

THE OUDH SUGAR MILLS LIMITED

MANAGEMENT DISCUSSION & ANALYSIS

[For the quarter ended 30th June, 2009]

Sugar Industry Overview

Global Sugar Scenario

Sugar, both through beet or sugarcane, is produced in 125 countries. Currently, 69% of the world's sugar is consumed in the countries of its origin, whilst the balance is traded on world markets.

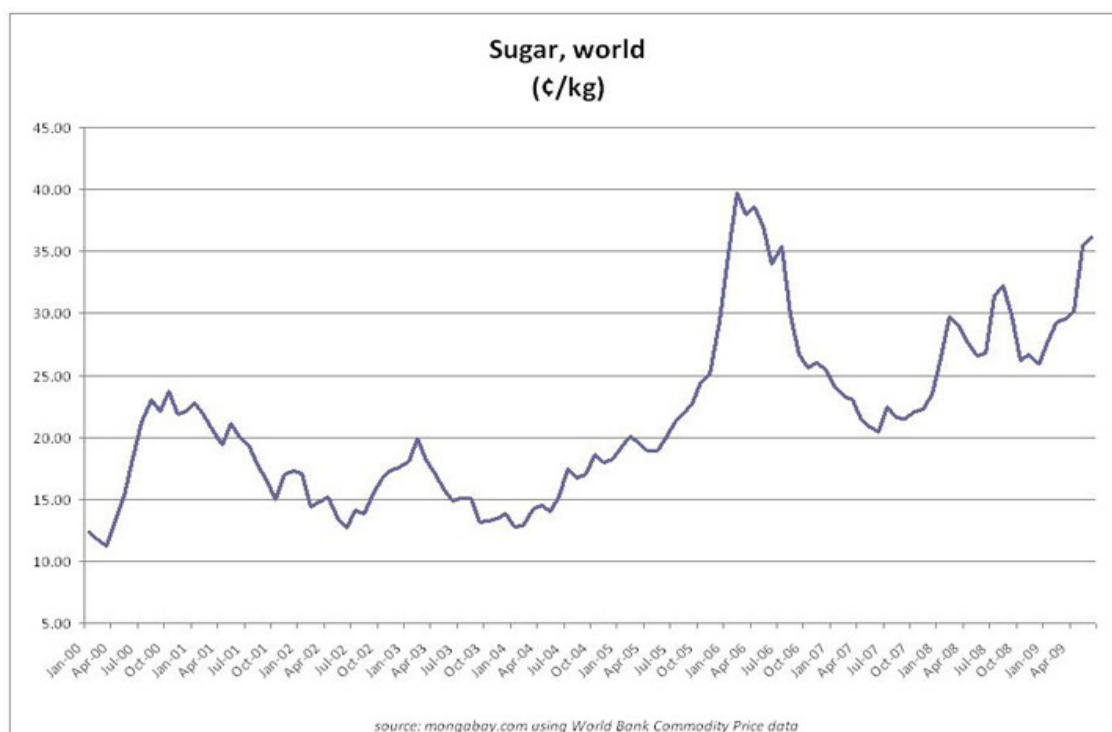
World Sugar Balance				
	2009-10	2008-09	Change	
	(million tonnes, raw value)		in million tonnes	in %
Production	159.042	154.225	4.817	3.12
Consumption	167.446	164.593	2.853	1.73
Surplus/Deficit	-8.404	-10.368		
Import demand	51.930	50.962	0.968	1.90
Export availability	51.964	50.903	1.061	2.08
End Stocks	53.234	61.672	-8.438	-13.68
Stocks/Consumption ratio in%	31.79	37.47		

Source: ISO quarterly market outlook, September, 2009

The five largest exporters of Sugar in 2009-10, i.e. Brazil, Thailand, Australia, India and SADC are expected to supply approximately 79% of all world free market exports. South Africa is currently ranked as the ninth largest exporter to the world market.

