Ajmera x-change
The Growth Catalyst
Mobile Application
#Letsgetgoing

Ajmera x-change
The Growth Catalyst

Ajmera House, Pathakwadi,
L.T. Marg,
Mumbai - 400002. INDIA

Tel: +91 22 4062 8853
Email: broking@ajmera.co.in
Website: www.ajmerax-change.co.in

EQUITY, DERIVATIVES, CURRENCY, COMMODITY, DEPOSITORY, MUTUAL FUNDS, INSURANCE* & NBFC*

VOL. 01/25 | SECTOR REPORT | 1 December 2017

Cement: *Cautiously optimistic*

The prospects of domestic cement sector look positive on strong demand potential in long term from the construction sector. This would be primarily led by demand from the affordable housing and infrastructure segments, even as the H1 of FY18 had seen the impact of the Real Estate (Regulation and Development) Act (RERA). Cement demand is likely to recover after monsoon and as the GST and RERA drag wanes off in the coming months and sand availability improves.

Good monsoon across most parts should also drive recovery in retail demand going forward, and also lead to sequential rebound in prices. Smart City and national highway projects would fuel demand for cement in the infrastructure sector. The project implementation of Smart Cities and infrastructure under the mission would begin in the coming quarters, boosting the overall demand for cement.

The cement sector's earnings were better than expected in Q2 of the fiscal ending March 2018 (FY 2018), as compared to the Q1 of FY 2018, as the companies made the shift to the GST regime.

However, the earnings trends distorted in Q2 of the FY 2018, due to reversal of DMF provision aided one-off cost respite, increased free-on-road sales resulted in companies reporting optically higher freight costs and realizations, and integration of acquired capacities led to moderate profit before interest and depreciation and tax (PBIDT) increase yet a fall in net-income.

The cement prices improved across regions owing to hike in operating cost while cement demand was muted with firms with a presence in Bihar, UP, Tamil Nadu and Kerala witnessed a decline in demand primarily due to shortage of river sand for construction and RERA implementation.

The all-India average cement price improved ~Rs. 12 per bag in Q2 of FY 2018 bag, with a sharp rise of ~Rs. 36 in the West and ~Rs. 15 in the South on a year-on-year basis, owing to rising production costs. Domestic cement production declined marginally 0.4% to 68.04 million tonnes (mt) in Q2 of FY 2018 over a year compared with industry volumes growth of 3.4% in Q2 of FY 2017.

Cement companies reversed prior period provision towards District Mineral Fund (DMF) paid on limestone mining post a Supreme Court ruling—the reversal pertains to the period from 12 January 2015 to 16 September 2015 post which DMF is deemed applicable. This resulted in reduction in other expenses for several companies, though companies also highlighted deferral of maintenance shut-downs as well as low advertising and marketing spends as reasons for reduction in other expenses.

Most of sales have moved to free-on-road (FoR), as invoice amount now includes freight costs for most shipments. Such arrangement allows for easier set-off of GST paid on freight costs for cement dealers. This change has optically inflated the realizations & freight cost of companies, while not having an impact on profitability.

Ultratech, for the first time reported an earnings print including acquired capacities of Jaiprakash Associates. This led to moderate improvement in but a fall in net-income as acquired assets have low PBIDT contribution due to weak plant utilizations and load a higher depreciation and interest charge.

Net profit of 28 major cement companies decreased 7% to Rs 1,594 crore in spite of net sales growth of 14% to Rs 25,144 crore in Q2 of FY 2018 over Q2 of FY 2017.

The operating profit margins (OPM) softened 70 basis points (bps) to 17.3% due to muted sales volume and higher production cost, owing to rising fuel cost overshadowed benefit of cement price improvement.

The drop in other income (OI), coupled with interest cost and depreciation increment weighed the profit after tax (Pat) down by 7% to Rs 1,594 crore.

PAT of north Indian cement players (18 listed entities, accounting for 86% of the aggregate profit) decreased 8% to Rs 1,344 crore in spite of 14% growth in net sales to Rs 21,692 crore.

South Indian players (10 listed entities accounting for 14% of the aggregate profit) posted a 6% drop in Pat to Rs 250 crore despite net sales gaining 9% to Rs 3,452 crore.

The cost escalations (power & fuel and logistics) and lower operating leverage (reduced utilisations) resulted in the OPM of North Indian players' OPM reducing 40 bps at 17% and south Indian players declining 240 bps to 19.2% over the year. With addition in OI, the PBIDT of north-based players was up 9% to Rs 4,288 crore and of South based players rose 1% to Rs 736 crore.

