Cement demand bounces back, aiding cost pass-through

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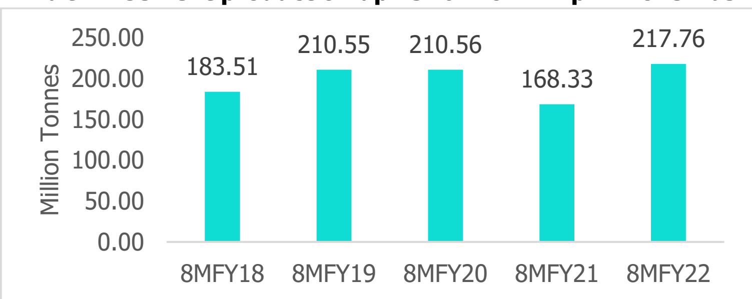
With the onset of the final quarter of FY22, CareEdge expects cement prices to trend higher due to pick up in the overall construction activities giving boost to cement demand. After gaining pace in October 2021, the demand offtake fell unexpectedly in November 2021 owing to construction bans in the Delhi NCR region, late and unseasonal rains in the South, availability issues of sand mining in the East and Uttar Pradesh and labour unavailability. Major slump was witnessed in the Eastern and Southern regions. Later, the demand picked up during December 2021 and has been firming up further during January 2022.

Demand rebound in Q4 should bolster cost pass-through for the industry. This, coupled with the fact that the key cost-side elements (coal/pet coke/diesel) have softened from the higher levels have alleviated concerns of a further increase in the operating costs for the industry. Though higher input costs will continue to impact the players in Q4FY22 due to the build-up of high-cost inventories, this should, thereafter, subside more in Q1FY23 assuming current trends in input costs. Therefore, Margins of cement players are expected to bottom out in Q3FY22 and improve thereafter at the back of potential price hikes and waning cost pressures. Furtherance to the earlier report dated October 28, 2021 (Cement Sector: Battling the cost wave), CareEdge re-iterates that the macros of the cement industry continue to remain positive and the industry is expected to witness a robust mid-teen growth in overall cement demand in FY22 and thereafter 6%-7% Y-o-Y in FY23. The demand is mainly driven by recovery of activity in the urban housing sectors, upcoming general elections in 2024, infrastructure projects as well as rural demand and renewed real estate demand. However, any potential halt on the construction activities amidst upsurge of infections pertaining to the third wave of Covid-19 shall remain a key monitorable for the growth in the coming months.

Demand momentum continues post the lacklustre in Q3FY22:

The cement industry is expected to be benefitted by high volume growth, majorly driven by revival in demand from the urban housing sectors, upcoming infrastructure projects such as construction of roads, railways, highways as well as generous rural demand. The long-term drivers of demand such as National Infrastructure Protection Plan, Bharatmala projects, mission 'Housing for All', rapid urbanisation, rising rural incomes remain strong with increased government impetus on infrastructure projects amid the upcoming elections in 2024. While a decent demand and volume expansion was witnessed in first seven months of FY22, the months of November and December saw muted growth mainly due to factors, including construction ban in the NCR, heavy rainfall in the South and few Northern states and issues related to availability of sand in the Eastern region and UP.

Exhibit 1: Cement production up 29% Y-o-Y - April-November 2021



Source: CMIE, Office of Economic Advisors, CARE Ratings

Production of cement fell by 3.3% in November 2021 year-on-year; however, cumulative cement production index increased by around 29% during April to November 2021 over the corresponding period of the previous year. Nevertheless, some recovery has thereafter taken place in the second half of December month, which is a significant month for the sector, as it marks the onset of peak construction period. Furthermore, historically, cement demand in January has been 4% higher than December.

With the strong demand momentum to sustain, the credit outlook for the cement sector is expected to remain positive. However, any potential halt on the construction activities amidst upsurge of infections pertaining to the third wave of Covid-19 shall remain a key monitorable for the growth in the coming months. With healthy growth in volumes coupled with stronger balance sheets, many cement players have planned capacity additions to maintain their market shares. CareEdge expects capacity addition of about 100-110 MT between FY22 and FY25. The third wave of Covid-19 may put some temporary breaks on the expansion plans of players. Nevertheless, the pace of expansion and demand matching up with the same shall be a key monitorable for the sector.

Input Costs: Elevated but pressures begin to ease up

The average fuel cost for the industry has increased by Rs.250-300 per tonne in H2FY22. There has been a decline in imported coal, pet coke and diesel prices in the last two months from their earlier peak levels, alleviating concerns of any further steep increase in the operating costs for the players. Although the fuel cost for the industry is believed to have peaked in Q3FY22, it would remain at slightly elevated levels for the players due to high-cost inventories in Q4FY22. Full benefits of fall in fuel prices are expected to start accruing from Q1FY23.

- Australian coal prices have fallen to USD 162-169 per tonne as in January 2022 from its peak of USD 224 per tonne in October 2021.
- Pet coke prices which move in tandem with crude oil prices fell to USD 150 per tonne in January 2022 from its peak of USD 200-220 per tonne in November 2021. The prices of domestic pet coke have increased from Rs.9,135/MT in December 2020 to Rs.20,781/MT in November 2021, and they declined in December 2021 with average price of Rs.15,680/MT which is still 72% higher Y-o-Y.

