Deregulating The Sugar Sector

Good Tidings For The Industry?

The government's recently proposed move to ease the norms for the sugar sector could sweeten the atmosphere for the players as well as investors, says Amit Bhanot

In all probability sugar decontrol will soon be a reality. If we go by the quotes of the Food as well as the Agriculture ministers, it appears that the matter has been decided in the power corridors and a Cabinet note in this concern has been moved. Though this is a long-awaited demand of sugar mill owners, it remains to be seen whether it will bring about a reversal their fortunes. At the same time, consumers are already having nightmares about the steep rise in the prices of sugar.

Even if steps are taken in the direction of decontrolling the ₹80000 crore sugar industry, as suggested by the Dr Rangarajan Committee, we cannot say with full certainty that the worst is over for the industry. In a democratic country like India, where farmers make up the largest section of the votebank, it is unlikely that the government would do away with all its control on such a key agri-sector, that too when we are expecting Union Elections within a year. However, this is certainly a very positive cue for the industry reeling under pressures.

The entire debate started on February 16, 2013, when on the sidelines of an ASSOCHAM program, Minister of State (I/C) for Consumer Affairs, Food and Public Distribution, Prof. K V Thomas announced that within 15 days, the government will decide on the decontrol of sugar industry, especially the levy of sugar and release mechanisms. "I think within the next 15 days, we would be able to take a decision on all the issues like levy of sugar, release mechanisms and others which the committee has studied," Thomas said.

Soon after this announcement, sugar stocks saw a spurt on the bourses as if some distant dream had come to life. But soon, another comment came in from Minister of Agriculture Sharad Pawar. This was regarding the doubling of excise duty on sugar mills to compensate the loss the government would incur following the deregulation of levy sugar, which amounts to around ₹3000 crore. The proposal regarding the hike in excise duty has been included in the Cabinet note, and in all probability, the government will ensure that sugar available in the PDS mechanism will not become dearer at any cost in an election year.

What it clearly means for a common consumer, is that a price rise is inevitable.

No Cakewalk For The Industry

When DSIJ investigated the repercussion of decontrol on the sugar producers, the result was a mixed bag. Prima facie, it seems to be a very positive move as Dr Rangarajan Committee calls for an immediate abolishment of levy sugar and released mechanism. "If this happens then firstly, the abolishment of released mechanism will help us in taking timely decisions and manage our cash flow well, as we will be able to decrease our inventories. Today, we are borrowing 14-16 per cent of our working capital as we are forced to keep inventories", informs Abinash Verma, Director General, Indian Sugar Mills Association (ISMA), the apex body of sugar mill owners.

