India I Equities

Industrial Consumables
Company Update

Change in Estimates ☐ Target ☑ Reco ☐

2 September 2020

Carborundum Universal

Rating: **Buy**
Target Price: ₹321
Share Price: ₹259

Ceramics and EMD seeing better traction; retaining a Buy

Key takeaways on hosting Carborundum Universal (CUMI) management for a non-deal roadshow.

CUMI's overall operations have picked up pace. Recovery is evident in its ceramics and electro-minerals divisions, in both domestic and international. Subdued demand from end users slowed recovery in abrasives. Management talked of 80-90% of last year's utilisation by end-H1 FY20 across the businesses. Supply disruption of minerals from China is likely to benefit EMD business of CUMI. With greater utilisation, focus on operating efficiency, new product launches and quitting the loss-making Foskor, management is confident of steady margins ahead. We expect consol. EBITDAM to step up from 15.3% in FY20 to 16.5% in FY23 and drive earnings growth. CUMI remains our top pick, with a revised TP of ₹321 (20x FY23e).

Ceramics, electro-minerals bouncing back faster: Domestically and internationally, these two businesses picked up pace. The healthy order book in engineered ceramics offers robust assurance for coming quarters. Wear ceramics is seeing traction from mining, power and process industries. Fused alumina & silicon carbide (electro-minerals) are seeing good domestic demand.

Slower recovery in abrasives: Sluggishness in the auto sector kept recovery in abrasives slow. Two-wheeler and agri-related vehicles gained traction, while PV and CV would take time to return to normal. Demand revival was seen in woodworking, renovation, painting, sanding and fabrication. At present, abrasives is being driven by the retail portion of the business. Hence, the focus continues on retail and the mass market.

Valuation. Management reiterated its positive stance on ceramics and electro-minerals, and only a gradual recovery in abrasives. We expect consolidated EBITDAM to step up from 15.3% in FY20 to 16.5% in FY23 and drive earnings growth. The stock trades at 24x/19x/16x FY21e/22e/23e. We maintain a Buy rating with a TP of ₹321 (21x FY23e).

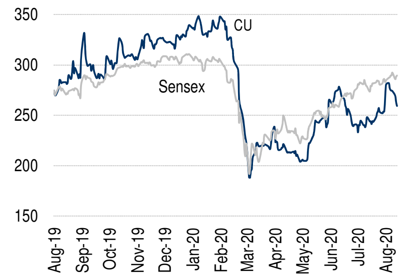
Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Sales (₹ m)	26,889	25,990	23,801	27,032	29,979
Net profit (₹ m)	2,476	2,724	2,076	2,592	3,037
EPS (₹)	13.1	14.4	11.0	13.7	16.0
PE (x)	19.8	18.0	23.6	18.9	16.1
EV / EBITDA (x)	10.9	11.5	12.5	10.2	8.6
PBV (x)	2.8	2.6	2.4	2.2	2.0
RoE (%)	15.1	15.2	10.7	12.1	12.8
RoCE (%)	19.3	17.4	12.8	14.7	15.5
Dividend yield (%)	1.1	1.2	0.9	1.1	1.3
Net debt / equity (x)	-0.1	-0.2	-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	39086 / 11535
3-m average volume	$1.4m
Market cap	₹49bn / $672.5m
Shares outstanding	189m

Shareholding pattern (%)	June' 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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Research Analyst

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Research Associate

Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Abrasives (% of sales)	42.3	38.7	38.8	39.9	39.2
Net revenues	26,889	25,990	23,801	27,032	29,979
Growth (%)	14.0	-3.2	-8.6	13.7	11.0
Material cost	9,550	8,869	8,123	9,225	10,231
Employee & other exps.	12,957	13,134	12,132	13,499	14,793
EBITDA	**4,383**	**3,986**	**3,546**	**4,308**	**4,956**
EBITDA margins (%)	16.3	15.3	14.9	15.9	16.5
- Depreciation	1,083	1,045	1,180	1,310	1,431
Other income	273	450	306	352	404
Interest expenses	85	63	65	67	69
PBT	3,488	3,328	2,607	3,283	3,860
Effective tax rate (%)	34.7	22.7	25.5	25.5	25.5
+ Asso. / (Minorities)	199	152	134	146	162
Net income	2,476	2,724	2,076	2,592	3,037
Adjusted income	2,476	2,724	2,076	2,592	3,037
WANS	189	189	189	189	189
FDEPS (₹ / sh)	13.1	14.4	11.0	13.7	16.0
EPS growth (%)	12.6	10.0	-23.8	24.7	17.2

