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Indian Sugar Sector

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Increase in sugarcane FRP likely to affect mills' margins; hike in MSP for sugar critical given the sugar surplus scenario

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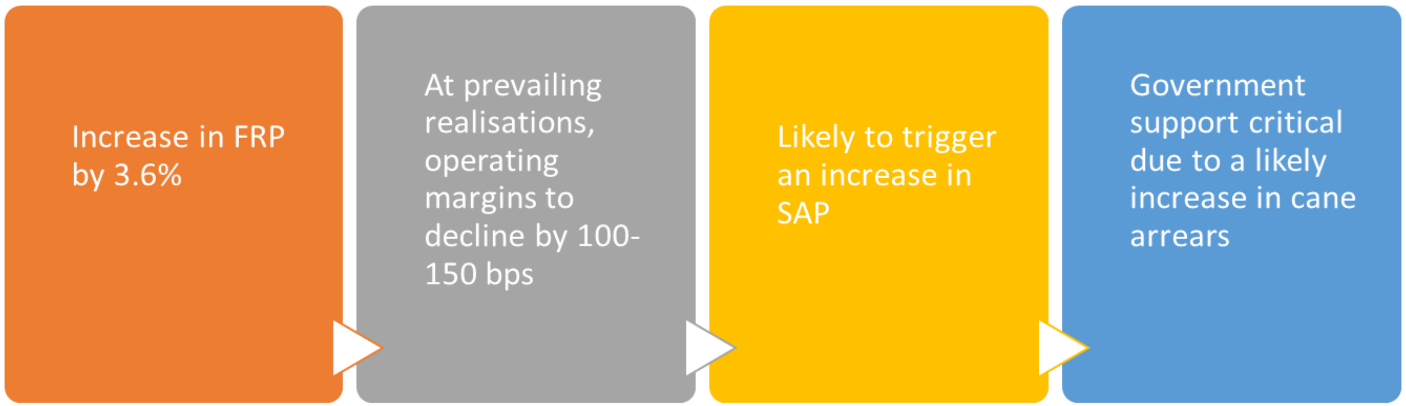
Impact Assessment of FRP hike

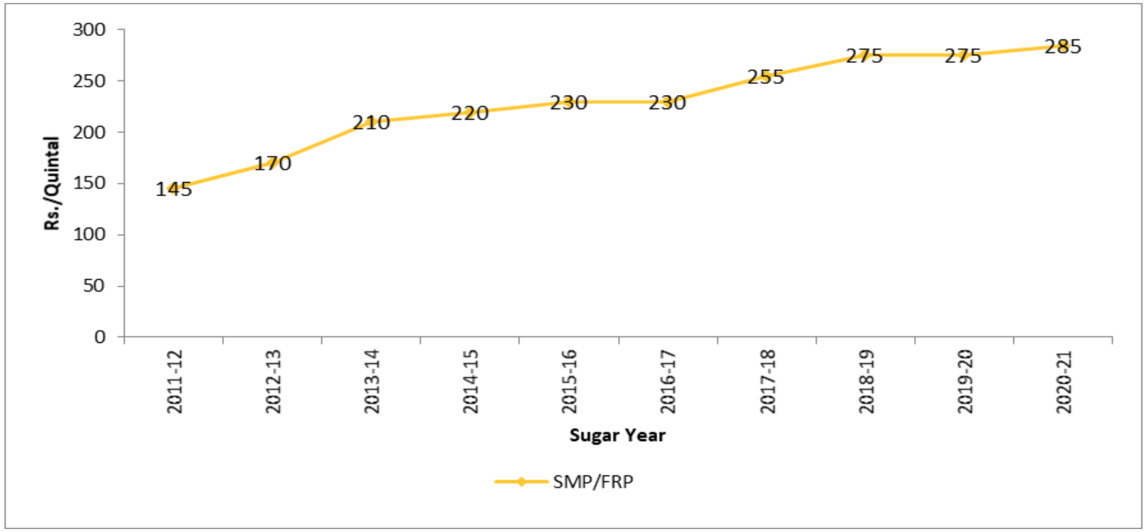
- The Cabinet Committee on Economic Affairs (CCEA) has fixed the Fair and Remunerative Price (FRP) at Rs. 285/quintal for SY2020-21[1] season, an increase of Rs. 10/quintal, compared to the previous year. The cane price is linked to a basic recovery rate of 10.0%. The increase in the FRP is 3.6% for the season SY2020-21, and it is likely to result in an increase in the cost of production by around Rs. 1000/MT of sugar. Sugar prices increased to Rs. 32-33/kg in June – July 2020 from to the minimum support price (MSP) levels of Rs. 31/kg in April – May 2020. While the recent pick-up in consumption and the pace of sugar exports is likely to support the sugar prices in the near term, given the sugar surplus scenario, some moderation in the sugar prices cannot be ruled out. Assuming that the prevailing sugar prices are likely to continue in SY2021, the operating margins of sugar mills are likely to get adversely impacted by 100-150 bps. The contraction in the operating margins is likely to increase for any correction in the sugar prices from the current levels. Given the increase in the FRP, the increase in the MSP for sugar remains critical, given the continued sugar surplus scenario in the domestic market.
- This increase in the FRP is likely to result in an increase in the state-advised price (SAP) set by the state governments in the SAP following states.
- At a higher FRP and an expectation of a higher sugar production for SY2021 YoY, the cane arrears are expected to increase. Thus, the Government's intervention in support of the sugar mills and the farmers will remain important in the coming sugar season to prevent an increase in the cane arrears.

