

Indian Sugar Industry- From Rags to Riches

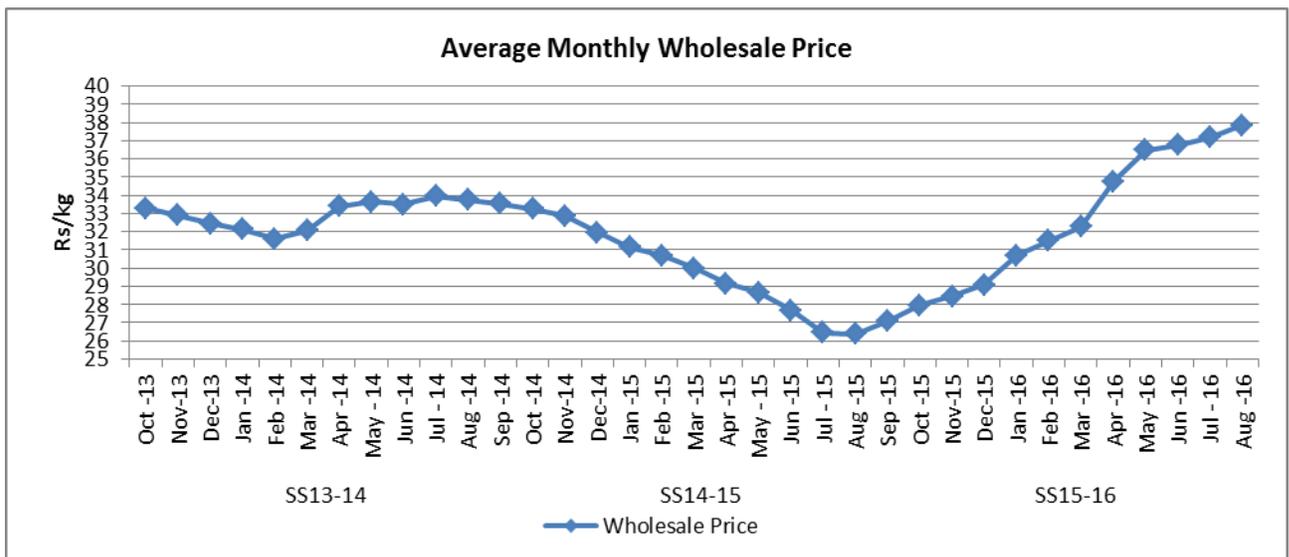
Falling of ex-mill sugar prices below production costs, mounting losses for sugar mills and accumulating cane price arrears leading to compulsive shut-downs—from this stage, the Indian Sugar Industry (ISI) is now exhibiting signs of complete turnaround with surging sugar prices and depletion in buffer sugar stocks due to decrease in global as well as domestic production and steady growth in sugar consumption.

Industry Overview

Sugar, the second-largest agro-based industry in India, is a sector of immense importance to the Indian economy. ISI impacts livelihoods of about 50 million farmers and their families and provides direct employment to over 5 lakh skilled and semi-skilled persons in sugar mills and related industries.

For past two sugar seasons (SS; refers to the period October 1 to September 30) ended SS2015-16, the ISI has been witnessing a challenging phase marked by extreme volatility in sugar prices and lopsided margins for the sugar mill owners.

