

Grasim Industries

Concrete growth prospects

The EBITDA margin outlook for Grasim's core business (cement and VSF) still looks stable. While cement volumes may be subdued in FY08F, we estimate strong 25% growth in FY09. We up EPS by 4-9% for FY08-09F. Buy, with a target price of Rs3,055.39.

Key forecasts

	FY06A	FY07A	FY08F	FY09F	FY10F
Revenue (Rsm)	99199.6	131914	141018	174750	182039
EBITDA (Rsm)	19409.1	38407.0	42806.8▲	55251.4▲	50838.5
Reported net profit (Rsm)	9692.3	19348.7	20972.1	24816.9▲	22526.2
Normalised net profit (Rsm) ¹	9692.3	19348.7	20972.1	24816.9	22526.2
Normalised EPS (Rs)	105.7	211.1	228.8	270.7▲	245.7
Dividend per share (Rs)	18.0	27.5	30.0▲	35.0▲	35.0
Dividend yield (%)	0.72	1.11	1.21	1.41	1.41
Normalised PE (x)	23.5	11.8	10.9	9.19▼	10.1
EV/EBITDA (x)	13.4	6.87	6.48	4.58	4.56
Price/book value (x)	3.21	2.50	2.03	1.65	1.42
ROIC (%)	9.70	21.4	18.8	19.6	17.3

1. Post-goodwill amortisation and pre-exceptional items

Accounting Standard: Local

Source: Company data, ABN AMRO forecasts

year to Mar, fully diluted

Stronger-than-expected 4Q07 performance

Grasim reported 71% yoy EBITDA growth in 4Q07, around 5% above our estimate. The company's key businesses – cement, VSF and sponge iron – showed strong momentum in terms of volume and pricing, thus driving revenue and EBITDA growth. Grasim's subsidiary, Ultratech, also registered 213% yoy EBITDA growth in the quarter.

Aggressive capex in cement and VSF should drive growth from FY09

Grasim has a capex budget of Rs75bn for FY07-09, which is to be spent largely on expanding cement capacity by 13.5mmt and raising VSF capacity by 20,000mt. The company has already spent Rs24bn in FY07. It plans to fund the balance through internal accruals and debt. We estimate Grasim will have generated a gross cash flow of Rs25.3bn in FY07, reducing its gross-debt-to-equity ratio from 49% in FY06 to 46% in FY08F and to 20% in FY09F.

Medium-term cement outlook remains positive

The government recently changed the excise structure for cement sold above Rs190/bag but below Rs250/bag to an ad valorem excise duty of 12%. We estimate this will reduce excise duty by around Rs2/bag for the retail market. We view the change as being positive for sentiment, as the industry so far has been subject to several policies aimed at liberalising imports in an effort to reduce domestic prices. We expect cement prices to fall 1% given the decline in excise duty, without hurting industry profitability. We remain positive about the demand-supply balance through FY09, though pricing pressure may emerge in FY10.

EPS raised 4-9% for FY08-09F; target price maintained at Rs3,055.39

Grasim's stronger-than-expected FY07 results prompt us to raise our EPS estimates by 4.9% for FY08 and by 8.7% for FY09. We also introduce our forecasts for FY10, when we expect EPS to decline 9.3% as we assume a 5% decline in cement prices. We maintain our DCF-based target price of Rs3,055.39.

Buy

Absolute performance

n/a

Short term (0-60 days)

Neutral

Market relative to region

Materials

India

Price

Rs2486.95

Target price

Rs3055.39 (from Rs3055.39)

Market capitalisation

Rs227.98bn (US\$5.57bn)

Avg (12mth) daily turnover

Rs123.42m (US\$2.75m)

Reuters

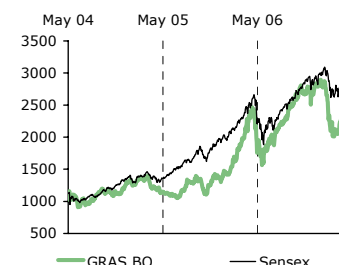
GRAS.BO

Bloomberg

GRASIM IN

Price performance (1M) (3M) (12M)

Price (Rs)	2195.0	2827.1	2433.8
Absolute %	13.3	-12.0	2.2
Rel market %	8.3	-7.2	-7.2
Rel sector %	9.0	-20.0	-6.3



Stock borrowing: Difficult

Volatility (30-day): 26.42%

Volatility (6-month trend): ↑

52-week range: 2908.00-1462.00

Sensex: 13781.51

BBG AP Diversifieds: 204.22

Source: ABN AMRO, Bloomberg

Researched by

ABN AMRO Institutional
Equities Team

www.abnamrobroking.co.in

Priced at close of business 9 May 2007. Use of ▲ ▼ indicates that the line item has changed by at least 5%.

