



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 Updated Dec 08, 2022 28.04

Medium Risk

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

Source: Morningstar

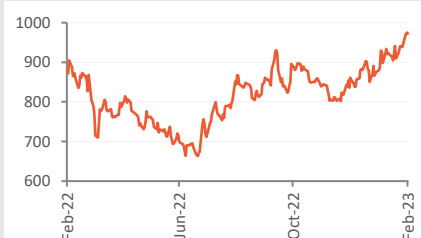
Company details

Market cap:	Rs. 18,477 cr
52-week high/low:	Rs. 993/652
NSE volume: (No of shares)	1.5 lakh
BSE code:	513375
NSE code:	CARBORUNIV
Free float: (No of shares)	11.0 cr

Shareholding (%)

Promoters	41.9
FII	9.1
DII	28.2
Others	20.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	11.5	16.2	14.5	10.9
Relative to Sensex	13.4	18.5	11.7	9.5

Sharekhan Research, Bloomberg

Carborundum Universal Ltd

Mixed Q3, robust outlook

Capital Goods

Sharekhan code: CARBORUNIV

Reco/View: Buy



Upgrade



Maintain

CMP: Rs. 973

Price Target: Rs. 1,125



Downgrade

Summary

- Carborundum Universal Limited (CUMI)'s top-line growth was driven by ceramics, electro minerals segments and contribution from Rhodius and Awuko.
- Higher integration cost of recent acquisitions and flattish sales in abrasives in standalone business impacted bottom-line.
- Company aims Rs 4,500 crore revenue in FY2023E and 5% PBIT margin. It expects OPM to improve meaningfully in FY2024/FY2025 driven by better product mix and reduction in losses from recent acquisitions.
- We expect growth momentum to pick up pace in the coming years driven by sanguine demand in key sectors and turnaround of new businesses. Hence, we retain a Buy with a revised PT of Rs. 1,125 and roll forward our estimates on FY2025E EPS.

CUMI's Q3FY2023 consolidated results were a mixed bag as sales came in-line with expectations. OPM fell short of estimates, while net profit was ahead of estimates owing to higher other income. Total revenue grew by 32% y-o-y to Rs. 1,187 crore. Operating profit grew at a slower pace of 8.5% y-o-y to Rs. 171 crore due to higher employee cost and other expenses on account of integration of new acquisitions – Rhodius and Awuko. Consequently, OPM declined by 312 bps y-o-y to 14.4% (vs. our estimate of 15%). Adjusted profit after tax grew by 7.4% y-o-y to Rs. 109 crore (vs. our estimate of Rs. 100 crore) owing to higher other income despite the increase in depreciation cost and interest. Segment wise, the abrasives segment grew by 50% y-o-y as revenue from Rhodius and Awuko is also part of it. The ceramics segment grew by 24% y-o-y and electro minerals sales grew by 14% y-o-y. EBIT margin in the abrasives segment declined by 960 bps y-o-y to 4%, while ceramics and electro-minerals margin improved by 490bps/250bps y-o-y to 25.1%/20%.

Key positives

- All segments – abrasives/ceramics/electro-minerals reported robust y-o-y revenue growth of 50%/~24%/~14%.
- Profitability in ceramics and electro-minerals business improved as PBIT grew by 54%/~31% y-o-y on account of higher realization and improvement in product mix. PBIT margin came in at 25.1%/20% for ceramics and electro-minerals respectively.
- Subsidiaries also performed well as new acquisitions – Rhodius and Awuko – contributed Rs. 145 crore to total sales.

Key negatives

- Operating profit growth was restricted to 8.5% y-o-y to Rs. 171 crore due to higher employee cost and other expenses incurred on integration of new acquisitions.
- Standalone abrasives sales were almost flat y-o-y at Rs.282 crore.
- Despite the strong top-line performance, the abrasives segment reported a ~56% y-o-y decline in PBIT to Rs. 21 crore due to the integration cost of new acquisitions.

