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Merchant Banking Services Ltd
(A Subsidiary of Indian Bank)

GRASIM INDUSTRIES LTD.

January 23, 2012

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Grasim Industries Limited (GIL), a flagship of the Aditya Birla Group, is among India's largest companies in the private sector in terms of assets and turnover. Initially established as a textile manufacturer in 1947, GIL has successfully diversified into VSF (Viscose Staple Fiber), Cement, Sponge Iron and Chemicals over the past years. During FY11, the cement division contributed to 75% of revenues with VSF contributing 21%. The other segments include textiles and chemicals that contributed 2% each.

Investor's Rationale

- GIL, a flagship of the Aditya Birla Group, is expected to garner a consolidated revenue growth at a ~CAGR 12% during FY'11-13E to ₹279.5 billion, while the net profit is expected to outpace revenue growth by growing at a CAGR of over 37% to ₹42.8 billion during same period.

- GIL maintains leadership position in the two distinct businesses viz. VSF business and Cement business. In order to retain its leadership position in both key businesses, the company has lined up total capex of around ~₹144 billion to be spent over FY'12-FY'14E. Grasim is expanding its capacity in the VSF segment from 0.33 million tonnes to 0.49 million tonnes in order to capitalize on future growth.

- GIL has reported an increase of 29.2% in its Q2 FY'12 net profit at ₹4,179 million from ₹3,234 million in the corresponding period last year, supported by improved performance of both Cement and VSF businesses. Further, GIL's net sales surged by 27.3% at ₹56,492 million from ₹44,390 million on yoy basis, mainly due to 17% and 9% rise in its revenue from its VSF and cement business respectively.

- GIL's cement division was a major contributor to the revenues, making for 75% of the total revenues in FY'11. In order to accelerate the pace of growth in cement, over the next 3 years, GIL has earmarked a capital outlay of US$2.5 billion (₹110 billion).

- Considering the diversified nature of group's business, we have valued GIL on SOTP methodology, and assigned 15% holding company discount. We recommend a Buy on the stock, with a target Price of ₹2,912, implying an upside of ~15% from current levels.

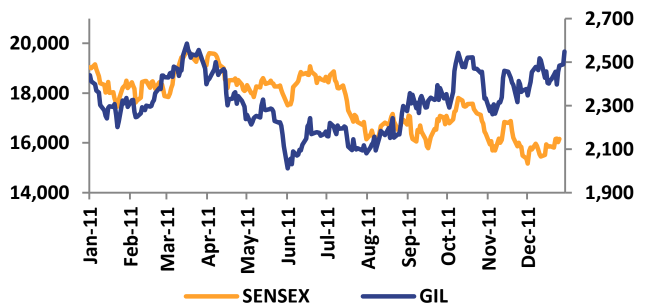
Market Data

Rating	**BUY**
CMP (₹)	2,540
Target (₹)	**2,912**
Potential Upside	~15%
Duration	Medium Term
52 week H/L (₹)	2,625/1,981
All time High (₹)	3,830
Decline from 52WH (%)	3.2
Rise from 52WL (%)	28.2
Beta	0.74
Mkt. Cap (₹ bn)	232.9
Enterprise Value (₹ bn)	324.1

Fiscal Year Ended

	FY10A	FY11A	FY12E	FY13E
Revenue (₹bn)	204.9	221.4	247.7	279.5
Net Profit(₹bn)	31.0	22.8	33.0	42.8
Share Capital	0.9	0.9	0.9	0.9
EPS (₹)	337.6	248.5	359.5	466.2
PE (x)	7.5	10.2	7.1	5.4
P/BV (x)	1.9	1.6	1.3	1.1
EV/EBITDA (x)	5.1	6.3	6.7	5.7
ROE (%)	24.7	15.6	18.9	20.4
ROCE (%)	22.3	15.4	12.4	13.4