Exhibit 1: Impact of FRP hike



Source: ICRA research

Exhibit 2: Trends in FRP



Source: ICRA research

Exhibit 3: Sugar production in FRP-based states

In Million MT	SY2018	SY2019	SY2020
Maharashtra	10.7	10.7	6.2
Karnataka	3.7	4.4	3.3
Tamil Nadu	0.6	0.9	0.8
Gujarat	1.1	1.1	0.9

The FRP, which is the minimum guaranteed cane price to the farmers, is fixed based on the recommendation of the Commission for Agricultural Costs and Prices (CACP). For SY2020-21, it has been fixed at Rs. 285/quintal for a recovery rate of 10%, subject to a premium of Rs. 2.85/ quintal for every 0.1 percentage point increase in recovery above that level compared to Rs. 275/quintal for a recovery rate of 10%, subject to a premium of Rs. 2.75/quintal in SY2019-20. For a recovery rate between 9.5%-10.0%, the reduction in FRP is by Rs. 2.85/quintal for every 0.1 percentage point decrease in recovery. For a recovery rate of below 9.5%, the price has been fixed at Rs. 270.75/quintal.

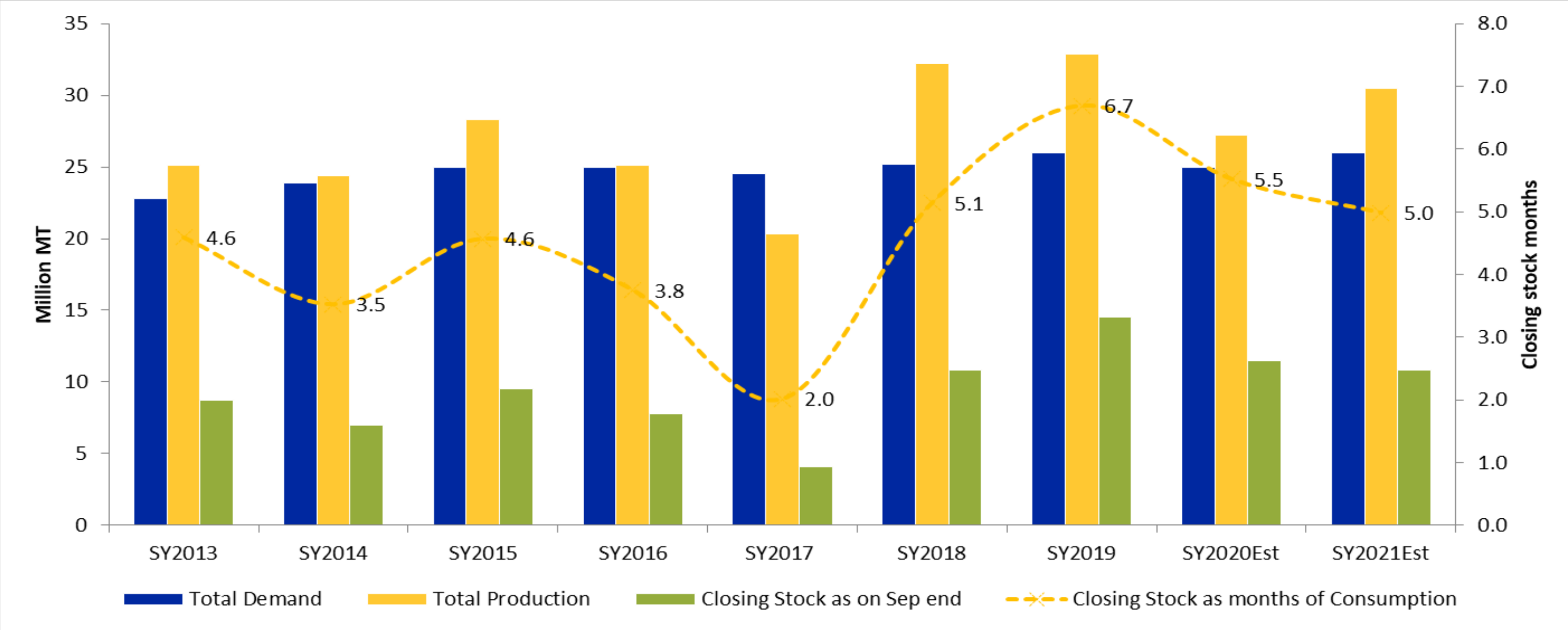
BACKGROUND

Cane-pricing mechanisms - There are two cane-pricing regimes in India: The SAP announced by the state governments, and the FRP announced by the Centre. Among the major sugar-producing states, Uttar Pradesh, Uttaranchal, Punjab and Haryana follow the SAP. Mills in Maharashtra, Gujarat, Tamil Nadu, Karnataka, Telangana and Andhra Pradesh follow the FRP. However, in these states, the FRP mainly serves as the floor price and the actual prices, which are usually at a premium to the FRPs when the sugar prices are healthy, are arrived at through negotiations between the sugar mills and farmers. The premium is usually determined by the relative bargaining power of the farmers and the mills and the prevailing sugar prices.

