INDIAN EDIBLE OIL INDUSTRY

Sharp rise in Palm oil prices to keep all edible oil prices elevated over the medium term; resulting in moderate price risks and higher working capital requirements for the domestic edible oil refiners

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HIGHLIGHTS

Significant increase in global prices of palm oil and other edible oils

- Global palm oil prices have risen sharply by ~50% from the lows of May 2020, with pickup in demand emanating from re-opening of economies . The prices are higher than pre-covid levels despite the demand continuing to remain muted This is largely on account of supply side issues in large palm oil manufacturing countries i.e. Indonesia and Malaysia. Palm oil constitutes a significant proportion (40%+) of the total Indian edible oil consumption, hence, with the increase in palm oil prices, other edible oil prices have witnessed a similar uptrend over the past few months.

- Prices in the near term would largely depend on the outcome of La Nina weather pattern in Southeast nations. While the higher rainfall induced by it could improve the palm fruit yield, higher than average rainfall could disrupt the production in the coming months which could maintain the firmness in palm oil prices over a longer period.

Nation-wide lockdown impacted the demand for palm oil in H1 FY2021

- On the other side, in terms of demand, Indian palm oil imports dropped by 25% YoY during H1 FY2021 post the nation-wide lockdowns forced by the outbreak of Covid-19. With the opening up of key end-user industries since June-2020, the demand from HoReCa (hotels, restaurants and catering) segment has started to improve gradually. Nonetheless, for full-year FY2021, the consumption would continue to stay moderated and ICRA expects total palm oil consumption to remain ~15% lower in FY2021.

Total value of India's edible oil imports to increase by ~12-15% due to price rise, despite moderated demand

- The value of major edible oil (palm, sunflower and soyabean oils) imports stood at ~Rs. 67,100 crore in FY2020 comprising 2.0% of the total imports of India. Due to a substantial increase in the prices in H1 FY2021, the total edible oil imports stood at ~Rs. 35,100 crore in H1 FY2021, 8% YoY increase in spite of a 13% YoY decline in consumption. ICRA expects the total value of edible oil imports to remain 12-15% YoY higher in FY2021 despite the decline in import volume.

Being an essential good, higher edible oil prices would also result in inflationary pressure

- The Oils and Fats sub-index has weightage of 3.56% in the composition of the CPI, and 9.1% in the food and beverages sub-index. Hence, higher oil prices not only impact the import bill for the country, they also result in inflationary pressure.

Domestic oil refiners require additional working capital

- Domestic oil refiners witnessed an increase in turnover followed by the price rise. Hence, the working capital requirement has increased substantially, which would have additional finance cost putting pressure on their already thin profitability. The cost would get partially compensated by gain on their low-cost inventory holdings. ICRA believes that the higher edible oil prices could have a positive impact on the realisations of domestic oilseed growers.

- While the higher prices would have limited impact on the refiners, ICRA expects credit metrics of the edible oil industry to continue to remain subdued in the medium term, given the inherently modest profitability and high debt levels.

Impact Of Increased Palm Oil Prices

Supply side issues have resulted in increased palm oil prices, which should persist in the near term

