

Equities

17 March 2011 | 12 pages

Grasim Industries (GRAS.BO)

Buy: Cement Valuations Attractive; VSF Doing Well

- Company Update
- Target Price Change
- Estimate Change

- **Maintain Buy** — Grasim offers exposure to both cement and VSF and we feel it offers either a cheap entry into cement or cheap entry into a robust VSF outlook, or an attractively valued combination of the two. If VSF is valued at 6x, then cement would trade FY12E EV/t of \$71, at a 35% discount to fair value. On the other hand, if we value cement at \$108/t, VSF is available at 3x. The VSF business (35-38% of cons. EBITDA) is attractive, with entry barriers, and offers downside protection with steady EBITDA of Rs18-20bn pa. We maintain our Buy.
- **Raising TP to Rs3,010** — We value its 51mtpa cement capacity using an EV/t of \$120/t for FY12E (vs. Dec 11), in line with replacement costs, but apply a 10% holding company discount, to get a value of Rs1,598 for Grasim's 60% holding in UTCL. We value Grasim's other businesses (VSF/Chemicals) at an EV/EBITDA of 6x FY12E, a 10% premium to hard commodity stocks (given its steady profit margins), giving a value of Rs1,411. Our TP implies a FY12E EV/EBITDA of 7.3x and P/E of 13x.
- **Cement: positive near term; but downside risk** — UTCL plans two 4.6mtpa brownfield capacities (Chhattisgarh & Karnataka) at a total capex of Rs56bn (US\$135/t) by early-FY14. In addition ~Rs45bn will be spent on modernization/logistics. While cement prices have recovered lost ground recently and should remain firm in 1QFY12, we believe there is downside risk as there is more than adequate supply and the market is still fragmented.
- **VSF outlook is robust** — Current capacity is 334ktpa (~11% of world) rising to 490ktpa by FY14. Margins in FY12 should be robust as prices have been hiked 16% since Jan 11 and Grasim gains from its integrated capacity. Key risk factors include prices of cotton/PSF, pulp/caustic soda prices, and Chinese VSF output.
- **Downside risks** — Lower cement/VSF prices/demand; capacity additions.

Buy/Low Risk	1L
Price (17 Mar 11)	Rs2,438.60
Target price	Rs3,010.00
	<i>from Rs2,640.00</i>
Expected share price return	23.4%
Expected dividend yield	1.2%
Expected total return	24.7%
Market Cap	Rs223,617M
	US\$4,957M

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

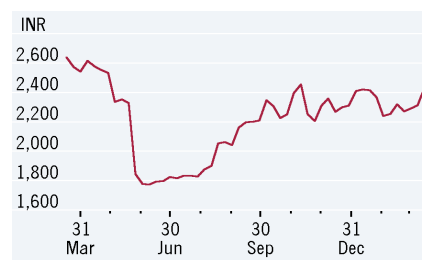


Figure 1. Grasim (Consolidated) – Statistical Abstract

YE 31 Mar	Revenue (Rs m)	Net Profit (Rs m)	EBITDA (Rs m)	EPS (Rs)	EPS growth (%)	P/E (x)	EV/EBITDA (x)	EV/tonne (US\$)
FY08	169,735	28,914	49,589	315		7.7	6.3	
FY09	184,039	21,867	43,296	239	-24%	10.2	7.3	
FY10	199,334	30,955	57,867	338	42%	7.2	4.8	
FY11E	205,757	20,860	47,218	227	-33%	10.7	6.8	82
FY12E	231,256	21,279	47,305	232	2%	10.5	5.8	71
FY13E	253,008	21,754	48,783	237	2%	10.3	5.6	70

Source: Company Reports and CIRA estimates. Price as on 17 March 2011. Rs/\$ rate at 45.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Grasim Industries (GRAS.BO)

