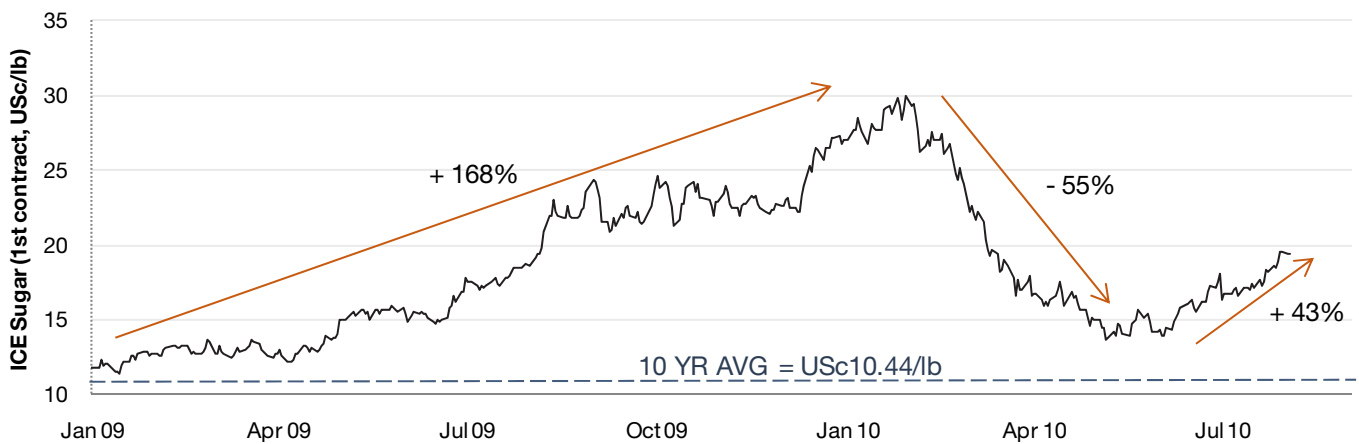


Sugar - the roller-coaster continues.

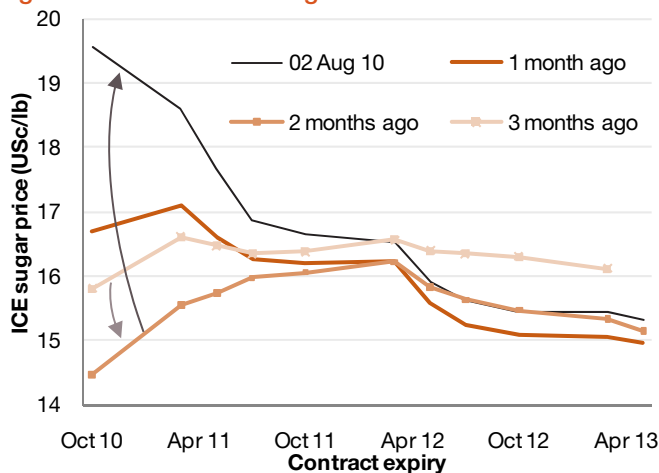
- The roller coaster in global sugar prices has continued with the New York raw sugar market rallying over 40% since the start of May. This follows the beating from 30 cents to 13 cents in the first few months of 2010.
- Current raw sugar prices, at ~USc19.40/lb are nearly double the prior ten year average of USc10.44/lb (first contract). The resurgence in prices in the past few months is the result of the continued global supply squeeze. Furthermore increased price volatility typically exists in most commodity classes as stocks decline to extremely tight levels.
- We expect that volatility in the global sugar market to persist in the near term. But we predict that prices will come under downward pressure as the market's supply squeeze dissipates in the fourth quarter.