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Share capital	189	189	189	189	189
Net worth	17,241	18,584	20,286	22,411	24,902
Debt	919	595	696	796	896
Minority interest	523	455	455	455	455
DTL / (Assets)	254	41	41	41	41
Capital employed	**18,937**	**19,675**	**21,478**	**23,704**	**26,294**
Net tangible assets	5,687	5,907	5,914	5,890	5,746
Net intangible assets	40	31	31	31	31
Goodwill	1,223	1,330	1,330	1,330	1,330
CWIP (tang. & intang.)	464	387	387	387	387
Investments (strategic)	1,304	1,212	1,212	1,212	1,212
Investments (financial)	961	675	675	675	675
Curr. assets (ex cash)	11,565	10,343	10,095	11,780	13,424
Cash	975	2,940	4,607	5,270	6,402
Current liabilities	3,282	3,150	2,773	2,872	2,912
Working capital	8,283	7,193	7,322	8,908	10,511
Capital deployed	**18,937**	**19,675**	**21,478**	**23,704**	**26,294**
Contingent liabilities	886	-	-	-	-

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
PBT	3,488	3,328	2,607	3,283	3,860
+ Non-cash items	895	658	939	1,025	1,096
Oper. prof. before WC	4,383	3,986	3,546	4,308	4,956
- Incr. / (decr.) in WC	1,183	-1,085	29	1,486	1,504
Others incl. taxes	1,353	969	665	837	984
Operating cash-flow	1,847	4,102	2,853	1,985	2,468
- Capex (tang. + intang.)	-766	-1,179	-1,186	-1,286	-1,286
Free cash-flow	1,081	2,923	1,666	699	1,181
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	520	572	436	545	638
+ Equity raised	0	0	-	-	-
+ Debt raised	-329	-323	101	100	100
- Fin investments	462	-378	-	-	-
- Misc. (CFI + CFF)	83	441	-337	-409	-488
Net cash-flow	-314	1,965	1,667	663	1,132

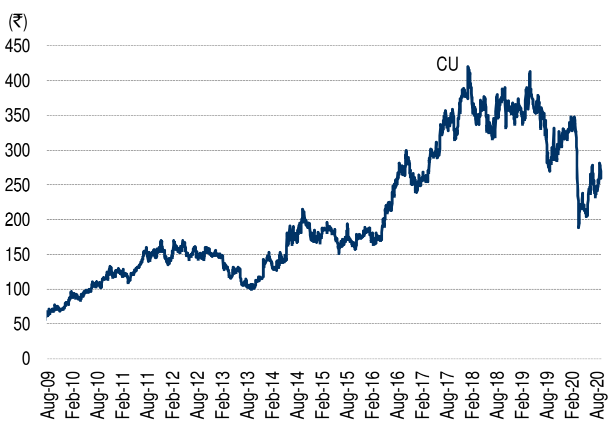
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
P/E (x)	19.8	18.0	23.6	18.9	16.1
EV / EBITDA (x)	10.9	11.5	12.5	10.2	8.6
EV / Sales (x)	1.8	1.8	1.9	1.6	1.4
P/B (x)	2.8	2.6	2.4	2.2	2.0
RoE (%)	15.1	15.2	10.7	12.1	12.8
RoCE (%) - after tax	19.3	17.4	12.8	14.7	15.5
RoIC (%) - after tax	16.4	18.4	14.4	17.0	18.0
DPS (₹ / sh)	2.8	3.0	2.3	2.9	3.4
Dividend yield (%)	1.1	1.2	0.9	1.1	1.3
Dividend payout (%) - incl. DDT	21.0	21.0	21.0	21.0	21.0
Net debt / equity (x)	-0.1	-0.2	-0.2	-0.2	-0.2
Receivables (days)	71	57	60	62	64
Inventory (days)	73	72	74	76	78
Payables (days)	34	32	30	28	26
CFO : PAT %	74.6	150.6	137.4	76.6	81.3

