

21 April 2011

Seasonal Report



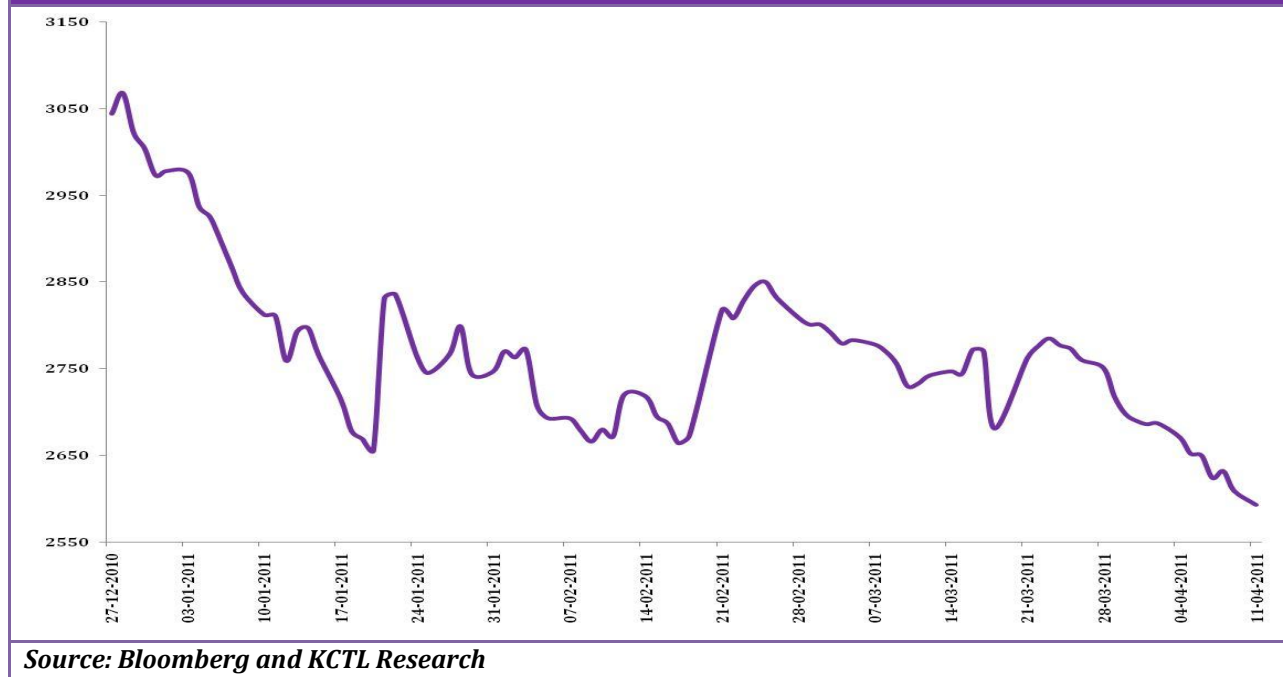
Exchange	Recommendation
NCDEX	Buy at 2570-2630 TP 2900 SL BELOW 2400
MCX	Buy at 2570-2630 TP 2900 SL BELOW 2400

Market recap

The futures trading in sugar was re-introduced on 27th December 2010. The central government had imposed a ban on sugar futures trading in May 2009 looking into sky-rocketing of the prices. However, Abhijeet Sen Committee commented that there is no direct relationship between futures trade and price rise. This ban was in force till 30th December 2009 and later it was extended to 30th September 2010. With the lapse of ban on 30th September, there was lot of expectations from traders, investors and sugar industry regarding re-launch of futures trading. But, the decision from the regulator was delayed as the government said it will review the sugar situation before restart.

Since beginning of re-launch sugar futures prices have been on a declining trend and prices have declined by 15%. Projection of bumper sugar production and trade restrictions imposed by the central government had a bearish impact on the market. In order to stabilize the prices, Indian government had allowed import of raw and white sugar at zero import in 2009. Earlier, import duty on sugar was 60%. Moreover, government had imposed stock holding limit on sugar. Traders and wholesalers are allowed to stock 200 tons of sugar per month. This has resulted into increased flow of produce in major spot markets. Based on all the above mentioned factors, prices were under pressure since launch of the contract.

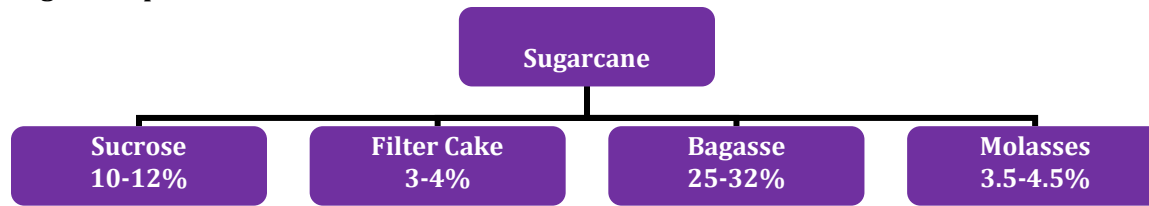
Figure 1: Sugar futures price movement



Introduction

In India, sugar industry is the second largest sector after textile industry in its volume. Presently, India is having 531 sugar mills spread in across major cane producing areas. Apart from white crystal sugar, sugarcane is used for manufacturing traditional sweeteners like Khandsari sugar and Jaggery that are mostly consumed in rural areas. About 60% of cane is utilized for the production of sugar, about 30% for alternate sweeteners, namely gur and khandsari and the balance 10% for seeds. India is also the largest consumer of sugar in the world. In India, Sugarcane is the source of Sugar, which is cultivated in almost all parts of India as the country's climatic conditions are suitable for the cane cultivation. Apart from sweetening product other by-products that are generated during processing are molasses, baggasse and ethanol. Globally Sugarcane and sugar beet are the major source of sugar.

