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## Indian Bulk Tea Industry

# December 2018

Firm trend in realisations to provide partial relief from sharp increase in wage rates for North Indian bulk tea players in FY2019



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## Executive Summary

## HIGHLIGHTS



- Aggregate tea production across major tea-growing nations witnessed a marginal increase during 10M CY2018, on the back of significant increase in Kenyan production, while India and Sri Lanka production remained marginally low.
- Prices at Kenyan and Sri Lankan auction centres experience pressure during 10M CY2018; domestic auction prices, however, remained on an uptrend. Also, the lower availability of end season teas has supported a firm price trend in recent weeks in NI auction.
- In 10M CY2018 Indian export volumes remained flat and realisations muted on the back of higher volumes from Kenya; however, clarity on export to Iran is likely to support volume and realisation going forward.
- While the sharp increase in input costs, particularly labour and energy costs, is expected to put pressure on operating profitability, firm price trend is likely to provide partial relief for large bulk tea players operating in North India in the current year. However, the exact trend in profitability would be a function of tea prices over the remainder of the fiscal as well as the level of production in March 2019

## OVERVIEW

In the current year, all-India auction prices remained on an uptrend, driven by the rise in North Indian (NI) tea prices at the beginning of the current fiscal year and sharp uptick in South Indian (SI) tea prices during the second half of the year. Prices at NI auctions, after initially witnessing a firm trend, dipped marginally during the months of September and October. However, prospects of lower tea availability of end season teas have supported a firm price trend in the recent weeks. Prices at SI auction centres on the other hand, after initially witnessing a very soft trend, have firmed up considerably from August, given the decline in production following the floods in Kerala. While auction prices have historically witnessed a sharp decline towards the end of the season on account of quality, in the current year such a sharp decline seems unlikely, given the lower availability of tea. Hence for the year, prices at auction centres for both NI and SI are expected to be firmer on a YoY basis. Better prices are expected to ease some of the pains associated with the sharp increase in input costs, particularly labour and energy costs, for North Indian-based bulk tea producers. Nonetheless, the operating profitability is expected to remain under pressure, although the exact trend would depend on the prices of the end season teas sold over the remainder of the fiscal as well as the level of production in March 2019, when the production in the new season restarts.

### **Aggregate tea production across major tea-growing nations witnessed a marginal increase during 10M CY2018, on the back of an increase in Kenyan production**

India is the single largest producer of black tea in the world, accounting for around 43% of the total black tea production globally, followed by Kenya (16%) and Sri Lanka (10%). Over the past few years, however, Indian tea production has remained relatively stable, leading to movements in global tea production being primarily driven by variations in Kenyan and Sri Lankan crop levels. During 10M CY2018, the aggregate tea production from the three countries, increased by 31.9 mkg (1.8%), on account of higher crop in Kenya. The Kenyan crop recorded a significant increase of 14% during the period. The Sri Lankan production, however, declined by around 2.8%, primarily due to unfavourable weather conditions. India recorded a nominal de-growth of 1% in crop levels during 10M CY2018 to touch 1117.6 mkg, primarily driven by a decline in South Indian (SI) production, while North Indian (NI) crop levels remained largely stagnant (at 930 mkg). Production from NI during CY2018 is, however, expected to be impacted by the directive of the Tea Board of India to stop plucking from mid-December, which will reduce the production of low-quality teas during the month. Production from SI declined during 10M CY2018, impacted by adverse weather in certain regions as well as the temporary suspension of operations at several bought-leaf factories in protest against the green leaf price fixed by the Tea Board. Though some recovery was witnessed during October 2018, for the full calendar year the SI production is likely to remain lower as compared to the previous year. Thus, the Kenyan crop increase is likely to play a key role in determining overall global cropping trends for the current year, given that both the Indian and the Sri Lankan production are likely to remain marginally low/stagnant.

