27 April 2021

ElaraCapital

Sugar

Global Markets Research

Brazil's loss can be India's gain

Trends point toward lower sugarcane yield this year in Brazil

The harvest season has commenced in Brazil and initial trends point to a lower crop yield this year, owing to less sowing and unfavorable Monsoon conditions. Sugarcane yield is likely to drop this season and its quality also is likely to go down, which could impact recovery rates in Brazil. As a result, we expect Brazil's millers to restrict sugar production this year. With some other key sugar-producing countries, such as Thailand, & EU, not expected to produce higher output, we believe the global demand-supply scenario to remain tight. Global commodity traders expect at least a 10% drop in sugar output in Brazil to 34-35mn tonnes. Hence, international sugar prices have started to firm up and crossed 16.5 US cents per pound. This augurs well for India's sugar industry, which has surplus inventory of 10.5mn tonne.

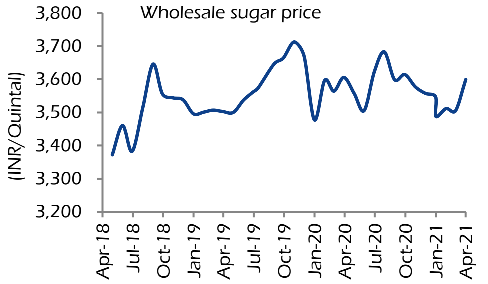
Exports of 6mn tonne now certainty; can sell additional 1mn tonne

We believe India's sugar industry will achieve 6.0mn tonne exports target set by the government at the start of the year on highly remunerative international prices. Indian Sugar Mills Association (ISMA) states ~3.0mn tonne of sugar has been physically exported during October 2020-March 2021, which is the same as last year's despite a delay in announcement of exports subsidy this year by three months. Key point to note here is that mills have physically exported ~2.5mn tonne during January-March 2021, including ~1.2mn tonne in March itself, driven by a sharp increase in sugar prices by 20% YoY. ISMA reports ~0.8mn tonne of sugar is in the pipeline for exports in April. Forecast by UNICA of lower sugar output from Brazil has driven prices higher, and with ~55% of exports target of 6.0mn tonne achieved by April, we believe India's millers will look to export an additional 1.0mn tonne this year. This would further reduce carry-over inventory.

Outlook: reiterate positive stance; Balrampur Chini is our top pick

We reiterate our positive stance on India's sugar industry as it is well poised to benefit from global and domestic factors. Lower output from countries like Brazil, Thailand and the EU would keep supplies tight and global prices firm, enabling India to increase exports. On the domestic front, favorable policies, rising ethanol demand (blending target of 20% by CY25 from 8% currently), aggressive ethanol capacity addition would drive an earnings CAGR of 15-20% over FY21-24E for our coverage companies. Sugar oversupply is a thing of the past as higher diversion of sugar in favor of ethanol (~2.0mn tonne sugar in SS21 and >5-6mn tonne by SS24) would keep net sugar production under ~30mn tonne. Our preferred pick is Balrampur Chini.

Domestic prices revert to INR 3,300/quintal

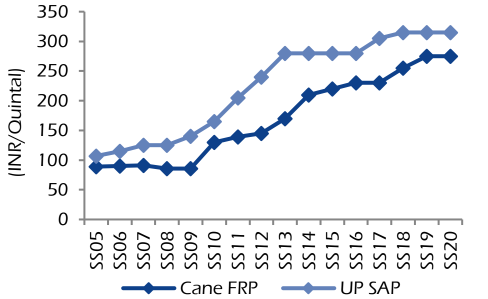


Source: Bloomberg, Elara Securities Research

Global sugar prices at a four-year high

Source: Bloomberg, Elara Securities Research

UP-State advise price unchanged since SS18



Source: Ministry of Agriculture, Elara Securities Research

Key financials

Company	Ticker	Rating	Mkt Cap (INR bn)	CMP (INR)	TP (INR)	Upside (%)	PE (x)		PB (x)		EV/EBITDA (x)		ROE (%)	
							FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Balrampur Chini	BRCM IN	Buy	55	264	⬆335	27	6.2	5.9	1.3	1.1	5.0	4.5	22.5	20.2
Dhampur Sugar	DSM IN	UR	14	206	UR	-	4.8	4.1	0.8	0.7	4.4	3.1	15.9	16.2
Dwarikesh Sugar	DSIL IN	Buy	7	36	⬆50	39	5.1	5.1	1.1	0.9	3.2	2.6	22.2	19.5

Note: UR is Under Review; pricing as on 26 April 2021; Source: Elara Securities Estimate

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Elara Securities (India) Private Limited

