



Grasim Industries

STOCK INFO.	BLOOMBERG
BSE Sensex: 19,978	GRASIM IN
	REUTERS CODE
S&P CNX: 5,906	GRAS.BO

29 October 2007

Buy

Previous Recommendation: Buy

Rs3,806

Equity Shares (m)	91.7
52-Week Range	4,074/1,927
1,6,12 Rel. Perf. (%)	-10/12/-14
M.Cap. (Rs b)	348.9
M.Cap. (US\$ b)	8.8

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/07A	140,952	19,683	214.7	90.1	17.7	5.3	29.6	32.0	3.0	10.8
03/08E	170,427	27,721	302.3	40.8	12.6	3.8	30.5	34.9	2.6	8.0
03/09E	200,176	30,835	336.3	11.2	11.3	2.9	26.0	37.5	2.0	6.5

* Consolidated

Grasim's 2QFY08 results (standalone) are better than our estimates, driven by better than expected performance of VSF and other businesses. However, cement business performance was lower than estimated due to higher cost inflation.

- Revenue grew 25% YoY to Rs25.2b, with EBITDA margin expanding 550bp YoY (~40bp QoQ decline) to 32%, translating into PAT of Rs5b (up 48%).
- Cement business performance impacted by cost push:** Cement business revenue grew 20% YoY to Rs13.7b, driven by 6.5% volume growth to 3.6mt and higher realizations by 12.4% YoY (~2.9% QoQ) to Rs3,173/ton. However, cost push in form of higher energy and freight cost, restricted PBITD margin expansion 130bp YoY (~280bp QoQ decline) to 32.5%.
- VSF business records strong volume and value growth:** VSF business benefited from strong demand, with volumes growing 11.2% YoY (v/s est 9.3%) to 70,180 tons and realizations were higher by 24% YoY (~9% QoQ) to Rs103/kg, translating into PBIDT margins improvement of 910bp YoY (~370bp QoQ) to 40.3%.
- Consolidated performance:** Grasim's consolidated revenue grew 25% YoY to Rs39.7b, while EBITDA grew 41% to Rs11.8b, resulting in EBITDA margin expansion of 330bp to 29.8%. Further, higher other income (up 57% to Rs839m) translated into PAT growth of 50% to Rs6.2b.

We are revising our earnings estimates for FY09E upwards by 8% to Rs336 to factor in higher VSF realizations (at Rs98/kg v/s earlier est Rs92/kg) and higher cement volumes (on account of on-schedule capex program). The stock trades at 11.3x FY09E EPS and 6.5x EV/EBITDA. Maintain **Buy** with revised target price of Rs4,300 (SOTP-based).

QUARTERLY PERFORMANCE (STANDALONE)

(Rs Million)

Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	18,917	20,114	22,794	24,938	24,448	25,192	26,693	28,237	86,757	104,570
YoY Change (%)	21.8	22.0	38.3	36.3	29.2	25.2	17.1	13.2	29.4	20.5
EBITDA	5,135	5,326	6,661	6,942	7,921	8,050	9,102	9,003	24,094	34,077
Margins (%)	27.1	26.5	29.2	27.8	32.4	32.0	34.1	31.9	27.8	32.6
Depreciation	741	756	807	876	850	875	915	1,069	3,179	3,709
Interest	238	245	240	366	285	272	280	383	1,118	1,220
Other Income	375	502	444	776	677	573	450	499	2,097	2,200
PBT before EO Items	4,532	4,827	6,058	6,476	7,464	7,476	8,357	8,051	21,893	31,347
Extraordinary Inc/(Exp)	0	0	0	371	0	0	0	0	371	0
PBT after EO Items	4,532	4,827	6,058	6,847	7,464	7,476	8,357	8,051	22,264	31,347
Tax	1,413	1,449	1,942	2,102	2,347	2,478	2,783	2,674	6,906	10,282
Rate (%)	31.2	30.0	32.1	30.7	31.4	33.1	33.3	33.2	31.0	32.8
Reported PAT	3,119	3,378	4,116	4,745	5,117	4,998	5,574	5,377	15,358	21,065
Adj. PAT	3,119	3,378	4,116	4,488	5,117	4,998	5,574	5,377	15,102	21,065
YoY Change (%)	51.7	80.0	154.3	72.7	64.0	47.9	35.4	19.8	73.1	39.5

E: MOST Estimates; Quarterly results do not add-up to full year results due to restatement

SEGMENTAL PERFORMANCE (RS M)

