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HELPING SRI LANKA TO GROW!

AgEnt is a dynamic USAID funded private sector agro-enterprise development initiative successfully assisting companies and entrepreneurs with viable business/marketing plans to expand existing operations or start-up new ventures targeted at both domestic and export markets.

25th May 1995

VANILLA - A NEW " LOW INVESTMENT/HIGH PROFIT " EXPORT MARKETING OPPORTUNITY FOR SRI LANKA !

BEST AVAILABLE

5th Floor, Deutsche Bank, P O Box 389, 86 Galle Road,

1. INTRODUCTION

The world market for natural vanilla is undergoing a structural change due to the development of new processing technologies and the breakdown of traditional marketing patterns. There is clear opportunity for a new supplier of upto at least 100 Tons/year of high quality natural vanilla - with gross export values in the range of US$4 million (net revenue US$2 million). Vanilla should become a new mainstream spice in Sri Lanka, with the business centered around a restricted number of large-scale centralised processors.

Vanilla is a high margin business - raw material costs are only around 40% of product value, and using new processing technology (which AgEnt has access to), processing costs are low.

AgEnt has been actively developing market contacts, and has brought discussions with QUEST (the multinational flavours subsidiary of Unilever) to the stage where QUEST want to start direct discussions with a private sector company in Sir Lanka with a view to joint development of a major new source of high quality vanilla.

A brief outline follows that illustrates a possible/very viable initial commercial development.

2. PROFILE OF VANILLA ENTERPRISE

Outline of a vanilla enterprise

Vanilla will be primarily grown by smallholder outgrowers. An estate company might also have a small nucleus estate development in the range 5 to 10 acres, but viability of this would depend on labour costs. Fresh beans will be purchased from the outgrowers, and cured (processed) by the estate/processor. Cured beans are the export product, and there is little scope in the foreseeable future for any further downstream processing in-country.

The key to development of the enterprise is the promotion of outgrower plantings and the development of good crop management skills in the outgrowers. Implementation of this should at the same time develop the linkages between the processor and the outgrowers that will ensure that the outgrower crop is sold to the processor. The key industry role by the central private sector company is therefore that of outgrower manager/processor.

Vanilla has a lead time of 2 to 3 years from planting to first harvest. Yields increase over the first 3 harvests until full yield is achieved. A well managed plant should yield for 8 years or so until replanting is required.

Vanilla requires a moist wet climate with a 3 month dry season. If the total number of dry months in the year (whether from a single season or divided over 2 dry seasons) is 6 or more, conditions become marginal. The crop requires shade, and mulching and composting to build up an organic soil. The dry season and other management practices stimulates flowering, and all flowers have to be pollinated by hand. Beans are on the plant for 9 months until ripe, and are harvested individually, over a 2 month period, as each bean becomes fully ripe.

A fully ripe bean has a maximum potential quality. This quality is realised during curing. If curing is done poorly, a poor quality, low priced product results. Curing can be done by either of two methods: the traditional method, or the rapid method. The rapid method is preferred as it is fully controllable, is much quicker, and can produce a higher quality product. However it is a newer product, and it is not widely accepted by the trade at present. Firm buyer linkages are required if the rapid process is to be followed.

3. INTERNATIONAL MARKETS AND PRICES

Annual supply of cured vanilla to the markets is around 1,800 to 2,000 tons. Of this, around 50% is for high quality, high priced, natural vanilla. The remainder is for lower quality, lower priced, natural vanilla. The major markets are the US, Europe, and Japan. Natural vanilla is used as a high quality flavouring in the food industry (with smaller niche markets in the perfumery industry). The major use is in ice cream, bakery products, and cola drinks. Natural vanilla is a niche market. The market is dominated by low quality artificial vanillin (the predominant chemical inside vanilla), which is produced cheaply as an industrial by-product.

The two major sources of vanilla are Madagascar (around 800 tons) and Indonesia (varying in the range 400 to 700 tons). The Comoros, Reunion, Tonga, Mexico, and Uganda are other smaller sources. There is no specific shortage of vanilla in the market, but there is scope for new entrants (in the range 20 to 100 tons/yr) who base their development on structuring strong linkages with dedicated buyers, thereby ensuring market entry at the ruling price for the quality offered.

