Sharekhan by BNP PARIBAS

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Grasim Industries Ltd

Strong Q1 in times of weak domestic demand

Diversified	Sharekhan code: GRASIM	Result 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. 1,498**	
Price Target: **Rs. 1,780**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

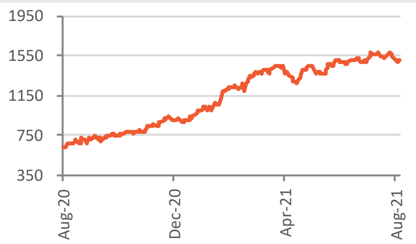
Company details

Market cap:	Rs. 98,554 cr
52-week high/low:	Rs. 1,614 / 611
NSE volume: (No of shares)	27.8 lakh
BSE code:	500300
NSE code:	GRASIM
Free float: (No of shares)	38.1 cr

Shareholding (%)

Promoters	42.1
FII	15.1
DII	16.2
Others	26.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.5	9.7	22.0	138.1
Relative to Sensex	-9.3	-4.1	15.7	91.8

Sharekhan Research, Bloomberg

Summary

- Grasim reported better-than-expected net earnings as operational performance of both the viscose and chemical divisions exceeded expectations.
- Grasim's expansion in VSF, chlor-alkali and e-poxy remain on track. Expect incremental capacity additions to aid growth amid a resurgence in pent-up demand post the second wave of COVID-19.
- Grasim is in the process of acquiring land for a paints plant that is expected to come up in the next two years.
- We retain a Buy on Grasim with a revised PT of Rs. 1,780 factoring revised valuation for UltraTech and its other listed subsidiaries.

Grasim Industries Limited (Grasim) presented restated numbers including financials of its wholly-owned subsidiary Grasim Premium Fabric as an effect of amalgamation w.e.f. April 1, 2019 in its textiles division. Standalone net sales rose 182% y-o-y (down 14% y-o-y) at Rs. 3,763 crore led by a strong rise in both the viscose (up 277% y-o-y) and chemical (up 105% y-o-y) segment's revenues. Other businesses such as textile and insulator) saw a 225% y-o-y rise at Rs. 390 crore. While viscose volumes were up 173% y-o-y (-24% q-o-q), it benefited from higher realisations, which were led by higher export sales (a 31% share versus 11% in Q4FY2021) and a higher share of value-added products (26% versus the average of 22% in FY2021). VSF prices have softened from RMB 15,805 in March 2021 to RMB 12,871 in June 2021 (led by deceleration in pipeline restocking in Q4FY2021 and lower VSF demand in China). However, the spread between cotton and VSF have widened which augurs well for VSF price going ahead. The chemicals division benefitted from higher ECU realization while caustic soda prices in international markets continue to surge, domestic prices have gradually risen. Standalone OPM stood at 19.7% (up 122 bps q-o-q) which were driven by fixed cost savings. The viscose division's margins dropped by 220 bps q-o-q to 22%, while those of the chemicals division were almost flat q-o-q at 12.5%. Overall, operating profits stood at Rs. 740 crore (down 8.7% q-o-q) versus operating loss of Rs. 226 crore in Q1FY2021. Standalone net profit stood at Rs. 482 crore versus an adjusted net loss of Rs. 225 crore in Q1FY2021 and lower by 4% q-o-q. The management is hopeful of a V-shaped demand recovery once COVID-led restrictions are reversed. However, rising pulp prices and a fall in VSF prices may drag OPM for the viscose division in the coming quarters. The VSF capacity expansion (600 TPD - one line each to be completed in Q2FY2022 and Q3FY2022), chlor-alkali (146 KTPA capacity additions each during Q2FY2022, H2FY2022 and FY2023) and epoxy (a 125 KTPA brownfield capex by FY2024) remain on track. With regards to the paints business, the company is currently acquiring land after which it will require environment clearances and other approvals and would take 18 months for setting up the plant, which means the plant would take at least two years to set up. The company expects the fertiliser business' sale to conclude and receive funds by September 2021. We expect Grasim to benefit from a strong growth outlook for its standalone business driven by capacity additions across the product portfolio and UltraTech, besides a premium valuation for its foray into the paints business. Hence, we maintain a Buy on the stock with a revised price target of Rs. 1,780 (factoring revised valuation for Ultratech and its other listed subsidiaries).

