Opportunities in new Africa

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Africa is a land of opportunity, rich in potential and certainly the next challenge for many cement producers. The sub-Saharan region is changing rapidly and the race is on to be a part of the growing market. Harpreet Duggal of Binani Cement, and former secretary of the East Africa Cement Producers Association, provides an optimistic overview of this important region. By Harpreet Duggal, Binani Cement, UAE.

Lafarge Hima cement works, Uganda

Africa is changing and at a very fast pace. If you compare its real GDP growth of five per cent between 2000-10 with that of the 1980s and 1990s, the pace of expansion has doubled (see Figure 1). Today, it is the second-fastest region after emerging Asia. GDP is currently equal to nations like Brazil, Russia or India and so it can be considered in the same light as a BRIC nation. Its telecommunications, retail and building sectors are flourishing. The construction sector is also booming, attracting foreign investors, while the demographics are taking Africa to the next level.

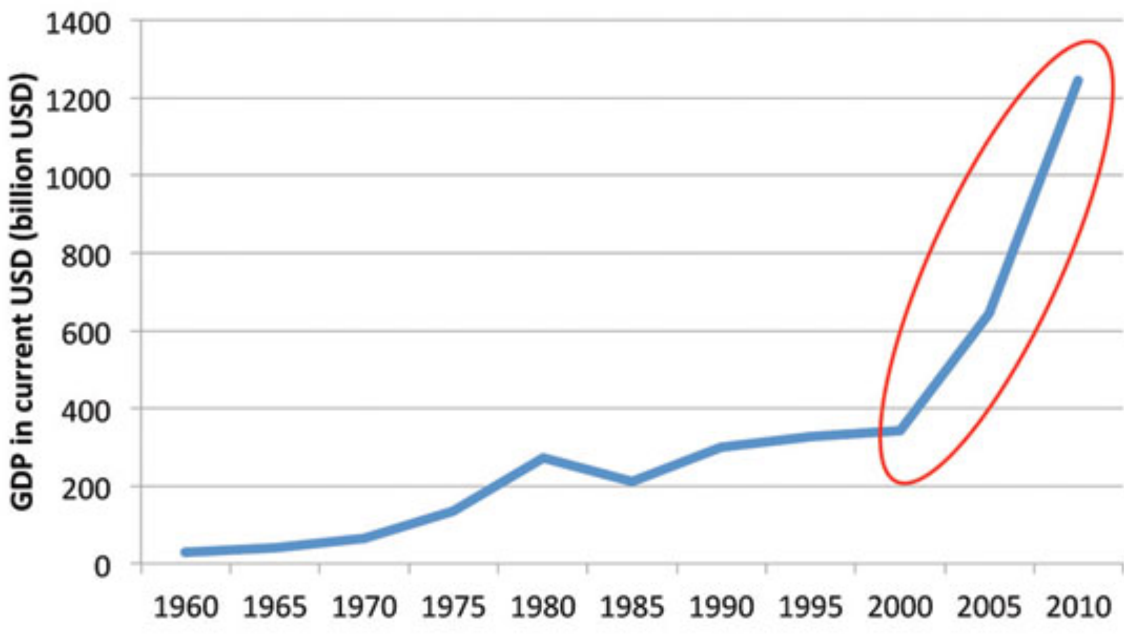


Figure 1: Africa's GDP accelerated after 2000 making it the world's second fastest-growing region (Source: World Bank)

Africa has the potential to become the next India or China. By 2030, Africa's top 18 cities could have a combined spending power of US$1.3trn and by 2040 Africa will have more than 1.1bn people of working age, which will be more than China or India.

The new Africa

Africa's slow growth was replaced after 2000 by a burst of activity. Individual governments acted to improve political affairs, end conflicts and foster stability, while the World Bank and the International Monetary Fund helped to accelerate development by introducing structural and fiscal reforms. Companies have also been privatised and economic management has brought new investors. Most of the advanced African nations today are not seeking support for the governance of their country, but guidance on how to attract more investors.

Africa's growth has been helped by robust commodity prices, increased capital flows, rising trade demand from China and India as well as improved organisation and demographics. Africa will have the largest-growing labour force by 2040. Consumerism is also blossoming with the number of mobile phones in Africa surpassing those used in the USA, while phone banking is bigger than in India. Urbanisation is accelerating and will reach 50 per cent by 2030. There is also global demand for Africa's rich resources of oil, natural gas, minerals, food and arable land. All these trends have enabled increased access to foreign capital.

