

## Review of Cement Industry of the Republic of Uzbekistan

- Uzbekistan aims to being a net exporter, first targeting Afghanistan, as neighbouring countries have increased own capacity in last years;
- Local demand has become one of the main drivers for the industry – level of construction in Uzbekistan increased 3.5 times in last 5 years and continues to grow fast;
- Total amount of announced projects reached \$2.5 billion, but realistic level is much lower – about \$1.5 billion;
- In 2020, it is planned to put into operation 3 new projects with total capacity 5.7 million tons per year;
- Price for existing operating capacity (\$34.4/ton) is much lower than construction of new capacity (\$100-125) or modernization/expansion of current plants (\$55-100);
- Record high cement prices helped companies to increase profits and drive average P/E ratio to record low levels. Even possible decrease of average prices could give great opportunities for investors;
- Average dividends yield for 2019FY – 8.55%;

### GENERAL INFORMATION

Uzbekistan is one of the leaders in cement production in the CIS area and it is fourth in this sphere after Russia, Ukraine and Kazakhstan, whose cement production outpaced Uzbekistan in 2017-2019.

Currently, 30 specialized enterprises are engaged in the production of cement, among which the largest listed/possible for investment are:

- JSC “Qizilqumcement” (QZSM);
- JSC “Akhangarancement” (OHSM);
- JSC “Bekabadcement” (ex.BECM);
- JSC “Quvasaycement” (KSCM).

According to the Decree of the President of the Republic of Uzbekistan dated October 27, 2020 "On measures to accelerate the reform of state enterprises and the privatization of state property" JSC “Qizilqumcement” (QZSM) should be privatized. It is expected that 51-75% of the shares could be sold to strategic investors, and the remaining part could be sold through an SPO. Furthermore, it is expected that the United Cement Group could win the lawsuit and regain its shares in JSC “Bekabadcement” (ex.BECM), where he will own more than 80% of the shares.

The total production capacity of the cement enterprises in Uzbekistan is 12.6 million tons per year, and by the end of 2020 expected to be 18.3 million tons which presently satisfies the domestic demand of the construction industry of the country and to export part of the output into neighboring markets.

However, due to ineffective use of capacity and lack of investments in previous years, and also sufficient growth of capacities in neighboring markets like Kazakhstan, Tajikistan and

Turkmenistan, Uzbekistan became a net importer of cement from 2014. Domestic capacities did not receive enough development and investment, and therefore, the government and companies are now taking active measures to develop this sector of the economy, reduce imports and enter export markets, including Afghanistan.

In 2019, the production of Portland cement in Uzbekistan increased by 15.9% compared to the previous year and reached 9.68 million tons, cement production in general - 10.99 million tons. Practically all of this output is produced by 6 large plants. At the same time, in 2019, Uzbekistan imported 3.6 million tons of cement, which is 56% more than in 2018. The value of imported cement increase by 39% to 190.4 million USD. In 9 months of 2020, import of cement reached \$122.5 million.

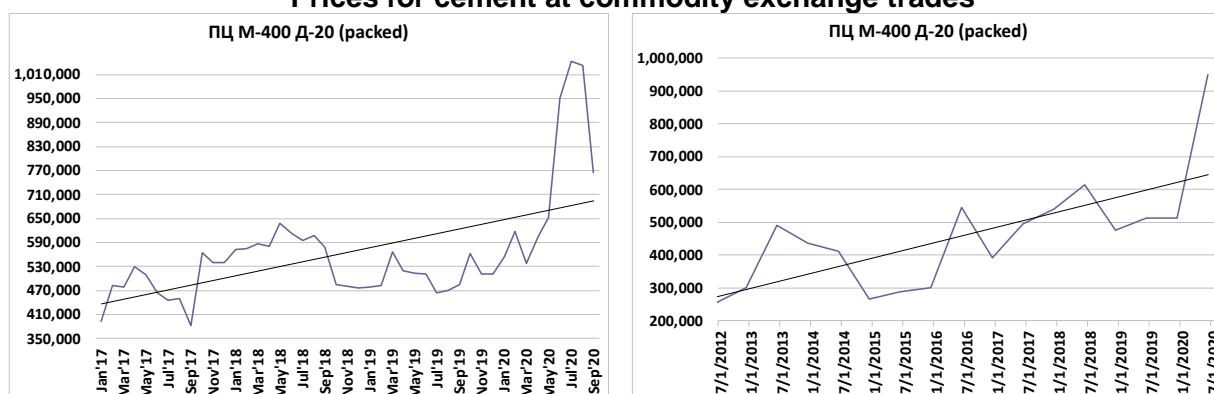
According to the statistics, cement imports from Kazakhstan increased by 38% to 1.22 million tons. Imports from Tajikistan, Turkmenistan and Iran also increased. In October 2019, in order to help match domestic demand with production president canceled the zero-customs duty rate for cement, which proceeded from January 2018. Then, due to quarantine restrictions in Uzbekistan, in May 2020 Cabinet of Ministers lifted this ban to ensure the uninterrupted supply of construction materials in the country.

