

## Company In-Depth

4 May 2007 | 13 pages

# Grasim Industries (GRAS.BO)

## Downgrading to Sell: Growth in Other Divisions Offset by Cement

 Rating change   
 Target price change   
 Estimate change 

- Target price cut** — Our new target price of Rs2,390 equates to 6.5x EV/EBITDA, an adjusted EV/tonne of US\$110 and a P/E of 11.1x for FY09E. The downturn in cement in FY09E is expected to be partly offset by other businesses, which should perform well in FY09E-10E. We therefore use a 10% premium to the stock's 7-year mean of 5.9x.
- Lower cement volumes expected; pricing pressures** — Volumes were lower than expected in FY07, and we have cut volume forecasts for FY08-09. We estimate prices to rise 7% yoy in FY08E and fall 9% in FY09E, as several large capacities (including Grasim's) are expected in North India in FY09. Our cement EBITDA rises 19% yoy in FY08E but falls 6% in FY09E and 8% in FY10E.
- Growth in Viscose Staple Fibre** — We expect the division to benefit from both pricing and volume growth in FY08E-09E. EBITDA margins should remain in the 28-30% range as higher costs will likely be passed on amid growing demand. Grasim is expanding its VSF capacity by 95,000 tpa (35%) to 365,000 tpa by FY10, which should help volumes grow 17% in FY10E.
- Other divisions doing well** — While cement and VSF together account for 85% of sales and 89% of EBITDA, Grasim's other divisions are doing reasonably well. Sponge iron should do better on the back of better pricing and improved availability of natural gas from end-FY08 onwards.
- Upside risks** — (1) Further delays in cement capacity; (2) higher international VSF prices; and (3) better scrap prices/cheaper gas could help sponge iron.

<b>Sell/Medium Risk</b>	<b>3M</b>
<i>from Buy/Low Risk</i>	
Price (30 Apr 07)	Rs2,442.35
Target price	Rs2,390.00
<i>from Rs3,460.00</i>	
Expected share price return	-2.1%
Expected dividend yield	1.2%
<b>Expected total return</b>	<b>-0.9%</b>
Market Cap	Rs223,900M
	US\$5,455M

### Price Performance (RIC: GRAS.BO, BB: GRASIM IN)



See Appendix A-1 for Analyst Certification and important disclosures.

**Figure 1. Grasim — Statistical Abstract**

Yr to Mar	Net Profit (Rs m)	EPS (Rs)	EPS cons (Rs)	EPS cons growth (%)	P/E cons (x)	EV/EBITDA cons (x)	EV/tonne cons (US\$)
FY05	8,857	103	96	19%	25.5	12.7	160
FY06	8,632	89	114	18%	21.6	13.4	179
FY07E	15,358	163	215	89%	11.4	7.1	147
FY08E	17,188	188	239	11%	10.2	6.4	151
FY09E	15,385	168	216	-10%	11.3	6.6	121
FY10E	14,342	156	200	-8%	12.3	6.6	93

Source: Company Reports and Citigroup Investment Research estimates

Note: Rs/US\$ rate at 42 for the forecast years.