Risks and perceived risks

However, high growth still comes with risk attached. Infrastructure is inadequate, skills are not available, foreign exchange volatility and high inflation prevail, while corruption and political instability exist. There is a big list of risk factors, although some concerns have been overstated and are not as bad when you consider them on the ground.

Governments are implementing stable policies, inflation still exists but has been reduced and the bureaucracy is getting better. While changes have been recognised by most Africans, outside the continent much perception is still based on the old Africa.

Some of the perceived risks include war and political instability, but apart from Somalia, Eritrea, Sudan, DR Congo and Mali, other sub-Saharan African territories are as stable as Asian countries. African inflation has also been dropping to 6.5 per cent, which is now lower than in India. Poverty, conflict and hunger is still associated with some African countries but there are also many that are quietly developing. Not every African nation can be painted with the same brush.

It is because of this gap between the perceived risk and the reality on the ground that there is a potential for investment. If one can manage the risks, the returns are there for industries like cement, which in Africa are among the most profitable in the world, especially in countries like Tanzania. The companies that know the opportunities of New Africa and those who know how to manage the risks will be the ones to extract the most.

Cement demand drivers

There are many positive drivers for the cement sector in Africa such as increasing demand for housing, low per capita consumption, huge mineral wealth and a big gap in infrastructure development. The only question is not whether countries like Kenya and Tanzania will develop but just how soon? The only way GDP is going, is up. Cement consumption divided by GDP growth implies a multiplier factor of 1.5-2.

There is still great demand for housing, spurred by formalisation of mortgage arrangements. A cement per capita consumption average of 85kg shows immense opportunity for growth. The continent has great potential for cement development in the next 15 years. Between 2010-25, it is expected that cement demand in Africa will grow from 129Mta to 269Mta.

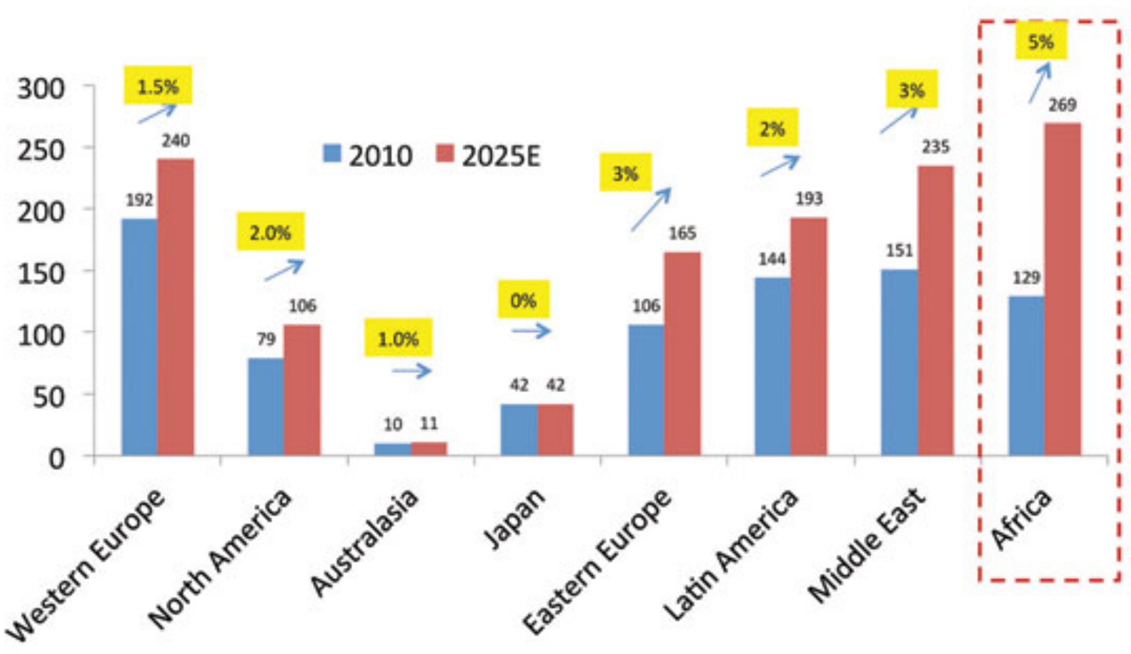


Figure 2: Africa will be the most rapidly-expanding region for cement demand in the next 15 years
(Source: Société Générale report May 2011. The graph excludes Asia where growth is expected to be four per cent)

