Research

Palm oil prices to rise 18-20% in India

Refiners' utilisation to improve on government moves

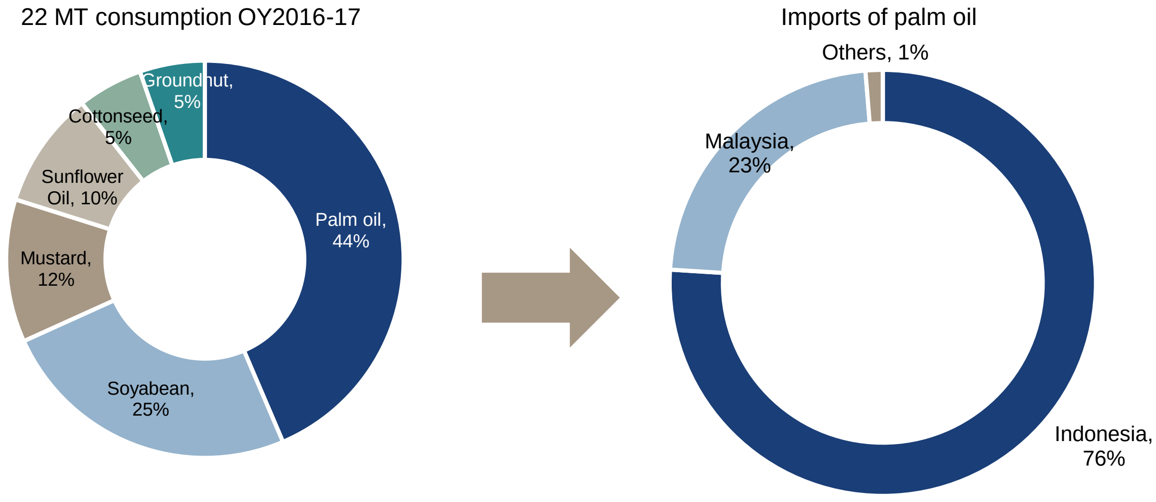
April 2018

Palm oil has a large share of consumption, mostly imported

Consumption of major edible oils[1] in India stood at 22 million tonne (MT) in oil year (OY) 2016-17, i.e. November 2016 to October 2017, and was valued at ~Rs 1.4 lakh crore. Domestic production met only 30% of that demand; the rest was imported.

Palm oil is the most consumed edible oil by volume in India, with a share of ~40%, followed distantly by soybean and mustard oils. However, domestic production of palm oil is limited, and over 95% of the requirement is imported, mostly from the world's top two producers – Indonesia and Malaysia. Consequently, palm oil imports constitute over 60% of the edible oil imports basket today.

Palm oil, the largest consumed edible oil in India, is almost completely imported



Note: Mustard oil includes rapeseed; country share in import of palm oil is for Jan-Oct 2017

Source: US Department of Agriculture, Directorate General of Foreign Trade, CRISIL Research

We expect palm oil's domination of India's edible oil consumption basket to continue in the medium term. Demand is supported by a price conscious domestic market, especially in the east, and the fact that palm oil is the cheapest of the lot. Besides, there is healthy offtake from the commercial segment (restaurants, hotels, food processing), which accounts for nearly 45% of total demand.

Palm oil prices to rise sharply in India, differing from global trend

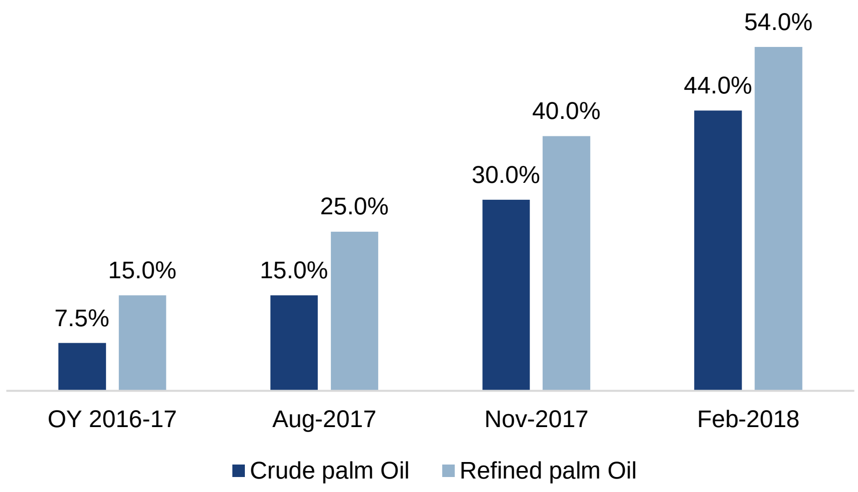
A series of duty hikes on edible oils since August 2017 (to support prices and crushing of domestic oilseeds) and a sharper increase in import duty for refined palm oil (a move aimed at improving refineries utilisation) will make palm oil more expensive in India.

