

THE OUDH SUGAR MILLS LIMITED

Management Discussion and Analysis

The Management of The Oudh Sugar Mills Ltd. (OSM) is pleased to present its report analysing the Company's operations in its various business segments and its future prospects based on the current prevailing market conditions. Its main business segments include manufacturing of sugar and its by-products, industrial alcohol, bio-compost and fruits & vegetable products. Sugar, which constitutes 81.64 % OSM's total sales, is produced at three sugar factories situated at Hargaon and Rosa in Uttar Pradesh and Narkatiaganj in Bihar. Industrial Alcohol and Bio-Compost (organic fertilizers) are produced at its distilleries at Hargaon and Narkatiaganj. Fruits & Vegetable products are produced at Allahabad Canning Co., Allahabad (U.P.). A segment-wise analysis is presented below:

A. SUGAR

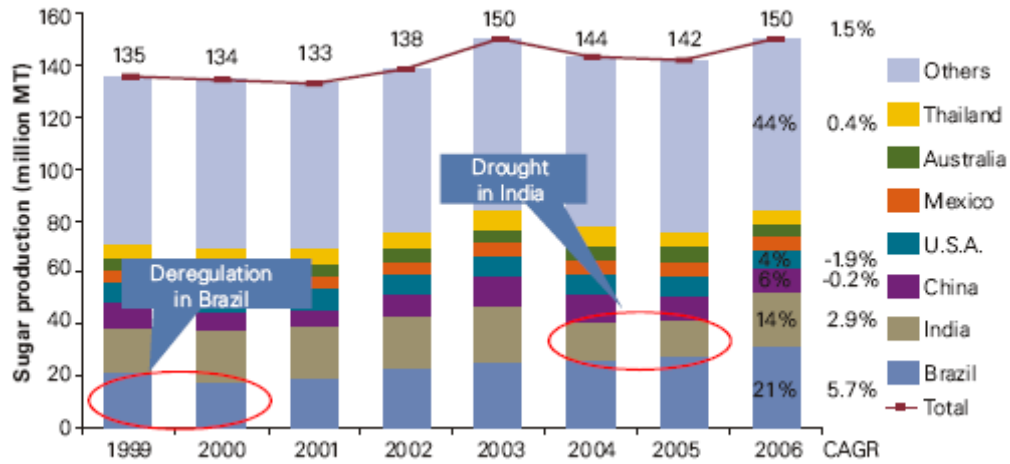
1. Global sugar overview

The world sugar market has entered a distinctive surplus phase, characterised by a significant excess in global production over consumption and export availability considerably higher than projected import demand. The gap between production and consumption has increased to a record high of 10.288 million tonnes during 2006-07. The sugar industry worldwide is regulated in nature. This is primarily because of the perishable nature of cane, the need to influence domestic prices and the landholding structure. The global sugar economy is largely influenced by Brazil as it is the lowest cost producer and largest exporter of sugar. India is also a large player in the global sugar market primarily because it is the largest consumer and the second largest producer of sugar.

a) Production

The world sugar production is expected to increase by 7% and reach 165.508 million tonnes in the sugar season 2006-07. The world sugar production has been increasing steadily at a CAGR of 1.5%. Brazil, India, China and U.S.A are the major sugar producing countries accounting for 45% of the total sugar production. EU collectively produces around 14% of the total sugar production. Brazil as the largest producer of sugar has increased its production at a rate of 5.7% CAGR over the last 7 years since 1999-00.

