

# INDIAN BASMATI RICE INDUSTRY

Lower volume and stable international demand should push up Basmati realisations;  
demonetisation to have moderate short-term impact on paddy procurement

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## Contacts

**Sabyasachi Majumdar**

+91 124 4545 304

[sabyasachi@icraindia.com](mailto:sabyasachi@icraindia.com)

**Harsh Jagnani**

+91 124 4545 394

[harshj@icraindia.com](mailto:harshj@icraindia.com)

**Sachin Sachdeva**

+91 124 4545 307

[sachin.sachdeva@icraindia.com](mailto:sachin.sachdeva@icraindia.com)

**Deepak Jotwani**

+91 124 4545 870

[deepak.jotwani@icraindia.com](mailto:deepak.jotwani@icraindia.com)

### 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 the 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 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.

Basmati rice constitutes a small portion of the total rice produced in India. By volume, the share of Basmati in total rice production is around 6% (as of FY2016), but by value, Basmati exports account for 60% (as of FY2016) of India's total rice exports and its exports have increased at a compounded annual growth rate (CAGR) of 13% from Rs. 10,890 crore in FY2010 to Rs. 22,718 crore in FY2016. The proportion of Basmati export in India's total exports was at around 1.3% in FY2016 and it remains an important constituent of the Indian export basket.

### Key Industry Updates

- i. Basmati paddy prices have witnessed significant decline in FY2015 and FY2016, thereby rendering cultivation of basmati paddy a less attractive option for farmers. Hence, there has been some shift out of Basmati paddy cultivation in the current year. The total area under cultivation is expected to have fallen from around 2.1 million hectares in FY2016 to 1.6 million hectares in the FY2017 resulting in a production decline from around 9.8 million tonnes to around 8.0 million tonnes during the same period.
- ii. On the demand side, Basmati rice has witnessed largely steady/growing demand in the domestic market for the last few years. The international demand, though, has remained weak for the last two years; it is expected to witness some uptick from H2 FY2017. Given the subdued demand till FY2016, the basmati rice export realisations declined from Rs. 77,988/MT in FY2014 to Rs. 56,149/MT in FY2016. However, during Q1 FY2017 there has been a slight recovery in export realisations and the same has improved to Rs. 59,247/MT.
- iii. The Director General of Foreign Trade (DGFT) has banned the use of documents against acceptance (DA – arrangement of shipping goods to importer on unsecured credit) from October 1, 2016 onwards in the trade associated with the shipment of long-grained aromatic rice. This has been done to protect the small exporters who were selling basmati rice under this arrangement of unsecured credit and facing disputes about settlement of payment with importers. Curbing sales against DA is favourable for the industry as it would ease competition amongst the exporters. However, this may result in some buyers shifting to large organised players as the advantage of unsecured credit, provided by small exporters would not be available any longer.
- iv. On November 8, 2016, the Government of India (GoI) announced demonetisation of Rs 500 and 1000 currency notes, making these notes invalid from November 9, 2016. This has resulted in a significant cash crunch, thereby leading to deferment of paddy procurement by millers/traders. Further, given that a large part of the rice industry is unorganised, many buyers may witness reduction in their buying capacity. Overall, there is expected to be some contraction in paddy demand in the near term, which could exert pressure on prices. Also, given the temporary reduction in purchasing power of the end users, the rice demand is expected to

slacken, which would translate into lower realisations. The organised Basmati rice players generate approximately 45% of revenues from domestic sales and this segment is likely to witness lower revenues in H2 FY2017. The long-term impact of the demonetisation exercise is likely to be transformational in nature by making more farmers adopt formal banking channels for transactions.

- v. 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. Almost a decade after the development of PUSA-1121 another hybrid variety – PUSA-1509 was developed. This variety promised better yield, lower input requirements and higher disease resistance. However, the market acceptance for this variety remained weak as it was unable to garner much recognition in the export market.
- vi. While Basmati rice is consumed across the globe, West Asian countries account for most of the imports (around 75% of Indian Basmati rice exports in FY2016). Within West Asia, Iran and Saudi Arabia are the two largest buyers, together accounting for over 50% of Basmati rice exports from India. Till two years back, Iran had emerged as the largest buyer of Basmati rice from India, however, given the significant stock accumulation and healthy domestic crop, Iran imposed a ban on import of rice in November 2014. This impacted the overall export demand from Iran in FY2015 and FY2016. As a result, Saudi Arabia regained its position as the largest importer of Indian Basmati rice.
- vii. ICRA expects the volume sales in FY2017 to be around 3.99 million MT (almost similar to the volume exported in FY2016). However some improvement in realisations is expected to push the values of exports to around Rs. 23,000 crore in FY2017. For FY2018, ICRA estimates the volume and value of exports to be around 4.03 million MT and Rs. 25,800 crore respectively.

### Consolidated Financial Analysis

- viii. The industry reported a decline in revenues in FY2015, primarily due to a sharp correction in prices on the back of subdued demand in the international market following Iran's ban on rice import which affected exports from India. While prices have continued to remain under pressure, increase in volumetric sales has driven the revenue growth in FY2016.
- ix. The industry remains vulnerable to the inventory price risk, given sizeable stock levels of the players. As witnessed in FY2015, weakness in demand led to correction in prices, which impacted the inventory positions of the players and hence their profitability. However, with some uptick in revenue and profitability margins, there has also been a marginal improvement in the leverage and coverage metrics in FY2016. The revenue growth and profitability margins have remained relatively stable over the past few quarters. Correspondingly, the interest coverage ratio has also shown considerable improvement.

