Cement Industry Q1-FY21 update

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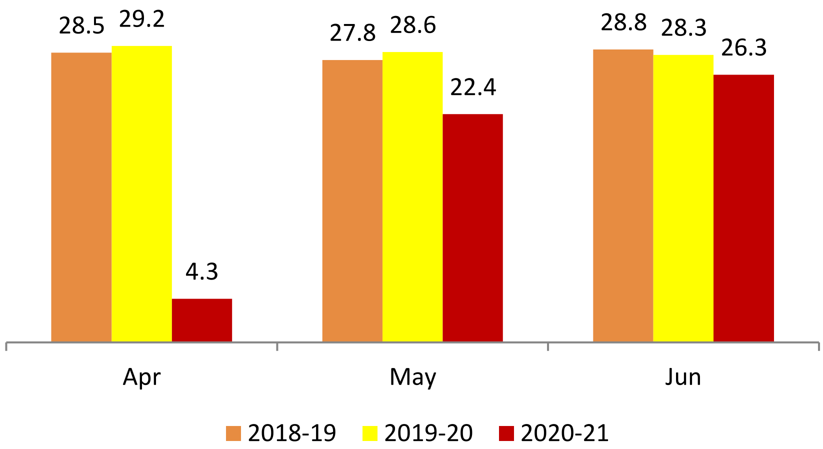
Demand-Supply during Q1-FY21

Domestic Production and Capacity Utilisation

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

	Production	Change (y-o-y)
Q1-FY19	85.1	16.3%
Q1-FY20	86.0	1.0%
Q1-FY21	53.1	-38.3%



Source: Office of the economic advisor

Domestic cement production has fallen by 38.3% during Q1-FY21 as compared with the 16.3% and 1% growth in production achieved during Q1-FY19 and Q1-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 domestic cement production.

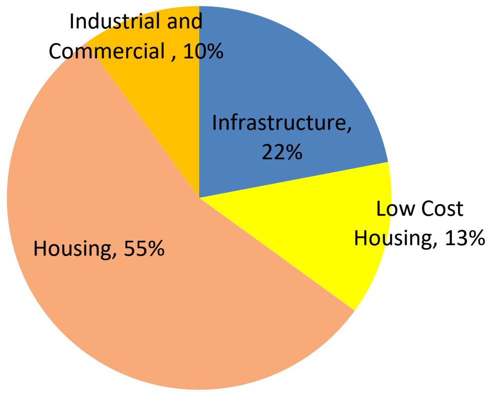
Fall in demand for cement from housing and construction activities coupled with units operating at sub-par capacities along with staggered shifts has led to the fall in production. Onset of the monsoons also has impacted domestic output during Q1-FY21.

Due to the imposition of the nationwide lockdown, capacity utilisation of domestic manufacturers was around 40% during the quarter. 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.

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

Cement demand was particularly tepid in metros/tier 1 cities as the number of cases kept increasing and the virus showed no signs of abating thus affecting construction work and limiting the need for cement. Even with the centre relaxing rules for unlocking the economy, the industry has faced challenges with regard to state specific lockdowns.

- Most of the infrastructure projects were operating at a much lower capacity due to labour availability issues. Even as real estate companies got permission to start work in April end, there was a delay in getting permissions as well.
- Construction of national highways has fallen by 15.4% during Q1-FY21 as the ministry has constructed 1,823 km of roads till June 2020 as compared with the 2,155 kms of roads constructed in the previous fiscal year's quarter.
- Institutional projects even with permissions in place had to conduct operations on the project site with social distancing norms which meant limited labourers were in place.
- In addition to all the above reasons, onset of the monsoons is usually defined as a weak period for the cement industry due to the temporary halt in construction activities.

Amidst the pandemic cement consumption has found its way into the rural and retail markets. Cement demand is currently being driven by rural India due to better labour availability. With reverse migration of workers, there has been an increase in construction of rural infrastructure.

