6 January 2022
Update | Sector: Cement

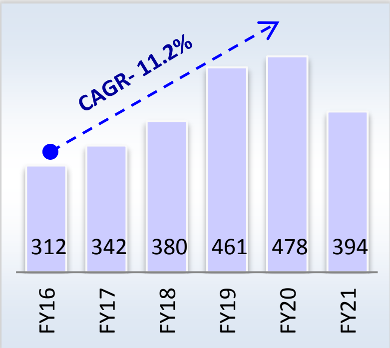
Grasim

BSE SENSEX	S&P CNX
59,602	17,746

Stock Info

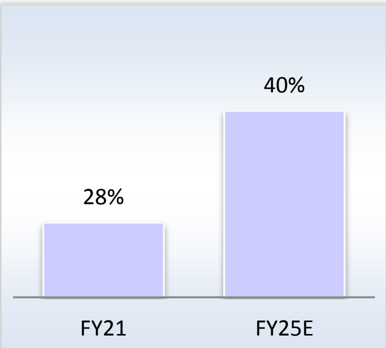
Bloomberg	GRASIM IN
Equity Shares (m)	657
M.Cap.(INRb)/(USDb)	1132.2 / 15.2
52-Week Range (INR)	1893 / 944
1, 6, 12 Rel. Per (%)	-1/2/51
12M Avg Val (INR M)	2285

Strong growth in domestic VSF volume of Grasim (kt)



Source: MOFSL, Company

Chlorine integration likely to improve to 40% by FY25E



Source: MOFSL, Company

CMP: INR1,720 TP: INR2,050 (+19%) Upgrade to Buy

Improving core business, Paints should shine

Capacity expansion in VSF/Caustic soda and foray into Paints should underpin growth

- **Grasim Industries (Grasim) should benefit from the changes in cotton industry dynamics. VSF demand growth should outpace cotton until FY25E. Further, the US ban on cotton imports from Xinjaing region may trigger a shift to substitute products.**
- **Focus on backward integration in the Chemical segment should improve chlorine usage as Grasim plans to increase chlorine consumption in value added products (VAPs) to 40% by FY25E from 28% in FY21. Chemical segment's OPM should improve to 19% in FY23E from 13% in FY21.**
- **Further, likely capacity expansions of 37%/33% in the VSF/Caustic soda segments, respectively, should improve volume/profits during FY22-24E. We estimate a 16%/15% volume CAGR for the VSF/Chemical business, respectively, over FY21-24.**
- **Grasim's plan to augment the capex of its Paints business indicates its intent of entering the paints segment on a large scale. Brand recall of Grasim as well as its strong balance sheet, and distribution network of UTECM's white paints segment should help the company succeed in this segment.**
- **We upgrade our rating on Grasim to BUY from Neutral. We assign a: a) 6x Dec-23 EV/EBITDA to the standalone segment, b) 40% HoldCo discount for its holding in subsidiary companies, and c) 5% premium to our SoTP-based TP for the paints business, to arrive at our revised target price of INR2,050. Grasim is a quasi-play on the cement segment with UTCEM being our top pick in the large-cap space.**
- **Key risks to our call: a) delay in entry into the paints business, b) inability to gain volumes in the paints segment and c) margin pressure on the VSF/caustic business.**

Changes in the cotton industry dynamics; higher growth potential for VSF

The US ban on cotton imports from Xinjiang, China (one of the major cotton producers accounting for 21% of global production in CY20) due to forced labor issues may lead to a shift to other regions or cotton substitutes to meet apparel manufacturers' needs. This may aid global VSF producers. VSF seems to be more sustainable than cotton in long run due to: a) lower water/pesticides requirement and b) no competition from food crops for arable lands. The consumption of wood-based fibers is estimated to record a 3-5% CAGR over FY19-25 (higher growth for Lyocell, Modal and Viscose) compared with -1 to 1% growth for cotton.

Caustic soda margins likely to improve; focus on Chlorine VAPs to help

Caustic soda prices in the industry have increased recently and margins seem to be improving from the lows of FY20/21. Grasim has gained a competitive edge by developing higher VAPs from chlorine, which results in better ECU realizations. The company targets to increase chlorine consumption in VAPs to 40% by FY25E from 28% in FY21. This will augment the production of Caustic Soda. Further, Grasim's tie up with Lubrizol will help the former raise its chlorine sales.

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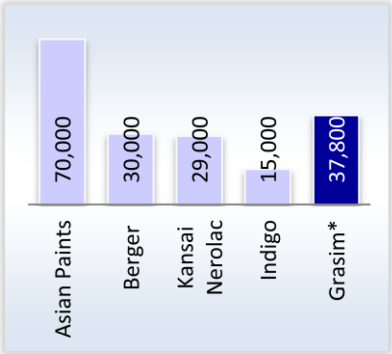
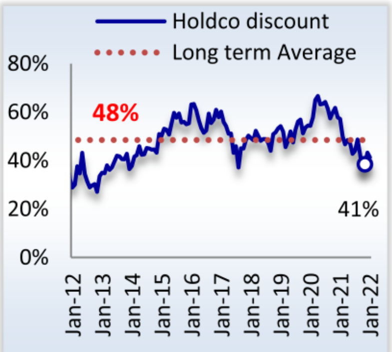
Dealer network of Birla White should help Grasim to enhance its reach



Source: MOFSL, Company, considering 70% of Birla White dealers where overlap exists

Holdco discount at 41%



Source: MOFSL, Company

Capacity expansions in VSF and Chemical segments to boost growth

Grasim is in the process of increasing its VSF segment capacity by 37% to 810ktpa, which is expected to be completed by 3QFY22. The company is likely to raise its caustic soda production by 33% to 1,530ktpa by FY23E (237ktpa in FY22E and 136ktpa in FY23E) and its epoxy capacity by 125ktpa as on FY24E. We estimate a 16%/15% volume CAGR for the VSF/Chemical business, respectively, over FY21-24. Grasim plans to improve its mix of VAPs in the chemical segment to 40% by FY25E from 28% in FY21 and to 35-40% by FY25E in VSF segment from 27% in 2QFY22.

Entry into paints to help diversify from cyclical to a high-RoCE business

Grasim's plan to invest INR50b of capex for the Paints business indicates its intent of entering the paints segment on a large scale. We view Grasim's entry into this business as a positive step as this marks its diversification into a high-growth, high-RoCE segment from the cyclical and non-core (divestment of its fertilizer business has been completed) business segments. Though, historically some of the companies have found it difficult to achieve a meaningful scale in this business, we believe Grasim has fair scope of succeeding. This is because: a) the distribution network of Birla White/Putty (of 54,000 dealers) has 70% overlap between Paints and Birla White dealers and b) the Birla group enjoys a strong brand recall. Further, Grasim's strong balance sheet will support this segment to grow initially and the company may pose a serious threat to incumbents over the long run. The management is targeting a 20% IRR from this business and is aiming to make Grasim the No. 2 player in the paints industry.

Quasi-play on the cement business; UTCEM is our top pick in the sector

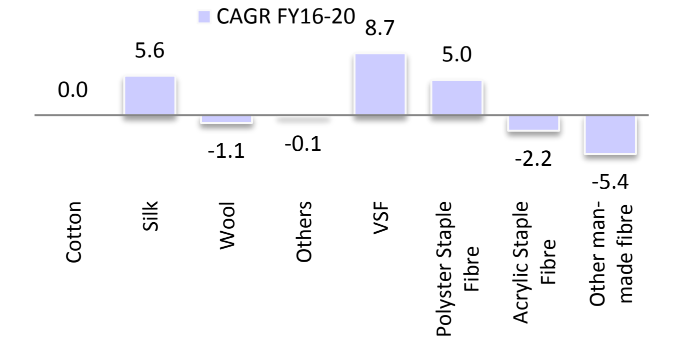
Grasim, through its holding in UTCEM, is also a quasi-play on the cement segment. In our SoTP valuation for Grasim, UltraTech contributes 65% of the total value for Grasim. We are positive on the cement business and UTCEM is our top pick in large-cap space driven by its: a) growth plans, b) cost-saving initiatives, c) leadership position and d) improving balance sheet strength. The HoldCo discount for Grasim's holding in subsidiary companies has reduced to 40-45% from 60%+ two years back (when there were concerns of fund infusion in VIL), which we expect to sustain going forward.

Valuation and view: Upgrade to BUY from Neutral

Grasim's significant capex plans for its Paints business indicates its intent to enter the segment on a large scale. The company's strong balance sheet is likely to be sufficient for its capex requirements in this segment. Grasim's net debt is anticipated to decline notably to INR11.7b in Mar'22 from INR29.4b in FY20. We expect the company to turn net cash positive in FY23 (excluding capex for the paints business). We value the standalone business at 6x Dec-23E EV/EBITDA and other listed subsidiaries at 40% HoldCo discount to arrive at our revised target price of INR2,050. Our target price for Grasim includes a 5% premium to the underlying SoTP valuation in order to capture the potential upside from its paints business. We upgrade our rating on Grasim to **BUY** from **Neutral**.

