Cement industry: Cementing growth post demonetisation

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Cement sector continues to play a vital role in the economic growth of the country. India is ranked 2nd, both in terms of production and consumption, in the global cement market after China. The major consuming sectors for cement are housing segment (67%) followed by infrastructure (13%), commercial (11%) and the remaining from Industrial segment.

As on March 31, 2017, India had a total of 575 cement plants with estimated installed capacity of 453.4 MTPA with majority of them in south India, i.e., 37% in the states of Andhra Pradesh, Telangana, Karnataka, Tamil Nadu and Kerala.

Demonetisation hits demand and production

The demand and hence the production was impacted post demonetisation wherein year-on-year production declined by 9% during December 2016, 14% during January 2017, 16% during February 2017 and 7% during March 2017. Production dipped to 24.4 million tonnes in March 2017 as against 26.3 million tonnes in March 2016. Cumulative cement production is estimated to be around 273.8 million tonnes for FY17 vis-à-vis 273.9 million tonnes in FY16 (decline of 1.3%) (refers to the period April 1 to March 31).

Consumption remained stagnant at around 270 million tonnes in FY17 vis-à-vis 269 million tonnes in FY16 owing to liquidity crunch in the market on account of demonetisation; this leads to slow pace of execution of infrastructure projects coupled with slowdown in demand from the real estate sector which is already on high level of inventory.

(Source: CMIE)

Union Budget 2017-18 has a positive impact on the sector

The recent increased allocation to rural low-cost housing under Pradhan Mantri Awaas Yojana- Gramin scheme to Rs.23,000 crore in FY18 from Rs.16,000 crore in FY17 as per budget is likely to increase the cement demand significantly. Furthermore, focus of the Government on strengthening infrastructure including road sector, development of smart cities and expected revival in the overall economic growth is expected to result in improved growth prospects for the cement sector. Moreover, fall in diesel prices, coal and pet coke prices will provide some respite to the cement industry on the cost front. Production increased from 20.65 MT in February 2017 to 24.41 MT in March 2017 (growth of ~ 18.18%) post budget announcement. Dispatches have witnessed increase in the months of March & April 2017 backed by increased demand across India.

Recent surge in cement prices in the month of April 2017

In the month of April 2017, there has been a surge in cement prices across India. Increase in price can be attributed to various reasons. While production declined post demonetisation on account of fall in demand, the sudden surge in demand has led to the surge in prices coupled with supply moderation. The truckers strike towards March 2017 end triggered the price hike. Furthermore, GST and increase in prices of pet coke is also expected to be a factor for the sudden steep increase in prices.

Cement prices witnessed a short lived decline post demonetisation resulting in low prices primarily in November 2016 to March 2017 and surged during April 2017. Prices were most impacted in the Southern markets, wherein the wholesale price declined from Rs.303/bag in the month of November 2016 to Rs.264/bag in the month of March 2017 and spiked to Rs.329/bag in the month of April 2017 (Hyderabad). Prices in the northern markets witnessed a steady price increase backed by stable demand. In the east and west, prices remained more or less stable. Prices across India have increased with average price per bag being around Rs.330 in the month of April 2017.

Source: CMIE

Impact of Central Goods & Service Tax Act, 2017

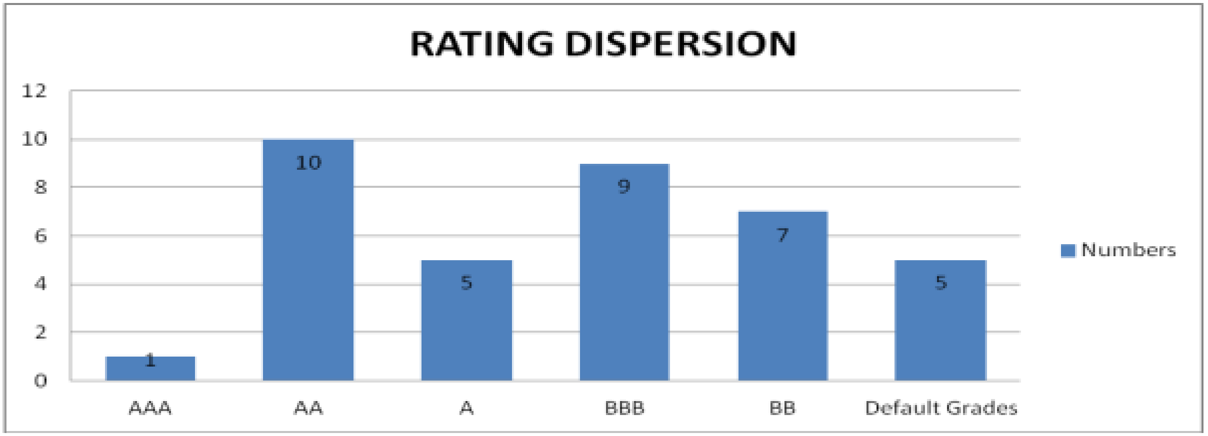
For a cement company, power & fuel, freight and raw material the three major cost drivers which contribute around 21-23% each to the overall cost of production of the sector. Under the GST Act, lower rate of 5% is applicable on inputs like coal and limestone. Furthermore, with GST likely to come into effect from July 1, 2017, freight costs are likely to decline significantly benefitting cement companies. However, although lower GST rate of around 18-20% was earlier envisaged for cement which was expected to improve the margins of the cement manufacturing companies, GST at the peak rate of 28% has been declared which is expected to be passed on to the consumers and hence result in further increase in prices. The overall impact of GST is expected to be more or less neutral for the cement industry with marginal increase of 1-3% in realisations.

Particulars	Current Tax Rate (%)	GST Rate (%)/Benefit
Cement	**25-32%**	**28%**
Coal	**11.69%**	**5%**

Way forward

Higher outlay and focus on infrastructure, housing and rural development are likely to boost the cement demand in the long-term, which in turn will benefit the companies in the sector. Also, with the price hikes and easy access to mines due to passage of Mines and Minerals (Development and Regulation) Act, the profit margins of cement companies are expected to improve marginally going forward. Furthermore, prices may further increase as the companies are likely to pass on the impact of GST peak rate to the consumers. This is, however, expected to be partially offset by the lower GST rate on coal and limestone coupled with lower tax incidence on logistics which will reduce the freight and transportation costs and hence the overall cost of production of the cement companies. Despite demonetisation, with increased price and likely increase in demand over the medium term, the credit profiles of the cement players are expected to be stable.

Rating dispersion of CARE rated entities in cement sector:



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