The price of raw sugar has increased to its highest level since March 1981, as supply concerns grow. Reuter reports that a growing global sugar deficit should help sustain world market prices despite the global economic downturn, which is seen as having little impact on global demand for sugar. Global sugar prices are likely to stay high in the months ahead, making the sweetener import costlier than it is now. World raw sugar prices rose steeply from only 11.4 cents/lb in January 2009 to 18 cents/lb in July. In August, 2009 raw sugar hit a 28-year high and now is being traded at over 22 cents/lb.

Non remunerative sugar prices led to a significant decrease in sugarcane acreage especially in India leading to a sharp fall in production during 2008-09. It was against this background of weak underlying fundamental factors that sugar prices rallied to new highs in the latter part of the season 2008-09 as a direct result of the reduced sugar inventories and continued focus on ethanol coupled with adverse climatic conditions in Brazil. These fundamental changes have attracted commodity investors to the future markets. The scale and significant impact of this investment activity created a sense of dislocation between market fundamentals and futures prices. As a consequence, futures prices have been increasing since December 2008 and are prevailing around US 23.43 cents/lb for March 2010.



However, the industry is expected to remain in deficit in Sugar Year 2008-09 as well as 2009-10 after 2 continuous years of surplus position. The world raw sugar output is expected to stand at 158.78 million tonnes against previous estimates of 161.7 million tones. However, on the demand side, the global consumption is expected to move up by 3.2 per cent to 162.11 million tonnes with an additional consumption of 3.3 million tonnes that could raise sugar prices further. **(Source: Financial Chronicle)**

Indian Sugar Industry

India has been known as the original home of sugar and sugarcane. Indian mythology supports the above fact as it contains legends showing the origin of sugarcane. The advent of modern sugar processing industry in India began in 1930 with grant of tariff protection to the Indian sugar industry. The number of sugar mills increased from 30 in the year 1930-31 to over 650 at present and the production during the same period

increased from 0.120 million tonnes to 26.3 million tonnes under the dynamic leadership of the private sector. India is the second largest producer of cane next only to Brazil. Presently, about 4 million hectares of land in India is under cane cultivation with an average yield of 70 tonnes per hectare.

The Indian sugar industry at present is highly fragmented in terms of its location as a direct result of strict government controls on licensing and distribution of sugar mills, and on the pricing of cane and sugar.

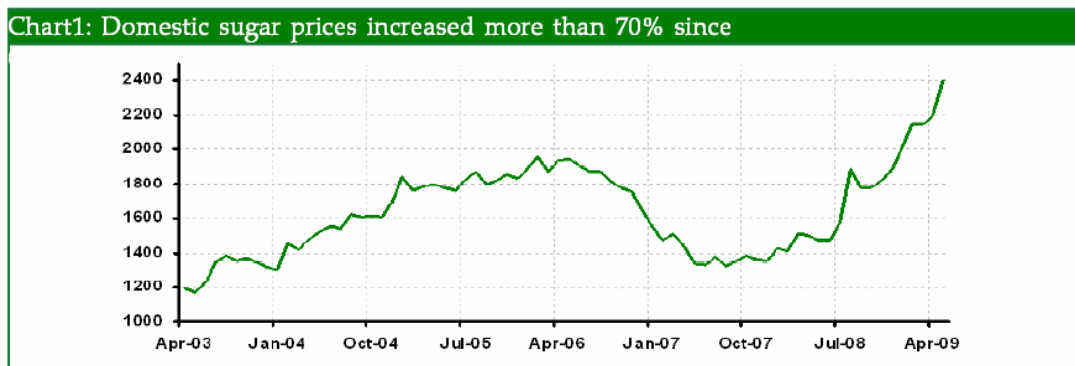


Number of Sugar Mills - 650 & Total Sugar Production - 14.7 million tones

REVIVAL OF SUGAR PRICES

Sugar price have been slowly reviving since June 2008 till the first quarter of 2009 due to lower production and increasing cane cost. Lack of vision and an unfocused sugar policy by the Governments at the Central and State levels with multiple levels of controls have been continuously hampering the growth of this sector. A short sighted policy to curb sugar prices led to lower cane payments leading to lower acreage which has been the major cause of this shortfall in production. An irrational sugarcane pricing policy led to huge cane arrears that have also compounded the problem. Sugar prices have increased despite Government's efforts to control the prices as sugar due to critical inventory position in the country. This rise in prices have led to better

profitability and recovery for the sugar manufacturing companies during the Financial Year 2008-09.



