This methodology document stands superseded. Refer to ICRA's website www.icra.in to view the updated methodology document on this subject.

RATING METHODOLOGY – BULK TEA

April 2023

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This rating methodology updates and supersedes ICRA's earlier methodology document on this subject, published in April 2021. While this revised version incorporates a few modifications, ICRA's overall approach towards rating entities in the sector remains materially similar. Also, a section has been added to provide a broad perspective on how environmental, social and governance (ESG) risks are incorporated by ICRA in its credit assessments.

Overview

Globally, black tea production is dominated by India, Sri Lanka and a few African countries (with Kenya being the largest), with these three regions accounting for around 64% of the global black tea production[1]. Other large producers (apart from China, which mostly produces green tea) are Turkey, Indonesia, Argentina, Malawi, Bangladesh, Vietnam, Uganda, and Tanzania.

India is the single largest producer of black tea in the world, accounting for around 39% of the total black tea production globally[1]. In India, Assam and West Bengal (referred to as the northern states in this document) account for around 80% of India's total tea production with the balance 20% contributed by Karnataka, Tamil Nadu and Kerala (referred to as the southern states in this document).

India is primarily a domestic consumption-driven tea market, with domestic demand accounting for around 83% of the total production, while Uganda, Kenya and Sri Lanka export 90-100% of their total production. North India (NI) accounts for more than 80% of domestic tea production with the Assam valley accounting for around 57%, followed by West Bengal, which contributes around 37%. Darjeeling tea, comprising around 1% of the NI production, is known for its high quality and is largely exported. In South India (SI), which accounts for 20% of domestic production, the Nilgiris and Coimbatore in Tamil Nadu alone account for around 70% of the total SI production.

On a regional basis, around 87% of North Indian tea production is consumed in the domestic market, with only 13% being exported. On the other hand, around 35% of South Indian tea is exported to other countries. Despite the lower contribution to global trade levels, exports still play a critical role in maintaining the demand-supply balance in the domestic market.

Tea is among the most labour-intensive of all plantation crops. In addition, the inherent supply-side cyclicality of the fixed cost-intensive tea industry leads to significant variability in profitability and cash flows of bulk tea producers. Such variability poses an analytical challenge in terms of predicting an entity's future cash flow patterns, which is an integral part of analysing credit protection levels. Overall, ICRA's rating methodology focuses on assessing an entity's fundamental credit quality and seeks to evaluate the credit risk profile across operating cycles.

1 *Figures exclude China's black tea production due to absence of data*

Risk Analysis Framework for Bulk Tea Producers

ICRA's rating framework for players in the bulk tea industry involves an assessment of the risks, which characterises the tea industry and an evaluation of the rated entity's business and financial position. Industry analysis encompasses a study of the cyclicality and movement in realisation of tea, the demand-supply position in both the domestic as well as the international markets. These apart, some of the key entity-specific parameters that are part of the credit analysis are given below:

Industry Risk Assessment

- Agro-climatic risks and cyclicality in supply
- High fixed cost intensity

Business Risk Assessment

- Asset diversity
- Scale of operations
- Operating efficiency and cost competitiveness
- Product quality and revenue-mix

Financial Risk Assessment

- Profitability metrices
- Leverage and coverage indicators
- Liquidity and financial flexibility
- Adequacy of future cash flows
- Tenure mismatches and risks relating to interest rates and refinancing
- Foreign currency risk

Other Elements of Credit Risk Assessment

- Debt-servicing track record
- Contingent liabilities and off-balance sheet exposures
- Parent support

Management Quality

Assessment of Environmental, Social and Governance (ESG) Risks

Industry Risk Assessment

Agro-climatic risks and cyclicality in supply

Tea, being an agricultural commodity, is susceptible to agro-climatic risks, with the production and quality of tea being primarily dependent on prevailing weather patterns. The crop is also exposed to pest attack issues, inherent to any agricultural produce. Favourable weather conditions conducive to the production of tea include temperatures in the range of mid-20 degree Celsius to mid-30 degree Celsius, with rainfall evenly spread out over the period. Tea cultivation needs well drained land as water stagnation is detrimental to tea bushes. Given these requirements, the crop is grown in a limited number of regions in India and the quality differs from region to region. In North India (NI), the tea-growing season is for around nine months—from mid-March to mid-December—with production peaking during the July–September period. In South India (SI) it is produced through the year with production peaking from April to June.

