PONNI SUGARS (ERODE) LIMITED

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Speech of
Sri N GOPALA RATNAM, Chairman
at the 23rd Annual General Meeting of the
Company on Tuesday, 23rd July 2019
at New Woodlands Hotel Pvt Ltd,
72-75 Dr Radhakrishnan Road,
Mylapore, Chennai 600 004

Ladies and Gentlemen:

I have great pleasure in welcoming you all to this 23rd Annual General Meeting of the company. With your permission, I shall take the Annual Report for FY 2018-19 that has been with you for some time as read.

FY 2018-19 at start seemed to pose ominous threat and overwhelming challenges for the company. It is heartening that later developments helped mitigate the hardship, minimise the pain and shore up our financial performance. I would delve on these while dealing with our company performance a little later.

Your Board has recommended a dividend of ₹2.00 per Equity Share for the year as against ₹1.00 per share last year.

Macro Economy – Global

After strong growth in 2017 and early 2018, global economic activity slowed notably thereafter. The global growth is now projected by IMF to decelerate from 3.6% in 2018 to 3.3% in 2019. Of this, share of Advanced Economies would be 1.8% as against 4.4% for Emerging Market and Developing Economies. Adverse geopolitical developments and trade tensions are seemingly taking a toll on business and consumer confidence. It cautions that lack of investment in traditional non renewable energy sources would have implications for oil deficit emerging market economies like India, as renewable sources of energy are inadequate to plug the medium term demand-supply gap.

RBI in its June 2019 bulletin has underpinned the losing pace of global economic activity after an improved show in Q1:2019, reflecting further slowdown in trade and manufacturing. Economic activity in the Euro area has remained weak due to muted industrial activity and weak business confidence, with the outlook further clouded by the uncertainty relating to Brexit. Economic activity in the US has however strengthened due to higher Government funding, increase in private investment and a lower trade deficit.

IMF projects a pick up in the second half of 2019 predicted on ongoing build up of policy stimulus in China, recent improvements in global financial market sentiments and gradual stabilisation of conditions in stressed emerging market economies. By contrast, advanced economies would slow down gradually as the impact of US fiscal stimulus fades.

Macro Economy – India

Indian economy has shown remarkable resilience amid global headwinds. The size of the economy witnessed a whopping 50% rise in the five years since 2014. It is poised to become a US$ 3 trillion economy in the current year itself, while the Government has resolved to reach US$ 5 trillion mark in the next two years. The Economic Survey 2018-19 underpins the need to sustain a real GDP growth rate of 8% to achieve same. For this, it has emphasized the role of investment, especially private investment, as the 'key driver'.

India is now the 6th largest economy in the world and in terms of purchasing power parity we are in fact the third largest economy, next only to China and the USA. India is also the top ranked economy in the South Asia. It has moved to 77th rank in the World Bank's 'Ease of Doing Business' survey 2019. It is further expected to stay unchanged as the fastest growing emerging market economy.

Our GDP growth for 2018-19 is now pegged down to 6.8%. Average inflation in the last five years was less than half the inflation level of the preceding five years, matching the lowest levels attained in the country's post independent history. The current account deficit remains within manageable level while foreign exchange reserves have risen to all time high, emboldening the Government to meet part of its gross borrowings from external markets in external currencies.

India however requires to undertake many structural reforms to achieve 8% GDP growth. The Government has already done well in terms of reforming the indirect tax system through GST and bringing in the insolvency and bankruptcy code for swift resolution of troubled accounts. Labour code consolidating large numbers of Central enactments has already been cleared by the Union Cabinet and should soon receive the nod of Parliament. It is certainly within our capability to achieve the set goals that however demands steadfast focus and sedulous drive.

World Sugar

World sugar output in 2018-19 season was initially envisioned to end with a modicum of deficit but is now expected to post a moderate surplus. It is due to late surge in production from India and Thailand. Indeed, India decisively dethroned Brazil this year after a decade and more to become the top sugar producer, while continuing to retain its *numero uno* status as the top consumer.

