

McLeod Russel (MCLRUS)

Wage increase continues to dent profitability

- McLeod Russel's sales was flat for the quarter at ₹ 377.9 crore (I-direct estimate ₹ 391.4 crore)
- On an annual basis, consolidated revenues increased 9.9% to ₹ 2,055.3 crore, driven by a 5.8% increase in both volume & prices to 901 lakh kg and ₹ 173/kg, respectively
- EBITDA loss increased 25.2% during the quarter owing to higher other expenses, which increased 36.6% YoY. EBITDA loss for the quarter came in at ₹ 267.9 crore against ₹ 213.9 crore in Q4FY18. Employee cost increased 3.8% to ₹ 190.2 crore. The company increased wages after renewing the wage contract for the next three years. We believe this would result in continuous increase in employee cost for the company
- Interest cost was up 25.1% to ₹ 49.3 crore during the quarter. Other income increased significantly from ₹ 104.8 crore to ₹ 152.5 crore during the quarter mainly on account of profit on sale of shares of the parent company held through a trust & higher dividend received from overseas subsidiaries

Wage cost continues to remain an overhang

Domestic tea prices remained marginally higher in FY18 (3.7% YoY) than the previous year. However, employee expenses, which are largely contributed by wagers, have risen 8% YoY. With the renewal of wage contract in January 2018 for three years, this wage increase would continue to cap any significant increase in operating margins in future. We are factoring a 7.6% and 4.7% increase in tea realisation in FY19E and FY20E respectively on the back of recent US\$ appreciation resulting in higher export realisation. In the first four months of CY18, Kenya tea prices have already seen an increase of 18.75% YoY. However, wage cost in India would further increase by 10% and 5% in FY19E & FY20E, which would remain an overhang of operating margins. We estimate a 7.2% revenue CAGR for the company in FY18E-20E with operating margins at 10.1% in FY20E.

Export revenue to improve on low base, improving international price

CY17 witnessed record black tea production led by increased production in India. However, Kenya suffered a crop loss due to unfavourable weather conditions. However, with good weather conditions in early CY18 (18.75% increase YoY), Kenya tea production is likely to come in at 435 million kg in CY18. Tea Prices at Mombasa Auction for African teas increased 20% to US\$2.47 compared to 2016. Going forward, it may remain stable in FY19. We factor in 6% CAGR in export realisation for FY19-20E on the back of normal weather conditions. We believe that with better export environment, MRL would focus on improving exports and report healthy growth on a low base. We expect export revenue to clock 16.4% CAGR in FY18-20E.

Debt shrinkage on the cards but wage rise to cap profitability; HOLD

Though the company plans to knock off its debt by selling some of its tea estates thereby resulting its better profitability, going forward, increasing employee cost would restrict a significant improvement in operating margin. We expect operating margins to hover around 10.1% for FY20E. We maintain our cautious view on the stock in the absence of any operational improvement. We reiterate our **HOLD** recommendation on the stock with a target price of ₹ 158.

Rating matrix		
Rating	:	Hold
Target	:	₹ 158
Target Period	:	12-15 months

What's changed?		
Target		Unchanged
EPS FY19E		Changed from ₹ 8.8 to ₹ 8
EPS FY20E		Changed from ₹ 14.5 to ₹ 13
Rating		Unchanged

Quarterly performance					
	Q4FY18	Q4FY17	YoY (%)	Q3FY18	QoQ (%)
Sales	377.9	376.9	0.3	556.4	-32.1
EBITDA	-267.9	-213.9	-25.2	52.3	-612.7
EBITDA (%)	-70.9	-56.7	-1413.0	9.4	-854.8
PAT	-142.1	-107.8	-31.8	67.5	-310.5

Key financials				
₹ Crore	FY17	FY18E	FY19E	FY20E
Net Sales	1,776.4	2,055.3	2,216.5	2,360.7
EBITDA	110.2	142.3	197.2	238.7
Net Profit	64.5	219.2	74.0	119.8
EPS (₹)	7.8	23.7	8.0	13.0

