Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Carborundum Universal Ltd

Strong top-line drives the performance

Capital Goods	Sharekhan code: CARBORUNIV

Reco/View: Buy	↔	CMP: Rs. 844	Price Target: Rs. 1,000	↑

↑ 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 28.04

Updated Jul 08, 2022

Medium Risk

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

Source: Morningstar

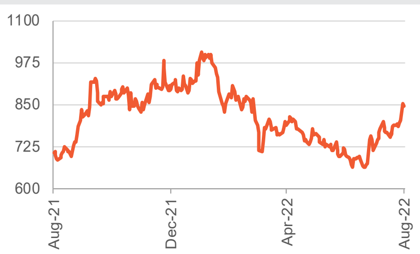
Company details

Market cap:	Rs. 16,028 cr
52-week high/low:	Rs. 1,035 / 652
NSE volume: (No of shares)	2.1 lakh
BSE code:	513375
NSE code:	CARBORUNIV
Free float: (No of shares)	11.0 cr

Shareholding (%)

Promoters	41.9
FII	9.8
DII	26.8
Others	21.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	14.7	10.8	-3.9	19.3
Relative to Sensex	5.4	8.7	-1.5	9.6

Sharekhan Research, Bloomberg

Summary

- Carborundum Universal Limited (CUMI) reported strong topline numbers, aided by recent acquisitions. The Russian subsidiary – VAW performed well on the sales front, but profitability was impacted by forex loss.
- Demand is sanguine across segments, led by better product mix and further aided by recent acquisitions.
- FY2023 OPM to be at FY2022 level and improve thereafter, helped by easing supply-chain constraints and turnaround in recent acquisitions.
- We retain Buy with a revised PT of Rs. 1,000, considering healthy long-term growth outlook across end-user industries.

Carborundum Universal Limited's (CUMI) Q1FY2023 consolidated results exceeded our and street expectations, particularly on the sales and profitability front. Total revenue grew by 60% y-o-y to Rs. 1,140 crore (versus our estimate of Rs. 836 crore), driven by steady performance across business segments and additional sales of Rs. 181 crore from newly acquired subsidiaries. Operating profit growth was restricted to 8% y-o-y to Rs. 127 crore due to a sharp increase in raw-material cost , employee cost, and other expenses. Consequently, operating profit margin (OPM) declined by 542bps y-o-y to 11.2% (versus our estimate of 14% y-o-y). Adjusted profit after tax grew by just 2% y-o-y to Rs. 79 crore due to poor operating performance but was above our expectation of Rs. 70 crore. Profit for the quarter was mainly impacted by exchange loss in the Russian subsidiary – Volzhsky Abrasive Works (VAW) – due to strengthening of Rouble. Standalone revenue for the quarter grew by 29%. Operating profit grew by 25% y-o-y with OPM coming in at 16.9% (down 52 bps y-o-y), while PAT growth was around 16% y-o-y.

Key positives

- All segments – Abrasives/ceramics/electro-minerals reported robust y-o-y revenue growth of 88%/40%/41%.
- Profitability in ceramics and electro minerals business improved as PBIT grew by 79%/47% y-o-y, leading to improved PBIT margin.
- Subsidiaries also performed well as new acquisitions – Rhodius and Awuko – contributed Rs. 181 crore to total sales.

Key negatives

- Operating profit growth was restricted to 8% y-o-y to Rs. 127 crore due to a sharp increase in raw-material cost , employee cost, and other expenses.
- Despite strong topline performance, the abrasives segment reported a ~53% y-o-y decline in PBIT to Rs. 18 crore due to cost impact in the standalone business and integration cost of new acquisitions.
- Russian subsidiary – VAW's profitability declined due to foreign exchange loss owing to Rouble appreciation against US Dollar and Euro.

Management Commentary

- The demand outlook is promising despite global headwinds. In abrasives, the construction sector may be subdued in the near term. However, long-term outlook remains buoyant. In ceramics and electro minerals, demand continues to be strong, driven by new products and better product mix.
- Management aims to achieve margins similar to FY2022 levels, led by likely margin improvement by Q4FY2023, particularly in recent acquisitions.
- The Russian subsidiary – VAW also has strong demand prospects and the company expects its annual performance to be better than last year on both sales and profit front.

