Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Grasim Industries Ltd

Chemical division weakens Q4; retain Buy

Diversified	Sharekhan code: GRASIM
Reco/View: Buy ↔	CMP: **Rs. 1,687**
	Price Target: **Rs. 1,950** ↑

↑ 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 42.75
Updated May 08, 2023

Severe Risk

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

Source: Morningstar

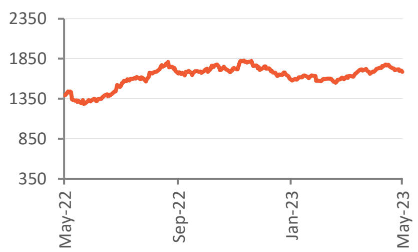
Company details

Market cap:	Rs. 1,11,094 cr
52-week high/low:	Rs. 1,839 / 1,277
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	16.3
DII	17.1
Others	23.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.5	7.4	-1.7	21.2
Relative to Sensex	-4.1	2.0	-1.7	6.0

Sharekhan Research, Bloomberg

Summary

- Grasim Industries Limited (Grasim) reported a big miss on standalone net earnings, led by a sharp contraction in the chemical division's operating margins, owing to weak demand, dip in realisations, and higher input costs.
- Viscose utilisation levels are expected to remain stable with gradual improvement in OPMs in FY2024. The chemical division may face near-term headwinds, led by a weak pricing environment.
- Paints and B2B commerce business phase-wise launch remain on track from Q4FY2024 and Q2FY2024, respectively. Capex on improving asset productivity and value-added products in viscose and chemicals.
- We retain Buy on Grasim with a revised PT of Rs. 1,950, as we pencil in upwardly revised valuation of UltraTech, partially getting offset by downwardly revised valuation of its standalone business.

Grasim Industries Limited (Grasim) reported a weak performance on standalone net earnings, led by weak operational performance in the chemical division. Standalone revenue (up 4% y-o-y at Rs. 6,646 crore), was aided by sequential recovery in the viscose division (revenue up 18% q-o-q led by 25% q-o-q volume growth), while the chemical division (revenue down 7% q-o-q, led by an 8% q-o-q decline) reported weak performance owing to global and domestic oversupply and subdued demand environment in chlorine downstream industries. Standalone OPM surprised negatively at 6.4% (down 539 bps y-o-y) owing to a sharp contraction in the chemical division's OPM (down 471 bps y-o-y to 15.3%). Lower realisations, weak demand environment, and higher raw-material costs affected the chemical division's OPMs. Consequently, standalone operating profit/adjusted net profit was down 43%/74% y-o-y at Rs. 426 crore/Rs. 93.5 crore, much lower than our estimates. While VSF utilisation levels are expected to remain stable with a gradual improvement in OPMs. The caustic division may remain weak in the near term. Grasim remains on track to commercially launch the paints business beginning Q4FY2024 in phases. The B2B e-commerce business would be launched in a phased manner from Q2FY2024, beginning with Maharashtra and Madhya Pradesh.

Key positives

- Viscose volumes rose 25% q-o-q, while EBITDA margins saw a sequential improvement of 185 bps to 3.8%.
- The company remains on track with respect to its commercial launch of the paints business and B2B e-commerce business.

Key negatives

- The chemical division reported an 8% q-o-q dip in realisations along with over 350 bps q-o-q contraction in OPM to 15.3%.
- Interest expense increased 32% y-o-y to Rs. 107 crore, with standalone net debt rising to Rs. 1,780 crore in FY2023 from net cash surplus of Rs. 553 crore in FY2022.

Management Commentary

- Margins in viscose are expected to recover gradually. Capacity utilisation in VSF will be maintained at 93-94% in FY2024.
- It is taking measures like sourcing renewable power, enhancing captive power capacity, increasing chlorine integration, and peratjonalising phosphoric acid plant in the caustic segment. Global prices and their impact on the Indian market would determine caustic profitability.
- It will be expanding Epoxy capacities at Vilayat and undertake brownfield expansion in South in caustic. It will be de-bottlenecking capacity of specialty fibres like Lyocell, which is expected to get completed in H1FY2024. It will also undertake small projects in chlorine derivatives.