Valuation summary				
	FY17	FY18E	FY19E	FY20E
P/E (Adj.)	18.9	6.2	18.5	11.4
Target P/E	20.2	6.7	19.7	12.2
Div. Yield	0.2	-	-	-
Mcap/Sales	0.9	0.8	0.7	0.7
EV/EBITDA	21.3	16.8	10.6	8.3
RoNW (%)	3.3	10.1	3.3	5.1
RoCE (%)	6.2	13.0	6.5	8.1

Stock data	
Particular	Amount
Market Capitalization (₹ Crore)	1,619.9
Total Debt (FY18) (₹ Crore)	930.8
Cash (FY18) (₹ Crore)	79.6
EV (₹ Crore)	2,471.1
52 week H/L	248 / 137
Equity capital	₹ 46.2 Crore
Face value	₹ 5

Price performance				
	1M	3M	6M	12M
McLeod Russel	-0.6	-6.7	-34.3	-7.5
Jayshree Tea	-8.9	-13.0	-36.2	-8.5
Goodricke Tea	-18.9	-22.2	-42.6	24.5

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Variance analysis

	Q4FY18	Q4FY18E	Q4FY17	YoY (%)	Q3FY18	QoQ (%)	Comments
Net Sales	377.9	350.5	376.9	0.3	556.4	-32.1	Net sales was flat for the quarter due to lower domestic volumes but higher export realisations helped maintaining the sales numbers
Raw Material Expenses	347.0	280.4	328.2	5.7	142.4	143.7	
Employee Expenses	190.2	140.2	183.2	3.8	206.1	-7.7	Labour cost increased by 3.8% which is the largest cost for tea companies. Tea companies increased the wages with new three year contract starting from Jan 2018
Other operating Expenses	108.6	63.1	79.5	36.7	155.6	-30.2	Other expenses increased by 36.6%
EBITDA	-267.9	-133.2	-213.9	-25.2	52.3	-612.7	
EBITDA Margin (%)	-70.9	-38.0	-56.7	-1,413.0	9.4	-854.8	Operating margins contracted by 1413 bps on the back of higher wages and overhead expenses
Depreciation	21.3	39.1	20.8	2.6	20.3	5.1	
Interest	49.3	1.7	39.4	25.1	43.3	13.8	
Other Income	152.5	-30.0	104.8	45.5	92.7	64.6	Other income increased significantly mainly on account of profit on sale of shares of the parent company, held through a trust & higher dividend received from overseas subsidiaries
PBT	-186.0	-204.0	-169.2	-9.9	81.4	-328.6	
Tax Outgo	-43.9	-40.3	-61.4	28.6	13.9	-416.2	
PAT	-142.1	-163.7	-107.8	-31.8	67.5	-310.5	
Key Metrics (%)							
Tea sales volumes growth (%)	-6.0	-12.0	5.0		19.0		Sluggish volume growth due to a dry spell in Assam & West Bengal
Tea realisation increase (%)	6.7	5.7	6.6		6.8		Higher export realisation benefitted overall realisations

Source: Company, ICICI Direct Research

Change in estimates

(₹ Crore)	FY19E			FY20E			Comments
	Old	New	% Change	Old	New	% Change	
Sales	2168.0	2216.5	2.2	2329.1	2360.7	1.4	We are changing our operating margin estimates on the back of robust export realisation
EBITDA	153.2	197.2	28.7	208.3	238.7	14.6	
EBITDA Margin (%)	7.1	8.9	183 bps	8.9	10.1	117 bps	
PAT	72.5	74.0	2.1	119.7	119.8	0.1	
EPS (₹)	8.8	8.0	-8.9	14.5	13.0	-10.7	