Review of FY21 Brazil sugar season

Brazil's FY21 sugar production at multi-year high

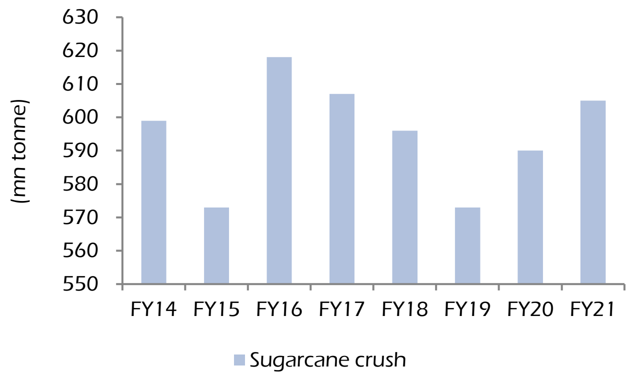
UNICA, Brazil's sugarcane industry association, in its latest release, states production in FY21 stood at 38.4mn tonne, registering an increase of 44% YoY on the back of strong prices and producers opting to produce more sugar and less ethanol in the wake of reduced demand for ethanol, resulting from lockdowns caused by the pandemic. As a result, cane diverted toward sugar was higher at 46% vs 34% in the previous year. Due to higher diversion toward sugar, the overall recovery rate also increased sharply to 6.4% vs 4.5% in FY20. Total recoverable sugar (TRS) Index also registered a rise of 7% YoY to 87.6mn tonne.

Exhibit 1: Final numbers for south-central region

Description	FY20	FY21	YoY (%)
Sugarcane crush (mn tonne)	590.4	605.2	2.5
Sugar (mn tonne)	26.8	38.4	43.6
Anhydrous ethanol (mn liters)	9,946	9,682	(2.7)
Hydrous ethanol (mn liters)	23,313	20,688	(11.3)
Total ethanol (mn liters)	33,258	30,370	(8.7)
TRS (mn tonne)	81.8	87.6	7.1
TRS/ ton of sugarcane	138.6	144.7	4.5
Cane diverted for			
Sugar (as % of total)	34.3	46.0	
Ethanol (as % of total)	65.7	54.0	
Liters of ethanol/ tonne of sugarcane	53.6	45.9	(14.3)
Kg of sugar/ tonne of sugarcane	45.3	63.5	40.1

Source: UNICA, Elara Securities Research

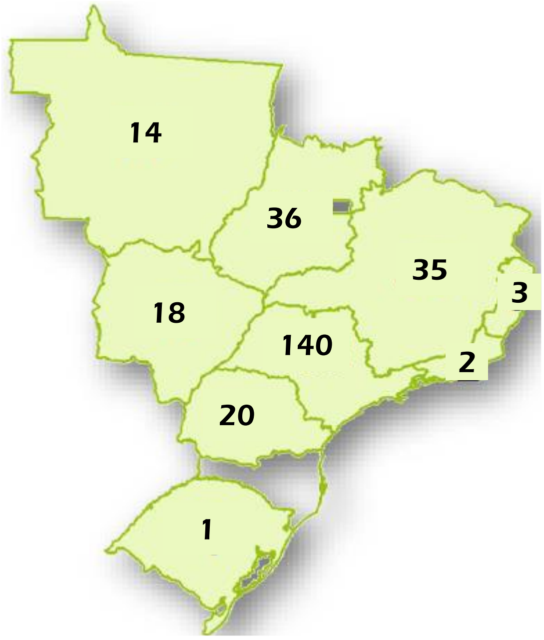
Exhibit 2: Brazil's sugarcane crush improves in the past three years



Source: UNICA, Elara Securities Research

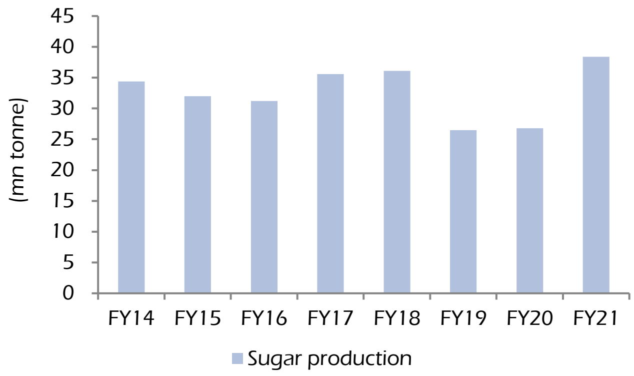
As per UNICA, a total of 269 sugarcane mills operated during FY21 sugar season in the south-central region. Six mills produced both sugarcane and corn ethanol. Five units in the region produced only corn ethanol during the year. A total of 60 standalone distilleries were operational this year and out of total ethanol production of 30.4bn liters, 34% was supplied by standalone distilleries.