Sugarcane products



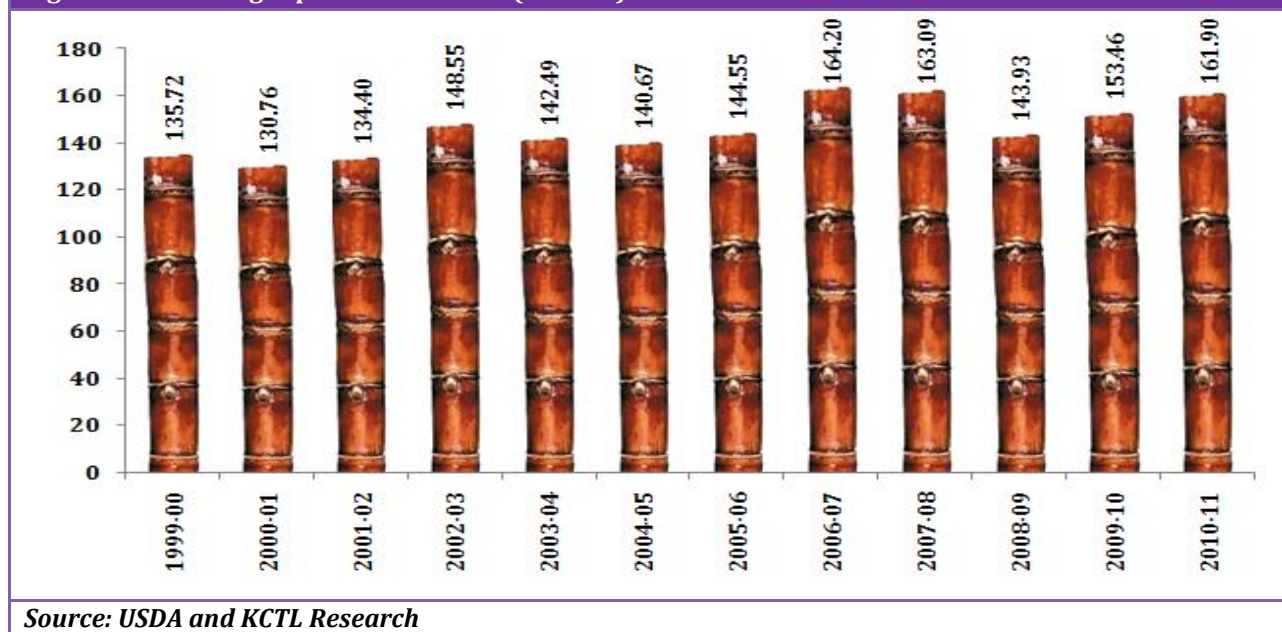
Sugar is one of the common household items that are used as sweetening agent in various household as well as industrial preparations. About 45 million Indian farmers and their families are engaged in the cultivation of sugarcane. In addition to it a large mass of agricultural labor is involved in sugarcane ancillary activities constituting 7.5% of the rural population. The era of planning for industrial development began in 1950-51 and sugar industry was part of the Five-Year Plans and has been under the direct control of the Government ever since. The industry not only generates power for its own requirement but surplus power for export to the grid based on byproduct bagasse. It also produces ethanol, an eco-friendly and renewable energy for blending with petrol.

As a commercial crop sugarcane has been popular among the farmers. One of the reasons for its success is the assured market, cane finds in sugar mills and the procurement price fixed for cane by the government. The price at which sugarcane are procured by the mills is controlled by central and state government notification on Statutory Minimum Price (SMP) and State Advised Prices (SAP) respectively. As a result of announcement by various state governments regarding rise in State Advised Price, cane farmers have increased the acreage under sugarcane during the current sugar season.

Global scenario

On a global front, sugar is being produced from sugarcane and sugar beet. Major sugar producing countries use sugarcane as raw material while European Union use sugar beet. Figure 2 throws a light on world sugar production trend. Global sugar production has been fluctuating over the years because of climatic conditions and changes in acreage. In last three years, output has been increasing on a steady trend. For 2010-11, world sugar production is likely to increase by 5% Y/Y to 161.90 million tons.

