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Subdued demand from Iran and weak HORECA demand expectations amid Covid outbreak dampen FY2021 prospects for Indian Basmati Rice Sector

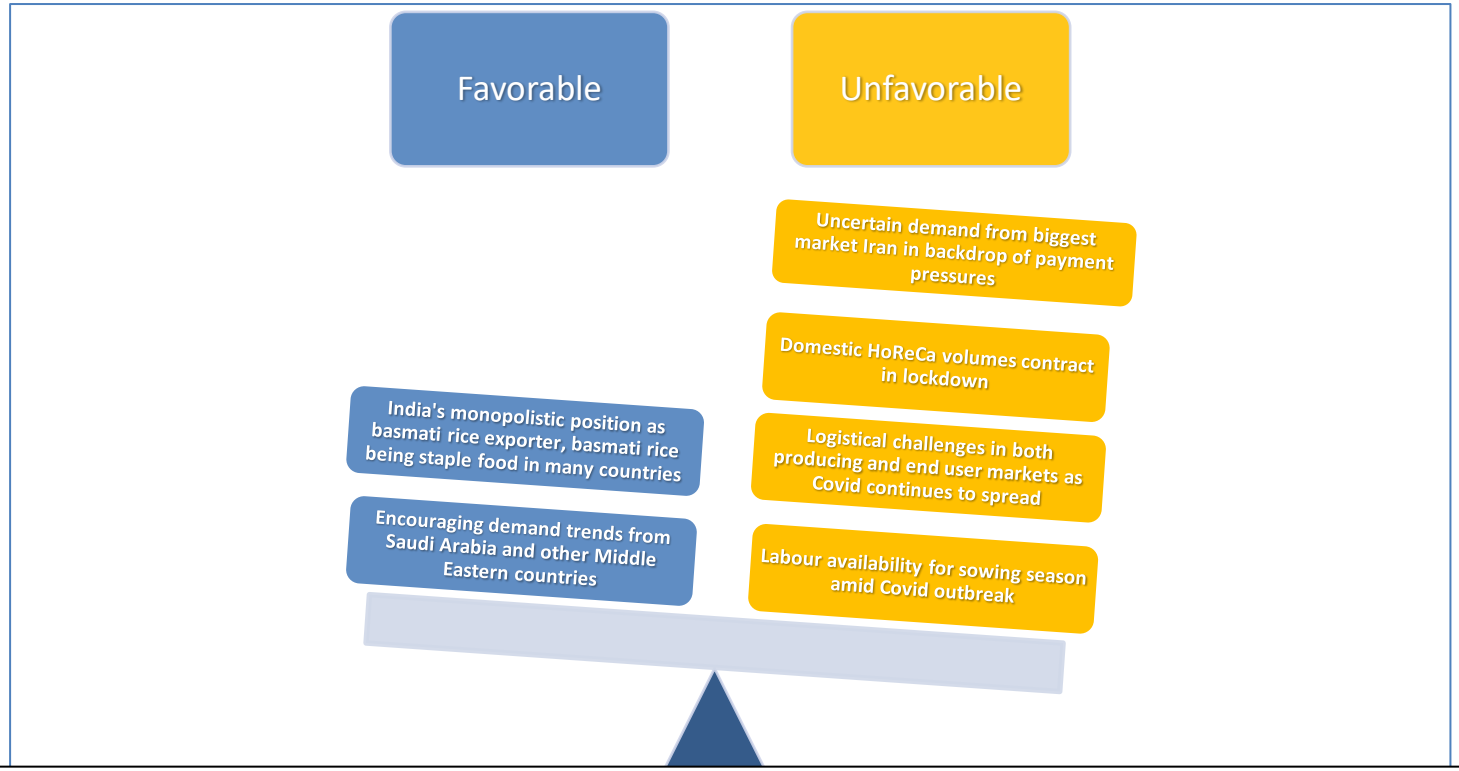
Sabyasachi Majumdar
+91 124 4545 304
sabyasachi@icraindia.com

Anupama Arora
+91 124 4545 303
anupama@icraindia.com

Sheetal Sharad
+91 124 4545 374
sheetal.sharad@icraindia.com

Covid outbreak in key consuming nations as well as extended lockdown in domestic market weighs on industry growth prospects

