Cement Industry FY20 update and FY21 outlook

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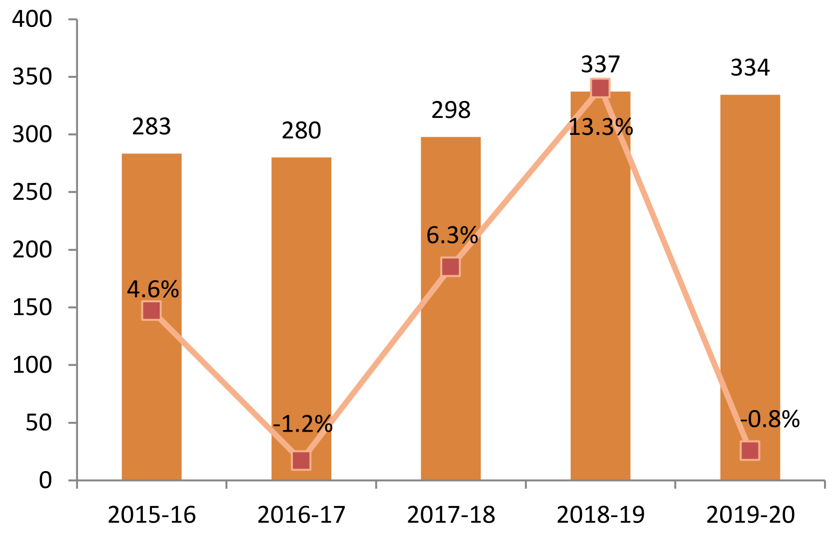
Overview

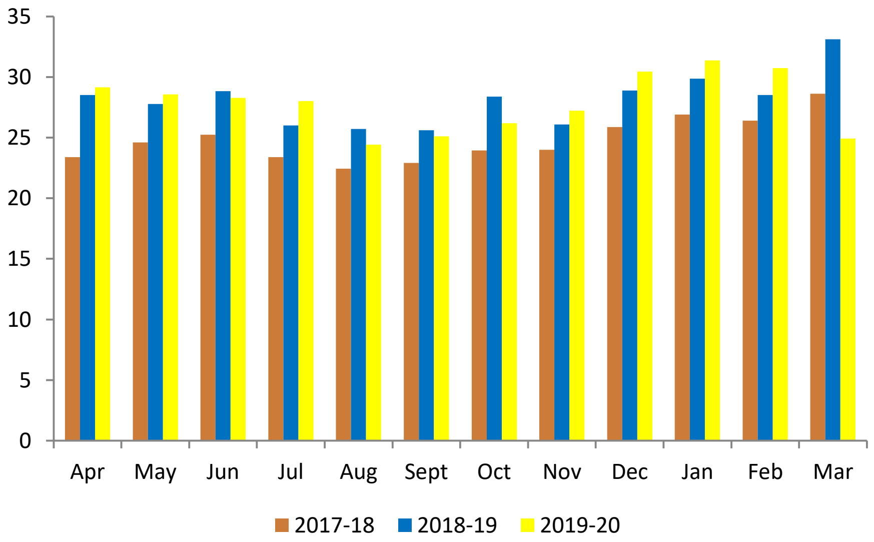
The Cement industry is part of the core industrial sector and plays a crucial role in building up the nation's economy. India is the world's 2nd largest cement market, both in terms of production and consumption.

Demand-Supply

Domestic Production

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





Source: Office of the economic advisor

Domestic cement production has grown at a CAGR of 4.2% during FY16-20. The industry has been on a sustained growth path adding capacity, driven largely by the construction sector and the ambitious infrastructural projects announced by the government from time to time. On the other hand, cement production fell by 0.8% during FY20 as compared with the robust 13.3% growth achieved during FY19.