In 2020-2021, it is planned to launch another 10 new cement plants. These plants will be built in the Republic of Karakalpakstan, Jizzakh, Kashkadarya, Surkhandarya, Tashkent, Andijan, Fergana and Namangan regions.

Forecasts for the 2020 predict production of about 14.5 mln tons. Average annual growth of cement production for the last 5 years is equal to 10%. Sufficient increase in production is predicted because of new plants, which put into operation in 2019 –Sherabad plant by AGMK and private SurhanCementInvest. In October 2019, the SurhanCementInvest plant with a capacity of 1.1 million tons was put into operation in the Surkhandarya region, which will be mainly exported. The project cost was 144 million USD.

Altogether, 12 brands of cement are produced in the country, including Portland cement, white cement and oil well cement, the latter of which is for the needs of the oil & gas industry. In 2019, Portland cement accounted for 88% of total production, while in 2009 it was 99.3%. In 2019, the demand for cement in the country increased by 23% compared to 2018 and amounted to about 13.1 million tons.

### Prices for cement at commodity exchange trades



Source: UzRTSB Commodity Exchange

In 2019 the average price of cement per ton (of M-400 type in bulk) was 488,994 UZS, or by 8.4% lower than in 2018. In 9M2020 average prices increased by 36.8% compared with same period in 2019, mostly due to cancelation the zero-customs duty rate for cement in October 2019. Moreover, since prices for cement peaked up to 1 million UZS per ton in July-August 2020, import procedures for cement were simplified.

Demand for cement has grown rapidly in Uzbekistan over the last three years due to the boom of construction projects. According to the State Statistics committee, the compound annual growth rate of construction in 2016-2019 was 34.2%, and in 2019 it increased by 39.2%. In January-August 2020, the volume of construction work performed in the Republic of Uzbekistan amounted to 55.5 trillion UZS, and the growth rate in relation to the corresponding period of 2019 reached 6.5%. On average, more than 12 million square meters of housing is commissioned in Uzbekistan per year. Currently, per person accounts for an average of 16 square meters, and it is expected that in the next 10 years it will increase.

Also, the President signed legislation to stimulate mortgage financing in Uzbekistan, including the establishment of the Mortgage Refinancing Company (MRC), so banks are able to receive long-time funding for mortgage projects. Moreover, the President has signed a special Decree to establish a touristic corridor Hanabad-Termez-Muynak from the eastern part of the Uzbekistan in Andijan region to southern in Surhandarya and western in Karakalpakstan Republic. More than 1,126 km of roads are to be reconstructed and supported with infrastructure by 2020-2021.

In 2018, cement has experienced changes in systems of distribution, i.e. selling cement is possible only via the Uzbek Republican Commodity Exchange, however cement monopolies engaged in social projects (construction of affordable housing for citizens in need of improved housing conditions, social facilities, transport infrastructure and water facilities) are allowed to sell at a fixed price.

