



Grasim Industries

STOCK INFO.	BLOOMBERG
BSE SENSEX: 15,261	GRASIM IN
	REUTERS CODE
S&P CNX: 4,440	GRAS.BO

30 July 2007

Buy

Previous Recommendation: Buy

Rs2,947

Equity Shares (m)	91.7
52-Week Range	3,062/1,927
1,6,12 Rel. Perf. (%)	8/-3/-4
M.Cap. (Rs b)	270.2
M.Cap. (US\$ b)	6.7

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/07A	140,952	19,683	214.7	90.1	13.7	4.1	29.6	32.0	2.3	8.3
03/08E	164,346	25,806	281.5	31.1	10.5	3.0	29.0	36.4	2.1	6.5
03/09E	182,585	25,123	274.0	-2.6	10.8	2.4	22.7	33.5	1.8	6.1

* Consolidated

Grasim's standalone results for 1QFY08 were better than expected. The VSF business surprised positively and other income was higher than we had anticipated. Revenues grew 29% YoY to Rs24.4b. EBITDA margin expanded 530bp YoY (~460bp QoQ) to 32.4%. Higher other income (up 81% YoY) boosted PAT to Rs5.1b (up 64% YoY).

Cement business - performance in line with expectations: Cement business revenues grew 27% YoY to Rs13.9b. Volume grew 11.4% YoY to 3.9m ton and realizations increased 13% YoY (~3.5% QoQ) to Rs3,083/ton. However, higher petcoke prices and freight cost restricted PBITD margin expansion at 100bp (both YoY & QoQ) to 35.3%.

VSF business - strong volumes, higher realizations: VSF business benefited from strong demand. Volumes grew 34% YoY to 69,400ton while realizations were up 20% YoY (~6.5% QoQ). Despite higher pulp prices (up 17% YoY & 3% QoQ), PBITD margins expanded 10.6pp YoY (~580bp QoQ) to 36.6%.

Consolidated performance: Grasim's consolidated revenues grew 26% YoY to Rs40.6b. EBITDA margin expanded 250bp to 31.2% and PAT grew 54% YoY to Rs6.7b.

We are revising our EPS estimates upwards by 13% for FY08 to Rs281 and by 17.3% for FY09 to Rs274, to reflect better than expected 1QFY08 performance and consolidation of JVs/associates in our estimates. The stock is valued at 10.5x FY08E EPS and 6.5x EV/EBITDA. We maintain **Buy**.

QUARTERLY PERFORMANCE (STANDALONE)										(Rs Million)	
Y/E MARCH	FY07				FY08				FY07	FY08E	
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			
Net Sales	18,917	20,108	22,794	24,938	24,448	23,833	25,226	27,068	86,757	100,575	
YoY Change (%)	21.8	21.9	38.3	36.3	29.2	18.5	10.7	8.5	29.4	15.9	
EBITDA	5,135	5,322	6,661	6,942	7,921	7,376	8,101	8,496	24,094	31,894	
Margins (%)	27.1	26.5	29.2	27.8	32.4	30.9	32.1	31.4	27.8	31.7	
Depreciation	741	756	807	876	850	910	915	1,034	3,179	3,709	
Interest	238	241	240	366	285	300	320	468	1,118	1,373	
Other Income	375	502	444	776	677	450	425	434	2,097	1,987	
PBT before EO Items	4,532	4,827	6,058	6,476	7,464	6,616	7,291	7,428	21,893	28,799	
Extraordinary Inc/(Exp)	0	0	0	371	0	0	0	0	371	0	
PBT after EO Items	4,532	4,827	6,058	6,847	7,464	6,616	7,291	7,428	22,264	28,799	
Tax	1,413	1,467	1,942	2,102	2,347	2,138	2,356	2,465	6,906	9,306	
Rate (%)	31.2	30.4	32.1	30.7	31.4	32.3	32.3	33.2	31.0	32.3	
Reported PAT	3,119	3,360	4,116	4,745	5,117	4,478	4,935	4,963	15,358	19,493	
Adj. PAT	3,119	3,360	4,116	4,488	5,117	4,478	4,935	4,963	15,102	19,493	
YoY Change (%)	51.7	79.1	154.3	72.7	64.0	33.3	19.9	10.6	73.1	29.1	