Source: Company, ICICI Direct Research

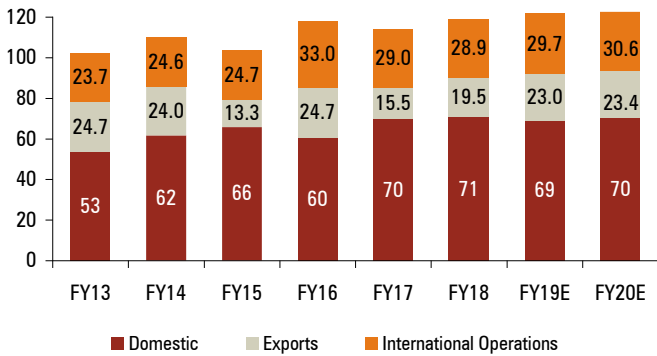
Assumptions

	Current				Earlier		
	FY17	FY18	FY19E	FY20E	FY19E	FY20E	
Sales volume (in mkg)	85.2	90.1	91.9	93.7	90.4	92.2	No change in estimates
Domestic	69.7	70.6	68.9	70.3	67.8	69.1	
Exports	15.5	19.5	23.0	23.4	22.6	23.0	
Africa + Vietnam (in mkg)	29.0	28.9	29.7	30.6	30.7	31.6	
Overall Realization (₹/kg)	163.2	173.1	186.3	195.0	186.3	195.0	
Domestic	156.3	162.1	170.0	180.0	170.0	180.0	
Exports	210.0	213.0	235.0	240.0	235.0	240.0	
Bought leaf Prod (mkg)	30.0	30.0	30.0	30.0	30.0	30.0	
Employee cost (₹ per kg)	73.6	77.2	83.4	85.1	83.4	85.1	

Source: Company, ICICI Direct Research

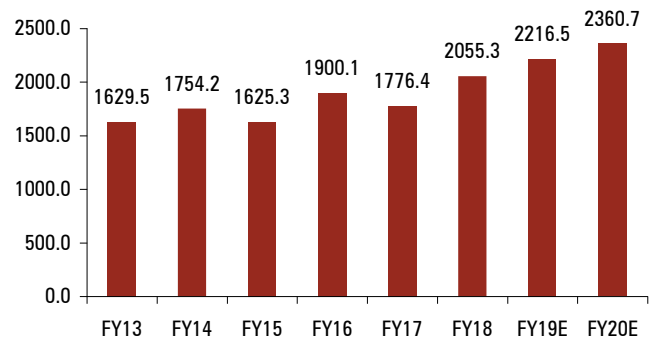
Company Analysis

Exhibit 1: MRL's sales volume (million kg)



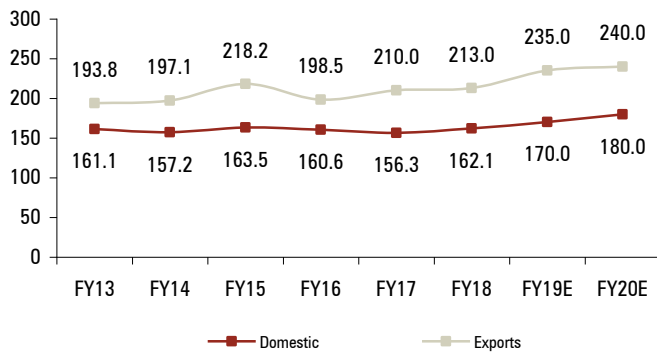
Source: Company, ICICI Direct, Research

Exhibit 2: Revenue to be driven by volumes (₹ crore)



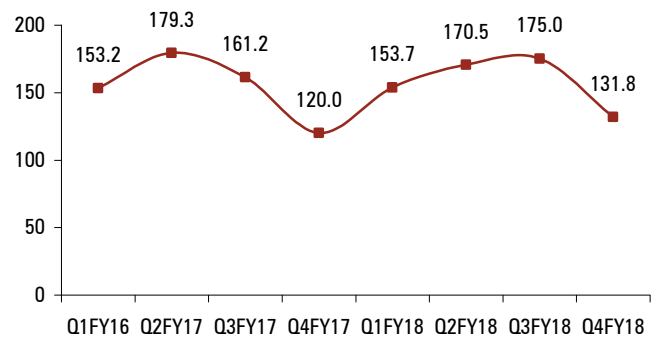
Source: Company, ICICI Direct, Research

Exhibit 3: Company realisation to witness reasonable improvement (₹/kg)



