MOTILAL OSWAL

Grasim Industries

BSE SENSEX	S&P CNX
16,996	5,127
Bloomberg	GRASIM IN
Equity Shares (m)	91.7
52-Week Range (INR)	2,625/1,981
1,6,12 Rel. Perf. (%)	-6/23/15
M.Cap. (INR b)	228.4
M.Cap. (USD b)	4.6

CMP: INR2,491 **TP: INR2,666** **Buy**

Year End	Net Sales (INR m)	PAT (INR m)	EPS (INR)	EPS Gr. (%)	P/E (X)	P/BV (X)	RoE (%)	RoCE (%)	EV/ EBITDA	EV/Ton (USD)
03/10A	199,334	27,342	298.2	25.0	-	-	22.7	23.9	-	-
03/11A*	212,690	22,790	248.5	-16.7	10.0	1.6	16.8	16.5	5.4	96
03/12E*	232,934	26,862	292.9	17.9	8.5	1.3	17.0	17.2	5.4	103
03/13E*	269,443	31,535	343.8	17.4	7.2	1.2	17.1	18.2	4.5	78

Consolidated; * Demerger of cement business assumed w.e.f. 1 October 2009

Grasim's 3QFY12 standalone numbers were lower than our expectations, impacted by ~8% YoY decline in VSF volumes. EBITDA for the quarter was INR2.8b (v/s our estimate of INR3.46b) and EBITDA margin was 22.7% (v/s our estimate of 26.4%).

- Net sales grew 2% YoY to INR12.4b (our estimate: INR13.1b), EBITDA was up 23% YoY at INR2.8b and PAT declined 3% YoY to INR2.75b. EBITDA margin declined 720bp YoY (~140bp QoQ) to 22.7% (our estimate: 26.4%).
- VSF business volumes were 78,215 tons (lower than our estimate of 88,520 tons), impacted by cautious approach adopted by the value chain due to global economic uncertainties. While VSF realizations at INR128/kg were in-line, lower than estimated volumes and higher cost push resulted in lower than expected PBITDA margin at 25.6% (our estimate: 29.1%).
- The management indicated that the unprecedented volatility in the VSF business over the last few quarters is likely to remain, as both competing fabrics - cotton and polyester - are witnessing high volatility. While demand at the retail level is holding up, demand from the chain has been muted in 3QFY12 and is now picking up in January 2012.

Valuation and view: We downgrade our consolidated EPS estimates by 2.4% to INR293 for FY12 and by 3.6% to INR345 for FY13 to factor in lower volumes and higher cost push. The stock trades at 7.2x FY13E consolidated EPS and an EV of 4.5x FY13E EBTIDA; implied valuation for the cement business is USD78/ton. Maintain **Buy** with an SOTP-based target price of INR2,666.

