Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Grasim Industries Ltd

Stellar Q1; Retain Buy with a revised PT of Rs. 1,881

Diversified	Sharekhan code: GRASIM
Reco/View: Buy ↔	CMP: Rs. 1,623
	Price Target: Rs. 1,881 ↑

↑ 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 Updated July 08, 2022				42.73
Severe Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

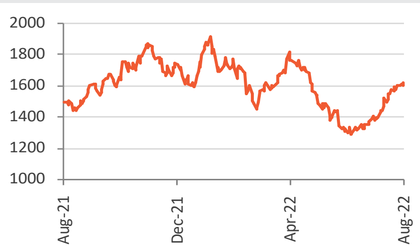
Company details

Market cap:	Rs. 106,822 cr
52-week high/low:	Rs. 1939/1277
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	11.5
DII	15.6
Others	30.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	16.0	10.0	-1.2	8.4
Relative to Sensex	4.8	-2.6	-6.7	1.1

Sharekhan Research, Bloomberg

Summary

- Grasim Industries Limited (Grasim) reported stellar performance for Q1FY2023, led by strong volume growth in VSF and historically high operating margins in its chemical and textile business verticals.
- The company reiterated its paints capex of Rs. 10,000 crore by FY2025, while it continues to expand its existing businesses especially the chemical division.
- Easing of VSF and caustic prices along with elevated input costs may put pressure on OPM in the near term. However, healthy demand and increasing value-added products would aid growth over the medium to long term.
- We retain Buy on Grasim with a PT of Rs. 1,881 factoring upwardly revised estimates and lower holding company discounts for its investments, especially in UltraTech, which has a strong growth outlook going ahead.

Grasim Industries Limited (Grasim) reported strong beat on standalone performance for Q1FY2023, led by robust volume growth in VSF and historically high quarterly operating margins in chemical and textile businesses. Standalone revenue at Rs. 7,253 crore, up 93% y-o-y, was led by both the chemicals (revenues up 90% y-o-y, driven by 61% y-o-y rise in realisations) and viscose (revenue up 105% y-o-y, led by 73% y-o-y rise in volumes and 19% y-o-y rise in realisation) divisions. Standalone OPM at 18.2% (down 147 bps y-o-y) surprised positively owing to historically high chemical margins (29.5%) and better-than-expected Viscose margins (11.6%, up almost 500bps q-o-q). Overall standalone operating profit/net profit were up 78%/68% y-o-y at Rs. 1,320 crore/Rs. 809 crore, respectively. The company reiterated its paint capex of Rs. 10,000 crore by FY2025 (Rs. 825 crore incurred till June 2022). Grasim continues with capacity expansion plans in its existing businesses (Rs. 3,117 crore for FY2023), which includes 80TPD VSF de-bottlenecking, Vilayat balance capex (Rs. 350 crore), 219KTPA caustic and VAPs, 123KTPA E-poxy (by Q1FY2024), 50KTPA ECH (by Q1FY2025), and in other businesses (VFY, Textiles and Insulator).

Key positives

- Chemical revenue grew by 105% y-o-y, led by sustained rise in caustic prices in Q1FY2023. The division reported strong OPM of 29.5% (up 10 ppts y-o-y), led by historically high ECU realisations.
- Viscose division reported 73% y-o-y volume growth, led by strong domestic demand, which accounted for 94% of total volumes.
- Textile division recorded 91% y-o-y rise in revenue to Rs. 620 crore along with historically high OPM of 15.6%.

Key negatives

- VSF margins, although better than our estimate, were lower by 11ppts y-o-y at 11.6%.
- Chlorine realisation continued to remain in the negative territory over trailing 2-3 quarters.

Management Commentary

- Pulp prices are not reducing to the extent of reduction seen in VSF prices on account of Force Majeure situation at major pulp supplier. Further, caustic, sulphur, and coal prices are higher y-o-y.
- Caustic soda prices have softened towards the end of June 2022 and are currently at $650/tonne compared to average price of $769/tonne in Q1FY2023.
- The company's target is to increase renewable power mix to 25% by 2030.

Revision in estimates – We have increased our estimates upwards for FY2023-FY2024, factoring in higher OPM for the Viscose division and chemical division.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 1,881: Grasim's standalone businesses continue to outperform on both volume and operating margin fronts, driven by global factors. The company may see a gradual decline in the chemical division's margins in the near term, led by the decline in caustic soda prices. Further, VSF margins are likely to remain under pressure with the decline in cotton prices along with elevated pulp prices in the near term. However, both businesses remain on a strong footing in terms of healthy demand environment and increasing contribution of value-added products. The company's expedited expansion in paints is likely to provide the next leg of growth for the company. We maintain Buy on the stock with a revised price target (PT) of Rs. 1,881 (factoring upwardly revised estimates and lower holding company discounts for its investments especially in UltraTech, which has a strong growth outlook going ahead).

