

Sugar Cycle - "History Repeats itself"

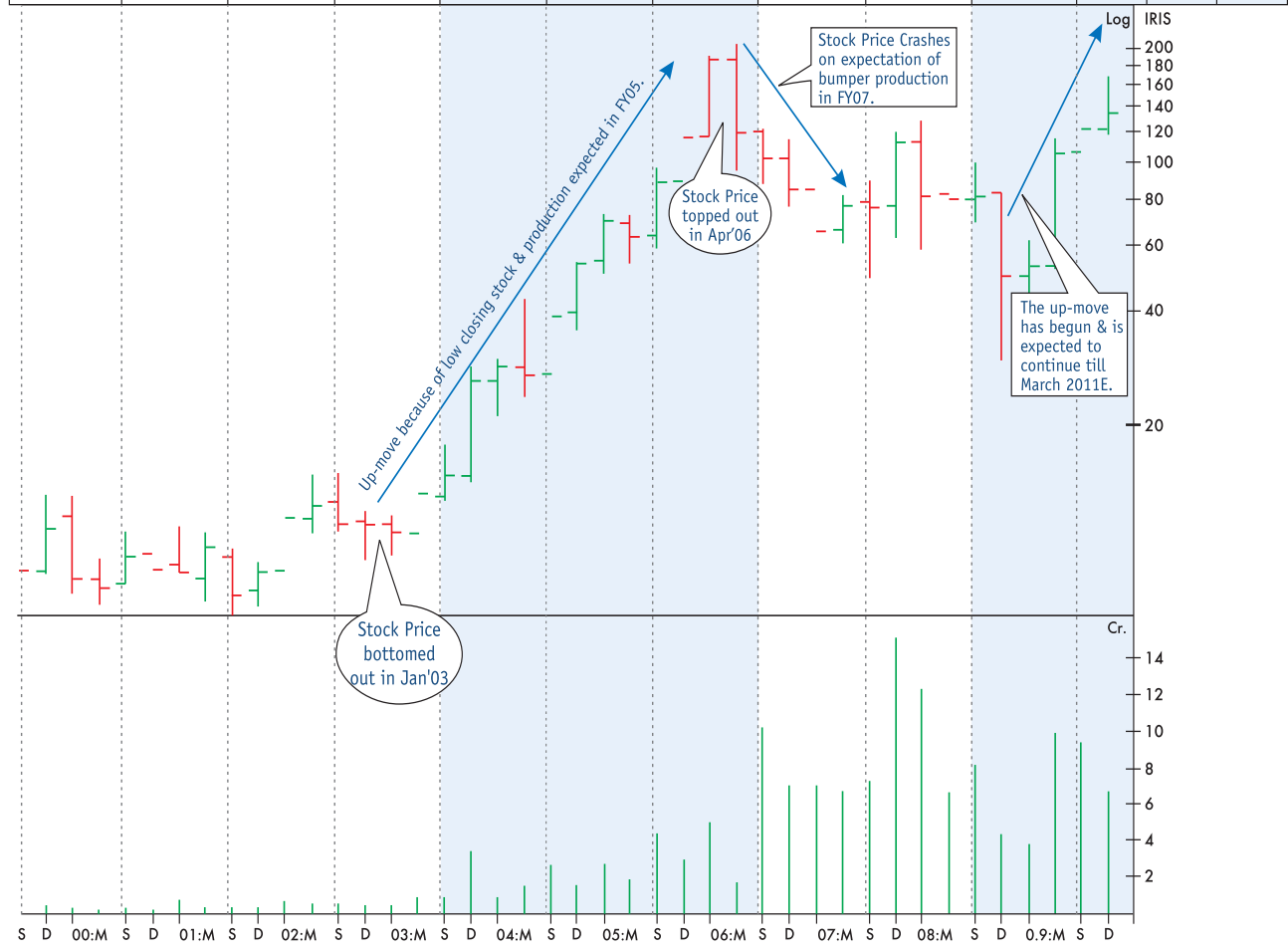
Sugar Sector - "Continue To Remain Sweet Amidst Shortage In Supply"

