Monday 21 August 2006

Change of price target

Grasim Industries

Investing in the next leg of growth

Grasim plans to spend Rs72.5bn over the next two years to drive the next leg of growth, after having successfully integrated the Ultratech Cement acquisition. Strong internal accruals should fund growth. We raise FY07F EPS by 16% and target price to Rs2,579.

Key forecasts

	FY05A	FY06A	FY07F	FY08F	FY09F
Revenue (Rsm)	88361.6	99199.6	121464	130724	153052
EBITDA (Rsm)	19483.3	19409.1	32753.9▲	37068.4▲	42623.7
Reported net profit (Rsm)	8874.3	9692.3	15648.7▲	17851.0▲	19101.8
Normalised net profit (Rsm)[1]	10219.3	9692.3	15648.7	17851.0	19101.8
Normalised EPS (Rs)	111.5	105.7	170.7▲	194.7▲	208.4
Dividend per share (Rs)	16.0	18.0	22.0	25.0	26.0
Dividend yield (%)	0.73	0.82	1.00	1.14	1.18
Normalised PE (x)	19.7	20.8	12.9▼	11.3▼	10.6
EV/EBITDA (x)	12.1	12.0	7.35	6.71	5.42
Price/book value (x)	3.10	2.83	2.31	1.90	1.60
ROIC (%)	15.9	9.70	17.8	16.8	15.3

1. Post-goodwill amortisation and pre-exceptional items
Source: Company data, ABN AMRO forecasts
Accounting Standard: Local
year to Mar, fully diluted

Grasim to invest 87% of capex over next two years in cement business
Grasim, with its 50%-owned subsidiary, Ultratech Cement, has embarked on a Rs72.5bn capex over the next two years to increase its captive power capacity by 250MW and cement capacity by 13.5mmt. We estimate consolidated cash profits of about Rs70bn for FY07-09, which should largely fund this capex. We expect debt/equity to remain at the current 49% for the next two years, before falling to 25% in FY09. The share of the cement business in total EBITDA rose steadily from 46% in FY05 to 70% in FY06. We expect it to stabilise at 80% going forward.

We remain positive on the medium-term outlook for the cement sector
Cement demand growth so far in FY07 has been strong at 10.1% and all-India average cement prices are up 30% yoy. We expect this strength in cement demand and prices to sustain in the medium term. We also expect capacity addition of 49mmt in the next three years versus our incremental demand forecast of 42mmt (assuming a demand CAGR of 10%), based on announcements by committed players. We expect utilisation to ease from 93% in FY06 to 91% in FY09, when we also expect some pricing pressure.

Cement and viscose staple fibre (VSF) seem to be on good momentum
Grasim's VSF business seems to be back to normal after facing lower production and sales volumes in 1QFY07. Pricing seems to have improved significantly in FY07. The company's cement business should be the key growth driver in FY07 and we expect strong prices and volumes to drive 92% growth in the overall cement EBITDA.

We raise our EPS estimates and target price to Rs2,579
We raise our consolidated EPS estimates for FY07 and FY08 by 16-17%. We incorporate FY09 numbers with a 3-4% drop in cement realisations, but cost savings and volume growth driving 7% overall EPS growth. We raise our DCF-based target price to Rs2,579 (from Rs2,378). Grasim trades at US$131 EV/capacity for FY07F.

Priced at close of business 18 August 2006. Use of ▲▼ indicates that the line item has changed by at least 5%.

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Buy

Absolute performance

n/a
Short term

Underweight
Market relative to region

Materials
India

Price
Rs2198.55

Target price
Rs2579.00 ▲

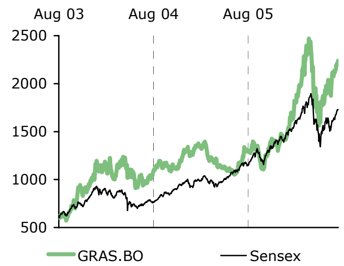
Market capitalisation
Rs201.54bn (US$4.34bn)

Avg (12mth) daily turnover
Rs131.16m (US$2.91m)

