Sharekhan
by BNP PARIBAS

Grasim Industries

Standalone business outlook remains challenging

Sector: Diversified
Result Update

	Change
Reco: **Hold**	↔
CMP: **Rs. 602**	
Price Target: **Rs. 634**	↔

↑ Upgrade ↔ No change ↓ Downgrade

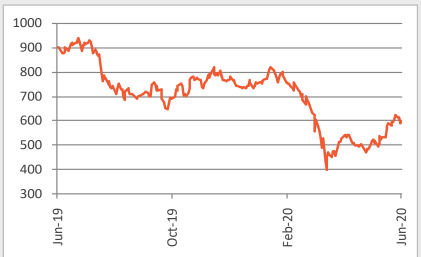
Company details

Market cap:	Rs. 39,603 cr
52-week high/low:	Rs. 950/380
NSE volume: (No of shares)	23.0 lakh
BSE code:	500300
NSE code:	GRASIM
Sharekhan code:	GRASIM
Free float: (No of shares)	39.3 cr

Shareholding (%)

Promoters	40.3
FII	13.5
DII	22.9
Others	23.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	15.1	4.4	-23.0	-33.2
Relative to Sensex	9.5	-3.2	-5.4	-18.8

Sharekhan Research, Bloomberg

Grasim Industries Limited's (Grasim's) reported marginally better-than-expected Q4FY2020 results. Its standalone net revenue declined 19% y-o-y (down 4.1% q-o-q) as both the viscose and chemical divisions were affected by loss of sales during last ten days of March 2020 (COVID-19 led nationwide lockdown) along with continued weak pricing environment. OPMs of the viscose division were 75 bps higher q-o-q than chemicals led by lower pulp prices. Adjusted OPM of the chemicals division declined 374 bps q-o-q led by lower user demand, higher imports and domestic capacity additions. Hence on a blended basis, OPM remained almost flat q-o-q at 9.1% (down 765 bps y-o-y) leading to 4.7% q-o-q decline in standalone operating profit to Rs. 394 crore (down 56% y-o-y). The company reported standalone net profit of Rs. 357 crore (up 93.4% q-o-q, down 20.9% y-o-y) on account of a reversal of deferred tax liabilities of Rs. 270 crore during Q4FY2020. Adjusting for the deferred tax liability and exceptional items, adjusted standalone net profit stood at Rs. 112 crore (down 40.4% q-o-q, down 77.8% y-o-y) which was marginally ahead of our estimates.In the near term, the viscose division is expected to be affected by high inventory levels in China while caustic soda segment suffers from capacity overhang and lower user industry demand. Consequently, the company will be finalizing future capex plan in the next quarter post reviving the economic environment. We have fine-tuned our estimates for FY2021 and FY2022. We continue to maintain our Hold rating with unchanged PT of Rs. 634.

Key positives

- OPM of viscose division improved q-o-q led by lower input prices.
- Expect 80-85% of demand to return in Q3FY2021.

Key negatives

- Chemicals division continues to perform poorly on operational front.
- Standalone net debt rise by Rs. 390 crore q-o-q.

Our Call

Valuation –Retain Hold with unchanged PT of Rs. 634: Grasim has been underperforming the broader market owing to key hangover related to financing of its investments in its group entities to maintain its stake along with deterioration in profitability of standalone businesses. In the near term, its standalone businesses are expected to remain muted owing to supply overhang and weak user-industry demand. We have fine-tuned our estimates for FY2021 and FY2022. At this stage, we continue to maintain Hold rating on the stock awaiting clarity of future capacity expansion plans in its standalone businesses and its telecom investment. Meanwhile, we believe investors can directly invest in UltraTech (which comprises ~70% of Grasim's SOTP valuation). Hence, we continue to maintain our Hold rating with unchanged PT of Rs. 634.

Key Risks

Funding requirement of its investment in Vodafone Idea & weak standalone business outlook are key risks.

