**Competition Commission of Pakistan**
Title: The Recent Cement Price Hike: Cartel or Not?

11th April, 2008

## The Recent Cement Price Hike: Cartel or Not?

**Objective:**

This report is a snapshot study with the narrow scope of determining the reasons for the recent cement price hike during March 2008. This "point-in-time" view has been taken in the report to address the specific (Rs.20 per bag) rise on 20-03-2008 which was widely quoted in the media as an alleged cement manufacturers cartel.
The price movement in the period under review is:

**Price on 19-03-2008 Rs.240 per bag**
**Price on 20-03-2008 Rs.260 per bag**

**Cartel or Not?**

At this point-in -time the Commission has not noted sufficient evidence to suggest there being one. The cartel question hence, remains an open one. After analysing industry fundamentals the opinion of the commission is that the current price hike in cement could be the result of change in sector fundamentals affecting the demand and supply dynamics and due to commercial reasons. Nevertheless, the Commission cannot completely rule out the possibility that this across-the-board, simultaneous price increase may have arisen from collusive behaviour of the incumbent cement manufacturers.

*The increase in price can be attributed to the interplay of the following factors.*

- **Higher input cost:**

Coal prices have soared from US$ 80 to US $ 130 per ton during FY07 to FY08 .These costs have been passed on to the end consumers.
Input costs are primarily comprised of the coal costs and the packaging costs with per bag price being in the range of Rs12-16 ea. Packaging has also been showing a steady increase in price.

Following are the average cement manufacturers' costs with respective % components.

| Cost Head | %age of Cost of Sales |
|---|---|
| Cost of Raw Material | 10 |
| Cost of Fuel | 41 |
| Cost of Power | 18 |
| Cost of Packaging | 9 |
| Other Cost | 22 |

*Source: CCP Internal Research*

On account of higher expected coal prices cement prices (ex factory) could rise for the domestic industry in the range of 4-5% over FY08-10E. It was noted that in the said period gas usage was in some cases replaced by furnace oil based production which is almost 50% more expensive per kWh.

The direct impact of (positive correlation) between rise in coal prices and cement prices is evident below.

| | Break-Even (Retention) | Break-Even (Ex-factory) |
|---|---|---|
| 1QFY08A (US$100) | 119 | 180 |
| US$115 (base case) | 126 | 188 |
| US$125 (current price) | 129 | 192 |
| US$135 | 133 | 196 |
| US$145 | 137 | 200 |
| US$155 | 140 | 204 |

*Source: KASB Research*

*The ex-factory price represents the price available to dealers. Please note that in the retention price the Excise duty of Rs.35/bag, the sales Tax of 15% and the Rebate to dealers has been deducted.*

| Domestic cement prices (Rs./bag) ex-factory raised to cover higher coal cost | | | | | | | |
|---|---|---|---|---|---|---|---|
| Local prices (Rs/bag) | 1QFY08 | 2Q FY08E | 3QFY08E | 4QFY08E | FY08E | FY09E | FY10E |
| Revised | 184 | 199 | 212 | 225 | 205 | 230 | 249 |
| Original | 184 | 193 | 194 | 219 | 220 | 220 | 240 |
| *% Charge* | | 3% | 9% | 3% | 5% | 5% | 4% |

*Source: KASB Research*

Despite passing on of costs to end consumers, resulting in a price hike, break even level for manufacturers has actually arisen and profit margins *per se* are not seen to expand. This in turn indicates that *prima facie*, it is likely that prices have been raised to offset higher costs of production, and seemingly not due to curtailment of production or collusive price fixing. Thus the price rise appears to be an economic and commercial reaction of manufacturers in response to the changing sector fundamentals.

**Pro-competition Factors**

Further factors to suggest that apparently, collusive pricing and pre-determined quota allocation are possibly not at play, are the industry dynamics themselves.

- **Demand expansion :**
  - Price disparity between India, Middle East and other regional markets has made it commercially feasible and attractive for these countries to import from Pakistan. Opening of new export avenues in the region has provided a welcome opportunity to cement manufacturers whose capacities are expanding.
  - Seasonal Local Demand surge as construction activity resumes post winter

As a result of the above factors, the cement monthly sales and exports higher than before levels in the Mar, 2008 to 2.61 million tonnes and 726,000 tonnes respectively, compared to 1.9 million tonnes local sales and 645,000 tonnes exports in Feb, 2008.

- **Supply Side Expansion:** The capacity expansion has not fully kicked in and is expected to be in place by FY10, when the total production capacity shall reach 48 Million tonnes. Nevertheless, the competitive effect has already started being felt as production expands. With greater capacities and higher input costs the competition for higher market share, both local and export, has increased. The exports and local demand surge does not completely offset nor significantly reduce supply. This pressure to compete for sales and higher production so that unutilized capacities are used will continue to be felt by the manufacturers.

