Research

Policy boost for sugar mills

Exports to pick up despite weak international prices

Sugar policy to revive millers' profitability

The event

The Cabinet Committee on Economic Affairs (CCEA) has approved a comprehensive policy package of Rs 5,500 crore on 26th September, 2018, to improve liquidity of sugar mills and provide assistance for clearing cane arrears, which stand at Rs 13,000 crore for sugar season (SS) 2017-18.

The package includes:

1. Rs 1,375 crore towards internal transport, freight, handling and other charges to facilitate export for SS 2018-19. The subsidy for mills across India would be as follows:
    a. Rs 1,000/ tonne of sugar for mills located within 100 km of ports
    b. Rs 2,500/tonne of sugar for mills located beyond 100 km from the ports and in coastal states
    c. Rs 3,000/tonne of sugar for mills located in non-coastal states or actual expenditure, whichever is lower

2. Raw material subsidy of Rs 13.88 per quintal of cane crushed during SS 2018-19 to be provided to mills which fulfil the conditions stipulated by the Department of Food and Public Distribution. A total expenditure of Rs 4,163 crore has been approved for this purpose

3. To ensure payment of cane dues to farmers, both these subsidies would be credited directly to accounts of farmers on behalf of sugar mills

Background

Due to depressed market sentiments and crash in sugar prices, the liquidity position of sugar mills was adversely affected in the sugar season 2017-18 leading to accumulation of cane price dues of sugarcane farmers which reached an alarming level of about Rs. 22,000 crores in May, 2018, highest in the last five years.

In order to stabilize sugar prices at reasonable level and to improve the liquidity position of the mills thereby enabling them to clear the cane price arrears of farmers, for the current sugar season 2017-18, Central Government took the following measures in past six months:

(i) **February 2018:** Increased custom duty on import of sugar from 50% to 100% to check any import in the country.

Impact on prices: Neutral.

(ii) **March 2018:** Withdrew custom duty on export of sugar to encourage sugar industry to start exploring possibility of export of sugar.

Impact on prices: Neutral.

(iii) **April 2018:** Allocated mill-wise Minimum Indicative Export Quotas (MIEQ) of 20 LMT of sugar for export during Sugar Season 2017-18.

Impact on prices: Positive

(iv) **May 2018:** Re-introduced Duty Free Import Authorization (DFIA) Scheme in respect of sugar to facilitate and incentivize export of surplus sugar by sugar mills.

Impact on prices: Positive

(v) **May 2018:** Extended financial assistance to sugar mills @ Rs.5.50/quintal of cane crushed during 2017-18 Sugar Season to offset the cost of cane.

Impact on prices: Neutral; Impact of profitability: Positive

(vi) **June 2018:** Notified Sugar Price (Control) Order, 2018 directing that no producer of sugar shall sell white/refined sugar at factory gate at a rate below Rs. 29/kg; along with imposition of stock holding limits on mills.

- (vii) Created buffer stock of 30LMT of sugar w.e.f01.07.2018, to be maintained by sugar mills for one year for which Government will bear a carrying cost of about Rs. 1175 crore.
- (viii) In order to augment ethanol production capacity and thereby also allow divergence of sugar for production of ethanol, approval has already been granted for extension of soft loan of Rs. 4440 crore through banks to the mills for setting up new distilleries/ expansion of existing distilleries and installation of incineration boilers or installation of any method as approved by Central Pollution Control Board for Zero Liquid Discharge for which Government will bear interest subvention of Rs. 1332 crore.

Impact on prices: Positive; Impact of profitability: Positive

(vii) **September 2018:** Increased prices of Ethanol produced from B heavy molasses and cane juice to Rs. 52.6 per liter and Rs. 59.2 per liter respectively from the previous Rs. 47.3 liter

Impact on prices: Neutral; Impact of profitability: Positive

As a result of above measures, all India average ex-mill prices of sugar increased from the range of Rs. 24-27/kg in May 2018 to Rs. 30-31/kg in July 2018; and all India cane price arrears of farmers have also come down to Rs. 13,000 crore as of September 2018 from the peak arrears of about Rs. 22,000 crore as of May 2018, a reduction of 41%.