Revision in estimates – We have lowered our estimates for FY2024-FY2025, factoring in weak operating margins in the chemical business.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 1,950: Grasim's standalone businesses is expected to face near-term muted demand and pressure on OPMs, especially in the chemical business. However, its efforts on increasing productivity of assets and focus on increasing value-added products are expected to yield results as the demand environment recovers. The company's expedited expansion in paints is likely to provide it the next leg of growth. Further, the outlook for its key subsidiary UltraTech remains healthy. We maintain Buy on the stock with a revised price target (PT) of Rs. 1,950, as we pencil in upwardly revised valuation of UltraTech (as per Q4FY2023 earnings update), partially getting offset by the downwardly revised valuation of its standalone business.

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	20,857	26,840	27,774	30,830
OPM (%)	15.4%	11.8%	12.0%	14.1%
Adjusted PAT	2,348	2,212	1,987	2,556
% YoY growth	163.4	(5.8)	(10.1)	28.6
Adjusted EPS (Rs.)	35.7	33.6	30.2	38.9
P/E (x)	47.3	50.2	55.9	43.5
P/B (x)	2.3	2.4	2.3	2.2
EV/EBITDA (x)	24.5	26.5	25.9	20.0
RoNW (%)	4.8	4.7	4.1	5.1
RoCE (%)	4.5	4.1	3.6	4.4

Source: Company; Sharekhan estimates

Chemical division leads to big miss on net earnings

Grasim reported a weak performance in its standalone net earnings, led by weak operational performance in the chemical division. Standalone revenue (up 4% y-o-y at Rs. 6,646 crore) was aided by sequential recovery in the viscose division (revenue up 18% q-o-q led by 25% q-o-q volume growth), while the chemical division (revenue down 7% q-o-q, led by an 8% q-o-q decline) reported weak performance owing to global and domestic oversupply and subdued demand environment in chlorine downstream industries. Standalone OPM surprised negatively at 6.4% (down 539 bps y-o-y), owing to a sharp contraction in chemical OPM (down 471 bps y-o-y to 15.3%). Lower realisations, weak demand environment, and higher raw-material costs affected chemical OPMs. Consequently, standalone operating profit/adjusted net profit declined 43%/74% y-o-y at Rs. 426 crore/Rs. 93.5 crore, much lower than our estimates.

Key Conference Call Takeaways

- **Outlook:** Margins in viscose are expected to recover gradually. In China, VSF prices have corrected, while prices have improved in India (reversed during Q4FY2023). Capacity utilisation in VSF will be maintained at 93-94% in FY2024. Caustic prices are coming down. Pulp prices are currently at $900, lower than the peak of $1,200. From now, pulp prices would reflect with one-month lag versus one quarter lag earlier. It is taking measures such as sourcing renewable power, enhancing captive power capacity, increasing chlorine integration, and operationalising phosphoric acid plant in the caustic segment. Global prices and their impact on the Indian market would determine caustic profitability.
- **Q4FY2023 performance:** Consolidated revenue increased by 16% y-o-y to Rs. 33,462 crore, while EBITDA declined by 5% y-o-y to Rs. 4,873 crore due to softening of realisation in key standalone businesses. Standalone revenue increased by 4% y-o-y to Rs. 6,646 crore, while EBITDA declined by 35% y-o-y to Rs. 542 crore due to subdued performance in both viscose and chemical divisions.
- **Expansion:** It will be expanding epoxy capacities at Vilayat and undertake brownfield expansion in South (under-utilised caustic market) in caustic. It will be de-bottlenecking capacity of speciality fibres like Lyocell, which is expected to be completed in H1FY2024. It will also undertake small projects in chlorine derivatives.
- **Anti-dumping duty:** DGFTR recommendation to Finance Ministry for anti-dumping duty on VSF imports has lapsed after 60 days. Currently, the Ministry of Textiles is providing temporary relief, allowing quality imports in the country.
- **Viscose:** VSF sales volume recovered sequentially. However, exceptionally subdued Q3 conditions continued initially in Q4FY2023, while VSF turned EBITDA positive during Q4. Chinese inventory during March 2023 came down to 23 days from 24 days in Q4FY2023. Viscose revenue increased by 18% q-o-q to Rs. 3,764 crore, realisations declined by 5% q-o-q, while EBITDA margin stood at 3.8% in Q4FY2023 vs. 2% in Q3FY2023.
- **Chemicals:** Global and domestic oversupply in the wake of subdued demand led to a 7% q-o-q drop in revenue at Rs. 2,397 crore for Q4FY2023, aided by a drop in caustic prices. Lower demand in chlorine downstream industries impacted the caustic segment. EBITDA dropped by 25% q-o-q and 26% y-o-y, affected by lower caustic realisation, temporary shutdown of phosphoric acid plant, and demand-supply mismatch in other chlorine derivative products. It has acquired land near Vilayat to increase chlorine integration to 72% over the next three years from 60% in FY2023.
- **Textile:** Revenue in the textile division increased by 8% y-o-y to Rs. 520 crore, led by strong demand; however, higher raw-material prices impacted operating margins.
- **B2B e-commerce:** The company would start full-scale operations in FY2024, beginning with Maharashtra and U.P. The business will have a universal website connecting vendors with MSME customers and retailers. It is working with six technology partners for the platform. The business is not capital-intensive.
- **Paints:** As per initial guidance, it will be launching commercial paints from Q4FY2024.
- **Capex:** It will be accelerating capex in FY2024 with long-term loan tie-up of Rs. 5,000 crore. It will be sharing capex for FY2024 once the board approves and finalises the capex plan.
- **Debt:** Standalone debt stands at Rs. 1,780 crore.

