Cement Industry: April-January update

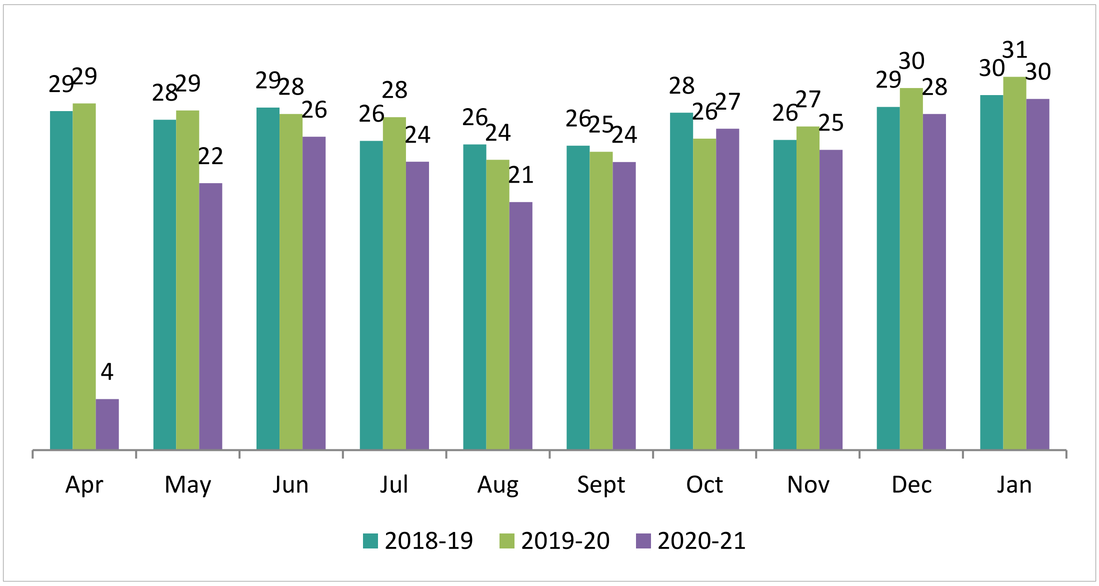
March 3, 2021 I Industry Research

Demand-Supply during April-January 2021 i.e. 10M-FY21

Domestic Production and Capacity Utilisation

Table and Chart 1: Domestic Production of Cement (Unit: Million tonnes)

	Production	Change (y-o-y)
2018-19	276	13.9%
2019-20	279	1.1%
2020-21	233	-16.6%



Source: Office of the economic advisor, CARE Ratings

Cement production fell by 5.9% during January 2021 compared with 7.2% decline witness during December 2020 and 5.1% increase during January 2020. Fall in production could indicate waning pent-up demand and normalising of operations in the infrastructure space. Usually cement production is high during Q4 as construction activities are at its peak.

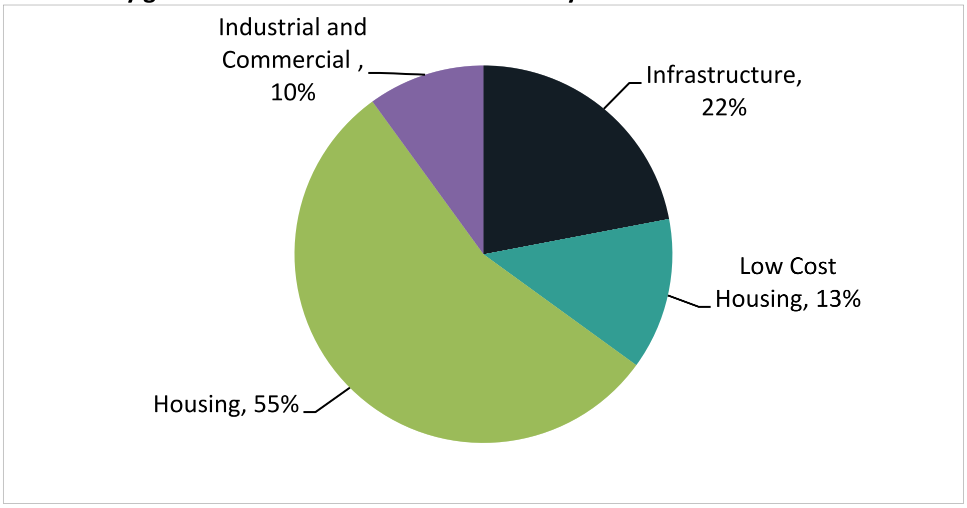
Cumulatively domestic cement production has fallen by 16.6% during 10M-FY21 compared with the 13.9% growth and 1.1% growth achieved during 10M-FY19 and 10M-FY20. Outbreak of the COVID-19 pandemic in the Indian sub-continent which forced the government to announce a nation-wide lockdown, 25th March 2020 onwards which had 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 51.2% during 10M-FY21 as units have been operating at sub-par capacities along with staggered shifts but it has been improving from 45% during H1-FY21 47% during 7M-FY21 and 48.5% during 8M-FY21 and 49.5% during 9M-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 many of the players have been announcing CAPEX expansion of CAPEX guidance 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, there has been a steady pick up in housing and government infrastructure projects which has resulted in reviving demand across our markets even in urban India. Project execution too has picked up pace once again following the receding of the monsoon season.

