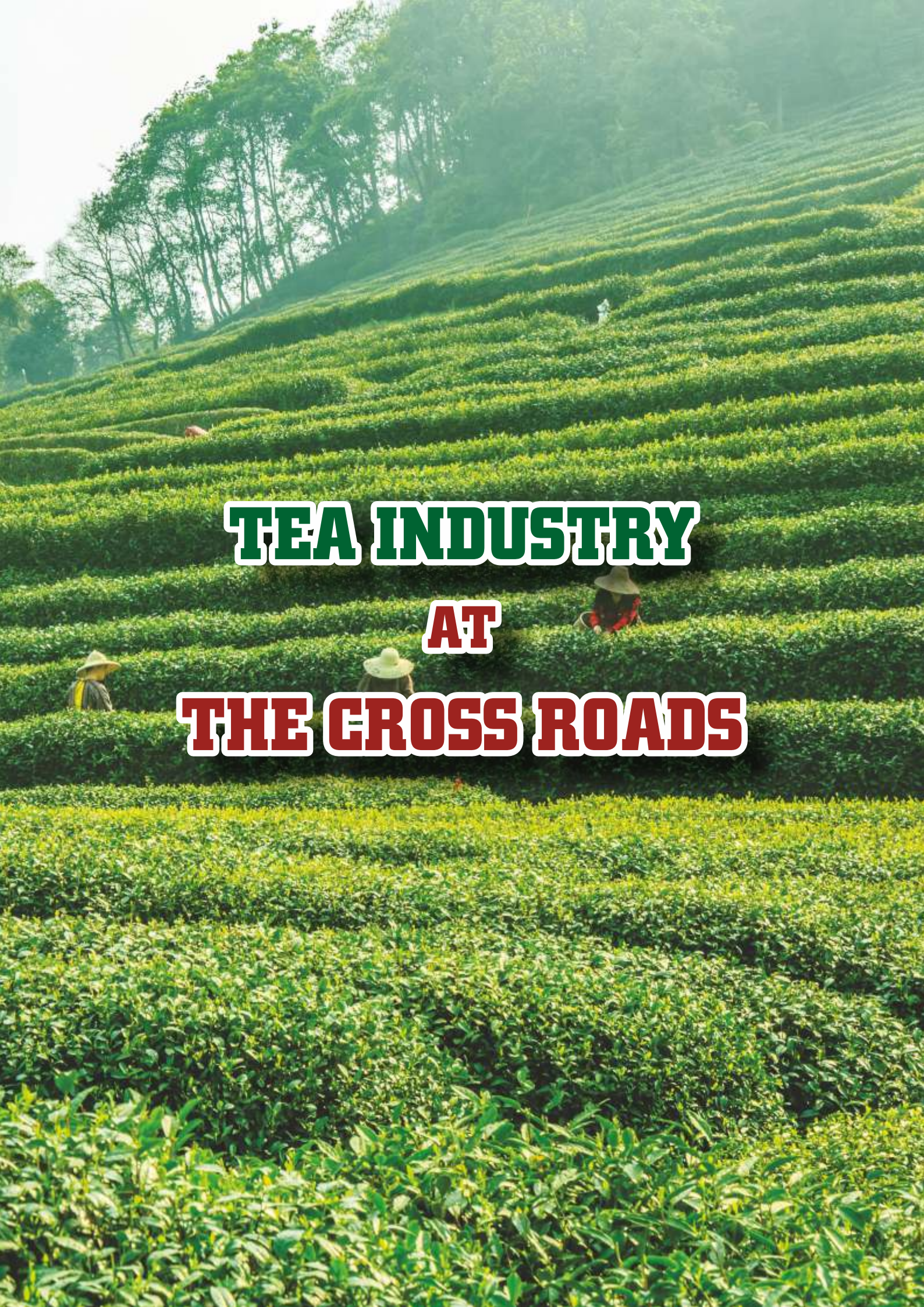


TEA INDUSTRY **AT** **THE CROSS ROADS**





TEA INDUSTRY
AT
THE CROSS ROADS





Mr Ravi Agarwal
Chairman
ASSOCHAM Eastern Region

I believe that the industry body at large has a pivotal role to play in uplifting the industrial sectors in India. ASSOCHAM epitomizes this concept. It works in tandem with the government and the industry.

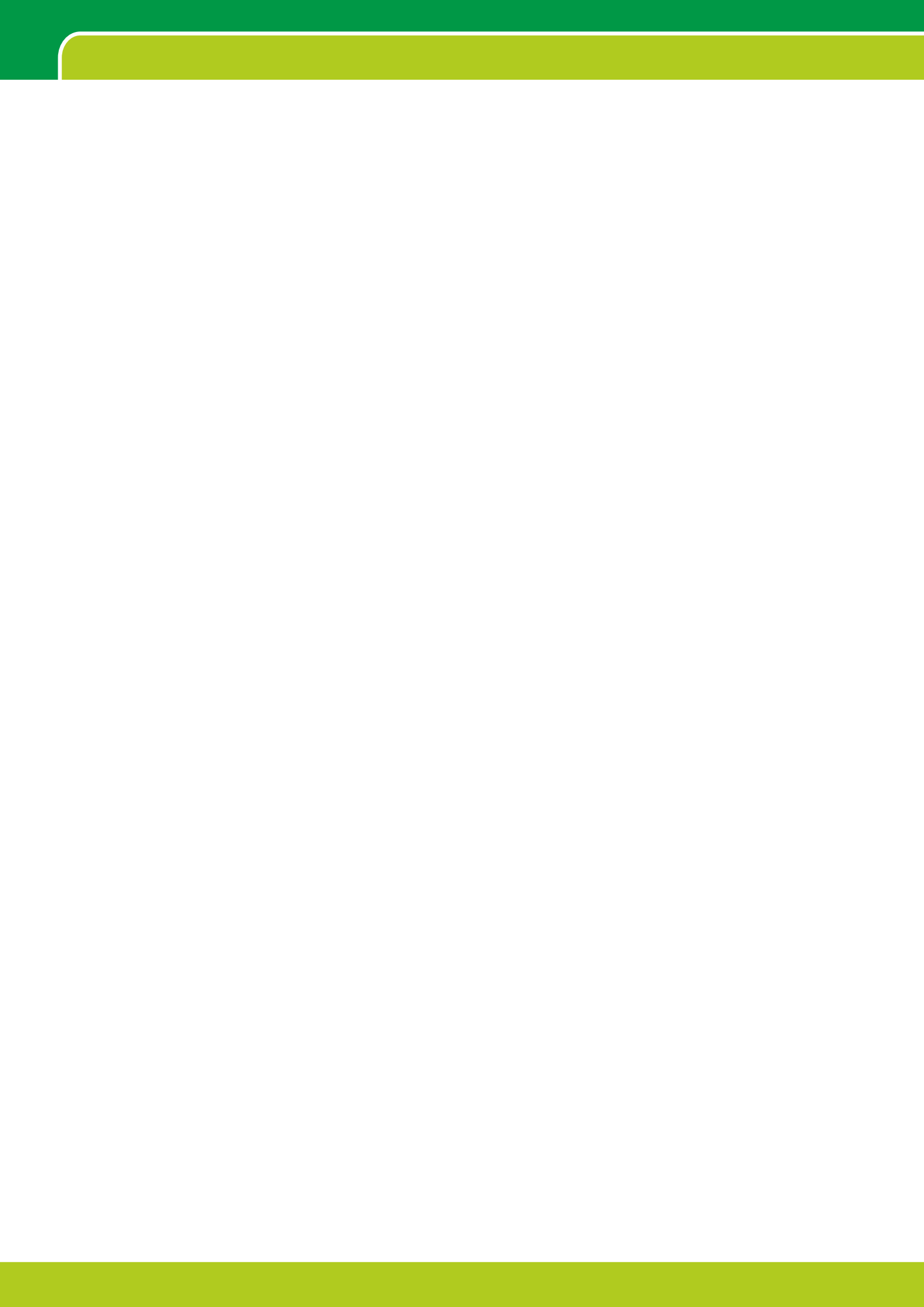
Tea is instrumental in strengthening our economy, global footprint and sustainability. This knowledge report on the Tea industry is both informative as well as comprehensive. Highlighting of the sector will serve as a much needed knowledge dissemination.

Indian Tea is world renowned for its heritage and legacy. Its distinctive quality and its high volume of production makes it unique. The price index should have a sufficiently higher margin than the production cost for the smooth functioning of the industry.

The report covers the strengths and challenges of the sector spanning from green leaf procurement, manufacturing process and marketing in bulk tea or other value added packaging. Recently it has been noted that there has been a sharp increase both in bulk tea consumption and its prices. The report further envisages strategies for the future development and overall progress of this dynamic sector.

I am confident that the Tea industry being amongst the foremost revenue and wage- earners for the country will benefit from this study.

I wish this endeavor all success.





Mr Manish Dalmia
Chairman

ASSOCHAM Tea Sector Sub Council-East

ASSOCHAM has been proactively engaged in boosting the economical development of the nation, by taking progressive and futuristic strides. In order to inform, educate and further enhance this initiative the chamber furnishes study or knowledge reports from time to time. This particular study focusing on the Tea Sector is very comprehensive and educative. This report is an inclusive study which lends visibility and focus on the illustrious tea industry of India.

India has the commendable distinction of producing almost 1350 million kgs of tea and which is second only to China. The challenges of the industry and the increased preference for quality tea are the dual factors for validating the future business strategies. Value added tea like packets and sachets though fetch a better price, the recent increasing demand for bulk tea brings us to a crossroad.

The Government of India and various governing bodies associated with tea industries have inculcated various initiatives to strengthen and promote the industry at large. The aim is to enhance production of orthodox and specialty tea. These teas are especially preferred in the overseas markets and can facilitate planters to fetch premium prices and there by strike a balance between the production of CTC tea and orthodox variety.

The endeavor is to promote the existing resources which in turn would be channelized for further growth in the Tea Industry.

This study report will help comprehend the sector in its entirety. It will be constructive and will help cater to responses from both internal and overseas markets.

I am sure it will serve as an impetus to the future development of the tea industries in India.

I wish ASSOCHAM great success in this venture.





Jayanta Roy
Senior Vice-President and Group Head
Corporate Sector Ratings

The bulk tea industry based out of North India (NI) went through a prolonged downcycle from FY2015 onwards. Proliferation of production from the low-cost base small tea growers and bought leaf factories led to stagnation in prices while input costs, particularly labour costs, have increased manifold. Consequently, the financial performance of the industry, which is one of the largest employers in the north eastern region, with the organised sector providing employment to more than 10 lakh labourers, significantly deteriorated over the period FY2015 to FY2019.

FY2021 provided some respite to bulk tea players – restrictions on operations due to the pandemic coupled with adverse weather condition led to a material decline in production even as consumption largely remained steady, resulting in a sharp increase in prices. Consequently, the bulk tea industry witnessed its best performance, in financial terms, since FY2014. Unfortunately, the sustainability of the same however looks unlikely. The industry is likely to face another challenging year in FY2022 with wage rates having increased sharply, with effect from February 2021, and prices at recently held auctions declining at a rapid rate.

In this backdrop, this knowledge report provides an analysis of the relative position of the Indian bulk tea industry, particularly that based out of North India, in the global tea industry and highlights key success factors that could lead to an improved financial performance of the industry on a sustainable basis.

Table of Contents

Background	12
Executive Summary	17
Challenges of The NI Bulk Tea Industry	21
Sharp and continuous increase in costs, particularly wage rates	21
Auction prices have remained range bound till recently	22
Deterioration in profitability and consequently credit profile of the industry	23
Global Tea Industry	27
Production	27
Imports	28
Exports	30
North Indian Bulk Tea Industry	33
Production	33
Exports	35
Domestic Demand	37
Auction Prices	37
Way forward for the NI Bulk Tea Industry	41
About ASSOCHAM	46
About ICRA	47

BACKGROUND

A lush green tea plantation under bright sunlight. The foreground is filled with sharp, detailed tea leaves, while the background is a soft-focus field of tea bushes. In the distance, several workers wearing hats are visible, engaged in tea-picking activities. The overall scene is bright and verdant, with a strong bokeh effect in the background.

BACKGROUND

Tea is believed to have originated from China in the 28th century BC, however, in India it owes its origins to the British who wanted to overthrow the Chinese monopoly on tea, as they found the soil in India apposite for tea cultivation. In 1826 the British East India Company started growing tea in upper Assam and established the first tea garden in 1840. Tea is one of the largest consumed beverages in the world. There are two main categories of tea: true teas and herbal teas. In addition, there are flavoured teas that combine a true tea base with herbal infusions. All true teas (Black, Green, Oolong, White, and Pu'erh) come from the same plant, which is *Camellia sinensis*. Green tea and white tea are the true teas, which undergo the least processing - these are not oxidised. Black tea is fully oxidised while oolong tea is only partially oxidised. Pu-erh tea is aged and considered a post-oxidised tea. Herbal teas are made by infusing fruits, roots, herbs, leaves, and stems of a variety of plants. It has been established that regular drinking of tea can have a lasting positive impact on one's health as all pure teas contain unique antioxidants called flavonoids. The caffeine content of true teas varies between the different types and on how the tea was produced.

