Research

CRISIL
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Cane arrears to decline 18% this season

Sugar price hike to give mills Rs 3,200-3,400 crore liquidity lift, international prices another Rs 100-200 crore

Impact Note I February 2019

The hike in minimum selling price of sugar by 7% to Rs 31 per kg from Rs 29 per kg, approved by the union cabinet last week, is expected to address the profitability and liquidity issues of sugar mills, and ease their cash crunch, thereby enabling payment of accumulated arrears to sugarcane farmers.

The hike, though, would be applicable to only the seven-and-a-half months remaining in sugar season (SS) 2019, which extends from October to September.

Given this, CRISIL estimates the rise in domestic sugar prices to add Rs 3,200-3,400 crore to millers' cash-flows. An increase in international sugar prices would add a further Rs 100-200 crore, taking the total fillip this season to Rs 3,400-3,600 crore.

Even standalone mills are expected to break even in SS 2019, given the pick-up in sugar prices.

Sugar prices to trend up, export realisations to improve

Although the minimum selling price was set at Rs 29 per kg in June 2018, prices were trending at Rs 30-32 in the open market between June 2018 and January 2019.

In SS 2019, sugar prices are expected to be at Rs 34-35 per kg in north India and Rs 33-34 per kg in south India.

This would enable the mills to just about cover their cost of production, which is estimated to be Rs 33 per kg in Uttar Pradesh, and Rs 31-32 in Maharashtra and Karnataka.

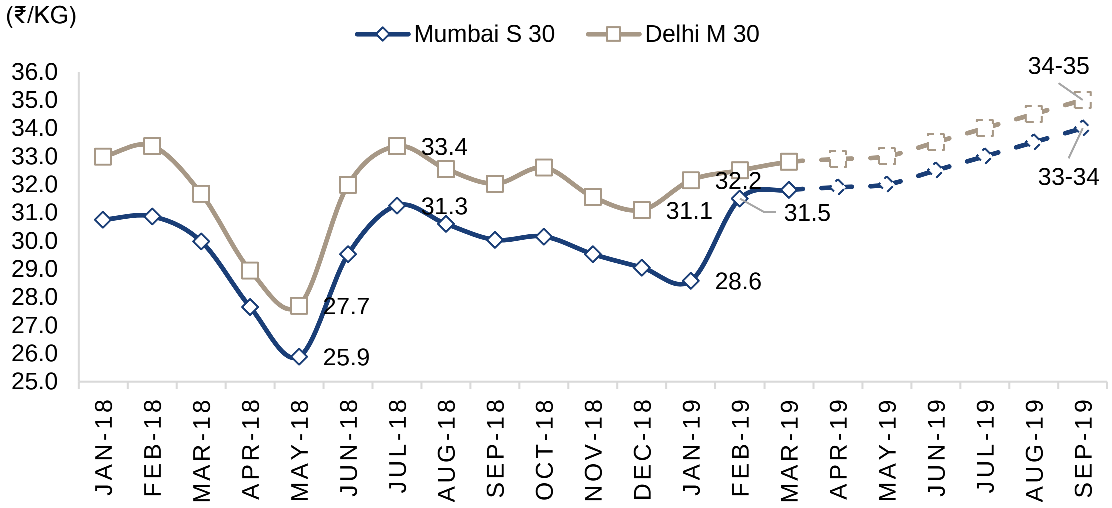
The liquidity of the mills would, however, improve by ~Rs 3,300 crore.

Meanwhile, high level of inventory would limit any further rise in sugar prices. The SS 2018 closing inventory was at 8.8 million tonne compared with an average of 7 million tonne in the past five years. The SS 2019 inventory is expected to be higher, at 9-10 million tonne, creating a supply glut.

Exports are expected to pick up to ~2.5 million tonne in SS 2019, with 0.7 million tonne already exported as of February 2019.

With world production expected to decline by around 5% and the output of Brazil, the largest sugar producer, declining by 12%, international sugar prices are expected to strengthen by 3% to $360 per tonne. This is estimated to benefit Indian exporters by Rs 1 per kg, infusing additional liquidity of Rs 100-200 Crore.

