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TEA MARKET UPDATE MARCH 2020

Euphoria over orthodox prices reaching multi-year highs in CY2019 tapers off towards year-end; although outlook supportive, several risk factors could manifest themselves thus impacting prices going forward



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Background

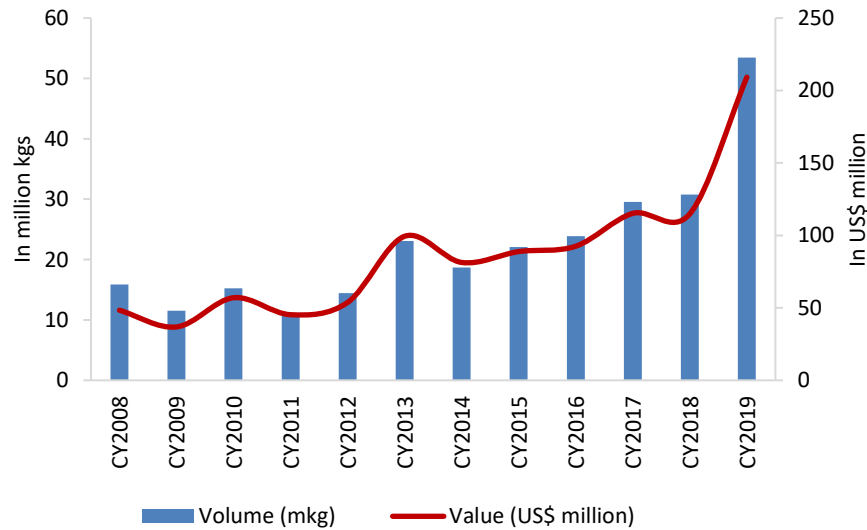
Indian tea production comprises both the crush tear curl (CTC) and the orthodox (ODX) varieties of tea. ODX tea production (excluding that from Darjeeling) accounts for ~7-8% of the Indian production. Strong demand from Iran, along with availability of advance funding from importers, drove prices of ODX teas to touch multi-year highs in the second quarter of CY2019. Prices, however, tapered off from the second half of the year, particularly during the last quarter. While deteriorating quality results in a drop in prices towards the end of the year on account of seasonality, the decline appeared sharper this year since towards the end of CY2018 prices had spiked on the restart of exports to Iran, following a temporary hiatus. Large established bulk tea companies increased ODX production to benefit from the healthy trend in ODX prices, as the prices of CTC teas remained subdued. Overall ODX production in CY2019 is estimated to have increased by ~ 14% with the volume of ODX teas in the auction centres of North India (NI) during CY2019 increasing by ~30%, as some of it, produced in CY2018, was sold in CY2019. The average prices of ODX teas in the NI auctions during CY2019, increased by almost Rs 14/kg. Going forward, the outlook for ODX teas remains supportive, with export demand likely to remain firm. However, a further escalation in the volatile geo-political situation in the Middle East could impact export demand. Also, any significant increase in production, from India and/or Sri Lanka (SL), could result in a supply-demand imbalance, thus impacting prices.

Of the total ODX production in India, Assam contributes to 55% with South India accounts for the bulk of the rest. ODX production is almost entirely export-oriented, with exports accounting for more than 95% of the total production, a sharp contrast to that of the CTC variety, where domestic consumption accounts for around 90% of the total production. In CY2019, while overall exports accounted for just under 20% of the total domestic production of teas (CTC + ODX), ODX exports accounted for ~35% of the total exports in volume terms and ~50% in value terms. The average realisation of the ODX teas command a significant premium to that of the CTCs, because of its better quality. In the international market, ODX teas from India competes with that of Sri Lanka, primarily the low grown varieties.