In addition to the regional differences in production, which impact overall supply trends, exports also play a critical role in maintaining the demand-supply balance in the domestic market. Indian tea is primarily exported to the CIS countries, European markets, the US, the Middle East and also Pakistan, Sri Lanka, Afghanistan, etc. However, India's contribution to the global tea trade stands at a relatively low 10%, with Kenya and Sri Lanka being the largest drivers of global tea supply.

High fixed cost intensity

Tea is a fixed cost-intensive industry with labour costs accounting for around 65-70%[1] of total cost of production. The number of labourers required by each estate remains largely constant, regardless of production levels, thereby imparting a fixed nature to the cost of labour. The increase in wage rates affected by the Government of Assam and Governments of West Bengal has led to a high cost of production. Moreover, availability of labour during peak tea producing months is a challenge for bulk tea producers.

1 *Excluding production from bought leaf and costs associated with non-tea businesses*

Business Risk Assessment

Asset diversity

Tea being an agricultural commodity is susceptible to agro-climatic risks, with the production and quality of tea being primarily dependent on favourable climatic conditions. Each tea-growing region is subject to unique agro-climatic conditions. Thus, geographically diversified tea-producing entities are seen to be less susceptible to adverse agro-climatic conditions affecting specific regions. In this context, ICRA also evaluates the ability of a bulk tea-producing entity to partially mitigate such agro-climatic risks through access to an established irrigation system and the extent of coverage of such systems as a proportion of the total tea-bearing land. Besides reducing agro-climatic risks to an extent, a diversified production base, with its presence in different geographies also provides easier access to the different markets.

Scale of operations

Bulk tea production is a fixed cost-intensive business, with labour costs accounting for a significant portion of the total cost of production. Thus, a larger scale of operations, which allows for better absorption of fixed costs, is an important factor in the credit analysis. ICRA considers revenues to be a good proxy for mapping a company's scale and market position. The size of the company's production base, in terms of acreage under cultivation as well as the quantum of the tea produced, both from own estates as well as from bought leaf operations[1], is also a good measure of the scale.

Operating efficiency and cost competitiveness

The operating efficiency of a tea producer is largely governed by the productivity of its tea estates and the share of bought leaf operations. Productivity of the estates, measured as kilograms of tea produced per hectare of tea-bearing land, is an important measure of the operating efficiency, as in a fixed cost-intensive business like tea, higher yield directly supports the cost structure and hence profitability. The age profile of the bushes, together with the out-turn ratio, determines the overall productivity per hectare. The constitution of tea bushes within the productive age bracket of 4-50 years is considered to be favourable for better productivity, given that young bushes have higher productivity. The age profile is a function of the annual replanting policy. ICRA assesses the policy followed by the entities to undertake annual uprooting, replantation and rejuvenation of land under tea cultivation to maintain a favourable age profile of the bushes. The out-turn ratio, which measures the tea produced as a percentage of green leaves consumed, is also an important measure of operating efficiency. ICRA also evaluates the share of bought leaf operation, in the overall size of the entity's business, since it helps reduce the effect of volatility in bulk tea prices. Around 52% of the total tea production in India is currently produced by small growers.

The significant difference in cost structure of small growers and organised players reduces the competitiveness of the organised players, even though the quality of produce of the organised players is generally superior to that of the small growers. Bought leaf operations provide stable, albeit low, margins as green leaf prices move largely in tandem with end-product realisations. The extent of involvement with the small tea growers (from whom the entity purchases green leaves) is also an important consideration, as it plays a vital role in maintaining the quality of bought leaves and hence the end-product. While bulk tea production is a fixed cost-intensive process, a number of subsidies and benefits available to bulk tea producers reduce the overall cost to an extent. Apart from the industry-wide benefits/subsidies, which include re-plantation and rejuvenation subsidy, the subsidy on the production of orthodox tea, bulk tea producers can set aside a part of the profits[2] with the National Bank for Agriculture and Rural Development (NABARD) to reduce tax liabilities. Additionally, there are some region-specific subsidies / benefits too, like the one on transportation expense for exports through the dry port of Inland Container Deport at Amingao (Assam).

Overall, ICRA reviews the cost structure and cost competitiveness among entities vis-à-vis movement in tea realisations to evaluate the profitability of bulk tea players.