Among the top Indian companies, revenues of India's biggest cement maker Ultratech (included earnings of cement plants of Jaiprakash Associates and Jaypee Cement Corp) were 20% to Rs 6,936.13 crore due to improvement in both sales volume and realization.

The combined domestic cement and clinker sales volume increased 17.6% to 12.41 mt, meanwhile realization grew 2.2% to Rs 5,589 per tonne. OPM decreased by 100 bps to 20.1%, as power & fuel expense inclined 340 bps to 19.9% as a percentage to sales and net of stock adjustments.

As a result, the operating profit was up 14% to Rs 1,394.56 crore. The drop in OI along with spike in interest and depreciation costs resulted in Pat declining 31% to Rs 422.77 crore.

South-based Ramco Cements posted 19% drop in Pat to Rs 168.52 crore inspite of 5% gain in revenues to Rs 1,066.43 crore. Cement sales volume (including exports) inclined 6.8% to 21.22 lakh tonne but cement sales realization dropped 0.6% to Rs 4851 per tonne.

The benefit of higher topline was offset by increase in operating cost. OPM reduced by 640 bps to 28.3%, thus, the operating profit shed 14% to Rs 301.53 crore.

Volume growth to pick up from a low base

The cement industry registered the lowest volume growth during the past 15 years IN FY 2017. Though the industry started the year on a positive note, achieving decent growth during the first six months of the year, the second half witnessed muted cement demand from the housing segment, the largest cement driver. The FY 2017 saw the industry adding another 12 mtpa new capacity, taking the total installed capacity in the country to around 420 mtpa. With the new additions coupled with contraction in demand, industry capacity utilisation declined to around 65% (LY 67%). Cement prices have not shown any improvement over the last year and escalation in fuel prices has resulted in higher operating costs.

Cement demand is expected to pick-up gradually. The Government sponsored affordable housing program, interest rate subvention scheme on housing loans, continuing infrastructure spending, improving demand sentiments in the markets of South India and revival in rural housing demand, backed by improved cash flow, are expected to be the key factors for cement demand growth. The government has been striving to improve India's competitiveness across segments, by introducing schemes like - Smart City, AMRUT, Housing for All, etc., which will make cities environmentally and economically viable.

The government has provided incentives for rural development and also allowed 100% FDI in the construction development and industrial parks. Overall, cement demand is expected to further grow in the in FY 2017-18 on account of higher government spending on various initiatives as announced in the Union Budget along with incentives for affordable housing by providing it with 'Infrastructure Status'. This is likely to boost the demand for cement by a positive multiplier. The housing sector is the biggest demand driver of cement, accounting for about 67% of the total consumption. The other major consumers of cement include infrastructure (13%), commercial construction (11%) and industrial construction (9%).

With the infrastructure sector enjoying top priority status under the Narendra Modi-led government at the Centre, the cement industry is poised to witness robust growth in the coming years. According to estimates, India will need as much as 550-600 million tonnes of cement by 2025 to keep up with the various ambitious infrastructure-building targets set by the government. The key drivers for the rise in demand for cement are the affordable housing sector, infrastructure growth such as the dedicated freight corridors, airports and ports, commercial real estate growth, smart cities, Swachh Bharat scheme, development of metro rail in key metropolitan cities in Mumbai, Bengaluru and Hyderabad, and the rapid urbanisation of the present Indian cities.

Prices gaining steadily

The Cement, Lime and Plaster Wholesale Price Index (WPI), with a weight of 1.644 in the WPI, inclined 1.3% to 114.1 in September 2017 over a year and up 0.5% over August 2017. The Cement, Lime and Plaster WPI grew 2.6% in April-September period of FY2018 compared with over a year ago period. The cement, lime and plaster WPI grew 0.6% in FY2017 as against de-growth of 0.9% in FY2016.

Meanwhile, the Ordinary Portland cement WPI, with a weight of 0.852 in the WPI, grew 1.5% at 111.7 in September 2017 over the year and up 0.1% over the month. The Ordinary Portland cement WPI grew 3.1% in April-September period of FY2018 compared with 1.2% growth a year ago period. The Ordinary Portland cement WPI grew 0.8% in the FY2017 compared with the 2.8% drop over a year ago period.

All-India cement production (proxy for demand), as reported by the Office of Economic Advisor, Ministry of Commerce and Industry, increased 0.1% to 229.12 lakh tonnes in September 2017 over a year and up by 2.1% over August 2017. Cement production declined 2.3% to 1,183.53 lakh tonnes in the April-September period of FY 2018 compared with 4.3% growth a year ago period. Cement production declined 1.2% to 2799.75 lakh tonnes in the FY 2017 compared with the 4.6% incline to 2834.57 lakh tonnes in FY2016.