Quarterly Performance (Standalone) **(INR Million)**

Y/E March	FY11 *				FY12 *				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
VSF Volume (ton)	67,302	67,488	84,621	85,650	54,839	78,959	78,215	85,225	305,072	297,238
YoY Change (%)	-0.2	-8.8	4.1	-0.1	-18.5	17.0	-7.6	-0.5	1.0	-2.6
VSF Realization (INR/ton)	117,910	116,465	123,060	144,962	152,409	124,689	128,499	128,380	126,614	131,864
YoY Change (%)	20.9	10.7	12.3	29.8	29.3	7.1	4.4	-11.4	18.9	4.1
QoQ Change (%)	5.6	-1.2	5.7	17.8	5.1	-18.2	3.1	-0.1		
Net Sales	**9,449**	**9,326**	**12,137**	**14,258**	**10,234**	**12,035**	**12,381**	**11,286**	**45,170**	**45,936**
YoY Change (%)	-69.0	-68.7	17.8	29.2	8.3	29.0	2.0	-20.8	-44.7	1.7
Total Expenditure	6,437	6,689	8,502	9,638	6,705	9,130	9,575	8,427	31,266	33,836
EBITDA	**3,012**	**2,638**	**3,635**	**4,620**	**3,529**	**2,905**	**2,807**	**2,860**	**13,904**	**12,100**
Margins (%)	31.9	28.3	29.9	32.4	34.5	24.1	22.7	25.3	30.8	26.3
Depreciation	445	453	442	423	351	356	366	377	1,763	1,450
Interest	102	103	117	133	106	107	72	-31	456	253
Other Income	593	1,623	842	1,209	1,010	2,157	1,140	1,193	4,267	5,500
PBT after EO Items	**3,058**	**3,705**	**3,917**	**5,273**	**4,082**	**4,599**	**3,509**	**3,707**	**15,952**	**15,897**
Tax	820	908	1,089	1,318	941	1,150	765	880	4,135	3,736
Rate (%)	26.8	24.5	27.8	25.0	23.0	25.0	21.8	23.7	25.9	23.5
Reported PAT	**2,238**	**2,796**	**2,827**	**3,955**	**3,141**	**3,448**	**2,745**	**2,827**	**11,817**	**12,161**
Adj. PAT	**2,238**	**2,796**	**2,827**	**3,955**	**3,141**	**3,448**	**2,745**	**2,827**	**11,817**	**12,161**
Margins (%)	23.7	30.0	23.3	27.7	30.7	28.7	22.2	25.0	26.2	26.5
YoY Change (%)	NA	NA	7.9	36.7	40.3	23.3	-2.9	-28.5	-27.8	2.9

E: MOSL Estimates; '* Not comparable YoY due to demerger of cement business

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Standalone performance below estimates impacted by lower VSF volumes

- Net sales up 2% to INR12.4b (v/s est INR13.1b), EBITDA up by 23% YoY at INR2.8b and PAT down 3% YoY to INR2.75b. EBITDA margin declined by 720YoY (~140bp QoQ) to 22.7% (v/s est 26.4%).
- Consolidated net sales grew by 16% to INR62.6b, with EBITDA margin improvement of 490bp QoQ (flat YoY) to 20.9%, EBITDA growth of 16% YoY to INR13.1b and PAT growth of 33% to INR6.7b.

Snapshot of consolidated performance (INR m)

	3QFY12	3QFY11	% YoY	2QFY12	% QoQ
Net Sales	62,601	53,899	16.1	56,492	10.8
EBITDA	13,090	11,255	16.3	9,028	45.0
EBIDT Margins (%)	20.9	20.9	0BP	16.0	490BP
Adj.PAT	6,691	5,018	33.3	4,179	60.1
Adj. EPS (INR)	73	55	33.3	46	60.1

Source: Company/MOSL

VSF business - muted volumes impact performance

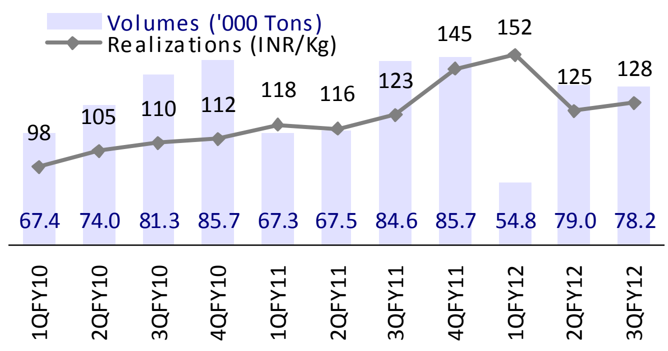
- VSF business volumes were below estimate at 78,215 tons (v/s est 88,520 tons) impacted by cautious approach adopted by the value chain due to global economic uncertainties.
- While VSF realizations at INR128/Kg (v/s est INR128/Kg) were in-line, lower than estimated volumes and higher cost push resulted in below estimate PBITDA margins at 25.6% (v/s est 29.1%).
- On consolidated basis, VSF PBIDT margins were 24.4% (down 820bp YoY & 120bp QoQ) and PBIDT of INR3.06b (v/s standalone PBIDT of INR2.78b). Consolidated VSF performance was severely impacted by higher input cost and rupee appreciation. Domsjo, an associate company, contributed INR85m to consolidated PAT.

