1. **PROJECT**

* 1. **Introduction**

United Sugar Co. (USC) is applying for a fourth SIDF loan of **SR 72 MM** representing 50% of total project costs; to fund productivity improvements and sugar capacity expansion from 520 M MT to 765 M MT. Additionally, part of the investment is directed at providing an incremental 120 M MT in new products capacity i.e. 80 M MT of liquid sugar (used in carbonated soft drinks) and 40 M MT of 4th boiling fine sugar, used in confectionery and baking industries.

The project was approved a Fund loan of **SR 275 MM** (Inv. # 1216/5-7-1413H) to establish the first white, crystal sugar refinery in the Kingdom. This original loan was followed by two SIDF, approved cost overrun loans of **SR 28 MM** and **SR 37 MM** in 1416H and 1419H, respectively. The latter two loans were used to support plant relocation and incremental costs incurred.

* 1. **Ownership**

USC is a limited liability company with paid-in capital of SR 395 MM, and ownership structure as per the following:-

1. Savola Sugar Investments - 51.18%

(Savola 32.5% & Al Muhaidib 18.68%)

1. 13 Saudi Sugar Traders/Industrial Companies - 33.82%
2. Tate & Lyle Co. Ltd. - 15.00%
   1. **Industrial License**

The sponsor has provided industrial license # 20 dated 06-02-1419H, which authorizes the following product range and licensed capacities:-

Fine, white crystal sugar - 340,000 TPA

Coarse, white crystal sugar - 175,000 TPA

Molasses - 21,000 TPA

An amended industrial license will be required to reflect the increased capacity and new products.

* 1. **Sponsor’s Sales Performance**

The imposition of 20% import duty on white sugar, in May 2000, has allowed USC to post its first year of profitablity (SR 28 MM, net profit), following cumulative net losses of SR 152 MM, in the prior three years. Prior losses were due to start-up delays, cost overruns, a dramatic downturn in the world, white premium and the absence of import duty to defend against preditory price/subsidized imports from UAE, China and Europe, specifically:-

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **USC: Financial Summary – 2000** | | | | |
| **Year** | **1997** | **1998** | **1999** | **2000** |
| **Local Vol. (M MT)** | **112** | **411** | **480** | **512** |
| **Export (M MT)** | **1** | **12** | **18** | **2** |
| **Total Vol. (M MT)** | **113** | **423** | **498** | **514** |
| **Total Rev. \* (SR MM)** | **153** | **529** | **478** | **547** |
| **R/M Costs (SR MM)** | **143** | **474** | **359** | **386** |
| **Net Profit/(Loss)** | **(34)** | **(100)** | **(18)** | **28** |

\* Includes molasses revenues/SR MM:- 1.0, 4.1, 3.3 and 3.3, respectively.

* 1. **Project Description/Rationale**

To improve profit margins and increase share of a strong, domestic growth market projected at 748 M MT in 2005, USC plan additional de-bottlenecking, capacity expansion and new products, as per the following:-

1. Improve reliability, flexibility and consistency in production process and product.
2. Improve technical efficiencies, increasing yields, output and minimize losses to molasses.
3. Increase output to 765 M TPA of white sugar by 2003, including the ability to produce 265 M MT of course sugar.
4. Provide production facilities for two new products, namely liquid sugar (80 M MT crystal sugar equivalent, substitute for crystal sugar in carbonated soft drinks and 4th boil, fine product (40 M MT) used in confectionery and baking sectors.

The rationale for the investment is supported by the following key benefits:-

1. Rapidly build domestic share and export sales to production capacity of 765 M MT and new products to 120 M MT, by 2003.
2. Grow domestic share and significantly increase cost competitiveness in anticipation of reduction or potential elimination of import duty by 2005.
3. Achieve a 26% reduction in unit (melt) operating costs by 2003; declining to SR 198/MT versus SR 266/MT, in 2003.
4. Correct the current, coarse sugar capacity constraint of 150 M MT, to grow share of domestic segment which is estimated at 208 M MT/33% of market in 2000.
5. Sell all high color sugar on export markets to protect domestic, fine crystal sugar volumes/price.
6. **PRODUCT**

To meet the needs of a market segmentation strategy and to differentiate competitively USC plans focuses on industrial sectors and sugar traders/re-packers (supply wholesalers retails and small industries), concentrating on a limited number of marketing offerings i.e. 50 kg, 1.2 MT jumbo bags and bulk shipments normally 25 MT, as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| **USC Products & Packaging Plan – 2003** | | | |
| **Product Range** | **Segment** | **Vol./M MT** | **% Total Mix** |
| **50 Kg Bags (Fine)** | **Traders & Industries** | **150** | **17** |
| **50 Kg Bags (Coarse)** | **Traders & Industries** | **180** | **20** |
| **50 Kg Bags (4th Boil fine)** | **Export Industries** | **40** | **5** |
| **1.2 MT Jumbo Bags (Fine)** | **Industries** | **255** | **29** |
| **1.2 MT Jumbo Bags (Coarse)** | **Industries** | **100** | **11** |
| **Bulk (Fine)** | **Industries** | **80** | **9** |
| **Bulk (Liquid Sugar)** | **CSD Industry** | **80** | **9** |
|  | **Total :** | **885** | **100** |

Molasses, the by-product of the sugar refining process is sold in liquid, bulk form for use as an animal feed ingredient.

