

Grasim Industries

BSE SENSEX	S&P CNX	CMP: INR3,378	TP: INR3,785	Buy
18,636	5,666			
Bloomberg	GRASIM IN			
Equity Shares (m)	91.7			
52-Week Range (INR)	3,511/2,208			
1,6,12 Rel. Perf. (%)	3/24/28			
M.Cap. (INR b)	309.8			
M.Cap. (USD b)	5.7			

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

Grasim Industries' standalone EBITDA for 2QFY13 was in line with our estimate at INR2.9b. Higher than expected VSF volume was offset by higher cost. However, lower tax boosted reported PAT to INR3.8b (v/s our estimate of INR3.6b).

- Standalone net sales grew 9.6% YoY and 7.7% QoQ to INR13.3b (v/s our estimate of INR11.7b). EBITDA declined 5.3% YoY and 1.8% QoQ to INR2.9b (v/s our estimate of INR2.85b). EBITDA margin contracted 340bp YoY and 210bp QoQ to 21.7% (v/s our estimate of 24.3%). PAT grew 11% YoY and 40% QoQ to INR3.8b (v/s our estimate of INR3.6b), led by higher other income.
- VSF volumes grew 8% YoY (declined 11% QoQ) to 85,312 tons (v/s our estimate of 77,838 tons) despite 11 days shutdown at Nagda plant. Realizations were stable at INR126.7/kg (down 1.1% QoQ; up 1.6% YoY). VSF PBIDT margin declined 690bp YoY and 440bp QoQ to 21.6%, as the benefit of higher volumes was diluted by (a) cost push in caustic soda, coal and sulphur, and (b) rupee depreciation neutralizing softening pulp prices.
- For the VSF business, environment continues to be challenging due to overcapacity in China and Euro zone issues. However, VSF prices would get support from EBITDA losses for Chinese players at current pricing.

Valuation and view: We are upgrading our FY13/14 EPS estimates by 2.5/3.6% to INR357/INR389 to account for (a) earnings upgrade in UltraTech, (b) higher volume growth in VSF and Chemicals business, and (b) cost push. The stock is quoting at attractive valuations of 8.7x FY14E consolidated EPS, EV of 5x FY14E EBITDA, and implied cement business valuations of USD102/ton (on 60mt capacity). Maintain **Buy** with a target price of INR3,785.

Y/E March	FY12				FY13				FY12	FY13E	FY13	Var.
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE				
VSF Volume (ton)	54,839	78,959	78,215	94,904	77,013	85,312	85,318	100,594	306,917	348,237	77,838	10
YoY Change (%)	-18.5	17.0	-7.6	10.8	40.4	8.0	9.1	6.0	0.6	13.5	-1.4	
VSF Realization (INR/ton)	152,409	124,689	128,499	121,293	128,024	126,656	127,656	127,900	129,563	127,563	127,024	0
YoY Change (%)	29.3	7.1	4.4	-16.3	-16.0	1.6	-0.7	5.4	2.3	-1.5	1.9	
QoQ Change (%)	5.1	-18.2	3.1	-5.6	5.5	-1.1	0.8	0.2			-0.8	
Net Sales	10,237	12,175	12,429	13,885	12,390	13,345	13,139	14,060	48,724	52,934	11,736	14
YoY Change (%)	8.3	30.5	2.4	-2.6	21.0	9.6	5.7	1.3	7.3	8.6	-2.5	
Total Expenditure	6,707	9,115	9,575	11,717	9,438	10,447	10,206	11,007	37,114	41,097	8,879	18
EBITDA	3,529	3,060	2,854	2,168	2,953	2,898	2,932	3,054	11,611	11,837	2,856	1
Margins (%)	34.5	25.1	23.0	15.6	23.8	21.7	22.3	21.7	23.8	22.4	24.3	-10.8
Depreciation	351	356	366	369	360	386	475	571	1,442	1,792	400	-3
Interest	106	107	72	74	61	78	80	65	358	284	60	30
Other Income	1,010	2,002	1,093	1,503	844	2,106	1,000	1,550	5,607	5,500	2,100	0
PBT after EO Items	4,082	4,599	3,509	3,228	3,376	4,540	3,377	3,968	15,418	15,261	4,496	1
Tax	941	1,150	765	792	647	712	642	1,051	3,648	3,052	899	-21
Rate (%)	23.0	25.0	21.8	24.5	19.2	15.7	19.0	26.5	23.7	20.0	20.0	-21.5
Reported PAT	3,141	3,448	2,745	2,436	2,729	3,827	2,736	2,916	11,770	12,209	3,597	6
Adj. PAT	3,141	3,448	2,745	2,436	2,729	3,827	2,736	2,916	11,770	12,209	3,597	6
Margins (%)	30.7	28.3	22.1	17.5	22.0	28.7	20.8	20.7	24.2	23.1	30.7	-6.4
YoY Change (%)	40.3	23.3	-2.9	-38.4	-13.1	11.0	-0.3	19.7	-0.4	3.7	4.3	