VSF business performance

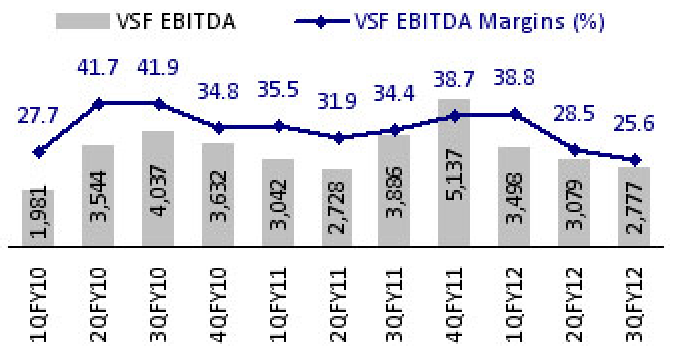
	3QFY12	3QFY11	% YoY	2QFY12	% QoQ
Production (ton)	84,233	83,026	1.5	83,516	0.9
Sales volume (ton)	78,215	84,621	-7.6	78,959	-0.9
Net Turnover (INR m)	10,851	11,293	-3.9	10,820	0.3
Avg Realizations (INR/ton)	128,499	123,060	4.4	124,689	3.1
PBIDT Margin (%)	25.6	34.4	-880BP	28.5	-290BP
PBDIT (INR m)	2,777	3,886	-28.5	3,079	-9.8

Source: Company/MOSL

Trend in VSF business volumes & realizations



Trend in VSF business EBITDA



Source: Company/MOSL

VSF volumes visibility poor driven by unprecedented volatility

- The management indicated that the unprecedented volatility in VSF business over last few quarters is expected to remain, as both competing fabrics i.e cotton and polyester are witnessing high volatility.
- Also, the value chain has been proactive in managing inventory. As a result, Grasim is having inventory of ~27,000 tons (~1 months). While demand at retail level is holding up, demand from the chain has been muted in 3QFY12 and is now picking-up in Jan-12.
- It has witnessed 7-8% QoQ decline in international VSF prices in 3QFY12, however weak INR resulted in ~3% QoQ improvement in Grasim's VSF realizations. Also, pulp prices have also softened, but benefit of which is not yet realized due to weak INR.

Short term outlook improving for Cement; however VSF business lacks clarity; investing aggressively to consolidate leadership in both businesses

- Outlook: "In VSF, the demand may remain volatile in the present macro economic conditions. In Cement, the surplus scenario should subside gradually over a period of 2-3 years with an expected growth in demand. The changed pricing mechanism by Coal India Limited w.e.f. Jan' 12 will lead to increase in energy costs. The rising energy cost is a challenge in both the businesses in the present context."
- Its capex program to add ~156,500 ton is on track, with Harihar brownfield addition of 36,000 tons in two phases by Jul-12 and Jan-13 and Vilayat Greenfield addition of 120,000 units by Jan-13. This would result in ~47% increase in Grasim's VSF capacity to ~490,000 tons.
- It has invested INR567m for 33% stake in JV with other promoter owned companies for setting up a 180,000 ton Greenfield VSF capacity in Turkey. This is initial capital required for acquiring land and meeting initial expenses.

Deferment of capex in both cement and VSF business (INR Cr)

	Net Capex to be spent as on 01.04.11	Cash Outflow		Capex spent during 9MFY12
		FY12	FY13 Onwards	
VSF Business				
- Expansion Projects: Vilayat (120K TPA), Harihar (36K TPA)	2,110			
- Other Capex	341			
Chemical Business – Vilayat (182K TPA)	756			
Balance Capex (Including normal capex for chemical)	173			
Standalone Capex (A)	3,380	1,130	2,250	628
Cement Subsidiaries				
- Capacity expansion – 4.8 Mn TPA at Raipur, Chhattisgarh 4.4 Mn. TPA at Malkhed, Karnataka	5,149			
- Material Evacuation and Logistic Infrastructure	1,104			
- Thermal Power Plant (75 MW) & Waste Heat Recovery System (45 MW)	684			
- RMC Business & New Products	335			
- Modernisation, Upgradation and others	3,728			
Cement Business Capex (B)	11,000	3,815	7,185	2,207
Capex (A + B)	14,380	4,945	9,435	2,835

