Management Discussion & Analysis

Sugar Industry – Global scenario

Sugar is one of the world's major agro-based industries and is also one of the most actively traded soft commodities on the exchanges. Brazil, India, the EU, China and Thailand rank amongst the top global producers of sugar. Around 80% of the sugar is produced from sugarcane while the balance is from sugar beet. Brazil and India are the largest sugar producers from sugarcane and EU and U.S are the major sugar producers from beet. India, the EU, China, Brazil and U.S are the major sugar consuming countries.

Global trends in Sugar

During the current five-year period, the Global Sugar Manufacturing industry has had to contend with unstable production and price levels. Till 2012 adverse weather conditions and increasing diversion of sugar stocks to ethanol production reduced the production of sugar, inflating the world price of sugar. In 2012, the prices crashed due to high global production and unhealthy stocks-to-use ratio and continued to decrease throughout the period, pushing the revenue down. In the next five years, the sugar industry is expected to perform better due to rising demand for renewable energies, growing global sugar consumption and government policies.

Sugar Industry – Domestic scenario

The domestic sugar production upto March 31, 2016 stood at 23.7 million tonnes, with a drop of 1.1 million tonnes less than last year. Lower production along with exports brought down the closing stocks to around 7.6 million MT in SY2016 from around 9.5 million MT in SY2015. The estimated decline in sugar stocks was a positive sign resulted in an improvement in domestic sugar realizations since August 2015. Despite the estimated decline in domestic sugar production, production may marginally outstrip domestic consumption by around 0.3 million MT. The decline in production is mainly driven by severe drought in the sugar producing States like Maharashtra and Karnataka, which impacted sugar cane availability. The production in Maharashtra is estimated to decline by 20% to around 8.4 million MT. In UP, production during SY2016 is estimated at similar levels to that in the previous year. In Karnataka, weaker monsoons are expected to negatively impact sugar production, while production is expected to marginally increase in Tamil Nadu.

Price of Sugar Cane

For the sugar year 2015-2016, the Commission for Agricultural Costs and Prices (CACP) has recommended a Fair and Remunerative Price @ ₹2300/- per Tonne for a basic recovery rate of 9.5% with a premium of ₹2.42 for every 0.1% increase in the recovery rate. There has been a steady increase in the Fair and Remunerative Price, without any corresponding increase in the sale price of sugar. For a recovery of 9.5% per ton, the FRP has continued to rise from ₹ 2100 in SY 2013-14 to ₹ 2200 for SY 2014-15 to ₹ 2300 per tonne for SY 2015-2016. However, for SY 2016-2017, the Government has committed to continue with the FRP of 2300 per ton. Further the Central Government announced a production subsidy of ₹ 45 per metric ton of cane, subject to certain conditions by sugar mills, pegging the effective cane price at ₹2255/-Mt for a recovery of 9.50%. The CACP has also recommended for creation of a Sugarcane Price Stabilization Fund mobilized through levy of a special cess to meet the differential price between the price determined through a Revenue Sharing Formula and the FRP which will be an effective mechanisim to support the Industry in case of fall in sugar price.

Apart from FRP, some of the State Governments fix a higher price for cane, called the State Advised Price (SAP) which has also been continuously increased over the years. The State Advised Price (SAP) fixed by the UP Government for cane remains high at ₹ 280/quintal for SY2016. In Tamil Nadu, the State government increased the SAP to ₹ 285/quintal in SY2016 from ₹ 265/quintal in SY2015. The ability of the industry to secure a linkage between cane price and sugar realizations is critical for its long-term sustainability. Unless such linkage is established as per the report of the Dr. Rangarajan committee and as implemented by the states of Karnataka/ Maharashtra with the Central Government support for any difference between such price and the FRP is holistically adopted, the sugar cane cost will remain a cause of concern for the Industry.

Sugar Price

The sugar prices touch a three-year low of around ₹ 20,000/- to ₹23,000/MT in July 2015 caused by consecutive years of surplus production from SY2013 leading to surplus sugar in the domestic market along with the international sugar-surplus scenario and muted international sugar prices. However, since August 2015 the sugar realizations are on a rising trend with prices increased marginally to around ₹ 24,000/ MT in August 2015 with the government considering the option of exporting surplus sugar. After the government notified the mandatory export quota for SY2016, domestic sugar prices firmed around ₹ 25,500/MT in September 2015. Festive demand for sugar during the months of October and November 2015 led to an increase in sugar prices to nearly ₹ 26,000/MT in October 2015 and to nearly ₹ 26,700/ MT in November 2015. The announcement of cane production subsidy in December 2015, the expected increase in sugar exports and the sugar deficit scenario due to drought have combined to cause sugar prices to firm up to ₹ 31,000/MT in February 2016 and to ₹ 31,600/MT in March 2016. However, going forward, despite lower sugar production during SY2016, the sustainability of the upward trend in sugar prices remains critical on the sugar exports for SY2016 season as well as expectations on production figures for SY2017.

