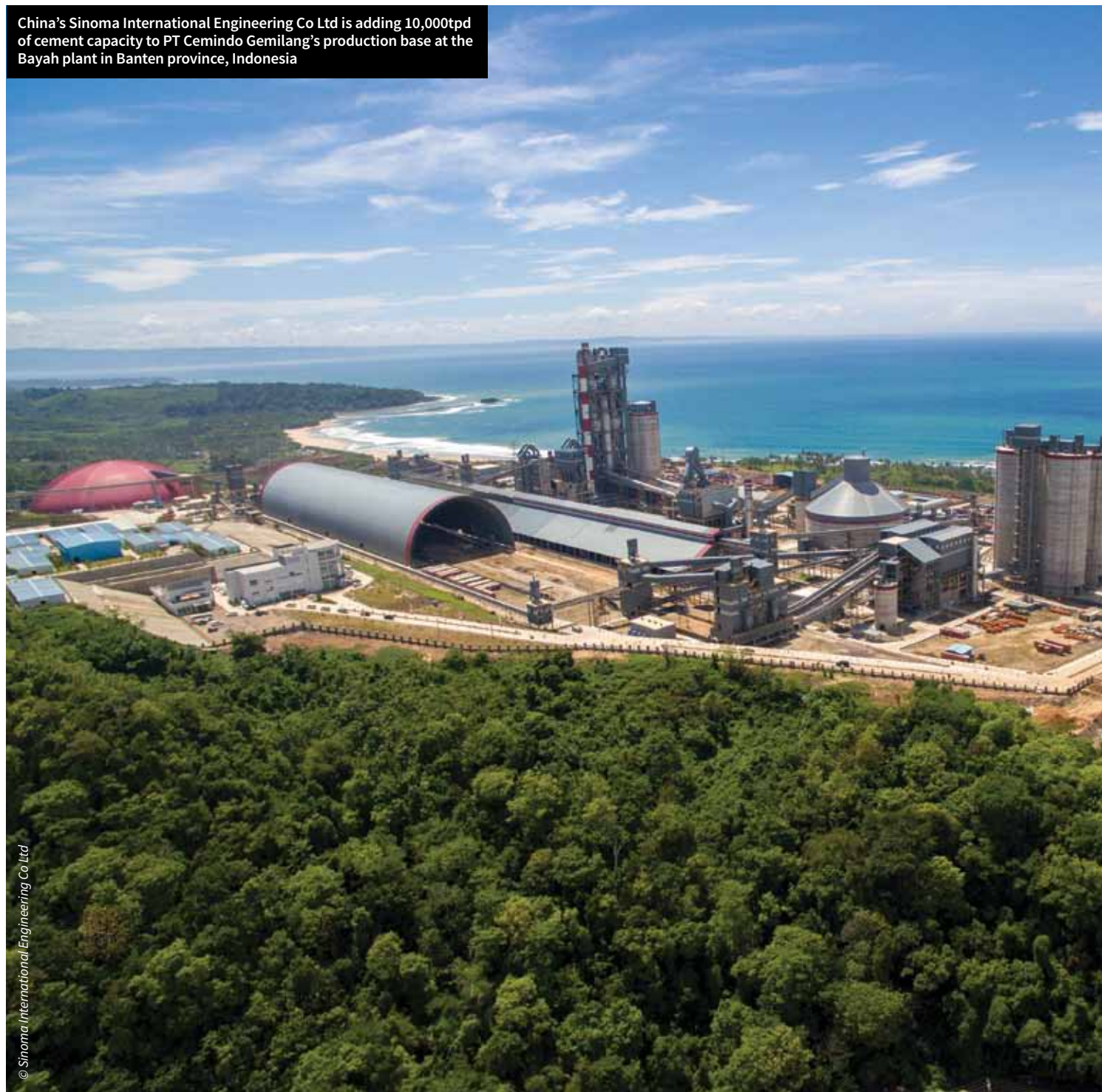


Southeast Asia: tough times – consolidation ahead?

As Western giants are exiting the southeast Asian cement market, a new wave of consolidation, this time by local companies, is taking place.

