Indian Gems and Jewellery Industry: An Analysis

Highlights

- Largely Export Driven
- Unorganised, Fragmented and Labour Intensive
- Largest Diamond Processing Centre In The World
- Rising Gold Prices Squeezing Margins
Gems and Jewellery Industry in India

Overview

The gems and jewellery Industry has been one of the fastest growing industries in India in the past few years. This industry has been vital for the economy, as it has contributed, on an average, to about 15.27% of the country’s total exports in past one decade.

India is one of the largest diamond processors in the world. This industry is engaged in sourcing, manufacturing and processing which involves cutting, polishing and selling of precious gemstones as well as diamond and precious metals like gold, silver and platinum.

The price of one of the main inputs in jewellery — gold — has been consistently touching all-time highs. The yellow metal’s spot price in the domestic market hit all time high of `28,540 per 10 gram on August 22, 2011. In the international market, prices breached $1,900 (per ounce) level. Investment demand for gold remains strong in the current environment of market uncertainty, triggered by worries of a double dip recession in the US and worries of sovereign debt contagion in Europe. Gold has slowly turned into a sophisticated investment instrument, an improvement over its traditional use for jewellery making in India.

Hence, the retailers have been trying to woo customers through cheaper alternatives, mainly silver jewellery. Because of this, Indian non-gold jewellery, a chunk of which is made in silver, is finding its way to export markets. This trend might strengthen in near future.

The industry is highly fragmented and mostly unorganised. However, due to the ongoing retail revolution in the country, this industry is undergoing a transformation and gradually moving towards being organised. As part of this phenomenon, a number of nation-wide jewellery chains are increasingly making their presence felt.

In recent times, the Government has taken various initiatives to support this sector. For instance, up to 100% FDI is allowed in the industry through automatic route. Also, special economic zones (SEZs) and jewellery parks have been set up to promote investments.

After witnessing a significant downturn during 2008-09, this industry is back on the a recovery path. However, due to export-import dependence, it remains susceptible to external developments, such as fluctuation in international prices, exchange rate volatility and demand scenario in key markets. It can be mentioned here that India has been one of the largest importers of gemstones, rough diamonds and precious metals over the years and most of it is used for exports after value addition.

PRU tries to analyse the trends in demand and exports, demand drivers, issues and opportunities and outlook of this industry.

Note: The sample period taken here is FY02-FY11.
Trends in demand

This sector is highly export-oriented and contributed about 14.53% to the total exports in FY11.

- Exports of gems and jewellery from India have grown at a CAGR of 19.02% over the past ten years (FY02-FY11). During FY11, total exports jumped by a whopping 46.55% Y-o-Y to reach $43.13 billion.

- Growth in gems and jewellery exports has been primarily driven by the cut and polished diamond segment over the years. This segment has an average share of 68% during FY02-FY11.
  Cut and polished diamond exports grew at CAGR of 16.95% during the same period to hit $28.25 billion in FY11.

- Changing Dynamics of Gold and Silver

  The share of gold jewellery in the exports of gems and jewellery increased from mere 15.3% in FY02 to 30% in FY11. Gold jewellery exports have grown at CAGR of 25.09% over the past 10 years.

  However, in the first four months of FY12 (April-July 2011), the trend seems to changing due to the spike in the gold prices.

  Silver jewellery exports have surged by massive 63.41% (Y-o-Y) during this period. Before this period, exports of silver jewellery was negligible. There is a clear indication of gold getting replaced by cheaper alternative, silver.

- Share of coloured gem stones in exports is quite small. Rough coloured gemstones and raw pearls are largely imported for value addition and exports.

Gold Price Movement and Impact On Exports

As we can see here gold jewellery exports from India has been very volatile over the years due to erratic global demand. Overall, jewellery demand has been affected mainly by gold prices. Exports witnessed a sharp drop during FY10 owing a slowing demand from
the UAE, one the key export destinations. NRI demand in these countries was more reactive to high prices.

The traditional use of gold in jewellery is slowly losing its significance and gold is turning into sophisticated investment instrument over the years. The recent market uncertainty triggered by worries of a double dip recession in the US and anxieties over sovereign debt contagion in Europe have pushed gold prices to new heights as it is regarded as a safe heaven instrument. The yellow metal’s spot price in the domestic market hit all time high of ₹28,540 per 10 gram on August 22, 2011. In the international market price breached $1,900 (per ounce) level.

