



Goodricke Group Limited

Tea as an industry: - After 5 years of sluggishness in tea industry which has led to distress among large as well as small tea players, I believe tea is ripe for an upturn in this season that begun in march 2018. We last saw this in 2008 and 2009 where tea prices jumped 30 and 21% respectively.

This is further supported by crop failure in the month of September that led to lower production of 44 million Kg as compared to the last year. Globally major tea exporting nations like Kenya had lower crop during 2017 leading to 30% rise in price already.

India tea prices have remained stagnant since 2012

Year	2012	2013	2014	2015	2016	2017*
Avg Realization	137.2	142.3	144.8	142.0	143.9	140-150

Source: Tea Board of India, Indian Tea Association

The single largest cost component in tea cultivation is labour as plucking tea leaves is a highly labour intensive operation. During the last 5 years while the labour costs and operating costs have gone up at a compounded rate of 10%, the tea prices have stayed flat compressing the margins of tea cultivators.

Here's a quick look at the P&L statement of the industry leader McLeod Russel, world's largest tea cultivator, operating over 1 lac acres.

McLeod Russel	FY12	FY13	FY14	FY15	FY16	FY17
Avg Realization per kg (Rs)	149.6	171.0	167.6	172.4	174.0	163.2
Operating cost per kg (Rs)	102.6	126.3	128.0	138.2	149.6	152.7
Operating Margins (%)	29.8	24.9	22.2	10.6	13.5	15.7
Net Profit (Rs Cr)	294.3	282.2	262.4	34.1	35.1	64.4



The net profitability is down to almost 1/5th in the last 5 years.

I believe that tea prices are expected to resume the upward trajectory on account of the following reasons.

1) The industry is in distress with many smaller estates and could soon start facing trouble in clearing the labour dues. A study of tea prices shows that instead of going up in a steady way the tea prices generally remain flat for 4-5 years and then jump steeply for a year or two.

2) Lower supply :- Production in most large tea producing regions Including India and Kenya has been lower in 2017 implying carry forward inventory would be much lower as we enter 2018.

3) Rising demand: - India historically has witnessed an annual demand rise of 3% (30 million kg). It is the marginal demand and supply that affect tea prices, and both turned favourable in 2017 helping the tea price rise by 5-7%.

India Qty. (mn kg)	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
2016	17.95	17.13	70.7	68.64	102.47	147.15	150.53	158.7	190	151.15	128.94
2017	19.16	13.59	56.16	89.89	121.33	143.02	155.59	167.98	145.83	177.32	118.9
Difference	1.21	-3.54	-14.54	21.25	18.86	-4.13	5.06	9.28	-44.17	26.17	-10.04

Till August 2017, India was ahead of last year production by 33 million Kg, however during September the production fell by 44 million Kg which was partly covered in October but slipped again in November implying overall similar production level as in 2016.

Annual incremental demand in India is about 30 million Kg to which there could be a shortfall. On global front the Kenyan crop has been down by 50 million Kg. Similarly other tea producing geographies have also recorded less production except Sri-Lanka where production is up by 10 million Kg.

Assuming a 2-2.5% incremental demand globally, there could be a supply deficit of around 150 million Kg around the world. This deficit has started reflecting in the latest price realizations across the key-markets in year of 2017. Sri-Lankan tea crop fetched realizations of 4.06\$/kg against 3.10\$/kg in the last year. Kenyan crop realization was around 2.99\$ against 2.32\$ in the previous year.



Operating Leverage At Play

Particulars	Goodricke			Mcleod Russel		
	CY07	CY09	CAGR(2 yr)	FY08	FY10	CAGR(2 yr)
Total Production (mn kg)	21.2	20	(2.5%)	74.4	81.6	4.5%
Price Realization (Rs/kg)	112	186	29%	87.2	137.3	25%
Net Sales (Rs Cr)	237	371	25.3%	653.2	1106.2	30%
Total Operating Cost (Rs Cr)	221	320	20.4%	586.4	774.6	15%
EBITDA (Rs Cr)	16	51	80.3%	128.1	385.2	73%
Net Profit	7.7	41.9	133%	46.4	231	123%

Operating tea estates is a largely a fixed costs business, hence when realization goes up, everything flows to the bottom line.

In previous upcycle of 2008 and 2009 when the tea price went up by 30 and 21% respectively, Tea players reported steep jump in profitability.

Understanding Seasonality!

Tea grows in moderately hot and humid climate, which is preferred for better yield, crop distribution and quality. A temperature within 18-32 is conducive for tea growth.

In India the temperature in winters is around or below 12 and there is hardly any growth during this period. Hence quarter 4 is always is loss making quarter with sales not enough to even cover the wages.

Why Goodricke group?

I prefer the Goodricke group over its peers mainly because of its fully integrated business model and the resilience shown even during the on-going lul since 2012. Even after such a slowdown in the industry Goodricke group has a healthy balance sheet – debt free and surplus cash of 20+ crores.

Company	M Cap ^ (Rs Cr)	Estates	Tea area (Hectares)	Production (Mn kg)	Exports (Mn kg)	Revenue (Rs Cr)	Realization (per kg)	Promoter Holding (%)	Debt- equity (x)
McLeod Russel	1,977	64	39,603	115.3	15.4	1,926	163.2	40.8	0.5
Goodricke	877	17	9,705	22*	5.6	680	360	74	0
Dhunseri Tea	300	12	7,200	20	N/A	301	176.5	66.3	0.8
Rossell India	434	7	3,000	5.8	0.9	108	198.3	74.7	0.5
Jay Shree Tea	300	21	NA	22.3*	~2	751	161.2	56.4	1.7
Warren Tea	145	7	NA	6.1	-	110	NA	74.9	0.24
Andrew Yule & Co.	1,780	15	NA	12	-	423	NA	89.25	0.2

McLeod Russel I being the largest globally with 39000 hectares of tea estates may provide a better delta, however I am not comfortable with the management as there have been lapses in terms of corporate governance. As on September 17 the company had about 1688 crore of debt on its balance sheet, majority of which is directed towards struggling group like McNally Bharat. Furthermore the company sold 9% of equity in open markets at depressed valuation just to deleverage their balance sheet.

In a cyclical and commoditized industry, leveraging balance sheet is extremely risky. While Dhanuseri has debt, others like Jayshree and Rossell are di-worsified into unrelated business.

In case of Goodricke we find a robust debt free balance sheet with a clean management, all available at a cheap valuation. If all plays out well delta may be less as compared to some of the peers but the if in case the lull continues the downside is also protected as against its peers with leveraged balance sheet.

The way forward?

As per the industry, based on the projected demand and supply for tea the prices should increase anywhere between 20-50 Rs per Kg for black tea, where the current realization is 130-150 Rs per Kg. If such a large percentage jump materializes, I expect Goodricke's profitability to jump substantially.

While their B2C business shields margins during the lull periods, their bulk tea business (70%) quickly captures the delta of higher realizations during an up cycle.



Risks and Concerns

- 1) Delay in revival of up cycle.
- 2) Wage hike in 2018 without the hike in tea prices.
- 3) Counter with very low liquidity and only listed on BSE.

Technical triggers

We recommend to buy the stock at current levels (CMP 338) and add on each decline till 275 levels (if it drops). Suggested buying range 275-350 levels.

One can allocate around 10% of his/her portfolio to this stock in the given buying range.

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