Digital push to drive growth for Cement sector

MAY 31, 2017

Indian cement industry's medium to long-term outlook looks cheerful

Standing at the second position in the world, in terms of the production capacity, Indian cement industry plays a vital role in the country's economy, providing employment to more than a million people, and attracting huge investments, both from local as well as foreign investors. It is also a significant contributor to the revenue collected by both the central and state governments through excise and sales taxes. Ever since it was deregulated in 1982, the industry has seen many ups & downs, but has steadily grown over the years, both in terms of production and capacity utilization. Currently, there are around 210 large cement plants in India with an installed capacity of over 350 million tonnes and more than 350 mini cement plants with a capacity of nearly 11.10 million tonnes (DIPP - 2016). The industry, which played a meaningful role in the nation building process is dominated by a few companies, with the top 20 cement companies accounting for about 70% of the country's total cement production. As the government is focusing more on infrastructure development, (like Smart Cities, Highways, ports and urban transformation), many industry players are ramping up their capability to provide quality building materials and services to match the engineering excellence that goes into implementing ambitious projects necessary in these segments.

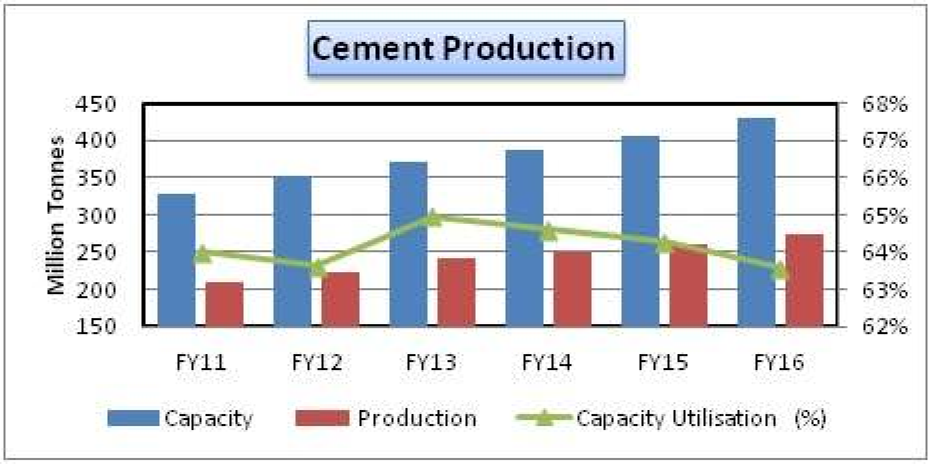
Industry inside

The country manufactures various types of cement like Ordinary Portland Cement (OPC), Portland Pozzolana Cement (PPC), Portland Blast Furnace Slag Cement (PBFS), Oil Well Cement, White Cement, etc. These different types of cement are produced as per the Bureau of Indian Standard (BIS) specifications and its quality is comparable with the best in the world. The housing sector is the biggest demand driver of cement, accounting for about 67% of the total consumption, followed by infrastructure at 13%, commercial construction at 11% and industrial construction at 9%. The Production and Dispatch figures for the fiscal year 2016 (FY16) were 283.45 Million Tonnes (MT) and 283.38 Million Tonnes (MT) respectively. India's current per capita consumption of cement is much lower than many developed and developing economies, also India has a lot of potential for development in the infrastructure & construction sector, therefore there is a significant business opportunity to cater to with unmet and rising demand. Finance Minister Arun Jaitley raised the allocation for roads from Rs 57,976 crore in FY17 to Rs 64,900 crore in FY18, with a stress on laying 2,000 km of coastal roads. According to industry estimates, cement comprised 30% of the cost of laying a road and the budgetary allocation would translate into a Rs 19,470 crore opportunity for the sector.

In terms of quality, technological advancement, productivity, and efficiency, India is one of the best in the world in cement production. The country exported about 6.29 MT cement valued at Rs 1847 crore (including 3.97 MT clinker, 1.55 MT of portland grey cement and 0.07 MT white cement) in 2014-15 to Sri Lanka, Nepal, Egypt, Bhutan, Bangladesh and Myanmar, etc. Further, the industry is attracting several top-notch global players, an indicator that the industry holds huge potential for investment. According to data released by the DIPP, cement and gypsum products attracted Foreign Direct Investment (FDI) worth $ 3.11 billion between September 2016 and April 2000.

