



Lubricants	Sharekhan code: CASTROLIND	Result Update
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3R MATRIX

	+	=	-
Right Sector (RS)	Green	Grey with check	Red
Right Quality (RQ)	Green with check	Grey	Red
Right Valuation (RV)	Green with check	Grey	Red

+ Positive = Neutral - Negative

Reco/View	Change
Reco: Buy	↔
CMP: Rs. 129	
Price Target: Rs. 150	↑
↑ Upgrade ↔ Maintain ↓ Downgrade	

Company details

Market cap:	Rs. 12,741 cr
52-week high/low:	Rs. 162/90
NSE volume: (No of shares)	14.8 lakh
BSE code:	500870
NSE code:	CASTROLIND
Free float: (No of shares)	48.5 cr

Shareholding (%)

Promoters	51.0
FII	12.0
DII	17.3
Others	19.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.7	14.5	12.2	-16.4
Relative to Sensex	0.4	-9.3	-21.1	-39.6

Sharekhan Research, Bloomberg

Summary

- Q4CY20 results lagged our expectations as revenue/adjusted operating profit at Rs. 935 crore/Rs. 274 crore, down 7.6%/19.6% y-o-y, missing our estimate by 9%/11%.
- The miss in operating performance was due to lower-than-expected OPM at 29.3% (down 438 bps y-o-y), volumes of 52 million litre (down 3.7% y-o-y) and weak realisations (down 4% y-o-y). However, gross margins improved by 172 bps y-o-y to 59.4%.
- However, the highlight was the strong operating cashflow of Rs. 893 crore (153% of CY20 reported PAT) due to strong working capital management and maintained DPS of Rs. 5.5 (payout of 93%). Alliance with Jio-BP retail network and focus on gaining market share bodes well for volume growth.
- Attractive valuation of 13.5x CY22E EPS (close to decade-low valuations) despite strong cash positions, FCF/dividend yields of 6%/9% and RoE of ~56-60%. Hence, we recommend a Buy on Castrol with PT of Rs. 150.

Castrol India's (Castrol) Q4CY2020 revenue declined by 7.6% y-o-y (up 5.9% q-o-q) to Rs. 935 crore, below our estimate of Rs. 1,027 crore. Revenues lagged estimates on the account of: 1) lower-than-expected sales volume at 52 million litres (down 3.7% y-o-y; up 10.6% q-o-q) versus our estimate of 55.5 million litres and 2) weaker-than-expected gross realisation at Rs. 185/litre (down 4% y-o-y; down 4.3% q-o-q). Gross margins improved by 172 bps y-o-y to 59.4% (above our estimate of 54%), but adjusted OPM contracted by 438 bps y-o-y to 29.3% (below our estimate of 30%) due to sharp rise in the other expenses (up 22% y-o-y) given higher spending on advertisement. We have adjusted operating profit by Rs. 16.8 crore related to a one-time cost for organisation transformation and restructuring programme. Consequently, adjusted operating profit also declined by 19.6% y-o-y (down 4.8% q-o-q) to Rs. 274 crore, 11% below our estimate of Rs. 308 crore. Adjusted PAT of Rs. 200 crore (down 26.2% y-o-y; down 2.1% q-o-q) was also below our estimate of Rs225 crore due to lower-than-expected revenues and margins. For CY2020, adjusted PAT declined by 27.5% y-o-y to Rs600 crore due to weakness in H1CY2020 on account of COVID-19. We highlight here that lubricant demand has recovered sharply in H2CY2020 and Castrol is keen to improve its market share for the CV segment (witnessed a sharp double-digit growth in Q4CY20 led by price cut). The company has undertaken a price hike of 4% in January, which would cushion its margin against rise in base oil prices. Castrol's valuation of 13.5x CY2022E EPS is attractive given steep discount of 46% to its historical average one-year forward P/E multiple of 25.1x. A strong balance sheet, healthy dividend yield of 6% and a strong RoE of ~56-60% lends comfort to investors. Hence, we recommend a Buy on Castrol with a PT of Rs. 150.

Key positives

- Better-than-expected gross margin of 59.4% (up 172 bps y-o-y) despite lower realisation.
- Sharp double-digit growth for lubricant volume for CV segment in Q4CY2020.
- Share improvement in working capital cycle led to strong operational cashflow of Rs. 893 crore (153% of CY2020 reported PAT).

Key negatives

- Lower-than-expected OPM (down by 439 bps) due to substantially high advertisement spends in Q4CY2020.