Key positives

- Better-than-expected performance by both viscose and chemical divisions.
- Capacity expansions on track.

Key negatives

- Standalone net debt rise q-o-q by Rs. 903 crore due to higher working capital needs and capex.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 1,780: Grasim has benefitted from the strong improvement in its standalone business, clarity on its capital allocation strategy, strong growth outlook for UltraTech and reducing leverage at both the consolidated and net level. Ongoing capacity expansions across products are likely to capture high demand expected over the next two years. Further, rising share of value-added products in the viscose and chemicals businesses would cushion OPMs in the wake of rising input costs. Further, UltraTech's growth outlook stays bright and it comprises over 70% of Grasim's SOTP valuation. We expect Grasim to benefit from strong growth outlook in its standalone business and UltraTech apart from getting premium valuation for its foray into paints business. Hence, we maintain a Buy rating on the stock with a revised price target of Rs. 1,780 (factoring revised valuation for UltraTech and its other listed subsidiaries).

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	12,386	14,682	17,468	19,850
OPM (%)	12.6%	14.2%	15.4%	15.4%
Adjusted PAT	891	1,158	1,566	1,796
% YoY growth	*(31.6)*	*29.9*	*35.2*	*14.7*
Adjusted EPS (Rs.)	13.6	17.6	23.8	27.3
P/E (x)	110.6	85.1	62.9	54.9
P/B (x)	2.3	2.2	2.2	2.1
EV/EBITDA (x)	45.6	34.2	26.5	23.1
RoNW (%)	2.1	2.6	3.4	3.8
RoCE (%)	1.9	2.3	3.1	3.4

Source: Company; Sharekhan estimates

Better than expected operational performance across segments

Grasim Industries Limited (Grasim) presented restated numbers including financials of its wholly-owned subsidiary Grasim Premium Fabric as an effect of amalgamation w.e.f. April 1, 2019 in its textiles division. Standalone net sales rose 182% y-o-y (down 14% y-o-y) at Rs. 3,763 crore led by a strong rise in both the viscose (up 277% y-o-y) and chemical (up 105% y-o-y) segment's revenues. Other businesses such as textile and insulator) saw a 225% y-o-y rise at Rs. 390 crore. While viscose volumes were up 173% y-o-y (-24% q-o-q), it benefited from higher realisations, which were led by higher export sales (a 31% share versus 11% in Q4FY2021) and a higher share of value-added products (26% versus the average of 22% in FY2021). VSF prices have softened from RMB 15,805 in March 2021 to RMB 12,871 in June 2021 (led by deceleration in pipeline restocking in Q4FY2021 and lower VSF demand in China). However, the spread between cotton and VSF have widened which augurs well for VSF price going ahead. The chemicals division benefitted from higher ECU realization while caustic soda prices in international markets continue to surge, domestic prices have gradually risen. Standalone OPM stood at 19.7% (up 122 bps q-o-q) which were driven by fixed cost savings. The viscose division's margins dropped by 220 bps q-o-q to 22%, while those of the chemicals division were almost flat q-o-q at 12.5%. Overall, operating profits stood at Rs. 740 crore (down 8.7% q-o-q) versus operating loss of Rs. 226 crore in Q1FY2021. Standalone net profit stood at Rs. 482 crore versus an adjusted net loss of Rs. 225 crore in Q1FY2021 and lower by 4% q-o-q.

Capacity expansion to help capture pent up demand

The management is hopeful of a V-shaped demand recovery once COVID-led restrictions are reversed. However, rising pulp prices and a fall in VSF prices may drag OPM for the viscose division in the coming quarters. The VSF capacity expansion (600 TPD - one line each to be completed in Q2FY2022 and Q3FY2022), chlor-alkali (146 KTPA capacity additions each during Q2FY2022, H2FY2022 and FY2023) and epoxy (a 125 KTPA brownfield capex by FY2024) remain on track. With regards to the paints business, the company is currently acquiring land after which it will require environment clearances and other approvals and would take 18 months for setting up the plant, which means the plant would take at least two years to set up. The company expects the fertiliser business' sale to conclude and receive funds by September 2021. We expect Grasim to benefit from a strong growth outlook for its standalone business driven by capacity additions across the product portfolio and UltraTech, besides a premium valuation for its foray into the paints business.

