Kazakhstan — steps up

by Tom Armstrong, ICRG, UK

This year BusinessCem's annual Central Asia Conference was held in Almaty, Kazakhstan's commercial centre. Visibly prospering from its massive wealth in natural resources, the economy is expanding rapidly, construction activity is frantic, and as cement demand skyrockets, producers are planning to expand operations, with nearly 6Mt new capacity announced to date. There could not be a better time to visit Kazakhstan!

Mr Hans Jürgen Seher of HeidelbergCement Central Asia addresses the 135 delegates at BusinessCem's 6th International Central Asia Conference in Almaty, 2006. Heidelberg plans to build a new 2Mta plant by the Caspian Sea to capitalise on the high growth in demand

Previously considered an obscure region, Kazakhstan has more recently come to the attention of the masses as a result of the infamous escapades of Sacha Baron Cohen's fictional character 'Borat'. The cement industry, on the other hand, has a somewhat more appreciative perspective of this country, as ICR discovered at BusinessCem 6th Central Asian Conference in Almaty, the buzzing commercial centre of this immense country pleasantly nestled in the foothills of the snowcapped Alatau mountain range.

The conference was attended by a wide array of representatives not only from Kazakhstan's cement industry, but also from Georgia, Ukraine, Uzbekistan, Kyrgystan, Russia and beyond. Combined with representatives hailing from all the major global and local equipment suppliers, BusinessCem provided the ideal platform for discussion of the rapid changes that are currently taking place in the local and regional cement industry.

The scene was set early on in the proceedings when delegates were addressed by Mr Hans Jürgen Seher of HeidelbergCement Central Asia, who was able to announce his company's intention to build a 2Mta plant near the western port of Aqtau in the Caspian Sea region, an area which is set to be the focus of large-scale energy-related investment over the next decade.

Indeed, the country is enjoying some of the highest rates of economic growth in the region – recorded at 9.4 per cent in 2005 – which are feeding through very favourably into the construction sector. Construction activity has recovered strongly from depressed levels seen in the 1990s, building its share of GDP up to six per cent. Housing completions, measured in square metres, were up 84 per cent in 2005 on the year before.

At present, cement demand is growing exponentially, rising by around 1Mta, with total demand reaching 5.3Mt in 2005, up a massive 38 per cent on the year before. Indeed, over the 2000-05 period, consumption growth has been sustained at an impressive annual growth rate of 33 per cent.

Consequently, output from Kazakhstan's five cement producers, most of which used antiquated Soviet-era wet process technology, has struggled to match demand. Combined nominal capacity is rated at 6.8Mta, though domestic output only reached 3.6Mt in 2005 – with imports required to fulfill the remaining 32 per cent of internal demand, or around 1.7Mt.

These supply shortages and rising import levels have inevitably resulted in rising prices, a situation which is compounded by increasing energy and transport costs. Rail transport, the primary method of cement distribution in the country, is in short supply, and according to some producers tariffs have increase by as much as 60 per cent over the 12-month period up to June 2006. In a country the size of Kazakhstan, where cement must frequently travel over 600km to market, the impact on cement prices is significant, with prices as high as Tenge 12,000/t (US$94/t) being observed.