Revision in estimates – We have changed our estimates for FY2022-FY2024E to factor in better sales growth but lower-than-earlier expected margins.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 1,000: We expect CUMI's growth momentum to sustain, driven by healthy demand across segments. CUMI stands to benefit from multiple factors such as uptick in capex in its end-user industries, China +1 strategy, strong government initiatives to support domestic manufacturing, and healthy demand prospects for regular and specialty products. Further, recent acquisitions as well as improving performance of its Russia, India, Australia, and America subsidiaries. We remain upbeat on the stock, considering its improving earnings growth outlook and a healthy balance sheet. Hence, we retain Buy on CUMI with a revised price target (PT) of Rs. 1,000.

Key Risks

1) Increased input cost and supply-side constraints could impact performance and 2) Delay in turnaround of operations of Rhodius and Awuko could continue to impact its profitability.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Total Revenue	2,632	3,325	4,038	4,743
OPM (%)	17.7	16.1	16.0	16.6
Net profit	299	333	398	507
PAT growth (%)	9.7	11.6	19.4	27.3
Adjusted EPS (Rs.)	15.7	17.6	21.0	26.7
PER (x)	53.7	48.1	40.3	31.6
P/B (x)	7.5	6.8	6.0	5.1
EV/EBIDTA (x)	30.7	27.3	22.3	18
RoCE (%)	19.0	18.9	19.1	21.5
RoE (%)	15.0	14.8	15.8	17.5

Source: Company; Sharekhan estimates

Robust topline, higher cost and forex loss restrict operating profit growth

CUMI's Q1FY2023 consolidated results exceeded our and street expectations, particularly on the sales and profitability front. Total revenue grew by 60% y-o-y to Rs. 1,140 crore (versus our estimate of Rs. 836 crore), driven by steady performance across business segments and additional sales of Rs. 181 crore from newly acquired subsidiaries – Rhodius Abrasives and Abrasives Wandmacher GmbH (AWUKO) in Europe. Operating profit growth was restricted to 8% y-o-y to Rs. 127 crore due to a sharp increase in raw-material cost , employee cost, and other expenses. Consequently, OPM declined by 542bps y-o-y to 11.2% (versus our estimate of 14% y-o-y). Adjusted profit after tax grew by just 2% y-o-y to Rs. 79 crore due to poor operating performance but was above our expectations of Rs. 70 crore. Profit for the quarter was mainly impacted by exchange loss in the Russian subsidiary – VAW due to strengthening of Rouble. Standalone revenue for the quarter grew by 29%. Operating profit grew by 25% y-o-y, with OPM coming in at 16.9% (declined by 52 bps y-o-y), while PAT growth was around 16% y-o-y.

Optimistic outlook given sanguine demand and acquisitions gaining traction

The company is optimistic about demand across segments, including subsidiaries, despite global headwinds. In abrasives, demand from the auto sector is likely to be favourable, while the construction sector may face near-term headwinds. In ceramics and electro minerals, the company has robust order book and demand continues to be strong. The company also aims to report similar level of margins as FY2022, led by likely margin improvement by Q4FY2023, particularly in recent acquisitions. Russian subsidiary is expected do well as the company is working towards further easing logistics and supply-side constraints. Recent acquisitions also would see significant improvement in the coming years on both sales and profitability post establishment of a new team, set up of infrastructure, changes in product mix, easing out of supply-side constraints, and customer acquisition.

