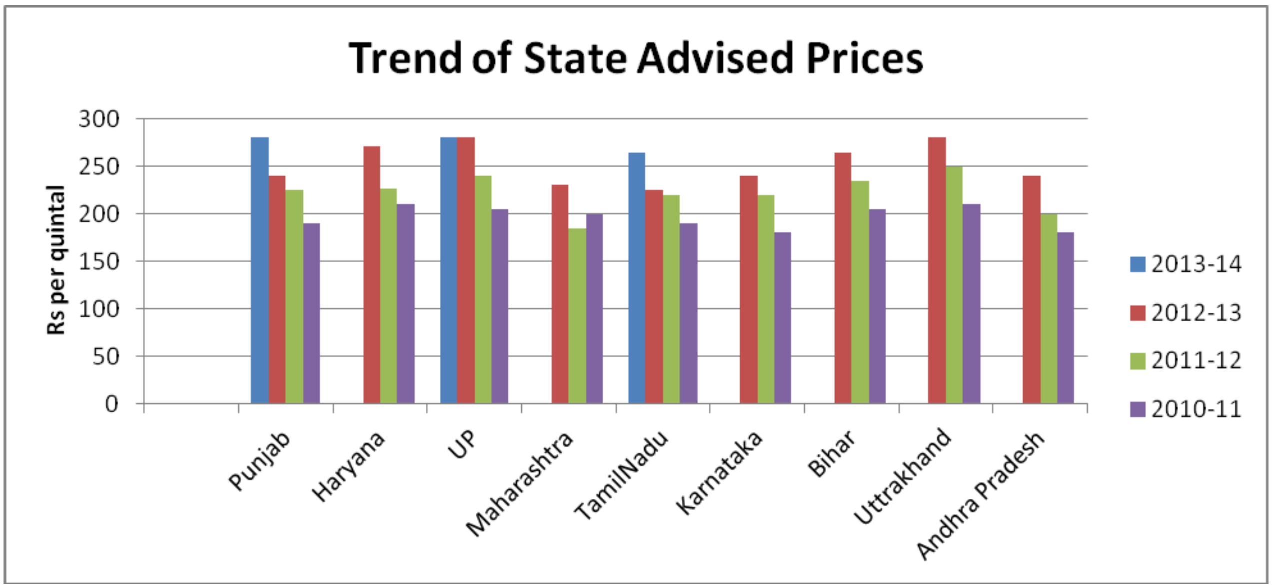
UP Sugar industry: The crisis continues…

The state of Uttar Pradesh (UP), despite being the second-largest sugar producer in the country has earned a dubious distinction of becoming a quagmire for the sugarcane farmers and sugar mills of the state and their inability to extricate themselves from the continuous crisis which has been plaguing the sector for the past few years. The UP sugar industry has been reeling under high sugarcane prices and low sugar sale realizations leading to recurring losses to mills and mounting cane arrears.

