

SUGAR

Unexciting excise sop

The Food Ministry and the Indian Sugar Mills Association (ISMA) have proposed a financial bailout package for the sugar industry; the proposal is awaiting central cabinet nod. It provides for deferment of excise duty payable w.e.f. July 2007 for three years on non-levy sugar sales. In our view, the proposed relief package is likely to provide only short term cash flow relief rather than alleviating any fundamental concerns.

* **Relief package unlikely to heal ailing sugar industry**

Though the relief package appears positive, we believe such measures are predominantly meant to clear cane arrears which would support millions of farmers associated with this politically sensitive sector. We, therefore, do not foresee any major euphoria based on excise duty relaxations for the ailing sugar sector on two counts.

First, such excise duty relaxations, if approved, are applicable with effect from July 2007 which technically means that the benefit will be available only for Q4FY07 and the coming two seasons (SS08E and SS09E). Our interaction with managements of sugar mills lead us to believe that ~ INR 30 bn worth of cane arrears have already piled up, largely in Uttar Pradesh and Maharashtra. The political implication is specifically significant in case of Maharashtra as the state is likely to have its next leg of state level elections in another 30 months. Further, if the current sugar realizations continue in the next season (SS08), cane arrears are going to increase further. Given that excise duty on levy sugar (90% of total sugar production) is fixed at INR 850/tonne of sugar production and assuming the domestic sugar consumption growing at 3% annually for next two years, we believe ~INR 40 bn will be retained by sugar mills on account of excise duty payment deferment. The retained amount will be used to pay cane arrears to incentivise farmers to grow sugarcane.

Table 1: Calculation showing implied cash benefit on account of excise duty relaxations

| | SS07E | SS08E | SS09E | Total |
|---|--------------|---------------|---------------|---------------|
| Sugarcane cultivation (MMT) | 270 | 270 | 270 | 810 |
| Sugar recovery (%) (assumed) | 10 | 10 | 10 | 10 |
| Sugar production (MMT) | 27 | 27 | 27 | 81 |
| Excise duty on sugar (INR/tonne) | 850 | 850 | 850 | 850 |
| Expected consumption* (domestic) | 6 | 21 | 21 | 48 |
| Non levy sugar consumption (%) | 90 | 90 | 90 | 90 |
| Expected non levy consumption (domestic) | 5 | 19 | 19 | 43 |
| Est. excise duty collection/ deferment (INR mn) | 4,590 | 15,759 | 16,232 | 36,581 |
| Interest saving (assumed at 8%) (INR mn) | 367 | 1,261 | 1,299 | 2,926 |
| Implied cash benefit (INR mn) | 4,957 | 17,020 | 17,530 | 39,507 |

Source: Edelweiss research

* Since excise relief, if approved will be effective from July,2007 we have assumed 3 months consumption for SS07

Note: 1.) No excise duty is levied on export shipments

June 11, 2007

Priyanko Panja
+91-22-2286 4300
priyanko.panja@edelcap.com

Siddharth Sanghvi
+91-22-2286 4397
siddharth.sanghvi@edelcap.com

Hiral Desai
+91-22-4009 4537
hiral.desai@edelcap.com

At this point in time, we expect cane arrears to increase in the next two seasons. Our scenario analysis leads us to conclude that cane arrears will be paid off in totality by excise duty relaxations only if there are no additional cane arrears arising over the next two seasons.

Table 2: Net cane arrears by SS09E end

| | (INR mn) | | | | | | | | | | | |
|--------------------------|--|--------|--------|---------------|--|--------|--------|---------------|--|--------|--------|------------|
| | Scenario I - Likely scenario Equivalent cane arrears' build up in next two seasons | | | | Scenario II - Likely scenario Declining cane arrears' build up in next two seasons | | | | Scenario III- Unlikely scenario No further cane arrears | | | |
| | SS07E | SS08E | SS09E | Total | SS07E | SS08E | SS09E | Total | SS07E | SS08E | SS09E | Total |
| Implied cash benefit | 4,957 | 17,020 | 17,530 | 39,507 | 4,957 | 17,020 | 17,530 | 39,507 | 4,957 | 17,020 | 17,530 | 39,507 |
| Cane arrears | 30,000 | 30,000 | 30,000 | 90,000 | 30,000 | 20,000 | 10,000 | 60,000 | 30,000 | - | - | 30,000 |
| Net arrears SS09E | | | | 50,493 | | | | 20,493 | | | | Nil |