One year Price Chart

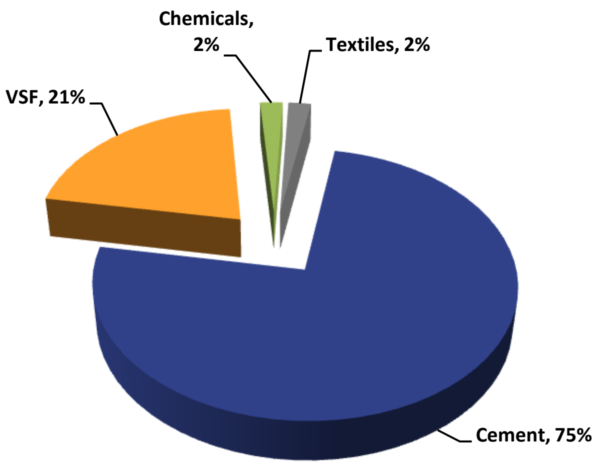


Shareholding Pattern	Sep'11	Jun'11	Diff.
Promoters	25.6%	25.6%	-
Institutional	41.1%	41.4%	(0.3)
General Public	11.1%	11.4%	(0.3)
Others	22.2%	21.6%	0.6

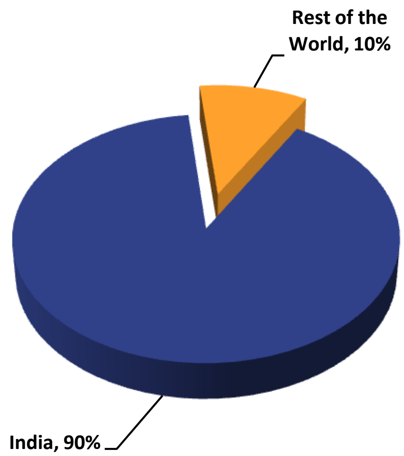
Segmental Performance

GIL derives major revenue from its cement business, as the cement division contributed 75% to the total revenues in FY'11. In line with this, the company's VSF division - the second biggest contributor to the overall revenues provided 21% to the total revenues. Further, the chemical and textiles divisions contributed 2% each to the total revenues in FY'11. Due to the rise in the demand of VSF and rise in prices, the revenue of the VSF division register a growth of ~23% as compared to the previous year. The chemical business achieved record production and sales volume aided by a capacity utilization of 94%. The textile division also recorded a double digit revenue growth driven both by higher off-take in the Ready Made Garment segment and better pricing. However, the revenue from the Cement and Chemicals division has witnessed de-growth in revenues. The decrease in the average cement realization has affected the performance of the cement division. In terms of profitability, the decline in the caustic soda prices due to cheap imports has affected the performance of the chemicals division. However, the VSF division has maintained its healthy margin (PBIDT) at 33.7% led by higher volumes and prices supported by better product quality that resulted in higher profitability. Further, the PBIT of the cement division contracted due to cost inflation and pressure on cement realization during FY'11.

Segment wise revenue break up for FY11 (consolidated)



Geographic revenue break-up for FY11 (Consolidated)



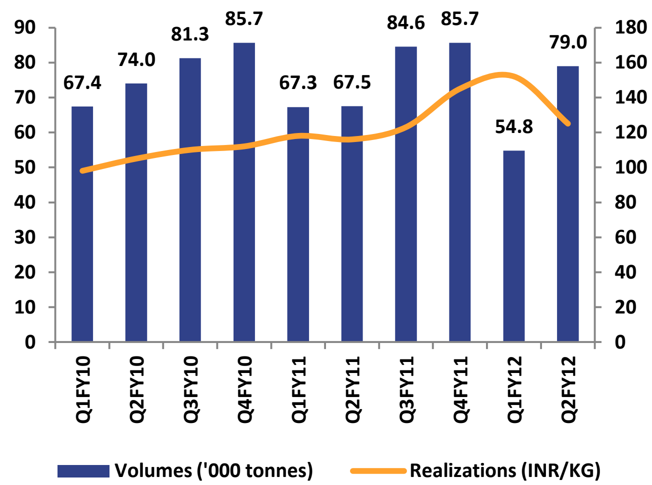
Strong Q2FY'12 results

GIL has reported an increase of 29.2% in its Q2 FY'12 net profit at ₹4,179 million from ₹3,234 million in the corresponding period last year, supported by improved performance of both Cement and Viscose Staple Fibre (VSF) businesses. Further, Grasim's net sales surged by 27.3% at ₹56,492 million from ₹44,390 million on yoy basis, mainly due to 17% and 9% rise in its revenue from its VSF and cement business respectively on yoy basis. Despite of higher input costs, GIL recorded improved performance in its business as its production grew by 20% with full capacity utilization at Nagda plant during Q2FY'12 while, sales volume surged by 17% on yoy basis. However, the performance of the pulp units was impacted by higher energy cost and scheduled annual maintenance. On account of growth in its production, GIL has reported a rise of 30.8% yoy in its EBITDA at ₹10,278 million from ₹7,855 million in the corresponding quarter last year Finally, net profit margin (NPM) of the company grew by 10bps to 7.1% in Q2 FY'12.