Strong demand from Iran during CY2019

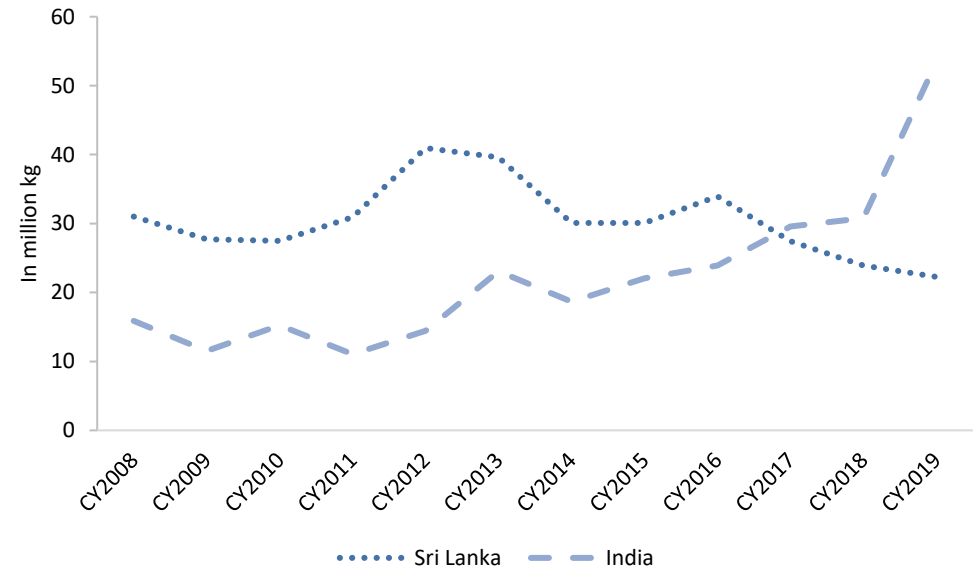
More than 95% of the ODX tea produced in India is exported with the primary export destinations being Iran, Germany, the Netherlands, the US, Saudi Arabia, the CIS countries and the UAE. Iran is India's single largest customer of ODX teas. During CY2019, while ODX exports to most geographies witnessed an increase, except the UAE, there was particularly very strong demand from Iran. Export to the country jumped by ~74% in volume terms and ~82% in value terms, accounting for almost 50% of total ODX exports in volume terms, consequently (Exhibit 1). The substantial increase in volumes was also driven by the fact that exports in CY2018 were impacted by payment concerns towards the second half of the year. As a result, merchant exporters deferred dispatches till the issues were sorted out, which took place towards the end of the year. Some of the exports during the beginning of CY2019 were spill-overs from the previous year.

Exhibit 1: Tea Exports to Iran from India in million kgs and US\$ million



Source: ICRA research, Tea Board of India

Exhibit 2: Tea Exports to Iran (in million kgs) from India and Sri Lanka



Source: ICRA research, Tea Board of India, teasrilanka.org

In the international ODX market, India's competitor is Sri Lanka, particularly in the category of teas grown in the lower altitudes (up to 600 m from sea level). In recent years India has overtaken Sri Lanka as the largest supplier of ODX teas to Iran ([Exhibit 2](#)). In CY2019, while exports to Iran from India almost doubled, Sri Lankan exports to Iran fell, by ~7%, for the third consecutive year. Exports to Iran now accounts for only ~8% of total Sri Lankan exports. Unlike India, Sri Lanka has a much more diversified export base, supplying to countries like Turkey, Iraq, Lybia and Syria, which cumulatively account for ~30% of tea exports from Sri Lanka in volume terms. India has a very marginal presence in these ODX tea-consuming nations.

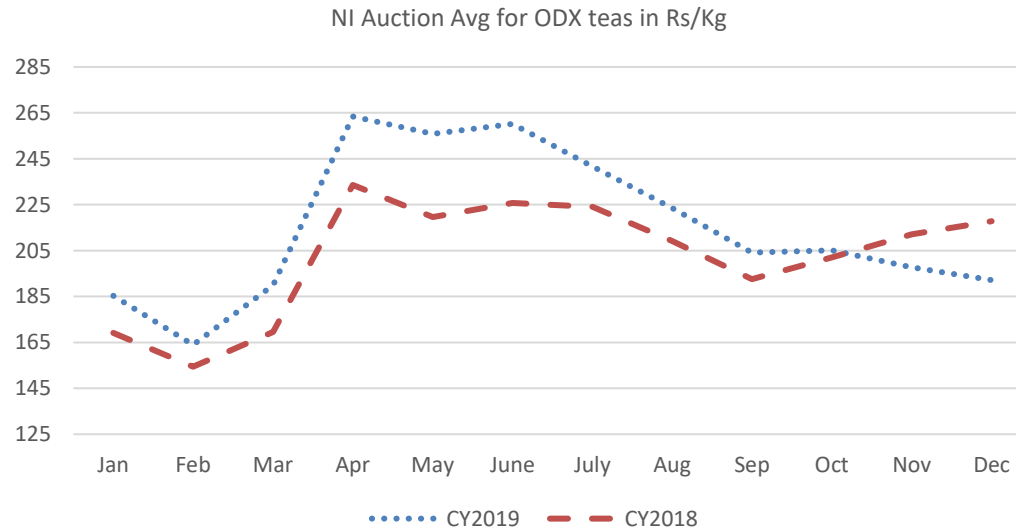
ODX production is estimated to have increased materially in CY2019