Source: Edelweiss research

current cane arrears of INR 30bn is as per industry estimates

Second, the proposal does not provide for total waiver of excise duty payable and sugar mills have to pay back the sum to the central government in monthly installments for three years starting July 2010.

Amongst companies in our coverage universe, the expected excise duty deferment will have the most positive impact on Bajaj Hindusthan given its scale of operations. However, we believe these relaxations will only help sugar companies survive tough times by paying off cane arrears.

Table 3: Excise duty deferment impact on cash flows

| | Bajaj Hind. | | Balrampur | | Dwarikesh | | Renuka Sugars | | Sakthi sugars | |
|---|-------------|--------------|--------------|--------------|-----------|------------|---------------|--------------|---------------|--------------|
| | SS07E | SS08E | SS07E | SS08E | SS07E | SS08E | SS07E | SS08E | SS07E | SS08E |
| Sugar sales (MMT) | 0.3 | 2.0 | 0.2 | 1.1 | 0.1 | 0.3 | 0.1 | 0.3 | 0.2 | 0.2 |
| Excise duty collection at INR 850/tonne (INR mn) | 259 | 1,505 | 187 | 832 | 42 | 230 | 56 | 253 | 147 | 174 |
| Interest saving (assumed at 8%) (INR mn) | 21 | 120 | 15 | 67 | 3 | 18 | 5 | 20 | 12 | 14 |
| Total cash benefit (INR mn) | 280 | 1,625 | 202 | 898 | 45 | 248 | 61 | 273 | 159 | 188 |
| Gross cash flow (ex-excise benefit) (INR mn) | 512 | 493 | 1,283 | 1,380 | (43) | 181 | 1,345 | 2,898 | 682 | 1,647 |
| Gross cash flow (post-excise benefit) (INR mn) | 792 | 2,118 | 1,485 | 2,278 | 3 | 429 | 1,406 | 3,171 | 841 | 1,835 |

Source: Edelweiss research

* **Reiterate bearish outlook over near to medium term**

Given that sugar production is expected to be over 27MMT for SS07 (Source: ISMA estimates) with domestic consumption pegged at 20 MMT and likely exports of 1 MMT, the inventory carriage is likely to be ~ 10 MMT plus at end of SS07. Current domestic sugar realisations are INR 12,500-13,500/tonne in North India and INR 11,500-12,000/tonne in South India. Further, the earlier estimates of export shipment of 1.5 MMT in SS07 seem unlikely given that only 0.3 MMT has been shipped till March 2007. We believe that out of the expected 1.2 MMT sugar exports in the next six months, only 0.7 MMT is likely to be shipped given the current global refined sugar prices and ability of ports to handle shipments. Current white sugar prices at LIFFE (August futures) are USD 335/tonne and raw sugar prices at NYBOT (July futures) are at USD 200/tonne. However, Indian white sugar trades at a ~ USD15-20/tonne discount to world sugar prices as India produces 100-110 ICUMSA grade sugar which has limited market. Normally, 45 ICUMSA sugar grade is traded on the world export market. We reiterate our bearish outlook on the sugar sector over the near to medium term.

We continue to maintain our 'ACCULUMATE' recommendation on **Shree Renuka Sugars** (SRSL) which has the most diversified business model and locational advantage arising from its South India presence. SRSL is amongst the few players in India which manufacture 45 ICUMSA grade sugar which is traded on the world sugar market. We continue to remain negative on the sector and maintain our 'REDUCE' recommendation on **Balrampur Chini** (BCML), **Sakthi Sugars** (SSL), and **Dwarikesh Sugar** (DSIL), and 'SELL' recommendation on **Bajaj Hindusthan** (BJH).

