Cement

Is there a new wave of consolidation in the Cement space?

If it happens, it will open a path towards value creation

Over the last one month, we have seen a 5-37% rise in Cement stocks, barring a few stocks (UTCEM, TRCL, and HEIM), which have underperformed off late. Rising hopes of a higher consolidation in the Indian Cement industry are behind the recent run-up in stock prices. Our interactions with Cement dealers suggest attempts at a price hike of INR10-20/bag in early Sep'22 in a few markets. However, to date, no material price hike has been taken, except an increase of INR5-10/bag in some parts of East and South India.

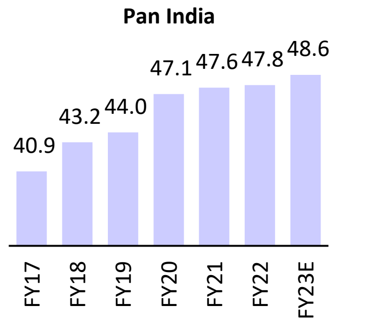
Change in industry dynamics can lead to higher consolidation

- The Adani group has forayed into the Cement business by acquiring Holcim's stake in ACEM and ACC, which has a combined Grinding capacity of 68mtpa (70mtpa by 1QFY24E). The management aims to achieve an installed capacity of ~140mtpa over the next five years and believes that the group will be the largest and most efficient cement company by 2030.
- Other large players (UTCEM, SRCM, and DALBHARA) too have continuously hinted at expanding capacities through the organic and inorganic route. Based on capacity expansion announcements (organically) by Cement players till date, the top five players will continue to register a higher installed capacity CAGR of ~8% over FY22-25E v/s ~3% for the rest of the industry.
- Most of the bigger players are eyeing inorganic growth opportunities, which have gathered pace after the foray of the Adani group into the Cement business. For instance, SRCM, as per media articles, is exploring inorganic growth plans in Central and South India.
- A consolidation in the industry, if it occurs, will boost: 1) pricing power, 2) synergies in the form of cost reduction and operational efficiency; and 3) cross branding, which will help expand market reach.

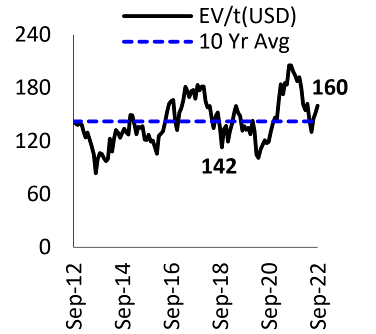
Bigger-sized acquisitions can lead to a re-rating in smaller names

- Given the aggression shown by larger players in expanding capacity and the changing industry dynamics, there can be a capacity acquisition of 45-50mtpa over the next two-to-three years.
- Many regional players have not added capacities over the last few years, and, have, in turn, lost market share. Few players are finding it difficult to pare their leverage and may be willing to exit the Cement business at good valuations.
- The replacement cost of Cement plants is in the USD100-120/t range, with the acquisition of good assets historically at USD106-151/t. Many mid/small-sized companies are trading at an EV/t of USD48-87. However, the actual valuation will depend on asset quality, the strategic needs of the buyer, and the bargaining power of the seller.
- The anticipation of bigger acquisitions in the industry is driving the valuation re-rating of regional and smaller players, which are trading at a discount to replacement cost. Historically, a valuation premium is assigned to assets based on their ability to generate cash flows and/or their market presence or operational efficiency.

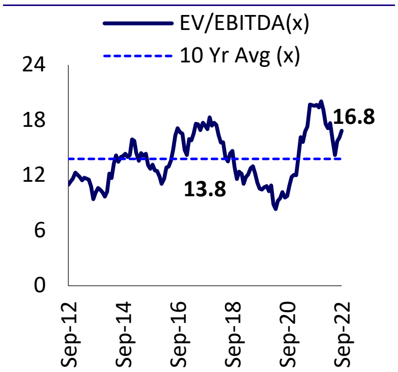
Increasing capacity share of the top five players (%)



