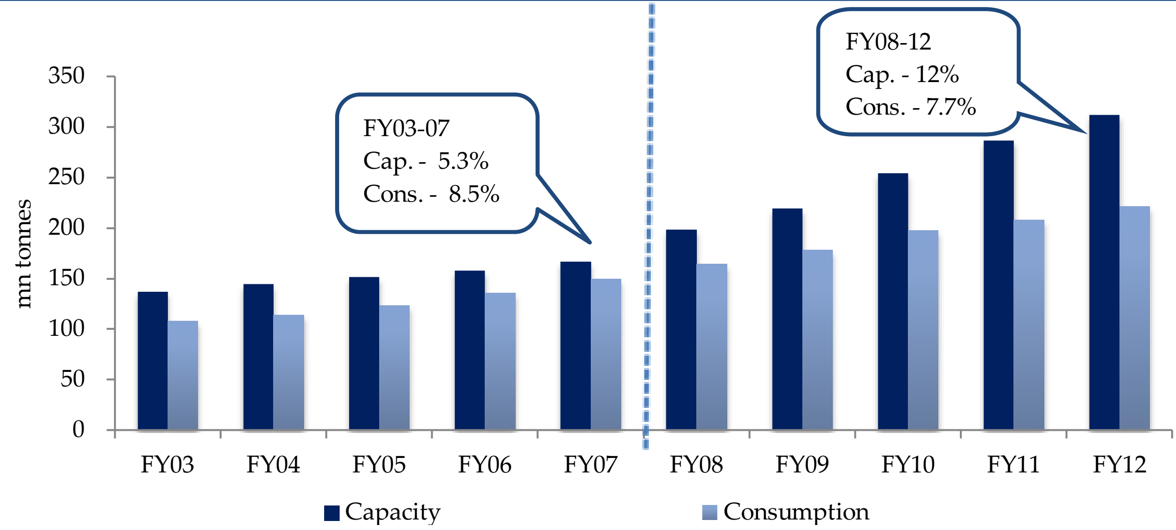
Alleged cartelisation and declining Break-even Cushion to put pressure on prices ...

Growth in capacity over striping demand in past few years...

Cement consumption in the country had grown at an incremental rate over the rate of capacity during the period FY03-07 which had led to tight demand supply situation in many parts of the country. Increased spending by the government on infrastructure activities, growth in real estate sector and increase in industrial capex had collectively led to increased appetite of cement. During this period, the cement consumption grew at CAGR of 8.5% while the capacity grew at 5.3%. This led to rise in utilization rate of the industry which supported northward movement of cement prices. The average cement prices had increased from Rs.139 per bag in FY03 to Rs.208 per bag in FY07, registering a CAGR of 10.6%. However, the scenario changed in next five fiscals. The gap between cement demand and capacity has been widening due to substantial capacity addition.

