Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Grasim Industries Ltd

Chemicals compensate for VSF; Outlook Positive

Diversified	Sharekhan code: GRASIM
Reco/View: Buy ↔	CMP: Rs. 1,643 / Price Target: Rs. 2,100 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Grasim reported better-than-expected revenues for Q3FY2022 led by strong growth in both viscose and chemicals. OPM was hit by weak performance of the VSF division. Standalone operations turn net cash positive.
- The company completed major expansions in VSF and caustic soda in 2HFY2022 till date which provide healthy volume growth for FY2023. Healthy demand and backward integration to support margins in midst of input cost inflation.
- The company receives environment clearances for a couple of land parcels for its paints venture.
- We retain a Buy on Grasim with a revised PT of Rs. 2,100 factoring downwardly revised valuation for VSF vertical.

Grasim Industries Limited (Grasim) reported better-than-expected standalone revenues at Rs. 5785 crores, up 56.5% y-o-y led by healthy volume and strong realization growth in both the viscose (up 12% y-o-y/39% y-o-y) and chemicals (up 8% y-o-y/69% y-o-y) divisions. The standalone OPM at 15.9% (down 149 bps y-o-y) were lower than estimate owing to weak Viscose margins (down 1045 bps y-o-y at 12%) that were impacted by an unprecedented rise in input costs (up Rs. 412 crore q-o-q) although compensated to a large extent cy chemicals (OPM up 877bps y-o-y at 22.6%). Overall standalone operating profit/net profit were up 43%/46% y-o-y. It completed major capacity expansion in VSF (100KTPA in February 2022), Caustic soda (117KTPA) and chloromethane (55KTPA) which would aid in strong volume growth in FY2023. The healthy demand in textile sector along with its backward integration would support margins in midst of increased input costs. The company secured ECs for two land parcels for its paints venture.

Key positives

- Viscose/Chemical realizations were up 39% y-o-y and 69% y-o-y respectively.
- Chemical division reports 877bps y-o-y improvement in margins due to steep rise in caustic realizations although chlorine realization remained negative.
- Standalone operations turn net cash positive at Rs. 432 crore) post adjusting the fertilizer business divestment.

Key negatives

- VSF margins dip 1045bps y-o-y due to an unprecedented rise in input costs.

Management Commentary

- The commissioning of VSF capacities would aid in healthy volume growth in Q1FY2023. The share of value added products is expected to increase from current 25-30% to 40-45% over 3-4 years.
- Out of Rs. 2604 crore budgeted capex for FY2022, it has incurred Rs. 1476 crore during 9MFY2022 and expects close the year well within the budgeted cost.
- The company received environmental clearance at two north based land parcels. It has incurred Rs. 505 crore capex in paints majorly in land acquisitions. The company would provide clarity on paints related capex and timeline in the next quarter.

Revision in estimates – We have increased estimates for FY2022-FY2024 factoring higher volumes and realizations partially adjusted for lower VSF OPM.

Our Call

Valuation –Retain Buy with a revised PT of Rs. 2,100: Grasim is expected to benefit from positive outlook in both its Viscose and chemical businesses in standalone operations. Further, the outlook for its key subsidiary Ultratech remains buoyant over a longer term. The company's venture into paints business is expected to yield premium valuation. Its capacity expansions across products are likely to capture high demand expected over the next two years. Further, the rising share of value-added products in the viscose and chemicals businesses would cushion OPMs in the wake of rising input costs. We maintain a Buy on the stock with a revised price target of Rs. 2,100 (factoring lower valuation for VSF).