### **In 10M CY2018 Indian export volumes remained flat and realisations muted on the back of higher volumes from Kenya; however, clarity on export to Iran is likely to support volume and realisation going forward**

India exports only around 20% of the black tea produced domestically. Notwithstanding the country's large domestic consumption base, exports play a vital role in maintaining the overall demand-supply balance in the domestic market. During 10M CY2018, overall export volumes remained flat at around 200 mkg. After considerable decline in August and September 2018, volumes recovered to an extent in October 2018, thus keeping the cumulative export volumes almost at the previous-year level. While NI export volumes (of 120

mkg during 10M) remained stagnant, the SI export volume increased by around 5% to reach 80 mkg for the period. Higher volumes from Kenya and uncertainty on exports to Iran, given the impending sanctions, which is a primary market for high quality orthodox teas, primarily impacted the NI tea export in the current year. However, the subsequent clarity on Iran with India getting a conditional waiver from the US sanctions and favourable payment mechanism is likely to support the export volume from India. Cumulative Indian export realisations till October 2018, increased slightly to Rs. 203/kg from Rs. 197/kg in 10M CY2017. However, in dollar terms the export prices continued to remain muted, primarily owing to increase in export volumes of 15% and lower realisation of Kenyan teas, India's main competitor for CTC teas. While Sri Lankan tea export volumes remained largely stagnant during 9M CY2018, realisations witnessed a downtrend, primarily on account of lower demand from Iran, given the impending sanctions. Going forward, into the new season, the ability to maintain healthy export volume at remunerative prices would be a key factor in determining the overall performance of the domestic tea industry

#### **Prices at Kenyan and Sri Lankan auction centres experience pressure during 10M CY2018; domestic auction prices, however, remained on an uptrend**

Average auction prices (in US\$ terms) in the major centres of Kenya and Sri Lanka witnessed a YoY decline of 12% and 10% respectively, during 10M CY2018. Kenyan prices were adversely impacted by the increased tea production levels in the country which led to prices reaching a two-year low. Sri Lankan weekly auction prices continued the downtrend witnessed over the past few months, largely on account of the impact of US sanctions on the demand of orthodox tea from Iran. While Indian auction prices during 11M CY2018 in INR terms increased by 4%, in US\$ terms it remained stable at around US\$2.03/kg given the sharp depreciation in the rupee from June. The uptick was primarily driven by the rise in North Indian prices, which rose by 4.2% in 11M CY2018, largely on account of the significant price increase during April-August 2018. Although in September and October NI prices witnessed a softer trend, it has again firmed up in the recent weeks with prospects of lower tea production, given the Tea Board of India directive to stop plucking from mid-December and lowering of uncertainty on exports to Iran. South Indian tea prices, which started off at a significant discount to previous year's prices, recovered to almost previous year levels of Rs. 100/kg during 11M CY2018 on a cumulative basis. Going forward, ICRA notes that the supply-side dynamics, particularly in Kenya and Sri Lanka, together with the currency movements, would remain crucial in determining the trajectory of international auction prices.

#### **Profit margins and debt coverage indicators for established bulk tea players of NI improved in FY2018, in the current year, however, given the sharp increase in wage rates, the trend in prices going forward would be critical determining the financial performance**

After registering a considerable decline in financial performance from FY2015 onwards, profit margins and debt coverage indicators for bulk tea players, particularly in North India, witnessed some improvement in FY2018 on the back of the increase in prices in the region, especially for players operating in relatively higher quality tea segments. Although prices at South Indian auctions were impacted by higher production levels, most large bulk tea players in South India did not witness any material contraction in operating profitability during the year, as the increase in production largely negated the impact of the lower prices.

In FY2019, the new wage structure applicable for tea plantation workers in the states of Assam and West Bengal is expected to continue to constrain operating profitability. However, firm price trend coupled with slight increase in own production is expected to ease the pain for large bulk tea players operating in NI to an extent. However, capital structure and debt-coverage indicators for large bulk tea players, in ICRA's sample set, is estimated to witness some improvement primarily on account of the expected decline in debt levels with the proceeds from the sale of the above mentioned tea estates being used mainly to reduce debt.



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- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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