The closing stock for the season ended on 1st October 2009 was the lowest in a decade. This was mainly due to low area under sugarcane cultivation, lowest yield, & lowest recovery rate. Historically, the domestic demand has been growing at a CAGR of 5%, while production has been growing at a comparatively slower pace. Thus, with the opening stock of merely 2.3 MT, estimated production of 16.2 MT & growing demand of ~ 23.3 MT, there would be shortage of ~5-6 MT which would be filled by the way of imports. We therefore believe that there would be a tremendous pressure in maintaining the inventory levels, not only by the end of season 2009-10E but also by the end of season after that. Thus sugar prices making new highs would be inevitable. We, therefore maintain our BULLISH stance on the sector.

Case Study - Balrampur Chini Mills

Typically markets discount the sugar cycle a year in advance. Refer to the chart below.

Million Tons	Season 1								Season 2			
	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E	FY12E
Production	18.5	18.5	20.1	14.0	12.5	19.3	28.3	26.3	14.7	16.2	21.9	27.0
Consumption	17.2	17.9	19.9	17.5	18.5	19.7	22.7	27.4	22.5	23.0	23.3	24.0
Closing Stock	10.7	11.3	11.5	8.5	4.5	3.6	9.2	8.1	2.3	1.5	2.1	4.1
Closing Stock (No.Of Months)	7.9	8.1	7.5	5.9	2.9	2.3	5.3	4.3	1.2	0.8	1.1	2.0



Source : ISMA, LKP Research

We have studied the price chart of Balrampur Chini from September 2000 onwards. Based on the above chart, our findings are as below:

- In the scenario when there is sufficient sugar in the country the sugar stocks typically move sideways with low market interest i.e. between September 2000 to December 2002.
- The markets starts discounting the 1st up move in the sugar cycle, at the end of the crushing season, as one can easily project the sugar output & the closing stock for the season. Thus, the up move in sugar stocks start a year prior to the country reporting a drop in sugar production, i.e. the up move started from March 2003.
- The down turn in the sugar cycle is discounted at the end of the previous crushing season, as one can easily project the area under sugarcane cultivation & probable sugar output for the next season. The sugar production in the country touched a record high of over 28 MT in FY07. The expected surplus in the country in the future factored well in advance, thus the sugar stocks peaked out in April 2006.

Key Difference in the current up cycle (FY09 - FY12E) V/S The Previous up Cycle (FY04 - FY06)

<p>Season 1 - FY04 to FY06 Uptrend in Sugar Cycle for 2.5 years.</p>	<p>Season 2 - FY09 - FY12E Uptrend in Sugar Cycle for 3.5 years</p>
<p>1. Production: Production was lower than previous year, however still manageable.</p> <ul style="list-style-type: none"> • FY04 - 14.0 MT • FY05 - 12.5 MT • FY06 - 19.3 MT 	<p>Production: Lower production but demand picking up at faster rate</p> <ul style="list-style-type: none"> • FY09 - 14.7 MT • FY10E - 16.2 MT • FY11E - 21.9 MT
<p>2. Consumption:</p> <ul style="list-style-type: none"> • FY04 - 17.5 MT • FY05 - 18.5 MT • FY06 - 19.7 MT 	<p>Consumption:</p> <ul style="list-style-type: none"> • FY09 - 22.5 MT • FY10E - 23.0 MT • FY11E - 23.3 MT
<p>3. Closing Stock : Closing stock was low for 2 years, resulting in high sugar prices.</p> <ul style="list-style-type: none"> • FY05 - 4 MT (2.9 months) • FY06 - 3.6 MT (2.3 months) 	<p>Closing Stock : closing stock has been lowest in a decade & hence sky rocket sugar prices. Closing stock is expected to be uncomfortable for the 3 consecutive years.</p> <ul style="list-style-type: none"> • FY09 - 2.3 MT (1.2 months) • FY10E - 1.5 MT (0.8 months) • FY11E - 2.4 MT (1.2 months)
<p>4. Surplus / Deficit (1-2): Better placed than current sugar cycle.</p> <ul style="list-style-type: none"> • FY05 - 2.5 MT • FY06 - 3.6 MT 	<p>Deficit (1-2): For the first time in a decade, the country would be importing sugar for 3 consecutive years. Highest ever imports will be made in FY10E.</p> <ul style="list-style-type: none"> • FY09 - 0.3 MT • FY10E - (4.5) MT (Resulting In Highest ever imports) • FY11E - 0.4 MT

