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SERVICE COMPANY

Indian Bulk Tea Industry

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Tepid tea prices to keep profitability of bulk tea players under pressure in current year



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Executive Summary

HIGHLIGHTS



- Aggregate tea production across major tea-growing nations witnessed a de-growth during 4M CY2019, on the back of a decline in Kenyan and Sri Lankan production, while Indian production witnessed an increase.
- The auction prices at the Kenyan and Sri Lankan auction centres witnessed a YoY decline of 20% and 19% respectively, during 4M CY2019; Modest increase in domestic auction average during 5M CY2019, largely driven by firm South Indian prices coupled with tepid increase in North Indian prices. In NI, while CTC prices have continuously declined from end-April 2019, the firm orthodox prices have partially supported the overall NI prices, given the limited orthodox volumes.
- In 4M CY2019 Indian export volumes remained largely stagnant while export realisations in US\$ terms witnessed an uptrend on the back of healthy demand for orthodox teas; healthy demand for Indian orthodox teas in the global market, particularly from Iran, which supported the firm trend in export prices.
- Last year, the North Indian bulk tea industry witnessed significant increase in costs – particularly wages and energy costs - which impacted the financial performance in FY2019. The industry continues to face challenges in controlling costs and any further material increase in wage rates in the near term would, in a scenario of tepid increase in tea realisations will exacerbate the stress on the financial performance of organised NI bulk tea players.

OVERVIEW

Overall bulk tea price trends in North India (NI) remained flat during Q1FY2020, on the back of continuous decline in CTC prices from end of April 2019, notwithstanding the significant improvement witnessed in the orthodox tea prices. Healthy export demand, particularly from Iran, on the back of upfronting of export volume has supported orthodox tea prices in the current year. Going forward, while the uncertainty regarding exports to Iran remains, orthodox exports are unlikely to be materially impacted in the current year given the large volumes already exported. However, it is expected to provide only marginal support to the overall prices, given limited volumes of orthodox teas in total NI tea production. On the other hand, South Indian (SI) tea prices remained firm during Q1FY2020 and increased by around Rs 10/kg during the period, owing to lower crop and healthy realisations of orthodox teas. ICRA notes that the higher proportion of orthodox teas in total SI production have largely driven the auction prices in South India.

At the global level, production from Kenya, a predominantly CTC tea producing country, is down YoY due to the base effect, since in the first four months of CY2018 Kenya witnessed record cropping levels. Going forward, the trend in production volumes, both in Kenya as well as in the domestic market, during the peak tea-producing months of June to October, will have a bearing on the CTC price trajectory. Given the initial trends, a substantial improvement in overall tea prices in the domestic market appears unlikely at present. Last year, the North Indian bulk tea industry faced significant increase in costs – particularly wages and energy costs - which impacted their financial performance in FY2019. The industry continues to face challenges in controlling costs and any further material increase in wage rates in the near term would, in a scenario of soft CTC tea realisations, would exacerbate the stress on the financial performance of bulk tea players.

Despite a surge in Indian production, overall tea production in the major tea-growing nations records de-growth of 2% during 4M CY2019 on the back of a decline 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 the first four months of CY2019, the aggregate tea production across the major tea-growing regions of Kenya, Sri Lanka and India declined by 9.2 mkg, representing a YoY de-growth of 2.2%, primarily due to a fall in Kenyan crop levels (by 12 mkg, around 8%), especially in the month of March and April 2019. Sri Lanka also reported a 5.2 mkg (5.1%) dip in crop levels in 4M CY2019. Production in India is up by ~ 4.4% during 4M CY2019, driven by a 12.7% increase in production from NI while the same in SI is down by 12%. The increase in NI production is primarily attributable to the small growers, while production of organised players remained largely stagnant. Going forward, the trend in Kenyan production levels, which reported record crops in CY2018, would be a particularly critical determinant of the global tea market dynamics. In terms of domestic production, ICRA notes that the full-year trend will primarily be determined by cropping levels in North India during the peak tea-producing months of June to October.