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	20,123	22,641	25,709
OPM (%)	12.6%	17.9%	19.0%	19.8%
Adjusted PAT	891	2,510	2,791	3,366
% YoY growth	(31.6)	181.6	11.2	20.6
Adjusted EPS (Rs.)	13.6	38.2	42.4	51.2
P/E (x)	121.3	43.1	38.7	32.1
P/B (x)	2.5	2.4	2.2	2.1
EV/EBITDA (x)	51.7	21.9	18.2	14.8
RoNW (%)	2.1	5.5	5.8	6.5
RoCE (%)	1.9	5.0	5.3	6.0

Source: Company; Sharekhan estimates

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 42.64

Updated Jan 08, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

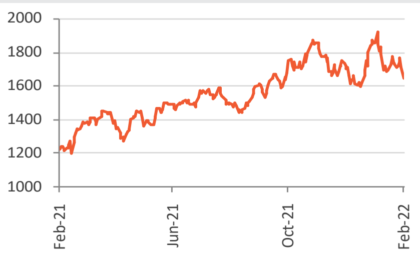
Company details

Market cap:	Rs. 108,170 cr
52-week high/low:	Rs. 1,939/1,192
NSE volume: (No of shares)	27.8 lakh
BSE code:	500300
NSE code:	GRASIM
Free float: (No of shares)	37.8 cr

Shareholding (%)

Promoters	42.5
FII	12.8
DII	15.0
Others	29.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-14.3	-11.4	10.2	33.8
Relative to Sensex	-6.3	-4.3	8.7	25.7

Sharekhan Research, Bloomberg

Chemical division compensates for weak VSF operational performance

Grasim Industries Limited (Grasim) reported better-than-expected standalone revenues at Rs. 5785 crore, up 56.5% y-o-y led by healthy volume and strong realization growth in both the viscose (up 12% y-o-y/39% y-o-y) and chemicals (up 8% y-o-y/69% y-o-y) divisions. The standalone OPM at 15.9% (down 149 bps y-o-y) were lower than estimate owing to weak Viscose margins (down 1045 bps y-o-y at 12%) were impacted by unprecedented rise in input costs (up Rs. 412 crore q-o-q) although compensated to a large extent cy chemicals (OPM up 877bps y-o-y at 22.6%). Overall standalone operating profit/net profit were up 43%/46% y-o-y. Its standalone operations turn net cash positive at Rs. 432 crore) post adjusting the fertilizer business divestment.

Healthy demand and expanded capacities to aid growth

The company expanded VSF capacity at Vilayat by 600TPD in two phases, 300TPD commissioned in November 2021 and 300TPD in this week. The overall capacity has increased by 37% from 591KTPA to 810KTPA. In chemicals, it commissioned 117KTPA capacity, BB Phase I of 26KTPA (out of 73KTPA) and Rehla 91KTPA. The capacity now stands increased to 1264KTPA. It also commissioned 55KTPA chloromethane plant at Vilayat. It would be increasing the capacity to 1530KTPA by 2025. On the paints venture, the company received environmental clearance at two north based land parcels. It has incurred Rs. 505 crore capex in paints majorly in land acquisitions. The company would provide clarity on paints related capex and timeline in the next quarter. The company's expanded capacity along with healthy demand in textiles is expected to aid in capturing growth going ahead.

