SECTOR RESEARCH

CEMENT

www.brickworkratings.com

Cement demand to post healthy growth, price rise will restrict contraction in margins despite expected high input costs in FY22

Industrial Sector Analysis

Contact

Rajee R
Chief Ratings Officer

Chintan Lakhani
Director - Ratings

Vidya Shankar
Principal Director – Ratings

Naveen S
Manager - Ratings

Praveen Pardeshi
Senior Research Analyst

Diya Roy
Jr Research Analyst

Investor & Media Contact
91 95133 99706
1-860-425-2742
investordesk@brickworkratings.com
media@brickworkratings.com

Executive Summary

Cement demand, after having declined in FY20 (-1%) and FY21 (-11%), is expected to see healthy 10-12% growth in FY22 owing to a faster-than-expected recovery in the housing sector and the government's thrust on infrastructure spending in the country. Pent-up demand and low interest rates have driven the realty sector amid the pandemic, and, the government's push towards big-ticket infrastructure projects has increased the growth momentum for the highways sector. An improvement in these two sectors, which are among the largest consumers of cement, indicates a strong recovery path for the cement sector. The growth momentum is likely to continue, and production is expected to grow by lower double digits in FY23.

A strong demand recovery shall support cement prices as the prices of raw materials such as limestone and pet coke have already witnessed an upward trend. Furthermore, with an increase in power, freight and logistics costs, Brickwork Ratings (BWR) expects overall cement prices to increase by 6-8% year-on-year.

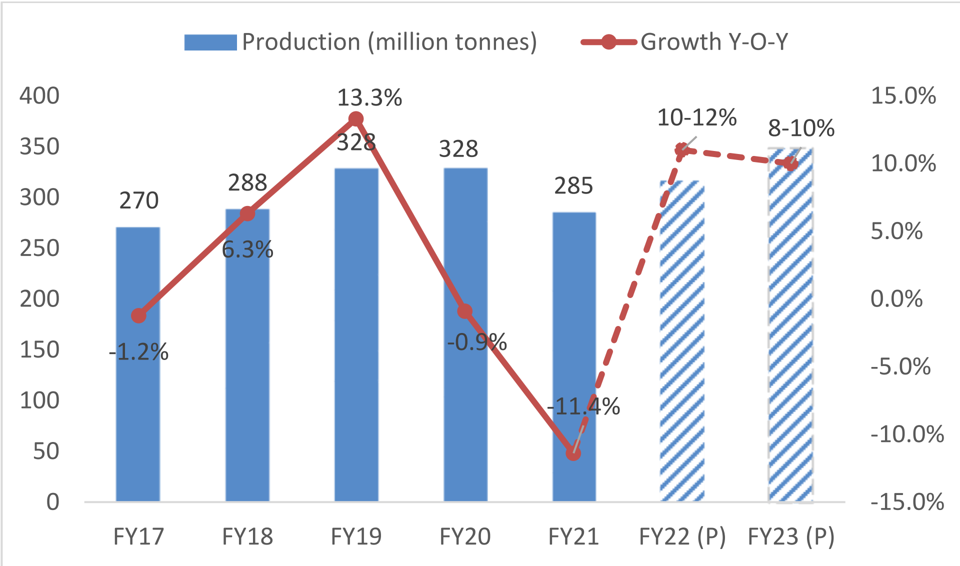
Limestone costs account for around 60% of the total raw material costs. As of August 2021, limestone prices had increased by 30-32% in FY22 from FY21 levels. Apart from these overheads, the increase in fuel, power and freight costs has also weighed on the profit margins. The recent increase in diesel and coke prices has had a major impact on cement companies' EBITDA margins. In FY22, BWR expects the EBITDA margins for cement players to contract by 40-60 bps on account of the rise in input costs for the companies. Although the companies have also raised cement prices, their increase in these prices is not in the same proportion as the input costs; the companies are, therefore, taking a hit on the margins to safeguard higher volumes.

Cement demand growth to be led by robust recovery in housing and infrastructure

Demand for cement is generated mainly by three segments, i.e., housing, infrastructure, and commercial and industrial construction. Cement demand has remained subdued in the last couple of years due to the economic slowdown and weak investor sentiments in FY20, and economic disruptions caused by the pandemic in FY21. Due to the pandemic-induced lockdown, construction activities came to a standstill, resulting in a 26% year-on-year fall in the production and consumption of cement in H1FY21. However, with the phase-wise easing of restrictions, the cement industry gained pace in H2FY21. Cement consumption increased in rural and semi-rural areas due to the better availability of labour on account of labour migration from urban centres; this led to an increased pace of construction of rural housing and infrastructure projects.

