Company Update

Carborundum Universal Ltd

Bloomberg Code : CU IN

India Research - Stock Broking

SELL

CUMI Q4 Results In-line with Estimates

Carborundum Universal (CUMI) Q4 and FY19 earnings were in-line with our estimates. Q4 earnings dropped by 6% YoY to Rs. 3.27 due to lower demand which was unusual for a year end quarter (low than Q3 volumes), however, CUMI managed to deliver full year earnings growth of 15% YoY to Rs. 13.1 due to better volume growth and product mix in the first 9M which negated cost pressures.

In terms of segments, Electrominerals (EMD-14%), Ceramics (12%) and Abrasives (3%) witnessed revenue growth in Q4. EBIT Margins improved for EMD segment by 173 bps in Q4 to 13.5% while the same dropped by 111 bps for Ceramics (14.5% Margin) and 249 bps for Abrasives (11.5% Margin) during Q4. Management revised down its revenue guidance for FY20E to Rs. 30 Bn and EBIT margin guidance similar to FY19 level or marginally better.

We revise down our earnings estimate for FY20 and FY21 by 5.8%/5.5% due to expected strain in volumes for standard products, resistance to price hikes and rising input prices. Hence, we revise our rating from **'HOLD'** to **'SELL'** by valuing CUMI at 22x of FY20E EPS for a target price of Rs. 343 which is close to 10 year average earnings multiple. Volume de-growth could be a significant risk to our earnings estimates.

Growth to come under strain: CUMI witnessed demand slackness in Q4 which could spill over to H1FY20 and price hikes to pass on input cost pressures could further strain volume in abrasives segment. We expect revenue CAGR growth of 13% for abrasives segment, ceramics segment to grow by 12.4% CAGR backed by new capacities, etc. and EMD could grow at 11.4% CAGR for next two years due to product mix.

Valuation and Risks

In the next two years, CUMI is expected to deliver revenue CAGR of 13.5% and earnings growth of 17.8%. Nevertheless, outlook on volumes for abrasives (down trading), ceramics (product mix), input cost push in EMD (grains, power, etc.) all warrant caution. We believe in the near-term, lack of traction for new capacities and product lines limits growth and margin expansion in FY20E. Hence, we revise our rating from **'HOLD'** to **'SELL'** by valuing CUMI at 22x FY20E EPS of Rs.15.6 for a target of Rs. 343.

Exhibit 1: Valuation Summary

YE Mar (Rs. Mn)	FY17	FY18	FY19	FY20E	FY21E
Net Sales	21125	23678	26889	30546	34639
EBITDA	3346	3986	4383	5323	6152
EBITDA Margin (%)	15.8	16.8	16.3	17.4	17.8
Net Profit	1838	2196	2476	2949	3439
EPS (Rs.)	9.3	11.4	13.1	15.6	18.2
RoE (%)	14.3	14.9	15.1	16.2	16.7
PE (x)*	31.3	30.4	31.3	23.0	19.7

*Source: Company, Karvy Research; *Represents multiples for FY17 - FY19 are based on historic market price*

Recommendation (Rs.)

CMP *(as on May 02, 2019)*	358
Target Price	343
Previous Target Price	400
Downside (%)	4

Stock Information

Mkt Cap (Rs.bn/US$ bn)	66.9 / 1.0
52-wk High/Low (Rs.)	419 / 314
3M Avg. daily value (Rs. mn)	50.5
Beta (x)	1.0
Sensex/Nifty	38981/11725
O/S Shares(mn)	189.1
Face Value (Rs.)	1.0

Shareholding Pattern (%)

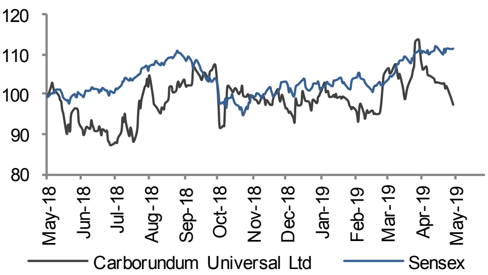
Promoters	42.4
FIIs	5.1
DIIs	23.8
Others	28.7

Stock Performance (%)

	1M	3M	6M	12M
Absolute	(13)	1	(2)	(4)
Relative to Sensex	(13)	(6)	(14)	(14)

Source: Bloomberg

Relative Performance*



*Source: Bloomberg; *Index 100*

Earnings Revision (%)

YE Mar	FY20E	FY21E
Sales (%)	↓ (3.5)	↓ (2.8)
EBITDA (%)	↓ (8.7)	↓ (6.2)
PAT (%)	↓ (10.6)	↓ (8.5)

Source: Karvy Research

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Key takeaways from quarterly earnings

Growth guidance: Full year revenue guidance revised downwards to Rs. 30 Bn and EBIT margin similar to FY19 levels or better. Growth in segments could come in between 15%-20% depending on volume pull in the market.

