

# Sugar Industry

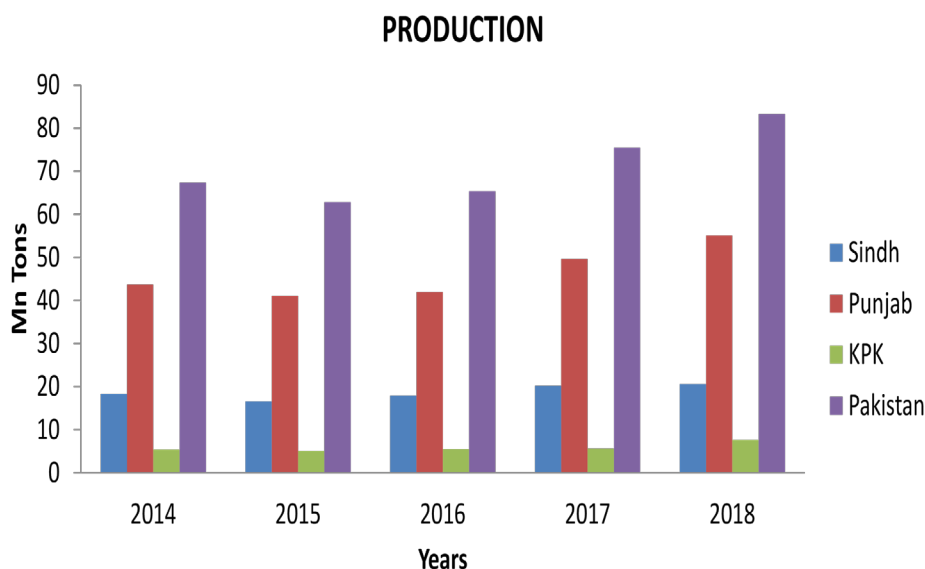
March, 2019

## Domestic Industry Profile

The sugar industry plays a vital role in creating economic activity for farmers as well as manufacturers, providing revenue to different segments of the economy. Sugar industry is the second largest agro based industry after textiles in Pakistan. The country is the 7th largest producer of sugar and 8th largest consumer of sugar. In Pakistan, sugarcane is grown on around 1.34 million hectares and provides raw material to 89 sugar mills. Area under cultivation has witnessed a sizeable increase over the last 2 years. After increasing by 7.6% in FY17, area under cultivation during FY18 crushing season was higher by 10.2% in FY18. In addition to sugar, sugarcane is also used in the production of pharmaceutical ethanol, fuel ethanol; bagasse, the by-product of the process, is used in paper and chip board manufacturing.

Production & Area (In Mn)			
Year	Area Under Cultivation	Production	Yield/Ton
2014	1.17	67.4	57.5
2015	1.11	62.7	56.4
2016	1.13	65.4	57.8
2017	1.21	75.4	62
2018	1.30	83.2	62.1

Increase in area under cultivation highlighted above is primarily attributable to attractive indicative prices for the sugarcane crop. In addition, sugarcane crop offers better yield vis-à-vis other crops. Punjab dominates the regional production with sugar mills followed by Sindh and KPK with 38 and 7 sugar mills, respectively.