Exhibit 3: Number of sugar mills in the S-C region



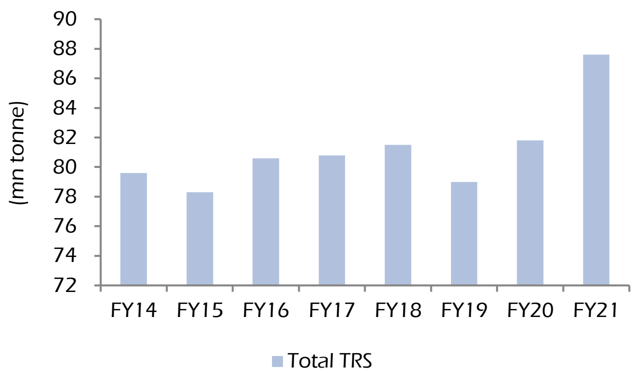
Source: UNICA, Elara Securities Research

Exhibit 4: Brazil sugar production at a multi-year high in FY21



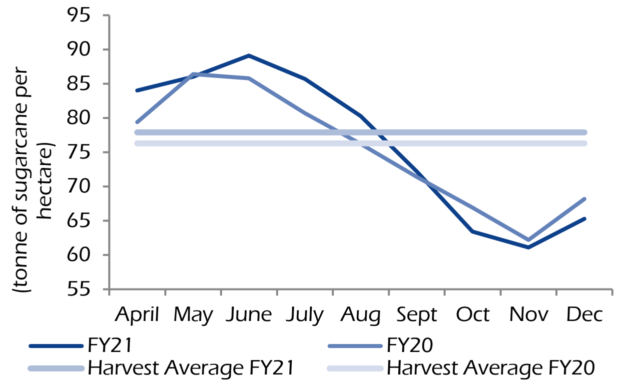
Source: UNICA, Elara Securities Research

Exhibit 5: Brazil registers the highest TRS in FY21



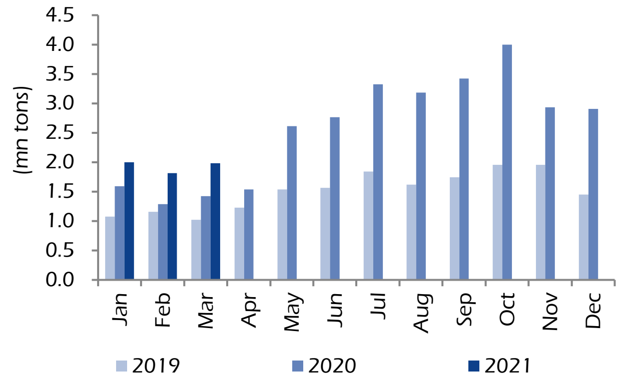
Source: UNICA, Elara Securities Research

Exhibit 6: Sugarcane yield improves 2% YoY in FY21



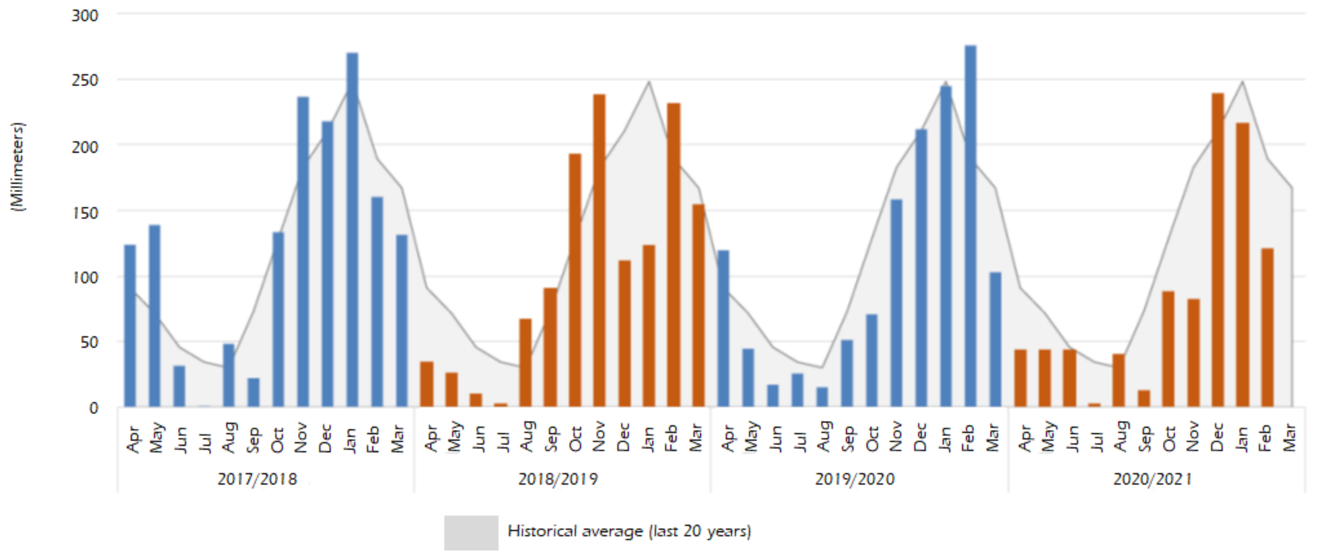
Source: UNICA, Elara Securities Research

Exhibit 8: Export volume grows 70% YoY



Source: UNICA, Elara Securities Research

Exhibit 7: Weak rains at the start of the Monsoon season and toward the end to impact cane yield



