



Investment
Evaluation
report in HRS
Company

Sample Reports



Contents

1.0 Executive Summary	2
2.0 Global Tea Industry	5
3.0 Local Tea Industry	7
3.1 Tea Auction Prices	8
3.2 Tea Exports	8
3.3 Key Players(revenue wise).....	8
4.0 The Company	9
5.0 Company Fundamentals.....	10
5.1 Revenue.....	10
5.2 Profit Margins	11
5.5Cost of Production	14
5.5.1 Labor	14
6.0 Peer Analysis	15
7.0 Key Positives	17
8.0 Key Risks	17
9.0 Valuation - Investment Rationale	22
9.0 Tea Industry SWOT Analysis	24

1.0 Executive Summary

Tea is one of the most popular and widely consumed hot beverages in the world with more than 30 countries producing tea. The estimated global production was 4.2m tonnes in 2011 and is highly influenced by climate conditions. In 2011, Country XXA produced approximately 328mn kg of tea and is considered to be the fourth largest tea producer in the world.

Company HRS comprises of Name DW Estate and Name GD Estate and grows high grown tea. Company HRS is experiencing a continuous drop in production affected by internal and external conditions. Externally, the company is impacted by adverse weather conditions, labor unrest and political instability in its export markets. Internally, Company HRS is experiencing low productivity, increasing labor costs and negative working capital to name a few of the challenges.

We value the company's common share at \$7.98 based on an adjusted price to sales (P/S) multiple of 0.10x.

We analyzed the tea industry in Country XXA and the company, Company HRS based on information received from the company, research reports and industry sources. As such we believe taking into consideration the tea operation only, that an investment in Company HRS is currently not best suited.

Our key findings are listed below

- Local tea industry to slowdown in 2012 with only a slight pickup in 2013. Country XXA Tea Board cut production forecast for 2012 to 325m kg (-0.8% YoY) from its previous estimate of 330m kg. The Intergovernmental Group on Tea expects Country XXA's tea production to grow by only 1% over the next decade. 2011 was an exceptionally poor year as many in the industry were impacted by poor weather conditions, labor unrest and unstable political conditions in the main export markets.
- Plantation workers are seen as fixed labor resources with compensation, welfare, accommodation etc. having to be maintained despite fluctuating production volumes. Further worker salaries and welfare matters are extremely sensitive and can cause strike action impacting estate productivity and profitability.
- Rainfall and temperature patterns indicate other regions in the country maybe more suitable for tea production. Temperature in the region is considered to be outside the ideal conditions and for three months of the year rainfall is below the minimum required for tea production.

- Company HRS's Net Sales Average (NSA) is lower than its peers; and is also lower than Cost of Production (COP). Despite Uva high grown prices reaching an average of \$322 in 2012, Name DW Estate average NSA is \$296.

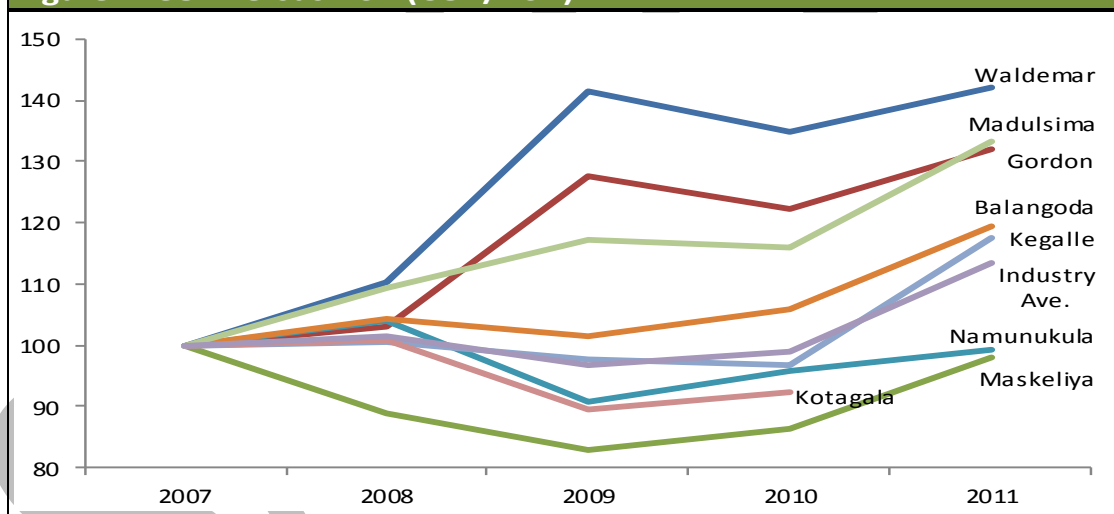
Figure 1: Auction prices versus NSA (Rs. Per kg)

Year	Waldemar			Gordon		
	Auction prices	NSA	Discount	Auction prices	NSA	Discount
2010	316.2	270.4	-14.5%	316.2	317.4	0.4%
2011	307.6	296.2	-3.7%	307.6	298.5	-3.0%
2012 to date	322.3	295.8	-8.2%	322.3	328.4	1.9%

Note: Our analysis is based on company information, the NSA result analysis for Gordon in 2010 and 2012 year to date does not appear to be realistic

- NSA is consistently lower than COP. While for several industry peers COP exceeds NSA, this gap at Company HRS is greater than the industry average. The below graph indicates the ratio of COP to NSA from a base of 2007 =100.

Figure 2: COP versus NSA (COP/NSA)



Source: Company reports

- Company HRS is a recipient of fertilizer subsidy thus reducing COP of VP tea by about \$11.39 per kg and COP of seedling tea by about \$16.59 per kg. A reduction or withdrawal of the fertilizer subsidy will significantly impact Company HRS.
- Company HRS's declining tea production volumes is a cause for concern. Since 2009 Name DW Estate has experienced a drop in production while production at Name GD Estate has been reducing since 2010.

Figure 3: Stallion Crop	2008	2009	2010	2011	1H12
Waldemar Estate	363,510	328,684	264,879	246,270	138,322
YoY Change %	NA	-9.6%	-19.4%	-7.0%	-
Gordon Estate	442,382	519,121	502,104	295,136	168,147
YoY Change %	NA	17.3%	-3.3%	-41.2%	-
Total	805,892	847,805	766,983	541,406	306,469
YoY Change %	NA	5.2%	-9.5%	-29.4%	-

Source: Company reports

- Name DW and Name GD estates have been consistently making losses prior to the Company HRS takeover.

Figure 4: Historical losses	2002	2003	2004	2005	2006
Gorden Estate					
Accumulated Profit/(Loss) (Rs.)	(5,848,234)	(12,181,557)	(11,335,915)	(13,819,612)	(17,697,324)
Waldemar Estate					
Accumulated Profit/(Loss) (Rs.)	(9,082,525)	(19,108,222)	(15,347,813)	(14,307,510)	(12,667,352)

Source: Company reports

- Labor costs are steadily increasing and now accounts for about 48% of COP. However this is still below industry standards of 55-60% of COP. Workers' wages are reviewed every two years with the next revision expected to be in April 2013.

On a positive note, the management had been able to come into an agreement to provide work for three days per week with the employees though the requirement is six days.

