Cement Industry H1-FY21 update

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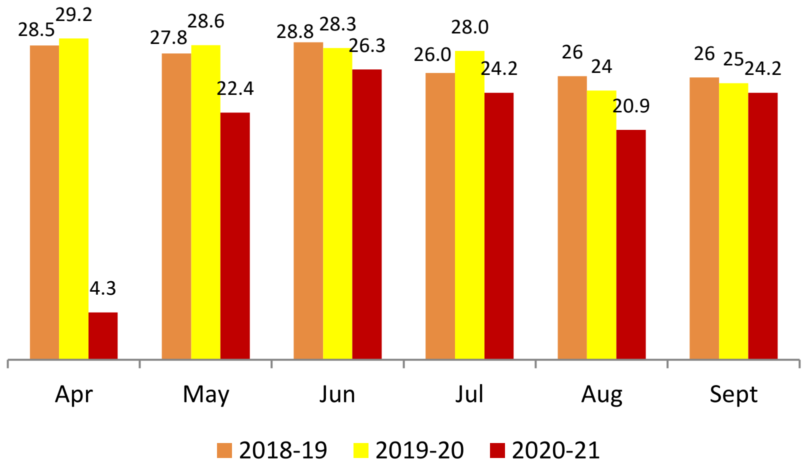
Demand-Supply during H1-FY21

Domestic Production and Capacity Utilisation

Table and Chart 1: Domestic Production of Cement (Unit: Million tonnes)

	Production	Change (y-o-y)
2018-19	162	14.4%
2019-20	164	0.7%
2020-21	122	-25.1%



Source: Office of the economic advisor, CARE Ratings

Cement production continues to record negative growth and has fallen by 3.5% in September. However there has been an improvement in the m-o-m numbers as increase in construction activity with the return of some of the labourers has resulted in an increase in demand for the commodity. Receding of the monsoons too has factored in increasing the production by 16.2% on a m-o-m basis.

Cumulatively domestic cement production has fallen by 25.1% during H1-FY21 as compared with the 14.4% and 0.7% growth in production achieved during H1-FY19 and H1-FY20. Outbreak of the COVID-19 pandemic in the Indian sub-continent which forced the government to announce a nation-wide lockdown, 25th March 2020 onwards has majorly affected the cumulative domestic cement production.

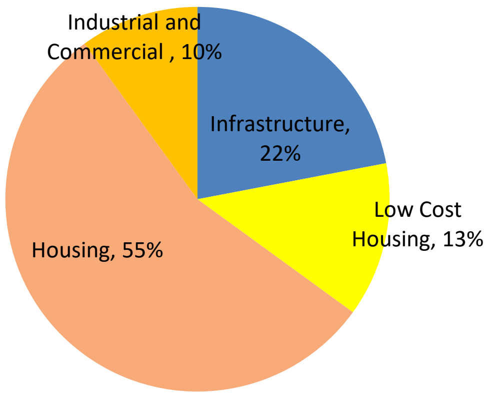
Capacity utilisation of domestic manufacturers has been around 45% during H1-FY21 as units have been operating at sub-par capacities along with staggered shifts. Cement manufacturers have at the moment cut down or deferred CAPEX expenditure given the fall in demand and also as companies look to conserve their capital/cash flows given the light of the events and the uncertainty of operations.

The nationwide lockdown had come at the time when construction activities was at its peak and now with the monsoon season where again the construction activity gets stalled usually, the entire cumulative demand-supply dynamics for cement has gotten impacted.

Trend in Demand Drivers for the Cement Industry

Cement demand is closely linked to the overall economic growth, particularly of the housing and infrastructure sector. Increasing demand from affordable housing and construction work for other government infrastructure projects like roads, metros, airports, irrigation etc. are demand drivers which support cement demand.

Chart 2: Key growth drivers for the Cement Industry



Source: CARE Ratings, Company Filings

Amidst the pandemic cement consumption is growing strong in the rural, semi-urban and retail markets. Cement demand is currently being driven by rural India due to better labour availability and with the reverse migration of workers; there has been an increase in construction of rural infrastructure and low cost housing. Rural demand is usually w.r.t. retail market largely which is the housing and repair and modification market.

Over the months as the economy is unlocking, demand has rebound in September, with most regions reporting a decent growth and with construction activities too picking up pace. Cement demand which has been particularly tepid in metros/tier 1 cities too is recovering in a calibrated manner.

- Tier-1 towns are opening up the real estate markets albeit it's been very slow but is garnering good traction as consumers want to buy their own space or a larger space.
- Cement demand in terms of housing is showing green shoots. Cheap housing loans and the need for space is also spurring some demand.
- A lot of infrastructure projects are also coming back into stream. Construction of national highways has fallen by 14.5% during H1-FY21 as the ministry has constructed 3,951 km of roads till September 2020 as compared with the 4,622 kms of roads constructed in the corresponding period in previous fiscal year.

Financials

The financials of 14 cement manufactures have been analysed here. The cement industry is dependent on natural resources and is highly energy intensive. Natural resources like limestone, coal and minerals are essential to produce cement. The industry needs to ensure the continuous supply of these materials at an optimum cost and quality. A significant factor which aids the growth of this sector is the ready availability of limestone and coal.