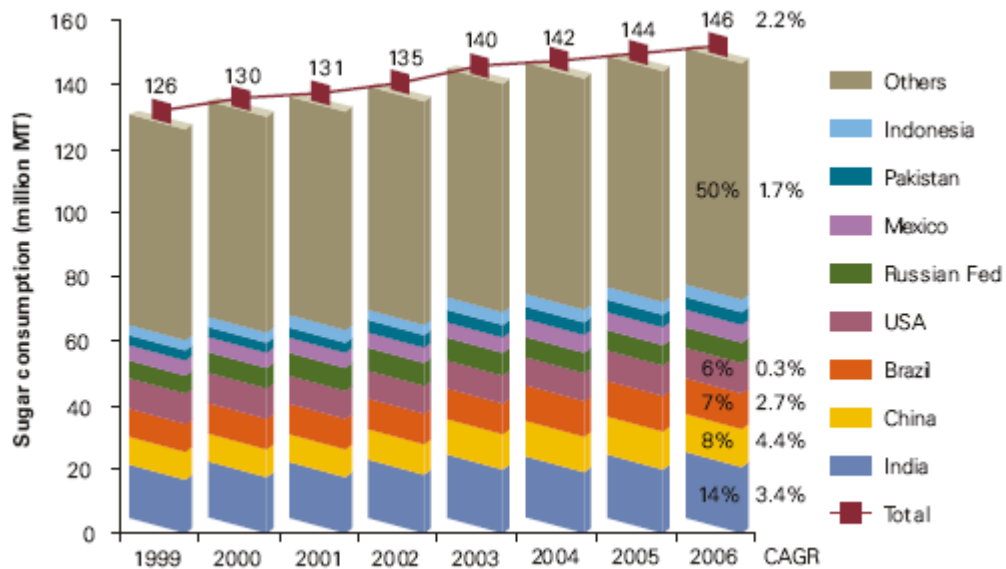
World sugar production (1999-2006)



b) Consumption

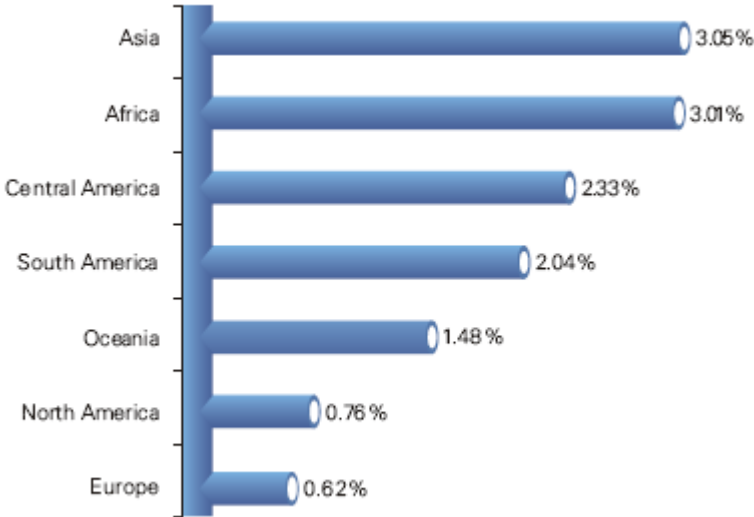
The total world consumption of sugar is at 155.220 MMT of sugar. India is the largest consumer of sugar followed by China, Brazil, USA and the Russian federation. Consumption in China, India and Brazil is growing at a rate higher than the world average of 2.2%. Going forward, these countries will play more and more important role in the global sugar consumption.

World sugar consumption (1999-2006)



The highest consumption growth in sugar is viewed in Asia, Africa and Central America with CAGR of over 2%. This is primarily aided by the high GDP growth rates and increasing population in these countries. The sugar consumption growth in developed economies like North America and Europe are the lowest at 0.7 percent and 0.6 percent CAGR respectively.

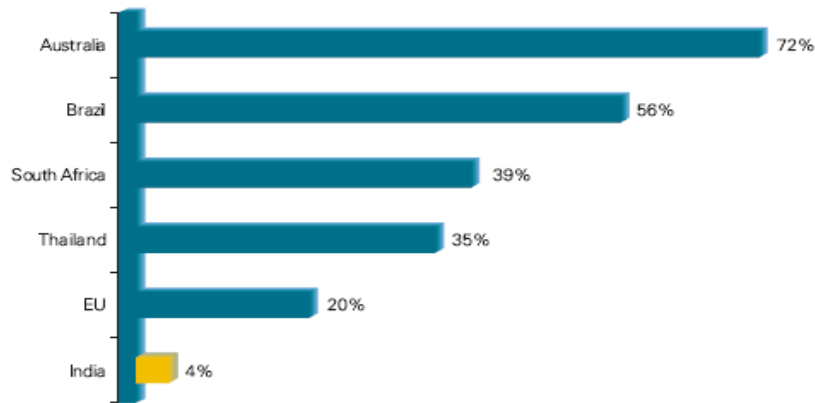
Consumption growth CAGR (1997-2006)



