Sharekhan by BNP PARIBAS

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Stock Update

Grasim Industries Limited

Improving outlook in standalone business

Diversified	Sharekhan code: GRASIM	Company Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↑	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 910**	
Price Target: **Rs. 1,120**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

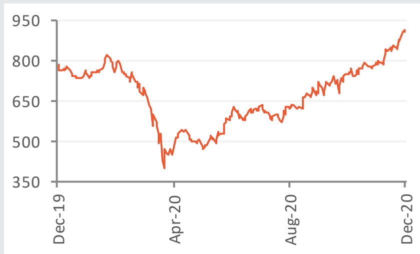
Company details

Market cap:	Rs. 59,875 cr
52-week high/low:	Rs. 924/380
NSE volume: (No of shares)	27.8 lakh
BSE code:	500300
NSE code:	GRASIM
Free float: (No of shares)	38.9 cr

Shareholding (%)

Promoters	40.9
FII	12.6
DII	20.5
Others	26.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	16.1	28.8	50.3	15.8
Relative to Sensex	6.2	12.5	19.0	6.6

Sharekhan Research, Bloomberg

Summary

- We retain our Buy rating on Grasim with a revised PT of Rs. 1,120 as we roll forward our valuation multiple for the standalone business and improve upon the valuation of its subsidiaries, Aditya Birla Capital and Vodafone Idea.
- VSF prices have risen by 27% from the historic lows in August 2020, led by strong demand in the Chinese textile market. The benefit of higher VSF prices is likely to accrue in ensuing quarters.
- Caustic soda prices have started bottoming out during October and November 2020, which along with healthy demand for chlorine to improve upon profitability going ahead.
- Exit from the fertilizer business, partnership with Lubrizol, and increasing capex in the standalone business instill confidence on increasing focus on its core business.

Grasim Industries Limited (Grasim) is expected to benefit from improving standalone operations, aided by improving outlook for both VSF and caustic soda. VSF prices have increased by 27% from their historic low of RMB 8300/tonne in August 2020 to now RMB 10,550, led by strong demand in the Chinese textile market. Operating rates in the VSF industry are now at 75%, while VSF inventory has significantly declined from 45 days in April 2020 to just 14 days in November. Blended realisation for Grasim's VSF segment had declined by 23% y-o-y/-3% q-o-q in Q2FY2021 as VSF prices bottomed out in August 2020 and began to tread higher thereafter. We expect the benefit of higher VSF prices to accrue in the coming quarters for Grasim, owing to firm prices and improved dynamics in the Chinese VSF market. Further, average caustic soda flake and lye prices in Mumbai for October-November 2020 have declined by 7.4% and 4.5%, respectively, compared to Q2FY2021. However, average caustic soda flakes price during October and November 2020 have stabilised with m-o-m improvement of 0.6% and 0.8%, respectively. Hence, we believe caustic soda prices are bottoming out and should improve from here on with demand pick up from textile, paper, and other segments. Further, demand for chlorine is expected to remain healthy, driven by demand from organic intermediaries, agrochemicals, and chlorine product segments. We expect Grasim's chemical segment to benefit from bottoming of caustic soda prices going ahead, which along with its partnership with Lubrizol would aid in improving captive chlorine integration. Grasim's recent exit from the fertiliser business would also increase its focus on the core business. Overall, we see healthy traction in its standalone operations going ahead. The company's revised capex guidance for FY2021 to Rs. 1,852 crore versus earlier guidance of Rs. 1,615 crore reinforces improving business sentiments in both VSF and chemical divisions. We retain our Buy rating on the stock with a revised SOTP-based price target (PT) of Rs. 1,120, as we roll forward our valuation for the standalone business to FY2023, incorporate increased market capitalisation, and lower holding company discount of listed subsidiaries (Aditya Birla Capital and Vodafone Idea).

Our Call

Valuation – Retain Buy with a revised PT of Rs. 1,120: Grasim is witnessing improving outlook for its standalone business with easing of lockdown restrictions domestically and improving textile demand environment in China. The firming up of VSF prices and bottoming out of caustic soda prices driven by demand from textile and paper industries is expected to benefit Grasim going ahead. Further, the outlook for its key subsidiary, UltraTech, remains healthy with expected demand from government-led infrastructure investments and sustained demand from rural and individual home builders. Hence, we retain our Buy rating on the stock with a revised SOTP-based PT of Rs. 1,120, as we roll forward our valuation for the standalone business to FY2023, incorporate increased market capitalisation, and lower holding company discount of listed subsidiaries (Aditya Birla Capital and Vodafone Idea).

