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Cement demand growth set to halve this fiscal

But profit margin to hit a 6-year high, given price hikes taken in Q1 and lower power & fuel cost

CRISIL expects cement demand growth to witness a mid-cycle slowdown to 5-5.5% on-year this fiscal, down sharply from 12% in fiscal 2019. Growth would be lower compared with even fiscal 2018, when it had printed 9%.

Demand growth will bear the brunt of weak government spending in first half which contributes to nearly 35-40% of cement demand and liquidity crunch impacting real estate market which consumes 5-8% of cement demand. Other external factors such as election-related labour shortage, sand and water availability in key states further accentuated the issue in first quarter of current fiscal.

Indeed, in the first quarter, pan-India cement demand growth had contracted by (2%), with the east and north logging a contraction of (4-5%) and (0.5-1.5%), respectively. Shortage of water and sand, and the impact of cyclone Fani had weighed on structurally weak demand factors in Bihar, Odisha and West Bengal in the east. Further funding challenges stalled various institutional projects in Andhra Pradesh and Telangana in the south.

Says Prasad Koparkar, Senior Director, CRISIL Research, "Growth in the second half will be better at 8-10% on a weak H1 led by gradual pick up in govt's fund release for institutional projects post higher dividend pay-out and one-time reserve transfer from RBI to govt. Delayed yet healthy monsoons shall augur well for rural housing demand. While west and central regions shall post healthy growth of 5-6% in current fiscal, south and east shall be weak at 2-4% on high base of past year and constrained spending by state government."

Around 22 lakh units are in different stages of construction under PMAY-Urban and the government has set a target of 60 lakh units under PMAY-Gramin for fiscal 2020. This alone will generate 80-85 MT of cement demand over the next year-and-a-half. This is higher than 15 lakh PMAY-Urban and 22 lakh PMAY-Gramin units that got constructed in fiscal 2019.

Despite these improvements, volume growth will remain under cloud given high base of last year and weak Q1. However, chunky price hikes taken at the onset of the first quarter will drive revenue growth. On pan-India basis, cement prices were up 12% on-year as of August this fiscal, with the north, south and east logging hikes of 20%, 12% and 11%, respectively. In fact, prices had increased by Rs. 56 per bag (Jan to May 2019) to Rs. 380 per bag as of May before falling to Rs. 355 in August. The fall is substantially higher than seasonal fall observed over last few years as demand growth has weakened.

South had seen the steepest price hike of Rs. 70 per bag over January-May, but has come off by Rs. 38 per bag since then, given contracting demand growth. In the east and west, the price hike per bag has also come off from Rs 55 per bag as of May to Rs 35 and Rs 22 as of August, respectively. North and Central markets in comparison have been able to sustain prices.

Prices are expected to soften further in months ahead as an additional 14-15 MT of capacities commission in the second half and ramp-up of acquired capacities continues. Despite this, for fiscal 2020 overall, CRISIL Research expects prices to be up 6-7% on-year primarily led by a robust Q1.

On the cost front, cement manufacturers shall benefit from falling global commodity prices. Power and fuel cost, which is 26% of the operating cost, is expected to reduce by 3-5% in the current fiscal given softening in petcoke and coal prices. Freight cost, too, is expected to support profit expansion, albeit marginally.

Says Hetal Gandhi, Director, CRISIL Research, "We expect the cement industry's EBITDA margin to touch a six-year high this fiscal. Healthy rise in cement prices and lower power & fuel cost should drive an EBITDA margin expansion of ~400 basis points (bps) pan-India, though it would be lower for players based in the south, at 250-300 bps, due to weaker demand growth and relatively lower price hikes. Players with higher

exposure to north and west will see 400-500 bps improvement, led by relatively higher demand growth and sustenance of prices hikes."

For the second half, release of funds for key infrastructure projects and transmission of rate cuts would be the key monitorables guiding demand recovery and pricing sustenance.

For further information,

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