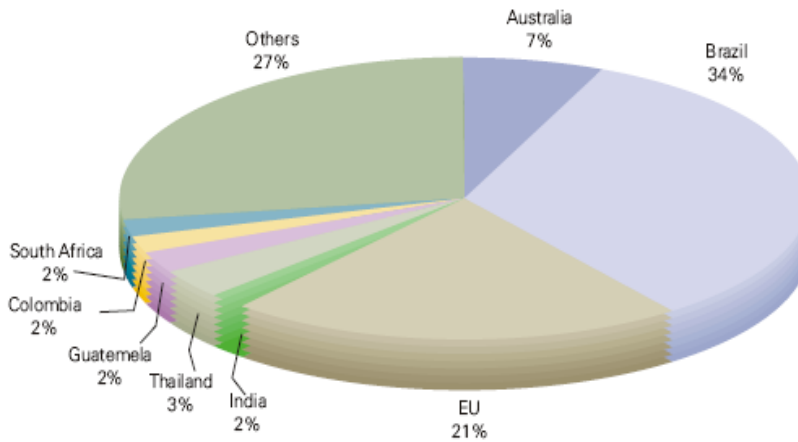
c) International trade

All the major producers of sugar in the world are the largest exporter of it as well. Australia exports around 72% of its production, while Brazil exports 56% of its production. Though India is one of the large exporters of sugar (exports around 2% of the global sugar exports), it has the unique advantage of being the largest consumer of sugar in the world and thus not really has larger dependence on the exports. It is largely insulated from the global sugar price variations. Though in case of a global surplus, domestic prices of sugar tend to get influenced by low global prices since exports from India are less viable.

Exports as a percentage of total production (2006)



Major sugar exporting countries in 2006



d) World sugar balance

The International Sugar Organisation (ISO) has estimated a higher global sugar surplus of 10.288 million tonnes million tonnes for the year 2006-07. Global sugar output is estimated at 165.508 million tonnes against a consumption demand of 155.220 million tonnes. World consumption is projected to grow by 2.4%, only a fraction down from the 10-year average of 2.3%.

World sugar balance (million tonnes, raw value)

	2006-07	2005-06	Change	
			In million tonnes	In %
Production	165.508	152.079	13.43	8.83
Consumption	155.220	149.859	5.36	3.58
Surplus/deficit	10.288	2.220	8.07	
Import demand	45.952	46.676	-0.72	
Export availability	45.939	46.689	-0.75	
End stocks	67.229	59.764	7.45	12.46
Stock/consumption ratio (%)	43.30	39.88		

e) Pricing

As a result of heavy surplus production of sugar worldwide, together with significant longer term investments in the world sugar market during the past 12 months, world sugar prices faced huge southward pressure. It is not expected that this mood will change within a short period of time but with gradual cyclical advancement of the industry, the prices will shift northwards in the medium term.

2. Indian sugar overview

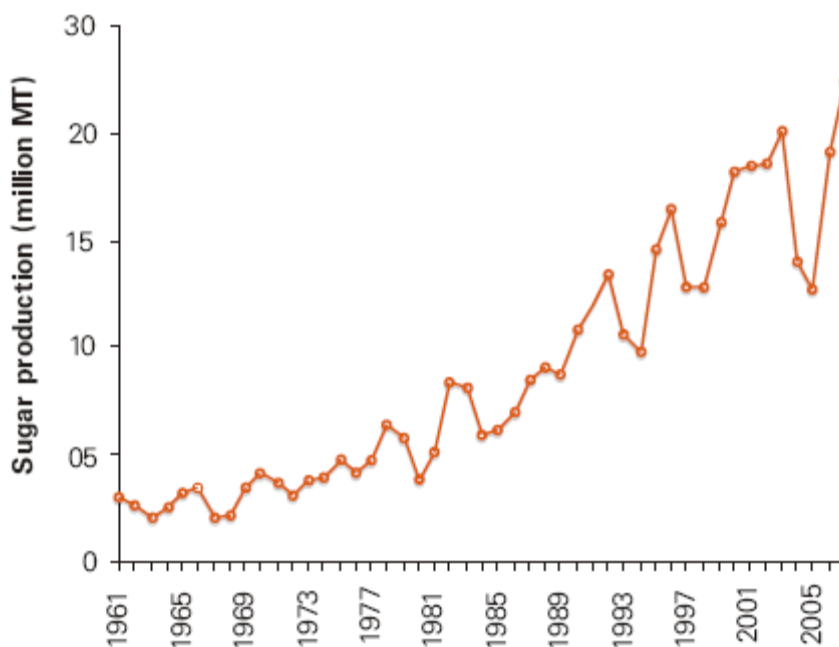
Sugar is a sector of significant importance to the national economy. At present, the sugar industry is regulated across the value chain and the sector has struggled to generate a return on invested capital in excess of its cost of capital in the last few years, primarily due to a high mandated fixed cane prices and a volatile sugar prices.

