# Cement: Industry Update H1FY19

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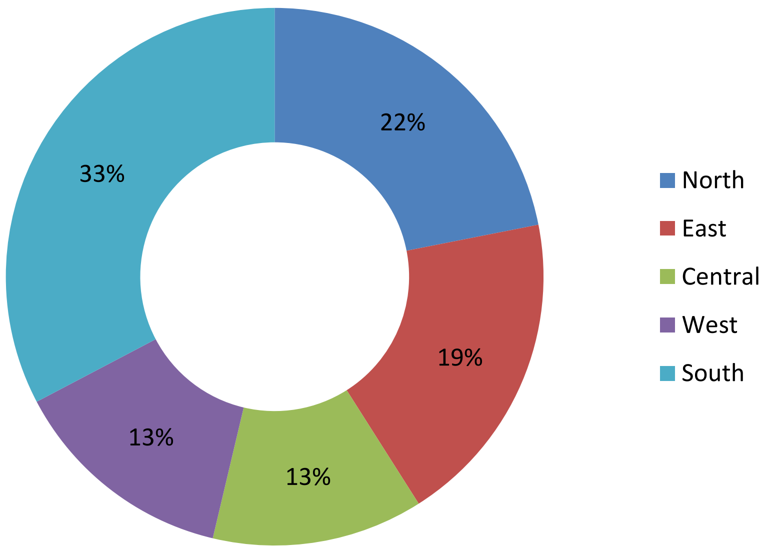
Cement industry in India witnessed robust growth of 14.4% during H1FY19 after having witnessed revival during FY18 backed by Government spending on infrastructure.

During the H1FY19, stable construction activity in residential real estate, increased demand from affordable housing and robust demand from infrastructure segment have ensured cement capacity utilization improves to 70%.

Construction activity picked up in the housing segment across Western, Eastern and Southern Region. Affordable housing scheme for rural and urban areas supported demand for cement in the housing segment. Though floods in the Southern state of Kerala and Karnataka disrupted demand during the Aug-September months, it is expected to recover in the following months as reconstruction and rehabilitation work picks pace.

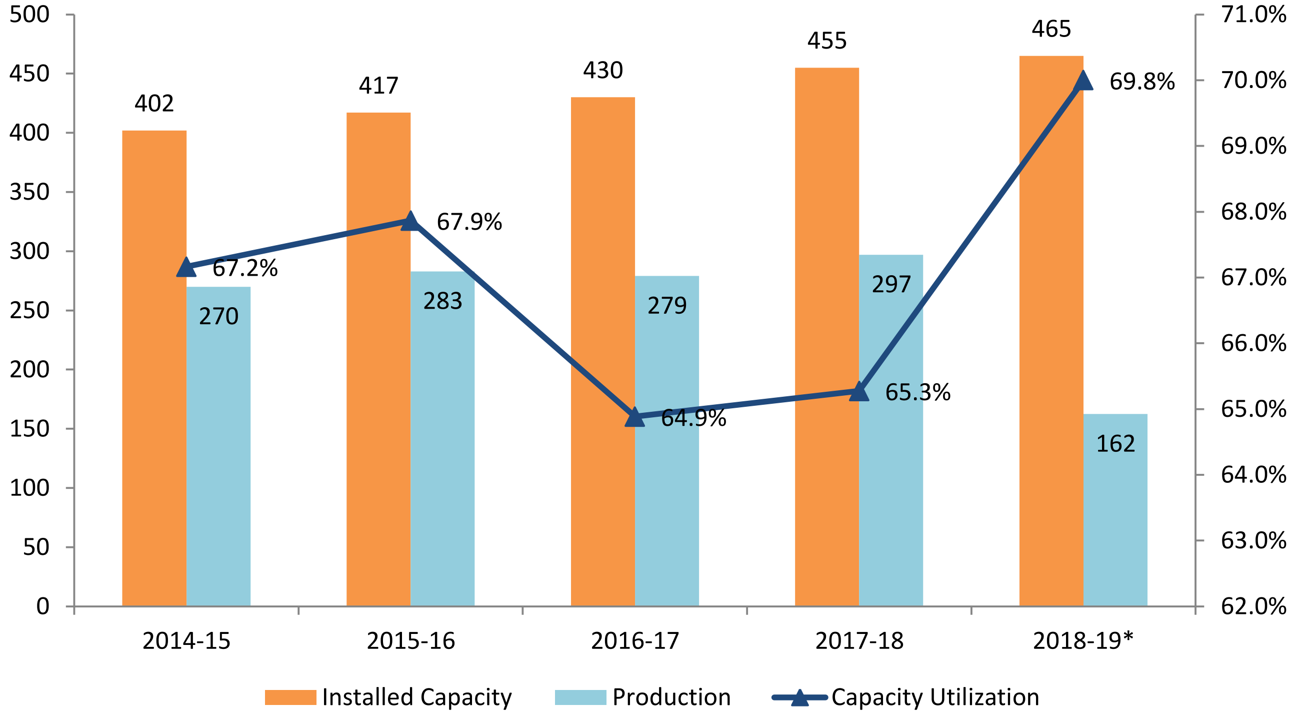
Northern and Central region witnessed higher activity in the infrastructure segment, especially with elections in 3 states in the region namely Rajasthan, Madhya Pradesh and Chhattisgarh.

