# How Sugar Mills Can Avoid Margins Turning Sour

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With margins getting crushed for the third consecutive year, a bitter struggle for survival of the sugar industry seems far from getting over. Consistent decline in sugar prices on one hand and farmers demanding higher cane prices in the wake of increased cost of cultivation, on the other, have left the cash-starved sugar industry with mounting debts and unviable operations. Dismal performance of the industry has multi-fold negative externalities, as sugar is one of the most essential commodities of day-to-day life, while sugar industry is the second largest agro-based industry providing livelihood to about 50 million sugarcane farmers and around 5 lakh workers who are directly employed in around 702 installed sugar mills across the country.

Sugar remains one of the most volatile of all the commodities being traded (with annualized volatility ranging from 10% to 30% during FY 2009-2014). Pronounced cyclicality in the production of sugar cane as well as in sugar on one hand and increasing demand for sugar from food and energy segments on the other has led to larger swings in production and trade. This has rendered India to become either net importer or exporter of sugar at intermittent intervals; thus making it to influence the global prices and in turn getting influenced by them.

India: Sugar Balance Sheet
(Figures in million tonnes, Raw value)

| | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 |
|---|---|---|---|---|---|
| Production | 20.6 | 26.6 | 28.6 | 27.3 | 27.0 |
| Human Domestic Consumption | 22.5 | 23.1 | 24.2 | 25.0 | 26.0 |
| Ending Stocks | 6.2 | 6.3 | 7.2 | 11.1 | 10.4 |
| Exports | 0.2 | 3.9 | 3.8 | 0.2 | 1.8 |

Source: USDA

The Indian sugar industry has evolved and grown under a different set of circumstances with sugar being regarded as an essential commodity. Regulatory policies vis-a-vis pricing, distribution and trade of sugar over the years have always been geared towards protecting the interest of cane growers and sugar manufacturers (to provide sustained income levels) and domestic consumers (to protect against sugar inflation). It has been observed that reconciling these objectives, however, has remained a challenge and moreover the mills have been the sufferers for most of the times.

In India sugarcane prices that are fixed by central and state governments have remained disconnected from the relatively market realized sugar prices. Hence sugar millers in India are not in a position to cut down on the expenses incurred in paying support prices to sugar cane growers in line with variation in sugar prices, thus, leaving a room for fluctuations in sugar prices arising due to demand–supply mismatch prevailing in domestic as well as international market.

High volatility in sugar prices poses significant downside risks to its value chain participants, as it affects their realisations and in turn credit re-payment ability. This, in turn, raises the probability of credit defaults, weakening the balance sheets of financial institutions involved in extending credit facilities to the sugar industry VCPs. Industry-wide deployment of bank credit data reveals that sugar industry accounts for 23.5% of the credit extended to Food Processing Industry and 1.4% of the credit lent to the Industrial sector as a whole. Bank credit to sugar industry (outstanding) as on March 21, 2014, has been Rs 34.8 thousand crore, which is an increase of 5.5% over the corresponding period of the previous year.

Hedging price risks on the futures platform helps stakeholders in sugar industry lock in their margins and insulate themselves against adverse movements in sugar prices.

Sugar futures contracts on the NCDEX platform provide a real-time pan-India level access to sugar prices which reflect the possible demand-supply conditions shaping up in the economy. Foreknowledge of possible fluctuation in prices has become crucial than ever in the post partial-decontrol period, where millers are free to sell any quantity of their produce in the market at their will. This makes it necessary for them to learn to release the right quantum of sugar at right time analyzing the demand-supply dynamics on their own, especially, in the absence of any kind of guidance from the government, unlike the case prior to partial decontrol of the industry.

> The partial- decontrol of sugar industry calls for deregulation of sugar distribution by abolishing the regulated release mechanism for open market sale of sugar and levy sugar obligation; while keeping the regulatory policies vis-à-vis sugarcane pricing intact.

Trading in sugar futures enables stakeholders to take timely decisions about their physical commitments. For example, sugar mills can decide the timing of sale, quantity of sale, liquidation of stocks and inventory management. Similarly, consumers like FMCG companies can also take decisions pertaining to timing of procurement, quantity of procurement and inventory management.

Moreover, through hedging operations, sugar miller is also able to hedge his produce by taking a short/sell position in sugar futures contracts, and can make good any loss that he may incur while selling his sugar in physical market.

Given that the timing and quantity of sales, whether in local markets or export will be the key differentiator for maximizing revenue per tonnes of cane, trading in sugar futures turns out to be sensible avenue for cash-strapped sugar millers to mitigate their price risks.

## DID YOU KNOW?

**NCDEX is set to launch the following two types of forward contracts:**
**i. Reference price contracts**
**ii. Fixed price contracts**

**A reference price contract is anchored to a relevant futures contract traded on the exchange whereas a fixed price contract is entered at a flat price. Reference price contract would be priced at a premium / discount to the NCDEX contract based on the inherent parameters of the forward contract.**

Extensive use of hedging can help participants in sugar industry to get easy access to institutional credit. That is because the credit lending institutions now can assess the risk exposure of the industry stakeholders more accurately, besides knowing the exact contract value they are going to receive on the execution of their futures contracts.

The sugar millers which have their positions hedged on the futures platform may obtain loan from banks that have tie-up with NCDEX Spot Exchange for loan against e-pledge. The banks can track Online the details of pledged lots and have the option of selling of sugar through e-auction module. This facility makes it easier for them to monitor the risk and extend credit.

Thus, trading in sugar futures can help the value chain participants to reduce their cash flow volatility, transforming their business from a high-debt-leverage enterprise to a one with more sustainable and stable income stream.

To know more about NCDEX Sugar Forward Contracts, log on to www.ncdex.com or call toll free no.1800 26 62339



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