Source: UNICA, Elara Securities Research

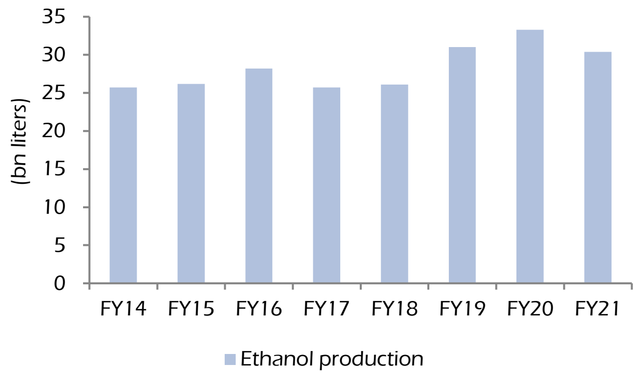
Sugar exports jump 70% YoY

Brazil has set a record by exporting 32.1mn tonnes of sugar in FY21 as per UNICA vs 18.9mn tonnes in FY20, growth of 70% YoY. In value terms, the country has exported sugar worth USD 9.3bn in FY21 vs USD 5.5bn in FY20, registering growth of 69% YoY. The reason for record exports is healthy global demand, firm sugar prices and favorable currency movement. However, with expectations of lower sugar production in FY22, we expect Brazil exports to drop, thereby providing a good opportunity for India's millers to increase sales in the international markets.

FY21 ethanol production at 30bn liters

UNICA says ethanol production in Brazil in FY21 was lower at 30.0bn liters vs 33.3bn liters in FY20, a drop of 9% YoY, due to a fall in demand caused by the impact of the pandemic on Brazil's economy and lower international oil prices in CY20.

Exhibit 9: Ethanol production down 9% YoY in FY21

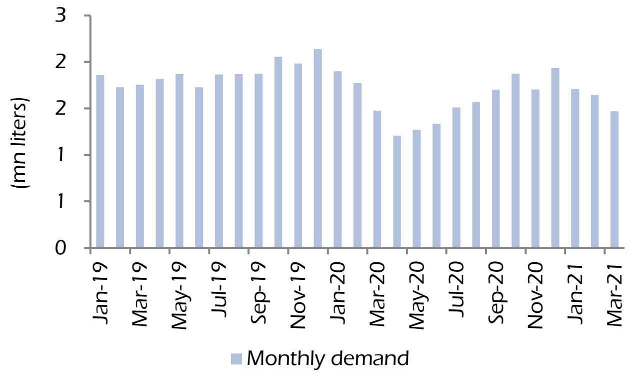


Source: UNICA, Elara Securities Research

Ethanol sales showing healthy revival in Brazil

From total sales, hydrous ethanol sales was mostly adversely affected and fell 11% YoY to 20.7bn liters, while anhydrous ethanol demand fell by a mere 3% YoY to 9.7bn liters (Refer Exhibit 1). Hydrous ethanol is used as a standalone biofuel E100 in Brazil and anhydrous ethanol is used in a mandatory blended of 27% in gasoline. Due to its lower energy content, hydrous ethanol offers an economic advantage for flex-fuel drivers whenever its price is up to 70% of gasoline; therefore, any lower gasoline price can be translated in lower E100 demand. While ethanol sales in FY21 dropped 9% YoY, ethanol sales in H2FY21 increased 20% over H1FY21, suggesting demand reinstatement in the latter half of the year.