Reuters	**Bloomberg**
GRAS.BO	GRASIM IN

Asset allocation	
Equities	Underweight
Cash	Overweight
Bonds	Overweight

Price performance	**(1M)**	**(3M)**	**(12M)**
Price (Rs)	1948.4	1985.9	1307.1
Absolute %	12.8	10.7	68.2
Rel market %	-1.1	5.2	13.7
Rel sector %	5.6	16.4	38.5



Stock borrowing: Impossible
Volatility (30-day): 33.89%
Volatility (6-month trend): ↑
52-week range: 2605.00-1087.00
Sensex: 11511.68
BBG AP Diversifieds: 166.18

Source: ABN AMRO, Bloomberg

Researched by

ABN AMRO Institutional Equities Team

www.abnamrobroking.co.in

Investing in the next leg of growth

Grasim has outperformed the cement sector's volume growth at a 25% CAGR in the last five years, due to the timely Ultratech purchase. We expect Grasim's volumes to grow 12% over three years, stronger than its peers.

Company has outperformed the industry…

Grasim's focus on the cement business for growth is clearly leading to higher-than-industry average growth in volumes. Its strategic acquisition of Ultratech Cement in 2004 was well timed, in our view, and has now started delivering results. Grasim achieved 25% capacity growth from FY02-06 due to the acquisition, outperforming the industry and peers like ACC and Gujarat Ambuja Cements.

Table 1 : Grasim's capacity growth vs its peers

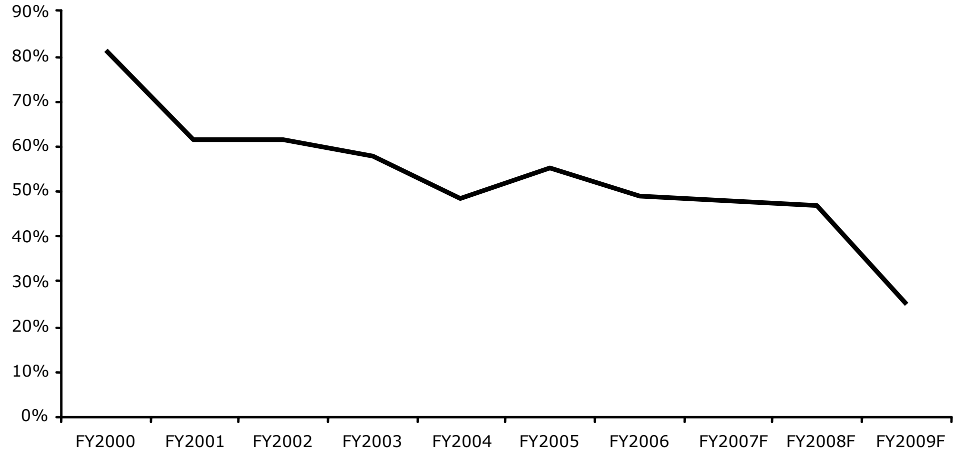
Grasim capacity record (mmt of cement capacity)	Grasim	ACC	Gujarat Ambuja
FY2002	12.7	15.9	10.7
FY2003	13.4	16.1	12.2
FY2004	14.1	17.6	12.6
FY2005	31.1	18.3	14.9
FY2006	31.2	20.2	15.0
Growth CAGR	**25%**	**6%**	**9%**
FY2007F	32.2	21.3	16
FY2008F	34.2	23.3	17
FY2009F	44.2	25.3	19
Growth CAGR	**12.3%**	**7.8%**	**8.2%**

Source: ABN AMRO forecasts, companies and CMA

… but leverage has been moderate

Strong cash flow generation from the VSF business, which has very low re-investment needs, has largely funded cement investments without a material change in Grasim's financial leverage. We expect the company's debt/equity to be a moderate 25% in FY09 despite the Rs22bn cash acquisition of Ultratech and the significant Rs72bn planned capex over the next two years. The share of the cement business in the overall EBITDA rose consistently from 30% in FY00 to 70% in FY06. We expect it to rise further to 80% in FY08.

