

# **Sugar industry bailout to clear over 40% of cane arrears**

Arrears stand at record Rs 22,000 crore

June 2018

## Measures to provide limited respite; profitability to remain under pressure

### Event

On June 6, 2018, the Cabinet approved the following measures, totalling Rs 7,000 crore, to address the liquidity issues of sugar mills and enable payment of accumulated arrears to farmers:

- The minimum domestic selling price of white / refined sugar to be fixed at the mill gate, initially at Rs 29 per kg. This can be revised subsequently based on revisions in 'fair and remunerative' (FRP) prices and other considerations.
- Creation of buffer stock of 30 lakh tonne for a year, entailing an estimated expenditure of Rs 1,175 crore, towards inventory carrying cost. Quarterly reimbursement to be credited to farmer accounts against mill arrears.
- To augment distillery capacity through upgradation and setting up new ones, the government will bear a maximum interest subvention of Rs 1,332 crore over five years (including a one year of moratorium) on bank loans of Rs 4,440 crore, to be sanctioned over three years based on a scheme formulated by the Department of Food and Public Distribution (DFPD).

### Background

In the sugar season (SS) 2018, from October to September, we expect production to have risen a sharp 48% to 31.5 million tonne (MT). A higher production of 32MT is expected in SS 2019 too, given the rise in acreage. As a result, sugar prices dropped sharply from an average of Rs 37 per kg in SS 2017 to Rs 26 per kg in June 2018. Due to the depressed market prices, the liquidity position of sugar mills has been weakening, leading to the accumulation of cane price arrears, which have crossed Rs 22,000 crore. To be sure, cane arrears have touched a record high surpassing the previous high of Rs. 19,430 cores for SS 2014-15 (calculated as of May 2015).

The government has taken the following steps in the past four months, which could not completely address the issue due to a steep fall in prices:

1. Increased the custom duty on sugar imports from 50% to 100% to curb cheap imports
2. Imposed stock-holding limits on producers in February and March 2018
3. Withdrew custom duty on exports and allocated a 'minimum indicative export quota' (MEIQ) of 20 lakh tonne for SS 2018. The mills have been reluctant in exporting at a loss, because of the lower international prices.
4. Extended financial assistance to sugar mills at Rs. 5.5 per quintal of cane crushed during SS 2018, to lower the cane cost (impact explained below in detail).

### Impact

Of the proposed measures, we estimate the bailout package to be limited to the first two measures, totalling only Rs 1,175 crore.

The remaining amount, comprising Rs 4,440 crore of loans and Rs 1,332 crore of interest subvention to upgrade or set up distillery capacity, would help in diversion of sugar during the surplus phase (diversion will be allowed from B molasses instead of C molasses, allowing more molasses to be produced, as per industry interactions). To support

the additional capacity, the Ministry of Petroleum has mandated blending of 10% ethanol with fuel (up from 5% previously), at a price of Rs 40.85 per litre to boost demand for ethanol over the next two years.

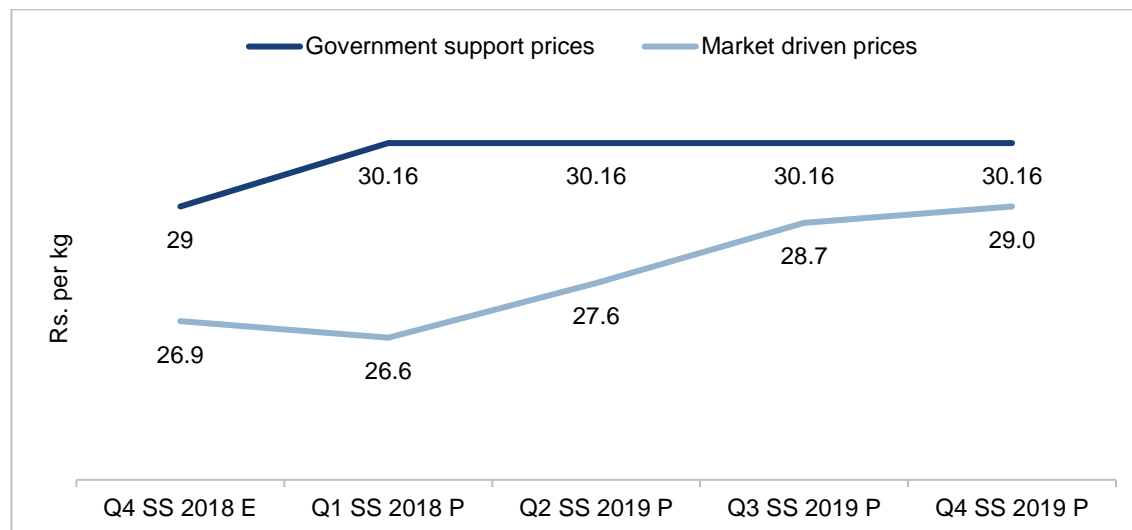
Ethanol generates higher margins than sugar for integrated sugar mills, besides being less cyclical. Also, the government subsidy is expected to increase the viability of this investment. We believe these benefits would accrue over the longer term and will have a limited role in addressing the current liquidity issue of millers.