Indian export volumes remained largely stagnant, however, export realisations witnessed an uptrend during 4M CY2019

India exports only around 20% of the black tea produced domestically. Nonetheless, exports play a vital role in maintaining the overall demand-supply balance in the domestic market. During the first four months of CY2019, aggregate Indian export volumes remained largely stagnant at ~82 mkg. While NI export volumes (49 mkg during 4M CY2019) declined by 2%, the SI export volume increased by 4% to reach 32 mkg during the period. Export realisations, however, witnessed a significant increase of 17% during 4M CY2019.

This sizeable increase in prices was largely attributable to the healthy demand for Indian orthodox teas in the global market, particularly from Iran, which supported the firm trend in export prices. Going forward, while the uncertainty regarding exports to Iran remains, given the US sanctions, orthodox exports are unlikely to be materially impacted in the current year. Volume of exports to Iran in the first four months of the year has already reached 70% of the total volumes exported in CY2018. Moreover, India is in a better position to export orthodox teas than Sri Lanka, the other main orthodox producer and exporter. Overall export prospects would be more dependent on the trend in production as well as export volumes from Kenya, which will continue to influence the export demand for the CTC variety.

Prices at global auction centres under pressure; however, domestic auction prices supported by lower SI production and healthy demand for orthodox teas

Average auction prices (in US\$ terms) in the major centres of Kenya and Sri Lanka witnessed a YoY decline of 20% and 19% respectively, during 4M CY2019. The Kenyan prices, which were adversely impacted during CY2018 owing to bumper tea production last year, continued to remain under pressure, notwithstanding a marginal improvement after April 2019. Sri Lankan weekly auction prices also continued the downtrend witnessed over the past year, largely on account of subdued demand from major importing countries. All-India cumulative auction prices increased by 5% on a YoY basis during Q1 FY2020, largely driven by firm South Indian prices as North Indian prices remained flat. In NI, while CTC prices have continuously declined from end-April 2019, the firm orthodox prices have partially supported the overall NI prices, given the limited orthodox volumes in total NI tea production. In addition, while the price improvement of CTC teas produced in the Dooars/Terai (primarily medium/low quality) remained modest (Rs 5-6/kg in May 2019), the poor performance of good category CTC teas produced in Assam, affected the overall NI price trend during Q1 FY2020. On the other hand, South Indian tea prices remained firm during Q1FY2020 and increased by around Rs 10/kg during the period. Lower crop has, to an extent, driven the SI price movement. Nonetheless, the overall auction volume for Q1 comprises only 18% of the annual auction volume. Hence the cropping pattern, both domestic and global for the full year, as well as the demand scenario for second flush teas (typically from end of May or early June) will determine the trajectory of the auction prices for the full year.

Profit margins and debt coverage indicators of bulk tea players expected to remain under pressure over the near term on the back of subdued tea price increase

Steep increases in wage rates had negatively impacted the profitability and debt coverage indicators of the organised bulk tea producers during FY2019, particularly given the modest increase in tea prices. The above is evidenced by ~115 bps contraction in operating margins of the seven listed bulk tea companies during FY2019. ICRA had earlier highlighted¹ 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 FY2019. However, the North Indian auction realisation for FY2019 increased by only 5.0% (around Rs. 7.3/kg), which adversely affected the margins of all the bulk tea companies, given that the production volume was almost flat during the period. Lower profitability impacted debt coverage indicators too in FY2019. In the current year, tepid tea prices would continue to impact the operating profitability and debt coverage indicators of the companies. Any further material increase in wage rates in the current year would have a severe impact on the overall health of the bulk tea industry, based out of North India.

¹ [ICRA Special Comments - Indian Bulk Tea Industry; Rise In Labour Expenses Adversely Impacted Operating Profitability Of Bulk Tea Players During The First Nine Months Of The Current Financial Year](#)

ABOUT ICRA

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