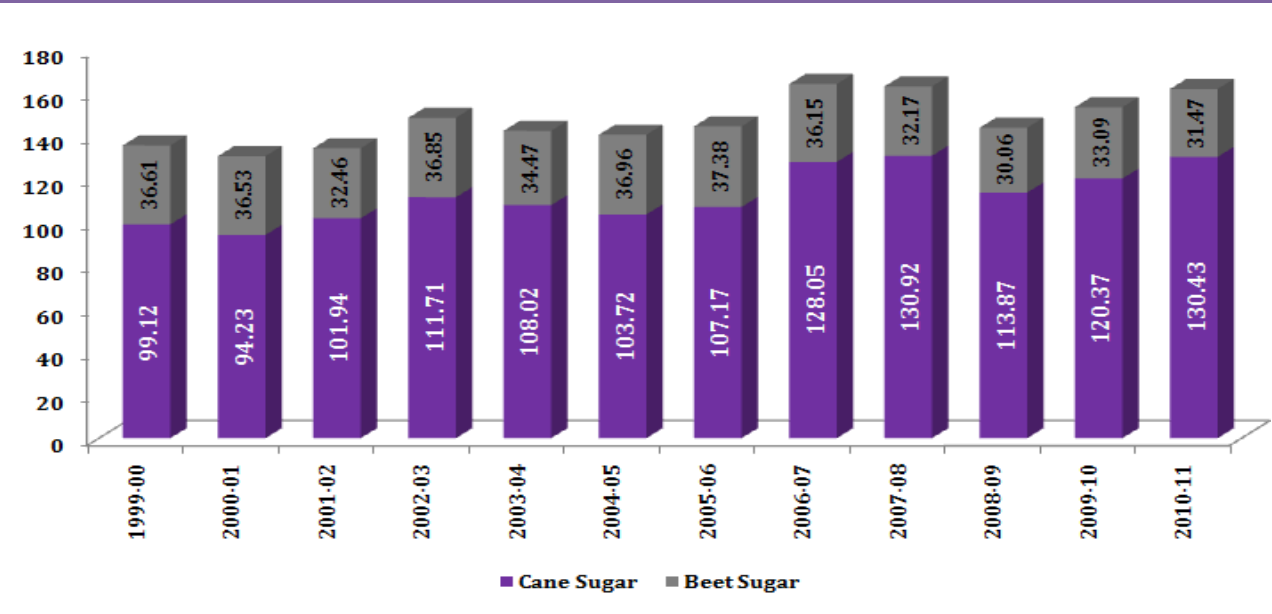
Figure 2: World sugar production trend (in MMT)



Source: USDA and KCTL Research

Of the total sugar produced in the world, 75-80% of the production is from sugar cane and rest is from sugar beet. Over the years, sugar production from sugar beet has shown increasing trend till 2005-06 and then onwards it declined. In the meantime, sugar production from sugar cane has shown a constant increase. Between 1999-2000 and 2010-11, sugar production from cane sugar registered a compounded annual growth of 2.6% while beet sugar based sugar production declined registered a negative growth (-1.26% CAGR).

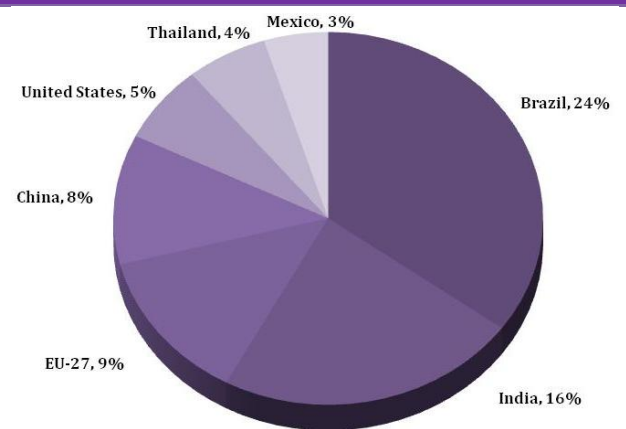
Figure 3: Cane and beet sugar production trend (in MMT)



Source: USDA and KCTL Research

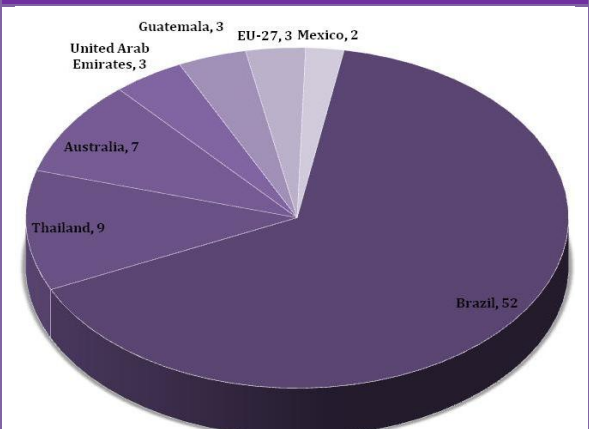
Brazil is the largest producer of sugar in the world having a contribution of 24% to the world production. Next to Brazil, India is the second largest producer and its accounts for 16% of the production. Other major producing countries are EU-27 (9%), China (8%) and US (5%). Brazil, India and EU-27 put together accounts for around 50% of the world production.

Figure 4: Share of major producing countries



Source: USDA

Figure 5: Share of major exporting countries



Source: USDA and KCTL Research

International Trade

Sugar is one of the important agricultural commodities in international trade. Of the total production, 32% of the produce is being traded as export and import between the countries. Being a largest producer, Brazil is also largest exporter of sugar in the world. It accounts for 52% of total exports in the world. Surprisingly, Brazil exports around 70% of its production and remaining is consumed. Other major exporters are Thailand (9%) and Australia (7%).

Balance sheet (in MMT)

	Beginning Stocks	Production	Imports	Total Supply	Exports	Consumption	Ending Stocks	Stock/Use Ratio
1999-00	34.11	135.72	37.02	206.85	41.77	127.63	37.46	29.35
2000-01	37.45	130.76	40.35	208.56	38.29	130.40	39.87	30.58
2001-02	39.87	134.40	39.69	213.96	42.33	134.99	36.64	27.15
2002-03	36.64	148.55	41.71	226.91	47.21	139.07	40.64	29.22
2003-04	40.64	142.49	41.23	224.35	46.54	139.72	38.10	27.27
2004-05	38.10	140.67	45.42	224.19	46.93	143.33	33.93	23.67
2005-06	33.93	144.55	44.76	223.24	49.86	142.59	30.78	21.59
2006-07	30.78	164.20	43.50	238.48	51.44	152.55	34.49	22.61
2007-08	34.49	163.09	45.49	243.07	51.54	152.20	39.33	25.84
2008-09	39.33	143.93	47.29	230.55	48.88	153.72	27.95	18.18
2009-10	27.95	153.46	51.41	232.81	51.81	154.86	26.15	16.88
2010-11	26.15	161.90	49.16	237.20	51.82	158.92	26.46	16.65