VSF business - strong volumes drive performance

GIL has reported a strong growth in its VSF business volumes at 78,959 tonnes in Q2FY'12, a growth of 17% YoY and 44% QoQ driven by better full utilization of capacity at the Nagda plant and sharp rise in demand for inventory restocking. The Nagda plant was remained shut for 25 days in Q2FY'11 and for 27 days in Q1FY'12. While, the realization from VSF business stood at ₹125/kg, an increase of ~7% YoY while it declined by ~18% QoQ. Further, the company expects the profitability from the VSF business to improve in the near future on the back of recovery in prices and volumes. Besides, for the VSF business, Grasim expects global demand to grow at 5-6% in the long run.

Trend in VSF business volumes & realizations



Cement division ~ major contributor to the revenues

The cement division was a major contributor to the revenues, making for 75% of the total revenues in FY'11. In order to accelerate the pace of growth in cement, over the next 3 years, GIL has earmarked a capital outlay of US$2.5 billion (₹110 billion). UltraTech Cement Ltd., (UltraTech), a subsidiary of the Company is in the process of setting up additional clinkerisation plants at Chhattisgarh and Karnataka together with grinding units, bulk packaging terminals and ready mix concrete plants across the country at a cost of ₹51,590 million. These expansions are expected to be operational in FY'14 and will augment the company's cement capacity by 9.2 mtpa. UltraTech is working on further projects to consolidate its leadership position in the business.

However, the cement sector is facing various challenges like demand supply mismatch, infrastructural bottlenecks and rising input costs. However, with the Government's enhanced focus on urban as well rural infrastructure development and housing and further capital allocation towards infrastructure in the 12th – Five year plan that will drive the sector in the long run.

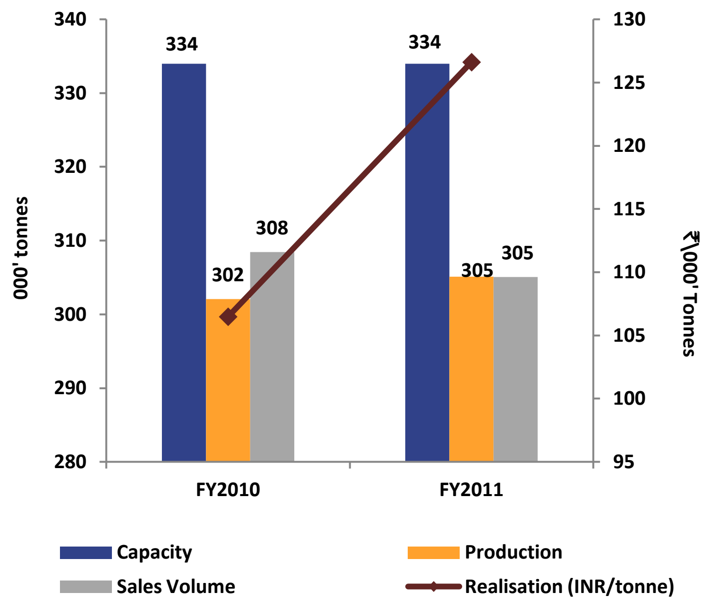
Cement division performance during FY2011

Grey Cement	FY'10	FY'11	% growth
Capacity (mtpa)	48.7	51.7	6.2
Production (mt)	37.0	39.6	7.2
Sales Volume			
Cement	37.2	39.9	7.2
Clinker	2.2	1.6	-30.1
Realisation (₹/tonne)			
Cement	3,503	3,360	-4.1
Clinker	1,785	1,697	-4.9
White Cement			
Volume (tonne)	509,054	546,661	7.4
Realisation (₹/tonne)	8,304	8,571	3.2