	2QFY08	2QFY07	% YOY	1QFY08	% QOQ
Revenue Mix					
Fibre	7,837	5,583	40.4	6,999	12.0
Cement	13,672	11,412	19.8	13,907	-1.7
Sponge Iron	2,096	1,412	48.4	2,188	-4.2
Chemical	1,088	762	42.8	863	26.1
Textile	851	808	5.3	554	53.6
Total	25,192	20,114	25.2	24,448	3.0
PBIT					
Fibre	2,947	1,567	88.1	2,362	24.8
Cement	3,948	3,138	25.8	4,447	-11.2
Sponge Iron	212	-28	-857.5	266	-20.3
Chemical	344	48	614.6	223	54.1
Textile	-3	-1	-	-18	-
Total	7,447	4,723	57.7	7,280	2.3
	2QFY08	2QFY07	Chg (BP)	1QFY08	Chg (BP)
PBIT Margins (%)					
Fibre	37.6	28.1	954	33.7	385
Cement	28.9	27.5	138	32.0	-310
Sponge Iron	10.1	-2.0	1,210	12.2	-204
Chemical	31.6	6.3	2,528	25.8	575
Textile	-0.4	-0.2	-19	-3.2	290
Total	29.6	23.5	608	29.8	-22

Source: Company/ Motilal Oswal Securities

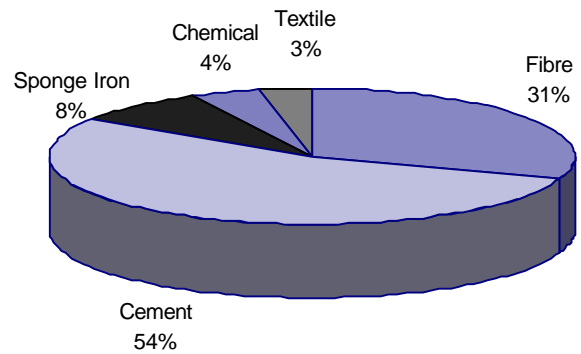
Results above estimates

Revenue grew 25% YoY to Rs25.2b, driven by 40% growth in VSF business and 20% growth in cement revenue. EBITDA grew 51% YoY to Rs8.05b leading to 550bp YoY margin expansion (~40bp QoQ decline) to 32%, based on strong margin expansion in VSF and performance of other businesses. However, higher tax provisioning (at 33% of PBT v/s 30% in 2QFY07) restricted PAT to Rs5b (up 48%).

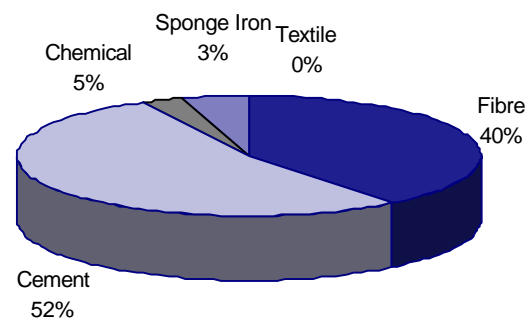
VSF and cement businesses drive revenue growth

Net sales grew 25% YoY to Rs25.2b, driven by 40% growth in VSF business and 20% growth in cement revenue. The sponge iron business continued to improve its performance with revenue growth of 48%. The chemicals business revenue grew 43% (on low base of last year as production was impacted by water shortage).