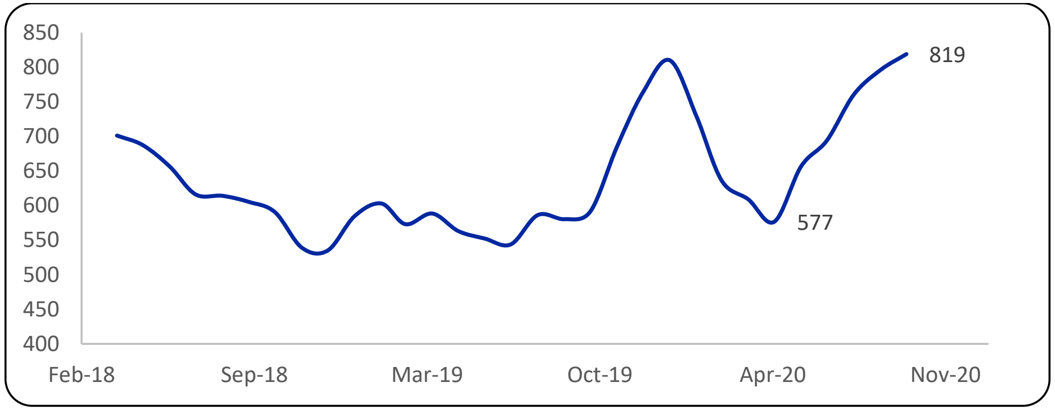
The total domestic palm oil consumption remains around ~9.5 million metric tonnes (MMT) with most of the demand being met through imports. Further, imports from Indonesia and Malaysia forms more than 90% of total imports. Hence, palm oil prices in the Indian market is driven by prices prevailing in Indonesia and Malaysia. Globally, Palm oil prices started declining from March 2020 on announcement of lockdown by major economies and reached a low of $570/tonne in May 2020. However, with gradual reopening of the global economy, the prices have started upward trend and have increased by ~50% from the lows of May 2020. The prices are higher than pre-covid levels despite demand for the same not being at pre-covid levels. The increased prices have more to do with supply side issues, ie. the impacted production, rather than pent-up demand. Following the pandemic, countries have put various restrictions which have impacted the man-power recruitment at palm oil farms. Further, dry weather in Indonesia and Malaysia has resulted in lower fresh yields and production. Both Indonesia and Malaysia, which account for ~80-85% of global palm oil production, have reported drop in their palm oil exports.

Prices in the near term would largely depend on the outcome of La Nina weather pattern in Southeast nations. While the higher rainfall induced by it could improve the palm fruit yield, higher than average reainfall could disrupt the production in the coming months which could maintain the firmness in palm oil prices.

Other Edible oil prices have increased by 30-40% following an uptrend in palm oil prices

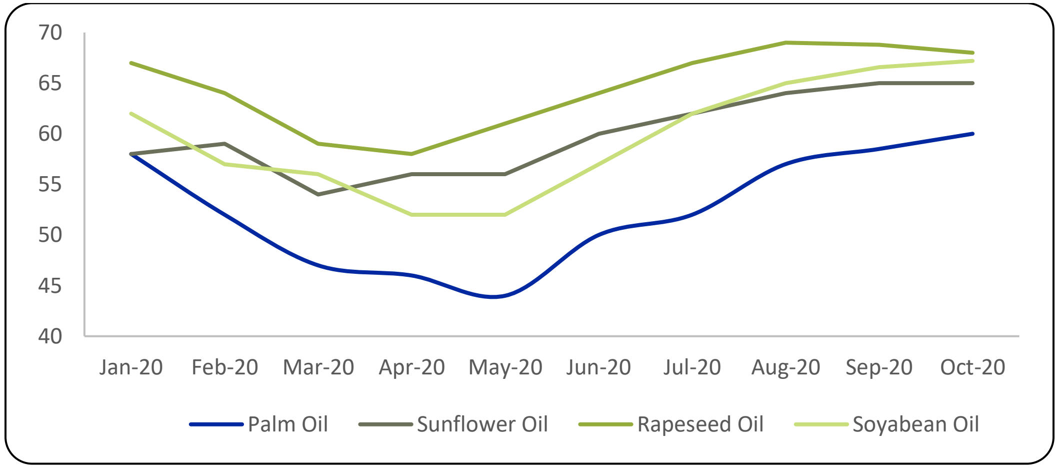
Palm oil constitutes a significant proportion (40%+) of the total edible oil consumption. In terms of pricing, it is the cheapest, the most abundantly available and the most neutral in its characteristics for usage. Its consumption tends to increase if consumers of other oils (which are all priced at a premium of ~15-100% in the retail market) see a higher price advantage. Following the increase in palm oil prices, other edible oil prices have witnessed a similar uptrend over past few months.

Exhibit 1: Palm Oil Price Trend (US$/Tonne)



Source: *ICRA research*

Exhibit 2: Edible Oil Price Trend (Rs./Kg)