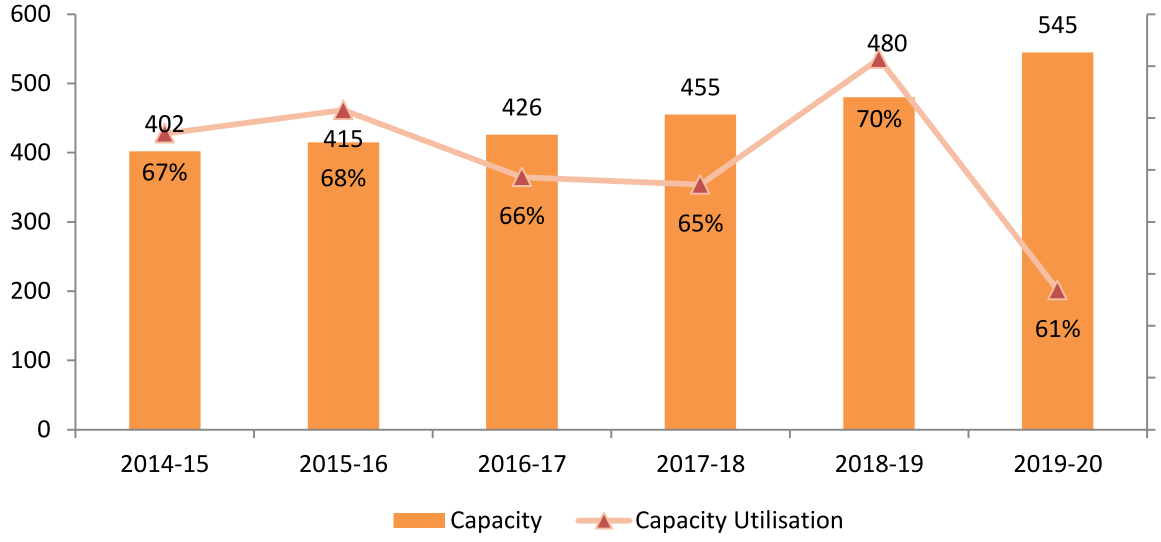
Weakness in housing demand, prolonged rains in many parts of the country and decline in demand from the infrastructure segment due to lack of funding and halting/ temporary stoppage of state projects following change in government post state elections has had a negative bearing on the production of cement in the domestic markets.

Outbreak of the COVID-19 pandemic in the Indian sub-continent which forced the government to announcement a nation-wide lockdown, 25th March 2020 onwards also affected the domestic cement production during FY20. Construction activity across the country was halted, which is normally at its peak in the month of March, affected the cement offtake. Production fell by 24.7% during March 2020 as compared with the 15.7% growth achieved during March 2019.

Capacity

As per Cement Manufacturers Association, India accounts for over 8% of the overall global installed capacity. Region wise, the Southern region comprises of 35% of the total cement capacity followed by the Northern, Eastern, Western and Central region comprising of 20%, 18%, 14% and 13% of the capacity respectively.

Chart 2: Installed capacity and Capacity Utilization rate of Cement Manufacturers (Unit: Million Tonnes)



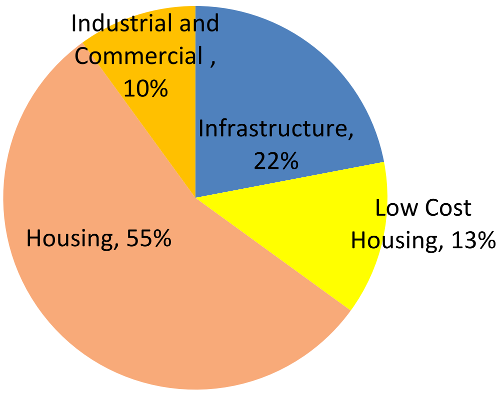
Source: CMA, Exchange Filings, CARE Ratings

Installed Capacity of domestic cement manufacturers has increased at a CAGR of 7.1% during FY16-20. Manufacturers have been able to maintain a capacity utilization rate above 65% in the last quinquennium (between FY15-19) but prolonged rains in many parts of the country and with the temporary closure of cement plants during the government enforced lockdown has led to the capacity utilization rate to fall from 70% during FY19 to 61% during FY20.

Demand Drivers for the Cement Industry

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

Chart 3: Key growth drivers for the Cement Industry



Source: CARE Ratings, Company Filings

National Infrastructure Pipeline: The government's newly introduced National Infrastructure Pipeline (NIP) which is to enable the country to meet its target of becoming a USD 5 trillion economy by 2025 is a detailed roadmap focused on economic revival through infrastructure development. The NIP covers a gamut of sectors; rural and urban infrastructure and entails investments to the tune of Rs.102 lakh crs to be undertaken by the central government, state governments and the private sector. Of the total projects of the NIP, 42% are under implementation while 19% are under development, 31% are at the conceptual stage and 8% are yet to be classified. The sectors that will be of focus will be roads, railways, power (renewable and conventional), irrigation and urban infrastructure. These sectors together are to account for 79% of the proposed investments in the 6 years period to 2025. Given the government's thrust on infrastructure creation, it is likely to benefit the cement industry going forward.