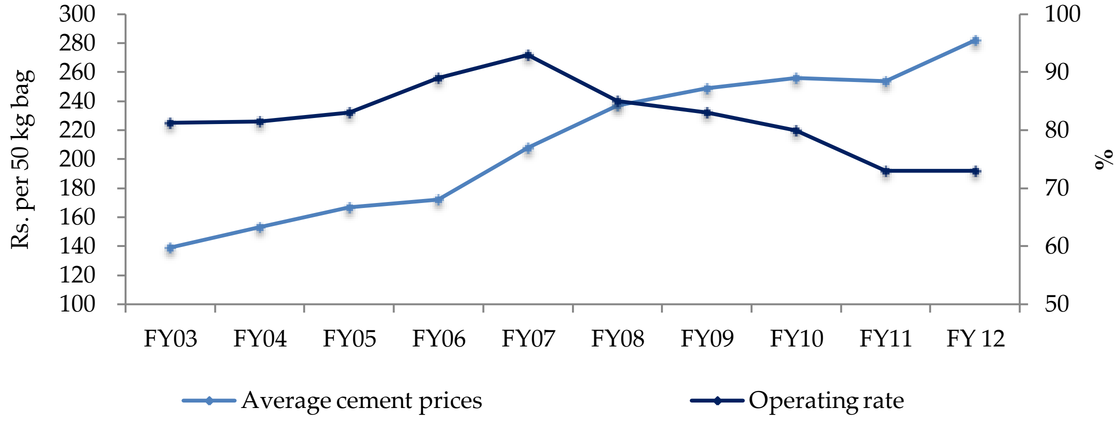
Trend of Capacity and Consumption



Source: CMA & CARE Research | Figures in callouts represent CAGR in %

Cement industry has witnessed a capacity addition of about 145 mn tonnes in FY 08-12, almost 47% of industry's total capacity as at the end of March 31, 2012. The capacity grew at a CAGR of 12% from 198.3 mn tonnes at the end of FY08 to 311.6 mn tonnes at the end of FY12 while the consumption grew at a CAGR of 7.7%. Consequently, the industry's capacity utilisation rate has witnessed a declining trend from the level of 93% in FY07 to 73% in FY12. Despite of the substantial drop in the operating rate, the cement prices continued the rising trend. The average cement prices have increased from Rs.237 per bag in FY08 to Rs.282 per bag in FY12, registering a CAGR of 4.4%. This diverse movement between cement prices and operating rate implies a production discipline to maintain cement prices.

Operating rate vs average cement prices

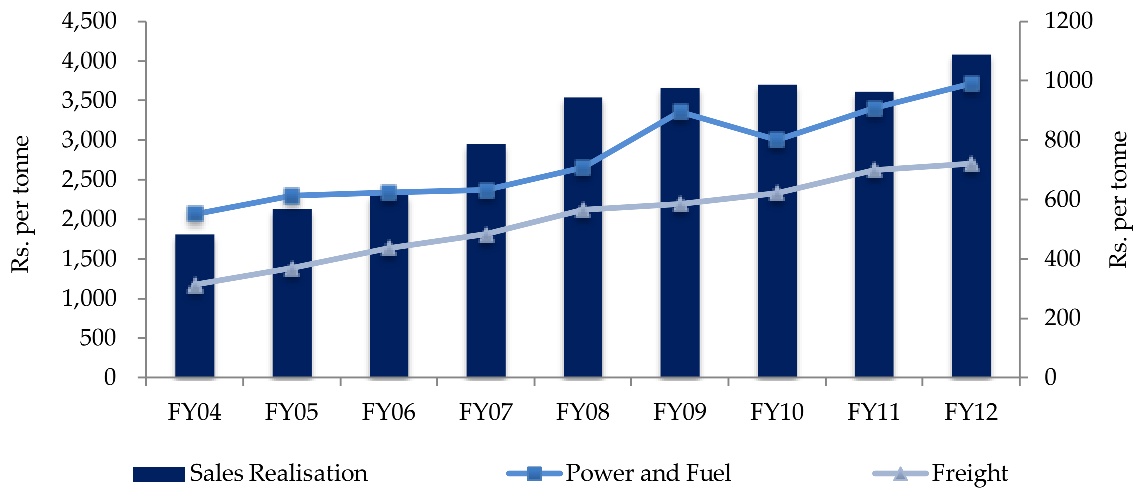


Source: CMA & CARE Research

Production discipline helped to sustain realisation …

During the period of FY04-07, on account of the tight demand and supply situation prevailing in the industry, sales realisation grew at a faster rate. During this period, sales realisation per tonne grew at a CAGR of 17.6% while the power & fuel cost and the freight cost (the two major cost components of the industry) increased by 4.6% and 15.6%, respectively. Post FY07, despite of the supply glut situation, the industry was able to pass on the increased cost burden to a large extent to the consumers on the back of the supply discipline followed by the cement players. During the period of FY07-12, power & fuel cost and the freight cost have grown at a CAGR of 9.4% and 8.3%, respectively while the realisations grew at a CAGR of 6.7%. The higher increase in input costs have led to a cost push increases in cement prices. The PBDIT margin of the industry has declined from 32.3% in FY 07 to 20.9% in FY 12.

