Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Carborundum Universal Ltd

Promising long-term outlook

Capital Goods	Sharekhan code: CARBORUNIV
Reco/View: Buy ↔	CMP: Rs. 1,174 / Price Target: Rs. 1,315 ↔

↑ 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 22.62

Updated Jul 08, 2023

Medium Risk

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

Source: Morningstar

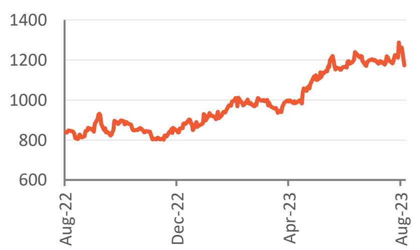
Company details

Market cap:	Rs. 22,294 cr
52-week high/low:	Rs. 1,305 / 788
NSE volume: (No of shares)	1.4 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	-2.0	6.7	16.3	38.9
Relative to Sensex	-3.1	-1.3	6.9	25.9

Sharekhan Research, Bloomberg

Summary

- Results lagged estimates due to a weak show by abrasives segment, while ceramics outshone on sales growth and profit fronts.
- We expect growth momentum to sustain as ceramics and electro-minerals are performing well led by value-added products. Profitability is likely to improve driven by improvement in subsidiaries and performance of new acquisitions.
- Emerging opportunities w.r.t. clean energy and demand from automotive and construction sectors are key long-term growth drivers.
- Stock trades at ~34xFY25E EPS. We retain a Buy with an unchanged PT of Rs. 1,315, building in a ~16%/~30% CAGR over FY23-FY25E.

Q1 consolidated results lagged estimates particularly on sales and OPM fronts mainly due to weak sales in abrasives segment. Total revenues grew by ~6% y-o-y to Rs 1,203 crore. Operating profit grew by ~33% y-o-y to Rs. 169 crore as other expenses declined. Consequently, OPM improved by 290 bps y-o-y to 14.1% (versus our estimates of 14.5%). PAT grew by 98.5% y-o-y to Rs 113 crore and was broadly in-line with expectations. Segment-wise, in abrasives; domestic subsidiary and American subsidiary registered double-digit growth, however, sales from Awuko and Rhodius were flat due to recessionary trends in Europe. Although profitability improved in both standalone and subsidiaries. In electro-minerals, standalone sales grew by 10% on back of volume growth and product mix. However, Volzhsky Abrasives Works, Russia and Foskor Zirconia (Pty), South Africa were almost flat. Ceramics segment revenues were higher by 18% driven by standalone as well as subsidiaries in Australia and America.

Key positives

- Ceramics segment reported strong growth of 18% y-o-y to Rs. 287 crore on account of healthy demand from all the end-user industries and geographies.
- Profitability of all the segments - Abrasives, ceramics, and electro-minerals business improved as PBIT grew by ~75%/~39%/~26% y-o-y on account of higher realisation better product mix. PBIT margins came in at 6%, 28.2%, and 17.7% for abrasives, ceramics, and electro minerals, respectively.
- OPM improved on a y-o-y basis by 290 bps to 14.1%.

Key negatives

- CUMI expects a revenue growth of ~10% for the abrasives in FY24 as its retail segment which forms 30-35% revenue is under pressure due to increasing competition from China.
- For Rhodius, company expects flat sales against its earlier guidance of an 8-9% growth. Thus, due to lower sales, the subsidiary is likely to make loss in FY24.

Management Commentary

- In abrasives, barring retail, other segments would continue to witness double digit growth which would aid overall revenue growth of ~10% in FY24.
- Rhodius' sales stood at EUR 15.5 million in Q1FY24 as against EUR 17.4 million in Q4FY23 and EUR 18 million in Q1FY23. The decline in sales is a result of lower volumes due to the price increases taken by the company.
- Awuko has managed to shrink its losses to EUR 0.7 million from EUR 1.2 million in Q4FY23 and management has maintained its guidance of loss of EUR 2.5 million in FY24 and break even by FY25.
- Clean energy is an emerging segment and the company intends to grow in this domain. However, since these materials are customized, scalability will take time.
- Its Russian subsidiary- VAW registered highest-ever quarterly sales of Russian Ruble 2.4bn and PAT came in at Russian Ruble 417 million. VAW's capacity utilisation has peaked and domestic sales (in Russia) increased to 60%.
- CUMI incurred capex of Rs. 55 crore in Q1FY24 and expects FY24 capex to be around ~Rs. 300 crore.

Revision in estimates – We have revised our estimates for FY24-FY25E in line with the management commentary.

