CRISIL RESEARCH

June 2013

# CRISIL Opinion

## Rising cane costs to ***crush*** profitability of sugar mills

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*CRISIL Research, India's largest independent and integrated research house, expects sugar mills in India to post net losses of over Rs. 10 billion during the sugar season (October to September) 2012-13 as a result of the widening gap between sugarcane and sugar prices. While sugar prices are determined by the market forces of demand and supply, sugarcane prices continue to be regulated by the central and state governments. This disparity in cane and end-product pricing will continue to cause wide variations in sugar production and mill profitability. We believe that this issue can be resolved only by linking sugarcane prices to the prices of end-products.*

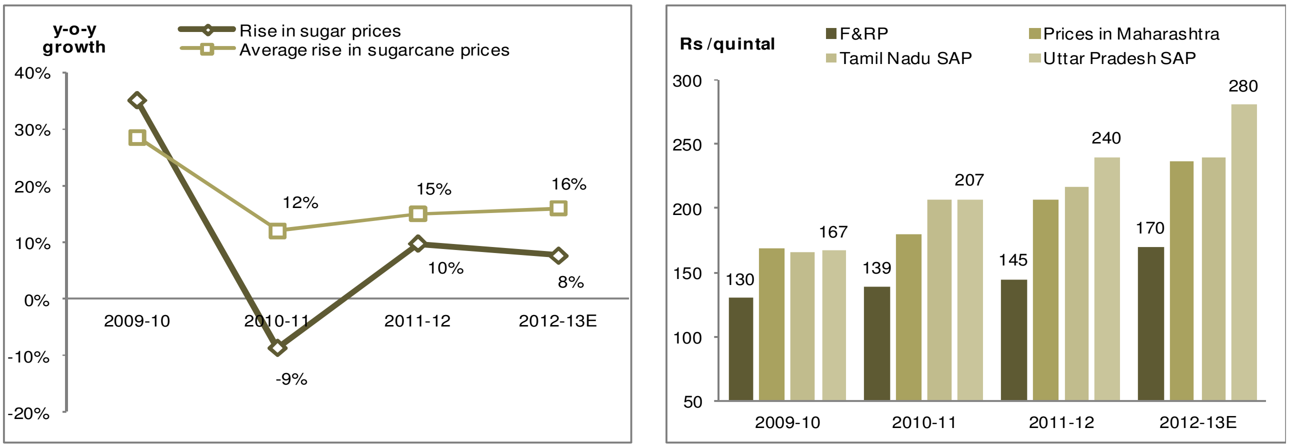
## Sugar mills to post heavy losses in 2012-13 season

Sugar mills in India are likely to post net losses of over Rs. 10 billion in 2012-13 sugar season (October to September) because of the widening gap between the sugarcane and sugar prices. While sugar distribution has been decontrolled with effect from April 2013 following the abolishment of the regulated releases mechanism and levy sugar obligation, cane prices continue to be regulated by the central and state governments.

Over the last few years, the increase in sugar prices has not kept pace with the increase in cane prices. While average sugarcane prices paid by mills increased at 14 per cent CAGR over the last three seasons from 2010-11 to 2012-13, the increase in sugar prices has been a mere 2.6 per cent. The steep rise in sugarcane procurement costs (accounting for about 70 per cent of total operating costs) vis-à-vis sugar prices has significantly impacted the profitability of sugar mills during this period.

To illustrate, in the last three seasons ending SS 2012-13, the ratio of sugarcane costs to revenues from the sale of sugar and its by-products has been as high as 76-79 per cent as compared with the previous decadal average of 67 per cent. Increasing cane costs have pushed several mills to report net losses during this period.

