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SERVICE COMPANY

## TEA MARKET UPDATE SEPTEMBER 2020

*Covid-19 pandemic a likely  
blessing in disguise for the  
beleaguered bulk tea industry*



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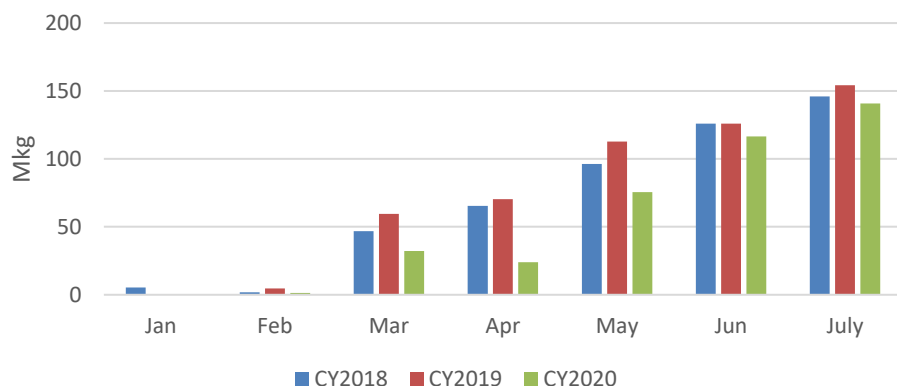
## Executive Summary

- Domestic tea prices have witnessed a significant increase, during the period April-August 2020, with the North India (NI) auction averages increasing by ~58% on a YoY basis and South India (SI) auction averages by ~25% on a YoY basis during the same period, driven by a supply demand mismatch. Restrictions on garden activities in the initial periods of the lockdown to contain the outbreak of Covid-19 had impacted tea production in the months of April and May 2020. Thereafter, inclement weather conditions and flooding in Assam in June 2020, coupled with subsequent adverse agro-climatic conditions have resulted in a ~26% (YoY) decline in NI production till July 2020 of the current calendar year. The decline in SI production has, however, been marginal at ~3%. Market news indicate that even for August 2020, the production in NI is down by ~10-15%. Hence till August of the current calendar year, domestic production is estimated to be down by ~155 mkg (~19% on a YoY basis). Although there were initial apprehensions that the lockdown would have an adverse impact on the overall consumption levels, anecdotal evidences and channel checks indicate that an increase in “at-home” consumption has more than offset the decline in “out-of-home” consumption – both in terms of quantity and quality. Shortfall in production, coupled with firm consumption has led to a sharp increase in prices of teas at various auction centres across India, with a rally in NI tea prices starting much earlier (in May), compared to that for SI teas (July).
- The increase in tea prices has been witnessed in both the crush tear curl (CTC) and the orthodox (ODX) varieties of tea; however, the increase in CTC tea prices is much steeper than the ODX teas, owing to both the base effect impact on ODX teas as well as differences in underlying demand trends. At the NI auction centres, prices of CTC teas were up by ~Rs 104 (67%) per kg on a cumulative YoY basis for the period April to August 2020. The corresponding increase in CTC teas from SI is ~Rs 26/Kg (26%). For ODX teas, at the NI auction centres, the cumulative increase is ~Rs 50/Kg (20%), while at SI auction centres, it is only ~Rs 5/Kg (3%). The rally in NI CTC prices has been broad-based, with all varieties of teas from Assam, Cachar and Dooars/Terai belt witnessing a significant increase in prices. In addition, the tea sold in the auction as a percentage of tea offered has increased substantially – ~87% for NI CTC teas for the period April to August (Last year (LY): ~73%) and that for ODX teas ~90% (LY: ~86%), owing to the scarcity of teas in the overall system.
- For the full year CY2020, ICRA expects domestic production to be lower by ~12% - ~13% for NI and only ~1% for SI, assuming that no further material change in production takes place during the balance four months of September to December. The drop in ODX production from NI is expected to be sharper than the overall decline, as producers are likely to increase the share of CTC teas, given the relative attractiveness of the CTC market. The decline in production is likely to result in an increase in the cost of production for the NI bulk tea producers, given the fixed cost intensive nature of operations. ICRA estimates costs to increase in the range of Rs 25 to Rs 30 per kg, without assuming any increase in labour wages from the current levels.
- The decline in production and the consequent increase in costs is, however, likely to be more than compensated by the increase in tea prices. While the current prices, particularly that of CTC teas, are very high as compared to last few years performance it is likely to witness some moderation, as the current supply-demand mismatch corrects to an extent, apart from the normal softening in prices in the latter half of the year. For FY2021, ICRA expects prices of NI CTC teas to be higher by ~Rs 65 per kg (~46% YoY basis), while that of NI ODX prices by ~Rs 50 per kg (~25% YoY basis). Consequently, the financial performance of NI bulk tea players is likely to witness a material improvement in FY2021. Nonetheless, in spite of the improvement, the debt metrics would continue to remain subdued compared to historical highs. While FY2021 is likely to turn out to be one of the better years for NI bulk year players in recent history, thus providing the industry with some respite, long-term sustainability of the same remains to be seen.