1-year forward EV/t trend for the coverage



1-year forward EV/EBITDA ratio trend for the coverage



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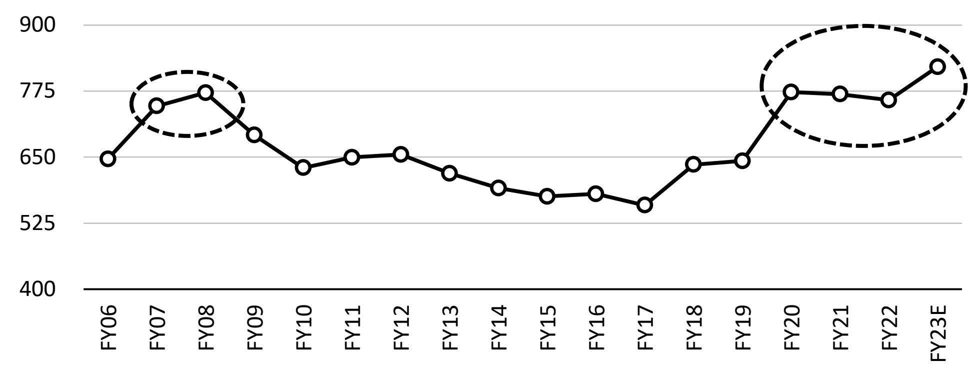
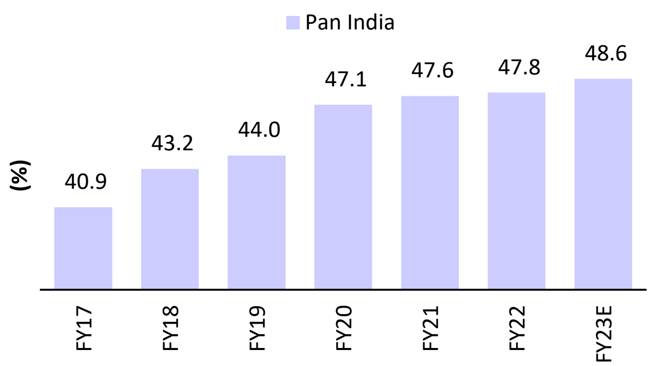
Story in charts

Exhibit 1: Herfindahl-Hirschman index – Consolidation rises after a decline over FY09-17



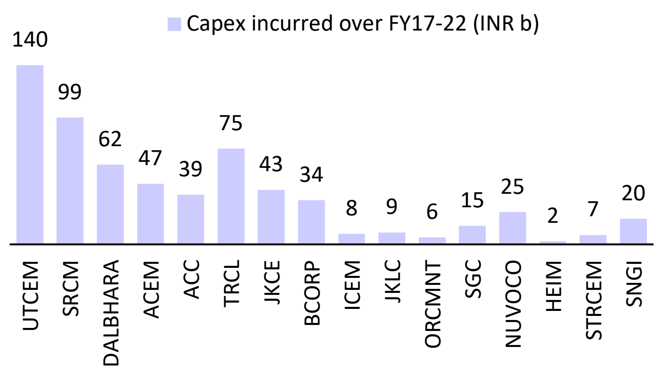
Source: MOFSL, Industry

Exhibit 2: Increasing capacity share of the top five players to ~49% in FY23E v/s ~41% in FY17



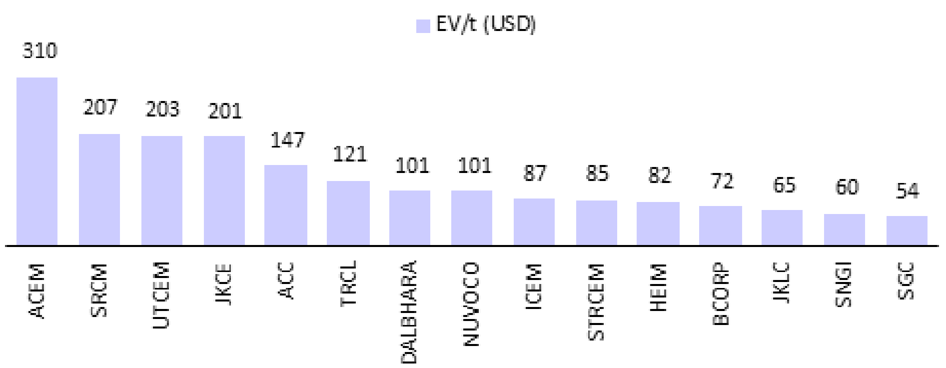
Source: MOFSL, Industry

Exhibit 3: Top five players account for 61% of the total capex incurred over FY17-22 (INR b)



Source: MOFSL, Industry

Exhibit 4: Analyzed companies EV/t (in USD)

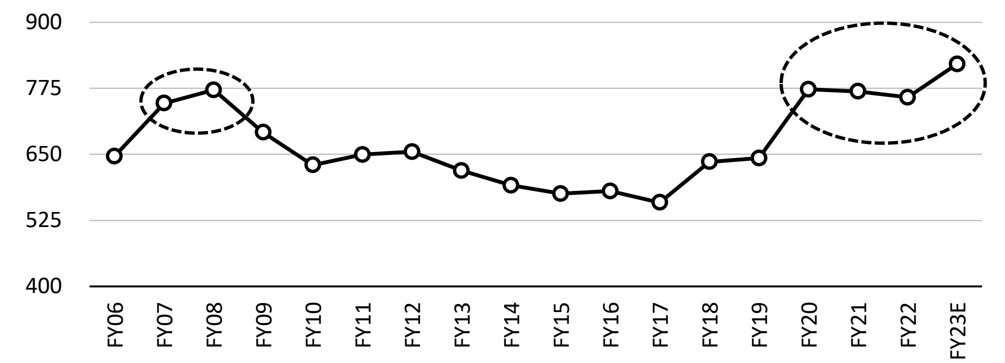


Source: MOFSL, Company; Note: Net debt considered at the end of Mar'22 and Dec'21 (for ACC and ACEM)