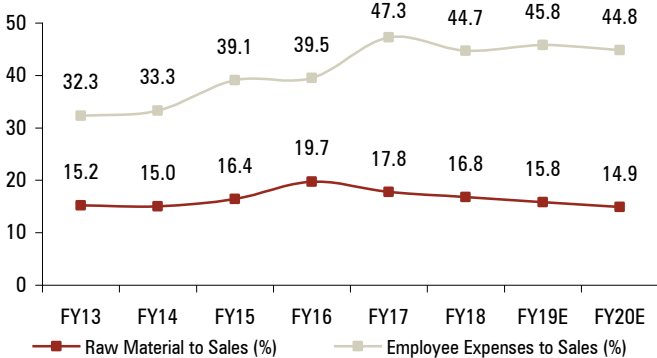
Source: Company, ICICI Direct, Research

Exhibit 4: Domestic tea prices (₹/kg)



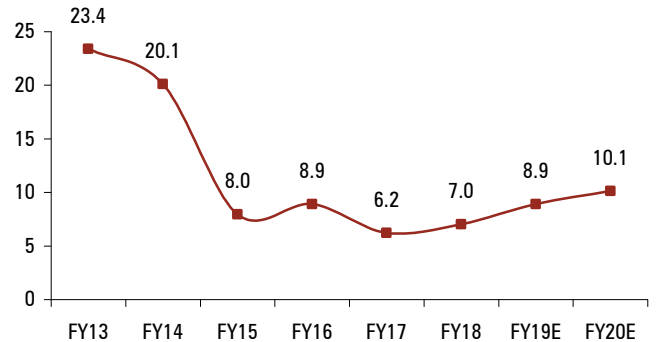
Source: Tea board of India, ICICI Direct, Research

Exhibit 5: Employee cost to remain elevated



Source: Company, ICICI Direct, Research

Exhibit 6: EBITDA margin to remain capped (%)



Source: Company, ICICI Direct, Research

Outlook & Valuation

McLeod Russel is the country's largest tea producer with domestic production of ~90 million kg (FY18) and production from Vietnam & Africa at ~29 million kg (FY18). Due to unavailability of further land to increase crop production, the only way to increase sales volume in tea industry is through acquisitions, re-plantation and processing of bought green leaves. MRL is actively undertaking all the above measures to increase its sales volume and has, thereby, increased it from ~75 mkg in FY08 to ~90 mkg in FY18. The increase in sales volume has been led by both domestic and international acquisitions (Africa & Vietnam). As per BSE filing, the company is also looking at an opportunity to form a JV with Eveready for developing 'packet tea business' through a separate entity. This JV, if finalised, will give MRL an entry into a ₹ 10,000 crore packet tea market.

Tea prices in India are witnessing early signs of a change in cycle as opening level for new season quality tea in India has risen by around ₹ 20 per kg higher compared to the opening level last year. Weather condition during the first few months of the new season has been normal. Prices have been higher after stagnant to lower prices over the last few years. Prices in India for the year are likely to improve substantially due to demand in global markets and improved economic activities particularly in the rural markets.