This spiralling gold price has negatively affected the Indian gems and jewellery industry by squeezing the margins of players. Overseas customers are holding back their orders and exporters are unable to settle their prices due to this.

Therefore, gems and jewellery exports for the first four months of FY12 (April-July) grew at slow pace of 5.08% Y-o-Y to hit $8.02 billion. With the continuing uncertainty in the western markets, we expect the upward gold price movement to continue in the future. This unprecedented upward spiral in gold prices has led to the use of silver as a main input in jewellery. This, in turn, has led to increasing silver imports into India.

Export Drivers of The Gems & Jewellery Industry

- This industry has a competitive edge over its peers due to relatively lower cost of production, driven by availability of cheap and highly skilled labour force. Indian craftsmen are famous for cutting and polishing of diamonds and other precious stones. Processed diamonds in India has more than 50% of the global share in value terms.

- The Government has been taking several initiatives to support this industry in order to boost exports and generate employment. As raw materials for this industry is largely imported, several initiatives have been taken to reduce the import barrier. For instance, import duty on cut and polished diamond has been reduced 0% since 2007.

- Post liberalisation (after 1991), the Government has lifted all restrictions on export and import of gold. Up to 74% FDI is allowed in exploration and mining of diamonds and precious stones. Also up to 100% FDI is allowed in the industry through the automatic route.

- Retailing of gems and jewellery in recent times has acted as a catalyst for the entry of international brands with innovative designs and marketing plans. This has contributed towards boosting exports.
Imports

The gems and jewellery industry is heavily dependent on imports as the required raw material is scarce in this country. Total imports increased steadily over the years. Imports have grown at CAGR of 22.05% over the past 10 years (FY02-FY11).

In recent years, imports have been driven by cut and polished diamonds which is completely exempted from import duty since 2007. As a result, imports registered an almost three-fold increase during FY08-FY11. Imports of cut and polished diamond hit as high as $20.77 billion during that period. India imports its entire requirement of rough diamonds. Import of rough diamonds during FY11 witnessed a significant rise of 31.63%(Y-o-Y) due to demand from international markets.

Challenges and Outlook

Unorganised and fragmented: More than 90% of the players in this industry are unorganised and mostly family-run. Hence, achieving economies of scale is difficult. Also, this industry is highly labour intensive and uses indigenous technology which makes it less as less competitive globally. This could act as a deterrent to the industry’s global aspirations and future growth prospects.

Foreign exchange risk: Players in this industry are heavily dependent on imports and exports and are, therefore, susceptible to exchange rate movements. Any volatility in exchange rate affects their margins.

Threat from China: China can emerge as a rival for India in the future as it is the second-largest diamond processing centre after India. China also has abundant availability of cheap labour which makes it cost competitive compared to its peers.

Going forward, this industry is likely to transform to organised retailing in the coming years. Even though this industry is highly export dependent, the domestic market has huge potential with rising income levels and changing life styles.

Gems and jewellery exports might diversify into newer markets in the coming years which could boost exports further. It can be mentioned here that UAE and Hong Kong have recently become significant export destinations. Given its low cost labour advantage, India will continue to dominate the world export market for a few more years. However, cheap labour as a global competitive advantage has a limited shelf life, as the information technology enabled services industry (such as BPOs) has found out to its detriment.
Cement On A Weak Ground

**Political impasse hurts cement demand:** While cement consumption in India fell for the first time in nearly two decades during the April-June quarter as political impasse in large consumer states holds up infrastructure and realty projects. (*The Times of India, August 17, 2011*)

- **PRU Analysis**
  The data released by the Cement Manufacturers Association reflected a flat year-on-year growth in despatches during the June 2011 quarter. However, cement production recorded a marginal y-o-y decline — for the first time in the past two decades.

While demand for cement in the June quarter is usually lower than the March quarter, dealers start building up inventories during the monsoon months. However, given the weak demand scenario, it may be likely that dealers are not stocking much. And, since the dealer demand is low, cement manufacturers choose to cut down on production rather than locking up high-cost working capital in inventories.

