MIRAE ASSET Sharekhan

Carborundum Universal Ltd

Vanishing blues bring an upgrade

Capital Goods	Sharekhan code: CARBORUNIV
Reco/View: **Buy** ↑	CMP: **Rs. 975** | Price Target: **Rs. 1,100** ↓

↑ 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		↔	

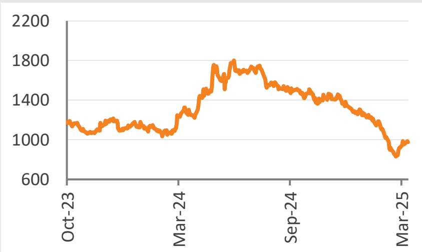
Company details

Market cap:	Rs. 18,554 cr
52-week high/low:	Rs. 1,835 / 810
NSE volume: (No of shares)	1.06 lakh
BSE code:	513375
NSE code:	CARBORUNIV
Free float: (No of shares)	11.1 cr

Shareholding (%)

Promoters	39.8
FII	13.0
DII	28.2
Others	19.0

Price chart



Source: NSE India, Mirae Asset Sharekhan Research

Price performance

(%)	1m	3m	6m	12m
Absolute	-3.8	-26.4	-34.9	-10.4
Relative to Sensex	-3.2	-19.9	-25.9	-14.1

Source: Mirae Asset Sharekhan Research, Bloomberg

Summary

- Fear of sanctions on Russian arm VAW has eased with much clarity leading to no material impact on the company's fundamentals.
- VAW's major business is focussed on Russia and 40% is from exports of which US contributes around 12% of the total revenues which would lead to 2% to overall bottomline estimates.
- Management has revised downwards the guidance to 5-6% versus 9-11% earlier. Moreover, margins to decline by 100-120 bps from the earlier guidance.
- We upgrade the stock to Buy with a revised PT of Rs. 1,100 (31x to FY2027EPS), factoring in a very minimal impact of VAW sanctions. The stock has meaningfully corrected by 34% and provides a value buying opportunity.

Clarifying the news, Carborundum Universal's management confirmed that VAW's sanctions are minimal and to the tune of 2% of overall profitability. The VAW's export now cease to exist and focus would be purely on domestic sales. Material sanctions have been levied on M/s. Volzhsky Abrasive Works (VAW), Russia, a step-down subsidiary of the CUMI leading to following implications 1. All property and interests in property within the US or under US persons' control are blocked, and 2. Most transactions involving US Dollar or US persons are prohibited unless specifically authorized by OFAC through a license or otherwise exempt. CUMI's growth trajectory remains robust, fueled by its new ventures and a strong emphasis on R&D to innovate specialty products and materials. We anticipate that these efforts will reshape CUMI's business framework within the next 3-5 years, unlocking a broader market potential and accelerating growth.

- **VAW's sanction fear diluted:** About 60% of VAW's business is domestically focussed and balance 40% is export oriented of which 12% is US-denominated transactions and 25% in Euro. The exports now would cease to exist, and the core focus shall only be domestic market. Considering the sanctions management has recorded provision expense of Rs 104 crores towards receivables in US Dollars and Euro including deposits in dollars. As per the management the total impact of sanctions shall not be more than 2% of consolidated bottomline. The impact of sanctions has been factored in by management by revising down the annual revenue and margins guidance.
- **The semicon story:** Semiconductors are the key focus area for CUMI starting from SiC powder manufacturing and targets to undertake wafer manufacturing. The forward integration would increase the TAM by 4x the current TAM. CUMI growth story would now be purely dependent on newer initiatives and focus on R&D technology products such as (1) High purity SIC (2) Ceramics for electronics, semiconductors and A&D, (3) Solid Oxide Fuel Cells, (4) Graphene and other value-added products.
- **Q3 results:** Revenues grew by 9.0% y-o-y to Rs 1255 crore backed by strong growth in Ceramics (29%) and Electrominerals (13%). Abrasives remain flat. Margins contracted by 262 bps as an impact of weak performance in abrasives and ceramics one off expense. Upon VAM'S sanction implications management has revised down its revenue and margins guidance.

Revision in estimates – We meaningfully revisited our estimates factoring in the implications of sanction on the Russia business.

Our Call

Valuation – Upgrade to Buy with a revised PT of Rs. 1,100: With the fear of VAW's sanctions diluting we expect growth momentum to continue, 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. The recent correction of 35% provides an attractive valuation of 28x to FY27 forward earnings. Hence, we upgrade the stock to a Buy rating with a revised price target (PT) of Rs. 1100 based on 31x its FY2027 EPS.

