Research

Cracks loom for cement dealers

Covid-19 to stretch credit cycle, up working capital needs

Survey report | May 2020

Risks mount for the cement supply chain

Like all other sectors of the Indian economy, cement has been hit hard by the Covid-19 pandemic, and has seen the entire supply chain disrupted.

To gauge the impact, CRISIL Research conducted a survey of 100+ dealers across 13 states. Notably, trade channels account for ~60% of total annual sales of cement and are, therefore, a vital indicator of the sector's condition.

The findings indicate a stretched credit cycle, which will elevate their working capital levels.

Key takeaways from the survey

- Almost all the dealers foresee 10-30% drop in demand in fiscal 2021 due to delay/freeze in construction activity
- More than 60% respondents have a minimal inventory of 2-4-days, but spoilage is a concern nonetheless
- The dealers' credit cycle is likely to get stretched from 4 weeks to 8 weeks over the next 2-3 quarters
- Working capital requirement is expected to increase 12-17% in a best case scenario, assuming dealers are able to limit operational expenditure, reduce credit sales and infuse additional capital in their business. A probable risk of retailers defaulting on payment dues will aggravate the financial pain
- Traders are hoping for manufacturers' support in terms of better margins (higher incentives)
- Chances of swift resumption to normalcy post the unlocking look bleak because of delay in return of migrant workers and resumption in freight operations
- Urban centres are likely to fare worse than rural ones given higher dependence on migrant labourer

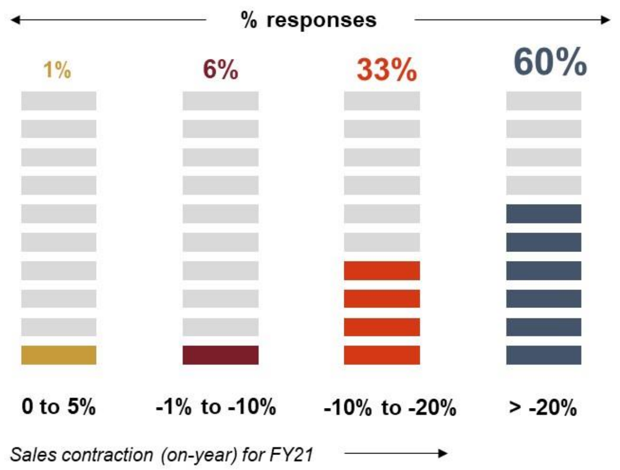
Dealers expect sales volume to decline more than 20% on-year in fiscal 2021

In fiscal 2021, more than half the dealers expect sales to decline more than 20% in a base case scenario, which assumes lockdown relaxation in May. An extension will result in further downside.

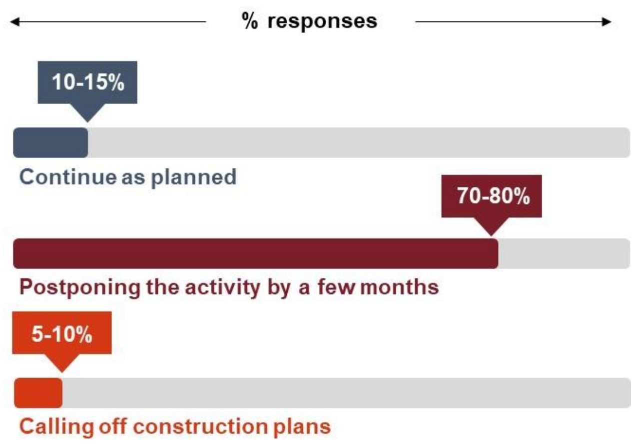
The main reason is delay in construction by individual home builders (IHB) -- who account for 60-70% of sales in rural areas and 40-50% of sales in urban centres -- and small real estate developers. For them, labour shortage and the resultant wage hike are key monitorables.

The delay could be anywhere between 4 and 6 months depending on how the lockdown pans out. We expect 5-10% of end-users to actually call off their plans due to the gloomy business/ income outlook.

Impact on dealers' annual volumes (fiscal 2021)



Impact on IHB construction

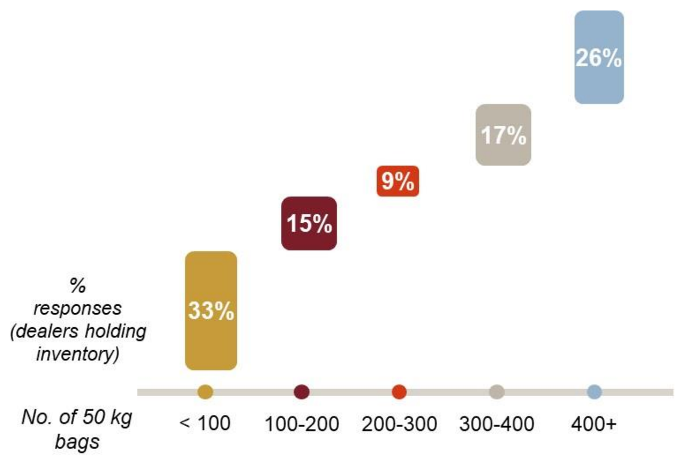


In contrast, affluent end users are likely to continue with planned activity.

Low inventory is a positive, but spoilage is a concern

Incidentally, 61% of the dealers have a small inventory of 2-4 days, which they hope to sell as the lockdown eases. Of these, nearly 26%, holding 400+ bags, plan to offer discounts to avoid spoilage, or they will have to incur the cost.

Cement inventory held by dealers



"We expect manufacturers to support us on inventory liquidation and address concerns on spoilage,"

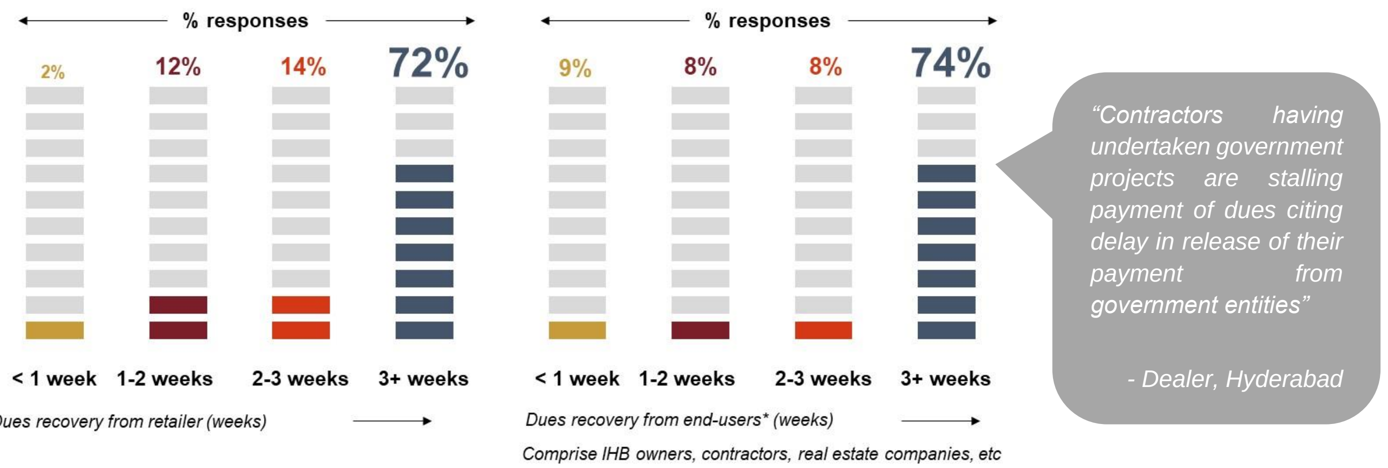
"Retailers holding cement inventory are at the highest risk of spoilage due to inadequate storage facilities"

As per our findings, 39% dealers are immune to liquidation and spoilage concerns as they do not have any inventory.

Dues recovery a major obstacle for managing cash flows

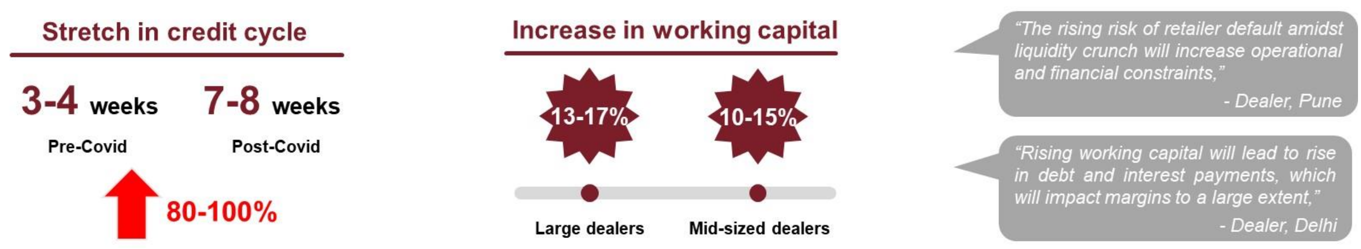
Dealers (95% of the respondents) typically offer credit to retailers and key end-users such as contractors and small real estate companies. Recovery of outstanding dues has become a huge challenge as small retailers are reeling under liquidity crunch amid dwindling demand, and inventory spoilage and backlog.

Delay envisaged in recovery of dues after the usual credit period of 4 weeks



The credit cycle is likely to get stretched from 4 weeks to 8 weeks for the next 2-3 quarters of this fiscal. About 70% of the dealers surveyed confirmed that most customers (especially contractors) might also delay the release of payment. Resultantly, we expect large and mid-sized dealers to see a hike in working capital requirement of 13-17% and 10-15%, respectively.

Stretch in credit cycle increases working capital requirement



Dealers expect the working capital cycle to improve in the second half of fiscal 2021 as demand picks up and receivables decline gradually. Once normalcy returns, they plan to reduce credit exposure, infuse additional capital and curb non-requisite expenditure to limit increase in working capital requirement. The collateral-free MSME loans announced by the government on Wednesday will come as a big relief, since it will help cement dealers access working capital debt.

Against a gloomy backdrop, dealers plan to undertake the following measures to manage working capital.

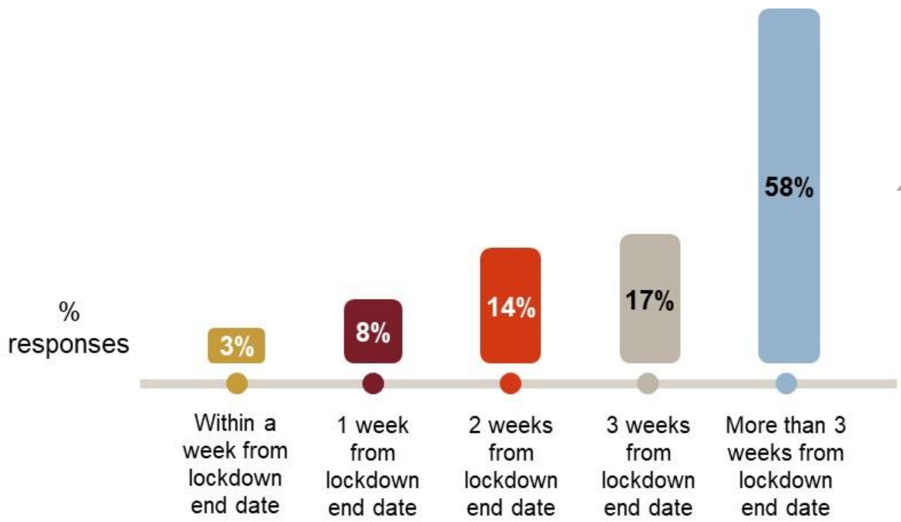
Attributes	Large dealer		Mid-sized dealer		
	Pre-Covid	Post-Covid	Pre-Covid	Post-Covid	
Monthly sales (tonne)	**1,300-1,500**	**1,100-1,200**	**400-500**	**300-400**	20% volume decline, on average, for fiscal 2021 has been considered
1. Limiting expenditure (Rs/ month)					
Rentals	65,000-75,000	65,000-75,000	25,000-35,000	25,000-35,000	Rentals unlikely to be impacted
Employee cost	40,000-50,000	*25,000-35,000*	10,000-20,000	10,000-20,000	Large dealers have the leeway to cut down employee expense
Miscellaneous expenses*	35,000-45,000	*20,000-30,000*	10,000-15,000	7,000-10,000	Dealers plan to limit non-requisite miscellaneous expenditure
Total cost	1.4-1.7 lakh	1.1-1.4 lakh	45,000-70,000	40,000-60,000	
Cost saving potential (%)	**15-20%**		**7-12%**		Possibility of reduction in employee cost for large dealers provides better cushioning
2. Capital infusion	**X**	**1.2X**	**Y**	**1.2Y**	Dealers to infuse capital to limit increase in working capital loans
3. Reducing risk by limiting the share of credit sales	**65-75%**	**50-60%**	**55-65%**	**40-50%**	Limiting credit exposure to trustworthy retailers to manage working capital and minimise the risk of bad debt

**Includes electricity bills, phone bills, maintenance, travel expenses, etc*

3+ weeks likely for businesses to normalise post lockdown

About 58% of the respondents believe it will take more than 3 weeks for operations to return to normalcy once lockdown is eased, factoring the return of migrant workers, regular freight operations, and restoration of consumer confidence. Having said that, the government's plan on phased unlocking is still being debated.

