

Visit highlights: stable business & confident management

Stable business & inexpensive valuations; maintain Neutral

Our recent meeting with Grasim's top management points to healthy profit outlook. Also, the Co believes that the worst phase for the macro-environment is behind us. We expect strong profits in 3Q-4Q FY12 & thereafter foresee lower downside risk for Grasim vs pure cement majors. Maintain Neutral on relatively better earnings & steep valuation discount of ~40-60% vs pure plays

VSF demand & margins intact despite global pressures

Grasim said the slowdown in global textile demand has not impacted their VSF offtake so far. Also, local VSF prices have been stable as rupee depreciation has offset pressure from falling VSF prices in China. Grasim imports 45-50% of its pulp (input) requirements but the impact of rupee depreciation is unlikely to be material due to falling global pulp prices (down ~10% vs 2Q). Our forecasts factor modest (~100bps) margin slippage in FY13 due to pot'l pressure on VSF prices

Cement outlook to improve over next 2 years

Grasim sees some signs of recovery in cement demand across most regions, except Andhra Pradesh. The Co expects pricing power to improve over the next 24-30 months. We think cement prices & EBITDA per ton have already risen sharply recently in 3Q FY12 and the best-case outlook for FY13 profits is flattish YoY as there is downside risk to cement prices, especially in south India.

No capex slowdown; mgt. confident about LT prospects

In contrast with macro-concerns, Grasim said there is no slowdown in its investment plans and the Co remains on track for ~50% capacity expansion in VSF and ~20% expansion in cement by FY14. The Co is also investing in logistics infrastructure & waste-recovery systems.

Estimates (Mar)

(Rs)	2010A	2011A	2012E	2013E	2014E
Net Income (Adjusted - mn)	27,595	22,648	27,083	23,277	27,647
EPS	300.96	247.01	295.38	253.86	301.53
EPS Change (YoY)	26.2%	-17.9%	19.6%	-14.1%	18.8%
Dividend / Share	30.00	20.00	20.00	20.00	20.00
Free Cash Flow / Share	370.02	91.02	116.13	63.97	173.00
GDR EPS (US\$)	6.34	5.42	5.68	4.89	5.80
GDR Dividend / Share (US\$)	0.632	0.439	0.385	0.385	0.385

Valuation (Mar)

	2010A	2011A	2012E	2013E	2014E
P/E	7.69x	9.37x	7.84x	9.12x	7.68x
Dividend Yield	1.30%	0.864%	0.864%	0.864%	0.864%
EV / EBITDA*	4.98x	6.15x	5.29x	6.15x	5.22x
Free Cash Flow Yield*	15.98%	3.93%	5.02%	2.76%	7.47%

* For full definitions of *iQmethod*SM measures, see page 7.

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Refer to important disclosures on page 8 to 11. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5. Link to Definitions on page 5. 11114426

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Stock Data

Price (Common / GDR)	Rs2,315 / US\$44.52
Price Objective	Rs2,360 / US\$47.70
Date Established	1-Aug-2011 / 24-Oct-2011
Investment Opinion	C-2-7 / C-2-7
Volatility Risk	HIGH / HIGH
52-Week Range	Rs1,981-Rs2,626
Market Value (mn)	US\$4,086
Market Value (mn)	Rs212,293
Shares Outstanding (mn)	91.7 / 91.7
Average Daily Volume	64,718
BofAML Ticker / Exchange	GRSJF / BSE
BofAML Ticker / Exchange	GRSJV / LUX
Bloomberg / Reuters	GRASIM IN / GRAS.BO
ROE (2012E)	17.1%
Net Dbt to Eqty (Mar-2011A)	5.0%
Est. 5-Yr EPS / DPS Growth	8.7% / 0%
Free Float	63.5%

iQprofileSM Grasim Industries

Key Income Statement Data (Mar)	2010A	2011A	2012E	2013E	2014E
(Rs Millions)					
Sales	199,334	212,690	233,616	243,679	280,337
Gross Profit	57,867	46,832	54,464	46,847	55,182
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	47,920	35,449	43,353	35,141	42,059
Net Interest & Other Income	2,010	3,079	5,177	4,525	4,999
Associates	NA	NA	NA	NA	NA
Pretax Income	49,930	38,528	48,529	39,665	47,058
Tax (expense) / Benefit	(15,705)	(9,576)	(13,601)	(10,995)	(13,031)
Net Income (Adjusted)	27,595	22,648	27,083	23,277	27,647
Average Fully Diluted Shares Outstanding	92	92	92	92	92

