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military dominance

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Egypt's cement crisis and military dominance

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The cement industry in Egypt seems to have been experiencing difficult times that are expected to continue for at least several years to come, as a result of the current situation in the cement market, represented in low demand, which leads to decreasing profitability and increasing rates of the idle production capacity.

According to a study by CI Capital, an investment bank, the total increase in demand in the current and next years is equivalent to only 72% of the production capacity to be added through one factory owned by the armed forces, which is due to open next month. However, the government is still maintaining plans to add more cement factories. This would increase the surplus production capacity over the next five years, and put pressure on the revenues of cement producing companies if no proper solutions, such as activation of cement export, were provided.

Anyway, all parties in the cement market complain of the hiking prices, including:

- a) Producers: who complain of the high prices of raw materials and fuel, such as coal and diesel, as well as high government fees.
- b) Consumers and traders: who complain of successive hikes in cement prices, occurring on almost a weekly basis.

The CI Capital report expects that the imbalance in cement industry will continue over the coming years until 2022 despite their optimistic forecasts of demand growth. The investment bank said that even after the expected demand increases by 3.9 million tonnes in 2018 and 5.6 million tonnes in 2019, the two increases combined represent only 72% of the production capacity of the new cement plant of the armed forces. As of 2020, according to the report, any increase in demand will be accompanied by an

increase in production capacity after the introduction of the new cement production licenses into the market.

According to these estimates, the idle production capacity of the cement sector will rise from 27% in 2017 to 33% in 2018 and will decline to 19% by 2020. The increase in clinker stocks in the period from 2018 to 2022 is expected to rise by 8.6 million tons to a cumulative stock of 15.7 million tons by 2022, about 21% of the total demand, which is likely to increase pressure on the industry over the medium and long term. According to the estimates, there will be no balance between supply and demand before 5 years, but clinker stocks are expected to continue to pressure the sector's profitability.

Cement prices rose by 20% in 2017 while the cost of production increased by about 37% for producers, reflecting the inability of producers to pass the price increase to consumers. It is also expected that there will be a marginal growth in consumer prices during the coming five years driven by higher cost to maintain earnings before interest, taxes, depreciation and amortization (EBITDA) to total revenue between 15 and 20% for producers with high operational efficiency and less than 15% for lower operational efficiency.

However, the CI Capital ruled out that any larger-than-expected increase in demand would drive prices higher, in light of higher operating costs and inventory accumulation in the cement sector, which limits its profitability. The report predicted a sharp drop in prices by the end of the first quarter of 2018 when the cement plant of the Ministry of Defense starts production. However, only a move by other producers to reduce production and supply can reduce the decline in prices.

The CI Capital report also indicated that the reduction of the dollar exchange rate to 17.7 pounds instead of 15.3 per pound in 2018 raised estimates of consumer and cost prices. The report added that the cement industry suffers from oversupply, and that cement production will increase with the opening of the cement factory of the ministry

of defense, which was announced in July 2016 and started operation late last year in the Beni Suef region. Also, the location of the armed forces' cement plant in Beni Suef means that it is geographically located in the middle of Egypt, providing an easy access to customers in Upper Egypt and the Delta provinces, as well as the heavy-populated Cairo. The investment bank expected that the plant will raise the current production capacity by 18.3% so that the total production capacity could reach 85 million tons per year during this year compared to the low growth in demand - only 57 million tons. Thus, the Ministry of Defense possesses 23.2% of the production capacity in the cement sector with a total of 20.4 Million tons per year. However, the report predicted that this ratio will decline to 22.5% by 2022.

The report also predicted that the plant will start production at 20% of its capacity only this year to reach about 60% by 2020, and that it is expected to sell its production to the government for the infrastructure projects.

The report pointed out that the most important point in the production of the armed forces' cement factory is in the way it is administered. It is known that the Ministry of Defense depends on introducing large quantities to drive market prices. The report explained that the Al Arish cement plant, owned by the armed forces has a production capacity of about 7.3 million tons annually, as it produces 55% of its capacity, used to sell its production at prices about 2% lower than the market prices during the period between 2012 and 2017.

The report said that with the acceleration of supply overshoot last year, some major companies studied production rationalization and reduction to protect profitability, but small producers reacted negatively to that move and continued to operate at full capacity at the expense of profitability.

Despite the unfavorable market conditions, eight out of twenty producers continued to operate at 100% of their production capacity during the first nine months of 2017,

reducing the EBITDA margin to less than 20% for the operational efficiency plants against 35% to 40% during the same period of last year.

