

25th January 2010

**BUY**

Price	Target Price
<b>Rs 2,608</b>	<b>Rs 3,100</b>

Sensex –	<b>16,780</b>
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**Price Performance**

(%)	1M	3M	6M	12M
Absolute	8	17	(8)	122
Rel. to Sensex	10	17	(16)	16

Source: Bloomberg

**Stock Details**

Reuters	GRAS.BO
Bloomberg	GRASIM@IN
Equity Capital (Rs mn)	917
Face Value (Rs)	10
No of shares o/s (mn)	92
52 Week H/L (Rs)	2,938/1,150
Market Cap (Rs bn/USD mn)	239/5,185
Daily Avg Vol (No of shares)	229349
Daily Avg Turnover (US\$ mn)	12.0

**Shareholding Pattern (%)**

	D'09	S'09	J'09
Promoters	25.2	25.2	25.2
FII/NRI	37.4	37.2	37.5
Institutions	21.0	20.6	20.5
Private Corp	4.0	5.4	5.0
Public	12.5	11.7	11.9

Source: Capitaline

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Grasim Industries' Q3FY2010 net profit at Rs5.95 bn (+97% yoy on a like to like basis) is ahead of our expectations (Rs5.66 bn). Like to like revenue grew by 29% yoy to Rs30.51bn driven by 17.7% growth in revenues of cement division (Rs20.3 bn) and 70.7% growth in revenues of VSF division (Rs9.62 bn). Like to like EBIDTA growth stood at 102% yoy (Rs10.75bn) driven by 49% growth in cement EBIDTA (Rs6.05bn) and a 5.3X jump in VSF EBIDTA (Rs4.03 bn). EBIDTA margin for the quarter improved 1356 bps yoy to 32.3%.

Grasim cement business is expected to report steady performance as volume benefits from capacity addition is expected to get negated by softening of cement prices on the back cement surplus situation in the industry. However with VSF volumes expected to sustain momentum on the back of pick up in demand witnessed globally and VSF prices, expected to remain stable, Grasim's earnings are showing clear signs of sustained recovery. We upgrade Grasim consolidated earnings for FY10 by 8% (Rs325) and FY11E earnings by 2% (Rs295).

At current levels the stock is implying holding company discount of 46% - for its expected holding in Ultratech + Samrudhhi combine cement entity. The discount we believe is unjustified. If we look at implied valuation from VSF perspective, at current levels, Grasim VSF business is available ~ 5 X its FY2011 earnings. We believe these are extremely attractive valuations for a Global scale, high margin and free cash generating VSF business. We continue to remain positive on Grasim and upgrade our rating on the stock to BUY from ACCUMULATE with an upgraded price target of Rs3100 - upside of 19%.

*Note: Q3FY2009 number included the numbers for the sponge iron business which was divested in Q1FY2010. Hence the numbers are not strictly comparable. We have given like to like growth numbers wherever possible.*

**Like to like revenue growth of 29% - VSF revenues surge 71%**

Standalone reported revenues grew by a healthy 14.8% yoy to Rs30.51bn (our expectation of Rs29.65bn) driven by 17.7% growth in revenues of cement division (Rs20.3 bn) and 70.7% growth in revenues of VSF division (Rs9.62 bn). Like to like revenue grew by 29% yoy

**EBIDTA up 102% - VSF EBIDTA up 5.3X**

Overall EBIDTA at Rs9.86bn (our expectation Rs9.5 bn) grew 97.9% yoy driven by 48% growth in Cement EBIDTA (Rs6.05bn) and a 5.3X jump in VSF EBIDTA (Rs4.03 bn). EBIDTA margin for the quarter improved 1356 bps yoy to 32.3%. Like to like EBIDTA growth stood at 102% yoy.

**Net profit surges 97%**

Depreciation jumped 18.9% on account of commissioning of new cement capacities at Shambhupura line II (1.6 mtpa), Aligarh Grinding unit (1.3 mtpa) and commissioning of 121 MW of captive power plants. Consequently net profit at Rs5.95 bn grew by healthy 80.8% yoy, ahead of our estimates of Rs5.66 bn. Like to like net profit growth stood at 97%.