## CAPACITIES AND PRODUCTION

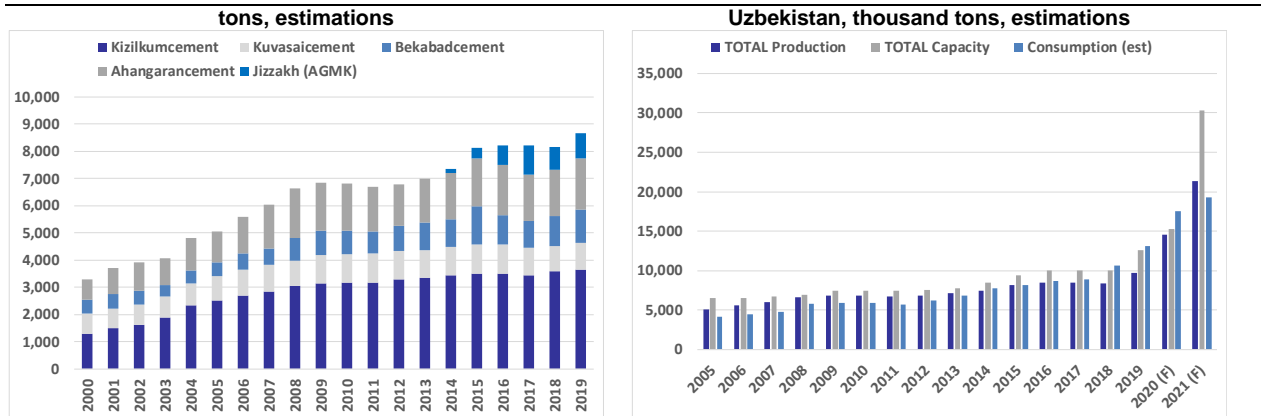
In 2019, the production of Portland cement in Uzbekistan increased by 15.9% compared to the previous year and reached 9.68 million tons, cement production in general - 10.99 million tons. At the same time, imports increased in physical terms by 56% to 3.59 million tons, and in monetary terms - by 39% to \$ 190.4 million.

In January-August 2020, enterprises of the Republic of Uzbekistan produced 6.73 million tons of cement, which is 33.9% more than in corresponding period of 2019. In 2020, it is planned to increase the volume of cement production up to 14.5 million tons.

The growth of production is taking place against the background of the implementation of large investment projects with the participation of foreign investments and credit lines. Over 79% of investment funds came from abroad. It is expected that the capacity of cement production enterprises in the Republic of Uzbekistan will increase by 45.2% by the end of 2020 and reach 18.3 million tons.

Aggregate design capacity of cement plants of Uzbekistan was equal to about 12.6 mln tons as the end of 2019. The largest plants by the production volume are JSC "Qizilqumcement" (QZSM) and "Akhanganacement" (OHSM).

JSC "Qizilqumcement" (QZSM) produced about 37% of nationwide output in 2019 with their 3.45 mln tons of capacity, while JSC "Akhanganacement" (OHSM) around 20% with current capacity of 2.18 million tons. However, in 2020, JSC "Akhanganacement" (OHSM) plans to commission an additional 3 million facilities.



Source: mass-media, web-sites of companies, other open sources, Calcs: Avesta Investment Group

In 2019, import reached \$190.4 million, while export amounted only to \$9.1 million. For 2019, the largest suppliers of imported cement to Uzbekistan were Kazakhstan, Tajikistan, Kyrgyzstan and Iran, which totaled 92% of total import. Moreover, in 9-month of 2020, export amounted \$6.9 million, Import – \$122.5 million.

In 2019, cement imported from Kazakhstan amounted to \$52.7 million, while in 9 months of 2020 it reached \$63.3 million with total 1.26 million tons of cement. Tajikistan exported cement production to Uzbekistan for \$46.6 million, that is 1.5 times higher than in previous year, and in 9M2020 import amounted \$33.2 million. Import from Kyrgyzstan in 2019 amounted \$31.8 million, which is 2.3 times higher than in 2018.