Industry performance

While Indian cement industry's production capacity increased from 328 MT in FY11 to 431 MT in FY16, its capacity utilization rate, a key indicator of the industry's health, showed no growth in last few years. During last three years, the capacity utilization rates were 64.60% in FY14, 64.29% in FY15, and 63.57% in FY16. Further, the county's overall cement production grew at CAGR of 5.5% between FY11 and FY16, even lower compared to India's gross domestic product (GDP) growth.



The sluggish growth in cement production in last few years was mainly due to slower economic & infrastructural activity, weak rural demand due to subdued monsoon and slowdown in real estate activity in big cities. Besides, surplus supply situation in the Industry had also impacted the capacity utilization rate adversely. Although relatively better monsoon in 2016 increased expectation of higher demand from rural markets, however the ban on high currency denomination notes in November 2016 wiped out all hopes of higher demand growth in FY 17. Going forward, 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 in the medium term. While capacity utilization rates would improve gradually from FY18 onwards, the pricing power of the players would be tested in the near term given oversupply situation and weak demand scenario.

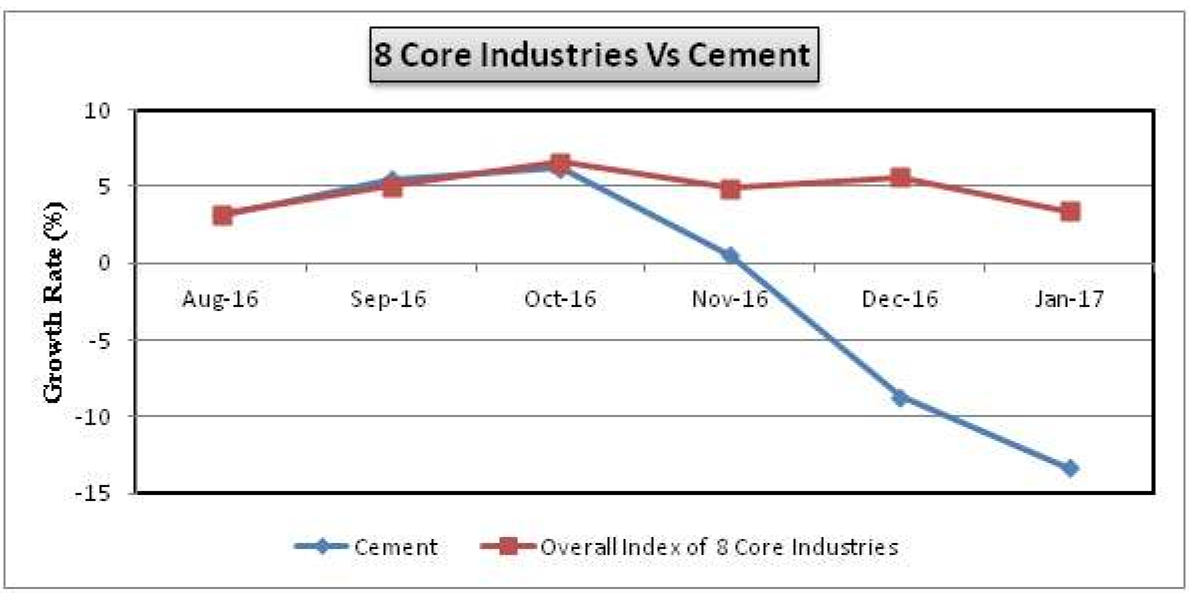
Economic scenario:

Despite the shock of demonetisation and a range of uncertainties, both at home and abroad, India's economy grew at a healthy 7% in the third quarter of FY 17. However, the pace of growth did slowed from the growth of 7.4% logged in the second quarter of the fiscal year. Central Statistics Office (CSO) retained its projection that the economy will grow 7.1% in FY17, slowing from 7.6% in the previous financial year. Indian government, in order to fight against black money, on November 8, 2016 invalidated Rs 500 and Rs 1000 currency notes, which made up 86% of the currency in circulation by value. The currency crunch that followed the demonetization of high-value notes was widely believed to have impacted consumption, driving down economic growth. However, solid performance by the agriculture & allied sectors, pump-priming by the government on the consumption side, better-than-expected performance by mining and manufacturing sectors and a seasonal - though larger-than-usual - pick-up in private consumption masked whatever negative effect the note swap exercise had on the economy.