Exhibit 10: Hydrous ethanol sales pick up from June 2020

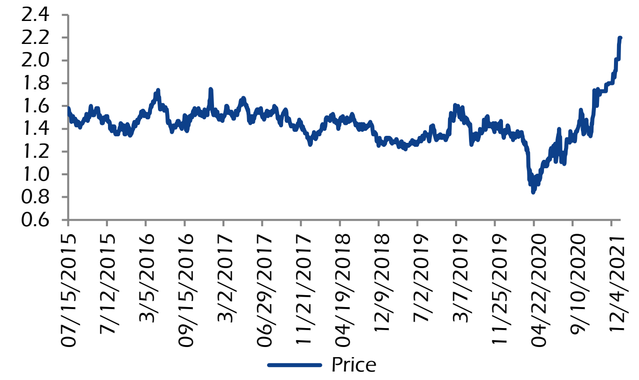


Source: Fitch Ratings, Elara Securities Research

Ethanol futures price above five-year high levels

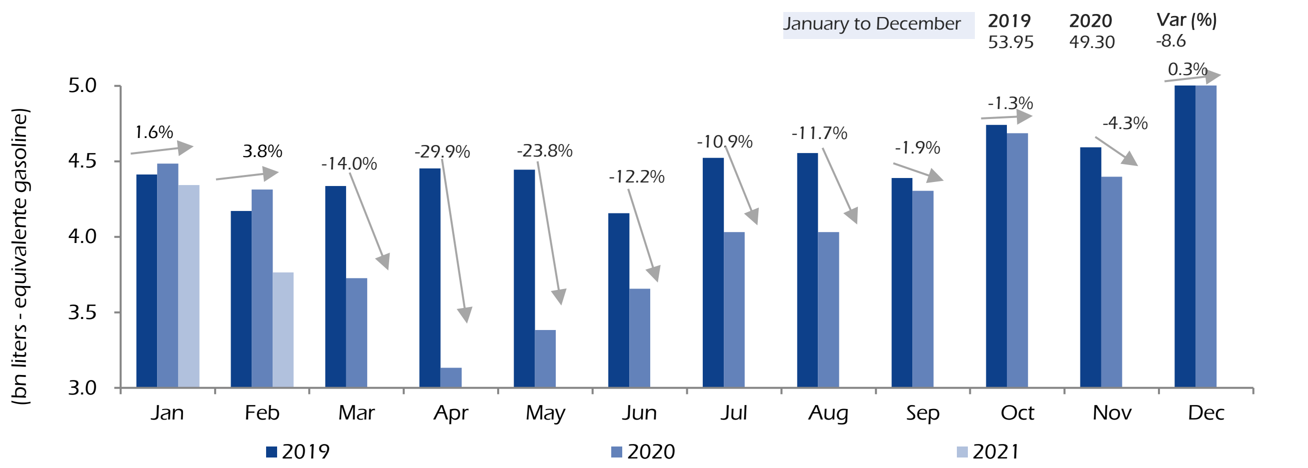
Ethanol futures prices rose to USD 2.2/gallon in April and crossed the previous highs of USD 1.75/gallon seen in September 2016. The sharp rally in ethanol prices has been fueled by falling inventory in the US and expectations of lower production in Brazil. US domestic ethanol inventory has declined for the fourth consecutive week to a 22-week low of 20.5mn bbl amid continued strength in blending demand, with ethanol input reaching the highest levels since before the pandemic, according to the latest US Energy Information Administration report. In Brazil, a sharp reduction in ethanol production is projected in FY22 to 27-28bn liters, from 30.0bn liters in FY21.

Exhibit 11: Ethanol futures prices at a five-year high



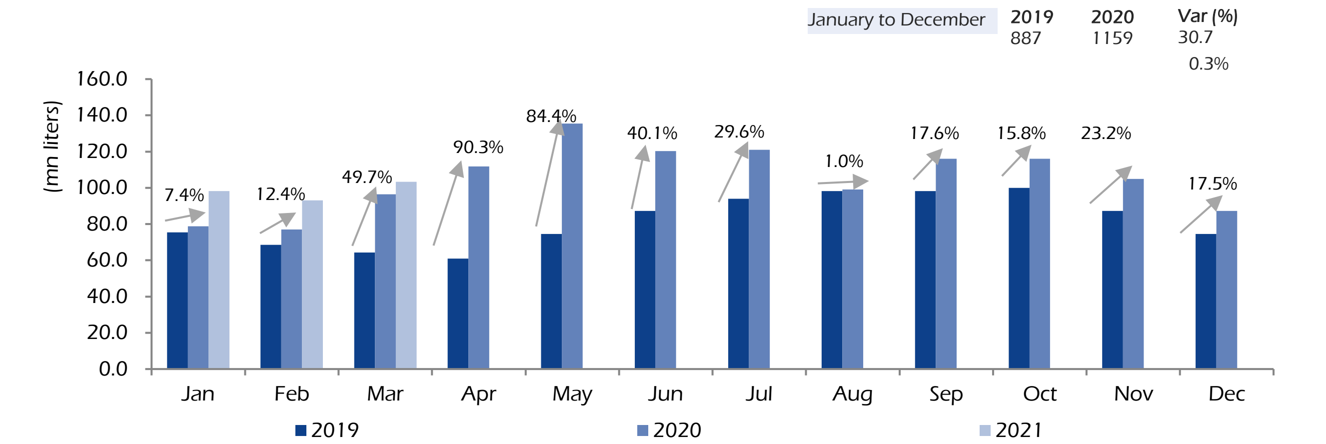
Source: NASDAQ, Elara Securities Research

Exhibit 12: Gasoline sales improve MoM from June 2020



Source: UNICA, Elara Securities Research

Exhibit 13: Non-fuel ethanol sales up 31% YoY, driven by an increase in use of sanitizers



Source: UNICA, Elara Securities Research

Sugar prices bounce back in April

Global prices back to US cents 16 per pound…

International sugar prices have climbed to a seven-week high, underpinned by prospects of tightening supplies as crop outlooks in Brazil and Europe have been downgraded. After touching a four-year high of US cents 18 per pound in February, sugar prices started to soften in March, just ahead of the start of the cane crushing season in Brazil. However, as reports of a weaker crop started to emerge from the south-central region, global commodity traders started to build long positions. This has led to a sharp rally in sugar prices, which have increased by 15% in the past four weeks.