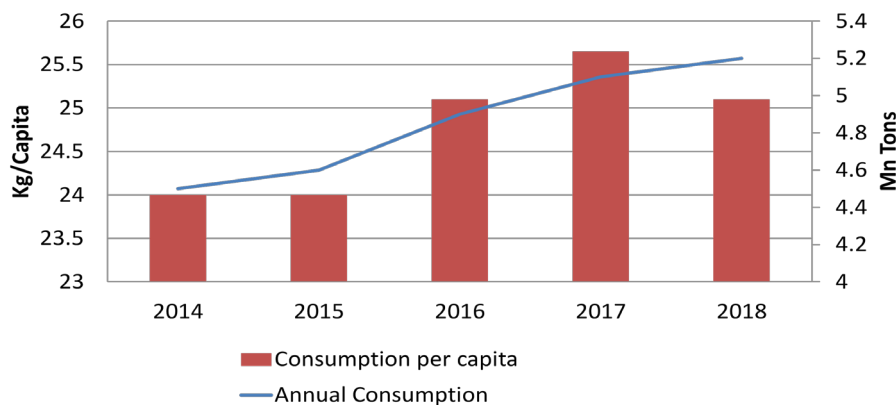
Overall recovery ratios recorded an increase on a timeline basis but still remain lower than levels noted in 2015 and 2016. In spite of higher production in Punjab, the recovery ratio tends to be lower than that of Sindh as it has recorded an average recovery ratio of 9.79% whereas Sindh has recorded the highest recovery ratio of 10.55% during MY18. Mills located in Sindh have a closer proximity to coastal areas as sea breeze is considered beneficial for sugar crop cultivation resulting in better recovery rates vis-à-vis other regions.

Source: PSMA Annual Report 2018

Recovery Ratio				
Year	Pakistan	Sindh	Punjab	KPK
2014	9.90%	10.21%	9.85%	8.75%
2015	10.12%	10.53%	9.97%	9.41%
2016	10.16%	10.65%	9.94%	9.44%
2017	9.87%	10.16%	9.77%	9.43%
2018	10.02%	10.55%	9.79%	9.52%

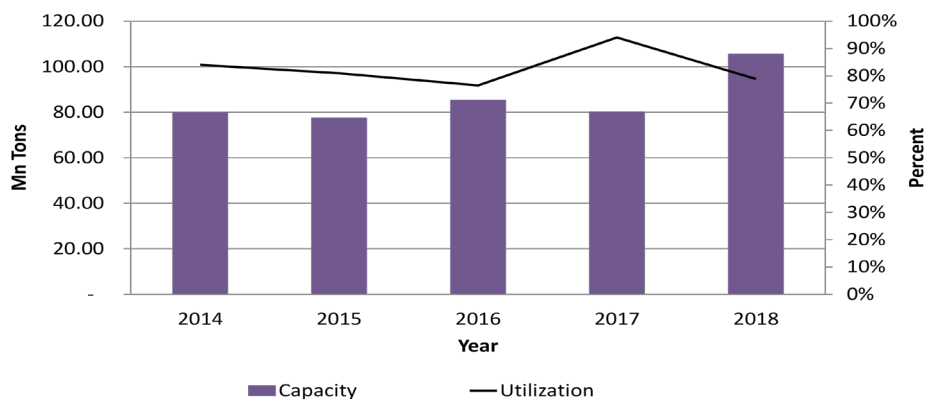
The demand for sugar is relatively inelastic since it is an item of household necessity. Over the past few years, consumption of sugar by the processed food sector (soft drinks, fruit drinks, dairy, traditional sweets and confectionary) has witnessed an increase. The corporate manufacturers including makers of candies, local sweets, bakery items and soft drinks account for bulk of the total sugar demand. As per recent statistics, the average per capita consumption of sugar in Pakistan is reported around 26kg which is higher than sugar consumed in other regional countries and slightly above global average of per capita consumption of sugar. The consumption of sugar is higher in Pakistan mostly due to the tradition of serving desserts in various festivals and events.

### Sugar Consumption



Sugar industry has been operating at high utilization levels over the last few years with capacity utilization crossing 100% during MY17. A high yield of sugarcane in MY17 led to an early start of the crushing season; as a result the overall industry recorded higher operating days in MY18.