17 March 2011

Other Per Share Data

NAV	na
Discount to NAV	na

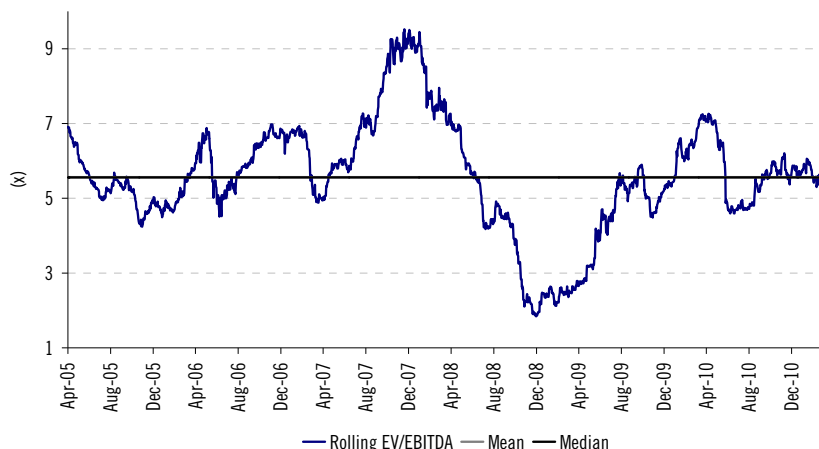
Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	10.2	7.2	10.7	10.5	10.3
P/BV (x)	1.9	1.8	1.6	1.4	1.3
Dividend yield (%)	1.2	1.2	1.2	1.2	1.2
Payout Ratio (%)	12.6	8.9	13.2	12.9	12.6
Per Share Data (Rs)					
EPS adjusted	238.52	337.57	227.48	232.05	237.23
EPS reported	238.52	337.57	227.48	232.05	237.23
BVPS	1,262.08	1,365.83	1,552.97	1,735.30	1,923.66
DPS	30.00	30.00	30.00	30.00	30.00
Profit & Loss (RsM)					
Net sales	184,039	199,334	205,757	231,256	253,008
Operating expenses	-144,869	-146,058	-164,446	-190,289	-211,208
EBIT	39,170	53,276	41,311	40,967	41,800
Net interest expense	-3,105	-3,346	-3,916	-3,799	-3,824
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	36,066	49,930	37,395	37,168	37,976
Tax	-9,914	-15,957	-11,055	-10,846	-11,054
Extraord./Min.Int./Pref.div.	-4,286	-3,018	-5,479	-5,043	-5,168
Reported net income	21,867	30,955	20,860	21,279	21,754
Adjusted earnings	21,867	30,955	20,860	21,279	21,754
Adjusted EBIT	39,170	53,276	41,311	40,967	41,800
Growth Rates (%)					
Sales	8.4	8.3	3.2	12.4	9.4
EBIT adjusted	-17.6	36.0	-22.5	-0.8	2.0
EPS adjusted	-24.4	41.5	-32.6	2.0	2.2
Cash Flow (RsM)					
Operating cash flow	34,625	48,288	37,992	38,719	41,592
Depreciation/amortization	8,658	9,947	11,421	12,324	12,768
Net working capital	-4,657	-1,497	-1,337	-1,335	201
Investing cash flow	-36,651	-34,967	-30,632	-59,434	-58,590
Capital expenditure	-51,181	-14,555	-13,957	-66,300	-62,306
Acquisitions/disposals	-11,868	-32,909	-14,800	0	0
Financing cash flow	1,715	-12,212	1,176	19,111	18,086
Borrowings	7,991	-4,647	8,382	26,000	25,000
Dividends paid	-3,270	-3,270	-3,290	-3,090	-3,090
Change in cash	-310	1,109	8,535	-1,604	1,088
Balance Sheet (RsM)					
Total assets	243,169	277,735	321,767	379,466	435,676
Cash & cash equivalent	2,270	2,370	10,905	9,301	10,389
Accounts receivable	8,239	8,803	8,263	10,296	11,275
Net fixed assets	142,190	145,527	167,867	221,843	271,381
Total liabilities	110,766	114,941	136,082	172,343	206,391
Accounts payable	20,313	17,866	27,586	35,786	40,495
Total Debt	59,162	55,992	68,374	94,374	119,374
Shareholders' funds	132,404	162,795	185,685	207,123	229,285
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	21.3	26.7	20.1	17.7	16.5
ROE adjusted	21.1	25.7	15.6	14.1	13.0
ROA adjusted	9.7	11.9	7.0	6.1	5.3
Net debt to equity	43.0	32.9	30.9	41.1	47.5
Total debt to capital	30.9	25.6	26.9	31.3	34.2

