Sharekhan by BNP PARIBAS

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Grasim Industries Limited

Strong operational performance

Diversified	Sharekhan code: GRASIM	Result Update

Stock 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. 1,242**	
Price Target: **Rs. 1,430**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 81,741 cr
52-week high/low:	Rs. 1,255/380
NSE volume: (No of shares)	27.8 lakh
BSE code:	500300
NSE code:	GRASIM
Free float: (No of shares)	38.5 cr

Shareholding (%)

Promoters	41.4
FII	13.0
DII	18.6
Others	27.0

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	20.2	47.7	96.6	65.2
Relative to Sensex	16.1	29.0	62.1	40.8

Sharekhan Research, Bloomberg

Summary

- We retain Buy on Grasim with a revised PT of Rs.1430 led by upwardly revised estimates and assigning premium due to its foray into paints business.
- Grasim reported strong outperformance during Q3 which was led by strong OPM for Viscose business led by higher realization, lower fixed costs and input cost benefits.
- Viscose demand and prices are expected to remain firm aiding in sustaining standalone profitability. Reduction in consolidated and standalone net debt continues to strengthen balance sheet.
- Viscose and chemical expansion plans on track and expected to complete by Q3FY2022. The board yet to approve capex plans for FY2022.

Grasim Industries Limited (Grasim) reported better-than-expected standalone operational performance for Q3FY2021 led by strong OPM for its Viscose business led by higher realization, lower fixed costs and input cost benefits. The company presented restated numbers excluding fertilizer business (under process of transferring the business post the sale agreement in November 2020) for Q3FY2021 and previous periods. Its standalone net sales rose 24.5% q-o-q (down 4.8% y-o-y) at Rs. 3672 crore led by strong rise in both Viscose (up 27.8% y-o-y) and chemical (up 13.8% q-o-q) revenues. The other businesses (textile and insulator) saw a 37.6% q-o-q rise. The strong surge in domestic demand for VSF (capacity utilization of 100% in Q3) along with a sharp rise in VSF prices (China VSF prices up 23% q-o-q to RMB 10,500 in Q3) led to strong sequential jump in Viscose revenues. Likewise the chemical division too saw a sequential improvement in demand with revenues reaching pre-COVID levels. Grasim outperformed significantly on OPM front with Viscose division recording OPM of 22.5%, which was up by almost 1100bps both y-o-y and q-o-q. Chemical OPM declined by 279bps q-o-q to 13.8% as ECU remained weak despite strong demand. Overall, the standalone operating profit jumped 90% q-o-q (up 68% y-o-y) to Rs. 646 crore. Strong operational performance led to standalone net profit growth of 84% y-o-y to Rs. 359 crore (almost flat q-o-q on account of lower other income and higher effective tax rate). The company's expansion plans in VSF and chemical is on track with two subsequent lines of VSF expected to commence during Q2FY2022 and Q3FY2022 while chemical expansion expected by Q1FY2022. The company's board is yet to approve the capex plan for FY2022. Grasim is expected to complete the sale and receive the proceeds from fertilizer sale in June-July 2021. The management has not yet disclosed the details regarding capital expenditure and other details with respect to its plans in decorative paints business (initial investment of Rs. 5000 crore over three year period) while the same is expected after a quarter. It has reduced its consolidated and standalone net debt by Rs. 7994 crore and Rs. 882 crore respectively during 9MFY2021. We have increased our standalone net earnings estimates for FY2021-FY2023E factoring higher OPM for Viscose business. We assign premium to valuation multiple for Grasim for its foray into paints business revising our SOTP based price target to Rs. 1430. We retain Buy on the stock.

Key positives

- Strong operational performance by Viscose division.
- Net debt at both consolidated and standalone level on downward trajectory.
- Expect demand and OPM in Viscose to sustain going ahead.

