

LMC World Sugar Price View

May 2014



CANEGROWERS

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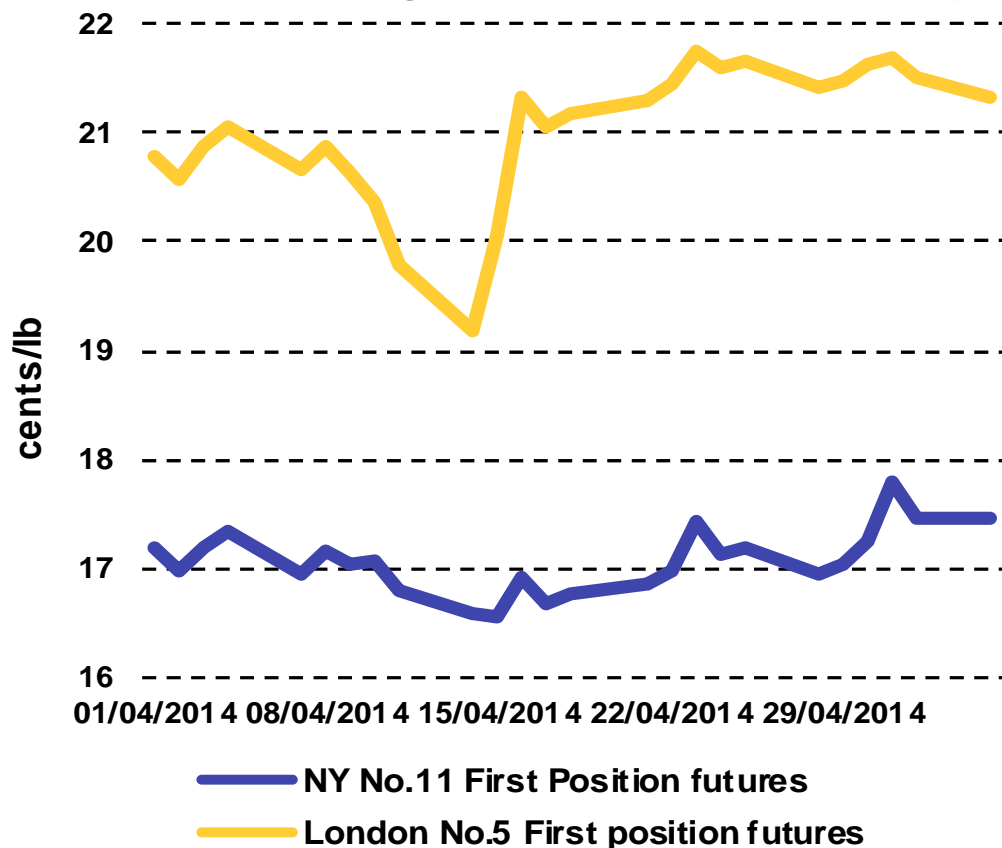
Key developments in the sugar market in April 2014



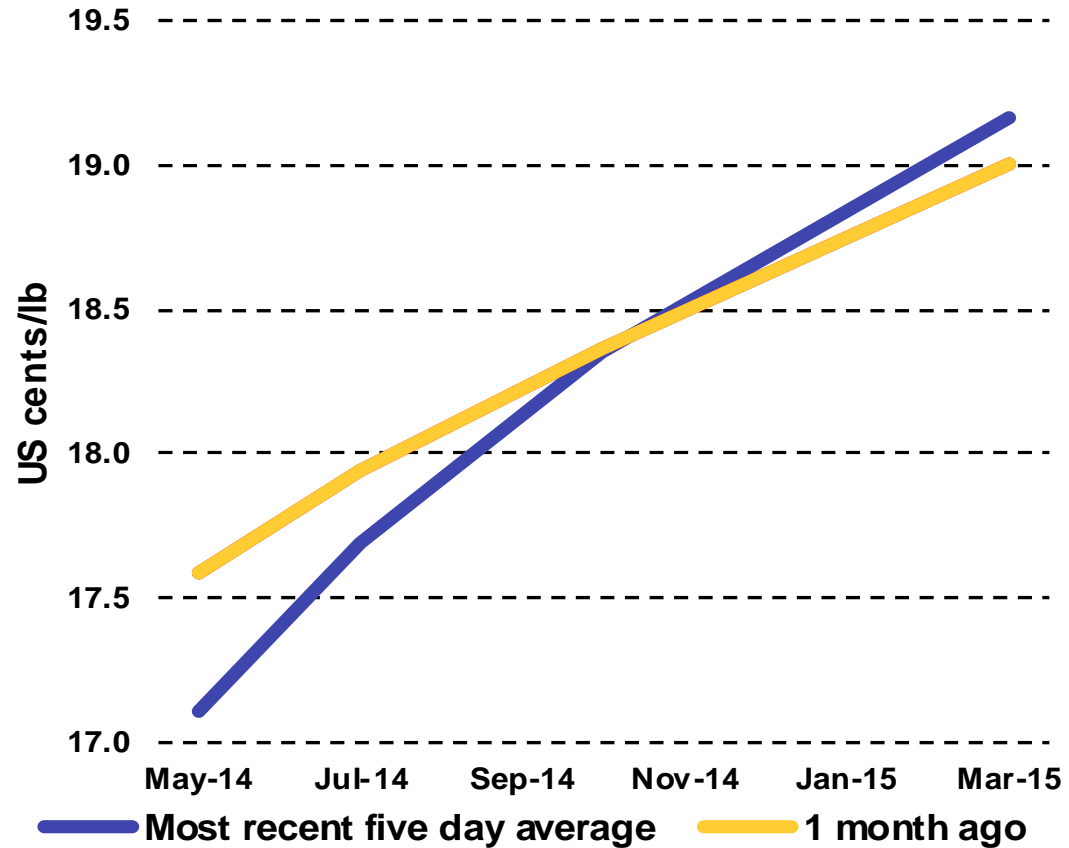
Raw and white sugar futures remained range bound during April.

At the same time, the carry structure of the market has widened, with the spreads now close to the cost of carry, reflecting large export availability from northern hemisphere producers and weak global import demand.