Exhibit 1: Factors affecting the Indian basmati rice industry



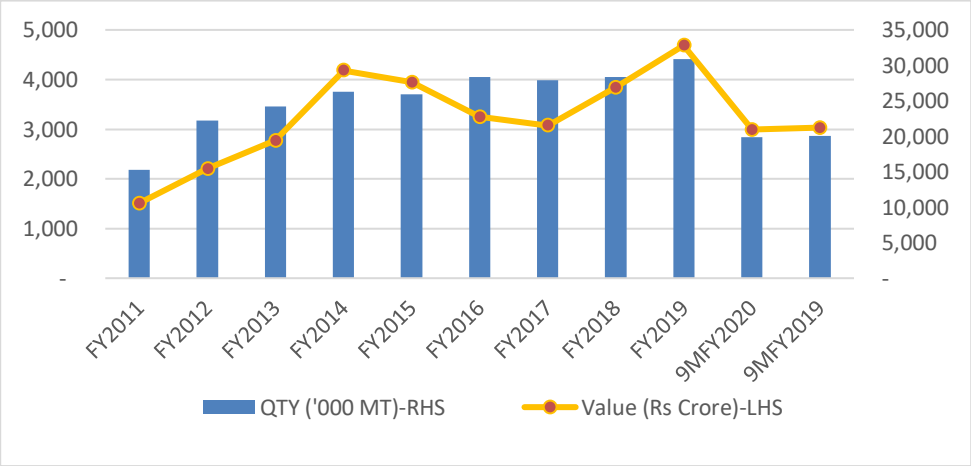
Notwithstanding the classification of Basmati Rice as an essential commodity, the near term demand prospects have weakened with the industry grappling with weaker demand prospects from the exports markets and a contraction in demand from the domestic Hotel-Restaurant-Café (HORECA) segment.

Adding to demand woes are the operational challenges faced by industry players on the logistics front besides anticipation of reduced labour availability during the coming sowing season which may affect raw material availability and pricing in the coming procurement season.

Exports form the backbone of the Indian Basmati rice industry

India is the largest producer of basmati rice enjoying a leadership position as a crucial source of the commodity world over, followed by Pakistan which remains a distant second. As per industry estimates, India produces about 6.5- 7.0 million tonnes of basmati rice every year out of which 4.4 million tonnes (62-67%) is exported. Exports thus have a critical bearing on the industry performance. Indian Basmati exports grew at a compounded average rate of 13.1% between FY2011-2019 in value terms even as there was volatility in growth rates on year on year basis. More recently, the Basmati exports grew by 10% in FY2019 aided by strong realisation and volume expansion followed by marginal de-growth. However, there was a de-growth in 9MFY2020 on account of absence of robust buying from key destinations like Iran, UAE and the EU.

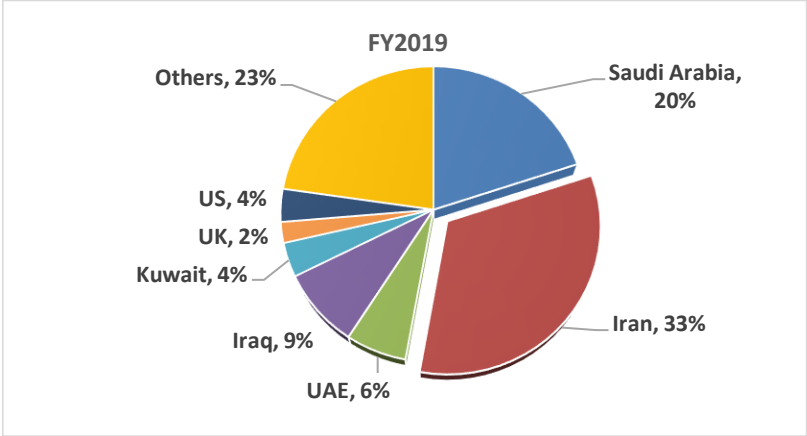
Exhibit 2: Indian basmati export trends (FY2011-9MFY2020)