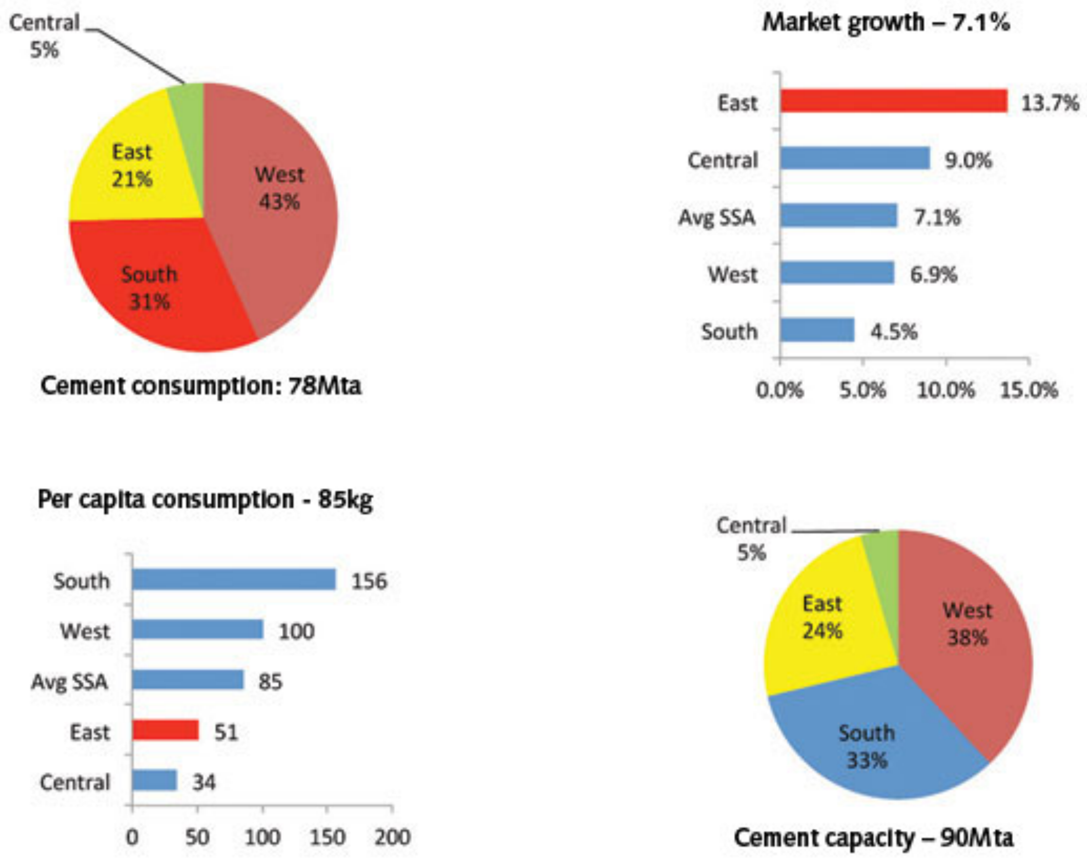


Figure 3: sub-Saharan cement market data

An attractive investment?

The growth in cement consumption of five per cent between 2010-15 in Africa is already attracting new players to the industry. The high cement prices that average US$150/t are not expected to weaken and there is high profitability to be had at EBITDA levels of 40 per cent. Many African countries have cement deficits, which are made up by imports, and free trade agreements are facilitating more intra-African trade.

Looking at sub-Saharan Africa, the total market size is 78Mta and capacity is 90Mta, which points towards overcapacity. However, there are pockets with a big share being filled by imports. Out of the four regions, East Africa is growing the fastest and if you look at per capita consumption it has the maximum potential for growth with current per capita levels of 51kg.

Who is expanding in Africa and where?

Historically, Lafarge has had a big presence in Africa. Lafarge has been overtaken, but still has a large capacity of 14.3Mta spread over 10 countries and is planning a new plant in Malawi although its further growth is being hampered by cash shortages (see Figure 4).

Figure 4: Lafarge's African footprint.
Countries in red indicate expansion of existing factories is planned in the coming five years

Meanwhile, HeidelbergCement has a footprint from East to West Africa. HeidelbergCement is expanding quickly and has one of the most profitable plants in Tanzania. The German group is adding new capacity in DR Congo as well as in sub-Saharan Africa (see Figure 5).