Investor update and conference call highlights

- **Segment-wise performance update:** 1) Abrasives: Segment revenue for the quarter grew by 88% y-o-y to Rs. 513 crore. Standalone abrasives grew by 20% to Rs. 269 crore. The newly acquired subsidiaries – Rhodius and Awuko added additional sales to the topline, besides growth from standalone and Indian subsidiary. EBIT was lower by 53% y-o-y to Rs. 18 crore. Lower profit is due to cost impact in standalone, closure cost at China, and integration cost. 2) Electro Minerals: The segment's revenue was at Rs. 406 crore, up 41% y-o-y. Standalone electro minerals grew by 34% y-o-y to Rs.179 crore. VAW, Russia, and Foskor Zirconia (Pty) Limited, South Africa, registered significant growth. EBIT stood at Rs. 59 crore (+47% y-o-y). Profitability growth was due to good performance at standalone and Foskor Zirconia, despite drop in profit of the Russian subsidiary due to foreign exchange loss. 3) Ceramics: The segment's revenue was higher by 40% y-o-y at Rs.243 crore, wherein standalone sales grew by 37% y-o-y to Rs. 193 crore despite logistics and cost-related challenges. Subsidiaries in Australia and America also registered significant growth. EBIT grew by 79% y-o-y to Rs. 58 crore on account of growth in volume, better realization, and product mix, aided by forex gains
- **Demand outlook:** Demand outlook is promising despite global headwinds. In abrasives, demand from the auto sector is likely to be favourable. However, demand from the construction sector may be subdued in the near term, thereby impacting sales and margin. However, long-term outlook remains buoyant. In ceramics and electro minerals segments, the company has robust order book and demand continues to be strong.
- **Margin guidance:** At the consolidated level, the company expects margin pressure for FY2023, given the high input cost, supply-side constraints, and integration cost of recent acquisitions. However, management hinted towards achieving similar level of margins as FY2022, led by likely margin improvement by Q4FY2023, particularly in recent acquisitions.
- **Debt/cash position:** The company's debt level increased to Rs. 254 crore as compared to Rs. 212 crore in Q4FY2022. Net cash stood at Rs. 118 crore. The company incurred capex of Rs. 56 crore during the quarter.
- **Russian subsidiary update and outlook:** VAW has reported double-digit sales growth, given strong volumes in both silicon carbide and abrasives. In local currency (Russian Rouble) sales have grown by 22% y-o-y on account of both higher volume and realization. On a sequential basis, it reported 9% growth,

aided by volume growth but realizations were lower. Share in the domestic market – Russia increased from 45% to 55%, while exports to India and Europe also improved as logistics constraints eased to a certain extent. Therefore, its operational margin improved by 800bps/340 bps y-o-y. However, PAT in local currency decreased due to restatement of receivables and payables due to Russian Rouble appreciating against US Dollar and Euro leading to an impact of Rs. 37 crore-40 crore. Demand outlook is positive and the company expects its annual performance to be better than last year on both sales and profit front.

- **Rhodius Germany to breakeven in FY2023:** In Q1FY2023, sales of Rhodius were good but incurred loss of Rs. 6 crore, given higher input and logistics costs. Currently, the company is incurring cost for setting up a new team and infrastructure, reviving the supply chain and gaining back customers. Therefore, the company expects additional cost of Euro 3 mn in FY2023. The company expects Rhodius to be profitable in Q4FY2023, leading to breakeven for FY2023 and come to 7.0-7.5% in FY2024. In the long-term, CUMI expects EBIT margin of 12-14% by FY2026, with high-teen return on capital employed.
- **Awuko update:** CUMI paid Euro 8 mn towards employee settlement cost. For FY2023, it expects sales of Euro 12 mn (Euro 2.7 mn in Q1FY2023) and Rs. 20 crore-25 crore loss in FY2023 (Q1FY2023 loss @ Rs. 8.4 crore). The company expects breakeven by FY2024, as it is still stabilising the team and reigniting the supply chain.
- **PLUSS Advanced Technologies (PLUSS), India:** The subsidiary achieved Rs. 50 crore sales, while it incurred operating loss of Rs. 2.64 crore but expects to breakeven in FY2023.
- **Strong volume growth across segments in the standalone business:** In abrasives, volumes were low q-o-q but higher y-o-y, however prices were soft. In ceramics, the company registered strong volume growth but moderate price growth both q-o-q and y-o-y. Electro-minerals reported strong volume as well as price growth.
- **Staff cost and depreciation**: Employee cost increased by 79% y-o-y to Rs. 173 crore, as it included cost of recently acquired subsidiaries – Awuko and Rhodius. Further, standalone employee cost increased due to employee addition and salary increments. Depreciation also includes cost of the new subsidiaries. The company expects the same run rate for the coming quarters.