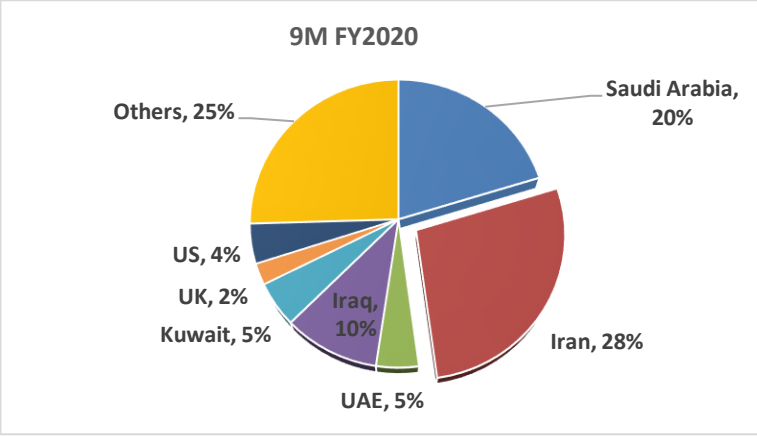


Source: APEDA, ICRA Research

Largest Basmati Rice Export Destination- Iran: Demand expected to be subdued in FY2021, severe Covid outbreak adds to woes

Exhibit 3: Share of Iran in Indian basmati export in FY2019 and 9MFY2020





Source: APEDA, ICRA Research

- Iran has remained the largest importer of Basmati rice from India in recent years. It imported rice worth Rs. 10, 790 crore in FY2019 constituting 33% of the entire industry exports, up from Rs. 5830 crore in FY2018 (22% of exports). The contribution remained high in 9MFY2020 as well at Rs. 5768 crore forming 28% of the industry exports.
- Iran is dependent on rice imports for fulfilling about one-third of its requirements. Iran's purchases of India basmati peaked in FY2019, particularly in Q4 FY2019, anticipating the uncertainty related to its global trade status. Consequently, high stock levels at the beginning of FY2020, resulted in reduced purchases from India, thus lower exports by the Indian basmati industry during that fiscal. Moreover, in the backdrop of its volatile global trade status pursuant to imposition of sanctions, Iran also faces currency related challenges in paying for its imports*. The depletion of reserves under the available payment mechanism between the Iran and India in mid FY2021 countries also remains a concerning factor with no plausible solution in the near term.

**Over the last few years, Iran has been facing uncertainties regarding its global trade given the frequent imposition of trade sanctions by the US. In absence of US dollars available with Iran to pay for its trade imports from India (commodities like basmati rice, tea, sugar, pharmaceuticals etc) Iran and India have been utilising a rupee payment mechanism through two identified two banks – IDBI and UCO Bank. Under this mechanism Indian refineries which import crude from Iran, deposit the payment for the same in rupee terms in escrow accounts held with these banks. Subsequently the banks use these funds to release payments to Indian exporters to Iran. This payment mechanism allows India to comply with the condition that forbids direct fund transfers to Iran. However, with India ceasing to import crude oil from Iran in May 2019, the said rupee reserves have been depleting over the last two years creating a fund availability challenge for the trade between the two countries.*

- As per ICRA's interaction with industry players, Iran has been reducing the subsidized foreign currency made available to private importers*, which could constrain business with India. Whether purchases by Government Trading Corporation (GTC) of Iran would compensate for the moderation in private imports and the Iran Government's continued allocation of funds to GTC for the same remains to be seen.
- Notably, Iran has been severely hit by the Covid outbreak resulting in logistical issues amid lockdown as initial challenges. The impact of the outbreak on its economy also has a large bearing on its ability to import basmati rice in addition to the aforementioned factors.
- Notwithstanding the above, basmati rice being a staple diet for the country augurs well for demand resilience. However, possibility of substitution through other rice varieties to a small extent or higher imports from other destinations cannot be ruled out.

**Iran has a multi-tier currency exchange rate system. There are three exchange rates for the US dollar namely the official rate, the open market and the NIMA rate. With Iran's currency Rial witnessing significant devaluation over the last few years and the imposition of US sanctions, the country has been facing currency related challenges in its global trade transactions. To support the purchase of important goods, the government offers a subsidized official rate (~42,000 Rials for 1 USD). Different from the official rate, the NIMA rate is used by exporters to sell their foreign currency, the same was initially established to facilitate trade of essential goods. The open market rate is typically the highest. In the recent months, the Government of Iran is reported to have been reducing subsidies/subsidized rate being offered to importers given their fiscal challenges.*

(Source: media reports and ICRA discussion with industry players)

Exports outlook weakens, notwithstanding higher purchases by Saudi Arabia and other Middle East countries