Key risk

Funding requirement of its group companies and weakness in the standalone business are key risks.

Valuation (Standalone) Rs cr

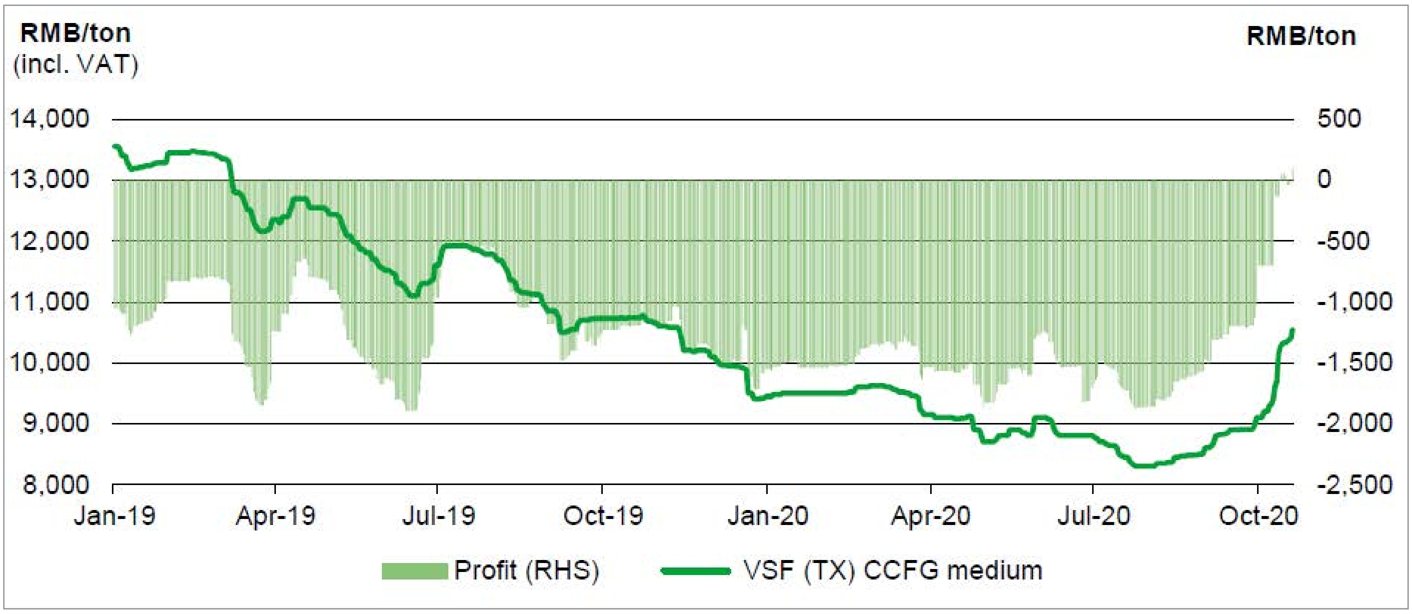
Particulars	FY20	FY21E	FY22E	FY23E
Revenue	18,609	14,526	18,136	22,227
OPM (%)	12.4%	6.9%	11.0%	11.8%
Adjusted PAT	1,267	390	979	1,403
% YoY growth	(50.8)	(69.2)	150.7	43.4
Adjusted EPS (Rs.)	19.3	5.9	14.9	21.3
P/E (x)	47.3	153.2	61.1	42.6
P/B (x)	1.6	1.5	1.4	1.4
EV/EBITDA (x)	17.1	36.3	18.3	14.0
RoNW (%)	3.4	1.0	2.3	3.3
RoCE (%)	2.8	0.9	2.1	2.9

Source: Company; Sharekhan estimates

Firm VSF prices and improved Chinese VSF market to benefit in the coming quarters