Over the medium term, international sugar prices will be largely determined by fluctuations in world sugar production as well as crude oil prices, which determine the raw sugar-ethanol blend in major exporting countries like Brazil. In the medium term, lower sugar prices will boost consumption, but on the supply side, farmers are likely to shift to other crops, which in turn would reduce the sugar output, leading to a supply correction. However, with a decline in the output of major supplying nations including India and Brazil, and the resultant lower supplies to the world market, a supply deficit appears likely. Nevertheless, in the near to medium term, significant accumulated stocks would provide insulation from any sharp spikes in international sugar prices.

Sugar Division

The Company's Sugar Plant located at Ramdurg, Belagavi District in Karnataka, was taken on 25 years lease from Shri Dhanalakshmi Sahakari Sakkare Karkhane Niyamat (DSSKN). During the year the Company fared well in the production front adding about 1.9 Lakh MT of cane to the crushing over the previous year. The Company crushed around 7.4 Lakh MT of cane as against 5.5 Lakh MT of cane last year. The average recovery percentage, though was lower at 11.91% as compared to 12.14% of last year, it was higher than the nearby mills in North Karnataka. During the year all operational parameters have been better than last year.

Cogeneration

Co-generation is the concept of producing two forms of energy from one fuel. One of the forms of energy must always be heat and the other may be electrical or mechanical energy. Cogenerated power has environmental benefits in terms of replacing fossil fuels and is also renewable in nature. For a sugar mill, opting for cogeneration of power has the advantages of getting an additional stream of revenue by selling electricity to the consumer through power grids.

The power produced through co-generation substitutes the conventional thermal alternative and reduces greenhouse gas emissions. In India, interest in high-efficiency bagasse based cogeneration started in the 1980s when electricity supply started falling short of demand. High-efficiency bagasse cogeneration was perceived as an attractive technology both in terms of its potential to produce carbon neutral electricity as well as its economic benefits to the sugar sector. In the present scenario, where fossil fuel prices are shooting up and there is a shortage and non-availability of coal, co-generation appears to be a promising development. The thrust on distributed generation and increasing awareness for cutting greenhouse gas emissions increases the need for cogeneration. Also it helps in controlling pollution from fossil fuels. The major bottlenecks in harnessing co-generation potential has been lack of management focus; weak financial position of many sugar mills, especially smaller units including those run by the co-operative sector; and relatively unattractive tariffs.

During the year, the Company's Unit at Ramdurg has generated power of 541 Lakhs units as against 383 Lakh units over the previous year.

Marketing

The Company is targeting lucrative sugar markets and increasing its sales target to Institutions, retail and to sugar deficit regions primarily in and around the Eastern part of the Country. With the production of M30 grade sugar, the Company is expanding its customer base. Besides the ability to sell the higher volumes of production, sales to these markets also has the advantage of a premium price as compared to local trade. The Company has also been participating in the PDS through e-tender and ventured into futures trading through NCDEX. During the financial year 2015-16, the Company has considerably increased the sales to institutions which offer a better price of its products.

OUTLOOK

The long-term profitability of Indian sugar companies will remain highly cyclical and dependent on domestic and international supply-demand trends. The latter in turn would hinge on agro-climatic conditions in the major sugar producing countries and the trends in crude oil prices. The price trends in the international markets will be one of the key determinants of the future profitability. Further, government/court action in ensuring removal of mandatory crushing by sugar mills for the entire cane offered to them by farmers in the command area and a rational linkage between cane and sugar prices will have a critical bearing on the long-term viability of sugar operations, especially in States governed by SAP. However, the sugar industry players with high operating efficiencies, forward integration and strong capital structure will be best placed to ride out the cycles.

RISKS AND CONCERNS

The Company has constituted a Risk Management Committee. The details of the Committee, its terms of reference are given in the corporate governance report. The methodology for risk management primarily involves mapping of risks with strategy, assessing the risks on its importance, identifying de-risking measures and assigning it to risk owners and continuously monitoring the status of the risks. The risks were categorized into Strategy & Planning, operations and compliance and the risks associated with each risk category was further classified and identified as 'critical', 'major' and 'moderate'.