Sugar prices U-turn in past three sugar seasons



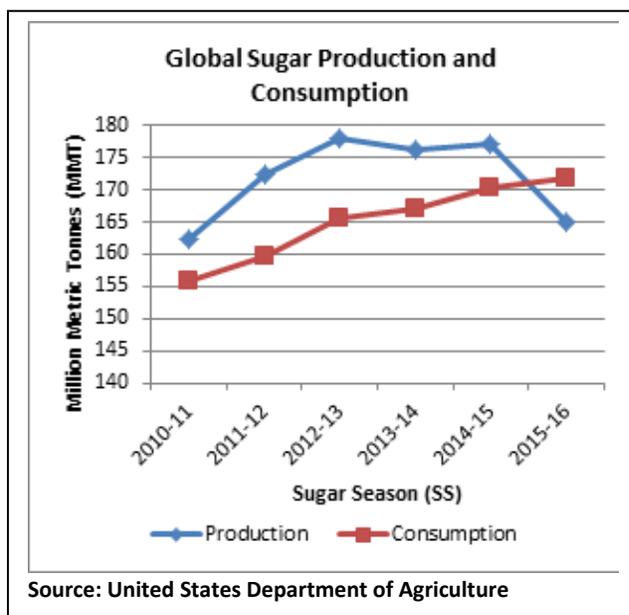
Source: Indian Sugar Mills Association

The sugar prices started declining from August 2014 on account of surplus sugar stock both in domestic and global markets. Sugar production exceeded the sugar consumption levels for past five consecutive SS

from SS2010-11 to SS2014-15. Wholesale price of sugar slumped from Rs.33.76/kg in August 2014 to a low of Rs.26.40/kg in August 2015 and remained below Rs.30/kg for almost half of production period in the SS2015-16.

The situation at present, however, seems totally reversed where the major cause of concern for the government is surging sugar price. The sugar price started picking up from September 2015 and since then it has been on a continuous uptrend. In August 2016, sugar price prevailed at Rs.37.86/kg in wholesale market and crossed the price level of Rs.40/kg in the retail market.

Reversal in the Global Production-Consumption pattern after five sugar seasons



The global consumption of sugar has shown rising trend on consistent basis. On the other hand, the global sugar production declined by 7% from 177.22 million metric tonnes (MMT) in SS14-15 to 164.92 MMT in SS15-16 causing a global sugar deficit in SS15-16 after 5 consecutive SS of surplus from SS10-11 to SS14-15.

The sugar production declined by 12.13 MMT in SS15-16 of which 98% of the aforesaid decline is contributed by top 5 sugar-producing countries/regions, namely, Brazil, India, European Union, Thailand and China.

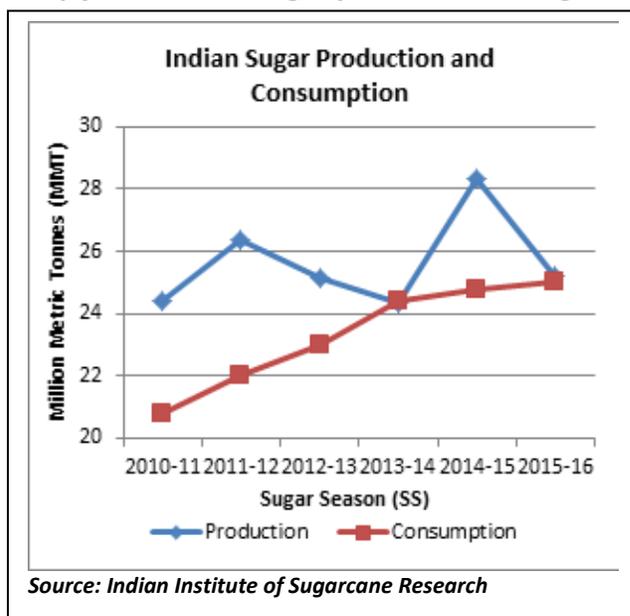
Country/Region	2014-2015	2015-2016	Decline (MMT)	Decline (%)
Brazil	35.95	34.65	1.30	3.62
India	30.46	27.70	2.76	9.06
European Union	18.45	14.00	4.45	24.12
Thailand	10.79	9.74	1.05	9.73
China	11.00	8.43	2.57	23.36
Total	106.65	94.52	12.13	11.37

Source: United States Department of Agriculture

The sugar production of Brazil, the world's largest sugar producer, declined on account of higher percentage of sugarcane [59% of total sugarcane production (estimated)] being converted to ethanol due to the increase in mandated ethanol blending in gasoline, from 25% to 27%.

Production in the European Union declined due to reduced sugar beet area. Thailand's production reduced on account of drought-induced yield decrease and sugarcane diversion for ethanol production and China's production declined on account of decrease in the area under cultivation due to high producer costs.