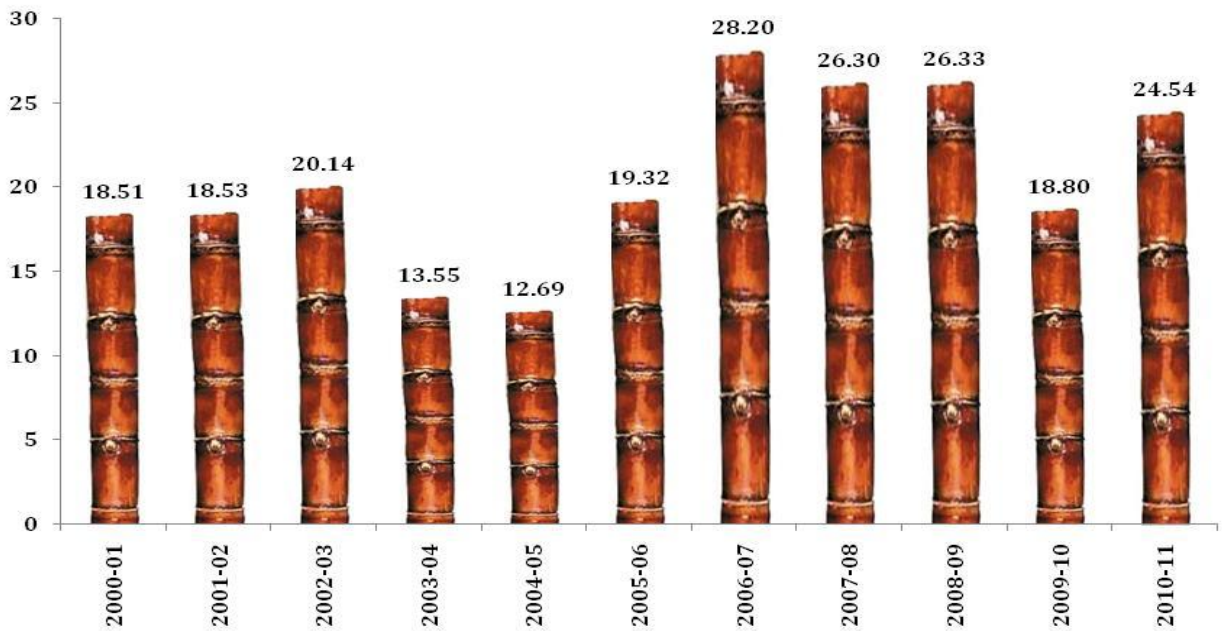
Source: USDA and KCTL Research

The world sugar production has increased at a compounded annual growth rate of 1.69% between 1999-2000 and 2010-11 while consumption has increased at the rate of 1.97%. This indicates that consumption growth is outpacing the production growth. As a result of this, world sugar prices have surged to multi-year high in recent past. Due to rise in consumption, stock-to-use ratio has been declining. The stock-to-use ratio, which was around 30% at the beginning of decade has been declining since then and now is stands at 16.65%.

Indian Scenario

India is the second largest producer of sugar in the world after Brazil. In the last decade, Indian sugar production has seen wide fluctuations because of varying weather conditions that affected the acreage and yield levels. Sugarcane requires maximum quantity of water for proper growth; hence, monsoon plays an important role in deciding upon India's sugarcane production. Moreover, relative returns and SMP/SAP for cane also determines the acreage.

Figure 6: India sugar production trend (in MMT)