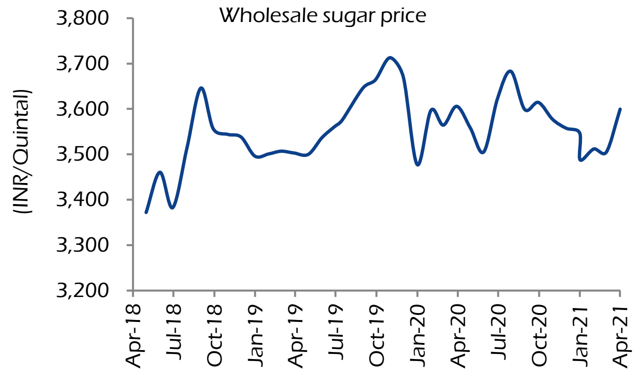
Exhibit 14: Global sugar prices recover from the lows

Source: Bloomberg, Elara Securities Research

…while domestic prices revert to pre-COVID-19 levels

Domestic sugar prices also have bounced back to pre-COVID-19 levels on the back of healthy improvement in demand, especially from the institutional segment. Ex-mill sugar prices were back in the range of INR 3,275-3,350/quintal in March and continue to hover in the same range during the first fortnight of April. Due to the lockdown, prices had fallen to INR 3,100-3,125/quintal in April 2020. With higher diversion of cane toward ethanol and expectations of additional allocation of sugar for exports, we expect domestic prices to improve to INR 3,400-3,500/quintal.

Exhibit 15: Domestic prices above INR 3,500/quintal



Source: Ministry of Agriculture, Elara Securities Research

Closing stock of 8.4mn tonne in SS21

India's sugar inventory for Sugar Season SS21 is likely to drop to 8.4mn tonne from 10.4mn tonne in SS20 on the back of increased diversion toward ethanol and higher exports. For SS21, production is likely to be higher at 30.2mn tonne (on post diversion basis), largely coming from an increase in production in Maharashtra to 10.5-11.0mn tonne in SS21 from 6.2mn tonne in SS20. With several new ethanol plants having been commissioned in the past 12-18 months, which will operate on B-Heavy molasses and direct cane juice, 2mn tonne of sugar will be offset this year and ~4-5mn tonnes over the next two years. We assume exports of 7mn tonne of sugar encouraged by lower global inventory and firm prices. We expect closing inventory for SS21E to be 7.6mn tonne, which is lower by 2.0mn tonne YoY.

Exhibit 16: Closing stock likely to drop by 3mn tonne

(mn tonne)	SS18	SS19	SS20	SS21E	SS22E
Opening stock	4.4	10.6	14.5	10.4	8.4
Gross production	**32.3**	**32.9**	**27.5**	**32.2**	**33.0**
YoY growth (%)	1.0	1.9	(16.4)	17.1	2.5
Diversion to ethanol	-	-	0.8	2.0	3.0
Net production	**32.3**	**32.9**	**26.7**	**30.2**	**30.0**
Imports	0.0	0.0	0.0	0.0	0.0
Domestic demand	25.5	26.0	25.0	26.0	26.0
YoY growth (%)	4.0	2.0	(3.8)	0	0
Exports	0.5	3.0	5.8	7.0	6.0
Closing stock	**10.6**	**14.5**	**10.4**	**7.6**	**5.6**

Source: Ministry of Agriculture, ISMA, Elara Securities Estimate

Cane arrears increase to INR 190.6bn

As on March 2021, arrears stood at INR 190.6bn of which 89% are due in CY21. Pending arrears for CY20 and CY19 were INR 17.7bn and INR 4.1bn, respectively. Uttar Pradesh, Karnataka and Maharashtra account for 77% of outstanding dues (Source: Ministry of Consumer Affairs, Food & Public Distribution). The Government of India usually facilitates payments in a no-lien bank account in a public and/or cooperative bank operated by respective sugar mills. The banks credit the amount owed to farmers on behalf of sugar mills against payable cane dues and any remaining balance is credited back to the sugar mills account.

Balrampur Chini

BRCM IN, Buy, CMP: INR 264, TP: INR 335, Upside: 27%

The company is well positioned to capitalize on the government's call to increase ethanol blending in petrol to 20% by CY25 as it will increase ethanol capacity by 60% to 300mn liters pa by October CY22, resulting in a distillery EBIT CAGR of 30% over FY21-24E. We expect a robust free cashflow of INR 25.7bn over FY21-23E on higher contribution from ethanol and improved sugar performance. This should lead to further reduction in debt with a gross debt-equity of 0.2x in FY22E vs 0.6x in FY20 and net cash of INR 2.5bn

We recommend **Buy** rating and a higher SOTP-based TP of INR 335 from INR 225. This implies 7.5x FY23 EV/EBITDA and 10x FY23E P/E. We value the sugar business at 5x (unchanged) FY23E EV/EBIT, distillery at 10x (unchanged) FY23E EV/EBIT and co-generation at 4.0x (unchanged) FY23E EV/EBIT. We expect an EBITDA CAGR of 15% and a PBT CAGR of 19% over FY21-23E. The stock currently trades at 5.9x FY23E EV/EBITDA and 7.8x FY23E P/E.

