Indian Sugar Sector: No hike in sugarcane price is a positive for UP-based sugar mills

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- The Uttar Pradesh (UP) state government has maintained the state-advised price (SAP) of sugarcane at Rs. 315/quintal for sugar year 2019 (SY2019), same as in the previous year. The non-increase in SAP sugarcane price is a saving grace for the sugar industry in UP, in the face of the supply-induced pricing pressures. While the downward revision in the sugar production in SY2019 resulted in some increase in sugar prices in October 2018, the onset of sugar crushing and the fresh supply entering the market has resulted in a decline in sugar prices in November 2018. Considering the minimum support price (MSP) of sugar as fixed by the Central Government in June 2018, the contribution margin is likely to decline by around Rs. 300 – 400/MT (after assuming production subsidy) in SY2019 on a YoY basis.

Exhibit 1: Trends in FRP

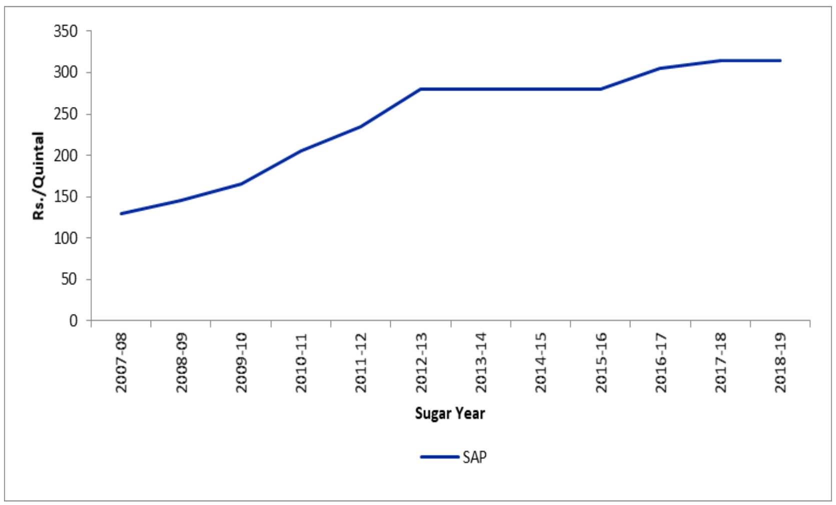
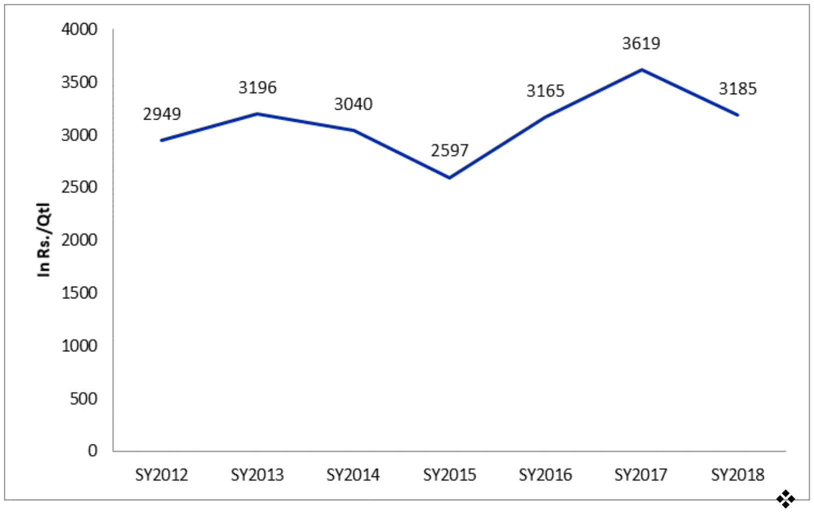


Exhibit 2: Trends in Domestic Sugar Prices



Source: ISMA and ICRA research

- The UP Government has announced the SAP for sugarcane for SY2019 at Rs. 315/quintal for the normal variety, the same as in SY2018. For the early maturing varieties, the cane price is Rs. 325/quintal and for the rejected varieties, it is Rs. 310/quintal. At these prices, the landed cost of cane (inclusive of basic SAP, taxes and levies and inward freight costs) is expected to be around Rs. 330-335/quintal.