SC bans the use of petcoke in Rajasthan, UP and Haryana

The Supreme Court (SC) has banned the use of petcoke in the states of Rajasthan, Uttar Pradesh and Haryana on 17-Nov-2017 in a bid to rein in the high levels of pollution in North India.

Earlier, the ban was only restricted to the NCR region. Over the past few years use of petcoke has increased significantly across cement companies (100% in Rajasthan) due to its cost effectiveness vis-à-vis coal (10-20% cheaper than coal despite recent hike in petcoke prices), particularly for plants in Rajasthan (higher inward freight to source coal from Eastern mines).

The petcoke ban would result in companies shifting to imported coal which would increase power & fuel costs for plants in these states.

Pursuant to the Supreme Court (SC) ban on the use of pet coke and furnace oil to fight pollution, both the Environment Ministry and the Central Pollution Control Board have prohibited the use of pet coke in the states of Uttar Pradesh, Haryana, and Rajasthan until further orders. Due to the ban, companies would be affected negatively if there is a delay in passing on cost increase for shifting to coal.

Share of pet coke usage in Rajasthan plants is 90-100%: Almost all the cement plants in Rajasthan use pet coke to the tune of 90-100%; 70-80% north-based companies have plants located in Rajasthan and the share is 5-25% for pan-India companies.

Given an industry-wide shift in fuel required, cement players likely to pass on the cost increase. Currently international coal price is around 15% higher compared with pet coke prices. Thus, the per tonne increase in power and fuel cost is likely to be Rs100-150, which would require a price increase of about Rs10 per 50kg bag (including taxes).

Rural demand seen holding up

Prime Minister launched Pradhan Mantri Awas Yojana (Gramin) on 20th November, 2016 from Agra. A target of completing one crore new houses by 31st March, 2019 was set. Of these, 51 lakh houses are to be completed by 31st March, 2018.

To meet the challenge of assisting 51 lakh Pradhan Mantri Awaas Yojana (Gramin) beneficiaries in construction of their homes by March, 2018, the Ministry of Rural Development, in partnership with the State Governments, has taken many steps, including setting month-wise target for completion of houses.

The target for completion of 10 lakh houses by November, 2017 has been achieved on 29th November, 2017, i.e. before the appointed date for completion of 10 lakh houses. It is expected that 15 lakh houses will be completed by 31st December 2017; 25 lakh houses by 31st January, 2018; 35 lakh houses by 28th February, 2018 and 51 lakh houses by 31st March, 2018.

Towards meeting the target of construction of 51 lakh houses by March, 2018, while 56.90 lakh beneficiaries have been sanctioned houses, 51.39 lakh beneficiaries have received 1st instalment, 31.03 lakh beneficiaries have nearly reached roof-cast levels and for 16.05 lakh beneficiaries the house construction is nearing completion.

States like Chhattisgarh, Jharkhand, Madhya Pradesh, Maharashtra, Orissa, Rajasthan, Uttar Pradesh and West Bengal, who have highest number of PMAY-G beneficiaries, are on course for completion of PMAY-G houses within the prescribed time-frame.

The Government in the year 2017-18 provided highest ever allocation of Rs. 48,000 crores at BE stage for MGNREGA. In the year, the allocation to the Department also crossed more than One lakh crores for all programmes put together at Rs. 1,05,442 crores.

The Ministry of Rural Development has been able to ensure payment of wages to the workers within 15 days in 85 percent of the cases as compared to only 37 percent in 2015-16 and 42 percent in 2016-17 on account of increased allocation for MGNREGA at BE Stage.

Outlook

From a medium term perspective, rising construction demand coupled with better supply-demand scenario and operational costs escalation could mean that cement price is likely to increase across most markets going ahead.

The slowdown in the pace of new capacity addition may boost capacity utilisation and cement prices going forward. Further, the prohibition of usage of pet coke in the Northern states will result in higher fuel cost for cement companies operating out of Rajasthan, Uttar Pradesh and Haryana. Substitute fuel is costlier than petcoke resulting in companies shifting to imported coal, which would increase power & fuel costs for plants.

The Supreme Court of India, has extended the ban on the use of petcoke beyond the NCR area to cover the whole of the three states—Rajasthan, Uttar Pradesh and Haryana. The ban prevents cement companies in these states from using petcoke, an inexpensive though highly polluting fuel source. SC further recommends other states to adopt a similar ban on the use of the fuel.

The rising prices of petcoke over the past few months had narrowed the cost arbitrage, though the current order will likely accelerate the pace of increase in production cost, especially impacting the players in North region.