

Muted prices + rising cost = stale brew for tea cos

December 2018

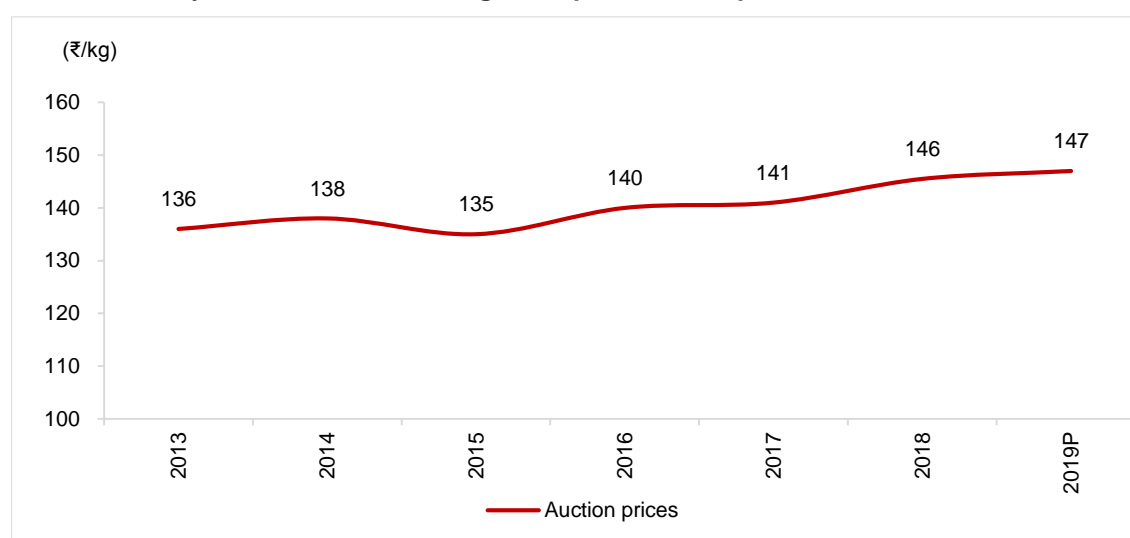


Price-sensitivity limits domestic realisations

CRISIL Research expects prices at tea auctions across the country to close calendar 2018 at Rs 145-146 per kg on average, 3-4% higher on-year, compared with a compound annual growth rate (CAGR) of 1.4% logged over calendar 2012-2017. Despite this, the players' margins are expected to be impacted adversely as the export-driven uptick would not be enough to offset a significant increase in labour cost.

In 2019, the auction prices are seen range-bound, with a marginal improvement to ~Rs 147 per kg, given the price-sensitive market.

The last five years have seen marginal uptick in tea prices



Note: The prices are weighted average, weights being monthly arrivals. To calculate pan India realisations, a weighted average of North Indian and South Indian tea prices has been calculated based on their share of production.

Source: Tea Board of India, CRISIL Research

Tea is sold in India through auction centres. The buyers are either private stockists who sell loose tea or large players who further process it and sell as branded packaged tea.

With ~50% share of the domestic market, loose tea caters to price-sensitive consumers and is available at Rs 150-160 per kg. This limits the ability of private stockists to pay higher procurement price.

Branded tea commands a high price differential of Rs 140-150 per kg over loose tea, and any further widening of this gap run the risk of downtrading by consumers.

Rising production adds to pressure

Tea production in India logged 3.2% CAGR over 2012-2017. However, consumption ran up only at 1.7% CAGR.

The domestic market is saturated, with penetration as high as 99% among the tea-drinking population (above 10 years). This has limited the growth potential and has increased the players' dependence on exports to maintain the overall demand-supply balance in the domestic market and thereby prices.

We expect record tea production of 1,328 million kg in 2018 and 1,339 million kg in 2019, driven by higher yields in Assam and West Bengal.

However, the share of exports is estimated to continue at 18-20% in volume terms.

Thus, healthy supplies due to higher production and limited scope for growth in domestic consumption and exports will cap any rise in prices for Indian players.

Growth in export realisations seen muted

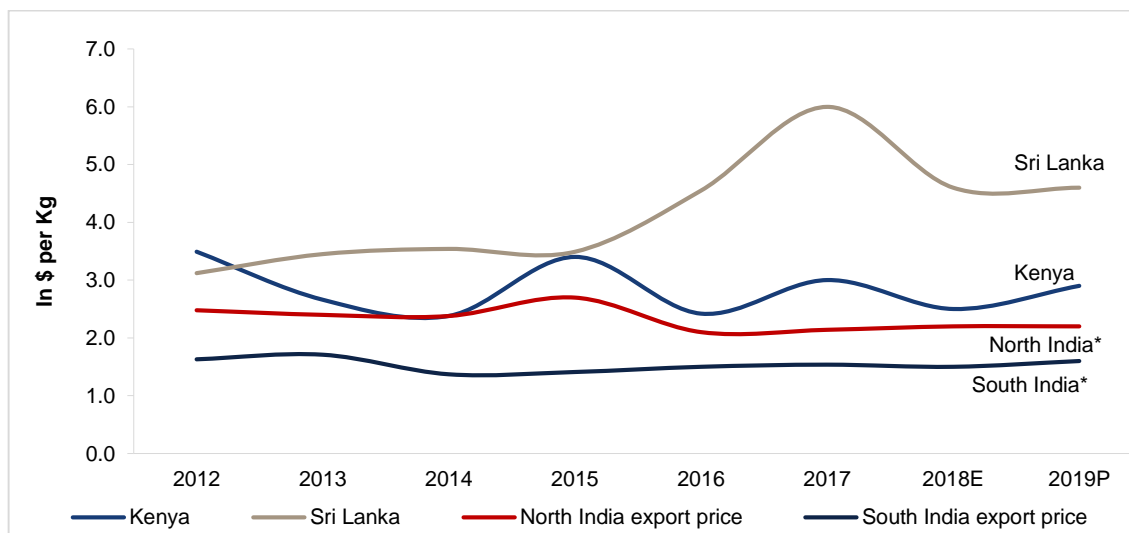
Export realisations of Indian tea producers dropped at ~2% CAGR over 2012-2017. In 2018, growth in realisations is expected to have remained muted, though 2019 could see a marginal increase of 1-2%.

