

Dalal & Broacha  
Stock Broking Pvt. Ltd.

## Grindwell Norton Ltd.

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### OUTPERFORM

Price:	Rs. 120.80
Target Price:	Rs. 180.00
52-Week Range:	Rs. 208.61 / 90.15

### KEY FINANCIALS

Rs In Mn.	2006P	2007P	2008P
Total Income	3885.36	4575.02	5254.60
EBITDA	795.93	977.02	1164.26
PAT	464.21	576.60	693.04
Equity	277.00	277.00	277.00
EPS	8.38	10.41	12.51
ROCE %	33.20	36.29	38.13
RONW %	24.04	25.51	26.88

### Key Share Data

Market Cap	Rs. 6.7 BN / \$ 148.7 MN
EV/ Sales	1.86
EV/EBIDTA	10.95
Volume	714,582
No.of Shares o/s (mn.)	55.4
Book Value	34.01
BSE / NSE	506076 / GRINDWELL
Bloomberg	GWN@IN

### Investment Case

Highly accelerated economic and industrial growth will create great opportunities for the abrasives & industrial ceramics industry

Accelerated investments in the infrastructure, construction and auto and auto ancillary industries, will fuel growth in the abrasives industry

Fundamentally, Grindwell's debt free status, better cash flows, ability to fund capex through internal accruals and sharp improvement in realizations lend support to higher valuations

Company can ride well on the back of the strong brand name it has & also the technological and sourcing benefits it derives from its parent

Grindwell Norton Ltd. being one of the two major abrasive players in the Indian market enjoys a considerable market share & is poised to improve its position further with the opportunities identified in the abrasives as well as the industrial ceramics industry.

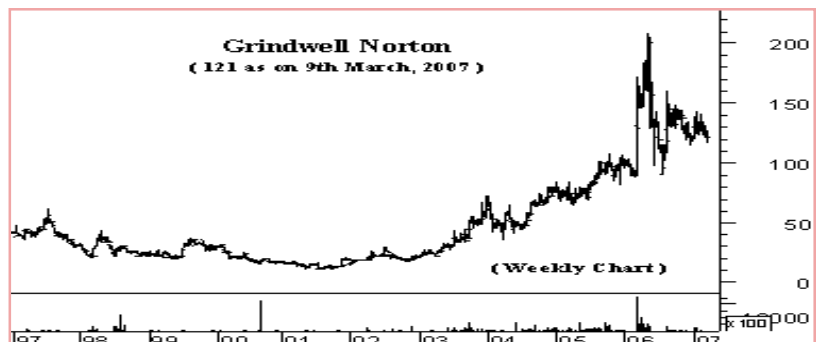
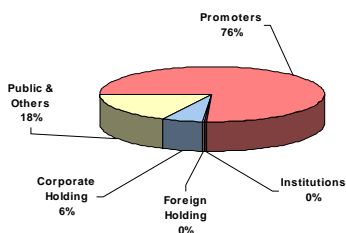
The stock trades at 11.6X its CY07E earnings of Rs 10.4. We expect the stock to be an out performer in the next 12-18 months and initiate coverage with a **BUY**.

### Concerns

Company being one of the two major players in the Indian market, has to resist strong competition to maintain and improve its market share