Our Call

Valuation – Retain Buy with an unchanged PT of Rs. 1,315: Q1FY2024 performance has been mixed as abrasives segment has underperformed due to increased competition. In the long term, we expect 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 increasing demand prospects for specialty products driven by clean energy initiatives. Further, recent acquisitions as well as improving performance of its Russia, India, Australia, and America subsidiaries bodes well for its long-term growth. Moreover, all segments are witnessing healthy profitability. The stock trades at ~34xFY25E EPS and the rich valuations are justified given strong earnings growth outlook and a healthy balance sheet and improving return ratios. Therefore, we retain Buy on CUMI with an unchanged 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	5,369	6,286
OPM (%)	16.1	14.0	14.9	15.7
Reported net profit	333	414	513	654
Adjusted net profit	333	389	513	654
PAT growth (%)	11.6	16.7	31.8	27.5
Adjusted EPS (Rs.)	17.6	20.5	27.0	34.4
PER (x)	66.9	57.3	43.5	34.1
P/B (x)	9.4	7.9	6.8	5.8
EV/EBIDTA (x)	38.2	30.1	25.0	20.1
RoCE (%)	18.9	18.2	20.3	22.9
RoE (%)	14.8	15.0	16.9	18.4

Source: Company; Sharekhan estimates

Weak abrasives sales impacts performance

Q1 consolidated results lagged estimates particularly on sales and OPM fronts mainly due to weak sales in abrasives segment. Total revenues grew by ~6% y-o-y to Rs 1,203 crore. Operating profit grew by ~33% y-o-y to Rs. 169 crore as other expenses declined. Consequently, OPM improved by 290 bps y-o-y to 14.1% (versus our estimates of 14.5%). PAT grew by 98.5% y-o-y to Rs 113 crore and was broadly in-line with expectations. Segment-wise, in abrasives; domestic subsidiary and American subsidiary registered double-digit growth, however, sales from Awuko and Rhodius were flat due to recessionary trends in Europe. Although profitability improved in both standalone and subsidiaries. In electro-minerals, standalone sales grew by 10% on back of volume growth and product mix. However, Volzhsky Abrasives Works, Russia and Foskor Zirconia (Pty), South Africa were almost flat. Ceramics segment revenues were higher by 18% driven by standalone as well as subsidiaries in Australia and America.

Investor update and conference call highlights

- **Segment-wise performance update:**
  1. **Abrasives:** The abrasives segment's revenue was almost flat at Rs.519 crore as compared to Rs.513 crore in Q1FY23. Standalone abrasives grew by 5% y-o-y to Rs.282 crore against Rs.269 crore. The domestic subsidiary and the subsidiary in America registered double digit growth. Sales from Awuko and Rhodius for the quarter was flat due to recessionary trends in Europe. PBIT rose by 75% y-o-y to Rs.31 crore as against Rs.18 crore in Q1FY23. This was on account of better profit margins from standalone and increase in profits from domestic and American subsidiaries.
  2. **Electrominerals:** This segment's revenues grew by 3% y-o-y to Rs.418 crore versus Rs.406 crore in Q1FY23. Standalone Electro Minerals sales grew by 10% y-o-y to Rs.197 crore from Rs.179 crore on back of volume growth and product mix. Sales of Volzhsky Abrasives Works (VAW), Russia and Foskor Zirconia (Pty) Limited, South Africa were almost flat. PBIT was at Rs.74 crore as against Rs.59 crore in Q1FY23. A significant portion of profits came from VAW. At standalone level, the division grew by 59% y-o-y to Rs.23 crore.
  3. **Ceramics:** The segment's revenue was higher by 18% y-o-y to Rs.287 crore as against Rs.243 crores in Q1 of last year. Standalone ceramics grew by 19% y-o-y to Rs.231 crore from Rs.193 crore on account of strong demand across end user industries and geographies. The subsidiaries in Australia and America also registered significant growth. PBIT grew by 39% y-o-y to Rs.81 crore from Rs. 58 crore on account of growth in volume, better realization and product mix.
- **Competition in abrasives segment intensifies:** The company expects revenue growth of ~10% for the abrasives in FY24 as its retail segment – which forms 30-35% revenue is under pressure due to increasing competition from China. Hence, the retail segment growth could be flat in FY24. However, other segments would continue to witness double digit growth which would help the overall revenue growth.
- **Update and outlook on Rhodius:** Rhodius' sales stood at EUR 15.5 million in Q1FY24 as against EUR 17.4 million in Q4FY23 and EUR 18 million in Q1FY23. The decline in sales is a result of lower volumes due to the price increases taken by the company. Since, the demand is subdued in Europe, company expects flat sales against its earlier guidance of 8-9% growth. Thus, due to lower sales, the subsidiary is likely to make loss in FY24 as against earlier guidance of profit by the company.
- **Update and outlook on Auwko:** Sales for Q1FY24 came in at EUR 2.5 million as against ~EUR 2.6 million each in Q1FY23 and Q4FY23. Awuko has managed to shrink its losses to EUR 0.7 million from EUR 1.2 million in Q4FY23 and management has maintained its guidance of loss of EUR 2.5 million in FY24 and break-even by FY25.

- **Update and outlook on Russian subsidiary - VAW:** The subsidiary registered its highest-ever quarterly sales of Russian Ruble 2.4bn led by higher realisation across the three segments and PAT came in at Russian Ruble 417 million. VAW's capacity utilisation is at peak levels and sales in the domestic market (Russia) increased to 60%.
- **Emerging opportunities:** Clean energy is an emerging segment and the company intends to grow in this domain. However, since these materials are customized, scalability will take time.
- **Capex guidance:** The company incurred a capex of Rs. 55 crore in Q1FY24 and the management expects FY24 capex to be around ~Rs. 300 crore.

