As Infra Takes Centre Stage, Cement Volume Set to Rise to 450MT by FY25

February 27, 2023 l Ratings

CareEdge RATINGS

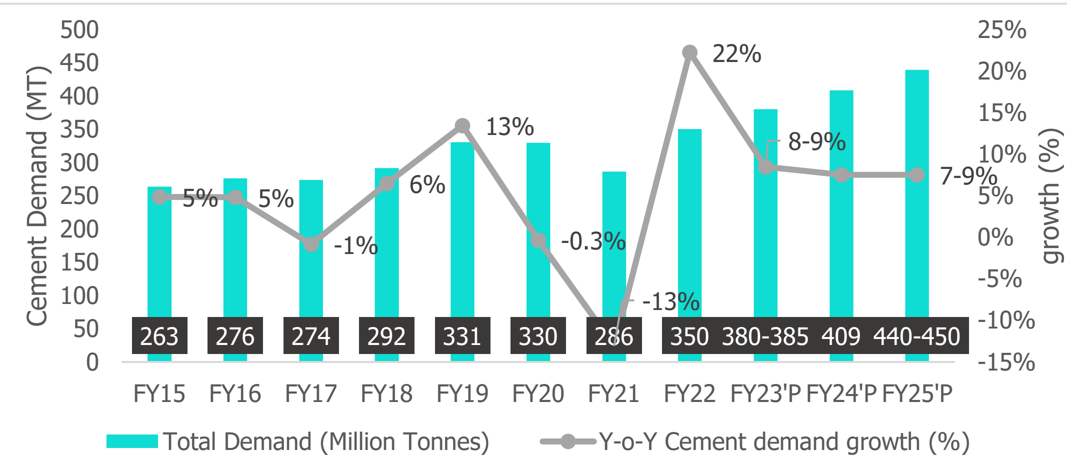
Synopsis

- According to CareEdge, the current upcycle in infrastructure and real estate is expected to significantly boost cement demand. We predict growth in cement volume by 8-9% in FY23, reaching 380-385 million tonnes (MT), and by FY25 year-end, reaching 440-450 MT.
- The Union Budget for FY24 marks the third consecutive year in which the government has increased the budget allocation for key infrastructure sectors, reflecting its commitment to infrastructure-led growth. This is a positive development for cement demand, as the higher outlays for Pradhan Mantri Awas Yojana (PMAY), railways, and construction of new airports are expected to support healthy demand. Additionally, higher government spending in the next fiscal due to general elections is likely to benefit the sector.
- Despite looming cost challenges, such as fuel prices straining margins, cement players are on an expansion spree and expected to add 85-100 MT by FY25. The industry is likely to add 30-32 MT by the end of the current fiscal, compared to 25 MT in FY22. The total installed capacity is expected to stand at 595 MT. For FY24-FY25, the incremental demand is expected to be 55-60 MT, against which 60-70 MT of capacity is expected to be added in the next two years, resulting in capacity utilisation remaining range-bound at 66-68% for the industry.

Demand Growth Intact

The cement industry has benefitted from high volume growth, majorly driven by a revival in demand from the housing sectors, upcoming infrastructure projects such as the construction of roads, railways, and highways as well as generous rural demand. The cement sector remains one of the key beneficiary of the economic growth as there is a positive corelation between GDP growth rate & cement demand growth. In the 9MFY23, the overall cement demand registered 11% growth over last year and on a full year basis CareEdge expects 8-9% growth.

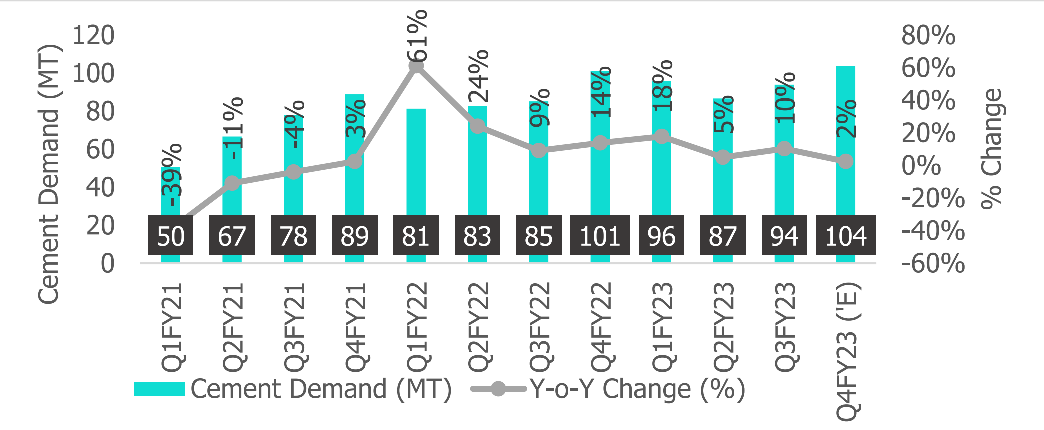
Chart 1: Cement Demand to stay strong.



