South Korea: new strategies

As South Korea's economy dips and government policies negatively influence infrastructure plans, the country's cement industry remains at overcapacity amid stagnant levels of demand. Moving forward, producers must find new strategies to operate competitively in this challenging market.

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With South Korean cement plants mainly located in the central and eastern coastal areas, cement producers face high distribution costs to deliver their product to high-demand centres such as Seoul

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Driven by innovation and technology, South Korea has transformed itself from an agrarian state devastated by war into the world's 12th largest economy.[1] Furthermore, despite being in one of the most heavily-militarised locations in the world, it is home to some of the globally-leading technology brands, such as Samsung, LG and Hyundai.

A series of historic events took place in 2018, with US and North Korean leadership meeting in June, followed by an agreement in September between North and South Korea to denuclearise the peninsula. But the year did end with Kim Jong-Un's threat to change direction once more if the US did not scale back sanctions.

However, despite its size, chief amongst South Korea's domestic issues is its struggling economy. The country reported one per cent QoQ growth in the 4Q18, but for 2018 as a whole, it recorded its slowest economic growth in six years at 2.7 per cent. While economic expansion is expected to recover to three per cent in 2019 and 2020, this will be achieved by government intervention in the shape of a large-scale fiscal stimulus.

South Korea has seen a slowdown in infrastructure construction

The USA has been an important destination for South Korean cement exports

SsangYong Cement, the country's largest producer, undertook cost reduction measures to weather the market downturn

Infrastructure slowdown

Demand for cement in South Korea has historically been driven by nation-building activities such as infrastructure and residential projects. However, this part of the market has weakened, as evidenced by job growth in the construction sector falling to 2.3 per cent in Jan-Oct 2018, compared with 6.3 per cent for the full-year 2017 period.[2] Further reports suggest that this will turn negative in 2019, as state investment is expected to decline by 2.3 per cent.

In particular, the country's housing market remains weak following the introduction of anti-speculative measures by the government. The measures saw higher property taxes for multiple home-owners, higher capital gains tax from property transactions and new levies to discourage the stockpiling of properties.

The higher taxes are one of the reasons that have been attributed to the soaring prices of properties in the country, with the price of apartments in the capital, Seoul, increasing 23 per cent to KRW716m (US$632,302) in the 12 months to September 2018. In the rest of the country, rates rose 12.5 per cent to KRW323m in the period.[3]

As South Korea has an export-driven economy, it also relies on overseas construction orders. However, in the 2016-17 period, the value of construction work completed internationally decreased 29.1 per cent compared to the previous year. In January 2019 the government announced plans to strengthen this weakening area. "The government will actively offer financial support for firms to significantly increase their orders for overseas construction and plants this year," said Finance Minister, Hong Nam-ki.

Meanwhile, a solution for the domestic industry may arrive in the form of government initiatives to develop land for the construction of 300,000 new homes in metropolitan areas and plans to relax restrictions to increase housing supplies in Seoul.

As part of this, recently-announced plans for Seoul include providing 80,000 units of public housing by 2020 through the acquisition of public land and idle lots, and by temporarily raising the maximum floor area ratio for commercial and semi-residential land for three years.[4]

Currently, residential and commercial developments represent between 34-40 per cent of cement demand, with infrastructure projects accounting for

History of demand

South Korea's cement consumption accelerated in the 1970s, driven by the launch of President Park Chung-Hee's New Village Movement. The programme was an infrastructure-driven step to improve the living conditions of the population, including the eradication of poverty.

Demand subsequently grew steadily and peaked at 62Mta in 1996-07 when it was hit by the economic chaos of the Asian Financial Crisis. Following this period, demand levels never again reached their previous high. Instead, they have fluctuated between 50-60Mta, supported by spurts of economic and social development generated by the 2002 FIFA World Cup and boosts in tourism.