Our Call

**Valuation – Recommend Buy on Castrol with PT of Rs. 150:** We have fine-tuned our CY2021-CY2022 earnings estimate to factor volume recovery as vehicular traffic has largely normalised. Castrol's recent alliance with the Jio-BP retail network provides long-term volume growth opportunity and management's renewed focus to gain share could result in better volume growth in coming years despite overall muted outlook for lubricant demand (given higher drain interval to change lubricants). Castrol's valuation of 13.5x CY2022E EPS is close to a decadal low and is at a steep discount of 46% to its historical average one-year forward P/E multiple of 25.1x. Moreover, robust free cashflow (FCF) yield of ~9%, consistent track record of high dividend payouts (93% in C2020 and a dividend yield of ~6%) and strong RoE of ~56-60% lends comfort to investors. Hence, recommend a Buy on Castrol with PT of Rs. 150.

Key risk

A prolonged economic slowdown due to COVID-19 could lead to lower-than-expected lubricant volumes, whereas a sharp rise in base oil prices could impact margins.

Valuation

Particulars	CY18	CY19	CY20	CY21E	CY22E
Revenue	3,905	3,877	2,997	3,914	4,152
OPM (%)	27.4	29.7	27.2	31.4	30.6
Adjusted PAT	708	827	600	914	948
% YoY growth	2.4	16.8	-27.5	52.4	3.7
Adjusted EPS (Rs)	7.2	8.4	6.1	9.2	9.6
P/E (x)	18.0	15.4	21.3	14.0	13.5
P/B (x)	10.9	9.3	9.0	7.9	7.2
EV/EBITDA (x)	11.2	10.2	14.1	9.3	8.8
RoNW (%)	64.8	65.3	43.1	60.4	56.2
RoCE (%)	100.6	90.7	56.5	83.5	80.5

Source: Company; Sharekhan estimates

Note: We now convert Castrol India Limited into a Stock update; it was earlier a 'Viewpoint' under our coverage.

### Lower-than-expected PAT due to miss in revenues and margins

Q4CY2020 revenue declined by 7.6% y-o-y (up 5.9% q-o-q) to Rs. 935 crore, below our estimates of Rs. 1,027 crore. The miss in revenues was on the account of: 1) lower-than-expected sales volume of 52 million litres (down 3.7% y-o-y; up 10.6% q-o-q) versus our estimate of 55.5 million litres and 2) weaker-than-expected gross realisation at Rs. 185/litre (down 4% y-o-y; down 4.3% q-o-q). Gross margins improved by 172 bps y-o-y to 59.4% (above our estimate of 54%), but adjusted OPM contracted by 438 bps y-o-y to 29.3% (below our estimate of 30%) due to a sharp rise in other expenses (up 22% y-o-y) due to higher spending on advertisement. We have adjusted operating profit by Rs. 16.8 crore related to one-time cost for organisation transformation and restructuring programme. Consequently, adjusted operating profit also declined by 19.6% y-o-y (down 4.8% q-o-q) to Rs. 274 crore, 11% below our estimate of Rs. 308 crore. Adjusted PAT at Rs200 crore (down 26.2% y-o-y; down 2.1% q-o-q) was also below our estimate of Rs. 225 crore due to lower-than-expected revenues and margins.

### Q4CY2020 conference call takeaways

- ◆ **Business update** – The company has taken a price cut for commercial vehicle (CV) portfolio and the same helped to register double-digit volume growth for CV segment in Q4CY2020 and resulted in inventory reduction for distributors. The company has taken a price hike of 4% in January 2021 and the same would cushion its margins against increase in the base oil prices.
- ◆ **Product launches** - The company launched a new premium range of two-wheeler lubricants in Q4CY2020, Castrol POWER1 ULTIMATE. The product is developed with full synthetic technology for bikes, sports bikes and scooters offering both protection and performance for riders.
- ◆ **Volume mix** - Personal mobility accounts for 45-50% of volumes, while the remainder is derived from industrial and commercial segments in H1CY2020. Volumes from automotive segment is at 80% plus while the remaining comes from industrial segment.
- ◆ **Alliance with Jio-BP fuel retail network** – The management said that Castrol lubricants are now available across over 1,350 Jio-BP sites and provides wider reach for its premium quality lubricants. The Jio-BP fuel station network would be expanded to 5000 sites over next few year, which would boost Castrol's volume. Moreover, the alliance provides Castrol an opportunity to participate in future mobility services by Jio-BP.
- ◆ **Sharp improvement in working capital cycle** – The company's cash conversion cycle improved substantially with nil WC days in CY2020 as compared to 30 days in CY2019. A sharp reduction in working capital cycle was led by a reduction in receivables days to 22 days (from 45 days in CY2019) and increase in payable days to 66 days (from 44 days in CY2019). Consequently, operating cash flows stood at Rs. 893 crore (153% of reported PAT) in CY2020. The company's FCF increased by 12% y-o-y to Rs869 crore in CY2020 and cash & bank balances stood at Rs. 1,274 crore (up 35% y-o-y).
- ◆ **Capex guidance** – The company has guided for Rs. 100 crore capex annually for next few years.
- ◆ **Advertisement expenditure** – The company has spent Rs. 65 crore (5x jump y-o-y) on marketing & advertisement in Q4CY2020 to promote its key brands.
- ◆ The company has portfolio of EV fluids and supplies to both global and domestic auto OEMs. Demand for synthetic lubricants is expected to improve with improvement in engine technology. The management expects share of synthetic lubricants (11% contribution currently) to increase going forward.

