



## INDIAN TEA INDUSTRY: OUTLOOK POSITIVE FOR THE SHORT TO MEDIUM TERM

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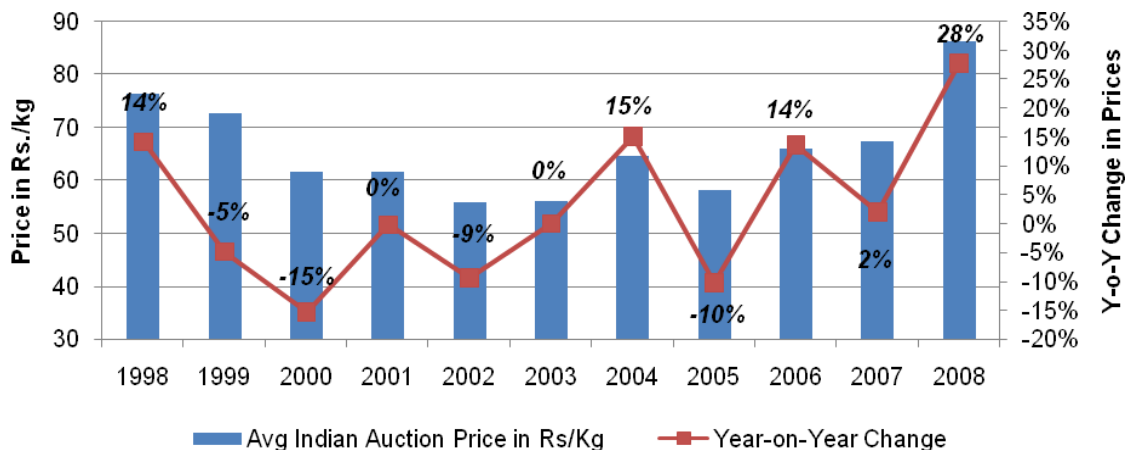
### Background

The tea industry occupies a place of considerable importance in the Indian economy, producing a fourth of the world's annual tea output—among them some gardens producing high quality teas - and employing around 1.26 million people at tea plantations and 2 million people indirectly. With domestic demand at an estimated 825 million kg (MKg) as of 2008, India is one of the largest consumers of tea globally. However, as domestic demand accounts for over 85% of the country's tea output and since tea imports are permitted only for re-export, India's share of the global tea trade is on the lower side. Nevertheless, exports have a critical role to play in maintaining the demand-supply balance in the domestic market. Although tea is produced in 14 States in India, five of them—Assam and West Bengal in North India, and Tamil Nadu, Kerala and Karnataka in South India account for over 98% of India's tea production. Within that, North India alone accounts for around 75% of India's total tea production, of which 85-90% is consumed in the domestic market. The balance, much of it of high quality, is exported. Tea is among the most labour-intensive of all plantation crops. On an average, around 65% of the cost of production is incurred on labour.

The Indian tea industry had positive tidings to report in 2008: low carry-forward stock from the previous (2007) season, steadily increasing domestic demand, and shortfall in production in many countries. This led to an increase in exports and the firming up of domestic prices during the year. Average domestic prices during 2008 were up by around 28% over the previous year. With around 65% of the costs of the bulk tea industry being fixed in nature, the increase in prices led to substantial improvements in the profitability of bulk tea players for the fiscal year (FY) 2008-09. In the current fiscal, that is FY2009-10, the estimated shortage of carry-forward stocks, increase in consumption and shortfall in production, both in India as well as globally, have resulted in tea prices increasing further. This in turn is likely to provide a further boost to the profitability of bulk tea players in FY2009-10.

The recent buoyancy in tea prices, which started from 2006, has come as a relief for bulk tea players, who have had to cope with depressed prices for almost a decade since 1999. Tea prices, after reaching a peak in 1998, went into a steady decline thereafter, with average domestic prices dwindling from around Rs. 76.43 per kg in 1998 to a low of around Rs. 58.05 per kg in 2005 (refer Chart 1 for trend in tea prices over the period 1998-2008). Although global tea prices also declined 1999 onwards, driven primarily by oversupply, the decline in average prices was sharper and of a longer duration for Indian teas vis-à-vis the teas from Kenya and Sri Lanka, India's two main rivals in the exports market. This was on account of a number of factors: lack of marketing initiative by the Indian players to look for export markets beyond the CIS1 countries; proliferation of small growers and bought-out leaf factories (which led to a decline in the quality of tea produced), and failure to check spurious varieties of tea from being traded as premium tea (which affected the image of Indian teas in the export market); higher cost of production of tea in India (as compared with that in Sri Lanka and Kenya) on account of the higher social costs here; and existence of certain non-tariff barriers like residual-pesticide (in tea) specifications imposed by a number of importing countries. All these factors led to the loss of key export markets, which in turn increased supplies in the domestic market, thereby bringing a downward pressure on prices. This apart, tea prices also came to be affected by the quality factor, which came into play during the early part of the current decade when the delay of re-plantation activities in the latter half of the 1990s began to tell on quality and hence on prices. Most players had deferred re-plantation during the latter half of the 1990s to cash in on the buoyancy in tea prices during 1997-98, but when the sharp price decline happened subsequently, their financial position got so weakened that they were unable to make the required investments in their tea estates.