Source: CMIE, KSBL Research.

In order to augment the supply and availability of sugar, the Government has announced several measures like duty-free import of raw sugar, permission to some state enterprises to import duty-free white sugar to extent of 1 million tonnes and imposition of stock limits for dealers to check the hoarding and ban of sugar futures, in the recent past.

Such measures and higher sugar release under the release mechanism by the Government have kept sugar prices under control for a short span. However, considering the strong fundamentals of the up move in the current sugar cycle (backed by a steep deficit), the uptrend in sugar prices is likely to continue for some time now. The higher global prices will ensure that the domestic price of sugar remains on a strong footing.

CANE PRICING

Sugar mills in India pay cane price either based on the Statutory Minimum Price (SMP) announced by the Central Government or the State Advised Price (SAP) announced by the State Government where a SAP regime is in place with the SAP usually being higher than SMP. Mills in India's largest cane producing state [Uttar Pradesh (UP)] pay cane price to farmers according to SAP. Historically, SAP has been significantly higher (20%-50%) than SMP and northern Indian mills had paid cane price of Rs. 140 per quintal. The Mills in Maharashtra, Karnataka and Tamil Nadu consider SMP or an agreed price as in the case of Bihar.

UP Cane Pricing Predicament

The UP sugar industry as a whole has been exposed to increases in cane prices. Historically, the State Government has been fixing cane price irrespective of the price of sugar. The industry is contesting in the court of law, the arbitrary fixing of the cane price and demanding a methodology of cane pricing based on the price of sugar. The outcome of this case is still awaited.

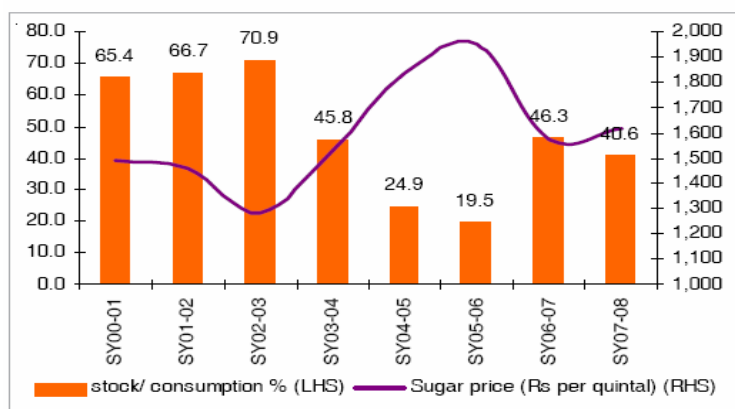
Sugar, for historical reasons, carries a very strong weightage in the Wholesale Price Index. Hence, the Government keenly monitors its price movement. In India, sugar is a strong political commodity since cane farming is the means of livelihood for a big mass

of population in states such as Maharashtra and UP. In both these states sugar farmers operate through co-operative societies and wield significant influence over local politics. Thus, while, on the one hand, the Government tries its best to check rise in sugar prices, on the other hand, the SAP is normally increased irrespective of the sugar mills' capacity to pay for cane.