- Real Estate markets in Tier-1 cities has been opening up and is garnering good traction 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 extra-budgetary resources.
    - The following announcement is to 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 9,129 km of National Highways upto January 2021 compared with 7,925 km constructed upto January , 2020.

Financials

The financials of 30 cement manufactures 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 30 Cement companies (Unit: % change)

	y-o-y	Q3-FY21		y-o-y	
	Q3-FY20	q-o-q	**y-o-y**	9M-FY20	**9M-FY21**
Net Sales	-1.4%	15.3%	**15.2%**	3.7%	**-4.5%**
Total Expenditure	-4.6%	15.5%	**6.1%**	-1.9%	**-9.6%**
Cost of Services & Raw Materials	-6.7%	20.8%	**11.0%**	-5.0%	**-10.0%**
Electricity Power & Fuel Cost	-18.5%	23.3%	**12.6%**	-9.4%	**-14.9%**
Selling & Distribution Expenses (Freight)	-7.7%	21.0%	**17.9%**	-4.8%	**-4.4%**
Profit after tax	19.9%	30.5%	**170.2%**	84.3%	**40.7%**
Operating Profit	14.1%	15.9%	**59.7%**	33.2%	**17.2%**

	Q3-FY19	Q3-FY20	Q3-FY21	9M-FY19	9M-FY20	9M-FY21
OPM (%)	16.3	18.9	**26.2**	16.8	21.6	**26.5**
NPM (%)	4.1	5.0	**11.6**	4.0	7.1	**10.4**
ICR (times)	3.9	4.2	**7.8**	3.9	4.8	**6.5**

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 Q3-FY21 and 9M-FY21.

The overall sales revenue has increased by 15.2% during Q3-FY21 y-o-y but has declined by 4.5% during 9M-FY21 y-o-y.

- There has been an uptick in Real Estate activities in Tier II, Tier III towns which initially was languishing and facing its own perils in the last few years, but has started showing signs of recovery, aided by the current low-interest cost regime, various benefits being given by the authorities to home buyers as well as to developers has boosted the real estate sector.
- Rural demand has sustained considering the monsoons have been favourable in most parts of the country.
- Pick up in housing and institutional infrastructure projects has resulted in an increase in demand across our markets during Q3-FY21.

Overall expenditure has increased by 6.1% during Q3-FY21 but due to supply chain management, contract renegotiations, third party spends and fuel efficiency overall expenditure has fallen by 9.6% during 9M-FY21. This 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 65%-66% of the total expenses for cement manufacturers during the current financial year.

- Electricity and fuel cost has increased by 11% after months of subdued oil prices (9M-FY21 electricity and fuel has declined by 10.1%). During Q3-FY21 petcoke prices have increased by 12.8% due to limited availability and increase in demand from Latin America and the Mediterranean. Many cement manufacturers are also switching from petcoke to coal (international) which has high calorific value and is cheaper than pet coke but coal prices too have increased by 1.6% during the quarter due to the production and logistic disruption, strong Chinese winter demand amidst ban on Australian coal as well.
- Logistics costs which are the biggest cost for cement industry has increased by 17.9% (selling and distribution) despite the railways not charging the busy season surcharge. Prices have increased due to the increase in price of diesel during Q2-FY21 but on the other hand during 9M-FY21 it fell by 4.4% on account of renegotiation of contracts, logistic efficiency as well as network optimization.
- Cost of raw materials has increased by 11.0% during Q3-FY21 even though cost of limestone has declined by 13.5% during quarter.

Outlook for FY21

Going forward, outlook for cement industry seems sanguine due to the government's thrust towards infrastructure creation and development and it being the propeller of growth in the economy going forward. Budgetary allocation made towards roads development, housing and rural infrastructure is slated to lead to an increase in demand for the months to come but at the moment the industry is riddled with the COVID-19 pandemic and issues associated with it.

Cement production is to fall by 11%-13% during FY21 and capacity utilization is to be around 50-55%. 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 during FY21 even though 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.

Supply side issues

- Cement manufacturers have resumed work many plants are still operating on staggered shifts.
- Cement manufactures are not expected to make any additions to the existing CAPEX and given the limited demand present there have also been CAPEX deferral announcements as well.

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.

- Given how fiscally strained the government finances are at the moment, not all infrastructure projects have resumed construction which 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 in the current financial year.

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