Table 1 : EPS revisions

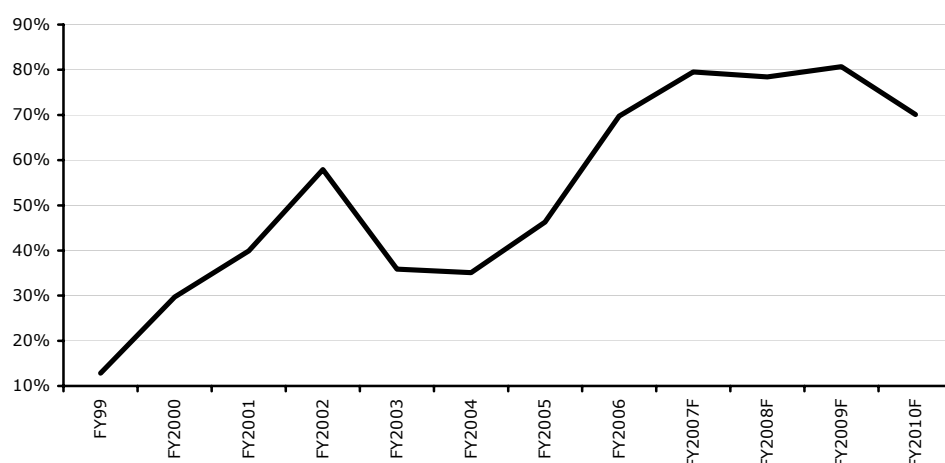
Rs	FY08F	FY09F
Old	218.04	249.03
New	228.78	270.72
% change	4.9%	8.7%

Source: ABN AMRO forecasts

Table 2 : Grasim – Commissioning schedule for cement expansion projects

(Rs m)	Cost	Scheduled commissioning
Grasim's 1.5mmt grinding unit at Dadri		October 2007
Ultratech's 0.5mmt unit		October 2007
Ultratech's 4mmt brownfield unit at Andhra Pradesh	12,750	April 2007
Grasim's 4mmt greenfield project in Kotpulti, Rajasthan	12,750	March 2008
Grasim's 4mmt greenfield project in Shambhupura	12,000	June 2008

Source: Company data

Chart 1 : Cement EBITDA percentage to total EBITDA

Source: ABN AMRO forecasts, company data

Table 3 : EBITDA breakdown

Rs m	FY05	FY06	FY07F	FY08F	FY09F	FY10F
Cement - Grasim	5512	7,996	16,230	17,946	24,198	17,946
Ultratech	3,508	5,543	14,314	15,630	20,389	17,694
Total cement	9,020	13,539	3,054	3,3576	44,588	3,5639
% of total	46%	70%	80%	78%	81%	70%
Viscose staple fibre (VSF)	6,108	4,950	7123	8,028	8,724	8,028
% of total	31%	26%	19%	19%	16%	16%
Sponge iron	3,897	847	851	1,173	1,440	1,173
Others	458	73	-111	30	500	5,998
Non-core businesses (ie, non-cement and VSF)	22%	5%	2%	3%	4%	14%
Total	19,483	19,409	38,407	42,807	55,251	50,839

Source: Company data, ABN AMRO forecasts

Table 4 : Grasim's cement earnings breakdown

	FY05	FY06	FY07F	FY08F	FY09F	FY10F
Volumes (mmt)	28	29	31.64	32.8	41	44
Sales (Rs m)	51,846	631,49	92,941	99,405	129,151	134,111
Average realisation (Rs/tonne)	1,864	2,150	2,936	3,028	3,153	3,014
Volume growth		6%	8%	4%	25%	9%
Price growth		15%	37%	3.1%	3.1%	-4.4%
EBITDA (Rs m)	8,643	12,832	29,627	32,566	43,507	34,629
EBITDA margin	16.7%	20.3%	31.9%	32.8%	33.7%	25.8%
EBITDA/mt	311	437	936	992	1,063	779
Proportion to consolidated EBITDA	44%	66%	77%	76%	79%	68%