a) Production

Sugar is produced in India primarily in nine major states. In 2006, the six states of Andhra Pradesh, Gujarat, Karnataka, Maharashtra, Uttar Pradesh and Tamil Nadu produced more than 1 MMT of sugar per annum each, with the three states of Bihar, Punjab and Haryana producing less than 1 MMT of sugar. In 2006, these states accounted for 94% of the total sugar production in India with Maharashtra and Uttar Pradesh leading with 27% and 30% of the total production.

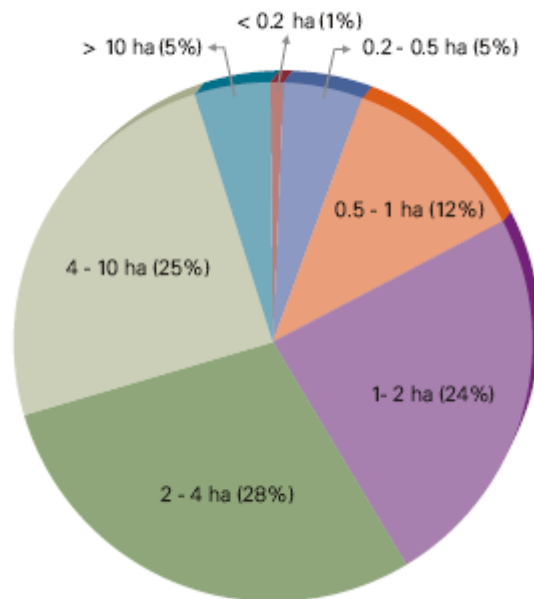
Sugar production has been increasing steadily but there have been periods of low production, due to a variety of reasons including pests and drought. Production has been cyclical, with the typical cycle duration ranging between 4 to 6 years. The Indian sugar production has grown at a CAGR of 6% over the last 4 decades.

Indian sugar production over the years (1961 - 2007)



The sugarcane production in India is unique in various aspects. The key characteristic among them is the small landholding size. The landholding size of 4 hectares or more is present in only 25 percent of the area under sugarcane cultivation. The bulk of the land under sugarcane is between 1 and 4 hectare.

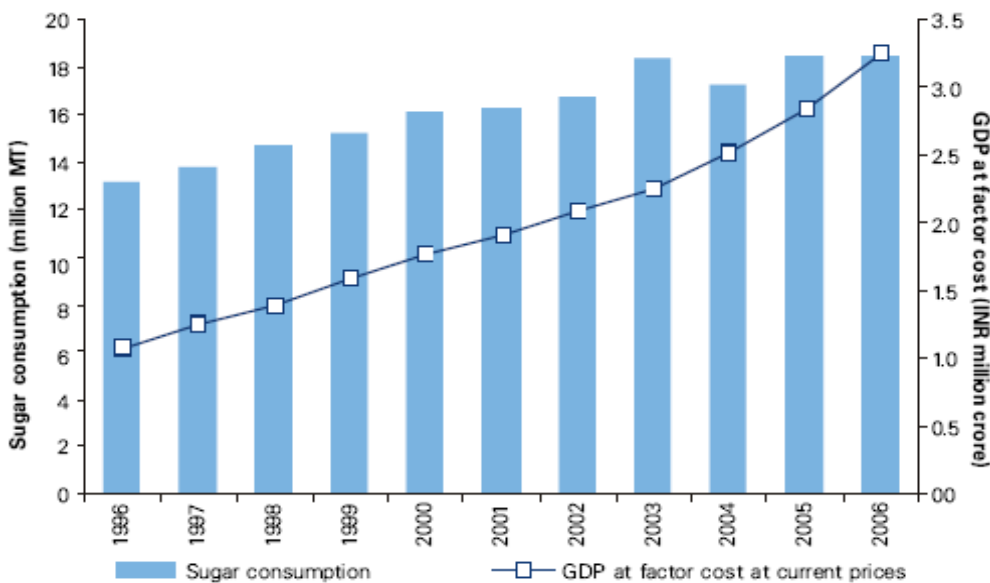
Distribution of area under sugarcane for different size of landholding



b) Consumption

The Indian sugar consumption has steadily increased at 3.5% since 1996. Sugar consumption is driven by the GDP growth and this has been the case for India as well. The per capita consumption has seen a steady growth of 2.1% CAGR over this period, while the population has grown at a CAGR of 1.4%.