In terms of global tea production, China is the leading producer, followed by India, Kenya and Sri Lanka. While China primarily produces the green variety of tea, the other three nations produce primarily the black variety of tea, accounting for over 60% of the global black tea production. In calendar year 2020 (CY2020), with a production of 1255 million kg (mkg) India is estimated to have produced over 29% of the global production of black tea. India's share of the global tea trade is, however, on the lower side as over 80%, sharp contrast to the other producing countries where exports make up the bulk of the demand, of the country's tea output is consumed within the country.

The tea industry in India is regulated. Under the Tea Act, 1953, the Tea Board of India (TBI) has been constituted by the Government of India (GoI) to i) regulate the production and extent of cultivation of tea; ii) improve the quality of tea; iii) promote cooperative efforts among growers and manufacturers of tea and iv) improve amenities and incentives for workers etc. The TBI also regulates and controls the total area of land under tea cultivation.

The various players in the domestic tea industry comprise integrated plantation companies, small green leaf growers, bought leaf factories and packet tea companies. The integrated plantation companies maintain plantations for the supply of green leaf, which are then processed to manufacture tea. The companies have to incur plantation-related costs that primarily include labour, agro-chemicals and estate development & maintenance costs to grow the green leaf and manufacturing-related expenses to convert the green leaf into made tea. Standalone green leaf growers sell it to bought leaf factories, which convert the green leaf into made tea. Integrated plantation companies, small leaf growers and bought leaf factories are part of the “bulk” tea industry.

The bulk tea industry occupies a place of considerable importance in the Indian economy, employing over 3.5 million people across India and producing nearly 25% of the world's total annual tea output. In addition, the Indian tea industry has also contributed to foreign exchange earnings, with tea export of around \$750 mn on an average during CY2016 to CY2020.

Within the domestic bulk tea industry, the North India (NI) producers hold a position of importance, accounting for around 82% of the production, 60% of exports in volume terms and 70% in value terms. NI tea is grown mainly in the states of Assam and West Bengal, accounting for around 60% and 38% of domestic production respectively, in CY2020. A wide variety and quality of teas are produced in these two states, which meets the requirement, both in the domestic and the exports markets.

The NI bulk tea industry has been facing difficult times from around FY2014 - with stagnating tea prices on one hand and consistent increase in costs, particularly labour wages, on the other. As a result, there was a significant decline in the financial performance of the industry from the peaks witnessed in FY2013 and FY2014. Although FY2021 turned out to be a good year, with pandemic-related restrictions and adverse weather conditions resulting in supply side issues, which resulted in a sharp jump in prices and consequently decent profits for the industry, long-term sustainability of the same remains to be seen.

This publication looks at the specific issues and factors impacting the NI bulk tea industry and explores some of the options available to ensure long term sustainability of the industry.





EXECUTIVE

SUMMARY



EXECUTIVE SUMMARY

The NI bulk tea industry has had to cope with the consistent increase in costs – particularly labour – over the last decade. Wages have more than trebled from around Rs 67 per day as in January 2010 to Rs 205 at present. While costs have multiplied, prices of teas have remained largely flat – average prices at NI auctions were ~ Rs 120 per kg in CY2010, which increased to ~ Rs 150 in CY2019. Significant increase in production, most of which has come from the unorganised small tea growers (STGs), has outpaced the growth in domestic consumption while exports have remained largely range bound. This oversupply, coming from the lower cost base STG segment, has led to pressure on prices of tea. Consequently, the operating profitability of bulk tea players declined from a peak of ~16% in FY2013 to ~2% in FY2020.

In CY2020, domestic production declined, due to Covid-19 related lockdown/restrictions as well as adverse weather conditions, in NI by almost 135 million kg (mkg). While export was down by ~45 mkg, domestic consumption is estimated to have been largely unaffected thus leading to supply falling short of demand. The shortages led to a sharp increase, of ~ 32%, in tea prices at NI auctions during CY2020. This increase far outpaced the increase in costs, due to lower production, resulting in a sharp improvement in financial performance of the bulk tea industry in FY2021.

While FY2021 proved to be one of the best years in recent times for the bulk tea industry, sustainability of the same appears unlikely. While labour wage has been increased recently, effective end-February 2021 in Assam, by ~23%, production returning to largely normal levels has led to pressure on prices. Consequently, the industry is likely to face another challenging year in FY2022. For the long-term sustainability of the industry, tea prices must consistently remain materially higher than the cost of production.

Against this backdrop, and as per opinions received by ICRA from various stakeholders in the NI bulk tea industry, the following factors are likely to emerge as key to ensuring the profitability of bulk tea players in the medium to long term:

- ❖ **Increase in volume and value of exports:** India has traditionally concentrated on select few markets to drive the bulk of the exports. Indian players need to expand their export base, particularly in countries where they have limited presence. Also, for exports to traditional geographies, there is scope to supply better quality tea, thus increasing the average price of exports. In addition, exports in value-added form like packets / tea bags, would also support average prices.
- ❖ **Increase in level of domestic consumption:** The per capita domestic consumption remains relatively low, when compared to some other large consuming nations, at around 0.8 kg. To increase consumption a lot of generic marketing activities may be required. In addition, efforts may also be taken to increase awareness amongst the consumers about the quality of the tea consumed.

- ❖ **Concentration on quality; control volume of end season teas:** A focus on improving the quality of their produce is of paramount importance to bulk tea players. Adoption of better garden practices would not only improve quality but also have a clear check on production. Further limiting the production in December, a step that has already been implemented, would also help in checking the extent of oversupply.
- ❖ **Meeting changing preferences of end customer directly with value-added products:** A direct connect with the end consumer, with offerings of teas in value-added form, particularly in packets and tea bags, may help in increasing average realisation for the bulk tea producers. The industry may also need to tweak their production strategy and invest in infrastructure to meet the changing consumption pattern – there is an increasing preference for green tea and other non-black tea as well as black tea infused with fruits and herbals.
- ❖ **Calibrated increase in production of orthodox (ODX) teas:** Globally ODX production (except from China) has stagnated over the last decade. Production from Sri Lanka, India's main competitor in the world market, has witnessed a decline in recent years. This gives an opportunity for India to produce and export higher volume of ODX teas.
- ❖ **Making auction the preferred route for the sale of teas:** At present, only around 40-42% of the total production of NI is sold through auctions, which is lower than the 50% level that the Tea Board of India (TBI) has directed. A high turnaround time, leading to increased working capital requirements, and apprehensions amongst sellers over the existing mechanism which may not be ideal and is not yielding the desired result of optimal price discovery, are some of the factors leading to this lower share. Such issues can be addressed along with improvement in auction infrastructure to attract higher volume of teas through the auction route. This may not only lead to a “better” price discovery but would also give an opportunity to evaluate teas on various parameters, including MRL levels, and accordingly certify the teas and the producers accordingly. Specific standards on quality may be established by this process.
- ❖ **Implementation of wage code for small growers and minimum sale price for green leaf:** Large bulk tea producers opine that to address the significant difference in cost of production of leaf between the plantation companies and the STGs, on account of the additional burden of welfare and development activities that the plantation companies have to bear as per the Plantation Labour Act, a wage code, benchmarked against the all-inclusive cost of labour of the plantation companies, for the STGs may be implemented. Additionally, such an implementation of a wage code may be accompanied by the introduction of a minimum price of green leaves – benchmarked against the average auction prices of teas from that particular district, with necessary adjustments for quality. This would ensure adequate earnings for the STGs. The TBI has recently come out with a communication towards introduction of minimum prices of green leaf, however, implementation of the same remains to be seen.
- ❖ **Greater financial support:** Given the financial condition of the industry, players also want financial support if it has to incur marketing expenses to increase exports and domestic consumption. Any increase in export benefits, including that to support ODX export volumes, would be beneficial to the industry. Apart from higher export subsidies, access to working capital facilities at competitive rates and timely receipt of subsidies will also help.



A photograph of a tea processing factory. In the foreground, there is a large pile of fresh, vibrant green tea leaves. In the background, a multi-story industrial building with a red metal frame and concrete walls is visible. The building has several windows and doors. Two signs with the word 'TEUCH' and numbers '24' and '10' are mounted on the building. The sky is bright and slightly hazy.

CHALLENGES OF THE NI BULK TEA INDUSTRY

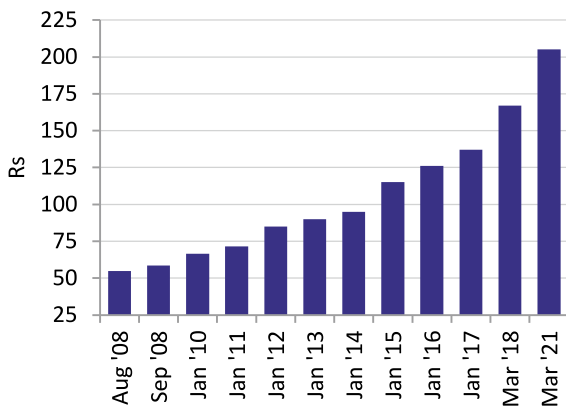
CHALLENGES OF THE NI BULK TEA INDUSTRY

Sharp and continuous increase in costs, particularly wage rates

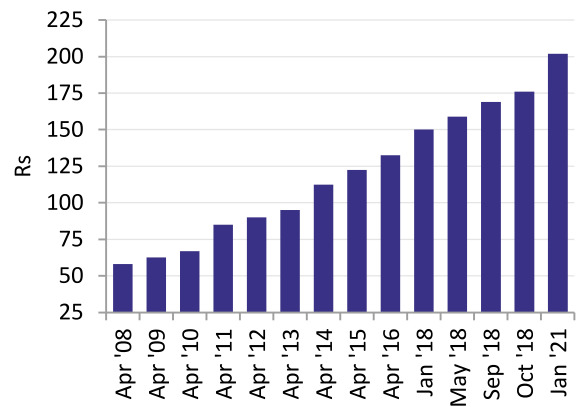
Tea is a fixed cost intensive industry with cost of labour accounting for ~60% of the cost of manufacture of tea. A tea estate usually employs ~2.7 labourers per hectare (ha). Thus with ~ 3.6 lakh ha of area under the big tea growers in NI, almost 10 lakh labourers are employed by that segment of the industry. The NI bulk tea industry has been faced with consistent increase in wages. In the past, wage rates for tea workers in North India have been governed by the bipartite agreement (trade unions and tea producers) in Assam and the tripartite agreements (trade unions, state government and tea producers) in West Bengal. Wage rates were finalised for a period of three years at a time, with a fixed annual escalation rate. However, in recent times that pattern is no longer applicable.