Chart 1 : Grasim's debt/equity ratio (%)



Source: Company accounts and ABN AMRO forecasts

Grasim plans to raise cement capacity by 42% over the next two years

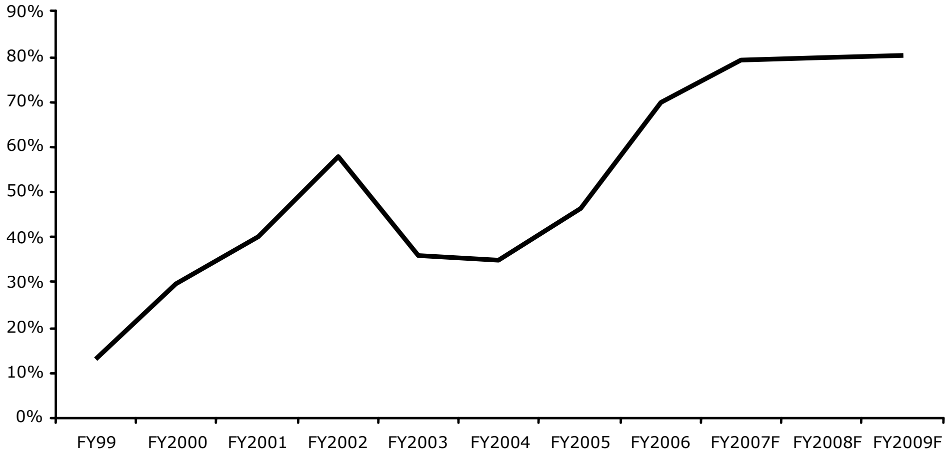
Grasim is in the process of setting up new cement plants under its fold and under Ultratech Cements, which should raise their combined cement capacity from 31mmt currently to over 44mmt by FY09. Grasim says it is also investing in captive power capability, by setting up 250MW of multi-fuel power generating capacity. Grasim's power cost would reduce by Rs2bn in FY09, when the power capacity is likely to become fully operational.

Table 2 : Details of Grasim's capital expenditure

	Amt (Rsm)	Business
4mmt green field at Kotputli, Rajasthan	12,750	Cement
4mmt green field at Shambupura, Rajasthan	12,000	Cement
Viscose expansion	3,270	VSF
Captive power	3,900	Cement
Ready mix concrete	670	Cement
Blending & de-bottlenecking	1,650	Cement
Cement modernisation	4,280	Cement
VSF modernisation	3,080	VSF
Caustic soda modernisation	1,780	Chemicals
Textiles	790	Textiles
Total	**44,170**	
Details of capex at Ultratech Cement (50% subsidiary of Grasim)		
4mmt expansion at Andhra Pradesh	12,750	Cement
Captive Power	7,650	Cement
Others-modernisation	6,590	Cement
Total	26,990	
Total capex of Grasim and subsidiary	**71,160**	
Proportion in cement business	87%	

Source: Company presentations

Chart 2 : Proportion of cement business EBITDA to Grasim's total EBITDA



Source: Company data, ABN AMRO forecasts

Firm cement demand and balanced demand supply outlook

Cement prices in 1QFY07 were up 30% yoy, while demand growth in FY07 so far has been 10.1% yoy.

- **High degree of top-level consolidation.** The top five cement groups in India – Grasim, Holcim (ACC and Gujarat Ambuja), BK Birla Group (Century Textiles, Kesoram, Mangalam Cements), Jai Prakash and India Cements – account for 60% of the industry's capacity. We believe going forward, the share of the top five cement companies will rise, as they have better investment potential due to moderate gearings in their balance sheets.
- **Cement demand growth looks healthy.** Cement demand growth has risen to 12% in the last eight months, stronger than the historical 8-9%. Our discussions with industry players indicate various infrastructure projects like power plants, sanitation, urban drainage, flyovers and roads have a combined order backlog of Rs1,740bn, which is expected to be completed in the next three to five years. This, coupled with housing demand, should sustain 10% cement demand growth going forward.
- **Demand-supply balance should stay favourable.** The all-India average cement capacity utilisation rate rose from 90.6% in FY05 to 93% in FY06. We estimate it will further rise to around 95% in FY07. We anticipate an incremental capacity addition of 48.8mmt and incremental demand growth of 42mmt over the next three years. We expect utilisation rates to dip to 91% in FY09, due to the clubbing of many capacity additions that year.