Results (Consolidated) Rs cr

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Total Revenue	**1,140**	**712**	**60.2**	**869**	**31.1**
Net raw material	416	232	79.6	297	40.4
Employees benefit	173	96	79.3	120	44.6
Power cost	119	97	23.1	88	35.1
Other expense	304	169	80.4	254	19.6
Operating profit	**127**	**118**	**7.9**	**111**	**14.9**
Other Income	25	10	156.9	12	100.4
Interest	4	1	494.7	2	88.2
Depreciation	43	26	67.4	34	24.8
PBT	**105**	**102**	**3.5**	**87**	**21.2**
Tax	26	28	-6.8	34	-24.0
Reported PAT	86	78	10.2	58	47.2
Adj PAT	**79**	**77**	**2.1**	**57**	**38.1**
EPS (Rs.)	**4.1**	**4.1**	**2.1**	**3.0**	**38.1**
Margin (%)			**BPS**		**BPS**
GPM	63.5	67.4	(396)	65.9	(242)
OPM	11.2	16.6	(542)	12.8	(158)
NPM	6.9	10.8	(393)	6.6	35
Tax rate	24.8	27.6	(274)	39.6	(1,477)

Source: Company; Sharekhan Research

Outlook and Valuation

Sector View – Healthy growth prospects ahead

India's *AtmaNirbhar Bharat* initiative and government's efforts on reviving industrial activities are likely to boost growth prospects. Further, the abrasives business caters to a number of industries such as steel, automobiles, auto components, and general metal fabrication. Thus, a diversified user industry keeps the momentum going further. Key success factors for abrasives in India are consistent quality, cost, right value proposition, innovation and differentiation, service, and capability, which are likely to provide total grinding solutions. Further, with pick-up in domestic industrial activities, abrasives are the early beneficiaries due to their diversified user industries.