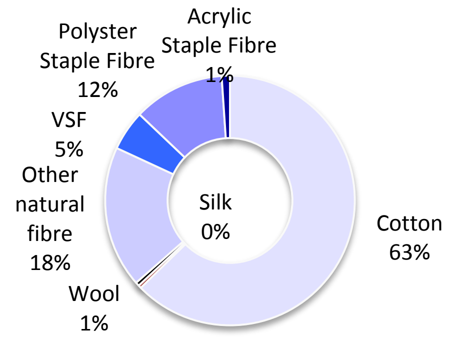
Story in charts

Exhibit 1: VSF demand growth higher v/s other fibers (%)



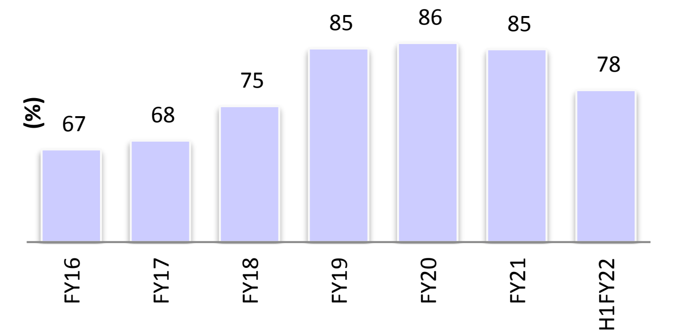
Source: MOFSL, Industry

Exhibit 2: VSF consumption mix at 5% v/s 6% globally



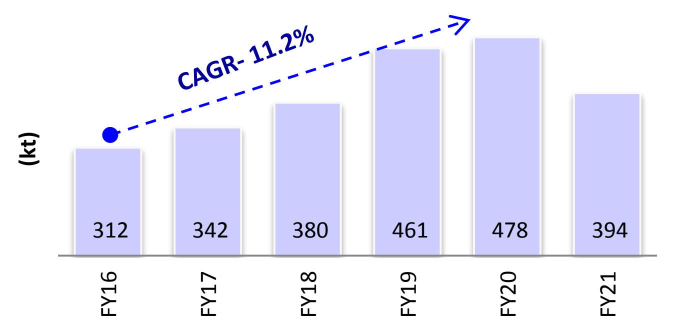
Source: MOFSL, Industry

Exhibit 3: Increase in sales mix (VSF) in domestic markets



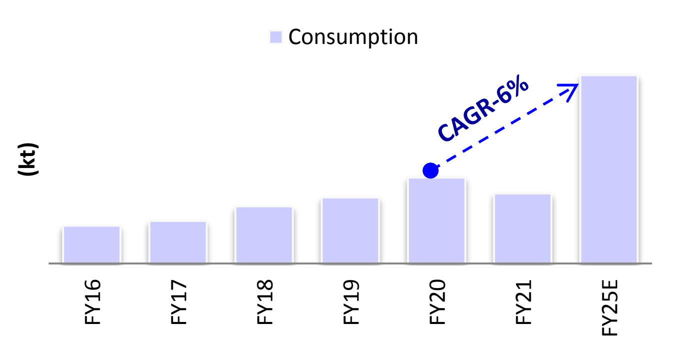
Source: MOFSL, Company

Exhibit 4: Strong growth in domestic VSF volume for Grasim



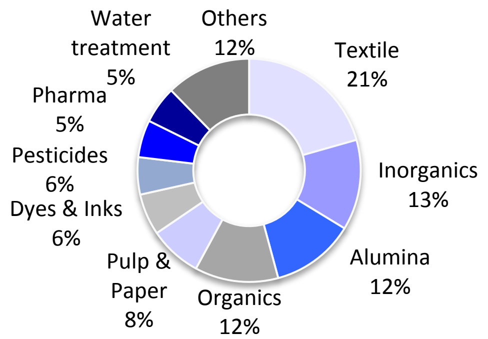
Source: MOFSL, Company

Exhibit 5: Caustic soda demand CAGR estimated at 6%



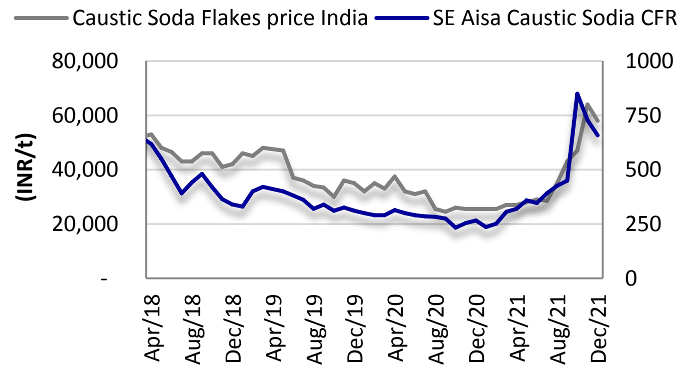
Source: MOFSL, Company

Exhibit 6: Breakdown of caustic soda consumption in India



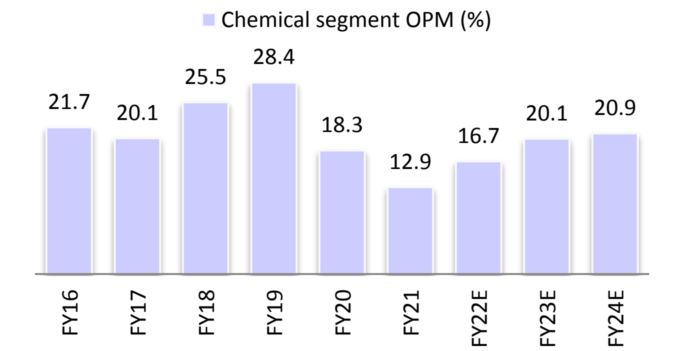
Source: MOFSL, Company

Exhibit 7: Improvement in caustic soda prices from Oct-21



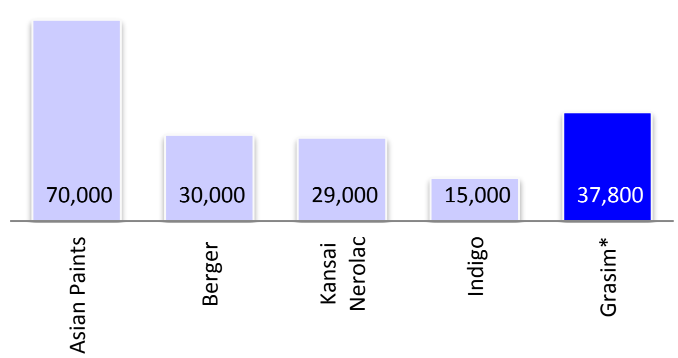
Source: MOFSL, Company

Exhibit 8: Expect improvement in Chemical segment OPM



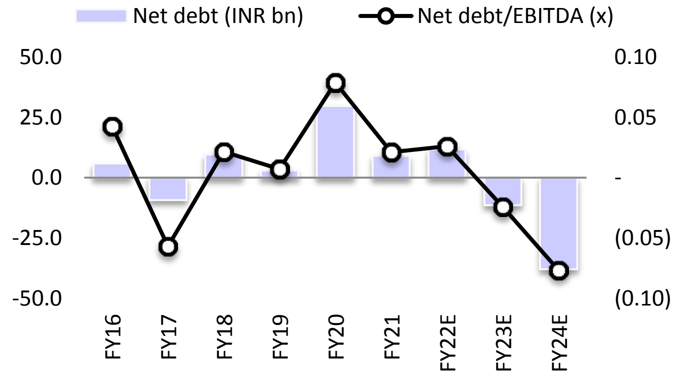
Source: MOFSL, Company

Exhibit 9: Distribution network considering overlap between white cement/wall putty distributors



Source: Company, MOFSL, Indigo Paints DRHP; *considering 70% of Birla White dealers where overlap exists

Exhibit 10: Expect to turn net cash positive in FY23E*



Source: Company, MOFSL, *excluding capex for paints business

Exhibit 11: SoTP valuation

Particulars	Valuation method	Unit	Dec-23E	INR/Share
UltraTech's Mcap based on target price		INR b	2,528	
HoldCo discount		%	40	
Grasim's stake		%	57	
Value of cement stake		**INR b**	**869**	
Value/share	**40% HoldCo discount to our TP**	**INR**		**1,321**
Value of Grasim's standalone business		INR b	246	
Value/share	**6x for standalone business**			**373**
Value of listed investments		INR b	64	
HoldCo discount		%	40	
Value of listed investments post HoldCo		**INR b**	**38**	
Value/share	**40% HoldCo discount on CMP**	**INR**		**58**
VSF & Fiber JV		INR b	8	
Value/share	**1x P/BV**	**INR**		**12**
Standalone Net Debt of Grasim		INR b	(31)	
Value/share		**INR**		**(48)**
Aditya Birla Capital		INR b	282	
HoldCo discount		%	40	
Grasim's stake		%	54	
Value of AB Capital's stake in Grasim		**INR b**	**92**	
Value/share	**40% HoldCo discount on CMP**	**INR**		**139**
SoTP-based target price		**INR**		**1,951**
Premium for the Paints business	**5%**			**98**
Target price		**INR**		**2,050**