1. **MARKET CHARACTERISTICS**

While there are no Saudi standards, fine and coarse crystal sugars are produced to international standard EEC 2 or better. Market demand is segmented 67% fine sugar directed primarily at the industrial sector and 33% coarse variety for consumer usage.

The sugar market is susceptible to highly volitile, weekly price shifts on the world sugar markets, given the commodity nature of the category. The pricing mechanism for finished product is driven by the World White Premium (WWP), which is the gross margin between selling price of white sugar and raw sugar costs. Strong crops, coupled with reduced demand (primarily in Asian and African markets) have resulted in depressed WWP and narrow producers’ margins in the past three years.

Historical preditory priced shipments from UAE and Chinese exporters, combined with heavily subsidized European exports have severely declined since the imposition of 20% import duty, in May 2000. This has permitted USC to achieve profitability in the 2nd half of 2000. Saudi Arabia is one of the last countries among over 100 duty supported states, with significant domestic sugar refining capabilities, to impose duty; to protect the local market against predictory pricing, for this strategically important food commodity.

4. **HISTORICAL SUPPLY/DEMAND**

4.1. **Domestic Supply**

Prioritizing the more profitable domestic market, USC have successfully built local unit sales to 512 M MT in 2000, equivalent to a 81.3% share of demand. Conversely, the sponsor has significantly reduced, lower margin exports to 2 M MT. The combined sales volume of 514 M MT has resulted in USC achieving 98.8% capacity utilization in the latest period.

4.2. **Imports**

FTS, six months data for 2000 report a total of 90 M MT of sugar imports from UAE (39 M MT), China (30 M MT) and Belgium (10 M MT). Imports data supplied by USC, from sea port unloading records, indicate a total of 125 M MT of imported crystal sugar for total year 2000.

4.3. **Demand**

Based on domestic and imports data, the refined sugar market has grown to 630 M MT in 2000, equivalent to 4.6% compound annual growth in the four years since USC entered the market. This higher than population growth (3.7%) is linked in great part to strong rises in the CSD consumption.

There has not been any local consumption of liquid sugar for use in carbonated soft drinks, dairy products, preservatives, sauce etc. This is due to lack of local supply and the delicate transport, storage nature of the product. The high distribution costs and risk of bacterial contamination restrict USC to targeting customers only in the Western Province.

There are very negligible quantities (1.2 MT) of lower grade (4th boiling) sugar imported into the Kingdom, from primarily South American countries.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **KSA: Historical Supply/Demand Trends – 2000 (M MT)** | | | | | |
|  | **1996** | **1997** | **1998** | **1999** | **2000** |
| **Market Demand** | **575** | **550** | **585** | **612** | **630** |
| **USC Volume** | **-** | **112** | **411** | **480** | **512** |
| **Mkt. Share (%)** | **-** | **20.4** | **70.3** | **78.4** | **81.3** |
| **Total Imports\*** | **647** | **358** | **237** | **132** | **125** |
| **UAE** | 87 | 118 | 90 | 66 | 70 |
| **China** | 300 | 125 | 92 | 38 | 40 |
| **France** | 110 | 72 | 23 | 5 | - |
| **A/O** | 150 | 43 | 32 | 23 | 15 |

\* Imports may exceed demand share due to inventory and re-exports.

5. **DEMAND FORECAST - 2005**

Driven by a projected population growth of 3.8% and continued strong demand in the industrial sector (60% of total market), sugar demand is projected to conservatively grow by 3.5% in the next five years building to 748 M MT in 2005, as follows:-

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **KSA: Sugar Demand Forecast – 2005 (M MT)** | | | | | | |
| **Year** | **2001** | **2002** | **2003** | **2004** | **2005** | **% CAGR** |
| **Mkt. Demand** | **652** | **675** | **698** | **723** | **748** | **3.5** |

6. **USC SALES FORECAST - 2005**

USC’s mission is to be the dominant crystal sugar and related products marketer in the Kingdom. The objectives are to more profitably grow market share across all market segments, achieving sales equivalent to 100% of expanded capacity by 2003. Strategically, the goals will be achieved by rapid capacity expansion, launch of new local and export based products and competitively optimize lower cost efficiencies, in anticipation of reduction or potential elimination of import duty in 2005.