Raw/white sugar prices – April/May 2014



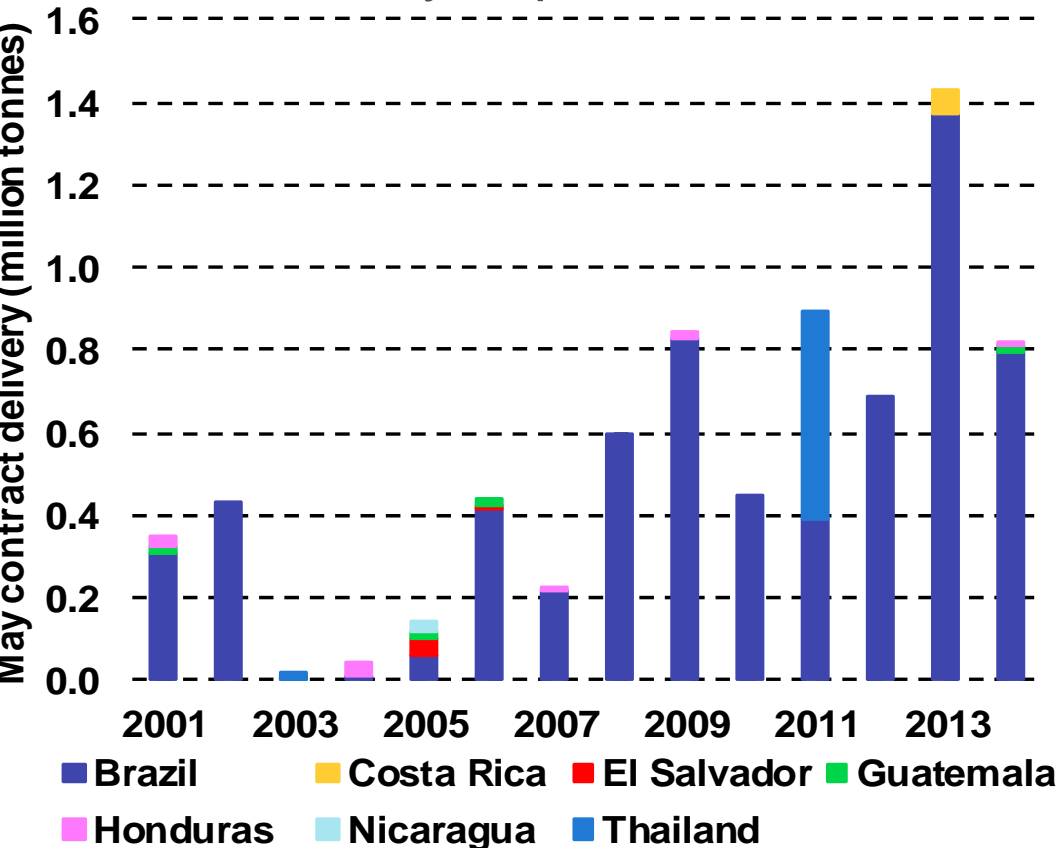
No.11 Market Structure



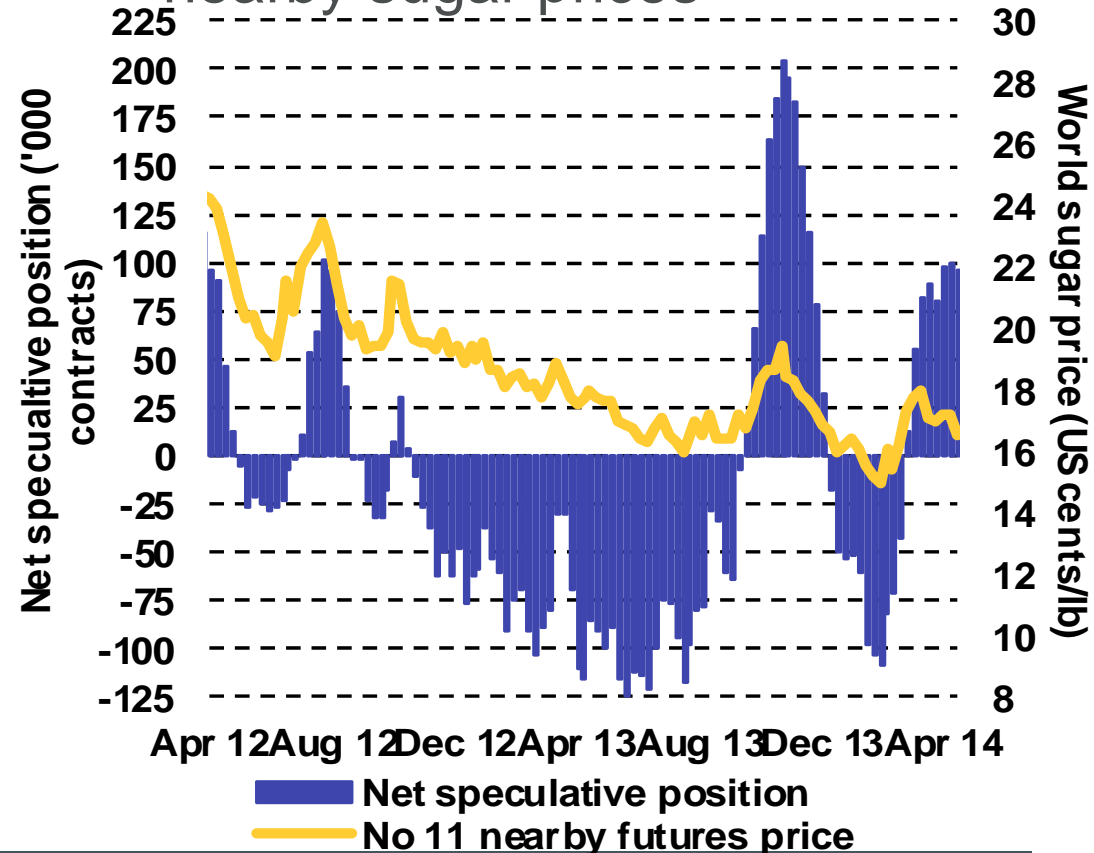
The ICE No.11 May expiry was larger than expected

Around 800,000 tonnes of (largely Brazilian) sugars was delivered to the exchange to one receiver. Meanwhile, the funds continue to hold a sizeable net long position.

ICE No.11 May expiries



No. 11 commitments of traders vs. nearby sugar prices



Raw sugar prices remain under pressure as a result of plentiful supplies and weak demand in the near term.

With the funds already holding a net long position, it has proved difficult for prices to move out of their current range.

Fundamental developments:

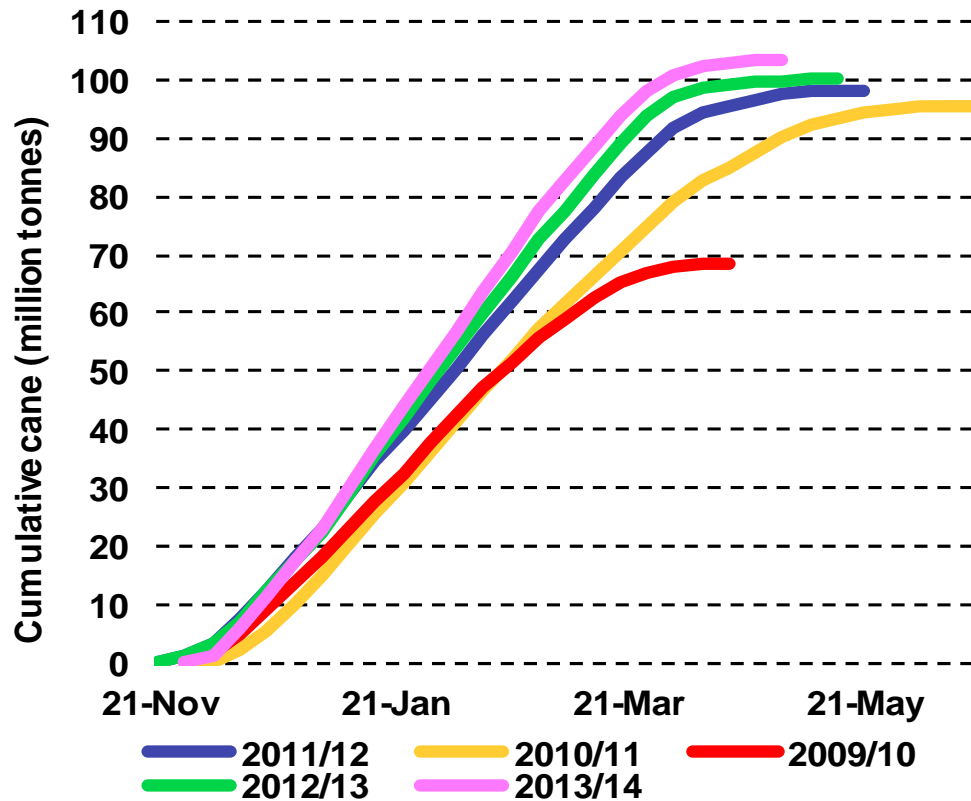
- The northern hemisphere harvests are now coming to an end, and results generally look to be in line or above expectations. Higher domestic prices in **India** have encouraged mills in Maharashtra and Karnataka to prematurely harvest cane that was originally planted as *adsali* (18 month) cane to be harvested in 2014/15. This has boosted cane supplies for the 2013/14 crush, and final sugar production could now breach 24 million tonnes.
- Elsewhere, other crops should match expectations. In **Thailand**, the record crop is close to completion, yielding sugar production of around 11.3 million tonnes. Taking stocks into account, Thailand's export availability could be 2.0 million tonnes more than last year as a result.
- At the same time, global import demand is expected to be 2-3 million tonnes less than last year as importers scale back their requirements having replenished stocks in 2013. Chief among these countries is **China**, which has been largely absent from the market in recent weeks.
- Meanwhile, focus is now on the 2014/15 cane crush in **Centre/South Brazil**. In the last week of April, the market digested two sharply contrasting forecasts for the Brazilian crop: First, UNICA released their estimate, which implied an expected cane crop of 580 million tonnes, towards the upper end of the consensus range. However, this forecast was then followed by Canaplan, who expect a much smaller crop of 540 million tonnes.



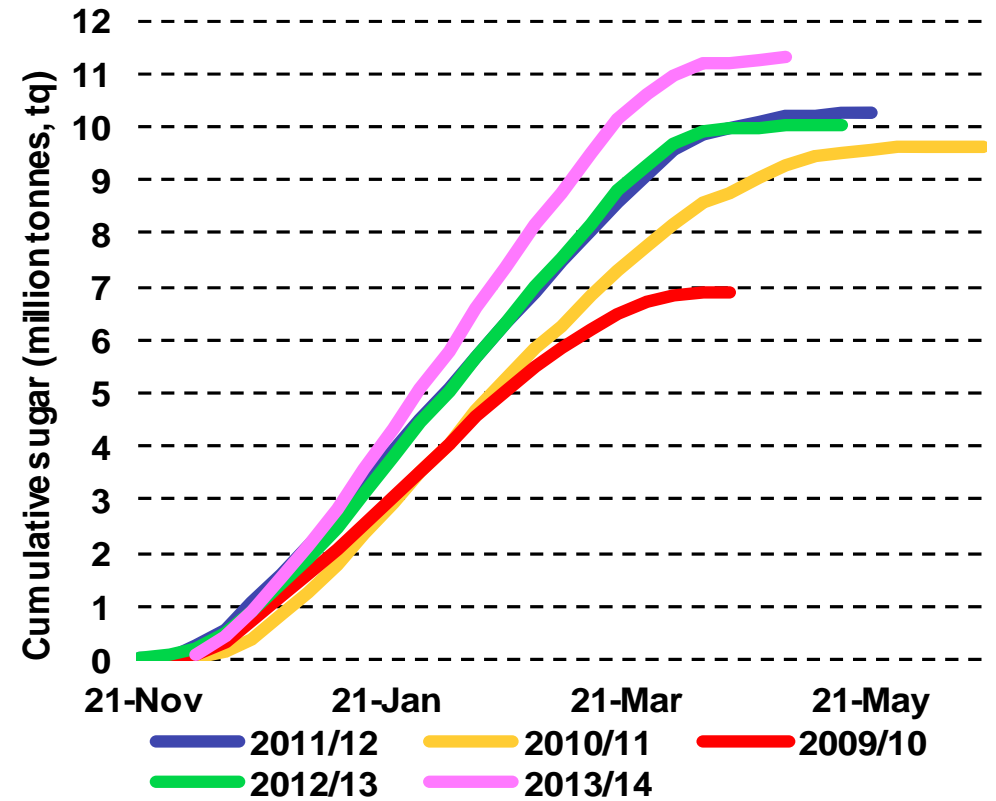
The Thai cane crush is almost complete, with only 7 mills out of 50 still crushing only marginal amounts of cane by the end of April.

The industry looks well set to produce a record 104 tonnes of cane, yielding 11.3 million tonnes of sugar.