DECLINING STOCK/CONSUMPTION RATIO OF SUGAR

The Stock/Consumption Ratio refers to the percentage of stock of sugar held at the end of a given year in respect to the amount of sugar consumed during the year. A declining Stock/Consumption Ratio strengthens the sugar prices considerably. This fact can be observed from the following table -

Correlation between sugar price and stock/consumption



Source: Sharekhan Research

DECLINING PRODUCTION AND STOCKS OF SUGAR

With the production declining and the consumption rising steadily, the stock of sugar at year end has been declining notwithstanding the fact that the Government has been importing raw sugarcane for inducing higher production. This has been steadily transforming into declining Stock/Consumption Ratio and thus steadily rising prices. As such prices are likely to remain on the higher side in the coming sugar year.

India's sugar scenario (mn tonne)

Sugar Year (Oct - Sep)	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09E	2009-10E	2010-11E
Opening stock	9.3	10.6	11.2	12.4	8.2	4.6	3.7	9.5	8.9	2.5	2.0
Production	18.5	18.5	20.1	13.5	12.7	19.3	28.0	26.3	14.5	19.0	25.0
% chg		0.0	8.6	-32.8	-5.9	52.0	45.1	-6.1	-44.9	31.0	31.6
Imports	0	0	0	0.4	2.1	0	0	0	2	4	0
Total availability	27.8	29.1	31.3	26.3	23	23.9	31.7	35.8	25.4	25.5	27
Domestic consumption	16.2	16.8	17.5	17.9	18.5	19.0	20.5	21.9	22.8	23.5	24.3
% chg		3.7	4.2	2.3	3.4	2.7	7.9	6.8	4.1	3.1	3.4
Exports	1.0	1.1	1.5	0.2	0	1.1	1.7	5.0	0.1	0	0
Total offtake	17.2	17.9	19	18.1	18.5	20.1	22.2	26.9	22.9	23.5	24.3
Closing stock	10.6	11.2	12.4	8.2	4.6	3.7	9.5	8.9	2.5	2	2.7
Stock/Domestic consumption (%)	65.4	66.7	70.9	45.8	24.9	19.5	46.3	40.6	11.0	8.5	11.1
Stock as no of months of consumption	7.9	8.0	8.5	5.5	3.0	2.3	5.6	4.9	1.3	1.0	1.3

Source: Sharekhan

THE LEVY SUGAR

The obligation placed by the Government on the sugar industry to supply 10% of its output as levy sugar at prices far below the actual cost of production and the open market prices. The levy sugar is distributed through the Public Distribution System channel to the B.P.L. population. Thus, while the sugar industry is forced to supply levy sugar, there is hardly any realization among the public that the subsidy on levy sugar is funded by the industry and not by the Government. Unfortunately, the public distribution system is highly inefficient where substantial leakages occur and the sugar supplied by the industry ends up in the free market where prices are normally higher. The Government is looking to revamp this entire system.

ANTICIPATING TIGHT SUGAR SUPPLY

India plays a crucial role in the world's sugar output. According to a US Governmental report, world sugar output may probably dip by 6.37 per cent in the Sugar season 2008-09 on the back of lower production in major sugarcane producing countries including India and spurt in the demand.

Indian Sugar output in the current sugar year 2008-09 has plummeted substantially as compared with the output in the previous few years. Current year's estimate is now placed at around 14.75 million tonnes, 44% lower than the output achieved in the previous year 2007-08 at 26.3 million tonnes. Such a sharp decline in sugar production by 11.55 million tonnes in one single year is unprecedented. This has happened mainly because the farmers seem to have lost interest in sugarcane planting in recent past due to lack of orderly disposal thereof in addition to the fact that there has been ambiguity regarding cane pricing and large dues by the industry to the farmers.

The season 2009-10 plantation has been poor due to the non-availability of sugarcane seed due to the sharp surge in sugarcane prices at the fag end of the season 2008-09. The yields are also likely to be affected due to less than normal rainfall in most of the sugarcane growing belt. Some of the districts producing cane have been declared drought hit. Indian sugar industry suffers from too many interventions by the authorities. Such interventions, lead to wide variations in sugar production. Domestic demand on the other hand is pegged at an increased level of 22.0 million tonnes. The country has contracted to import around 4 million tonnes of raw sugar.