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	FY24	FY25E	FY26E	FY27E
Net Sales	4,702	4,951	5,321	6,050
Operating Profit Margin (%)	15.7	14.9	15.3	17.3
PAT	461	397	505	664
Growth (%)	18.6	(13.9)	27.1	31.5
EPS (Rs.)	24.3	20.9	26.6	35.0
P/E (x)	40.1	46.6	36.7	27.9
EV/EBITDA (x)	22.0	21.8	19.4	15.0
RoCE (%)	18.7	16.8	16.6	19.5
RoE (%)	15.5	12.1	13.8	16.0

Source: Company; Mirae Asset Sharekhan estimates

Outlook and Valuation

■ Sector View – Demand outlook encouraging, healthy growth prospects

India's AtmaNirbhar Bharat initiative and the government's efforts to revive industrial activities are likely to boost growth prospects. Further, the abrasives business caters to several industries such as steel, automobiles, auto components, and general metal fabrication. Thus, a diversified user industry keeps the momentum going. 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.

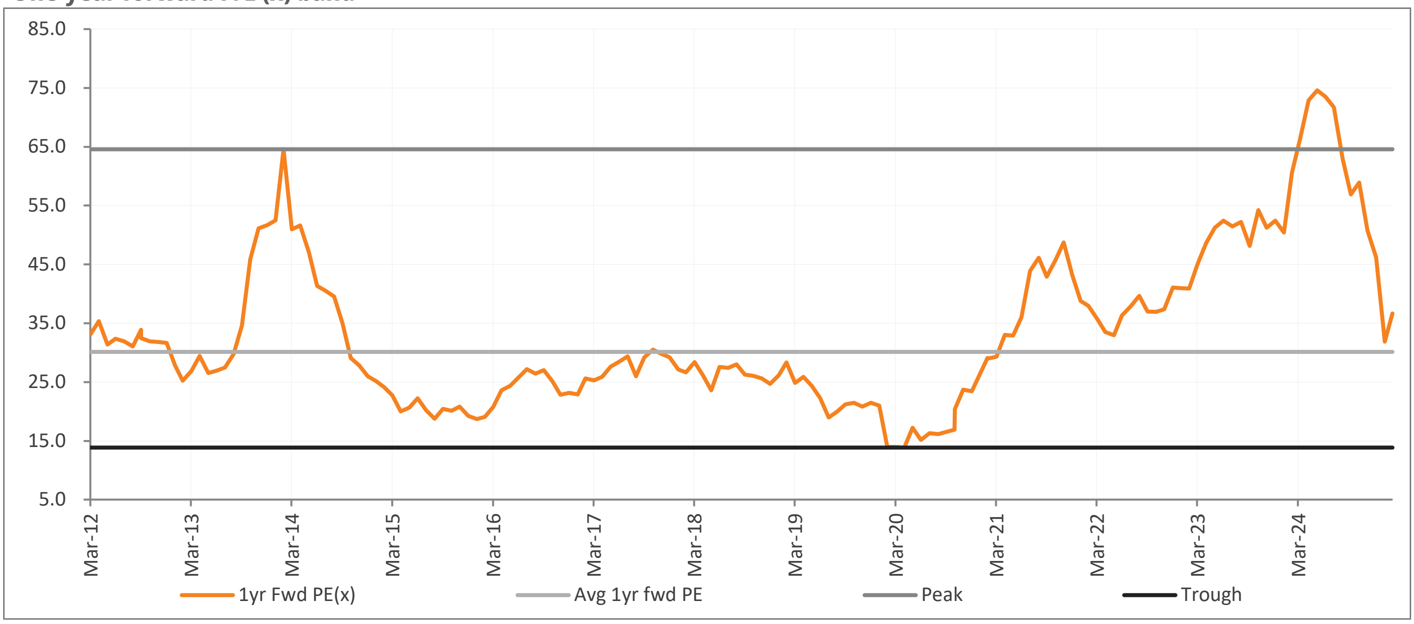
■ Company Outlook – Long runway for growth

CUMI is expected to benefit from an early economic cycle recovery in the domestic market and improved 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 issues, 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 – Upgrade to Buy a revised PT of Rs. 1,100

With the fear of VAW's sanctions diluting we expect growth momentum to continue, 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. The recent correction of 35% provides an attractive valuation of 28x to FY27 forward earnings. Hence, we upgrade the stock to a Buy rating with a revised price target (PT) of Rs. 1100 based on 31x its FY2027 EPS.

One-year forward P/E (x) band



Source: Company; Mirae Asset 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-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 a 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

Name	Designation
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	9.58
2	Nippon Life India Asset Management	4.06
3	FundRock Management Co SA	3.98
4	Kotak Mahindra Asset Management Co	2.53
5	Vanguard Group Inc/The	2.31
6	MURUGAPPA EDUCL & MED FDTN	2.00
7	HDFC Asset Management Co Ltd	1.89
8	Axis Asset Management Co Ltd/India	1.52
9	Southern Energy Development Corp L	1.29
10	ICICI Prudential Asset Management	1.26

Source: Bloomberg

Understanding the Mirae Asset 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: Mirae Asset Sharekhan Research

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