

# GRASIM INDUSTRIES

## Cement atones for weakness in VSF

India Equity Research | Cement



Grasim Industries' (Grasim) consolidated EBITDA of INR14.1bn was above our estimate of INR11.5bn, led primarily by a robust performance of cement. Standalone EBITDA of INR3.1bn was, however, below our estimate of INR3.5bn due to weak performance of VSF. PBIDTA margins of VSF dipped 440bps QoQ due to 1% decline in blended realisations and higher cost. With near term outlook for VSF segment being weak, we are lowering VSF EBITDA estimate for FY13 by 1% and for FY14 by 5%. However, with the improving cement pricing outlook, we are revising up our cement EBITDA estimates by 18% and 20% for FY13 and FY14 respectively leading to our consolidated EBITDA also being revised up by 15.5% for both FY13 and FY14 respectively. We are also introducing our FY15 earnings estimate with an EBITDA growth of 21%. With revised TP of INR4,322 per share (INR 3,033 earlier), we maintain 'BUY'.

### Firm prices fuel cement business performance

Performance of its 60.3% subsidiary, UltraTech was above estimates with a blended EBITDA/t of INR1,099 vs our expectation of INR852. Blended realisations increased 2.9% QoQ vs our expectation of a decline. EBITDA at INR10.3bn was significantly above our estimate of INR7.9bn. Higher clinker sales (230kt) and above expected revenues of white cement segment (INR3.2bn) contributed to the overall EBITDA outperformance.

### Weak near term outlook for VSF

VSF segment's PBIDTA margin declined 440bps QoQ to 21.6% due to 1% QoQ dip in blended realisations (versus our expectation of 1% increase) and increase in costs. VSF performance will remain under pressure in near term due to weak prices.

### Outlook and valuations: cement shines; maintain 'BUY'

We are lowering our VSF EBITDA/kg estimates by 5% for FY13 and 6% for FY14. However with an improving cement price outlook, we revise up our EBITDA/t by 21% for FY13 and 25% for FY14. We are also introducing our estimates for FY15, signifying 7% growth in cement EBITDA/t and 5% growth in VSF EBITDA/kg. We continue to value Grasim on SOTP basis (see table 3) yielding us a TP of INR4,322 on FY15 earnings estimate. Maintain 'BUY'/Sector Outperformer' recommendation/ rating on the stock.

#### Financials (Consolidated)

(INR mn)

Year to March	Q2FY13	Q2FY12	% change	Q1FY13	% change	FY12	FY13E	FY14E
Net rev.	66,021	57,741	14.3	68,320	(3.4)	252,443	270,145	317,648
EBITDA	14,054	10,278	36.7	16,318	(13.9)	55,749	64,694	76,818
PAT	6,196	4,179	48.2	7,180	(13.7)	26,475	31,356	34,184
EPS (INR)	67.6	45.6	48.2	78.3	(13.7)	288.6	341.9	372.7
P/E (x)						11.7	9.9	9.1
EV/EBIDTA (x)						6.2	5.8	4.9
ROE (%)						22.4	23.3	22.1

#### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Underweight

#### MARKET DATA (R: GRAS.BO, B: GRASIM IN)

CMP	: INR 3,381
Target Price	: INR 4,322
52-week range (INR)	: 3,511 / 2,205
Share in issue (mn)	: 91.7
M cap (INR bn/USD mn)	: 310/ 5,744
Avg. Daily Vol.BSE/NSE('000)	: 79.0

#### SHARE HOLDING PATTERN (%)

	Current	Q1FY13	Q4FY12
Promoters *	25.5	25.5	25.5
MF's, FI's & BK's	16.8	16.8	16.9
FII's	23.5	23.5	23.5
Others	34.2	34.2	34.1
* Promoters pledged shares (% of share in issue)	:		NIL

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Construction Material Index
1 month	5.2	(0.0)	12.3
3 months	30.3	11.2	25.6
12 months	48.7	12.7	58.9

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### Other highlights for the quarter

Joint ventures in the VSF segment (Pulp and Fibre JVs) reported a PBIDT of INR176mn (versus loss of INR85mn in Q1FY13). However at the PBIT level, it continued to make a loss of INR7mn vs a loss of INR156mn in Q1FY13. Decline in pulp prices affected the performance of the JVs.

Its 33% associate company, Domsjo reported a PAT of INR305mn (Grasim's share) versus a loss of INR32mn in Q1FY13, due to an improvement in volumes and forex gains. The 45 ktpa of pulp capacity was reported as being commissioned in Q2, taking its capacity of 255ktpa. Pulp from Domsjo will be used at Grasim's greenfield expansion at Vilayat, Gujarat.