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EV/EBITDA chart

Figure 2. Grasim – 1-year forward rolling EV/EBITDA chart



Source: Datastream, Company Reports and Citi Investment Research and Analysis

Estimate changes table

Figure 3. Estimate Changes, FY11-13E

	FY11E			FY12E			FY13E		
	Old	New	% change	Old	New	% change	Old	New	% change
Net sales (Rs bn)	195.9	205.8	5%	207.1	231.3	12%	228.8	253.0	11%
EBITDA (Rs bn)	44.3	47.2	7%	40.2	47.3	18%	41.2	48.8	18%
Net profit (Rs bn)-adj	18.3	20.9	14%	17.0	21.3	25%	17.6	21.8	23%
EPS - Consolidated (Rs)	200	227	14%	186	232	25%	192	237	23%
Avg Cement Realisation (Rs/t)	3,293	3,237	-2%	3,210	3,334	4%	3,295	3,404	3%
Avg VSF Realisation (Rs/kg)	119.5	126.5	6%	117.1	145.5	24%	119.5	148.4	24%

Source: Citi Investment Research and Analysis estimates

Figure 4. Target price calculation

	New	Old
SOTP		
Cement business – based on UltraTech (Rs m)	162,844	159,961
Holding company discount	10%	10%
Cement business - discounted value (Rs m)	146,560	143,964
Grasim - value of cement per share (Rs)	1,598	1,570
Grasim standalone EBITDA (Rs m)	17,510	12,375
EV/EBITDA (x)	6.0	6.0
EV (Rs m)	105,062	74,252
Standalone net debt (Rs m)	-24,371	-23,736
Market cap (Rs m)	129,433	97,988
Grasim - value of other businesses per share (Rs)	1,411	1,069
Target price (Rs)	3,010	2,640

Source: Citi Investment Research and Analysis

Quarterly results

Figure 5. Grasim Industries – 3Q FY11 Consolidated Results

(Rs m)	3Q FY11	3Q FY10	% chg
Revenue	53,845	47,904	12%
Operating costs	42,644	34,063	25%
EBITDA	11,202	13,841	-19%
EBITDA margin (%)	20.8%	28.9%	
Interest	1,088	794	37%
Depreciation	2,992	2,547	17%
Other income	1,472	1,270	16%
PBT	8,594	11,771	-27%
Tax	2,604	4,092	-36%
Tax rate (%)	30%	35%	
PAT	5,991	7,679	-22%
Add: Share of profit in associates	127	99	
Less: Minority Interest	1,100	1,975	-44%
Net Profit	5,018	5,803	-14%

Source: Company Reports and Citi Investment Research and Analysis

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Data as of: 11-Mar-11

Radar Screen Quadrant Definitions

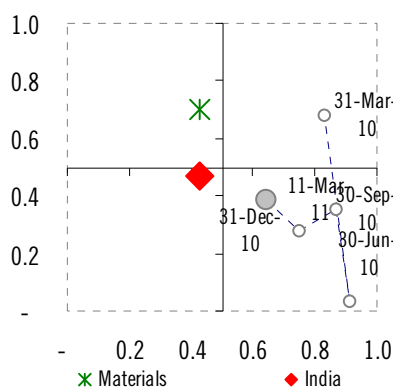
Glamor <i>Poor relative value but superior relative momentum</i>	Attractive <i>Superior relative value and superior relative momentum</i>
Unattractive <i>Poor relative value and poor relative momentum</i>	Contrarian <i>Superior relative value but poor relative momentum</i>