Results (Consolidated) **Rs cr**

Particulars	Q1FY24	Q1FY23	Y-o-Y %	Q4FY23	Q-o-Q %
Net Sales	1,203	1,140	5.6	1,200	0.3
Total RM cost	468	416	12.4	457	2.5
Employee cost	180	173	4.1	167	7.9
Power and Fuel cost	131	119	10.3	136	-3.3
Other Expenses	254	304	-16.3	250	1.7
Operating profit	**169**	**127**	**32.9**	**190**	**-11.0**
Other Income	31	25	24.3	20	56.0
Interest	5	4	15.7	7	-28.3
Depreciation	46	43	6.8	53	-13.2
PBT	**149**	**105**	**42.2**	**150**	**-0.6**
Tax	42	26	60.3	41	2.5
Reported PAT	118	86	36.9	86	36.9
Adjusted PAT	**113**	**79**	**43.7**	**112**	**0.9**
Adj. EPS (Rs.)	**6.0**	**4.1**	**43.7**	**5.9**	**0.9**
Margin (%)			**BPS**		**BPS**
GPM	61.1	63.5	(237)	61.9	(84)
OPM	14.1	11.2	290	15.9	(179)
NPM	9.5	7.0	253	9.5	2
Tax rate	28.0	24.8	314	27.1	82

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.

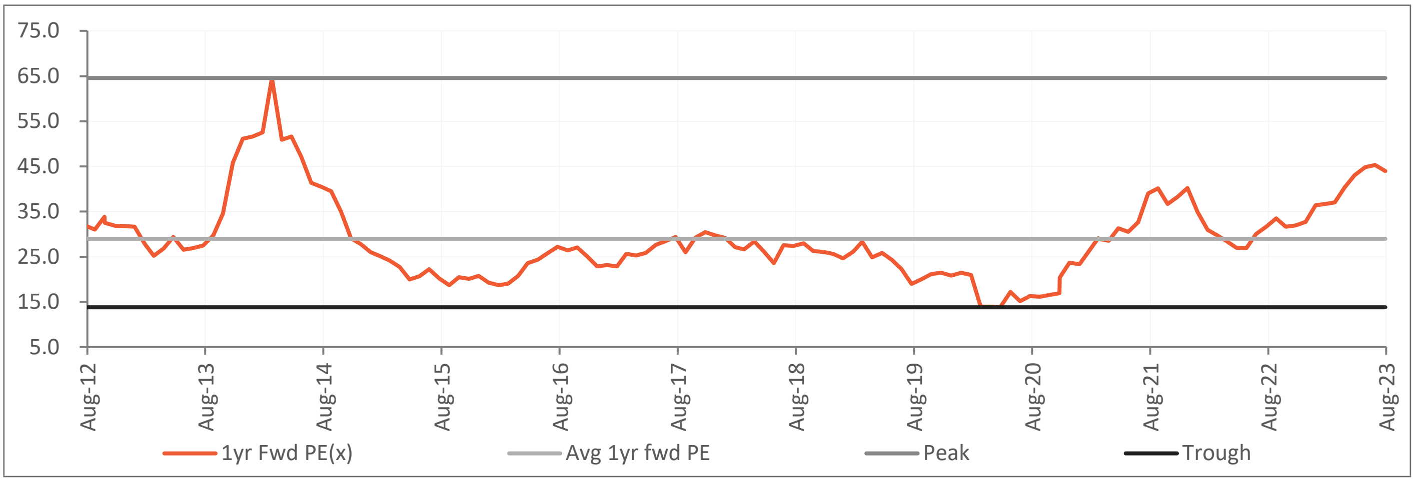
■ Company Outlook – Promising times ahead

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 FY23-FY25E. 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 an unchanged PT of Rs. 1,315

Q1FY2024 performance has been mixed as abrasives segment has underperformed due to increased competition. In the long term, we expect 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 increasing demand prospects for specialty products driven by clean energy initiatives. Further, recent acquisitions as well as improving performance of its Russia, India, Australia, and America subsidiaries bodes well for its long-term growth. Moreover, all segments are witnessing healthy profitability. The stock trades at ~34xFY25E EPS and the rich valuations are justified given strong earnings growth outlook and a healthy balance sheet and improving return ratios. Therefore, we retain Buy on CUMI with an unchanged price target (PT) of Rs. 1,315.

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 ~32% earnings CAGR from FY2015-FY2022 and is expected to post a healthy ~30% earnings CAGR over FY2023-FY2025E, 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 CAGR of ~16% (FY2023-FY2025E), 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	9.74
2	Kotak Mahindra Asset Management	3.87
3	HDFC Asset Management	2.03
4	Vanguard Group Incorporation	1.92
5	Nippon Life India Asset Management	1.92
6	Axis Asset Management	1.75
7	Shamyak Investment Private Ltd.	1.58
8	Massachusetts Institute of Technology	1.30
9	Southern Energy Development Corp L	1.29
10	FundRock Management Co SA	1.28

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

DISCLAIMER

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Other registrations of 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.

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