

# Future of M&As in cement industry

Consolidation in the cement industry drew a lot of attention in the recent past. After the new Government took over in 2014, the industry expected healthier growth, however, the same is yet to be realised. Today, despite numerous challenges, cement players are continuing to set up plants and are active in the M&A space – thereby indicating better times ahead, writes **Jagdeep Verma** of **Holtec Consulting**.



**T**he Indian cement industry is envisaged to enter an upward cyclical phase with demand estimated to grow at seven to eight per cent in the medium term, and capacity increase being relatively subdued. As new limestone mines can primarily be obtained through the auction route, acquisitions have gained momentum. Since 2015, when the MMDR Act was amended, nine acquisitions in the cement sector have taken place, resulting in nearly 60 MT of cement capacity exchanging hands.

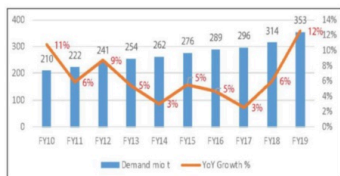
## PAST AND FUTURE OUTLOOK

Past cement consumption: Indian cement consumption has historically, till FY10 (2009-2010), grown at a CAGR (cumulative average growth rate) of around 8 per cent, indicating an elasticity with GDP of 1.1 to 1.3. However, in the last decade, cement consumption increased from 210 MT in FY10 to 353 MT in FY19, leading to a CAGR of six per cent.

There have been three deviations from the average cement growth of 5 to 6 per cent in the past decade,

when demand growth dipped to three per cent in FY14 and FY17, and when demand soared by 12 per cent in FY19. The probable reasons are:

- FY14 was the year preceding the general elections of May 2014 and no major investment policy related decisions were taken, which had a negative effect on cement demand as not many new projects were initiated.
- The dip in FY17 can be attributed to demonetisation in November 2016, when the cash economy plunged downwards, and construction was adversely affected leading to a depression in cement demand.



- In FY19, country was getting ready for the general election of May 2019 and implementation of a substantial number of projects, including affordable housing and infrastructure activities, commenced and this fueled cement demand. The demand was also driven by an increase in cement consumption in the southern states of India, which had been witnessing a depressed demand for past four to five years and there was part realisation of latent demand during this year.

## CEMENT DEMAND DRIVERS

Primary influencers of cement demand are economic growth and government policies which impacts the construction related sectors, including housing and infrastructure. As per World Bank and other international agencies' estimates, Indian economy is slated to grow at around 5.5 to 6 per cent in the current fiscal year, a dip from previous year's seven per cent. In subsequent years, Indian GDP is projected to grow at over seven per cent per annum. The current year has been a year of global slowdown with the Indian economy also facing the heat. The Indian cement industry is not isolated from the impact of this slowdown, and therefore the cement growth in the current year is expected to be subdued at around two to four per cent. Apart from the slow pace of the economy,

lower cement growth in the current year can also be attributed to the slowdown in rural market due to liquidity constraints and lower disposable income. This coupled with failing non-banking finance companies (NBFCs) and housing finance companies (HFCs), which has made credit approval more stringent, has resulted in a general slowdown in the consumption pattern of the country.

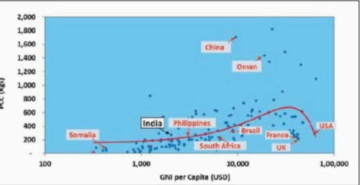
The Indian Government has been focusing on building infrastructure and in its Union Budget of 2019-20, Rs 100 lakh crore investments have been earmarked for infrastructure development over the next five years. Under the Pradhan Mantri Gram Sadak Yojana-III (PMGSY), 1.25 lakh km of rural roads are expected to be upgraded over the next few years at estimated cost of Rs 80,250 crore. The Government also plans to invest Rs 50 lakh crore on railway infrastructure during 2018 to 2030, and Rs 6,600 crore have been allocated for the Smart Cities Mission. Affordable housing is another focus area of the Central Government and Rs 25,853 crore has been allocated for Pradhan Mantri Awas Yojana (PMAY) under the Housing for All scheme for urban poor. These efforts by the government to increase the infrastructure spend in the economy are envisaged to have a positive impact on the sentiments of the construction sector.

Increase in urbanisation is another cement demand driver; currently around 35 per cent of Indian population lives in urban areas and this figure is estimated to increase to 45 per cent by 2025. India's current population is about 1.4 billion and is expected to surpass that of China in the next five to six years. By 2040, the population in India is estimated to be about 1.6 billion. This implies that there will be a higher strain on housing and infrastructure in not only major cities, but also the smaller cities and villages.

