

Acquires 40% stake in sick pulp manufacturer

First Look

Grasim Industries has announced an acquisition of 40% stake in a distressed pulp manufacturer Terrace Bay Pulp, Canada. Another 60% has been acquired by an Aditya Birla Group entity Thai Rayon. While further details have not been revealed, Grasim will infuse USD44 mn over a three year period into Terrace Bay out of a total equity requirement of USD110 mn. At this moment the mill is shutdown after an explosion in its plant in Oct'11 further weakened an already weak financial position and will be restarted by Oct'12. Terrace Bay at this moment has been placed under credit protection by Canadian authorities.

Till now the mill was producing paper grade pulp with a capacity of 550,000 tonnes per annum and over the next 3-4 years, the mill would be converted into a 280,000 tonnes per annum dissolving pulp grade manufacturer to supply VSF manufacturers like Grasim. This would require an investment of USD250 mn in total. Terrace Bay currently has total assets of USD46.3 mn and has debt of USD54 mn from Ontario province and unsecured creditors.

This acquisition is in-line with Grasim's intention to vertically integrate and have an in-house supply of pulp for its VSF business. Grasim is expanding its VSF capacity by 156,500 tonnes per annum or by almost 50% of its current capacity in India by end of FY13 apart from creating a Greenfield capacity in Turkey. We believe more acquisitions of pulp manufacturers are likely to come through in the future as the current in-house pulp capacity is sufficient only for ~75% of Grasim's current capacity. Grasim's has USD430 mn of cash on its standalone books and almost USD1 bn of cash on its consolidated books which would be more than sufficient for this acquisition and further acquisitions. Grasim in May'11 had acquired 33% stake in Domsjo Fabriker, a Swedish pulp manufacturer for USD62 mn apart from further investments. Grasim does not necessarily ship pulp from these countries to its plants in India but hedges its purchases from nearby pulp manufacturers through sales from its acquired entities to other VSF manufacturers.

We do not expect any significant reaction by the stock to these acquisitions and at current levels after rallying 20% in the last one month we expect the stock to look for an upward movement in VSF prices or cement prices/volumes to further outperform.

July 6, 2012

Rating Remains	Buy
Target price Remains	INR 2852
Closing price July 5, 2012	INR 2664

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Appendix A-1

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Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Grasim Industries	GRASIM IN	INR 2664	05-7-2012	Buy	Not rated	

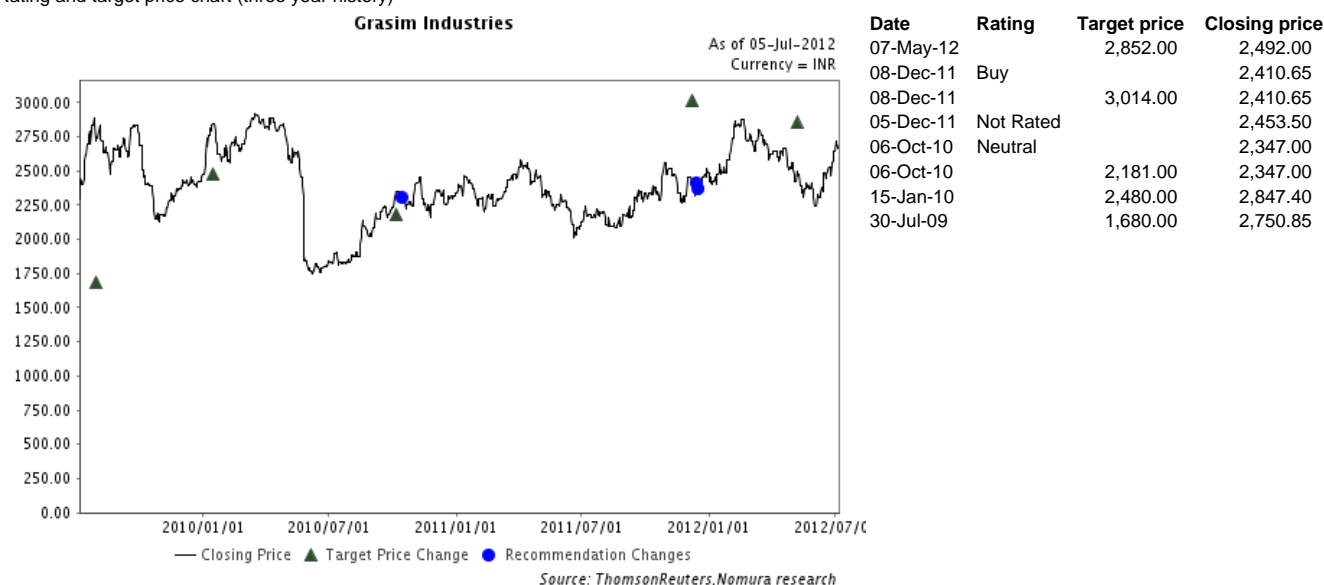
Previous Rating

Issuer name	Previous Rating	Date of change
Grasim Industries	Not Rated	08-12-2011

Grasim Industries (GRASIM IN)

INR 2664 (05-7-2012) Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We arrive at a target price of INR2,852 per share by valuing the company's non-cement business at 5.0x EV/EBITDA (FY13F) and 60.3% stake in Ultratech Cement at our TP of INR1,422/share with a 25% holding company discount. Separately, we value its equity holding in other group companies at CMP, applying a 25% discount thereafter, and valued other investments at book value.

Risks that may impede the achievement of the target price Risks to downside: 1) a negative CCI judgement and a consequent fall in cement prices would have an indirect impact on Grasim as these would likely result in lower profitability of UltraTech Cement. Given Grasim holds a 60.3% stake in its UltraTech Cement subsidiary, this would be a key downside risk to the company's valuations. 2) Historically, VSF prices have been correlated to cotton prices. A greater-than-expected fall in the cotton prices could impact the company's VSF realisations, thus impacting profitability. Key risks to the upside: 1) Higher-than-expected realisation/volume on account of its leadership position in the cement & VSF businesses can be an upside risk to our earnings estimates. 2) We have assumed a continuation of the existing correlation between VSG & cotton prices and assumed subdued VSF prices going forward. Hence, any breakdown of this correlation could impact the company's earnings on the upside.

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STOCKS

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SECTORS

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan

STOCKS

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