Table 3 : All-India cement-demand supply, FY07F

mmt of cement capacity	Net effective	Potential supply	Domestic	Cement exports	Total exports	Demand/ Supply
FY07 (E)	Capacity #	at 95% utilisation	demand			
North	37.4	35.6	44.5			-9.0
East	14.2	13.5	20.8		0.7	-8.0
Central	32.9	31.3	10.4		1	19.9
North+East+Central	84.6	80.4	75.8		1.7	2.9
North+East+Central						0.0
West	28.4	27.0	28.8		8	-9.8
South	49.1	46.7	40.5			6.2
South+West	77.5	73.7	69.2		8	-3.6
Total All India	162.1	154.0	145.0	6.5	9.7	-0.7
Total Cement sales				151.48		
Total sales				154.68	9.6%	
Cement demand growth				10.1%		
Capacity utilisation rate				95%		
Capacity growth				6.4%		

 # Gross capacity would be 6.2mmt more, adding the non-operational capacity
Source: ABN AMRO forecasts

Table 4 : All-India cement demand-supply, FY08F

mmt of cement capacity	Net effective	Potential Supply	Domestic	Cement exports	Total exports	Demand/ Supply
FY08 (E)	Capacity #	at 95% utilisation	demand			
North	41.9	39.8	49.0			-9.2
East	17.2	16.4	22.9		0.7	-7.2
Central	32.9	31.3	11.4		1	18.8
North+East+Central	92.1	87.5	83.3		1.7	2.4
West	29.4	27.9	31.6		5	-8.7
South	55.2	52.5	44.5			8.0
South+West	84.6	80.4	76.2		6	-1.8
Total All India	176.7	167.9	159.5	4.0	7.7	0.7
Total Cement sales				163.48	7.9%	
Total sales				167.18	8.1%	
Cement demand growth				7.9%		
Capacity utilisation rate				95%		
Capacity growth				9.0%		

 # Gross capacity would be 6.2mmt more, adding the non-operational capacity
Source: ABN AMRO forecasts

Table 5 : All-India cement demand-supply, FY09F

mmt of cement capacity	Net effective	Potential supply	Domestic	Cement exports	Total exports	Demand/ Supply
FY09 E)	Capacity #	at 95% utilisation	demand			
North	54.4	51.7	53.9			-2.2
East	19.2	18.3	25.2		0.7	-7.6
Central	32.9	31.3	12.6		1	17.7
North+East+Central	106.6	101.3	91.7		1.7	7.9
West	29.4	27.9	35.1		5	-12.2
South	65.2	62.0	49.4			12.6
South+West	94.6	89.9	84.5		5	0.4
Total All India	201.2	191.2	176.2	4.0	6.7	8.3
Total Cement sales				180.19		
Total sales				182.89		
Cement demand growth				10.2%		
Capacity utilisation rate				90.9%		
Capacity growth				13.9%		

 # Gross capacity would be 6.2mmt more, adding the non-operational capacity
Source: ABN AMRO forecasts

Upgrade forecasts and target price

We have raised our FY07 earnings forecast by 16%, given better-than-expected EBITDA margins in the cement business, and recent hikes in the VSF price. We raise our DCF-based target price to Rs2,579.

Cement business to drive earnings growth

- Cement realisation in 1QFY07 grew better than we expected, as companies were able to retain a large portion of the cement price gain seen by the retail market.
- The VSF business too performed stronger than we expected in 1QFY07. Grasim raised VSF prices by Rs5,000/mt (6.2%) in mid-July 2006, which should improve its margins.
- The sponge iron business, which carried a higher yoy base for the last four quarters, is unlikely to impact growth going forward, in our view. We expect a meaningful improvement in the business only in FY09, when gas supplies to its plant improve.

