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Pakistan Research | Sugar

KSE100 Index: 16805.58(+62pts)

Sugar industry – prospects not that compelling given ground realities but exports offer good avenue

There is a tug of war going on between growers who had forced government in both Punjab and Sindh province to increase support prices to Rs 170/kg to Rs 172/kg per 40kg wherein ex-mill prices remain at around Rs 50/kg which means there is minimal margins left for mill owners; thus making their prospects not that compelling at this point. However, we see better fundamentals in JDWS, MRNS, HABSM, MIRKS and improvement in NONS (see earnings matrix on the following page)**.**

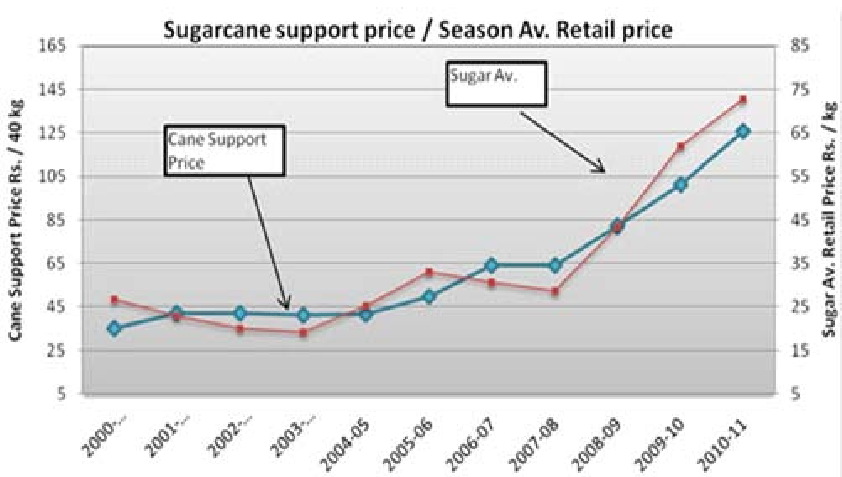
Only trigger in the industry is the allowing of exports for which sugar players would jostle.

Sugar industry dynamics: much the same as it was decade ago

Sugar cane is one of the vital cash crops in Pakistan and second largest agro-based industry in Pakistan. Pakistan is overall a fifth largest producer of sucrose. At present, the total mill production from Pakistan is close to 3.1mn tons (output of 81sugar mills) wherein 2.6mn tons is sold out (showing 40% growth from last year). As per newspaper reports, the Economic Coordination Committee (ECC) has allowed sugar mill owners to export sugar (previously the quota was allocated at around which is now been converted into unlimited exports). It further states that TCP has been asked to create a buffer of 0.5mn tons of sugar for the smooth local consumption and supply populace in order to avert FY11 like crisis situation where prices of sugar reached to unimaginable proportions wherein Supreme Court intervened; that was the time when sugar mills made windfall profits.

In all sugar cane is an important crop which yields not only sucrose but in the same process (on the conveyer) also produces higher margin products such as industrial alcohol for pharmaceutical companies (mostly exported to European destinations such as Germany), ethanol as fuel and waste such as bagasse which is sold out to local paper mills.

Sugar production emanates from all the provinces (mostly from Punjab and Sindh). However, most recovery (crushing rate) comes from Punjab based mills i.e. more than 11%. But Pakistan's average recovery rate is stated to be 9.4%. Hence it is a kind of benchmark that the company having better recovery rate has the highest proportion of margins.



source: Pakistan sugar mills association

Sugar cane support prices vis-à-vis sugar prices; mill owners would suffer in FY13

There is a concept of support prices both in Punjab and Sindh province. For instance, in FY10 Govt. of Punjab had fixed price of Rs 100/kg over a 40kg bag. However in FY12, the support prices have increased to Rs 150 – 154/kg over a 40kg bag (latest reported as per 9 month accounts reported). As of November 2012, as per press reports, Sindh Agriculture Department has rejected any possibility of reduction in official fixed price of Rs 172/kg per 40kg of sugar cane despite severe confrontation from mill owners. Same thing happens in Punjab.

Only last week, sugar production has started in Pakistan. As for the wholesale sugar price, it is ranging around Rs 50/kg. As per industry people, the real cost of producing sugar (bearing in mind Rs 170/kg per 40kg sugar cane price) is Rs 65/kg but it's being available at Rs 50 – 51/kg (the prices could go as high as Rs 54/kg). But this whole situation does not sound compelling for sugar companies in current financial year.

This means that government owing to political expediencies such as general elections would like to keep growers happy by increasing support prices of sugar cane wherein sugar mill owners wouldn't be able to pass on the sugar prices to general public in early part of the 2013. Later on there is a likelihood that prices of sugar could increase at the whims of sugar mills. Hence sugar outlook looks murky.

Molasses sales increased from Pakistan

In FY11, nearly 2mn tons of molasses was produced (mostly exported) as against 1.5mn tons in FY10. Till 9MFY12, we have seen increasing trend of molasses exports in major companies (also depicting good margins since distillery prices hiked globally), however, now these prices have shown a decreasing trend. Molasses and ethanol offers greater margins over sucrose yet constitute minimal part of segment wise sales.

MRNS	FY09	FY10	FY11	FY12	PE	3-year avg PE	*Company discription*	*Sugar recovery*
Dil.EPS	8.41	11.6	15.43	13.02	3.8	4.5	Mehran Sugar	10.2%
Dividend %	3.5	3.5	3	2.5			investment in Unicol	
Bonus %	30	20	20	10				
JDWS	**FY09**	**FY10**	**FY11**	***9MFY12***	***exp. PE***	***3-year avg PE***		
Dil.EPS	8.4	20.8	22.47	*15.87*	***7.0***	9.5	JDW Sugar	10.4% & 10.6%
Dividend %	4	7	9				most progressive unit	
Bonus %	-	10	-					
HABSM	**FY09**	**FY10**	**FY11**	***9MFY12***				
Dil.EPS	3.27	3.56	5.03	*3.6*	***5.1***	7.3	Habib Sugar	9.9%
Dividend %	3.5	2.5	5				having home textile unit	
Bonus %	25	25	-					
MIRKS	**FY09**	**FY10**	**FY11***	***9MFY12***				
Dil.EPS	17.9	10.0	16.33	*10.73*	***4.0***	3.6	Mirpurkhas Sugar	10.4%
Dividend %	2.5	1.5	1				Cherat Group company	
Bonus %	10	20	15					
						*	non recurring	
NONS	**FY09**	**FY10**	**FY11**	***9MFY12***				
Dil.EPS	3.42	-14.9	2.11	*3.97*	***5.0***	10.6	Noon Sugar	9.6%
Dividend %	1	-	1.5				Noon Group company	
Bonus %	10	-	-					
				average	5.0			10.0%

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Valuation: JDWS, MRNS, HABSM, MIRKS are better players; NONS has shown improvement

JDW Sugar is always been considered best company in terms of efficiencies (crushing recovery) and progressive management; however, we signal a cautious stance given a situation where companies may face tough months before elections. Among emerging players, NONS looks attractive (offers greater free float of over 10mn shares).

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