- High outstanding overdraft. The outstanding overdraft is almost on par with total assets for 2011. A risk is that banks would not extend overdraft limits or request Company HRS to make payments.
- Negative working capital. Working capital over the past three years has been negative and there are significant increases in related party balances indicating to us that related parties are funding the day to day operations of the company.
- Approval from the golden shareholder has not been obtained. As per the Articles of Association of Company PUL, COMPANY PUL must obtain the written consent of the "Golden Shareholder" (Secretary to the Treasury) prior to sub leasing, ceding or assigning its rights in part or all of the said Estates. We have been made aware that this approval has not been obtained.
- A majority of directors do not possess tea industry related experience. We believe this to exclude the Director, Mr. Name RN, who is a Non-Executive Director of Company FJ, Chairman and Managing Director of Company HP and Company PUL and a member of

the Plantation Trust Fund. Not possessing adequate industry related experience would impact the strategic and operational activities at Company HRS.

However in a positive development, Company HRS had for the past three months recruited the services of an Country DI consultant. With his active involvement and despite poor weather conditions pluckers at Name DW Estate have increased their plucking average from 13 kg to 16kg per plucker.

- Limited alternative use of land extent. The advantages of transforming the estates as a tourist destination maybe limited as Company HRS estates are not in close proximity any other tourist attractions. Further the infrastructure of the bungalows is in a depleted state thus requiring additional capital infusion to bring it to required standards.
- In November 2011, the government passed a law allowing it to take over private businesses which are deemed to be under-performing. The law was titled "Revival of Underperforming Enterprises and Underutilized Assets. It states that the enterprises or assets for takeover are on government lands that have been provided for private operators for a specific purpose and that the government still owns the lands.

Whilst we have not received new information that the government plans to re-enact the law to take over more companies, we cannot completely rule out the possibility that this may happen in the future.

- Our 12-month target price of \$7.98 for Company HRS's common shares is based on applying an adjusted price to sales (P/S) multiple of 0.10x to our forward 12-month revenue estimate (last six months of 2012E; 2H12 and first six months of 2013E; 1H13).

Given the company's characteristics we applied a marketability discount of 20% and an illiquidity discount of 20% to the industry multiple of 0.16x to arrive at 0.10x. The industry P/S multiple was adjusted by the proportion of tea hectares of the total hectares at each individual company and was also adjusted for outliers, Company HP (P/S 0.50x) and Company PKH (P/S 0.72x)

2.0 Global Tea Industry

Tea is one of the most popular and widely consumed hot beverages in the world with more than 30 countries producing tea. The global tea industry is dominated by Country YU (37% market

share), followed by Country DI, Country KY, Country XXA and Country SA. These countries account for around 80% of global production and 77% of total exports.

Country XXA is the fourth largest producer of tea and is known to only trail Country KY in tea exports. However, Country XXA's share of the world tea trade has dropped from 40.0% in 1970 to 27.9% in 2000 and to 21.6% in 2011.

Figure 5: Share of Global Tea Production: 2011

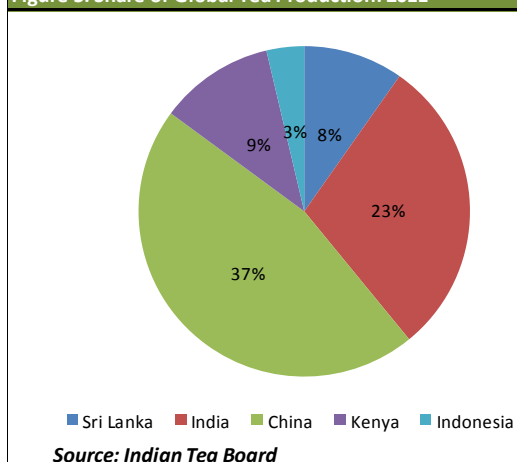
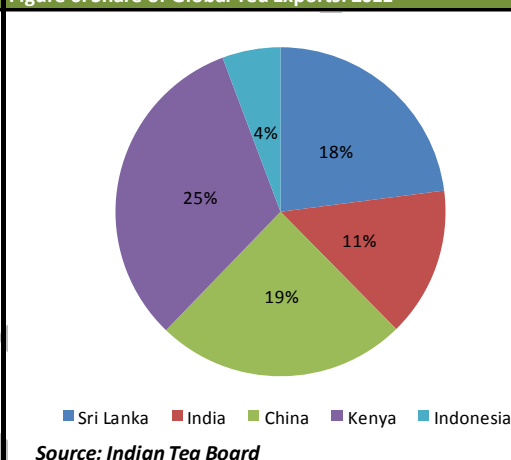


Figure 6: Share of Global Tea Exports: 2011



Global Tea Composite Prices

The Food and Agricultural Organization's tea composite price in 2011 rose to USD2.85 (USD 2.81 in 2010). High prices are due to a weaker USD, high oil prices and low yields. Prices are expected to remain firm in 2012 as demand continuous to exceed supply.

It has been forecasted that based on current projections, supply and demand for black tea will reach equilibrium in 2012 at a price of USD2.75 per kg if there is no significant increase in supply due to firm prices.

Figure 7: FAO Tea Composite Price

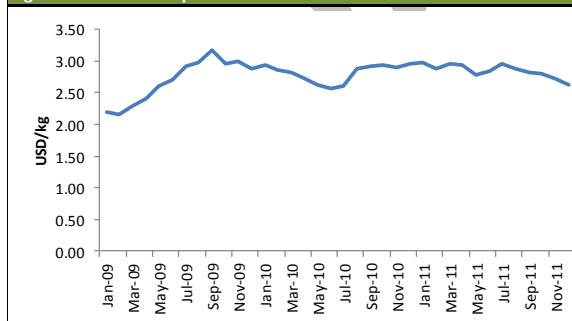
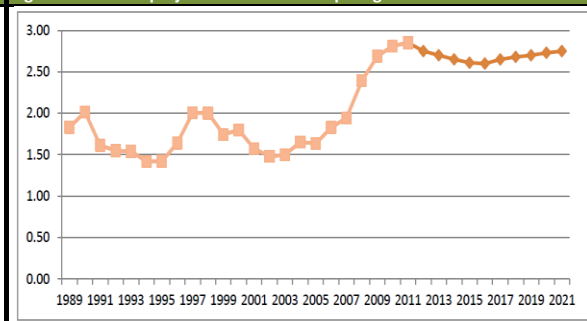


Figure 8: Baseline projections to 2012 USD per kg



Outlook

The Intergovernmental Group on Tea expects production in Country YU, Country DI, Country XXA and Country KY to grow at 3.4%, 1.5%, 1.0% and 2.8% annually over the next decade. However, the ten year projections to 2021 indicate that world black tea production will grow at a slightly lower rate compared to the previous decade.

Figure 9: Black Tea estimated/projected production

Country	Black Tea Production			
	Estimated	Projected	Growth Rates	
	2011	2021	2002/2011	2012/2021
	Tonnes		% Per Year	
China	185,000	259,700	16.1%	3.4%
India	990,337	1,149,214	1.7%	1.5%
Sri Lanka	325,543	358,418	0.4%	1.0%
Kenya	370,000	487,678	2.8%	2.8%
Indonesia	92,000	83,536	-3.6%	-1.1%

Source: Intergovernmental Group on Tea

Black tea exports are projected to reach 1.52m tonnes in 2021 with Country YU, Country XXA and Country KY to grow at 7%, 1% and 2.9% annually over the next decade.