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	12,386	20,857	25,948	28,684
OPM (%)	12.6%	15.4%	17.1%	17.6%
Adjusted PAT	891	2,545	3,029	3,311
% YoY growth	(31.6)	185.5	19.0	9.3
Adjusted EPS (Rs.)	13.6	38.7	46.0	50.3
P/E (x)	119.8	42.0	35.3	32.3
P/B (x)	2.5	2.2	2.1	2.0
EV/EBITDA (x)	50.9	23.1	17.0	15.1
RoNW (%)	2.1	5.2	5.9	6.2
RoCE (%)	1.9	4.9	5.3	5.4

Source: Company; Sharekhan estimates

The chemical division continues to post strong performance

Grasim reported better-than-expected standalone revenue at Rs. 7,253 crore, up 93% y-o-y, led by both the chemicals (revenue up 105% y-o-y driven by 61% y-o-y rise in realisations and 18% y-o-y rise in volumes) and viscose (revenue up 90% y-o-y led by 73% y-o-y rise in volume and 19% realisation growth) divisions. Standalone OPM at 18.2% (down 147 bps y-o-y) surprised positively owing to historically high Chemical margins at 29.5% along with better-than-expected Viscose margins at 11.6% (up 494 bps q-o-q). Chlor-alkali reported historically high ECU although chlorine realisations continued to remain in the negative territory over the trailing 2-3 quarters. Overall, standalone operating profit rose by 78% y-o-y to Rs. 1,320 crore, while reported net profit was up 68% y-o-y at Rs. 809 crore.

Key Conference Call Takeaways

- **Q1FY2023 performance:** Consolidated revenue increased 41% y-o-y to Rs. 28,042 crore, while EBITDA increased 10% y-o-y to Rs. 5,243 crore. Standalone revenue increased 93% y-o-y to Rs. 7,253 crore and EBITDA increased 69% y-o-y to Rs. 1364 crore. VAP share was 20% in Q1FY2023.
- **Capex:** The company would be incurring Rs. 3,117 crore capex for FY2023, excluding new businesses (paints and B2B e-com). Grasim is undertaking 80TPD de-bottlenecking in VSF at a capex of Rs. 200 crore. The company's maintenance capex is Rs. 1000-1500 crore per annum.
- **Paints:** Grasim has spent Rs. 825 crore in the paints business as of June 2022 (Rs. 212 crore spent in Q1FY2023). The company maintained its capex guidance of Rs. 10,000 crore for paints. Grasim would be incurring Rs. 3,542 crore in paints in FY2023.
- **VSF Q1FY2023 performance:** VSF volumes rose 10% q-o-q and 76% y-o-y, with domestic sales accounting for 94% of the sales volumes. Speciality volumes were down q-o-q, led by seasonality and reduction in exports (overseas clients had higher inventory levels). The 600TPD brownfield plant at Vilayat contributed ~51KT sales volumes in Q1FY2023. Global demand remained weak. Cotton prices peaked in May and since then have softened, leading to demand slowdown. The company has integrated 35% pulp.
- **VSF outlook:** Pulp prices are not reducing to the extent of reduction seen in VSF prices on account of Force Majeure situation at major pulp suppliers. Further, caustic, sulphur, and coal prices are higher. The company would target to achieve over 90% capacity utilisation in VSF in FY2023.
- **Chemical Q1FY2023 performance:** The chlor-alkali segment registered the highest-ever ECU realisation of Rs. 53,560/tonne. Global average caustic prices increased to $769/tonne in Q1FY2023 from $719/tonne in Q4FY2022. Prices softened towards the end of June and are currently at $650/tonne. Chlorine remained in the negative realisation territory over trailing 2-3 quarters. The company has 60% chlorine integration and 40% is merchant sales. Captive chlorine VAP volumes increased 32% y-o-y, while advanced material business reported sales volume growth of 35% y-o-y.
- **Renewable energy:** The company's target is to increase renewable power mix to 25% by 2030.