Source: *ICRA research*

IMPORT TRENDS OF PALM OIL IN INDIA

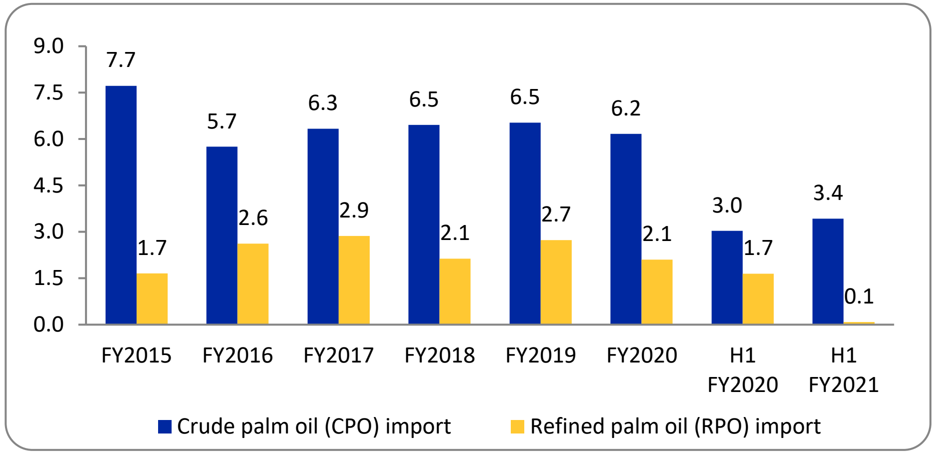
Palm oil import down by ~25% in H1FY2021

India is the largest importer of palm oil and accounts for about 18-20% of the global palm oil imports as per industry sources. Nearly all of the Palm oil demand in India is met through imports, in the form of crude palm oil (CPO) or refined palm oil (RPO). RPO formed about 29% of the total palm oil imports in FY2019 which came down to 22% in FY2020 and further to 3% in H1 FY2021. This is because the Director General of Foreign Trade (DGFT), Government of India (GoI), vide its notification dated January 8, 2020 imposed restrictions on imports of RPO wherein import of palm oil has been moved to "restricted" category from "free". Given this, the total palm oil imports dropped to 8.3 million MT in FY2020 from 9.2 million MT in the previous year. The reduction was mainly contributed by the 45% YoY drop in the palm oil import in Q4 FY2020 (January-March 2020) due to the RPO import restriction. The continued import restrictions coupled with the outbreak of Covid-19 in India in March 2020 and the consequent nation-wide phased lockdown announced by GoI over March-May 2020, the import of palm oil dropped further by 25% YoY in H1 FY2021.

Gradual improvement in palm oil demand with re-opening of economy; overall palm oil demand to remain low by ~15% YoY in FY2021

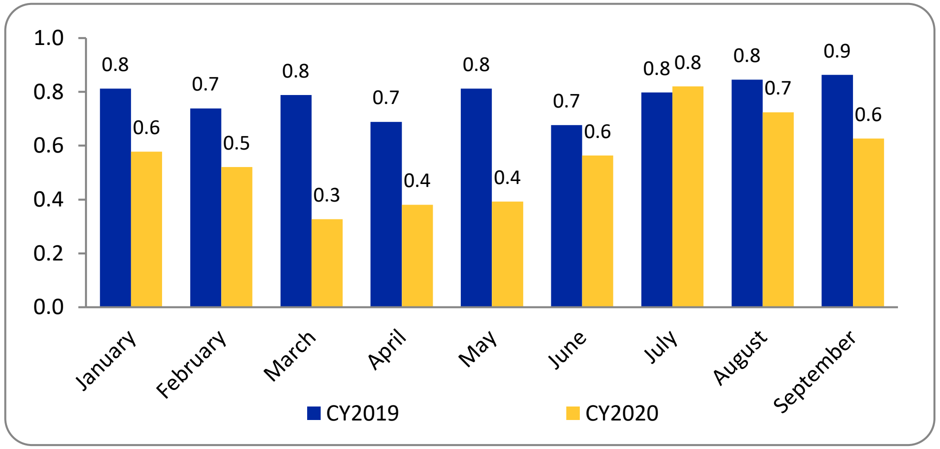
The demand from the HoReCa (hotels, restaurants and catering) segment, which is the major consumer of palm oil, plummeted during the lockdown as evident from the drop in the monthly volume. As the economy started to gradually unlock since June 2020, the demand for palm oil has also improved and the increased imports in June-July 2020 is partly attributable to the pent-up demand for previous months. The ongoing festival season in the country is also expected to have resulted in an increase in the demand for palm oil and its imports due to increased consumption of bakery products, fast food, etc. Nonetheless, on an overall basis, palm oil demand will continue to stay moderated for a prolonged period and improve gradually, as adverse effect of Covid-19 will take time to subside. The overall demand for palm oil is expected to remain ~15% lower in FY2021 as compared to previous year.