Valuation (Standalone) Rs cr

Particulars	FY19	FY20	FY21E	FY22E
Revenue	20,550	18,609	17,862	20,795
OPM (%)	19.8%	12.4%	13.2%	15.2%
Adjusted PAT	2,574	1,267	1,108	1,660
% YoY growth	35.7	(50.8)	(12.5)	49.9
Adjusted EPS (Rs.)	39.1	19.3	16.8	25.2
P/E (x)	15.4	31.3	35.7	23.8
P/B (x)	0.9	1.1	1.0	1.0
EV/EBITDA (x)	3.5	8.4	8.2	6.1
RoNW (%)	6.1	3.4	2.9	4.1
RoCE (%)	5.3	2.8	2.5	3.6

Source: Company; Sharekhan estimates

Results marginally ahead of estimates adjusting for deferred tax liability reversal

Grasim reported a 19.4% y-o-y decline (down 4.1% q-o-q) in its standalone net sales to Rs. 4,313 crore (marginally better than our estimates) for Q4FY2020, mainly led by the continued weak pricing environment in viscose (realization down18% y-o-y) and chemical (down21% y-o-y).The quarter was also affected by loss of sales due to COVID-19-led nationwide lockdown from mid-March 2020. Sales volume for the viscose and chemical divisions declined by 2.7% y-o-y and 3.4% y-o-y respectively. Viscose division benefited from lower pulp prices, which led to a 75 bps q-o-q improvement in OPM (although down by 332 bps y-o-y). The caustic soda division continued to suffer on account of capacity additions during FY2020 which led to adjusted OPM (adjusting for a Rs. 23 crore one-time expense) to decline by 374 bps q-o-q (down 1587 bps y-o-y). Consequently, OPM for Q4FY2020 remained almost flat q-o-q at 9.1% although down 765 bps y-o-y. Hence, operating profit declined 4.7% q-o-q (down 56.1% y-o-y) to Rs. 394 crore (which was higher than our estimate). The company reported a standalone net profit of Rs. 357 crore (up 93.4% q-o-q, down 20.9% y-o-y) on account of reversal of deferred tax liabilities of Rs. 270 crore during Q4FY2020. Adjusting for the deferred tax liability and exceptional items, its adjusted standalone net profit stood at Rs. 112 crore (down 40.4% q-o-q, down 77.8% y-o-y), which was marginally ahead of our estimates.

Expect near term environment to be tough; Capex to be planned in next quarter

The onset of the COVID-19 pandemic in China during January 2020 to March 2020 period led to high buildup of viscose inventory (~125 days versus normal 40-45 days) in the absence of demand from user industries. Consequently, although Grasim had benefitted from pricing discipline in viscose during Q4FY2020, the next two months remains crucial as Chinese manufacturers liquidate their inventory. The chemicals division too suffers from domestic capacity additions during FY2020 which is expected to cap its OPM. Overall, the management expects 80-85% of demand to come back in Q3FY2021. Due to the current weak demand environment, the company will be finalising its full year plan along with capex requirements in the next quarter.

Key Conference Call Takeaways

- **COVID-19 impact:** The company's Q4FY2020 financials were affected by COVID-19-led nationwide lockdown from mid-March 2020 as a large part of sales was forgone during March 2020. During January 2020 and February 2020, it had achieved highest production of VSF at 1700 tonnes per day as the onset of COVID-19 in China during that period provided an opportunity for sales while prices had stabilized.
- **Current capacity utilization:** Its VSF plants are currently operating at a 30-40% capacity utilization as the end user markets like Textiles remained in red zones during May 2020. The management expects 80-85% of demand to come back in Q3FY2020. The chemicals business is currently operating at 60% capacity utilization which had been gradually ramped up from 20% to 50% and now 60% over the trailing two months.
- **Chinese scenario:** China got affected by COVID-19 first during January to March 2020 period, which led to pricing discipline in VSF market. However, Chinese plants kept running while user industries did not pick up due to which inventory at the end of March 2020 stood at 125 days versus normal inventory period of 40-45 days. Currently, the capacity utilisation of Chinese plants has come down to 60% which coupled with pick up in textile market may bring price stability in the market. However, next two months remains challenging owing to high inventory levels in China.
- **VSF exports may increase:** The non-woven market (which comprises about 30% market for VSF, balance being textiles) has been doing very well on account of its usage in masks. The company may increase exports if it gets better pricing for VSF.
- **VSF pricing scenario:** The management expects little room for further price correction in VSF and pulp prices as globally they are hovering around variable costs.However, liquidation of inventory from China can pose a near-term threat to pricing. In India, a capacity expansion of 250 kilotonnes has been completed by FY2020 end. As of now, there are no domestic capacity expansion plans announced apart from Grasim and Gujarat Alkalies.

