ENAM Securities
India Research

Rs 774
Target Price: Rs 808
Potential Upside: 4%

COMPANY UPDATE

Tata Tea Ltd

Relative to sector: **Underperformer**

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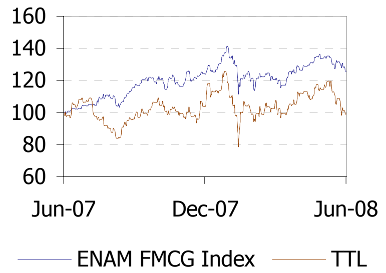
Relative Performance



Source: Bloomberg, ENAM Research

Stock data

No. of shares	: 61.8mn
Market cap	: Rs 48bn
52 week high/low	: Rs 1,014/ Rs 586
Avg. daily vol. (6mth)	: 186,500 shares
Bloomberg code	: TT IB
Reuters code	: TTTE.BO

Shareholding (%)		Mar-08	QoQ chg
Promoters	:	35.3	(0.1)
FIIs	:	12.9	(0.3)
MFs / UTI	:	9.8	0.4
Banks / FIs	:	16.9	0.5
Others	:	25.0	(0.6)

CORE EARNINGS TO MODERATE

- **Revenue growth of 9% in FY08** was led by the base effect of the Eight O' Clock and Vitax acquisitions. Despite firm branded sales growth in India (↑15% YoY) and Tata Tea GB (↑6% YoY in £ terms), forex translation losses neutralized overall growth. We believe commodity led price increases and gains from rupee depreciation will drive 10% revenue growth in FY09.
- **Drivers for accelerated growth** include acquisitions in specialty tea and ready-to-drink beverages, extension of the branded coffee portfolio beyond the USA and entry into the Chinese green tea market. While in the past, Tata Tea (TTL) acquired controlling interest in large cash cow businesses (Tata Tea GB and EOC), we believe **future scalability rests in the company's ability to make big-ticket acquisitions in high growth categories** such as RTD beverages etc, at reasonable valuations.
- **Core growth remains unattractive, EBIT growth at 7% CAGR over 2 yrs**: The sharp increase in tea (Kenyan prices ↑ 37% in 2MFY09) and coffee bean prices (↑ 27% in 2MFY09) is likely to impact margins, despite the rational price hikes effected across categories.
- **Low debt burden to drive pre-tax earnings:** Sale of its investment in Energy Brand Inc. (Oct-07) resulted in a profit of Rs 16bn, significantly reducing the net debt position from Rs 41bn in FY07 to ~Rs 25bn in FY08. Lower interest cost is expected to drive 16% growth in pre-tax profits over the next 2 yrs.
- **Unattractive at current growth**: In our opinion, TTL's current valuation of 14.6x P/E FY09E is a tad below mid-cycle valuations and adequately reflects lower core earnings growth as well as its significant presence in mature categories. We do not see any scope for a re-rating, despite reasonable pre–tax earnings growth due to a lower interest burden. We have lowered our earnings estimate for FY09E to Rs 53.8 (↓18%) and FY10E to Rs 60.2 (↓19%), reflecting inflationary cost pressures and are downgrading our rating on the stock to sector **Underperformer**.

Financial summary

Y/E Mar	Sales (Rs mn)	Adj .PAT (Rs mn)	Consensus EPS* (Rs.)	Adj. EPS (Rs.)	Change YoY (%)	P/E (x)	RoE (%)	RoCE (%)	EV/EBIDTA (x)	DPS (Rs.)
2007	40,249	2,772	-	48.4	(3)	-	12.7	13.2	-	15.0
2008	43,923	2,207	-	35.8	(26)	21.6	6.3	9.0	11.5	35.0
2009E	48,403	3,319	70.3	53.8	50	14.4	7.5	9.6	10.7	16.0
2010E	50,969	3,708	82.5	60.2	12	12.9	7.9	10.5	9.6	18.0

Source: *Consensus broker estimates, Company ENAM estimates. Note: ^Includes special one time dividend of Rs 20 per share.