Rising power & fuel costs can put margins under pressure

### Shareholding Pattern

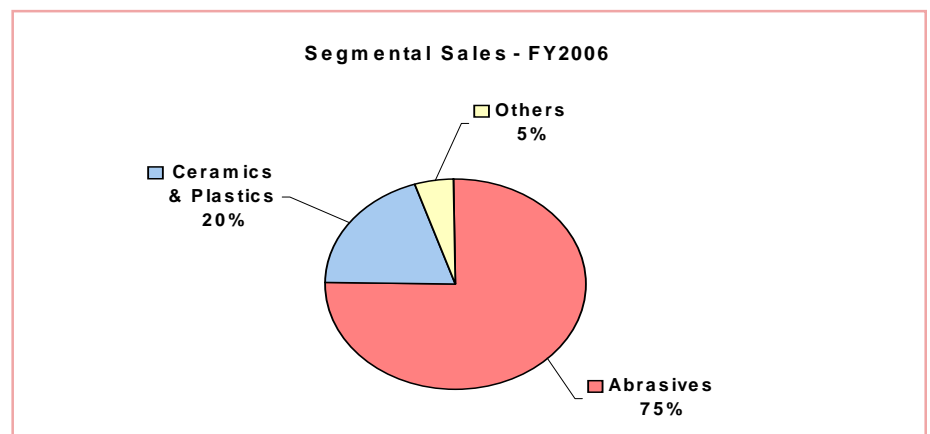


### Company Background

Grindwell Norton Ltd. is India's leading manufacturer of abrasives and industrial ceramics. It is the only company which offers a full line of abrasive products. It is a leading manufacturer of abrasives (Bonded, Coated and Super abrasives) and Silicon Carbide (Grains & Refractories).

Grindwell Norton also manufactures industrial ceramics, fused cast refractories, and total solutions for waste water treatment. The company also sources & sells performance plastic products, which can be put to various kinds of uses where traditionally steel, iron & other metal products were used (e.g. bearings, fluid systems, etc.)

Grindwell Norton is a part of Saint-Gobain Abrasives and continually invests in plant, equipment and manufacturing processes that adhere to stringent international quality standards. The company has facilities at Tirupati for manufacturing Silicon Carbide and at Bangalore, Nagpur and Uran for manufacturing abrasives.



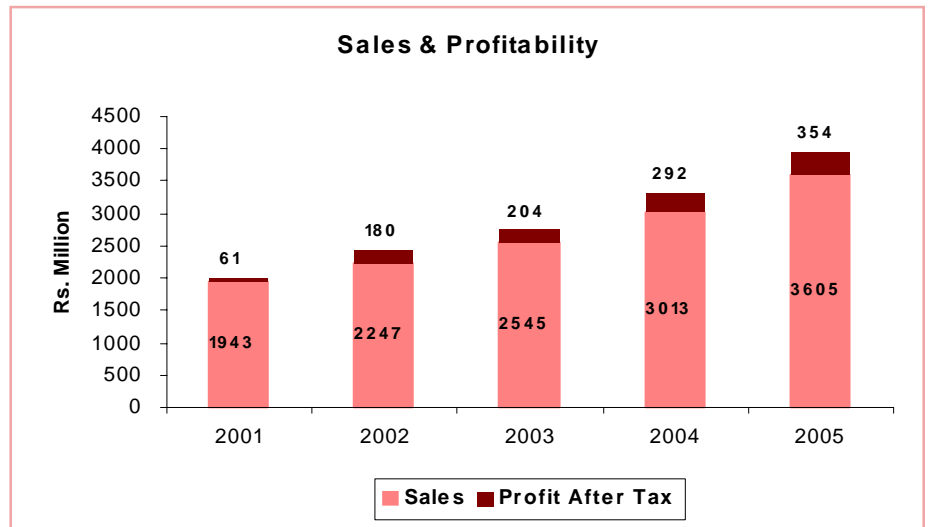
### Products & Services

The business of the company is distributed broadly in to 3 segments i.e. Abrasives, Ceramics & Plastics and Other businesses.

**ABRASIVES:** Abrasives is the major revenue earning segment which contributes around 75% of the total sales.

Of the total abrasive sales, bonded abrasives contribute around 40% - 45% and coated abrasives contribute around 30%. Sustained economic and industrial growth, as well as higher exports, have driven the abrasive sales.

**Grinding wheels:** Grindwell Norton produces largest range of grinding wheels & other abrasives in the country, which can be used for various applications such as Tool Grinding, Cutting Sheet Metal, Polishing Tiled Floors, Surface Grinding, Ship Building, etc.



