

## Outlook for cement industry remain stable amid the pandemic

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### Industry outlook

PEFINDO views the outlook of the national cement industry in 2021 as stable. We expect the industry performance will be somewhat better than 2020, but will not return to the pre-pandemic level, assuming the national macroeconomic growth is expected to recover to the positive level, the infrastructure budget to jump by 48% in 2021 to IDR417.8 trillion from IDR281.0 trillion in 2020, and the BI rate to remain low at 3.5%. However, those positive catalysts might be hampered by the massive of the Covid-19 daily cases, particularly after the Eid Al-Fitr (Lebaran) holiday, and the emergence of new Covid variants that may weaken the economic recovery triggered by the reallocation of the infrastructure budget for the containment of the Covid-19.

In the near term, we expect the growth of the demand for cement will be driven from the more-resilient and diversified retail segment. In the first quarter of 2021, the national demand for cement grew by 2.0% year on year (YoY), after a contraction of 10% YoY in 2020, prompted by the growth in the retail segment of 7%. It reflects an increase in house renovation activities following macroeconomic improvements during the first quarter of 2021.

On the other hand, the demand from the bulk segment has remained contracted by 14% in the first quarter of 2021, as the government budget absorption slowed down in the first semester. The demand from this segment is highly dependent on property and infrastructure industries, which we view the outlook as remaining challenging during 2021. The implementation of Emergency Enforcement of Restrictions on Public Activities (PPKM Darurat) in the Java-Bali area may weaken economic activities, hence dampening demand for cement. Furthermore, the massive daily Covid-19 cases could trigger the reallocation of the infrastructure budget to the health sector as was the case in 2020, thereby curtailing the demand for the bulk cement during 2021.

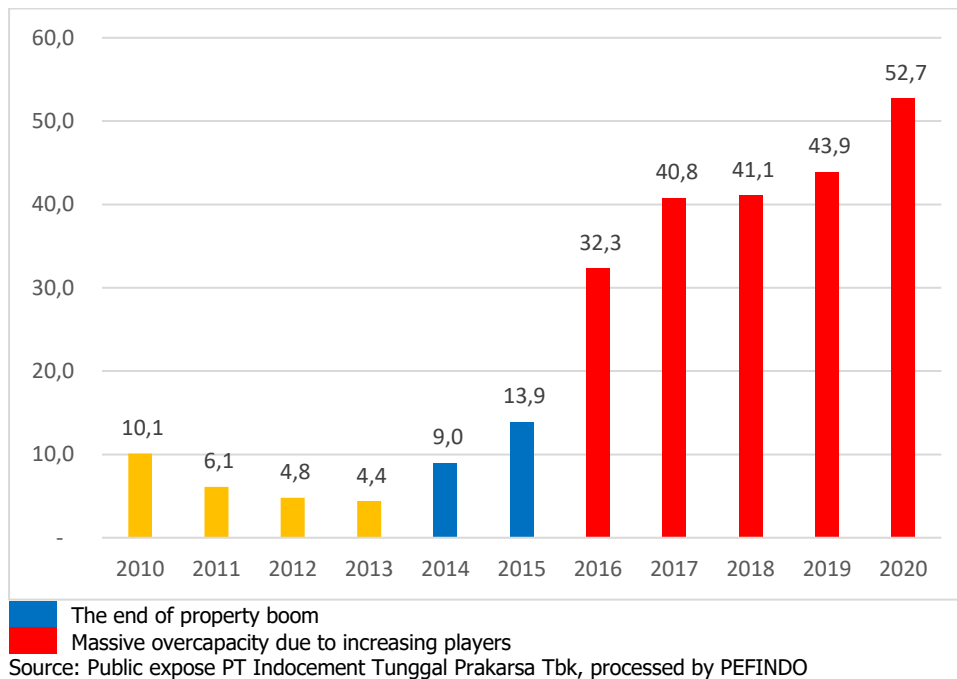
In the medium to long term, we expect the outlook of the cement industry to be stable, arising from the demographic bonus with a total population of around 270 million people in 2020. In 2020, Indonesia's cement consumption per capita was approximately 230 kg, well below those in the neighboring countries, such as Singapore (more than 750 kg), Malaysia (more than 600 kg), and Thailand (more than 400 kg). It reflects ample room for the cement industry to grow, bolstered by the acceleration of the infrastructure development, which will create the multiplier effect on the economy.

### Oversupply as the main concern

PEFINDO views the cement industry outlook as being overshadowed by oversupply in the near to medium term. Such a condition is expected to be further exacerbated by the entry of two new players in 2020, which will intensify competition in the Java market, particularly East Java and Central Java. Those two players are PT Semen Grobogan and PT Semen Imasco Asiatic Raya (Semen Singa Marah), with an annual capacity of 1.5 million tons each. Accordingly, the national excess capacity hit the highest level during last 25 years at 52.7 million tons in 2020.

