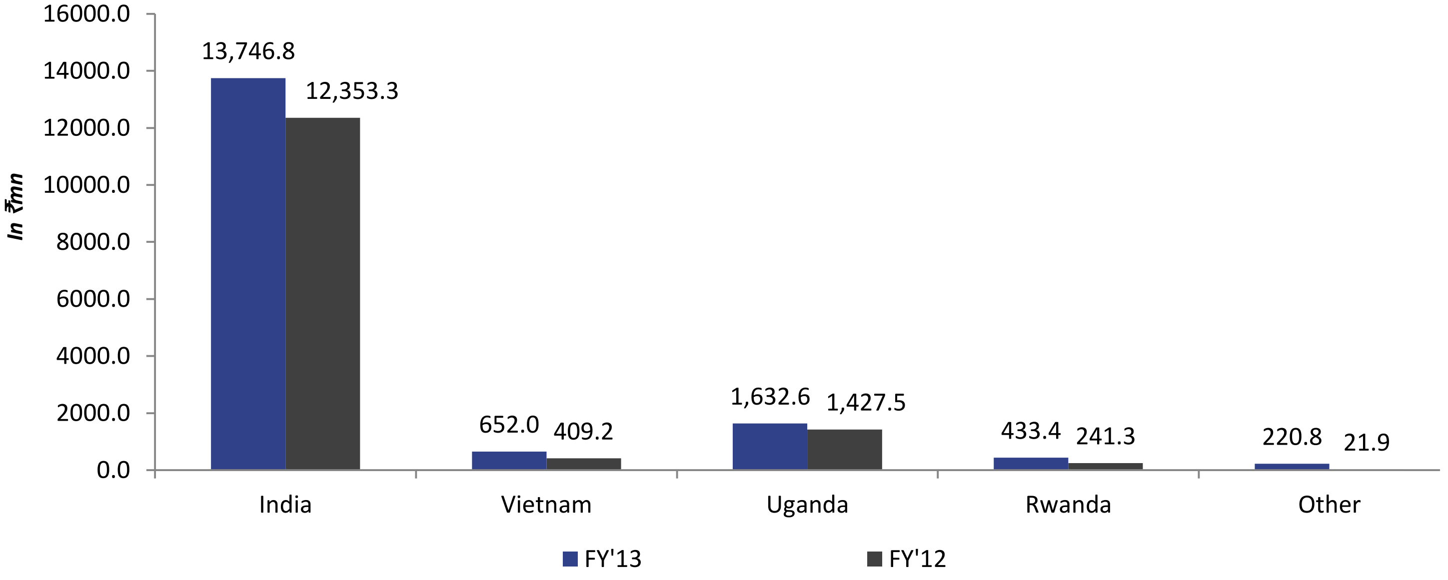
Looking forward for 13-14% increase in volume in FY'14

After witnessing a decent performance in Q2FY'14, the management of the company seems quite optimistic for the rest of the year. The performance for first half of FY'14 has been one of the best ever. Even in overseas operations, there has been a good increase in production, prices remained stable and cost was manageable. Given this year's improved climatic conditions, the company is observing strong recovery and it hopes that it will be able to increase the overall production in India by 10 mn kgs to ~88 mn kgs.

MRIL expects a 13-14% increase in volume taking into account that for the rest of the year, given the normal weather conditions.

The company expects a 13-14% increase in volume taking into account that for the rest of the year, weather will be normal as far as the tea production is concerned. Further, the company expects quality tea prices to be higher by ₹5-10 a kg, this year. So, on higher volume and higher prices, the profitability for the current year looks better.

Geography-wise revenue trend



Plans to shore up Indian production to 140-150 mn kg in next 3-4 years

MRIL has acquired a tea processing plant in Vietnam for USD 2.75 mn with annual production capacity of 1.2 mn kg.