In the case of the SAP, prices are fixed by the state governments, which are usually on a higher side compared to the FRP. In this case, the cane pricing is primarily influenced by political considerations and a lot less by economical, and there is limited correlation between cane costs and sugar realisations.

Surplus sugar in the domestic market - As per the preliminary estimates of ISMA, the domestic sugar production is likely to increase to 30.5 million MT, by 12.1% YoY, in SY2021 (after adjusting for the impact of the diversion of B-heavy molasses and sugarcane juice for ethanol manufacture). This is primarily driven by the increase in cane availability in Maharashtra and Karnataka in SY2021, which was adversely impacted in the previous year due to drought. Without considering the impact of the diversion of B-heavy molasses and sugarcane juice for ethanol manufacture in SY2021, the production is expected to be around 32.0 million MT.

Exhibit 4: Trends in demand, production and closing stock



Source: ICRA research

ICRA expects the sugar consumption to get back to around 26.0 million MT levels in SY2021. An opening stock of around 11.0-11.5 million MT, coupled with sugar production of 30.5 million MT, is likely to result in an overall sugar availability of around 41.5-42.0 million MT, resulting in a sugar surplus in the domestic market. In the light of the expected continued sugar surplus, the Government support for exports is likely to continue for SY2021. Assuming that the exports are likely to be around 5.0-5.5 million MT, similar to the SY2020 figures, ICRA expects the closing stocks to be around 10.5-11.0 million MT for the SY2021 season, which is higher when compared to the normative sugar stock levels.

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ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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