Increasing Wages Rates

Assam Wage Rate in Rs / day



West Bengal Wage Rate in Rs / day

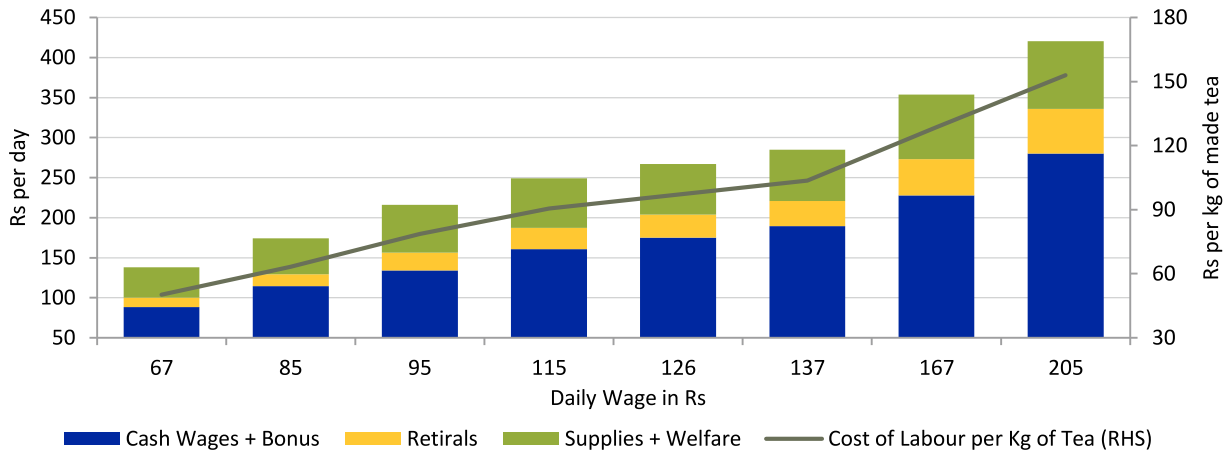


Source: ICRA research

² Including production from bought leaf and costs associated with non-tea businesses, labour costs as a proportion of total costs would be around 48%

³ Source: Tea Board of India, which defines growers who have more than 10.1 ha as big tea growers (BTG)

Increasing Cost of Labour per day

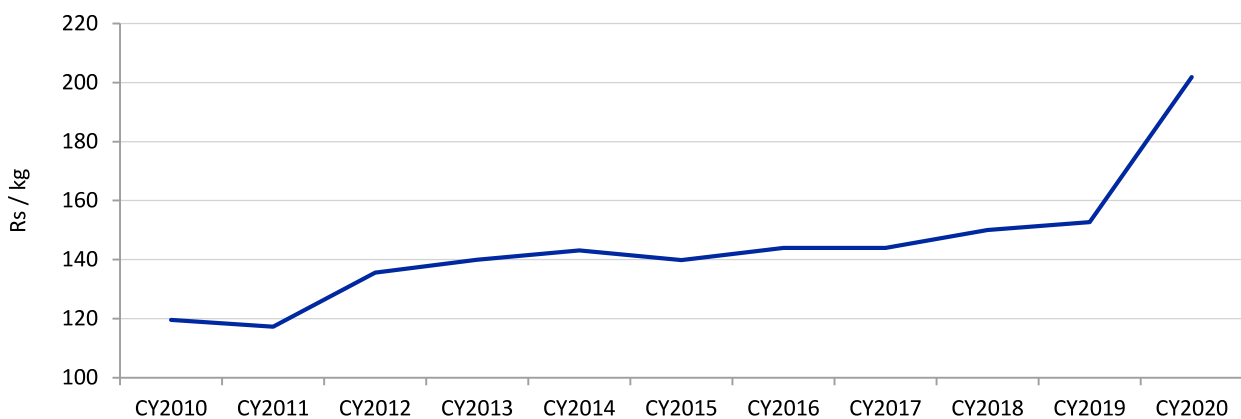


Source: ICRA research

Apart from daily wages and the associated bonus, gratuity and provident fund, tea plantation companies have to also provide other benefits such as ration, medical, housing, educational and other welfare facilities. Considering these expenses towards labour, the cost per day works out to be significantly higher (almost 2x) than the daily wage rates that the plantation companies must pay. Consequently, the cost of labour per kg of made tea has almost tripled from around Rs 50 in CY2010 to around Rs 150 at present. Not only labour but other costs, particularly fuel and agro-chemicals, have also increased significantly over the years.

Auction prices have remained rangebound till recently

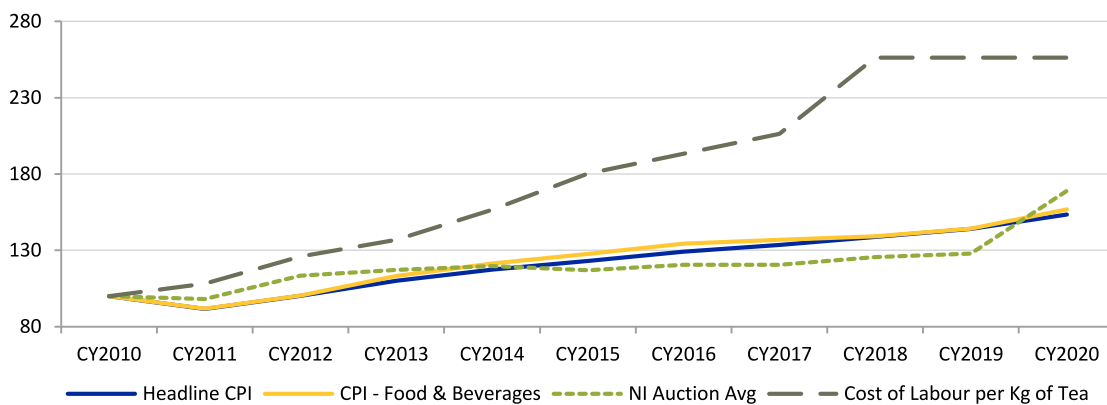
Average Prices at NI Auction Centres



Source: Tea Board of India

The increase in costs has far outweighed the increase in price of teas at NI auctions. NI auction prices have remained largely rangebound from CY2012 to CY2019 (average increase of only 1.7%), before witnessing a sharp jump (32%) in CY2020 on the back of a 12% decline in production, due to Covid-19 related restrictions as well as adverse weather conditions.

Relative Movement of NI Auction Prices, Cost of labour and CPI



Source: ICRA Research, Tea Board of India

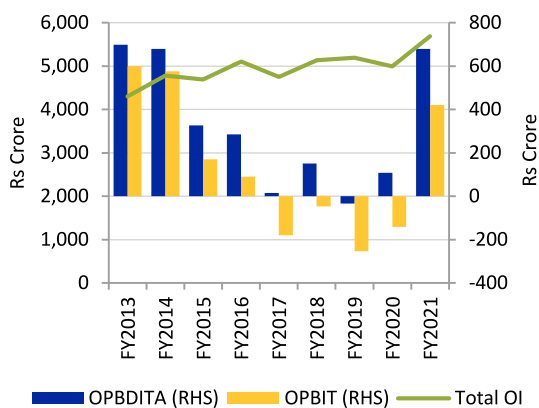
The above chart highlights the relative movement (indexed to CY2010 as base year) in cost of labour per kg of tea and average NI auction realisations and compares the two to both Headline CPI Index and CPI - Food & Beverages.

Deterioration in profitability and consequently credit profile of the industry

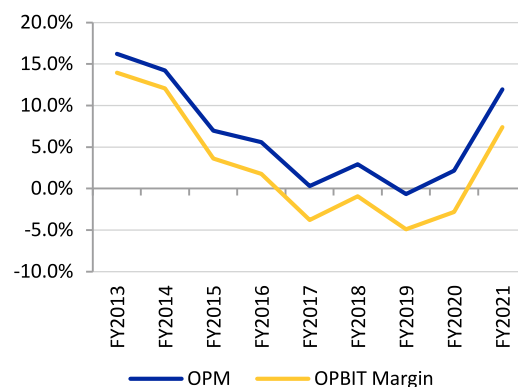
Stagnation in tea prices and increase in costs has led to decline in operating profitability of bulk tea players, particularly from FY2015 onwards as can be seen from the following charts.

Aggregate Financial Performance of Select⁴ Bulk Tea Producers

Operating Income and Profit



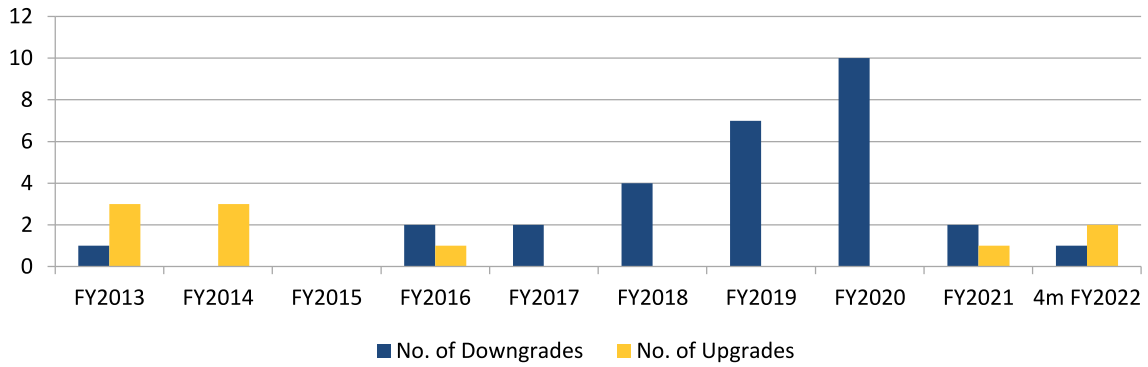
Margins



Source: ICRA Research

⁴ Aggregate of 29 companies

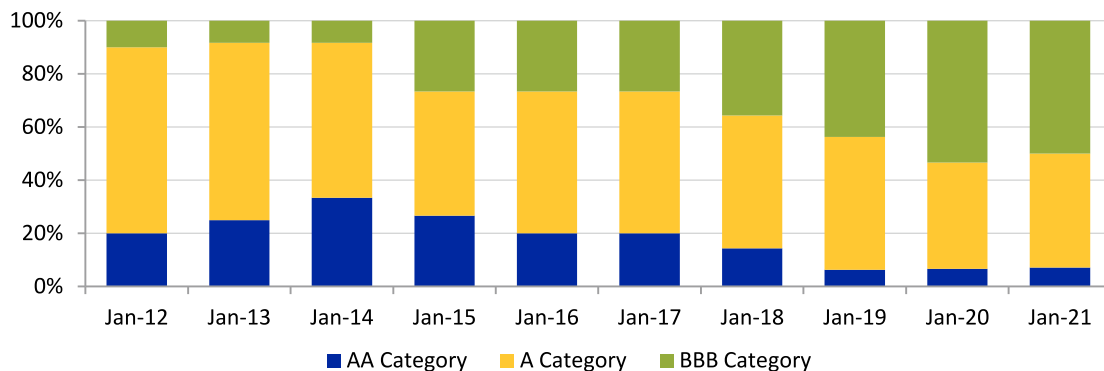
ICRA Rating Actions in the Bulk Tea Industry



Source: ICRA Research

With inadequate cash flows to meet its garden upkeep and capital expenditure programme, the companies had to leverage their balance sheet, thus leading to further deterioration of the credit profile – as reflected in the downward rating actions taken by ICRA. There were only seven upgrades and 26 instances of a downgrade in ratings over the period FY2013 to FY2020; a bulk of the downgrades happened during the years FY2018-2020 whereas most of the upgrades happened between FY2013 and FY2014. It was only in FY2021, when prices witnessed a sharp increase due to lower aggregate production of the industry, has the profitability and credit profile of the industry witnessed some improvement, as reflected in the upgrades in FY2021 and YTD FY2022.

Distribution of Investment Grade Ratings



Source: ICRA Research

Consequently, within the “investment grade” category, the percentage of BBB category ratings had increased from 10% as at end of March 2012 to 50% as at end of March 2021, while number of entities rated in the AA category has declined from four, as at end of March 2014 to one as at end of FY2021. Some of the previously higher rated entities are now rated in the “non-investment grade” category.

While FY2021 turned out to be a good year for the industry, sustainability of the performance, as production returns to normal levels leading to moderation in prices, remains to be seen.

To understand the strategy and policies that may help in ensuring the long-term sustainability of the NI bulk tea industry, it is important to understand the position of the industry in terms of the global tea industry.