While looking for M&A opportunities in Africa and Vietnam, the company is eyeing production of 40-45 mn kg from the overseas market, out of the target of a total of 140-150 mn kg of consolidated production in the next 3-4 years. Currently, the company produces around 100 mn kg of tea annually. The company has gone overseas as it believes that it is quite risky to concentrate the entire plantation in one area due to weather related uncertainties. Recently, MRIL has acquired a tea processing plant in Vietnam for USD 2.75 mn with annual production capacity of 1.2 mn kg. The acquisition was in line with its steps in achieving its decided target.

Besides, the company has incorporated a trading outfit in Kenya to procure and supply African tea to the company's Dubai blending unit. The Dubai blending unit is the second such facility for the company. These units serve the global blended tea market for the company.

For FY'14, the company expects the tea output to be better.

Favourable weather to result in better production

During FY'13, McLeod Russel India has benefitted from higher tea prices, but lower tea output has affected the performance. Since costs rose sharply due to a few factors such as a wage settlement, higher power and fuel costs and the cost of buying tea leaves from other plantations, its profit declined. But the company's portfolio of acquired tea

Normal weather conditions in most leading black tea producing countries have led to better production in Q1 and the trend is expected to continue for the upcoming quarter too.

plantations overseas contributed to a slightly better performance at the consolidated level. For FY'14, the company expects the tea output to be better, on account of favourable weather conditions. It was reported that normal weather conditions in most leading black tea producing countries have led to better production in Q1 and the trend will continue for the upcoming quarters too.

The company expects FY'14 to be a normal year on cost front, due to a 6% increase in wages and normal increase in input costs. While higher prices in FY'13 did not really help MRIL's performance as a drop in output and higher costs led to a decline in profitability, a combination of higher output and a normal increase in costs are likely to be the positive factors in FY'14.

Building blocks towards growth

Quality Focus	✓ Consistently positioned as a quality driven tea producer to generate higher than industry average realisations.
Volume Growth	✓ Enhance yields from within its own gardens and increase the number of purchase of tea leaves from other gardens to drive volume growth higher than the industry average. ✓ Reduce the excessive dependence on tea garden from one region or country to mitigate climatic conditions.
Cost Management	✓ Progressively strengthened the human productivity in its tea estates, helping to amortize fixed costs more effectively and emerge as one of the lowest cost tea producers.
Process Orientation	✓ Invested in an operational environment that has standardized processes and practices across workers, managers, gardens and countries which has enhanced operational predictability and replaced dependence on the diverse operating styles of managers with a stable institutionalized approach.

Tea industry to grow by 5% in 2013

Indian tea industry is the second largest producer of tea and largest producer of black tea in the world.

The Indian tea industry is the second largest producer of tea and largest producer of black tea in the world. During the last two years, Indian tea production has exceeded total demand, with tea industry crossing 1,000 mn kg mark, producing approximately 1,111 mn kg in CY'12 as against 1,115 mn kg in CY'11. This represents 40% of the global tea production. However, domestic tea production grew marginally by 1% YoY to reach 1,126 mn kg in CY'12. The steady increase in domestic consumption and marginal increase in output led to higher prices in CY'12.

