Cement Industry : Galloping Towards Growth

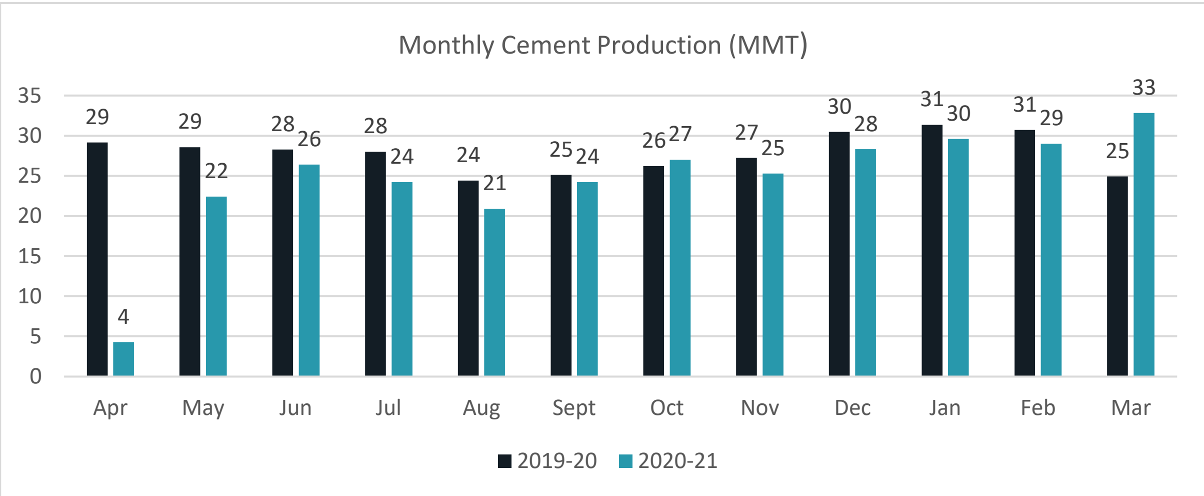
June 23, 2021 I Ratings

CARE Ratings expects demand for cement to improve in a calibrated manner from July 2021 onwards. The second wave of Covid (Covid II) snapped the momentum gained in the overall demand during last quarter of FY21. Unlike its predecessor, Covid II proved to be a mixed bag. On one side, supply constraints are low, considering there has been no halt in operations for the cement manufacturing companies; however, on the other side, the rural cement demand is likely to be weaker with higher rate of infections therein. Double-digit cement volume growth seems unlikely as of now for FY22 considering the uncertainty with respect to the constantly evolving covid situation in the country including the likelihood of third Covid wave later during the current fiscal year. However, the profitability for cement players is expected to remain healthy during FY22 supported by expected higher volumes and continuing pricing power enjoyed by cement companies which is likely to offset the cost pressures considerably.

The performance for CARE's cement portfolio companies is likely to remain stable despite the challenges of second wave of Covid. For FY22, the domestic cement production is expected to grow by around 4%-7% y-o-y after two consecutive years of de-growth as against the initial estimate of 11%-14%. This is considering that the economic conditions today are volatile and unstable. The unlocking process which was earlier envisaged for May 2021 has now been pushed to July 2021 thereby affecting cement demand for Q1FY22.

Going forward, although the demand for the cement industry is supported by government's thrust and spending towards infrastructure creation and development, pent-up urban demand and continuing rural demand; the severity of prevailing Covid-II shall have a bearing on the timelines for demand revival for the cement industry.

Cement- Q1FY21 laggard; swift recovery from Q2FY21

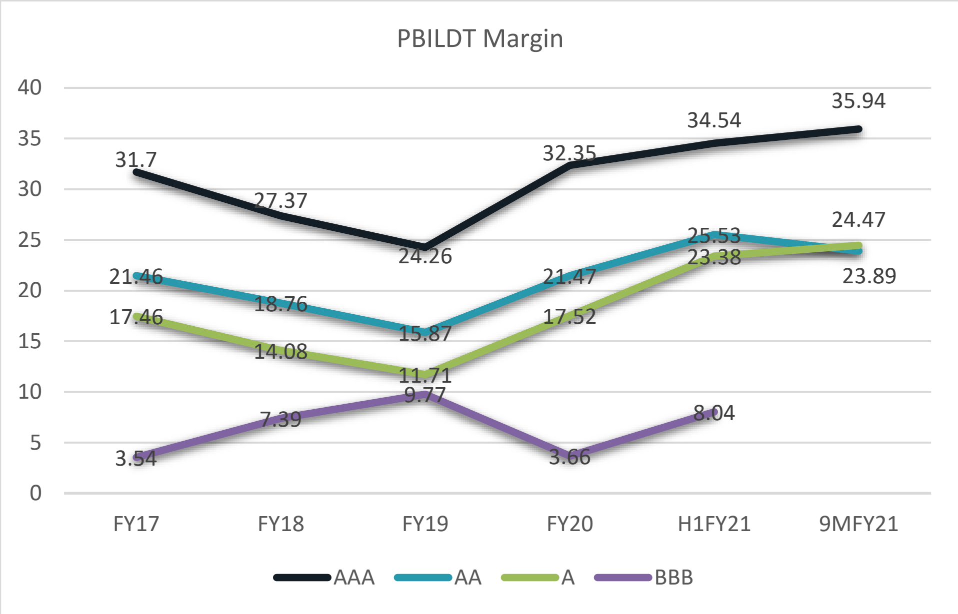


(Source: Office of Economic Advisor, CARE Ratings)

While Q1FY21 was severely hit by the pandemic, the industry, however, witnessed a swift recovery wherein domestic cement production reached 88% of pre-Covid levels (i.e., 88% of Q2FY20) during Q2FY21 and for Q3FY21 production was 96% of the corresponding period previous year. Monthly domestic cement reached pre-Covid levels during March 2021 and was approximating to March 2019 levels.