Cumulative cane crushed



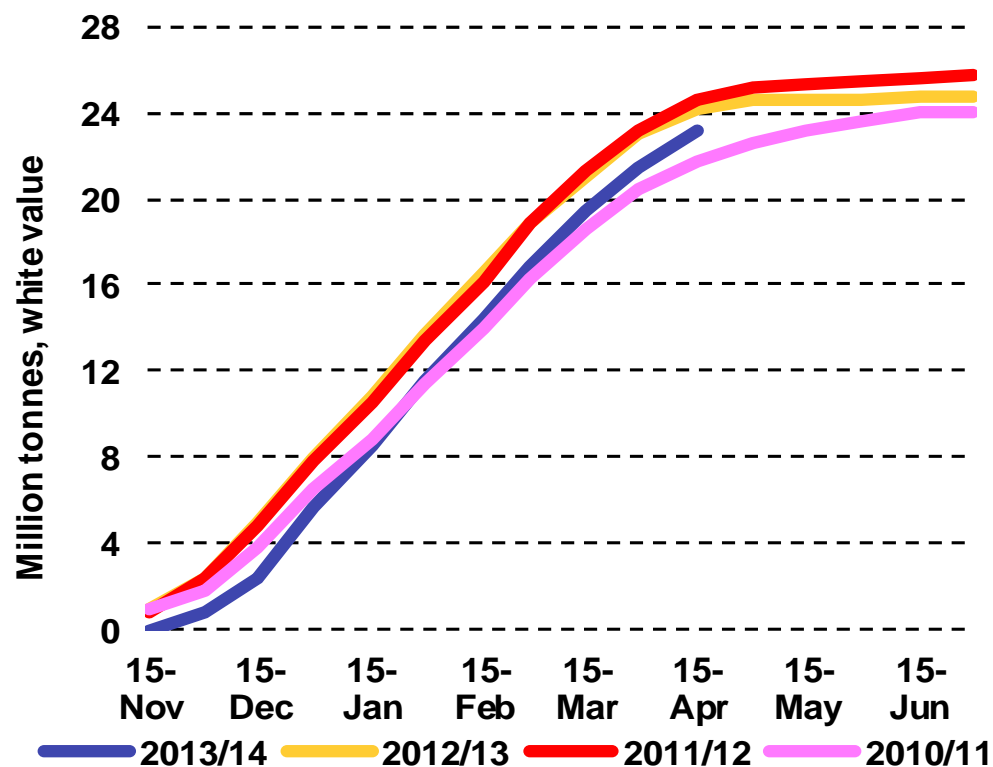
Cumulative sugar produced



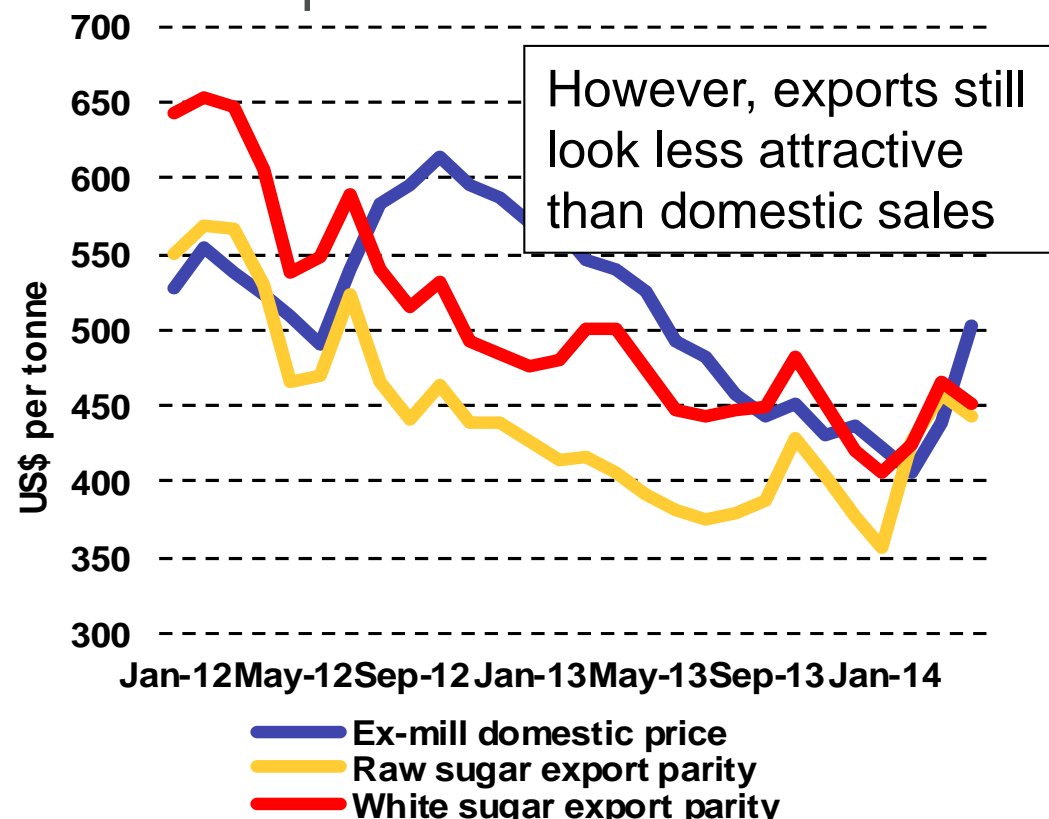
Final Indian production could breach 24 million tonnes.

Higher Indian domestic prices, as well as making exports less attractive, have encouraged millers in Karnataka and Maharashtra to prematurely harvest cane that was originally planted as adsali (18 month) cane for 2014/15. With 80 mills still operating, this means that final output in 2013/14 could breach 24 million tonnes.

Indian harvest progress



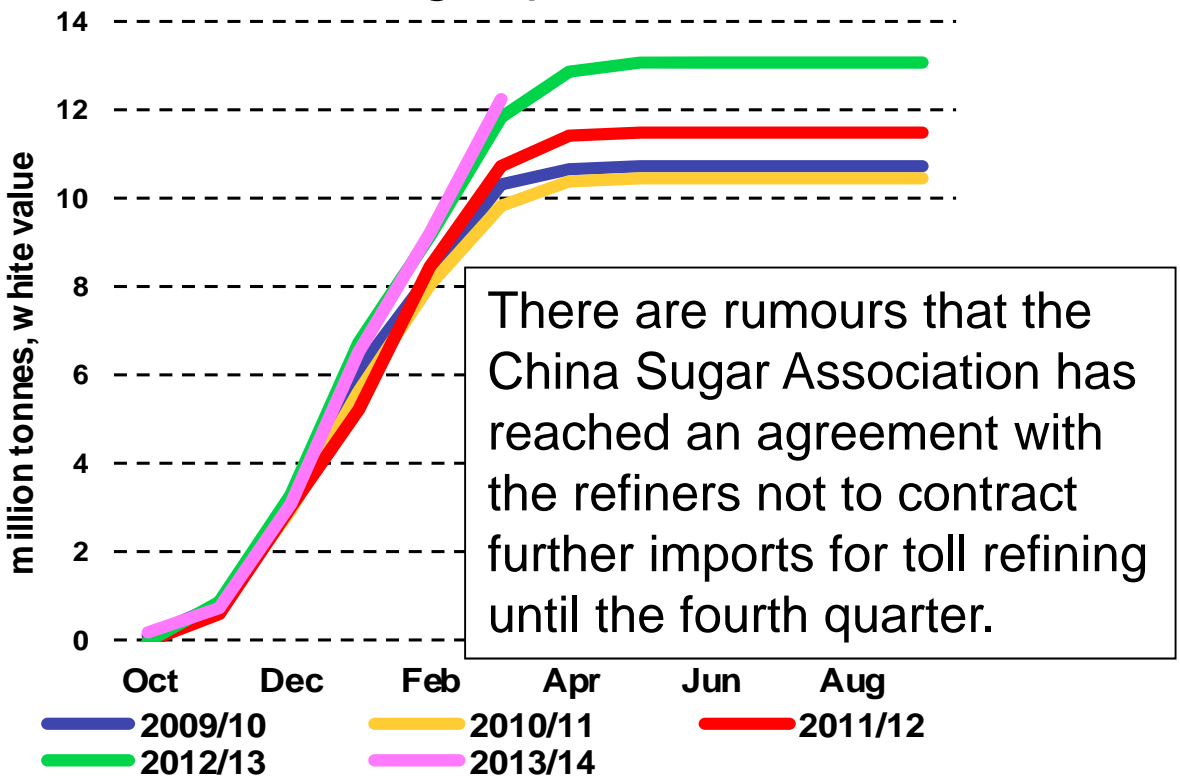
Indian raw sugar export parities vs. domestic prices



China produced 12.2 million tonnes of sugar by the end of March, 3% higher compared to last year. Domestic prices have remained steady over the past month, at around US\$750-760/tonne.

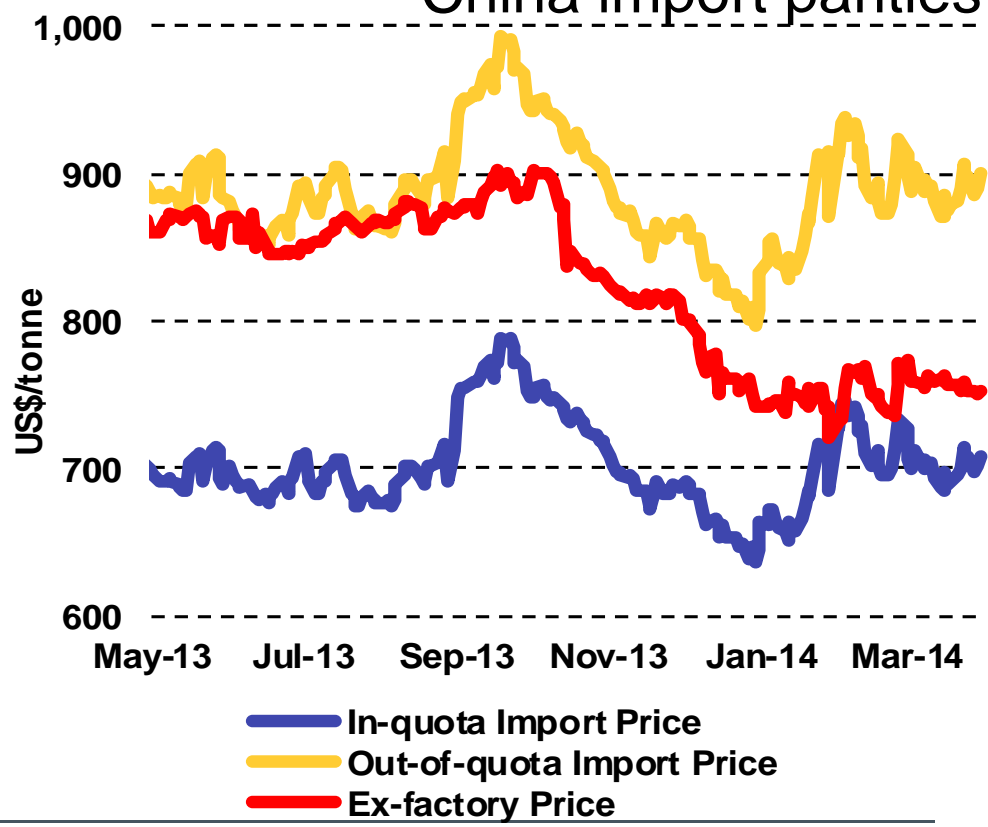
The central government has confirmed a stockpiling programme which will provide financial support for storage of 3 million tonnes from private companies. They will allocate the amount of sugar to each company in early May.

Cumulative sugar produced



There are rumours that the China Sugar Association has reached an agreement with the refiners not to contract further imports for toll refining until the fourth quarter.