**Chart 1: Trend in Domestic Tea Prices**



Source: ICRA research

To enable a revival of the domestic tea industry from the downturn, the Tea Board of India (TBI) took up active marketing of tea both in the domestic and export markets with a view to pulling the domestic tea industry out of the state of weakness that the downturn had plunged it into. Simultaneously, TBI also undertook various other measures, such as providing subsidy for production of orthodox teas, for re-plantation, and on expenses incurred on transportation of teas for exports. Aimed at enhancing the quality of produce, these subsidies are still being provided.

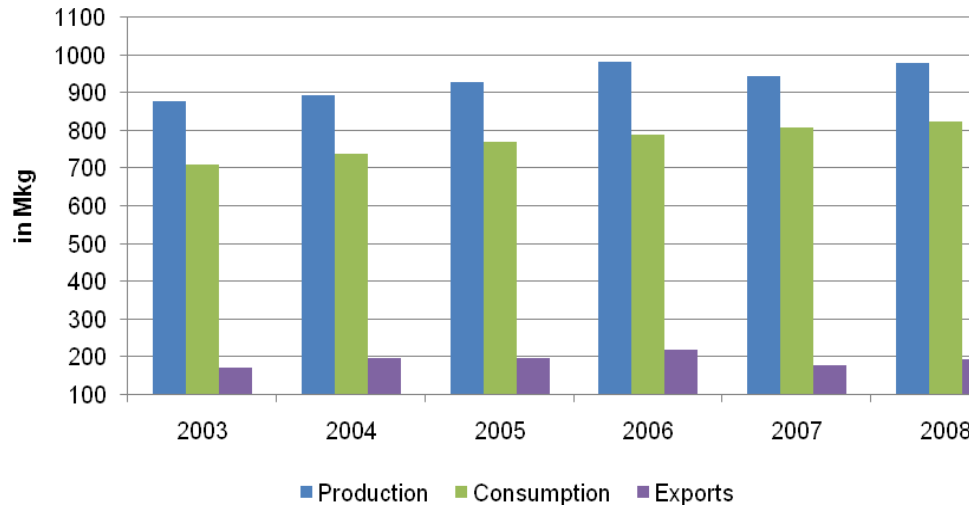
### **Increasing domestic consumption, and exports to an extent, behind current buoyancy in prices**

The gradual depletion in pipeline stock since 2003, following a secular increase in domestic consumption on the one hand and muted increase in production on the other, has been the main factor supporting the increase in tea prices from 2006 onwards. According to ICRA's estimates, while the average growth in production during the period 2003-07 was just 1.9% or so, domestic consumption would have increased annually at around 3.5% during the same period. The steady increase in domestic demand, range-bound export volumes and low

<sup>1</sup> Commonwealth of Independent States

growth in production absorbed the pipeline stock over the years and left virtually no carry-forward stock at the end of the 2007 season. Chart 2 presents the trend in India's production, consumption and export of tea over the period 2003-08.