3.0 Local Tea Industry

Country XXA's tea production falls into three broad categories in terms of elevation – high grown (4,000 feet above sea level), mid grown (2,000 – 4,000 feet above sea level) and low grown (2,000 feet or less above sea level). In 2011, low grown tea contributed 60% of total production while high and medium contributed 24% and 16%.

In July 12, tea production declined for the sixth consecutive month with year-to-date tea production dropping by 3.9% YoY to 188.1m kg. The Country XXA Tea Board cut production forecast for 2012 to 325m kg from its previous estimate of 330m kg.

Figure 10: Sri Lanka Tea Production

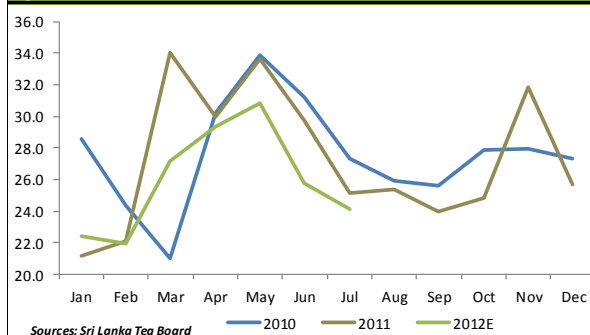
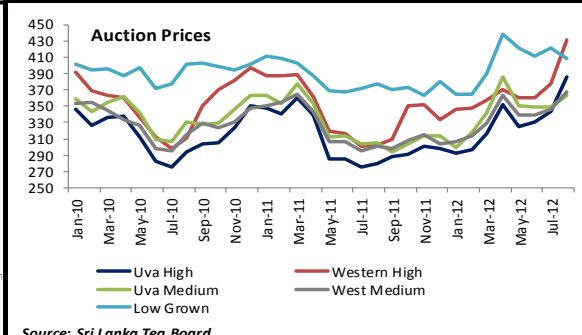


Figure 11: Sri Lanka Tea Auction Prices



3.1 Tea Auction Prices

Auction prices of high and medium grown tea rose in 2012 due to low yields from drought conditions. However, the prices of low grown tea have declined over the past few months as supply was unaffected. In August 12, auction price of Uva high grown tea was \$385.64 (+ 38% YoY). Year-to-date high grown tea production dropped 7.3m kgs compared to the same period in 2011 due to adverse weather conditions.

3.2 Tea Exports

Country XXA exports around 90% of tea produced in the country with the Middle East being the largest buyer accounting for over 50% of total exports. However, political instability in this region has taken its toll on tea exports; tea exports to the Country ED in 2012 was down 63.5% YoY to 2.43m kg. Exports to Country RNI were disrupted due to trade embargos imposed by the US. Country RNI currently accounts for around 13% of total exports. Exports to the top ten destinations declined by 4.34% YoY for 1Q2012.

Figure 12: Top ten destinations of Pure Ceylon tea from Jan– March 2012/2011 Units:Qty - MKg

Country	2012	2011	Change		Total tea Exports %	
	Qty	Qty	Qty	%	2012	2011
Russia	11.2	12.7	-1.5	-11.9%	14.6%	15.9%
Iran	10.1	7.5	2.6	34.0%	13.2%	9.4%
Syria	6.8	6.2	0.6	10.2%	8.9%	7.8%
Iraq	5.3	4.9	0.4	8.2%	6.9%	6.1%
Turkey	4.3	5.8	-1.5	-25.2%	5.6%	7.2%
Libya	3.9	1.9	2.0	105.9%	5.1%	2.4%
Azerbaijan	2.7	2.6	0.0	1.9%	3.5%	3.3%
Japan	2.5	3.2	-0.7	-22.8%	3.2%	4.0%
UAE	2.4	6.7	-4.2	-63.5%	3.2%	8.4%
Ukraine	1.9	2.0	0.0	-1.0%	2.5%	2.5%
Total	51.0	53.3	-2.3	-4.3%	66.9%	66.9%

Source: Sri Lanka Tea Board

3.3 Key Players(revenue wise)

Company PKLT- Owned by Company LKO Group, the estate consists of a total cultivated area of 11,876.6 hectares (Ha) of tea (71%) and rubber (29%). Revenue was \$3,610m (-2% YoY) and

net profits were \$438m (-34% YoY) for FY12. The company generated a tea crop of 5.5m kg which produced a yield of 2,230kg per Ha.

Company VKL– A wholly-owned subsidiary of Company DPY, comprises of 27 estates with approximately 13,000 Ha with an equal extent of tea and rubber. Revenues for 2011 were \$6,110m (+57.3% YoY) and profit after tax was \$463m (+41.9% YoY). Total production for 2011 amounted to 6.1m kg (+10.1% YoY).

Company MGB- A subsidiary of Company YXU, the estate is 10,561 Ha which is fully used for tea. In FY12 tea production was 9.2m kg achieving a yield of 1,536kgper Ha. Cost of production increased to \$328.0 per kg compared to \$304.30 per kg in FY11. Revenue was \$3,063m (-5.8% YoY) with a net loss \$370m.

4.0 The Company

In January 2007 COMPANY PUL Limited handed over management of Name DW and Name GD estates to Company HRS for a 38 year period. The agreement took effect from January 01 2007 and will end on June 21, 2045. Name DW and Name GD estates have a total land extent of 910 acres and 984 acres respectively and consist of two factories on each estate. The cultivated tea extent is 713 acres at Name DW Estate and 756 acres at Name GD Estate.

Produce of the two estates reaches the local and international market through the City AAA tea auction and buyers include Company KABS, Company TEM, Company STEL, Company SGXE and Company LCPU.

Board of Directors

Chairman: Mr. Name FMM

Mr. Name FMM, is also the Chairman of Company LHO, Company CLOS, Company QYXZ, Company GLC, Company HRS Holdings, Company HRS Consultancy, and a Director of Company GTIL, Company CGSV, Company PFC, Company VGK, and Company JAKP. Mr. Name FMM is the Vice President of the Asian Football Confederation (AFC) and is the FIFA Development Officer for the Asian region. Mr. Name FMM is also an Attorney at law.

Director:Mr. Name TTA

Mr. Name TTA is also a Director of Company FSSO,

Director: Mr. Name RN

Mr. Name RN is a Non-Executive Director of Company FJ, Chairman and Managing Director of Company HP and Company PUL and a member of the Plantation Trust Fund.

Director/Chief Executive Officer: Mr. Name AFFC

Director/Finance: Mr. Name FMKB

Extract from the lease agreement

COMPANY PUL has on or about 6th December 2006 entered into Management / Operational Agreement (MOA) bearing No.2104 and attested by Name FPL Notary Public with Company HRS whereby COMPANY HRS was given powers and rights to manage and control Name GD and Name DW Estates together with the Plantations / buildings / fixtures and assets with the exclusive right to all income and profit. A Power of Attorney bearing No.2105 was also given to COMPANY HRS for managing the estates and its employees.

As per the said MOA COMPANY HRS shall have absolute and exclusive right to all income and profits from the said estates inclusive of any other business carried on therein. Clause 5(b) of the said MOA states that COMPANY HRS cannot sublet or otherwise part with the premises or assign same without the consent of COMPANY PUL.

