Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Grasim Industries Ltd

An in-line Q2; Retain Buy with revised PT of Rs. 2005

Diversified	Sharekhan code: GRASIM
Reco/View: Buy ↔	CMP: Rs. 1,748
	Price Target: Rs. 2,005 ↑

↑ 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 42.73

Updated Aug 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. 1,15,082 cr
52-week high/low:	Rs. 1,939/1,278
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	15.9
DII	17.2
Others	24.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	3.3	9.8	20.3	-5.8
Relative to Sensex	-2.2	6.8	3.9	-7.3

Sharekhan Research, Bloomberg

Summary

- Grasim Industries Limited (Grasim) reported largely in performance led by strong revenue growth in both Viscose and chemical divisions. Both witnessed q-o-q contraction in OPM as per expected lines.
- The company upwardly revised FY2023 capex to Rs. 3498 crore including chlorine VAP expansion and de-bottlenecking of pulp capacity. It incurred Rs. 1263 crores capex in paints for H1FY2023.
- The first factory for paints is expected to be rolled out in Q4FY2024 with 200-220MLPA capacity. It would also be doing commercial launch of its B2B E-commerce business by Q4FY2024.
- We retain Buy on Grasim with a PT of Rs. 2,005 factoring our upwardly revised price target of UltraTech, and higher valuation of Aditya Birla Capital.

Grasim Industries Limited (Grasim) reported broadly in-line performance for Q2FY2023. Standalone revenue at Rs. 6,745 crores, up 36.7% y-o-y, was led by both the chemicals (revenues up 66.5% y-o-y, driven by 43% y-o-y rise in realisations) and viscose (revenue up 30% y-o-y, led by 10% y-o-y rise in volumes and 18% y-o-y rise in realisation) divisions. Standalone OPM at 14.2% (down 206 bps y-o-y) remained on expected lines owing to anticipated q-o-q pressure on margins in chemical (lower 701bps q-o-q at 22.5%) and Viscose (lower 333bps q-o-q at 8.3%, up almost 500bps q-o-q). Overall standalone operating profit/net profit was up 19%/7.5% y-o-y at Rs. 957 crore/Rs. 1052 crore, respectively. Grasim upwardly revised its budgeted FY2023 capex to Rs. 3498 crores (Rs. 873 crore spent in H1FY2023) by Rs. 381 crores to include land purchase at Vilayat for chlorine VAP expansion and de-bottlenecking of pulp capacity at Harihar from 210TPD to 260TPD. The earlier capex plans viz. 80TPD VSF de-bottlenecking, VSF modernisation and maintenance, 219KTPA caustic and VAPs, 123KTPA E-poxy (by Q1FY2024), 50KTPA ECH (by Q1FY2025), and in other businesses (VFY, Textiles and Insulator) remain as it is. Its first paint unit is expected to be rolled out in Q4FY2024 with 200-220 million litres p.a. capacity.

Key positives

- Chemical revenue grew by 66.5% y-o-y while Viscose revenues were up 30% y-o-y.
- Textile division recorded 43% y-o-y rise in revenue to Rs. 584 crores along with a strong OPM of 12.2%. Insulators division recorded a 75% y-o-y rise in revenues with an OPM of 18.1%.
- Standalone net cash surplus increased to Rs. 230 crores from Rs. 96 crores in Q1FY2023.

Key negatives

- Viscose and Chemical OPMs contracted by 333bps/701bps q-o-q to 8.3%/22.5%.
- Weak VSF spot prices are expected to further squeeze in margins in Q3FY2023.

Management Commentary

- It will be setting up its first paint plant having 200-220 mn litres per annum by Q4FY2024. Currently, construction work is in progress for five out of six sites for paints.
- It plans to commercially launch its B2B e-commerce platform by Q4FY2024. The business would have high growth but not high margins. It aims to be one of the largest in the B2B e-commerce building material space.
- The standalone net cash surplus is Rs. 230 crore. It would be ending FY2023 with net debt position. The net debt/EBITDA post-completion of all capex is estimated to be 2.73x.

Revision in estimates – We have fine-tuned our estimates for FY2023-FY2024, factoring higher Viscose volume growth and lower OPMs.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 2,005: Grasim's standalone businesses continue to benefit from a healthy demand environment. The company has started witnessing normalising of chemical and VSF margins which is expected to continue 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 introduce our FY2025E earnings in this note. Although we have not factored in revenues from the paints business awaiting further details. We maintain Buy on the stock with a revised price target (PT) of Rs. 2,005 (factoring in our upwardly revised price target for UltraTech and increased valuation of Aditya Birla Capital).

