Arihant Capital
Generating Wealth

Sugar Sector Update
2nd Sep 2020

Indian Sugar Sector

Increase in sugarcane FRP is likely to affect sugar mills margins; However, hike in MSP holds the key

In an era where there is a need for inclusive growth, the Sugar industry is amongst the few industries that have successfully contributed to the rural economy. Sugar industry is highly volatile industry but now it has witnessed some stabilization due to increased government regulations and initiatives. The common interest between Government, farmers and industry keeps adequate profitability of the Sugar sector. Policy initiative such as MSP hike, Ethanol blending program and export subsidies have helped sugar industry majorly.

India has now become world's largest Sugar producing countries beating Brazil. India produced 33.2 million tons of sugar in 2018-19. Excess sugar production in the last couple of years has resulted in surplus sugar inventories.

According to ISMA (Indian Sugar Mills Association), the production in the sugar season (SS) 2019-20 is expected to be 27.2 MT. The season started in October, 2019 with 14.6 MT of opening stock.

The domestic consumption in 2019-20 is estimated to be 25 MT and exports of nearly 5.2 MT. Therefore, the closing stock as on September 2020, is expected to be nearly 11.6 MT.

Sugar stock situation for Last 3 Sugar Seasons (SS) as per ISMA (in million tonnes) (SS – Oct/Sep)

in MT	SS 2017-18	SS 2018-19	SS 2019-20E
Opening Stock	3.9	10.7	14.6
(+) Production	32.5	33.2	27.2
(+) Imports	0.2	0.0	0.0
Total Availability	36.6	43.9	41.8
(-) Domestic Consumption	25.4	25.5	25.0
Balance	11.2	18.4	16.8
(-) Exports	0.5	3.8	5.2
Closing Stock	10.7	14.6	11.6

Source: ISMA, CMIE and CARE

Weak exports during the year 2017-18 were due to subdued international sugar prices. In the following SS 2018-19 the outbound shipments of sugar rose to 3.8 MT from 0.5 MT in SS 2017-18 which further increased to 5.2 MT for the current SS 2019-20. This was backed by export subsidy of Rs 10.4 per kg to sugar mills provided for expenses on marketing costs including handling, upgrading and other processing costs, costs of international and internal transport and freight charges.

The subsidy is applicable for export of up to 6 MT of sugar limited to Maximum Admissible Export Quantity (MAEQ) allocated to sugar mills for the SS 2019-20.

Government's Ethanol Blending Target: In a recent meeting, Government has set 10% blending target for mixing Ethanol with Petrol by 2022. A series of measures have been taken by Government to make Ethanol more remunerative. During the meeting, it was agreed that as producers of ethanol (sugar mills), buyers of ethanol (OMCs) and the lenders (banks) are willing to enter into a tri-partite agreement (TPA) about producing, buying and paying for the ethanol through an escrow account etc., the banks can consider giving loans to sugar mills even with weak balance sheets.

This would facilitate mills to avail loans from banks to set up new distilleries or to expand their existing distilleries, thereby enhancing the overall distillation capacity in the country.

Ethanol Measures to ease cash flow and less volatility: Government's such measures have led to good earnings visibility, timely payment to the cane farmers and low leverage. Focus on blending high quantity of Ethanol would mean the low import of crude oil.

Covid Impact on Sugar Industry: Covid pandemic has put the pressure on the sugar consumption patterns as there are curbs on social gatherings & outings, the industry is also facing reduced offtake from beverage & other FMCG companies amid the lockdown. The lockdown restrictions were eased in the third and fourth phase of lockdown. The fourth phase allows restaurants to operate kitchens for delivery of food items which is expected to increase consumption of sugar by these bulk consumers. However, the consumption of sugar is expected to remain lower for few months as bans on celebrations and gatherings continue.

Outlook: Sugar is a sector of significant importance to the National Economy. While consumption has been slowed down, the production has been cyclical and remained higher. At present, the sugar industry is regulated across the value chain. The sector has always traded at very low earnings multiples due to volatile nature of policy and cash flow.

However, Government's different initiatives such as Ethanol blending program, MSP hike announced in Feb'19 (Current Rs 31/Kg) and export subsidies will help the sector to improve profitability.

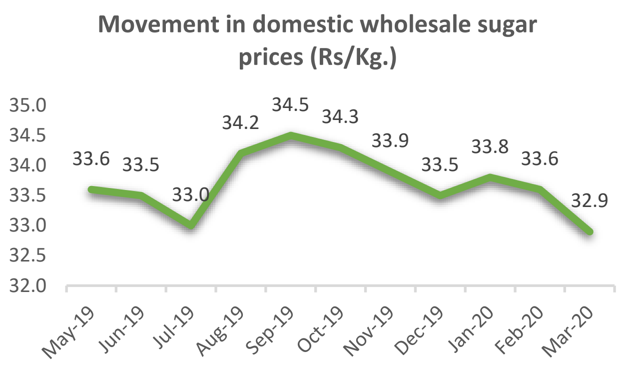
The products interchangeability from Sugar to Ethanol and vice-versa will help in reducing the cyclicality of earnings of Sugar mills. This will help to optimize the Sugar production and inventory, thus improving the profitability and liquidity of the Sugar mills.