Table 6 : Earnings revision table

EPS change	Old	New	%change
FY07F	147.1	170.71	16%
FY08F	166.7	194.73	17%
FY09F		208.38	

Source: ABN AMRO forecasts

New target price of Rs2,579

We raise our DCF-based target price to Rs2,579, due to the following factors:

- We have increased our near-term earnings forecasts by 16-17%;
- We have increased our invested capital growth forecast for FY09, reflecting Grasim's aggressive cement capex plans;
- We have adjusted the cost of equity to a higher risk-free rate of 8%; and,
- Grasim trades at an EV/capacity of US$131/mmt of cement capacity currently. This should fall to US$83, adjusting for potential new capacities we expect to go on-stream by FY09.

Table 7 : Grasim valuation of EV/capacity basis (Rs/mt)

Valuation	FY05	FY06	FY07F	FY08F	FY09F
Stock	2200				
M.cap			201674	201674	201674
Net debt			25228	33243	15177
Enter price value			226902	234917	216851
Value of non-cement business					
VSF (valued at 7x EV/EBITDA)			39736.61	44064.29	47975.96
Sponge iron (we are giving no value)					
Value of Cement business			187165	190853	168875
Capacity			31	32.5	44.5
EV/Capacity			6037.594	5872.395	3794.95
EV/Capacity (US $)			131.3	127.7	82.5

Source: Company data, ABN AMRO forecasts

Risks to earnings forecasts and target price

Any material slowdown in cement demand would impact our volume forecasts and price assumptions. A sharp decline in the prices of cotton, a substitute for VSF, could also impact our assumptions for the business and thus our target price.

DISCLAIMER APPENDIX

GRASIM INDUSTRIES: KEY FINANCIAL DATA

Income statement

Rsm	FY05A	FY06A	FY07F	FY08F	FY09F
Revenue	88361.6	99199.6	121464	130724	153052
Cost of sales	-68878	-79791	-88710	-93655	-110428
Operating costs	n/a	n/a	n/a	n/a	n/a
EBITDA	**19483.3**	**19409.1**	**32753.9**	**37068.4**	**42623.7**
DDA & Impairment (ex gw)	-5063.5	-5076.7	-5270.3	-5328.9	-7542.9
EBITA	**14419.8**	**14332.4**	**27483.6**	**31739.6**	**35080.8**
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	**14419.8**	**14332.4**	**27483.6**	**31739.6**	**35080.8**
Net interest	-373.8	542.8	-290.7	-452.0	-1313.7
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)	-1344.9	0.00	0.00	0.00	0.00
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
Reported PTP	**12701.1**	**14875.2**	**27192.8**	**31287.6**	**33767.2**
Taxation	-3812.5	-4034.0	-8209.4	-9145.5	-10465
Minority interests	-14.3	-1148.9	-3334.7	-4291.1	-4200.6
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	**8874.3**	**9692.3**	**15648.7**	**17851.0**	**19101.8**
Normalised Items Excl. GW	-1344.9	0.00	0.00	0.00	0.00
Normalised net profit	**10219.3**	**9692.3**	**15648.7**	**17851.0**	**19101.8**

Source: Company data, ABN AMRO forecasts *year to Mar*

Balance sheet

Rsm	FY05A	FY06A	FY07F	FY08F	FY09F
Cash & market secs (1)	1429.6	2171.8	2155.8	2155.8	2155.8
Other current assets	25486.2	25821.0	27988.2	29094.8	32915.5
Tangible fixed assets	58056.2	59892.3	83058.0	109729	110726
Intang assets (incl gw)	19565.9	19565.9	19565.9	19565.9	19565.9
Oth non-curr assets	11391.1	16264.0	16264.0	16264.0	16264.0
Total assets	**115929**	**123715**	**149032**	**176810**	**181627**
Short term debt (2)	335.3	335.3	335.3	335.3	n/a
Trade & oth current liab	15476.0	18294.2	20180.4	21128.3	24425.0
Long term debt (3)	35397.2	34315.0	41492.0	49507.1	31441.2
Oth non-current liab	0.00	0.00	0.00	0.00	0.00
Total liabilities	**50873.2**	**52609.2**	**61672.4**	**70635.5**	**55866.2**
Total equity (incl min)	65055.8	71105.8	87359.5	106174	125761
Total liab & sh equity	**115929**	**123715**	**149032**	**176810**	**181627**
Net debt (2+3-1)	33967.6	32143.2	39336.2	47351.3	29285.4