The impact

The comprehensive sugar policy released on Wednesday, 26th of September, 2018, is aimed at improving liquidity of the mills. The two key provisions that are expected to have a significant impact would be

1. Providing a raw material subsidy of Rs. 13.88 per quintal of cane crushed which would bring down cost of producing sugar by 4-5%.
2. Transport cost subsidy of Rs 1000-3000/ tonne that is expected to lower export linked transport expenses by 50-60%.

However, this only applies if mills export their assigned quota of sugar as directed under the Minimum Indicative Export Quota (MIEQ) the targeted exports for the industry, 5 million tonnes represents 15% of SS2018-19 production. And the mills are required to maintain monthly inventory levels as directed by the government.

This policy that intends to improve the liquidity of the mills could bring down the cane arrears of SS 2017-18 by 70-75%. However, numerous conditions set to avail the subsidy benefits may prove to be a roadblock for mills to take advantage of this scheme.

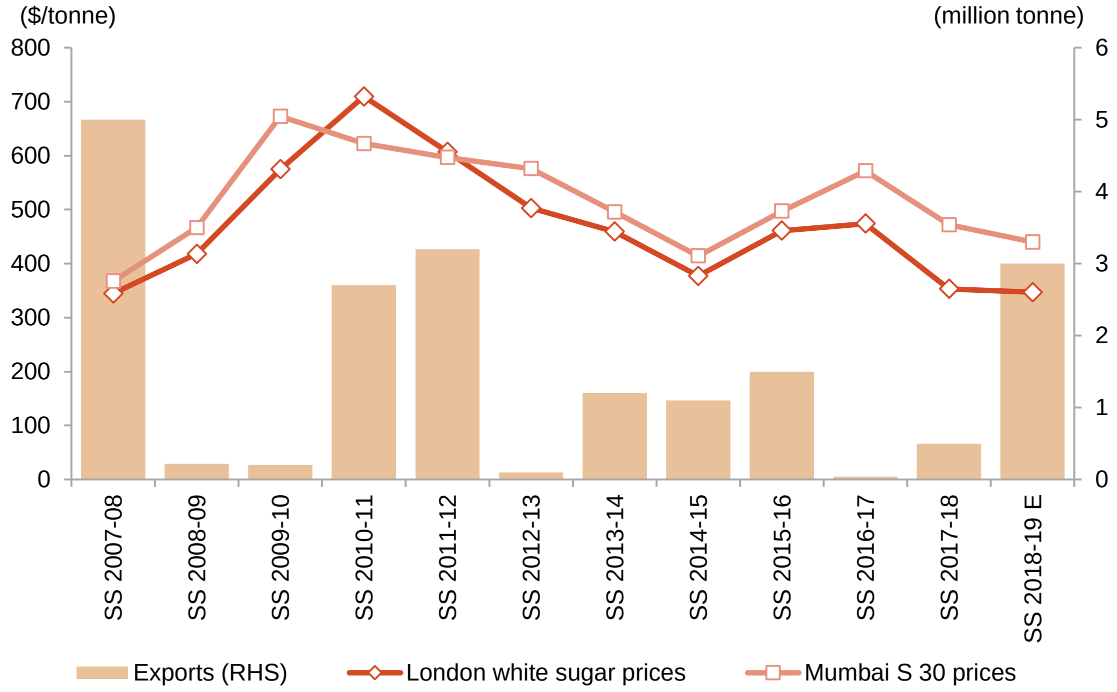
Exports to pick up despite weak international prices

The minimum indicative export quota of 2 MT for SS 2017-18 was not met and the mills only exported 0.5 MT in SS 2017-18. This was because international sugar prices remained soft and the quota was announced only in April 2018 for SS 2017-18, after half the season (October-September) was over.

However, in SS 2018-19, with the export quota announced well in advance and a slew of measures including raw material subsidy and transport subsidy, exports are expected to get a boost.

Our interactions suggest that while the industry may not fulfil its 5 MT export quota, as much as 3 MT could be exported. International sugar prices are expected to remain weak next season, too, given bumper production expected from Thailand and the EU.

