INDIAN SUGAR SECTOR

Firm sugar prices to allow absorption of sharp increase in state advised price; Government support still critical

NOVEMBER 2021

Highlights

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Cane pricing – The State Advised Price in UP (UP-SAP) has been increased by Rs. 25/quintal for SY2022, after being stagnant for three years. The Fair and Remunerative Price (FRP) increase for SY2022 has been by Rs. 5/quintal following an annual hike of Rs. 10/ quintal per annum in the past three years. Thus, for SY2022, UP-SAP would be Rs. 350/quintal for early maturing variety and Rs. 340/quintal for normal variety while FRP would be Rs. 290/quintal at 10% recovery. This would result in higher sugar production cost by ~Rs. 2.18/Kg in UP and ~Rs. 0.5/Kg in FRP following states.

Sugar Prices – The domestic sugar prices have remained rangebound within Rs. 31,800 – 32,500/MT in April–July 2021, however, the prices rose to around Rs. 33,500/MT in August 2021 owing to lower domestic quota announced by the Government amid onset of the festive season. Further, the uptick in prices continued in September-October 2021 whereby, the prices firmed up to Rs.35,700-Rs.37,000/MT. However, they are expected to moderate slightly in November with the beginning of the next crushing season. Also, the downward revision in expected Brazilian sugar production aided in the uptick in international raw sugar prices, which rose to around US$420-440/MT (19-20 cents/lb) in August-October 2021, the highest in the past four years.

Tolling Margins* – Increased cost of sugar production would result in stable tolling margins for SY2022 in UP despite firmed up domestic sugar prices. However, tolling margins are likely to increase for other three states – Maharashtra, Karnataka and Tamil Nadu in SY2022.

Impact on Profitability – With favourable mix of ethanol from B-heavy/juice (feedstock), coupled with higher sugar and ethanol realisations, the operating margin for the ICRA Samples is expected at 12.5%-13.5% in FY2022 (slightly higher than FY2021 levels) notwithstanding the hiked cane prices. This indicates that with the current favourable price scenario as well as inventory position, the industry can absorb the announced cane price hikes. Further, the revenues of ICRA sample are expected to remain stable with modest growth in FY2022 supported by firmed up domestic and international sugar prices and improved ethanol realisations.

**Considering gross recovery rates (without considering diversion towards B-heavy molasses/juice-based ethanol)*

Cane pricing regulated by Government

Cane Pricing in major sugar-producing states

States to follow

State Advised Price (SAP)

- Uttar Pradesh
- Uttaranchal
- Punjab
- Haryana

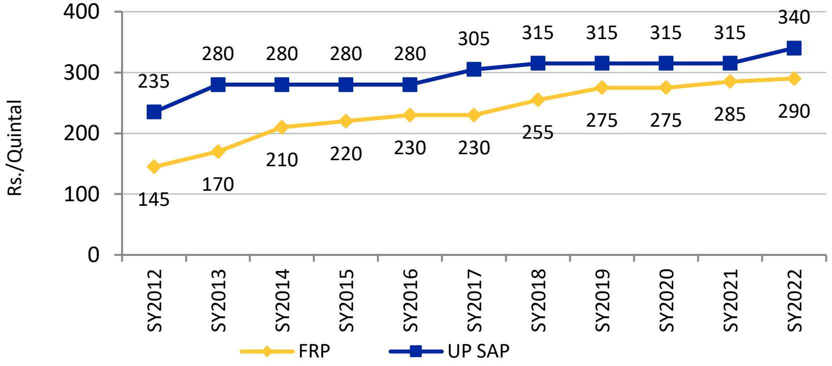
States to follow

Fair Remunerative Prices (FRP)

- Maharashtra
- Gujarat
- Tamil Nadu
- Karnataka
- Andhra Pradesh
- Bihar

Sharp cane price increase in UP for SY2022

Exhibit: Trend in cane prices



Source: ICRA Research; Tolling margins are based on recovery rates unadjusted for B-heavy molasses