Despite world output reducing by 4.5 million tonnes, 2018-19 records the second largest sugar production. Further, the high stock environment is far from over. Despite distinct and definitive signalling for returning to the deficit phase in 2019-20, global sugar prices hold little promise and limited prospects for resurgence, weighed by the humongous stock pile.

A virtual collapse in world sugar prices was virtuously averted, thanks to Brazil allocating about two-third of cane, an all time high mix, for ethanol production. At current levels of price parity between sugar and ethanol, it is likely that such a historic high allocation of cane for ethanol would as well continue in the coming year. The concomitant cut in sugar production has capped closing stock correspondingly.

Indian Sugar

Sugar production in 2018-19 has since crossed the record production of the previous season. The twin years of 2017-18 and 2018-19 registering record production, surplus and stock pile lamentably led to a veritable collapse in sugar prices in early 2018. No wonder, sugarcane price arrears mounted to monstrous levels.

Sensing the gravity of problem on hand, Government of India swiftly responded with the usual, and this time a couple of unusual, measures to check the malice. Traditionally, Government intervention in pricing is by way of minimum support price for agricultural commodities, while essential industrial products are fixed with maximum selling price. Such an approach is unexceptionable so as to protect the farmer in the case of former and consumer in the case of latter. In a unique and well meaning departure from conventional wisdom, Government chose to mandate a Minimum Selling Price (MSP) for an industrial product, viz. sugar this time, warranted by the symbiotic structure of the relationship between the industry and farmers.

This singular move at once stemmed the sloppy fall and stoked sugar prices up. One is dreaded to think of the level of sugarcane price arrears in the country but for this bold and imaginative measure. Fact however remains that sugar prices weighed by demand-supply disequilibrium continue to hover only around the MSP that is decidedly below cost of production. This is all too evident from the decline but not disappearance of sugarcane price arrears. Having taken the right call, the Government should go the full distance and rise the MSP closer to the cost of production of sugar, so long as fixed cane price regime continues so that the two move in tandem.

The other major policy booster is on the ethanol front. The cane price in India is about 60% higher compared to other major sugar producing and exporting countries that follow a market based revenue sharing model. As a result, sugar exports are unarguably uncompetitive and outright unviable for Indian producers. Government subsidies aimed at bridging the price gap have also become a matter of grave challenge before WTO. Accordingly, in lieu of solely relying on export route to de-clog sugar surplus, the Government has imaginatively come out with a pricing model to boost ethanol production.

Taking cue from the proven Brazilian model, the Government has devised a pricing mechanism to facilitate dynamic switch between sugar and ethanol. In this endeavour, it has come out with a differential pricing model that for the first time offers a premium for ethanol produced from different stages of sugar manufacturing and the quantum thereof is logically linked to the level of sugar substitution. Concurrently the Government has incentivized the creation of new and additional ethanol production capacities in the country with interest subvention support. While this may not help in instant correction of the surplus sugar on hand, it is indeed a game changer, laying the foundation for long term stability and sustainability of sugar industry.

While so, there is now increasing emphasis on electric vehicle with an intent to totally displace petrol driven vehicles in the near future. Yet, old vehicles would continue to form a large chunk of our fleet for many years to come. I do hope the current hype on electric vehicles does not dilute or deviate from the well-meaning thrust on an eco-friendly fuel like ethanol. Policy making must clearly be for the long term and all forms of eco-friendly automobiles deserve their due place and policy support in the bargain.

Sugarcane

International Sugar Organization (ISO) has done a survey on cane and beet payment system. Its June 2019 report shows the diversity of cane and beet payment system in vogue around the world. As per its primary findings, majority of the sugar producing countries follow a revenue sharing system for cane price. Further, the price for delivered cane is not just based on the weight but also on its quality determined by the sucrose content. It is time India aligns its cane pricing on such well founded rationale in a globally integrated sugar economy.