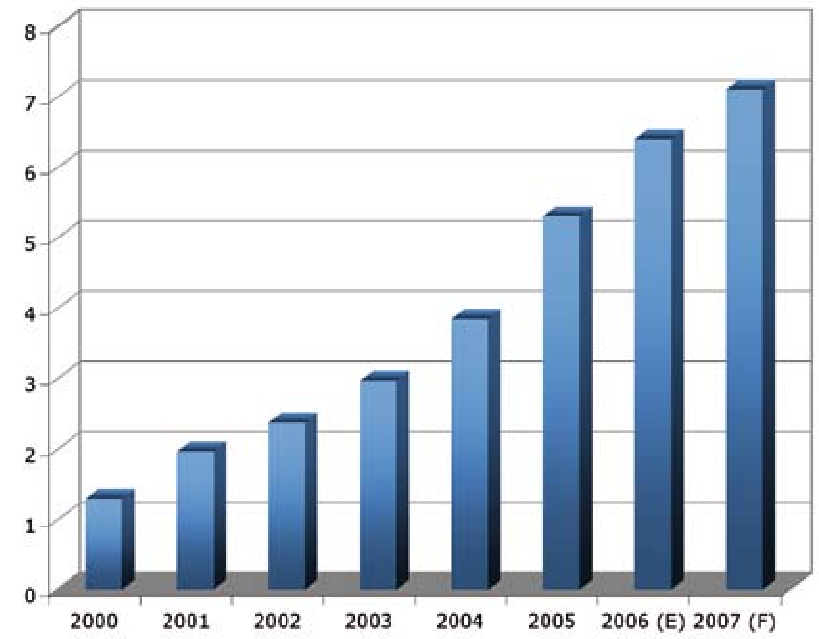
The Kazakh cement production base: (planned capacity in brackets)

Karcement (Steppe Cement)	2.0Mta	(3.2Mt)	one plant
Shymkent Cement (Italcementi)	1.6Mta	(4.2Mt)	one plant (3)
HC Vostok (HeidelbergCement)	1.6Mta	(3.6Mt)	one plant (2)
Semey Cement	1.2Mta		one plant
Sas-Tiubinskiy Cement Works	0.4Mta		one plant

Average prices noted for mid-2006 were reported at US$75/t (Tenge 9,585/t), up around 25 per cent from US$60/t a year earlier.

Ultimately, domestic demand is expected to reach 6.4Mt by 2006 year-end, up 21 per cent on the year before, rising a further 11 per cent YoY to 7.1Mt in 2007. Provided existing favourable political and economic conditions prevail, Kazakhstan should enjoy double-digit growth over the next four to five years.

Cement consumption, Kazakhstan (2000-2007F)



Source: Global Cement Report, ICRG forecast

Meeting demand

The challenge ahead for the industry is to reduce its dependency on imports and boost domestic production to meet demand. This is particularly pressing as the availability of import supply is not guaranteed going forward as current suppliers in Russia, Kyrgyzstan and Uzbekistan, are likely to scale back their imports in response to higher domestic demand.

Fortunately, a series of projects designed to upgrade existing plants is underway. HeidelbergCement's HC Vostok, located near Ust'-Kamenogorsk in northeastern Kazakhstan, has increased capacity at its facility from 0.9Mta to 1.2Mta over the last year, following an upgrade to its fourth kiln line. The plant is expected to produce 1.5Mt in 2007.

Similarly, Malaysian-controlled Steppe Cement, located in Karaganda Oblast in northeastern Kazakhstan, is undergoing a major transformation which will see its nominal capacity increase to 3.2Mta by 2008. As a result of ongoing improvements to the existing four wet lines, the company will boost production to 0.8Mt by 2006 year-end, and 0.85Mt in 2007. The company, which was listed on AIM in London in September 2005, has also launched an investment programme worth around US$76m to rehabilitate one dry kiln line and rebuild a second (FLS are providing the pyro line, including two-string, four-stage ILC preheater, SF Cross-Bar Cooler, with a guaranteed clinker output of 3500tpd). This ensures effective capacity is expanded by another 2.3Mta. The ebullient Chairman, Javier del Ser, with overall responsibility for delivering this major capital investment programme told ICR that work was well underway, and it is hoped that both these lines will be completed by 2007 and 2008 respectively, ready to take advantage of the market which he sees growing at a rate of 1Mta.

In the short-term ongoing rehabilitation to existing plants in Kazakhstan will allow local production to increase to 4.2Mt in 2006 and up to 5Mt in 2007. Nevertheless, the market is experiencing such strong growth that imports will remain high at around 2Mt for both 2006 and 2007.

Stepping up production

Steppe Cement, however, is not the only player intent on capitalising on this appealing market. The aforementioned HeidelbergCement project near Acqtau Port on the Caspian Sea is due to come on-stream in the first quarter of 2009, ensuring the company has a dominant role in the local industry. "With two plants, Heidelberg Cement will have good coverage of the country," Mr Seher told ICR.