## ICRA expects full year production in CY2020 to be down by ~12%

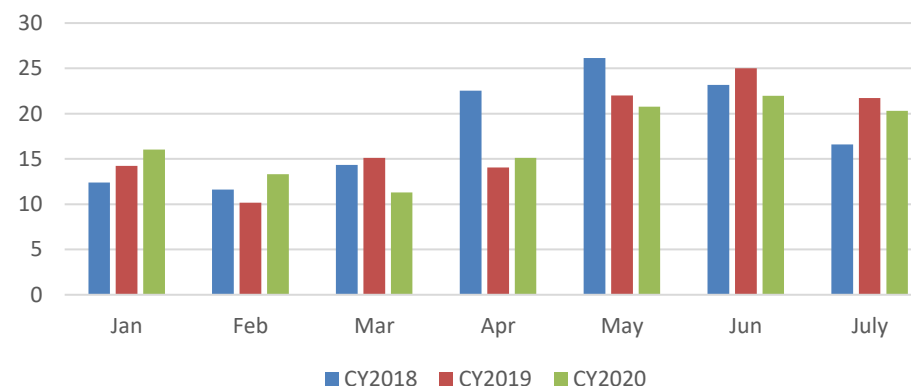
A combination of several factors has impacted domestic tea production, particularly that of North Indian bulk tea players in an unfavourable manner. While production was impacted during the months of March, April and May 2020, due to restrictions on labour deployment amidst the ongoing Covid-19 pandemic, inclement weather conditions and flooding in Assam in June 2020 led to crop losses. Some impact of the adverse weather conditions was felt in July 2020 as well. As per provisional data published by the Tea Board of India (TBI), production from NI is down by ~140 mkg (26%). Market feedback indicates that production in August 2020 is also likely to have been impacted by adverse agro-climatic conditions with production likely to be down by ~10-15%. Consequently, cumulative NI production till August 2020 is likely to be lower by ~22%. On the other hand, the South Indian (SI) production witnessed only a marginal loss during the lockdown period. Till June, cumulative production was down by only ~3.5 mkg (~3%), as per TBI provisional data. Given the trend till August 2020, ICRA expects the overall domestic production to be down by ~12% in CY2020, with NI production likely to be down by ~13% and SI witnessing only a marginal decline.

