

Sugar Industry Update

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With sugarcane production coming down for two successive years, 2015-16 and 2016-17, sugar production has moved downwards from 28.3 mn tonnes in 2014-15 to 25.2 mn tonnes in 2015-16 and is further expected to touch 22.5 mn tonnes in 2016-17. Subsequently, prices have firmed up and will continue to do so in the coming months if the supplies are not increased. With an expected closing stock of 4.7 mn tonnes for 2016-17, India is unlikely to meet the normative requirement of three months stock for the next year. Thus, the country may need to import sugar in 2016-17 to ensure adequate supplies during the year.

As per ISMA's first advance production estimates, India will produce 23.4 mn tonnes of sugar in 2016-17. Also, ISMA estimates the country to have a closing stock of around 6 mn tonnes for the current sugar year.

Production

All-India sugar output is expected to decline for the second year in a row. Production is likely to stand at around 22.5 million tonnes in sugar year October 2016-September 2017. Lower availability of sugarcane for crushing due to back-to-back drought situation in Maharashtra and Karnataka will drag down sugar output from the country during the year. This will bring the availability of sugar to 30.2 million tonnes during the year after adding stocks. This includes opening stock of 7.7 million tonnes for the year, which is 15.2% lower than the opening stock of 2015-16.

In 2014-15, all-India sugar production grew by a healthy 14.8% to 28.3 million tonnes backed by a growth in sugarcane production. In the following year, sugar output declined by 11% to 25.2 million tonnes on account of drop in sugarcane production.

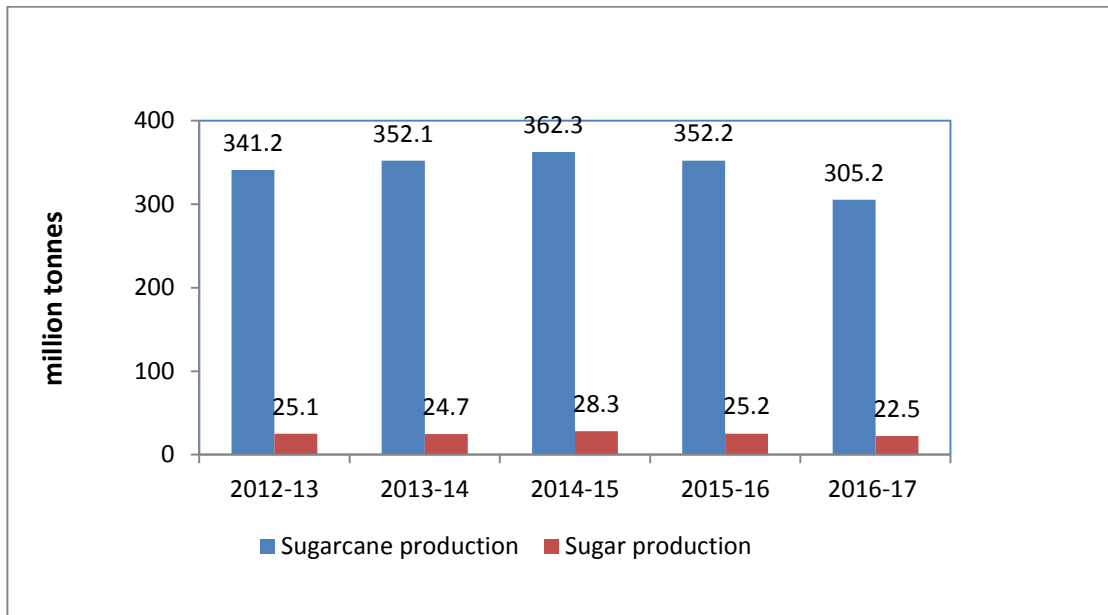
After meeting the domestic requirement of around 25.5 million tonnes, India is likely to end the year 2016-17 with stock of 4.7 million tonnes. This, however, will not be sufficient to meet the domestic requirements of the first three months of the next year 2017-18. India generally keeps a normative requirement of three months to deal with supply shocks. This, in turn, will create a tight demand-supply situation during the year. Also, this will be after a gap of six years that the country's domestic consumption will surpass domestic production. For

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the period 2010-16, India’s sugar production remained higher than domestic consumption according to Indian Sugar Mills Association (ISMA).