BACKGROUND

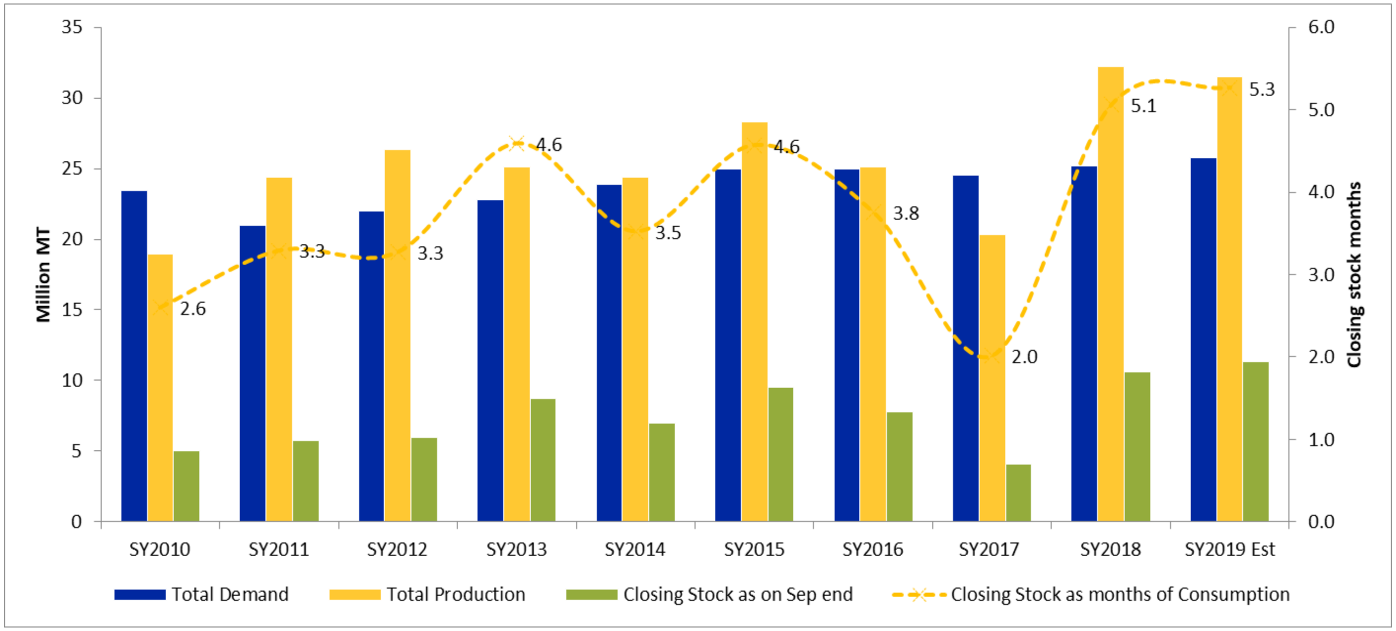
- **Cane-pricing mechanisms -** There are two cane-pricing regimes in India: The SAP announced by the state governments and the FRP announced by the Centre.

  Among the major sugar-producing states, Uttar Pradesh, Uttaranchal, Punjab and Haryana follow the SAP. Mills in Maharashtra, Gujarat, Tamil Nadu, Karnataka, Telangana and Andhra Pradesh follow the FRP (Tamil Nadu follows SAP, but the same is applicable to state-owned mills and not enforceable on private mills). However, in these states, the FRP mainly serves as the floor price and the actual prices, which are usually at a premium to FRPs when the sugar prices are healthy, are arrived at through negotiations between sugar mills and farmers. The premium is usually determined by the relative bargaining power of the farmers and the mills and the prevailing sugar prices.

  In the case of the SAP, prices are fixed by the state governments, which are usually on a higher side compared to the FRP. In this case, the cane pricing is primarily influenced by political considerations than by economical considerations, and there is limited correlation between cane costs and sugar realisations.

- **Surplus sugar in the domestic market -** The sugar production in SY2019 is expected around 31.5 million MT, lower than the preliminary estimate (given in July 2018) of 35.0 million MT due to a decline in the sugarcane availability in UP, Maharashtra and Karnataka.

Exhibit 3: Trends in demand, production and closing stock



In UP, untimely rainfall in September 2018 has adversely impacted the yields and the sugar recovery and hence the revised production estimate is around 12.1 million MT, down by 7% from 13.0 million MT (preliminary estimate). In Maharashtra, lower rainfall along with white grub infestation is likely to result in lower-than-anticipated yields and the production is revised to 9.5 million MT from 11.4 million MT (17% lower than preliminary estimate). The northern part of

Karnataka being contiguous to the southern part of Maharashtra is also impacted due to lower rainfall and some infestation of white grub, however, the impact is lower, and the revised production is at 4.2 million MT, down from 4.5 million MT (7% lower than preliminary estimate). In addition to the above-mentioned factors, the sugar production could be further impacted by the diversion of 'B' heavy molasses and sugarcane juice away from sugar into ethanol. Domestic sugar consumption is expected to increase by 2-3% to around 25.8 million MT in SY2019. Hence, the production would be higher by at least 5.5 million MT than the estimated consumption. An opening stock of around 10.5 million MT, coupled with sugar production of 31.5 million MT, is likely to result in an overall sugar availability of around 42 million MT, resulting in significant sugar surplus in the domestic market. Assuming 4 – 5 million MT of sugar exports occurred in SY2019, supported by the increase in the cane production subsidy, the closing stocks still would continue to remain high at around 11.3 – 12.3 million MT.

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