Demand for cement is considered as a reflection of the on-going economic activity. However, the weak pace of infrastructure development, muted growth in real estate sector and slower pace of capacity addition across industries has resulted in stagnation in demand. Uncertain global economic situation and turmoil in the Indian political scenario has led to companies going slow on their capex plans. Hardening interest rates is another factor affecting capital expansion plans.

State-wise cement consumption statistics reveal that Andhra Pradesh and Karnataka were the worst affected regions. The Telangana issue in Andhra Pradesh may have resulted in a 21% contraction in demand. Karnataka recorded an 8% fall in consumption during the last financial year.

- **PRU View**
  We continue to believe (as we had mentioned in our earlier reports also) that the cement industry will remain under demand pressure. Higher cost of raw materials, fuel and freight have reduced profit margins of cement companies to almost half. These costs are expected to rise at a faster pace than the demand during the current financial year.

  With rising capacity and muted demand growth, the bargaining power of the manufacturers will remain weak. Unless, of course, these companies hold up prices together and pass on the cost increase to the end consumers. If they do hold up prices, it may be at the cost of lower sales volumes.
Interest Cost Of Large Hotel Players Likely To Subside

**Hotel Leela to sell Kerala hotel for ₹500 crore:** Hotel Leelaventure has signed a pact with Travancore Enterprises to transfer its hotel property in Kerala to a special purpose vehicle (SPV), which would be taken over by the latter for ₹500 crore. Hotel Leela will continue to operate the hotel through a long-term management contract to be finalised with the SPV. (Mint, August 17, 2011)

**PRU Analysis**

The June 2011 quarter has been a positive one for the Indian hotel industry. Travel by both domestic and foreign tourists is growing at a healthy pace during the current year. Companies that declared their financial performance for the June 2011 quarter also reflect a healthy growth in profits.

Increase in room rates and higher occupancy bolstered revenues of the hotels industry. Several hotel expansion projects also came on stream during the quarter ended June 2011 which boosted supply.

- The ‘Leela Palace Kempinski’ hotel in New Delhi started operations in April 2011. The hotel has 260 rooms and four restaurants.
- East India Hotels opened its Gurgaon ‘Oberoi’ hotel with a capacity of 202 rooms
- Mahindra Holidays & Resorts India completed its Tungi resort (near Lonavala) in June 2011. The resort has a capacity of 155 rooms but awaits approval from Maharashtra government to commence operations
- Uppal Housing completed its 164-room hotel in Chandigarh
- A 267-room Lemon Tree hotel was set up in Hyderabad
- Alcon Resort Holdings completed its 132-room Cavelossim Beach Radisson Blu Resort Project in Goa

Media reports state that Reliance Industries is expected to team up with EIH to set up hotels in India at an estimated investment of ₹7 billion. It is noteworthy that RIL came in as a white knight and picked up a 14.8% stake in EIH last year to prevent a possible takeover of the company.

Indian Hotels (which owns the Taj group of hotels) stated that Sea Rock Hotel in Mumbai is likely to be completed by 2014 and the Taj Exotica that is coming up in Andaman Island is likely to be ready by 2013. Also, it is expected that Roots Corporation Limited, a subsidiary of IHCL that runs the Ginger Hotel chain, is likely to break even in the current fiscal year.

A look at the 20 hotel companies that declared their financial results for the June 2011 quarter reflect a positive picture. While aggregate income of these companies grew by 15.6% year-on-year, the industry’s net profit surged by 49%. A more than proportionate increase in income vis-à-vis expenses enabled a rise in profits. Expenses such as other expenses, interest costs and depreciation provisions witnessed a slower growth compared to the year ago quarter.

Nearly half the interest cost of the total industry is incurred by EIH and Indian Hotels. While EIH has repaid a large portion of its outstanding debt through funds raised from its rights issue, Indian Hotels issued shares and warrants to its promoters on a preferential basis in order to decrease its debt. Hotel Leelaventure, reportedly, is also looking at raising funds from private equity firms to reduce its debt burden. It has plans to sell its luxury hotel property at Kovalam in Kerala to Travancore Enterprises to reduce its debt. The debt restructuring initiatives of these hotel companies will result in lower interest expenses for the sector during the current financial year.


Renewed Energy: Need Of The Hour

Power generation capacity through renewable energy sources crosses 20,550 mw: A total grid interactive renewable power generation capacity of around 20,556 MW has been set up in the country which is about 11.5% of the total power generation installed capacity from all sources. (PIB, August 16, 2011)

- **PRU Analysis**

Power generation in India is mainly driven by coal-based plants. Hydel power generation is not a very reliable source, given the uncertainties of the monsoons. Nuclear power, until recently was facing a severe raw material supply constrain.