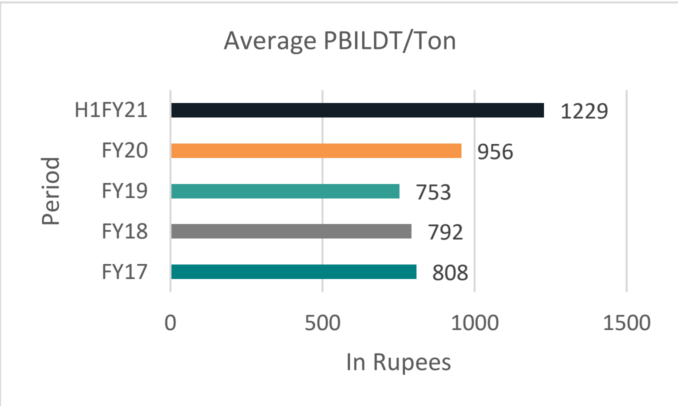
Overall, the domestic cement production has fallen by 12% during FY21 vis-à-vis FY20 as against the initial estimate of de-growth of 25%-30% made in April 2020.

Profitability



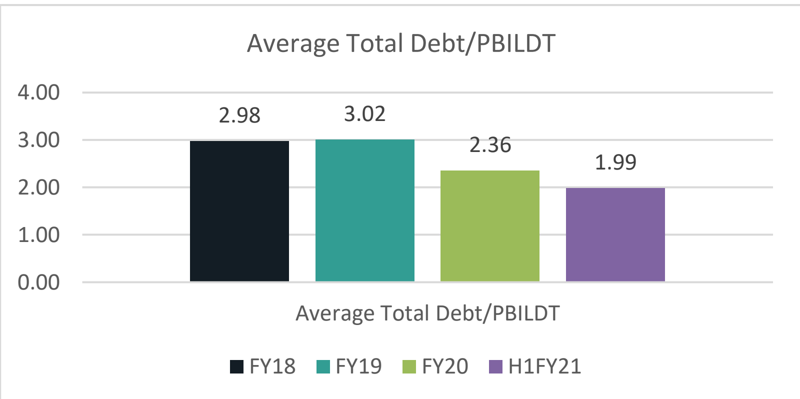
(Source: Care Ratings Study; data for H1FY21 and 9MFY21 is based on limited data available for CARE Rated investment grade portfolio)

Though volumes declined, profitability margins for the cement players improved significantly during H1FY21 and 9MFY21 vis-à-vis FY20 due to improved realizations backed by continuing pricing power of cement players, lower input costs especially till H1FY21 and various cost-rationalization measures like change in fuel mix; temporarily switching to imported coal vis-à-vis pet coke to the extent possible and overhead controls. On the pricing front, at an all-India levels, average cement prices were higher by around 2%-3% (y-o-y) during FY21.



(Source: Care Ratings Study; data for H1FY21 is based on data available for CARE Rated investment grade portfolio)

While the average PBILDT margin improved from around 20% for FY20 to around 24% for H1FY21 and further to 25% for 9MFY21; the average PBILDT/Ton for cement companies increased from Rs.956/ton during FY20 to Rs.1,229/ton during H1FY21 for the CARE-rated investment grade cement portfolio.



(Source: Care Ratings Study; data for H1FY21 is based on limited data available for CARE rated investment grade portfolio, annualized wherever necessary)

Furthermore, the debt load on cement companies has been reducing. The average total debt to PBILDT for the CARE-rated investment grade portfolio has been improving y-o-y since FY19.

Key drivers for FY22:

Positive

- Increased capital outlay towards infrastructure creation by 26% to Rs.5.54 lakh crore
- Enhanced outlay of Rs.1,18,101 crore for MoRTH of which Rs. 1,08,230 crore is for capital.
- Central Counterpart Funding to various metros aggregating to Rs.88,059 crore
- Proposals to further incentivize and boost affordable housing.
- Pent up urban demand and continuing rural demand.

Negative

- Slow pick up of demand with ongoing Covid II
- Increase in input costs
- Excess capacities

Way ahead:

For FY22, CARE Ratings estimates its entire portfolio of investment grade cement companies with aggregate rated debt of around Rs.23,964 crore to report stable performance. Although the profitability for cement players is expected to moderate during FY22 owing to increasing input costs especially for pet coke, diesel, coal and packing materials, etc, the impact of the same on cash accruals is envisaged to be less, backed by higher volumes and stable prices. In terms of debt, most of the cement companies are envisaged to continue their focus on strengthening their balance sheet during FY22. Furthermore, liquidity for majority of the CARE-rated investment grade portfolio is likely to remain strong or adequate for FY22 supported by high cash balances, un-utilized or minimally utilized working capital funding lines and healthy cash flows.

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