Sharekhan by BNP PARIBAS

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Stock Update

Carborundum Universal Limited

Traction to remain strong for user industries

Capital Goods	Sharekhan code: CARBORUNIV	Company Update

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. 508**	
Price Target: **Rs. 611**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

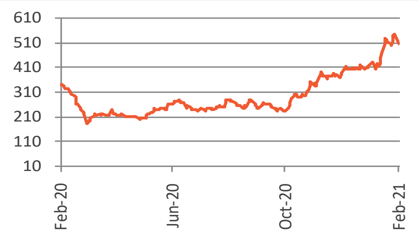
Company details

Market cap:	Rs. 9,630 cr
52-week high/low:	Rs. 571/175
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	6.5
DII	27.7
Others	23.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	22	47	80	59
Relative to Sensex	20	35	52	33

Sharekhan Research, Bloomberg

Summary

- We retain Buy on Carborundum Universal Limited (CUMI) with a revised PT of Rs. 611, considering its healthy earnings growth profile.
- CUMI, with its diversified user industries, is expected to gain traction, led by improvement in economic recovery, government-push spurring manufacturing activity, and automotive recovery with additional thrust from PLI schemes and auto scrappage policy.
- 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. With strong traction across customers and government efforts on developing manufacturing prowess, better demand is expected in the domestic markets such as engineering, basic metals, infrastructure, energy, power, and housing. High frequency indicators such as PV sales, two-wheeler sales, construction, and rail freight index remain at encouraging levels, indicating recovery. With demand improving across industrial end-users along with automotive recovery, abrasives growth should continue (utilisation levels have also improved above 75% versus 55%-60% pre COVID-19). Abrasive demand has been recovering in coated (catering to mass-markets such as housing, construction, fabrication etc.) along with market share gains, while precision-based abrasives has gathered steam from autos (pickup in two-wheelers and small segment cars). Going ahead, the outlook remains sanguine for the domestic abrasives market owing to lower Chinese imports amid geopolitical tensions, stricter implementation of environmental norms in China and shipping delays on low container availability, which have augured well for domestic players. The company also plans to venture into adjacencies, viz. masking tapes and power tools, to secure a bridgehead in major markets such as the US and Europe through technical partnerships. Over the long term, management expects coated abrasives to grow at 10%–12% and bonded abrasives at 7%–8%.

Further, ceramics segment is expected to rebound, with technical ceramics growing above 15%, while the dip in Australia should be mitigated. Earlier management had indicated that it expects the largest transformation in the ceramics division, with increased usage in aerospace, defence, and electronics manufacturing industries, accentuated by newer products in wear ceramics and composites where the company is expanding. On newer product development in the segment, the company has been focussing on thin ceramics – products for tape casting technology and composites. EMD demand should pick pace, led by strong demand in abrasives, ceramics, and refractories. In EMD, over the long term, management has been focussing on materials for batteries, which will drive EV revolution, silicon carbide for electronic applications, high surface area powders for 3D printing, etc. With additional thrust on PLI schemes management anticipates better demand with opportunities across the abrasives, ceramics and EMD divisions in automotive, electronics, pharmaceuticals and alloy steels, among others. Further, auto scrappage policy can augment demand for CUMI. We have revised the valuation multiple for the company, considering its strong earnings growth outlook and improving domestic demand along with robust balance sheet. The company is currently trading at PE of 31.6x /27.4x on FY2022E/FY2023E earnings. Hence, we retain Buy on CUMI with a revised PT of Rs. 611.

Our Call

Valuation: Retain Buy with a revised PT of Rs. 611: The business is looking up with better-than-anticipated pickup in economic recovery and manufacturing activity. CUMI's growth momentum is expected to sustain, given 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 have revised the valuation multiple for the company, considering its strong earnings growth outlook and improving domestic demand along with robust balance sheet. The company is currently trading at PE of 31.6x/27.4x on FY2022E/FY2023E. Hence, we retain Buy on CUMI with a revised PT of Rs. 611.

Key Risks

1) Weak economic environment both domestically and globally; 2) Fluctuation in key raw-material prices.

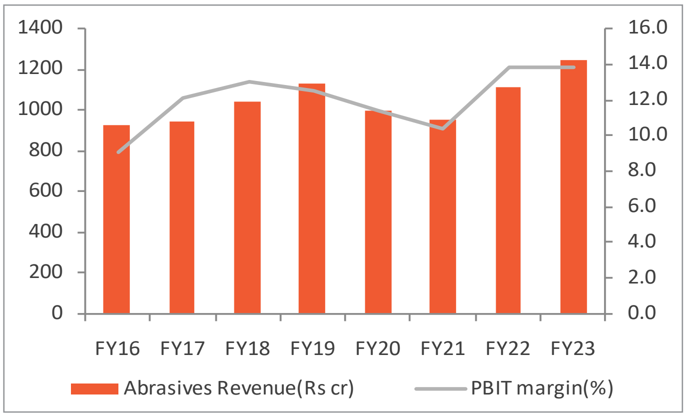
Valuation (Consolidated) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	2,599	2,510	2,942	3,323
OPM (%)	15.3	15.4	15.7	16.1
Adjusted PAT	272	248	304	350
% Y-o-Y growth	10.0	(9.0)	22.8	15.0
Adjusted EPS (Rs.)	14.4	13.1	16.1	18.5
P/E (x)	35.3	38.7	31.6	27.4
P/B (x)	5.2	4.6	4.2	3.7
EV/EBIDTA (x)	20.7	20.3	16.6	14.2
RoNW (%)	15.2	12.6	13.9	14.4
RoCE (%)	17.7	15.3	17.1	17.9