Tata Tea (Standalone)

(Rs mn)	FY07	FY08	FY09E	FY10E
Revenue	**10,704**	**11,534**	**13,149**	**14,464**
% YoY	9.0	7.8	14.0	10.0
RM	3,396	5,941	6,745	7,449
% of revenue	32	51.5	51.3	51.5
Other cost	5,331	3,830	4,313	4,672
% of revenue	50	33.2	32.8	32.3
EBITDA	**1,977**	**1,763**	**2,091**	**2,343**
% of revenue	18	15	16	16
EBIT	**1,791**	**1,661**	**1,986**	**2,233**
% of revenue	17	14	15	15

Source: Company, ENAM Research

- **TTL's branded tea sales grew by 15% in FY08** (vs. tea consumption growth of 3%), led by value market share gain of 180bps to reach 20.4%. The largest brands in the domestic tea portfolio, Tata Tea Premium and Tata Tea Agni, demonstrated strong growth over previous year despite price increases. Growth in other regional brands, Gemini, Kanan Devan & Chakra gold, was driven by consumer promotion and market activation initiatives. We expect domestic sales growth to be maintained at 12% CAGR over the next 2 years.
- **A variable cost model**: Post the hive-off of South India plantations (17 estates in Dec 2005 to Kanan Devan Hills Plantations) and North India plantations (24 estates in March-2007 to Amalgamated Plantations Pvt. Ltd), TTL has now completely moved to a variable cost model. The standalone domestic entity will now purchase nearly all its raw material requirements from the hived off estates at auction prices. Thus a general increase in auction prices will have a direct bearing on raw material costs.
- **Domestic tea prices are firm:** The average price of Indian tea at the auction centers has been on the rise in the first quarter of CY08. While domestic auction prices increased by 3% to Rs 67/kg in FY08, we expect prices to further increase by 8% in FY09 on account of shortfall of Kenyan tea (Indian auction prices largely governed by Kenyan tea production), rising domestic consumption and low carry forward stock. Tata Tea has taken a price hike of Rs 5 to Rs 8 across its key brands. Other players including HUL are expected to follow suit. Thus we believe gross margin at best will remain stable in FY09.
- **Operating margin is estimated to improve in FY09,** driven by lower employee cost and control on media spends. Core earnings (EBIT excluding other non operating income) for the standalone entity is expected to grow by 16% CAGR through FY08-FY10E.

Tata Tea GB Ltd. (77.7% subsidiary)

(Rs mn)	FY07	FY08	FY09E	FY10E
Revenue	**22,980**	**23,040**	**24,639**	**25,095**
% YoY	13.0	0.3	6.9	1.9
Cost of sales	10,853	11,000	11,827	11,920
% of revenue	47.2	47.7	48.0	47.5
Selling / Admin & Depreciation	8,927	9,020	9,683	9,862
% of revenue	38.8	39.1	39.3	39.3
EBIT	**3,200**	**3,020**	**3,129**	**3,313**
% of revenue	13.9	13.1	12.7	13.2