China import parities

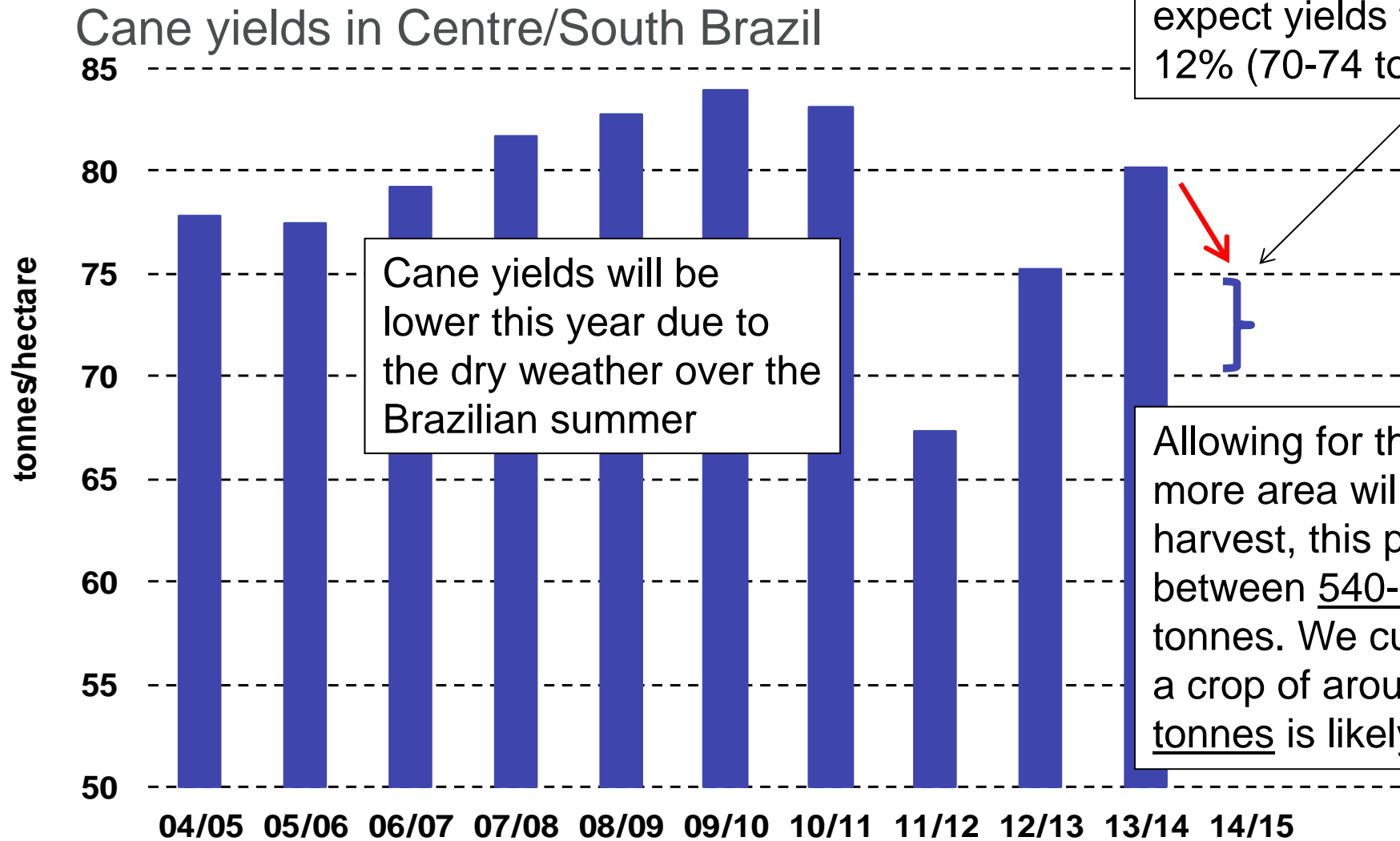


In the last week, we have seen widely varying forecasts for the 2014/15 C/S Brazilian crop.

UNICA: 580 mn tonnes; 78.3 mn tonnes ATR

Canaplan: 540 mn tonnes; 73.5 mn tonnes ATR

Major Brazilian producers have indicated that they expect yields to drop by 7-12% (70-74 tonnes/hectare).



Cane yields will be lower this year due to the dry weather over the Brazilian summer

Allowing for the fact that more area will be available to harvest, this points to a crop between 540-580 million tonnes. We currently believe a crop of around 560 million tonnes is likely



Despite the recent rains, we maintain our view that there is a strong likelihood that Brazil's crop will fall below current market expectations (i.e. ~560 million tonnes)

Even if this doesn't happen, and the crop partially recovers during Q2 due to improved rains, cane quality is likely to be reduced, offsetting the increase in terms of ATR production

Possible ATR production outcomes (million tonnes, ATR)

	ATR (kg/tonne cane)	132	133	134	135	136
Cane Crop (mn tonnes)	540	71	72	72	73	73
	550	73	73	74	74	75
	560	74	74	75	76	76
	570	75	76	76	77	78
	580	77	77	78	78	79

Current LMC base case

Red = likely; Blue = unlikely

Based on likely outcomes, ATR production is likely to be in the region of 74-75 million tonnes, well below 2013/14 (80 million tonnes)



What is the damage to the Brazilian cane crop likely to mean?

Our base case estimate implies that Brazil will produce around two million tonnes less this year

- Given the current surpluses and weak import demand, we would expect sugar to continue to trade at or below ethanol parity until the surplus has been consumed.
- However, a smaller Brazilian crop will support sugar prices in two ways:
 - It will tighten the ethanol market, supporting the ethanol price parity.
 - The greater the uncertainty about the final size of the crop, the closer sugar will trade to ethanol parity.
- BUT, prices will only be able to rise substantially if it becomes clear that there will be a large deficit in the foreseeable future. For this to happen, either (a) the damage to the Brazilian crop needs to exceed market expectations and/or (b) unfavourable weather in the rest of the world provides a helping hand (see later discussion).



Other fundamental developments

- With the 2014/15 harvest due to begin in May, Queensland growers in **Australia** were affected by tropical cyclone *Ita* in mid-April, with early reports suggesting that up to 10 million tonnes of cane was flattened, mainly in north/central regions of the state. Sugar content is also likely to be impacted negatively as a result of flooding.
- The 2013/14 **Mexican** harvest has continued to catch up with last year. By the end of April, sugar output was 12% behind 2013. Final sugar production is expected to total 5.5-6.0 million tonnes, white value, compared to 6.8 million tonnes last year.
- Final production from the 2013/14 cane crush in **Pakistan** is likely to total a record 5.5 million tonnes, white value. The government has permitted additional exports of 250,000 tonnes, on top of a 500,000 tonne tranche that had previously been allowed. It remains unsure as to whether any subsidies would be provided on these additional exports.