***Graph 1. Installed Capacity***




The overall trend of prices witnessed a slight decline for a 50kg bag of cement. Southern market with a 33% share of installed capacity continued to record lowest prices. Eastern and Northern markets recorded the highest prices, especially states like Punjab, Haryana and West Bengal.

Graph 2. India: Supply, demand (in million tonnes) and capacity utilization (in %)




*Source: CMIE, CARE Estimates *Production Data for April-September FY19*

**India: FY19 Updates**

- Cement production during H1FY19 stood at 162.4MT MT, 14.4% higher than 142 MT cement production in H1FY18. Total installed capacity stood at approximately 465 MT. The regional break-up of installed capacity is shown in Graph 1.
- Overall capacity utilisation has improved by over 4 percentage points to close to 70% which is a substantial improvement. Higher volume would provide some comfort and help spread the increased cost of fuel & power for manufacturing.
- The year witnessed steady implementation and completion of mega-infrastructure projects especially in the Northern and Central region with Rajasthan and Madhya Pradesh set for Assembly Election in Nov-Dec. Union Government-backed mega-infrastructure projects such as "Bharatmala" for roads, "Sagarmala" for ports and development of dedicated freight corridors and smart city projects witnessed a surge in activity in terms of award and implementation of new and existing projects respectively. Around 34 infrastructure projects with an outlay of over Rs. 150 crore have been completed in April-August period across major infrastructure sectors.
- Two successive years (FY18 & FY19) witnessed above average monsoons ensuring steady demand from housing segment especially rural housing. Real estate segment witnessed stable activity and there are signs of improvement over H1FY18 which witnessed disruption due to Demonetization, RERA and GST. Affordable housing in rural areas continued to boost the demand in housing segment and the same is expected to peak by the end of Q3FY19.

**Demand Drivers:**

Cement consumption can be broadly classified into demand from three segments:

- Housing and real estate (63-65%)
- Infrastructure (22-25%)
- Commercial and Industrial development (10-12%)

*Housing and real-estate segment* is driven by demand from rural and urban housing in affordable segment. Above average monsoon ensured steady demand from the rural markets. In the residential real estate segment, the demand has remained stable and construction activity improved in H1FY19 vs FY18. RERA implementation had led to disruption in construction activity and real estate developers abstained from launching new projects in Q1 and Q2 FY18.

We expect the affordable housing activity to increase going forward in Q3 & Q4 of FY19 as the general elections close-in. The Union Government allocated Rs. 65 billion for urban housing and Rs. 210 billion for rural housing. 4.5 million Rural houses were completed in FY18 and a similar number is expected to be achieved in FY19. Above average implementation and completion of affordable housing targets for the current fiscal year, would lead to the sustained demand growth for cement going forward.

