

25 September 2019

Grindwell Norton – BUY

CMP :Rs.610.0
Target Price :Rs.840.0
Upside : 38%+
Stop Loss :Rs.470.0 (Closing basis)

Investment Thesis

Recently, the stock price of Grindwell Norton Ltd. (Grindwell Norton) corrected by ~10% from 52-week high of Rs.672.00 as the company has reported lower margins due to higher employee cost in the last quarters.

Grindwell Norton is a leading player in the domestic abrasives market with ~25% revenue market share. It has reported a strong growth in financial performance where its revenue and profit has grown at a CAGR of 15.6% and 13.5%, respectively over the last 10 years. It is well diversified across segments catering mainly to abrasives (~62% of revenues) and ceramics & plastics (~30% of revenues). It manufactures a wide range of abrasives (bonded, coated and super abrasives) and ceramics & plastics (abrasive grains, refractories and performance plastics). Backed by the strong parentage of Saint Gobain, robust balance sheet and huge product portfolio, Grindwell Norton is poised to benefit from the industrial recovery, going ahead. We expect a double-digit growth for Grindwell Norton during FY19-21E led by growth in abrasives, ceramics and new initiatives like new and innovative products like road grids for defence & civil airports, shingles for house roof-tops and the IT infrastructure business.

With higher utilization and decline in input cost, Grindwell Norton's EBITDA has grown by 11% CAGR during FY15-19. As a result, the EBITDA margin has also increased by ~140bps to 17.2% in FY19. Going forward, we expect healthy margin trajectory to continue and Grindwell Norton will report EBITDA margins of ~18% in FY20-21E mostly due to softening commodity prices. Parent company, Saint Gobain, has revised royalty rates for the company. The same has increased steadily from 0.5% of sales to 2.5% of sales (royalty rates of 1% in FY14, 1.5% in FY15, 2% in FY16 and 2.5% in FY17 onwards). As guided by the management, the rates are unlikely to increase any further and help to maintain a healthy margin.

Financials

- During the past 5 years, revenue of Grindwell Norton grew at a CAGR of 11.4% while PAT grew at a CAGR of 14.8% in the same period.

Consol. (Rs. Mn)	FY17	FY18	FY19	FY20E	FY21E
Revenue	13,553	14,459	15,829	18,203	20,934
EBITDA	1,931	2,469	2,718	3,126	3,595
% growth	6.1	27.8	10.1	15.0	15.0
PAT	1,194	1,497	1,672	1,920	2,200
EPS (INR)	10.8	13.5	15.1	17.3	19.9
P/E (x)	56.0	44.7	40.0	34.8	30.4
RoE (%)	12.1%	15.0%	15.4%	16.1%	16.9%

- Grindwell Norton has reported 5.7% YoY growth to Rs.4,053mn in Q4FY19 on account of 5.2% and 11.9% YoY growth in abrasives and ceramics & plastics segment, respectively.

Stock Data

Market Cap (Rs. Mn)	66,653
Market Cap (\$ Mn)	940.4
Shares O/S (in Mn)	110.7
Avg. Volume (3 month)	17,000
52-Week Range (Rs.)	672/ 470

Shareholding Pattern

Promoters	58.33%
FII's	4.36%
Institutions	15.37%
Others (incl. body corporate)	21.94%

Performance (%)	1M	6M	1Yr
Absolute	6.8%	5.6%	24.5%
BSE 500	5.4%	-0.6%	1.6%

Key Ratios

Div Yield	1.0%
TTM PE	40.1x
ROE	15.4%
TTM EPS (Rs.)	15.1/-

- Grindwell Norton's EBITDA declined 6.8% YoY to Rs.677mn in Q4FY19 due to 23.6% YoY higher employee expenses and 22.3% YoY increase in power and fuel expenses. As a result, EBITDA margin declined by 223bps to 16.7% in Q4FY19.
- Grindwell Norton's abrasives, ceramics and 'new initiatives' segment contributed 61.9%, 29.7% and 8.4% in total revenue, respectively.

Key Business Highlights

- Grindwell Norton, a part of the Saint-Gobain Group (currently holds more than 51% of the equity capital), has majorly presence in two business segments, Abrasives and Ceramics & Plastics.
- Abrasives segment of Grindwell Norton markets and manufactures a full range of bonded abrasives, coated abrasives (including non-woven abrasives), thin wheels and superabrasives.
- Grindwell Norton's Ceramics & Plastics segment includes silicon carbide, used as raw material in the manufacture of Abrasives, High Performance Refractories, which are used for processing ferrous and non-ferrous metals and Performance Plastics.

