Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Carborundum Universal Limited

User industries traction to remain strong

Capital Goods	Sharekhan code: CARBORUNIV	Company Update

Summary

- We recommend Buy on CUMI with a revised PT of Rs. 500, rolling forward our valuation multiple to FY2023E.
- CUMI with its diversified user industries is expected to be a major beneficiary led by improvement in economic recovery, manufacturing activity, and auto sales.
- Improving overseas operations aided by capacity expansion, success of new products, and being an alternative global supplier are likely to aid exports growth.
- Strong balance sheet, healthy return ratios, and consistent dividend paying record are key salient features.

Carborundum Universal Limited's (CUMI) is the leading manufacturer and developer across its businesses in abrasives, industrial ceramics, refractories, and electro minerals in India having application across diversified user industries. CUMI is expected to benefit from improving demand scenario across its core user industries such as auto, auto components, engineering, basic metals, infrastructure, energy, power, and housing, substantiated from indicators such as PV sales, two-wheeler sales, construction, and rail freight index, which are at encouraging levels. Pickup in construction and manufacturing activities along with demand revival in the auto sector has benefitted the company's industrial and auto ancillary segment, such as roll grinding wheels, hot press (used in steel industry), bearings, and gear grinding, which are expected to sustain as further recovery happens. The company has been witnessing abrasives demand recovering in coated (catering to mass-market like, housing, construction, fabrication etc.) along with market share gains, while precision-based abrasives gathered steam mid-quarter from autos (pickup in two wheelers and small segment cars); and this is expected to continue further, supported by recent auto numbers. The steel industry has been slowly reviving and better demand is coming up in repairs and maintenance segments of core industries such as coal and power. Going ahead, doubling of coated abrasives should drive sustained market share gains and ability to drive exports over the next 2-3 years, wherein the company has earlier targeted 20% of segment sales. On the export and overseas front, the company has been working on offering reliable and quality products to ensure a shift from China (benefit of having the largest capacity and lowest cost advantage in fused alumina domestically), while increased capacity in Volzhsky Abrasives Works should aid growth for its electro mineral division (EMD). In ceramics, demand pull from refractory customers and expansion in metallised cylinders is expected to maintain high revenue growth trajectory. CUMI is emerging as an integrated industrial material player with a wide product portfolio and is eyeing higher volume growth due to capacity expansion and exports along with focus on product innovation and improving reach, which we believe should aid in market share gains from import substitution. Focus on cost efficiencies and automation with a gradual uptick in economy should aid growth and support earnings going ahead. In the upcoming budget, the government's focus is expected to remain on development of infrastructure and on reviving industrial activities, which remain positive for CUMI having a diversified user base. CUMI is expected to see better results y-o-y for Q3FY2021, wherein we expect revenue growth of 6% y-o-y, led by abrasives and electro mineral business along with stable margins due to cost rationalisation leading to PAT growth of 4% y-o-y. However, results can further surprise on the upside, given better-than-anticipated recovery in the industry. The company is currently trading at PE of 27.7x /24.0x on FY2022E/FY2023E earnings, which we believe is reasonable, considering its strong earnings growth outlook and robust balance sheet. We recommend Buy on CUMI with a revised PT of Rs. 500, rolling forward our valuation multiple to FY2023.

Our Call

Valuation: Recommend Buy with a revised PT of Rs. 500: The business is looking up with better than anticipated pickup in economic recovery and manufacturing activity along with encouraging auto numbers. CUMI is on the cusp of growth revival with expected improvement in domestic economic activity and a strong product line-up for overseas operations. The company's capacity expansion, new product introduction, end-user demand, and geographic diversification are expected to revive its earnings growth trajectory from FY2022. We expect CUMI to report revenue/operating profit/PAT at a CAGR of 15.1%/19.2%/20.8% during FY2021E-FY2023E. The company is currently trading at a P/E of 27.7x/24.0x on FY2022E/FY2023E earnings, which we believe is reasonable, considering its strong earnings growth outlook and robust balance sheet. Hence, we recommend buy on CUMI with a revised PT of Rs. 500, rolling forward our valuation multiple to FY2023.

Key Risks

1) Weak economic environment both domestically and globally; 2) Delay in sale of its loss-making Fosker Zirconia unit.

