CEMENT INDUSTRY EXPECTED TO MISS THE GROWTH MULTIPLIER THIS FISCAL

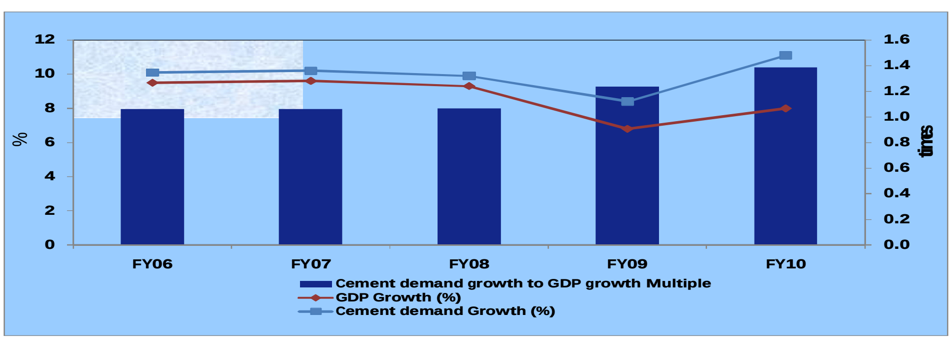
Analytical contact:

Revati Kasture
Head – Industry Research
Tel- +91-22-67543465
revati.kasture@careratings.com

Chaitanya Raut
Analyst
Tel- +91-22-67543410
chaitanya.raut@careratings.com

The Indian cement industry had witnessed an incredible growth journey in the past few years. During the period FY06-10, cement consumption in the country has grown at an average multiplication factor of approximately 1.2 times the GDP growth rate. In FY10, cement demand grew at 11.1% recording a multiplier of 1.4 times with the economic growth rate. However, in FY11, cement demand growth is expected to take a slight breather. During the first nine months of FY11, the cement demand registered a growth of 6% on yoy basis. Construction activities remained subdued during this fiscal on account of prolonged monsoon, heavy winter, delay in execution of infrastructural projects due to environmental hurdles and end of construction activities related to Commonwealth Games which all together led to slowdown in cement offtake.

Growth trend of GDP and cement demand



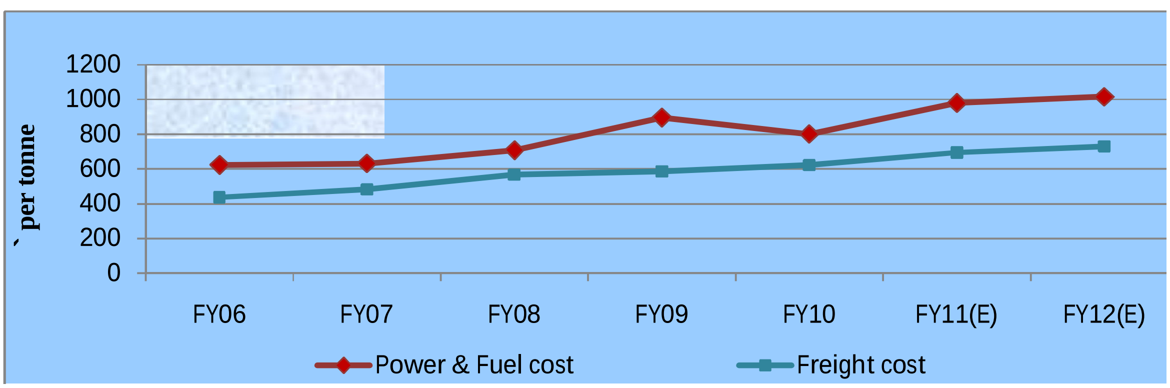
Source: CARE Research

Cement demand is expected to bounce back in the last quarter of FY11 on the back of the peak construction season and register the year-end growth of 7% on yoy basis, albeit at a lower rate compared to the last year. But, the long-term cement demand in the country is expected to remain intact. Going forward, cement demand will largely be driven by the increased focus of the government on the infrastructure development and promotion of low-cost affordable housing in the country. "Cement demand is expected to grow at a CAGR of 9.1% during the period FY 10-14" said Ms. Revati Kasture, Head - CARE research.

Rising cost to exert pressure on margins ……………

Going forward, cement companies will lack pricing power given the supply glut situation in the country. However, the cement industry is in a better position to operate at a lower utilisation rate and avoid substantial price cuts, thanks to the comfortable break-even cushion value at two times. CARE Research does not foresee a drop in average realisation of the industry in FY12. Considering the first nine months of FY11, the cement industry has registered a substantial drop in PBDIT margin to about 19% mainly due to rise in input cost. CARE Research has estimated that the per tonne freight cost and power & fuel cost is expected to increase at a CAGR of 8.3% and 12.6%, respectively during the period of FY10-12. "PBDIT margin is expected to drop to a level of 16% in FY12" said Chaitanya Raut, Manager - CARE Research.

Projected Power & fuel cost and Freight cost



Source: CARE Research

Consolidation still at some distance ….

The domestic cement industry had witnessed a consolidation with remarkable merger and acquisition activities in the past. However, of late, some slowdown has been observed in striking the deals as the valuations of cement companies have risen from the lowest level in FY09. Currently, Enterprise Values per tonne of some major cement companies are trading above the replacement costs. Even, some of the major cement companies are quoting anywhere from 1 to 2 times the replacement cost.

Many mid-sized cement players in the country, especially in the Southern region, which are unable to compete because of rising input costs, constraints in passing on the incremental cost, subdued demand etc would be eager to sell their assets. However, having seen the deals at extremely higher valuations, none of the cement makers, however small, are willing to sell below US $140-150 per tonne and are demanding a hefty premium over the replacement cost. Domestic companies are clearly unwilling to pay such a huge premium. Under this scenario, CARE Research expects consolidation is still at some distance. However, foreign players which are keen on strengthening their foothold in the Indian cement market would continue to hunt for lucrative deals.

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