Abrasives segment: Full year growth largely came on the back of volumes and mix. Q4 volumes were impacted due to demand slackness, de-stocking due to GST adjustments and channel inventory. Bonded products witnessed strong growth in 9MFY19 and new products were launched in coated segment. Coated capacity is being doubled at a cost of Rs. 600 Mn – 700 Mn which will be operational by Oct'19 and will be the largest coated capacity in the world at a single site. DSO days are less than 30 days now and will be maintained at current levels to main stability in prices. Management is cautious on down trading in this segment.

Opportunity in US-China tariff regime for abrasives: CUMI sales volumes in US were impacted due to pre-stocking, as the new tariff regime could significantly push up Chinese product prices. Management is also cautious on possible en-route of Chinese products into US via Vietnam. Otherwise, CUMI is positive on the medium-term opportunity.

Electrominerals segment: Alumina based product volumes were higher, fused volumes were moderate while zirconium volumes were lower in India and international markets. The fine part of business volumes were also down for the past two quarters as the demand for diesel particulate filter dropped in line with fall in diesel car production. Demand for semiconductor application was stable, but for the first time company had lower off take of high crystalline high purity material.

At present, 80% of revenues are commoditised and remaining 20% comes from specialty products. CUMI is working towards a long-term plan to migrate to 60% commodity and 40% specialty revenue profile. New materials like Z450 and Graphene are the steps in this direction which involves customers in co-creating products of the future and this will insulate the segment from margin volatility. Z450 has witnessed reasonable traction from Japan and Germany.

Audit Opinion on Foskor Zirconia, South Africa: Management clarified that it's a joint venture with state owned entity and all decisions are driven by FZL board. At present the plant is running at levels below its fixed cost levels and has incurred a loss of Rs. 247 Mn and Rs. 126 Mn was consolidated as share of JVs and associates into CUMI. CUMI has already written-off this investment and auditors are of the view that there is no financial impact.

Ceramics segment: Ceramics generate 60% of revenues and 40% of revenues come from refractories. The growth in the segment is driven by improvement in overall mining activity; CUMI Australia witnessed 14% growth. This segment was impacted by high alumina prices and fuel prices; however, due to B2B nature of sales and co-creation of products facilitates pass-on of costs in a pre-defined manner. The NKT capacity for Metalized cylinder facility shifted from Japan had been commissioned and overall annual capacity is at 1.5 Mn cylinders and current monthly run rate stands at 1-1.2 lakh cylinders.

Exhibit 2: Earnings in line with estimates

YE Mar - Consolidated (Rs. Mn)	Q4FY19	Q3FY19	QoQ (%)	Q4FY18	YoY (%)	FY19	FY18	YoY (%)
Turnover (Net)	7021	6929	1.3	6495	8.1	26889	23678	13.6
Op Expenditure	5828	5897	(1.2)	5337	9.2	22506	19691	14.3
EBITDA	1193	1032	15.6	1158	3.0	4383	3986	9.9
Depreciation	259	270	(3.9)	276	(6.2)	1083	1060	2.2
EBIT	934	762	22.5	882	5.9	3300	2927	12.8
Interest	26	19	41.2	24	12.3	85	86	(1.5)
Other Income	15	66	(78.2)	46	(68.1)	273	229	19.1
PBT	922	810	13.8	904	2.0	3488	3070	13.6
Tax (Net)	338	269	25.7	314	7.9	1212	1020	18.8
PAT (before share in JVs)	583	541	7.9	590	(1.2)	2277	2049	11.1
Share of JVs & Associates	27	45	(41.1)	39	(31.4)	199	147	36.0
PAT (after non controlling interest and share in profit/(loss) of JVs)	610	586	4.1	629	(3.0)	2476	2196	12.8
EBITDA Margin (%)	17.0	14.9	210 bps	17.8	(84) bps	16.3	16.8	(54) bps
EBIT Margin (%)	13.3	11.0	230 bps	13.6	(28) bps	12.3	12.4	(9) bps
PAT Margin (%)	8.7	8.5	23 bps	9.7	(100) bps	9.2	9.3	(7) bps

