Stock Update

Company Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Carborundum Universal Ltd

Poised for broad based long-term growth

Capital Goods	Sharekhan code: CARBORUNIV

Reco/View: Buy	↔	CMP: Rs. 1,136	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 Aug 08, 2023

Medium Risk

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

Source: Morningstar

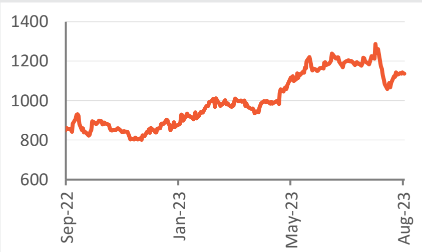
Company details

Market cap:	Rs. 21,573 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	-11.7	-1.9	16.6	33.9
Relative to Sensex	-10.1	-6.7	6.6	22.6

Sharekhan Research, Bloomberg

Summary

- CUMI's annual report is reflective of the company's vision to pursue broad-based growth in all the three segments through product innovation, capex, and broadening of its market presence.
- In abrasives, sustained demand from auto, metals, construction, and railways would keep up the growth momentum. Further, Rhodius and Awuko have enhanced the company's offerings and market reach, which shall aid growth in the long term.
- Increasing revenue from specialised products in electro-minerals and demand from the U.S., Australia, and Europe would drive overall growth.
- Improved collection efficiencies have reduced working capital cycle and cash flow from operations have also improved. The stock trades at ~33x its FY25E EPS. We retain our Buy rating with an unchanged PT of Rs. 1,315, building in a ~16%/~30% CAGR over FY2023-FY2025E.

CUMI's FY2023 annual report emphasises the company's vision to pursue growth in all the three segments through new product launches, capacity enhancement, and broadening of its market presence in various products to leverage demand from key sectors. In abrasives, turnaround of RHODIUS Abrasives GmbH (RAG) and CUMI AWUKO Abrasives GmbH (CAAG) would be a key growth catalyst. In electro minerals, it aims to increase the share of specialised products in the next two years from 25% currently. Moreover, the increase in industrial capex through PLI Scheme would spur demand of industrial consumables, which bodes well for its business segments. Further, increasing use of specialised products in abrasives, ceramics, and refractories would lead to better profitability as well. Thus, we have built in a revenue/PAT CAGR of 16%/30% over FY2023-FY2025E.

- **Abrasives segment performed well due to overseas acquisitions:** Abrasives revenue grew by 59% owing to incremental sales by recent acquisitions – RHODIUS Abrasives GmbH (RAG) and CUMI AWUKO Abrasives GmbH (CAAG). The business's profitability was impacted due to increased input cost and cost involved in integrating the newly acquired subsidiaries. While the uptick in demand from the auto sector and price increases led to healthy volumes, competition from cheap imports and rising prices of raw materials impacted the efficiency, the adverse effects of which were minimised by several cost-control initiatives such as packaging cost improvements, process efficiencies, and several digital techniques to keep costs under control. The Indian market has been witnessing a shift from manual grinding methods to mechanised processes, thereby creating the need for new products in the coated abrasives segment. The global abrasives market especially Europe and U.S. was impacted in Q1/Q2 of FY2023 due to heavy cost inflation followed by Russia-Ukraine war.
- **Electro minerals and ceramics growth was driven by the overseas business:** The electro minerals business registered 25%/13% revenue growth on standalone/consolidated basis. VAW registered double-digit growth by increasing its domestic market share, while Foskor Zirconia Pty Limited, South Africa (FZL), has seen a year of a turnaround in operations owing to higher product demand and better efficiencies through a revamped distribution strategy. The demand outlook for key domestic core industries remained strong for ceramics and refractories. Demand for technical ceramics, driven by technology transformations in the auto industry is likely to drive growth for the ceramics segment.
- **Short working capital cycle:** Prudent working capital management with significant reduction in debtor days led by a strong demand environment has helped the company improve its working capital cycle over the years from 94 days in FY2019 to 58 days in FY2023.

Revision in estimates – We have maintained our estimates for FY2024-FY2025E.