E: MOSL Estimates

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Standalone EBITDA in line; positive volume surprise offset by cost push in both VSF and Chemicals

- Standalone net sales grew 9.6% YoY and 7.7% QoQ to INR13.3b (v/s our estimate of INR11.7b). EBITDA declined 5.3% YoY and 1.8% QoQ to INR2.9b (v/s our estimate of INR2.85b). PAT grew 11% YoY and 40% QoQ to INR3.8b (v/s our estimate of INR3.6b), led by higher other income.
- EBITDA margin contracted 340bp YoY and 210bp QoQ to 21.7% (v/s our estimate of 24.3%).
- Consolidated net sales grew 16% YoY (declined 3.5% QoQ) to INR65.5b. EBITDA margin expanded 440bp YoY (declined 280bp QoQ) to 20.7% and EBITDA grew 47% YoY (declined 14.9% QoQ) to INR13.6b. PAT grew 48.2% YoY (declined 13.7% QoQ) to INR6.2b.

Snapshot of consolidated performance (INR m)

	2QFY13	2QFY12	% YoY	1QFY13	% QoQ
Net Sales	65,519	56,595	15.8	67,906	-3.5
EBITDA	13,551	9,216	47.0	15,932	-14.9
EBITD Margins (%)	20.7	16.3	440BP	23.5	-280BP
Adj. PAT	6,196	4,180	48.2	7,180	-13.7
Adj. EPS (INR)	67.5	45.6	48.2	78.3	-13.7

Source: Company, MOSL

VSF business rides on strong volume surprise, stable pricing; cost push dilutes benefits

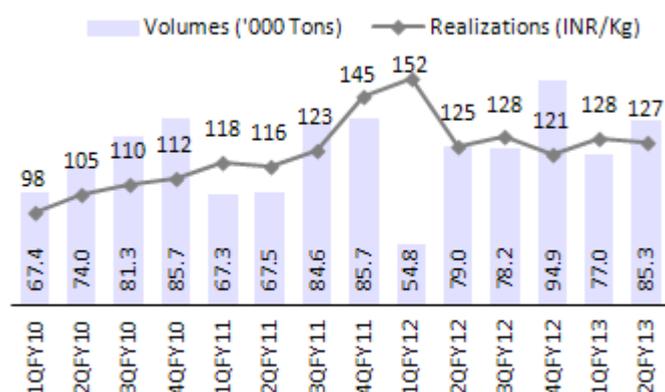
- VSF volumes grew 8% YoY (declined 11% QoQ) to 85,312 tons, beating our estimate of 77,838 tons despite macro slowdown and stoppage of work at its Nagda plant for 11 days due to delayed monsoon.
- Average realizations were stable at INR126.7/kg (down 1.1% QoQ; up 1.6% YoY) compared with peak prices in 1QFY12, led by cotton shortage.
- VSF PBIDT margin declined 690bp YoY and 440bp QoQ to 21.6% (v/s our estimate of 25.5%), as the benefit of higher volumes was diluted by (a) cost push in caustic soda, coal and sulphur, (b) rupee depreciation neutralizing softening pulp prices, and (c) higher overheads.
- On consolidated basis, VSF PBIDT margin was 19.7% (down 2.6bp QoQ and 5.9bp YoY). Consolidated VSF performance (down 21% YoY) was impacted by lower pulp realizations. Domsjo reported PAT of INR305m (Grasim's share) as against loss of INR91m/INR32m in 2QFY12/1QFY13, driven by improvement in volumes and reversal of MTM forex losses.