Given the shortfall of coal in India, rapid development of renewable energy generation units has become need of the hour. According to the latest data released by the ministry of renewable energy sources, capacity of renewable energy sources stands at 11.5% of the total power generation capacity.

The statistics reveal that nearly 8.1% of the total power generation capacity in India comes from wind energy. It must be noted that installation of wind power units recorded a sharp increase on account of tax incentives offered. In order to promote wind power development, the Government had offered tax breaks against the amount invested in setting up of wind power units. Since the companies used this as a tax shelter, a sharp growth in wind capacity is seen. However, there was not much improvement in actual power generation. Hence, the ministry is now planning to alter the incentives from being investment-based to generation-based for wind power.

The ministry of new and renewable energy is also implementing a programme for setting up of five new projects on energy recovery from municipal solid wastes. The programme provides for capital subsidy of `2 crore per MW with an upper limit of `10 crore per project. So far, no projects have been implemented under this scheme. But, there have been projects based on municipal solid wastes set up earlier.

The present installed capacity for generation of power from biomass, including paddy husk and bagasse based cogeneration in sugar mills, is 1,045 MW and 1,742 MW respectively.

It must be noted that while the ministry declares installed capacity figures for renewable sources, it does not update generation figures regularly. This makes generation from these sources incomparable with growth in installed capacity.

### Source-wise Capacity of Renewable Energy (in MW)

<table>
<thead>
<tr>
<th>Type</th>
<th>Capacity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wind</td>
<td>14,551</td>
</tr>
<tr>
<td>Small Hydro Power</td>
<td>3,105</td>
</tr>
<tr>
<td>Bio-Power</td>
<td>2,806</td>
</tr>
<tr>
<td>Solar Power</td>
<td>40</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20,556</strong></td>
</tr>
</tbody>
</table>

New Developments In Iron Ore: The Key Raw Material For Steel

Global firms set to vie for Afghan iron ore: Afghanistan may see top global miners bid for its Hajigak iron ore deposit, a senior government official said, in what could mean that the group led by Steel Authority of India Ltd will face a tough fight to clinch the 1.8 billion tonnes reserves of the key steel making commodity. (Mint, August 23, 2011)

- **PRU Analysis**

In a recent move, the top three global mining companies – BHP Billiton, Rio Tinto and Vale S.A. — have joined major Indian steel makers to bid for the Hajigak iron ore mine in Afghanistan.

The Indian steel majors who are bidding for the reserves include Steel Authority of India Ltd (SAIL), Tata Steel Ltd, JSW Steel Ltd, Jindal Steel and Power Ltd, NMDC Ltd and Rashtriya Ispat Nigam Ltd.

Profit margins of steel companies in India have been recently hit by a sharp rise in raw material costs, including iron ore costs. Hence, the level of raw material integration is critical for profitability under the current situation. The Indian steel industry is likely to face a
shortage of iron ore in the future due to the ban imposed by Supreme Court on iron ore mining from Bellary district in Karnataka. About one-third of the total iron ore production is produced in Karnataka.

Domestic growth in iron ore production has also been hampered by issues of land acquisition and regulatory approvals.

It can be mentioned here that according to US Geological survey, Hajigak reserves in Afghanistan, which contains about 1.8 billion tonnes of high quality magnetite (> 62% Fe content), is among the largest unexplored iron ore deposits in the world.

However, these mines are located 130 km west of Kabul and require huge amounts of investment (around $6 billion including exploration) in infrastructure like rails and roads for operating in these remote areas. This can be huge cost guzzler. The government of Afghanistan has indicated that it might prefer to go with a company that will add value to the Hajigak iron ore mines by setting up a steel plant there. It can be highlighted here that there is also presence of coking coal in at Shabashak in the Dar-l-Suf District.