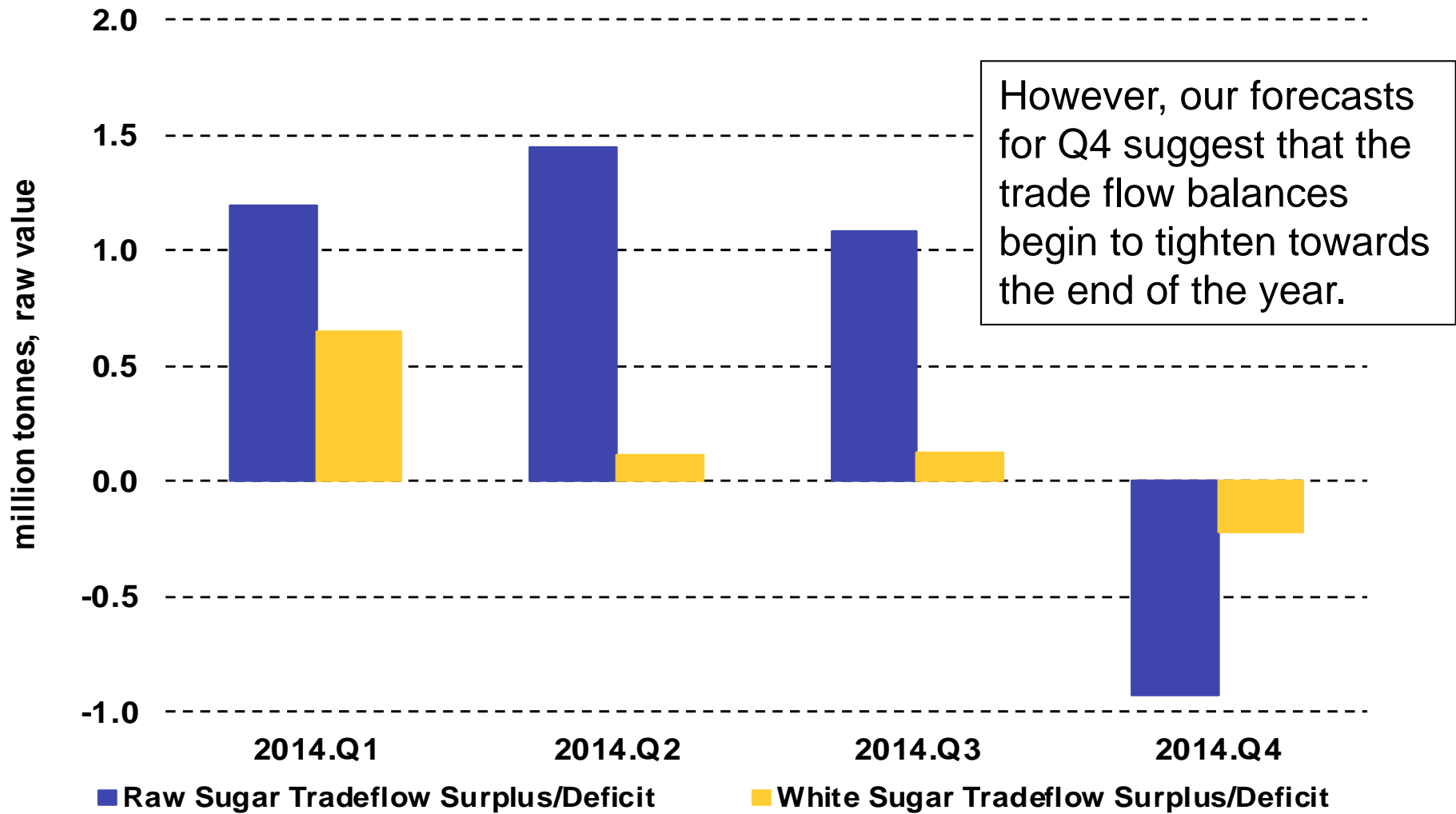


Market outlook and points to watch

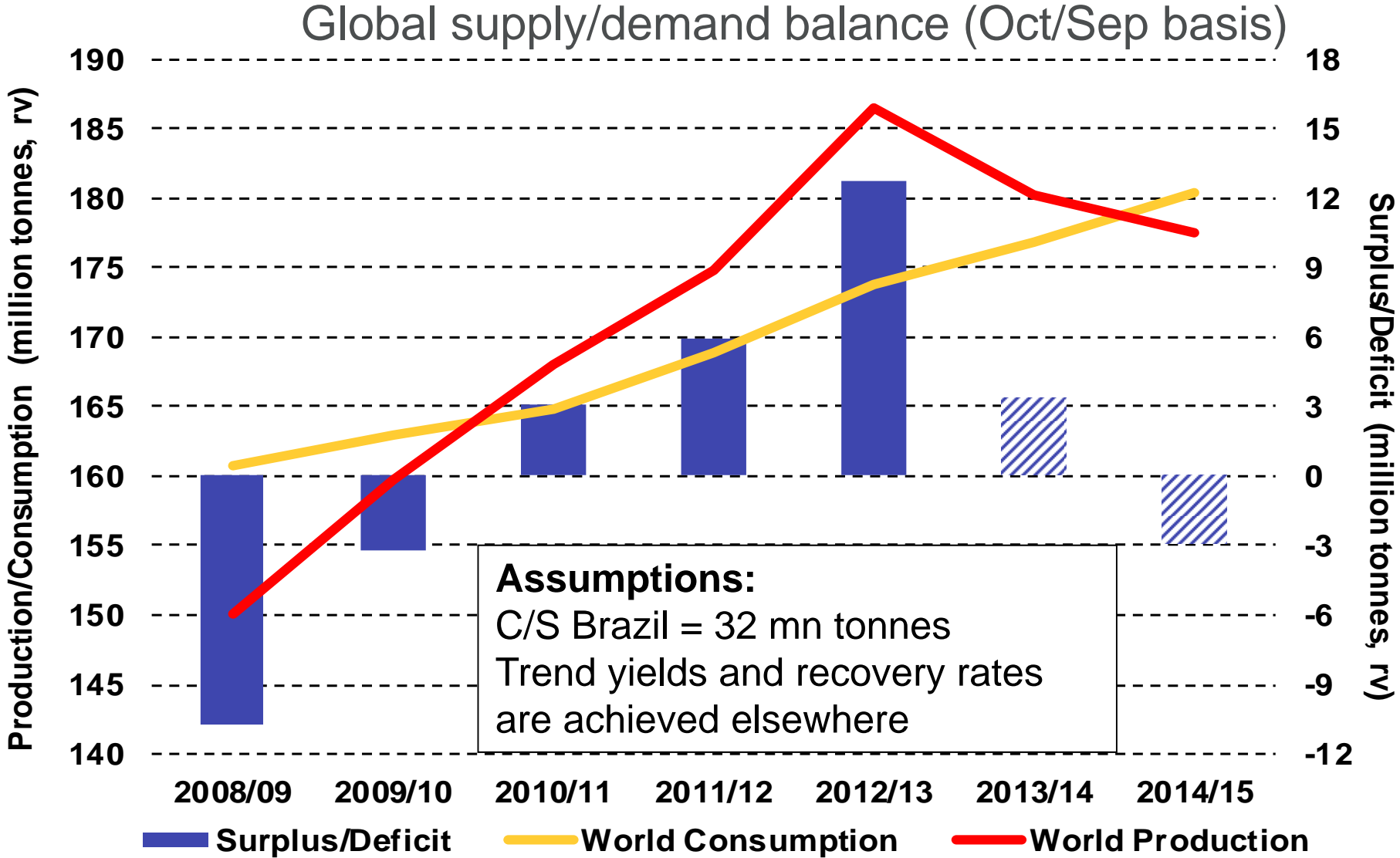


Our latest projections of trade flows suggest there is plentiful supply of sugar available in the near term, particularly from Thailand and Central America.

Raw and white sugar trade flows, 2014



Our initial look at the 2014/15 global balance suggests that the world will produce a modest deficit.



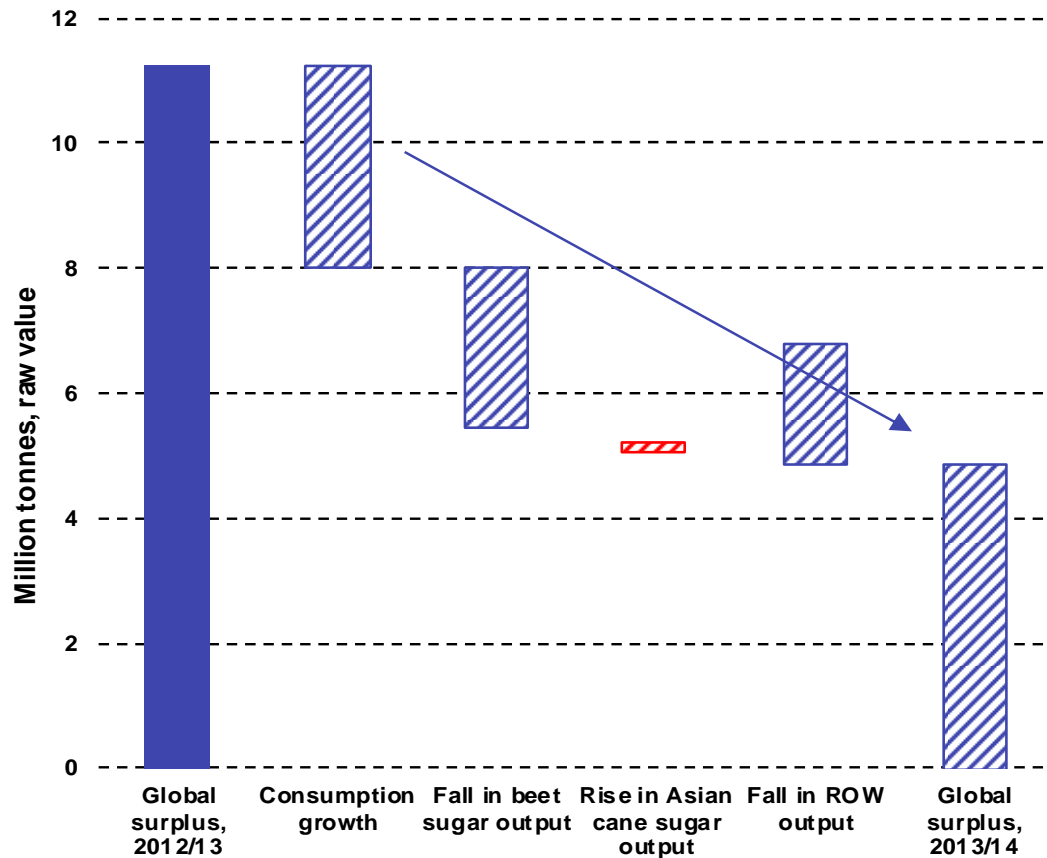
Key drivers of the 2014/15 global balance

- A smaller cane crop combined with an incentive to focus on ethanol early in the season, raises the possibility that **C/S Brazil** will produce significantly less sugar than last year, possibly as much as 1-2 million tonnes to 32-33 million tonnes, *tel quel*.
- In **India**, the build-up in cane arrears is likely to lead to a sizeable contraction in cane area in Uttar Pradesh. However, any downturn in resulting output is likely to be more than offset by an expansion in area under cane in Maharashtra. Overall, we forecast that sugar production could increase by around 10% in the state, with the result that total Indian production in 2014/15 could increase to 24-25 million tonnes, white value.
- Early signs indicate cane remains a good choice for farmers in **Thailand**. Assuming trend yields and recovery rates, this implies that sugar output could remain roughly unchanged year-on-year. We also only anticipate a modest drop in cane area in **Pakistan**.
- In contrast, the outlook for **Chinese** cane sugar production is more negative. Cane prices have been reduced while the 2013/14 cane crushing campaign has been taking place, which is likely to dissuade farmers who have been faced with rapidly escalating costs.
- Finally, in the beet sector, while sugar output is forecast to show little change in the protected markets of the **EU** and **US**, we foresee a sizeable reduction in **Russian** beet sugar production, where sugar output could fall by more than 10%.

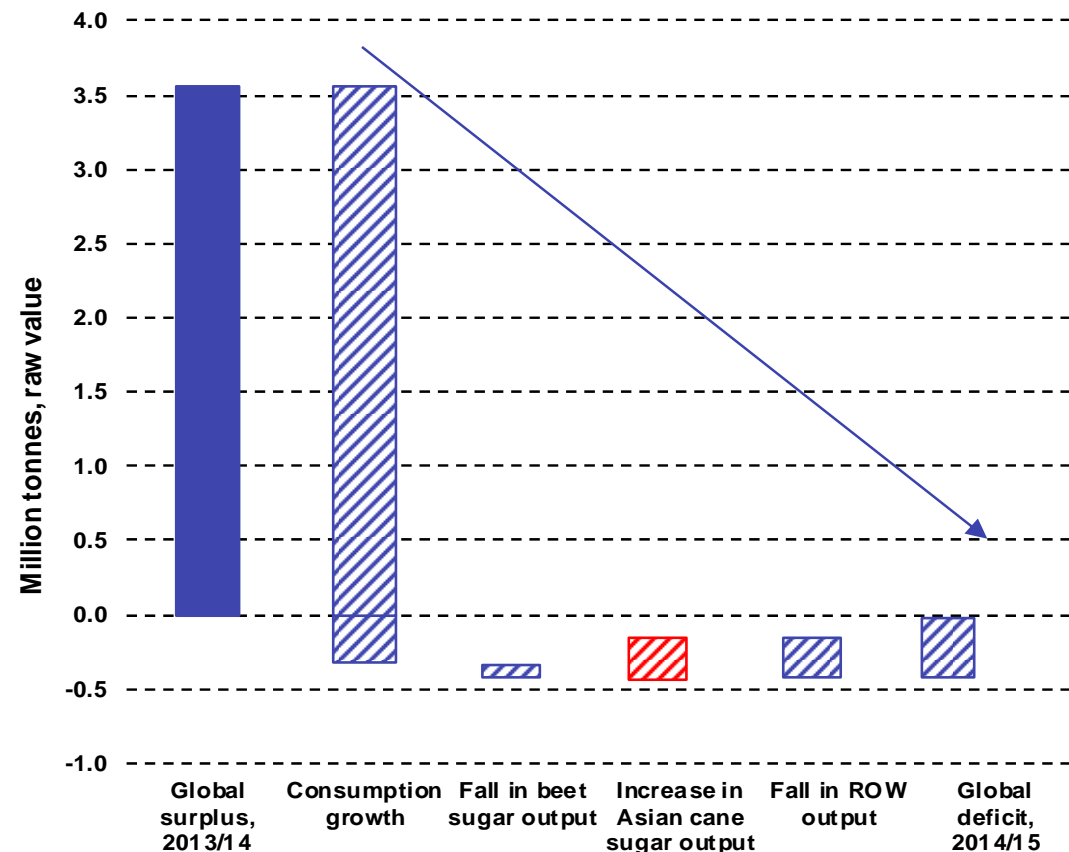
Our balance assumes trend yields and recovery rates to derive our production forecasts. While this is a reasonable assumption at this point in time, there is the potential for an El Niño weather pattern forming which could have a negative impact on sugar crops.

