

## MCLEOD RUSSEL:

*Inline numbers than Street expectation with margin dip,*

McLeod Russel, world's largest tea grower witnessed inline numbers than street estimates in 3QFY13, reported 10.7% (YoY) sales growth led by 6% growth on domestic revenue (contributes 56% of sales) and export revenue (contributes 44% of sales) by 16%(YoY). PAT Growth by 1.7% (YoY).

Due to higher cost on consumption of raw material (mainly attributed to loss of crop) and increase in wage, power and fuel cost impacted margin, Company's EBITDA margin declined by 270bps to 30.4% on YoY basis. Wage revision as per agreement, and fuel cost hike due to price inflation of diesel and petroleum and loss of company's own crop could expectedly impact its margin by Rs 19-20/kg during the year.

Lower opening Inventory in India and lower production in India on adverse weather condition and strong consumption growth has taken the domestic prices by 20-25/kg. Domestic tea prices per kg increased to Rs198 against the Rs 177 (2QFY12), while it was almost flat on sequential basis. Export prices for CTC teas are higher by Rs. 22 per kg due to Production shortfall in Kenya and Other African Countries. We expect this trend to continue for the rest of the season.

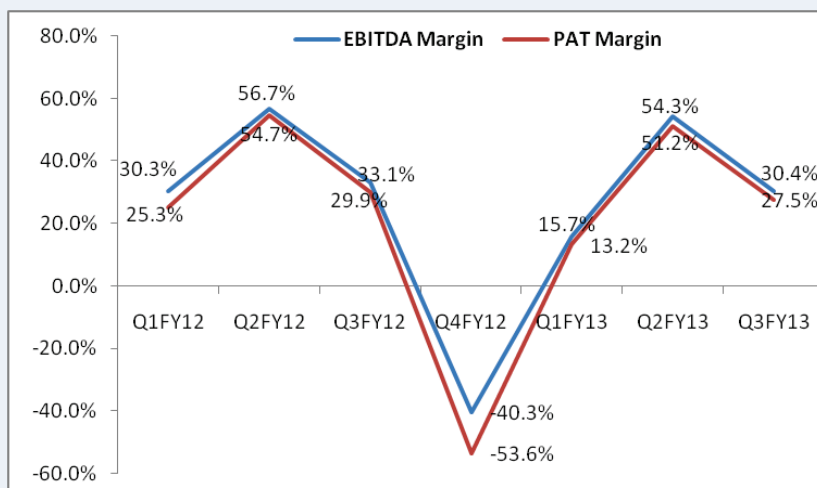
The primary reason for the strength in tea prices, as we have indicated before, remains favorable demand-supply dynamics—demand has been stable while supply is constrained given that nearly half of the global supply is from India and Sri Lanka where there is little scope to expand production.

During the quarter, Company's average realization has improved to Rs179.8 from Rs 153.8(3QFY12), However, EBITDA/kg improved to Rs128.3 from 153.8(3QFY12). In the tea Industry, as 90%of cost is fixed, we expect better realization, which would partly offset low sales volume would lead to an increase in margin in coming quarter.

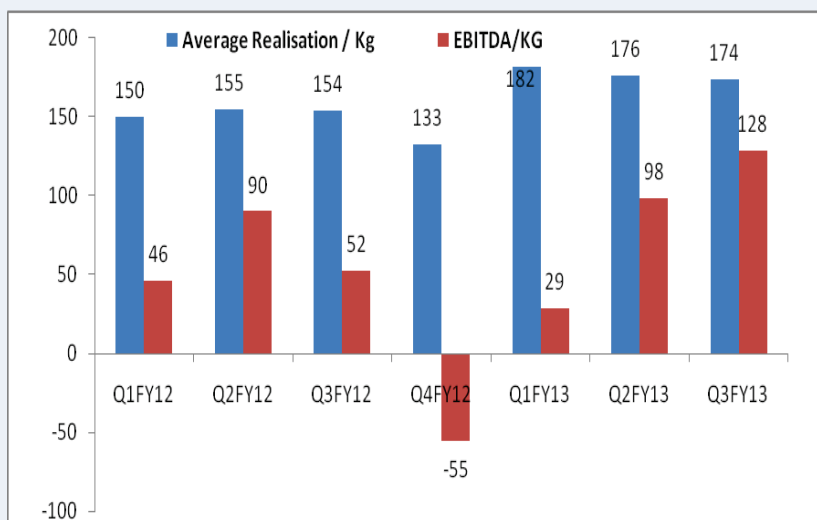
During the quarter, Olyana Holdings LLC (USA), a step-down subsidiary of the company has been closed down for not having any business activity, after having complied with required legal formalities.

Management expects a production target of 25mn ton this year and expects to add 10mn tone in FY14E than FY13, however, their Indian inventory remains at an all time low to support prices. Going forward, Company expects to Rs10-15 price hike per kg in FY14E. Compare to last year EBITDA and PAT could be high because of high tea price.

We expect that the company will get a significant profitability boost driven by a realization uptick, assumption of a normalized production and stable cost/kg. 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 FY14E. However, any significant drop in tea production for McLeod Russell could act as a key risk. At a CMP of Rs 349, stock trades at 9.2x FY14E earnings. We rate the stock "Neutral" with meaningful upsides in volume and continued uptrend in tea prices key upside risks to our view.



(Source: Company/Eastwind)



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