Figure 5 : HeidelbergCement's African footprint.
HeidelbergCement plans a 0.9Mta expansion project in DR Congo, highlighted in green

PPC is another producer that is looking to expand and already has a capacity of 9.5Mta mostly concentrated in southern Africa, but it has moved into Ethiopia and Rwanda and has further long-term goals to reach more sub-Saharan countries (see Figure 6).

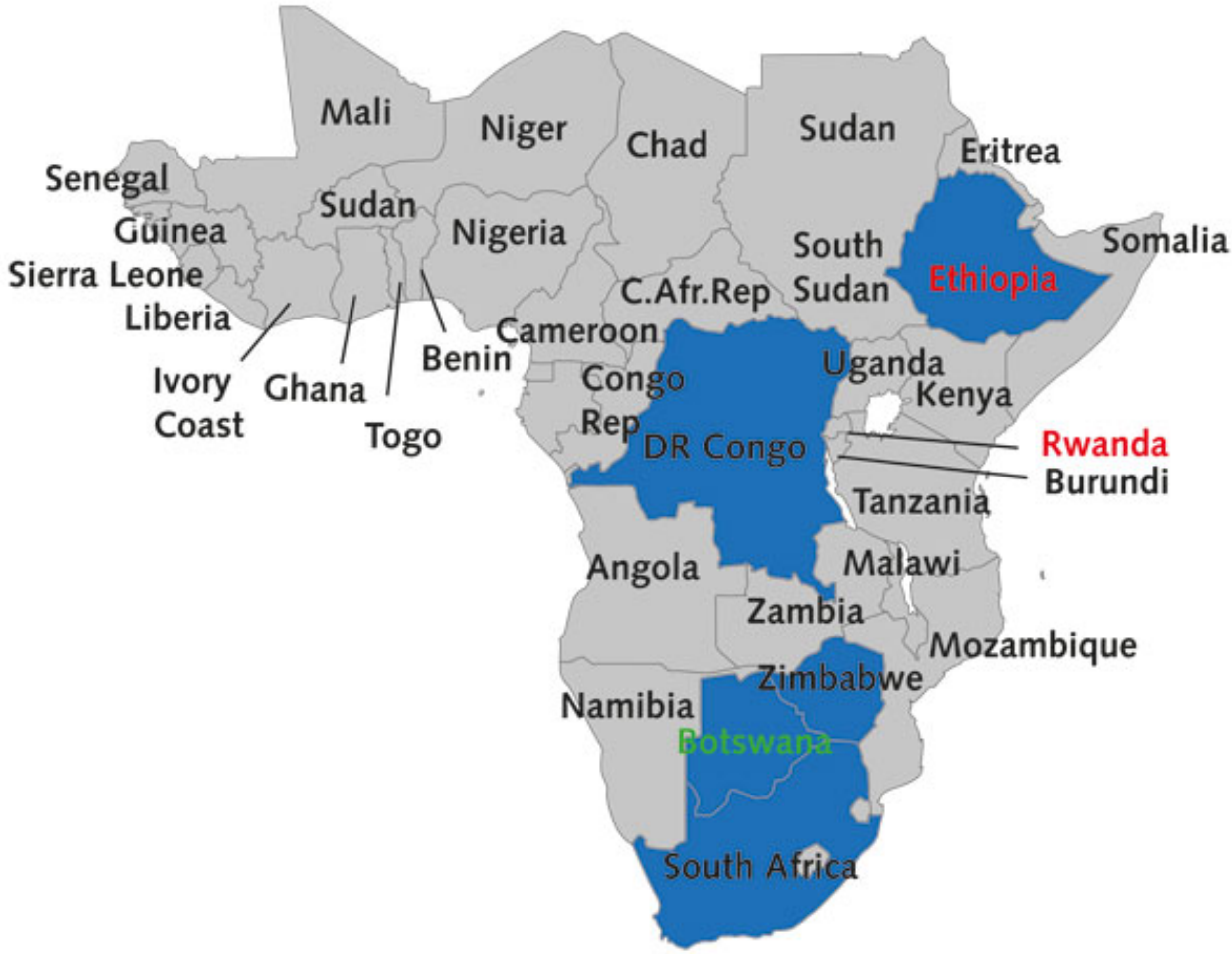


Figure 6: PPC's African footprint.
Countries in green indicate where expansion is planned, while new markets for PPC are in red – Habesha Cement in Ethiopia and Cimerwa in Rwanda