### Total Capacity Vs Utilization levels



Source: PSMA Annual Report 2018  
 USDA Foreign Agriculture Service – November 2018

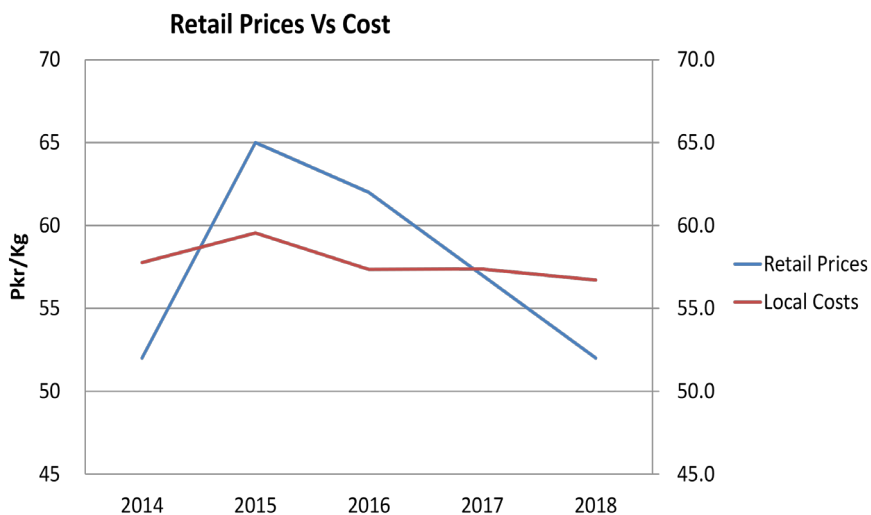
## Business Risk

Local demand supply dynamics projected to depict some improvement in MY19; slight upward pressure expected in local price.

Mn Tons	MY16	MY17	MY18
Opening Inventory	0.849	0.777	2.326
Sugar Production	5.1	7.048	6.5
Sugar Available	5.949	7.825	8.826
Domestic Consumption	4.9	5.1	5.4
Exports	0.272	0.399	1.5
Ending Inventory	0.777	2.326	1.926

Over the last two years excess supply of sugar has prevailed on the back of sugar production outpacing the overall consumption. Significant increase in production and lower allowable export quota set by the Government resulted in a sizeable increase in ending inventory at end-FY17. While production continued to outpace supply, higher export quota of 1.5m tons (with subsidy benefit by federal government and an additional subsidy by Sindh government for sugar mills in Sindh) has facilitated in reducing inventory levels which continued to remain at elevated levels at end-MY18. Decline in production for MY19 (expected to be significantly lower at around 6m tons but still higher than domestic consumption for MY19) along with export quota of 1.1m tons allowed is expected to improve local demand supply dynamics (resulting in lower ending inventory) and result in some upward pressure on prices. However, profitability of sugar mills will remain dependent on quantum of increase in domestic prices of sugar along with quantity of sugar exported. Subsidy allowed by Punjab Government is significantly lower vis-à-vis overall subsidy of prior year while no subsidy has been announced by the Federal and Sindh Government.

**Existing pricing dynamics are a drag on the profitability of the sector. Based on current international prices and existing exchange rate, international prices are still at a discount to local prices**



Local retail prices which are driven by market forces have remained depressed on account of surplus supply of sugar. Higher fixed sugarcane prices (including the impact of quality premium which is estimated to range between Rs. 5 to Rs. 12 per moud for mills in Sindh) set by the government to facilitate growers and farmers coupled with depressed retail prices has compressed margins for the industry. Based on current sugar cane prices announced by the government and assuming average recovery ratio for the industry, cost of production of sugar is slightly higher vis-à-vis local prices. Given the expected increase in sugar prices, this trend is expected to reverse in MY19 with retail prices expected to be higher vis-à-vis cost of production.

Source: PSMA Annual Report 2018

USDA Foreign Agriculture Service – November 2018

However, margins and profitability are expected to remain depressed. On the export front, current international prices (assuming exchange rate of 140) translate into a 10% discount vis-à-vis local prices. Break even international prices accounting for freight and sales tax advantage at existing exchange rate are \$370 vis-à-vis existing prices of \$339.

