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Cement Industry: April-November update

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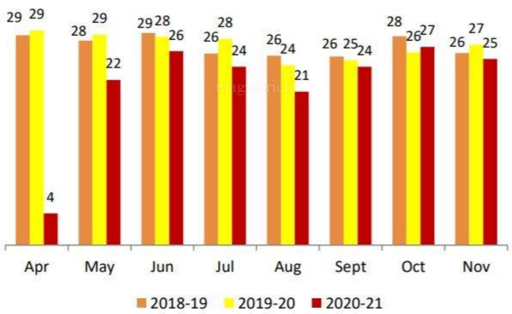
Demand-Supply during April-November 2020 i.e. 8M-FY21

Domestic production and capacity utilisation

Table and chart 1: Domestic production of cement (Unit: Million tonnes)

	Production	Change (y-o-y)
2018-19	217	14.2%
2019-20	217	0.0%
2020-21	175	-19.5%



Source: Office of the economic advisor, CARE Ratings

After registering a positive growth in the previous month, cement production has yet again fallen by 7.1% during November 2020. Fall in production could indicate waning pent-up demand and normalising of operations in the infrastructure space.

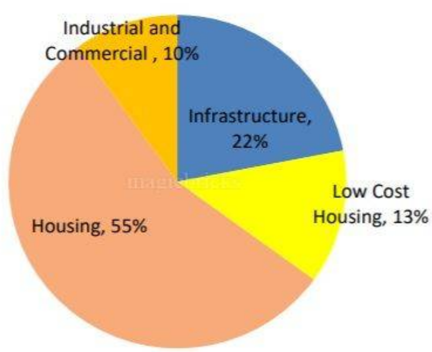
Cumulatively domestic cement production has fallen by 19.5% during 8M-FY21 compared with the 14.2% growth and 0% no-growth achieved during 8M-FY19 and 8M-FY20. Outbreak of the COVID-19 pandemic in the Indian sub-continent which forced the government to announce a nation-wide lockdown, 25th March 2020 onwards has majorly affected the cumulative domestic cement production. The nationwide lockdown had come at the time when construction activities are at its peak.

Capacity utilisation of domestic manufacturers has been around 48% during 8M-FY21 as units have been operating at sub-par capacities along with staggered shifts but has increased from it being 45% and 47% during H1-FY21 and 7M-FY21. Cement manufacturers had cut down or deferred CAPEX expenditure given the fall in demand and also as companies looked to conserve their capital/cash flows but lately some of the players have been announcing CAPEX expansion plans.

Trend in demand drivers for the Cement Industry

Cement demand is closely linked to the overall economic growth, particularly of the housing and infrastructure sector. Increasing demand from affordable housing and construction work for other government infrastructure projects like roads, metros, airports, irrigation etc. are demand drivers which support cement demand.

Chart 2: Key growth drivers for the Cement Industry



Source: CARE Ratings, Company Filings

Amidst the pandemic cement consumption is growing strong in the rural, semi-urban and retail markets. Over the months, cement demand is being driven by rural India due to better labour availability; there has been an increase in construction of rural infrastructure and low cost housing. Rural demand is usually w.r.t. retail market largely which is the housing and repair and modification market.

Now as the economy has unlocked, demand has started to gain traction, with most regions reporting growth with construction activities too picking up pace. Cement demand which has been particularly tepid in metros/tier 1 cities too is recovering in a calibrated manner.

- Real Estate markets in Tier-1 cities has been opening has been gradual. With the advent of “work from home”, consumers want to buy their own space or a larger space.

* Realtors are also focusing on completing existing or stalled projects. - Cement demand in terms of low cost housing is showing green shoots. Cheap housing loans, extension of the CLSS and the need for space is also spurring some demand.

* As part of the Atmanirbhar Bharat package, the government has also made a provision for an additional outlay of Rs 18,000 crore for the urban housing scheme (PMAY-U). The allocated amount is over and above the Budget Estimates for 2020-21 (Rs 8,000 crore) and will be through additional allocation and extrabudgetary resources.This will help complete real estate projects in the affordable housing segment. It is to help start work on 12 lakh houses as well as complete 18 lakh houses, create 78 lakh new jobs and augment the demand for steel and cement.

- Demand is also getting influenced by the non-trade segment gaining momentum with the resumption of construction work of institutional infrastructure projects such as roadways and metros.

* MORTH has constructed 6,207 km of National Highways upto November 2020 compared with 5,958 km constructed upto November , 2019.

Financials

The financials of 41 cement manufacturers have been analysed here. The cement industry is dependent on natural resources and is highly energy intensive. Natural resources like limestone, coal and minerals are essential to produce cement. The industry needs to ensure the continuous supply of these materials at an optimum cost and quality. A significant factor which aids the growth of this sector is the ready availability of limestone and coal.

