

## RESULTS

## REVIEW

## Grasim Industries Ltd.

Well positioned...

ACCUMULATE

Analyst

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Nifty: 5,598; Sensex: 18,431

CMP	Rs3,291
Target Price	Rs3,565
Potential Upside/Downside	+8%

## Key Stock Data

Sector	Textiles
Bloomberg / Reuters	GRASIM IN/GRAS.BO
Shares o/s (mn)	92
Market cap. (Rs mn)	301,914
Market cap. (US\$ mn)	5,600
3-m daily average vol.	11,968

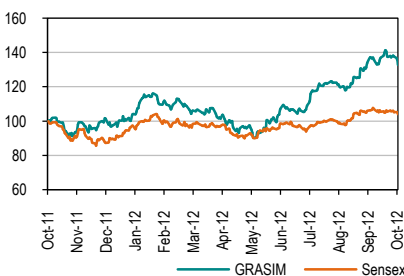
## Price Performance

52-week high/low	Rs3,511/2,208
	-1m -3m -12m
Absolute (%)	(3) 19 33
Rel to Sensex (%)	(1) 12 29

## Shareholding Pattern (%)

Promoters	25.5
FII/IRIs/OCBs/GDR	39.2
MFs/Banks/FIs	15.9
Non Promoter Corporate	8.9
Public & Others	10.5

## Relative to Sensex



Source: Capitaline

## Summary

Grasim Industries delivered good standalone performance driven by sustained realizations and good sales volume growth (up 8% YoY) in the VSF segment. To add, the chemical division saw marginal volume decline on account of lower chlorine off take but ECU realizations remained strong (up 14% YoY). The company commissioned 1<sup>st</sup> Phase of the Harihar, KN expansion with a capacity of ~18.2ktpa in the VSF segment as per schedule in Sep-2012. On a consolidated basis the company continues to benefit from the strong performance of the cement subsidiary. While we maintain our target P/E for the standalone business at 6x, our SoTP based TP stands revised to Rs3,565 led by improved cement business valuations. Maintain ACCUMULATE.

## Key Highlights

- VSF volume growth shows resilience and realizations remain intact...

Despite headwinds to VSF demand from the continued slowdown in Eurozone and US, the company delivered a volume growth of 8%. In addition, VSF realizations remained flattish vs. the previous year on account of a weaker Rupee (international fiber prices remain under pressure).

...but near term challenges to remain. The company has indicated a challenging environment amidst a global slowdown and surplus capacity in China with the propensity to impact margins negatively. We continue to believe that the company's integrated business model will allow it to withstand rising input costs and maintain competitiveness in adverse business cycles.

- Chemical division continues to deliver strong ECU realization growth

While volume growth in the Chemical division was (3%) YoY largely on account of lower Chlorine off take and on account of water shortage, ECU realizations remained strong (up 14%YoY) driven by higher caustic prices.

- Cement subsidiary and pulp JV's deliver improved performance

While UltraTech continues to deliver strong performance, Grasims' pulp JV's performed relatively better despite falling pulp realizations. Domsjo reported net profit with improvement in volumes (~45ktpa pulp capacity commissioned in the quarter) and reversal of forex losses in Q2FY13. Overall, consolidated performance got a boost with Net sales, EBITDA and Adj. PAT being higher 14%, 37%, and 48% YoY respectively.

- Outlook and Valuation

We value the company on SoTP (see page no. 4) and derive the value for the standalone (VSF, Chemical) business based on a P/E multiple of 6x. We give Grasims' stake in UltraTech and other investments a 30% holding company discount to arrive at our fair value estimate of Rs3,565. Maintain ACCUMULATE.

Table: Financial snapshot

(Rs mn)

Year	Revenue	EBITDA	EBITDA (%)	Adj. PAT	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoE (%)	RoCE (%)
FY11	212,690	46,832	22.0	22,790	248.5	13.2	6.4	16.8	13.8
FY12	249,878	53,184	21.3	26,475	288.6	11.4	5.7	16.7	14.2
FY13E	285,992	63,076	22.1	28,227	307.8	10.7	4.6	15.4	14.5
FY14E	323,407	70,119	21.7	32,647	355.9	9.2	4.1	15.5	14.0

Source: Company; IDBI Capital Research

### ■ Commissioning of capacity on track

The company has successfully commissioned the first phase of Harihar, KN expansion project with a capacity of ~18.2ktpa on schedule (Sep-2012). We expect Phase-2 commissioning (~18,250tpa) by Q4FY13. For the Vilayat (Greenfield), GJ expansion we expect Phase-1 (~60,000tpa) to commission by Q1FY14 (as opposed to management expectation of Dec-2012) and Phase-2 (~60,000tpa) by H2FY14E. Building in additional capacity we expect VSF capacity utilizations to drop to 94%/90% in FY13/14E. For the chemical business we expect the Caustic Soda plant (~182,500tpa, 60MW CPP, backward integrated with VSF) to commission by Q4FY13E.