The Indian sugar industry expects the Government to extend its duty-free raw sugar import policy by one more year to encourage overseas purchases and curb domestic prices in the year of tight supplies. The Government, earlier this year, removed the export obligation that was linked to the import raw of sugar, as tight supplies threatened to push up prices, stoking inflation.

THE ETHANOL

Ethanol fuel is available as a by-product of sugar mills producing sugar. It can be used as a fuel, mainly as a bio-fuel alternative to gasoline, and is widely used in cars in Brazil and as an oxygenate to gasoline in the United States. It is steadily becoming a promising alternative to gasoline throughout much of the world and thus instead of sugar may be produced as a primary product out of sugarcane processing.

Brazil is the world's second largest producer of ethanol fuel and the world's largest exporter. Together, Brazil and the United States lead the industrial production of ethanol fuel, accounting together for 89% of the world's production in 2008. In 2008 Brazil produced 24.5 billion litres (6.47 billion U.S. liquid gallons), which represents 37.3% of the world's total ethanol used as fuel.

India has initiated the use of ethanol as an automotive fuel. In fact, 5% blending is already underway with oil companies inviting tenders from the sugar industry for supply of ethanol. 5% blending has been a grand success. The Government of India had approved a 10 percent ethanol blend with gasoline for mandatory use in vehicles from October 2008.

However, the ethanol blending programme has suffered a setback due to the sharp fall in sugarcane production in the country. Fall in sugarcane production has also resulted in a sharp fall in the production of molasses a by-product of sugarcane and the raw material for ethanol. Consequently, a tight supply of molasses has sent its prices soaring resulting in the non-viability of ethanol and industrial alcohols production. Global prices have not risen resulting in large scale imports of industrial alcohol into India.

The quantitative figures of production and recovery of the Company's Distilleries are as under:

	Year 2008-09 (Full year ended 30 th June, 2009)			Year 2007-08 (Full year ended 30 th June, 2008)		
	Hargaon	Narkatiaganj	Total	Hargaon	Narkatiaganj	Total
Alcohol Produced (Lac Qtls.)	131.33	102.15	233.48	165.47	80.02	245.49
Average Recovery	21.03	23.02		22.37	23.48	

(%)						
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THE GREEN POWER/CO-GEN CAPABILITY OF SUGAR

The sugar industry can make a significant contribution in meeting the national power requirements. Sugar mills in India produce 2,000 megawatt of biomass-based energy every year, as much as windmills produce, and at half the cost, a new study has found. Sugar mills, which produce both electricity and heat through co-generation, are already selling power to the grid and can produce up to 5,100 MW - 69 percent of the country's total co-generation capacity [according to the study carried out by the New Delhi-based NGO Centre for Science and Environment (CSE)]. If the resources and technology are improved, co-generation can produce almost 10,000 MW or 40 percent of the country's 2008 power deficit. Such alternatives to fossil fuel energy are critical for India's energy and climate security.

Sugar mills generate biomass-based 'green' energy from bagasse, a by-product that comes from cane crushing. Mills in five major cane growing states of Andhra Pradesh, Karnataka, Maharashtra, Tamil Nadu and UP are generating enough bagasse to meet the energy needs of a business centre the size of Gurgaon.

However, India has no policy framework in place to strengthen this green energy source. Today, out of the 650 odd sugar mills in India, 107 have co-generation plants. This revenue stream has managed to provide a much needed cash flow support at times of low sugar prices.

Bagasse-based cogeneration plants also earn carbon credits as the carbon dioxide absorbed by sugarcane plants while growing up is more than the carbon dioxide produced in burning bagasse. India launched its biomass power (bagasse-based cogeneration) policy in 1990. As the shortage of power grew in many sugarcane states, the policy was revised in 2006 to provide capital subsidy and tax rebates. The 2003 Amendment to the Electricity Act also provided the necessary framework for promoting renewable energy sources - asking states to fix a minimum limit for energy utilities to buy green energy.