Our Call

Valuation: Retain Buy with an unchanged PT of Rs. 1,315: CUMI has a 25% market share in the organised abrasives market and it aims to increase profitability of the abrasives segment through higher capacity utilisation. CUMI is also expanding its capacity in the abrasives division. In electro minerals, the company is focused on increasing the share of specialty products to ~30%. 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 bode well for its long-term growth. Moreover, all segments are witnessing healthy profitability. The stock trades at ~33x its FY2025E EPS and rich valuations are justified, given a strong earnings growth outlook, a healthy balance sheet, and improving return ratios. Therefore, we retain our Buy rating 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)	64.7	55.4	42.1	33.0
P/B (x)	9.1	7.6	6.6	5.6
EV/EBIDTA (x)	36.9	29.2	24.2	19.4
RoCE (%)	18.9	18.2	20.3	22.9
RoE (%)	14.8	15.0	16.9	18.4

Source: Company; Sharekhan estimates

Annual Report Excerpts

Abrasives segment performed well due to overseas acquisitions

Abrasives revenue grew by 59% owing to incremental sales by recent acquisitions – RHODIUS Abrasives GmbH (RAG) and CUMI AWUKO Abrasives GmbH (CAAG). This was also supported by Volzhsky Abrasives Works (VAW) in Russia and CUMI America Inc. The business's profitability was impacted by increased input costs and costs involved in integrating the newly acquired subsidiaries. While the uptick in demand from the auto sector and price increases led to healthy volumes, competition from cheap imports and rising prices of raw materials impacted the efficiency, the adverse effects of which were minimised by several cost-control initiatives such as packaging cost improvements, process efficiencies, and several digital techniques to keep costs under control. Volume growth can also be attributed to the expanding distribution network of the business and enhanced digital marketing initiatives. On a consolidated level, the performance of subsidiaries in China and the Middle East was subdued as the company minimised its operations in these regions due to continuing business challenges associated with these geographies. The company's associate – Wendt (India) Limited grew by 17% due to enhanced export sales and increased sales to the auto and auto component sectors. Overall, a better product mix, operational efficiency measures, and cost control led to a significant 48% y-o-y increase in profitability.

Cost inflation and competition impacted the abrasives industry

The Indian market has been witnessing a shift from manual grinding methods to mechanised processes, thereby creating the need for new products in the coated abrasives segment. The bonded abrasives segment constitutes a key consumable in the construction and transportation industries, which is growing due to rapid urbanisation and increased disposable income. The global abrasives market especially Europe and U.S. was heavily impacted in Q1/Q2 of FY2023 due to heavy cost inflation, followed by Russia-Ukraine war. Moreover, entry of several paint manufacturers in the abrasives segment relying on cheap imported products from China impacted CUMI and other India-based manufacturers.

Electrominerals grew reasonably well, led by turnaround in the overseas subsidiary

The electrominerals business registered 25%/13% revenue growth on standalone/consolidated basis. VAW registered double-digit growth by increasing its domestic market share, while Foskor Zirconia Pty Limited, South Africa (FZL) has seen a year of a turnaround in operations owing to higher product demand and better efficiencies through a revamped distribution strategy. A balance sheet restructuring programme also helped improve its net worth position.

Strong domestic demand, while restrictions on Russian material posed challenges

The business has seen an unprecedented demand for its minerals due to the revival of auto, construction, and steel sectors. The government's focus in infrastructure spending and continued growth of the steel industry have pushed demand for abrasives and refractory products in the domestic market. Some of the European customers insisted on the supply of non-Russian originated materials, which posed a challenge. Hence, despite decent demand for diesel particulate filters (DPF) and semi-conductors, the company could not cater to them due to restrictions imposed on the usage of feed material available from the Russian subsidiary.

Ceramics growth was largely driven by demand from power and mining industry

The ceramics business comprising industrial ceramics, refractories, and composites delivered good growth at the consolidated level (29%) and standalone level (26%). Demand growth in key user industries, technological advancements in vital sectors, and overall sustainability push across domestic and international industries drove strong growth. The company is continuously upgrading its technological capabilities in the segment. CUMI (Australia) Pty Ltd. recorded its highest-ever growth during last year, backed by increasing demand for mineral processing, resulting in large volumes and better results. CUMI America Inc., the U.S. subsidiary, also contributed significantly to volume growth and profitability. Ceramics is largely an export-driven business and CUMI is one of the major players in India, U.S., Australia, and Europe, along with a presence in specific product groups in Japan and China. Demand outlook for key domestic core industries remained strong for ceramics and refractories. Demand for technical ceramics, driven by technology transformations in the auto industry is likely to drive growth for the ceramics segment.