Looking at the attractiveness of the ODX market, a number of established players increased the share of ODX in their overall portfolio during CY2019. Consequently, the overall ODX production in India is estimated to have witnessed an increase of ~13% to reach around 115 Mkg, as per industry sources. Production from North India, primarily in the Assam Valley, is estimated to have witnessed an increase of ~20% while that from South India increased by only ~5% (estimates). Of the total ODX production in India, NI accounts for ~60% while SI accounts for ~40%. With NI accounting for just over 80% of the total Indian production, the share of ODX production in NI is only ~5%, while for SI it is significantly higher - at ~25%. However, the quality of ODX grown in NI is significantly better than that in SI. Auction realisations reflect the same with an average of ~ Rs 218 for NI as against ~ Rs 133 for SI during CY2019.

Healthy increase in ODX realisations during CY2019, notwithstanding some tapering off towards the end of the year; NI auction volumes also increased substantially

The ODX prices in NI auction centres during CY2019 witnessed a substantial increase, particularly during Q2 of the calendar year ([Exhibit 3](#)). Strong export demand from Iran pushed up prices of new season teas which come into the market in Q2, by almost Rs 35 during the months of April to June. While the prices remained strong in Q3 as well, higher by ~ Rs 15, they softened during Q4, falling below that during the same period of the previous year. As the season progresses, the quality of tea usually declines, thus impacting prices. In Q4 of CY2018, prices were supported by the restart of exports to Iran, after concerns on payments were sorted out. A spike in demand had led to firm price trends in Q4 of CY2018, which continued in Q1 of CY2019 as well. With such a spike not witnessed in Q4 of CY2019, prices were impacted particularly against a backdrop of falling quality. One characteristic of ODX teas is that the prices of off-grade/ secondary ODX teas sell at a substantial discount to primary grade teas. With ODX production increasing by ~20% in NI, the volume of secondary grade teas is also estimated to have increased. With secondary grade tea hitting the market in Q4 of CY2019, auction prices came down in Q4, a trend which has continued in Q1 of CY2020 as well. Nonetheless, for the full year CY2019, average auction prices of ODX teas in NI increased by ~Rs 14 per Kg, which, coupled with higher volumes, is expected to support the overall earnings and profitability of bulk tea players.

Exhibit 3: Average Prices, in Rs/kg, of ODX teas at NI auction centres – CY2018 vs CY2019



Source: ICRA research, Parcon India

Exhibit 4: Value and Volume of ODX teas sold in NI auctions

NI ODX Auction Performance	CY18	CY19
Vol in MKg	29.64	38.44
Avg Price in Rs/Kg	204	218
Value in Rs Million	6051	8382

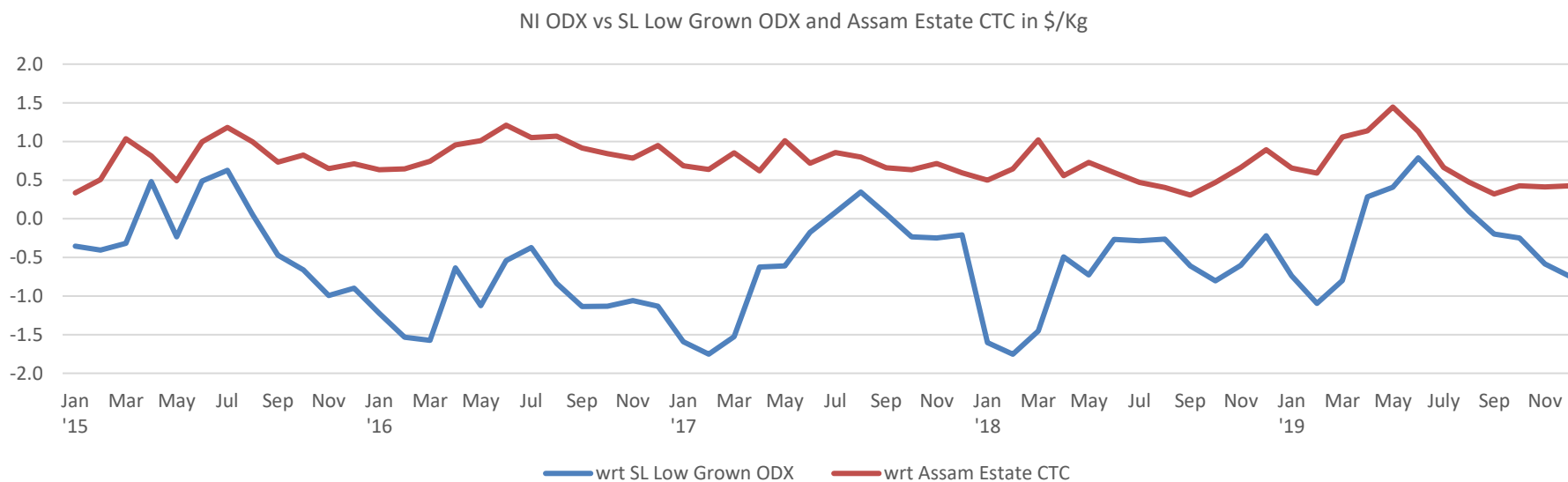
Total volume of ODX teas sold in NI auction centres during CY2019 increased by ~8.8 MKg (~30% higher). With prices increasing by ~Rs14/Kg on an average, the total value of tea sold in auctions increased by ~39% to reach Rs 8382 million. This is an all-time high. Trend in value (in Rs million) of ODX sold in NI auctions in recent years is given below.

