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INDIAN BULK TEA INDUSTRY MARCH 2019

Rise in labour expenses adversely impacted operating profitability of bulk tea players during the first nine months of the current financial year

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High cost-pressures dented operating margins for organised players in current fiscal

The analysis of the reported financials of the listed bulk tea companies in the first nine months of the current financial year (9M FY2019) by ICRA indicates that the financial profile has weakened with operating margins contracting by over 300 bps, thus adversely impacting the debt-coverage indicators of the entities. The deterioration was driven mainly by the significant increase in labour cost for all the entities, post announcement of interim wage rate hike in July 2018 by a minimum amount of Rs. 30/manday with retrospective effect from March 1, 2018. ICRA, in its earlier note of August 2018¹, had raised concerns over the steep increase in wage rates for tea estate workers in Assam and West Bengal, adversely impacting the operating cost of organised bulk tea players. Tea is a fixed cost-intensive industry, with labour costs accounting for around 60%² of the total cost of production for tea plantation companies having only own leaf production. The operating margins of bulk tea players have already witnessed pressures over the last few years on account of increased cost pressures, with the increase in realisations not adequately compensating for the increase in wage costs. In the current financial year (FY2019), the significant increase in cash wages for both Assam and West Bengal tea estates workers is likely to further dent the operating margins of the organised tea players. ICRA had earlier highlighted that tea realisation would need to increase by more than 15% (around Rs. 20/kg) to offset the sharp increase in wage rates, ceteris paribus, in the current year, however, the North Indian auction realisation for 9M FY2019 has increased by only 4.4% (around Rs 7/kg), which adversely affected the margins of all the bulk tea companies, given that the production volume was almost flat during the aforementioned period. As a result, as can be seen from the exhibits below, the proportion of employee expenses (as % of operating income) has increased to 37.0% in 9M FY2019 as compared to 34.9% in the corresponding period of last year, which, along with the increase in raw material costs, has led to a contraction in operating margins, consequently impacting interest cover.

Exhibit 1: Trend in operating profitability

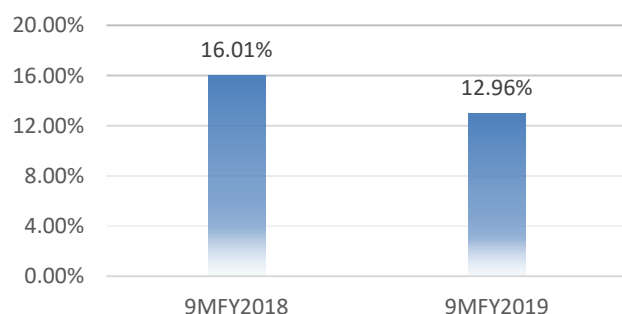


Exhibit 2: Trend in cost structure³ (as a % of Operating Income)

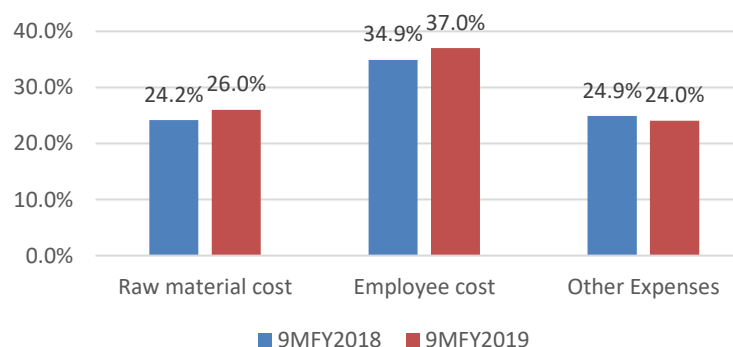
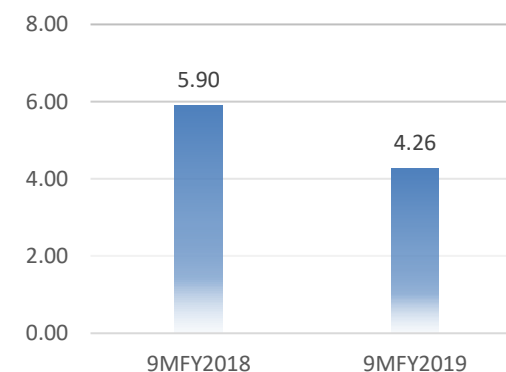


Exhibit 3: Trend in Interest coverage



Source: BSE filings; ICRA research; ICRA has considered the financials of seven listed entities⁴ operating in North India; the cost structure includes cost of production for bought leaf