Source: MOFSL, Company

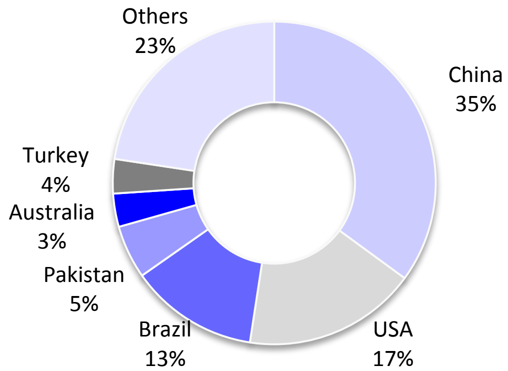
Better growth prospects for the VSF business

- **The US ban on cotton imports from Xinjiang may trigger a shift to substitute products**
- **Viscose is the ideal alternative for cotton given its superior properties**
- **Higher growth expectation for wood-based fibers over the next few years**
- **VSF gaining acceptance in domestic markets: 85% sales by Grasim in India in FY21 v/s 67% in FY16**

The US banned cotton imports from Xinjiang on concerns of forced labor

The Xinjiang region accounted for 21% of global cotton and 87% of China's cotton production in CY20. However, there are concerns that cotton is being produced here by using forced labor, mainly the imprisoned Uyghurs and ethnic Kazakhs. In Jan-21, the US government banned the cotton from this region citing concerns of alleged human rights violations. Consequently, several apparel brands (such as H&M, Adidas, Patagonia, millennial "it" etc.) announced discontinuation of Xinjaing-made materials from their supply chains. In Dec-21, the US House of Representatives passed a legislation to ban imports from the Xinjiang region. However, as there will be challenges in verifying the identity of cotton in the end product, many brands and retailers are likely to switch to substitute products.

Exhibit 12: Cotton production in 2020/21 (season starting from 1st August 2020)

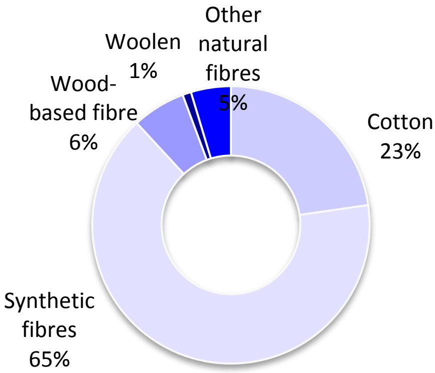


Source: MOFSL, USDA

Higher growth for the wood-based fibers over the last few years

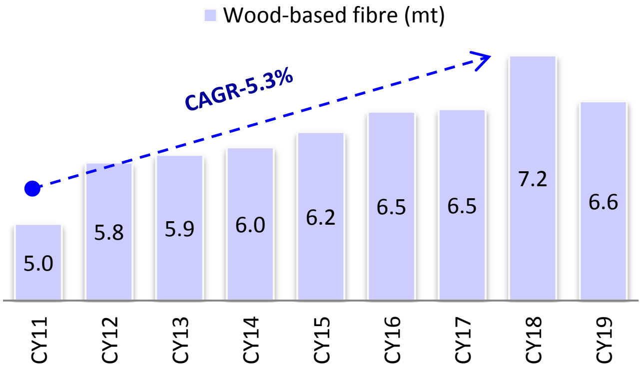
The demand for wood-based fiber has registered a 5.3% CAGR over CY11-19 (before the pandemic) v/s 1-2% growth for Cotton. Viscose is a substitute for Cotton with a higher moisture absorption capacity and having a lightweight, lustrous finish and a soft feel, etc. Concerns on use of cotton produced in Xinjiang region can improve the outlook for Viscose fibers. Cotton has limited growth potential in the long run as it: a) competes with food crops for arable lands and b) requires high amount of water and pesticides.

Exhibit 13: Global fiber consumption at 106.1mt in CY19



Source: MOFSL, Lenzing

Exhibit 14: Consumption trend of wood-based fiber



Source: MOFSL, Lenzing

Viscose is the ideal alternative for cotton given its superior properties

Viscose provides better comfort, look and durability than cotton, thereby making it an ideal alternative. Viscose has much higher moisture absorption capabilities than cotton. It has a brilliant luster, wide range of colors (600+ shades) and a good drape that makes it an ideal choice for premium fashion brands; moreover the fabric retains freshness even after repeated washes.

Exhibit 15: Viscose compares favorably to both cotton and polyester

	COTTON	VISCOSE	MODAL	EXCEL	POLYESTER
Moisture Absorption	◑ 7.5%	● 13%	● 13%	● 13%	○ 0.4%
*Wet/Dry Strength**	● 1.14	○ 0.58	◔ 0.63	◑ 0.84	◕ 1.01
Elongation-at-break	○ 8%	● 19%	◕ 15%	◑ 13%	◕ 15%
Tenacity (gpd)	◑ 2.8	◑ 2.9	◕ 3.8	◕ 4.2	● 6.0
Wrinkle-resistant	○	◔	◑	◕	●
Ease of dyeing	●	○	○	●	○
Hand (Surface feel)	◑	●	●	●	○
Drape	◑	●	●	●	○
Resistance to fading	○	●	●	●	●
Ability to 'Breathe'	●	●	●	●	○
Skin Friendly	●	●	●	●	○

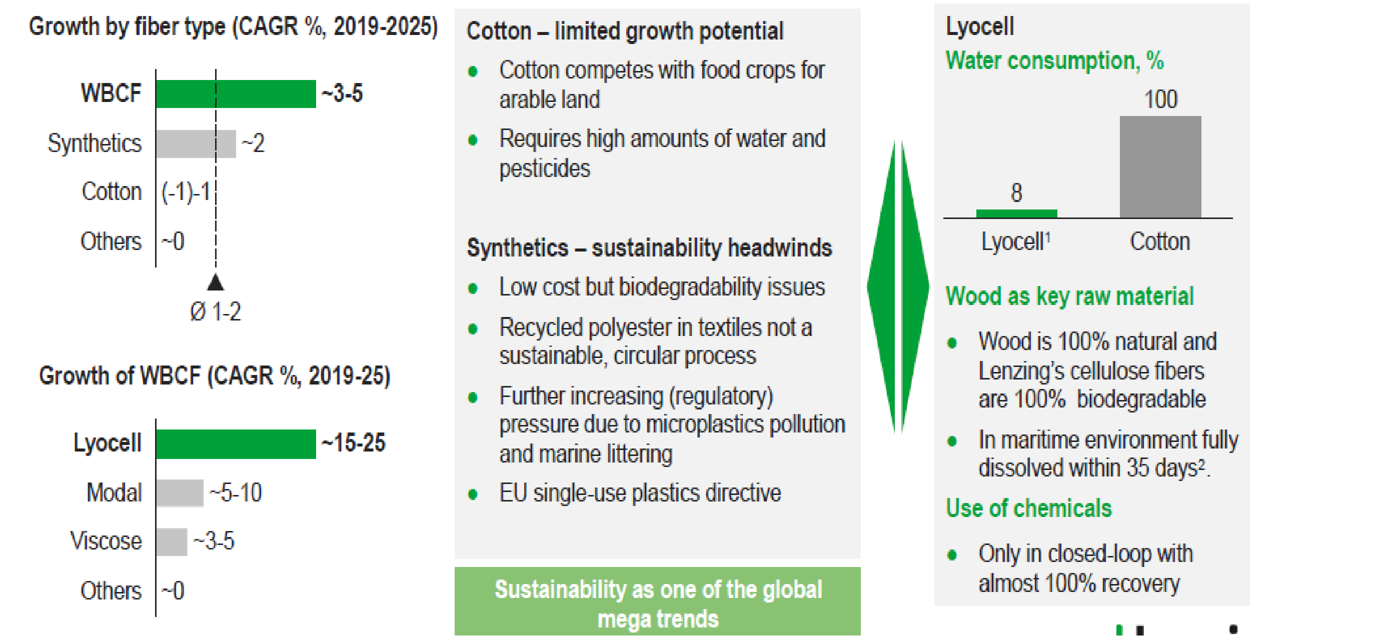
Source: MOFSL, Grasim

Higher growth expected to continue for wood-based fiber

According to Lenzing (the largest producer of VSF globally), the consumption of wood-based fiber is expected to record a CAGR of 3-5% over CY19-25 v/s 2% growth of synthetics fiber and -1 to 1% growth of Cotton. Both cotton and synthetic fibers face structural issues that may aid higher growth of wood-based fibers.

Among the wood-based fibers, consumption of Lyocell is projected to achieve a CAGR of 15-25% during CY19-25 followed by 5-10% CAGR for Modal and 3-5% CAGR for grey viscose. Lyocell is considered to be more environmental friendly than grey viscose/modal due to the use of different solvents to extract the cellulose from the wood-N-Methylmorpholine N-oxide against sodium hydroxide (caustic soda). In this process, there is no gaseous emission and more than 99% of the solvent used is recovered and recycled. Viscose and Modal are made using a similar process with similar chemicals at each stage of production. However, modal fibers are treated slightly differently after spinning, to make the filaments stronger.