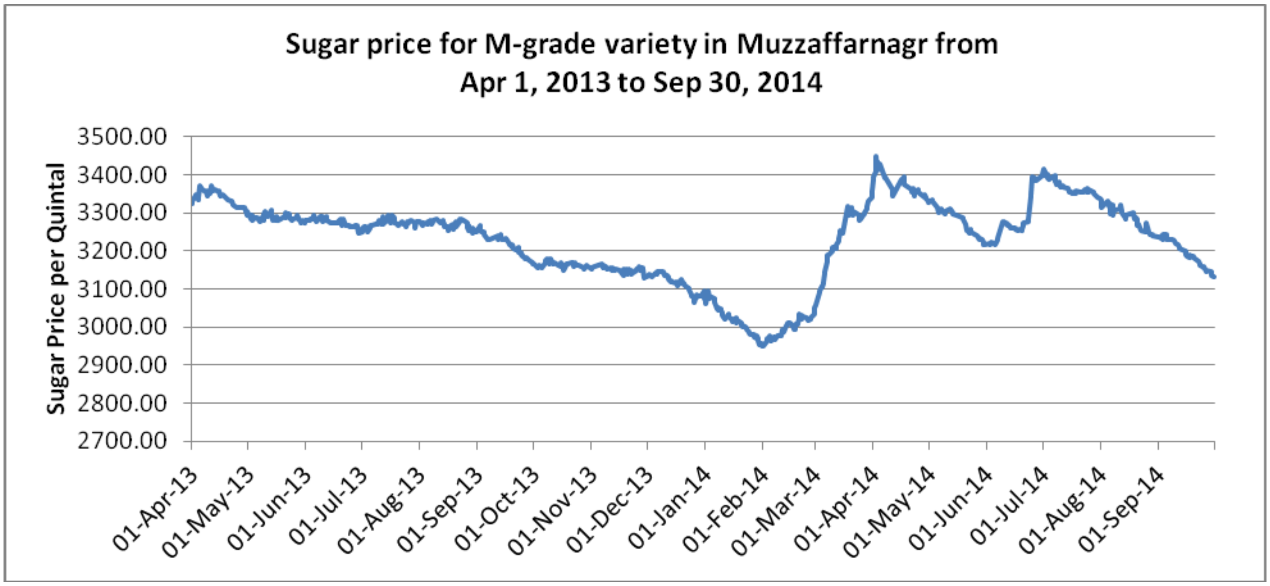
Regulatory issues leading to a crisis

Sugar industry remains highly regulated with significant government intervention due to various factors including its importance in the wholesale price index (being an essential commodity) and with regard to safeguarding the interests of farmers (with over 50 million farmers and their families depend on cane farming for livelihood). The government fixes the raw material (sugarcane) prices in the form of state advised prices (SAP) and fair & remunerative prices (FRP), and as seen in the chart below, historically, the cane prices have been, year after year, amongst the highest in UP as compared with other major sugar producing states.

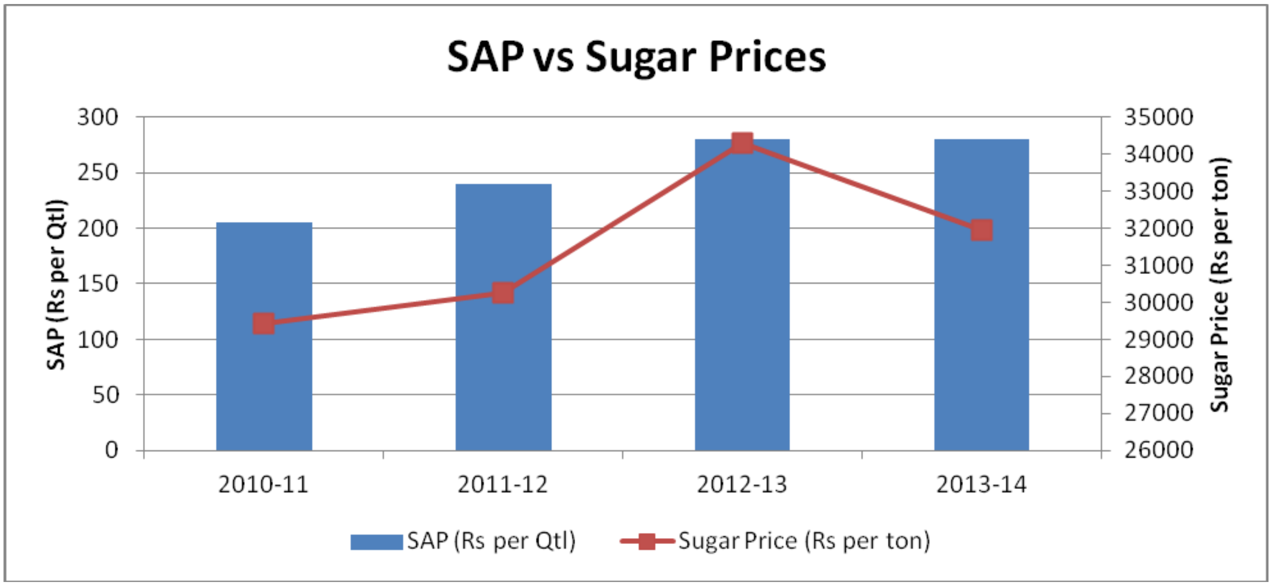


Source: Indian Sugar Mills Association (ISMA)

The sugar prices, on the other hand, have remained subdued and lower than the cost of production in case of many sugar mills culminating into huge operational losses. The contentious issue of aligning the cane price with sugar prices has largely been unaddressed despite widespread protests by the millers last year leading to a delay in crushing activities for sugar season 2013-14. There was a temporary relief for mills during the last sugar season following partial decontrol of sugar sector and allowance of sops (comprising waiver with respect to entry tax, purchase tax and society commission of Rs.11.03 per quintal for cane purchase making effective cane price of Rs.269 per quintal). There was a further relief assured in terms of additional benefit of Rs.8.97 per quintal to resolve the stalemate between sugar mills and the government during last sugar season (thus making the total waiver amount of around Rs.20 per quintal) and rationalization of cane pricing policy during the ensuing sugar season, ie, 2014-15. However, the dipping trend of sugar prices during major part of FY14 (refers to the period April 1 to March 31) has only compounded the losses of millers.



