Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Carborundum Universal Ltd

Muted Q2, Promising long-term outlook

Capital Goods	Sharekhan code: CARBORUNIV
Reco/View: Buy ↔	CMP: **Rs. 1,107**
	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

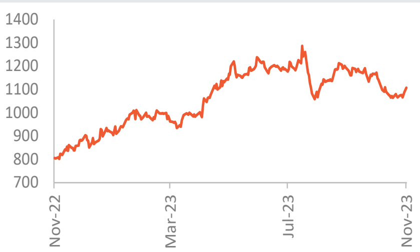
Company details

Market cap:	Rs. 21,043 cr
52-week high/low:	Rs. 1,300/790
NSE volume: (No of shares)	2.0 lakh
BSE code:	513375
NSE code:	CARBORUNIV
Free float: (No of shares)	11.2 cr

Shareholding (%)

Promoters	41.3
FII	10.2
DII	29.7
Others	18.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.4	0.8	-5.7	36.7
Relative to Sensex	-4.6	-0.8	-13.1	29.7

Sharekhan Research, Bloomberg

Summary

- PAT missed estimates by 13% due to lower-than-expected growth in Ceramics segment and a decline in electrominerals segment.
- We expect growth momentum to sustain in abrasives business mainly due to a recovery in industrial sector, while Ceramics segment is expected to regaining growth momentum once Engineered Ceramics' customer inventory level normalised.
- Management expects consolidated revenue growth of 5% in FY24 and PBIT margin to improve y-o-y.
- Stock trades at ~29xFY26E EPS. We retain a Buy with an unchanged PT of Rs. 1,315, building in a Revenue/PAT ~11%/~24% CAGR over FY23-FY26E.

Q2 consolidated results lagged estimates particularly on sales fronts mainly due to weak sales in Ceramics and Electrominerals segment. Total revenues grew by ~2% y-o-y to Rs 1,146 crore. Operating profit grew by ~3% y-o-y to Rs. 168 crore as power and fuel cost declined. Consequently, OPM improved by 16 bps y-o-y to 14.6% (versus our estimates of 14.5%). PAT grew by 14.5% y-o-y to Rs 102 crore and was below our estimate mainly due to lower-than-expected revenue growth. Among segments, abrasives & ceramics registered y-o-y sales growth of ~6% & 4% respectively, while electrominerals segment registered a y-o-y decline of 8% as dumping by Chinese producers led to decline in product prices price of product in this segment. EBIT margin in electrominerals segment declined by 59bps y-o-y to 16.3% but improved considerably on a q-o-q basis, while ceramics and abrasives margin improved by 245bps and 149bps y-o-y to 27.8% and 7.3%, respectively.

Key positives

- Abrasives and ceramics reported improved profitability as PBIT grew by ~33%/~14%
- Power & Fuel cost declined by 4% y-o-y and 9% q-o-q

Key negatives

- Electrominerals segment revenue/EBIT declined by 8%/11% on y-o-y basis

Management Commentary

- In H1FY24, the company witnessed close to a double-digit growth in terms of the volume in Industrial Segment and Precision Segments. However, in Retail segment, the company witnessed challenges due to increases in supplies from China, and new entrants in the segment.
- In H1FY24, volume growth in alumina and refractories were in high teens on y-o-y basis. However, price of product dropped due to dumping by Chinese producers.
- Rhodius achieved net sales of €15.2 million compared to €14.2 million in Q2FY23. Rhodius' revenue is expected to be flattish due to softening of the demand, parts of Europe and competitive pricing in the market. Management expects price increase to offset lower order intake.
- AWUKO reported a loss of €0.86 million in Q2FY24 against the loss of €0.5 million in Q2FY23. Management expects losses of around €2.5 million in FY24, with breakeven eyed in FY25.
- CUMI incurred capex of Rs. 97 crore in H1FY24 and expects FY24 capex to be around ~Rs. 260-280 crore.

Revision in estimates - We have fine-tuned our FY2024-FY2025 earnings estimates. We have introduced our FY2026 earnings estimates in this report.