**Price support to play a major role; limited impact from subsidies**

The implications of the key measures listed above add up to 40-45% of the accumulated arrears of Rs.22,000 crore. Of this, the price support would contribute to 70% of the incremental cash flow. Lower raw material and inventory carrying cost, which entail a cost of Rs 2,675 crore to the exchequer, would have reduced the arrears by just 12%. These cash flow benefits would accrue over the next 12 months, spanning a quarter of SS 2018 and three quarters of SS 2019. A breakdown of the benefits is as follows:

**Measure 1: Sugar price support:** With the prices set at Rs 29 per kg, an incremental cash inflow of Rs 65-70 billion is expected over the next four quarters. Of the incremental cash inflow, the cooperatives’ share will be 60%, with the remainder of Rs 26-28 billion benefiting corporates. This improvement factors in a price stagnation of around Rs 26-27 per kg during the period, if the price support were not implemented. While prices are set at Rs 29 and likely to be revised linked to the FRP change, we have assumed a 4-5% increase in FRP and a 4% increase in regulated prices (cane cost being ~90% of revenue at current sugar prices). The change in FRP and in regulated prices remain key monitorables.

**Sugar prices expected to remain stable with government intervention**



Source: Industry, CRISIL Research

**Measure 2 – Carrying cost of the inventory:** The sugar industry are expected to have a cash inflow of Rs 10-11 billion by saving the inventory carrying cost of 3-million-tonne (Rs 3.5-4.0 per kg annually) subsidised by the government. The cash inflow of corporate players is expected to be Rs 4-5 billion. Inventory typically piles up in the first five months of the sugar season as the entire production takes place in these months and peaks in Q2 and Q3 of the sugar season. For calculating inventory carrying cost, we have assumed 55% of the average inventory to remain with the mills and the rest with wholesalers and distributors.

**Raw material subsidy:** Mills would save Rs 5.5 for every quintal of sugarcane purchased as a part of the raw material subsidy introduced by the government in May 2018. Among sugar mills, corporate sugar mills are expected to see a Rs 6.0-6.5 billion benefit.

### **Further deterioration in sugar mills' margin to abate**

Quarterly EBITDA margin of listed players (have 33% market share and command higher margins than the industry average) steadily declined over the past four quarters, turning negative in the March quarter at (4.5)%. The pressure on margins is expected to lessen in sugar season 2018, owing to the government's measures. In fact, during the season, margins are expected to range between 0-(3)% vis-a-vis our previous projection of (1)-(3)%. In sugar season 2019 as well, margins are expected to sustain at 0-(3)% levels as compared with the earlier forecast of (5)-(7)%.

### **Working capital impact to be minimal from current levels**

Most of the benefits, such as raw-material subsidy and carrying cost, are proposed to be credited directly to farmers' accounts towards arrears. The rest (price support) is expected to be passed on to them against outstanding arrears, having minimal impact on working capital from current levels. However, the improved liquidity from these measures would prevent the working capital situation from worsening.

### **Analytical contacts**

**Hetal Gandhi**

Director, CRISIL Ltd.  
[hetal.gandhi@crisil.com](mailto:hetal.gandhi@crisil.com)

**Geoffrey Dcunha**

Associate Director, CRISIL Ltd.  
[geoffrey.dcunha@crisil.com](mailto:geoffrey.dcunha@crisil.com)

### **Media Contacts**

**Saman Khan**

Media Relations  
**CRISIL Limited**  
D: +91 22 3342 3895  
M: +91 95940 60612  
B: +91 22 3342 3000  
[saman.khan@crisil.com](mailto:saman.khan@crisil.com)

**Hiral Jani Vasani**

Media Relations  
**CRISIL Limited**  
D: +91 22 3342 5916  
M: +91 982003 9681  
B: +91 22 3342 3000  
[hiral.vasani@crisil.com](mailto:hiral.vasani@crisil.com)

## About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India's foremost provider of ratings, data, research, analytics and solutions, with a strong track record of growth, culture of innovation and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

## About CRISIL Research

CRISIL Research is India's largest independent integrated research house. We provide insights, opinion and analysis on the Indian economy, industry, capital markets and companies. We also conduct training programs to financial sector professionals on a wide array of technical issues. We are India's most credible provider of economy and industry research. Our industry research covers 86 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our large network sources, including industry experts, industry associations and trade channels. We play a key role in India's fixed income markets. We are the largest provider of valuation of fixed income securities to the mutual fund, insurance and banking industries in the country. We are also the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today the country's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgments and forecasts with complete objectivity. We leverage our deep understanding of the macro-economy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. Our talent pool comprises economists, sector experts, company analysts and information management specialists.

## CRISIL Privacy Notice

CRISIL respects your privacy. We use your contact information, such as your name, address, and email id, to fulfil your request and service your account and to provide you with additional information from CRISIL and other parts of S&P Global Inc. and its subsidiaries (collectively, the "Company") you may find of interest.

For further information, or to let us know your preferences with respect to receiving marketing materials, please visit <http://www.crisil.com/privacy>. You can view the Company's Customer Privacy at <https://www.spglobal.com/privacy>.

**Last updated: April 2016**

## Disclaimer

CRISIL Research, a division of CRISIL Limited (CRISIL) has taken due care and caution in preparing this Report based on the information obtained by CRISIL from sources which it considers reliable (Data). However, CRISIL does not guarantee the accuracy, adequacy or completeness of the Data / Report and is not responsible for any errors or omissions or for the results obtained from the use of Data / Report. This Report is not a recommendation to invest / disinvest in any company covered in the Report. CRISIL especially states that it has no financial liability whatsoever to the subscribers/ users/ transmitters/ distributors of this Report. CRISIL Research operates independently of, and does not have access to information obtained by CRISIL's Ratings Division / CRISIL Risk and Infrastructure Solutions Limited (CRIS), which may, in their regular operations, obtain information of a confidential nature. The views expressed in this Report are that of CRISIL Research and not of CRISIL's Ratings Division / CRIS. No part of this Report may be published / reproduced in any form without CRISIL's prior written approval.