

## Grasim Industries

Q4FY10/Target price change

21 May 2010

## Buy

Target Price: Rs3,023

CMP: Rs2,522\*

Upside: 19.8%

\*as on 20 May 2010

## VSF exults, but stingy on dividends

Grasim Industries' (Grasim) posted inline results on the back of robust performance by the VSF division and stable cement business. However, the proposed dividend of Rs30 per share (the same like last year) is disappointing given the modest capex requirement for the VSF business. Though we maintain our Buy rating, we have lowered our target price to Rs3,023 (earlier: Rs3,187) as we believe the market would now assign a higher holding company discount to the stock on account of the poor dividend payout.

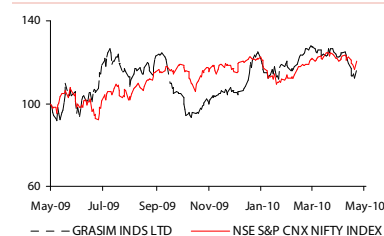
- **Inline results:** Standalone Q4 EBIDTA and PAT at Rs9.7bn and Rs6.3bn were 9% and 2% below our estimates, respectively. Net sales at Rs34.37bn came 1.5% above our estimate.
- **Robust VSF performance:** Buoyed by robust pricing environment and volume growth, VSF sales grew 64% YoY to Rs10.44bn (vs our estimate of Rs9.87bn) and EBIDTA grew 231% YoY to Rs3.63bn (vs our estimate of Rs3.95bn). The cement segment's sales and EBIDTA were inline at Rs22.96bn (estimate: Rs22.41bn) and Rs6.37bn (Rs6.43), respectively.
- **Dividend payout disappoints, target price lowered:** The proposed dividend of Rs30 per share (the same as last year) is disappointing given the modest capex requirement for the VSF business. We believe the market would assign a higher holding company discount to the stock on account of the poor dividend payout. We have lowered our target price to Rs3,023 (earlier: Rs3,187) based on holding company discount of 30% (vs 20% earlier) for Grasim's 60.3% stake in Ultratech Cements. However, we retain our Buy rating.

## Key Data

Bloomberg Code	GRASIM IN
Reuters Code	GRAS.BO
Current Shares O/S (mn)	91.7
Diluted Shares O/S(mn)	91.7
Mkt Cap (Rsbn/USDbn)	231.3/4.9
52 Wk H / L (Rs)	2,988/2,006
Daily Vol. (3M NSE Avg.)	26,321
Face Value (Rs)	10

USD = Rs47.0

## One year Indexed Stock Performance



## Price Performance (%)

	1M	6M	1Yr
Grasim	(10.7)	8.7	15.1
NIFTY	(6.6)	(3.0)	16.3

Source: Bloomberg, Centrum Research  
\*as on 20 May 2010

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Y/E March (Rsmn)	Q4FY10	Q4FY09	YoY (%)	Q3FY10	QoQ (%)	Q4FY10E	Variance (%)
Net sales	34,373	29,315	17.3	30,879	11.3	33,861	1.5
Operating Profit	9,702	7,245	33.9	10,219	(5.1)	10,665	(9.0)
OPM (%)	28.2	24.7	351bp	33.1	(487)bp	31.5	(327)bp
Depreciation and amortization	1,490	1,285		1,424		1,430	
Interest expense	590	385		504		504	
EBT	7,622	5,575		8,292		8,732	
Other income	658	293		528		450	
PBT	8,280	5,868	41.1	8,820	(6.1)	9,182	(9.8)
Provision for tax	2,250	2,053	9.6	2,861	(21.4)	3,030	(25.7)
- effective tax rate	27.2	35.0		32.4		33.0	(582)bp
PAT (reported)	6,030	3,815	58.0	5,959	1.2	6,152	(2.0)
NPM (%)	17.5	13.0	(452)bp	19.3	(175)bp	18.2	(62.5)bp
Adj EPS (Rs)	66	42		65		67	
Cash EPS (Rs)	82	56		81		83	(0.8)

Source: Company, Centrum Research

Y/E Mar (Rsbn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	Fully DEPS	RoE (%)	RoCE (%)	P/BV	P/E (x)	EV/EBITDA (x)
FY08	169.7	20.6	49.6	29.2	26.2	33.4	286.2	33.4	21.1	3.3	9.1	5.7
FY09	184.0	8.4	43.3	23.5	21.9	(16.7)	238.5	21.1	15.0	2.5	10.9	6.3
FY10E	199.3	8.3	57.9	29.0	27.6	26.2	301.0	22.9	16.4	2.2	8.4	4.6
FY11E	206.5	3.6	48.0	23.5	19.6	(29.0)	214.0	14.8	11.6	1.6	9.6	4.9
FY12E	214.2	3.7	47.0	21.9	18.7	(4.8)	203.0	12.7	10.1	1.4	10.1	5.1