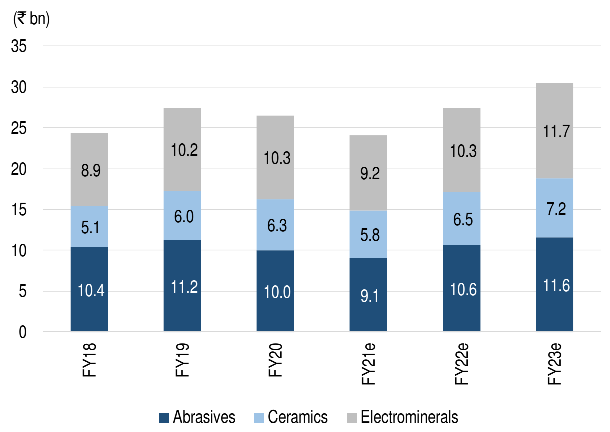
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Revenue mix



Source: Company

Key highlights

Electro-minerals

The electro-minerals performance is better, both in Russia and India.

- The company manufactures basic raw material for the steel industry such as white fused and brown fused alumina and silicon carbide, which are seeing a good pick-up. Abrasives yet to witness recovery.
- **India.** Many Chinese plants and ports were shut, post-Jan'20. Hence, China, with the largest fused material capacity in the world, was unable to ship material out. Users in India started looking at local sources. Conversion of fused-bubble capacity to fused-alumina capacity was successfully carried out in Q4 FY20 and Q1 FY21, meeting local demand to some extent (the rest would be imported from Russia). Converted capacity could lead to ~₹400m revenue at full utilisation.
- **Russia.** The product mix was changed, tilting toward metallurgicals and refractories. Silicon carbide is doing well. Russia's VAW plant is running at ~90%. The company has been gradually increasing its silicon carbide capacity, expected to rise from 80,000 tons to 100,000 tons in the next few years.

Ceramics

- Ceramics has been less affected because of exports.
- **Engineered ceramics.** The order backlog here is healthy, offering robust assurance for coming quarters, especially with global demand returning. Customised thermals are seeing sluggishness due to delayed capex; however, demand from repairs and maintenance has seen healthy traction.
- **Metz cylinder (part of engineered ceramics).** Two lines are currently running at 80-85%. The new line of 0.5m pieces is expected to be commissioned in H2, and can generate ₹300m-350m revenue at full utilisation.
- **Wear ceramics.** Lower revenue was seen in this category in Q3 and Q4 FY20 because of the management decision to reduce dispatches due to expectations of delay in payments. This category is doing well domestically and internationally, with traction from mining, power and process industries.
- Engineered/technical ceramics brought 50-55% to ceramics revenue in FY20, the rest is between thermal/wear ceramics, of which thermal is 60% and wear 40%.
- Entire thermal ceramics is for refractories, used in steel industries and making up ~15% of the off take. Other applications would be in carbon black, aluminium, non-ferrous metals and chemicals among others.
- The company targets revenue from ceramics similar to last year, with a greater emphasis on engineered ceramics. In FY21 wear ceramics revenue is expected to be lower than the previous year.
- 70-75% of Indian manufactured ceramics are exported.

Abrasives

This segment was most abraded in Q1.

- The company's Precision category produces both conventional and super abrasives for the auto industry, which was sluggish. Two wheelers and agri-related vehicles have gained traction. However, demand in PVs and CVs would take time to return to normal. Competition in this area is largely global. Mass market competition arises from China.
- Demand revival was seen in wood-working, renovation, painting, sanding and fabrication. Apart from auto, the company is attemptin to increase its precision operations in bearings, medical equipment, syringes and needles (in pharma equipment), aerospace, Defence both conventional and super.
- Abrasives is largely driven by the retail portion of the business. Hence, the company is now emphasising the retail and mass market spaces. Internationally, it would look for partnerships and acquisitions to widen its footprint.
- **Coated abrasives.** The new coated-abrasive capacity is likely to generate revenue of ₹3bn at full utilisation. Management expects 10-15% utilization levels for this maker in the first year of operations, and to reach optimal levels in five years. The coated abrasives market is now pegged at ₹12bn-15bn (including imports), growing 15%. The company would use its old maker to for existing customers, the new one for the growing demand.
- **Bonded abrasives.** Utilisation was 30-35% in Q1, The company aims at 50-55% in Q2. The FY20 target would be 60-65%. Bonded abrasives contribute 60% to abrasives revenue, the rest arises from coated abrasives.