VSF business performance

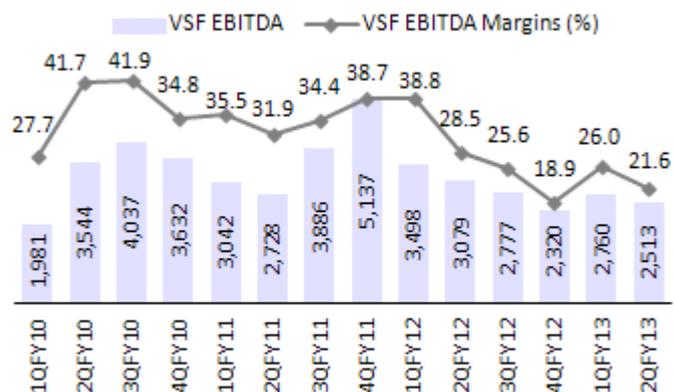
	2QFY13	2QFY12	% YoY	1QFY13	% QoQ
Production (ton)	79,798	83,516	-4.5	83,404	-4.3
Sales volume (ton)	85,312	78,959	8.0	77,013	10.8
Net Turnover (INR m)	11,640	10,820	7.6	10,619	9.6
Avg Realizations (INR/ton)	126,656	124,689	1.6	128,024	-1.1
PBIDT Margin (%)	21.6	28.5	-690bp	26.0	-440bp
PBDIT (INR m)	2,513	3,079	-18.4	2,760	-8.9

Source: Company, MOSL

Trend in VSF business volumes and realizations



Trend in VSF business EBITDA



Source: Company, MOSL

Limited downside to pricing; upside dependent on cotton outlook and Chinese players' rationality

- The management indicated that it does not see further downside to VSF pricing amidst the challenging near term, as at current global prices, Chinese players would be making losses.
- Chinese players are operating at 65-68% utilization. Surplus capacity in China remains a major overhang on margins. Outlook for the cotton crop and rationality of Chinese players would be key to VSF pricing.

Worst over for VSF; investing aggressively to consolidate leadership in both businesses

- **Outlook for VSF:** In the short term, the environment continues to be challenging, given the prevailing global slowdown. Global slowdown and surplus capacities in China will impact market conditions and margins despite softening in pulp prices. Profitability will also be influenced by competing fiber dynamics. The cotton crop in the current season will be an influencing factor. In the long term, cotton production is unlikely to keep pace with demand, given the increasing use of land for competing crops.
- Grasim's capex program to add ~156,500 tons is on track. While phase-I of Harihar brownfield expansion (total 36,500 tons) of 18,250 tons was commissioned in September 2012, phase-II is expected to commence by 4QFY13. The Vilayat greenfield addition of 120,000 tons will be completed by mid-1QFY14. Also, in 2QFY13, pulp capacity at Domsjo was expanded by 45,000 tons to 255,000 tons.
- Grasim has announced fresh capex of INR2.23b for setting up an epoxy plant (51,500 tons per year) at Vilayat, expected to be operational in 3QFY14.
- It has invested INR567m for 33% stake in JV with other promoter owned companies to set up an 180,000-ton greenfield VSF capacity in Turkey. The JV has acquired requisite land and is in the process of getting regulatory approvals including environment clearance.
- **For Cement,** Grasim expects demand to grow at over 8% over the next 2-3 years. It expects supply of ~66m tons by FY15, resulting in a surplus scenario, which would subside gradually over the next three years. As a result, it expects pricing and margins to remain volatile and challenging. It is investing INR120b in its cement business for augmenting capacity (~10.2m tons @ ~INR60b), logistics infrastructure and modernization/upgradation.