Asian production did not contract in 2013/14, and we are forecasting a slight increase in regional output in 2014/15. Indeed, the main reason for forecasting a return to deficit is due to a projected 2% growth in global consumption. Overall sugar production in 2014/15 is expected to remain roughly unchanged (assuming trend yields)

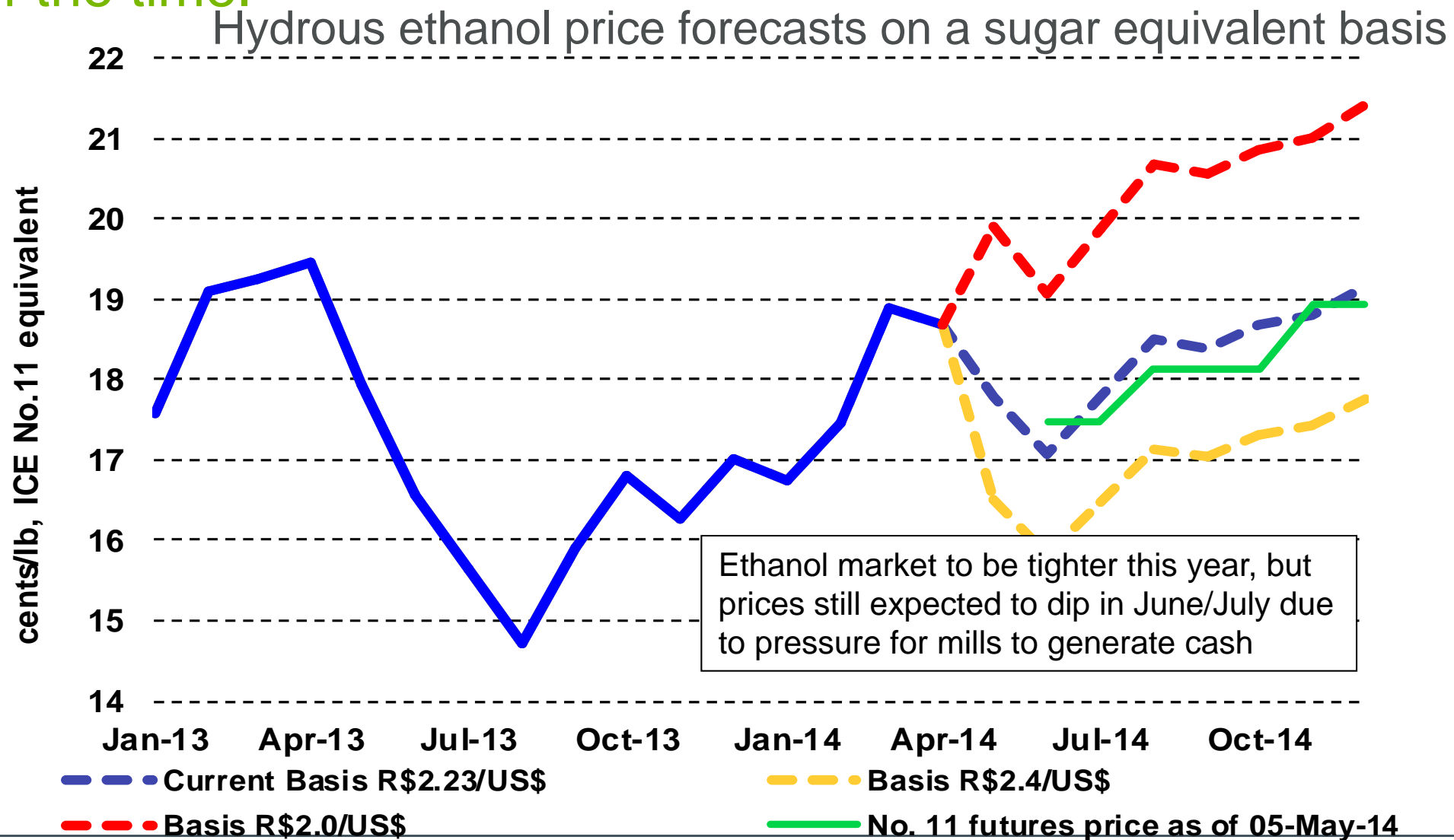
Global S&D change 12/13 vs 13/14



Global S&D change 13/14 vs 14/15



Point to watch: Ethanol parity will remain an important factor to monitor once the **C/S Brazilian** harvest gets underway. At current exchange rates, we see ethanol trading between 17-19 cents/lb most of the time.



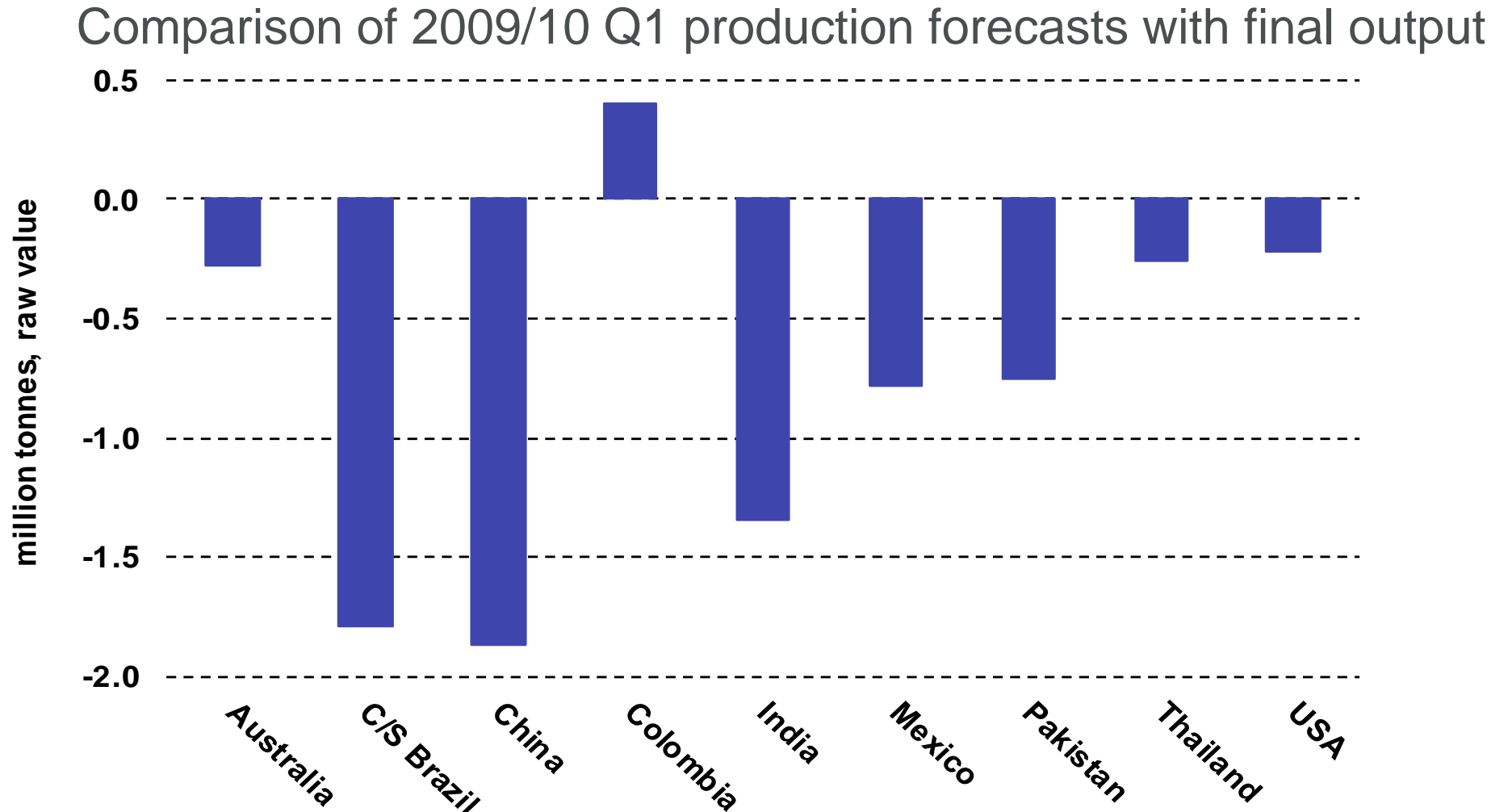
Point to watch: A return of El Niño?

- Weather agencies have reported an increasing likelihood of an **El Niño** weather phenomenon during the second half of the year, with the Australian Meteorological Bureau now indicating that it is 'likely' to occur as early as July.
- If it does occur then it has implications for the weather conditions for a number of important sugar crops around the world, as it typically results in:
 - Wetter than normal weather to areas such as C/S Brazil, Colombia, Mexico and Midwest US.
 - Drier conditions in Southeast Asia, India, Australia and parts of Africa.
- Indeed, there are indications that its effects are already being felt with drier-than-normal conditions in Australia and parts of SE Asia.



