Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Grasim Industries Ltd

Expediting paints venture to capture growth

Diversified	Sharekhan code: GRASIM
Reco/View: Buy ↔	CMP: Rs. 1,403
	Price Target: Rs. 1,740 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

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 Feb 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. 92,336 cr
52-week high/low:	Rs. 1939/1351
NSE volume: (No of shares)	27.8 lakh
BSE code:	500300
NSE code:	GRASIM
Free float: (No of shares)	37.7 cr

Shareholding (%)

Promoters	42.8
FII	12.7
DII	14.7
Others	29.9

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-17.3	-10.4	-20.6	2.1
Relative to Sensex	-12.8	-7.2	-12.5	-4.7

Sharekhan Research, Bloomberg

Summary

- Grasim reported better-than-expected standalone revenues for Q4FY2022 led by strong growth in both viscose and chemicals. OPM was hit by the weak performance of the VSF division. Adjusted standalone net profit was up 12% y-o-y.
- The company would be expediting its paint venture with a revised project cost of Rs. 10,000 crore by FY2025 to become the second largest profitable paint company with an installed capacity of 1332MLPA.
- The details regarding debt to equity funding of paints business and capex plan for existing business are awaited. Healthy standalone cash surplus and strong cash flow expected from existing businesses to support faster execution in paints.
- We retain a Buy on Grasim with a revised PT of Rs. 1,740 factoring in our revised valuation for Ultratech and downwardly revised estimates for standalone operations.

Grasim Industries Limited (Grasim) reported better-than-expected standalone revenues at Rs. 6376crores, up 45% y-o-y led by both the chemicals (revenues up 69% y-o-y driven by 65% y-o-y rise in realizations) and viscose (revenues up 46% y-o-y led equally by volume and realization growth of over 20% y-o-y) divisions. The standalone OPM at 11.8% (down665bps y-o-y) negatively surprisedowing to historically weak Viscose margins at 6.7% affected by a steep rise in input costs especially caustic soda. On the other hand, Chlor-alkali reported historically high ECU while epoxy margins normalized leading to 252bps y-o-y dip in chemical margins at 20.1% (although were up 750bps y-o-y). Overall standalone operating profit declined by 7% y-o-y to Rs. 753 crore was, while adjusted net profit was up 12% y-o-y at Rs. 562 crore (adjusted for exceptional items).The company would be expediting its paint venture at a revised project cost of Rs. 10,000 crore by FY2025 (earlier capex plan of Rs. 5000 crores by FY2024) to become the second largest profitable paints company with 1332MLPA capacity. Despite a steeprise in project cost, it expects a similar project IRR of ~20%. It would be sharing further details on its Capex plans per annum for both its paints and existing businesses in the near term.

Key positives

- Chemical revenues grew by 69% y-o-y led by a 65% y-o-y rise in realizations for Q4FY2022. The division reported a strong OPM of 20.1% (up 750bps y-o-y) led by historically high ECU realizations.
- Viscose division reported 21% y-o-y volume growth led by both market expansion and lower imports.
- Standalone net cash surplus increase to Rs. 553 crore versus Rs. 432 crore in Q3FY2022.

Key negatives

- VSF margins reported historically low margins of 6.7% affected by the inability to pass on the increased costs, especially caustic soda.
- The paint business project cost increased to Rs. 10,000 crore by FY2025 from the initial plan of Rs. 5000 crore capex by FY2024.

Management Commentary

- The management outlined a broader capex of Rs. 10,000 crore for paints biz by FY2025 to become the second largest profitable paint company with a capacity of 1332MLPA.
- The company would share details regarding capex per annum and financing for its paints and existing business in the near term.
- It expects to reach synergetic agreements with Ultratech forprocurement of putty for its paints business.
- It would pass on dividends received from Ultratech with a special dividend of Rs. 5 per share apart from Rs. 5 per share recommended for FY2022. Going ahead, it expects dividends received from Ultratech to be passed on.

Revision in estimates – We have increased estimates downwards for FY2023-FY2025 factoring in lower OPM for the Viscose division and higher interest expense factoring increase in capital expenditure.

Our Call

Valuation –Retain Buy with a revised PT of Rs. 1,740: Grasim's decision on expediting its paint venture is likely to aid in capturing higher industry growth earlier than expected.However, the key details regarding debt-to-equity financing of paints business and capital expenditure in existing businesses area waited. The company's healthy standalone net cash position and strong cash flow generation expected from existing businesses would aid in expediting investments in the paint business without much stressing the balance sheet. We have not yet factored in the valuation for its paint venture in our SOTP based price target awaiting further details. We maintain a Buy on the stock with a revised price target of Rs. 1,740 (factoring in our revised valuation for Ultratech and downwardly revised estimates for standalone operations).