Source: Company; Sharekhan estimates

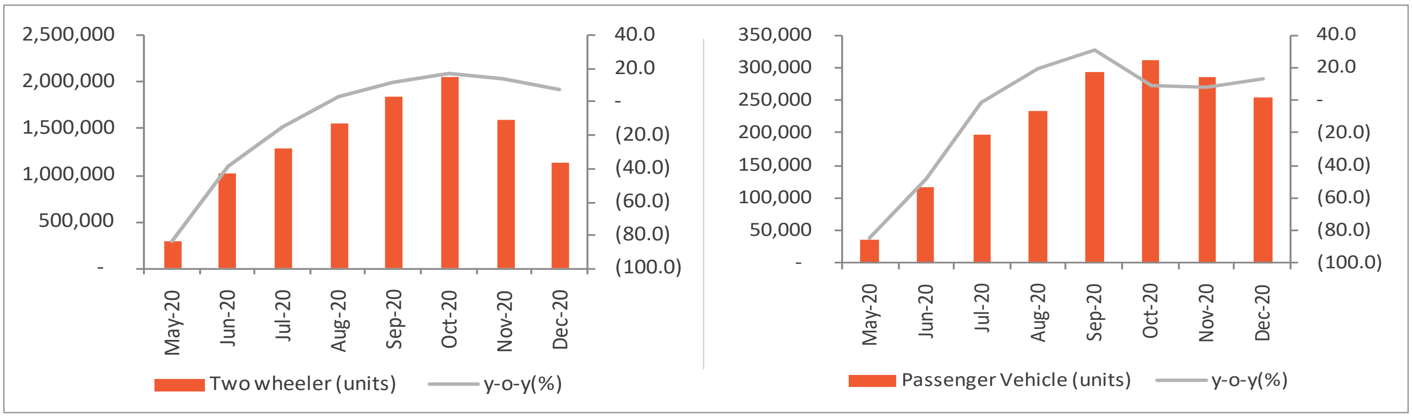
Business looking up for user industries for abrasives: With strong traction across customers and government efforts on developing manufacturing prowess, better demand is expected in the domestic markets such as engineering, basic metals, infrastructure, energy, power, and housing. High frequency indicators such as PV sales, two-wheeler sales, construction, and rail freight index remain at encouraging levels, indicating recovery. With demand improving across industrial end-users along with automotive recovery, abrasives growth should continue (utilisation levels have improved above 75% versus 55%-60 % pre-COVID-19). Abrasive demand has been recovering in coated (catering to mass-market such as housing, construction, and fabrication) along with market share gains, while precision-based abrasives has gathered steam from autos (pickup in two wheelers and small segment cars). Going ahead, the outlook remains sanguine for the domestic abrasives market, owing to lower Chinese imports amid geopolitical tensions, stricter implementation of environmental norms in China, and shipping delays on low container availability, which have has augured well for domestic players. The company also plans venturing into adjacencies, viz. masking tapes and power tools, to secure a bridgehead in major markets such as the US and Europe through technical partnerships. Over the long term, management expects coated abrasives to grow at 10%–12% and bonded abrasives at 7%–8%.

Abrasives revenue and PBIT trend



Source: Company, Sharekhan

Two-wheeler and passenger vehicles sales trend



Source: SIAM, Sharekhan

Ceramics and EMD faring well: Ceramics is also expected to rebound with technical ceramics growing above 15%, while the dip in Australia should be mitigated. Earlier management indicated that it expects the largest transformation in the ceramics division, with increased usage in aerospace, defence, and electronics manufacturing industries, accentuated by newer products in wear ceramics and composites where the company is expanding. On newer product development in the segment, the company has been focussing on thin ceramics – products for tape casting technology and composites. EMD demand should pick pace, led by strong demand in abrasives, ceramics, and refractories. In EMD, over the long term, management has been focussing on materials for batteries, which will drive the EV revolution, silicon carbide for electronic applications, and high surface area powders for 3D printing. With Additional thrust on PLI schemes, management anticipates better demand with opportunities across the abrasives, ceramics and EMD divisions in automotive, electronics, pharmaceuticals and alloy steels, among others. Further, auto scrappage policy can augment demand for CUMI.