5.0 Company Fundamentals

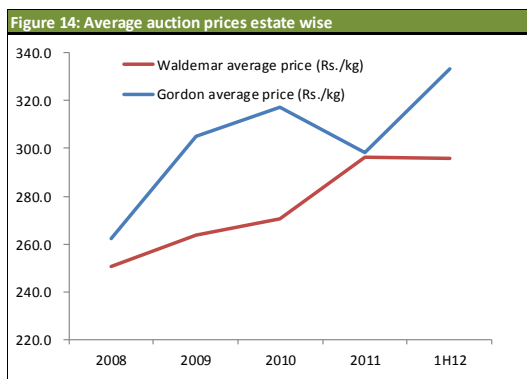
5.1 Revenue

Revenue at Company HRS grew at 15.6% CAGR during 2007 to 2010. However 2011 was an exceptionally poor year as many in the industry were impacted by poor weather conditions, labor unrest and unstable political conditions in the main export markets.

Company HRS generates revenue from tea cultivated on Name DW and Name GD estates, reportedly producing about 15 different types of tea. Name DW Estate's revenue has been steadily declining since 2009 whilst Name GD Estate experienced a decline only in 2011. Growth of revenue is sustained by higher tea prices offsetting the steady decline in production.

Figure 13: Stallion revenue	2007	2008	2009	2010	2011	1H12
Waldemar Estate Revenue (Rs.)	64,484,894	97,797,020	81,525,077	80,430,887	70,776,205	51,176,780
YoY Change %	NA	51.7%	-16.6%	-1.3%	-12.0%	-
Gordon Estate Revenue (Rs.)	93,910,630	112,807,858	155,509,302	164,551,026	90,850,962	44,266,308
YoY Change %	NA	20.1%	37.9%	5.8%	-44.8%	-
Total Revenue (Rs.)	158,395,524	210,604,878	237,034,379	244,981,913	161,627,167	95,443,107
YoY Change %	NA	33.0%	12.5%	3.4%	-34.0%	-

Source: Company reports



Source: Company reports

Production is impacted by the above mentioned poor weather conditions and to a certain extent labor unrest curtailing productivity

Figure 15: Stallion crop

	2008	2009	2010	2011	1H12
Estate Crop (kgs.)	597,141	463,011	509,361	488,519	281,492
YoY Change %	NA	-22.5%	10.0%	-4.1%	
Bought Crop (kgs.)	208,751	384,794	257,622	52,887	24,977
YoY Change %	NA	84.3%	-33.0%	-79.5%	
Total	805,892	847,805	766,983	541,406	306,469
YoY Change %	NA	5.2%	-9.5%	-29.4%	
Net sales Volume	802,455	800,314	799,431	527,889	284,448
YoY Change %	22.8%	-0.3%	-0.1%	-34.0%	

Source: Company reports

5.2 Profit Margins

Figure 16: Profit margins

	2007	2008	2009	2010	2011	1H12
Gross profit	47,201,121	41,554,180	22,838,305	40,642,731	(6,853,446)	18,637,638
Gross Profit margin (%)	29.8%	19.7%	9.6%	16.6%	-4.2%	19.5%
EBITDA	3,045,189	(14,582,360)	(40,305,305)	(10,278,765)	(60,184,506)	(10,504,363)
EBITDA margin (%)	1.9%	-6.9%	-17.0%	-4.2%	-37.2%	-11.0%
EBIT	(5,110,566)	(23,430,094)	(49,044,436)	(11,998,139)	(62,637,726)	(11,180,045)
EBIT margin (%)	-3.2%	-11.1%	-20.7%	-4.9%	-38.8%	-11.7%

Source: Company reports

Fluctuating gross margins has largely been due to varying cost of sales levels. Over the past five years cost of sales as percentage of sales has been within the range of 70-104%. Salaries and other labor related expenses are a significant portion of manufacturing costs, reaching over 80% in 2010.

5.3 Name DW Estate

Name DW Estate contributes approximately 35-45% of total revenue at Company HRS. Sales volume in 2011 of 226,953 kgs was the lowest since Company HRS took over Name DW Estate in 2007. However the average price in 2011 was \$296.2 per kg, the highest on record at Name DW. Name DW Estate has been experiencing a decrease in production

Figure 17: Waldemar Estate Crop and Net Sales	2007	2008	2009	2010	2011	1H12
Estate Crop	NA	315,381	230,331	264,408	238,756	138,322
YoY Change %	NA	NA	-27.0%	14.8%	-9.7%	-
Bought Crop (kgs.)	NA	48,129	98,353	471	7,514	-
YoY Change %	NA	NA	104.4%	-99.5%	1495.3%	-
Total	NA	363,510	328,684	264,879	246,270	138,322
YoY Change %	NA	NA	-9.6%	-19.4%	-7.0%	-
Net sales Volume (kgs)	273,062	362,035	318,898	273,150	226,953	61,587
YoY Change %	NA	32.6%	-11.9%	-14.3%	-16.9%	-
Waldemar average price (Rs./kg)	232.0	250.4	263.6	270.4	296.2	295.8
YoY Change %	NA	0.5%	19.4%	-2.8%	9.9%	-
Waldemar Estate	64,484,894	97,797,020	81,525,077	80,430,887	70,776,205	51,176,780
YoY Change %	NA	51.7%	-16.6%	-1.3%	-12.0%	-

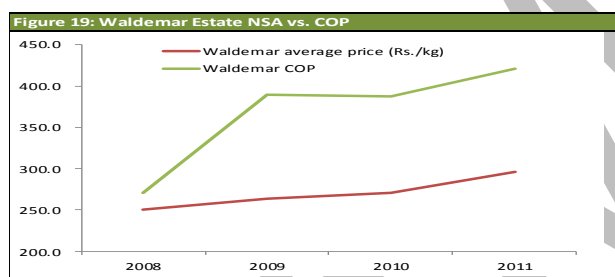
Source: Company reports

The table below indicates, net sales volume in five months of 2012 at Name DW Estate was significantly lower compared to the previous five years.

Figure 18: Waldemar Estate	2007	2008	2009	2010	2011	2012
Net sales volume kgs. (5 months)	128,332	202,294	176,410	196,887	105,633	71,658
Change in 5 months of 2012 net sales volume versus 5 months in previous years	-	-44.2%	-64.6%	-59.4%	-63.6%	-32.2%

Source: Company reports

COP is increasing at a faster pace than NSA.



Source: Company reports

Name DW Estate buying patterns - Company TEM continues to be the top buyer of Name DW Estate teas. During the Jan – Jun 12 eight of the ten top individual buyers reduced their purchases. Union Commodities reduced their purchases by as much as 87%.

Figure 20: Waldemar - Top ten individual buyers	Jan - Jun 2011	% of 2011	Jan - Jun 2012	% of 2012	YoY
EMPIRE TEA (PVT)LTD	27,260	12.0%	10,424	16.9%	-62%
AKBAR BROTHERS	18,622	8.2%	6,528	10.6%	-65%
CEYLON ESTATE TEAS (PVT) LTD.	2,748	1.2%	4,624	7.5%	68%
CEYLON TEA SER.LTD	20,924	9.2%	3,655	5.9%	-83%
VAN REES CEYLON LTD	11,712	5.2%	3,482	5.7%	-70%
UNION COMMODITIES	25,708	11.3%	3,428	5.6%	-87%
ESWARAN BROTHERS	6,452	2.8%	3,241	5.3%	-50%
IMPERIAL TEAS (PVT)LTD	6,577	2.9%	2,788	4.5%	-58%
RANFER TEAS (PVT)LTD	-	0.0%	2,390	3.9%	100%
G.T.L. LANKA (PVT) LTD.	1,751	0.8%	2,232	3.6%	27%
BPL TEAS (PVT)LTD	3,943	1.7%	1,790	2.9%	-55%

Source: Company reports

5.4 Name GD Estate

Name GD Estate contributes approximately 55-65% of total revenue at Company HRS. Sales volume in 2011 of 300,936 kgs was the lowest since Company HRS took over Name GD Estate in 2007. Name GD Estate has been experiencing an increase in estate crops. Average prices in 2011 was \$298.5 lowest in recent years.