Dwarikesh Sugar

DSIL IN, Buy, CMP: INR 36, TP: INR 50, Upside: 39%

DSIL expanded ethanol capacity from 30 KLPD to 130 KLPD in FY21, resulting in 4x increase in the company's ethanol capacity. Higher realization in B-Heavy would drive ethanol segment EBIT CAGR to 16% over FY21-23E while firm sugar prices would result in a 31% EBIT CAGR in the sugar division over the same period. With no major capex, DSIL is likely to generate healthy free cashflow of INR 7.5bn in the next two years, which will help to deleverage balance sheet. Subsequently, we expect D/E ratio to reduce to 0.2x by FY23E from 0.6x in FY21. We roll forward our valuation to FY23. We expect an EBITDA CAGR of 14% and a 350bp improvement in EBITDA margin to 15.4% over FY21-23E.

Based on our SOTP valuation, we assign 6x (from 5x) FY23E EV/EBIT for the distillery division, 5x (unchanged) FY23E EV/EBIT for the sugar division and 4x (unchanged) FY23E EV/EBIT for power co-generation. We arrive at a higher SOTP-based TP of INR 50 from INR 41. We reiterate **Buy.**

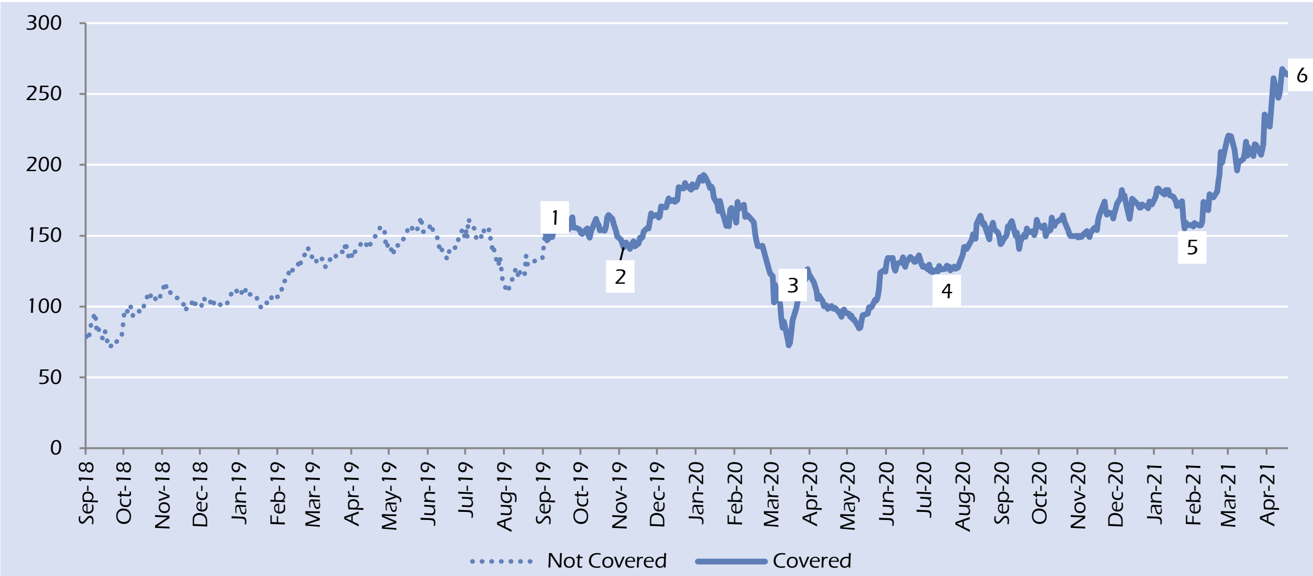
Dhampur Sugar

DSM IN, Rating: Under Review, TP: Under Review

Management says the two promoters of the company have proposed restructuring of the company involving segregation of management and ownership of the company's various manufacturing facilities equally between the two promoter family groups. As a result, we have placed our rating under Under Review as we await clarity on the restructuring process.

