

# INDIAN BASMATI RICE INDUSTRY

Industry facing headwinds; weak demand and oversupply keep players under stress;  
some revival expected in FY2017

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### Executive Summary

Rice is one of the most crucial food crops in the world and a staple diet for nearly half the global population. Over 90% of the global rice output and consumption is centred in Asia, wherein the world's largest rice producers, China and India, are also the world's largest rice consumers. High domestic consumption and restrictive trade policies of several countries for rice have restricted international trade of rice to only 6-7% of the production. Food security objectives and the need to provide income support to domestic producers are the main reasons cited by countries to restrict rice imports. Among the several varieties of rice, basmati rice is considered the most superior in terms of product characteristics and therefore the most premium. The Indian rice industry consists of both basmati rice and non-basmati rice; however this note covers only the basmati rice industry in India.

### Industry Preview

- i. Basmati rice, considered the finest variety of rice, is grown only once a year in the Indo-Gangetic plain. It is a *kharif* crop sowed in May-June and harvested in October-November. Basmati rice can only be cultivated in India and Pakistan, which makes them the sole supplier of basmati in the world. India accounts for over 70% of the world's basmati rice production.
- ii. Basmati rice constitutes a small portion of the total rice produced in India. By volume, the share of basmati rice is around 6% (as of 2014-15), even as by value, basmati rice exports account for 57% (as of 2014-15) of India's total rice exports. Basmati rice exports have increased at a compounded annual growth rate (CAGR) of 27% from Rs. 28.24 billion in 2004-05 to Rs. 275.98 billion in 2014-15. The proportion of basmati rice exports in India's total exports has increased from around 0.6% to around 1.3% during the last one decade.
- iii. During the last two decades, evolved varieties of basmati rice have been adopted by the industry, especially PUSA 1121, which has led to a significant improvement in yield and hence the overall production of basmati rice in the country. Moreover, this variety has significantly replaced the traditional varieties of basmati rice. Today PUSA 1121 accounts for most of basmati rice production and exports. Apart from PUSA 1121, a new variety PUSA 1509 has been approved, which has better yield, low input requirements and better disease resistance; however its acceptance by the industry is yet to be established.
- iv. While basmati rice is consumed across the globe, West Asian countries account for most of the imports (75% of Indian basmati rice exports in 2014-15). Within West Asia, Iran and Saudi Arabia are the two largest buyers, together accounting for over 50% of basmati rice exports from India. However, even as Iran emerged as one of the largest importers of basmati rice in recent years (largest share of 37% in 2013-14), the country imposed a ban on basmati rice imports from India in 2014-15, citing its own healthy rice crop and large basmati inventory. The ban led to a decline in Iran's proportion of total exports from India from 37% in 2013-14 to 24% in 2014-15 and the trend continued in first half of 2015-16. The ban has been removed in November 2015 and exports to Iran are likely to pick up, going forward.