Edelweiss Securities

14th Floor, Express Towers,
Nariman Point, Mumbai – 400 021
Board: (91-22) 2286 4400
Email: research@edelcap.com



Naresh Kothari – 2286 4246

Co-Head, Institutional Equities

Vikas Khemani – 2286 4206

Co-Head, Institutional Equities

| INDIA RESEARCH | SECTOR | INSTITUTIONAL SALES |
|-------------------------------|---|---------------------------------|
| Shriram Iyer - 2286 4256 | Head – Research | Nischal Maheshwari - 2286 4205 |
| Gautam Roy - 2286 4305 | Airlines, Textile | Rajesh Makharia - 2286 4202 |
| Ashutosh Goel - 2286 4287 | Automobiles, Auto Components | Vikrant Oak - 4019 4712 |
| Vishal Goyal, CFA - 2286 4370 | Banking & Finance | Shabnam Kapur - 2286 4394 |
| Revathi Myneni - 2286 4413 | Cement | Abhijit Chakraborty - 4019 4823 |
| Harish Sharma - 2286 4307 | Infrastructure, Auto Components, Mid Caps | Balakumar V - (044) 4263 8283 |
| Priyanko Panja - 2286 4300 | Infrastructure, Engineering, Telecom | Ashish Agrawal - 2286 4301 |
| Parul Inamdar - 2286 4355 | Information Technology | Nikhil Garg - 2286 4282 |
| Priyank Singhal - 2286 4302 | Media, Retail, FMCG | Swati Khemani - 2286 4266 |
| Prakash Kapadia - 4097 9843 | Mid Caps | Neha Shahra - 2286 4276 |
| Niraj Mansingka - 2286 4304 | Oil & Gas, Petrochemicals | Priya Ramchandran - 2286 4389 |
| Manika Premsingh - 4019 4847 | Economist | Anubhav Kanodia - 2286 4361 |
| Sunil Jain - 2286 4308 | Alternative & Quantitative | Tushar Mahajan - 2286 4439 |
| Yogesh Radke - 2286 4328 | Alternative & Quantitative | Harsh Biyani - 2286 4419 |
| | | Nirmal Ajmera - 2286 4258 |
| | | Ankit Doshi - 2286 4671 |
| | | Dipesh Shah - 2286 4434 |

Email addresses: firstname.lastname@edelcap.com

e.g. naresh.kothari@edelcap.com

unless otherwise specified

RATING INTERPRETATION

| | | | |
|--------------------|---|---------------------|---|
| Buy | Expected to appreciate more than 20% over a 12-month period | Reduce | Expected to depreciate up to 10% over a 12-month period |
| Accumulate | Expected to appreciate up to 20% over a 12-month period | Sell | Expected to depreciate more than 10% over a 12-month period |
| Trading Buy | Expected to appreciate more than 10% over a 45-day period | Trading Sell | Expected to depreciate more than 10% over a 45-day period |

This document has been prepared by Edelweiss Securities Private Limited (Edelweiss). Edelweiss and its holding company and associate companies are a full service, integrated investment banking, portfolio management and brokerage group. Our research analysts and sales persons provide important input into our investment banking activities. This document does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. The information contained herein is from publicly available data or other sources believed to be reliable, but we do not represent that it is accurate or complete and it should not be relied on as such. Edelweiss or any of its affiliates shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult his own advisors to determine the merits and risks of such investment. The investment discussed or views expressed may not be suitable for all investors. We and our affiliates, officers, directors, and employees may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as advisor or lender / borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject Edelweiss and affiliates to any registration or licensing requirements within such jurisdiction. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. Edelweiss reserves the right to make modifications and alterations to this statement as may be required from time to time. However, Edelweiss is under no obligation to update or keep the information current. Nevertheless, Edelweiss is committed to providing independent and transparent recommendation to its client and would be happy to provide any information in response to specific client queries. Neither Edelweiss nor any of its affiliates, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.