**Coated Abrasives:** Coated abrasive products are very efficient and effective tools for the industry in a wide variety of grinding, polishing, deburring, cleaning and buffing jobs. They are used for various applications such as Weld Blending, Sheet Metal fabrication, Automotive Body shops, Marble / Granite finishing, etc

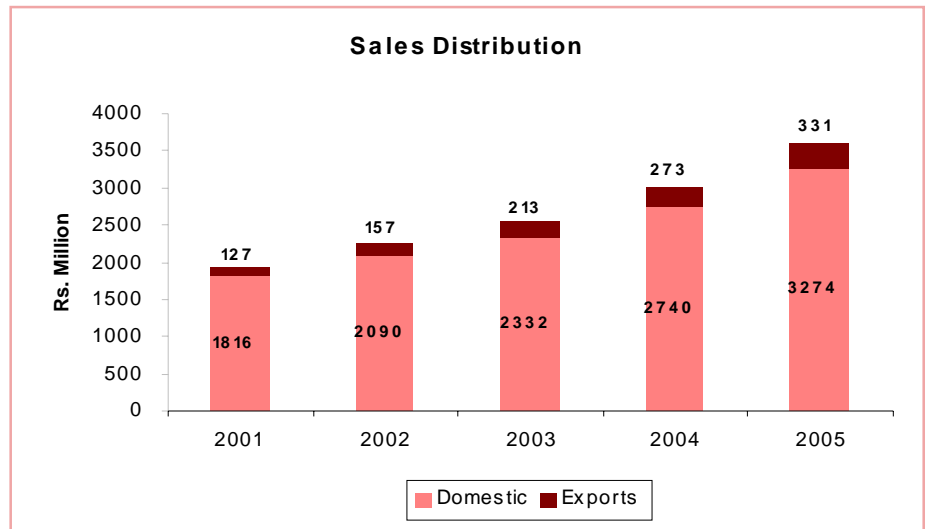
**Non-Woven Abrasives (Bear-Tex):** The majority of Bear Tex (non-woven) products consist of a non-woven web of nylon fibres impregnated throughout with abrasive grains and bonded with resin.

These abrasives can be used for purposes like rust removal, cleaning, deburring, and decorative finishing, etc.

**Super abrasives (Diamond and CBN Products):** The term Super abrasive collectively refers to the Diamond and Cubic Boron Nitride (CBN) abrasives used in grinding wheels. Because of their high hardness, abrasion resistance and other unique properties, these materials find extensive use in a variety of applications.

Typically, diamond is used on all non-ferrous applications and CBN is used as an abrasive for ferrous materials. Diamond Super abrasives can be used for stone, concrete cutting & shaping, precision grinding of carbide glass, industrial ceramics etc. CBN Super abrasives can be used for Internal Grinding, Tool regrinding, etc.

**CERAMICS & PLASTICS:** The other segment of the business is Ceramics & Plastics which contributes around 20% of the total sales. This segment is broadly divided into Industrial Ceramics, Performance Plastics & Silicon Carbide.



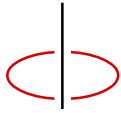
**Industrial Ceramics:** Ceramics, has a wide range of industrial applications ranging from high temperature refractories, wear parts, fused cast ceramics to filters for chemical plants and much more. Grindwell Norton is a leader in silicon carbide based refractories for the ceramics industry and also covers a variety of products for the steel and non-ferrous metal industries.

**Performance Plastic:** Performance Plastics products are of high tensile strength, high load bearing, low friction products. Performance Plastics has a huge potential market & is expected to grow at a faster rate than others.

Performance Plastics produces and markets more than 800 standard and custom polymer products through GNO's four businesses: Precision Products, Fluid Products, Fluid Systems, Foams/Films/Laminates, and Composites.

- **Precision Products:** Include products such as bearings, gaskets and seals used in the automotive and chemical industries. These products are used in applications such as car door hinges, shock absorbers etc.
- **Fluid Systems:** The best-known product of this business is Tygon flexible tubing used for medical, food and laboratory applications.
- **Foams, Films and Laminates:** The foams based on PVC or polyurethane, are used for gaskets, mounting, sealing and soundproofing in automotive and construction applications.