Results					Rs cr	
Particulars	Q4CY20	Q4CY19	y-o-y (%)	Q3CY20	q-o-q (%)	
Net Sales	935.2	1,011.8	-7.6	883.1	5.9	
Total Expenditure	677.6	670.6	1.0	594.9	13.9	
<b>Operating profit</b>	<b>257.6</b>	<b>341.2</b>	<b>-24.5</b>	<b>288.2</b>	<b>-10.6</b>	
<b>Adjusted operating profit</b>	<b>274.4</b>	<b>341.2</b>	<b>-19.6</b>	<b>288.2</b>	<b>-4.8</b>	
Other Income	15.3	16.2	-5.6	11.7	30.8	
Interest	0.8	0.3	166.7	0.9	-11.1	
Depreciation	22.3	18.3	21.9	21.5	3.7	
Exceptional income/(expense)	0.0	0.0	NA	0.0	NA	
PBT	249.8	338.8	-26.3	277.5	-10.0	
Adjusted PBT	266.6	338.8	-21.3	277.5	-3.9	
Tax	62.1	67.5	-8.0	72.9	-14.8	
RPAT	187.7	271.3	-30.8	204.6	-8.3	
<b>Adjusted PAT</b>	<b>200.3</b>	<b>271.3</b>	<b>-26.2</b>	<b>204.6</b>	<b>-2.1</b>	
Equity Cap (cr)	98.9	98.9		98.9		
Reported EPS (Rs)	1.9	2.7	-30.8	2.1	-8.3	
Adjusted EPS	2.0	2.7	-26.2	2.1	-2.1	
<b>Margins (%)</b>			<b>BPS</b>		<b>BPS</b>	
Gross margin	59.4	57.7	172	60.1	-74	
Adjusted OPM	29.3	33.7	-438	32.6	-329	
Effective tax rate	24.9	19.9	494	26.3	-141	
Adjusted NPM	21.4	26.8	-539	23.2	-175	

Source: Company; Sharekhan Research

#### Key operating performance

Particulars	Q4CY20	Q4CY19	YoY (%)	Q3CY20	QoQ (%)
Volume (million litres)	52.0	54	-3.7	47.0	10.6
Realisation (Rs/litre)	179.8	187.4	-4.0	187.9	-4.3
Gross margin (Rs/litre)	106.8	108.1	-1.2	113.0	-5.5
EBITDA margin (Rs/litre)	49.5	63.2	-21.6	61.3	-19.2

Source: Company; Sharekhan Research

## Outlook and Valuation

### ■ Sector View – Lubricant demand sees strong recovery in H2CY2020; long demand to remain muted given high drain interval

Lubricant demand has seen a strong recovery in H2CY2020 and momentum is expected to continue in the near term as lubricant demand from the CV and industrial segments is also expected to recover with a revival in economic activities going ahead. We expect lubricant demand from personal mobility to remain strong, while revival in demand from CV segment would depend upon overall recovery in Indian economy. However, overall lubricant demand is expected remain muted due to higher drain interval period to change lubricants. Rise in base oil prices (due to higher crude oil prices) would require lubricant players to take price hike to sustain gross margins.