Affordable Housing: The Pradhan Mantri Awaas Yojana (PMAY) aimed at providing affordable housing will be a strong driver to drive up cement demand in the next few years. Under PMAY the government has been consistently increasing budgeted allocation for the constant implementation of this scheme which is aimed in providing around 20 million houses at an affordable price. The centre had introduced the credit link subsidy scheme, in May 2017, which was initially extended till March 31st, 2020 but now has been extended for one more year till March 2021. The credit link subsidy scheme has benefitted 3.3 lakh families till now and aims to benefit another 2.5 lakh to get affordable houses.

Trend in prices

Chart 4: All India Wholesale and Retail Price of Cement (Rs/50kg bag)

Source: CMIE

Prices of cement (wholesale and retail) have increased by 11.7% and 12.5% during FY20. Prices have started correcting Q4-FY20 onwards due to revival in demand of the commodity given the restart of major infrastructure projects, new launches, pick-up in the real-estate demand in urban areas and announcement of the NIP.

Financials

The financials of 11 cement manufactures have been analyzed 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.

Table1: Financials of 11 Cement companies (Rs/crore)

	2017-18	2018-19	2019-20
Net Sales & Other Operating Income	50588	62934	63771
Total Expenditure	41073	52099	49746
Operating Profit	10655	11722	15151
OPM (%)	21.1	18.6	23.8
Interest	1774	2340	2419
ICR (Times)	6.0	5.0	6.3
Profit after tax	3926	3581	7615
NPM	7.8	5.7	11.9

Source: ACE Equity, CARE Ratings

Tepid demand throughout the country in the first half of the year has led to the contraction of sales revenue. Fall in the total expenditure of cement manufacturers had aided in improving the operating profit and net profit margins of the industry. Interest coverage ratio too has improved on an overall basis.

Table 2: Perspective on the Sales Revenue growth and Total Expenditure growth of Cement Manufactures

(Unit: y-o-y % terms)

	2018-19	2019-20
Net Sales & Other Operating Income	24.4%	1.3%
Total Expenditure	26.8%	-4.5%
Cost of Services & Raw Materials	20.3%	-4.4%
Electricity Power & Fuel Cost	41.0%	-12.7%
Selling & Distribution Expenses	31.7%	-7.9%

Source: ACE Equity, CARE Ratings

The overall sales revenue has increased by only 1.3% during FY20 as compared with the 24.4% growth rate achieved during FY19. Overall expenditure has declined by 4.5% which has benefitted the industry largely given the moderation in sales. Selling and distribution, cost of raw materials and fuel/electricity cost encompass around 70% of the total expenses for cement manufacturers.

- Electricity and fuel cost have declined by about 12.7% during FY20 due to the sharp drop in crude oil prices.
- Logistics costs which are the biggest cost for cement industry has also dropped by 7.9% (selling and distribution) as the railways extended the benefit of exemption from busy season surcharge.
- Cost of raw materials too declined by 4.4% given the price of limestone of had also fallen by 9.6% during FY20

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 as against the grown of 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.

The nationwide lockdown has come at the time when construction activities is at its peak and it will be followed by the monsoon season where again the construction activity will again be impacted thereby affecting entire dynamics of demand-supply for cement.

Supply side issues

- Cement manufacturers who had suspended operations during the lockdown (25th March 2020 onwards), have been allowed to resume work by the government (in the orange and green zones) post mid-April 2020 onwards but only by adhering social distancing norms which mean only limited manpower are present in the plants currently.
- Logistics and transportation remains a barrier as railways is primarily focused in transporting essentials at the moment.
- 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.

- Even with the lifting of lockdown, cement production will not be able to gain momentum as the reverse migration of workers has led to a standstill in operations, disrupting the entire supply chain operations. Labourers are not expected to return anytime soon, at least till the monsoon season recedes.

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 shortage 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.

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 to the lack of activity in the housing and infrastructure sector the cement industry is expected to remain in the red zone till October 2020 at least, till the end of the monsoon season. Partial recovery is expected November 2020 onwards and normalisation of operations post January 2021 onwards

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