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Grasim Industries Ltd.

May 26th, 2017

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Riding high on better growth prospects…

Grasim Industries Ltd, flagship company of Aditya Birla Group is a diversified company with interests in cement, textiles, retail and chemicals.

Investment Rationale

Strong growth outlook for VSF business

Grasim is a pioneer in the viscose staple fibre (VSF) business with an aggregate capacity of 498 ktpa. Grasim's VSF business commands 9% market share globally. It is continuously focusing on increasing the usage of VSF in India by leveraging its Brand Liva and enriching the product mix through a larger share of specialty fibre. Besides, the company is expanding its VSF capacity by 161 tpd by Q4FY18 (of which 54 tpd has already comes on stream) through debottlenecking. Besides the management has guided for a stable outlook for VSF over the next two years due to lack of fresh capacity additions globally. All these factors would augur well for margin going forward. In chemical business, the company is expanding its caustic soda capacity to 1048 KTPA from 840 KTPA currently which is expected to be completed by Q4FY18. The company is also expanding its caustic soda capacity through debottlenecking of its existing capacities. Further it is doubling its phosphoric acid capacity to 54 KT from 25KT which is expected to be completed by Q2FY18. We believe the company's capacity expansion of caustic soda will further strengthen its leadership position. However, the volumes growth in VSF & chemicals businesses are expected to remain restricted as the company is operating at near full capacity utilisation.

Well positioned to gain from demand upsurge

Grasim operates its cement business through its subsidiary, UltraTech Cement Ltd with a capacity of 69.3 mtpa in FY17. UltraTech's position as the largest cement player is poised to be consolidated with the acquisition of Jaiprakash Associates' 21.2 MTPA cement capacity which is expected to be complete by Q2FY18. The acquisition will provide Ultratech an entry into central India and also strengthens its presence in north and south India. The acquisition is likely to be EPS accretive only after two years given the low capacity utilization level of the latter. Besides, Ultratech's 3.5 MT per annum integrated cement plant at Dhar, Madhya Pradesh is on track and is expected to commence commercial production by Q4FY19. Post the above expansion and acquisition, the total capacity of Ultratech will increase to 95.4 MTPA. This will provide Ultratech with a competitive edge and we believe it will be a key beneficiary of any uptick in demand from housing & infrastructure sectors.

Restructuring to complete by Q2FY18

In a mega restructuring of the business, Aditya Birla Group plans to merge Aditya Birla Nuvo into Grasim. The merger of Aditya Birla Nuvo with Grasim is in advanced stage and is expected to be complete by H1FY18. The merger will lead to Grasim becoming holding company for ABFSL, Idea, Hindalco and Aditya Birla fashion & retail (ABFRL). The restructuring will also lead to listing of the financial services arm - Aditya Birla Financial Services (ABFSL).

Valuations: Given its leadership position globally, better product mix (higher proportion of Speciality fibre) coupled with firm VSF demand, we expect consolidated revenue/PAT to grow at a CAGR of 10%/22% over FY17-19E. Further, steady ramp up in capacities at Ultratech and uptick in demand from housing and infrastructure bodes well for the cement business. We value Grasim based on SOTP, valuing standalone business at 5.5x EV/EBITDA, 60% holding in Ultratech at our TP and stake in others post 40% discount at CMP. Recommend BUY with a TP of Rs1,222.

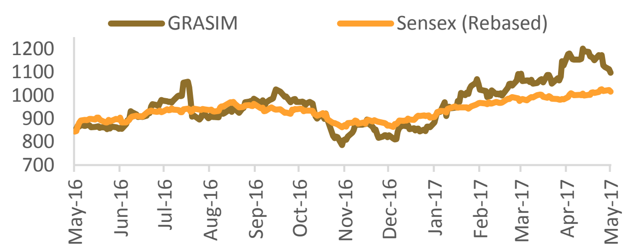
Market Data

Rating	**BUY**
CMP (Rs.)	1,109
Target (Rs.)	1,222
Potential Upside	10%
Duration	Long Term
Face Value (Rs.)	2
52 week H/L (Rs.)	1,237/782
Adj. all time High (Rs.)	1,237
Decline from 52WH (%)	10.3
Rise from 52WL (%)	41.8
Beta	1.1
Mkt. Cap (Rs.Cr)	51,755