*Table 1. Affordable Housing (Gross Budgetary support)*

| | 2017-18 | 2018-19 |
|---|---|---|
| | *Budgetary support* | *Budgetary Support* |
| PMAY-Grameen | Rs. 23,000 | Rs. 21,000 |
| PMAY-Urban | Rs. 6,043 | Rs. 6,500 |

*All figures in Rs. crores Source: Budget 2018*

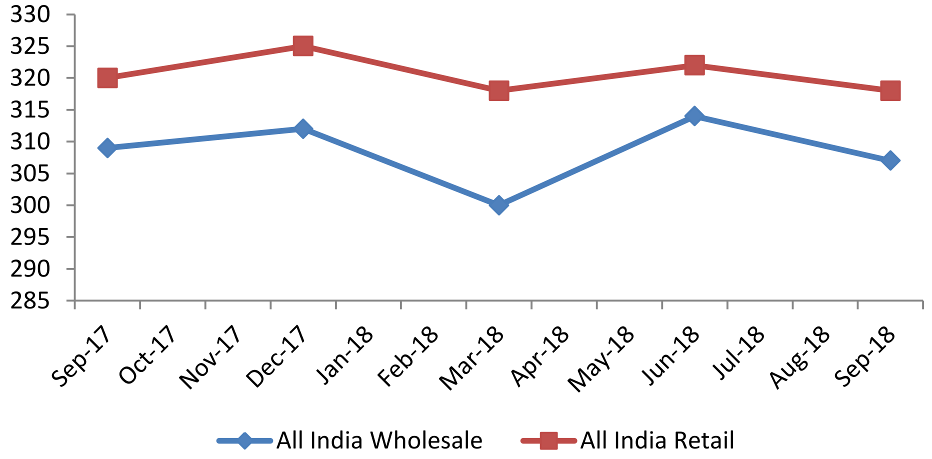
*Infrastructure segment* may continue to remain in focus during the year as far as cement demand is concerned. Roads and public infrastructure like railways, bridges, metros would contribute to over 3-5 MT of incremental demand for cement. The development of the infrastructure projects is dispersed across regions and hence, cement demand is expected to remain high across all the 5 regions. Southern states of Andhra Pradesh and Telangana have been drivers of demand in their region due to new infrastructure development in Andhra Pradesh and pending elections in Telangana.

*Sand availability* which has been a challenge across the country and especially Central and Northern states of MP, UP and Bihar seems to be easing out. Bans and restrictions are gradually expected to be eased out once a mining policy is in place to be finally implemented by respective states. A draft mining policy has already been initiated, which focuses on curbing illegal sand mining and make the market more accessible for buyers in order to curb cartelisation in pricing of sand. There are also reports of sand being imported from Malaysia and close to 1 lakh tonne having reached the Indian shores, though pricing and other details are still unclear. But this does highlight the need to address the larger issue of availability of sand for construction.

## Pricing- Regional capacity and demand key to prices

- Cement prices have remained range bound even though demand has increased substantially. Northern and Eastern region continue to be regions with better price realisation and Southern region continues to be the most competitively priced.
- With an exception of Kerala where the cement prices have remained high due to very less installed capacity for manufacturing cement in the state, other southern states continue to report lowest price for cement in the country.
- The difference between wholesale and retail prices of cement has narrowed, which is indicative of retail segment still being price sensitive and institutional segment driving most of the demand for cement.

**Graph 3. Cement Prices (in Rs. /50 Kg bag)**




*Compiled by CARE Ratings, Source: CMIE*

- Western, Central and Eastern region with favourable demand continues to record higher price for cement. These regions are driven by demand from infrastructure, housing and commercial real estate. Competition in this region is offset by limited capacity expansion plans in the near future which supports higher prices.

## Capacity addition:

Madhya Pradesh, Rajasthan, Andhra Pradesh, Gujarat, Chhattisgarh, Tamil Nadu and Karnataka are the largest limestone producing states in the country which is an essential raw material for cement.

