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CERAMICS & GAS

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Expert call: Demand moderation and cost inflation to persist

- **Gas demand from Morbi ceramic cluster has plummeted but could recover partially in near term with potential increase in propane prices**
- **Sluggish exports due to higher freight costs and challenges in container availability have resulted in ~25% cut in Morbi turnover**
- **Ceramic players to face margin pressure near term owing to slowdown in domestic demand and commodity cost inflation**

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We interacted with Kiritbhai Patel, President – Sanitaryware Division, Morbi Ceramics Association, to gain a perspective on the ceramic industry's growth prospects and gas demand & cost outlook. Key takeaways:

Sluggish exports and higher gas cost driving ~25% cut in Morbi turnover: The Morbi ceramic industry has a Rs 400bn turnover, of which 60% is domestic and 40% comes from exports (130 countries). Turnover has decreased in both exports and domestic market. In the last six months, non-availability of containers and higher freight cost (US$ 10k-12k per container from US$ 7k-8k) have led to a 25% decline in exports. Freight cost has reduced a bit to US$ 9-10k in April but container shortage remains a challenge. Additionally, the rising gas cost has intensified cost inflation, forcing a quarter of the Morbi plants into temporary shutdowns.

Capacity growth of 0.4-0.5mn sq ft under implementation: The Morbi industry is setting up ~100 units, with half of these already commissioned during the past year and another ~30 expected over 4-6 months. Last year, 60-70 units closed down but the industry saw a net addition of 2-3x the size of the closed capacity.

Gas consumption down sharply but could recover partly near term: Gas consumption has reduced to 4mmscmd from 7.0-7.2mmscmd, with a 1.5-2.0mmscmd decrease in consumption and 1.0-1.2mmscmd of substitution by propane and LPG. However, propane is no longer at a discount to gas and prices may turn higher near term. This could help raise gas consumption.

Ceramic players to face margin pressure: Post Covid, the ceramic industry witnessed strong pent-up demand which let players take multiple price hikes. Real estate demand has remained robust which increased the churning of old inventory. However, the rising metals/cement cost inflation and third pandemic wave in Jan'22 have hindered new construction activity over the last six months. Given the rising commodity inflation, ceramic players have taken price hikes in April to partially pass on costs despite demand moderation. However, margins still remain under pressure.

Other key takeaways

- **Morbi industry profit margin down to 5-7% from 10-15% pre-Covid:** Pre-Covid, gas cost was at Rs 27/scm which currently stands at Rs 58/scm plus taxes for 80% of contractual quantity. The additional 20% is purchased on spot basis at above Rs 100/scm. This has resulted in a halving of profit margin for the Morbi ceramic industry to 5-7% from 10-15% pre-Covid. The ideal gas rate for sustenance of the business and competition with China is Rs 30-35/scm (the cost of transport for China is 4-6% of revenue vs. 10-12% for India).

- **Morbi industry enhancing gas-to-propane switching facilities:** With propane at a 10-15% discount to gas in Q1FY22, existing propane capacity utilisation was running full and had prompted the industry to implement further capacities. Out of 850 manufacturing units, 60-70 already have a propane facility and now 8-10 units per month are adding this facility. Companies take 4-6 months (including government approvals) to set up and operationalise propane capacity. Capital cost ranges from Rs 3mn-10mn for a capacity of 10-60t.

- **Narrowing price differential of Morbi players with organised players:** The price differential has narrowed to 10-15% from 20-25% with increasing contract work from the Morbi capacity.

- **Domestic ceramics (tiles and sanitaryware) demand to slow:** Post Covid, the increased churning of old real estate inventory and replacement market revival led to robust demand for ceramic players. Demand for old real estate inventory has been steady in April thus far as consumers are buying property in anticipation of increasing prices. However, with the rising commodity costs and absorption of pent-up demand, new construction activity has slowed down. This, in turn, will affect demand for tiles and sanitaryware.

- **Morbi industry capacity/turnover up ~30%/~60% over three years:** The Morbi ceramic industry comprises ~850 manufacturing units with a total production capacity of 2,000mn sq ft and turnover of Rs 400bn. This includes 300 units for vitrified/GVT flooring, 300 units for wall tiles and the balance for sentinel floor tiles. Over the past three years, while capacity has grown by ~30%, turnover has risen ~60%. However, the number of units has remained the same with ~125 older units (mainly wall tiles) being replaced by new technology (vitrified floor tiles) offering higher capacity.

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