Per Kg Prices	MY14	MY15	MY16	MY17	MY18
Average Local Prices (Rs)	54.8	58.91	63.77	61.43	53.57
Average International Prices (USD)	0.459	0.377	0.461	0.474	0.358

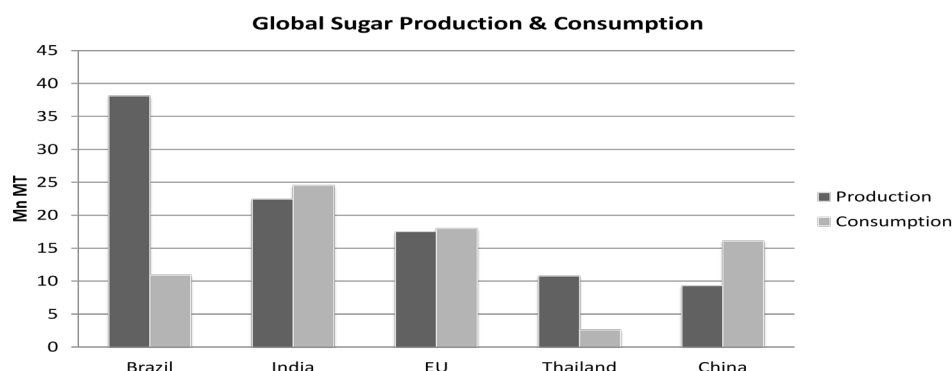
Given the high ending inventory levels and weak pricing dynamics, overall business risk profile of the sector is considered to be on the higher side. Players that have diversified into other related sectors including Ethanol, MDFB and Power are considered to have better business risk profiles vis-à-vis players operating solely in the sugar segment. This is also evident from financial results of companies during MY18 and 1QMY19 where players operating in the ethanol segment (besides the sugar sector) have performed relatively better.

### Global Industry Profile

Baring two years (MY16 & MY17), global production of sugar has outpaced consumption over the last decade resulting in sizeable global sugar ending inventory. Resultantly, ending inventory has stood at over 50% of the total consumption over the last 5 years. The demand-supply dynamics have kept international sugar prices on the lower side during MY18 (Average sugar prices were \$357.5/tonne in MY18 vis-à-vis \$477.4/tonne in MY17). Going forward, global stock levels are projected to rise as higher production from India is expected to offset decline in production from Brazil (As Brazil is now diverting its sugarcane output towards ethanol). Resultantly, international prices are expected to remain bearish during MY19 with exports for local producers in Pakistan being only profitable with subsidy support from government. Other factors that may impact demand and supply include lower consumption in Thailand on account of new sugar excise tax on beverages.

Mn Tons	MY16	MY17	MY18
Opening Inventory	96.40	91.21	88.06
Sugar Production	164.20	168.30	179.44
Sugar Available	260.60	259.51	267.50
Consumption	169.09	171.40	174.40
Import Demand	66.00	60.04	57.40
Exports	66.30	60.10	61.09
Ending Inventory	91.21	88.06	89.41

India is forecasted to become the largest sugar producer (due to enhanced yields and increase in area under cultivation) in the world in MY19 overtaking Brazil for the first time in the last fifteen years. Other major sugar producers include Brazil, Thailand, China, USA, Mexico, and Pakistan. In terms of sugar consumption, India is the largest sugar consumer followed by China and Brazil. For MY18, Brazil was the leading net exporter of sugar followed by Thailand, Australia and Guatemala.



Source: PSMA Annual Report 2018  
USDA Foreign Agriculture Service – November 2018

