

Grasim Industries Ltd

Fairly Valued

Neutral

GRAS.BO, GRASIM IN

Price: Rs2,367.50

▲ **Price Target: Rs2,450.00**
Previous: Rs2,350.00

- Valuing as a holding company:** We forecast preliminary financials post the merger of Samruddhi (Grasim's cement business) with UltraTech. While Grasim on a consolidated basis is unlikely to see major changes (it would hold 60% in the newly combined UltraTech) in terms of consolidated financials, we value the company's holdings in the new UltraTech at a 20% holding company discount. We believe going forward while Grasim would have a significantly larger free float compared to subsidiary UltraTech (60% compared to 40% for UltraTech) and would remain a proxy for the largest cement business in India, the investment case for Grasim would likely be a function on VSF cash usage visibility and UltraTech's valuations. Post the de-merger of the cement business, the new stand-alone entity would have net cash to the tune of Rs15bn with the VSF business on a steady state should be able to generate Rs7-9bn of EBITDA per year.
- VSF- Strength to continue:** Combination of strong real demand for VSF, lower cotton production, and increase in pulp prices should continue to support strong VSF prices and subsequently margins for Grasim over the next two quarters at least. For FY11-12E we forecast VSF EBITDA margins at 32% and VSF EBITDA of Rs9.2bn and Rs9.3bn, respectively.
- Restructuring time lines:** The proposed scheme of merger would need court, shareholder and lender approvals with the appointed date for the merger of Samruddhi with UltraTech being July 1st, 2010. As per the company, the merger is likely to get done by Q3CY10E.
- Price target, valuation, key risks:** We revise Sept-10 target price to Rs2450 (based on SOTP) as we incorporate the revised holding structure of Grasim. We remain Neutral and key risks to our earnings estimates remain a larger than expected decline in cement prices, impacting UltraTech's financials, and VSF prices and volumes being lower than our estimates.

India

India Cement

Pinakin Parekh, CFA^{AC}

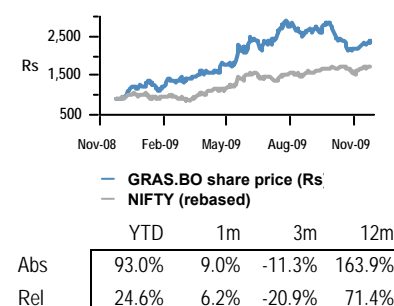
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Price Performance



Bloomberg: GRASIM IN; Reuters: GRASS.BO

Rs in millions, year-end March	FY08	FY09	FY10E	FY11E	
Net sales	157,238	171,871	182,621	184,410	52-wk range (Rs) 2940 - 872
Net profit (post minority)	24,473	21,853	27,182	18,945	Mkt cap. (Rs MM) 216,933
EPS (Rs)	267	238	296.4	206.6	Mkt cap. (US\$ MM) 4,694
Net sales growth (%)	17%	9%	6%	1%	Avg. daily volume (MM) 0.3
Net profit growth (%)	28%	-11%	24%	-30%	Average daily value (Rs MM) 637.5
ROE (%)	31%	21%	21%	14%	Average daily value (US\$ MM) 13.8
P/E (x)	8.9	9.9	8.0	11.5	Shares O/S (MM) 92
P/BV (x)	3.0	2.3	1.8	1.8	Index (BSE Sensex) 17,199
EV/EBITDA (x)	6.1	7.1	4.8	6.9	Date of price 25-Nov-09

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

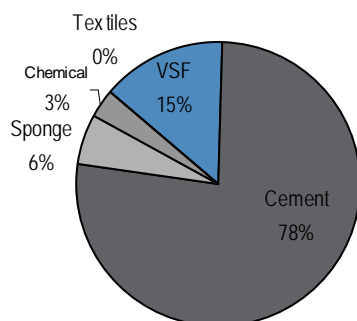
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Company description

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
FY10E	296.4	290.0
FY11E	206.6	252.9

Source: Bloomberg, J.P. Morgan estimates.