Results (Standalone) Rs cr

Particulars	Q4FY23	Q4FY22	y-o-y%	Q3FY23	q-o-q%
Net sales	**6,645.8**	**6,376.4**	**4.2**	**6,195.6**	**7.3**
Total expenditure	6,219.8	5,623.8	10.6	5,718.6	8.8
Operating profit	**426.0**	**752.6**	**(43.4)**	**477.0**	**(10.7)**
Other Income	116.4	87.4	33.2	102.7	13.3
EBIDTA	542.5	840.0	(35.4)	579.7	(6.4)
Interest	106.7	80.6	32.4	89.2	19.7
PBDT	435.7	759.4	(42.6)	490.5	(11.2)
Depreciation	300.5	282.9	6.2	275.5	9.1
Extraordinary item	-	(448.7)	-	-	-
PBT	**135.3**	**925.1**	**(85.4)**	**215.0**	**(37.1)**
Tax	41.8	111.5	(62.5)	(42.4)	-
Net profit/(loss) from discontinued operations	-	254.4	-	-	-
Reported PAT	**93.5**	**1,068.0**	**(91.2)**	**257.4**	**(63.7)**
Extraordinary item	-	(703.1)	-	-	-
Adjusted PAT	**93.5**	**364.9**	**(74.4)**	**257.4**	**(63.7)**
EPS (Rs.)	1.4	5.5	(74.4)	3.9	(63.7)
Margin (%)			**BPS**		**BPS**
Operating margin	6.4%	11.8%	-539	7.7%	-129
Net Margin	1.4%	5.7%	-432	4.2%	-275
Tax rate	30.9%	12.1%	1882	-19.7%	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Standalone business faces near-term challenges

Grasim is facing subdued demand environment in its standalone businesses, led by global oversupply and volatility in the pricing environment. However, the viscose demand environment is expected to remain stable with gradual improvement in OPM. The chemical division's performance would be determined on global demand and pricing environment. 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.