Furthermore, for the first time since the opening up of the economy in 1991, India's current account deficit - the excess of imports over exports - is being funded by foreign direct investment (FDI), a sign of rising confidence among long-term investors in the government's ability to strengthen the country's economic foundation for sustained growth. Gross FDI from April 2016 to January 2017, the first 10 months of the fiscal year, had totaled $53.3 billion, compared with $47.2 billion in the same period a year earlier and $55.6 billion in the entire fiscal 2016. Meanwhile, India's manufacturing activity expanded the fastest in five months in March, buoyed by a sharp uptick in production and new orders. The Nikkei India Manufacturing Purchasing Managers' Index (PMI) rose to 52.5 in March, up from 50.7 in February and the highest since demonetisation in November last year. Going forward, good Monsoons, strong Rabi sowing, and better harvests could lead to improvement in the rural economy. That along with the government's focus on pushing up spending in infrastructure and Job creation is likely to lead to improved demand conditions across the economy.

Current industry scenario:

The industry is witnessing a mismatch in supply and demand as many leading cement players have invested in additional capacity on the back of the government's projected infrastructure spending, though the anticipated increase in cement demand did not materialize. Further, strong monsoons had lifted the possibility of strong revival in demand especially from drought-hit regions in Maharashtra, Telangana and Karnataka. However, post demonetization thngs have taken a turn for the worse. After growing for 5.5% and 6.2% in September and October, Cement production growth slowed to 0.5% in November (demonetization was announced on November 8) and fell 8.7% in December-taking production growth for the first nine months of fiscal 2017 to a mere 2.8%.



The situation further deteriorated in January as the eight core sectors slowed to a five-month low of 3.4% in January mainly due to contraction in output of refinery products, fertiliser and cement. Cement production declined by 13.3% in January 2017 over January 2016. The continued de-growth in cement output highlights the disruption to construction activities that set in after the note-ban is persisting. Last year, cement makers benefitted from low fuel and commodity costs. However, prices of coal and petcoke, key raw materials for the sector have risen sharply in the past six months. Pet coke has shown an upward movement in prices to around $60-$70 per tonne from $ 40 per tonne at the beginning of the financial year (FY17). The rise in pet coke prices coupled with increase in diesel prices is likely to raise power, fuel and freight costs for cement companies. Overall, the higher input cost and lower demand are expected to limit the ability of cement manufacturers to pass on the higher prices to the end consumers, thus potentially squeezing margins.

Major demand drivers for the sector:

Affordable housing may pave the way for Housing segments: Housing segment is the largest demand driver of cement industry, accounting for about two-thirds of the total consumption followed by infrastructure, commercial construction and industrial construction. In past few years, the segment has been impacted by slow growth as buyers and investors were deferring their home purchase decisions in expectation of a decline in real estate prices and subdued demand from the self-employed cluster. However, with the government's focus on affordable housing segment including a number of initiatives such as 39% higher allocations vis-a-vis FY2017 under the Pradhan Mantri Awas Yojana (PMAY), extension of the credit-linked Subsidy scheme to loans of value up to Rs. 1.2 million, efforts are being made to address the supply side, demand side and affordability issues. Besides, increased migration to big cities will also support the housing segments. As per Economic Survey 2016, migration has almost doubled, to an annual flow of nine million a year for 2011-16, from 5.5-6 million a year between 2001-11. Though data of 2016-17 showed the highest migration to Delhi, there were well over 90 cities in India with annual population growth rates of 3% or more. Against this, in 2012, the urban housing shortage in India was estimated to be almost 19 million homes, with the vast majority required for lower-income households.