Table 1: Grasim—P&L sensitivity metrics

FY10E	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 price target for Grasim is based on a sum of the parts methodology by valuing the company's 60% holding at UltraTech (UTCEM valued at FY11E EV/tonne \$100/MT, 6.7x EV/EBITDA) at a 20% holding company discount and its VSF business at 5.0x FY11E EV/EBITDA. We remain Neutral and key risks to our earnings estimates remain a larger than expected decline in cement prices, impacting Ultratech's financials and VSF prices and volumes lower than our estimates.

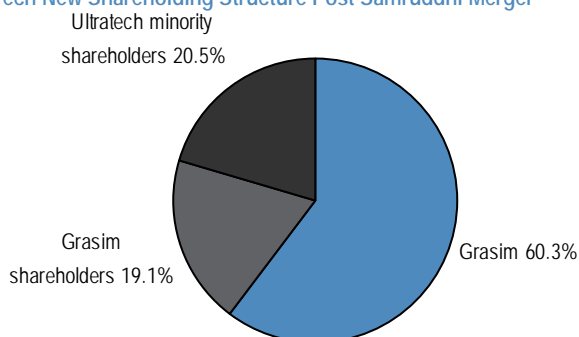
Now a holding company

Table 3: UltraTech and Samruddhi's Cement Business Overview

	UltraTech	Samruddhi	Combined
Grey Cement (MT)	23.1	25.7	48.8
Composite Plants	5	6	11
Grinding Units	6	5	11
White Cement (MT)	-	0.6	0.6
TPPs (MW)	236	268	504
RMC - No.	32 plants	36 plants	68 plants
RMC - Mn Cu M	4.99	6.76	11.76
Key Investments - Subsidiaries	Equity in Lanka	100% Equity in Harish Cement	Combined Investments
Market Share : Grey Cement	9%	10%	19%

Source: Company reports.

Figure 2: UltraTech New Shareholding Structure Post Samruddhi Merger



Source: Company reports.

Key Assumptions and estimate changes

Table 4: Grasim-Key Assumptions for VSF Segment

	FY10E	FY11E
Old Volumes	260,000	280,000
New Volumes	260,000	270,000
% Change	0%	-4%
Old EBITDA	7,554	8,020
New EBITDA	11,009	9,206
% Change	46%	15%
Old EBITDA Margins	27.5%	27.0%
New EBITDA Margins	37.0%	32.0%
% Change	35%	19%

Source: J.P. Morgan estimates.

Table 5: Grasim Consolidated Assumptions

	FY10E	FY11E
Old EBITDA	57,760	43,167
New EBITDA	56,251	44,653
% Change	-3%	3%
Old EPS	302.5	230.1
New EPS	296.4	206.6
% Change	-2%	-10%

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

Valuations and Key risks

Our revised price target for Grasim is based on a sum of the parts methodology by valuing the company's 60% holding at UltraTech (UTCEM valued at FY11E EV/tonne \$100/MT, 6.7x EV/EBITDA) at a 20% holding company discount and its VSF business at 5.0x FY11E EV/EBITDA. Key downside risks to our earnings estimates remain a larger than expected price declines in VSF and cement.

Table 6: SOTP valuation

	Multiple	Mcap Contribution (Rs bn)
VSF	5.0x of EBITDA	46
Chemicals	1.0x of Sales	5
	Grasim standalone EV	51
	Net debt	-20
	Grasim Standalone Mcap	71
Cement- 60% of UTCEM	20% Holding co discount on UTCEM value (\$100/MT capacity)	109
Cement-Grasim's shareholder's 19% stake	UTCEM value (\$100/MT capacity)	43
	Total Grasim Implied Mcap	223
	Per share value (Rs)	2450

Source: J.P. Morgan estimates.

Figure 3: Grasim—EV/EBITDA bands



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

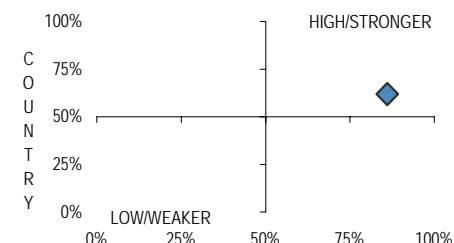
All Data As Of 25-Nov-09

Q-Snapshot: Grasim Industries Ltd.