Source: Company, ENAM Research

- **Growth of 6% YoY** in FY08 (at a constant foreign exchange rate) was largely driven by acquisitions. Volume growth is still a struggle as black tea consumption in Tata Tea GB's key markets i.e. Great Britain, US, and Canadian has continued to decline. Value market share has also declined by 10bps to 26.1% in GB and 10bps to 5.5% in US. However going ahead we believe select price increases and a depreciating rupee will offset the impact of lower sales in FY09. As Tata Tea GB financial accounts are in pound sterling and consolidated at the group level in Indian rupees, we have considered rupee depreciation vs. the pound sterling in our revenue growth estimate of 4% CAGR over the next 2 years. We believe inorganic growth through smaller acquisitions (Vitax & Flosana trademarks in Poland, acquired for Rs 390mn in May 2007) will help Tata Tea GB to build its presence in specialty teas (green/ fruit/ herbal) going forward. Such acquisitions are not factored into our growth estimates.
- **Margin to remain under pressure due to sharp rise in tea prices.** Tata Tea GB buys a bulk of its raw tea requirement from Kenya (in USD) apart from other regions. Due to the ongoing political crisis in Kenya and the presence of drought-like conditions, Kenyan production is expected to decline by around 10% to 335mn kg in 2008. In fact, tea auction prices in Kenya were up 37% YoY for the first two months of FY09. Despite USD depreciation (against the pound sterling) providing a partial hedge, we expect higher raw material prices to impact the EBIT margin in FY09. We have forecasted core earnings growth of 5% CAGR over FY08-FY10E.
- **Strengthening its presence in China, the world's 2nd largest tea market.** Tata Tea GB has entered into a joint venture with Zhejiang Tea Import and Export Company, which accounts for nearly 25% of Chinese exports. The JV (70% owned by Tata Tea GB) will manufacture and market green tea polyphenols, green tea extracts, cold and hot water soluble instant tea, liquid tea concentrates and other value added tea beverage products. With the popularity of green tea going across global markets, the JV not only marks the entry into the world largest green tea market (Green tea production accounts for 93% of China's total tea production and also forms the bulk of consumption) but also increases Tata Tea GB's presence in higher growth categories.

Tata Coffee Ltd. (57% subsidiary)

(Rs mn)	FY07	FY08	FY09E	FY10E
Revenue	**7,500**	**9,832**	**11,062**	**11,814**
% YoY	304	31	13	7
RM	2,443	3,090	3,651	3,896
% of revenue	32.6	31.4	33.0	33.0
Ads	1,614	1,944	2,162	2,304
% of revenue	21.5	19.8	19.5	19.5
Other cost	2,216	3,010	3,374	3,603
% of revenue	29.5	30.6	30.5	30.5
EBITDA	**1,226**	**1,787**	**1,876**	**2,011**
% of revenue	16.4	18.2	17.0	17.0
EBIT	**1,016**	**1,484**	**1,556**	**1,661**
% of revenue	13.6	15.1	14.1	14.1

Source: Company, ENAM Research

Tata Coffee's consolidated revenues increased 31% to Rs 9.8bn in FY08, due to the base effect of the Eight O Clock Coffee (EOC) acquisition (only 8 months of financials included in FY07, as the company was acquired in August 2006). EOC enjoys significant retail distribution with approximately 67% penetration in the US retail coffee market. EOC now plans to extend the branded whole bean and value gourmet segment beyond the US retail market to other regions such as Russia and China. Tata Coffee (standalone) reported robust growth of 15% to Rs 3.1bn led by increased instant coffee exports. On a consolidated basis we expect 10% CAGR in revenues over the next 2 years, driven by improving realization of domestic plantation crops and inflation-led price increases by EOC.

Coffee prices continue to rise in CY08E due to increased demand. International coffee prices were up 22% for the first 4 months of CY08, although from Feb 2008, prices have been on a declining trend due to an estimated increase in production from Brazil. However growing demand for coffee worldwide (according to ICO –"imports by importing members during CY07 totaled ~100mn bags, the highest level ever recorded in the history of the coffee trade") and coupled with the increase in crude linked input costs (transportation and fertilizers) will keep coffee prices firm in CY08. While rising commodity prices will benefit the plantation business in India, we expect EOC margins to be marginally impacted despite select price increases. EBIT for the consolidated entity is expected to grow by 6% CAGR over the next 2 years.