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Other Per Share Data		Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E	
NAV	na	<b>Valuation Ratios</b>						
Discount to NAV	na	P/E adjusted (x)	23.7	27.5	14.9	13.0	14.6	
		P/BV (x)	5.2	4.5	3.6	2.9	2.5	
		Dividend yield (%)	0.7	0.8	1.1	1.2	1.3	
		Payout Ratio (%)	15.5	22.5	16.8	16.0	19.4	
		<b>Per Share Data (Rs)</b>						
		EPS adjusted	102.91	88.76	163.49	187.50	167.83	
		EPS reported	96.62	94.17	167.54	187.50	167.83	
		BVPS	472.17	543.48	675.62	828.83	959.51	
		DPS	16.00	20.00	27.50	30.00	32.50	
		<b>Profit &amp; Loss (RsM)</b>						
		Net sales	62,293	66,205	86,757	96,164	105,583	
		Operating expenses	-47,291	-53,667	-63,746	-69,833	-81,896	
		<b>EBIT</b>	<b>15,001</b>	<b>12,538</b>	<b>23,011</b>	<b>26,331</b>	<b>23,688</b>	
		Net interest expense	-1,388	-973	-1,118	-1,420	-2,320	
		Non-operating/exceptionals	0	0	0	0	0	
		<b>Pre-tax profit</b>	<b>13,614</b>	<b>11,565</b>	<b>21,893</b>	<b>24,911</b>	<b>21,368</b>	
		Tax	-4,180	-3,428	-6,906	-7,722	-5,983	
		Extraord./Min.Int./Pref.div.	-577	495	371	0	0	
		<b>Reported net income</b>	<b>8,857</b>	<b>8,632</b>	<b>15,358</b>	<b>17,188</b>	<b>15,385</b>	
		Adjusted earnings	9,434	8,137	14,987	17,188	15,385	
		Adjusted EBIT	15,001	12,538	23,011	26,331	23,688	
		<b>Growth Rates (%)</b>						
		Sales	na	6.3	31.0	10.8	9.8	
		EBIT adjusted	na	-16.4	83.5	14.4	-10.0	
		EPS adjusted	na	-13.7	84.2	14.7	-10.5	
		<b>Cash Flow (RsM)</b>						
		<b>Operating cash flow</b>	<b>10,505</b>	<b>10,364</b>	<b>16,724</b>	<b>15,885</b>	<b>19,295</b>	
		Depreciation/amortization	2,846	2,916	3,179	3,600	4,865	
		Net working capital	-2,047	421	49	-4,208	-1,391	
		<b>Investing cash flow</b>	<b>-8,684</b>	<b>-7,066</b>	<b>-24,187</b>	<b>-17,361</b>	<b>-11,724</b>	
		Capital expenditure	-2,672	-3,658	-14,984	-19,228	-13,393	
		Acquisitions/disposals	-6,835	-4,997	-11,300	0	0	
		<b>Financing cash flow</b>	<b>-3,228</b>	<b>-2,610</b>	<b>6,491</b>	<b>1,405</b>	<b>-5,463</b>	
		Borrowings	-569	-287	9,700	5,700	0	
		Dividends paid	-1,448	-1,675	-2,091	-2,875	-3,143	
		<b>Change in cash</b>	<b>-1,408</b>	<b>688</b>	<b>-972</b>	<b>-71</b>	<b>2,108</b>	
		<b>Balance Sheet (RsM)</b>						
		<b>Total assets</b>	<b>80,445</b>	<b>88,195</b>	<b>111,588</b>	<b>130,793</b>	<b>144,644</b>	
		Cash & cash equivalent	867	1,556	584	513	2,621	
		Accounts receivable	5,220	4,135	4,754	5,796	6,364	
		Net fixed assets	32,085	33,110	44,915	60,543	69,071	
		<b>Total liabilities</b>	<b>37,161</b>	<b>38,374</b>	<b>49,654</b>	<b>54,814</b>	<b>56,686</b>	
		Accounts payable	5,975	7,410	8,248	7,880	9,120	
		Total Debt	20,083	19,797	29,497	35,197	35,197	
		<b>Shareholders' funds</b>	<b>43,283</b>	<b>49,821</b>	<b>61,933</b>	<b>75,978</b>	<b>87,958</b>	
		<b>Profitability/Solvency Ratios (%)</b>						
		EBITDA margin adjusted	24.1	18.9	26.5	27.4	22.4	
		ROE adjusted	na	17.5	26.8	24.9	18.8	
		ROA adjusted	na	9.7	15.0	14.2	11.2	
		Net debt to equity	44.4	36.6	46.7	45.6	37.0	
		Total debt to capital	31.7	28.4	32.3	31.7	28.6	