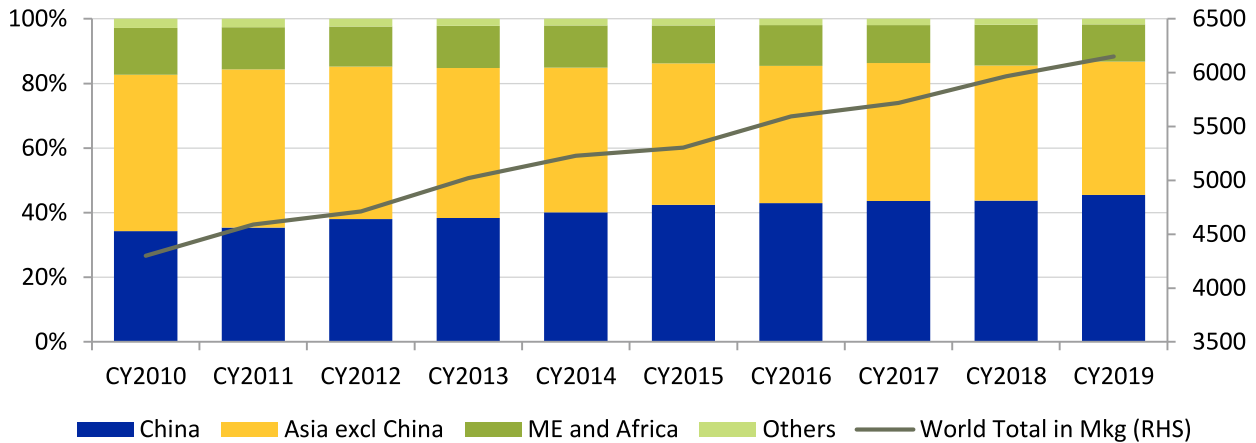
GLOBAL TEA INDUSTRY



GLOBAL TEA INDUSTRY

Production

World Production & Region Wise Share

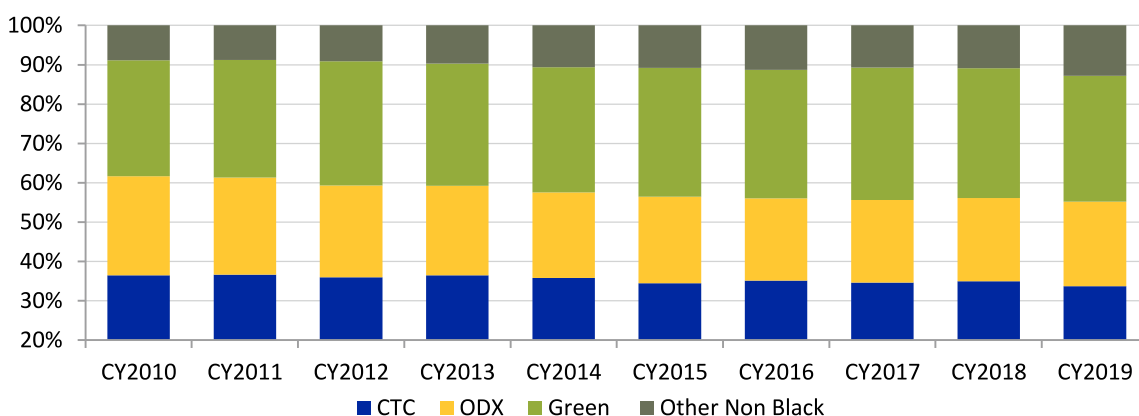


Source: ICRA Research

Global tea production has increased at a CAGR of ~ 4.1% from CY2010 to reach 6.15 billion kg in CY2019; the increase has been driven primarily by China (CAGR of ~ 7.4%); consequently, China now accounts for ~ 46% (in CY2019) of global tea production as against ~34.5% in CY2010; excluding China, global tea production increased at a CAGR of ~2%; more than 98% of the total tea produced in CY2019 were from the three main producing regions - China, Asia (excl China) and Africa & the Middle East.

China, however, largely produces non-black teas (90%); with production of such teas increasing over the last decade, non-black tea now (CY2019) accounts for ~45% of global production against 38.5% in CY2010; over the period (CY2010 – CY2019), production of black tea has grown at a CAGR of ~2.8%, while non-black tea has grown at ~5.9%.

Share of Different Types of Teas Produced

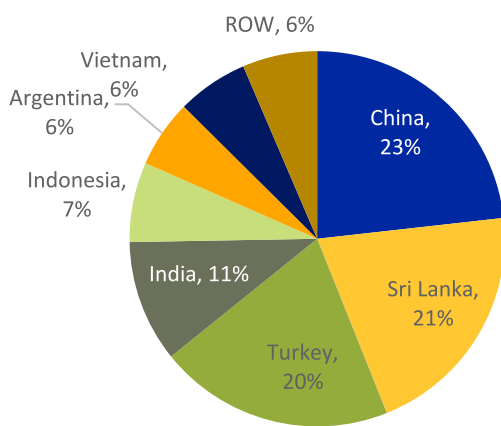


Source: ICRA Research

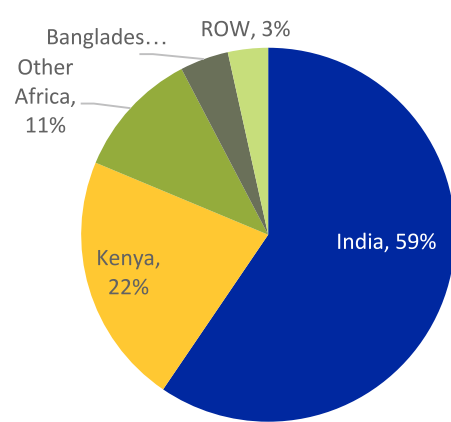
Within the black tea category, CTC production has increased at a CAGR of ~3.2%, while that of ODX production has increased at a rate of ~2.3%. Sri Lanka, Turkey, China, India, Vietnam and Indonesia are the primary producers of ODX teas, while India, Kenya and other African countries are the primary producers of CTC teas.

Producer of Black Tea

Share of ODX Production in CY2019



Share of CTC Production in CY2019

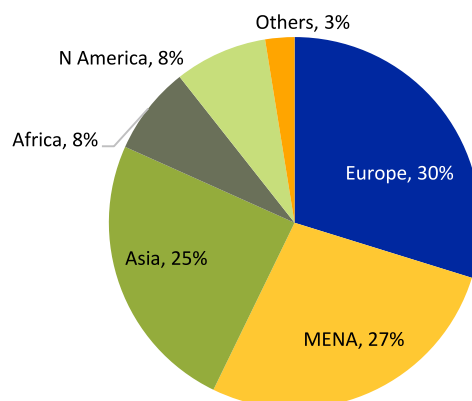


Source: ICRA Research

Imports

Global imports of tea stood at an average of ~ 1.8 billion kg per annum over the period CY2016 to CY2019.

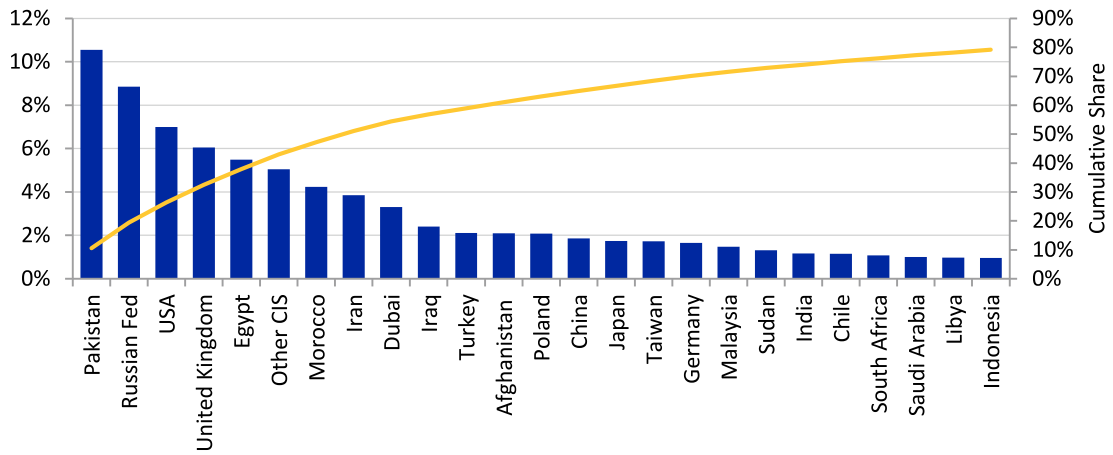
Major Importing Geographies



Source: ICRA Research

Pakistan is the largest importer averaging ~ 185 Mkg (11%) of tea imports annually between the period CY2016 to CY2019. Other large importers include the Russian Federation, the US, the UK and Egypt. These five regions cumulatively account for almost 38% of global imports.

Share of Total Global Imports by Top 25 Countries / Regions – CY2016 to CY2019



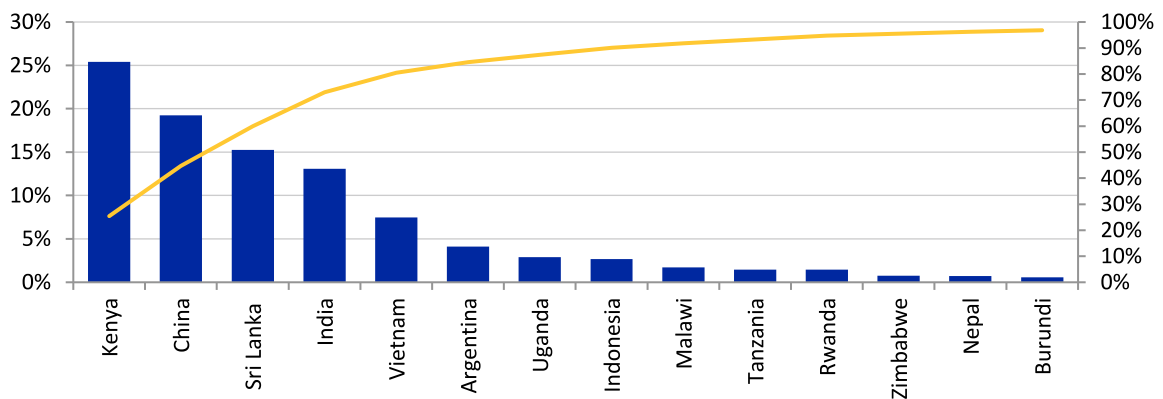
Source: ICRA Research



Exports

In terms of exports, Kenya is the single largest exporter, accounting for 25% of global exports, followed by China (19%), Sri Lanka (15%) and India (13%). The top 15 exporting countries cumulatively account for ~97% of exports.

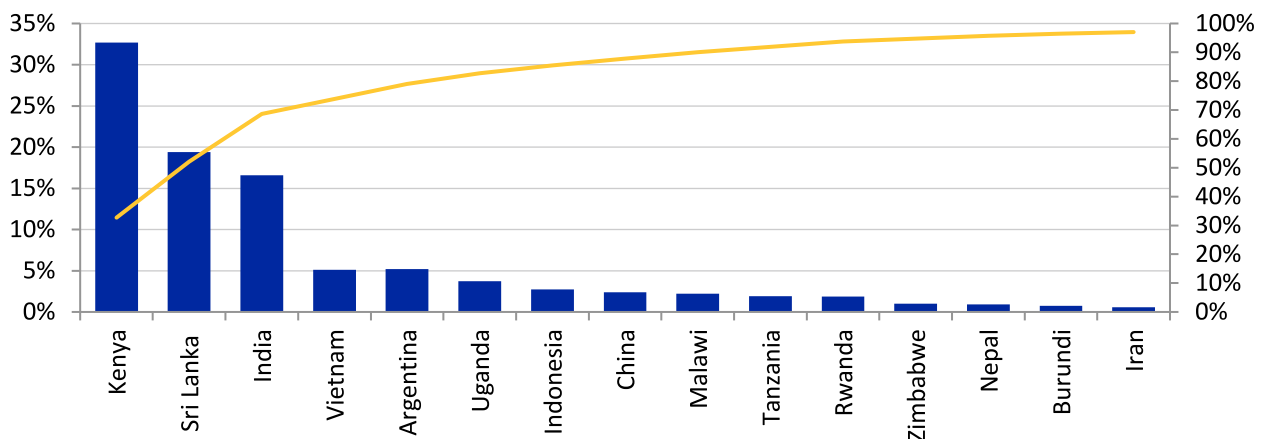
Share of Total Global Exports by Top 20 Exporters – CY2016 to CY2019



Source: ICRA Research

Amongst the exporting countries, China, Vietnam and Indonesia are the major exporters of non-black tea. These three countries together account for ~96% of non-black tea exports globally. Considering only black tea, Kenya, Sri Lanka and India together account for ~70% of the global exports.

