

Cement makers face recovery slowdown

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The scenario has worsened for cement stocks after the December quarter (Q3FY22), which had prompted earnings cuts for the companies for FY22 and FY23. Just when the Q3 results season got over, analysts were worried that the earnings downgrades may get steeper if the companies were not able to sustain higher prices.

What is more, the sharp rise in input costs so far in the March quarter (Q4) has made matters worse. Cement companies now require substantial price hikes to fight cost inflation and protect operating margins unless the cost pressures ease meaningfully.

The main culprits in this story are crude-derived petroleum coke (petcoke) and coal, key inputs in making cement. In a report dated 7 March, analysts at JM Financial Institutional Securities Ltd said that the price of coal imported from Australia has increased by 42% month-on-month.

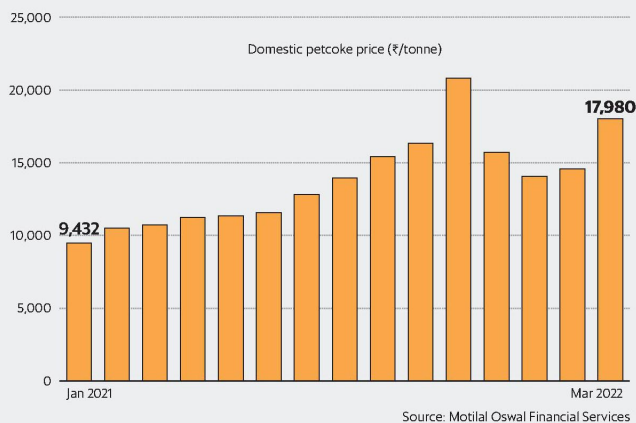
Similarly, on average, the cost of imported petcoke has risen to nearly \$360 a tonne in March from \$210 a tonne in February. After softening for a brief period, domestic petcoke prices in March are up 24% month-on-month. In short, the variable cost for cement makers is likely to remain elevated from a near-term perspective. Power and fuel costs are estimated to account for 25-30% of the sector's total operating costs.

Furthermore, retail diesel prices are also expected to be revised higher, and is likely to translate into higher freight costs for cement makers. What's more, the near-term outlook on commodity prices remains strong until the Russia-Ukraine conflict eases.

To offset this steep cost inflation pressure, analysts estimate that cement companies have to raise prices by another ₹50-90 a bag. At the all-India level, a cement bag, weighing 50 kg, is priced at around ₹360. Cement companies in

Cost pressures rising

Prices of a key crude-based input for the cement industry, petroleum coke, or petcoke, have shot up again with the ongoing Russia-Ukraine conflict.



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most regions took price hikes in February and March, but they were marginal, according to dealer channel checks.

In general, Q4 is a seasonally strong quarter for the cement sector as construction and allied activities witness a pick-up.

However, this time around, this has not played out as expected.

For one, demand for construction of houses has been muted, especially in

given the continuation of a high base for March 2022, the industry may post year-on-year decline for the quarter," said analysts from Jefferies India Pvt. Ltd in a report on 3 March. "There is a risk to demand recovery in H1FY23 if the rally in construction material costs continues," they added.

In simple terms, subdued demand may limit the ability of cement manufacturers to raise prices further. This concern is well reflected in stock performances. Shares of large cement makers Ultratech Cement Ltd, Shree Cement Ltd and ACC Ltd fell to 52-week lows this week.

The stocks have declined by 13-22% in the last one month. They are now trading at a one-year forward EV/Ebitda of 8-16 times, showed *Bloomberg* data.

EV is short for enterprise value. Ebitda is earnings before interest, taxes, depreciation, and amortization.

The key risk for cement stocks is the companies' inability to take adequate price hikes, which would lead to steeper cuts in earnings estimates for 2022-23.

HURDLES TO CLEAR

CEMENT makers now need massive price hikes to fight cost inflation and protect margins

SHARP rise in input costs so far in the March quarter has made matters worse for the firms

SHARES of key cement companies have declined in the range of 13-20% in the past one month

rural areas due to higher inflation. Besides, delayed execution or assignment of infrastructure projects due to higher project costs and elections in Uttar Pradesh and Punjab, are factors that have weighed on cement demand in the current quarter, according to analysts.

"With demand for both January 2022 and February 2022 turning weak, and