Consolidation in the Indian Cement industry: A brief overview

Over FY09-17, the Indian Cement industry saw a decline in market concentration, with the addition of capacity by several smaller players. Installed Cement capacity for the top five players clocked 8% CAGR, while the same for the rest of the players stood at 10% over FY09-17. However, the extent of concentration in the Indian Cement industry increased from FY18 levels, with multiple mergers and acquisitions (M&A) and faster capacity additions by larger players. The installed Cement capacity of the top five players clocked 7% CAGR over FY17-23E v/s a CAGR of 2% for the rest of the industry. As per the Herfindahl–Hirschman index, the consolidation in the Indian Cement industry improves over FY20-23E.

Exhibit 5: Herfindahl-Hirschman index – Consolidation rises after a decline over FY09-17



Source: MOFSL, Industry

Exhibit 6: Major M&A activities in the industry over the past 12 years

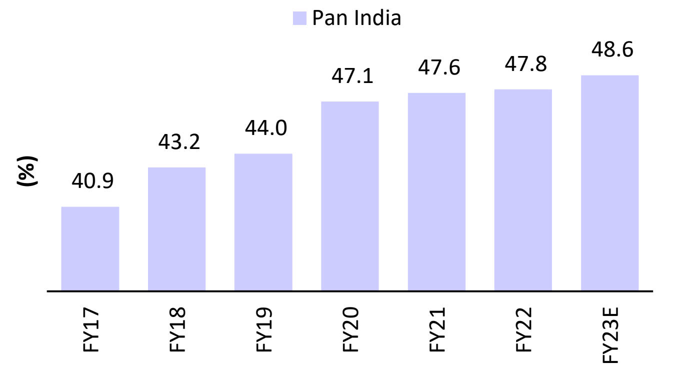
Year	Company/plants acquired	Acquiring company	Capacity (mtpa)	Region	Deal value (INR b)	EV/t (INR)	EV/t (USD)
CY10	OCL India (45.4% stake)	DALBHARA	5.3	East	3.8	1,567	32
CY12	Adhunik Cement	DALBHARA	1.5	East	5.0	3,338	64
CY12	Calcom Cement (76% stake)	DALBHARA	2.1	East	3.2	1,975	37
CY13	Heidelberg Cement (Dolvi GU)	JSW Cement	0.6	West	1.7	2,767	49
CY13	Sree Jayajothi Cements	My Home Industries	3.2	South	14.0	4,375	67
CY13	Gujarat units of JPA group	UTCEM	4.8	West	38.0	7,917	131
CY14	Jaypee Cement (Bokaro GU)	DALBHARA	2.1	East	9.0	4,296	68
CY14	Jaypee Cement (Panipat GU)	SRCM	1.5	North	3.6	2,400	38
CY14	BMM Cements	SGC	1.0	South	5.4	5,400	87
CY15	OCL India (26.6% stake)	DALBHARA	6.7	East	10.2	5,744	89
CY16	JP group (Cement plants)	UTCEM	21.2	Central/North/South	161.9	7,636	118
CY16	Lafarge India	NUVOCO	11.1	North/East	94.0	8,507	127
CY16	Reliance Cement	BCORP	5.5	Central/West	48.0	8,727	130
CY17	Murli Industries	DALBHARA	3.0	West	4.0	1,340	21
CY18	Century Cement	UTCEM	14.6	East/West/Central	86.2	5,905	106
CY18	Binani Cement	UTCEM	8.6	North	80.3	9,386	131
CY20	Emami Cement	NUVOCO	8.3	East	55.0	6,627	93
CY22	ACC and ACEM (Holcim's stake)	Adani group	67.8	Pan India	501.8	11,727	151

Source: MOFSL, Industry

- M&A activity in the sector has led to increased consolidation (share of capacity of the top five players has increased) in North, Central, and East India over the last few years. While West India saw a de-consolidation due to the entry of new players (such as DALBHARA, BCORP, and SRCM, with a combined capacity addition of 10mtpa), the South remains the most fragmented market with a capacity share of ~43% for the top five players in FY23E.