Source: Company, Centrum Research Estimates

**Please refer to important disclosures/disclaimers in Appendix A**

## Q4 results inline

Grasim Industries posted inline Q4 result on back of robust VSF performance and stable cement business. Q4 net sales at Rs34.37bn came 1.5% above our estimate of Rs33.87bn, while EBITDA at Rs9.7bn was 9% below our estimate of Rs10.7bn and PAT Rs6.03bn (2% below our estimate of Rs6.16bn).

Even though the VSF division registered robust performance during the quarter led higher volume growth and increased realizations, standalone VSF profit was impacted by rising raw material costs. However, the overall impact of higher raw material costs was offset on account of Grasim's backward linkages through its investment in VSF JVs and subsidiaries which posted a higher profit at Rs312mn in Q4FY10 vs Rs42mn in Q4FY10.

The cement segment's performance was stable as volume growth cushioned the impact of marginally lower realization and cost push. Cement realizations declined (both on a YoY and QoQ basis) and volume growth has tapered to 10.6% YoY in Q4FY10 from 21% YoY during Q3. Since other cement players are already ramping up capacity, Grasim's cement business (Ultratech Cements) is expected to register lower-than-industry growth in FY11.

### Exhibit 1: Segmental performance

Segmental performance	Q4FY10	Q4FY09	YoY (%)	Q3FY10	QoQ (%)	Q4FY10E	Variance (%)
<b>Cement</b>							
Cement Sale (mn tons)	5.3	4.8	10.6	4.8	12.2	5.4	(1.5)
Realization (Rs/ton)	3,378	3,448	(2.0)	3,404	(0.8)	3,404	(0.8)
Net Sales (Rsmn)	22,965	20,511	12.0	20,302	13.1	22,419	2.4
EBIDTA (Rsmn)	6,369	6,375	(0.1)	6,052	5.2	6,435	(1.0)
EBIDTA/ton (Rs)	1,164	1,288	(9.6)	1,240	(6.2)	1,160	0.3
Margin (%)	27.7	31.1	(335)bp	29.8	(208)bp	28.7	(97)
<b>VSF</b>							
VSF Sale (Tons)	85,714	65,409	31.0	81,306	5.4	81,761	4.8
Realization (Rs/ton)	111,644	86,734	28.7	109,600	1.9	114,600	(2.6)
Net Sales (Rsmn)	10,447	6,341	64.8	9,624	8.6	9,870	5.9
EBIDTA (Rsmn)	3,632	1,097	231.0	4,023	(9.7)	3,948	(8.0)
EBIDTA/Ton	42,368	16,771	152.6	49,478	(14.4)	48,286	(12.3)
Margin (%)	34.8	17	1,746bp	41.8	(704)bp	40	(524)bp
<b>Sponge Iron</b>							
Sponge Iron Sale (Tons)		98,826	(100.0)				
Realization		15,382	(100.0)				
Net Sales (Rsmn)		157	(100.0)				
EBIDTA (Rsmn)		(18)	(100.0)				
EBIDTA/Ton		(1,800)	(100.0)				
Margin (%)		(11)					

Source: Company, Centrum Research

### Structural shift in outlook for cotton prices to support VSF segment

The lower acreage devoted towards cotton during 2009-10 and 2010-11 is expected to keep cotton prices buoyant on account of lower inventories (International Cotton Advisory Committee, May 2010 forecast). At the same time, the resolution of US cotton subsidy dispute in Brazil's favor with WTO awarding unprecedented retaliatory measures to Brazil could lead to US eventually phasing out cotton subsidies. We believe this would be structurally positive for long-term cotton/VSF prices.

