Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Carborundum Universal Ltd

Robust quarter, bright long-term prospects

Capital Goods	Sharekhan code: CARBORUNIV

Reco/View: Buy	↔	CMP: Rs. 1,140	Price Target: Rs. 1,315	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Stock Update

Result 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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 28.04

Updated Mar 08, 2023

Medium Risk

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

Source: Morningstar

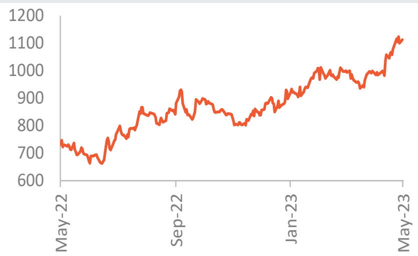
Company details

Market cap:	Rs. 21,649 cr
52-week high/low:	Rs. 1,185/652
NSE volume: (No of shares)	1.3 lakh
BSE code:	513375
NSE code:	CARBORUNIV
Free float: (No of shares)	11.1 cr

Shareholding (%)

Promoters	41.5
FII	28.8
DII	9.4
Others	20.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	13.0	17.0	39.2	55.7
Relative to Sensex	9.8	15.4	38.0	42.3

Sharekhan Research, Bloomberg

Summary

- Carborundum Universal Limited's (CUMI) results exceeded our estimates on the profitability front, driven by higher revenue growth and strong margin across segments.
- The company expects revenue/PAT contribution from subsidiaries to increase meaningfully in the coming years.
- We expect growth momentum to sustain, and profitability should pick up pace in the coming years, driven by sanguine demand in key sectors and turnaround of new businesses.
- We retain Buy with a revised PT of Rs. 1,315, valuing the stock on FY2025E EPS, building in a ~21%/36% CAGR over FY2023-FY2025E.

Carborundum Universal Limited's (CUMI) Q4FY2023 consolidated results were ahead of expectations on the OPM and net profit front, while sales were in-line with estimates. Total revenue grew by 38% y-o-y to Rs. 1,200 crore. Operating profit grew by 71.6% y-o-y to Rs. 190 crore, as the integration cost of recent acquisitions declined. Consequently, OPM improved by 311bps y-o-y to 15.9% (vs. our estimate of 15%). Reported PAT grew by 135% y-o-y to Rs. 137 crore, helped by exceptional gain of Rs. 24.9 crore on account of reversal of liability recognised towards fair value changes of a financial instrument availed by a step-down subsidiary. Adjusted PAT also grew at a healthy rate of ~97% y-o-y to Rs. 112 crore. Segment wise, the abrasives segment grew by ~53% y-o-y, as revenue from Rhodius and Awuko are also part of it. The ceramics segment grew by ~32% y-o-y and electrominerals sales grew by 19% y-o-y. EBIT margin in the abrasives segment declined by 60bps y-o-y to 7.3% but improved considerably on a q-o-q basis, while ceramics and electrominerals margin improved by 583bps and 311bps y-o-y to 23.2% and 16%, respectively.

Key positives

- All segments – Abrasives/ceramics/electrominerals reported robust y-o-y revenue growth of 53%/~32%/~19%. New acquisitions – Rhodius and Awuko – also contributed to abrasives sales.
- Profitability in abrasives, ceramics, and electrominerals business improved as PBIT grew by 40%/ 76%/~48% y-o-y on account of higher realisation due to elevated commodity prices and improvement in the product mix. PBIT margin came in at 7.3%, 23.2%, and 16% for abrasives, ceramics, and electrominerals, respectively.
- OPM improved on a y-o-y and q-o-q basis and adjusted PAT grew by ~97% y-o-y to Rs. 112 crore.

Key negatives

- Steep rise in energy cost and Russia-Ukraine war has impacted Awuko's performance.
- Management outlook is cautiously optimistic as realisations may decline for some products due to softening commodity prices, thereby impacting revenue growth.

Management Commentary

- 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 and break even in FY2025.
- The abrasives segment is seeing increasing demand from non-auto segments.
- VAW's market share in Russia has increased from 45% to 58% in FY2023.
- De-bottlenecking and modernising of plants of certain capacities would require Rs. 180-200 crore of capex in the coming years.
- The company would continue to look at acquisitions in the future. Cash and cash equivalents including deposits stood at Rs. 166 crore.

Revision in estimates – We have marginally tweaked our estimates for FY2024-FY2025E to factor in better sales growth.