Results (Standalone) Rs cr

Particulars	Q1FY23	Q1FY23	y-o-y %	Q4FY22	q-o-q %
Net sales	**7,253.0**	**3,762.7**	**92.8**	**6,376.4**	**13.7**
Total expenditure	5,932.8	3,022.5	96.3	5,623.8	5.5
Operating profit	**1,320.2**	**740.2**	**78.4**	**752.6**	**75.4**
Other Income	43.7	64.9	(32.7)	87.4	(50.0)
EBIDTA	1,363.9	805.2	69.4	840.0	62.4
Interest	86.7	58.1	49.1	80.6	7.5
PBDT	1,277.3	747.0	71.0	759.4	68.2
Depreciation	255.1	201.8	26.4	282.9	(9.8)
Extraordinary item	-	-	-	(251.5)	-
PBT	**1,022.1**	**545.3**	**87.5**	**727.9**	**40.4**
Tax	213.6	99.3	115.0	(85.7)	(349.3)
Net Profit/(loss) from discontinued operations	-	35.7	-	254.4	-
Reported PAT	**808.6**	**481.6**	**67.9**	**1,068.0**	**(24.3)**
Extraordinary item	-	-	-	(505.9)	-
Adjusted PAT	**808.6**	**481.6**	**67.9**	**562.1**	**43.8**
EPS (Rs.)	12.3	7.3	67.9	8.5	43.8
Margin (%)			**BPS**		**BPS**
Operating margin	18.2%	19.7%	-147	11.8%	640
Net Margin	11.1%	12.8%	-165	8.8%	233
Tax rate	20.9%	18.2%	268	-11.8%	3266

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 caustic soda prices, driven by demand from textile and paper industries along with improvement in operating margins, 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.

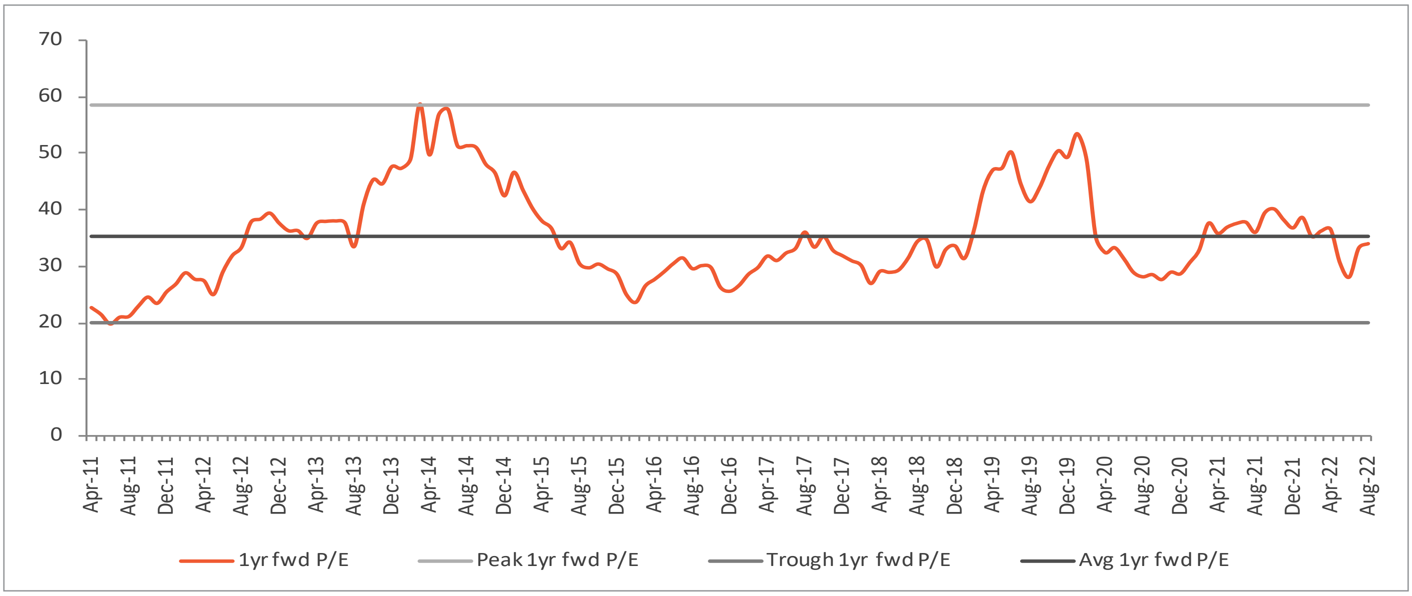
■ Company outlook - Improved business environment and clarity on capital allocation

Grasim is benefiting from 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, 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 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, 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. 1,881

Grasim's standalone businesses continue to outperform on both volume and operating margin fronts, driven by global factors. The company may see a gradual decline in the chemical division's margins in the near term, led by the decline in caustic soda prices. Further, VSF margins are likely to remain under pressure with the decline in cotton prices along with elevated pulp prices in the near term. However, both businesses remain on a strong footing in terms of healthy demand environment and increasing contribution of value-added products. The company's expedited expansion in paints is likely to provide the next leg of growth for the company. We maintain Buy on the stock with a revised PT of Rs. 1,881 (factoring upwardly revised estimates and lower holding company discounts for its investments especially in UltraTech, which has a strong growth outlook going ahead).

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, the company 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

Grasim 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, management's clarity on capital allocation with first priority to be given to standalone business and nil future investment for listed telecom investment remove 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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