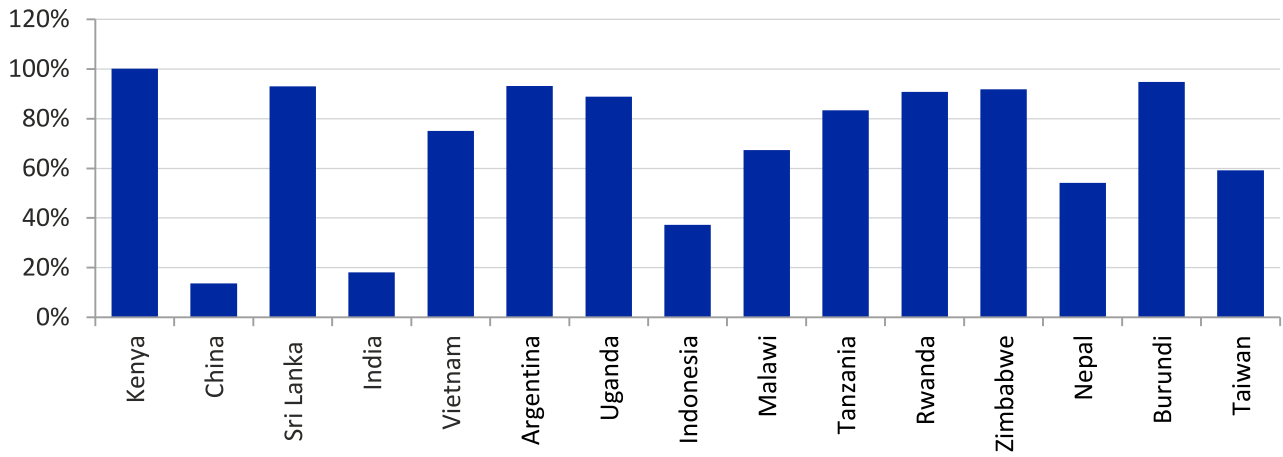
Share of Global Black Tea Exports of top 15 Countries – CY2016 to CY2019



Source: ICRA Research

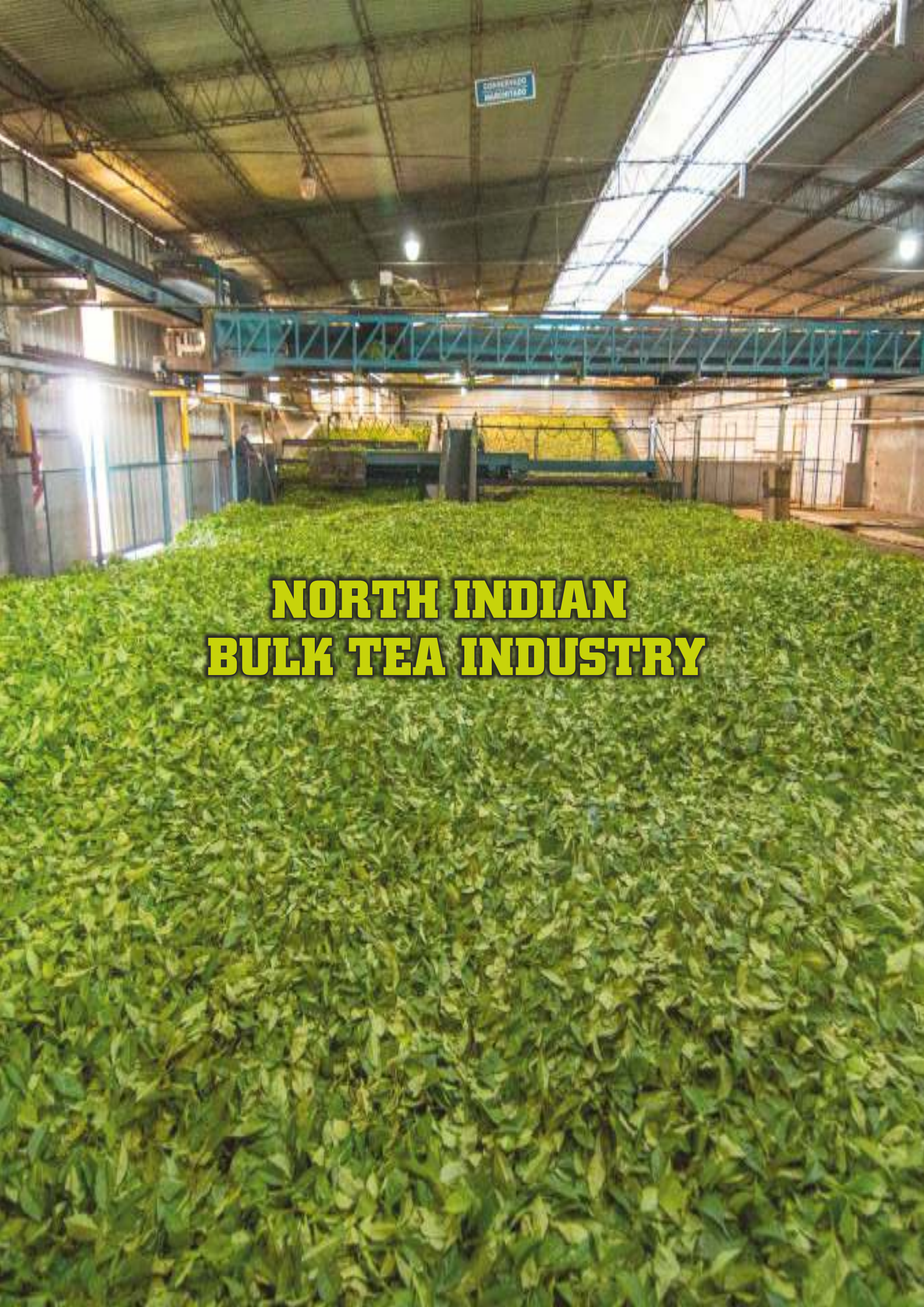
Of the major exporters, except for China, India and Indonesia, almost all other producing countries export most of their production.

Exports as a % of Production



Source: ICRA Research





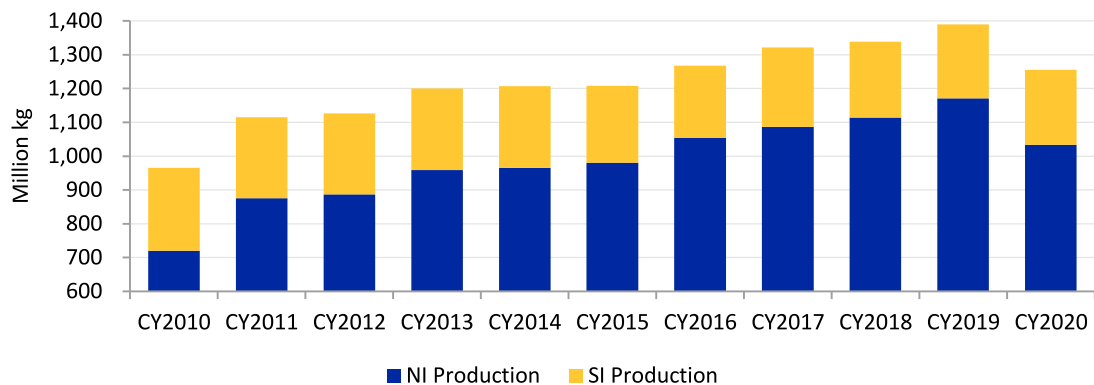
NORTH INDIAN BULK TEA INDUSTRY

NORTH INDIAN BULK TEA INDUSTRY

Production

Indian tea production has witnessed a significant increase from ~ 0.95 billion kg in CY2010 to ~ 1.39 billion kg in CY2019, an increase of 24.6%, almost entirely driven by higher production from NI. Production from SI has averaged ~ 230 mkg, while that from NI increased by ~ 450 mkg (63%).

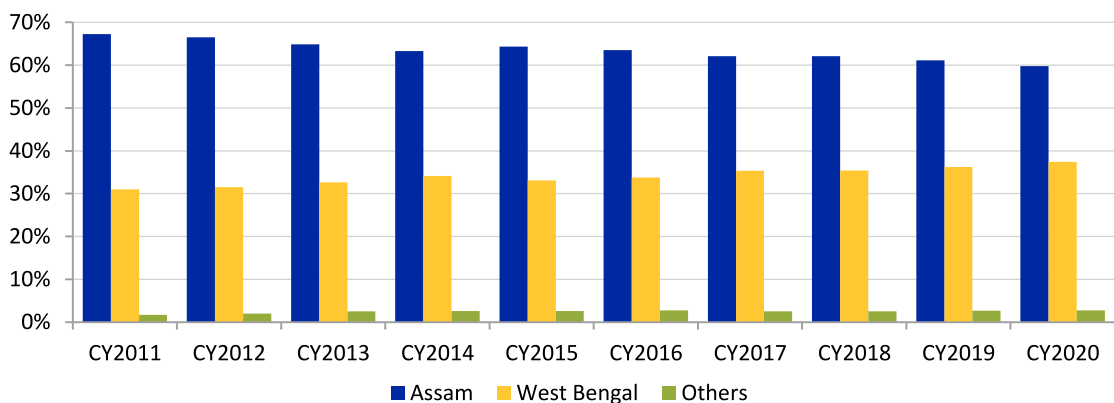
Region wise Indian Production



Source: ICRA Research, Tea Board of India

Within NI, production from West Bengal has increased substantially from ~270 mkg in CY2010 to a peak of ~425 mkg in CY2019, an increase of ~150 mkg (56%). In contrast, the increase in production from Assam was much more modest at ~126 mkg (21.5%). Consequently, Assam's share in the overall NI production has declined from ~67% in CY2011 to ~60% in CY2020.

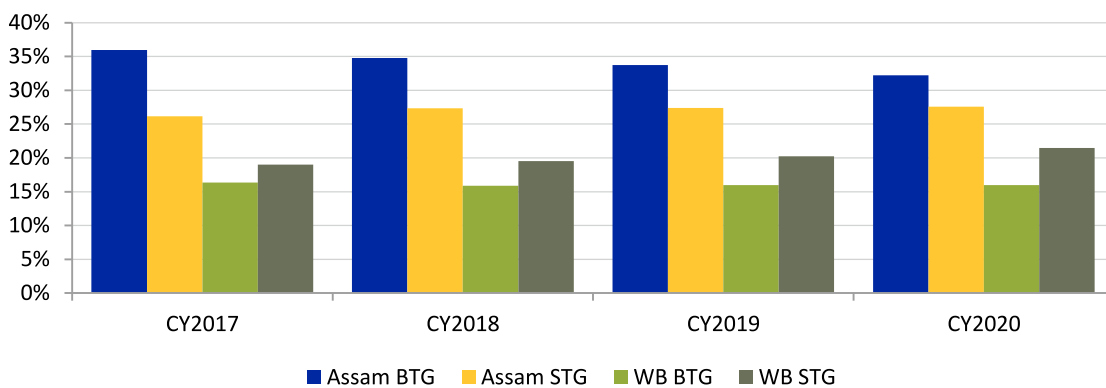
State wise Production in North India



Source: ICRA Research, Tea Board of India

Most of the incremental production over the years has come from the small tea growers (STG). In CY2020, STGs accounted for ~49% of the total NI production, up from ~45% in CY2017. With BTGs of Assam witnessing a flattish trend in production (except for CY2020, when production declined), its share in the overall NI production declined by ~400 basis points (bps) from ~36% in CY2017 to ~32% in CY2020.

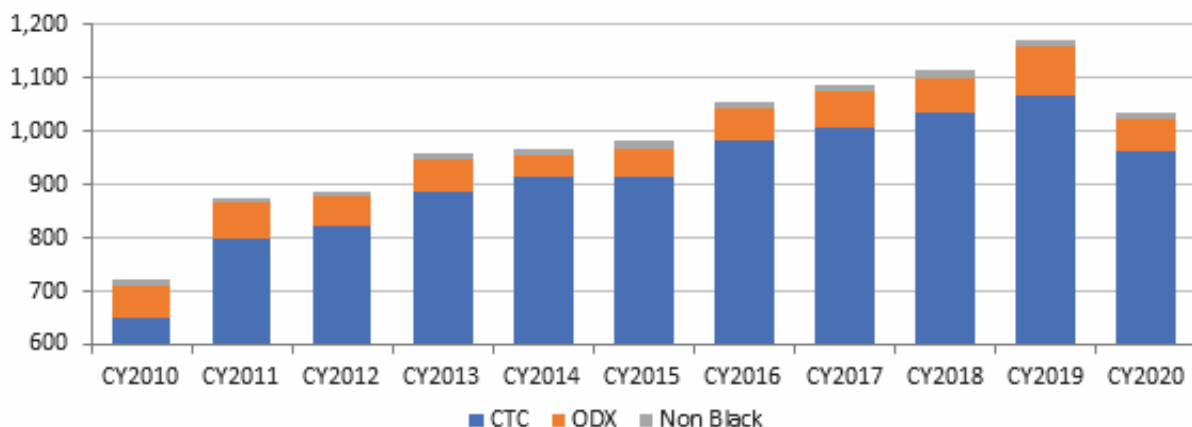
Production from Big Growers vs Small Growers for North India



Source: ICRA Research, Tea Board of India

In terms of varieties of tea, CTC accounts for the lion's share, accounting for ~93% of total NI production. CTC production has witnessed continuous increase between CY2011 and CY2019. ODX production, however, witnessed some volatility – adjusting to demand from the exports markets. While ODX production has averaged at ~ 60 mkg per annum, in CY2019 it witnessed a YoY increase of ~ 42% on the back of strong demand from Iran, one of the primary export countries. In CY2020, however, tepid demand conditions for ODX teas combined with a very remunerative CTC market, on the back of shortfall in production, resulting in almost a 63% decline in ODX production. Non-black teas account for only 1% of NI production.