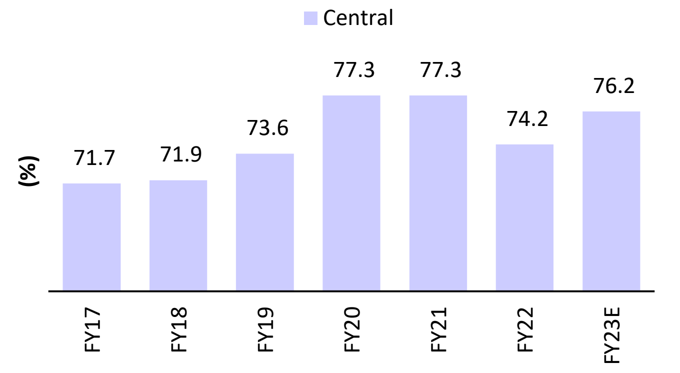
- The acquisitions (JP Group's Cement plants, Binani Cement, and the Cement business of Century Textiles) as well as organic expansions (including the ongoing Phase I expansion of 19.9mtpa) have helped UTCEM emerge the largest player in terms of installed grinding capacity across regions.

Exhibit 7: Increasing capacity share of the top five players



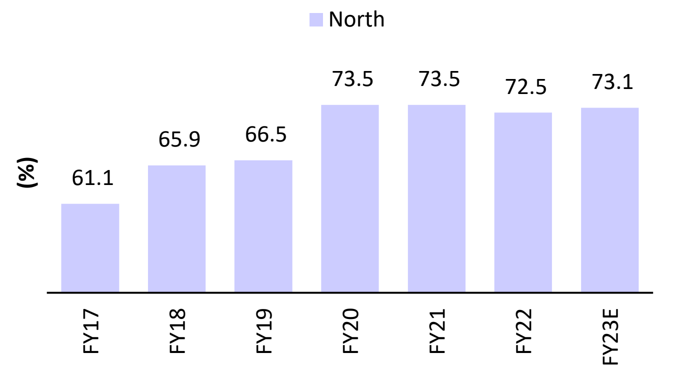
Source: MOFSL, Industry

Exhibit 8: Central India is the most consolidated region…



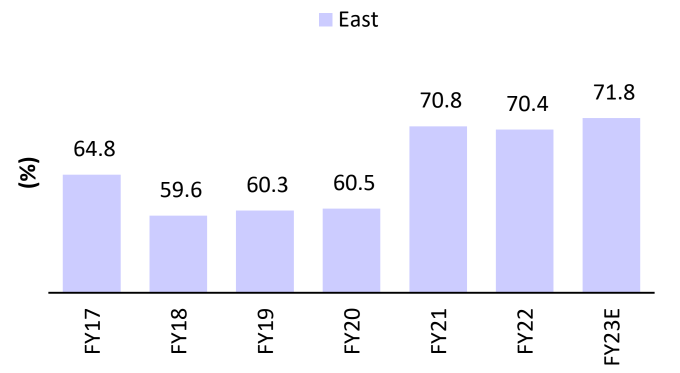
Source: MOFSL, Industry

Exhibit 9: …followed by North India



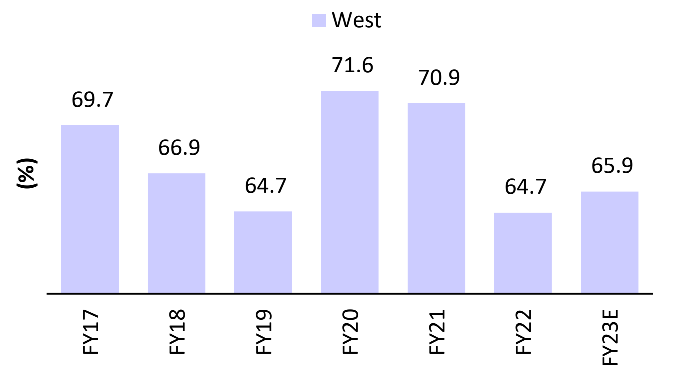
Source: MOFSL, Industry

Exhibit 10: Consolidation increases in East India



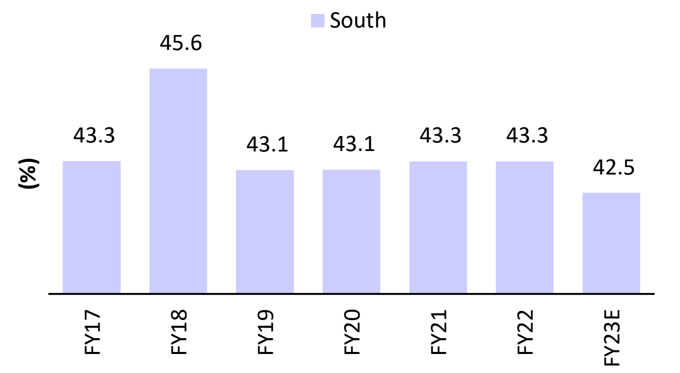
Source: MOFSL, Industry

Exhibit 11: New entrants lead de-consolidation in West India



Source: MOFSL, Industry

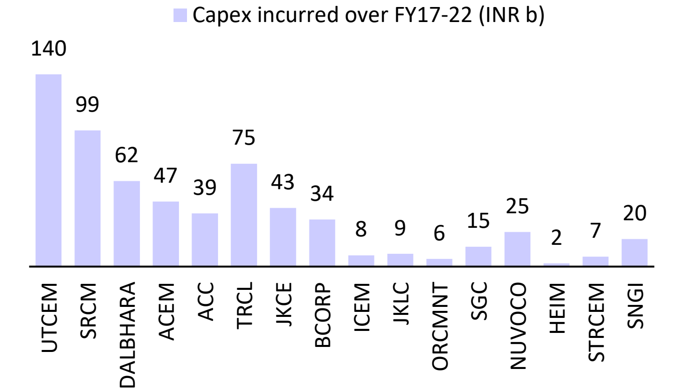
Exhibit 12: South India remains the most fragmented region



Source: MOFSL, Industry

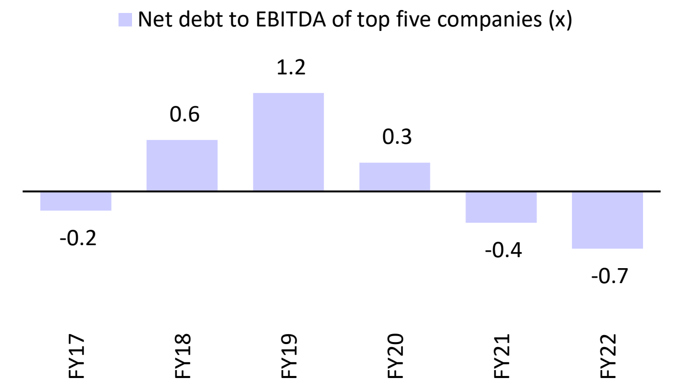
- The top five players contributed ~61% of the total capex incurred by the companies analyzed in Exhibit 19 over FY17-22. Healthy operating cash flow generation has helped them fund capacity expansions via internal accruals as well as an improvement in the Balance Sheet (net cash for the top five players rose to INR162b by FY22 v/s INR29b in FY17 and net debt-to-EBITDA ratio improved to -0.7x in FY22 v/s -0.2x in FY17).

Exhibit 13: Capex incurred by analyzed companies over FY17-22 (INR b)



Source: MOFSL, Industry; Note: ACC and ACEM follow a December year ending

Exhibit 14: Net debt-to-EBITDA ratio for the top five players improves



Source: MOFSL, Industry, Note: ACC and ACEM follow a December year ending

Change in industry dynamics can aid consolidation