- **One-time items:** The fertiliser segment's EBITDA included Rs. 23 crore fixed cost reimbursement of FY2020 which was included in Q4FY2020. The segment will be getting recurring Rs. 25 crore to Rs. 30 crore income as reimbursement from the government each year. The chemical division's EBITDA was impacted by a one-time cost of Rs. 23 crore in Q4FY2020 leading to lower margin.
- **Capex:** The company will be finalizing a full-year plan along with capex requirement during next quarter.
- **Increase in standalone debt:** The company's standalone net debt increased by Rs. 390 crore sequentially.

Results (Standalone) Rs cr

Particulars	Q4FY20	Q4FY19	YoY %	Q3FY20	QoQ %
Net sales	4,313	5,352	-19.4%	4,499	-4.1%
Total expenditure	3,918.4	4,453.7	-12.0%	4,085.5	-4.1%
Operating profit	394	899	-56.1%	413	-4.7%
Other Income	73.3	101.3	-27.6%	81.3	-9.8%
EBIDTA	467.4	999.8	-53.3%	494.7	-5.5%
Interest	72.4	46.8	54.9%	67.3	7.5%
PBDT	395.0	953.1	-58.6%	427.4	-7.6%
Depreciation	222.7	197.4	12.8%	212.3	4.9%
Extraordinary item	(4.1)	55.1		3.8	
PBT	176.4	700.6	-74.8%	211.3	-16.5%
Tax	(180.8)	249.3	-172.5%	26.6	-779.3%
Reported PAT	357.1	451.2	-20.9%	184.7	93.4%
Extraordinary item	(244.8)	55.1	-	3.8	-
Adjusted PAT	112.3	506.3	-77.8%	188.4	-40.4%
EPS (Rs.)	1.7	7.7	-77.8%	2.9	-40.4%
			BPS		**BPS**
Operating margin	9.1%	16.8%	-765	9.2%	-5
Net Margin	2.6%	9.5%	-686	4.2%	-158
Tax rate	-	35.6%	-	12.6%	-