Key Cash Flow Statement Data

Net Income	27,595	22,648	27,083	23,277	27,647
Depreciation & Amortization	9,947	11,384	11,111	11,706	13,123
Change in Working Capital	3,040	(8,311)	2,468	1,284	(1,332)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	6,630	6,376	8,923	6,702	7,912
Cash Flow from Operations	47,212	32,096	49,586	42,969	47,351
Capital Expenditure	(13,285)	(23,751)	(38,938)	(37,103)	(31,488)
(Acquisition) / Disposal of Investments	1,693	(16,546)	(2,750)	0	0
Other Cash Inflow / (Outflow)	3,577	(965)	0	0	0
Cash Flow from Investing	(8,015)	(41,262)	(41,688)	(37,103)	(31,488)
Shares Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(3,151)	(2,196)	(2,196)	(2,196)	(2,196)
Cash Flow from Financing	(6,089)	9,639	3,815	1,313	(2,196)
Free Cash Flow	33,927	8,345	10,648	5,866	15,862
Net Debt	(1,842)	9,519	3,817	147	(13,519)
Change in Net Debt	(36,045)	11,361	(5,702)	(3,670)	(13,667)

Key Balance Sheet Data

Property, Plant & Equipment	145,527	157,894	185,721	211,119	229,484
Other Non-Current Assets	31,365	47,911	50,661	50,661	50,661
Trade Receivables	8,803	14,346	15,758	14,737	16,770
Cash & Equivalents	57,834	58,308	70,021	77,200	90,866
Other Current Assets	34,206	41,607	43,648	45,560	52,165
Total Assets	277,735	320,066	365,809	399,276	439,947
Long-Term Debt	49,905	63,234	69,299	72,808	72,808
Other Non-Current Liabilities	20,057	19,616	19,616	19,616	19,616
Short-Term Debt	6,087	4,593	4,539	4,539	4,539
Other Current Liabilities	38,891	43,524	49,444	51,619	58,926
Total Liabilities	114,941	130,967	142,898	148,582	155,889
Total Equity	162,795	189,100	222,911	250,694	284,058
Total Equity & Liabilities	277,736	320,066	365,809	399,276	439,947

iQmethodSM - Bus Performance*

Return On Capital Employed	15.7%	11.8%	12.0%	8.9%	9.5%
Return On Equity	22.9%	16.7%	17.1%	12.9%	13.5%
Operating Margin	24.0%	16.7%	18.6%	14.4%	15.0%
EBITDA Margin	29.0%	22.0%	23.3%	19.2%	19.7%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.7x	1.4x	1.8x	1.8x	1.7x
Asset Replacement Ratio	1.3x	2.1x	3.5x	3.2x	2.4x
Tax Rate (Reported)	31.5%	24.9%	28.0%	27.7%	27.7%
Net Debt-to-Equity Ratio	-1.1%	5.0%	1.7%	0.1%	-4.8%
Interest Cover	7.3x	3.9x	4.8x	3.9x	4.6x

Key Metrics

* For full definitions of iQmethodSM measures, see page 7.

Company Description

Grasim Industries is a flagship company of the AV Birla Group. It is a monopoly producer of viscose staple fiber (VSF) in India. Grasim also owns 60% stake in Ultratech, which is India's largest cement producer with a total capacity of around 52mn tpa.

Investment Thesis

We rate Grasim as a Neutral primarily due to inexpensive valuations that imply a steep discount both versus pure cement plays in India and relative to international fiber majors like Lenzing. However upside triggers are missing as the business outlook for both viscose staple fiber (VSF) and cement seems unexciting over next 6-12 months.

Stock Data

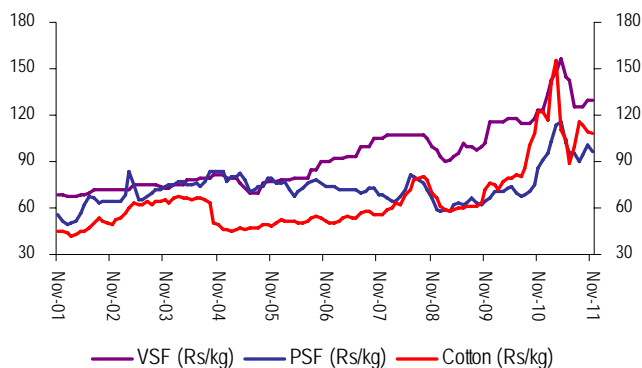
Shares / GDR	1.00
Price to Book Value	1.2x