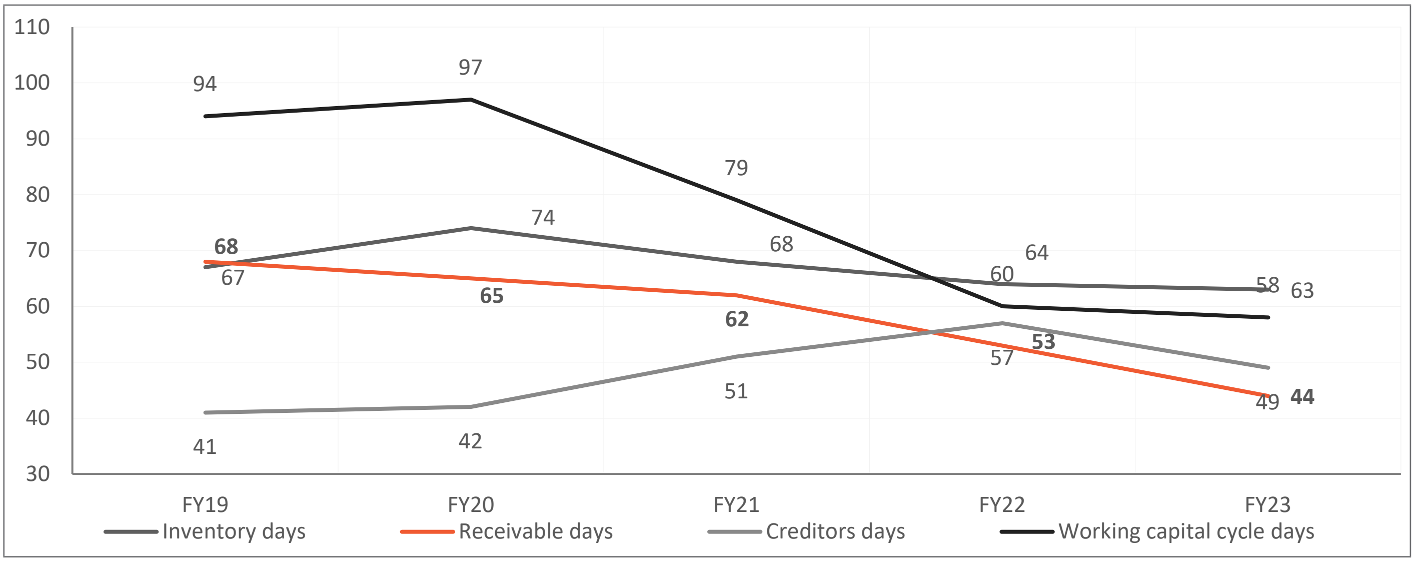
Industry overview of ceramics

Strong recovery in the mining and mineral processing industry, especially in Australia, was seen in FY2023, resulting in significant demand for wear protection materials and services. The outlook for core segments like steel, cement, and power plants remained strong throughout the year. Further, solid oxide fuel cells and hydrogen market remained buoyant during the year due to increased focus on sustainability and policy-driven push by countries like U.S., Korea, and India for green hydrogen. This has resulted in the engineered ceramics vertical doing very well during the year. Moreover, the mobility industry – both electric and ICE based remained strong during the year.

Short working capital cycle

Prudent working capital management with significant reduction in debtor days led by strong demand environment has helped the company improve its working capital cycle over the years from 94 days in FY2019 to 58 days in FY2023.