1 *Bought leaf operation signifies the processing of green leaf purchased from small tea growers to augment the produce of in-house tea plantations.*

2 *Lower of the amount deposited with NABARD or 40% of the profit computed under 'Profits and gains from business or profession' is eligible for deduction under Section 33AB of the Income Tax Act, 1961.*

Product quality and revenue-mix

Realisations from black tea are to a large extent a function of the demand-supply situation in the global tea market, and the quality of the product. Apart from the demand-supply factors, realisations of the produce can vary from one tea estate to another, depending on the quality of the garden. Realisations can also vary across months with the "second flush" batch of teas, produced during May and June in Assam, commanding the maximum price because of its premium quality compared to tea produced in the other months of the year. A good measure of the overall quality of the tea produced by an entity is the weighted average realisation for the year. ICRA compares the weighted average realisation of the rated entity with that of the district and national auction averages to assess the relative quality of the produce of the entity. Higher average realisation, indicating better quality of produce, is a key rating strength evaluated by ICRA.

The average realisation is also a function of several other factors—the mix between CTC and orthodox varieties of tea produced and sales mix in the auction, private sales and the export markets. Historically, the orthodox variety of tea has commanded a premium over the CTC variety. However, orthodox tea is largely exported and hence realisations of such a variety have a stronger linkage to prices in the global markets. The Indian domestic consumption is almost entirely of the CTC variety. ICRA, therefore, evaluates the entity's capability/flexibility to switch production between the two varieties of teas in response to market conditions. In terms of sales mix, high quality tea is typically sold through private consignments or exported. The balance tea is sold through the auction route. India has six auction centres (Kolkata, Siliguri, Guwahati, Cochin, Coimbatore and Coonoor), with auction sales accounting for over 50% of domestic sales in the past years.

A significant portion of the exported tea volumes is of high-quality orthodox teas, which generally fetch relatively higher realisations for the exporting entities. ICRA factors in the extent of export sales while evaluating bulk tea producers. Apart from good prices, bulk tea exporters also receive monetary benefits under the Remission of Duties or Taxes on Export Products Scheme (RoDTEP) and the Duty Drawback Scheme for the volume of exports undertaken, which adds to their income and profits.

Summary of the Salient Business Risk Factors

		Strongest		Weakest
Scale and Market Position	Revenues	> Rs. 800 crore	→	< Rs. 100 crore
	Area under Cultivation	> 15,000 Hectares		< 6000 Hectares
	Total Tea Produced	> 40 Mkgs		< 5 Mkgs
Diversification of tea estates	Spread of production base across region (NI or SI) in total revenue	Highly diversified; no single region accounts for more 50% of revenues	→	Key region accounts for 90-100% of revenues
	Spread of production base across state	Highly diversified; no single state accounts for more 50% of revenues		Key state accounts for 90-100% of revenues
	Extent of irrigation	Highly irrigated; irrigated regions account for 75-100% of the total tea bearing land		Irrigated regions account for <25% of the total tea bearing land
Operating Efficiency	Productivity of the tea estates (Kgs/ Hectare)	>1800	→	<1500
	Constitution of tea bushes	>70% of tea bushes are within the productive age bracket of 4-50 years		<30% of tea bushes are within the productive age bracket of 4-50 years
	Out-turn ratio	>22%		<19%
	Share of bought leaf operation	>20%		<5%

Product Quality and Revenue Mix	**Weighted average realization for the year**	>30% premium over auction averages	→	Discount to auction averages
	Mix between CTC and Orthodox	>40% orthodox production		<5% orthodox production
	Sales mix in the domestic and export markets	>15% of revenues from export sales		<1% of revenues from export sales

Financial Risk Assessment

ICRA analyses long period past financial performance trends as well as estimates future financial performance to assess the financial risk profile of an entity. The financial metrics provide a useful reference not only to evaluate the performance trends of an entity over a given time horizon, but also enable a comparison with peers. The financial risk assessment is not done in isolation but in conjunction with the business and the industry risks that the entity is exposed to. An entity with low exposure to business and industry risks would generally have stable cash flows and thus a higher tolerance to operate with a relatively modest financial risk profile. In contrast, entities that are exposed to high business and industry risks need to maintain a stronger financial risk profile for an adequate cushion to manage cash flow volatility. The various financial metrics assessed by ICRA could be divided into five categories—profitability, leverage, coverage, liquidity and cash flows. This document provides a summary of why ICRA considers these ratios to be important. For a more detailed description, readers may refer to the note titled – *Rating Approach - Financial Ratio Analysis*, published on ICRA's website.