Exhibit: Variety wise UP-SAP

Cane variety	SY2018-SY2021	SY2022
Early maturing variety	Rs. 325 per quintal	Rs. 350 per quintal
Normal Variety	Rs. 315 per quintal	Rs. 340 per quintal
Rejected Variety	Rs. 310 per quintal	Rs. 335 per quintal

- The sugarcane UP-SAP has been hiked by Rs. 25/quintal (unchanged during SY2018-2021) while the FRP has been increased by Rs. 5/quintal for SY2022. Thus, for SY2022, UP-SAP would be Rs. 350/quintal for the early maturing variety and Rs. 340/quintal for the normal variety while FRP would be Rs. 290/quintal. Further, this would result in higher sugar production cost by ~Rs. 2.18/Kg in UP and ~Rs. 0.5/Kg in FRP followed states.
- While the industry can absorb the hiked prices with current favourable sugar pricing scenario (both domestic and international) and increased ethanol prices for Ethanol Supply Year (ESY) 2022 along with planned higher diversion towards ethanol, the sustainability of firmed-up domestic prices and thus, the operating margin of sugar mills, would critically depend on the industry's ability to manage the inventory position.

FRP linked to recovery rates – floor price

Exhibit: Fair and Remunerative Pricing (FRP) fixed by Central Government - Trend

	SY2016	SY2017	SY2018	SY2019	SY2020	SY2021	SY2022
Base price	Rs. 230 per quintal	Rs. 230 per quintal	Rs. 255 per quintal	Rs. 275 per quintal	Rs. 275 per quintal	Rs. 285 per quintal	Rs. 290 per quintal
Linked to base recovery rate of	9.50%	9.50%	9.50%	10.00%	10.00%	10.00%	10.00%
Premium: for every 0.1 percentage of increase in recovery above base recovery rate	Rs. 2.42 per quintal	Rs. 2.42 per quintal	Rs. 2.68 per quintal	Rs. 2.75 per quintal	Rs. 2.75 per quintal	Rs. 2.85 per quintal	Rs. 2.90 per quintal

Source: Cabinet Committee of Economic Affairs - CCEA

- In the states following FRP, it largely serves as the floor price and the actual prices, which are usually at a large premium to the FRP, 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. Further, there has been a continuous increase in cane prices (both SAP and FRP) over the years, which has often been unrelated to the price of the end-product (sugar), which could adversely impact the mill's margin by disproportionate increase in cane price in any particular year.

Firmed up sugar prices in recent months

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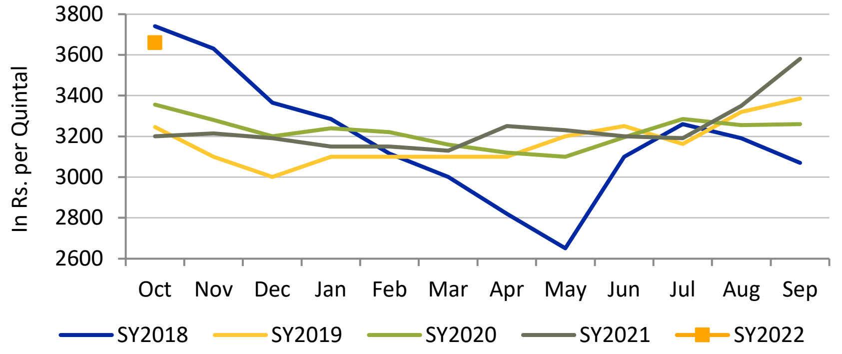
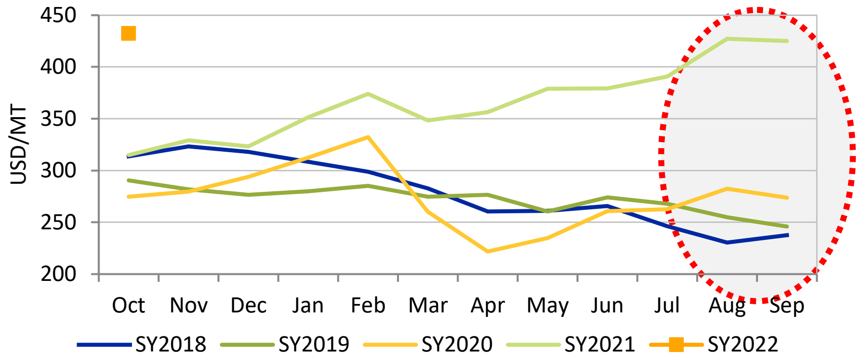
Exhibit: Monthly trends in domestic sugar prices (UP ex-mill)