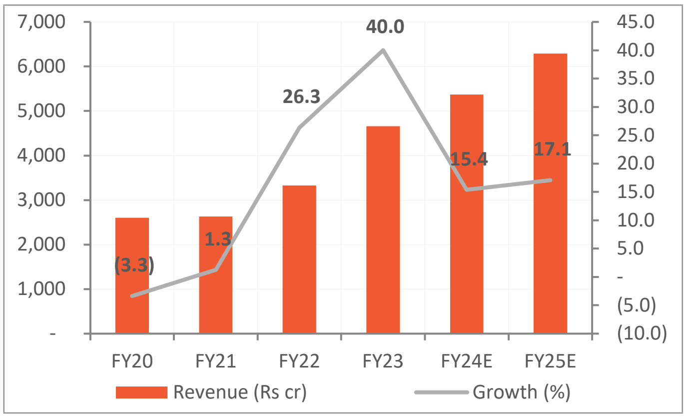
WCC has improved over the years



Source: CUMI Annual Report 2023, Sharekhan Research

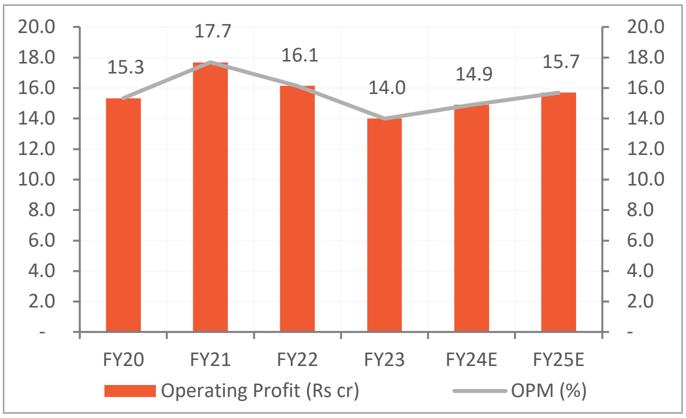
Financials in charts

Revenue growth trend



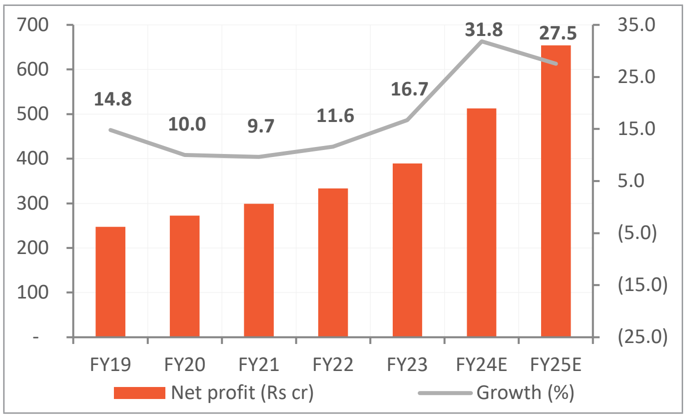
Source: Company, Sharekhan Research

Operating profit and margin trend



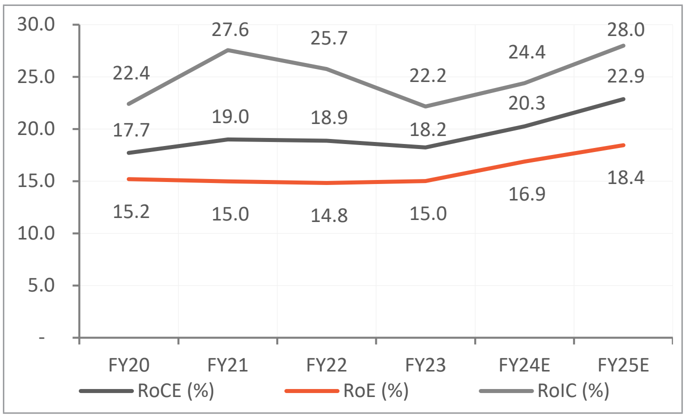
Source: Company, Sharekhan Research

Net profit growth trend



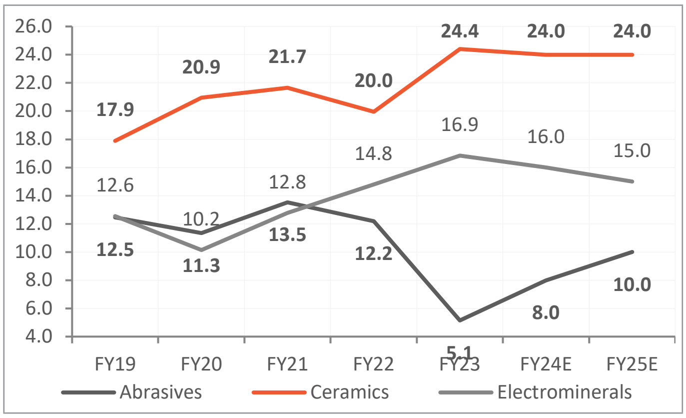
Source: Company, Sharekhan Research

Return ratios trend



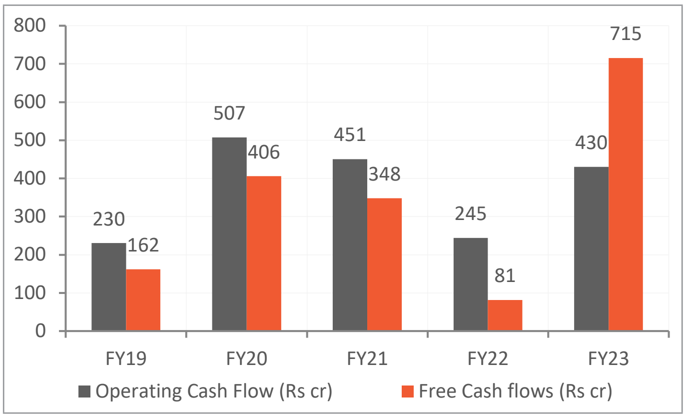
Source: Company, Sharekhan Research

Segment-wise PBIT margin (%)



Source: Company, Sharekhan Research

Cash flow trend



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.