**Exhibit 1: Production tea production in NI**



Source: ICRA research, Tea Board of India

**Exhibit 2: Production tea production in SI**

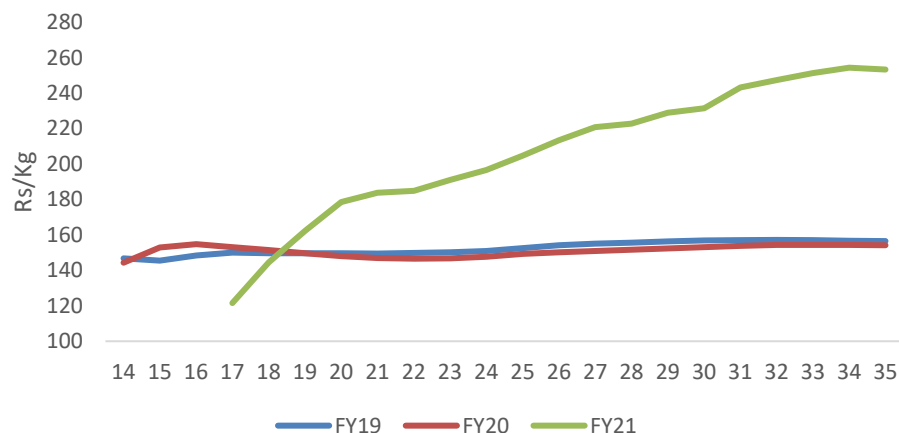


Source: ICRA research, Tea Board of India

## Decline in production and steady demand witness sharp increase in auction prices in the current financial year

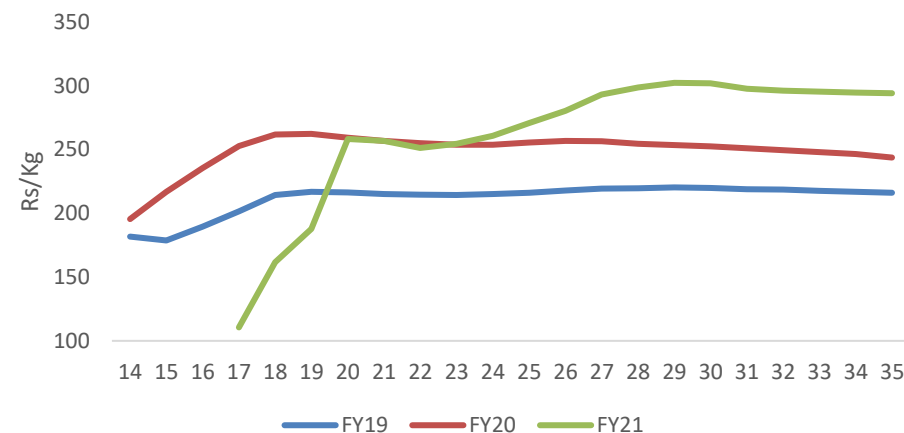
Domestic tea prices have seen a sharp increase in recent months, driven by a supply-demand mismatch. Although there were initial apprehensions that the lockdown would have an adverse impact on the overall consumption levels, anecdotal evidences and channel checks indicate that increase in “at-home” consumption has more than off-set the decline in “out-of-home” consumption – both in terms of quantity and quality. Consequently, the overall demand is estimated to have increased, albeit marginally. Thus, a decline in production, coupled with firm consumption, has led to a sharp increase in prices of teas at various auction centres across India. The increase has been the sharpest for CTC teas from NI, prices of which are up by ~85% in the recent auctions and by ~65% on a cumulative basis for the period April to August – both on a YoY basis. Prices of ODX teas from NI were up ~35% and by ~22% (cumulative) in the recent auctions. The uptrend in SI tea prices started later, compared to that for NI teas. While current prices for CTC teas in SI is up by more than 80%, on a YoY basis, cumulative prices for the period April to August increased by ~24%. The prices of SI ODX teas have witnessed the least increase, with cumulative prices up by only ~3% although in recent auctions it has been higher by ~20% to 30%.