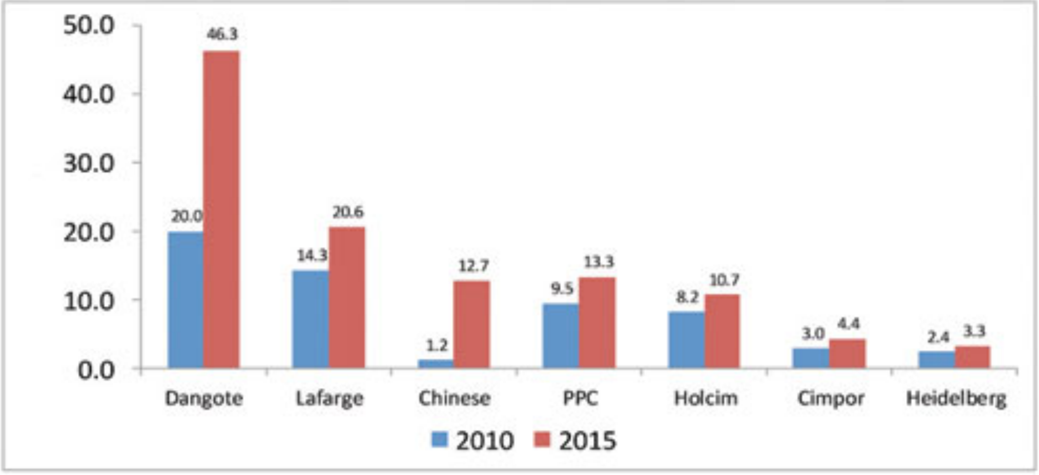
Holcim in South Africa (through AfriSam) and Tanzania has a cement capacity of 8.2Mta, while it also has grinding units in West Africa under Holcim Trading (see Figure 7). Holcim and Lafarge are not currently putting as much into new investments in Africa as some of the other producers. Cimpor has also transferred its cement assets in Morocco and Tunisia to Votorantim via InterCement, but it still has 2Mta of capacity in South Africa, 1Mta in Mozambique, 4Mta in Egypt and will have a 1.6Mta plant in Angola, plus operations in Cape Verde.

Figure 7: Holcim's African footprint. Holcim has significant existing capacity but has not been expanding its market share in Africa

But it is Dangote Cement that has really set out on a course to be a truly pan-African cement producer. From a 2Mta terminal in 2002, it has expanded its capacity to 20Mta, taking its market capitalisation to US$15bn. It is the fastest-growing player in Africa with US$4bn of investments in Nigeria, South Africa, Zambia, Tanzania, Ethiopia, Senegal, Republic of Congo, Cameroon and Gabon in the pipeline. By the end of the 2010-15 period, Dangote Cement will take its capacity in Africa to 45Mta (Figure 9).

Figure 8: Dangote's African footprint. Dangote's greenfield cement plant projects are shown in blue.

Looking at regional capacity development as a whole, North Africa is fairly saturated, East Africa is still expanding, West Africa is the fastest-growing market but mostly driven by Dangote, while South Africa is the most developed and most saturated market.



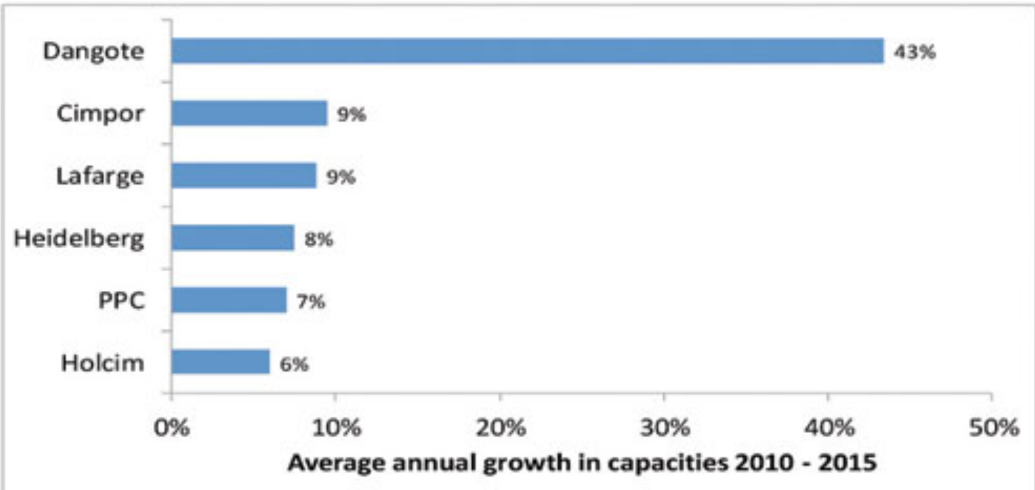


Figure 9: who is expanding in Africa?