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	20,857	27,684	30,886	33,437
OPM (%)	15.4%	15.7%	15.8%	17.5%
Adjusted PAT	2,545	2,899	3,128	3,696
% YoY growth	185.5	13.9	7.9	18.2
Adjusted EPS (Rs.)	38.7	44.1	47.6	56.2
P/E (x)	45.2	39.7	36.8	31.1
P/B (x)	2.4	2.3	2.2	2.0
EV/EBITDA (x)	25.7	19.3	17.5	14.5
RoNW (%)	5.2	5.7	5.9	6.6
RoCE (%)	4.9	5.1	5.1	5.7

Source: Company; Sharekhan estimates

An in-line performance

Grasim Industries Limited (Grasim) reported broadly in-line performance for Q2FY2023. Standalone revenue at Rs. 6,745 crores, up 36.7% y-o-y, was led by both the chemicals (revenues up 66.5% y-o-y, driven by 43% y-o-y rise in realisations) and viscose (revenue up 30% y-o-y, led by 10% y-o-y rise in volumes and 18% y-o-y rise in realisation) divisions. Standalone OPM at 14.2% (down 206 bps y-o-y) remained on expected lines owing to anticipated q-o-q pressure on margins in chemical (lower 701bps q-o-q at 22.5%) and Viscose (lower 333bps q-o-q at 8.3%, up almost 500bps q-o-q). Overall standalone operating profit/net profit was up 19%/7.5% y-o-y at Rs. 957 crore/Rs. 1052 crore, respectively.

Key Conference call takeaways

- **Q2FY2023 performance:** Consolidated revenues increased 37% y-o-y to Rs. 27,486 crores led by strong growth in AB Capital and Ultratech. EBITDA declined by 12% y-o-y to Rs. 3783 crore due to increased cost pressure at Ultratech.
- **Outlook:** VSF margins may see a further decline in Q3FY2023 due to weak spot prices.
- **Paints:** It will be setting up its first paint plant having 200-220 mn litres per annum by Q4FY2024. Currently, construction work is in progress for five out of six sites for paints.
- **B2B E-com:** It plans to launch its B2B e-commerce platform commercially by Q4FY2024. The leadership team for the business would be in place by Q4FY2023. The business would have high growth but not high margins. It aims to be one of the largest in the B2B e-commerce building material space.
- **Capex:** The company's board approved additional capex of Rs. 560 crores out of which Rs. 82 crores would be spent in FY2023. The additional capex is for land purchase at Vilayat for chlorine value-added products expansion and de-bottlenecking at Harihar pulp plant (which would increase its chlorine integration by 2% from 35% to 37%). It is expanding pulp capacity from 210TPD to 260TPD at a capex of Rs. 227 crores over two years. Its E-poxy plant (Rs. 360 crore capex to double capacity) is expected in Q1FY2024. The ECH plant (capex of Rs. 454 crores) is expected to commission by Q1FY2025.
- **VSF and VFY performance:** VSF revenues were Rs. 3241 crores for Q2FY2023 while EBITDA declined 59% y-o-y to Rs. 212 crore. VSF was impacted by lower demand in developed economies and increase in costs of pulp, caustic soda and coal. The VSF volumes declined by 14% q-o-q on account of demand slowdown and imports. The VSF September exit prices were 9% lower than June exit prices while cotton prices were lower by 21% during same period. The VFY sales volumes were up 31% y-o-y led by strong domestic demand while it was able to pass on the rise in costs to customers.
- **Chemical performance:** Chemical business reported EBITDA of Rs. 609 crore along with 17% y-o-y rise in volumes. International caustic soda prices declined q-o-q on easing of supply chain disruptions. The ECU for Q2FY2023 was Rs. 49503/MT (up 89% y-o-y, down 8% q-o-q). Chlorine realisation remained in negative territory. The chlorine integration stood at 61% versus 52% in Q2FY2022.
- **Lubrizol project status:** The change in management of Lubrizol has caused delay of 12-18 months. The first phase of the project would take 24 months to execution time period from today. Grasim does not have any capital commitment for the project.
- **Debt:** The standalone net cash surplus is Rs. 230 crores. It would be ending FY2023 with net debt position. The net debt/EBITDA post-completion of all capex is estimated to be 2.73x.