Quant Return Drivers (a Score >50% indicates company ranks 'above average')

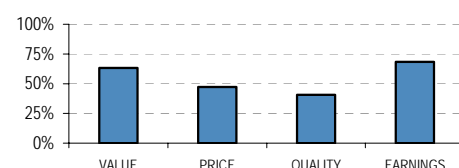
Score 0% (worst) to 100% (best)	vs Country	vs Industry	Raw Value
Value			
P/E Vs Market (12mth fwd EPS)	82%	89%	0.6x
P/E Vs Sector (12mth fwd EPS)	88%	92%	0.5x
EPS Growth (forecast)	6%	5%	-6.7%
Value Score	63%	77%	
Price Momentum			
12 Month Price Momentum	61%	61%	156.1%
1 Month Price Reversion	15%	25%	10.1%
Momentum Score	47%	54%	
Quality			
Return On Equity (forecast)	57%	79%	19.3%
Earnings Risk (Variation in Consensus)	28%	49%	0.16
Quality Score	41%	73%	
Earnings & Sentiment			
Earnings Momentum 3mth (risk adjusted)	59%	54%	47.7
1 Mth Change in Avg Recom.	84%	93%	0.38
Net Revisions FY2 EPS	63%	68%	29%
Earnings & Sentiment Score	69%	83%	
COMPOSITE Q-SCORE* (0% To 100%)	62%	86%	

J.P. Morgan Composite Q-Score

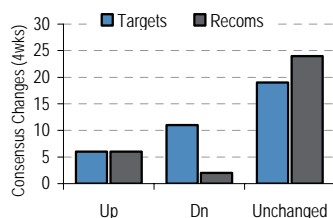


INDUSTRY

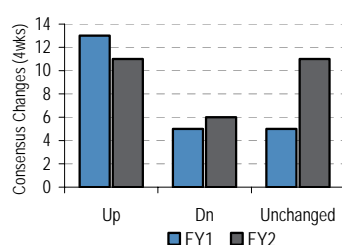
Quant Return Drivers Summary (vs Country)



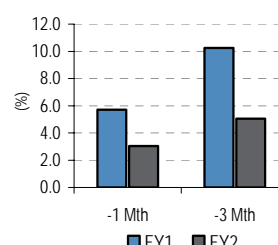
Targets & Recommendations**



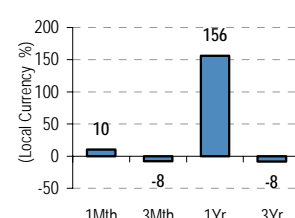
EPS Revisions**



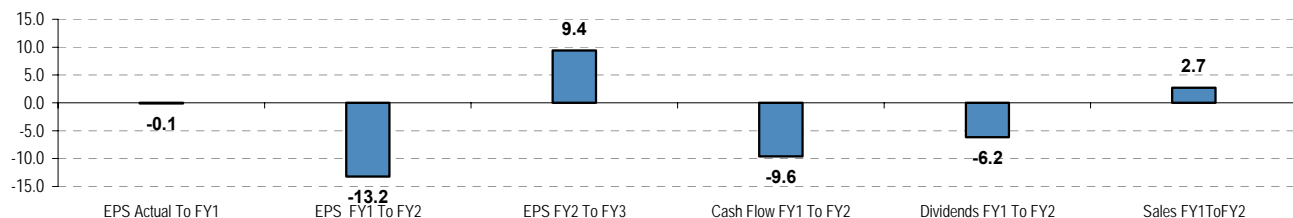
EPS Momentum (%)



Historical Total Return (%)



Consensus Growth Outlook (%)



Closest in Country by Size (Consensus. ADV = average daily value traded in US\$m over the last 3 mths)