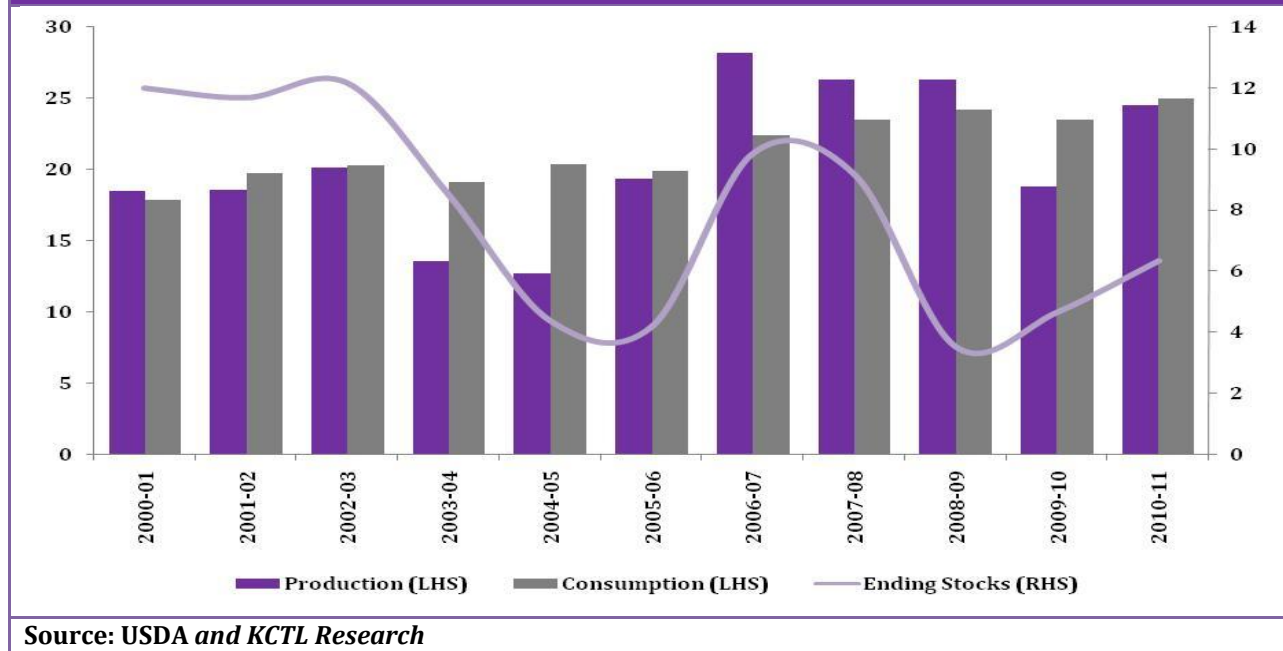


Source: USDA and KCTL Research

India had produced a record sugar in the year 2006-07 when the output reached 30 million tons. In 2006-07, the area under sugarcane cultivation increased substantially because of higher price realization in previous year and good monsoon rains. During the year, sugarcane acreage rose by 23% to 5.15 million hectares and production increased by 26% to 355.52 million tons though yield level saw a marginal increase. After touching all-time high, the output level saw a decline in subsequent years. Due to server drought situation in 2008-09 and delay in cane crushing has resulted into sharp decline in production n 2009-10 by around 30%. This decline was because of sharp decline in acreage and lower yield level due to adverse climatic conditions. Sugar production in 2009-10 was 18.80 million tons against 26.33 million tons produced in earlier year. As a result of sharp decline in the production, sugar prices sky-rocketed to all-time highs.

After witnessing a last decade's production in 2009-10, the output level started recovering and India's production showed a gradual increase. For 2010-11, the output is estimated at 24.54 million tons, up 30% Y/Y. After severe drought in India in 2009, the country has received above normal rainfall in 2010. According to Indian Meteorological Department, 2010 monsoon rainfall was 2% above normal and in quantitative terms the country received 914.8 mm rainfall. Good showers and higher price for sugar and sugarcane attracted farmers to go for cane planting. As a result of all these factors, sugarcane acreage increased by 16% and production by 25%.

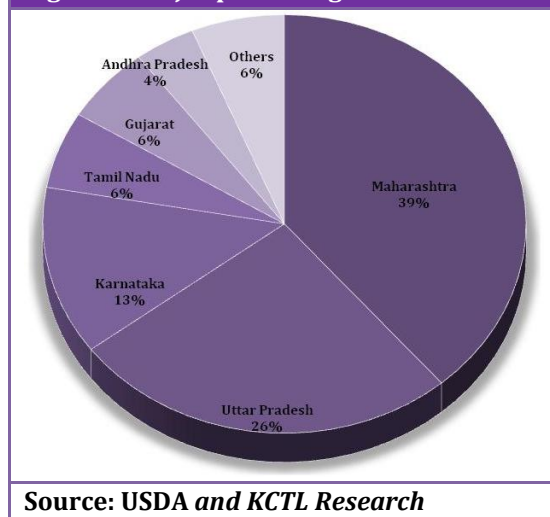
Figure 7: Production, consumption and ending stock



Source: USDA and KCTL Research

The sugar consumption in India has been hovering in the range of 20-22 million tons. In a normal situation, production of any commodity will be in surplus of consumption. However, in case of sugar, there are certain instances where consumption exceeded the production level. With the increasing population day-by-day, the consumption demand has been growing but stagnant area and varying climatic conditions are constraints to the production. In 2008-09 and 2009-10, India’s consumption level was higher than production. In 2010-11, production is likely to be higher than consumption. As a result of this, stock-to-use ration is likely to increase marginally.

Figure 8: Major producing states

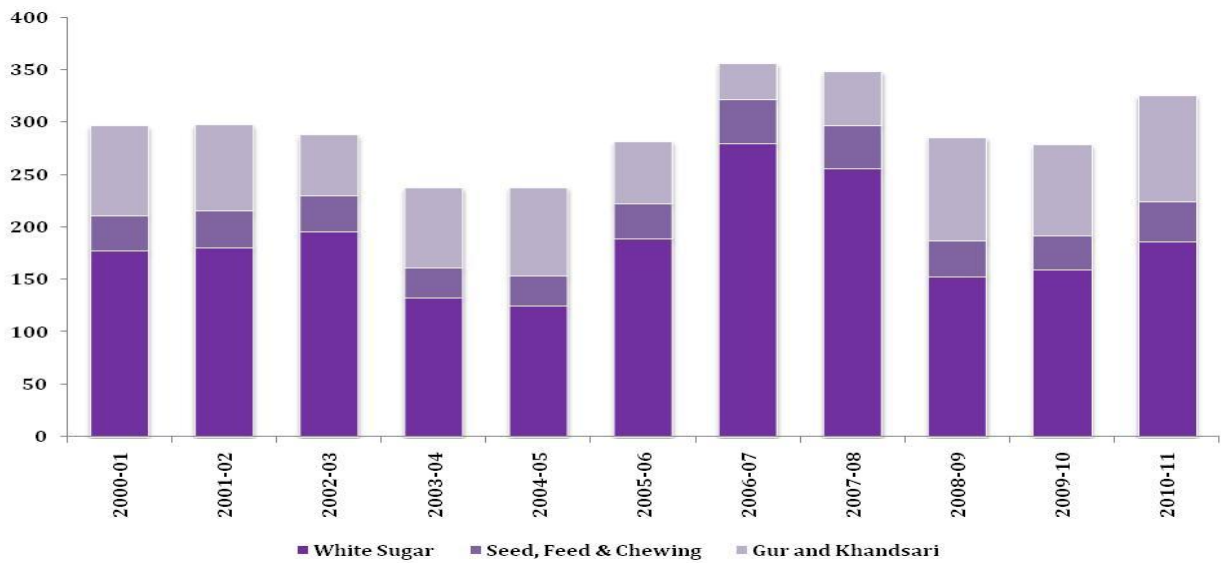


Source: USDA and KCTL Research

In India, sugar is produced in almost all the states; however, large chunk of output is restricted to few states. Maharashtra is the largest producer of sugar in India and it accounts for 39% of the country’s total production. Uttar Pradesh is the second largest producer contributing 26% to India’s total output. Other major producing states are Karnataka (13%) and Tamil Nadu (6%).