Table 1: clinker capacity of South Korean producers

Company	Clinker capacity (Mta)
SsangYong Cement Co	15.33
Hanil Cement	13.99
Asia Cement Co	12.33
Sampyo Cement	10.05
Sungshin Cement Co	9.69

Source: The Global Cement Report, 12th Edition

another 16 per cent. However, as measures to stabilise the housing market cause a decline in residential construction orders, the cement industry is facing a flat period. Therefore, it is likely to experience overcapacity and low levels of demand.

Demand downturn

South Korea is a traditional cement market with ordinary Portland cement accounting for 80-85 per cent of total consumption primarily distributed in bulk.

Demand was largely concentrated in the northwest around Seoul but has slowly shifted over the last 10 years to other provinces such as Gyeongnam and Gyeongbuk. Meanwhile, other regions such as Chungnam and Busan are growing faster than the national average. Today Seoul consumes approximately 30 per cent of the country's total cement demand, compared to up to 40 per cent prior to 2010. This pattern of consumption is expected to remain the same in the near term.

Initial estimates for 2018 state that cement demand in the country reached 52Mt in 2018, with this expected to fall to 50Mt in 2019.[5] However, the thawing of relationships between North and South Korea may provide a much-needed boost to cement demand in the future. North Korea's inefficient plants have a limited production capacity, estimated at around 12Mta. Therefore, South Korea's significant overcapacity could easily support the additional requirements of its northern neighbour.

Solutions for oversupply

With no recorded additions of clinker or cement plants, the country's cement capacity has not increased in a decade. Clinker capacity has remained at 62Mta and cement capacity at 73Mta. This creates a sizeable and, as consumption decreases, widening demand-supply gap.

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Moreover, the country's cement industry faces additional challenges. South Korea's production facilities are located on the central and eastern coast of the peninsula, close to limestone sources. This causes a substantial cost to manufacturers when transporting cement to high demand areas such as Seoul. Including transport, the average production cost ranges from US$45-50/t.

Like much of the country's economy, the cement industry has been dominated by domestic players. Prior to 2015 the home market comprised eight large local companies, which together held a 90 per cent market share.

The tables have turned over the last five years, with a period of weak demand and poor visibility causing a degree of rationalisation within the industry. As such, following the collapse of Tongyang Group in 2013, Tongyang Cement & Energy was acquired by the Sampyo Group and renamed as Sampyo Cement in 2017. Furthermore, Baring Private Equity took control of Lafarge Halla Cement in 2017 and sold it to Asia Cement in 2018, while Hanil Cement acquired Hyundai Cement in 2017.

As a further response to the flat cement market, some producers have undertaken cost reduction strategies such as those

SsangYong Cement results

SsangYong Cement Group posted a 42.9 per cent YoY surge in revenue for the second quarter of 2018, rising to KRW415bn from KRW290bn a year earlier. The strong results for the year, disregarding the first quarter, were expected to secure a 4.5 per cent YoY increase in full-year revenue to KRW1,585bn.[6] However, despite the acquisition of Daehan Cement in 2017, the total revenue from the sale of cement in 2018 was expected to record a minor dip to KRW944bn from KRW946bn.

In the first and second quarters of 2018 SsangYong Cement Co posted a consistently-lower revenue, falling 16.1 per cent and five per cent YoY, respectively. In the full-year 2018, the company was forecast to show a 16.5 per cent decline in operating profit to KRW146bn.

However, Daehan Cement is showing the opposite trajectory. Forecasts suggest the company will post a revenue of KRW192bn in 2018, growing further to KRW211bn in 2019.

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employed by SsangYong Cement, the country's largest producer (see Table 1), at its Donghae plant in Gangwon Province. In September 2018 the company inaugurated the world's largest waste heat power generator (WHPG) in a cement plant, which is expected to reduce electricity costs by 30-35 per cent. The 43.5MWh WHPG represents an investment of KRW100bn and will save 280,000MWh of electricity. The WHPG consists of 11 boilers and turbines plus cooling towers, installed on six kilns.

Despite the lack of new domestic capacity, Asia Cement has built ready-mix concrete facilities in Vietnam and Cambodia to take advantage of the Indochinese region's positive construction outlook. The company also has additional plans to do the same in the Middle East. Furthermore, Korea's LG International, previously inactive in the local cement industry, began production at a cement facility in Myanmar in 2017.