**Exhibit 1: NI CTC auction prices (Cumulative) for Sale no 14-35**



Source: ICRA research, Tea Board of India; sale no 14 starts from April

**Exhibit 2: NI ODX auction prices (Cumulative) for Sale no 14-35**



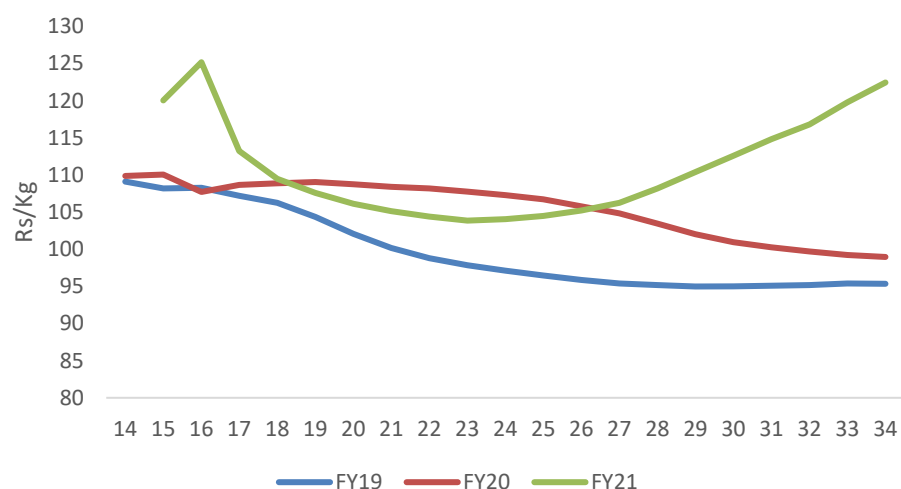
Source: ICRA research, Tea Board of India; sale no 14 starts from April

The divergence in price movement of the two variety of teas from the two regions is because of the difference in the underlying supply and demand factors. Indian tea production primarily comprises the CTC variety of teas, which accounts for ~92%, with most of the balance being accounted for by ODX teas. While CTC teas (~90%) are primarily consumed within India, ODX teas (more than 95%) are mostly exported. Also, while NI production is seasonal in nature, with quality and quantity varying across months, the SI production trend is much more uniform in nature throughout the year. For NI, the period from the middle of March to that of end-June, except for a three to four-week period between mid-April to mid-May, is considered to be the best, in terms of quality. These four months, however, account for a third of the annual production from NI with the months of July to October, each accounting for ~13% of the annual production. Significant loss in production (~33%) in the four months of high-quality production, led to a sharp increase in the prices of CTC teas.



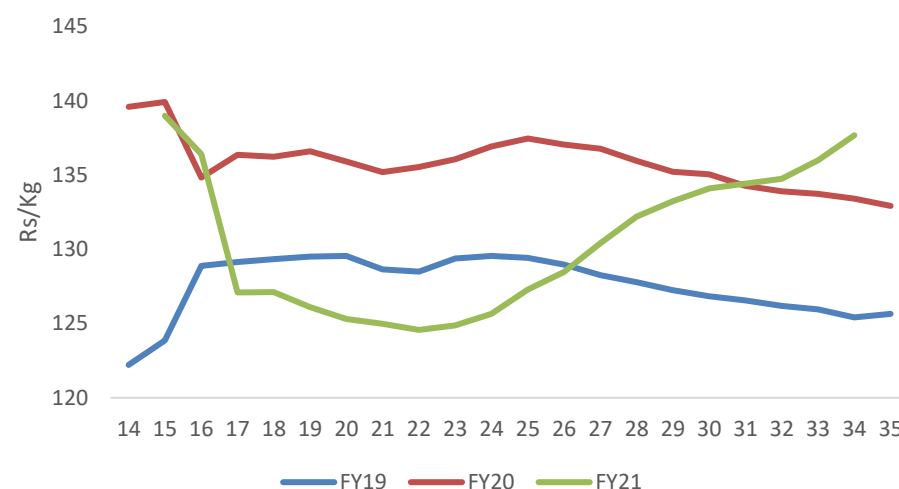
Increase in ODX prices in NI was relatively lower, part of which is on account of the base effect. The prices of ODX teas, which anyway command a significant premium over that of CTC teas, were ruling at a much higher level in CY2019 compared to that in CY2018, on the back of healthy demand from Iran. Also, since ODX teas are largely exported, the trend in production and prices of Sri Lankan (SL) ODX, the other primary source of ODX teas globally, also have an influence on Indian prices. In the first seven months of the current calendar year ODX production in the low elevation areas of SL teas, which compete with Assam ODX teas in the international market, has been down by ~21%. Consequently, SL ODX prices are higher by ~24% in the recent auctions.