**Financial Snapshot**

	Net sales (Rs.mn)	EBIDTA (Rs.mn)	EBIDTA (%)	PAT (Rs.mn)	EPS (Rs.)	EPS growth (%)	ROCE (%)	PE (x)	EV/ EBIDTA (x)	EV/ Ton (USD)
<b>FY08</b>	170569	49520	29.0	28897	315.2	46.8	35.6	8.3	3.9	153.3
<b>FY09</b>	184039	43298	23.5	21867	238.5	-24.3	22.3	11.0	4.6	110.7
<b>FY010E</b>	188022	59328	31.6	29845	325.6	36.5	26.4	8.0	3.2	91.8
<b>FY011E</b>	199881	53948	27.0	26994	294.5	-9.6	16.1	8.9	3.2	84.4

**Consolidated revenues up 27%**

Consolidated revenues for the quarter grew by 4.4% to Rs47.8bn, while consolidated EBIDTA at Rs13.85bn grew by an impressive 44%. On a like to like basis consolidated revenues grew by 16.4%, where as consolidated EBIDTA grew by 54.3%. Consolidated EBIDTA margins at 28.9% improved by 800 bps yoy. Consolidated net profit (after minority interest) for the quarter grew by 55.7% yoy to Rs7.15bn. On a like to like basis consolidated net profit growth stood at 65%.

**Results Table Standalone**

(Y/E Mar, Rs mn)	Q3FY09	Q3FY10	yoy (%)	9MFY09	9MFY10	yoy (%)
<b>Net Sales</b>	<b>26587.7</b>	<b>30518.9</b>	<b>14.8%</b>	<b>79374.6</b>	<b>90809.8</b>	<b>14.4%</b>
Total Expenditure	21604.3	20659.2	-4.4%	61071.0	61935.7	1.4%
<b>Operating profit</b>	<b>4983.4</b>	<b>9859.7</b>	<b>97.9%</b>	<b>18303.6</b>	<b>28874.1</b>	<b>57.8%</b>
Other Income	812.5	887.6	9.2%	2620.3	2938.8	12.2%
PBIDT	5795.9	10747.3	85.4%	20923.9	31812.9	52.0%
Interest	438.9	503.7	14.8%	1028.9	1484.2	44.3%
PBDT	5357.0	10243.6	91.2%	19895.0	30328.7	52.4%
Depreciation	1197.7	1423.5	18.9%	3316.7	4152.3	25.2%
PBT	4159.3	8820.1	112.1%	16578.3	26176.4	57.9%
Tax	863.6	2861.3	231.3%	3945.7	8190.2	107.6%
<b>Adjusted PAT</b>	<b>3295.7</b>	<b>5958.8</b>	<b>80.8%</b>	<b>12632.6</b>	<b>17986.2</b>	<b>42.4%</b>
Extra-ordinary Items	0.0	0.0		0.0	3360.7	
Reported PAT	3295.7	5958.8	80.8%	12632.6	21346.9	69.0%
EPS (Rs)	35.9	65.0	80.8%	137.8	196.2	42.4%
<b>Margins</b>						
OPMs	18.7%	32.3%		23.1%	31.8%	
EBIDTA	21.8%	35.2%		26.4%	35.0%	
PBT(%)	15.6%	28.9%		20.9%	28.8%	
PAT	12.4%	19.5%		15.9%	19.8%	
Tax rate	20.8%	32.4%		23.8%	31.3%	

**Consolidated Financials highlights**

(Y/E Mar, Rs mn)	Q3FY09	Q3FY10	yoy (%)	9MFY09	9MFY10	yoy (%)
Revenues	45878.6	47883.5	4.4%	134715.7	145506.3	8.0%
Operating Profit	9588.2	13848.1	44.4%	31505.4	44509.4	41.3%
Operating Margin	2.1	2.9	38.4%	7.0	9.2	30.5%
PAT	4595.5	7153.2	55.7%	16178.8	22400.5	38.5%

**Like to like comparison\***

Standalone	Q3FY09	Q3FY10	yoy (%)	9MFY09	9MFY10	yoy (%)
Revenue	23970	30880	28.8%	71700	90870	26.7%
EBIDTA	5330	10750	101.7%	19390	32200	66.1%
PAT	3030	5960	96.7%	11740	18310	56.0%
Consolidated						
Revenue	41620	48440	16.4%	122690	146040	19.0%
EBIDTA	9790	15110	54.3%	31620	48610	53.7%
PAT	4330	7150	65.1%	15280	22700	48.6%

\*Like to like: excluding sponge iron business which was divested in Q1FY2010

## Segmental Performance

### Cement

Cement revenues grew by 17.7% yoy to Rs20.3 bn as Grasim benefited from expansion of cement capacities at Shampuram and Kotputli and delivered a volume growth of 17.7% backed by healthy demand in key markets in northern (+29% yoy) and eastern India (+19% yoy). Grasim's blended cement realisation at Rs4110 and Grey cement realization at Rs3404 stayed flat yoy. However on a sequential basis Grey cement realizations fell 7.7% or Rs285/ton. Helped by lower coal & pet coke prices and also on account of higher proportion of captive power of 121 MW, Cement EBIDTA grew by 48.5% yoy to Rs6.05bn. EBITDA/ton of Rs1225 registered an improvement of 26.3% yoy.