Like molasses the production of bagasse has also been seriously curtailed due to shortage of sugarcane. Soaring bagasse prices and lack of availability has also reduced the production of energy during the season 2008-09. This trend is likely to continue during 2009-10.

The Company has co-generation power plants at Hargaon and Narkatiaganj. The sale of power to State Grid by the company is as follows:

	Year 2008-09 (Full year ended 30 th June, 2009)			Year ended 2007-08 (Full year ended 30 th June, 2008)		
	Hargaon	Narkatiaganj	Total	Hargaon	Narkatiaganj	Total
Power Sale	155.65	36.33	191.98	201.63	44.30	245.92

(Lac units)						
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Operating Performance Review

Oudh Sugar Mills performed well during 2008-09 backed by strong demand, better recovery, better cost management and operational efficiencies. Higher sales price coupled with higher liquidation of stocks in hand have led to the topline growth inspite of lower production during the year.

THE COMPARATIVE OPERATIONAL FIGURES OF THE SUGAR FACTORIES FOR THE LAST TWO SEASONS:

	Season 2008-09 (Actual)					Season 2007-08 (Actual)				
	Hargaon	Rosa	Narka-tiaganj	Hata	Total	Hargaon	Rosa	Narka-tiaganj	Hata	Total
Sugarcane Crushed (Lac quintals)	71.67	29.55	45.16	1.45	147.83	122.05	45.61	69.39	--	237.05
Recovery	9.34	8.59	9.02	8.00		10.59	9.85	8.83	--	
Sugar Produced (Lac quintals)	6.69	2.54	4.07	0.12	13.42	12.93	4.49	6.12	--	23.54
Crushing days	102	86	73			136	115	116		

Financial Performance Review

The Company's total turnover increased by 64.74% to Rs.58,304.32 lacs during the year 2008-09 as compared to Rs. 35,393.59 lacs during the year 2007-08. The Company was able to earn profit during the year 2008-09 after 2 years of losses suffered during the years 2006-07 and 2007-08. The net profits for the year stood at Rs. 1917.38 lacs as against a net loss of Rs. 451.27 lacs in 2007-08. The Net Worth of the Company rose by 41.72% to be placed at Rs. 14069.83 lacs as on 30th June , 2009 as against Rs. 9927.66 lacs as on 30th June, 2008.

Internal Control System

The Company has a sound and robust system of internal control for financial reporting of various transactions, efficiency of operations and compliance with relevant laws and regulations. The controls span over all the functions and departments of the

organisation. The internal control system is adequate and commensurate with the size of the Company and the nature of its business.

Human Resources And Industrial Relations

Employee strength as on 30th June, 2009 was 1916 employees as against [1926] as on 30th June, 2008.

Except a change in the office of the Company Secretary there has been no material change in the senior management team of the Company. The Company's HR Policy continues to be based on inspiring and unleashing creative potential in human assets of the Company. This is possible in an environment where we all respect the rights of those around us. In this direction, we endeavor:

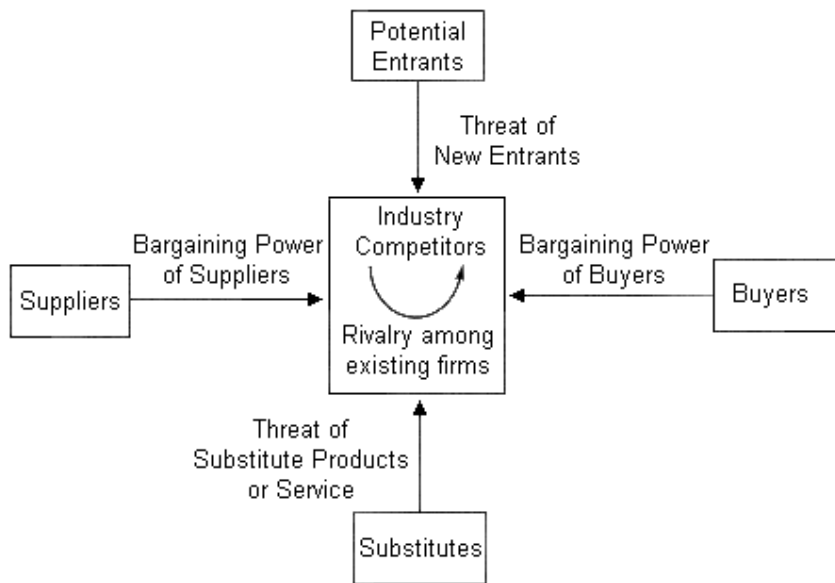
- 1) To treat individuals in all aspects of employment solely on the basis of ability irrespective of race, caste, creed, religion, age, disability, gender, sexual orientation or marital status.