Source: Company data, ABN AMRO forecasts *year ended Mar*

Cash flow statement

Rsm	FY05A	FY06A	FY07F	FY08F	FY09F
EBITDA	19483.3	19409.1	32753.9	37068.4	42623.7
Change in working capital	-3367.7	-2076.0	-1902.2	-948.0	-3296.7
Net interest (pd) / rec	-1387.6	-1869.6	-2127.5	-2389.8	-3434.3
Taxes paid	-4177.0	-4034.0	-8209.4	-9145.5	-10465
Other oper cash items	1871.9	2412.4	1836.8	1937.8	2120.6
Cash flow from ops (1)	**12422.9**	**13841.9**	**22351.6**	**26522.9**	**27548.6**
Capex (2)	-2748.4	-7577.5	-28436	-32000	-8539.7
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	-4413.7	-4872.9	0.00	0.00	0.00
Cash flow from invest (3)	**-7162.1**	**-12450**	**-28436**	**-32000**	**-8539.7**
Incr / (decr) in equity	-343.9	0.00	0.00	0.00	0.00
Incr / (decr) in debt	-568.9	-1082.2	7177.0	8015.1	-18066
Ordinary dividend paid	-1782.4	-2133.7	-2729.5	-3327.4	-3715.7
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	-3923.3	-3770.3	-4608.2	-5909.0	n/a
Cash flow from fin (5)	**-2351.3**	**-3215.9**	**4447.5**	**4687.7**	**-21782**
Forex & disc ops (6)	-3754.7	2566.6	1620.9	789.3	2772.7
Inc/(decr) cash (1+3+5+6)	**-845.2**	**742.2**	**-16.0**	**0.00**	**0.00**
Equity FCF (1+2+4)	9674.5	6264.4	-6084.4	-5477.1	19008.9

Lines in bold can be derived from the immediately preceding lines. *year to Mar*
Source: Company data, ABN AMRO forecasts

GRASIM INDUSTRIES: PERFORMANCE AND VALUATION

Standard ratios

Performance	Grasim Ind FY05A	FY06A	FY07F	FY08F	FY09F	Associated Cement FY05F	FY06F	FY07F	Gujarat Ambuja Cement FY06F	FY07F	FY08F
Sales growth (%)	69.5	12.3	22.4	7.62	17.1	-17.9	64.1	11.2	16.6	39.2	13.8
EBITDA growth (%)	52.8	-0.38	68.8	13.2	15.0	-16.5	146.7	17.7	47.4	54.0	11.9
EBIT growth (%)	43.9	-0.61	91.8	15.5	10.5	-18.0	205.2	17.1	67.1	60.1	10.2
Normalised EPS growth (%)	36.2	-5.16	61.5	14.1	7.01	-16.4	149.4	18.6	42.2	41.9	11.2
EBITDA margin (%)	22.0	19.6	27.0	28.4	27.8	16.2	24.3	25.7	35.0	38.7	38.1
EBIT margin (%)	16.3	14.4	22.6	24.3	22.9	11.1	20.6	21.7	29.0	33.3	32.3
Net profit margin (%)	11.6	9.77	12.9	13.7	12.5	9.97	15.7	16.7	21.8	24.8	24.2
Return on avg assets (%)	11.1	8.74	14.1	13.8	13.5	7.85	16.5	17.1	17.4	23.1	20.8
Return on avg equity (%)	19.0	14.2	19.8	18.4	16.5	17.2	32.0	28.9	23.7	30.2	26.7
ROIC (%)	15.9	9.70	17.8	16.8	15.3	6.90	20.0	20.4	15.9	25.2	22.6
ROIC - WACC (%)	0.00	0.00	0.00	0.00	0.00	-4.01	9.13	9.53	4.40	13.7	11.1
					year to Mar			*year to Dec*			*year to Jun*