Current prices for high quality vanilla are in the range US$45 to US$60/kg (US$45,000 to US$60,000/ton). Prices for low quality vanilla are in the range US$10 to US$25/kg. There is no market opportunity for Sri Lanka in the low quality end of the market. It could not be in any way competitive, and the market is over supplied. Sri Lanka has to target the high quality end of the market.

Prices are declining, and a long term target price should be taken in the range US$35 to US$50/kg. A price of US$40/kg should be taken as a basis for discussions and analysis.

4. CURING AND COSTS

Raw material costs (fresh beans) should account for no more than 50% of the cured bean export price. The balance is required for costs of outgrower management, processing, and profit.

In a well run operation, harvesting fully mature beans, 5 kg of fresh beans are required to produce 1 kg of cured beans. The conversion ratio is 5:1.

The basic fresh bean selling price, at the farm gate is currently US$3/kg (Rps 150) - although with the very small supply at present, higher prices occur as suppliers to the domestic tourist market compete for supplies for their very small demand. US$3/kg is internationally competitive compared to other major origins, where farm gate prices vary in the range US$2 to US$5/kg.

Currently therefore:

	US$
Fresh bean costs in 1 kg cured bean	15
Export price cured bean/kg	40
Gross margin/kg (US$30,000/ton)	30

Additional operating costs:

-bonus to farmer purchasing agents @ 10% fresh bean price;
-transport to processing unit, packaging etc @ 5% fresh bean price;
-processing costs @ 20% of fresh bean costs;
-outgrower extension costs fixed at US$60,000/yr

5. CAPITAL INVESTMENT COSTS

Outline costs for a rapid curing plant are:

	US$
5 sweating drums and associated pipework	20,000
Hot water boiler	3,000
3 hot air burners	5,000
Drier beds etc	2,000
Total	30,000

A building, approx 20m by 30m is also required, together with electrical connections, water supply etc. Typical building costs are US$50,000.

SIMPLE FINANCIAL OUTLINE - ALL FIGURES IN US$

Item	1995	1996	1997	1998	1999	2000	2001	2002
Tons cured vanilla	0	0	1	3	5	10	18	25
Gross Revenue	0	0	40,000	120,000	200,000	400,000	720,000	1,000,000
Fresh bean purchase costs	0	0	15,000	45,000	75,000	150,000	270,000	375,000
GROSS MARGIN	0	0	25,000	75,000	125,000	250,000	450,000	625,000
Other Operational Costs:								
Purchase comm., pack etc @ 15% of fresh bean costs	0	0	2,250	6,750	11,250	22,500	40,500	56,250
Processing @ 20% fresh bean cost	0	0	3,000	9,000	15,000	30,000	54,000	75,000
Extension costs	60,000	60,000	60,000	60,000	60,000	60,000	60,000	60,000
NET MARGIN	(60,000)	(60,000)	(40,250)	(750)	38,750	137,500	295,500	433,750
Investment costs:								
Equipment			30,000				30,000	
Building (if required to construct)			50,000					

VANILLA ENTERPRISE - FINANCIAL SUMMARY

Vanilla export price US$/kg	40
Fresh bean buying price US$/kg	3
Conversion fresh:cured	5
Purchase commsion etc % fresh bean price	15%
Processing costs as % fresh bean price	20%

year	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
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NET MARGIN	**(60,000)**	**(60,000)**	**(40,250)**	**(750)**	**38,750**	**137,500**	**295,500**	**433,750**
Investment costs:								
Equipment			30,000				30,000	
Building			50,000					
GROSS CASH FLOW	(60,000)	(60,000)	(120,250)	(750)	38,750	137,500	265,500	433,750
IRR	**30%**							
Calculation with 50% AgEnt cost sharing								
Gross Cash Flow	(30,000)	(30,000)	(90,250)	(750)	38,750	137,500	265,500	433,750
IRR	**44%**							

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