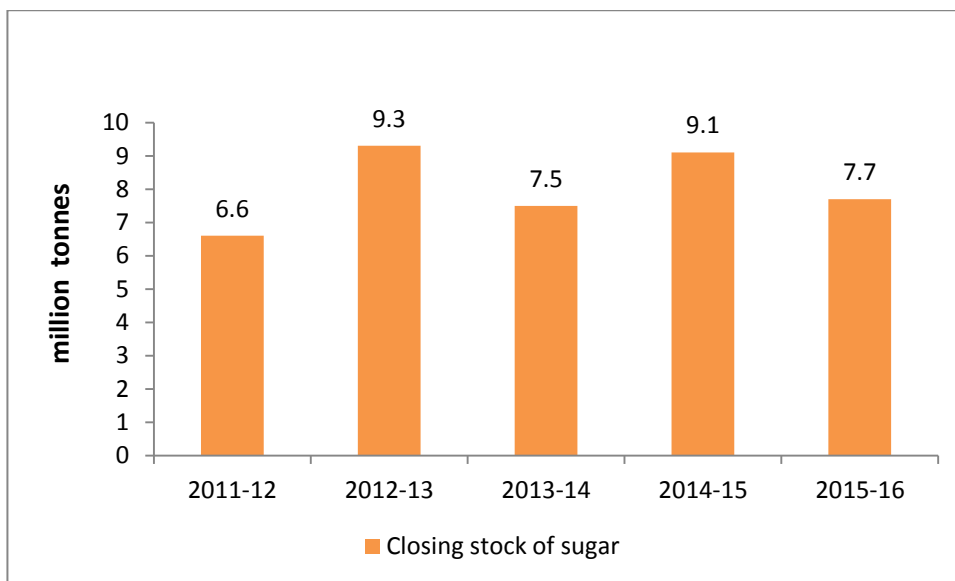
In addition to this, the United States Department of Agriculture (USDA) expects global sugar consumption to be around 174 million tonnes while production is likely to be at 171 million tonnes during 2016-17 which, in turn, will keep the international sugar prices firm, thus, supporting domestic sugar prices.

Chart 1: Sugarcane and sugar production in India



Source: Ministry of Agriculture and ISMA

Chart 2: Closing stock of sugar in India

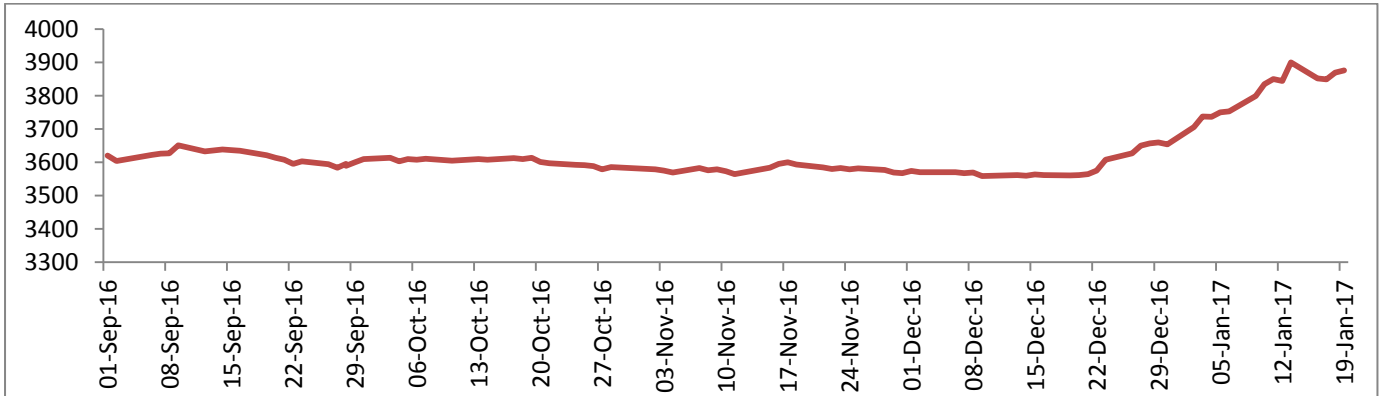


Source: ISMA

Prices

Sugar prices are important as it is an important component of the price indices which are also used for policy formulation. Sugar has a direct weight of around 1.3% in the CPI and around 2.7% in WPI. The tenuous domestic demand-supply situation kept the small grade sugar prices in Mumbai up by 30.6% in December 2016 quarter compared to the corresponding quarter a year ago. ***This is also likely to keep the prices firm in the next two quarters if supplies are not augmented.***

Chart3: Spot sugar prices (Rs/qtl)