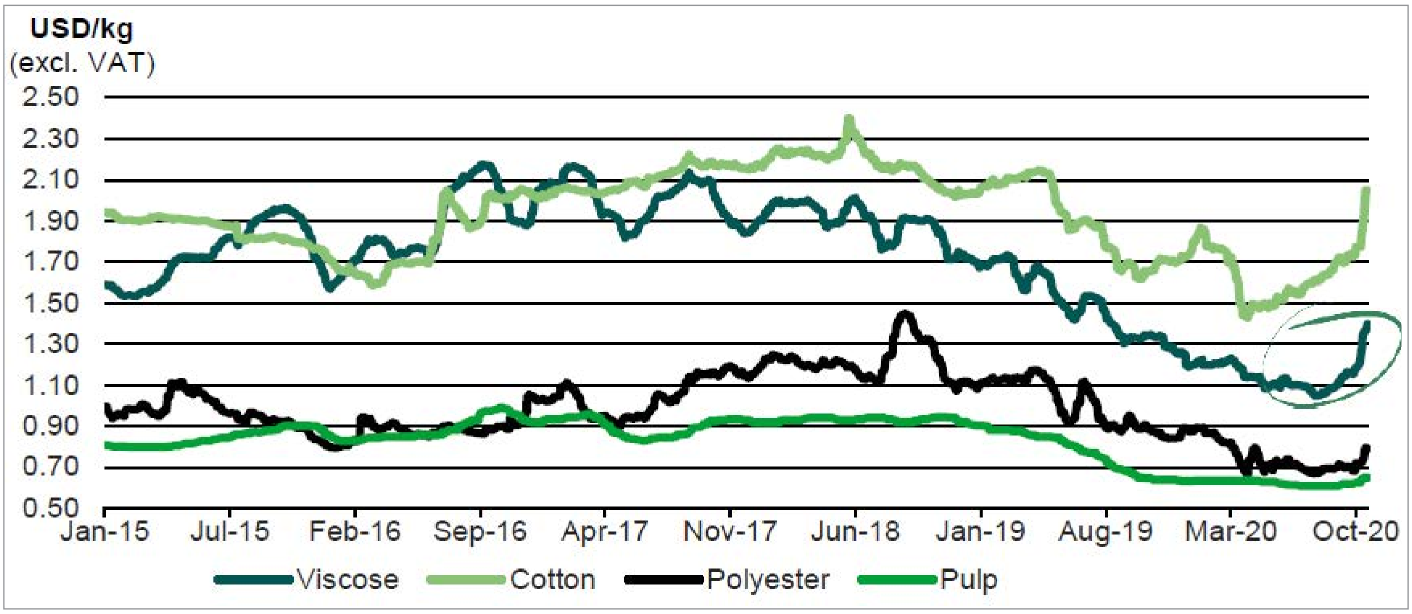
VSF prices increased by 27% from their historic low of RMB 8300/tonne in August 2020 to now RMB 10,550, led by strong demand in the Chinese textile market. Operating rates in the VSF industry are now at 75%, while VSF inventory has significantly declined from 45 days in April 2020 to just 14 days in November. Blended realisation for Grasim's VSF segment had declined by 23% y-o-y/-3% q-o-q in Q2FY2021, as VSF prices bottomed out in August 2020 and began to tread higher thereafter. We expect the benefit of higher VSF prices to accrue in the coming quarters for Grasim owing to firm prices and improved dynamics in the Chinese VSF market.