We expect consolidation in the Cement industry to increase further through the organic and/or inorganic routes. The following factors will enhance consolidation in the industry:

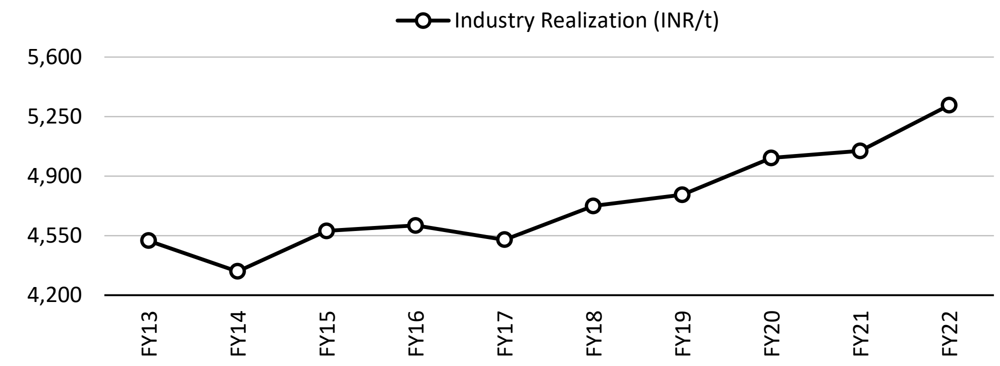
- **Organic and inorganic capacity expansion announcements by large players:** Larger players (UTCEM, the Adani Group, SRCM, and DALBHARA) are on continuous talks to expanding their capacity through the organic and inorganic route. Before the completion of Phase I expansion of 19.9mtpa, UTCEM announced an expansion of 22.6mtpa, which will help it achieve an installed grinding capacity of 154mtpa by FY25E. The management hinted at a capacity of 200mtpa by FY30E through the organic and inorganic growth. The Adani group after announcing acquisition of Holcim's stake in ACC and ACEM has stated to achieve a capacity of 140mtpa over the next five years (v/s its current capacity of 68mtpa). SRCM, which has largely grown organically, is eyeing acquisitions. It has announced expansion plans of 9.5mtpa (via the brownfield and greenfield route), which will help it to achieved an installed grinding capacity of 56mtpa by FY25E (v/s current capacity of 46.4mtpa). DALBHARA, which is keen to acquire assets (it acquired multiple assets in the past, including distressed assets) is looking to expand capacity to 110-130mtpa by CY31 from 49mtpa, including ongoing expansions, via the organic and inorganic route. Based on the capacity expansion announcements (organically) by Cement players till date, the top five players will continue to register a higher installed capacity CAGR of ~8% v/s ~3% for the rest of the industry over FY22-25E.
- **Market share loss by a few regional players:** Few regional players have lost market share due to lack of growth plans, inefficiencies, and a poor marketing strategy. Many regional players like ICEM, SANGI, HEIM, and PRSMJ have lost market share over FY15-22.

