

Grasim Industries Ltd

Cost pressures emerging in VSF but demand, ASP outlook strong

- Operating results slightly ahead:** Grasim's 3QFY11 Consol EBITDA of Rs12.0bn was slightly ahead of JPMe at Rs11.5bn and well above the consensus at Rs10.6bn. Besides the inline 3QFY11 results reported by UTCEM and strong performance from the VSF segment, the company's JVs contributed Rs448MM to the consol EBITDA during the quarter. Reported consol PAT was Rs5.0bn; inline with our estimates of Rs4.9bn. Standalone tax rate of 27.8% was lower than our expectation of 25%.
- VSF- demand and realizations strong, but increasing cost pressures:** VSF segment reported EBITDA at Rs3.9bn (-4% y/y, +42% q/q) with sales volumes increasing 4% y/y and 25% q/q, while ASP increased by 12% y/y and 6% q/q. However, EBITDA margins (standalone) declined y/y at 34.4% v/s 41.9% in Q3FY10. GRASIM highlighted the cost pressures across the chain with pulp costs +35%, sulfur costs +119%, and energy costs +17%. On a consolidated VSF segment including the pulp JV, EBITDA was up 2% y/y.
- VSF- Demand and ASP outlook remains strong:** We agree with management's expectations of continued strength in the VSF segment. Demand outlook remains robust with the textile sector recovering. Importantly, continued elevated cotton prices are a strong positive for VSF prices, given that VSF is a substitute for cotton. Increasing spot pulp prices is also positive for VSF prices, as it pushes up the cost curve for VSF in China. However, cost pressures are likely to limit margin expansion. We expect VSF EBITDA at ~Rs13bn over FY11-13E.
- Star Cement update:** The 3Q results included 0.75MT sales volume (~7% of total cement volume) from STAR Cement in the quarter with realizations at \$55/MT with positive EBITDA but PAT loss of Rs270mn. GRASIM highlighted that the acquisition is operating at ~80% capacity utilization currently despite the 'challenging environment in Middle East'.
- We remain OW with a revised March-12 PT of Rs2625** based on sum of the parts. We value VSF business at a multiple of 5.5x and our cement valuations are based on 20% holding company discount to our target valuations of UTCEM (we value UTCEM on \$130/MT). Key risk includes sharp collapse in VSF demand and prices from current levels.

Grasim (Bloomberg: Grasim IN; Reuters: GRAS.BO)

Rs in millions, year-end March	FY10	FY11E	FY12E	FY13E	52-wk range (Rs)	2510 - 1668
Net Sales (Rs mn)	195,214	197,643	205,730	222,280	Mkt cap. (Rs MM)	217,133
Net Profit (Rs mn, post minority)	27,351	21,090	21,026	25,636	Mkt cap. (US\$ MM)	4,751
EPS (Rs)	298.3	230.0	229.3	279.6	Avg. daily volume (MM)	0.1
Net profit growth (%)	25%	-23%	0%	22%	Average daily value (US\$ MM)	3.6
ROE (%)	23%	16%	14%	21%	Shares O/S (MM)	92
P/E (x)	7.9	10.3	10.3	8.5	Index (BSE Sensex)	18,969
P/B (x)	2.1	1.7	1.6	2.7	Exchange rate	45.7
EV/EBITDA (x)	5.4	6.4	6.3	5.3	Date of price	25-Jan-11

Source: Company reports, Bloomberg, J.P. Morgan estimates.

Overweight

GRAS.BO, GRASIM IN

Price: Rs2,367.95

▲ Price Target: Rs2,625.00
Previous: Rs2,550.00

India

Cement

Pinakin Parekh, CFA^{AC}

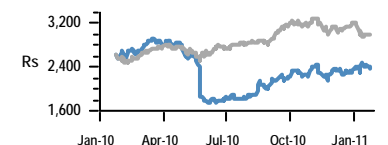
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Price Performance



	YTD	1m	3m	12m
Abs	0.5%	3.7%	4.1%	-9.7%
Rel	7.8%	8.9%	11.0%	-23.3%

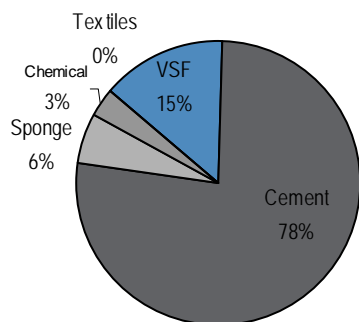
See page 7 for analyst certification and important disclosures, including non-US analyst disclosures.

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Company description

Grasim's principal activities include manufacture of viscose staple fibre (VSF), cement, sponge iron, chemicals and textiles. The company's VSF plants are located at Nagda in Madhya Pradesh, Kharach in Gujarat and Harihar in Karnataka, with an aggregate capacity of 333,975tpa. Grasim, along with its subsidiary UltraTech Cement Ltd., has a capacity of 45.65MT and is a leading cement player in India.

Figure 1: Grasim—FY09 revenue break-up



Source: Company reports.

Table 2: EPS est—J.P. Morgan vs. consensus

Rs	J.P. Morgan	Consensus
FY11E	230	228
FY12E	229	246
FY13E	280	259

Source: Bloomberg, J.P. Morgan estimates.

Table 1: Grasim—P&L sensitivity metrics

FY11E	EBITDA impact (%)	EPS impact (%)
Cement sales volume growth assumption		
Impact of each 1%	+/-2%	+/-2%
Cement average realization growth assumption		
Impact of each 1%	+/-2%	+/-2%
VSF sales assumption		
Impact of each 5%	+/-1%	+/-1%

Source: J.P. Morgan estimates.

Price target and valuation analysis

Our revised PT of Rs2625 is based on sum of the parts due to the roll forward our target date to Mar-12 from Sept11. We value VSF business at a multiple of 5.5x and our cement valuations are based on 20% holding company discount to our target valuations of UTCEM (we value UTCEM on \$130/MT).

The key risk remains the lack of visibility regarding the usage of VSF cash flows (steady state EBITDA of ~Rs13bn), which historically were invested in the cement business.

3QFY11 Results as expected

Grasim reported 3QFY11 Consol EBITDA of Rs12.0bn slightly ahead of JPMe at Rs11.5bn but 13% higher than the consensus estimate of Rs10.6bn. The results were on the back of an inline 3QFY11 results reported by UTCEM (*please see our update on UltraTech 'Inline 3Q; Anemic demand an industry wide problem' published on 25 Jan 2011*) and strong performance from the VSF segment. Cement performance improved sequentially despite a muted 3% volume growth mainly driven by the 12% increase in realizations. The pulp and China fibre JVs contributed Rs448MM to the consol EBITDA during the quarter. Reported consol PAT was Rs5.0bn, inline with our estimates of Rs4.9bn as standalone tax rate of 27.8% was lower than our expectation of 25%.

Table 3: Grasim Consolidated Quarterly Summary

Rs Mn, %	3QFY10	2QFY11	3QFY11	%y/y	%q/q
Net Sales	48,435	45,034	54,612	13%	21%
EBITDA	14,402	7,856	11,969	-17%	52%
Interest	794	974	1,088	37%	12%
Depreciation	2,547	2,727	2,992	17%	10%
Other Income	712	980	705	-1%	-28%
Profit before tax	11,773	5,134	8,594	-27%	67%
Less Current Tax	2,801	1,508	2,604		
Less Provision for deferred tax	1,012				
Less Minority Share	804	393	973		
Recurring Profit	7,155	3,234	5,018	-30%	55%
EBITDA Margin (%)	29.7%	17.4%	21.9%		
Tax rate (%)	32.4%	29.4%	30.3%		

Source: Company reports, J P Morgan estimates.

Another strong quarter for VSF

VSF segment reported a robust quarter with improving demand and higher VSF prices. VSF sales increased 25% q/q (2Q volumes impacted by Nagda plant shutdown) and the realizations grew by 6% q/q as the company took two price hikes (~2% in Oct and another 5-6% in mid-Nov) supported by the rising cotton and PSF prices. **Outlook for VSF realization remains strong as the segment would see full benefit from the price increase in 3Q and the continued strength in cotton prices. The company has highlighted that pricing trend are expected to remain firm, 'but with volatility'.** EBITDA margins were impacted by increasing cost pressures from pulp (+35% y/y), sulphur (+119% y/y) and coal. We expect cost pressures are likely to limit margin expansion.

Table 4: VSF Quarterly Summary

Rs Mn, Rs, %	3QFY10	2QFY11	3QFY11	%y/y	%q/q
Sales volume (tonne)	81,306	67,488	84,621	4%	25%
Revenue	9,624	8,555	11,293	17%	32%
EBITDA	4,037	2,728	3,886	-4%	42%
EBITDA Margin	41.9%	31.9%	34.4%		
Realization per tonne	109,600	116,465	123,060	12%	6%

Source: Company reports, J P Morgan estimates.

Valuation and key risks

Our revised PT of Rs2,625 is based on sum of the parts and roll forward our target date to Mar-12. We value VSF business at a multiple of 5.5x and our cement valuations are based on 20% holding company discount to our target valuations of UTCEM (we value UTCEM on \$130/MT).

The key risk remains the lack of visibility regarding the usage of VSF cash flows (steady state EBITDA of ~Rs13bn), which historically were invested in the cement business.

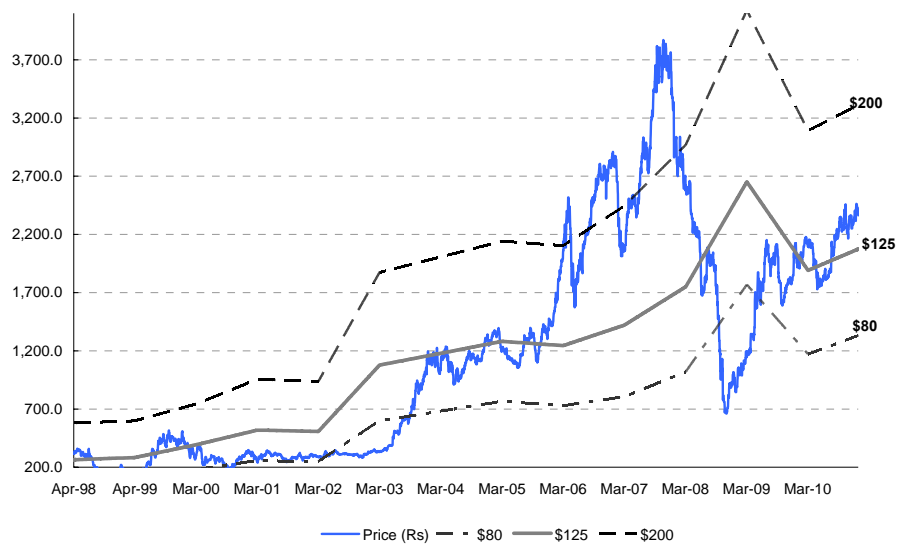
Table 5: GRASIM- SOTP Break Up

Rs bn, Rs

	Mcap Contribution (Rs bn)
VSF 5.5x of FY12E EBITDA	72
Chemical 0.5x of FY12E Sales	3
Grasim standalone EV	74
Net debt - Standalone	-14
Grasim - Standalone M cap	88
20% Holding co discount on UTCEM value	151
Total Grasim Implied M cap	240
Per share value	2,625

Source: Company reports and J.P. Morgan estimates.

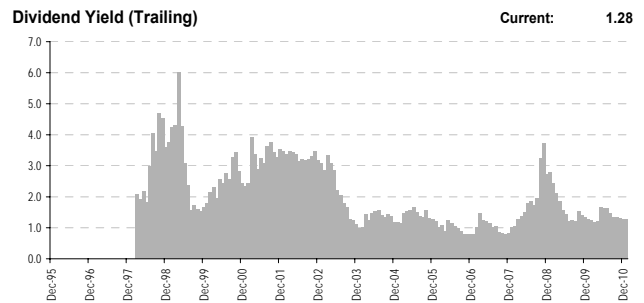
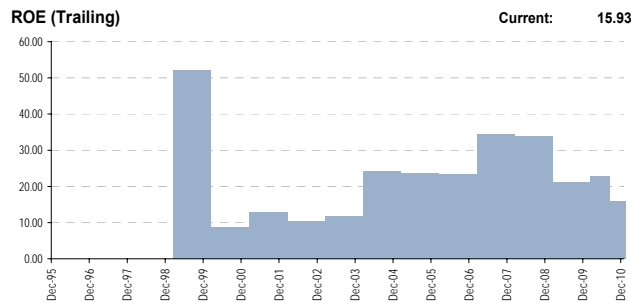
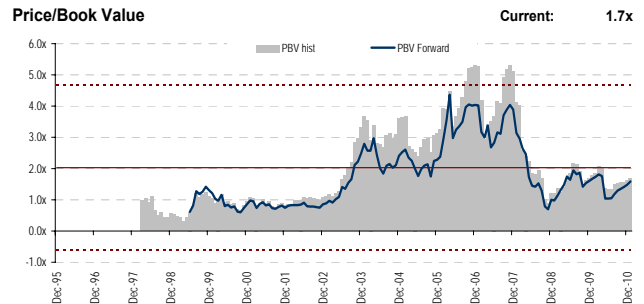
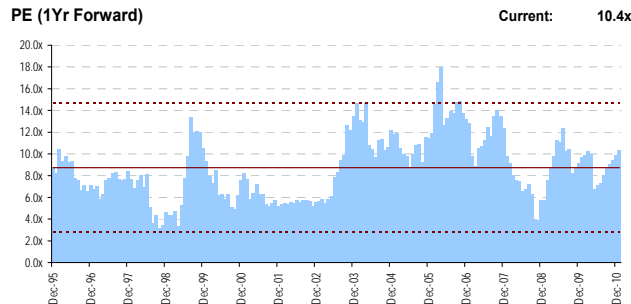
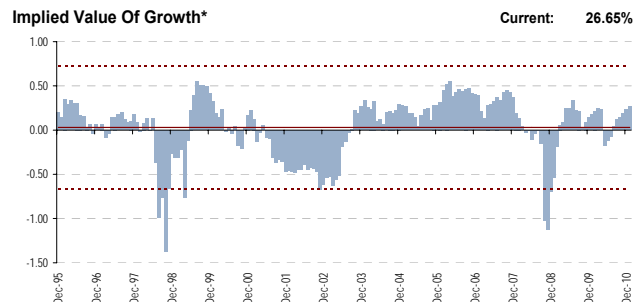
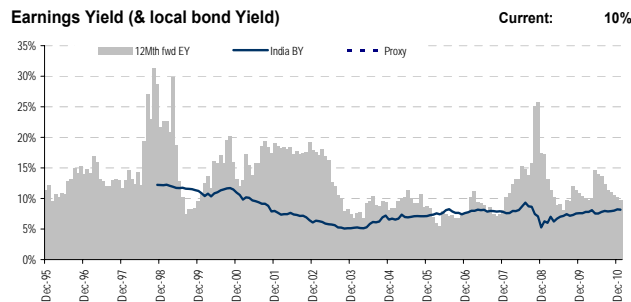
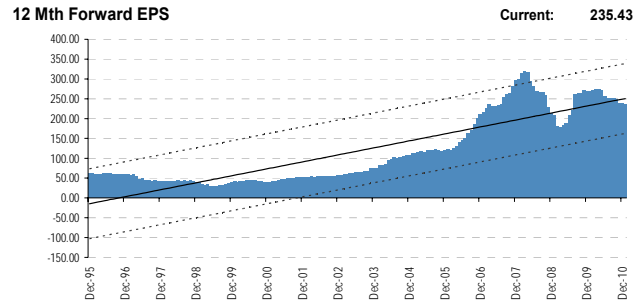
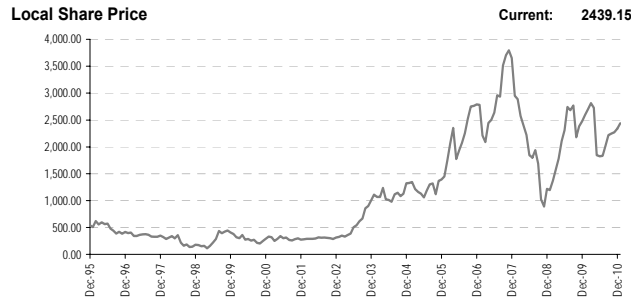
Figure 2: Grasim EV/EBITDA band chart



Source: Company reports, Bloomberg and J.P. Morgan estimates.

JPM Q-Profile
Grasim Industries Ltd. (INDIA / Materials)
 As Of: 21-Jan-2011

Global Equity Quantitative Analysis
 Quant_Strategy@jpmorgan.com



Summary

Grasim Industries Ltd.		SEDOL		6099927		As Of:		21-Jan-11			
INDIA						Local Price:		2,439.15			
Materials						EPS:		235.43			
	Latest	Min	Max	Median	Average	2 S.D. +	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	10.36x	3.18	17.99	8.28	8.73	14.66	2.80	-69%	74%	-20%	-16%
P/BV (Trailing)	1.67x	0.31	5.30	1.56	2.03	4.67	-0.62	-81%	217%	-7%	21%
Dividend Yield (Trailing)	1.28	0.79	6.02	1.64	2.07	4.16	-0.01	-38%	370%	28%	62%
ROE (Trailing)	15.93	8.58	52.23	23.32	23.01	47.17	-1.15	-46%	228%	46%	44%
Implied Value of Growth	26.6%	-1.37	0.55	0.13	0.03	0.72	-0.67	-614%	107%	-52%	-89%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, J.P. Morgan Calcs

* Implied Value Of Growth = (1 - EY/Cost of equity) where cost of equity = Bond Yield + 5.0% (ERP)

Grasim Industries Ltd: Summary of Financials

Income Statement					Cash flow statement				
Rs in millions, year end Mar	FY10	FY11E	FY12E	FY13E	Rs in millions, year end Mar	FY10	FY11E	FY12E	FY13E
Revenues	195,214	197,643	205,730	222,280	Net Income (Pre exceptionals)	27,351	21,090	21,026	25,636
% change YY	13.6%	1.2%	4.1%	8.0%	Depr. & amortization	4,039	5,101	3,973	1,958
EBITDA	57,621	49,190	48,929	56,206	Change in working capital	3,271	-7,140	-465	-1,736
% change YY	37.1%	-14.6%	-0.5%	14.9%	Cash flow from operations	47,236	31,509	39,584	43,054
EBITDA Margin	29.5%	24.9%	23.8%	25.3%	Net Capex	-12,861	-19,439	-8,400	-31,400
EBIT	53,581	44,089	44,955	54,248	Free cash flow	34,375	12,070	31,184	11,654
% change YY	38.2%	NM	2.0%	20.7%	Equity raised/(repaid)	-21,806	-8,691	-17,304	-12,149
EBIT Margin	27.4%	22.3%	21.9%	24.4%	Debt raised/(repaid)	-3,169	-8,492	-2,000	0
Net Interest	-3,250	-3,750	-3,585	-3,308	Other	24,923	15,051	7,996	9,937
Earnings before tax	50,332	40,339	41,370	50,940	Dividends paid	-3,090	-2,613	-2,613	-2,613
% change YY	39.5%	-19.9%	2.6%	23.1%	Beginning cash	2,270	2,370	22,333	39,596
Tax	15,890	12,591	13,094	16,108	Ending cash	2,370	22,333	39,596	46,425
as % of EBT	31.6%	31.2%	31.7%	31.6%	DPS	30.00	25.00	25.00	25.00
Net Income (Pre exceptionals)	27,351	21,090	21,026	25,636					
Minority interest	-7,090	-6,658	-7,250	-9,196					
PAT (Post minority interest)	27,351	21,090	21,026	25,636					
EPS-consolidated	298.34	230.04	229.34	279.62					
% change YY	25.1%	(22.9%)	(0.3%)	21.9%					

Balance sheet					Ratio Analysis				
Rs in millions, year end Mar	FY10	FY11E	FY12E	FY13E	Rs in millions, year end Mar	FY10	FY11E	FY12E	FY13E
Inventories	21,835	22,472	23,402	25,352	EBITDA margin	29.5%	24.9%	23.8%	25.3%
Debtors	8,803	8,631	8,965	9,573	Operating margin	27.4%	22.3%	21.9%	24.4%
Cash and cash equivalents	2,370	22,333	39,596	46,425	Net margin	14.0%	10.7%	10.2%	11.5%
Loans and advances	12,371	11,800	11,000	11,000	Sales growth	13.6%	1.2%	4.1%	8.0%
Total CA	45,379	65,235	82,964	92,350	EPS growth	25.1%	(22.9%)	(0.3%)	21.9%
LT investments	66,759	54,120	54,120	54,120	Interest coverage (x)	17.73	13.12	13.65	16.99
Net fixed assets	212,286	208,185	204,811	226,254	Net debt to total capital	5.8%	-8.1%	3.1%	-0.4%
Goodwill	20,071	16,824	16,824	16,824	Net debt to equity	8.3%	-10.6%	3.9%	-0.5%
Total Assets	277,735	290,244	304,599	335,428	Sales/assets	0.75	0.70	0.69	0.69
Liabilities					Assets/equity	1.72	1.55	2.03	1.97
Provisions	-	-	-	-	ROE	22.7%	15.8%	14.4%	16.0%
Other current liabilities	8,522	14,644	14,644	15,466	ROCE	30.1%	23.8%	23.4%	26.4%
Total current liabilities	38,891	31,644	31,644	32,466					
Total debt	55,992	47,500	45,500	45,500					
Other liabilities	20,057	18,679	18,679	18,679					
Total Liabilities	114,941	97,823	95,823	96,645					
Shareholders' equity	125,246	141,690	150,049	170,119					

Source: Company reports and J.P. Morgan estimates.

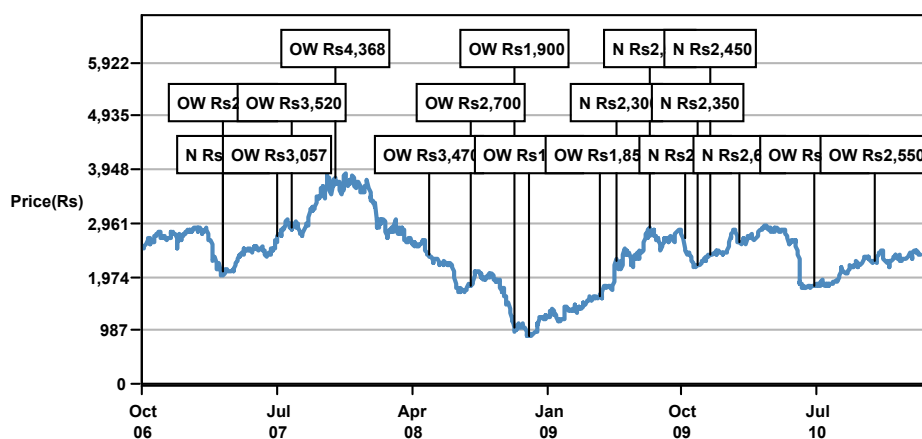
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- **Client of the Firm:** Grasim Industries Ltd is or was in the past 12 months a client of JPM.

Grasim Industries Ltd (GRAS.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
13-Mar-07	N	2053.90	2800.00
14-Mar-07	OW	2053.90	2800.00
04-Jul-07	OW	2739.30	3057.00
30-Jul-07	OW	2861.60	3520.00
28-Oct-07	OW	3805.70	4368.00
04-May-08	OW	2380.45	3470.00
27-Jul-08	OW	1816.15	2700.00
24-Oct-08	OW	1033.70	1900.00
25-Nov-08	OW	898.90	1350.00
16-Apr-09	OW	1610.30	1850.00
20-May-09	N	2253.35	2300.00
28-Jul-09	N	2884.70	2550.00
05-Oct-09	N	2691.65	2300.00
01-Nov-09	N	2178.75	2350.00
26-Nov-09	N	2360.50	2450.00
23-Jan-10	N	2623.15	2640.00
25-Jun-10	OW	1798.65	2250.00
28-Oct-10	OW	2255.10	2550.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Break in coverage Mar 03, 2004 - May 09, 2005. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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	Overweight (buy)	Neutral (hold)	Underweight (sell)
J.P. Morgan Global Equity Research Coverage	46%	42%	12%
IB clients*	53%	50%	38%
JPMS Equity Research Coverage	43%	49%	8%
IB clients*	71%	63%	59%

*Percentage of investment banking clients in each rating category.

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