MCLEOD RUSSEL INDIA LTD

McLeod witnessed inline operational performance for Q2FY13 than street expectation with 8% (YoY) sales growth ***(Figure:1.1)*** led by 7% domestic revenue growth (contributes 65% on Sales) and 10% (YoY) export revenue growth (contributes 355 on sales) on YoY basis. PAT increased by 1% (YoY), affected by higher input cost and EBITDA margin declined by 300bps to 54% on YoY basis due to the mix (higher proportion of "bought leaves" and lower exports) and increase in power and fuel costs.

During the quarter, Company posted 24.9mn kg volume of tea against the 26mn kg of Q2FY12. Average realization per Kg ***(Figure:1.2)*** inched up to Rs176 from Rs 155 (Q2FY12) and EBITDA per Kg increased to Rs 98 from Rs 90(Q2FY12). McLeod lost 4mn kg of production in 2Q due to poor weather around the end of September and compensated for it somewhat with higher purchase of leaves from small growers. Dry weather situation during January to May across all major black tea producing countries and excess rains during July and September in North India region had adverse impact on company's production. Production from own leaf for the company is lower by 6.7mn kg, while production from bought leaf is higher by 2.6mn kg during six month ended 30 September. Tea prices ***(Figure:1.3)*** remained firm at Rs195/kg higher by Rs25-30/kg on YoY, even in the peak Sep-Oct season when prices usually moderate.

Company reduced its debt by Rs78cr during the six month ended 30 September, but in FY12, the consolidated debt reduced by Rs53.2cr largely through the incremental cash generated at the operating level (which increased by almost Rs40cr in FY2012). As on 30 September 2012, Debtors days increased to 16days from 7days (FY12) and Creditors payable days increased to 23 days from 18 days on LTM basis. On the back of improved (operating) cash flows, the company was able to reduce the consolidated debt from Rs460cr in FY10 to Rs171cr in FY12. Return ratios sustained in high teens in FY2012. The return on equity (RoE) and return on capital employed (RoCE) stood at 17% and 20% in FY2012 as against 17.3% and 18.4% in FY2011 respectively.

Management expects to recover some of the lost production in Nov'12 and Mar'13 due to favorable YoY comparison. Tea prices remained firm at Rs18-20/kg higher YoY even in the peak Sep-Oct season. If the prices hold on to similar levels as of now, the expected tea price increase for FY13 could be at Rs25-30/kg.

Management expects both Sales and PAT growth by 15-20% for FY13E and expects its margins to improve from 25-26% to around 30% post hike in tea prices. Lower tea production might lead to flat sales volume, but we expect the higher anticipated sales realization to boost the top line growth and the margins in FY2013. However, any significant drop in tea production for McLeod Russell could act as a key risk. At a CMP of Rs 307, stock trades at 9.7x FY13E earnings. We rate the stock "Neutral" with meaningful upsides in volume and continued uptrend in tea prices key upside risks to our view.

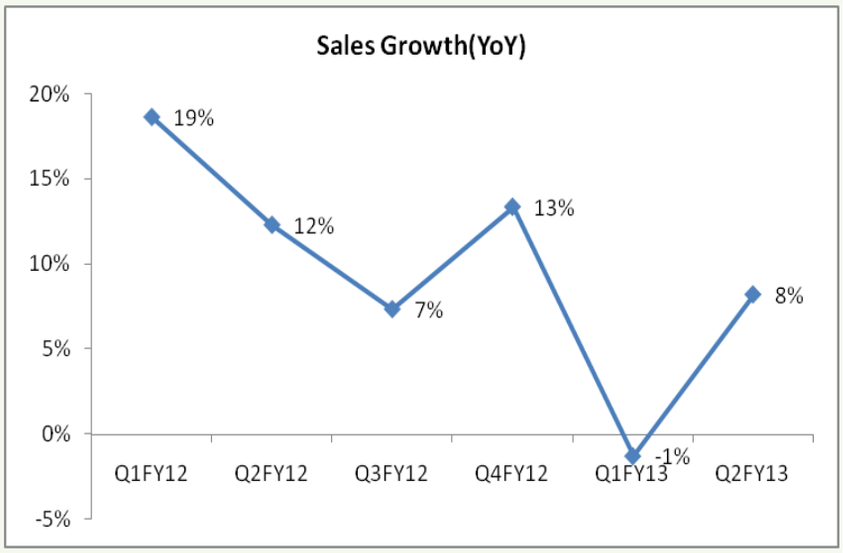

Figure:1.1 (Source: Eastwind)

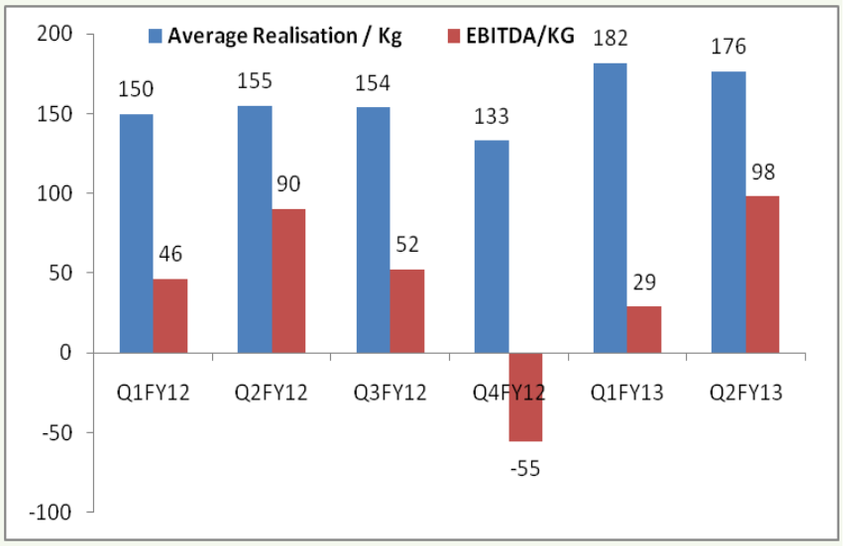

Figure:1.2 (Source: Eastwind)

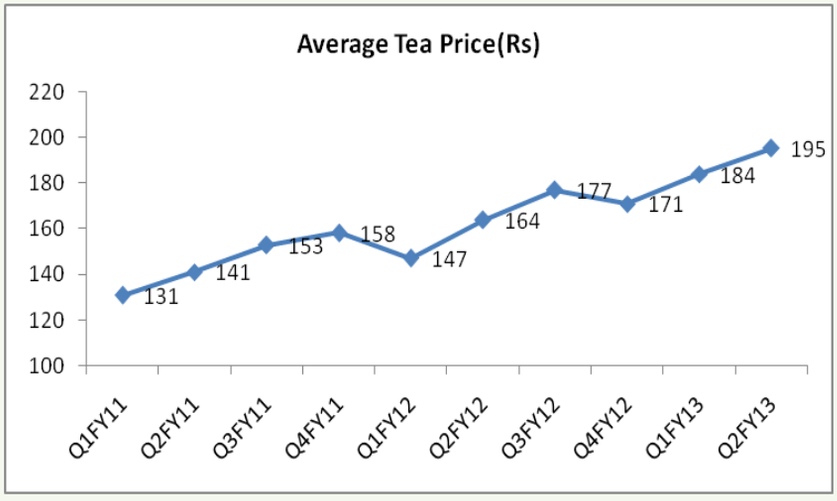

Figure:1.3 (Source: Eastwind)