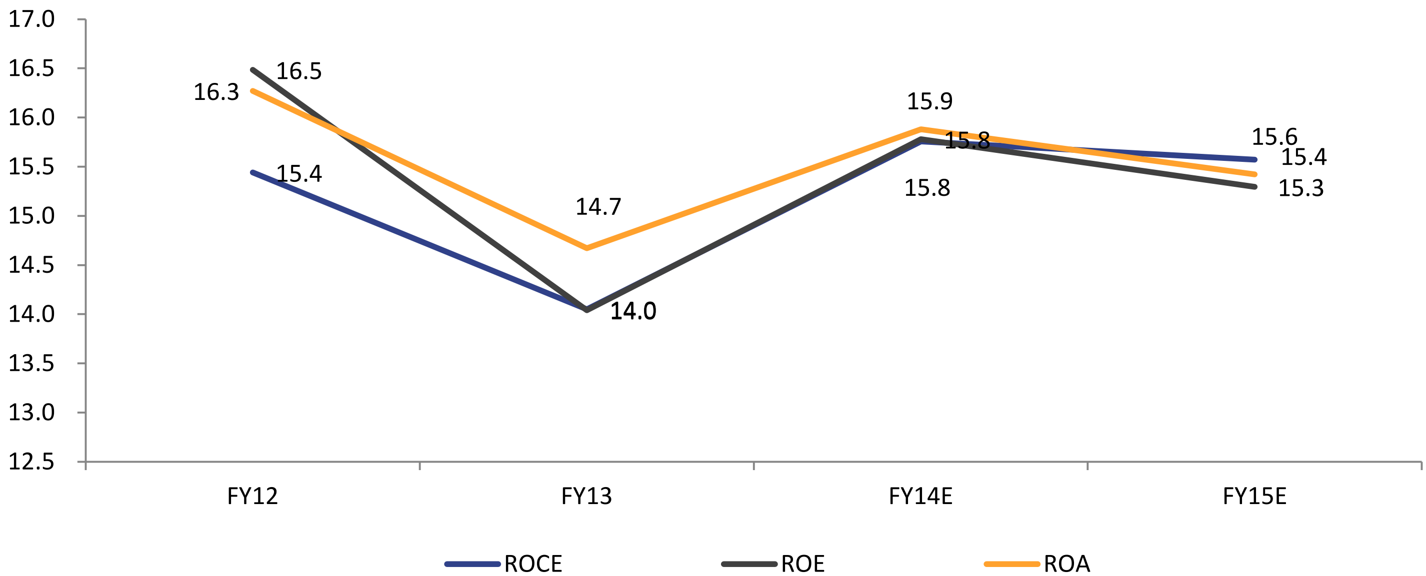
In CY'12, due to unfavourable climatic conditions in peak production months India lost approx. 5 mn kg of crop as against the production in CY'11. On account of strong consumption growth, low inventory and lower production, the prices got increased by ₹22

With healthy estimations for the industry as a whole coupled with suitable climatic conditions, we believe the company is well placed to achieve good growth in the coming quarter and in FY'14 as a whole.

per kg in domestic market. Prices in global markets were also higher by 5 to 7% due to lower production in Kenya. However, it is expected that tea production in CY'13 would grow by 5% and is likely to end above 1,180 mn kg due to adequate rains. The tea exports have picked up as well which further will be a boon for the country. For the first quarter ended March 2013, exports rose by about 34% to 59.8 mn kg. It was reported that during January to August 2013, tea production has risen by 6.2% to 705 mn kg as compared to 664 mn kg during the corresponding period of last year.

With healthy estimations for the industry as a whole coupled with suitable climatic conditions, we believe the company is well placed to achieve good growth in the coming quarters and in FY'14 as a whole.

Key Ratios



Key Concerns

Negligible addition of land under tea cultivation and higher labour cost remains two of the major concerns for the company.

