# Cement: Perspectives and Outlook

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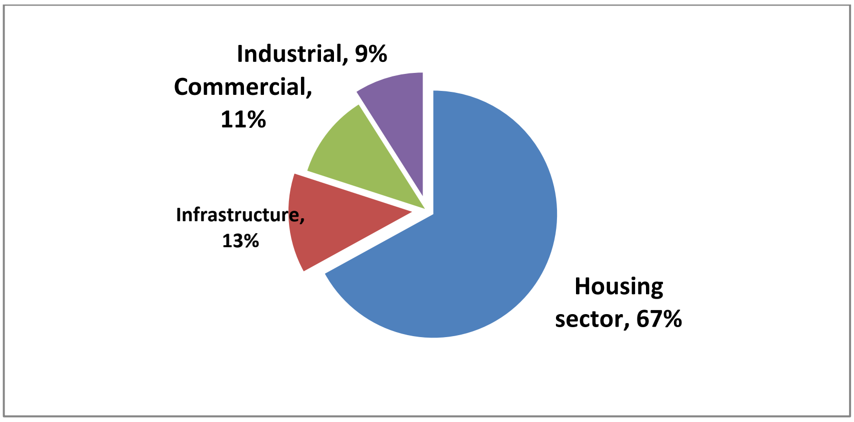
## Overview

India is the second largest cement producer after China with production capacity of 431.4 million tons as of 2015-16. The top 10 companies account for around 65% of the market which prove that the industry is dominated by few players. There are a total of 575 plants out of which 210 are the larger ones. Further 188 large plants cover 97% of total installed capacity while 365 mini plants account for the balance. (Source: IBEF). Major demand drivers for cement are housing and Infrastructure sector.

**Chart 1: % share of cement demand in consuming sector as of FY15**



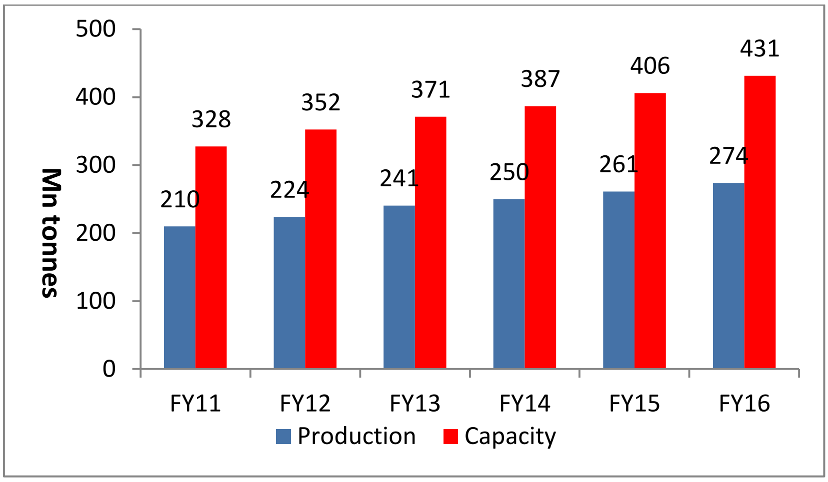

*Source: IBEF*

**Capacity and Production Scenario:**

Capacity increased at a CAGR of 5.7% from 328 mn tonnes in FY11 to 431 mn tonnes in FY16. For the same period, production increased at a CAGR of 5.5% from 210 mn tonnes in FY11 to 274 mn tonnes in FY16.

Cement production grew by 4.7% y-o-y in FY16 compared with 5.6% in FY15 and 3.1% in FY14. Slower than envisaged economic and infrastructural activity, weakness in rural demand due to subdued monsoon and slowdown in real estate activity in large cities had impacted the growth rates of the industry in past few years. This along with surplus supply situation in the Industry had impacted the capacity utilization rate adversely.

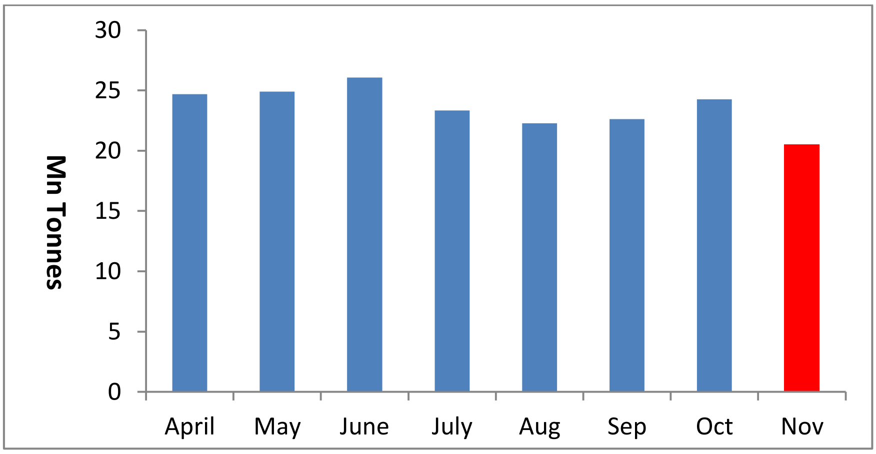
**Chart 2: Production and Capacity in Cement Industry**