Others highlights

- Q1 FY21 was challenging. The pick-up now is faster in rural areas and smaller towns. Orders across business segments rose in Jun and Jul. It's India and overseas operations gained significant stability compared to Q1. Management expects Q3 and Q4 margins to be better because of greater volumes. The company's focus has been on improving margins in abrasives. It is also working to lower operational costs. It said that 1–1.5 percentage point improvements can be seen in abrasives. Margins in ceramics could be in the high teens, while EMD margins should be in the low teens. Raw material inventory is sought to be trimmed and the manufacturing process speeded up so that working capital can be improved.
- CUMI has been investing in automation and newer technologies to improve the efficiency. The ₹1bn capex planned for FY21 could be reduced.
- The expected investments in electronics manufacturing in India is likely to open avenues for CUMI. These are a) Aluminium ceramics (used in packaging electronics), b) super abrasives (which play a vital role in silicon ingot) and c) thermal ceramics, which should see some demand.
- **Graphene and graphite.** Commercialisation would take some time, the current focus being on qualification. CUMI is working with a few large companies and consortiums, i.e., CRI.

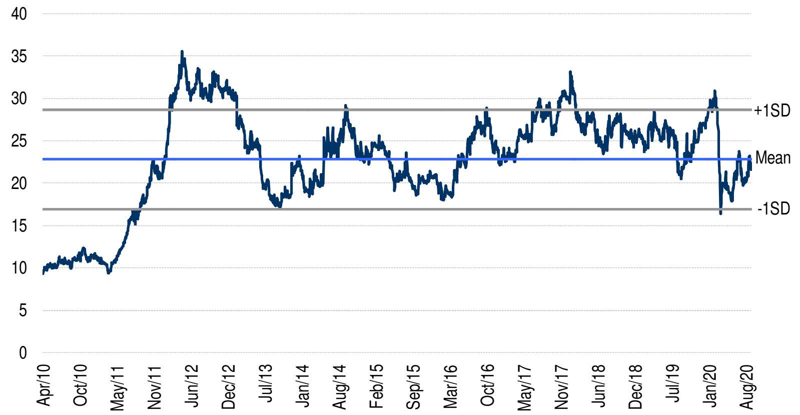
- **Overseas operations.** Australia and Russia did not suffer as much from lockdowns as other countries. Australia supplies to coal using industries, i.e., the energy sector was considered essential. In Russia, the steel industry was considered essential. South Africa was completely locked down for 45 days, then began to slowly pick up like India. America was mixed, with a few states under lockdown.
- The Foscar Zirconia exit is targeted by Q4 FY21.

Valuation

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

With the focus on operating efficiency, cost control, new product launches and exiting the loss-suffering Foskor Zirconia this year, management is confident of steady margins ahead. We roll over our estimates to FY23, with revenue/PAT growing 11%/17% y/y. CUMI remains our top pick, with a revised TP of ₹321 (20x FY23e), earlier ₹303.

Fig 7 – One-year-forward PER



Source: Company, Anand Rathi Research

Key risks

- **Highly responsive to growth (or its lack) 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

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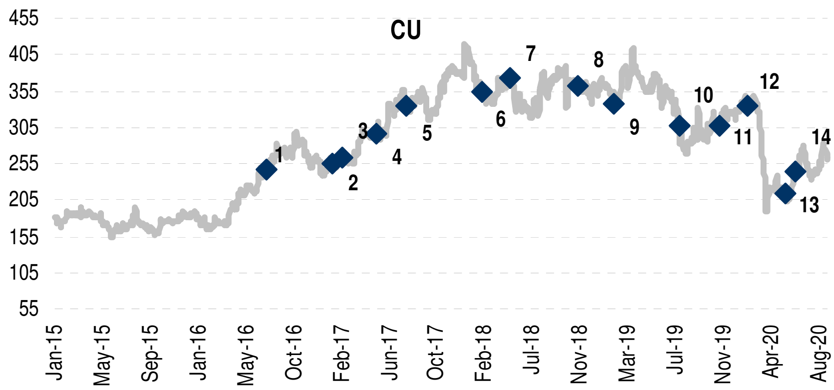

	Date	Rating	TP (₹)	Share Price (₹)
1	22-Jul-16	Buy	396	247
2	16-Jan-16	Buy	352	256
3	08-Feb-16	Buy	373	260
4	11-May-16	Buy	386	296
5	02-Aug-17	Hold	359	336
6	19-Feb-18	Hold	419	351
7	08-May-18	Hold	427	351
8	02-Nov-18	Hold	400	360
9	06-Feb-19	Hold	422	360
10	02-Aug-19	Hold	320	309
11	20-Nov-19	Hold	351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