Steep fall in Indian sugar production during SS15-16

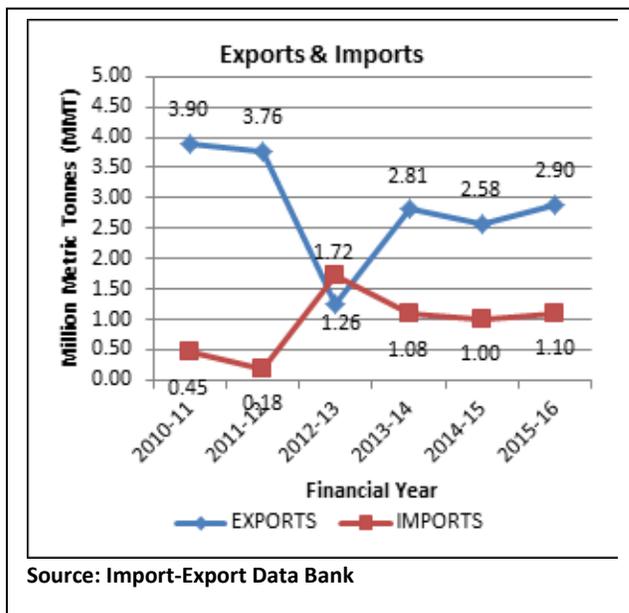


India's sugar production is estimated at about 25.20 MMT in SS2015-16, a 10.95% drop from SS2014-15 sugar production of 28.30 MMT. At the same time, sugar export is expected to remain about 2 MMT higher than import in SS2015-16. This would result into depletion in closing stock of sugar from about 9 MMT at the end of SS2014-15 to about 7.2 MMT at the end of SS2015-16. This decline in Indian sugar production is attributed primarily to drought in states of Maharashtra (largest sugar-producing state in India) and Karnataka (third largest). There is huge fall in

these two states — from 10.52 MMT to 8.40 MMT; a decline of 20% in Maharashtra and from 4.99 MMT to 4.10 MMT; a decline of 18% in Karnataka.

Impact of Exports-Import Policy of Government on ISI

During SS2014-15, in order to improve domestic sugar price sentiments and make Indian sugar export competitive in international market, the government introduced various measures to boost exports and curtail sugar imports. In September 2015, Government announced Minimum Indicative Export Quotas (MIEQ) for mills and co-operatives for mandatory exports of 4 MMT of sugar in 2015-16. On the other hand, as a measure to curb imports, the Government had enhanced import duty on sugar from 25% to 40% from April 30, 2015.



As a result, the export increased by 12.40% from 2.58 MMT in FY15 (refers to the period April 1 to March 31) to 2.90 MMT in FY16. On the other hand, sugar import during the same period increased marginally by 0.10 MMT to 1.10 MMT. On account of sharp increase in the prices of sugar the GOI has now withdrawn scheme of MIEQ w.e.f June 8, 2016, and has introduced export duty of 20% from June 16, 2016.

Government initiated cane arrears reduction measures given impressive results

Production Linked Subsidy

In order to revive the ailing sugar industry and reduce cane price arrears, the government in December 2015, announced production subsidy @ Rs.4.50 per quintal of cane crushed which shall be paid directly to the farmers on behalf of the mills. The production subsidy, however, now stands withdrawn as the prices are substantially higher than what is required for making operations viable for the sugar industry.