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## Estimate revisions

Figure 2. Grasim — Estimate Changes, FY08E-09E

	FY08E			FY09E		
	Old	New	% change	Old	New	% change
Net sales (Rs bn)	92.5	96.2	4%	104.2	105.6	1%
EBITDA (Rs bn)	28.3	28.1	-1%	27.8	26.9	-3%
Net profit (Rs bn)-adj	17.2	17.2	0%	17.9	15.4	-14%
EPS - Standalone (Rs)	188	188	0%	195	168	-14%
EPS - Consolidated (Rs)	252	239	-5%	254	216	-15%

Source: Citigroup Investment Research estimates

## Valuation framework

Our main valuation tool to value Grasim is EV/EBITDA, which is supported by P/E and EV/tonne.

### Primary valuation tool — EV/EBITDA

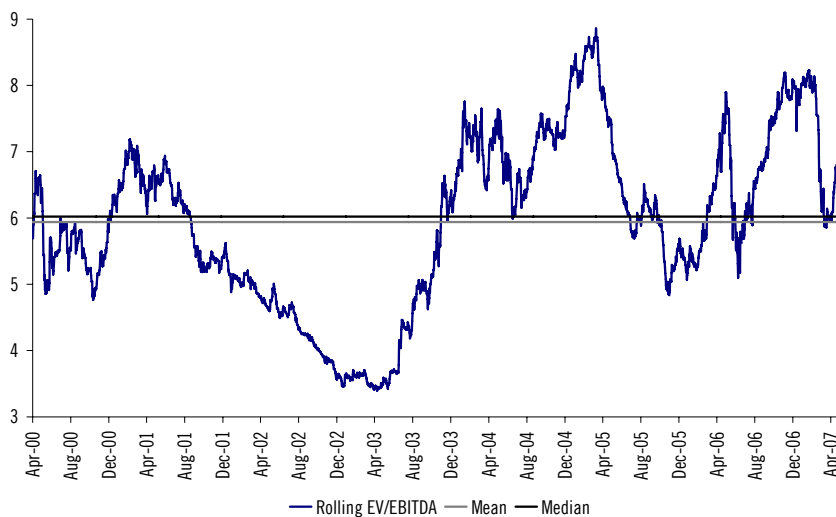
Grasim's EV/EBITDA has moved in a wide range since April 1995. The stock traded below its 7-year mean of 5.9x from April 2000 to April 2003. This was because of its diversified business mix. The stock was re-rated from April 2003 onward largely due to the completion of a substantial reorganization, which, among other things, involved closure of loss-making and non-core businesses and investments. This resulted in some streamlining of its business mix.

Our target price of Rs2,390 is derived from a consolidated EV/EBITDA of 6.5x for FY09E

Grasim also enjoyed a re-rating as its main businesses improved profitability from FY04. Cement and sponge iron did well in FY04 and FY05, and VSF had three good years during FY03-05. In FY06 cement did well but there was a downturn in VSF. In FY07 we saw both VSF and cement recover, and we expect this trend to continue in FY08 as well, in both cases due to better volumes and firm pricing. The downturn we expect in FY09 in cement is expected to be partly offset by strong growth in the other divisions in FY09E-10E. Our target multiple is therefore at a premium of 10% to the seven-year mean to incorporate growth in EBITDA of the other divisions. Our target price of Rs2,390 is derived from a consolidated EV/EBITDA of 6.5x for FY09E (versus 8.5x used earlier for FY08E). We use a lower multiple to reflect the unfavorable government measures that are taking away the last leg of pricing upside.