Since the prime objective of the rating exercise is to assess the adequacy of the debt servicing capability of an entity, ICRA draws up projections on the likely financial position of the rated entity based on the expected movements in operating performance, while factoring in the capex and investment requirements as well as upcoming debt obligations. Depending on the uncertainty around how the various credit drivers could evolve in the future, ICRA also carries out sensitivity analysis to assess the impact of key variables on various financial metrics.

In case of groups consisting of entities with strong financial and operational linkages, various parameters such as capital structure, debt coverage indicators, and future funding requirements are assessed at the consolidated / group level.

Profitability Metrics

Profitability metrics are a measure of an entity's efficiency and return on investments. It is imperative for most businesses to invest regularly in product development, marketing, physical assets and human capital to sustain or improve their competitive position. Entities that have superior profitability do so through internally generated resources with low dependence on external financing. Moreover, such entities can generate sufficient surplus for not only meeting debt servicing obligations but also to reward equity investors. This in turn improves their ability to attract fresh capital for future business requirements. Moreover, entities with higher profitability have better resilience to economic downturns and are more likely to generate adequate internal resources for re-investment and debt servicing.

Profitability is a measure of the earnings generated by an entity in a given period in relation to the resources deployed and is measured by profit margins and the return on capital employed (RoCE). Profitability of a bulk tea producer is primarily a function of its cost structure, product mix, and realisations. However, tea being a cyclical industry, profitability varies significantly through the cycle. Also, there is a wide variation in QoQ performance of a North India-based bulk tea players, since the major production happens during April to October period. Thus, QoQ/ sequential comparison is not relevant as much as a YoY analysis. Nevertheless, producers with efficient cost structures and premium quality produce are observed to perform better across cycles.

Validation of Business Risk through Profitability Metrics

[Indicative metrics[1]]

	Strongest	Weakest
RoCE	>=25%	<10%
Volatility in RoCE	<=10%	>55%

[1] *The indicative financial metrics mentioned here and elsewhere in the document are intended to provide a broad overview to the readers regarding what ICRA generally considers as 'relatively strong' or 'relatively weak' metrics. It is, however, possible that an entity has relatively weaker metrices on one or more financial parameters, but its credit risk is assessed to be low because of other mitigating factors, including (but not limited to) stronger metrices on other financial parameters, a healthy business risk profile, strong financial flexibility or a strong promoter group that is willing to extend distress support to it.*

Leverage and Coverage Indicators

Leverage ratios measure the indebtedness of an entity. Entities that pursue an aggressive financial policy, including heavy reliance on debt financing, are likely to be more vulnerable to cyclical downturns than entities who employ conservative financial leverage in their business. Besides protecting the cash flows of players by imposing a lower debt service burden, especially during periods of cyclical stress, lower leverage also imparts greater financial flexibility to raise incremental external capital (debt or equity) for re-investment in business or to tide over temporary funding shortfalls. ICRA also notes that the extent to which an entity leverages its balance sheet is, in addition to business requirements, also a function of the philosophy of the management towards growth and funding mix.

Assessment of leverage

[Indicative metrics]

	Strongest		Weakest
Indebtedness Ratio	<=0.9x	→	>3.0x
Debt-to-Profit Ratio	<=0.5x		>5.0x

Coverage is a measure of an entity's debt-servicing ability and is calculated as the ratio of profits (or cash flows) to the debt-servicing obligations within a given period. The interest coverage indicator reflects the entity's ability to service the cost of external borrowings after meeting all operating expenses. It is an important rating consideration as a weak OPBITDA-to-interest multiple indicates the entity's inability to generating adequate operating profits to meet its interest obligations and may signal a default risk. The Debt-Service-Coverage Ratio (DSCR) indicates the entity's ability to service its interest and repayment from cash accruals generated from the business. ICRA is particularly concerned with an entity's capability to honour its contractual obligations under stress conditions. The more robust its performance is under a stress scenario, the better it is from a credit evaluation perspective.