Source: NCDEX



With no development on the rationalization of the cane pricing policy of the state government, the private millers in the state of UP have issued notices for suspension of crushing activities ahead of the sugar season 2014-15. The situation has reached a deadlock whereby millers have been asking for adoption of 'linkage formula' and the protesting farmers for payment of their substantial cane arrears. To clear the deadlock, the U.P state government on Nov 12, 2014 has announced SAP of Rs.280 per quintal for the sugar season 2014-15 keeping it unchanged for the third consecutive season. Providing marginal relief to the millers, the SAP shall be paid in two tranches. The mills would be required to pay Rs.240 per quintal within 14 days of the cane purchase and the balance Rs.40 per quintal within three months of the end of crushing season.

Cane arrears

The sugar mills in UP have entered into statutory agreements under the U.P Sugarcane Supply and Purchase Order, 1954, for the purchase of sugarcane from the assigned areas. The agreement casts an obligation on part of farmers to sell sugarcane only to sugar mills in the designated area as stipulated by the cane commissioner and they are dependent on these millers for repayment of their dues. The agreement also contains an arrangement regarding tagging a certain percentage of advances extended by banks for their working capital requirement for payment to farmers (cane price). It also empowers the District Collector to issue recovery certificates to millers to recover cane price along with interest as if it were an arrear of land revenue. Despite these measures, UP had the highest cane arrears amounting to Rs. 8,754.52 crore as of May 29, 2014, pertaining to the sugar season 2013-14. These cane arrears accounted for more than 50% of the total cane arrears of the country and was reflective of plight of the farmers and warranted a remedial action by the state authorities. The state government in their bid to expedite the payment to farmers have taken several steps including serving recovery certificates to errant millers and also seizing their stocks for auction. However considering the precarious situation of the farmers who were left at the mercy of millers for payment of their dues, Allahabad High Court on a petition filed by Rashtriya Kisan Mazdoor Sangathan mandated all the sugar mills in the state to clear their cane dues by October 31, 2014. As a result of these steps, the cane arrears have gradually come down to Rs.2,800 crore as on October 14, 2014.

Initiatives by the governments

The UP state government has extended various financial benefits to the sugar mills in UP amounting to around Rs.4,890.34 crore. These benefits were in the form of loan to sugar mills under interest subvention scheme (Rs.1,527.34 crore), rebate granted by state government in form of purchase tax, society commission and entry tax (approximately Rs.770 crore), Reimbursement of Rs.6 per quintal to those sugar mills which cleared cane arrears by September 30, 2014 (payment estimated at Rs.377 crore), payment of Rs.1,000 crore by power corporation towards electricity generated and supplied by the sugar mills and price of molasses recovered

(Rs.1,216 crore). The central government also announced a slew of policy reforms for the sector in June 2014, which included:

- Raising import duty on sugar from 15% to 25% (against proposed increase up to 40%) to ensure competitive domestic prices and to keep a check on cheap sugar imports flooding the Indian markets.
- Reinstatement of the subsidy on export of raw sugar at Rs.3,300 per tonne for June-July 2014 and further increase to Rs.3,371 per tonne for Aug-Sep 2014. The move was expected to offload surplus stock of the millers and the government shall take stock of forecasted output by millers for the new season to consider extension by another year.
- The mandatory blending of ethanol with petrol increased from 5% to 10% is expected to ease the liquidity pressure of the millers to some extent, if fully implemented.

In order to clear the cane arrears, the government has announced additional interest free loan to millers to an extent of Rs.4,400 crore. These measures were successful in improving the market sentiments and marginally firming up the sugar prices to some extent but the price trend did not sustain. Following the Allahabad High Court order, the mills have offloaded their sugar stocks to clear the dues leading to sugar prices again showing a declining trend. The measures implemented by the government thus far have fell short of reviving the sector as the most crucial reform of aligning the cane and sugar prices is still unaddressed.