**Exhibit 2: World cotton supply and demand forecast**

	2008/09		2009/10		2010/11	
	Million Tons	Change over forecast in April 10	Million Tons	Change over forecast in April 10	Million Tons	Change over forecast in April 10
Beginning Stocks	12.7	0.6	12.7	0.4	10.4	0.1
Production	23.4	0.0	22.1	0.0	24.8	0.1
Supply	36.1	0.6	34.8	0.4	35.2	0.2
Consumption	23.4	0.2	24.4	0.3	24.8	0.2
Exports	6.5	0.0	7.5	0.1	7.7	0.2
Ending Stocks	12.7	0.4	10.4	0.1	10.5	(0.1)

Source: ICAC

**Exhibit 3: ICAC Price Projections - Season-average Cotlook A Index (US cents per pound)**

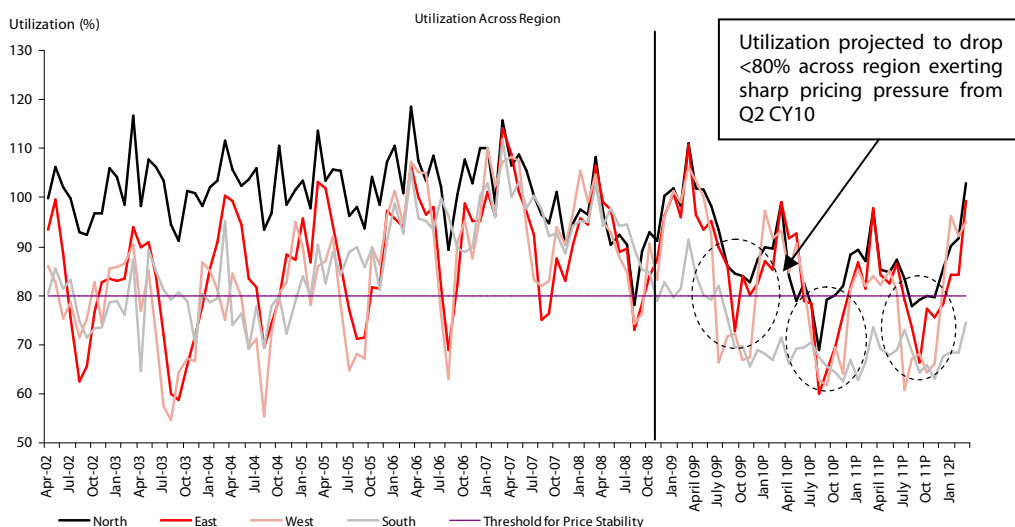
	Projection	Change over forecast in April 10
2009/10	77	Increase of 2
2010/11	85	Increase of 3

Source: ICAC

**Cement prices to remain challenging**

Being a pan-India player with 20% market share, Grasim’s overall realizations would remain relatively stable vs peers. However, given the oversupply scenario prevailing in the industry, pricing pressure may further accentuate in Q2FY10, after the recovery in Q4FY10. Grasim’s Cement subsidiary Ultratech Cements too would be hit on account of the worsening pricing scenario this year, as utilization levels drop below 80% levels across regions, including the northern zone during monsoon this year.

**Exhibit 4: Industry utilization projection points to sharp pricing pressure ahead**



Source: Centrum Research Estimate

## Dividend payout disappoints, lowering target price

The proposed dividend of Rs30 per share (the same like last year) is disappointing given the modest capex requirement for the VSF business. We believe the market would now assign a higher holding company discount to the stock on account of the poor dividend payout. We have lowered our target price to Rs3,023 (earlier: Rs3,187 earlier) based on holding company discount of 30% (vs 20% earlier) for Grasim's 60.3% stake in Ultratech Cements. However, we retain our Buy rating.

We arrive at a fair value of Rs3,023 on SOTP for Grasim. We have valued Grasim as a holding company of Ultratech, assigning a 30% holding company discount to 60.3% direct holding, Valuing at par with 19% share in Ultratech against Samruddhi shares issued to Grasim shareholders (Fair value of Ultratech is Rs830). We have valued the VSF business at a P/E of 12x FY11E, strategic investments at 0.7x market cap and liquid investments at 1x.

### Exhibit 5: Grasim's valuation

	Value Per Share (Rs)
Share in Ultratech (with 30% holding company discount)	1,049
Share in Ultratech as Samruddhi shareholder (minority)	474
Value of strategic investments (0.7x Mcap)	200
Value of liquid investments (1x)	310
Value of VSF business (12x FY11E)	990
<b>Value of Grasim's share post restructuring (Inc Samruddhi)</b>	<b>3,023</b>
<b>Value of Grasim's share post restructuring (Ex Samruddhi)</b>	<b>2,549</b>

Source: Centrum Research Estimates

At CMP of Rs2,522, Grasim remains the best play among the large-cap cement players. Our fair value of Rs3,023 translates into an upside of 19.8% from current levels. We retain our Buy rating on the stock.

## Appendix A

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