Our Call

Valuation - Retain Buy with an unchanged PT of Rs. 1,315: 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. Moreover, all segments are witnessing healthy profitability. The stock trades at ~29xFY26E 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	FY23	FY24E	FY25E	FY26E
Net sales (Rs cr)	4,654	4,894	5,725	6,413
OPM (%)	14.0	14.4	16.3	17.2
Net profit (Rs cr)	389	451	608	734
PATgrowth (%)	16.7	15.8	35.0	20.7
Adjusted EPS (Rs)	20.5	23.7	32.0	38.7
EPS growth (%)	16.7	15.8	35.0	20.7
PER (x)	54.0	47.3	35.0	29.0
P/B (x)	7.5	6.7	5.7	4.9
EV/EBIDTA (x)	28.4	26.5	20.2	16.8
RoCE (%)	18.2	17.7	21.7	22.7
RoE (%)	15.0	15.0	17.6	18.1
RoIC (%)	22.2	22.0	28.1	30.9

Source: Company; Sharekhan estimates

Investor update and conference call highlights

- **Guidance:** Management expects standalone growth to be in the range of 10% to 12% and consolidated could be in the range of 5% mainly due to exchange impact of Rouble. Standalone and consolidated PBIT margins should improve as compared to FY'23.
- **Capex Guidance:** The company incurred a capex of Rs 97 crore and plans to incur capex of around Rs. 260-280 crore for FY24.
- **Rhodius Update:** Rhodius achieved net sales of €15.2 million compared to €14.2 million in Q2FY23. RHODIUS revenue is expected to be flattish due to softening of the demand, parts of Europe and competitive pricing in the market. Management expects price increase to offset lower order intake.
- **AWUKO Update:** The company reported loss of €0.86 million in Q2FY24 against the loss of €0.5 million in Q2FY23. Management expects losses of around €2.5 million in FY24, with expectation of breakeven in FY25.
- **Abrasives business:** In H1FY24, the company witnessed close to a double-digit growth in terms of the volume in industrial segment and precision segments. However, in the retail segment, company witnessed challenges due to increases in supplies from China, and new entrants in the segment. The Standalone Abrasives segment in India grew by 4% y-o-y in H1FY24. The management is focused on improving margins through product mix optimisation, increasing sales in value-added products and improving internal efficiencies.
- **Electrominerals:** In H1FY24, volume growth in alumina and refractories were in high teens on y-o-y basis. However, price of product dropped due to dumping by Chinese producers. The management expects that margins could be under pressure in this segment in short-term.
- **Ceramics:** Refractories, Wear Ceramics and Metallised Cylinder business registered the growth in high teens in H1FY24. Delay in offtake in Engineered Ceramic business resulted in a growth of ~11% in H1FY24. Subsidiaries in Australia and America also registered a significant growth in H1FY24.

Results (Consolidated) — Rs cr

Particulars	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Net Sales	1,146	1,128	1.6	1,203	-4.7
Total RM cost	405	400	1.2	468	-13.6
Employees cost	179	170	4.9	180	-0.7
Power and Fuel cost	120	125	-3.9	131	-8.6
Other Expenses	276	269	2.2	254	8.3
Operating profit	**168**	**163**	**2.8**	**169**	**-1.1**
Other Income	20	8	144.3	31	-36.5
Interest	5	5	-3.6	5	-5.6
Depreciation	46	45	3.1	46	0.3
PBT	**136**	**122**	**12.3**	**149**	**-8.7**
Tax	44	37	16.9	42	4.7
Reported PAT	104	94	10.9	86	20.8
Adjusted PAT	**102**	**89**	**14.5**	**113**	**-10.0**
Adj. EPS (Rs.)	**5.4**	**4.7**	**14.5**	**6.0**	**-10.0**
Margin (%)			**BPS**		**BPS**
GPM					
OPM	64.7	64.5	17	61.1	361
NPM	14.6	14.5	16	14.1	53
Tax rate	9.1	8.0	110	9.5	(44)

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – 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 a pick-up in domestic industrial activities, abrasives are the early beneficiaries due to their diversified user industries.