Valuations (Consolidated) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	2,599	2,362	2,768	3,128
OPM (%)	15.3	15.0	15.7	16.1
Adjusted PAT	272	222	281	324
% Y-o-Y growth	*10.0*	*(18.6)*	*26.7*	*15.1*
Adjusted EPS (Rs.)	14.4	11.7	14.9	17.1
P/E (x)	28.6	35.1	27.7	24.0
P/B (x)	4.2	3.8	3.4	3.1
EV/EBIDTA (x)	16.6	17.5	13.9	11.9
RoNW (%)	15.2	11.4	13.0	13.6
RoCE (%)	17.7	13.7	16.0	16.8

Source: Company; Sharekhan estimates

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		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 411**	
Price Target: **Rs. 500**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

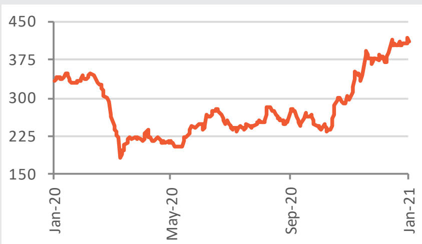
Company details

Market cap:	Rs. 7,797 cr
52-week high/low:	Rs. 430 / 175
NSE volume: (No of shares)	1.8 lakh
BSE code:	513375
NSE code:	CARBORUNIV
Free float: (No of shares)	11.0 cr

Shareholding (%)

Promoters	42.0
FII	6.2
DII	30.2
Others	21.6

Price chart



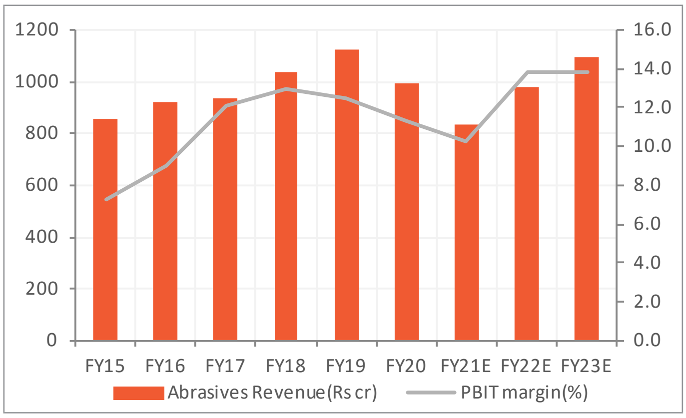
Price performance

(%)	1m	3m	6m	12m
Absolute	44	32	47	14
Relative to Sensex	36	17	8	6

Sharekhan Research, Bloomberg

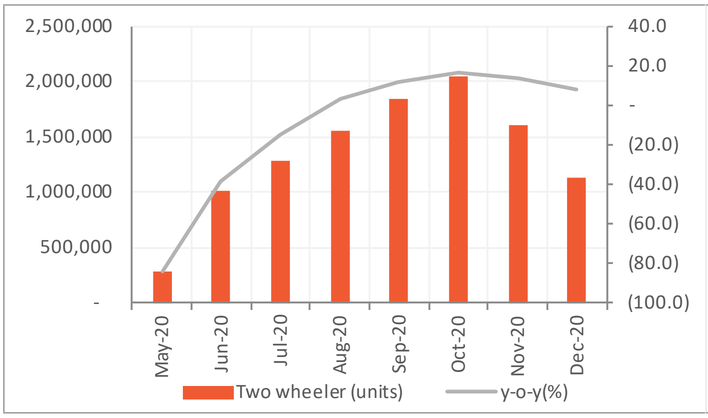
Abrasive business gradually looking up: CUMI's abrasive business is looking up led by faster-than-expected economic recovery, manufacturing activity pickup, and encouraging auto numbers (concluded the strong festive season). Further, some high-frequency indicators such as manufacturing PMI, PV sales, two-wheeler sales, and rail freight index are possibly at encouraging levels, signalling faster recovery of the economy going ahead, thus further benefitting companies such as CUMI, which are present in core user industries such as auto, auto components, engineering, basic metals, infrastructure, energy, power, and housing. The company has been witnessing abrasives demand recovering in coated (catering to mass-market like, housing, construction, and fabrication) along with market share gains, while precision-based abrasives gathered steam mid-quarter from autos (pickup in two wheelers and small segment cars); and this is expected to continue, further supported by the recently concluded festive season. Going ahead, doubling of coated abrasives should drive sustained market share gains and ability to drive exports over the next 2-3 years (target of 20% of segment sales). Further, India's Atma Nirbhar initiative and government's efforts on reviving industrial activities are likely to boost the outlook. Further, the government's sops to the electronics sector would be a good opportunity for the company. Currently, the company offers precision abrasives in this sector, which can grow significantly.