Given the uncertainty in duty protection being maintained at 20% over the forecast period, volatility of world pricing and competitive export environment, MSCD recommends a more conservative forecast stance for crystal sugar. In the areas of the two new products, market research has not been completed by the sponsor. The challenges to convert CSD uses of crystal to liquid sugar have not been confirmed/proven; given the potential customers’ stringent product specifications and required capital investments. Additionally, the sponsor’s forecast has not fully accounted for cannibalization of liquid (68% brix, i.e. 1 MT liquid equals 1.47 crystal) on crystal sugar demand. The 4th boiling sugar export targets of East African countries has yet to be determined.

Consequently, due to above issues, combined with potential for delays in full implementation of expansion plans, MSCD recommends reduced projections, as follows:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **USC: Sales Forecast – 2005 (M MT)** | | | | | | |
|  | **Year** | **2001** | **2002** | **2003** | **2004** | **2005** |
| **Market** | **652** | **675** | **698** | **723** | **748** |
| **USC F/C** | **Sugar Vol. (local)** | 550 | 650 | 698 | 723 | 748 |
| **% Share** | 84.3 | 96.3 | 100 | 100 | 100 |
| **Exports** | - | - | 67 | 43 | 17 |
| **Total :** | **550** | **650** | **765** | **765** | **765** |
| **Liq. Sugar** | - | - | 80 | 80 | 80 |
| **4th boil (export)** | - | - | 40 | 40 | 40 |
| **MSCD F/C** | **Sugar Vol. (local)** | 550 | 620 | 630 | 650 | 660 |
| **% Share** | 84.3 | 91.9 | 90.3 | 89.9 | 88.2 |
| **Exports** | - | 20 | 60 | 70 | 70 |
| **Total :** | **550** | **640** | **690** | **720** | **730** |
| **Liq. Sugar** | - | - | 30 | 40 | 60 |
| **4th boil (export)** | - | - | 20 | 30 | 40 |

7. **PRICING STRATEGY**

The world rebate premium declined significantly in 2000, to an average $ 43.5/MT; severely straining profitability throughout the industry. Increases in raw sugar prices of 33% (2000/1999) were only partially reflected in white sugar prices (+ 15.3%). The white premium continued to decline in 2001 reaching as low as $ 26 in third week of January. Details of world raw and white sugar price trends in Appendix 1 and 2.

|  |  |  |  |
| --- | --- | --- | --- |
| **World Sugar Pricing Trend (US $/MT)** | | | |
| **Year** | **Raw Sugar** | **White Sugar** | **White Premium** |
| **1995** | **299** | **390** | **91** |
| **1996** | **269** | **368** | **99** |
| **1997** | **238** | **301** | **63** |
| **1998** | **212** | **269** | **57** |
| **1999** | **135** | **193** | **58** |
| **2000** | **179** | **222.5** | **43.5** |

Source: USC

The effect of increased white sugar prices and the impact of 20% duty has resulted in a 53% - 57% increase in USC’s factory selling prices from SR 840 – 860/MT to 1320/MT 1st half versus 2nd half 2000. At wholesale level, this has resulted in the key 50 Kg bag price increasing from SR 51 to SR 78 in the period.

USC’s pricing objectives are to optimize profits prior to potential, import duty elemination in June 2005. The plan is based on 2001 prices **(it is important to note that USC have not supplied requested 5 year detailed sales, pricing and financial forecasts),**  and assumes 10с/lb raw sugar No. 11 (SR 826.5/Mt) and US $ 45 world white premium, yielding the following factory selling prices:-

|  |  |
| --- | --- |
| **USC: Factory Selling Prices SR/MT** | |
| **Product** | **Selling Price** |
| **Fine** | **1400** |
| **Coarse** | **1440** |
| **Liquid Sugar\*** | **1320** |
| **4th Boiling Sugar** | **1300** |
| **Molasses** | **225** |

\* Based on crystal sugar equivalent.

While, MSCD supports the sponsor’s base selling price assumptions, in principle, given historical developments, it is recommended that sensitivity analysis be conducted at reduced raw sugar costs (8.5 – 9.5 c range), with white premium ranges of $ 50 - $ 60 over the forecast period (still below historical levels of $ 70). Additionally, given the competitive environment, crystal sugar export selling prices should be calculated at a minimum 10% discount to domestic prices. Further, a volume promotion discount equivalent to 0.2% of gross sales needs to be applied.

**Conclusion**

The strategy to rapidly expand capacity and reduce costs (USC estimated at SR 68/MT), equivalent to 26% reduction in unit melt operating costs), to more competitively profitably grow domestic share is sound. This is supported by strong growth market, current capacity constraint on coarse sugar, MSCD assumption that competition will implement efficiency/cost reduction and potential that import duty will be reduced/eliminated. Successful implementation of liquid and 4th boiling sugars need to be confirmed through comprehensive research.  **Long term domestic sales forecast (risk 150 – 200 M MT), unit revenues and profitability will again be at risk/compromised without the support of a minimum 15% import duty beyond 2005**. Sensitivity analyses need to confirm long term ability of debt repayment and acceptable returns on investments, without the benefit of duty protection.