Iron ore mining clamp hits foundry sector: The closure of mines in Karnataka’s Bellary-Hospet region has started hitting the downstream sector. Around 5,000 foundry units and a similar number in the sponge and pig iron sector have been facing a big shortage of iron ore supply. The foundry sector makes key equipment for the auto and engineering industries. (Business Standard, August 18, 2011)

• PRU Analysis

Foundry is the art of melting metals and casting them into different shapes. These shapes are generally very complicated, which cannot be made by any other process. The foundry sector caters to need of industries like automotives, auto-components, engineering goods, sanitary fittings, oil and natural gas exploration and textiles and railways.

In India, there are around 6,000 foundries of large, medium and small category with production capacity of 7.5 million tonnes of cast and ductile iron, which is then used for production of high quality specialized steel products.

Currently, about 90% of the foundry units are facing a supply shortage of quality pig iron, which is a key raw material for all major auto and engineering grade foundries. This is due to the shortage of iron ore supplies which has hit independent sponge and pig iron making units in the Karnataka as well as neighboring states.

It can be mentioned here that in the last week of July, Supreme Court had ordered suspension of all mining activities in Karnataka’s Bellary district following the Lokayukt report which found large scale illegal mining in the state. The order affected about 100 iron ore mines accounting for about 80% of the mines in the state.

Karnataka produces 50-60 million tonnes iron ore annually, which contributes to about one-third of the national output. Karnataka is the second-largest producer of iron ore after Orissa.

Karnataka and the neighbouring states have added huge capacities for manufacturing iron and steel pellets. Besides supplying raw material for steel production capacities of 16 million tones, including major producers like JSW Steel, the state also supplies iron ore for production of approximately 5.6 million tonnes of sponge iron and pig iron.

Currently, mining of iron ore in the area is restricted to only NMDC which produces about 1 million tonne per month. This is inadequate to meet the requirement of sponge and pig iron units as well as the steel producers.

Foundry units are facing problems from both sides — lower realisation and high cost of production due to a dramatic spurt in interest rates for their working capital.
Tractor Sales Update

Tractor sales grow on demand from agri and non-agri sectors: Even as sales declined in the passenger vehicle segment for the first time in nearly 30 months this July, tractor sales continue to post sturdy growth numbers. *(Business Standard, August 19, 2011)*

**PRU Analysis**

The rise in rural incomes — both farm and non-farm, government focus on rural development, aids to farmers and increasing farm mechanization — has been the main growth driver for tractor sales in India. Domestic tractor sales in India has grown at a **CAGR** of 12.6% in the last years to 480,377 units in FY11. Mahindra & Mahindra (M&M) enjoys the largest market share of around 42% in the domestic market and has consistently grown above the industry average. In FY11, domestic tractor sales of M&M grew by **22% Y-o-Y** compared to the **20% industry growth**. The market share also inched up to **42.2%** in FY11 from **41.6%** in FY10.

Tractor sales are also growing steadily due to the rise in use of farm equipment in non-agri sectors, such as construction (mainly for haulage of material) and as an alternative mode of transportation in the rural areas. The growth in tractor sales has traditionally been a function of a good monsoon and during this year, the monsoon has been behaving well so far. According to industry sources, the proportion of tractor usage in non-farm segment has increased from 30% to about 45% over the past two to three years as more and more tractors are diverted towards construction work during off-season.

The total tractors sales in the June quarter grew by **13.3% Y-o-Y** but declined by **1%** on Q-o-Q basis. In spite of the increasing use of tractors in the non-farm sector, the farm sector still contributes to a bulk of the requirement, and the requirement being seasonal, a Y-o-Y comparison is ideal. However, as the use of tractors increases in the non-farm sector, the Q-o-Q comparison in growth will also gain importance in the times to come.

**PRU View**

The tractor industry has always been a barometer for the state of the rural economy. The Indian tractor market has witnessed a significant rise post liquidity crises of FY08 and FY09. However, the continuous rise in Minimum Support Prices (MSPs), favourable farm credit scenario, shortage of agricultural labour, healthy monsoons and increase in multi-usage of tractors (increased mechanisation) have led to the revival of the tractor market and the same factors would help keep the growth rates high in the future. Moreover, increasing non-agricultural use of tractors in transportation and haulage is expected to provide an impetus to overall growth of the tractor market on back of the government’s focus on infrastructure development.