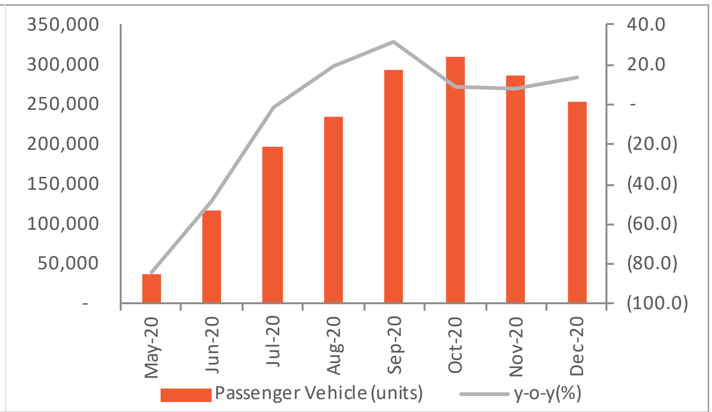
Abrasives revenue and PBIT trend



Source: Company, Sharekhan Research

Two-wheeler and passenger vehicles sales trend

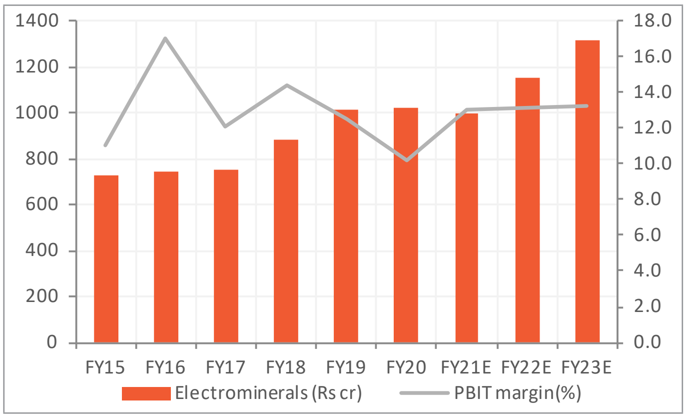




Source: SIAM, Sharekhan

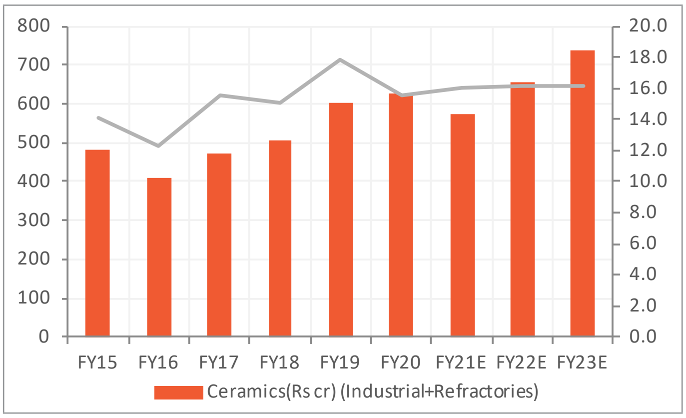
Overseas business faring strong: CUMI's overseas operations (~45% revenue mix), catered predominantly by ceramics and electrominerals, are expected to do well as the company has been working on offering reliable and quality products to ensure a shift from China (benefit of having the largest capacity and lowest cost advantage in fused alumina domestically), while increased capacity in Volzhsky Abrasives Works should aid growth for its electro mineral division (EMD). In ceramics, demand pull from refractory customers and expansion in metallised cylinders (commissioning a 0.5 million capacity) are expected to maintain a high revenue growth trajectory.

EMD revenue and PBIT trend



Source: Company, Sharekhan Research

Refractories revenue and PBIT trend

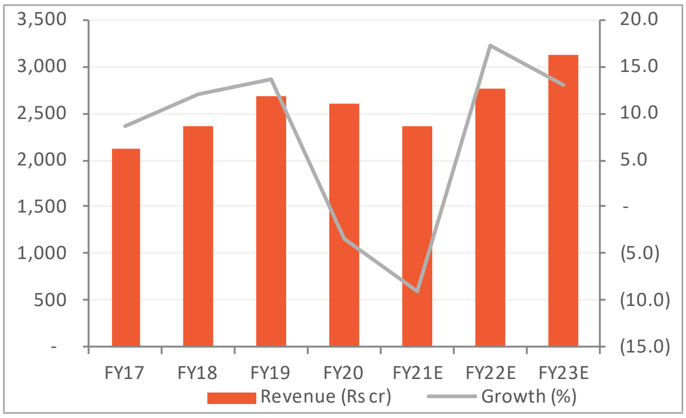


Source: Company, Sharekhan Research

Growth momentum to continue with better results in Q3FY2021: CUMI is expected to see better results for Q3FY2020, wherein we expect revenue growth of 6% y-o-y, led by abrasives business along with stable margins due to cost rationalisation, leading to PAT growth. However, results can further surprise on the upside, given better-than-anticipated recovery in the industry.