Sugar prices in north trending Rs 1/kg above those in the south



Note: Dotted line indicates CRISIL estimated numbers

Source: Industry, CRISIL Research

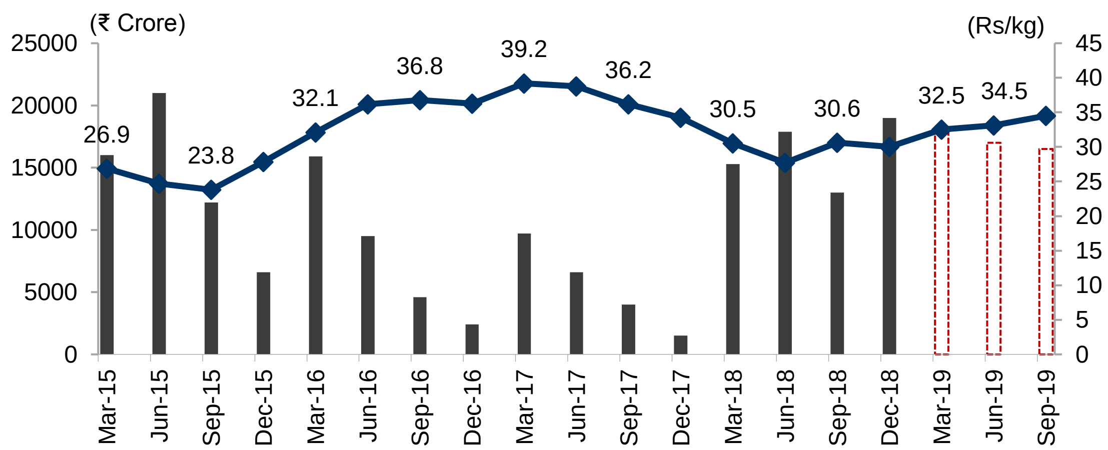
Increased cash flow to bring down cane arrears by 18% this sugar season

Given the additional Rs 3,400-3,600 crore cash flow of mills, cane arrears are expected to reduce to ~Rs 16,000-17,000 crore by the end of SS 2019, from Rs 20,000 crore this month.

Still, the arrears would remain higher than usual, compared with ~Rs 9,000 crore on average in the last three sugar seasons. Hence, additional government incentive would be needed to clear all arrears.

Uttar Pradesh is expected to continue contributing to a lion's share of total arrears. As of February 2018, 40-42% of arrears pertained to Uttar Pradesh, 25% to Maharashtra and 12-15% to Karnataka, with Tamil Nadu, Andhra Pradesh, Telangana, Punjab and Haryana accounting for the rest.

Cane arrears to remain elevated



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Source: Industry, CRISIL Research

Overall EBITDA margins to improve 300-400 bps in SS 2019

EBITDA margins expected to improve by 200-300 basis points for mills in the north and by 300-400 basis points (bps) for those in the south, given that cost of cane is lower in the south. However, stagnant cane costs and higher sugar prices would enable mills in the north to make higher margins compared with their southern peers.

Higher minimum support price (MSP) would mean non-integrated millers could break even or report low single-digit operating margins of 2-5% this season compared with (1)-2% in SS 2018, while integrated players could see that number up 13-15% compared with 9-12%. Integrated sugar millers will also continue to benefit by fast-tracking ethanol manufacturing