Key negatives

- Chemical OPM below expectations lead by weak ECU

Our Call

Valuation –Retain Buy with a revised PT of Rs. 1430: Grasim has benefitted from the strong improvement in its standalone business (led by Viscose), clarity on its capital allocation strategy, strong growth outlook for Ultratech and reducing leverage at both consolidate and net level. The improved demand and firm prices for Viscose is expected to sustain going ahead both domestically and in Chinese market. Further, Ultratech's growth outlook remains buoyant which comprises over 70% of Grasim's SOTP valuation. We have increased our standalone net earnings estimates for FY2021-FY2023E factoring higher OPM for Viscose business. We assign premium to valuation multiple for Grasim for its foray into paints business revising our SOTP based price target to Rs. 1430. We retain our Buy rating on the stock.

Key risk

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

Valuation (Standalone) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	18,609	13,416	16,442	19,385
OPM (%)	12.4%	13.2%	13.6%	14.7%
Adjusted PAT	1,267	867	1,202	1,621
% YoY growth	(50.8)	(31.5)	38.6	34.8
Adjusted EPS (Rs.)	19.3	13.2	18.3	24.6
P/E (x)	64.5	94.2	67.9	50.4
P/B (x)	2.2	2.0	1.9	1.9
EV/EBITDA (x)	26.6	32.4	25.5	19.8
RoNW (%)	3.4	2.1	2.8	3.7
RoCE (%)	2.8	1.9	2.5	3.3

Source: Company; Sharekhan estimates

Strong outperformance by Viscose drives net earnings: The company presented restated numbers excluding fertilizer business (under process of transferring post sale agreement in November 2020) for Q3FY2021 and previous periods. Its standalone net sales rose 24.5% q-o-q (down 4.8% y-o-y) at Rs. 3672 crore led by strong rise in both Viscose (up 27.8% y-o-y) and chemical (up 13.8% q-o-q) revenues. The other businesses (textile and insulator) saw a 37.6% q-o-q rise. The strong surge in domestic demand for VSF (capacity utilization of 100% in Q3) along with sharp rise in VSF prices (China VSF prices up 23% q-o-q to RMB 10,500 in Q3) led to strong sequential jump in Viscose revenues. Likewise the chemical division too saw sequential improvement in demand with revenues reaching pre-COVID levels. Grasim outperformed significantly on OPM front with Viscose division recording OPM of 22.5%, which was up by almost 1100bps both y-o-y and q-o-q. Chemical OPM declined by 279bps q-o-q to 13.8% as ECU remained weak despite strong demand. Overall, the standalone operating profit jumped 90% q-o-q (up 68% y-o-y) to Rs. 646 crore. Strong operational performance led to standalone net profit growth of 84% y-o-y to Rs. 359 crore (almost flat q-o-q on account of lower other income and higher effective tax rate).

Capacity expansion on track; Balance sheet de-leveraging: The company expansion plans in VSF and chemical is on track with two subsequent lines of VSF expected to commence during Q2FY2022 and Q3FY2022 while chemical expansion expected by Q1FY2022. The company's board is yet to approve the capex plan for FY2022. Grasim is expected to complete the sale and receive the proceeds from fertilizer sale in June-July 2021. The management has not yet disclosed the details regarding capital expenditure and other details with respect to its plans in decorative paints business (initial investment of Rs. 5000 crore over three year period) while the same is expected after a quarter. It has reduced its consolidated and standalone net debt by Rs. 7994 crore and Rs. 882 crore respectively during 9MFY2021.