Exports to touch 3 MT in SS 2018-19



Source: Industry, CRISIL Research

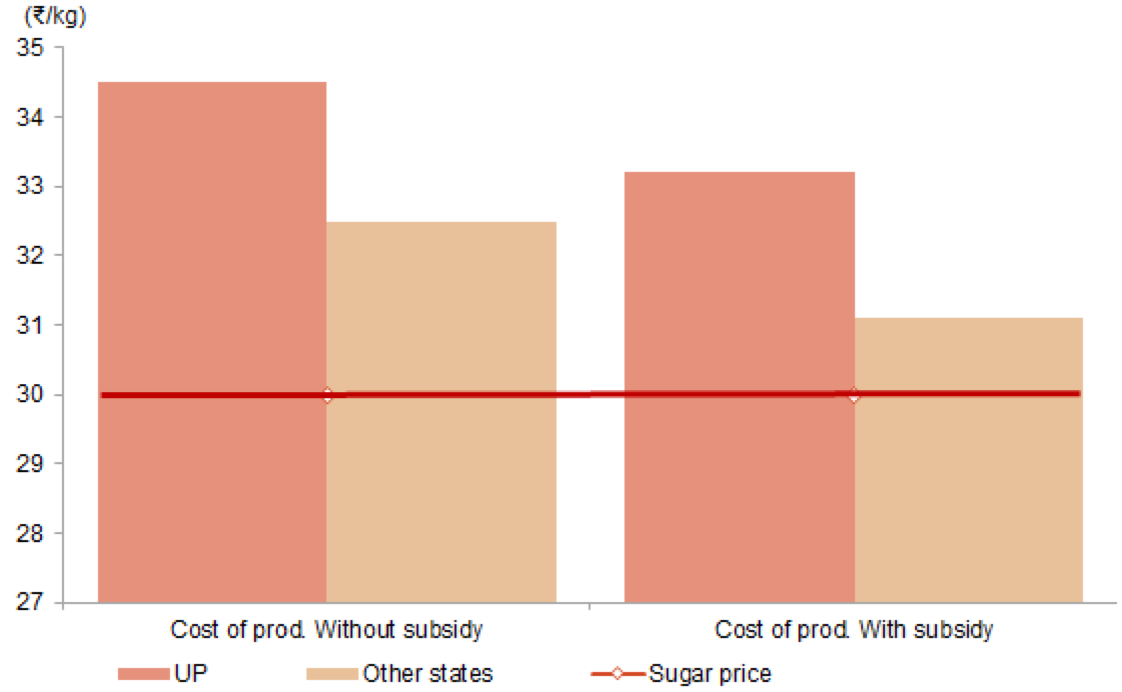
Sugar mills to see an improvement in EBITDA margins

Losses of standalone sugar mills to reduce, although they would continue to remain in red

A study of the cost economics for a non-integrated mill indicates margins could improve by ~400 bps to between -4% and -6% if the subsidy is availed.

The raw material cost of standalone sugar mills is expected to decline by 4-5% if they avail the raw material subsidy. However, since sugar prices, both domestic and exports, are projected to remain below the cost of production, the standalone mills are expected to continue making losses

Cost of raw materials to decline, pulling down overall cost of production



Source: Industry, CRISIL Research

EBITDA margins of integrated mills to turn positive in SS 2018-19

Integrated mills typically earn higher margins than standalone sugar mills owing to better operational economics of their distilleries and power segments with revenues from the distillery and power segments accounting for 9-10% each of overall revenues. CRISIL expects EBITDA margins for its sample set of 24 companies (large proportion being integrated public listed entities) to improve to 600-800 bps in SS2018-19 from (5)-(7)% expected earlier to 0-2% in SS 2018-19.

Integrated mills that upgrade distilleries could see a higher margin improvement of up to 1,000-1,100 bps. Along with a decline in raw material cost, they would see a 20% increase in revenue from the distillery segment driven by higher realizations for ethanol.

Given the low sugar prices, we expect many of the integrated mills to upgrade facilities to produce ethanol from B heavy molasses (intermediate sugarcane juice). These investments would happen gradually over the next few quarters. We expect very few large mills to upgrade all the way to divert 100% sugarcane juice to ethanol despite the 25% increase in ethanol realisations and the healthy demand prospects from OMCs to meet higher blending norms, given the order of investment required.

Significant capacity addition can take place in distillery segment

To avail the benefit of higher ethanol prices, many distilleries are expected to upgrade their capacity to produce ethanol from B heavy molasses. In the days following the announcement of a rise in price of ethanol, Shree Renuka Sugars announced a 25-30% expansion in its distillery capacity with an investment of Rs 207 crore, while Balrampur Chini mills announced an expansion of 50%.

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