In addition, Domsjo (Grasim holds 33% stake as JV partner) commissioned ~45ktpa of pulp producing capacity over this quarter.

**Table: Capacity break-up**

Division	Location	Current Capacity (tpa)	Addition (tpa)	Est. CoD	Total (tpa)
VSF	Harihar, KN	~333,975	~36,500 (Brownfield)	Phase 1- Sep 2012, Phase 2- Jan 2013	490,475
VSF	Nagada, MP				
VSF	Karach, GJ				
VSF	Vilayat, GJ	NA	~120,000 (Greenfield)	Phase 1- Dec 2012, Phase 2- Mar 2013	
VSF	Birla Jingwei, China	70,000			70,000
VSF	Turkey	NA	~180,000 (Greenfield)	NA	
Rayon-grade pulp	Harihar, KN	70,000			70,000
Rayon-grade pulp	AV Cell, Canada	122,500			122,500
Rayon-grade pulp	AV Nackawic, Canada	189,000			189,000
Rayon & Specialty grade pulp	Domsjo, Sweden	210,000	~45,000 (Brownfield)	~Q1FY13	210,000
Rayon-grade pulp	AV Terrace Bay, Ontario	NA	~280,000 (Conversion)	~FY16E	

Source: Company; IDBI Capital Research

### ■ Capital expenditure plans

The company unveiled its plans to revamp the Nagada plant over the next 3 years for technological upgradation (at an estimated expense of Rs3bn). In addition it plans to set-up an Epoxy plant at Vilayat for a total cost of Rs2.23bn. The Epoxy plant is expected to have a capacity of ~51.5ktpa and its commissioning is expected in FY14.

The company expects H2FY13 to see significant capital expenditure for all its divisions.

### ■ Acquisition of Terrace Bay

Grasim had acquired 40% stake in Terrace Bay Inc. (paper grade pulp producer, Canada) via its newly formed SPV AV Terrace Bay in July-2012 for a consideration of ~USD44mn (Rs2.42bn). Terrace Bay has been shut over the months leading up to the acquisition and has a paper grade pulp production capacity of ~285ktpa. Grasim's management has indicated that the plant has been reopened for operations and is producing paper grade pulp. A sum of USD250mn is expected to be spent on the plant to convert it to a Rayon Grade pulp producer.

### ■ Slight caution on VSF outlook

Management indicated their cautious stance on VSF prices but also suggested the possibility of a turnaround in prices on account of cotton and competing fiber prices firming up. With area under cultivation in cotton stagnating due to competition for cultivated land used for food, animal feed and bio-fuels and with natural calamities leading to poor cotton crops, the company feels VSF prices could rebound with firming up cotton prices globally.

Management also cautioned on the weak retail sales outlook in Eurozone and US which have a bearing on the textile value chain. Textile producers are becoming increasingly cautious and are holding minimal inventory levels in an uncertain business environment.

#### ■ Backward integration to provide significant cost advantage

While risks due to a weak global retail industry persist and significant capacity in China continues to threaten the company, we find the company well positioned to weather any cyclicity and/or competitive threats. Grasim's strength lies in its global brand positioning and its backward integrated business model. The company meets ~85-90% of wood pulp through captive and strategic sources and has an in house manufacturing of all major chemicals and auxiliaries used in VSF production. In addition, it meets its power requirements through captive power plants at its manufacturing locations. We believe this backward integration will enable the company to mitigate rising cost pressures

#### ■ Specialty fiber capacity and Turkey project to provide competitive advantage

Grasim is implementing a Greenfield expansion plan at Vilayat, GJ with a total VSF capacity of ~120ktpa. Of the ~120ktpa, 75-80% of capacity is dedicated to Specialty VSF. Specialty VSF production demands higher technological infrastructure and expertise which is an industry barrier. As highlighted earlier, while most of the VSF manufacturing capacity has shifted to Asia, a notable gap exists in terms of technical expertise and innovation when juxtaposed with developed countries. Asian plants mostly produce regular VSF with ~20% differentiation. In contrast, developed countries are predominantly focused on Specialty VSF.