Exhibit 16: Viscose fiber consumption is likely to grow at a higher rate

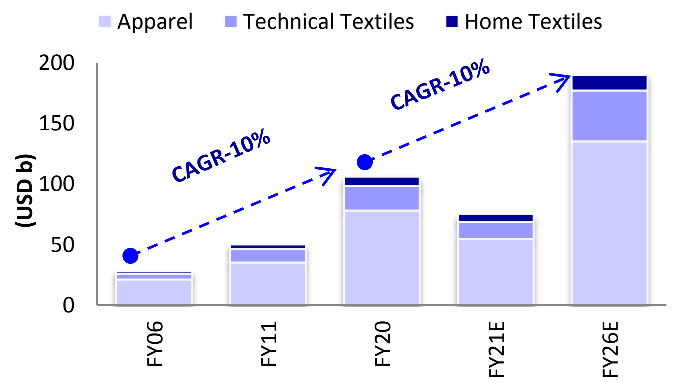


Source: MOFSL, Lenzing

Strong growth expected in the Indian textile market

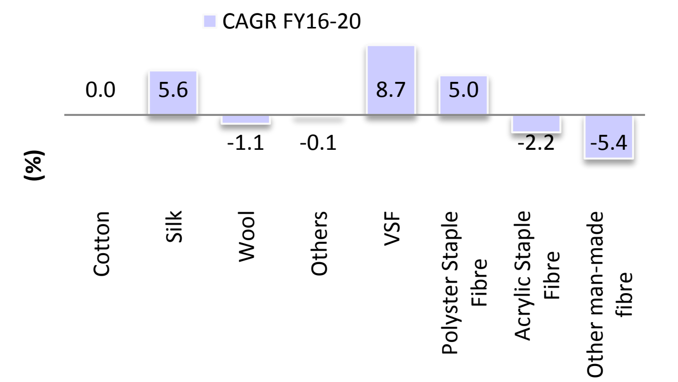
The domestic textile and apparel market has witnessed a 10% CAGR over FY06-20 with an estimated market size of USD106b in FY20. The pandemic led to a ~30% YoY decline in the textile and apparel industry's revenue in FY21. However, the market is likely to rebound and register a CAGR of 10% during FY21-26. This will support the continued growth in fiber. Over the last few years, VSF demand growth is the highest among all other fibers.

Exhibit 17: Textile & Apparel revenue CAGR of 10% expected



Source: MOFSL, Industry

Exhibit 18: VSF demand growth higher v/s other fibers

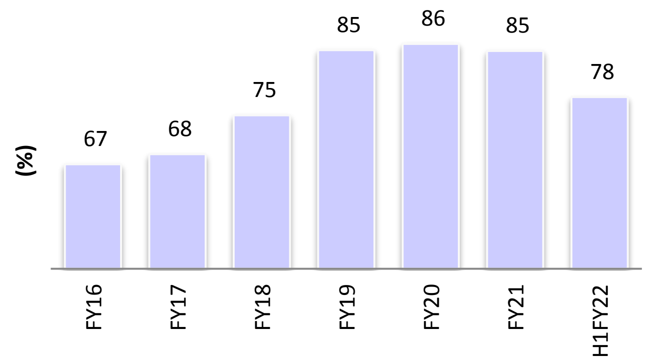


Source: MOFSL, Industry

Viscose getting better acceptance in the domestic markets

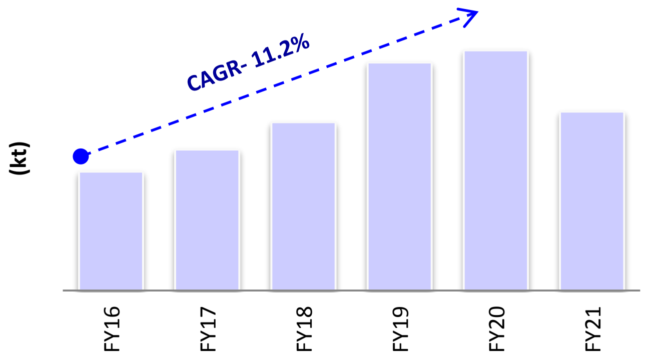
The domestic consumption of VSF has improved over the last few years and Grasim's domestic VSF sales volume has registered an 11.2% CAGR during FY16-20 (volume got impacted in 4QFY20/FY22 due to Covid-19). Grasim's VSF sales stood at 85-86% of total sales volumes in FY20/21 v/s 67-68% in FY16/17.

Exhibit 19: Increase in domestic sales mix



Source: MOFSL, Company

Exhibit 20: Strong growth in domestic VSF volume of Grasim



Source: MOFSL, Company

High backward integration in VSF to keep cost favorable

Grasim has strong integration across the value chain in the VSF segment, which renders a competitive advantage over non-integrated players. The company gets 55-60% of its requirements of dissolving grade pulp (50-55% of costs) through captive sources; while rest of the requirements is met through contracts with large suppliers. Requirements of caustic soda (10-15% of costs), power & steam (10% of costs) and carbon disulphide (3% of costs) are completely being met through captive sources.

Exhibit 21: Backward integration for ~80% of Grasim's RM costs

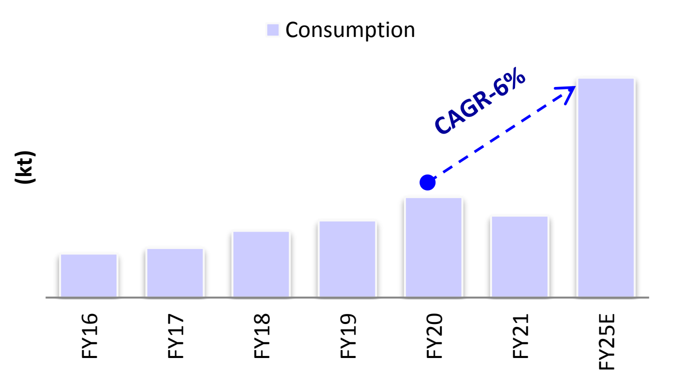
Input	% of costs	Requirement met
Dissolving grade pulp	50-55%	55-60%
Caustic Soda	10-15%	Fully captive
Power & Steam	10%	Fully captive
Carbon Disulphide	3%	Fully captive

Source: MOFSL, Company

Plans to increase chlorine VAPs, margins should improve

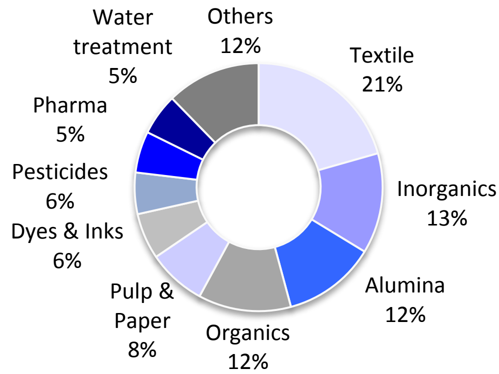
The Indian caustic soda industry had an installed capacity of 4.5mtpa in FY21 v/s 4.3mtpa in FY20. Caustic soda production has recorded a 5.8% CAGR over FY16-20 (before Covid-19), whereas, demand has witnessed a CAGR of 3.3% during that period. The industry's capacity utilization of Caustic soda stood at 80% in FY20, which declined to 75% in FY21 as the demand fell 4% YoY in FY21. The caustic soda demand is expected to witness a 6% CAGR over FY20-25E, whereas, demand for chlorine derivatives Chloromethane, Hydrogen Peroxide and CPVC Resin is projected to register a CAGR of 10%+ during this period.

Exhibit 22: Caustic soda demand CAGR estimated at 6%



Source: MOFSL, Company

Exhibit 23: Breakdown of caustic soda consumption in India



Source: MOFSL, Company

Demand growth expectations from different segments

Alumina: Caustic soda demand from the alumina sector is expected to clock a robust 7-8% CAGR during FY20-25 led by increase in alumina production. Import substitution of alumina, growth in domestic aluminum consumption, and rising aluminum exports should propel caustic soda demand over the next five years.

Textiles: Cotton yarn production is likely to clock 2-3% CAGR over the next five years, v/s c.1% during the past five years, even as demand for man-made and blended yarn is projected to exceed that for cotton yarn. Meanwhile, VSF production is expected to log a healthy 7% CAGR during the same period, driven by Grasim's capacity expansions. Therefore, overall caustic soda demand from the textiles segment is expected to clock 4-5% CAGR over the next five years.

Paper: Caustic soda demand from the paper segment is likely to post 2-3% CAGR over the next five years, led by its increased usage in packaging for end-use industries such as household appliances, fast-moving consumer goods, readymade garments and e-commerce.

Chemicals: Demand from the organic chemicals segment is anticipated to clock 3-4% CAGR over the next five years, driven by growth from end-user industries such as dyes and paints. Demand from the inorganic chemicals segment is likely to grow lesser than the organic chemical segment at c.2.5% CAGR during the next five years.

Soaps and detergents: Caustic soda demand from this segment is expected to clock 4-5% CAGR over the next five years, led by increasing hygiene awareness amid the pandemic, rising penetration in rural areas, and a rise in per capita consumption.