Results (Standalone) **Rs cr**

Particulars	Q2FY23	Q2FY23	y-o-y%	Q1FY23	q-o-q%
Net sales	**6,745.2**	**4,933.0**	**36.7**	**7,253.0**	**(7.0)**
Total expenditure	5,788.6	4,131.9	40.1	5,932.8	(2.4)
Operating profit	**956.6**	**801.2**	**19.4**	**1,320.2**	**(27.5)**
Other Income	755.5	702.4	7.6	43.7	1,628.9
EBIDTA	1,712.1	1,503.6	13.9	1,363.9	25.5
Interest	85.1	55.1	54.4	86.7	(1.8)
PBDT	1,627.1	1,448.5	12.3	1,277.3	27.4
Depreciation	266.2	207.5	28.3	255.1	4.3
Extraordinary item	88.0	-	-	-	-
PBT	**1,272.8**	**1,241.1**	**2.6**	**1,022.1**	**24.5**
Tax	308.5	294.2	4.9	213.6	44.5
Net Profit/(loss) from discontinued operations	-	32.3	-	-	-
Reported PAT	**964.3**	**979.1**	**(1.5)**	**808.6**	**19.3**
Extraordinary item	88.0	-	-	-	-
Adjusted PAT	**1,052.3**	**979.1**	**7.5**	**808.6**	**30.1**
EPS (Rs.)	16.0	14.9	7.5	12.3	30.1
Margin (%)			**BPS**		**BPS**
Operating margin	14.2%	16.2%	-206	18.2%	-402
Net Margin	15.6%	19.8%	-425	11.1%	445
Tax rate	24.2%	23.7%	54	20.9%	335

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 easing 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 market from rural and individual home builders.

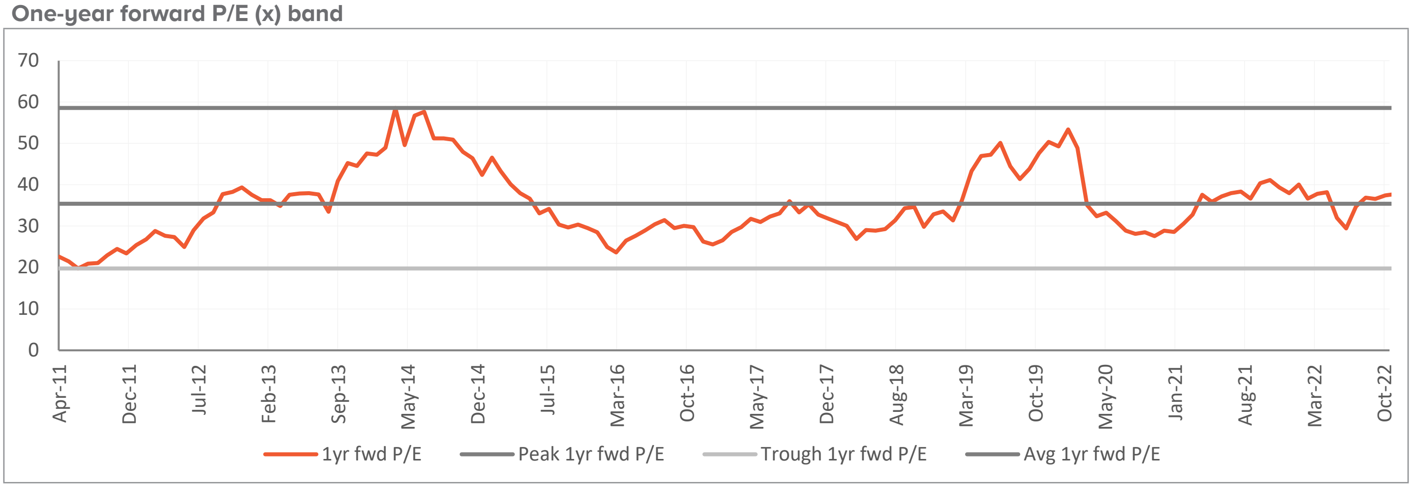
■ **Company Outlook – Improved business environment and clarity on capital allocation**

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 increased 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. 2,005**

Grasim's standalone businesses continue to benefit from healthy demand environment. The company has started witnessing normalizing of chemical and VSF margins which is expected to continue 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 introduce our FY2025E earnings in this note. Although we have not factored in revenues from paints business awaiting further details. We maintain Buy on the stock with a revised price target (PT) of Rs. 2,005 (factoring our upwardly revised price target for UltraTech and increased valuation of Aditya Birla Capital).

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 benefits 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 increased capex expenditure and expansion in both 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Birla Group Holdings Pvt Ltd	19
2	Life Insurance Corp of India	11.29
3	IGH Holdings Pvt Ltd	5.77
4	Hindalco Industries Ltd	4.29
5	Umang Commercial Co Ltd	4.07
6	Standard Life Aberdeen PLC	3.98
7	Pilani Investment & Industries Cor	3.76
8	ICICI Prudential Asset Management	1.93
9	Vanguard Group Inc/The	1.73
10	ICICI Prudential Life Insurance Co	1.4

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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