Sugar

Credit metrics improve but regional diversity prevails and challenges ahead

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Background

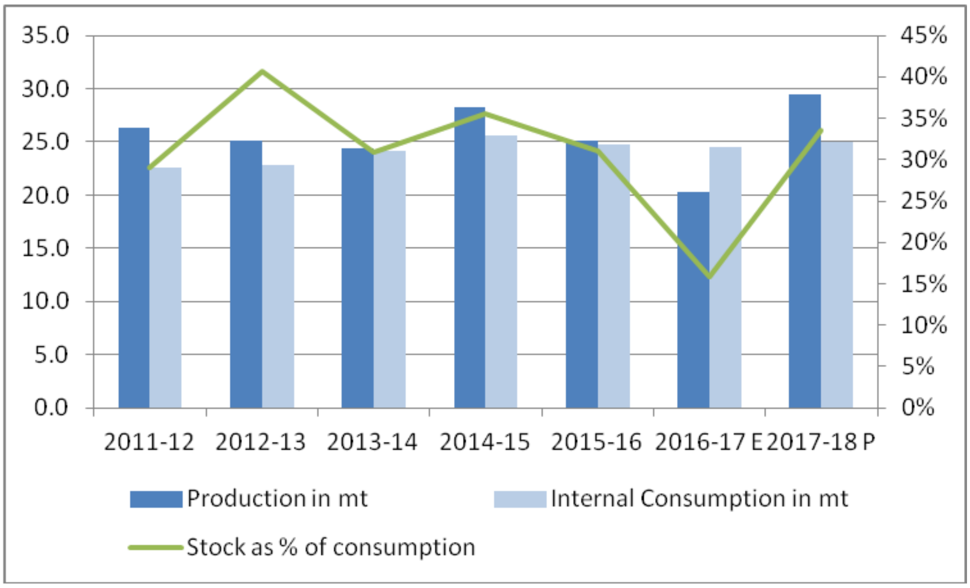
Driven by firm sugar prices resulting from favourable sugar balance, credit metrics for sugar companies improved in FY17. Even as strong cash accruals helped north-based mills pare debt exposure, most south mills continue to reel under high outside liabilities.

The key challenges sugar companies face today are continuing control over cane costs by the states and fundamental pricing volatility. Just about 2-3 years back, north-based mills were impacted by increasingly deteriorating environment suffering from high cane cost (state-advised price adopted by UP state was significantly higher than central-advised FRP) vis-à-vis average sugar price realisation and lower recovery rates as compared to south-based mills. Things have turned around with UP-based mills reporting significant improvement in operating cash flows, benefiting from firm sugar prices while unfavourable climatic conditions have impacted the performance of south-based mills. Going forward, significant surplus estimate in the ongoing sugar season poses serious threat to sustenance of the recent recovery in credit metrics.

Favourable demand-supply dynamics so far

India's sugar production for the sugar season (SS) 17 (refers to the October to September SS) is about 20.3 mt, a decline of 18.8% over production last season. This is the second year in a row wherein consumption is higher than / matches the production after five seasons of production surpassing consumption. Based on the opening sugar balance of 7.7 mt for SS17 and consumption of about 24.2 mt, the closing balance for the season is 3.9 mt. The closing sugar balance as a percentage of consumption at about 16-17% is one of the lowest in history and has augured well for the sugar prices.

Domestic sugar balance



Source: ISMA, CARE

Surplus situation estimated

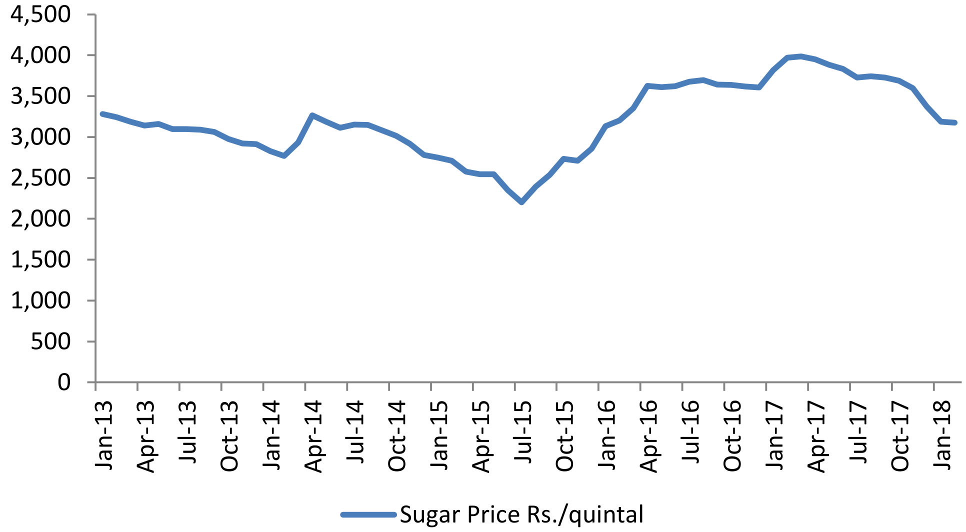
The sugar production in the ongoing season (SS18) is projected at a record 29.5 mt (by ISMA) which is about 45% more than the production achieved last year. The sugar balance as a result is expected to rise to level which can impart pressure on sugar prices. Till February 2018, sugar mills have produced 23.0 mt, as compared to 16.2 mt last season. While Maharashtra, UP and Karnataka contributed to the growth in production in the ongoing season, TN, AP and Telangana are witnessing lower sugar production.