### VSF

VSF division continued its impressive performance with revenues growing by 70.7% yoy to Rs9.62bn. The performance was driven by volume growth of 51%, as domestic demand for VSF saw resurgence as well as the value chain saw restocking of inventory which resulted in higher than expected volumes. Exports (~30% of total volume grew by 209% where as domestic volumes grew 33% yoy. Helped by demand surge and prices of competing fibres VSF realisations, improved 13.4% yoy and 4.4% jump sequentially at Rs109.6/Kg. The division has also witnessed some cost benefits due to base effect (higher price of raw materials in Q3FY2009) of lower cost of pulp, caustic soda and sulphur - decline of more than 25% in key cost. With capacity utilization of 98% economies of scale kicked in and helped the division register a massive 5.35 X jump in its EBIDTA to Rs4.03 bn with margins improving by 30.7 % points to 41.9 %. The abnormally low base of Q3FY2009 also is helping the growth number.

On the cost front though on a yoy basis company has seen its cost/declining by more than 25%, we note that sequentially the cost s are up close to 5% are likely to move up further as price of pulp and Sulphur start impacting costs.

### Chemical

Grasim's Chemical division has seen some stabilization in its performance with 12% volume growth. However over supply situation in market meant that ECU realization dipped 20%. Consequently revenues or the quarter declined by 5% yoy to Rs1.2 bn where as EBIDTA at Rr 283 mn registered a decline of 15% yoy. Division's EBIDTA margins declined by 270 bps to 23.3%.

### Segmental highlights

(Rs mn)	Q3FY09	Q3FY10	YoY
<b>Sales</b>			
VSF	5639.0	9624.0	70.7%
Chemical	1277.0	1213.0	-5.0%
Cement	17249.0	20300.0	17.7%
<b>EBIDTA</b>			
VSF	635.0	4037.0	535.7%
Chemical	333.0	283.0	-15.0%
Cement	4076.0	6051.4	48.5%
<b>EBIDTA (%)</b>			
VSF	11.3%	41.9%	30.7%
Chemical	26.1%	23.3%	-2.7%
Cement	23.6%	29.8%	6.2%

### Capex Plan

Grinding capacity at Kotputli (Rajasthan) of 3.1 mtpa is expected to be commissioned by Q4FY10, which will take the consolidated cement capacity of Grasim (including Ultratech) to 48.8 mtpa. Grasim has planned to invest Rs41.11bn of cement capex (including Rs20.4bn in Ultratech) which will be invested over next three years in various capex plans like grinding and evacuation facility, Bricks and RMC plants, West Recovery systems (7MW) Logistic initiatives and completion of existing projects.

Grasim is also planning to invest Rs10bn in Greenfield VSF plant to be set up at Vilayat, Gujarat which is expected to start commercial operation by FY2013. The company Chinese JV is expected to double its capacity to 70000 tons by Q1FY2011.

### Consolidated Capex Plan

Rs bn	Project cost	Spent Till FY09	Net capex	Cash Outflow	
				FY10	FY11 & Onwards
<b>Grasim Cement</b>	<b>59.41</b>	<b>38.71</b>	<b>20.7</b>	<b>12.3</b>	<b>8.4</b>
Projects: Kotputli (4.5 Mn. TPA), Shambhupura (4.4 Mn. TPA), Dadri - GU (1.3 Mn. TPA) (incl. 96 MW TPP)	46.18	37.92	8.26	0	0
Bricks & RMC Plants	2.25	0.19	2.06	0	0
Waste Heat Recovery System (7 MW)	0.7	0	0.7	0	0
Logistics initiatives	2.74	0.6	2.14	0	0
Modernisation & up gradation etc	7.54	0	7.54	0	0
<b>VSF &amp; other</b>	<b>15.28</b>	<b>0</b>	<b>1.07</b>	<b>4.35</b>	<b>10.93</b>
VSF Business - Modernisation & Up gradation	1.07	0	1.07	0.65	0.42
Vilayat Expansion	10	0			10
Chemical & Other businesses	4.21	0		3.7	0.51
<b>Grasim</b>	<b>74.69</b>	<b>38.71</b>	<b>22.84</b>	<b>21</b>	<b>30.26</b>
<b>Ultratech</b>	<b>38.97</b>	<b>18.57</b>	<b>20.4</b>	<b>5.7</b>	<b>14.7</b>
4.9 mn TPC Tadpatri Project, A.P. (incl 50 MW TPP)	21.17	18.54	2.63		
Thermal Power Plant (25 MW), Waste Heat Recovery System (11 MW)	2.5	0	2.5		
2 mn GCW Grinding capacity augmentation * logistic initiatives	10.04	0	10.04		
RMC plants (2 nos, capacity 5 lac cu mtrs)	0.52	0.03	0.49		
Modernisation & upgradation	4.74	0	4.74		
<b>Cement Business (Grasim &amp; Ultratech)</b>	<b>98.38</b>	<b>57.28</b>	<b>41.1</b>	<b>18</b>	<b>23.1</b>