Volumes of the chemicals business were below estimates declining 3% YoY. While blended realisations were broadly in line, lower than expected costs helped PBIDTA margins increase 140bps QoQ to 29.7%. PBIDTA at INR669mn remained nearly flat QoQ.

**Capex update:** Grasim has commissioned 18,250tpa (Phase I) of VSF capacity expansion at Harihar, Karnataka. Phase II expansion of similar capacity will get commissioned by Q4FY13. The 120ktpa greenfield expansion at Vilayat, Gujarat is slightly delayed and will now get commissioned by middle of Q1FY14 as against by end of Q4FY13 guided earlier.

It plans to set up an Epoxy plant at Vilayat at a cost of INR2.2bn with capacity of 51,500tpa by Q3FY14.

The Terrace Bay, Canada acquisition was completed and operations re-started in October 2012, thereby strengthening pulp integration.

In cement, the 10.2 mtpa brownfield expansion (including 1 mtpa grinding unit at Pipavav (Gujarat) is on track to get commissioned in Q1FY14.

### SOTP valuation

Particulars	FY15E
Assumed EV/EBITDA multiple for VSF (X)	5.0
EV of VSF segment (1)	74,926
EV of Chemicals & Textile segments @3x EV/EBITDA (2)	9,114
EV of Grasim Standalone(1) + (2) = (3)	84,040
Net debt of Grasim excl Ultratech (4)	7,181
Derived Mcap of Grasim Standalone (3) + (4) = (5)	76,859
Value of 60.3% holding in UltraTech @20% discount (6)	319,409
Derived Mcap of Grasim (5) + (6) = (7)	396,268
S/o (mn) (8)	91.7
Value per share (INR) (7/8)	4,322

Source: Edelweiss research

**Financial snapshot - Consolidated**
**(INR mn)**

Year to March	Q2FY13	Q2FY12	% change	Q1FY13	% change	FY12	FY13E	FY14E
Revenues	66,021	57,741	14.3	68,320	(3.4)	252,443	270,145	317,648
Raw material	13,888	13,805	0.6	14,024	(1.0)			
Staff costs	869	701	24.0	759	14.5			
Power & fuel	3,912	3,396	15.2	3,753	4.2			
Freight outward	13,853	12,408	11.6	13,890	(0.3)			
Others	9,776	7,850	24.5	10,786	(9.4)			
Total expenditure	51,968	47,464	9.5	52,002	(0.1)	196,694	205,451	240,830
EBITDA	14,054	10,278	36.7	16,318	(13.9)	55,749	64,694	76,818
Interest	868	894	(2.9)	740	17.3	3,136	2,772	2,825
Depreciation	3,066	2,837	8.0	2,979	2.9	11,544	10,774	14,747
Other income	998	1,068	(6.5)	1,357	(26.4)	7,454	8,263	7,635
PBT	11,118	7,615	46.0	13,955	(20.3)	48,522	59,412	66,880
Tax	3,089	2,374	30.1	3,856	(19.9)	13,208	16,474	19,551
Core profit	8,029	5,241	53.2	10,100	(20.5)	35,314	42,938	47,329
PAT	6,196	4,179	48.2	7,180	(13.7)	26,475	31,356	34,184
No. of shares (mn)	91.7	91.7		91.7		91.7	91.7	91.7
EPS (INR)	67.6	45.6	48.2	78.3	(13.7)	288.6	341.9	372.7
PE (x)						11.7	9.9	9.1
EV/EBITDA (x)						6.2	5.8	4.9
Market cap / Revenues (x)						1.2	1.1	1.0

**as % of net revenues**

Raw material	21.0	23.9		20.5				
Staff expenses	1.3	1.2		1.1				
Power & fuel	5.9	5.9		5.5				
Freight outward	21.0	21.5		20.3				
Other expenses	14.8	13.6		15.8				
EBITDA	21.3	17.8		23.9		22.1	23.9	24.2
Adjusted net profit	12.0	8.9		14.5		13.6	15.4	14.6
Tax rate (%)	27.8	31.2		27.6		27.2	27.7	29.2

**Change in estimates**

	FY13E			FY14E			Comments
	New	Old	% change	New	Old	% change	
Revenue (INR mn)	270,145	262,815	2.8	317,648	309,408	2.7	We are lowering our VSF EBITDA/kg estimates by 5% and 6% for FY13/FY14 resp. For cement segment, we revise up our EBITDA/t by 21% for FY13 and 25% for FY14.
EBITDA (INR mn)	64,694	56,027	15.5	76,818	66,491	15.5	
EBITDA margin (%)	24	21		24	21		
Net profit (INR mn)	31,356	24,201	29.6	34,184	27,994	22.1	
PAT margin (%)	16	12		15	12		