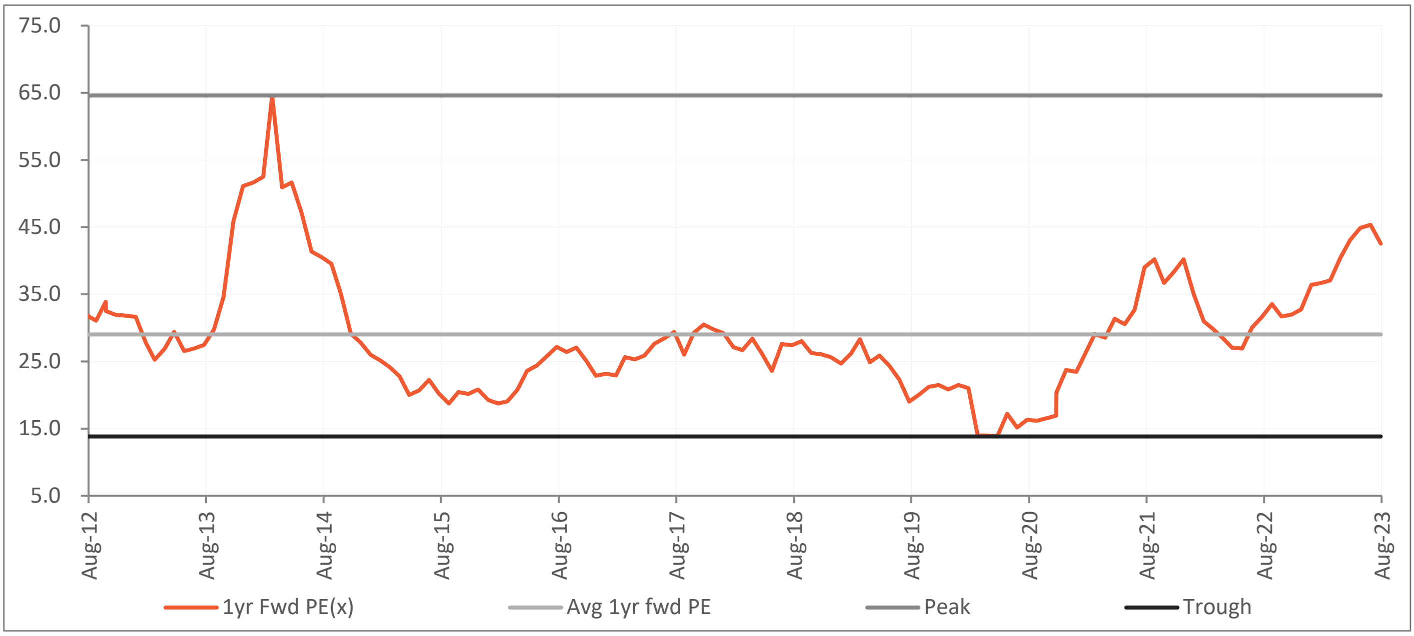
Company Outlook – Promising times ahead

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 an unchanged PT of Rs. 1,315

CUMI has a 25% market share in the organised abrasives market and it aims to increase profitability of the abrasives segment through higher capacity utilisation. CUMI is also expanding its capacity in the abrasives division. In electro minerals, the company is focused on increasing the share of specialty products to ~30%. 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 bode well for its long-term growth. Moreover, all segments are witnessing healthy profitability. The stock trades at ~33x its FY2025E EPS and rich valuations are justified, given a strong earnings growth outlook, a healthy balance sheet, and improving return ratios. Therefore, we retain our Buy rating 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 U.K., 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-FY2023 and is expected to post a healthy ~30% earnings CAGR (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 a 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 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 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
Sridharan Rangarajan	Managing Director
P. Padmanabhan	Chief Financial 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 (Old data)

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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