Quants View - Contrarian

Grasim Industries currently lies in the Contrarian quadrant of our Value-Momentum map with relatively weak momentum but strong value scores. It has been a resident there for the past eight months. Compared to its peers in the Materials sector, Grasim Industries fares better on the valuation metric but worse on the momentum metric. Similarly, compared to its peers in its home market of India, Grasim Industries fares better on the valuation metric but worse on the momentum metric.

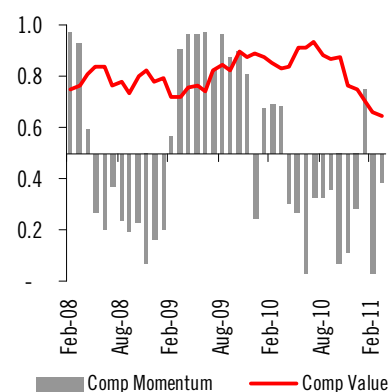
From a macro perspective, Grasim Industries has a low Beta to the region, so can be expected to hold its own given a decline in the regional market. It is also likely to benefit from tightening US credit spreads, falling EM yields, and a weaker US dollar.

Figure 6. Radar Quadrant Chart History



Source: CIRA

Figure 7. Radar Valuation and Momentum Scores



Source: CIRA

Figure 8. Radar Model Inputs

IBES EPS (Actual and Estimates)

FY(-2)	289.54	Implied Trend Growth (%)	(4.00)
FY(-1)	238.49	Trailing PE (x)	11.26
FY0	337.47	Implied Cost of Debt (%)	6.56
FY1	219.90	Standardised MCap	(0.07)
FY2	245.55		

Note: Standardised MCap calculated as a Z score - (mkt cap - mean)/std dev - capped at 3

Source: Citi Investment Research and Analysis, Worldscope, I/B/E/S

Figure 9. Stock Performance Sensitivity to Key Macro Factors

Region	0.69	Commodity ex Oil	(0.12)
Local Market	0.60	Rising Oil Prices	(0.06)
Sector	0.06	Rising Asian IR's	(0.04)
Growth Outperforms Value	0.21	Rising EM Yields	(0.59)
Small Caps Outperform Large Caps	0.75	Weaker US\$ (vs Asia)	1.40
Widening US Credit Spreads	(0.28)	Weaker ¥ (vs US\$)	(0.11)

Source: Citi Investment Research and Analysis

Grasim Industries

Valuation

We value Grasim using SOTP. We value its 51mtpa cement capacity using an EV/tonne (a common metric used for cement companies) of US\$120/t for Dec-11E, in-line with replacement costs, but apply a 10% holding company discount due to the changed group structure, imputing a value of Rs1,598/share for Grasim's 60% holding in UTCL. We value Grasim in line with replacement costs as demand growth is robust and new capacity creation is slowing down. Grasim's other businesses (VSF/Chemicals) are valued at an EV/EBITDA of 6x Dec-11E, a 10% premium to hard commodity businesses (given its steady margin generating capability), giving a value of Rs1,411/share. Our Grasim target price of Rs3,010 implies FY12E EV/EBITDA of 7.3x and P/E of 13x.