Management Commentary

- CUMI has guided for ~Rs 4,500 crore of sales on consolidated basis for FY2023.
- The company aims PBIT of Rs 525-550 crore and PBIT margin of 5% for FY2023.
- The company expects Rhodius to be PBIT positive by FY2024 and achieve PBIT margin of 12-15% by FY2027. Awuko may register a small loss in FY2024.
- Abrasives segment is facing slowdown in demand from two wheelers and farm equipments and higher competition from imports.
- VAW's 9MFY2023 sales were Rs 750 crore vs Rs 540 crore last year, while profits were at Rs 150 crore vs 100 crore in the same period last year.
- On a sustainable basis, overall margin for electro minerals would be around ~15% in the coming years

Revision in estimates – We have changed our estimates for FY2023-FY2024E to factor in better sales growth and introduced FY2025E estimates.

Our Call

Valuation: Retain Buy with a revised PT of Rs. 1,125: CUMI's 9MFY23 performance has been a mixed bag where in sales have grown because of contribution of new acquisitions. At the same time, integration cost has resulted in lower margins coupled with subdued performance of abrasives segment at the standalone level as well. We expect CUMI's growth momentum to sustain, driven by sustainable 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 bodes well for its long-term growth. Moreover, ceramics and electro minerals segments are witnessing margin improvement. Hence, improving earnings growth outlook and a healthy balance sheet provide us comfort. Hence, we retain Buy on CUMI with a revised price target (PT) of Rs. 1,125 rolling forward our estimates to FY2025E EPS.

Key Risks

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

Valuation (Consolidated)

Particulars	FY22	FY23E	FY24E	FY25E
Net sales	3,325	4,411	5,196	6,137
OPM (%)	16.1	13.8	15.2	16.3
Net profit	333	380	501	654
PAT growth (%)	11.6	14.1	31.8	30.5
Adjusted EPS (Rs.)	17.6	20.0	26.4	34.5
PER (x)	55.4	48.6	36.9	28.2
P/B (x)	7.8	6.9	6.0	5.1
EV/EBIDTA (x)	31.6	26.7	20.9	16.4
RoCE (%)	18.9	18.5	21.7	24.3
RoE (%)	14.8	15.1	17.4	19.4

Source: Company; Sharekhan estimates

Integration of new businesses impacted profitability

CUMI's Q3FY2023 consolidated results were a mixed bag as sales came in line with expectations. OPM fell short of estimates, while net profit was ahead of estimates owing to higher other income. Total revenue grew by 32% y-o-y to Rs. 1,187 crore. Operating profit grew at a slower pace of 8.5% y-o-y to Rs. 171 crore due to higher employee cost and other expenses on account of integration of new acquisitions – Rhodius and Awuko. Consequently, OPM declined by 312 bps y-o-y to 14.4% (vs. our estimates of 15%). Adjusted profit after tax grew by 7.4% y-o-y to Rs. 109 crore (vs. our estimate of Rs. 100 crore) owing to higher other income despite the increase in depreciation cost and interest. Segment wise, the abrasives segment grew by 50% y-o-y as revenue from Rhodius and Awuko is also a part of it. The ceramics segment grew by 24% y-o-y and electro-minerals sales grew by 14% y-o-y. EBIT margin in the abrasives segment declined by 960bps y-o-y to 4%, while ceramics and electro-minerals margin improved by 490bps/250bps y-o-y to 25.1%/20%.

Acquisitions, sanguine demand for the overall business would drive long-term growth

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 farm equipments and other price-sensitive sectors may face near-term headwinds. Moreover, ceramics and electro-minerals are on a healthy growth trajectory. Recent acquisitions would also 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. Hence, we expect considerable improvement in its performance from FY2024.

Investor update and conference call highlights

◆ Segment-wise performance updates

1) **Abrasives:** Segment revenue for the quarter grew by 50% y-o-y to Rs. 513 crore. Standalone abrasives were almost flat at Rs. 282 crore. The newly acquired entities – Rhodius and Awuko – added additional sales of Rs. 145 crore. The domestic, American as well as Russian subsidiary registered double-digit growth. Profits at the standalone level improved by 16% sequentially on account of softening input costs, price increase implementation, and efficiency improvements. PBIT at the consolidated level was lower by 56% y-o-y to Rs. 21 crore due to higher energy and input costs in Rhodius and re-establishing business in Awuko.