**Exhibit 3: SI CTC auction prices (Cumulative) for Sale no 14-35**



Source: ICRA research, Tea Board of India; sale no 14 starts from April

**Exhibit 4: SI ODX auction prices (Cumulative) for Sale no 14-35**



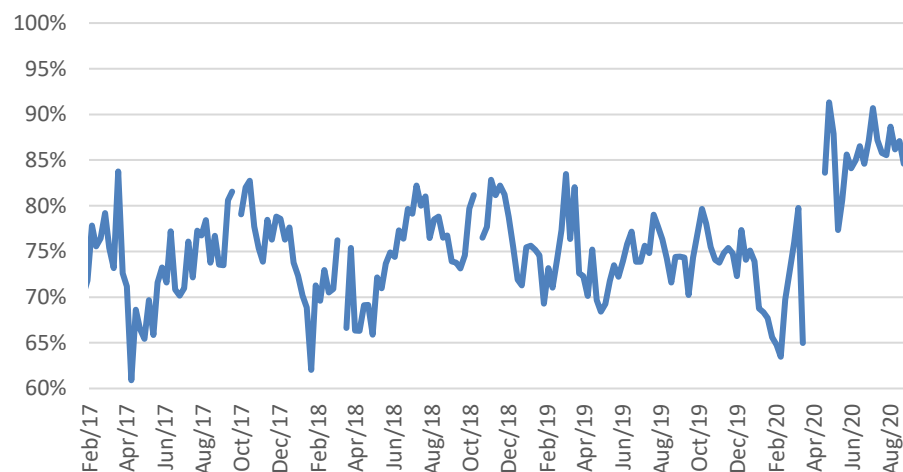
Source: ICRA research, Tea Board of India; sale no 14 starts from April

Teas from SI, the CTC and the ODX varieties, are generally considered to be lower in quality compared to that of the NI variety and are usually used as “fillers” in blends with high quality NI teas to bring down the overall cost of the packet. Moreover, of the total tea produced in SI, almost 45% is exported (corresponding figure for NI is only ~13%) – hence price movements of SI teas are more influenced by trends in the international market when compared to that of NI teas. With Kenya, primarily a CTC producer, witnessing a 42% (~90 mkg) increase in production in H1 CY2020, the prices of Kenyan CTC teas in the international market continued to remain soft at ~\$2/Kg (down by ~7% YoY basis). The impact of the same has been more on CTC teas from SI as the region exports around a third of its CTC production, whereas NI exports only ~8% of its CTC teas and that too of high quality, which is not generally produced from Kenya and thus is relatively detached from the trend prevalent in Kenyan CTC teas.

## Rally remained broad-based irrespective of quality; unsold inventory in the auction reduced significantly

The analysis of NI auction prices suggests that in the current year a significantly higher proportion (~90%) of CTC teas are being sold at above Rs 200 per kg, a sharp difference compared to the previous years (last year the corresponding figure was only 31%). Also, apart from teas from the Assam region, the low-to-medium quality teas of the Cachar and Dooars/Terai belt have also witnessed a significant increase in prices, which implies that the rally remained broad-based with price improvement in all varieties/qualities of teas. In addition, the tea sold in the auction as the percentage of tea offered has increased substantially – ~87% for NI CTC teas for the period April to August (Last year (LY): ~73%) and ~90% (LY: ~86%) for ODX teas, which implies that the unsold inventory in the auction has reduced significantly owing to the scarcity of teas in the overall system, which is expected to support tea prices going forward.