Fiscal Year Ended

Y/E	FY16	FY17	FY18E	FY19E
Revenue (Rs.Cr)	36,218	36,068	39,434	43,929
Adj. profit (Rs.Cr)	2,387	3,167	3,635	4,691
Adj. EPS (Rs.)	51.1	67.8	77.9	100.5
P/E (x)	21.7	16.3	14.2	11.0
P/BV (x)	2.0	1.6	1.5	1.3
ROE (%)	9.8	11.1	11.0	12.7

One year Price Chart



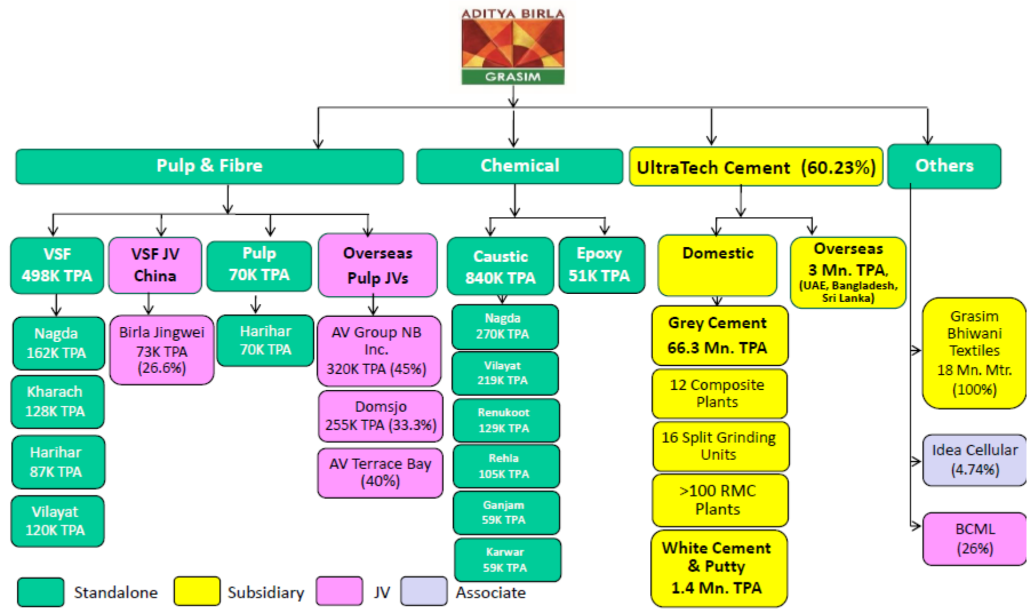
Source: Company, In-house research

Shareholding Pattern	Mar-17	Dec-16	Chg.
Promoters	31.3	31.3	-
FII's	21.7	21.8	(0.1)
MFs/Insti	14.6	19.7	(5.1)
Public	9.2	14.9	(5.7)
Others	9.7	12.3	(2.6)

Grasim Industries: Business overview

Grasim Industries Ltd, flagship company of Aditya Birla Group is a diversified company with interests in cement, textiles, retail and chemicals. Grasim is also into cement business through its subsidiary, UltraTech Cement Ltd. The company's core businesses include Viscose Staple Fibre (VSF) and Cement, contributing over 90% of its revenues. Its chemicals business is a backward integration for VSF. Grasim Industries is a leading global player in Viscose Staple Fibre (9% global market share) and the largest player in the Cement and Chlor Alkali Chemicals in India. Grasim is embarking on ambitious growth plans through capacity expansions in VSF and Cement, which will further consolidate its leadership position in both the businesses.