Capex of ~INR84b in FY13 for both cement and VSF businesses (INR Cr)

	Capex under Implementation	Work in Progress as on 01-04-12	Cash Outflow		Capex spent during H1 2012-13
			FY13	FY14	
Standalone					
VSF Expansion : Vilayat (120K TPA), Harihar (36K TPA)	2,257				
Chemical Expansion : Vilayat (182K TPA)	807				
Epoxy Project : Vilayat (51,500 TPA)	223				
Normal Capex : VSF	527				
: Chemical & Others	188				
Standalone Capex (A)	4,002	961	2,793	248	1,229
Cement Subsidiaries					
- Capacity expansion : Raipur (4.8 Mn TPA) : Malkhed (4.4 Mn. TPA)	5,886				
- Material Evacuation, Logistic Infrastructure (Incl. Pipavav Grinding expansion 1 Mn. TPA)	917				
- Thermal Power (50 MW) & Waste Heat Recovery (45 MW)	680				
- RMC Business	447				
- Modernisation, Upgradation and others (Incl. Land)	4,007				
Cement Business Capex (B)	11,937	3,221	5,587	3,129	1,826
Capex (A + B)	15,939	4,182	8,380	3,377	3,055

Source: Company, MOSL

Takeaways from interaction with the management**Cement**

- It expects ~8% growth in 2HFY13, as there are signs of demand recovery in most of the markets except Andhra Pradesh. It would try to pass-on cost inflation to consumers, although might happen with a lag.
- Apart from on-going capacity addition of 10mt, it is working on multiple projects of further capacity addition. Of its capex plans of ~INR119b, ~INR20b would be investments for acquisition of land for future capex plans. It also has scope to further increase capacity through brownfield route.
- It is open to inorganic route of capacity addition, with two requirements viz a) full management control and b) IRR of atleast 13%.
- With objective of backward integrating and having energy security, it is evaluating acquisition of coal mines in Australia and South Africa.
- Star Cement operated at capacity utilization of ~92% and EBITDA/ton improved to INR700/ton.

VSF

- VSF prices have corrected in October 2012 by ~3% to reflect softening in global prices and INR appreciation.
- Considering cost curve of the pulp industry, it expects limited decline in pulp prices from here-on.
- Of ~120,000 ton Greenfield capacity at Vilayat, ~80,000 ton would be for specialty fibre, with initial focus on export markets. Specialty fibre has limited competition from Chinese players, enjoys superior pricing and profitability.
- Apart from planned capex of ~INR40b in VSF business (including INR2.2b capex for Epoxy plant), it would be investing ~INR3b for modernization of Nagda plant.

Valuation and view

- We are upgrading our FY13/14 EPS estimates by 2.5/3.6% to INR357/INR389 to account for (a) earnings upgrade in UltraTech, (b) higher volume growth in VSF and Chemicals business, and (b) cost push.
- The outlook for VSF is improving driven by expectations of weak cotton production in FY13. Cement business outlook is improving, with expected improvement in demand and pricing. Further, Grasim's aggressive capex plan of INR159b over the next 2-3 years endorses our long-term positive outlook for both the businesses.
- Stock is quoting at attractive valuations of 8.7x FY14E cons. EPS, EV of 5x FY14E EBITDA, and implied cement business valuations of USD102/ton (on 60mt capacity).
- Maintain **Buy** with a target price of INR3,785 (SOTP-based, valuing economic interest in cement business at 9x EV/EBITDA and 30% hold-co discount, and the VSF business at 5x EV/EBITDA).

Grasim (Consolidated): Revised forecast (INR m)

	FY13E			FY14E		
	Rev	Old	Chg (%)	Rev	Old	Chg (%)
Net Sales	276,514	267,983	3.2	312,941	306,836	2.0
Net Profit	32,735	31,944	2.5	35,695	34,468	3.6
EPS (INR)	356.9	348.3	2.5	389.2	375.8	3.6

Source: MOSL

Grasim: SOTP based fair value (INR m)

	Parameter	Multiple	FY13E	FY14E
Standalone VSF business	EV/EBITDA (x)	5	59,184	66,392
UltraTech Cement @ 60.3% (post 30% holdco discount)	EV/EBITDA (x)	9	225,288	239,281
Total EV			284,471	305,672
Less: Gross Debt (incl pro-rata in subs)			47,288	44,273
Add: Cash & liquid invest			43,472	61,694
Add: Group holdings	@ 20% discount		24,021	24,021
Total Equity Value			304,677	347,115
Fair value (INR/sh) post demerger			3,322	3,785

Source: MOSL

Grasim Industries: an investment profile

Company description

Grasim Industries is a diversified company, with Cement and VSF being core businesses, accounting for 65% and 35% of revenue, respectively (post restructuring). Its other businesses include Chemicals and Textiles. The acquisition of UltraTech Cement, L&T's cement division, by Grasim catapulted it to number one position in the Indian cement industry, with total capacity under control of 51m tons.