*Source: CMIE*

However, green shoots of recovery were witnessed till October 2016 with cement production increasing by 4.8% for the period of April-October 2016 as against 2.9% for the same period last year. Relatively better and widespread monsoon this year was expected to have favorable impact on cement demand starting H2-FY17. However, the ban on high currency denomination notes in November 2016 has impacted the demand growth of the industry.

**Chart 3: Cement production in FY17**



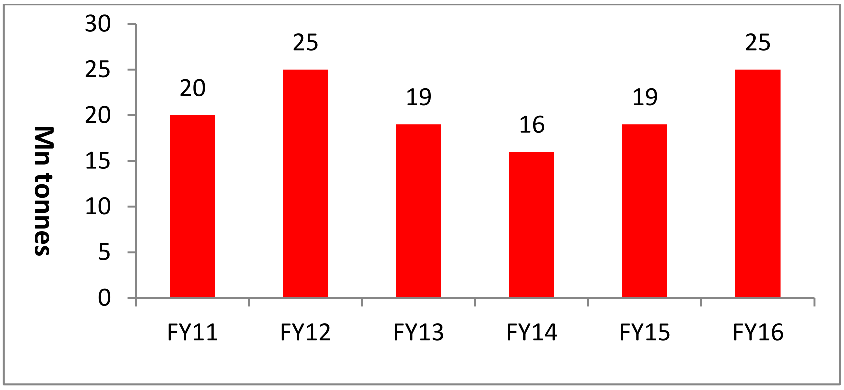

*Source: Govt of India, Ministry of Commerce and Industry*

Due to cash crunch in the system impacting housing and infrastructure (more impact on the trade/retail segment where relatively higher cash dealings are prevalent including rural sector) the cement production/demand has declined for the month of November 2016 (refer Chart 3). While the decline in demand was expected, the pricing did not see major correction based on interaction with various dealers and industry sources, with prices falling in the range of Rs.5-10/bag in most markets in November-December 2016. During January 2017 so far, based on market sources the decline in the despatches has halted and pricing environment has been stable in the Northern markets, subdued in Western region and stable to marginally down in Southern region. *For FY17, CARE expects demand growth to be flat and marginally grow at around 1-2% y-o-y.* CARE expects gradual release of pent up demand, easing of liquidity in the system and higher infrastructure spending to spill over partially to Q1-FY18.

### Capacity additions

Capacity addition has grown at CAGR of 4.4% between FY11 and FY16. Pace of capacity addition in next few years is expected to be lower compared with previous years as there is already excess capacity in the industry. Companies had added the capacities on the back of expenditure laid down in the Budget by the government but demand did not pick up the way it was expected. This had resulted in excess capacity.

**Chart 4: Capacity Addition in Cement Industry**

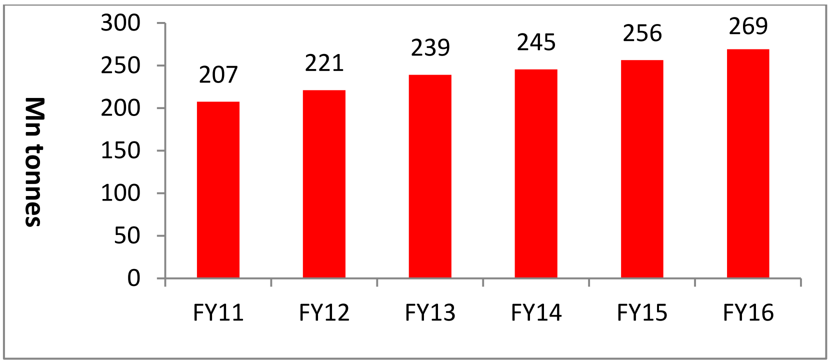



*Source: CMIE*

### Consumption Scenario

The consumption grew at a CAGR of 5.4% from 207 mn tonnes in FY11 to 269 mn tonnes in FY16.

**Chart 5: Consumption in Cement Industry**




*Source: CMIE*

In FY16, sharp decline in real estate demand, floods in Tamil Nadu and a lower government spending led to a decline in cement sector in this region. North region witnessed lower demand due to lack of rural demand and already piled up real estate inventories. But, there was a huge government spending witnessed in north eastern states backed by allocation of funds in Union Budget. This led to an increase in demand for cement in this region.