Current market scenario and way forward

The global sugar stock surplus has kept the international sugar prices suppressed for four consecutive years which has not only squeezed the margins of the firms but also forced closure of mills and consolidation in the sector. The domestic sugar prices have also remained subdued due to surplus sugar stock and stagnant consumption pattern. The sugar prices started firming up recently on announcement of export subsidy and estimated lower sugar production during the current season due to sporadic rain fall. However, the latest estimates as per the Department of Food & Public Distribution do not expect any shortfall in production due to deficient rainfall.

	2011-12	2012-13	2013-14	2014-15 P
Opening Sugar Stock (Million Ton)	5.8	6.6	9.3	7.5
Sugar Production (Million Ton)	26.3	25.2	24.3*	25.3
Sugar Price (Average Rs per ton)	30,248	34,301	31,951	-
Cane cultivation area (Lakh Hectare)	50.38	50.64	50.12	-

Source: ISMA
** Estimated*

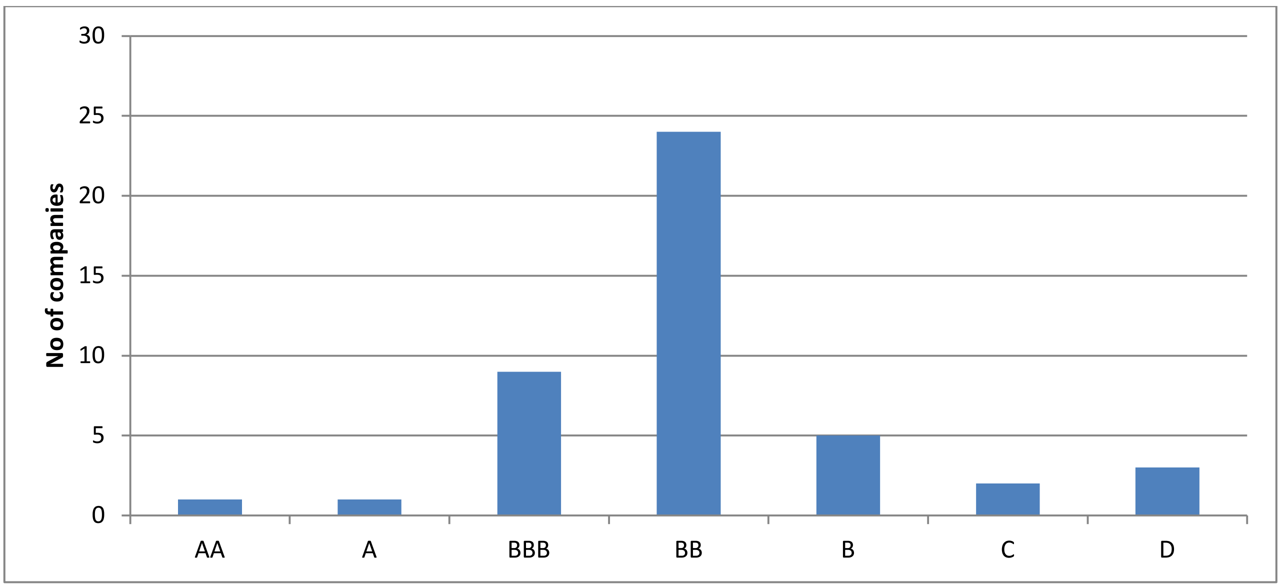
Besides the low sugar prices, the state of UP also has to cope with steep challenge of negotiating with state advised prices arbitrarily set by the state government which is far higher than the fair and remunerative prices set by the central government. The UP government has retained SAP at Rs.280 per quintal for the sugar season 2014-15 which remains significantly higher than the FRP.

Going forward, an early resolution for the current faceoff between the millers and the UP state government, devising a mechanism for ensuring that the advances disbursed for cane payment reaches the farmers without delay and cane pricing linkage shall be the key for resurrecting the confidence in the sector.

Rating dispersion of CARE rated sugar companies

CARE has outstanding ratings in sugar sector for 45 entities, the rating distribution of which is given in the following graph. CARE's Modified Credit Ratio (MCR) for sugar sector for FY14 and H1FY15 was 1.09 and 1.14 respectively which signifies moderately improving credit quality on pan India basis for the rated entities during the period.

Given the challenging operating environment in UP, the fortunes of the sugar mills in the state shall be largely dependent upon a long term government policy on the cane pricing and timely commencement of crushing operations.



Contact:

Gaurav Dixit
Assistant General Manager
gaurav.dixit@careratings.com
+91-11-4533 3235

Sachin Mathur
Deputy Manager
sachin.mathur@careratings.com
+91-11-4533 3206