China dominates the global VSF market with ~58% share of total world capacity at the end of 2010. China is currently the global textile hub and has a thriving domestic textile industry which in turn feeds the export markets of Western Europe and North America. The rate of growth in demand from western markets is expected to decrease for logistical reasons as the fashion market is demanding fast response times from garment manufacturers. As a result, retailers from the west are turning to suppliers closer to home, thus creating demand in Turkey, East Europe and North Africa. Grasim has plans of setting up a ~180ktpa VSF plant in Turkey via its JV entity Aditya Birla Elyaf Sanayi Ve Ticaret Anonim Sirketi (ABEST) in which it holds ~33% stake. As of Q2FY13, necessary land has been tied up for the project and the company is seeking required approvals including environmental clearance.

Table: Quarterly snapshot (Standalone)

(Rs mn)

Year end: March	Q2FY12	Q1FY13	Q2FY13	YoY Chg	QoQ Chg
<b>Net sales</b>	<b>12,035</b>	<b>12,390</b>	<b>13,345</b>	<b>11%</b>	<b>8%</b>
Expenses	9,130	9,438	10,447	14%	11%
<b>EBIDTA</b>	<b>2,905</b>	<b>2,953</b>	<b>2,898</b>	<b>0%</b>	<b>(2)%</b>
<i>EBIDTA margin (%)</i>	24.1	23.8	21.7	(242) bps	(211) bps
Depreciation	356	360	386	8%	7%
Interest	107	61	78	(27)%	28%
Other income	2,157	844	2,106	(2)%	149%
<b>PBT</b>	<b>4,599</b>	<b>3,376</b>	<b>4,540</b>	<b>(1)%</b>	<b>34%</b>
Total tax	1,150	647	712	(38)%	10%
Effective tax rate (%)	25.0	19.2	15.7	(932) bps	(347) bps
<b>Adjusted PAT</b>	<b>3,448</b>	<b>2,729</b>	<b>3,827</b>	<b>11%</b>	<b>40%</b>
<i>Net margin (%)</i>	28.7	22.0	28.7	3 bps	665 bps
E/O items	-	-	-		
<b>Reported PAT</b>	<b>3,448</b>	<b>2,729</b>	<b>3,827</b>	<b>11%</b>	<b>40%</b>
Reported EPS (Rs)	37.60	29.76	41.71	11%	40%
FD EPS (adjusted, Rs)	37.57	29.73	41.71	11%	40%

Source: Company; IDBI Capital Research

Table: Quarterly snapshot (Consolidated)

(Rs mn)

Year end: March	Q2FY12	Q1FY13	Q2FY13	YoY Chg	QoQ Chg
<b>Net sales</b>	<b>57,741</b>	<b>68,320</b>	<b>66,021</b>	<b>14%</b>	<b>(3)%</b>
Expenses	47,464	52,002	51,968	9%	0%
<b>EBIDTA</b>	<b>10,278</b>	<b>16,318</b>	<b>14,054</b>	<b>37%</b>	<b>(14)%</b>
<i>EBIDTA margin (%)</i>	17.8	23.9	21.3	349 bps	(260) bps
Depreciation	2,837	2,979	3,066	8%	3%
Interest	894	740	868	(3)%	17%
Other income	1,068	1,357	998	(7)%	(26)%
<b>PBT</b>	<b>7,615</b>	<b>13,955</b>	<b>11,118</b>	<b>46%</b>	<b>(20)%</b>
Total tax	2,374	3,856	3,089	30%	(20)%
<i>Effective tax rate (%)</i>	31.2	27.6	27.8	(339) bps	15 bps
<b>Adjusted PAT before MI</b>	<b>5,241</b>	<b>10,100</b>	<b>8,029</b>	<b>53%</b>	<b>(21)%</b>
<i>Net margin (%)</i>	9.1	14.8	12.2	308 bps	(262) bps
Add : Share in Profit of Associates	(41)	86	381	(1,037)%	341%
Less : Minority Share	1,021	3,006	2,215	117%	(26)%
Adj. PAT after MI	4,179	7,180	6,196	48%	(14)%
E/O items	-	-	-		
<b>Reported PAT</b>	<b>4,179</b>	<b>7,180</b>	<b>6,196</b>	<b>48%</b>	<b>(14)%</b>
Reported EPS (Rs)	45.57	78.27	67.52	48%	(14)%
FD EPS (adjusted, Rs)	45.54	78.21	67.52	48%	(14)%

Source: Company; IDBI Capital Research

### ■ Revise FY13/FY14 estimates

Given the sustained prices in both the Cement and VSF segment we revise our FY13/FY14 realization assumptions and also factor in cost escalation. Resultantly our Consolidated Net sales, EBITDA and Adj. PAT stand revised by 4.8%/3.8%, 12.7%/5.1% and 16.5%/10.8% for FY13/FY14E respectively.