Figure 21: Gordon Estate Crop and Net Sales	2007	2008	2009	2010	2011	1H12
Estate Crop	NA	281,760	232,680	244,953	249,763	143,170
YoY Change %	NA	NA	-17.4%	5.3%	2.0%	
Bought Crop (kgs.)	NA	160,622	286,441	257,151	45,373	24,977
YoY Change %	NA	NA	78.3%	-10.2%	-82.4%	
Total	NA	442,382	519,121	502,104	295,136	168,147
YoY Change %	NA	NA	17.3%	-3.3%	-41.2%	
Net sales Volume (kgs)	380,247	440,420	481,416	526,281	300,936	222,861
YoY Change %	NA	15.8%	9.3%	9.3%	-42.8%	-
Gordon average price (Rs./kg)	241.5	262.2	305	317	299	334
YoY Change %	NA	7.0%	20.1%	2.1%	-7.5%	-
Gordon Estate Revenue (Rs.)	93,910,630	112,807,858	155,509,302	164,551,026	90,850,962	44,266,308
YoY Change %	NA	20.1%	37.9%	5.8%	-44.8%	-

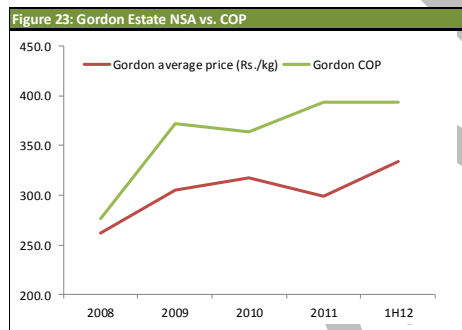
Source: Company reports

Net sales volume during the first six months of 2012 at Name GD Estate was lower compared to the previous years apart from 2011.

Figure 22: Gordon Estate	2007	2008	2009	2010	2011	2012
Net sales volume (6 months)	229,673	224,964	302,636	260,224	167,389	222,861
Change in 6 months of 2012 net sales volume versus 6 months production in previous years		-3.0%	-0.9%	-26.4%	-14.4%	33.1%

Source: Company reports

COP is increasing at a faster pace than NSA.



Source: Company reports

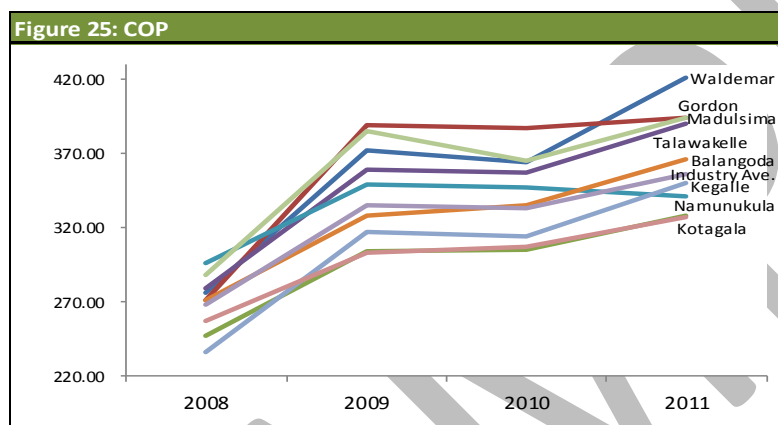
Name GD Estate Individual buying patterns - Company KABS continue to be the top buyer of Name GD Estate teas. During the Jan – Jun 12 six of the ten top ten buyers reduced their tea purchases. Expo Lanka Teas reduced its purchase by as much as 53%.

Figure 24: Gordon - Top ten individual buyers	Jan - Jun 2011	% of 2011	Jan - Jun 2012	% of 2012	YoY
AKBAR BROTHERS	54,584	18.1%	45,815	20.8%	-16%
ANVERALLY & SONS	28,900	9.6%	27,186	12.3%	-6%
GEORGE STEUARTS	28,697	9.5%	16,470	7.5%	-43%
INTER TEA.	8,774	2.9%	15,348	7.0%	75%
EXPO LANKA TEAS (PVT)LTD	22,584	7.5%	10,522	4.8%	-53%
IMPERIAL TEAS (PVT)LTD	7,121	2.4%	8,410	3.8%	18%
J-CEY-TEA (PVT) LTD.	16,760	5.6%	8,056	3.7%	-52%
STASSEN INTERNATIONAL (PVT) LTD	3,468	1.2%	7,866	3.6%	127%
CEY TEA PLANTATIONS EX(PVT)LTD	8,750	2.9%	6,744	3.1%	-23%
UNIWORLD TEAS (PVT) LTD	6,524	2.2%	6,718	3.0%	3%
UNION COMMODITIES	7,868	2.6%	6,191	2.8%	-21%

Source: Company reports

5.5 Cost of Production

Company HRS has high cost of production (COP) among its peers.



Source: Company reports

5.5.1 Labor

Plantation workers are seen as fixed labor resources with compensation, welfare, accommodation etc. having to be maintained despite fluctuating production volumes. Further worker salaries and welfare matters are extremely sensitive and can cause strike action impacting estate productivity and profitability.

Workers' wages are reviewed every two years with the next revision expected to be in April 2013. These negotiations are through a collective agreement between regional plantation companies (RPC) s and trade unions. The trade unions include the Ceylon Workers Congress (CWC), the Lanka Jathika Estate Workers Union (LJEWU) and the Joint Plantations Trade Union Centre (JPTUC).

Labor costs have been increasing despite a continuous drop in production. This inefficiency leads to increasing labor cost per tea kg produced.

Figure 26: Labour	2008	2009	2010	2011	1H12
Total labour expenses (Rs.)	78,007,779	82,093,844	85,611,066	101,223,861	53,147,860
YoY%	25%	5%	4%	18%	NA
Production (kgs.)	805,892	847,805	766,983	541,406	306,469
YoY%	NA	5%	-10%	-29%	
Labour cost per kg	96.8	96.8	111.6	187.0	173.4
Cost of production Rs. (combined COP X combined crop)	220,338,883	321,700,046	286,164,004	219,941,828	111,725,171
Labour costs as % of COP	35%	26%	30%	46%	48%

Source: Company reports

However two labor related statistics show Company HRS in a positive light;

a) Labor costs as a percentage of cost of production: Labor cost accounting for about 55 - 60% of the cost of the production is the industry norm. However at Company HRS this amounted to 48% during 1H12.

b) Workers per hectare: Three workers per hectare is the industry norm. At Company HRS there are only about two workers per hectare. This is based on 543 tea hectares and 1,134 workers.