Figure 1: ICE raw sugar futures (first contract, USc/lb)



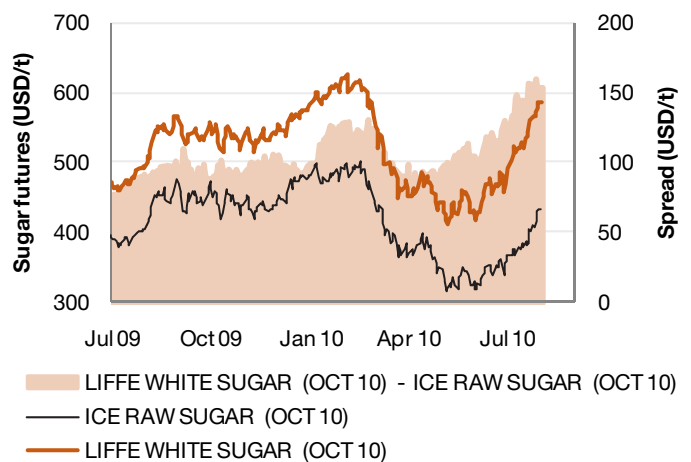
- The markets' bounce since May has been nearly as impressive as the declines observed in the preceding three months. The two key attributes of the rally since May are that (1) It has mainly been confined to nearby contracts; and (2) refined sugar prices have led recovery.

Figure 2: New York raw sugar curve



Source: Bloomberg and CBA

Figure 3: Raw vs white sugar (Oct 10 contract, USD/t)



Source: Bloomberg and CBA



Front end curve movements

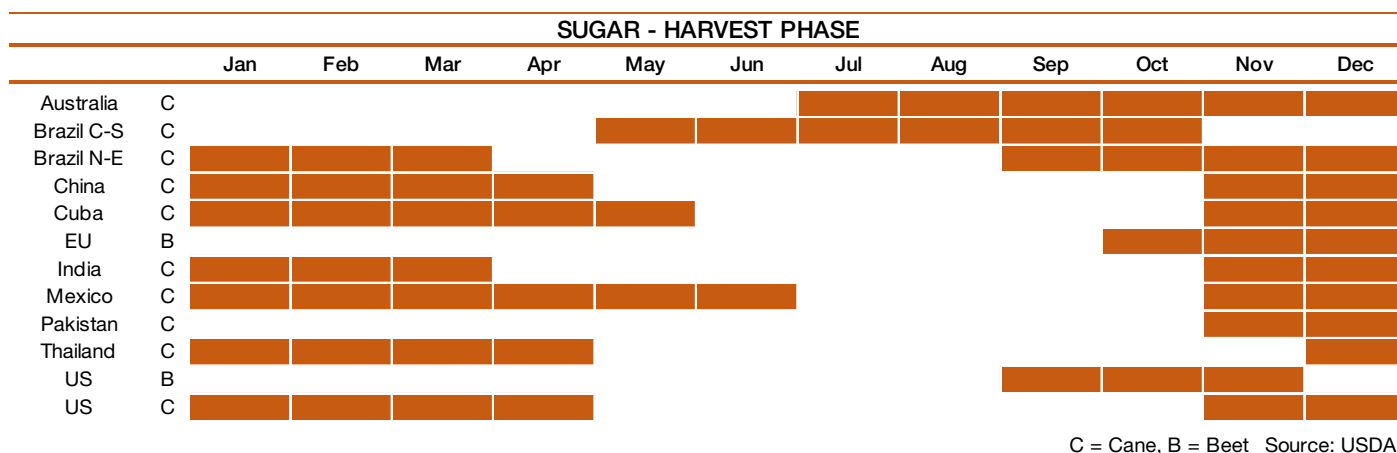
The whip-like action in the front end of the sugar curve and the expanding white sugar premium is the result of the nearby supply squeeze. Key importing nations – such as Pakistan – who deferred purchases back in Q1'10 had to come back into the market in Q2 and Q3 to satisfy domestic demand requirements. A significant proportion of this buying had to be focussed on refined sugar because of time constraints, thereby supporting the refined sugar premium.