In India, sugarcane is grown in the states having enough water resources. Cane cultivation takes places in the areas having river-bed. Maharashtra took the first place surpassing Uttar Pradesh in 2003-04. Until then UP was the largest producing state in India.

Figure 9: Use of cane for different purposes

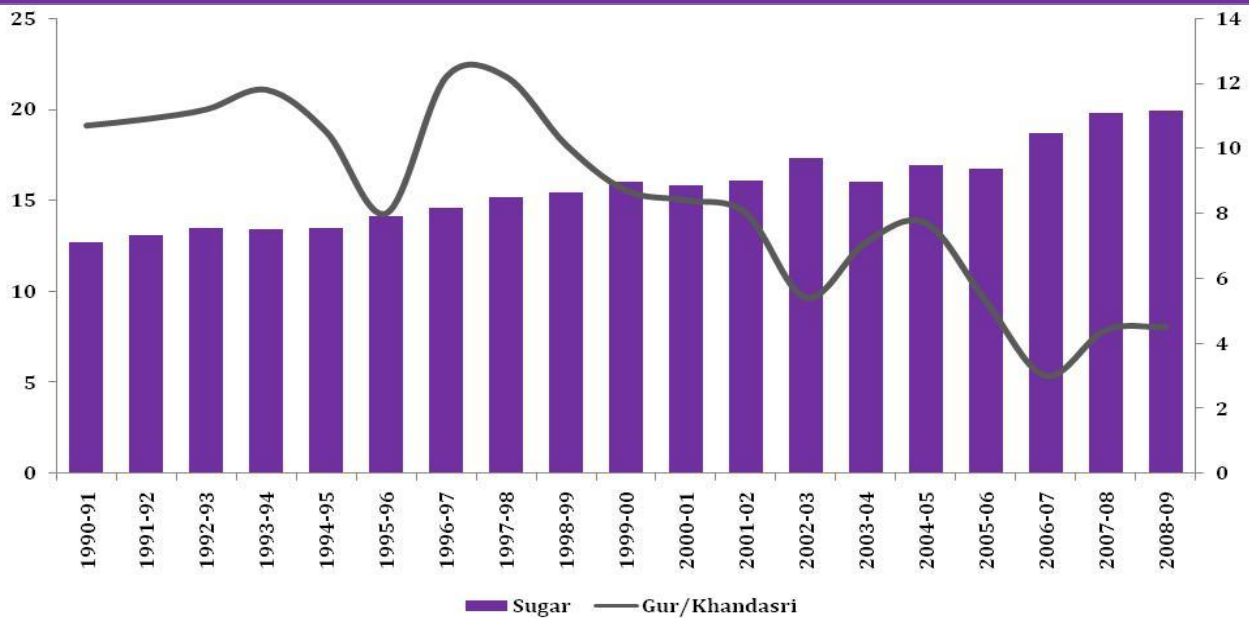


Source: USDA and KCTL Research

Sugarcane is being used for various purposes like making sugar, gur/khandsari, direct consumption and as seed for next year planting. Major chunk of cane goes for production of sugar. Cane used of sugar production is around 58%, for gur/khandsari 30% and for seed, feed and chewing it is 12%. In last three years use of cane for sugar production has declined substantially and it was diverted for manufacture of gur/khandsari. Delay in crushing of cane because of price war between mills, farmers and government led to diversion of cane for gur production.

Consumption Trends

Figure 10: Per capita consumption of sugar and gur/khandsari



Source: USDA and KCTL Research

In India, apart from white sugar, jaggery and khandasari are also consumed, which contributes major percentage to the total utilization of sugar cane. Consumption of white sugar is comparatively more than that of gur and khandasari. Apart from sweeteners cane can also be used for seed, feed and chewing. The consumption of white sugar showing an increasing trend as against gur and khandasari, which indicates the changing dietary habits of the consumers over the years due to change in income levels and standard of living. The continuous rise in both these factors fuelled the sugar consumption to a large extent especially in urban India. In recent past, gur prices are much higher than sugar; hence, even rural consumers are preferring consumption of sugar over gur.

International trade

India's presence in international trade is very limited because of huge consumption base in the country. As we know that sugar sector is under the government control and exim trade is also subjected to government control. India export limited quantity of sugar to very few nations under Open General License scheme. Looking into sharp decline in production in 2009 because of poor monsoon, which propelled surge in prices, the central government eased the import norms. The centre eased the import norms for duty-free import of raw sugar against advance licenses on a 'tonne-to-tonne' basis (which means import raw sugar now, but meet the export obligation out of domestic sugar one or two seasons later). Prior to the issue of notification, duty-free raw sugar imports under the AL/advance authorization (AA) scheme were subject to the 'grain-to-grain' condition (which means import raw sugar now and re-export immediately after processing). With the recent notification, millers are allowed to import sugar for domestic use and export the quantity within 24 months of the AL being issued, and this time frame has extended to 36 months. The imports were allowed at zero duty against earlier duty of 60%. Along with raw sugar imports, the government asked its agencies to import white sugar also.