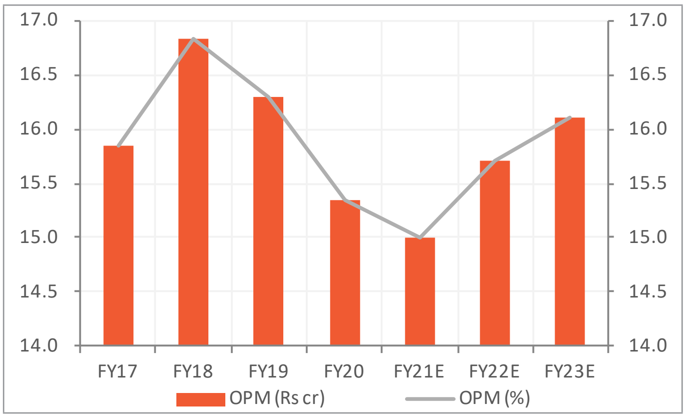
Financials in charts

Revenue trend



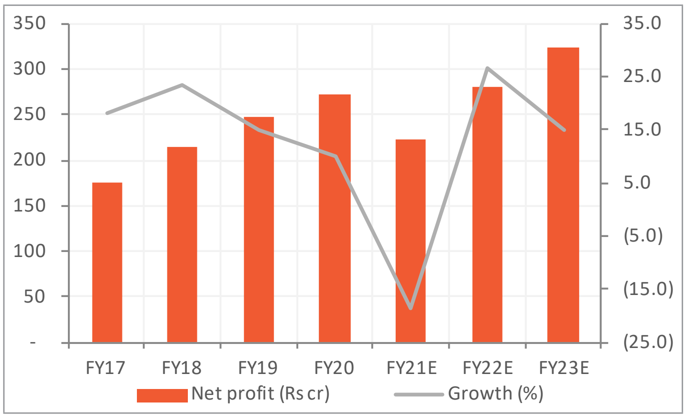
Source: Company, Sharekhan Research

EBITDA trend



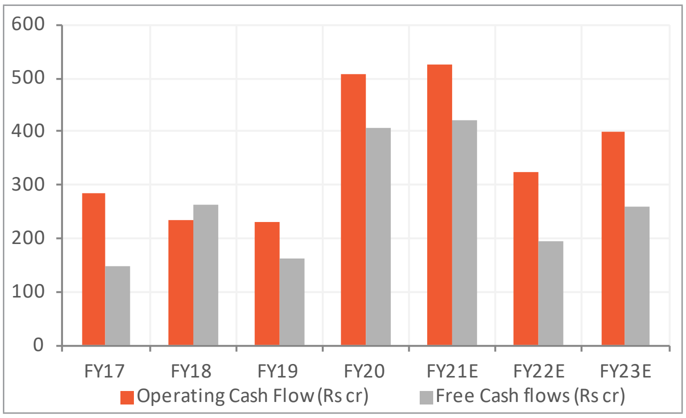
Source: Company, Sharekhan Research

Net profit trend



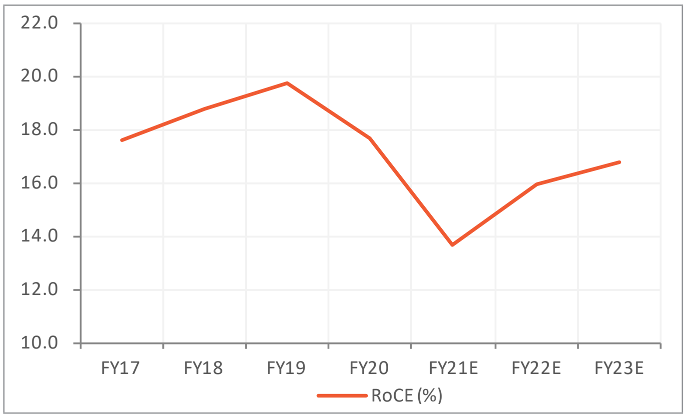
Source: Company, Sharekhan Research

OCF/FCF trend



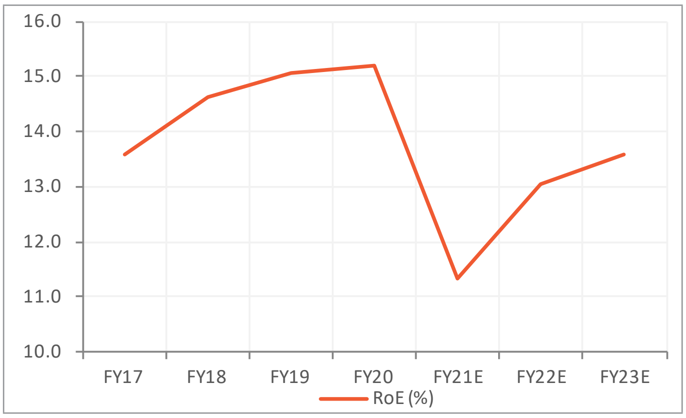
Source: Company, Sharekhan Research

ROCE trend



Source: Company, Sharekhan Research

ROE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view – Outlook encouraging, healthy growth prospects

India's Atma Nirbhar initiative and government's efforts on reviving industrial activities are likely to boost the company's growth prospects. Further, the