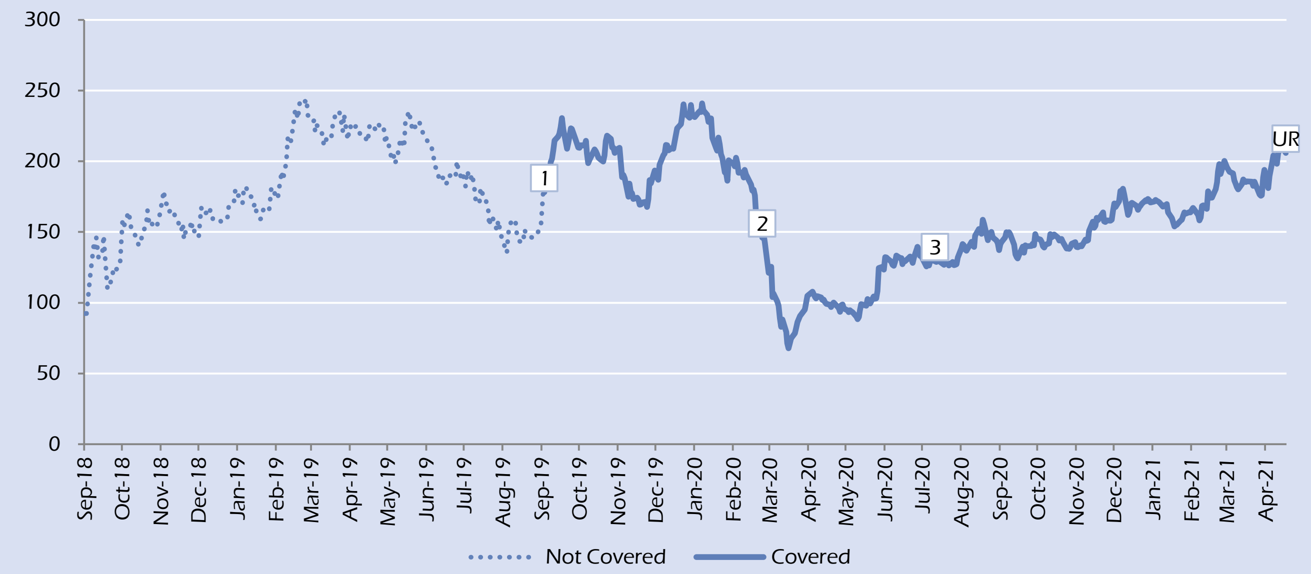
Coverage History

Balrampur Chini Mills



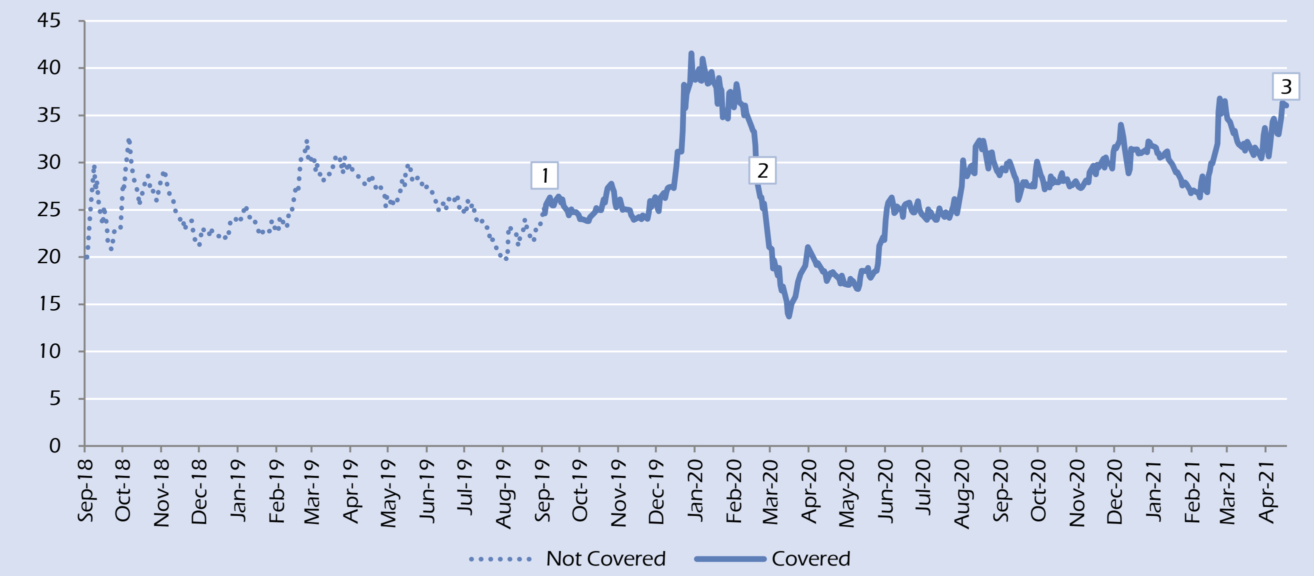
	Date	Rating	Target Price	Closing Price
1	12-Sep-2019	Buy	INR 251	INR 151
2	13-Nov-2019	Buy	INR 236	INR 144
3	31-Mar-2020	Buy	INR 192	INR 104
4	20-Jul-2020	Buy	INR 213	INR 126
5	3-Jan-2021	Buy	INR 225	INR 158
6	26-Apr-2021	Buy	INR 335	INR 264

Dhampur Sugar Mills



	Date	Rating	Target Price	Closing Price
1	12-Sep-2019	Buy	INR 260	INR 178
2	4-Mar-2020	Buy	INR 235	INR 146
3	20-Jul-2020	Buy	INR 201	INR 129
4	26-Apr-2021	Under Review	Under Review	INR 206

Dwarikesh Sugar



	Date	Rating	Target Price	Closing Price
1	12-Sep-2019	Buy	INR 40	INR 25
2	4-Mar-2020	Buy	INR 43	INR 25
3	26-Apr-2021	Buy	INR 50	INR 36

Guide to Research Rating

BUY	Absolute Return >+20%
ACCUMULATE	Absolute Return +5% to +20%
REDUCE	Absolute Return -5% to +5%
SELL	Absolute Return < -5%

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