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

China's Sinoma International Engineering Co Ltd is adding 10,000tpd of cement capacity to PT Cemindo Gemilang's production base at the Bayah plant in Banten province, Indonesia



© Sinoma International Engineering Co Ltd

As inflexible Western giants continue to withdraw from their positions in southeast Asia, the region's cement market is experiencing the beginning of a likely wave of local consolidations, exploring cost-effective regional investment and agile, diverse revenue streams.

Surplus capacity and low prices

Surplus production capacity is continuing to place pressure on the cement industry across southeast Asia, with low market prices and profitability trending downwards. In 2017 LafargeHolcim's APAC

operating margin had declined to just 0.1 per cent, compared to 22 per cent in 2009, according to Thomson Reuters Eikon. With the exception of the Philippines (see box story), southeast Asian players are also experiencing slow growth in local demand (see Figure 1).

To counter this slow local growth, export markets, including the Philippines, Sri Lanka, Bangladesh and Australia have become more attractive to players in Indonesia and Vietnam, where capacity continues to increase. In 2018 Vietnam sent 20Mt of cement and clinker overseas.

Thailand, also considered an export powerhouse, exported 11Mt during the same period.

However, overall profitability remains a major concern without structural changes in the industry. The combination of under-utilised production capacity and relatively slow demand growth, which is predicted to persist into the early 2020s, requires considered investigation.

Local consolidation and the exit of Western giants

Following the Asian Financial Crisis in 1997 many Western players entered and thrived in a consolidating Asian concrete market, building their success on technical expertise and financial strength. However, more recently this competitiveness has eroded, leading to ongoing reports of Western divestment and local consolidations, marking the exit of the global cement giants from the Asian market.

LafargeHolcim's sale of its southeast Asian assets in Indonesia, the Philippines and Malaysia over 2018-19 is an exciting start to the new wave of consolidation predicted throughout the region.

Local conglomerates, including Siam Cement Group (Thailand), YTL Corp (Malaysia) and San Miguel Group (Philippines), with their vertically-integrated and diversified revenue streams have more nimble operations than the single-commodity model used by Western players. This has given local companies more success in dealing with unpredictable commodity and construction cycles, where Western companies have remained overexposed and overleveraged.

The last 20 years has seen the southeast Asian cement industry mature, particularly in terms of developing local technical expertise, and importing cost-effective expertise from Japan and China, allowing consolidation to occur with improved confidence.

Notable business activity in the last few years includes:

- In 2016 Cemex sold its Thai and Bangladeshi businesses to Siam City Cement.
- In 2018 HeidelbergCement, which owns around 57Mta of capacity in the region, publicly announced its strategy of "no new positions" in Asia.
- CRH has signalled the scaling down of its Asian ambitions in its 2018 financial reports, moving 'Asia' from a standalone unit into 'European Materials'.



The acquisition of Holcim Indonesia by Semen Indonesia marked the start of a wave of consolidation



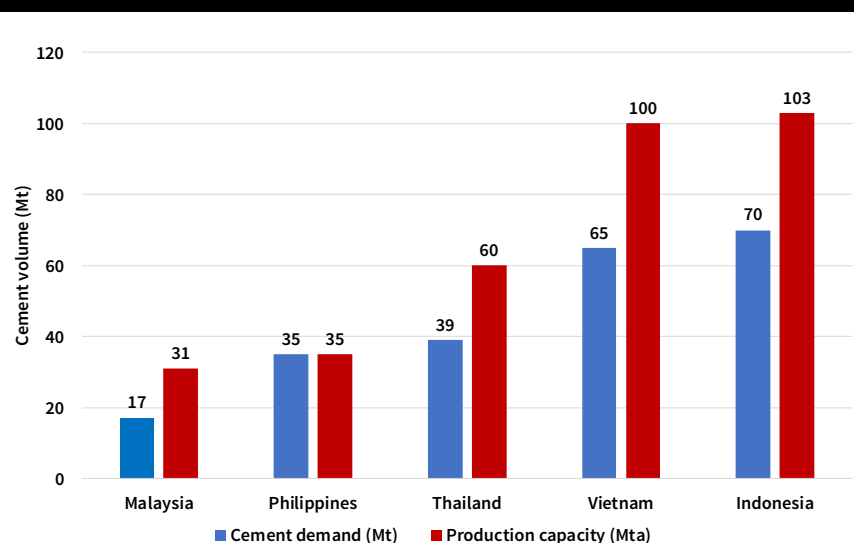
As Western cement producers exit the region, plant construction is increasingly undertaken by Chinese contractors such as Sinoma International Engineering Co Ltd



Siam City Cement Co recently acquired cement plants in Vietnam and Sri Lanka



Figure 1: domestic cement demand and production capacity in selected southeast Asian countries, 2018



Source: Siam Cement Group, LEK Consulting estimates

Rise of Thai and Chinese giants

With fewer Western players active in southeast Asia, Thai and Chinese cement giants have taken on vital roles within the industry, with activities ranging from technical manufacturing to sales and distribution, and acting as providers of capital.