Key Conference call takeaways

- **Fertiliser business sale:** The company has received CCI approval and NoC from stock exchanges. It has now filed application to NCLT. It expects the sale to be completed by June-July along with receipt of funds.
- **Paints venture:** The venture into paints business will provide scale, growth and reduce cyclicality of the standalone business. The company is venturing into decorative paints business with an investment of Rs. 5000 crore over three year period. The company will share the details regarding capital investment in Q4.
- **Capacity expansion:** The first line of VSF would be completed by Q2FY22 and second line by Q3FY2022. Incremental capacity in VSF would take 3 to 4 months to ramp up. The three chemical projects would be completed in Q1FY2022. The incremental caustic capacity will be ramped up to normal level by FY2022 end.
- **VSF:** The VSF capacity operated at 100% capacity utilization during Q3. VFY operated at 89% during December 2020 while for the quarter the utilization was at 77%. The company saw strong demand for VSF in the domestic market. Domestic revenues comprised 91% in Q3 versus 82% in Q2. The share of Value Added Products (VAP) was at 22% in Q3 versus 15% in Q2. There was strong demand generation from tier 2, 3 and rural segment. The VSF prices increased 23% q-o-q to RMB10,500 in Q3 while they have further risen to RMB 13,800 in January 2021. The inventory in the Chinese markets had reduced from 23 days in September to just 10 days in January. The Chinese plants capacity utilization rates were at 80-81% in Q3 versus 65% in Q2. Rise in cotton yarn prices have led to increase in VSF prices. The pulp prices started to increase post Q3 and is now at $890/tone.
- **Chemical division:** The chloroalkali division operated at 89% capacity utilization. The revenues from the division reached pre-Covid levels. However, ECU realization were lower during Q3. The prices improved from $239/MT to $270/MT. Chlorine saw some weakness on account of lower demand from health &

wellness sector. The epoxy saw strong demand from auto and consumer sector. Though epoxy business has a pass through of raw material prices, the lag effect of raw material rise and higher inventory led to benefits of margins.

- **Debt:** The consolidated net debt at the end of Q3 stood at Rs. 12,767 crore, 39% lower than March 2020 level. The standalone net debt lowered from Rs. 2975 crore in March 2020 to Rs. 2093 crore in Q3FY2021.
- **Demand outlook:** The company is seeing strong demand tailwinds for Viscose. The chloroalkali demand is positive although ECU is weak.
- **Capex:** Out of the approved Rs. 1825 crore capex plan for FY2021, it has done Rs. 800 crore during 9MFY2021. Out of the balance Rs. 1025 crore, some would get spilt to Q1FY2022. The capex plan for FY2022 is yet to be approved by the board.
- **Investment in other entities:** The management is of the view that it is highly unlikely for investments in other listed entities or subsidiaries except in solar business.

Results (Standalone) Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y%	Q2FY21	q-o-q%
Net sales	**3,672**	**3,858**	**-4.8%**	**2,949**	**24.5%**
Total expenditure	3,026.2	3,474.1	-12.9%	2,609.2	16.0%
Operating profit	**646**	**384**	**68.2%**	**339**	**90.2%**
Other Income	63.8	81.4	-21.7%	281.4	-77.3%
EBIDTA	709.4	465.2	52.5%	620.7	14.3%
Interest	50.7	46.0	10.4%	64.0	-20.7%
PBDT	658.7	419.2	57.1%	556.7	18.3%
Depreciation	200.2	198.5	0.9%	200.8	-0.3%
Extraordinary item	-	10.2		-	
PBT	**458.5**	**210.6**	**117.7%**	**355.9**	**28.8%**
Tax	126.2	22.2	469.5%	17.5	623.3%
Net Profit/(loss) from discontinued operations	27.1	(3.7)	-	21.7	24.8%
Reported PAT	**359.4**	**184.7**	**94.6%**	**360.2**	**-0.2%**
Extraordinary item	-	10.2	-	-	-
Adjusted PAT	**359.4**	**194.9**	**84.4%**	**360.2**	**-0.2%**
EPS (Rs.)	5.5	3.0	84.4%	5.5	-0.2%
Operating margin	17.6%	9.9%	764	11.5%	607
Net Margin	9.8%	5.1%	474	12.2%	-243
Tax rate	27.5%	10.5%	1700	4.9%	2263

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 the 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, Ultra Tech, 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 witnessing improving traction, while the outlook of its key subsidiary,UltraTech, remains positive.