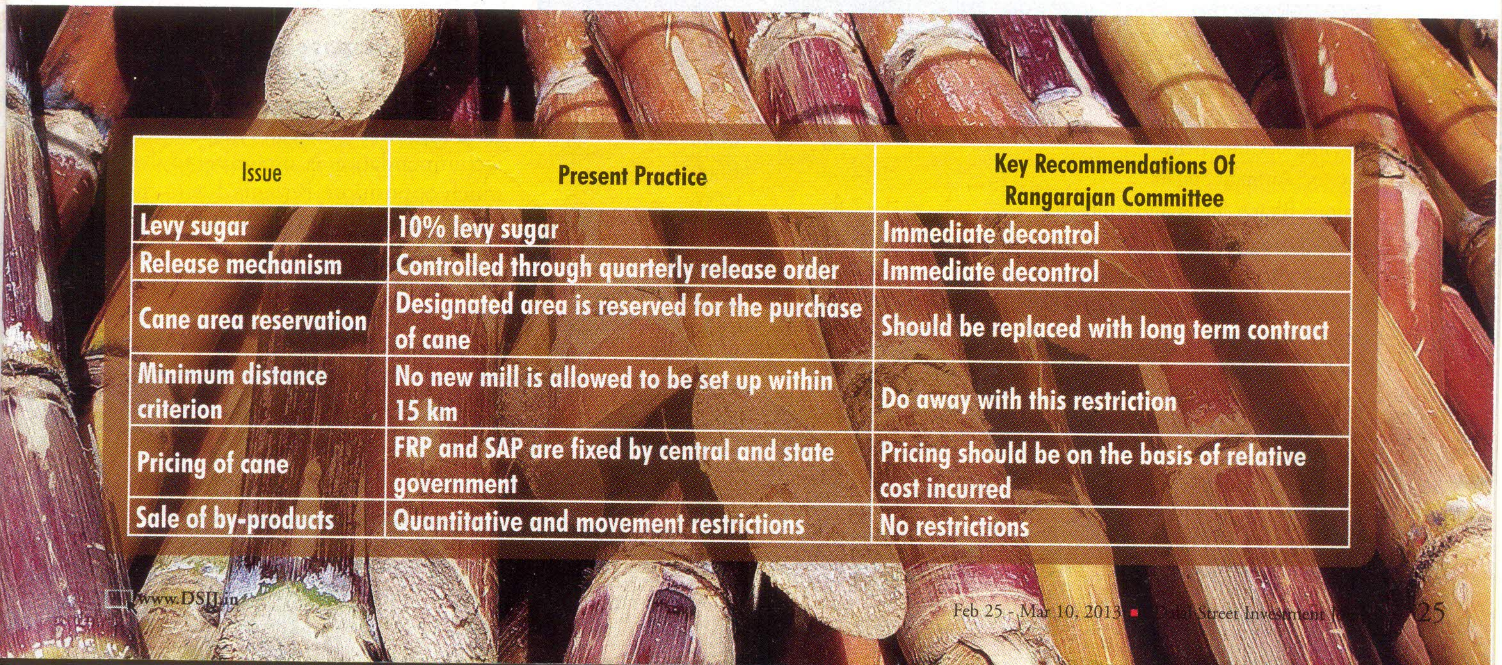
But the real benefit would come from the decontrol of levy sugar. "If it would happen then mill owners are straightaway going to save around 27 lakh tonnes of sugar that they give to the government for PDS supply, and in turn would sell it in the open market, thereby saving around ₹11/kg", opines Verma. This clearly means a saving of around ₹3000 crore for the industry. It is important to note here that presently, mill owners have to give 10 per cent of their output to the central government in the form of levy sugar at a price of around ₹20/kg, thereby losing around ₹11/kg (considering the market price at ₹31/kg). The government sells this sugar as PDS supply at ₹13.50/kg. In this regard, Arihant Jain, Executive President (Finance), Dhampur Sugar, says, "If decontrol happens, then it would be very positive for the sugar industry as we will save huge costs both in terms of levy sugar as well as release mechanism. In the long term, it will certainly help producers to improve their margins".

On the other side, the sword of excise duty is a deadly one. The excise duty on sugar presently stands at ₹0.98/kg, which the government wants to double now. This will help it to generate an additional amount of around ₹2600 crore (at a total sugar stock of 270 lakh tonnes) to finance the PDS supply of sugar.

But here is a catch. If in any year (like in 2008-09 when production was just 145 lakh tonnes while the current demand is 225 lakh tonnes) there will be a drastic drop in sugar production, then the government will be forced to increase excise duty on the producers to finance supply to the PDS. In such a condition, the question arises as to whether producers will be able to pass on the burden to consumers. "In the matter of any indirect tax, the total value cannot be passed on to the consumer, producers have to absorb some part of it," Verma adds. At the same time there is certainly a limit to which the price of sugar can be elevated, as 65 per cent of the total sugar stock goes to bulk or industrial consumers. In that condition, it would be interesting to see how the sugar mill owners would save their margins.

Sugar Production In Last 5 Years

Year	Production (000 tonnes)
2007-08	26356
2008-09	14538
2009-10	18912
2010-11	24394
2011-12	26342



Issue	Present Practice	Key Recommendations Of Rangarajan Committee
Levy sugar	10% levy sugar	Immediate decontrol
Release mechanism	Controlled through quarterly release order	Immediate decontrol
Cane area reservation	Designated area is reserved for the purchase of cane	Should be replaced with long term contract
Minimum distance criterion	No new mill is allowed to be set up within 15 km	Do away with this restriction
Pricing of cane	FRP and SAP are fixed by central and state government	Pricing should be on the basis of relative cost incurred
Sale of by-products	Quantitative and movement restrictions	No restrictions

Not So Bitter For Consumers

Though is it mooted that deregulation would make sugar dearer, but we shouldn't jump to the conclusion, as the price will be determined by the forces of demand and supply. "At the first instance, the 10 per cent levy stock will straightaway come to the market that will certainly put pressure on the price of sugar," Verma says. Also, due to abolishment of released mechanism, the mill owners would be free to sell their stock in the market according to their need and cash flow. Now, during the production season (November-April), the supply will surely surpass the demand, thereby pulling prices down, and vice versa for the rest of the year.