Source: ICRA Research

Exhibit: Monthly trend raw sugar prices



Source: ICRA Research

- The domestic sugar prices remained rangebound between Rs. 31,800 and 32,500/MT in April–July 2021. However, the prices rose to around Rs. 33,500/MT in August 2021 tracking global price increase besides limited domestic supply following lower quota announced by the Government amidst onset of the festive season. Further, the uptick in prices continued in September-October 2021, whereby, the prices firmed up to Rs.35,700-Rs.37,000/MT in UP. However, the prices are expected to moderate slightly in November with the beginning of the next crushing season.
- Even as sugar prices have been trending higher since the beginning of calendar 2021, anticipating lower global surplus position for the commodity, the downward revision in expected Brazilian sugar production aided in further uptick in international raw sugar prices, which rose to around US$420-440/MT (19-20 cents/lb) in August-October 2021, the highest in the past four years.

Cane price increase to restrict improvement in tolling margin for UP-based mills

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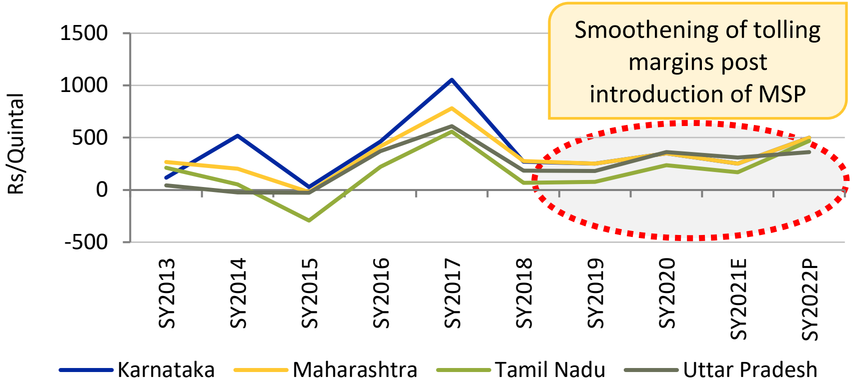
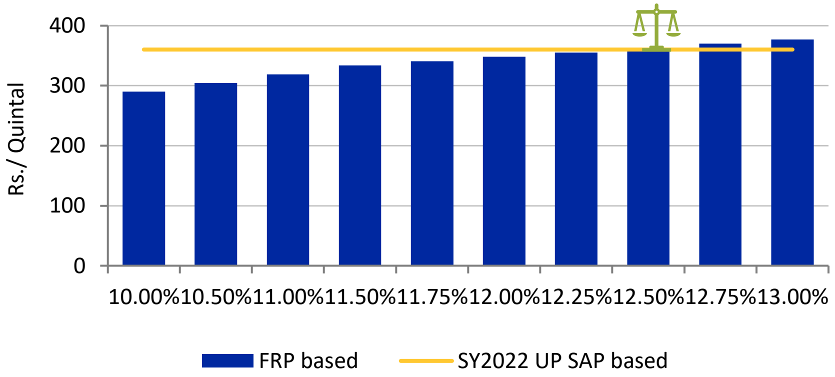
Exhibit: Trend in tolling margins for U.P.