- **Lack of interest by MNCs to increase capacities in India:** Many MNCs (Holcim, HeidelbergCement, Vicat, Italcementi, Lafarge, CRH, and SIMEC) have forayed into the Indian Cement market. However, most MNCs did not pursue aggressive growth plans like their domestic counterparts. Lafarge had to sell its Cement plants in India after the global merger of Holcim and Lafarge. Recently, Holcim sold its stakes in ACEM and ACC. ACC and ACEM have historically not been aggressive in capacity expansion (installed capacity grew by 2% each over FY09-22), whereas the same for the industry and other top players clocked a CAGR of 5% and 9%, respectively.
- **Amendment to the MMDR Act, a year back, waived off transfer charges on mining leases:** The government amended the Mines and Minerals (Development and Regulation) Act, 2021 with effect from 28th Mar'21. The amendment states that the transferee of the mining lease will not be required to pay transfer charges (80% on royalty), which we believe is a positive development towards industry consolidation.

What if consolidation increases?

A consolidation in the industry will boost: 1) pricing power, 2) synergies in the form of cost reduction and operational efficiency; and 3) cross branding, which will help expand market reach. For instances – 1) UTCEM successfully integrated the cement brands of acquired companies under the UltraTech brand in majority of the markets that it operates in, 2) NUVOCO launched 'Double Bull', a brand of the erstwhile Emami Cement (an East India player), in North India, 3) DALBHARA also launched its most trusted brand 'DSP' in Bihar from Kalyanpur Cements (acquired under the IBC process), and BCORP converted the Reliance Cement brand into an MP Birla Group brand in majority of the markets that it operates in.

Exhibit 15: Realization improves over FY18-22 with an increase in industry consolidation



Source: MOFSL, Industry

Bigger-sized acquisitions can lead to a re-rating in smaller names

The valuation of Cement plants is based on: 1) the EV/EBITDA multiple – the premium to be assigned to assets that generate immediate cash flows; and 2) EV/t – calculated based on multiple factors such as the availability of limestone reserves; the nature of the plant (whether integrated or a grinding unit), including facilities attached to the main plant and equipment (WHRS, CPP, railway siding, etc.), and plant's location. In such case a premium is to be assigned to assets that are efficient and located in regions which offer higher capacity utilizations such as North and Central India.

Historically, a valuation premium is assigned to assets based on their ability to generate cash flows and/or their market presence or operational efficiency.

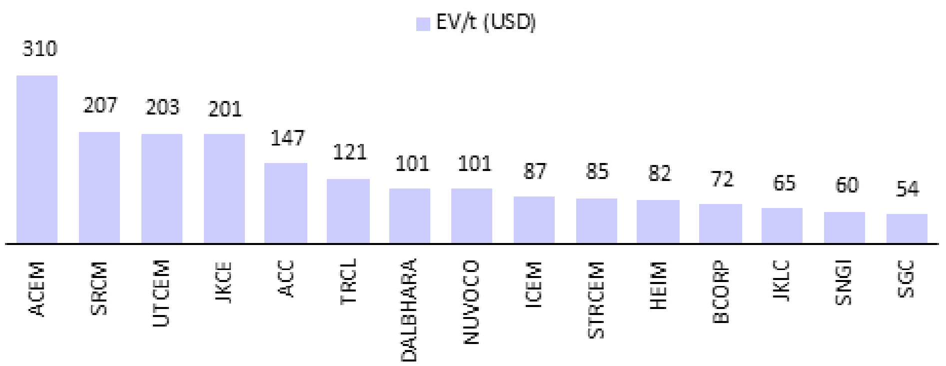
Exhibit 16: Historical M&A premium or discount to the replacement cost based on multiple factors