Kazakhstan and Tajikistan have benefited the most from the growth of cement imports to Uzbekistan since 2014, whose import volume increased significantly - by 11.8 times for Kazakhstan and for Tajikistan import reached 0.86 million ton from zero. Average price of imported cement in years 2016-2019 was about \$50-60 per ton, while previously it was more than \$100, as most imported cement was used for some special purposes. Now most of the cement is imported by trading companies.

During 2018-9M2020 AGMK remains to be top 1 exporter of cement abroad. Most of the Uzbek export goes to Afghanistan and it should be a largest market in nearest few year taking into consideration a few projects in Surhandarya and Qashqadarya region and already available railroad to Mazar-i-Sharif city in the northern Afghanistan. Within a few years new line will be constructed to Herat city which will increase the amount of export from Uzbekistan.

### RAW MATERIALS BASE

The development of the cement business is closely connected with the development of the raw material base – limestone and loess/shale quarries. In accordance with The Decree of the President of the Republic of Uzbekistan “On additional measures for the accelerated development of the building materials industry”, the measures will be taken to increase the volume of raw material resources in 2019-2025 by 1.8-4.4 times, including the growth of reserves of quartz sand 4.4 times, gypsum 2.4 times and limestone 2.2 times.

According to the Association "O'zsanoatqurilishmateriallari" (01.01.2019), reserves of category A, B, C1 limestone amount to about 1.32 billion tons. Most of them belong to Tashkent region (23.5%), Jizzakh region (21.6%), Samarkand and Kashkadarya regions (16.5 and 13.5%, respectively). It is worth noting that about 10.6% of the reserves are not used. Loess's raw material reserves amount to 401.99 million tons, 32.3% of which are in Tashkent region, about 40% are in Kashkadarya and Samarkand regions. However, almost half of the raw material reserves are not put into operation, 47.8% of loess remains unused.

JSC Qizilqumcement (QZSM) has a following raw material base: a limestone quarry located at a distance of 7 km from the industrial site of the plant and a shale quarry 10 km from the plant. Limestones and slates are delivered from the faces by heavy-duty mining dump trucks to the crushing department. After crushing, limestone and slates are transported to the plant by a 5.5 km long conveyor belt. The main raw material base as of October 1, 2017 contained industrial reserves of 113.8 million tons of limestone and 96.8 million tons of shale at the Navoi deposit, 30.2 million tons of diabase pyroxenite at the Tillatyag deposit, 6.04 million tons of gypsum at the Karnabskoye field;

JSC Bekabadcement's (ex.BECM) limestone quarry Baliqly-Tau is located in the Jizzakh region and it carries limestone for almost 180 kilometers. Loess shale delivered from Sirdarya region, 19 km from the plant. Previously company used Hilkovskoe deposit, which is depleted now.

JSC Akhangarancement (OHSM) is currently using Urgaz (80 mln ton) and Karahtay (3.9 mln ton) deposits to deliver limestone. In order to supply new production capacity, which is currently under construction, company obtained the license for Shavazsay (36.9 mln ton) deposit in Pskent district of Tashkent region which was opened in 1974 year. Company purchased equipment from Italian TESMEC for \$1.6 million to use this new deposit.

JSC Quvasaycement (KSCM) has depleted own deposits and for a few last years is using Lyagan, Kyzyl-Kiy, Lyagan-Oktash, Karynkursay, Tash-Bulak, Chal-Tash and Jil-Jigan deposits in Kyrgyzstan, which is just 4-5 km from the plant.

SurkhanCementInvest owns a limestone quarry (19,5 million tons) and gypsum stone (1 million tons) in the Baysun district, located at a distance of 116 km from the industrial site of the plant. In addition, the company owns loess rocks in Jarkurgan, Khaudak deposit with reserves of 6 million tons at a distance of 8 km from the plant.

## **NEW CAPACITY**

Projects to be completed this year include the Huaxin Cement plant with a capacity of 1.5 million tons per year in the Jizzakh region, Qarshi Conch Cement plant with a capacity of 1.2 million tons per year in Kashkadarya, and a subsidiary of Eurocement, JSC Akhangarancement (OHSM), a 3 million tons per year plant, which is currently under construction by the Chinese company Beijing Triumph International Engineering. To new production line, Eurocement Group invested about \$160 mln. The potential capacity of the cement market in Uzbekistan by 2022 is estimated by Eurocement Group to be 15-18 million tons. At the same time, the republic is one of the leaders in introducing energy-efficient technologies (the share of the "dry method" is more than 50%) and has the highest utilization rate of production capacities in the CIS (95-97%).