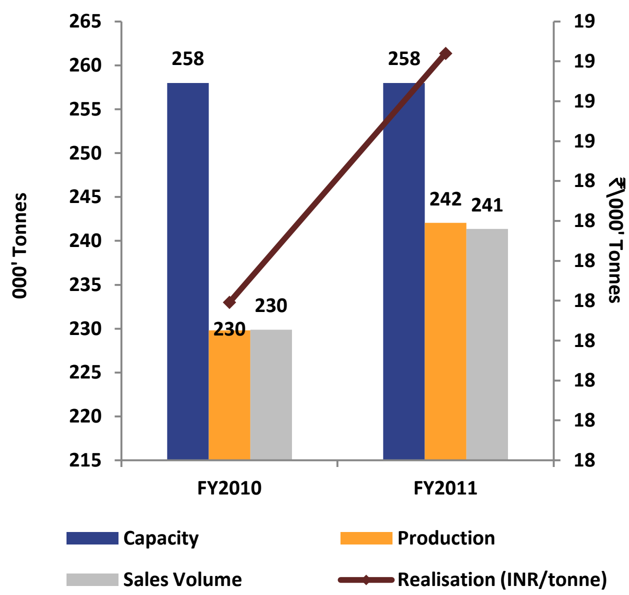
Maintain leadership position in the VSF business–

GIL is the market leader in the VSF sector worldwide with having a total capacity of over 744,000 tonnes per annum (TPA). In a move to maintain the leadership position in the VSF business and to gain from the growing demand for textiles in emerging market, the company is expanding its capacity at Harihar (Karnataka) by 36,500 TPA through a brownfield expansion at a cost of ₹4.49 billion. Further, the company is also setting up a 120,000 TPA Greenfield VSF plant at Vilayat, Gujarat, at an investment of ₹17,000 million, that will cater to the specialty fibre segment and will provide a strong foothold in the value added product range. Both the projects are slated for commissioning in FY'13. Meanwhile, in China, the company has already nearly doubled its production capacity from 36,000 TPA to 70,000 TPA. Thus considering the above planned expansion, the total capacity of its VSF business will get augmented by ~50% to half a million tonnes and will put the VSF business on a high growth trajectory in the future.

VSF division performance during FY2011



Production & Sales of Caustic Soda in FY2011



Chemical division ~ stellar performance in FY'11

The chemical division contributes 3% to the overall revenue of the company. The company has achieved a record production and sales volume during FY'11 supported by a capacity utilization of 94%. The net sales of the division grew by 10% to ₹5,423 million driven by volume growth and increase in realisation. Sales volumes during the year grew by 5%. However, due to an increase in the raw material prices, the PBIDT margin has declined to 22.9% in FY'11 as against 25.3% in FY'10. During FY'11, GIL has commissioned a 10,000 TPA Chlorinated Paraffin Wax plant for increasing the captive use of chlorine. The capacity of the plant will be doubled by FY'12. Besides, in line with its strategy of backward integration, GIL is also planning to establish a caustic soda plant of 182,500 tonnes with a 60MW power plant at Vilayat. The cost of setting up the plant will be ₹7,560 million.

Restructuring of business operations and key developments

GIL has demerged its cement business into a separate subsidiary, Samruddhi Cement Ltd (SCL), and the subsequent merger of SCL with UltraTech Cement (UltraTech) was completed during the financial year 2011 to achieve economies of scale. The merged entity now becomes the India's largest cement producer. GIL also sold off its sponge iron business to focus on its core businesses. Apart from this, UltraTech completed the acquisition of ETA Star Cement Company with its assets comprising of 2.3 million TPA clinker facility and grinding units spread across UAE, Bahrain and Bangladesh, that paved the way for the company to have a direct access to these markets. Post the acquisition, the total cement capacity rose to 52MTPA. Further, on the VSF front, the company has acquired a 33% stake in Aditya Holding AB, Sweden, which in turn acquired a pulp mill company Domsjo Fabriker AB (Domsjo), Sweden, for a total consideration of around ₹15,700 million that provides GIL to secure its captive pulp requirement for VSF production.