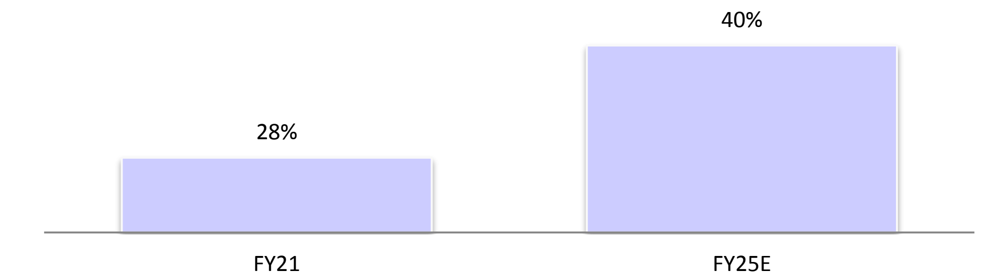
Others: Caustic soda demand from the others segment is likely to clock 4-5% CAGR during FY20-25E led by growth in the pharmaceuticals, pesticides, dyes and pigments, and water treatment segments.

Grasim targets to increase chlorine integration to 40% by FY25E

Globally, the majority of chlor-alkali capacity is used as a feedstock for the vinyl chain (EDC and PVC), demand for which is strongly correlated with construction spending. According to industry estimates, about 38% of the chlorine produced globally is used by the vinyl industry compared with 8% in India. Therefore, the domestic caustic-chlorine industry is driven by caustic demand, whereas, in the rest of the world demand is driven by chlorine usage. Lower integration (30%) of domestic chlorine capacity impacts the capacity utilization of caustic industry.

Grasim has increased the usage of chlorine in VAPs and targets to further increase chlorine integration through: a) rise in VAP capacities, b) new chlorinated product development and c) improvement in pipeline supply. The management targets to augment the consumption of chlorine in VAPs to 40% by FY25E from 28% in FY21. The company has entered into a partnership with Lubrizol Advanced Materials to manufacture and supply chlorinated polyvinyl chloride (CPVC) resin. The construction of 100 KTPA CPVC resin plant (single largest site capacity) at Vilayat (Gujarat) in two phases is under progress. The financial investments will be made by Lubrizol, whereas Grasim will manage the plant operations for commercial considerations.

Exhibit 24: Chlorine integration likely to improve to 40% by FY25E

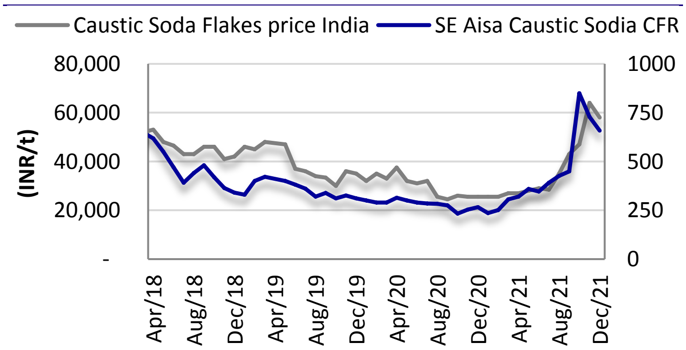


Source: MOFSL, Company

Increase in caustic soda prices to underpin margin improvement

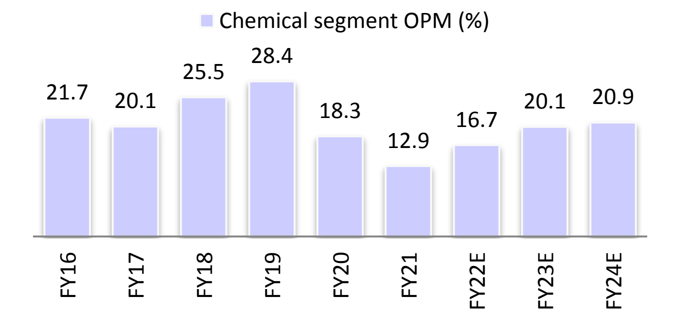
Caustic Soda prices started to decline from Jun'19 leading to margin pressure for the caustic-chlorine industry in India. Between May'19 and Aug'20, caustic soda price declined 46% which in turn led to margin pressure for Grasim's chemical segment. However, there has been a rebound in caustic soda prices recently, which should lead to margin improvement for the Chemical segment. We expect the EBITDA margin of Grasim's chemical segment to be at 16.7%/20.1%/20.9% in FY22/23/24E, respectively, compared with 12.9% in FY21.

Exhibit 25: Improvement in caustic soda prices from Oct-21



Source: MOFSL, Company

Exhibit 26: Expect improvement in Chemical segment OPM

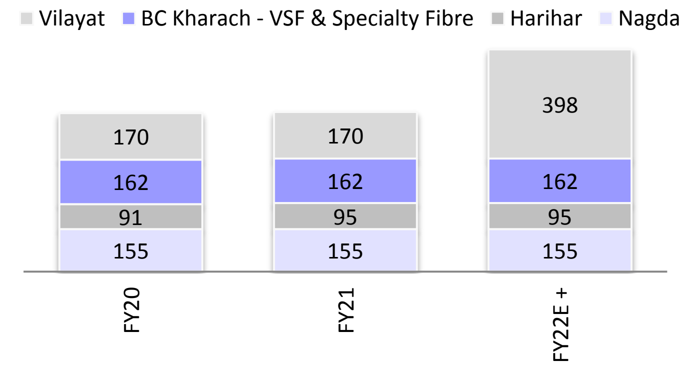


Source: MOFSL, Company

Capacity expansion to aid growth

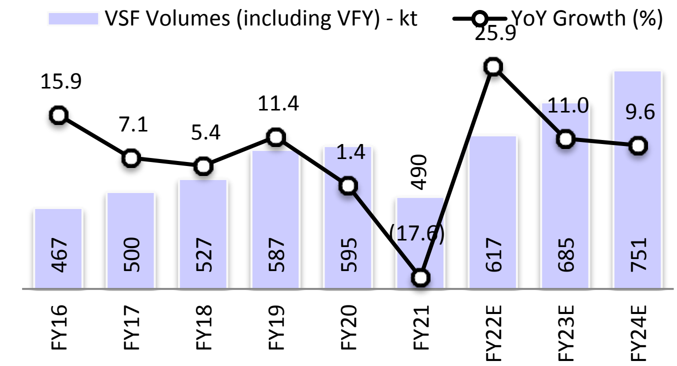
Grasim is in the process of increasing the capacity of its VSF segment by 37% to 810ktpa (Vilayat VSF expansion of 219ktpa), which is anticipated to be completed by 3QFY22. We estimate a 16% volume CAGR for VSF over FY21-24. The company plans to increase its mix of VAPs in the VSF segment to 35-40% in FY25E from 27% in 2QFY22.

Exhibit 27: VSF capacity being expanded by 40%



Source: MOFSL, Company

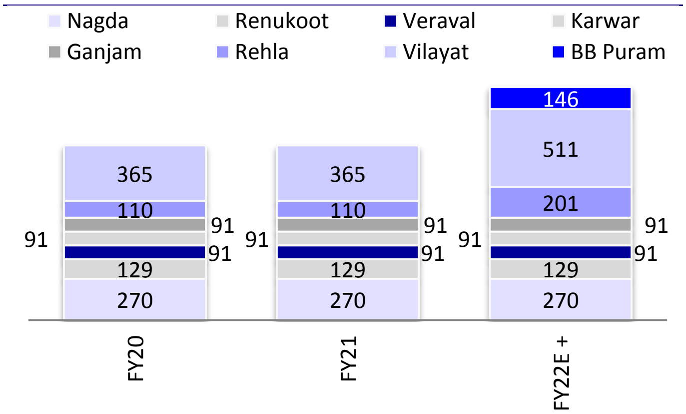
Exhibit 28: Capacity expansion to drive VSF volume growth



Source: MOFSL, Company

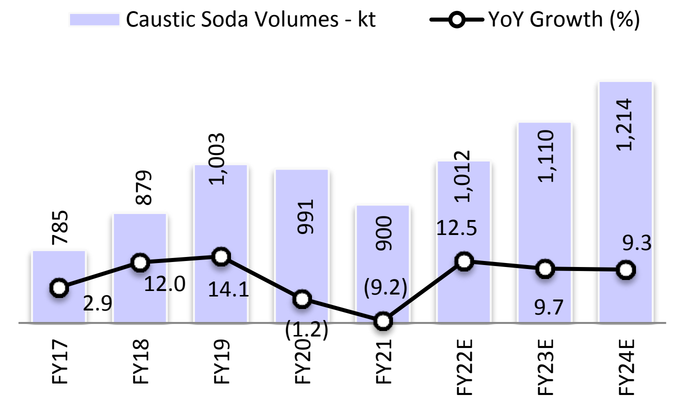
Grasim will increase its caustic soda production by 33% to 1,530ktpa by FY23E due to: a) 91ktpa/73ktpa/73ktpa at Rehla/Vilayat (Phase 1)/BB Puram (phase 1) in FY22E and 73ktpa each at Vilayat /BB Puram (phase 2) in FY23E, while the epoxy capacity expansion of 125ktpa will be commissioned by FY24E. We estimate a 15% volume CAGR for the Chemical business during FY21-24. The company plans to increase its mix of value added products (VAP) in the chemical segment to 40% by FY25E from 28% in FY21.