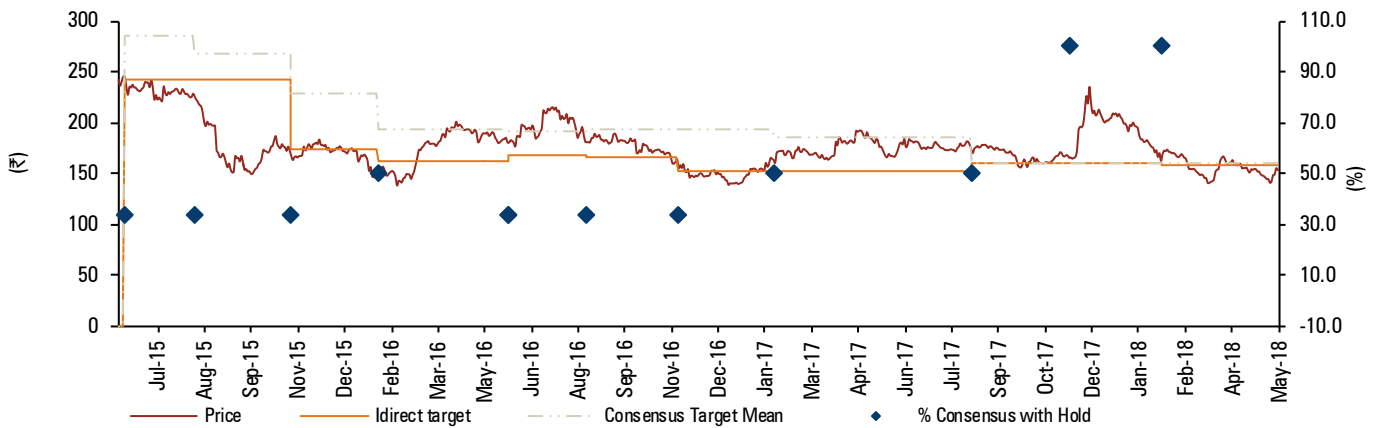
Though the company plans to knock off its debt by selling some of its tea estates thereby resulting its better profitability, going forward, increasing employee cost would restrict a significant improvement in operating margin. We expect operating margins to hover around 10.1% for FY20E. We maintain our cautious view on the stock in the absence of any operational improvement. We reiterate our **HOLD** recommendation on the stock with a target price of ₹ 158.

Exhibit 7: Valuations

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY17	1776.4		7.8		18.9	21.3	3.3	6.2
FY18E	2055.3	15.7	23.7	202.9	6.2	16.8	10.1	13.0
FY19E	2216.5	7.8	8.0	-66.2	18.5	10.6	3.3	6.5
FY20E	2360.7	6.5	13.0	61.8	11.4	8.3	5.1	8.1

Source: Company, ICICI Direct Research

Recommendation history vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Key events

Date	Event
Aug-09	Government of Rwanda approves sale of 60% shares of Gisovu Tea Co to Borelli Tea Holdings, UK, a wholly owned subsidiary of MRIL
Dec-09	Borelli Tea Holdings Ltd, UK, wholly-owned subsidiary of MRIL signs a share purchase agreement with James Finlay Ltd and James Finlay International Holdings Ltd (both of UK) for acquisition of 100% of share capital of Rwenzori Tea Investments Ltd, Uganda for a provisional consideration of \$25 million (James Finlay has six tea estates with annual production around 15 mkg of black tea)
Feb-11	India's tea production drops 1.3% to the lowest in five years on account of damaged crops due to pest attacks in Assam and West Bengal
Jan-12	Tea production in India climbs 2.3% and exports fall 3% resulting in stable domestic tea prices and moderate increase in MRIL's realisation
Apr-13	Export realisation of McLeod Russel witnesses a steep increase by 14% mainly due to sharp currency depreciation in FY13
May-13	MRIL sets up a company in Kenya called McLeod Russel Africa Ltd to engage in tea trading activities in Africa
Dec-13	Kenya reports highest production in 10 years resulting in a drop in global prices and limiting the increase in Indian tea prices, thereby limiting MRIL's realisations
Mar-14	Purchases a tea processing factory in Vietnam with annual production capacity of 6 lakh kg of green tea for a consideration of \$820,000
Jul-14	Acquires a tea processing factory in Vietnam with an annual production capacity of 1.2 mkg for \$2.09 million (~₹ 13 crore)
Nov-14	Acquires Pfunda Tea Co. Ltd., Rwanda's biggest private tea plantation for \$19.5 million making McLeod Russel account for 25% of Rwanda's tea production