Mount Everest Mineral Water

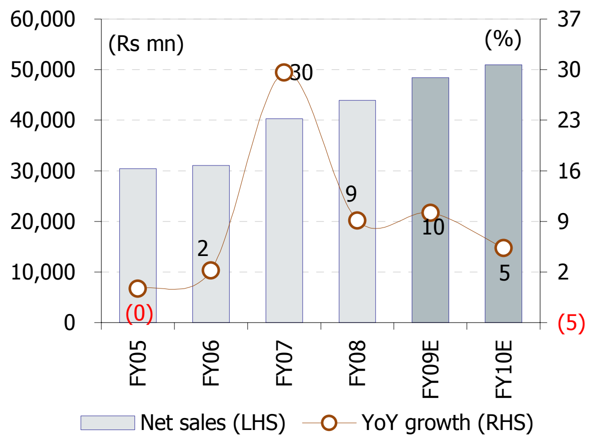
Acquisition summary: TTL acquired a 32% stake in Mount Everest Mineral Water Company, owners of the Himalayan brand of bottled water in June 2007, through a combination of promoter stock and market offerings. Besides gaining an opportunity to enter the fast growing bottled water segment, the water source located at the foothills of the Himalayas in Himachal Pradesh has been certified as one of the largest, purest and perennial sources of natural mineral water in the world (certified by Hidell-Eyster International, a leading water specialist in the USA).

Revenue growth potential: The bottled water segment in India is estimated in the range of Rs 13bn - 15bn and is growing at a rate of ~25% p.a. The category covers both natural mineral water and packaged drinking water, and is highly fragmented with nearly 200 brands and a wide spectrum of price-value offerings. The Himalayan brand falls under the natural mineral water category, which is retailed at a premium vs. packaged drinking water products.

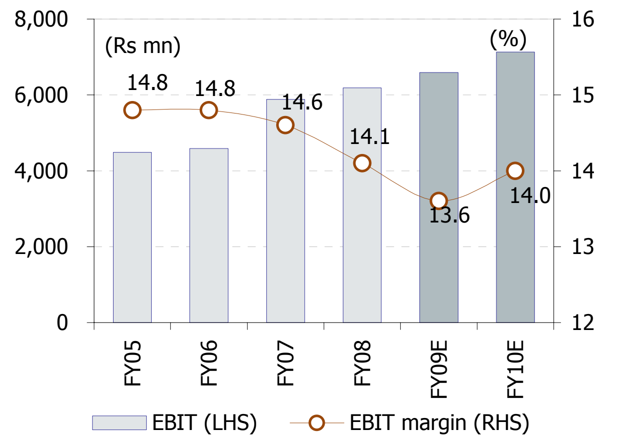
With a growing number of water related diseases and higher awareness amongst consumers, the bottled water segment is expected to grow in the 25-30% range over the next few years. However the challenge for TTL would be to educate the consumer about the benefits of natural mineral water vs. packaged drinking water and convince them to pay a premium price. Having said that, large & premium institutional buyers are slowly moving towards better beverage offerings and hence we believe that TTL with its present distribution network and institutional customers will be able to significantly scale up the Himalayan brand. We have forecasted a revenue growth of 40% CAGR over the next 2 years.

Earnings impact on consolidated entity: Mount Everest Mineral Water reported revenues of Rs 247mn and a net loss of Rs 63mn in FY08 (vs. revenues of Rs 239mn and a profit of Rs 13mn in FY07). We believe in order to scale the brand, TTL will continue to incur higher ad spends and distribution costs, which will have a negative bearing on the EBITDA margin. Despite being a 32% subsidiary, its financials are consolidated as TTL has a controlling interest in the company.