Code	Name	Industry	USD MCAP	ADV	PE FY1	Q-Score*
500390-IN	Reliance Infrastructure Ltd.	Electric Utilities	5,288	53.05	18.2	29%
532281-IN	HCL Technologies Ltd.	Information Technology Services	4,950	9.56	18.7	56%
500440-IN	Hindalco Industries Ltd.	Aluminum	4,881	27.52	15.0	63%
532659-IN	Infrastructure Development Finance Co. Ltd.	Finance/Rental/Leasing	4,801	28.59	21.8	69%
532921-IN	Mundra Port & Special Economic Zone Ltd.	Other Transportation	4,729	4.03	34.1	31%
500300-IN	Grasim Industries Ltd.	Construction Materials	4,657	11.12	8.0	62%
532977-IN	Bajaj Auto Ltd.	Motor Vehicles	4,628	6.59	15.1	96%
500111-IN	Reliance Capital Ltd.	Finance/Rental/Leasing	4,619	73.78	25.5	2%
532149-IN	Bank of India	Regional Banks	4,421	13.25	8.3	44%
512599-IN	Adani Enterprises Ltd.	Wholesale Distributors	4,406	2.34	18.4	33%
533096-IN	Adani Power Ltd.	Electric Utilities	4,406	12.06	163.5	

Source: Factset, Thomson and J.P. Morgan Quantitative Research. For an explanation of the Q-Snapshot, please visit <http://jpmorgan.hk.acrobat.com/qsnapshot/>. Q-Snapshots are a product of J.P. Morgan's Global Quantitative Analysis team and provide quantitative metrics summarized in an overall company 'Q-Score'.

Q-Snapshots are based on consensus data and should not be considered as having a direct relationship with the J.P. Morgan analysts' recommendation.

* The Composite Q-Score is calculated by weighting and combining the 10 Quant return drivers shown. The higher the Q-Score the higher the one month expected return. On a 14 Year back-test the stocks with the highest Q-Scores have been shown (on average) to significantly outperform those stocks with the lowest Q-Scores in this universe. ** The number of up, down and unchanged target prices, recommendations or EPS forecasts that make up consensus.

Grasim Industries Ltd: Summary of financials

Rs in millions, year-end March

Profit and loss statement					Cash flow statement				
	FY08	FY09	FY10E	FY11E		FY08	FY09	FY10E	FY11E
Revenues	157,243	171,871	182,621	184,410	Net income (pre-exceptional)	26,339	26,250	32,033	26,214
% change Y/Y	17%	9%	6%	1%	Depreciation & amortization	8,117	7,800	9,685	10,067
EBITDA	47,667	42,029	56,251	44,653	Change in working capital	-11,315	-4,490	-7,778	7,537
% change Y/Y	27%	-12%	34%	-21%	Cash flow from operations	23,141	29,560	33,941	43,818
EBITDA margin (%)	30%	24%	31%	24%	Net capex	-21,291	-20,766	-11,040	-7,270
EBIT	46,539	38,770	50,566	41,786	Free cash flow	1,850	8,794	22,901	36,548
% change Y/Y	31%	-17%	30%	-17%	Equity raised/ (repaid)	-1,768	1,177	-4,571	-28,024
EBIT margin (%)	30%	23%	28%	23%	Debt raised/ (repaid)	-771	3,391	-14,162	2,400
Net interest	1,827	2,677	3,675	3,602	Other	7,822	8,189	10,333	38,067
Earnings before tax	44,712	36,093	46,891	38,184	Dividends paid	-2,927	-3,164	-2,614	-2,091
% change Y/Y	33%	-19%	30%	-19%	Beginning cash	2,903	2,903	2,270	36,565
Tax	14,617	9,843	14,858	11,970	Ending cash	9,896	2,270	36,565	66,865
as % of EBT	33%	27%	32%	31%	DPS	28	30	25	20
Net income (pre-exceptional)	30,095	26,250	32,033	26,214					
Minority interest	4,595	4,397	4,851	7,269					
PAT (post minority interest)	24,473	21,853	27,182	18,945					
EPS-consolidated	267	238	296	207					
% change Y/Y	28%	-11%	24%	-30%					
Balance sheet					Ratio analysis				
	FY08	FY09	FY10E	FY11E	%	FY08	FY09	FY10E	FY11E
Inventories	17,450	22,220	22,323	21,958	EBITDA margin	26%	24%	31%	24%
Debtors	10,185	8,239	9,666	7,741	Operating margin	26%	24%	31%	24%
Cash and bank balances	2,903	2,270	36,565	66,865	Net profit margin	15%	15%	18%	14%
Loans and advances	12,047	12,615	13,300	13,300					
Total CA	42,585	45,343	81,853	109,864	Sales growth	9%	9%	6%	1%
LT investments	16,607	35,626	13,220	29,820	EPS growth	-9%	-11%	24%	-30%
Net fixed assets	129,223	142,190	143,545	140,748					
Goodwill	19,913	20,010	16,824	16,824	Interest coverage (x)	14.0	15.7	15.3	12.4
Total assets	208,327	243,169	255,441	297,255	Net debt to total capital	20%	23%	3%	-7%
Liabilities					Net debt to equity	35%	43%	5%	-10%
Provisions	0	0	622	1,370	Sales/assets	75%	71%	71%	62%
Other current liabilities	36,783	35,685	29,500	34,000	Assets/equity	200%	210%	182%	218%
Total current liabilities	36,783	35,685	30,122	35,370	ROE	22%	21%	21%	14%
Total debt	55,771	59,162	45,000	47,400	ROCE	21%	20%	23%	17%
Other liabilities	24,336	32,622	39,770	77,836					
Total liabilities	116,889	127,469	114,892	160,606					
Shareholders' equity	91,438	115,701	140,549	136,649					

