Higher ethanol blending and improving export levels – two sweeteners for the Sugar Industry.

June 8, 2021 | Sugar

“With tight global demand-supply scenario, favourable policies, exports, and ethanol blending doing their bit in rationalizing the inventory levels in India, CARE Ratings believe that the sector is on track with its transformational plan. With considerable increase in ethanol sales and demand-supply balance evening out, integrated sugar mills are expected to witness sustained increase in their cash flows going ahead.”

Running on the highly remunerative global prices, the industry is all set to meet its export target of 6 million tonnes (MT) in this sugar season (SS). Furthermore, with the expected dip in the Brazilian production due to poor cane crop and reduced crushing capacity in that country, the export dynamics are expected to prevail over the next SS as well. With ethanol blending by oil marketing companies (OMCs) picking up pace and with the Government’s stance on increasing the blending targets to 20% supported by the remunerative ethanol pricing and incentive schemes to build up capacities to achieve the same, the economics of sugar industry are getting better. By 2023 India is planning to have zero surplus sugar by diversion to ethanol and the recent move of advancing the 20% ethanol blending by government by two years from 2025 to 2023 is a step forward in achieving the same.

Sugar inventory shrinking

Chart 1: Domestic Demand Supply and Stock Position

Source: ISMA, CARE

30.57 million tonnes of sugar have been produced in the current sugar season (SS; 2020-21) till May 30, 2021. This would be around 13.2% higher production as compared to the production in the same period in last SS. The higher production is primarily due to the higher contribution by Maharashtra and Karnataka backed by increased sugarcane area and better yields. Given the structural increase in sugar production in India, India has become a consistent exporter since SS2018-19. Sugar inventories which peaked at 14.5 MT in September 2019 came down to 10.6 MT in September 2020, given diversion of sugarcane towards B- heavy ethanol production and 6 MT of exports supported by export subsidy of Rs 10.4/kg for SS2019-20 announced by the Government. The Government announced the export subsidy for the current SS little late on 16 December 2020 for Rs 3,500 crore and the same translates into an assistance of around Rs.5.8 per kg for 6MT for sugar to be exported. As per ISMA’s latest release, the mills have contracted to export 5.7 million tonnes of sugar by May 19, 2021, which is 95% of the 6 million tonnes of the export target for the ongoing season fixed by the government. Close to 65% of the contracted exports of sugar have been physically exported out of the country during the January-April period of this season. The export of sugar in the current SS is supported by the surge in global prices. The Government announced the assistance when the raw sugar prices had been ruling at 14.20 cents a pound (c/lb) in December 2020 and now the global prices have surged to over 17 c/lb. Following this surge in international prices, recently the Government reduced the export subsidy from Rs 5.85/kg to Rs 4/kg on any sugar contracted for export on or after May 20, 2021. However, with the bulk of exports already contracted earlier, this would effectively mean that only 0.3 MT of targeted exports would not be able to avail the incentive in full as announced earlier.
Sugar prices inching up

Global sugar prices (raw sugar) have moved up from the lows of 10.2 c/lb in April 2020 to 16.5 cents/lb in May 2021. The initial growth in prices was backed by the unlocking of global economies and improvement in international sugar demand. In addition to this, expected lower sugar output in the European Union (world’s third largest sugar producer) and Thailand (second largest global sugar exporter) and uncertainty over Brazil’s diversion of cane crop towards sugar for the SS 2020-21 led to the upward trend in international sugar prices moving ahead. Including the export subsidy which the government announced in Dec 2020, average realisations for the Indian exporters in white sugar at London and raw sugar prices at New York averaged Rs. 38.7 per kg and Rs. 31 per kg, respectively, during 1 January-24 February 2021 for the Indian exporters. The average wholesale sugar prices in India averaged Rs. 32.9 per kg during the same period which indicates support from the international sugar prices for Indian sugar mills to export sugar.

Chart 2: Trend in international sugar prices

The industry will be able to complete exporting the contracted volumes by early June 2021 itself. The surge in international prices in April is attributed to the expectation of lower sugar output from Brazil & Thailand. Furthermore, considerable increase in crude prices have increased the possibility of aggressive sugarcane diversion towards ethanol by Brazil in the upcoming SS. As per ISO (International Sugar Organization), global sugar deficit during the current SS is expected to be at 4.78 MT vis-à-vis the earlier expected deficit of 3.5 MT. Indian millers may export beyond the quota and without any incentive in the light of the firm global prices.