Other factors helped support prompt values. This included:

- Production concerns in the Thailand, the world's second largest exporter. This resulted in downwardly revised Thai production estimates and the dramatic Thai government sugar buyback of nearly 75kt of 2009/10 white sugar. As a result, Thai white sugar prices continue to set record premiums over London white futures.
- The world's reliance on Brazil to satisfy demand through the middle of year, which left the market extremely susceptible to any potential issues originating in Brazil. Talk of lower yields in the back half of the Brazilian season raised concerns that production would fail to meet expectations. Plus frequent reports of logistic logjams at Brazilian ports through the month of July, and therefore delayed exports, helped support market mentality.

Figure 4 indicates that the world is primarily reliant on Brazilian supplies through to Q4; however it is also evident that the local Australian exporter is also well placed to fill the supply void.

Figure 4: Global sugar harvesting



How long will the gains persist?

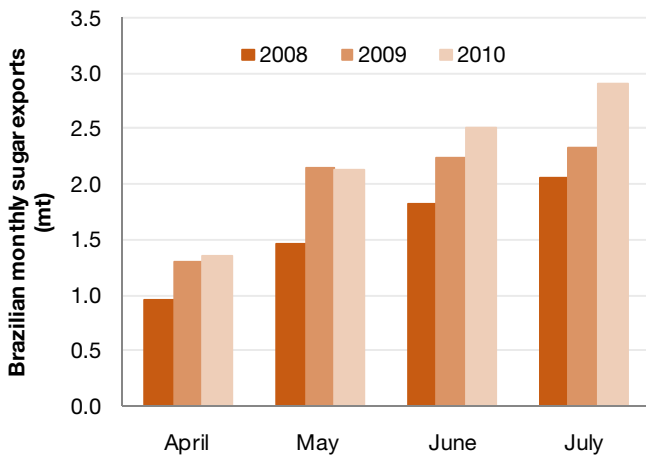
We are a little wary about how long the gains in global sugar persist will persist. In particular, we feel that the concerns about logistic logjams / export delays in Brazil are a little overcooked.

Are there Brazilian export delays?

In fact, Brazilian sugar exports in the month of July 2010 hit a record 2.9mt. This smashed the previous monthly record of 2.55mt set in September 2009 and easily surpassed July 2009 exports of 2.3mt. Furthermore, the record result in July followed the very strong 2.5mt shipped in June 2010. In the current Brazilian marketing year (from 1st April), Brazilian sugar exports totalled 8.9mt, up 11% from the corresponding period last year.

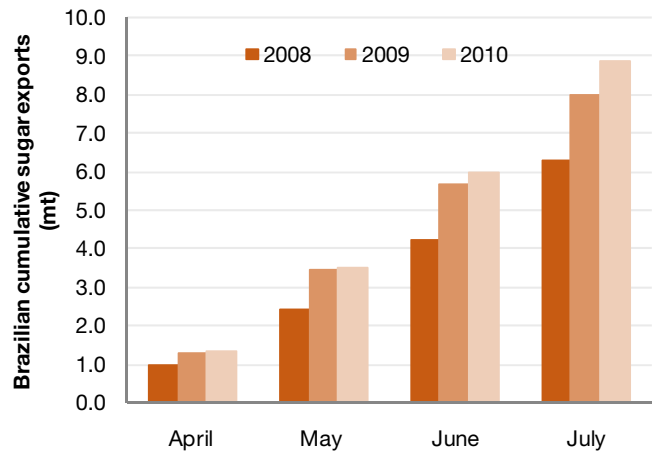


Figure 5: Brazilian sugar exports, monthly (mt)



Source: Unica and CBA

Figure 6: Brazilian sugar exports, cumulative (mt)