2) **Electro-minerals:** Segment revenue was at Rs. 412 crore resulting in an increase of 14%. Standalone electro-minerals was flat sequentially but declined against Q3 of last year by 2% to Rs. 173 crore after softening of commodity prices. PBIT was at Rs. 82 crore and growth was due to good performance by the Russian subsidiary.

3) **Ceramics:** Segment revenue was higher by 24% at Rs. 264 crore. Standalone ceramics grew by 23% to Rs. 219 crore on account of strong demand across sectors and geographies. Subsidiaries in Australia and America also registered significant growth. PBIT grew by 54% to Rs. 66 crore on account of growth in volume, realisation, and product mix.

◆ **Impressive sales guidance for FY2023:** The company has guided for ~Rs. 4,500 crore of sales on a consolidated basis for FY2023. Out of this, 50% growth will be contributed organically. Rhodius and Awuko will contribute Rs. 600 crore to the total revenue. The company aims PBIT of Rs. 525-550 crore and PBIT margin of 5% for FY2023. The company is seeing healthy growth in both ceramics and electro-minerals, while abrasives is witnessing slowdown in some specific industries such as three wheelers and farm equipment.

◆ **Abrasive margin to improve substantially from FY2024:** If the standalone EBIT trend improves in FY2024 and if Rhodius and Awuko are able to break even, then EBIT margin from abrasives could be around 9% on a consolidated basis.

- ♦ **An increase in energy cost in Europe may impact Rhodius going forward:** Steep rise in energy cost has not yet impacted as the company already has contracts for electricity supplies. However, FY2024 may be impacted due to high energy cost although it will be partially offset by the decline in some of the material cost.
- ♦ **Abrasives demand outlook:** The segment is facing slowdown in demand from two wheelers and farm equipments and higher competition from imports. In addition, there is slowdown in government projects in specific markets. However, with improving product mix, the company is hopeful of better growth and margins in the coming years.
- ♦ **Electro minerals margin:** On a sustainable basis, overall margin for electro minerals would be around 15% in the coming years.
- ♦ **Working capital cycle:** The company has working capital cycle of 30-35 days.
- ♦ **Russian subsidiary - VAW 9MFY2023 performance:** VAW's 9MFY2023 sales were Rs 750 crore vs Rs 540 crore last year, while profits were at Rs 150 crore vs 100 crore in the same period last year.
- ♦ **Rhodius to be profitable from FY2024 onwards –** The company expects Rhodius to be PBIT positive by FY2024 and achieve PBIT margin of 12-15% by FY2027. Auwko may register a small loss in FY2024.
- ♦ **Un-allocable expenses –** Consolidated un-allocable expenses have risen to Rs 68 crore vs 37 crore on y-o-y basis. It includes some of the generic cost, dividend tax from Russia and professional charges that the company incurred in two acquisitions. In Q4FY2023 too, Rs 60-65 crore of un-allocable expenses could be there.
- ♦ **Capex/debt:** The capex incurred during 9MFY2023 was Rs.267 crore at consolidated level. The debt equity ratio at the consolidated level was at 0.14. Debt on standalone level is Rs 265 crore, while consolidated debt is Rs 384 crore. Net cash stands at Rs.30 crore.

Results (Consolidated)

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Net Sales	1,187	899	32.0	1,128	5.3
Total RM cost	441	330	33.8	400	10.2
Employee cost	183	103	77.9	170	7.2
Power and Fuel cost	129	112	15.3	125	3.0
Other Expenses	264	198	33.3	269	-2.1
Operating profit	171	158	8.5	163	4.9
Other Income	24	9	167.3	8	198.5
Interest	7	1	363.9	5	35.0
Depreciation	47	28	69.5	45	6.3
PBT	141	137	2.7	122	15.9
Tax	34	30	11.9	37	-9.2
Reported PAT	94	103	-8.8	86	9.0
Adjusted PAT	109	102	7.4	89	22.6
Adj. EPS (Rs.)	5.7	5.4	7.4	4.7	22.6
Margin (%)			BPS		BPS
GPM	62.9	63.3	(49)	64.5	(167)
OPM	14.4	17.5	(312)	14.5	(5)
NPM	9.3	11.4	(209)	8.0	134
Tax rate	24.1	22.1	198	31	(669)

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.