Rising export market

To stay afloat amidst the stagnant domestic market, cement producers have pursued cement and clinker exports. The United States and Chile have historically been important destinations for cement, with the former sourcing 13 per cent of its cement and clinker imports from South Korea.

Elsewhere, the country was the leading exporter of clinker to Peru in 2018, making up a third of its total clinker imports of 0.78Mt. The Philippines is also increasing in importance in terms of South Korean export markets.

Prices

The national cement base price has been set at KRW75,000/t since 2014. However, market prices have remained well below KRW70,000/t, after rebates provided by producers. This year, rebates are expected to be phased out to insulate manufacturers from the impact of a fall in demand.

Outlook for 2019

With tempered demand and production overcapacity, South Korea's cement manufacturers are entering 2019 in a difficult position. On the positive side, there is a commitment from the government to get the economy moving again through increased spending. According to the OECD, South Korea's public expenditure will increase 9.7 per cent in 2019, taking it to the highest level since the global financial crisis in 2008.

However, this financial stimulus may not be as beneficial to the cement industry as previously hoped. Whereas many governments follow a similar pattern of expenditure that focusses on infrastructure projects such as bridges, roads, rail, ports or schools, President Moon Jae-in's will take a different approach. Instead, jobs are expected to be created by expanding the public sector to support the social safety net. Therefore, according to some reports, infrastructure expenditure in the budget may actually fall.[7]

As a result, the South Korean cement industry has not been provided with a great deal of visibility or security. The lack of a clear direction from the government means that producers will have to continue to rely on their own strategies to survive in the challenging market conditions. ■

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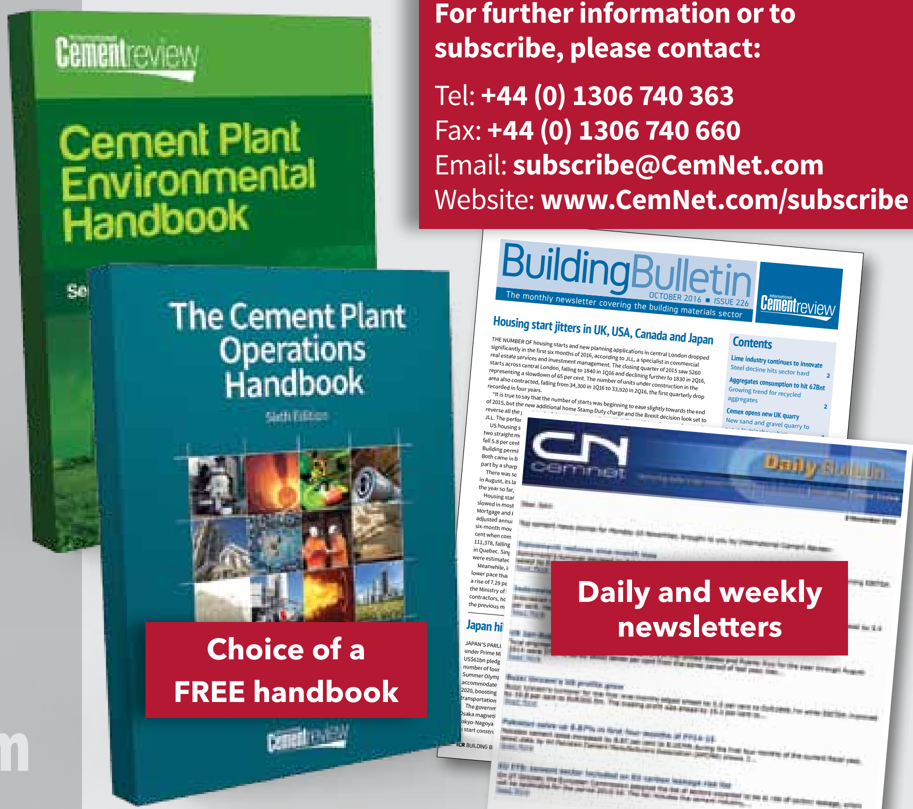

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