Valuation

- Abrasives business of Grindwell Norton has four manufacturing sites located at Mora, (near Mumbai), Bengaluru, Nagpur and Bated (Himachal Pradesh). With past capacity expansions, Grindwell Norton is well placed to capture the growing demand due to pick-up in manufacturing and industrial activity. Post multiple disruptions in the market place, Abrasives segment of Grindwell Norton is set for gradual recovery in the next two years. Market share accretion by organized players remains a key swing factor for the sector. However down trading continues apart from absence of broad-based recovery in the economy. Going forward, we expect pickup in economic activity could lead volume growth for Abrasives segment.
- Ceramics and plastics division, which contributes to 25-30% in revenue, has reported strong growth in recent quarters due to strong offtake in the end user industries. The segment is expected to grow at 15-18% CAGR in the next two years on the back of strong growth in the high performance refractories, traction in the plastics segment where the company has introduced multiple products for industrial application covering sectors like auto, road, defence, etc. This apart, single use portfolio focused on hospitals and hygiene is also expected to maintain traction in the future. However, recovery in Silicon Carbide production may not pickup in the near future.
- For Grindwell Norton, exports have historically contributed 8-12% to the topline of the company. The same has grown at 13.2% CAGR in FY04-18. For FY18, it has reported 18.5% export growth to Rs.1,470mn and contributed ~10% of topline. Going forward, the management believes a healthy growth trajectory of 15-20% CAGR in FY19-21E.
- With leading player in the domestic abrasives market, strong parentage and huge product portfolio, no further increase in royalty rate, pickup in economic activity to lead volume growth and expected strong growth in high performance refractories and plastics segment, we value Grindwell Norton at 42.2x FY21E EPS of Rs.19.90 to arrive at target price of Rs.840.00, an upside of ~38%.

Risk & Concern

- Growth of Grindwell Norton is highly sensitive to growth in user industries and any slowdown in user industries could slash growth.
- Any increase in royalty by parent company may pose a negative impact on the margin of Grindwell Norton.
- In standard abrasives, the company is faced with competition from Chinese manufacturers. Any lower import duty may impact its realizations and margins.

Graphs & Charts

Figure 1: Net Sales Trend

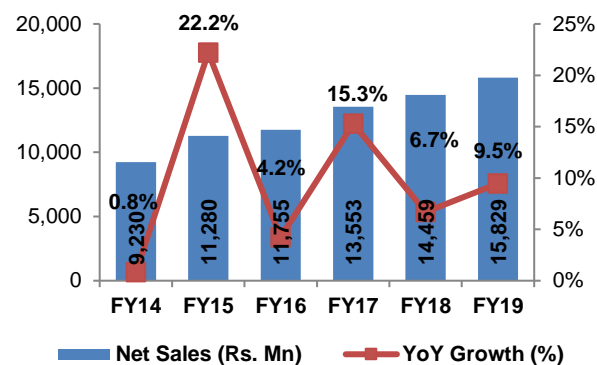


Figure 2: EBITDA & EBITDA Margin Trend

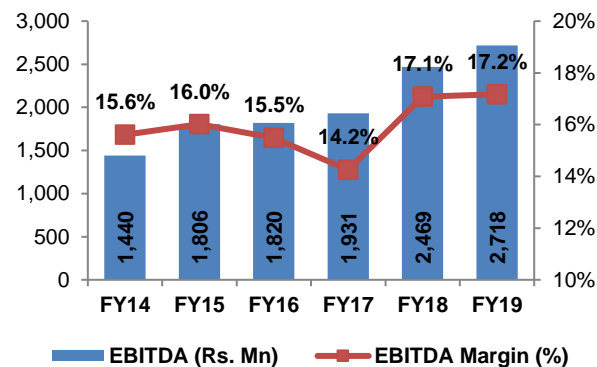


Figure 3: PAT Trend

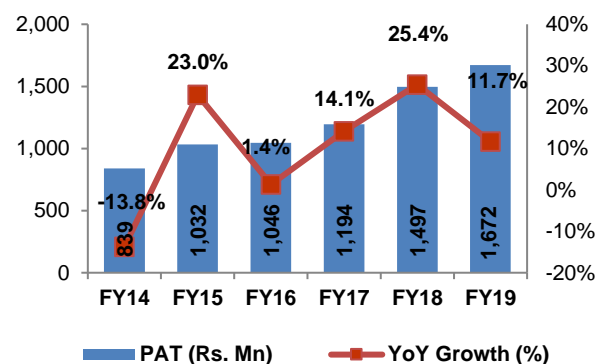
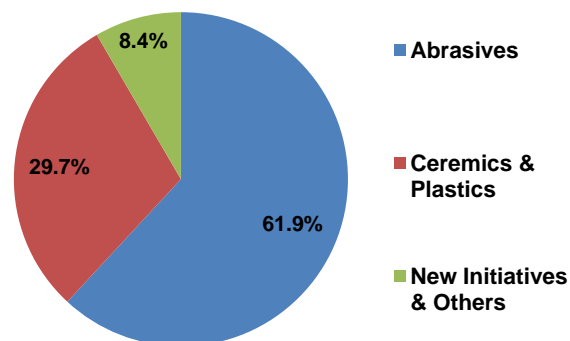


Figure 4: Segmental Revenue Contribution



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