## Financial snapshot - Standalone

(INR mn)

Year to March	Q2FY13	Q2FY12	% change	Q1FY13	% change
Revenues	13,534	12,485	8.4	12,583	7.6
Raw material	6,783	5,588	21.4	5,766	17.6
Staff costs	893	809	10.4	885	0.8
Power & fuel	1,797	1,751	2.6	1,793	0.2
Freight outward	194	170	14.1	206	(6.2)
Others	781	813	(3.9)	787	(0.7)
Total expenditure	10,447	9,130	14.4	9,438	10.7
EBITDA	3,087	3,355	(8.0)	3,145	(1.9)
Interest	78	107	(27.1)	61	27.7
Depreciation	386	356	8.4	360	7.4
Other income	1,917	1,707	12.3	652	194.2
PBT	4,540	4,599	(1.3)	3,376	34.5
Tax	712	1,150	(38.1)	647	10.1
Adjusted net profit	3,827	3,448	11.0	2,729	40.2
Net profit	3,827	3,448	11.0	2,729	40.2
Equity capital (FV INR 10)	917	917		917	
No. of shares (mn)	91.7	91.7		91.7	
Adj EPS (INR)	41.7	37.6	11.0	29.8	40.2

## as % of net revenues

Raw material	50.1	44.8		45.8	
Staff expenses	6.6	6.5		7.0	
Power & fuel	13.3	14.0		14.3	
Freight outward	1.4	1.4		1.6	
Other expenses	5.8	6.5		6.3	
EBITDA	22.8	26.9		25.0	
Adjusted net profit	28.3	27.6		21.7	
Tax rate (%)	15.7	25.0		19.2	

## Segmentwise results - standalone

Segment	Q2FY13	Q2FY12	% change	Q1FY13	% change
<b>Viscose staple fibre</b>					
Revenue (INR mn)	11,640	10,820	7.6	10,619	9.6
Volume ('000 tonnes)	85.3	79.0	8.0	77.0	10.8
Net realisation (INR/tonne)	129,000	124,689	3.5	128,571	0.3
PBIDTA (INR mn)	2,513	3,079	(18.4)	2,760	(9.0)
PBIDTA margin (%)	21.6	28.5		26.0	
PBIDTA / tonne (INR/tonne)	29,452	38,989	(24.5)	35,838	(17.8)
<b>Chemicals</b>					
Revenue (INR mn)	2,252	1,915	17.6	2,344	(3.9)
Volume ('000 tonnes)	66	67	(2.7)	69	(5.7)
Net realisation (INR/tonne)	34,388	28,444	20.9	33,745	1.9
PBIDTA (INR mn)	669	466	43.7	664	0.9
PBIDTA margin (%)	29.7	24.3		28.3	
PBIDTA / tonne (INR/tonne)	10,220	6,921	47.7	9,551	7.0

## Company Description

Headquartered in Mumbai, Grasim is the flagship company of the Aditya Birla Group, and is one of the largest private sector companies in India. Incorporated in 1947, it commenced operations in 1948 as a textile manufacturer. Over the years, it has become a diversified conglomerate with presence in four business segments—VSF, cement, chemicals, and textiles. VSF and cement are the main segments, contributing ~90% to the company's revenue and operating profit. Post the de-merger of its cement business, Grasim holds 60.3% in UltraTech, which now has a cement capacity of 52mtpa (including 3 mtpa of ETA Star Cement).

## Investment Theme

Grasim being a monopoly player in VSF will benefit from higher volume growth due to capacity expansion. Volumes in the cement business too will outperform industry growth due to capacity expansion. With valuations being attractive, we continue to like the stock and maintain 'BUY'.

## Key Risks

Sharp decline in cement and VSF prices.

Sharp increase in input cost for VSF and also international and domestic coal prices.