Sugar consumption and GDP over the years (1996 - 2006)



3. Government policies

- a) Indian sugar industry is highly regulated. The government controls the entire sugar value chain activity from cane sourcing to pricing to distribution of the sugar.
- b) The free sugar to levy sugar ratio in India is 90:10 which is being continued by the government since the last 2 years.
- c) With oversupply of sugarcane in the market there is overproduction of sugar that has led to a sugar surplus of 7.8 mt in 2006.
- d) Estimated demand & supply of sugar in India (in million tonnes)

Sugar Equation (million/tonnes)

	2002-03	2003-04	2004-05	2005-06	2006-07*
Opening stock	11.32	11.62	7.67	4.00	3.90
Production	20.14	14.00	12.69	19.27	28.50
Imports	0.04	0.40	2.14		
Total supply	31.50	26.02	23.34	23.27	32.80
Consumption	18.38	18.13	18.50	18.24	20.00
Exports	1.50	0.22	0	1.13	2.00
Total demand	19.88	17.51	18.50	19.37	22.00
Closing stock	11.62	7.67	4.00	3.90	10.80
Closing stock/consumption	63.17%	49.18%	21.62%	21.38%	54.00%

*Estimated

4. Sugarcane pricing

In India, the government announces a minimum support price for sugarcane. The price announced by the central government is termed as Statutory Minimum Price (SMP). The Central government fixed the SMP for sugarcane at Rs. **80.25** per quintal linked to a recovery of **9.00%** for the sugar season 2006-07.

Furthermore, factories are required to pay an additional price under Clause 5A of Sugarcane (Control) Order, 1966, which is calculated by the Government based on any additional sugar price realized by the factories.

Basic Statutory Minimum Price (Rs. per quintal)

	2006-07	2005-06
Hargaon	94.65	91.82
Rosa	82.05	82.14
Narkatiaganj	82.95	83.90

5. Levy sugar prices

The price of levy sugar for the Company's sugar factories for the season 2003-04 was fixed and is given in the table below. The Government is yet to fix the levy sugar prices for the season 2004-05, 2005-06 and 2006-07. The industry has represented to the Government to finalize the levy prices urgently.

Levy price for Season 2003-2004 (Rs. per quintal)

Hargaon	1383.41
Rosa	1330.77
Narkatiaganj	1409.30

6. Operations

- The Company's gross sales decreased by **11.46 %** from Rs. 52871.61 lakh in 2005-06 to Rs. 46812.06 lakh in 2006-07.
- The company reported a net loss of Rs. 2689.55 lakh in 2006-07 compared to a net profit of Rs.4536.51 lakh in 2005-06.
- 12.57% increase in the income from distilleries from Rs.1168.24 lakh in 2005-06 to Rs.1315.14 lakh in 2006-07.
- The Company was able to achieve significant cost savings due to its superior technical capabilities and usage of state-of-the-art machineries at the plant level.
- Despite huge glut in the industry the Company was able to contain the losses to a minimum level with proper control on the processes and better management of the resources and remains better off than its competitors.
- Going forward, the Company wants to make a strategic shift towards making of higher quality of sugar and thus invests on R&D of the crop plantation and creating awareness among the farmers to make a long-term sustainable product portfolio.
- The Company crushed higher quantity of sugarcane at **290.04** lakh quintals in 2006-07 as against **233.59** lakh quintals crushed during the season 2005-06, an increase of about **24 %**. This increase was due to significantly higher crushing at the Hargaon factory due to the expansion of crushing capacity and increased availability of sugarcane. The crushing operations at Rosa and Narkatiaganj factories improved significantly during the season 2006-07. Due to increased crushing, the production of sugar was higher at **27.81** lakh quintals during the season 2006-07 as against **23.01** lakh quintals during the season 2005-06.