Sales Realisation vs Power & Fuel and Freight cost

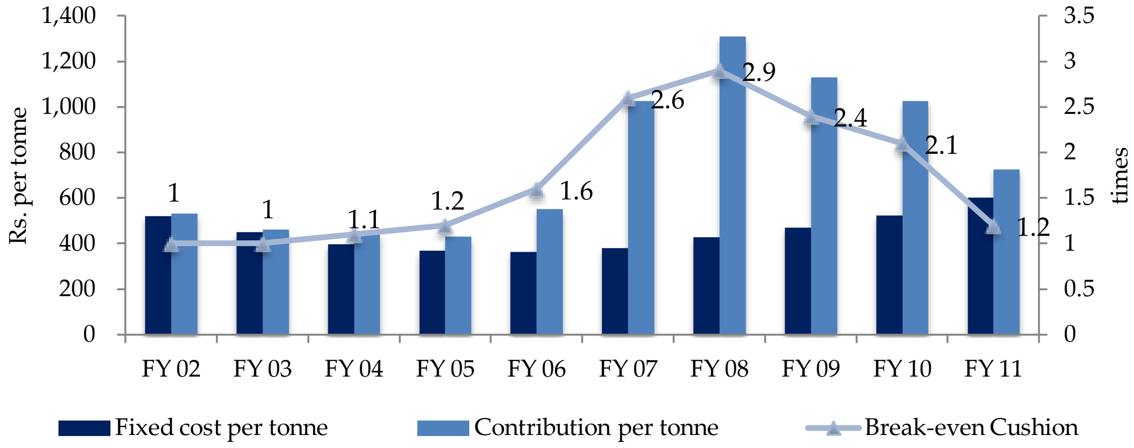


Source: CARE Research

Declining trend of Break-even Cushion...

The cement industry was operating under the break-even utilisation rate in the period FY2000-01. On an average, the per tonne fixed cost was higher than the contribution per tonne. As a result, many companies in the cement industry were making losses in this period. With a notable increase in contribution per tonne, post FY 03, the break-even capacity utilisation rate of the industry had gone down considerably and breakeven cushion value had increased to about 2.9 times in FY 08.

Trend of Break-even Cushion



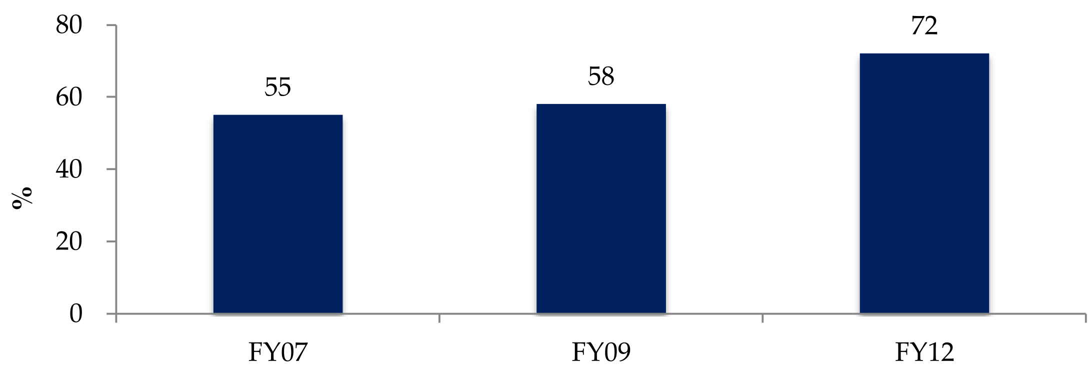
Source: CARE Research
Break-even Cushion is defined as the ratio of overall capacity utilisation rate of the industry to the utilisation rate at the break-even point in a particular year.

However, with the increasing cost pressures and lower growth in realisation, breakeven cushion value has declined to 1.2 in FY 11. Even with the decline in the operating rate to a level below 80% in the past few years, the cement industry has been able to hold the prices due to comfortable break-even cushion value. However, the declining Break-even Cushion is a cause of concern for the industry.

Rising break-even capacity pose a challenge for new players ...

On the back of the spiralling interest rates, the fixed cost for the new plants has increased notably in the past couple of years.

Break-even capacity utilisation point for new plant



Source: CARE Research

RBI has increased interest rates by 375 bps from 4.75% in March 2010 to 8.5% till March 2012 making money dearer. Increase in fixed costs and declining contribution per tonne has led to substantial increase in the break-even capacity utilisation level of the new plant from 55% in FY07 to 72% in FY12. The rising break-even level coupled with the excess capacity in the industry pose a major challenge on the sustainability of new cement players.

Alleged cartelisation to put pressure on prices…

Competition Commission of India (CCI) has imposed a hefty penalty of about Rs.6,300 crore on 11 cement producers, under the allegation of violating the provisions of the Competition Act, 2002. CCI has investigated that cement companies have decreased production to inflate prices. However, the cartelisation is difficult to prove. Cement companies are claiming that prices are always decided by the demand & supply dynamics in the market and not by collusion. Cement companies are expected to appeal to the Competition Appellate Tribunal to contest the order. Going ahead, as the cement price movement is expected to remain under scrutiny by CCI, pricing power of cement companies will be affected. Also, the increasing cost pressure is likely to keep the profitability of cement players under pressure.

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