Key investment arguments

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

Key investment risks

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

Comparative valuations

		Grasim	ACC	GACL
P/E (x)	FY13E	9.5	18.7	17.6
	FY14E	8.7	16.0	15.7
P/BV (x)	FY13E	1.5	3.4	3.6
	FY14E	1.3	3.1	3.1
EV/Ton (USD)	FY13E	140	140	193
	FY14E	102	138	188
EV/EBITDA (x)	FY13E	6.3	10.1	10.3
	FY14E	5.0	8.8	9.0

Shareholding pattern (%)

	Sep-12	Jun-12	Sep-11
Promoter	25.5	25.5	25.6
Domestic Inst	15.9	16.8	17.8
Foreign	39.3	39.0	38.0
Others	19.3	18.7	18.7

Recent development

- Grasim's Board approved a fresh capex of INR2.23b for setting up an epoxy plant (51,500TPA) at Vilayat, expected to be operational in 3QFY14.

Valuation and view

- The stock is quoting at attractive valuations of 8.7x FY14E consolidated EPS, EV of 5x FY14E EBITDA, and implied cement business valuations of USD102/ton (on 60mt capacity).
- Maintain **Buy** with a target price of INR3,785 (SOTP-based, valuing economic interest in cement business at 9x EV/EBITDA and 30% hold-co discount, and the VSF business at 5x EV/EBITDA).

Sector view

- We believe we have already witnessed bottom-of-the-cycle utilization and profitability, and expect gradual improvement hereon, given sustainable demand drivers.
- Continued revival in cement demand, witnessed in 2HFY12 would be the key catalyst for stock performance.
- VSF prices have bottomed-out, as many Chinese players are loss making at current pricing and limited downside risk to cotton pricing.

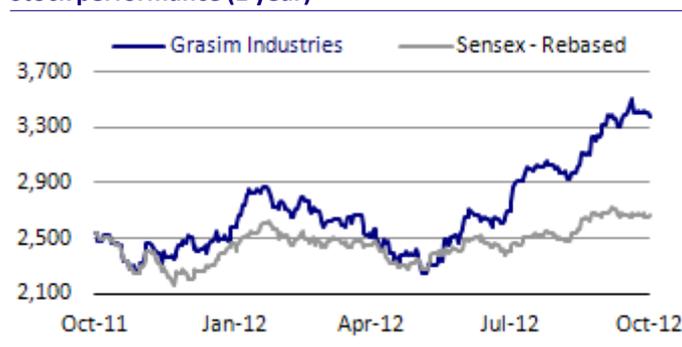
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY13	356.9	292.6	22.0
FY14	389.2	339.0	14.8

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
3,378	3,785	12.0	Buy

Stock performance (1 year)



Financials and Valuation

Consolidated Income Statement				(INR Million)		Ratios			
Y/E March	2011	2012	2013E	2014E	Y/E March	2011	2012	2013E	2014E
Net Sales	213,183	249,878	276,514	312,941	Basic (INR)				
Change (%)	6.9	17.2	10.7	13.2	EPS	248.5	288.6	356.9	389.2
Total Expenditure	165,548	196,694	209,174	234,545	Cash EPS	371.0	458.0	543.9	599.8
EBITDA	47,635	53,184	67,340	78,396	BV/Share	1,587	1,861	2,183	2,531
Change (%)	-17.7	11.7	26.6	16.4	DPS	20.0	22.5	30.0	35.0
Margin (%)	22.3	21.3	24.4	25.1	Payout (%)	9.4	9.0	9.8	10.5
Depreciation	11,384	11,544	12,394	15,331	Valuation (x)				
EBIT	36,251	41,640	54,946	63,064	P/E	13.6	11.7	9.5	8.7
Int. and Finance Charges	4,068	3,136	3,021	3,255	Cash P/E	9.1	7.4	6.2	5.6
Other Income - Rec.	6,310	10,018	9,256	8,306	P/BV	2.1	1.8	1.5	1.3
PBT before EO items	38,494	48,522	61,181	68,115	EV/ EBITDA	7.7	7.5	6.3	5.0
Change (%)	-22.9	26.1	26.1	11.3	Dividend Yield (%)	0.6	0.7	0.9	1.0
EO Exp	0	0	0	0	EV/Ton (US\$)	135	139	140	102
PBT after EO items	38,494	48,522	61,181	68,115	Return Ratios (%)				
Tax	9,542	13,208	16,342	19,015	RoE	15.7	15.5	16.4	15.4
Tax Rate (%)	24.8	27.2	26.7	27.9	RoCE	19.9	21.9	24.4	24.6
Reported PAT	28,952	35,314	44,839	49,100	Working Capital Ratios				
PAT Adj for EO items	28,952	35,314	44,839	49,100	Debtor (Days)	25	25	24	24
Change (%)	-14.8	22.0	27.0	9.5	Asset Turnover (x)	0.8	0.8	0.8	0.8
Margin (%)	13.6	14.1	16.2	15.7	Leverage Ratio				
Less: Minority Interest	6,162	8,840	12,104	13,405	Debt/Equity (x)	0.5	0.4	0.3	0.2
Consolidated PAT	22,790	26,475	32,735	35,695					
Change (%)	-16.6	16.2	23.6	9.0					