Financials

The financials of 16 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 16 Cement companies (Unit: Rs/crore)

	Q1-FY19	Q1-FY20	Q1-FY21
Net Sales & Other Operating Income	22,262	24,954	16,653
Total Expenditure	18,533	19,641	12,799
Operating Profit	4,090	5,718	4,501
OPM (%)	**18.4**	**22.9**	**27.0**
Interest	777	876	744
ICR (times)	**5.3**	**6.5**	**6.1**
Profit after tax	1,355	2,355	1,567
NPM (%)	**6.1**	**9.4**	**9.4**

Source: ACE Equity, CARE Ratings

Sharp fall in the demand for cement has led to the contraction of sales revenue during Q1-FY21. Due to various cost rationalisation measures and overhead controls undertaken by cement manufacturers, there has been an increase in the operating profit margins (OPM) and stability in the net profit margins (NPM).

Table 3: Perspective on the Sales Revenue growth and Total Expenditure growth of Cement Manufactures

(Unit: y-o-y % terms)

	Q1-FY20	Q1-FY21
Net Sales & Other Operating Income	12.1%	-33.3%
Total Expenditure	6.0%	-34.8%
Cost of Services & Raw Materials	-0.1%	-45.7%
Electricity Power & Fuel Cost	6.2%	-42.7%
Selling & Distribution Expenses	3.0%	-38.8%

Source: ACE Equity, CARE Ratings

The overall sales revenue has declined sharply by 33.3% during Q1-FY21 as compared with the 12.1% growth rate achieved during Q1-FY20. Overall expenditure has also fallen sharply by 34.8% mainly on account of supply chain management, contract renegotiations, third party spends and fuel efficiency. This has helped the industry largely given the sharp fall in the top line numbers during the quarter. Selling and distribution, cost of raw materials and fuel/electricity cost encompass around 60% of the total expenses for cement manufacturers.

- Electricity and fuel cost have declined by about 42.7% during Q1-FY21 due to the sharp drop in crude oil prices and lower pet coke prices. Diesel prices have been continuously increasing since June ’20 onwards; however, the average price for the quarter remained more or less at the same level as March quarter. The industry will face any adverse impact during this quarter but the increase in diesel prices will have an impact for the industry in the coming quarters.
- Logistics expenses which are the biggest cost for cement industry has also dropped by 38.8% (selling and distribution) on account of lower railway freight given no busy surcharge season. Savings in logistics on account of renegotiation of contracts, logistic efficiency as well as network optimization also gained momentum due to acceleration of master supply agreement. Logistics synergies however may not be achieved in Q2 due to increasing diesel prices.
- Cost of raw materials too declined by 45.7%. Lower gypsum and fly ash prices have aided in the overall fall in cost of raw materials.

Outlook for FY21

The cement industry was already impacted by the general economic slowdown prevalent in the economy and now with the COVID-19 pandemic prevalent, it has further added on to the weakness present in the industry even though the macros seem strong in the long term.

Cement production is to fall sharply by 25-30% during FY21 and capacity utilization is to be around 40-45%. This will be the steepest ever fall in production (and capacity utilisation) that the industry has ever witnessed. Production of cement has fallen by 0.8% during FY20 and has grown by 13.3% during FY19. Cement production is usually closely in-line with demand which is also poised to fall sharply given the lockdown related restrictions present as the virus is showing no signs of abating.

Even as the nation is under a unlock phase, 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 demand-supply dynamics for cement has gotten impacted.

Supply side issues

- Cement manufacturers have been allowed to resume work by the government mid-April 2020 onwards but only by adhering to social distancing norms which means only limited manpower are present in the plants currently and plants are operating on staggered shifts.
- Logistics and transportation remains a barrier as many states have gone into localized lockdown in order to curb the spread of the virus.
- Cement manufactures are not expected to make any additions to the existing CAPEX and given the limited demand present there has also been CAPEX deferral announcements.
- Production will not be able 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 and when all the agri-work is over.

Demand side issues

- Although cement manufacturers have been allowed to resume production, demand for cement from real estate will continue to be muted as the sector is plagued by labour shortages and lack of liquidity.
- Given how fiscally strained the government finances are at the moment, there could be cuts in spending on infrastructure which will put 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, sales and new leasing will not be able to fully recover during FY21 and realtors will only be focusing on project completing and clearing of existing inventory.
- Rural markets have been good so far but now the virus is spreading there too.
- If monsoons have been equally good, in most part of the country and the outlook for Kharif crop has been favorable as sowing was much higher, it could translate in an inflow of cash flows in the rural economy which could revive infrastructure thus augmenting cement demand. (positive)

Table 4: 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 to the lack of 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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