Government policy: Imposition of stock limit

Further, the Union Cabinet decided to impose stock limits on sugar hoarding by the traders. With the notification, traders in the country would be allowed to hold only up to 200 tons of sugar in a month. Traders in Kolkata and adjoining areas, who buy sugar from states other than West Bengal, however, would be allowed to stock up to 1,000 tons in a month. The notification further stated that traders would have to clear sugar stocks within 30 days from the date of receipt.

Government control on sugar

In India, sugar industry is fully under the control of government. It is covered under the Essential Commodities Act, 1955. The entire process starting from cane procurement, fixing cane prices to final distribution is controlled by government. In addition to this, it also decides on licensing, procurement of cane, sugar pricing, and finalization of cane procurement area for mills and imports and exports. Government will decide the amount cane to be released for every month in open market and also supplying for Public Distribution System at concessional rates. The sugar exports are also governed by the Sugar Export Promotion Act, 1958, which stipulates that the Government can use 20 per cent of the country's total production for sale abroad. For every quarter the government will announce the amount of sugar to be released by each sugar factories as free sale quota.

Sugar cane pricing

Sugarcane is the main raw material for sugar industry and accounts for 70% of the cost of production of sugar. It is also the major source of income for millions of farmers. The determination of price for sugarcane is, therefore, a matter of critical importance both for the sugar industry and the cane growers. It was noted that for a sustainable production both of sugarcane and sugar, the sugarcane price should be fixed on a

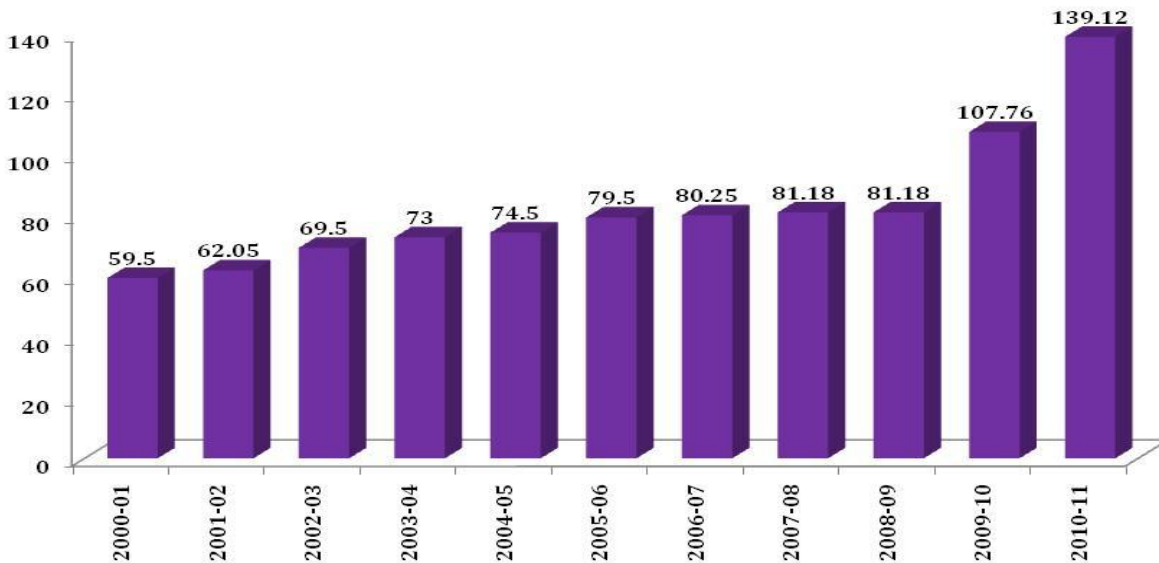
realistic basis. The Central Government fixes a Statutory Minimum Price factory wise in respect of each sugar season considering the following factors:

- Cost of production of sugarcane
- Return to the growers from alternative crops and the general trend of prices of agricultural commodities
- Availability of sugar to consumers at a fair price
- Price at which sugar produced from sugarcane is sold by sugar producers
- Recovery of sugar from sugarcane

Statutory Minimum Price (SMP) and State Advised Price (SAP)

In order to protect the interest of the farmers, the central government will announce the statutory minimum prices for a particular sugar season before start of the season, which guarantees the assured price to the farmers. Apart from central government's SMP to protect the farmers from price crash, all the state governments also support the farmers by way of fixing State Advised Price (SAP) to be paid by each cane mills to the cane procured from the farmers. Different states have their own policies to fix the SAP.

Figure 11: Statutory minimum price of sugar cane (₹ /quintal)



Source: KCTL Research

Release Mechanism

Under the partial control of sugar industry followed by the Central Government, 90% of the sugar produced by sugar mills may be disposed off by them, without any restriction on price and movement. The balance 10% is to be supplied by them at prices fixed by the Central Government. However, both free sale sugar and levy sugar are subject to monthly quotas decided by the Central Government. The sugar produced in 4 to 5 months in a sugar seasons is controlled and regulated to be sold throughout the year. This release mechanism has been in place since 1942, when the Sugar and Sugar Products Control Order was first promulgated and has since been followed except for a break during 1978-79, when monthly release was given up. The reason for monthly release of sugar has been to ensure that sugar is available throughout the year at reasonable prices to consumers, while at the same time maintaining the price at a steady level helps the industry.

Recent developments

Following a projection of bumper sugar production, the Indian government took a concrete decision to ease the trading norms imposed in 2009. It allowed export of sugar under open general license. The quantity allowed for export of sugar is 500,000 tons. Subsequently, the centre also revised stock limit on traders. According to new government order, stock limit on traders has revised from 200 tons to 500 tons.