**Silicon Carbide:** Silicon Carbide is a ceramic compound of silicon & carbon, which occurs in the nature as a very rare mineral. Realizing the advantages of backward integration, Grindwell Norton set up a silicon carbide plant in Bangalore, which has now shifted operation to Tirupati. The Silicon Carbide business has grown in volumes & also in market share. It is also used as a raw material for the refractories manufactured by the company.



**OTHER BUSINESSES:** This is the smallest segment of the business contributing around 5% to the topline. It is divided into two divisions namely Waste Water Management (WWT) and Project Engineering Group (PEG).

**Waste Water Technology:** Waste Water Technologies (WWT) offers the complete range of products and services from concept to commissioning in water management including recycling of treated water. The work is carried out on project basis.

**Project Engineering Group:** The Project Engineering Group (PEG) of Grindwell Norton Ltd predominantly executes all the new, expansion and modernization projects of the Saint Gobain group companies. Its constitutes to a very small portion of company's business.

#### Financial Analysis and Capex

- The net revenues of the company for the year ended FY2005 increased by 19.6% from Rs 2657.2mn to Rs 3178.8mn. The growth in the revenues was primarily driven by 22% growth in exports. The EBIDTA margins of the company stood at 19.3% in FY2005.
- For the nine months period ended September 2006, the net revenues stood at Rs 2775mn, an increase of 19%. The EBITDA margins stood at 21.4% against 18.6% for the same period last year, an improvement of over 250 bps on a y-o-y basis.
- The effective tax rate for the company is approximately 33-34%. For our earnings estimate, we have taken tax rate of 34%.
- Going forward, the company has no major capex plans. The company plans around Rs 200mn, maintenance capex every year.

#### Valuation and Outlook -

- Rapidly accelerating industrial growth will keep the growth momentum going
- Major emphasis on infrastructure development, rapid growth of auto & auto ancillary industries and the growing demand of the performance plastics products will help company sustain the growth & the margins going forward
- The stock trades at 11.6x its CY07E EPS of Rs 10.4

We initiate coverage with a **BUY**.



**Financials :**

<b>Profit and Loss Account Particulars (Rs MN)</b>	<b>12/04A</b>	<b>12/05A</b>	<b>12/06E</b>	<b>12/07E</b>	<b>12/08E</b>	<b>12/09E</b>
Gross Sales	3013.5	3604.9	4268.6	5036.9	5792.5	6661.3
Income from products traded by co.	0.0	0.0	0.0	0.0	0.0	0.0
Excise Duty and Sales Tax	(356.3)	(426.1)	(504.5)	(595.4)	(684.7)	(787.4)
<b>Operating income</b>	<b>2657.2</b>	<b>3178.8</b>	<b>3764.0</b>	<b>4441.6</b>	<b>5107.8</b>	<b>5874.0</b>
P/(L) on investments/f. assets	0.0	0.0	0.0	0.0	0.0	0.0
Dividend & interest	0.0	0.0	0.0	0.0	0.0	0.0
Others	116.1	110.3	121.3	133.5	146.8	161.5
<b>Other income</b>	<b>116.1</b>	<b>110.3</b>	<b>121.3</b>	<b>133.5</b>	<b>146.8</b>	<b>161.5</b>
<b>Total income</b>	<b>2773.4</b>	<b>3289.1</b>	<b>3885.4</b>	<b>4575.0</b>	<b>5254.6</b>	<b>6035.4</b>
Raw materials	(927.3)	(1219.8)	(1449.3)	(1710.2)	(1966.7)	(2261.8)
Employee costs	(390.0)	(401.6)	(449.0)	(516.4)	(568.0)	(624.8)
Other expenses	(942.3)	(1053.6)	(1191.1)	(1371.4)	(1555.6)	(1766.8)
<b>Cost of sales</b>	<b>(2268.1)</b>	<b>(2676.8)</b>	<b>(3089.4)</b>	<b>(3598.0)</b>	<b>(4090.3)</b>	<b>(4653.4)</b>
<b>PBIDT</b>	<b>505.3</b>	<b>612.4</b>	<b>795.9</b>	<b>977.0</b>	<b>1164.3</b>	<b>1382.1</b>
Interest	(2.0)	(1.3)	(1.2)	(1.2)	(1.2)	(1.2)
<b>PBDT</b>	<b>503.3</b>	<b>611.1</b>	<b>794.7</b>	<b>975.8</b>	<b>1163.1</b>	<b>1380.9</b>
Depreciation	(67.4)	(75.6)	(91.4)	(102.2)	(113.0)	(123.8)
<b>Profit before tax</b>	<b>435.8</b>	<b>535.5</b>	<b>703.3</b>	<b>873.6</b>	<b>1050.1</b>	<b>1257.1</b>
Provision for tax	(134.9)	(181.5)	(239.1)	(297.0)	(357.0)	(427.4)
<b>Profit after tax</b>	<b>300.9</b>	<b>354.0</b>	<b>464.2</b>	<b>576.6</b>	<b>693.0</b>	<b>829.7</b>
<b>Profitability indicators (%)</b>						
PBIDT	19.0	19.3	21.1	22.0	22.8	23.5
PBIDT (Ex-other income)	14.6	15.8	17.9	19.0	19.9	20.8
PBDT	18.9	19.2	21.1	22.0	22.8	23.5
PBT	16.4	16.8	18.7	19.7	20.6	21.4
PAT	11.3	11.1	12.3	13.0	13.6	14.1
<b>Growth ratios (yoy) %</b>						
Net sales	18.4	19.6	18.4	18.0	15.0	15.0
PBIDT	30.7	21.2	30.0	22.8	19.2	18.7
PBT	38.9	22.9	31.3	24.2	20.2	19.7
PAT	47.4	17.7	31.1	24.2	20.2	19.7



