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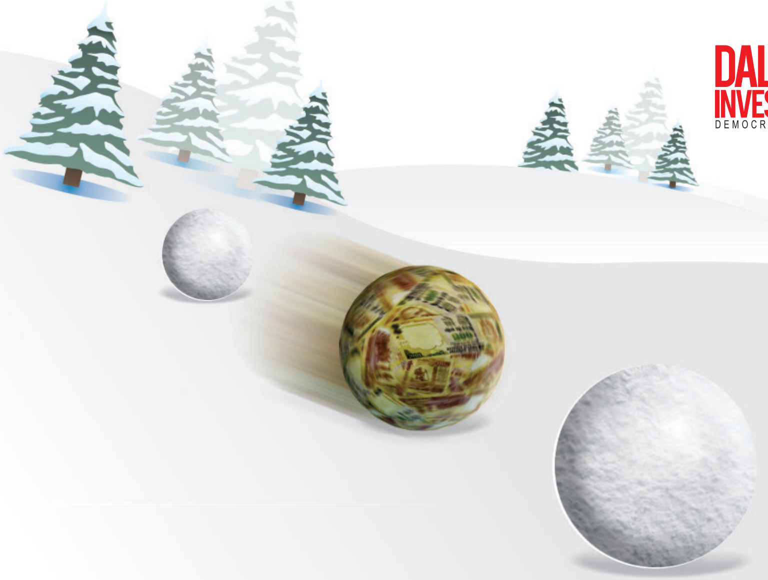
DALAL STREET INVESTMENT JOURNAL
DEMOCRATIZING WEALTH CREATION

MID BRIDGE
THE MIDCAP MARVEL

August 2020



COMPANY NAME	:	**CARBORUNDUM UNIVERSAL LTD.**
BSE Code	:	**513375**
Time Duration	:	**1 year**
CMP	:	**₹267.00 (as on 20 August, 2020)**
Target Price	:	**₹355**

The Mid Bridge recommendation for the month of August is Carborundum Universal (CUMI). It is a part of a collaboration between Murugappa Group, The Carborundum Co., USA, and Universal Grinding Wheel Co. Ltd (UK).

The company operates mainly in three business segments namely, abrasives, ceramics, and electro minerals. It caters to a wide range of industries with the help of its 20,000 plus product mix and state-of-the-art manufacturing facilities. The company is one of the five manufacturers in the world with fully-integrated operations that include mining, fusion, hydropower stations, manufacturing, marketing, and distribution.

Product driven growth

The company mainly deals with abrasives, ceramics, and electro minerals. These products have a very large scope in nearly every industry. Major applications that are found in these industries for abrasives are automobiles, woodworking, machinery, floor restoration, construction, and bearings. The company is one of the major manufacturers of coated abrasives, bonded abrasives, nonwoven, metalworking fluids, and power tools. Ceramic user industries are mainly cement, steel, fabrication, petroleum, etc.

The discrete demand from multiple industries was the key reason for its sustainability during the lockdown. For example, the minerals segment, which is 38 per cent of the total revenue, witnessed good demand from certain product groups such as the refractory industry and metal matrix composites. The segment contributed more to the top-line and the bottom-line thereby, showing a high resilience to the slowdown.

Industrial revival to help recover

The economic activity, which had come to a grinding halt, has picked up the pace again. Major sectors such as auto and infra are registering good growth prospects. In a bid to recover the losses and maintain its financial stability, it can be expected that the company opts for hike prices by 6 per cent to 8 per cent in abrasives and ceramics segments as well as in the electro mineral segment in a phased manner. With its vast spread across the industries, the incremental price would not have large scale impacts on sales volumes.

The new capacities ceramics segment can be expected to help the company attain double-digit growth. Its capacities are operational and running at above optimal capacity. According to management, electro minerals would grow on the back of higher volumes and it expects the prices to recover during this period and clock a growth of 21.5 per cent. It has also achieved capacity utilisations close to 75-80 per cent levels.