¹ [ICRA - Bulk Tea Sector: Impact Assessment: Hike in wage rates to increase pressure on operating margins of bulk tea companies](#)

² If production from bought leaf and costs associated with non-tea businesses are also included, labour costs as a proportion of total costs would be around 48%

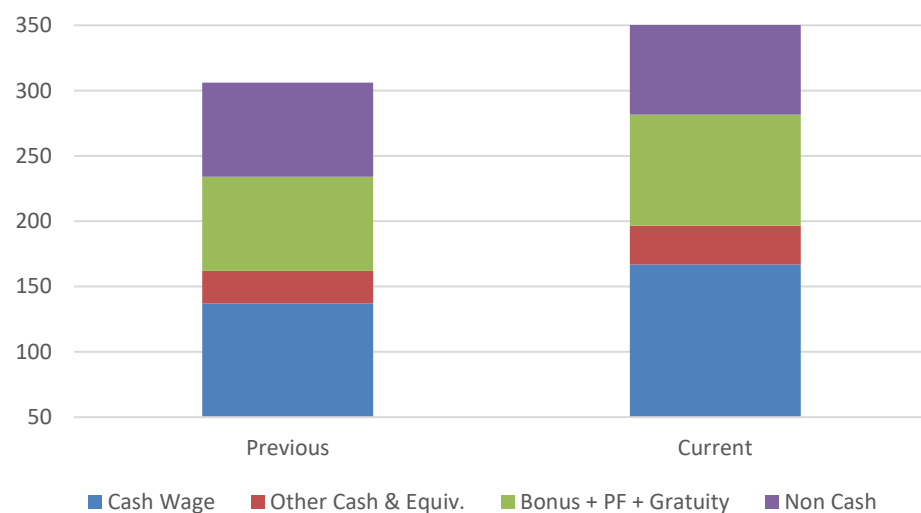
³ Employee cost as a percentage of operating income comes to 37% as costs related to bought leaf operations has been classified under raw material costs

⁴ Goodricke Group Limited, Jayshree Tea & Industries Limited, Rossell India Limited, Warren Tea Limited, Dhunseri Tea & Industries Limited, Kanco Tea Industries Limited and The Grob Tea Company Limited

Interim increase in wage rates has led to a significant increase in labour costs for all organised bulk tea companies

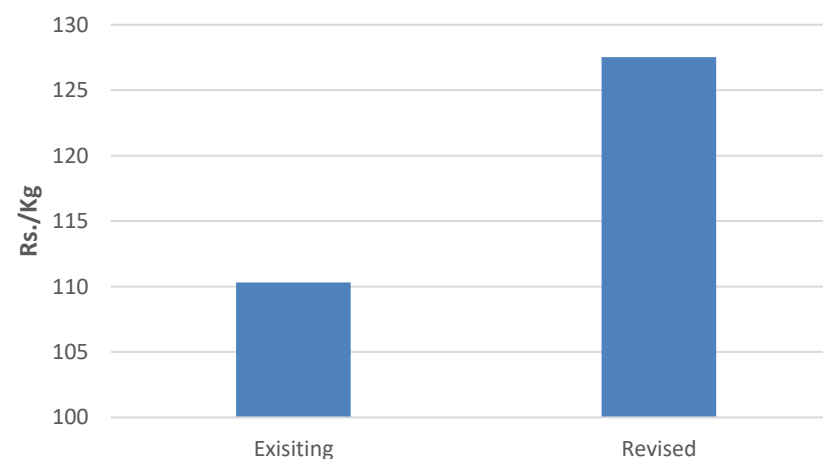
The interim enhancement of cash wages by Rs 30/manday announced in July 2018 is expected to be in place till the composite and all-inclusive wage structure is finalised. The Government of Assam had earlier proposed it to be Rs 351 per day, although no further communication has taken place in this regard. While the extant rate of Rs 167 per day appears significantly lower than the proposed composite figure, apart from the daily cash wages, tea plantation workers receive a host of other benefits, which include free housing, medical facilities, ration and firewood. Considering these facilities as well as other benefits of bonus, provident fund, gratuity and leave with pay, the total benefits per day, as per ICRA estimates, works out to be around Rs 350/ mandays as compared to around Rs 300/manday, prior to the announcement of the interim wage rate increase. At an average productivity of 2.75 kg of made tea per manday, this translates into an increase of ~ Rs 17 / kg of made tea.