Assessment of coverage

[Indicative metrics]

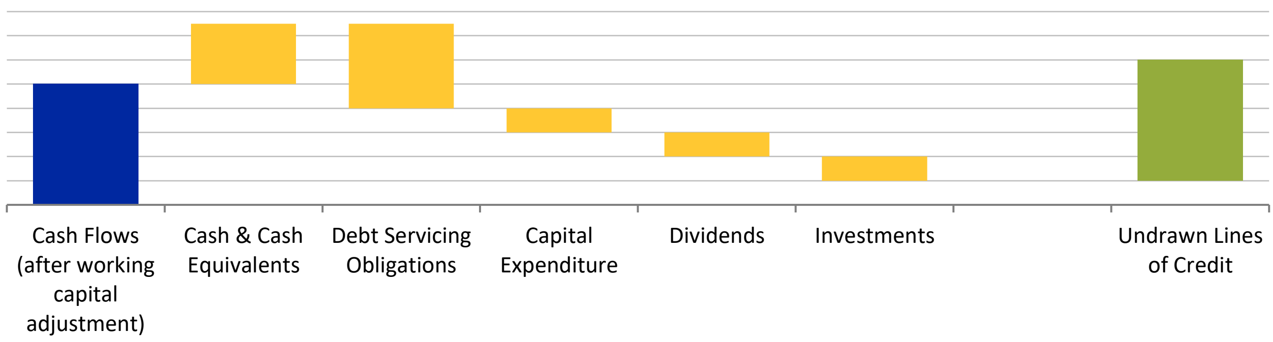
	Strongest		Weakest
Interest Coverage	>=18.0x	→	<2.0x
DSCR	>=4.0x		<1.1x

Liquidity and financial flexibility

Liquidity is the indicator of an entity's ability to meet its short-term cash obligations from various internal or external resources. Internal resources include fund flow from operations, unencumbered cash and cash equivalents on the balance sheet, and cash inflows expected from the monetisation of physical and financial assets. External resources include undrawn lines of credit or equity capital. Short-term obligations include committed as well as contingent claims on an entity's cash, including the debt-servicing obligations, working capital requirements, capital expenditure and other investment outlays, dividend and share buyback-related outflows, besides the sudden demand arising from the crystallisation of discrete events such as litigation penalty. The higher the cushion between available resources (especially internal resources) and obligations, the better the liquidity profile of an entity. Liquidity is generally assessed in conjunction with the vulnerability of an entity to timely refinancing / renewal of short-term sources of funding. Depending upon the circumstances, an entity that has a relatively modest liquidity profile, but a strong refinancing ability may not be viewed too unfavourably. ICRA also notes that the liquidity available with an entity may be for a temporary period and hence an entity's overall policy towards maintaining adequate liquidity (given the trade-off between returns and liquidity) is accorded due importance in the analytical approach.

An entity's financial flexibility (or the lack thereof) is reflected by its ability to access the capital or money markets at short notice, attract diverse and marquee investors, and enjoy the confidence of banks, financial institutions and intermediaries. A strong financial flexibility allows an entity to raise fresh borrowings or refinance existing ones quickly, whenever required. Financial flexibility could arise from factors such as an entity's large scale of operations with strong financials, large unencumbered cash flows (such as rental income) unencumbered assets and the flexibility to borrow against such assets, or strong parentage or linkage with a strong group.

Liquidity snapshot over any defined period



Adequacy of future cash flows

Since the prime objective of the rating exercise is to assess the adequacy of the entity's debt-servicing capability, ICRA draws up projections on the likely financial position of the entity under various scenarios. Besides, ICRA takes into account the commitments of the entity towards other group entities, new ventures, and its investments in subsidiaries. Subsequently, future cash flows are projected after taking into account the entity's tea production levels and the likely cost of production and realisations of finished products, the growth it envisages, debt repayment schedule, its funding requirements and the funding options available to it. These cash flows are then used to determine the entity's future debt-servicing capability under various scenarios.

Tenure Mismatches and Risks Relating to Interest Rates and Refinancing

Large dependence on short-term borrowings to fund long-term investments can expose an entity to significant re-financing risks, especially during periods of tight liquidity. The existence of adequate buffers of liquid assets / bank lines to meet short-term obligations is viewed positively. Similarly, the extent to which an entity could be impacted by movements in interest rates is also evaluated.