Key Conference Call Takeaways

- **Viscose expansion:** The company expanded VSF capacity at Vilayat by 600TPD in two phases, 300TPD commissioned in November 2021 and 300TPD in this week. The overall capacity has increased by 37% from 591KTPA to 810KTPA.
- **Chloralkali:** It commissioned 117KTPA capacity, BB Phase I of 26KTPA (out of 73KTPA) and Rehla 91KTPA. The capacity now stands increased to 1264KTPA. It also commissioned 55KTPA cholomethane plant at Vilayat. It would be increasing the capacity to 1530KTPA by 2025.
- **Capex:** Out of Rs. 2604 crore budgeted capex for FY2022, it has incurred Rs. 1476 crore during 9MFY2022 and expects close the year well within the budgeted cost.
- **Paints:** The company received environmental clearance at two north based land parcels. It has incurred Rs. 505 crore capex in paints majorly in land acquisitions. The company would provide clarity on paints related capex and timeline in the next quarter.
- **Fertiliser divestment:** The company had earlier divested fertilizer business for Rs. 2649 crore including outstanding fertilizer subsidies. It has now received the final amount of Rs. 1860 crore adjusted for the government subsidies received by the company earlier.
- **Debt:** The company turned net cash positive at Standalone level with net cash of Rs. 432 crore.
- **Margin pressure:** The unprecedented rise in prices of oil, coal, chemical etc has put pressure on margins. The VSF division saw Rs. 400 crore plus (Rs. 120 crore attributable to energy costs) cost escalation q-o-q. It expects backward integration would aid margins going ahead. For VSF, it has 100% in-house power consumption while chemical it has 50%.
- **Q3 performance:** The company witnessed strong demand in textiles in Q3. Domestic sales contribution increased to 91% from 84% in Q2. The Value added share products increased to 29% from 27% in Q2. The VSF sales and EBITDA stood at Rs. 3335 crore and Rs. 401 crore, VFY sales and EBITDA were at Rs. 574 crore and Rs. 80 crore. In chemicals, the international caustic price continued to tread higher for the fourth quarter. It operated at 93% capacity utilisation, which was 7% higher sequentially. The VAP products suffered due to cost pressure and lower demand. The chemicals reported revenue of Rs. 2338 crore and EBITDA of Rs. 528 crore. Overall standalone revenues were up 56% y-o-y at Rs. 5785 crore and net profit

up 46% y-o-y at Rs. 522 crore. The consolidated revenues were up 16% y-o-y at Rs. 24402 crore and net profit up 26% y-o-y at Rs. 1746 crore.

- **Viscose outlook:** The Chinese capacity operated at peak 85% during Q3 which has now come down to 81-82% with inventory going up. Hence, viscose prices have come down in December and January. The prices should increase as cotton is at an all time high. The commissioning of VSF capacities would lead to reasonable volume growth from Q1FY2023.

- **Chemicals outlook:** The international caustic prices went up from $475 to $900 within a month. The current VAP share is 25-30% which would increase to 40-45% over the next three to four years. The domestic price increase is constraint by the imports from China and Malaysia apart from yarn imports. Globally the demand for VSF stood at 6mn tonnes in CY2021 while capacity was at 8.5mn tonnes. The global demand is expected to grow at ~4% p.a. while India is expected to grow at a faster pace. Generally, 80000 tonnes per year yarn imports happen in India. Two third of demand in VFY is met from imports.

Results (Standalone) Rs cr

Particulars	Q3FY22	Q3FY21	y-o-y%	Q2FY22	q-o-q%
Net sales	**5,784.7**	**3,696.6**	**56.5**	**4,933.0**	**17.3**
Total expenditure	4,862.6	3,052.1	59.3	4,131.9	17.7
Operating profit	**922.1**	**644.5**	**43.1**	**801.2**	**15.1**
Other Income	40.6	63.8	(36.4)	702.4	(94.2)
EBIDTA	962.7	708.3	35.9	1,503.6	(36.0)
Interest	53.4	51.6	3.5	55.1	(3.0)
PBDT	909.2	656.6	38.5	1,448.5	(37.2)
Depreciation	221.8	205.1	8.1	207.5	6.9
Extraordinary item	-	-	-	-	-
PBT	**687.5**	**451.5**	**52.3**	**1,241.1**	**(44.6)**
Tax	198.5	120.8	64.4	294.2	(32.5)
Net Profit/(loss) from discontinued operations	33.5	27.1	23.5	32.3	3.8
Reported PAT	**522.5**	**357.9**	**46.0**	**979.1**	**(46.6)**
Extraordinary item	-	-	-	-	-
Adjusted PAT	**522.5**	**357.9**	**46.0**	**979.1**	**(46.6)**
EPS (Rs.)	7.9	5.4	46.0	14.9	(46.6)
Margin (%)			BPS		BPS
Operating margin	15.9%	17.4%	-149	16.2%	-30
Net Margin	9.0%	9.7%	-65	19.8%	-1082
Tax rate	28.9%	26.7%	213	23.7%	517

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Improving outlook of the standalone business and healthy outlook of key subsidiary

Grasim is witnessing an 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.