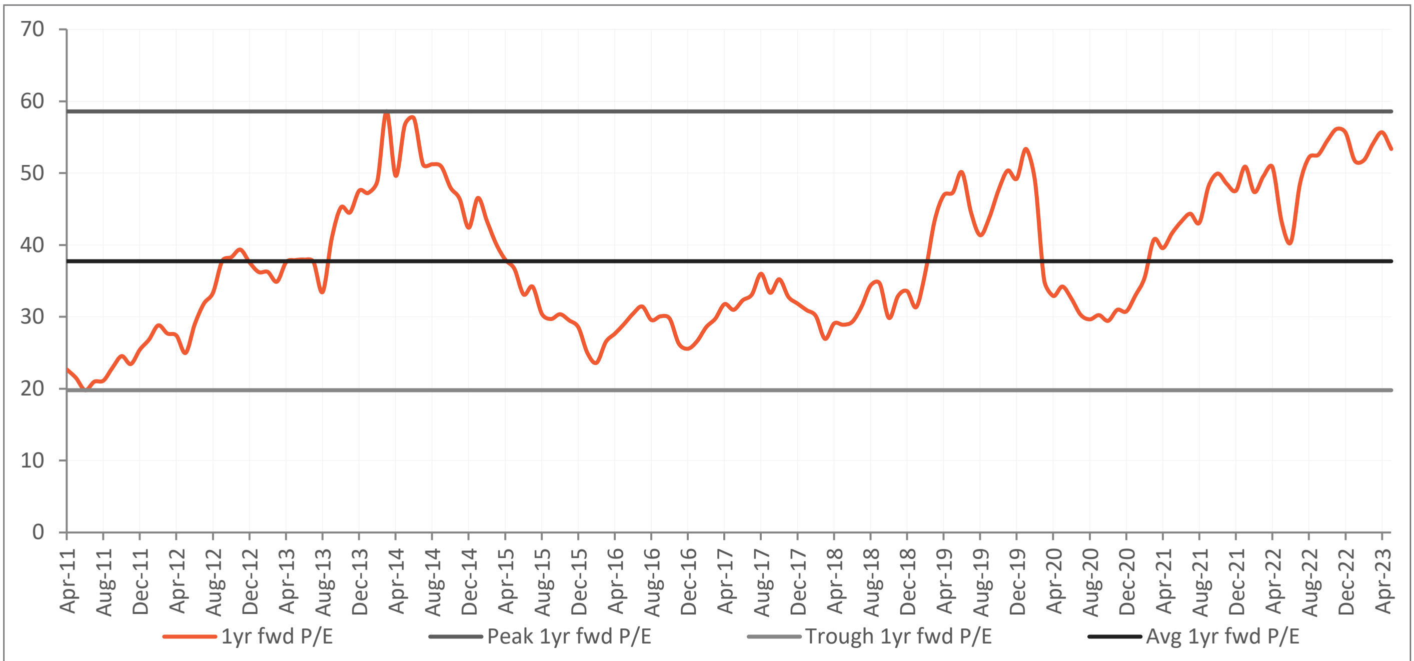
■ Company Outlook – Healthy outlook for key subsidiary and paints venture

Grasim is benefiting from the healthy growth outlook in its key subsidiary, UltraTech, while its standalone businesses are expected to face near-term subdued demand along with volatility in OPMs. The company would be focusing on increasing asset productivity and the share of value-added products to improve operating margins in the viscose and chemical divisions. 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, a healthy growth outlook in UltraTech and venture into paints are expected to drive valuation.

■ Valuation – Retain Buy with a revised PT of Rs. 1,950

Grasim's standalone businesses is expected to face near-term muted demand and pressure on OPMs, especially in the chemical business. However, its efforts on increasing the productivity of assets and focus on increasing value-added products are expected to yield results as the demand environment recovers. The company's expedited expansion in paints is likely to provide it the next leg of growth. Further, the outlook for its key subsidiary UltraTech remains healthy. We maintain Buy on the stock with a revised PT of Rs. 1,950, as we pencil in the upwardly revised valuation of UltraTech (as per Q4FY2023 earnings update), partially getting offset by the downwardly revised valuation of its standalone business.

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 the standalone business and nil future investment for listed telecom investment removes a key hangover on the stock. The company's 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 negatively affects profitability.
- Higher holding company discounts for any of its other businesses such as telecom, cement, and financial services.

Additional Data

Key management personnel

Kumar Mangalam Birla	Chairman
H K Agarwal	Managing Director
Pavan K Jain	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Birla Group Holdings Pvt Ltd	18.99
2	Life Insurance Corp of India	9.35
3	IGH Holdings Pvt Ltd	6.45
4	Hindalco Industries Ltd	4.29
5	Umang Commercial Co Ltd	4.06
6	Pilani Investment & Industries Cor	3.75
7	Vanguard Group Inc/The	2.23
8	GOVERNMENT PENSI	1.93
9	Norges Bank	1.92
10	SHAMYAK INVESTMENT PRIVA	1.40

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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