## S-CURVE

There is a causal relation between per capita income and per capita cement consumption. As the per capita income of a country increases, so does its per capita cement consumption. The current per capita cement consumption in India is around 270 kg; whereas, the average per capita cement consumption of the world is about 550 kg. The typical relationship between per capita income and per capita cement consumption is depicted.

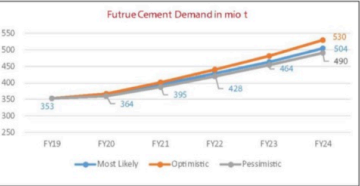
The per capita cement consumption takes a higher trajectory when the per capita income reaches around \$5,000 to \$7,000. After the per capita income exceeds \$20,000 to \$30,000, the per capita cement



consumption slows down as most of the infrastructure and housing needs have been met with. In recent years, we have noticed that per capita cement consumption is likely to again increase in highly developed countries as their infrastructure and housing sectors require refurbishment/ replacement (due to the deterioration with age).

FUTURE CEMENT DEMAND ESTIMATES

The future cement demand estimation is based on quantitative forecast while considering GDP, population, time, cement spend, GCF, etc., as independent variables and cement demand as dependent variable. Based on this, cement demand is projected to reach approximately 500 MT in FY24, from current level of around 350 MT, growing at a most likely rate of 7.5 per cent per annum.



CEMENT CAPACITY

In FY19, Indian cement industry had a rated capacity of about 500 MTPA with 270 operating cement plants, consisting of 160 integrated plants and 110 downstream facilities (grinding/ blending plants and terminals) owned by over 80 cement players. Approximately 90 MTPA cement capacity is expected to be added over the next five to six years; with 30 MTPA Brownfield expansions and 60 MTPA Greenfield capacity additions.

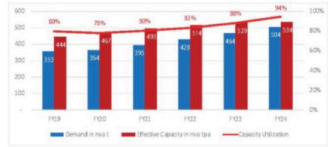
In the next cement capacity build up cycle, the industry is likely to see more Brownfield integrated/ clinker plants as compared to Greenfield plants.

The reason is that it is more strenuous and time consuming to set up a Greenfield plant with limestone now being available primarily through the auction route and land procurement and allied statutory clearances reportedly becoming relatively arduous.

Cement companies have generally ensured that they have adequate clinker to meet their cement grinding capacity. Though at an All India level, the cement-clinker balance is adequate, there are a few players that do not have adequate clinker capacity and rely on purchased clinker; nevertheless, it is likely that these players will increase/set up their own clinkerisation plants to meet their long-term needs.

Historic data indicates that at an all India level cement plants can achieve a maximum of about 90 per cent capacity utilisation; this is due to differences in seasonality in the various regions of India, new capacities being set up in the middle of the year and other operational considerations. Thus, the effective cement capacity as on 31st March 2019 (FY19) was about 445 MTPA, when the rated capacity was around 500 MTPA. Considering the effective capacity, the Indian cement industry operated at an effective capacity utilisation of 80 per cent in FY19. However, plants located in Maharashtra and South India have a lower effective capacity utilisation of approximately 70 per cent compared to the average 85 per cent capacity utilisation in rest of India. The effective capacity utilisation at all India level is projected to reach +90 per cent over next five to six years. This is likely to trigger more capacities augmentation to meet the demand beyond FY24. Capacity utilisation of the plants is predominantly governed by fluctuations in domestic cement demand and is not influenced by exports; as cement/ clinker export quantities and opportunities are limited from India.

As seen in the picture below, the southern region is likely to remain cement surplus even in FY24, and the other regions are likely to turn deficit by FY24. Thus, in all likelihood, further new capacities will need to come before the end of FY23 in most regions, apart from south India, to meet their region's





cement demand.

In the Indian cement industry, about 25 per cent players own around 75 per cent of cement capacity. The two national players—UltraTech and LafargeHolcim—hold around 30 per cent of cement capacity share, 17 regional players like Shree Cement, Dalmia Cement, India Cements, Chettinad Cement, Birla Corp, Ramco Cements, Century, etc., own 45 per cent of cement capacity share, and the balance 25 per cent share is held by over 60 players.