- **Cement Plant Efficiency:** Disparity between plant efficiencies and break even levels of different plants is another pro-competition factor.
  - European Plants: These require the highest capital outlay but have low running costs due to efficient fuel consumption and production efficiencies
  - Chinese Plants: These require a low capital outlay but are less cost effective to run due to higher fuel consumption and greater requirement of maintenance, with possibility of down time also affecting plant efficiency.
  - Hybrid Plants: Here the critical cement manufacturing equipment is sourced from the Europe and the rest is sourced from china. These plants fare well both on accounts of efficiency and cost effectiveness.

- **Capacity Utilization:** During the period under consideration the utilization levels are high and do not suggest that there is an artificial shortage created to raise prices. The industry trend is that greater capacities are being utilized to meet increasing demand as is evidenced from a representative sample below.

**Capacity Utilization of Leading Cement Companies in FY 06 & FY 07**

| | Lucky | | Maple Leaf | | Best way | | Fauji Cement | |
|---|---|---|---|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| **Capacity Utilization (%)** | 68 | 43 | 71 | 66 | 77 | 39 | 99 | 91 |

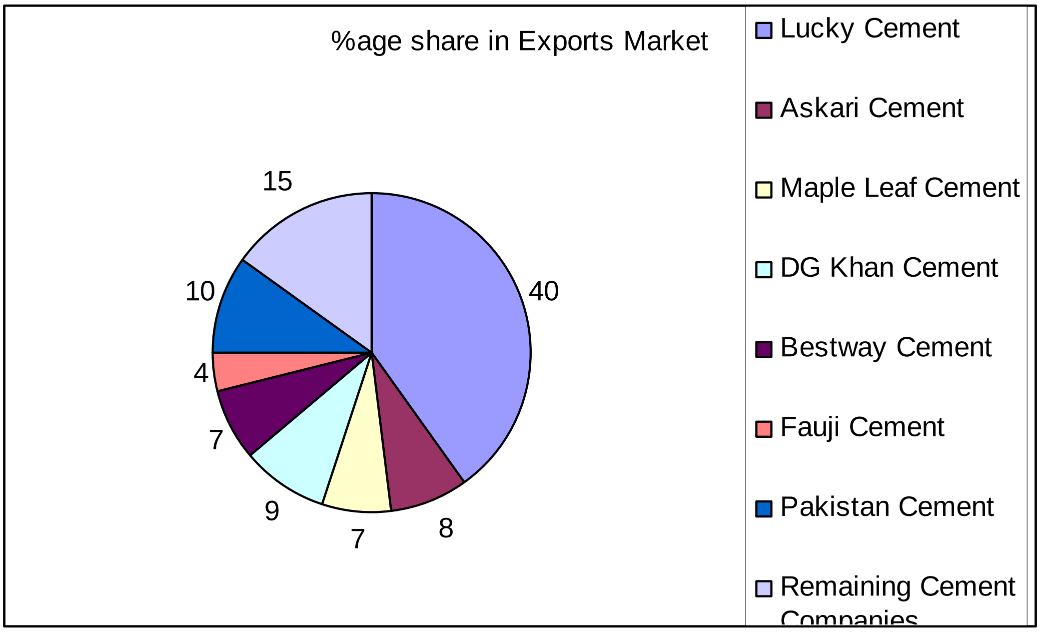
*Source: CCP Internal Research*

**As per nine month ended on *31st March 2008***, the figures of Total Local Sales, Exports and Current Installed Capacity are as it follows:

***Total Local Sales during the 3QFY08 was 16,728,800 tonnes.***
***Total Exports during the 3QFY08 was 5,156,160 tonnes.***
***Total Installed Capacity of Cement Industry is 37,156,750 tonnes.***

**The Plum in the Export Pie**

Export market provides a lower break even due to the low packaging cost, no excise duty and sales tax , but an uneven playing field with some having access through licensing to the market, others not. Exporters break even at Rs12-16/bag below peers exposed primarily to the local market, due to lesser packaging costs for cement exported in bulk. Thus production capacities can be utilized and booked for longer terms provided the exporters can close (often very price competitive) deals , where manufacturers have to compete in the regional arena against ,at times, more cost effective regional manufacturers.




*Source: CCP Internal Research*

The following regional markets have opened up to Pakistan cement exporters due to regional price disparities accompanied by surge in demand.

**India**
Currently, India has around 8 Million tons of excess demand, which is being catered to largely by exports from Pakistan, In India, the landed price of cement imported from Pakistan is expected to be around INRs210 (Rs300-Rs350), which is higher than the local selling price. There is significant capacity expansion planned in India which is expected to come online by FY09.