Source: CareEdge Ratings, Industry, CMIE

After moving into negative territory, Cement demand bounced back in FY22 and since then cement demand has registered continuous growth for last 8 quarters on y-o-y basis.

Chart 2: Y-O-Y growth in Demand for last 8 quarters



Source: CareEdge Ratings, CMIE

The central government continues to focus on increasing capex outlay to spur growth in light of the 2024 general elections. The capex for 2023-24 (Budget Estimate) at Rs. 10 lakh crore is almost 3 times of the capital expenditure in FY2019-20. The capex spree also augurs well with the central government's aim to make growth more inclusive as investment in infrastructure and productive capacity have a multiplier effect. The public sector capex has focused on improving the connectivity inside the country and gradually the allocation for highways and railways have surged from 35% in FY18 to 43% in FY23. The Union Budget 2024 also increased outlay on railways and plans 50 new airports.

On the real estate front to provide housing for all, the government has launched the smart city project and increased the allocation to the PM Awas Yojana budget allocation for FY24 by 66%. The private capex is expected to pick up in the coming years with the support of Rs. 1.94 lakh crore allocated towards 13 manufacturing sectors under the PLI scheme and rising domestic demand.

The combined effect of increasing infrastructure spends, real estate upcycle, low per capita consumption and the expected increase in private sector capex well supports the demand growth for cement in FY24-FY25. CareEdge expects the sales volume for the cement industry to grow by 8-9% in FY23 to 380-385 MT and to 440-450 MT by FY25 year-end with Central and eastern regions witnessing more lucrative demand. Given the demand is expected to remain robust in upcoming years, the cement players have also announced additional capacity to keep up with the growth pace.

Players on Expansion Spree will Keep Utilisations Under Check

Given the strong demand visibility for the cement sector as a whole, the cement players have shown enthusiasm to announce capacity additions over the next three years. The cement players are expected to add 85-100 MT of additional capacity till FY25 end, as opposed to 104 MT of capacity added in the last 5 years during FY17-FY22. Out of the total capacity addition, 30-32 MT is expected to be added by FY23 end and balance capacity over the next two years.

The robust capacity addition plans by players for FY23-FY25 are leading to additional capacity to be at 1-1.1x of the expected incremental demand of 90 MT during the same period. This is expected to keep the industry's capacity utilization (grinding) under check, and they are unlikely to improve beyond 67-69% despite a better demand outlook. However, going forward any variation in the demand drivers amid the upcoming capacity expansion will remain a key monitorable.

The cement industry is concentrated with the top 10 players having more than 68% of the installed capacity share. Going forward as well the capacity expansion during FY23-FY25 is expected to be predominantly undertaken by the top players and hence the consolidated nature of the sector is likely to continue. "The sector may also witness acquisition of mid or smaller-sized players by the top players amid the prolonged margin pressure which the sector is witnessing. This will lead to further consolidation in the sector and better pricing discipline amongst remaining players," said Ravleen Sethi, Associate Director, CareEdge.

Meaningful Price Hikes Not Coming this Fiscal

The cement realisations have remained quite firm in the last two years which are FY20 and FY21 with players having taken timely price hikes leading to good profitability across the sector. After that, the players started feeling the heat of rising input costs, particularly from H2 of fiscal 2022. For the last 6 quarters, the growth in total cost per tonne has been at a much faster pace than the growth in net sale realization which has led to steep erosion in EBITDA per tonne for the players.

In the current year, the players will not be able to offset the higher input costs through hikes in cement prices given the unprecedented input prices. While players have announced price hikes across regions recently, the absorption and sustainability of these hikes remain monitorable. In CareEdge's view, these hikes are not enough for any major shift in the operating margins. CareEdge had already estimated a drop in margins for cement players in FY23 in its earlier report published in Dec 2022 titled "Cement Industry Margins Set to Contract in FY23, Price Hikes Imminent" and expects the profitability margins to remain moderated till H1FY24 on account of elevated fuel cost from the past average and not much price hikes coming through. This is going to moderate the credit profile of the players. The absolute profitability of major players may get cushioned on account of operating leverage on the back of robust demand drivers.

CareEdge Ratings View

"The macros of the cement industry remain stable in the long term, driven by demand from the housing sector, upcoming infrastructure projects as well as generous rural demand. The capex spree by the government on infrastructure and housing spending in the wake of the 2024 general election paints an encouraging picture of cement demand. The private capex is also expected to pick up gradually lending further support on the demand front. The cement players have also responded enthusiastically by announcing huge capacity addition over FY23-FY25. With several companies looking to commission capacities in the next 2 years, the industry's pricing may come under some pressure.

In the current fiscal as well, the players are walking on a tightrope, and they have not been able to offset the higher input costs through hikes in cement prices given the unprecedented levels of input prices with cement prices already being at their peak. Though price hikes and absorption of the same are imminent for the sector's profitability, but so far players have not been able to take meaningful hikes. Hence, Operating leverage driven by strong volume uptake and continuous focus of the players to improve cost efficiency are expected to aid margin in the medium terms for the sector," said Ravleen Sethi, Associate Director, CareEdge.

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