CY14	CY15	CY16	CY17	CY18	CY19
3639	3578	4508	5913	6051	8382

Source: ICRA research, Parcon India

During the period April to August 2019, average prices of ODX teas at NI auctions were selling at a premium to SL low grown ODX teas. This was in sharp contrast to the trend prevailing during the same period of CY2018, when NI prices were at a significant discount to SL prices. When compared to prices of Assam Estate CTC teas also, prices of NI ODX teas were trading at almost a premium of \$1.5/kg in some auctions during May 2019. The following chart (Exhibit 5) gives a trend of the premium / discount of NI ODX prices vis-a-vis SL low grown ODX and Assam Estate CTC.

Exhibit 5: Price differential of NI ODX teas against Sri Lanka low grown ODX teas and Assam Estate CTC teas in \$/kg



Source: ICRA research, Tea Board of India, teasrilanka.org, www.rbi.org.in

Healthy performance of ODX market vital in determining the overall performance of the organised bulk tea industry; outlook favourable, but risks persist

With ODX production accounting for ~15% of the production of large bulk tea producers, healthy performance of the same remains a critical factor impacting the performance of the large / organised bulk tea players. Higher realisations support the overall profitability of the producers, notwithstanding the higher cost of production of ODX teas, relative to that of the CTC variety. India has gradually established itself as a key supplier of quality ODX teas to large consuming countries based out of Europe and the Middle East. Demand for quality ODX teas in the international market is expected to remain firm in CY2020, albeit Iran expected to purchase at a more sedate rate compared to last year. Additionally, with India expected to maintain its competitive advantage, vis-a-vis its main competitor Sri Lanka, the outlook for ODX tea produced in India remains favourable. Nonetheless, downside risks remain. A further escalation in the volatile geo-political situation in the Middle East could result in a slowdown in export demand, particularly if India loses its competitive advantage against a backdrop of heightened sanctions on Iran.

Another material risk, although internal to the industry, is a scenario of oversupply of ODX. Looking at the attractiveness of the buoyant ODX prices, bulk tea producers, particularly those sans substantial experience of manufacturing and selling ODX teas, may decide to increase their ODX production substantially, leading to an oversupply situation. Apart from the supply-demand factors, controlling the quality of ODX production is the key in ensuring premium realisations for the teas. Historical trends have shown that while good quality ODX sells at a significant premium to that of quality CTC teas, prices of secondary grade ODX can be lower than even the plain category of CTC teas. Consequently, the profitability can be severely impacted if the proportion of secondary ODX teas produced is not controlled. A calibrated increase in production of ODX teas would be critical in ensuring the supply-demand balance and consequently healthy realisations.

Additionally, over the long term, diversification of the export base for ODX teas would help in reducing dependence on Iran, thus ensuring a steady demand pattern. Any increase in subsidy for production of ODX would also provide support to the overall profitability of ODX producers, since the present level of subsidy is inadequate to materially compensate for the incremental cost associated with the production of ODX teas. To conclude, while the outlook for ODX teas remains favourable, domestic ODX producers would need to successfully navigate through several downside risks.

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