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Tea companies may see their profitability rise marginally in FY20

SHOBHA ROY

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There might be a marginal improvement in the profitability of domestic tea producers in FY20, primarily on the back of an improvement in orthodox tea prices and input costs remaining soft.

However, wage rates would play an important role in determining their profitability in FY21.

There has been no wage revision so far in FY20 – the last one happened in March 2018. While there is little possibility of a wage revision happening anytime this fiscal, the industry does not rule out the possibility of one in FY21.

Wage costs account for 60-70 per cent of the total cost of the organised sector. While fixed costs for the tea plantation sector have increased by close to 45 per cent (largely on account of increase in labour wages), the price realisation has increased only by about 17 per cent in the past three years.

A majority of tea producers saw their profit margins squeezed in FY19 primarily due to a steep increase in costs. McLeod Russel, once considered the country's largest bulk tea producer, saw its net profit margin (NPM) fall to -0.34 per cent in FY19, compared to 4.21 per cent in FY18.

Wage rates will play a big role in determining profitability

Goodricke saw its NPM decline to 1.27 per cent in 2019, against 4.34 per cent in FY18. Jay Shree Tea's NPM came down to 0.55 per cent (0.61 per cent) while Warren Tea's NPM declined to (-13.43 per cent) (-6.63 per cent).

"While wage rates have remained stable over the last one year, any improvement in profitability (of tea companies) will be constrained by (just a) marginal increase in overall tea prices," Kaushik Das, Vice-President and Sector Head, Corporate Sector Ratings, ICRA, told *BusinessLine*. "However, players with a high proportion of orthodox tea are likely to fare better. In FY21, however, wage rates will be the single most important factor in determining the profitability of tea companies."

Trouble brewing

The tea industry has been going through rather difficult times with cost outstripping price realisation. Most companies are cash starved and have been facing issues on the profitability front. The deteriorating financial health of most tea companies is visible from the fact that most, barring one or two large tea producers, have been downgraded in the last 12-15 months.

Companies have been resorting to the sale of estates and other assets to pare debt and strengthen their financial position. McLeod Russel has sold around 19 out of 52 estates to keep itself afloat; Warren Tea has signed an MoU with Swananda Tea Pvt Ltd for disposing of its Sealkotee Tea estate in Assam. Jay Shree Tea has entered into a definitive agreement with Grand Lacs Trading SA, Belgium, to sell its stake in two of its tea estates in East Africa.

Scan & Share

Higher production, lower prices

The industry is pinning its hopes on a fair increase in prices to stay afloat. However, the steady rise in production, primarily coming in from small tea growers (almost 50 per cent of total production) and the demand not keeping pace with supply are proving to be major challenges.

"Prices have not increased; costs will rise every year and it is only natural given the inflation but unless prices go up it is going to be very difficult for the industry," said Vivek Goenka, Chairman, Indian Tea Association.

According to data available on the Tea Board of India website, the country's tea production in April-November 2019 rose around 28 million kg (mkg) to 1,219.05 mkg, against 1,190.91 mkg in the previous-year period.

The industry expects production to be higher by around 40 mkg this year, the bulk of it coming in from small growers. Higher production would mean more carryover stock, which again could have an impact on prices. The average price of tea at auctions is ruling slightly lower at around ₹156.49/kg this year, compared with ₹156.60/kg last year. While average orthodox prices are ruling high at around ₹219/kg this year as compared to ₹214/kg last year, CTC dust prices are hovering around ₹149/kg (₹152/kg).

Export demand

The price rise in orthodox tea was mainly on the back of a steady demand from Iran. India witnessed an 84 per cent surge in tea exports to Iran to 50.43 mkg in January-November 2019, compared to 27.41 mkg in the same period in 2018. The total value of exports rose 106 per cent to ₹1,389.36 crore during the period (₹674.66 crore).

While there is some uncertainty over India's trade ties with Iran due to escalating tension between that country and the US, industry expects tea exports to continue.

"For us it has been business as usual, our shipments are going and payments are coming in. There is a lot of demand (from Iran) in the pipeline, as long as the political and financial situation holds up we feel it should be ok," said Anshuman Kanoria, Chairman, Indian Tea Exporters Association.