Indeed, cement prices in this region are especially high, since supply currently relies on imports or else on domestic sales from cement plants located over 3000km away. "Currently transportation costs can be high, especially to the Caspian Sea," explains Mr Seher. "From East to West Kazakhstan, where transport is only by rail, the cost is a minimum of US$20/t."

The new Heidelberg plant will clearly provide a reliable and cheaper source of cement to this part of the country – but will demand is this relatively unpopulated region of Kazakhstan be enough to justify such an investment?

According to Mr Seher, the development prospects for this region are immense. "West Kazakhstan will be the main market going forward," he argues. "Oil and gas related projects are set to bring wealth and employment into the region, radically transforming the economy in the process." "Three new ports will be built at Aqtau. Caspian Sea and related projects will help

Mr Seher sees immense development prospects in Western Kazakhstan

boost consumption up by 1Mta, provided they go ahead."

While the plant is intended to serve the local market first and foremost, its location also fits well with Heidelberg's wider regional strategy and will complement its East European and Central Asian supply network that has been rapidly built up in the second half of 2006, when the company acquired factories in the high growth markets of Georgia and Russia. The new plant will offer export possibilities to Russia and the Moscow market via barge transport up the Volga, accessed through by the Caspian.

High aspirations

In a seperate move which expresses immense confidence in the country – and in the region as a whole – Italcementi announced in December its intention to build not one, but two new dry-process plants in Kazakstan, in partnership with the leading industrial group in Kazakhstan, the Mercury Group, and the Turkish construction group, Sembol.

The new cement plants, each with an annual capacity of 1.3Mt, will be integrated with the existing Shymkent Cement operations, with separate locations in eastern and western Kazakhstan. On completion of this ambition expansion programme, Italcementi will be the leading producer in Kazakhstan with a nominal capacity of 4.2Mta which will correspond one third of total domestic capacity.

Conclusions

The outlook for the cement industry in Kazakhstan is clearly positive. The government's own forecast is that consumption will reach 9Mt by 2009, and some observers believe the market could reach 10Mt by 2010. By our estimates, a CAGR of 10 per cent is more realistic and would see demand rise to 9.4Mta by 2010. ICR estimates that total nominal production capacity in Kazakhstan will reach 12.6Mt by 2009/10, should all confirmed projects take place. This would result in a capacity utilisation rate of between 70-75 per cent by 2010.

However, this presents only a best-cast scenario, and there are significant risks to this outlook. On the demand side, the future largely depends on the political stability of the country (doubts remain over the democratic legitimacy of president Nursultan Nazarbayev's rule), and the ability of the government to bring to fruition a range of major projects throughout the country, particularly the energy-related projects of the Caspian Sea.

Encouragingly, Nazarbayev recently announced a deal which could see his country supplying the EU (keen to lessen its dependency on energy supplies from Russia) with 25 per cent of its future energy imports. This pact would also release major European investment in the Caspian state's still nascent energy infrastructure.

On the supply side, the long-term risk is of over-investment into new capacity. While the level of investment currently proposed is in line with demand projections.

ICR has learned of at least five additional speculators eager to jump into this attractive, high growth market, proposing to build new plants with a combined additional capacity of 5Mt. And this does not take into account the possibility that independent producers Semey Cement and Sas-Tiubinskiy Cement could also want to expand their existing operations.

The field is therefore set for play. Over-investment is a risk, but in a market with such opportunities, speculation by new entrants is inevitable. Competition will become increasingly tough, and many additional challenges will need to be overcome. How will the expected surge in demand for high quality human resources be met? How will the logistical challenges of this market be met?

All in all, barring any major upsets, the rising prosperity currently being enjoyed by this increasingly impressive country looks set to continue – and that can only be good for cement.

BusinessCem's 15th Anniversay conference takes place in Moscow between 28-30 May, 2007.