Cement Industry Margins Set to Contract in FY23, Price Hikes Imminent

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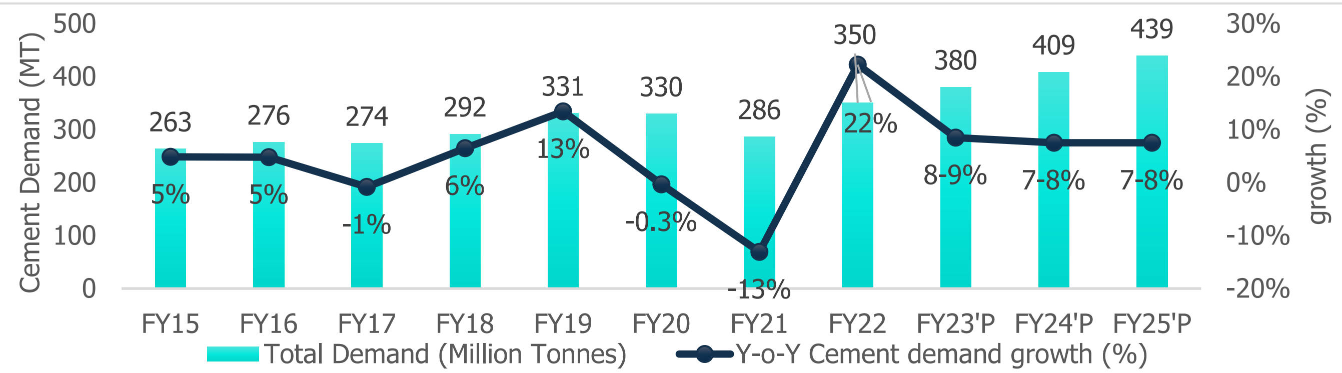
Synopsis

- Driven by the housing and infrastructure sectors, the cement industry has witnessed a V-shaped recovery and healthy growth in FY22. At 350 million tonnes, the demand surpassed pre-Covid levels of 331 MT in FY19 and is expected to grow by 8-9% y-o-y in FY23. Increased government spending on infrastructure and a pickup in real estate is likely to support demand further.
- The combined impact of all the input costs, primarily that of fuel is expected to inch up the cost for the cement players by Rs.350–400 per tonne on a year-to-year basis. While there is a heightened focus on efficiency measures, we believe it would still be difficult to fully offset the higher energy costs.
- CareEdge expects the cement prices on average at pan-India level to rise 3.5-4% on the high base of FY22. Though this is not enough to completely offset the cost pressures but these partial hikes in realisations will limit the contraction in operating margin to a certain extent. While players have announced price hikes across regions in November 2022 in the range of Rs 15-20 per bag, the absorption and sustainability of these hikes are key monitorable.
- The moderation in the EBITDA margins amid the cost pressures and after considering the year-on-year price hikes to the tune of 3.5-4% will be in the range of 320-380 bps y-o-y in FY23 or an EBITDA per tonne impact of Rs 180-200.

Demand Momentum Continues

The cement industry has benefitted from high volume growth, majorly driven by a revival in demand from the urban housing sectors, upcoming infrastructure projects such as the construction of roads, railways, and highways as well as generous rural demand. The long-term drivers of demand such as the National Infrastructure Plan, Bharatmala projects, mission 'Housing for All', rapid urbanisation, and 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 the first half of FY23, the month of October saw muted growth mainly due early festive season and unavailability of labour. The momentum, however, picked up from November 2022 and in the current year, on a full year basis, it is expected that demand would register an 8-9% growth in FY23.