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<b>Balance Sheet</b>						
<b>Particulars (Rs MN)</b>	<b>12/04A</b>	<b>12/05A</b>	<b>12/06E</b>	<b>12/07E</b>	<b>12/08E</b>	<b>12/09E</b>
Equity capital	138.4	138.4	277.0	277.0	277.0	277.0
Profit & loss/general reserve	1428.7	1607.2	1839.3	2127.6	2474.1	2888.9
<b>Net worth</b>	<b>1567.1</b>	<b>1745.6</b>	<b>2116.3</b>	<b>2404.6</b>	<b>2751.1</b>	<b>3165.9</b>
Secured loans	0.0	0.0	0.0	0.0	0.0	0.0
Unsecured loans	13.9	6.1	6.1	6.1	6.1	6.1
<b>Total debt</b>	<b>13.9</b>	<b>6.1</b>	<b>6.1</b>	<b>6.1</b>	<b>6.1</b>	<b>6.1</b>
<b>Capital employed</b>	<b>1581.0</b>	<b>1751.7</b>	<b>2122.4</b>	<b>2410.7</b>	<b>2757.2</b>	<b>3172.0</b>
Gross block	1321.7	1432.4	1692.4	1892.4	2092.4	2292.4
Accumulated depreciation	(660.6)	(720.6)	(812.0)	(914.1)	(1027.1)	(1150.9)
<b>Net block</b>	<b>661.0</b>	<b>711.9</b>	<b>880.4</b>	<b>978.3</b>	<b>1065.3</b>	<b>1141.5</b>
Capital WIP	27.4	26.9	0.0	0.0	0.0	0.0
<b>Total fixed assets</b>	<b>688.4</b>	<b>738.8</b>	<b>880.4</b>	<b>978.3</b>	<b>1065.3</b>	<b>1141.5</b>
Investments	739.7	767.7	882.9	1015.3	1167.6	1342.8
Inventories	409.2	416.7	493.4	582.2	669.5	769.9
Sundry debtors	387.3	477.1	564.9	666.6	766.6	881.6
Cash & bank	197.0	253.3	346.9	388.0	480.6	627.8
Loans & advances	114.7	165.8	182.3	200.6	220.6	242.7
Other current assets	4.6	0.3	0.4	0.4	0.4	0.5
Current Liabilities	(511.6)	(557.5)	(660.2)	(779.0)	(895.9)	(1030.2)
Acceptances/other liabilities	(272.7)	(320.6)	(336.6)	(353.5)	(371.1)	(389.7)
Provision for dividend	(138.4)	(152.2)	(232.1)	(288.3)	(346.5)	(414.8)
<b>Working capital</b>	<b>190.2</b>	<b>282.8</b>	<b>359.0</b>	<b>417.1</b>	<b>524.3</b>	<b>687.8</b>
<b>Capital deployed</b>	<b>1581.0</b>	<b>1751.7</b>	<b>2122.4</b>	<b>2410.7</b>	<b>2757.2</b>	<b>3172.0</b>
<b>Return on (%)</b>						
Networth (post tax)	20.0	21.4	24.0	25.5	26.9	28.0
Capital employed (pre tax)	28.7	32.2	33.2	36.3	38.1	39.7
<b>Per share (Rs)</b>						
Net earnings (EPS)(ex-extord. Expenses)	21.7	25.6	8.4	10.4	12.5	15.0
Net book value (NAV)	113.2	126.1	38.2	43.4	49.7	57.1