Point to watch: A return of El Niño? (continued)

Final production in 2009/10 was much lower than the preliminary forecasts for a number of industries, particularly in China, C/S Brazil and India. This highlights the clear risks to our current sugar production forecasts.



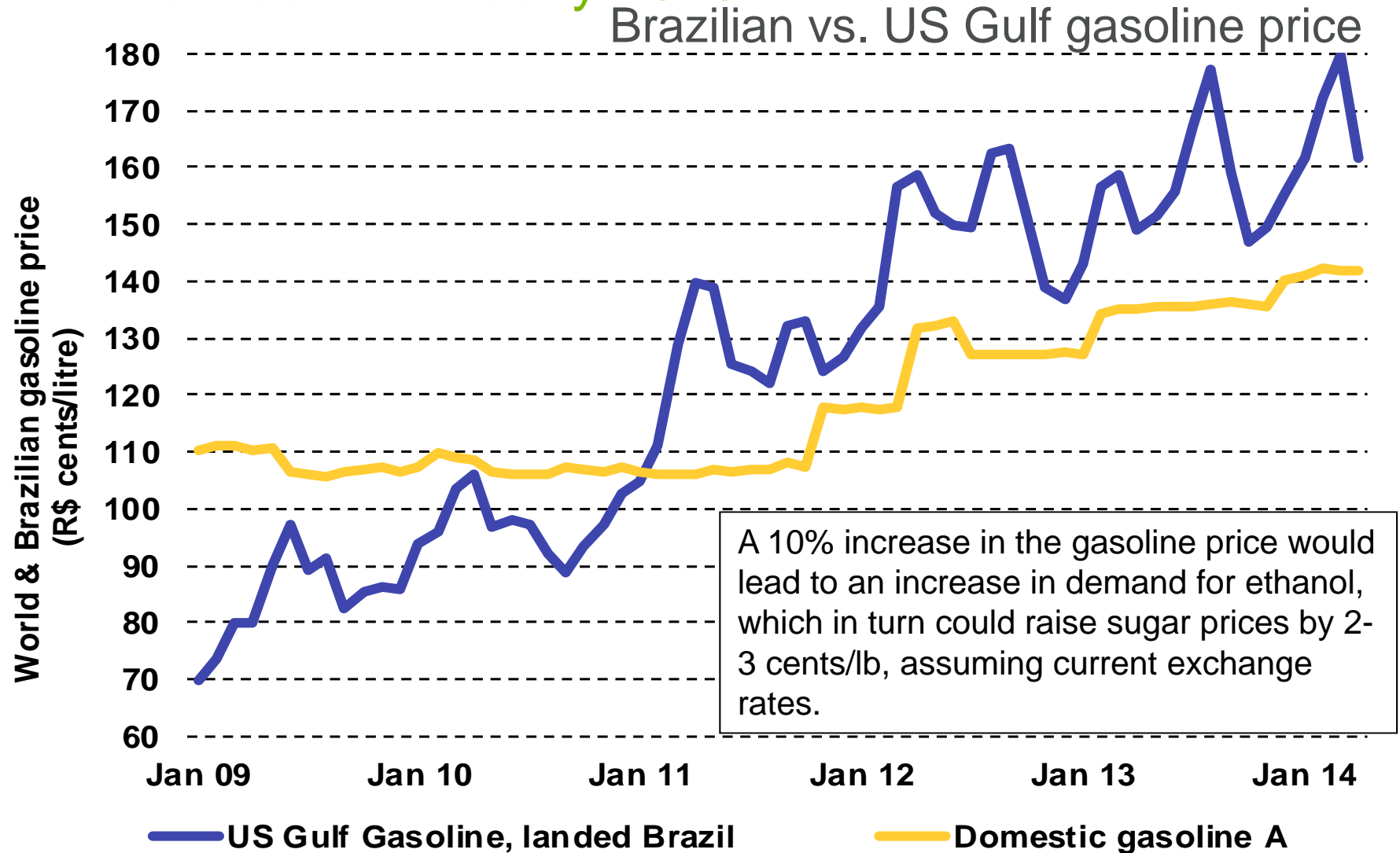
Point to watch: Brazil's political economy and negative 2015/16 crop outlook could have an impact on the sugar market in 2015

Brazil will hold presidential elections in October 2014.

- **Inflation** is a key political issue and the price of many essential goods are being controlled prior to the election. Gasoline prices will almost certainly remain unchanged. However, **there is a strong likelihood of a significant increase in the gasoline price after the election.** *This would be supportive to sugar prices.*
- Moreover, the dry summer this year has **reduced plantings**, meaning that the cane crop in 2015/16 is also likely to fall below crushing capacity once again. This is also *supportive for prices* long term, especially if combined with weather problems this year.
- **Exchange rate.** Expectations for continued weak economic growth mean that the consensus view is for the R\$ to weaken against the dollar moving back towards R\$2.4/US\$. The likelihood of this is increased if Dilma is re-elected. *This would be bearish for sugar prices.*



2015 Point to watch: A continued wide disparity between domestic Brazilian and world market gasoline values is likely to lead to an increase in the Brazilian gasoline price, but not until after the election or early 2015.



Conclusions

- Prices remain under pressure in the near term in the face of large export availability from northern hemisphere producers, notably Thailand, and weak global import demand. This has been reflected by the spreads widening close to the cost of carry.
- The logical outcome is for sugar prices to remain below Brazilian ethanol until this surplus has been eroded. However, there remain greater risks for future supply than there have been for some time (size of Brazilian crop/ El Niño).
- As the Brazilian harvest begins in earnest over the next month, price parity relative to hydrous ethanol will become an important factor to monitor, with our latest view suggesting that this could trade at 17-19 cents/lb over the coming months (at current exchange rates).
- However, the market is facing longer term risks around supply that are perhaps greater than they have been for some time. Producers in Brazil continue to mark down their expectations for yields this year, while the risk of an El Niño weather pattern emerging has increased further.
- Looking ahead, a key point to watch is the potential for a more bullish outlook for prices in 2015 if the Brazilian government is forced to increase gasoline prices and the 2015/16 Brazilian cane crop falls below crushing capacity, particularly if El Niño causes supply problems elsewhere in the world.



World price forecasts



Justification for our forecasts — raw sugar

Our base case view is based on the following assumptions:

Short term (0-12 months):

- The Brazilian *real* continues to trade at R\$2.23/US\$, the averaging prevailing rate in April and slightly stronger than our assumption last month, meaning that our price forecasts have increased slightly.
- The overall global surplus for 2013/14 (Oct/Sep) is 2-3 million tonnes, raw value, implying a trade surplus during 2014.
- The world moves into deficit of around 2 million tonnes in 2014/15. While Asian production may not show a significant downward production response, lower output from Brazil means that our early forecast is for a modest deficit.
- Prices start to recover from Q3/Q4 as the market looks ahead to reduced output in 2014/15.
- Brazilian gasoline prices remain unchanged going forward, although there is a risk they could increase after the election in October 2014.



Justification for long run forecasts — raw sugar

Our base case view relies on the following assumptions:

Long term (12-36 months):

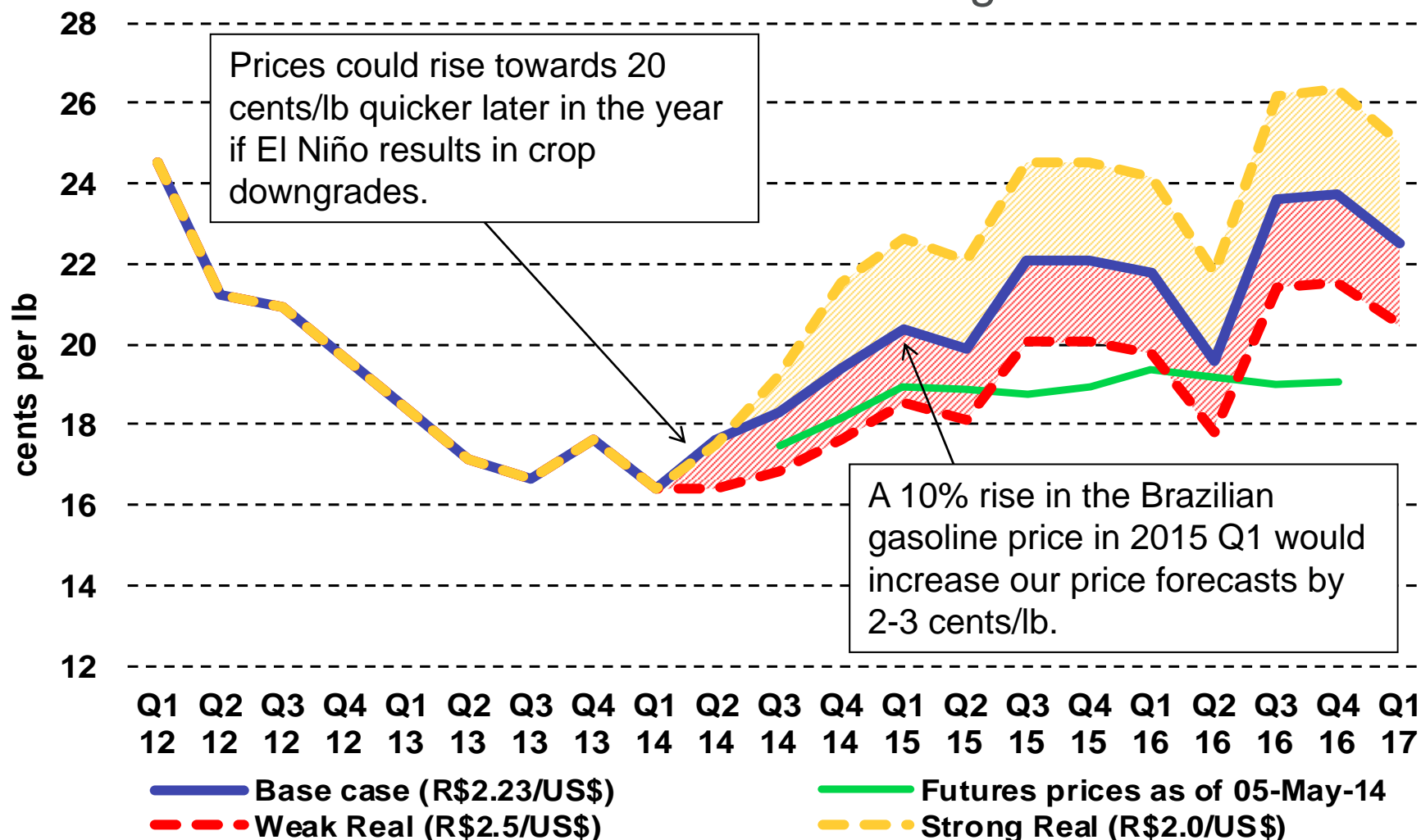
- The global balance returns to deficit in 2014/15.
- Brazilian *real* remains at R\$2.23/US\$ (given the difficulty forecasting exchange rates, we have assumed the *real* remains at the current level).
- In 2015, we have assumed that the build up in global stocks (and the threat of those stocks being exported, e.g. from India) means that prices do not need to rise to a level to encourage further investment in new capacity.
- Looking further ahead to 2016, Brazil does not add significantly to its production capacity, meaning that there will be a requirement for sugar to trade at a premium to ethanol (which we estimate at around 3 cents/lb) to encourage investment in crystallisation capacity.