Price Outlook

Correlation

	<i>NCDEX</i>	<i>MCX</i>	<i>Kolhapur</i>	<i>ICE</i>	<i>LIFFE</i>
NCDEX	1.00				
MCX	0.89	1.00			
Kolhapur	0.85	0.86	1.00		
ICE	0.42	0.68	0.48	1.00	
LIFFE	0.36	0.58	0.50	0.91	1.00

The above mentioned table shows the correlation of sugar prices between NCDEX, Kolhapur spot market, Inter Continental Exchange (ICE) and London International Financial Futures and Options Exchange (LIFFE). It is clearly seen that ICE and LIFFE sugar futures are having a strong correlation of 0.91% while with Indian market they are having a weak correlation. This is because of limited exposure of Indian market to the global. India's production is confined for consumption in domestic market and price movement is based on various factors like free sale quota, demand and government policies. Since, Kolhapur is the base centre for sugar futures trade for both MCX and NCDEX, it having strong correlation of 0.86 and 0.85, respectively.

Price outlook

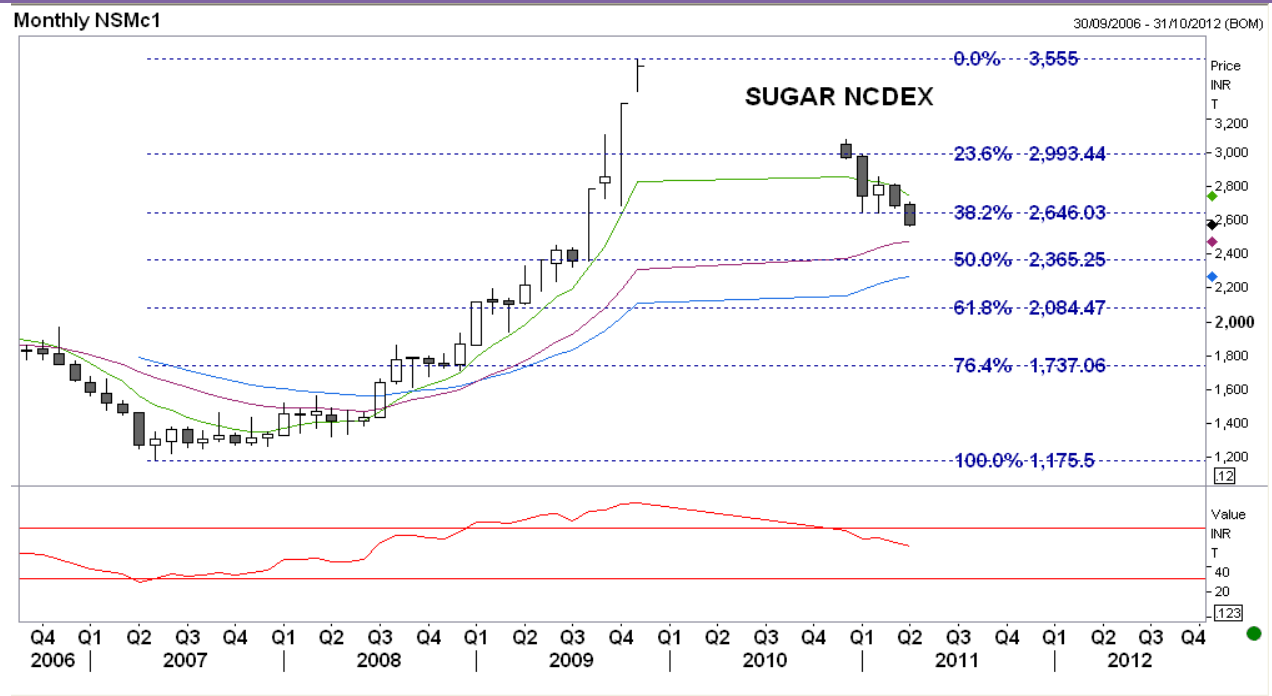
The sugar prices are trading on a bearish note since re-launch of futures trading because of bumper crop expectation and higher sales quota in each month. Due to poor off-take of the produce, the unsold quota of sugar has been carried forwarded to next month. This is resulting into ample supplies in the market. At the same time, restriction on trade like stock limit propelled traders to stay away from active buying. Till second week of April, the summer season demand from beverage and ice-cream industry was poor, which had a bearish impact on the market. In the short term, prices are likely to remain under pressure on ample supplies and poor off-take of the produce. We are expecting a positive trend from May onwards once the summer season reaches its peak level. Moreover, summer and marriage season starting from June will also add bullishness to the market. Looking into bumper crop, the government may further ease the trade restriction on sugar.

Technical analysis

Sugar prices trading lower since its re-introduction in the month of December 2010. Prices have breached the key support at 2680 levels (previous swing lows). On sustained trade below is likely to remain lower. The principle of Fibonacci retracement states that prices have breached support at 2646 levels which is 38.2% retracement of the range 1182-3555 levels. On sustained trade below is likely to test 2365 levels which is 50% retracement of the above mentioned range. The moving Average principle suggests prices are witnessing crucial support of medium term EMA of 21 months at 2470 levels. On sustained trade above is likely to remain higher. The momentum indicator RSI 14 monthly is trading at 0.553 levels and suggesting indecisiveness for the prices.

Conclusion: As prices are witnessing Fibonacci support of 50% and EMA of Moving average support at 2365 and 2470 respectively. We expect prices to take a bounce back and recommend buying at support levels.

Figure 12: NCDEX Sugar – Technical analysis



Source: KCTL Research

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