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

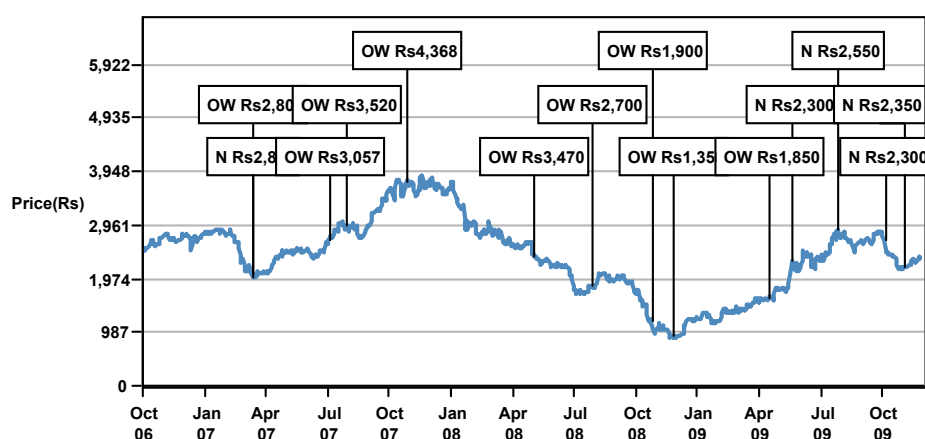
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Grasim Industries Ltd (GRAS.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
13-Mar-07	N	2014.25	2800.00
14-Mar-07	OW	2053.90	2800.00
04-Jul-07	OW	2702.55	3057.00
30-Jul-07	OW	2946.85	3520.00
28-Oct-07	OW	3772.60	4368.00
04-May-08	OW	2368.60	3470.00
27-Jul-08	OW	1842.95	2700.00
24-Oct-08	OW	1182.00	1900.00
25-Nov-08	OW	908.40	1350.00
16-Apr-09	OW	1622.75	1850.00
20-May-09	N	2289.40	2300.00
28-Jul-09	N	2888.05	2550.00
05-Oct-09	N	2691.65	2300.00
01-Nov-09	N	2184.10	2350.00

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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IB clients*	56%	57%	42%
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IB clients*	76%	72%	56%

*Percentage of investment banking clients in each rating category.

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