Source: Company

- For Cement, it expects demand to grow over 8-9% over next 2-3 years. It expects ~17mt of capacity addition in FY12 over and above 88mt of capacity in FY10-11, resulting in a surplus scenario which would subside gradually over next 2 to 3 years. As a result, it expects pricing and margins to remain challenging. It is investing INR110b in its cement business for augmenting capacity (~9.2MT @ INR56b), logistic infrastructure and modernization/upgradation.
- It has reduced FY12 expected capex to INR49.5b (incl INR38.2b in UltraTech) from INR63.9b (incl INR47.1b in UltraTech), with ~INR28.3b invested in 9MFY12 (incl INR28.4b in UltraTech).

Valuation and view

- The short term outlook for both VSF is not positive. However, cement business outlook is improving with expected improvement in demand and pricing. Further, its aggressive capex plan of investing INR144b over next 2-3 years endorses our long term positive outlook for both the businesses.
- The stock is quoting at very attractive valuations of 7.2x FY13E consolidated EPS and 4.5x FY13 EV/EBITDA and implied valuation of cement business valuations of US$78/ton (on 60mt capacity).
- Maintain **Buy** with target price of INR2,666 (SOTP based, valuing economic interest in cement business at 8x EV/EBITDA post 20% hold-co discount and VSF at 4x EV/EBITDA).

Grasim: SOTP based fair value

INR m	Parameter	Multiple	FY12E	FY13E
Standalone VSF business	EV/EBITDA (x)	4	48,401	53,272
"UltraTech Cement @ 60.3% (post 30% holdco discount)	EV/EBITDA (x)	8	128,464	159,584
Total EV			**176,865**	**212,855**
Less: Gross Debt (incl pro-rata in subs)			49,329	49,329
Add: Cash & liquid invest			49,829	55,621
Add: Group holdings	@ 20% discount		25,361	25,361
Total Equity Value			202,726	244,508
Fair value (INR/sh) post demerger			**2,210**	**2,666**

Source: MOSL

Implied Hold-co discount

(INR m)	FY12E	FY13E
Market Cap	228,442	228,442
Add: Net Debt	-25,861	-31,653
EV	**202,581**	**196,790**
Less: EV of VSF @ 4x EV/EBITDA	48,401	53,272
Implied EV of Cement	**154,181**	**143,518**
Implied EV/EBITDA (x)	**6.7**	**5.0**
Implied EV/Ton (USD)	**103**	**78**
Implied Discount to		
UltraTech on replacement cost (%)	25	43
UltraTech on EV/EBITDA (%)	49	62
ACC/Ambuja on EV/EBITDA (%)	46	59

Source: Company/MOSL

Grasim Industries: an investment profile

Company description

Grasim is a diversified company with cement and VSF being core business, accounting for 65% and 35% of revenues (post-restructuring). Its other business includes chemicals and textiles. The acquisition of UltraTech Cement, the cement division of L&T, by Grasim catapulted it to number one position in the Indian cement industry with total capacity under control of 51mt.

Key investment argument

- Being largest player with total capacity of 51MT (existing capacity) under control and highest organic growth visibility, Grasim would be biggest beneficiary of any further increase in cement price.
- Global leader in VSF business, with backward integration in pulp, experiencing robust demand in both global and domestic markets.

Key investment risks

- Cement sector is likely to add huge capacities in coming year which can result in significant volatility in cement prices.
- Declining competing fibre prices coupled with increasing cost would put pressure on VSF business profitability.

Recent development

- It has invested INR567m for 33% stake in JV with other promoter owned companies for setting up a 180,000 ton Greenfield VSF capacity in Turkey. This is initial capital required for acquiring land and meeting initial expenses.