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Figure 3. Grasim — Rolling EV/EBITDA

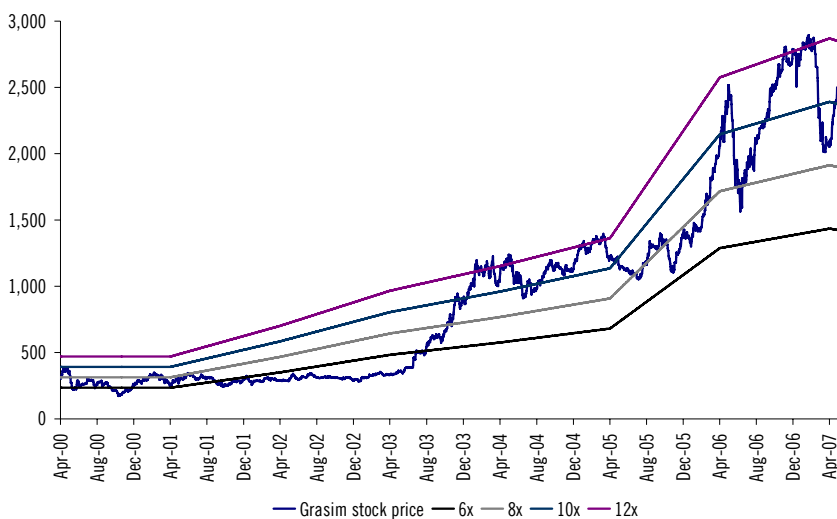


Source: DataStream, Company Reports, Citigroup Investment Research

At our target price of Rs2,390, the stock would trade at a P/E of 11.1x FY09E earnings

Grasim's forward P/E band chart also shows the re-rating since April 2003. For much of the period since April 2000, the stock has traded below 8x. The restructuring and better divisional performance took the P/E to a range of 10-12x until a difficult period for VSF and lackluster cement pricing led to the P/E falling once again to the 6-8x range. With a substantial improvement in cement profitability and also better divisional profits for VS, P/E is back in the range of 10-12x. While the strong performance of the non-cement divisions is expected to sustain, we expect a downturn in cement in FY09. At our target price of Rs2,390, the stock would trade at a P/E of 11.1x FY09E earnings.

Figure 4. Grasim — Forward P/E Bands



Source: DataStream, Company Reports, Citigroup Investment Research

At our target price the consolidated EV/tonne for Grasim equates to US\$110

As Grasim is a diversified company we have made adjustments to arrive at its cement EV/tonne. At our target price the consolidated EV/tonne for Grasim equates to US\$110. This is worked out by stripping out the non-cement businesses by valuing VSF at 8x EV/EBITDA and others such as chemicals, sponge iron and textile businesses at 5-6x EV/EBITDA.

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## Financial summary

Figure 5. Grasim — Operating Statistics

Year to 31 March	FY05	FY06	FY07E	FY08E	FY09E	FY10E
<b>Operating Data</b>						
Cement capacity (m tonnes)	13.1	13.1	13.1	14.6	22.6	22.6
VSF capacity (m tonnes)	0.25	0.26	0.27	0.27	0.37	0.37
Sponge Iron capacity (m tonnes)	0.90	0.90	0.90	0.90	0.90	0.90
<b>Sales</b>						
Cement (m tonnes)	12.6	14.0	14.5	15.3	19.1	22.5
VSF (m tonnes)	0.23	0.24	0.25	0.26	0.27	0.32
Sponge Iron (m tonnes)	0.77	0.48	0.57	0.62	0.71	0.82
<b>Average Exchange Rate (Rs/US\$)</b>	<b>44.9</b>	<b>44.3</b>	<b>45.3</b>	<b>41.8</b>	<b>40.0</b>	<b>39.0</b>

Source: Company Reports and Citigroup Investment Research estimates

Figure 6. Grasim — Profit and Loss Account (Rs m)

