30 July 2020

Carborundum Universal

Early beneficiary of normal industrial activity; retaining a Buy

Rating: **Buy**
Target Price: ₹303
Share Price: ₹241

The steep, 45% y/y, drop in Carborundum's(standalone) sales reflects already weak industrial activity, further aggravated by the nation-wide lockdown. The better performance of international subsidiaries, though, led to consolidated sales falling less(-33% y/y),as we expected. The ~10%EBITDA margin wasaffected by lower volumes, an adverse product mix and a ₹75m forex loss. With gradually improving utilisation, management is confident of steady margin, supported by operating efficiency, cost controls, product launches in ceramics and cutting out the loss-suffering Foskor Zirconia this year. We maintain a Buy, with an unchanged target price (₹303, 22x FY22e).

Demand to pick up in line with industrial activity: Domestic abrasives was bruised by low demand from key end-users (auto/auto anc, construction, engineering-component manufacturers, etc.) and the nation-wide lock down. Management expects demand to pick up in line with growth in manufacturing and in other key industries. On the recent commissioning of the new coated-maker and on rising demand, we expect coated-abrasives sales to grow in FY21. Also, the new metz cylinder capacity will be expanded in H2 FY21 from 1.7m pieces to 2.2m.

Margins to expand: At present, CUMI's domestic operations are running at ~60% capacity, expected to gradually increase. Also the company is investing in digitisation for remote ordering, monitoring and inspection. With improving utilization, focus on operating efficiency, costcontrol, ceramic product launches and quitting the loss-suffering Foskor Zirconia this year, management is confident of steady margins ahead. We expect the consolidated EBITDA margin to step up from 15.3% in FY20 to 16% in FY22.

Valuation. Despite the near-term dimmer abrasives outlook, the growth momentum in minerals and engineered ceramics is good. We expect marginsto improve over FY20-22, and drive earnings growth. Hence, we maintain our Buy rating on the stock. **Risks:** Drag in industrial production for long; delay in the sale of Fosker Zirconia.

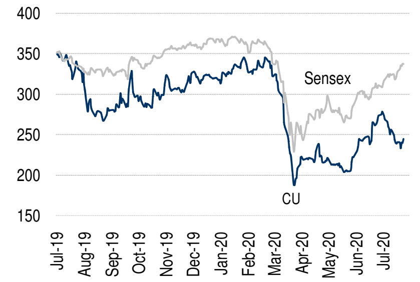
Key financials (YE Mar)	FY18	FY19	FY20	FY21e	FY22e
Sales (₹ m)	23,678	26,889	25,990	23,801	27,032
Net profit (₹ m)	2,196	2,476	2,724	2,093	2,612
EPS (₹)	11.6	13.1	14.4	11.1	13.8
PE (x)	29.9	18.8	17.1	22.2	17.8
EV / EBITDA (x)	16.3	10.4	10.9	11.8	9.6
PBV (x)	4.2	2.7	2.5	2.3	2.1
RoE (%)	14.9	15.1	15.2	10.8	12.2
RoCE (%)	18.3	19.3	17.4	12.8	14.6
Dividend yield (%)	0.6	1.1	1.2	0.9	1.2
Net debt/equity (x)	-0.0	-0.1	-0.2	-0.2	-0.2

Source: Company, Anand Rathi Research

Key data	CU IN / CRBR.BO
52-week high / low	₹362 / 175
Sensex / Nifty	37736 / 11102
3-m average volume	$0.9m
Market cap	₹46bn / $611m
Shares outstanding	189m

Shareholding pattern (%)	Jun' 20	Mar' 20	Dec'19
Promoters	42.1	42.1	42.1
- of which, Pledged	0.2	0.2	0.2
Free float	58.0	58.0	57.9
- Foreign institutions	6.6	6.5	6.0
- Domestic institutions	28.0	28.2	27.6
- Public	23.4	23.2	24.3