Demonstrating the appetite for southeast Asian consolidation, Thailand's Siam City Cement has recently acquired LafargeHolcim's Vietnam and Sri Lanka businesses, while fellow Thai producer,

SCG, has been acquiring and building greenfield capacity across the region.

As Western companies recede, Chinese firms like Sinoma have undertaken expanding roles in equipment and plant development contracting, alongside greenfield investments, including Anhui Conch Cement's expansion into Indonesia.

Whereas European cement producers have traditionally relied upon European equipment suppliers and contractors, local producers are now working closely

“With fewer Western players active in southeast Asia, Thai and Chinese cement giants have taken on vital roles within the industry.”

with Chinese suppliers to deliver new production capacity. Importantly this shift has led to a significant reduction in costs, where an integrated cement plant built by a Chinese EPC contractor is estimated to be up to 25-30 per cent cheaper than an equivalent plant supplied according to European standards via a European equipment supplier.

Outlook for cement players

In the short-term, LEK Consulting predicts that the cement industry in most southeast Asian markets is likely to face continued challenges. However, there are key opportunities for players to make considered changes to operating models, maximising current and potential market environments.

LEK believes the winners will be those who are:

• Nimble

Players able to make swift capital expenditure decisions (from new lines



The rise of local conglomerates, including SCG, YTL and Eagle, has sparked a move towards diversified revenue streams, allowing for vertical integration and a more nimble operation than the single-commodity model used by Western players

and new grinding stations to packing and distribution) will have an edge in reacting quickly to changing market conditions and import situations.

- **Low cost**

In hypercompetitive micromarkets companies must offer a high degree of cost competitiveness in manufacturing alongside sales, marketing and distribution. All aspects are critical to maintaining share and profitability.

- **Able to price better**

More than just selling another bag of cement, companies should be leveraging high-quality analytical tools and big data to determine the needs of customer sub-segments and improve price outcomes.

- **Diversified**

To improve longer-term sustainability of profits, players will need to introduce value-added and solutions-driven product lines, looking beyond cement commodity sales to create multiple product offerings.

As is often the case in the cement industry, tough times call for rationalisation of production capacity, leading to shifts in ownership and industry consolidation. A new landscape is emerging in southeast Asia's cement sector. ■

Philippines: bucking the trend

The Philippines has been bucking the general trend of surplus capacity in light of current domestic demand, which has led to a robust growth in cement prices there.

The government's "Build, Build, Build" infrastructure

investment programme is providing confidence in the market. However, the swing towards imports to respond to growing demand has more recently resulted in a dampening of prices. Controversially, earlier this year the Philippine government imposed duties on cement imports, due to concerns on quality and in response to lobbying from local manufacturers.