E: Most Estimates; Quarterly results do not add-up to full year results due to restatement

STRONG PERFORMANCE IN CORE BUSINESSES (RS M)

	1QFY08	1QFY07	% YOY	4QFY07	% QOQ
Revenue Mix					
Fibre	6,999	4,397	59.2	6,516	7.4
Cement	13,907	10,968	26.8	13,708	1.5
Sponge Iron	2,188	1,754	24.7	2,388	-8.4
Chemical	863	715	20.7	927	-6.9
Textile	554	527	5.1	675	-17.9
Total	24,448	18,917	29.2	24,938	-2.0
PBIT					
Fibre	2,362	979	141.3	1,791	31.9
Cement	4,447	3,342	33.1	4,239	4.9
Sponge Iron	266	56	375.0	283	-6.1
Chemical	223	134	66.4	283	-21.3
Textile	-18	1	-	-15	-
Total	7,280	4,512	61.3	6,582	10.6
EBIT Margins (%)					
			CH. (BP)		CH. (BP)
Fibre	33.7	22.3	1,148	27.5	626
Cement	32.0	30.5	151	30.9	105
Sponge Iron	12.2	3.2	896	11.9	30
Chemical	25.8	18.7	710	30.6	-471
Textile	-3.2	0.2	-344	-2.2	-103
Total	29.8	23.9	593	26.4	338

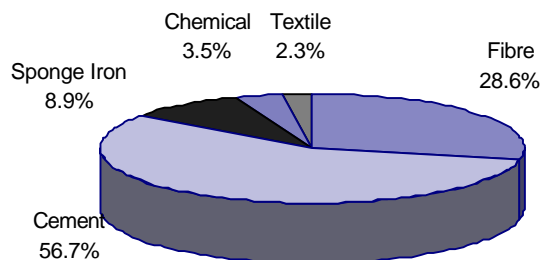
Source: Company/ Motilal Oswal Securities

Grasim's standalone results for 1QFY08 were better than expected. The VSF business surprised positively and other income was higher than we had anticipated. Revenues grew 29% YoY to Rs24.4b. EBITDA margin expanded 530bp YoY (~460bp QoQ) to 32.4%. Higher other income (up 81% YoY) boosted PAT to Rs5.1b (up 64% YoY).

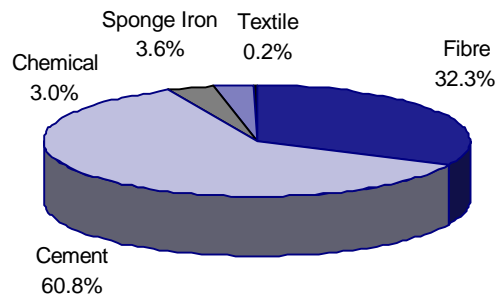
VSF and cement businesses drive revenue growth...

Net sales grew 29% YoY to Rs24.4b, driven by 27% growth in cement revenues and 59% growth in VSF revenues. While sponge iron business performance improved, with revenue growth of 25% YoY, chemicals business revenue grew 21% YoY (on low base of last year, when production was impacted by water shortage).