With more than 80 players owning about 210 cement plants, India is a fragmented market with no particular cement company being in a dominant position to influence market policies. This is also demonstrated by Herfindahl Index, which is a commonly accepted measure of market concentration in which its values range from zero to one, with one indicating a monopolistic market. Herfindahl

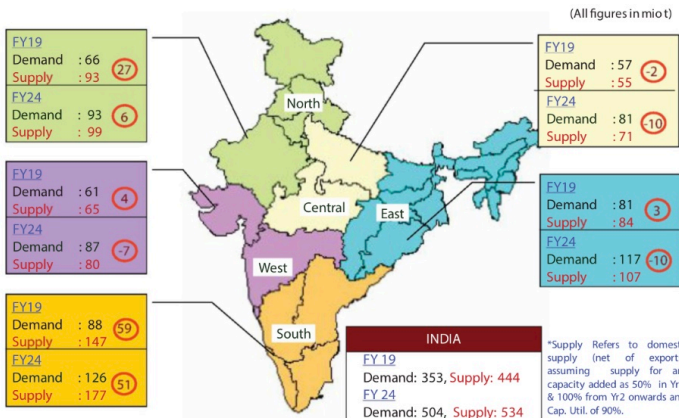
Index for the Indian cement industry is seen to range between 0.062 to 0.075, in the period FY12 to FY24, indicating a competitive market.

## INVESTMENT SCENARIO IN CAPACITY CREATION & SERVICING DEBT

The prevailing cost of setting up a Greenfield integrated cement plant with all allied facilities/ infrastructure, like captive power plant (CPP), waste heat recovery (WHR), railway siding, housing colony, etc., is around Rs 9,000 to Rs 10,000 per tonne of OPC (Rs 6,500 to Rs 7,500 per tonne of cement). For a similar configuration brownfield plant, the investment cost is approximately Rs 6,000 to Rs 7,000 per tonne of OPC (Rs 4,000 to Rs 5,000 per tonne of cement). The total investment in creating 90 MTPA capacities over next five years is estimated to be around Rs 55,000 crore.

Most companies take on some amount of debt to setup a cement plant. It is estimated that a 6,000 tpd plant, with 2.8 MTPA cement capacity, requires around Rs 800 to Rs 900 per tonne of free cash to service its debt and interest. It is further estimated that a typical cement plant that makes an EBITDA of Rs 900 per tonne, after servicing the debt and interest for the year, is left with less than Rs 100 per tonne of free cash.

As mentioned earlier, limestone mines are now



List of acquisitions in past 10 years is given in the table:

Year	Acquirer	Target	Cement Capacity MTPA	EV/ t of cement (Rs.)	Value (Rs crore)
2010	Vicat	Bharathi Cement (51%)	2.5	11,900	1,520
2011	Jaypee Cement	Andhra Cements (60% stake)	1.5	2,300	210
2012	Dalmia Cement	Adhunik Cement	1.5	7,100	1,060
2013	UltraTech Cement	Jaypee Cement (Gujarat)	4.8	6,900	3,330
2013	Baring Asia	Lafarge Cement (14% stake)	8.0	13,000	1,455
2013	My Home-CRH	SreeJayajothi Cements	2.3	6,200	1,420
2013	JSW Cement	Heidelberg Cement (Raigad)*	0.6	Undisclosed	
2014	Dalmia Cement	Jaypee Cement (Bokaro)*	2.1	5,500	1,150
2014	Chettinad Cement	Anjani Cement	1.2	Undisclosed	
2014	Shree Cement	Jaypee Cement (Panipat)*	1.5	2,500	370
2015	Dalmia Cement	OCL India (stake increased from 48% to 75%)	5.4	7,000	1,025
2015	Sagar Cements	BMM Cements	1.0	5,400	540
2016	Birla Corp	Reliance Cementation	5.5	8,700	4,800
2016	UltraTech Cement	Jaypee Cement	22.4	7,600	16,970
2016	Nirma Cement	Lafarge Cement	11.0	8,500	9,400
2017	Dalmia Cement	Murli Industries	3.0	2,700	819
2018	Dalmia Cement	Kalyanpur Cements	1.0	3,500	350
2018	UltraTech Cement	Binani Cement	9.5	8,400	8,025
2018	Emami Cement	Eco Cement*	0.6	4,100	245

Note: \* indicates grinding plant. Rest all are integrated plants

available primarily through the auction route. The typical successful limestone auction value has been in the range of Rs 250 to Rs 300 per tonne of limestone. This implies, if the cement plant predominantly produces blended cement, the EBIDTA per t of cement will reduce by Rs 250 to Rs 300 per tonne, i.e., to Rs 600 to Rs 650 per tonne. Thus, these plants may find themselves in a financial predicament if they are unable to service their debt and interest. It may be inferred that first-time entrepreneurs/companies without deep pockets are likely to find it difficult to sustain their cement business, especially during initial years of debt servicing, and this could act as a potential entry barrier for new players. On the other hand, existing large business houses, which have multiple cement plants and/or other businesses with lower leverage and high free cash flows, are likely to tide-over the initial years of their cement operations when the EBIDTA is lower than the cash outflow required to service debt.