Table 2: Financials of 41 Cement companies (Unit: % change)

	Q2-FY21		y-o-y	
	q-o-q	y-o-y	H1-FY20	H1-FY21
Net Sales	28.8%	6.0%	5.3%	-11.6%
Total Expenditure	28.3%	-1.4%	-1.3%	-15.3%
Cost of Services & Raw Materials	44.8%	3.7%	-2.2%	-20.3%
Electricity Power & Fuel Cost	37.1%	-10.2%	-5.6%	-24.9%
Selling & Distribution Expenses	38.1%	6.9%	-5.2%	-10.9%
Operating Profit	22.0%	33.1%	39.2%	3.3%
Profit after tax	50.2%	73.1%	102.5%	4.6%

	Q2-FY20	Q1-FY21	Q2-FY21	H1-FY20	H1-FY21
OPM (%)	20.4	27.0	**25.6**	22.5	**26.2**
NPM (%)	6.1	8.6	**10.0**	7.9	**9.4**
ICR (times)	4.2	5.0	**6.5**	5.1	**5.7**

Source: ACE Equity, CARE Ratings

Due to various cost rationalisation measures and overhead controls undertaken by cement manufacturers, there has been an increase in the operating profit margins (OPM), net profit margins (NPM) and interest coverage ratio during Q2-FY21 and H1-FY21.

The overall sales revenue has increased by 6% during Q2-FY21 y-o-y but has declined sharply by 11.6% during H1-FY21 y-oy. Overall expenditure has also fallen sharply by -1.4% and 15.3% during Q2-FY21 and H1-FY21 mainly on account of supply chain management, contract renegotiations, third party spends and fuel efficiency but has increased by 28.3% on a q-o-q basis. The y-o-y decline has greatly benefitted the industry largely given the sharp fall in the topline numbers during the first half of current financial year. Selling & distribution, cost of raw materials and fuel/electricity cost accounted for 63%- 65% of the total expenses for cement manufacturers during the current financial year.

* Electricity and fuel cost have declined by about 10.2% and 24.9% during Q2-FY21 and H1-FY21 due to the sharp drop in crude oil prices and lower pet coke prices. Petcoke price fell by 14.3% and 18.6% during Q2-FY21 and H1- FY21. Another reason attributable to the fall in this component of expenditure can also be attributable to the fact that many cement manufacturers are also switching from use of petcoke to international coal which has high calorific value and is cheaper than pet coke.

* Logistics costs which are the biggest cost for cement industry has also dropped by -10.9% (selling and distribution) on account of renegotiation of contracts, logistic efficiency as well as network optimization during H1-FY21 but increased by 6.9% on a y-o-y basis and by 38.1% on a q-o-q basis due to the increase in price of diesel during Q2- FY21. Selling and distribution expenses have also declined on a half-yearly basis as September onwards there is always a busy season surcharge which is implemented by the Railways, but it was not been implemented this year because of the supply chain disruptions caused due to COVID-19.

* Cost of raw materials too declined by 20.3% during H1-FY21 due to the overall fall in the prices of limestone but has increased by 3.7% on a y-o-y basis and by 44.8% on a q-o-q basis.

Outlook for FY21

The macros of the cement industry seem to be positive in the long term even though presently the sector is riddled with the COVID-19 pandemic and issues associated with it.

We have revised our cement production outlook. Production is to fall sharply by 14%-16% during FY21 (instead of the earlier stated 20%-25%) and capacity utilization is to be around 45-50%.This will be the steepest ever fall in production (and capacity utilisation) that the industry has ever witnessed. Production of cement has grown by 13.3% during FY19 and fallen by 0.8% during FY20. Cement production is usually closely in-line with demand which is also poised to fall sharply given the operations are still picking up. The industry could benefit with the pent up demand phenomena as the economy has been on an unlock mode but on the flipside as the second wave of the contagion is hitting the economy, this could be a detriment to the entire demand-supply of the industry.

Supply side issues

* Cement manufacturers have resumed work but is still challenged by limited manpower with most plants operating on staggered shifts.

* Cement manufacturers are not expected to make any additions to the existing CAPEX given the limited demand.

* Production is trying to gain momentum as the reverse migration of workers had led to a standstill in operations, disrupting the supply chains. Certain groups of labourers have been returning but a major part of the labour workforce will only come back after all the agri-work is over.

Demand side issues

Going forward the cement industry demand is slowly improving from the disruption created from COVID-19 due pick-up in government spends on infrastructure and affordable housing along with rising rural consumption. We believe rural demand will be the major driver for cement considering the monsoons have been favourable in most part of the country. This could translate in an inflow of cash in the rural economy which could commensurate in infrastructure creation thus augmenting cement demand. On the flipside demand for the commodity is still gathering momentum and is subdued in urban India.

* Given how fiscally strained the government finances are at the moment, not all infrastructure projects have resumed construction which is putting a halt to new investments towards infrastructure creation thus affecting the demand for cement.

* Growth in the housing segment which forms about 68% of cement demand (including low cost housing) is likely to be impacted as commercial & new residential launches will not be able to fully recover during FY21 as realtors are not undertaking new projects as they're only focusing on completing existing projects and clearing existing inventory.

Source: Care Ratings

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