Company/plants acquired	Acquiring Company	Capacity	Region	Valuation (EV/t)	Comments
Deals on premium valuation to the replacement cost					
Binani Cement	UTCEM	8.6	North	131	❖ Higher limestone reserves, a favorable market presence, and scope for future expansion at lower cost
JPA group Gujarat units	UTCEM	4.8	West	131	❖ A modern plant, with the latest technology. A CPP and a jetty for clinker and coal movement will aid a reduction in cost
Reliance Cement	BCORP	5.5	Central/ West	130	❖ Higher limestone reserves and a favorable market presence
ACC+Ambuja Cements (Holcim stake)	Adani group	67.8	Pan India	151	❖ To generate immediate cash flows and long-term growth opportunities
Deals on discounted valuation to the replacement cost					
Sree Jayajothi Cements	My Home Industries	3.2	South	67	❖ Lower capacity utilization in South India
Emami Cement	NUVOCO	8.3	East	93	❖ Significantly lower clinker capacity as against grinding capacity
Murli Industries	DALBHARA	3.0	West	21	❖ A distressed asset requiring substantial time and capex for a plant revival

Source: MOFSL, Industry

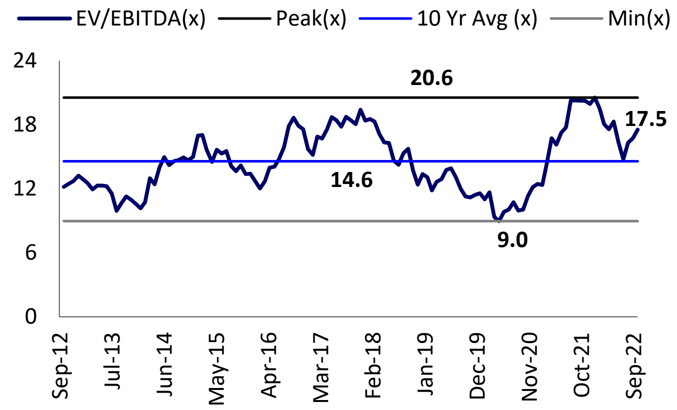
Given the aggression shown by large players to expand capacity and changing industry dynamics, there may be an acquisition of 45-50mtpa Cement capacities over the next two-to-three years. The replacement cost of Cement plants is in the USD100-120/t range, with the acquisition of good assets historically at USD106-151/t. Many mid/small-sized companies are trading at an EV/t of USD45-87. However, the actual valuation will depend on asset quality, the strategic needs of the buyer, and the bargaining power of the seller. The anticipation of bigger acquisitions in the industry is driving the valuation re-rating of regional and smaller players, which are trading at a discount to replacement cost.

Exhibit 17: Analyzed companies EV/t (in USD)



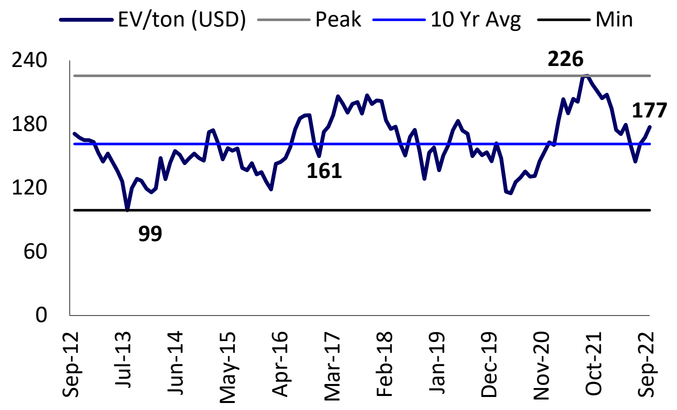
Source: MOFSL, Company; Note: Net debt considered at the end of Mar'22 and Dec'21 (for ACC and ACEM)

