Asian cement 2017: looking to the future

Following an exciting 2016, this year sees opportunities and challenges abound for the Asian cement industry. LEK Consulting gives an overview and outlines strategies that help position cement companies in this part of the world for long-term growth.

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The year 2016 was an exciting one for Asia's cement industry. LafargeHolcim continued to trim its presence in the region with disposals in India, Korea, Vietnam and Sri Lanka. It wasn't the only one that slimmed down. Other examples include a distressed exit by Jaypee in India, sub-scale assets sales by Cemex in Bangladesh and Thailand, and non-core divestment by Hyundai in Korea.

The buyers were local and regional champions: most notably, Siam City Cement's aggressive expansion into Vietnam and Sri Lanka at prices that initially raised eyebrows but in hindsight look astute – it has created a balanced footprint in a region that appears to be increasingly "swimming" in cement/clinker oversupply. The oversupply is largely a result of the significant overcapacity in China and to a smaller extent, in other prominent producing countries such as Thailand, Vietnam and India.

The year ahead: expectations for 2017

Considering the year ahead, what can be expected of the Asian cement industry in 2017?

The China effect

The word "China" instills a sense of fear in many Asian cement producers. The current state of the world steel market exemplifies what can happen to a global commodity if there is overcapacity in China. Estimates of actual capacity in China are surprisingly hard to obtain, but are around 3.16bnta, according to The Global Cement Report. To put this into perspective, the rest of Asia Pacific cement production is roughly 600-700 Mta. Irrespective of the actual size, low capacity utilisation in China (60-65 per cent in 2015), combined with the country's export capability (several hundred million tons of capacity are estimated to have access to sea ports in China), means there is a huge untapped potential for the country to disrupt a majority of Asian markets. Already Chinese clinker and finished products can be seen actively competing across Asia – from the Philippines to Bangladesh to the Maldives – often at very competitive prices. This trend is likely to intensify in 2017 as cement producers in China look to escape the forced shutdowns of inefficient plants by increasing utilisation rates.

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China's overcapacity will help to change the Asian cement market from a national into a regional game

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Pricing pressures

Economic expansion in several major Asian countries such as Indonesia, Malaysia and Thailand has been lower than anticipated, muting cement demand growth, which in turn is negatively impacting cement prices in these countries. Therefore, the players in these countries are looking at export markets as a panacea, further adding volumes to the regional supply which already features China, Vietnam and Thailand as big exporters, and exacerbating the regional supply-demand imbalance. Consequently, cement and clinker pricing across Asia will be capped by import price parity, and pricing growth could be negative in many countries in the coming year.

Rise of protectionism

In 2017 the local cement players are expected to be actively lobbying their respective governments to protect them from an onslaught of imports. Some of these lobbying efforts are likely to succeed with a series of non-tariff barriers (eg, environmental and safety standards) to be erected. If President Donald Trump is able to slap tariffs on Chinese steel imports, it is possible that similar tariffs will be introduced by Asian countries on Chinese and other cement imports.

Mergers and acquisitions activity continues

There are likely to be further asset sales by producers that find themselves in distress, global majors continuing to deleverage, and conglomerates exiting difficult non-core businesses. China, Korea and Vietnam are prime candidates for consolidation with local deals likely to be most common in these countries. India, Indonesia, Malaysia and Thailand could also benefit from further industry consolidation.

With Asian family owners, the cultural act of 'saving face' and making gracious gradual exits can be expected to drive transactions, in addition to offered deal values. Any would-be buyers should, hence, plan accordingly.

Cement & clinker go regional

The rising threat of exports also points to another phenomenon that can be expected to intensify in 2017 – cement as a regional play rather than within national or sub-national boundaries. With low logistics costs, cross-border trading of cement and clinker will continue to gain traction and cement producers will find imports to be an increasingly viable option in the context of their own supply chains.

Australia provides a good example, where despite sufficient natural resources, roughly half the clinker is imported. It is often claimed that the country will not ever need to build another new kiln.

Role of infrastructure grows

In developing Asia most governments are focussed on building critical infrastructure in their countries, and are investing significant sums into fixed assets such as roads, ports, airports, energy and power. On the other hand, the outlook for property and commercial real estate remains mixed. Therefore, we expect infrastructure's share of cement consumption to rise in 2017.

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Positioning for growth

These trends could pose commercial challenges to cement producers across the region. At the same time, there are a number of strategic initiatives and tactics that the producers can pursue to be better poised for growth in the long run.

Analyse the threats

The key to responding to the Chinese (and other) import threats is to understand the level of risk in the context of a company's home market. In-depth analysis at micro-market level to evaluate cost-curves and delivered import pricing is the first step to understanding "what is at risk" at a geographic or customer segment, and product level. Companies can then go on to craft competitive responses.