Our Call

Valuation: Retain Buy with a revised PT of Rs. 1,315: CUMI's Q4FY2023 and FY2023 performance has been impressive, driven by robust demand and contribution of new acquisitions. We expect CUMI's growth momentum to sustain, driven by sustainable demand across segments in the long term. CUMI stands to benefit from multiple factors such as an 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 electrominerals segments are witnessing margin improvement. Hence, improving earnings growth outlook and a healthy balance sheet provide us comfort. Therefore, we retain Buy on CUMI with a revised price target (PT) of Rs. 1,315.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Net sales	3,325	4,654	5,638	6,786
OPM (%)	16.1	14.0	14.9	15.9
Reported net profit	333	414	545	722
Adjusted net profit	333	389	545	722
PAT growth (%)	11.6	16.7	40.2	32.5
Adjusted EPS (Rs.)	17.6	20.5	28.7	38.0
PER (x)	64.9	55.6	39.7	30.0
P/B (x)	9.2	7.7	6.6	5.5
EV/EBIDTA (x)	37.1	29.3	23.2	18.0
RoCE (%)	18.9	18.2	21.5	24.8
RoE (%)	14.8	15.0	17.8	20.0

Source: Company; Sharekhan estimates

Strong performance across all segments

CUMI's Q4 consolidated results were ahead of expectations on the OPM and net profit front, while sales were in-line with estimates. Total revenue grew by 38% y-o-y to Rs. 1,200 crore. Operating profit grew by 71.6% y-o-y to Rs. 190 crore, as the integration cost of recent acquisitions declined. Consequently, OPM improved by 311bps y-o-y to 15.9% (vs. our estimate of 15%). Reported PAT grew by 135% y-o-y to Rs. 137 crore, helped by an exceptional gain of Rs. 24.9 crore on account of reversal of liability recognised towards fair value changes of a financial instrument availed by a step-down subsidiary. Adjusted PAT also grew at a healthy rate of ~97% y-o-y to Rs. 112 crore. Segment wise, the abrasives segment grew by ~53% y-o-y, as revenue from Rhodius and Awuko are also part of it. The ceramics segment grew by ~32% y-o-y and electrominerals sales grew by 19% y-o-y. EBIT margin in the abrasives segment declined by 60bps y-o-y to 7.3% but improved considerably on a q-o-q basis, while ceramics and electrominerals margin improved by 583bps/311bps y-o-y to 23.2%/16%.

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 equipment and other price-sensitive sectors may face near-term headwinds. Moreover, ceramics and electrominerals are on a healthy growth trajectory. Recent acquisitions would also see significant improvement in the coming years on both sales and profitability front post the 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 update:***

  1) **Abrasives:** The abrasive segment's revenue for the quarter grew by 53% y-o-y to Rs. 525 crore. The newly acquired entities – Rhodius and Awuko – contributed to the segment's growth. The domestic, American as well as Russian subsidiaries registered strong growth. Sales from Awuko and Rhodius for the year stood at Rs. 619 crore in FY2023 as compared to Rs. 10 crore in FY2022. Standalone abrasives grew by 5% y-o-y to Rs.1,107 crore. Profit 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) **Electrominerals:** The electrominerals segment's revenue stood at Rs. 405 crore, resulting in an increase of 19%. Revenue at a consolidated level grew by 25% y-o-y to Rs.1,634 crore as against Rs. 1,312 crore last year. Standalone electrominerals grew by 13% to Rs. 702 crore from Rs. 621 crore. VAW, Russia, registered double-digit growth. This year had been a turnaround year for Foskor Zirconia (Pty) Limited, South Africa, which registered double-digit growth.

  3) **Ceramics:** The ceramics segment's revenue was higher by ~32% at Rs. 265 crore. Consolidated revenue grew by 29% to Rs. 1,027 crore in the current year from Rs. 798 crore last year. Standalone ceramics grew by 26% to Rs. 834 crore from Rs. 661 crore on account of strong demand across sectors and geographies. Subsidiaries in Australia and America also registered significant growth. PBIT grew by 57% y-o-y to Rs. 251 crore from Rs. 159 crore on account of growth in volume, realisation, and product mix.

- **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 improve meaningfully.

- **Rhodius to be profitable from FY2024:** The company recorded sales of Euro 17 mn in Q4FY2023 as compared to Euro 15 mn in Q3FY2023. Rhodius has suffered due to Russia – Ukraine war resulting in the shortage of production and high energy cost and made a loss of Euro 3.7 mn. CUMI expects Rhodius to be PBIT positive by FY2024 and achieve PBIT margin of 12% by FY2027.
- **Awuko update:** Awuko registered Euro 2.6 mn sales; and for the full year, sales were at Euro 9.4 mn. The company may register a small loss in FY2024 and break even in FY2025.
- **Ceramics –** In refractories and ceramics, project orders coming from mining, steel, and power generation continue to be robust.
- **Capex/debt/net cash:** Capital expenditure incurred during the year was Rs. 294 crore at the consolidated level, of which close to Rs. 50 crore was towards the purchase of a land and, therefore, is non-recurring in the future. De-bottlenecking and modernising of plants of certain capacities would require Rs. 180-200 crore of capex in the coming years. The company would continue to look at acquisitions in future. Cash and cash equivalents including deposits stood at Rs. 166 crore.