Risks

We rate Grasim Low Risk, in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key downside risks to our target price include: (1) Sharp downward rating for cement stocks due to falling cement prices/demand; (2) Fall in prices of VSF and/or competing fibres would negatively impact margins; and 3) Changes in the duty/tax regime to the detriment of producers.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Grasim Industries (GRAS.BO)

Ratings and Target Price History Fundamental Research

Analyst: Pradeep Mahtani



Chart current as of 12 March 2011

	Date	Rating	Target Price	Closing Price
1	22-Jul-08	3M	*1,667.30	1,592.79
2	24-Oct-08	3M	*1,007.61	951.99

	Date	Rating	Target Price	Closing Price
3	28-Apr-09	3M	*1,265.16	1,615.88
4	27-Jul-09	3M	*2,232.11	2,609.89

	Date	Rating	Target Price	Closing Price
5	28-Oct-10	*1L	*2,640.00	2,281.95

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Grasim Industries (GRAS.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Pradeep Mahtani



Chart current as of 12 March 2011

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Grasim Industries Ltd (GRAS.NS)

Rating History
Global Quantitative Research
Asia Radar Screen

Analyst: Paul R Chanin

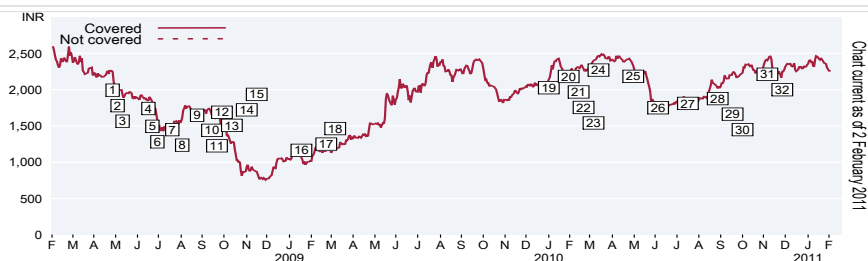


Chart current as of 27 February 2011

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Date	Rating	Target Price	Closing Price
1 28-Apr-08	*2	-	2,246.81
2 5-May-08	*1	-	2,030.41
3 12-May-08	*2	-	1,925.24
4 17-Jun-08	*3	-	1,851.72
5 23-Jun-08	*2	-	1,830.95
6 30-Jun-08	*3	-	1,577.96
7 21-Jul-08	*2	-	1,473.95
8 4-Aug-08	*1	-	1,614.51
9 25-Aug-08	*2	-	1,673.83
10 15-Sep-08	*3	-	1,646.33
11 22-Sep-08	*4	-	1,652.26

Date	Rating	Target Price	Closing Price
12 29-Sep-08	*3	-	1,477.31
13 13-Oct-08	*2	-	1,275.68
14 3-Nov-08	*3	-	939.49
15 17-Nov-08	*4	-	871.59
16 19-Jan-09	*3	-	1,062.95
17 23-Feb-09	*4	-	1,147.90
18 6-Mar-09	*1	-	1,195.46
19 1-Jan-10	*3	-	2,111.10
20 29-Jan-10	*1	-	2,217.00
21 12-Feb-10	*3	-	2,311.89
22 19-Feb-10	*1	-	2,287.58

Date	Rating	Target Price	Closing Price
23 5-Mar-10	*2	-	2,400.00
24 12-Mar-10	*1	-	2,465.84
25 30-Apr-10	*2	-	2,327.88
26 4-Jun-10	*3	-	1,772.50
27 16-Jul-10	*2	-	1,834.10
28 27-Aug-10	*3	-	2,017.70
29 17-Sep-10	*2	-	2,230.35
30 1-Oct-10	*3	-	2,232.05
31 5-Nov-10	*4	-	2,402.60
32 26-Nov-10	*3	-	2,249.00

Grasim Industries Ltd (GRAS.BO)

Rating History
Global Quantitative Research
World Radar Screen

Analyst: Chris Montagu

Covered since May 23 2009



Chart current as of 17 January 2011

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Date	Rating	Target Price	Closing Price
1 3-Jun-08	*2	-	1,982.82
2 3-Jul-08	*3	-	1,516.52
3 3-Aug-08	*5	-	1,659.26
4 8-Sep-08	*6	-	1,817.99
5 7-Oct-08	*5	-	1,462.48
6 4-Dec-08	*6	-	839.16
7 7-Jan-09	*1	-	1,207.64
8 5-Feb-09	*4	-	1,198.47