Source: ICRA Research; Tolling margins are based on recovery rates unadjusted for B-heavy molasses

Exhibit: Landed Cane cost at various recovery rates for SY2022



Source: ICRA Research, CCEA

- While increase in FRP was announced for SY2022 by Rs. 5/quintal compared to SY2021; the UP-SAP has been increased by Rs. 25/quintal (unchanged during SY2018-2021). This would result in slightly higher than SY2021 tolling margins in UP for SY2022 owing to firmed up domestic sugar prices despite dented by increase in cane cost. However, tolling margins are likely to almost double for other three states – Maharashtra, Karnataka and Tamil Nadu in SY2022.
- Prior to the MSP, mills' profitability remains vulnerable to a sharp decline in sugar prices during the downturn, however, with the introduction of MSP since SY2018, the volatility in the tolling margins has reduced, especially during unfavourable swings.

Ethanol prices hiked for ESY2022 by 1%-3%YoY

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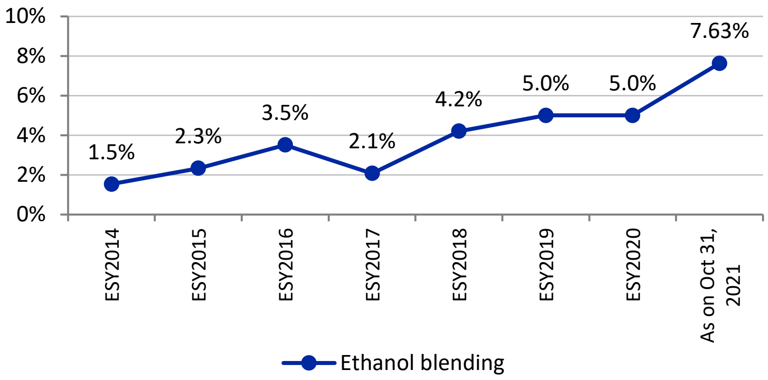
Exhibit: Ethanol prices excluding taxes and transportation cost

Feedstock	Rs./litre (ESY2020)	Rs./litre (ESY2021)	Rs./litre (ESY2022)	YoY change
Sugarcane Juice	59.48	62.65	63.45	1.3%
B-Heavy molasses	54.27	57.61	59.08	2.6%
C-Heavy molasses	43.75	45.69	46.66	2.1%

Source: ISMA, MoPNG, CCEA, ICRA Research

Exhibit: All India average ethanol blending

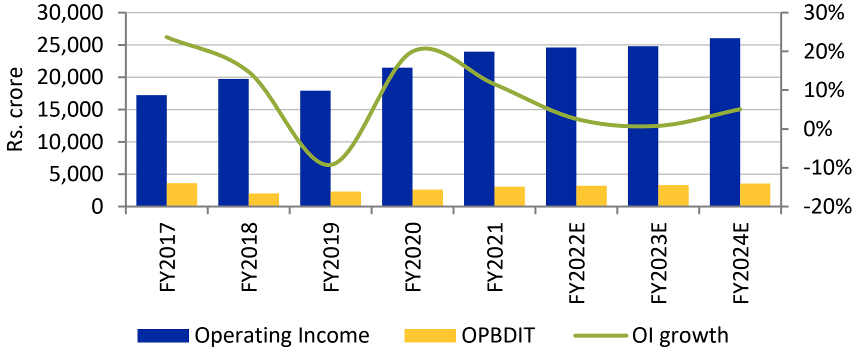


Source: ISMA, ICRA Research; ESY: Ethanol supply year (from Dec 1 to Nov 30)

- The CCEA has increased the basic price of ethanol produced from C-heavy, B-heavy molasses and sugarcane juice by Rs. 0.97/ litre (or 2.1%), Rs. 1.47/litre (or 2.6%) and Rs. 0.8/litre (or 1.3%) respectively for the ethanol supply year starting December 2021. With distillery contributing 17-25% of integrated sugar mills' turnover, this increase in ethanol prices underpins continuation of supportive regulatory framework for enhanced ethanol blending.
- ICRA expects the operating margin of integrated sugar mills to expand by 30-50 bps, pursuant to the price hike announced even as the increased sugarcane prices get absorbed. In addition, the price hike would encourage the industry to increase sucrose diversion towards ethanol to improve the domestic sugar supply demand balances that will in turn support domestic sugar prices.