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	12,386	20,857	24,488	27,444
OPM (%)	12.6%	15.4%	14.9%	16.6%
Adjusted PAT	891	2,545	2,431	2,932
% YoY growth	(31.6)	185.5	(4.5)	20.6
Adjusted EPS (Rs.)	13.6	38.7	37.0	44.6
P/E (x)	103.5	36.3	38.0	31.5
P/B (x)	2.1	1.9	1.8	1.8
EV/EBITDA (x)	41.6	18.6	16.9	13.8
RoNW (%)	2.1	5.2	4.8	5.6
RoCE (%)	1.9	4.9	4.3	4.9

Source: Company; Sharekhan estimates

The chemical division continues to compensate Viscose's performance

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Expediting paints venture

The company would be accelerating capacity implementation led by an optimistic industry outlook. The revised project cost stands at Rs. 10,000 crore by FY2025 for 1332MLPA capacity. It had initially guided for a capex of Rs. 5000 crore by FY2024. The earlier plans were to reach 1332MLPA capacity over 6-7 years. However, now the commissioning of plants would start from Q4FY2022 reaching full capacity implementation over 12-15 months post Q4FY2022. However, the management expects project IRR to remain unchanged at ~20% to be achieved with a reworked business model and economies of scale. It expects to be the number two profitable company in the paints sector.Grasim and Ultratech would be reaching some kind of agreement concerning the usage of putty in paints going ahead. The company would only procure titanium oxide from outside while resins and emulsions would be used from in-house production.

Key Conference Call Takeaways

- **Paints venture:** The company would be accelerating capacity implementation led by an optimistic industry outlook. The revised project cost stands at Rs. 10,000 crore by FY2025 for 1332MLPA capacity. It had initially guided for a capex of Rs. 5000 crore by FY2024. The earlier plans were to reach 1332MLPA capacity over 6-7 years. However, now the commissioning of plants would start from Q4FY2022 reaching full capacity implementation over 12-15 months post Q4FY2022. However, the management expects project IRR to remain unchanged at ~20% to be achieved with a reworked business model and economies of scale. It expects to be the number two profitable company in the paints sector.
- **Synergies with Ultratech:** Grasim and Ultratech would be reaching some kind of agreement concerning the usage of putty in paints going ahead. The company would only procure titanium oxide from outside while resins and emulsions would be used from in-house production.
- **Capex:** Although the management highlighted capex related to paints at Rs. 10,000 crore by FY2025, it has not given guidance on per annum capex to be incurred. It has also not put a number to the capex for FY2023 for non-paints businesses and would be sharing it in the near term. In an existing business, there is a pending capex requirement of ~Rs. 600 crore while maintenance capex has increased from the historical Rs. 500 crore per annum. It is yet to share the financing details for its paint venture.
- **Dividend:** The company recommended a dividend of Rs. 10 per share including Rs. 5 per share special dividend for FY2022. The total dividend outflow would be Rs. 658 crore. The company have been passing dividends received from Ultratech to its shareholders over the last two years and is expected to continue going ahead.
- **Chemical performance:** Within chemicals, Chlor-alkali business reported the highest ECU of Rs. 47,267/tonne. The chemical division OPM was lower q-o-q owing to the normalisation of margins in Epoxy resins (advanced materials). Caustic soda imports for FY2022 stood at 2 lakh tonnes. India turned net exporter during FY2022 and is expected to maintain the status quo over 1-2 years
- **Viscose performance:** Market expansion and lower imports aided 21% y-o-y growth in Viscose volumes for Q4FY2022. Imports at 90,000 tonnes comprised 10-11% of the total market during FY2022. It would be de-bottlenecking Excel (Lyocell) capacity by 30% by February 2023. The rise in input costs like Pulp, caustic, and sulphur along with an increase in energy costs and transport costs affected OPM during Q4FY2022 which stood at a multi-year low of 6.7%. The company has taken a 27% price hike from September 2021 March 2022 in grey fibre. The pulp prices had seen a strong run up over the trailing few months and are

now expected to stabilise. Also, a new pulp plant is getting commissioned in Brazil. The Chinese VSF prices have started increasing. It expects more of the costs to be recovered in VSF going ahead.

- **Exceptional items during Q4FY2022:** The company recognised Rs. 540 crore pre-tax gain on sale and transfer of its fertiliser business. It wrote back tax provisions of Rs. 321 and deferred tax reversals of Rs. 197 crore.
- **VAP share:** The current share of value-added products is 30% which is expected to increase by 3-4% per annum over a five year period.