Chart 3: Trend in wholesale domestic sugar prices

The cost of production in India is significantly high when compared to the costs across the globe owing to ever-increasing Fair and Remunerative Price (FRP) and State Advised Price (SAP) prices. Hence, in the wake of low international prices to support the exports in year of surplus production, the Government has been announcing export subsidies. Export subsidies being offered were questioned by WTO members; however, the Government can continue the export subsidies till 2023. Exports will be a key driver for managing the overall inventory levels in India till 2023, by which time the country will be expected to have sufficient distillery capacities for ethanol production to absorb the excess production. In the light of the same, sugar inventories are expected to shrink to comfortable levels. Stable sugar inventories would push domestic sugar prices to around Rs 34/kg, which would keep the sugar segment profitable. Exports are relevant to manage surplus stock but not a sustainable solution as India has moved to a surplus state by breaking the cyclicity.
Ethanol blending – key for sustenance
India has only around 2% share in the global production of ethanol while it has close to 17% share in global sugar production. As against that Brazil which is the largest producer of Sugar globally (around 18% share) has 30% stake even in global ethanol production. In Brazil, the average ethanol blending in petrol is around 48%. In India, the average blending in petrol is only around 7.5% so far which is significantly low when compared to Brazil. Considering the untapped potential - National Bio-fuel Policy was announced by the government among other measures of fixing and increasing ethanol prices for different grades and announcing incentives to set up/expand distillery capacities.

**Chart 4: Ethanol prices for different grades**

| Source: ISMA |

The EBP program aims to increase ethanol blend level with petrol to 7.5%-8% by 2020-21, 10% by 2022 and 20% by 2025 (advanced from 2030 earlier this year). The government has brought forward the target date for achieving 20% ethanol-blending with petrol by two years to 2023 in a recent notification primarily to help reduce India's dependence on oil imports which are costly. The thrust that government has shown on this sector is visible from the fact that, the ethanol production capacity in India has almost doubled over a period of 5 years with capacity increasing substantially from Ethanol Supply Year (ESY) December 2017-November 2018 onwards. The capacity has grown at a strong CAGR of 17.8% from 222 crore litres in ESY 2015-16 to 427 crore litres in ESY 2019-20. While ethanol production capacity for ESY 2019-20 stood at 427 crore litres, ethanol supply for EBP Programme for the year was estimated at ~173 crore litres based on the offers received from ethanol producers. This is because produced ethanol is also used for other purposes that include potable liquor and chemicals. However, the higher mix of fuel ethanol in the total alcohol requirement over the years is on account of significant support extended by the Government in the form of remunerative prices for ethanol each year. The above measures have resulted in EBP rising from 1.5% in ESY14 to around 5.12% in ESY20.

**Chart 5: Ethanol Capacities, Supply and Blending rates**

| Source: MoPNG, ISMA, CARE |

The blending percentage of 7.56% has been achieved in the current SS on an average with some States like Uttar Pradesh, Maharashtra, Karnataka, Uttarakhand, Bihar, etc. have even achieved higher blending percentage of up to ~10%. With the surplus sugar situation auguring well for the ethanol industry and with the support government has shown in the recent past in the form of interest subventions for the distillery capacity expansion, aggressive capex is underway already as around 1000 crore litres of ethanol is required to achieve the target of 20% blending. With the build-up of capacity and more impetus of the government on blending, it is likely that 10% ethanol blending will be achieved by 2022 which requires close to ~420 crore litres of ethanol. Furthermore, augmenting the tankage capacities
and promoting manufacturing of flexible fuel vehicles are the next steps that domestically need more focus going forward to achieve the said 20% target apart from the capacity expansion.

The sugar industry is producing almost 6 MT of surplus sugar every year which can be diverted to produce 700 crore litres of ethanol out of the total requirement of 1000 crore litres and balance can be produced from excess grains. With government allowing ethanol through grain-based distilleries as well gives additional stream of revenue to some of the sugar companies who are willing to expand. Currently the excess sugar produced is largely being exported depending on the global demand-supply dynamics & export incentives by Government. The road map that every year the surplus sugar can be reduced by 2 million tons is being worked on by the industry and the Government. By 2023 India is planning to have zero surplus sugar by diversion to ethanol (with 2MT every year till 2023) and this move of advancing the 20% of ethanol blending target from 2025 to 2023 by government is a step forward in achieving the same. Ethanol has hence turned into a vital policy instrument for the Government in managing the looming surplus. The sticky issues in the sector shall be solved with augmentation of ethanol capacities.

