Research

CRISIL

An S&P Global Company

Cement cracks

Covid-19 culls demand, crude cushions blow to profit

April 2020

Cement demand to contract as Covid-19 hurts construction

Covid-19 has cast a long shadow over a much-anticipated mild recovery in Indian economy in fiscal 2021. Along with external factors such as weak global demand, supply disruptions, and global financial shocks, the economy is grappling with lockdown, factory shutdowns, reduced discretionary spending, and delayed capex cycle.

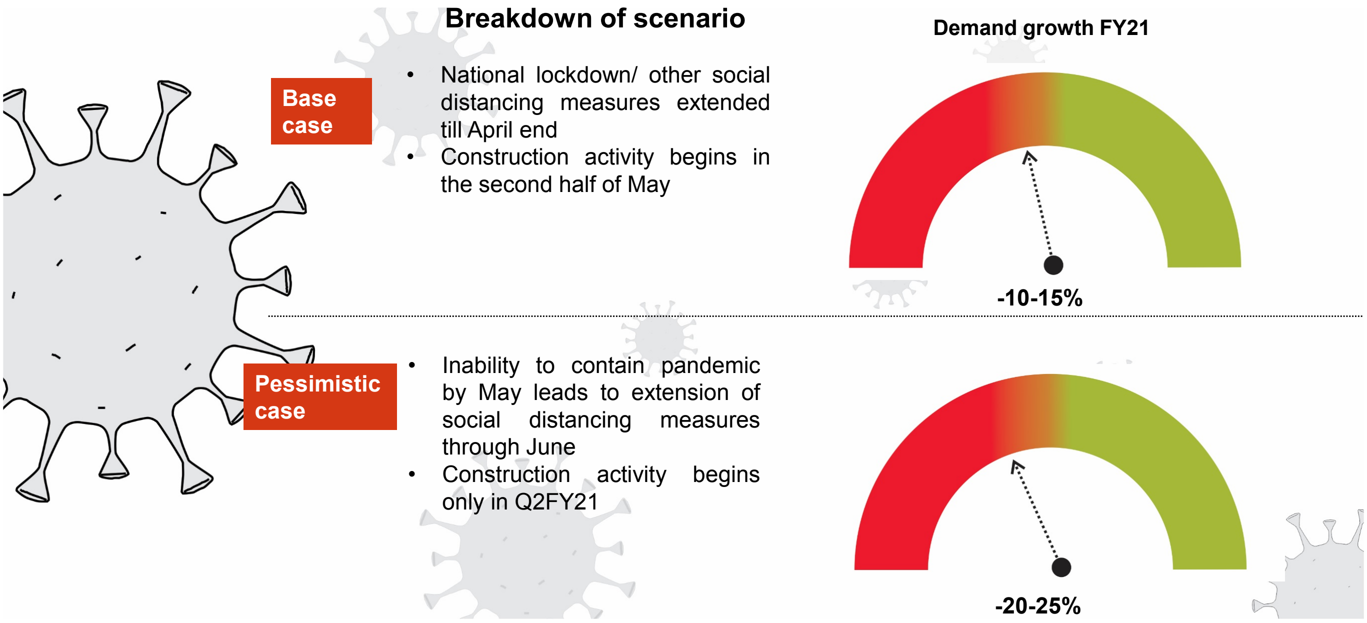
All this is expected to affect construction, and thereby cement demand.

Given the uncertainty in the current environment, we have based our analysis on two possible scenarios based on spread and containment period of the pandemic.

- Our baseline view assumes lockdown/ other social distancing measures to continue till April end and construction activity to resume in mid-May
- Our pessimistic view assumes extended vulnerability to the virus with construction activity beginning only in the second half of this fiscal

Cement demand growth in fiscal 2021 based on possible scenarios

In our baseline scenario, cement demand in India would contract by an unprecedented 10-15% this fiscal. Extended vulnerability will deepen the damage for the sector to 20-25%.



Source: CRISIL Research, industry

On a quarterly basis, cement demand would be a washout in the first quarter of this fiscal, given lockdown measures across India that would hurt construction. Demand will pick up only from the second half of this fiscal.

A full-fledged recovery will take longer because of:

- Lower capex by government, given diversion of funds towards health and public welfare (government-led projects account for 35-40% of cement demand)
- Weak real estate and private individual houses and buildings (IHB) housing
- Lower spend on PMAY-Urban given the impact on incomes, and hence spends

Rural housing, PMAY-Rural, PMGSY, and spend on key infrastructure projects will be the saving grace for the sector in the second half of the fiscal.