Viscose/Cotton/Pulp price trend



Source: Industry; Sharekhan Research

VSF price trend in China

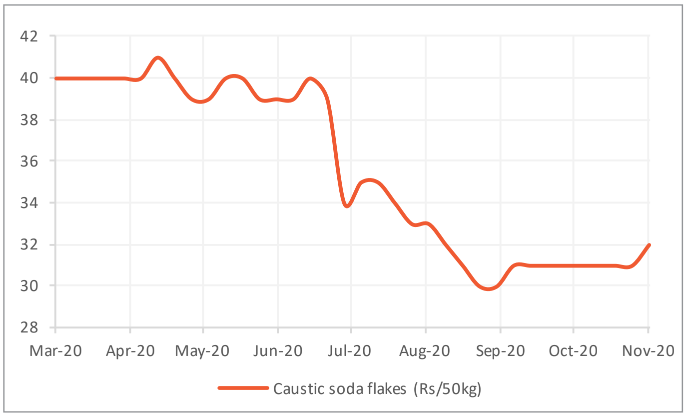


Source: Industry; Sharekhan Research

Caustic soda prices bottoming out

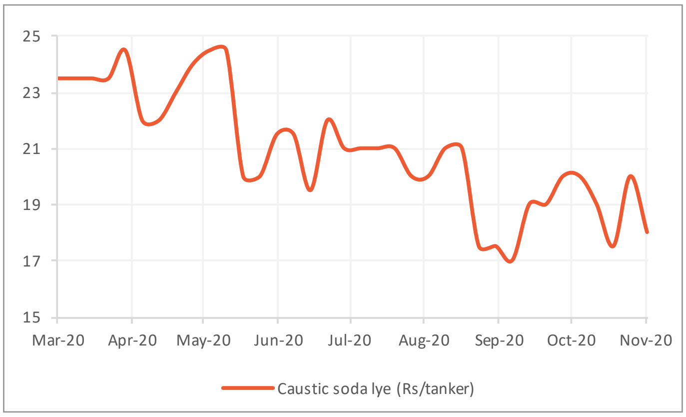
The average caustic soda flake and lye prices in Mumbai for October-November 2020 has declined by 7.4% and 4.5%, respectively, compared to Q2FY2021. However, average caustic soda flakes price during October and November 2020 has stabilized with m-o-m improvement of 0.6% and 0.8%, respectively. Hence, we believe caustic soda prices are bottoming out and should improve from here on, with demand pick up from textile, paper, and other segments. Further, demand for chlorine is expected to remain healthy, driven by demand from organic intermediaries, agrochemicals, and chlorine product segments. We expect Grasim's chemical segment to benefit from bottoming of caustic soda prices going ahead.

