

MANAGEMENT DISCUSSION AND ANALYSIS

Industry structure and developments

The Indian sugar industry is composed of cooperative sugar factories, private and public sector sugar factories. Cooperatives account for about 55% of the total number of factories.

The country witnessed lower production of sugar during the season 2003-04 and 2004-05 and the trend reversed during the season 2006-07 with expectation of record production. Good monsoon and remunerative sugarcane prices have resulted in higher cane planting by the farmers and hence the substantial increase in production.

The industry saw reversal of its fortunes since May 2006 when the sugar prices were at the highest peak. Though the export market for sugar was lucrative in the middle of 2006, the industry could not capitalize on it due to ban on export of sugar by the Central Government in June 2006 as a measure to control inflation. This resulted in supply/demand mismatch and high inventory of sugar thereby bringing down the sugar prices sharply even below the levy sugar price. By the time sugar export ban was lifted in January 2007, the international prices has come down drastically from \$400 per MT to \$300 MT again putting the industry in a disadvantageous position. The dampening domestic and international prices and huge inventory has resulted in arrears of cane payment which was hitherto promptly paid.

In order to support the sugar industry, the Central Government has created a buffer stock of 20 lakh tonne from 1st May 2007 for a period of one year thereby undertaking to bear the interest, storage and insurance cost of the buffer stock. For sugar exports, the Government has also announced freight subsidy of Rs.1350 per tonne for mills near coastal areas and Rs.1450 per tonne for those mills in interior areas. The measures instead of benefiting the industry has further

discounted the international prices. The rising rupee against the US dollar has also made exports further unremunerative.

Opportunities and threats

The record production of sugar in the country has given the industry an opportunity to play a major role in the international sugar market by capturing a sizeable market share. Effective utilization of by products to manufacture value added products like power and alcohol offer opportunities for the sugar industry to limit the impact of price volatility due to sugar cycle and sustain the economic viability of the factories during downtrend scenario. The Central Government is proposing to make it mandatory blending of 10% ethanol with petrol which will provide business opportunity to the sugar industry. Global warming is being recognized as an international problem and most of the countries are giving encouragement for use of renewable energy to reduce carbon emissions. The bagasse based cogeneration projects which come under this category provide opportunity to sugar factories to earn additional revenue by sale of carbon credits under the Clean Development Mechanism.

The industry is still controlled by the Government through levy obligation and release mechanism. Due to these regulations, the industry is unable to take timely effective steps to tackle environmental challenges or devise effective strategy to meet those challenges. Continuing decline in sugar prices may affect the viability of the sugar mills in future, especially the stand alone sugar mills which may face liquidity crunch.

Segment wise performance

The segments for the purpose of reporting are Sugar, Distillery and others consisting of property development. The sugar segment includes both sugar and cogeneration divisions. The sugar segment achieved a sales turnover of Rs.382 crores while the Distillery segment recorded a turnover of Rs.23 crores. There

were no transactions in the property development division during the year 2006-07. The sugar segment earned a profit before interest of Rs.42.63 crores as against 13.05 crores earned by the Distillery division. The net profit ratio of the sugar division is substantially lesser than the ratio of distillery division on account of depressed sugar prices during the year reported on. The operational performance of the segments is given under the Directors' Report.

Outlook

The sugar production for the season 2006-07 is expected to be sustained during the season 2007-08. On account of the expected higher production, the sugar prices are likely to remain depressed during the year 2007-08 and hence the margins will be affected. Though the buffer stock of 20 lakh tones created by the Central Government for one year from 1st May 2007 may help the Companies to get proportionate interest cost and storage cost reduced and enhancement of the drawing power of the Companies in respect of cash credit, it may not help the Companies even to break even as the sugar price realizations are not sufficient to cover the sugarcane cost alone. In this scenario, it is imperative that the Government devise a mechanism for matching sugarcane cost and sugar price realizations so that the sugar mills can be economically viable and also the farmers are paid promptly. In the long term the outlook for the industry is expected to be positive with likely uptrend in sugar cycle.

Risks and concerns

Sugarcane being the sole raw material for the sugar industry, its availability depends upon good monsoon. Competition from other crops may affect the supply of sugarcane for crushing. Also competition from alternate sweeteners like khandasari and gur may affect the sugarcane supply. In the present scenario of falling sugar prices, the mandatory payment of SMP and SAP fixed by the Governments for sugarcane will affect the profitability of the companies. Fixation of sugarcane prices commensurate with the sugar price realizations will stabilize

the industry. Molasses is being strictly controlled by the State Governments and hence its usage according to market situations is severely restricted. The success of the ethanol blended petrol programme of the Central Government depends on its consistent policy and the support for the same from the State Governments.

Internal control systems and their adequacy

The Company has installed proper internal control systems for the various functional areas. The checks and control measures are effective and adequate.

Financial performance and operational performance.

The details of financial performance and operational performance is mentioned in the Directors' Report.

Cautionary statement

Statements in this Report describing the Company's objectives, estimates and expectations may constitute "forward looking statements" within the meaning of applicable laws and regulations. Actual results might differ materially from those either expressed or implied.