Key Conference Call Takeaways

- **Outlook:** The company expects a rapid demand recovery as seen in 2020 once COVID-led restrictions ease. Global demand remains strong. In Q4FY2021, not only demand was good but there was re-stocking.
- **Viscose demand and pricing:** Domestic demand for Viscose grew by 9% y-o-y in Q4FY2021. The share of VAP increased to 26% from 22% in Q3FY2021. Chinese VSF prices rose from RMB 12,800 in January 2021 to RMB15,800 in March 2021 driven by strong consumer demand, re-stocking and a rise in cotton prices. China's inventory significantly declined from 45 days in April 2020 to 13 days in March 2021.
- **Chemical:** Chlor-Alkali capacity operated at a 94% capacity utilisation as against 89% in Q3FY2021. The e-poxy business in chemical was driven by demand from auto and wind sectors. ECU realisations were marginally higher q-o-q due to higher prices at the end of Q4FY21 quarter. The company is hopeful of maintaining or increasing margins in the chemicals division.
- **Capex:** FY2021 capex stood at Rs. 1,508 crore. The capex for FY2022 excluding paints and fertiliser is Rs. 2604 crore. The capex includes VSF expansion at Vilayat in which line one will be completed in Q2FY2022 and line-2 in Q3FY2022. The other capex includes increase in e-poxy capacity by 125 KTPA through brownfield expansion at Vilayat. In the chlor-alkali space, it would invest in a 200 TPD brownfield expansion at Vilayat taking it to total 1,400 TPD at Vilayat to be commissioned in 24 months. The company commissioned 182 MW in solar business in FY2021 taking it total 502 MW in its subsidiary. In next two years, it is scheduled to add another 343 MW. The capex in paints will happen this year and it is looking at land acquisitions for plant. It maintained a capex target of Rs. 5,000 crore for three years in the paints business.
- **Debt:** Consolidated debt as at the end of FY2021 declined 58% y-o-y to Rs. 8831 crore. The standalone net debt reduced from Rs. 2,999 crore in FY2020 to Rs. 914 crore in FY2021. The company would not be

net cash by FY2022 end due to capex plans. It would not go beyond 2.5x net debt to EBITDA over five years even after paints capex.

- **Fertilizer business divestment:** The management expects divestment of fertilizer business to complete by Q2FY2022.
- **Soktas:** The appointed date for the merger is April 2019. The textile financials include the financials of Soktas for FY21.
- **Dividend:** The company announced Rs. 5 per share dividend for FY2021 and a special dividend of Rs. 4 per share totalling to Rs. 9 per share for FY2021.

Results (Standalone) Rs cr

Particulars	Q1FY22	Q1FY21	Y-o-Y %	Q4FY21	Q-o-Q %
Net sales	**3,763**	**1,336**	**181.7%**	**4,394**	**-14.4%**
Total expenditure	3,022.5	1,561.4	93.6%	3,583.4	-15.7%
Operating profit	**740**	**(226)**	**-**	**811**	**-8.7%**
Other Income	64.9	99.2	-34.6%	69.2	-6.1%
EBIDTA	805.2	(126.5)	-	880.0	-8.5%
Interest	58.1	65.8	-11.6%	53.6	8.3%
PBDT	747.0	(192.2)	-	826.4	-9.6%
Depreciation	201.8	202.9	-0.6%	214.5	-5.9%
Extraordinary item	-	57.7	-	23.3	-
PBT	**545.3**	**(452.9)**	**-**	**588.6**	**-7.4%**
Tax	99.3	(141.4)	-	125.6	-20.9%
Net Profit/(loss) from discontinued operations	35.7	28.6	24.9%	17.2	107.9%
Reported PAT	**481.6**	**(282.9)**	**-**	**480.2**	**0.3%**
Extraordinary item	-	57.7	-	23.3	-
Adjusted PAT	**481.6**	**(225.2)**	**-**	**503.5**	**-4.3%**
EPS (Rs.)	7.3	(3.4)	-	7.7	-4.3%
			BPS		**BPS**
Operating margin	19.7%	-16.9%	-	18.5%	122
Net Margin	12.8%	-16.9%	-	11.5%	134
Tax rate	18.2%	-	-	21.3%	-312

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. 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.