The major risks faced by Sugar business are the availability of cane, regulatory risks, price of sugar and that of sugar cane. The management periodically reviews the risk management framework to identify the major business risks as applicable to the Company and works out their mitigation strategy. Sugarcane is the key raw material for sugar and any difficulty in getting cane at right time will have impact on the business. The key factors that influence cane availability are climatic condition, availability of cane harvesting labour and farmers opting competitive crops.

The sugar industry is regulated by the central and state governments. The Company is in close association with ISMA and SISMA to understand the development in the sector at the country level and regional level. The risks of rising prices of sugar cane and volatility in sugar prices are expected to be met by a number of measures viz. improving the yield, increasing the cane cultivation and improving the operating efficiency etc. besides effort to increase the revenue from the byproducts.

Internal control systems and their adequacy.

The Company has well-established processes and clearly-defined roles and responsibilities for people at various levels. This coupled with adequate internal information systems in SAP ensures proper information flow for the decision-making process. The control mechanism also involves well documented policies, authorisation guidelines commensurate with the level of responsibility and standard operating procedures specific to the respective businesses. Adherence to these processes is ensured through frequent internal audits. The internal audits conducted are reviewed by the Audit Committee and requisite guidelines and procedures augment the internal controls. The internal control system is designed to ensure that financial and other records are reliable for preparing financial statements and other information which ensures that all transactions are properly reported and classified in the financial records.

Financial performance with respect to operational performance.

The Company's Sugar Plant located at Ramdurg in Karnataka, was taken on 25 years lease from Shri Dhanalakshmi Sahakari Sakkare Karkhane Niyamat (DSSKN). At the time of takeover, this unit was in a semi-finished condition. The Company made the necessary capital investment and made the unit operational. The performance of the unit since inception is as follows:

Sugar season	Cane crushed (MT)	Recovery	Sugar Produced (Qtls.)	Power exported (Lakh Units)
2008-2009	56,964	9.04	51,474	Nil
2009-2010	2,05,071	10.12	2,07,522	Nil
2010-2011	4,57,703	11.75	5,37,803	40.28
2011-2012	4,90,047	12.10	5,92,761	6.44
2012-2013	5,61,079	11.07	6,20,961	138.58
2013-2014	5,55,165	11.70	6,49,550	187.39
2014-2015	6,66,234	12.12	8,07,475	236.69
2015-2016	5,82,886	11.84	6,90,212	208.28

The initial capacity of the unit was 2500 TCD and 6 MW Co Gen. This unit commenced commercial operation in December 2008. The Company over the years has enhanced the cane crushing capacity to 4000 TCD and Co-generation capacity to 13 MW. During the year under review, the total revenue of the Company from operations was ₹29121.44 lakhs, 46.80% higher than ₹19836.63 lakhs in the previous year. The average sales realization was at ₹ 23784 per MT vs ₹ 27684 last year. Operating profit (EBITDA) was ₹(328.65) lakhs as against ₹805 lakhs in the previous year. The interest cost was ₹1526.85 lakhs as against ₹1666.43 lakhs during the last year. The Company is continuously working on further improving operational efficiencies and production techniques, benchmarking with the best in the industry. The efforts of the Company in this direction have resulted in improvement of recovery, reduction of down time and production of quality sugar inviting better margin for the Company products.

Sugar	₹ in Lakh
Revenue (excluding inter-segmental revenue)	27,338.36
EBIDTA	(1,466.45)

Cogeneration	₹ in Lakh
Revenue (excluding inter-segmental revenue)	1,442.13
EBIDTA	1,137.80

Material developments in Human Resources

In a challenging and competitive environment, the Company believes that people are the key to success and continues to focus on people capabilities by leveraging technology and creating a learning environment. The Human Resources function proactively develops innovative and business focused methods to attract, develop, motivate and retain talent. Human resources strategy is closely aligned to key business and stems from the organisation purpose which is – "To build Credible, Reliable & Capable Human Capital to deliver superior Individual and Business performance". This vision is delivered by a high level of policy deployment initiatives and contemporary HR practices focusing key imperatives such as Capability Development, Talent Management, Employee Engagement, Productivity & Cost and HR excellence.

During the year under review, there were no cases filed pursuant to the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013.

CAUTIONARY STATEMENT

The management discussion and analysis report containing your Company's objectives, projections, estimates and expectation may constitute certain statements, which are forward looking within the meaning of applicable laws and regulations. Actual results may differ materially from those expressed or implied in the statement. Your Company's operation may inter-alia be affected by the supply and demand situations, input price and the availability, changes in the government regulations, tax laws and other factors. The Company cannot guarantee the accuracy of the assumptions and perceived performance of the Company in future.