## Financial Statements

### Key Assumptions

Year to March		FY11	FY12	FY13E	FY14E	FY15E
<b>Macro -</b>	GDP(Y-o-Y %)	8.4	6.5	6.4	7.0	7.0
	Inflation (Avg)	9.9	8.8	7.0	6.0	6.0
	Repo rate (exit rate)	6.8	8.5	7.3	6.8	6.0
	USD/INR (Avg)	45.6	47.9	53.5	52.0	50.0
<b>Sector -</b>	All India cement demand (mt)	207	221	241	263	284
	Industry volume growth (%)	5.6	6.6	7.6	9.1	9.1
	Industry capacity utilisation (%)	79.2	77.0	77.7	77.0	81.0
	All India average price (INR/50 kg)	244.0	266.0	305.7	322.0	337.7
<b>Company -</b>	VSF volumes ('000 tonnes)	305	307	337	388	427
	VSF realisations(INR/tonne)	126,606	129,563	125,239	130,115	138,092
	VSF EBITDA/tonne (INR)	44,051	35,809	29,656	33,314	35,091

### Income statement

(INR mn)

Year to March	FY11	FY12	FY13E	FY14E	FY15E
Income from operations	212,690	252,443	270,145	317,648	373,664
Total operating expenses	165,858	196,694	205,451	240,830	280,569
EBITDA	46,832	55,749	64,694	76,818	93,095
Depreciation & Amortization	11,384	11,544	10,774	14,747	17,520
EBIT	35,449	44,205	53,921	62,071	75,575
Other income	7,135	7,454	8,263	7,635	9,166
Interest expenses	4,056	3,136	2,772	2,825	3,505
Profit before tax	38,528	48,522	59,412	66,880	81,235
Provision for tax	9,576	13,208	16,474	19,551	23,805
Net profit	28,952	35,314	42,938	47,329	57,430
Profit after minority interest	22,790	26,475	31,356	34,184	40,780
Shares outstanding (mn)	92	92	92	92	92
Diluted EPS (INR)	248.5	288.6	341.9	372.7	444.6
CEPS (INR)	441.4	509.0	585.6	676.8	817.2
Dividend per share (INR)	20.0	22.5	30.0	30.0	30.0
Dividend payout (%)	16.6	11.0	8.1	9.4	7.9

### Common size metrics - as % of net revenues

Year to March	FY11	FY12	FY13E	FY14E	FY15E
Operating expenses	78.0	77.9	76.1	75.8	75.1
EBITDA margins	22.0	22.1	23.9	24.2	24.9
Net profit margins	13.6	14.0	15.9	14.9	15.4

### Growth ratios (%)

Year to March	FY11	FY12	FY13E	FY14E	FY15E
Rev. growth (%)	6.7	18.7	7.0	17.6	17.6
EBITDA	(19.1)	19.0	16.0	18.7	21.2
Net profit	(15.4)	22.0	21.6	10.2	21.3
EPS growth (%)	(17.4)	16.2	18.4	9.0	19.3

<b>Balance sheet</b>						(INR mn)
<b>As on 31st March</b>	<b>FY11</b>	<b>FY12</b>	<b>FY13E</b>	<b>FY14E</b>	<b>FY15E</b>	
Equity capital	917	917	917	917	917	
Pref. Capital	377	419	419	419	419	
Reserves & surplus	144,439	169,350	198,167	229,132	266,692	
Shareholders funds	145,734	170,687	199,503	230,468	268,029	
Minority interest (BS)	43,514	52,334	64,606	78,442	95,782	
Secured loans	38,346	36,262	36,262	36,262	36,262	
Unsecured loans	29,481	29,481	29,481	29,481	29,481	
Borrowings	67,827	65,744	65,744	65,744	65,744	
Deferred tax (net)	19,616	19,790	19,790	19,790	19,790	
<b>Sources of funds</b>	<b>276,691</b>	<b>308,554</b>	<b>349,643</b>	<b>394,444</b>	<b>449,345</b>	
Gross block	228,066	245,820	271,542	366,032	386,032	
Depreciation	83,749	95,293	106,067	120,814	138,334	
Net block	144,316	150,527	165,476	245,218	247,698	
Capital work in progress	13,578	24,611	63,889	8,399	6,399	
Intangible assets	24,203	24,964	24,964	24,964	24,964	
Investments	79,333	78,758	62,758	79,758	129,758	
Inventories	27,216	30,711	32,323	34,736	37,921	
Sundry debtors	14,346	17,288	18,732	21,857	23,813	
Cash and equivalents	2,844	3,252	2,098	1,548	1,349	
Loans and advances	14,378	34,909	34,909	34,909	34,909	
Other current assets	-	324	324	324	324	
Total current assets	58,784	86,484	88,385	93,374	98,316	
Sundry creditors and others	35,753	47,006	46,044	47,485	48,006	
Provisions	7,771	9,784	9,784	9,784	9,784	
Total current liabilities & provisions	43,524	56,790	55,829	57,270	57,791	
Net current assets	15,261	29,694	32,557	36,104	40,525	
Miscellaneous expenditure	-	-	-	-	-	
<b>Uses of funds</b>	<b>276,691</b>	<b>308,554</b>	<b>349,643</b>	<b>394,444</b>	<b>449,345</b>	
Book value per share (INR)	1,588.9	1,861.0	2,175.1	2,512.7	2,922.3	