Exhibit 29: Caustic Soda capacity being expanded by 33%



Source: MOFSL, Company

Exhibit 30: Capacity expansion to drive volume growth



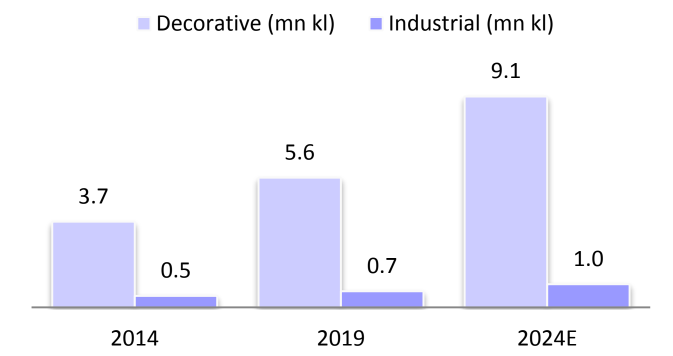
Source: MOFSL, Company

Foray into the paints business to aid diversification

Paints industry clocking an 11% CAGR during the last few years

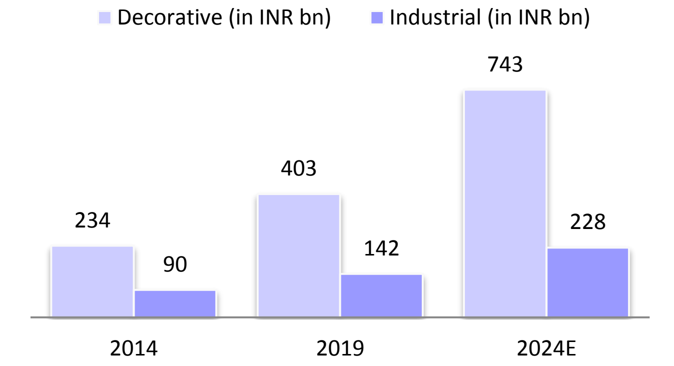
The decorative paints industry's revenue size stood at INR403b in FY19 and it has been recording an 11% CAGR over last few years. The industry is expected to attain a CAGR of 10% in volume terms and 13% in value terms until FY24.

Exhibit 31: Paints industry posted 11% CAGR over FY14-19



Source: Indigo Paints DRHP

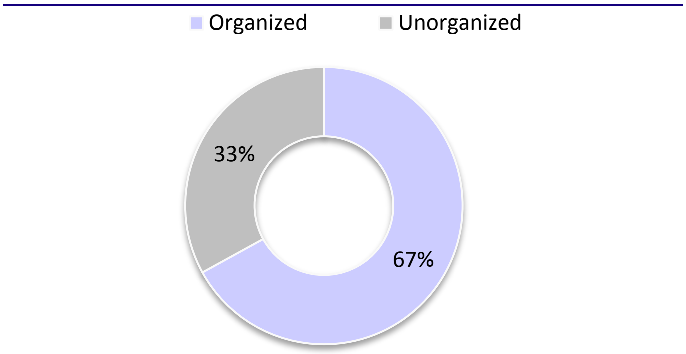
Exhibit 32: Industry can clock 9-10% CAGR in value terms



Source: Indigo Paints DRHP

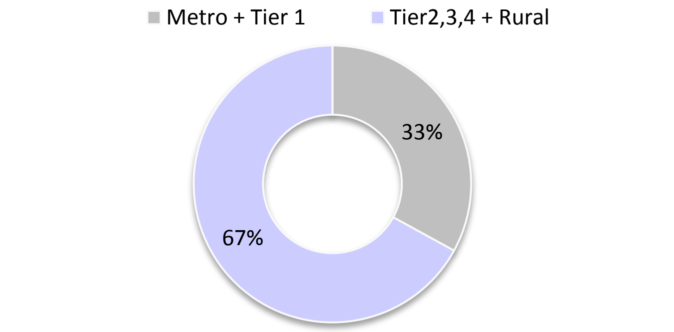
About 33% of the industry is catered by unorganized players (Source: Indigo Paints DRHP) and hence, this provides an opportunity for the entry of a branded player. In terms of consumption, Metros and Tier 1 cities constitute 33% of the total industry size, while the rest is from Tier 2/3/4 and rural areas.

Exhibit 33: Large unorganized segment may provide growth opportunities for organized players



Source: Indigo Paints DRHP

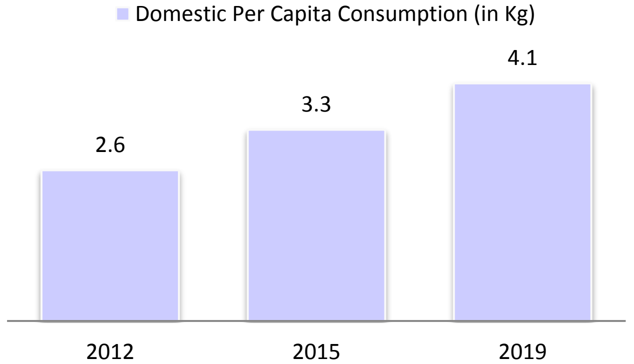
Exhibit 34: Metros and Tier1 cities account for 33% of paints consumption



Source: Indigo Paints DRHP

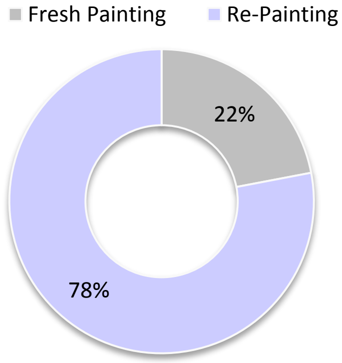
Domestic per capita consumption of paints is clocking a 7% CAGR over the last seven years. The repainting cycle has been shortened and repainting is done after 4-5 years compared with 7-8 years earlier. This would ensure industry growth in the long run.

Exhibit 35: Domestic per capita consumption posted 7% CAGR over 2012-19



Source: Indigo Paints DRHP

Exhibit 36: Repainting accounts for 78% of paints consumption

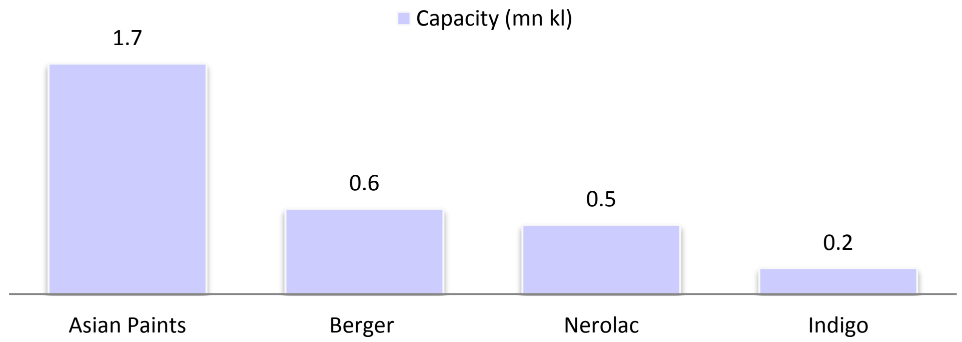


Source: Indigo Paints DRHP

Grasim aims to be the second largest paints player in India

Grasim targets to capture the second spot in the domestic paints industry. The company plans to invest INR50b, which as per our calculation can help it create a capacity of 1.2m kl. To date, the company has disclosed five locations – Ludhiana (Punjab), Panipat (Haryana), Mahad (Maharashtra), Cheyyar (Tamil Nadu) and Chamrajangar (Karnataka) – to set up its manufacturing plants. It has already spent INR2.7b on land acquisition across plant locations. We believe that post completion of the capex, Grasim will become the No. 2 player for decorative paints in terms of capacities, unless Berger Paints becomes aggressive for capacity additions.

Exhibit 37: Current capacities of the paint companies

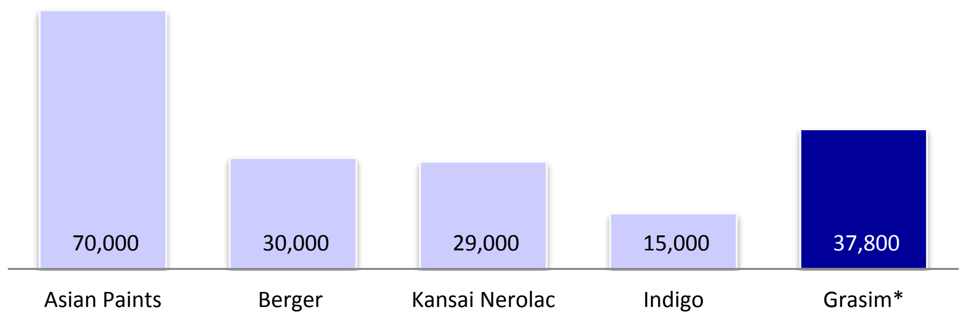


Source: Indigo Paints DRHP

Well spread dealer network and strong brand recall of Birla White & Putty should help

Though aggressive capacity commissioning at one go does not guarantee instant acceptance of a new brand as several sizeable players (such as Akzo Nobel, Indigo Paints, Nippon Paints etc.) faced difficulties in attaining reasonable market share during their initial years of operations, we believe that strong brand identity of "Birla" group and its subsidiary UTCEM's presence in the White Cement/Wall Putty segment would support Grasim in establishing a reasonable market share at the earliest. UTCEM's Birla White division has a pan India network of 54,000 dealers as well as there is a 70% overlap between distributors of paints and white cement/putty, which will aid in creating a strong distribution network. Moreover, UTCEM is planning to double its existing retail network of "UltraTech Building Solutions" having ~2,500 outlets that can help Grasim expand its footprint and enhance its reach.

