

# Economy Macro Tailwind : Cementing Growth – The Cement Story

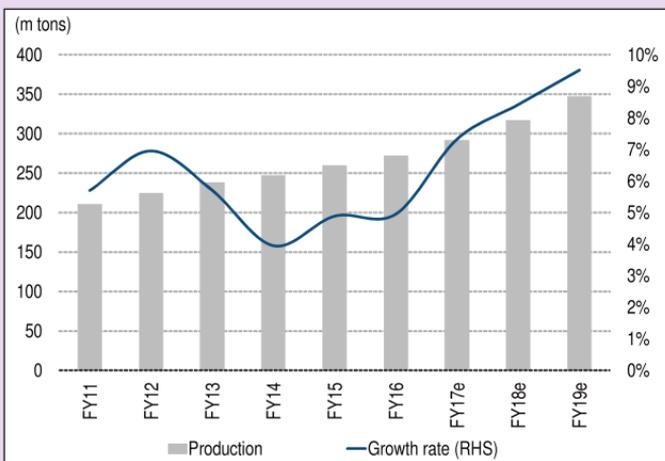
## Cement - Pricing power is coming back to companies:

- **Consolidation in the industry:** The industry has been consolidating for a while now and names like Ultratech, Shree Cements have consistently gained significant market share. Top 5 players which used to have about 32% market share in FY14, now owns more than half of industry capacities and the further consolidation is still taking place. This reduces competition within the players and brings stability in the cement prices.
- **Demand rate exceeding supply:** Capacity addition has been very slow in recent past due to slowdown in the entire demand scenario. India at present operates at about 70% capacity utilisation. Next 3 years, capacities are likely to grow at just 3% whereas demand is expected to grow at over 8-10% (1.5-1.8x of GDP growth). By this if we go; Northern, Western and Central markets are likely to fall short of capacities resulting into comeback of era of 2005-10 where prices witnessed growth for 5 consecutive years and the average pricing growth was at close to 12%.

3 Cycles analysis - CAGR growth	FY00-05	FY05-10	FY10-15
Supply	7.0%	7.0%	10.0%
Demand	6.0%	9.0%	5.0%
Change in Cement Prices - %	10.0%	50.3%	32.5%
Average Utilization	77.0%	90.0%	74.0%
Average RoCE	6.4%	19.3%	11.0%

Source: Anand Rathi Research

- **Recent M&A to support valuations:** For the recent acquisitions to make sense for acquirer, the cement prices have to move up to beat the opportunity cost / cost of capital. Recent transactions have taken place at around USD 130-150 a ton; at current prices and profitability, at these valuations, RoCE turns out to be sub 8-10% levels which does not even beat cost of funds. Hence we are of the view that prices will continue to trend upwards and our analysis suggests that every 2-3% (INR 10) jump in cement prices leads to about 5-6% jump in overall earnings.



Source: Anand Rathi Research

**Government efforts will continue to drive the demand:** Infrastructure sector is already witnessing fastest ever growth in India. Data shows that government has able to exceed 30km a day of target which is remarkable number considering that it had started with 3-5km per day when it had taken change of government in 2014. Further, increase in government spending in irrigation projects, focus on developing ports, metro projects, Smart Cities and other rail projects are likely to drive demand from non-trade segment. Moreover, increased MSPs on various crops, implementation of 7th pay commission, Housing for all initiative and lastly good monsoon is likely to result into strong increase in rural incomes which will also have cascading effects on Urban India.

The sustained increase in cement prices, growth in demand from certain pockets, etc have started showing an impact on the P&L of cement companies. For Instance, of the companies that have reported numbers for Q1FY17, with a volume growth of about 3-7%, the profitability growth has been as high 30-80%.

We are investing in the infrastructure and entire economical revival theme through companies that are cost efficient, consistently gaining market share, have huge operating leverage and lastly presence in right region.

DHFL Pramerica Mutual Fund's investments in the cement sector include:

- UltraTech Cement Ltd
- Shree Cements Ltd
- The Ramco Cements Ltd
- JK Lakshmi Cement Ltd

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