Relative price performance



Source: Bloomberg

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Quick Glance – Consolidated Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Abrasives (% of sales)	*44.0*	*42.3*	*38.7*	*38.9*	*40.0*
Net revenues	23,678	26,889	25,990	23,801	27,032
Growth (%)	*12.0*	*14.0*	*-3.2*	*-8.6*	*13.7*
Material cost	8,049	9,550	8,869	8,123	9,225
Employee & other exps.	11,642	12,957	13,134	12,132	13,499
EBITDA	3,986	4,383	3,986	3,546	4,308
EBITDA margins (%)	*16.8*	*16.3*	*15.3*	*14.9*	*15.9*
- Depreciation	1,060	1,083	1,045	1,180	1,310
Other income	229	273	450	306	352
Interest expenses	86	85	63	65	67
PBT	3,070	3,488	3,328	2,607	3,283
Effective tax rate (%)	*33.2*	*34.7*	*22.7*	*25.5*	*25.5*
+ Associates / (Minorities)	147	199	152	151	166
Net income	2,196	2,476	2,724	2,093	2,612
Adjusted income	2,196	2,476	2,724	2,093	2,612
WANS	189	189	189	189	189
FDEPS (₹ / sh)	11.6	13.1	14.4	11.1	13.8
EPS growth (%)	*18.8*	*12.6*	*10.0*	*-23.2*	*24.6*

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Share capital	189	189	189	189	189
Net worth	15,644	17,241	18,584	20,300	22,442
Debt	1,248	919	595	696	796
Minority interest	615	523	455	455	455
DTL/(Assets)	274	254	41	41	41
Capital employed	**17,780**	**18,937**	**19,675**	**21,493**	**23,734**
Net tangible assets	6,144	5,687	5,907	5,914	5,890
Net intangible assets	61	40	31	31	31
Goodwill	1,151	1,223	1,330	1,330	1,330
CWIP (tang.&intang.)	303	464	387	387	387
Investments (strategic)	1,232	1,304	1,212	1,212	1,212
Investments (financial)	570	961	675	675	675
Current assets (ex cash)	10,124	11,565	10,343	10,095	11,780
Cash	1,289	975	2,940	4,622	5,301
Current liabilities	3,096	3,282	3,150	2,773	2,872
Working capital	7,028	8,283	7,193	7,322	8,908
Capital deployed	**17,780**	**18,937**	**19,675**	**21,493**	**23,734**
Contingent liabilities	690	886	-	-	-

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
PBT	3,070	3,488	3,328	2,607	3,283
+ Non-cash items	1,075	895	658	939	1,025
Oper.prof. before WC	4,145	4,383	3,986	3,546	4,308
- Incr./(decr.) in WC	980	1,183	-1,085	29	1,486
Others incl. taxes	1,035	1,353	798	665	837
Operating cash-flow	2,130	1,847	4,273	2,853	1,985
- Capex (tang. +intang.)	-1,013	-766	-1,179	-1,186	-1,286
Free cash-flow	1,117	1,081	3,094	1,666	699
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	425	520	572	440	549
+ Equity raised	0	0	0	-	-
+ Debt raised	-243	-329	-323	101	100
- Fin investments	557	462	-378	-	-
- Misc. (CFI + CFF)	-137	83	441	-355	-429
Net cash-flow	29	-314	2,136	1,682	679

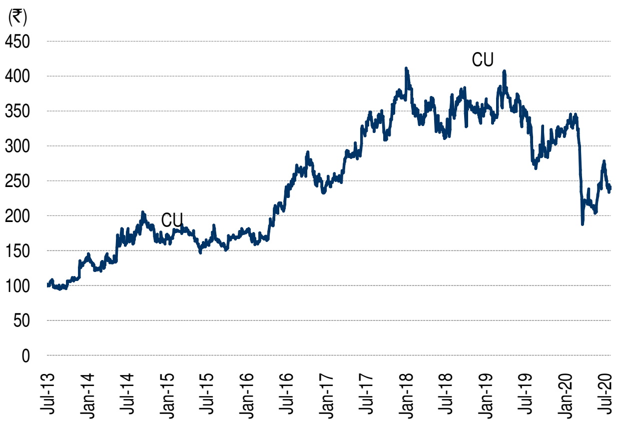
Source: Company, AnandRathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
P/E (x)	29.9	18.8	17.1	22.2	17.8
EV / EBITDA (x)	16.3	10.4	10.9	11.8	9.6
EV / Sales (x)	2.8	1.7	1.7	1.8	1.5
P/B (x)	4.2	2.7	2.5	2.3	2.1
RoE (%)	14.9	15.1	15.2	10.8	12.2
RoCE (%) - after tax	18.3	19.3	17.4	12.8	14.6
RoIC (%) - after tax	15.9	16.4	18.4	14.4	17.0
DPS (₹ /sh)	2.3	2.8	3.0	2.3	2.9
Dividend yield (%)	0.6	1.1	1.2	0.9	1.2
Dividend payout (%) - incl. DDT	19.4	21.0	21.0	21.0	21.0
Net debt / equity (x)	-0.0	-0.1	-0.2	-0.2	-0.2
Receivables (days)	74	71	57	60	62
Inventory (days)	69	73	72	74	76
Payables (days)	30	28	27	26	24
CFO : PAT %	97.0	74.6	156.9	136.3	76.0