Year to 31 March	FY05	FY06	FY07E	FY08E	FY09E	FY10E
Viscose staple fibre	19,564	19,354	23,276	24,821	25,985	30,663
Wood pulp/chemicals	3,518	3,872	3,190	3,339	3,537	3,774
Cement	27,980	36,076	51,727	57,986	64,360	69,884
Sponge iron	10,214	6,336	7,511	8,919	10,401	11,331
Textiles	1,017	568	1,053	1,099	1,300	1,516
<b>Net sales</b>	<b>62,293</b>	<b>66,205</b>	<b>86,757</b>	<b>96,164</b>	<b>105,583</b>	<b>117,168</b>
Operating expenses	46,318	52,339	62,663	68,100	78,700	91,000
<b>Operating profit</b>	<b>15,975</b>	<b>13,866</b>	<b>24,094</b>	<b>28,064</b>	<b>26,883</b>	<b>26,168</b>
Operating profit margin %	26%	21%	28%	29%	25%	22%
Other income	1,872	1,589	2,097	1,867	1,669	1,778
<b>EBITDA</b>	<b>17,847</b>	<b>15,455</b>	<b>26,190</b>	<b>29,930</b>	<b>28,552</b>	<b>27,946</b>
EBITDA margin %	29%	23%	30%	31%	27%	24%
Depreciation	2,846	2,916	3,179	3,600	4,865	5,679
% of avg gross block	4.9%	4.9%	4.9%	5.1%	5.5%	5.1%
<b>EBIT</b>	<b>15,001</b>	<b>12,538</b>	<b>23,011</b>	<b>26,331</b>	<b>23,688</b>	<b>22,267</b>
Interest	1,388	973	1,118	1,420	2,320	2,620
PBT	13,614	11,565	21,893	24,911	21,368	19,647
Total Tax	4,180	3,428	6,906	7,722	5,983	5,305
Eff. tax rate %	31%	30%	32%	31%	28%	27%
<b>PAT</b>	<b>9,434</b>	<b>8,137</b>	<b>14,987</b>	<b>17,188</b>	<b>15,385</b>	<b>14,342</b>
Extraordinary items	-577	495	371	0	0	0
<b>Net profit</b>	<b>8,857</b>	<b>8,632</b>	<b>15,358</b>	<b>17,188</b>	<b>15,385</b>	<b>14,342</b>
Profit from subsidiaries						
UltraTech	15	1,148	3,990	4,379	4,051	3,641
Shee Digvijay Cements	-61	180	287	314	344	269
Others	-7	446	40	41	42	42
<b>Consolidated profit</b>	<b>8,803</b>	<b>10,406</b>	<b>19,675</b>	<b>21,923</b>	<b>19,821</b>	<b>18,294</b>
Consolidated EBITDA/tonne (Rs)	354	534	1,000	1,108	869	687
Consolidated EBITDA/tonne (US\$)	7.9	12.0	22.1	26.4	20.7	16.4

Source: Company Reports and Citigroup Investment Research estimates

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Figure 7. Grasim — Balance Sheet (Rs m)

As at 31 March	FY05	FY06	FY07E	FY08E	FY09E	FY10E
<b>Fixed Assets</b>	<b>32,085</b>	<b>33,110</b>	<b>44,915</b>	<b>60,543</b>	<b>69,071</b>	<b>74,392</b>
Gross Block	58,970	61,141	68,654	72,541	103,681	120,681
Acc.Depreciation	28,482	31,095	34,274	37,874	42,738	48,417
Net Block	30,489	30,046	34,380	34,668	60,943	72,264
CWIP	1,597	3,064	10,535	25,875	8,128	2,128
<b>Investments</b>	<b>29,820</b>	<b>34,817</b>	<b>46,117</b>	<b>46,117</b>	<b>46,117</b>	<b>46,117</b>
Liquid investments	5,740	10,001	20,001	20,001	20,001	20,001
<b>Current Assets</b>	<b>18,539</b>	<b>20,268</b>	<b>20,556</b>	<b>24,133</b>	<b>29,456</b>	<b>37,176</b>
Stocks + WIP	6,786	7,507	7,331	8,208	9,913	11,649
Sundry debtors	5,220	4,135	4,754	5,796	6,364	7,062
Loans and advances	5,666	7,070	7,887	9,616	10,558	11,717
Cash/bank	867	1,556	584	513	2,621	6,748
<b>Current Liabilities and provisions</b>	<b>11,083</b>	<b>12,734</b>	<b>14,332</b>	<b>14,041</b>	<b>16,126</b>	<b>18,688</b>
Sundry creditors	5,975	7,410	8,248	7,880	9,120	10,717
Taxation	720	495	0	0	0	0
Proposed dividends	1,676	2,091	2,875	3,143	3,405	3,667
Other creditors/liabilities	2,712	2,738	3,210	3,018	3,601	4,305
<b>Overall Capital employed</b>	<b>69,362</b>	<b>75,461</b>	<b>97,256</b>	<b>116,752</b>	<b>128,517</b>	<b>138,996</b>
<b>Shareholders Funds</b>	<b>43,283</b>	<b>49,821</b>	<b>61,933</b>	<b>75,978</b>	<b>87,958</b>	<b>98,633</b>
Share capital	917	917	917	917	917	917
Reserves and Surplus	42,367	48,904	61,017	75,062	87,041	97,716
<b>Deferred tax liability</b>	<b>5,995</b>	<b>5,844</b>	<b>5,826</b>	<b>5,576</b>	<b>5,363</b>	<b>5,166</b>
<b>Total debt</b>	<b>20,083</b>	<b>19,797</b>	<b>29,497</b>	<b>35,197</b>	<b>35,197</b>	<b>35,197</b>
<b>Total sources of Funds</b>	<b>69,362</b>	<b>75,461</b>	<b>97,256</b>	<b>116,752</b>	<b>128,517</b>	<b>138,996</b>