6.0 Peer Analysis

A. Revenue growth

Figure 27: Tea Revenue Growth	2009/FY10	2010/FY11	2011/FY12
Stallion	13%	3%	-34%
Maskeliya	32%	4%	-6%
Bogawantalawa	24%	7%	-20%
Talawakelle	21%	7%	-8%
Agalawatte	-33%	28%	8%
Namunukula	16%	34%	-23%
Watawala	51%	9%	-11%
Balangoda	20%	2%	-10%
Kegalle	34%	5%	-14%
Hapugastenne	-1%	16%	-15%
Kotagala	44%	-1%	-3%
Kelani Valley	0%	25%	72%
Kahawatte	23%	9%	-15%
Madulsima	4%	13%	-13%
Industry Ave.	18%	12%	-4%

Source: Company reports

Revenue generated from tea at major plantation companies grew at a compounded annual growth rate (CAGR) of 8% over the past three years compared to an 8% decline for Company HRS. 2011 was a troubled year for all companies, with tea revenue declining 4% YoY on average, however Company HRS recorded a 34% drop in revenue in 2011.

B. Net sales average (NSA)

For the period 2008-2011, the NSA for the peers averaged \$312 compared to \$270 for Name DW and \$296 for Gordon. Name DW has registered a NSA CAGR growth of 5.8% from 2008-2011, in line with peer growth. However, Name GD has only grown at a CAGR of 4.4%.

Figure 28: Net Sales Average for Industry Peers					Figure 29: Cost of Production for Industry Peers				
	2008/FY09	2009/FY10	2010/FY11	2011/FY12		2008/FY09	2009/FY10	2010/FY11	2011/FY12
Stallion					Stallion				
Waldemar	250.39	263.56	270.35	296.21	Waldemar	275.78	372.47	364.08	421.04
Gordon	262.23	304.95	317.37	298.50	Gordon	270.53	389.00	387.49	393.90
Maskeliya	276.85	366.48	352.88	334.28	Maskeliya	246.47	304.30	304.86	328.07
Agalawatte	266.80	306.73	328.16	303.02	Talawakelle	279.35	359.24	357.07	390.52
Namunukula	285.02	384.60	362.27	343.54	Namunukula	296.31	349.53	346.70	341.23
Balangoda	260.43	322.98	316.37	306.75	Balangoda	271.44	327.72	334.69	366.33
Kegalle	234.79	324.06	324.55	297.75	Kegalle	236.13	316.82	314.17	350.00
Kotagala	254.35	339.21	332.64	NA	Kotagala	256.44	303.47	307.29	326.79
Madulsima	263.75	327.94	314.98	295.59	Madulsima	288.46	384.80	365.44	394.05
Industry Ave.	263.14	338.86	333.12	313.49	Industry Ave.	267.80	335.13	332.89	356.71

Source: Company reports

Source: Company reports

C. Cost of production

In 2011, COP for the peers averaged \$357 per kg compared to \$421 for Name DW estate and \$393 for Name GD estate. During the past three years, COP for peers has grown at a CAGR of 10.1% compared to 15.1% and 13.3% for Name DW and Name GD respectively. COP for 2011 for Name GD estate is 10.3% higher than the peer average and is 17.9% higher for Name DW.

D. Production per hectare

Figure 30: Productivity			
	Tea pdtn (m kg) 2011/FY12	Tea hectares	production per hectare
Stallion	0.5	543.0	899.7
Maskeliya	9.2	10,561.3	871.2
Talawakelle	6.9	4,221.4	1,632.2
Agalawatte	2.4	1,548.0	1,552.3
Watawala	9.4	8,325.4	1,128.4
Balangoda	6.7	4,905.9	1,368.4
Kegalle	2.6	1,365.9	1,925.5
Hapugastenne	8.0	4,696.7	1,712.7
Kotagala	7.0	2,649.0	2,630.8
Kelani Valley	6.1	4,038.0	1,510.6
Kahawatte	6.1	4,911.0	1,231.9
Madulsima	5.0	3,801.0	1,321.2
Industry Ave.	69.9	51,566.6	1,355.6

Source: Company reports, research reports

Company HRS production per hectare is low compared to its peers. On average, industry peers recorded a production of 1,355.6kg per Ha compared to 899.7kg per Ha at Company HRS.

7.0 Key Positives

A. Company HRS labor costs lower than industry average

Company HRS's labor costs now accounts for about 48% of COP, below industry standards of 55-60% of COP. At present the management has been able to come into an agreement to provide work for three days per week with the employees, though the requirement is six days.

B. Consultant adding value

Company HRS had for the past three months recruited the services of an Country DI consultant. With his active involvement and despite poor weather conditions pluckers at Name DW Estate had managed to increase their plucking average from 13 kg to 16kg per plucker.

C. Underutilized factory capacity

As evidenced by the previous high production volumes we believe the factories are currently underutilized. Thus the factories could accommodate higher bought leaf levels thereby reducing the combined COP.

D. Other

The estates possess valuable timber. As an alternative source of revenue this could be sold subject to obtaining approval.

8.0 Key Risks

We have identified the following factors as those that could have a substantial impact on the operations of the company.

A. “Golden Shareholder” approval

The “Golden Share” is held by the Secretary to the Treasury and it is noted that it should be owned either directly by the government of Country XXA or by a 100% government owned public company. As per the Articles of Association of COMPANY PUL, COMPANY PUL must obtain the written consent of the “Golden Shareholder” (Secretary to the Treasury) prior to sub leasing, ceding or assigning its rights in part or all of the said Estates.

We have been made aware that COMPANY PUL has not received written consent from the Golden shareholder for its sub lease of Name DW and Name GD estates to Company HRS.

B. Historical losses of the two estates

Historically (i.e. the period prior to taking over by Company HRS) the two estates had been incurring losses.

Figure 31: Historical losses	2002	2003	2004	2005	2006
Gorden Estate					
Accumulated Profit/(Loss) (Rs.)	(5,848,234)	(12,181,557)	(11,335,915)	(13,819,612)	(17,697,324)
Waldemar Estate					
Accumulated Profit/(Loss) (Rs.)	(9,082,525)	(19,108,222)	(15,347,813)	(14,307,510)	(12,667,352)

Source: Company reports

C. Maintenance of estate work force

The estate resident work force has to be maintained at any cost. At present the work force position of both estates are given below.

Figure 32: Work force	No of Staff	Work force
Waldemar	27	578
Gordon	23	556
Total	50	1134

Source: Company reports

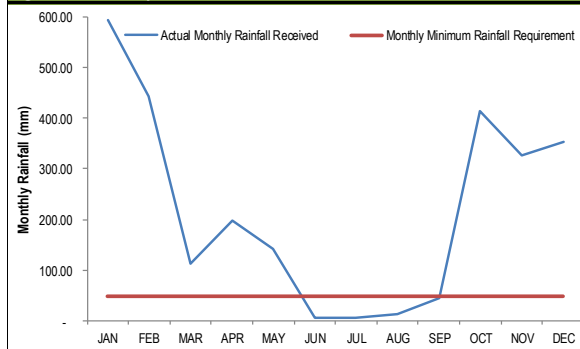
This would result with a continuous outflow in the form of salaries, wages, etc in addition to gratuity contributions. The wage rates are revised upwards every two years. As seen in the past in the industry, any deviations from the existing status quo could result in labor unrest which in turn result in potential disruption of factory operations and at worst lead to property damage. The most recent strike was reported in February 2012 in protest over a \$31 increase in the price of kerosene. A significant proportion of estate workers use kerosene for cooking and were impacted by the price rise, thus prompting strikes.