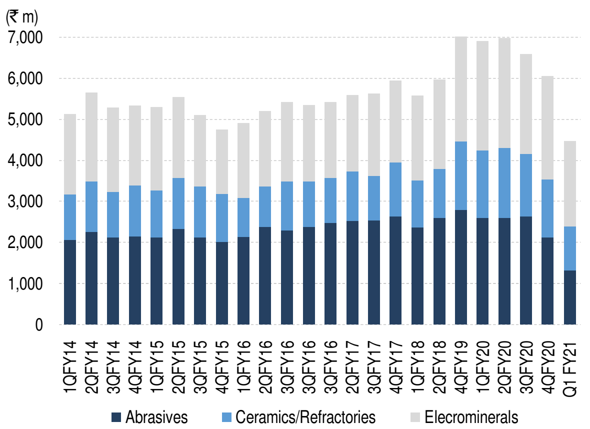
Source: Company, AnandRathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Sales mix



Source: Company, Anand Rathi Research

Result Highlights

Fig 7 – Results (Consolidated),by segment

(₹ m)	Q1 FY20	Q1 FY21	Y/Y (%)	FY19	FY20	Y/Y (%)
Revenue						
Abrasives	2,594	1,314	*(49.3)*	11,244	9,953	*(11.5)*
Ceramics	1,653	1,076	*(34.9)*	6,044	6,290	*4.1*
Electro-minerals	2,642	2,096	*(20.7)*	10,185	10,258	*0.7*
Others	171	118	*(31.2)*	639	708	*10.9*
EBIT margins %						
Abrasives	10.9	(2.3)	*NA*	12.5	11.3	*-111.7*
Ceramics and Plastics	18.0	11.0	*-703.3*	17.9	20.9	*304.6*
Electro-minerals	9.2	11.1	*188.4*	12.6	10.2	*-240.5*

Source: Company, Anand Rathi Research

Fig 8 – Results (Standalone), by segment

(₹ m)	Q1 FY20	Q1 FY21	Y/Y (%)	FY19	FY20	Y/Y (%)
Revenue						
Abrasives	2,137	1,009	*(52.8)*	9,209	8,147	*-11.5*
Ceramics	1,382	788	*(43.0)*	4,985	5,120	*2.7*
Electro-minerals	1,046	654	*(37.5)*	4,534	4,109	*-9.4*
Total	**4,566**	**2,451**	*(46.3)*	**18,728**	**17,376**	***-7.2***
EBIT margins (%)						
Abrasives	13.0	(1.9)	*NA*	14.1	13.3	*-79.5*
Ceramics and Plastics	18.0	8.9	*-908.8*	16.4	19.5	*314.3*
Electro-minerals	3.0	2.1	*-92.3*	9.8	5.3	*-452.0*

Source: Company, Anand Rathi Research

Fig 9 –Cost-structure trend and margins (Consolidated)

(₹m)	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21
Sales	5,195	5,872	6,116	6,495	6,343	6,596	6,929	7,021	6,714	6,843	6,494	5,940	4,496
Material cost	1,682	2,060	2,051	2,257	2,197	2,334	2,571	2,448	2,384	2,440	2,253	1,793	1,428
Employee cost	757	761	790	801	826	843	791	813	840	917	886	805	824
Power and fuel	776	768	835	896	875	914	1,018	979	955	937	900	925	706
Other expenses	1,257	1,224	1,403	1,383	1,371	1,421	1,517	1,589	1,583	1,504	1,491	1,392	1,104
% of sales													
Material cost	32.4	35.1	33.5	34.8	34.6	35.4	37.1	34.9	35.5	35.7	34.7	30.2	31.8
Employee cost	14.6	13.0	12.9	12.3	13.0	12.8	11.4	11.6	12.5	13.4	13.6	13.5	18.3
Power and fuel	14.9	13.1	13.7	13.8	13.8	13.9	14.7	13.9	14.2	13.7	13.9	15.6	15.7
Other expenses	24.2	20.8	22.9	21.3	21.6	21.5	21.9	22.6	23.6	22.0	23.0	23.4	24.6
Margins	13.9	18.0	17.0	17.8	16.9	16.4	14.9	17.0	14.2	15.3	14.9	17.3	9.6