Source: Company, ICICI Direct Research

Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	Williamson Magor Group	31-Mar-18	16.04	17.6	0.0
2	Baheti (Kamal)	31-Mar-18	15.59	17.1	0.0
3	Nomura Asset Management Co., Ltd.	31-Mar-18	8.24	9.0	0.3
4	Edgbaston Investment Partners LLP	31-Mar-18	6.46	7.1	0.2
5	ICICI Prudential Asset Management Co. Ltd.	31-Dec-17	5.00	5.5	-1.1
6	Woodside Parks, Ltd.	31-Mar-18	4.12	4.5	0.0
7	Bishnauth Investments, Ltd.	31-Mar-18	3.63	4.0	0.0
8	Sundaram Asset Management Company Limited	31-Mar-18	3.62	4.0	0.0
9	Nomura Asset Management Singapore Ltd.	31-Dec-17	2.11	2.3	2.3
10	Dimensional Fund Advisors, L.P.	31-Mar-18	1.72	1.9	0.0

Source: Reuters, ICICI Direct Research

Shareholding Pattern

(in %)	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Promoter	49.9	49.9	49.9	40.8	40.8
FII	18.3	18.3	16.7	23.7	23.2
DII	14.5	14.5	16.2	13.5	11.5
Others	17.3	17.3	17.2	22.1	24.5

Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
Nomura Asset Management Singapore Ltd.	7.4	2.3	ICICI Prudential Asset Management Co. Ltd.	-3.5	-1.1
HDFC Asset Management Co., Ltd.	2.3	1.0	Kotak Mahindra Asset Management Company Ltd.	-2.0	-0.6
Nomura Asset Management Co., Ltd.	0.7	0.3	BNP Paribas Asset Management India Pvt. Ltd.	-0.9	-0.4
Reliance Nippon Life Asset Management Limited	0.6	0.3	Baroda Pioneer Asset Management Company Limited	-1.0	-0.4
Edgbaston Investment Partners LLP	0.4	0.2	M & G Investment Management Ltd.	-0.6	-0.3

Source: Reuters, ICICI Direct Research

Financial summary

Profit and loss statement		₹ Crore			
(Year-end March)	FY17	FY18	FY19E	FY20E	
Total operating Income	1870.8	2055.3	2216.5	2360.7	
Growth (%)		9.9	7.8	6.5	
Raw Material Expenses	315.6	340.4	351.0	351.0	
Power & Fuel Expenses	208.0	0.0	210.6	236.1	
Employee Expenses	839.8	906.8	1,014.5	1,058.0	
Marketing Expenses	94.9	0.0	99.7	106.2	
Other expenses	302.4	665.9	343.6	370.6	
Total Operating Expenditure	1,760.6	1,913.0	2,019.4	2,122.0	
EBITDA	110.2	142.3	197.2	238.7	
Growth (%)		29.1	38.5	21.1	
Depreciation	103.5	102.2	100.4	100.9	
Interest	135.9	180.4	124.0	124.0	
Other Income	183.8	391.8	117.5	134.0	
PBT	54.6	251.6	90.3	147.9	
Others	0.0	0.0	0.0	0.0	
Total Tax	-9.9	32.4	16.2	28.1	
PAT	64.5	219.2	74.0	119.8	
Growth (%)		239.7	-66.2	61.8	
EPS (₹)	7.8	23.7	8.0	13.0	

Source: Company, ICICI Direct Research

Balance sheet		₹ Crore			
(Year-end March)	FY17	FY18	FY19E	FY20E	
Equity Capital	41.2	46.2	46.2	46.2	
Reserve and Surplus	1917.6	2121.2	2195.2	2315.0	
Minority Share	22.2	23.4	23.4	23.4	
Non-Current Liability					
Long Term Borrowings	226.4	407.9	417.9	427.9	
Deferred Tax Liabilities (Net)	185.1	151.7	151.7	151.7	
Long term Provisions	53.1	60.4	60.4	60.4	
Current Liabilities					
Short term Borrowings	614.8	522.9	422.9	322.9	
Trade Payable	116.6	126.6	145.7	155.2	
Other current Liabilities	255.2	345.2	303.6	323.4	
Short term provisions	19.7	37.5	116.7	129.0	
Total Liabilities	3,451.9	3,842.8	3,883.6	3,954.9	
Fixed Assets	2228.5	2226.7	2236.7	2246.7	
Tangible Assets	1820.3	1790.8	1800.8	1810.8	
Intangible Assets	317.0	329.4	329.4	329.4	
Capital WIP	91.2	106.5	106.5	106.5	
Intangible assets UD	0.0	0.0	0.0	0.0	
Non current assets	72.3	96.1	96.1	96.1	
Long term Loans and Advances	0.1	0.0	0.2	0.2	
Other non-currents assets	57.9	79.7	79.7	79.7	
Current Assets	1093.2	1440.3	1473.5	1534.8	
Inventory	237.2	233.6	273.3	258.7	
Trade Receivable	108.9	126.0	121.5	129.4	
Cash & Bank	50.7	79.6	289.3	305.9	
Short-term Loans & Liability	409.5	354.2	485.8	517.4	
Other current assets	286.9	646.9	303.6	323.4	
Application of Funds	3,451.9	3,842.8	3,886.2	3,957.5	