Date	Rating	Target Price	Closing Price
9 4-Mar-09	*3	-	1,279.98
10 7-Apr-09	*2	-	1,416.44
11 8-Jun-09	*1	-	2,152.49
12 8-Oct-09	*2	-	2,224.74
13 9-Nov-09	*1	-	2,017.48
14 1-Jan-10	*5	-	2,239.07
15 1-Feb-10	*1	-	2,398.48
16 1-Apr-10	*3	-	2,556.30

Date	Rating	Target Price	Closing Price
17 1-May-10	*5	-	2,465.48
18 1-Jun-10	*3	-	1,783.85
19 1-Jul-10	*5	-	1,843.00
20 1-Aug-10	*2	-	1,833.45
21 1-Oct-10	*3	-	2,231.85
22 1-Nov-10	*7	-	2,317.70
23 1-Jan-11	*6	-	2,340.80

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Data current as of 31 Dec 2010	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
Citi Investment Research & Analysis Global Fundamental Coverage	52%	37%	11%	0%	100%	0%
<i>% of companies in each rating category that are investment banking clients</i>	45%	44%	40%	0%	44%	0%
Citi Investment Research & Analysis Quantitative World Radar Screen Model Coverage	30%	40%	30%			
<i>% of companies in each rating category that are investment banking clients</i>	24%	23%	19%			
Citi Investment Research & Analysis Quantitative Decision Tree Model Coverage	45%	0%	55%			
<i>% of companies in each rating category that are investment banking clients</i>	55%	0%	50%			
Citi Investment Research & Analysis Asia Quantitative Radar Screen Model Coverage	20%	60%	20%			
<i>% of companies in each rating category that are investment banking clients</i>	23%	20%	20%			
Citi Investment Research & Analysis Australia Radar Model Coverage	51%	0%	49%			
<i>% of companies in each rating category that are investment banking clients</i>	30%	0%	15%			

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Investment ratings are a function of CIRA's expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating.

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To satisfy regulatory requirements, we correspond Under Review to Hold in our ratings distribution table for our 12-month fundamental rating system. However, we reiterate that we do not consider Under Review to be a recommendation.

Relative three-month ratings: CIRA may also assign a three-month relative call (or rating) to a stock to highlight expected out-performance (most preferred) or under-performance (least preferred) versus the analyst's coverage universe over a 3 month period. The relative call may highlight a specific near-term catalyst or event impacting the company or the market that is anticipated to have a short-term price impact on the equity securities of the company. Absent any specific catalyst the analyst(s) will indicate the most and least preferred stocks in his coverage universe, explaining the basis for this short-term view. This three-month view may be different from and does not affect a stock's fundamental equity rating, which reflects a longer-term total absolute return expectation. For purposes of NASD/NYSE ratings-distribution-disclosure rules, most preferred calls correspond to a buy recommendation and least preferred calls correspond to a sell recommendation. Any stock not assigned to a most preferred or least preferred call is considered non-relative-rated (NRR). For purposes of NASD/NYSE ratings-distribution-disclosure rules we correspond NRR to Hold in our ratings distribution table for our 3-month relative rating system. However, we reiterate that we do not consider NRR to be a recommendation.

For securities in emerging markets (Asia Pacific, Emerging Europe/Middle East/Africa, and Latin America), investment ratings are: Buy (1) (expected total return of 15% or more for Low-Risk stocks, 20% or more for Medium-Risk stocks, 30% or more for High-Risk stocks, and 40% or more for Speculative stocks); Hold (2) (5%-15% for Low-Risk stocks, 10%-20% for Medium-Risk stocks, 15%-30% for High-Risk stocks, and 20%-40% for Speculative stocks); and Sell (3) (5% or less for Low-Risk stocks, 10% or less for Medium-Risk stocks, 15% or less for High-Risk stocks, and 20% or less for Speculative stocks).

Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

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