Foreign Currency Related Risk

The foreign currency risk can arise due to the export-related revenues and from unhedged liabilities. ICRA focuses on the hedging policy of the entity concerned in the context of the tenure and nature of its contracts with counterparties (short-term / long-term, fixed price / variable price). Analysis of net foreign exposure and the extent of the timing difference in expected receipts vis-a-vis scheduled outflows is also looked into.

Other Elements of Credit Risk Assessment

Debt-Servicing Track Record

The debt-servicing track record of an entity is an important input for any credit rating exercise. Any delays or defaults in the past in the repayment of principal or interest payments reduce the comfort level with respect to the tea player's future debt-servicing capability and willingness. Nevertheless, ICRA appropriately analyses the reason behind past defaults, which could also be due to adverse demand situations in the underlying industry.

Contingent Liabilities and Off-balance Sheet Exposures

In this case, the likelihood of devolvement of contingent liabilities / off-balance sheet exposures and the financial implications of the same are evaluated.

Management Quality

All debt ratings necessarily incorporate an assessment of the quality of the rated entity's management. An entity with an experienced management team and independent directors on its board are considered positive factors. Thus, the comfort level of the management, evident from discussions and past actions, becomes a key rating consideration in such cases. Thus, ICRA gives considerable importance to qualitative aspects resulting from management meetings. A detailed discussion is held with the management to understand their business strategies, growth plans as well as risk appetite which may have an impact on the future performance of the entity, besides the outlook on the industry. Periodic interactions with the management also help ICRA evaluate the management's tendency to deviate from its business and financial policies in times of stress. The management's ability to meet their committed performance targets and ensure stability in operations is an important input for analysis.

For tea players, in particular, ICRA looks at management strategies with respect to the entity's cost position and product mix (own production versus bought leaf production, CTC versus orthodox varieties of tea). ICRA also evaluates how the management responds to the cyclical behaviour of the industry, evaluating strategies followed to mitigate the risks arising out of such cyclicality.

Some of the points assessed are:

- Experience of the promoter/management in the line of business concerned
- Commitment of the promoter/management to the line of business concerned
- Attitude of the promoter/management to risk taking
- The entity's plans on new projects, acquisitions and expansion, including investment plans in non-core business segments
- The rated entity's policies on leveraging, interest risks and currency risks
- Transparency and consistency in communication with all stakeholders
- Accounting policies and disclosures reflecting true financial position
- Track record of balancing the interests of shareholders, creditors and other stakeholders

Parentage

Apart from standalone credit considerations, the likelihood of extraordinary support coming in from the parent to an entity or the support that an entity is likely to extend to the other group companies is factored in while assessing the credit profile of the entity. Support here means financial support from the parent expected to be available to the entity in the form of loans, equity, extended credit period, advances etc in times of credit or liquidity stress on the entity. Support here does not mean operational support in the form of new business opportunities, technology sharing, distribution network sharing and so on as these aspects are factored in the standalone credit profile assessment itself. This process involves an assessment of the ability and willingness of the parent to extend support to the entity (and vice-versa), in addition to evaluating the entity's own fundamental credit strength.

Assessment of Environmental, Social and Governance (ESG) Risks

As this methodology highlights, while undertaking credit assessment of entities, ICRA seeks to incorporate all relevant credit considerations into its rating decisions while taking a forward-looking view on the risks and the mitigants. The relevant credit considerations include (sometimes overtly, sometimes covertly) the E&S factors that could affect the rated entity/ transaction. While ICRA's analytical approach does not explicitly disaggregate these risks to assess their impact on the rating, these risks are often assessed broadly. Further, it is not always feasible to fully or precisely disaggregate the sub-components of E&S risks in credit analysis since these considerations often tend to overlap.

That said, the materiality of the E&S risks and the time horizon over which they are expected to crystallise differ widely across sectors and entities. In some cases, while the E&S risks could be material, their effect on the credit profile may be muted because of other fundamental strengths of the entity. In other cases, the adverse impact of E&S risks is expected to play out in the distant future and, hence, these considerations do not necessarily weigh on the rating today—with the expectation that when these risks manifest in future, the rated entity would possibly have adapted itself by realigning its business model.