While arbitrarily fixed high cane price is certain to price Indian sugar out of global market, there is no denying that the farmers' lot do need definitive improvement. This however must come out of improved crop productivity and optimised cost structure. While India's record in respect of agricultural yield remains too poor for most crops, sugarcane is just the contrarian with yields comparable to global norms, thanks to the active and continual engagement of sugar mills with the sugarcane farmers and the commendable role played by our sugarcane research institutes. One can't however rest on laurels.

Innovation through GM technology has proved hugely successful in the case of cotton in our country. Regrettably, there is considerable slackening in embracing genetically modified organisms for other crops. Recent media reports indicate that farmers in large number in Maharashtra have chosen to defy Government bans and deploy GM seeds for select crops. No doubt, the underlying concerns in growing a transgenic crop needs holistic evaluation and environment concerns effectively addressed and efficaciously eliminated. The progress on this till date is painfully slow. It is time that Government constitutes a high level expert committee to study the scope of GM technology for major crops. It must come out with a white paper and clear roadmap for tapping GM technology for diverse crops, including sugarcane.

Electricity Reforms

Electricity reforms initiated since the advent of Electricity Act, 2003 virtually turned the country from shortage to surplus and paved the way for precipitous fall in the price for electricity in the exchange platforms. There however remains catenae of problems crying for urgent policy intervention. The frail financial health of State Discoms has become contagious and in our State payment for electricity gets delayed by more than a year. It is gratifying to observe that the Union Power Ministry has since approved the implementation of a payment security mechanism for IPPs. I do hope that this is not just confined to IPPs but get extended to renewable energy producers like bagasse based cogeneration.

The Hon'ble Finance Minister in the Budget Speech has underlined the urgency for electricity reforms. She has emphasized that the Centre would work with States to remove barriers like cross subsidy surcharges, undesirable duties, etc. The GST has been a game changer in moving towards 'one country-one tax' concept by subsuming multitude of levies. Presently electricity producers and consumers are faced with multitude of tariffs and taxes. There are parallel operation charges, captive consumption tax, cross-subsidy surcharge, scheduling and system operation charges, et al. It is time under the proposed reform electricity is brought under GST and a simple and composite pricing model is adopted, leaving the subsidies for deserving consumers to be met through direct beneficiary transfers.

Sugar distress in Tamil Nadu

In striking contrast to the surfeit of cane and surplus of sugar production in other parts, Tamil Nadu has been the lone victim and solitary sufferer by dint of successive years of monsoon failure. The State has slipped from 4th to 8th rank in sugar production and slid to the bottom of sugar recovery chart in 2017-18.

One-third of the private sector mills have remained shut for more than one season, while the remaining operate for hardly one-third of their capacity. As a result of gross under capacity utilization, their cost of production is almost one-third higher than their peers in other parts. Force majeure conditions have forced sugar mill operations to suffer heightening losses and heinous cash deficits.

I am deeply saddened to observe that a number of established sugar players in our State have been classified as NPA by the Banks, while one has already been pushed to IBC process by the NCLT. All this undeniably underscores the deep stress and despicable state of sugar industry in the State. SISMA-TN, the industry body, has made repetitive pleas to the State Govt for urgent policy intervention and appropriate financial relief package.

Recognizing the imperative to innovate on new cane varieties, private millers together had launched a 'sweet bloom' project in collaboration with the Sugarcane Breeding Institute. The objective is to identify and introduce cane varieties that are high yielding, high sucrose content, drought resistant and relatively shorter duration. A couple of varieties have been shortlisted after successful experiments at the demo plots and these would be scaled up to fields in the coming season. The outcome of this experiment is too critical for the commercial viability and long term sustainability of the industry in our State.

Company Performance

The Board's report along with the Management Discussion and Analysis report gives a descriptive account of our company performance in FY 2018-19. I am happy to state that our prognosis and pessimism at the start of the year mercifully turned mis-proved. The benevolent south-west monsoon in Karnataka last year led to copious flow in river Cauvery, filling the Mettur reservoir to its full capacity. With water access made available for about two-third of our command area covered under canal irrigation, we could readily witness higher cane productivity and improved sugar recovery.