Table: Valuation

Segment	Basis	Multiple (x)	Value (Rsmn)	Value per share (Rs)	Rationale
Grasim standalone	P/E	6.0	81,323	887	~DCF implied multiple
UltraTech			202,080	2,204	60.33% Stake after 30% hold co. discount
<b>Investments</b>					
Aditya Birla Nuvo Ltd.	P/Inv.	1.0	1,764	19	~30% discount
Idea Cellular Limited	P/Inv.	1.0	9,218	101	
Larsen & Toubro Ltd.	P/Inv.	1.0	3,605	39	
Hindalco Industries Limited	P/Inv.	1.0	3,856	42	
Other	P/Inv.	1.0	25,059	273	
<b>Total Fair value</b>			<b>326,905</b>	<b>3,565</b>	

## Company Background

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Grasim is one of the largest manufacturers of cellulose fiber products in the world. It has a presence in the upstream Dissolving grade Wood Pulp (DWP) segment through its JV's and has a major presence in the downstream VSF segment through its standalone entity and via strategic investments. Grasim's VSF plants are located at Nagda in Madhya Pradesh, Kharach in Gujarat and Harihar in Karnataka, with an aggregate capacity of ~333,975 tpa which translates to a ~10% global market share.

## Financial Summary

### Profit & Loss Account

(Rs mn)

Year-end: March	FY11	FY12	FY13E	FY14E
<b>Net sales</b>	<b>212,690</b>	<b>249,878</b>	<b>285,992</b>	<b>323,407</b>
Growth (%)	6.7	17.5	14.5	13.1
Operating expenses	(165,858)	(196,694)	(222,916)	(253,288)
<b>EBITDA</b>	<b>46,832</b>	<b>53,184</b>	<b>63,076</b>	<b>70,119</b>
Growth (%)	(19.1)	13.6	18.6	11.2
Depreciation	(11,384)	(11,544)	(13,453)	(14,985)
<b>EBIT</b>	<b>35,449</b>	<b>41,640</b>	<b>49,623</b>	<b>55,134</b>
Interest paid	(4,056)	(3,136)	(4,953)	(5,958)
Other income	7,135	10,018	8,160	10,133
<b>Pre-tax profit</b>	<b>38,528</b>	<b>48,522</b>	<b>52,830</b>	<b>59,309</b>
Tax	(9,576)	(13,208)	(14,010)	(15,565)
Effective tax rate (%)	24.9	27.2	26.5	26.2
<b>Net profit</b>	<b>22,790</b>	<b>26,475</b>	<b>28,227</b>	<b>32,647</b>
<b>Adjusted net profit</b>	<b>22,790</b>	<b>26,475</b>	<b>28,227</b>	<b>32,647</b>
Growth (%)	(17.4)	16.2	6.6	15.7
Shares o/s (mn nos)	92	92	92	92

### Balance Sheet

(Rs mn)