Considering all the duty hikes since August 2017 and the 10% social welfare cess, and assuming these remain unchanged through OY 2017-18, we expect average palm oil prices in the domestic market to increase 18-20% on-year in OY 2017-18. The duty hikes will offset the softening in international prices following a bumper crop, though

[1] 6 major edible oils comprise over 90% of the total edible oil exports, the remaining are sesamum, nigerseed, Castor, linseed, coconut, rice bran, tree and forest origin and solvent extracted

these could remain dynamic and responsive to exchange rates, food inflation and export duty changes of trade partners.

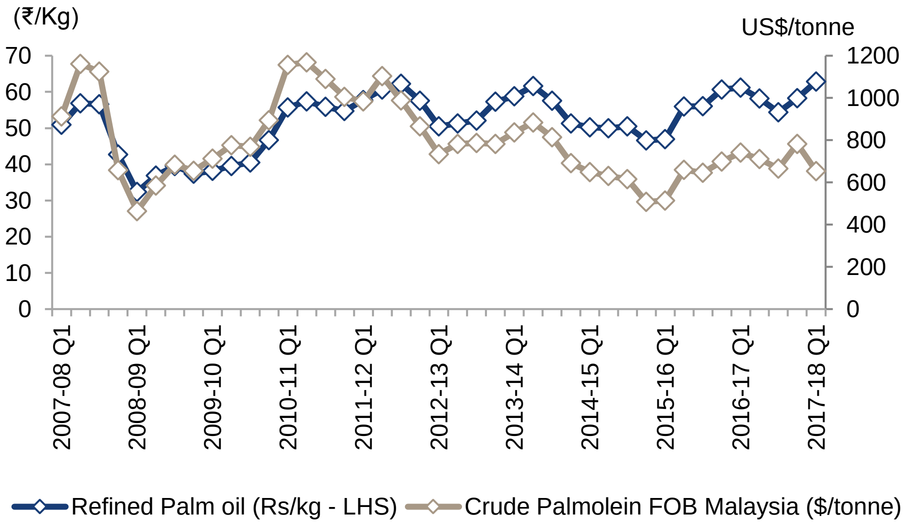
Series of hikes since August 2017 has raised import duties on palm oil to highest in over a decade…



Note: Chart shows basic import duty (without cess)

Source: CRISIL Research

…leading to upward movement in domestic prices contrary to a softening international trend



Source: Solvent extractors association, CRISIL Research

On the global front, we expect production of palm oil fruits to increase 7% to 69 million tonne in OY 2017-18, over the 10% increase seen in OY 2016-17, driven by Indonesia and Malaysia. International prices are consequently expected to soften by ~5%. The 6-month futures quotes for crude palm oil (f.o.b. Malaysia/ Indonesia port) are trading lower than the average price for OY 2016-17. India being the largest importer of palm oil in the world, and a key trading partner for both Indonesia and Malaysia, lower imports resulting from duty increases could weigh further on international prices of palm oil in the near term.

Domestic palm oil prices in the past typically moved in line with international prices as 98% of the oil is imported. A clear diverging trend is seen since the hiking of domestic duties. An appreciating rupee till January 2018 curbed the impact of the divergence to some extent. However, this trend has reversed since February. We expect rupee to continue to depreciate in coming months, but remain stable on average compared with OY 2016-17, putting pressure on domestic prices.