TTL Consolidated: Revenue & growth trend

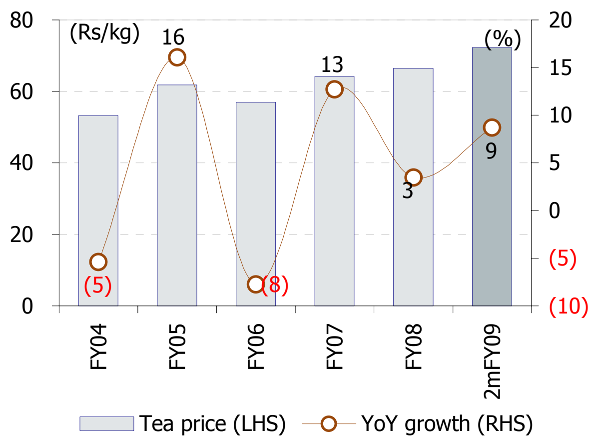


TTL Consolidated: EBIT^ & margin trend

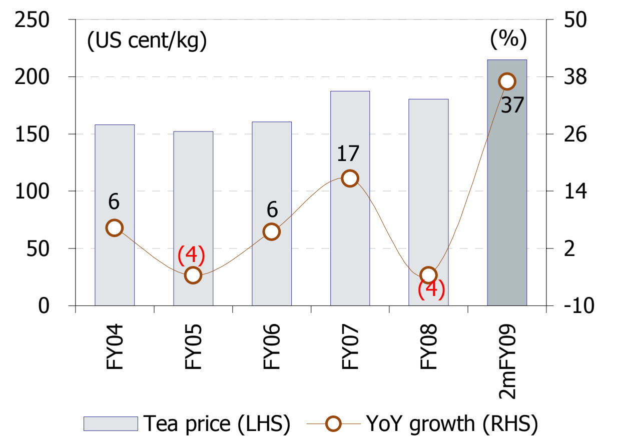


Source: Company, ENAM Research ^Note: EBIT is pre non-operating other income and extraordinary items