REVENUE MIX

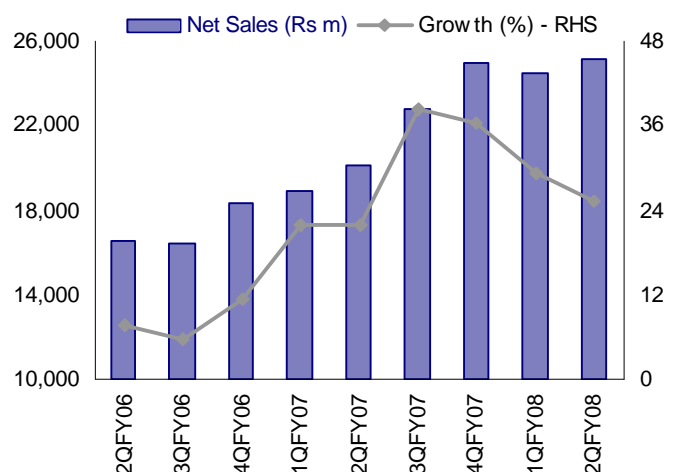


PBIT MIX



Source: Company/ Motilal Oswal Securities

TREND IN NET SALES

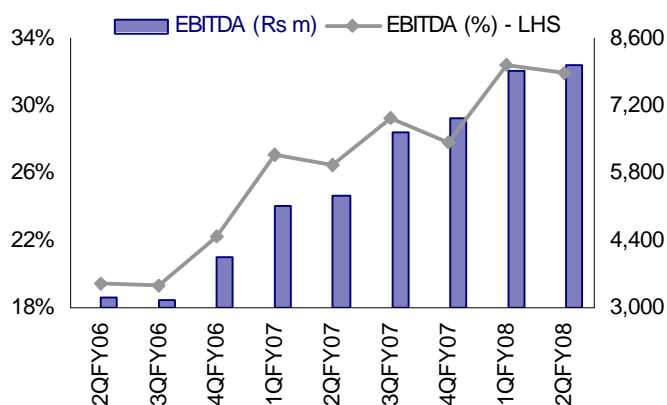


Source: Company/Motilal Oswal Securities

Cost push restricts margin expansion

EBITDA grew 51% YoY to Rs8.05b leading to 550bp YoY margin expansion (~40bp QoQ decline) to 32%, based on better performance in VSF and other businesses. Margin expansion would have been higher but for cost push in cement business in form of higher energy and wage cost. Further, higher tax provisioning (at 33% of PBT v/s 30% in 2QFY07) restricted PAT to Rs5b (up 48%).

TREND IN EBITDA



Source: Company/Motilal Oswal Securities

Segment-wise performance

VSF division: Strong volume and value growth

VSF business benefited from strong demand, with volumes growing 11.2% YoY to 70,180 tons and realizations were higher by 24% YoY (~9% QoQ) to Rs103/kg. Despite higher pulp prices (up 10% YoY and 3% QoQ), PBIDT margins improved 910bp YoY (~370bp QoQ) to 40.3%.

VSF DIVISION PERFORMANCE

	2QFY08	2QFY07	% YOY	1QFY08	% QOQ
Production (ton)	69,678	65,083	7.1	68,755	1.3
Sales Volume (ton)	70,183	63,119	11.2	69,396	1.1
Net Turnover (Rs m)	7,837	5,583	40.4	6,999	12.0
Avg Realiz. (Rs/ton)	102,978	83,279	23.7	94,455	9.0
PBIDT (Rs m)	3,156	1,743	81.1	2,563	23.1
PBIDT Margin (%)	40.3	31.2		36.6	

Source: Company/Motilal Oswal Securities

Also, with further 5% (Rs5/Kg) increase in VSF prices (w.e.f 01/Oct/2007) in domestic market (in-line with global

prices), Grasim's margins are expected to improve further in near term. Though it is positive about volume/demand outlook for VSF, the management indicated that margins might not be sustainable at such high levels depending on sustainability of current high VSF prices and cost inflation (our FY09 figures est Rs4/Kg decline in VSF prices over FY08E).

Demand for VSF is expected to grow based on strong demand from Indian textile industry post quota. Also, the company is taking initiatives to introduce VSF based non-woven products in domestic market and is also focusing on high value niche fibres, which would benefit over a period of time. Grasim is likely to enhance its VSF capacity from current 2,66,450 ton to 3,34,000 ton by end of FY08. Further, it is adding another 31,000TPA at Harihar (brownfield) and 88,000 tons at Gujarat (greenfield), which are expected to take around two years after receipt of environmental clearances. Also, it is doubling capacity in its Chinese JV to 60,000 TPA by 2QFY09.

Cement division: Cost push restricts margin expansion

Cement business revenue grew 20% YoY to Rs13.7b, driven by 6.5% volume growth to 3.6mt (v/s est 3.65mt) and higher realizations by 12.4% YoY (~2.9% QoQ) to Rs3,173/ton (v/s est Rs3,123/ton). However, cost push in form higher energy and wage cost restricted PBIDT margin expansion 130bp YoY (~280bp QoQ decline) to 32.5%.