Category wise Production from North India

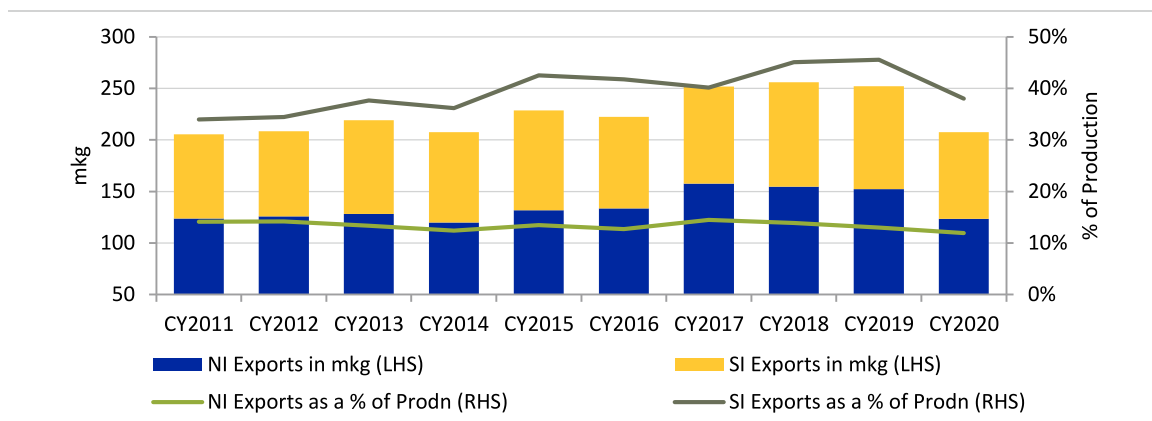


Exports

India is the 2nd largest producer of tea in the world and accounts for the highest tea consumption globally. Around 80% of the total tea produced in India is consumed by the domestic population. While, exports account for only ~20% of production, a healthy export market is key to maintaining the domestic supply demand balance. Exports having remained rangebound around the 220 mkg over a number of years, witnessed a material increase in CY2017. From CY2017 to CY2019, exports averaged at around 250 mkg. However, in CY2020, it again dipped to ~208 mkg.

Exports from NI accounts for ~60% of the total Indian exports. As a share of production, NI exports ~12-15% of its production while SI exports ~40-45%. While NI, approximately, exports ~7-8% of its CTC production and ~85% of its ODX production, for SI the corresponding percentages are ~30% and ~90-95% respectively.

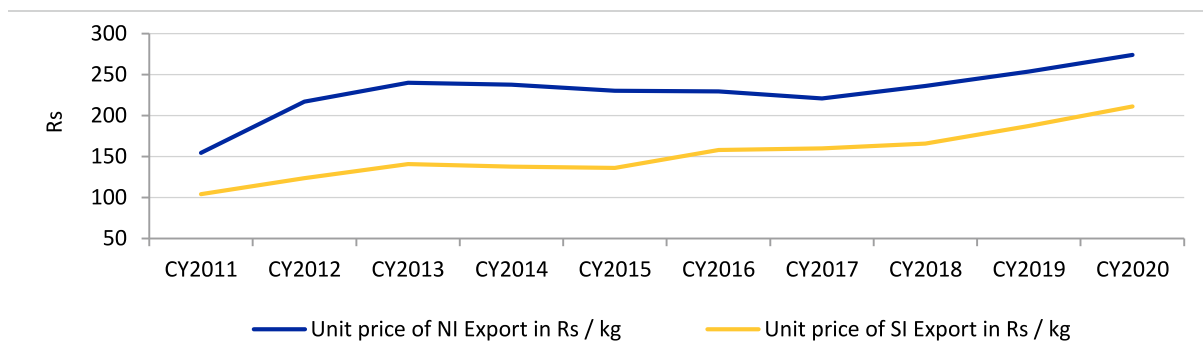
Exports from India



Source: ICRA Research, Tea Board of India

The quality of teas exported from NI are superior than that of SI as reflected in the higher average realisations of such exports

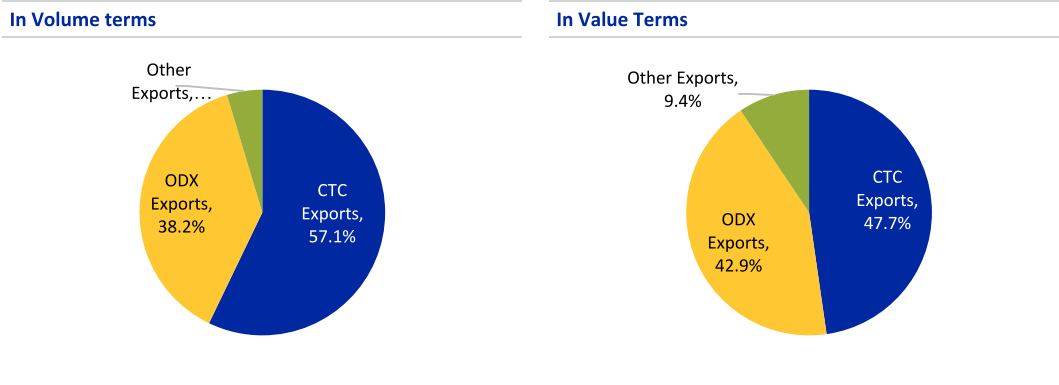
Export Realisations



Source: ICRA Research, Tea Board of India

India exports both the CTC and ODX varieties of teas. Over the period CY2016-2020, total tea exports stood at ~1.19 billion kg earning foreign exchange to the tune of ~ \$3.7 billion. CTC exports accounted for ~57% in volume terms and ~48% in value terms.

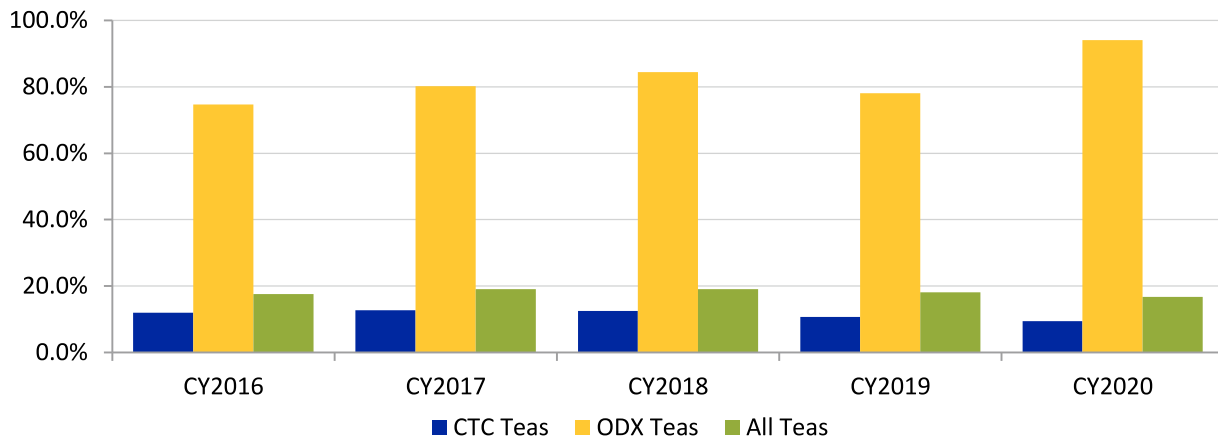
Category Wise Exports



Source: ICRA Research, Tea Board of India

While around 10-12% of the total CTC produced domestically is exported, dependence on exports for ODX is significantly higher.

Exports as a % of Production

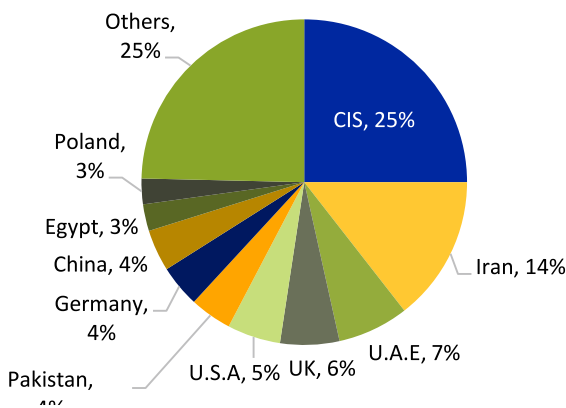


Source: ICRA Research, Tea Board of India

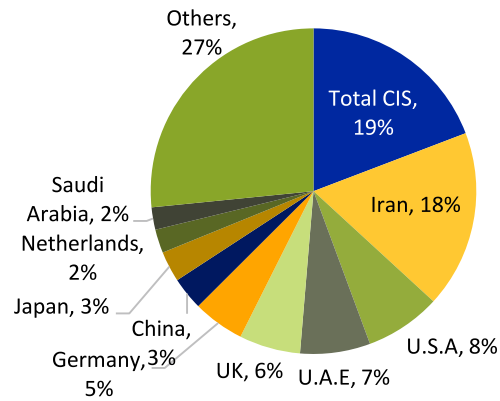
India exports to several countries. The CIS, Iran, the UAE, the UK and the US are the top five export destinations accounting for almost 58% of total exports in volume terms. In terms of value, the premium markets of Japan and Netherlands feature in the top 10. Pakistan, which is the single largest importer of teas globally, used to account for sizeable export of CTC teas, although of the medium to plain categories. However, due to political tensions, there were no import of tea by Pakistan from India in CY2020.

Destination wise Exports

Share of Exports - Volume



Share of Exports - Values



Source: ICRA Research, Tea Board of India

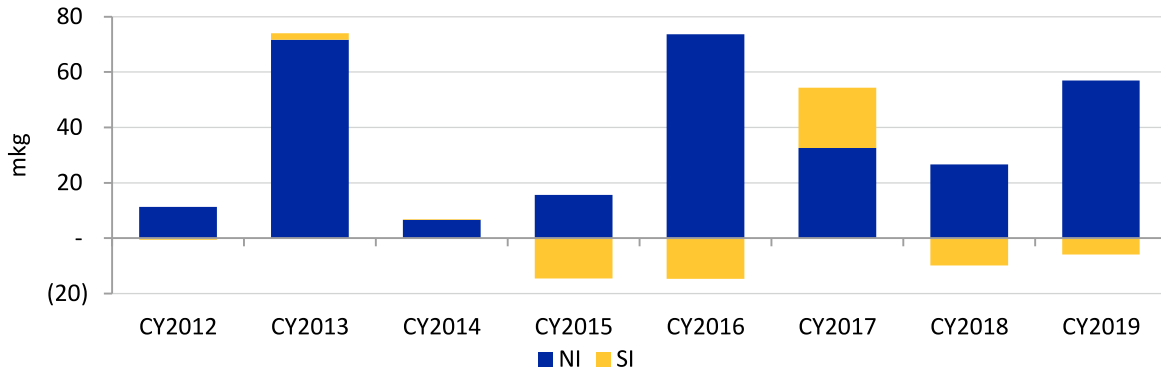
Domestic Demand

There is a lack of periodic study on the domestic consumption of tea. As per the latest available one, commissioned by the Tea Board of India in CY2017, domestic consumption was estimated to be ~ 1.06 billion kg. Thus, despite having a big domestic consumption base, the per capita consumption figures (estimated to be less than 800 gm) in the country are low when compared India's neighbours – Pakistan and Sri Lanka. Domestic consumption is estimated to be growing at ~2.5%. One distinct change in purchase pattern of tea that has been witnessed is the growing preference of households for tea in the packet form. Perception of better quality is perhaps the single largest factor behind this change. The northern and western states account for most of the demand, at around 31% each, with the balance demand being split largely equally among the eastern and southern states. The domestic demand of teas is skewed in favour of the CTC variety, which accounts for ~98% of domestic tea consumption.

Auction prices

Consistent increase in production, except in CY2020, from NI has exerted pressure on prices of tea in the domestic market. Over the period CY2011 to CY2019, overall domestic production has increased by ~ 275 mkg; while SI production has declined by ~21 mkg (SI reported a lower y-o-y production in five out of the eight years under consideration), production from NI witnessed an increase of ~295 mkg (a 34% increase compared to CY2011).

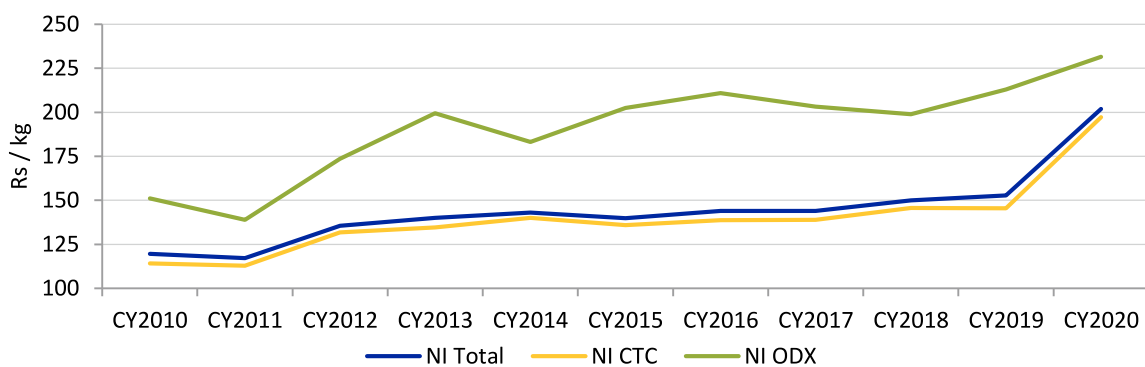
Y-o-Y Change in Production



Source: ICRA Research, Tea Board of India

The increase in production in NI teas has been mainly driven by higher production from the STG segment. Over the period CY2017 to CY2019, almost 80% of the increase in production was because of the STGs. Similarly, over the period CY2014 to CY2016, ~67% of the increase was driven by higher production through the Bought Leaf route. The proliferation in production from the STGs started from ~CY2010, when large established producers, faced with increasing cost pressures favoured augmenting the production from their own leaves and consequently bringing down the average cost of production, looked at this segment as a business model. However, over the years consistent increase in production from STGs has turned out to be detrimental for the large integrated players. The surfeit of teas, primarily of the plainer category, from the STG segment has led to pressure on auction averages, particularly of the CTC variety, since such CTC teas are largely consumed domestically, unlike ODX teas that are exported and hence subjected to stringent restrictions on use of pesticides and other agro-chemicals.