Source: Company Reports and Citigroup Investment Research estimates

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Figure 8. Grasim — Cash Flow Statement, Stock Metrics and Ratios

Year to 31 March	FY05	FY06	FY07E	FY08E	FY09E	FY10E
<b>Cash flow statement (Rs m)</b>						
PBIT	15,001	12,538	23,011	26,331	23,688	22,267
Depreciation	2,846	2,916	3,179	3,600	4,865	5,679
Other income	-1,872	-1,589	-2,097	-1,867	-1,669	-1,778
Changes in working capital	-2,047	421	49	-4,208	-1,391	-1,292
Tax	-3,802	-3,923	-7,419	-7,971	-6,197	-5,501
Others	378	0	0	0	0	0
<b>Net cash from operations</b>	<b>10,505</b>	<b>10,364</b>	<b>16,724</b>	<b>15,885</b>	<b>19,295</b>	<b>19,374</b>
Purchase of fixed assets	-2,672	-3,658	-14,984	-19,228	-13,393	-11,000
Purchase of investments	-6,835	-4,997	-11,300	0	0	0
Other income	1,137	1,589	2,097	1,867	1,669	1,778
Others	-314	0	0	0	0	0
<b>Net cash used in investment activities</b>	<b>-8,684</b>	<b>-7,066</b>	<b>-24,187</b>	<b>-17,361</b>	<b>-11,724</b>	<b>-9,222</b>
Shares issued	0	0	0	0	0	0
Debt	-569	-287	9,700	5,700	0	0
Interest paid	-1,388	-973	-1,118	-1,420	-2,320	-2,620
Dividend paid	-1,448	-1,675	-2,091	-2,875	-3,143	-3,405
Others	176	325	0	0	0	0
<b>Net cash from financing activities</b>	<b>-3,228</b>	<b>-2,610</b>	<b>6,491</b>	<b>1,405</b>	<b>-5,463</b>	<b>-6,025</b>
<b>Net cash flow</b>	<b>-1,408</b>	<b>688</b>	<b>-972</b>	<b>-71</b>	<b>2,108</b>	<b>4,127</b>
Opening cash balance	2,275	867	1,556	584	513	2,621
Closing cash balance	867	1,556	584	513	2,621	6,748
<b>Stock Metrics</b>						
No. of shares (m)	91.7	91.7	91.7	91.7	91.7	91.7
Book value per share (Rs)	472	543	676	829	960	1076
EPS (Rs) - Standalone	103	89	163	188	168	156
EPS (Rs) - Consolidated	96	114	215	239	216	200
CFPS (Rs)- Standalone	134	121	198	227	221	218
Net Debt/EBITDA (x)	0.8	0.5	0.3	0.5	0.4	0.3
Total debt/Tangible net worth (x)	0.5	0.4	0.5	0.5	0.4	0.4
Net debt/equity (x)	0.3	0.2	0.1	0.2	0.1	0.1
ROE (%)	24%	17%	27%	25%	19%	15%
ROCE (%)	23%	17%	27%	25%	19%	17%
Total dividend (Rs m)	1676	2090	2875	3143	3405	3667
DPS (Rs)	16.0	20.0	27.5	30.0	32.5	35.0
Dividend payout (%)	19%	20%	15%	14%	17%	20%
<b>Ratios</b>						
Current ratio	1.7	1.6	1.4	1.7	1.8	2.0
Interest coverage	10.8	12.9	20.6	18.5	10.2	8.5
Days in inventory	132	150	120	125	125	125
Days receivable	31	23	20	22	22	22
Days payable	116	148	135	120	115	115