Valuation	Grasim Ind FY05A	FY06A	FY07F	FY08F	FY09F	Associated Cement FY05F	FY06F	FY07F	Gujarat Ambuja Cement FY06F	FY07F	FY08F
EV/sales (x)	2.67	2.36	1.98	1.90	1.51	5.62	3.35	2.95	5.01	3.56	3.11
EV/EBITDA (x)	12.1	12.0	7.35	6.71	5.42	34.8	13.8	11.5	14.3	9.19	8.17
EV/EBITDA @ tgt price (x)	13.9	13.8	8.42	7.66	6.23	34.5	13.7	11.4	13.2	8.46	7.52
EV/EBIT (x)	16.3	16.3	8.76	7.84	6.58	50.9	16.3	13.6	17.3	10.7	9.65
EV/invested capital (x)	2.38	2.26	1.90	1.62	1.49	5.14	4.38	3.94	4.18	3.38	2.78
Price/book value (x)	3.10	2.83	2.31	1.90	1.60	7.96	5.59	4.54	4.91	4.26	3.44
Equity FCF yield (%)	4.80	3.11	-3.02	-2.72	9.43	1.96	3.74	5.94	4.16	2.65	3.36
Normalised PE (x)	19.7	20.8	12.9	11.3	10.6	51.2	20.5	17.3	22.5	15.9	14.3
Norm PE @tgt price (x)	23.1	24.4	15.1	13.2	12.4	50.9	20.4	17.2	20.9	14.7	13.2
Dividend yield (%)	0.73	0.82	1.00	1.14	1.18	0.88	1.31	1.64	1.57	1.93	2.17
					year to Mar			*year to Dec*			*year to Jun*

Per share data	FY05A	FY06A	FY07F	FY08F	FY09F
Tot adj dil sh, ave (m)	91.7	91.7	91.7	91.7	91.7
Reported EPS (INR)	96.8	105.7	170.7	194.7	208.4
Normalised EPS (INR)	111.5	105.7	170.7	194.7	208.4
Dividend per share (INR)	16.0	18.0	22.0	25.0	26.0
Equity FCF per share (INR)	105.5	68.3	-66.4	-59.7	207.4
Book value per sh (INR)	709.7	775.7	953.0	1158.2	1371.9
					year to Mar

Solvency	FY05A	FY06A	FY07F	FY08F	FY09F
Net debt to equity (%)	52.2	45.2	45.0	44.6	23.3
Net debt to tot ass (%)	29.3	26.0	26.4	26.8	16.1
Net debt to EBITDA	1.74	1.66	1.20	1.28	0.69
Current ratio (x)	1.74	1.53	1.49	1.48	1.44
Operating CF int cov (x)	13.0	10.6	15.4	15.9	12.1
Dividend cover (x)	5.73	4.54	5.73	5.36	5.14
					year to Mar

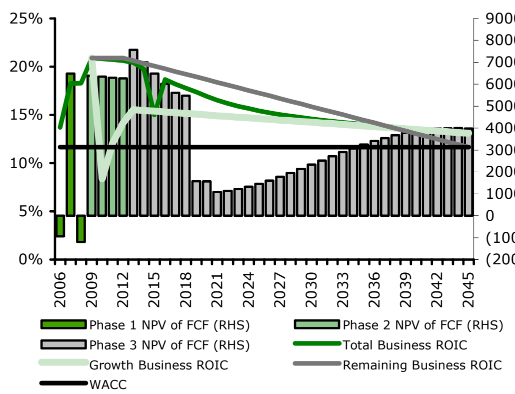
Priced as follows: GRAS.BO - Rs2198.55; ACC.BO - Rs913.20; GACM.BO - Rs110.45
Source: Company data, ABN AMRO forecasts

GRASIM INDUSTRIES: VALUATION METHODOLOGY

Economic Profit Valuation	Rs m	%
Adjusted Opening Invested Capital	76096.1	39
NPV of Economic Profit During Explicit Period	8434.7	4
NPV of Econ Profit of Remaining Business (1, 2)	52088.4	27
NPV of Econ Profit of Net Inv (Grth Business) (1, 3)	58747.8	30
Enterprise Value	195367.0	100
Plus: Other Assets	46326.5	24
Less: Minorities	0.0	0
Less: Net Debt (as at 21 Aug 2006)	5256.6	3
Equity Value	236436.9	121
No. Shares (millions)	91.7	
Per Share Equity Value	**2579.0**	
Current Share Price	2198.6	