Average Prices at NI Auction Centres

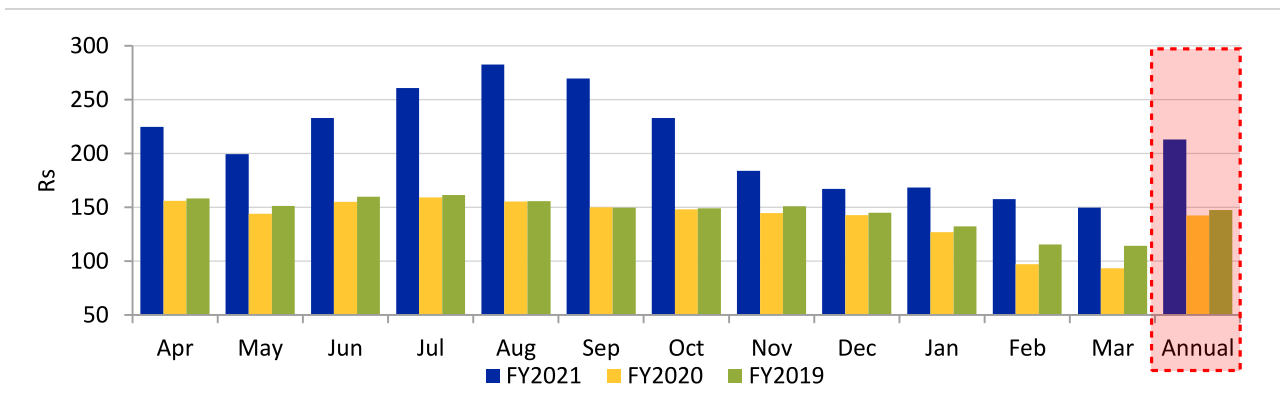


Source: ICRA Research

Even at low prices, the STGs, which supply the green leaves and bought leaf factories, which process such leaves to manufacture black tea, remain profitable because of their favourable cost structure compared to large integrated plantation companies. Given the numerous statutory and welfare requirements that a plantation company must fulfil in addition to better garden practices that needs to be followed, specially if catering to international clients, the cost structure of a large plantation company is significantly higher.

The fact that the domestic market is over-supplied has been further established by the sharp increase in prices witnessed in FY2021, given lower production in CY2020 – first due to restrictions due to Covid-19 and then adverse weather conditions in NI. During CY2020, overall NI production declined by ~137 mkg (11.7%); CTC production declined by ~ 102 mkg (9.7%), while ODX production by ~36 mkg (37.5%). While production was down, exports from NI also declined by ~ 29 mkg from NI. Out of this, ~18 Mkg was because of lower CTC exports. Hence, availability of NI CTC teas in the domestic market was lower by ~85 mkg (~8% of average production over the period CY2017-2019). A 8% lower availability led to a 50% increase in average prices for FY2021, with prices going as high as 80% (y-o-y) in the months of August and September.

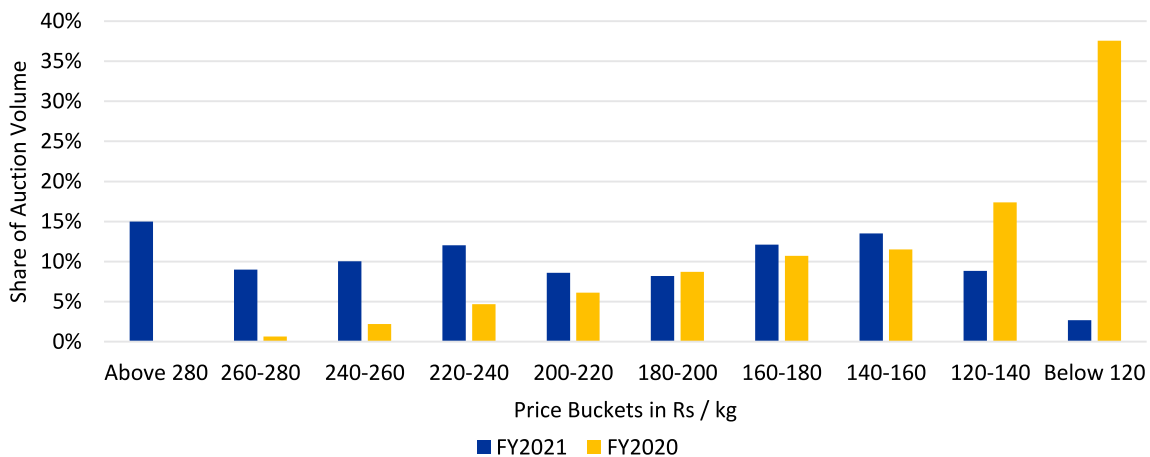
Monthly CTC Prices at NI Auctions
Auction Prices in Rs / kg



Source: ICRA Research

An analysis of auction sales reveal that 54% of CTC teas at NI auction centres were sold at a price higher than Rs 200 / kg in FY2021 (including 15% above Rs 280 as against nil in previous year), against only 14% in FY2020.

Percentage of NI CTC Teas sold in different Price Range



Source: ICRA Research, Parcon India

WAY FORWARD FOR THE NI BULK TEA INDUSTRY



WAY FORWARD FOR THE NI BULK TEA INDUSTRY

For the long-term sustainability of the NI bulk tea industry, tea prices should remain higher than the cost of production. That would ensure healthy yearly cash accruals, which the companies can employ to fund investments towards the upkeep of gardens and factories as well as future growth options. As seen in the previous sections, oversupply is the primary factor pushing down tea prices. For remunerative prices to sustain, the supply-demand situation needs to be corrected. As per estimates, before the onset of the Covid-19 pandemic, the domestic market was over supplied to the tune of ~ 100 mkg. Not only was there an oversupply situation, most of the incremental supply that had happened in the last 10 years was from the STGs. The cost of production of STGs is significantly lower than the plantation companies and hence that segment continues to perform relatively better than plantation companies in a scenario of depressed tea prices.

Against this backdrop, and as per opinions received by ICRA from various stakeholders in the NI bulk tea industry, the following factors are likely to emerge as key to ensuring the profitability of bulk tea players in the medium to long term:

Increase in volume and value of exports – India has traditionally concentrated on a select few markets to drive the bulk of the exports. For CTC teas, the major market for India has been the CIS region, accounting for 30-35% of the exports followed by the UK (7%) and the UAE (6%) for the period CY2016-2020. Pakistan used to be a major (~8% of CTC volumes) importer of CTC teas in the recent past, however, due to geo-political reasons the country did not import any tea from India in CY2020. For ODX teas, the CIS and Iran are the two largest customers accounting for ~30% and 12% of the total ODX teas exported over the last five years. India needs to expand its export base, particularly in countries where it has limited presence.

Export Potential – a comparison of cumulative exports to some select countries over last 5 years by India vis-a-vis Kenya / Sri Lanka

Primarily CTC Teas											
Importing Country	Country	Egypt		Afghanistan		Sudan		Pakistan		Yemen	
Exporting Country	Country	Kenya	India	Kenya	India	Kenya	India	Kenya	India	Kenya	India
Cumulative Exports Volume	Mkg	334	29	66	4	92	N/A	645	46	58	0
Cumulative Exports Value	\$ Million	808	60	195	11	190	N/A	1830	65	188	0
Average Export Price	\$ / kg	2.42	2.02	2.98	2.68	2.06	N/A	2.84	1.41	3.23	2.66
Primarily ODX Teas											
Importing Country	Country	Turkey		Iraq		Libya		Syria		Chile	
Exporting Country	Country	SL	India	SL	India	SL	India	SL	India	SL	India
Cumulative Exports Volume	Mkg	178	6	178	10	58	N/A	50	N/A	38	N/A
Cumulative Exports Value	\$ Million	773	14	596	20	228	N/A	251	N/A	150	N/A
Average Export Price	\$ / kg	4.33	2.41	3.35	1.95	3.93	N/A	5.00	N/A	3.95	N/A

Source: ICRA Research

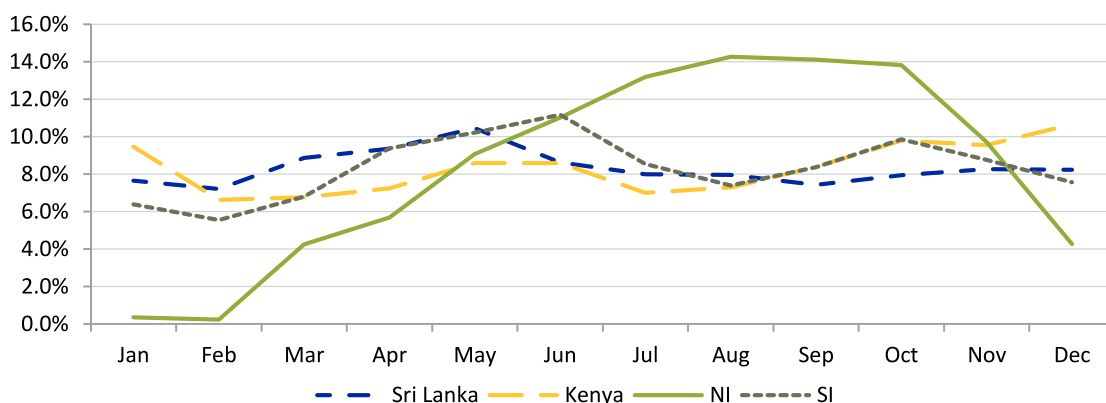
Also, for exports to traditional geographies, there seems to be a scope to supply better quality teas, thus increasing the average price of exports. In addition, exports in value added forms like packets / tea bags, would also support the average prices. Sri Lanka for instance exports 55% of its tea in the value-added forms against only ~ 10% by India.

Increase in the level of domestic consumption; awareness of quality of teas – Although India is the 2nd largest consumer of tea in the world, the per capita consumption remains relatively low, at around 0.8 kg. To increase per capita consumption, a lot of generic marketing activities may be required. Apart from the thrust on increasing per head consumption, efforts may also be taken to increase awareness amongst the consumers about the quality of teas that they consume - awareness on quality, sustainable sourcing of teas, use of quality agro-chemicals and maximum concentration of pesticide residue (MRL). Registration of brands and labels of packet teas and certification of the same, on quality and MRL by an independent recognised body, could have a positive impact on the demand of quality teas produced by the plantation companies.

Meeting changing preferences of end customer directly with value-added products – In the entire value chain of tea production and retailing, the plantation companies enjoy the least profits while carrying the maximum risks. A direct connect with the end consumer, with offerings of teas in value-added form, particularly in packets and tea bags, may help in addressing this issue of disproportionate risk-return for the bulk tea producers. The industry would also need to tweak their production strategy and invest in infrastructure to meet the changing consumption patterns. There is an increasing preference for green teas and other non-black teas as well as black teas infused with fruits and herbals. The demand growth of such teas is considerably higher, albeit on a small base, than growth in demand for traditional black tea.

Concentration on quality; control volume and quality of end season teas – A focus on improving the quality of their produce is of paramount importance to bulk tea players. Adoption of better garden practices would not only improve quality, thus resulting in better prices, but also introduce a check on production, thus limiting the extent of oversupply. One of the characteristics of the NI bulk tea industry is the seasonality in production – both in terms of quality as well as production volume. The best quality teas are produced during the initial period of the season, till around June after which the quality tapers off as production volume reaches its peak in the months of July to October. Such very high level of seasonality is not faced by any other major black tea-producing region as shown in the chart below.