Prudent research and development

The company, over the past few years, had a larger focus on its R&D. As per FY20 data, it holds 250 IPs (patents, trademarks, and designs). One of the products, Z450 uses one-third of graphite and half the power required to produce the final output in the area of radioactive application. CUMI has a trial order of Rs 30 crore for Z450, which can turn profitable at Rs 50 crore on a quarterly run rate. Similarly, another new material that the company has developed is grapheme, which is supposed to be the strongest material and has multiple applications across industries. The company has already seen a cash outlay of Rs 15 crore for plants aimed just at trial processes. On the other hand, the overall Capex of almost Rs 300 crore has been incurred over the past three financial years.

Increased capacity and utilisation, key growth triggers

The company has focussed heavily on its product diversification and therefore, its capital expansion is expected to benefit in the near future. The major Capex that the company executed was for a coated abrasives segment, which contributes very high portion to the top line. This plant has been recently commissioned. It also depicts the major capex initiated for different products of

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the company are running at satisfactory capacities amid the current restrictions.

The rise in demand and riding on economic revival, Capex would help the company gain in the coming few quarters. The total Capex has the potential to be able to hit revenue between Rs 3,200 crore to Rs 3,400 crore on a consolidated basis, on a full-year basis.

Financial performance

On the financial front, for nearly the last three fiscal years; the company has registered 9 per cent CAGR in sales growth. The top-line growth can be considered as good as one of the major customer side, auto companies, have seen a sharp decline consistently. On the operating profit margin front, it has maintained between 15 per cent and 18 per cent over the past three years, which is largely due to the supportive rubber and metal prices. Its balance sheet remains healthy with no standalone debt. The company has been able to maintain return on equity (ROE) in the range of 15 per cent to 18 per cent. The ROE being stable shows that the company has been able to generate steady cash internally.

Looking at the current pandemic and lockdown, Q1FY21 numbers are also needed to be considered. The consolidated revenue for Q1FY21 came in at Rs 449.58 crore as against Rs 671.4 crore in the corresponding quarter last year, registering a 33 per cent YoY decline. This was driven by an abrasive segment, though, resisted by minerals. EBITDA was Rs 43.37 crore as against Rs 95.24 crore in the corresponding quarter last year, with a corresponding margin contraction of 454 bps. EBITDA margin for the quarter stood at 9.6 per cent. PAT for the quarter came in at Rs 19.25 crore as against Rs 51.4 crore in the corresponding quarter last year, with a YoY decline of 62.5 per cent.

Valuation and outlook

The stock is currently trading at a PE multiple of 20 times its FY20 earnings and two times of FY20 sales. These valuations are very attractive when compared to its closest peers, Grindwell Norton, PE multiple of 35x, and price to sales ratio of 4x. Further, the company does not have very intense competition from the unorganised sector, justifying its valuations. Hence, by virtue of recovering economic conditions and attractive valuations, we recommend you to BUY the scrip with a target price of Rs 355.

Inc/Exp Statement (Consolidated)

Description	202003	201903	201803	201703	201603
Net Sales	2598.97	2688.90	2367.76	2112.49	1943.98
Total Income	2645.25	2717.43	2390.68	2141.13	1973.68
Total Expenditure	2201.64	2251.83	1969.12	1783.75	1642.86
PBIDT	443.61	465.60	421.56	357.38	330.82
PAT	257.21	227.67	204.93	164.69	139.69
Dividend %	275.00	275.00	225.00	175.00	150.00
Adj. EPS(Rs)	14.38	13.09	11.41	9.27	7.65

Quarter On Quarter (Consolidated)

Particulars	202006	202003	Q on Q Var %	201906	Y on Y Var %
Net Sales	443.80	586.02	-24.27	663.58	-33.12
Total Expenditure	406.21	491.50	-17.35	576.16	-29.50
PBIDT (Excl OI)	43.37	102.47	-57.68	95.24	-54.46
PAT	18.39	93.29	-80.29	45.50	-59.58
PBIDTM% (Excl OI)	9.65	17.25	-44.06	14.19	-31.99
PBIDTM%	11.08	22.21	-50.11	14.92	-25.74
PATM%	4.09	15.71	-73.97	6.78	-39.68
Adj. EPS(Rs)	1.04	4.87	-78.64	2.79	-62.72

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