D. Adverse weather patterns

Fluctuating rainfall in the region affecting tea production

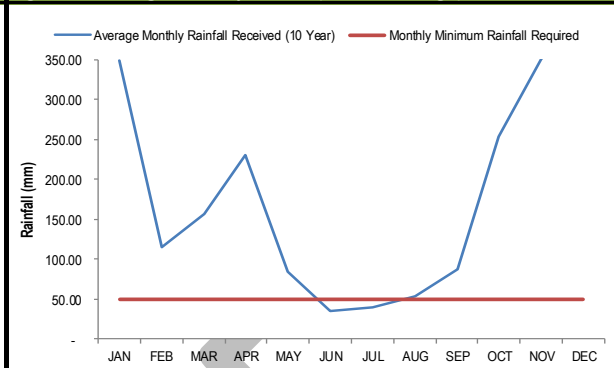
The estates are located in the City ENN district at an elevation of approximately 1,200 m to 1600 m. As revealed during our preliminary enquires this particular area has one monsoon along with two drought periods. In addition, the area has exceptional strong winds. As per industry information an annual rainfall of 2,500 – 3,000mm is considered to be optimum for tea production, with a minimum of 1,200mm required. The minimum monthly rainfall for tea production is considered to be 50mm.

Figure 33: Monthly Rainfall 2011



Source: Meteorological Department

Figure 34: Average Monthly Rainfall (10 Year average)



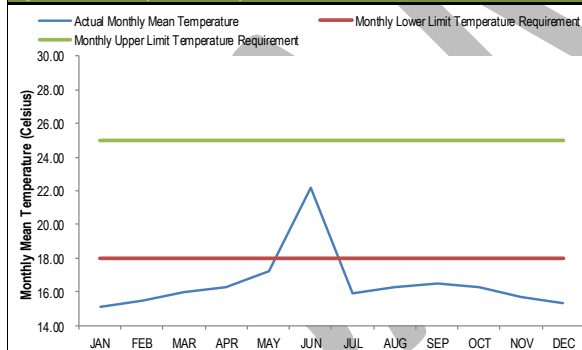
Source: Meteorological Department

We analyzed rainfall patterns at Name TTL Estate which is located in close proximity to Name DW and Name GD estates. The results indicate that during three months of the year minimum rainfall needed for tea production is not received.

Low temperature not ideal for tea production

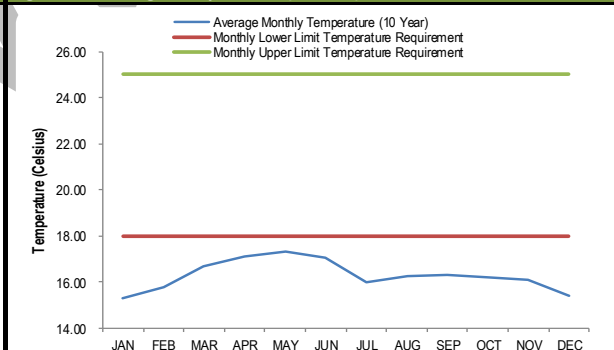
The ideal ambient temperature for growing tea is 18-25C with seasonal temperature to be above 13C (average for the coldest month) and not more than 30C (average for the hottest month). Temperature data for City ENN released by the Meteorological Department indicate that this region is not ideally suited for growing tea.

Figure 35: Monthly Mean Temperature - 2011



Source: Meteorological Department

Figure 36: Average Temperature (10 Year)



Source: Meteorological Department

E. Revival of Underperforming Enterprises and Underutilized Assets

In November 2011, the government passed a law allowing it to take over private businesses which are deemed to be under-performing. The law was titled "Revival of Underperforming Enterprises and Underutilized Assets."

It stated that the enterprises or assets for takeover are on government lands that have been provided for private operators for a specific purpose and that the government still owns the lands. In November 2011, 37 companies were identified by the government as underperforming and underutilized. Among them two sugar plantation companies were taken over namely, Company SPLU and Company ISP

Whilst we have not received new information that the government plans to re-enact the law to take over more companies, we cannot completely rule out the possibility that this may happen in the future.

F. Converting the Tea plantation for other cultivations

Assuming the necessary permission to utilize the land for other cultivation purposes was received the ability and therefore the viability of using the same for such purposes would be doubtful taking into consideration the adverse weather patterns prevailing in the area as disclosed above.

G. Bungalows and the Tea plantation as a tourist attraction

In order to operate as a tourist attraction the location would need to have suitable facilities.

Easy access to the location as well as other places of tourist attractions is another key criterion for success. But in the case of Company HRS there are no such places of tourist interest at close proximity. Further the level of infrastructure is at a depleted state which will require further capital infusion so as to bring it to the high standards that are expected in the industry. As disclosed by management, to date no revenues had been obtained as rental income even though Company HRS's website indicate rent-out rates.

H. Significant current liabilities and negative working capital

Figure 37: Current Liabilities and working capital	2007	2008	2009	2010	2011
Bank Overdraft	11,757,341	30,274,629	47,472,715	19,254,203	72,696,387
Accounts Payable	30,500,275	31,618,935	83,809,083	71,433,621	79,519,527
Amounts Due to Related Parties	12,188,203	22,495,819	33,302,356	96,773,000	99,942,350
Total current liabilities (Rs.)	54,445,818	84,389,383	164,584,154	187,460,824	252,158,263
Working capital (Rs.)	20,755,406	5,201,979	(37,752,823)	(41,529,940)	(56,498,636)
Current asset ratio	1.34	0.61	0.36	0.34	0.15

Source: Company reports

The current liabilities have steadily increased. A concern is that the outstanding overdraft is now almost on par with total assets for 2011. The current ratio has been in a steady decline. Current ratio indicates the company's ability to pay back its short-term liabilities (debt and payables) with its short-term assets (cash, inventory, receivables). Further negative working capital over the past

three years and significant increases in related party balances indicate to us that related parties are funding the day to day operations of the company.

I. Continuance of the fertilizer subsidy

Company HRS is a recipient of fertilizer subsidies. This was initiated by the government in May 2011 to support paddy, rubber, coconut and tea growers. A subsidized 50 kilo bag of non-mixed fertilizer for all other crops (non-paddy) is sold at \$1,200 and a 50 kilo bag of mixed fertilizer sold at \$1,300. It was reported that the market price for a 50kg bag is in the range of \$3,500-4,000.

The government incurs about \$40bn annually on fertilizer subsidies. A change in this policy is likely to affect the entire industry. Research conducted by the Tea Research Institute of Country XXX indicate that this subsidy reduces COP for Uva elevation VP tea by \$11.39 per kg and Uva elevation seedling tea by \$16.59 per kg.

J. Replanting

Company HRS plans to replant 40 acres per year at a cost of \$400,000. The company has provided the following replanting cost per hectare.

Figure 38: Replanting cost per hectare	Labour Man days	Labour Cost Rs.	Material Cost	Total Cost
Year of Uprooting	1,360	837,352	71,470	908,822
1st Year Grass Upkeep	200	123,140	14,034	137,174
Year of Planting Tea	938	577,527	431,288	1,008,814
1st Year Upkeep Tea	700	430,990	83,888	514,878
2nd Year Upkeep Tea	685	421,755	77,918	499,673
Total	3,883	2,390,763	678,597	3,069,360

Source: Company reports

K. COMPANY PUL payments

Analysing the financial statements of Company HRS, the following payments are owed to COMPANY PUL on account of the management contract.