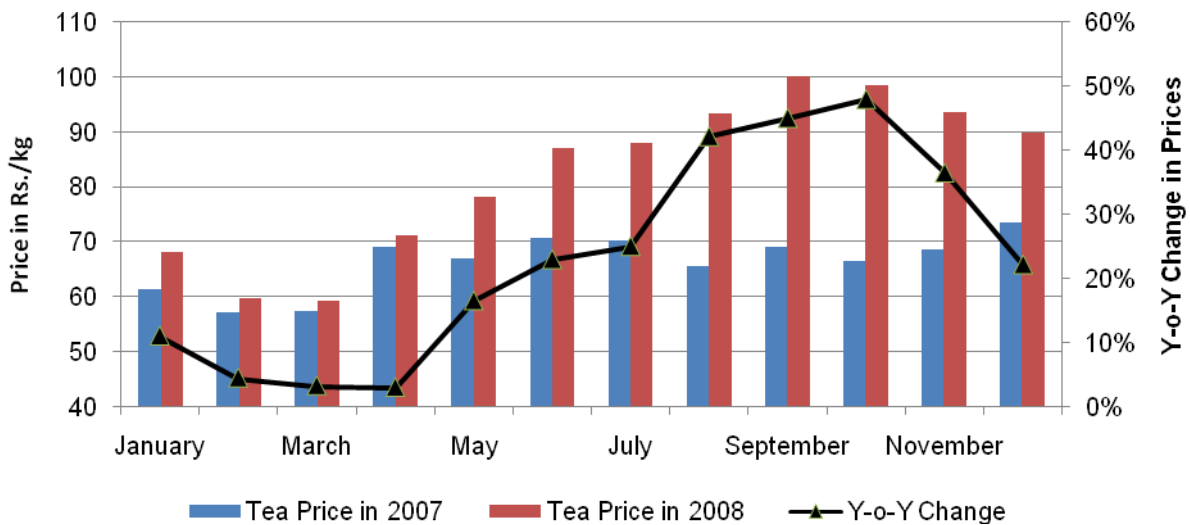
**Chart 2: Trend in India's Production, Consumption and Exports of Tea**



Source: ICRA research

Tea prices in India remained buoyant during the calendar year (CY) 2008, being driven by the absence of any significant carry-forward stock at the beginning of the season, sustained domestic demand and increase in exports on the back of a shortfall of around 10% in Kenyan production. During the year, tea prices scaled a peak in September, recording an almost 45% increase over the corresponding previous. Chart 3 presents a comparison of monthly tea prices in 2008 against the same in 2007. Although tea prices reported a correction in November and December, on account of a slowdown in the exports markets, given the financial meltdown, the cumulative average for the year was around 28% higher than the same for the previous year.

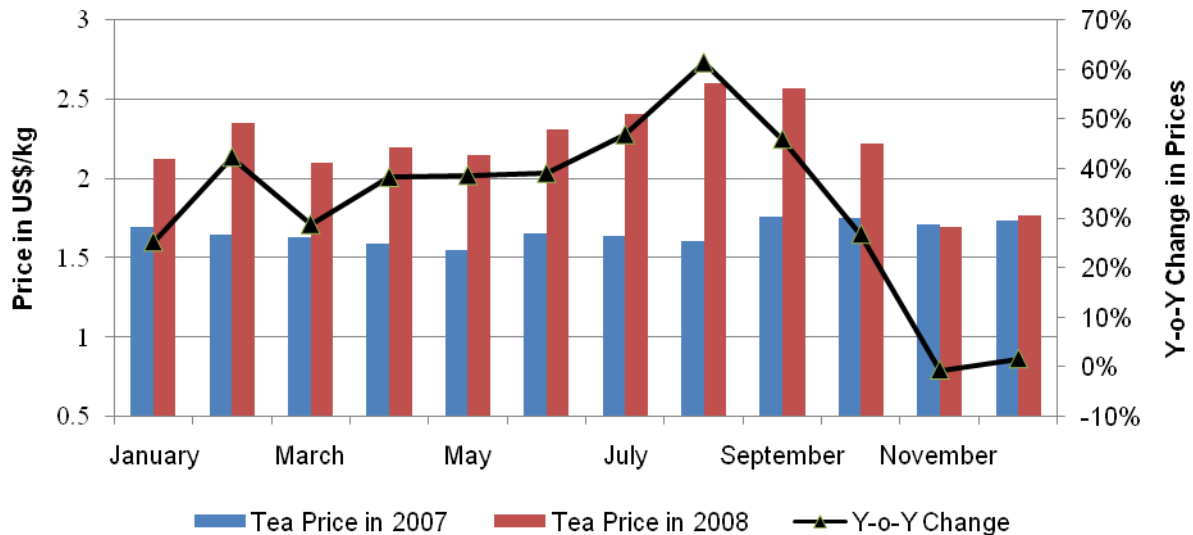
**Chart 3: Monthly Domestic Tea Prices—2008 vs. 2007**



Source: ICRA research

The month on month movement of tea prices in India has reflected the movement in tea prices at major auction centres globally. Chart 4, compares the monthly auction price in US \$ per kg, at Mombasa, in 2008 against the same in 2007. As can be seen, international tea prices also suffered in the second half of 2008, following the global financial crisis.