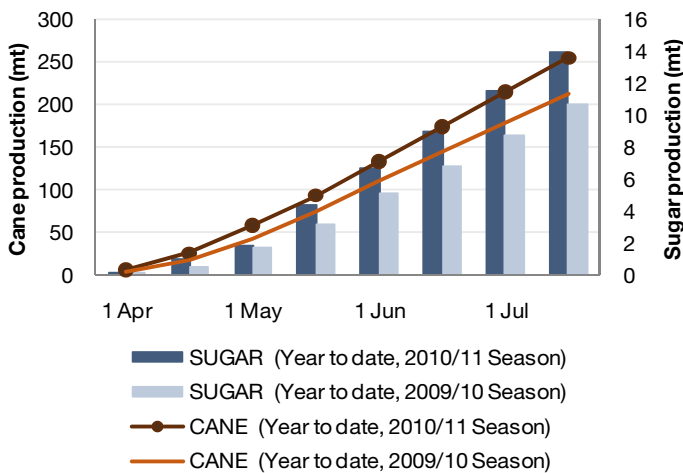
Source: Unica and CBA

Brazilian centre-south crush continues to surge.

Supporting strong Brazilian sugar exports is the very strong centre-south crush. Back in March Unica forecast the Brazilian cane crush would reach 596mt in 2010/11, up 10% from 2009/10 while sugar production would surge 19% to a record 34.1mt in 2010/11 (figure 8).

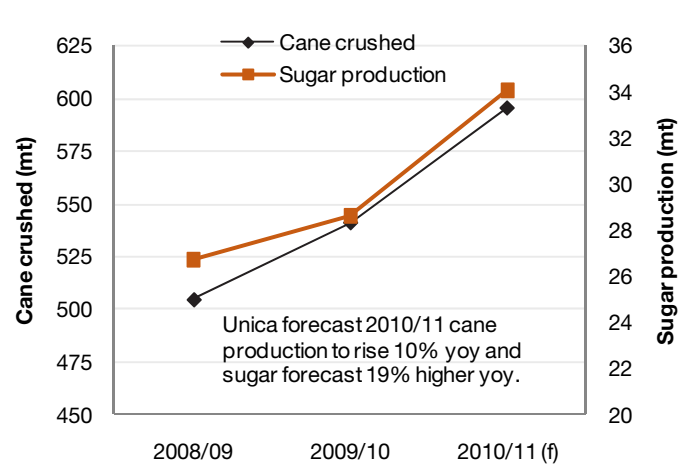
Indeed, YTD centre-south production has been particularly strong. In each of the fortnightly periods from April through to mid July, cane crushing and sugar production easily exceeded the corresponding periods a year earlier. From 1 April through to 16 July, cumulative centre-south cane production was 256mt, up 20% from a year earlier; sugar production was over 14mt, up 30%; and sucrose yields averaged 130.8kg/tonne of cane, up 25%. Even with a decline in cane yields in the back half of this season, as many analysts are predicting, Brazilian sugar production is on target to meet Unica's forecast.

Figure 7: Brazilian cane and sugar production results



Source: Unica and CBA

Figure 8: Brazilian cane and sugar production forecasts.



Source: Unica and CBA

India's crop on the rebound

Uncertainty still shrouds the size of the upcoming subcontinent cane harvest. All reports indicate that there has been a significant increase in Indian cane acreage. But the below average Indian



monsoon rains early in the season cast doubt about the possible rebound in yields.

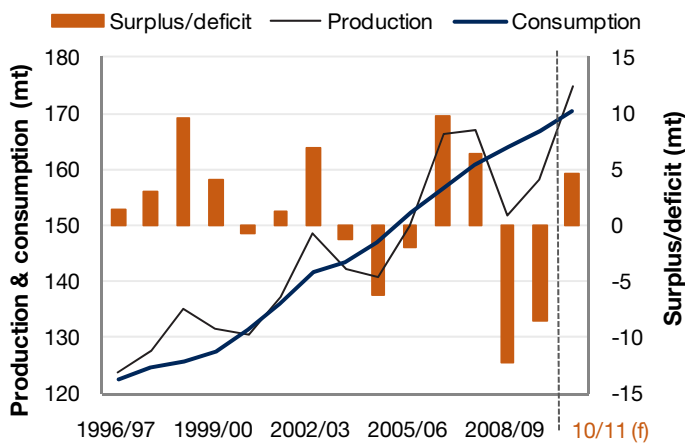
However, despite the slow start to the season, rains have improved and most forecasts for Indian sugar production now centre on 25mt. This is up from earlier forecasts of 23mt and up sharply from drought affected crops of the prior two years (18.8mt last year and ~14½mt in 08/09).