Source: Company; Sharekhan Research

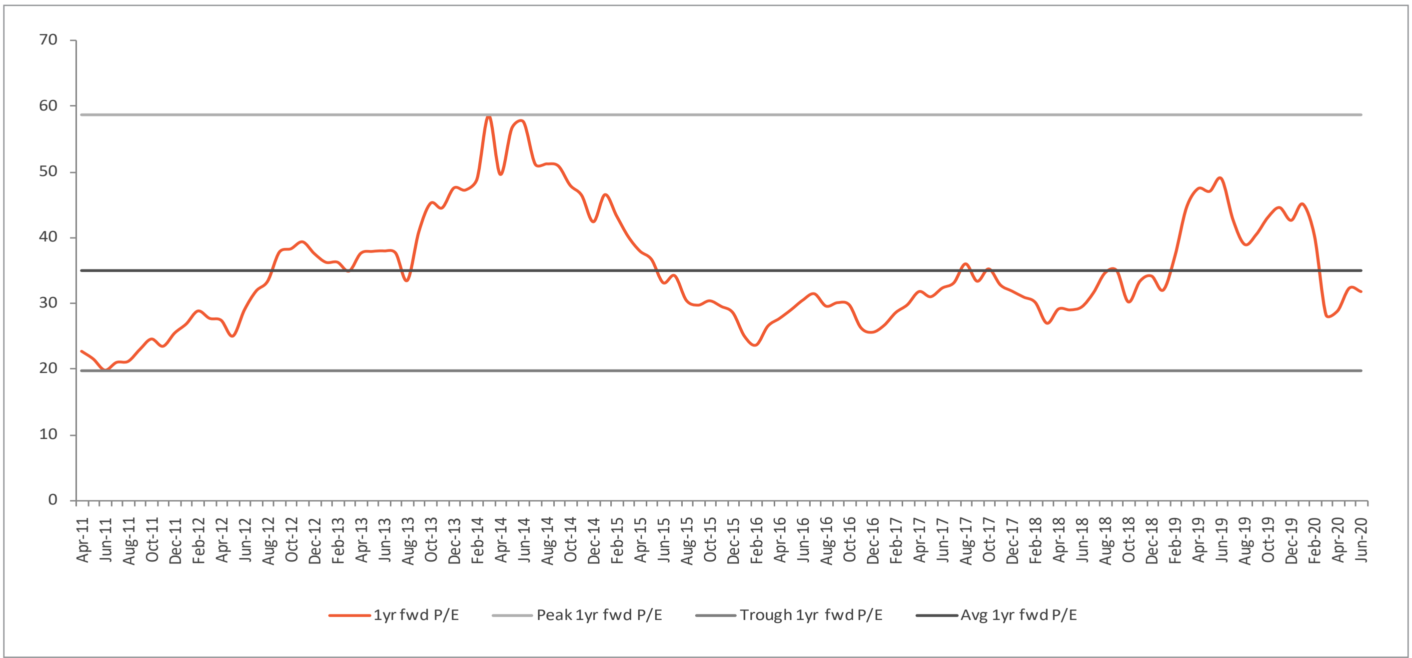
Outlook

Standalone profitability to remain under pressure in near to medium term: High inventories in China pose a near-term risk for viscose prices, while demand from user industries takes time to revive. The chemicals division is also expected to suffer from domestic capacity overhang, weak user industry demand and rising imports. Further, the management expects 80-85% of demand to return in Q3FY2021. A weak near-term outlook has led to management reviewing its capex plan for standalone business which is expected to be finalised in the next quarter. Currently, the Viscose plants are operating at 30-40% capacity utilisation while chemicals division is operating at 60% capacity utilization, which are expected to further improve going ahead.

Valuation

Retain Hold with unchanged PT of Rs. 634: Grasim has been underperforming the broader market owing to key hangover related to financing of its investments in its group entities to maintain its stake along with deterioration in profitability of standalone businesses. In the near term, its standalone businesses are expected to remain muted owing to supply overhang and weak user-industry demand. We have fine-tuned our estimates for FY2021 and FY2022. At this stage, we continue to maintain Hold rating on the stock awaiting clarity of future capacity expansion plans in its standalone businesses and its telecom investment. Meanwhile, we believe investors can directly invest in UltraTech (which comprises ~70% of Grasim's SOTP valuation). Hence, we continue to maintain our Hold rating with unchanged PT of Rs. 634.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Grasim is the flagship company of Aditya Birla Group. The company started as a textiles manufacturer in India in 1947. The cement business was started in 1985 with capacity of 0.5 MTPA. Aditya Birla Nuvo Limited, an Aditya Birla Group Company, was merged with Grasim w.e.f. July 1, 2017. Subsequently, the financial services business was demerged from the merged entity and was listed on the bourses as Aditya Birla Capital Limited (ABCL) on September 1, 2017. Currently, it is a leading global player in VSF, and is the largest chemicals (Chlor-Alkalis), cement and diversified financial services (NBFC, Asset Management and Life Insurance) player in India.

Investment theme

Grasim has been underperforming due to its exposure in Vodafone Idea with 11.55% stake. Vodafone Idea's highly leveraged balance sheet, weak telecom outlook and delay in monetisation of assets may lead to further capital infusion by FY2021 from its stakeholders, including Grasim, to retain its stake. This is expected to lead to erosion in liquid investments or higher leverage at Grasim standalone. Further, weak macro environment is expected to lead to underperformance of ABCL (57% Grasim stake) in the near term. Hence, UltraTech remains a safe bet, which comprises major value of Grasim's SOTP. We believe investors can directly have exposure in UltraTech, which has no overhangs and a better earnings growth outlook over the next two years. Hence, we have a Hold rating on Grasim.

Key Risks

- Funding requirements of its other listed entities.
- Pressure on VSF and chemical division's demand and/or realisations affects profitability negatively.
- Higher holding company discounts for any of its other business such as telecom, cement and financial services.

Additional Data

Key management personnel

Mr. Kumar Mangalam Birla	Chairman
Mr. Dilip Gaur	Managing Director
Mr. Ashish Adukia	Chief Financial Officer
Mrs. Hutokshi R Wadia	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Birla Group Holdings Pvt. Ltd.	19
2	Life Insurance Corp. of India	11.3
3	IGH Holdings Pvt. Ltd.	5.11
4	Hindalco Industries Ltd.	4.29
5	Umang Commercial Co Ltd.	4.07
6	Standard Life Aberdeen PLC	3.98
7	Pilani Investment & Industries Corp.	3.69
8	ICICI Prudential Asset Management	1.8
9	Franklin Resources Inc.	1.75
10	ICICI Prudential Life Insurance Co	1.41

Source: Bloomberg

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