East African market in focus

When talking about East Africa the markets covered include: Sudan, South Sudan, Ethiopia, Uganda, Rwanda, DR Congo, Kenya, Tanzania, Malawi, Zambia and Mozambique. The region is characterised by high cement demand, high prices and high costs for electricity, fuel, and transportation which all make it difficult to do business here. At the same time, this challenging climate for investments and operations gives a protected environment to those who are brave to invest. Cement prices can range from US$130/t up to US$300/t. Customer needs are very basic, usually bagged PPC, which makes up 82 per cent of the market or OPC accounting for 18 per cent. The shift towards bulk cement is expected but progress remains slow. At first glance it would seem that there is enough capacity but in this part of the world there is a lot of latent demand because per capita consumption is so low. Any addition of new capacities stimulates new demand. Secondly, the current regional deficit in clinker is masked by investment in grinding operations. In spite of these new grinding units coming on-stream, there is a shortfall in cement in regional pockets that is evident with the continued imports into the region, especially from Pakistan.

There are a number of challenges for cement producers in East Africa, including electricity supply and the cost and quality of power. Power outages are a daily occurrence and transportation is a big issue because of poor roads and high fuel costs. Port facilities are nonexistent in many African cities, while landing charges are usually prohibitive. Cement companies really need to build their own infrastructure. The lack of infrastructure increases the project costs which are significantly higher than the rest of the world. The project cost further increases if the project is located deep inland.

In terms of market size, Ethiopia is the largest, followed by Kenya and Sudan. South Sudan is an interesting market as it has lots of scope for growth but is high risk. These countries are followed by Tanzania and Uganda.

In the region, Kenya has the highest per capita consumption at 78kg, while DR Congo, Malawi, Rwanda and Burundi have a lot of catching up to do (see Figure 10). Even Ethiopia only has a cement consumption of 39kg.