Quarterly trend in cement demand growth

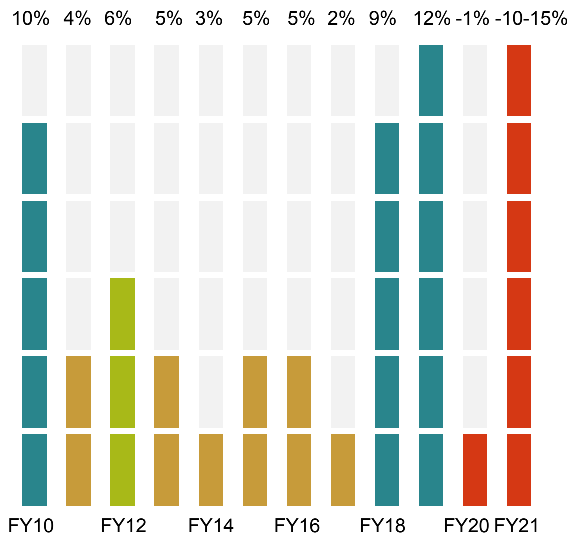
	Share in demand	On-year growth	Takeaways
Q1FY21	26%	(50-70%)	• Washout till mid-May; momentum to build from June • Rural belt to witness traction early on • Urban clusters likely to face challenges in workforce mobilisation (just ahead of kharif sowing)
Q2FY21	22%	(5-10%)	• Weak public spending by governments (diversion of funds) • PMAY-G and PMGSY to pick up given higher potential to engage rural workforce • Urban affordable and private urban housing to be hit
Q3FY21	25%	6-8%	• Release of pent-up demand • Key infra projects, especially roads, irrigation and metros, to drive growth • Gradual pickup in urban belt as worker shortage reduces • Industrial capex near completion (projects that got stuck) to pickup
Q4FY21	27%	8-10%	

Source: CRISIL Research, industry

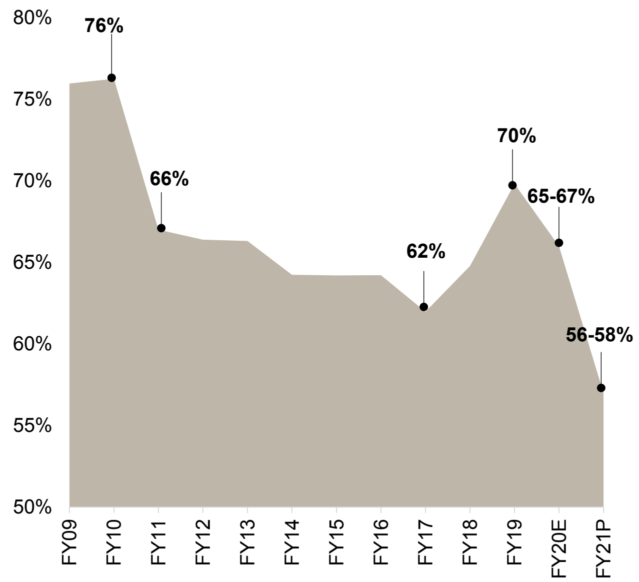
Note: Share in demand for each quarter is the average of demand share of the past three fiscals

Washout in the first quarter, followed by continued mildness through the seasonally weak second quarter, will weigh on the sector's growth, leading to a first-ever demand contraction of this proportion for it this fiscal.

Cement demand growth sinking deeper



Cement sector utilisation seen sliding lower



Source: CRISIL Research, industry

Contracting demand growth will push the sector's utilisation level down further to 56-58%, adding to the pain from the weakening seen in fiscal 2020, when incremental supply exceeded demand by 27 MT.

Pre-election spending in fiscals 2018 and 2019 had led to a surge in demand, and in turn to an 800 bps improvement in utilisation level to 70% in fiscal 2019. This had encouraged players to undertake aggressive capacity addition to capture incremental demand. Furthermore, to maintain market share, players with relatively weaker financials had even entered newer markets.

However, the current demand shock is expected to dent the capacity addition plans of the industry, and stall or delay projects in the medium term.

Weak crude to limit margin fall despite revenue erosion

Despite muted demand, the cement industry logged a healthy price hike of Rs 25 per bag in fiscal 2020. This came after several years, despite healthy demand growth in the preceding years, and was helped in part by continued consolidation in regional markets by the largest player.