abrasives business caters to a number of industries such as steel, automobiles, auto components, and general metal fabrication. Thus, the diversified user industry keeps the momentum going further. The abrasives market in India stands at Rs. 3,200 crore and is expected to grow further as the economy further gains steam. Key success factors for abrasives in India are good, consistent quality, cost, right value proposition, innovation and differentiation, service, and capability are likely to provide total grinding solutions. Further, with pickup in domestic industrial activities, abrasives are the early beneficiaries due to their diversified user industries.

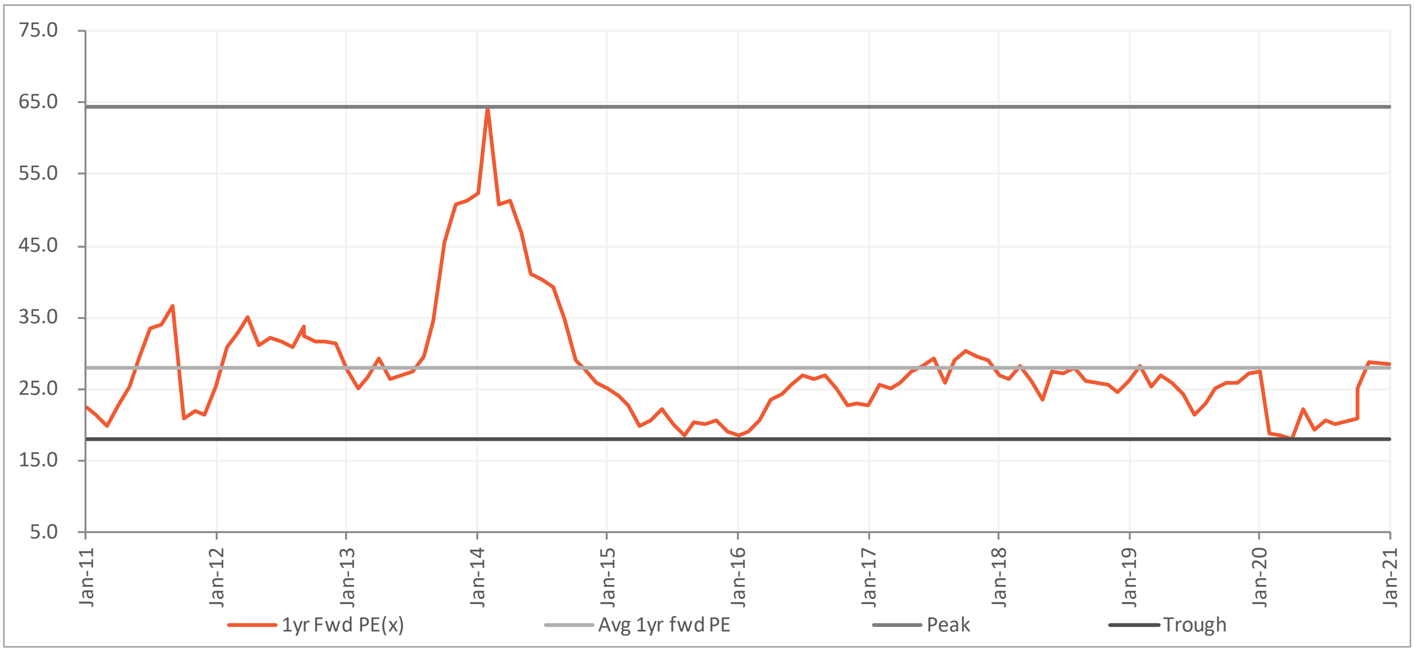
■ Company outlook - Promising outlook ahead