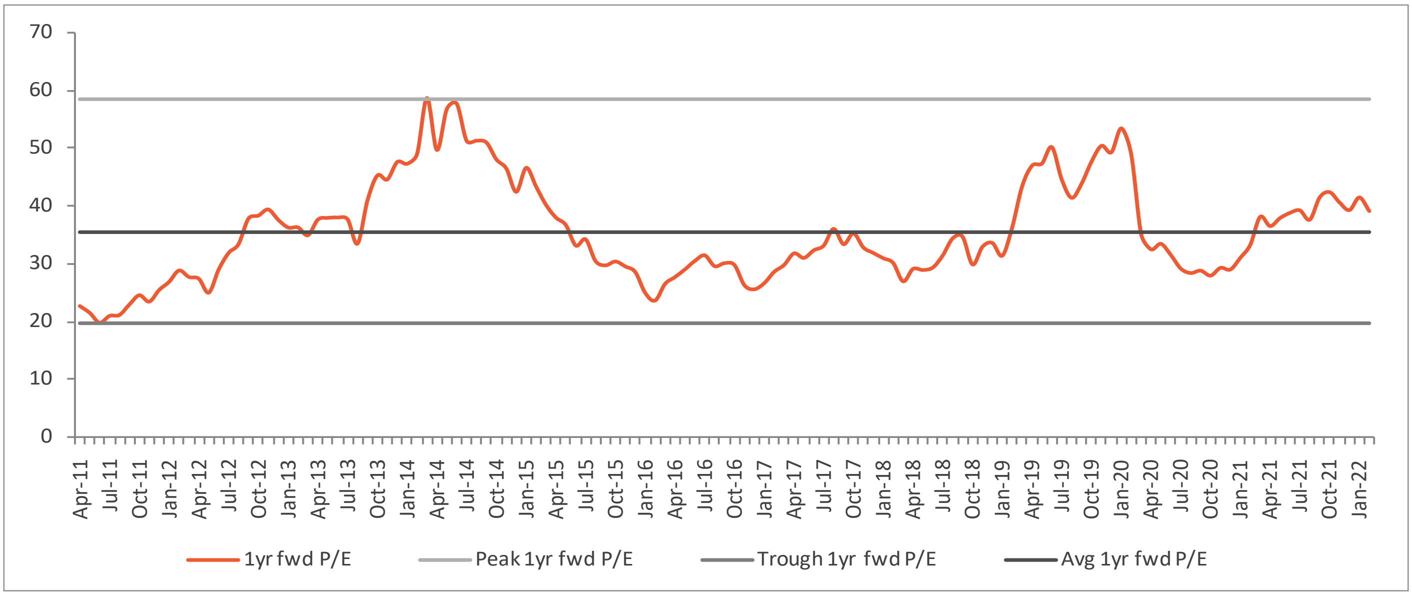
■ Company outlook - Improved business environment and clarity on capital allocation

Grasim is benefiting from a rise in domestic demand for its 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 company's venture into the paints business will provide scale, growth and reduce cyclicality of the standalone business. Grasim 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. 2,100

Grasim is expected to benefit from positive outlook in both its viscose and chemical businesses in standalone operations. Further, the outlook for its key subsidiary Ultratech remains buoyant over a longer term. The company's venture into paints business is expected to yield premium valuation. Its capacity expansions across products are likely to capture high demand expected over the next two years. Further, the rising share of value-added products in the viscose and chemicals businesses would cushion OPMs in the wake of rising input costs. We maintain a Buy on the stock with a revised price target of Rs. 2,100 (factoring lower valuation for VSF).

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

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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