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Crisis of Egypt's Cement Sector

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Egypt ranks 14 on the list of the cement producing countries with a production volume of about 60 million tons per year. In early 2016, the government put to bid, through the Industrial Development Authority (IDA), 14 cement licenses which were won by 3 companies, namely, Egyptian Cement Group in Sohag, El Sewedy Cement Company in Al-Ein Al-Sokhna and South Valley Cement Company in Beni Suef.

Cement companies operating in Egypt face major difficulties amid declining demand and surging supply, badly affecting their activity and threatening its continuation.

According to data of 5 companies listed at the Stock Exchange, sales declined during the first quarter of this year due to increased supply and lower domestic demand.

According to a recent report by the Pharos Holding for Financial Investments' research unit, released on Thursday 17 May 2019, cement companies are under considerable pressure as supply increases, domestic demand and exports fall, with a 9% demand decline, 12.3 million tons, in the first quarter of 2019, causing a 5.3% drop in sales prices.

The report added that the total revenues of cement companies declined during the first quarter of this year for companies operating in the domestic market, while export-based companies managed to stabilize their revenues compared to the same quarter last year.

The Federation of Egyptian Industries' cement division is constantly complaining about the challenges faced by cement companies due to a high surplus in production (33 million tons) by the end of last year. The total capacity of cement plants in Egypt (19 companies, including 18 private sector companies) reached 83 million tons last year, according to previous data from the FEI cement division.

This paper attempts to shed light on the suffering of cement companies during the current period, and explore opinions of experts on the future of this situation, and finally provide some guidelines on how to get out of this crisis:

First: About the Cement Sector in Egypt

The Cement Industry in Egypt is one of the oldest industries, where the first cement plant was constructed in 1911, to be followed in 1927 by Egypt launching joint stock cement companies. Later, a large number of cement companies were launched and owned by the state, until the beginning of 1998, which was the start of the Private Sector Investments in the Cement Industry. At the moment there are 19 operating cement companies with 42 producing lines, which are geographically diversified in location across Egypt. Out of the 42 lines, 18 are owned by the private sector, and one by the state, with foreign investors owning 52% of the Industry. The productivity of each production line varies according to the production capacity and technology used in operation. Some lines have a production capacity of 2 million tons per year.

To further highlight this important sector, the following can be reviewed:

A- The producing capacity of cement plants in Egypt

- The overall producing capacity of cement plants in Egypt is 83.5 metric ton (M/T), while domestic consumption does not exceed 53 million tons per year, a production surplus of about 30 million tons.
- The surplus in production significantly increased with the operation of Beni Suef Cement Complex in in 2018. In 2016, the production surplus was 15 million tons and increased to 20 million tons in 2017.

B- The size of cement industry investments in Egypt

- Cement investments in Egypt amount to about \$ 4.5 billion, where each production line costs between \$ 110 million and \$ 150 million.
- The average per capita consumption of cement in Egypt during the past five years is between 580 and 620 kg. where average consumption of poor countries is about 400 kg per capita.
- Egypt's cement exports in 2016 amounted to 279 thousand tons and increased to 1.02 million tons in 2017 and 386 thousand tons by the end of the first half of last year. So far, the exports of the second half of last year have not been monitored, but the volume of exports during last year would not exceed 800 thousand tons.

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- Cement is a labor-intensive industry, where there are direct labor ranging from 800 workers to 1,000 workers per 2 million tons of cement.

Second: Examples of difficulties faced by cement companies in Egypt

Following are some examples of the difficulties faced by cement companies in Egypt:

1- Suez Cement Company

The problem of the Suez Cement Company is most prominent example of the suffering of the cement companies, where the company announced on Sunday 19 May 2019 suspension of its Tora Portland cement plant temporarily due to its losses, amounting to LE 72 million during in the first quarter of this year.

In the first quarter of 2019, the Suez Cement Company told the Stock Exchange that the domestic demand on cement fell by 8.8% compared to the same period last year, adding that there is a surging supply in cement market exceeding 30 million tons per year, amid declining demand, "which leads to lower prices to levels that do not cover the production cost".

The company announced that the decision to close the plant was based on deterioration of the financial results of the Egyptian Tora Portland Company, which is 66.12% owned by Suez Cement Company, where its losses exceeded the value of shareholders' equity, with a negative value of LE 196 million in in 2018, while the cement activity separately made losses of LE 37 million in 2018, and LE 72 million during the first quarter of the current year.

The company said that despite all its efforts to reduce the cost of production and operation, "the cement market's worsening situation leads to continued losses of the company's cement activity, which is not expected to see a breakthrough in the near future," indicating that the company had only two options: either liquidation or temporarily suspending its cement activity.

It is worth mentioning that Suez Cement Company lost LE 26.4 million during the first quarter of this year against a profit of LE 243.3 million during the same period last year.

2- Examples of losses of some cement companies during the last period:

The results of the activity of most of the cement companies operating in Egypt showed losses or a decline in profits during the first quarter of the current year as follows:

- South Valley Cement Company announced in a report sent to the Stock Exchange that its profits in 2018 decreased by 54%, due to lower prices with increased supply, where the company posted a profit of LE 10.18 million in 2018 compared to LE 22.14 million in 2017.
- Misr Cement Company (Qena) reported a decline of 80.9% in net profits for the first quarter of this year, recording a net profit of LE 12.05 million compared to LE 63.1 million during the same period last year.
- Arabian Cement Company reported a decline of 96.3% in net profit during the first quarter of this year, recording a net profit of LE 5.97 million compared to LE 162.01 million during the same period last year.
- Misr Beni Suf Cement Company reported a decline of 76.5% in profits during the first quarter of the year, recording a net profit of LE 29.53 million compared to LE 125.9 million during the same period last year.
- Alexandria Portland Cement Company reported a loss of LE 77.6 million, recording a loss of LE 34.8 million; which the company attributed, in a report to the Stock Exchange, to a decrease in consumption and an increase in supply.
- Sinai Cement Company reported losses of LE 83.1 million pounds during the third quarter of the year compared to 71.5 million pounds in the previous quarter,

Third: Expectations of Experts and Analysts on the Future of Cement Sector in Egypt

1- Analysts of the Pharos Holding for Financial Investments

- Analysts of the Pharos Holding for Financial Investments expected in their quarterly report continuation of the wave of price declines in the second quarter of 2019, due to weak demand in Ramadan and continued supply increase.