Exhibit 2: Imported Coal (Australian) prices down 28% from peak/ still up 87% Y-o-Y in January 2022

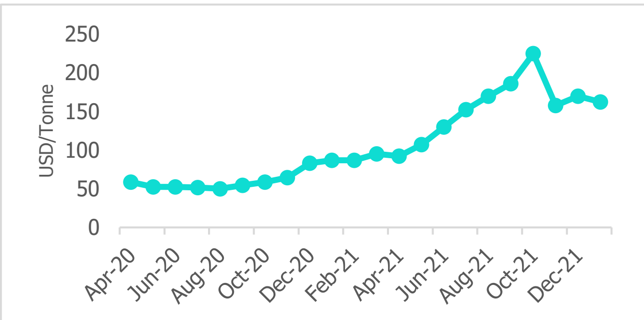
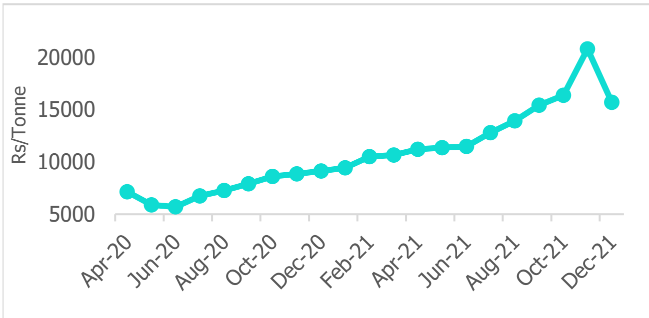
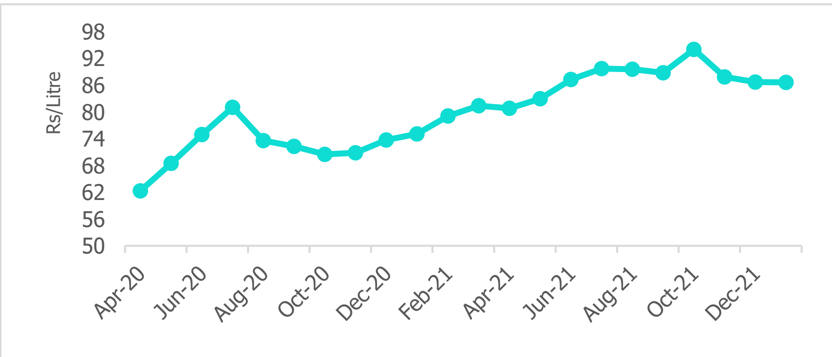


Exhibit 3: Pet coke prices (domestic) down 25% M-o-M in December 2021



Source: CMIE, CARE Ratings

Exhibit 4: Diesel prices (Delhi) down 8% in past couple of months but 16% up Y-o-Y

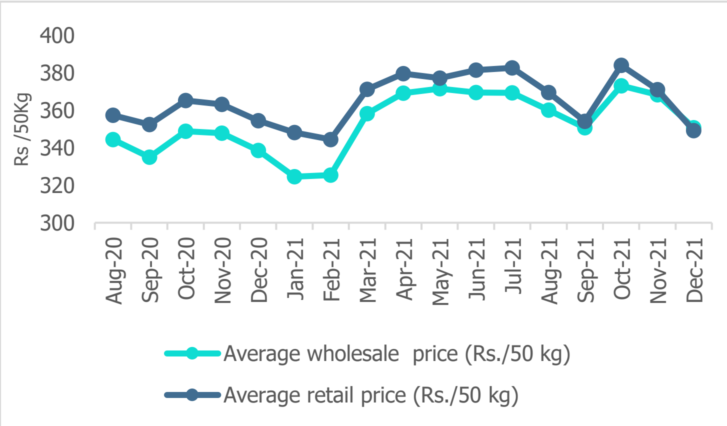


Source: CMIE, CARE Ratings

Realisations: Expected to stay strong

The previous attempt by the cement players to hike the prices in October 2021 could not last longer and these hikes were rolled back due to lack of demand in November 2021. With expected volume growth going forward, the industry is again poised to take price hikes. The price hikes are required to pass on the increased cost pressures as imported coal/pet coke and diesel prices, though lowered from previous high, remain elevated.

Exhibit 5: Pan-India prices increased 1% Q-o-Q in Q3FY22 and 4% Y-o-Y in December 2021



Source: CMIE, CARE Ratings

The month of October 2021 saw Rs.20-30/bag price hikes across regions, but these were partially rolled back in November – December 2021. Pan-India prices seem up around 1% in Q3FY22 Q-o-Q led primarily by price rise in Northern, Central and Western regions but partially offset by Q-o-Q fall in prices in the Eastern and Southern regions. In FY22 on a Y-o-Y basis, Pan-India prices are likely to remain up around 4%-5%. With pickup in demand, companies are expected to announce price hikes in the range of Rs.10-25 per bag across regions for the month of January 2022.

Demand momentum should keep pace for the price hikes to sustain, and any potential halt on the construction activities amidst upsurge of infections pertaining to a possible third wave of Covid-19 affecting cement demand shall be key monitorable.

Due to the cost upsurge until November 2021 coupled with the roll back of the price hikes (earlier announced in October 2021) in the cement prices in Q3FY22, the EBITDA margins for the quarter ending December 2021 is likely to bottom out, though margins are expected to recover partially in Q4FY22 with the likely price hikes to be taken by players.

In the present circumstances where the sector is grappling with the higher input cost, a sustained increase of prices along with demand stand critical for the operational performance of the players in the near term. Going forward, CareEdge expects cement prices to trend higher in Q4FY22 due to a pickup in the overall construction activities, leading to a higher cement demand.

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