Valuation and view

- The stock is quoting at very attractive valuations of 7.2x FY13E consolidated EPS and 4.5x FY13 EV/EBITDA and implied valuation of cement business valuations of USD78/ton (on 60mt capacity).
- Maintain Buy with target price of INR2,666 (SOTP based, valuing economic interest in cement business at 8x EV/EBITDA post 20% hold-co discount and VSF at 4x EV/EBITDA).

Sector view

- We believe we have already witnessed bottom-of-the-cycle utilization & profitability, and it should gradually improve hereon given sustainable demand drivers.
- Structural increase in cost base would necessitate higher cement prices.
- Revival in cement demand, which we expect to improve from 2HFY12, would be key catalyst for the stock performance.

Comparative valuations

		Grasim	ACC	GACL
P/E (x)	FY12E	8.5	22.0	19.6
	FY13E	7.2	20.8	19.7
P/BV (x)	FY12E	1.3	3.4	3.3
	FY13E	1.2	3.1	3.1
EV/Ton (US$)	FY12E	103	129	176
	FY13E	78	125	161
EV/EBITDA (x)	FY12E	5.4	12.8	12.1
	FY13E	4.5	11.3	11.1

Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	25.6	25.6	25.5
Domestic Inst	18.0	17.8	19.6
Foreign	38.3	38.0	38.2
Others	18.2	18.7	16.7

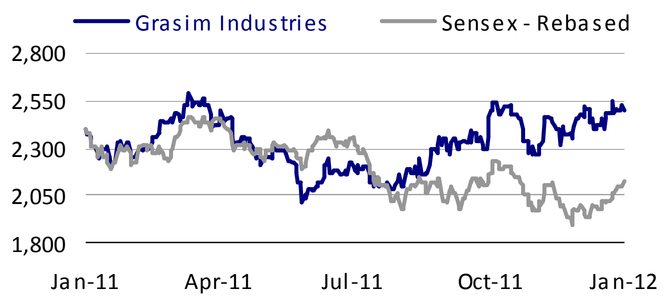
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	292.9	260.2	12.6
FY13	343.8	275.6	24.7

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
2,491	2,666	7.0	Buy

Stock performance (1 year)



Financials and Valuation

Consolidated Income Statement (INR Million)

Y/E March	2009	2010	2011	2012E	2013E
Net Sales	182,966	199,334	212,690	232,934	269,443
Change (%)	7.8	8.9	6.7	9.5	15.7
Total Expenditure	139,643	141,467	165,858	180,511	206,486
EBITDA	43,323	57,867	46,832	52,424	62,957
Change (%)	-12.7	33.6	-19.1	11.9	20.1
Margin (%)	23.7	29.0	22.0	22.5	23.4
Depreciation	8,658	9,947	11,384	11,013	12,525
EBIT	34,665	47,920	35,449	41,411	50,433
Int. and Finance Char	3,067	3,346	4,056	2,574	2,606
Other Income - Rec	4,468	5,356	7,135	8,856	9,006
PBT before EO items	36,066	49,930	38,528	47,692	56,832
Change (%)	-20.4	38.4	-22.8	23.8	19.2
EO Exp	0	-3,613	0	0	0
PBT after EO items	36,066	53,543	38,528	47,692	56,832
Tax	9,914	15,957	9,576	12,504	15,312
Tax Rate (%)	27.5	29.8	24.9	26.2	26.9
Reported PAT	26,152	37,586	28,952	35,188	41,520
PAT Adj for EO items	26,152	33,973	28,952	35,188	41,520
Change (%)	-17.0	29.9	-14.8	21.5	18.0
Margin (%)	14.3	17.0	13.6	15.1	15.4
Less: Minority Interes	4,286	6,631	6,162	8,326	9,985
Consolidated PAT	21,867	27,342	22,790	26,862	31,535
Change (%)	-18.9	25.0	-16.6	17.9	17.4

Consolidated Balance Sheet (INR Million)