Source: Company data, ABN AMRO forecasts

DISCLAIMER APPENDIX

This document is not for public distribution and has been furnished to you solely for your information only and must not be reproduced or re-distributed to any other person. Persons into whose possession this document may come are required to observe these restrictions. This material is for the personal information of the authorized recipient and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of ABN AMRO Asia Equities (India) Limited (AAAEIL). It does not constitute a personal recommendation or take into account the particular investment objectives, financial situation or needs of individual clients. We have reviewed the report and in so far as it includes current or historical information, it is believed to be reliable though its accuracy or completeness cannot be guaranteed. Neither AAAEIL nor any person connected with it accepts any liability arising from the use of this document. The information contained in the said report should be construed as non-discretionary in nature and the recipient of this material should rely on their own investigations and take their own professional advice. Price and value of investments referred to in this material may go up or down. Past performance is not a guide for future performance. Opinions expressed are our current opinions as of the date appearing on this material only. Clients should not await such reports at regular intervals / frequency and should not hold AAAEIL responsible for failure to send such reports. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance or other reasons that prevent us from doing so. Prospective investors are cautioned that any forward looking statements are not predictions and may be subject to change without notice. Our proprietary trading may make investment decisions that are inconsistent with the recommendations expressed herein. AAAEIL has two independent equity research groups : Institutional Equities (IE) and Retail Broking Services (RBS). This report has been prepared by the IE and is being distributed to RBS clients after the report has been distributed to IE clients. We and our affiliates, officer, directors and employees worldwide may (a) from time to time have long or short positions in and but or sell securities thereof, of company(ies) mentioned therein or (b) be engaged in any other transactions involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities and no part of his or her compensation was, is or will be directly related to specific recommendations and related information and opinions. No part of this material may be duplicated in any form and / or re-distributed without AAAEIL's prior written consent.

GRASIM INDUSTRIES: KEY FINANCIAL DATA

Income statement

Rsm	FY06A	FY07A	FY08F	FY09F	FY10F
Revenue	99199.6	131914	141018	174750	182039
Cost of sales	-79791	-93507	-98211	-119499	-131201
Operating costs	n/a	n/a	n/a	n/a	n/a
EBITDA	19409.1	38407.0	42806.8	55251.4	50838.5
DDA & Impairment (ex gw)	-5076.7	-5467.1	-7302.3	-7932.3	-8873.1
EBITA	14332.4	32939.9	35504.6	47319.2	41965.5
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	14332.4	32939.9	35504.6	47319.2	41965.5
Net interest	542.8	695.6	-1299.3	-1299.7	687.7
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
Reported PTP	14875.2	33635.5	34205.3	46019.4	42653.1
Taxation	-4034.0	-10792	-8968.2	-15813	-15408
Minority interests	-1148.9	-3494.8	-4265.0	-5389.9	-4718.8
Exceptionals (post-tax)	n/a	n/a	n/a	n/a	n/a
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	9692.3	19348.7	20972.1	24816.9	22526.2
Normalised Items Excl. GW	0.00	0.00	0.00	0.00	0.00
Normalised net profit	9692.3	19348.7	20972.1	24816.9	22526.2

Source: Company data, ABN AMRO forecasts

year to Mar

Balance sheet

Rsm	FY06A	FY07A	FY08F	FY09F	FY10F
Cash & market secs (1)	2171.8	2155.8	2155.8	2155.8	3156.8
Other current assets	25821.0	29598.1	30882.4	36009.8	37578.3
Tangible fixed assets	59892.3	82861.2	117559	118166	119743
Intang assets (incl gw)	19565.9	19565.9	19565.9	19565.9	19565.9
Oth non-curr assets	16264.0	16264.0	16264.0	16264.0	16264.0
Total assets	123715	150445	186427	192162	196308
Short term debt (2)	n/a	n/a	n/a	n/a	n/a
Trade & oth current liab	18294.2	21548.5	22644.7	27107.6	28507.5
Long term debt (3)	34315.0	37872.8	51361.6	27072.0	7219.0
Oth non-current liab	0.00	0.00	0.00	0.00	0.00
Total liabilities	52609.2	59421.4	74006.3	54179.7	35726.5
Total equity (incl min)	71105.8	91023.6	112421	137982	160582
Total liab & sh equity	123715	150445	186427	192162	196308
Net debt (2+3-1)	32143.2	35717.0	49205.8	24916.2	4062.2