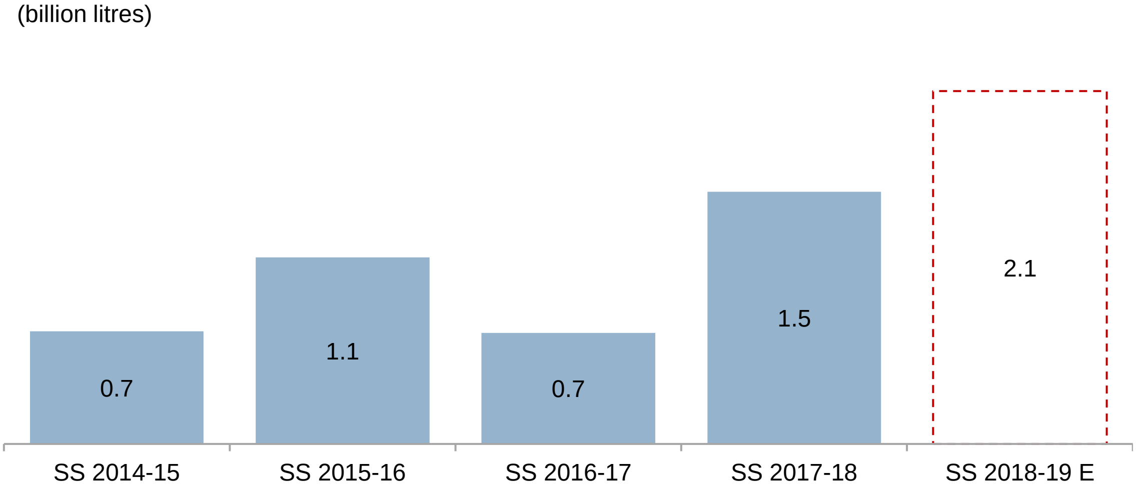
Mills to increase fuel-ethanol production with government support

In SS 2019, mills are increasingly diverting their cane towards B heavy molasses to produce fuel grade ethanol, which now fetches a higher realisation of Rs 52.4 per litre compared with Rs 47.1 previously

Sugar mills had welcomed the soft loans of Rs 4,440 crore granted by government for expansion and setting up of new distilleries in June 2018. As of December 2018, 160 distilleries had applied for capacity expansion totalling ~2 billion litres, almost equal to the existing capacity of ~2 billion litres.

However, industry sources indicate only 30-40% of these applications would be granted loans by banks considering the weak financial profile of the mills. Also, obtaining environmental and statutory clearances for setting up a new distillery takes more than a year.

Ethanol production to increase significantly in SS 2019



Note: Dotted line indicates CRISIL estimated numbers

Source: Industry, CRISIL Research

Hence, CRISIL Research expects ethanol production to increase by ~40% to 2.1 billion litres, of which ~15% would be from B heavy molasses. Sale of ethanol produced from B heavy molasses is expected to improve distillery margins by 200 bps in SS 2019.

Credit profiles of sugar producers to improve

CRISIL-rated sugar producers account for about 25% of the industry revenue.

The credit profiles of sugar mills have moderated compared with last fiscal because of continued losses at the operations level, increasing capital expenditure intensity because of investments planned in distilleries, and stretched working capital requirements. This is also reflected in the sugar sector's credit ratio (or rating upgrades to downgrades) of 0.3 time in the first nine months of fiscal 2019.

With expected increase in profitability and cash generation, liquidity and debt metrics of millers are likely to improve in fiscal 2020. For instance, the debt-to-EBITDA ratio of CRISIL-rated sugar mills is expected to marginally improve to about 4-4.5 times in fiscal 2020 compared with the estimate of ~5 times for fiscal 2019.

Background

In SS 2018, sugar prices fell 18% following a steep 55% increase in sugar production. This pushed up cane arrears to a whopping Rs 18,000 crore as of June 2018.

The government took the following measures throughout SS 2018 to improve the liquidity of mills:

Timeline	***Government policy***
February-18	*Increased custom duty on import of sugar from 50% to 100% to check any import in the country.*
March-18	*Withdrew custom duty on export of sugar to encourage sugar industry to start exploring possibility of export of sugar. However, no export took place due to low international prices*
April-18	*Allocated mill-wise minimum indicative export quotas of 2 million tonne and 5 million tonne for SS 2018 and 2019, respectively*
May-18	*Extended financial assistance to sugar mills @ Rs 5.50/quintal of cane crushed during SS 2018 and raised it to Rs 13.8/quintal for SS 2019*
June-18	*Set minimum selling price of sugar at Rs 29 per kg*
June-18	*Created buffer stock of 3 million tonne for which government would pay the carrying cost for a year*
June-18	*Provided soft loans of Rs 4,440 crore to augment ethanol production capacity and also allowed divergence of cane juice for production of ethanol.*
September-18	*Increased prices of ethanol from B heavy molasses and cane juice; provided transport subsidy of Rs 1,000-3,000 per tonne of sugar exported*

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