Also, JSC "Bekabadcement" as part of a joint project with the World Bank, is modernizing the silo farm, specially equipped facilities for high-quality storage of cement. Until the end of 2020, it is planned to implement about 40 projects to modernize existing facilities and introduce modern technological equipment.

Also, the turning of production from consumption of gas into coal is a big issue for cement producers. If previously it was backed with a huge economic reasons, as the companies with coal energy consumption were free from paying a super-profit tax, now the process mostly pushed with intensions of Government to decrease the gas consumption, as the gas prices at local market is sufficiently subsidized and increasing very fast – retail gas prices increased 2.5 times for last five years, and for industrial suppliers prices were increased sufficiently and 2-3 times higher, than for retail. Same with electricity prices, which increased 4 times for last five years. According to our information JSC Bekabadcement and JSC Quvasaycement are considering projects to turn production to coal, and also few new plants are building with special equipment designed for coal consumption. The only supplier of bricked coal in Uzbekistan,

which is allowed to be used according to technical requirements, is JSC Shargunkumir in Surkhandarya region.

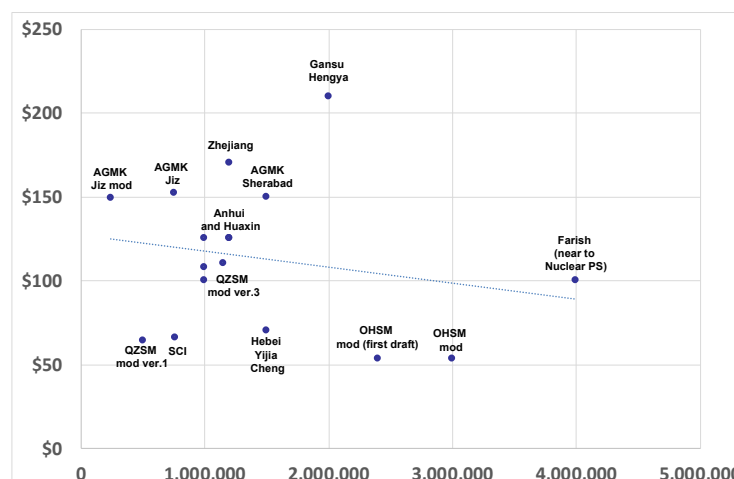
Analyzing potential new plants to be constructed it's should be noted, that a lot of projects do not turn at the construction phase after announcement. By our observations it is a total 25 projects announced over last 5 years with a total capacity of 26.97 mln ton for \$2.486 bln. By current understanding, only 3-5 of these projects are at real construction stage or have sufficient plants to be realized. Projects announced before 2017-2018 are definitely have sufficient demand to re-calculation of financial models due to changes in taxation system, as previously the margins, which could be received due to absence of super-profit tax with consumption of coal, could be planned at very high levels and entire financial plan of the investors could be based on this idea.

Few big projects, which should be noted, are:

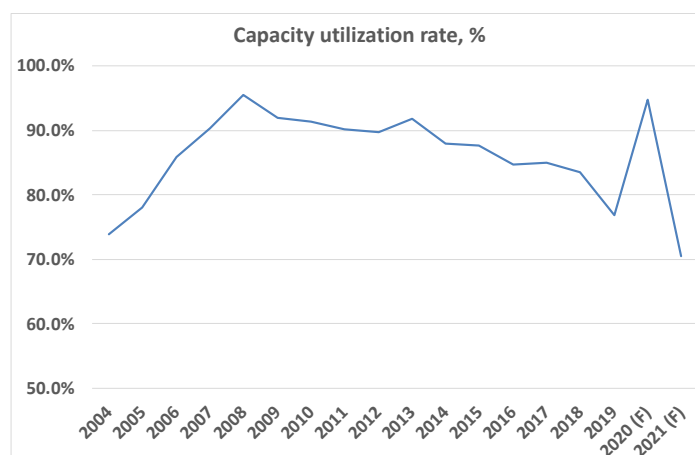
- New 4 million ton capacity cement plant for \$400 million to be constructed by the end of 2021 in Farish district of Jizzakh region on the land plot of 74 hectares. Operating company UTD Cement LLC established by UTD-Holding LLC, where German “Phoenix Consulting GmbH” and “Medianet in H.M.Hermesen” are investors. Plant will be concentrated on production of high quality M500-M900 (0.98 million ton capacity for M500, 1.22m for M600 and 0.94m for M900) and white (0.86m) cements and will create 1,500 new jobs. Plant could be located near the planned location of nuclear power station expected to be constructed in next ten years;
- Huaxin Cement starts construction of new 1.2 million ton of M-500 cement capacity plant with total cost of \$300 million in Jizzakh region. The commissioning of capacities is planned for December 2020. Due to pandemic, deadline could be postponed;
- Chinese Anhui Conch Cement will construct 1.2 million ton capacity plant in Qarshi with total amount of investments of \$150.5 million.

Installation of new capacities by current plants and start of the few new projects will help to increase and stabilize the utilization rate at the high level of more than 90%, but if all 6-8 projects announced in last years will be finalized and put into production, Uzbekistan could face the sufficient overproduction, which will decrease utilization rates and force neighboring countries to decrease overall cement prices to support the sales. In these conditions a lot of companies could face the decrease of margins, so the projects financed with borrowings are in the risk zone.

**New capacities and modernization of current ones  
(announced projects for last 10 years with reported capacity and cost)  
price per 1 tone of capacity**



We could only express our hope that Ministry of economy and production of Uzbekistan controls and monitor the situation with installation of new capacities and our expectations on level of consumption and its growth rates are sufficiently undervalued. Number of projects could be cancelled due to changes in taxation system, which will positively effect on the rest ones.



Source: Avesta Investment Group

### PEERS

Previously, before transfer of the cement trading onto UzRTSB Commodity Exchange, private cement production companies show better results than majority state-owned ones in terms of efficiency, that can be observed through gross margin and EBIT margins. In 2017 gross margin of JSC Akhangaransment (OHSM) and JSC Quvasaycement (KSCM) accounted about 57-60%, while JSC Bekabacement (ex.BECM) and JSC Qizilqumcement (QZSM) showed only 42-47%. However, in 2018 as a consequence of changes in distribution system, which became much more transparent, state owned plants outperformed the private ones. But still state owned-plants are losing more margins on SG&A expenses, which is clearly seen in analysis of EBIT margin (adjusted to other operational incomes) – if private companies are losing 14-15%, state-owned spend 15-18% of their revenues on administrative expenses.