## Financial Risk Profile

### Profitability

Rs. in m	JDW Sugar Mills			Thal Industries			SGM Sugar Mills		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
<b>Net Sales</b>	37,287	45,432	37,265	10,673	14,919	14,104	2,447	2,194	3,524
<b>Gross Profit</b>	6,454	4,625	3,116	1,342	1,843	369	-197	-332	-128
<b>Gross Margin</b>	17%	10%	8%	13%	12%	3%	-8%	-15%	-4%
<b>PBT</b>	2,319	2,180	-141	667	942	-153			
<b>PAT</b>	2,034	1,588	-203	660	708	-160	-315	-604	-443
<b>Net Profit Margin</b>	5%	3%	-1%	6.20%	4.70%	-1.10%	-12.90%	-27.50%	-12.60%
Rs. in m	Al-Abbas Sugar Mills			Chashma Sugar Mills			Habib Sugar		
	FY16	FY17	FY18	FY16	FY17	9M18	FY16	FY17	FY18
<b>Net Sales</b>	5,794	5,327	7,494	11,206	11,412	7,542	8,517	7,135	7,759
<b>Gross Profit</b>	764	572	2,073	1,105	1,191	1,016	1,017	590	1,274
<b>Gross Margin</b>	13%	11%	28%	10%	10%	13%	12%	8%	16%
<b>PBT</b>	525	207	1,371	215	132	192	971	497	959
<b>PAT</b>	458	143	1,294	297	92	185	825	557	901
<b>Net Profit Margin</b>	7.90%	2.70%	17.30%	2.70%	0.80%	2.40%	10%	8%	12%
Rs. in m	Mehran Sugar Mills			Noon Sugar			Shahtaj Sugar		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
<b>Net Sales</b>	7,113	5,501	4,791	2,589	4,836	6,273	4,707	5,807	4,878
<b>Gross Profit</b>	743	268	590	235	572	711	527	660	-132
<b>Gross Margin</b>	10%	5%	12%	9%	12%	11%	11%	11%	-3%
<b>PBT</b>	668	199	430	52	190	270	280	322	-411
<b>PAT</b>	542	132	413	40	144	211	179	143	-409
<b>Net Profit Margin</b>	7.60%	2.40%	8.60%	1.50%	3.00%	3.40%	3.80%	2.50%	-8.40%
Rs. in m	Jauharabad Sugar Mills			Al-Noor Sugar Mills			Shahmurad Sugar Mills		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
<b>Net Sales</b>	2,095	2,582	2,195	8,103	6,896	9,081	5,910	5,056	7,220
<b>Gross Profit</b>	206	300	49	964	705	-653	670	584	810
<b>Gross Margin</b>	10%	12%	2%	12%	10%	-7%	11%	12%	11%
<b>PBT</b>				226	-127	-243	170	-74	548
<b>PAT</b>	106	32	5	170	-30	-121	125	7	601
<b>Net Profit Margin</b>	5.10%	1.20%	0.20%	2.10%	-0.40%	-1.30%	2.10%	0.10%	8.30%

- Profitability profile of players with operations solely in the sugar segment has remained under pressure
- Players that have diversified in the ethanol segment have witnessed sharp jump in profitability in MY18 owing to ample availability of molasses at competitive rates.
- Going forward, profitability profile is expected to witness some improvement with slight uptick expected in sugar prices.