**Chart 4: Monthly Auction Prices at Mombasa—2008 vs. 2007**

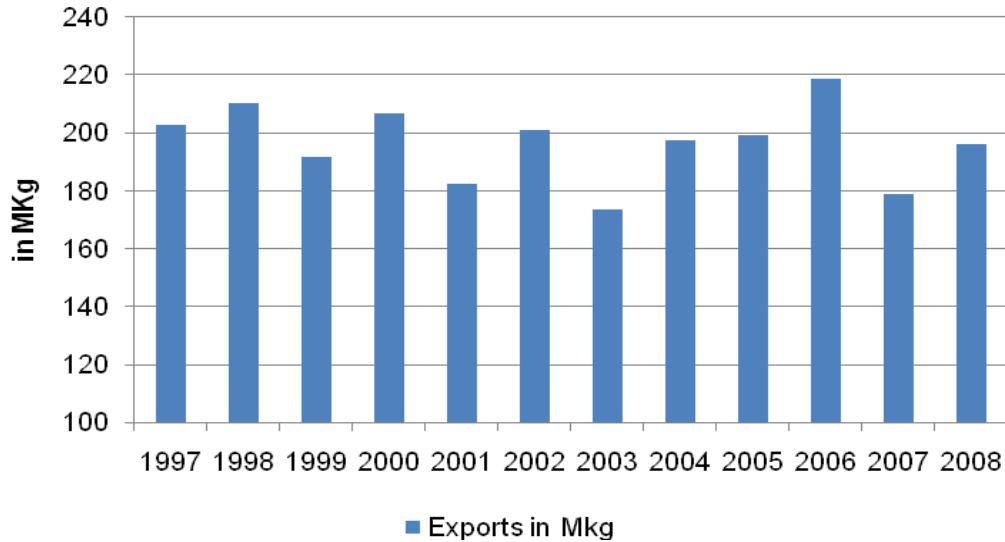


Source: ICRA research

For the Indian tea industry, the main driver of demand is the domestic market, with domestic consumption now growing at an estimated 3.5% annually, as against around 2.5% a decade earlier. The increase in demand is a result of active marketing of tea by players as well as TBI, positioning tea as a health drink, and also the rising affluence of Indian consumers. At the current growth rate, the domestic market would require an incremental 30 Mkg or so annually, going forward. As against that, tea supply has been growing at less than 2% p.a because it is difficult to improve garden yield of tea even during favourable climatic conditions, and new plantations need a long gestation period of at least 4-5 years. Therefore the demand-supply gap in India is likely to persist at least over the medium term. Large domestic consumption is an advantage that India has over its nearest competitors, namely Kenya and Sri Lanka, who have to depend almost entirely on export demand to sell their produce.

Notwithstanding the large domestic consumption base that India has, exports play a vital role in maintaining the overall demand-supply balance in the domestic market. Healthy export realisation is also crucial for domestic realisations as un-remunerative prices in the export market may lead to exporters dumping the produce in the domestic market, which in turn would exert a downward pressure on domestic prices. As Chart 5 overleaf shows, tea exports from India have remained range bound over the period 1997-2008 with some year-to-year fluctuations seen in between.