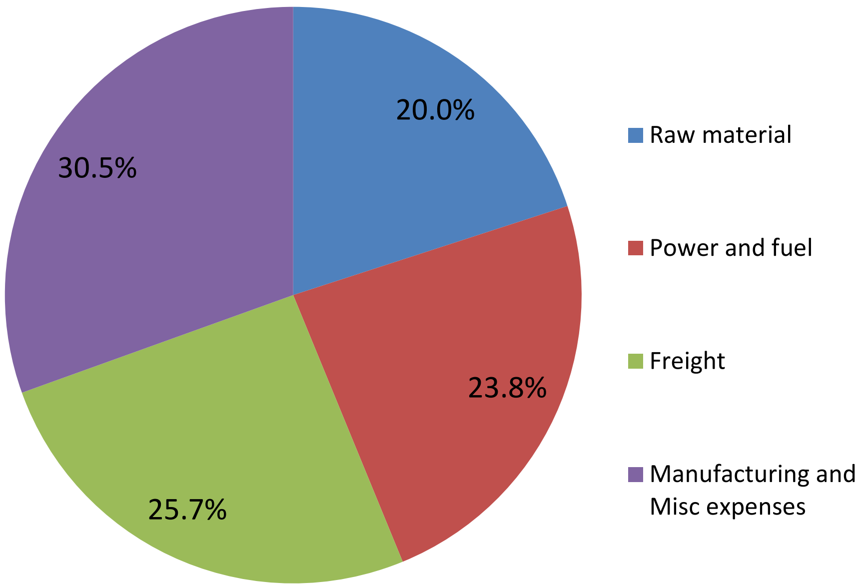
- During FY19, capacity addition of around 5-7 MT is expected in Eastern and Western region. Central, Northern and Southern regions combined are expected to witness an addition of 8-10 MT of production capacity. The top 6 cement manufacturers have been expanding in newer geographies, which can be inferred from the latest round of limestone blocks auctions. They would continue to add sizeable capacity across these regions.
- During the last 18 months, the industry witnessed consolidation with existing large players taking-over assets of smaller-regional players. There have been some new developments in the form of resolution of Non-performing assets under the Insolvency and Bankruptcy Code in the cement industry. The trend is expected to continue and expected future capacity addition would be in the form of brownfield expansion in these acquired assets. Acquiring cement assets is cost affective for the acquirer and provides access to new market and a ready-made supplier network.

**Cost drivers:**

Breakup of major costs in cement industry is shown in Graph 5. Among the major costs, change in prices of few raw-materials, feedstock and fuel are expected to drive costs and hence affect the operating margins of cement producers.

- **Fuel and power:** Petcoke is used as feedstock for production of clinker. India imports around 45% of its petcoke requirement and the remaining demand is met by domestic refineries.

***Graph 4. Cement Industry cost break up***




*Compiled by CARE Ratings Source: Aceequity*

  - Petcoke prices have remained on the higher side (Rs. 7,800-8,500 / per tonne) and imported coal too has remained at $100 and above which has left less scope for manufacturers to offset feedstock costs. An upward movement in Dollar vs Rupee has further hiked the price of imported feedstock.
  - Power prices from spot market too have remained high and non-captive power users had to pay heightened power tariffs as a result of scarcity of coal supply during peak-demand period.
  - Fuel and power prices on an average for the industry have increased by 15-18% during H1FY19 over the corresponding period in the previous year.

- **Freight:** Rising diesel prices would have a direct impact on the margins of cement manufacturers. Freight costs as per our estimates now account for more than 1/4$^{th}$ the total cost of cement manufacturers. Cement manufacturers with higher dependence on road freight for transportation of raw materials and supply of finished cement to markets would be impacted in case of a further increase in diesel prices.
- The overall operating margin for the industry has declined by 3% y-o-y due to fuel, freight, currency and power cost impact. Additionally, Clinker, which is a key raw-material for cement, too has witnessed an increase in few regions, which has further impacted the operating margins of some companies. Manufacturers are finding it difficult to pass-on the costs due to the heightened competition across some regions.

## Outlook:

- The cement production is expected to cross 310 million tonnes during the year 2018-19. We continue with our earlier estimate on cement production, to grow by 5.50-6.50% during FY19. Housing and real estate segment demand is expected to grow by around 5% whereas Infrastructure and commercial sector is expected to grow by 6-8%.

- Two major states (Rajasthan and Madhya Pradesh) going into Assembly elections followed by General Elections in Q1-Q2 CY2019, the demand from infrastructure and construction is expected to peak in central, eastern and western region.

- We continue to expect prices to remain range bound and may fall further with addition of new capacity especially in the Southern region. We expect the all-India prices to remain in the range of Rs. 317(+/- 5% per bag post GST) during the year. Further fall in prices in few regions may be an indicator for improvement in installed capacity utilization especially in Southern region.