<b>Cash Flow Statement</b>						
<b>Particulars (Rs MN)</b>	<b>12/04A</b>	<b>12/05A</b>	<b>12/06E</b>	<b>12/07E</b>	<b>12/08E</b>	<b>12/09E</b>
Pre tax profits from operations	319.7	425.2	582.0	740.2	903.3	1095.6
Depreciation	67.4	75.6	91.4	102.2	113.0	123.8
Other income/prior period ad	116.1	110.3	121.3	133.5	146.8	161.5
Tax	(134.9)	(181.5)	(239.1)	(297.0)	(357.0)	(427.4)
<b>Cash profits</b>	<b>368.3</b>	<b>429.6</b>	<b>555.6</b>	<b>678.8</b>	<b>806.0</b>	<b>953.5</b>
<b>(Inc)/Dec in</b>						
-Sundry debtors	17.1	(89.8)	(87.8)	(101.7)	(100.0)	(115.0)
-Inventories	(104.4)	(7.4)	(76.7)	(88.8)	(87.3)	(100.4)
-Loans/advances	(37.0)	(51.0)	(16.6)	(18.2)	(20.1)	(22.1)
-Sundry creditors	75.0	45.9	102.6	118.8	116.9	134.4
-Others	234.3	66.0	95.9	73.0	75.9	86.8
Change in working capital	185.0	(36.4)	17.4	(16.9)	(14.7)	(16.3)
<b>Operating activities</b>	<b>553.4</b>	<b>393.2</b>	<b>573.0</b>	<b>661.9</b>	<b>791.4</b>	<b>937.2</b>
(Inc)/Dec in fixed assets	(122.7)	(125.9)	(233.1)	(200.0)	(200.0)	(200.0)
(Inc)/Dec in Investments	(100.7)	(28.0)	(115.2)	(132.4)	(152.3)	(175.1)
<b>Investing activities</b>	<b>(223.4)</b>	<b>(154.0)</b>	<b>(348.2)</b>	<b>(332.4)</b>	<b>(352.3)</b>	<b>(375.1)</b>
Inc/(Dec) in debt	(23.1)	(7.8)	(0.0)	0.0	0.0	0.0
Inc/(Dec) in equity/premium	0.0	0.0	138.6	0.0	0.0	0.0
Trf from amalgamated subsidiary	(42.3)	(22.9)	(37.7)	0.0	0.0	0.0
Dividends	(138.4)	(152.2)	(232.1)	(288.3)	(346.5)	(414.8)
<b>Financing activities</b>	<b>(203.8)</b>	<b>(183.0)</b>	<b>(131.2)</b>	<b>(288.3)</b>	<b>(346.5)</b>	<b>(414.8)</b>
Cash generated/(utilised)	126.1	56.3	93.6	41.1	92.5	147.2
Cash at start of the year	70.9	197.0	253.3	346.9	388.0	480.6
<b>Cash at end of the year</b>	<b>197.0</b>	<b>253.3</b>	<b>346.9</b>	<b>388.0</b>	<b>480.6</b>	<b>627.8</b>

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