Source: Company data, ABN AMRO forecasts

year ended Mar

Cash flow statement

Rsm	FY06A	FY07A	FY08F	FY09F	FY10F
EBITDA	19409.1	38407.0	42806.8	55251.4	50838.5
Change in working capital	-2076.0	-3270.3	-1096.2	-4462.9	-398.9
Net interest (pd) / rec	-1869.6	-1986.4	-3455.3	-3529.5	-1543.1
Taxes paid	-4034.0	-10792	-8968.2	-15813	-15408
Other oper cash items	2412.4	2682.0	2156.0	2229.8	2230.8
Cash flow from ops (1)	13841.9	25040.2	31443.2	33676.2	35719.3
Capex (2)	-7577.5	-28436	-42000	-8539.7	-10450
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	-4872.9	0.00	0.00	0.00	0.00
Cash flow from invest (3)	-12450	-28436	-42000	-8539.7	-10450
Incr / (decr) in equity	n/a	0.00	0.00	0.00	0.00
Incr / (decr) in debt	-1082.2	3557.8	13488.7	-24290	-19853
Ordinary dividend paid	-2133.7	-3295.4	-3840.0	-4645.4	-4645.4
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	n/a	1408.3	-24.4	553.3	-3015.0
Cash flow from fin (5)	-3215.9	1670.7	9624.3	-28382	-27513
Forex & disc ops (6)	2566.6	1709.1	932.5	3245.2	3245.2
Inc/(decr) cash (1+3+5+6)	742.2	-16.0	0.00	0.00	1001.0
Equity FCF (1+2+4)	6264.4	-3395.8	-10557	25136.5	25269.3

Lines in bold can be derived from the immediately preceding lines.

Source: Company data, ABN AMRO forecasts

year to Mar

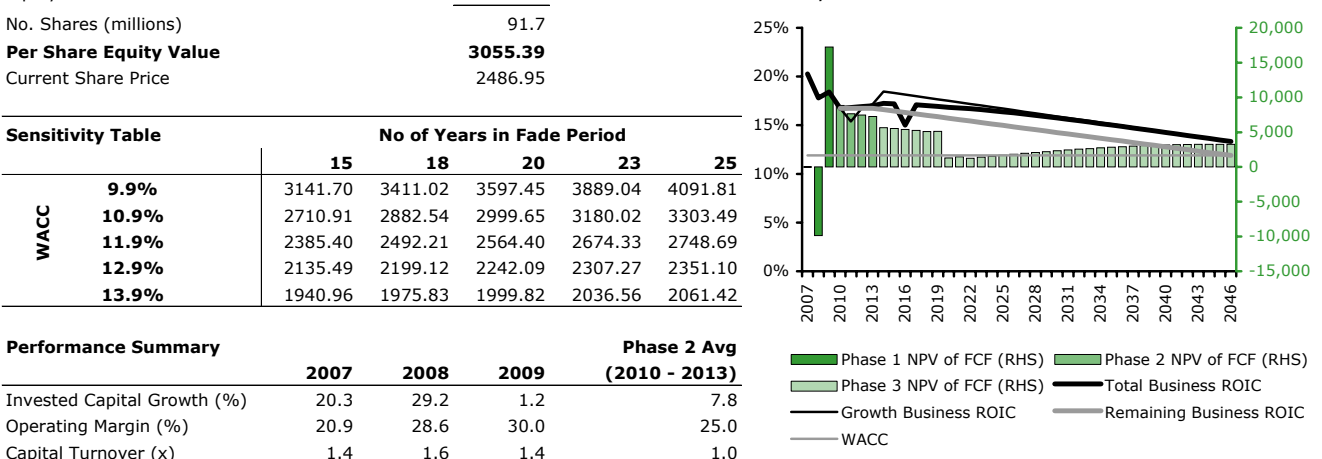
GRASIM INDUSTRIES: PERFORMANCE AND VALUATION