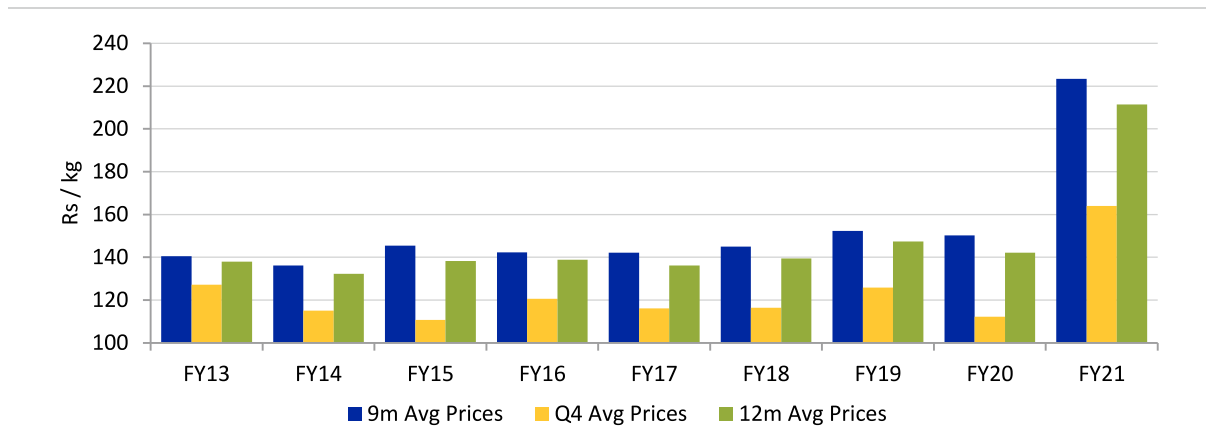
Monthly Production as a % of Annual for Different Regions



Source: ICRA Research

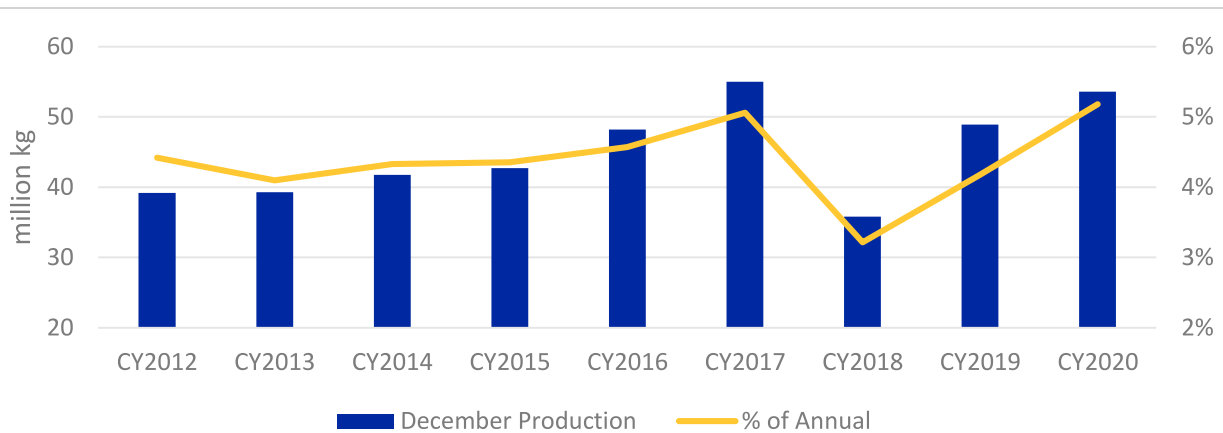
End-season teas produced in November and December are of particularly poor-quality fetching very low prices in the auction. Average auction realisations of CTC teas in NI auctions during Q4 (January to March) of a financial year drop by around 20-25% from the average levels witnessed during the first nine months (April to December). Average prices in Q4 have been as low as Rs 110 – 115 per kg in the past, down by ~25% from the average of 9m and substantially lower than the average cost of production, leading to large losses reported by the industry in Q4 of a financial year. It was only in FY2021, on the back of a 12% lower production during CY2020, that prices averaged at ~ Rs 165 per kg in Q4, a somewhat respectable range, compared to the cost of production.

Impact of Prices of End Season Teas on Annual Averages



Keeping the impact of such low-quality teas on average prices in mind, the TBI has introduced a policy to restrict production in the month of December. Strict implementation of such policy would further support restoring the supply-demand situation going forward. As per historical trends, on an average ~45 mkg (~4.5% of annual) of teas are produced in the month of December.

December Production



Source: ICRA Research, Tea Board of India

Early closure of production, say by November-end, would not only reduce the excess supply substantially. Tea companies undertake substantial expenditure during the period January and February period, including pruning of tea bushes, which is critical to maintain the quality of the gardens. Historically, plantation companies typically pruned ~50% of the area under mature tea cultivation; however, in the recent past only ~30% is pruned. Higher unpruned area not only impacts the quality of teas, but also results in higher production – thus impacting prices. The plantation companies have gradually adopted this strategy to reduce the per kg cost – with wages and other costs going up, higher production leads to lower per kg costs. However, this has turned out to be detrimental for the industry in terms of oversupply in the market.

Calibrated increase in ODX production – Globally ODX production (except from China) has stagnated over the last decade. Production from Sri Lanka, India's main competitor in the world market, has witnessed a decline in recent years. This gives an opportunity for India to produce and export higher volume of ODX. Increase in ODX production would take away some of the CTC oversupply too. However, such an increase has to be calibrated as an oversupply of ODX teas would result in a sharp drop in ODX prices – a phenomenon that was witnessed in CY2019 / FY2020, wherein ODX prices were substantially higher during the initial period but crashed towards the latter half as production witnessed a sharp increase (41% increase in ODX production from NI).

Auction the preferred route for sale of teas – At present, only around 40-42% of the total production of NI is sold through auctions; this is significantly lower than that in Kenya and Sri Lanka, where almost all tea is routed through the auctions. The primary factor which makes auction less attractive to sellers is the high turnaround time – from production to realisation of money after conclusion of sale. The current system results in higher working capital requirements for producers, compared to private sales as it typically takes around six to eight weeks from production of teas to realisation of sale proceeds in the auctions. Also, sellers are apprehensive that the mechanism may not be yielding the desired result of optimal price discovery. The TBI, had, a few years ago, come out with a directive to producers to route at least 50% of their produce through the auctions. However, the same is yet to be reached. In fact, the TBI in a recent publication has highlighted that several producers have routed an insignificant part of their produce through the auction route. However, to achieve the desired level of 50%, the current auction infrastructure would need to be augmented substantially to handle the increase in volumes. Also, strictly enforcing the 50% target on producers without indicating a corresponding level for the buyers may lead to an undesired outcome of higher availability of teas in the auction thus depressing prices. Routing of higher volume of teas through the auction, along with necessary changes to the auction process to make it more attractive to both sellers and buyers, may not only lead to “better” price discovery but would give an opportunity to evaluate teas on various parameters, including MRL levels, and accordingly certify the teas and the producers. Specific standards on quality may be established, and only teas passing the filter criteria may be allowed to be sold through the auction. In addition, implementing a minimum reserve price, in line with what Kenya has recently adopted, commensurate with the quality, may be explored.

Implementation of wage code for small growers and a minimum sale price for green leaf – As per larger plantation companies, one of the primary challenges facing them is the significant difference in the cost of production of leaf from their own gardens via-a-vis the price at which green leaf from the small growers is available in the market. The difference has been in the range of Rs 10 to 12 per kg of leaf, which translates to ~Rs 45 to 55 per kg of made tea, a substantial difference, given that the average CTC prices have been around the Rs 140 per kg mark in the past (before CY2020). The differential cost is primarily because of the large expenses that the plantation companies must bear towards housing, welfare and other statutory requirements, apart from wages, as per the Plantation Labour Act – which the small tea growers are not subjected to. Implementation of a wage code, which will factor in the all-inclusive cost of similar labour for a plantation company, for the small growers would have some impact in correcting the significant difference in the cost of production. It would also help in vastly improving the earnings of such workers who do not enjoy similar benefits as their counterparts in a plantation. Also, implementation of such a wage code may be accompanied by the introduction of a minimum price of green leaves – benchmarked against the average auction prices of teas from that particular district, with necessary adjustments for quality. This would ensure adequate earnings for the STGs. The TBI has recently come out with a communication towards introduction of minimum prices of green leaf, however, implementation of the same remains to be seen.

Greater financial support - The bulk tea industry has been reeling under the impact of higher costs and stagnant prices in recent times (except FY2021). In the opinion of the industry, given the financial condition of players, it would require funding support if it has to undertake marketing expenses to increase exports and domestic consumption. Any increase in export benefits, to support export volumes would be beneficial to the industry. Sri Lanka has been able to maintain a high export volume, when average realisations



remained range bound and the cost of production in the island country has increased over the years, primarily on account of support from the Government. Apart from any higher export subsidy, accessibility to working capital facilities at competitive rates may also boost exports. The cyclicity of the NI bulk tea industry results in high working capital requirements for the industry – particularly exports, since the buyers typically require a staggered delivery throughout the year, whereas the bulk of the production (~50%) happens in the four months between June and September. Higher level of subsidy aside, timely receipt of the same and other types of subsidies, would also be important.

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Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
+91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: Jayantac@icraindia.com
Tel: +91 80 4332 6401 / +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: Communications@icraindia.com
Tel: +91 124 4545 860

Registered Office

B-710, Statesman House 148,
Barakhamba Road
New Delhi-110001
Tel: +91 11 23357940-45

Corporate Office

Building No. 8, 2nd Floor,
Tower A, DLF Cyber City, Phase II,
Gurgaon - 122 002
Tel: +91-124-4545300

Ahmedabad

1809-1811, Shapath V,
Opp: Karnavati Club,
S.G.Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/501

Bengaluru 1

'The Millenia', Tower B Unit No. 1004,
10th Floor, 1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

4th Floor, 'Shoban'
6-3-927/A&B, Somajiguda
Raj Bhavan Road,
Hyderabad - 500 082
Tel: +91 40 4067 6500

Hyderabad 2

No. 7-1-58, 301, 3rd Floor, 'Concourse',
Above SBI-HPS Branch, Amierpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata - 700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony, S. No. 210
CTS 3202 Range Hills Road,
Shivajinagar, Pune - 411 020
Tel: +91 20 2556 1194

Email: Info@icraindia.com

Helpdesk: 9354738909

Website: www.icra.in/ www.lcraesearch.in

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HEAD OFFICE

4th Floor, YMCA Cultural Centre and Library Building,
01, Jai Singh Road, New Delhi 110001
Tel: 011-46550555 (Hunting Line), Fax: 011-23347008/09
Email: assochem@nic.in

REGIONAL OFFICE BANGALORE

Ms. Uma Shashi Nair, Regional Director
#F1, First Floor, Richmond Plaza,
No. 10 & 10/1, Raja Ram Mohan Roy Road
Bengaluru – 560 025
PH: +91 80 4113 2467 / 4113 1891 / 4113 4838
Mb : 9036333975
Email: umasnair@assochem.com
secretariat.kar@assochem.com

WESTERN REGION OFFICE

Mr. Vipul Gajingwar, Regional Head
608, 6th Floor, SAKAR III
Opposite Old High Court
Income Tax Cross Road, Ashram Road,
Ahmedabad- 380014
Gujarat, India.
Tel: 079-2754 1728-29/2754 1876
Mb : 8010472950
Email: Vipul.bg@assochem.com

REGIONAL OFFICE, NORTHERN REGION

Mr. Gourav Mahajan, Regional Director
SCO: 55, 56, 57, II Floor
Sector- 8C, Madhya Marg, Chandigarh- 160008
Phone: 0172-4800855, 4800865, Mb : 9876438111
Email : gourav.mahajan@assochem.com

REGIONAL OFFICE, J&K

Mr. Amit Khajuria, Asst. Director & Nodal Officer
SHREE TOYOTA, Batra Group Complex,
Milestone Zero, Narwal Bala,
Jammu - 180001, India.
Mb : +91 9419238684
Email : amit.khajuria@assochem.com

REGIONAL OFFICE RANCHI

Mr Bharat Kumar Jaiswal, Regional Director
503/D, Mandir Marg-C
Ashok Nagar Ranchi-834 002
Tel: 0651- 2242443
Mb : +91 9971047550
Email: bharat.jaiswal@assochem.com,
ranchioffice@assochem.com

EASTERN REGIONAL HEAD QUARTER

Mrs. Perminder Jeet Kaur, Regional Director
5th Floor, Sahaj Building, Tangra Industrial Area II,
45, Radhanath Chowdhury Road, Kolkata 700 015, West Bengal,
E-mail : perminder.kaur@assochem.com, kolkata@assochem.com,
M: 9674312234

ODISHA CHAPTER OFFICE

Visa House, 11, Ekamra Kanan, Nayapalli, Bhubaneswar 751015, Odisha

NORTH EAST REGION OFFICE

Meghalaya Cements Ltd. Mega Plaza, 4th Floor, G.S. Road,
Guwahati 781005, Assam
www.assochem.org