CUMI is expected to benefit from early economic cycle recovery in the domestic market along with improvement in overseas operations. The company's ceramics and electro mineral verticals are expected to maintain their high revenue growth trajectory during FY2021-FY2023E. Further, abrasives revenue is expected to revive from low base in FY2020. CUMI's has a cost-competitive position in electrominerals as it is the largest and lowest cost producer domestically and offers marginal difference from China. This is expected to benefit the company in terms of being a domestic and overseas supplier (countries looking to reduce dependence on China). Overall, we expect the company to return to its high earnings growth trajectory during FY2021-FY2023E with improved domestic operations along with sustained healthy overseas operations.

■ Valuation - Recommend Buy with a revised PT of Rs. 500:

The business is looking up with better than anticipated pickup in economic recovery and manufacturing activity along with encouraging auto numbers. CUMI is on the cusp of growth revival with expected improvement in domestic economic activity and a strong product line-up for overseas operations. The company's capacity expansion, new product introduction, end-user demand, and geographic diversification are expected to revive its earnings growth trajectory from FY2022. We expect CUMI to report revenue/operating profit/PAT at a CAGR of 15.1%/19.2%/20.8% during FY2021E-FY2023E. The company is currently trading at a P/E of 27.7x/24.0x on FY2022E/FY2023E earnings, which we believe is reasonable, considering its strong earnings growth outlook and robust balance sheet. Hence, we recommend Buy on CUMI with a revised PT of Rs. 500, rolling forward our valuation multiple to FY2023.

One-year forward P/E (x) band



Source: Company Data; Sharekhan Research

About company

CUMI was incorporated as a joint venture between Carborundum Company USA, Universal Grinding Wheel Company, UK, and Murugappa, India in 1954. The company manufactures a wide range of abrasives (bonded, coated, and super abrasives), ceramics (wear resistance, lined equipment, engineered ceramics, and metallised ceramics), refractories (fired products and monolithics), and electrominerals (silicon carbide, alumina, and zirconia). The company has 30 plants located across seven countries.

Investment theme

CUMI delivered a 44.7% earnings CAGR over FY2015-FY2020 and is expected to post strong 21% earnings CAGR over FY2021-FY2023E, led by: (1) jump in realisation led by progress in product value chains across segments; and (2) recovery in abrasives and ceramics margins on improved industrial production growth. We expect revenue to report a 15% CAGR over FY2021-FY2023E, as profitability of the domestic business recovers in abrasives, led by major user industries along with recovery in ceramics, driven by better project investments, improved product mix with increasing contribution of the profitable Metz cylinders in the overall mix, and global tie-ups such as Anderman and Sheffield in refractories. In electrominerals, recovery will be led by moving up the value chain such as micronisation in case of sic microgrit, finding alternate utilisation to photovoltaic such as diesel particulate filters, and increasing utilisation in metallurgical sales in Volzhsky Abrasive Works (Russia) and monoclinic capacity in Foskor Zirconia (South Africa).

Key Risks

- Highly responsive to growth (or the lack of it) in user industries: Slowdown in user industries could lead to CUMI's growth contracting.
- Delay in sale of Foskor Zirconia: If management is unable to find a suitable buyer, margins would keep shrinking.

Additional Data

Key management personnel

Mr M M Murugappan	Chairman
MR. N ANANTHASESHAN	Managing Director
Mr Ninad Gadgil	President -Abrasives
Mr P S Jayan	Executive Vice President – Electrominerals
MR. P PADMANABHAN	CHIEF ACCOUNT OFFICER

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Ambadi Investments Ltd.	29.59
2	HDFC AMC	9.22
3	SBI Funds Management Pvt. Ltd.	7.27
4	SBI Long Term Fund	5.28
5	Capital Group Company Inc	3.03
6	ICICI Pru Life Insurance Co. Ltd.	2.70
7	Shamyak Invest	2.11
8	Murugappa EDUCL & Med FDTN	2.01
9	Reliance Capital Trustee Co. Ltd.	1.64
10	L&T Mutual Fund Trustee/India	1.55

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

Sharekhan
by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;