## Capitalization

Rs. in m	JDW Sugar Mills			Thal Industries			SGM Sugar Mills		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
<b>Total Debt</b>	16,546	23,367	36,590	3,568	4,367	5,405	1,074	1,830	2,800
<b>Liabilities</b>	25,825	33,742	49,586	4,899	6,515	8,329.04	4,255	5,109	5,042
<b>Equity</b>	8,536	8,620	8,227	1,890	2,334	1,886	802	343	983
<b>Leverage</b>	3.03	3.91	6.03	2.59	2.79	4.42	5.31	14.90	5.13
<b>Gearing</b>	1.94	2.71	4.45	1.89	1.87	2.87	1.34	5.34	2.85
Rs. in m	Al-Abbas Sugar Mills			Chashma Sugar Mills			Habib Sugar		
	FY16	FY17	FY18	FY16	FY17	9M18	FY16	FY17	FY18
<b>Total Debt</b>	16	1,789	702	3,946	4,737	7,743	-	-	-
<b>Liabilities</b>	978	2,703	2,013	5,997	6,561	9,410	2,093	2,159	2,356
<b>Equity</b>	2,335	2,508	3,594	1,310	1,461	1,728	6,531	6,983	8,104
<b>Leverage</b>	0.42	1.08	0.56	4.58	4.49	5.45	0.32	0.31	0.29
<b>Gearing</b>	0.01	0.71	0.20	3.01	3.24	4.48	-	-	-
Rs. in m	Mehran Sugar Mills			Noon Sugar			Shahtaj Sugar		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
<b>Total Debt</b>	509	1,778	2,955	708	2,705	2,693	300	1,494	1,787
<b>Liabilities</b>	2,193	3,504	4,225	1,242	3,410	3,238	439	1,795	2,292
<b>Equity</b>	2,323	2,218	2,609	466	592	742	1,182	1,264	798
<b>Leverage</b>	0.94	1.58	1.62	2.67	5.76	4.36	0.37	1.42	2.87
<b>Gearing</b>	0.22	0.80	1.13	1.52	4.57	3.63	0.25	1.18	2.24
Rs. in m	Jauharabad Sugar Mills			Al-Noor Sugar Mills			Shahmurad Sugar Mills		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
<b>Total Debt</b>	37	577	1,442	2,739	5,667	4,630	1,389	4,437	5,346
<b>Liabilities</b>	580	1,353	2,024	4,295	6,920	6,440	2,240	4,999	6,585
<b>Equity</b>	3,228	3,921	4,679	2,600	1,542	1,474	1,148	1,131	1,751
<b>Leverage</b>	0.18	0.35	0.43	1.65	4.49	4.37	1.95	4.42	3.76
<b>Gearing</b>	0.01	0.15	0.31	1.05	3.68	3.14	1.21	3.92	3.05

\*Source: Annual reports

- Borrowings by sugar companies are primarily short-term in nature
- Leverage indicators have increased on a timeline basis due to high ending inventories
- Increase in interest rates will have a negative impact on profitability of leveraged players

## Liquidity

Rs. in m	JDW Sugar Mills			Thal Industries			SGM Sugar Mills		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
<b>FFO</b>	5,028	2,884	1,297	941	1,182	(48)	408	67	198
<b>FFO/Total Debt</b>	0.30	0.12	0.04	0.26	0.27	(0.01)	0.38	0.04	0.07
<b>Current Ratio</b>	0.80	0.80	0.84	1.13	1.12	0.93	0.12	0.25	0.38
Rs. in m	Al-Abbas Sugar Mills			Chashma Sugar Mills			Habib Sugar		
	FY16	FY17	FY18	FY16	FY17	9M18	FY16	FY17	FY18
<b>FFO</b>	591	250	619	718	904	538	784	364	1,055
<b>FFO/Total Debt</b>	38	0	1	0.18	0.19	0.09	NA	NA	NA
<b>Current Ratio</b>	1.61	1.12	1.80	0.72	0.75	0.85	2.23	1.96	2.14
Rs. in m	Mehran Sugar Mills			Noon Sugar			Shahtaj Sugar		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
<b>FFO</b>	574	(150)	229	138	307	358	194	328	(494)
<b>FFO/Total Debt</b>	1.13	(0.08)	0.08	0.19	0.11	0.13	0.65	0.22	(0.28)
<b>Current Ratio</b>	1.33	1.00	1.14	0.60	0.93	0.88	1.71	1.50	0.93
Rs. in m	Jauharabad Sugar Mills			Al-Noor Sugar Mills			Shahmurad Sugar Mills		
	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
<b>FFO</b>	245	357	157	361	35	(213)	268	16	658
<b>FFO/Total Debt</b>	6.62	0.62	0.11	0.13	0.01	(0.05)	0.19	0.004	0.12
<b>Current Ratio</b>	2.10	1.02	1.04	1.28	1.16	1.02	0.99	1.02	0.92

\* Source: Annual Reports

- Cash flow coverage of outstanding debt for the sector remains on the lower side
- Stock carried on balance sheet provide adequate coverage of outstanding short-term borrowings
- Sensitizing for higher interest rates and lower sugar prices, cushion in debt servicing is limited for smaller players.

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