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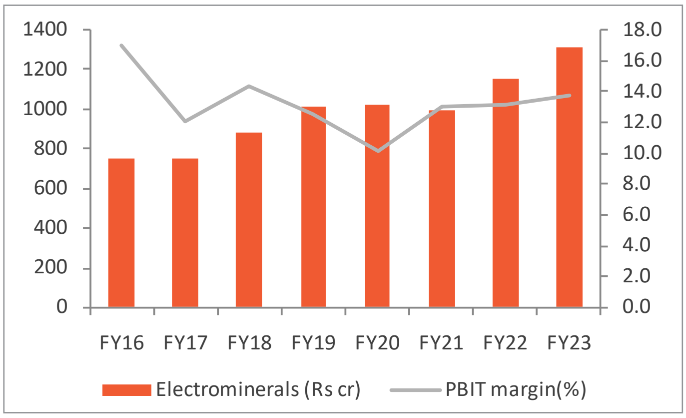
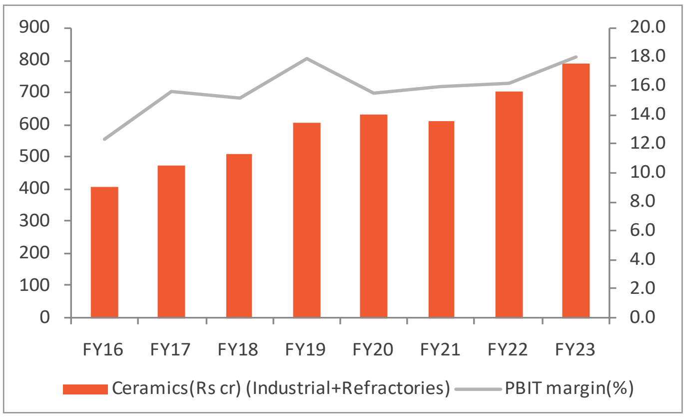
EMD revenue and PBIT trend



Source: Company Data; Sharekhan Research

Refractories revenue and PBIT trend



Source: Company Data; 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.

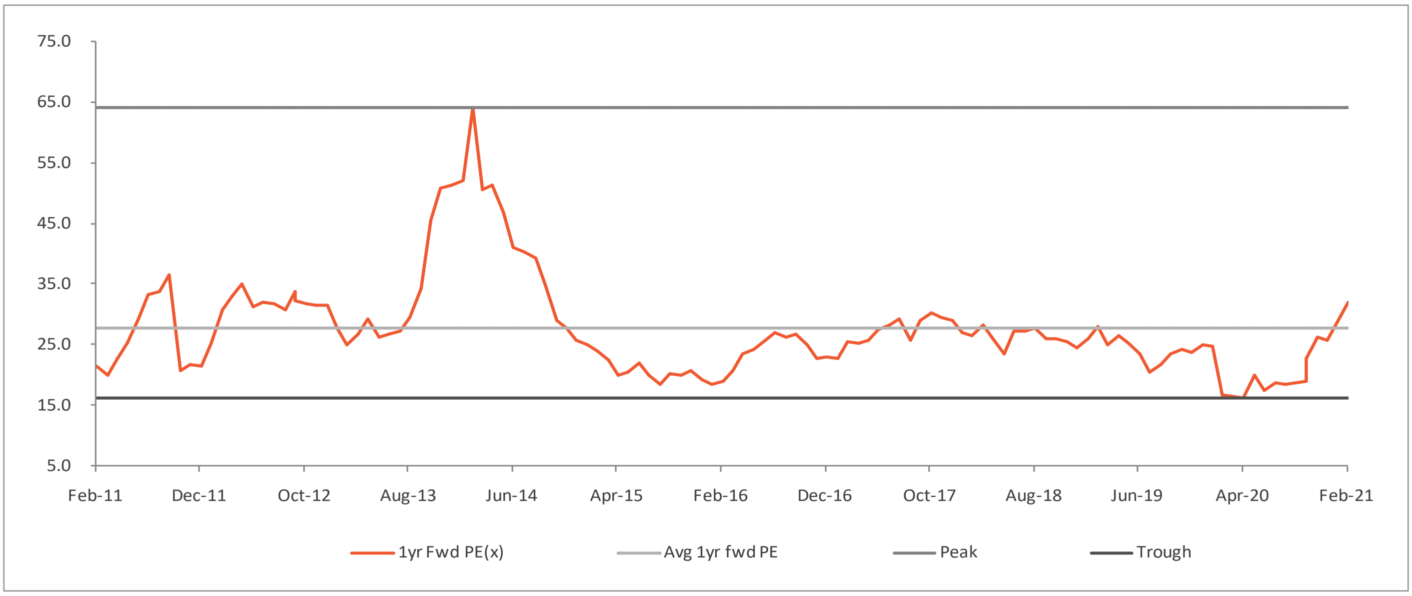
■ Company outlook - Promising outlook ahead

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 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 - Retain Buy with a revised PT of Rs. 611

The business is looking up with better-than-anticipated pickup in economic recovery and manufacturing activity. CUMI's growth momentum is expected to sustain, given 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 have revised the valuation multiple for the company, considering its strong earnings growth outlook and improving domestic demand along with robust balance sheet. The company is currently trading at PE of 31.6x/27.4x on FY2022E/FY2023E. Hence, we retain Buy on CUMI with a revised PT of Rs. 611.

One-year forward P/E (x) band



Source: 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 a 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.
- **Price rise in key raw materials:** Fluctuations on key raw materials to affect margins and profitability.

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

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

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