Caustic soda flakes price in Mumbai trend



Source: Industry; Sharekhan Research

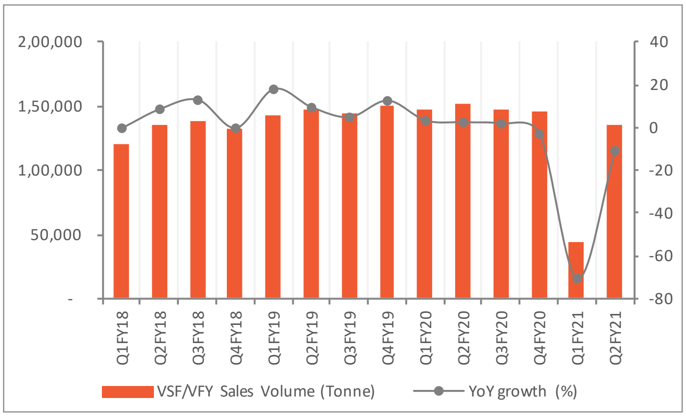
Caustic soda lye price in Mumbai trend



Source: Industry; Sharekhan Research

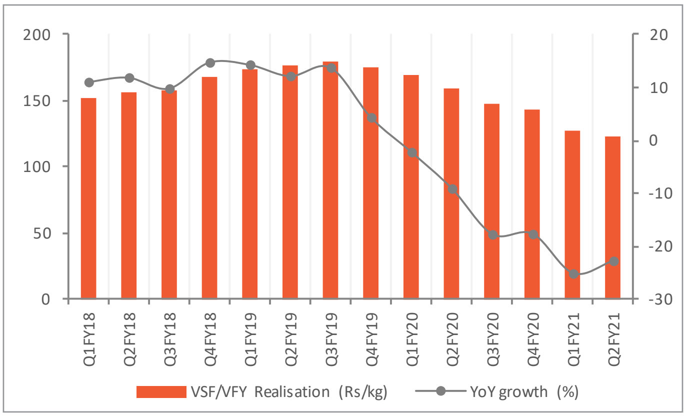
Financials in charts

VSF/VFY sales volume trend



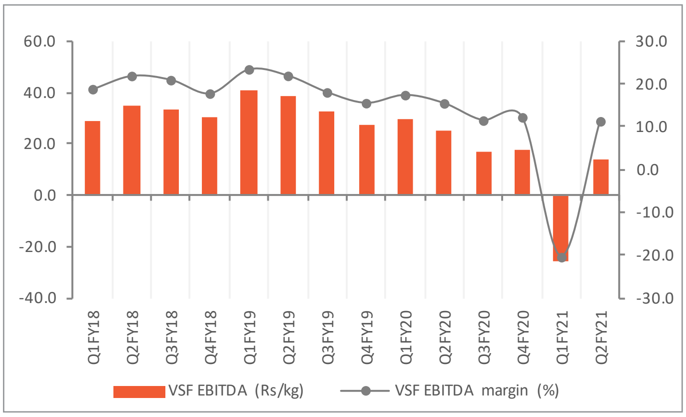
Source: Company, Sharekhan Research

VSF/VFY realisation trend



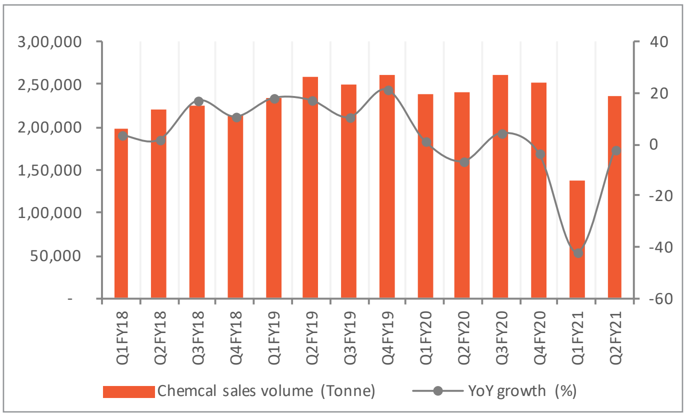
Source: Company, Sharekhan Research

VSF EBITDA trend



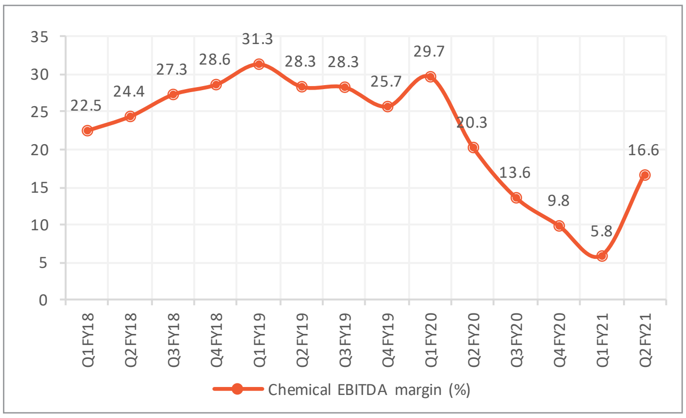
Source: Company, Sharekhan Research

Chemical sales volume trend



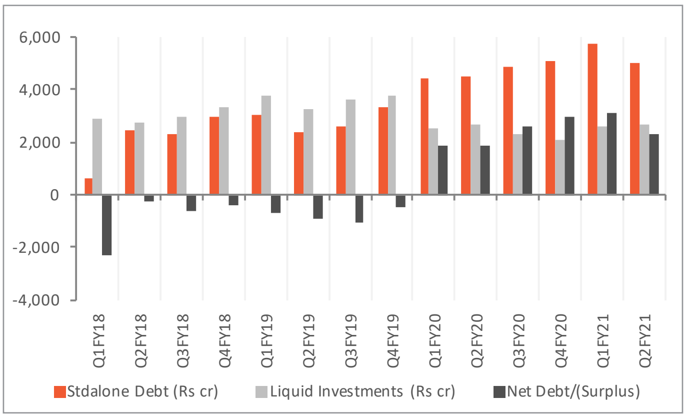
Source: Company, Sharekhan Research

Chemical EBITDA margin trend



Source: Company, Sharekhan Research

Standalone Leverage trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector View – Improving outlook of the standalone business and healthy outlook of key subsidiary**

Grasim is witnessing improving outlook for its standalone business with easing of lockdown restrictions domestically and improving textile demand environment in China. The firming up of VSF prices and bottoming out of caustic soda prices driven by demand from textile and paper industries is expected to benefit Grasim going ahead. Further, the outlook for its key subsidiary, UltraTech, remains healthy with expected demand from government-led infrastructure investments and sustained demand from rural and individual home builders. Hence, overall Grasim's standalone operations are seeing improving traction, while the outlook of its key subsidiary, UltraTech, remains positive.