Results (Consolidated) **Rs cr**

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Net Sales	**1,200**	**869**	**38.0**	**1,187**	**1.1**
Total RM cost	457	297	54.0	441	3.6
Employee cost	167	120	39.4	183	-8.7
Power and Fuel cost	136	88	54.1	129	5.5
Other Expenses	250	254	-1.6	264	-5.2
Operating profit	**190**	**111**	**71.6**	**171**	**11.3**
Other Income	20	12	59.6	24	-17.5
Interest	7	2	203.8	7	5.6
Depreciation	53	34	53.5	47	11.3
PBT	**150**	**87**	**73.4**	**141**	**6.6**
Tax	41	34	18.9	34	20.1
Reported PAT	**137**	**58**	**134.8**	**86**	**59.5**
Adjusted PAT	**112**	**57**	**96.7**	**109**	**2.8**
Adj. EPS (Rs.)	5.9	3.0	96.7	5.7	2.8
Margin (%)			**BPS**		**BPS**
GPM	61.9	65.9	(395)	62.9	(93)
OPM	15.9	12.8	311	14.4	146
NPM	9.5	6.6	284	9.3	18
Tax rate	27.1	39.6	(1,245)	24.1	304

Source: Company, Sharekhan Research

Outlook and Valuation

Sector View – Healthy growth prospects ahead

India's AtmaNirbhar Bharat initiative and the 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.

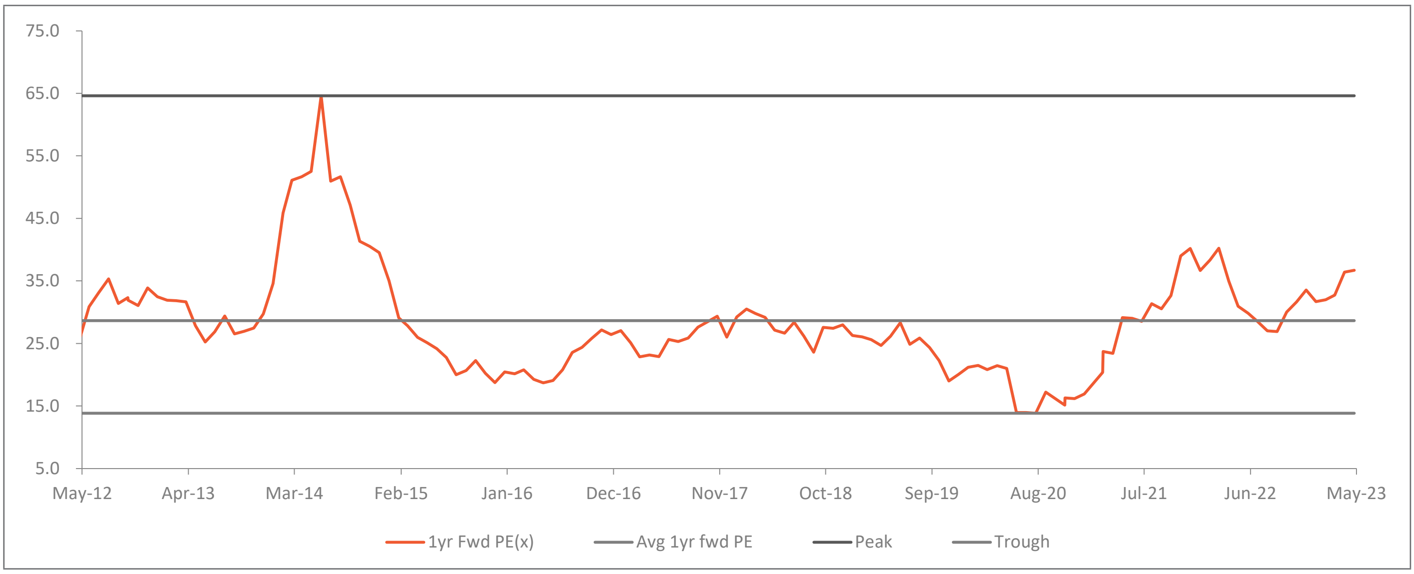
Company Outlook – Promising times ahead

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 revenue growth trajectory during FY2023-FY2025E. 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. 1,315

CUMI's Q4FY2023 and FY2023 performance has been impressive, driven by robust demand and contribution of new acquisitions. We expect CUMI's growth momentum to sustain, driven by sustainable demand across segments in the long term. CUMI stands to benefit from multiple factors such as an 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 electrominerals segments are witnessing margin improvement. Hence, improving earnings growth outlook and a healthy balance sheet provide us comfort. Therefore, we retain Buy on CUMI with a revised price target (PT) of Rs. 1,315.

One-year forward P/E (x) band



Source: Company Data; Sharekhan Research

About the 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 ~34% earnings CAGR from FY2015-FY2022 and is expected to post a healthy ~23% earnings CAGR over FY2022-FY2024E, driven 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

M M Murugappan	Chairman
N. ANANTHASESHAN	Managing Director
Ninad Gadgil	President – Abrasives
P. S. Jayan	Executive Vice President – Electrominerals
P. PADMANABHAN	Chief Account Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management Limited	9.7
2	Kotak Mahindra Asset Management Company	4.2
3	Kotak Infrastructure Fund	3.3
4	Vanguard Group Incorporation	2.2
5	Shamyak Investment	2.0
6	Nippon Life India Asset Management	1.9
7	Massachusetts Institute of Technology	1.3
8	ICICI Prudential Life Insurance Company	1.3
9	FundRock Management Company SA	1.3
10	Franklin Resources Incorporation	1.0

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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