Y/E March	2009	2010	2011	2012E	2013E
Equity Share Capital	917	917	917	917	917
Reserves	114,783	124,329	144,669	168,848	197,163
Net Worth	115,700	125,246	145,586	169,765	198,081
Loans	59,162	55,992	67,827	65,784	65,784
Deferred liabilities	15,919	20,057	19,616	19,616	19,698
Minority Interest	16,704	37,548	43,514	51,840	61,825
Capital Employed	207,484	238,844	276,543	307,004	345,387
Gross Block	190,622	209,439	228,066	269,697	317,697
Less: Accum. Deprn.	68,254	71,646	83,749	94,762	107,287
Net Fixed Assets	122,368	137,793	144,316	174,935	210,410
Capital WIP	19,822	7,734	13,578	22,000	15,000
Investments	35,626	66,759	79,185	73,068	80,967
Goodwill	20,010	20,071	24,191	24,191	24,191
Curr. Assets	45,343	45,379	58,797	61,728	71,402
Inventory	22,210	21,835	27,229	27,952	32,333
Account Receivables	8,249	8,803	14,346	15,141	17,514
Cash and Bank Balan	2,270	2,370	2,844	3,494	4,042
Others	12,615	12,371	14,378	15,141	17,514
Curr. Liability & Prov.	35,685	38,891	43,524	48,916	56,583
Account Payables	24,374	22,209	29,372	32,611	37,722
Other Liabilities	4,749	8,161	6,381	6,988	8,083
Provisions	6,562	8,522	7,771	9,317	10,778
Net Current Assets	9,659	6,488	15,273	12,811	14,819
Appl. of Funds	207,484	238,844	276,542	307,004	345,387

E: MOSL Estimates

Ratios

Y/E March	2009	2010	2011	2012E	2013E
Basic (INR)					
EPS	238.5	298.2	248.5	292.9	343.8
Cash EPS	298.6	396.2	371.1	458.5	533.7
BV/Share	1,262	1,366	1,587	1,851	2,160
DPS	30.0	30.0	20.0	25.0	30.0
Payout (%)	15.0	12.0	9.4	10.0	10.2
Valuation (x)					
P/E			10.0	8.5	7.2
Cash P/E			6.7	5.4	4.7
P/BV			1.6	1.3	1.2
EV/ EBITDA			5.4	5.4	4.5
Dividend Yield (%)			0.8	1.0	1.2
EV/Ton (US$)			96	103	78
Return Ratios (%)					
RoE	21.1	22.7	15.7	15.8	15.9
RoCE	20.6	23.9	20.0	21.3	22.5
Working Capital Ratios					
Debtor (Days)	16	16	25	24	24
Asset Turnover (x)	0.9	0.8	0.8	0.8	0.8
Leverage Ratio					
Debt/Equity (x)	0.5	0.4	0.5	0.4	0.3

Consolidated Cash Flow Statement (INR Million)

Y/E March	2009	2010	2011	2012E	2013E
OP/(Loss) before Tax	44,791	60,975	46,832	52,424	62,957
Interest/Dividends R	1,700	2,216	7,135	8,856	9,006
Direct Taxes Paid	-5,509	-11,190	-10,018	-12,504	-15,230
(Inc)/Dec in WC	-4,657	-1,497	-8,311	3,112	-1,460
CF from Operations	36,325	50,503	35,638	51,887	55,273
EO Items	0	0	0	0	0
CF frm Op. incl EO	36,325	50,503	35,638	51,887	55,273
(inc)/dec in FA	-26,468	-5,312	-23,751	-50,053	-41,000
(Pur)/Sale of Invest	-11,882	-32,880	-16,742	6,117	-7,900
CF from Invest.	-38,350	-38,192	-40,493	-43,936	-48,900
Issue of Shares	438	18	-304	0	0
(Inc)/Dec in Debt	7,991	-4,647	11,835	-2,044	0
Interest Paid	-3,160	-4,039	-4,056	-2,574	-2,606
Dividend Paid	-3,553	-3,545	-2,146	-2,683	-3,219
CF from Fin. Activity	1,715	-12,212	5,328	-7,301	-5,826
Inc/Dec of Cash	-633	100	474	650	548
Add: Beginning Balan	2,903	2,270	2,370	2,844	3,494
Closing Balance	2,270	2,370	2,844	3,494	4,042

NOTES

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