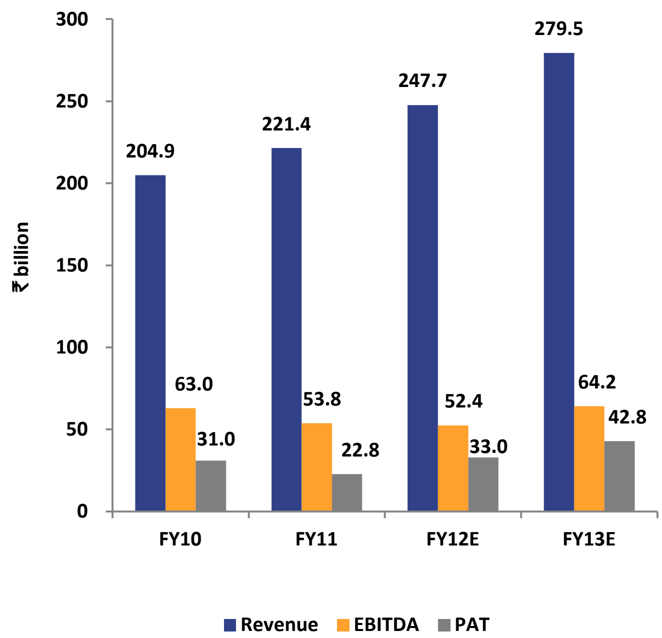
Rupee depreciation to offset the benefit of decline in input costs

Earlier, the company had witnessed a sharp rise in the input costs in past couple of quarters mainly due to higher coal as well as pulp prices, however, during the Q3 FY'12, GIL witnessed an ease in the coal prices. The company met around 35-40% of the total coal requirement from linkage coal, while, the rest while were sourced from open markets and imports. Even though, the imported coal prices have witnessed a correction during Q3 FY'12, however, the sharp rupee depreciation in the third quarter had a negative impact on overall costs. Apart from this, the company also imports 45-50% of its pulp requirement. But, the prices of pulp also eased during Q3 FY'12 that fell around ~9% as compared to the previous quarter. However, the company is not going to derive the full benefit of the fall in the pulp prices, due to the rupee depreciation.

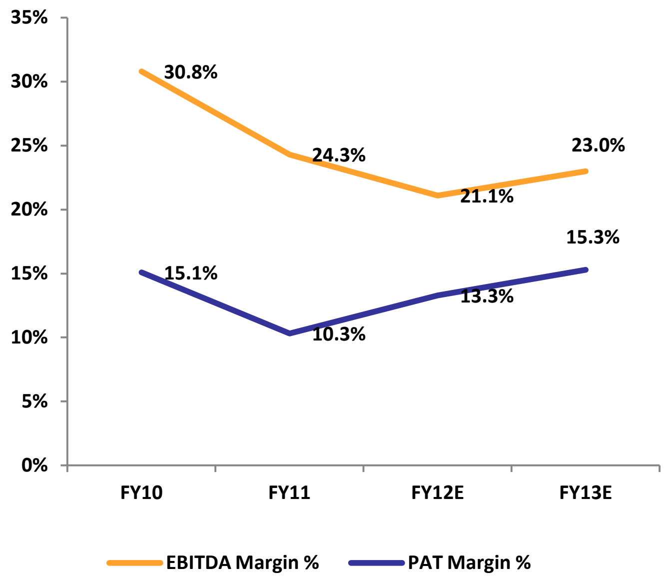
GIL's Capex Plans (₹ in billion)

Particulars	Net Capex plan as on 01.04.11	Cash Flow		Capex spent during H1 FY12
		FY12	FY13 Onwards	
VSF Business	21.1			
– Expansion Projects: Vilayat (120K TPA), Harihar (36K TPA)				
– Other Capex	3.4			
Chemical Business – Vilayat (182K TPA)	7.56			
Balance Capex (Including normal capex for chemical)	1.74			
Standalone Capex (A)	**33.8**	**16.8**	**17.0**	**4.14**
Cement Subsidiaries				
– Capacity expansion – 4.8 Mn TPA at Raipur, Chhattisgarh 4.4 Mn. TPA at Malkhed, Karnataka	51.49			
– Material Evacuation and Logistic Infrastructure	11.05			
– Thermal Power Plant (75 MW) & Waste Heat Recovery System (45 MW)	6.82			
– RMC Business & New Products	3.26			
– Modernisation, Upgradation and others	37.38			
Cement Business Capex (B)	**110.00**	**47.10**	**62.90**	**11.31**
Capex (A + B)	**143.80**	**63.90**	**79.90**	**15.45**

Future growth pegged @ 37% CAGR~ FY'11-FY'13E



Margins to remain upward



Valuation Methodology ~ SOTP valuation (₹million)