Chart 1: Demand Growth of 8-9% in FY23



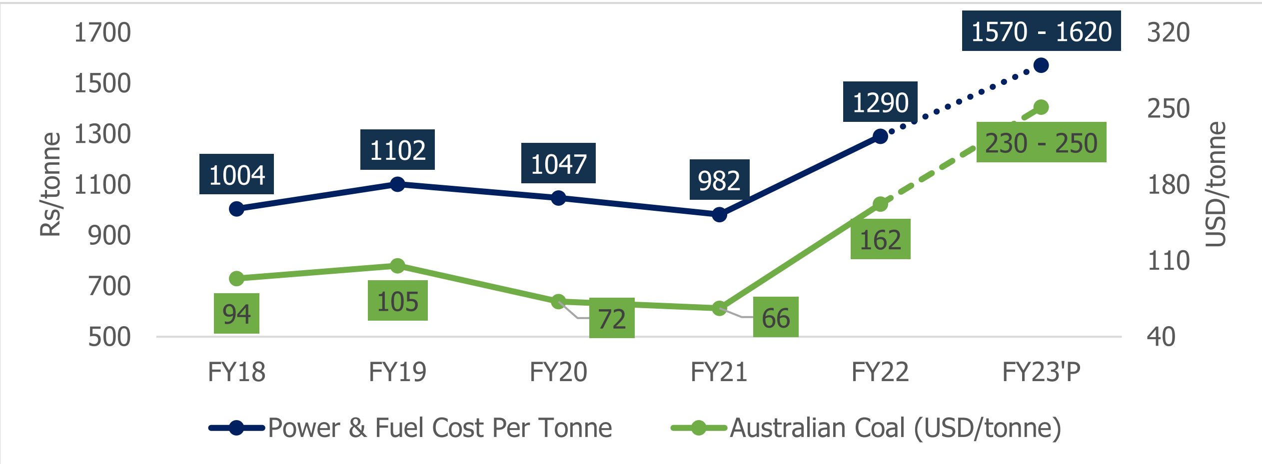
Source: CareEdge, CMIE

With healthy growth in volumes, many cement players have planned capacity additions to maintain their market shares. CareEdge expects a capacity addition of about 105-110 MT between FY22 and FY25. The pace of expansion and demand matching up to it will be a key monitorable that would determine any intermittent demand-supply imbalances.

Cost Battle Intensified in FY23

The two main components in the cost structure are power and fuel and freight expenses, together constituting about 55-60% of the total costs. Power and fuel costs/tonne increased by 31% YoY in FY22 due to a significant increase in coal and pet coke prices and the cost inflation continues in FY23. In the current year, both pet-coke and thermal coal have surged up substantially and are already over and above FY22. The average fuel cost for the industry has increased by Rs.400-500 per tonne y-o-y in H1FY23. There has been a decline in imported coal and pet coke prices in the last month from their earlier peak levels, alleviating concerns of any further steep increase in the operating costs for the players. The fuel cost for the industry is believed to have peaked in Q2FY23, it should soften from those levels in Q3FY23 but these prices continue to be soaring high not just past averages but also Year to year. This cost is likely to increase by Rs 300- 330/Tonne on a full year basis. Not much increase in freight cost is expected in FY23 as the volatility in diesel prices has not been much on a year-to-year basis t high from the past average. This cost may either remain flat or just increase by 1% from FY22 levels.

Chart 2: Fuel Cost Increase: Unabated and Prolonged

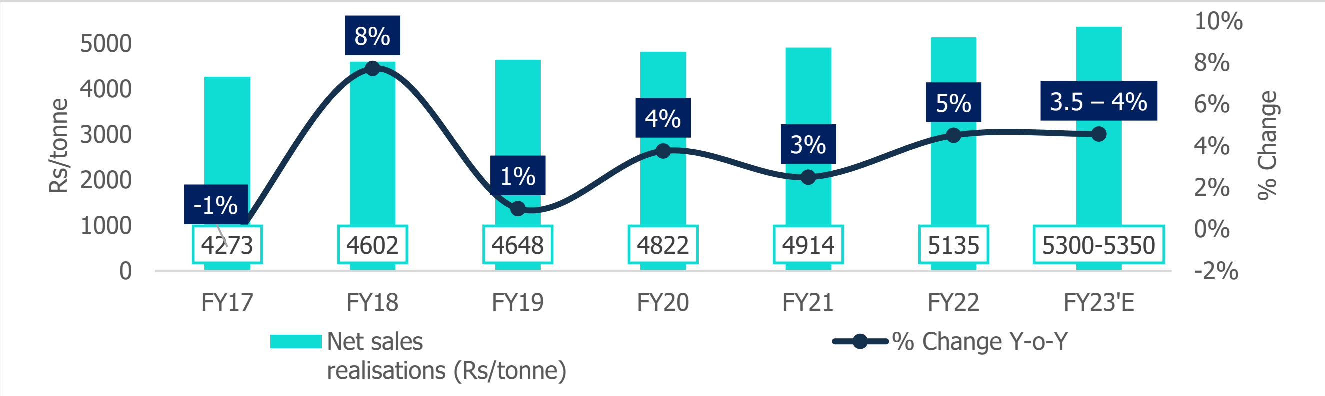


Source: Sample set of Industry top 20 players (covering >80% of Industry) compiled by CareEdge, CMIE

Sustainable Price Hikes: Key Monitorable

The players need to take price hikes in a gradual manner such that it should not weigh down on demand revival. In CareEdge's estimates, an increase of approximately Rs.25-30 per bag would be required to offset the cost inflation on a year-to-year basis and a hike of Rs 45-50 per bag is required to restore the profitability to FY21 levels. 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.