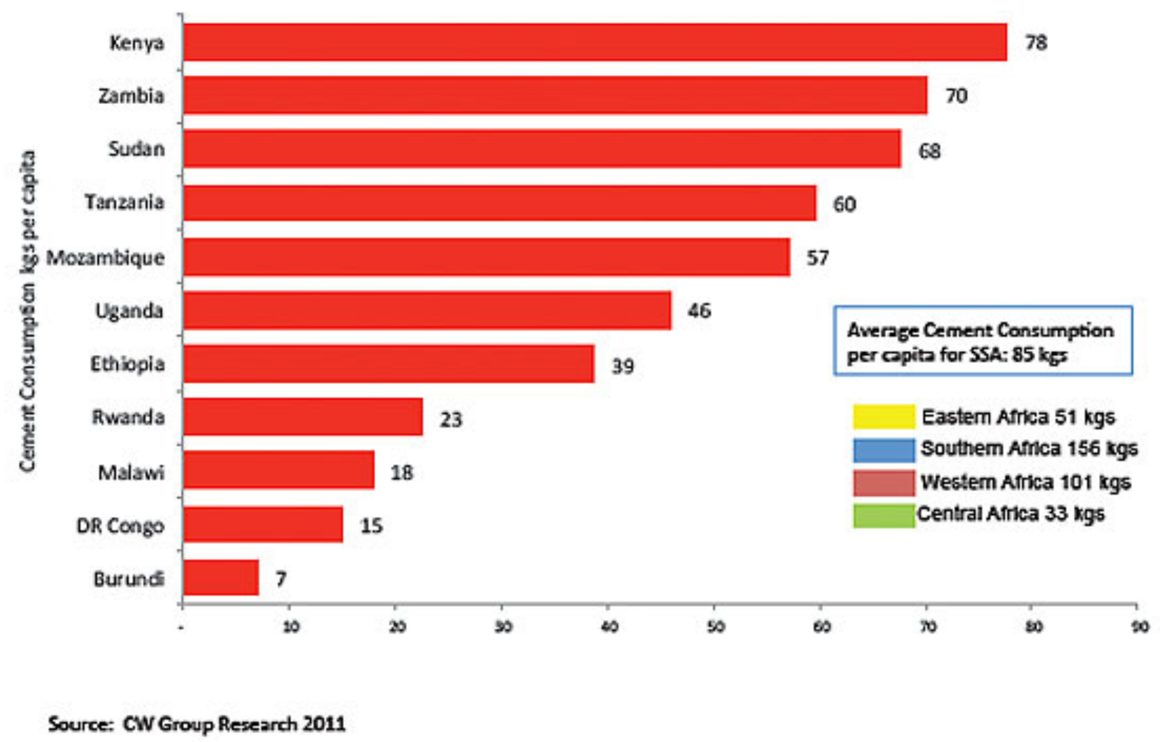


Figure 10: East African per capita consumption, 2011

Looking at market growth, Ethiopia is one of the fastest-growing at 15.2 per cent, while overall market expansion for East Africa is 13.7 per cent. This compares to an average African cement market growth of 7.1 per cent (see Figure 11). So East Africa has maximum potential for cement investors.

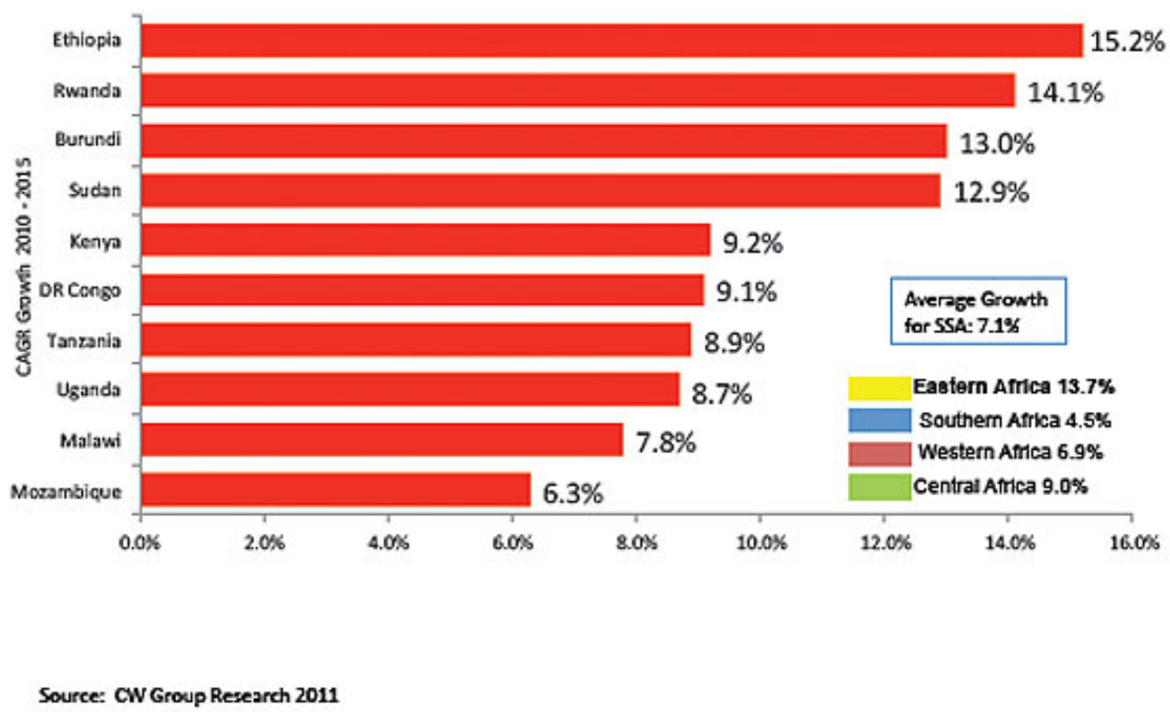


Figure 11: East African CAGR growth, 2010-15E

Cement capacity is catching up here, especially in the East African Community (EAC) countries of Kenya, Uganda, Tanzania, Rwanda and Burundi. Many cement companies expanded capacities in these countries after 2009. There is excess capacity now, but this excess is grinding capacity. The amount of cement manufactured from local clinker still has a shortfall. While plenty of limestone exists in the region it is not simple to acquire the licences, and companies with secured sources of clinker are in the best position. It is important to be situated close to the customer as transport costs are high. There are lots of pockets in the market but the further you travel the more difficult it becomes to make a profit.