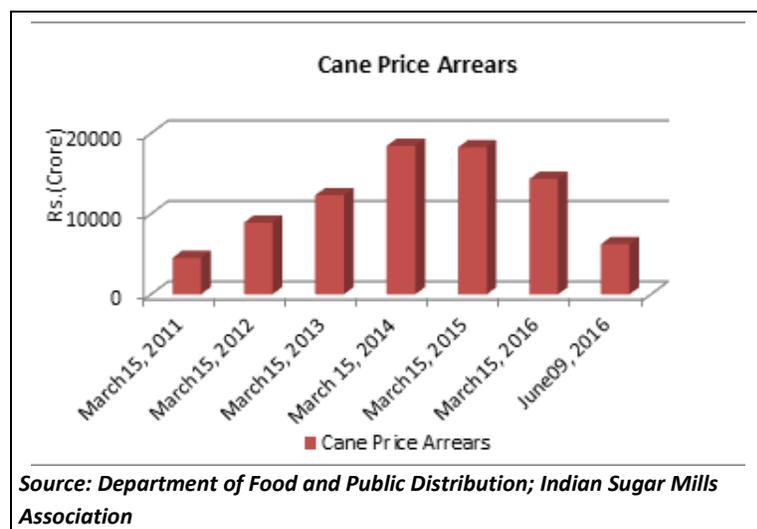
Soft Loan Scheme

In June 2015, a scheme for extending soft loans to the extent of Rs.6,000 crore to the sugar industry was introduced to facilitate clearance of cane price arrears of the farmers for the SS14-15 relating to FRP (Fair & Remunerative Prices) fixed by Central Government. The government would bear interest burden up to 10% simple interest or actual rate of interest, whichever is lower, for maximum period of one year by way of interest subvention.

Ethanol Blending Program (EBP)

Blending targets under EBP has been scaled up from 5% to 10%. In January, 2015 remunerative prices for Ethanol supplied under EBP have been fixed in the range of Rs.48.50-49.50 per litre, a substantial increase over previous years. For the SS15-16, the government had also waived-off excise duty on ethanol supplied for blending in order to further incentivise the mill owner.

However, with the improvement in liquidity of sugar mills on account of rise in sugar prices the exemption



from excise duty on ethanol supplied for blending now stands withdrawn w.e.f August 10, 2016.

The above steps taken by the government have augured well for ISI and as per the latest report of ISMA, cane arrears have come down to about Rs.6,225 crore as on June 09, 2016, from about Rs.18,249 crore outstanding as on March 15, 2015.

Revival in operating performance of Indian sugar companies during H2FY16

Particulars	(Rs. Crore)			
	H1FY15	H2FY15	H1FY16	H2FY16
Total Income	12,572	13,343	11,893	15,085
Operating Expenses	12,123	13,175	11,640	12,538
PBILDT	449	169	253	2,547
Depreciation charges	446	469	431	518
Interest Expenses	1,032	1,019	1,033	970
Profit before tax	-1,029	-1,319	-1,210	1,059
Income Tax	-157	-192	-45	-105
Profit After Tax	-872	-1,127	-1,166	1,164
Key Operating Indicators				
PBILDT Margin (%)	3.57	1.26	2.13	16.88
PAT Margin (%)	-6.94	-8.45	-9.80	7.72
Interest Coverage (PBILDT/Interest (times))	0.43	0.17	0.25	2.63

Source: Published results on Bombay Stock Exchange (consisting of 18 BSE listed entities)

The average realisation of sugar declined from Rs.33.63/kg in H1FY15 to Rs.31.65/kg during H2FY15. Moreover, sugar mills incur higher operating cost in H2 as compared with H1 as sugarcane crushing begins October onward and generally end in March. Thus, the declined realisations coupled with higher operational overheads resulted into reduced PBILDT margins for sugar companies during H2FY15.

In H1FY16, the prices continued to decline and average realisations reached a low of Rs.27.56/kg as compared with average realisation of 33.63/kg during H1FY15. However, on account of trend of lower

operational overheads during H1, sugar companies managed to earn meager operating margin of 2.13% during H1FY16.

However, the effect of significant hike in prices during H2FY16 translated into increase in PBILDT margin from 2.13% during H1FY16 to 16.88% in H2FY16 (almost 1475 bps improvement during H2FY16 against H2FY15).

The performance of sugar companies has improved in H2FY16 owing to improved realisations on back of demand-supply gap, remunerative prices for ethanol under EBP and reduction in interest burden which has translated into better operating profits and net profits. This has further resulted into enhanced liquidity in hands of sugar entities which has consequently aided in repayment of cane dues and reduced working capital requirement.