The report expected that the increase in production capacity will add about 6 million tons annually by the end of 2020, especially after the Industrial Development Authority granted new cement licenses to three companies in November 2016 for producing six million tons. The report noted that two of the new three license holders are South Valley and Suwaidi Cement, having factories operating at full production capacity, which is likely to flood the cement market.

Expected improvement in 2018 demand will not make for 2017 significant decline:

The report said that demand on cement mainly depends on the low-income and average-income classes which were badly affected by the devaluation of the Egyptian pound against the dollar. Accordingly, the demand on cement declined by 7.5 percent during the first nine months of 2017, and major projects (including the implementation of the first phase of the Administrative Capital construction) failed to compensate the decline in demand. The total demand on cement in 2017 was estimated at 53 million tons compared to 56.4 million tons in 2016, a decline of 6%.

The significant competition and the falling demand have contributed to the rise in clinker stocks. During the first nine months of 2017, about 4.2 million tons of clinker was added, bringing the cumulative stockpile to 6.4 million tons by the end of last September, and it was expected to rise to 7.1 million tons by the end of 2017. The report also forecast a higher demand in 2018 by 7.3% to grow to 9.9% during 2019, reflecting the deferred demand on cement since 2011 after the cement sector's consumption has stopped growing since 2011. The report explained that the increase in demand will be supported by an inflow of investments with an expected reduction

of interest rates by about 6% in 2018, due to the economic reform measures and the gradual improvement in unemployment rates and wages.

According to a study by the Cement Division, the contribution of the sector to GDP increased in 2016 to 22% compared with 17.5% in 2006 and 13.6% in 1999. The study also recommended reconsidering the industrial cost structure, especially in the export-oriented quantities to enable Egyptian companies of competitiveness in foreign markets.

Most important causes of cement production's high cost:

- The high prices of fuel, especially after the local currency devaluation, which also led to higher customs duties, higher raw material prices, and higher road fees, as well as the VAT which raised taxes from 5%.to 14%.
- The rise in interest rates on loans to 23%, which has contributed to increasing the production costs. In addition, there were other costs such as clinker fees, social insurance, the new quarry law.
- The rise in fuel prices for cement factories following the government decision to float the Egyptian pound.
- Most cement factories have stopped using local raw material (clinker) and started to import it from abroad to spare money, after prices of clinker was increased.
- However, some believe that the cement price increase is unjustified, and that the cement plants reduced their production capacity only to move prices.
- Four foreign companies dominate the cement sector, led by French Lafarge after buying the factories of "Beni Suef", "Alexandria", "The Egyptian for Cement"; and "Suez Group" which acquired the factories of "Suez", "Helwan" and "Torah". The two companies control 65% of the local production of cement. Also, two Portuguese and Mexican companies dominate about 22% of the production, and the rest is distributed

among all domestic companies, including one belonging to the government, the National Cement company, and two other companies belonging to the armed forces.

- In light of the crisis, the Industrial Development Authority (IDA) is preparing to issue 11 grey cement licenses during the coming period. In January 2016, the Authority had issued 14 licenses, the second of its kind since 2007, with a production capacity of 28 million tons, two million tons per license, and stipulated that investors provide their fuel needs.

There are 24 cement factories in Egypt, including four factories in Cairo, two in Alexandria, five in Suez, five in Beni Suef, two in El-Menia, two in Assiut, one in Qena, one in Aswan and two in North Sinai.

The market will receive the production of four new licenses over the next two years, all of which are expected to focus on foreign markets, given the local market saturation.

Export of cement:

There are three key factors to secure success for the export of cement:

First: to reduce the fuel prices for factories, as it rose more than once after the government decision to float the Egyptian pound in November 2016.

Second: To back the cement export and secure its success. In spite of the fact that there is news of the government bearing 50% of the value of transport to the markets of Libya and Iraq, but this support is insufficient. Although the Egyptian product is good and competitive, but the cost abroad is still much lower, which necessitates more support from the government.

Third: To provide studies on neighboring markets and the size of their actual needs, through Egypt's commercial representation offices, in cooperation with trade missions including board members of cement companies.

Conclusion

In the framework of the previous review, a series of questions arise, whose answers can determine the course of the cement crisis in Egypt and its future implications, including:

- Why did the army enter a settled industry that has no problems?
- Why does the army try to confuse and monopolize already existing economic projects?
- Why does the government insist on issuing many licenses for cement production regardless of the environmental dimension?
- What is behind the rises in cement prices amid production abundance?
- Where will the cement production go after issuance of new licenses, especially those given to the army?

Also, the exaggerated road fees imposed by the army on cement factories are likely to expose cement companies to significant losses, taking into account that the army-owned cement plants are exempted from such fees.