Largest 'producer' tag no sweetener

Low prices of sugar, surging stocks and record output will weigh on financials in the current season

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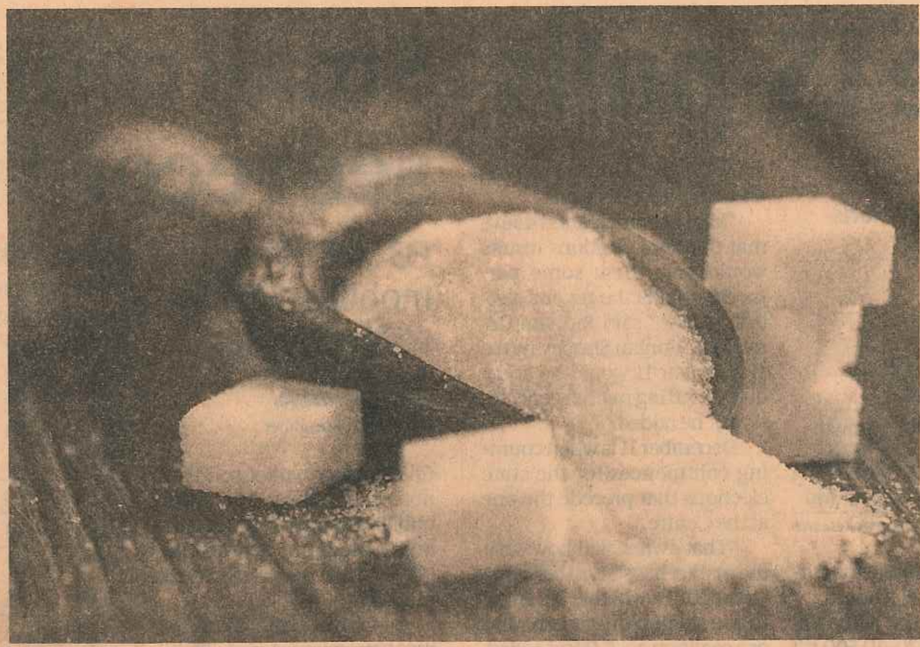

After a gap of 15 years, India is set to pip Brazil as the world's largest sugar producer.

This, however, may not be a thing to cheer about for Indian manufacturers of the commodity.

The reason for this is that the differential between the minimum selling price (MSP) and production cost has had an adverse effect for makers of the commodity.

Moreover, the existing buffer or inventory in the country is way ahead of consumption, resulting in an oversupply situation.

India's production, according to the US Department of Agriculture's Foreign Agricultural Service, may rise 5.2 per cent to a record 35.9 million tonnes (mt) on increasing acreage and improving yields in the May 2018 to April 2019 period. Sugar output in Brazil, on the other hand, may tumble 21 per cent to 30.6 million tonnes due to adverse weather and a shift to cane-based ethanol in the same period.

Sugar year 2019 (October 1, 2018 to September 30, 2019) in India began with an opening balance of about 10.7 mt. The initial estimates by experts were already around 35-35.5 million tonnes per annum (mtpa). These, however, were revised downward to 32 mtpa by the Indian Sugar Mills Association (ISMA).

Even then, sugar year 2019 is likely to end with a surplus which will be significantly higher than the ideal 6-7 mt of inventory at the end of any sugar year, experts say.

ICRA, for instance, expects the sugar surplus to continue and pegs the closing stock for SY2019 to around 11.5-12 mt, ruling out a significant uptick in sugar prices. Sugar prices have dropped to ₹29-30 per kilogram (factory gate prices) with the start of the crushing season from ₹30-31 per kilogram, reports suggest.

While the prices may not go down further from here, given that the MSP of ₹29 fixed by the government is providing some respite, the MSP is still much lower than the production cost of ₹35 a kilogram (including depreciation and interest costs).

STANDING OUT

(₹billion)

	Balrampur Chini		EID Parry	
	FY19E	FY20E	FY19E	FY20E
Net sales	41.4	44.7	19.0	20.2
% chg y-o-y	-4.7	8.0	0.3	6.3
Ebitda	7.0	6.5	1.6	1.9
% chg y-o-y	54.2	-6.4	-1.6	15
Adj. net profit	4.2	3.7	1.0	1.4

E: Standalone estimates Source: JM Financial

Manufacturers are not out of the woods yet. Sugar producers will face a challenging year ahead, said Abhinash Verma, director general, ISMA.

Though the government continues to provide support to the industry through various measures, including regulating the MSP of sugar, soft loans, export subsidies, cane price assistance, higher ethanol pricing and blending mandates, analysts at JM Financial suggest ethanol is unlikely to break the cyclicality of the sector given its limited impact on sugar production.

While the increased procurement price of ethanol in September seems to be attractive and can lure companies to make further investment in new capacities, the move is unlikely to benefit firms much during current year.

Given this backdrop, analysts have a cautious stand on the sector, saying investors consider companies with a strong balance sheet and a lower cost of production.

Balrampur Chini Mills, that has never slipped into losses at the operating profit level on a full-year basis, is one such pick of analysts at ICICI Securities.

"Balrampur Chini, Dhampur Sugar Mills and Dalmia Bharat Sugar may see some upside in the short-to-medium term," said Rahul Agarwal, director at Wealth Discovery.

Among other producers, EID Parry remains a safe bet in the sugar sector, said analysts at JM Financial, given the company's geographical advantage (located in Tamil Nadu, Karnataka and Andhra Pradesh) that can help lower cane costs and the ability to exploit export or import opportunities.

"Further, EID's current share price reflects a 73 per cent holding company discount to the value of its stake in Coromandel International (EID owns 60.5 per cent stake), which is one of the highest in the past three years," they stated in a recent report.

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