Not-so-favourable global sugar outlook

Global production for the crop year 2016-17 was at 171.5 mt, an increase from about 165 mt achieved in SS16. Global sugar production is estimated to increase to record 185 mt in SS18 on gains from European Union, India and Thailand; a surplus situation estimate after two years of global demand outstripping supply. Brazil which accounts for 20-25% of the global output is not expected to contribute much to the estimated surplus. With only 30% of the produce traded internationally and significant share of which under bilateral terms, global sugar prices are highly sensitive to small change in production. In the backdrop of higher sugar production, international sugar prices have come off their highs during the last one year.

Strong domestic sugar prices but challenge ahead

The domestic prices have remained insulated from the sharp decline in prices witnessed in the international market. From about $560/mt in February 2017, London Sugar Future prices are trading at $389/mt this January 2018, weighed down by increase in global sugar production. Besides the weak domestic sugar balance, government maintaining high import duty on sugar (raised to 50% in July 2017 from 40% earlier and now to 100%, though in the interim period, duty-free import of specific quantity was allowed) deterred any significant imports and largely assisted such resilience exhibited by domestic sugar price. However, the potential for any further increase in sugar prices has diminished. With an unviable export market at the current prevailing international sugar prices, pressure on domestic price is likely.

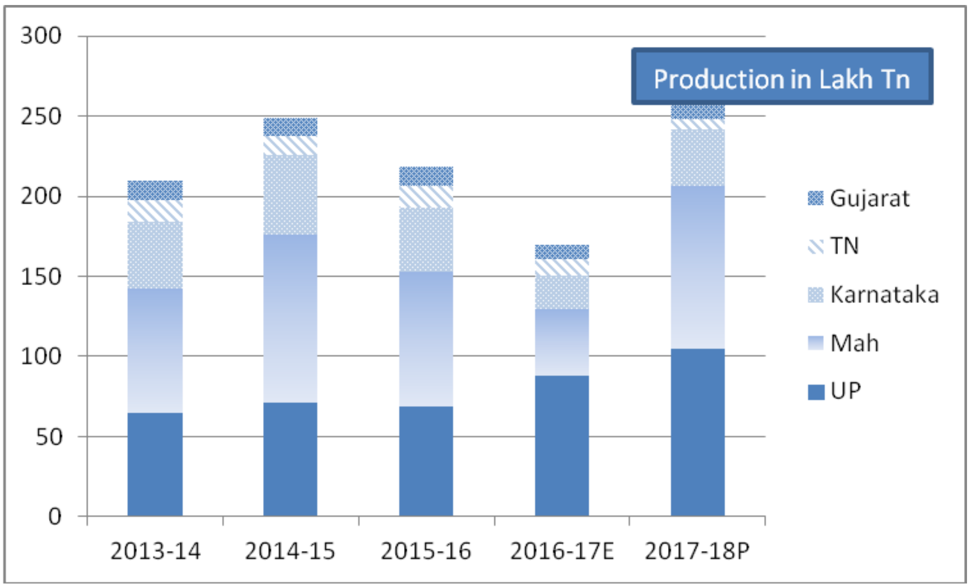


Source: CMIE

Regional diversity

Even as country produced lesser quantity of sugar during SS17 with sharp deficit in cane availability in the southern and western states, Uttar Pradesh defied with higher sugar production during the period. Unfavourable climatic conditions impacted sugar area under cultivation, sugar recovery and ultimately sugar production in key sugar-producing states of Maharashtra, Karnataka and Tamil Nadu.