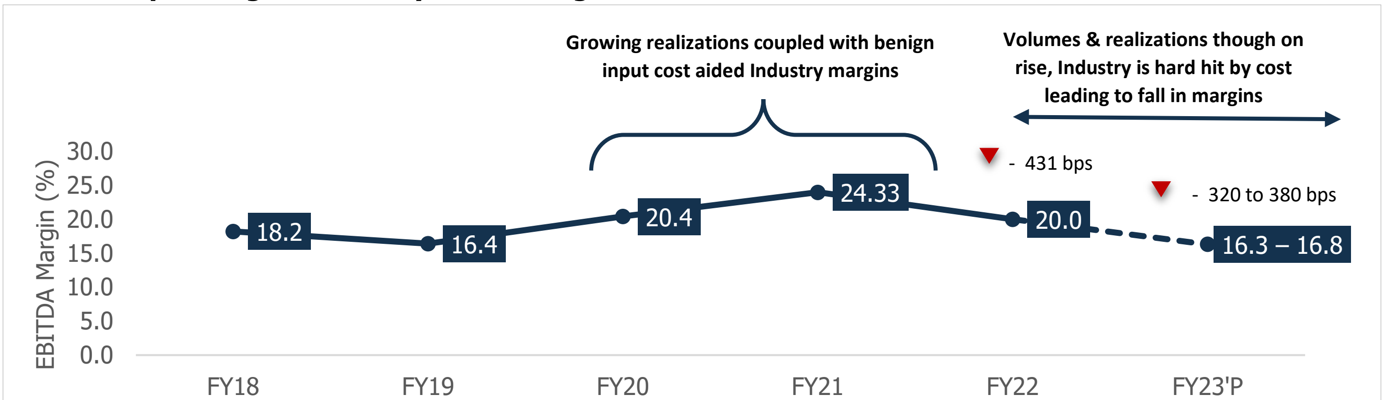
Chart 3: Net Sales Realisations



Source: Sample set of Industry top 20 players (covering >80% of Industry) compiled by CareEdge, CMIE

Post that the players started feeling the heat of rising input costs particularly from H2 of fiscal 2022 and we see that on a full year basis, players reported a drop in margins by approximately 430 basis points in FY22 despite volumes and realisation registering growth. In the current year as well, the players will not be able to fully offset the higher input costs through hikes in cement prices given the unprecedented levels of input prices. While players have announced price hikes across regions in November 2022, the absorption and sustainability of these hikes are key monitorable. In CareEdge's estimates, the moderation in the EBITDA margins after taking price hikes in the range of 3.5-4% y-o-y will be in the range of 320-380 bps in FY23 or an EBITDA per tonne impact of Rs 180-200.

Chart 4: Operating Profitability Moderating



Source: Sample set of Industry top 20 players (covering >80% of Industry) compiled by CareEdge, CMIE

CareEdge View

"The macros of the cement industry remain stable in the long term, driven by demand from the urban housing sectors, upcoming infrastructure projects as well as generous rural demand, though presently the sector is riddled with the cost-side issues. In the present circumstances where the sector is grappling with the higher fuel cost, a sustained increase in prices without impacting the demand momentum stands critical for the operational performance of the players in the near term. While the credit metrics of the industry largely remain stable due to the net cash positive position of the large players, medium-sized players are likely to witness more moderation in the credit metrics due to subdued profitability and capex-related debt, which is expected to come on their balance sheets. The players need to take price hikes in a gradual manner such that it should not weigh down on demand revival. An increase of approximately Rs.25-30 per bag would be required to offset the cost inflation on a year-to-year basis and a hike of Rs 45-50 per bag is required to restore the profitability back to FY21 levels," said Ravleen Sethi, Associate Director, CareEdge.

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