REVENUE MIX

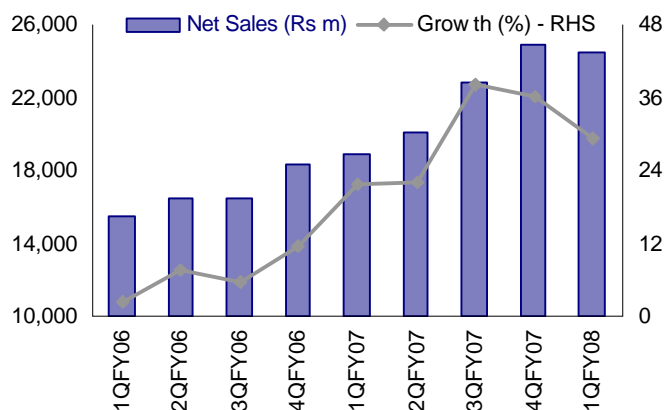


PBIT MIX



Source: Company/Motilal Oswal Securities

TREND IN NET SALES

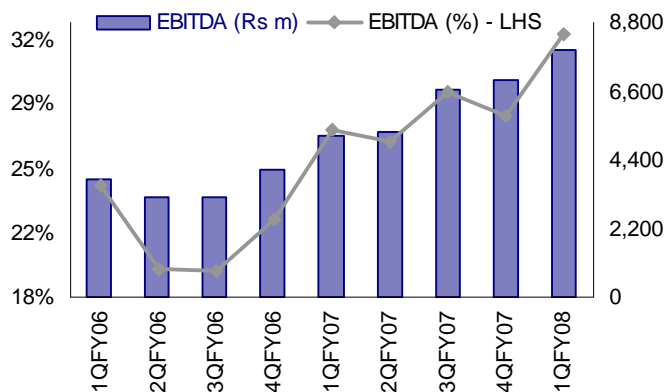


Source: Company/Motilal Oswal Securities

...as well as margin expansion

EBITDA grew 54% YoY to Rs7.9b, led by higher realizations in both VSF and cement. EBITDA margin expanded to 32.4%. Higher other income (up 81%) boosted PAT to Rs5.1b (up 64%).

TREND IN EBITDA



Source: Company/Motilal Oswal Securities

VSF business - strong volumes, higher realizations

VSF business benefited from strong demand, with volumes growing 34% YoY to 69,400ton (on low base of last year, when production was impacted due to water shortage) and realizations increasing 20% YoY (~6.5% QoQ). Despite higher pulp prices (up 17% YoY & 3% QoQ), PBIDT margins expanded 10.6pp YoY (~580bp QoQ) to 36.6%.

VSF DIVISION PERFORMANCE

	1QFY08	1QFY07	% YOY	4QFY07	% QOQ
Production (ton)	68,755	45,194	52.1	67,772	1.5
Sales volume (ton)	69,396	51,957	33.6	68,588	1.2
Net Turnover (Rs M)	6,999	4,397	59.2	6,516	7.4
Avg Real (Rs/ton)	94,455	78,983	19.6	88,687	6.5
PBIDT Margin (%)	36.6	26.0		30.8	
PBIDT	2,563	1,143	124.2	2,005	27.8

Source: Company/Motilal Oswal Securities

Also, with further 7% (Rs6.5/Kg) increase in VSF prices (w.e.f. 1 July 2007) in the domestic market (in line with global prices), Grasim's margins are expected to improve further in the near term. However, over the medium term, management expects margins to come under pressure depending on sustainability of current high VSF prices and cost inflation (our FY09 estimates assume Rs4/Kg decline in VSF prices).

Demand for VSF is expected to grow based on strong demand from Indian textile industry post quota. Also, the company is taking initiatives to introduce VSF-based non-

woven products in the domestic market and is focusing on high-value niche fibers, which would benefit over a period of time. Grasim is enhancing its VSF capacity from the current 2,66,450 ton to 3,34,000 ton by end-FY08. Also, the company has sought regulatory clearances for brownfield expansion of 31,000ton at Harihar. Further, it is doubling capacity in its Chinese JV to 60,000ton by 2QFY09.