Indian tea price trend

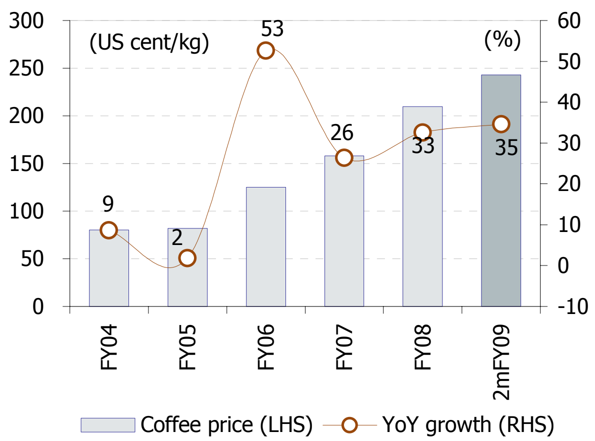


Kenyan tea price trend

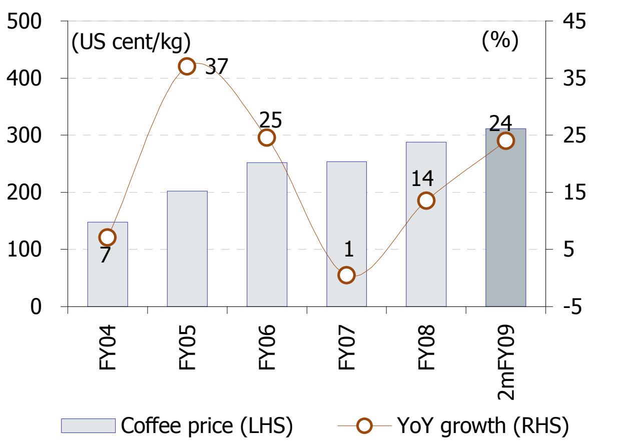


Source: CMIE

Robusta coffee price trend



Arabica coffee price trend



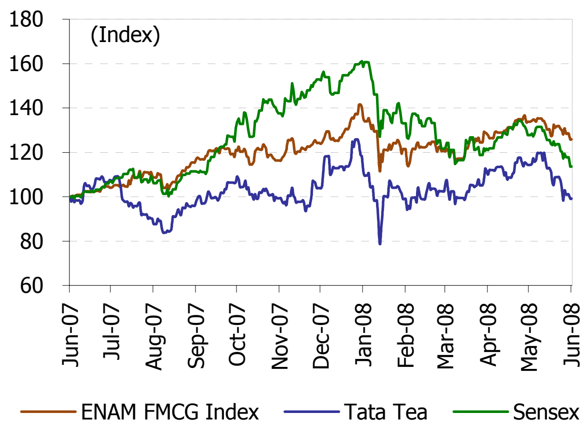
Source: CMIE

TT: Branded tea market share trend

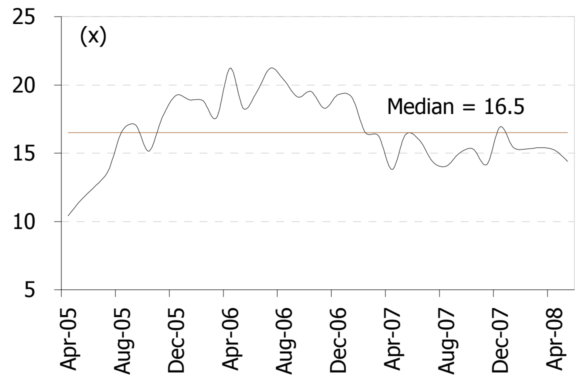
Geography	Volume (%)		Value (%)	
	Mar '08	Change	Mar '08	Change
GB	30.1	1.2	26.1	(0.1)
Australia	18.8	(0.9)	12.4	(1.3)
Canada	41.3	1.1	36.6	0.8
France	9.1	0.5	9.0	0.5
USA	7.7	0.4	5.5	(0.1)
India	20.2	2.3	20.4	1.8

Source: Company

Relative stock price performance



Tata Tea: 1yr Forward P/E trend



Source: ENAM Research Note: ENAM FMCG composite includes 24 companies

Index/stock performance

(%)	Mkt Cap (Rs bn)	3 mth	6 mth	1 yr
Sensex	-	(1.1)	(24.4)	8.5
ENAM FMCG Index	-	4.9	(2.8)	24.2
Tata Tea	**48**	**(0.7)**	**(17.2)**	**(4.4)**
ITC Ltd	744	6.5	0.3	29.9
Hindustan Unilever LTD	493	1.8	6.9	21.3
Nestle India Ltd	164	19.7	18.4	41.7
Asian Paints Ltd	121	11.1	28.2	48.9
Dabur India Ltd	86	1.4	(16.4)	(2.2)
Colgate Palmolive India Ltd	50	(4.0)	(3.3)	4.7
Marico Ltd	39	4.0	(7.1)	16.2

Source: ENAM Research

Company Financials

Income statement

(Rs. mn)

Y/E Mar	FY07	FY08	FY09E	FY10E
Net sales	**40,249**	**43,923**	**48,403**	**50,969**
Other operating income	0	0	0	0
Total income	**40,249**	**43,923**	**48,403**	**50,969**
Cost of goods sold	21,195	24,283	27,043	28,601
A&SP	8,467	9,377	10,358	10,805
Admin overheads	3,734	3,162	3,485	3,517
Operating Profit	6,853	7,100	7,517	8,045
Other income	1,144	397	420	450
PBIDT	**7,997**	**7,497**	**7,937**	**8,495**
Depreciation	967	916	928	914
Interest	2,858	2,214	1,869	1,724
	0	0	0	0
Pre-tax profit	**4,172**	**4,368**	**5,140**	**5,858**
Tax provision	1,074	1,534	1,645	1,875
(-) Minority Interests	326	627	176	275
Associates	0	0	0	0
Adjusted PAT	**2,772**	**2,207**	**3,319**	**3,708**
E/o income / (Expense)	1,661	13,218	(120)	0
Reported PAT	**4,433**	**15,425**	**3,199**	**3,708**

Key ratios

(%)