Exhibit 3: Annual palm oil Imports (million MT)



Source: *ICRA research*

Exhibit 4: Monthly Palm oil imports (million MT)



Source: *ICRA research*

Rising Palm Oil Prices Impact India's Import Bill And Inflation

Edible oil Import in terms of value increased despite ~13% drop in consumption

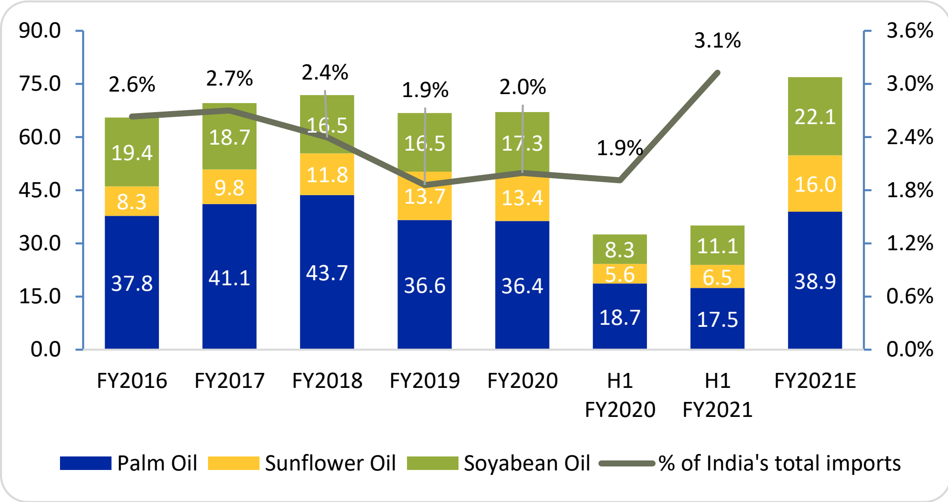
India's total edible oil imports have contributed sizeable portion of the total imports over the years. The value of major edible oil (palm, sunflower and soyabean oils) imports stood at ~Rs. 67,100 crore in FY2020 comprising 2.0% of the total imports of India as against ~Rs. 66,800 crore in the previous year. CPO and RPO together form a significant proportion of the total edible oil imports (it formed 55% of the total edible oil imports in FY2019 and 54% in FY2020). Thus, any major rise in the price of palm oil and other major oils in the global market will directly impact the total imports of the country.

For instance, due to a substantial increase in the prices of all major edible oils in the global market in H1 FY2021, the total edible oil imports stood at ~Rs. 35,100 crore in H1 FY2021, 8% YoY higher than imports in H1 FY2020 in spite of a 13% YoY decline in the total consumption.

The significant increase in the edible oil imports as a proportion of total imports to 3.1% in H1 FY2021 is due to the decline in total imports of the country by about 40% YoY due to lower consumption of crude oil as well as non-crude oil items (machinery, electrical goods, etc.) during the lockdown, while the import of edible oil in value terms remained higher due to higher prices.

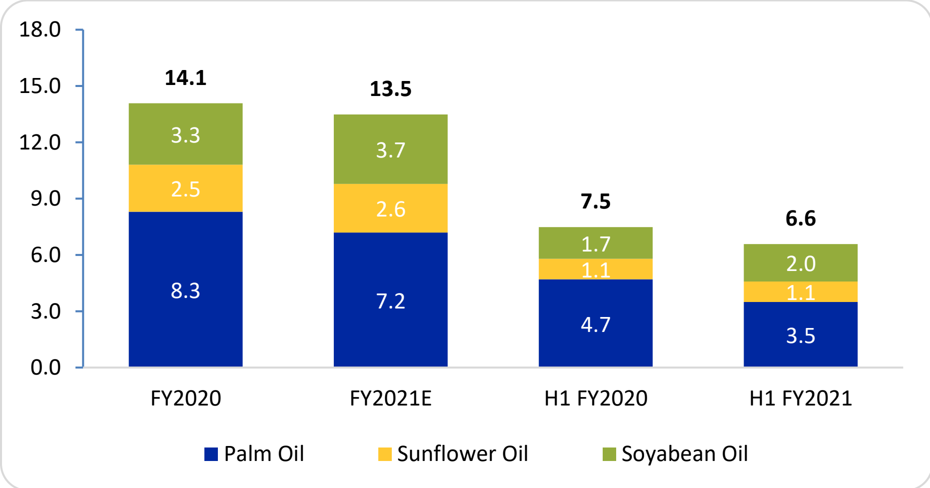
With the gradual opening up of the end-user segments, the edible oil consumption is expected to be higher in H2 FY2021. However, for the full-year, ICRA expects the total edible oil import volume to remain 5-7% lower in FY2021 as compared to previous year. But with the global edible oil prices expected to continue to remain high in H2 FY2021, the total import value is estimated to remain 12-15% YoY higher in FY2021 which will impact the overall trade position of the country to some extent.