The comparative operational figures of the sugar factories for the last two seasons:

	Season 2006-07			Season 2005-06		
	<u>Hargaon</u>	<u>Rosa</u>	<u>Narkatiaganj</u>	<u>Hargaon</u>	<u>Rosa</u>	<u>Narkatiaganj</u>
Sugar cane crushed (lac quintals)	145.77	69.53	74.74	105.45	57.25	70.89
Recovery (per cent)	10.40	9.55	8.06	10.56	9.23	9.30
Sugar produced (lac quintals)	15.15	6.64	6.02	11.14	5.28	6.59
Crushing days	177	173	147	163	160	129

7. Future outlook

World sugar prices have been under continuous bearish pressure during most of 2007. The significant excess of global production over consumption has depressed sentiments leading to a sharp fall in sugar prices during the year. It is estimated that sugar production will further increase by 4.1 mln tonnes during 2007-2008 which would only accentuate the problem. World sugar production is expected to reach a new record of 169.584 mln tonnes against a consumption estimated at around 158.784 mln tonnes during 2007-08 with a surplus of 10.80 mln tonnes.

The global outlook of sugar in different countries of the world is briefed below.

Brazil

Brazil may produce 32.5 million tonne of raw sugar this year, 17% more than last year, according to F.O. Licht. Trading houses posted notices on June 29 that 604,000 tonne of raw sugar would be delivered for the July contract, with a surprising 389,000 tonne from Brazil, Fimat USA LLC in New York. Sugar for October delivery fell 0.28 cent, or 2.9%, to 9.24 cents a pound on the NYBOT, the biggest drop for a most-active contract since June 5 and the lowest closing price since June 15. Futures dropped 44% in the past year.

EU

The reduction in EU exports, which started in mid 2006 as a result of a WTO ruling, is scheduled to continue till 2010. It is expected to lead to redistribution of global trade and players like India could benefit.

US

Currently, US policy protects sugar producers and processors from competition by limiting imports and excluding lower-cost producers from open access to the market. This keeps domestic sugar prices artificially high. However, 40 countries have been given preferential access to US markets, including certain high-cost producers, such as a number of Caribbean countries. As EU reforms proceed, the U.S could come under pressure to change its sugar price support programme. Potentially, the US could end sugar subsidies and institute a buyout, as it has for peanut quotas and tobacco price supports. Restrictions on imports and domestic production could be relaxed and tariffs lowered. Although these changes would bring sugar prices down, their impact on developing countries would vary.

Thailand

Thai sugar exporters have called on the government to hold talks with India in a bid to get its sugar export subsidy removed. According to them, India announced that every tonne of sugar exported would have a subsidy of US\$32 (Bt1,108) to \$35 to support transportation costs. As a result, world prices immediately dropped by \$ 30. India's subsidy policy has directly hit major sugar-exporting countries, including Brazil, Thailand and Australia.

Pakistan

The PSMA has drawn attention of the Punjab government to bring down the minimum support price of sugarcane back to Rs 45 per maund from existing Rs 60 per maund because the subsidy, being given by the government to the tune of Rs 18 billion, had crashed the sugar market. The PSMA said that if immediate measures were not taken to bring the sugar prices to Rs 31/kg, most of the mills would suffer huge losses and would be forced to close down. The government has made arbitrary fixation of high support price of sugarcane just to please one group of stakeholder (growers) while pleasing the other stakeholder (consumer) by giving subsidy of huge amount on imported sugar.

India

The Indian sugar industry is poised for an even higher sugar production in SY 2007-08 with a production estimate of more than 30 mln tonnes and the domestic sugar demand is expected to be around 21 mln tonnes. It is expected that India will overtake Brazil as the world's largest sugar producer in the SY 2007-2008.

Even the world production is expected to rise primarily on account of a strong Indian production. The only silver lining is that plantation scheduled in November-February is likely to suffer due to delay in payment of sugarcane dues and strong prices in alternate food crops such as paddy and wheat. Part of sugarcane acreage is likely to be diverted to other food crops.