Source: Company, Anand Rathi Research

Fig 10 – Cost-structure trend and margins (Standalone)

(₹m)	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21
Sales	3,260	3,895	4,115	4,493	4,154	4,426	4,641	4,600	4,307	4,401	4,150	3,655	2,381
Material cost	1,373	1,704	1,716	1,851	1,707	1,869	2,063	1,881	1,795	1,804	1,696	1,302	1,104
Employee cost	416	427	457	443	476	475	431	439	495	527	527	410	462
Power and fuel	377	365	417	465	445	485	534	465	470	454	429	456	210
Other expenses	721	735	884	918	839	867	889	984	937	944	876	795	512
% of sales													
Material cost	42.1	43.7	41.7	41.2	41.1	42.2	44.5	40.9	41.7	41.0	40.9	35.6	46.4
Employee cost	12.8	11.0	11.1	9.9	11.5	10.7	9.3	9.5	11.5	12.0	12.7	11.2	19.4
Power and fuel	11.6	9.4	10.1	10.3	10.7	11.0	11.5	10.1	10.9	10.3	10.3	12.5	8.8
Other expenses	22.1	18.9	21.5	20.4	20.2	19.6	19.2	21.4	21.8	21.5	21.1	21.7	21.5
Margins	11.4	17.0	15.6	18.2	16.6	16.5	15.6	18.1	14.2	15.2	15.0	18.9	4.0

Source: Company, Anand Rathi Research

Concall highlights

Electro-minerals

- Consolidated revenue of the electro-minerals division was down 21%y/y;its EBIT margin rose 190bps y/y. Minerals has been more resilient than other businesses and good demand is arising from refractories and metal composites.
- Also, the outlook is upbeat as mining and steel are likely to benefit from huge fiscal measures globally.
- VAW sales grew 49% y/y during the quarter.

Ceramics

- Revenue of the ceramics division was down 35% y/y; its EBIT margin fell 700bps y/y to 11%.
- The weak performance stemmed chiefly from the home market;the overseas markets, however, did well, with 6% revenue growth and just a 145bp dip in the margin to 17%.
- The company is seeing good demand in wear ceramics in India and internationally mainly due to repair and maintenance of plants.
- Exports to Australia were hampered by logistical issues. Also, sales of cylinders fell due to the lockdown.
- Reasonable improvement was seen in metallised cylinders. Will see traction frompower GTD.
- Industrial and super-refractories enjoyed better margins. A better product-mix is key to support marginsahead.
- The company invested ₹150m in metallized cylinders. Management expects a 0.5m-pieceincrease in capacity this year.Hence, total capacity would be 2.2m pieces by H2FY21.
- Product launches will be in wear materials, expanding from ceramics into other materials as well, composite and electronic ceramics.
- Cost efficiency, technology and product development would be the key focus areas ahead.

Abrasives

- Abrasives' revenue was hugely impacted, with a 45% fall in sales and EBIT loss of ₹19m (standalone). This was chiefly due to low demand from key end-users (auto/auto ancillaries, construction, engineering component manufacturers, etc.)and to the nation-wide lockdown.
- Also, demand for abrasivesfrom auto and construction in Russiawas lower, slashing volumes and profitability.
- Management talked of higher margins ahead with greater utilisation and cost reduction. It said opportunities for import substitution were largely driven by the rupee depreciation.
- The product mix has shifted from high precision (used in auto and its ancillaries) to coated abrasives (used in construction, wood-working and infrastructure), which command a mass market. The present productmix is 55% bonded,45%coated.