CEMENT DIVISION PERFORMANCE

	2QFY08	2QFY07	% YOY	1QFY08	% QOQ
A. Grey Cement					
Sales Volume (m ton)	3.6	3.38	6.5	3.90	-7.7
Avg Realizations (Rs/ton)	3,173	2,822	12.4	3,083	2.9
B. Ready-mix concrete					
Sales Volume (Lakh Cu Mtr)	4.5	3.65	22.2	3.74	19.3
Avg Realizations (Rs/Cu Mtr)	2,727	2,424	12.5	2,585	5.5
B.White Cement					
Production (ton)	89,733	92,766	-3.3	92,594	-3.1
Sales Volume (ton)	92,566	90,253	2.6	85,005	8.9
Net Turnover (Rs m)	634	916	-30.8	544	16.5
Avg Realizations (Rs/ton)	6,850	6,614	3.6	6,403	7.0
PBIDT	13,672	11,412	19.8	13,907	-1.7
PBIDT Margin (%)	32.5	31.2		35.3	

Source: Company/Motilal Oswal Securities

Cement business is expected to benefit from the significant capacity addition (~16mt) and captive power plants (~250MW at existing plants) 1QFY09 onwards.

Sponge iron division: Strong volume growth

Grasim's sponge iron business continued its recovery, driven by higher global scrap prices. While volumes grew 28% (v/s est 15%), realizations improved 17% YoY (v/s est 11%) to Rs14,500/ton, translating into PBIDT margins of 14.3% (higher by 10.2pp YoY).

SPONGE IRON DIVISION PERFORMANCE

	2QFY08	2QFY07	% YOY	1QFY08	% QOQ
Production (ton)	146,673	113,567	29.2	138,136	6.2
Sales volume (ton)	141,960	110,933	28.0	139,706	1.6
Net Turnover (Rs m)	2,096	1,412	48.4	2,188	-4.2
Avg Realiza. (Rs/ton)	14,503	12,354	17.4	14,753	-1.7
PBIDT (Rs m)	299	58	415.5	353	-15.3
PBIDT Margin (%)	14.3	4.1		16.1	

Source: Company/Motilal Oswal Securities

Grasim's sponge iron business is expected to remain under pressure due to poor gas availability which affects production. The company is hopeful of adequate gas availability by March 2008, although gas pricing remains unclear. Upon availability of gas, we expect Grasim's sponge iron division to operate at higher utilization, resulting in better absorption of fixed cost and resulting in improvement in margins.

Mega expansion plans

Grasim is investing significantly in its core business, with total capex of around Rs100b. It is investing Rs91b in augmenting cement capacity from 31mt to 47mt (incl UltraTech) and Rs7.3b in adding 64,000 ton in VSF business (excl 30,000 ton expansion in China JV and proposed 31,000 ton expansion at Harihar). These capex programs are running as per schedule and are expected to commence operations from 1QFY09. Further, it is planning to setup 88,000 ton (capex of Rs8.4b) greenfield project at Gujarat. Among its large peers, Grasim has the most aggressive and timely cement capacity addition program, which will result in significant volume growth and cost savings from FY09.

Upgrading estimates

We are revising our earnings estimates upwards for FY08E and FY09E by 1.3% and 8% to Rs302.3 and Rs336.3 respectively. Earnings upgrade is to factor in:

- ✍ Increase in VSF prices from Oct 1 2007
- ✍ Higher cement volumes in FY09 driven by on-schedule capex program

However, the upsides are to some extent diluted by higher cost push in cement business and lowering of estimates for UltraTech and Shri Digvijay Cement. Our estimates factor in a) Rs3/bag improvement in 3Q/4Q each and flat cement prices in FY09E over FY08E and b) no further price increase in FY08E and Rs4/Kg decline in VSF prices (to Rs98/Kg) in FY09E.

REVISED FORECAST (RS M)

	FY08E			FY09E		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Net Sales	170,427	167,200	1.9	200,176	190,121	5.3
Net Profit	27,721	27,355	1.3	30,835	28,480	8.3
EPS (Rs)	302.3	298.3	1.3	336.3	310.6	8.3

Source: Motilal Oswal Securities

Valuation and view

With outlook on both of its core businesses (cement and VSF) positive and being a leader in both the businesses, Grasim would be one of the biggest beneficiaries of any further upturn in these businesses. Also, Grasim is financially well placed to fund its future growth plans. Valuations at 11.3x FY09E EPS and 6.5x EV/EBITDA are reasonable for the largest cement player in the industry. Maintain **Buy** with revised target price of Rs4,300 (SOTP-based).