Additionally, some forecasts for the upcoming harvest have been as high as 28mt, a level that would dwarf their domestic consumption requirement of around 23mt. The possibility of substantial Indian sugar exports in 2011 is rising, yet their first priority must be in rebuilding depleted reserves.

Global production response

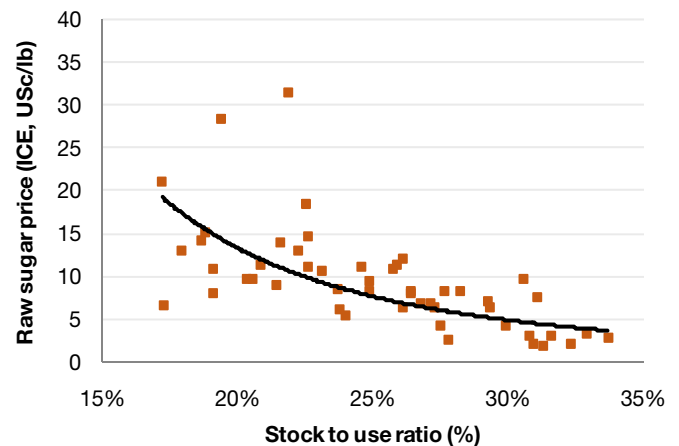
Largely a result of big crops in Brazil and India, we expect global sugar market to return to a significant surplus in 2010/11 of around 5mt (see figure 9). Furthermore, the supply surplus could swell to 8-10mt in 2011/12 because of the very strong prices currently on offer. This rebound in production will help restore global stock levels from Q4'10. We expect this rebuild in stocks to continue throughout the 2011 and into the early stages of 2012.

Figure 9: Global raw sugar supply balance sheet



Source: ISO and CBA

Figure 10: Raw sugar prices verse global sugar inventories



Source: USDA, Bloomberg and CBA

Price expectations

This rebound in global supplies is the key factor underlying our projection of weak international sugar prices over the coming 18 months.

Such a scenario would be consistent with patterns of prior international sugar price spikes. We have previously highlighted (6th May CBA Agri Updates) that the 3 previous major price spikes (1974, 1980 and 2005) had two key features. Firstly, prices return to where they started, and secondly, each cycle is 'somewhat' symmetrical. Applying these themes to the current market suggest that the market will bottom out by the middle of 2011 around 11 cents per pound.

Furthermore, our expectation is that firm Australian dollar will also pressure domestic values.