Against the background of massive infrastructure budget allocation during the Joko Widodo administration, property boom in 2009-2013, and Indonesia's high housing backlog, many players were attracted to enter the market, especially from overseas with abundant capital, hence substantially raising the national production capacity. Conversely, the property boom era ceased in 2014, while the national production capacity almost doubled, resulting in a soaring oversupply since 2016. PEFINDO expects that in the near to medium term, the national supply will increase by around 2.0 million tons, widening the excess supply. It will remain the industry's main concern in the near to medium term.

Table 1. The national excess capacity during last 10 years (2010-2020) in million tons



### Seeking new opportunity in export market

The sizable excess supply amid the weak demand in the domestic market during the pandemic has prompted cement players to shift their business to the export market to maintain its utilization rate at an optimum level. At the end of 2020 and the first four months of 2021, cement export increased by more than 50% and 100%, respectively. The main markets are countries with the absence or limited natural resources in the form of limestone, such as Bangladesh, China, Australia, Filipina, Peru dan several other countries in Africa. Going forward, we view that the players will keep exporting the cement in the form of a clinker until the national demand recovers.

### Intense competition

Given the numerous players in Indonesia, competition in the cement industry is intense, leading to a price war among players either to maintain or expand market shares. In 2020, the national selling price in the retail market declined by around 2%. Players with a relatively small market share experienced the sharpest decline at below than 3%. Going forward, we expect the national cement selling price to remain low, but less volatile. Following the industry consolidation in late 2018, we expect that the two largest players, PT Semen Indonesia Tbk (SMGR) and PT Indocement Tunggak Perkasa Tbk (INTP), commanding the domestic market share of above 70%, managed to stabilize the industry's selling price and profitability. In addition, the existence of the Business Competitive Supervisory Commission (KPPU), is expected to help mitigate the predatory pricing strategy that may hurt the other players. We expect that the competition climate among players will be fairer going forward.

### High barrier to entry

We are of the view that the barriers to entry in the cement industry are high. The construction of a cement facility calls for a large capital outlay and takes two years to complete, including a trial run prior to commercial operation. The investment includes the cost of mining permits, machinery, and supporting infrastructure. In addition, the players are required to control the logistics in its market, considering the industry is a regional business, and cement has a relatively short life production. The players focus on core and domestic markets, which generate higher margins, given the lower transportation costs.

Currently, given an oversupply in the domestic market, we hope the Government to conduct a moratorium on construction permits of new plants, especially for the new players. We view it as helping reduce the oversupply and rebalance the supply and demand in the medium to long term. However, up to now, we have not seen any indication of whether such a moratorium will be approved by the Government. Our main concern is the mounting of excess supply in several areas, especially in Java where the excess supply is the highest.

### Rating actions during pandemic

PEFINDO has rated two cement entities, PT Semen Indonesia (Persero) Tbk (Semen Indonesia) and PT Semen Baturaja Tbk (Semen Baturaja). Semen Baturaja's rating was lowered by 1 notch to *idA-/stable* in November 2020 due to the lower selling price and intensifying competition in its core market, South Sumatra and Lampung. Semen Baturaja has a relatively low market share nationwide at around 3.0%, but a dominant presence in South Sumatra. The delay in the construction of several Jalan Tol Trans Sumatera (JTTS) project due to the pandemic have led to subdued demand for cement in southern Sumatera in 2020, resulting in an aggressive Semen Baturaja's financial leverage.

In March 2021, we raised the rating for Semen Indonesia by 1 notch to *idAA+/stable*. We are of the view that Semen Indonesia will maintain conservative financial profile, reflected by its lower debt level even during the pandemic, resulting in a lower financial leverage. Semen Indonesia also manages to monetize the synergy among its subsidiaries and maintain a stable profit margin, and by commanding more than 50% shares in the national market, we expect it will enable Semen Indonesia to stabilize the industry's selling price.

Table 2. Semen Indonesia and Semen Baturaja's financial highlight

Financial Highlight (IDR billion)	Semen Indonesia		Semen Baturaja	
	1Q2021	FY2020	1Q2021	FY2020
Total adjusted debt	25,252.3	25,735.6	1,786.0	1,728.0
Total adjusted sales	8,076.7	35,171.7	403.5	1,721.9
EBITDA	1,857.2	9,076.9	116.7	361.4
[%] Debt Growth	-11.9	-14.3	10.1	10.2
[%] Sales Growth	-5.9	-12.9	20.2	-13.9
[%] EBITDA Growth	2.8	5.5	233.7	-8.8
[%] Gross Profit Margin	28.6	33.0	48.7	41.8
[%] EBITDA Margin	23.0	25.8	28.9	21.0
[%] EBIT Margin	13.0	16.1	15.7	9.3
[x] Debt/EBITDA	3.4	2.8	3.8	4.8
[x] DER	0.8	0.8	0.6	0.5
[%] FFO to debt	19.7	23.1	16.5	10.6
[x] EBITDA/IFCCI	4.2	3.9	2.5	2.0

Source: Financial statement, processed by PEFINDO

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