<b>Free cash flow</b>						(INR mn)
<b>Year to March</b>	<b>FY11</b>	<b>FY12</b>	<b>FY13E</b>	<b>FY14E</b>	<b>FY15E</b>	
Net profit	22,790	35,314	42,938	47,329	57,430	
Depreciation	11,384	11,544	10,774	14,747	17,520	
Deferred tax	151	(177)	-	-	-	
Others	9,584	7,279	-	-	-	
Gross cash flow	43,909	53,961	53,712	62,076	74,950	
Less: Changes in WC	8,299	14,025	4,017	4,097	4,620	
Operating cash flow	35,610	39,936	49,694	57,979	70,330	
Less: Capex	14,326	28,788	65,000	39,000	18,000	
<b>Free cash flow</b>	<b>21,284</b>	<b>11,148</b>	<b>(15,306)</b>	<b>18,979</b>	<b>52,330</b>	

<b>Cash flow metrics</b>					
<b>Year to March</b>	<b>FY11</b>	<b>FY12</b>	<b>FY13E</b>	<b>FY14E</b>	<b>FY15E</b>
Operating cash flow	35,610	39,936	49,694	57,979	70,330
Investing cash flow	(32,092)	(36,410)	(48,309)	(55,309)	(67,309)
Financing cash flow	(3,107)	(3,662)	(2,540)	(3,219)	(3,219)
Net cash flow	411	(135)	(1,155)	(550)	(199)
Capex	(14,326)	(44,278)	(65,000)	(39,000)	(18,000)
Dividends paid	(3,790)	(2,902)	(2,540)	(3,219)	(3,219)

**Profitability & efficiency ratios**

Year to March	FY11	FY12	FY13E	FY14E	FY15E
ROAE (%)	21.4	22.4	23.3	22.1	23.1
ROACE (%)	19.2	20.7	20.9	20.6	23.8
Debtors days	20	28	24	19	15
Current ratio	1.4	1.5	1.6	1.6	1.7
Debt/EBITDA	1.4	1.2	1.0	0.9	0.7
Debt/Equity	0.5	0.4	0.3	0.3	0.2
Adjusted debt/equity	0.5	0.4	0.3	0.3	0.2
Interest coverage	8.7	14.1	19.4	22.0	21.6

**Operating ratios**

Year to March	FY11	FY12	FY13E	FY14E	FY15E
Total asset turnover	0.8	0.9	0.8	0.9	0.9
Fixed asset turnover	1.5	1.3	1.5	1.7	2.0
Equity turnover	1.6	1.6	1.5	1.5	1.5

**Valuation parameters**

Year to March	FY11	FY12	FY13E	FY14E	FY15E
Diluted EPS (INR)	248.5	288.6	341.9	372.7	444.6
Y-o-Y growth (%)	(17.4)	16.2	18.4	9.0	19.3
Diluted PE (x)	13.6	11.7	9.9	9.1	7.6
Price/BV (x)	2.1	1.8	1.6	1.3	1.2
EV/tonne (USD/tonne)	89	91	-	-	-
EV/Sales (x)	1.6	1.4	1.4	1.2	0.9
EV/EBITDA (x)	7.3	6.2	5.8	4.9	3.7
Dividend yield (%)	0.6	0.7	0.9	0.9	0.9



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ACC	REDUCE	SU	M	Ambuja Cement Ltd	REDUCE	SU	M
Grasim Industries	BUY	SO	M	India Cements	BUY	SO	H
Shree Cements	BUY	SO	M	UltraTech Cement	HOLD	SP	M

### ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

### RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

### RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

### SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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### Coverage group(s) of stocks by primary analyst(s): Cement

ACC, Ambuja Cement Ltd, Grasim Industries, India Cements, Shree Cements, UltraTech Cement

#### Recent Research

Date	Company	Title	Price (INR)	Recos
16-Oct-12	<b>Shree Cements</b>	Shining star; <i>Result Update</i>	4058	Buy
15-Oct-12	<b>Cement Channel Check</b>	Price recovery on course; <i>Monthly Update</i>		
14-Sep-12	<b>Cement Channel Check</b>	Monsoon gloom: Not as bad as last year; <i>Monthly Update</i>		

#### Distribution of Ratings / Market Cap

##### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	113	53	19	186
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	14	

#### Rating Interpretation

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

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