## MERGERS & ACQUISITIONS (M&AS)

In past 10 years, India has seen around 20 acquisitions and three mergers. The value of the acquisitions has been over Rs 52,000 crore resulting in +80 MTPA cement capacity changing hands. The three mergers in last decade have taken place in India are Lafarge and Holcim in 2015, Heidelberg and Italcementi in 2016 and UltraTech and Century in 2019.

The first major acquisition was made by Holcim when they acquired Ambuja Cement and ACC in 2005-2006. Ambuja's cement plants were acquired at a price of almost \$200 per tonne. This led to an expectation that future acquisitions could be at a similar valuation. What is interesting is that the exchange rate in 2005-2006 was about Rs 45 to \$1, converting the acquisition price in Rupees to Rs 9,000 per tonne. As depicted in the table, the typical acquisition price in recent years of an integrated plant has typically been in the range of Rs 7,500 to Rs 9,000 per tonne, barring strategic investment by



PE firms and cement companies. The exceptions have been when a player has chosen to acquire a cement plant for strategic reasons and is willing to pay a high valuation, or when a cement plant is compelled by its creditors to sell its assets under financial duress.

## FUTURE OF M&A

Indian cement industry is not likely to witness a merger of any two major cement groups in the near future; however, acquisitions are foreseen to continue playing an important role in shaping of the industry. There are several standalone cement plants that are under financial distress and are considering selling their assets as one of their options to avoid them is taken to National Company Law Tribunal (NCLT). On the other hand, there are potential buyers who are scouting to acquire cement plants, rather than go in for organic growth, as it enables them to sidestep the uncertainty of being awarded with limestone mines through the auction process, obtaining clearances, procuring land, etc. Another important factor is that the acquisition will generate immediate cash flow for the buyers.

Buyers are likely to be existing players who for their strategic reasons want to maintain/ increase their capacity share, and new players/MNCs wanting to enter the Indian cement market.

The future may see 20 to 25 MTPA cement capacity getting acquired. Valuation of cement plants is envisaged to be based on the following factors:

- Asset valuation comprising of
  - o Land valuation
  - o Limestone valuation –based on reserves quality and quantity
  - o Plant and machinery valuation –based on contemporariness of technology, condition of assets and operations bottlenecks, if any
  - o Miscellaneous other assets, including stocks
- Premium for early cash flow –premium for the asset as it enables the acquiror to get immediate cashflows and avoid the extensive gestation period. Typically, a Greenfield plant's commissioning can take four to five years after grant of limestone lease.

As mentioned earlier, depending upon the strategic need of the buyer, he may pay a higher premium for the cement asset or based on the financial distress of the seller get the asset at a bargain. Typically, the valuation of cement plants is expected to be in the range of Rs 8,000 to Rs 10,000 per tonne of cement for an integrated plant. Considering 20 to 25 MTPA cement plants that are likely to be open

for acquisition, the total acquisition value could be in the range of Rs 18,000 to Rs 25,000 crore.

## WHAT THE FUTURE HOLDS?

The Indian cement industry is moving towards higher capacity utilisation. Demand is estimated to grow by seven to eight per cent per annum over the medium term and capacity expansions by three to four per cent per annum. This implies that by FY24, demand is likely to be about 500 MT and effective capacity about 535 MTPA. To meet the future cement demand, more capacity will need to be created by FY22-23. Cement plants with split located grinding facilities are envisaged to be set up, with many clinker plants being Brownfield in nature. It is also possible that players in the power and steel businesses may enter the cement sector due to the former having fly ash and slag at their disposal. Transportation cost being a key determinant for market reach, the water mode of movement is likely to gain momentum, and this may attract companies with strong logistics infrastructure and experience to also enter the cement sector.

Indian cement industry is likely to continue witnessing organic and inorganic capacity growth. Organic growth is likely to be more Brownfield than Greenfield. Inorganic growth could take place by acquisition of the estimated that 20 to 25 MTPA of cement capacity that is likely to be open to sale. Players with deep pockets may bid a higher value for cement assets if the same are of strategic value to them. At the same time, there could be some plants which are going through financial distress and could sell their assets at a lower valuation to meet their financial obligations. The typical acquisition value for an integrated plant is estimated to be in the range of Rs 8,000 to Rs 10,000 per tonne of cement.

A total investment of around Rs 77,000 crore (Greenfield and Brownfield capacity buildup plus acquisitions) is estimated over the next four to six years. With cement capacity-demand balance narrowing down and a slower growth envisaged in capacity expansions, there is a likelihood of EBIDTA margins improving and return on capital employed returning to healthier levels.

## ABOUT THE AUTHOR:



The article is authored by Jagdeep Verma, Head – Business Consulting, Holtec Consulting, India. He can be contacted on: [jv@holteconet.com](mailto:jv@holteconet.com)