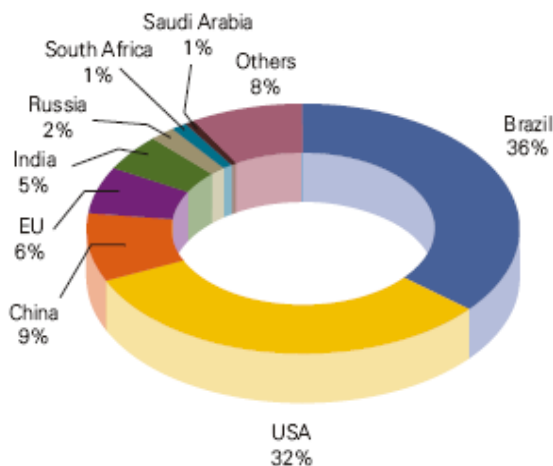
The industry is gradually shifting from standalone sugar manufacturing unit to integrated complexes through the commissioning of downstream distilleries and co-generation units that process by-products like molasses and bagasse to manufacture stable demand products such as

ethanol and power with attractive returns. By products, productivity improvements and product innovations combined with price risk management tools and international trade would help improve the industry's profitability and reduce the volatility in the production cycles. Apart from catering to the largest sugar consuming population in the world, the industry can emerge as a significant source of electric power through co-generation as well as of fuel ethanol for blending with petrol through the E5 program and beyond. The co-generation opportunity can add 9700 MW power capacity to meet almost 6% of additional power requirement by 2017 and generate almost 48 million carbon credits.

B. INDUSTRIAL ALCOHOL

- a) The major sugar producing countries are also the major ethanol producers, as sugarcane is a major raw material for ethanol production.
- b) Brazil and USA together produce more than 68 percent of the total world ethanol production. They are the largest consumers of ethanol as well in the world.

World ethanol production (2003)



- c) The blending of ethanol with petrol at 5% was mandated by the Government with effect from 1st October, 2003 in nine States and the four Union Territories but was later discontinued. Due to persistent hike in international oil prices, the Government has announced blending of petrol with ethanol at 5% from 1st November, 2006 on all India basis excepting North-East States.

Company's performance:

- a) The performance of the Company's Bio-Compost plant at Hargaon producing organic fertilizers marketed under the brand name "Oudh Shakti Jaivik Khad" was satisfactory.
- b) The production and sales of distilleries at Hargaon and Narkatiaganj were improved significantly during the year under review as the oil companies resumed purchase of ethanol.
- c) The comparative quantitative figures of production and sales of the Company's Distilleries are as under:

	2006-07	2005-06
Industrial Alcohol/Ethanol (lakh litres)		
Production		
Hargaon Distillery	130.36	93.29
Narkatiaganj Distillery	74.18	84.26
Sales (Rs. lakh)		
Hargaon Distillery	117.19	95.09
Narkatiaganj Distillery	72.89	93.99
Bio-Compost (quintals)		
Production		
Hargaon	75761	121610
Narkatiaganj	54460	53461
Sales (Rs.lakh)		
Hargaon	70261	125125
Narkatiaganj	27642	42834

C. CO-GENERATION

Some 100 sugar units across the country generate about 1700 MW of electricity per annum, of which 925 MW is supplied to state electricity boards (SEBs). Uttar Pradesh heads the list with a generation capacity of about 450 MW and an estimated 400 MW of capacity under various stages of implementation. Sugar units in Tamilnadu produce 285 MW, Karnataka 271 MW, Andhra Pradesh 171 MW and Punjab 6 MW.

The Company supplied 25 million units and 1.26 million units of power from its plants at Hargaon and Narkatiaganj respectively during the year. The Company has made a profit of Rs. 612.87 lakh on sale of power.

D. CANNING

1. The production and sale of the Company's canning division was 3427 tonnes and 3954 tones respectively during the year under review.
2. The Company has good potential for growth in the current year in terms of both production and sales.

CAUTIONARY STATEMENT

The statements in the Management Discussions & Analysis Report detailing the Company's objectives, projections, estimates, expectations or predictions may be forward looking within the meaning of applicable securities laws and regulations. As these statements are based on certain assumptions and expectations of future events, actual results could differ materially from those expressed or implied. Important factors that could make a difference to the Company's operations include economic conditions affecting global or domestic demand and supplies, political and economic developments in India or other countries, government regulations and taxation policies, prices and availability of raw materials, prices of finished goods, abnormal climatic and geographical conditions, etc. The Company assumes no responsibility in respect of forward looking statements that may be revised or modified in the future on the basis of subsequent developments, information or events.