Exhibit 5: Edible oil imports as % of total imports (Rs. '000 crore)



Source: *ICRA research*

Exhibit 6: Edible oil imports (million MT)



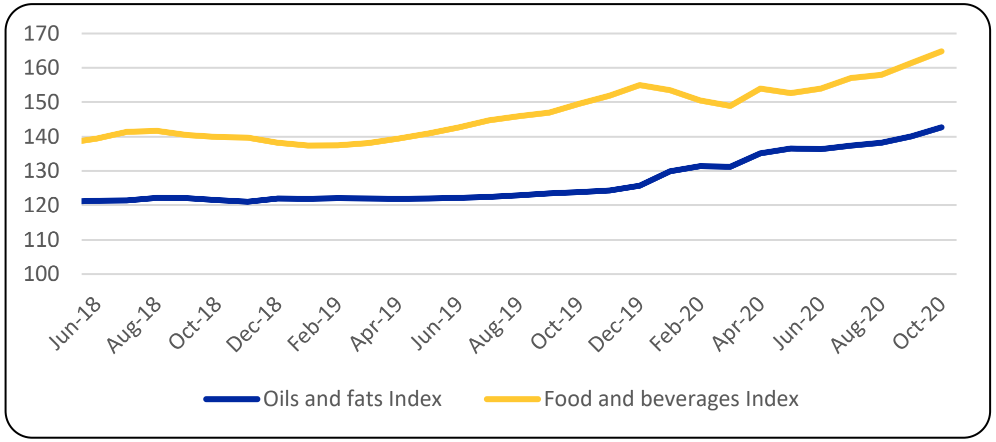
Source: *ICRA research*

Increase in oil prices impacts the Consumer Price Index (CPI)

The Oils and Fats sub-index has weightage of 3.56% in the composition of the CPI, and 9.1% in the food and beverages sub-index. As shown in Exhibit 7, despite the modest weightage in the food and beverages sub-index, Oils and Fats has largely mirrored the movement in the former. Though other food items have also played a role, the increase in oil prices has contributed to the uptrend in the food and beverages sub-index over past few months.

Hence, higher oil prices not only impact the import bill for the country, they also result in inflationary pressure.

Exhibit 7: Oil and Fat Index and Food and Beverages Index



Source: *ICRA research*

High oil prices result in additional working capital requirement for the oil refiners whereas high volatility demands additional efforts on inventory management

The palm oil prices have increased ~50% over the last few months whereas the demand was down by 25% in H1FY2021. Hence, on overall turnover basis, there would be increase of ~20-25% for palm oil refiners and with restriction of refined palm oil, palm oil demand is necessarily to be met through domestic palm oil refiners. Hence, there has been significant increase in the working capital requirement for the domestic refiners which would result in additional finance cost and would put pressure on their profitability. The refiners are expected to get certain benefit of higher prices on their low-cost inventory holdings which would off-set the higher finance cost to some extent. Moreover, the prices have witnessed significant volatility in the recent periods and any speculative transaction or unhedged position could impact the profitability of the refiners to a great extent. Hence, a prudent hedging policy is imperative in order to avoid any losses.

ICRA believes that the higher edible oil prices could have a positive impact on the realisations of oilseed growers which would fetch better realisations for their crops. While the higher prices would have limited impact on the refiners, ICRA expects credit metrics of the edible oil industry to continue to remain subdued in the near to medium term, given the inherently modest profitability and high debt levels.

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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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- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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