Exhibit 38: Dealer network of Birla White should help Grasim to enhance its reach



Source: MOFSL, Company, considering 70% of Birla White dealers where overlap exists

Group's brand recall should attract new distributors to Grasim

The paints industry has been witnessing continuous additions of new dealers as most of the large players (except for Akzo Nobel) have added new dealers at a CAGR of 7-11% over last 3-4 years. So, apart from conversion of current dealers, Grasim may target potential new dealers who might opt for its paints due to: a) Birla group's brand recall and b) the competitive schemes/incentives, if offered.

Exhibit 39: Increase in various companies' dealer networks

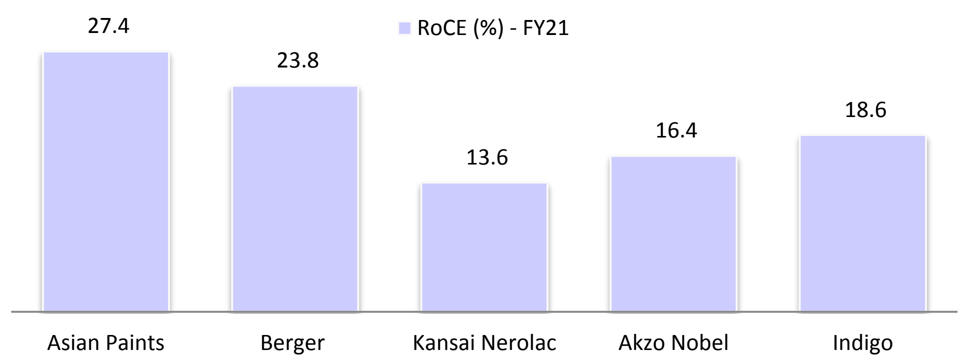
Active distribution/dealer network	2017-18	2020-21	CAGR (%)
Asian Paints	53,000	70,000	10%
Kansai Nerolac	21,000	29,000	11%
Berger Paints	25,000	30,000	6%
Akzo Nobel	16,500	15,000	-3%
Indigo Paints	9,210	11,230	7%

Source: Indigo Paints DRHP

Entry into the paints business will help stabilize cash flows

Grasim's business segments, VSF and Chemical, are cyclical in nature and hence, its entry into a high-growth/high-RoCE (decorative paints companies had RoCE of 16-27% in FY21) business will stabilize cash flows in the long run. Grasim has already completed divestment of its fertilizer business in Jan'22.

Exhibit 40: RoCE of existing large players in the paints industry



Source: MOFSL, Bloomberg

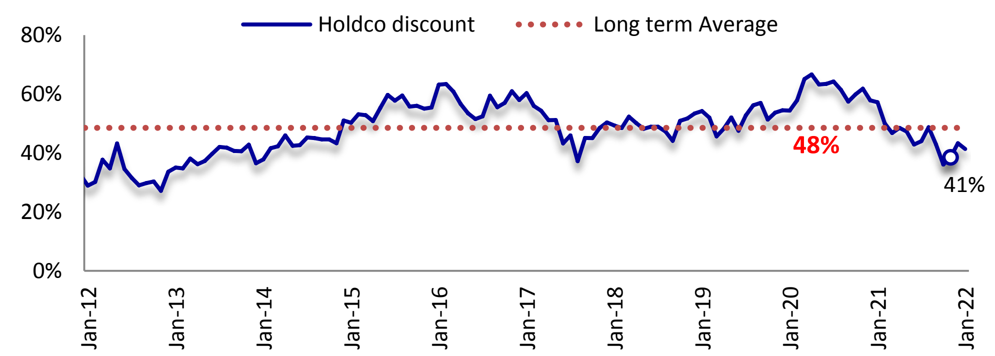
Quasi-play on cement; UTCEM is our sector top pick

Grasim, through its holding in UTCEM, is also a quasi-play on the cement business. In our SoTP valuation, UltraTech contributes 65% of the total value for Grasim. We are positive on the cement business and UTCEM is our top pick in large-cap space due to;

A. Growth plans – Setting up cement capacities of 19.5mtpa, with 5.4mtpa capacity to be commissioned by FY22E and the balance in FY23E.
B. Cost-saving initiatives – Margin is likely to improve due to: a) reduction in lead distance; b) increase in the green power mix; and c) control on fixed costs.
C. Leadership position – Enjoys leadership position across regions, with a capacity share of 12%/15%/23%/36%/39% in South/East/North/West/Central India, respectively, which helps it maintain its premium pricing in most of the markets.
D. Improving balance sheet strength – Clocked 45% CAGR in OCF over FY19-21, driven by an improvement in profitability and working capital reduction. This, in turn, led to debt reduction and a significant improvement in net debt/EBITDA ratio, which stood at 0.66x in FY21 v/s 3.1x in FY19. We expect UTCEM to turn cash positive in FY23.

The HoldCo discount for Grasim's holding in subsidiary companies has reduced to 40-45% v/s 60%+ two years back (when there were concerns of fund infusion in VIL). We have assigned 40% HoldCo discount for its holding in UTCEM and other subsidiaries.

Exhibit 41: Holdco discount at 41%



Source: MOFSL, Company

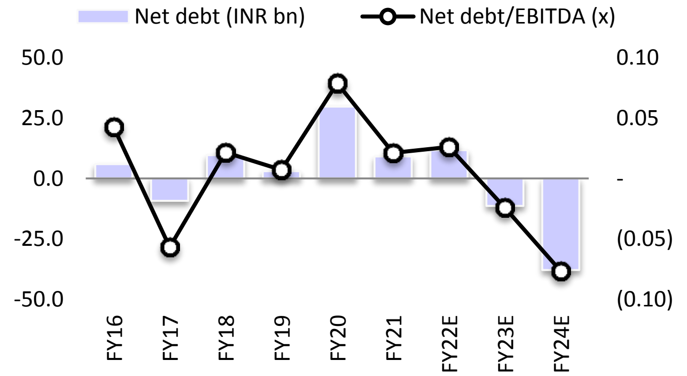
Valuation and View: Upgrade to BUY from Neutral

In Jan'21, Grasim announced its intention to enter the paints business and committed a capex of INR50b for the venture over a three-year period. The management is targeting an IRR of 20% from this business and aims to make Grasim the second largest player in the paints industry. Grasim's significant capex plans for its Paints business indicates its intent to enter the segment on a large scale. We view Grasim's entry into this business as a positive step as it marks the company's diversification into a high-growth, high-RoCE segment from its cyclical and non-core business segments.

Grasim is in the process of increasing its VSF segment capacity by 37% to 810ktpa, which is expected to be completed by 3QFY22. The company is likely to raise its caustic soda production by 33% to 1,530ktpa by FY23E (237ktpa in FY22E and 136ktpa in FY23E) and its epoxy capacity by 125ktpa as on FY24E. We estimate a 16%/15% volume CAGR for the VSF/Chemical business, respectively, over FY21-24. Grasim plans to improve its mix of VAPs in the chemical segment to 40% by FY25E from 28% in FY21 and to 35-40% by FY25E in VSF segment from 27% in 2QFY22.

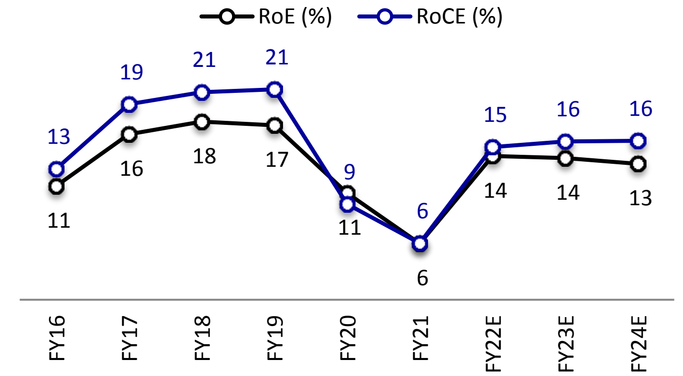
The company's strong balance sheet is likely to be sufficient for its capex requirements in the paints business. We expect the company to turn net cash positive in FY23 and expect its standalone RoCE to improve to 16% in FY23E from 6% in FY21. We value the standalone business at 6x Dec-23E EV/EBITDA and other listed subsidiaries at 40% HoldCo discount to arrive at our revised target price of INR2,050. Our target price for Grasim includes a 5% premium to the underlying SoTP valuation in order to capture the potential upside from its paints business. We upgrade our rating on Grasim to **BUY** from Neutral.