Figure 39: Accounts Payable - relating to UPL	2007	2008	2009	2010	2011
Provision for UPL profit share	3,959,888	9,225,010	15,121,833	11,799,239	18,514,562
UPL Debit notes	-	-	-	1,141,714	2,790,069
UPL Accounts	-	-	20,050,585	15,363,971	15,610,488
Total	3,959,888	9,225,010	35,172,418	28,304,924	36,915,119

Source: Company reports

L. Limited expertise in operating a tea plantation

A majority of directors do not possess tea industry related experience. We believe this to exclude the Director, Mr. Name RN, who is a Non-Executive Director of Company FJ, Chairman and Managing Director of Company HP and Company PUL and a member of the Plantation Trust Fund. Not possessing adequate industry related experience would impact the strategic and operational activities at Company HRS.

M. Other developments

Local tea exporters are wanting to import low quality teas, re-blend it and export, thus making Country XXA a tea hub. They have requested the government to remove the 25% import duty currently applied on imported tea. However local tea producers are against this move as they view this as being seriously detrimental to the country's "Pure Ceylon tea" brand image. A final decision in this regard is pending.

9.0 Valuation - Investment Rationale

Our 12-month target price of \$7.98 for Company HRS's common shares is based on applying an adjusted price to sales (P/S) multiple of 0.10x to our forward 12-month revenue estimate (last six months of 2012E; 2H12 and first six months of 2013E; 1H13).

Given the company's characteristics we applied a marketability discount of 20% and an illiquidity discount of 20% to the industry multiple of 0.16x to arrive at 0.10x. The industry P/S multiple was adjusted by the proportion of tea hectares of the total hectares at each individual company and was also adjusted for outliers, Company HP Plantations (P/S 0.50x) and Company PKH (P/S 0.72x).

We believe Company HRS is under pressure from several internal and external factors. Internally, declining revenue, decreasing profit margins and increasing bank overdraft are major causes for concern. Externally, the tea industry in Country XXA is experiencing a volatile period. The industry has been impacted by poor weather conditions leading to lower crops, labor unrest and unstable political conditions in its major export markets.

Figure 40: Price to Sales (P/Sales)		Tea hectares/Total hectares			P/S	P/S adjusted for tea hectares contribution
Stallion revenue 2H12E	65,815,689	Figure 41: P/S adjustment				
Stallion revenue 1H13E (@57% of annual)	95,621,790	Maskeliya	100%		0.12x	0.12x
Stallion revenue 2H12E and 1H13E	161,437,480	Bogawantalawa	100%*		0.26x	0.26x
P/S Industry Average	0.16x	Talawakelle	83%		0.15x	0.13x
Valuation discount		Agalawatte	22%		0.28x	0.06x
a) Lack of marketability	0.03x	Namunukula	12%		0.76x	0.09x
b) Lack of liquidity	0.03x	Watawala	67%		0.48x	0.32x
Adjusted P/S ratio	0.10x	Balangoda	76%		0.25x	0.19x
Market Capitalisation	15,964,769	Kegalle	18%		0.84x	0.15x
Number of shares	2,000,020	Hapugastenne	81%		0.62x	0.50x
Value per share (Rs.)	Rs. 7.98	Kotagala	29%		0.49x	0.14x
		Kelani Valley	31%		0.42x	0.13x
		Kahawatte	79%		0.92x	0.72x
		Madulsima	100%		0.22x	0.22x
		Industry Ave.	58%		0.45x	0.16x

Source: Gradient estimates

*Due to lack of information assumed 100%
Source: Company reports and Colombo Stock Exchange

Our total revenue forecast for 2H12 and 1H13 is \$161.4m. About 57% of annual net revenues are generated in the first half of the year, thus we have apportioned full year 2013 revenue to determine 1H13 revenue.

Our revenue forecast is based on a 2% decrease in tea production in 2012 and a 1% increase in 2013. The 2012 drop in tea production is based on Country XXA Tea Board cutting Country XXA's tea production volumes to 325m kg in 2012 from a previous estimate of 330m kg. Further as per the inter governmental group on tea, Country XXA's tea production is expected to grow at only 1% over the next decade.

In 2012 Name DW Estate's average NSA is \$296, thus we are forecast NSA of \$295 for the remainder of the year and \$305 in 2013 (+3.0% YoY). For Name GD Estate tea we maintain the current NSA prices of \$328 for 2012 and a 3% increase to \$338 in 2013.

To gauge the validity of our target price derived from the P/S multiple we developed a price to tea hectare (P/THec) multiple. Based on this approach we determine a target price of \$10.18. However, P/S is more widely accepted hence our decision to use this method.

Figure 42: Price to Tea hectare (P/THec)		
Stallion Plantations (Pvt.) Ltd.	Acres	Hectares
Seedling	1,013	410
VP	303	123
Immature tea	27	11
Tea hectares at Stallion	1,343	543
P/THec industry average (exlcuding outliers)		62,463x
Valuation discount		
a) Lack of marketability		12,493x
b) Lack of liquidity		12,493x
Adjusted P/THec ratio		37,478x
Market Capitalisation		20,368,993
Number of shares		2,000,020
Value per share (Rs.)		Rs. 10.18

Source: Gradient estimates

As cash flows are negative the discounted cash flow valuation method was not used. Moreover, as shareholder equity is negative and assets are leasehold, net asset valuation method was not considered. Further due to the resulting low enterprise value, enterprise value to sales (EV/Sales) method could not be used.

Positive and negative risks to our target price include possible upward/downward movement in tea production and changes in demand from external market conditions. Specific negative risks may materialize from banks not extending overdraft facilities or requesting the company to make payments, and possible changes to the government policy, mainly relating to fertilizer subsidies.

9.0 Tea Industry SWOT Analysis

Strengths

- Strong government support given the high level of national interest of the industry
- Strong brand name in international markets ensures sustainable demand despite hardships faced in the global market.

Weaknesses

- Cost of production in Country XXA is amongst the highest in the world with wages amounting to about 55-60%. Average COP increased from \$121.9 per kg in 2001/2002 to \$355.0 per kg in 2010/2011. In April 2011, a collective agreement between plantation trade unions resulted in a 33.3% increase in basic wages. The next wage revision is in April 2013.

- Country XXA has generated low yields on average compared to other key tea producing nations. Country XXA averages around 1,400kg per Ha compared to Country KY (2,000kg per Ha) and Country DI (1,800kg per Ha).

Opportunities

- Country RED, Country XXA's largest buyer of tea has one of the highest per capita tea consumptions in the world. Moreover, the entrance of Russia in the WTO would result in reduced import duties on tea which would boost demand and export revenue for Country XXA.
- Increase in demand for tea globally based on health concerns.
- Change in consumption patterns. For example, the Country ENG switched from bulk tea to tea bags which enabled Country KY, which mainly produces CTC tea, to capitalize on it. However, 95% of the tea produced in Country XXA is orthodox tea.

Threats

- Adverse weather conditions could hamper productivity.
- Labor intensity of the industry makes it vulnerable to strikes.
- Changes in consumption patterns could impact Country XXA's position in the global market due to its main focus on bulk tea.
- Import restrictions have prevented the country from developing into a tea hub.