Exhibit 4: Break-up of the Composite labour cost



Source: ICRA Research

Exhibit 5: Labour Cost per kg of tea produced

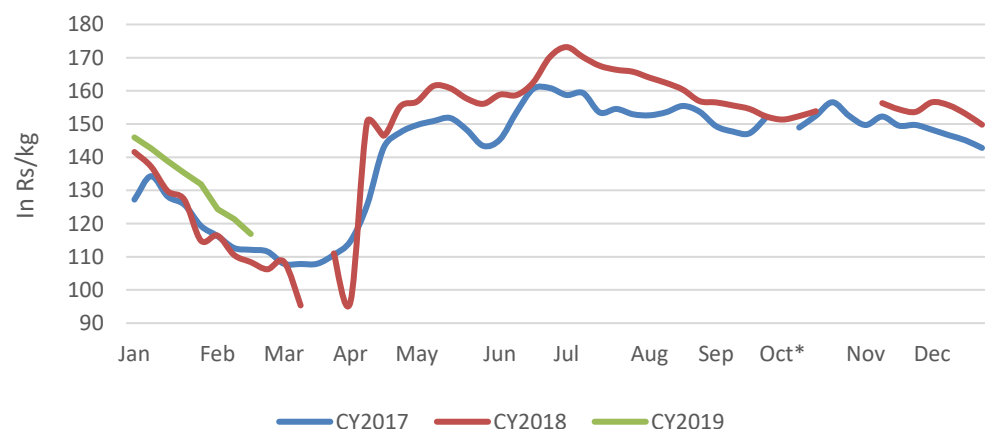


Source: ICRA Research; *based on the productivity of around 2.8kg of tea produced per manday

Improvement in North India auction prices during 9M FY2019 remains modest but insufficient to offset the increase in costs; although prices have firmed up considerably in recent auctions, the impact of the same on full year average averages would be limited

Prices at the North Indian (NI) auction cumulatively increased by around 4.4% on a YoY basis to Rs 157.3/kg during 9m FY2019. This increase in tea prices (by around Rs 7/Kg during 9M FY2019) has been the highest in the last four years. ICRA notes that though the prices witnessed an uptrend (by almost Rs 8-12/kg) during April-July 2018, the increase in tea production during August and September 2018 as well as uncertainties related to exports to Iran resulted in softer tea prices during August to October 2018, thus hampering the overall price trend during 9M FY2019. During CY2018 too, the cumulative auction price increase remained modest at 4.2% over the previous calendar year. In the current calendar year, although recent weekly auction prices remained firm, with NI prices up by ~Rs. 9-10/kg till mid of February 2019, the impact of such a movement on cumulative average prices for the entire FY2019 is going to be limited, given that the auction volume during Q4 comprises only 20% of the annual auction volume. As per ICRA estimates, for the full FY2019, the overall auction prices are likely to be around Rs 9/kg higher over the previous fiscal. Though this increase in prices would be the highest in the last four financial years, it would largely remain insufficient to offset the cost increase. Consequently, the operating profitability is expected to deteriorate further for all the organised bulk tea players during FY2019, which is likely to adversely impact the debt protection metrics as well.

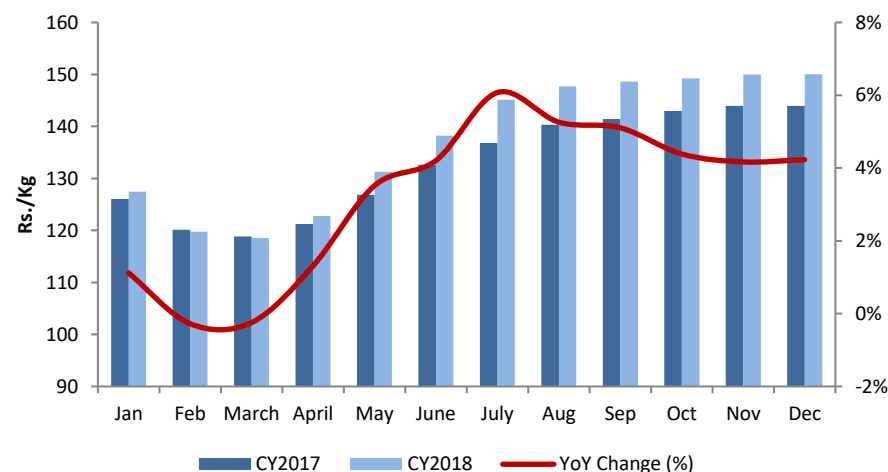
Exhibit 7: Weekly Auction prices in North India



Source: Tea Board of India, ICRA Research

*Few auctions in October were not conducted

Exhibit 8: Monthly Cumulative Auction Prices (CY2017 vs CY2018)



Source: Tea Board of India, ICRA Research

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

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The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

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- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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