SOTP VALUATION

	BASIS	MULTIPLE	FY09E
VSF - EBITDA	EV/EBITDA (x)	6.0	71,685
Sponge Iron - EBITDA	EV/EBITDA (x)	4.0	7,875
Other Business - EBITDA	EV/EBITDA (x)	2.5	2,939
Cement (Consolidated) - EBITDA	EV/EBITDA (x)	8.0	288,579
Total EV (Rs m)			371,078
Less: Debt (Rs m)			30,920
Add: Cash & Investments (Rs m)			53,943
Mkt Cap (Rs m)			394,101
Grasim' Equity (m shares)			91.7
Fair Value per Share (Rs)			4,298

Source: Motilal Oswal Securities

Grasim Industries: an investment profile

Company description

Grasim is a diversified company with core businesses cement and VSF accounting for 60.4% and 23.1% of FY06 revenue. Its other businesses include sponge iron, 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 31mt.

Key investment argument

- Being largest player with total capacity of 31MT (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 years, which can result in significant softening in cement prices.
- Softening in prices of competing fibres (cotton & PSF) can put pressure on VSF prices.

COMPARATIVE VALUATIONS

		GRASIM	ACC	GACL
P/E (x)	FY08E	12.6	221.8	33.3
	FY09E	11.3	280.0	41.5
P/BV (x)	FY08E	3.8	212.0	294.3
	FY09E	2.9	199.9	294.3
EV/Sales (x)	FY08E	2.6	217.1	274.9
	FY09E	2.0	197.4	265.9
EV/EBITDA (x)	FY08E	8.0	14.8	14.4
	FY09E	6.5	13.3	13.2

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	25.2	25.2	25.1
Domestic Inst	19.8	21.1	22.3
Foreign	38.3	37.6	36.2
Others	16.7	16.1	16.4

Recent development

- Setting up 88,000 ton greenfield VSF plant at Vilayat, Gujarat.

Valuation and view

- The stock trades at 11.3x FY09E EPS and 6.5x EV/EBITDA.
- Grasim will be one of the biggest beneficiaries of current upturn in cement prices as well as its organic expansion plan. Maintain **Buy** with target price of Rs4,300.

Sector view

- Strong GDP growth, coupled with sustainable demand drivers, augurs well for cement demand growth.
- Although significant capacity addition has already been announced, real impact of these capacities would be felt only in 2HFY09.
- Imports not a significant threat, due to infrastructural bottlenecks.

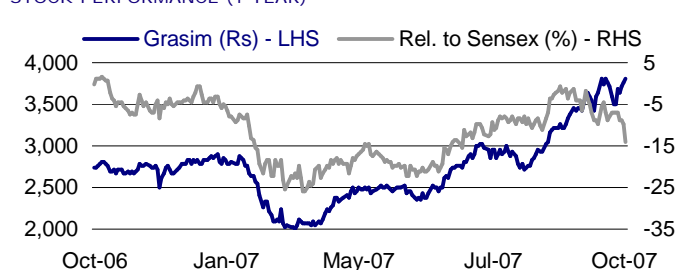
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	302.3	248.9	21.5
FY09	336.3	267.3	25.8

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
3,806	4,300	13.0	Buy

STOCK PERFORMANCE (1 YEAR)



CONSOLIDATED INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Net Sales	92,917	102,240	140,952	170,427	200,176
Change (%)	69.3	10.0	37.9	20.9	17.5
Total Expenditure	72,645	81,553	101,228	115,447	135,802
EBITDA	20,272	20,687	39,723	54,980	64,374
Margin (%)	21.8	20.2	28.2	32.3	32.2
Depreciation	5,562	5,631	6,100	7,213	9,901
EBIT	14,709	15,056	33,624	47,767	54,472
Int. and Finance Charges	2,846	2,183	2,286	2,358	2,717
Other Income - Rec.	2,452	2,679	3,177	3,218	3,096
PBT & EO items	14,316	15,552	34,515	48,626	54,852
Change (%)	37.8	8.6	21.9	40.9	2.8
Extra Ordinary items	1,281	-41	0	0	0
PBT but after EO items	15,597	15,511	34,515	48,626	54,852
Tax	4,421	4,027	10,921	15,616	17,811
Tax Rate (%)	28.3	26.0	31.6	32.1	32.5
Reported PAT	11,176	11,484	23,594	33,011	37,041
PAT Adj for EO items	10,258	11,514	23,594	33,011	37,041
Change (%)	39.0	2.2	104.9	39.9	2.2
Margin (%)	11.0	11.3	16.7	19.4	18.5
Less: Minority Interest	-190	1,160	3,911	5,289	6,205
Consolidated PAT	10,448	10,354	19,683	27,721	30,835
Change (%)	41.5	-0.9	90.1	40.8	11.2