Cement business - in-line performance

Cement business revenues grew 27% YoY to Rs13.9b, driven by 11.4% volume growth to 3.9m ton and 13% YoY (~3.5% QoQ) increase in realizations to Rs3,083/ton. However, higher petcoke prices and freight cost restricted PBIDT margin expansion at 100bp (both YoY & QoQ) to 35.3%.

CEMENT DIVISION PERFORMANCE

	1QFY08	1QFY07	% YOY	4QFY07	% QOQ
A. Grey Cement					
Sales volume (Mton)	3.9	3.50	11.4	3.92	-0.5
Avg Realizations (Rs/ton)	3,083	2,726	13.1	2,979	3.5
B. Ready-mix concrete					
Sales volume (Lakh Cu Mtr)	3.7	3.14	19.1	3.70	1.1
Avg Realizations (Rs/Cu Mtr)	2,585	2,588	-0.1	2,475	4.4
B.White Cement					
-Production (ton)	92,594	83,045	11.5	97,116	-4.7
-Sales volume (ton)	85,005	81,143	4.8	102,200	-16.8
-Net Turnover (Rs M)	544	754	-27.8	1,123	-51.5
Avg Realizations (Rs/ton)	6,403	6,213	3.1	6,518	-1.8
Net Turnover (Rs M)	13,907	10,968	26.8	13,708	1.5
PBIDT Margin (%)	35.3	34.3		34.3	
PBIDT	4,911	3,765	30.4	4,702	4.4

Source: Company/Motilal Oswal Securities

The cement business is expected to benefit from the significant capacity addition of around 16m ton (incl UltraTech) from 1QFY09. Also, Grasim is taking initiatives to control cost by improving rail-road mix, increasing blending and setting-up captive power plants.

Sponge iron business - recovery continues

Grasim's sponge iron business continued its recovery, after PBIDT loss in 2QFY07, driven by higher global scrap prices. While volumes were flat, realizations improved by 22% YoY (~9% QoQ) to Rs14,750/ton, translating into PBIDT margins of 16.1% (up 800bp YoY and 60bp QoQ).

SPONGE IRON DIVISION PERFORMANCE

	1QFY08	1QFY07	% YOY	4QFY07	% QOQ
Production (ton)	138,136	126,941	8.8	167,680	-17.6
Sales volume (ton)	139,706	140,912	-0.9	171,942	-18.7
Net Turnover (Rs M)	2,188	1,754	24.7	2,388	-8.4
Avg Realizations (Rs/ton)	14,753	12,054	22.4	13,518	9.1
PBIDT Margin (%)	16.1	8.1		15.5	
PBDIT	353	142	148.6	370	-4.6

Source: Company/Motilal Oswal Securities

Grasim's sponge iron business is expected to remain under pressure due to poor gas availability, which impacts production. The company is hopeful of adequate gas availability by December 2007, although gas pricing remains unclear. Upon availability of gas, we expect Grasim's sponge iron division to operate at higher utilization, resulting in better absorption of fixed cost and resulting in margin expansion.

Mega expansion plans; existing capex plan enhanced

Grasim is investing significantly in its core business, with total capex of around Rs100b (incl Rs17b invested in FY07). It is investing Rs91b in augmenting cement capacity from 31m ton to 47m ton (incl UltraTech) and Rs7.3b in adding 64,000ton in VSF business (excl 30,000ton expansion in China JV and proposed 31,000ton expansion at Harihar).

Also, it has enhanced its existing capex plans in cement business - it would be adding incremental 1.7m ton capacity (0.4m ton each at Rajasthan and 0.9m ton at Andhra Pradesh) and is setting-up a 2m ton grinding unit at UltraTech's Gujarat plant. These capex programs are running as per schedule and are expected to commence operations from 1QFY09 onwards. Among its large peers, Grasim has the most aggressive and timely cement capacity addition program, which will result in significant volume growth and cost savings from FY09.