Discounted Cash Flow Valuation	Rs m	%
Value of Phase 1: Explicit (2006 to 2008)	4342.7	2
Value of Phase 2: Value Driver (2009 to 2012)	25303.8	12
Value of Phase 3: Fade (2013 to 2045)	109923.1	53
Terminal Value	68946.6	33
Enterprise Value	208516.3	100
FCF Grth Rate at end of Phs 1 implied by DCF Valuation		12.4
FCF Grth Rate at end of Phs 1 implied by Current Price		12.5

Returns, WACC and NPV of Free Cash Flow



Sensitivity Table

		No of Years in Fade Period				
		15	18	20	23	25
WACC	9.7%	2878.7	3096.9	3240.9	3456.5	3600.9
	10.7%	2447.2	2584.8	2674.1	2805.3	2891.5
	11.7%	2118.6	2203.2	2257.1	2335.1	2385.6
	12.7%	1864.0	1913.3	1944.4	1988.8	2017.2
	13.7%	1663.5	1689.4	1705.8	1729.1	1744.0

Performance Summary	2006	2007	2008	Phase 2 Avg (2009 - 2012)
Invested Capital Growth (%)	9.9	8.8	20.1	12.0
Operating Margin (%)	20.9	27.1	27.4	26.0
Capital Turnover (x)	1.4	1.6	1.4	1.2

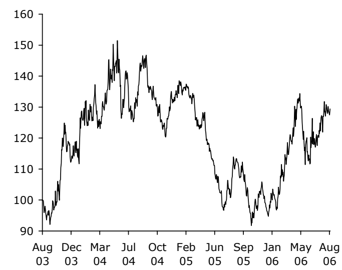
Source: ABN AMRO estimates
1. In periods following the Explicit Period i.e. Phase 2 and Phase 3
2. Remaining Business is defined as Capital as at the end of Phase 1 and capex = depreciation thereafter
3. Net Investment is defined as capex over and above depreciation after Phase 1

Grasim Industries

Company description — Buy

Grasim, part of the US$6.5bn 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.

Price relative to country



Strategic analysis — Average SWOT company score: 3

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.

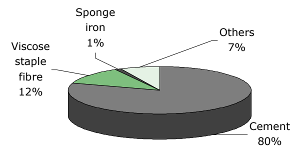
Weaknesses — 2
A diversified business portfolio, especially the presence in sponge iron and textiles, lowers ROCE. Besides, Grasim has not been investing incrementally in these non-core assets, while continuing to restructure them to improve returns.

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)

EBITDA break-up, 1QFY07



Source: Company results

Market data

Headquarters
Aditya Birla Centre, A wing, 2nd Florr, 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

India

Country view — Underweight

We are concerned the Indian market is now significantly overvalued. We see a risk of a reversal in the strong liquidity flows into the market from local and foreign investors and with the earnings cycle becoming less clear due to the broadening of the corporate capex cycle and growing regulatory concerns in the local market. We believe the government is unlikely to engineer a meaningful slowdown in economic growth this fiscal year. We may see some fine-tuning in interest rates, but it should be mild and is unlikely to derail the growth momentum. We downgraded India in May 2006 from Neutral to Underweight.

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

Country rel to Asia Pacific

Competitive position — Average competitive score: 3+

Supplier power — 4+
With the recent 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. However, Grasim looks set to dominate the Indian cement market given its 21% market share.

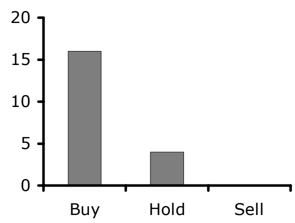
Customer power — 2+
Grasim has a 30%+ market share in cement in key states like Maharashtra and Karnataka, which account for 42% of India's cement market. It would have the power to influence pricing as well.

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

Broker recommendations



Source: Bloomberg