



ICRA

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SERVICE COMPANY

Indian Bulk Tea Industry

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Firm tea prices to drive material improvement in financial performance of bulk tea players in FY2021



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Executive Summary

HIGHLIGHTS



- Aggregate tea production across the major tea-growing regions of Kenya, Sri Lanka and India declined by 92 mkg, representing a YoY contraction of 7.0%, primarily due to a significant fall in Indian and Sri Lankan crop levels, despite increase in production in Kenya.
- Average auction prices (in US\$ terms) in the major centres of India and Sri Lanka witnessed a YoY increase of 42% (during 6M FY2021) and 11% (9M CY2020) respectively. The Kenyan prices, however, witnessed a further decline of ~7% in 7M CY2020 over and above ~15% decline, already witnessed in CY2019.
- Price increase has been the sharpest for the crush tear curl (CTC) variety of teas from NI, average prices of which are up by Rs 105/Kg (~68%) for the period April to September 2020, while that of orthodox (ODX) teas from NI are up by Rs 52/kg (~22%). ICRA expects prices of NI CTC teas to be higher by ~Rs 65 per kg (~46% YoY basis), and NI ODX prices by ~Rs 50 per kg (~25% YoY basis) on an average during FY2021.
- In 7M CY2020, aggregate Indian export volumes recorded a decline of 26 mkg (a contraction of ~18%). While NI export volumes declined by 49 mkg (~20%) during 7M CY2020, the SI export volume declined by 16% (~ 10 mkg) during the period.
- The financial performance of NI bulk tea players is likely to witness a material improvement in FY2021 on the back of a positive price-cost effect. Nonetheless, in spite of the improvement, the debt metrics would continue to remain subdued, compared to historical highs.

OVERVIEW

The financial performance of the bulk tea players is set to witness a material improvement in FY2021, particularly for the North India (NI) based producers having high proportion of CTC variety of teas, on the back of a significant improvement in tea prices during 6M FY2021. Owing to the lockdown/restriction on labour deployment during March-May 2020, the domestic tea production was severely impacted with ~151 Mkg (22%) drop in North India (NI) production, while South India (SI) witnessed only a marginal loss of ~2 Mkg (1%) till August 2020. However, the crop that has been lost is primarily of the first and the second flush, which are the best quality teas and are in high demand from packet tea companies to ensure the quality of the blend. The dearth of such quality tea has resulted in the sharp increase in prices. Also, contrary to earlier expectations, the tea demand continued to remain stable during the lockdown with increase in 'at-home' consumption more than offsetting the decline in 'out-of-home' consumption, thus further supporting the price levels. The price increase has been the sharpest for the CTC variety of teas from NI, average prices of which are up by ~68% for the period April to September 2020, while that of ODX teas from NI are up by 22%. The SI auction prices have also sharply improved recently. While tea prices are likely to moderate in the latter half with a correction in the supply-demand mismatch, apart from normal softening in the prices of end-season teas, the full year prices are expected to significantly improve with NI CTC teas likely to be higher by ~Rs 65 per kg (~46% YoY basis), while NI ODX prices higher by ~Rs 50 per kg (~25% YoY basis). Such a sharp price increase would offset the expected cost increase, owing to the production loss, and operating profitability is likely to improve to around 10% in FY2021. This implies a 600-bps increase on a YoY basis for ICRA's sample set of large NI-based bulk tea players. Nonetheless, despite the improvement, the debt metrics would continue to remain subdued at an absolute level with interest coverage and Total Debt/OPBDITA in ICRA's sample set estimated to be around 2.5-2.7 times and ~4.0 times respectively in FY2021 compared to less than 1.0 times and over 12.0 times respectively in FY2020. Also, 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. However, the long-term sustainability of the same remains to be seen.