Upgrading estimates

We are revising our EPS estimates upwards by 13% for FY08 to Rs281.5 and by 17.3% for FY09 to Rs274. The earnings upgrade is to factor in:

- ✍ Better than expected VSF business performance in 1QFY08
- ✍ Rebasing our cement pricing assumption to 1QFY08 average prices as against March 2007 prices, resulting in increase in cement price assumption by Rs4.5/bag.
- ✍ Consolidation for 6.59% stake in Idea Cellular, which adds around Rs5.8 and Rs8.6 to FY08E and FY09E EPS.
- ✍ Consolidation for Shree Digvijay Cement (~53.64% stake), which adds around Rs3.7 and Rs2.2 to FY08E and FY09E EPS
- ✍ Four joint-ventures in VSF business, which add around Rs1.2 and Rs3.2 to FY08E and FY09E EPS
- ✍ Increase in stake in UltraTech Cement to 53% (from 51.1%)

However, our FY09E estimates still factors in (a) Rs5/bag decline in cement prices in FY09, and (b) Rs4/kg decline in VSF prices.

REVISED FORECAST (RS M)

	FY08E			FY09E		
	REV	OLD	CHG (%)	REV	OLD	CHG (%)
Net Sales	164,346	149,420	10.0	182,585	161,739	12.9
Net Profit	25,806	22,832	13.0	25,123	21,413	17.3
EPS (Rs)	281.5	249.0	13.0	274.0	233.5	17.3

Source: Motilal Oswal Securities

Valuation and view

With the outlook on both its core businesses (cement and VSF) positive and Grasim being the leader in both, it would be the biggest beneficiary of any further upturn in these businesses. Also, Grasim is financially well placed to fund its growth plans. Valuations at 10.5x FY08E EPS and 6.5x EV/EBITDA are reasonable for the largest cement player in the industry. We maintain Buy, with a revised SOTP-based target price of Rs3,200.

SUM OF PARTS VALUATION - FAIR VALUE

	BASIS	MULTIPLE	FY08E	FY09E
VSF - EBITDA	EV/EBITDA (x)	5.0	51,625	51,080
Sponge Iron - EBITDA	EV/EBITDA (x)	4.0	2,249	5,558
Other Business - EBITDA	EV/EBITDA (x)	2.5	2,888	2,860
Cement (Consolidated) - EBITDA	EV/EBITDA (x)	8.0	236,455	240,603
Total EV (Rs m)			293,216	300,101
Less: Debt (Rs m)			40,245	34,630
Add: Cash & Investments (Rs m)			40,200	46,242
Mkt Cap (Rs m)			293,172	311,713
Grasim' Equity (m shares)			91.7	91.7
Fair value per share			3,197	3,399

Source: Motilal Oswal Securities

Grasim Industries: an investment profile

Company description

Grasim is a diversified company, with cement and VSF being its core businesses. Cement and VSF accounted for 60.4% and 23.1%, respectively of FY06 revenue. Its other businesses include sponge iron, chemicals and textiles. The acquisition of UltraTech Cement, the cement division of L&T, by Grasim catapulted it to the number one position in the Indian cement industry, with total capacity under control of 31m ton.

Key investment argument

- ✎ Being the largest player with total capacity of 31m ton (existing capacity) under control and highest organic growth visibility, Grasim would be the biggest beneficiary of any further increase in cement price
- ✎ Global leader in VSF business, with backward integration in pulp, experiencing robust demand in both global and domestic markets.

Key investment risks

- ✎ Cement sector is likely to add huge capacities in the coming year, which could result in significant softening of cement prices.
- ✎ Softening in prices of competing fibres (cotton & PSF) could put pressure on VSF prices

Recent development

- ✎ Nil

Valuation and view

- ✎ The stock quotes at valuation of 10.5x FY08E EPS and 6.5x EV/EBITDA
- ✎ Grasim will be one of the biggest beneficiaries of current upturn in cement prices as well as its organic expansion plan. Maintain **Buy** with target price of Rs3,200.

Sector view

- ✎ Strong GDP growth, coupled with sustainable demand drivers, augurs well for cement demand growth
- ✎ Although significant capacity addition has already been announced, real impact of these capacities would be felt only in 2HFY09
- ✎ Uncertainty on cement prices, due to government intervention, is expected to prevail in the near term.

COMPARATIVE VALUATIONS

		GRASIM	ACC	GACL
P/E (x)	FY08E	10.5	13.6	12.2
	FY09E	10.8	14.6	12.8
P/BV (x)	FY08E	3.0	4.6	3.8
	FY09E	2.4	3.7	3.1
EV/Sales (x)	FY08E	2.1	2.6	3.1
	FY09E	1.8	2.4	2.8
EV/EBITDA (x)	FY08E	6.5	8.7	8.0
	FY09E	6.1	9.0	7.7

SHAREHOLDING PATTERN (%)

	JUN-07	MAR-07	JUN-06
Promoter	25.2	25.2	25.1
Domestic Inst	21.1	20.1	23.3
Foreign	37.6	38.2	34.8
Others	16.2	16.6	16.9

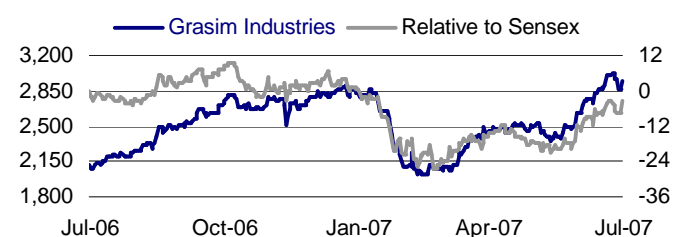
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	281.5	222.1	26.7
FY09	274.0	238.3	15.0

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,947	3,200	8.6	Buy

STOCK PERFORMANCE (1 YEAR)



CONSOLIDATED INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Net Sales	92,917	102,240	140,952	164,346	182,585
Change (%)	23.8	10.0	37.9	16.6	11.1
Total Expenditure	72,645	81,553	101,228	112,133	127,507
EBITDA	20,272	20,687	39,723	52,213	55,077
Margin (%)	21.8	20.2	28.2	31.8	30.2
Depreciation	5,562	5,631	6,100	7,169	9,850
EBIT	14,709	15,056	33,624	45,044	45,227
Int. and Finance Charges	2,846	2,183	2,286	2,611	3,017
Other Income - Rec.	2,452	2,679	3,177	2,738	2,351
PBT & EO items	14,316	15,552	34,515	45,171	44,561
Change (%)	36.4	8.6	21.9	30.9	-1.4
Extra Ordinary items	1,281	-41	0	0	0
PBT but after EO items	15,597	15,511	34,515	45,171	44,561
Tax	4,421	4,027	10,921	14,337	14,255
Tax Rate (%)	28.3	26.0	31.6	31.7	32.0
Reported PAT	11,176	11,484	23,594	30,834	30,306
PAT Adj for EO items	10,258	11,514	23,594	30,834	30,306
Change (%)	32.3	2.2	10.9	30.7	-1.7
Margin (%)	11.0	11.3	16.7	18.8	16.6
Less: M inority Interest	-190	1,160	3,911	5,028	5,183
Consolidated PAT	10,448	10,354	19,683	25,806	25,123
Change (%)	37.4	-0.9	90.1	31.1	-2.6

CONSOLIDATED BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Equity Share Capital	917	917	917	917	917
Reserves	39,943	47,459	65,482	88,070	109,975
Net Worth	40,859	48,376	66,399	88,987	110,892
Loans	39,339	36,833	48,731	42,301	312,10
Deferred liabilities	11,793	11,583	11,526	11,898	12,191
Minority Interest	5,002	5,136	8,587	13,615	18,798
Capital Employed	96,993	101,927	135,242	156,801	173,091
Gross Block	111,116	114,836	125,269	168,069	175,569
Less: Accum. Deprn.	50,181	55,160	60,125	67,294	77,144
Net Fixed Assets	60,935	59,676	65,144	100,775	98,424
Capital WIP	2,053	4,480	19,577	5,000	1,500
Investments	7,690	13,521	22,719	23,181	44,364
Goodwill	19,577	17,728	19,217	19,217	19,217
Curr. Assets	23,971	26,185	33,216	39,032	43,364
Inventory	10,567	11,645	13,581	17,256	19,171
Account Receivables	7,232	5,908	8,252	9,039	10,042
Cash and Bank Balance	1,635	2,374	3,692	3,698	4,108
Others	4,537	6,259	7,691	9,039	10,042
Curr. Liability & Prov.	17,233	19,663	24,632	30,404	33,778
Account Payables	8,982	11,382	15,373	18,078	20,084
Other Liabilities	5,209	5,003	7,189	9,039	10,042
Provisions	3,043	3,277	2,070	3,287	3,652
Net Current Assets	6,738	6,523	8,585	8,628	9,586
Appl. of Funds	96,993	101,927	135,242	156,801	173,091

E: MOST Estimates

RATIOS					
Y/E MARCH	2005	2006	2007	2008E	2009E
Basic (Rs)					
EPS	114.0	112.9	214.7	281.5	274.0
Cash EPS	173.5	178.6	285.2	367.1	376.3
BV/Share	445.7	527.6	724.2	970.5	1209.4
DPS	16.0	20.0	27.5	30.0	30.0
Payout (%)	16.9	18.4	12.5	10.4	10.6
Valuation (x)					
P/E		26.1	13.7	10.5	10.8
Cash P/E		16.5	10.3	8.0	7.8
P/BV		5.6	4.1	3.0	2.4
EV/Sales		3.4	2.3	2.1	1.8
EV/EBITDA		16.7	8.3	6.5	6.1
Dividend Yield (%)		0.7	0.9	1.0	1.0
Return Ratios (%)					
RoE	25.6	21.4	29.6	29.0	22.7
RoCE	21.4	20.8	32.0	36.4	33.5
Working Capital Ratios					
Debtor (Days)	28	21	21	20	20
Asset Turnover (x)	10	10	10	10	11
Leverage Ratio					
Debt/Equity (x)	10	0.8	0.7	0.5	0.3

CONSOLIDATED CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
OP/(Loss) before Tax	25,274	20,820	43,175	57,241	60,260
Interest/Dividends Recd.	2,452	2,679	3,177	2,738	2,351
Direct Taxes Paid	1,047	-4,237	-10,978	-13,965	-13,962
(Inc)/Dec in WC	-1,881	954	-744	-38	-547
CF from Operations	26,892	20,216	34,631	45,977	48,102
EO Items	-1,281	41	0	0	0
CF from Op. incl EO	28,173	20,175	34,631	45,977	48,102
(inc)/dec in FA	-36,368	-6,798	-26,665	-28,223	-4,000
(Pur)/Sale of Investments	-1,861	-3,981	-10,688	-462	-21,183
CF from Investments	-38,229	-10,780	-37,353	-28,685	-25,183
Issue of Shares	-4,690	-1,846	-2,626	-5,028	-5,183
(Inc)/Dec in Debt	18,687	-2,506	11,898	-6,430	-11,091
Interest Paid	-2,846	-2,183	-2,286	-2,611	-3,017
Dividend Paid	-1,735	-2,121	-2,944	-3,218	-3,218
CF from Fin. Activity	9,416	-8,656	4,041	-17,287	-22,509
Inc/Dec of Cash	-640	739	1,318	6	410
Add: Beginning Balance	2,275	1,635	2,374	3,692	3,698
Closing Balance	1,635	2,374	3,692	3,698	4,108



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Disclosure of Interest Statement

Grasim Industries

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
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