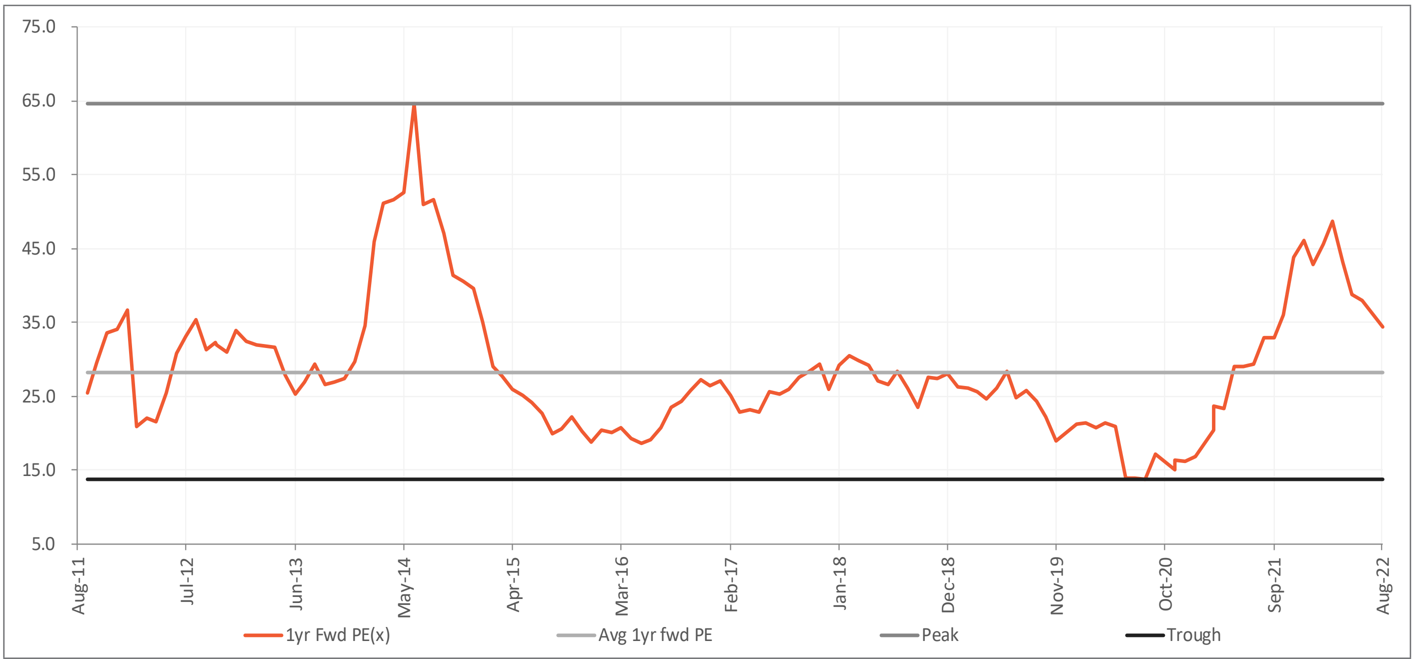
Company Outlook – Promising times ahead

CUMI is expected to benefit from an early economic cycle recovery in the domestic market along with improvement in overseas operations. The company's ceramics and EMD verticals are expected to maintain their high-revenue growth trajectory during FY2022-FY2024E. CUMI's cost-competitive position in electrominerals (being the largest and lowest cost producer domestically and at a marginal difference with China) is expected to benefit in terms of being a domestic and overseas supplier (countries looking to reduce dependence on China). Overall, barring the likely short-term impact of the Russia-Ukraine crisis, logistics, and supply-side challenges, we expect CUMI to be on a high earnings growth trajectory during FY2022-FY2024E with improved domestic operations along with sustained healthy overseas operations, aided by recent acquisitions.

Valuation – Retain Buy with a revised PT of Rs. 1,000

We expect CUMI's growth momentum to sustain, driven by healthy demand across segments. CUMI stands to benefit from multiple factors such as uptick in capex in its end-user industries, China +1 strategy, strong government initiatives to support domestic manufacturing, and healthy demand prospects for regular and specialty products. Further, recent acquisitions as well as improving performance of its Russia, India, Australia, and America subsidiaries. We remain upbeat on the stock, considering its improving earnings growth outlook and a healthy balance sheet. Hence, we retain Buy on CUMI with a revised PT of Rs. 1,000.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

About company

CUMI was incorporated as a joint venture between Carborundum Company USA, Universal Grinding Wheel Company UK, and the 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 zircoania). The company has 30 plants located across seven countries.

Investment theme

CUMI delivered a ~34% earnings CAGR from FY2015-FY2022 and is expected to post healthy ~23% earnings CAGR over FY2022-FY2024E, led by: (1) jump in realisation led by progress in product value chains across segments; and (2) growth in abrasives and ceramics margins on improved industrial production growth. We expect revenue to report a ~19% CAGR (FY2022-FY2024E), given improved profitability of the domestic business particularly in abrasives, better product mix with increasing contribution from subsidiaries, and recent acquisitions in Europe. In EMD, 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 VAW.

Key Risks

- Increased input cost and supply-side constraints could impact performance.
- Delay in turnaround of operations of Rhodius and Awuko could continue to impact its profitability.
- Slowdown in user industries – both domestic and overseas – could lead to lower growth for CUMI's.

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	SBI Funds Management	9.79
2	HDFC Asset Management	3.34
3	Kotak Mahindra Asset Management	3.26
4	Kotak Infrastructure	3.26
5	Shamyak Invest	2.66
6	Vanguard Group Inc.	2.11
7	Nippon Life India Asset Mgt.	1.87
8	L&T mutual fund trustee Ltd.	1.74
9	ICICI Prudential Life Insurance	1.44
10	Massachusetts institute of Technology	1.40

Source: Bloomberg

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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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Compliance Officer: Ms. Priya Sonavane; Tel: 022–61150000; email id: compliance@sharekhan.com;

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

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