Consolidated Balance Sheet				(INR Million)	
Y/E March	2011	2012	2013E	2014E	
Equity Share Capital	917	917	917	917	
Reserves	144,669	169,769	199,285	231,224	
Net Worth	145,586	170,687	200,202	232,141	
Loans	67,827	65,513	62,420	57,420	
Deferred liabilities	19,616	19,790	19,790	19,712	
Minority Interest	43,514	52,334	64,438	77,843	
Capital Employed	276,543	308,324	346,850	387,116	
Gross Block	228,066	248,433	283,933	366,933	
Less: Accum. Deprn.	83,749	95,293	107,688	123,019	
Net Fixed Assets	144,316	153,140	176,245	243,914	
Capital WIP	13,578	22,000	70,000	20,000	
Investments	79,185	78,758	60,433	81,027	
Goodwill	24,191	24,964	24,964	24,964	
Curr. Assets	58,797	86,483	73,276	82,929	
Inventory	27,229	30,711	33,182	37,553	
Account Receivables	14,346	17,288	17,973	20,341	
Cash and Bank Balance	2,844	3,252	4,148	4,694	
Others	14,378	35,232	17,973	20,341	
Curr. Liability & Prov.	43,524	57,020	58,068	65,718	
Account Payables	29,357	26,353	38,712	43,812	
Other Liabilities	6,395	20,883	8,295	9,388	
Provisions	7,771	9,784	11,061	12,518	
Net Current Assets	15,273	29,462	15,208	17,212	
Appl. of Funds	276,542	308,324	346,850	387,116	

E: MOSL Estimates

Consolidated Cash Flow Statement				(INR Million)	
Y/E March	2011	2012	2013E	2014E	
OP/(Loss) before Tax	47,635	53,184	67,340	78,396	
Interest/Dividends Recd.	6,310	10,018	9,256	8,306	
Direct Taxes Paid	-9,984	-13,033	-16,342	-19,093	
(Inc)/Dec in WC	-8,311	-13,781	15,149	-1,457	
CF from Operations	35,650	36,389	75,403	66,151	
EO Items	0	0	0	0	
CF frm Op. incl EO	35,650	36,389	75,403	66,151	
(inc)/dec in FA	-23,751	-28,790	-83,500	-33,000	
(Pur)/Sale of Invest.	-16,742	-347	18,325	-20,594	
CF from Invest.	-40,493	-29,136	-65,175	-53,594	
Issue of Shares	-304	1,020	0	0	
(Inc)/Dec in Debt	11,835	-2,314	-3,093	-5,000	
Interest Paid	-4,068	-3,136	-3,021	-3,255	
Dividend Paid	-2,146	-2,394	-3,219	-3,756	
CF from Fin. Activity	5,317	-6,824	-9,333	-12,011	
Inc/Dec of Cash	474	428	896	546	
Add: Beginning Balance	2,370	2,844	3,252	4,148	
Closing Balance	2,844	3,252	4,148	4,694	

Disclosures

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