Source: Company Reports and Citigroup Investment Research estimates



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## 4Q FY07 results

Figure 9. Grasim — 4Q FY07 Results

Rs m	4Q FY07	4Q FY06	% chg
<b>Net sales</b>	<b>24,938</b>	<b>18,298</b>	<b>36</b>
Total Expenses	17,995	14,221	27
<b>EBITDA</b>	<b>6,942</b>	<b>4,077</b>	<b>70</b>
EBITDA (%)	28	22	
Interest	366	248	48
Depreciation	876	759	15
Other income	776	575	35
<b>Pre-tax profit</b>	<b>6,476</b>	<b>3,645</b>	<b>78</b>
Tax	2102	1059	98
Tax rate (%)	33	29	
<b>Net profit before exceptionals</b>	<b>4,374</b>	<b>2,586</b>	<b>69</b>
Less: Extraordinary items	371	41	798
<b>PAT reported</b>	<b>4,745</b>	<b>2,627</b>	<b>81</b>

Source: Company Reports

4Q FY07 was driven by better performance from cement and sponge iron

4Q FY07 was driven by better performance from cement and sponge iron. VSF volumes beat expectations, but both EBITDA margins and prices for the division fell sequentially and YoY. Overall, Grasim reported sales growth of 36% yoy to Rs24.9bn, EBITDA growth of 70% yoy to Rs6.9 bn, and adjusted PAT growth of 69% yoy to Rs4.4bn. EBITDA and adjusted PAT for the quarter were about 10% below expectations. Divisional performance: (1) Cement (59% of sales, 34.3% EBITDA margin) continued to do well. Divisional EBITDA grew 77% yoy and 12% qoq largely on the back of better prices, 35% higher from the low levels last year and 2% higher sequentially. Sales volumes were flat with only 1.4% yoy growth. EBITDA margins rose from 26.1% in 4Q FY06 despite higher fuel and freight costs. (2) VSF (26% of sales, 31% EBITDA margin) did not perform as well as expected as Grasim gave higher rebates due to higher sales volumes in 4Q leading to lower average realizations. EBITDA margins were in line with last year despite a 15% yoy price rise and a 13% yoy rise in volumes, due to a rise in pulp and labour costs. Grasim expects demand growth to be buoyant and margins to be maintained as most cost increases should be passed on. (3) Sponge iron (8% of sales, 15.5% EBITDA margin) did well in 4Q FY07 due to better pricing (up 24% yoy) as a result of higher prices of substitute products. The higher prices allowed the use of alternative fuels, which helped hike production and sales (by 79% yoy). Grasim expects sponge iron profitability to sustain with better prices in the near term, and improve in the long term with better availability of natural gas.

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## Grasim Industries

### Company description

Grasim is a diversified company with five main divisions — cement, viscose staple fibre (VSF), sponge iron, chemicals and textiles. Cement (13m tpa) is its largest division, accounting for 60% of sales and 60-65% of EBITDA. VSF is the other core business. The two core businesses account for around 85% of sales and around 90% of EBITDA. It has two subsidiaries — UltraTech (52% equity, holding) which has a capacity of 17m tpa; and Shree Digvijay Cement (54% holding), which has a capacity of 1.1m tpa. This takes the current group capacity to 31m tpa, which is expected to rise to 45m tpa by June 2008. Grasim's domestic markets are well spread across regions, and it does not export cement.