Cement demand is driven by the infrastructure and housing sectors. Therefore, with the allocation of new projects and construction activities gaining pace, cement demand is expected surge in FY22.

Trend in cement production

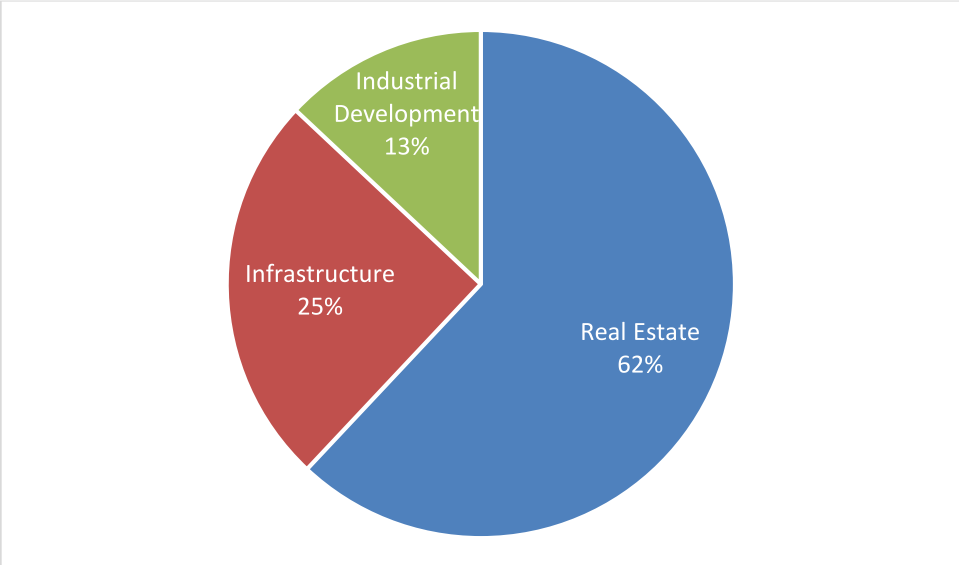


P-Projected

Source: CMIE, BWR Research

Going forward, in FY22, BWR expects cement demand to increase by around 10-12% owing to the faster-than-expected recovery in housing, and spending push by the government on infrastructure in the country. This momentum is expected to continue in FY23 as well, with lower double-digit growth anticipated on account of continued government focus on housing and infrastructure spending. Additionally, an increasing pace of completing pending projects (as restrictions are lifted) in key sectors such as real estate, roads and highways, metro rail and other large-scale infrastructure projects will further support demand growth for cement. Some of the major initiatives by the government, including urban rejuvenation projects worth Rs 13,750 crore, the smart cities mission of Rs 12,294 crore and the Pradhan Mantri Awas Yojana of Rs 27,500 crore, are expected to provide a significant boost to demand for the cement industry, going forward.

Share of sectors in cement demand



Source: Company Reports, BWR Research

In the past few years, the cement industry faced the challenge of the underutilisation of resources; however, with pent-up demand during FY21, companies have been forced to increase their capacity.

The real estate sector has been the major cement consumer, accounting for over 60% of the total cement demand. After witnessing a few subdued years, the sector has started to gain momentum in the last couple of quarters owing to improved sentiments, further boosted by stamp duty cuts in states such as Maharashtra, historically low interest rates, the need for owning a home amid the pandemic and attractive pricing/offers from developers. While pent-up demand has helped keep the sector afloat during the pandemic, the launches lined up by real estate developers actually provided momentum for the revival. While demand for commercial spaces is increasing at a slower pace, the ongoing work-from-home scenario has led to an increase in demand for residential spaces. In addition, the government's scheme for affordable housing, which got derailed due to the pandemic, is anticipated to help increase the pace of construction of affordable housing units; around 44% of the total sanctioned housing units were completed in FY21, compared to 80% units in FY20. The government's aim is to construct 4.4 million housing units in FY22.