**UAE**
The construction boom in the UAE had pushed prices up by almost 40% during early 2008. To alleviate prices, the government has removed the 5% duty on the import of cement and steel. In UAE, cement prices have increased form AED 16 per bag (Rs273 per bag, US$87 per ton) to AED 22 per bag (Rs. 376 per bag, $119 per ton), and is currently at more than AED 25 per bag (Rs427 per bag, $136 per ton).

**Future: Exploring and Capturing New Markets**

Going forward the most effective means for utilizing additional capacity for cement manufacturers could prove to be the export market.

Another market currently being explored is South Africa, which is showing excess demand concerns due to increasing construction for the upcoming football world cup in 2010. Till then, Pakistan can potentially export 9 Million tons of cement to South Africa to fulfil their demand, However, Lucky Cement is the only local cement producer that has received and export certificate from the South African Bureau of Standards

Due to large-scale construction in China, India, Middle East and Africa, the emerging markets are expected to account for 85% of the global demand for cement by 2020, leaving Pakistan with many export avenues to exploit as long as excess supply prevails in the country. Additionally, efficient utilization of capacity will lead to benefits from economies of scale, hence reducing the cost of production for the manufacturers.

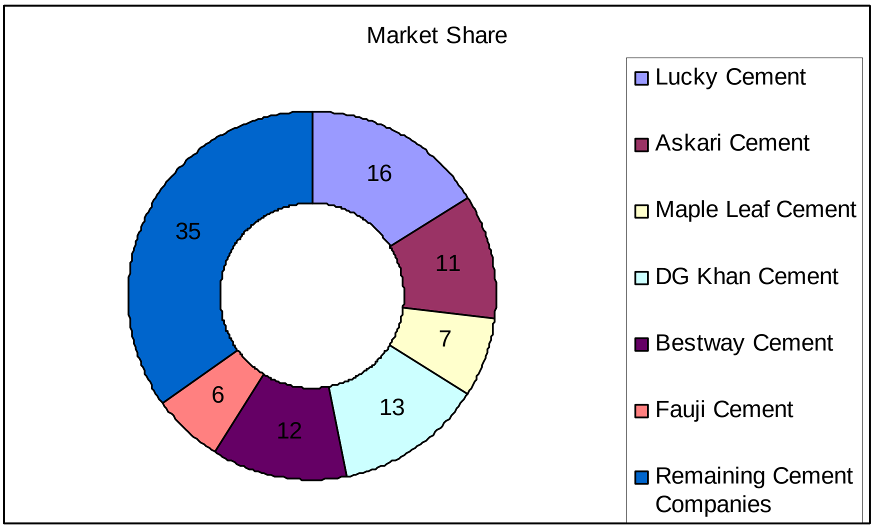
**Competition Vulnerabilities:**

Cement is a classic product/ industry which possess characteristics which tempt manufacturers to indulge in collusive or cartel-like practices.

These characteristics are:

- Homogeneity and substitutability of product
- Excess/unutilized capacity

Further, despite there being 29 cement manufacturers –a fact which should encourage competition amongst manufacturers for market share--there is concentration of market power with a few leading companies, namely Lucky Cement, DG Khan Cement, Bestway Cement, Maple Leaf Cement, Askari Cement & Fauji Cement , which control 65% of market between them. *(Please see pie chart below):*



**Conclusion**

For the period under consideration and the quoted price movement no evidence of collusive or cartel-like behaviour by the cement manufacturers came to the surface nor could be noted by the Commission. Therefore, the analysis and the conclusions focus on the industry dynamics.

With capacity expansions kicking in and fully rolling out by FY10 the Commission will be closely analyzing industry dynamics and competitive environment. It is believed that with the opening of new markets and the global surge in demand a sizable portion of local production will find its way into the exports markets. In this scenario the Commission predicts heightened and not lessened competition amongst the players both in the local and international markets.

The Competition Commission will continue to closely monitor this sector to ensure efficiencies and healthy competitive behaviour amongst cement manufactures is the means to obtaining and sustaining local and export market share and the ensuing market power.

**Maleeha Mimi Bangash**
*Member (Research and Advocacy)*
*Competition Commission of Pakistan*
*Government of Pakistan*

*Information sources:*
*CCP Research & Investigation*
*IGI Securities, Research*
*KASB Research*

*Special Acknowledgement:*
*IGI Securities, Research*

**Disclaimer:**

*The view taken in this report is based upon a study for a specific period under consideration, after analysing economic factors, industry fundamentals, and competitive activities of the incumbent firms. It should be noted that the author and the Commission reserves the right to change the view taken as the industry dynamics, economic conditions and competitive behaviour of incumbents change.*