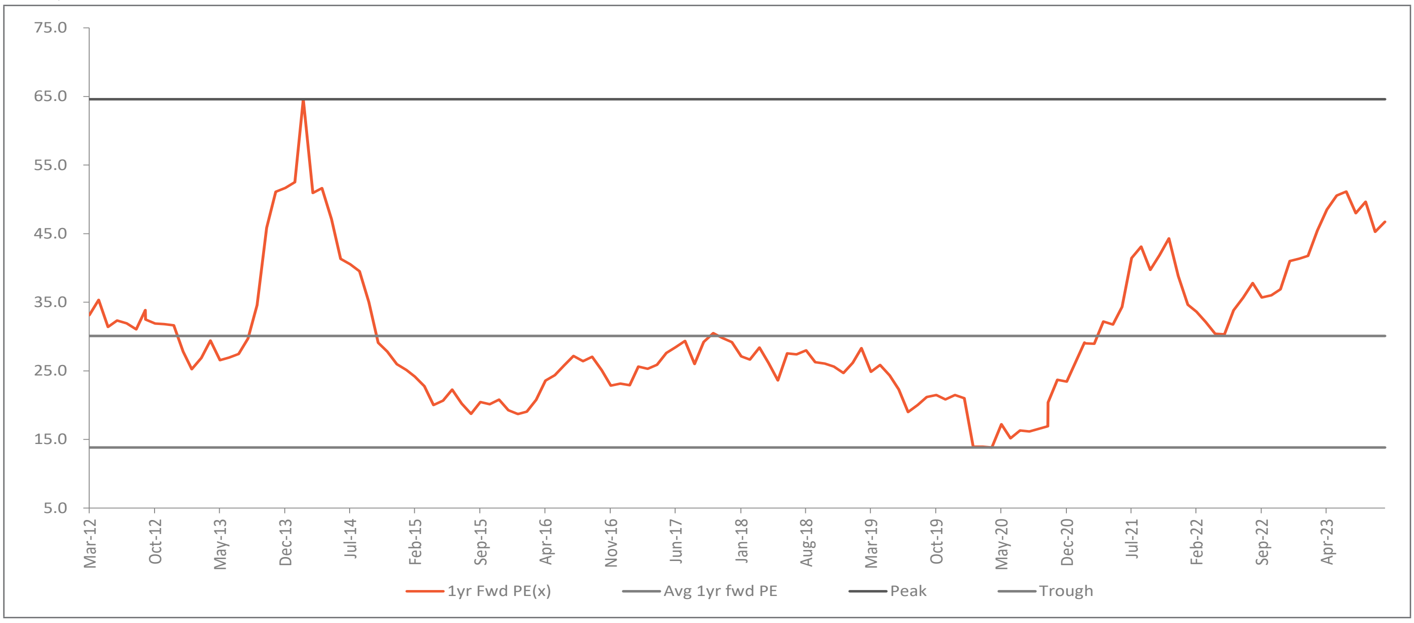
■ Company Outlook – Promising times ahead

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

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. Moreover, all segments are witnessing healthy profitability. The stock trades at ~29xFY26E 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 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 ~32% earnings CAGR from FY2015-FY2023 and is expected to post a healthy ~24% earnings CAGR over FY2023-FY2026E, 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 ~11% (FY2023-FY2026E), 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 Ltd	9.6
2	Kotak Mahindra Asset Management Co	4.4
3	Nippon Life India Asset Management	2.9
4	Vanguard Group Inc/The	2.3
5	HDFC Asset Management Co Ltd	2.1
6	Axis Asset Management Co Ltd/India	1.7
7	L&T Mutual Fund Trustee Ltd/India	1.7
8	FundRock Management Co SA	1.3
9	Massachusetts Institute of Technol	1.0
10	Franklin Resources Inc	1.0

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

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by BNP PARIBAS

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