- Pharos Holding for Financial Investments suggests that there are several scenarios that could improve the conditions of cement companies, including reform of the sector, demand recovery or exit of more producers from the market.

2- Expectations of Egypt Belton

- Egypt Belton for the Management of Investment Funds' industrial sector report said cement companies are suffering from a negative outlook during the current period, expecting that the companies' profits would continue to decline during the fourth quarter of 2018.

- The report attributed the drop in the profits of the cement sector companies to the rising costs due to the increase in electricity prices by about 40%, and in fuel prices from 40% to 50% by the middle of the current year, resulting in an increase in costs between 50 to 60 Egyptian pounds per ton.

- The report pointed out that cement companies were unable to pass the price increase because of the gap between supply and demand, up to 15 million tons, before the entry of El Arish Cement Factory with about 12 thousand tons.

- The report predicted that the impact of the crisis may extend to the first quarter of 2019.

Fourth: The causes of the crisis

1- Internal causes

Analysts of the industrial and building materials in some research companies attributed the crisis to three reasons related to the internal market and the Egyptian economic situation: the increase in cement supply and demand gap, the rising cost due to electricity and diesel price hikes, and pressures exercised by the small companies through decreasing prices for obtaining a market share.

2- External causes

In addition to the internal reasons mentioned above, there are many external reasons that negatively affect the cement sector in Egypt, including:

A- Surplus of competing regional countries: There are several countries in the region that also have a surplus production that they work to export such as Saudi Arabia, which has an annual surplus of 26.6 million tons, in addition to Greece, Spain and Turkey.

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B- Difficulties of cement export to Africa: There are difficulties in cement export to Africa due to lack of a river transport system that can be exploited for export of cement to African markets, in addition to the government suspension of incentives to exporters to Africa. Cement companies that export their production to African countries used to receive 50% of the cost of shipping which helped to reduce the prices of cement exports, making it more competitive, but the government stopped these incentives three years ago.

C- High price of Egyptian cement: The price of Egyptian cement is more expensive than its counterpart in competitive countries, because of the high cost of production in Egypt, due to several reasons, including:

- Energy prices increased by almost 40% in June, which contributed to raising the cost of cement production, especially that the energy represents between 50 and 65% of the cost of cement production.
- The imposition of a tax on the limestone granules used in the manufacture of cement caused a 35% increase in prices, and a real estate tax was imposed on the factories.
- The increase in value added tax from 5 to 14% in recent years, and the increase in road charges, as well as the price hikes of coal by 200% because of the devaluation of the Egyptian pound against the US dollar.
- Transformation of all cement factories in Egypt to reliance on coal increased the production cost, taking into account that the cost of transforming each coal production line between 10 and 15 million dollars.

As a result of the above reasons, the cost of cement production has increased significantly. In view of the high elasticity of demand, manufacturers have not been able to pass this increase to the local market, in addition to the difficulty of cement storage; all these increases contributed to lack of export opportunities for Egyptian cement.

Fifth: Key solutions to get out of the crisis

The cement division of the FEI building materials chamber stressed the need for a government effort to find solutions to overcome the crisis of losses facing cement manufacturers, which could lead some

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companies to declare bankruptcy if the government does not seriously intervene to save the cement industry. In addition, the crisis may turn into a scarecrow to scare away foreign investment that amounted to 52% of the volume of cement investments in Egypt.

The cement division noted that the companies did everything they could to get out of this crisis. Some of them resorted to selling some of their (land) assets because of the difficulty of borrowing. Other factories used waste as a fuel for factory furnaces to reduce operating costs. Also, research is underway to increase reliance on alternative energy, while some factories have suspended some production lines to reduce costs and lay off some workers.

To help the cement sector get out of its current crisis, experts suggest the following:

- Major companies should acquire loser exiting companies, according to some investment banks, which reduces the gap and helps the major companies to control prices and translate them according to cost.
- The government should support factories that rely on alternative energy to motivate them and expand use of this kind of energy.
- The government should reconsider taxes imposed on the limestone granules used in production of cement.
- Restoration of the incentive of export to Africa, 50% of the transportation costs in cash or as a set-off of the State's entitlements to producers, whether taxes or electricity use costs.
- Opening new markets for cement export.
- Building a river transport network to facilitate export to Africa, which will have positive economic and political results.

Finally, we can say that the cement sector in Egypt suffers from many problems, especially the surging supply after the new army-owned plant entered production (El Arish Cement Co. owned by Egypt's military), as well as the imposition of more taxes, raising of energy prices and lack of new export markets, especially in Africa.

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Thus, we can conclude that most of the cement sector's problems are closely linked to either unregulated actions of the government, which have added new increases to the supply glut, its failure to carry out appropriate studies before imposing new taxes, or its failure to open new markets. Without cooperation between the government and producers to get out of this crisis, some companies may declare bankruptcy during the current year; and this crisis may turn into a scarecrow for scaring investors away in general, not only in the cement sector.