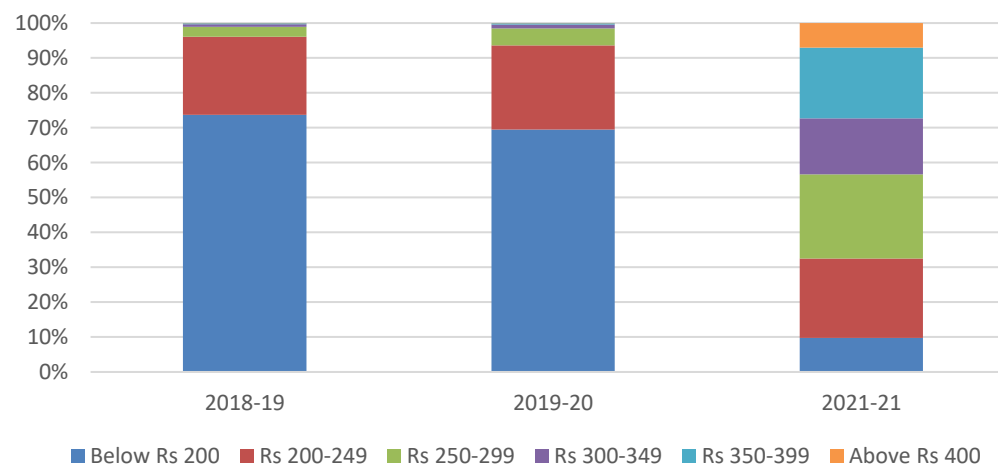
**Exhibit 5: Tea sold as % of tea offered in the NI auction**



Source: ICRA research, Parcon India data

The significant drop in production during the early part of the season in April-May 2020 impacted the availability of tea. The low availability as well as the lockdown/restrictions led to cancellation of 4-7 auctions at various auction centres in NI during the same period. Auction volumes have, however, recovered in recent weeks with volumes in the auctions during August registering volumes at almost the same level as last year.

**Exhibit 6: Price-range for CTC teas sold in the NI auction (till Aug 2020)**



Source: ICRA research, Parcon India data

## Financial performance of NI bulk tea players may witness material improvement in FY2021; long-term sustainability remains to be seen

ICRA expects the financial performance of NI bulk tea producers to witness significant improvement in FY2021, particularly for producers who have a high share of CTC teas, on the back of a positive price-cost effect. While cost per kg is estimated to increase by ~Rs 25 to 30 per kg, assuming a 13% decline in production, the prices of teas are likely to witness a higher increase. While the current prices, particularly that of CTC teas, are very high some moderation is expected as the current supply-demand mismatch corrects to an extent, apart from the normal softening in prices in the latter half of the year, given the seasonal decline in quality of tea produced. In the 2<sup>nd</sup> half of FY2020, tea prices had witnessed a sharp decline, given the abundant supplies and it was sharper for ODX teas in Q4 FY2020. For the current year, ICRA expects a much lesser decline in tea prices given the production loss. Prices of ODX teas would be further supported by even lower supplies, given the shift of some manufacturers from ODX to CTC in the current season. ICRA expects higher prices of NI CTC teas by ~Rs 65 per kg (~46% YoY basis), and that of NI ODX teas by ~Rs 50 per kg (~25% YoY basis) on an average during FY2021. Consequently, the financial performance of NI bulk tea players is likely to witness a material improvement in FY2021. Nonetheless, in spite of the improvement, the debt metrics would continue to remain subdued compared to historical highs. While FY2021 is likely to turn out to be one of the better years for NI bulk tea players in recent history, thus providing the industry with some much-needed respite, however, long-term sustainability of the same remains to be seen. From FY2014, the industry has been plagued by a consistent increase in costs, driven mainly by an increase in labour wages, and the stagnating prices of teas. Reports confirm that most packet tea companies have increased prices in recent months. This seems to be a sign of hope for the bulk tea industry about the long-term sustainability of firm bulk tea prices, even when production returns to normal. With the increase in MRP, packet tea companies may be more accommodative of the firm tea prices going forward. However, any change in strategy of the packet tea companies or any material increase in labour wages in the near term, may prove to be detrimental to the beleaguered bulk tea industry.

## 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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- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- 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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