Operating margin in FY2022 to remain stable despite ramp up in ethanol and favourable pricing

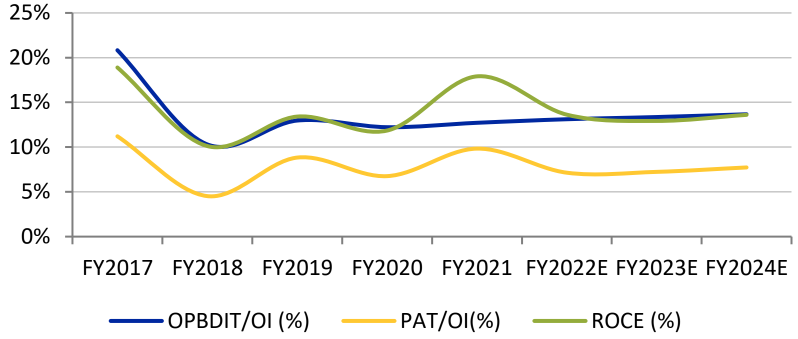
Exhibit: Trend in industry revenues and revenue growth



Source: ICRA Research

The revenues of ICRA sample are expected to remain stable with 1%-3% YoY growth in FY2022 supported by firmed up domestic and international sugar prices and improved ethanol realisations in addition to expected healthy sugar export and ethanol volumes. Further, stable revenue in FY2023 on YoY basis is projected owing to likely lower exports despite higher volumes and realisations from distillery division for most of the integrated sugar mills.

Exhibit: Trend in industry profit margins

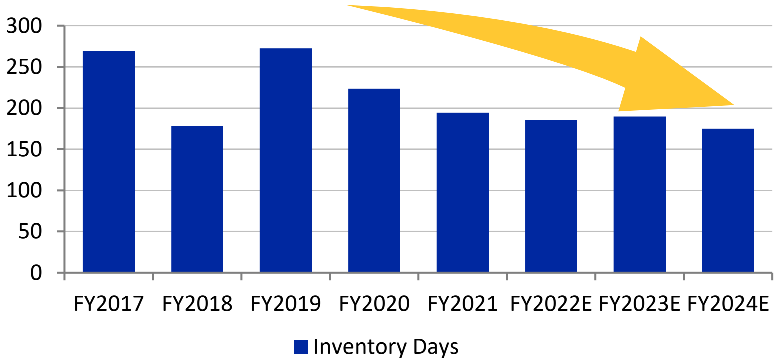


Source: ICRA Research

With favourable mix of ethanol towards B-heavy/juice (feedstock) coupled with higher sugar realisations; operating margins are expected at 12.5%-13.5% in FY2022 (slightly higher than FY2021 levels) moderated by cane price hike. This indicates that with current favourable pricing scenario, the industry can absorb the cane price hike. The margins are further expected to improve in FY2023-FY2024 to 13.0%-14.0% supported by operationalisation of ongoing distillery expansions (including grain-based ethanol capacities for few players).

Inventory to reduce meaningfully going forward

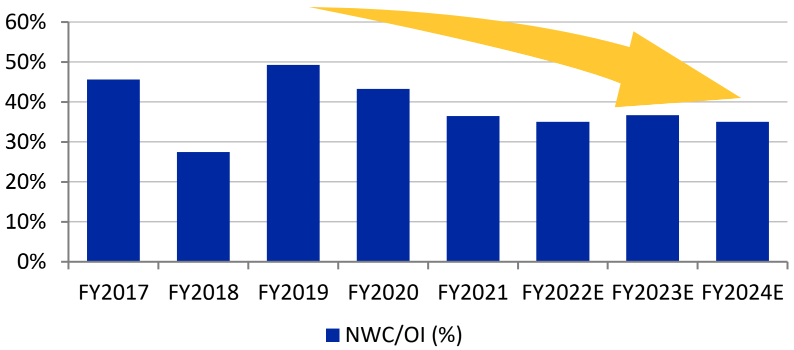
Exhibit: Trend in Inventory Days



Source: ICRA Research

Higher diversion towards B-heavy molasses/juice – based ethanol coupled with healthy export prospects for FY2022 would result in both reduced/stable sugar production as well as healthy sugar sales respectively, especially for FY2022. This would lead to reduced inventory days going forward from the current levels.