### Key Risk Factors for the Industry

- v. As in the case of other agricultural commodities, basmati paddy is also vulnerable to cyclical price fluctuations. Higher prices in the market encourage higher basmati paddy cultivation, which increases supply in the next season. This depresses the price, thereby erasing gains and shifting farmers away from basmati paddy cultivation. Consequently, supply declines and prices go up, restarting the cycle.
- vi. Basmati paddy prices are driven also by the anticipated international demand. During the procurement season of 2012-13 & 2013-14, there was a steep increase in paddy prices (from around Rs. 18,000 per metric tonne (MT) in 2011-12 to around Rs. 37,000/MT in 2013-14), given the strong demand in the international market. This made farmers shift to basmati paddy cultivation, which increased supply in 2014-15, thereby leading to a decline in prices. Moreover, demand too witnessed a sharp decline in 2014-15 as Iran imposed a ban on import of Indian basmati. This led to a correction in paddy prices to around Rs. 22,000/MT in 2014-15 and further to around Rs. 20,000/MT in 2015-16.
- vii. Movement in basmati paddy prices impacts basmati rice realisations, but the transition happens with a lag. This is because a sizeable portion of paddy is aged for a few months before being milled and sold. Apart from input prices, basmati rice prices are also impacted by variations in demand, especially in the international market, given that most of the production is exported. This makes it vulnerable to economic cycles, political developments and regulatory changes in the importing nations as well. Increased demand in the market especially given the increased buying by Iran pushed Indian basmati rice export realisations to an all-time high of Rs. 77,988/MT in 2013-14. However, during 2014-15, the industry witnessed a significant decline in demand following the Iranian ban. This in turn led to a decline of around 25-30% in basmati rice realisations in 2015-16.
- viii. While the international market remains the mainstay of the Indian basmati rice industry, the domestic market too has reported increasing consumption over the last few years. This has been on account of rising disposable incomes of consumers and increasing aspiration for premium products.
- ix. Till a few years ago, the basmati rice industry was dominated by unbranded rice sales in both the domestic and export markets. However, over the last few years the industry has gone for branding and started selling basmati rice under various brand names. Brands help sellers command premium pricing, improve profitability and provide some cushion against adverse movement in prices. The trend of selling under brands is more dominant in the domestic market as the growth of modern retail and increasing purchasing power of consumers favour branded players. Some of the dominant brands in the domestic market are *India Gate, Daawat, Kohinoor, Amira, Best, and Aeroplane*.
- x. The millers or processors require to stock sizeable volumes of inventory for ageing and to assure supply of raw material for the full year. Thus in case of rising scale of operations the players need to fund increasing working capital requirements continually. Most of this funding comes from working capital borrowings from banks, which links the industry players' growth prospects to the availability of bank funds.
- xi. The inventory procured and processed by the players consists of different qualities and grades of paddy and rice. This makes inventory valuation a complex exercise and leaves room for misreporting for larger bank funding. Apart from this, the volume of inventory itself makes it difficult to judge the appropriateness of valuation by the management. Further, since most of the industry is in the unorganised sector, the risk of poor corporate governance persists.

- xii. Usually, agro commodities face significant government intervention in various forms, covering aspects such as supply and prices of seeds, incentives or disincentives for particular crops, minimum support price for final output, and export and import. However, basmati being a premium variety of rice and accounting for a small portion of domestic rice consumption, it is largely free of government intervention.
- xiii. The Indian basmati rice industry is characterized by a few large and established players and a large number of small to medium sized participants. There are only a handful of players exporting basmati rice under their own brands. The big basmati rice players are at a competitive advantage against their smaller counterparts, given the high working capital intensive nature of the industry, high competitive intensity in the industry, and the risks related to export markets, viz. foreign exchange risk and credit risk.

### Consolidated Financial Analysis

- xiv. The industry has reported steady growth in its revenues till 2013-14 given the rising demand in the market leading to high volume of sales and high realizations. However 2014-15 industry witnessed decline in demand following the ban imposed by Iran on import of rice. Consequently Indian basmati rice industry reported decline in value of sales in 2014-15.
- xv. The industry remains vulnerable to inventory price risk given sizeable stock levels of the players. As witnessed in 2014-15 weakness in demand led to correction in prices which impacted the inventory positions of the players and hence their profitability. The decline in profitability and industry's inability to liquidate its sizeable stocks resulted in increased working capital borrowings. Thus the industry reported increase in leverage and weakness in coverage metrics in 2014-15. The significant impact was witnessed in quarter ending March 2015 when the sales did not grow (unlike same quarters in previous years) and profitability & hence interest coverage declined significantly. This was largely driven by decline in realisations in the aftermath of ban imposed by Iran on import of rice. Further as reflected in the first three quarters of 2015-16, the pressure on revenue and profitability is expected to continue in the near term.

### Outlook

The current scenario of excess supply (weak demand) is expected to continue in the near term and exporters are likely to continue facing financial stress in the near term. Weak sales growth and decline in profitability, along with inventory losses, are expected to be the key trends in the financials (to be reported) of basmati rice players in 2015-16. This is expected to further weaken the leverage profile of industry players. Any improvement in the situation is likely only from the next basmati paddy harvest season, that is, the second half of 2016-17. In the meantime, supply of basmati paddy is expected to witness some moderation as farmers are likely to shift away from basmati, given the non-remunerative prices in the last two crop cycles. Moreover, since Iran has removed the ban on import of rice, demand is also expected to witness some improvement, going forward.

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