### Outlook

The excess supply and weak international demand in the past two years has led to a decline in prices resulting in financial stress for the players (including farmers) in the industry. This led to farmers shifting away from Basmati paddy cultivation. Consequently, paddy production is expected to be lower in the FY2017. The paddy prices have opened higher by around 20% in the current season starting October 2016 and are expected to remain firm.

On the demand side, there has been a steady growth in the domestic market, although demonitisation should adversely impact the demand in the near term. With regard to the international demand, Q1 FY2017 has reported some improvement, resulting in an increase in export realisations; however, the overall demand scenario has not changed much. The demand in the export market is expected to witness some pickup in the coming months when a majority of the export orders are received. This would help the industry, which is currently reeling under stress, owing to losses suffered in past. There is a likelihood of an increase in realisations in H2 FY2017 and FY2018 and the players holding inventory, which had been bought at low prices, are expected to benefit from this.

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Please contact ICRA to get a copy of the full report

**CORPORATE OFFICE**

Building No. 8, 2<sup>nd</sup> Floor,  
Tower A, DLF Cyber City, Phase II,  
Gurgaon - 122002  
Ph: +91-124-4545300, 4545800  
Fax: +91-124-4545350

**REGISTERED OFFICE**

1105, Kailash Building, 11<sup>th</sup> Floor,  
26, Kasturba Gandhi Marg,  
New Delhi – 110 001  
Tel: +91-11-23357940-50  
Fax: +91-11-23357014

**CHENNAI**

Mr. Jayanta Chatterjee  
Mobile: 9845022459  
5th Floor, Karumuttu Centre,  
498 Anna Salai, Nandanam,  
Chennai – 600035  
Tel: +91-44-45964300,  
24340043/9659/8080  
Fax: +91-44-24343663  
E-mail: [jayantac@icraindia.com](mailto:jayantac@icraindia.com)

**HYDERABAD**

Mr. M.S.K. Aditya  
Mobile: 9963253777  
301, CONCOURSE, 3rd Floor,  
No. 7-1-58, Ameerpet,  
Hyderabad - 500 016  
Tel: +91-40-23735061, 23737251  
Fax: +91-40-23735152  
E-mail: [adityamsk@icraindia.com](mailto:adityamsk@icraindia.com)

**MUMBAI**

Mr. L. Shivakumar  
Mobile: 9821086490  
3rd Floor, Electric Mansion,  
Appasaheb Marathe Marg, Prabhadevi,  
Mumbai - 400 025  
Ph : +91-22-30470000,  
24331046/53/62/74/86/87  
Fax : +91-22-2433 1390  
E-mail: [shivakumar@icraindia.com](mailto:shivakumar@icraindia.com)

**KOLKATA**

Ms. Vinita Baid  
Mobile: 9007884229  
A-10 & 11, 3rd Floor, FMC Fortuna,  
234/ 3A, A.J.C. Bose Road,  
Kolkata - 700020  
Tel: +91-33-22876617/ 8839,  
22800008, 22831411  
Fax: +91-33-2287 0728  
E-mail: [vinita.baid@icraindia.com](mailto:vinita.baid@icraindia.com)

**PUNE**

Mr. L. Shivakumar  
Mobile: 9821086490  
5A, 5th Floor, Symphony,  
S. No. 210, CTS 3202,  
Range Hills Road, Shivajinagar,  
Pune - 411 020  
Tel : +91- 20- 25561194,  
25560195/196,  
Fax : +91- 20- 2553 9231  
E-mail: [shivakumar@icraindia.com](mailto:shivakumar@icraindia.com)

**GURGAON**

Mr. Vivek Mathur  
Mobile: 9871221122  
Building No. 8, 2nd Floor,  
Tower A, DLF Cyber City, Phase II,  
Gurgaon - 122002  
Ph: +91-124-4545300, 4545800  
Fax; +91-124-4545350  
E-mail: [vivek@icraindia.com](mailto:vivek@icraindia.com)

**AHMEDABAD**

Mr. Animesh Bhabhalia  
Mobile: 9824029432  
907 & 908 Sakar -II, Ellisbridge,  
Ahmedabad - 380006  
Tel: +91-79-26585049/2008/5494,  
Fax:+91-79- 2648 4924  
E-mail: [animesh@icraindia.com](mailto:animesh@icraindia.com)

**BANGALORE**

Mr. Jayanta Chatterjee  
Mobile: 9845022459  
'The Millenia', Tower B,  
Unit No. 1004, 10th Floor,  
Level 2, 12-14, 1 & 2, Murphy Road,  
Bangalore - 560 008  
Tel: +91-80-43326400,  
Fax: +91-80-43326409  
E-mail: [jayantac@icraindia.com](mailto:jayantac@icraindia.com)



**CORPORATE OFFICE**

Building No. 8, 2<sup>nd</sup> Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300; Fax: +91 124 4545350

Email: [info@icraindia.com](mailto:info@icraindia.com), Website: [www.icra.in](http://www.icra.in)

**REGISTERED OFFICE**

1105, Kailash Building, 11<sup>th</sup> Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50; Fax: +91 11 23357014

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Branches: **Mumbai:** Tel.: +( 91 22) 24331046/53/62/74/86/87, Fax: + (91 22) 2433 1390 **Chennai:** Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 **Kolkata:** Tel + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008, Fax + (91 33) 2287 0728 **Bangalore:** Tel + (91 80) 2559 7401/4049 Fax + (91 80) 559 4065 **Ahmedabad:** Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 **Hyderabad:** Tel +(91 40) 2373 5061/7251, Fax + (91 40) 2373 5152 **Pune:** Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 553 9231

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