Exhibit 18: One-year forward EV/EBITDA ratio Large-Cap



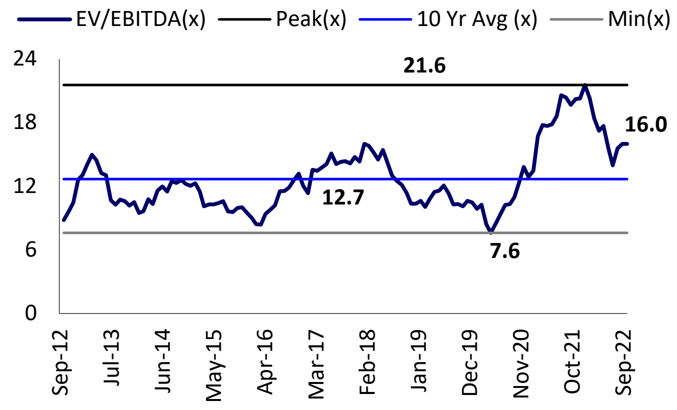
Source: MOFSL, Industry

Exhibit 19: One-year forward EV/t Large-cap



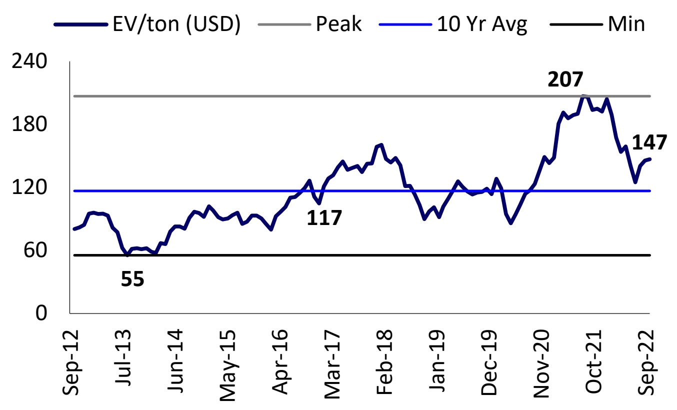
Source: MOFSL, Industry

Exhibit 20: One-year forward EV/EBITDA ratio Mid-Cap



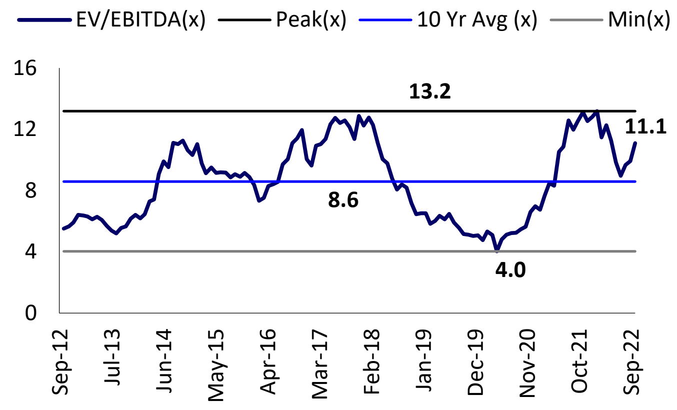
Source: MOFSL, Industry

Exhibit 21: One-year forward EV/t Mid-cap



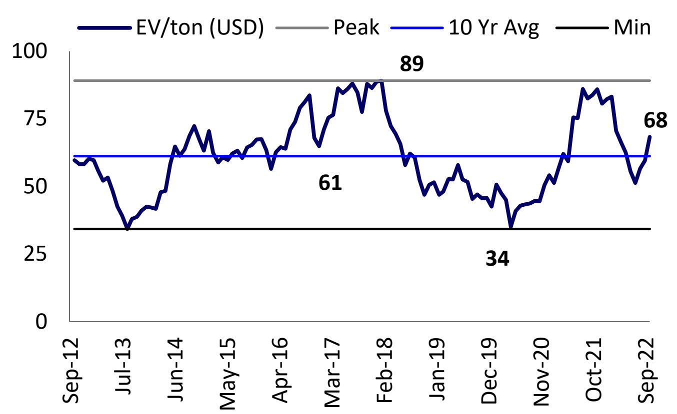
Source: MOFSL, Industry

Exhibit 22: One-year forward EV/EBITDA ratio Small-Cap



Source: MOFSL, Industry

Exhibit 23: One-year forward EV/t Small-cap



Source: MOFSL, Industry

Exhibit 24: Valuation summary

	M-cap (USD b)	CMP (INR)	Rating	P/E (x)		EV/EBITDA (x)		EV/t (USD)		RoE (%)		Net debt/EBITDA (x)	
				FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
UltraTech Cement	23.5	6,481	Buy	36.3	29.0	17.3	14.2	177	174	9.8	11.3	0.1	(0.2)
Shree Cement	10.6	23,309	Neutral	60.3	45.5	24.6	19.6	204	182	7.8	9.6	(2.1)	(1.6)
Ambuja Cements	12.9	516	Neutral	40.9	34.8	29.6	22.9	308	304	17.5	19.1	(1.7)	(1.3)
ACC	6.2	2,615	Neutral	47.3	29.6	21.8	15.1	145	138	7.3	11.2	(3.0)	(2.5)
Dalmia Bharat	4.0	1,685	Buy	51.8	41.1	13.5	11.3	94	81	3.8	4.7	(0.3)	0.2
The Ramco Cements	2.3	762	Neutral	55.8	29.7	19.8	14.1	133	127	4.9	8.6	3.8	2.4
JK Cement	2.8	2,837	Neutral	36.4	30.8	15.6	14.0	193	167	13.3	14.2	2.1	1.8
Birla Corp	1.0	1,084	Buy	36.6	17.6	10.4	7.7	71	65	3.7	7.4	2.7	1.9
India Cements	1.0	266	Sell	(79.9)	44.1	39.3	15.6	85	83	(1.8)	3.1	10.4	3.9
JK Lakshmi	0.9	607	Buy	20.2	15.9	9.3	7.7	61	57	13.6	15.3	(0.4)	(0.9)
Grasim Industries	14.4	1,744	Buy	40.3	41.1	27.0	26.3	N/A	N/A	13.6	11.5	0.0	(0.3)

Source: MOFSL, Company

NOTES

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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