CONSOLIDATED BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Equity Share Capital	917	917	917	917	917
Reserves	39,943	47,459	65,482	89,985	117,602
Net Worth	40,859	48,376	66,399	90,902	118,519
Loans	39,339	36,833	48,731	55,000	35,000
Deferred liabilities	11,793	11,583	11,526	12,802	14,178
Minority Interest	5,002	5,136	8,587	13,876	20,082
Capital Employed	96,993	101,927	135,242	172,580	187,778
Gross Block	111,116	114,836	125,269	187,269	205,269
Less: Accum. Deprn.	50,181	55,160	60,125	67,338	77,239
Net Fixed Assets	60,935	59,676	65,144	119,931	128,030
Capital WIP	2,053	4,480	19,577	5,000	1,500
Investments	7,690	13,521	22,719	19,485	28,523
Goodwill	19,577	17,728	19,217	19,217	19,217
Curr. Assets	23,971	26,185	33,216	40,476	47,542
Inventory	10,567	11,645	13,581	17,895	21,018
Account Receivables	7,232	5,908	8,252	9,373	11,010
Cash and Bank Balance	1,635	2,374	3,692	3,835	4,504
Others	4,537	6,259	7,691	9,373	11,010
Curr. Liability & Prov.	17,233	19,663	24,632	31,529	37,032
Account Payables	8,982	11,382	15,373	18,747	22,019
Other Liabilities	5,209	5,003	7,189	9,373	11,010
Provisions	3,043	3,277	2,070	3,409	4,004
Net Current Assets	6,738	6,523	8,585	8,947	10,509
Appl. of Funds	96,993	101,927	135,242	172,580	187,778

E: MOST Estimates

RATIOS					
Y/E MARCH	2005	2006	2007	2008E	2009E
Basic (Rs)					
EPS	114.0	112.9	214.7	302.3	336.3
Cash EPS	173.5	178.6	279.5	382.0	434.0
BV/Share	445.7	527.6	724.2	991.4	1,292.6
DPS	16.0	20.0	27.5	30.0	30.0
Payout (%)	16.9	18.4	12.5	9.7	8.7
Valuation (x)					
P/E		33.7	17.7	12.6	11.3
Cash P/E		21.3	13.6	10.0	8.8
P/BV		7.2	5.3	3.8	2.9
EV/Sales		4.3	3.0	2.6	2.0
EV/EBITDA		21.3	10.8	8.0	6.5
Dividend Yield (%)		0.5	0.7	0.8	0.8
Return Ratios (%)					
RoE	25.6	21.4	29.6	30.5	26.0
RoCE	21.4	20.8	32.0	34.9	37.5
Working Capital Ratios					
Debtor (Days)	28	21	21	20	20
Asset Turnover (x)	10	10	10	10	11
Leverage Ratio					
Debt/Equity (x)	10	0.8	0.7	0.6	0.3

CONSOLIDATED CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
OP/(Loss) before Tax	20,272	20,687	39,723	54,980	64,374
Interest/Dividends Recd.	2,452	2,679	3,177	3,218	3,096
Direct Taxes Paid	1,350	-4,237	-10,978	-14,340	-16,435
(Inc)/Dec in WC	-3,878	954	-744	-220	-892
CF from Operations	20,196	20,083	31,179	43,638	50,142
EO Items	-1,281	41	0	0	0
CF from Op. incl EO	21,477	20,041	31,179	43,638	50,142
(inc)/dec in FA	-33,011	-6,798	-26,665	-47,423	-14,500
(Pur)/Sale of Investments	-2,623	-3,981	-10,688	3,234	-9,038
CF from Investments	-35,634	-10,780	-37,353	-44,189	-23,538
Issue of Shares	-1,485	-717	1,285	0	0
(Inc)/Dec in Debt	15,143	-2,506	11,898	6,269	-20,000
Interest Paid	-2,846	-2,183	-2,286	-2,358	-2,717
Dividend Paid	-1,735	-2,121	-2,944	-3,218	-3,218
CF from Fin. Activity	9,077	-7,527	7,952	693	-25,935
Inc/Dec of Cash	-5,080	1,735	1,778	142	669
Add: Beginning Balance	2,441	1,635	2,374	3,692	3,835
Closing Balance	-2,640	3,370	4,152	3,835	4,504

N O T E S



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

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Disclosure of Interest Statement

Grasim Industries

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
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