Table 1: Sum-of-the-parts valuation for Grasim

Key value drivers	FY13E benchmark	Share price (Rs)
Ultratech/Cement	-US\$95per ton	1416
Embedded value of Idea Cellular	@ Rs100/sh of Idea	187
Embedded value of ABNL	@ Rs1090/sh of ABNL	40
Embedded value of Hindalco	@ Rs141/sh of Hindalco	84
Embedded value of L&T	@ Rs1660/sh of L&T	70
Total equity value of holdings including cement		1796
<i>less</i> Holdco discount	20%	359
Net equity value of holdings		1436
Equity value of Grasim standalone/VSF business	7.5x PE	1020
<i>less</i> conglomerate discount 10%	10%	96
Target share price of Grasim		2360

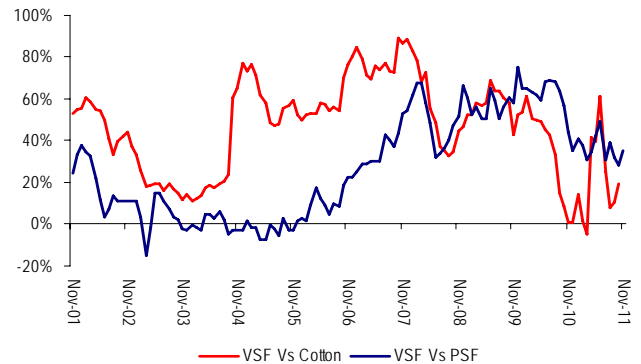
Source: BofA Merrill Lynch Global Research estimates

Chart 1: Trend in VSF, PSF & Cotton prices



Source: Crisinfac, Industry sources

Chart 2: Premium of VSF prices versus Cotton & PSF



Source: Crisinfac, Industry sources

Table 2: Supply-demand outlook for the Indian cement industry

As on 31 March (mn tpa)	FY09	FY10	FY11	FY12E	FY13E
Reported cement capacity	216	256	300	330	353
Effective cement capacity	202	234	274	310	330
Capacity growth	20%	18%	20%	15%	7%
Cement demand	181	200	209	217	237
Demand growth	8.0%	10.3%	4.7%	4.0%	9.0%
Domestic consumption	178	197	207	215	235
Growth in domestic consumption	8%	11%	5%	4%	9%
Cement exports	3.2	2.2	2.0	2.0	2.0
Export growth	-12%	-31%	-9%	0%	0%
Cement - capacity utilization	90%	85%	76%	70%	72%
Cement/clinker ratio	1.37	1.36	1.37	1.37	1.37
Blended cement as % of total production	75%	75%	75%	75%	75%
Clinker - capacity utilisation (incl. exports)	81%	76%	66%	59%	61%
Clinker - capacity utilisation (excl. exports)	79%	74%	65%	59%	60%

Source: CMA, BofA Merrill Lynch Global Research estimates

Table 3: Valuation comparison of Indian cement majors

	Share Price	Market Cap (US\$ mn)	BofAML Rating
ACC	1170	4503	C-3-7/UNDERPERFORM
Grasim	2304	4337	C-2-7/NEUTRAL
Ambuja Cements	150	4678	C-3-7/UNDERPERFORM
Ultratech Cement	1,169	6577	C-3-7/UNDERPERFORM
Shree Cement	2039	1459	C-2-7/NEUTRAL
India Cements	72	455	C-3-7/UNDERPERFORM
BSE30	16094		
Yr to 31 March/Dec	2010/FY11	2011E/FY12E	2012E/FY13E
EV/Capacity (US\$/ton)			
ACC	166	128	125
Grasim-Cement business	58	68	66
Ambuja Cements	163	149	136
Ultratech Cement	140	133	133
Shree Cement	85	94	76
India Cements	51	55	55
Replacement cost benchmark-India (US\$/ton)	120-125	120-125	120-125
RoE (%)			
ACC	17	17	14
Grasim	17	17	13
Ambuja Cements	18	16	17
Ultratech Cement	20	19	13
Shree Cement	10	14	13
India Cements	1	13	1
Local Market RoE	19	18	18
P/E (x)			
ACC	21.7	19.7	22.5
Grasim	9.3	7.8	9.1
Ambuja Cements	18.5	18.4	15.9
Ultratech Cement	20.6	14.4	19.1
Shree Cement	35.7	22.6	22.9
India Cements	46.1	4.2	43.2
Local Market PE	18.0	14.5	12.7
EV/EBITDA (x)			
ACC	13.2	11.0	12.0
Grasim - Cement business	5.0	4.6	5.5
Ambuja Cements	11.6	10.2	8.8
Ultratech Cement	11.5	8.6	10.7
Shree Cement	8.3	6.1	5.3
India Cements	10.7	4.3	8.9
Local Market EV/EBITDA	9.7	8.7	7.6