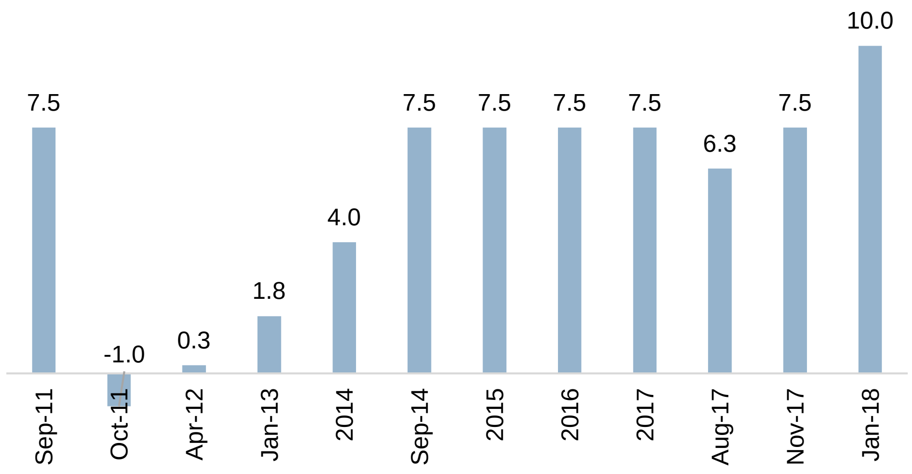
Duty differential between crude and refined palm expands; refiners to benefit

The proportion of crude palm oil in overall palm imports is a function of the price differential in landed costs of refined and crude palm oil. This is significantly influenced by duty structure changes made by exporting and importing countries. Historically, whenever Indonesian and Malaysian governments have reduced export duties on refined palm oil, imports of refined palm oil have increased sharply in comparison to crude imports, as it was cheaper than importing and refining. Low export duties on refined palm oil impacted business models of players, who traded in refined oils, resulting in capacity utilisation of Indian palm oil refiners sinking to 35-40% by OY 2016-17, our industry interactions reveal.

To promote domestic refining of palm oil, the government, in addition to the duty hikes on palm oil, also raised the differential import duty between crude and refined palm oil. The differential since August 2017 stands at 10% (11% since March 2018, including social welfare surcharge), up from 7.5% since 2014 and 5% since 2013.

Interestingly, Malaysia, in January 2018, suspended export taxes on crude palm oil for a three-month period to encourage exports and support prices. This is contrary to the general trend of both the large producers discouraging crude palm exports by duty levies in the past in order to ensure higher utilisation for their refineries. The trend in duty differentials, including the levies by exporting countries, is summarised in the below chart.

Higher duty differential on crude and refined palm to benefit refiners in OY2017-18



Note: (1) Duty differential considering aggregate import and export duties of India, Indonesia and Malaysia.

(2) These are aggregation of basic customs duty. Including social welfare surcharge in India, the duty difference between crude and refined oil has further increased to 11% in March 2018

Source: USDA, FAO, Ministry of Commerce, India

Refiners to benefit as capacity utilisation gets a much-needed fillip

Despite the government's measures in the past decade, the share of refined palm oil in total palm oil imports has risen steadily to 31% in OY 2015-16 and OY 2016-17. Even at a duty differential of 7.5%, edible oil sellers are finding it convenient to import refined palm oil directly. However, post the government's move to increase the duty differential to 11% (including social welfare surcharge), the share of refined palm oil slipped to 18% of total palm oil imports in November and December 2018. Also, as a result of the recent measures promoting imports of crude palm oil as well as crude soya oil and sunflower oils over refined palm oil, we expect capacity utilisation of refiners to improve.

However, for Indian palm oil refiners whose utilisation levels are much lower than soft oil refiners, a nil duty on key by-products – palm stearin and PFAD, which is generated to the extent of 25% of crude palm oil – would limit the benefits as it affects viability by denying them a level playing field. Also, palm oil refiners will have to compete relatively harder on pricing vis-à-vis soft oils since the duties on palm oil have seen a sharper increase.

Overall, EBITDA margins of key listed players in the industry are expected to improve 30-50 bps. Rising demand for branded products and higher pricing power in these segments will support profitability of players operating in this segment.The near-term outlook for the edible oil companies is expected to be stable on steady domestic demand and improvement in operating margin due to increasing refining operations and rising demand for branded and packaged oils.

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