Infrastructure development gained momentum: the government's thrusts on infrastructure development gained momentum in FY18 Budget, with increased allocation to development schemes.

Fund allocation towards various segments (Rs crore)	Actual Expenditure (FY16)	Budgeted Expenditure (FY17)	Revised Expenditure (FY17)	Budgeted Expenditure (FY 18)
Rural Development	90,235	1,02,543	1,14,947	1,28,560
Transport	87,413	1,07,098	1,14,947	1,28,560
Urban Development	20,180	29,934	37,835	40,618

Construction activity has started increasing in the country owing to a boost from infrastructure development and the government's efforts to boost the economy. The government's constant initiatives such as creation of smart cities and housing for all are likely to give further push to the cement sector.

RBI permits banks to invest in REITs and InvITs: Reserve Bank of India (RBI) has allowed banks to invest in Real Estate Investment Trust (REITs) and Infrastructure Investment Trusts (InvITs), which are positive initiatives as they would help revive the stressed infrastructure and realty sectors and revival of these sectors would give direct a boost to cement demand. Earlier, Securities and Exchange Board of India (Sebi) has put in place regulations for REITs and InvITs and requested the RBI to allow banks to participate in these schemes.

Key issues of the industry

Cement Industry in India is currently in the midst of challenging times with relatively low consumption growth rates and an over-built capacity. The situation has also aggravated due to rise in pet coke prices coupled with an increase in diesel prices, which is likely to increase power, fuel and freight costs for cement companies. With low demand in over-supply regime, industry is unable to pass on the higher costs to end user thereby keeping their margin under pressure or voluntarily opting to keep the volume low. Further, cement demand got impacted in most part of the country due demonetisation, with southern India being an exception. Cement production growth slowed to 0.5% in November and it recorded a fall of 8.7% in December, 13.3% in January and 15.8% in February 2017.

Duty-free import of cement: Since 2007-08, import of cement into India is freely allowed without having to pay basic customs duty whereas all the major inputs for manufacturing cement such as Limestone, Gypsum, Coal, Pet coke, Packing Bags etc. attract customs duty. Presently due to low demand of cement in the country more than 116 MT of domestic cement capacity is laying idle and duty-free import of cement is causing further undue hardship to the Indian cement industry reeling under low capacity utilization.

Customs Duty on coal: Cement Industry has been subject to perennial shortages of coal, the main fuel. Approximately about 26% of linked coal is received by the member companies against their total fuel requirement for kiln under the Coal Linkage Scheme. This adversely impacts the Cement Industry through increased fuel cost, as the balance requirement of fuel has to be necessarily procured from open market/e-auction, import of coal and use of alternative fuel like Pet coke at a substantially higher rate than linked coal. In the last Budget (2015-16) the basic custom duty on both steam coal and bituminous coal was raised from 2% to 2.5% while the basic customs duty of coking coal was increased from Nil to 2.5%, whereas on final product 'Cement', there was no basic customs duty.

Higher excise duty on cement: As per Section 4 of Central Excise Act, Excise duty on Cement is levied on transaction value. In case of bags on which Maximum Retail Price (MRP) is printed, MRP is considered as transaction value. Since MRP consists of excise duty, VAT, freight component, post sales expenses and discount etc. MRP works out very high as compared to transaction value. Moreover, in cement industry, billing is done at a higher price and subsequently credit note is issued for all types of discounts/incentives viz. Rate difference, Cash discounts, annual incentives etc, which ultimately result in reduction of net realization of the company whereas excise duty is paid at a higher value, which is 70% of MRP.

Major expansions and investments

JSW Cement, part of the $11 billion JSW Group, is planning to complete expansion of its capacity to 17 million tonnes (MT) by April 2018 and has entered into a joint venture with Australian firm Wagners to launch and promote earth-friendly concrete (EFC) in India. On overseas projects, the company will set up a 1 MT facility at Fujairah in UAE, where work will start in March and likely to be completed in 18 months.

Adani Group is planning to invest Rs 49,000 crore in Gujarat for expansion of port capacity as well as foraying into water and cement businesses over the next five years. The Group will set up a 10 million tonnes cement clinker plant at an investment of Rs 5,500 crore and another Rs 2,000 crore in a desalination plant in Gujarat.