Standard ratios	Grasim Ind					Associated Cement			India Cements		
Performance	FY06A	FY07A	FY08F	FY09F	FY10F	FY07F	FY08F	FY09F	FY07F	FY08F	FY09F
Sales growth (%)	12.3	33.0	6.90	23.9	4.17	15.2	12.9	7.44	33.3	28.0	13.0
EBITDA growth (%)	-0.38	97.9	11.5	29.1	-7.99	20.7	15.9	-2.89	155.2	35.9	18.1
EBIT growth (%)	-0.61	129.8	7.79	33.3	-11.3	18.6	13.7	-10.1	223.7	38.7	19.7
Normalised EPS growth (%)	-5.16	99.6	8.39	18.3	-9.23	12.0	13.3	-8.38	1218.3	18.5	9.13
EBITDA margin (%)	19.6	29.1	30.4	31.6	27.9	29.3	30.1	27.2	32.5	34.5	36.0
EBIT margin (%)	14.4	25.0	25.2	27.1	23.1	24.3	24.5	20.5	28.7	31.0	32.9
Net profit margin (%)	9.77	14.7	14.9	14.2	12.4	17.9	18.0	15.4	22.1	22.3	21.6
Return on avg assets (%)	8.74	16.3	15.5	16.4	13.8	19.2	18.3	14.6	16.4	18.7	19.1
Return on avg equity (%)	14.2	23.9	20.6	19.8	15.1	33.4	30.0	22.8	38.7	33.3	26.8
ROIC (%)	9.70	21.4	18.8	19.6	17.3	24.0	22.9	17.0	8.41	10.8	11.6
ROIC - WACC (%)	0.00	0.00	0.00	0.00	0.00	12.1	11.0	5.04	0.00	0.00	0.00
				year to Mar			year to Dec			year to Mar	
Valuation	FY06A	FY07A	FY08F	FY09F	FY10F	FY07F	FY08F	FY09F	FY07F	FY08F	FY09F
EV/sales (x)	2.62	2.00	1.97	1.45	1.27	2.56	2.28	2.06	2.73	2.01	1.60
EV/EBITDA (x)	13.4	6.87	6.48	4.58	4.56	8.73	7.58	7.56	8.41	5.85	4.45
EV/EBITDA @ tgt price (x)	16.1	8.22	7.69	5.52	5.59	9.75	8.46	8.46	10.6	7.44	5.80
EV/EBIT (x)	18.1	8.01	7.81	5.34	5.53	10.5	9.32	10.0	9.53	6.49	4.87
EV/invested capital (x)	2.52	2.08	1.71	1.55	1.41	3.26	2.71	2.49	2.12	1.80	1.56
Price/book value (x)	3.21	2.50	2.03	1.65	1.42	4.06	3.26	2.79	2.80	2.16	1.65
Equity FCF yield (%)	2.75	-1.49	-4.63	11.0	11.1	2.14	1.49	5.55	6.11	11.7	24.4
Normalised PE (x)	23.5	11.8	10.9	9.19	10.1	13.7	12.1	13.2	9.02	7.61	6.98
Norm PE @tgt price (x)	28.9	14.5	13.4	11.3	12.4	15.3	13.5	14.8	11.9	10.1	9.24
Dividend yield (%)	0.72	1.11	1.21	1.41	1.41	1.83	2.28	2.40	0.00	0.00	0.00
				year to Mar			year to Dec			year to Mar	
Per share data	FY06A	FY07A	FY08F	FY09F	FY10F	Solvency					
Tot adj dil sh, ave (m)	91.7	91.7	91.7	91.7	91.7	Net debt to equity (%)	45.2	39.2	43.8	18.1	2.53
Reported EPS (INR)	105.7	211.1	228.8	270.7	245.7	Net debt to tot ass (%)	26.0	23.7	26.4	13.0	2.07
Normalised EPS (INR)	105.7	211.1	228.8	270.7	245.7	Net debt to EBITDA	1.66	0.93	1.15	0.45	0.08
Dividend per share (INR)	18.0	27.5	30.0	35.0	35.0	Current ratio (x)	1.53	1.47	1.46	1.41	1.43
Equity FCF per share (INR)	68.3	-37.0	-115.2	274.2	275.7	Operating CF int cov (x)	10.6	19.0	12.7	15.0	34.1
Book value per sh (INR)	775.7	992.9	1226.4	1505.2	1751.7	Dividend cover (x)	4.54	5.87	5.46	5.34	4.85
				year to Mar						year to Mar	

Priced as follows: GRAS.BO - Rs2486.95; ACC.BO - Rs875.70; ICMN.BO - Rs184.90
Source: Company data, ABN AMRO forecasts