### Investment thesis

We rate Grasim as Sell/Medium Risk (3M) with a target price of Rs2,390. Despite its diversification, cement has the biggest impact on Grasim's revenues and profits. The expected downturn in cement will offset the upside seen in other divisions, based on our analysis. We expect the recent uncertainty caused by government measures, and the increased threat of cement supplies from imports as well as domestic sources to hurt the cement division's profits. The cement division's EBITDA will rise 19% yoy in FY08 but fall 6% yoy in FY09 and 8% yoy in FY10, based on our estimates. In VSF (26% of sales and EBITDA) we expect the division to benefit from both pricing and volume growth in FY08-09. We forecast EBITDA margins at 28-30% as higher costs are passed on amid growing demand. Grasim's other divisions are doing reasonably well. Sponge iron (8% of sales and 3% of EBITDA) should do better on the back of better pricing and improved availability of natural gas from end-FY08E onward.

### Valuation

We value Grasim on EV/EBITDA, a common metric used for cement companies. Our target price of Rs2,390 is based on a 10% premium to the stock's seven-year mean of 5.9x. The downturn in cement in FY09E is expected to be partly offset by other businesses, which should perform well in FY09E-10E. We therefore use a premium to value the stock. At our target price the consolidated EV/tonne for Grasim equates to US\$110/tonne and a consolidated P/E of 11.1x for FY09E.

### Risks

Grasim is rated as Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. The key upside risks to our target price include: (1) further delays in industry capacity; (2) higher than expected domestic cement demand growth; (3) changes in the duty/tax regime in favor of producers; (4) higher international prices or rise in prices of competing fibres, both of which will positively impact VSF prices; and (5) better prices for scrap and cheaper natural gas than we anticipate, leading to better sponge iron margins than expected.

## Appendix A-1

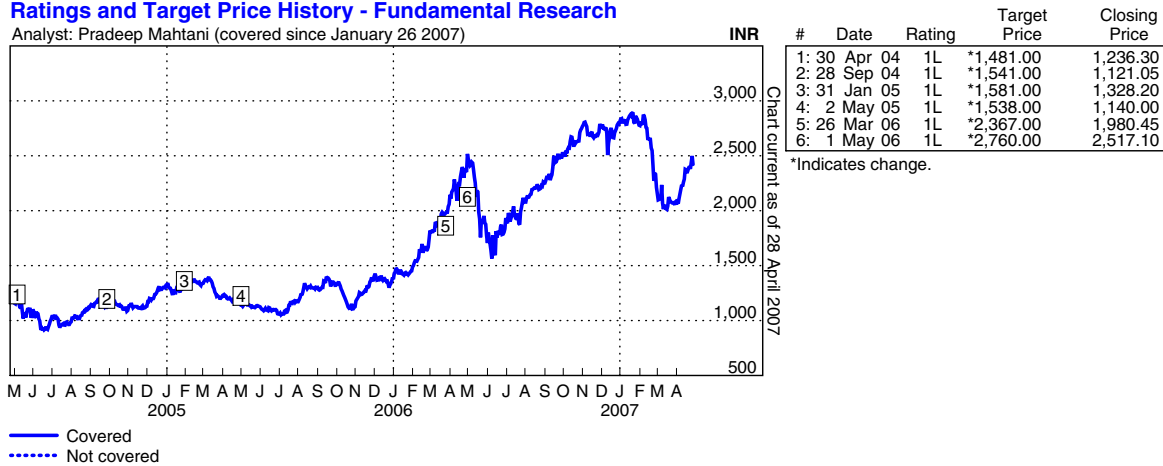
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Analyst: Pradeep Mahtani (covered since January 26 2007)



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