**Chart 5: Trend in India's Tea Exports**

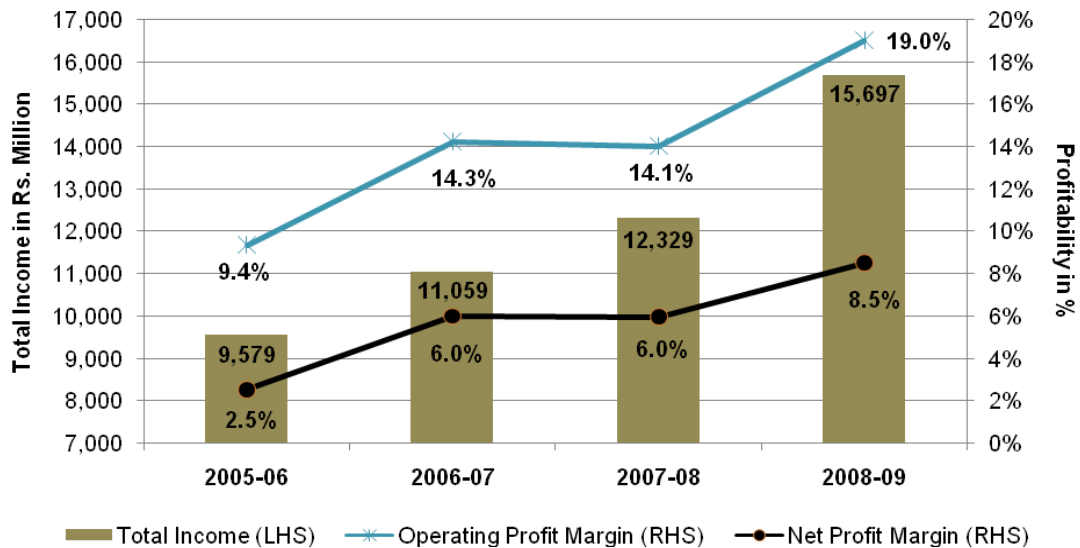


Source: ICRA research

**Buoyant tea prices in 2008 perk up financial results of bulk tea players**

An increase of around 28% in tea prices on an average in 2008 has meant considerable increase in the profitability of bulk tea players in FY2008-09, given that around 65% of their costs are fixed in nature. Chart 6 brings out the positive impact of increasing tea prices on the aggregate total income and profitability indicators<sup>2</sup> of some of the large bulk tea players in India<sup>3</sup>, which shows significant improvement over the past few years.

**Chart 6: Trend in Aggregate Income and Profitability Indicators of Bulk Tea Companies**



Source: Bombay Stock Exchange

<sup>2</sup> Data taken from the Bombay Stock Exchange (BSE) and hence definition of financial indicators may not be in accordance with standard ICRA definitions as published in other ICRA publications

<sup>3</sup> McLeod Russel India Limited, Jayshree Tea & Industries Limited, Warren Tea Limited, and Dhunseri Tea and Industries Limited.

**Outlook positive for the medium term**

With a spell of dry weather affecting domestic production during the first seven months of calendar 2009, tea output declined by around 16Mkg during this period over the corresponding previous. The shortfall in domestic production along with the substantial decline in output in both Sri Lanka and Kenya primarily on account of adverse weather conditions there has caused tea prices to firm up both in India and in the international markets. Average domestic tea prices during the period January-July 2009 were up by around Rs. 21/kg (around 28%) over the levels reported during the corresponding period of the previous year. Given this scenario, large bulk tea companies who have been able to largely maintain production at last year's levels, primarily on the strength of superior garden practices, are in a position to benefit substantially from the continuing trend of buoyant prices.

The decline in production apart, the estimated shortage of carry-forward stocks at the beginning of the 2009 season, continued increase in domestic consumption and healthy exports are also expected to keep prices at high levels at least over the medium term. The upside however continues to be tempered by the possibility of the industry being unable to maintain exports at the current levels and by the risks arising from its exposure to commodity cycles. Moreover, while the current conditions are favourable for tea companies, the likelihood of increased production world-wide, particularly if weather conditions improve in major tea producing countries and tea productions starts in newer geographies, thereby moderating international tea prices, cannot be ruled out. Any substantial increase in production from new gardens would however come with a lag, given that there is a gestation period involved in new plantation areas producing quality teas. Better climatic conditions in major competing countries in the short term may dampen international prices, and such moderation may potentially impact domestic tea prices through higher availability of teas in the country. Nevertheless, ICRA expects domestic tea prices to rule at high levels relative to the historical trend over the short to medium term, given the expected expansion of the demand-supply gap in the country. Such conditions are likely to result in better profits and cash accruals of Indian bulk tea companies.

## Annexure

### List of Tea Companies rated by ICRA

Company	Instrument	Rating
McLeod Russel India Limited	Rs. 2.1 billion fund based bank facilities	LA+
	Rs. 1.01 billion fund based and Rs. 188 million non-fund based bank facilities	A1+
	Rs. 400 million commercial paper programme	A1+
Amalgamated Plantations Private Limited	Rs. 1.57 billion term loans and Rs 400 million fund based bank facilities	LA
Goodricke Group Limited	Rs. 500 million fund based and Rs. 80 million non fund based bank facilities	LA+/A1+
Koomber Tea Company Private Limited	Rs. 41 million fund based bank facilities	LA/A1
Stewart Holl (India) Limited	Rs. 45 million fund based bank limits	LA/A1
	Rs. 2.7million non fund based bank limits	LA
	Rs. 1.5million non fund based bank limits	A1
Amgoorie India Limited	Rs. 50 million fund based bank facilities	LA/A1
Tata Tea Limited	Rs. 3.25 billion debenture programme, Rs. 2.75 billion fund based facilities and Rs. 4 billion proposed long term debt programme	LAA
	Rs. 750 million commercial paper programme, Rs. 2.9 billion fund and non fund bank facilities and Rs. 5 billion proposed short term debt programme	A1+
Gujarat Tea Processors and Packers Limited	Rs. 130 million fund based bank facilities	LAA-



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