GRASIM INDUSTRIES: VALUATION METHODOLOGY

Economic Profit Valuation	Rs m	%	Discounted Cash Flow Valuation	Rs m	%
Adjusted Opening Invested Capital	116167.5	48	Value of Phase 1: Explicit (2007 to 2009)	7386.4	3
NPV of Economic Profit During Explicit Period	4212.6	2	Value of Phase 2: Value Driver (2010 to 2013)	31217.1	13
NPV of Econ Profit of Remaining Business (1, 2)	34002.5	14	Value of Phase 3: Fade (2014 to 2046)	99038.5	42
NPV of Econ Profit of Net Inv (Grth Business) (1, 3)	89112.6	37	Terminal Value	95471.1	41
Enterprise Value	243495.3	100	Enterprise Value	233113.1	100
Plus: Other Assets	58404.5	24	FCF Grth Rate at end of Phs 1 implied by DCF Valuation		4.3
Less: Minorities	0.0	0	FCF Grth Rate at end of Phs 1 implied by Current Price		2.4
Less: Net Debt (as at 10 May 2007)	22601.1	9			
Equity Value	279298.7	115			
No. Shares (millions)	91.7				
Per Share Equity Value	3055.39				
Current Share Price	2486.95				



Source: ABN AMRO forecasts

1. In periods following the Explicit Period i.e. Phase 2 and Phase 3
2. Remaining Business is defined as Capital as at the end of Phase 1 and capex = depreciation thereafter
3. Net Investment is defined as capex over and above depreciation after Phase 1

Grasim Industries

Company description

Grasim, part of the Birla Group, is a conglomerate with business exposure to cement, viscose staple fibre (VSF) and sponge iron. It is the second-largest producer of VSF in the world with a 12% share of global production, and the largest cement producer in India after its acquisition of Ultratech Cement. It is also the ninth-largest cement producer in the world. The company has been focusing on the cement business for growth.

Buy

Price relative to country



Strategic analysis

Average SWOT company score:

3

EBITDA mix, FY07F

Strengths

4

Grasim generates strong free cash flows from its VSF business, and we believe it has the critical size in the cement business on a consolidated basis to outperform industry volume growth over the next three to five years.

Weaknesses

2

A diversified business portfolio, especially the presence in sponge iron and textiles, lowers ROCE. Besides, Grasim has not been investing incrementally in these non-core assets, while continuing to restructure them to improve returns.

Opportunities

4

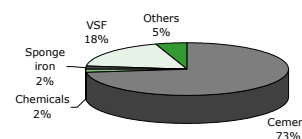
Post acquisition, we see tremendous potential synergies in a freight-sensitive business such as cement. These could be from cross-manufacturing, scale in material sourcing, and optimum and effective utilisation of cement and other plants.

Threats

3

A sustained slowdown in cement demand could impact earnings, and Grasim's earnings are now highly sensitive to cement prices.

Scoring range is 1-5 (high score is good)



Source: ABN AMRO estimates

Market data

Headquarters

Aditya Birla Centre, A wing, 2nd Floor, SK Ahire Worli, Mumbai-400025

Website

www.adityabirla.com

Shares in issue

91.7m

Freefloat

70%

Majority shareholders

Birla Group (25%), Aberdeen Asset Management (7%), HSBC Asset Management (4%)

India

Country view

Neutral

Country rel to Asia Pacific

The market looks expensive, but we believe it will remain supportive when regional funds seek a domestically-driven home with continuing robust earnings growth. The ABN AMRO Indian PMI suggests the economy is still powering ahead despite the global headwinds, thanks to its domestically-oriented economic structure. At the sector level, we still like autos, software and construction-related stocks.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.



Competitive position

Average competitive score:

3+

Broker recommendations

Supplier power

4+

With the acquisition of Ultratech Cement, Grasim enjoys significant scale to secure better terms of trade with suppliers.

Barriers to entry

3+

Cement is a commodity business, hence it does not have very high entry barriers in most markets.

Customer power

2+

Grasim has a 30%+ market share in cement in key states like Maharashtra and Karnataka, which account for 42% of India's cement market. It would have the power to influence pricing as well.

Substitute products

2-

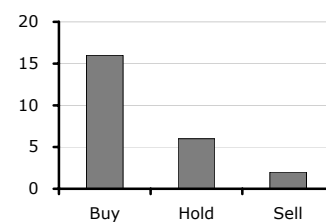
There are no substitutes for cement. For VSF, cotton and polyester are substitutes. But VSF must be used in a certain proportion to maintain texture in a tropical country like India.

Rivalry

3-

While the top end of the cement industry is well consolidated with four top players accounting for 50%, there are over 40 players, which can lead to price competition in many markets.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg