



INDIA

Grasim Industries Limited

1 December 2006

GRASIM IN Outperform

Stock price as of 30 Nov 06	Rs	2,788.00
12-month target	Rs	3,215.00
Upside/downside	%	+15.3
Valuation	Rs	3,215.00
- DCF (WACC 11.3%)		

GICS sector		materials
Market cap	Rs m	255,587
30-day avg turnover	Rs m	112.1
Market cap	US\$m	5,737
Number shares on issue	m	91.67

Investment fundamentals

Year end 31 Mar		2006A	2007E	2008E	2009E
Total revenue	bn	99.2	125.0	143.6	155.7
EBITDA	bn	19.4	37.9	49.7	50.5
EBITDA growth	%	-0.3	95.3	31.1	1.6
Reported profit	bn	9.8	18.0	23.6	23.6
EPS rep	Rs	107.31	196.14	257.53	257.16
EPS rep growth	%	10.9	82.8	31.3	-0.1
PE rep	x	26.0	14.2	10.8	10.8
Total DPS	Rs	18.00	20.00	22.00	22.00
Total div yield	%	0.6	0.7	0.8	0.8
ROA	%	13.4	24.9	28.1	23.8
ROE	%	25.5	31.5	31.2	24.3
Net debt/equity	%	57.7	41.6	29.6	22.7
Price/book	x	5.2	3.9	3.0	2.4

GRASIM IN rel SENSEX performance, & rec history



Source: Datastream, Macquarie Research, November 2006 (all figures in INR unless noted)

Analysts

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Cement leader in the making

Event

- **We raise our target price to Rs3215, upside of 15%:** As a consequence of our increase in the cement price forecast, we upgrade the earnings estimate for FY3/07E, FY3/08E and FY3/09E by 20%, 31% and 14%, respectively.

Impact

- **Strong earnings outlook:** We estimate EPS to grow by 83% and 31% in FY3/07E and FY3/08E driven by both core businesses (cement and VSF) doing exceedingly well. EBITDA margins are likely to see a 500bp expansion to 35% in FY08.
- **Cement division to dominate:** The cement division has increased its contribution to profit from 39% in FY3/05 to roughly 70% in FY3/07E. With proposed plans to increase capacity by 10m tonnes to 23m tonnes in the next three years, we see Grasim emerging as the undisputed leader in the cement business in India.
- **VSF the surprise package:** Strong demand, due to the unleashing of textile business in India post the WTO quota dismantling and the increase in prices of competing fibres, has led to an unprecedented bull run. Grasim, with 98% market share of the country's VSF market, is set to reap the benefits of the proposed expansion by 22% by 2008.
- **Sponge Iron will continue to lag:** Profitability in this division has gone down to the breakeven point, hurt by rising iron ore prices and unavailability of gas. Grasim has prudently reduced production to economic levels, but we see no respite for this division over the next two–three years.

Earnings revision

- Our EPS estimates are revised upwards by 20% for FY07E, 31% for FY08E and 14% for FY09E to Rs196, Rs257 and Rs257, respectively.

Price catalyst

- 12-month price target: Rs3,215.00 based on a DCF methodology.
- Catalyst: Sharp increase in cement and VSF prices.

Action and recommendation

- We maintain our Outperform rating on the stock, while upgrading the target price to Rs3,215 (from Rs2,955 previously) based on DCF. At our target price, Grasim would trade at 6x EV/EBITDA, 12.5x PER, and US\$164 on real EV/T on FY3/08E estimates.
- Grasim is our top pick in the sector, and we believe it has rightly moved fast to announce huge capacity expansions, taking a lead over Holcim, its nearest competitor. Holcim, which recently acquired both ACC (ACC IN, Rs1,130, N, TP: Rs1,230) and Gujarat Ambuja (GAMB IN, Rs143.75, OP, TP: Rs168), is in the process of consolidating and is not in a position to respond to the challenge.

Upgrading our earnings estimates

We have incorporated the increased cement price forecast.

We have also increased our estimate of VSF sales realisation to Rs91 per kg for FY3/07E, from our earlier estimate of Rs81 per kg. We have revised upward FY3/08E and FY3/09E as well, to Rs96 and Rs 91 per kg, respectively, from our earlier Rs85 and Rs88 per kg.

Fig 1 Grasim Industries - revised estimates

Rs m	Old estimates			New estimates		
	FY3/07E	FY3/08E	FY3/09E	FY3/07E	FY3/08E	FY3/09E
Revenue	117,721	132,780	148,212	124,962	143,626	155,686
EBITDA	32,942	39,900	44,886	37,905	49,698	50,489
Net Profit	14,977	18,030	20,596	17,984	23,613	23,579
EPS	163.3	196.6	224.6	196.1	257.5	257.2

Source: Macquarie Research, November 2006

Key operating assumptions

- Clinker production is expected to increase only with the commissioning of its 4m tonne brownfield expansion at Shambhupura in Rajasthan (North India) by FY3/09.
- The blending ratio is expected to show a gradual increase with the commissioning of its 1.3mnt grinding unit at Dadri (North India).
- The company will only witness a strong volume growth by FY3/10, when most of its expansions are likely to be completed.
- VSF volume growth is expected to be better this year, as the company has made additional reservoirs to avoid the usual 40-day shutdown seen during the summer. Also, with the completion of its 22% capacity expansion, production is expected to increase.
- We have assumed capacity utilisation of only 50% for sponge iron.
- Caustic soda production has also been scaled down in FY07 due to the breakdown of the captive power plant in that unit.

Fig 2 Grasim Industries - key operating assumptions

Cement (m tonnes)	FY3/05	FY3/06	FY3/07E	FY3/08E	FY3/09E
Cement capacity	13.6	13.6	14.5	15.0	19.0
Clinker production	10.6	11.3	11.7	12.0	12.7
Conversion factor	1.19	1.22	1.26	1.30	1.34
Cement production	12.8	14.2	15.1	16.0	17.4
Cement despatch	12.94	14.34	15.07	16.05	17.42
Cement capacity utilisation (%)	95%	105%	105%	108%	92%
Average realisation (Rs/t)	2,041	2,151	2,904	3,137	3,074
% Change YoY		5%	35%	8%	-2%
VSF (m tonnes)	FY3/05	FY3/06	FY3/07E	FY3/08E	FY3/09E
Capacity	253,675	257,325	270,850	310,850	310,850
Production	247,952	228,981	249,182	270,440	289,091
Despatch	226,674	242,399	249,182	270,440	289,091
Capacity utilisation	98%	89%	92%	87%	93%
Average realisation (Rs/t)	86,309	79,159	91,033	95,584	90,805
% Change YoY		-8%	15%	5%	-5%

Source: Macquarie Research, November 2006

Grasim Industries Limited (GRASIM IN, Outperform, Target price: Rs3,215.00)

Annual Results					Profit & Loss						
	2003A	2004A	2005A	2006A		2006A	2007E	2008E	2009E		
Revenue	m	46,062	52,132	89,103	99,200	Revenue	m	99,200	124,962	143,626	155,686
Gross Profit	m	13,269	15,743	25,914	25,067	Gross Profit	m	25,067	44,452	56,617	57,865
Cost of Goods Sold	m	32,793	36,390	63,189	74,133	Cost of Goods Sold	m	74,133	80,510	87,009	97,821
EBITDA	m	10,165	12,749	19,473	19,408	EBITDA	m	19,408	37,905	49,698	50,489
Depreciation	m	2,541	2,731	5,064	5,077	Depreciation	m	5,077	5,906	6,746	7,490
Amortisation of Goodwill	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0	Other Amortisation	m	0	0	0	0
EBIT	m	7,624	10,019	14,409	14,332	EBIT	m	14,332	31,999	42,953	42,999
Net Interest Income	m	-1,684	-1,539	-2,456	-1,870	Net Interest Income	m	-1,870	-2,006	-2,052	-2,026
Associates	m	0	0	0	0	Associates	m	0	0	0	0
Exceptionals	m	0	0	0	0	Exceptionals	m	0	0	0	0
Other Pre-Tax Income	m	-756	2,293	750	2,454	Other Pre-Tax Income	m	2,454	2,468	2,431	2,513
Pre-Tax Profit	m	5,183	10,773	12,703	14,916	Pre-Tax Profit	m	14,916	32,461	43,331	43,486
Tax Expense	m	-1,370	-2,980	-3,816	-3,951	Tax Expense	m	-3,951	-10,712	-14,299	-14,350
Net Profit	m	3,813	7,793	8,887	10,966	Net Profit	m	10,966	21,749	29,032	29,136
Minority Interests	m	0	0	14.49623	1125.922	Minority Interests	m	-1,126	-3,765	-5,419	-5,557
		0	0	0	0						
Reported Earnings	m	3,813	7,793	8,873	9,840	Reported Earnings	m	9,840	17,984	23,613	23,579
Adjusted Earnings	m	3,413	7,793	8,873	9,840	Adjusted Earnings	m	9,840	17,984	23,613	23,579
						EPS (rep)		107.31	196.14	257.53	257.16
						EPS (adj)		107.31	196.14	257.53	257.16
						EPS Growth (adj)	%	10.9	82.8	31.3	-0.1
						PE (rep)	x	26.0	14.2	10.8	10.8
						PE (adj)	x	26.0	14.2	10.8	10.8
						Total DPS		18.00	20.00	22.00	22.00
						Total Div Yield	%	0.6	0.7	0.8	0.8
						Weighted Average Shares	m	92	92	92	92
						Period End Shares	m	92	92	92	92
Profit and Loss Ratios					Cashflow Analysis						
	2006A	2007E	2008E	2009E		2006A	2007E	2008E	2009E		
Revenue Growth	%	11.3	26.0	14.9	8.4	EBITDA	m	19,408	37,905	49,698	50,489
EBITDA Growth	%	-0.3	95.3	31.1	1.6	Tax Paid	m	-4,268	-10,063	-13,433	-13,481
EBIT Growth	%	-0.5	123.3	34.2	0.1	Chgs in Working Cap	m	1,445	-6,578	-1,403	766
Gross Profit Margin	%	25.3	35.6	39.4	37.2	Net Interest Paid	m	-1,870	-2,006	-2,052	-2,026
EBITDA Margin	%	19.6	30.3	34.6	32.4	Other	m	2,412	2,468	2,431	2,513
EBIT Margin	%	14.4	25.6	29.9	27.6	Operating Cashflow	m	17,128	21,726	35,241	38,261
Net Profit Margin	%	11.1	17.4	20.2	18.7	Acquisitions	m	0	0	0	0
Payout Ratio	%	16.8	10.2	8.5	8.6	Capex	m	-5,182	-14,436	-8,500	-26,400
EV/EBITDA	x	14.8	7.6	5.8	5.7	Asset Sales	m	0	0	0	0
EV/EBIT	x	20.1	9.0	6.7	6.7	Other	m	-4,873	6,995	-1,000	-1,000
						Investing Cashflow	m	-10,054	-7,441	-9,500	-27,400
Balance Sheet Ratios						Dividend (Ordinary)	m	-3,301	-3,668	-4,034	-4,401
ROE	%	25.5	31.5	31.2	24.3	Equity Raised	m	0	0	0	0
ROA	%	13.4	24.9	28.1	23.8	Debt Movements	m	-999	-670	-391	-250
ROIC	%	15.7	25.1	27.5	22.1	Other	m	0	0	0	0
Net Debt/Equity	%	57.7	41.6	29.6	22.7	Financing Cashflow	m	-4,300	-4,338	-4,425	-4,651
Interest Cover	x	7.7	15.9	20.9	21.2						
Price/Book	x	5.2	3.9	3.0	2.4	Net Chg in Cash/Debt	m	2,773	9,947	21,315	6,210
Book Value per Share		535.9	709.3	941.7	1,171.5						
					Balance Sheet						
	2006A	2007E	2008E	2009E		2006A	2007E	2008E	2009E		
						Cash	m	2,266	2,709	3,103	3,269
						Receivables	m	5,785	9,693	11,099	11,734
						Inventories	m	11,531	12,867	14,749	15,568
						Investments	m	15,300	16,185	30,076	50,472
						Fixed Assets	m	60,974	70,951	83,011	87,352
						Intangibles	m	0	0	0	0
						Other Assets	m	22,846	25,602	25,535	25,412
						Total Assets	m	118,701	138,006	167,573	193,807
						Payables	m	15,348	13,449	15,299	16,093
						Short Term Debt	m	0	0	0	0
						Long Term Debt	m	33,573	33,441	32,860	32,123
						Provisions	m	3,261	3,133	3,494	3,753
						Other Liabilities	m	12,243	13,473	14,334	15,110
						Total Liabilities	m	64,425	63,496	65,987	67,080
						Shareholders' Funds	m	49,140	65,034	86,347	107,417
						Minority Interests	m	5,136	8,900	14,319	19,876
						Other	m	0	0	0	0
						Total S/H Equity	m	54,276	73,934	100,666	127,294
						Total Liab & S/H Funds	m	118,701	137,430	166,653	194,373

All figures in INR unless noted.

Source: Macquarie Research, November 2006

Important disclosures:

<p>Recommendation definitions</p> <p>Macquarie Australia/New Zealand Outperform – return >5% in excess of benchmark return (>2.5% in excess for listed property trusts) Neutral – return within 5% of benchmark return (within 2.5% for listed property trusts) Underperform – return >5% below benchmark return (>2.5% below for listed property trusts)</p> <p>Macquarie Asia Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Recommendations – 12 months</p> <p>Note: Quant recommendations may differ from Fundamental Analyst recommendations</p> <p>Recommendation proportions</p> <p>Macquarie Australia/New Zealand</p> <table border="0"> <tr><td>Outperform</td><td>42.81%</td></tr> <tr><td>Neutral</td><td>44.60%</td></tr> <tr><td>Underperform</td><td>12.59%</td></tr> </table> <p>Macquarie Asia</p> <table border="0"> <tr><td>Outperform</td><td>57.12%</td></tr> <tr><td>Neutral</td><td>26.36%</td></tr> <tr><td>Underperform</td><td>16.52%</td></tr> </table> <p>For quarter ending 30 September 2006</p>	Outperform	42.81%	Neutral	44.60%	Underperform	12.59%	Outperform	57.12%	Neutral	26.36%	Underperform	16.52%	<p>Volatility index definition*</p> <p>This is calculated from the volatility of historic price movements.</p> <p>Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p>High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p>Medium – stock should be expected to move up or down at least 30–40% in a year.</p> <p>Low–medium – stock should be expected to move up or down at least 25–30% in a year.</p> <p>Low – stock should be expected to move up or down at least 15–25% in a year.</p> <p>* Applicable to Australian/NZ stocks only</p>	<p>Financial definitions</p> <p>All "Adjusted" data items have had the following adjustments made: Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests</p> <p>EPS = adjusted net profit / efpowa* ROA = adjusted ebit / average total assets ROA Banks/Insurance = adjusted net profit / average total assets ROE = adjusted net profit / average shareholders funds Gross cashflow = adjusted net profit + depreciation *equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p>
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