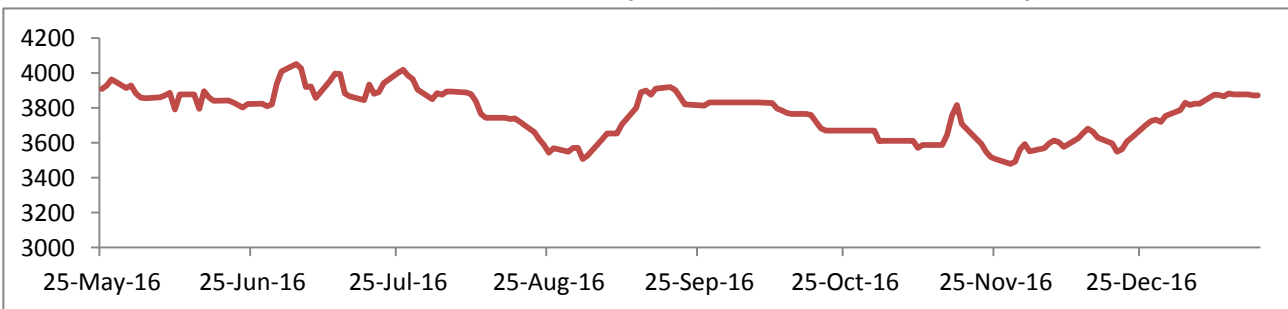


Source: NCDEX

With back-to-back fall in production, sugar prices have been growing y-o-y and they hovered in the range of Rs.35-Rs.35.8 per kg during 1 September 2016 to 22 December 2016. The prices picked up then and increased to Rs.37.5 per kg by 6 January 2017 and reached to a high of Rs.39 per kg on 13 January 2017. A drastic fall in sugar production from Maharashtra affecting all-India sugar output is believed to have resulted in the price rise. The gradient of the schedule has increased sharply towards the end of December and especially in January. ***This is a concern from the perspective of policy as higher sugar inflation has in the past tended to push up the CPI index which in turn has affected the course of monetary policy. This is one reason why these prices are monitored regularly.***

Futures prices are a good indication of the likely prices to prevail at a future point of time. In this regard the trends in the movement of the NCDEX futures prices for the Sugar-M contract have been plotted in the graph below to discern trends. The sugar futures contract for March 2017 ruled in the range of Rs.35.1-Rs.40.5 per kg during the period 25 May 2016 to 18 January 2017. This indicates the market expectations of higher sugar prices on the back of a fall in production in the current season. Therefore it does appear that the prices are not likely to ease anytime soon and they will continue to rise until supplies are increased given that demand is unlikely to change in the short run. The festival season too would be commencing in January and carry on till March which will increase demand for sugar.

Chart 4: Movement in Futures prices (March 2017 contract Rs/q)



Source: NCDEX

Import duty

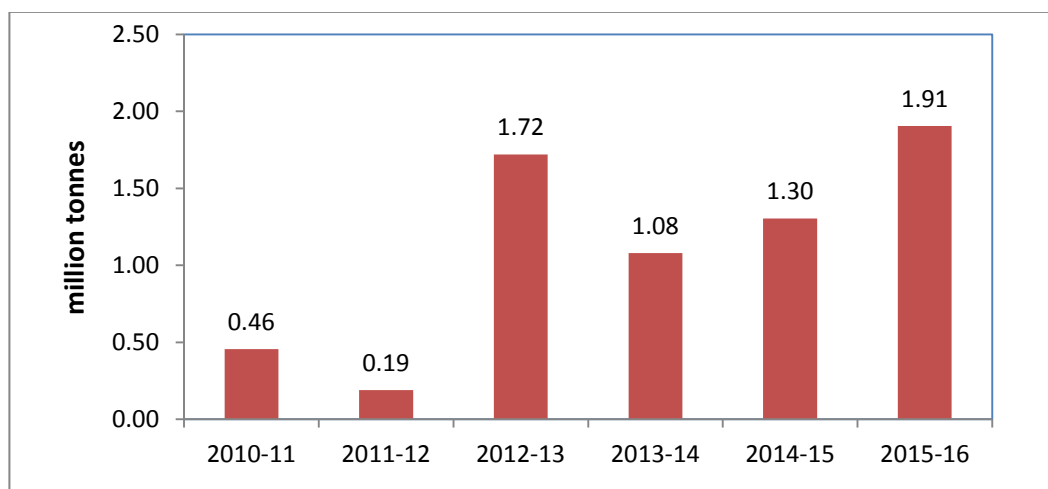
In the sugar year 2008-09, when India’s sugar production declined by a sharp 44.8% to 14.5 million tonnes, the government allowed duty-free import of raw sugar without export obligation till 1 August 2009 to increase the availability of sugar in the domestic market. The country’s sugar imports rose significantly to 1.3 million tonnes during 2008-09 on a y-o-y basis. After that, a duty of 10% was imposed in July 2012. The duty was then increased to 15% in July 2013 to increase the sales of domestic sugar. In August 2014, the import duty was further increased to 25% to aid the business of cash-starved sugar mills.