Production in key sugar producing states

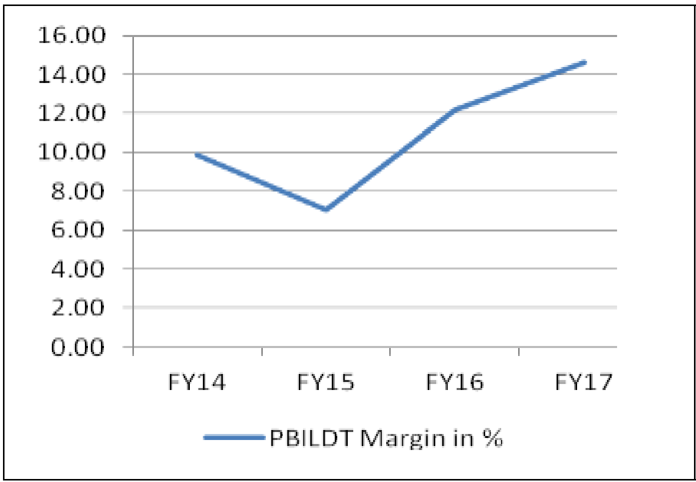


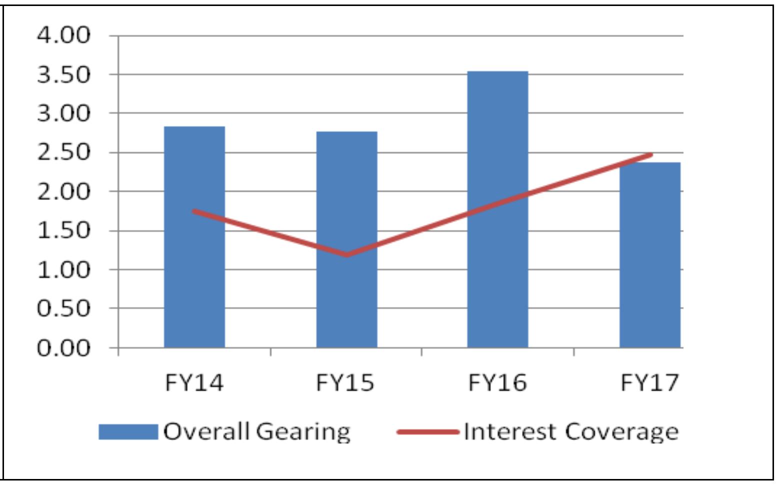
Source: ISMA, CARE

While sugar output in UP is expected to continue to grow, production estimates for SS18 expect sharp recovery in production in Maharashtra and Karnataka, but TN is likely to produce less. At 0.6 mt production estimate (down from 1.1 mt in SS17), TN units would be operating at 20% capacity utilization, severely impacting its cost of production.

Impact on credit profile

In general, credit metrics of sugar companies have improved in FY17 (refers to the period April 1 to March 31) over the previous year. Even as strong cash accruals help north-based mills pare debt exposure, most south mills continue to reel under high outside liabilities.





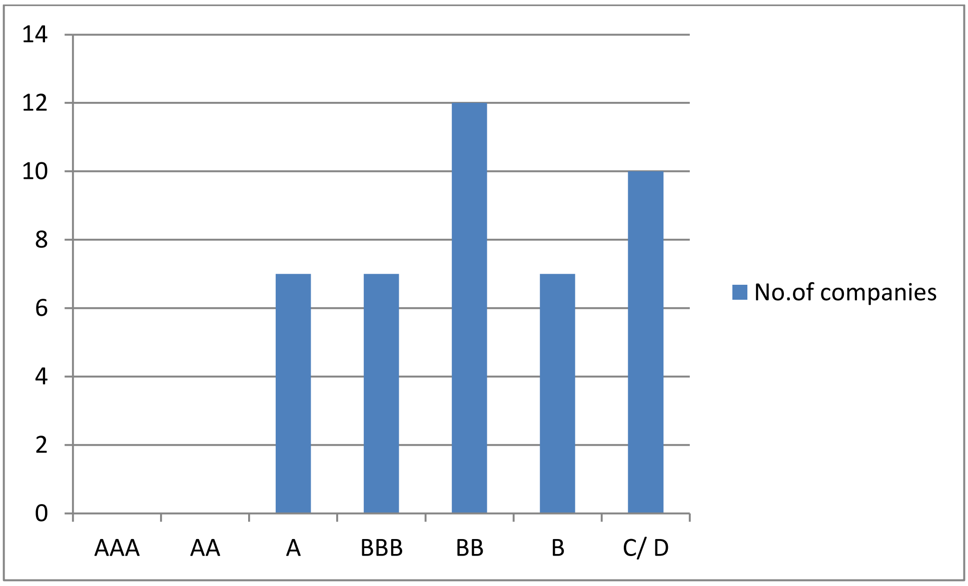
Source: CARE, for sample companies

The performance of the sugar companies in South India was impacted by prolonged drought conditions in command areas. As noted earlier, the aggregate quantity of sugarcane crushed by factories declined in SS17. Sugar recovery was also lower, impacting the cost of production. Uneconomical price realisation for most part of FY17 and reduced cane availability and hence low inventory limited gains from firm sugar prices, impacting sugar division's performance of south-based mills. Lower cane availability also meant weaker performance of distillery and co-gen operation for the mills.

For the mills in north, particularly UP, production stood improved supported by ample cane availability as well as improved recovery rates (from about less than 9.5% before SS15 to over 10.5% by SS16). This along with firm sugar prices resulted in significant improvement in profitability in FY17 which is expected to sustain.

While the present level of sugar prices underpins a favourable operating environment for sugar mills, supply-side surprises in the domestic market are likely to exert pressure on prevailing prices and pose serious threat to sustenance of the recent recovery in credit metrics.

Rating Dispersion of CARE rated entities



Source: CARE

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