Raw sugar price forecast

Note: For the purpose of our forecasting model, we have based our high and low forecasts on different R\$/US\$ exchange rates. However, as we discuss, there are many factors that could push prices above or below our forecasts

No.11 Raw Sugar Price Forecast



Based on our model result, our expected trading ranges are presented below for raw sugar

Trading ranges for raw sugar – 12 month outlook (No.11 contract)

Cents/lb	Q2	Q3	Q4	Q1
	14	14	14	15
Base case	16.1 - 19.1	16.8 - 19.8	17.4 - 21.4	18.4 - 22.4
High	16.0 - 19.0	17.7 - 20.7	19.5 - 23.5	20.7 - 24.7
Low	14.9 - 17.9	15.4 - 18.4	15.6 - 19.6	16.5 - 20.5

Detailed forecasts (data from chart)

	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
	14	14	14	15	15	15	15	16	16	16	16	17
Raw sugar												
Base case	17.6	18.3	19.4	20.4	19.9	22.1	22.1	21.8	19.6	23.6	23.7	22.5
High (R\$2.0/US\$)	17.5	19.2	21.5	22.7	22.1	24.5	24.5	24.2	21.8	26.2	26.3	25.0
Low (R\$2.5/US\$)	16.4	16.9	17.6	18.5	18.1	20.1	20.1	19.8	17.8	21.4	21.6	20.5



What could make prices rise above our base case forecast?

The upside risk for prices is limited in the near term, but there are some points to watch

Short term (0-12 months):

- More inclement weather in C/S Brazil during Q2/Q3 will impact further on cane development and the harvest. While our trade flow forecasts suggest that reduced Brazilian exports could be covered from other origins, the sentiment from Brazil could lead to higher prices and volatility.
- The Brazilian government increases the gasoline price after the election (we believe this is likely to occur) and/or raises the mandatory ethanol blend from 25% to 27.5%.
- The Brazilian government intervenes further to support the *real*. Fed Reserve actions re: bond buying program will also drive emerging market currency values.

Long term (12-36 months):

- R\$/US\$ strengthens further.
- El Niño impacts on sugar crops around the world leading to a larger global deficit in 2014/15.
- If the world generates a large deficit in 2014/15 or 2015/16, lack of expansion in Brazil could mean that it is unable to increase sugar production sufficiently. This could result in price spikes similar to the ones seen in 2010/11.



What could make prices fall below our base case forecast?

Short term (0-12 months):

- Further weakening of the R\$/US\$. This is a risk, particularly if the US accelerates tapering.
- The Brazilian cane crop recovers with good rains in Mar/Apr and Jun/Jul.
- Crops in the northern hemisphere exceed expectations.
- Chinese imports dry up due to large scale stock build up over the last 12 months.

Long term (12-36 months):

- R\$/US\$ weakens as quantitative easing comes to an end.
- India does not return to deficit in 2014/15 and 2015/16.
- If larger crops elsewhere in the world can be maintained, this will reduce the pressure on Brazil to increase its sugar output meaning that sugar prices do not have to trade at a premium to ethanol as we have assumed in our base case.



Justification for forecasts — white sugar

Our base case view is derived from the following assumptions:

Short term (0-12 months):

- The white premium is expected to remain under pressure going into Q2 2014.
- Stronger demand in Q2/Q3 should allow it to recover later in 2014, although any sustained increase in the premium is likely to lead to an increase in white sugar exports from India and Thailand and possibly Mexico, limiting the upside potential.

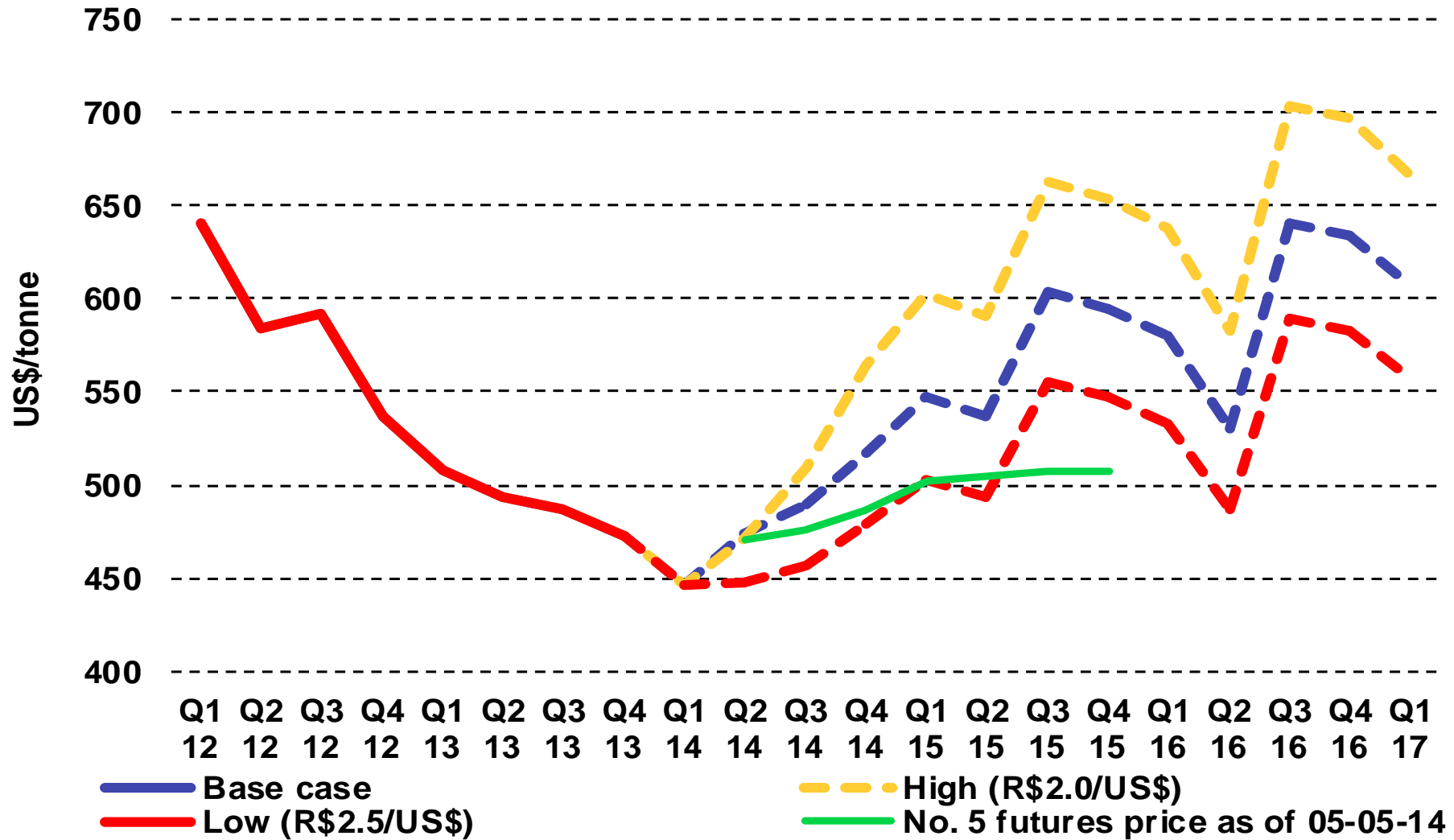
Long term (12-36 months):

- In order to cover their operating costs (assuming (US\$100/bbl oil), refiners need a white premium of around US\$100 per tonne.
- We have adjusted this to allow for the seasonal pattern of demand for white sugar.



White sugar price forecast

No.5 White Sugar Price Forecast



Based on our model result, our expected trading ranges are presented below for white sugar

Trading ranges for white sugar – 12 month outlook
(No.5 contract, US\$/tonne, f.o.b.)

US\$/tonne	Q2 14	Q3 14	Q4 14	Q1 15
Base case	444 - 504	459 - 519	477 - 557	508 - 588
High	441 - 501	479 - 539	525 - 605	562 - 642
Low	417 - 477	427 - 487	439 - 519	463 - 543

Detailed forecasts (data from chart)

	Q2 14	Q3 14	Q4 14	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Q4 16	Q1 17
White sugar												
Base case	474	489	517	548	537	604	595	581	530	640	634	606
High (R\$2.0/US\$)	471	509	565	602	590	663	654	638	582	703	697	666
Low (R\$2.5/US\$)	447	457	479	503	494	556	547	533	487	589	583	557



Based on raw and white price forecasts, our white premium forecasts are presented below

Trading ranges for white premium – 12 month outlook
(tel quel, US\$/tonne)

Cents/lb	Q2	Q3	Q4	Q1
	14	14	14	15
Base case	82 - 88	82 - 88	86 - 94	94 - 102
High	82 - 88	82 - 88	86 - 94	99 - 107
Low	82 - 88	82 - 88	86 - 94	91 - 99

Detailed forecasts

	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
	14	14	14	15	15	15	15	16	16	16	16	17
White premium												
Base case	85	85	90	98	98	117	108	101	98	120	111	109
High (R\$2.0/US\$)	85	85	90	103	103	122	113	106	102	125	117	114
Low (R\$2.5/US\$)	85	85	90	95	95	113	105	97	95	116	107	105



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