- 2) Not to tolerate racial, sexual or any other kind of harassment.

The Company had cordial industrial relations in all the Mills and offices during the year under review.

Risks and Concerns Review

Michael Porter Analysis



RIVALRY AMONG EXISTING FIRMS

There are some 650 mills located all across India. Oudh Sugar Mills is not yet among the large players in the industry. Large scale businesses have operational advantages as against the smaller players. However, the Company has taken a number of steps that put its operational efficiencies at par with the larger players.

Medium to High

THREAT OF NEW ENTRANTS

The sugar industry in India already has a number of players with a strong foothold. Presently there is shortage of sugarcane production in India. As such there is high competition for procurement of the same. This acts as a deterrent for new entrants into the industry.

Low to Medium

BARGAINING POWER OF BUYERS

The demand for sugar has been increasing regularly and is also expected to rise further in the future. The release of sugar into the market is regulated directly by the Government. As such the bargaining power of buyers is limited to a very certain extent.

Low to Medium

THREAT OF SUBSTITUTE PRODUCTS

Increase in demand for substitute products could negatively affect the Company's business. However, the primary substitutes for sugar - gur and khandsari do not have a large and strong market and as such do not act as a big threat to sugar companies.

Low

BARGAINING POWER OF SUPPLIERS

The sugar industry has typical cyclicity in operations. At a time when there is shortage of sugarcane production due to cyclical factors, the bargaining power of buyers rise considerably and vice-versa.

Medium

Other Risks And Concerns

INDUSTRY RISK

Global economic downturn might negatively affect the sugar industry.

Risk Mitigation

Demand for sugar not impacted by a great deal due to economic slowdowns. Even during a year in which the global economy was largely affected, the demand for sugar was robust and is expected to continue to be so.

RAW MATERIAL RISK

Cane is the main raw material for a sugar mill. The area under cane cultivation is expected to have come down during sugar year 2008-09 as compared to sugar year 2007-08. As a result production of sugarcane has fallen. In addition to this, unfavorable climatic conditions also negatively impact productivity.

Risk Mitigation

The Government is importing large amount of canes from abroad to meet the industry requirement. The Company has taken measures to ensure harmonious relationships with cane growers to ensure that the Company's mills do not fall short of its requirements.

REGULATORY RISK

Sugar industry is regulated by both Central as well as State Governments. The input prices are regulated by both Central and State Governments. The release mechanism used by Central Government to regulate outputs has an impact on sugar prices. In

addition to these, levy sugar, i.e. 10% of the total output is required to be sold at prices far below the market prices.

Risk Mitigation

The Government is considering deregulating the sector as much as possible. Over the years, the levy sugar has been brought down to 10% of output. Government has also taken steps to provide export incentives and other measures to reduce problems faced by sugar mills.

BUSINESS CONCENTRATION RISK

Sugar being a cyclical commodity, may pose a threat to the Company's financial and operational performance if it is largely dependent on sugar business.

Risk Mitigation

To reduce this concentration risk, the Company is diversifying its business to various other segments like ethanol, co-generation and canning segments.