### Outlook – earnings recovery under way

Going forward Grasim cement business is expected to report steady performance as the cement business benefits from large capacity addition and benefits of captive power plants. Cement prices though have seen a uptick recently, the same are expected to soften in Q2FY11 on the back of large capacity addition as 48 mtpa of new capacities are planned over next 4-5 quarters.

VSF division has seen a sharp reversal in its performance with volume surge and increase in VSF prices on the back of pick up in demand momentum witnessed globally. Management sounded upbeat on sustained volume growth as it sees improvement in the end consumer offtake. VSF realisations are expected to remain stable on back of buoyant demand and prices of its competing fibres. Margins though seem to have peaked out at 40%+, as pulp & sulphur prices have seen some uptrend recently and are likely to continue the trend.

**Consolidated earnings upgraded by 8% – Upgrading Rating to BUY**

With VSF volumes expected to sustain volume momentum and prices currently ruling at Rs110/kg, Grasim earnings are showing clear signs of sustained recovery. We upgrade Grasim FY2010 standalone earnings by 12% (EPS of Rs257.3) and FY2011 earnings by 3% (EPS of Rs228.9). The upgrade our consolidated earnings is lower on account of 4% downgrade in Ultratech earnings. Our consolidated earnings for FY2010 stands upgraded by 8% to Rs325.6 and FY2011E earnings by 2% to Rs249.5.

At current levels the stock is implying holding company discount of 46% - for its expected holding in Ultratech + Samrudhhi combined cement entity. The discount we believe is unjustified. If we look at implied valuation from VSF perspective, at current levels, Grasim VSF business is available at very lucrative valuation of 3X EV/EBITDA or ~ 5 X it FY2011 earnings. We believe these are extremely attractive valuations for a global scale, high margin and free cash generating VSF business.

We continue to remain positive on Grasim and upgrade our rating on the stock to BUY from ACCUMULATE with a revised price target of Rs3100 (earlier Rs2400), with upside of 19%. We have valued the consolidated cement business at USD 120/tonne (same value as ACC) and have applied a 20% holding company discount for Grasim 60.33% holding in the business. We have valued the VSF business at 6X EV/EBITDA and the chemical business at 4X EV/EBITDA.

**Grasim SoTP fair value at Rs3100**

Business Segment	Valuation Measure	Rs mn	Rs / share	Holding company discount			
<b>Replacement Cost of Ultratech + SCL</b>	<b>48.8 mtpa @ USD 120</b>	<b>274950</b>		<b>5%</b>	<b>10%</b>	<b>15%</b>	<b>20%</b>
Grasim holding in combined entity - 60.33%		165877	1810	1719	1629	1538	1448
Grasim Shareholders - 19.1%		52515	573	573	573	573	573
<b>Value of consolidated cement business</b>		<b>218393</b>	<b>2382</b>	<b>2292</b>	<b>2201</b>	<b>2111</b>	<b>2020</b>
<b>ADD: Value of Non Cement Business</b>							
Viscose Staple Fibre	6X EV/EBIDTA	87196	951	951	951	951	951
Chemical	4X EV/EBIDTA	4967	54	54	54	54	54
Other	3X EV/EBIDTA	2315	25	25	25	25	25
<b>Total Value Of Non Cement Business</b>		<b>94478</b>	<b>1031</b>	1031	1031	1031	1031
<b>Total value of Investments</b>	<b>25% discount to CMP</b>	<b>34848</b>	<b>380</b>	380	380	380	380
<b>Total Enterprise value</b>		<b>347718</b>	<b>3793</b>	<b>3703</b>	<b>3612</b>	<b>3522</b>	<b>3431</b>
<b>Less:</b>							
Debt		30360	331	331	331	331	331
<b>Fair Value</b>		<b>317358</b>	<b>3462</b>	<b>3371</b>	<b>3281</b>	<b>3191</b>	<b>3100</b>

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