CemBR' views on:

The departure of major cement companies from developing markets

Case study:

Holcim Indian Disposal

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INTRODUCTION

There has been a spate of cement asset disposals by major cement companies in developing markets in the last few years. Such transactions include Holcim disposal of its entire Indonesian cement base, CRH exiting Brazil, and Holcim abandoning Malaysia. In addition to these significant transactions, many major cement companies have undertaken sales of assets across the board, but mainly in developing markets.

The unsuccessful disposals of Holcim Philippines and CRH Philippines are also examples of this trend.

It appears that nothing is safe in developing markets. "There are no sacred cows. Everything is on the table" was what the CEO of HeidelbergCement said to analysts at the beginning of 2021.

This is rather surprising. These are the same companies that touted global consolidation as a panacea to all the sector ills not too many years ago. After a bout of what many describe a "cannibalistic" behaviour in the last fifteen to twenty years when Lafarge acquired Blue Circle Industries plc., CEMEX acquired RMC plc., Holcim acquired Aggregate Industries plc., Heidelberg

acquired Hanson plc., Lafarge and Holcim merged, CRH acquired the disposed assets stemming from LafargeHolcim's merger, and Heidelberg acquired Italcementi, (to mention the large ones) there is now a distinct reversal of that theme.

BUT WHY?

Firstly, let us review the reasons behind the push for global consolidation. There were two main themes supporting the global consolidation push. The first was the strong belief that geographical diversification, particularly in developing markets where cyclicality was not then an issue, would protect the majors from the notorious cyclical behaviour of developed markets. The second assumed that developing markets will only experience growth going forward whilst lacking any meaningful presence of indigenous players.

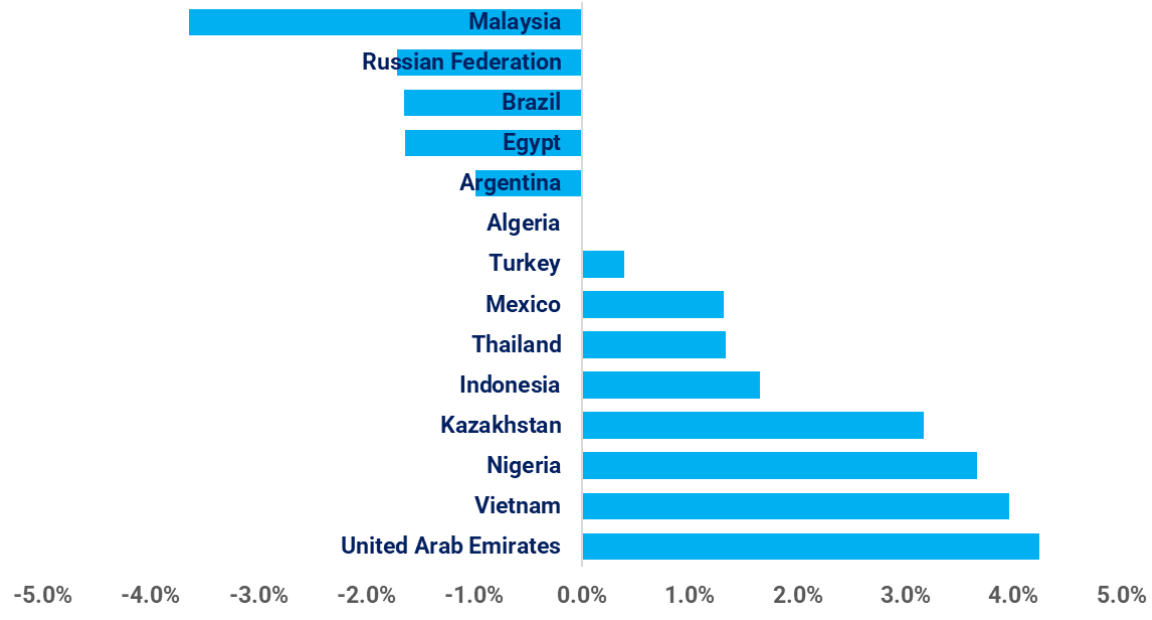
So, via the above-mentioned mega-mergers, the acquiror satisfied both the above considerations. For completeness's sake, one should perhaps mention "synergies" as an auxiliary reason for subsuming a major competitor, a reason used by most participants in the mega-merger period.

WHAT HAS CHANGED?