The demand for cement has been affected after demonetization. This has also been corroborated by reports which talk of lower freight revenue by railways. Indian railways have witnessed significant impact on revenue due to reduction in coal and cement traffic after demonetization.

It is possible hence to say that had demonetization not been invoked, growth would have been pushed by the housing segment on the back of announcements made regarding PMAY- rural and Housing for all by 2022, smart cities and various irrigation projects.

**Import and Export Scenario**

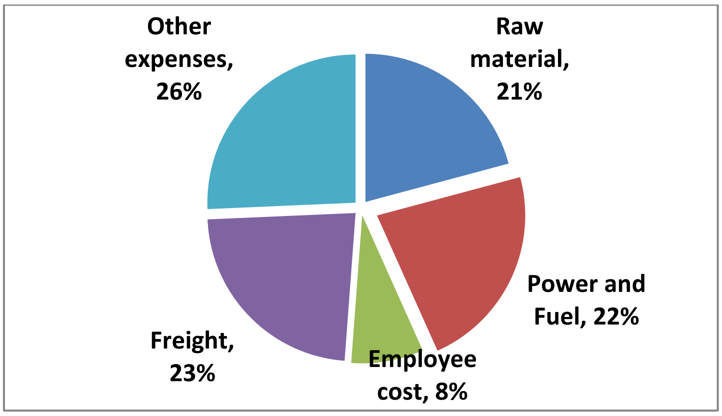
Cement imports in the country are almost close to negligible with domestic supply being adequate. Nevertheless, 64% of our import demand in terms of quantity was from Pakistan in FY16. Imports have increased from 1.095 mn Tonnes in FY11 to 1.35 Mn tonnes in FY16.

Exports on the other hand have increased from 3.49 Mn tonnes from FY11 to 6.22 Mn tonnes in FY16.

**Rising input costs to put pressure on the margins:**

Power & fuel and freight are the major components of costs of the cement industry given the fact that it is an energy and freight intensive industry. Power & Fuel costs as well as transport/freight costs contribute about 22-23% each to the overall cost of production for the sector. Therefore, the margins of the players are susceptible to adverse changes in these input costs. Chart 3 gives the cost structure of the industry based on the cost structure of a select sample of 42 companies as of FY16.

**Chart 6: Industry cost breakup in FY16**



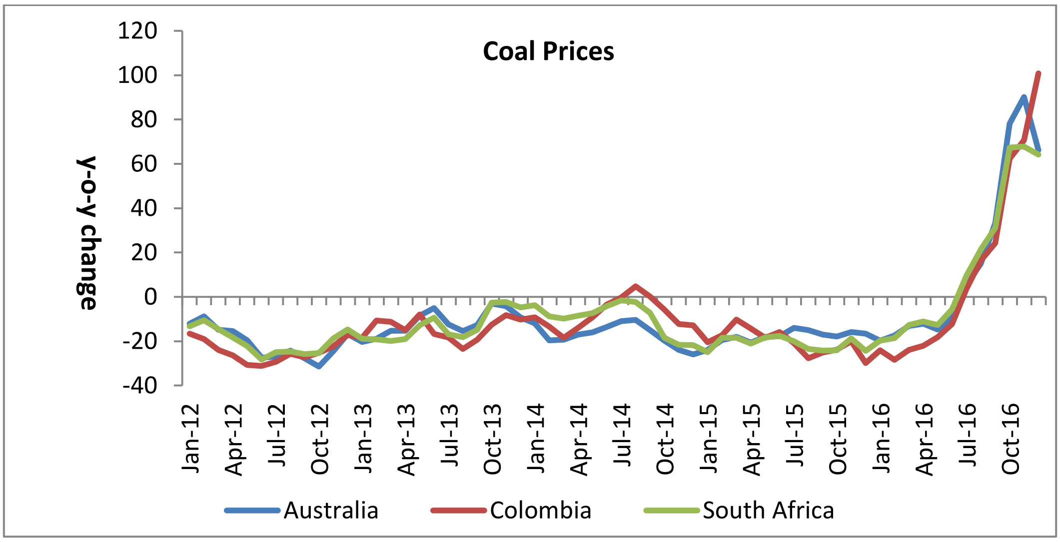

*Source: Ace equity*

Increase in freight rates was partially mitigated by softening of the diesel prices in FY15 and FY16, though the same have increased in FY17. Also, the cement industry during Q4-FY16-H1-FY17 benefitted from subdued coal and pet coke prices. However, coal prices have started to firm up since July 2016. Further, pet coke which is an alternative to coal has also witnessed price increase since February 2016 (price increased by 78% since February 2016) primarily due to supply constraints as well as high demand. Therefore, the ability of the companies to pass on the rise in input costs would be crucial in order to sustain the margins.