Table 2: Financials of 14 Cement companies (Unit: % change)

	Q2-FY21		y-o-y	
	q-o-q	y-o-y	H1-FY20	H1-FY21
Net Sales	27.2%	3.9%	7.0%	-12.1%
Total Expenditure	27.6%	-3.7%	1.5%	-15.8%
Cost of Services & Raw Materials	43.6%	-3.1%	-1.5%	-25.3%
Electricity Power & Fuel Cost	35.9%	-10.2%	-3.2%	-22.9%
Selling & Distribution Expenses	36.8%	3.6%	-2.1%	-11.1%
Operating Profit	16.7%	32.1%	36.9%	2.5%
Profit after tax	46.3%	73.3%	103.0%	-1.4%

	Q2-FY20	Q1-FY21	Q2-FY21	H1-FY20	H1-FY21
OPM (%)	19.4	26.8	24.6	22.0	25.6
NPM (%)	5.3	7.7	8.8	7.4	8.3
ICR (times)	3.7	4.8	6.1	4.6	5.4

Source: ACE Equity, CARE Ratings

Due to various cost rationalisation measures and overhead controls undertaken by cement manufacturers, there has been an increase in the operating profit margins (OPM), net profit margins (NPM) and interest coverage ratio during Q2-FY21 and H1-FY21.

The overall sales revenue has increased by 3.9% during Q2-FY21 but has declined sharply by 12.1% during H1-FY21. Overall expenditure has also fallen sharply by 3.7% and 15.8% during Q2-FY21 and H1-FY21 mainly on account of supply chain management, contract renegotiations, third party spends and fuel efficiency but has increased by 27.6% on a q-o-q basis. The y-o-y decline has greatly benefitted the industry largely given the sharp fall in the topline numbers during the first half of current financial year. Selling & distribution, cost of raw materials and fuel/electricity cost accounted for 65% of the total expenses for cement manufacturers during the current financial year.

- Electricity and fuel cost have declined by about 10.2% and 22.9% during Q2-FY21 and H1-FY21 due to the sharp drop in crude oil prices and lower pet coke prices. Petcoke price fell by 14.3% and 18.6% during Q2-FY21 and H1-FY21. Many cement manufacturers are also switching from use of petcoke to international coal which has high calorific value and is cheaper than pet coke.
- Logistics expenses which are the biggest cost for cement industry has also dropped by -11.1% (selling and distribution) on account of renegotiation of contracts, efficiency as well as network optimization during H1-FY21 but increased by 3.6% on a y-o-y basis and by 36.8% on a q-o-q basis due to the increase in price of diesel during Q2-FY21.

- Cost of raw materials too declined by 3.1% and 25.3% during Q2-FY21 and H1-FY21 due to the fall in the prices of limestone.

Outlook for FY21

Government thrust and spend on infrastructure is one of the key drivers

The macros of the cement industry seem strong in the long term even though it is currently with the COVID-19 pandemic prevalent there is still some weakness present in the industry even though it is on a recovery mode.

Cement production is to fall sharply by 18-20% during FY21 and capacity utilization is to be around 45-50%. This will be the steepest ever fall in production (and capacity utilisation) that the industry has ever witnessed. Production of cement has grown by 13.3% during FY19 and fallen by 0.8% during FY20. **Cement production is usually closely in-line with demand which is also poised to fall sharply** given the operations have not been able pick up pace fully even with the economy on an unlock mode as the virus is showing no signs of abating.

Supply side issues

- Cement manufacturers have resumed work but are plagued with limited manpower and plants too are operating on staggered shifts.
- Cement manufactures are not expected to make any additions to the existing CAPEX and given the limited demand present there have also been CAPEX deferral announcements as well.
- Production is trying to gain momentum as the reverse migration of workers had led to a standstill in operations, disrupting the entire supply chain operations. Certain groups of labourers have been returning but a major part of the labour workforce will only come back after Diwali or when all the agri-work is over.

Demand side issues

Going forward the cement industry demand is slowly improving from the disruption created from COVID-19 due to pent up demand pick-up in government spends on Infrastructure and affordable housing along with rising rural consumption. We believe rural demand will be the major driver for cement considering the monsoons have been favourable in most part of the country and the outlook for Kharif crop too looks promising. This could translate in an inflow of cash in the rural economy which could commensurate in infrastructure creation thus augmenting cement demand. On the flipside demand for the commodity is still gathering momentum and is subdued in urban India.

- Demand for cement from real estate is still recovering as the sector is plagued by labour shortages and lack of liquidity.
- Given how fiscally strained the government finances are at the moment, not all infrastructure projects have resumed construction which is putting a halt to new investments towards infrastructure creation thus affecting the demand for cement.
- Growth in the housing segment which forms about 68% of cement demand (including low cost housing) is likely to be impacted as commercial & new residential launches will not be able to fully recover during FY21 and realtors will only be focusing on project completing and clearing of existing inventory.

Table 3: A timeline of recovery for cement firms during 2020-21

	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21
Cement												

Source: CARE Ratings

Towards Recovery Partial Recovery Stressed

Given the weakness in end user demand due subdued activity in the housing and infrastructure sector the cement industry is expected to remain in the red zone till September 2020 at least, till the end of the monsoon season. Partial recovery is expected October-November 2020 onwards post Diwali with return of migrant labourers and normalisation of operations is expected January 2021 onwards.

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