Also, the cost of production of sugar varies in different states. For example, it stands at ₹31/kg In Maharashtra but at ₹36/kg in UP. This is due to differences in the quality of cane available (different recovery rate). After deregulation, the mill owners would be forced to improve their efficiency due to competition.

The only threat to the interest of consumers would be the possibility of cartelisation in the cement sector, as seen in cement. On this, Verma maintains, "This is not at all possible in this industry, as there are more than 600 mill owners in the country and farmers and state governments are also the key stakeholders of the industry."

The Dregs Of The Matter

In spite of all the positivism shown by the government on deregulation, there are still some pending issues that are very complex. First of all, there is the matter of the price of sugarcane that is to be paid to farmers. In addition to Fair and Remunerative Price (FRP), the minimum price to be paid to farmers as fixed by the central government, many state governments also put forward the State Advised Price (SAP). This is the real bone of contention as state governments don't want to do away with this control in favour of the interests of farmers.

The Rangarajan Committee has suggested that the pricing of cane (revenue sharing) should be done on the basis of relative costs incurred by farmers and millers, taking into account the saleble by-products like bagasse, molasses and press mud. "Based on an analysis of the data available for the by-products, and if by-products are loaded on the value of sugar, the value-sharing ratio for farmers is estimated to amount to roughly 75 per cent of the ex-mill value of sugar alone," the Committee reported in its recommendations.

Also, presently there is a minimum distance criterion of 15 km as prescribed by the central government to set up a new mill. The Rangarajan Committee has recommended that this practice should be completely done away with as "it inhibits entry and further investment and adversely impacts competition for the purchase of sugarcane as well as for improving mill efficiency." But the mill owners are not very keen on this, as they think it will hamper the availability of cane.

In the same way, the committee has said that the cane area reservation should also be replaced by long-term contracts with farmers as the current practice reduces the bargaining power of farmers. At the same time, it hampers the mills' interest of augmenting cane supplies. Practically speaking, this recommendation is also going to invite much opposition. Perhaps due to these issues, major sugar producing states i.e. Maharashtra and UP hasn't given their suggestions on the panel's recommendations.

While the sugar stocks have moved up since this announcement, we advise our readers to be cautious and hold on to the stocks till further clarity emerges on the matter.

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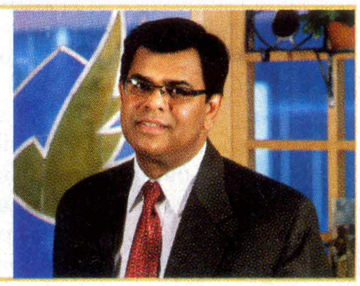
- Abinash Verma, *Director General,* ISMA



Change In Share Prices Since Proposal Announcement

Company Name	Current Share Price (20/02/2013)	Price (15/02/2013)	Change (%)
Bajaj Hindustan	23.90	22.50	6
Balrampur Chini Mills	49.40	50.85	-3
Bannari Amman Sugars	914.60	908.00	1
Dalmia Bharat Sugar and Industries	17.85	17.50	2
Dhampur Sugar Mills	47.95	44.35	8
Dwarikesh Sugar Industries	35.65	32.90	8
KCP Sugar & Industries Corporation	21.45	20.50	5
Kesar Enterprises	35.55	33.60	6
Oudh Sugar Mills	24.00	23.10	4
Ponni Sugars	328.6	310.00	6
Shree Renuka Sugars	28.85	27.45	5
Simbhaoli Sugars	27.50	23.20	19
Triveni Engineering & Industries	17.05	16.50	3
Upper Ganges Sugar & Industries	46.35	43.70	6

Note: Hold on to the sugar stocks; it's better to be cautious.

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