Business	Stake %	Parameter	Multiple (x)	EBIDTA FY'11	Sales FY'11	Valuation	Final Value
Manufacturing							
Standalone VSF business	100%	EV/EBIDTA	7.4	34,832		256,100	256,100
Cement business (UltraTech)	60.3%	EV/EBIDTA	4.4	16,279		71,708	43,240
Textile	100%	EV/Sales	2.0		3,420	6,829	6,829
Chemical	100%	EV/EBIDTA	5.5	1,243		6,829	6,829
Grand Total							312,998
Less: Net Debt (Conso.)							64,983
ABNL Business Value							248,015
Add: Investment		@20%disc				79,333	63466
Add: Cash		@8%disc				2,844	2616
ABNL Business value							314,098
Holding Company Discount (%) (stake in cement bus.)							15
ABNL Adj. Business value							266,983
Per share price (₹)							**2,912**
CMP (₹)							2,540.00
Upside potential (%)							**14.63**

Balance Sheet (Consolidated)

(₹billion)	FY10A	FY11A	FY12E	FY13E
Share Capital	0.9	0.9	0.9	0.9
Preference Paid up & Esop o/s	0.5	0.5	0.5	0.5
Reserve and surplus	123.8	144.3	173.2	207.8
Net Worth	125.2	145.7	174.6	209.2
Minority Interest	37.5	43.5	51.4	60.9
Loan funds	56.0	67.8	71.2	74.8
Deferred Tax Liability	20.1	19.6	22.7	27.0
Capital Employed	**238.8**	**276.7**	**319.9**	**371.9**
Gross fixed assets	209.4	228.1	263.7	306.5
Less: acc. depreciation	71.6	83.7	96.3	110.5
Capital WIP	7.7	13.6	15.7	18.2
Net Fixed assets	145.5	157.9	183.1	214.3
Investment	66.8	79.3	91.7	106.6
Goodwill	20.1	24.2	28.0	32.5
Net Current Assets	6.5	15.3	17.1	18.4
Capital Deployed	**238.8**	**276.7**	**319.9**	**371.9**

Profit & Loss Account (Consolidated)

(₹billion)	FY10A	FY11A	FY12E	FY13E
Operating Income	204.9	221.4	247.7	279.5
Expenses	141.9	167.7	195.3	215.3
EBITDA	63.0	53.8	52.4	64.2
EBITDA Margin %	30.8	24.3	21.1	23.0
Depreciation	9.7	11.2	12.5	14.2
EBIT	53.3	42.6	39.8	50.0
Interest	3.3	4.1	4.5	5.1
Extra ord.Item	3.4	-	-	-
Profit Before Tax	53.3	38.5	35.3	44.8
Tax	15.7	9.6	10.7	12.1
Profit After Tax	37.6	29.0	24.6	32.7
Minority Interest	7.1	6.6	7.9	9.5
Share of asso.	0.5	0.4	0.5	0.5
Adj. Net Profit	31.0	22.8	33.0	42.8
NPM %	15.1	10.3	13.3	15.3

Key Ratios

	FY10A	FY11A	FY12E	FY13E
EBITDA Margin (%)	30.8	24.3	21.1	23.0
EBIT Margin (%)	26.0	19.2	16.1	17.9
NPM (%)	15.1	10.3	13.3	15.3
ROCE (%)	22.3	15.4	12.4	13.4
ROE (%)	24.7	15.6	18.9	20.4
EPS (₹)	337.6	248.5	359.5	466.2
P/E (x)	7.5	10.2	7.1	5.4
BVPS	1,365.8	1,588.9	1,903.5	2,281.1
P/BVPS (x)	1.9	1.6	1.3	1.1
EV/Operating Income (x)	1.6	1.6	1.5	1.4
EV/EBITDA (x)	5.1	6.3	6.7	5.7
EV/EBIT (x)	6.1	8.0	8.8	7.3

Valuation

GIL commands strong valuation, due to its strong balance sheet, comfortable debt - equity ratio (0.4x FY'11), attractive valuation and diversified business. According to our estimate, GIL's consolidated earnings to grow at a compounded annual growth rate (CAGR) of ~37% during FY'11-13E. Further, in order to retain its leadership position in both key businesses, the company has lined up total capex of around ~₹144 billion to be spent over FY'12-FY'14E in order to capitalise on future growth. The Group's financial position remains good, with ongoing focus on working capital, delivering a strong cash flow performance in the period. Further the valuations look very attractive at the current market price ₹2,540 and therefore we rate the stock as 'BUY'. At the current market price, the stock is trading at a PE of 7.1x on FY'12E EPS of ₹359.5 and 5.4x on FY'13E EPS of ₹466.2.

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