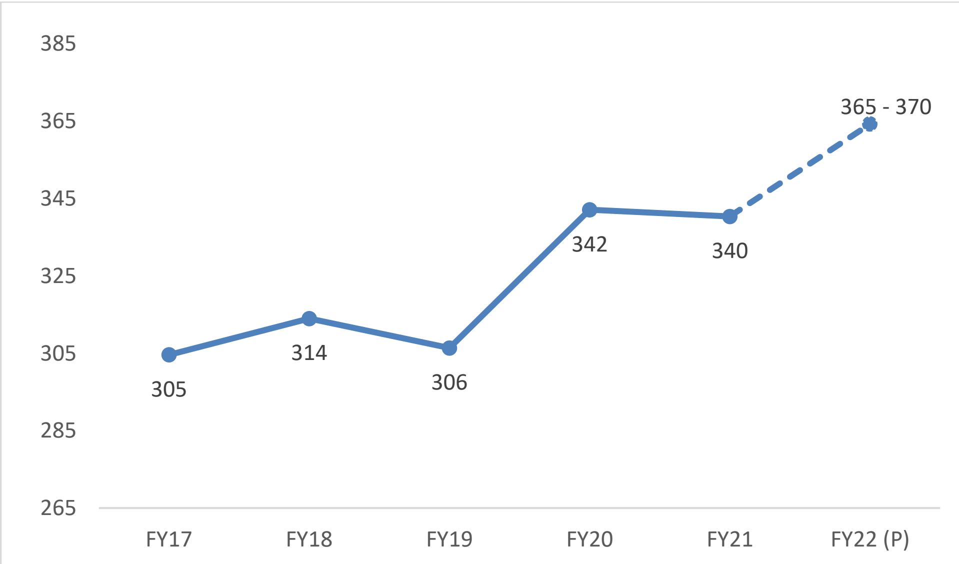
The infrastructure sector, especially roads and highways, is the second most crucial sector that influences cement demand. BWR expects road and highways construction to grow by 12-14% y-o-y in FY22. Despite lockdown restrictions being imposed, the NHAI recorded the highest ever pace of road construction of 37 km/day in FY21 (FY20: 23 km/day), which is further expected to increase in FY22. Additionally, the government's thrust on other big-ticket infrastructure projects such as the development of railways, construction of metro rail, greenfield airports and ports under the National Infrastructure Pipeline has also gained pace and is expected to support growth in cement demand. Under the National Infrastructure Pipeline, India aims to invest Rs 100 lakh crore by 2025 in various infrastructure projects across the country. The cement sector is expected to benefit from the government's continuing focus on infrastructure for sustainable development in the country. With sustained recovery in demand and the expectation of continued healthy growth, going forward, capacity utilisation levels have started to improve, and companies' optimism on this improvement is expected to pave the way for further capacity expansion. Almost all the large cement players have announced their capacity expansion plans.

Cement prices to rise in FY22 on account of robust demand and input cost pressure

Cement companies saw a rise in raw material costs and indirect expenses in FY21; therefore, companies had to increase cement prices to safeguard their margins.

Cement prices remained subdued in FY21 on account of demand disruptions and lower commodity prices for the majority of the year. Going forward, in FY22, BWR expects cement prices to increase by 6-8% year-on-year on account of an anticipated strong demand recovery, which will support the rise in prices. Additionally, input costs have been on an upward trend, with the prices of raw materials like limestone and pet coke rising, along with an increase in power, logistics and freight costs.

Trend in Wholesale Price of Cement (Rs per 50kg)



P- Projected

Source: CMIE, BWR Research

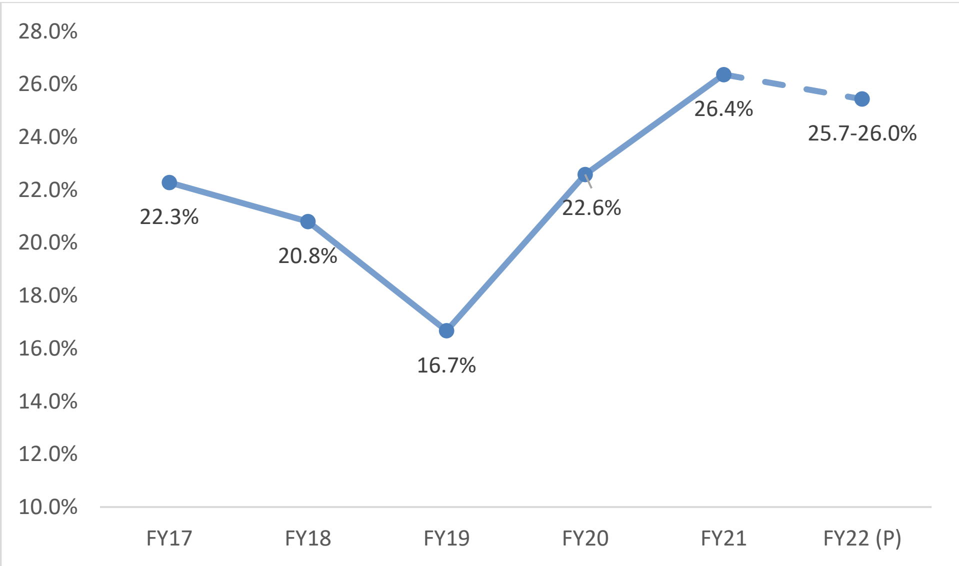
While cement prices are expected to increase in FY22, the rise may not be proportional to the rise in input costs. The reason for this disproportionate increase is the cement companies' concern regarding the pandemic and monsoon season. Although the economy is recovering, the risk of the pandemic causing further disruptions cannot be ruled out. Therefore, cement companies are being cautious while increasing the prices. In addition, major demand is from affordable housing or infrastructure development, where prices can be an important factor in ensuring sales.