**Global Turmoil Affects Natural Rubber Prices Temporarily**

Spot rubber slips below ₹200 per kg: Physical rubber market fell further on Friday. Broad declines in the domestic and international futures weighed on the prices. *(The Hindu Business Line, August 20, 2011)*

**PRU Analysis**

After the recent peak in February 2011, the natural rubber prices have come down significantly. The domestic prices have declined by...
18% from ₹240.5 per kg to ₹198 per kg while the international natural rubber prices have declined by 28% from ₹293 per kg to ₹211 per kg.

The fall in prices have largely been due to lack of buyers and the current global turmoil rather than increase in the number of sellers in the market or any fundamental change in the demand supply situation.

Thailand, the largest producer of natural rubber in the world, contributes around 30% of the total natural rubber output followed by Indonesia with around 27% share. According to the Association of Natural Rubber Producing Countries (ANRPC) which represents around 92% of the world production, natural rubber production in key growing countries like Thailand &Indonesia may miss estimates this year as weather has played spoilsport in destroying the crop and delaying the tapping of rubber.

- **PRU View**

Last year also the industry hoped for the softening of natural rubber prices with the onset of peak tapping season in September. However, prices went spiraling and overshot international prices.

However, since the gap between rubber production and consumption is widening globally due to lower supplies and higher consumption, we foresee prices rising from here. The current softening of prices might provide some temporary relief in the coming quarters to the associated industries but overall the financials would be severely impacted.

For instance, the domestic rubber prices in the quarter declined by 9% while the prices in the international market declined by 19%. However, due to lag effect and higher inventory cost, the Indian tyre industry has witnessed sliding profitability in the June 2011 quarter. Despite a rise in sales, the EBITDA and Adjusted PAT (APAT) have fallen considerably. The raw material prices have risen sharply Q-o-Q mainly due to high rubber prices as it constitutes around 60% of total raw material, both in volume and value terms.

With the expected rise in rubber prices, the financials are expected to weaken further.
Cane Pricing Fixed

Sugarcane price fixed at ₹2000 per tonne for 2011/12: The Karnataka Government has fixed sugarcane price at ₹2000 a tonne supplied to government-run factories for the crop year 2011-12. (The Hindu Business Line, August 19, 2011)

- PRU Analysis

Sugar in India is primarily produced in nine major states. Maharashtra and UP are the leading producers, contributing around 37% & 22%, respectively, to the total production. Sugarcane and sugar production in India is cyclic in nature, typically following a 4-6 year cycle, wherein 2 to 3 years of higher production are generally followed by 2 to 3 years of lower production.

From the 2009-10 season, the central Government decided to fix fair and remunerative price (FRP) as the price to be paid by the sugar mills to the cane farmers, instead of the Statutory Minimum Price (SMP) earlier. The Centre also specified that any state government fixing a price for the crop above the FRP would have to bear the difference themselves. FRP is linked to a basic recovery rate of 9.5% and a premium of ₹1.53 is received for every 0.1% increase in recovery rate above 9.5%. Recovery rate is the sugar produced from the crushed cane.

Some state governments announce State Advised Prices (SAP) for sugarcane for their sugar factories. The SAP system is currently followed in Punjab, Haryana, Gujarat, Uttar Pradesh and Tamil Nadu and generally the SAP price is way higher than the FRP and the respective governments bear the difference between the SAP and FRP.

Also, in a bid to procure high quality and quantity of sugarcane, the sugar mills many times pay a price even higher than the SAP. In states where SAP is not followed, the millers decide on the cane pricing.

The FRP fixed by the central government for the 2011-12 season is ₹1450 per tonne, a Y-o-Y increase of 4.2% (In 2010-11, the FRP was ₹1391.2 per tonne). The Karnataka government has fixed a sugarcane price of ₹2000 per tonne for the government run sugar factories while the final price for cane supplied in 2010-11 has been fixed at ₹1900 per tonne.

The Maharashtra state government has advised millers to restrict the initial price paid equal to the FRP initially so that the farmers can avail bank loans for sowing the crop. However, a final price will be decided later and paid accordingly by the millers. Punjab government had announced the SAP for the state in the beginning of the year and fixed it at ₹2300 per tonne. The farmers in UP have been demanding ₹2600 per tonne but the millers have stated that they won’t be going beyond the last year’s SAP price of ₹2050 per tonne.

- PRU View

Buoyed by the higher prices received by the farmers from the millers (in many cases, the price paid was higher than the SAP & FRP), the farmers have increased the acreage of sugarcane in the country during the current season. According to the latest data available, the sugarcane acreage has increased by 6.1% Y-o-Y to 51.13 lakh hectares which is more than the average area sown for a year, a trend similar to last year.