Sugar prices recovered from their rock bottom, piggybacking on the Government mandated minimum selling price, while the price of by-products vaulted to record high levels. Our concerted efforts to procure and use disparate varieties of bio-fuel helped in fuel cost optimisation and strident step up in power production and sale that touched an all time high. As a combined effect, we could end the year on a comforting note.

Power dues from TANGEDCO remain a major cause for concern, the delay now stretching to over a year. We have largely been helped by the interim order of the Hon'ble High Court of Madras for selling sugar in excess of the mandatory monthly quota. The additional cash generation therefrom has eminently ensured that our cane payment remains on track. Inexplicably, the Government of India chooses to enforce its policies conceived in the interest of surplus sugar producing regions to a State like Tamil Nadu that is discernibly deficit in production and facing distinctly different set of problems. Despite repetitive representations, it has shown little response to move from its 'one size fits all' concept.

In the light of formidable challenges being faced by sugar companies in the State, it gives me immense pleasure to inform our valued shareholders that our company could end the year with an improved bottom-line and double its dividend payment.

Performance for Q1/ FY 2019-20

The first quarter predominantly represents our off-season with dwarfed days of crushing operations. Power production however was undertaken on standalone mode with little recourse to the expensive coal and mobilizing cost effective bio-fuels. Indeed, our power production and sale is on par with the record level achieved during the same period last year. The margins however are massacred by the massive delay in realization that are in clear defiance of tariff regulations.

Sale volume of sugar surged up but prices continued to remain unviable. The South-west monsoon has covered much of the June month deficiency since the beginning of July 2019 in rest of the country. But in Tamil Nadu, the rainfall is still one-half below the long period average.

The financial results for the quarter would be considered by the Board after the conclusion of this meeting. They would be filed with the Stock Exchanges and uploaded on the company website later in the day.

Outlook for FY 2019-20

Much of the challenges persist and would continue to daunt the industry in FY 2019-20. The decline in global and Indian sugar production isn't decisive enough to correct the huge stockpile, thereby denting the prospects for an upsurge in sugar prices. Defying initial forecast, the south-west monsoon is menacingly deficient in the southern peninsula and in particular our State. Fresh planting is slothful, while cane yield and sugar recovery would be under stress.

Standalone power production during off-season is an available option to supplement our revenues and strengthen the profitability. However, the inordinate delay in the realization of the power dues and consequent increased interest burden often times evaporates our calculated margins. We thus remain constrained in being able to leverage our Cogen capacity to its full potent.

As observed in the Board's Report, the company is currently weighing the options for setting up ethanol production facility. It has since received the in-principle approval of the Central Government for interest subvention support for a total debt of ₹57.80 crores for this project. There however still remains a host of risks and uncertainties primarily caused by the persistence of drought and consequent curtailment in feed stock availability for ethanol production. Your Board would take an appropriate call on this project in due course.

Amidst these adversities, we remain steadfastly focused and committed on cost control measures and cane development initiatives. Closer and continual interaction with our farmers, engaging alongside outside experts, has enthused them adapt to challenging times. Micro irrigation is being intensively promoted by our company offering 100% interest subvention support for the entire loan tenure.

In sum, we have formidable challenges on hand but with our strong financial foundation and committed team of employees, we remain undaunted, would valiantly face the headwinds and strive for positive results.

Acknowledgement

Our sugarcane farmers braving drought and other adversities have shown remarkable resilience in cultivating and supplying cane to us and I profusely thank them for same. I greatly appreciate the committed role of our employees in optimising our operational performance.

I thank all Government officials, Banks and customers for their understanding and support. I hasten to acknowledge the wise counsel and guidance received from my colleagues on the Board. I wish to place my appreciation for the valued contribution rendered by Mr N R Krishnan as independent director who retired at the close of our financial year in March 2019. Above all, I sincerely convey my deep sense of appreciation and thanks to our valued shareholders for showing unstinted support in all our endeavours.

Thank you

Note : This does not purport to be a record of the proceedings of the Annual General Meeting.