

More triggers needed for sugar rally to sustain

Balrampur Chini remains the only pick among analysts given low leverage and cost of production

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Stock prices of sugar companies have gained sharply after the government's decision to hike ethanol price, a few days ago. Balrampur Chini, Bajaj Hindusthan, Shree Renuka Sugar, and Dhampur Sugar have all risen 13-57 per cent since the move. The price hike for a by-product (ethanol) brought some relief to a sector struggling with cost pressures, even as sugar realisations are trending down.

The average cost of production of sugar in the country is about ₹35 a kg, while sugar prices are trading much lower at about ₹31. Further, after 32 million tonnes (mt) sugar production in Sugar Year 2017-18 (SY17-18), the country is expected to produce another 35 mt in SY18-19, whereas sugar consumption in the country is close to 25 mt. Clearly, with supply outpacing demand, sugar prices are likely to remain under pressure. Hence, better by-product realisations, such as those related to ethanol, boosted Street sentiment.

Abinash Verma, director general of the Indian Sugar Manufacturers Association (ISMA), says the increased procurement price of ethanol from B type heavy molasses seem attractive, making further investments in new capacities viable.

While the news is positive, experts still feel supportive ethanol policies will have a limited impact in the short term. Analysts at Morgan Stanley say such measures may incentivise investment in ethanol production but have a small short-term impact. This is because of limited production and blending capacity. Second, the shift to ethanol



could take out just about 1 mt of sugar (under 3 per cent of production) from the market, during the next crop season.

Hence, sugar production will continue to outpace demand. Verma of ISMA believes the next sugar season will be a testing one for manufacturers. Verma is expecting some hike in minimum sugar prices, in line with the rise in fair and remunerative price for sugar cane procurement, to help industry. Analysts at ICICI Securities say that if significant quantities are not exported in the next year, sugar prices could fall below ₹27-28 per kg in the long run, which could result in significant losses to the sector.

Therefore investors, who wish to take an exposure to the sector, could look at companies with a stronger balance sheet and lower cost of sugar production (₹31-32 a kg). Balrampur Chini Mills is one such pick to have never slipped into losses at the Ebitda level on a full-year basis, historically.

ICICI Securities has a target price of ₹106 for the stock, which currently trades at ₹84.90. The other pick for brokerage firm is Dhampur Sugar Mills, with a fair value of ₹135 a share. Nevertheless, the stock is trading near this fair value.