Source: Company, ICICI Direct Research

Cash flow statement		₹ Crore			
(Year-end March)	FY17	FY18	FY19E	FY20E	
Profit before Tax	54.6	251.6	90.3	147.9	
Add: Depreciation	103.5	102.2	100.4	100.9	
(Inc)/dec in Current Assets	-121.1	-318.2	176.5	-44.7	
Inc/(dec) in CL and Provisions	160.9	25.9	-43.2	-58.5	
Others	-20.8	-64.7	-16.2	-28.1	
CF from operating activities	177.2	-3.2	307.7	117.5	
(Inc)/dec in Investments	0.0	0.0	0.0	0.0	
(Inc)/dec in Fixed Assets	69.1	-67.7	-10.2	-10.0	
Others	-103.5	-102.2	-100.4	-100.9	
CF from investing activities	-34.4	-169.9	-110.6	-110.9	
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0	
Inc/(dec) in loan funds	-99.0	181.6	10.0	10.0	
Dividend paid & dividend tax	-2.4	0.0	0.0	0.0	
Inc/(dec) in Sec. premium	0.0	0.0	0.0	0.0	
Others	0.0	0.0	0.0	0.0	
CF from financing activities	-101.4	181.6	10.0	10.0	
Net Cash flow	41.3	8.4	207.2	16.6	
Opening Cash	32.5	73.7	82.2	289.3	
Closing Cash	50.7	82.2	289.3	305.9	

Source: Company, ICICI Direct Research

Key ratios		FY17	FY18E	FY19E	FY20E
Per share data (₹)					
EPS		7.8	23.7	8.0	13.0
Cash EPS		20.4	34.8	18.9	23.9
BV		237.8	234.6	242.6	255.6
DPS		0.3	0.0	0.0	0.0
Cash Per Share		6.1	8.6	31.3	33.1
Operating Ratios (%)					
EBITDA Margin		6.2	7.0	8.9	10.1
PBT / Total Operating income		3.1	12.4	4.1	6.3
PAT Margin		3.6	10.8	3.3	5.1
Inventory days		48.7	41.5	45.0	40.0
Debtor days		22.4	22.4	20.0	20.0
Creditor days		24.0	22.5	24.0	24.0
Return Ratios (%)					
RoE		3.3	10.1	3.3	5.1
RoCE		6.2	13.0	6.5	8.1
RoIC		0.2	1.3	3.4	4.8
Valuation Ratios (x)					
P/E		18.9	6.2	18.5	11.4
EV / EBITDA		21.3	16.8	10.6	8.3
EV / Net Sales		1.3	1.2	0.9	0.8
Market Cap / Sales		0.9	0.8	0.7	0.7
Price to Book Value		0.6	0.6	0.6	0.6
Solvency Ratios					
Debt/EBITDA		7.6	6.5	4.3	3.1
Debt / Equity		0.4	0.4	0.4	0.3
Current Ratio		2.7	2.7	2.1	2.0
Quick Ratio		2.1	2.2	1.6	1.6

Source: Company, ICICI Direct Research

RATING RATIONALE

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Strong Buy: > 15%/20% for large caps/midcaps, respectively, with high conviction;

Buy: > 10%/15% for large caps/midcaps, respectively;

Hold: Up to +/-10%;

Sell: -10% or more;



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