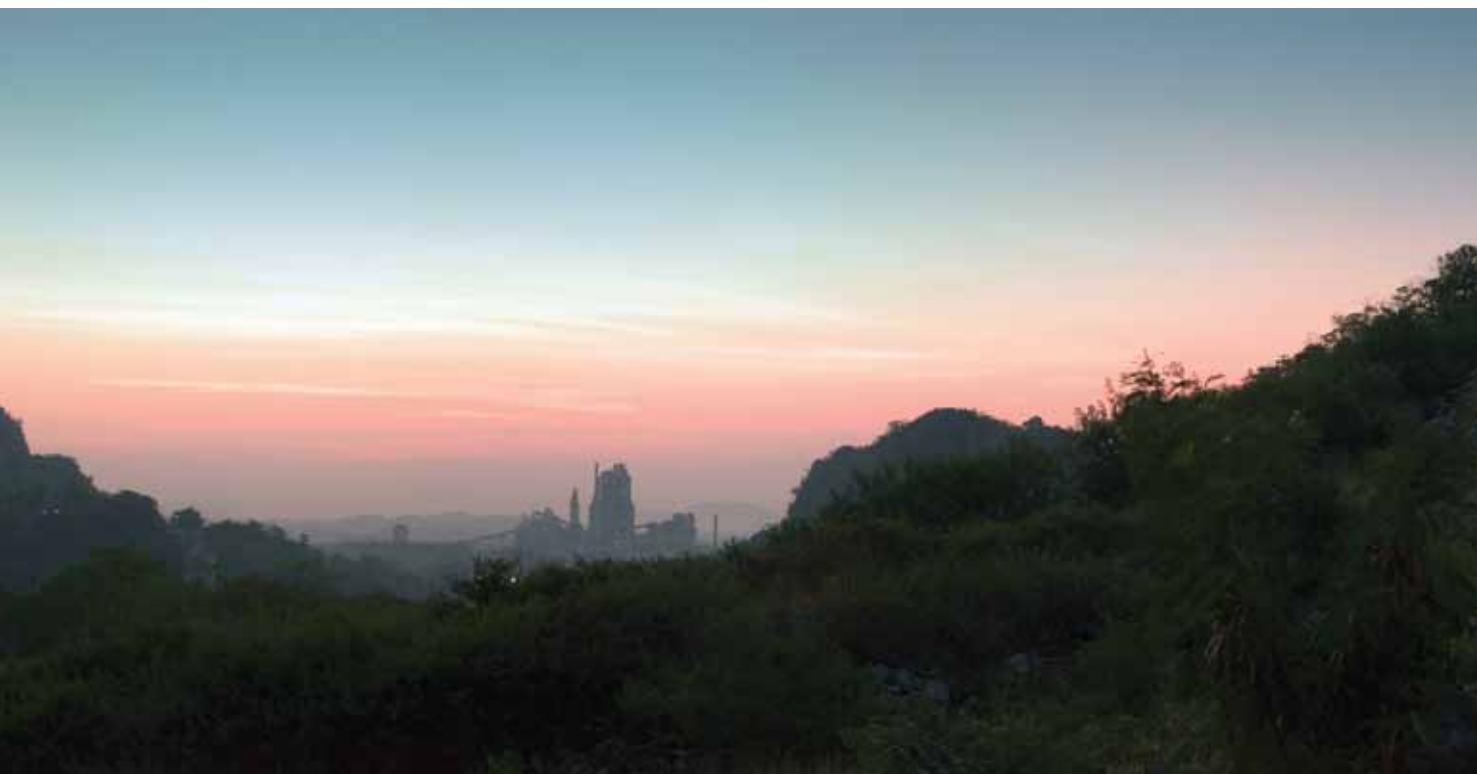
In 2016 the Philippines saw an approximately two per cent rise in retail prices and around three per cent for wholesale prices. As cement consumption in the country is in its early stages relative to other parts of the region (per capita cement consumption stands at 250kg – cf an ASEAN average of 425kg/capita), the country has experienced a strong appetite for growth, recording a 7-10 per cent annual expansion in the market in recent years. These increases have largely occurred within the context of a highly-disciplined industry where cement capacity is nearly fully utilised and demand is outstripping effective supply in the islands.

To account for the muted growth in local production, imports rose rapidly to nearly 30 per cent of demand in 2017.

The significant increase in imports has resulted in downward pressure on prices, clearly affecting manufacturer profitability, as seen through the decline of Holcim Philippines' EBITDA from 27 per cent in 2016 to 14 per cent in 2018. However, in the current context of import duties, there may be an opportunity for local firms to increase their supply capacity.



Holcim Philippines' Lugait plant



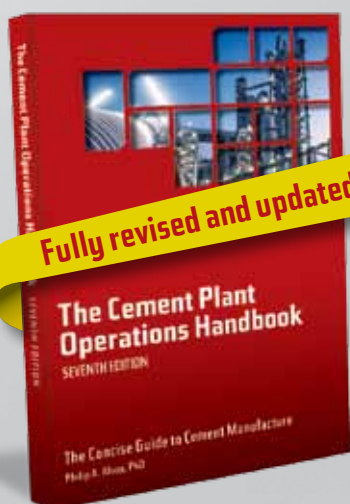
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