CARE expects stable credit profile of cement companies on the back of expected moderate recovery for the industry in FY13

Sector Overview

CARE believes that following the trough of FY11 & FY12, demand for cement is likely to witness moderate recovery in FY13 depending upon the pace of infrastructure growth in the country. Although government has planned for huge investment in the infrastructure sector as highlighted in the Union Budget, a lot depends upon ground action on key fronts including correction in interest rates by the RBI and prompt regulatory approvals for many on-hold projects. While weak economic fundamentals characterised by rising energy costs, higher freight & distribution costs, depreciation of rupee, etc is a cause of concern for the industry which needs to be addressed, recent small steps taken by the government on infrastructure development and interest rate front are likely to support growth for the industry. CARE expects credit profile of 32 **CARE-rated cement companies to remain steady in FY13.** Overall, CARE expects demand to grow by about 8% during FY13. Although there is a likelihood of slowdown in demand and decline in prices during monsoons, the industry volume is likely to witness growth thereafter.

During FY12, the industry witnessed increasing demand-supply mismatch with further capacity addition of about 25 mn tonnes in FY12 while demand increased by about 13 mn tonnes (from 209.8 mn tonnes in FY11 to 223.1 mn tonnes). This impacted the industry negatively which witnessed further pressure on margins in H1FY12. However, the scenario improved in the last quarter with the industry witnessing higher price realisation which was primarily driven by rising input costs. Resultantly, the industry witnessed a growth of about 6-6.5%, in line with estimated GDP growth of around 6.6-6.8%. Average capacity utilisation rate remained at about 74% during FY12.

In line with our last year's expectation, the industry-determined systematic risk factors did not have a major impact on the credit profile of cement companies rated by CARE and the rating revisions (4 downgrades and 3 upgrades of the total portfolio of 27 companies) were primarily on account of company-related unsystematic risk factors.

Going forward, the credit profiles of large cement companies are likely to remain stable on account of their strong balance sheets and moderate capex plans. However, increase in vigilance by Competition Commission of India might impair their ability to raise prices. Besides, the fragmented sector of the industry dominated by the small and mid-sized cement companies with high debt-driven capex and limited flexibility in their cost structures may witness a deterioration of debt coverage. As such, these companies would need to manage their cash flow efficiently and the credit profile of such companies largely depends on the pace of infrastructure development and improvement in economic sentiment.

CARE believes that extraordinary delay in land clearance, non-availability of domestic coal leading to imports, power tariff hikes, increased taxation impact alongwith other macro economic factors prevailing currently can pose a hurdle for the cement industry whereas increasing FDI inflows, accelerated industrialisation and growth in the infrastructure segment can bring some relief to the industry. Further, prices are expected to improve over the longer term with improved demand from the infrastructure sector, which is expected to be around 690 mn tonnes during the 12th five year plan (as estimated by Planning Commission).

In the short run, profitability of cement companies is expected to be volatile in view of rising input costs as well as moderate capacity utilisation. However, over the longer term, demand is likely to increase supporting prices and profitability. Consequently, CARE believes that the credit profile of cement companies is likely to remain almost stable.

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