Develop closer user relationships

Fighting off cheap imports should be done on several fronts. Improving production costs through a focus on efficiency should always remain a critical part of a cement producer's agenda. However, distribution capabilities and brand are key differentiating factors against a new entrant. Control over the distribution network (eg, reduce reliance on distributors) and optimising distribution can provide a cost advantage and sustainable competitive edge to the incumbents.

Reconfigure supply chain

Cement companies should take this opportunity to re-evaluate their role and participation in the cement value chain. The increasing regionality of cement and clinker requires companies to think hard about their core competencies.

The answer for some companies may be to view themselves as marketers and distributors of cement rather than manufacturers. For others, it could be a large Asian "hub-and-spoke" model, with centralised regional clinker manufacturing combined with localised grinding and distribution.

Bulk up downstream

In developing markets, focus on infrastructure development, cities with traffic problems that necessitate onsite concrete mixing, and other drivers will create several interesting ways for cement players to undertake downstream activities, particularly in bulk. Companies should, therefore, be developing their bulk cement and downstream strategies that fill the gaps in meeting customers' needs, form closer relationships with end customers, and provide actionable growth platforms.

Improve market structure

Like many other capital-intensive industries, cement requires disciplined and structured markets to earn back the cost of capital.

Several Asian countries are in need of further consolidation to improve industry dynamics. Some players should be bold enough to take the lead in initiating consolidation and others bold enough to exit.

Innovate and disrupt

There is significant scope for cement players to innovate their manufacturing process. As an example, alternative fuels are only likely to grow in importance in coming years due to increasing restrictions on waste disposal, rising energy costs, and increasing demands for a greener product in some quarters. Management of the trade-off between alternative fuels as a source of energy versus as a revenue stream will be critical. The economics of who-pays-whom will be vital to value creation. The rest of Asia is a long way behind Japan in this field, but it could eventually catch up as the markets and models further mature.

New opportunities among the headwinds

Overall, greater regional integration and Chinese overcapacity are predicted to create headwinds for players in upstream capacity.

However, new opportunities will emerge downstream too, as markets, bulk channels and distribution models mature in Asia.

The region's infrastructure deficit could very well prove to be the incentive for change that developing countries in Asia are looking for. These winds of change could shape 2017 into another exciting year for Asian cement. ■

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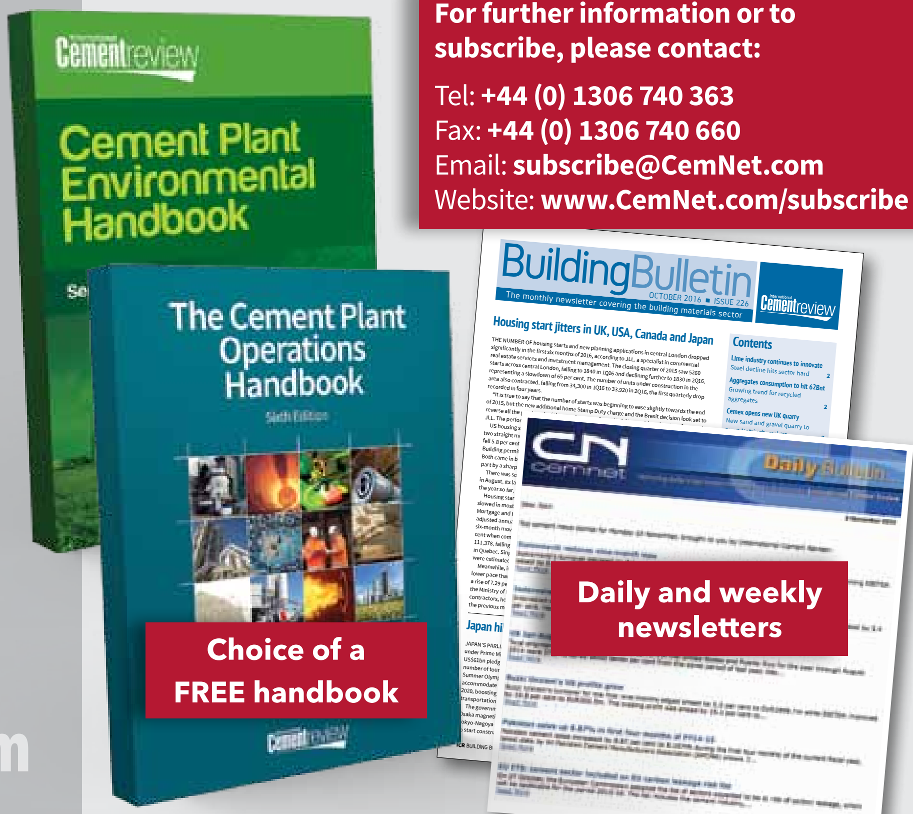

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