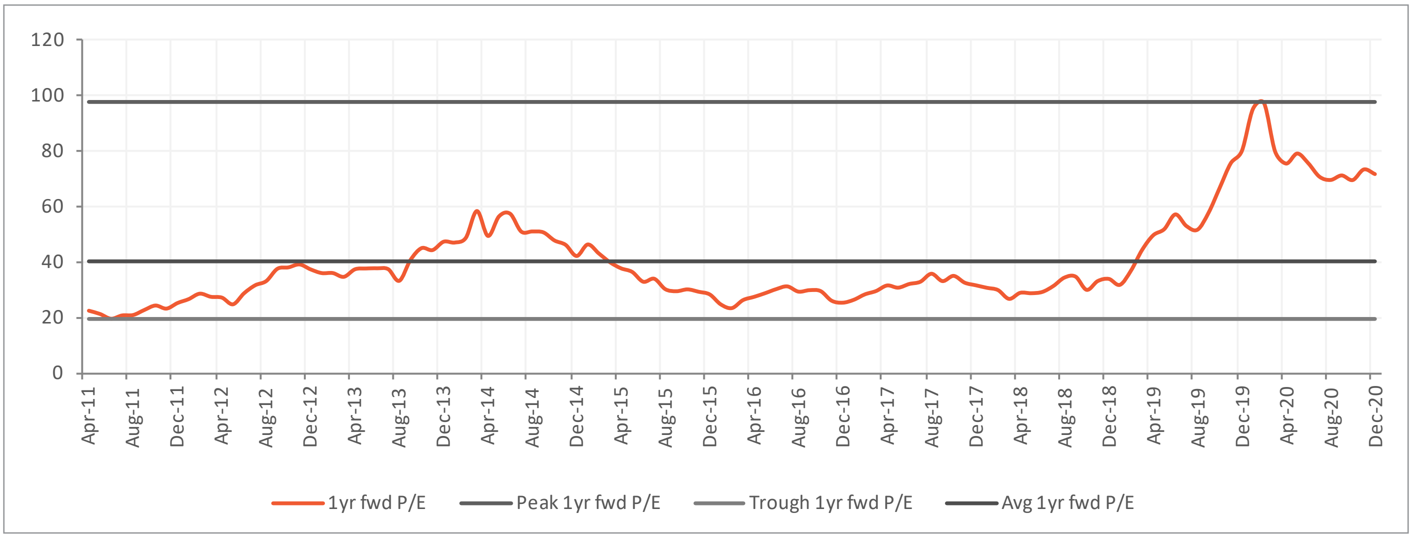
■ **Company Outlook – Improved business environment and clarity on capital allocation**

The company is benefitting from improved domestic demand environment for its key standalone businesses, led by a pickup in demand from end-user industries. The same has led to increased capex expenditure and expansion in both the verticals. Further, management's clarity on capital allocation with first priority to be given to the standalone business and nil future investment for listed telecom investment removes a key hangover on the stock. Hence, overall, improvement in standalone the business along with clarity on capital allocation is expected to improve upon its earnings and valuation.

■ **Valuation – Retain Buy with a revised PT of Rs. 1,120**

Grasim is witnessing improving outlook for its standalone business with easing of lockdown restrictions domestically and improving textile demand environment in China. The firming up of VSF prices and bottoming out of caustic soda prices driven by demand from textile and paper industries is expected to benefit Grasim going ahead. Further, the outlook for its key subsidiary, UltraTech, remains healthy with expected demand from government-led infrastructure investments and sustained demand from rural and individual home builders. Hence, we retain our Buy rating on the stock with a revised SOTP-based PT of Rs. 1,120 as, we roll forward our valuation for the standalone business to FY2023, incorporate increased market capitalisation, and lower holding company discount of listed subsidiaries (Aditya Birla Capital and Vodafone Idea).

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 is witnessing improving outlook for its standalone business with easing of lockdown restrictions domestically and improving textile demand environment in China. The firming up of VSF prices and bottoming out of caustic soda prices driven by demand from textile and paper industries is expected to benefit Grasim going ahead. Further, the outlook for its key subsidiary, UltraTech, remains healthy with expected demand from government-led infrastructure investments and sustained demand from rural and individual home builders.

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	11.29
3	IGH Holdings Pvt Ltd	5.77
4	Hindalco Industries Ltd	4.29
5	Umang Commercial Co Ltd	4.07
6	Standard Life Aberdeen PLC	3.98
7	Pilani Investment & Industries Cor	3.76
8	ICICI Prudential Asset Management	1.93
9	Vanguard Group Inc/The	1.73
10	ICICI Prudential Life Insurance Co	1.4

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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