However, the two reasons upon which global consolidation was based were never tested before. By now we know that even developing markets have shown cyclical behaviour plus and more importantly, the surge in indigenous players' new investments flooded many a market with high quality cement assets. So, although growth may have been good in certain markets, for e.g., India's consumption grew from around 220 million tonnes to over 335 million tonnes between 2011 and 2019, the new capacity additions created unfavourable supply-demand profiles. In addition, most developing markets, mainly because of new entrants, have become fragmented further increasing competitive pressures.

If we throw into the mix that in the last decade, we have seen subdued or negative growth in many a developing market, the reasons behind global consolidation appear now questionable.

Figure: Large developing markets 2012-2020 CAGR (cement consumption)



Clearly, 2021 was a better year in many of these markets, but the cyclical behaviour of developing markets has been confirmed in the last decade.

In short, the fact that developing markets can be cyclical, and that indigenous players have invested heavily in cement assets exacerbating the supply-demand imbalance and increasing fragmentation, plus finally the by now obvious absence of synergies have shed a light into the global consolidation fallacy.

IS THERE ANOTHER REASON FOR ABANDONING EMERGING MARKETS?

It has been widely reported that major cement companies may seek to unburden themselves from the heavy carbon weight that developing markets carry. And this may be why they divest those assets. This will be reviewed later in this article. But let us first take a closer look into the Holcim Indian assets disposal.

HOLCIM INDIAN DISPOSAL

THIS IS NOT A TWEAK

The Holcim Indian disposal is a major divestment. It is not an attempt to tweak the asset base or get rid of some unattractive operations. Holcim is exiting India altogether where the company has a nationwide footprint, after close to twenty years presence in the country. Coupled with the recent disposals of Malaysia and Indonesia, and the unsuccessful exit from the Philippines there is an indication that Holcim is attempting to exit a whole continent, not merely a market.

Figure: Holcim assets in India

NUMBER OF	CEMENT PLANTS	INTEGRATED PLANTS	GRINDING PLANTS
Ambuja	14	6	8
ACC	17	11	6

M/T	TOTAL CEMENT CAPACITY	CEMENT CAPACITY - INTEGRATED	CEMENT CAPACITY - GRINDING	CLINKER CAPACITY
Ambuja	31.5	18.5	13.0	19.8
ACC	34.9	25.4	9.5	20.9

Source: CGC™

It is also reported that the deal includes some 78 ready-mix concrete plants as well.

WAS THE GROWTH BAD?

India was doing quite well until the onset of the pandemic in 2020. From 2010 to 2019, the market grew by a CAGR of 5.5%. In 2020 the market experienced a whopping 14.4% decline due to the pandemic, driving the 2010-2020 CAGR to around 3.3%. The expectation is that the market will have recovered strongly in 2021.

So, the market's growth path, although not as strong as in the previous decade was reasonable in India. However, the industry also experienced a supply growth of around 5% CAGR between 2010 and 2020. As a result, at the end of 2020 the industry found itself in an overcapacity situation. Furthermore, the Consolidation Index in the market stood at around 820 (lower 0 – perfect competition, higher 10,000 – monopoly), which indicates that the industry is highly fragmented.

WHAT ABOUT THE PRICE?

This is not a detailed analysis of the transaction, merely we are trying to establish some metrics as to what kind of price was paid for the Holcim Indian assets.

Firstly, the value of the transaction from the Holcim announcement indicates that Holcim's stake in the combined business is valued at 6.4 billion SF (close to US$ 6.6 billion). Assuming that there is no debt associated with this value then the buyer acquires the business on the following multiples:

Per tonne of cement capacity	Per tonne of clinker capacity
US$ 203 million	US$ 330 million