- ✓ The company may face a little difficulty in the next few years as Indian and global tea production is likely to remain stagnant due to negligible addition of land under tea cultivation by the organized sector. Demand, on the contrary is expected to increase by 2 to 3% per annum thereby creating further shortages and lower inventory levels. But the negative impact will be somehow reversed by an improvement in exports on strong demand for orthodox tea from Iran.
- ✓ The industry is highly labour intensive and is subject to stringent labour laws. Comparatively high labour costs, high social cost over most other tea producing countries, high infrastructure costs and increasing energy and other input costs remain the major problems for the Indian Tea Industry. Shortage of labour during peak season in some pockets is also a cause for concern. In order to regain the Industry's competitiveness in the global market, Tea industry in Assam had signed an agreement with Labour Union in Assam for the period 1st January 2012 to 31st December 2014.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Share Capital	547.3	547.3	547.3	547.3
Reserve and surplus	16,919.2	18,962.0	21,366.5	23,991.0
Net Worth	**17,466.5**	**19,509.3**	**21,913.8**	**24,538.3**
Minority Interest	117.4	153.2	153.2	153.2
Loan funds	1,979.8	1,685.9	1,348.7	1,079.0
Provisions	1,928.2	2,151.3	2,151.3	2,151.3
Current Liablilities	2,351.1	2,447.3	2,692.0	2,961.2
Net Deferred Tax Liability	769.2	823.3	823.3	823.3
Capital Employed	**24,612.2**	**26,770.3**	**29,082.3**	**31,706.3**
Fixed assets	18,953.4	19,680.2	20,664.2	21,697.4
Investments	189.7	166.5	166.5	166.5
Loans and Advances	2,791.5	3,515.4	4,218.5	5,062.2
Current Assets	2,299.5	3,030.1	3,636.2	4,363.4
Other long term Assets	378.2	377.9	396.8	416.7
Capital Deployed	**24,612.2**	**26,770.3**	**29,082.3**	**31,706.3**

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Operating Income	**14,453.2**	**16,685.5**	**19,021.5**	**21,113.8**
Expenses	10,559.3	12,873.3	14,418.1	16,148.3
EBITDA	**3,893.8**	**3,812.2**	**4,603.3**	**4,965.5**
EBITDA Margin (%)	*26.9*	*22.8*	*24.2*	*23.5*
Depreciation	369.7	392.0	444.9	489.4
Exceptional Item	86.8	3.1	0.0	0.0
EBIT	**3,437.4**	**3,417.1**	**4,158.5**	**4,476.2**
EBIT Margin (%)	*23.8*	*20.5*	*21.9*	*21.2*
Interest	567.4	510.5	459.4	413.5
Other Income	410.7	344.2	378.7	416.5
Profit Before Tax	**3,280.6**	**3,250.8**	**4,077.7**	**4,479.2**
Tax	338.0	429.7	530.1	627.1
Profit After Tax	**2,942.6**	**2,821.1**	**3,547.6**	**3,852.1**
MI/Share of profit&loss of associates	63.4	81.8	90.0	99.0
Net Profit	**2,879.2**	**2,739.3**	**3,457.6**	**3,753.1**

Key Ratios (Consolidated)

Y/E	FY12A	FY13A	FY14E	FY15E
EBITDA Margin (%)	26.9	22.8	24.2	23.5
EBIT Margin (%)	23.8	20.5	21.9	21.2
NPM (%)	19.9	16.4	18.2	17.8
ROCE (%)	15.4	14.0	15.8	15.6
ROE (%)	16.5	14.0	15.8	15.3
EPS (₹)	26.3	25.0	31.6	34.3
P/E (x)	10.5	11.1	8.8	8.1
BVPS (₹)	159.6	178.2	200.2	224.2
P/BVPS (x)	1.7	1.6	1.4	1.2
EV/Operating Income (x)	2.2	1.9	1.6	1.4
EV/EBITDA (x)	8.2	8.3	6.7	6.0

Valuation and view

We expect the company to do well in FY’14 as the management seems quite optimistic about FY’14 results. The company targets to achieve 140-150 mn kg of consolidated production, from the current annual production of around 100 mn kg, in the next 3-4 years which shows that the company is quite confident about the growth prospects. Further, given the recent depreciation in Indian currency, MRIL is likely to see healthy gains from exports in FY’14 results. Moreover, the company is eyeing overseas mergers and acquisitions in order to mitigate the risk associated with weather related conditions.

Looking at the endless efforts by the company to witness improved performance in the coming quarters, we recommend ‘BUY’ with a target price of ₹320, which implies potential upside of ~15.4% to the CMP from 1 year perceptive. At a current market price (CMP) of ₹277.3, the stock trades at 8.8x FY14E and of 8.1x FY15E, P/E.

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