Y/E Mar	FY07	FY08	FY09E	FY10E
Sales growth	**29.6**	**9.1**	**10.2**	**5.3**
OPM	**17.0**	**16.2**	**15.5**	**15.8**
Oper. profit growth	28.2	3.6	5.9	7.0
COGS / Net sales	52.7	55.3	55.9	56.1
Overheads/Net sales	9.3	7.2	7.2	6.9
Depreciation / G. block	1.4	1.3	1.3	1.2
Effective interest rate	9.1	5.8	6.5	6.8
Net wkg.cap / Net sales (x)	0.0	0.0	0.0	0.0
Net sales / Gr block (x)	0.8	0.6	0.7	0.7
Incremental RoCE	3.4	(21.4)	42.3	(164.4)
RoCE	**13.2**	**9.0**	**9.6**	**10.5**
Debt / equity (x)	1.7	0.7	0.6	0.5
Effective tax rate	25.7	35.1	32.0	32.0
RoE	**12.7**	**6.3**	**7.5**	**7.9**
Payout ratio (Div/NP)	19.4	14.0	30.8	29.9
EPS (Rs.)	**48.4**	**35.8**	**53.8**	**60.2**
EPS Growth	(2.6)	(26.1)	50.4	11.7
CEPS (Rs.)	65.3	50.7	68.9	75.0
DPS (Rs.)	15.0	35.0	16.0	18.0

Balance sheet

(Rs. mn)

Y/E Mar	FY07	FY08	FY09E	FY10E
Total assets	**73,541**	**74,362**	**73,031**	**72,667**
Gross block	71,425	72,175	73,025	73,805
Net fixed assets	64,473	64,307	64,229	64,096
CWIP	159	150	110	105
Wkg. cap. (excl cash)	1,599	382	1,457	1,265
Investments (trading)	3,450	2,138	2,138	2,138
Cash / Bank balance	1,188	3,689	1,401	1,367
Investment in sub.	2,672	3,696	3,696	3,696
Capital employed	**73,541**	**74,362**	**73,031**	**72,667**
Equity capital	588	616	616	616
Reserves	26,764	42,448	44,789	47,475
Borrowings	45,778	30,622	26,900	23,800
Deferred tax (net)	412	675	725	775

Cash-flow

(Rs. mn)

Y/E Mar	FY07	FY08	FY09E	FY10E
Sources	**37,994**	**1,473**	**(453)**	**499**
Cash profit	5,854	3,831	4,473	4,947
(-) Dividends	(715)	(2,157)	(986)	(1,110)
Retained earnings	5,140	1,673	3,487	3,837
Issue of equity	7,515	2,183	0	0
Borrowings	28,150	(15,156)	(3,722)	(3,100)
Others	(2,810)	12,772	(218)	(239)
Applications	**37,994**	**1,473**	**(453)**	**499**
Capital expenditure	825	741	810	775
Investments	35,277	(288)	0	0
Net current assets	925	(1,481)	1,025	(242)
Change in cash	967	2,501	(2,288)	(34)

Source: Company, ENAM Research

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CONFLICT OF INTEREST DISCLOSURE STATEMENT

We, at ENAM, are committed to providing the most honest and transparent advice to our clients. However, given the nature of the capital markets, from time to time we are faced with situations that could give rise to potential conflict of interest. In order to provide complete transparency to our clients, before we make any recommendations, we are committed to making a disclosure of our interest and any potential conflict IN ADVANCE so that the interests of our clients are safe- guarded at all times. In light of this policy, we have instituted what we believe to be the most comprehensive disclosure policy among leading investment banks/brokerages in the world so that our clients may make an informed judgment about our recommendations. The following disclosures are intended to keep you informed before you make any decision- in addition, we will be happy to provide information in response to specific queries that our clients may seek from us.

Disclosure of interest statement (As of June 09, 2008)

1. Analyst ownership of the stock	No
2. Firm ownership of the stock	No
3. Directors ownership of the stock	No
4. Investment Banking mandate	No
5. Broking relationship	No

We are committed to providing completely independent and transparent recommendations to help our clients reach a better decision.