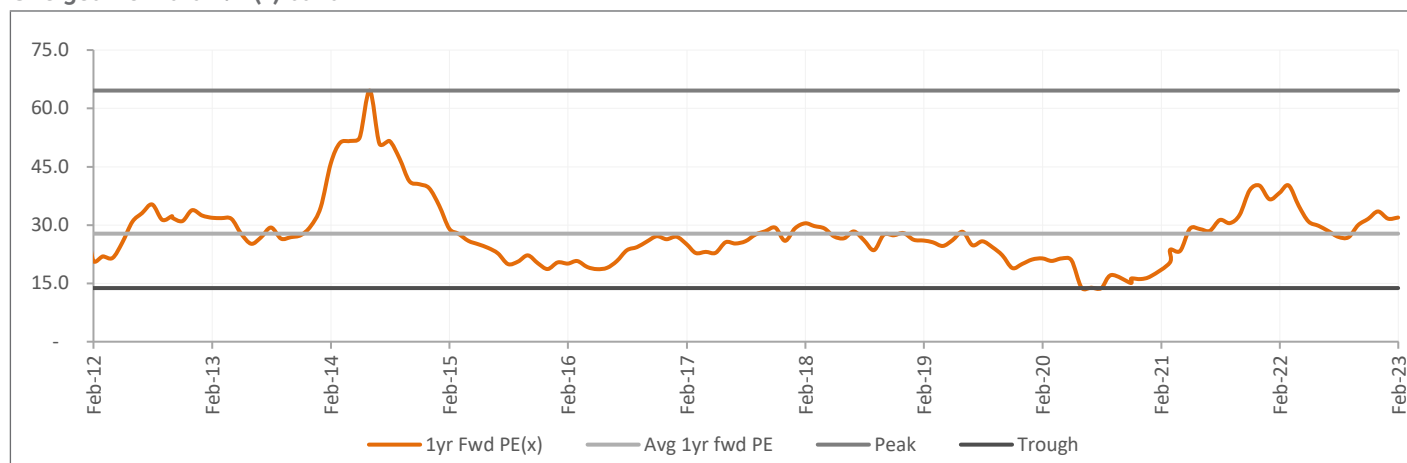
■ Company Outlook – Promising times ahead

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 in the long-term with improved domestic operations along with sustained healthy overseas operations, aided by recent acquisitions.

■ Valuation – Retain Buy with a revised PT of Rs. 1,125

CUMI's 9MFY23 performance has been a mixed bag where in sales have grown because of contribution of new acquisitions. At the same time, integration cost has resulted in lower margins coupled with subdued performance of abrasives segment at the standalone level as well. We expect CUMI's growth momentum to sustain, driven by sustainable 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 bodes well for its long-term growth. Also, ceramics and electro minerals segments are also witnessing improvement in margins. Hence, improving earnings growth outlook and a healthy balance sheet provide us comfort. Hence, we retain Buy on CUMI with a revised price target (PT) of Rs. 1,125 rolling forward our estimates to FY2025E EPS.

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 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 the 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.

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	29.52
2	SBI Funds Management Ltd	9.75
3	Kotak Mahindra Asset Management Co Ltd	3.94
4	Vanguard Group Inc	2.19
5	HDFC Asset Management Co Ltd	2.02
6	Nippon Life India Asset Management Ltd	1.92
7	L&T Mutual Fund Trustee	1.70
8	ICICI Prudential Life Insurance Co Ltd	1.26
9	FundRock Management Co SA	1.26
10	Tata Asset Management Pvt Ltd	0.94

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 deteriorating 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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