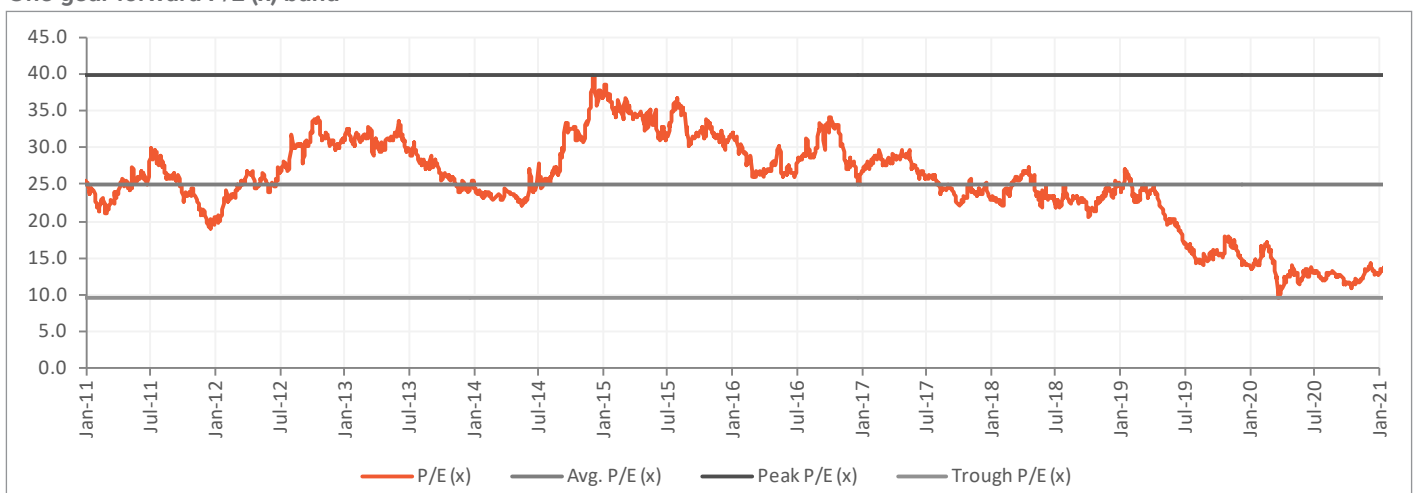
### ■ Company Outlook – Sharp volume recovery and price hike improves earnings outlook

Earnings outlook for Castrol has improved given a sharp volume recovery and margin expansion in H2CY2020. Potential revival in the CV and industrial segments would help volumes normalise over CY2021E-CY2022E, while margins are expected to remain healthy led by better realisations and operating leverage. Hence, we expect Castrol's revenue, EBITDA and PAT to register 18%, 25% and 26% CAGR over CY2020-CY2022E and RoE would remain strong at 56-60%.

### ■ Valuation – Recommend Buy on Castrol with PT of Rs. 150

We have fine-tuned our CY2021-CY2022 earnings estimate to factor volume recovery as vehicular traffic has largely normalised. Castrol's recent alliance with the Jio-BP retail network provides long-term volume growth opportunity and management's renewed focus to gain share could result in better volume growth in coming years despite overall muted outlook for lubricant demand (given higher drain interval to change lubricants). Castrol's valuation of 13.5x CY2022E EPS is close to a decadal low and is at a steep discount of 46% to its historical average one-year forward P/E multiple of 25.1x. Moreover, robust free cashflow (FCF) yield of ~9%, consistent track record of high dividend payouts (93% in C2020 and a dividend yield of ~6%) and strong RoE of ~56-60% lends comfort to investors. Hence, recommend a Buy on Castrol with PT of Rs. 150.

One-year forward P/E (x) band



Source: Sharekhan Research

## About company

Castrol India, a 51% subsidiary of BP Plc, is the largest private sector lubricant player in India. The company caters to the automotive, industrial and marine & energy segments. The company derives 40-45% of its volume from personal mobility, industrial segment contributed 12% to volumes while remaining comes from CVO and heavy-duty vehicles. The company is market leader with ~22% share in Bazaar segment. Castrol operates 3 manufacturing plants in India and has the largest distribution network of 380 distributor and servicing customers through 110,000 retail sites.

## Investment theme

Castrol's recent alliance with the Jio-BP retail network provides long-term volume growth opportunity and management's renewed focus to gain share could result in better volume growth in coming years despite overall muted outlook for lubricant demand (given higher drain interval to change lubricants). Strong FCF generation, healthy dividend yield and robust RoE of ~56-60% lends comfort to investors. Castrol is trading at steep discount to historical valuations.

## Key Risks

- ◆ Lower-than-expected lubricant volume in case of prolonged economic slowdown due to COVID-19.
- ◆ Likely impact on margin in case of sharp rise in crude oil prices.

## Additional Data

### Key management personnel

R Gopalakrishnan	Chairman
Sandeep Sangwan	Managing Director
Rashmi Joshi	Chief Financial Officer

Source: Company Website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	10.6
2	JPMorgan Chase & Company	2.9
3	Vanguard Group Inc/The	1.7
4	Standard Life Aberdeen PLC	1.5
5	MURRAY INTERNATIONAL TRUST	1.4
6	Aditya Birla Sun Life Trustee Company	1.3
7	Aditya Birla Sun Life Asset Management	1.3
8	L&T Mutual Fund Trustee Ltd/India	0.9
9	Norges Bank	0.5
10	UTI Asset Management Co Ltd	0.4

Source: Bloomberg

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## Understanding the 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 deteriorating 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: Sharekhan Research

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