The credit risk profile of the sugar companies is expected to remain stable in the medium term on the back of envisaged efficient price realisation of sugar and its allied products going forward which is expected to translate into improved profitability margins, adequate debt coverage indicators and improvement in the liquidity position.

Industry outlook

SS15-16 witnessed significant recovery of sugar sector both in global and Indian market from gloomy phase of past two SS of SS13-14 and SS14-15. On the global front, USDA has given better estimates for SS16-17 with increase in global production from 165 MMT to 169 MMT on the back of increase in sugar production in top sugar-producing countries like Brazil, European Union and Thailand. However, the forecasted sugar consumption of 174 MMT is expected to outpace the production levels, resulting in yet another season of global sugar deficit.

As regards the domestic market, envisage decrease in production of sugar (from about 25.2 MMT in SS2015-16 to about 23.3 MMT SS2016-17) due to lower area under cultivation for sugarcane during SS2016-17 (from approximately 5.3 million hectares in SS2015-16 to about 5 million hectares in SS2016-17), lower opening stock of SS16-17 (about 7.2 MMT) and a steady rise in consumption would further deplete the closing-stock of sugar. Hence, the sugar price is expected to remain stable providing reasonably good margins to mill owners. On the other hand, government has introduced measures such as imposition of stock holding limits at the traders' end, imposition of export duty of 20% and withdrawal of excise duty exemption on ethanol supplied for blending in order to keep sugar availability in domestic market intact.

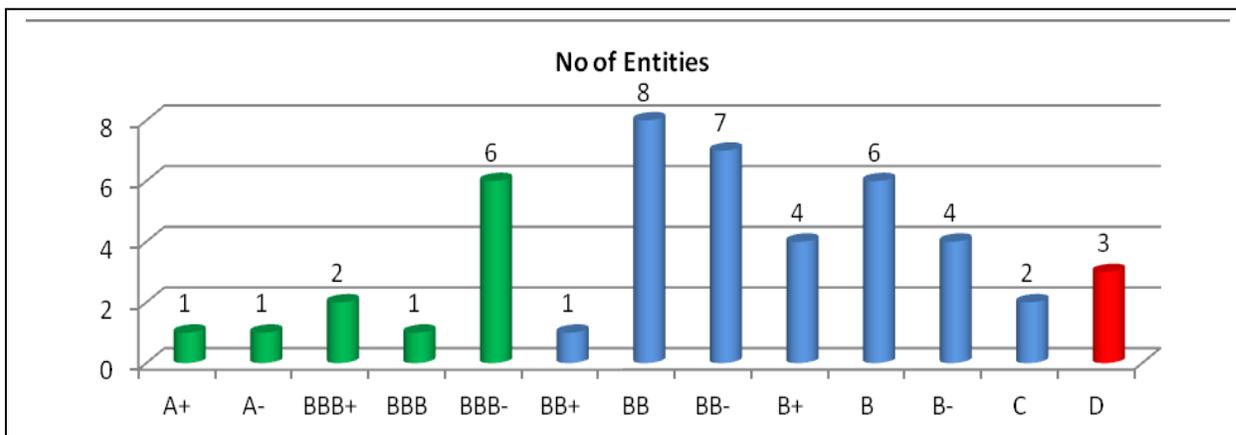
CARE expects stable outlook for industry in medium-term on the back of favourable developments in SS15-16, envisaged scenario of consumption outpacing production for SS2016-17 and supportive measures by the government.

However, continuation of the government policies to regulate sugar sector and actual global as well as domestic production-consumption patterns would be crucial for ISI during SS16-17.

Rating Dispersion

CARE has outstanding credit ratings (as on March 31, 2016) on 46 sugar mills. Majority of the entities are in the non-investment grade rating category on account of inherent weakness of low profitability margins, high working capital intensity of operations, weak debt coverage indicators and seasonal & cyclical nature of the sugar industry, operating under highly regulated environment.

Rating dispersion of sugar mills rated by CARE



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