Year-end: March	FY11	FY12	FY13E	FY14E
Net fixed assets	157,894	175,132	215,758	238,595
Investments	11,744	16,316	18,308	20,358
Other non-curr assets	24,203	24,972	24,972	24,972
<b>Current assets</b>	<b>126,373</b>	<b>148,925</b>	<b>167,422</b>	<b>191,031</b>
Inventories	27,216	30,711	30,680	35,012
Sundry Debtors	14,346	17,610	12,097	14,783
Cash and Bank	2,844	3,252	34,028	30,575
Marketable Securities	67,589	62,443	71,443	84,443
Loans and advances	14,356	34,909	19,175	26,218
<b>Total assets</b>	<b>320,214</b>	<b>365,344</b>	<b>426,461</b>	<b>474,956</b>
<b>Shareholders' funds</b>	<b>145,734</b>	<b>170,687</b>	<b>195,821</b>	<b>224,757</b>
Share capital	917	917	917	917
Reserves & surplus	144,817	169,769	194,904	223,840
<b>Total Debt</b>	<b>67,827</b>	<b>65,513</b>	<b>96,564</b>	<b>97,164</b>
Secured loans	38,346	57,009	87,744	88,344
Unsecured loans	29,481	8,505	8,820	8,820
Other liabilities	19,616	19,790	19,728	19,728
<b>Curr Liab &amp; prov</b>	<b>43,524</b>	<b>57,020</b>	<b>51,865</b>	<b>60,170</b>
Current liabilities	35,753	47,236	40,159	45,325
Provisions	7,771	9,784	11,706	14,844
<b>Total liabilities</b>	<b>130,967</b>	<b>142,324</b>	<b>168,157</b>	<b>177,062</b>
<b>Total equity &amp; liabilities</b>	<b>320,214</b>	<b>365,344</b>	<b>426,461</b>	<b>474,956</b>
<b>Book Value (Rs)</b>	<b>1,589</b>	<b>1,861</b>	<b>2,135</b>	<b>2,450</b>

### Cash Flow Statement

(Rs mn)

Year-end: March	FY11	FY12	FY13E	FY14E
Pre-tax profit	38,528	48,522	52,830	59,309
Depreciation	12,104	11,184	12,888	14,985
Tax paid	(10,018)	(13,033)	(14,072)	(15,565)
Chg in working capital	(8,299)	(13,793)	16,123	(5,757)
Other operating activities	3,358	10,737	(97)	(16)
<b>Cash flow from operations (a)</b>	<b>35,673</b>	<b>43,617</b>	<b>67,671</b>	<b>52,956</b>
Capital expenditure	(24,471)	(28,422)	(53,514)	(37,822)
Chg in investments	(450)	(4,572)	(1,993)	(2,050)
Other investing activities	4,953	(8,563)	4,824	4,919
<b>Cash flow from investing (b)</b>	<b>(32,092)</b>	<b>(36,410)</b>	<b>(59,683)</b>	<b>(47,952)</b>
Equity raised/(repaid)	0	0	-	-
Debt raised/(repaid)	11,835	(2,314)	31,051	600
Dividend (incl. tax)	(2,237)	(2,540)	(3,378)	(4,009)
Chg in minorities	(196)	(20)	(444)	(443)
Other financing activities	(12,508)	(1,925)	(4,225)	(5,217)
<b>Cash flow from financing (c)</b>	<b>(3,107)</b>	<b>(6,798)</b>	<b>23,005</b>	<b>(9,069)</b>
<b>Net chg in cash (a+b+c)</b>	<b>474</b>	<b>409</b>	<b>30,993</b>	<b>(4,065)</b>

### Financial Ratios

Year-end: March	FY11	FY12	FY13E	FY14E
Adj. EPS (Rs)	248.5	288.6	307.8	355.9
Adj. EPS growth (%)	(17.4)	16.2	6.6	15.7
EBITDA margin (%)	22.0	21.3	22.1	21.7
Pre-tax margin (%)	18.1	19.4	18.5	18.3
ROE (%)	16.8	16.7	15.4	15.5
ROCE (%)	13.8	14.2	14.5	14.0
<b>Turnover &amp; Leverage ratios (x)</b>				
Asset turnover (x)	0.7	0.7	0.7	0.7
Leverage factor (x)	2.2	2.2	2.2	2.1
Net margin (%)	10.7	10.6	9.9	10.1
Net Debt / Equity (x)	0.0	0.0	0.0	(0.1)
<b>Working Capital &amp; Liquidity ratio</b>				
Inventory days	47	45	39	40
Receivable days	25	26	15	17
Payable days	79	88	66	65

### Valuation

Year-end: March	FY11	FY12	FY13E	FY14E
PER (x)	13.2	11.4	10.7	9.2
Price/Book value (x)	2.1	1.8	1.5	1.3
PCE (x)	8.8	7.9	7.2	6.3
EV/Net sales (x)	1.4	1.2	1.0	0.9
EV/EBITDA (x)	6.4	5.7	4.6	4.1
Dividend Yield (%)	0.6	0.7	0.9	1.1



# Notes

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**BUY:** Absolute return of 15% and above; **ACCUMULATE:** 5% to 15%; **HOLD:** Upto  $\pm 5\%$ ; **REDUCE:** -5% to -15%; **SELL:** -15% and below.

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