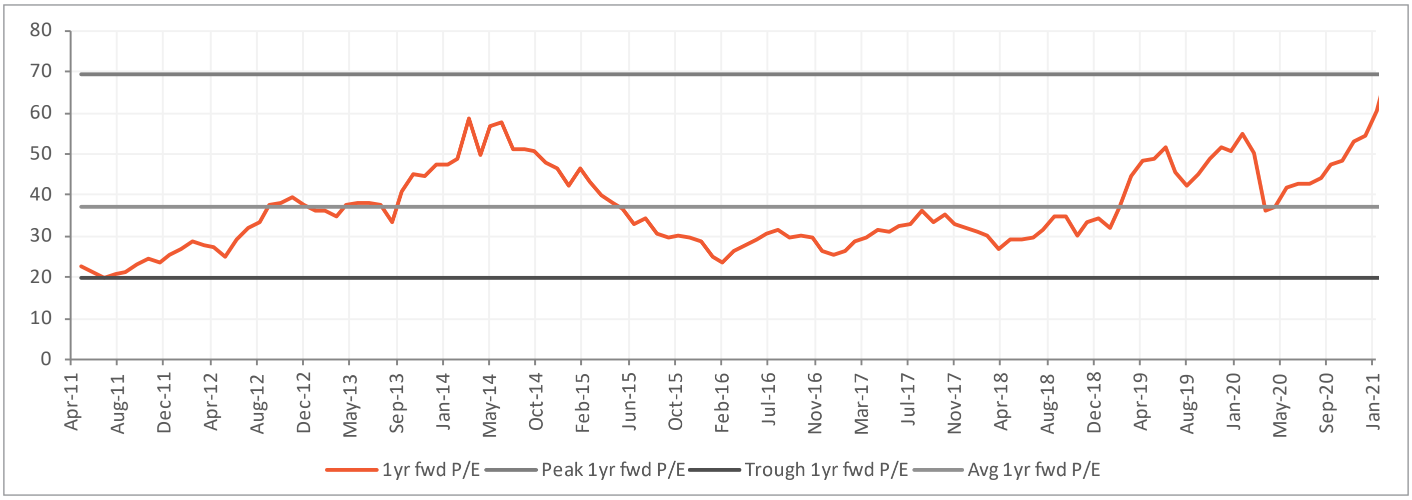
■ Company Outlook – Improved business environment and clarity on capital allocation

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 increase in capex expenditure and expansion in both the verticals. Further, the management's clarity on capital allocation with first priority to be given to standalone business and nil future investment for listed telecom investment removes a key hangover on the stock. The venture into paints business will provide scale, growth and reduce cyclicality of the standalone business. The company is venturing into decorative paints business with an investment of Rs. 5000 crore over three year period.Hence, overall the improvement in standalone 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. 1430

Grasim has benefitted from strong improvement in its Standalone business (led by Viscose), clarity on its capital allocation strategy, strong growth outlook for Ultratech and reducing leverage at both consolidate and net level. The improved demand and firm prices for Viscose is expected to sustain going ahead both domestically and in Chinese market. Further, Ultratech's growth outlook remains buoyant which comprises over 70% of Grasim's SOTP valuation. We have increased our standalone net earnings estimates for FY2021-FY2023E factoring higher OPM for Viscose business. We assign premium to valuation multiple for Grasim for its foray into paints business revising our SOTP based price target to Rs. 1430. We retain Buy on the stock.

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

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 increase in capex expenditure and expansion in both the verticals. Further, the management's clarity on capital allocation with first priority to be given to standalone business and nil future investment for listed telecom investment removes a key hangover on the stock. The venture into paints business will provide scale, growth and reduce cyclicality of the standalone business.Further, Ultratech's growth outlook remains buoyant which comprises over 70% of Grasim's SOTP valuation.

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

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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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