Shree Cement has received its board's approval to build a 3 million tonne plant in Karnataka at a cost of Rs 1800 crore. The proposed plant is expected to be ready by the quarter ending 31 December 2018. The project is to be funded by internal accruals. Furthermore, the company is planning to set up two to three million tonne grinding unit in Sarai Kale Karasawa in Jharkhand. The company will invest about Rs 500 crore- Rs 600 crore for the same. In this regard, the company has entered into a memorandum of understanding (MoU) with the Jharkhand government on July 20 during the investment promotion roadshow organised by the State.

UltraTech Cement has received an approval for setting up of a 3.5 million tonnes per annum (MTPA) integrated cement plant at Dhar in state of Madhya Pradesh. The board of directors at its meeting held on January 21, 2017 has approved for the same. Meanwhile, the company has reported 5.13% rise in its consolidated net profit at Rs 594.61 crore for the quarter ended December 31, 2016 as compared to Rs 565.61 crore for the same quarter in the previous year.

Burnpur Cement is planning to invest Rs 500 crore for expansion of its production capacity to 3 million tonnes per annum (mtpa) in the next 3-4 years. The cement producer has two plants, one in Asansol in West Bengal and the other in Patratu district in Jharkhand. Each plant has 0.3 MTPA installed capacity. The company also aims to increase its sales revenue to Rs 250 crore in the next year from Rs 100 crore in the last fiscal.

JK Lakshmi Cement has received environment clearance for expansion of its limestone mine output in Rajasthan, entailing an investment of Rs 120 crore. The company's proposal was to enhance the production capacity of its limestone mine located in Sirohi district from 8 million tonnes per annum (MTPA) to 13 MTPA. The mined limestone will be supplied to a cement plant in Sirohi. The green nod to the project was given subject to some conditions.

Emami Cement, part of the Rs. 50,000 crore diversified Emami Group of companies, has commissioned its 2 million tonnes per annum (MTPA) cement grinding unit at the Panagarh Industrial Park in Burdwan district of West Bengal. The project came up at a cost of Rs. 500 crore. The plant has been developed on 65 acres of land and is expected to generate direct and indirect employment of over 500 people. The grinding unit is a part of the Rs. 3500 crore, 5.5 MTPA integrated cement plant comprising an operational facility of a central clinker plant and a grinding unit at Risda in Balodabazar district of Chattisgarh. Another grinding unit with a capacity 1.8 MTPA is coming up in Odisha.

Outlook

Competition in India's cement industry is becoming more intense, a reality likely to sustain in near term due to lack of rural demand and already piled up real estate inventories. Besides, high pet coke prices, higher coal prices, and subdued demand post demonetization, will continue to weigh on the industry and this could be aggravated by weak monsoon in 2017. The Industry is also under pressure with constant rise in logistics cost and frequent tariff revision by the Railways. However, the impact during the last year was low due to steep fall in the diesel prices. But, the volatility in the prices of oil products is another cause of concern. Going forward, incremental capacity addition is likely to be limited, while cement demand is expected to improve, resulting in higher capacity utilization. The prospects of cement industry are directly linked to economic growth as if the economy revives, the country's cement industry will also perform better. Furthermore, the Union Budget's stimulus for roads, affordable housing and other infrastructure projects will boost cement demand, which is a positive for pan-India cement players. Overall, medium to long-term outlook looks optimistic for cement industry.

Companies Financial Data In Industry

Company Name	CMP	MCAP	BOOK VALUE	DIV. YEILD %	TTM EPS	TTM PE
Shree Cement Ltd.	18000.90	62710.14	2209.74	0.78	384.39	46.83
Ultratech Cement Ltd.	4197.10	115215.32	872.13	0.24	95.72	43.85
HIL Ltd.	810.95	605.18	671.86	2.47	73.13	11.09
OCL India Ltd.	1181.80	6724.47	413.95	0.42	67.46	17.52

Sorted with TTM EPS (High to Low)

Source – Ace Equity