International tea prices are driven by the Kenyan and Sri Lankan prices, which are largely dependent on the production trends in these countries. With a revival in Kenyan production and healthy output in India and Sri Lanka, global tea production is expected to be higher in 2018 compared with 2017, leading to a correction in international prices. That said, the rupee’s depreciation against the dollar is expected to provide some relief to Indian tea producers.

In 2017, India accounted for 23% of the global production. However, its share of exports was only 13% due to stiff competition from Kenya and Sri Lanka, and high domestic consumption. Interestingly, those two countries accounted for only 13% of global tea production, but cornered 39% exports share during the year.

Kenya and Sri Lanka also enjoy much higher realisation compared with India, given better-quality tea. In other words, lower quality restricts Indian tea’s export growth potential.

Higher production in Kenya has driven down international prices in 2018



Note: *These are export prices

E: Expected, P: Projected

Source: Tea Board of India, CRISIL Research

Rising costs, muted realisations expected to dent profitability

Tea is a cost-intensive industry. Labour constitutes ~65% of the total production cost and 50% of the revenue.

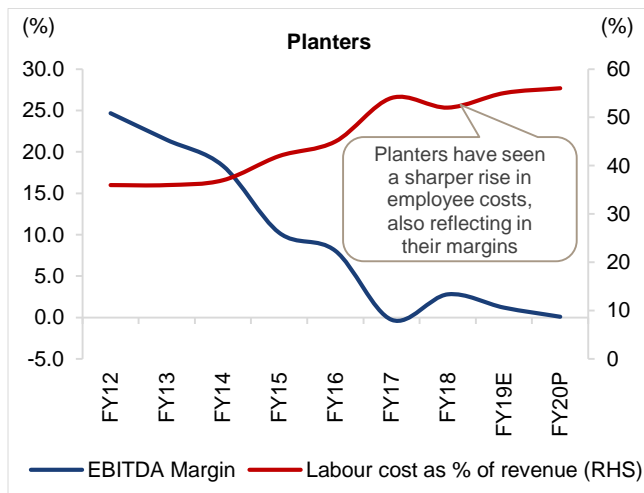
In March 2018, tea estate workers' wages increased a significant 22-25% in north India, which accounts for ~80% of the country's total tea production. In addition, labourers in Assam have demanded a further hike of Rs 17 per day (another ~10% revision), which is being discussed and, if implemented, would add to the burden of planters.

The wages of workers are revised every three years. The last revision agreement expired on March 31, 2017. The industry is under pressure as the wages are determined by the government, independent of tea prices and company revenues. Strong labour unions, strikes, and unavailability of workers during the peak season further aggravate the situation.

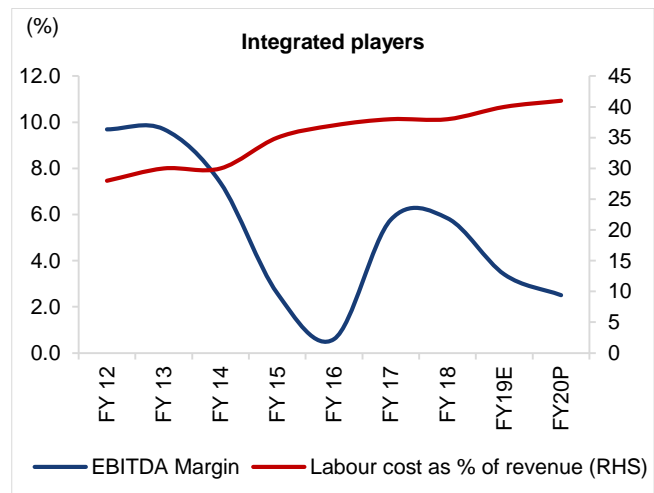
CRISIL Research expects profit margins of Indian tea planters to contract 140-170 basis points (bps) in fiscal 2019 and a further ~100 bps in fiscal 2020. The margins of integrated players are expected to contract 200-240 bps and a further ~90 bps.

Ability of the tea producers to sell at remunerative prices and manage costs would be critical for the industry's overall performance.

Planters to see margins wilt...



...integrated players better placed



Note: Integrated players are those which, apart from being tea growers, have diversified into the packaged-tea segment. These players are present throughout the value chain, right from estate operations to manufacture and processing of tea, blending, marketing and sales in the domestic retail or export markets.

EBITDA – Earnings before interest, taxes, depreciation, and amortisation

Source: Industry, CRISIL Research

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