**Comparison between rise in sugarcane and sugar prices**

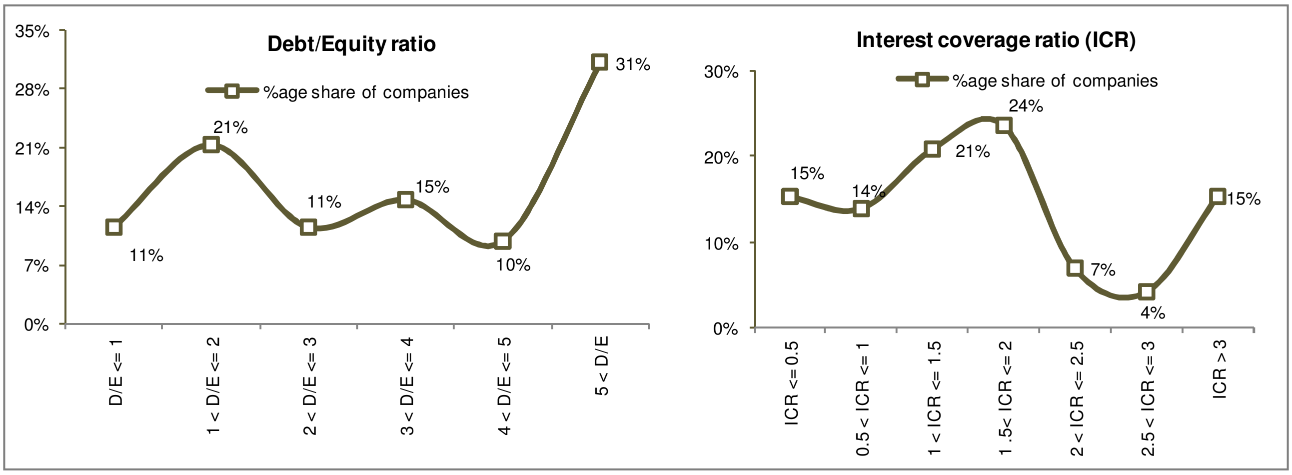



**Note: The years on the x axis refer to sugar season from October to September**
**SAP=State advised price; F&RP=Fair & Remunerative price**
**Source: Industry, CRISIL Research**

## Debt servicing ability of the industry to weaken

CRISIL Research analysed the financial performance of 74 companies which account for about 50 per cent of domestic sugar production. About 40 per cent of these companies posted net losses in SS 2011-12. Only large mills that have integrated forwards into power generation and distillery business have been relatively resilient to the pressures on profitability. Nearly 75 per cent of the companies – up from 45 per cent in SS 2009-10 – had interest cover of less than 2 times.

**Dispersion of D/E and interest coverage ratios across companies analysed(2011-12)**

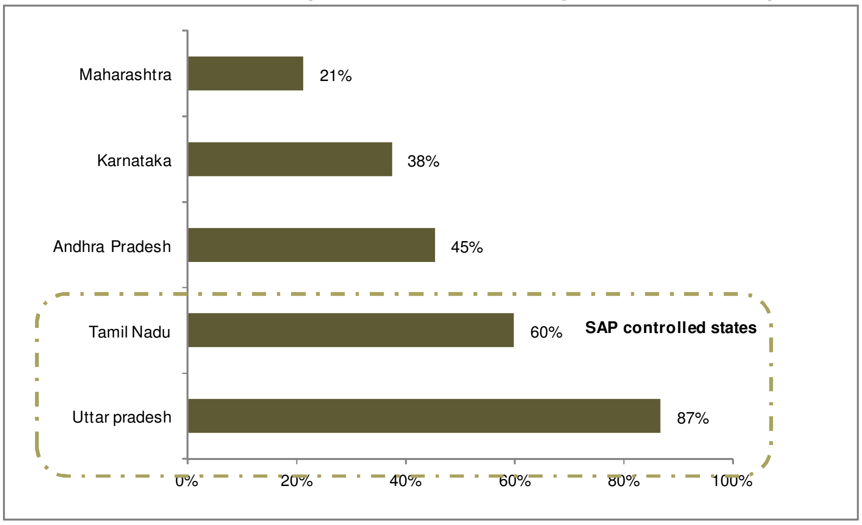



**Source: CRISIL Research**

## Minimum support price announced for SS 2013-14 to add to mills' woes

For the SS 2013-14, the central government has announced a 23.5 per cent hike in the minimum price payable for sugarcane through the Fair and Remunerative Price (F&RP) mechanism. However, the increase in market prices of sugar is likely to be limited to 8-9 per cent. With the world sugar prices expected to be under pressure because of surplus production and Indian import duty on sugar as low as 10 per cent, any further increase in domestic prices would trigger cheaper sugar imports. CRISIL Research believes that this mismatch between cane and sugar prices would erode the operating margins of sugar mills by 200-250 bps. Sugar mills in Uttar Pradesh and Tamil Nadu, where the State Advised Price (SAP) for sugarcane is higher than the F&RP, would be more adversely impacted, compared with their counterparts in other states that adhere to F&RP.

**State-wise share of companies with net margins less than 1 per cent (2011-12)**




**Source: CRISIL Research**

## Linking of end-product prices to cane prices – the only long-term solution

Although the decontrol of sugar distribution and the impetus given to blending ethanol with petrol are expected to provide some relief to the sugar mills, the issue of sugarcane pricing remains unresolved. High cane costs typically lead to higher cane arrears, which in turn prompts farmers to either divert cane for other purposes or shift to the cultivation of alternate crops, thus precipitating a dip in sugar production. A dip in sugar production pushes up sugar prices and sets off a period of upswing in sugar production, thus perpetuating the cyclicality in the industry.

With the intention of ensuring profitability of sugar mills and stability of farmer revenues, the Rangarajan Committee, in October 2012, had recommended abolishing SAP and sharing 70 per cent of the revenues from the sale of sugar and its by-products with farmers. The government is, however, yet to implement this recommendation.

CRISIL Research believes that linking sugarcane prices to the prices of end-products is critical for safeguarding the long-term financial health and sustenance of the industry. This will also help reduce the extent of volatility in sugar production by enabling more efficient transmission of price signals to farmers.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