The cane growers are demanding very high prices for the current season (In UP, farmers are demanding ₹2600 per tonne). The expected oversupply situation in the country for this year and the next along, with the government not allowing enough exports to reduce the stock levels, has resulted in a steady decline in domestic sugar prices. Sugar manufacturers are already making losses by being forced to sell sugar at prices lower than their cost. If the demands of the farmers are met, the cost of production would rise above the

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<table>
<thead>
<tr>
<th>Sugarcane Pricing (₹ per tonne)</th>
<th>2010/11</th>
<th>2011/12</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SAP</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UP</td>
<td>2050</td>
<td>NA</td>
</tr>
<tr>
<td>Punjab</td>
<td>2000</td>
<td>2300</td>
</tr>
<tr>
<td>TN</td>
<td>1900</td>
<td>NA</td>
</tr>
<tr>
<td><strong>FRP</strong></td>
<td>1391</td>
<td>1450</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Kharif Sowing Area (Lakh hectares)</th>
<th>WPI Index Weight</th>
<th>As on August 5</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sugarcane</strong></td>
<td>0.6</td>
<td>51.1</td>
</tr>
<tr>
<td></td>
<td><strong>2011</strong></td>
<td><strong>2010</strong></td>
</tr>
<tr>
<td>Sugarcane</td>
<td>48.2</td>
<td>6.1%</td>
</tr>
<tr>
<td>Sowing As % Of Normal Area</td>
<td>111.2%</td>
<td>104.8%</td>
</tr>
</tbody>
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August 24, 2011
current selling price that would hurt the financials of the sugar companies even further.

The table gives a snapshot of 45 sugar companies that have declared their results for the June 2011 quarter. Sales for the June quarter have increased by 8% Y-o-Y. The EBITDA margin has improved — on a Y-o-Y basis — due to low cost inventory but at the PAT level, the industry is still loss making.

Sales for the June 2011 has declined by 3% on a Q-o-Q basis. EBITDA margin has declined sharply which has led to a loss for the quarter.

### Declining Crude Polymer Prices

**Polymer prices fall on low crude, naphtha prices:** Polymer prices, after rising for less than a month, fell once again in the domestic market following low crude oil and naphtha prices globally. *(Business Standard, August 19, 2011)*

- **PRU analysis**

Domestic polymer prices had picked up in month of July in tandem with international prices. International polymer prices had risen following the rise in crude oil prices. Crude oil prices (brent crude) after softening for two consecutive months rose by 3.5% in July M-o-M to hit $116/p per barrel.

It can be mentioned here that naphtha is used as a feedstock for manufacturing of polymers. Naphtha normally is a distillation product from petroleum. Ethylene and propylene in turn are produced through thermal cracking also known as steam cracking, using naphtha as a predominant feed. Ethylene is then mixed with catalysts to produce polymers.

International crude oil prices have witnessed a dip after downgrade in credit rating of US. This attributable to demand softening on expectation of economic slowdown in the US.
Falling crude oil prices have led to drastic decline in price of naptha across the globe. Naphtha prices are currently hovering around $920/ per tonne, a decline of $80-90 from its peak of $1,007 per tonne in the third week of July.

This has drastically brought down the raw material cost for petrochemical manufacturers which use naphtha as feedstock for manufacturing polyethylene and polypropylene and related polymers.

Among petrochemical manufacturers in India, Indian Oil Corporation (IOC), GAIL and Reliance Industries have slashed low density polyethylene (LLDPE) prices by ₹1500-2000 a per tonne or ₹1.5 - 2 per kg across varieties.

The price decline can be attributable to other reasons as well. Domestic demand is also slowing down as user industries are deferring purchase decisions in anticipation of further fall in crude prices which will result in even lower polymer prices in future.

Low Density Polyethylene (LDPE) is the most popular variety of polyethylene and is widely used.

However, domestic price of High Density Polyethylene (HDPE) and polypropylene remains firm. In India, there is anti-dumping duty for import of polypropylene which discourages imports hence helps in keeping the price firm.

International price of HDPE has fallen by almost $55 per tonne since beginning of this month and currently hovering around $1,385 per tonne.
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