Grasim group structure



Source: Company

Strong growth outlook for VSF business

The company is a pioneer in the viscose staple fibre (VSF) business with an aggregate capacity of 498 ktpa. Grasim's VSF business commands 9% market share globally. Grasim's VSF plants are located at Nagda in Madhya Pradesh, Kharach and Vilayat in Gujarat and Harihar in Karnataka. The ramp up of its VSF capacity through a Greenfield project at Vilayat (Gujarat) - 120,000 TPA and Brownfield expansions at Harihar (Karnataka) - 36,500 TPA has further consolidate its leadership position in this space. Hence it has led to 25% growth in sales volumes over last two years.

Further the company is expanding its VSF capacity by 161 tpd (of which 54 tpd has already comes on stream) through debottlenecking. The company is awaiting environmental clearance for this and is expected to be complete by Q4FY18. Besides the company is continuously focusing on increasing the usage of VSF in India by leveraging its Brand Liva, enriching the product mix through a larger share of specialty fibre and partnering with the textile value chain. All these factors would augur well for VSF margin going forward.

VSF capacities as a glance

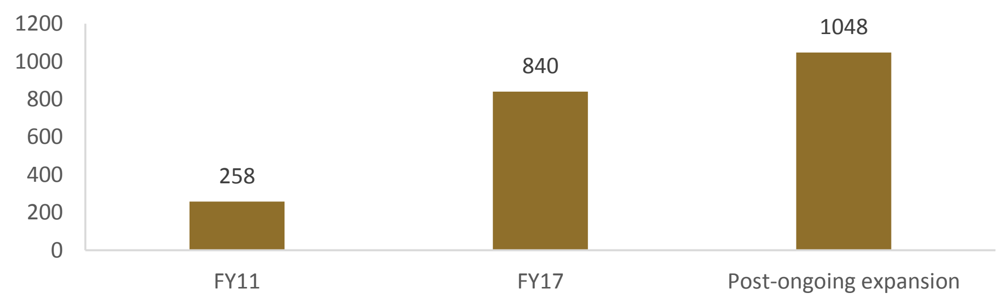
Division		Capacity
Viscose Staple Fibre (VSF)		498,000 tpa
Joint venture		
::	Birla Jingwei Fibres Company Limited	72,000 tpa
Rayon grade pulp		
::	Harihar, Karnataka	70,000 tpa
Joint ventures		
::	AV Cell Inc (Atholville, New Brunswick in Canada)	126,000 tpa
::	AV Nackawic Inc. (Nackawick, New Brunswick in Canada)	189,000 tpa
::	Domsjö Fabriker (Sweden)	255,000 tpa
::	AV Terrace Bay Inc. (North Western Ontario, Canada)	280,000 tpa

Source: Company

Deepening its foothold in chemicals business

The company also has presence in chemicals business which is essentially a backward integration for its VSF business. The chemicals business accounts for mere 10% of the overall revenue in FY17. Grasim is the largest player in India in chlor alkali with caustic soda capacity of 452K TPA in India. Over the years, the company has increased its capacity by more than double to 840 ktpa in FY17 from 258 ktpa in FY11. In order to consolidate its leadership position, the company has merged Aditya Birla Chemicals with itself in FY16. The merger has provided the company with a pan-India presence. With the company's chlor alkali plants operating at near full capacity levels, the company is expanding its caustic soda capacity to 1048 KTPA from 840 KTPA currently which is expected to be complete by Q4FY18 through both brownfield expansion and debottlenecking of its existing plants. It is also doubling its phosphoric acid capacity to 54 KT from 25KT which is expected to be complete by Q2FY18. We believe the company's capacity expansion of caustic soda will further strengthen its leadership position.