Tea production in the major tea-growing nations records a contraction of 7% during 8M CY2020 on the back of a decline in Indian and Sri Lankan production

During the first eight months of CY2020, the aggregate tea production across the major tea-growing regions of Kenya, Sri Lanka and India declined by 92 mkg, representing a Yo contraction of 7.0%, primarily due to a significant fall in Indian and Sri Lankan crop levels, despite the increase in production in Kenya. The major reason for the significant decline was lockdown/ restrictions on labour deployment during March-May 2020 amidst the ongoing Covid-19 pandemic. While Indian production declined by 153 Mkg (a growth contraction of ~19%), the Sri Lankan production reported a 34 mkg (~16%) dip in crop levels till August 2020. The Kenyan production, on the other hand, rose by 95 mkg (growth of ~34% YoY) till August 2020, owing to a significant crop increase during the early part of the current calendar year (Feb-Apr). In India, the major production loss happened in NI, which was down by ~151 Mkg (~22%), while the SI witnessed only a marginal loss during the lockdown period. Given the trend till August 2020, ICRA expects the overall domestic production to be down by ~12% in CY2020, with ~13% decline for NI and only ~1% for SI, assuming no further material change in production takes place during the balance four months - September to December. In addition, 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 estimated to increase the cost per kg by ~Rs 25 to 30 per kg for NI-based bulk tea producers.

Indian export volumes declined in 7M CY2020 given logistics issues owing to Covid-19 pandemic

During the first seven months of CY2020, aggregate Indian export volumes recorded a decline of 26 mkg (a dip of ~18%). While NI export volumes declined by 49 mkg (~20%) during 7M CY2020, the SI export volume declined by 16% (~10 mkg) during the period. The major decline happened owing to lower export to Iran and Pakistan. Last year, the export to Iran had significantly increased to 53.5 mkg (~74%) in CY2019, which has moderated by around 43% to 21 mkg during 7M CY2020. Also, there was no exports to Pakistan (last year ~6 mkg), which further accentuated the decline in export volume. Export realisation has also moderated by around 3% in rupee terms, notwithstanding the depreciation of the rupee against the US dollar. While inherent export demand is unlikely to witness a material decline, logistical issues resulted in an interim decline in export volume. The sequential uptick in export volumes in June and July 2020 with the gradual easing of restriction, further corroborates the same. While the overall export volume is likely to be lower in the current calendar year, the trend in export volumes for balance months would be a key factor in determining the net shortage in the domestic tea industry.

Prices at Indian and Sri Lankan auction remained buoyant on the back of crop shortages

Average auction prices (in US\$ terms) in the major centres of India and Sri Lanka witnessed a YoY increase of 42% (during 6M FY2021) and 11% (9M CY2020) respectively. The Kenyan prices, however, witnessed a further decline of ~7% in 7M CY2020 over and above the ~15% decline already witnessed in CY2019. The supply overhang, coupled with effects of the Covid-19 pandemic on access to global markets, continue to adversely impact the Kenyan prices. Sri Lankan weekly auction prices increased sharply from March 2020 onwards, after witnessing production losses. In the Indian auction, the tea prices witnessed a sharp increase with the NI auction averages increasing by ~61% and SI auction averages by ~36% on a YoY basis during the period April-September 2020, driven by a supply-demand mismatch. While 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 offset the decline in 'out-of-home' consumption. The price increase has been the sharpest for the CTC variety of teas from NI, average prices of which are up by Rs 105/Kg (~68%) for the period April to September 2020, while that of ODX teas from NI are up by Rs 52/kg (~22%). For SI teas, while the current prices for CTC teas are up by more than 80-90%, on a YoY basis, average prices for the period April to September have increased by Rs 37/Kg (~37%). SI ODX teas have witnessed the least increase, with average prices being higher by only Rs 13/kg (~10%), driven mainly by a ~40% to 50% increase in recent auctions. ICRA expects prices of NI CTC teas to be higher by ~Rs 65 per kg (~46% YoY basis), and NI ODX prices by ~Rs 50 per kg (~25% YoY basis) on an average during FY2021.

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

The financial performance of NI bulk tea players is likely to witness a material improvement in FY2021 on the back of a positive price-cost effect. Nonetheless, despite the improvement, the debt metrics would continue to remain subdued, compared to the 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 continues to face headwinds owing to a significant increase in the cost of production, mainly increase in labour wages without commensurate increase in tea prices. However, as per market reports, 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.

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