Results (Standalone) Rs cr

Particulars	Q4FY22	Q4FY21	y-o-y%	Q3FY22	q-o-q%
Net sales	**6,376.4**	**4,394.3**	**45.1**	**5,784.7**	**10.2**
Total expenditure	5,623.8	3,583.4	56.9	4,862.6	15.7
Operating profit	**752.6**	**810.9**	**(7.2)**	**922.1**	**(18.4)**
Other Income	87.4	69.2	26.4	40.6	115.5
EBIDTA	840.0	880.0	(4.6)	962.7	(12.7)
Interest	80.6	53.6	50.3	53.4	50.8
PBDT	759.4	826.4	(8.1)	909.2	(16.5)
Depreciation	282.9	214.5	31.9	221.8	27.6
Extraordinary item	(251.5)	23.3	-	-	-
PBT	**727.9**	**588.6**	**23.7**	**687.5**	**5.9**
Tax	(85.7)	125.6	-	198.5	-
Net Profit/(loss) from discontinued operations	254.4	17.2	-	33.5	-
Reported PAT	**1,068.0**	**480.2**	**122.4**	**522.5**	**104.4**
Extraordinary item	(505.9)	23.3	-	-	-
Adjusted PAT	**562.1**	**503.5**	**11.7**	**522.5**	**7.6**
EPS (Rs.)	8.5	7.7	11.7	7.9	7.6
Margin (%)			BPS		BPS
Operating margin	11.8%	18.5%	-665	15.9%	-414
Net Margin	8.8%	11.5%	-264	9.0%	-22
Tax rate	-11.8%	21.3%	-	28.9%	-

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 the textile demand environment in China. Firming up 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.

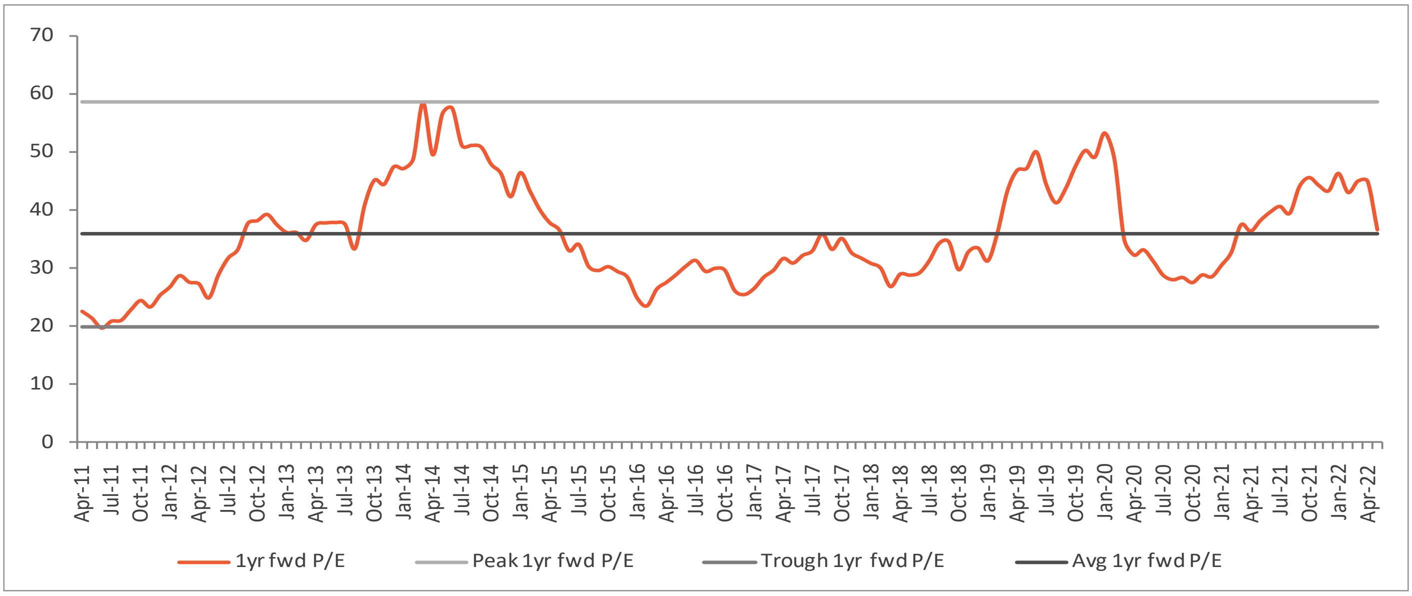
■ **Company outlook - Improved business environment and clarity on capital allocation**

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 investmentsin listed telecom investment removes a key hangover. The company's venture into the paints business will provide scale, and growth and reduce the cyclicality of the standalone business. Grasim is venturing into the decorative paints business with an investment of Rs. 10,000 crore by FY2025. Hence, overall, the improvement in standalone business along with clarity on capital allocation is expected to improve its earnings and valuation.

■ **Valuation - Retain Buy with a revised PT of Rs. 1,740**

Grasim's decision on expediting its paint venture is likely to aid in capturing higher industry growth earlier than expected. However, the key details regarding debt to equity financing of paints business and capital expenditure in existing businesses area waited. The company's healthy standalone net cash position and strong cash flow generation expected from existing businesses would aid in expediting investments in paint business without much stressing the balance sheet. We have not yet factored in the valuation for its paint venture in our SOTP based price target awaiting further details. We maintain a Buy on the stock with a revised price target of Rs. 1,740 (factoring in our revised valuation for Ultratech and downwardly revised estimates for standalone operations).

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 a 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 an improved domestic demand environment for its key standalone businesses led by a pickup in demand from end-user industries. The same has led to an 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 the paints business will provide scale, and growth and reduce the 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 businesses 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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