Twitter Thread by Kirtan A Shah



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In a business where the buying & selling price is fixed by the government, how is that the sugar stocks are rallying so much?

A thread ■ to learn how the sugar sector works. Do re-tweet and hence us educate more investors (1/n)

- Sugar is made out of Sugarcane
- The government fixes buying price (FRP – Fair & Remunerative price) for the mill from the farmers at 2.850/Kg
- Selling price is also fixed at Rs. 31/Kg (MSP – Minimum selling price) (2/n)

Lets understand the sector,

- Sugarcane purchased by the mill is crushed to remove the juice (exactly like you have sugarcane juice at a hotel)
- Juice is heated & boiled to remove sugar (3/n)

- The juice can be boiled upto 3 times to remove sugar. Each time it is boiled, sugar is removed, than some water is added and boiled again to remove more sugar (4/n)

- There are 2 by-products as well. The residue left behind after the boiling process is over is like a gum/paste called molasses & the fiber/stem of the sugarcane after juice is extracted (5/n)

-U can either directly convert the juice into molasses without extracting sugar so that U can produce more molasses or boil the juice twice, extract sugar & use the remaining juice 2 extract molasses (B Molasses) or burn the juice 3 times & extract the molasses (C Molasses) (6/n)

Sugar industry deals in 3 products,
-Sugar
-Molasses can be further processed to make Ethanol & Alcohol
-The fiber is burned to generate electricity. Sugar mills use the same electricity for running the mill & extra is sold. This is called co-generation (7/n)

Rough calculations,

1 Tonne of sugarcane roughly can produce
- 110 Kg of sugar (or)
- 70 L of Ethanol
You produce 1.6 times more sugar than Ethanol from 1Tonne of sugarcane.

& Sugar mills rough business split is,
60-65% sugar, 20-25% ethanol, 10-15% co generation (8/n)

What should the mill focus on producing depends on the rate of sugar or Ethanol. Sugar currently is 31/kg & ethanol is 62.65. So 1 tonne of sugarcane can generate the below revenue
-Sugar = 31*110 = 3410
-Ethanol – 70*62.65 = 4385.5 (9/n)

So what should they produce more? Ethanol

So why are they even producing sugar?
Ethanol production needs a proper distillery set up which not all mills have. Mills are now investing for the same. (10/n)

Why are stocks going up?
- Demand & Supply
- Exports
- Ethanol
- Working Capital (11/n)

Demand & Supply (12/n)

Demand & Supply

- Brazil & Thailand are the largest producers in the world with roughly 38 & 15 Million Tonne of production. Because of drought like situation in Brazil & production drop in Thailand, there is expected to be a short fall in global trade by about 2-5 MT, which is about 5-10% of the global trade of 40-45 MT
- Sugar prices are going up because of the same. Even corn, soybean, wheat, coffee rising for the same reason.

Exports (13/n)

Export

- India produces 25MT, domestic demand is 30MT and hence 5MT can be exported
- We are not export competitive with higher cost of production. Brazil & Thailand produces sugar at 40% lower cost
- To support the industry government give export subsidy of 6,000/Tonne
- With higher sugar prices internationally + Export subsidy, exports are making money

Ethanol (14/n)

Ethanol

Oil marketing companies buy Ethanol from sugar mills to add in the fuel. Currently the average mix is 5-6% and this is expected to increase upto 20% as the policy is becoming better for Ethanol to save fuel cost & export subsidy. Fuel will have 20% Ethanol, making it more bio & cheaper. This is expected to increase the demand for ethanol from 300 cr. Liters to 600 cr. Liters

Working Capital

Working capital to get better with more focus on Ethanol as payments from OMC happen monthly vs selling sugar which take 7-9 months of inventory time where as the farmers have to be paid in 14 days after acquiring the crop from them (15/n)

What to look for in a sugar company?

- UP based companies to do well. Water is available for cultivation, crop is also good & hence the factory capacity utilization is better & sugar produce per tonne is more
- Ethanol capacity/Tonne of crop crushed
- Working capital (16/n)

Cant end this thread without crediting @varinder_bansal for a very good video on sugar sector from where I have taken the latest data for the thread. You can watch the entire episode here -https://t.co/kDtnHmzL98 (17/n)

I have written multiple threads earlier on
- Sector Analysis - Banking, Paints, Logistic, REIT, InvIT
- Macro Economics
- Debt Markets
- Equity Markets
- Gold
- Personal Finance etc.

You can find them all in the link below ■ (**END**)

https://t.co/UrRt87OLLF

> Here\u2019s a compilation of Personal Finance threads I have written so far. Thank you for motivating me to do it.
>
> Hit the 're-tweet' and help us educated more investors
>
> — Kirtan A Shah (@KirtanShahCFP) December 13, 2020