Moreover, the Government's push towards Ethanol blending target of 10% by 2022 will lead to reduction in less import of Crude oil resulting in improvement in balance of payments.

Recent Newsbreak: As per ET now Exclusive news sources, Sugar package which has been under consideration for a month has given a nod in Cabinet meeting. Before Oct 1, Government is likely to bailout sugar package for the Industry with 1) Increase in MSP from Rs 31/Kg to Rs 33/KG 2) Besides, that there will be some 5% hike in export quota. This news is positive for Sugar industry.

Story in Charts

Exhibit:1

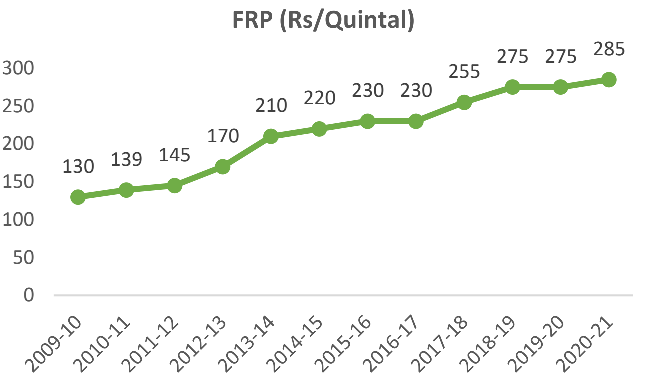


Source: CARE

The average domestic sugar prices remained almost stable and were in the range of Rs 33 per kg – Rs 34 per kg during the period October 2019-March 2020 backed by lower sugar output and higher exports for the SS 2019-20. In addition to this, monthly sales quota and encouragement to increase diversion of sugarcane towards ethanol to reduce sugar inventory have also aided the stability in prices.

In July 2020 sugar prices improved by 4.7% m-o-m to Rs 33.9 per kg. The prices also increased 1.6% sequentially in June 2020 as per Wholesale Price Index (WPI). Some recovery in demand from bulk consumers such as restaurants which were allowed to operate (though with various restrictions) is believed to have resulted in the improvement in prices.

Exhibit:2



Source: ISMA

Recently, Cabinet Committee of Economic Affairs (CCEA) has approved a 4% hike in the Fair and Remunerative Price (FRP) of sugarcane (from INR 275/quintal to INR 285/quintal for SS21 (Oct'20-Sep'21). The government said that the determination of FRP will be in the interest of sugarcane growers and is announced keeping in view their entitlement to a fair and remunerative price for their produce.

The announcement of higher FRP will result in a rise in cost of sugar production. As per CARE rating, Cost of sugar production is expected to increase by 3.6% to Rs 33.5 per kg for SS 2020-21 from Rs 32.4 per kg for SS 2019-20. The higher cost of sugar production is likely to affect the sugar mills given the current scenario of industry where surplus sugar supply is already restricting any major growth in sugar prices

Sugar Industry Stocks Peer Group Comparison

in Cr.	CMP (Rs)	Market Cap	Sales	EBITDAM (%)	PAT	EPS	D/E (x)	Div. yield (%)	RoE (%)	ROCE (%)	P/E(x)
EID Parry	294	5,199	17,128	11.8	468	26.4	1.1	0.0	26.9	21.7	11.1
Balrampur Chini Mills	155	3,257	4,741	14.3	519	23.6	0.6	1.6	21.5	16.5	6.6
Triveni Engg.	73	1,819	4,436	12.2	335	13.3	0.3	1.4	27.0	18.9	5.5
Dhampur Sugar Mills	149	993	3,526	10.2	216	32.6	1.2	3.7	16.7	10.2	4.6
Dwarikesh Sugar	31	586	1,336	10.6	73	3.9	1.7	0.0	15.5	8.5	7.9
Mawana Sugar	30	120	1,427	5.8	-83	-21.2	1.6	0.0	-24.0	2.3	-

Source: Arihant Research, Ace equity

Arihant Research Desk

Email: instresearch@arihantcapital.com

Tel. : 022-42254800

Head Office	Registered Office
#1011, Solitaire Corporate Park	
Building No. 10, 1st Floor	Arihant House
Andheri Ghatkopar Link Road	E-5 Ratlam Kothi
Chakala, Andheri (E)	Indore - 452003, (M.P.)
Mumbai – 400093	Tel: (91-731) 3016100
Tel: (91-22) 42254800	Fax: (91-731) 3016199
Fax: (91-22) 42254880	

Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

Research Analyst Registration No.	Contact	Website	Email Id
INH000002764	**SMS: 'Arihant' to 56677**	www.arihantcapital.com	instresearch@arihantcapital.com

Arihant Capital Markets Ltd.
1011, Solitaire Corporate park, Building No. 10, 1st Floor,
Andheri Ghatkopar Link Road, Chakala, Andheri (E)
Tel. 022-42254800Fax. 022-42254880