- Saudi Arabia, the second largest destination for Indian Basmati Rice exports, implemented new import regulations with respect to pesticide residues in Q4FY2020. While there was increased buying by private importers prior to the implementation of these rules, with the Covid outbreak, industry players continued to witness a healthy demand from this region even after the implementation of revised regulations that resulted in increased compliance costs, hence prices. Moreover, in the backdrop of upcoming Ramadaan period, festive buying continued even as India went into lockdown in the last week of March 2020.
- In case of the EU, while export volumes contracted sharply in FY2019 pursuant to implementation of new pesticide residue related norms, the extent of de-growth reduced in 9MFY2020. The slowdown in de-growth is expected to continue in early FY2021 as market participants continually increase adherence to the required norms.
- Given that India remains the largest producer of this essential commodity, an increased demand from regions where basmati rice is a staple is a likely trend in early FY2021 as importers have depicted a tendency to stock up on the essential commodity in backdrop of the pandemic. The higher offtake, thus, could compensate only partly against weak offtake from Iran resulting in softening of exports.
- However, uncertainty with respect to Iran's offtake which has been a significant contributor, pegs the outlook for exports during the full year FY2021 on a weaker footing. This is owing to the significant buying which Iran does making the Indian industry dependent on these volumes for a good performance. The outlook is marred by Covid and lockdown related pressures both in producing and consuming nations. High initial stocking at consuming nation level can keep demand for Crop-2020 under check with respect to the non-aged/fresh rice purchases.

Domestic HORECA volumes contract adding to industry woes

- Given the Covid outbreak and ongoing lockdown, domestic sales through traditional channels of modern trade have been adversely impacted in Q1FY2021. The Hotel-Restaurant-Cafe or HORECA segment has been severely hit globally. As per ICRA's discussions with industry players, this segment typically contributes as high as one- fourth of the total domestic sales in most rice eating nations and India too could have a similar trend.
- Even though sales through e-commerce channels spiked during the lockdown, increasing manifold, their value remains low in relation to other traditional channels even though profit margins are higher. Shifting preferences towards packaged items in order to ensure safety and minimum contamination, however, augurs well for branded rice players.
- Paddy prices softened by 15-20% during Crop-2019 and most industry players undertook record volume buying in the season thus being well poised for fulfilling increased export requirements in the near term. However, with domestic volumes moderating due to the Covid outbreak, larger than usual stockpiles with players could depress domestic prices in the near term. ICRA notes that at present owing to logistical challenges, basmati prices have seen a spike like many other food products; the same is expected to be gradually corrected as the situation normalises.

Logistical challenges for exporters due to Covid outbreak, now normalising with Government support

- With the outbreak of Covid in key export destinations, Indian exporters had started grappling with travel related restrictions, delays in documentation etc since February 2020. Further, lockdown in India decelerated the pace of exports with millers having to shut down operations. However, with gradual restart of operations in early April 2020, as part of essential commodity classification, pace of exports resumed as local logistics streamlined with active support of the Indian Government.
- Issues related to labour availability, implementation of social distancing at plants, availability of packaging material, transportation of goods are being addressed. As indicated by various industry players, export orders remained healthy in March-April 2020 in the backdrop of *Ramadaan* festival in the Middle Eastern markets even as players expected a weak outlook for Q4FY2020 as compared to previous corresponding owing to lower offtake expected from Iran.
- Much of the spike in March 2020 could be attributed to festive buying in the Middle East.

Labor availability crucial to determine Basmati sowing acreage in next season

- In its March 2020 report, ICRA had said that with the basmati rice industry being cyclical, weak prices in a year can result in lower acreage in the next season. This results in a balancing effect on the demand supply gap, limiting further contraction of prices relative to preceding season.
- Since paddy prices declined in Crop-2019, a possible lower acreage given the continued uncertainty from key import destinations had been an industry expectation. However, the Covid outbreak and consequent lockdown brought with it the concern over labor scarcity - a crucial element towards crop sowing in the next season.
- With the lockdown continuing in May 2020, when sowing for non-basmati varieties like *parmal* commences, the sowing in this segment could be substantially lower in light of the labour scarcity. At present, India faces a complex situation with respect to migrant workers and availability of labour, with state government making efforts to help labourers return to their hometowns. As the lockdown eases, labour availability is likely to witness only a gradual improvement. This can support basmati sowing which starts only by June 2020 and could result in higher acreage. Despite a moderate pricing outlook for paddy in the upcoming season, such a higher acreage could further put pressures on paddy prices. However, if the labor availability remains reduced, the acreage could suffer pushing up prices.

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