Source: Company, Karvy Research

Exhibit 3: Segmental Financials

YE Mar - Consolidated (Rs. Mn)	Q4FY19	Q3FY19	QoQ (%)	Q4FY18	YoY (%)	FY19	FY18	YoY (%)
Segment-wise revenues								
Abrasives	2797	2995	(6.6)	2714	3.1	11244	10364	8.5
Ceramics	1664	1491	11.6	1493	11.5	6044	5068	19.3
Electrominerals	2702	2639	2.4	2366	14.2	10185	8887	14.6
Segment-wise EBIT								
Abrasives	320	385	(16.8)	379	(15.4)	1402	1325	5.8
Ceramics	242	278	(12.8)	234	3.6	1082	759	42.6
Electrominerals	366	279	31.3	279	30.9	1279	1270	0.8
Segment-wise EBIT Margin (%)								
Abrasives	11.5	12.9	(140) bps	13.9	(249) bps	12.5	12.8	(32) bps
Ceramics	14.5	18.6	(407) bps	15.6	(111) bps	17.9	15.0	293 bps
Electrominerals	13.5	10.6	297 bps	11.8	173 bps	12.6	14.3	(173) bps

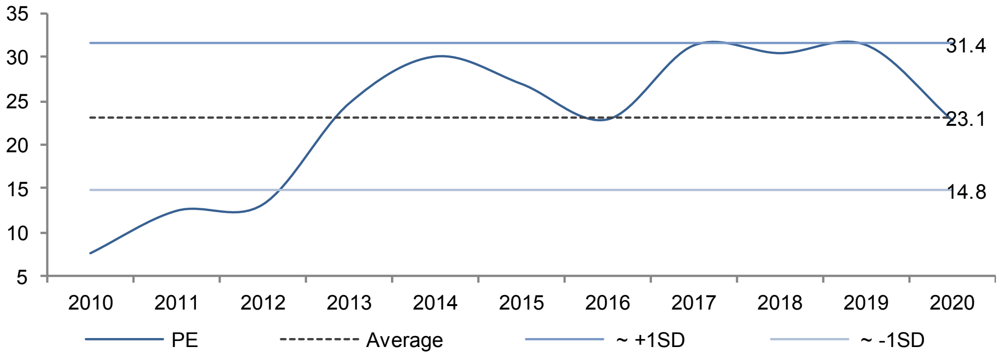
Source: Company, Karvy Research

Exhibit 4: Change in Earnings Estimates

YE Mar - Consolidated (Rs. Mn)	FY20E			FY21E			Comments
	Old	New	% Change	Old	New	% Change	
Net Sales	30546	31665	(3.5)	34639	35624	(2.8)	We expect growth for next two years in abrasives segment to be at 13%, ceramics segment to grow at 12.4% and EMD to grow at 11.4%.
EBITDA	5323	5830	(8.7)	6152	6560	(6.2)	We have kept the operating costs at moderate level, any surprises could lead to deterioration in the overall margins.
EBITDA Margin (%)	17.4	18.4	(99) bps	17.8	18.4	(65) bps	
Adj. PAT	2949	3297	(10.6)	3439	3759	(8.5)	
EPS (Rs.)	15.6	17.4	(10.6)	18.2	17.4	4.2	

Source: Karvy Research

Exhibit 5: Carborundum Universal - 10 yr PE Valuation



Source: Bloomberg, Karvy Research

Financials

Exhibit 6: Income Statement

YE Mar (Rs. Mn)	FY17	FY18	FY19	FY20E	FY21E
Revenues	21125	23678	26889	30546	34639
Growth (%)	8.7	12.1	13.6	13.6	13.4
Operating Expenses	17779	19691	22506	25223	28487
EBITDA	3346	3986	4383	5323	6152
Growth (%)	11.0	19.1	9.9	21.4	15.6
Depreciation & Amortization	965	1060	1083	1143	1213
EBIT	2381	2927	3300	4180	4939
Other Income	228	229	273	290	312
Interest Expenses	181	86	85	68	41
PBT (incl share of profits)	2619	3216	3688	4402	5210
Tax	781	1020	1212	1453	1771
Adjusted PAT	1838	2196	2476	2949	3439
Growth (%)	18.2	19.5	12.8	19.1	16.6