Currently, the import duty on sugar stands at 40%. It was in April 2015 that the government increased the import duty on sugar by 15% to 40%. The import duty was raised to support the domestic sugar prices which were weak then on account of excess supply of sugar in the country. The government, thus, cuts or hikes import duty according to market situations.

Considering the above measures taken by the government to keep a check on supply of sugar, the government may reduce the import duty on sugar in 2016-17 to contain the price rise on the back of a fall in domestic sugar production for the second consecutive year and a tight stock situation during the year.

During the period 2010-16, when India’s sugar production was higher than domestic consumption, the country’s sugar imports remained in the range of 0.2-1.9 million tonnes. In the year 2015-16, imports stood at 1.9 million tonnes, a y-o-y growth of 46.2%. With domestic consumption expected to surpass production in 2016-17, India need to ensure adequate supply of sugar in the domestic market.

Chart 5: Import of Sugar

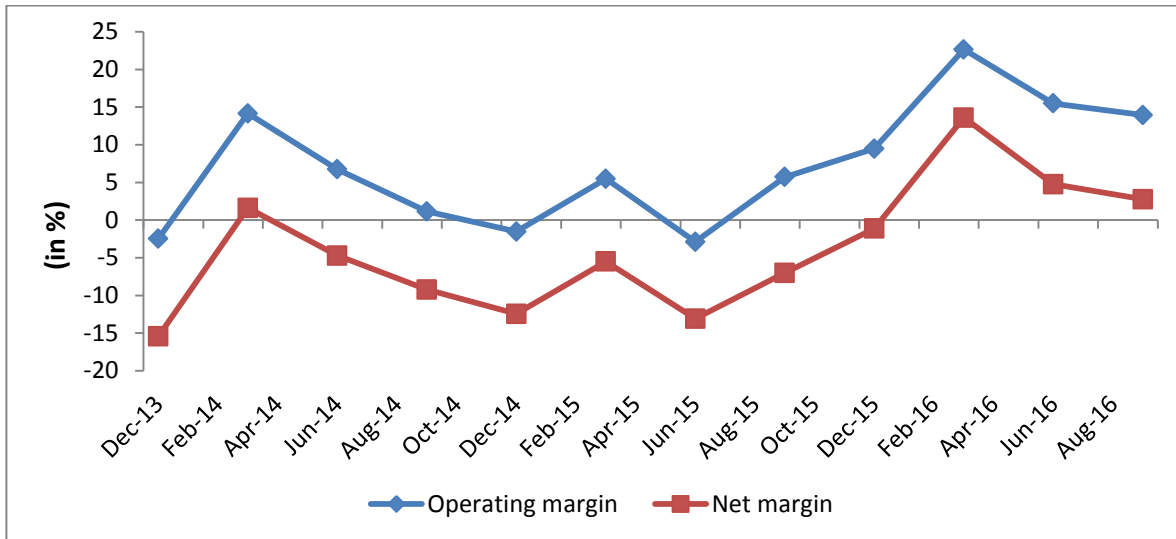


Source: DGCI&S

Impact of sugar prices on industry’s financial performance

The increase in sugar prices augured well for the industry during 2016. On a y-o-y basis, the sugar companies made net profits in each of the quarters during January-September 2016 backed by higher sugar prices after remaining in red in each of the seven quarters during April 2014-December 2015. Also, operating margin of the industry remained in double-digits in each of the quarters during January-September 2016, in range of 13-23 % , it was too after a gap of seven quarters. The industry’s profitability is based on the financial results of 36 listed sugar companies.

Chart 6: Operating and Net margins



Source: Ace Equity

The expected firm trend in prices will continue to benefit the sugar industry. However, if the import duty on sugar is reduced, the prices of sugar will soften. This, in turn, will put some pressure on profits of sugar mills.

Concluding remarks

1. India may need to import sugar in 2016-17 to ensure adequate supplies during the year
2. This may result in a cut in import duty on sugar in 2016-17
3. Prices are expected to remain firm until such time supplies are augmented.

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