While evaluating E&S risks, ICRA's objective is only to assess the direct and indirect risks that an entity faces and how it already is or is intending to mitigate the impact of such risks on its credit profile. As an example, ICRA only assesses whether an entity is exposed to physical climate risks, or carbon transition risks such as those arising from changes in regulations or other environmental and social risks; and seeks to understand the various mitigation and adaptation approaches that the entity is implementing to mollify these risks. In spite of the above, as an example, it is possible that even if entity A has a higher carbon footprint than entity B, it does not materially affect ICRA's credit opinion on entity A. This is because ICRA's credit opinion on an entity considers a wide gamut of credit-relevant factors, and the E&S factors are only one among those.

Environmental considerations

Tea, being an agricultural commodity, is susceptible to agro-climatic risks, with the production and quality of tea primarily dependent on rainfall, temperature and humidity. Among these factors, rainfall plays the most important role. Though these environmental factors pose supply-side risks, the demand side risks are largely protected as tea is one of the most popular, widely consumed and low-cost beverages. Adverse environmental conditions may potentially affect tea productivity, the extent of irrigation and pest control activities required, etc., thereby leading to revenue loss and/or an increase in the cost of production, in turn, resulting in margin contraction. ICRA considers such risks to be inherent in the tea production business.

Social considerations

Tea production is highly manpower intensive. A large proportion of the population, particularly women, in the major tea-producing regions in the country is involved as workforce for tea production. The stakeholders of a tea production business include, inter alia, local communities and Government authorities, which influence the operating environment of the business. The wage rates for tea estate workers are regulated by the Government and are revised regularly as the level of wages and welfare costs for tea estate workers have significant socio-economic implications. Tea-estate costs are primarily fixed, with labour-related costs accounting for a significant portion of the production cost. Hence, any significant increase in wage rates may adversely impact the cost structure of tea producers, impacting the margins. Shortage of workers, due to diminishing interest in the garden-based field work on the back of sociological changes, remains a concern.

Governance Risks

A sound corporate governance structure attempts to make clear the distinction of power and responsibilities between the Board of Directors and the management. The constitution of an entity's Board and the Board's participation in strategy formulation, besides the entity's adherence to legal and statutory compliances is factored in during credit assessments. ICRA seeks to gain a qualitative understanding of an entity's commitment to following transparent and credible practices by the way its financial statements are reported, its level of disclosures, consistency in communication and openness in sharing information during the credit rating exercise. Besides, the corporate group structure (whether simple or complex), the rated entity's related party transactions and instances of supporting group entities at the expense of debt holders are assessed.

Summing Up

ICRA's credit ratings are a symbolic representation of its opinion on the relative credit risk associated with the instrument being rated. This opinion is arrived at following a detailed evaluation of the entity's business and financial risks, its competitive strengths, its likely cash flows over the life of the instrument being rated, and the adequacy of such cash flows vis-à-vis its debt-servicing obligations. As this note highlights, ICRA's analytical framework for bulk tea producers involves an evaluation of a variety of factors, including the rated entity's scale of operations, operating efficiency, cost competitiveness, product quality, sales mix, management strategies for managing cyclical downturns and an overall approach towards investment and growth.

ANNEXURE

Summary of rating factors and an example to illustrate the key building blocks of a credit rating for a bulk tea entity

		Strong	Comfortable	Adequate	Moderate	Weak
Industry Risk	Industry Position					
Business Risk	Scale & Market Position					
	Diversification of tea estates					
	Operating Efficiency					
	Product Quality and Revenue Mix					
Financial Risk	Leverage					
	Coverage					

		Enhance	Support/ Neutral	Hinder
	Diversification			
Do these factors enhance or hinder the credit profile?	Refinancing Dependence, Liquidity and Financial Flexibility			
	Foreign Exchange Risk			
	Financial Policy			
	Management, Governance & Reporting			

		Very High				High				Moderate				Low	
Parent Support	Likelihood of Parent Support														
	Rating of Parent	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B/ C category
	Final Rating	**AAA**	**AA+**	**AA**	**AA-**	**A+**	**A**	**A-**	**BBB+**	**BBB**	**BBB-**	**BB+**	**BB**	**BB-**	**B/ C category**

The above graphic is only for illustration purpose and does not represent a rating output from a formulaic model. The ratings assigned by ICRA are determined by Rating Committees based on both quantitative and qualitative considerations. The final rating could be further notched up on the basis of implicit support from the parent and various structural features/ credit enhancement features associated with the rated instrument.

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