Source: Holcim Announcement, CemBR analysis

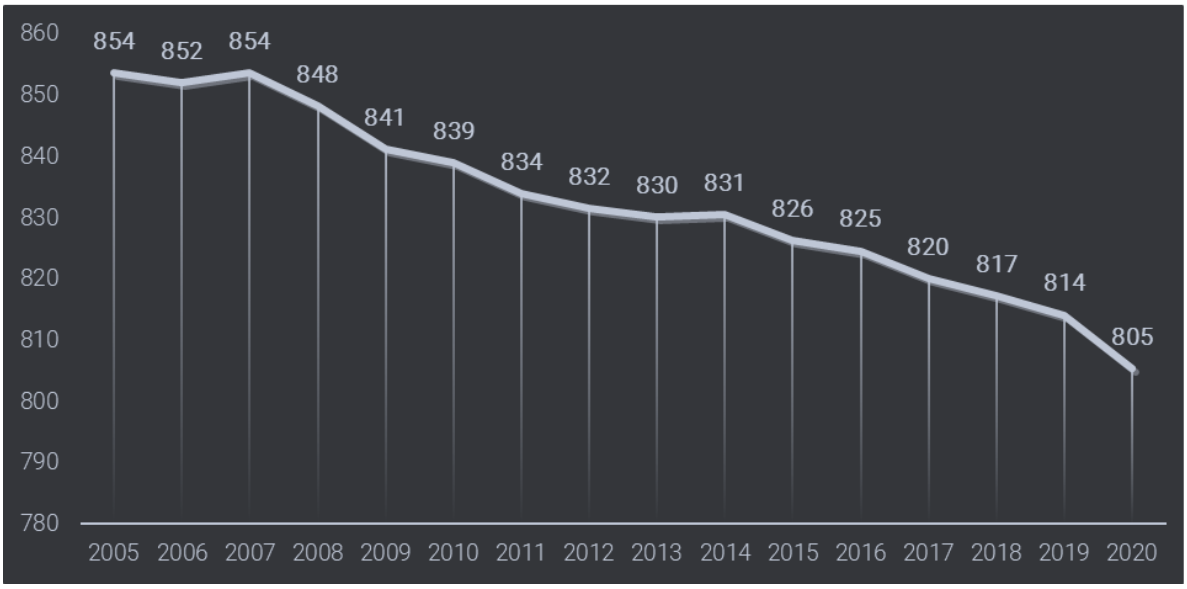
Although CemBR cannot comment on the valuation of this business, the per tonne of clinker price is above replacement costs. Also, bearing in mind that out of the 31 cement plants, 14 are grinding units the price per tonne of cement also appears to be above replacement costs.

What is also noteworthy is the absence of any other major cement producer from the list of interested parties for this disposal. We now know that Holcim has secured a deal with the Adani Group, an Indian conglomerate.

WHAT ABOUT CARBON?

In CemBR's recent report on the EU ETS & Cement, we have presented the historical performance of all scheme plants in Europe.

FIGURE: LONG-TERM EVOLUTION OF KG OF CO_2/T OF CLINKER (EU ETS)



NB: Note that this is a European average and not an average of all the major cement producers operating in Europe i.e., it includes all clinker producing plants (majors and others). The precise performance of each plant is detailed in CemBR's report on EU ETS & Cement.

So, since the inception of the scheme, the European cement industry managed to reduce the emission per tonne of clinker by a mere 0.4% CAGR. In 2020, despite a significant usage of alternatives the industry still only managed an 805 Kg of CO2 per tonne of clinker. This, by many industry observers, is not considered as a stellar performance.

Could cement plants in India or Southeast Asia or other developing markets be able to produce clinker at 800 Kg of carbon? CemBR believes that many of them could, particularly in Southeast Asia where over 95% of installed capacity has precalciners (hence able to utilise alternative fuels).

It is therefore debatable as to whether the majors (particularly those who have a strong presence in the EU ETS scheme) can use carbon as the main reason for exiting developing markets.

THE CONCLUSIONS

Apart from the price, the clues given above as to why major cement producers exit developing markets can be summarised as follows:

- Emergence of new local entrants with brand new technology assets
- Emerging markets exhibit cyclical behaviour
- Supply – demand balances have become unfavourable

- Apparent inability of majors to compete effectively with the locals – particularly new entrants with new assets
- Most such markets are highly fragmented increasing competition and price pressures

Our view is that the above reasons are behind most of the recent disposals of developing markets' assets by major cement companies.

CemBR's opinion is that carbon as applied to the departure from developing markets is an excuse at best or another misguided trend (much like global consolidation) at worst. After all, if a major cement company wishes to achieve their ambitious carbon targets by abandoning the cement sector, they may do so. Whether this is a good or bad idea is for their shareholders to decide.

We at CemBR, being a cement only organisation, consider reducing the carbon emissions per tonne of clinker (or carbon emissions per tonne of cementitious materials) the only logical way of addressing the carbon issue in our industry.

All data and insights based on: CGC™, and CemBR's report on EU ETS & Cement.