Full Decontrol – Real sweetener for the industry

Sugar industry is the second-largest agro-based industry in India and plays a pivotal role in the socio-economic development of the rural India. The industry is cyclical in nature and the entire value chain is regulated leaving very little scope to the industry to play under free market forces. The excessive control mechanism led the Indian Sugar Industry to grapple under several challenges including mounting debt, squeeze on profitability because of high sugarcane prices fixed by various State Governments, sole dependence on the farmers of allotted area for sugar cane procurement and loss on account of meeting levy obligation at a subsidized price.

In a move to decontrol the industry, a Committee headed by Dr. C Rangarajan was formed which submitted its report in October 2012.The major recommendations were as under:

a) Dispensing with the levy sugar obligation
b) Dismantling the present monthly release mechanism of non-levy sugar
c) Replacement of State Advised Price (SAP) with sugarcane price-sugar price linkage formula
d) Phasing out of sugarcane area reservation

The industry was partially decontrolled in April 2013 by implementing the first two recommendations. While partial decontrol is certainly a great step forward for liberating the industry, the same failed to bring in much cheer, with situation remaining almost same or even worse with further dip in the profitability parameters of sugar companies post decontrol. A comparative analysis of a sample of 33 sugar entities before and after partial decontrol (9MFY13 vis-à-vis 9MFY14) has been tabulated below:

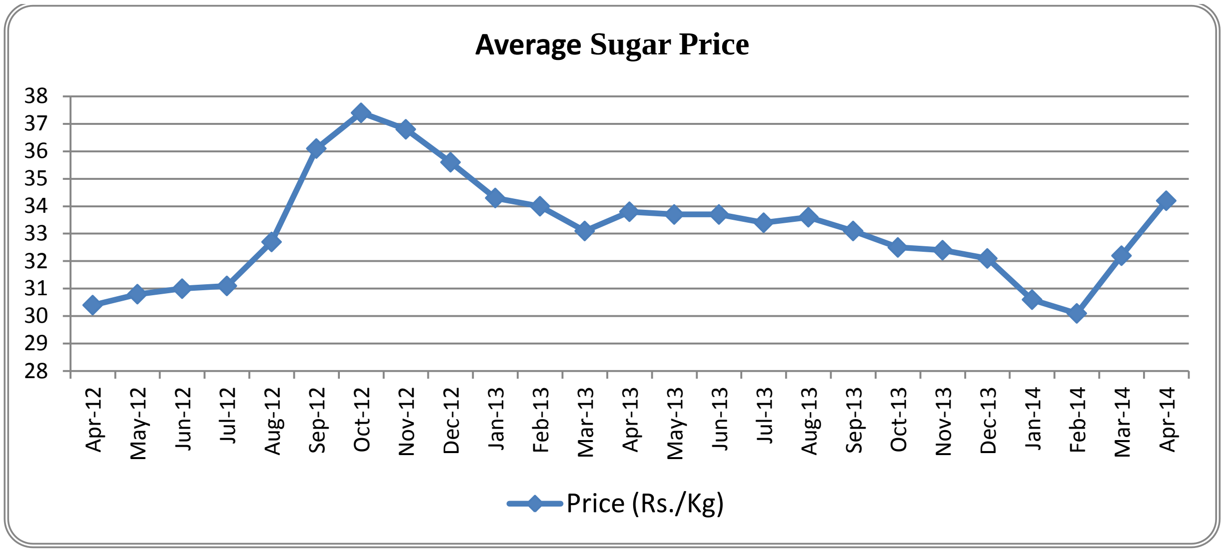
Table 1: Financial Performance

Median ratios	9MFY13	9MFY14
PBILDT Margin (%)	9.9	1.6
Interest coverage (times)	1.2	0.1
PBT Margin (%)	1.3	(12.4)
Average sugar price (Rs./kg)	33.5	33.1

Despite implementation of partial decontrol measures like abolition of levy sugar obligation and monthly release mechanism, rising inventory levels, lower exports and slow implementation of the ethanol blending program continue to be the overriding factors.

High inventory level

The rising inventory level coupled with virtually no export (because of relatively lower international prices) since SS2012-13 (October to September) led to sluggish sugar price trend till February 2014 (see graph below).



Source: NCDEX spot price (Kolkata)

The declining sugar price coupled with increasing SAP adversely impacted the profitability of sugar companies. Quick offloading of the inventory by the cash strapped sugar mills in absence of monthly release mechanism also contributed to the fall in sugar prices to an extent. However, the sugar price has started moving northward from February2014 primarily on account of lower than expected production estimates for SS2013-14 and the export subsidy. A snapshot of the inventory position movement in the last four years is tabulated below:

(in mn MT)

Particulars	2009-10	2010-11	2011-12	2012-13	2013-14 (P)
Opening stock (A)	3.3	4.7	5.7	6.7	9.2
Production (B)	18.9	24.4	26.3	25.1	23.8
Imports (C)	4.1	0.0	0.0	0.7	0.4
Total Availability (D = A+B+C)	26.3	29.1	32.1	32.5	33.4
Internal Consumption (E)	21.3	20.8	22.0	23.0	24.4
Exports (F)	0.2	2.6	3.4	0.3	1.5
Total Offtake (G = E+F)	21.6	23.4	25.4	23.3	25.9
Closing Stock (D-G)	**4.7**	**5.7**	**6.7**	**9.2**	**7.5**
Stock as % of consumption	22%	27%	30%	40%	30%
Surplus (B-E)	-2.4	3.6	4.3	2.1	-0.6

Export

The impact of increased production and thereby piling up of inventory can be partially offset by exports. Due to the higher export in SS11-12, the closing stock not only remained at a manageable level but sugar price also witnessed improvement. However, the sluggish prices in global market led to insignificant export in SS12-13. Besides, the global sugar stocks in the current SS, estimated at the same level as that in previous year, is also acting as a dampener for export of sugar.

Ethanol Procurement by Oil Marketing Companies (OMCs)

In Jan 2013, ethanol blending of 5% with petrol was made mandatory across the country. Pursuant to this, OMCs floated tenders twice for procurement of the ethanol. However, the delay in finalization of tenders and slow lifting by the Oil Marketing Companies (OMCs) led to piling of inventory of ethanol and increased working capital requirements for sugar companies. Besides, lower base price also adversely impacted the profitability.

Initiatives by GoI for revival

To make export competitive in the global market, export subsidy of Rs.3.30/kg was introduced in February, 2014. The subsidy will be given for export of 4mn tonne of raw sugar for the industry as a whole for a period of two years. Besides, the recent hike in the import duty on raw sugar from 15% to 40% is likely to boost the domestic prices. Further, hike in ethanol blending requirements from 5% to 10% will also augment the profitability of the sugar companies.

Though these measures may provide some respite to the ailing sugar industry in the short-term, the revival of the same is still dependent on the regulatory environment. In order to provide a viable and robust business model to the industry, the unscientific way of fixation of SAP has to be replaced with linking sugarcane procurement price with the sugar price.

Thus, the real turnaround of the Indian Sugar industry will depend much on the full implementation of the Rangarajan Committee's recommendation especially implementation of sugarcane price-sugar price linkage formula.

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