Capacity to witness three-fold jump post expansion (in KTPA)



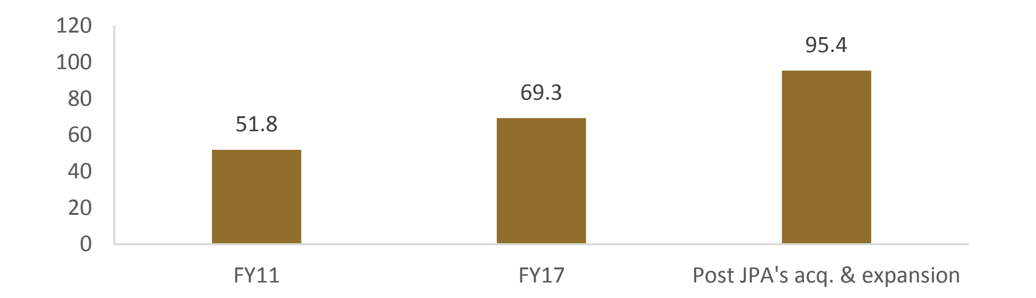
Source: Company, In-house research

Cement business: Well positioned to gain from demand upsurge

The company operates its cement business through its subsidiary, UltraTech Cement Ltd. Post the acquisition of Ultratech business in 2004, the company has increased its overall cement capacity (through both organic and inorganic route) by more than four-fold over FY04-17 from 17 mtpa to 69.3 mtpa. Ultratech is the largest manufacturer of grey cement in India and is also India's largest exporter of cement and clinker. It has an overall installed grey cement capacity of 69.3 MTPA. UltraTech is also the largest producer of white cement and ready-mix concrete in India. Besides, Ultratech has entered into an agreement to acquire Jaiprakash Associates' 21.2 MTPA cement capacity which is expected to be complete in Q2FY18.

UltraTech's position as the largest cement player is poised to be consolidated with this acquisition, which will provide Ultratech an entry into central India and also strengthens its presence in north and south India. After the completion of the acquisition, the company plans to improve the capacity utilisation of the acquired assets to 60% in the first 12 months and further to 75% in the next 12 months. The acquisition is likely to be EPS accretive only after two years. Besides, Ultratech's 3.5 MT per annum integrated cement plant at Dhar, Madhya Pradesh is on track and is expected to commence commercial production by Q4FY19. Post the above expansion and acquisition, the total capacity of Ultratech will increase to 95.4 MTPA. This will provide Ultratech with a competitive edge and it will be a key beneficiary of any uptick in demand. We expect sales volume to grow at 7% CAGR over FY17-19E owing to steady ramp up in capacities and pickup in demand from housing and infrastructure sectors.

Ultratech's cement capacity to surpass 90 mtpa



Source: Company, In-house research

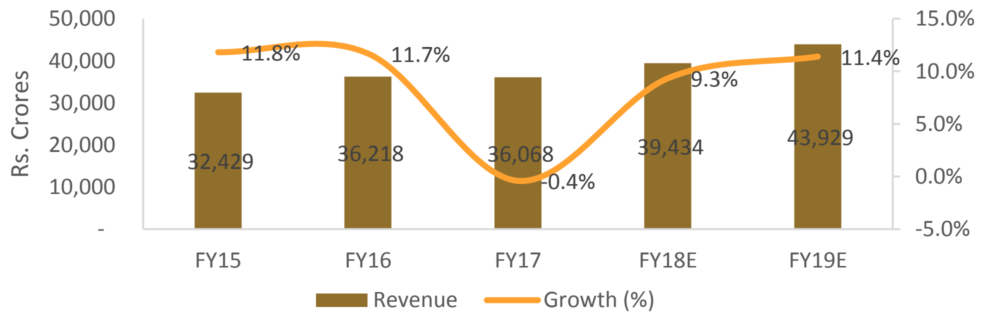
Restructuring to be complete by Q2FY18

In a mega restructuring of the business, Aditya Birla Group plans to merge Aditya Birla Nuvo into Grasim. The merger of Aditya Birla Nuvo with Grasim is in advanced stage and is expected to be complete by H1FY18. The merger will lead to Grasim becoming holding company for ABFSL, Idea, Hindalco and ABFRL. The restructuring will also lead to listing of the financial services arm - ABFSL. Grasim is awaiting approvals from National Company Law Tribunal (NCLT) and stock exchanges for the proposed merger of Aditya Birla Nuvo into itself.