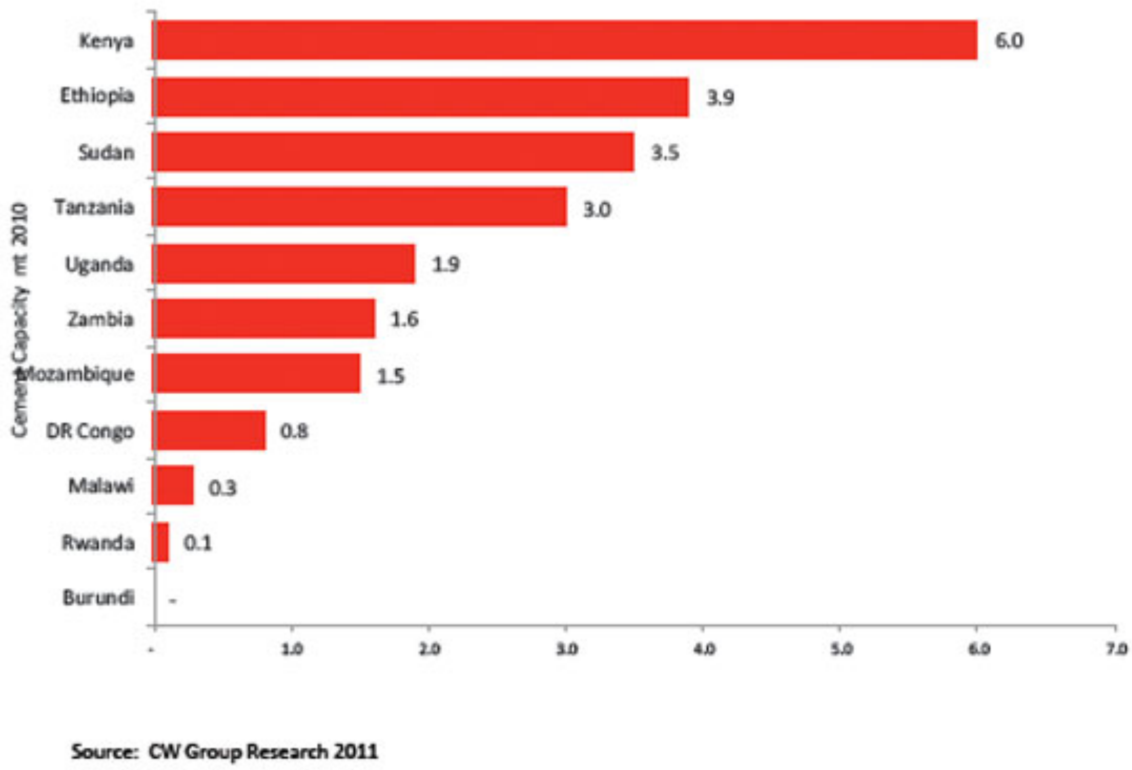


Figure 12: East African cement capacities, 2010

Cement demand is expected to rise above capacity in the EAC in the future even if the situation does not look great at the moment. The low per capita consumption means that the EAC will grow at some point. These are interesting markets but deciding when to invest in them is not so important over the long term as we know they will grow.

Summary

Operating a cement plant in Africa is very different from running a plant anywhere else in the world. African experience is more important than cement experience for companies trying to establish themselves in one of New Africa's growing cement markets. So getting to see how firms like Dangote have expanded is beneficial. For a local conglomerate making a variety of products, not just cement, it has been easier for Dangote to expand than for others coming in from outside. It is highly recommended that new entrants partner with established local businesses who know the local terrain.

In the coming years, excess capacities and increased costs will put pressure on industry margins. While overall excess capacities will exist, a clinker capacity shortfall is evident and fresh limestone mining will be limited. Own sources of clinker would attract a premium.

In spite of the excess capacities some geographical pockets for expansion with greenfield plants exist and there are opportunities here. From 2016, demand is expected to surpass installed capacities, making Africa a market to be in for the long term.

The three questions that potential investors are asking are: Where to invest? When to enter the market? How to manage the intricacies of doing business in Africa? But for those who know opportunities in Africa and those who know how to manage the risks of Africa, this profitable frontier market is theirs to tap.

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