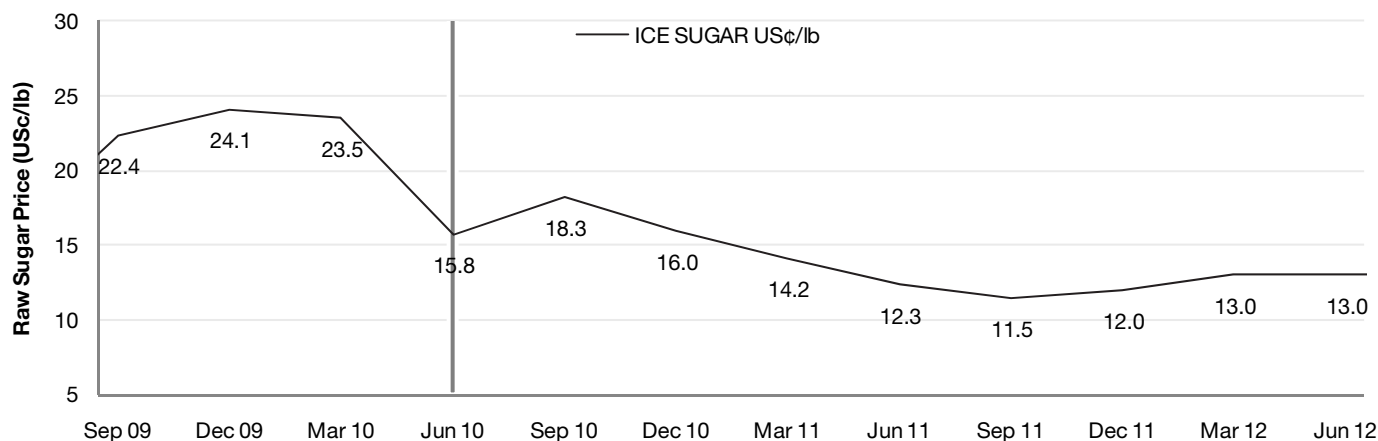
The main threats to increased world production, and therefore higher prices in the next 6-12 months, include the possibility of:

- Weaker than expected Thai sugar production in 2010/11 (which we assume has already been accounted for),
- deteriorating Russian and EU beet harvests because of excessive dryness, and/or,
- lower than expected Chinese cane harvests.



Longer term, we still favour the prospect of higher sugar prices with increasing demand out of Asia, in particular China, the main driver. Chinese sugar consumption has been expanding by around 5% per annum (compound), and will likely result in China becoming the world's largest importer within the next 5 years. Increasing import reliance by China, and the continued growth in the cane based renewable fuel sector, supports longer term sugar prices.

Figure 11: ICE raw sugar price forecast (nearby contract, USc/lb, quarterly average)



Source: CBA Research

Figure 12: Forecasts (Raw sugar and AUD/USD)

| | | Current | Actual (Quarter Average) | | | | Forecast (Quarter Average) | | | | | | | | | | |
|-----------------------|---------|--------------|--------------------------|--------|--------|--------|----------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| | | at 3/08/2010 | Sep 09 | Dec 09 | Mar 10 | Jun 10 | Sep 10 | Dec 10 | Mar 11 | Jun 11 | Sep 11 | Dec 11 | Mar 12 | Jun 12 | Sep 12 | Dec 12 | Mar 13 |
| Raw Sugar (ICE) | USc/lb | 19.4 | 22.4 | 24.1 | 23.5 | 15.8 | 18.3 | 16.0 | 14.2 | 12.3 | 11.5 | 12.0 | 13.0 | 13.0 | 13.0 | 13.4 | 13.6 |
| | US\$/t | 428 | 493 | 532 | 519 | 347 | 402 | 353 | 312 | 272 | 254 | 265 | 287 | 287 | 287 | 296 | 299 |
| | A\$/t | 469 | 578 | 589 | 578 | 400 | 457 | 421 | 384 | 333 | 302 | 311 | 337 | 337 | 337 | 348 | 352 |
| Currency (period end) | AUD/USD | 0.91 | 0.88 | 0.90 | 0.92 | 0.85 | 0.87 | 0.82 | 0.81 | 0.82 | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 |

Source: CBA Research

Figure 13: Australian sugar price matrix (A\$/t)

| | | AUD/USD Exchange Rate | | | | |
|------------------------------|------|-----------------------|------|------|------|------|
| | | 0.75 | 0.80 | 0.85 | 0.90 | 0.95 |
| ICE Raw Sugar Price (USc/lb) | 10.0 | 294 | 276 | 259 | 245 | 232 |
| | 12.5 | 367 | 344 | 324 | 306 | 290 |
| | 15.0 | 441 | 413 | 389 | 367 | 348 |
| | 17.5 | 514 | 482 | 454 | 429 | 406 |
| | 20.0 | 588 | 551 | 519 | 490 | 464 |
| | 22.5 | 661 | 620 | 584 | 551 | 522 |



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