Resumption of normal operations



"Even after the lockdown ends, things will move towards normalcy at a very gradual pace. Allowing inter-state transportation for migrant workforce to return to work will play a key role"

- Dealer, Mumbai

Recovery in urban areas to take longer due to higher dependence on migrant workers

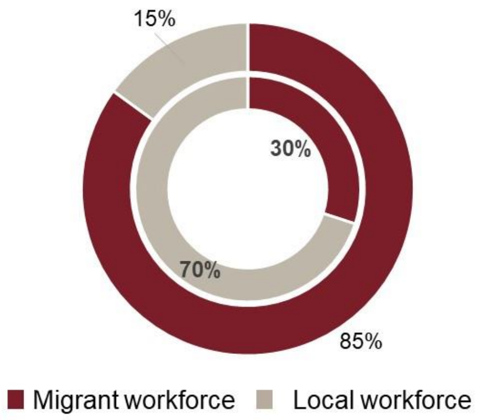
Rural areas, where engagement of migrant labourers is just 30% compared with 80-85% for urban regions, are expected to see quicker resumption in construction activities.

The perceived duration of 3 weeks for return of migrant labourers is expected to limit further upside in construction activity. Owing to labour shortage, 60% of the locations polled reported an increase in daily wages, increasing the construction cost. This could potentially discourage new projects.

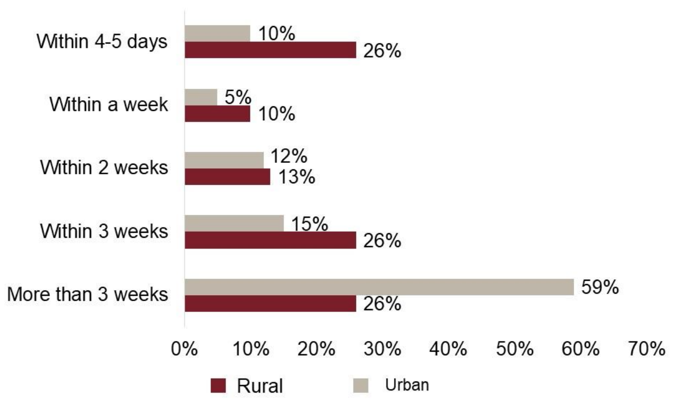
On a positive note, migration of labourers to their hometowns/ villages will boost pre-monsoon kharif sowing.

A few dealers, though, are optimistic that labourers would return swiftly to capitalise on pent-up demand and halted construction activity as they have not been able to earn wages for nearly 2 months.

Share of local and migrant workers in rural (inset) and urban areas



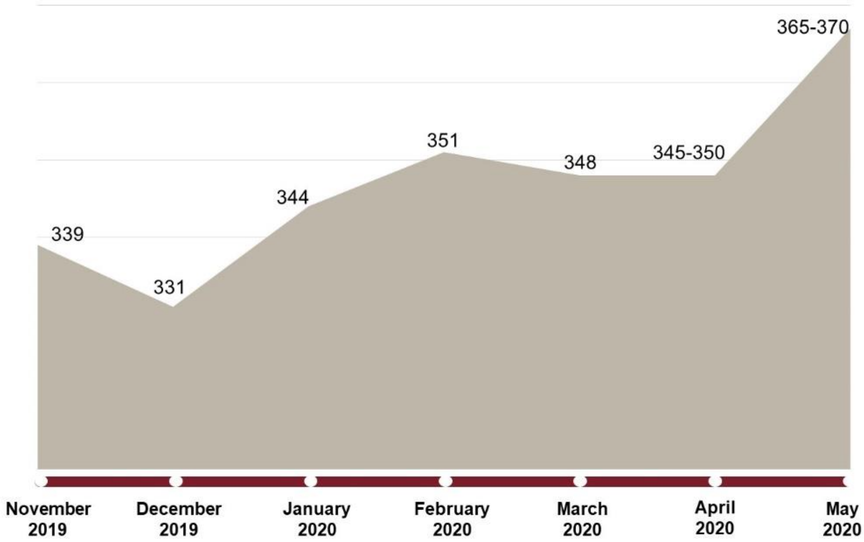
Expectation on migrant labourers returning to workplace



A temporary upswing in cost might delay construction activities further

Lastly, over 90% of the dealers highlighted that logistics and handling costs are slated to rise 20-30% post lockdown as social distancing norms will stretch delivery schedules.

Cement trade prices (average) in Rs/ 50 kg bag



Prices remained stable in April owing to lockdown-led supply restrictions

As markets reopen in the second half of May, cement prices are expected to jump Rs 15-20/ bag initially due to supply constraints

However, over the medium term, we expect price hike to be rolled back due to lack of demand pick-up and rising competition

Please Note: The above prices are average Category-A retail prices for key cities covered for the survey viz. Kolkata, Patna, Ahmedabad, Mumbai, Pune, Jaipur and Delhi

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