**Chart 6: Sugar sacrifice due to diversion to ethanol (in million tonnes)**

![Chart 6](image)

<table>
<thead>
<tr>
<th>Year</th>
<th>Sacrifice (in million tonnes)</th>
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</thead>
<tbody>
<tr>
<td>2022-23 (P)</td>
<td>5.9</td>
</tr>
<tr>
<td>2021-22 (P)</td>
<td>3.8</td>
</tr>
<tr>
<td>2020-21</td>
<td>2</td>
</tr>
<tr>
<td>2019-20</td>
<td>0.1</td>
</tr>
</tbody>
</table>

Source: Industry Data, ISMA, CARE

Raw material base has diversified with ethanol supplies from C-heavy molasses accounting for about 42% of the total ethanol supply contracts, B-heavy molasses and sugarcane juice contributed about 40% and ~9%, respectively, of the total ethanol supply contracts during ESY 2019-20 so far and the rest being contributed by damaged food grains. This if compared to earlier SS is a significant improvement as earlier largely everything was from C-heavy. In the current season, against the total LOI quantity of 346.52 crore litres, 321.18 crore litres have been contracted for and 145.38 Cr litres of ethanol have been supplied as on 24th May 2021. As per ISMA out of the total supply about 76% comprises of ethanol made from sugarcane juice /B-heavy molasses. This is purely on account of the Government showing a lot of thrust on ethanol through B-heavy or direct sugarcane juice and announcing higher price realizations accordingly which shall help industry manage the surplus by diverting more sugarcane towards ethanol production. Going forward with extensive capex underway for producing ethanol from B-heavy and grain based, this mix going forward will significantly reduce from C-heavy. Revenue mix of the industry players where higher contribution comes from b-heavy or direct sugarcane juice is an indicative factor that the cash flows of these players is going to increase which shall help them lower the cane arrears and lower the overall working capital borrowings.

**Credit Perspective**

Sugar industry has been registering year-on-year growth in net revenues for the past 7-8 consecutive quarter and the trend is likely to continue even in Q4FY21. The industry has been reporting almost a double-digit growth rate in revenues excepting in Q3FY21 when the y-o-y growth for the quarter stood at ~5% which was primarily due to late announcement by Government for the export subsidy for the SS2020-21. Q4FY21 again is expected to clog a double-digit y-o-y growth in revenue of sugar millers with majority exports taking place in Q4 and due to ethanol dispatches.

**Chart 7: Y-o-Y growth in Net Sales across quarters**

![Chart 7](image)

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Y-o-Y Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1 FY20</td>
<td>8%</td>
</tr>
<tr>
<td>Q2 FY20</td>
<td>15%</td>
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<tr>
<td>Q3 FY20</td>
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<td>Q4 FY20</td>
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<td>Q2 FY21</td>
<td>25%</td>
</tr>
<tr>
<td>Q3 FY21</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: Ace Equity, CMIE.
The earnings of the sugar companies are likely to grow at a stable pace going forward rather than the cyclical ups & downs which they used to face earlier. This is primarily due to the support that government has extended towards the sector ever since the minimum support price (MSP) was introduced in 2018 and mill wise sales quota have been fixed. The industry remained profitable at the operating level in the past seven quarters. The (SAP) for sugarcane in UP has been kept at Rs 315/quintal for the season unchanged from last three years. However, it is expected that due to the upcoming state election in 2022, the SAP might be revised up for the upcoming SS. Following this, the Government might even revise the sugar MSP upwards which has been pending with government for quite some time. The increase in MSP along with the increase in ethanol sales shall aid in absorption of the increased cane cost.

Chart 8: Net Sales & EBITDA for the respective quarters.

Tight sugar supply situation in the global market has pushed up the international sugar prices to 4-year high. The firmness in international prices is expected to continue unless sugar output from the other major sugar producing and exporting nations starts coming in for the next season 2021-22.

CARE Ratings believe that with sugar inventories getting rationalised, demand-supply balance evening out and considerable increase in ethanol sales, the cash flows of integrated sugar mills is going to enhance in the next three to four years. The increase in cash flows is on account of better returns from ethanol sales as the prices fixed by the government are more remunerative vis-à-vis sugar prices currently. Furthermore, ethanol sales give sugar mills immediate cash flows as compared to delays witnessed in sales of sugar as sugar mills have to adhere to the sugar sale quota released by the government and dispatches pan over 6 to 8 months. With the export quota of 6MT of sugar being met and increased ethanol sales from last season, the profitability is expected to increase further by 100-150 bps in FY22 and the working capital requirements of the industry players who are having integrated operations should come down with the reduction in the inventory levels. This shall lead to the improvement in the overall leverage position of these players. Distillery revenues are expected to contribute to a higher proportion of the overall revenues for sugar companies and strengthen their credit profiles going ahead.

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