Source: BofA Merrill Lynch Global Research estimates

Price objective basis & risk

Grasim (GRSJF / GRSJY)

We have a price objective of Rs2360 (GDR of US\$47.7) for Grasim. We value the company's dominant cement business at 25% discount to the industry's current replacement cost of US\$120-125/ton. The 25% discount is in line with the average (rather than trough) discount witnessed through the previous downturn (1997-2002). The VSF business is pegged at an FY13E-PE of about 7.5x, implying a sharp discount vs local market (BSE 30). Sharp slowdown in VSF demand and unforeseen rise in energy prices for the cement business present downside risks to our PO. Upside risk could stem from strong and sustained rational pricing behaviour of cement producers across the industry and unforeseen rise in cotton and PSF prices.

Link to Definitions

Industrials

Click [here](#) for definitions of commonly used terms.

Analyst Certification

I, Reena Verma Bhasin, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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India - General Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Aditya Birla Nu	ADYAF	ABNL IN	Reena Verma Bhasin, CFA
	Anant Raj Industries Ltd	XNRJF	ARCP IN	Gagan Agarwal
	Brigade Enterprises	XBDGF	BRGD IN	Gagan Agarwal
	DLF Limited	XVDUF	DLFU IN	Abhishek Kiran Gupta
	Exide Indus Ltd	XEDRF	EXID IN	Sanjaya Satapathy
	Havells	HVLIF	HAVL IN	Sanjaya Satapathy
	Indiabulls Real Estate Ltd	IBELF	IBREL IN	Abhishek Kiran Gupta
	Motherson Sumi	XMSUF	MSS IN	Sanjaya Satapathy
	Oberoi Realty Ltd	XRXOF	OBER IN	Abhishek Kiran Gupta
	Opto Circuits	OPOCF	OPTC IN	Sanjaya Satapathy
	SINTEX INDUSTRIES LTD	SIXDF	SINT IN	Prasad Deshmukh
NEUTRAL				
	Chambal Fertilisers & Chemicals	CHBZF	CHMB IN	Prasad Deshmukh
	Coromandel International Ltd	CMDFF	CRIN IN	Prasad Deshmukh
	Grasim	GRSJF	GRASIM IN	Reena Verma Bhasin, CFA
	Grasim -G	GRSJY	GRAS LX	Reena Verma Bhasin, CFA
	Jain Irrigation Systems Ltd	JNIDF	JI IN	Prasad Deshmukh
	Shree Cements	SREEF	SRCM IN	Reena Verma Bhasin, CFA
	Unitech Ltd	UTKIF	UT IN	Abhishek Kiran Gupta
UNDERPERFORM				
	Ambuja Cements	AMBUF	ACEM IN	Reena Verma Bhasin, CFA
	Assoc. Cement	ADCLF	ACC IN	Reena Verma Bhasin, CFA
	Bajaj Hindusthan	BJJHF	BJH IN	Sanjaya Satapathy
	Balrampur Chini	BMPRF	BRCM IN	Sanjaya Satapathy
	Container Corp	CIDFF	CCRI IN	Sanjaya Satapathy
	Cummins India	CUIDF	KKC IN	Sanjaya Satapathy
	Housing Development and Infrastructure	XGHSF	HDIL IN	Gagan Agarwal
	India Cements	INIAF	ICEM IN	Reena Verma Bhasin, CFA
	India Cements -G	IAMUY	ICEM LX	Reena Verma Bhasin, CFA
	Jaypee Infratech	XJAYF	JPIN IN	Gagan Agarwal
	Jet Airways	JTAIF	JETIN IN	Anand Kumar
	Jindal Saw	SWPFF	JSAW IN	Sanjaya Satapathy
	Omaxe Limited	XOMXF	OAXE IN	Gagan Agarwal
	Puravankara Projects Ltd	XPJVF	PVKP IN	Gagan Agarwal
	Renuka Sugars	SRNKF	SHRS IN	Sanjaya Satapathy
	Sobha Developers	SBDRF	SOBHA IN	Gagan Agarwal
	SpiceJet Ltd	MDLFF	SJET IN	Anand Kumar
	Tata Chemicals Ltd	TTCXF	TTCH IN	Prasad Deshmukh
	UltraTech Cemen	XDJNF	UTCEM IN	Reena Verma Bhasin, CFA
	Voltas	VTSJF	VOLT IN	Sanjaya Satapathy
RSTR				
	Nagarjuna Fertilizers & Chemicals Ltd	NFACF	NFCL IN	Prasad Deshmukh
RVW				
	Fortis Healthcare Limited	XFFTF	FORH IN	Prasad Deshmukh