	Gross profit					EBIT margin (adj)					Tax/Revenues				
	2016	2017	2018	2019	9M2020	2016	2017	2018	2019	9M2020	2016	2017	2018	2019	9M2020
QZSM	44.0%	42.7%	52.5%	39.2%	45.6%	27.0%	26.4%	37.3%	16.7%	30.7%	21.1%	22.0%	18.9%	4.0%	7.0%
BECM	50.5%	47.4%	43.3%	27.4%	38.4%	27.5%	25.7%	23.3%	0.9%	20.5%	25.1%	27.1%	19.9%	1.1%	4.5%
KSCM	60.5%	57.6%	41.1%	41.1%	49.9%	44.2%	40.6%	30.2%	30.2%	35.5%	26.1%	27.2%	20.8%	20.8%	7.5%
OHSM	59.5%	56.8%	45.7%	42.3%	48.9%	44.3%	50.1%	32.8%	35.3%	34.3%	27.0%	28.9%	23.3%	34.9%	6.4%
<b>Average</b>	<b>51.2%</b>	<b>48.8%</b>	<b>48.2%</b>	<b>38.3%</b>	<b>45.7%</b>	<b>33.7%</b>	<b>33.9%</b>	<b>33.3%</b>	<b>20.4%</b>	<b>30.5%</b>	<b>23.9%</b>	<b>25.2%</b>	<b>20.2%</b>	<b>13.0%</b>	<b>6.5%</b>
	P/E					P/B					Mcap/t of capacity				
	2016	2017	2018	2019	9M2020	2016	2017	2018	2019	9M2020	2016	2017	2018	2019	9M2020
QZSM	10.79	11.68	2.05	2.62	1.39	0.75	0.61	0.49	0.48	0.45	\$69.0	\$33.0	\$25.1	\$23.6	\$25.3
BECM	4.92	6.15	7.24	15.56	2.11	0.70	0.19	0.88	0.77	0.65	\$34.1	\$6.0	\$24.9	\$21.3	\$21.2
KSCM	1.93	2.60	3.75	6.64	1.26	0.53	0.42	0.47	0.83	0.47	\$32.9	\$19.0	\$14.8	\$23.9	\$19.8
OHSM	2.03	4.18	15.93	37.44	3.68	0.28	0.62	1.18	1.07	0.89	\$45.3	\$66.0	\$72.9	\$71.4	\$63.5
<b>Average</b>	<b>4.92</b>	<b>6.15</b>	<b>7.24</b>	<b>15.56</b>	<b>2.11</b>	<b>0.57</b>	<b>0.46</b>	<b>0.76</b>	<b>0.79</b>	<b>0.61</b>	<b>\$52.0</b>	<b>\$35.8</b>	<b>\$36.7</b>	<b>\$36.4</b>	<b>\$34.4</b>

Source: Single Portal for Corporate Information Disclosure, Calcs: Avesta Investment Group

In 2019, EBIT decreased significantly because of two main reasons – aforementioned decline of cement prices and change of tax system (substitution of super-profit tax on subsoil tax in 2018). As we could see, sufficient drop in amount of taxes paid to revenues are mostly caused with adjustment of subsoil tax, which is reflected on COGS accounts. Average EBIT margin decreased from 33.9 to 21%, while the taxes from 25.2 to 6.9%. We could presume, that subsoil tax creates about 15-17% of companies’ sales and up to 40-45% of cost. Average net profit margin in cement industry decreased to 10.4% in 2019 and equaled to 25.2% in 9M2020.

Average P/E ratio for cement industry shows the stable incline trend – from 6.15 in 2017 to 15.56 in 2019 (on the basis of three companies’ valuations, JSC Bekobodcement (ex.BECM) was not traded for many years and adjusted to average). However, in 9M2020 average P/E ratio equaled 2.11, due to significant increase of net profit. According to market price as the end of

November 2020

9M2020, most expensive company is JSC Akhangarancement (OHSM), which is probably caused with expectations of investors on their new 3 mln ton/year production facility building without any debt attracted. Average P/B ratio in 9M2020 declined to 0.61 from 0.79 in 2019. Cheapest company as the end of 9M2020 is JSC Quvasaycement (KSCM), which is traded at 1.26 profits. For 2019FY, JSC Qizilqumcement (QZSM) and JSC Bekobodcement (ex.BECM) paid dividends yield at 28.7 and 5.5% respectively, while 2 other observing cement producers did not pay.

Average market capitalization of one ton of cement production capacity is about \$34.4 as the end of 9M2020, while JSC Akhanagarancement (OHSM) is almost twice more expensive - \$63.5/ton. Other 3 plants are 26-42% cheaper than average: \$19.8/ton for JSC Quvasaycement (KSCM), \$21.2/ton for JSC Bekobodcement (ex.BECM), and \$25.3/ton for JSC Qizilqumcement (QZSM).

At the same time, most of the new announced projects are expected to be build at \$100-125 and up to \$200-210 per ton of capacity for most expensive projects. Modernization of current capacities is valued for \$60-100 per ton of new capacities, with a sufficient difference between state-owned and private projects. Such situation present a great opportunity for investors to benefit from investments into cheap current capacities, which will remain to have stable positions on the market in next few years before new capacities will be installed.



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