**Coal**

Coal is primarily used as a fuel in the process of cement manufacturing. Approximately, 0.12-0.14 tons of coal (excluding coal consumption in captive power plant) is required for the production of one tonne of OPC. Due to limited availability and inferior quality of coal, Indian cement Industry is dependent on high calorific coal from foreign countries like Indonesia, Australia and African countries. Thus, making it vulnerable to international supply shocks, currency fluctuation and price volatility.

**Chart 7: Y-o-Y Growth in International coal prices**




*Source: CMIE*

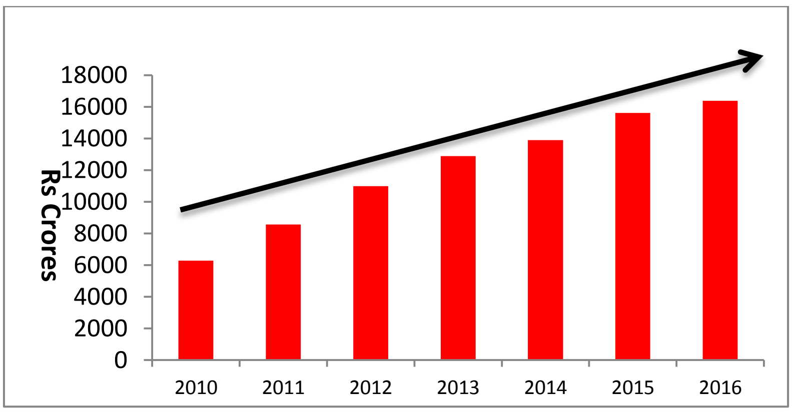
**Power:**

The standard power requirement to produce one tonne of cement varies in the range of 80-110 units for different cement companies. In order to save themselves from regular supply cuts, cement companies has shifter to captive power generation which requires coal. Even though this makes them vulnerable to price volatility and supply shock, the consistent supply of power is ensured.

**Freight cost:**

Companies use railways, roads and sea route to transport cement, cement clinker and ready mix concrete. But roads and railways are the preferred modes. Chart 8 gives an idea of how freight and forwarding charges have moved in 6 years for the Industry (Aggregate of 42 companies has been taken):

**Chart 8: Freight costs for the Industry**




*Source: Ace Equity*

The freight and forwarding charges has increased by a CAGR of 17.3% from FY10 to FY16 and is expected to further increase in FY17 as the diesel costs have increased by 6% y-o-y in April-August 2016. *(A part of this increase in cost would also be linked to the volumes that are transported).*

The reason of an increase in costs could be attributed to increase in the lead distance, increase in the rail freight and increase in the volumes transported. But, the increase was marginally offset due to a decline in diesel prices in FY15 and FY16.Shortage of wagons, increase in the rail freight rates and a decrease in the diesel prices had made companies to shift to road transportation. However, increase in diesel prices is likely to affect the industry in FY17.

**Pricing Scenario:**

**Chart 9: Y-o-y growth in Wholesale prices of cement**


*Source: Govt of India, Ministry of commerce and Industry*

- During 2012-13, cement prices had risen as a result of increase in the cost of production. There was a rise in logistic cost due to an increase in rail freight and diesel price which was transmitted into cement prices.
- Growth in cement prices declined in 2013-14 on account of fall in construction activity, prolonged monsoon, drop in government spending and an increase in the interest rates.
- In 2014-15, the reasons were different compared with other years. The prices rose on account of a supply crunch due to the closing of major plants in Himachal Pradesh and Rajasthan.
- In 2015-16, Cement demand could not pick on account of delay in government spending and a muted demand from private housing.

***Future scenario***

1. Coupled with high pet coke prices, higher coal prices, an increase in freight costs and subdued demand post demonetization, the short-term outlook for cement Industry is not too positive. CARE expects flat to marginal growth in cement demand in FY17 on a y-o-y basis. Presently there is subdued industrial activity and low private sector capex expectation in the medium term. Also demonetization has impacted real estate demand.

2. Increased government spending on infrastructure and incentives to housing especially in the affordable segment as well as lower tier-cities should lead to higher growth rates for the sector FY18 onwards. The announcements on

interest rate subvention for lower value of home loans and further expectations of tax breaks on interest paid on such loans to be made in the Union Budget will be the positive factors to watch out for in FY18.

3. Pricing power of the players would be tested in the near term given oversupply situation and weak demand scenario. However, pent up demand, lower capacity addition in the medium term, and supply discipline being maintained in most markets by the players, extreme pressure on pricing front is not expected.

4. Also, capacity utilization rates should gradually improve FY18 onwards with low base effect, lower incremental capacity addition and gradual demand growth.