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

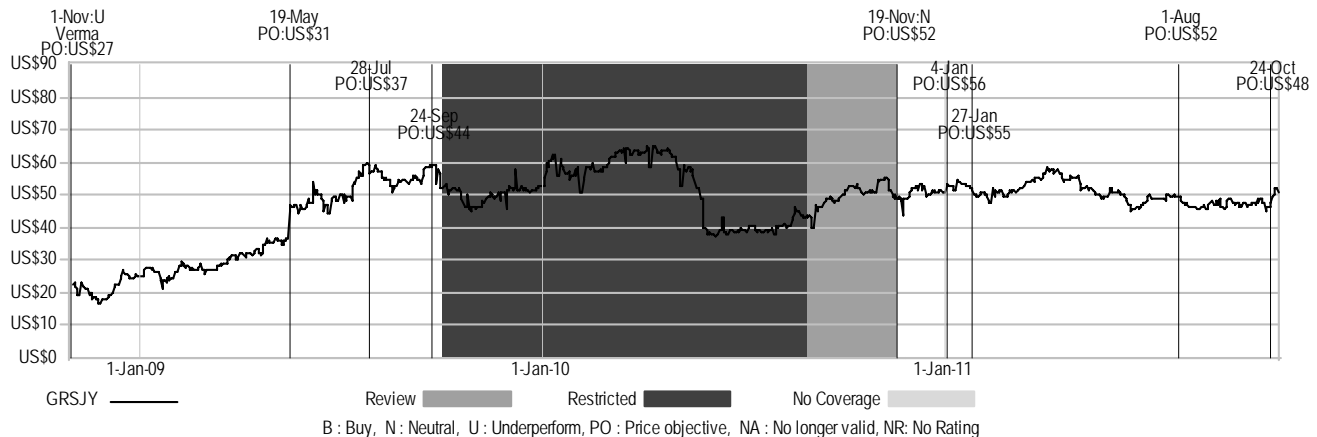
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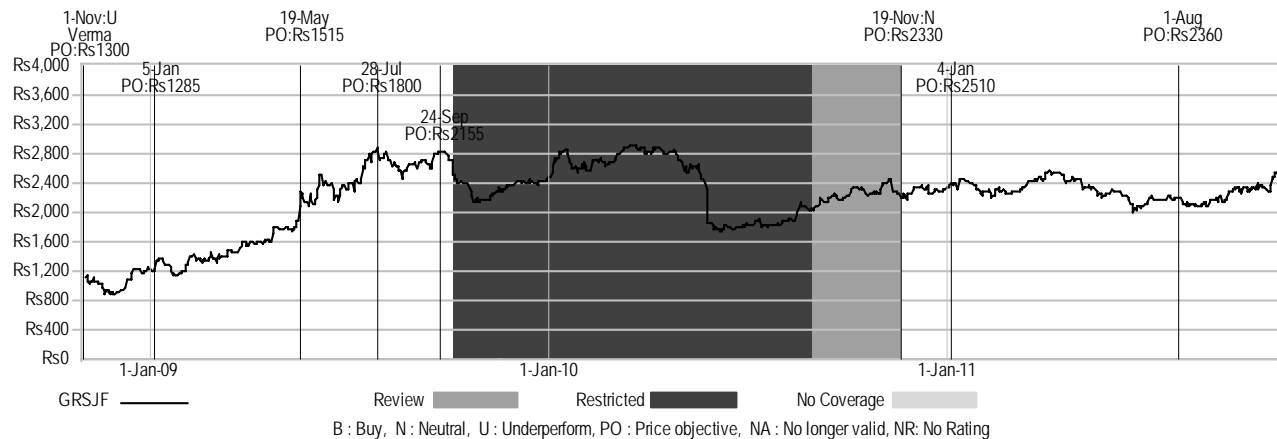
Important Disclosures

GRSJY Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of [October 31, 2011] or such later date as indicated.

GRSJF Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of [October 31, 2011] or such later date as indicated.

Investment Rating Distribution: Industrials/Multi-Industry Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	56	67.47%	Buy	29	60.42%
Neutral	15	18.07%	Neutral	7	58.33%
Sell	12	14.46%	Sell	5	45.45%

Investment Rating Distribution: Global Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2073	54.13%	Buy	923	49.12%
Neutral	961	25.09%	Neutral	460	52.57%
Sell	796	20.78%	Sell	287	38.32%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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