Enhanced capacity to aid overall revenue growth

Grasim is on track in expanding its overall capacity through both brownfield and debottlenecking in both VSF & chemical businesses. This would aid in driving growth going forward. Hence, we expect consolidated revenue to grow at a CAGR of 10% over FY17-19E. However, PAT is expected to grow at a CAGR of ~22% on account of lower interest charges. As a result, ROE/ROCE are expected to improve to 12.7%/16% in FY19E from 11.1%/13.6% in FY17.

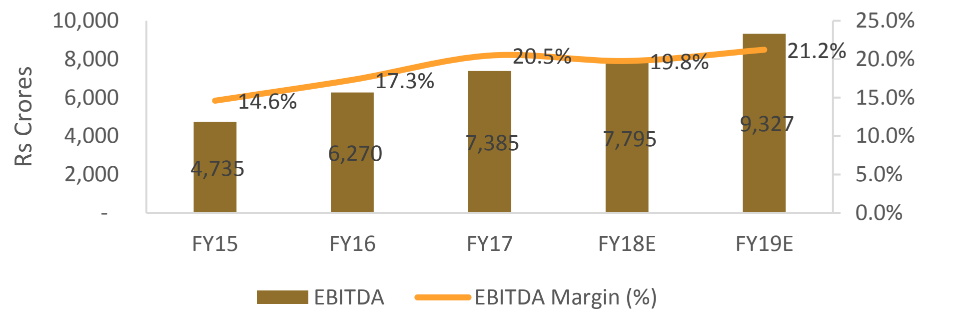
Overall revenue to grow at 10% CAGR during FY17-19E



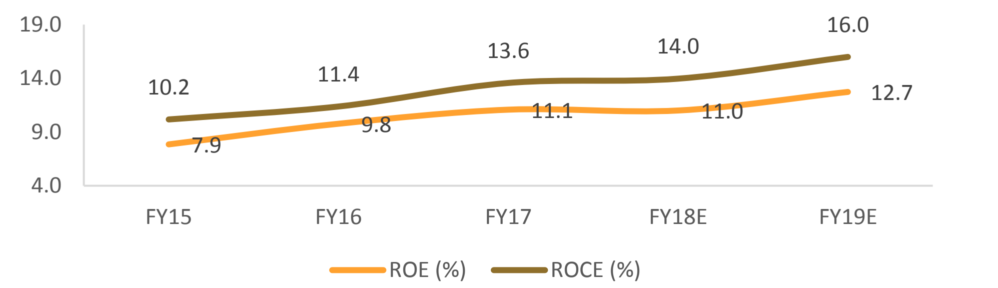
EBITDA margin to expand by 70bps over FY17-19E

We factor consolidated EBITDA margin expansion of 70bps over FY17-19E owing to better profitability in VSF and cement business. EBITDA margin after declining in FY18E is expected to inch above 21% in FY19E.

EBITDA to grow at 12% CAGR over FY17-19E



Return ratios trend



Source: Company, In-house research

Key Risks:

- Volatility in prices of raw materials.
- Scarcity of limestone may impact growth of cement business.
- Near full capacity utilisation in VSF & chemicals business would restrict in capturing any incremental demand.

Sum-of-the-parts Valuation

	Basis	Multiple (x)	Value (Rscr)	Value/share (Rs)
Standalone (6x EV/EBITDA)	Mar-19 EV/E	5.5	*12,132*	*260*
Ultratech (60% stake post holding company discount at 40%)			*42,894*	*919*
Stake in others (post holding company discount at 40%)			*2,015*	*43*
Target SOTP			***57,042***	***1,222***
CMP				*1,199*
Upside (%)				*10*