Exhibit: Trend in working capital intensity



Source: ICRA Research

Working capital intensity of the industry is expected to improve going forward to 30-37% from the current levels with reduced inventory levels as well as lower subsidy receivables (with subsidy likely to be nil/minimal for next sugar season) despite considering a slight reduction in payable days in the view of the Government's focus for clearing cane dues as early as possible.

Reduced inventory levels to allow strengthening of credit profile

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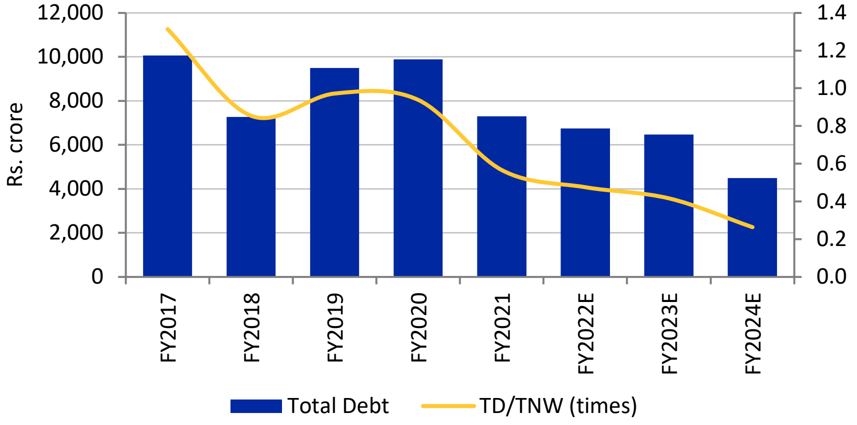
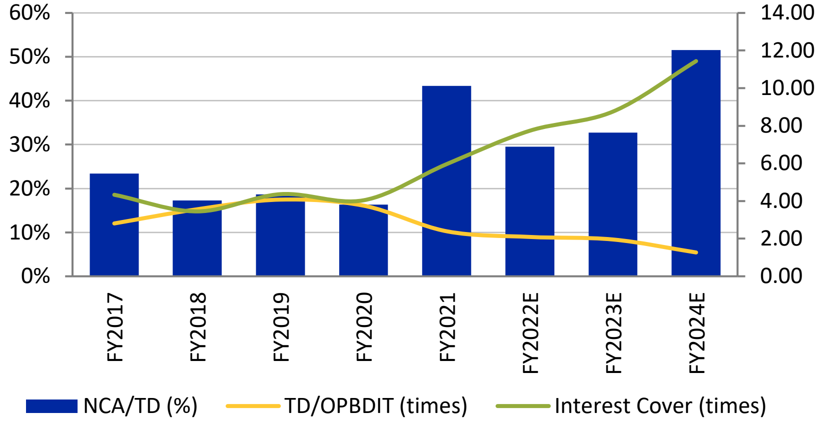
Exhibit: Trend in total debt and capital structure of the industry



Source: ICRA Research

Exhibit: Trend in coverage metrics of the industry



Source: ICRA Research

With the reduced closing inventory levels, the borrowings of ICRA samples are expected to reduce going forward, despite ongoing debt-funded capex plans (for distillery and crushing capacities) for various players. Also, debt is expected to reduce substantially by FY2024. Further, with accretion of profits, the capital structure is expected to be bolstered.

With improved operating profits and reduced debt levels, the coverage metrics would emerge stronger.

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Thank You!