Exhibit 42: Expect to turn net cash positive in FY23E*



Source: Company, MOFSL, *without capex for paints business

Exhibit 43: Return ratios to improve



Source: Company, MOFSL, *without capex for paints business

Financials and Valuations

Standalone Income Statement

(INR m)

Y/E March	2017	2018	2019	2020	2021	2022E	2023E	2024E
Gross Sales	**112530**	**160347**	**205504**	**186094**	**123864**	**191969**	**200684**	**205727**
Change (%)	15.1	42.5	28.2	-9.4	-33.4	55.0	4.5	2.5
Excise	9073	2462	0	0	0	0	0	0
Net Sales	**103,457**	**157,885**	**205,504**	**186,094**	**123,864**	**191,969**	**200,684**	**205,727**
Change (%)	15.3	52.6	30.2	-9.4	-33.4	55.0	4.5	2.5
Total Expenditure	81,909	127,083	164,793	162,989	108,220	157,526	161,728	164,106
EBITDA	**21,548**	**30,802**	**40,712**	**23,105**	**15,643**	**34,443**	**38,956**	**41,621**
Change (%)	44.4	42.9	32.2	-43.2	-32.3	120.2	13.1	6.8
Margin (%)	20.8	19.5	19.8	12.4	12.6	17.9	19.4	20.2
Depreciation	4,461	6,277	7,604	8,468	8,282	8,262	9,857	10,179
EBIT	**17,086**	**24,525**	**33,108**	**14,638**	**7,362**	**26,181**	**29,100**	**31,442**
Int. and Finance Charges	576	1,281	1,991	3,039	2,360	2,194	1,703	1,196
Other Income - Rec.	4,739	4,614	5,680	5,255	5,137	8,609	8,778	8,951
PBT & EO Items	**21,249**	**27,858**	**36,797**	**16,854**	**10,139**	**32,595**	**36,175**	**39,197**
Change (%)	68.8	31.1	32.1	-54.2	-39.8	221.5	11.0	8.4
Extra Ordinary (income)/expense	0	2,726	23,680	2,941	810	0	0	0
PBT but after EO Items	**21,249**	**25,131**	**13,117**	**13,913**	**9,329**	**32,595**	**36,175**	**39,197**
Tax	5,649	7,445	7,964	1,214	1,224	7,513	8,338	9,035
Tax Rate (%)	26.6	26.7	21.6	7.2	22.0	23.1	23.1	23.1
Reported PAT	**15,600**	**17,687**	**5,153**	**12,700**	**8,105**	**25,082**	**27,836**	**30,162**
PAT Adj for EO items	**15,600**	**19,684**	**23,708**	**15,640**	**8,914**	**25,082**	**27,836**	**30,162**
Change (%)	57.0	26.2	20.4	-34.0	-43.0	181.4	11.0	8.4
Margin (%)	15.1	12.5	11.5	8.4	7.2	13.1	13.9	14.7

Standalone Balance Sheet

(INR m)

Y/E March	2017	2018	2019	2020	2021	2022E	2023E	2024E
Equity Share Capital	934	1,315	1,315	1,316	1,316	1,316	1,316	1,316
Employee Stock options outstanding				527	527	527	527	527
Reserves	161,376	446,584	418,277	427,636	427,636	447,184	469,118	493,009
Net Worth	**162,310**	**447,898**	**419,592**	**429,479**	**429,479**	**449,027**	**470,961**	**494,852**
Loans	7,015	29,690	33,108	41,634	41,634	33,130	24,883	15,883
Deferred liabilities	6,630	18,350	18,789	17,339	17,339	17,339	17,339	17,339
Capital Employed	**175,955**	**495,938**	**471,488**	**488,452**	**488,452**	**499,497**	**513,183**	**528,074**
Gross Block	81,549	127,290	138,489	148,940	148,940	206,149	214,149	220,149
Less: Accum. Deprn.	12,681	19,125	26,166	39,302	39,302	47,564	57,421	67,599
Net Fixed Assets	**68,868**	**108,166**	**112,322**	**109,637**	**109,637**	**158,585**	**156,728**	**152,549**
Capital WIP	3,755	7,451	15,672	40,334	40,334	5,000	3,000	3,000
Non-Current Investments /Strategic	74,241	335,867	281,616	305,230	305,230	305,230	305,230	305,230
Current - Financial	16,053	20,790	29,931	41,553	41,553	20,704	30,904	41,204
Curr. Assets	**35,594**	**65,015**	**78,398**	**46,827**	**46,827**	**72,015**	**80,065**	**89,783**
Inventory	17,327	25,917	29,317	21,790	21,790	28,122	29,583	30,620
Account Receivables	11,896	26,093	34,916	13,120	13,120	27,257	28,508	29,507
Cash and Bank Balance	527	419	425	1,327	1,327	1,278	5,919	13,199
Others	5,844	12,586	13,741	10,590	10,590	15,358	16,055	16,458
Curr. Liability & Prov.	**22,557**	**41,351**	**46,452**	**55,130**	**55,130**	**62,036**	**62,743**	**63,693**
Account Payables	11,434	21,705	23,757	27,069	27,069	29,420	29,583	30,063
Provisions	1,626	5,087	4,604	3,250	3,250	6,403	6,577	6,678
Other Liabilities	9,497	14,559	18,091	24,811	24,811	26,213	26,582	26,951
Net Current Assets	**13,038**	**23,664**	**31,947**	**-8,303**	**-8,303**	**9,978**	**17,322**	**26,091**
Appl. of Funds	**175,954**	**495,938**	**471,488**	**488,452**	**488,452**	**499,497**	**513,183**	**528,074**

Financials and Valuations

Standalone Ratios (INR m)

Y/E March	2017	2018	2019	2020	2021	2022E	2023E	2024E
Share price								
EPS	**167.1**	**29.9**	**36.0**	**23.8**	**13.5**	**38.1**	**42.3**	**45.8**
Cash EPS	43.0	39.5	47.6	36.6	26.1	50.7	57.3	61.3
BV/Share	347.7	681.3	638.0	572.7	652.6	682.3	715.6	751.9
DPS	5.5	6.2	7.0	4.0	4.0	4.0	4.0	4.0
Valuation								
P/E	10.3	57.4	47.7	72.3	127.0	45.1	40.7	37.5
PEG (x)	0.2	2.2	2.3	-2.1	-3.0	0.2	3.7	4.5
Cash P/E	40.0	43.6	36.1	46.9	65.8	33.9	30.0	28.1
P/BV	4.9	2.5	2.7	3.0	2.6	2.5	2.4	2.3
EV/Sales	10.8	7.2	5.5	6.2	9.1	6.0	5.6	5.3
EV/EBITDA	52.1	37.0	27.9	50.3	72.3	33.2	28.7	26.3
Dividend Yield (%)	0.3	0.4	0.4	0.2	0.2	0.2	0.2	0.2
Return Ratios (%)								
RoE	16.4	17.6	17.2	10.6	5.5	14.2	14.0	13.4
RoCE	19.3	20.5	20.8	9.4	5.6	15.1	15.6	15.7
Working Capital Ratios								
Debtor (Days)	42	60	62	57	39	52	52	52
Asset Turnover (x)	0.6	0.3	0.4	0.4	0.3	0.4	0.4	0.4
Leverage Ratio								
Debt/Equity	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0

Standalone Cash Flow Statement (INR m)

Y/E March	2017	2018	2019	2020	2021	2022E	2023E	2024E
OP/(Loss) before Tax	21,249	27,858	36,797	12,916	9,329	32,595	36,175	39,197
Depreciation	4,461	6,277	7,604	8,135	8,282	8,262	9,857	10,179
Interest & Finance Charges	-2,609	-1,540	-1,435	-249	-421	-4,090	-4,707	-5,342
Direct Taxes Paid	-2,210	-5,233	-5,123	-2,183	-1,786	-2,588	-8,338	-9,035
(Inc)/Dec in WC	2,802	-2,797	-10,735	12,611	9,350	-31,352	-3,072	-1,858
CF from Operations	**23,694**	**24,564**	**27,108**	**31,231**	**24,754**	**2,827**	**29,914**	**33,141**
Others	-1,100	-1,009	-1,553	1,919	-780	0	0	0
CF from Operating incl EO	**22,593**	**23,555**	**25,555**	**33,150**	**23,974**	**2,827**	**29,914**	**33,141**
(Inc)/Dec in FA	-4,325	-10,689	-20,440	-26,823	-11,932	-26,000	-6,000	-6,000
Free Cash Flow	**18,269**	**12,867**	**5,115**	**6,328**	**12,041**	**-23,173**	**23,914**	**27,141**
(Pur)/Sale of Investments	108	167	56	127	102	16,491	0	0
Others	-4,224	-8,726	-2,247	-17,904	-10,249	17,331	-3,790	-3,762
CF from Investments	**-8,440**	**-19,247**	**-22,631**	**-44,600**	**-22,079**	**7,822**	**-9,790**	**-9,762**
Issue of Shares	26	23	86	90	126	0	0	0
Inc/(Dec) in Debt	-11,322	942	3,504	17,127	-9,384	-8,504	-8,247	-9,000
Interest Paid	-597	-1,417	-2,050	-2,130	-3,241	-2,194	-1,703	-1,196
Dividend Paid	-2,145	-4,060	-4,530	-5,155	-2,622	0	-5,534	-5,902
Others	0	0	0	0	0	0	0	0
CF from Fin. Activity	**-14,038**	**-4,512**	**-2,990**	**9,932**	**-15,120**	**-10,698**	**-15,483**	**-16,099**
Inc/Dec of Cash	**115**	**-204**	**-65**	**-1,517**	**-13,226**	**-49**	**4,641**	**7,280**
Opening Balance	231	346	261	195	510	692	643	5,284
Add: Cash on amalgamation	0	119	0	1,832	13,408	0	0	0
Closing Balance	**346**	**261**	**196**	**510**	**692**	**643**	**5,284**	**12,564**

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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