The price hike, coupled with lower commodity prices, is expected to drive margins to a seven-year high in fiscal 2020.

In fiscal 2021, we expect the price run up to reverse as players struggle on the demand front. The decline would be limited to 1-2% (or Rs 5-10 per bag) as players exhibit pricing discipline, as they did last fiscal, too.

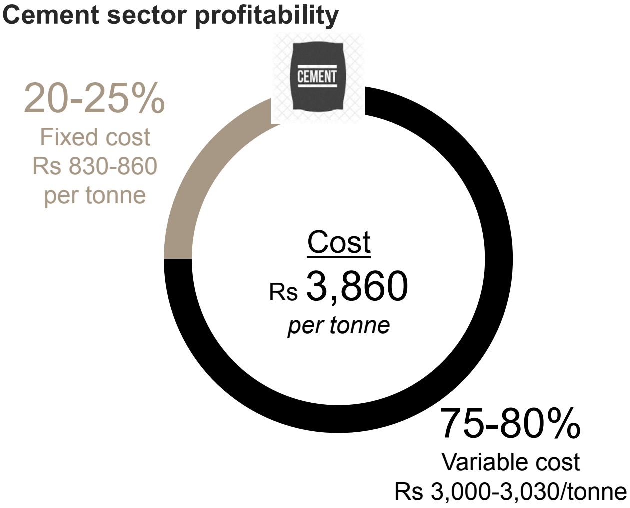
However, we expect realisation to fall 2-3% as the share of non-trade is likely to increase.

Profitability, on its part, is expected to be under pressure after some expansion last fiscal. The impact of demand freefall, though, will be limited by lower input prices.

We expect earnings before interest, tax, depreciation and amortisation (Ebitda) margin for the sector to contract by 100-125 bps in fiscal 2021. Lower crude and coal prices should limit margin erosion as power, fuel and freight costs are expected to ease. Crude prices are expected to ease to $35-40/ barrel in 2020 from $64/ barrel in 2019. Petcoke prices will also fall, though not commensurate with that of crude, given higher freight and disruptions in US markets.

However, fixed costs are expected to rise given plant shutdown during lockdown as well as lower volumes.

Cement sector profitability



Rs/ tonne	2017-18	2018-19	2019-20P	2020-21P
Realisation	4586	4658	4877	4750-4760
Rs / bag	334	331	356	350
P&F	916	1008	940-960	900-920
Freight cost	1099	1132	1060-1080	1000-1200
Raw material	633	711	660-680	640-660
EBITDA margin	18.7%	17.1%	21-21.3%	19.5-20.5%

Source: CRISIL Research, industry, annual reports

Healthy credit profile to help weather the storm; barring a few

A sample analysis of 23 listed firms with total installed capacity of 372 MT – amounting to over 70% of the total installed capacity – and total debt of Rs 53,400 crore as of September, 2019, threw up some interesting takeaways.

23 firms · **372 MT capacity** · **Rs 53,400 crore debt**

- 9 firms, accounting for a third of the set's capacity but only 5% of its debt, enjoy a healthy debt/ Ebitda ratio of <1. However, 4 firms, holding 11% of the set's debt, have a relatively high debt/ Ebitda ratio of >3
- 16 firms, holding 85% of the sector's debt, have a relatively comfortable ISCR of >2 times
- 5 firms, holding 15% of the total debt of the sample set, have an interest coverage of <2. Majority of these players are small regional firms with weak cash balances
- Also, 22% of the sample's debt has a quick ratio/ adjusted acid test ratio of <0.25

Dispersion analysis across key financial ratios

Interest service coverage ratio

ISCR	No. of cos 23	Debt Rs 53,400 cr	Capacity 372 MT
<2	30%	15%	12%
2-5	22%	68%	43%
5-10	22%	13%	15%
>10	26%	4%	30%

Debt/ Ebitda ratio for sample

	No. of cos 23	Debt Rs 53,400 cr	Capacity 372 MT
<3	17%	11%	8%
2-3	30%	72%	46%
1-2	13%	12%	14%
<1	39%	5%	33%

Adjusted acid test ratio

	No. of cos 23	Debt Rs 53,400 cr	Capacity 372 MT
<0.25	21%	22%	21%
0.25-0.5	59%	77%	59%
0.5-1	10%	1%	10%
>1	13%	-	10%

Source: CRISIL Research, industry, company reports

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