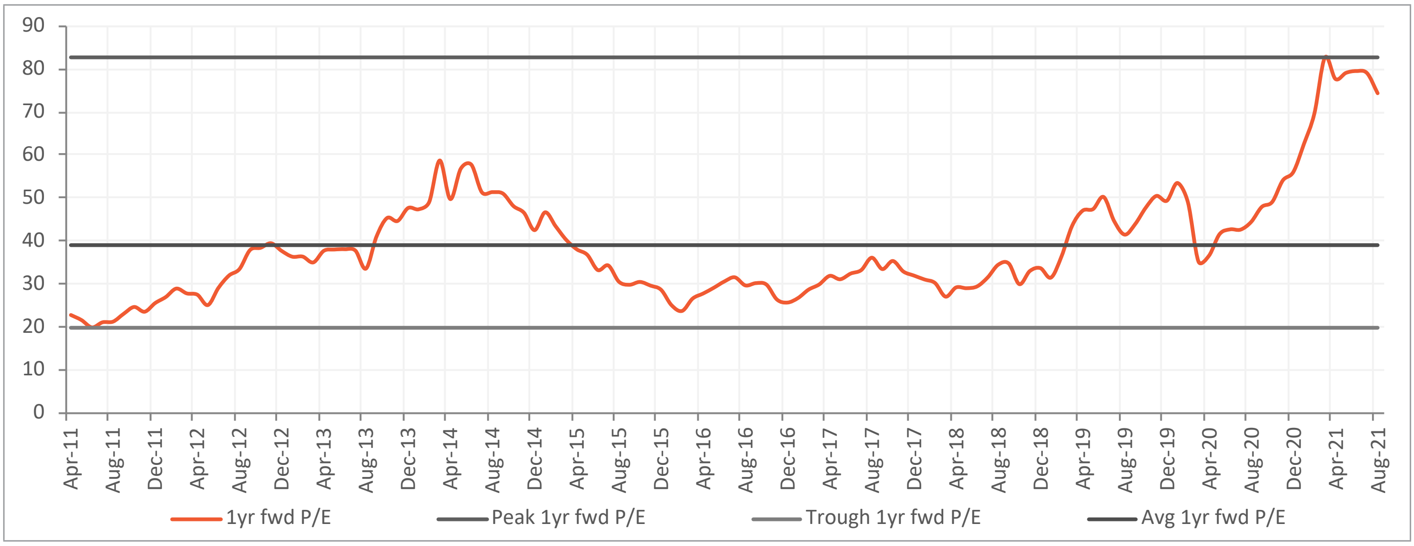
■ Company outlook – Improved business environment and clarity on capital allocation

Grasim is benefiting from a rise in domestic demand for key standalone businesses as offtake from end-user industries improves. The same has led to an increase in capex expenditure and expansion in both verticals. Further, the management's clarity on capital allocation with priority being given to the standalone business and nil investments in listed telecom investment removes a key hangover. The venture into the 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. 5,000 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. 1,780

Grasim has benefitted from the strong improvement in its standalone business, clarity on its capital allocation strategy, strong growth outlook for UltraTech and reducing leverage at both the consolidated and net level. Ongoing capacity expansions across products are likely to capture high demand expected over the next two years. Further, rising share of value-added products in the viscose and chemicals businesses would cushion OPMs in the wake of rising input costs. Further, UltraTech's growth outlook stays bright and it comprises over 70% of Grasim's SOTP valuation. We expect Grasim to benefit from strong growth outlook in its standalone business and UltraTech apart from getting premium valuation for its foray into paints business. Hence, we maintain a Buy rating on the stock with a revised price target of Rs. 1,780 (factoring revised valuation for UltraTech and its other listed subsidiaries).

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

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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