Indian Bulk Tea Industry

Regional supply-side dynamics support average realisations for Indian teas, although cost pressures keep margins under check; long-term demand prospects favourable

ICRA

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In the current calendar year, lower production in South India (SI) and better export demand for orthodox teas have supported domestic auction averages, negating the adverse effect on prices stemming from increased availability of tea from Kenya and, to a lesser extent, from North India (NI). However, continuing cost pressures attributable to the increase in wage rates, kept margins and debt coverage indicators under check. The credit worthiness of large companies[1] in the sector, however, continues to be supported by the favourable capital structure. Over the long term, increasing domestic demand for black tea, combined with a limited increase in domestic production, is likely to support a positive price and margin trajectory for the Indian bulk tea industry, although export volumes would play a key role.

During 10M CY2016, Indian tea production recorded a marginal increase on a YoY basis; Kenyan tea production, on the other hand, witnessed considerable growth while Sri Lankan crop declined

Increase in Indian tea production in the current year largely driven by NI crop with SI production recording a considerable decline

India is the single largest producer of black tea in the world, accounting for around 44% of the total black tea production globally, followed by Kenya and Sri Lanka. Over the past few years however, Indian tea production has remained largely stable, leading to movements in global tea production being primarily driven by variations in Kenyan and Sri Lankan crop levels. In the current year, production from North India (NI) till October, 2016 is up by around 3%, whereas South India (SI) production is down by around 10%, resulting in overall Indian production being up by around 0.8%.

Global production increased by around 2.5% during 10M CY2016, largely on account of higher crop in Kenya. The Kenyan crop recorded a significant increase of around 24% during the period. Sri Lankan production, however, declined by around 15%, primarily due to unfavourable weather conditions

Although tea export volumes declined during 10M CY2016 due to surplus Kenyan production, export realizations increased on the back of demand for orthodox tea and rise in the prices of South Indian teas

India's ability to maintain adequate export volumes at remunerative prices, despite fluctuations in global supply, would be critical to the overall financial performance of the tea industry going forward.

India exports only around 20% of the black tea produced domestically. 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.

The surplus in Kenyan production in the current year led to higher availability of tea in the global market, thus leading to a decline in export volumes from India, which, in turn, led to higher availability of tea in the domestic market as well. Export realisations, however, still witnessed an increase, primarily on the back of a surge in demand for orthodox teas, given the downtrend in Sri Lankan production, which is largely of orthodox variety. Moreover, the rise in prices of South Indian teas, given the decline in production from that region, also supported the overall export price trajectory.

Going forward, India's ability to maintain adequate export volumes at remunerative prices, despite fluctuations in global supply, would be critical to the overall financial performance of the tea industry.

[1] *ICRA sample of 12 companies, which account for around 18% of total Indian tea production*

Executive Summary

Geographical variations in supply have determined domestic price levels in the current year

Domestic auction averages recorded an increase of 9% in 10M CY2016, supported mainly by a significant rise in prices of South Indian tea

In the current year, despite the increased availability of tea in the global market, the all-India cumulative auction price recorded a YoY increase of around 9%. South Indian auction prices witnessed a significant increase during the period, due to a steep decline in production in the region. North Indian auction prices, on the other hand, witnessed a marginal increase, despite growth in production from the region, with realisations largely supported by domestic demand for CTC tea. Increased export demand for orthodox tea of both North Indian and South Indian origin, given the downtrend in Sri Lankan production, which is largely of the orthodox variety, further supported the overall price trajectory.

Increase in employee costs kept profitability under check since the growth in realisations did not adequately compensate for the increase in cost; however, the capital structure of companies in the sector is expected to remain comfortable

Increased cost pressures, especially employee cost, have adversely impacted profitability of bulk tea players; profitability and debt coverage indicators expected to remain under check during the current year as well

Tea is a fixed cost intensive industry with labour costs accounting for around 60%[2] of the total cost of production, followed by raw material cost (25%) and power and fuel cost (10%). The increase in cost of production of bulk tea players in North India, which accounts for around 80% of bulk tea production in the country, over the last two years, has primarily been driven by increased labour costs. Steep increases in wage rates have put pressure on the profitability of bulk tea producers, particularly given the fact that average realisations have largely remained flat. In addition to the basic wages, the tea companies also have to provide health, ration and welfare benefits to workers employed at plantations, which further increases the overall cost of production. The above is evidenced by an 11% decline in the operating profit margin for companies in ICRA's sample over the past two years (on an aggregate basis).

The capital structure of the companies in ICRA's sample has remained conservative, despite an increase in debt levels in recent years. However, interest coverage[3] was adversely impacted during the past two years on account of a decline in profitability. Nonetheless, while cost pressures are expected to continue, the capital structure of the companies in ICRA's sample is expected to remain comfortable going forward.

[2] *Including production from bought leaf and costs associated with non-tea businesses, labour costs as a proportion of total costs would be lower at around 45%*

[3] *Calculated on profit before interest, taxation, depreciation and amortization to account for the high non-operating income recorded by most tea companies*

Please contact ICRA to get a copy of the full report

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