Others

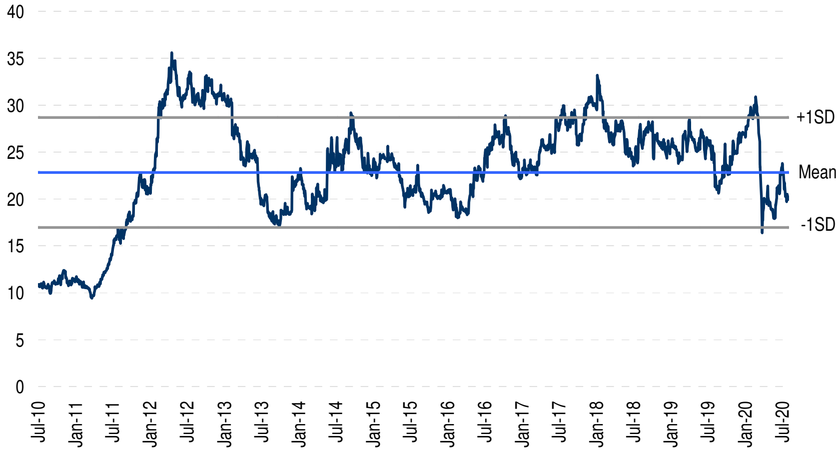
- **Foskor Zirconia exit:**The lockdown in South Africa impacted the performance. CUMI's share of losses for the quarter was ₹20m. On exiting, the due diligence is in progress with one of the potential buyers.
- Capex during Q1FY21 was ₹340m. The debt-equitycame at 0.03x with debt of ₹630m(vs.₹610m the quarter prior). Cash was ₹3.9bn, vs.₹2.9bn in Mar'20.
- The company continue to see better demand in Jul for minerals and ceramics. Abrasivestoo are improving and are s now 70% of normal. Russian operations are doing well.
- The 32% y/y increase in other income was due to dividend received (standalone). The company suffered a ₹75m forex loss in the quarter.
- Realisationsin alumina and SIC were lower during the quarter due to weak end-user demand.
- Current domestic abrasives utilisation: 50%;ceramics: 60-65%.A second line for metzcylinders is in the process of commissioning (target H2FY21). EMD: 65% utilisation domestically; Russian factory: 90%.
- The grossmargin was impacted by weakness in abrasives and ceramics due to the change in the product mix. Additional costs were incurred to bring operations back to normal. In ceramics, lower engineered-ceramics sales impacted the gross margin.
- Import substitution opportunities: Abrasives and minerals offer import substitution opportunity due to the rupee depreciation. Also, with enough capacity, the company is well placed to address demand. On the minerals side, local manufacturers are wary of supply from China, and are looking for local supplies.
- **Increasing market share in abrasives**byaddressing both the mass markets through channel and reach especially in coated abrasives. And also to address global opportunities in bonded and coated abrasives.

Valuation

We expect CUMI to be an early beneficiary of normal industrial activity. Ceramics would add to healthy growth because of good demand in Australia and in metallised cylinders.

With its focus on operating efficiency, costcontrol, launches of products in ceramics and quitting the loss-suffering Foskor Zirconia this year,management is confident of steady margins ahead. We maintain a Buy on the stock, with a TP of ₹303 (22x FY22e).

Fig 11 – One-year-forward PER



Source: Company, Anand Rathi Research

Key risks

- **Highly responsive to growth (or the lack of it) in user industries:** Slowdown in user industries could lead to Carborundum Universal's growth contracting.
- **Delay in sale of Foskor Zirconia:**If management cannot find a suitable buyer, margins would keep shrinking.

Appendix

Analyst Certification

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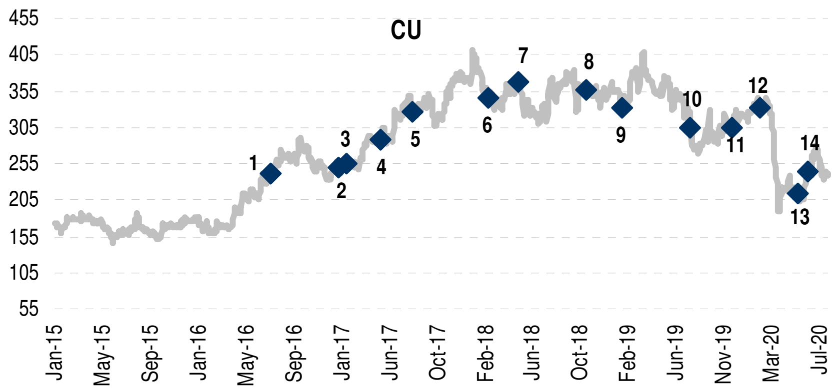
Rating and Target Price History (as of 30 July 2020)



	Date	Rating	TP (₹)	Share Price (₹)
1	22-Jul-16	Buy	396	247
2	16-Jan-16	Buy	352	256
3	08-Feb-16	Buy	373	260
4	11-May-16	Buy	386	296
5	02-Aug-17	Hold	359	336
6	19-Feb-18	Hold	419	351
7	08-May-18	Hold	427	351
8	02-Nov-18	Hold	400	360
9	06-Feb-19	Hold	422	360
10	02-Aug-19	Hold	320	309
11	20-Nov-19	Hold	351	306
12	31-Jan-20	Hold	367	334
13	11-May-20	Hold	245	213
14	09-Jun-20	Buy	303	243

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Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

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