Profit & Loss Account (Consolidated)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Total operating Income	**36,218**	**36,068**	**39,434**	**43,929**
Raw Material cost	9,502	9,475	10,075	11,179
Employee cost	2,407	2,266	2,524	2,768
Other operating expenses	18,038	16,943	19,040	20,656
EBITDA	**6,270**	**7,385**	**7,795**	**9,327**
Depreciation	1,911	1,808	1,857	1,962
EBIT	4,359	5,578	5,939	7,365
Interest Cost	751	702	401	266
Other income	756	948	1,081	1,161
Profit before tax	**4,363**	**5,823**	**6,619**	**8,261**
Tax	1,211	1,707	1,940	2,421
PAT	3,152	4,116	4,679	5,839
Minority Interest	911	1,078	1,186	1,305
P/L from Associates	145	129	142	157
Adjusted PAT	**2,387**	**3,167**	**3,635**	**4,691**
E/o income / (Expense)	28	-	-	-
Reported PAT	**2,359**	**3,167**	**3,635**	**4,691**

Balance Sheet (Consolidated)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Paid up capital	93	93	93	93
Reserves and Surplus	25,679	31,293	34,590	38,908
Net worth	**25,773**	**31,387**	**34,683**	**39,002**
Preference Share Capital	58	-	-	-
Minority interest	8,484	9,702	10,888	12,193
Total Debt	12,840	7,927	5,927	3,927
Other non-current liabilities	326	449	449	449
Total Liabilities	**47,481**	**49,464**	**51,947**	**55,570**
Net fixed assets	32,171	31,792	32,936	33,974
Capital WIP	1,835	1,297	1,297	1,297
Goodwill	3,374	2,994	2,994	2,994
Investments	7,655	12,044	13,044	15,044
Net Current Assets	4,033	1,700	2,039	2,624
Deferred tax assets (net)	(4,226)	(3,518)	(3,518)	(3,518)
Other non-current assets	2,640	3,155	3,155	3,155
Total Assets	**47,481**	**49,464**	**51,947**	**55,570**

Cash Flow Statement (Consolidated)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Pre-tax profit	**4,335**	**5,952**	**6,762**	**8,417**
Depreciation	1,911	1,808	1,857	1,962
Chg in Working Capital	529	1,116	(194)	(72)
Others	513	(245)	(681)	(896)
Tax paid	1,187)	(1,346)	(1,940)	(2,421)
Cash flow from operating activities	**6,101**	**7,284**	**5,804**	**6,990**
Capital expenditure	(2,772)	(891)	(3,000)	(3,000)
Chg in investments	(110)	(4,389)	(1,000)	(2,000)
Other investing cashflow	288	948	1,081	1,161
Cash flow from investing activities	**(2,594)**	**(4,333)**	**(2,919)**	**(3,839)**
Equity raised/(repaid)	8	0	-	-
Debt raised/(repaid)	(367)	(4,913)	(2,000)	(2,000)
Dividend paid	(321)	(308)	(339)	(373)
Other financing activities	(790)	2,152	(401)	(266)
Cash flow from financing activities	**(1,470)**	**(3,069)**	**(2,740)**	**(2,638)**
Net chg in cash	**2,037**	**(118)**	**146**	**513**

Key Ratios (Consolidated)

Y/E	FY16	FY17	FY18E	FY19E
Valuation(x)				
P/E	21.7	16.3	14.2	11.0
EV/EBITDA	11.3	9.1	8.5	7.0
EV/Net Sales	2.0	1.9	1.7	1.5
P/B	2.0	1.6	1.5	1.3
Per share data (Rs.)				
EPS	51.1	67.8	77.9	100.5
DPS	4.5	5.5	6.1	6.7
Growth (%)				
Net Sales	11.7	(0.4)	9.3	11.4
EBITDA	32.4	17.8	5.6	19.6
Net profit	36.1	32.7	14.8	29.0
Margin (%)				
EBITDA	17.3	20.5	19.8	21.2
EBIT	12.0	15.5	15.1	16.8
NPM	6.6	8.8	9.2	10.7
Return Ratios (%)				
RoE	9.8	11.1	11.0	12.7
RoCE	11.4	13.6	14.0	16.0
Turnover Ratios (x)				
Sales/Total Assets	0.6	0.6	0.6	0.6
Sales/Working Capital	21.5	72.1	(77.2)	(116.3)

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* Grasim is a large-cap company.

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