Note: September year ending

Outlook & Conclusion

The current sugar cycle is one of the most buoyant sugar cycles; where in the production is at record low, yield & recovery rate are also low and the demand is at a record high, there by widening the GAP between the demand & the supply. The above facts have resulted in record high sugar prices (over 85% YoY growth). The current cycle is the longest cycle in the history & is expected to last for 4 years (previous cycle was 3 years long). Thus, based on historical movement of sugar stocks in relation to closing inventory & production in the country, **we believe that there is still sweetness left in sugar stocks. We also believe that the sugar prices will continue to make new highs, where as the sugar stocks would top out by March 2011E.**

News Headlines

Domestic News

Sugar recovery in Maharashtra dips 1% *(Business Standard 30th Nov' 09)*

Sugar recovery in the state declined to 8.9 per cent during the first month of the crushing season this year, as against 10.2 per cent during the same time last year, according to the data compiled by the Maharashtra State Federation of Co-operative Sugar Factories, the apex trade body representing about 175 sugar factories in the state. Despite the quantity of crushed cane increasing by over one million tonnes, the total sugar output in the state remained almost rangebound at 730,000 tonnes as compared to 735,000 tonnes a year ago.

India Lifts 1 MN-Tonne cap on Duty-Free White Sugar Import *(Business Standard 30th Nov' 09)*

India today lifted the one million tone cap on duty free imports of white sugar allowed over a year ending March 2010, a government official said.

Sugar mills to pay Rs 190/qtl for cane *(Business Standard 30th Nov' 09)*

The Uttar Pradesh sugar mills have agreed to pay Rs 25 a quintal as incentive to farmers over and above the state advised price (SAP) of Rs 165-170. Farmers in the country's second biggest sugar producing state had been demanding a price of Rs 280 a quintal. Given the current realization of Rs 3,200-3,300 a quintal in sugar, mills will make decent profits even after paying Rs 190-195 for every quintal of sugarcane.

Global News

Czarnikow Cuts Forecast for Brazilian Sugar Production by 7.3% *(Bloomberg 29th Nov' 09)*

Brazil, the world's biggest sugar producer, will make 7.3 percent less of the sweetener in 2009-10 than forecast in August, worsening a global supply shortfall, Czarnikow Group Ltd. said. Sugar output in the country will be 35.3 million metric tons raw value, below the August estimate of 38.1 million tons, Czarnikow said in a report today. Raw-sugar prices jumped 88 percent this year in New York as excess rains in Brazil and dry weather in India hurt harvests of the world's largest growers.

Thai Sugar-Cane Crop May Rise to Record 80 Million Tons *(Bloomberg 20th Oct' 09)*

Sugar-cane output in Thailand, the world's second-biggest sugar exporter, may rise to a record 80 million metric tons in the year starting Nov. 1, 2010, said Prasert Tapaneeyangkul, secretary-general at the Office of the Cane and Sugar Board. Output of the tropical plant will rise from 71.6 million tons in the year starting next month, Prasert said in an interview in Sao Paulo. Thailand may raise its regulated price for sugar cane to more than 1,000 baht per ton for the coming crop year, from between 890 and 900 baht this season, he said.