Source: Company, Karvy Research

Exhibit 7: Balance Sheet

YE Mar (Rs. Mn)	FY17	FY18	FY19	FY20E	FY21E
Cash & Cash equivalents	1248	1276	959	1349	1908
Sundry Debtors	3806	4751	5139	6193	7213
Inventory	3867	4380	5329	5435	6238
Loans & Advances	1015	818	893	893	893
Investments	1422	1991	2485	2485	2485
Net Block	5900	6205	5727	5574	5461
CWIP	726	303	464	464	464
Miscellaneous	1238	1261	1324	1324	1324
Total Assets	**19222**	**20985**	**22320**	**23717**	**25985**
Current Liabilities & Provisions	2112	2428	2539	2423	2422
Debt	2162	1916	1662	1168	705
Other Liabilities	1120	997	879	879	879
Total Liabilities	**5394**	**5341**	**5079**	**4470**	**4005**
Shareholders Equity	189	189	189	189	189
Reserves & Surplus	13639	15455	17052	19058	21791
Total Networth	**13828**	**15644**	**17241**	**19247**	**21980**
Total Networth & Liabilities	**19222**	**20985**	**22320**	**23717**	**25985**

Source: Company, Karvy Research

Exhibit 8: Cash Flow Statement

YE Mar (Rs. Mn)	FY17	FY18	FY19	FY20E	FY21E
PBT	2619	3216	3688	4402	5210
Depreciation	965	1060	1083	1143	1213
Interest	181	86	85	68	41
Tax Paid	(781)	(1020)	(1212)	(1453)	(1771)
Inc/dec in Net WC	228	(907)	(1322)	(1276)	(1824)
Other non cash items	(98)	(84)	(273)	(290)	(312)
Cash flow from operating activities	**3114**	**2351**	**2048**	**2594**	**2557**
Inc/dec in capital expenditure	(1185)	(939)	(766)	(990)	(1100)
Inc/dec in investments	0	(0)	(410)	0	0
Others	372	191	273	290	312
Cash flow from investing activities	**(813)**	**(748)**	**(903)**	**(700)**	**(788)**
Inc/dec in borrowings	(1631)	(307)	(254)	(493)	(463)
Issuance of equity	28	33	0	0	0
Dividend paid	(189)	(330)	(625)	(943)	(705)
Interest paid	(181)	(86)	(85)	(68)	(41)
Cash flow from financing activities	**(1973)**	**(691)**	**(963)**	**(1505)**	**(1210)**
Net change in cash	328	911	183	389	559

Source: Company, Karvy Research

Exhibit 9: Key Ratios

YE Mar	FY17	FY18	FY19	FY20E	FY21E
EBITDA Margin (%)	15.8	16.8	16.3	17.4	17.8
EBIT Margin (%)	11.3	12.4	12.3	13.7	14.3
Net Profit Margin (%)	8.7	9.3	9.2	9.7	9.9
Dividend Payout Ratio (%)	18.9	19.7	21.0	18.6	17.1
Net Debt/Equity (x)	0.1	0.0	0.04	(0.01)	(0.05)
RoE (%)	14.3	14.9	15.1	16.2	16.7
RoCE (%)	10.5	11.9	12.2	14.2	15.1

Source: Company, Karvy Research

Exhibit 10: Valuation Parameters

YE Mar	FY17	FY18	FY19	FY20E	FY21E
EPS (Rs.)	9.3	11.4	13.1	15.6	18.2
DPS (Rs.)	1.8	2.3	2.8	2.9	3.1
BVPS (Rs.)	73.3	82.8	91.3	101.9	116.4
PE (x)*	31.3	30.4	31.3	23.0	19.7
P/BV (x)*	4.0	4.2	4.5	3.5	3.1
EV/EBITDA (x)*	16.7	16.6	17.8	12.7	10.8
EV/Sales (x)*	2.6	2.8	2.9	2.2	1.9

*Source: Company, Karvy Research; *Represents multiples for FY17 - FY19 are based on historic market price*

Stock Ratings		Absolute Returns
Buy	:	> 15%
Hold	:	5-15%
Sell	:	< 5%

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