Profitability of cement players may be hit by rising input costs; increase in realisation to restrict margin contraction

In FY22, BWR expects the EBITDA margin for cement players to contract by 40-60 bps on account of the rise in input costs for companies. The cost of raw materials such as limestone and clinkers has increased. Limestone is the basic raw material for cement production and accounts for around 60% of the total raw material cost. As of August 2021, limestone prices had increased by 30-32% in FY22 compared to FY21. Apart from this, overheads such as fuel, power and freight costs have also increased. The recent increase in diesel and coke prices have had a major impact on cement companies' EBITDA margins.

The disproportionate rise in the prices of cement and its raw material is likely to squeeze the EBITDA margins of cement companies.

Trend in EBITDA margins



P-Projected

Note: Profitability is derived based on the financials of the top 5 players accounting for 65% of the overall cement production in FY21.

Source: Company reports, BWR Research

While the input costs and overheads have increased, players have also raised cement prices, but not in the same proportion, thereby taking a hit on the margins to safeguard higher volumes. However, a higher realisation will restrict the contraction in margins to some extent.

ABOUT BRICKWORK RATINGS

Brickwork Ratings (BWR) is India's home-grown credit rating agency built with the superior analytical prowess of the industry's most experienced credit analysts, bankers and regulators. Established in 2007, BWR aims to provide reliable credit ratings by creating new standards for assessing risk and by offering accurate and transparent ratings. BWR provides investors and lenders timely and in-depth research across the structured finance, public finance, financial institutions, project finance and corporate sectors. BWR has employed over 350 working professionals including credit analysts and credit market professionals across 8 offices in India. Our experienced analysts have published over 12,000 ratings across asset classes. BWR is committed to providing the investment community with products and services needed to make informed investment decisions. BWR is a registered credit rating agency by Securities and Exchange Board of India (SEBI) and a recognised External Credit Assessment Agency (ECAI) by the Reserve Bank of India (RBI) to carry out credit ratings in India. BWR is promoted by Canara Bank, India's leading public sector bank. More information on Canara Bank is available for reference at www.canarabank.com

BWR Rating Criteria are available at https://www.brickworkratings.com/ratingscriteria.aspx

Brickwork Ratings, a SEBI-registered credit rating agency, has also been accredited by the RBI, and it offers rating services for bank loan, NCD, commercial paper, bonds, securitised paper etc. BWR has Canara Bank, a nationalised bank, as its promoter and strategic partner.

BWR has its corporate office in Bengaluru and a country-wide presence, with offices in Ahmedabad, Chandigarh, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi, along with representatives in 150+ locations. BWR has rated debt instruments/bonds/bank loans, securitised paper of over ₹ 10,00,000 Cr. Additionally, fixed deposits and commercial papers, among others, worth over ₹24,440 Cr have been rated.

DISCLAIMER

 In issuing and maintaining its ratings, Brickwork Ratings relies on factual information it receives from issuers and underwriters and from other sources Brickwork Ratings believes to be credible. Brickwork Ratings conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Brickwork Ratings' factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Brickwork Ratings' ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Brickwork Ratings relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Brickwork Ratings and to the market in offering documents and other reports. In issuing its ratings Brickwork Ratings must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

THE INFORMATION IN THIS REPORT IS PROVIDED "AS IS" WITHOUT ANY REPRESENTATION OR WARRANTY OF ANY KIND. A Brickwork Ratings rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Brickwork Ratings is continuously evaluating and updating. Therefore, ratings are the collective work product of Brickwork Ratings and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Brickwork Ratings is not engaged in the offer or sale of any security. All Brickwork Ratings reports have shared authorship. Individuals identified in a Brickwork Ratings report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Brickwork Ratings rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time, for any reason in the sole discretion of Brickwork Ratings. Brickwork Ratings does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Neither Brickwork Ratings nor its affiliates, third party providers, as well as their directors, officers, shareholders, employees or agents (collectively, "BWR Reps") guarantee the accuracy, completeness or adequacy of the Report, and no BWR Reps shall have any liability for any errors, omissions, or interruptions therein, regardless of the cause, or for the results obtained from the use of any part of this publication. In no event shall any BWR Reps be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Report even if advised of the possibility of such damages. Brickwork Ratings receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities.