Malaysia - finding its resolve

Within southeast Asia, Malaysia represents one of the largest consumers of cement per capita. The lacklustre demand trends seen in the past 4-5 years were forecast to ameliorate in 2020 due to an influx of government-backed projects. However, as COVID-19 wreaks havoc on economies and industries, the impact on demand remains to be seen.

■ *by **Manas Tamotia**, LEK Consulting, Singapore*

Given that Malaysia's cement sector was showing a resolve to rationalise and yield long-term value, LEK Consulting provides a thorough assessment of historic trends and plausible predictions in light of COVID-19 disruptions and further political turmoil

Malaysia is divided into two parts – Peninsular Malaysia and East Malaysia in the northern part of the island of Borneo. Peninsular Malaysia comprises 13 states, which account for ~85 per cent of the country's GDP. These states operate as one cement market that is distinct from the cement markets of the Sabah and Sarawak states in East Malaysia.

Malaysia's per capita cement consumption of approximately 600kg is higher than that of developed economies such as the US and Australia, or even regional southeast Asian cement giants such as Vietnam and Thailand. As is the case in most developing nations, the demand drivers for the Malaysian cement sector can be linked to ongoing urbanisation and infrastructure development.

Since the late 1980s, the country had witnessed a spike in cement demand led by government initiatives to modernise infrastructure in rural areas and create free trade zones. Aside from a dip after the 1997 Asian financial crisis, the sector had benefitted from ever-increasing demand driven by both residential and infrastructural construction. Between 2010-15, cement consumption grew at a compound annual growth rate (CAGR) of six per cent.

Between 2010-15, Malaysia's residential and infrastructural construction sectors supported the growing cement demand

© Spencer White

However, since 2015, declining demand, political uncertainty and cement overcapacity have presented significant challenges to the country's cement industry

Supply rationalisation is hoped to bring price discipline to the market

Cement sector overcapacity

However, since 2015 the cement market has recorded diminishing demand as a result of an overall slowdown in economic growth to below five per cent per annum, reduced residential real estate activity due to prior overbuild and significant political uncertainty.

The declining demand trends since 2015 were met by rising industry capacity as major cement players like YTL, Hume Cement and CIMA added new production lines between 2010-15. Consequently, utilisation declined and led to a price war among cement manufacturers. Prices declined from over MYR280/t (US$65/t) in 2015 to MYR190/t in 2019. At these prices, most producers are barely breaking even and some are losing money.

COVID-19 disruption amid political turmoil

Participants in the value chain had looked towards 2020 with optimism – hoping that the Mahatir government, having securely been in power for a couple of years with a planned handover to a new leader, would result in a revival of megaprojects, which in turn would translate to growth in the construction sector and consequently in cement demand (see Figure 1). However, the COVID-19 outbreak and further political issues have had major ramifications for the industry.

The novel coronavirus pandemic has created a universal chasm – on either side of this rift are the realities before and after the outbreak. The Malaysian cement industry is not immune to this disruption. Pre-COVID-19 trends indicated that the construction sector would grow by about four per cent in 2020.

However, the post-outbreak market poses new realities with a complex set of challenges. There has not only been a slowdown in incremental demand but also a significant impact on existing projects. Efforts to stem infections led to the quarantining of foreign nationals that slowed down demand as many in the construction industry are foreign workers. The government's Movement Control Order (MCO) that closed down non-essential businesses also brought the entire construction industry to a virtual standstill. Many megaprojects such as the

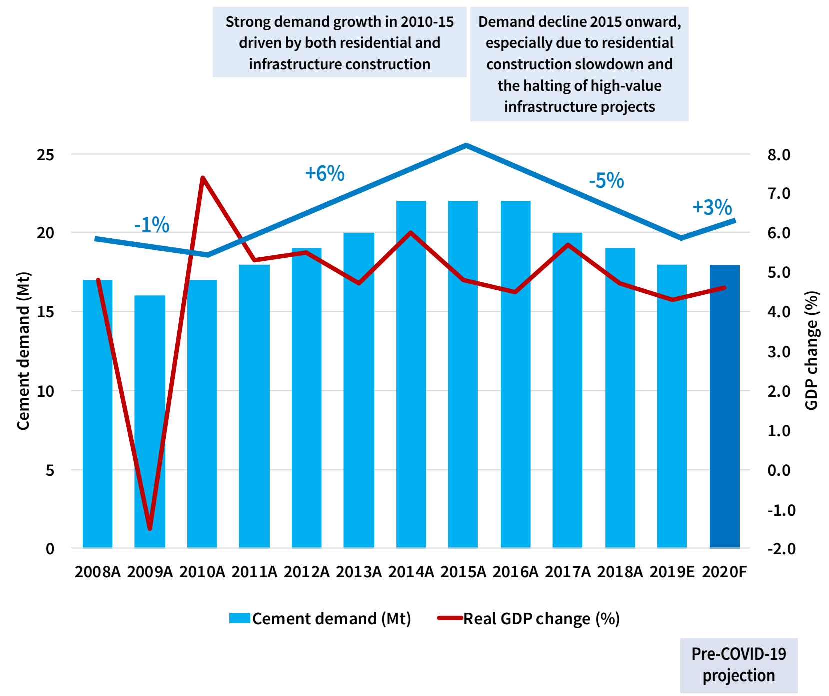
East Coast Rail Line (ECRL) are now at risk of severe delays. In addition, Malaysia is a main supplier of cement to Singapore, which itself is reeling from the pandemic, and therefore further reducing Malaysian cement demand.

The MCO has also meant that cement plants around the country ceased production since staff could not access the facilities. Moreover, the Malaysian cement industry is reliant upon imported coal, particularly from Indonesia, and thus exposed to the risks of continuing lockdown measures elsewhere even as its own MCO is lifted.

At the time of this major exogenous event, Malaysian politics added further uncertainty with the dissolution of the Mahatir Administration and the appointment of a new Prime Minister and an entire cabinet.

A silver lining offered by the COVID-19 crisis to the Malaysian cement sector could be perhaps a reduction in prices of raw materials, especially energy, in the medium-term, owing to a slowdown in global demand. The government's robust response to the pandemic via an emergency aid package could also support some demand bounce back. The change in government led by a much younger Prime Minister, Muhyiddin Yassin, could also drive a significant rebuild of the economy once the after-effects of the crisis subside.

Figure 1: cement demand, Peninsular Malaysia, 2008A-20F



Source: The Global Cement Report, World Bank, LEK research and analysis

Immediate-term cement demand scenarios

However, the magnitude of the viral impact remains to be seen. As industry participants look for a 'new normal' there are two immediate-term post-coronavirus demand scenarios:

- scenario 1: if real GDP growth is assumed to drop by two per cent in 2020 compared to the pre-COVID-19 forecast, there will be a 5-10 per cent decrease in cement demand
- scenario 2: if real GDP growth is assumed to drop by six per cent in 2020 compared to the pre-COVID-19 forecast, there will be a significant impact on demand – perhaps decreasing by more than 20 per cent.

The calm before the storm

Before the underlying fear of a downturn created by the volatile COVID-19 situation, the cement industry had been focussed on consolidation, optimising demand-supply dynamics and improving realised prices.

Until recently, the Malaysian cement industry in Peninsular Malaysia was led by five producers: Lafarge Malaysia, YTL Cement, CIMA, Hume Cement and Tasek Industries. In East Malaysia the key players are Cement Industries (Sabah) and Cement Manufacturers Sarawak. In 2019 YTL acquired LafargeHolcim's Malaysian unit (and subsequently renamed it Malayan Cement), rendering it a market share of more than 50 per cent. The combined entity now controls eight of the 12 cement plants in Peninsular Malaysia, giving it a capacity of roughly 18Mta. Significant operational, distribution and logistical synergies can be expected from this merger.

In addition, the industry witnessed further overhaul in its supply infrastructure, as several plants were mothballed in 2019. Even prior to the merger Lafarge, Tasek and CIMA had paused at least one production line each. Overall, the industry consolidation and supply rationalisation is hoped to bring price discipline to the market, which may provide much needed respite to the domestic manufacturers suffering from low profitability.

As the demand-supply balance rationalises, manufacturers have hoped for improvements in realised prices. However, recent efforts to increase cement prices have been met with public resistance. An attempted price hike of about 40 per cent was reversed after customers raised concerns and the intense media as well as political attention made the proposed increases untenable. The Cement and Concrete Association of Malaysia cited high operational costs in defence of the proposal and predicted an adverse impact on the country's macroeconomic conditions in light of the challenged profitability of cement producers. In pre-COVID-19 days, market participants were planning for a 10 per cent increase in cement prices in 2020 with the 4Q19 seeing some rises in bulk cement prices. However, pricing under COVID-19 conditions is further challenged.

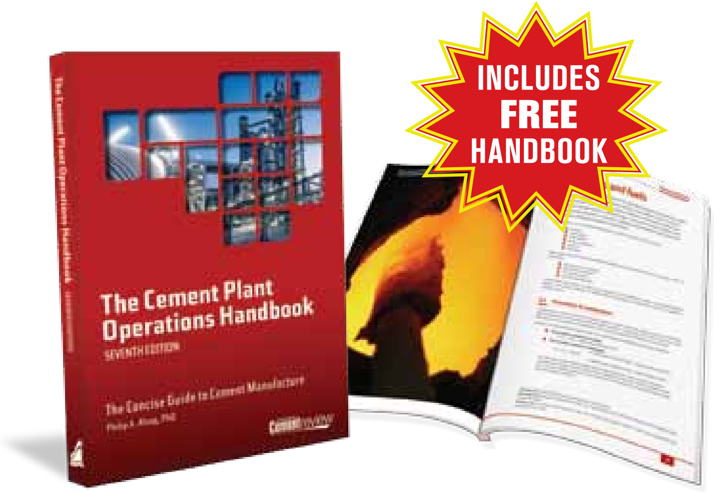
The road ahead

The Malaysian cement industry has had a difficult journey in recent years, from the growth spurt in the 1980s to becoming one of the world's largest cement consumers on a per capita basis. Going forward, the industry faces many challenges, such as an uncertain political situation, continued overcapacity and often ill-disciplined competition. Although recent consolidation and an emphasis on industry profitability will help, the wreckage of COVID-19 is yet to be fully realised and the resilience of the Malaysian cement industry will be tested further. ■

International Cement review

SUBSCRIPTIONS 2020

"DELIVERING BUSINESS INSIGHT, MARKET KNOWLEDGE AND TECHNICAL EXPERTISE TO THE GLOBAL CEMENT INDUSTRY"



SUBSCRIPTION PACKAGE INCLUDES:

- **MONTHLY MAGAZINE** – 12 issues of the cement industry's leading publication, delivered direct to your desk by First Class Airmail with early access to the digital magazine via CemNet.com.
- **FREE HANDBOOK** ***The Cement Plant Operations Handbook, 7th Edition*** (fully-revised and updated for 2019).
- **ICR SUBSCRIBER DISCOUNTS** on all other reference works published by ICR.
- **BUILDING BULLETIN NEWSLETTER** Monthly newsletter covering the latest developments in the building materials sector – complimentary to all ICR subscribers.

Subscriber access to CemNet.com

- **Read** ICR magazine anywhere, anytime
  Download the app to read ICR via Apple Store or Google Play
- **Search** the ICR archive of digital back issues
- **Access** premium articles
- **Watch** video presentations in high-definition

A COMBINED PRINT AND DIGITAL SUBSCRIPTION

Annual subscription to ICR
GBP 205 / USD 315 / EUR 260

Subscribe online at www.CemNet.com/subscribe

cemnet

www.CemNet.com

THE LEADING INDUSTRY WEBSITE